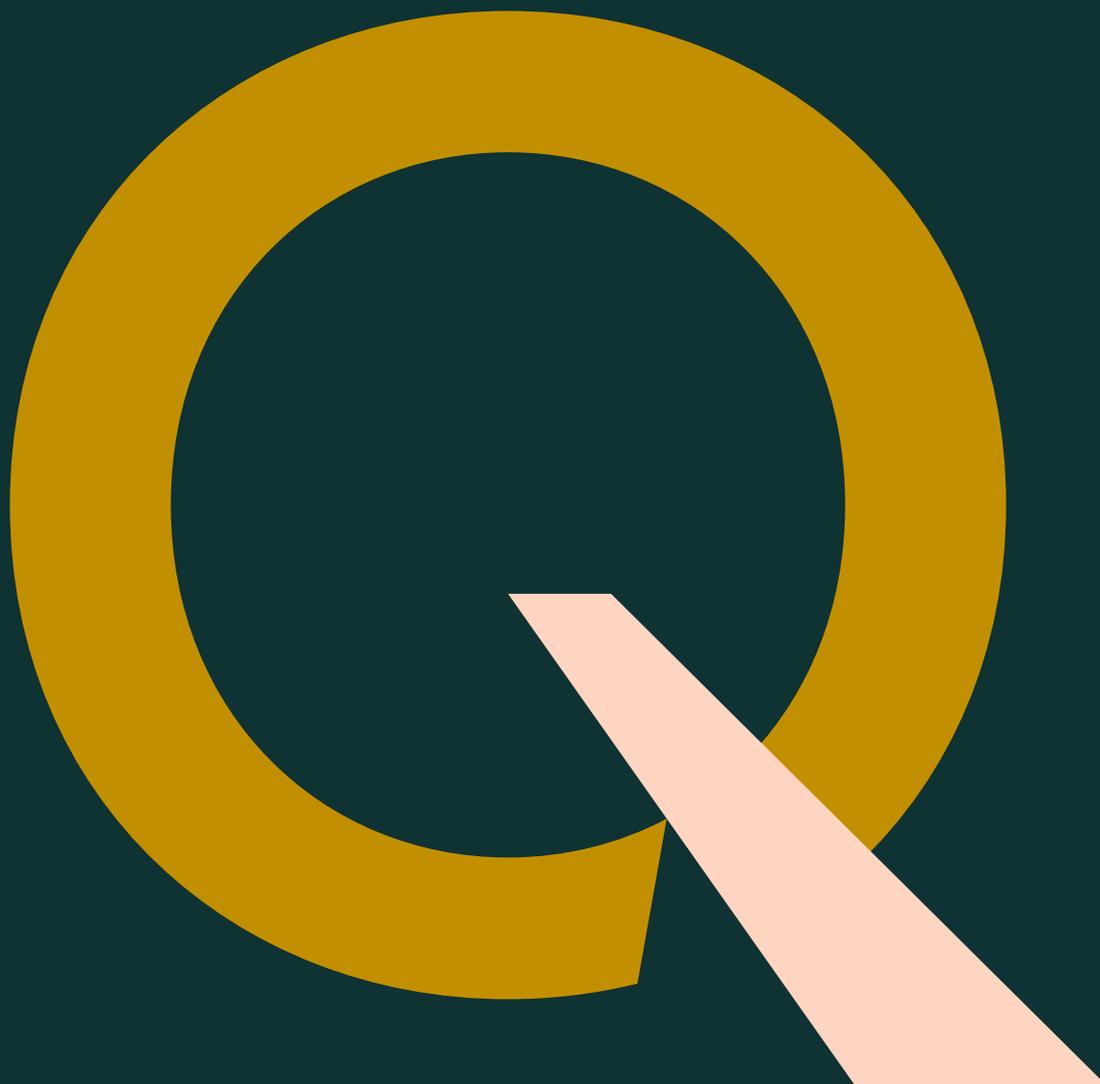


Discovering the full potential of your
SME banking strategy:
Unleashing hidden SMEs in a
mass-market portfolio



Global survey and executive interviews takeaways

Mastercard SME propensity model

A non-profit organization for over 50 years, Qorus is a cornerstone of the financial services industry. Qorus facilitates networking that helps banks and insurers to reinvent themselves to thrive. It is a catalyst for reinvention for its members by helping them to go further, be faster and work together. 1,200 financial brands in 120 countries are Qorus members.

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Authors:

Lukas Dzuoska → Head of Communities,
Qorus
lukas@qorusglobal.com

&

Kevin Spangenberg → Strategic Content Project
Manager, Qorus
Kevin@qorusglobal.com

&

Tunmise Osinubi → Director, M&A Integration
Mastercard

Executive editor:

Boris Plantier → Strategic content manager
Qorus
boris@qorusglobal.com

Production team:

Dorota Valkova → Communities Manager, Qorus
dorota@qorusglobal.com

&

Jess Wolfe → Manager, Product
Management and Maddie Jarombek
Director, Global Small Business Products
Mastercard

&

Rizwan Pasha → Graphic designer, Qorus

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Discovering the full potential of your SME banking strategy: Unleashing hidden SMEs in an mass-market portfolio

There are many ways to describe the journey that financial institutions have taken to better serve their SME clients and transform these offerings into a fully fledged and profitable banking strategy. From underserved to a priority segment. From being a financial partner to a real business partner. From basic financial operations to a full range of business services and beyond. From tedious, lengthy bureaucratic account opening procedures to an end-to-end digital and customer-centric approach.

After successful forays into retail banking, the segment has also become a point of focus for many fintechs and neobanks looking to carve out their own slice of the SME pie.

The last two pandemic-impacted years have especially highlighted the importance of SMEs across all industries and our everyday lives. Many small businesses with no online presence were severely impacted by COVID-19. It was an extinction level event for many of them, as they struggled to merely survive, let alone thrive. In the financial services industry, a lot of attention was dedicated to this segment in the form of immediate support to SMEs amid the crisis – primarily financial, but in many cases the support went beyond immediate financial concerns. Helping SMEs transition to online, implementing marketing campaigns to support local businesses, and networking and procurement platforms to find new clients among other SMEs or corporates were just some of the focus areas from many banks.

Luckily, we seem to be reaching the light at the end of the tunnel in terms of the pandemic. Looking ahead, the question then becomes where to focus in order to enhance and leverage a complex, transformed SME banking strategy. We believe that one focus area should be the entrepreneurs and SME clients that haven't been served properly and are currently using their personal banking accounts for their business because of cheaper and easier transactions or because they are not aware of further benefits that a business account can bring them and their businesses. Moreover, there is a relevant segment of micro-SMEs that cannot access a business account due to outdated KYC processes and lack of data strategy.

Many banks haven't set a clear strategy regarding this hidden segment due to the following:

1. Lack of business cases or know-how

It's understandable that this segment is misperceived as very niche with low revenue generation potential, and many institutions would need to invest significantly to arrive at the right strategy; however, we believe this stems from a lack of understanding of the potential value this segment brings and the absence of the necessary expertise to create an efficient approach to capture SMEs. Also, it's a rather long-term strategy that can be challenged by short-term approaches that require quick revenue generation. This means only well-informed, experienced, and business-backed SME leaders are able to properly plan an approach for this segment. Or, as we will address later, those leaders that can identify the right, external ready-to-use solution. We understand all the issues here and believe there are relevant business cases and solutions to prove the potential of this segment. We'll try to highlight some of them in the next pages.

2. Segmentation issues

Many financial institutions have outdated approaches to segmentation. Micro segment or single profession clients are included as part of retail/mass-market strategies and in some cases, even SMEs are included as well. This is mainly due to the fact that banks do not assign dedicated relationship managers or teams to them or the customers expect just a basic, digital-first offer with self-service management. We believe it's once again a lack of understanding around the real needs and business potential for banks. Moreover, these customers are often novice entrepreneurs with low financial literacy who require further education or at least more information on how to run their business, optimize their operations, and the clear options in terms of financing. In their beginnings, these entrepreneurs simply require more support from their bank in terms of business advisory and services and they will surely repay it with loyalty, once they grew into large corporates.

3. Lack of cross-department collaboration and agility

Traditional banks are used to working in silos and focus primarily, and in many cases purely, on their own customer segments. With segments like SMEs, a joint approach between the retail segment and the business banking segment is essential to identify hidden SMEs and reach out to them with the services they need. SMEs often use their personal accounts for banking because they either do not see the monetary value in switching to a business account or they lack information about the options, possibilities, and benefits.

4. Insufficient data strategy

In many financial institutions, overall data-based strategies did not exist prior to the pandemic; hence, banks were not yet able to utilize them for different business lines and the SME segment was definitely not among the top priorities. Moreover, the most common sources of data gathering are not robust enough for banks to develop actionable insights. Transactional data, CRM insights, and all market financial data should be enriched by behavioral, business performance, e-commerce and other third-party data insights. There are obviously many more insights to obtain, but the most important element is to adjust to market specifics and follow the key customer data points.

The COVID-19 pandemic brings to mind the years of 2008-2015, during which most banks realized there was a segment deserving of their attention and created a dedicated approach with a stand-alone department or business line to serve their needs. The financial crisis not only highlighted SMEs as the backbone of most economies, but revealed their potential to eventually become long-term and loyal high retention customers if served the right way. And all of these changes in strategy were achieved while providing crucial support to these businesses and helping local economies out of the crisis.

We believe it's the ideal time to set a data-based strategy to serve this segment, because many of these SME clients revealed themselves when asking for government-backed loans during the pandemic. Additionally, once digital transformation has achieved a certain level of maturity and beyond banking services can be offered, there is ample space for banks to increase and diversify their client portfolio. Based on our research, these customers form in some cases 10-20% of all your SME banking clients and the number is only expected to grow. There is unlimited potential in what these businesses and individuals behind them may become – progressively-growing businesses backed by strong affluent/premium segment-type individuals; exactly the type of clients every bank wants to have in their portfolio.

We hope that in the following pages of this report you will find answers regarding the current state of data-based strategies in SME banking from leading financial players worldwide, best practices on identifying these customers, how to make them your business customers, and ultimately how to serve them and overcome challenges on this exciting journey.

Section 1

Global survey and executive interviews takeaways



Mastercard survey / interview takeaways

Earlier this year, we conducted a worldwide survey with more than 50 SME bankers. We surveyed them on their practices and methodologies when it comes to the hidden entrepreneurs in their retail banking portfolio. The data from that survey provided a nice snapshot of how this topic is being addressed and some of the associated challenges. In addition to the survey, we also spoke with eight bankers from different Qorus member institutions from around the globe. The interviews allowed us to go deeper and add some color and insight around the survey results. Below are some of the major findings from this combined research.

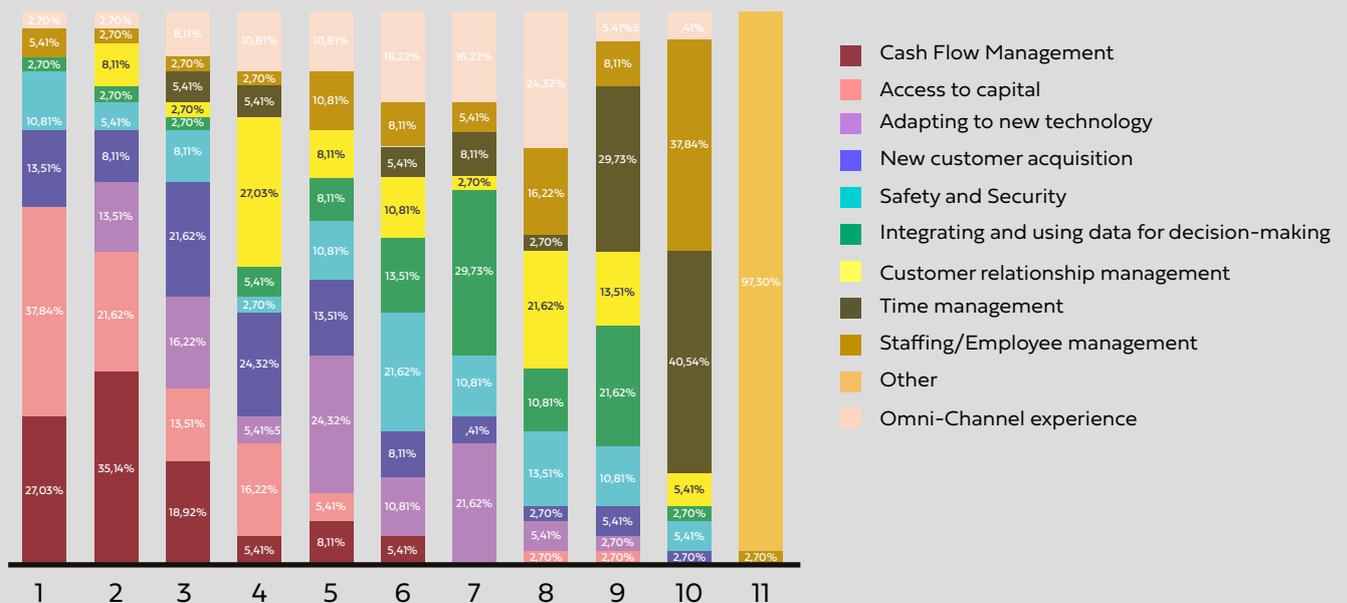
Interview Questions:

- > What type of data insights are you using to build your SME strategy?
- > What gaps do you see in your SME services offering that you think should be and could be filled?
- > Are you able to identify small business customers who are using personal products for their business expenses?
 - > If yes, how are you trying to incentivize them to become business customers? What has been successful, what hasn't?
 - > If no, what would help you identify these customers?
- > What are the biggest challenges you face around reaching the SME segment?
- > Has your organization done market research on the SME segment? Any interesting insights to share?

Top challenges facing SME customers

SMEs in this day and age require the tools that enable them to scale and grow in an international environment. According to both the survey and the interviews, there were two clear frontrunners in terms of the types of services that SMEs need: cash flow management (80%) and access to capital (72%). In the Philippines, for example, credit access is hindering the ability of businesses to grow. 'The number one gap that we are seeing in the Philippines mainly is access to formal credit' said Jaypee Soliman, SME and Micropreneurs Segment Head, Union Bank of the Philippines.

Q1/ Exhibit1: What are the most pressing needs for SMEs?



1 – Most important / 11 – least important

Mastercard survey / interview takeaways

Without the ability to manage cash effectively or receive credit quickly, businesses, especially smaller ones, will struggle to grow. That matter of size is an especially important one. Big businesses have dedicated banking resources and people that provide catered, instant service. That's not the case for SMEs.

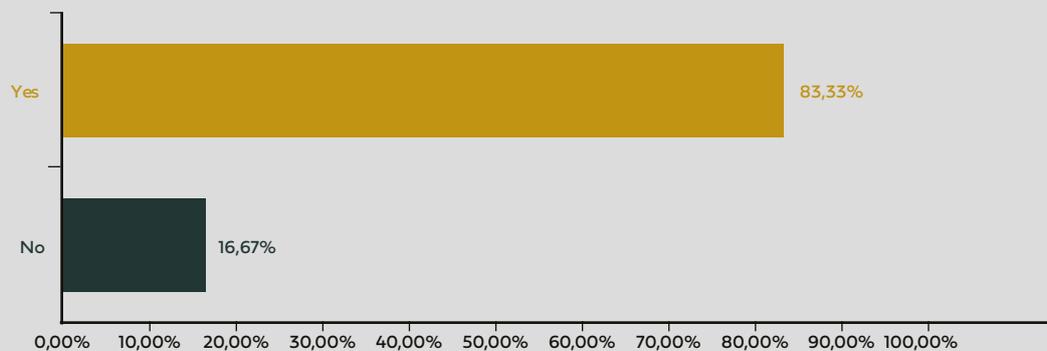
'For entrepreneurs and micro businesses –80% of the Portuguese market – the biggest challenge is related to customer care as they don't have a dedicated RM, meaning that almost all needs regarding their daily business activities must be fulfilled with very easy to use digital financial services' according to Antonio Fery Antunes, Head of Direct Channels for Micro, SME & Corporates, Millenium BCP Portugal.

Banks must work to address this customer care gap and deliver digital tools that scale across the SME sector, regardless of size. Digital tools scale a lot quicker and more easily than methods of old. Now it is a matter of finding the right partner who can produce the type of digital banking experience that SMEs deserve.

Difficulties identifying hidden SMEs

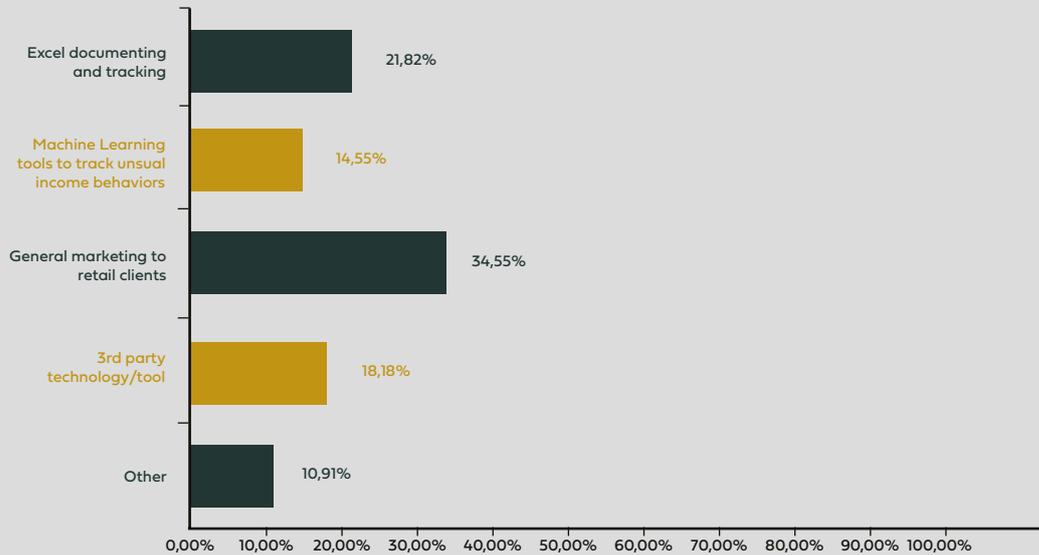
When it comes to strategies for identifying entrepreneurs and SMEs among consumer portfolios, 83% said they had a plan. However, a majority of them said their plan only consisted of general marketing to retail clients. Another big group said their plan centered around excel documenting and tracking. Very few are using advanced tools or machine learning to unearth this type of client, suggesting a need for more sophisticated ways of identifying and reaching out to hidden entrepreneurs.

Q2/ Exhibit 2: Do you have a comprehensive strategy to target the SME owners currently in your consumer portfolio?



One bank has a plan: 'We are working on a special project to identify small business customers who are using personal products for business expenses. We believe that there are only 10% of our customers in this category and we expect that 10% will be reduced to less than 1% with the project's success. The project has been continuing synergistically with the collaboration of several teams including CRM management, SME and retail business lines' explained Serhat Yilmaz, Senior Vice President, SME Banking Marketing, Denizbank Turkey (Emirates NBD group).

Q3/ Exhibit 3: If yes, what does your strategy consist of?

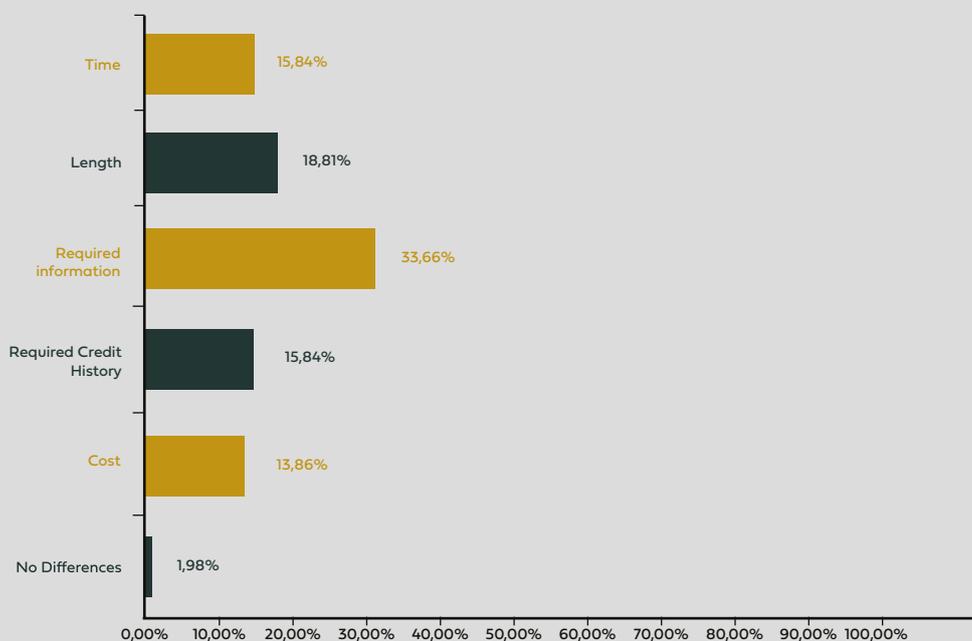


Others, however, have noted the difficulty in classifying expenses and capturing the whole picture of what it costs to run a business. 'Unfortunately, bank account reports and debit/credit card reports will always fail to fulfil the need of classifying all expenses, and these reports will be treated by business owners as only a 'proxy' of their expense reality' said Antonio Fery Antunes, Head of Direct Channels for Micro, SME & Corporates at Millenium BCP Portugal.

What is keeping entrepreneurs from becoming SME customers?

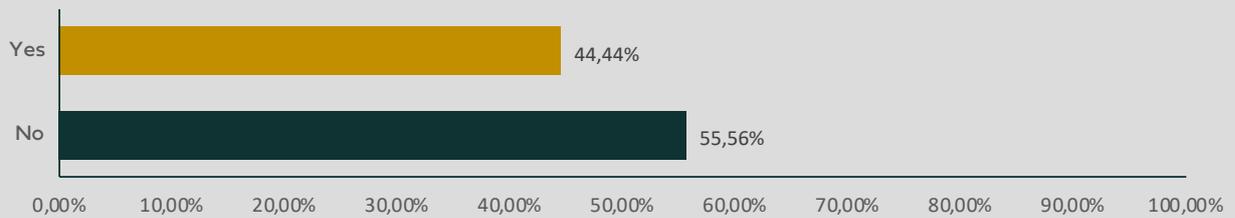
Half of the surveyed bankers (50%) believe the extra info required for SMEs is deterring customers from applying for business banking. Stacks of paperwork, in-person meetings, and a lengthy waiting period would deter even the most determined entrepreneur. While certain information is required when signing on to become a business customer, banks must find a way to make this a more pleasant and enjoyable experience.

Q4/ Exhibit4: Are there any differences in the application process for a personal account/services vs. an SME account/services?



In some countries, technology and geography can be barriers to bringing customers onboard. At TBC Georgia, for example, Deputy CEO of Retail and Business Banking, Tornike Gogichaishvili, noted that 'The biggest challenge for us is to reach small businesses located in rural areas and provide them with the type of remote service that they need.'

Q5/ Exhibit5: Do these keep customers from applying for business banking?

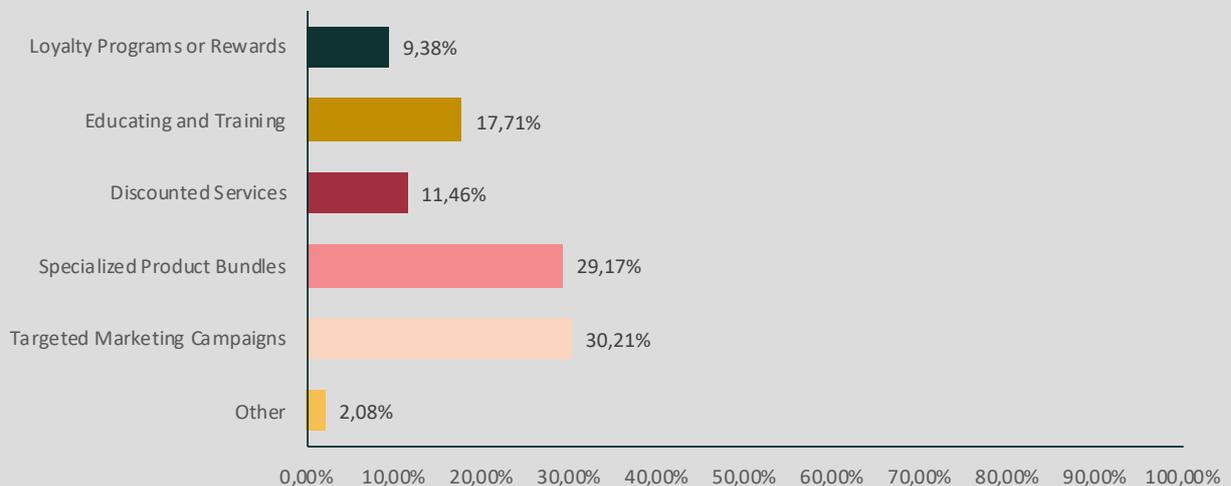


One surefire way to expand services to remote areas is with digital tools. It may not make economic sense to maintain RMs in areas with sparse populations, but digital banking can easily expand and quickly deliver service to these areas. Expanding simple, straightforward access will lead directly to business growth in previously hard-to-reach areas.

The approach to conversion

The primary way of addressing SMEs for banks is through targeted marketing campaigns and special bundles that they provide. But their current techniques aren't bearing a ton of fruit, according to Alan Shanon, executive of Small Business and Professional Banking at Nedbank South Africa. 'We have had mixed success when testing converting clients using their personal account for business into a business account, and we have not pushed the issue too hard as the transactional revenue we earn on the personal account does not vary significantly from the earnings for the same transactional behavior on a business account' he noted.

Q6/ Exhibit6: How are you currently trying to engage the SME segment?



What banks need is a 'smart' way that identifies these hidden entrepreneurs with attractive offers. An automated tool that can detect, reach out, and seamlessly onboard, can increase those conversion numbers. This type of innovative approach is no longer a mere competitive advantage, but a necessity, according to Yilmaz from Denizbank Turkey.

'We believe that a customer-centric marketing approach will not be enough to meet the challenge, but an innovative approach to SME services will be the key. Considering SME services, innovation is not only "nice to have" but will be important to transform our functions, and create new types of products and services across all channels' said Yilmaz.

A question of perception

Ultimately, SMEs face numerous challenges in today's global business environment. They are willing to turn to anyone and any service they can to help them navigate the road to growth. Today's landscape also includes a host of new fintech challengers to banks, meaning businesses have more options at their disposal. 'When you have a banker and a fintech talking to you about a fintech gateway, people normally go to the fintech, because they are scared of the banker! So that is also one of the things we are trying to change – the way we present ourselves' said Jaypee Soliman from Unionbank of the Philippines.

Banks must enhance their offerings, make everything seamlessly digital, and target the right people in order to capture the next generation of entrepreneurs. If not, their reputation of not responding quickly enough to business needs will remain in place. And they risk losing out to fintechs who truly are listening and meeting the needs of both hidden and revealed entrepreneurs.

Section 2

Mastercard SME propensity model



1. Sizing the opportunity

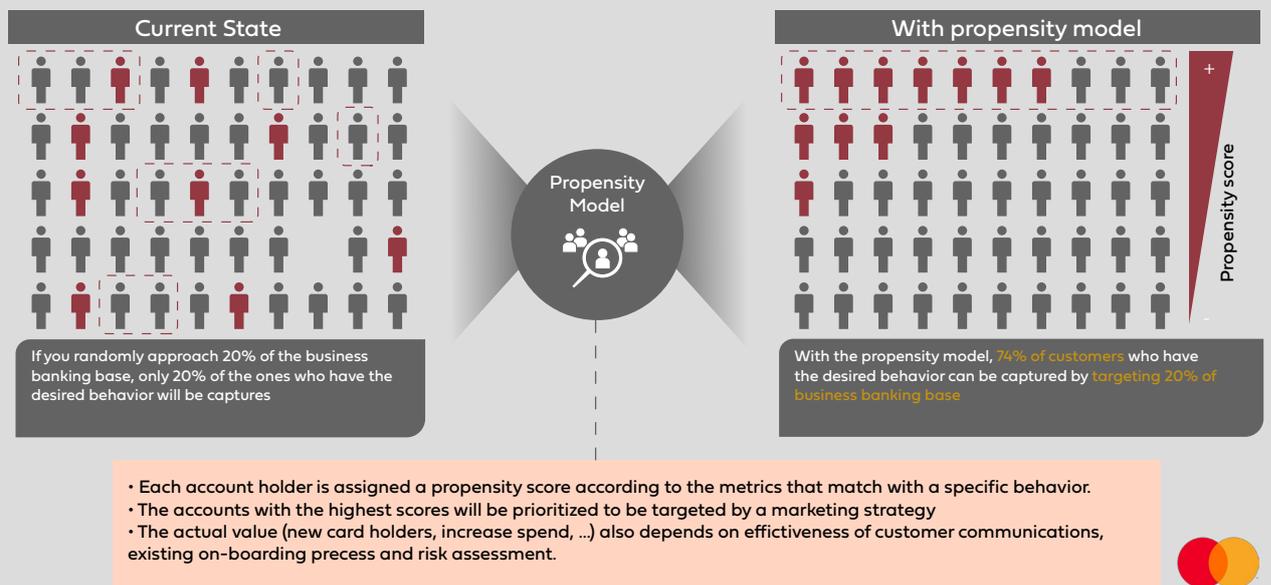
- > As it stands, a large number of SME owners use personal banking products to run their business – 99% in developing markets and 82% in developed markets.
- > Along with the extra paperwork which serves as a deterrent to SME owners opening business accounts, there is also the problem of lack of awareness. In some markets, banks will only issue business cards if requested and because SME owners are not aware of the features and benefits of using a business product vs. a personal product, they never request one.
- > At Mastercard, we have observed that within our largest consumer portfolios, up to 15% of cardholders are likely to be SMEs. This represents millions of potential SME cardholders.
- > An opportunity therefore exists for issuers to grow incremental volumes and revenues by up to 30% and 300% respectively if they identify these SME owners that use personal banking products and provide them with the right SME solutions to support and grow their business.

2. Analytical capabilities

- > At Mastercard, we employ a data-driven methodology to identify these hidden SMEs and are uniquely positioned to help issuers tap into this opportunity and accelerate growth. Through Data & Services, our professional services arm, we are able to deliver customized solutions for our customers and drive value beyond just transactions.
- > Beyond helping issuers identify SMEs within their consumer portfolio, Mastercard Data & Services has also developed strong modeling and analytical capabilities to help issuers design strategies that would improve engagement with their SME cardholders, and drive spend across all stages of the cardholder lifespan. This capability allows for better targeting and prioritization of the right cardholders and increases the chance for success.

3. How the SME propensity model works

- > From the research, we have learned that issuers tend to limit their SME conversion activities to general messaging. This means that they will have to send these messages to a large audience to be able to reach very small conversion targets, at the expense of personalization. To reduce the noise, specialize the messaging, and improve conversion, Mastercard D&S has developed propensity models that help issuers to identify, at the cardholder level, those accounts that are the most likely to be receptive to an SME card offering. Using these modeling capabilities will help design more targeted messaging & strategies.



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- > The model achieves this by looking at each cardholder's activity within the consumer portfolio and assesses the observed spend behavior against multiple criteria that are typical of an SME card, such as size of spend, number of transactions, industry vertical where the spend occurs, etc., and through our machine learning algorithms identifies which cardholders are likely to be receptive to an SME card offering and ranks them by degree of certainty.

With the potential SME cardholders identified, the Mastercard Data & Services team is then able to engage with the issuer to prioritize these cardholders to be targeted for a marketing strategy and execution plan.



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