PARTNER. ADVISOR. CATALYST.

Winning the Battle for Small-Business Customers

Prepared for:

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

EXECUTIVE SUMMARY

Winning the Battle for Small-Business Customers, commissioned by Bottomline Technologies and produced by Aite Group, explores the growing presence of technology players in the small-business banking space. It identifies the products and services small businesses are most likely to pay nonbank partners for and offers recommendations to financial institutions seeking greater success with this important customer segment.

Key takeaways from the study include the following:

- Bank strategies, product offerings, and pricing models in the small-business banking space need to evolve. Only 28% of businesses generating between US$100,000 and US$20 million in annual revenue (most of which bank with one of the four largest U.S. banks) award their primary institution the top grade for innovation. Additionally, 44% of small businesses are paying nonbank providers for financial services.
- Banks are missing an opportunity to drive more value from this important segment. More than one-third (40%) of small businesses believe that technology providers (such as Square, Mint, and Bill.com) are more likely than their bank to offer products and services for which their business is willing to pay. This belief becomes more widespread as businesses grow in size (54% of businesses generating between US$10 million and US$20 million in annual revenue) and among those with aggressive growth plans (57%). Fifty-eight percent state that most of the products and services they use at their bank are offered free of charge.
- Customer expectations for their banks have diminished, placing banks at risk of simply becoming deposit holders and missing out on the large potential revenue stream associated with the small-business customer segment as it continues to grow more sophisticated and technologically savvy.
- Banks can win back small-business customers by focusing on what matters most to them: customer service, advanced fraud management, sophisticated channel capabilities and superior user experience, broader product portfolios and toolsets, and tighter integration.
- For the purposes of this study, a small business is defined as any business generating between US$100,000 and US$20 million in annual revenue.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

INTRODUCTION

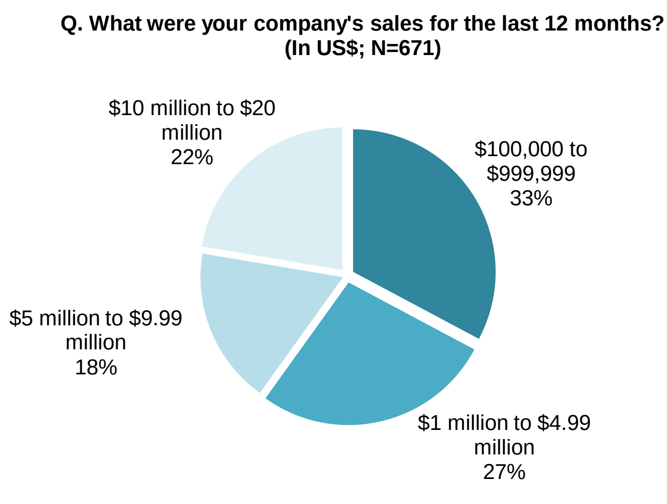
Business banking is experiencing a paradigm shift, forcing banks to evolve their strategies and customer interactions or risk losing market share to competitors. External forces, such as emerging technology players and customers' personal technology experiences, are further compounding the urgency for change and creating a need for new innovative banking capabilities. Unfortunately, innovation is happening more rapidly outside of most banks than it is within them. Only 28% of businesses generating between US$100,000 and US$20 million in annual revenue (most of which bank with one of the four largest U.S. banks) award their primary institution the top grade for innovation. Additionally, 44% believe that technology providers are more likely than their bank to offer products and services for which their business is willing to pay. That percentage is 57% among businesses looking to grow aggressively over the next two years. It is clear that banks need more tools in their arsenals to win the battle for small-business customers.

METHODOLOGY

This paper is based primarily on the results of an Aite Group October 2015 online survey of U.S.-based businesses generating less than US$20 million in annual revenue. For the purposes of this paper, "small businesses" are defined as those businesses generating between US$100,000 and US$20 million in annual revenue. There were 671 such businesses participating in our survey. These participants represent a group that is often underserved by banks, despite their growing needs and sophistication. This paper's content also leverages Aite Group research of banks' small-business offerings and strategies and the author's extensive knowledge of the market.

Figure 1 breaks down survey participants by their annual revenue.

Figure 1: Survey Participants by Annual Revenue



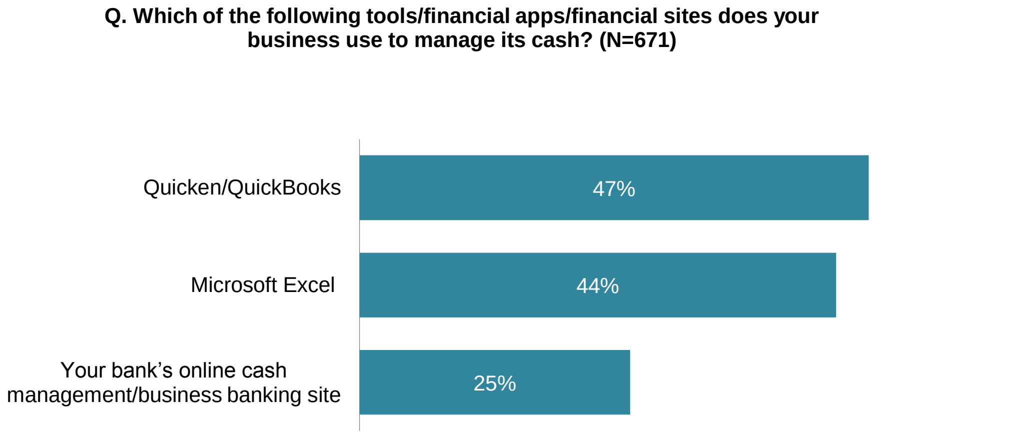
Source: Aite Group's survey of 671 U.S small businesses, October 2015

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

MEETING SMALL-BUSINESS NEEDS

Overall feedback from small businesses about their primary financial institutions is surprisingly positive, despite banks' self-proclaimed struggles to serve them. As such, 69% of businesses surveyed believe their banks understand their needs. Sixty-two percent even went as far as to say that their bank is focused on doing what is best for the customer, even if it is at the expense of its bottom line. For a good number of small businesses, however, the apparent high levels of satisfaction may not be showing the full picture. In many cases, small business expectations for their banks have diminished. This is likely due to their being underserved for so many years. For example, while 74% of small businesses describe their primary institution as providing them with the money management tools they need, only 25% manage their finances from their bank's online banking site. These businesses are far more likely to use Microsoft Excel (44%) and other systems, such as Intuit's Quicken or QuickBooks (47%), for such purposes (Figure 2).

Figure 2: Tools Used to Manage Cash

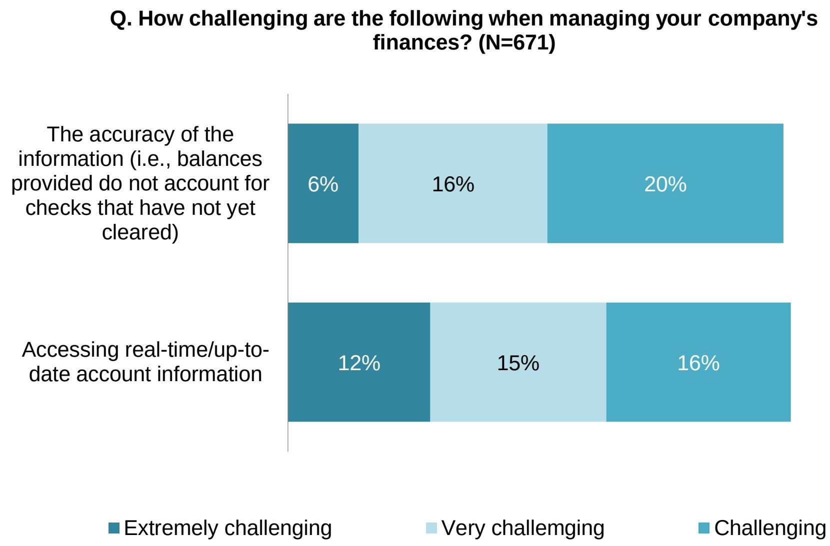


Source: Aite Group's survey of 671 U.S small businesses, October 2015

Further, 42% of survey participants are challenged by the accuracy of the account information presented by their banks given its static nature, while 43% struggle to access real-time information (Figure 3). This is not surprising, as banks often have a limited and delayed view of their customer's payables and receivables, which lacks insight into checks that have not yet cleared. Without the ability for a business user to enter additional information or automatically sync bank systems with external information, banks are unable to provide the money management and forecasting capabilities small businesses truly need. While banks are successfully offering basic banking capabilities, most are failing to address their customers' financial management pain points and delivering information in a way that is neither actionable nor helpful to their customers.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Figure 3: Challenges with Account Information

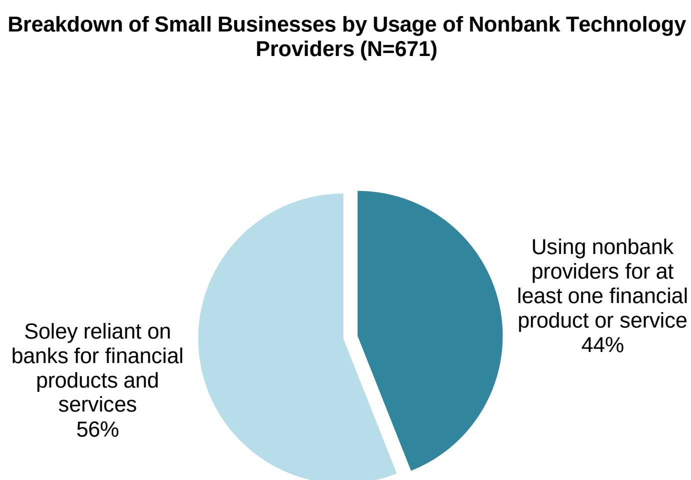


Source: Aite Group's survey of 671 U.S. small businesses, October 2015

USE OF NONBANK PROVIDERS

Additionally, despite preferring their banks as a one-stop shop for finance, several small businesses seem to have given up on that coming to fruition. A large number of them are going elsewhere for products and services banks could and should be offering. Forty-four percent of small businesses are using a nonbank provider for at least one financial service, such as electronic invoicing or payroll, with some using more than one (Figure 4).

Figure 4: Small-Business Use of Nonbank Technology Providers

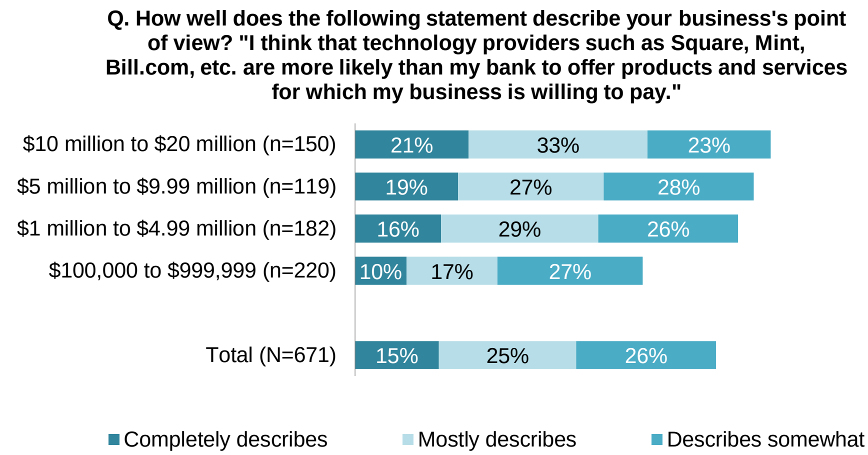


Source: Aite Group's survey of 671 U.S. small businesses, October 2015

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Even more alarming is that 40% of small businesses believe technology providers (such as Square, Mint, and Bill.com) are more likely than their bank to offer products and services for which their business is willing to pay. An additional 26% believe that statement is "somewhat" true. This belief becomes more widespread as businesses grow in size (Figure 5).

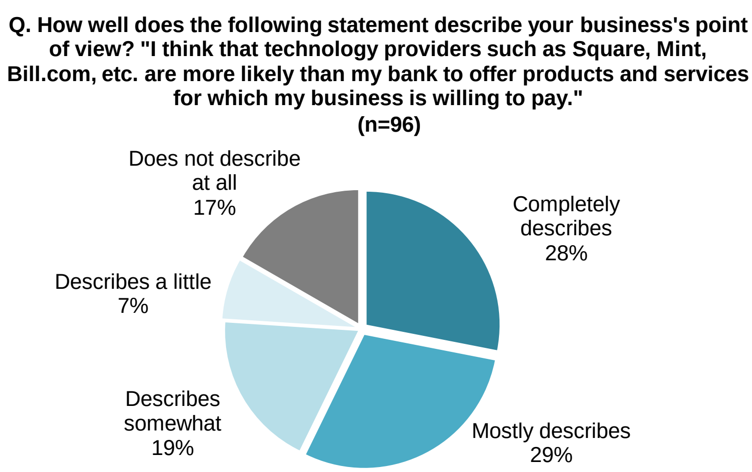
Figure 5: Attitudes Toward Nonbank Providers



Source: Aite Group's survey of 671 U.S. small businesses, October 2015

Among the 96 businesses in our sample planning to grow aggressively over the next one to two years, 57% believe technology providers are more likely than their banks to offer products and services for which their business is willing to pay (Figure 6). These businesses should represent a strong target market for banks, given their likely need for additional products and services as they grow in size, but these findings suggest that banks will not enjoy the benefits of deeper, more multiproduct relationships with those customers down the road.

Figure 6: Aggressively Growing Business's Perceptions of Technology Providers

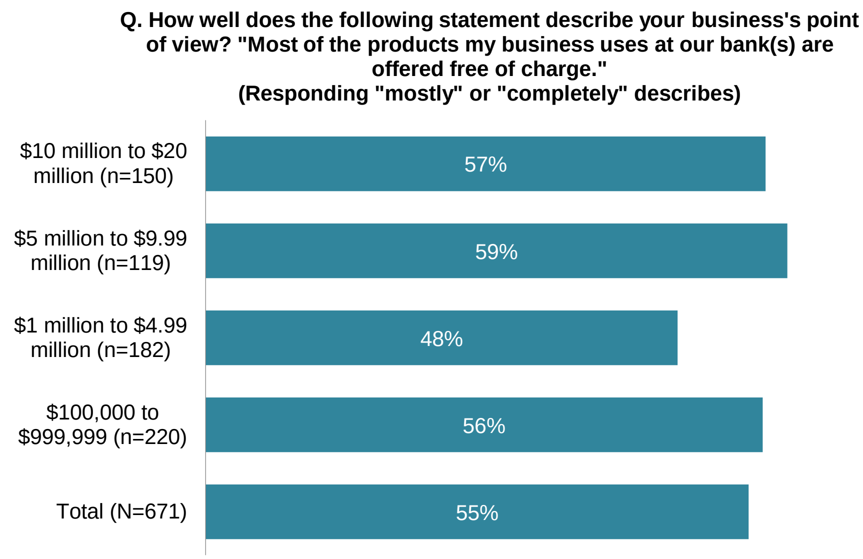


Source: Aite Group's survey of 671 U.S. small businesses, October 2015

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

In addition to creating strong revenue opportunities for nonbank technology providers by failing to offer many of the products their customers need and pay for, banks are also leaving money on the table for offerings they do have. Most banks believe that small businesses are not willing to pay for products and, as a result, they don't charge for them. In fact, 55% of small businesses surveyed state that most of the products and services they use at their bank are offered free of charge (Figure 7). Interestingly, there are no statistically significant differences between the largest and smallest revenue segments; thus, improvements can be made to bank pricing models for all businesses.

Figure 7: Banks Giving Products Away



Source: Aite Group's survey of 671 U.S. small businesses, October 2015

PRODUCTS FOR WHICH BUSINESSES GO ELSEWHERE

Some banks have begun to evolve their strategies in an effort to better serve their small-business customers. A growing number have also begun to seek out potential partnerships with technology providers offering the capabilities for which small businesses are most likely to go elsewhere. Bank movement has been relatively slow, however. While customers of the largest banks are enjoying access to some of the less traditional small-business banking products, customers of other banks must often look beyond their financial institutions. Some of the products and services for which small businesses are most likely to go elsewhere include accounts payable and receivable reporting, employee expense tracking, and analytics (Figure 8). The likelihood to do so grows as businesses increase in size, particularly among those generating greater than US$1 million in annual revenue.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Figure 8: Products and Services for Which Businesses Are Most Likely to Use Nonbanks

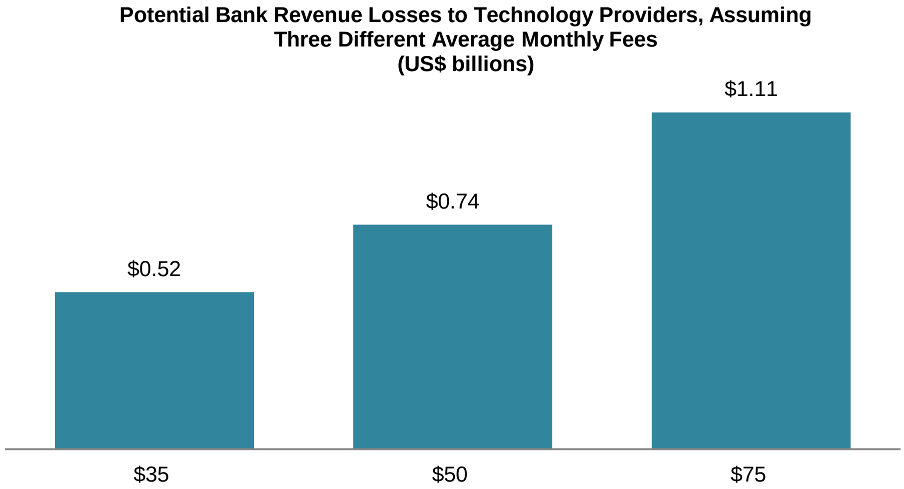
Source: Aite Group's survey of 671 U.S. small businesses, October 2015

Each time a customer goes elsewhere for a product, the bank loses revenue, as most small businesses are willing to pay for the products and services listed in Figure 8. Assuming three different scenarios of small-businesses spending— US$35, US$50, and US$75 per month—Aite Group estimates that banks could be losing between US$517 million and US$1.1 billion annually in potential revenue to nonbank technology companies. These estimates assume there are approximately 2.8 million small businesses in the United States generating greater than US$100,000 in annual revenue,[1] 44% of which are using at least one financial service at a nonbank provider (1.232 million; Figure 9).

1. Based on Small Business Administration's estimate that there are approximately 28 million U.S. small businesses (defined as businesses with fewer than 500 employees) and Aite Group's estimate that approximately 10% of them generate greater than US$100,000 in annual revenue.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Figure 9: Potential Revenue Lost to Nonbank Technology Companies



Source: Aite Group estimates

Table A and

Table B break out the amounts small businesses are willing to pay for each product.

Table A: Banks' Potential Lost Revenue for New Capabilities

How much would your business be willing to pay each month for the following services? (In US$)	$0	$1 to $25	$26 to $50	$51 to $100	$101 to $250	$251 to $500	More than $500
Payroll processing	5%	17%	17%	25%	19%	11%	7%
Ability to send and create electronic invoices	11%	27%	23%	18%	10%	6%	4%
Services allowing online payments to vendors, customers, and service providers	15%	21%	23%	16%	13%	9%	4%
Cash flow and sales forecasting tools	18%	17%	24%	19%	10%	9%	2%
Employee expense tracking, submission, and reimbursement tools	15%	17%	23%	19%	17%	8%	2%

Source: Aite Group's survey of 671 U.S. small businesses, October 2015

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Table B: Banks' Potential Lost Revenue for Reporting Capabilities

How much would your business be willing to pay each month for the following services? (In US$)	$0	$1 to $25	$26 to $50	$51 to $100	$101 to $250	$251 to $500	More than $500
Expense reporting and management	13%	19%	18%	18%	17%	9%	4%
Accounts payable and receivable reporting	14%	16%	16%	25%	15%	11%	2%
Analytics (e.g., trends, benchmarking)	15%	15%	20%	23%	16%	8%	4%

Source: Aite Group's survey of 671 U.S. small businesses, October 2015

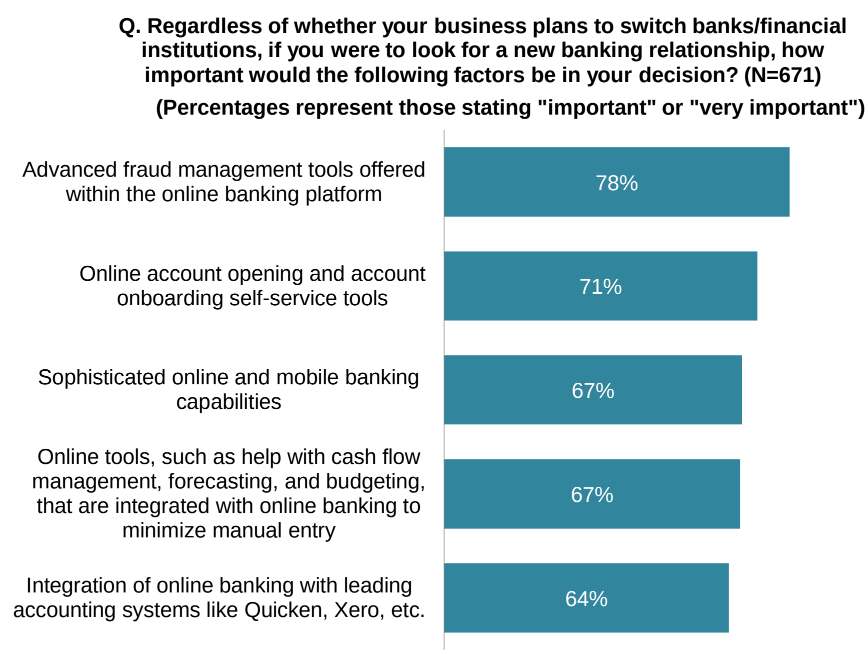
© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

WHAT BANKS SHOULD DO

Banks are at a critical point in their evolution. The risk of disintermediation has never been greater as competition from nonbank providers continues to rise. Additionally, customers are growing more demanding and tech savvy; thus, banks need to provide more user-friendly and flexible experiences that more closely mirror experiences from users' personal lives to meet their expectations. Finally, 24% of small businesses state that they "definitely" or "probably" will switch financial institutions over the next two years. That percentage grows as businesses increase in annual revenue. Maintaining the status quo is no longer sufficient.

What can banks do to reclaim lost business and their role as primary financial providers and advisors, while also retaining and attracting new customers? They must focus on what matters most to small businesses. In addition to providing the high levels of customer service that small businesses expect, banks should also focus on other important factors businesses consider when they select new bank partners, such as advanced fraud management, sophisticated channel capabilities and superior user experience, broader product portfolios and tools, and tighter integration, to increase their success with this important customer segment (Figure 10).

Figure 10: Small-Business Considerations When Selecting a New Bank Partner



Source: Aite Group's survey of 671 U.S. small businesses, October 2015

ADVANCED FRAUD MANAGEMENT

While businesses of all sizes worry about fraud, fraudulent activities can shut down a small business. Therefore, it is not surprising that advanced fraud protection tools within the online banking platform is something that 78% of businesses generating less than US$20 million in

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

annual revenue consider to be “important” or “very important” when selecting a new bank partner. Small businesses want to know that their banking information is secure and want to be protected against internal fraud as well as external account takeovers. Moving businesses off consumer platforms onto commercial ones with entitlement capabilities that limit account access and transaction approval authority is one way banks can help reduce customer vulnerability to fraud. Eighty-one percent of small businesses that bank online have at least two individuals (within and/or outside their company) who access their online banking account and thus would benefit from such capabilities.

Small businesses also have a lot of concerns about accounts payable fraud and express high levels of interest in fraud prevention products, such as positive pay. In fact, among small businesses that bank online, 41% that don’t already use positive pay express interest in doing so if their bank offered it to them.

Finally, banks should also be utilizing analytics and alert capabilities to better notify and inform customers of unusual account activities.

SOPHISTICATED CHANNEL CAPABILITIES AND SUPERIOR USER EXPERIENCE

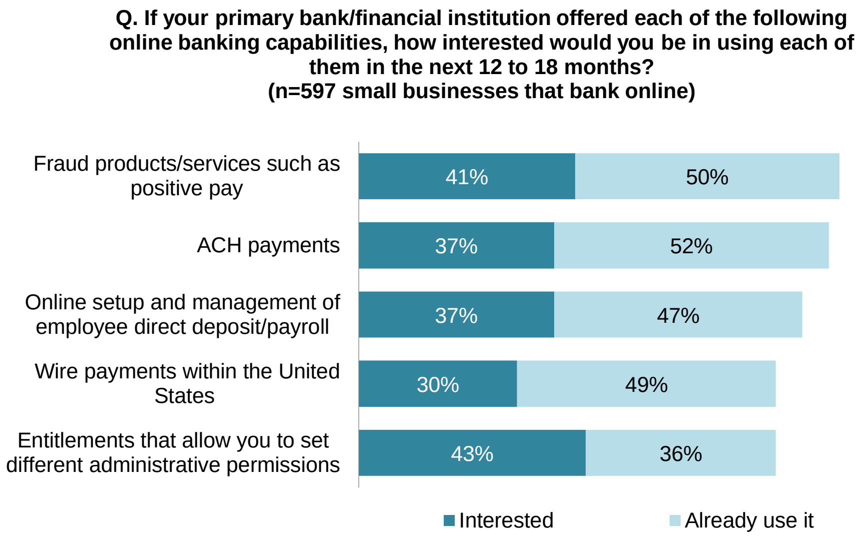
Small businesses are growing more comfortable with technology as they increasingly use it in their personal lives. Forty-two percent even state that they generally adopt a new technology product as soon as it is released. This comfort level not only makes small businesses less expensive and thus more attractive for banks to serve (compared to the past when they preferred to interact with their banks via the costly branch channel) but also places pressure on banks to continue investing in the digital channels these customers now prefer. Online and mobile capabilities as well as user experience are increasingly becoming potential points of differentiation for banks. Sixty-seven percent of small businesses consider the sophistication and user friendliness of a bank’s online and mobile capabilities to be “important” or “very important” when selecting a bank partner.

THE ONLINE CHANNEL

Small-business needs often more closely mirror those of commercial clients than those of consumers. As such, a growing number of banks have begun migrating small businesses onto commercial platforms where their needs will be better met (and products can be charged for). For example, it is not uncommon for small businesses to be interested in positive pay, ACH payments, and the ability to set up and manage employee direct deposit/payroll, all capabilities commonly found within commercial platforms (Figure 11). The consumer platforms from which many small businesses are served lack these and other business capabilities, thus leaving them underserved and more likely to look elsewhere to fill gaps.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

Figure 11: Interest in Online Products and Services



Source: Aite Group's survey of 671 U.S. small businesses, October 2015

Bank success in the small-business space is largely dependent on the usability of its online banking solutions, especially its commercial ones. Solutions must offer the right balance of functionality and usability. Luckily, technology has evolved to more easily enable that balance and allow banks to better address small-business expectations. Some of the things these customers look for include an intuitive user interface with easy-to-use workflows, multichannel support, self-service tools for problem resolution, and a personalized dashboard. Banks must therefore improve the ease of navigation within their offerings by breaking down modules into more transaction-oriented widgets. In essence, banks must make it easier for the business to make its next transaction as opposed to navigating through various modules and searching for information. Workflows should also be further simplified with wizards, especially to help business customers with online payments. Only 43% of small businesses have a clear understanding of the difference between ACH, wire, and electronic bill payments, and know when it is best to use each payment type. Finally, data needs to be more consolidated. Small businesses want a single location to view their account balances and manage their funds, rather than the siloed experiences that are commonly found in bank offerings.

The onboarding process should also be made seamless and efficient to further improve user experience. Onboarding is typically the first impression a customer gets of the bank, so it should be as efficient and painless as possible. Unfortunately, that is not the case for many institutions, as customers struggle with paper and delays due to manual processes. A bank's onboarding process and self-service tools are important considerations for 71% of businesses when seeking out a new bank partner.

THE MOBILE CHANNEL

Mobile capabilities are also highly desired and expected by small businesses, even those not yet ready to use them. Forty-eight percent of small businesses use their bank's mobile offering, while an additional 23% are likely to. Those institutions not offering mobile access should

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

implement plans to do so or risk being perceived as less technologically savvy, and thus likely to begin losing market share among these customers.

A bank's mobile capabilities must be robust and not limited to checking balances. The most highly desired mobile capability by small businesses is the ability to approve payments. Many businesses also look for the ability to initiate repetitive payments, make positive pay decisions, remotely deposit checks, and perform internal transfers. Additionally, solutions must adapt to device type to offer a similar experience across devices while also leveraging the strengths of each device, such as using a sliding menu on mobile.

BROADER PRODUCT PORTFOLIOS AND MORE TOOLS

As stated previously, most banks are losing the innovation battle against emerging technology players as small businesses are increasingly looking outside their banks to meet their needs. Banks need to urge their online banking partners to build new capabilities or forge partnerships with companies that will integrate needed capabilities, such as cash flow management, forecasting, and budgeting, into their online platforms to keep customers on bank sites. Such tools will get customers more engaged in the channel and using more products. Banks will also gain greater insights into their customers' businesses and needs, thereby enabling them to better serve them.

A broader product portfolio will also lead to new revenue streams for banks. While price sensitive, small businesses are more willing to pay for products and services than banks often give them credit for. They have already proven a willingness to pay nonbank providers for products that banks could and should be offering. Small businesses are especially willing to pay for products and services that help them overcome pain points and allow more time to focus on what they are most passionate about—growing their business. These businesses struggle with manual processes resulting from unconsolidated bank data and a lack of real-time capabilities and often appreciate tools that automate processes and help them operate more efficiently. Among survey participants, 57% are willing to pay for products that cut operational costs, while 54% are willing to pay for those that save time and increase convenience.

TIGHTER INTEGRATION

The final area banks should focus on to strengthen their position in the small-business space and acquire new customers is tighter integration. While important, this integration should include systems across the bank to offer a more consolidated experience with a richer view of client data. It should also include tighter integration with the accounting systems most often utilized by small businesses, such as Quicken/QuickBooks. Information between the two should automatically sync to eliminate or lesson manual and dual entry by the business user to create greater time savings through automation and a lower risk of data entry errors.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

CONCLUSION

Outdated legacy systems coupled with slowly evolving strategies are preventing many banks from effectively meeting small-business needs and keeping up with new market trends. Leaner, more focused technology providers are out-innovating most banks and increasingly stealing market share and diminishing their role. To make matters worse, small businesses are stating that they are satisfied with banks in their more limited roles, as their expectations have declined. Banks must fight back by deploying new next-generation online and mobile banking platforms that offer the necessary flexibility and component-based architectures that enable banks to provide a more customer-driven experience with improved workflows and easier access to information. They must also broaden their product portfolios and be willing to charge customers for new products. Those banks failing to do so risk greater attrition and an inability to remain competitive in today's dynamic and potentially lucrative small-business market.

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.

ABOUT AITE GROUP

Aite Group is an independent research and advisory firm focused on business, technology, and regulatory issues and their impact on the financial services industry. With expertise in banking, payments, securities & investments, and insurance, Aite Group's analysts deliver comprehensive, actionable advice to key market participants in financial services. Headquartered in Boston with a presence in Chicago, New York, San Francisco, London, and Milan, Aite Group works with its clients as a partner, advisor, and catalyst, challenging their basic assumptions and ensuring they remain at the forefront of industry trends.

AUTHOR INFORMATION

Christine Barry
+1.617.398.5040
cbarry@aitegroup.com

CONTACT

For more information on research and consulting services, please contact:

Aite Group Sales
+1.617.338.6050
sales@aitegroup.com

For all press and conference inquiries, please contact:

Aite Group PR
+44.(0)207.092.8137
pr@aitegroup.com

For all other inquiries, please contact:

info@aitegroup.com

© 2016 Aite Group and Bottomline Technologies. All rights reserved. Reproduction of this white paper by any means is strictly prohibited.