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Unlocking the potential of SME banking

The Edge, Malaysia

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From street markets to kiosks to mom-and-pop shops and factories, Malaysia is rich in small and medium enterprises — and they matter. SMEs account for 48% of total employment and 37% of gross domestic product, but only a quarter of total banking pools, according to McKinsey research.

Also, they are changing. Pushed in part by Covid-19, the country's SMEs are rapidly digitising. By 2026, we estimate that online will be the primary sales channel for 44% of them, significantly higher than in the rest of Asean (36%). We estimate that nearly half of SMEs are already operating across multiple channels, including e-commerce platforms.

These two factors — under-representation in banking, plus rapidly growing digital capabilities — add up to significant opportunities. Traditionally, the banking needs of SMEs have been served by a high-cost relationship manager-led model. The problem is that financing has often been directed at established businesses that have acceptable collateral in hand and a strong credit profile.

The result is that too many SMEs cannot get financing: 55% of micro and small enterprises and 35% of medium ones are dissatisfied with their options. And that matters: more than 70% of digitally savvy SMEs — those that get most of their revenue from digital channels — are investing in expansion and their need for financing is acute.

The opportunity, then, is to create a profitable digital-led model to serve these SMEs. There is momentum. According to McKinsey research, the digital SME banking revenue pool will grow about 20% a year for the next five years, owing to the emergence and expansion of new digital banks and continued regulatory support. In 2022, five digital banking licences were approved, which should help to enhance fully digital propositions for SMEs, and there will still be significant opportunities for banks to unlock.

To successfully seize these opportunities, banks will need to devise a compelling strategy — and to do so quickly. There are four key actions to consider.

- **Develop tailored value propositions.** It sounds simple: Financial institutions need to understand SMEs' specific difficulties and then deliver simple, focused solutions to address them. One example: offering operating accounts that allow payments across multiple channels, faster reconciliation and cash flow forecasting. The principle should be to make it easier for SMEs to meet their banking and management needs, wherever they are. The deployment of analytic tools can help. Using internal and external data sources, such as transactions, e-commerce sales or point-of-sales data, can provide a better picture of SMEs' credit, and thus help them to qualify for a higher loan limit;
- **Build seamless digital journeys.** Digital SMEs need funds quickly in order to serve changing consumer preferences, and also to expand. They want cash flow insights and faster reconciliation across platforms. One priority, then, is to create seamless omnichannel capabilities — going from offline to online, and vice versa. Effective digitisation can also help address an irritating sticking point — that it takes so long to process loan applications (three to four weeks). Finally, offering automated toolkits can help SMEs address common problems such as cash and collections monitoring;
- **Reimagine risk management.** SMEs are more likely to have their loan applications turned down, in part because traditional metrics are not suited to evaluating their business models and creditworthiness. Deploying analytics capabilities could enable better credit risk management. Modular credit decision engines that incorporate insights from alternative data sources, such as sales on e-commerce platforms and utility bills, could replace or supplement traditional credit underwriting, and thus help get credit to high-potential SMEs that might not meet traditional standards. Banks could also explore artificial intelligence-powered monitoring and early-warning systems; and
- **Provide services that go beyond banking.** SMEs want and are willing to pay for non-traditional banking services that financial institutions are well positioned to provide, such as payroll, inventory management, expense management, accounting services and cybersecurity. They can also help their customers grow, by offering tools such as digital marketing and business platforms that connect SMEs with each other. All this not only results in new revenue streams but also builds loyalty.

The landscape for SME finance is evolving rapidly in Malaysia and throughout the region. If banks do not step up, there is little doubt that new entrants, such as fintechs, will fill the gaps. Doing better by SMEs, then, is not only good for those enterprises, but for banks, too — and, ultimately, for Malaysia as a whole. ■

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SUMMARIES

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