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With the expert contribution of the
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SME Finance Forum, managed by IFC

The SME Finance Forum was established in 2012 by the G20 and is managed by the International Finance Corporation (IFC), a member of the World Bank Group. Its objective is to scale SME finance to drive job creation and economic growth. As the premier SME finance network, with over 300 members and partners globally, it steers industry innovations, supports replication of best practices, facilitates policy advocacy, and fosters global knowledge transfer. The Forum also empowers its global peer learning membership network by connecting them with relevant partners, investors, and policymakers. Learn more at smefinanceforum.org

Foreword

Small and medium-sized enterprises (SMEs) form the backbone of the global economy, representing 90% of all firms, employing approximately 70% of the world's workforce, and contributing 50% to global GDP.[1] Despite their significance, SMEs face many challenges within a rapidly evolving economic landscape that demands innovative banking solutions.

Realizing this, banks are seizing the opportunity to redirect costs toward investing in exponential technology and ecosystem platforms. In response to the needs of SMEs, some banks are moving beyond merely reacting to short-term trends and are strategically redesigning their operations.

However, many banks have yet to fully capitalize on the transformative potential of hybrid cloud, data, and AI. There remains a hesitation to transition from integrating AI into existing business functions (+AI) to making AI the foundation for all business operations (AI+).

Our research provides strategic insights into the current state of SME banking and its fintech future. Conducted by the IBM Institute for Business Value (IBM IBV) in collaboration with the Banking Industry Architecture Network (BIAN), the study benefits from the expertise of the SME Finance Forum, managed by the International Finance Corporation (IFC).

We offer actionable insights into how banking strategies can embrace innovation to meet the evolving needs of SMEs. Our survey data is enriched by qualitative interviews with senior executives at financial institutions, bringing to light the perspectives of key decision-makers in SME banking.

Looking ahead, the transformation of business culture, operating models, and IT systems is essential to align with a digitally driven global economy. Realizing the benefits of technology-led innovation in SME banking requires both a strategic perspective and pragmatic actions.

We hope our work will ignite productive discussions within your organization and help you balance ambition with action, leveraging the opportunities presented by AI+ to redefine your banking experience and empower SMEs, the vital engines of the global economy, to thrive.

John J. Duigenan

General Manager
Financial Services
IBM Technology

Shanker Ramamurthy

Global Managing Partner
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Key takeaways

Notwithstanding their pivotal role, SMEs are often overlooked by banks, which can be discouraged by the substantial costs associated with serving this diverse market.

SMEs are major contributors to the global economy

They are 90% of all firms, 70% of the workforce, and 50% of GDP worldwide.[2] They demand innovative banking solutions that cater to diverse needs in real time.

Bankers' perspectives diverge from the actual needs of SMEs.

SMEs want a seamless experience on integrated ecosystem platforms. Bankers are looking inward and focusing on risk management and productivity.

Banks can increase their relevance to SMEs by embracing tech-led innovation, while taming operational costs and managing risks.

Bankers prioritize foundational layers: cloud for business-critical processes (63%), AI for credit risk (56%), and modular core banking (55%). Yet, they risk delaying investments in embedded finance (42%) and generative AI for client experiences (38%)—key opportunities that can dictate digital winners.

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An untapped SME market

Financial services are particularly susceptible to fluctuations in macroeconomic conditions, a phenomenon that was starkly illustrated by the 2008 financial crisis in which interest rates precipitously declined and impacted banks' profitability worldwide.

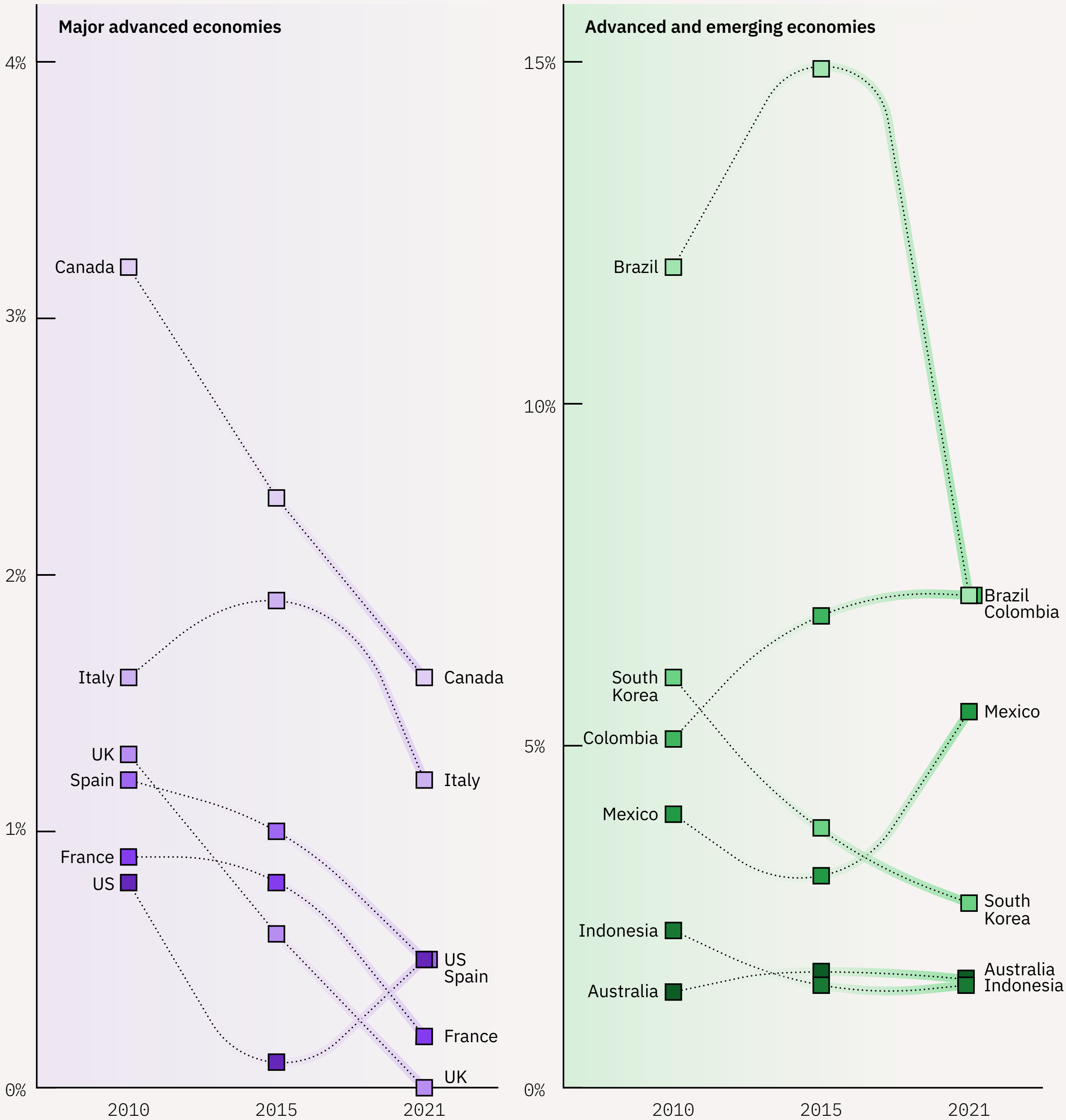
Banking plays a vital role in the smooth operation of the economy, with healthy banks facilitating the efficient allocation of financial resources. Conversely, when banks encounter difficulties, the consequences can be far-reaching, causing significant repercussions throughout local and international ecosystems.

This holds significant implications for SMEs, which tend to be particularly vulnerable to economic fluctuations, funding costs, and credit availability. As the backbone of the global economy, SMEs account for a staggering 90% of all firms and accounts, employ approximately 70% of the world's workforce, and contribute a substantial 50% to global GDP.[3] Notwithstanding their pivotal role, these enterprises are often overlooked by banks, which can be discouraged by the substantial costs associated with serving this diverse market.

FIGURE 1

SMEs pay a structural credit premium to large corporates when accessing funding opportunities–here is where new data and AI can help reduce the gap.

Percentages indicate the SME credit spread premium to large corporate borrowing.



Source: "Financing SMEs and Entrepreneurs: An OECD Scoreboard." OECD.

As the financial landscape continues to evolve, a new set of challenges are on the horizon. One of the more pronounced is the difficulty for SMEs to access sustainable finance due to the heavy burden of reporting requirements.

More than a decade of accommodative monetary policies created an environment where SMEs had access to financial services at a lower cost in most countries. Unfortunately, the escalating cost of capital became a pressing concern, forcing banks to prioritize tighter risk management over serving SME segments where credit risk is harder to estimate. The diversity of business scope within SME markets, and the scarcity of granular data to inform lending decisions, makes credit risk assessment inherently complex.

The Organization for Economic Cooperation and Development (OECD) estimated that SMEs tend to pay a risk premium relative to larger corporates when borrowing from financial institutions (see Figure 1).[4]

The situation became even more complex as the pandemic ended. Policy rates rose significantly, resulting in a reversal of favorable credit conditions for borrowers. This was particularly pronounced in major advanced economies, where rates had languished to near zero or even dipped into negative territory.

Notably, banks stood to benefit from interest rate hikes—at least initially—as they were able to recalibrate business loan conditions. Yet, diminished client appetite for borrowing at such elevated costs limited banks' capabilities to maintain lending portfolios. According to the OECD, lending to SMEs contracted in most countries.[5]

As the financial landscape continues to evolve, a new set of challenges are on the horizon. One of the more pronounced is the difficulty for SMEs to access sustainable finance due to the heavy burden of reporting requirements. This is a paradoxical situation, as the growing demand for sustainable finance presents an opportunity for SMEs to access new sources of capital.

According to a comprehensive study by the World Bank, SMEs need to do more than merely access finance.[6] They must also acquire the skills necessary to integrate new technologies into operations and innovate to expand their customer base. The challenge for SMEs spans beyond traditional banking relationships. Therefore, the opportunity for banks is to help SMEs bridge the gap between business intent and tech-led productivity.

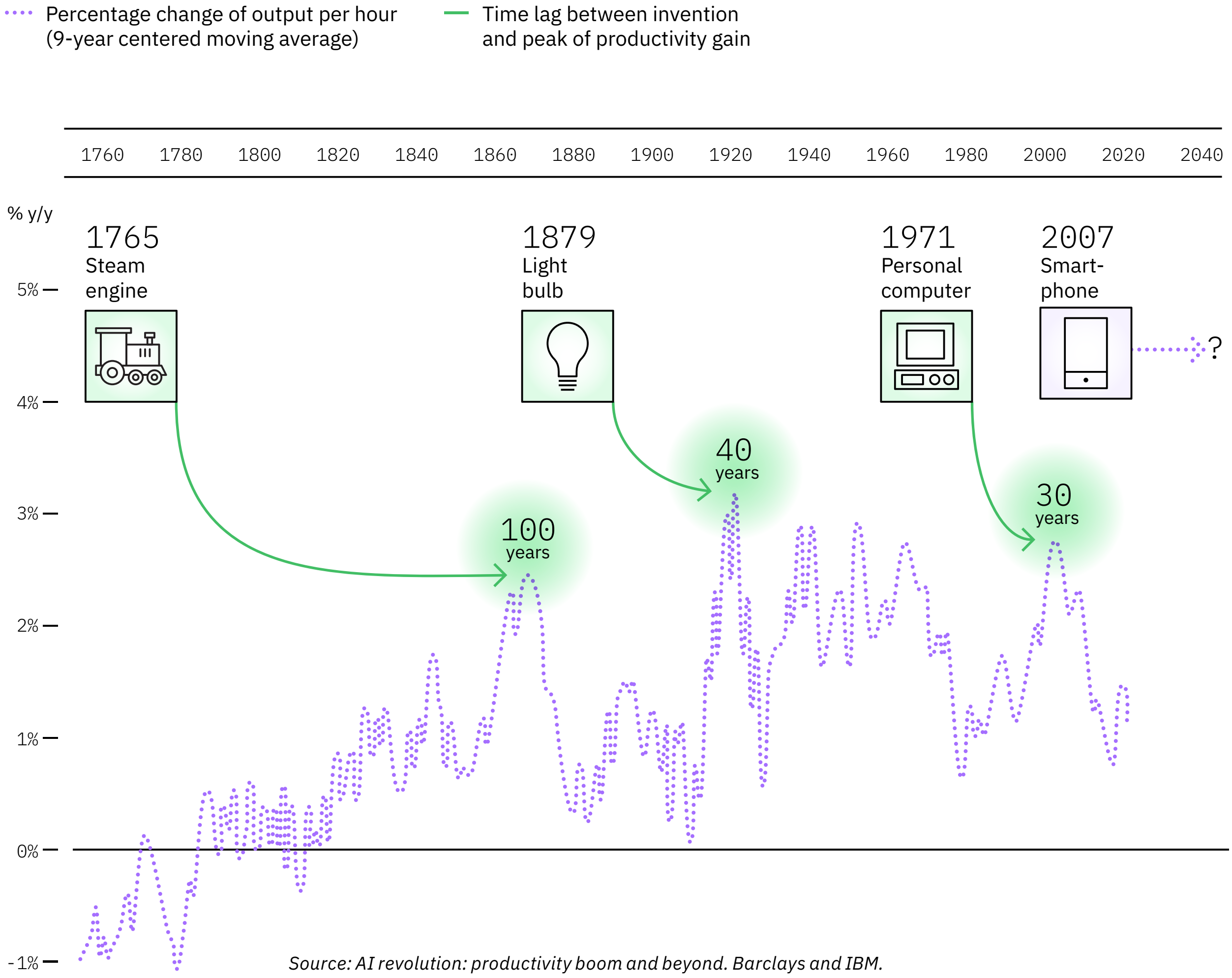
The impact of innovation on labor productivity

Throughout history, transformative technologies have consistently driven productivity rates, measured by output per hour worked and reflected in GDP statistics—of which SMEs represent 50%.[7] However, the productivity growth rate of the global economy has contracted since the turn of the century.[8] This is despite the impact of the digital revolution on everyday life, marked by the introduction of the smartphone in 2007 (see Figure 2).

One explanation could be the typically long gap between the invention of new technologies and the point when they materialize in macroeconomic gains. This has been experienced in past technology revolutions, as in the case of steam engines (1765), light bulbs (1879), and personal computers (1971).[9]

FIGURE 2

A time gap persists between innovation and its impact on labor productivity.[10]



Source: AI revolution: productivity boom and beyond. Barclays and IBM.

Another—more pessimistic—interpretation is that digitalization and portable devices might not compare to past productivity revolutions, such as the automobile or air conditioning. Measurement errors could also play a role, as traditional GDP statistics may not fully capture the value of digital products with zero marginal costs. The truth might involve a mix of these factors, but the key question remains: Can we witness a new AI-driven economic renaissance, one that benefits SMEs and their financial institutions with better services at lower costs, propelling the global economy forward?

According to IBM IBV and Barclays analysis, this is possible. Most of the time gap between innovation and the impact on productivity rates has likely passed, since AI is not a novelty: its roots date back to the 1950s when Alan Turing first proposed a test to measure the extent of "computer intelligence."[11] What is new, however, is the accessibility of AI such as large language models (LLMs).

AI can help banks resolve critical hurdles to serving SMEs, boosting their productivity and, conversely, adding to SME productivity by making financial services more intuitive, consumable, and relevant for their business development (see Perspective, "AI+ foundations for SME banking" on page 12). For example, banks have new means to secure payments, addressing the resilience of infrastructure that is business-critical to SMEs. Furthermore, AI can enable banks to augment SME capabilities in making informed business decisions, contributing to their risk management and financial health.

Banks must stay the course. Neobanks are increasingly shifting competitive focus from retail banking to SME banking, starting to service the needs of micro businesses—these solo entrepreneurs are already their clients. Given the prowess of their cloud-native technology, neobanks are also raising the bar of expectations for serving SMEs of larger size in terms of revenue and number of employees.[12]

AI can help banks resolve critical hurdles to serving SMEs, boosting their productivity and, conversely, adding to SME productivity by making financial services more intuitive, consumable, and relevant for their business development.

Perspective

AI+ foundations for SME banking

According to IBM IBV research, a staggering 78% of banks are working with generative AI but lack a cohesive, enterprise-wide approach to AI overall, failing to integrate this transformative technology across multiple business domains and use cases. Only 8% of banks have a systematic approach.[13]

To fully mobilize the capabilities of AI, a shift is required—a paradigm transformation from merely integrating AI into existing processes (+AI) to fundamentally reimagining these processes around AI (AI+). This approach has far-reaching implications for how financial institutions operate, as AI assumes a pivotal role in every stage of business functions.

What does this paradigm shift to AI+ portend for SME banking processes such as onboarding, risk analysis, and relationship management?

- **Client onboarding.**
  As the +AI era dawned, banks began to modernize their onboarding processes, leveraging AI to reduce friction and digitize KYC and AML checks. AI was initially employed as a supporting tool, harmonizing with traditional onboarding processes that relied heavily on human verification and judgment.

  However, the transition to AI+ marks a profound shift, one in which AI assumes the pivotal role of orchestrating every aspect of the onboarding experience: from client communications to prefilled forms, requests for additional data and creation of follow-ups.

- **Credit risk analysis.**
  As the +AI era emerged, SME bankers began to harness the power of AI to analyze new datasets such as cash flows to enable more accurate risk assessments. AI was initially employed as a supporting tool, harmonizing with traditional risk management methods.

  However, the transition to AI+ heralds a paradigm shift in which AI systems assume full agency, autonomously managing financial analysis, performing risk assessments, and empowering credit risk managers to manage more informed and timely lending decisions across digital channels.

- **Relationship management.**
  SME bankers started using AI to streamline access to client and sector information, liberating relationship managers from mundane research tasks and empowering them to focus on high-value activities. AI was initially employed as a supplementary tool, awaiting banker instructions to initiate research requests and generate analysis.

  However, the transition to AI+ organically changes the way of working, where AI systems proactively initiate outreach campaigns, screen clients, and categorize them for potential financial needs. This integration enables relationship managers to make more informed and timely decisions for greater efficiency and a deeper understanding of clients' needs.

SMEs speak out: What they really need from banking

The IBM Institute for Business Value—in collaboration with BIAN and the expert contribution of the SME Finance Forum, managed by IFC—surveyed almost 700 banking executives with business responsibilities in SME banking domains and conducted direct interviews with selected executives about their strategies.

We also surveyed more than 1,000 SME owners and managers across different world economies. This enabled a unique comparison between bankers' opinions and clients' expectations, providing a nuanced understanding of the SME market landscape (see "Study approach and methodology" on page 40). The study investigated crucial questions, including: Do SME owners and managers prefer face-to-face conversations or mobile apps? What do they value most from their bank?

Cracking the code to a perfect banking match

Our findings reveal an interesting disparity between the perspectives of bankers and SMEs when it comes to choosing a bank. Overall, SMEs expect bankers to understand their unique business needs, offer tailored solutions, and facilitate networking with business partners and clients.

In contrast, bankers tend to focus on the foundational aspects of banking, such as easy-to-use apps, dedicated banking managers, and the proximity of branches (see Figure 3).

Looking into survey data by jurisdiction, we observe nuances in the top three choices. SMEs in the US, the UK, France, and China also report branch proximity as one of their top three preferences. Many bank branches in major advanced economies have closed due to digital advancements and industry consolidation, often at a pace that does not align with how quickly clients are adapting to digital services. Conversely, SMEs in India highly value easy-to-use mobile apps, as the government-led intervention accelerated digital adoption throughout society. Notably, a bank's social responsibility is appreciated in India and Brazil more than in other markets.

These differences speak to the need for bankers to better understand local nuances that influence the calculus that drives SME decision-making, thus better adapting their branding approach to meet the evolving and differing needs of these vital businesses.

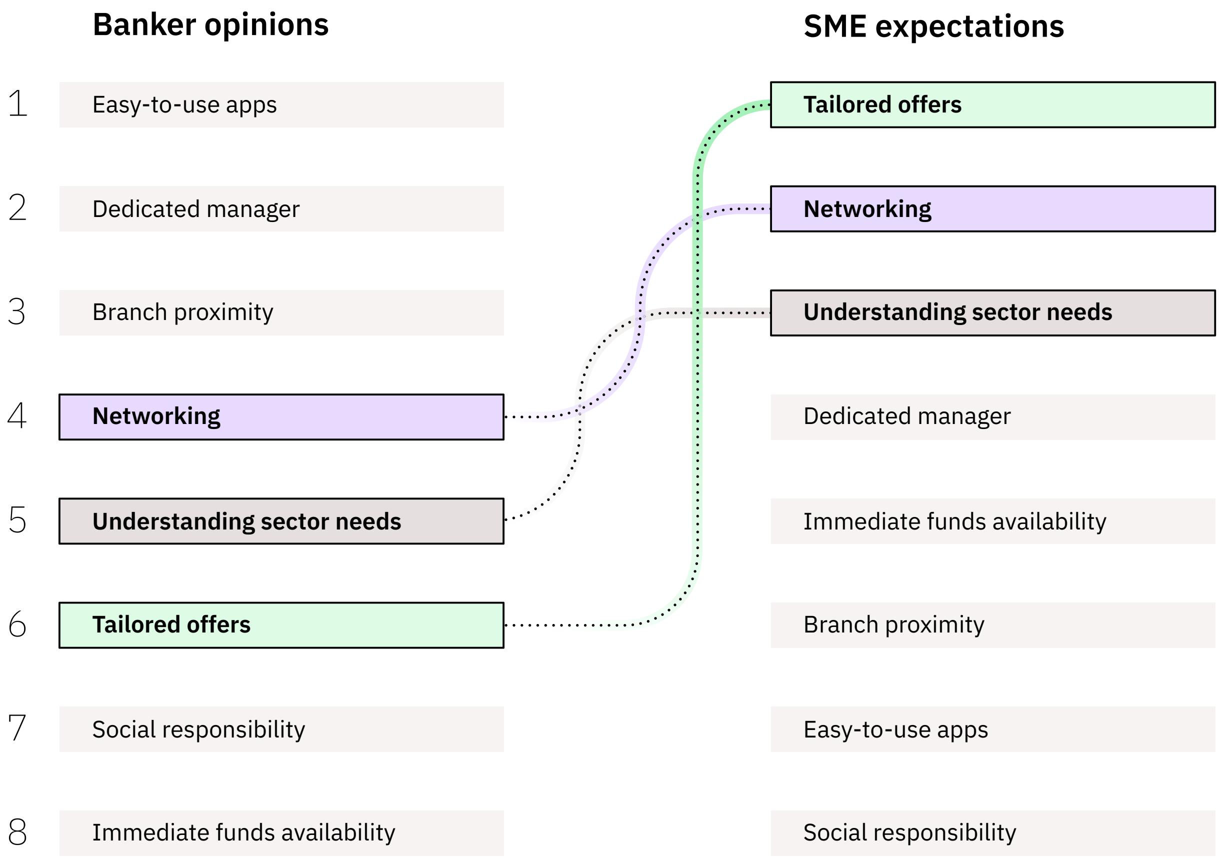
Overall, SMEs yearn for a trusted relationship built on professional understanding of their business domains. By embracing an ecosystem approach, banks can transcend their role as transactional providers and become valued partners in the growth and development of their SME clients.

"What's important is that you don't just design for the market; you design with the market. You need to embed yourself in the realities of these businesses and the way these business owners run their operations, and then design tailored solutions for them, keeping in mind the dynamics of not just the business owners but also the entire SME ecosystem."

Ayodele Olojede
Divisional Head of Retail and SMEs, Wema Bank

FIGURE 3

SMEs value banks that demonstrate deeper understanding of their sector and business ecosystems.



Q. Which are the most important priorities for SME clients when choosing a bank?

Our survey covers SMEs with more than 50 employees and does not specifically include micro businesses. Micro businesses (enterprises that are solo entrepreneurs) are a significant part of the overall SME market, and they often exhibit behavior similar to consumers. In a recent study, we also queried consumers about what could persuade them to switch their primary account to another bank. We found a preference for better customer service, the ability to instantly transfer funds, and frictionless mobile access.[14]

It is logical to infer that as micro businesses grow, their habits will influence expectations of the higher tiers of the SME category. This indicates that banks must carefully fine-tune their services to meet the unique needs of SMEs along their differing paths to growth.

SMEs seek banks with expertise to address business growth

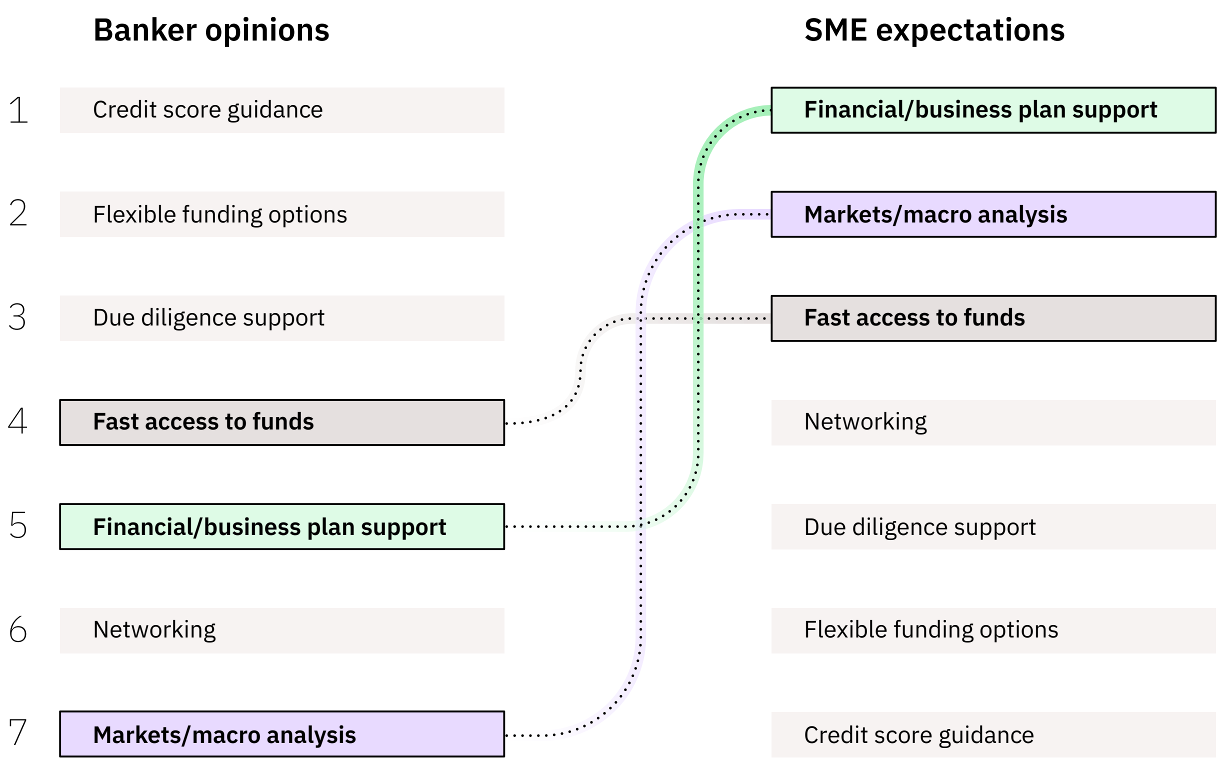
When it comes to the banking services that can facilitate growth, SME owners and managers tend to emphasize the importance of expert support in planning for expansion corroborated by market and economic analysis (see Figure 4).

In the US, key priorities include guidance for credit scoring, flexibility of funding options, and expert support in planning.

Overall, SMEs recognize the role of banking stewardship as they seek trusted advisors who can provide counsel and navigate the complexities of business expansion. Fast access to funds also ranks high on their list of priorities, as SMEs need to minimize bureaucratic hurdles and save time. For these dynamic entrepreneurs, every moment counts, and cumbersome credit applications can be an obstacle to overcome.

FIGURE 4

Bankers look inward, underestimating the SME need for fast money and expert advice to grow their businesses.



Q. Which services should be improved to better support the business growth of SMEs?

"If we truly want SMEs to thrive and flourish, we need to recognize their immense potential ... while we're moving in the right direction by facilitating more informed lending, I think there's still a lot more we can do to support these vital businesses."

Challla Sreenivasulu Setty
Managing Director (International Banking, Global Markets & Technology), State Bank of India

According to 2023 IFC research, 30% of enterprises in the formal sector struggled with credit constraints. Among the 70% of firms that were not credit-constrained, 52% reported having sufficient funds, rendering loan applications unnecessary. Conversely, 27% of firms were deterred from applying due to unfavorable loan terms and conditions. The analysis also reveals that credit-constrained firms tended to be smaller and exhibited a negative correlation with performance. Furthermore, the data suggests that as economies become more developed, the share of credit-constrained firms decreases.[15]

When asked how they make important financial decisions, almost 60% of SMEs ranked their reliance on a banker's support and online searches, with only 23% of SMEs reporting reliance on internal expertise to make these decisions autonomously. As new competitors rely on digital-only engagement, financial institutions can differentiate themselves by empowering both clients and relationship managers with the best combination of human and digital advice.

"We realized that customers are interested in more than just financing; they want to see how their business is prospering."

Fabio Fasoli
Head of SME Banking, Santander Brazil

Banks’ contributions to simplifying and streamlining SME operations

In the pursuit of optimizing business efficiency, SMEs place a premium on instant payments and streamlined digital access to all banking and non-banking services. As such, comprehensive super apps seem to appeal to SMEs not only in emerging markets but also across EU countries. These centralized platforms could provide a wealth of benefits, including enhanced decision-making facilitated by data-driven insights and cash flow forecasts.

FIGURE 5

SMEs recognize the value of integrated ecosystem platforms with banking and non-banking services.

	Banker opinions	SME expectations
1	**Instant payment for all operating expenses**	**Instant payment for all operating expenses**
2	Aggregation of bank accounts	**Super app across non-banking and banking**
3	**Analysis/forecast for all operating expenses**	**Analysis/forecast for all operating expenses**
4	Hotline financial queries	Tailored investments for idle cash
5	Tailored investments for idle cash	Collection of delinquent receivables
6	Collection of delinquent receivables	Hotline financial queries
7	**Super app across non-banking and banking**	Aggregation of bank accounts

Q. Which services should be improved to better support the operational efficiency of SMEs?

While payments efficiency tends to dominate overall, there are interesting distinctions across countries. In the US, where checks are still a relevant payment method, SMEs value services that facilitate collection of delinquent receivables, whereas in countries with established Open Banking charters, account aggregation tends to be valued. This is the case in the UK, Spain, Brazil, and also Japan.

Overall, bankers agree on the relevance of instant payments and cashflow analysis. However, they don't always recognize client appetite for super apps that integrate banking and non-banking services (see Figure 5). SMEs, on the other hand, do desire a unified platform to harmonize their financial operations beyond banking. A platform experience that embeds banking and non-banking services in the context of the daily life of SME businesses can liberate them from burdensome complexity that can stifle productivity and innovation. With a one-stop-shop solution, SMEs can redirect their energies toward strategic growth, creativity, and competitiveness, rather than being bogged down by administrative tasks.

"Many SMEs don't have a professional person on their payroll to handle these tasks, which require some expertise. When we provide a genuine solution, it's truly appreciated."

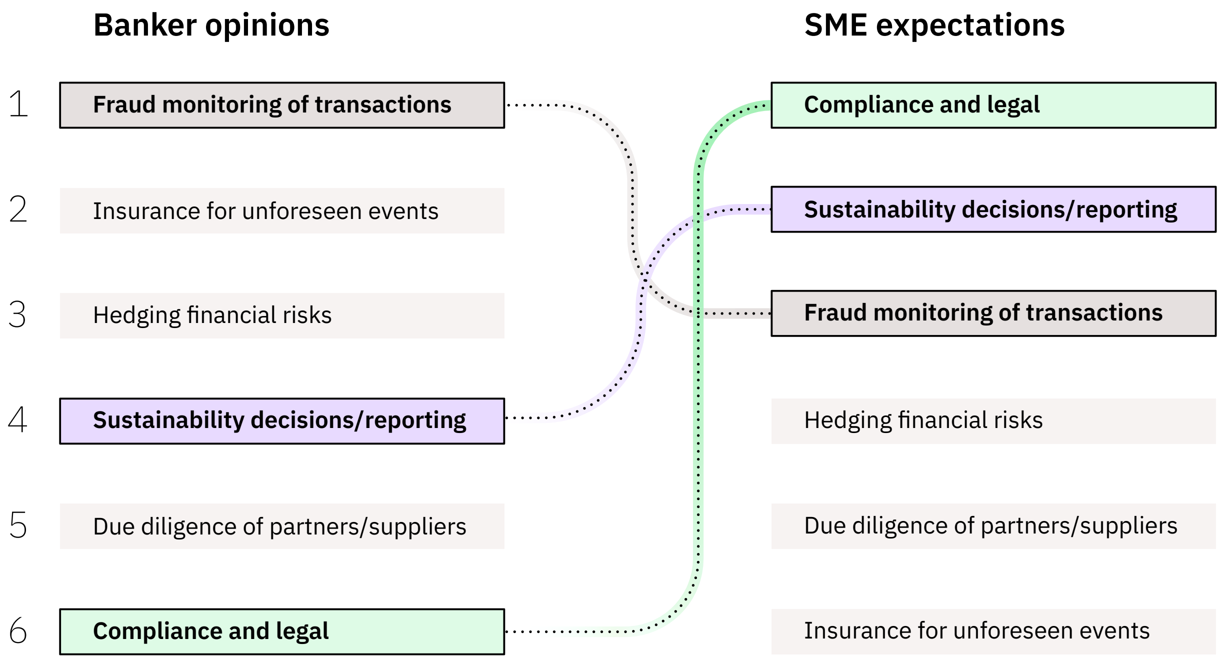
Gokhan Koca
Global Head of SME Banking, BBVA

Compliance made easier to help SMEs thrive with protection

Finally, the survey uncovers a gap between the SMEs and bankers relative to the value banks can bring to mitigating risks faced by SMEs and addressing their compliance concerns.

FIGURE 6

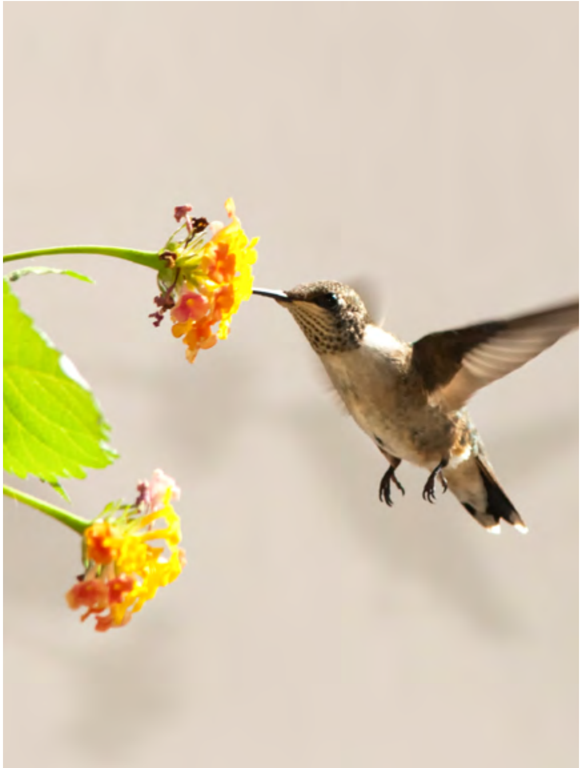
SMEs seek help to navigate regulatory complexity and sustainability considerations.



Q. Which services should be improved to better support risk mitigation, security, and compliance of SMEs?

“It’s essential to help [SMEs] become more financially disciplined. This includes ensuring they comply with statutory filing requirements, which positively impact their creditworthiness when applying for loans.”

Nadia Sood
CEO and Founder, CreditEnable



While SMEs crave guidance and support to navigate the complexities of compliance obligations and make informed decisions about sustainability, they also crave enhanced confidence in fraud monitoring. Conversely, bankers expect a greater interest from SMEs in insurance and financial hedging products (see Figure 6). Rather than addressing these more advanced elements, SMEs first require guidance to address cumbersome compliance obligations.

It is worth noting that SMEs in the US, the UK, Japan, and Mexico are more apt to look for financial hedging compared to other parts of the world, while insurance for unforeseen events is a more pressing topic in the UK, Brazil, and China. This highlights the imperative for banks to understand local dynamics.

Perspective

Modular core banking foundations for SMEs

Not every bank has assessed themselves as an "A" letter grade institution in terms of competing in an increasingly dynamic SME banking landscape, but this milestone is within reach. As technology becomes the business, a harmonious, iterative strategy is essential. The strategy should begin with the construction of hybrid cloud building blocks, such as robust security, unparalleled scalability, and seamless portability. From this foundation, banks can expand to create data architectures that facilitate integrated access to a varied SME ecosystem in which data is not always immediately within reach, is often incomplete, and requires complex analysis to derive valuable business insights.

Working with clear API standards and technological understanding of business domains facilitates a "build once" development methodology that enables business innovation to accelerate and become more cost-effective. The potential dividends are substantial: reduced friction in business-technology collaboration, enhanced self-service capabilities that accelerate development speed, seamless data sharing both within and outside the bank throughout ecosystems, and the widespread adoption of AI at scale.

We also found that more than 60% of executives are focused on four primary ways to add value with industry standards:

- **Build faster** (64%). Standards accelerate ecosystem building and bank-partner integrations.
- **Maintain better** (64%). Standards reduce development and maintenance costs because APIs can be reused.
- **Integrate faster** (60%). Standards improve the partner's experience during banking API integrations.
- **Manage better** (58%). Standards make it easier and less complex for banks to focus on higher value when deploying embedded finance.

Banks that are still struggling with foundational elements might not have the bandwidth to focus on the more advanced factors that drive competitiveness and success in SME banking. Addressing strategic stumbling blocks is a precondition to unlocking business value.

As SME banking continues to evolve, a pivotal aspect will be the seamless integration of banking services into the diverse industries that shape the business journeys of each SME. According to IBM IBV research, the path to embedded SME finance is fraught with challenges. When we probed banking executives about the obstacles hindering their embedded finance strategies, we uncovered fundamental hurdles that threaten to undermine their efforts. The top constraints cited by these executives were the lack of modularity in core banking systems, which hinders the ability to adapt to changing market conditions (53%), and inadequate API standards, which impede the seamless exchange of data (52%).[16] These foundational challenges must be addressed if banks are to successfully embed their services into the industries that shape the SME landscape.

A modern business architecture is a prerequisite to any digital strategy. But embedded finance requires banks to interlock with external entities and platforms—which puts openness and flexibility at the core. That's why a combination of technical modularity and industry standards are essential for success.

The tech foundations of banking competitiveness

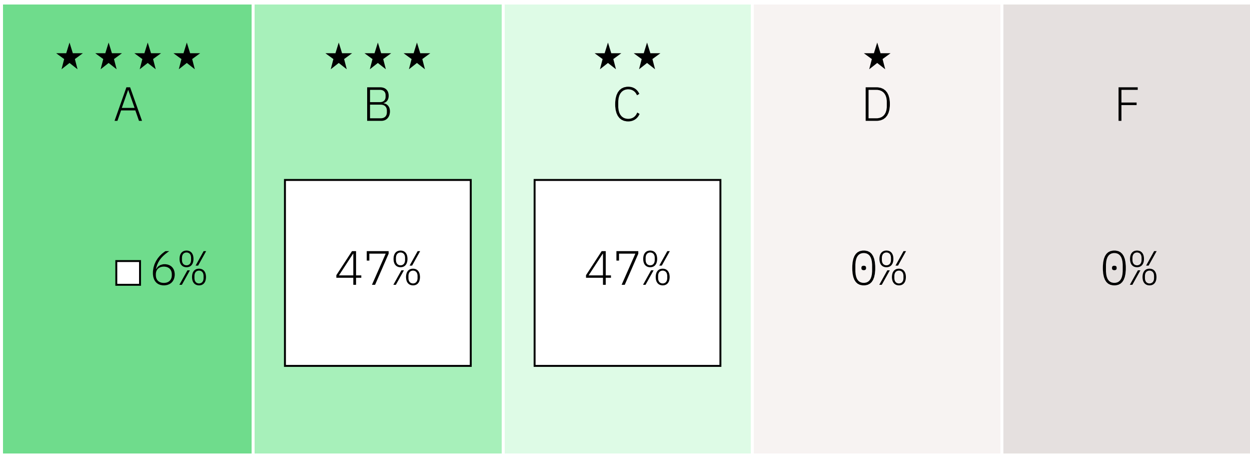
Bankers acknowledge the imperative to improve their services while simultaneously reducing the costs to serve.

When asked to grade their institution's performance, only 6% granted themselves an "A" grade. Conversely, 47% of bankers assessed themselves as either a "B" or a "C," a lukewarm evaluation (see Figure 7).

However, being average is no longer a viable strategy in today's competitive landscape. As new entrants are poised to disrupt the status quo and expand beyond retail banking, the bar has been raised for traditional institutions to remain relevant. The need for transformation is palpable, necessitating not only the augmentation of digital interfaces but also a comprehensive overhaul of the fundamental architecture of banking institutions. This transformation is required to render these these core foundations adaptable and responsive to the evolving needs of a varied SME landscape (see Perspective, "Modular core banking foundations for SMEs" on page 22).

FIGURE 7

Very few institutions give themselves an "A" grade in effectively serving SMEs.



Q. What letter grade would you give your own bank in terms of quality of SME banking services?

"I expect every SME to have a cloud-based accounting platform, in which case I see banks connecting to it, making data analysis for lending easier."

Rajeev Chalisgaonkar
Head of Business Banking and NEOBiz, Mashreq Bank

"A key advantage is that we operate our technology in a greenfield, allowing us to innovate freely. Our modern technology stack is very attractive."

Maximiliano Damian Rodrigues
General Manager, SME Business, Nubank

Where to begin? We posed the question to bankers, seeking their insights into the most coveted technology that's poised to transform the industry. 65% of respondents identified the journey to cloud for business-critical processes, 58% of bankers highlighted the potential of AI to enhance credit risk analysis, and 57% advocated making core banking architectures modular and flexible (see Figure 8).

In addition to these priorities, more than 35% of executives indicated embedded finance and generative AI as transformative initiatives. When it comes to embedded finance, a recent IBM IBV survey revealed that 20% of organizations are live with an embedded finance solution, and 51% are in the implementation phase.[17]

We also surveyed 600 banking executives with decision-making responsibility for AI from strategy to operations across retail, SME, and corporate banking. When asked where they see the greatest business value in the application of generative AI across domains, 32% indicated risk and compliance, 26% improving client engagement, 24% accelerating IT development, and 18% augmenting or automating other support areas.[18]

Given that banking complies with high fiduciary standards compared to other industries, its starting point with generative AI tends to favor internal activities more often than external processes that directly engage clients.

> *“If someone else destroys our old business model, we will be ruined. But if we destroy our old business model, we will survive.”*

Nobuhiro Tsunoda
Former Chairperson, Ernst & Young Tax Co., Japan

FIGURE 8

Banking executives look for sounder IT foundations, an essential precondition for innovation.

Q. Select the top 3 technologies that will yield the highest business value for SME banking.

Despite the pressing need for transformation in the past decade, many banks have been reluctant to embark on a comprehensive overhaul of business and technology. Instead, they've opted for a more targeted digitalization.

The words of Mario Draghi, former Chair of the European Central Bank, still resonate: "*The necessity to adjust the business model to the digitalization, to the changes in technology, is something much more compelling than being angry about negative rates.*"[19] His cautionary warning serves as a poignant reminder that the status quo is no longer sustainable, and that banks must be willing to challenge their conventional thinking.

Banks are in danger of being left further behind. The exponential acceleration and widespread availability of LLMs has catapulted generative AI to the forefront of corporate boardrooms and executive-level discussions. This sudden prominence has transformed AI from a buzzword to a business-critical imperative, as banks look for increased profitability, lower cost to serve clients, and improved risk and compliance.

"This shift in mindset is not just an internal transformation for the bank, but also a reflection of the digital transition happening in our clients' businesses."

Gokhan Koca
Global Head of SME Banking, BBVA

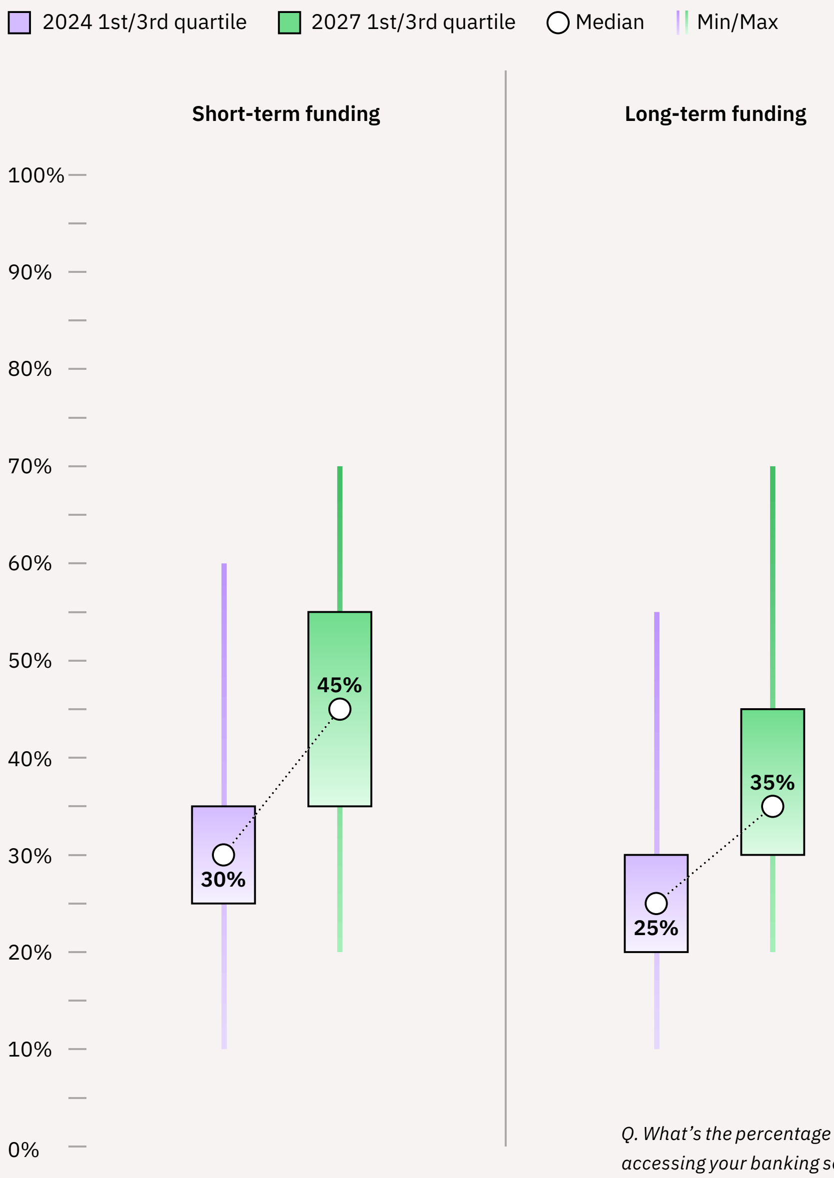
Enhance profitability with digital engagement

Bankers are acutely aware that clients are rapidly embracing mobile apps to conduct their financial transactions. However, they remain skeptical about the likelihood of all SME clients adopting digital consumption in the next three years. This presents a catch-22: SMEs may still be hesitant to adopt digital channels, but banks may not even be providing comprehensive digital offerings.

Not all banks are on the same page regarding digital-first client behaviors. Half the banks (those below the median point in Figure 9) currently report that less than 30% of SMEs prefer applying for short-term funding on digital. For the other half of banks, they report that 30% to 60% of their SME clients are digitally savvy. All banks expect digitally savvy clients to grow in numbers by 2027, with the midpoint increasing from 30% to 45% for short-term funding and 25% to 35% for long-term funding.

FIGURE 9

Not all banks are on the same track with digital-first engagement, yet all expect to improve.
Percentage of clients who prefer digital instead of branch visits for funding services



Q. What's the percentage of SME clients who are primarily accessing your banking services on your mobile app or website, and what is expected in 2027?

SME banking is a harmonious marriage of digital innovation and human connection. Not surprisingly, when banking executives were asked to identify the most crucial initiatives to enhance the management of client relationships, 65% emphasized the importance of empowering dedicated relationship managers. These executives expect technology innovation to enable the integration of timely data about clients and their respective industries (51%). They also expect AI-driven automation of campaign efforts to facilitate proactive outreach (59%). By striking an optimal balance between human touch and digital sophistication, banks can foster more meaningful connections with their clients.

"Currently, relationship managers don't report to branch managers. Instead, they primarily visit customers outside the branch, and they can use any branch in their region if they need physical support. With this model, we are visiting more customers than we had in the past."

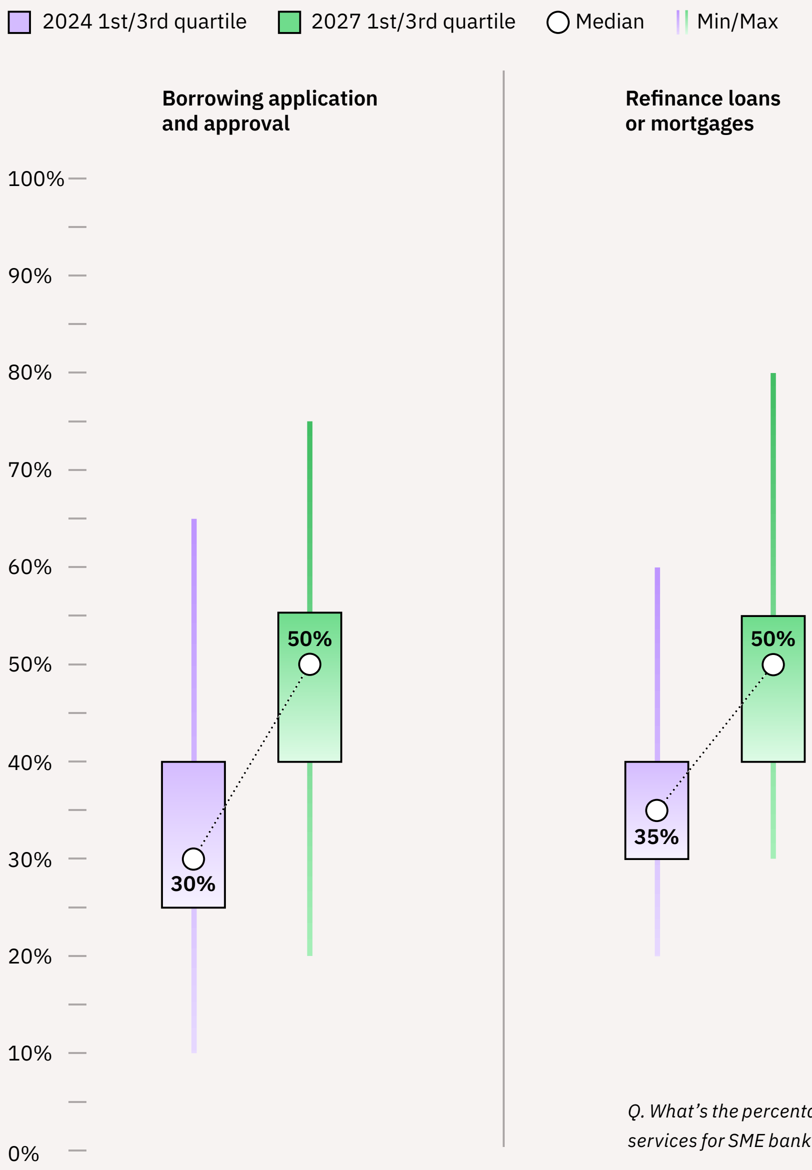
Fabio Fasoli
Head of SME Banking, Santander Brazil

Cutting costs—but not services—for efficient SME banking

To improve cost-to-serve, banks must automate their critical business activities—such as SME lending operations—end-to-end. Our findings indicate a big disparity among banks relative to their level of automation. For example, in 2024, banks automated between 10% and 65% of their processes for SME borrowing, from applications to approvals. However, there is a consensus that automation will increase within the next three years, with the midpoint reaching 50% for new borrowing and refinancing existing obligations (see Figure 10).

FIGURE 10

Achieving full automation of key business processes is still a long-term journey.
Percentage of processes automated



Q. What's the percentage of end-to-end digital automation of your services for SME banking, and what's expected in 2027?

"Banks are now starting to recognize the importance of better understanding their SME customer base and are working to improve their segmentation and feedback collection. This is crucial, as many SMEs are now migrating to alternative providers in search of better financial services and user-friendly experiences."

Jane Prokop
Global Head of SME, Mastercard

For example, digital onboarding is a critical space to gain banking efficiency and increase relevance to SME clients. When it comes to enhancing the onboarding experience, banking executives overwhelmingly target centralizing client data and documents for seamless access and cross-selling opportunities (56%). Similarly, when it comes to streamlining lending processes, the majority (64%) identify the digitalization of documentation as the key initiative to facilitate easier borrowing applications. A striking disparity emerges when considering the importance of implementing performance metrics such as feedback to improve onboarding quality. Despite its critical role in driving excellence, only a mere 34% of banking executives recognize the value of performance metrics in this context.

However, banks should move beyond merely digitalizing analog processes to effectively implement automation. Adopting an AI+ approach allows banks to redesign all processes from first principles focusing on simplicity and ease of use, helping ensure that human intervention into operations is only required for exceptions and more added-value activities.

AI-driven risk modeling: The key to enhanced security and compliance

According to the IBM IBV 2024 CEO Study, 66% of CEOs acknowledge that the potential productivity gains from automation are so substantial that they must be willing to assume significant risk to remain competitive. Furthermore, a staggering 67% of CEOs are willing to take more risk than their competitors to maintain their edge in the market.[20]

As financial institutions work on new technologies, the spotlight shifts to risk management, underscoring the need for advanced risk control and governance.

In today's complex financial and technology landscape, risk management and compliance require a holistic approach. The fragmented handling of AI and generative AI use cases can lead to inefficiencies and vulnerabilities.

According to IBM IBV 2024 research, only 8% of banks have adopted a systemic approach to implementing generative AI, whereas 78% are deploying generative AI use cases in an ad hoc manner as opportunities arise, without a unified strategy.[21] This piecemeal approach conflicts with the creation of the necessary controls for mitigating security risks, bias concerns, data protection on an expanded supply chain, and hallucination pitfalls. What is essential is an AI+ approach that is grounded in a consistent, compliant data architecture.

While banks address their AI+ foundations to scale innovation enterprise-wide, they must also redesign risk management analytics. 50% of banking executives indicate difficulties accessing sufficient and reliable data to ensure accurate risk estimates. As many SMEs do not maintain standard annual reporting, machine learning enables banks to integrate new data, such as cash flows and transactions, to improve risk management and confidently scale digital lending operations.

"Improving the accuracy ratio through machine learning has been the enabler that makes our risk management approach fit for a digital multichannel world."

Davide Alfonsi
Group Chief Risk Officer, Banca Intesa Sanpaolo

When it comes to enhancing the lending processes for SMEs, a significant majority (64%) say that digitalizing documentation for easier application is essential. 54% of respondents also emphasize the need for more frequent credit evaluations, incorporating novel data and events to inform their assessments. Also, 50% of respondents prioritize increasing the level of detail in client-specific information to facilitate more accurate credit risk evaluations, pricing, and approval decisions.

However, only 22% of respondents acknowledge the critical role that ecosystem collaboration plays in improving access to data. This can be a crucial omission, as credit bureaus are not universally available, and the data they provide may be insufficient. Open banking can play a pivotal role in addressing this challenge, facilitating the secure, standardized sharing of financial data.

Nevertheless, executives interviewed in *The voice of the makers* compendium to this research also report encountering resistance from clients who are hesitant to grant access to granular information on payments and transactions.[22] As the financial sector continues to evolve, it is essential to find a balance between safeguarding client privacy and promoting information sharing that can facilitate more informed lending decisions and ultimately drive economic growth.

But opening the data coffers for open banking and cloud consumption is not risk free. It requires the application of clear industry standards that align API development with business domains for easier consumption across banking and non-banking ecosystems. This can create efficiency and the potential for risk reduction in cloud journeys (see Perspective, "Hybrid-by-design cloud foundations for SME banking" on page 35).

According to the stark reality of data breaches unveiled by 2024 IBM research, about 40% of all breaches involved data distributed across multiple environments, such as public clouds, private clouds, and on premises. Fewer breaches involved data stored solely in a public cloud, private cloud, or on premises.[23] With data becoming more dynamic and active across environments, it's harder to discover, classify, track, and secure. This statistic underscores the pressing need for banks to refine their capabilities in configuring hybrid cloud environments and building secure API connectivity in a way that prioritizes safety and compliance.

Research evidence also suggests that human factors play a critical role in this equation. As SMEs migrate their customer interactions to digital platforms and operate on cloud with software-as-a-service (SaaS) solutions, it is essential that they develop a deep understanding of the security measures required. The onus is on both banks and SMEs to recognize the importance of a multifaceted approach to data security, one that encompasses both technological advancements and human factors. By doing so, they can help ensure the integrity of their digital operations across expanded and complex financial ecosystems and supply chains.

"It seems that SMEs become more aware of security concerns once they've had an issue ... More education is needed for businesses to become more proactive with security measures."

Jane Larimer
President and CEO, Nacha

Perspective

Hybrid-by-design cloud foundations for SME banking

Hybrid-by-design tech architecture lays the groundwork for the kind of long-term growth SME bankers expect to serve such a diverse, dynamic market. It deliberately facilitates systems that work together seamlessly, can scale for growth, and are built to last.

But navigating hybrid architecture requires careful orchestration. Streamlining data movement between on-premises and cloud environments, along with robust security protocols, is crucial. The potential rewards—faster innovation cycles, cost optimization, and a future-proofed AI strategy—far outweigh challenges.

Strong tech architecture bridges this gap by creating a shared language between business and IT. By defining the technology roadmap and aligning it with business goals, architecture fosters collaboration where both sides work together to achieve objectives. As business needs change, architecture flexes so that it drives to the right outcomes at the right time.

Adopting hybrid-by-design cloud techniques and practices enables organizations to manage integrated operations that achieve four distinctive levers of value:

- **Shared language between business and IT**. Standardize using open technologies and ecosystems, simplifying skill requirements.
- **Security first**. Help to secure, govern, and operate consistently across deployment locations with resilience.
- **Power of choice (flexibility)**. Deploy application components to any compatible platform in any connected data center, including on premises, public cloud, and at the edge.
- **Rocket-fueled application development.** Simplify and accelerate application development as their need to serve SME markets evolves (for example, real-time user data, personalization, and rapid deployment).

The result is that business ideas can be engineered fast and operated automatically to compete in a dynamic SME market. And the business shifts from cloud as infrastructure to hybrid-by-design operating models.

Conclusion

SME banking is a critical opportunity for banks looking to improve financial performance. SMEs are 90% of all firms, 70% of the workforce, and 50% of GDP worldwide.[24] And they demand innovative banking solutions that can cater to diverse needs in real time.

The challenge for banks is that SME markets are very heterogenous, both geographically and across sectors. Historically, serving such a varied market efficiently was not feasible due to cost constraints and risk management roadblocks. However, recent advances in AI can unlock new opportunities that neobanks are already rapidly pursuing.

For banks to compete and succeed, they must shift from a traditional inward focus to a broader ecosystem mindset while preserving profitability, efficiency, and risk management. Because our survey reveals a disparity between banking executives' opinions and actual needs of SMEs, we believe our research will help inform more business-oriented technology investments.

After reading our extensive research, you've undoubtedly realized that banks must keep ahead of this rapidly evolving SME landscape. As our guiding actions outline, this requires continuous thought and a consultative approach to harnessing AI—and it's imperative to get started now.

"Time is money, as the saying goes. And banking often means the time that business owners must take away from their core activities ... That's why, to create trusted value and relationships, we must be obsessed with helping clients save time while banking with us."

Maximiliano Damian Rodrigues
General Manager, SME Business, Nubank

Action guide

Three imperatives emerge along the core pillars of banks' economic models.

1

Drive growth with differentiating client experiences.

In a market where very few banks excel at SME banking, those that differentiate their client experience will gain a significant competitive advantage. By understanding each client's specific sector, business cycle, and challenges, banks can offer customized solutions beyond banking that not only meet but anticipate client needs, fostering deeper relationships and driving growth.

2

Lower the cost to serve while increasing service granularity.

To compete and increase profitability, banks must also focus on lowering the cost to serve SMEs while expanding their offers. By going beyond automation of routine tasks, and embracing an AI+ approach, banks can meaningfully increase efficiency of their services. Yet, to successfully balance efficiency with efficacy, banks must also invest in modular core banking that preserves capabilities to customize offerings to markets, sectors, and client needs.

3

Compete in the SME market and manage the risks.

SMEs often struggle with access to finance at convenient prices due to structural deficiencies in the data needed to run banks' risk management models. Banks can overcome this challenge by helping clients to increase their digital footprint and capture new sources of data that feed AI-driven credit risk modeling. This improved accuracy allows banks to support a wider range of SMEs while maintaining financial stability.

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Study approach and methodology

SME owner and manager survey

In June 2024, the IBM Institute for Business Value (IBM IBV) surveyed more than 1,000 SME owners and managers equally distributed across nine countries to explore their banking needs and how they are adapting to the progressive availability of digital services. This is relevant to understanding where and how to calibrate SME banking strategies to better serve clients and accelerate return on investment. While not all countries are represented, those selected, as well as the variety of business sectors, make the analysis indicative of behavioral shifts in key regions and markets.

Banking executive survey

In June 2024, we surveyed almost 700 banking executives across 25 countries to explore how their institutions are competing in SME banking. We learned where they are in implementation of new solutions, which hurdles they encountered, and how they resolved key challenges to accelerate transformation.

One-on-one interviews with financial services executives

Between June and August 2024, we conducted a set of one-on-one interviews with executives at financial institutions and fintech startups. We learned what truly matters in SME banking and digital transformation from the professionals who work in the field. Their expert contributions can be found in the multiple quotes enriching this paper, all sourced from our upcoming compendium, *The voice of the makers*.

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2024 Global Outlook

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