BANKING ON SMEs: TRENDS AND CHALLENGES

Perspectives from SME Banking Leaders

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About IFC

IFC – a sister organization of the World Bank and member of the World Bank Group – is the largest global development institution focused on the private sector in emerging markets. We work with more than 2,000 businesses worldwide, using our capital, expertise, and influence to create markets and opportunities in the toughest areas of the world. In fiscal year 2018, we delivered more than $23 billion in long-term financing for developing countries, leveraging the power of the private sector to end extreme poverty and boost shared prosperity. For more information, visit www.ifc.org

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Acronyms

API	Application Programming Interface
CRM	Customer Relationship Management
EAP	East Asia and the Pacific
ECA	Europe and Central Asia
GSI	Goods & Services Tax in India
KYC	Know Your Customer
LAC	Latin America and the Caribbean
MENA	Middle East and North Africa
MNO	Mobile Network Operator
MSME	Micro, Small and Medium Enterprises
NBFI	Non-Bank Financial Institutions
NPLs	Non-Performing Loans
SA	South Asia
SME	Small and Medium Enterprises
SSA	Sub-Saharan Africa

Workers at Microvast's assembly line in Huzhou, China.

Foreword

The IFC, a member of the World Bank Group, is committed to supporting Micro, Small and Medium Enterprises. As part of our larger Creating Markets strategy, we help mobilize private and public sector stakeholders to expand financial inclusion. Yet small businesses face significant challenges accessing finance and other resources they need to thrive.

IFC's MSME Finance Gap study, launched in 2017, found that 40 percent of MSMEs, the equivalent of 65 million enterprises in emerging markets, need an estimated $5.2 trillion in additional financing to develop and support their businesses. In addition, the informal sector remains largely underserved with a roughly $2.9 trillion demand for finance. There is a significant opportunity for financial institutions to increase their small-business banking infrastructure and cater to this market segment.

IFC conducted the global SME Banking survey to better understand the challenges and trends SME banking operations experience in serving the small business segment in their countries. More than 110 SME Banking practitioners and leaders from around the world participated in the survey. The survey findings provide insight into the trends and dynamics of SME finance, identify pain points, and illuminate the future of SME banking in a digitized world.

More than half of the survey's respondents indicated that credit is the top challenge in SME finance. A third said that external factors pose challenges to sustainably serve small businesses, stressing issues such as the macroeconomic environment and government policy changes. Other challenges include technology adoption, client engagement, and competition. More than half of the respondents said that they would invest in technology systems as a priority, followed by around a fifth that would invest to improve segmentation, followed by SME capacity building and product design.

While there are serious hurdles to expand SME finance in emerging markets, there are also sizable opportunities for financial institutions and policymakers to work together to improve the enabling environment, drive innovation, develop collaborative frameworks, and design robust propositions. Wide engagement of various stakeholders will develop new approaches in SME finance to help close the SME finance gap in emerging markets, while contributing to financial inclusion and job creation.

Paulo De Bolle
Senior Director
Global Financial Institutions Group

Executive Summary

What is the future of SME banking? In IFC's inaugural SME business banking survey, we asked the heads of SME Banking operations serving small businesses around the world. The online survey launched in 2018 posed questions to better understand what the biggest issues SME banking leaders are grappling with and where they see opportunities to run innovative, competitive and sustainable SME banking units.

The survey received responses from 114 SME banking executives serving more than 17.5 million small businesses from the biggest SME banks working at a regional and multinational level. Of the total respondents, 14 percent serve small businesses in Latin America and the Caribbean (LAC), 8 percent in East Asia and the Pacific (EAP), 11 percent in South Asia (SA), 16 percent in Europe and Central Asia (ECA), 12 percent in the Middle East and North Africa (MENA), 30 percent in sub-Saharan Africa (SSA), and 9 percent cover multiple regions.

Figure 1: Where the respondents serve small businesses

Latin America and the Caribbean	14%
East Asia and the Pacific	8%
South Asia	11%
Europe and Central Asia	16%
Middle East and North Africa	12%
Sub-Saharan Africa	30%
Global	9%

This report aggregates the responses to provide insight into the biggest issues occupying SME bankers' minds, broken down by regional trends and client-base size. The analysis includes the challenges banks face while serving small businesses, investment areas that are yielding results and innovations that will shape SME banking and client engagement going forward.

IFC launched this survey and report because it saw a gap in the market. Small businesses represent a significant part of the world economy, and can be one of the strongest drivers of economic development and employment when given the right tools, have access to financial services and operate amid a supportive regulatory environment. However, there is no guide or best practices manual for SME banking practitioners to consult as they design, implement and grow SME banking operations around the world.

IFC worked with Genesis Analytics, supported by Atlas.ti software, to conduct the qualitative data analysis on the survey responses. For each question, the responses were grouped into thematic categories to calculate the response frequency. Qualitative analysis was then conducted on the themes that appeared with the highest frequency to unpack the key issues and trends. The full quantitative survey results are available in the appendix of this report.

Pain points

The survey results indicate the two biggest challenges SME banks contend with globally are credit risk, with half of the respondents noting this as a top challenge, and external factors, with a third stressing issues such as the macroeconomic environment and government policy changes pose challenges to serving small businesses sustainably. The remaining challenges within the top five cited by respondents are technology adoption, client engagement, and competition.

With hindsight

The survey results show that a fifth of respondents wished they had better segmented their SME market and customers. A similar number said they should have improved risk management processes and practices. Technology adoption, better client engagement and SME capacity building also recurred within the top five themes cited most often as areas SME banking heads said they would improve upon with hindsight.

What's working

The findings show that a fifth of respondents excelled at product design, 15 percent built strong internal SME banking capacity initiatives and 11 percent derived efficiencies from digital applications. While a fifth of respondent banks struggled with risk management, a similar share of respondents said they implemented processes and innovations that reduced NPLs and supported strong lending. The same goes for segmentation, with 19 percent of respondents saying their segmentation models delivered strong results, against 20 percent saying they should have improved segmentation in the previous year.

The future of SME banking

The top responses mirror many of the challenges SME banking operations face globally. A third of respondents said they believed policy and regulation, and generally the external environment, are the top issues that will influence small business performance in their countries and regions. Also within the top five frequently listed issues as perceived by the SME banking heads, are technology, SME capacity building and funding access.

Blue-sky thinking

The survey asked respondents, if given the opportunity to make a big investment to grow their SME banking, what they would choose. The top responses related to technology and the SME banking digitization journey. The responses encapsulate a lot of the issues the heads of SME banks highlighted when noting the challenges they faced, the investments that went well in the past year and the areas that could have gone better. They also reinforce the need SME banks face to adapt to a changing marketplace with new players and technology disruptors. More than half of respondents said that they would invest in technology systems as a priority if given the chance, followed by around a fifth that would invest to improve segmentation, 16 percent to build SME capacity, and 14 percent to advance product design.

1. Pain Points: SME Banking Challenges

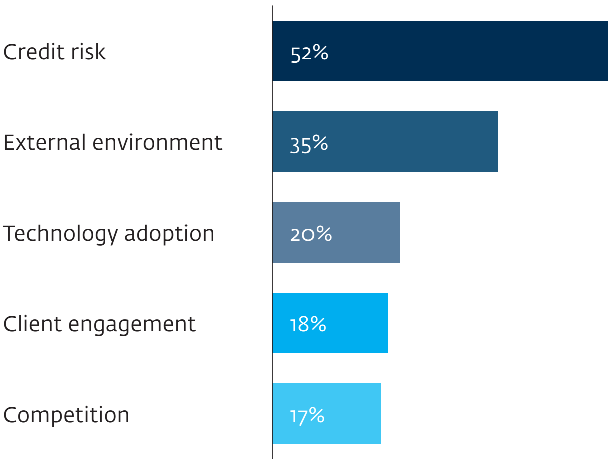
The survey asked heads of SME banking units at financial institutions to describe the biggest challenges their businesses faced while serving small business customers in the previous calendar year. Understanding the barriers influencing SME banking sustainability and profitability is key to designing effective policy, financial products and services that support a strong small business ecosystem. This knowledge can also help financial institutions at different stages of their SME banking journey to anticipate potential barriers to their development and therefore put in place systems and processes that can address the challenges.

The survey results indicate the two biggest challenges SME banks contend with globally are credit risk, at 52 percent of respondents, and external factors such as the macroeconomic environment and government policy changes, at 35 percent of respondents. The remaining challenges within the top five cited are technology adoption at 20 percent, client engagement at 18 percent, and competition at 17 percent. Table 1 ranks the top challenges according to the response frequency rate. The remainder of this section explores these themes in more detail.

Table 1: Biggest operational challenges encountered in the previous calendar year

THEME	% OF RESPONSES
Credit Risk	52%
External environment	35%
Technology adoption	20%
Client engagement	18%
Competition	17%
Internal capacity	16%
Scaling	14%
Funding	13%
SME capacity	11%
Product design	9%
Partnerships	4%
Strategy alignment	3%

Figure 2: Top five challenges in SME Banking, % of respondents



Credit risk: Managing NPLs, information asymmetry and market informality

A majority of respondents from East Asia and the Pacific, Sub-Saharan Africa, and South Asia stated that credit risk was a major challenge for them in the past year. Only 6 percent of Europe and Central Asia-based respondents and 33 percent of Latin America and the Caribbean-based respondents cited credit risk as the main challenge. Filtering responses based on the size of the SME banking business, the survey found 88 percent of respondents with an SME client base between 50,000 and 400,000 said credit risk was a top challenge, while 38 percent of respondents with a client base greater than 400,000 SMEs listed credit risk as their biggest issue. This suggests credit risk is a bigger challenge for smaller banks.

Approximately 52 percent of respondents identified credit risk as the biggest challenge their respective banks faced in the previous year. This included concerns around the increase in non-performing loans (NPLs) in bank portfolios. An SME bank executive in east Africa described high NPLs within the bank's SME portfolio and said the actions taken to manage that were costly: "The result of high NPLs was that the business changed its focus from sales to collections. Many factors, including profit and capital adequacy, suffered because of that business decision," he said.

Respondents also described with concern poor macroeconomic conditions and subsequently higher interest rates, which increased the cost of borrowing for SMEs and contributed to increased incidences of default and late payment. Some SME clients were constrained by government payment cycles, which had a ripple effect on banks' payment collection timelines. The survey results also found many financial institutions face risks due to SME over-indebtedness caused by multiple lending sources to the same customer.

Credit risk challenges are being driven by information asymmetry, resulting in high cost SME risk assessments and limited lending to the informal SME sector. As one respondent from a South Asia-based bank put it, "a lack of verifiable information to properly assess the SME's financial situation" makes risk assessment more difficult. **Globally, much of the SME market is informal with small businesses that do not have formal record-keeping processes such as financial accounts or audited financial statements.** Informal SMEs are often not banked, which prevents banks from using electronic data to assess cash flows. As a result, respondents noted that the loan origination and assessment process has been costly for banks, particularly when assessing smaller informal SMEs. This is particularly so because these SMEs typically require smaller loan sizes, but the cost of loan origination and assessment is fixed. This has contributed to financial institutions' reluctance to lend to informal SMEs. Respondents stressed that the risk assessment process needs to be simplified and based on alternative data in order to accommodate informal SMEs and improve the profitability of SME lending.

Banks have traditionally seen SMEs as risky and tend to be conservative in their SME risk assessments. The survey indicated that this contributed to the slow growth of SME portfolios – financial institutions have been hesitant to diversify their portfolios through lending to the lower segment of the SME market due to the lack of information and collateral from the client's side. Respondents noted that there is a large contrast between the size of loans SMEs require and what underwriting norms grant. As one SME bank executive in India said, "Underwriting norms gave lower loan eligibility than clients require." The challenge that banks face is an internal one created by silo business units: SME banking teams need to get buy-in from the underwriting team to make the modifications required to expand lending to new SME segments. This is further exacerbated by the banks' inability to secure quality guarantors.

The external environment: Economic instability, regulatory demands and political change

The external environment was the second most frequently listed challenge by respondents, ranging from 25-47 percent across regions. The ECA, LAC and SA regions had the highest number of respondents citing external issues as a challenge. The response rates were similar among banks of different sizes, with the highest number of respondents citing it as the primary challenge in the 2,000-50,000 client base category.

The external environment was cited as a major challenge among 35 percent of heads of SME banking. Many of the countries and regions where the respondents operate, particularly the ECA, LAC and SA regions, experienced political, social or economic instability in the past year, which contributed to a contraction in consumer markets, limited expansion of businesses and reduction in public and private investments. This created a difficult environment for SMEs to operate. Respondents noted that the lack of liquidity in the market made it difficult for SMEs to raise equity, high interest rates increased the cost of borrowing for SMEs, and currency devaluation significantly affected SME competitiveness due to the cost of imported inputs. For example, one respondent said, "Political and economic instability has increased PAR rates in many countries, especially in Tanzania, the DRC, and Azerbaijan."

Respondents highlighted that the fall in international commodity prices affected value chains of agro-exporting businesses. This is one of the key supply chains with SME participation globally and has led to the contraction of the SME market in some economies. Furthermore, respondents noted that the contraction of SME lending opportunities in the agriculture sector limited diversification for bank portfolios and banks' future portfolio growth prospects.

The respondents indicated that there was a lack of public sector support for SMEs with low financial literacy. A respondent from the EAP region highlighted that SMEs are not receiving "the sufficient support from government to strengthen their management practices." This points to the urgent need for banks to initiate and invest in SME capacity building in order to assist SMEs in building financial skills.

Banks faced tough regulatory constraints over the past 12 to 18 months. Survey respondents expressed that there is an "over-regulation burden" on banks, as they are obligated to follow more stringent regulation that limits their lending practices and limits the size of loans granted to SMEs. This also adds to the bank's cost of risk assessment because there will be more regulatory requirements banks need to fulfill. Regulatory issues cited by respondents included interest rate capping in Kenya, which restricted the capacity of banks to lend to small businesses, and the Goods and Services Tax (GST) in India, which one executive cited as a strain on small business cash flows. As one India-based SME banking executive said in the survey, "The twin impact of demonetization and introduction of GST, was the biggest challenge, as this resulted in a cascading impact on the cash flows of SMEs, the most vulnerable of the lot."

Technology adoption: Learning how to go digital

Respondents from the ECA region listed technology adoption as one of their biggest challenges with the highest frequency at 41 percent. On the other end of the spectrum, only 8 percent of respondents from South Asia listed technology as their primary challenge. The frequency of which technology adoption challenges were cited increases according to the client base size. The bigger banks listed technology adoption more often as one of their main challenges than small banks: 75 percent of banks with a client base greater than 400,000 said technology adoption was one of their biggest challenges.

Overall, 20 percent of all respondents identified technology adoption, in particular the digitization of bank processes, as a significant challenge in the SME banking environment. Many banks noted insufficient capacity to execute on digital processes and channels, which limited process efficiency. Respondents said to fully reach the SME market they need to identify "better digitization strategies" through technology adoption. Banks are focusing on digitizing processes such as the risk assessment process, where banks can pull data from other sources to enhance their own information, as well as distribution channels, which allow financial institutions to scale their customer numbers quickly.

Banks are focused on the digitization of products and services offered to SMEs, which requires efficient implementation of technology tools. Many respondents noted the availability of experienced developers to design these platforms is limited, and banks have struggled to find the correct resources, in terms of people with the correct skills to design and build platforms. Another issue that respondents highlighted in the survey is sourcing the capital required for the upgrading of banks' infrastructure and the digitization of products.

Banks are exploring opportunities for digital partnerships and learning how to engage fintechs. Most respondents citing technology adoption challenges indicated that they do not have the adequate IT infrastructure to digitize processes and product offerings. Many said they are exploring fintechs to provide a platform where banks can use existing digital infrastructure to perform processes such as risk assessments more efficiently or leverage data that fintechs already have. One executive at a multinational bank said, "Fintech-enabled financial services and products will enable more small businesses to obtain financing from non-traditional channels."

Client engagement: Building lasting SME relationships

Respondents from the MENA region had the highest incidence of client engagement challenges reported at 43 percent, with the lowest frequency from respondents in South Asia at 8 percent. Client engagement challenges were cited with similar frequencies among banks of all client sizes, ranging from 15-25 percent of respondents.

Of the respondents, 18 percent found it challenging to acquire and keep clients. The contraction of the SME market due to tough economic conditions made it difficult for banks to acquire healthy customers and build strong relationships with customers in order to retain them. Respondents highlighted that they are changing business processes around client acquisition that will focus on giving more hands-on advice in order to gain client loyalty and trust. This has involved implementing relationship-based service models in order to increase the quality of front office functions with the aim to improve customer interaction and experience and reduce churn in the banks' customer base.

Building stronger relationships with SMEs can be more costly for banks because it requires investment in relationship managers. A respondent from India raised the challenge of "finding, hiring and retaining the right people at the relationship level." An effective relationship management approach to client engagement requires more staff time as well as resourcing highly qualified staff with sector expertise. Some banks believed that this couldn't be justified considering the revenue they generate through SME banking. Some respondents noted that deeper relationship management engagement with SMEs could erode profit margins their banks are making.

Competition: New players, new challenges

Global banks reported competition challenges with the highest frequency, as well as those operating in the South Asia and EAP regions. No banks from MENA reported competition as a primary challenge. Competition challenges were reported with greater frequency among larger banks with a client base of more than 400,000.

Overall, 17 percent of respondents noted that competition posed a challenge in recent months, mostly competition between banks around credit facility pricing. Respondents struggled to balance having competitive interest rates and maintaining their profitability. SMEs are becoming a more appealing segment to fund, and traditional SME banks face competitive pressure from commercial banks moving into the small business segment as well as microfinance institutions moving into the small and medium business segment. As one executive from a bank in South America put it, "Competition with very competitive interest rates due to high liquidity and new players in the market such as NBFIs and credit houses," was a big challenge. Respondents noted that the increasingly competitive market is forcing banks to change their business models, which costs money and diverts attention away from business-as-usual functions.

Banks are not just competing with one another, but also with alternative lenders. One multinational bank executive operating in Africa said, "Threats from telecommunications companies in the Mobile Money Space," was the big challenge his operation faced. Respondents stressed that the boom in mobile money and digital credit providers led many SMEs to get lines of credit using these providers, who tend to be less risk-averse. Alternative lenders also use alternative credit scoring methods that banks often do not have access to, collecting data from sources such as mobile phones in order to generate a credit score for the client. Many banks viewed this as unhealthy competition between banks and other financial institutions because SMEs are borrowing from several sources, which may result in over-indebtedness. Some survey respondents said they are concerned that alternative lenders are not subject to the same stringent regulation and cost of compliance that banks are subjected to, allowing alternative lenders to undercut banks on pricing.

2. With Hindsight: What Banks Would Change

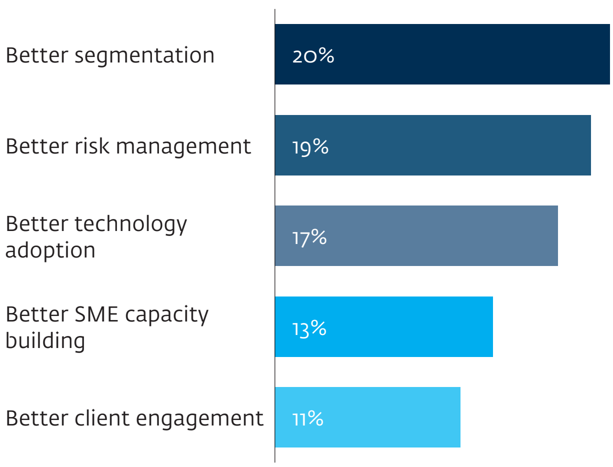
The second survey question asked heads of SME banking units at financial institutions what they would have done differently looking back on the previous year. The question provides a sense of SME banking executive regrets and insight into what worked and what they missed as they ran operations in markets around the world.

The survey results show that a fifth of respondents wished they had better segmented their SME market and customers. A similar number said they should have improved risk management processes and practices. Technology adoption and better client engagement also pop-up within this section as areas SME banking heads said they would improve upon with hindsight. Executing better SME capacity building was also noted within the top five most frequently listed business segments that banks could have improved upon. Table 2 ranks the top themes according to the respondent frequency rate. The remainder of this section explores these themes in more detail.

Table 2: What banks would have done differently in the previous year

THEME	% OF RESPONSES
Better segmentation	20%
Better risk management	19%
Better technology adoption	17%
Better SME capacity building	13%
Better client engagement	11%
Better internal capacity	11%
Better strategies	10%
Better funding	8%
Better efficiency	7%
Better partnerships	6%
Better product design	3%
Better data	3%

Figure 3: Top five regrets in SME banking, % of respondents



Improve SME market segmentation

Of the respondents from the SA and LAC regions, 42 percent and 40 percent respectively stated that they could have had better segmentation. None of the respondents from the ECA region noted this. Smaller banks were more likely to want better segmentation: 22 percent of banks with a client base of less than 2,000 and 27 percent of banks with a client base of 2,000-50,000. No banks with a client base of more than 400,000 noted regrets on segmentation.

Looking back on the previous year, respondents said they would do better segmentation of their SME client base with the largest consensus, at 20 percent. One of the key tools to run a profitable SME banking business is client segmentation, and that requires developing a framework to differentiate their client base, such as turnover and sector of operation. For example, an SME sector could be segmented by using the size of herds for small businesses operating in the livestock segment. Respondents stated that segmenting SME clients allows them to better understand each segment's unique needs, and implement different processes and products to serve each segment more efficiently. Respondents stressed that they can better address specific risks pertinent to each segment when clients are segmented correctly. Once banks develop a segmentation framework, they need to construct a compelling value proposition for each segment. This requires activities such as market sizing, customer needs assessments, and competitor reviews. These exercises will assist in determining the banks' niche where they can successfully operate. While some respondents said segmentation would have helped them diversify their SME base, others said it would have enabled them to be more focused. "I would have focused purely on the priority sectors and supported businesses on the critical value chains," said one SME bank executive in Africa.

Segmentation can help expand the SME client base by informing the development of new products and services to reach sectors not currently served. In many markets globally, small businesses are concentrated in a few sectors, such as agriculture and retail trade. However, banks can provide facilities to SMEs in other sectors to diversify their portfolios and manage external risk. Some respondents emphasized that they wished they had expanded their focus beyond the sectors they already served to explore new value chains. For example, a number of respondents noted they could have focused business on an entire value chain, working with SMEs participating in different areas along that value chain to capture a larger piece of the market opportunity. Some respondents indicated that they should focus on granting smaller loans at larger volumes in order to maintain profitability margins.

Redesign risk management structures

Respondents operating globally and in the SA, SSA, and EAP regions had the highest frequency of responses relating to better risk management. None of the respondents from Europe and Central Asia had regrets related to their risk management processes in the previous year. The frequency of responses among banks of different client sizes varied between 6-26 percent.

Overall 19 percent of survey respondents said their banks should undertake a review and redesign of the loan origination and assessment process. Respondents here noted the need to design credit policies that are favorable to the SME segment and involve customer segmentation to correctly address SME risk exposure. Survey responses from more established banks raised the point that they should review their assessment process to consider cash flow based lending, where the focus is on the SMEs' cash flow rather than collateral requirements, as well as alternative credit scoring methods. Respondents from less established banks identified the need to improve risk assessment basics including ensuring they have effective due diligence. This involves the implementation of KYC norms, in-depth analysis on loans before offering credit to clients, and better guarantees.

A number of respondents acknowledged their operational risk structure needs to be strengthened in order to decrease the number of non-performing loans. The respondents here said their bank should not only focus on the quality of the current portfolio, but should also explore other risk mitigating instruments, such as insurance schemes for agricultural loans. Respondents highlighted the need to manage interest rate risk better to control costs and default risk among clients. Respondents also noted that there should be greater focus on collections to lower the amount of late payments on loans and recover funds in cases of default.

Have a better technology adoption strategy

Respondents from multinational banks said they should have focused on doing better technology adoption most frequently at 30 percent. Respondents operating in the EAP region noted this as an area in need of improvement at a rate of 25 percent. The spread of respondents noting the need for better technology adoption was relatively equal across banks with different client sizes.

Overall, 17 percent of respondents noted with urgency the need to develop aggressive digitization strategies to keep up with international standards. The respondents said digitization strategies should focus on digitizing the banks systems, which will streamline SME processes and allow for further integration within the bank, and improve data quality and collection to leverage new tools such as artificial intelligence. Respondents noted that improved data analytic tools and process automation would allow them to improve customer experience, increase customer retention, and streamline process efficiencies. For example, one executive at a bank in Eastern Europe said looking back on the previous year he should have "fastened the development of digital lending to SMEs." Similarly, an executive at a bank in Africa said he would have "invested more in automation of credit processes."

Respondents stressed that strategic partnerships with fintechs, Mobile Network Operators and aggregators is becoming more important for banks to fulfill their digital strategies. Respondents acknowledged that they need to speed up the development of digital lending to SMEs, and form strategic partnerships with fintechs, MNOs and aggregators to allow banks to leverage existing third party platforms, thus saving them time and money on internal development. Some respondents noted that scoping potential partners would be based on the partners' ability to implement a digital strategy, and bring infrastructure and skills the bank does not have. To do this, respondents noted changing the bank's risk appetite for outsourcing critical functions to third parties.

Build SME skills and capacity

24 percent of respondents from the SSA region stated that they should have supported better SME capacity building in the previous year, while none of the respondents from MENA and ECA regions cited SME capacity building as a priority area they would have changed, with hindsight. Based on bank size, respondents who wished that had focused more on small business capacity building were concentrated in smaller, more local banks. No one from a bank with a client base greater than 400,000 said they should have focused more on SME capacity building.

Overall, 13 percent of respondents said they could develop better SME capacity building tools. These respondents observed a trend, that financial literacy levels of SMEs are low across the board in their market. The respondents said their bank recognized the need to be more pro-active offering training and education on financial literacy to their SME clients. This involves setting up expert groups to advise SME clients on financial and entrepreneurial skills, as well as advising SMEs on how to weather macroeconomic and political change and uncertainty.

Digital platforms facilitate online learning for SMEs and allow banks to scale their capacity building activities at a relatively low amount of development capital. Respondents emphasized that digital learning gives SMEs the flexibility to choose when they would like to participate in training and also gives SMEs access to a large amount of content on one platform. Banks stressed that increasing the coverage of financial literacy tools in their client portfolios is necessary to encourage the formalization of SMEs.

Deepen client engagement

Better client engagement was cited as an area of improvement among 33 percent of global respondents and 25 percent of EAP regional respondents. Respondents from banks with over 400,000 clients did not list client engagement as a priority area requiring improvement.

Heads of SME Banking surveyed recognized that there was a strong correlation between the skill level of relationship managers and client experience. A number of respondents said the key to SME client satisfaction is high quality service, which can only be provided by well-trained, knowledgeable employees. Respondents here noted the small business knowledge of employees dealing with SMEs has been traditionally low, which has prevented them from identifying obvious problems in the SME business and consequently led to a below-par customer experience.

Respondents noted more emphasis should be placed on improving the customer care model and value proposition for SME clients. To improve the customer care model, banks need to focus on customer relationship management (CRM) development to enable client analysis, client segmentation and customer management, according to many of the respondents. This will allow banks to fine-tune their marketing and awareness campaigns to target specific SME client segments. Respondents also identified technology as a key tool to improve CRM with client data analysis and a tracking and performance management system.

Silversmith and jeweler Um Sreytouch working at her shop in Kandal Province, Cambodia.

3. What's Working: SME Banking Activities Yielding Results

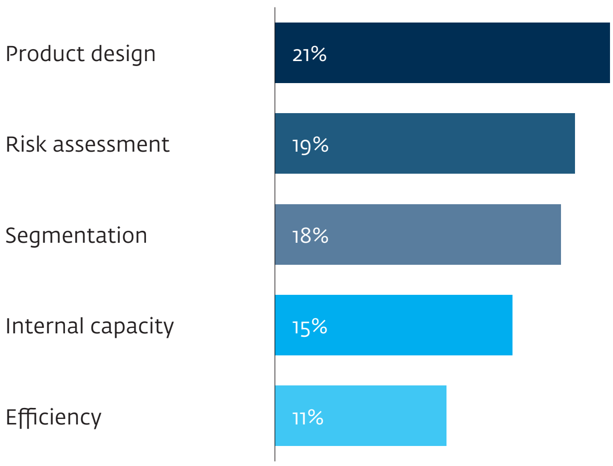
The first two questions focused on the pain points SME banking executives grappled with around the world, to understand their biggest challenges and the areas where banks could have improved looking back on the previous year. The third survey question shifts the conversation to the success stories, to what's working well based on the bank's decisions and trade-off choices. It asked heads of SME Banking what decisions they took and activities they implemented that yielded the best results.

The findings show that a fifth of respondents excelled at product design, 15 percent built strong internal SME banking capacity and 11 percent derived efficiencies from digital applications. While a fifth of respondent banks struggled with risk management, a similar share of respondents said they implemented processes and innovations that reduced NPLs and supported strong lending. The same goes for segmentation, with 18 percent of respondents saying their segmentation models delivered strong results, and 20 percent saying they should have improved segmentation in the previous year. Table 3 ranks the top themes according to the respondent frequency rate. The remainder of this section explores these themes in more detail.

Table 3: Business decisions and trade-off choices that yielded the most benefit in the last year

THEME	% OF RESPONSES
Product design	21%
Risk assessment	19%
Segmentation	18%
Internal capacity	15%
Efficiency	11%
Technology adoption	11%
Client engagement	8%
SME capacity building	7%
Partnerships	4%

Figure 3: Top five business decisions that have yielded the most benefit in SME banking, % of respondents



Innovative digital product design

33 percent of respondents from SA and 25 percent of respondents from EAP found their product design decisions yielded the most results. However, of the respondents from the ECA region, only 6 percent said that business decisions made on product design have yielded the most benefit. The spread of responses between banks of different sizes are relatively even.

Overall, 21 percent of SME banking respondents surveyed benefited from improved product design. These respondents noted that they focused on granting credit in both local and foreign currency, which allowed the bank to be more competitive in terms of cost, as well as improving the quality of service from the foreign trade departments. Another product design banks noted was the use of technology to improve the product itself and the delivery channel, such as better online banking functionality enabling SME customers to open and manage accounts online. For example, one executive at a bank in Africa said the bank developed a digital lending product that is easy to use for both the lender and the borrower. This, he said, enabled the bank to "really embark on a digital journey."

Improved risk scoring models

42 percent of respondents from the South Asia region and 38 percent of respondents from the East Asia and the Pacific region emphasized that decisions around risk assessment yielded the most benefit. Breaking the results down by bank size, 96 percent of respondents with a client base of below 2,000 and 92 percent of respondents with a client base between 2,000-50,000 noted that decisions involving risk assessment yielded a great deal of benefit.

The second most commonly cited business decision that yielded the most benefit for respondents in the previous year is risk assessment at 19 percent. The decisions around risk management included adding new credit scoring models and using new sources of data and data analytics to improve lending, which contributed to reducing NPLs in respondent bank portfolios. An SME banking leader in India said a hybrid data-powered and human-centric model was the key to its success. "Having a strong collection system driven by analytics with feet on street" yielded benefits, he said.

Respondents spent a significant amount of time benchmarking their risk scoring models to international standards in order to better manage risk. For some banks, this involved extensive engagement and consultation with institutions, like the IFC, in order to refine and improve their risk scoring systems and assessment processes for small businesses. Many SMEs struggle to obtain loans from banks due to the fact that they have insufficient or no collateral. Respondents indicated that they started to implement non-collateralized loans where the loan assessment is based on cash flow rather than collateral in order to serve more SMEs. Some respondents said their banks changed due diligence procedures to take into consideration behavioral traits of SME clients, in addition to traditional documentation requirements. Other banks started to launch rule-based credit concession systems in order to better determine which SMEs they should grant credit to, based on specific SME factors or behaviors banks correlated with good repayment.

Many respondent banks increased focus on building strong collection systems driven by data analytics to decrease NPLs in their portfolios. Respondents said their banks started to streamline the collection process through more regular collection periods with teams on the ground engaging with clients, as well as developing an early warning signal system where potential late or non-payments are flagged early on in the collection process. Collection periods refer to the frequency of collecting loan repayments, such as monthly. Respondents also discovered that establishing a dedicated SME collections unit decreased the probability of NPLs because risk policies are designed to cater to SME-specific issues.

Growth-oriented segmentation

Multinational banks and those operating in Latin America and the Caribbean, MENA and Sub-Saharan Africa had a higher frequency of responses about yield from improved segmentation. None of the respondents from East Asia and the Pacific noted this. Of the respondents with a client base smaller than 2,000, 19 percent found that focusing on segmentation yielded benefit, with a slightly smaller portion of respondents noting this among banks of larger sizes.

Overall, 18 percent of respondents noted improved SME segmentation strategies yielded a benefit particularly in the areas of customer management and risk management, by enabling lenders to correctly address their risk exposure. These respondents said that they are starting to explore different methods to segment SMEs beyond the traditional annual turnover segmentation factors. For example, some banks noted segmenting SMEs in the agricultural sector by size of land or size of livestock. This assists banks to determine new client types and business models to provide finance, which helps banks to expand and diversify their portfolios.

Respondents emphasized that focusing and investing in priority sectors will be beneficial to the banks' growth. Banks started to tap into the micro and small business segments of the SME market in order to gain market share in the competitive sector, according to respondents. Some bank executives in the survey said their bank focused on opening a division dedicated to SMEs. The division provides support to small business borrowing needs and offers value-added services to support SME development.

Internal capacity investment

24 percent of respondents from the Europe and Central Asia region stated in the survey that decisions around internal capacity yielded a substantial amount of benefit, with the lowest frequency of responses in MENA and South Asia.

In order to improve the quality of customer services and the loan portfolio, banks focused on training and developing their employees. Respondents noted that the quality of SME relationship managers in particular is crucial, because they need to be able to fully understand specific challenges faced by SME clients and advise clients accordingly. The implementation of more stringent recruitment processes led some respondent banks to increase employee quality to be equipped to address SME client requirements.

Some respondents said they restructured the sales teams by increasing the number of employees to attract new clients. Using motivational incentive systems, such as additional bonuses to high-performing employees, as well as giving branch managers the opportunity to have control over the customer portfolio, helped these respondents to expand the banks' client base and loan book.

Efficient technology adoption

While efficiency and technology adoption were cited by 20 percent of Latin America and Caribbean respondents, none of the respondents from the East Asia and the Pacific region, nor respondents with a client base greater than 400,000 noted this to provide a large benefit.

Overall, 11 percent of banks reported the efficiency yields associated with restructuring their processes and revamping their IT infrastructure. Of the respondents from the Europe and Central Asia region, 35 percent said that technology adoption resulted in substantial benefit. Banks noted the decision to decentralize credit decision-making sped up the process, as well as provided pertinent information about the SME client to relationship managers. Digitization of systems and processes allowed banks to cut costs by removing redundant processes and increase SMEs uptake in products and services. Some respondents stated that they focused on developing a digital lending product that makes it easier for SMEs to request a loan, increasing the usage of digital channels and taking pressure off relationship managers.

Women entrepreneurs participating in Bank of Palestine's mini MBA program.

4. The Future of SME Banking: Trends That Will Drive Decision-Making

The previous section looked at the trends and decisions made where respondent SME banks derived benefits in the previous year. The next section focuses on the themes that will influence SME operations looking ahead, both from the small business and the business banking perspective.

The survey first asked heads of SME Banking to describe what they think will have the greatest influence on the small businesses they serve. The top responses mirror many of the challenges SME banking operations face globally from the first section. A third of respondents said they believed policy and regulation, and generally the external environment, are the top issues that will influence small business performance in their countries and regions. Also within the top five frequently listed issues as perceived by the SME banking heads is technology, SME capacity building and funding access. Table 4 ranks the top themes according to the respondent frequency rate.

The second question within this theme asked respondents what they think will be the most important issue and trend for financial institution SME managers to consider in the year to come in their countries and regions of operation. The majority of responses were related to digitization and innovation and how banks need to continue their digital journey and product development to remain competitive and relevant to SME customers. Nearly 40 percent of respondents said they would like to invest more in fintech and digital innovation in general, and 31 percent said more specifically they should focus on channel digitization. Table 5 ranks the top themes according to the respondent frequency rate. The remainder of this section explores the themes that will drive the future of SME banking for small businesses and SME banking leadership in more detail.

Table 4: Factors that will have the greatest impact on SMEs in countries of operation

THEME	% OF RESPONSES
Policy and regulation	32%
External environment	29%
Technology	17%
SME capacity building	14%
Funding	13%
Product design	11%
Efficiency	9%
Data and analytics	4%
Segmentation	4%
Risk sharing and guarantee facilities	2%

Figure 4: Top five greatest impacts on SMEs, % of respondents

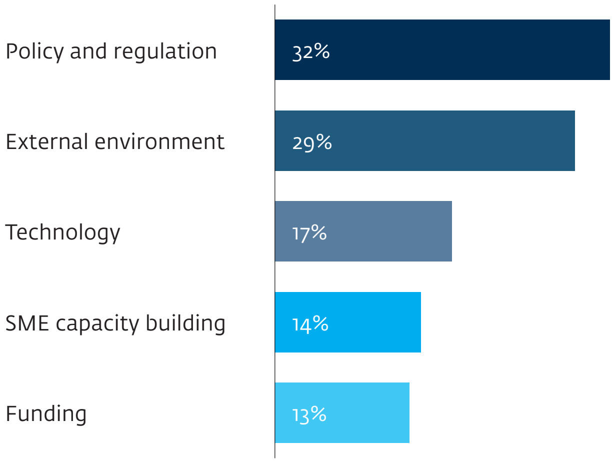
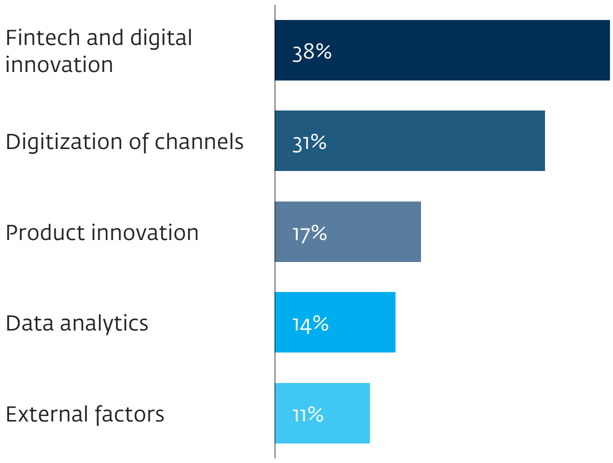


Table 5: Trends that will shape the nature of SME banking

THEME	% OF RESPONSES
Fintech and digital innovation	38%
Digitization of channels	31%
Product innovation	17%
Data analytics	14%
External factors	11%
SME capacity building	9%
Formalization of SMEs	5%
More efficient decision-making processes	5%
Customer-centricity	5%
Business model development	4%

Figure 5: Top five trends that will shape the nature of SME banking, % of respondents



Policy and regulation

Respondents operating globally and in the MENA region described the role of policy and regulation on SME performance as the most important issue looking ahead, with 40 percent and 50 percent of respondents respectively raising this as a high impact area for SMEs.

Overall, 32 percent of all respondents stated that policy and regulation would have the greatest impact on SMEs in the year to come.

Respondents noted that many governments have started to advocate for SME-friendly legal and regulatory frameworks to promote the growth of the SME sector. Respondents predicted many countries will begin to see changes in income tax structure as well as the introduction of government incentives for priority sectors, like agricultural and manufacturing, to enable SMEs to grow faster and scale. Respondents also observed that there is a developing trend in government policy and regulation to exempt businesses in the informal sector from tax for a certain length of time.

Specific policies relating to SME finance access will shape the nature of SME banking in the future. Respondents noted that some governments have focused their efforts on financial inclusion, entrepreneurship support and formalizing informal businesses; and select central banks started to issue regulations aimed at facilitating more bank lending to small businesses efficiently and effectively. Respondents noted that there are also new regulations on crowd funding being implemented, which impact the competitive landscape for capital raising among SMEs. In addition, the survey responses highlighted the role of governments to implement centralized and reliable credit bureaus to speed up paralegal processes and enable risk assessment processes to be more efficient. The credit bureau importance is showcased in the comment by one SME banking head in the East Asia and the Pacific region, who said, “Asymmetry of information, especially on the lower segment of the SME market, was further exacerbated by the still non-functioning credit bureau.” Respondents warned that stringent risk regulation and information demands from authorities as well as general compliance demands will have an adverse effect on banks’ profitability, customer satisfaction and overall efficiency.

The external environment

Of the respondents from the South Asia region, 67 percent stated that the external environment would have the greatest impact on the SMEs themselves. The response among banks operating in other regions was lower – the lowest frequency was 15 percent among Sub-Saharan Africa respondents.

Survey respondents noted that SMEs are extremely sensitive to changes in political and economic stability. Situations of political uncertainty, such as presidential elections, can cause instability within the economic environment where the loss of business or investor confidence often negatively impacts SMEs first. As highlighted by an SME bank head in South America, "the loss of confidence, the lack of stability, and the devaluation of the exchange rate" will have the greatest impact on SMEs. Respondents emphasized that any policies that cause a loss of confidence in government, the devaluation of the local currency, or volatility in commodity prices will harm SME balance sheets and business. On the other hand, some respondents said they believed policies that promote currency liberalization and good relationships with neighboring countries would support the business environment and encourage international trade and investment in the country, which will ultimately be beneficial for SMEs.

Respondents from the EAP region, in particular, emphasized the external environment would inform the nature of SME banking operations. Based on banking operation size, only smaller bank respondents with a client base of 50,000 and below described the external environment as a key influencer to shape the nature of SME banking going forward.

Respondents said trends within the external environment would also shape the nature of SME banking in the years to come. New regulations that support the financial inclusion of SMEs, such as tax incentives, and regulations enhancing the ease of doing business will open up opportunities for banks to reach more SMEs. The development of robust SME policy frameworks will be a critical step to ensure SME growth. Respondents expect that there will be more policies implemented that will require government and financial institutions to support SMEs with technical assistance and capacity building.

Macroeconomic factors are expected to affect the future of SME banking. Respondents noted that higher volumes of exports and imports would support growth in the SME sector and consequently demand for SME banking. In addition, interest rate volatility in the future could negatively impact SME growth and banks' ability to fund SMEs. Some respondents believed the establishment of business register infrastructure for SMEs will encourage more to become part of the formal economy. One SME bank head in the East Asia and the Pacific region said government and Central Bank policy is something it's watching closely. "The Central Bank has issued several regulations in the last two years that will greatly impact how banks can enhance their business models to efficiently and effectively reach out to the MSME sectors."

Digital technology and fintechs

50 percent of respondents from the EAP region believe that digital innovation will shape the nature of SME banking. A majority at 64 percent of respondents from the MENA region reported the digitization of channels to be a key trend that will shape the nature of SME banking. Of the respondents that have a medium-sized client base of 50,000-400,000, 69 percent said digital innovation will have an impact on the nature of SME banking in the future. Of the respondents with a client base greater than 400,000, 50 percent believe the digitization of channels will shape the nature of SME banking.

Overall 17 percent of all respondents believed that technology would have a significant impact on SMEs in the year to come. Respondents said automating processes and implementing digital lending would make lending processes more efficient for both banks and SMEs. Using data analytics and external databases to inform decisions in the loan origination and assessment processes will allow banks to give more SMEs access to credit. Respondents highlighted that the digital delivery of high quality product offerings and services will significantly improve customer experience as it enables banks to react quickly to customer requests and tailor products to suit SME-specific needs.

Respondents emphasized that increasing digital innovation will continue to shape the nature of the SME sector in years to come. In order to increase the number of SMEs in the market and advance the development of SMEs, banks need to develop digitally innovative products and platforms that improve the ease of doing business for SMEs. Respondents raised the fact that crowd funding will be an innovative tool in the SME financing space, where SMEs can apply for loans or capital using alternative channels. Banks can scale their product and service offerings using technology, which improves efficiency by lowering costs. "Digital delivery of product offerings, application, and online set-up and self-service" will have the greatest impact on SMEs, said one multinational SME banking head.

Banks noted in the survey that the digitization of channels is crucial for banks to improve SME banking going forward. Respondents stated that the digitization of channels creates more customer touch points for banks and allows them to expand their reach to SMEs including those based in rural areas, which often don't have access to large physical branch networks. Respondents noted that allowing SMEs to capture their own data on digital channels further formalizes their relationship with banks. They also noted that digitization of channels, particularly business-to-business platforms, enables easier access to credit for SMEs.

Banks also noted that data analytics is an essential tool for developing innovative digital products. Respondents here said they are putting more time and money into developing their IT structures, particularly in developing analytical systems that will drive big data analysis. These respondents stressed that advanced data analytics will enable banks to automate decision-making processes, thereby creating more efficiencies within their operating structure. Respondents are also focusing on database management in order to ensure that the data is accurate and reliable. "Lending is data, and data is digital, so the lending decision needs to follow the same patch. The earlier we all move into this journey the more SMEs can be access credit," said one SME banking head operating in Africa.

Respondents highlighted that new fintechs continue to enter the SME ecosystem, which will add a fresh dimension to SME banking. Respondents stressed that this forces banks to adapt to the increased competition in the SME space by coming up with better digital products and services or explore partnerships with the new players. SMEs are quick to absorb technological advancements, and fintechs will play an increasingly larger role in providing more technology-savvy options to clients. Since fintechs often have a wealth of alternative data on SMEs, respondents emphasized that partnerships with alternative lenders will allow them to leverage their ability to capture smaller businesses, which enables banks to expand their customer base.

Respondents stated that they are focused on improving the integration of digital solution platforms and APIs in order to collaborate across platforms and ecosystems. Respondents emphasized that efficient digital platforms will allow banks to engage digitally with SMEs and improve financial literacy amongst clients. Some respondents pointed out that building integrated digital platforms will inspire banks to form partnerships with alternative lenders that perform functions banks traditionally do not. These providers are able to supply new financial services and products to smaller businesses who cannot obtain financing from traditional channels, such as reverse factoring and invoice discounting.

Supporting SME development

Almost all of the respondents that named SME capacity building as a factor that will have a large impact on SMEs operate globally and in the EAP, SA and SSA regions.

Overall, 14 percent of respondents said more focus on SME capacity building will positively impact SMEs' ability to grow and access formal financial services. The majority of respondents are continuing to improve their non-financial and advisory services where dedicated resources can provide technical assistance to SMEs. Better structured finance solutions will also enable SMEs to grow, as well as develop improved financial capabilities. Respondents stated that the development of digital platforms will allow banks to conduct financial literacy training that can reach more SMEs compared to traditional offline approaches. The survey highlighted that organizations and financial institutions other than banks are also starting to focus on initiatives that will empower and develop SMEs.

Funding access

Overall, 13 percent of respondents said the cost and accessibility of funds for banks will have a strong impact on their ability to lend to SMEs. The existence of lines of credit and guarantees will allow banks to fund more SMEs at a reduced cost. Respondents here observed that increasing access to local currency funding had a large impact on their ability to lend to SMEs in the local market using local currency without significant hedging risk.

Product innovation

24 percent of respondents from the ECA region and 21 percent of respondents from the SSA region stated that product innovation will have a strong impact on the nature of SME banking. Of the respondents that have a client base of 2,000-50,000, 30 percent listed product innovation as a primary issue that will have an impact on the nature of SME banking, and none of the respondents with a client base larger than 50,000 listed product innovation as the issue that will most significantly shape the SME banking sector.

Product innovation is another strong factor that respondents believe will shape the nature of SME banking, with 17 percent of respondents flagging it as a primary driver. One executive at a bank in Central Asia described its product innovation goals: “We need to bring in more sophistication on the product side. We used to address SME client’s needs primarily by loan products. We need to introduce new products to offer a comprehensive service to SMEs.” Respondents noted that they are continually innovating their products in order to satisfy SME needs and improve the quality of service they provide to SMEs. Respondents pointed out that this does not only include financial products but also non-financial products and services, in particular technical assistance where SMEs require sector-specific advice on their business. Some respondents noted that their bank is focused on developing products that are aimed at SMEs in particular sectors, such as the agriculture, agro-processing and tourism sectors. Respondents stated that the majority of SMEs require simple products with fast turn-around times, particularly for credit and insurance products. The survey indicates that banks are starting to provide uncollateralized short-term working capital credit that is sensitive to SMEs’ cash flows.

Consolee Uwanyirigira, (right) Managing Director at Keni Business Group, a wholesale distributor in Muhanga, Rwanda.

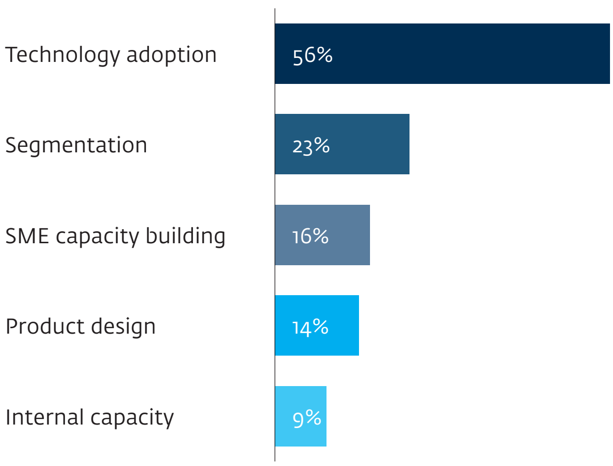
5. Blue-sky Thinking: Where SME Banks Will Invest

The final portion of the survey asked the heads of SME banking to describe what project or program they would prioritize making an investment in the year to come given the resources. Table 6 shows all the themes that came up in the responses and the frequency of responses. Figure 6 shows the top five focus areas that were most common among responses across the board. The responses encapsulates a lot of the issues the heads of SME banks highlighted when noting the challenges they faced, the investments that went well in the past year and the areas that could have gone better. It also reinforces the continuing theme of digital innovation and the need for SME banks to adapt to a changing marketplace with new players and disruptors. More than half of respondents said that they would invest in technology systems as a priority if given the chance, followed by around a fifth that would invest to improve segmentation, 16 percent to build SME capacity, and 14 percent to advance product design. The remainder of this section explores the blue-sky thinking amongst SME banking survey respondents.

Table 6: Focus areas for SME banking in the year to come

THEME	% OF RESPONSES
Technology investment	56%
Segmentation	23%
SME capacity building	16%
Product design	14%
Internal capacity	9%
Systems that enhance marketing campaigns	2%
Sustainability	2%

Figure 6: Top five focus areas for SME banking, % of respondents



Technology adoption

A majority of respondents from the EAP region and those operating globally, 75 percent and 70 percent respectively, said that they would invest in technology adoption. Of the respondents with a client base larger than 400,000, 63 percent said they would invest in technology adoption compared to 30 percent amongst banks with a client base of less than 2,000.

The majority of respondents at 56 percent agreed that they would primarily focus on improving their core infrastructure if they had money to spend, targeting improved technology systems. Banks stated that they would focus on improving their internal audit systems, analysis and reporting systems, financial analysis systems, as well as IT security systems. The survey showed that many banks want to focus on improving the core banking systems which would enable banks to introduce more digital innovations that can improve access to finance for SMEs. Digital enhancement of systems and advanced IT infrastructure will be able to support the bank in executing SME business development.

Respondents noted that improving core banking systems would involve the automation of information and decision-making processes in order to generate tailor-made offers and financial solutions for SMEs. Introducing AI-based acquisition systems that are integrated with the core banking system and connected to other operating systems will allow customer information to flow more freely between business units in the bank and build a single view of customer relationships. This will also allow banks to digitize their lending processes by using data analytics as well as alternative data, allowing for automated workflows for SME credit evaluation and approval process to ultimately speed up the process for clients. Respondents also noted that procuring a fintech solution around credit assessment tools driven by alternate data would be something they would invest in. For example, an SME banking head in North Africa said he would love to invest in "a scoring system with a digital front end for customers to apply and get their loans."

The survey highlighted that creating business-to-business platforms to connect corporates and governments with SMEs will allow banks to gather data that they can use to enrich their internal customer information. Respondents indicated they would like to invest to subsidize the continued rollout of agency networks and create a digital ecosystem that would allow them to deliver additional services through agents, field-based tablet operations and mobile phones. Respondents stated that improving android platforms will allow banks to add new products, like block chain-based solutions in trade finance, as well as small business solutions, such as accounting software, which will enable SMEs to conduct business online.

New customer segments

40 percent of respondents from the LAC region said they would focus on segmentation projects, while other regions ranked this as a top priority less often. Based on client size, 37 percent of respondents with a client base smaller than 2,000 indicated they would use the money to invest in their segmentation process, which becomes less common amongst respondents from larger banks.

Overall, 23 percent of respondents said they would focus on investment projects linked to key priority sectors. Many banks are starting to focus on sectors and industries that governments flagged as important to economic growth and employment creation, such as agriculture, general export, mineral processing, technology and tourism sectors. Respondents indicated the importance of focusing on SME segments where participants have been previously disadvantaged, in particular women, as well as SMEs located in rural areas. Respondents acknowledged that they will need to start developing sector-specific business units that are able to provide adequate technical assistance to SMEs in these sectors. Banks also highlighted the need to develop a clear framework on how to segment SMEs according to their specific financial and non-financial needs and requirements.

SME capacity building

Of the respondents from the SA region, 33 percent responded that they would invest in SME capacity building, whilst none of the respondents from the LAC region mentioned SME capacity building as an area they would invest in as a blue-sky priority.

Overall, 16 percent of banks stated that they would prioritize improving their financial and non-financial training to SMEs. A number of survey responses indicate that there is a crucial need to increase the level of financial education of the SME population globally to improve loan performance. Respondents identified financial literacy and business efficiency campaigns as well as entrepreneurship incubators for SMEs as effective methods in orienting non-banking clients to adopt lending and non-lending products and assist SMEs to develop their business skills. The survey highlighted another emerging method to provide technical assistance to SMEs using digital platforms that SMEs can easily access. One microfinance bank in Africa studying the SME capacity building programs at other financial institutions said, "The numerous testimonies make me a believer in the positive effect that financial education will have on the performance of a loan."

Product design

Respondents from the ECA and LAC regions emphasized that they would use money to invest in product design projects, whilst respondents from the EAP and MENA regions did not highlight a need for projects in this area. Product innovation was more of a priority among smaller banks than larger ones.

Overall, 14 percent of banks responded that they would focus on product design if they were given a boost in their budget to spend. Respondents noted that they need to improve the design of their financial and non-financial product offerings to suit the SME-specific needs across sectors. The survey showed that banks have started to focus on providing microcredit through digital channels in order to reach more SMEs and expand their portfolios. Respondents also noted that they should invest in a facility to add value to local products that will enable them to meet the standards of both the local and export market. Banks are also exploring the possibility of developing equity funds that are dedicated to funding SMEs.

Internal capacity

The majority of respondents that aspired to invest in internal capacity operate in the EAP and SA regions, and none or very few of the respondents from the ECA, MENA and SSA regions said they would invest in internal capacity as a priority. None of the largest banks would prioritize internal capacity development.

To provide quality service to SME clients, 9 percent of respondents cited the need to ensure their internal capacity is sufficiently developed. The respondents here indicated that they would invest heavily in their human resources departments where employees are trained to have the sufficient skills to deal with SMEs. Responses emphasized that bank employees need to be able to efficiently process loans to SMEs, as well as advise SMEs on the most effective business processes in their respective sectors. Respondents noted that they would use funds to develop an e-learning platform for SME credit officers in order to address skill gaps.

A small farmer in Turkey sells his grapes at market.

In Conclusion

The survey highlights that there are no simple answers to the issues SME banking leaders are grappling with, nor easy roads to success. It underlines the importance of building strong foundations in terms of segmentation, product design and risk management competencies, as well as digital innovation, data analytics and client engagement capabilities. These are vital to enable financial institutions to compete in a changing marketplace and weather the impact of changes in the external environment.

Without discounting the nuances by region and size of operation highlighted by survey respondents, the report finds that the trends, challenges and opportunities in SME banking are common globally.

To succeed in SME banking, banks require strong and integrated capabilities, with a minimum level of competence across key elements. IFC's SME Banking Competency Framework, developed over decades of working with financial institutions around the world, structures the proficiencies required by banks to achieve strong SME performance into five core competency areas.

We recommend that financial institutions use the below framework as a tool to assess the key components of their SME banking units, both individually, as well as each capability as a whole, identifying areas of strength and weakness.

As part of its Advisory offering to client banks, IFC offers Diagnostic Assessments to financial institutions providing independent feedback to banks in comparison to SME benchmarks. The Diagnostic Assessment assists client banks to prioritize areas requiring further development, so partners can continually adapt and innovate to provide sustainable SME financing that is profitable and competitive.

Figure 7: IFC SME Banking Competency Framework

Business Model Design 1		Products & Services 2		Sales & Delivery 3		HR & Systems 4		Credit & Risk Management 5	
Segmentation	Data Mining & Analysis	Unsecured Products	Deposit Products	Dedicated Relationship Managers	Business Centers	Relationship Manager Certification	Incentive Program	SME Behavioral Scoring	SME Application Scoring
Operating Model	Financial Plan	Total Relationship solutions	Advisory Services	Sales Effectiveness	Acquisition & Retention	HR System	Relationship Managers' Scorecard	Alternative Scoring	Industry Benchmarks
Coverage Model	Competitive Differentiation	Agricultural Finance	Internal Referral Programs	Cross-Sell & Deepening	Existing Channels Alignment	Training Programs	LOS System	Credit Delegations	Collections Framework
Branding & Campaigns	Organizational Fit	Product & Segment Management	Supply Chain Finance	Alternate Channels Enhancement	Customer Management Policy	Customer Relationship Management	Customer Intelligence Unit	Service Level Agreement	Early Warning Systems
Customer Value Proposition	SME Definition	Business Insurance Solutions	Transactional Products	Incentive Schemes	Customer Experience Management	Customer Models	Portfolio Management	Basic Risk Rating Model	Credit Policy for SME
Business Boundaries	Service Model	Asset Finance Products	E-Commerce Solutions	Customer Journeys	Mobile Sales Force	Data Warehousing	Propensity Models	Credit Process Reengineering	Non-Performing Loan Management

IFC SME Finance Advisory

Tackling the $5.2 trillion SME finance gap hinges on providing best practices for small and medium enterprises to thrive and grow. Alongside our Investment services, we provide these through Advisory Solutions to catalyze investment opportunities in emerging- and developing-market economies.

IFC SME Finance Advisory Solutions work with financial institutions to grow small and medium enterprise banking and build financial institutions' capacity to expand access to credit to increase financial inclusion and improve access to finance in the SME sector. The team offers technical expertise on SME banking to clients, from building the SME business model and implementing strategy to product development and risk management.

We help our clients strengthen their SME banking capabilities while enabling them to meet their competitiveness and profitability goals. We incorporate digital and data analytics in our programs as well as sales effectiveness and non-financial services, capacity building and training.

As of June 2018, IFC's Global SME Banking Advisory Services Program had 47 ongoing projects, spanning 32 countries, with $34.8 million funds under management. About 35 percent of these projects are concentrated in International Development Association (IDA) countries.

For more information, visit www.ifc.org

Appendix: Detailed Qualitative Results

Question 1: What were the biggest challenges in the previous year?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Credit Risk	52%	75%	6%	33%	43%	67%	79%	50%	63%	59%	88%	38%
External environment	35%	25%	47%	40%	36%	42%	33%	10%	26%	41%	25%	38%
Technology adoption	20%	25%	41%	13%	21%	8%	12%	50%	7%	14%	38%	75%
Client engagement	18%	13%	29%	33%	43%	8%	12%	10%	15%	22%	31%	25%
Competition	17%	25%	18%	13%	0%	33%	9%	40%	15%	19%	6%	38%
Internal capacity	16%	25%	18%	7%	21%	42%	6%	0%	19%	14%	25%	0%
Scaling	14%	0%	24%	13%	21%	17%	9%	10%	15%	22%	0%	13%
Funding	13%	0%	18%	20%	0%	17%	12%	20%	22%	14%	0%	25%
SME capacity	11%	0%	0%	27%	7%	17%	15%	0%	7%	14%	6%	13%
Product design	9%	13%	18%	0%	0%	17%	9%	10%	4%	8%	13%	0%
Partnerships	4%	13%	6%	0%	0%	0%	3%	10%	4%	0%	0%	0%
Strategy alignment	3%	13%	0%	7%	0%	0%	0%	10%	0%	0%	6%	0%

Question 2: In hindsight, what would you have done differently in the previous year?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Better segmentation	20%	13%	0%	40%	21%	42%	18%	10%	22%	27%	6%	0%
Better risk management	19%	25%	0%	20%	14%	25%	27%	30%	26%	19%	6%	25%
Better technology adoption	17%	25%	18%	7%	14%	17%	15%	30%	11%	19%	19%	13%
Better SME capacity building	13%	13%	0%	7%	0%	17%	24%	10%	7%	16%	19%	0%
Better client engagement	11%	25%	18%	7%	14%	33%	0%	0%	4%	11%	19%	0%
Better internal capacity	11%	0%	12%	0%	29%	0%	12%	10%	11%	11%	13%	13%
Better strategies	10%	13%	6%	7%	0%	8%	12%	30%	7%	14%	0%	0%
Better funding	8%	0%	18%	13%	7%	0%	9%	0%	11%	8%	13%	13%
Better efficiency	7%	0%	18%	13%	0%	8%	3%	10%	4%	11%	6%	13%
Better partnerships	6%	13%	6%	0%	0%	8%	9%	10%	4%	5%	6%	13%
Product design	3%	13%	12%	0%	0%	0%	0%	0%	0%	5%	0%	0%
Better data	3%	0%	0%	7%	7%	0%	3%	0%	0%	5%	6%	0%

Question 3: Considering the business decisions and trade-off choices you made during the course of the previous year, what has yielded the most benefit?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Product design	21%	25%	6%	27%	21%	33%	21%	10%	22%	22%	31%	25%
Risk assessment	19%	38%	6%	20%	14%	42%	15%	10%	96%	92%	69%	63%
Segmentation	18%	0%	12%	27%	21%	8%	21%	40%	19%	16%	13%	13%
Internal capacity	15%	13%	24%	20%	7%	8%	12%	20%	0%	24%	19%	13%
Efficiency	11%	0%	12%	20%	14%	8%	15%	0%	15%	11%	31%	0%
Technology adoption	11%	13%	35%	7%	0%	8%	6%	10%	11%	8%	6%	25%
Client engagement	8%	13%	6%	13%	7%	0%	9%	10%	4%	14%	6%	0%
SME capacity building	7%	13%	0%	0%	7%	17%	12%	0%	0%	8%	19%	13%
Partnerships	4%	25%	6%	7%	0%	0%	3%	0%	7%	8%	0%	0%

Question 4: What do you believe will have the greatest impact on SMEs in your country/countries of operation in the coming year?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Policy and regulation	32%	38%	35%	20%	50%	42%	15%	40%	22%	38%	38%	13%
External environment	29%	25%	24%	33%	29%	67%	15%	30%	19%	27%	31%	50%
Technology	17%	25%	29%	7%	0%	0%	21%	20%	7%	22%	19%	13%
SME capacity building	14%	25%	0%	7%	0%	25%	27%	10%	15%	19%	19%	13%
Funding	13%	0%	12%	20%	14%	25%	12%	10%	22%	16%	6%	25%
Product design	11%	25%	6%	13%	7%	25%	10%	0%	15%	8%	13%	0%
Efficiency	9%	0%	12%	20%	0%	0%	9%	10%	15%	8%	6%	13%
Data and analytics	4%	13%	12%	0%	0%	0%	6%	0%	4%	3%	13%	0%
Segmentation	4%	13%	6%	7%	0%	0%	3%	0%	4%	0%	6%	0%
Risk sharing and guarantee facilities	2%	0%	0%	0%	0%	0%	6%	0%	4%	0%	6%	0%

Question 5: If you had US $1 million to spend on a project or program of your choice in the coming year, what would you focus on?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Technology adoption	56%	75%	53%	33%	36%	50%	33%	70%	30%	54%	50%	63%
Segmentation	23%	0%	18%	40%	14%	17%	30%	10%	37%	24%	13%	0%
SME capacity building	16%	13%	12%	0%	14%	33%	21%	10%	15%	19%	25%	13%
Product design	14%	0%	24%	27%	0%	8%	15%	10%	22%	16%	0%	13%
Internal capacity	9%	25%	6%	13%	0%	25%	6%	0%	4%	16%	6%	0%
Systems that enhance marketing campaigns	2%	13%	0%	7%	0%	0%	0%	0%	4%	0%	0%	0%
Sustainability	2%	0%	0%	7%	7%	0%	0%	0%	7%	0%	0%	0%

Question 6: Which trends do you believe will shape the nature of SME banking in years to come?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Fintech and digital innovation	38%	50%	24%	40%	43%	25%	36%	50%	26%	32%	69%	38%
Digitization of channels	31%	25%	24%	33%	64%	33%	24%	30%	22%	43%	38%	50%
Product innovation	17%	13%	24%	13%	7%	17%	21%	0%	19%	30%	0%	0%
Data analytics	14%	38%	0%	13%	14%	17%	12%	30%	15%	5%	31%	50%
External factors	11%	25%	18%	0%	7%	8%	12%	20%	22%	11%	0%	0%
SME capacity building	9%	0%	0%	7%	7%	0%	24%	0%	15%	8%	13%	13%
Formalization of SMEs	5%	0%	6%	13%	7%	8%	3%	10%	0%	8%	0%	13%
More efficient decision-making processes	5%	0%	6%	0%	14%	17%	3%	0%	0%	14%	0%	13%
Customer-centricity	5%	13%	12%	0%	0%	8%	3%	10%	4%	5%	0%	0%
Business model development	4%	0%	6%	7%	7%	0%	3%	10%	4%	0%	0%	13%

Question 7: How would you rate the strength of your SME banking capabilities, going into the coming year?

Theme	All Responses	Regions							Client size			
		EAP	ECA	LAC	MENA	SA	SSA	Global	<2K	2K-50K	50K-400K	>400K
Above average	46%	13%	47%	53%	36%	75%	48%	20%	52%	46%	50%	50%
Average	29%	63%	35%	33%	7%	17%	30%	30%	26%	32%	13%	25%
Excellent	18%	25%	18%	30%	13%	36%	8%	15%	19%	22%	19%	13%
Below average	6%	0%	0%	0%	21%	0%	6%	10%	4%	0%	19%	0%

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Wilson Torres relaxes after working on his farm and milking his cows in Suesca Town, Colombia.

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In Côte d'Ivoire, IFC's leasing program helped thousands of cocoa farmers benefit from new trucks to transport their beans to markets, allowing them to increase productivity and profitability without the prohibitive costs associated with purchasing such equipment.

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