AiteNovarica

MARCH 2023

DELIVERING VALUE TO SMALL BUSINESSES

PREPARED FOR:

APITURE®

INTRODUCTION

Financial institutions are falling short on demonstrating value and on understanding small businesses' needs. By doing so, they are missing out on opportunities to deepen relationships with this critical customer/member segment. According to Aite-Novarica Group research, only 35% of small businesses feel their primary financial institution is fully addressing their unique digital banking needs. Equally alarming is the risk of attrition; 19% of all small businesses and 27% of businesses run by millennials and Generation Zers "definitely" or "probably" will consider switching or switch primary financial institutions over the next two years. Action is needed, as maintaining the status quo will no longer keep an institution competitive. Those willing to implement the right strategies and make the right technology investments will enjoy new successes and opportunities to grow market share and revenue.

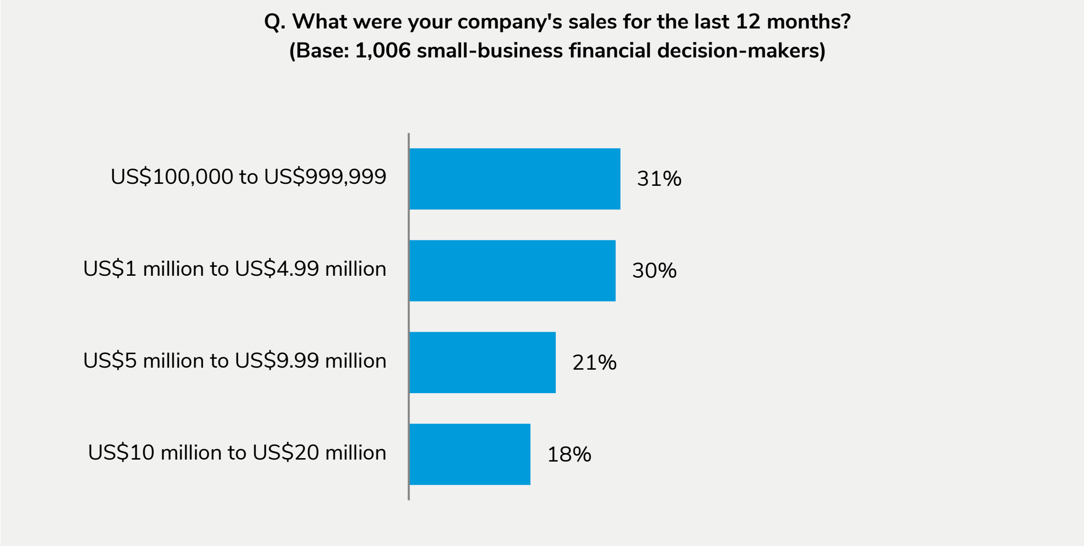
This white paper, commissioned by Apiture but independently authored by Aite-Novarica Group, highlights the steps financial institutions should take to better deliver and demonstrate value to small businesses. Recommendations are supported by data-driven insights regarding small businesses' needs and preferences, and the capabilities required to attract and retain their business.

METHODOLOGY

This paper is based primarily on the results of a Q1 2023 Aite-Novarica Group 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. While this revenue range extends beyond how some banks or credit unions may define the segment, this revenue range 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 Aite-Novarica Group's research of banks' and credit unions' small-business offerings and strategies, along with the author's extensive knowledge of the market.

Figure 1 breaks down survey participants by their annual revenue.

FIGURE 1: SURVEY PARTICIPANTS



Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

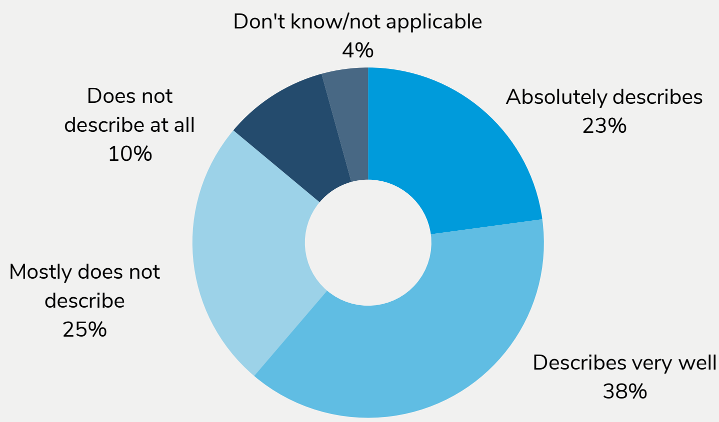
MARKETPLACE

Most small businesses describe their bank or credit union as “easy to bank with.” While that sounds like good news for the industry, it is not enough to keep their business. These businesses are more demanding and less loyal than they were in the past. They need more tools and capabilities than their financial institutions are currently providing, desire greater information and transaction transparency, and expect a more modern and intuitive user interface. Their dissatisfaction is evidenced not only by the number of small businesses stating a high likelihood to switch institutions but also by their actions. According to Aite-Novarica Group research, more than 65% of small businesses go beyond their primary financial institution to meet at least one financial need. Further, while they view fintech companies as innovators, they see financial institutions as simply transaction providers, often with little difference from one institution to another.

While they are price sensitive, small businesses are willing to pay for value. They demonstrate that willingness each time they pay for capabilities from a fintech provider. For them, value is often measured in the ability to save time, increase convenience, or operate more efficiently. Unfortunately, financial institutions are less successful than fintech companies at demonstrating value. 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% said this describes their business’s viewpoint very well or absolutely (Figure 2). 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.

FIGURE 2: SMALL BUSINESSES' PERCEPTIONS OF FINANCIAL INSTITUTION PRODUCT VALUE

Q. How well does the following statement describe your business's point of view? "My business would like to see my bank or credit union offer more digital tools to effectively manage cash flow." (Base: 1,006 small-business financial decision-makers)



Source:: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

DEMONSTRATING VALUE TO CUSTOMERS

With so many small businesses considering switching financial institutions over the next two years, it is important for banks and credit unions to understand what matters to them most and what is needed to retain their business. This section explores not only what attracts a small business to a new banking partner but, more importantly, what is needed to retain and deepen a relationship with them.

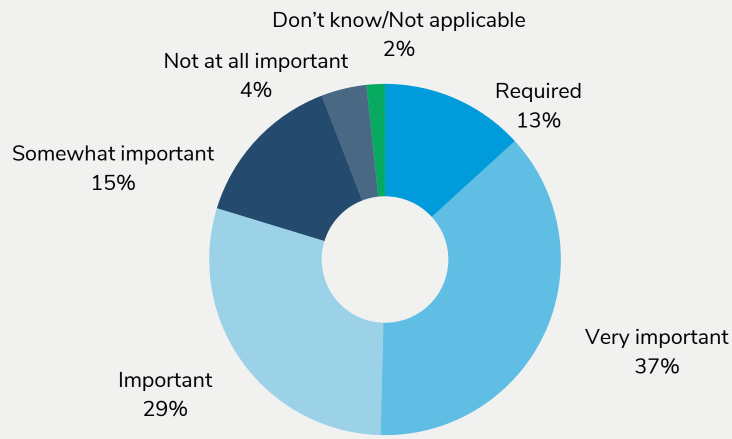
A Solution Tailored for Small Businesses

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 as well as tools to help guide them through unfamiliar territory. Despite this, it is not uncommon for many financial institutions to service these businesses with consumer platforms with little to no tools to run their business. This leaves them feeling misunderstood and with unmet needs. It also leaves money on the table, as consumer capabilities are often free.

Fifty percent 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 3).

FIGURE 3: 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: Aite-Novarica Group 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. Almost 90% of small businesses consider this full range of products important, very important, or required. Unfortunately, the market is not meeting this need, as 49% of small businesses want more sophisticated capabilities than what their primary financial institution offers (Figure 4).

Small businesses commonly use products such as checking accounts, online and mobile banking with mobile check deposit, various digital payment capabilities, and a credit product, but they want more. They are increasingly making international payments, leveraging positive pay, and needing entitlement capabilities. Of those surveyed, 49% would like to see more sophisticated mobile banking capabilities, such as enhanced alerting with the ability to take action, and more payment capabilities than what they are currently provided. Real-time/faster payment capabilities are also high on their wish lists. While less than 25% of small businesses currently use real-time payment options such as same-day ACH (20%), Zelle for business (16%), or RTP from The Clearing House (13%), 40% state they are considering using real-time payments in the next year. The ability to make faster payments is especially important to businesses run by millennials and Gen Zers. Finally, small businesses require more robust reporting capabilities to lessen their dependence on error-prone Microsoft Excel spreadsheets and the need to create their own reports. Only 60% of small businesses believe their primary financial institution effectively meets their reporting needs.

FIGURE 4: SMALL BUSINESSES NEED MORE SOPHISTICATED MOBILE BANKING CAPABILITIES

49%

of small businesses want more sophisticated capabilities than what their primary financial institution offers

Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

A Richer and More Intuitive User Experience

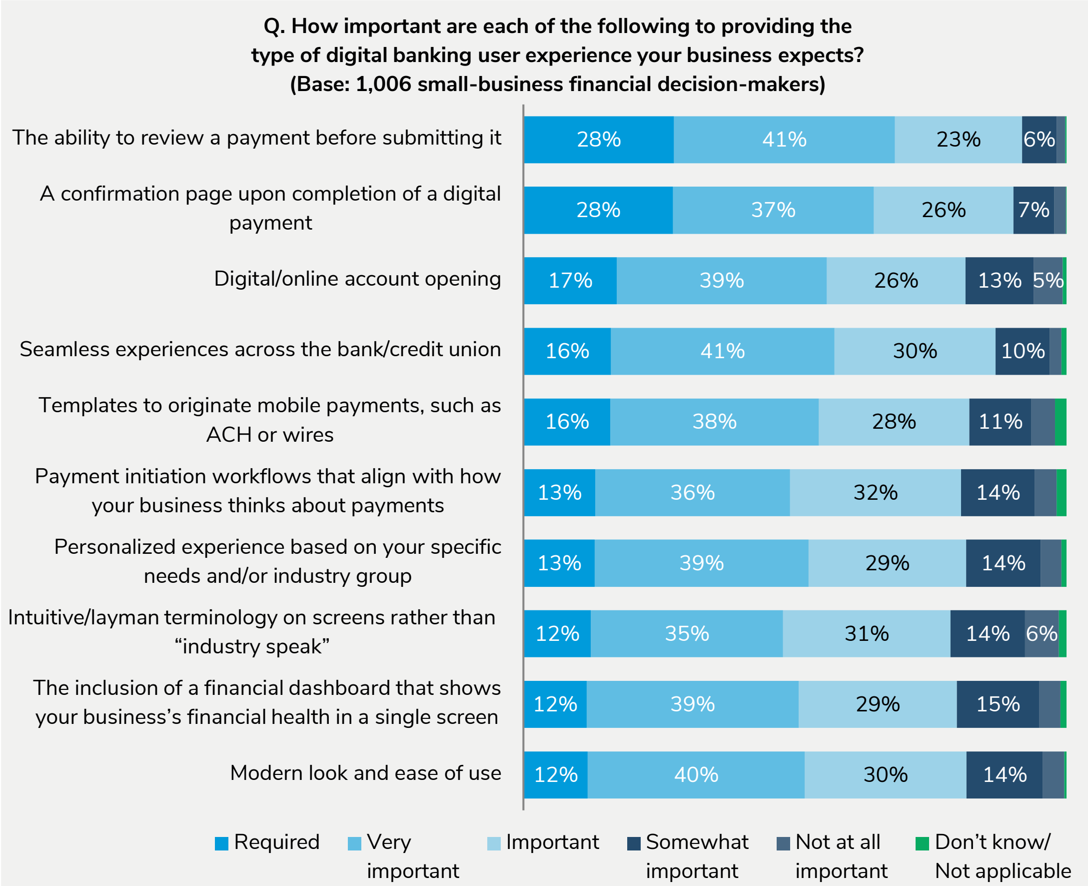
A tailored small-business experience means more than simply having business-specific transactional capabilities. Equally important is a tailored user experience when performing those transactions, especially digital transactions. Small businesses have several expectations when it comes to their digital banking user experience. Figure 5 highlights the attributes of a digital banking user experience that small businesses value highly.

Those expectations fall into three major buckets:

- **Ease of use:** 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. While small businesses increasingly need many of the same capabilities as larger businesses (just at a lower volume), they are often less familiar with "industry speak" and complex terms. Thus, in addition to important digital experience attributes, such as a modern user interface, digital account opening, and a seamless experience across the bank, they also value intuitive/layman terminology on screens, for example, “payment date” rather than “settlement date.” Layman’s terms, as well as templates, eliminate confusion and make transaction initiation much easier.

- **Greater transparency around payments:** Some small-business owners are less tech-savvy or familiar with initiating online payments and need additional information or assistance than their larger business counterparts do. Thus, providing additional information and transparency will instill greater confidence that they are doing things correctly. For example, they value a confirmation page upon completing a payment to ensure the payment has gone through, as well as the ability to review a payment before it is sent. These seemingly small enhancements to a traditional payment workflow make a huge difference to small-business owners and will likely encourage greater usage.
- **Personalization:** Businesses of all sizes are looking for higher levels of personalization that demonstrate their financial institution understands their business and unique needs. Component-based platforms and embedded analytics help to make this possible. Small businesses value workflows that align with how their business thinks about making transactions, as opposed to being forced into workflows that align with the often-siloed organizational structures of financial institutions. This is especially true when a client-aligned workflow will enable them to initiate several payment types from a single login, as opposed to requiring multiple logins. Small businesses also value personalized experiences based on their unique needs or industry group. Arming bankers with data-driven intelligence enables this and will ultimately lead to greater client satisfaction and cross-selling success.

FIGURE 5: VALUE ATTRIBUTES OF A DIGITAL BANKING USER EXPERIENCE



Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

Tighter Integration With External Systems and Across the Institution

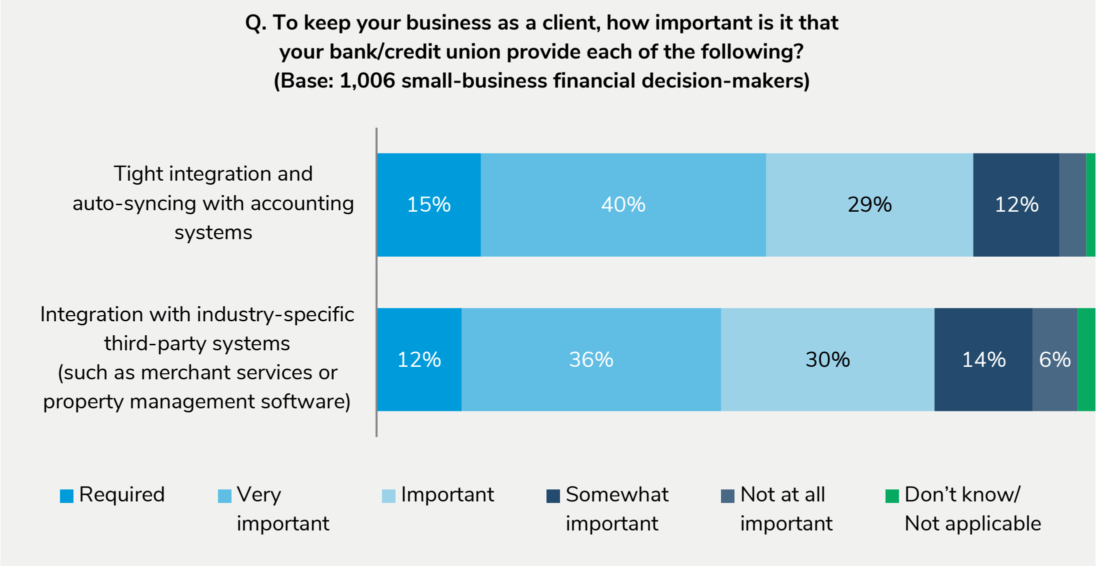
As stated, it is critical that digital banking offerings are tailored to specific small-business needs from both a functionality and user experience standpoint. However, their needs and the attributes they most highly value are often not limited to what appears within their financial institution's digital banking portal. Banks and credit unions must shift from a portal to a platform strategy that enables tight integration not only across bank systems but also with external ones. This integration comes in several forms:

- **Integration with accounting systems:** Thirty-two percent of small businesses feel their primary financial institution doesn't effectively meet their needs when it comes to tightly integrating with external accounting systems. Although 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 tight integration and auto-synching with accounting systems is very important or required to keep their business, while an additional 29% describe it as important.

- **Integration with other third-party platforms:** Banks and credit unions should not be integrating with just accounting platforms. Integration with industry-specific third-party systems, such as merchant services or cross-currency payments software, is also required or very important for client/member retention for 48% of small businesses (Figure 6). This integration is especially important to the highest end of the small-business segment.

- **Integration across internal bank platforms:** Different platforms and groups across the bank must also be tightly integrated and working more closely together for a seamless experience and to maximize cross-sell opportunities. A seamless experience across the bank/credit union that enables a single login to access all accounts and products is required or very important for 57% of small businesses and important to an additional 30%. This integration should not be across just business products but should also account for the high percentage of small-business owners that also have their personal account at the same institution and want the ability to see all account information on the same screen or through a single login. Only 65% of small businesses believe their primary financial institution sufficiently meets their expectations for viewing personal and business account information through a single login.

FIGURE 6: THE IMPORTANCE OF INTEGRATION WITH ACCOUNTING AND OTHER THIRD-PARTY SYSTEMS



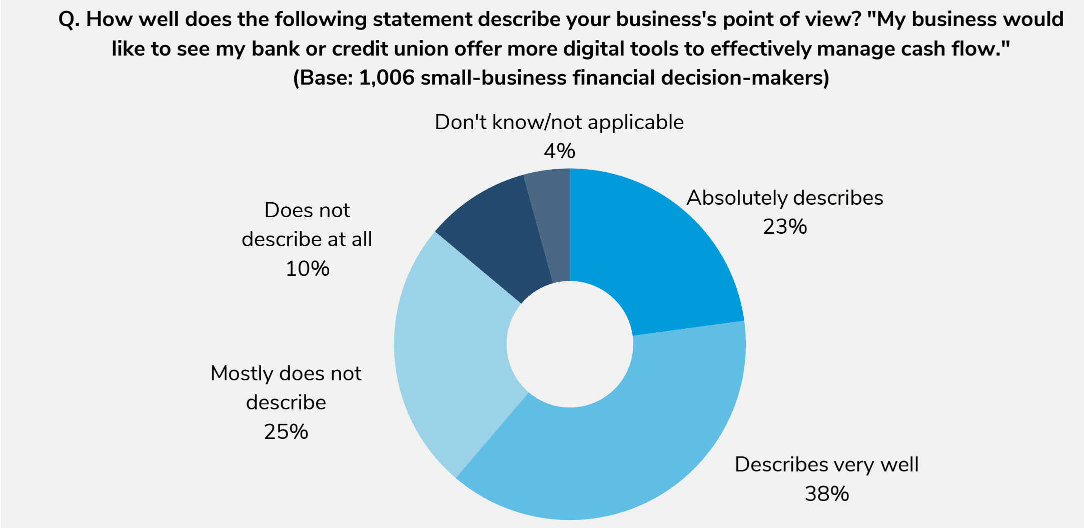
Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

More Money Management Tools

Small businesses are severely underserved by traditional bank and credit union offerings that typically lack financial insights and guidance. As a result, many business owners have been forced to go beyond their financial institution to seek out needed capabilities or do without, making their businesses vulnerable to unexpected financial challenges. This is a risk, as accurate cash positioning and forecasting is critical and could mean the difference between a business' survival and its failure. Small businesses need transparency into their financial health, alerts when there may be a cash shortfall, and ideally, the ability to analyze the impact of different scenarios and actions to make more informed decisions.

Limited to no availability of these types of tools at most financial institutions has made effectively managing finances one of the most common challenges faced by small businesses. It is no surprise that 61% of small businesses would like to see their bank or credit union offer more digital tools to help in this area (Figure 7). Thirty-three percent of small businesses would even consider switching financial institutions for online tools integrated with online banking that help with cash flow management, forecasting, and budgeting.

FIGURE 7: SMALL BUSINESS DESIRE FOR TOOLS TO MANAGE CASH FLOW



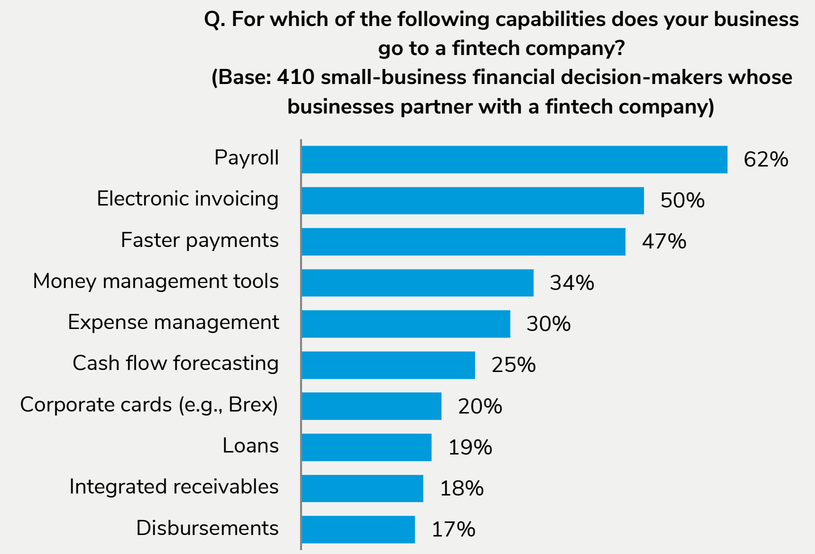
Source:: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

Money management tools have widespread appeal but are most important to the largest businesses, especially those generating between US$10 million and US$20 million in annual revenue. They are also highly valued by millennials and Gen Zers running small businesses of all sizes, 71% of whom want to see their primary institution offer them. Most financial institutions will fill this gap by partnering with a fintech company. This is explored in greater detail in the next section.

More Fintech Company Partnerships

The last way to deliver value and capabilities small businesses would be willing to pay for is to partner with fintech companies. Most banks and credit unions have begun to look beyond these companies as competitors and now view them as partners. The largest banks have dedicated internal groups responsible for identifying and managing direct fintech company relationships, while most smaller ones will leverage vendors already vetted by their core banking or digital banking providers. Such partnerships fill gaps, broaden and enhance product portfolios with best-in-breed capabilities, and offer speed to market. According to Aite-Novarica Group research, speed is especially important, as about 65% of small businesses are already going outside their primary financial institution to a fintech company to fill unmet needs. The most common areas for them to do so include payroll, electronic invoicing, faster payments, money management, and expense management (Figure 8).

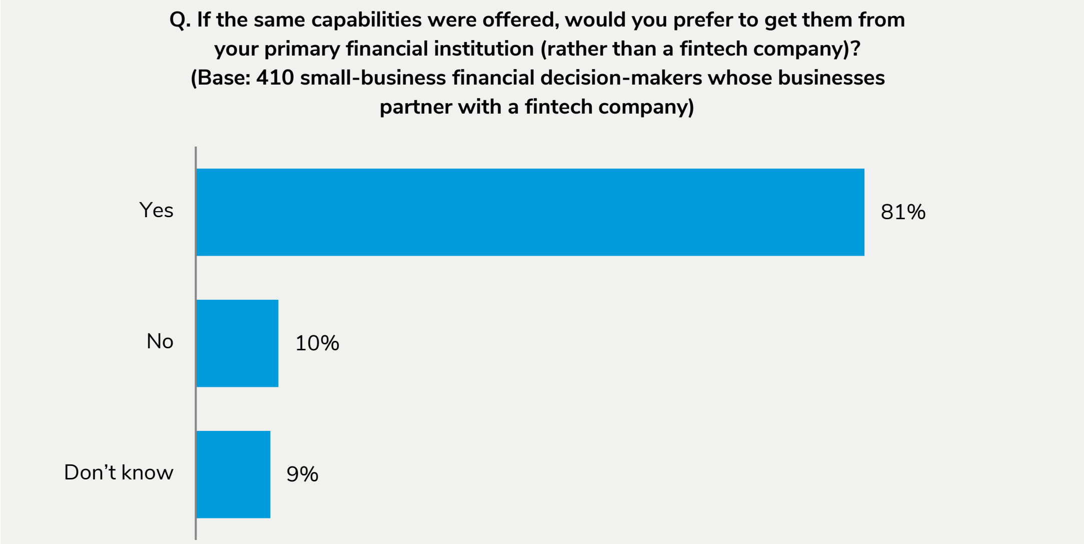
FIGURE 8: CAPABILITIES SMALL BUSINESSES ARE MOST LIKELY TO GO TO A FINTECH COMPANY FOR



Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

Most small businesses are doing so because they feel they have no other choice. In fact, 81% of businesses that currently partner with tech companies state that if their primary financial institution offered the same capabilities, they would prefer to get them from that institution (Figure 9). 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.

FIGURE 9: SMALL BUSINESSES PREFER FINANCIAL INSTITUTIONS OVER FINTECH COMPANIES



Source: Aite-Novarica Group survey of 1,006 U.S. small-business financial decision-makers, Q1 2023

By partnering with fintech companies, banks and credit unions can further deepen relationships with these clients/members while also lowering the risk of disintermediation. In fact, 53% of small businesses want to see their banks/credit unions partnering with more fintech companies.

CONCLUSION

The small-business banking space is experiencing a paradigm shift. Banks and credit unions must do more to demonstrate value or risk high attrition rates. Opportunities exist for financial institutions able to demonstrate value through their digital capabilities, user experiences, and partnerships. More specifically, they must deliver banking platforms tailored to small businesses consisting of both the right functionality and intuitive experiences that align with their expectations. Platforms must be modernized and replaced if personalization is not possible or if third-party applications cannot easily integrate with them. Finally, fintech partnerships should be considered to broaden available capabilities, help businesses overcome key challenges, and demonstrate an understanding of their needs. Taking these actions positions banks and credit unions as partners, rather than transaction providers, thereby better enabling them to attract small-business clients/members, deepen relationships with them, and retain them.

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group 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. The quality of our research, insights, and advice is driven by our core values: independence, objectivity, curiosity, and integrity.

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