

# The small business customer is ready to switch— for payments products

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In recent years, banks have begun to focus more closely on their small business banking franchises. After all, small business customers tend to be far more profitable than their retail consumer counterparts. Yet, based on survey questions and interviews with more than 1,000 small- and mid-size businesses included in BAI's Small Business Payment Strategies research study, small businesses feel underserved. This is particularly so in the payments arena, with banks potentially missing an opportunity to capitalize on emerging needs.

BAI research finds that small businesses feel they are underserved by banks in payments products and services. At the same time, the study reports that bankers tend to underestimate the opportunities available to them. The study recommends that banks take a targeted, segmented approach to offering payments services and products and identify opportunities in several key areas: cash management, remote deposit capture, credit cards, electronic payments and integrated risk management.

With client relationships at stake, banks clearly need to do more to address the payments needs of small businesses and should approach their customers in a targeted manner. In general, the study finds that small businesses with revenues of between \$5 million and \$10 million are most receptive to payments services. Such firms have the scale to use these services. They are also the most inclined to switch banks if offered a better competing product.

The \$5 million to \$10 million segment is often considered the most attractive to banks. Our research indicates it is also the most receptive and the most likely to benefit from new payments products and innovations. First, these businesses have the wherewithal to utilize efficiency-driven payments products, and would often pay to have a centralized, integrated payments platform. Second, this segment is also the most vulnerable to competitors' offers, according to our analysis. Attrition of customers

from this segment can significantly impact a bank's revenues and net income, even if it continues to grow its share of smaller customers. Third, this segment often has a professional financial executive tasked with increasing financial automation and operational efficiency.

### Mixing in payments

What does it take to acquire and develop small business relationships? Bankers have tended to focus on three elements. Convenience, or proximity to the bank branch, is always important to small businesses. The second is service, particularly service provided by the client's business banker. Individualized and personalized service by a dedicated representative of the bank has often been linked to the durability (or lack thereof) of small business relationships. Finally, there's localized decision-making. Large banks with distant headquarters have difficulty maintaining this perception, which is why community banks have gained wallet share at their expense.

While these core elements remain critical, banks are trying to differentiate themselves with unique offerings and value-added services. Our study suggests payment products and services should be part of that mix.

### Bankers underestimate business' interest

This research identifies a disconnection between what small business owners want and what bankers think they want. The survey shows that small business owners' interest in new technology-based payment solutions is high. In fact, almost 80 percent of businesses with revenues between \$5 million and \$10 million expressed strong interest in a technology-based electronic payment platform.

While many bankers are looking to offer new products to their small business customers, most admit that they do not have all of the technical and analytical tools needed to understand their

customers' changing payment needs. Banks might like to rapidly respond with the right mix of products, such as remote deposit capture, credit cards, electronic payments, etc., but they cannot.

### Significant opportunities

In spite of the challenges suggested by the research, banks continue to be well positioned to serve small business customers. Banks, after all, "own" the transaction accounts. This anchor point is important because it is the source from which most payment-oriented transactions are executed and consummated.

The BAI survey identified the following key opportunities for banks:

#### Cash management

Maintaining cash (working capital) management continues to be a concern for many small businesses; roughly 45 percent of those surveyed stated this was a problem. Many banks have excellent working capital, cash management and treasury management services for the middle-market. Migrating such services down to the larger small business segments can be beneficial, provided the right sub-segments and industries are targeted—for example, asset-heavy industries, such as manufacturing.

#### Remote deposit capture

Similarly, remote deposit capture (RDC) could also be extremely beneficial to small business customers, provided the economics, pricing and appropriate training/onboarding programs accompany the sale of such services. It is up to the banks to assure that the benefits of this technology are communicated effectively, and that the accompanying pricing structure is palatable to the small businesses they serve.

#### Credit cards

Small businesses continue to use credit cards for short-term financing. With borrowing rates on credit card debt relatively low in recent years, credit cards have gained in attractiveness as a vehicle for providing short-term financing for small businesses. One of the most interesting findings from our study, however, is that less than half of small businesses surveyed use credit cards issued by their primary deposit service provider—a huge opportunity lost for banks.

#### Electronic payments

Integrated electronic payment products also represent a significant opportunity. While the need for such electronic transfers is tepid in the smaller segments (less than \$5 million in revenue), the opportunity with large small businesses is tremendous. When asked about current or planned usage of different electronic payment protocols, businesses in the \$5 million to \$10 million range expressed deep interest. For example, 82 percent of respondents in this segment said they use or plan to use automated clearinghouse (ACH) direct deposit and 79 percent currently use or plan to use wire transfers. Any integrated payments solution would need to accommodate such functionality so that business-to-business or business-to-consumer transactions are seamless and easy to use.

#### Integrated risk management

With fraud and identity theft emerging as serious concerns in banking today, small business owners are seeking financial institutions that go the extra mile to ensure the security of accounts and payments. Many bankers recognize this trend and are integrating risk management tools and analytics into their payment offerings.

### Courting the lucrative small business segment

The most lucrative segment for banks is also where the vulnerability is the highest; 57 percent of the respondents in the BAI study in the \$5 million to \$10 million segment said they would switch providers if their payment needs were not met.

Banks must decide quickly which opportunities they want to pursue aggressively. They risk losing certain components of the financial value chain to nontraditional alternatives and specialists, posing a long-term threat to the deposit relationship itself. Banks that do not address this issue soon are more likely to experience customer attrition, particularly within the more lucrative small business segments.

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