THE DIGITAL BATTLE IN SME LENDING

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Incumbent banks are working hard across all markets to drive down costs and drive up customer service through a mix of digitization and new product offerings. In few places is this fight more pronounced than in the segment of small and medium-sized enterprise (SME) loans. In this segment, there is typically a confluence of cost and need. Multiple legacy systems and high human-touch service models bring cost, as well complexity and risk. They make historical approaches hard both to unwind and essential to address to improve customer experience. But are incumbent banks' innovation efforts in this space aimed at what customers want?

To answer this question, during Q2 2021 we conducted a survey of almost 1,000 small businesses, evenly distributed across China, Malaysia, Indonesia and Australia, asking them to share their experiences and preferences in accessing credit. Despite the many obvious differences between the markets, the respondents' needs were strikingly common.

- Major banks remain the dominant provider to this segment, with regional banks in second place, and fintech a distant yet significant and growing third.
- Across all markets, the speed and flexibility of the repayment terms are a must-have need, being consistently among the top three most valued aspects.
- Australia and Indonesia value an end-to-end digital experience, while Malaysia and China value the certainty that comes with pre-approved credit limits.
- The lion's share of funding in this segment across markets remains equity and traditional debt products, including property-based finance. However, in Australia, larger firms are more likely to also access working capital products, and trade and equipment financing.
- With the majority of SME owners across the four markets owning personal property, and at least about 30% of them using it as collateral for business-related loans, there is still a strong link between these owners' personal and business finances.
- In most markets, businesses view the requirement of a personal guarantee as one of the biggest pain points of the credit experience, further highlighting the interlinkages that can exist between SME owners' personal and business finances.

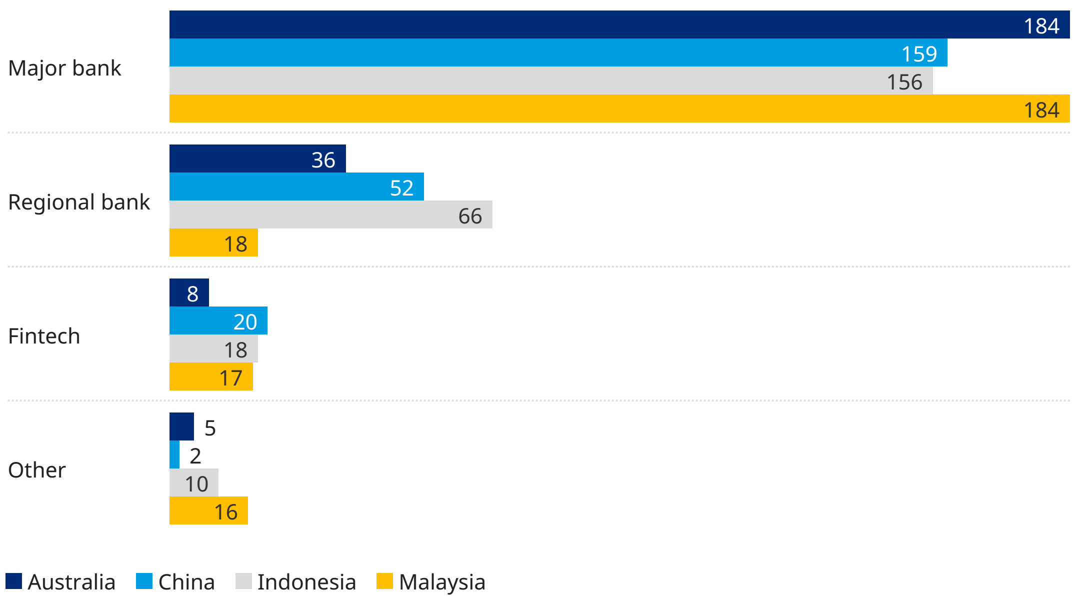
Based on this research, incumbent banks remain in the enviable position as the go-to provider of funding for SMEs. However, the data also reinforces the need to take the threat of fintech and monoline providers seriously, as they are especially advantaged in what customers want: greater speed in terms of making decisions, and potentially greater policy flexibility. Of unspoken value too is how incumbent banks can provide insight that leads to different financing options, such as working capital, and trade and equipment financing. Open banking regimes of different stages of maturity in the four countries will be vital for incumbent banks to provide the insights needed to educate the smallest firms on the breadth of options available to them, and the ways in which banks can service those needs.

INCUMBENT BANKS REMAIN AHEAD OF THE PACK

In all the geographical locations assessed, major and regional bank lending dominates the funding mix. Fintechs, however, have become a meaningful contributor, pushing towards as much as 10% of the reported funding outside Australia. This context makes it more important than ever for incumbent banks to understand and provide what customers want.

Exhibit 1: Credit Funding by Source

Survey responses by category and geography (n = 980)



Source: Oliver Wyman

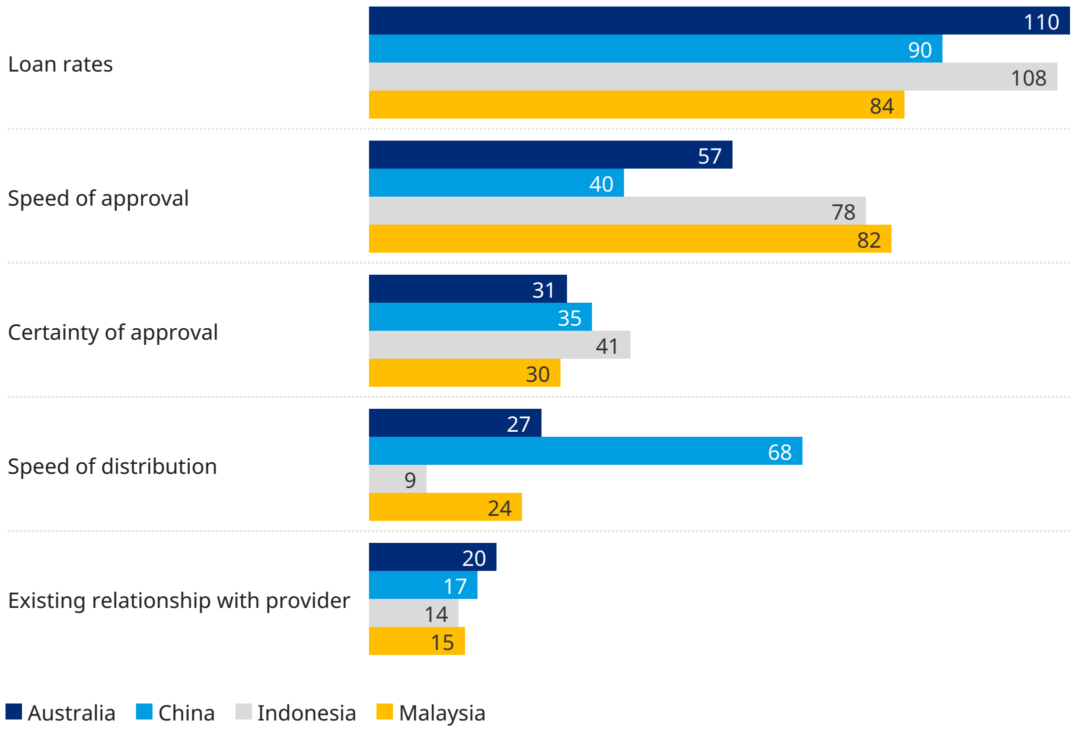
TIME-TO-DECISION IS CRITICAL

While price was reported as the most important factor in taking on new credit in all four markets, the time it takes to make a decision was consistently second. This suggests that unless there is a willingness to compete on price, time-to-decision is a must-win battleground. Inevitably this means that credit providers need to go digital, and further points to the fintech threat. This battle requires investment, linking-credit models and rule engines to open banking and cloud accounting to make approvals right upon or even before application.

Existing relationships came last in almost all countries, reinforcing the idea that incumbents must invest in the time-to-decision factor.

Exhibit 2: Most Important Factor in Taking On New Debt

Survey responses by category and geography (n = 980)



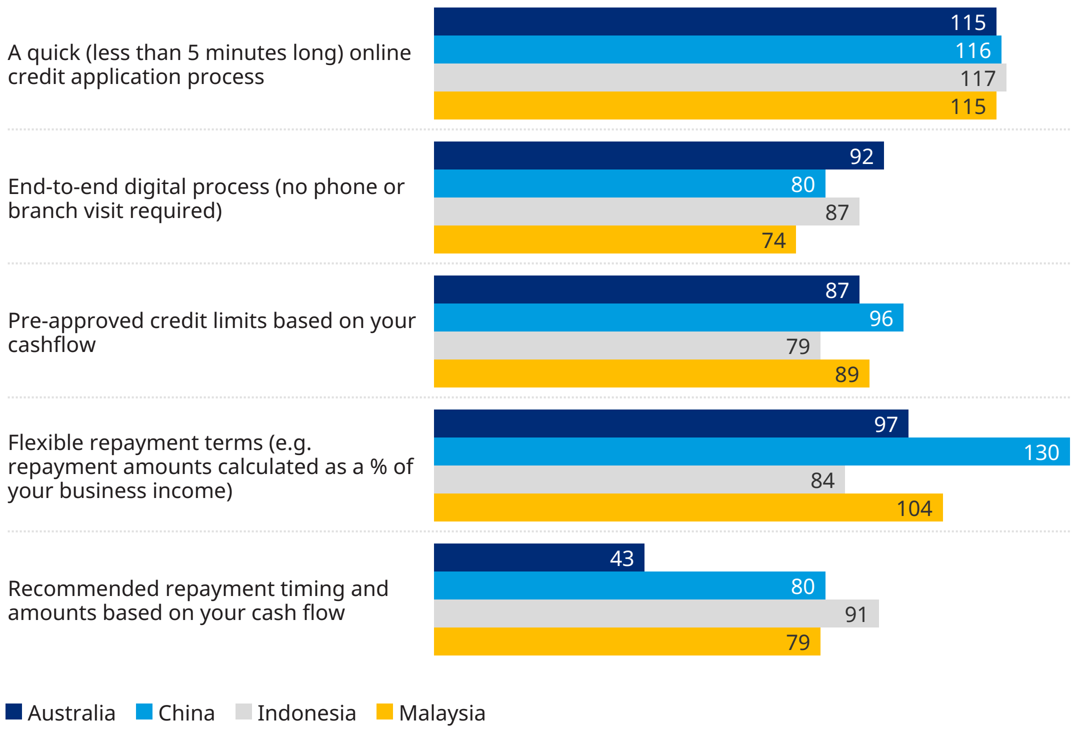
Source: Oliver Wyman

When thinking about the credit experience itself, the time it takes to make a decision again emerges, perhaps unsurprisingly, as number one. What is fascinating is the extent to which the sort of insights possible by smart credit processes would be appealing, if offered. Respondents were asked to rank the top three most desirable features of the credit process. Their answers saw nearly as many firms ranking insight-based features, such as terms and repayment timing recommendations based on the analysis of their cash flow, as the other options.

With the promise of open banking across the region, albeit presently at different stages, leaders are already investing in developing forward-looking credit assessments. These are based on 'always on' views of customer financials, balance sheets and P&L statements, fed by cloud accounting and transaction data. They position the provider to target all the features desired by the small businesses in our survey. An ancillary benefit to open banking and transaction-based analysis is the potential for forecasting cash flows and extracting one-off payments, such as tax, and crucially, COVID-based forms of temporary shock or support. Again, this space should be one where incumbents may have an advantage: the greater range of needs being serviced for a given customer, the easier the provider will find it to marry and interpret different data sources. Incumbents can already do this assessment and prepare themselves for the additional competition that will come as data becomes more freely available.

Exhibit 3: Most Desirable Features of the Credit Process[1]

Survey responses by category and geography (n = 980)



Source: Oliver Wyman

BALANCE SHEETS MAY REMAIN UNTAPPED

Secured and unsecured lending alongside credit cards are the top three sources of funding in our sample in all the geographical locations covered. Invoice financing and other forms of short-term working capital solutions are utilized much less. While fintechs are attacking this space (e.g. Timelio, Waddle, Taulia and others), the data collected suggests that there could be material untapped potential in the balance sheets of small businesses. Moreover, with the usage of these capital-efficient offers being so relatively limited at present, the opportunity to improve customer finances is likely marked.

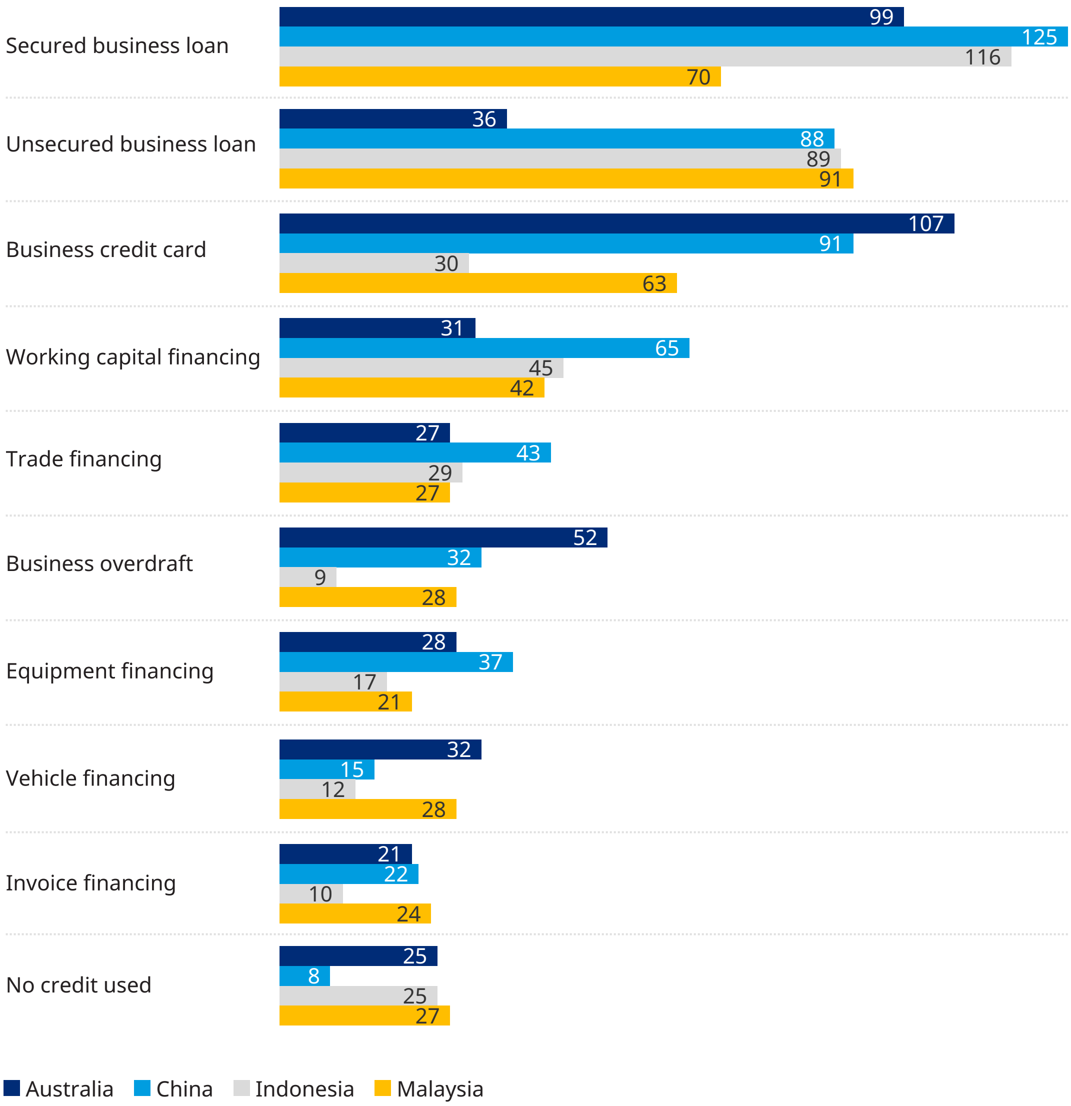
The use of different credit products does vary by market somewhat more than the features customers report that they want. While Australia is the greatest user of business credit card financing, larger firms there report themselves as more likely to use a range of working

1 Respondents were asked to select their top three most desirable features in the credit process. The data represented in this chart shows the number of respondents who selected the features shown as amongst their top three. These five categories received the most top three rankings across the whole sample. With between 235-250 firms in each country's sample size, the maximum that any category could receive was in this range. At least 30%, and often as many as 50% of the respondents rated these features as their top three in almost all countries.

capital solutions. China and, to some extent, Indonesia are more advanced generally in their use of working capital and trade financing. Malaysian firms, based on this data, place the greatest reliance on unsecured funding, and may therefore have the largest potential gains from restructuring their use of financing.

Exhibit 4: Types of Credit Accessed

Survey responses by category and geography (n = 980)



Source: Oliver Wyman

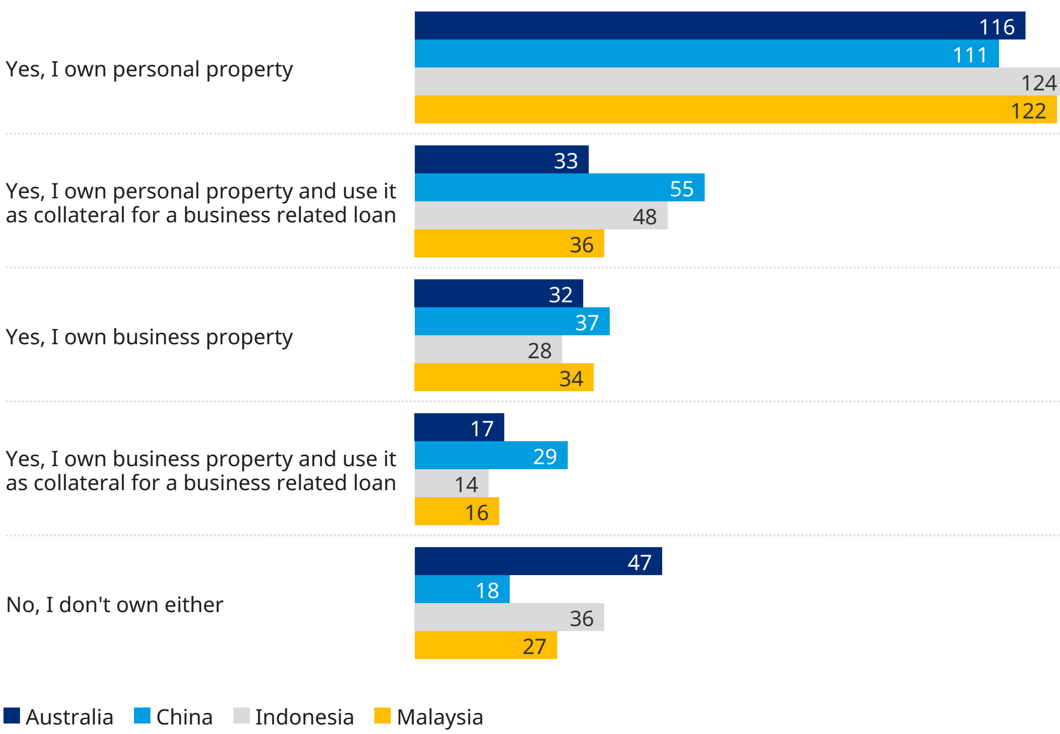
This again appeals to the value in 'always on' credit analysis. In some jurisdictions, the insight that flows from such analysis might fall foul of Financial Advice regulation. However, the opportunity to develop automated insight provision for the improvement to capital structures is intriguing. Open banking regimes can allow for this analysis to be provided at scale in a cost-effective fashion.

SAFE AS HOUSES?

Between 15% and 25% of small-business owners in our sample use their personal property as collateral for business activity, but almost 50% own personal property. Again, this points to the potential for credit providers to help small-business clients improve their overall funding, collateral and pricing mix. While tax rules and pricing structures will vary, for many business owners, using personal property as collateral could generate cost savings in their overall funding mix.

Exhibit 5: Property Collateral

Survey responses by category and geography (n = 980)



Source: Oliver Wyman

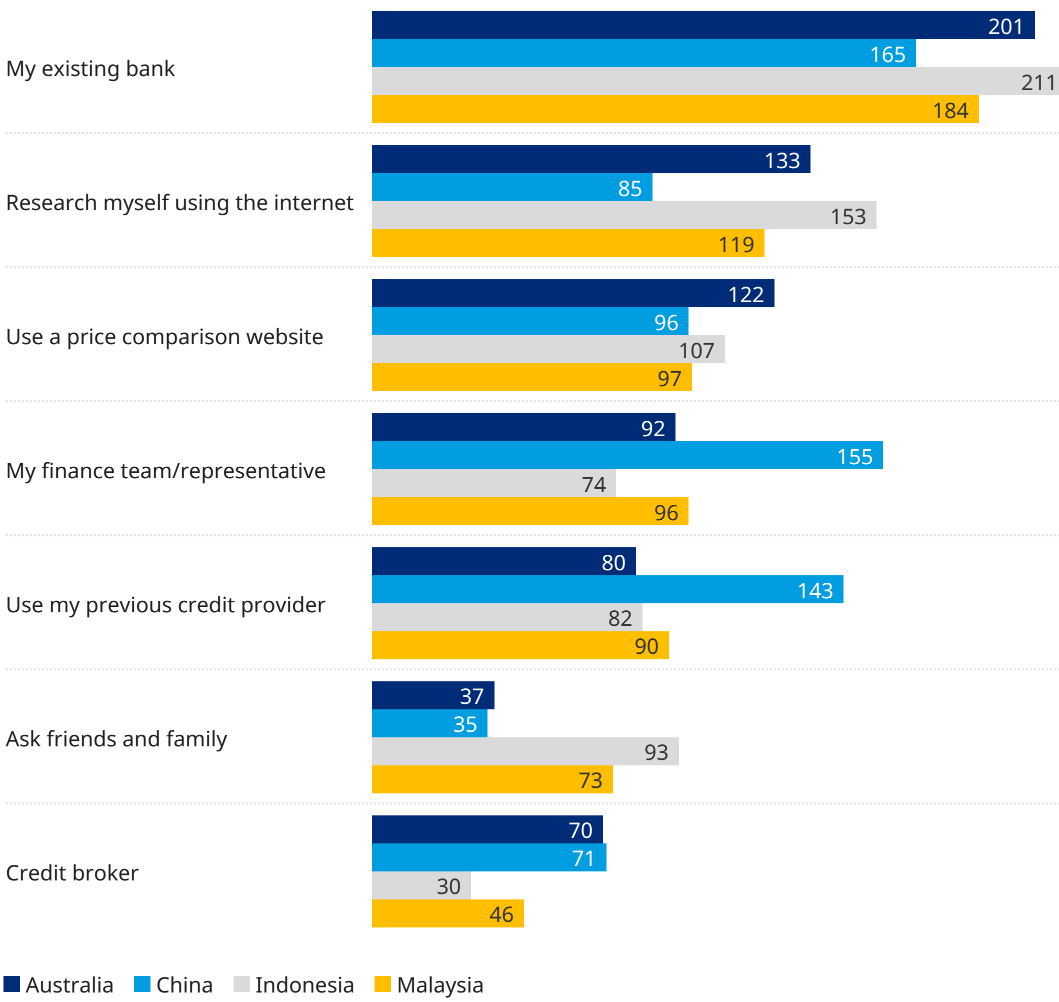
MAIN FINANCIAL INSTITUTIONS REMAIN FRONT OF MIND

Banks with pre-existing relationships are the top destination for firms in all geographies when looking for new credit. However, there is no room for complacency. With price listed as the top concern and speed as number two, existing banks can only thrive by providing a responsive experience and flexible options. If they do not change with the times, they risk losing primacy. Fintech-attacker propositions come with a low cost-to-income ratio, excellent customer experiences and quick time-to-money; they also benefit from being generally monoline, with simplicity on their side.

What incumbents have which fintechs lack include being front-of-mind, convenient and trusted, as well as having greater data access (certainly for existing-to-bank and potentially for new-to-bank) and a broader view of customer archetypes. The data show that many firms simply go to their existing provider. Moreover, major and regional banks typically have more than one and often several products with each customer. Nevertheless, unless incumbents are willing to fight on price, or customer service (which is typically expensive), our data suggests that they must invest in going digital to defend their primacy. Moreover, to be truly fruitful, any investment in digital needs to drive towards the sort of cash-flow-based insights for which customers yearn.

Exhibit 6: Sources of Finance — First Point of Call

Survey responses by category and geography (n = 980)



Source: Oliver Wyman

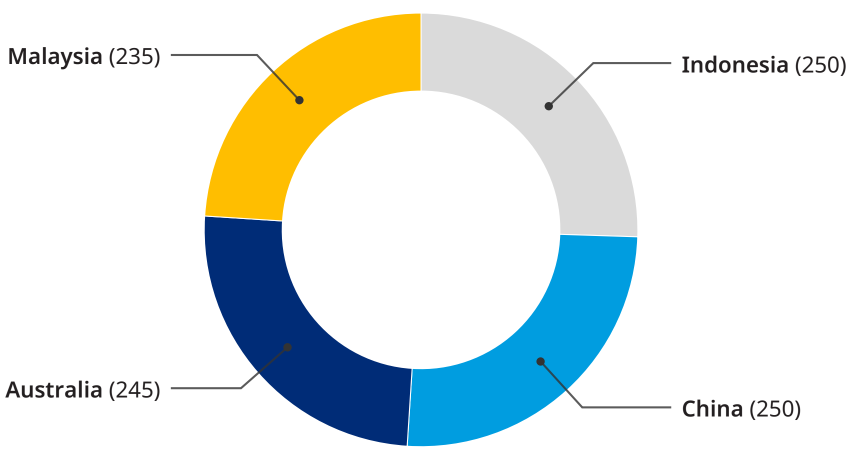
CONCLUSION

The needs and wants of small-business funding are remarkably similar, even across quite different economies in the Asia-Pacific region. Unless you want to be a low-cost provider, your primary focus should be to optimize your time-to-decision speed. Moreover, data is coming online through open banking regimes that allow providers to gain a rich understanding of customers ahead of time. Small businesses are hungry for the various types of insight you can offer, which will improve both their economics and yours.

APPENDIX: ABOUT THE SURVEY PARTICIPANTS

Our survey collected responses from 980 small-business representatives, split evenly across participating countries and industries.

Exhibit 7: Geographical split of participants (n = 980)



Source: Oliver Wyman

Responses came from a variety of industries, with the top five (covering approximately 60%) by country given in the table below. Retail trade is the only industry that appears in the top five for each country.

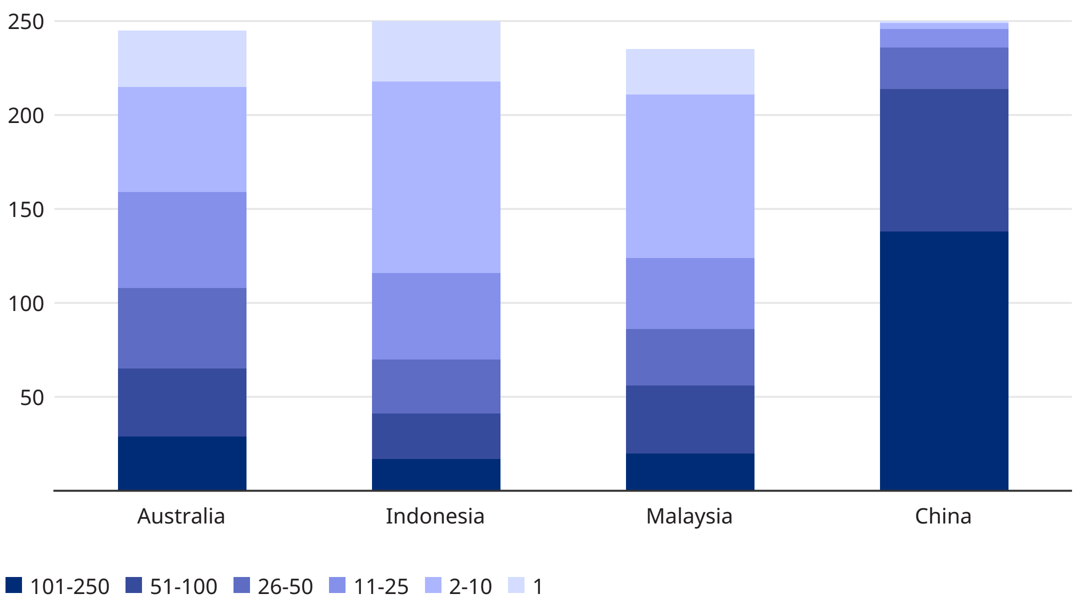
Exhibit 8: Top 5 industries from which participants responded (as a share of country total)

Australia		Indonesia		Malaysia		China	
Retail trade	19%	F&B, and restaurant	23%	F&B, and restaurant	16%	Manufacturing	24%
Professional services	13%	Wholesale trade	19%	Retail tradee	14%	Retail trade	13%
Construction	9%	Retail trade	11%	Wholesale trade	10%	Professional services	11%
Other	8%	Agriculture	8%	Manufacturing	10%	Wholesale trade	10%
F&B, and restaurant	8%	Manufacturing	6%	Professional services	9%	Construction	6%

Source: Oliver Wyman

The distribution of company size (as measured by the number of FTEs) was generally quite similar with the bulk of participants having less than 25 FTEs, except in China, where the sample represented a greater proportion of larger companies.

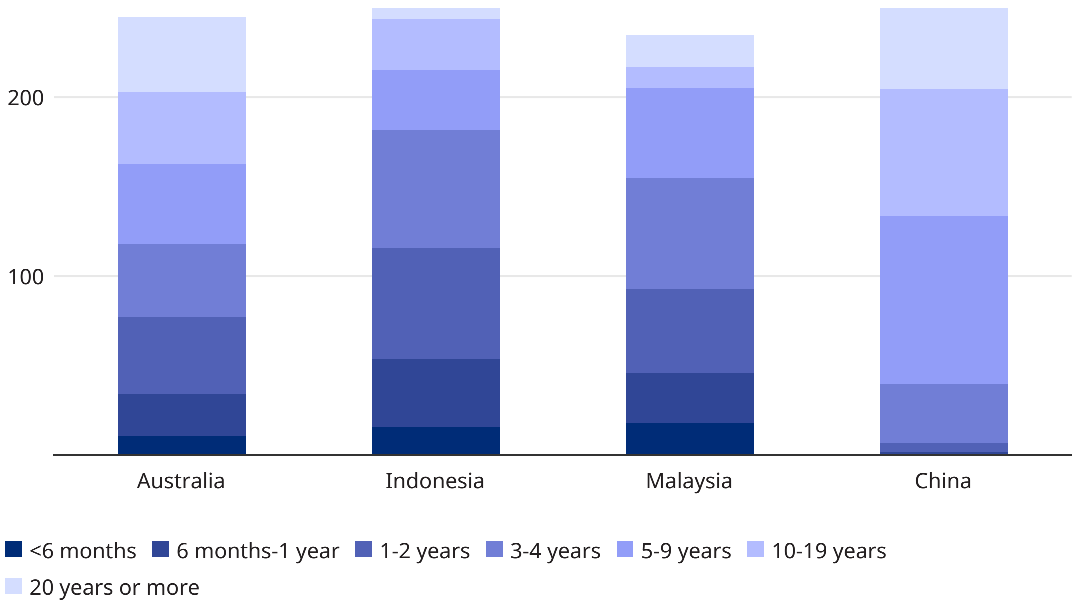
Exhibit 9: Distribution of survey participants by the number of FTEs



Source: Oliver Wyman

The participants from Australia have a fairly uniform distribution in terms of the years they have been in operation, whereas Indonesia and Malaysia are skewed towards younger companies that have been in operation for four years or less. The participants from China, meanwhile, are primarily more established businesses.

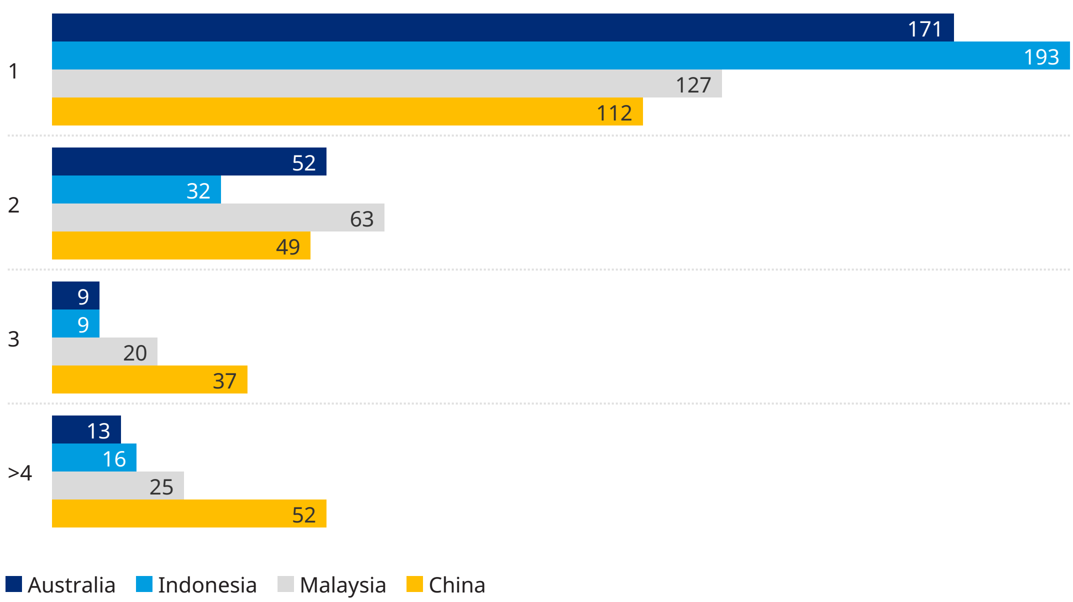
Exhibit 10: Distribution of survey participants by years of operation



Source: Oliver Wyman

Compared to the small-business participants from Malaysia and China, the small-business participants in Australia and Indonesia were more likely to be operating in only one country.

Exhibit 11: Distribution of survey participants by the number of countries in which they operate



Source: Oliver Wyman

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