How Small Banks Can Grow Their Share of the Small-Business Markets

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INTRODUCTION

Banks have a tremendous opportunity to deepen relationships with and generate untapped revenue from the highly sought after yet underserved small-business customer segment. These customers are far more sophisticated in their banking needs and comfortable with technology than they were in the past. Despite that, most banks maintain past strategies of serving customers from consumer banking platforms, which lack the products and services they need, thus leaving them underwhelmed and feeling as though they have to seek out fintech companies to fill bank gaps. More than 60% of small businesses have already partnered with a fintech company to meet at least one financial need while more than 70% believe their banks don't truly understand their needs.

Small banks, in particular, have much to gain by more effectively serving this customer segment. These banks are well-positioned to provide the type of custom experience small businesses seek and are often active members of the local community, which these customers highly regard. Unfortunately, such advantages are often not leveraged, as small banks are far less likely than their larger bank counterparts to enjoy success with small businesses. Achieving greater success requires them to not only offer the right product portfolio but to also change their mindset and adopt a more forward-looking digital banking experience and strategy.

This white paper was commissioned by Q2 and produced by Aite Group to analyze the evolving small-business banking market and highlight what small banks must do to enjoy greater success with this critical and potentially lucrative customer segment.

METHODOLOGY

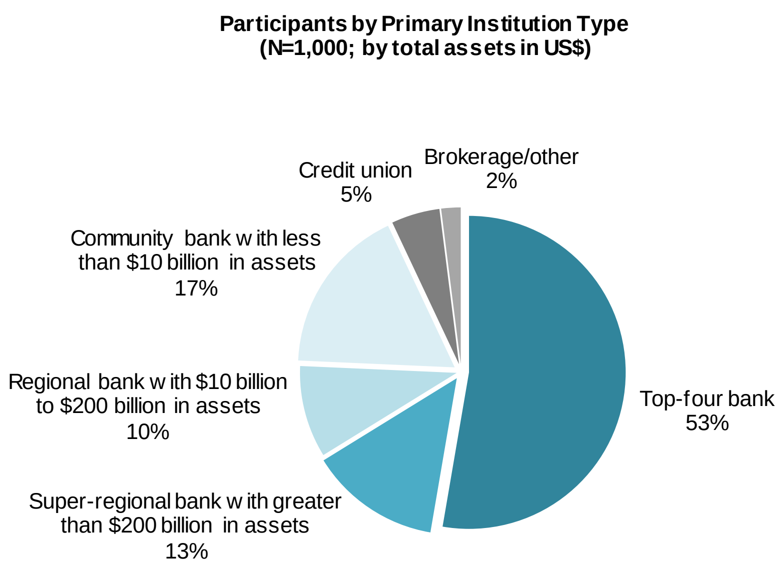
The information in this paper is primarily based on the results of a June to July 2017 Aite Group survey of 1,000 U.S.-based businesses generating between US$100,000 and US$20 million in annual revenue, the segment referred to throughout this paper as "small business." A survey of this size offers a 3-point margin of error at a 95% confidence level. It also leverages the analyst's deep understanding of bank strategies and the evolution of digital banking capabilities.

TODAY'S REALITY

More than half (53%) of U.S.-based small businesses are generating between US$100,000 and US$20 million in annual revenue, with one of the four largest banks ranked by total assets (Bank of America, Citi, JPMorgan Chase, and Wells Fargo—referred to within this white paper as the top-four banks). These banks enjoy large geographic footprints, strong brand recognition, and deep wallets for new products and technology development. Their large IT budgets often enable early rollouts of new technologies and the ability to be more innovative, both of which are extremely important to today's tech-savvy small-business customers.

Only 17% of small businesses consider a bank with less than US$10 billion in assets (referred to within this paper as community banks) to be their primary bank, despite approximately 90% of U.S. banks falling within the asset category. These institutions have the potential to not only increase their market share but to also, and more importantly, see greater success with the customers they serve (Figure 1).

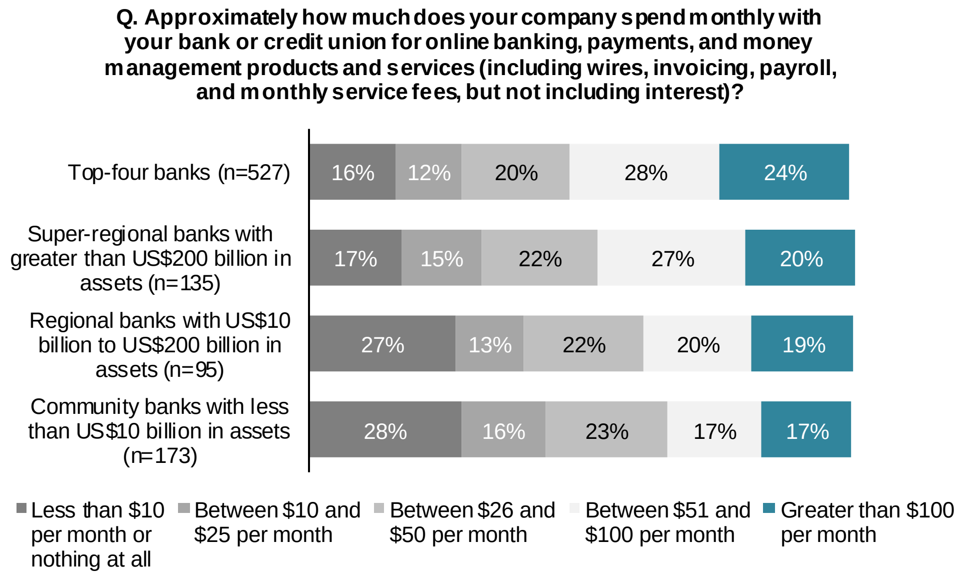
Figure 1: Primary Financial Institution



Source: Aite Group survey of 1,000 U.S. businesses generating between US$100,000 and US$20 million in revenue, June to July 2017

The largest banks have also been more effective at communicating the value proposition of their products and recognize the potential source of untapped revenue small businesses offer, while community banks are more likely to leave money on the table by believing they have to give products away. As such, community bank customers are more likely to pay less than US$10 per month or nothing at all to their banks than are top-four and super-regional bank customers. Twenty-eight percent of community bank customers fit this description, compared to only 16% of top-four bank customers and 17% of super-regional bank customers (Figure 2). This is also due in part to a greater likelihood of community banks to serve the lower end of the segment from a revenue standpoint and to have a narrower breadth of product offerings than larger banks. Such factors often limit opportunities to justify a fee.

Figure 2: Monthly Spend

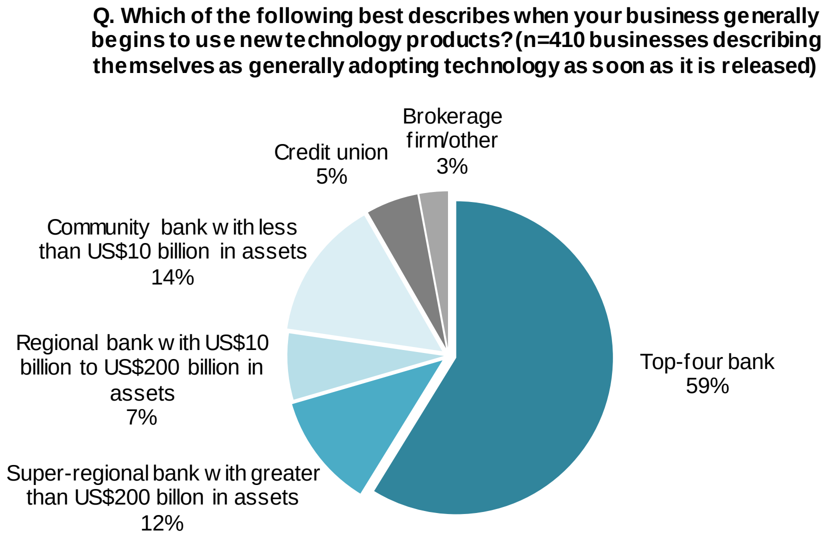


Source: Aite Group survey of 1,000 U.S. businesses generating between US$100,000 and US$20 million in revenue, June to July 2017

Small businesses are willing to pay for the right products and services, especially those that save them time and increase convenience, but many community banks have been slower to offer such products to these customers. This is largely due to their tendency to treat small businesses like consumers by serving them from consumer online banking platforms that don't offer the business capabilities they need, such as positive pay, more sophisticated electronic payments options beyond basic bill pay, entitlement capabilities, international payments, and payroll.

The failure to serve small businesses more business capabilities and digital options will grow more problematic in time as customer needs and technology expectations continue to advance. We already see evidence of this. For example, the percentage of today's small businesses claiming to adopt new technologies as soon as they are available is 41% versus just 15% in 2011. Further, the sophistication of a bank's digital capabilities is an important consideration for these customers as they select new bank partners. This trend is already challenging community banks with the wrong digital platforms by preventing them from winning the business of tech-savvy customers. Only 14% of tech-savvy small businesses claim a community bank is their primary bank versus 59% of which claim a top-four bank (Figure 3). Tech-savvy customers use more products and spend more money with their bank than do less tech-savvy ones; thus an inability to win their business negatively impacts a bank's bottom line.

Figure 3: Speed of Technology Adoption

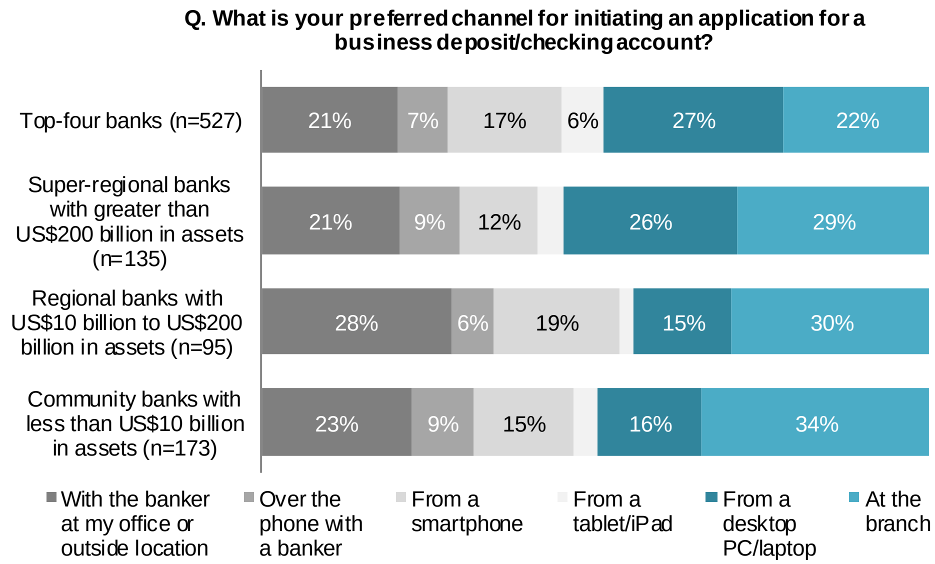


Source: Aite Group survey of 1,000 U.S. businesses generating between US$100,000 and US$20 million in revenue, June to July 2017

Not surprisingly, speed of technology adoption is even faster among millennial-run companies, an important subsegment within this customer base for which we also see smaller banks falling short. Among millennial-run businesses participating in our study, 62% consider a top-four bank to be their primary financial institution over any other bank type. These businesses represent the future of the banking industry, and thus winning their business and being able to address their needs is critical to future success.

As the top-four banks are serving tech-savvy customers and millennials, community banks are instead most likely to win the business of customers who are more expensive to serve and prefer the branch channel for even basic transactions, such as opening a checking account (Figure 4). While banks must also look for ways to more effectively provide the high-touch level of service some customers desire for more complex transactions, the more straightforward and basic ones should be moved to self-service digital channels for greater cost efficiency and scale. A high-touch service model is not scalable for serving the more than 25 million small businesses operating in the United States. Community banks relying heavily on their branches to serve small-business customers are not on the winning side of the cost-efficiency equation.

Figure 4: Channel Preferences



Source: Aite Group survey of 1,000 U.S. businesses generating between US$100,000 and US$20 million in revenue, June to July 2017

Given the data presented, Aite Group concludes that community banks continuing along their current path are not well-positioned for future success in the small-business banking space. Further, at a time when fintech companies are introducing new and innovative products and services that are wowing the small-business community and threatening potential disintermediation of banks, institutions not quickly evolving their strategies are offerings risk looking dated and out of touch. Only 18% of community bank customers rate their primary banks as being innovative and ahead of the curve. This practice of status quo banking makes it difficult for community banks to grow market share and remain competitive, a challenge that will only grow in time as other banks increase their focus and investment in this customer segment.

CHANGE IS NEEDED

There is no question that change is needed. The good news is most banks realize this. Small-business strategies must evolve, product portfolios must broaden, and technology must be modernized. This section provides insights and recommendations into the areas in which banks should focus over the coming months.

MIGRATE SMALL BUSINESSES ONTO THE RIGHT DIGITAL PLATFORM

First and foremost, small businesses are businesses and must be treated as such. As stated previously, most small banks erroneously serve small businesses from consumer platforms that ineffectively meet their needs and lack the business capabilities they require. Those banks doing so must begin migrating these customers onto more commercially focused business platforms capable of growing with the customer as their needs advance. Payment centers providing a single location to initiate and view different payment types; entitlement capabilities that enable different individuals to initiate and approve transactions; money management tools to more effectively manage, view, and forecast cashflows; and fraud prevention tools to protect their business are needed by today's small-business customers.

While functionality is critical, the platform must also be intuitive and easy for small businesses to use. Tools such as payment wizards with rules-based engines and customized workflows designed with small-business users in mind will help them navigate through complex processes. While businesses are increasingly adopting different types of electronic payment options, such as wires, ACH, and business bill pay, 60% are not confident they are selecting the right payment type each time. The option to leverage some type of digital bank guidance would be looked upon favorably in such situations. Banks must also avoid past practices of taking a one-size-fits-all approach for a customer segment that expects an experience customized to their exact needs, as they get from online retailers in their personal lives. User-defined dashboards with the ability to select those tiles or widgets that meet their needs enable such an experience.

BETTER LEVERAGE ANALYTICS AND MACHINE LEARNING

Banks sit on a treasure trove of valuable data that often goes unutilized. Better leveraging analytics will enable banks to gain insights from that data to more effectively serve customers, demonstrate an understanding of their needs, and better predict the next product they will most likely need for greater cross-selling success. Analyzed data will also provide small-business end users with valuable information about their businesses to help protect them and prevent fraud, see how they compare against industry benchmarks, and create more accurate cash forecasts—a challenge that plagues many of them. Machine learning, when used in unison with data analytics, will further automate common tasks and processes and enable end users to more efficiently manage their businesses and enjoy a better digital experience.

ENHANCE MOBILE CAPABILITIES

The online channel is the channel small businesses most prefer for interacting with their banks. However, as mobile phones continue to play an important role in our personal lives, they are also increasingly being used by small businesses to manage their finances. Checking balances and transferring funds internally within a bank remain the most common mobile transaction types performed, but for small businesses, the ability to approve transactions offers the greatest value. Other use cases are also growing in popularity, especially as person-to-person payment vehicles, such as Venmo and Zelle, enjoy growing transaction volume. While most of us, regardless of age, have fallen victim to being lost without our phones, millennials are among the most common mobile phone owners and users of capabilities beyond simply making phone calls. Millennials have grown up with mobile devices; thus, it is not surprising that 58% of them would like to see their bank offer more mobile capabilities, compared to only 26% of businesses run by baby boomers. Other mobile capabilities small businesses are increasingly demanding include mobile capture and the ability to reset passwords, make payments, view invoices, and communicate with their bank through a mobile device. These devices are also increasingly being used for out-of-bank authentication and enhanced security through biometrics. More than 75% of small businesses consider the sophistication of a bank's mobile capabilities to be important or very important when selecting a new bank partner.

LEVERAGE FINTECH CAPABILITIES TO DEMONSTRATE GREATER INNOVATION

Among the various bank types, community banks are the least likely to be viewed as innovative by their small-business customers. While these institutions often do not have the resources to invest directly in or even vet fintech companies like their larger bank counterparts, they must put pressure on their digital banking providers to do so on their behalf. These partnerships will help them fill product gaps and better address new customer needs for capabilities beyond traditional banking. In fact, 68% of small businesses would like to see more bank/fintech partnerships. One way vendors can achieve this is through the creation of fintech ecosystems composed of pre-integrated capabilities with hand-picked partners. While system architectures must be open and able to easily integrate via APIs with other vendors a bank may prefer, such a model offers banks an easier option. Some vendors have already begun looking to identify leading fintech companies in different areas, such as invoicing/receivables management, forecasting, payroll, and expense management, but will also be looking for guidance from their bank customers to determine other potential areas of focus.

IDENTIFY NEW WAYS TO SERVICE AND COMMUNICATE WITH CUSTOMERS

Having the right product with a value proposition that resonates with small businesses is only half the battle. Banks must also be able to effectively get that message out to customers to lead to the greatest opportunity for sales. To do so, banks must understand the ways in which small businesses prefer to learn about new products and services and leverage those channels. Further, while good communication is key, banks must have an easy and intuitive onboarding process with self-service capabilities for small businesses.

Banks must also be prepared to alter the ways in which they communicate with customers as needs evolve, and they must have segment-specific strategies when it makes sense. For example, while business owners above the age of 52 are more likely to believe their banks are doing a good job at telling them about new products and services they can benefit from, almost three-quarters of millennial business owners believe their banks could be doing a better job. Banks must have a continuously evolving multichannel strategy for customer communication that leverages more traditional channels, such as pop-up alerts, online videos, and emailed information, while also exploring newer methods, such as online knowledge centers, chat capabilities, and video conferencing with a bank relationship manager, which customers are increasingly demanding.

FIND THE RIGHT TECHNOLOGY PARTNER

A bank's ability to achieve much of what has been recommended thus far is largely dependent on the technology it has in place and its partner for that technology. Community banks must find the right technology partner that enables the modern and user-friendly digital experience customers now expect. Small businesses compare the digital experience of one bank not only to another but also to their best digital experience in general (i.e., banks are being compared to Amazon.com). Modern and sophisticated digital capabilities are a top consideration for small businesses when selecting a new bank partner, and those unhappy with a bank's current capabilities are twice as likely to switch and go to another bank. A dated user interface gives the impression that a bank is not forward-looking. Vendor partners should also have a clearly communicated and forward-looking product roadmap that they can implement on time.

DON'T BE AFRAID TO CHARGE FOR THE RIGHT PRODUCTS AND SERVICES

Lastly, small banks must move beyond past beliefs that small businesses must be given products for free or that charging for products will be perceived as nickel and diming. Small businesses will and are paying for financial products with the right value propositions. Banks must roll out such capabilities with the right messaging so their value is clearly understood and business customers can justify paying for it.

CONCLUSION

Community banks have a tremendous opportunity to increase their small-business market share over the next few years. Their existing customers are often more loyal than those of other bank types, offering opportunities to deepen relationships with them while simultaneously acquiring new customers from larger bank counterparts looking for change. Almost 20% of small businesses state they are likely to consider switching primary financial institutions over the next two to three years. Taking advantage of this opportunity requires change, and while change is never easy or without risk, in the case of small-business banking, the opportunities far outweigh the risks.

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