Retail banking in crisis

Why banks need to provide more than financial services to smbs

Retail banks are in a tricky position. Recent results from the banking sector have been mixed, while the banks that are doing better are tainted by bad press from bonuses and illegal activities in their investment arms. And despite the problems of 2008, banks across Europe have missed regulator targets to retain safe assets and avoid future panics by €300 billion. The perception is that banks are the bad guys.

Trust in banks has never really recovered from the financial crisis of 2008. The idea of the friendly local bank manager, already on the wane, was broken completely. Customers, especially small and medium-sized businesses (SMBs), have since struggled to believe that banks truly have their interests at heart. According to research from PwC less than one in three customers now trust their retail bank.

New challenger banks are looking to take advantage of this failure of trust. In the UK, Metro Bank, the first new high street bank in over a century, has been followed by several others, including Civilised Bank and Aldermore.

It's not a phenomenon limited to the UK. Starling is planning to launch in Ireland, and Fidor Bank in Germany has been growing since 2007 and is planning to launch in new markets. And Spanish bank BBVA sent shock waves through the industry when it acquired US digital-only bank Simple for a staggering $117 million last year.

All of these challenger banks use similar attack lines – they don't have the baggage of the past, they will use new technology to deliver exactly what the customer wants, and they are focused on the needs of the customer. Some are targeting particular markets they say are underserved – Civilised Bank, for example, is marketing itself as the new bank for SMBs that is 'fair, transparent, and responsible'.

Added to this is the ongoing reputational hits that are nothing to do with retail banking, but still manage to taint the names involved – such as the regular negative headlines around bonuses, or the revelations that the investment arms of banks have been engaging in illegal activities.

The same PwC research singles out the 'customer experience' as the most significant factor in determining and rebuilding trust in financial services organisations. The problem for banks is that the core services they offer are highly commoditised.

The basic everyday experience of retail banking – deposits, transfers, bill payments, and so on – is hard to distinguish from one bank to another. This makes loyalty more difficult to engender – and as trust in banks fails to recover, then the risk of churn increases as people are attracted by new entrants to the market without the reputational problems of their long-standing rivals.

The lending gap misconception

With financial services in a reputational tailspin, banks are a handy scapegoat for a group looking to protect their own.

There is a general perception by governments that SMB success is entirely predicated on the amount of money available to borrow. Success is measured by the amount being loaned – if it's increasing, then this suggests confidence and is a good thing.

If it's decreasing, then governments will call on the banks to lend, or introduce policies that encourage lending. It's a win-win situation – if lending is up, the government's policies are doing well. If it's down, then banks are the problem.

But this is a poor metric for measuring the success of SMBs, and the relentless focus on it is misguided. Seventy-five per cent of small businesses choose not to borrow when starting their business or expanding. Whether it's because they already have the capital available, or they don't want to take on the extra risk of debt, the majority don't require this sort of help from banks.

The growth of digital services

It's increasingly rare for people to visit their bank branch these days – only certain transactions make that necessary. In fact, the main point of contact any SMB customer will have with its bank is through its digital services – checking balances, reconciling accounts, running payroll, and so on.

With branch banking declining, 'digital' is seen as the major way banks can differentiate from the competition. Many challenger banks are launching without branches, and promoting themselves as forward-looking, digital-first banks. These banks market their lack of branch infrastructure as a positive aspect – they can pass the savings on to their customers, and focus on delivering the best online and mobile experience, rather than just an added extra.

Increasingly, technology companies such as Facebook are launching financial services. These companies don't offer, nor do they want to offer, a suite of banking services. Rather they are selecting particular products that will improve engagement and bring them closer to the customer.

Consultancy McKinsey estimates that this challenge from new digital entrants will put upward of 30 percent of the revenues of a typical European bank in play, particularly around high-turnover commoditised products such as personal loans and payments.

Banks are already seeing a financial impact. Deutsche Bank's fourth quarter results led some to speculate on the future of their retail arm. Citigroup and Bank of America were described by the Wall Street Journal as 'struggling to boost profits'.

What started as a perception issue has suddenly become very real.

Reframing 'digital services'

Among all of these threats to banks, there is also an opportunity. Launching and growing an SMB is no mean feat. Each business faces similar challenges, whether it's a detailed business plan that takes everything necessary into account, or dealing with late-paying clients, or attracting the right talent to help them grow.

To meet these challenges SMBs need digital tools – marketing, accounting, HR and so forth. These tools used to be the preserve of big business that could afford IT departments to manage these services. But now, there are nearly 6,000 small business focused apps available on the web.

Parts of a business that used to require entire teams of people are now 'virtualised' by software, and these tools are increasingly available as cloud services. Rather than installing software on a number of PCs, access is available on-demand, online.

When banks think about delivering 'digital services' to their customers, they need to think more broadly. It's about more than just the services you receive in the branch, but now on your smartphone or laptop. Banks that truly want to support and nurture their SMB customers should provide both the tools that they need and the ones they don't know they need.

So, for example, rather than simply providing a loan, overdraft, and an upgraded account with a number of benefits, banks should instead listen to their customers' requirements and provide the tools for them to take action.

If a sole trader is spending too much time balancing their books, but can't afford an employee who can be dedicated to this task, then the solution may be accountancy software.

There are also opportunities where SMBs are unaware of what could help them. So a small business owner may know that they need accountancy software and an office suite in order to run their business more effectively, but may not know the benefits that a CRM system and website creation software can deliver.

Take, for example, a carpet cleaning business that has until now got by on word-of-mouth recommendations, and the occasional call via a business directory. Its bank recommends and provides a CRM system to help the business retain customers.

Working closely with the bank the business identifies loyal customers and launches a referral scheme to acquire new customers. Now the business is getting more enquires, the bank suggests that it launches a website and again provides the tools. This leads to expansion, higher credit balances for the bank and a requirement for additional finance.

Suddenly these tools have created a platform for engagement by providing insight that the bank can base its advice upon. The bank is no longer a provider of products the business can get anywhere else. It's become a trusted partner that the SMB is fully engaged with.

Banks thrive when their customers do well, so it is in their interests to position themselves as the true friend to SMBs – not just a place to keep and move money around, but providing digital services that help businesses to grow and succeed.

From transaction to engagement

Small businesses make up almost all – 99.8 per cent – of enterprises in Europe. 20.7 million of these businesses account for over half of the total turnover in the European, 'non-financial' economy.

Banking is behind when it comes to digital services. McKinsey estimates that retail banks have digitised only 20 to 40 per cent of their processes and 90 per cent of European banks invest less than 0.5 per cent of their total spending on digital. The traditional retail banks are playing catch up. The issue is how they choose to catch up – or indeed leapfrog.

The temptation will be to simply digitise their services to match the challenger banks and digital upstarts. However, given the severe reputational damage of the past few years, the banks that really want to make sure that their customers stay will offer compelling reasons to stay by not just being a bank, but a provider of digital services, both financial services and broader business services.

By providing more and better services, the bank will increase its insight into the business and its ability to provide timely and relevant guidance and counsel. Only then will banks move from a being a transaction provider to an engaged partner.

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