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HOW COMMUNITY FINANCIAL INSTITUTIONS CAN MAKE MONEY FROM BUSINESS CLIENTS

PREPARED FOR:



INTRODUCTION

Most small businesses don't pay for banking products and services because their financial institutions don't charge them. While capability limitations are a factor in some cases, not charging is primarily the result of misaligned value propositions, underestimated needs, and, especially, mistaken beliefs that small businesses won't pay. Small businesses are price sensitive, but recent Aite-Novarica Group research finds they will pay for the right capabilities and experiences—especially those that save them time, increase convenience, and improve overall efficiency. Fintech companies realize this and have been enjoying tremendous revenue growth from the more than 60% of small businesses using and often paying for their products. The “big four banks” (Bank of America, Citibank, JPMorgan Chase, and Wells Fargo) have also found ways to generate revenue from these customers, but most community financial institutions are missing out on these opportunities. Twenty percent of businesses considering a small bank (with less than US\$10 billion in assets) to be their primary financial institution pay nothing at all for non-interest-bearing banking services, with an additional 21% spending less than US\$25 per month (compared to only 7% and 13%, respectively, for those banking with the big four banks).

Community financial institutions must change their mindsets and evolve their strategies and offerings to better align with small-business needs and expectations. Doing so will enable them to deliver the value these customers desire and are willing to pay for. This white paper highlights four key areas community financial institutions should focus on to better position themselves for success and new streams of revenue. It supports those recommendations with data-driven insights regarding small-business challenges and capabilities required to attract and retain their business.

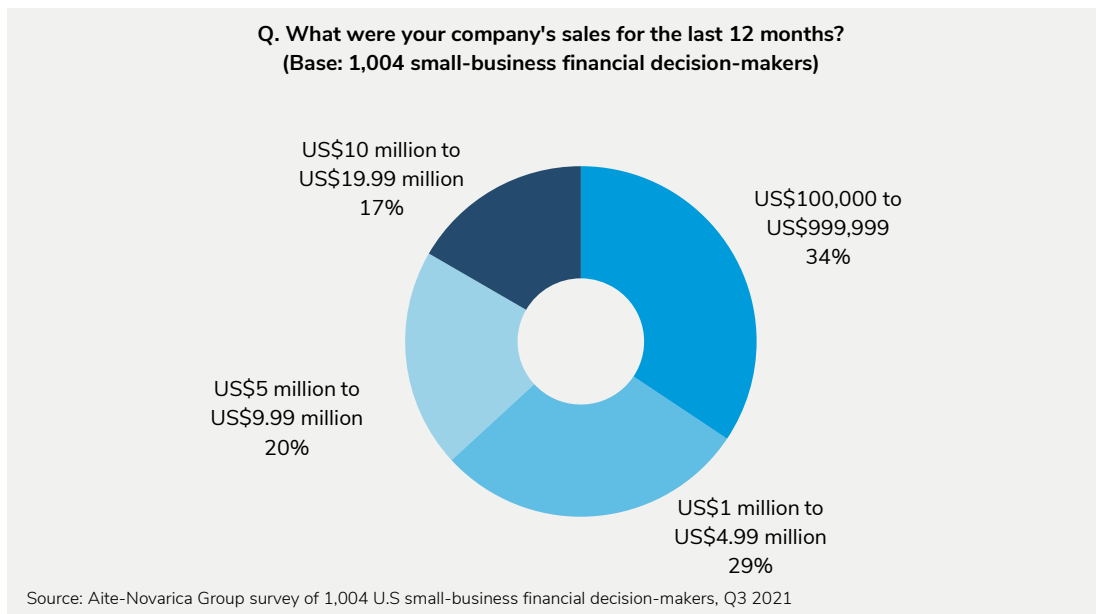
METHODOLOGY

This paper is based primarily on the results of a Q3 2021 Aite-Novarica Group online survey of 1,004 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 may define the segment, the group as a whole represents a large opportunity for banks. 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 of significance among differences 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.

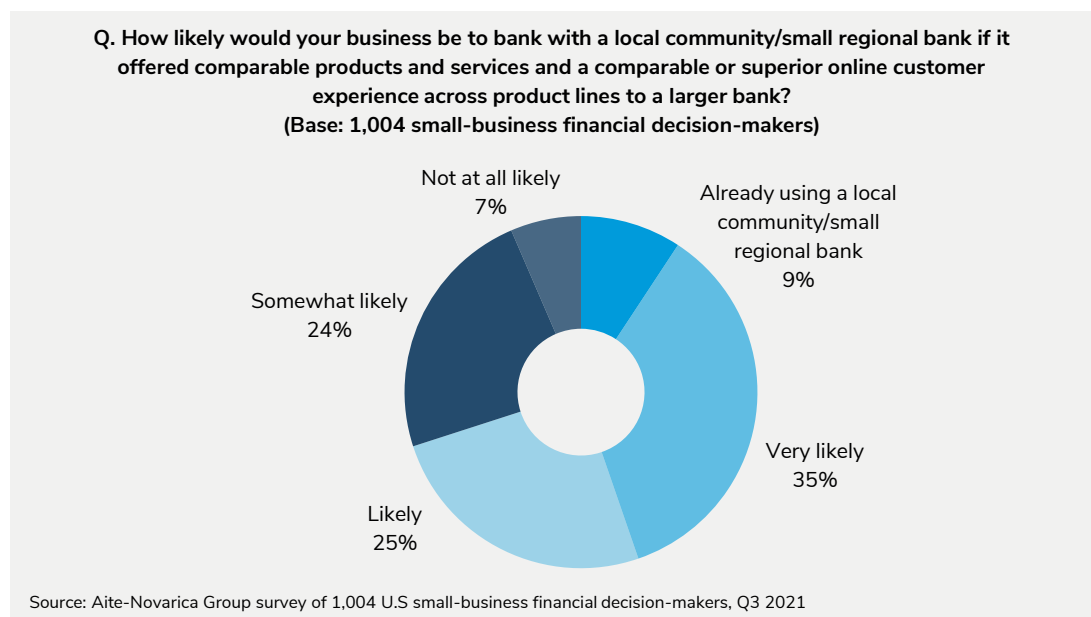
FIGURE 1: SURVEY PARTICIPANTS



MARKETPLACE

The largest banks dominate the U.S. small-business banking space. Approximately 58% of the more than 30 million small businesses in the United States consider one of the big four banks to be their primary bank, compared to less than 15% banking primarily with a small institution. That doesn't need to be the case, and never has the opportunity for change been greater for those financial institutions with the right strategy and offerings. As such, 60% of small businesses state they would be likely or very likely to bank with a local community/small bank if it offered capabilities and online banking experiences comparable to those of larger banks (Figure 2). Fortunately, advances in technology have made that possible at price points that fit the budgets of even the smallest community financial institutions.

FIGURE 2: MARKET SHARE CHANGES ARE POSSIBLE



Further, the four largest banks are also winning when it comes to attracting millennial-run businesses (millennials are twice as likely to bank with a big four bank than a small bank—41% vs. 21%) and those businesses most likely to adopt technology as soon as it is available (54% bank with a big four bank vs. 23% that bank with a small bank). Aite-Novarica Group believes those banks are winning because they are more likely to be viewed as being innovative, they have been faster to align with fintech companies to

broaden their product portfolios, and their capabilities and online experiences better align with small-business expectations. Community financial institutions must strive to better align their offerings with the expectations of millennial-run and tech-savvy businesses, as these businesses not only represent the future of the banking industry but also tend to show a greater propensity to pay for products than those run by older business owners (97% of millennial-run businesses pay for banking products and services vs. 77% of those run by baby boomers and seniors). These customers are accustomed to paying for products and services they value and are less likely to leave if the bank charges for them.

RECOMMENDED BANK FOCUS AREAS FOR GREATER SUCCESS AND REVENUE GENERATION

This section highlights four key recommendations for community financial institutions to better position themselves for success:

- Deliver a more modern and connected banking experience
- Invest in analytics and higher levels of personalization
- Offer more robust functionalities/capabilities
- Partner with fintech companies

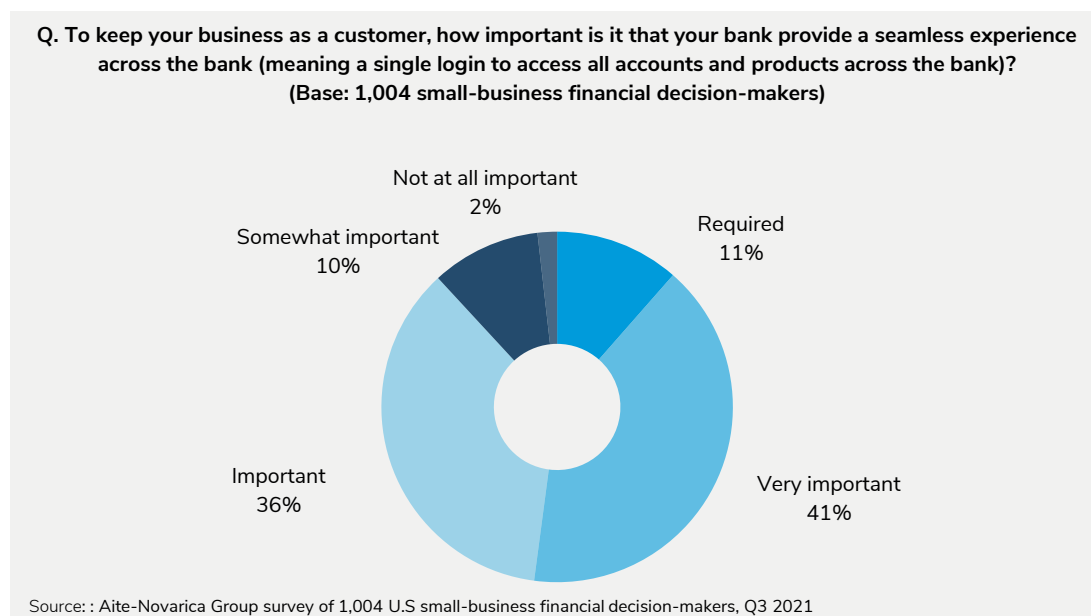
DELIVER A MORE MODERN AND CONNECTED BANKING EXPERIENCE

The online channel is the preferred channel for businesses to interact with their financial institutions. Further, the quality of the online experience is critical to both customer acquisition and retention. Thus, community financial institutions must continue to invest in their digital experiences to ensure they are modern and easy to use, with workflows that align with end-user processes and navigation across products, services, and channels. Despite the importance of the digital experience, 34% of small businesses are challenged by banking experiences that are not seamless and require them to log in to multiple systems; an additional 32% are somewhat challenged. Such experiences create unnecessary friction for customers and waste valuable time, while also making the bank look out of touch and dated. Customer expectations are highly impacted by personal experiences; therefore, banks must strive to better align with the seamless and connected experiences offered by companies like Amazon.

Banks not leveraging APIs and offering a connected customer experience are also missing out on important opportunities to cross-sell products and enrich experiences. For example, tight integration between online banking and lending offers customers the convenience to transfer funds and pay down loans from a single location, while also enabling financial institutions to potentially extend lines of credit or other credit products when customers are short on funds for upcoming payments. Another example is the ability to view both personal and business banking in a single location. When coupled with strong entitlement capabilities, this creates significant convenience to the more than 70% of small-business owners that leverage a single institution for both personal and business banking. Of businesses surveyed, 52% state a seamless experience across

the bank is required for or very important to keeping their business; an additional 36% state it is important (Figure 3).

FIGURE 3: THE IMPORTANCE OF A SEAMLESS EXPERIENCE



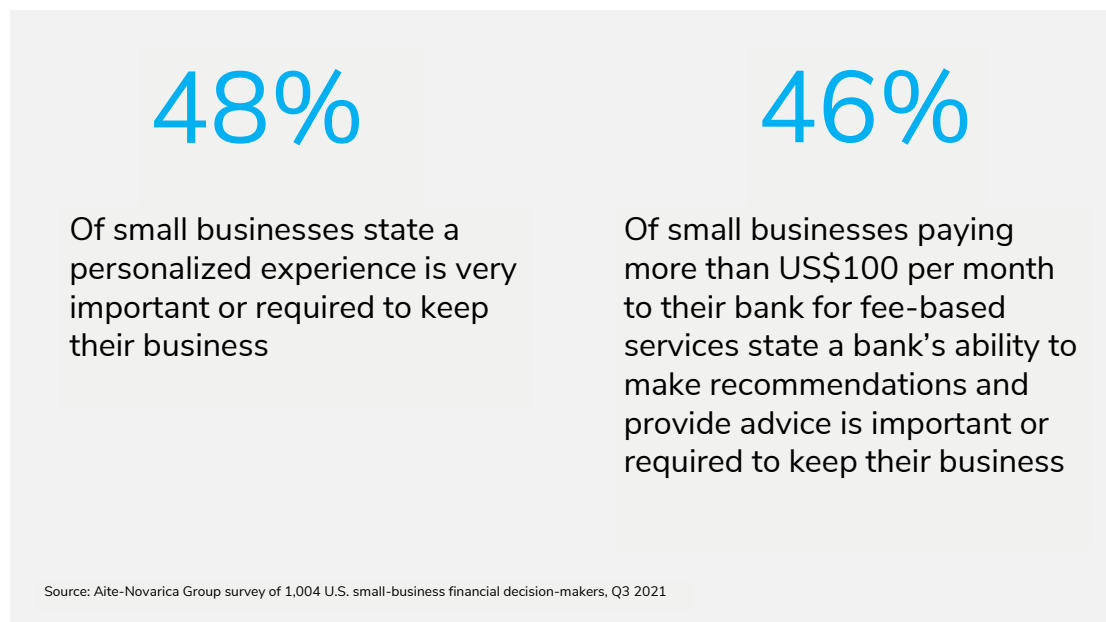
Finally, banking experiences must extend beyond the financial institution portal to also enable small businesses to perform banking transactions and manage funds from within client-preferred external systems, such as accounting and industry-specific platforms. This is an area in which many financial institutions are falling short, as 67% of small businesses state they are challenged or somewhat challenged to pull information from their bank site into external systems.

INVEST IN ANALYTICS AND HIGHER LEVELS OF PERSONALIZATION

Many small businesses feel banks and credit unions don't understand their needs. This is due in part to one-size-fits-all, cookie-cutter experiences and a lack of personalization and custom advice from their financial institutions. A greater investment in analytics and use cases beyond fraud prevention is needed. By embedding analytics into portal navigation, onboarding, product bundling, and cross-selling processes, community financial institutions will better understand customer needs and improve their ability to suggest products, make recommendations, and service small businesses. This will

position community financial institutions as partners and advisors rather than simply as transaction providers, and it will lead to greater cross-sell and revenue generation. It will also enable small banks and credit unions to create a more personalized end-user experience by delivering the insight needed to create unique experiences around capabilities and industry segments. Financial institutions must move in this direction, as 48% of small businesses state a personalized experience is very important or required to keep their business. A failure to do so will lead to attrition and customers feeling misunderstood. Further, an ability to offer custom advice based on customer knowledge will position community financial institutions to create more profitable client relationships; 46% of small businesses paying more than US\$100 per month to their financial institution for fee-based services state an institution's ability to make recommendations and provide advice is important or required to keep their business (Figure 4).

FIGURE 4: THE IMPORTANCE OF PERSONALIZED EXPERIENCES AND ADVICE



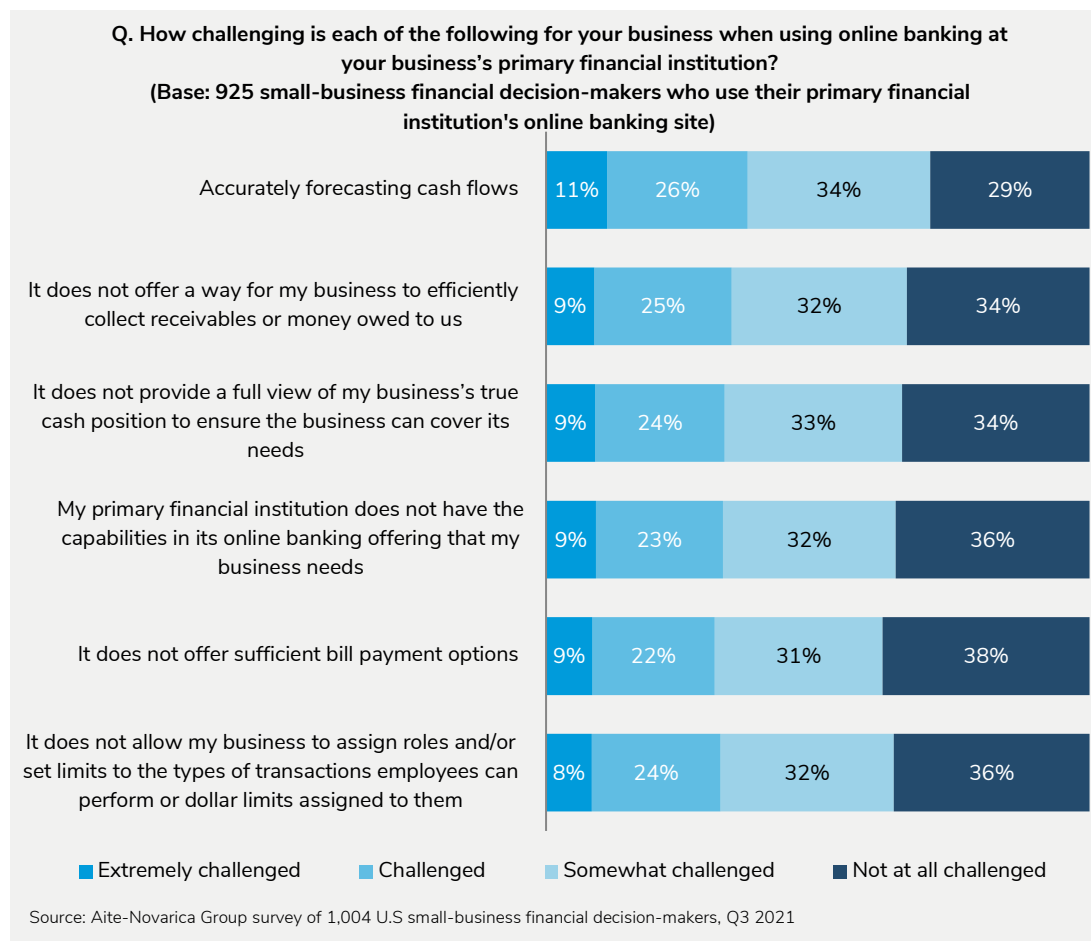
OFFER MORE ROBUST FUNCTIONALITY/CAPABILITIES

Many financial institutions, especially the smallest ones, continue to serve small-business customers with consumer products and services. While that may have been an effective strategy in the past, today's small businesses are sophisticated in their needs,

aware of new products being offered, and interested in using advanced technologies. In many cases, their needs more closely mirror those of commercial customers than consumers, while at a lower volume. Thus, failing to offer business capabilities such as positive pay, entitlements, invoicing, international payments (driven by a more global economy), and business-specific bill payment is leaving money on the table and failing to address their needs. It also limits cross-sell capabilities and the ability to grow with the customer as its needs increase, while also making it harder to begin charging for products it once received for free. Having a business account is also beneficial to the business for reasons beyond receiving the capabilities it needs, such as lower risk and liability (as an LLC protects its personal assets), easier bookkeeping and tracking of cash flow and expenses, and cleaner financials if the business requires a loan.

Offering the right products makes a financial institution more valuable and leaves customers less frustrated. Now more than ever, today's challenging economic environment has made it critical for small businesses to make faster payments, closely manage their finances, and reduce days sales outstanding as much as possible. Thirty-two percent of small businesses are challenged by their primary financial institution not offering the digital capabilities their business needs, while an additional 32% are somewhat challenged by this. Other frustrations include an inability to accurately forecast cash flows, no way to efficiently collect receivables or see a full view of their cash position, insufficient bill payment options, and a lack of entitlement capabilities (Figure 5).

FIGURE 5: SMALL BUSINESSES ARE CHALLENGED BY FINANCIAL INSTITUTIONS' DIGITAL CAPABILITIES



A broader set of digital capabilities will also increase a community financial institution's chances of winning its customers' payments business, and of becoming its primary bank. As such, 66% of businesses state that they would be more likely to give their valuable payments business to an institution that also offers nontraditional bank products (such as invoicing, faster payments, and forecasting) because it gives them a richer experience.

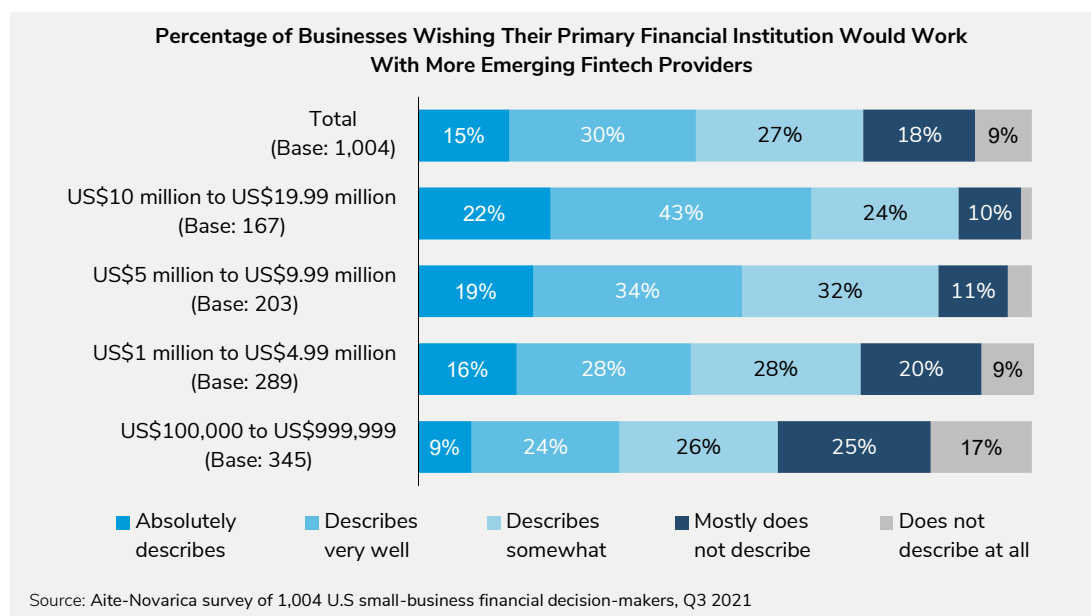
Of course, winning a customer's payments business also requires robust payment capabilities. Small businesses use or plan to use a broad range of payment types, such as business bill payment, ACH, wires, Zelle, and international payments. While real-time payment adoption by small businesses has been low to date, this primarily reflects their limited bank offerings. In fact, almost 30% of small businesses find it frustrating that their financial institutions don't offer them a way to make immediate payments. While

some community financial institutions are not yet seeing high demand for real-time payments, it is important to note that many businesses expect forward-looking and advanced capabilities even if they aren't ready to use them. Institutions requiring high demand to move forward with an initiative will often be too late.

PARTNER WITH FINTECH COMPANIES

The definition of banking continues to broaden as the needs of small businesses increase. As shown in the previous section, customers' banking expectations are no longer simply about deposits, loans, and payments. Most small businesses have already looked at alternatives to traditional banks and credit unions for key financial capabilities, such as cash flow management (72%), financial reporting (72%), digital invoicing (70%), and ways to collect payments and pay suppliers (69%), because most financial institutions have been slow to offer these capabilities. Further, more than 60% of small businesses are already working with fintech companies. Among businesses generating greater than US\$5 million, the percentage increases to 70%. In order to ensure future success, community financial institutions must broaden their offerings by partnering with fintech companies or risk disintermediation. Forty-five percent of businesses want to see their banks do this (Figure 6).

FIGURE 6: SMALL BUSINESSES WANT THEIR FINANCIAL INSTITUTIONS TO PARTNER WITH FINTECH COMPANIES



Bank/fintech partnerships bring with them many benefits. In addition to better addressing customer needs and positioning an institution as a provider of value, they align financial institutions with innovation and enhance their ability to generate revenue. Less than half (41%) of small bank customers view their banks as innovative. Additionally, 70% of small businesses believe to some degree that fintech companies are more likely than banks to offer products they are willing to pay for. Alignment with fintech companies will help to change this perception while also enabling the community financial institution to charge for new value-added capabilities.

Fortunately, several forward-looking online banking providers have begun forming fintech marketplaces/ecosystems by enabling integration and performing due diligence on behalf of their customers to make this process easier. Therefore, when selecting online banking partners, banks should look for open platforms with strong API capabilities, software development kits, and pre-integrated relationships to give them a leg up on slower-moving competitors.

CONCLUSION

Successfully servicing the small-business customer segment is no easy task; however, those community financial institutions willing to make the necessary changes and investments have much to gain. Central to their success is selecting the right digital banking technology provider with an open and modern platform, an API-first strategy for enhanced integration with third-party platforms and personalization, and a forward-looking roadmap that aligns with customer needs and expectations as they continue to evolve. Small businesses will pay for value. Those institutions offering it need to start charging for it.

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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