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Five Strategies for Small Business Success

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Introduction

Eighty-five percent of banks feel greater success in the small-business banking space is critical to their overall success. Yet, the Big Four banks (Bank of America, Citibank, JPMorgan Chase, and Wells Fargo) dominate it with over 55% market share. Further, most small businesses feel banks are not adequately meeting their needs, resulting in more than 65% going beyond their primary financial institution to leverage a fintech company offering. These problems are not new. They will continue to intensify if financial institutions don't evolve their strategies and more effectively utilize data and technology to serve these critical customers better.

In fact, 19% of all U.S. small businesses and 27% of those run by millennials or Gen Zers state they "definitely" or "probably" will consider switching or switch primary financial institutions over the next two years. Maintaining the status quo is no longer an option and will likely result in attrition for those institutions doing so. This industry is ripe for change, and the opportunity to attract new clients, deepen relationships, and generate new streams of revenue from small businesses has never been greater.

This white paper, commissioned by Q2 but independently authored by Datos Insights, highlights the strategies financial institutions must adopt to attract small businesses. Recommendations are supported by data-driven insights regarding small businesses' needs and preferences and the capabilities required to attract and retain their business.

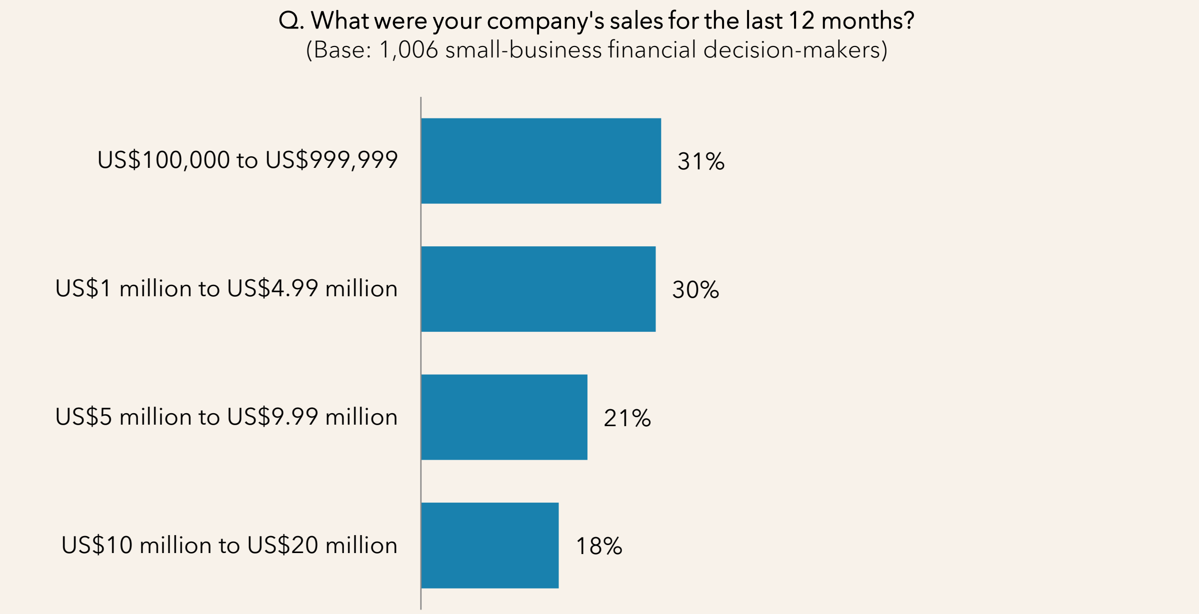
Methodology

This paper is based primarily on a Q1 2023 Datos Insights online survey of 1,006 U.S.-based small businesses. For the purposes of this paper, "small businesses" are defined as those businesses generating between US$100,000 and US$20 million in annual revenue. This revenue range extends beyond how some banks or credit unions may define the segment, but it represents a large opportunity for financial institutions. Businesses generating less than US$100,000 in annual revenue have intentionally been left out, as their actions most likely mirror those of consumers.

A survey of this size offers a 3-point margin of error at a 95% confidence level; statistical tests for differences between segments were conducted at either the 95% or 90% level of confidence, depending on sample size. This paper's content also leverages Datos Insights' research of banks' and credit unions' small-business offerings and strategies and the author's extensive market knowledge.

Figure 1 breaks down survey participants by their annual revenue.

Figure 1: Survey Participants



Source: Datos Insights survey of 1,006 U.S. small business financial decision-makers, Q1 2023

Marketplace

There are more than 30 million small businesses in the U.S. Despite its size, this customer segment has historically been underserved by most financial institutions. However, those days are over, as financial institutions see this group as a critical source of untapped revenue potential. Thanks to technological advances and a greater understanding of their needs, it is now possible for all financial institutions, regardless of size, to serve them more effectively and efficiently. However, doing so requires the right combination of strategy, technology, and data.

There are five key strategies financial institutions must adopt to be more successful with small businesses:

1. Personalized experiences
2. Offering innovative payment capabilities
3. Partnering with fintech companies to broaden the value proposition
4. Tighter integration with accounting systems
5. Striving to capture the full relationship

Personalized Experiences

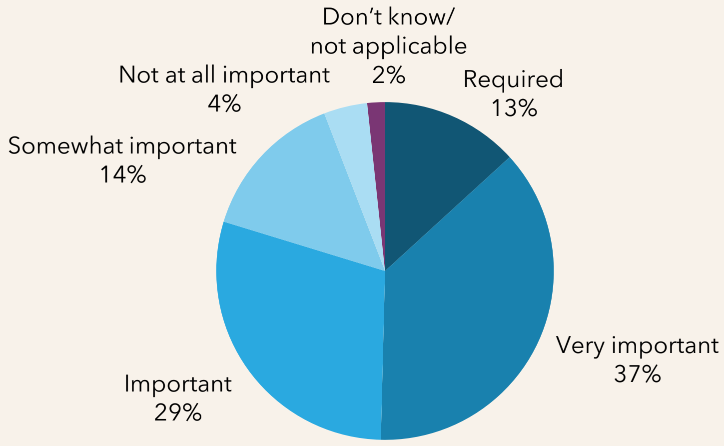
Large online retailers such as Amazon have altered consumer expectations for digital experiences that have carried over to their business lives. When banking, businesses seek high levels of personalization, seamless experiences across tightly integrated providers, and recommendations based on the financial products and transactions used by others like them.

Modern, flexible technical architectures are a must. Twenty-six percent of all small businesses and 32% of businesses run by millennials and Gen Zers would consider switching financial institutions for a more modern and user-friendly digital experience. Delivering the right user interface coupled with rich data and analytics is central to meeting their expectations and, thus, should be critical components of any financial institution strategy.

First and foremost, small businesses are neither consumers nor corporate clients, and managing finances is often not their forte. Thus, they need digital banking capabilities designed with their specific needs and level of sophistication in mind and tools to help guide them through unfamiliar territory. The consumer banking platforms that many financial institutions continue to serve them on are not effective and leave them feeling misunderstood and with unmet needs. As such, 50% of small businesses consider it a requirement or very important that their bank or credit union provide solutions tailored to them rather than adapted consumer experiences. An additional 29% feel it is important (Figure 2).

Figure 2: The Importance of a Tailored Experience

Q. To keep your business as a customer, how important is it that your bank/credit union provide solutions tailored to small businesses rather than adapted consumer experiences?
(Base: 1,006 small-business financial decision-makers)



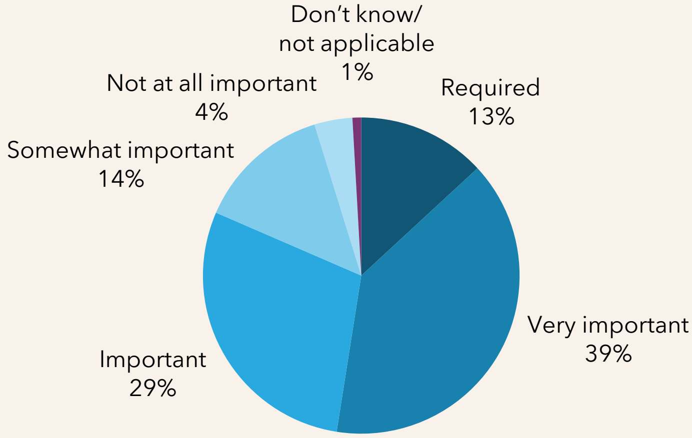
Source: Datos Insights survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

To them, a tailored solution includes offering a full range of credit and noncredit products and capabilities. Of businesses surveyed, 49% want more sophisticated capabilities than what their primary financial institution currently offers. For example, they want more robust and international payment capabilities, fraud prevention tools such as positive pay, tools to collect money owed to them more efficiently, and entitlement capabilities. Additionally, 49% would like more sophisticated mobile banking and payment capabilities, such as enhanced alerting with the ability to take action.

Beyond functionality, a tailored experience relies heavily on analytics to offer dashboards highlighting unique customer information, end-user journeys aligned with their business processes rather than those of the banks, and personalized advice. Of small businesses surveyed, 52% state that a personalized experience based on their specific needs or industry group is very important or required to provide the type of user experience they expect; an additional 29% state it is important (Figure 3).

Figure 3: Personalization Is Needed to Meet Expectations

Q. How important is a personalized experience based on your specific needs or industry group to providing the type of digital banking user experience your business expects?
(Base: 1,006 small-business financial decision-makers)



Source: Datos Insights survey of 1,006 U.S. small-business financial decison-makers, Q1 2023

Data also helps banks and credit unions interact more effectively with and make recommendations to clients/members based on their specific behaviors, preferences, and patterns. It also positions them better to predict future needs. Forty-two percent of small businesses state that a bank's/credit union's ability to provide recommendations and advice is very important or required to keep their business. An additional 31% state it is important.

Data and analytics are largely underutilized for use cases beyond fraud prevention. Still, financial institutions are quickly realizing their essential role in client retention by helping deepen client relationships, improve the overall customer experience, and demonstrate knowledge of client needs.

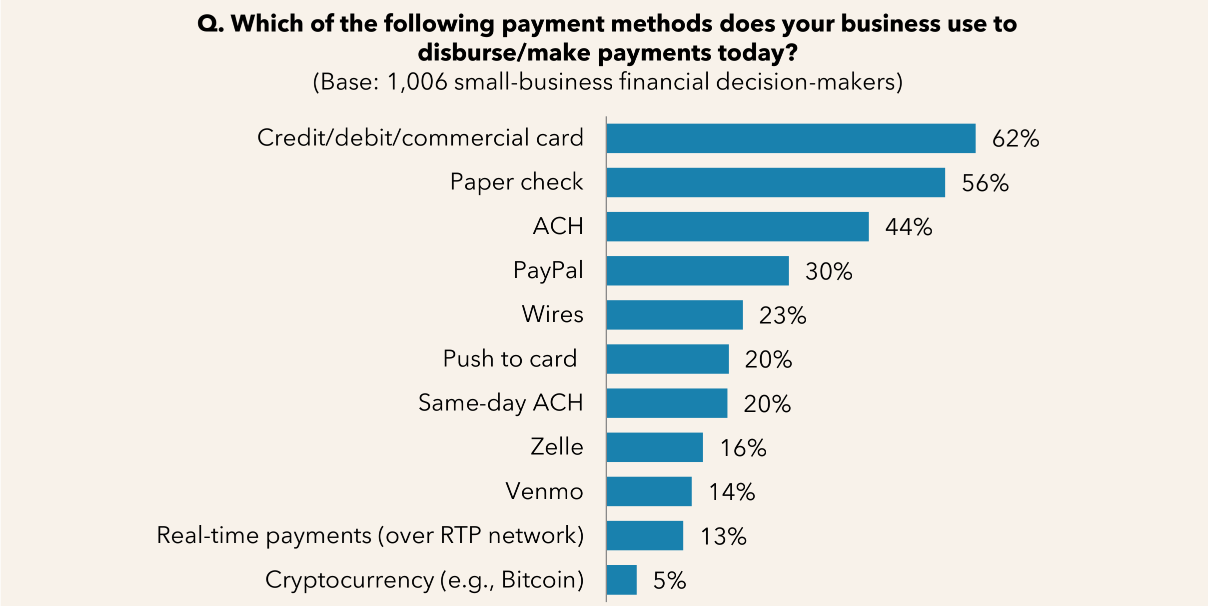
Offering Innovative Payment Capabilities

The ability to initiate and receive payments is a central function for banks and credit unions. However, in recent years, this business has come under attack. A growing number of fintech companies have emerged offering digital payment capabilities (often in real time) targeted at small businesses. Currently, only 52% of small businesses prefer to make electronic payments from their financial institution's online or mobile banking site. In contrast, the remaining businesses instead prefer other options such as the biller direct model or doing so from accounting systems or fintech offerings.

End users often stray to other models and providers for greater ease of use, speed, more payment options, and greater end-user satisfaction. Forty-seven percent of small businesses go to a fintech company for faster payment capabilities. Banks and credit unions can't afford to lose this business. Not only are payments "sticky," but very often, whoever owns the payment owns the customer. Thus, banks and credit unions must stay on top of payment trends and continue to invest in and innovate in this area.

In doing so, financial institutions need to be able to accommodate the broad range of payment types that small businesses currently use and be ready to move quickly as new types, such as FedNow, are rolled out (Figure 4).

Figure 4: Small Business Payment Types



Source: Datos Insights survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

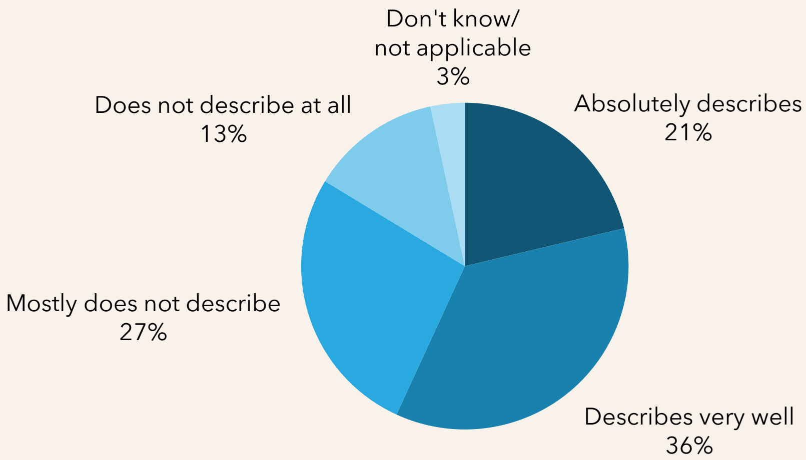
Sixty-five percent of small businesses consider real-time payments important or very important to their business. However, many institutions do not yet offer it, forcing businesses to seek other options. In addition to keeping up with new payment types, financial institutions must also ensure their payment offerings are easy to use, leverage layman's terms as opposed to industry speak, and incorporate nice-to-have features, such as the ability to review payments before submission, to improve the overall payment experience for small businesses.

Partnering With Fintech Companies to Broaden the Value Proposition

Over 65% of small businesses leverage a fintech solution to meet at least one financial need. Further, while banks are often viewed as transaction providers, fintech companies are often more favorably seen as innovative and offering a superior user experience. In fact, 84% of small businesses feel to some degree that their primary financial institution offers few products they are willing to pay for; 57% state this describes their business' viewpoint very well or absolutely (Figure 5).

Figure 5: Small Businesses' Perceptions of Financial Institution Product Value

Q. How well does the following statement describe your business's point of view? "My financial institution offers few products and services my business would be willing to pay for."
(Base: 1,006 small-business financial decision-makers)



Source: Datos Insights survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

These numbers are highest among more tech-savvy businesses run by millennials and Gen Zers, a subsegment that represents the future needs of small businesses, at 88% and 66%, respectively. This should raise a red flag for banks and credit unions, as financial institutions perceived to be offering little value are easy to replace.

Financial institutions must form partnerships with fintech companies to broaden the value proposition they offer. Enabling business end users to perform banking transactions from third-party systems that sync with their bank portal is very important or required by 51% of small businesses to provide the type of digital banking user experience they expect. It is important to an additional 29%.

These partnerships with fintech companies also help businesses vet and narrow down the large and often overwhelming number of fintech company offerings in the market. When selecting partners, financial institutions should focus on those areas small businesses are most likely to go beyond their bank for, such as payroll (62%), electronic invoicing (50%), faster payments (47%), money management (34%), and expense management (30%)[1].

It is worth noting that most small businesses seek other providers because they feel they have no choice. In fact, 81% of businesses that currently partner with fintech companies state that if their primary financial institution offered the same capabilities, they would prefer to get them from that institution. Financial institutions have their trust and, when coupled with an already broad product set, offer the opportunity for a more convenient and richer banking experience.

Bank and credit union partnerships with fintech companies help deepen client/member relationships while lowering the risk of disintermediation. Fifty-three percent of small businesses want to see their banks/credit unions partnering with more fintech companies. Doing so will also help them appear more innovative. The largest banks are currently perceived to be the fastest moving with innovation and fintech partnerships. Thus, it is not surprising that 70% of small businesses are most likely to adopt technology as soon as it is available with a Big Four bank versus only 13% banking with a community bank or credit union.

Tighter Integration With Accounting Systems

Banks must also offer tight integration with the accounting systems their small-business clients use. Thirty-two percent of small businesses feel their primary financial institution doesn't effectively meet their needs in this area. This often results in error-prone manual entry and a failure to deliver the seamless, automated experience they require. Though other accounting packages are growing in popularity, QuickBooks is the most used platform for small businesses; integrating with it is table stakes.

Additionally, 55% of small businesses state that tight integration and auto-syncing with accounting systems are very important or required to keep their business, while 29% describe it as important (Figure 6).

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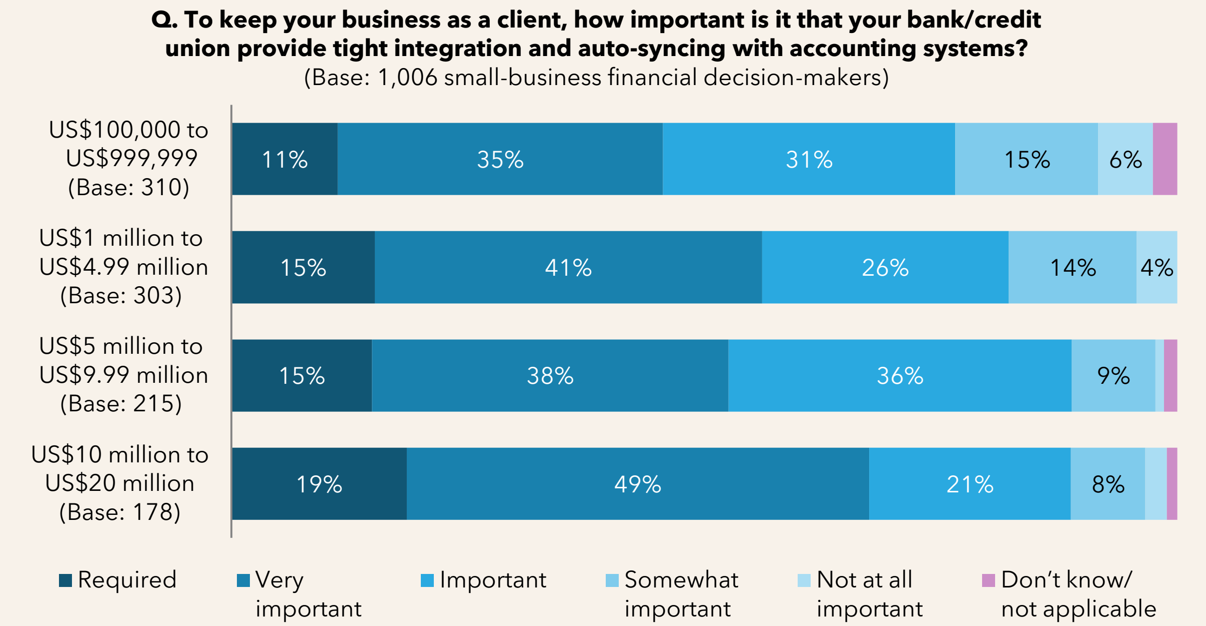
1 These percentages are only among those businesses surveyed stating they partner with a fintech company.

Figure 6: The Importance of Integration With Accounting Systems



Source: Datos Insights survey of 1,006 U.S. small business financial decision-makers, Q1 2023

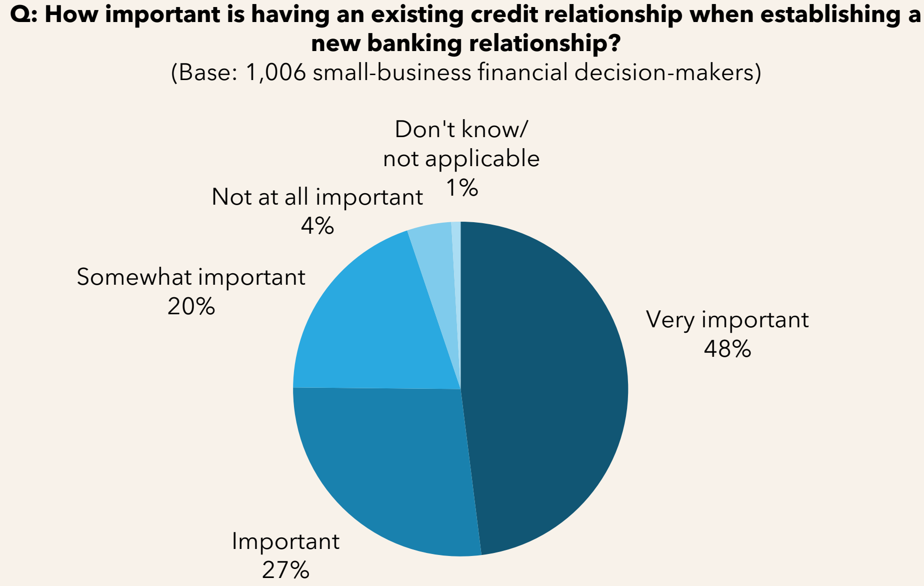
Striving to Capture the Full Relationship

Most banks remain siloed despite efforts to tighten integration and deploy enterprise-wide strategies. However, it is becoming increasingly critical for the credit and deposit sides of the financial institution to work more closely together.

Most business relationships begin on the credit side, but it is through deposit products that a financial institution can anchor a client and keep them beyond the loan term. Thus, despite more attractive loan/credit card rates being the likely reason for a business to consider switching financial institutions (48%), financial institutions should be prepared to sell a broader product bundle at the time of customer onboarding.

Further, when establishing a new banking relationship on the deposit side, 75% of small businesses surveyed state that having an existing relationship with the financial institution on the credit side is an important or very important factor (Figure 7).

Figure 7: Credit Relationships



Source: Datos Insights survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

Tight integration across a bank's credit and digital banking platforms is critical for many reasons. First, it better positions a bank to cross-sell deposit/business banking products to a new business lending client at the time of onboarding. Later in the relationship, it provides bankers with a richer view across the entire relationship to identify cross-sell opportunities. Finally, it significantly enhances the overall user experience. It eliminates the frustration of being asked the same information again, but more importantly, it better aligns with how a business works by providing a more seamless experience. For example, if a business customer has an upcoming payment and is short on funds, they should be able to draw on a line of credit without having to log into a different system. In fact, 75% of small businesses are interested in applying for loans within online banking applications, yet most financial institutions offer siloed experiences.

Conclusion

Financial institutions can no longer afford to underserve small businesses. The ramifications of maintaining the status quo are too great. These customers/members are already going beyond their financial institutions for unmet needs, placing financial institutions at risk of greater disintermediation if the trend continues.

Financial institutions must respond by implementing and leveraging the strategies outlined in this paper coupled with modern technologies and data. The benefits of doing so far outweigh the costs, and, more importantly, the urgency to do so will only increase in time as small-business needs continue to evolve, making change essential for any institution to remain competitive in this critical space.

About Datos Insights

Datos Insights is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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