



**PARADIGM SHIFT IN
BUSINESS BANKING
FOR SMALL AND MEDIUM SIZED
ENTERPRISES**

CAPCO
THE FUTURE. **NOW.**

TABLE OF CONTENTS

INTRODUCTION	03	PARADIGM SHIFT	13	IN CLOSING	20
CURRENT STATE OF AFFAIRS	04 - 08	• Introduction to Ecosystem	14	GLOSSARY	21
TRENDS	09	• Historical State	15	REFERENCES	22 - 23
• Canadian Trends	10 - 11	• Paradigm Shift State	16	MEET THE TEAM	24
• Global Trends	11 - 12	• Future State	17		
		• Foundations of an Ecosystem	18		
		• Why is NOW the Time to Invest in Business Banking	19		



INTRODUCTION

Business banking refers to the offerings a financial institution provides to its business customers. Examples of offerings include: cash management, credit facilities, deposit accounts, payments, foreign currency conversion, and group benefits.

The world of business banking is currently undergoing a paradigm shift. The ecosystems that support interactions between banks, their customers, and other intermediaries (such as FinTechs) are changing due to shifting customer expectations, demographics, technology, and business models. This is especially true for small and medium enterprises (SMEs).

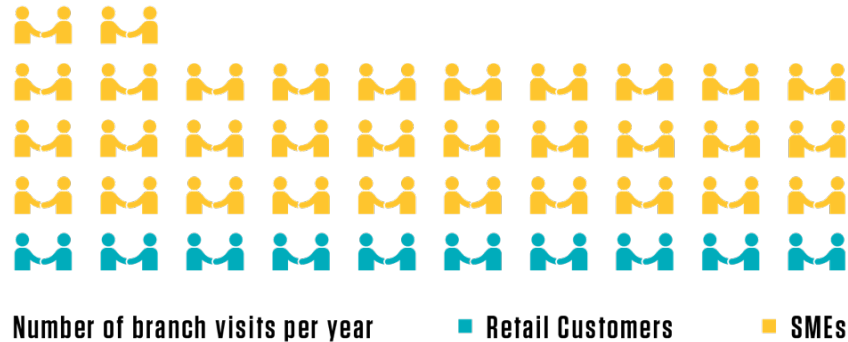
This point of view will describe the current state of the industry, identify notable trends, and provide our opinion on what the future of business banking could look like with sound advice to help you meet tomorrow's challenges.

Disclaimer: this point of view reflects Capco's professional opinion on the subject matter. Its content including predictions, statements and recommendations has been generated through diligent efforts of qualified professionals, and, as indicated by footnotes, is based on data and information published or otherwise provided by others. Although this point of view is an assessment of the current state of business banking, as well as current and future trends, it in itself does not provide, nor shall it be construed as, a warranty or guaranty of any specific outcome.

CURRENT STATE OF AFFAIRS

This section outlines the Current State of Affairs from the point of view of Small and Medium sized Enterprises (SMEs) and banks.

SMEs Still Rely On Traditional Banking



Research from J.D. Power indicates that SMEs still heavily rely on traditional "personal engagement" banking for their core needs, especially when compared to Canadian retail customers. With such a captive audience, Canadian banks have a built-in customer base when introducing new / enhanced products to market.

This means that while banks will need to play catch-up with new entrants for certain growth opportunities, banks as a whole still hold a competitive advantage in serving their customers' core financial needs.^[1]

Canadian SME's Satisfaction

Canadian SMEs who believe they are well served by their FIs^[2]



Canadian SMEs who feel like their banks are treating them fairly^[3]



Canadian SMEs are generally satisfied by the level of service that their existing banks provide. The enhanced level of trust also implies that SMEs would be more confident in trying out new products that are offered by their banks.

Nonetheless, Canadian banks should not allow this level of customer satisfaction to lull them into complacency. Instead, this should spur them into pushing the envelope in product and service innovation.

Increasing Competition From New Entrants

North American SMEs already using Non-Banks

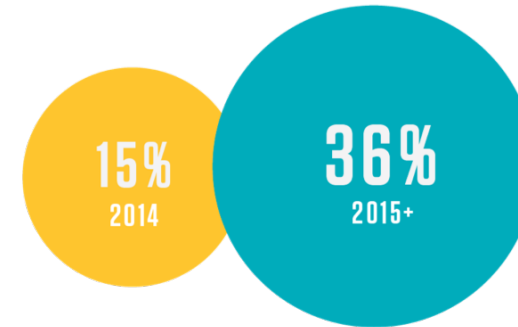


North American SMEs considering using Non-Banks in the future



48% of SMEs in North America are already using services offered by non-banks in some capacity, while 53% of SMEs in North America have considered using services offered by new entrants in the future. New competitors continue to disrupt the established business banking ecosystem by offering traditional banking services in new and innovative ways, which is directing revenue away from the banks at a rapid pace.^[4]

Decreasing Client Loyalty



North American SMEs who have switched their primary FIs

In 2014, more than 15% of SMEs in North America changed their primary bank. This trend was intensified with an estimated 36% leaving in 2015 and beyond. We expect this number to increase in the coming years as non-banks continue to create packaged products that are both complete and tailored for the needs of the SMEs.

Banks can avoid this attrition if they offer curated services aimed at SMEs and one such way of accomplishing this is to partner with other vendors.^[4]

Difficulty In Obtaining Finance

Canadian SMEs facing difficulties obtaining the capital needed to grow their business

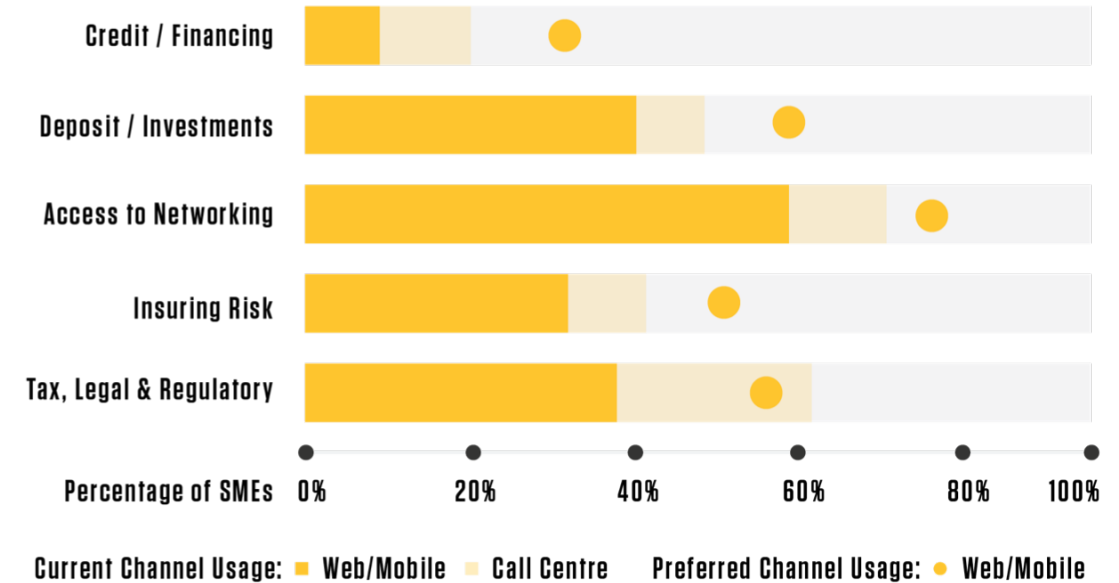


Canadian SMEs facing A/P issues due to inadequate cash flows^[5]



It is currently difficult for SMEs to obtain financing from banks due to a variety of factors such as a lengthy application process, large amounts of required documents, or uncertainty on their application status. As such, many SMEs have looked to new entrants, mostly FinTech companies, because their credit application processes are digital, streamlined and simple.

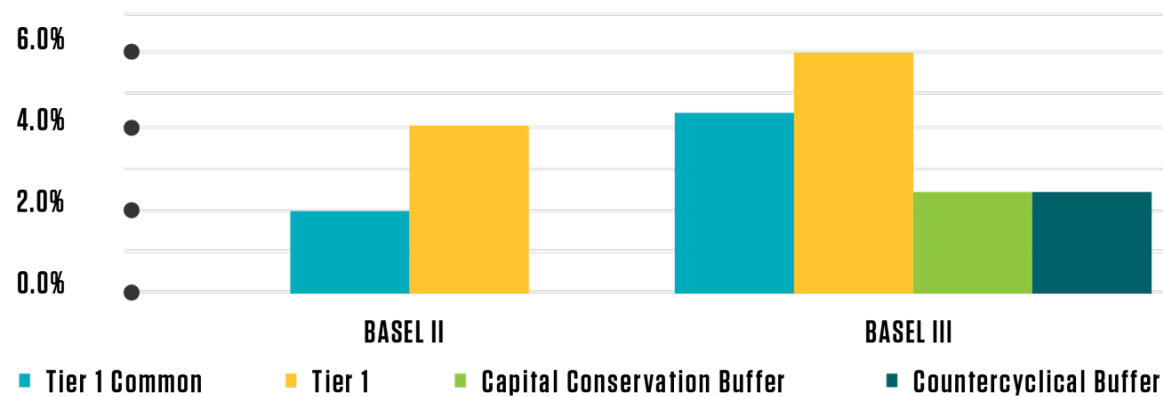
Online Banking Services For SMEs Are Not Mature Yet



There is a gap between the percentage of SMEs who would like to perform banking services online vs. those who actually do so in practice. This gap can be attributed to the lack of functionality and ease-of-use in existing platforms of the traditional bank.^[6]

Increased Regulatory Compliance

Basel II vs Basel III Requirements



With the implementation deadline for Basel III fast approaching (March 31, 2019), and a Basel IV Accord already in the works, capital requirements will become more and more stringent. If coupled with the potential decline in deposits from retail and business accounts, banks will face severe liquidity pressures which may result in a contraction in credit.

To Recap

- SMEs are the largest and most frequent users of core banking services through traditional channels (e.g. in-branch) and have generally been satisfied with these services.
- Despite this, incumbents are facing increased competition from non-banks who are providing a more customized and simplistic approach to traditional services.
- While banks continue to perform their services in a conventional manner, they are lagging behind in the "digital-first" world.

A low-angle, upward-looking perspective of several modern skyscrapers with glass facades. The buildings are dark and their reflections are visible on the windows, creating a complex geometric pattern of lines and shapes. The sky is a uniform dark grey.

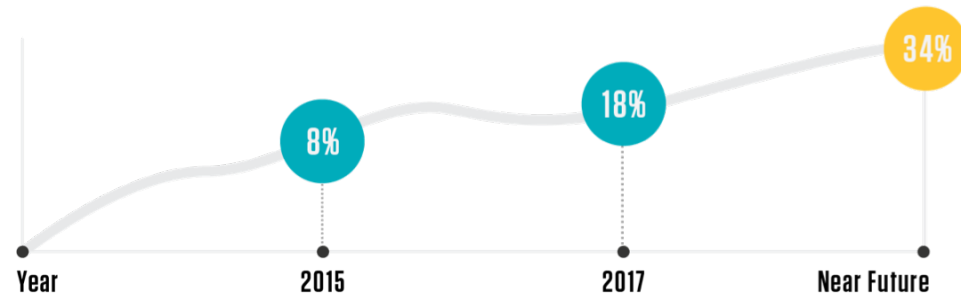
TRENDS

This section outlines the Canadian and Global trends experienced in the world of Business Banking for Small and Medium sized Enterprises (SMEs).

Continued Growth In FinTechs

FinTech adoption rates in Canada have grown significantly in the past 2 years and are expected to continue in the near future. To prevent attrition, banks must offer greater value-added services rather than commoditized banking products.

Canadian FinTech Adoption Rates^[7]



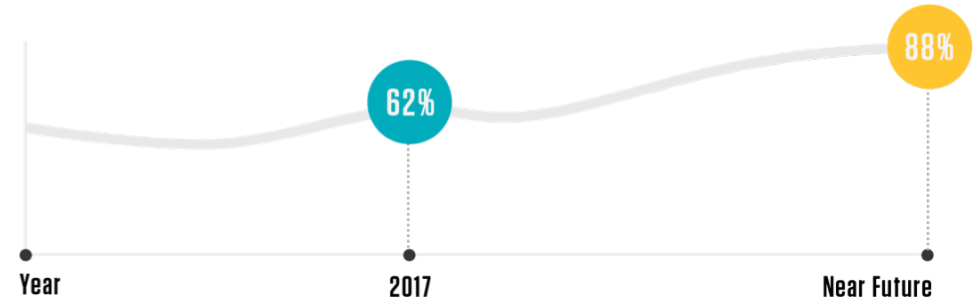
Due to the complexity in obtaining financing when needed, SMEs are beginning to look to non-traditional forms of funding. The following statistics show the projected percentages of SMEs who choose to fund their businesses through various unconventional channels in 2018.^[5]



Increased FI & FinTech Partnerships

Recognizing the threat of new entrants, banks are increasingly partnering with FinTechs who offer complementary services. This trend will continue, where 88% of Canadian banks plan to either continue, begin, or increase their partnerships with FinTechs.

Canadian FinTech Partnership Projections^[8]



Financial Institutions continue to not only partner, but also acquire FinTech companies. In the next 3-5 years, 50% of Financial Services firms plan to acquire FinTechs and incorporate them into their existing ecosystems.^[8] These acquisitions not only give banks greater economies of scale, but also add a greater variety of services which may be simultaneously offered to the customer.

Partnerships With Leading Universities

In addition to innovation labs, a number of banks have partnered with Canadian universities to catalyze their innovation. This provides additional means of attracting the best and brightest young minds to the industry.

SCOTIABANK / Ivey Business School, Queens University, Rotman School of Business

BANK OF MONTREAL / Ryerson DMZ Incubator

TORONTO DOMINION BANK / University of Waterloo Innovation Hub

In-House Innovation Labs

Banks around the world have formed their own in-house innovation labs. These banks are just some of the many around the world who have begun to invest significant amounts of resources in developing their own 'Digital Factories'. They recognize the importance of continuous innovation, speed to market, and attracting and retaining top talent, in order to remain competitive in the marketplace.



J.P.Morgan



Goldman Sachs



Tech Giants: Ecosystem + FinTech

In an effort to capitalize on their existing ecosystems and user base, technology companies have already begun integrating financial service offerings into their platforms. As indicated in the chart below, payments was the first service to be integrated.

Overseas technology companies have started to integrate insurance, wealth management, credit score monitoring, and personal lending into their platforms. This is a notable trend that has slowly started to permeate into the Canadian banking landscape.

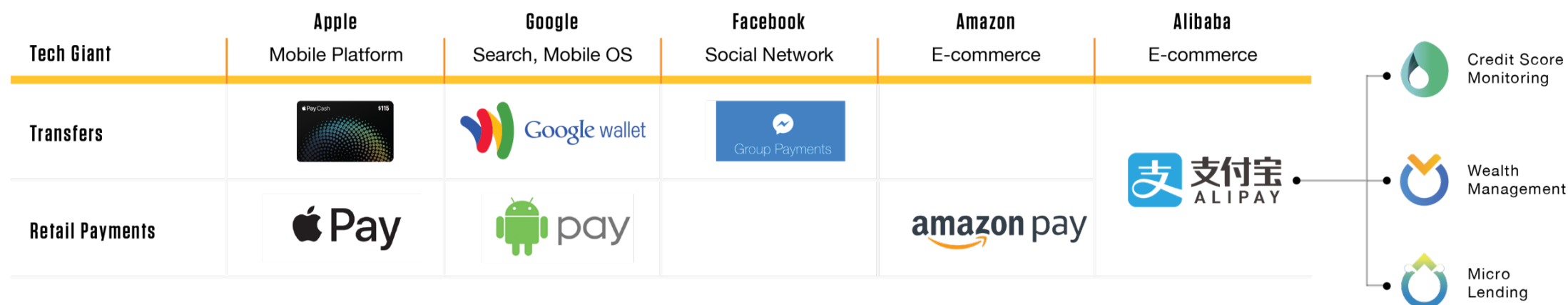
Banks are at risk of losing customer loyalty if they do not adjust to these trends. However, having recently developed solutions for mobile payments (Apple Pay, etc.), banks are positioned to move swiftly.

To Recap

FinTechs have seen adoption growth in recent years as SMEs are looking for non-traditional forms of service provisioning.

As a response to the increasing growth of FinTechs, banks have opted for two approaches - partnering up with FinTechs, and creating in-house innovation labs.

To be a market leader, both banks and FinTechs will need to capitalize on existing ecosystems through well formed synergies between service offerings and technologies.



PARADIGM SHIFT

This section explains the key concepts of an ecosystem, as well as the past, present (paradigm shift), and the future states of the business banking ecosystem for SMEs.

What Is An Ecosystem?

An ecosystem is an integrated system of connected parties, where each party forms beneficial relationships with one another and shares a set of common goals. Each party has a defined role, and information is shared amongst all parties. As a result, ecosystems make the customer journey easier by reducing the friction of data exchange.

The example below showcases how a customer interacts within an ecosystem when running weekend errands. Some services are provided by Costco, an integrated ecosystem, while the other services need to be sourced by the customer elsewhere.

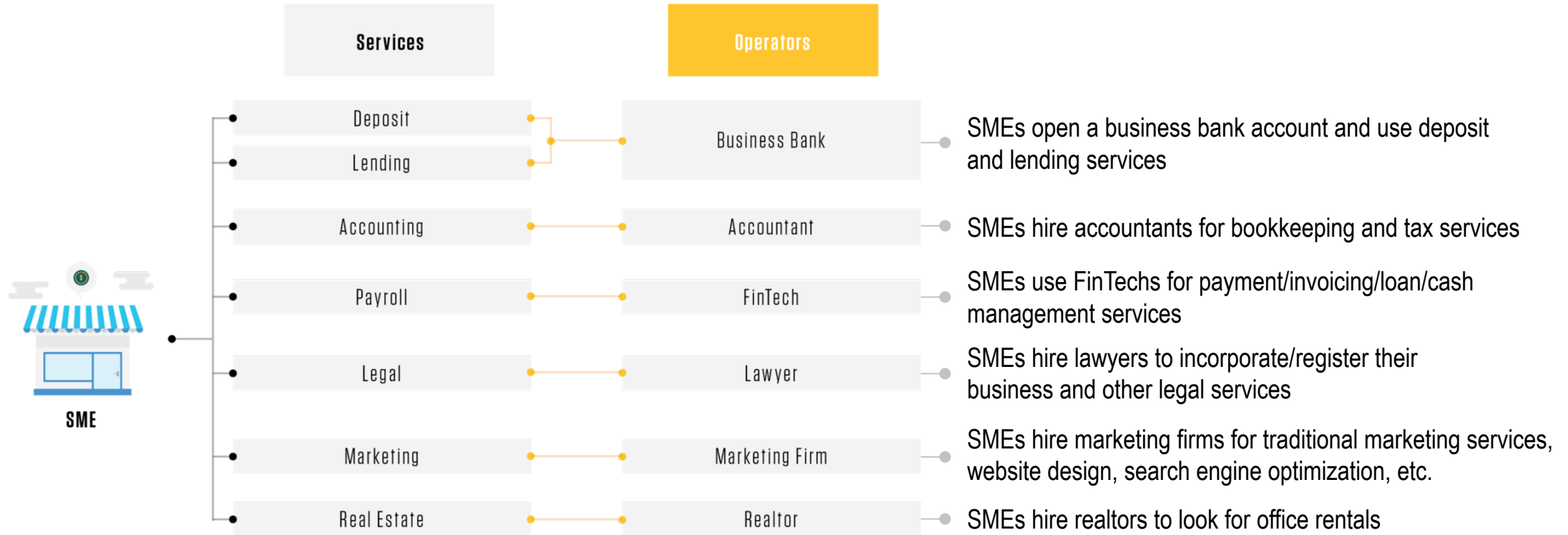


Insights

- 1** Service offerings within an ecosystem are complementary to one another. This provides the customer with a channel for one-stop shopping and provides the business with an opportunity to cross-sell.
- 2** Not all services need to be operated by the host of the ecosystem. For example, while Costco operates the ecosystem, its pharmacy is owned and operated by a third party company.
- 3** Some services are purposefully not integrated within an ecosystem. This is due to these services having low synergies with the company's core offerings or due to a lack of expertise in that service. For example, Costco does not offer financial services.

Historical State: Business Banking Ecosystem

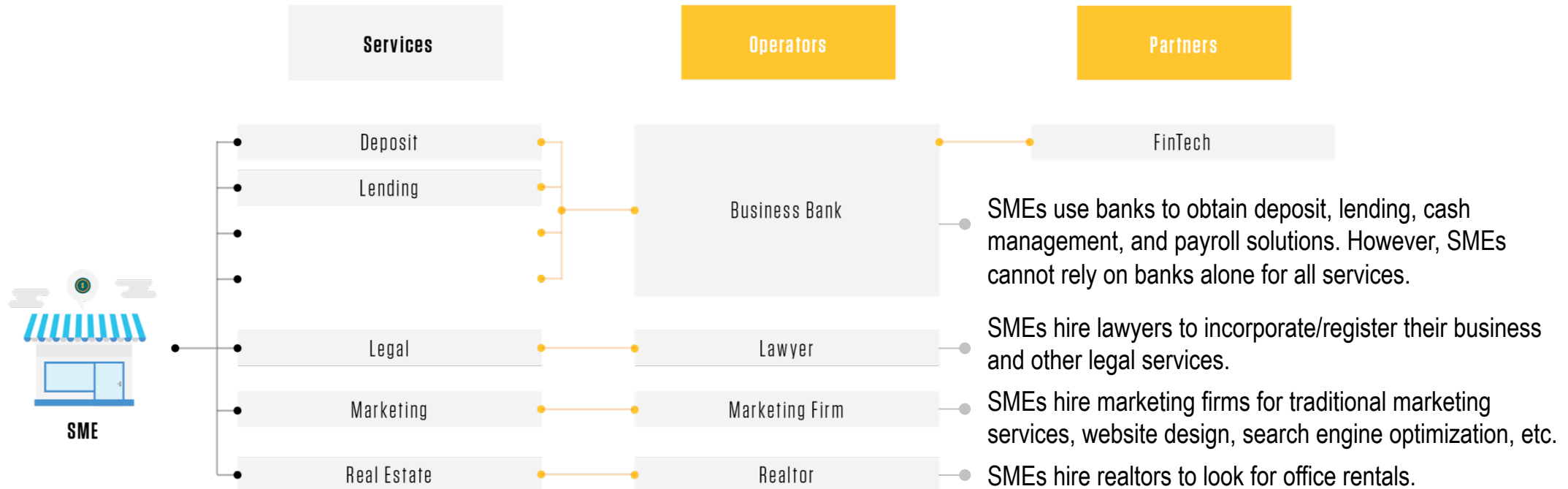
In the past, SMEs would get all their services through different service providers, with the bank being just one of them. The diagram below showcases the sample service requirements for SMEs and the operators who provide them when a SME starts a new business.



Banks were historically viewed as "just another" service provider for the SMEs.

Paradigm Shift In Action

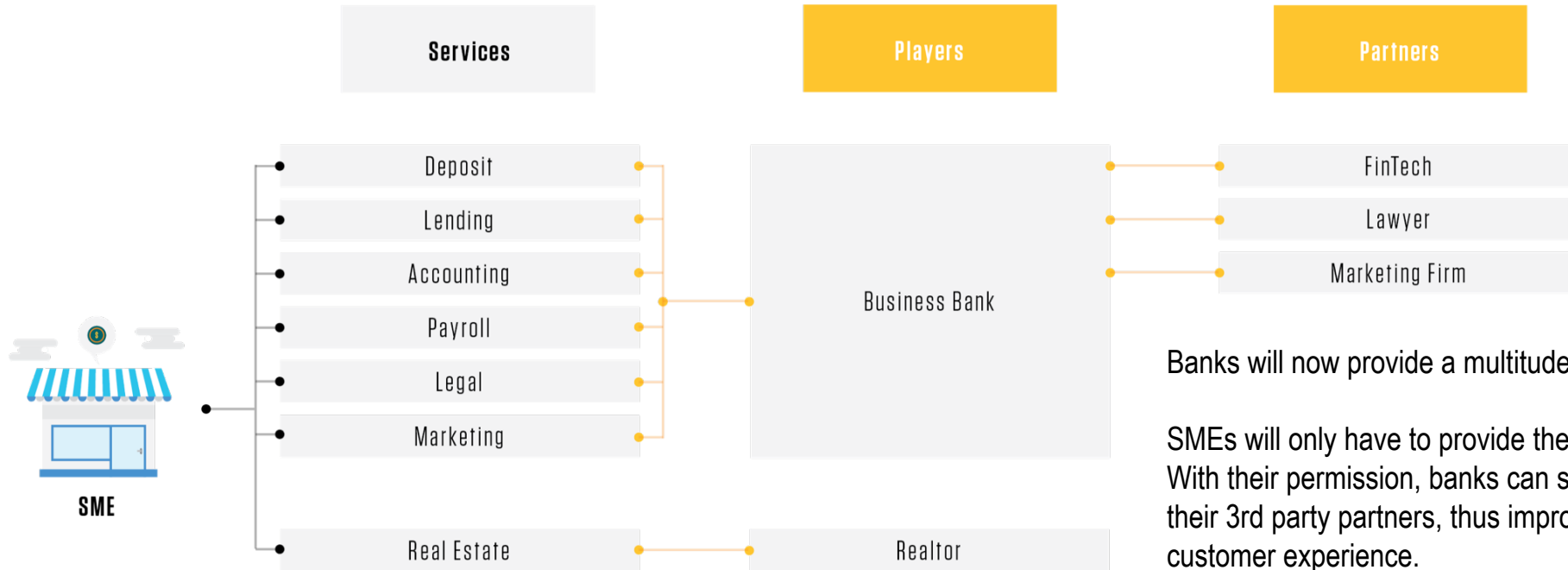
Based on recent developments and trends in technology, banks are beginning to form their own micro-ecosystems by forming beneficial partnerships with other service providers. The diagram below shows the larger ecosystem with all the key operators, as well as, the micro-ecosystems created by the bank. This shift allows SMEs to enjoy a wide array of services offered by the bank when starting a new business.



Banks are well positioned to become the key players within the business ecosystem for SMEs. They have the most access to client data, client capital, and adhere to the highest security and regulatory requirements.^[9]

Trending Future State View

Based on the accelerating pace of change within the industry, most service needs of SMEs are met through the business banking relationship. Similar to the "Costco-model" as mentioned earlier, leaders in banking will evolve into fully integrated ecosystems by collaborating with FinTechs and other 3rd parties to provide a full suite of high value-added services necessary to SMEs. The example below showcases how this ecosystem would look like in the future.



Banks will now provide a multitude of services.

SMEs will only have to provide their information once. With their permission, banks can share their data among their 3rd party partners, thus improving the overall customer experience.

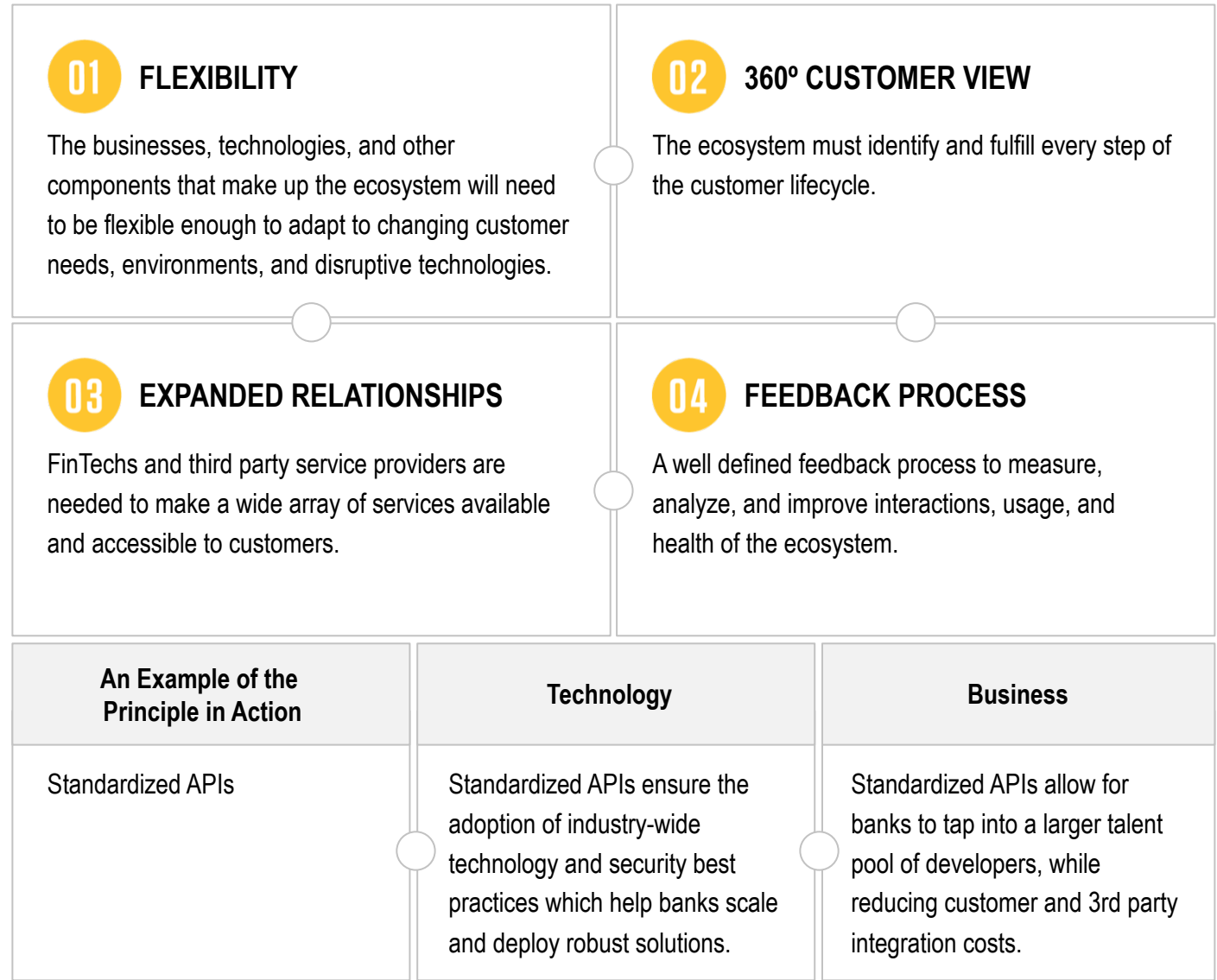


Some services, such as Real Estate, may not be seen as essential or complementary to the rest of the bank's offerings. As such, banks may not see a business case to incorporate such services into their ecosystems.

Principles Of The Ideal Ecosystem

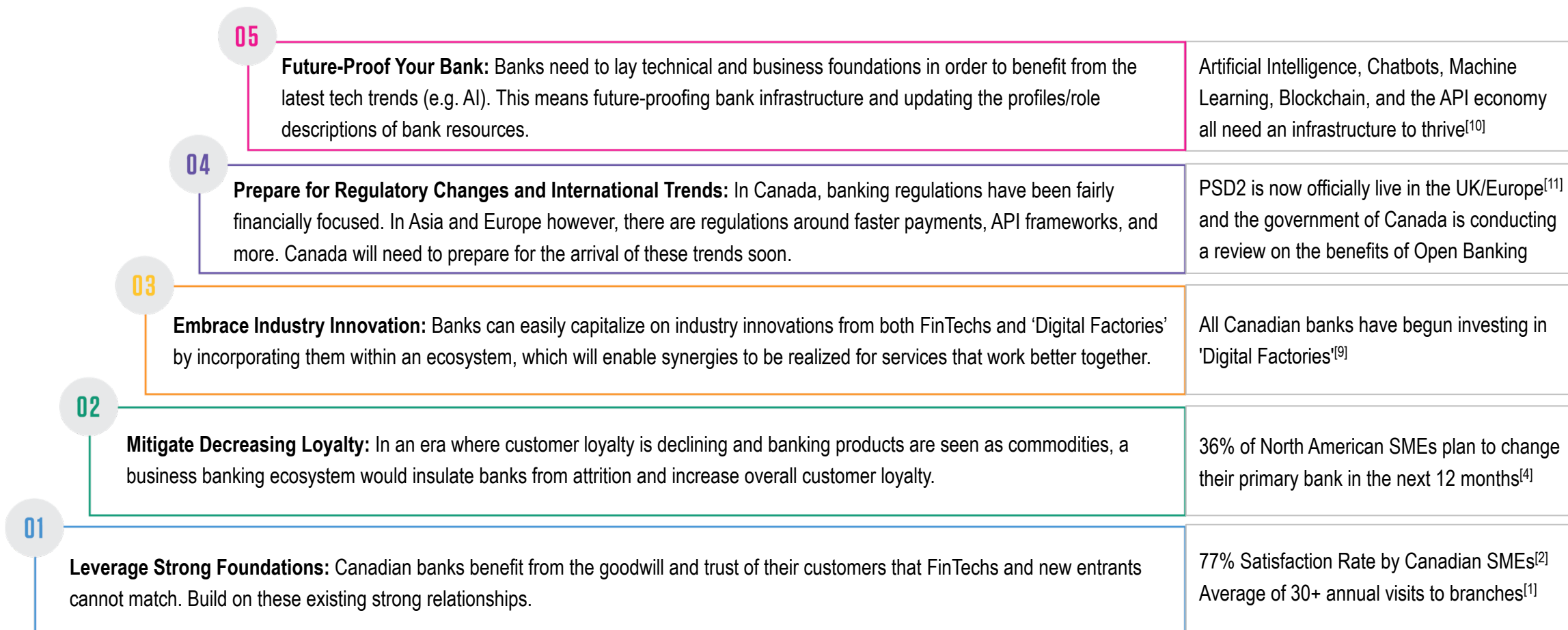
These 4 pillars are the principles Capco has identified as key success factors for the future of business banking. To achieve these successfully isn't easy, however, they are guidelines to consider as the business matures.

Without these four pillars, a bank reduces its ability to react to immediate customer needs and as a result, reduces its insulation to the increasing threat of disruption.



Why Is NOW The Time To Invest In Business Banking?

Technology is enabling innovation within business banking faster than ever. Here are the reasons and the roadmap to capitalize on the Paradigm Shift:





IN CLOSING

For large Financial Services providers, Small and Medium Sized Enterprises (SMEs) have often been in the awkward position of being too small to be individually catered to, yet too big for a one-size-fits-all approach. While Canadian banks have historically maintained solid relationships with SMEs through dedicated relationship managers, the entrance of new FinTechs and the increasing acceptance of new technologies have given SMEs greater choice. Consequently, banks are now beginning to feel pressure on continuing with the "status quo" for SMEs.

In response, leaders in banking have come up with various strategies to retain and grow their market share with SMEs. There have been two main approaches to accomplish this: creating in-house innovation labs and partnering with existing FinTechs. Regardless, any player who wishes to lead the market will need an effective ecosystem, as this allows the company's service offerings and technologies to work together and create synergies. An effective ecosystem can also provide a single channel for which the customer can access all services, making it easier for them to consolidate their financial services needs into one space.

By offering more on-demand products where SMEs can experience the convenience, engagement, and transparency through an easy-to-use interface, incumbents can better position themselves to compete with new entrants. Additionally, banks can better retain their existing customers, as it would be more difficult for a customer to leave a platform which already houses a myriad of its services. Therefore, the traditional view of Small-and-Medium Enterprise Banking will evolve into a technologically-driven form of information exchange and management, with the relationship management aspect serving as a conduit to achieve this and more.

Glossary

A/P – Accounts Payable or general obligatory short-term liabilities

API – Application Programming Interface, set of definitions and protocols to building application software

Basel III - Internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks. (<https://www.bis.org/bcbs/basel3.htm>)

Basel IV Accord - Proposed standard on capital reserves for banks, to mitigate against the risk of financial crisis

Customer Journey – Complete sum of experiences that customers go through when interacting with the company and brand

E-commerce – Electronic commerce

FinTech – Portmanteau of companies specializing in the emerging financial technology sector

KYC – Know Your Customer, process in which business identifies and verifies its clients to prevent money laundering, fraud, and terrorism funding

OS – Operating system

P2P – Peer to Peer

Paradigm Shift – Concept of fundamental change

POV – Point of view, opinion piece

PSD2 – Payment Services Directive 2, an EU regulation which requires banks to share customers' account information with third-parties, such as FinTechs, if the customer consents

Scalable Infrastructure – Capability of the system or network to grow and leverage from economies of scale

SME – Small and Medium sized Enterprises

SSO – Single Sign-On, session and user authentication service that permits user to use one set of login credentials to access multiple applications

References 01/02

- 01 Tews, J. (2014). Small Business Banking Satisfaction Rebounds As Fees Stabilize and Banks Focus on Customer Satisfaction. [online] J.D. Power.**
Available at: <http://canada.jdpower.com/press-releases/2014-canadian-small-business-banking-satisfaction-study> [Accessed 20 Dec. 2017].

- 02 Canadian Bankers Association (2016). Small and Medium Sized Enterprises: Lending and More. [online] Canadian Bankers Association.**
Available at: https://www.cba.ca/Assets/CBA/Files/Article%20Category/PDF/bkg_smelending_en.pdf [Accessed 20 Dec. 2017].

- 03 Sharma, S. (2017). CANADA VS US: FinTech. Mintel.**
Available at: <http://www.mintel.com/blog/finance-market-news/canada-vs-us-FinTech> [Accessed 20 Dec. 2017].

- 04 EY (2014). Advancing service in a digital age. Global Commercial Banking Survey 2014. [online]**
Available at: [http://www.ey.com/Publication/vwLUAssets/EY-global-commercial-banking-survey-2014/\\$FILE/EY-global-commercial-banking-survey-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-global-commercial-banking-survey-2014/$FILE/EY-global-commercial-banking-survey-2014.pdf) [Accessed 20 Dec. 2017].

- 05 Roman, P. (2016). Canadian SMEs shrug off uncertainty and eagerly anticipate growth in 2017. [online] Newswire.ca.**
Available at: <https://www.newswire.ca/news-releases/canadian-smes-shrug-off-uncertainty-and-eagerly-anticipate-growth-in-2017-615070734.html> [Accessed 21 Dec. 2017].

- 06 Strategy& (2015). Banks' small business imperative: New strategies for offering digital services for SMEs. [online] p.8.**
Available at: <https://www.strategyand.pwc.com/media/file/Banks-small-business-imperative.pdf> [Accessed 20 Dec. 2017].

References 02/02

- 07 EY (2017). The rapid emergence of FinTech. EY FinTech Adoption Index 2017. [online] EY.**
Available at: [http://www.ey.com/Publication/vwLUAssets/ey-FinTech-adoption-index-2017/\\$FILE/ey-FinTech-adoption-index-2017.pdf](http://www.ey.com/Publication/vwLUAssets/ey-FinTech-adoption-index-2017/$FILE/ey-FinTech-adoption-index-2017.pdf) [Accessed 22 Dec. 2017].

- 08 PwC (2017). Redrawing the lines: FinTech's growing influence on Financial Services. Global FinTech Report. [online] PwC.**
Available at: <https://www.pwc.com/gx/en/industries/financial-services/assets/pwc-global-FinTech-report-2017.pdf> [Accessed 22 Dec. 2017].

- 09 Alexander, M. (2017). RBC, Scotiabank Get Highest Rankings on Canada FinTech Efforts. [online] Bloomberg.com.**
Available at: <https://www.bloomberg.com/news/articles/2017-02-17/rbc-sciotiabank-get-highest-rankings-on-canada-FinTech-efforts> [Accessed 31 Jan. 2018].

- 10 Conroy, J. (2018). Top 10 Trends in Retail Banking & Payments, 2018: Accelerating Evolution | Aite Group. [online] Aitegroup.com.**
Available at: <https://aitegroup.com/report/top-10-trends-retail-banking-payments-2018-accelerating-evolution> [Accessed 31 Jan. 2018].

- 11 Hafstad, Thomas, et al. (2018). PSD2 - Strategic Opportunities beyond Compliance. [online]**
Available at: <https://www.evry.com/en/news/articles/psd2-the-directive-that-will-change-banking-as-we-know-it> [Accessed 23 Mar. 2018].

Meet The Team



Daman Gill

Daman is a Principal Consultant in Capco's Payments Practice with over 9 years of experience working in business and technology delivery across the full delivery lifecycle within North America, UK and India. Daman has supported clients across many large business transformations, technology transformations and M&A programs within the Banking and Cards Industries.



Tom Zheng

Tom Zheng is an Associate at Capco with experience on large-scale digital transformational projects, where he has served in Project Management and Test Automation roles. Tom specializes in the Capital Markets, Retail and Commercial Banking, and Payments domains, and possess past work experience in private equity, commercial lending, and real estate financing.



Alexander Fonkatz

Alexander is an Art Director and Senior Experience Designer at Capco with over 12 years of experience in telling visual stories. The last 5 years he specialized in delivering enterprise level digital products for banks and startups in the Financial industry.



Diana Halder

Diana Halder is a Financial Services executive based in Toronto, Canada. She has over 11 years of experience in payments strategy, large scale payments program delivery and plays a key role in defining innovation in payments for Canada. Diana is a member of the Standards Council of Canada and represents Canada on the ISO Working Groups of Financial Services.



Rebecca Liu

Rebecca is an Associate at Capco with experience working on large-scale transformation projects by serving in the Project Management and Testing capacities. Rebecca specializes in the Payments and Financial Fraud domains, with previous work experiences in finance and project management.



Sunil Bansal

Sunil Bansal is a Consultant at Capco who specializes in Payments & Product Management. Sunil has experience on large scale projects within the Top 5 Canadian banks, including the implementation of an enterprise level payments platform. He has experience performing financial analysis, creating product roadmaps , and creating customer journey maps.

A low-angle, upward-looking perspective of several modern skyscrapers with glass facades. The buildings are dark and their reflections are visible in the windows, creating a complex geometric pattern of lines and shapes. The sky is a uniform dark grey.

THANK YOU
