



CIRCLE OF TRUST OR OUT OF THE LOOP?

Banking on SMEs



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HOW BANKS CAN STOP SMEs BEING FROZEN OUT OF VITAL FINANCIAL SERVICES AND HOW BANKS THEMSELVES CAN BENEFIT

Among the rapid acceleration of innovation in the financial services sector, Europe's small and medium sized businesses (SMEs) can be forgiven for feeling excluded. Not only are the shiny new solutions passing them by, but even the most basic of financial services are out of reach.

Caught between offerings for retail consumers and feature-rich solutions for big companies, small businesses find that their very specific needs are not being fully met – despite broad

recognition that SMEs play an essential role in Europe's economic and social development.

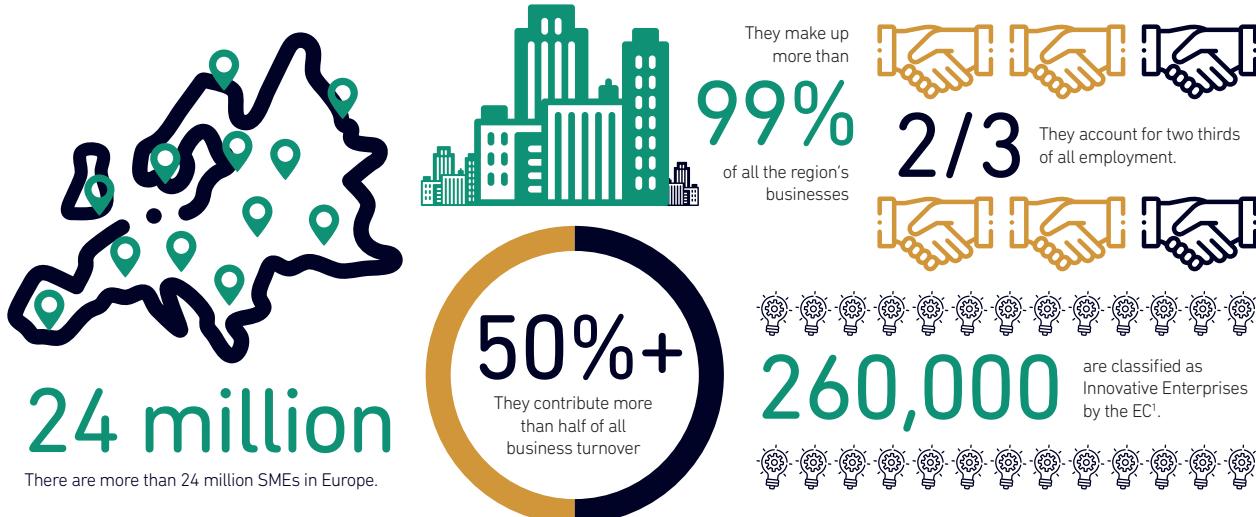
The priority for policy-makers and financial institutions is access to flexible funding mechanisms. As the number of small businesses seeking external funding increases¹, whether they need the funds to develop and launch new products or to invest in skilled labour, the link between this form of financial inclusion and economic growth becomes ever more obvious.

And yet, ambitious companies and entrepreneurs are increasingly vocal in their demands regarding financial inclusion, pointing out that their own commitments to innovation and growth are being hampered by limited support from financial institutions. Their argument is that formal directives have, so far, focused too much on access to funding rather than access to a broader suite of financial services.

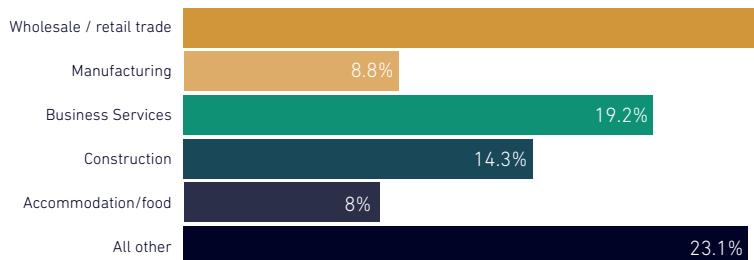
¹ SAFE: October 2017 to March 2018



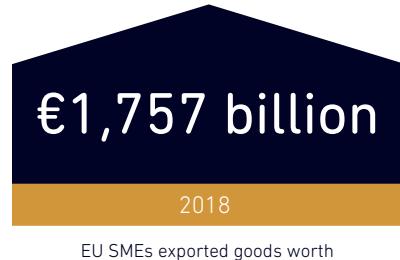
The SME sector in Europe



What do SMEs do?



SMEs and exports



Why financial inclusion?



¹ Eurostat, Product and process innovative enterprises by NACE Rev. 2 activity and size class [inn_cis9_prod]

THE RHETORICAL GAP

To put it bluntly, there is a growing rhetorical gap between what SMEs say they actually want and need, and what banks are providing. This gap affects the way that success is measured, and if it continues could undermine efforts to boost Europe's small-business sector.

The focus on improving access to available funding is exemplified by the European Commission's flagship report on the subject: the survey on the access to finance of enterprises (SAFE), the latest edition of which paints a generally positive picture of financial access for euro-area SMEs. The European Banking Federation (EBF) says that SMEs' ability to access bank lending is improving², while the EIB reports a steady increase in approval rates for bank financing since 2014³. SMEs themselves report improvements in the availability, size and maturity of bank financing.

The EBF can therefore rightly say that: "European structural and investment funds are delivered most efficiently through the banking system, benefiting from the expertise, tools and the proximity of banks, also helping to leverage private finance especially for those SMEs with a short credit history, lack of collateral or a risk profile which to some extent keeps them out of traditional financing."

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European Banking Federation

² European Banking Federation: *Financing the Europe of Tomorrow*
³ EIBIS 2017 p.19: http://www.eib.org/attachments/efs/eibis_2017_european_union_en.pdf



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A lot of large banks withdrew from SMEs because they want to take a standardised approach, which doesn't work in this sector."

Patty Zuidhoek, Director of Business, Triodos Bank

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As a young but experienced company, if we ask for financial support, we are automatically treated as a high-risk investment"

Dr Barbara Fretter, Co-founder of Solid Development Consult

STANDARDS. PLEASE.

But this is not the complete picture. SMEs are reporting growing problems with terms and conditions of their financing. Interest rates have, on balance, declined. On the other hand, charges, fees and commissions remain high, and collateral requirements are increasing⁴.

For Patty Zuidhoek, Director of Business Banking at Triodos Bank – a sustainable bank based in The Netherlands – central direction is part of the problem, with the ECB demanding a far more stringent gatekeeping role for banks. 'All these checks and balances can be discouraging,' she says. 'A lot of large banks withdrew from SMEs because they want to take a standardised approach, which doesn't work in this sector.'

Dr Barbara Fretter and Maarten Lammens, who co-own Solids Development Consult, an ambitious enterprise in Germany, are familiar with the problem. 'As a young but experienced company, if we ask for financial support, we are automatically treated as a high-risk investment,' they say. 'We couldn't convince banks that, as a spin-off from the University of Bonn, our activities and experiences go back

for more than 10 years. They just see the date of founding the company.'

The largest incumbent banks are yet to embrace new technology sufficiently to balance risk and innovation and serve the majority of the SME sector effectively. That manifests itself, not just in terms of financial access, but financial services more broadly.

Rob Israch, the chief marketing officer at Tipalti, a global payables automation software business, says that the company is seeing 'Huge demand for Accounts Payable from SMEs who currently spend large amounts of finance personnel's time on onboarding suppliers, collecting tax IDs, processing invoices, making global payments and reconciling.'

CFOs who are buried in the minutiae of accounts payable, payroll and financial operations do not have the capacity for more valuable activities like forecasting, building new products or even exploring financial services more thoroughly. This is the kind of financial inclusion, along with finance-adjacent advice on tax matters and solution providers, that SMEs want – but are not getting – from their banks.

⁴ SAFE: October 2017 to March 2018



CHALLENGE FOR BANKS

The primary reason that banks have found it so difficult to add the needed depth and breadth to their small-business services is that European SMEs are by no means a homogenous group. They differ widely in their contribution to the broader economy; geographic distribution is nowhere near uniform; and SMEs operate across and serve a wide number of sectors.

Even the size of the company can vary from sole-traders and micro-businesses to enterprises with 250 employees and a sizeable turnover.

This diversity is a barrier to providing financial solutions at scale, which puts the viability of both product and provider at risk. It is worth noting that banks are not alone here. Challenger banks may see SMEs as an opportunity, but most FinTechs have also stayed clear.

"SMEs are notoriously hard to reach, so they are rarely a major part of a bank or financial institution's strategy," says Ivo Gueorguiev, chairman of Paynetics, an infrastructure payments provider to

FinTechs and smaller players. Gueorguiev describes a self-reinforcing proposition that strengthens barriers to entry. "It means that payment products are usually priced-up with the obvious cost implications. That hinders the SMEs' ability to offer more attractive products to their clients, improve their efficiency, increase profitability and ultimately, reinvest in the business."

A similar pattern can be seen elsewhere. If we zoom out to look at modern financial services within the context of digitalisation, we can see another hurdle. Not all SMEs are certain about the net benefits of digitalisation⁵ - suggesting a wider education campaign is necessary.

More significantly, financial constraint remains a significant barrier to adoption⁶. Again, it's a self-reinforcing proposition: SMEs that lack the finances to invest in digital tools face stalled growth and – in turn – restricted access to funds. That translates back into lack of in-house interest or skills, which further alienates the business from digitally enabled growth.



An explosion of new commercialised 'islands of digital innovation', created by financial service companies who are each vying for the custom of SMEs by holding them captive in their 'spheres of influence'."

Roger Vincent, CIO, Trade Ledger

⁵ IDC, *The Road to the Digital Future of SMEs*, 2017
⁶ KfW, *SMEs face a wide range of barriers to innovation – support policy needs to be broad-based*, 2016



A FLOURISHING ECOSYSTEM

Breaking the vicious circles described above can only be good news for banks, for SMEs and for other innovators within the sector. However, achievements are likely to remain limited without further collaboration, communication and joined-up thinking in the financial services sector.

Roger Vincent, Chief Innovation Officer at Trade Ledger, describes the current situation as "An explosion of new commercialised 'islands of digital innovation', created by financial service companies who are each vying for the custom of SMEs by holding them captive in their 'spheres of influence'."

That model is no longer sustainable for current and potential participants in this market. Indeed surviving and remaining profitable in the age of digital requires a pivot to what Vincent calls 'networked value creation', rather than ongoing reliance on the traditional 'closed' model of banking innovation.

However, rather than relying on top-down directives from state authorities, this needs to be closer to a grass-roots movement, led by the participants who can develop joint solutions. That requires bridges to be built between Vincent's 'islands of innovation'.

For banks, this indicates two strategic moves: to build their own ecosystem platforms; and design interoperable services that can be distributed through other value ecosystems. This is a distinct step back from vertically integrated 'whole-of-banking' relationships enjoyed so far. But the reality is that the industry is now at an inflection point where exclusive relationships with customers are making way for a more shared approach.

However, it should be reiterated that although digital technologies are key to financial inclusion for SMEs, business fundamentals still apply. In the words of

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The real differentiator will be who best understands the problems SMEs face, not who has the best technology."

Alex Park, Director of Digital, Metro Bank

Alex Park, Director of Digital at Metro Bank, the real differentiator will be "Who best understands the problems SMEs face, not who has the best technology. Those problems are not always obvious."

To move forward, therefore, banks need to participate in the conversation, leading on areas of strength, listening to others, and building collaborative solutions to fit this diverse and disparate sector. Those that succeed will help build a larger marketplace from which everyone can benefit.

HOW CAN BANKS AND FINANCIAL INSTITUTIONS BEST SUPPORT FINANCIAL INCLUSION FOR EUROPE'S SMES?

01

Provide easy access to finance-adjacent services and advice such as tax advice, compliance support or even technology reviews

02

Choose your role: make digital tools available to SMEs, either through partnership, acquisition or in-house development

03

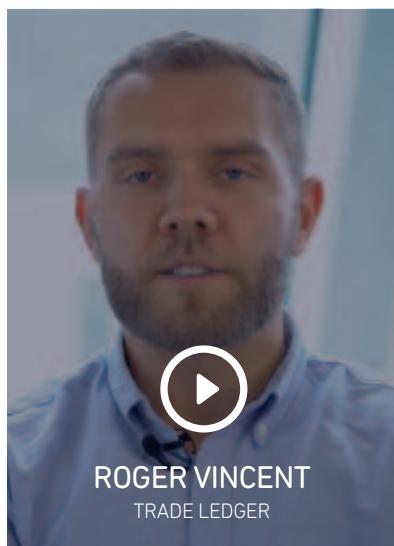
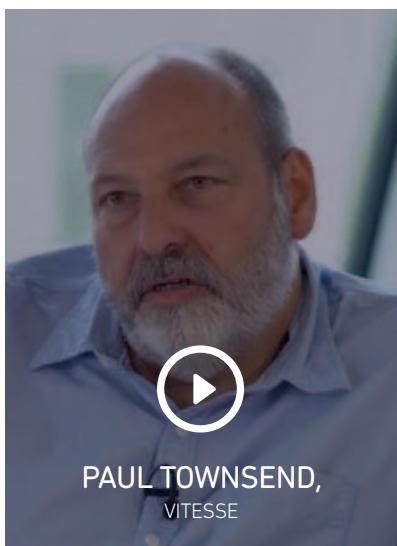
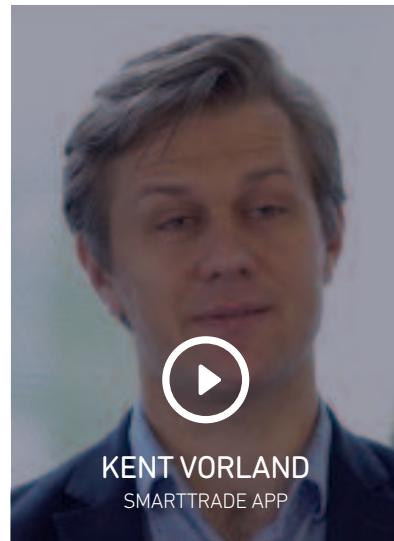
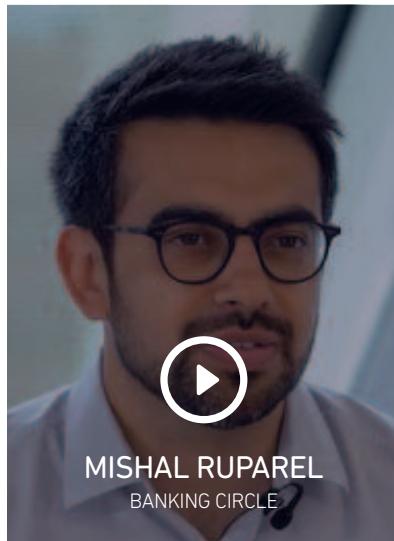
Talk to SMEs' CFOs regularly for insight into what they actually need. They appreciate the personal touch

04

Build the conversation: communicate effectively with SMEs, PSPs, and FinTechs to create financial awareness

05

Recognise the strengths that alternative providers bring to the ecosystem, and how they complement or supplement traditional banking services





ABOUT BANKING CIRCLE

Banking Circle is a global scale financial utility that gives financial institutions the ability to enhance their customer proposition.

Leading the rise of a super-correspondent banking network, Banking Circle is helping FinTechs and banks increase financial inclusion by providing their customers with faster, cheaper banking solutions, including banking accounts, local and cross border payments and lending, without the need to build their own infrastructure and correspondent banking partner network. As such, Banking Circle is empowering financial institutions to support their customers' international trading ambitions, without the need for multiple banking relationships, whilst reducing risk and the operational cost of transactions. And that is enabling them to remain competitive.

When Banking Circle launched the aim was to address the time and cost challenges of existing business payment solutions which had led to many businesses being financially excluded and unable to achieve their potential. The company has remained committed to this mission, developing and delivering effective, valuable solutions to help businesses of all sizes improve payment efficiency and cashflow.

Banking Circle has created a suite of innovative solutions to meet changing market needs and increase financial inclusion.

BANKING ACCOUNTS AND BANKING CIRCLE VIRTUAL IBAN

Through Banking Circle, Banks and Financial Tech businesses can provide customers with accounts in 25+ currencies. Financial institutions can issue multi-currency physical and virtual IBANs for customers in their own name, in multiple jurisdictions. Accounts deliver full transparency and faster settlement, enabling Financial Institutions to offer merchant customers a full transactional service.

Banking Circle Virtual IBAN enables financial institutions to give clients their own virtual IBANs, negating the need for several banking relationships. Improvements are experienced across payments acceptance, screening time, reconciliation/settlement times, and customer experience. Payments are made and received at low cost per transaction, delivering a valuable competitive advantage previously unavailable to smaller firms.

BANKING CIRCLE LENDING AND BANKING CIRCLE INSTANT SETTLEMENT

Banking Circle commissioned a study of 500+ SMEs to uncover pain points they experience in accessing funding through traditional lenders. In response, the company built two propositions: Banking Circle Lending and Banking Circle Instant Settlement.

These innovative solutions provide financial institutions with the capability to offer merchant customers a fast, transparent, flexible, low-cost, and easy-to-manage loan solution. Where once smaller businesses were unable to achieve global ambitions due to a lack of necessary funds, Banking Circle is improving financial inclusion by giving financial institutions the ability to offer SMEs fast access to loans with flexible repayment options.

Banking Circle Instant Settlement enables PSPs to offer their merchants instant access to cash, while they wait for payment from customers or marketplaces – taking up to 90 days. Banking Circle Instant Settlement, a receivables financing solution, gives Merchants access to the cash flow they need to run their business effectively.