White Paper

Successful routes to servicing the SME sector

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The numbers speak for themselves when it comes to the value SMEs represent to our economic well-being and future growth. In fact, the OECD (Organisation for Economic Co-operation and Development) regards SMEs as the dominant form of enterprise across its region. They account for approximately 99% of all firms, provide the main source of employment - for about 70% of jobs on average - and are major contributors to value creation, generating between 50% and 60% of value on average. In emerging economies, SMEs contribute up to 45% of total employment and 33% of GDP.

But these are generally regarded as conservative estimates. When taking the contribution of sole-traders and informal businesses into account, SMEs are believed to contribute to more than half of employment and GDP in most countries - irrespective of income levels. In addition, SME development can contribute to economic diversification and resilience. This is especially relevant for resource-rich countries that are particularly vulnerable to commodity price fluctuations.[1]

Despite their value, the critical challenge remains when it comes to analysing, selecting and serving the SME sector.

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[1] Enhancing the Contributions of SMEs in a Global and Digitalised Economy - OECD publications, June 2017 www.oecd.org/mcm/documents/C-MIN-2017-8-EN.pdf

Analysis of the current SME situation

SMEs are underpinning the economy in many countries. It is therefore in the interest of regulators and government that they are healthy and prosperous. With an increasing portion of the working population in many countries being defined as sole traders or working for SMEs, the sector is potentially a massive growth area for firms, offering high lifetime value.

Businesses are now actively looking to take advantage of the growth of the SME sector - they report increased budgets for SME services and fully expect their SME customer base to grow significantly in the near future.

39%

Given the value and potential they represent, it comes as little surprise that within the next three years 39% of firms expect SMEs to make up more than a fifth of their customer base.

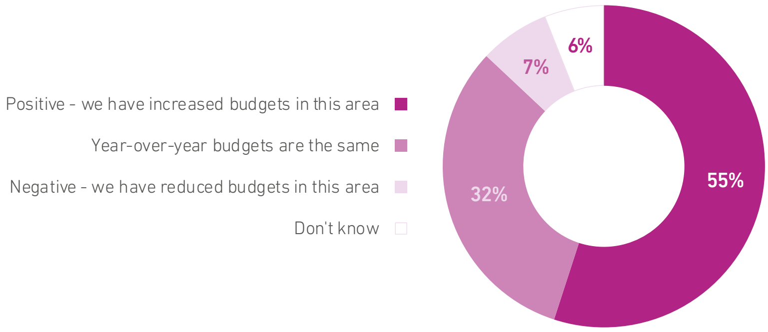
10%

In fact, for nearly half of all firms (43%), SMEs account for less than 10% of their current customer base. But we are set to see a seismic shift within the next three years, when SMEs are expected to make up more than a fifth of the customer base for 39% of firms.

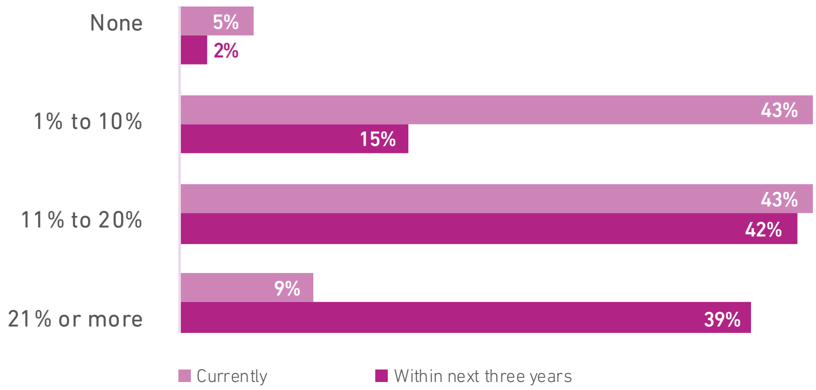
21%

It's clear risk appetites towards SMEs are softening and are now regarded as a key area of investment for many. Right now, only around one in 10 (9%) firms say that a fifth (21%) of their customer base can be defined as SMEs. Below, we outline the key trends, approaches and routes to success when it comes to serving SMEs.

Please estimate your firm's year-over-year budget increase or decrease for the following areas in 2018 (or the closest fiscal year). Showing results for 'SME services'.



To the best of your knowledge, what proportion of your firm's customer base could be defined as SMEs? How will this change within the next three years?



Base: 705 global managers and above with responsibility or influence over customer data, analytics, risk and SME services.

Classification of SMEs

34%

The classification of SMEs is confused. Some lenders treat them as corporate customers making them expensive to serve, while others try to treat them as a retail customer, which doesn't suit SMEs. Only around a third of businesses currently have a dedicated SME division. (34%). Right now, there is a very poor consensus among businesses as to how best to define and serve this hugely valuable sector. Some companies base it on turnover, some on the number of employees.

OECD definition

€50M.

SMEs are defined as small or medium sized enterprises if they have less than 250 employees and not more than €50million turnover, or a balance sheet of less than €43million. At the same time, no more than 25% of its shares can be owned by another business.[2]

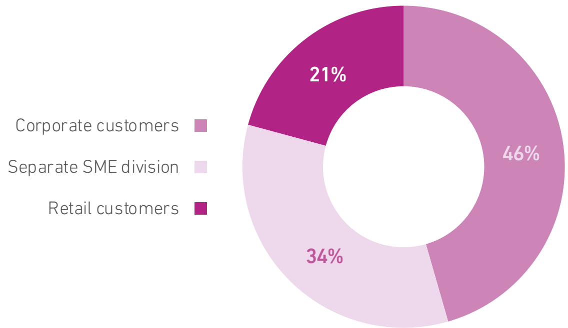
Challenges

Due to scarcity and limited access to viable data sets, organisations find it challenging to analyse and select high-quality opportunities. Firms also struggle to organisationally handle SME portfolios, with some placing the segment within retail, while others put SMEs in corporate customer segments. Servicing the SME sector is also challenging due to a high default risk, diverse needs of the segment, and differing price points for services.

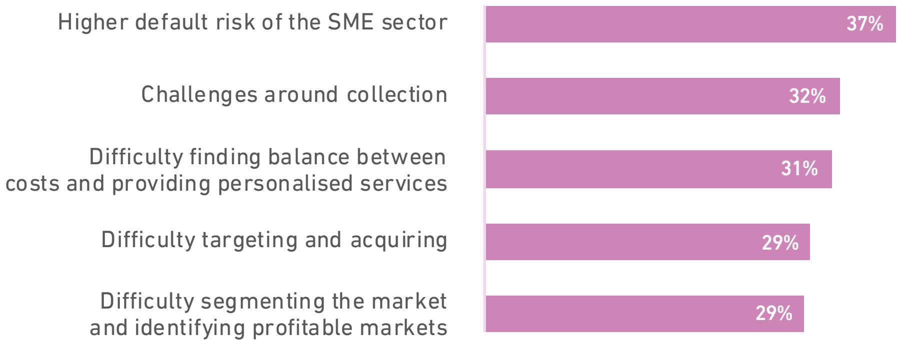
Research shows there is no clear consensus on how firms should organisationally handle SMEs, with some treating the segment as corporate customers and others treating them as retail. The definition of SMEs also varies widely. Firms report that high default risk and collection challenges continue to be the top hurdles to serving SME customers.

[2] Statistics Directorate - OECD
www.oecd.org/mcm/documents/C-MIN-2017-8-EN.pdf

Under which division of your organisation is your SME portfolio housed?



What are the main challenges experienced by your organisation when it comes to serving SME customers?



Base: 705 global managers and above with responsibility or influence over customer data, analytics, risk and SME services.

Common challenges posed by SMEs

Consistently defining how SMEs are best served and fitting them in to the portfolio continues to pose a headache for financial services firms right across the EMEA region.

31%

In fact, around a third of firms admit they're are unsure (31%). Some lenders treat SMEs as commercial customers, resulting in high-costs to serve. Others simply hand them off to retail banking arms, which often doesn't suit SMEs. At the same time, more than a third (37%) of businesses regard SMEs as a high default risk and as posing collection challenges (32%), while one in four simply admit (25%) they don't have any experience in serving them whatsoever.

26%

A similar number, (26%) say they're uneasy at the distinct lack of data when it comes to serving this segment, while the acute challenge of finding balance between costs and providing personalised services proves tricky for one in three. (31%)

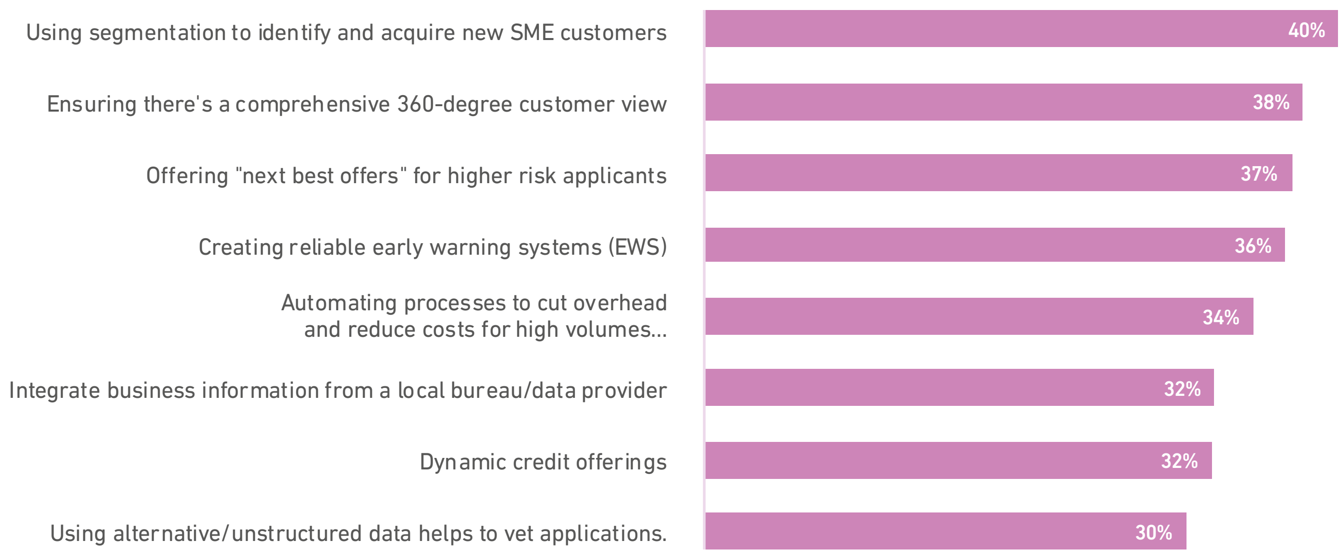
The SME sector's diverse size, characteristics and needs also prove difficult for many firms, along with a fundamental lack of internal expertise on the SME sector.

The SME opportunity

Firms can capitalise the potential of the growing SME market by using alternative or unstructured data to help vet applications, setting scorecards to critically weigh against or in favour of key factors, automating processes to cut overheads and reduce costs for high volumes of lower-risk applicants.

Alternatively, ensuring there's a comprehensive 360-degree customer view and providing dynamic credit offerings to drive long-term customer loyalty, as well as 'next best offers' for higher-risk applicants.

Which of the initiatives below is your firm undertaking to improve your products and services for SME customers?



Base: 705 global managers and above with responsibility or influence over customer data, analytics, risk and SME services.

Sizing the market appetite and opportunities for SME initiatives

Firms are attempting to apply segmentation and get a 360-degree customer view to improve their products and services for SME customers. Three key areas are driving opportunities and initiatives in this hugely lucrative sector. They are:

Adoption of alternate data sources

There's a clear appetite (30%) to consider adopting alternative data sources. Clients partnering with us are continually asking for us to look for numerous options including regional bureaux, or analysis of directors' prior commercial backgrounds, wherever possible. Web-harvesting underpinned by machine learning has also proved effective in delivering a more complete picture of SMEs and their principals.

Automation drives faster decision-making with Early Opportunity Models

Unsurprisingly, automation is also proving effective for many clients pressed for time and resources. As a result, they're coming to us to get help in applying automated solutions to speed up and ensure more cost-effective decision-making along with an early opportunity model that offers smart, pro-active and appropriate credit limit modelling.

Adopting machine learning to drive data categorisation

The third and most popular option among clients serving SMEs, has proved to be the adoption of machine learning to drive data categorisation, which analyses real-time affordability and cash flow.

It's already proved successful in several key European markets thanks to the system's ability to assess and clearly define SME risk versus opportunity based on available and reliable predictive analytics.

Experian has already invested heavily in a categorisation technology platform to support the SME sector. It will not only work out accurate cash flow forecasts for SMEs within a matter of seconds, but will also deliver other crucial insights when lending to SMEs - including next best offer recommendations, analysis of other business interests, alternate sources of income, as well as delivering critical fraud indicators.

The other major innovation for the platform hinges on its adaptability with client APIs, which can easily be integrated directly to their accounting software to enable automatic access to SMEs' financial data. By then applying machine learning and clustering techniques, analysis and scoring can accurately calculate multiple elements of financial data - including risk ratios, cash flow, cash flow cycles and profit forecasts – vital insight that further underpins the verification of SME information, automation and improved customer service.

Of the three systems developed, research suggests segmentation of the sector is a priority for nearly half (40%), while effective early opportunity models are regarded as a key area of investment for more than one in three (36%) banks and lenders. But despite the broad unease at the lack of available data on the SME segment, around a third of businesses (34%) are also keen to press ahead and use machine learning to help automate their specific offerings to help reduce costs, where they can.

Data, technology, emerging regulations and evolving opportunities

There are several key regulatory and technological drivers for change that can now help support SME lending decisions and helping make the sector even more viable.

Explosion of data

The growing digital transformation of the economy, thanks to connected technologies including mobile, tablets and social media, has generated an explosion of data and the ability to access it. This expansion of data has meant that a better understanding of the SME customer's needs, motivations and creditworthiness are now possible.

New technology

We are also at a tipping point with innovation as to how this mass of data can be used, as new technologies are now able to extract new insights from datasets that have only recently become available. Artificial intelligence and machine learning are also key evolutions in the delivery of ever-more insights and real-time data processing to facilitate faster lending decisions. This is achieved because these technologies enable the most relevant data, appropriate to SMEs and their unique financial circumstances, to be consolidated to give a full picture of their financial behaviour, habits and traits. It's this drive to speedier to decisions that may have historically driven poor lending decisions around credit worthiness, but innovations around data and technology have allowed streamlining, robotics and ever-more robust assessment process to be developed.

Changing SME expectations

At the same time, new technologies are changing habits, behaviour and expectations. SMEs along with consumers in general now rightly demand wider and quicker access to products and services including more personalised offers. They are also becoming less tolerant to delays. Lengthy forms, friction and sluggish progress quickly leads to impatience, frustration, abandoned credit applications and lost sales. While face-to-face contacts are disappearing as part of the process, it is expected lenders be more transparent and ensure the bureaux used, cloud storage systems and customer data are secure and appropriately safeguarded.

New legal frameworks are opening access to even more data

A new and emerging legal landscape has prompted legislators and regulators to ensure that the borrowers are at the centre of all policy and guidance. This includes GDPR, designed to empower and protect citizens on the use of their personal data, while PSD2 is expected to open competition even further with the more flexible use of data – subject to customer opt-ins. This new regulatory framework is allowing more datasets to be made available for creditworthiness assessments.

Thanks to PSD2, borrowers are now empowered to share their bank transaction data with third parties – if they believe it's in their best interests. So-called 'data portability rights' recognised by the GDPR, which allows consumers to transfer their data from one organisation to another, permits the wider use of non-credit data including gas, electric, water, broadband and mobile phone payment information to be used for creditworthiness evaluations. Elsewhere, widespread digital transformation is creating new possibilities for public data to be shared with and used more broadly by lenders.

PSD2 and the broad move towards the culture of so-called 'Open Banking' will have an impact on SME customers. Right now, it only applies to consumers. But it will underpin a natural move towards SMEs - and plans are already being put in place by many banks - to further help stimulate lending to the sector and overcome a key challenge by ensuring access to capital is easier.

Identifying the SME market at speed and scale

Managing SMEs is not easy. Our clients are always on the lookout for new ways to assess this relatively untapped market. One of the more accessible routes is through alternate data - without adversely affecting the client experience. Outlined below are two ways of using existing regulatory changes and technology to further help identify profitable SMEs.

PSD2 (Payment Services Directive 2)

PSD2 is a new European Union (EU) regulation that requires banks, when requested by the account owner, to provide third-party access to their current account data allowing them to initiate payments on behalf of SMEs. It not only alters the way SMEs bank, but also the way they make and receive payments. Consented data is accessed via various APIs (Application Program Interfaces), while the actual transfer of all the account data is delivered through AISPs (Account Information Service Providers). The shift to open data will allow third parties, such as fintechs, to access real-time financial and transactional data on a SME, calculate its cash flow and affordability independently, to help evaluate the SME's existing and future needs.

Risk of not adapting

The risk for traditional banks is highlighted by the way 'open data' and the overall offering to SMEs is likely to become wholly client-centric and digital. As a result, switching costs will fall and loyalty will come at a premium. Recent research of more than 200 UK SMEs showed just how far this segment has now evolved and what is needed to successfully serve the sector.

Three key findings emerge

SMEs favour a customer-centric approach, similar to the journey many consumers now enjoy. They want their bank, lender, or financier, to be a partner that understands their business and specific challenges - not just a vendor that helps them make payments.

SMEs want a greater digital experience, because business owners want everything at their fingertips. They do not want to be obliged to constantly visit a bank branch. The costs are not worth it.

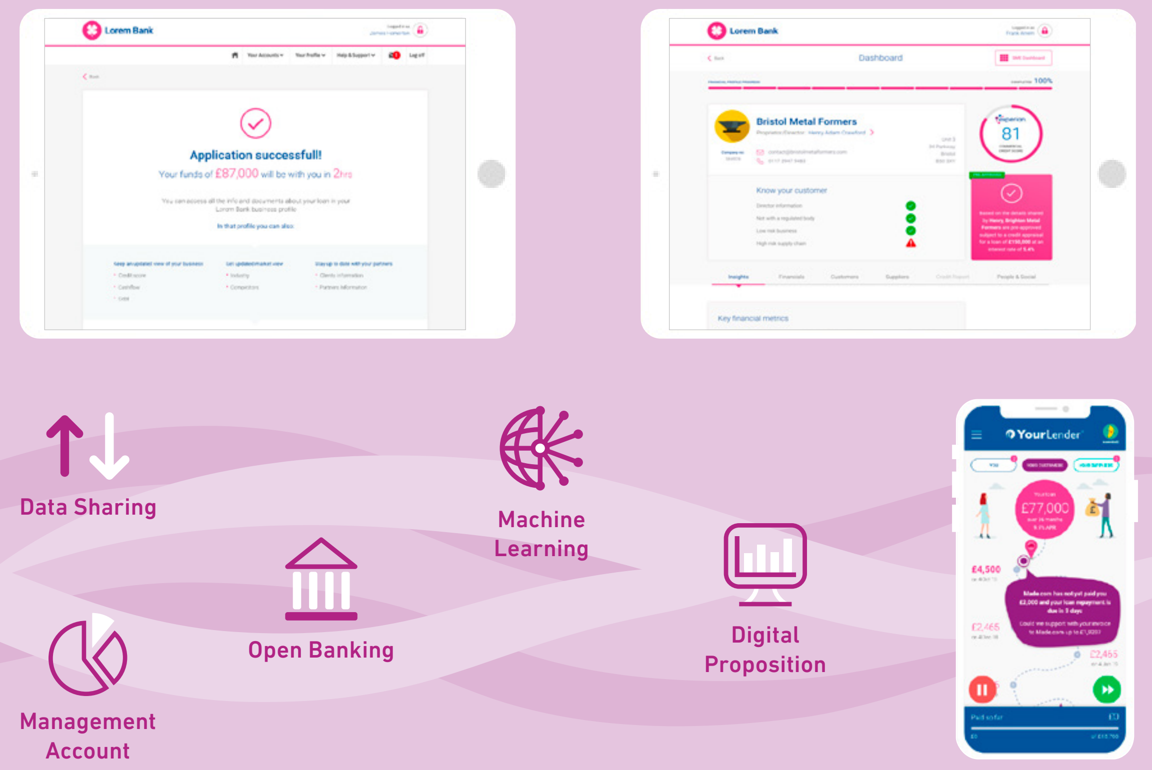
SMEs also want a finance partner to provide digital financial tools that can directly help run and support their business, including everything from online cash flow management, to credit facilities, budgeting, invoicing help and so on. Significantly, most SMEs are also willing to pay for these services. It marks a new trend developing across the EMEA region and makes logical sense given the principal reason for failure of SMEs is down to cash flow challenges. It's an approach that also brings the financier closer to the business to make sure their investment is safer.

What the future looks like

Many banks are acting now. Having put SMEs on the back burner for many years, they see how lucrative the size of the untapped market really is. In many EMEA countries, the consumer market has rapidly embraced automation and digital platforms, but it has also remained hugely competitive. In many countries, like South Africa, the market is rapidly approaching saturation with so many new banks emerging.

Data sharing among SMEs will help drive the development of a comprehensive 'financial web' - a platform that captures all meaningful data and interprets it into valuable insight. Information sources have also extended into alternate data like APIs links into the general ledger accounts of SMEs, or accounting software systems, which offer further financial insight into affordability and the all-important cash flow cycles.

Various segmentation and categorisation technology platforms can be used to cluster data of a similar nature, before then applying Machine Learning techniques to derive further insight in a simple and useful output. Data sharing in this format has many advantages for banks and lenders.



Consolidated transactional real-time view

The platforms can help solve questions around accurate affordability calculations for SMEs. Fraudulent, out-of-date, or un-audited financials, are no longer as high-risk. Additional insight over a period can also calculate Customer Lifetime Value, or Next Best Offer metrics, based on trends and cash flow cycles that are picked up and recorded over specific trading periods. Financiers can now pro-actively offer SMEs the most appropriate products to best match their needs, ensuring greater loyalty and up-selling opportunities. Insight into other banking accounts, or foreign income, can also be addressed alongside aggregated comparisons of regular expenses like insurance and utilities.

Greater customer experience

The sharing of data also helps directly address concerns raised by SMEs around the need for a finance partner, rather than just a payment vendor. Sharing of data will enable faster pre-approval offers, reduce onboarding time and costs for SMEs. Unique offers that best match the SMEs given needs can be tailored accordingly.

Link to financial data

Direct links to financial data not only provide important insight into vital performance metrics through key ratios, but also offer insight into a host of key factors including stock, or debtor's turnover, cash flow patterns, interest payments, tax calculations, payments tracking and so on.

This so-called 'Open Data' created as a result of PSD2 will help drive alternate financing methods like factoring and invoice discounting. There's already been a big lift in these types of finance, which were traditionally regarded as cumbersome and costly, but with greater insight into the cash flow and trends of a business, risks associated with this type of lending are more manageable.

70%

SMEs will directly benefit from PSD2 in the long run, irrespective of whether there are teething problems in implementing multiple APIs at the outset. SMEs need this change and support. They are crucial for growth and are the birthplace of many entrepreneurs. In EMEA alone, more than 70% of the region's workforce is employed by SMEs - equating to more than 90 million people - so the regulation's impact is crucial to help drive increased access to finance and overall economic growth.

SDK (Software Development Kit) for SMEs

The need for alternate data is a top-priority for many banks and lenders - especially when it comes to assessing SMEs that do not have the same footprint as consumers or central data repositories. It's an acute challenge when moving into unbanked regions like Africa, where there's simply a lack of comprehensive data on thin-file clients.

The impact on SMEs is a significant challenge as it is almost certain to limit their access to finance. But the one technology tool that is common among all SMEs is a mobile phone, making it the most obvious device to try gather consented insight from.

SDK (Software Development Kit) technology is used as an alternate way to harvest mobile phone data - with the owner's consent. Information is then used to create a score for thin-file clients, to help enable access to financial products and services. SDK is simply a tool that allows for the creation of applications for certain roles, and in this case to assess selected mobile data fields to build a risk score for an SME.

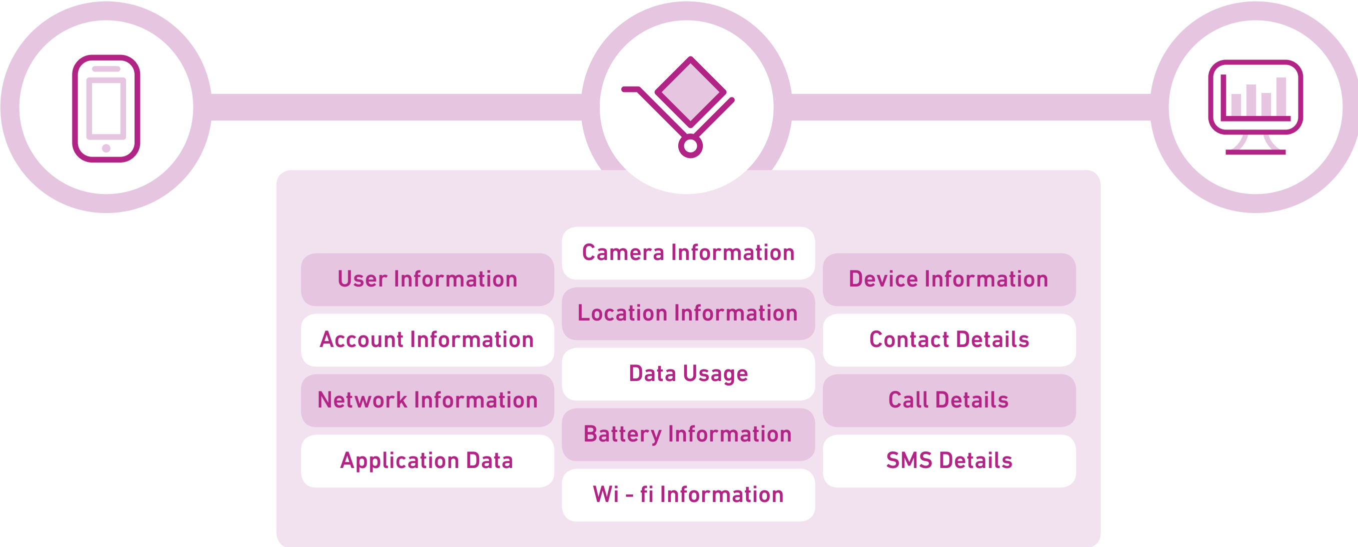
Risks of not adapting

Right now, financiers face numerous challenges when looking at serving SMEs in developing countries including everything from proximity of branches, lack of traditional credit data, limited verification and KYC tools, to collecting remotely.

	Distribution - Reliance on branches and agent network
	System - Decisioning (scoring) and insights from alternative data
	Digital Identity/Financial Passport, SME
	Managing Collections

How it works

When the user has opted-in, the technology is loaded on to their mobile phone via an app. From there, key data is collected and analysed from the device over time. It includes:



Proprietary information is not compromised in any way. Only very general device information can be obtained. For instance, a SME owner with more than 50 contacts in their phone will be scored a better risk, than one with just 10. All variables combined can subsequently create a meaningful risk score, especially when supported by a categorisation platform and Machine Learning techniques.

Next steps

The SDK does not affect the client experience, as data is collected in the background and processed real-time, at minimal cost. As a result, the user will not see any functional change and should benefit by consenting to improved access to financial services which may have been unattainable in the past.

SDK also has other benefits as typical behavior can be analysed on the mobile device creating specific personas like traveler, multi-banked, parent with children, or person with foreign interests.

The various data points obtained from the device can also drive further insight about the SME, including:

Size of the business based on turnover	**Business activity**	**Frequency of deposits**	**Analysis of supplier network**	**Geo-location behavior**	**Cash management habits**

This in turn creates strong up-sell opportunities, without having to contact or inconvenience the SME owner, again linking to the customer-centric model SME owners want from their finance partners.

In South Africa alone, more than 5 million SMEs cannot access finance due to insufficient data, so the potential for both lenders and sole traders alike is very positive.

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