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Thought Leadership

OPEN BANKING FOR SMEs – ENHANCING FINANCIAL SERVICES FOR THE BACKBONE OF EUROPE'S ECONOMY

EBA Open Banking Working Group

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EXECUTIVE SUMMARY

The SME sector is the backbone of the economy, heterogeneous, and highly impacted by digitalisation

- SMEs (small and medium-sized enterprises) account for 99.8% of enterprises in the non-financial business sector in the European Union, make up 53% of value added produced, and account for 65% of employment in that sector. In 2019, SMEs showed significantly higher growth than large enterprises.[1]

- SMEs are a very diverse sector, differing greatly in size, maturity, and type of activity. Micro-SMEs with less than 10 employees represent 93% of all SMEs in the EU and have shown the greatest growth within the SME segment. In 2021, there were 21 million micro-SMEs in Europe. Small SMEs with less than 50 employees and below 10 million EUR turnover make up 6% of the sector, with medium-sized SMEs with up to 250 employees and 50 million EUR turnover making up the remaining 1%.[2]

- The Covid-19 pandemic not only caused declining output and employment as well as significant liquidity issues, but also had a high impact on the speed of digitalisation in the SME sector. This includes the move from physical to digital channels and modes of interaction, the move from on premise to cloud applications and "as-a-Service" offerings, the increasing availability of data along all digital activities and transactions and the ability to leverage data using technologies such as artificial intelligence and machine learning

- Digitalisation presents both challenges and opportunities for SMEs:

  - Challenges include the need to keep up with developments. Hindering factors include a potential lack of awareness, capabilities, capacity, and access to funding to execute necessary digitalisation measures.

  - Opportunities include access to data and applications via new, cloud-based services and technology that can help level the playing field. Easy access to digital, company-related data may enable loan issuers to make better and faster credit decisions, improving SMEs financing and liquidity situations.

SMEs' financial needs are complex, and banks have traditionally not adequately served this customer segment with tailored financial services

- The heterogeneous nature of the SME sector also results in diverging financial needs depending on size, maturity, and type of activity. Very small companies may look at loans to fund day-to-day operations and small investments or collecting point-of-sale payments, while larger SMEs may require more efficient expense management, working capital finance, risk management, FX solutions or cross-border payments.

[1] In 2020, according to the European Commission Annual Report on European SMEs 2020/2021 of July 2021. The source for figures in this chapter is the report cited herein, unless another source is expressly referred to.

[2] Source: Europe: number of SMEs | Statista

- Financial needs of SMEs can be grouped into three categories:

  - Fundamental financial needs revolve around ensuring the liquidity necessary to keep the business running and funding for required capital expenses. The “SME financing gap” is a global phenomenon: SMEs systematically receive less funding than would be optimal due to a lack of information and transparency regarding if and how their business may be impacting bank risk. This funding gap is found to be especially high for digitalisation-related investments.

  - Operational efficiency needs relate to those that help SMEs run their business more smoothly and result in less time spent on non-core activities. They can be covered with typical banking products but also extend to adjacent areas such as accounting, tax or payroll.

  - Competitive differentiation needs relate to services that help SMEs stay ahead of competition and provide them with superior business intelligence or enables them to make smarter decisions.

- Across these needs, convenience is a key value driver and relates to topics like fast onboarding, short credit decision cycles, or an omnichannel “whenever, wherever, however” service.

- Meeting the needs of SMEs for financial services is particularly challenging. Reasons lie in the complexity of the segment, which makes it difficult to apply a “one-size-fits-all” approach to SMEs. Also, the high cost to serve, driven by said complexity as well as high credit risk has made it more difficult to adequately serve SMEs as a customer segment compared to retail customers and corporates.

An evolving ecosystem provides the foundation for a host of new, innovative propositions for SMEs

- A vibrant ecosystem of financial and technological service providers has developed offerings in the financial services space that cater to the specific needs of the SME market. PSD2 and Open Banking have accelerated this evolution with additional use cases based on Account Information Services (AIS) and Payment Initiation Services (PIS) functionality.

- The propositions offered can be categorised as follows – with lending services and banking platforms being the most dominant:

  - lending, invoicing and payments,
  - accounting and tax,
  - bank infrastructure,
  - business finance management,
  - onboarding,
  - and banking platforms.

- Examples are providers that tackle the SME lending challenge in very different ways, for instance by end-to-end lending process innovation, by embedding an innovative loan offering based on real-time merchant data within shop management or account information services. New banking platforms provide a banking experience fully dedicated to SMEs while leveraging Banking-as-a-Service offerings from licensed banks.

- SME-focused Open Banking services have developed more slowly than those for retail customers but are now accelerating. Within those, B2B2B models where fintechs provide specific products and services to banks are on the rise. While some fintech offerings compete with banks, this also gives rise to partnering opportunities with the potential to alleviate where relevant the traditional shortcomings of bank SME propositions.

Leveraging Open Banking can lead to a win-win-win situation for SMEs and different financial service providers

- Numerous financial service providers have started to open up beyond the requirements of PSD2 and developed "premium APIs" to make available data, products and services in an easily accessible, secure, and monetisable way. These can be based on partnerships and collaboration models among different providers.

- By focusing on an API-enabled setup internally and externally, financial service providers can also more easily than before insource capabilities and products from third parties, enriching their own offering towards SME clients. SMEs stand to gain as the wealth and quality of services will further increase, leading to a win-win-win situation.

- API-enabled services have the potential to address all need categories of SMEs, from real-time credit decisions to enhanced financial management tools.

Different Open Banking strategies can be pursued, based on a direct (incorporation) or indirect (provision) distribution model or a combination of multiple approaches

- Open Banking strategies that provide data, capabilities or products are aimed at cooperating with third parties, whereas strategies that incorporate third party data, products and services are used to enhance own processes or product/service offerings. Both strategies primarily rely on APIs.

- Providing strategies include API-as-a-channel, API-as-a-product, Banking-as-a-Service and embedded finance provider approaches. While the modularisation and "API-fication" of a bank's services play an important role in all of these, the strategic intent and distribution models differ significantly – yet they can and should be combined.

- Incorporating strategies are "data miner", capability builder, one-stop-shop, and marketplace approaches, with the latter two being Banking-as-a-Platform approaches. The one-stop-shop strategy is aimed at building a comprehensive, own-branded service platform tailored to the specific needs of SME clients by leveraging, among other things, third party white-label services. In contrast, the marketplace approach provides a platform for both providers and consumers of services that aims to achieve relevance by creating network effects.

- There are no one-size-fits-all strategies for SMEs. Instead, appropriate Open Banking approaches need to support a chosen market strategy and strategic choices regarding "where to play" and "how to win". Likewise, the relevance of different Open

Banking approaches strongly depends on whether micro-SMEs or larger companies are targeted.

Further accelerating the move towards an open data economy will benefit SMEs

- In the context of an accelerating digital economy, facilitating data sharing for SMEs beyond the financial sector in a standardised, secure, and data-sovereign way can play an important role in further strengthening the availability of financial services in general and financing in particular for SMEs.

- Initiatives such as the Nordic Smart Government Initiative are aimed at standardising access to credit-relevant company information, subject to the SME's consent, which can alleviate the information deficit and lead to faster and easier access to loans. The development of such schemes in line with the EU's data strategy would be useful for both SMEs and their providers.

For the success of Open Banking, a range of attention points needs to be observed

- To succeed in the SME segment, Open Banking needs to be embedded in a broader transformation. The prerequisite is to establish a customer-centric mindset and implement a clear SME strategy before choosing an Open Banking approach and make any related "build or buy" decisions.

- Ultimately, the provider's operating model needs to accommodate a truly customer-driven approach leveraging Open Banking with elements including a digital-ready culture, an API-enabled technology stack and the capabilities for leveraging internal and external data.

1. INTRODUCTION

The SME sector is incredibly diverse and heterogenous with companies of different sizes and maturity stages. The wide range of business models and risk profiles of SMEs as well as their differing financing needs traditionally have made it difficult for financial service providers to optimally serve these needs with tailored offerings.

The Covid-19 pandemic accelerated digitalisation efforts in the SME sector. This includes the move from physical to digital channels and modes of interaction, the move from on-premise to cloud applications and as-a-service offerings, the increasing availability of data and the ability to leverage data using technologies such as artificial intelligence and machine learning.

At the same time, PSD2 and similar regulations have led to a tectonic shift in the market landscape with an evolving ecosystem of financial service providers. Easier and faster access to funding and digital, cloud-based services are just some of the solutions that an Open Banking-based ecosystem is able to offer. The exchange of data, products and services between financial service providers has the potential to support this shift.

This report is aimed at shedding light on the banking needs of SMEs, how the evolution of a provider ecosystem is diversifying and complementing offerings for SMEs and how Open Banking initiatives can increase the quality of services provided in the SME domain. The report builds on previous work of EBA's Open Banking Working Group to put a spotlight on the developments, the potential, and the implications of Open Banking and Open Finance on banks and other financial service providers. Chapter 2 introduces the SME sector in Europe, chapter 3 structures the financial and operational needs and pain points of SMEs, chapter 4 describes the developing ecosystem of financial SME service providers, chapter 5 deep-dives into potential Open Banking strategies for the SME sectors, chapter 6 discusses key success factors for these strategies, and chapter 7 presents a brief outlook.

FIGURE 1 **SME FACTS & FIGURES**

Within the SME segment, three main types in terms of size can be categorised – Micro companies thereby making up the vast majority of all SMEs in Europe

SME FACTS & FIGURES

	MICRO *including Solo Entrepreneurs*	SMALL	MEDIUM
#Employees	1 – 9	10 – 49	50 – 249
Annual turnover	< 2m €	< 10m €	< 50m €
% Share of all SME companies (EU)	93%	6 %	<1 %

Source: INNOPAY analysis, SME Finance Forum, Harvard Business Review

2. THE SME SECTOR IN EUROPE

2.1 THE SME SECTOR IN NUMBERS

Small and medium-sized enterprises are the cornerstone of the global economy. The SME sector accounts for over 90% of global businesses, 60-70% of global employment and 55% of GDP in developed economies.[3] In the European Union, SMEs constitute 99.8% of all enterprises in the non-financial business sector (NFBS) and, in line with the global picture, account for 53% of value added produced in the NFBS and 65% of employment in this sector.[4]

SMEs are also the most important contributor to economic growth. In 2019, small and medium-sized businesses in the EU not only increased in number, but also demonstrated a stronger growth in value added (with 3.8%) than large enterprises (2.8%) and the EU GDP at large (3.3%).

The term "SME" refers to companies that are highly diverse in size, maturity stage, and type of business. Micro SMEs, in the EU defined as companies with less than 10 employees and below 2 million euro in turnover, make up the lion share of the SME sector. More than 93% of all SMEs fall into this category (around 21 million in total), and slightly less than half of all SME employees are employed by them. Micro SMEs have played an outstanding role in the EU's overall growth, providing 20% of total value added and showed stronger value-added growth, with 5.6%, than any other segment.

In accordance with the categorisation used by the European Commission, small SMEs have 10 to less than 50 employees and below 10 million euro in turnover, whereas companies with less than 250 employees and below 50 million euro in turnover are classified as medium-sized SMEs. There are 1.3 million small SMEs and 200 thousand medium-sized SMEs in the European Union – still sizeable numbers and equally important employers and growth drivers.[5]

2.2 IMPACT OF THE PANDEMIC ON SMEs

The Covid-19 pandemic has had a severe impact on the SME sector. Many, while not all, SMEs experienced steep declines in sales and consequently, value added by SMEs contracted by 7.6% in 2020 after the strong 2019 growth. The situation, though, differed a lot across countries. In Spain and France, for example, the impact was especially strong with declines of -16.6% and -13%, respectively. Other countries like the Netherlands (-1.3%) and Germany (-3.9%) saw a far lesser decline in SME output. Likewise, SME employment dropped in most countries, whereas in a small number of markets, such as Luxembourg, it was the opposite.

These differences are linked to divergencies on a country basis, as well as the composition of the SME segment in terms of sectors. For example, SMEs in digital industries experienced a far lesser economic impact of the pandemic than those in non-digital industries.

Since the beginning of the pandemic, SMEs previously operating at a profit were suddenly faced with lockdowns, temporary halt of operations, supply chain disruptions, rising prices for goods and services, incoming payment delays and fewer customers. In the

[3] WTO World Trade Report 2016 – Levelling the trading field for SMEs

[4] In 2020, according to the European Commission Annual Report on European SMEs 2020/2021 of July 2021. The source for figures in this chapter is the report cited herein, unless another source is expressly referred to. Source: DocsRoom - European Commission (europa.eu)

[5] Source: SME definition (europa.eu)

face of these issues, bankruptcy became a real threat for many SMEs, especially in the micro segment.[6] While the short-term liquidity schemes put in place in a number of European countries provided an important cushion, access to liquidity, a major challenge and pain point for SMEs globally at any point in time, painfully took centre-stage for SMEs in Europe throughout the pandemic.

2.3 SMES AND DIGITALISATION

The pandemic has accelerated the digitalisation of the economy and left its mark on the speed of transformation in the SME segment. Major components are the move from physical to digital channels and modes of interaction, the move from on-premises to cloud applications and “as-a-Service” offerings, the increasing availability of data along all digital activities and transactions and the ability to leverage this data using technologies such as artificial intelligence and machine learning.

For the SME sector, this transformation presents both challenges and opportunities. As digitalisation progresses, it is essential for SMEs to keep up with developments to maintain their competitiveness. However, SMEs frequently encounter a range of hurdles: first, they may lack sufficient awareness of digital data and technology as well as of their implications and opportunities. Second, even if they are aware, SMEs may lack the capabilities necessary to leverage, operationalise and embed digitalisation initiatives in their business and operating models. Third, SMEs often lack the capacity in terms of resources and funding to put digital transformation into practice. In fact, in a survey of SME associations, the lack of internal financial funds or lack of access to external financing were cited as the two major reasons for limited or no digitalisation in SMEs, second only to the lack of skills.[7]

Yet, digitalisation also carries rich opportunities for SMEs. Data-sharing via APIs, data analytics and Software-as-a-Service (SaaS) solutions are the basis for enabling the SME sector in ways that previously were only accessible for large companies. Access to alternative data sources for SMEs can help reduce friction where lack of information is concerned as well as the risk of lending. Digital offerings powered by banks and other providers offer unprecedented choice and powerful cloud applications can boost operational efficiency and decision-making to name only a few examples. Open Banking is one of the foundations for SMEs to benefit from next level financial services that were previously inaccessible. At the same time, it also puts banks and other financial service providers in a position to open up the enormous SME market, which traditionally may not have been adequately served.

6 For example, according to one survey, at the end of 2020 over 15% of micro-SMEs in the UK saw a high risk of going out of business within a tthree-month-period as opposed 5% for those with 50-99 employees. Source: https://blogs.lse.ac.uk/businessreview/2021/02/02/a-wave-of-covid-related-bankruptcies-is-coming-to-the-uk-what-can-we-do-about-it/

7 LE Europe survey for European Commission report, November/December 2020 (Source: DocsRoom - European Commission (europa.eu))

3. UNDERSTANDING THE NEEDS OF THE SME MARKET SEGMENT

3.1 SMEs' FINANCIAL NEEDS AND PAIN POINTS

The SME sector is heterogeneous by nature in terms of size, maturity, and types of businesses. For example, the need for financial products and services of a small café owner is very different from that of a one hundred-employee manufacturer of jewellery saws. For the former, ensuring day-to-day liquidity to pay rent and staff, receiving funding for small capital investments and collecting non-cash POS payments are key topics. For the latter, it may rather be about liquidity management and optimisation, financing international expansion, and efficient cross-border invoicing and payments. Likewise, the degree of focus on and professionalism in the finance function highly differs by the size and maturity of the SME. Whereas a shop owner handles his/her company finances much like he/she would handle his/her personal ones, a larger SME's dedicated finance department requires a different kind of interaction and client relation.

Generally, however, SMEs' financial needs can be grouped into three different categories: (1) fundamental needs that ensure an SME's short-term survival, (2) operational efficiency needs that enable the company's efficient and effective execution of financial and business operations, and (3) competitive differentiation needs, which enhance business decision-making and further strengthen the competitive position.

Fundamental financial needs

Companies require liquidity to cover day-to-day and operational expenses, to be able to make required capital expenditure and invest in their own growth. For SMEs, access to funding is an even more pressing issue than for large companies. Especially in Europe, SMEs of all sizes heavily rely on external debt financing for both operating expenses and investments. The pandemic has rendered the topic of financing even more severe: from 2019 to 2020, the share of European SMEs reporting access to finance to be a significant problem has increased significantly.[8] In the UK, for example, the reliance on external finance – including government support – has massively increased in the wake of Covid, as it has in other European economies.[9]

The lack of sufficient financing of SMEs, also known as the SME financing gap, is a substantial barrier to growth and constitutes a global phenomenon fundamentally linked to adverse selection due to limited or incorrect information available on the borrowers. This means that many SMEs get less funding than they should as they are evaluated on market averages, rather than their specific situation. This is an especially profound issue in Central and Eastern Europe.[10]

Next to debt financing through banks, leasing as well as equity financing play an increasing role for SMEs, all the while the move to digital business models may reduce the need for asset financing over time. However, to undergo successful digital transformation, investment is required to carry out digital projects. Research by the European Investment Bank suggests the existence of a specific funding gap for digital projects – with SMEs generally being less capable of raising money for digital projects

[8] Source: https://www.eif.org/news_centre/publications/eif_working_paper_2021_75.pdf

[9] Source: https://www.british-business-bank.co.uk/wp-content/uploads/2021/03/SME-Finance-Survey-2020.pdf

[10] The SME Finance Forum calculates the SME finance gap in Central and Eastern Europe to amount to 20-40% of GDP depending on the market (https://www.smefinanceforum.org/data-sites/msme-finance-gap)

than for general corporate purposes.[11] One reason for this is that banks as traditional lenders lack the ability to assess the value and risk of a digital project and tend to rely on historical performance, capital strength and collateral. Consequently, especially digital native companies such as tech start-ups tend to rely on a more diversified funding base.

Operational efficiency needs

Beyond financing, SMEs require financial services to support their day-to-day business operations as effectively and efficiently as possible. This includes a broad range of services like payments collection, international transfers, foreign exchange, cards, deposit products or bancassurance.

Needs in this category strongly depend on the nature of the business and its maturity – with increasing size, financial needs also become more complex. Correspondingly, SMEs expect financial solutions that are specifically tailored to their situation and needs and turn to providers that can best meet them.

Generally, smaller SMEs tend to prefer a one-stop-shop approach with a single financial service provider covering most or all of their financial needs, including "beyond-banking" use cases such as payroll or tax. As these businesses move up the maturity curve and become larger, the specialised services required are more likely to be covered by different providers, while at the same time, integration of financial operations in their application landscape becomes more important.

Competitive differentiation needs

The third category of needs relates to the added value SMEs can derive from financial services that allow for better and more informed decision-making, enable growth and support differentiation.

Examples of this are advanced cash forecasting, business intelligence dashboards, aggregation services, or specialised funding, but also services beyond banking services including market analysis and advice, value chain optimisation, access to additional sales and marketing channels or facilitating network-building and partnerships.

Convenience is key

SMEs want to be able to spend more time on their core business activities. Among the respondents of one exemplary survey, SMEs spent on average only a quarter of their time on profit-generating activities, whereas three quarters went into required, but non-core activities such as accounting or banking.[12]

For banks and financial service providers, addressing this pain point means taking complexity out of onboarding processes, reducing lead times for credit decisions, providing convenient user interfaces and servicing customers through the channels most adapted to their business requirements, among other things.

[11] Financing the digitalisation of small and medium-sized enterprises, EIB (https://www.eib.org/attachments/thematic/financing_the_digitalisation_of_smes_en.pdf)

[12] Source: https://www.mckinsey.com/industries/financial-services/our-insights/how-banks-can-use-ecosystems-to-win-in-the-sme-market

Evolving pain points along growth stages

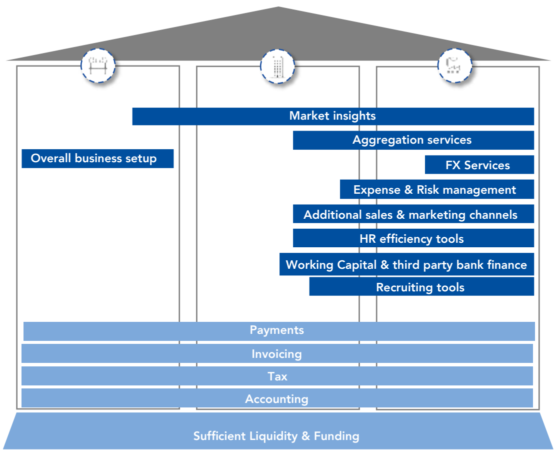
Irrespective of their absolute size, newly founded companies usually go through a series of growth stages from launch through growth to further expansion. In these phases, major pain points with regard to financial services typically differ. In the launch phase, questions around initial funding, setting up the business and knowledge exchange may prevail, these will make room for questions about an efficient set up of accounting, payroll and HR processes, managing regulatory requirements, and optimisation of working capital, for example. As expansion continues, questions about international markets, cross border payments and FX risk may arise.

Financial service providers that want to succeed in the SME market need to account for the diversity of issues and pain points according to size, maturity and industry of SMEs and address them with dedicated, customer-centric services and solutions.

FIGURE 2 **SME HOUSE OF NEEDS**

Survival & basic needs are independent of respective SME categories, however priorities shift depending on the SME size and type of client segment

SME HOUSE OF NEEDS (NON-EXHAUSTIVE)



Source : INNOPAY analysis, SME Finance Forum, McKinsey Survey, British Business Bank Survey

KEY TAKE-AWAYS

MICRO

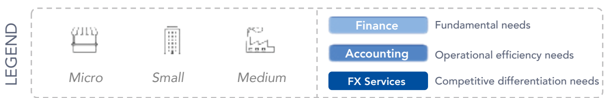
- Vast majority mainly has **basic financial needs** and is looking for a seamless financial integration to enable daily banking without hassle
- **Additional support on beyond-banking services** (start up company, notary, onboarding, …) is well-received within this group

SMALL

- **The bigger the SME, the more structured processes** are being implemented resulting in additional services being requested
- These can entail either additional financial (e.g. aggregating multi-bank accounts) or beyond-banking services (e.g. efficient tooling to recruit new employees and similar products to manage HR activities)

MEDIUM

- Needs are getting more sophisticated and **need for tailoring of certain products** and services becomes more and more relevant
- Especially for the largest within this group and depending on the industry or business model **certain needs** (e.g. FX services and cash flow optimisation) **are comparable to smaller corporates**



3.2 CHALLENGES IN SME BANKING TO DATE

The needs for financial services of the SME market are important, as demonstrated by the figures presented in the previous chapter[13]. However, they have often not been adequately served and traditionally financial institutions may have failed to tap into their full potential.

One important reason is the strong variation of credit risk among SMEs. With a lack of data and information, financial service providers have difficulties making proper credit decisions, leading to the adverse selection explained further above. Together with the varied financial needs of SMEs, this leads to a cost to serve for SMEs that is higher than that for other customer segments.

[13] SMEs are estimated to account for one fifth of global banking revenues. Source: https://www.mckinsey.com/industries/financial-services/our-insights/global-banking-annual-review

Consequently, banks have often not evolved this banking business segment at the same pace as retail or corporate banking. In fact, propositions, processes, and workflows from either corporate or retail banking, or both, were frequently used or adapted to SMEs. This lack of tailor-made solutions for SMEs has often resulted in financial services that SMEs perceived as being suboptimal for meeting their needs. To improve this situation, attention is required in the following areas, as identified by heads of SME banking units at financial institutions in a recent global survey:

- better and more fine-grained SME market segmentation in order to better address clients' needs,
- redesigned risk management setups to better reflect individual SMEs' risk profiles, including, for example, more focus on cash flow-based rather than collateral-based lending,

FIGURE 3 SME PAIN POINTS IN DIFFERENT BANKING AREAS

AREA	GAP WITH SME NEED
Account Onboarding	• **Lack of convenience** – Especially start-ups are unfamiliar with complex KYC, KYB & AML procedures and often overloaded with the amount of documents they need to provide (a survey[1] shows 84% of SMEs indicate that they have had a bad experience with bank KYC processes)
Lending	• **Threat for existence** – THE most relevant pain point for SMEs overall is **fast access to adequate funding** – current bank timeframes to receive credit decision and pay-out can result in SME bankruptcy • **Higher costs** – a survey in UK pointed out that SMEs often rely on a single loan provider due to the **hassle of the loan application** journey thus potentially **missing out on better offers / rates** due to fear of having to wait too long for a loan
Financial steering	• **Lack of real-time financial control** – especially larger SMEs with multiple accounts & loans at multiple banks have difficulties aggregating all financial data and need to spend a lot of time consolidating
Payments	• **Lack of flexibility** – SMEs do not have the variety of payment methods at their disposal that matches their business model • **Lack of transparency** – for most SMEs, pricing structure of traditional card payments can be confusing, leading to potentially higher costs than planned
Accounting, Invoicing & Tax	• **Lack of convenience** – Manual creating, tracking & consolidating of invoices with the internal accounting program often results in higher risks of errors in consolidating or creating tax statements

Source : INNOPAY analysis, Ross Republic, hernaes

[1] https://internationalbanker.com/technology/business-cannot-be-disrupted-without-digital-in-onboarding

- implementing technology to adequately service SMEs in a digital and customer-centric way,

- stronger focus on SME skills and capacity.[14]

SMEs, on the other hand, are presented with an increasing number of providers of tailor-made financial services and are willing to grasp the opportunity. A 2020 study on "Digital Banking and SMEs in Singapore", for example, found that 88% of SMEs would consider using new, digital providers for some services. Their expectations were that this could reduce their overall cost of banking, increase convenience, facilitate online bill payment, reduce overall time and effort conducting bank transactions and cater for availability 24/7. The study also showed the increasing importance of digital solutions for areas such as accounting, invoicing, payroll, or bill payments.[15]

[14] Source: https://www.ifc.org/wps/wcm/connect/dd06b824-c38b-4933-9108-0c834f182fee/IFC+on+Banking+SMEs+Publication+June+2019.pdf?MOD=AJPERES&CVID=mSdrGtA

[15] Source: https://thefintechtimes.com/visa-study-finds-underserved-smes-look-to-digital-banks/

PSD2 has levelled the playing field for access to data and for a variety of market actors, which together with the emphasis on new technologies brings about new opportunities and threats for the industry players in the ecosystem. The ability to custom-design services and user experience, by bundling banking and beyond-banking services to attractive packages, has shown to be of particular relevance for the SME sector.

4. AN EVOLVING ECOSYSTEM FOR SME FINANCIAL SERVICES

PSD2 and the introduction of licensed third-party providers (TPPs) as intermediaries infused a new dynamic into the development of the provider ecosystem and provided the foundation for a host of new, innovative propositions that both complement and compete with bank offerings.

4.1 KEY TRENDS IN THE PROVIDER ECOSYSTEM

Open Banking initially was marketed and discussed most prominently in the retail banking space, resulting in the majority of licensed third parties and use cases targeting that segment. Private individuals thereby got more and more used to vertically integrated and bundled financial products and services and started expecting the same level of digitalisation within their business environment. This trend as well as the SME sector's importance and rising awareness thereof led to an increase of Open Banking-based propositions serving small and medium-sized businesses.[16]

Three key trends can be observed regarding the SME provider ecosystem:

- **Slow(er) Open Banking adoption:** bank-offered Open Banking propositions targeted specifically at SMEs are still not widely available compared to the ones in the retail space, but the number of offerings is increasing steadily. Most live use cases can be found in the UK.
- **Service providers and bank partnerships rise:** Many initiatives of larger banks either consist of acquiring service providers to focus on SME servicing or co-created offerings, whereby the service provider often acts as product or capability provider towards the bank and the latter incorporates the provided capability within the offering towards SME clients – service providers therefore can focus on building relevant services for SMEs, while banks can focus on advising SME clients, thereby enhancing the product offering
- **Lending and banking platforms dominate:** Within the offered proposition areas, lending (as a service) and "one-stop-shop" platforms stand out with regard to the number of providers and the level of Open Banking involvement.

[16] Source:https://rossrepublic.com/the-sme-market-opportunity-for-fintechs-and-banks/

4.2 SME ECOSYSTEM PROPOSITION AREAS

The great variety of SME-targeted services can be grouped in seven different types of propositions, which cover most of the currently available use cases.

SME lending

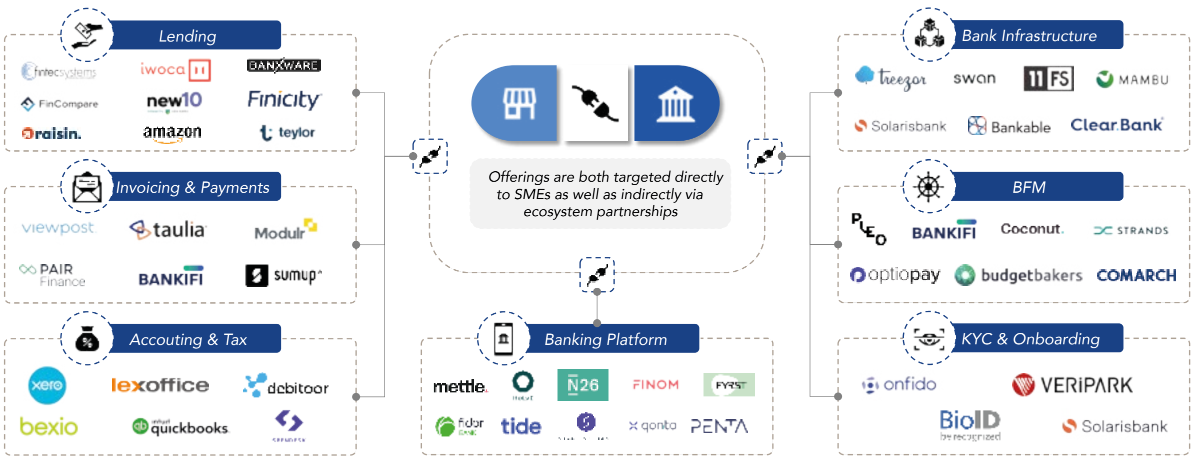
Ensuring liquidity remains the most relevant need of every SME. In line with this, lending-related services dominate the propositions landscape.

Specific offerings, however, differ from each other. Next to lending propositions that are targeted directly to SME clients (e.g., Iwoca), others diverge especially regarding target client group and can be categorised roughly into three approaches:

FIGURE 4 **OPEN BANKING PROPOSITION AREAS FOR SMEs**

Majority of non-banks focus on building niche capabilities as a service, while neo-banks focus on attracting SME customers and offer comprehensive banking experience

MARKET SEGMENTS & PLAYERS (NON-EXHAUSTIVE)



Source : INNOPAY analysis, Ross Republic, EY, McKinsey

- **Dedicated lending marketplaces** (e.g., FinCompare) provide a platform where SMEs can search for loan offers, which are published by a variety of external loan providers, thus bringing together both sides of the SME lending market
- **Lending-as-a-Service (LaaS)** capability providers (e.g., Banxware) focus on building strong lending capabilities, that can be embedded in platforms that serve SMEs.
- **Credit risk capability providers** (e.g., Finicity) offer products and services based on data aggregation to provide relevant insights into the financial situation of SMEs for credit provisioners to make well-founded decisions, both directly and “as-a-Service”.

These three areas are not mutually exclusive, combinations are possible.

SME banking platform

Becoming a go-to-platform or one-stop-shop may be a more challenging proposition for incumbent banks compared to other providers who are already well established in this area. Within this category, three types of actors can be identified:

- Fully licensed providers (e.g., N26 or Starling Bank) are regulated credit institutions and can therefore build and offer regulated products and services themselves

CASE 1 – TWO DIFFERENT APPROACHES TO ENSURE SME LIQUIDITY

As described in chapter 3, the most essential pain point for SMEs is to acquire funding that suits the current or future needs and situation of the SME as well as to ensure funding is realised in time. Two examples that tackle both those needs with different "Lending-as-a-Service" (LaaS) approaches are Banxware and Teylor.

BANXWARE provides an LaaS proposition that enables fintechs, neo-banks and merchant platforms to offer instant loans that are paid out within minutes. The loan thereby is backed by a loan providing bank to ensure credit warranty. Banxware's solution combines internal credit scoring with received SME data, that for instant the respective merchant platform already holds.

The main advantages for SMEs therefore consist of acquiring needed funding, instantly and embedded within the SMEs existing channels, which saves the SME valuable time from having to search on other channels. Banxware's direct customers benefit as their offering for SMEs provides additional added value and strengthens their SME relationship.

TEYLOR's LaaS proposition on the other hand is primarily targeted towards (incumbent) banks, as well as directly to SME clients. Their niche approach especially targets smaller ticket loans between 100k and 1 m€ as within this range, traditional loan providers often have a negative return on investment, as requirements for business onboarding often results in higher costs than the interest earnings.

Teylor is an alternative lender in Germany but partners with several providers and other partners, for example Solarisbank, Fintecsystems and Sopra Steria , to enhance their offering without acquiring additional licenses. Although the preferred solution is making use of account & transaction data as this allows an instant end-to-end credit check, Teylor also offers the traditional way of submitting relevant documentation, e.g., bank statements.

CASE 2 – BECOMING A ONE-STOP-SHOP FOR SMEs

Another example of a new business model enabled by Open Banking is **Penta**.

Relying on SolarisBank's BaaS solutions, Penta focuses entirely on serving SMEs via a one-stop-shop approach and bundles all services along the “SME need chain” within their platform. As (financial) products and services such as lending offers are not built internally but provided by partner organisations, Penta can focus fully on the client interaction.

The majority of SMEs seem willing to pay for timesaving, quality banking services, as being able to focus on core activities instead of having to deal with non-core tasks is one of the most pressing SME pain points currently that is also described in chapter 3.

Furthermore, Penta solves the chicken-and-egg problem when it comes to onboarding SMEs by supporting SMEs with setting up their business from the start, thus creating a trust relationship.

- In-house challenger banks (e.g., Fyrst) operates under the "regulated roof" of the respective mother bank, allowing it to offer regulated products

- Non-licensed providers (e.g., Finom) who do not possess the needed permissions to offer financial products themselves and therefore partner with a bank infrastructure provider and offer the consumed regulated services in a broker-like role

Banking Infrastructure

For non-licensed providers, partnering with BaaS providers that hold required financial licenses and offer regulated products is a necessity. This approach allows non-banks to act like regulated entities while focusing on building capabilities that can be embedded into the platforms of both regulated and non-licensed providers. As multiple parties can make use of the same capabilities, infrastructure providers can scale their solutions. This can be a significant trigger to facilitate the entry of new players into the market.[17] Examples for providers in this space are for example Solarisbank, Treezor and Swan, among others.

Business Finance Management (BFM)

As the business equivalent to personal finance management applications, which gained traction in the early days of PSD2 and Open Banking[18], business finance management offers basic account overviews with integrated accounting, bookkeeping and key data insights to support businesses in keeping track of their financial situation in real time. Reconciliation and processing of tax data can be performed automatically, thereby freeing up time that businesses can then spend on their core activities. Within this area, mature solutions are offered by for example Strands, Pleo and Coconut, among others.

Invoicing & Payments

An efficient invoicing process that makes payments easy for customers and reduces the time for an invoice to be settled improves in-time funding for any business. Recent studies in the UK have shown that more than half[19] of all small businesses are dealing with late payments which may result in loss of business and therefore jobs.

To tackle this issue, many non-bank propositions based on request to pay functionality have been developed, most often embedding the invoicing functionality within the accounting and bookkeeping system, thereby significantly increasing transparency, traceability, and speed of payments received.[20]

Accounting & tax services

Unlike the previously described propositions, accounting and tax services were already provided for SMEs prior to the introduction of PSD2. However, the functionality and quality of these services were limited due to a lack of capability to either properly access and/or process data from various financial sources or manual processes such as uploading transaction data.

[17] Source: https://stormotion.io/blog/which-baas-provider-to-choose/

[18] Source: https://www.businessinsider.com/personal-finance-management-market

[19] Source: https://www.british-business-bank.co.uk/finance-hub/how-to-deal-with-late-payments/

[20] Source: https://www.openbankingexpo.com/news/tsb-unveils-open-banking-payments-app-for-uk-smes/

Since the introduction of Open Banking, accounting providers benefit from three main advantages: firstly, automated data processing saves time and helps reduce internal processing costs significantly. Secondly, accounting providers can improve their service for customers by providing a full end-to-end view over all accounts in real time.[21] And thirdly, software providers can make use of additional sales channels as software, white-labelled or branded, can be offered either to SMEs directly or to account-servicing entities like banks or fintechs. The latter is very common and is reflected by the many bank partnerships with providers, e.g., Bexio, Debitoor or Intuit QuickBooks, among others.

Apart from expanding the role of accounting capability provider, some providers create new opportunities by either building relevant products and services themselves or by partnering with other providers to expand the initial service offering with additional services, for example provisioning of office administration services.

[21] Source: https://tink.com/blog/open-banking/benefits-accounting-platforms/

Onboarding

Some of the challenges to be overcome for a digital onboarding solution are personal identification of the applicant, automated document scanning and biometric verification.

Currently, there are two main approaches:

- **Onboarding-as-a-Service:** providers (e.g., SolarisBank or Onfido) offer a full or partial end-to-end solution, either white label or branded, to banks and fintechs. The modular set-up of individual onboarding blocks allows for the solution to be tailored to each client. The speed with which onboarding at a financial institution can be completed is a main advantage for SMEs.

- **Biometrics-as-a-Service:** providers like BioID, for example, focus on identity verification of the applicant during the onboarding process. Offerings range from "periocular recognition" (a face recognition method that focuses on the eyes) and "face liveness detection" (a face recognition method that detects if it is presented with a live user rather than a picture or similar) to other forms of "privacy by design" solutions. These solutions can help to prevent identity fraud, saving financial institutions resources and effort.

5. LEVERAGING OPEN BANKING FOR SMEs

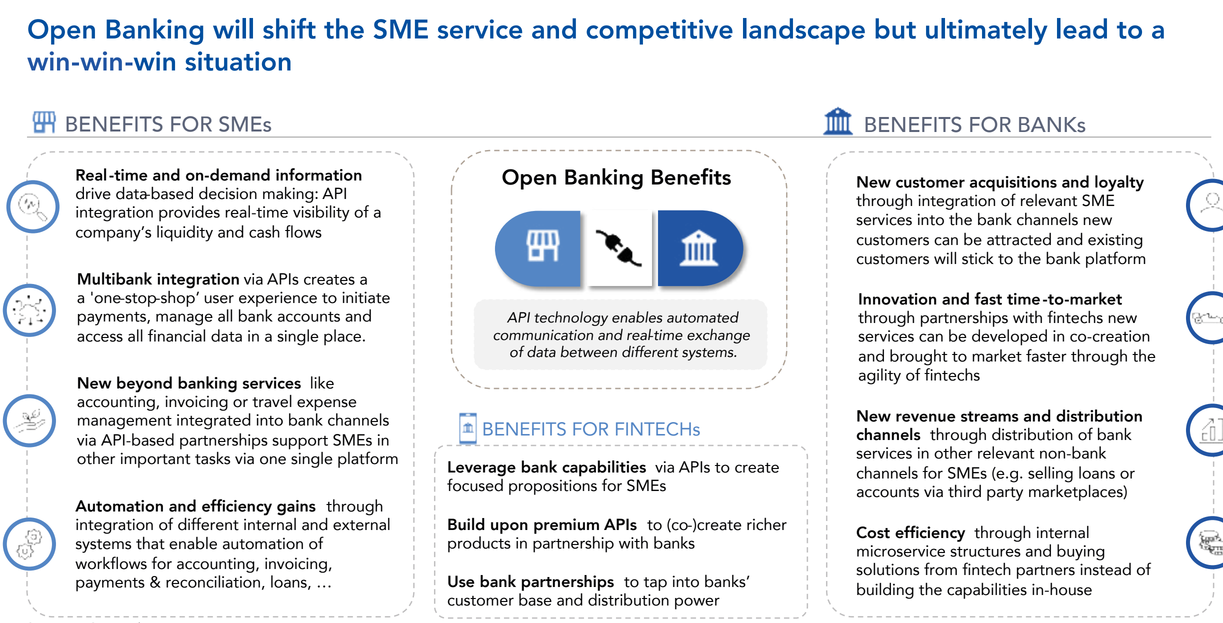
5.1 OPEN BANKING AS WIN-WIN-WIN

The introduction of PSD2, allowing third parties to access account information and initiate payments on behalf of payment services users, has helped fuel the evolution of the third-party provider landscape: by the end of 2021, more than 500 licensed TPPs where registered throughout Europe. The result has been a flourishing ecosystem of providers catering to specific needs of SMEs, as depicted in the previous chapter, while shifting the competitive dynamics in SME banking.

At the same time, many banks have started to take Open Banking beyond the regulatory requirements of PSD2 and developed their own API offerings to provide access to a broader array of banking data and services. These "premium" API offerings allow banks to actively position themselves in collaborative value creation for their clients and develop rich use cases together with partners, broaden their reach to new customers and embed themselves more deeply in customer journeys.

SMEs themselves stand to gain from this development. Larger businesses with dedicated IT and finance capabilities can leverage premium APIs made available by banks to gain access to real-time data and on-demand functionality to improve processes and decision-making in their finance function, while smaller entities can access a wide array of services, individually or as one-stop platforms to simplify their handling of financial non-core activities.

FIGURE 5 **OPEN BANKING ENABLED WIN-WIN-WIN SITUATION**



Source : INNOPAY analysis

PSD2 and Open Banking accelerate a “tectonic shift” for financial services to SMEs driving players on the field to rethink their approach to the SME segment. At the same time, Open Banking has the potential to create win-win-win situations in the collaborative space for banks, third party providers and SME customers alike.

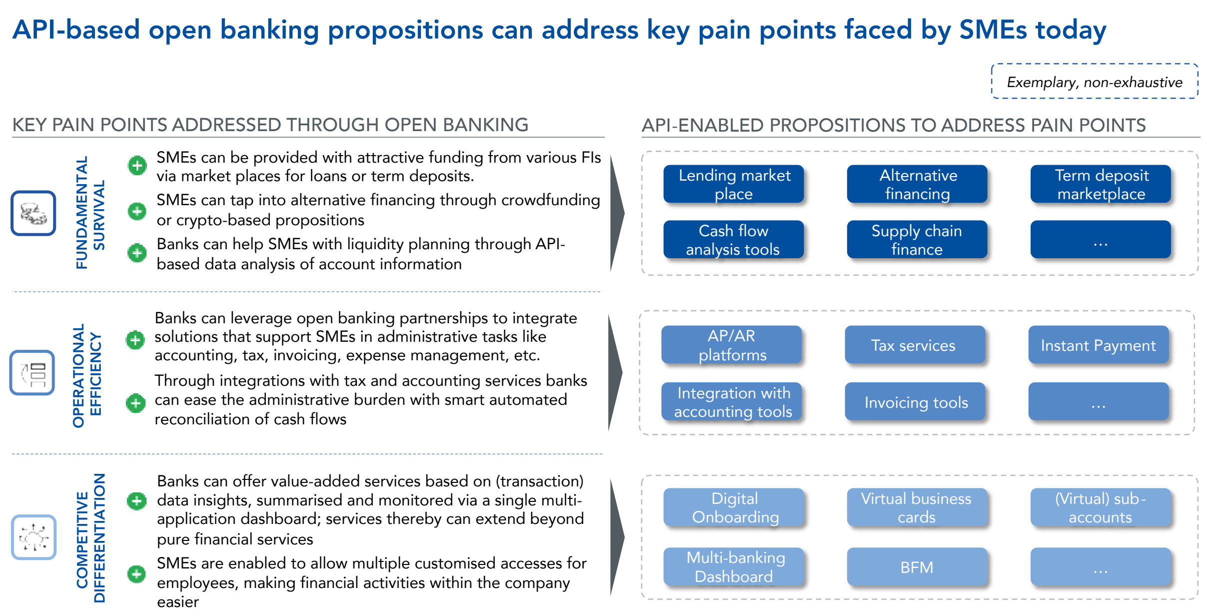
5.2 HOW OPEN BANKING ADDRESSES SME PAIN POINTS

The adoption of Open Banking-based services not only generates benefits for all players involved (as detailed in Figure 5) but addresses the most relevant SME pain points in particular.

This is mainly due to emerging propositions that rely on data being shared between all three types of participants via standardised interfaces. As a result, SMEs benefit from real-time, multi-bank account views, instant decision-making with regard to loan applications, significant time and cost savings due to automated processing and integrated tools for accounting, invoicing and payments, as well as additional value-added insights and services.

Open Banking allows banks to engage with third party providers in strategies that involve either providing or using data, products and services, depending on the chosen strategy and positioning.

FIGURE 6 **OPEN BANKING ADDRESSING SME PAIN POINTS**



Source : INNOPAY analysis

5.3 A walk through possible Open Banking strategies for SMEs based on an indirect distribution model

Open Banking strategies that involve providing data, products or services via APIs or other means can be differentiated in API-as-a-Channel, API-as-a-Product, Banking-as-a-Service, and embedded finance approaches. Except for API-as-a-Channel, these approaches relate to an indirect distribution model that aims to leverage third parties to reach new customers. At the same time, these approaches can blend into each other and act in combination in practice.

API-as-a-Channel provider

An API-as-a-Channel provider focuses on the digitisation and “API-fication” of banking products and services. This approach sees APIs as a new access channel next to or replacing existing channels such as physical banking, online banking or data exchange channels such as host-to-host, or specific protocols such as EBICS. Several leading banks have started to implement an “API-first” policy to mandate every new product or service development to be enabled by APIs. Others work with their business or corporate customers to specifically identify needs and use cases that can be served or improved by APIs.

APIs also can improve the performance or quality of existing products as compared to other channels and enable real-time, on-demand functionality and access to information. An example is an API that provides access to intra-day liquidity reporting or allows for the pre-validation of payments.

API banking can be used to directly target larger SMEs and corporates that can integrate APIs themselves or via their technical service providers. It also constitutes a foundation for Banking-as-a-Service and embedded finance approaches detailed below.

API-as-a-Product provider

With API-as-a-Product, a bank makes available data as input for third party products, services, or processes. An increasing number of banks are developing API data products and make them available via their developer portals. One example, among many others, is a bank offering an API to third parties to retrieve validated address information of their customers with their consent.

Beyond data, banks develop API-powered white-label products or services such as AML checks, sanction screening, or smart data algorithms. An example would be a bank offering an API-based solvency check to third parties based on analysing customers’ transaction data.

These API products are usually not specifically designed for SMEs. However, they can be a valuable component for SME propositions. Furthermore, by offering products and services based on its unique assets and strengths, a provider can effectively participate in value creation for client segments that are not the core focus or enable complementary services for customers.

Banking-as-a-Service (BaaS) provider

As a Banking-as-a-Service (BaaS) provider a bank not only provides individual products and services but rather is making a broad range of banking products and services, such as accounts, payments, and cards, available as a white label offering based on its own license so that non-banks can “repackage” these services into targeted banking propositions. This allows fintechs with a highly vertical SME offering to leverage core banking capabilities while focusing on tailoring user experience and additional services to the target group. One example is the collaboration between Solarisbank as a white-label BaaS provider and the SME banking service Penta. Likewise, a BaaS provider can also enable third parties with complementary business models, such as account software providers, to provide credit cards or a current account in addition to its core offering.

For banks pursuing a BaaS strategy, the focus is on leveraging a highly flexible, scalable, and efficient banking infrastructure by making it available via APIs, while reaching scale via multiple partners that provide access to a broad range of end customers.

Embedded Finance Provider

The previous three Banking-as-a-Service strategies focus on making data or capabilities available to empower third-party providers to build or improve end user propositions. An embedded finance provider approach is fundamentally different: it leverages third party propositions, channels, or user journeys to embed banking services and offer them to customers in a context and environment where these services add immediate value. An example is embedding a lending product for SMEs inside an online B2B marketplace, as for example in the partnership between ING and Amazon.[22] Typically, embedded finance offerings are co-branded, making a direct relationship between bank and SME customers possible from the start.

The strategic intent of an embedded finance provider approach is to broaden both the reach to and relevance for specific customer groups.

[22] In this example, Amazon acts as broker presenting loan proposals to eligible sellers who are then redirected to ING’s website to submit a loan application. See also infobox in chapter 5.6 and https://www.ing.com/Newsroom/News/ING-in-Germany-and-Amazon-join-forces-in-SME-lending.htm

5.4 A walk through possible Open Banking strategies for SMEs based on a direct distribution model

The flipside of the provider-side strategies is the use of third-party data, capabilities, product, and services to enable, improve, complement, or render more attractive one's own value proposition – or underlying processes – for customers. At the core, the strategic intent of any "incorporating" open banking strategy is to increase the quality of service for customers by broadening the range of products and services offered. The approaches may range from simply incorporating data and capability to a full "Banking-as-a-Platform" strategy including one-stop-shop and marketplace approaches.

Data Miner

As a data miner a bank incorporates and possibly aggregates data via APIs from other banks, partner, or third-party sources, driving insights or adding value to its own SME products. A typical example is the aggregation of account data from other banks to provide a single and complete view of an SME's financial position. However, this approach can extend well beyond banking data. For example, a bank could use and prepare data relevant for ESG compliance and reporting, such as CO_2 footprints of supplier organisations, as a service for its SME customers.

Capability builder

As a capability builder, the counterpart to the capability provider approach, a bank integrates third party capabilities or services into its own processes or products to enrich its proposition or improve user experience. One example would be a bank connecting to an external KYC database or service provider to speed up the SME onboarding process. Another example is the use of specialised Software-as-a-Service solutions to digitise and automate the lending process for SMEs. Integrating external capabilities can be a key differentiator in meeting the needs of SMEs in terms of speed, convenience, and service depth.

One-stop-shop

Banks that act as a one-stop-shop aim to provide a complete set of products and services to address a broad range of needs in their target segment. To do that, banks develop or, more often, integrate from one or multiple third parties additional white-label services beyond typical banking products. An example would be providing a business intelligence dashboard and additional financial management tools to smaller companies. Providers such as for example BankiFi, Strands, or Comarch offer complete white-label product suites for SMEs that banks can offer their customers to support them in cash forecasting, accounting, billing, collections, and other areas.

Banks pursue a one-stop-shop strategy to extend value creation for SME customers, intensify their customer relationships and effectively cover a broader range of the needs of SMEs as described in chapter 3.

Marketplace

Finally, a marketplace strategy consists of orchestrating a platform of own and (co-)branded third party services, acting as a matchmaker for supply and demand. With this approach, banks aim to create and coordinate an ecosystem of partners to provide a broad range of potential solutions for their customers. If executed well, it can benefit from cross-sided network effects, the platform gaining in value as it attracts more customers and providers.

Many banks that have launched API developer portals in the last years, are proceeding to integrate third party API propositions in a move to transform their API portals into service marketplaces. Other examples targeted at SMEs operate a marketplace with a range of third-party services ready for integration for a broad range of SME topics including accounting, payments, insurance, pensions, HR, loyalty, and more.

5.5 ONE SIZE DOES NOT FIT ALL

The Open Banking strategies listed above are neither mutually exclusive nor should they be a goal in themselves – rather, they can and should be combined to best support a bank's SME banking strategy. The diversity and heterogeneous nature of the SME segment and the different needs of small business owners and medium-sized enterprises call for a combination of different Open Banking approaches which are more likely to deliver value for each of these.

Micro and small businesses' core needs are easy and timely access to funding, a convenient, multichannel banking experience and support with non-core financial and operational activities. For banks aiming to target these customer groups, Banking-as-a-Platform strategies can be essential building blocks to create a compelling small business-proposition beyond classical banking services. Pursuing data miner and capability builder strategies by using third party technology and processes to speed up the loan application process while accessing and analysing additional data sources to make better lending decisions.

FIGURE 7 **OPEN BANKING STRATEGIES FOR SME BANKING**

Eight different Open Banking strategies for SME banking, centred around "Banking as a Service" and "Banking as a Platform"

"BANKING AS A SERVICE" STRATEGIES

BANK → 3RD PARTY → SME CUSTOMER

DATA PROVIDER Make available bank and customer data to third parties as input to their products and services	EXAMPLE *Bank offers an API to retrieve KYC-proofed company data from customers*
CAPABILITY PROVIDER Provide access to white-label capabilities (e.g. payment transactions, fraud mgt, risk mgt, AML check, sanction screening, algorithms) to third parties	EXAMPLE *Bank offers an API-based solvency check based on analysing transaction data to third parties*
FULL BaaS PROVIDER Provide range of banking products (e.g. current account, payments, cards) as complete white-label offering to third parties	EXAMPLE *Bank powers not under license mobile banking app provider targeting SMEs*
EMBEDDED FINANCE PROVIDER Embed banking products (e.g. loans) in third party propositions, channels or user journeys, usually co-branded	EXAMPLE *Bank embeds SME lending proposition in B2B online marketplace checkout flow*

"BANKING AS A PLATFORM" STRATEGIES

3RD PARTY → BANK → SME CUSTOMER

DATA MINER Aggregate data via APIs from other banks, partner or third party sources, driving insight and/or empowering/adding value to own products	EXAMPLE *Bank aggregates account data across banks to provide single view to SME*
CAPABILITY BUILDER Integrate third party capabilities or services in own processes or products to enrich proposition or improve user experience	EXAMPLE *Bank connects to external KYC database to speed up SME onboarding*
ONE-STOP-SHOP Provide a complete set of products and services to cover a broad set of needs of the target segment, integrating white-label products from one or more third parties	EXAMPLE *Bank provides white-label business intelligence dashboard to SME*
MARKETPLACE Orchestrate a platform of own and (co-)branded third party services to act as match-maker for supply and demand	EXAMPLE *Bank offers marketplace with integrations to ext. services around accounting & payments*

Source : INNOPAY analysis

As small enterprises have little time or interest in dealing with a multitude of providers, providers have an opportunity to position themselves as one-stop-shops in this segment, leveraging one of the growing numbers of “as-a-Service” white-label providers.

For the more complex financial needs of larger SMEs with activities across countries and dedicated finance departments, other strategies may be more promising. To support their cash management activities across accounts at multiple financial institutions, providers can position themselves as aggregators to provide a single view and touchpoint for their customers.

However, as companies grow larger, dedicated treasury management and ERP systems are used to steer the business. A viable customer strategy towards these companies could be to partner with and integrate relevant system providers using APIs to provide real-time information and functionality for the most important banking activities, effectively applying a similar approach as for corporate customers.

SMEs at the larger end of the scale are also more likely to have their own IT resources and capabilities, enabling them to directly incorporate APIs and integrate services. Making APIs and external services available through a marketplace model for direct use by SME customer can become an attractive option in this segment.

5.6 THE IMPORTANCE OF PARTNERING

In 2017, a global survey among banks showed partnering with fintechs was considered the most important way to go about product and channel innovation – ahead of buying, renting and making – and would become even more dominant in the future.[23] In 2020, another international survey confirmed that nine out of ten financial institutions consider fintech collaboration as a key driver for their success as a company.[24] The fact that collaboration has become the most predominant fintech mode of operation is also witnessed in a relative growth of B2B2C or B2B2B fintech business models.

Prerequisites for successful collaboration include addressing key challenges which relate to technology, governance, mutual management support and last, but not least, working culture.

After several years of increasing activity in Open Banking, experience from some of the leading “open banks” suggests that focus on concrete partnerships and use cases is a strong driver of success of Open Banking initiatives. Successful initiatives that have proven to work with one partner may have the potential to scale and be applied to other contexts in the future.

[23] Source: KPMG International Global Fintech Survey, 2017

[24] Finastra Open Banking and collaboration: State of the nation survey 2020

Info box: Three examples of bank-(fin)tech partnerships

ING AND AMAZON.DE – EMBEDDED LENDING COLLABORATION

In 2020, ING Germany and Amazon launched a cooperation regarding the brokerage of bank loans to SMEs selling on the Amazon platform as part of ING Germany's strategic focus on the business segment in addition to its consumer banking business. In this cooperation – one of the first of its kind – Amazon offers ING business loans to eligible sellers. In this example of an embedded finance approach, Amazon provides reach through its platform while ING retains the customer interface and remains in full commercial control of the loan agreement. For the technical integration and execution, ING leverages the previously acquired credit fintech Lendico.

THE CO-OPERATIVE BANK AND BANKIFI – ONE-STOP-SHOP FOR CASH-SENSITIVE SMALL BUSINESSES

Micro and small businesses are especially vulnerable to liquidity shortages due to late payment, an issue that has been worsened by the pandemic. UK-based Co-operative Bank decided to add a fully-fledged solution to its product portfolio addressing the late payment problem. In collaboration with white-label solution provider BankiFi the bank launched a request-to-pay service called Incoming based on UK Open Banking payment initiation that allows small businesses issue payment requests to their buyers, including invoice handling and reconciliation. This helps SMEs to boost cash flow and collect payments more effectively and quickly. Next to serving their own customers, the Co-operative Bank and BankiFi also offer the service as a white-label solution to third parties.

DBS AND SLEEK – FULL END-TO-END SME SERVICING FOR STARTING BUSINESSES

When setting up a business, apart from the obvious business-related activities, a lot of administration needs to be put in place before the business can launch. Especially for smaller companies, this is often very time-consuming and costly. To support businesses with these critical activities, DBS has partnered with Sleek, a fintech that offers administration support for start-ups when setting up their business. By expanding their SME banking platform with additional services, DBS can attract SMEs before they even go-live with their business and can serve potentially all SME needs, ranging from setting up the business to providing loans.

5.7 COLLABORATIVE OPEN DATA CONSIDERATIONS FOR THE SME SECTOR

Based on regulatory developments, such as PSD2, industry initiatives, such as Open Banking UK or the Berlin Group, have enabled SMEs to share their account data with third parties. In their practical product implementation enabling this data sharing via APIs, banks as well as other industry players have been following different strategies. Yet, the digital data footprint of SMEs is becoming ever larger and with it the potential of making this data shareable for purposes benefitting the SMEs. Faced with the adverse selection problem due to a lack of transparency and insight, being able to share data beyond the bank account in an easy and standardised way across economic actors could vastly improve the environment and conditions for SME lending on a broad scale.

To put this into practice, a standardised scheme would need to be developed, allowing data sharing with permission from SMEs from a variety of sources via standardised APIs, resulting in a “portable credit file” that lenders can use to easily assess credit worthiness and make competitive lending offers. In 2020, the Bank of England has developed a high-level proposal for the development of such a data sharing scheme.[25]

[25] https://www.bankofengland.co.uk/-/media/boe/files/fintech/open-data-for-sme-finance.pdf

A similar approach initiated by multiple governments in the Nordics is already in implementation: The Nordic Smart Government Initiative has declared as its goal to simplify the lives of SMEs and to create new business opportunities and growth based on economic data. Its aim is to have 80% of business systems used by Nordic SMEs to support free data sharing with prior consent between them. Access to in-depth data and real-time information about SMEs will help the financial sector to make faster and more adequate credit decisions, benefitting SMEs and credit providers alike.

6. SUCCESS FACTORS FOR REAPING THE POTENTIAL OF OPEN BANKING FOR SMEs

Open Banking can be a decisive enabler for financial service providers' SME businesses going forward. But it needs to be embedded in a broader transformation and consideration of success factors to leverage its full potential.

The Open Banking Working Group's (OBWG) previous report "Ready or Not: Gearing the bank operating model towards digital and Open Banking readiness" provides an in-depth account of operating model transformation requirements in light of Open Banking.[26]

6.1 ADOPTING AN ENABLING (DIGITAL) OPERATING MODEL

The Open Banking approaches described in the previous chapter are more than mere strategies – they require a fully-fledged digital operating model. For financial service providers with a traditional operating model and a great deal of legacy IT infrastructure, such as many banks, this requires a fundamental rethinking and a broader transformation journey.

From an IT infrastructure perspective, these banks need to develop a fundamental capability to flexibly develop, deploy and combine products and services based on (internal) APIs and a modular, micro-service-based technology stack. In combination with this, they need to rethink their approach to data, develop a sound data strategy, data policies and undergo a thorough exercise of cleaning up and structuring their data to make these digitally available, accessible and usable.

An enabling digital operating model also includes cultural aspects, an agile organisational setup, and the digitalisation of processes as core ingredients of transformation. Experience shows that the implementation of Open Banking business models requires in-depth consideration of the implications of the selected operating model in aspects such as product strategy, roles and responsibilities, and incentive-setting.

6.2 OPENING THE MINDSET TOWARDS SMEs

Perhaps most fundamentally, financial service providers need to adapt their mindset towards SMEs and treat them as a stand-alone and diverse customer segment. Rather than consider SME services a by-product of other business lines, they need to adopt a customer-centric view that aims to understand the complexity and diversity within the SME segment, look at its different subsegments by business area, size or maturity stage, and uncover their true needs and pain points.

6.3 POSSIBLE MARKET STRATEGIES WITH RESULTING BUY, BUILD OR COOPERATE DECISIONS

Specific Open Banking approaches for SMEs need to go hand in hand with an overall strategy for the segment and a clear analysis of "where to play" and "how to win". To support a chosen overall strategy, financial service providers will have to determine, for example, which products or services to develop inhouse and which ones to insource. This will, for instance, also be relevant for decisions on whether to use one's

[26] Source: https://www.abe-eba.eu/thought-leadership-innovation/open-banking-working-group/, available for download for EBA members

own or third-party channels as well as external and/or internal data sources.

Decisions on an embedded finance approach for SMEs will, as buy or build decisions, be key foundations for a chosen strategy. The role of financial services embedded in existing platforms with deep customer engagement and far reach in given target groups will continue to grow. Deciding upon an embedded finance approach for SMEs will become one of the key market strategy decisions.

6.4 STRONG OMNICHANNEL EXPERIENCE

As SME customers increasingly move to digital services and more digital business models, they also expect similar experiences from their financial service providers. During the pandemic, SMEs have accelerated their move towards online and mobile banking, much like retail customers. Financial service providers need to reflect this shift with a strengthening of digital channels, tools, and user experience. At the same time, these providers need to acknowledge different degrees of digital savviness in the SME segment and ensure that the concerns and challenges of less IT literate organisations are addressed as well, both in the setup of digital channels as well as through continued personal support and advice.

6.5 SME FUNDAMENTALS

To begin with, financial service providers need to aim at providing excellent core banking services to SMEs as a baseline to build upon. For example, easing the onboarding process, possibly with the support of external partners, can lay the foundation for customer loyalty.

Customer onboarding is considered by a large share of SMEs as suboptimal, with tedious processes and long onboarding lead times being key issues.[27] Account opening procedures for companies in foundation are typically seen as especially complicated, often leading to customer frustration at the outset of the business relationships.

Hassle-free initiation and receipt of payments with low, transparent fees are of fundamental importance to get right. Real-time payments become more important. Furthermore, access to financing being a key issue for SMEs, easy loan applications and fast and transparent credit decisions are equally important.

27 According to one survey, 84% of SMEs in the UK have had a bad experience with KYC procedures at banks (source: https://internationalbanker.com/technology/business-banking-cannot-be-disrupted-without-digital-in-onboarding/)

7. CONCLUSIONS AND OUTLOOK

The entry of tech and other players offering targeted solutions based on new technologies has introduced a new dynamic in the SME sector. The unlocking of new opportunities for this customer segment has been further driven by the sector's accelerated move towards digitalisation.

Open Banking provides a series of instruments around Banking-as-as-Platform, Banking-as-a-Service and embedded finance that enable financial service providers to implement a more tailored, and thus more effective, SME strategy and leverage in various ways the rich and growing SME provider ecosystem. Engaging with and making use of ecosystem partnerships is an essential element, as is the principle that a "one size fits all" approach needs to be abandoned in the SME segment – Open Banking can support micro-SMEs in different ways than large cap SMEs whose needs resemble much more those of corporates.

While providers are continuing to find more innovative ways to alleviate SMEs' most pressing issue, namely financing, by process innovation and leveraging additional data, the sector also needs to look at collaborative ways to address this issue. Several initiatives across Europe are being implemented or discussed to push standardised SME data sharing with the goal of creating more transparency and a level playing field for SME credit decisions. It should be in the interest of all ecosystem players and stakeholders to closely follow and support such cross-sector initiatives going forward.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