SME lending: global trends in 2022

15.02.2022

Content table

Borrowed time? The SME lending gap

The vital SME sector plays an outsized role in the world, yet small businesses are currently being starved of the funding they need to thrive.

In 2020, the International Finance Corporation, a member of the World Bank Group, warned that "access to financial services for SMEs remains severely constrained in many developing countries, restricting business growth[2]", after warning that the funding gap stands at $5.2 trillion.

"SMEs require access to credit for continued business operation and survival," the World Economic Forum also warned[3]. "Banks and fintech platforms have been scrambling to find a way to address that need, but the existing frameworks for servicing businesses are not a great fit."

SME Lending is often seen as a low priority topic for banks. Even though SMEs represent more than half of the employment worldwide, banks have still not found a quick and reliable way to help small businesses flourish.

> **SMEs represent about 90% of businesses and more than 50% of employment worldwide.**
>
> **The World Bank[1]**

Regulatory and risk-related constraints have prevented banks from approving loans, while manual processes and legacy systems make SME lending risky and unprofitable.

Traditionally, SME Lending was a paper-based or in-branch process. Today, the onboarding and loan process is still cumbersome and fragmented, which slows down approvals. When Covid hit, the industry slowed down even further.

The SME lending gap may sound like a crisis, but in fact it is an opportunity for both challengers and incumbents to introduce innovative new methods of getting smaller businesses the money they need to grow.

In this paper, we will set out what's going wrong in SME lending right now, lay out the solutions that are emerging, and reveal how FintechOS can help banks, fintechs and other financial institutions power the future of SME lending.

SMEs account for more than 80% of net job origination in developing countries – but

40%

across 128 countries are "credit-constrained". IFC [4]

What makes a good SME lending journey?

Fast

The process should incorporate automation to save the bank and applicants from time-consuming manual data entry. This will make decisions faster and more accurate.

Digital

Onboarding should not require a visit to the physical branch or endless paperwork. The process should be digital and provide access to funds in minutes, not days or weeks.

Personalized

Access to data allows banks and financial institutions to tailor their services to individual SMEs, rather than adopting a "one size fits no-one" approach.

Why the SME sector is important

Small businesses are the beating heart of the global economy. But they do not have the gleaming skyscrapers and shiny campuses of multinational corporations, often working almost invisibly behind the scenes.

In the EU, SMEs represent 99.8% of all non-financial companies, providing 66.6% of jobs and generating 56.4% of added value. [5]

There are 55 million SMEs in the UK, representing 99.9% of businesses and generating three-fifths of the employment and around half of the turnover in the UK private sector. [6]

In the US, there are 30 million SMEs, accounting for nearly two-thirds of net new private-sector jobs in recent decades. [7]

Small businesses are nimble and agile, allowing them to quickly adapt to changing circumstances and exploit new opportunities or innovations. Yet their size makes them vulnerable.

"While smaller businesses tend to be more flexible and quick to change than larger corporates, they are much more vulnerable to deterioration in the business environment," according to the European Bank for Recon-struction and Development[8].

"They are also more sensitive to harassment from government institutions and have fewer resources to draw on when times are hard.

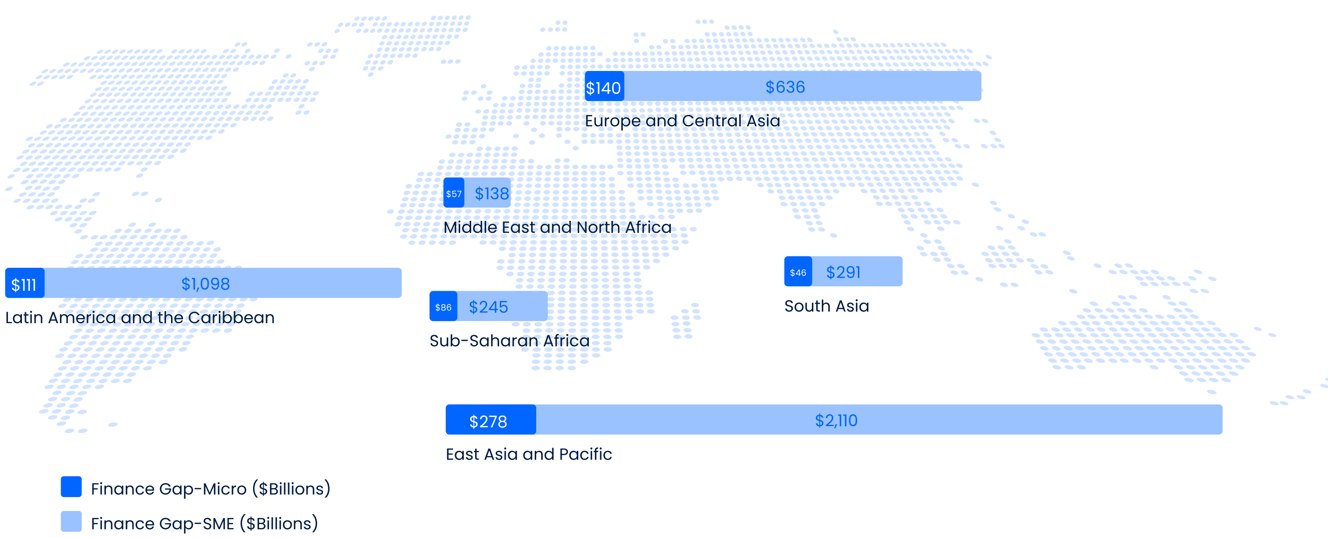
"One great challenge for small businesses is accessing the finance they need to develop and grow. Issues of collateral and alignment with international accounting standards affect SMEs disproportionately, while financial institutions have less experience lending to the small business segment and often perceive them as riskier than the evidence shows them to be."

The SME sector is particularly important in developing countries, where they contribute up to 40% of national income, yet also find it hard to access lending. Small businesses create up to 70% of jobs and play a role in empowering women and lifting people out of poverty.

By enabling better financing of SMEs, financial institutions can power beneficial social change.

600 million jobs will be needed by 2030 to absorb the growing global workforce, which makes SME development a high priority for many governments around the world. In emerging markets, most formal jobs are generated by SMEs, which create 7 out of 10 jobs. However, access to finance is a key constraint to SME growth, it is the second most cited obstacle facing SMEs to grow their businesses in emerging markets and developing countries.

The World Bank [9]



The state of SME lending

Before COVID-19, lenders took an average 90 days to provide capital to SMEs – with 57% of all SME credit applications abandoned due to the difficulty of the process[10].

The governmental support offered to smaller businesses during the pandemic should have been an opportunity to pioneer a faster, more effective way of funnelling money to SMEs. Yet banks and lenders around the world have been criticised for the slow delivery of Covid-19 business interruption loans, which often relied on arduous, unfriendly and time-consuming applications.

In April 2020, just one in five UK businesses that applied for government-backed loans were granted the emergency funding they needed, raising concerns that the program was not fit for purpose.[11]

The British Coronavirus Business Interruption Loan Scheme (CBILS) was rolled out slowly, with many applicants turned away because they did not meet the criteria to quality for support[12].

In the US, 51.9% of small businesses surveyed in January 2022 said they had received financial assistance from the Paycheck Protection Program (PPP), a government initiative to combat the effects of the COVID-19 pandemic. However, 43.6% said that their business had not received any financial assistance from any source since December 2020.[13]

In the EU, the situation was different because the system is less fragmented than the UK, where 40 banks took part in the CBILS drive. European banks also have more experience in handing out state-supported money, which may have allowed them to operate faster than in Britain.

However, there is a storm ahead for SMEs in the EU, where almost one in 10 SMEs already struggle to secure funding.[14]

Changes in regulations across the EU will create new problems for SMEs by increasing funding costs for banks and therefore making loans subject to increased levels of scrutiny[15]. This could result in fewer loans being issued to SMEs, with those whose creditworthiness is considered substandard facing particular difficulties

“The banks' interest in extending or granting loans to SMEs with rather poor creditworthiness is likely to decline with the new EU directives on banking regulation,” warned Ron van het Hof, CEO of Euler Hermes in Germany, Austria and Switzerland.[16]

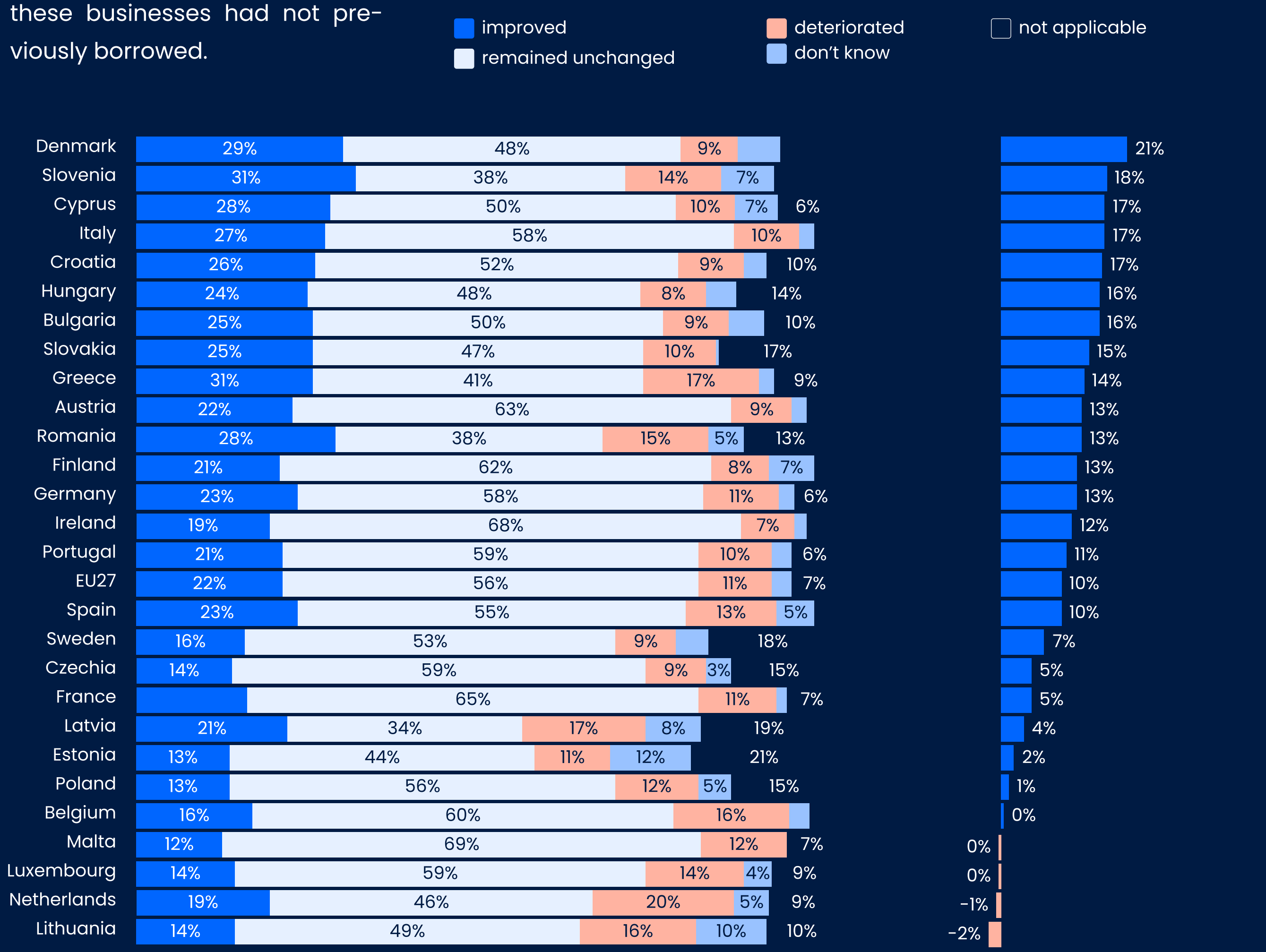
If banks are unable to provide SMEs with the loans they need, companies may begin to turn to non-banks, posing an opportunity for fintechs and challengers. To meet the de-mand and avoid losing ground, incumbents would be wise to adopt new digital onboarding and overhaul their lending processes.

The level of debt taken on by UK businesses has increased moderately during the pandemic. But there has been a larger increase in borrowing by small and medium-sized enterprises (SMEs). Many of these businesses had not previously borrowed.

> A high level of debt among UK businesses can lead to risks to the financial system. Higher debt levels can cause businesses to cut back on employment and investment in the face of economic shocks. This can have a negative impact on people's jobs and incomes. Banks can also take losses if businesses struggle to pay back their loans.

The Bank of England[17]

Changes in the bank lending during April to September 2021 for SMEs in the EU27, by country



The problems with SME lending

Unfortunately, smaller businesses face many obstacles when it comes to financing. Fledging SMEs often do not have adequate credit ratings which allow banks to make lending decisions. At the same time, financial institutions rely on inefficient, inflexible risk-assessment technology which is rooted in the old analog processes which involved face-to-face meetings between bank managers and small business owners.

The traditional culture of paper-based lending applications is ill-suited to the online world. which offers consumers access to real-time credit yet often forces business lenders to jump through hoops and causes friction. Companies working in innovative and fast-growing sectors face particular difficulties, due to outdated risk analysis at banks.

The lending industry has also been hit with a wide range of new regulations in the wake of the 2008 financial crisis as well as strict rules requiring rigorous new approaches to Anti-Money Laundering (AML) and Know Your Customer (KYC).

Problems with lending have sparked fears that the situation will become chronic unless new ideas are introduced.

“While bank financing will continue to be crucial for the SME sector, there is a broad concern that credit constraints will simply become ‘the new normal’ for SMEs and entrepreneurs,” the Organisation for Economic Co-operation and Development (OECD) warned.

> **It is therefore necessary to broaden the range of financing instruments available to SMEs and entrepreneurs, in order to enable them to continue to play their role in investment, growth, innovation and employment.**
>
> **The Organisation for Economic Co-operation and Development (OECD)**

The power of collaboration

McKinsey has estimated that three quarters of fintechs focus on retail banking, lending, wealth management, and payment systems.[18]

However, this does not necessarily mean that they are interested only in disruption, because collaboration between challengers and incumbents is on the rise.

"Startups have sought to target the end customer directly, bypassing traditional banks and deepening an impression that they are disrupting a sector ripe for innovation," McKinsey wrote.

"However, our... analysis suggests that the structure of the fintech industry is changing and that a new spirit of cooperation between fintechs and incumbents is developing."

Fintechs once took inspiration from banks, but now incumbents can learn from challengers or even collaborate with them, devising innovative new ways to get SMEs the financing they need to grow and thrive.

> **Traditional banks will need to look for alternative ways to create innovative lending products if they are to compete for customers with Fintech lenders in the evolving gig economy. Banks should be looking at tailoring products and services to different needs and creating new solutions.**

Ed Herman,
Microsoft global head of
financial services institutions.[19]

SME lending leaders

Here are three companies that are showing the way forward for SME financing:

Funding Circle

The organization Funding Circle specializes in peer-to-peer lending. It was founded in 2010 and has enabled 100,000 UK businesses to borrow more than £6.2 billion since 2010, which it claims has supported the creation of 100,000 jobs.

Kabbage

Kabbage is a digital lending veteran that launched to serve online merchants who sell on eBay, Etsy, Amazon, and other online retail website.

Today, Kabbage works with SMEs that have difficulty accessing funding from traditional sources. It is an automated platform that can make credit decisions as quickly as 10 minutes.

Capital Float

Capital Float was backed by $22 million in C series funding from retail titan Amazon. Founded in Bangalore in 2031, Capital Float describes itself as India’s leading Buy Now Pay Later and credit platform.

It started by serving merchants in India’s booming e-commerce industry but now offers finance and cash advances to both online and offline merchants.

No paperwork

Fast credit decisions

No collateral

	P2P Marketplace	Online Lending	Fintechs that serve banks
Business Model	Individual investors lending money to borrowers	Institutional investors lend money to borrowers	Tech companies offer services including automated credit scoring, BNPL and regtech
Key Feature	Investors bear the risk	Risk transferred to the platform, rather than investor	Specialized services
Relationship with banks	Partner banks generate loans and transfer them using loan notes	Can represent alternative to traditional bank lending	B2B provision of services to banks

Powering the future of SME lending

Here are three companies that are showing the way forward for SME financing:

Automated

SMEs don't have time to wait around while lengthy, manual processes are completed. Automation can liberate bank staff from tedious work, allowing them to focus on serving customers.

Flexible

The era of one-size fits no-one is over. SMEs need access to lending services which meet their needs and flexible enough to offer them the right financing, delivered in the right way.

Data-driven

Banks and other lenders need access to rich data in order to make fast, fair decisions. Open banking and APIs now offer access to a better understanding a customer, allowing informed credit decisions to be made at speed.

End-to-end

Companies should have access to lending services which incorporate all stages of the process in one journey, from origination to payout. Introducing extra stages outside the journey creates friction, which should be avoided where possible.

FintechOS has a clear understanding of what banks should do to unlock the potential of the SME market: an end-to-end automated digital loan origination process. A digitized solution can reduce time to yes to under 10 minutes, give SMEs the experience they need, and reduce lending costs by 40%.

**Mike Fullalove,
SVP, Strategy and Business Development at FintechOS**

Embedded finance for SMEs

Disruption is coming to the SME lending sector. The rise of embedded finance and banking will allow businesses to access financial services from inside the apps they use every day.

Accenture has predicted that embedded banking for SMEs could "capture up to 26% of global SME banking revenue by 2025", representing nearly $124 billion in value.[20]=

It found that 49% of SMEs are using digital services in day-to-day operations, while 12% rely on digital services for at least half of their revenue.

Accenture found that SMEs have not yet "rushed to switch from incumbent banks to new digital players", but predicted that will change in the near future as "digital platforms target SME customers with embedded finance offerings".

These platforms include e-commerce, marketplace, pay-ment and social media platforms as well as cloud-based accounting, collaboration and financial management tools.

"Not only do these platforms have high levels of SME market penetration, they also have earned high levels of trust among small business owners," Accenture wrote.

"From an SME's perspective, the beauty of embedded finance is that they can access financial services when they're wanted, without needing to log into another app or website to make a bank transfer or fill in a loan application. Plus, a platform's embedded finance offering may also come with value-added services such as financial management and analytics tools."

In the coming years, embedded finance for SMEs is likely to rapidly disrupt old business models. To benefit from these changes – or survive them – banks, fintech and financial institutions should start preparing for change.

How FintechOS can help

FintechOS Lighthouse is a customer-centric platform for banks which allows cutting-edge digital journeys to be built in days, not weeks.

The Lighthouse modular Super-Composable Blocks offer pre-built functionality, allowing journeys to be created rapidly and quickly customized.

Here are some of the problems the FintechOS high-productivity financial infrastructure can solve:

Problem

It takes too long for SMEs to access credit

Solution

An end-to-end automated digital loan origination process powered by FintechOS can reduce the cost of lending and power faster decisions.[21]

Problem

Lending services are not designed for SMEs

Solution

Automation and personalization can tailor services for smaller businesses, improving customer experience while lowering costs.

Problem

Current lending journeys are complex and time-consuming

Solution

With FintechOS, lenders can build seamless, end-to-end journeys eliminate that reduce the need for manual input of data and enable real-time decision-making.

Problem

Lenders do not have access to data

Solution

FintechOS sits on top of legacy tech, incorporating data from existing systems as well as external sources. Real-time access to data can power fast decisions.

The FintechOS solution

Onboarding Made Easy.

FintechOS is here to help incumbents power their digital lending platforms. The high productivity FintechOS platform offer customized SME Banking - because every business is unique. FintechOS can help financial institutions create products and journeys that are tailored around the customer, driven by data-rich insights and enabled by automation.

Banks and fintechs can draw on advanced personalization capabilities to understand their customers' needs and impress them with tailored products and a hassle-free journey, whether it's in-branch, online or at their office.

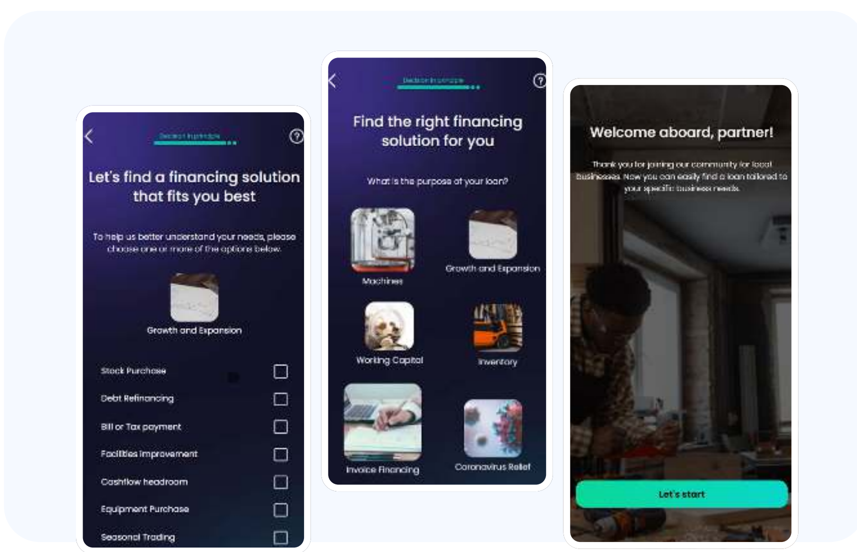
SME customers are busy running their business, so don't have time for friction or slow legacy processes. They need to be able to access an end-to-end digital process so they can upload digital Documents, take a selfie for ID Verification, eSign the contract and get the funding they need without filing paperwork. FintechOS 22 is the first high productivity financial infrastructure platform, making it easier for internal teams to launch digital projects without needing significant resource or specialized knowledge. The platform gives incumbents the ability to efficiently roll out cutting-edge products and lending journeys at a pace that was simply impossible with legacy solutions.

FintechOS is fully compliant with industry standards, allowing customers tick all the necessary boxes quickly and efficiently. Our AI-enabled verification processes get to work straight away, enabling everything from AML to company KYC. FintechOS automated decision tools won't keep the customer waiting.

Automated Risk Analysis means no manual input from underwriters is required. The FintechOS Risk Engine automates real-time scoring using internal and external data sources. And with automated decisions, FintechOS can approve, reject or route to a human if needed. No more waiting around.

Cut Time-to-Cash with credit data and cost details are generated in the Digital Contract, ready for the customer to eSign. Once that's done, the funds can be paid out quickly.

All of this can be achieved by building on top of older systems. FintechOS enables transformation with the minimum of internal friction.

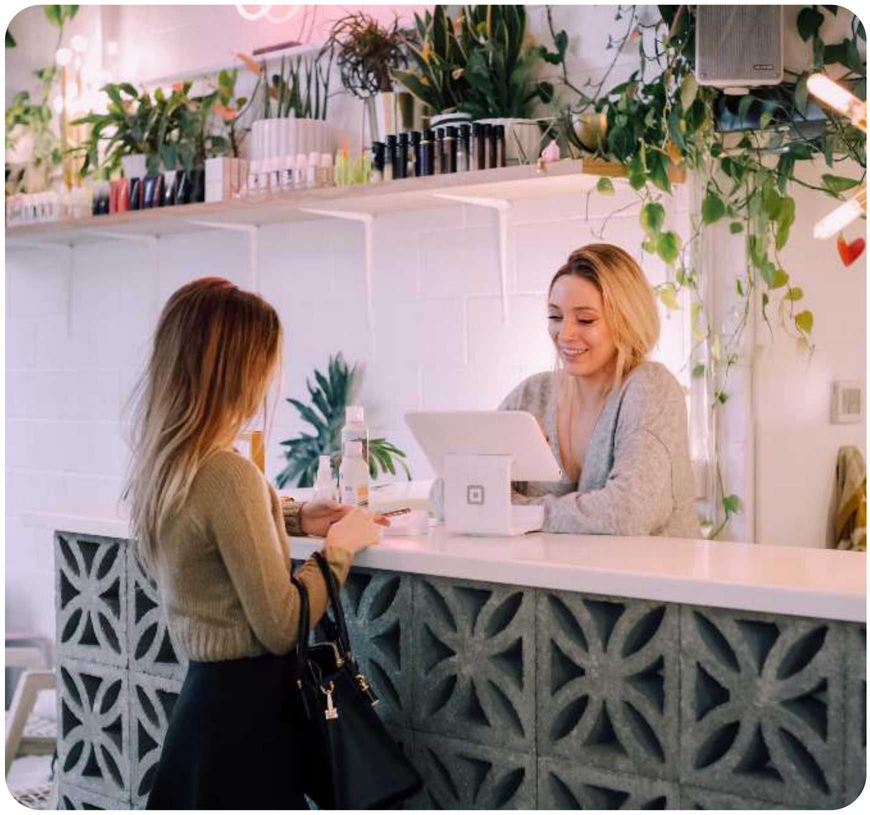


Empowering SMEs with better lending with FintechOS

SME lending is a growth area for banks as well as a vital service that powers the wider economy. By using the right tech, banks can serve a wider range of SMEs and offer better, faster access to funding.

Access to affordable, flexible business finance could mean the difference between a SME failing or going onto global success.

As the world recovers from Covid-19, SMEs should be leading the way. FintechOS is here to help lenders enable this historic recovery and build a brighter future.



References

[1] https://www.worldbank.org/en/topic/smefinance

[2] https://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Financial+Institutions/Priorities/SME+Finance

[3] https://www.weforum.org/agenda/2021/07/decentralized-finance-transaction-banking-smes/

[4] https://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Financial+Institutions/Priorities/SME+Finance

[5] https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210301_1~ab924b7e65.en.html

[6] https://www.fsb.org.uk/uk-small-business-statistics.html

[7] https://ustr.gov/trade-agreements/free-trade-agreements/transatlantic-trade-and-investment-partnership-t-tip/t-tip-12

[8] https://www.ebrd.com/what-we-do/sectors-and-topics/why-small-businesses-matter.html

[10] https://www.worldbank.org/en/topic/smefinance

[11] https://ffnews.com/thought-leader/sme-banking-why-banks-forget-and-neglect-an-untapped-market/

[12] https://www.finextra.com/blogposting/18777/how-fintechs-are-transforming-sme-lending

[13] https://www.statista.com/statistics/1221446/us-covid-19-financial-aid-small-businesses/

[14] https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/ecb.safe201905~082335a4d1.en.html#toc2

[15] https://hollandfintech.com/2019/10/eu-banks-to-restrict-lending-to-smes/

[16] https://www.eulerhermes.com/en_global/news-insights/news/stricter-regulation-could-force-european-smes-to-rely-more-on-non-banks.html

References

[17] https://www.bankofengland.co.uk/financial-policy-summary-and-record/2021/october-2021/financial-stability-in-focus

[18] https://www.mckinsey.com/~/media/McKinsey/Industries/Financial%20Services/Our%20Insights/Fintechs%20can%20help%20incumbents%20not%20just%20disrupt%20them/Fintechs-can-help-incumbents-not-just-disrupt-them.ashx

[19] https://fintechos.com/whitepaper/sme-lending-how-data-and-tech-can-bring-a-surge-for-banks/

[20] https://www.accenture.com/us-en/insights/banking/embedded-finance-smes

[21] https://fintechos.com/blogpost/sme-banking-lending-has-emerged-as-a-priority-area-for-digital-innovation/

Our technology supports more than 50 clients across the globe

We enable financial institutions of all sizes to offer innovative digital financial products with hyper-personalized customer experiences

Book a demo

Scan the code below or visit **fintechos.com** to learn more about us.

For any other inquiries, please reach us by email at: **contact@fintechos.com**

fintechOS

Introducing FintechOS, the high-productivity financial infrastructure. Our nimble, modular platform empowers existing systems, builds differentiated financial services, and radically transforms the customer experience. Currently, more than 50 financial institutions of all sizes, across the globe are powered by FintechOS technology.

London The Grove, 248 Marylebone Rd, Marylebone, NW1 6JZ, London

New York 12 East 49th Street NY 10017, New York, United States

Amsterdam Weesperstraat 61-105 1018 VN Amsterdam

Bucharest Oregon Park, Building C, 2nd Floor, 46-48 Pipera Road, 2nd District, Bucharest, Romania