

Industry Insights

Focused Thought Leadership for the UK Financial Services Industry

Next generation SME banking

How banks can apply innovation to seize the SME revenue growth opportunity



High performance. Delivered.

Industry Insights

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The financial services landscape is undergoing a fundamental change. Timely insight and clear focus has never been more critical. With this in mind the Financial Services practice in Accenture is producing a series of 'Industry Insights' to help the industry address the challenges it faces. The series will focus on the five key issues facing the industry in the UK and Ireland:

- The regulatory challenge
- Innovating for the changing customer
- Globalisation
- Restructuring for growth
- Rebuilding trust and reputation

This point of view explores how UK banks can address the changing customer challenge by applying innovation to seize the SME revenue growth opportunity.

What's next in the Industry Insights publication series?

Over the course of the next several months, we will be issuing points of view addressing different aspects of each of the five key themes identified above. Below are the upcoming and recently released publications in the series.

What's next?

- Financial Reporting Challenges in Investment Banking
- Accenture FS Online Digital Diagnostic Scan
- The UKI Customer Service Survey 2011
- Managing Regulatory Change in Banking and Capital Markets
- The Digital Insurer

Recently published

- Top Ten Challenges for Investment Banks 2012
- Banking 2012: Revenue Growth and Innovation
- Spotlight on Solvency II for Insurers
- If a Country Leaves the Euro...

Contact Us

To know more about the Industry Insights Research, Upcoming Events or Future Publications please contact:

James Sproule
Financial Services, Research
+44 20 7844 5963
james.sproule@accenture.com

Geetika Rai
Financial Services, Marketing
+44 20 7844 5982
geetika.raai@accenture.com

Next generation SME banking: this time it's different

From mobile credit card payments to virtual advisers, and from automated cash deposit machines to social networking, the next generation of SME banking is emerging now. It's time for banks to deliver the services SMEs want profitably – or risk losing out to competitors and new entrants.

It is generally held that the SME segment is underserved, reflecting the risks associated with the sector. Despite the number of small businesses in the UK remaining broadly stable at ~4.5 million, the sector is highly dynamic, experiencing frequent births and deaths as companies are established, are acquired, and in some cases close. However, for UK banks, the SME market still represents a huge and underexploited growth opportunity.

Employing nearly 60% of private sector workers, SMEs generate a proportion of UK private sector turnover that is virtually identical to that of the UK's 6,000 large businesses. Their attractiveness is further underlined by their tendency to be fiercely loyal and 'sticky' customers that are historically unprejudiced to multi-banking.

Today, a powerful combination of new regulation, evolving customer needs, and the emergence of new players and technologies is driving an unbundling of SME banking. This has pushed the market towards a 'tipping point', and created a clear but short-lived window of opportunity for banks to seize the initiative and grow SME market share and revenues (See Figure 1). However, getting SME banking right presents real challenges and risks in a period of intense economic uncertainty.

According to recent data from the Bank of England (see Figure 2), the value of outstanding SME lending fell by nearly one-fifth following the financial crisis, retreating back to 2006 levels. Regardless of whether SMEs are simply less reliant on credit, or are merely tapping alternative sources of funding, the traditionally strong credit relationship between bank and business customer is eroding.

Banks risk being disintermediated in the emerging SME banking marketplace, pushed to the side as the unbundling of deposit, transaction and risk gathers pace.

To retain their stake in the game, banks must shift focus, from product-push to customer-pull, by fully embracing the opportunities of a more client-centric strategy.

To fully capitalise on the growth potential represented by this tipping-point in SME banking, Accenture believes that banks must apply innovation across the value chain, learning lessons from other industries and firms already succeeding in this segment.

Today's SMEs want many things: more appropriate and innovative financial services; sound, commercially-aware advice, not just on products and services, but also wider business issues; and more tailored and responsive multi-channel banking. By driving a more customer-centric strategy, through product, service and channel design, harnessing the power of new technology and learning from other industries, banks can deliver all of this...and more.

Figure 1: The tipping point in SME banking is being driven by four key factors

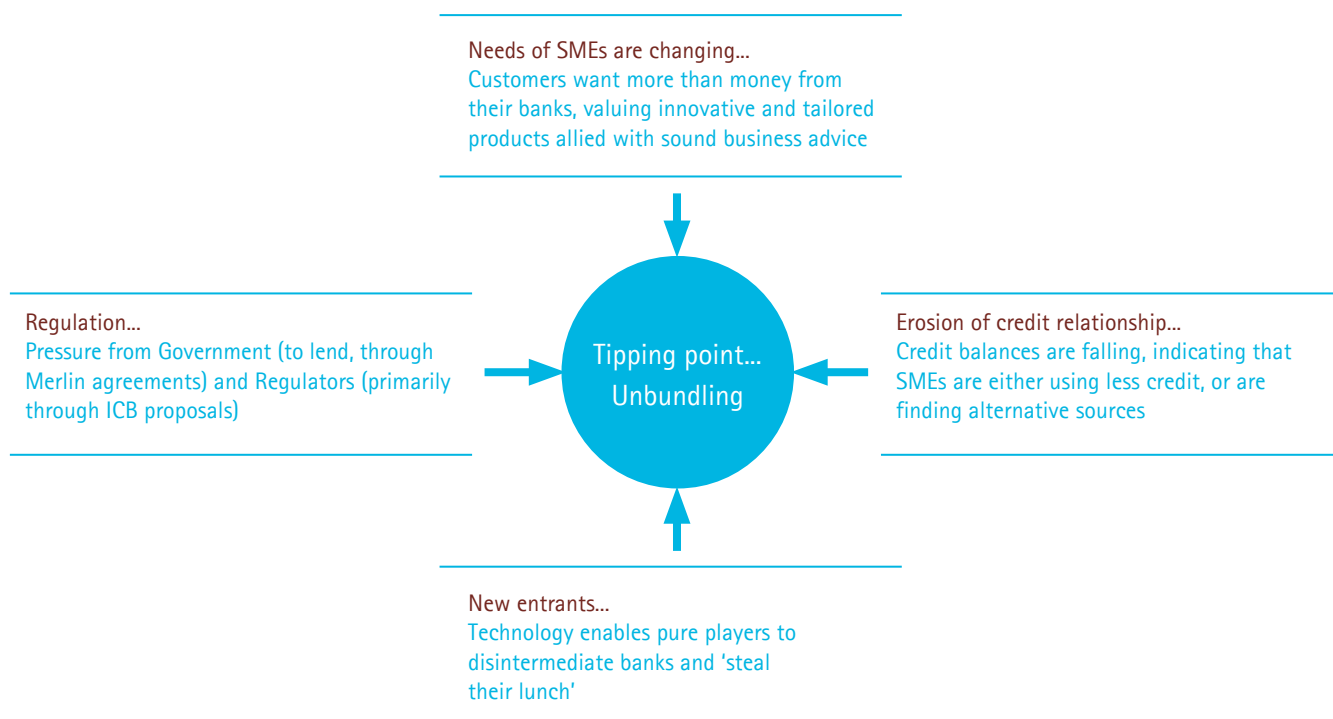
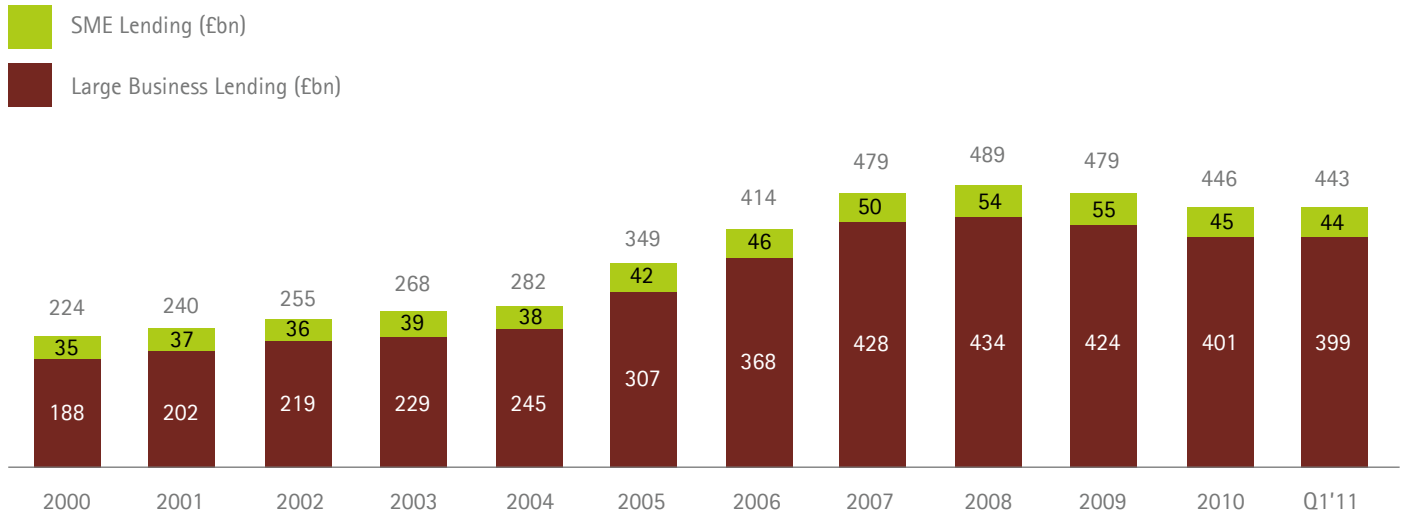


Figure 2: SME's reliance on bank credit has declined since the crisis
Lending to UK Businesses, Balances Outstanding, 2000-Q1'11 (£bn)



Source: Bank of England

Scoping out the profitable revenue opportunity presented by SMEs

The UK's large SME community presents banks with major opportunities for profitable growth – provided they can first overcome the risks and challenges involved.

In terms of the sector's size and economic contribution, the figures speak for themselves. Some 59% of UK private sector employees work for SMEs¹. And as Figure 4 shows, while SMEs represent 99% of UK private sector enterprises, they are the 'long tail' of the business banking market, representing a pool of revenues as large as the UK's near-6,000 strong base of large businesses.

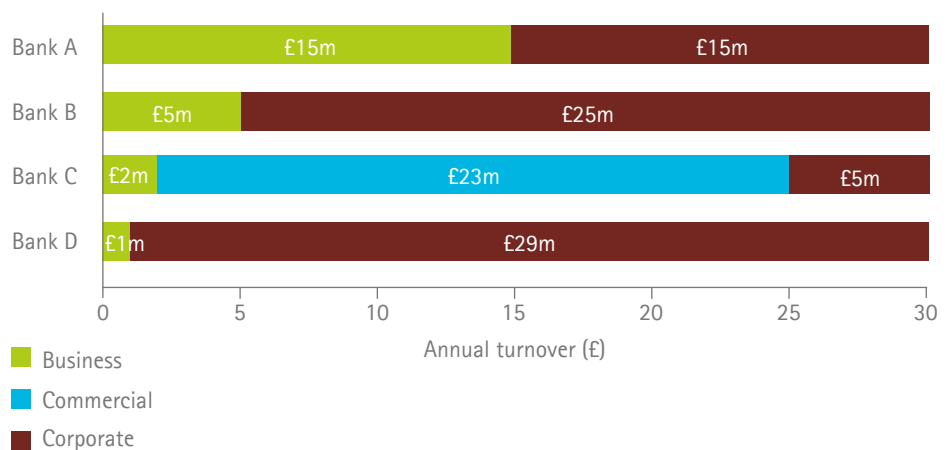
1. Department for Business, Innovation & Skills (BIS), 2011

What do we mean by SME?

In this paper, SMEs are defined as businesses with fewer than 250 employees, while 'small' businesses are those with fewer than 50 employees.

However, as Figure 3 illustrates, UK Banks employ a range of turnover-based criteria to classify SMEs.

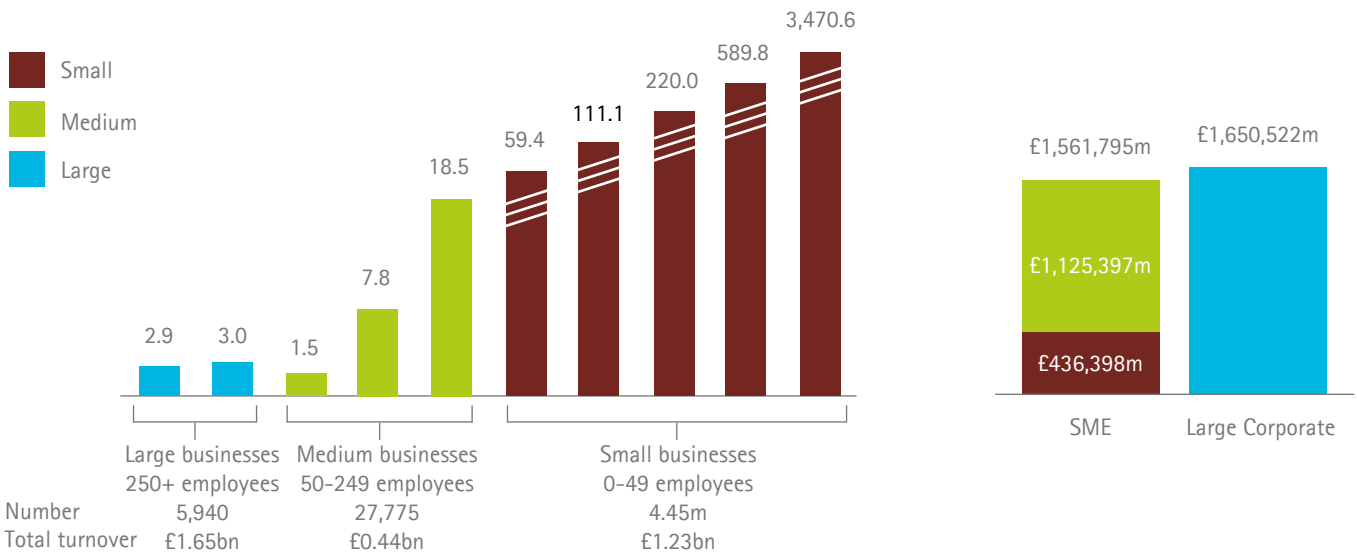
Figure 3: Classification of business / commercial / corporate clients by turnover



Source: Accenture

Figure 4: SMEs make up 99% of UK private sector enterprises

...and 49% of private sector turnover



Source: Department for Business, Innovation & Skills (BIS)

Unrealised potential...

These facts underline the revenue opportunity in serving SMEs' banking needs. However, to capture the full potential of this market, the differences between SME and Retail customers must first be acknowledged.

Since 2000, the total number of SME bank accounts has grown in every year except one. Unlike Retail, this expansion has been largely driven by current accounts rather than savings activity, with SME deposits growing at a much slower rate

than retail and corporate deposits. One explanation for this is that SMEs have simply not had surplus cash to put on deposit, preferring in recent years to use such funds to pay down debt or fund working capital. Alternatively, a proportion of SME deposits may simply be 'hidden' within retail accounts.

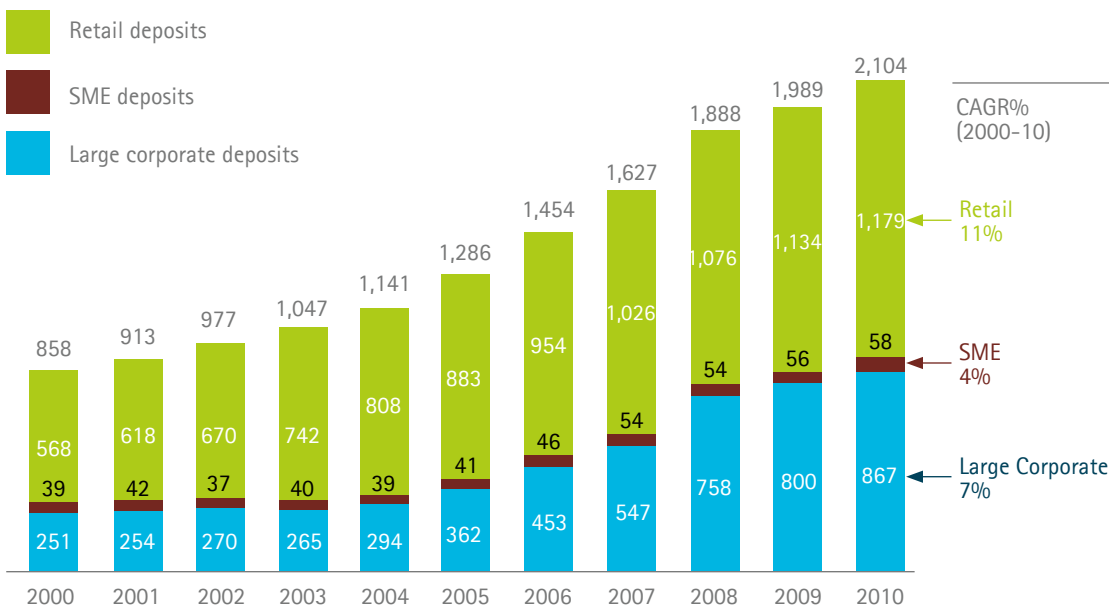
Research indicates that around 20 percent of SME customers use retail financial products to meet their business banking needs². The reasons for this situation are not clear; it may be because SMEs see it as the most expedient way to access

credit or because the SME products and services offered have little perceived benefit. In either case, this 'hidden' SME customer group represents an unrealised opportunity for banks. Their borrowings are priced using retail analytics, and are consequently not optimised for SME customer behaviours. Likewise, banks are unable to optimise the service experience or provide additional SME value-add services as they have no visibility of this hidden component of their small business customer base.

2. Mintel, 2011

Figure 5: SME deposits have not grown as fast as retail and large corporate

UK Business banking deposit balances, 2000-2010 (£bn)



Source: Mintel, Bank of England

...the 'tipping-point' is approaching

A new eco-system is emerging in finance, with banks competing across industries for the same pool of customers. As Figure 6 illustrates, there is rapidly intensifying scope for banks to "lose their lunch" as a wave of convergence radically changes the traditional competitive landscape for banks and their customers.

Pressure from these emerging eco-systems will mean that traditional players in the SME banking market will need to constantly justify their place at the table, as new competitors and pureplayers continue to emerge. Rebuilding relationships with SMEs through a more customer-centric approach is one way to consolidate a position in this market, and is discussed later in this paper.

Impact of inbound regulation

In addition to the impact of new eco-systems, driving the unbundling of products and services that were once the preserve of the bank, intensifying regulatory pressure is also working to loosen the competitive logjam.

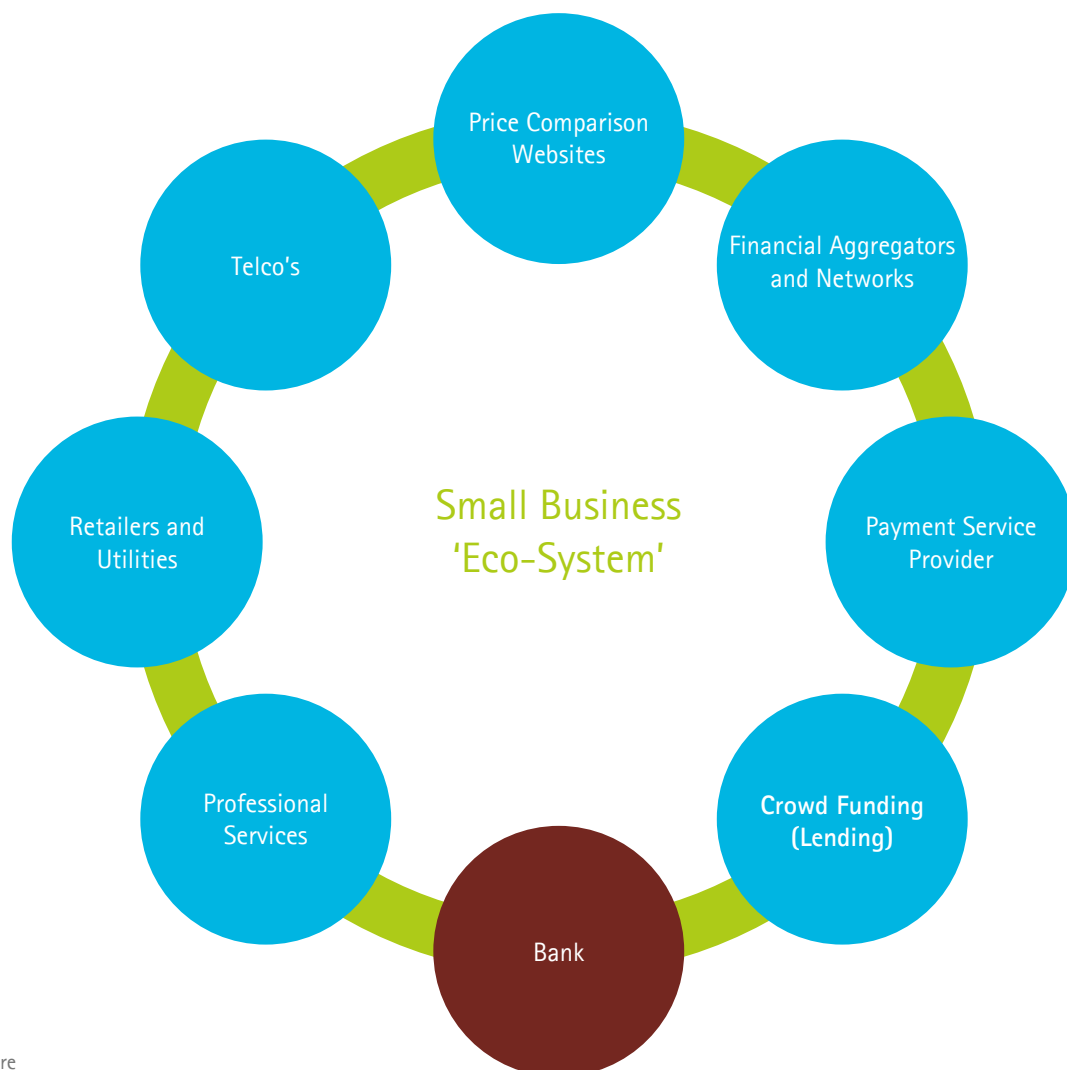
A combination of escalating regulation – including Sir John Vickers' Independent Commission on Banking (ICB) – and unprecedented numbers of asset sales continue to dilute bank branch concentration, and provide cash-based SMEs with new choices in terms of their closest branch. For example, the ICB's proposed 'branch sharing schemes' could allow smaller banks to offer cash-handling for SMEs through other banks' branches, or perhaps even through the Post Office network.

At the same time, wider moves to drive competition and account switching in the personal market will create opportunities for new entrants to tap into the 35% of SMEs who use the same provider for business and personal banking³. The net result should be a better deal for SME customers – and a unique chance for new entrants to erode the historical dominance of the big five retail banks, which currently hold 85% of Business Current Accounts (BCAs)⁴.

The challenges in pursuing SME-driven revenue growth

While the opportunity is both current and pressing, getting SME banking right presents real challenges and risks. These can largely be divided between the difficulty of achieving true customer-centricity in SME banking, and the challenges posed by a number of structural barriers in the marketplace.

Figure 6: New eco-systems emerging as industries converge



Source: Accenture

³Source: Independent Commission on Banking (ICB), 2011

⁴Source: Independent Commission on Banking (ICB), 2011

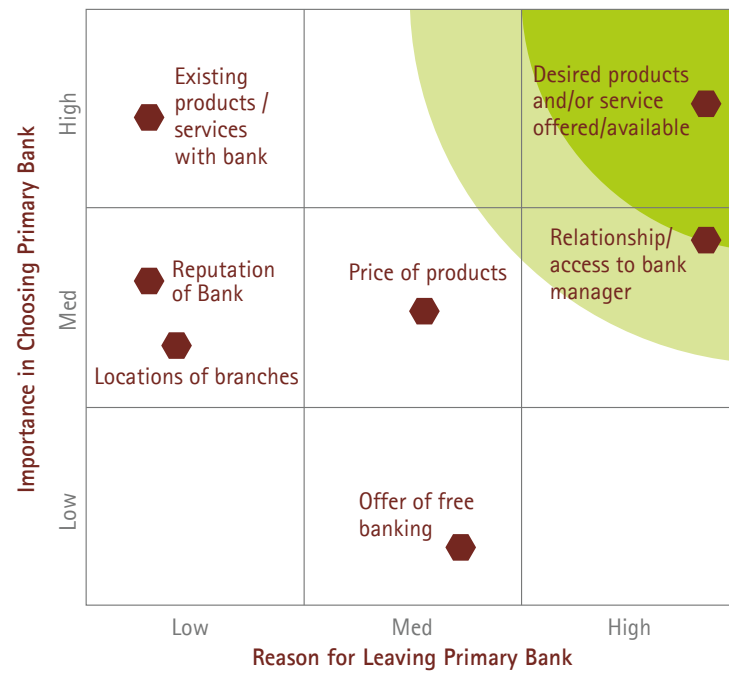
Customer centricity: crucial, but tough to achieve

For all banks pursuing the SME opportunity, customer-centricity is recognised as being essential, but hard to deliver. The challenge is made all the more pressing by ongoing shifts in what SMEs are looking for from their banks, and the fact that banks themselves face the real risk of being supplanted by new entrants and pure-players offering innovative multi-channel products and services to SMEs.

Figure 7 maps the reasons given by SMEs for switching away from a previous bank against their reasons for joining a new one. The high importance of innovative services on both axes underlines that the needs of SMEs are moving away from basic transaction banking and 'vanilla' lending towards more tailored and innovative financial services. It is also clear that today's SME customer wants a different type of relationship with their relationship manager – one offering access to sound, trustworthy advice on products and services, as well as on a range of wider business issues. Meanwhile price is revealed to be an important, but secondary factor for SMEs. In short, while banks must continue to seek to be competitive on price, a strategy based on price alone will not deliver a sustainable advantage, merely exerting downward pressure on the profitability of the sector as a whole.

Following broader customer trends across retail banking and other industries, SMEs increasingly want innovative products and services, as well as interaction with their bank, to be delivered seamlessly over multiple channels. Executing multichannel service has emerged as an imperative for the customer-centric SME bank. Online and mobile have grown – according to Mintel, almost two million SMEs, around half of the UK total, used online banking in 2009, more than twice the number in 2003 – but the branch

Figure 7: Customer centricity leaver / joiner matrix



High: >30% of respondents
 Med: 15-30% of respondents
 Low: <15% of respondents and not mentioned

Source: Accenture Analysis; Mintel (2011); OFT (2011)

and business centre remain important channels for serving SME customers, with OFT reporting that 42% of SMEs conducted at least three-quarters of their banking transactions through the branch⁶.

In addition, the challenges of meeting the increasingly sophisticated needs of SMEs have been amplified by the impact of the financial crisis. SMEs are now less inclined to ask for credit due to a growing distrust of banks, with recent Bank of England research revealing that SMEs were turning to other funding sources, such as credit cards, in increasing numbers.

Innovation Case Study: Mobile Payments

SMEs need the ability to accept card payments on the go.

Companies such as Square (an instant card payment utility for iPhone), and iZettle (a tool enabling customers to accept credit card payments through swipe technology) pose significant challenges to the traditional bank payments model. iZettle has shown innovation leadership by adding a social twist through a feature which allows merchants to email a photo and receipt to buyers who can then upload details of their purchases to Facebook.

As more SMEs begin to capture digital payments with Smartphone Apps, banks risk becoming further disaggregated from the payment value chain. Some, like Singapore-based OCBC Bank, have seen the opportunity and have launched new apps that capitalise on the trend. OCBC's app allows customers with Android devices to scan barcodes, obtain billing details, and make payments with merchant partners thanks to their "Scan & Pay" facility, highlighting the opportunity for banks to innovate and create real time payment utilities across mobile platforms.

⁵Mintel, 2011

⁶Source: Independent Commission on Banking (ICB), 2011

"I wish my bank understood that having a credit line will allow me to take on more projects at a time and also work on projects faster...With a credit line, I'll be able to invest in materials before deposits come in and [without] having to invest my own working capital."

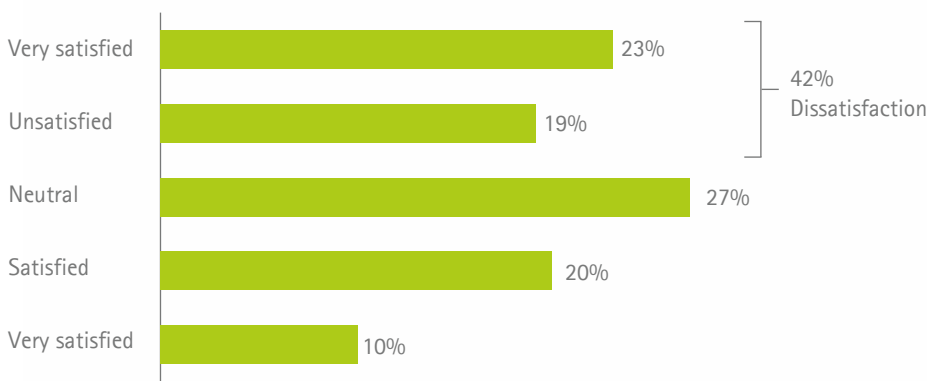
Landscaping and property maintenance company

This trend is fuelled by higher loan request rejection rates: one-in-four SMEs that applied for bank finance in 2010 received an outright rejection, compared to just one-in-twenty five in 2007, with the smallest firms being hit the hardest. Despite Government efforts to boost SME lending, demand for traditional forms of 'external finance' has continued to decline. Survey data indicates that SMEs believe banks neither support them nor understand their individual requirements, feeling that banks have taken a 'step back' in their efforts to meet their needs.

In 2010, Mintel asked a group of 292 small business owners whether they were satisfied with their bank. Their survey revealed that 42 percent were dissatisfied (see Figure 8). The results of a subsequent series of qualitative in-depth interviews, conducted by Accenture in the last 12 months with 25 UK SMEs, shed light on some of the key issues causing dissatisfaction. Interestingly, interviewees believed their banks were failing most in the dimensions of support and personal service, while lack of financial support ranked low down their list of concerns.

The work of providing more relevant services to SMEs, particularly advice and tools that help them become more robust players in difficult economic times, carries with it a significant social dividend. Trust between society and institutions is at an all-time low, following the financial crisis and subsequent global economic instability. At a time when banks, and other institutions, are under intense pressure to 'do more' for society, engaging with and nurturing small businesses, frequently referred to by UK Government ministers as "the engines of economic growth", could be an important steppingstone on the path to restoring trust.

Figure 8: Current levels of satisfaction with current principal banking provider, 2010



Source: Mintel (n=292)



Innovation Case Study: Peer to Peer Lending

SMEs, especially start-ups, often need funding and financial support through their lifecycle.

Non-Bank Financial Institutions (NBFIs) such as Funding Circle (an online marketplace where people can lend directly to small businesses in the UK) and Crowdcube (offering a new model for sourcing capital for start-ups by utilizing an online platform to help match investors with businesses through equity stakes and non collateralized loans) are competing against the traditional 'big bank' lending model for SMEs – where the vast majority of SME lending currently sits. In addition the giant NBFIs like GE are investing in growing their SME lending business through acquisitions and are looking to take a greater share of this market.

Banks have the opportunity to co-create investment opportunities with their customers, playing a bigger part in this emerging market. Business banks can look to create new asset classes by allowing retail and private banking customers to invest in SME customers – effectively sharing the risk.

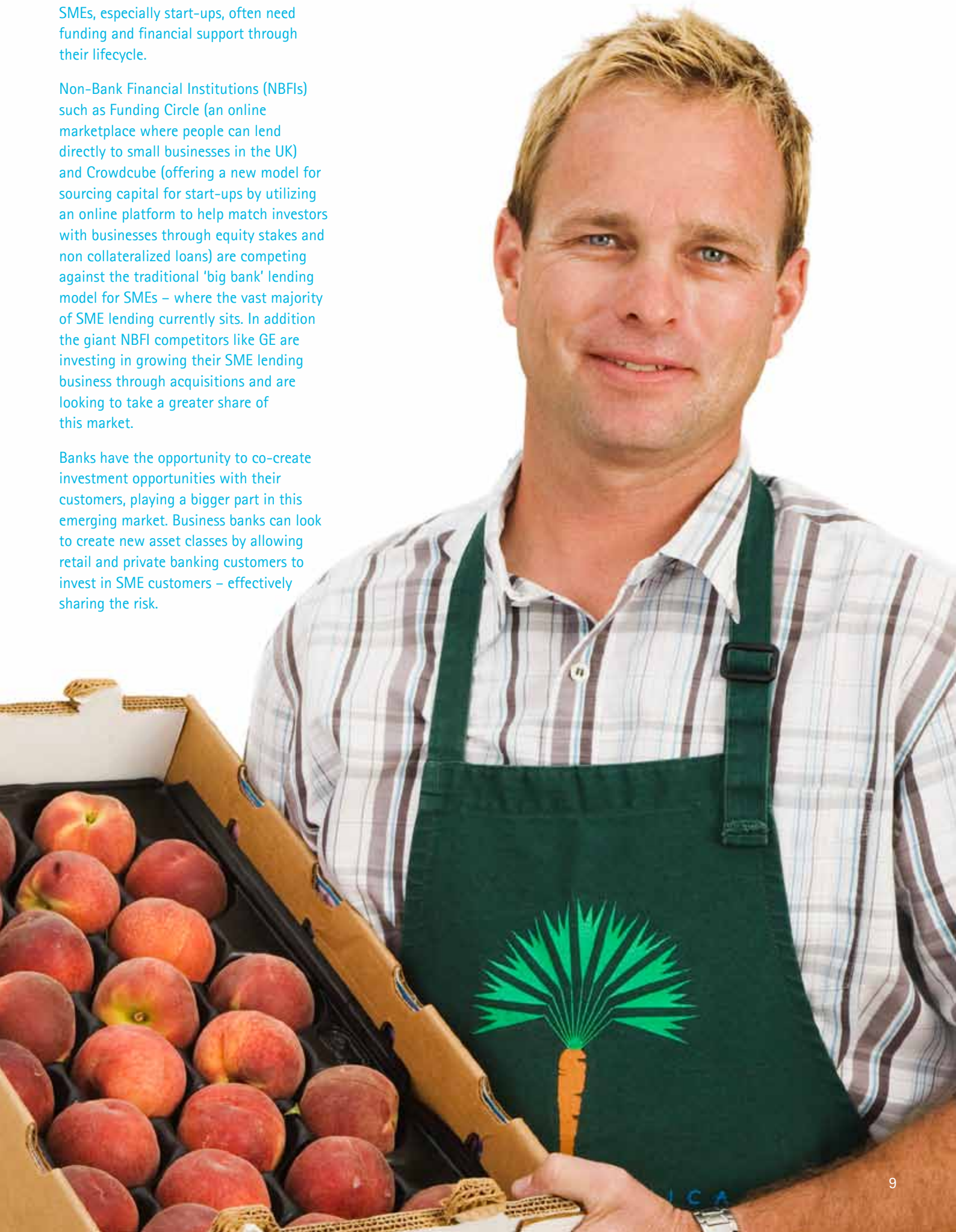
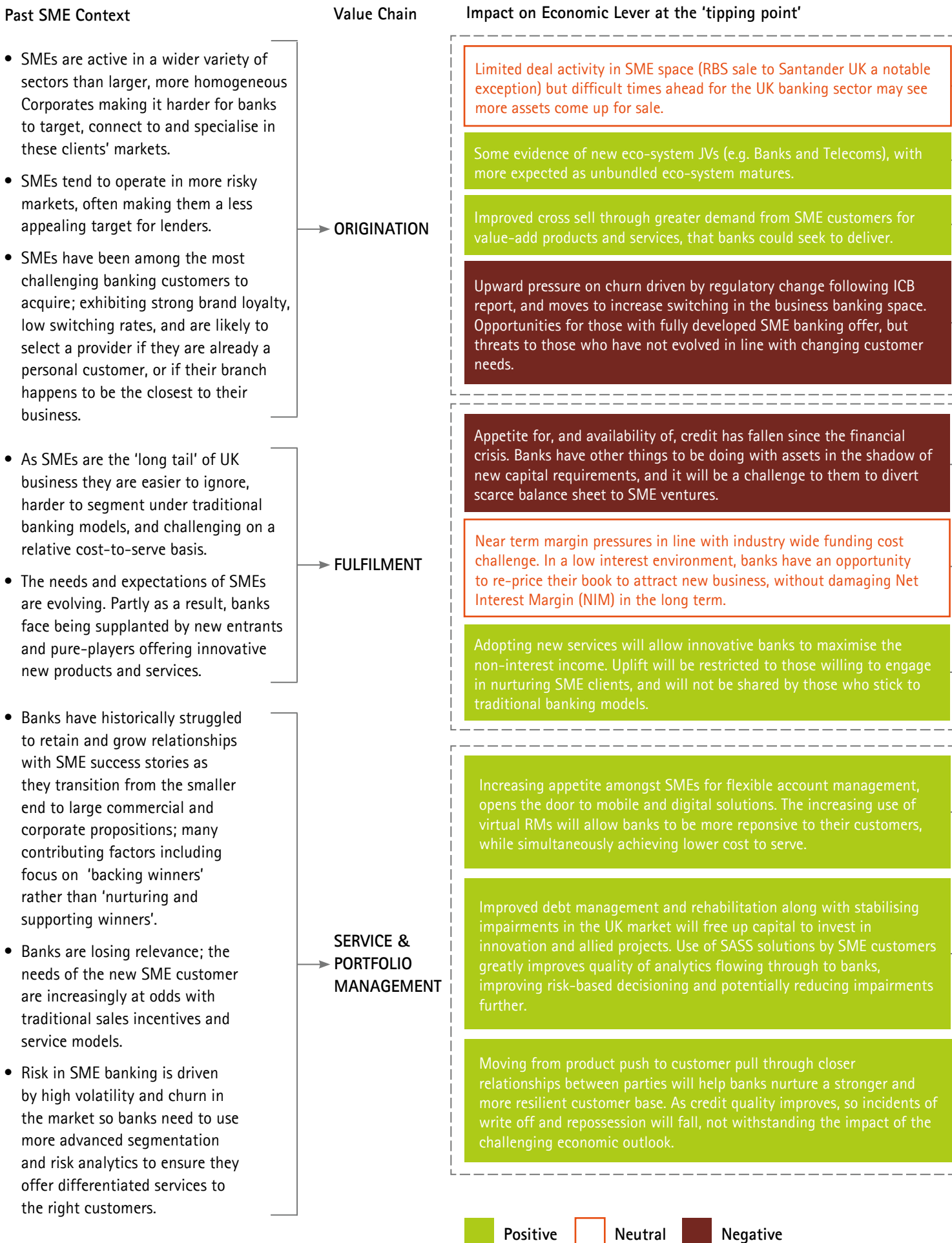


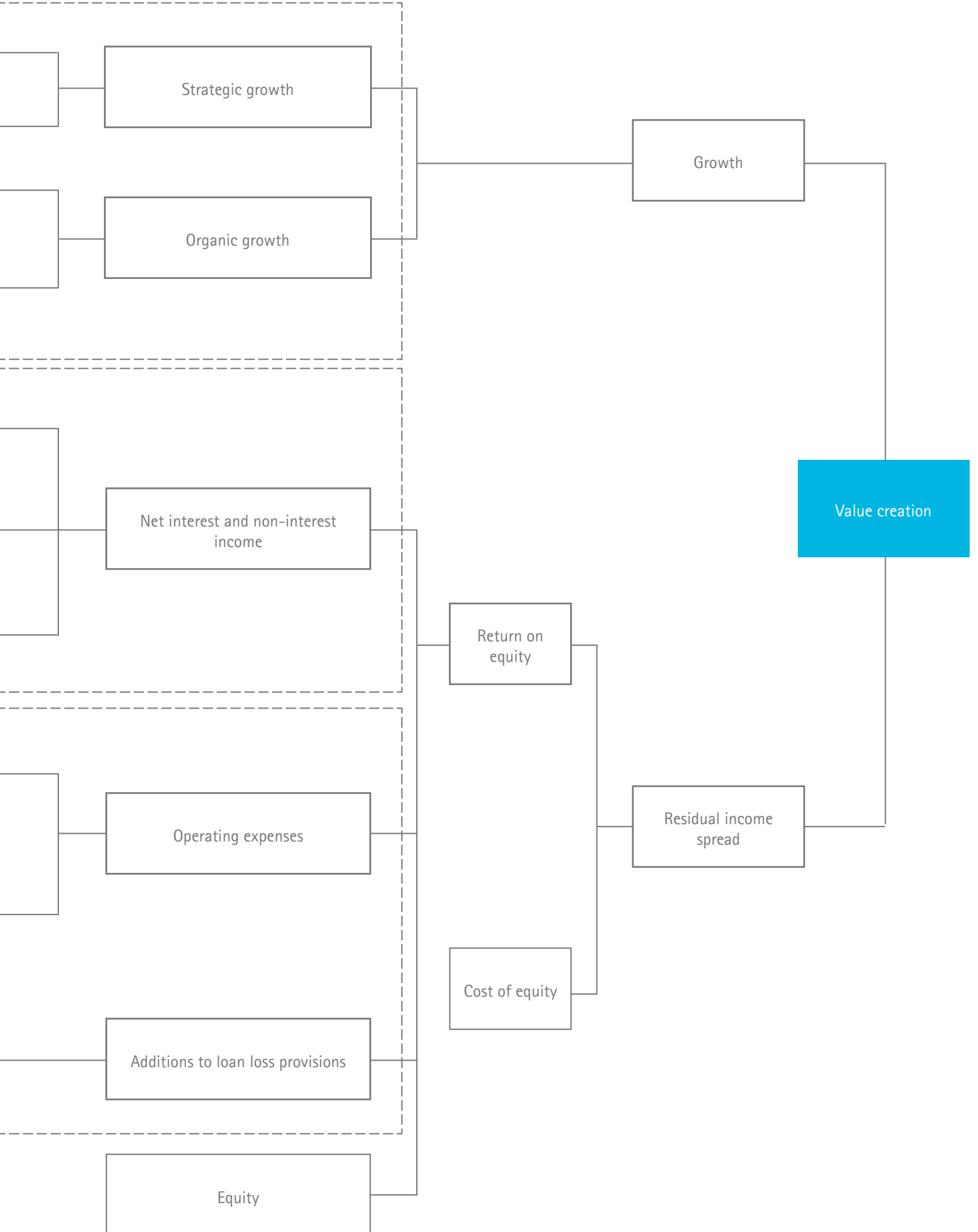
Figure 9: Realising the potential of SME customers to drive growth requires specific actions carefully balancing risks and opportunities



Positive
 Neutral
 Negative

Source: Accenture analysis

Value Drivers in Commercial Banking



Innovation Case Study: Business Education

SMEs often lack the ability to create ambitious and sustainable learning and development programs for their employees.

Banks, such as Barclays (launched 'MyBusinessWorks' – a fee-based service for business start-up customers) and HSBC (opened its e-Masterclass-Global Knowledge Centre for SME learning – with free modules) are offering solutions to meet this need.

However, Banks could go even further by providing mobile learning offerings, and developing a broader syllabus of education and information material for their business customers.

"I feel they should know me as I go to the bank often. If I have a problem or need something, I want to have somebody's name or person to call directly."

Restaurant owner

"I would like to introduce my services into newer areas and scale up my delivery service. I am looking for advice and guidance on this."

Club owner

"It would be great if they can help me manage my finances and advise us how we can be more profitable and grow our existing fleet, yet continue to provide a high-end service...I feel they have several customers like me and will know better how to help such businesses."

Airport services provider

Low churn, high barriers

Another structural challenge for banks seeking to win established SMEs away from competitors is the historically low churn rate of the segment. Some 52% of SMEs have been with the same current account provider for at least nine years⁷, while 51% claim to have always had the same main bank⁸. Meanwhile, 35% of SMEs told the ICB that holding their personal current account with a particular provider was one of the main reasons they selected them for their business account.

The tide is beginning to turn though, with a tipping point of deposit, transaction and risk unbundling already reached. Market and regulatory pressure are now working together to erode the importance of the main bank relationship. But, even in the face of these powerful trends, we have not yet reached the new paradigm.

Right now, it remains essential to achieve 'main provider' status to increase SME share of wallet. This is largely because SMEs still tend to stick closely to their primary bank for their other financial needs, such as revolving credit, deposits and term loans. And, since 97% of SMEs surveyed by the ICB identified their 'main bank' as the one with whom they hold their BCA, despite this turning tide, winning current accounts remains a critical success factor.

Since convincing established SMEs to switch their main banking relationship is so difficult, the answer might seem to be to acquire them at an earlier stage. However this is a risky strategy, since one-in-three start-ups will fail in the first three years. To successfully tap into early-stage SMEs, banks need to provide them with more than just funding. To actively help SMEs survive and flourish through the challenging first years, Banks need to offer real expertise, business aware advice, and practical support as well as finance.

When done well, this approach should blend better, more comprehensive financial and business services, with advice and new ways of incentivising relationship managers based on the value they add to the relationship as well as profits they generate. As a result it will not only build business, but it will also build trust between the bank and the customer – benefiting sales and share of wallet in a more sustainable fashion.

But driving revenue growth remains difficult, as the traditional sales, segmentation and service models deployed in business banking – dominated by size-based segmentation, large RM portfolios and sales based performance incentives – are at odds with the need of SMEs for truly relevant products and services. In addition, the challenging economics of banking mean the benefits and risks have to be managed carefully. Specific actions designed to control risk and cost are illustrated in the chart in Figure 9 in the centre spread of this publication.

⁷Mintel, 2011

⁸Mintel, 2011

Using innovation to harness the SME opportunity

To overcome these challenges and harness the SME opportunity, banks must innovate across the supply chain, within origination, fulfilment, and service & portfolio management.

Origination is where most high profile innovation is occurring. Some banks are implementing new value-based and needs-based segmentation models, offering SMEs variable pricing and service options across products, and support through multiple channels. Across Fulfilment and Service leaders in this space are adopting more light-touch relationship manager models – including remote relationship managers available via online messaging tools – which are proving successful, despite the fears of some that SMEs would find it too impersonal. In fact, this approach has been shown to boost sales conversions.

Innovation must be harnessed to address a real customer need or to alleviate internal challenges, and primary research conducted by Accenture uncovered a range of best practice examples illustrating some of the ways that innovation can be employed to meet these challenges (see Figure 10).

However, innovation must also be a multifaceted and cross-disciplinary capability, delivering sustainable innovation that helps businesses deliver on their ambitions. Joint Ventures offer the potential to significantly lower support and distribution costs while expanding reach and access to knowledge and technology expertise. Alternatively, banks may opt for a cross-border partnership-based approach, to tap emerging market growth through expanded business bank franchises.

Innovation Case Study: Virtual Channels & Advisors

SMEs are constantly looking for ways to improve efficiency, save time and money.

BankInter allow their business customers to use virtual channels to interact with them via online video conferencing, helping SMEs save valuable time by providing anytime/anywhere access. They launched their 'Mobile Virtual Network' in partnership with Dutch telecoms operator KPN, using the Orange network to reduce customer's cost of data transfer. A Cisco case study claims this model delivered positive results with over 1,000 video calls

per day and improved closure rates (up to 25%). Elsewhere Leumi Bank, Israel's leading commercial bank, are going further with applications such as 'Leumi V', which delivers face-to-face contact for customers at their desktop and through mobile devices.

From this base, it is conceivable that banks will seek to expand their multichannel offerings. For example, tablet applications with video functionality could open virtual channels for product co-creation, allowing banks to leverage virtual focus groups to test new products with customers before hitting the market.

Figure 10: Innovation Best Practice

SOCIAL COMMUNITIES	ADVICE & SUPPORT
<p>There have been various social media ventures in recent years, where companies have allowed others to access their customer base with digital advertising.</p> <p>Results have been mixed, but SME banks have a unique opportunity to use their online presence to market their own products and services as well as those of their SME customers.</p> <p>Not only does this allow SMEs to reach new potential customers, but the idea could be leveraged further to offer exclusive deals and money saving vouchers.</p>	<p>One mid-sized UK bank offers its customers access to a tiered range of advice and support offerings, from basic credit control templates, online business management tools, and newsletters, through to HR, Health & Safety and legal advice tools, discounts on business software, and representation to local, national and European Government.</p> <p>The flexibility of such a system is a key factor driving uptake. As businesses grow, the level of support available grows with them, rendering the difficult transitioning phase from small to medium, or medium to large less likely to result in a switch away to a competitor.</p>
VIRTUAL RMs	FASTER DECISIONING / eINVOICING
<p>One UK bank already offers its customers a choice of 'instant access' virtual RM, available by telephone or instant messaging, or a face-to-face relationship with an RM, available by appointment.</p> <p>This trend exemplifies the concept of delivering relevant services to SMEs. Virtual advisors can help maintain the 'relationship' element of relationship banking while driving down cost-to-serve.</p> <p>They also empower small business with the tools to be able to self serve, reducing business banking operational spend while improving their customer experience.</p>	<p>Numerous companies offer rapid online loan decisioning through greater use of STP and automation. In the same vein, several major UK banks are offering e-invoicing services, which alleviate working capital issues by enabling business customers to draw down funds more rapidly.</p> <p>As banks seek to reduce the time it takes to deliver services, many may consider assessing real time account opening. Banks may allow customers to open accounts online, by partnering with key organisations such as utility companies or governments, that allow for rapid KYC (know your customer/know your SME) to confirm address and identity details automatically.</p>

Accenture believes banks must embrace a new SME banking manifesto

Banks must respond to the tipping point, or risk being left behind as the un-bundled SME customer increasingly multi-sources products and services from alternative providers in the new eco-system. The combined forces of four emerging trends mean that the future landscape for UK Commercial and Business Bank's will soon look very different:

- Changing customer needs and behaviours mean existing banking propositions are losing relevance for SMEs
- Erosion of the traditional credit relationship between SMEs and banks is loosening historically 'sticky' banking relationships
- Regulation will act as a powerful catalyst for new entrants, driving higher rates of switching activity
- New technologies will continue to support the emergence of new entrants and business models

Accenture believes that a proactive response is required from banks if they are to retain their dominant position in the emerging eco-system. Key to this will be their willingness to embrace the new SME banking manifesto, with models shifting from historical 'product-push' to more relevant propositions based around advice, with a willingness to partner with SMEs to support and nurture growth and future success.

To achieve this aim, bank's must focus on customer-centricity to rebuild their relevance with SME customers. Innovation is the key to executing this through new products, services and channels. Done right, this will re-establish a new relationship between banks and businesses, based on more than just credit, but predicated on expert advice and desire to nurture and promote the SME customer. The case for change is clear, with benefits to be shared by both bank and customer.

Figure 11: SME Opportunity can be Win:Win

CUSTOMER BENEFITS	BANK BENEFITS
<ul style="list-style-type: none"> • Relevant services and advice • "More than money" • More robust business, with greater chance for survival and growth • More confidence in funding and credit availability • Access to banks that provide more relevant services and richer content 	<ul style="list-style-type: none"> • Increased fee income through provision of value-added services • Greater insight into and knowledge of their customers • Reduced NPL rates and impairment charges • Increase accuracy of risk assessment and capital allocation efficiency • Reduced cost-to-serve through digital channels and direct access

The time for establishing and executing this new manifesto is now, and it can be done.

There are many examples of organisations around the world that are rising to this challenge and harnessing innovation to create new propositions to better meet customer needs – but more can be done across the spectrum: from analytics to deliver more enhanced and sophisticated views of the customer, to product, service and channel innovation, with new partnerships across the emerging eco-system.

Our experience with leading banks around the globe enables us to recognise the complexities and challenges to success. Nevertheless, the opportunity is real, the cost of inaction is high, and the time has never been better for banks to reach for the future.

**To find out more about
how Accenture can help
your bank seize the SME
growth opportunity, please
contact:**

Alastair Blair
Head of UK Banking
+44 20 7844 2577
alastair.blair@accenture.com

Stuart Chalmers
Senior Manager, Financial Services
+44 77 8992 6834
stuart.chalmers@accenture.com

Frederick Jones
Manager, Financial Services
+44 20 7844 0725
frederick.g.jones@accenture.com

Rob Stubbs
Manager, UKI Banking Research
+44 20 7844 9845
robert.a.stubbs@accenture.com

**With special thanks to the
study team:**

Noel Gordon
Managing Director, Banking Industry

Lupus Maltzahn
Senior Executive, Financial Services

Stephanie Antonian
Analyst

