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SME Banking Channels: converting a money pit into a business opportunity

Small and Medium Entreprises (SMEs) make up the majority of businesses globally and spend significant amounts on accounting and payments services across every region. Yet, banks struggle to successfully address this market segment, which is often seen as too heterogeneous in terms of requirements, and, therefore, as a cash drain. But the situation can change if banks review their digital channel strategy. They can convert a compounding cost centre into a business opportunity.

The size of the SME market for banks

SMEs represent about 90% of businesses and employ more than 50% of the workforce worldwide. To support their core business, SMEs invest significantly in accounting and payments services. In the United States alone, SMEs spend roughly $225 billion[1] annually on these services and, when asked, most SMEs admit that they first look to banks to provide these key services. When being asked, most of the SMEs declare that they first turn towards their banks to provide these key services. Indeed, SMEs have traditionally asked their historic bank to fulfill their banking and lending needs, having generally used a single provider. However, the quality of the services is often not on par with SMEs' expectations. Convoluted online account management, slow speed of answers, and lack of flexibility are serious roadblocks faced by the SMEs today, distracting them from focussing on running their core business. As a result, many SMEs are likely to look for a new banking relationship within a year, and would actually consider alternative providers.

1. Figures from The $370 billion small business opportunity for banks written by Cornerstone Advisors
2. https://www.forbes.com/sites/ronshevlin/2020/06/30/banks-370-billion-small-business-opportunity/?sh=4a42ff4688cd

The cost of SME channels

The situation is daunting for banks, particularly for incumbent players. Banks invest significantly in their channels in order to attract and retain customers. The cost of acquiring a SME customer is about £75 to £90 on average, but can go up to £300 for the higher range.

Using the classification displayed in Table 1, our total cost analysis study reveals that most of these costs can be attributed to marketing and system modernisation. With the adoption of Open Banking, many third-party providers have entered the SME market, seriously increasing the level of investment that banks had to commit to. Banks had to modify their IT systems to open up their data to abide by Open Banking regulations. Banks had to improve their digital channels and, for some, even implement a brand new ones, as showing a user-friendly digital touchpoint becomes a table stake to acquire and retain customers. Since then, banks have kept pouring more money into these channels, constantly racing to offer an experience as good as the third-party apps.

When it comes to customer retention, the cost profile, is with no surprise, similar. Interviewing banks of different sizes and located in various regions, using the cost classifications displayed in Table 1, we discovered that the total cost of ownership is so vast that it is actually spread out across different departments and budget owners, particularly for banks that haven't used any third-party providers to build their channels and maintain them on their own.

Banks don't want to lose touch with their customers at the profit of these new entrants, so they are willing to invest what it takes to retain a relationship. The risk is too high. Banks could lose customers' data and, as a consequence, be unable to understand their own customers. In the long run, they could even lose their customers' deposits. Why would SMEs stick with a bank that shows less and less empathy towards them and is unable to understand their needs properly anymore? Particularly when the rest of the accounting and payments have been outsourced to other parties, that demonstrated that they can be trusted? They don't stick and leave the banks.

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How can banks retain their SME customers?

This strategy of increasingly throwing more money to improve the channel is not sustainable and, moreover, has proven to be unsuccessful. The increase of Open Banking calls by about 30%[3] shows that SMEs are turning more towards third-party providers, making the increasing costs of serving them compound, as the economy of scale decreases. Actually, by keeping this strategy, the repercussions could be even more damaging for banks by jeopardizing their ability to lend, as SMEs leverage more and more one-stop shop solutions like Stripe or Amazon to deposit their money.

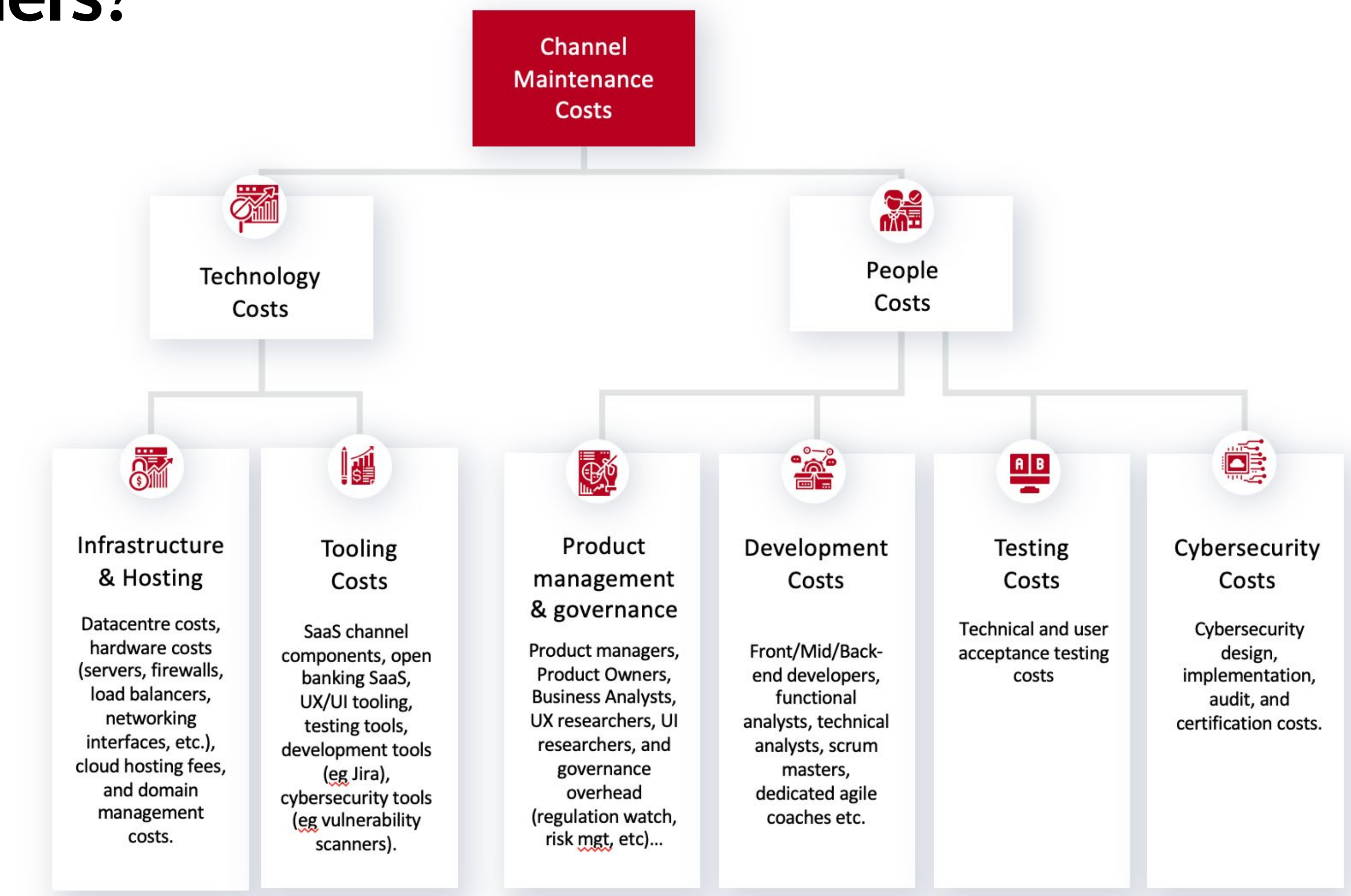

Table 1

Here's the positive news: the situation can change if banks review their strategy.

Interestingly, some costs could be potentially waived should banks leverage external providers, like BankiFi, whose mission is to put banks and financial institutions at the heart of business and help over two million SME by 2024.
Indeed, our cost analysis revealed that marketing, people, infrastructure, and tool costs could be significantly reduced. Leveraging expert providers has also demonstrated to have a positive impact on the indirect cost. With a more efficient digital channel, the support required by SMEs to perform their day-to-day banking, payments, and accounting tasks reduce significantly.

Looking at the revenue side, turning towards external providers could unlock significant opportunities for the banks.
By using the SME expertise of some third-party providers, banks could most certainly reduce the customer churn, providing SMEs with what they really need to perform their business. The successful adoption of Go Get Paid and Simply Invoice[4] from Co-operative Bank, along with The Moneyfacts award they received, demonstrate that banks can still compete with one-stop shop providers like Stripe.

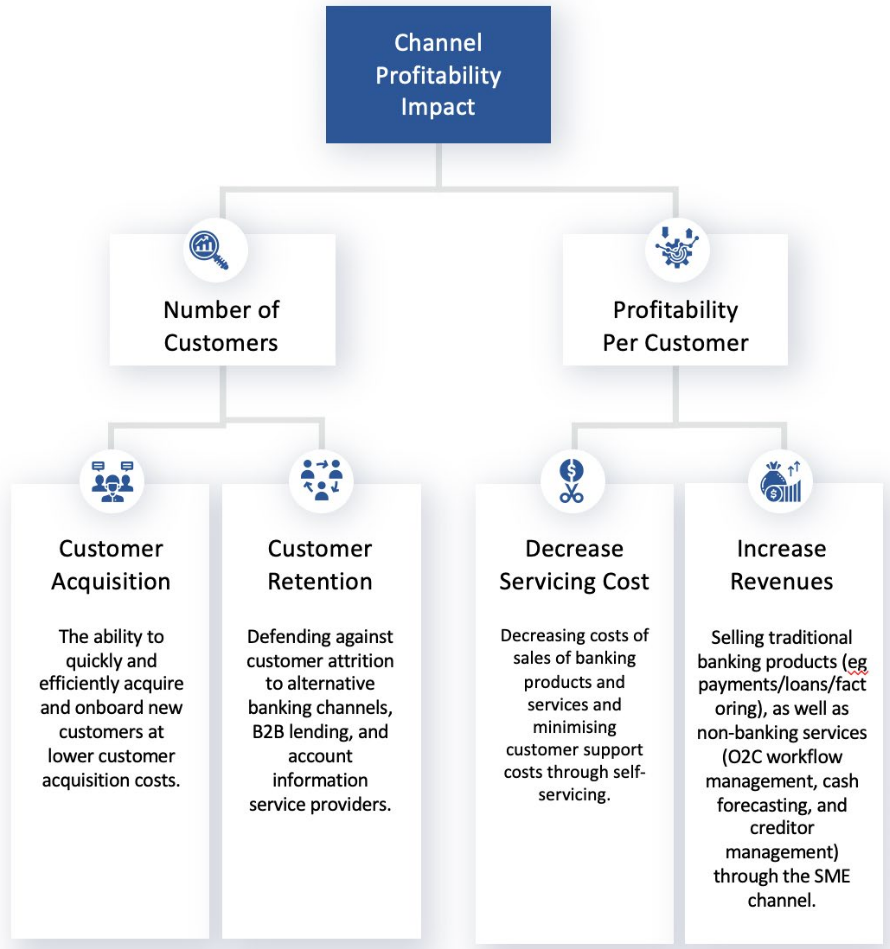

Table 2

3. Calculations made using the official number of API calls published by Open Banking

Beyond reducing customer churn, a more efficient digital channel could also significantly increase the profitability per customer. Indeed, it could decrease the cost of sales of some other products, like loans. Allowing easy cross-sales, banks could suggest relevant products based on payments and accounting data analysis and promote these products within a user-friendly digital channel. A Cornerstone Advisor study reveals that 62% of small businesses express an interest in obtaining accounting and payments services from a bank intend to borrow over the next two years on average nearly $2 million[5] .

Similar to what Starling has implemented5, the digital channel could also become a marketplace for SMEs. SMEs could benefit from value-added services, with featured products from the bank themselves, as well as frompartners. Banks could even charge a small fee to the SMEs that wish to use some services and, at the same time, to the partners whose products are displayed, creating two new separate revenue streams. Banks could really become a one-stop shop for SMEs, offering products like cash forecasting, credit management, or order to cash workflow management, just to name few.

4 https://www.co-operativebank.co.uk/business/products/current-accounts/business-directplus/?cid=ppc_srcgoogle_prdbusinessbanking_grpproductexact_kwbusinesscurrentaccount

5 https://www.forbes.com/sites/ronshevlin/2020/06/30/banks-370-billion-small-business-opportunity/?sh=4a42ff4688cd

6. https://www.starlingbank.com/business-account/marketplace-for-businesses/

Summary

In conclusion, banks are facing a pivotal point when it comes to serving the SME market. On the one hand, they can retain their existing strategy, losing more customers every day and suffering from exponential cost increases. On the other hand, banks can review their strategy, particularly on how their channels are designed and managed. Deeply re-thinking the role of the channel and moving away from seeing it as a cost center, an exit to data, and a means to cannibalize the bank business is a game changer. This has a positive snowball effect as costs are reduced and new revenues can be generated. Leveraging third-party SME experts like BankiFi can really accelerate time to market and entering the virtue circle described above. In the end, we are looking at a market of $370 billion in the US alone[7], according to Cornerstone Advisors.

Call to actions

In order to leverage the opportunity that lies in a well-managed channel, we encourage banks to

- Move away from the traditional banking services approach
- Understand the total cost of ownership of the bank channels
- Identify the channel features used by the customers and prospects
- List the features that are not in the existing bank channels and define a plan to implement in the bank defacto channel, as opposed to offering them as an add-on or in a separate app

7. https://www.forbes.com/sites/ronshevlin/2020/06/30/banks-370-billion-small-business-opportunity/?sh=4a42ff4688cd

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RedCompass Labs is committed to helping open the doors of finance to all with our payment expertise and data-led technologies, and to protecting all who enter – most specifically by disrupting financial crime that affects the most vulnerable. We have invested in technology tools to support our clients during all stages of the complex journey through payment transformation programmes. We have also developed the RedCompass Labs RedFlag Accelerator, the global point of reference of modern slavery, human trafficking, and Child Sexual Exploitation red flags for the financial industry. The RedFlag Accelerator won the PayTech For Good award and Themis Anti Financial Crime Innovation award.

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RedCompass Labs is a Participant of the United Nations Global Compact and adheres to its principles-based approach to responsible business.

In 2022 RedCompass Labs joined Mojaloop Foundation's technical governing board and supports driving financial inclusion all over the world.

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WOULD YOU LIKE TO ASSESS THE EFFECTIVENESS OF YOUR SME BANKING CHANNEL?

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RedCompass Labs retains full editorial control.