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SIBOS PODCAST: COMMERCIAL BANKING AND THE SME MARKET

PODCAST TRANSCRIPT

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Brett Price: The Sibos Insider podcasts debate the future of finance, providing insights and analysis of topical industry themes. Each episode will bring you a thought-provoking dissection of the greatest challenges and opportunities facing financial services, from renowned experts direct to the Sibos community. The podcasts examine not only the way the industry is achieving its goals, but how it achieves them, including a focus on the mindset, working practices and well-being factors needed to build a successful career in finance.

For this Insider podcast, we'll be discussing how commercial banks can best serve the SME market. I'm joined today by two senior executives from Accenture who've just carried out detailed research into this issue, so without further ado, let me introduce my guests. Joining me here in the UK is Accenture's Commercial Banking Strategy Managing Director Tom Merry. Since joining Accenture, Tom has focused his career on advising global clients across retail banking, commercial, corporate banking and capital markets. Tom has a particular interest in the opportunity that disruptive new advances in technology present for banks, with a chance to reshape the industry as forces of technology change, consumer behavior changes and cross-convergence collides. Welcome, Tom.

Joining us from North Carolina in the U.S. is Global Commercial Banking Practice Lead Jared Rorrer. Jared has been with Accenture for 15 years now and is the Senior Executive responsible for Global Commercial Banking and nCino practices. Jared has overall accountability for defining the most important industry trends and priorities in commercial banking and helping clients to successfully execute their strategies. Thanks for joining us today, Jared.

Jared Rorrer: Hi, thank you, nice to be here.

Brett Price: Can you, first of all, just give me a little background into the research you've carried out into the challenges and opportunities of SME banking?

Jared Rorrer: Sure! As we started thinking about this research, before the pandemic, we recognized, that this segment continues to be the backbone of most countries and economies across the world.

We recognized the way banks are organized, where small and medium enterprise customers fall there tends to be a bit of a gap between the retail bank and the commercial bank. And we recognized that because of that there are unique challenges banks face in trying to bring forward the best solutions for those customers at a scale that's relevant, while ensuring not only scale but also the depth and quality of services needed by business owners who are likely most in need, who represent the highest cost to serve, and ultimately who are most immature in their financial skills. All of which makes for a tough segment.

As we looked at that as an early idea and then realized the impact of COVID-19 globally on this segment, we realized there was a huge opportunity for banks to cement their path with this important segment for the next 20 years. An opportunity to move towards a view that these are the most important – and need to be the most profitable – clients they have. This means treating them properly and giving them the right advice and coaching and guidance. It's a path to great success long term for not only the bank but also its customers, because it provides them with valuable insights and the right digital tools.

So we set off on this survey to talk to 26 or 27 different banks across the globe to understand both what matters most to these segments as well as how banks need to think about bringing that to life as we migrate from an analog to a digital world for SME and commercial banking.

Brett Price: Thanks for that background. Well, we know that SMEs are the backbone of most countries' economies and they represent an extremely large and highly diverse customer segment, with huge profit and growth potential for banks. And yet SME clients feel that banks have failed them, particularly in these trying times. So why do you feel that is?

Jared Rorrer: It's interesting. When I think about why customers feel that way, in some respects it goes back to some core things that we talked about. Banks struggle to serve this market because it is high volume, specialized need and demands expertise that banks struggle to bring forward. If you think about a SME business owner or a SME executive relative to their personal experiences in retail banking, the level of sophistication that they see when they operate as a retail customer versus when they operate as a SME customer, it pales in comparison.

And importantly, when you look at this broad segment, at the lower end of that segment specifically, the need is more important than ever. When we look at COVID in particular, there is a greater need for banks to think about why customers feel they've been failed by their banks. Frankly I don't think that's fair, but I think they feel underserved. And there's an opportunity to serve them more effectively with more data that's relevant at the particular moment in time, and with faster access to money. You know, it's the idea that if I'm in need I need the bank to help me as opposed to taking the umbrella away on a rainy day.

Brett Price: Tom, can I bring you in here, please? Can you perhaps tell us some of the specific hurdles and challenges that banks face in serving their SME clients?

Tom Merry: One thing became apparent when we looked globally – and the benefit of being in all of these markets is that a lot of these themes are completely consistent. That's not always the case when we do banking strategy work and we see some quite profound regional differences. This is definitely not the case in SME banking, where the same questions seem to be perplexing our clients in a fairly consistent way. We'll come to those in a second, but I think one of the takeaways for me was just how consistent some of these issues are across geographic boundaries.

There are a number of reasons why I think banks struggle, as Jared was just saying, to get the right services and offers to their customers. This is a diverse set of customers with different needs. So you have largish manufacturing clients who operate very differently to very small local authorities, even though the two may be considered through the segmentation model to be the same. And so being able to understand your customers and then change the offer that you give them is something that I think SME banks have struggled with.

Just stepping back for a second, I think there are four things that fundamentally are hard. One thing to acknowledge is that margins are under significant pressure. There's always talk of this being an attractive segment and, of course, you always have new businesses being founded and growing, so to some degree it's always got a new influx each year. But at the same time, lending margins are under significant pressure. We obviously know the impacts of lower-for-longer rates almost across the globe. And then in other areas, be it working capital products, be it trade finance, be it FX, what we've seen is greater transparency and more competition.

The progress that's been made on digital tooling and the sophistication of those tools means that across every product we've got margin compression. So that makes it a difficult place for banks to operate. It means that they need to be getting the right cost to serve these customers, otherwise, with the margin of revenue pressure, they just make losses.

There's a lot of customers who are overserved. What I mean is they get a one-size-fits-all model that is too good for what their needs are. And similarly, a lot of customers are underserved. They need a more sophisticated model, they indeed make more revenue for the bank, and yet they receive the same one-size-fits-all model. The number of customers in the sweet spot, getting the right service model and price for their needs and for the value they create, is relatively small. I think the overall impact of that is it's a challenged-profitability play.

So margins are under pressure. The cost to serve in general is too high. Certainly, my observation in the UK is that SME and commercial banks have been underinvested in, relative to their retail peers within universal banks.

I think that's something that's consistent globally. And so the digital technology and the supremacy of data analytics don't exist in the same way they do in some other areas of the bank. One of the impacts of it being hard to be relevant and agile is that it also becomes expensive. And so we see a high cost to serve.

As Jared was saying, these are complicated clients. There are multiple entry points. There are also regulatory considerations in this space. In our opinion it's just too costly to serve clients in today's world at the cost point that they're at. Banks struggle with a clear and effective segmentation. They always have done. People in SME and commercial banks always seem to be moving the goalposts on what is an SME versus a business banking client versus a midmarket client, and so on. I think traditional segmentation still persists in these banks. It's about sector. It's about turnover. It's about number of employees.

We would advocate a more sophisticated overlay that considers propensity, sensitivities, digital maturity, behaviors. To my earlier point, if you get that right, you really understand your client. Then you can probably optimize your cost to serve and indeed the proposition you're putting forward, because you understand the client in a more sophisticated way and a less black-and-white traditional segmentation view.

And that's coupled to the final point, which came out in the interviews with some of the executives. There's a lack of deep understanding of needs. I often say I don't think needs have changed that much for SMEs. They need to set up as a business, establish themselves, grow, expand regionally, expand internationally. That's a fairly standard set of steps and indeed the products that go with that have been locked in stone for some time. But it's the needs below that. It's how they want to be interacted with. It's one of the value-add services around the edge, which have value for them.

So I think understanding clients, a lack of sophisticated segmentation, a cost point that's too high, and margins under pressure … these four things are resulting in what we said, and as our research supports, that there's a lack of sustained profitability in any region globally in this sector.

Brett Price: I love that phrase that I saw in your report: to find the sweet spot between heroic service and bank profitability. You touched on that, but what other long-term negative repercussions are there for banks that don't figure out how to serve this critical segment? Can I direct that to you, please, Jared?

Jared Rorrer: When I think about the impacts of COVID-19 on commercial banks, and I think about the key traits of winning in digital and commercial banking, empathy comes out first and foremost followed by responsiveness and focus. Those three things, to me, put the human into digital strategy, and are going to be the most important components of how banks in the SME space globally are going to be successful.

Now what I see with COVID-19 is banks beginning to say "I have a unique circumstance in that everybody is essentially working remotely, and digital is the only way. And I have a unique set of data points or at least use cases right now to think about how I reinvent the way my RMs are interacting with customers, how I think about what's most relevant to those customers, and how I arm my RMs with data and information and insights to make those conversations meaningful and fruitful in a way that they, frankly, just haven't had the need before to do so".

Now I've seen banks operate and think about this in two different ways. One is: some banks are very focused on saying "how do I take this opportunity with COVID-19 where I know that I am fundamentally seeing my strategy shift before my eyes, and investing in that, and leveraging that to test and learn? How do I begin to accelerate towards a rapidly changing world where digital is the only way forward?" And that is, I believe, clearly the winning strategy

The other path I see, unfortunately, is a lack of a clear strategy as to what I'm going to do to capitalize on COVID-19, and what it is doing to accelerate the digitization of my overall strategy. And the concern I have is that banks that are passively looking at COVID-19, reacting rather than being proactive, will miss out on the opportunity of COVID-19 to bring empathy forward, bring the data forward, bring the focus of the bank forward to the customer at a very hyper-specific level. And I think when we get to the other side of COVID-19, what we'll see is a pretty significant divide between banks that have begun in earnest this acceleration towards digital, and those that are still letting every RM pick out their own strategy as to how they're going to handle this.

Brett Price: Thank you. So I'm just picking up on those four traits of a winning commercial bank in the SME market. Let's talk about empathy. Is there an example you can give of a bank that is doing this and doing it well?

Tom Merry: I think first I'd say that the need for empathy now is higher than it ever has been, so COVID has put this back on the table. Have banks been prioritizing this as a characteristic? Not in my observation. There are definitely banks – some UK banks, I can't be specific – that are bringing out tools around how to bounce back, how to support financial stability, what is good financial acumen, and quasi-advisory tools. This suggests that the bank's underlying concern is the health and well-being of those businesses. But I think empathy needs to go much further than that. I think it is clearly a trade-off between shareholders on the one hand, who are interested in a financial return, of course, and on the other, the organization doing the right thing.

And then, as we look into what is going to be a bleak and tricky period, you've got a number of clients who are going to struggle and find themselves in financial difficulty. What needs to be consistent, wherever you pitch yourself on the spectrum of where you need to lean, is doing it in an empathetic, engaging and honest fashion. And I think that runs through everything that you do as a bank. So even when you're making very difficult decisions, there are ways to do it in an empathetic way. There are creative tools for the use of language, for example, and behavioral techniques and communications to help you word things and communicate as empathetically as it should be. Because sometimes, let's be honest, policies, protocols and communications from banks have tended to be impersonal and often quite black-and-white. And I think that's one area where we can do better. But it's about being trusted through consistency as well.

So I think there are banks who are on this journey and recognize the importance of this, but I wouldn't say that it's a characteristic that is universally, consistently followed through by our banks globally.

Jared Rorrer: Let me add one quick point here around empathy and reinforce the opportunity. If you look at 2008 in comparison to 2020, the sheer perspective on what a bank can and should do is fundamentally different. In 2008 the banks were the villains. In 2020, banks have the opportunity to really be the heroes in their communities. And it starts with this segment. I think if banks can identify how to bring empathy forward in a way that is cost effective, and make this segment feel as if it is truly a two-way street, they have the opportunity to change the paradigm of the way banks are thought of and perceived globally for the next generation. I don't think I'm overstating it when I say it that way.

Brett Price: So we're at a critical time right now to lay out some new ways of engaging with SMEs?

Jared Rorrer: Yes, 100%.

Brett Price: So talking about responsiveness now, is there a bank that is truly responsive to SMEs? And do fintechs perhaps play a role here?

Jared Rorrer: Fintechs do have a role in responsiveness, and in two ways. First of all, as we see these non-bank fintechs march their way into the SME banking space, they're able to do things better, faster and feel hyper-focused in a way that the large banks haven't been able to achieve. So I think competitive pressure because of fintechs is going to continue to be one of the things that push banks forward toward a digital strategy.

Importantly, as we've looked at what's happened with COVID, we're seeing that some of these fintech lenders have products that are really effective, but the fact that they're not attached to a bank is a bit of a detriment during COVID. This is the idea that in a storm the security of a bank matters.

So I think that demonstrates to me that while there is competitive pressure, at least in the short-term I don't think the fintechs would displace banks. However, some of our largest fintechs out there, our largest global companies and technology firms, are pushing into this space. Whether or not they'll be true direct competitors to banks remains unseen. That said, leveraging these fintechs for the technology plays at hand becomes really key. They need to figure how to do it, whether it be access to a treasure trove of external data to drive better signals, to drive better micro-segmentation, to increase effectiveness and efficiency, to drive better loan closings that ultimately get you a "yes" faster and get money out to the customer faster.

Doing those things in partnership with fintechs provides banks an opportunity to really accelerate getting to the end output, as opposed to delivering iteratively on baseline technology. This allows them to move in a much more rapid fashion towards that true value-add across the board.

Brett Price: And presumably, technology can help mitigate the costs of serving SMEs.

Jared Rorrer: Yeah, 100%. I think when we look at the level of differentiation globally between these banks, and the problems they face and the opportunity in front of them, it's very limited. So what we see is cost to serve, time to "yes" and responsiveness remain the most effective levers in dealing with these problems. But as we look at bringing costs forward in that equation, to eliminate the paper – or at least the email that has replaced paper – is not digitization. To drive that effectiveness and efficiency in an end-to-end play takes out a significant amount of cost. And simultaneously, as you digitize that capability, you're now able to harvest that data and drive that into the insights that allow you to become more responsive.

Brett Price: Tom, thinking of the other trait – being focused – are there any examples of where you see this being done well currently?

Tom Merry: I think progress is being made in some of the European banks who started to recognize that the one-size-fits-all model just can't survive. It goes back to what Jared was just saying, which is there are now tools and techniques, often provided by externals, which allow you to sharpen your focus on the two-way value exchange you're having with your clients.

What we're not suggesting by being focused is to let SMEs go to have a bad book, to only focus on those where you make most revenue. That's not what we're saying here. What we're saying is you need to be able to recognize what you as a bank can provide that is valuable to the client That varies, because people have different needs and they place a different premium on different things. But also to recognize where value is accrued for you as an organization. And too often you hear anecdotes from executives and leaders in SME and commercial banks who recognize that they're making a loss on a long tail of clients because, the same time as having to adhere to a one-size-fits-all approach of serving those clients, they don't have the kind of relationship with them financially that merits that.

But it comes back a little bit to what I was saying earlier about underserving and overserving, and trying to think of a better way of doing that where you recognize the value for the client and the value for the organization, and trying to match that up. Again, a lot of this comes back to our four characteristics, which naturally come together – particularly responsiveness and focus. It's the same capabilities that will allow you to be effective in both of those things: to be able to observe where clients' needs and preferences are shifting, and to respond to those. And then to also be able to understand where you need to place your focus. Because our view is that given the backdrop, given the challenges historically on profitability in this sector, and given the outlook, looking forward, you need to be focused on where that value exchange exists. That's what will help you get to the right level of profitability going forward.

Jared Rorrer: Let me chime in. You know, when I think about where it's being done well, there's a digital challenger bank in the UK that is essentially now a fintech as well. And what they've been able to do is take this idea that credit monitoring doesn't have to be an annual or quarterly event based on financial statements in arrears as much as leveraging data that's accessible out in the marketplace: industry-level data, macroeconomic drivers, scenario analyses, specific information around customer sentiment and customer reviews. It's bringing all that data together to help drive a whole new way of looking at proactive ongoing credit monitoring that can indeed be event-driven in a way that we haven't seen before.

And this digital challenger bank has done a phenomenal job of putting something on the market that other banks have talked about forever, and bringing that work forward in a way that is being shared with other banks. This is not unlike what we've seen with other banks coming into their own and becoming a massive global force. This bank has done the same, or is in the process of potentially doing the same, with data and analytics and being able to proactively drive that work forward. But all of that drives to a more cost effective way of serving, a way that's more responsive and helps banks identify problems frankly before a customer might. And the power in that is that it drives a two-way conversation that's value-add, as opposed to coming and saying "I think you've got a problem". It's like "let me help you solve for a problem that may be emerging", and it's a fundamental shift.

Brett Price: Jared, we've touched on this, but I wonder if we could have some final thoughts on the last trait: being efficient. What are the priorities that make an efficient bank?

Jared Rorrer: Banks in this market have to get focused on a couple of things, and we're seeing this across the board. The key components are modernizing the end-to-end capability within the center of the bank. Eliminating the non-value-add paper processes which, frankly, exist at every bank. So if you feel like you're the only one, that's not true. But getting rid of that, and driving it toward a pivot where data is the true asset – usable data, not just having a bunch of data, but useful data that makes you really able to drive that effectiveness – that is key.

That drives to what is probably still the most important component of cost. We talk about the operating model shifting toward value-add on the front end with relationship managers. I look again at COVID and say now is the opportunity for banks to really think differently about this role. We've talked for years about creating efficiency in the front office by eliminating non-value-add tasks. Well, we've eliminated the non-value-add task of travel for at least the next 6 to 10 months, and because of that bankers have 20 to 30 to 40% more capacity. So if the theory is that that's going to drive costs out, or drive more effectiveness, let's test it right now. Let's see what changes we can build in this operating model that will change this role and should be the driver of better value-add and insights or cost saving for these banks.

Brett Price: It seems like there's a huge opportunity there that's mutually beneficial for both banks and the SMEs. Maybe finally as a conclusion, Tom, you could tell us how you see clients moving forward?

Tom Merry: What came out loud and clear from our research was that there is real consensus across our interviewed executives around the opportunity. And we believe that right now, particularly in light of COVID, there are four characteristics you need to get right: empathetic, responsive, focused and efficient. That being said, it's clear that banks need to start off on the journey. So what do we recommend? The research will go into more detail on this when it's published, but there are five areas where we think real opportunity exists.

The first is around having a relevant proposition underpinned by clear purpose, and this plays to the point we make about purpose-driven banking and the need for empathy, particularly at this time. Setting the right strategic direction and sticking to it. Thinking about what it means to be supportive throughout an SME's life journey. Thinking about the scope of financial advice and how you treat vulnerable customers as they get into financial difficulty, if they do. A relevant proposition underpinned by a clear purpose.

Clearly, the technology transformation is important here. I talked a bit about this, but there's a long way to go. Many of these banks are riddled by legacy, and yet the mainstream tools are available now and should be exciting because they all have that and they can make a profound difference for SMEs. We're talking about next-generation platforms of which many now are cloud native and offered as a service. We've got artificial intelligence and intelligent automation throughout the lifecycle. How you ruthlessly decommission the legacy and accelerate that tech modernization journey is going to be important. The tooling is out there now to get on that journey.

I think a data-driven operating model is key to this. We've talked about the need to be intimate with your customers, understand their needs, their behaviors, their sensitivities, and then be able to change your proposition flexibly and cheaply. A lot of that comes down to whether you are a data analytics supremacist, and what does it mean to be that? Is it early warning indicators to drive preemptive actions on your loan losses or being able to spot customers who need a different engagement than the RM model within data-driven basics and data-driven analytics? These are all available now on a very widespread basis and will be key.

There's something new about the digital ecosystem, without doubt. So we talked about the need to embrace the fintech ecosystem and best-of-breed technology and partnerships. Again, SME banks have tended to shy away from this. For big banks in general this hasn't been their sweet spot. We've seen progress made, but I think it can go further. So what does it mean to be able to open up your APIs, to think about developing your portals, to think about non-financial partners who could help you to expand your proposition? What are the operating model changes you need to do that? What do you need to change about your policy, your risk appetite, your mindset and your skills?

We think being open to recognizing that there are others in the ecosystem who can help you be more effective is a really important part of this.

And finally, as Jared mentioned earlier, it's about how you empower your bankers. We believe there is huge potential in the RM base who we see working tirelessly, often against the odds with poor tooling, to try and make good the relationship with their clients. They're working extremely hard and invariably clients say, at the end of it, it's all okay. But they know that their RMs had to go through a heavy process and a long day to get there. We think that can change. The potential of the human / machine relationship, preemptive information, customizable reporting, next best action prompts – the basics that are now seen in other industries – you want to give these to your RMs so they feel empowered, so they can focus on the high-value interactions, and so they can, together with other initiatives, ensure that the bank is empathetic, responsive, focused and much more efficient than it is today.

So that's a long list, Brett. There are five things that we think will allow you to achieve these four characteristics. The future, you know, is a bright one for SMEs despite the challenges of COVID. We think there's massive headroom here around the progress that can be made, and we hope that our banking clients will be interested in the research and go with us on the journey towards being more empathetic, responsive, focused and efficient.

Brett Price: Jared, do you have some final thoughts?

Jared Rorrer: I do but I'll keep them brief. I said earlier in the discussion today that the differentiation is razor thin here. To put a fine point on it, what I believe the differentiation will be over the next 18 to 24 months is execution. The strategy is fairly straightforward, but the execution – picking the right priorities, putting the right initiatives in place, bringing that together in a way that drives the value for the segment – is going to be the differentiator.

So focusing on execution, putting a clear path in place and not being overwhelmed by all the things we're talking about, and simply getting started … these things become key.

We recently built a tool called myIndustry that allows banks to go in and begin to build out, from the center, core uses cases within a technology ecosystem that's fully integrated, and then across the commercial bank. So we can put data and insights in front of a customer to help think about what that use case is, and even test those things with real customers. It's a powerful way to think about how you drive that execution in a way that gets you to an end outcome. So to me the key has to be getting started, driving a clear purpose and being laser-focused on a strategy that's going to deliver on executing.

Brett Price: That's a fantastic conclusion, and we dealt with a lot of detail today. Jared, can you tell us when and where clients may be able to look at this research?

Jared Rorrer: Sure, we'll be publishing this report the first week of October. You can find this and much more on our Commercial Banking page.

Brett Price: Thank you so much for your time, gentlemen. Tom Merry, thank you. Jared Rorrer, thank you very much for your time and your terrific insights.