# SME Lending

Seize the moment:
how data and tech can bring
an SME lending surge for banks

# Contents

# Introduction

Europe's banks have a golden opportunity to boost lending to small and medium-sized enterprises (SMEs). In the midst of the pandemic, they are the conduits for billions in state funding to support this crucial segment of the economy. However cumbersome legacy IT systems and outdated risk profiling stand in the way. Agile new competitors are already taking customers away from established banks, even though many companies have existing banking relationships.

But banks can stop this business from flowing away; by taking a data-centric approach they can streamline risk assessment and loan approvals, create products personalized to their customers' needs, meet new regulatory requirements, and ultimately power this potentially high-growth market to the recovery that all economies need post-pandemic.


# SMEs are dramatically underserved by banks

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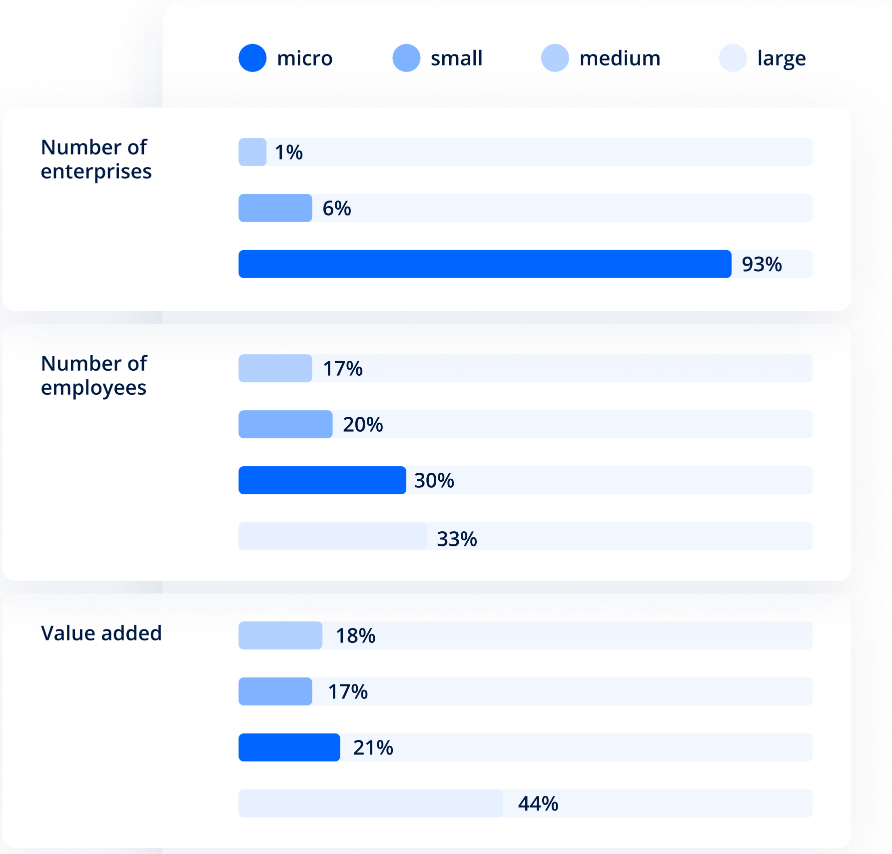
## SMEs are dramatically underserved by banks

SMEs are an underserved but vital engine of growth for all economies in Europe. There are more than 25 million SMEs in the European Union (figures include UK before Brexit) and they frequently make up almost the entire non-financial business sector of many countries. Most are tiny enterprises employing fewer than 10 people, but together they power the majority of economic growth and employ nearly 70 percent of workers, according to figures from the European Commission, published in November 2019[1].

But these crucial businesses often struggle to get the finance they need to grow. It's a decades-old issue and shows few signs of improving. What's known as the SME "financing gap" – their need for external finance to stay alive or fund expansion plans and other strategies – was €400 billion ($481 billion) in 2019 in Europe, according to research from Allianz and EulerHermes[2].

The Bank of England puts the shortfall at £22 billion ($30.5 billion) for the UK alone in the same year[3].

Small and medium-sized enterprises (SMEs): share in total companies, employment and value added




*Sources: European Comission, Allianz Research*

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**SMEs are dramatically underserved by banks**

Despite often not getting what they need from banks, most SMEs have been going to their current account provider in the first instance when looking for a loan, according to the Bank of England's paper on Open Data for SME Finance, published in March 2020[4]. And loans remain a preferred financing option – some 85 percent of outstanding SME debt is in bank lending.

In Europe, about half of SMEs considered bank loans and credit lines for their businesses, according to the latest half-yearly report from the European Central Bank[5]. And 71 percent of SMEs applying for loans said they were successful in receiving the full amount. Still, nearly one-fifth were relying on family and friends for a helping hand.

## COVID has made the situation worse

The pandemic has naturally made the funding situation worse for SMEs. Traditional sources of funding have often become slower because of the lack of face-to-face meetings and bank staff working remotely.

A survey conducted by McKinsey in August 2020 found

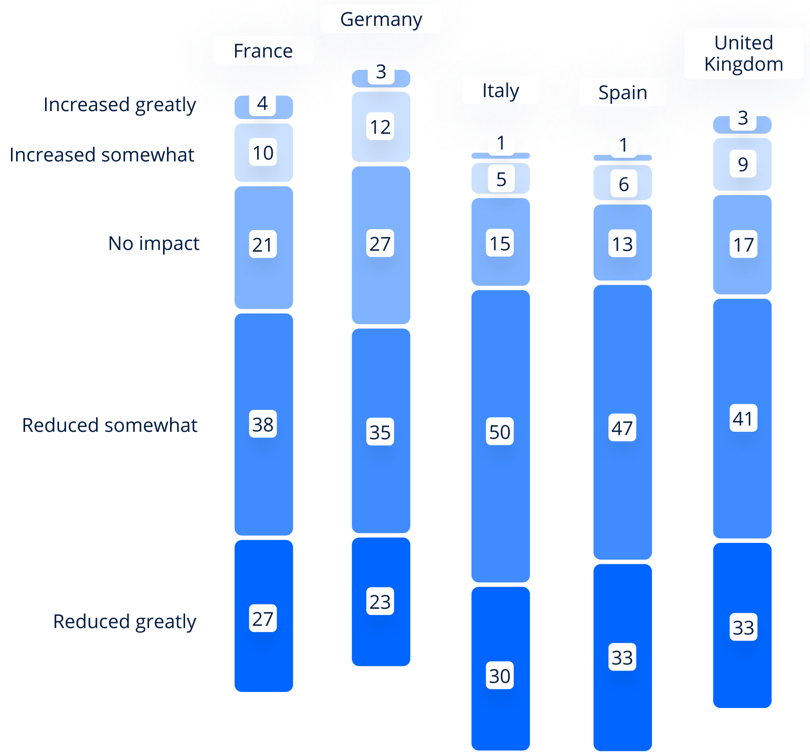

of SMEs in the five European countries it looked at (France, Germany, Italy, Spain, and the UK) said the pandemic had hit revenues

One-in-five was worried about defaulting on loans and more than half felt their business might not survive another year[6].

SMEs are dramatically underserved by banks

# Revenues have fallen for the vast majority of small and medium-sized enterprises in Europe since the onset of the COVID-19 crisis.

**Respondents' views of COVID-19 impact on their companies' revenues**




*Note: Figures may not sum 100%, because of rounding.*

**Source:** Survey of SMEs conducted in August 2020; n = 500 in United Kingdom, n = 505 in Germany, n = 502 in France, n = 351 in Italy and n = 350 in Spain

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SMEs are dramatically underserved by banks

# Governments are pushing banks to lend

Small businesses are less flexible in their product lines than larger businesses, so are finding it difficult to retool should their existing sources of revenue be threatened. Access to affordable, flexible business finance could make the difference between a small business failing or succeeding.

And it's not as if governments are not pushing for more finance to small companies. The European Union's four biggest economies – Germany, France, Italy, and Spain – have committed to spend $3.1 trillion on loan guarantees, subsidies for wages, and bailing out scores of companies, according to the IMF[8].

In the UK, as of February 21, about £45.6 billion ($62 billion) has been borrowed by more than two million small companies under the "bounce back" scheme, offering state-backed loans of up to £50,000. Just over £22 billion has been offered under the Coronavirus Business Interruption Loan Scheme (CBILS) in larger loans to SMEs[9]. This is not only indicative of demand, but also perhaps shows the difficulty companies are facing in accessing money direct from banks.

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Nearly a year ago (March 2020) the European Union announced its new strategy to "unleash the full potential of European SMEs." Front and center is improved access to finance, along with cutting red tape for trade and ensuring sustainable and digital transitions[10].

The opportunity is clearly there for banks to be at the forefront of lending initiatives, using their established positions in SME finance to expand into this growing market.


# Why banks struggle to lend to SMEs

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## Why banks struggle to lend to SMEs

### If banks have such a clear potential growth market, why are SMEs so frequently short of funds?

There are many obstacles for banks. Small businesses often do not have credit ratings to assist banks in making their lending assessments. Meanwhile banks are generally saddled with inflexible legacy risk-assessment technology and loan assessment processes that still have their origins in face-to-face meetings between local branch manager and small business.

Data systems that were set up when banking was primarily face-to-face often keep information siloed and in the wrong location. A culture rooted in paper-based processes, requiring hard copies of documents for identification and risk assessment, is ill-equipped to adapt to an online economy and fast-growing new sectors.

Banks simply struggle to assess credit risk for new tech and service-sector businesses, which often don't have old forms of collateral such as real estate and machinery. Many SMEs seeking finance are small outfits, perhaps just the owner or a handful of people, without the capacity to prepare the comprehensive accounts and forecasts that banks require on account of their outdated systems.

In addition there has been a barrage of regulation and credit constraints stemming from the 2008 financial crisis, as well as Anti-Money Laundering (AML) rules and "Know Your Customer" (KYC) requirements.

## Why banks struggle to lend to SMEs

It's not difficult to see why the system has become sclerotic. But times are changing. Regulators and governments have recognized that lending needs to be more digital to spur SME growth. The Bank of England is working on establishing an Open Data platform. The European Union has promised to cut red tape and improve access to finance for SMEs in a strategy paper published in March 2020[11].

Meanwhile the pandemic has also accelerated a digital shift in banking practices, as it has boosted digital changes in all our lives. The adoption of new technology presents a real opportunity to change the lending landscape in ways that benefit companies and the economy.

insight

### Andy Piggott

Director of lending products for **Metro Bank**, on using data and technology to compete successfully in SME lending

Challenger banks like Metro Bank have seen an opportunity to better meet customer needs and improve customer service and experiences, to win that business and drive profitable returns. Our small business loans platform is a good example of how it can be win-win. It is a digital, fully automated process, looking to minimize the need to refer customers out for credit reviews, so it should be very fast. That's better for the customer – they get funds more quickly – and more efficient for us.

We also have plans for incorporating some more exciting, more sophisticated data points. Things like eBay data and Amazon Marketplace data for businesses selling through those channels.

You can also use data to achieve more sophisticated segmentation of the market, to make sure you get the right products to the right customers. Segmentation has been very simplistic, based on turnover, for example, or number of employees. But SME lending covers a very broad range, from a sole trader needing a business credit card for expenses to a large manufacturer looking to expand its premises. Opportunities are there for lenders who crack this challenge.

# Fintechs to the fore

As countries look to come out of lockdown and return to growth, the race to provide faster, more flexible, more personalized lending solutions for SMEs will gather pace.

Fintech lenders – agile, digital, innovative, and unconstrained by legacy systems – have the advantage here over established banks and it's beginning to show. Fintech lenders account for most of the flow of new SME lending in the UK over the past half a decade, according to Andy Haldane, chief economist at the Bank of England[12], and even though it is only around 10 percent of the total, it is set to grow.

Digital lender Kabbage started by offering loans to online merchants who sell on eBay, Etsy, Amazon, and other online stores. It uses data and automation to process applications and decisions can be made in minutes. Over 11 years, around half a million small businesses have accessed some $16 billion in funding. Kabbage has been so successful that it was bought by American Express.

To assess risk, Kabbage uses an algorithm developed with credit-score company FICO that considers 30 data points, including cash flow. It can also learn from historical data. That means Kabbage can outsmart traditional banks in working out how risky a potential client in a business with low fixed assets might be. The speed of the loan-origination process partly relies on technology that can input customer data, such as addresses or bank account numbers, automatically into online forms. That cuts time for the applicant and also reduces errors in data input. Credit score data and business performance can also be added.

No paperwork or simplified application

Fast credit decisions

No interest, no collateral

Another pioneer is Funding Circle, which specializes in peer-to-peer lending, matching investors to small businesses in the US, UK, Germany, and the Netherlands for a variety of finance, including loans and credit.

Businesses can check if they are eligible for financing in an online questionnaire that takes 30 seconds. A simple online application[13] takes about 10 minutes. After a credit bureau and Companies House search, a personalized quote comes back in as little as five hours. If accepted, after some final checks, the money is deposited directly into a current account.

In 2018 Funding Circle's business grew dramatically. The total value of loans under management jumped 55 percent on the previous year to £3.1 billion. That is still only a fraction of the total addressable market, but the growth is significant.

Loyalty among Funding Circle's customers is extremely high, with

**82%**

saying they would approach Funding Circle first for finance in the future, rather than a bank.

**73%**

of customers went straight to Funding Circle for their new loan in 2018

## It's clear traditional lenders are missing out[14]

Another company growing fast is Australia's Prospa, whose application forms take 10 minutes to complete online and where applicants can expect a decision on the same day they apply, possibly even within an hour. Prospa has lent almost AUS$ 1 billion in six years. Innovative online lenders outpace traditional banks in digital channels such as online and mobile, with personalized offers for credit cards and car leasing arrangements. They can also provide flexible payment options and repayment holidays.

One of the main reasons why SMEs choose a non-bank lender is greater flexibility to make repayments at a time that suits the business, according to research commissioned by technology company Banking Circle[15].

But banks do not have to miss out. There are tech providers with many of the answers that can put banks on a level playing field with the new breed of fintech lenders.

insight

**Ed Herman**

Global head of financial services institutions at **Microsoft**, shares his thoughts on how traditional banks can compete in the new SME lending market

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. Take Uber drivers: a few years ago, there were none, but now there are thousands, needing to buy a car, fund repairs and insurance, and even leverage their vehicle for a side job as, say, a grocery delivery driver.

To launch and market such products and services, banks will need solutions and systems designed for speed to market, quick scaling, and visibility into the volumes of data available. Using traditional approaches and technologies will not work.

Leveraging the power of solutions built on the cloud provides scaling capability that is unmatched by anything a bank can do on its own. The computer power, scalability and ease of use for cloud-based solutions would allow a bank's own personnel to focus on addressing customer questions and helping them navigate other issues.

The challenges to innovation are the same ones that have existed for years: lack of executive support; failure to embrace new technologies; reliance on outdated business models; and not recognizing the changing face of the SME market.


# About FintechOS

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# About FintechOS

**FintechOS Lighthouse** is a digital-on-top offering that allows SME banks to create new products that are smart and personalized and bring them to market quickly. With **FintechOS Lighthouse** SME banks can retain their existing core banking system and innovate to unleash their full potential for SME lending.

**FintechOS Lighthouse** is built to put banks at the center of the modern fintech landscape. The platform gives SME banks access to external data sources and third-party fintech services to incorporate in their own offerings. It combines traditional siloed banking information with a single customer view, all in one place. This allows banks to make products more targeted and build digital marketing right into the products themselves.

With the **Lighthouse** platform SME banks can deliver innovative financial services and customer experiences faster than ever before, because the majority of the expected functionality is already present in the form of Automation Blocks. Banks can customize the last mile to suit their needs using the **Innovation Studio**, a low-code function that allows business users to deliver state-of-the-art experiences with minimal IT involvement.

# How can banks be future proof: the FintechOS approach

Traditional banks have to face the reality that their operations are not suitable for the pace of innovation of today's market. CTOs and CIOs are aware of this fact and at the same time know that there is no silver bullet that will solve the challenge of digital transformation.

The big bang overhaul of banking systems has been tried often enough for banks to understand that it is too risky, too costly, and not worth the trouble. The right question to ask, therefore, is what phased approach banks should choose. Banks want to create value through innovation as soon as possible and at the same time build a sustainable infrastructure. FintechOS offers an approach to start small, scale fast, and gradually move away from outdated infrastructure.

# What innovating with FintechOS means for banks

## Personalized banking

The FintechOS Lighthouse platform is built on the premise that better customer experiences start with better data. All the data needed for a single customer view is stored right along the traditional banking data so that the data to build and market smarter products is always available together in the same place. This place is called the Evolutive Data Core. Now banks can create customer segments and inclusion criteria at the heart of their financial services and create products that are more relevant, more targeted, and offer a better experience to the customer.

## Operational efficiencies

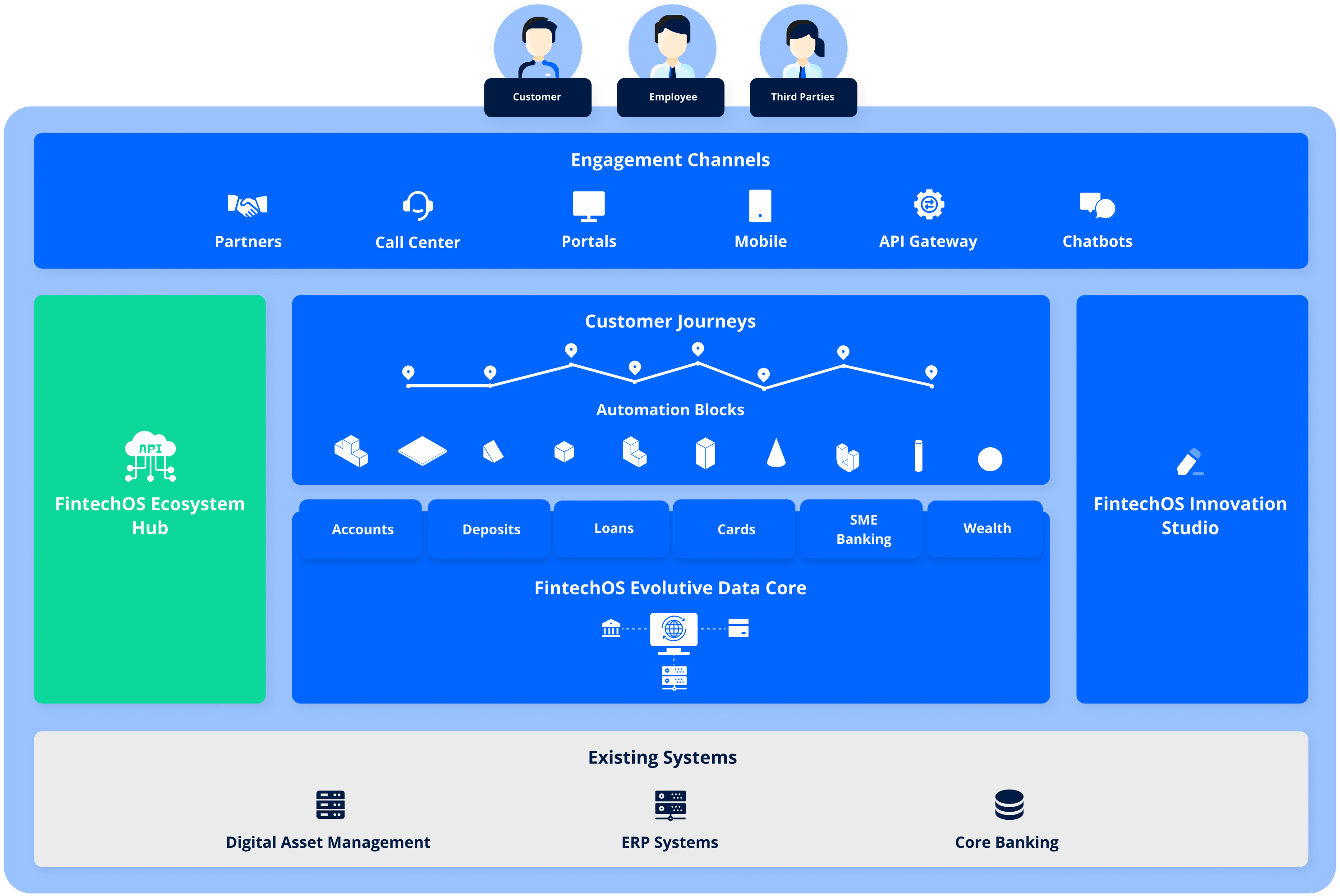
Better customer experiences also result in lower operational cost for banks. Especially in banks that still rely on paper-based processes and manual handovers, automation can bring time savings and cost savings. To name a few examples, fully digitized operations that eliminate paper-based processes increase the speed of business processes and increase their reliability. Digital document creation and electronic signatures make sure that loan origination can be completed in a single session for standard applications and drastically reduce time-to-money for customers. Face recognition, liveness technology, and OCR help to streamline KYC checks that otherwise slow down operations and create friction with customers.

## Short time-to-market

Lighthouse helps banks to build the majority of the customer journeys needed out of pre-built, productized functionality called Automation Blocks. These contain necessary and often reused technology for things such as security, identity and access management, business logic for scoring and rating, workflows, and digital documents and sooignatures. Building with Automation Blocks is fast and reliable and allows banks to focus on the elements of their customer experience that need to be unique. The FintechOS Innovation Studio helps banks to build that unique experience for their target audience. It offers business users a low-code approach to configure new customer journeys and financial services, or to build bespoke business logic.

About FintechOS

# FintechOS Lighthouse

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# FintechOS technologies

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FintechOS technologies

# The Evolutive Data Core

FintechOS brings together data from the bank's legacy systems alongside third-party data and ecosystem services in its Evolutive Data Core.

This is an API-driven extensible data model that can be updated continuously with new data and connections. This means that FintechOS enables the bank's systems to grow  and learn over time to keep pace with business changes. It also offers pre-configured integrations with over 150 external sources, such as Transferwise, Onfido, and Dun&Bradstreet.


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# Customer Journeys

**FintechOS** provides pre-configured functionality in Automation Blocks that can be combined in many configurations to meet diverse needs. For a loan application, for example, a bank might put together blocks addressing KYC, workflows, scoring rules and credit decisioning, document generation, and digital signatures. With 90 percent of the new customer journey already available as Automation Blocks, creative teams can build the final customization to create new standout experiences at speed. This kind of capability is rare if not unique among digital banking technology providers today, but it will be critical to providing the truly customer-centric experiences of the future.

### Comprehensive

Customer Journeys span all layers of the platform, from the Evolutive Data Core to the Digital Engagement Layers

### Flexible

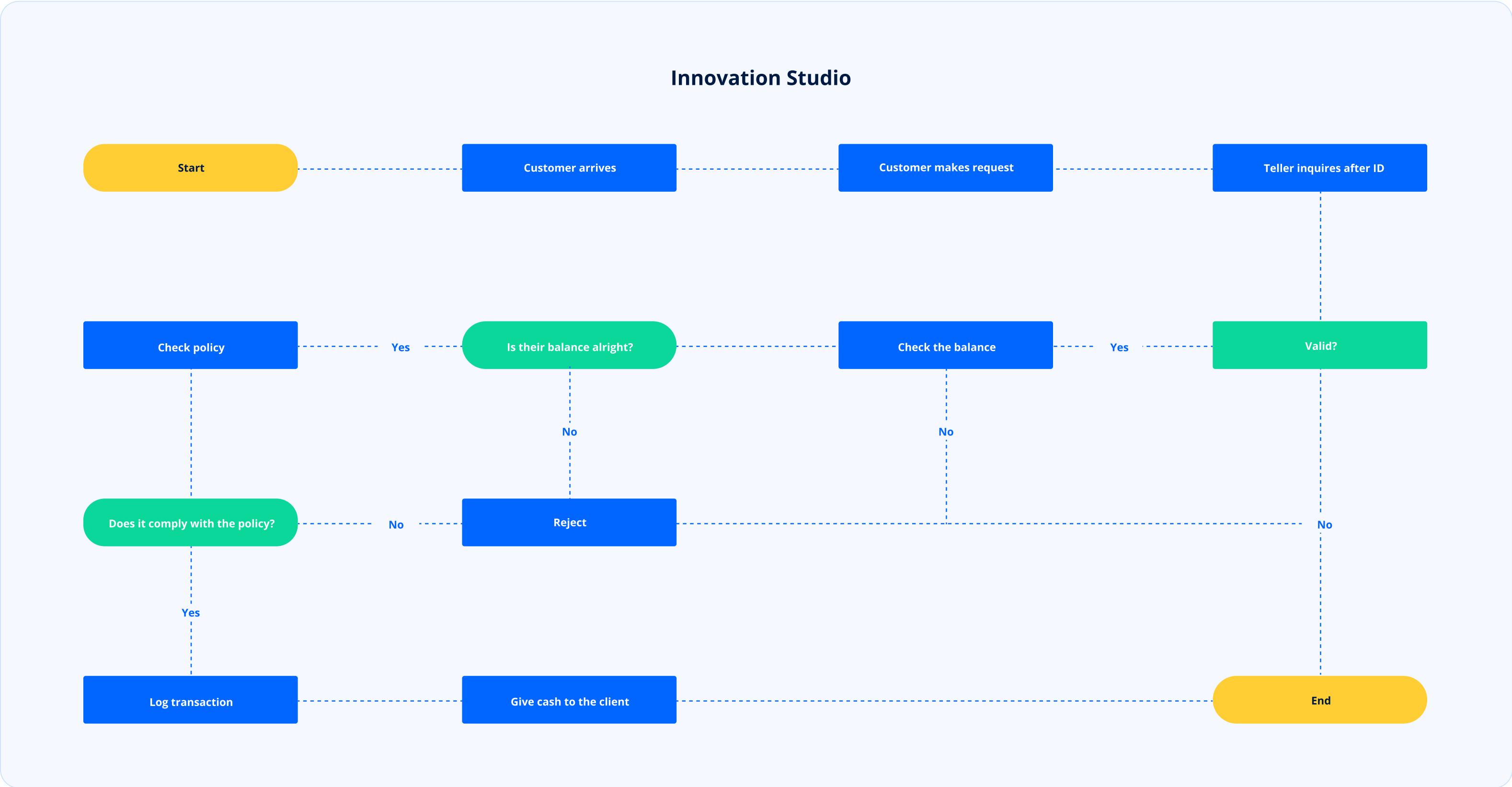
Customer Journeys are orchestrated and customized with the Innovation Studio.

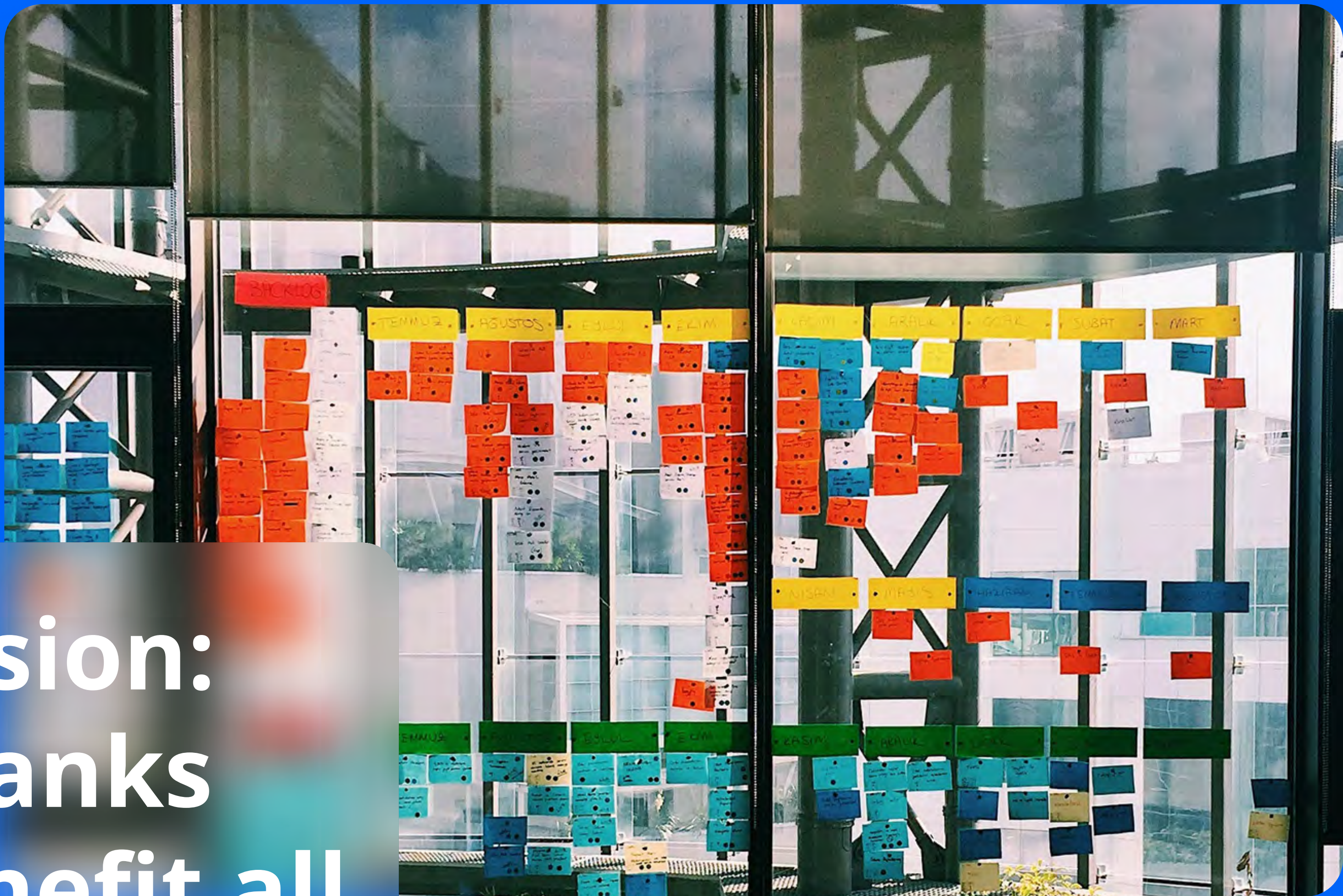
### Connected

Customer Journeys can be exposed in third-party engagement layers too and can use ecosystem data and services

# Innovation Studio

Within the creative playground of **FintechOS Innovation Studio**, lenders can create and deploy financial services and customer experiences in a low code environment. This is faster, more direct, and more user-friendly for finance experts than the traditional approach of working with IT teams. This allows the bank's product developers to use their experience and knowledge to innovate even if they do not have deep technical expertise.





# Conclusion: Agile banks will benefit all

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## Agile banks will benefit all

The pressure on banks to address the funding needs of SMEs is only going to increase over time. Governments who have put up billions to support small businesses threatened by the impact of the pandemic are now looking at ways in which to ensure these companies recover and drive growth. They expect their country's banks to play their part.

The OECD has already called for action, pointing out that SMEs were "deeply affected" by the economic effects of the pandemic, especially in their ability to access finance for cash flow needs and longer-term investments. The OECD said it would be "crucial" to monitor SME financing developments. Small businesses, it warned in an April 2020 report, might not be able to leverage digital technologies enough to obtain the external finance they need[16].

Banks can and must help and to do so will need smarter technology and more actionable data. These are the kinds of solutions offered by digital technology providers and the kinds of technology already being used by nimble newcomers in the SME lending market.

Without these changes, traditional lenders in the sector will be left behind. New arrivals will continue to snap up customers and eat into market share. And, perhaps most importantly, the future for millions of SMEs will remain uncertain.

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