A global research report by Misys and TMI

The Needs of SMEs: Working Capital Challenges and Digital Solutions

Findings of a Misys Survey in Association with TMI

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Executive summary

To expose the key trends and drivers behind how small to mid-sized enterprises manage working capital and access financing solutions, Treasury Management International and Misys undertook a survey of financing practices with 100 responses from small and mid-cap corporations with a turnover up to $1bn in the US, EMEA and APAC.

28%

of SMEs are finding access to finance harder

According to McKinsey & Company, companies with annual revenues of up to $1 billion represent a $1.85 trillion annual revenue opportunity for financiers. This represents an attractive market for banks that can digitise and provide cost efficient solutions to manage working capital services and supply chain finance programmes via centralised, multi-bank portals. But where are we today? To what extent are banks directly serving the working capital needs of this market? And what is the role of buyer led supply chain finance programmes in the overall landscape?

Key findings from the survey include:

- While a third of respondents say access to bank financing has become easier, 28% are finding it more difficult. Market conditions remain challenging for smaller corporates. Banks can play a pivotal role in helping to alleviate operational pain. The need for commercial and corporate banks to get closer to their customers has never been higher.

“9% of small-to-medium sized businesses surveyed have a greater reliance on alternative funding than two years ago.”

“Rapid, secure and transparent payments processing garnered a 53% response rate in terms of importance: firms need more speed, but not at the expense of resilience and reliability.”

- While traditional instruments (i.e. credit facilities and overdrafts) remain prevalent, corporates are also exploring creative ways to finance their working capital needs. For example, 24% are financing through a combination of traditional banks and non-bank alternatives. Interestingly, 9% of respondents have a greater reliance on alternative funding than 2 years ago. Growth in this area is likely to continue, as corporates are attracted by lower costs and faster turnaround times of nimbler niche lenders. Banks need to respond accordingly, or risk their margins becoming eroded.
- Cross-border transactions are the lifeblood of many corporates: banks need to make their lives as easy as possible through the automation of trade finance instruments , documentation processing and support for supply chain finance programmes. More focus is required in this area, although the blame does not solely lie at the banks' door. 35% of corporates are hampered by a lack of time and resources to perform the requisite amount of automation or the technology to support key steps such as direct ERP integration.
- The provision of a single view still dominates from an online and mobile perspective, which indicates that despite best efforts (or some efforts) objectives have yet to be fully met.
- In recognition of the importance of avoiding the creation of more silos, 45% of corporates require their online and mobile activities to be integrated with ERP and TMS. This is the only sensible strategy to follow.

"A quarter of respondents indicate there has been no automation of traditional trade to date. 37% say they have achieved this to some extent."

1.0 Introduction

As the Asian Development Bank (ADB) reports, there is an annual global trade financing gap of $1-2 trillion, much of it in Asia and much of it hurting SMEs. The International Chamber of Commerce recently polled 482 banks across 112 countries and revealed that only 53% of trade finance requests from small business were accepted.

The results of this survey of 100 small to mid-cap enterprises highlights that corporates not only face challenges in accessing finance but also in in monitoring the complexities of cash, trade and treasury requirements as they expand and work with an increasing number of suppliers, banks and customers around the globe. One of the biggest obstacles reported by the interviewed companies is the ability to access financing, as it is not being supported effectively by their banks. Similarly the role of large buyers in the supply chain and working capital picture comes into greater focus.

Demographics

The researchers took answers from 100 respondents from small and medium-sized enterprises and mid-cap corporations with a turnover up to $1bn in the US, EMEA and APAC, who were asked to share their views on the challenges of managing their working capital.

The demographics of this survey are interesting in that it attracted a large proportion of mid-cap companies, with the majority of respondents based in Central & Eastern Europe (CEE) – 38% or Western Europe – 28%. Furthermore, smaller companies in particular (<$100m) have their largest cross-border supplier and customer bases in these regions.

The importance of other regions for cross-border trade, even for smaller companies, should not be underestimated, particularly Asia Pacific, North America, MENA and Africa. Over one quarter (26%) conducted most of their business operations domestically, which is significant when looking at trade finance data.

The increasingly global nature of export/ import operations, and therefore the complexity of cash, trade and treasury requirements for companies of all sizes is a significant challenge, as many of these companies lack access to the sophisticated technology that is more traditionally associated with larger companies, constrained by budget and resourcing issues.

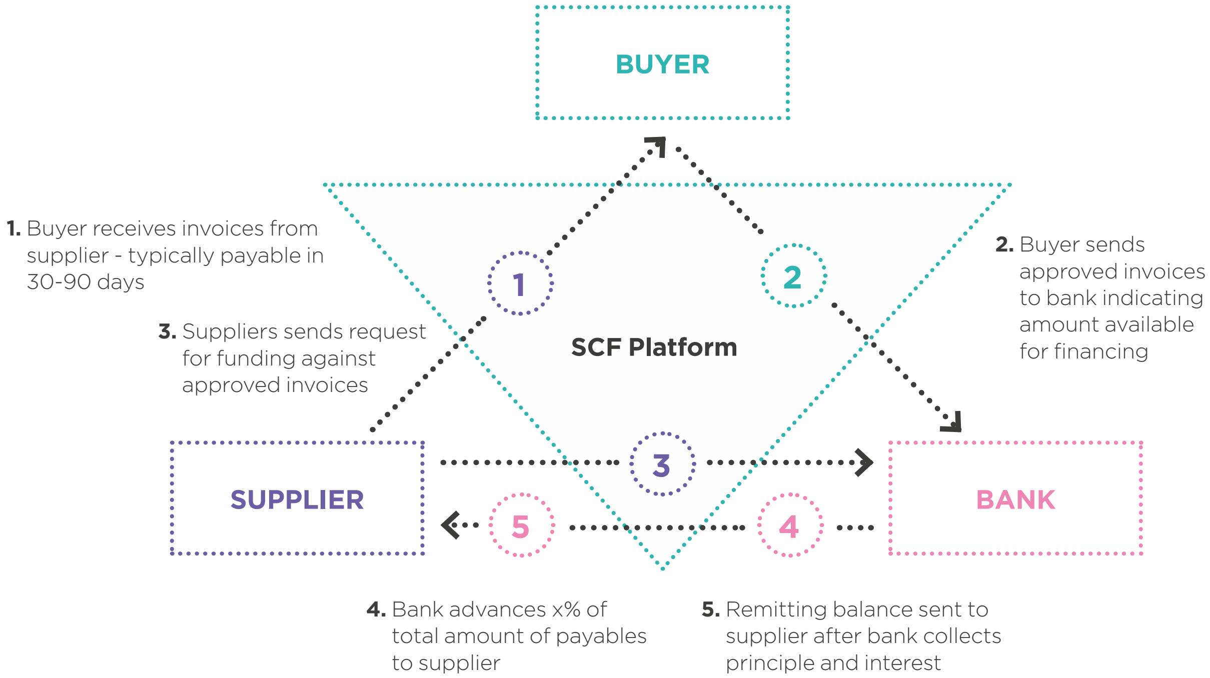
The interplay between suppliers, buyers and financial institutions

The flip side of the survey findings that warrants a separate study is the need for large corporates to protect their own supply chains and make the implementation of programs as easy and painless as possible. Better support can decrease the need of large fixed assets such as plants, warehouses and transportation vehicles in the supply chain. Ally this to a supply chain finance program and the large corporate has security that their suppliers are managing cashflows and the ability to build better relationships. Large corporates today are utilising SCF programstructures to add the self-funding of suppliers into the mix with funding from external sources.

The preconception for SCF initiatives has been that buyers are driven by the need to extend their payment terms. In truth, the driver is more likely to be the need to balance their own working capital and negotiate with suppliers to maintain stable supply. Risk management is key.

Large multi-nationals have suffered the cost of increasing bank regulation too, but shoudn't they now also look to embrace technology to help their suppliers and in turn help themselves?

Figure 1: Approved Payables Finance. Supports big corporate 'buyers' to finance their supplier network



2.0 Working capital challenges

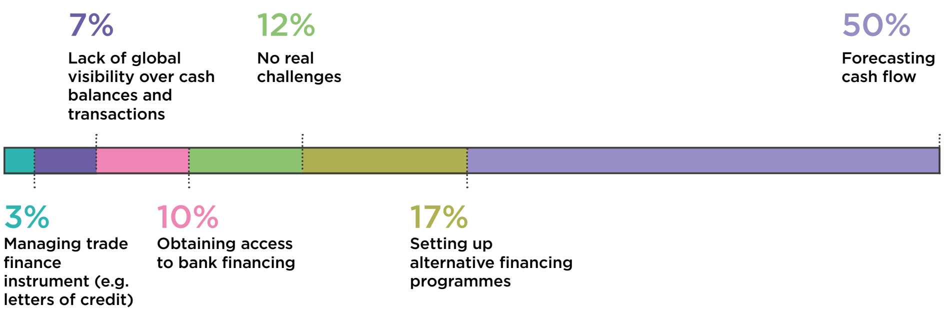
> "Once the root causes of excess working capital are addressed, cash flows more freely—no squeezing required—and can be put to far better use. For instance, one company cut working capital by 30 percent and used the cash to fund a major acquisition in Asia without having to take on debt and the associated interest costs."

The Boston Consulting Group
Cash for Growth, The Neglected Power of Working-Capital Management

Forecasting cash flow is the primary challenge for the majority of respondents (50%) with difficulties setting up alternative financing programmes also an issue, identified by 17%.

Forecasting cash flow with a high degree of accuracy is particularly challenging without access to consistent, timely information from across the business. Fragmented systems and a lack of appreciation amongst local business units of the importance of cash flow forecasting often pose significant obstacles.

Figure 2: What would you identify as your biggest working capital challenge today?



> "An effective approach is to fundamentally rethink and streamline key processes across the value chain. This can lead to greater reductions in working capital— as much as 30 to 40 percent—and to cost savings of 5 to 10 percent."

The Boston Consulting Group
Cash for Growth, The Neglected Power of Working-Capital Management

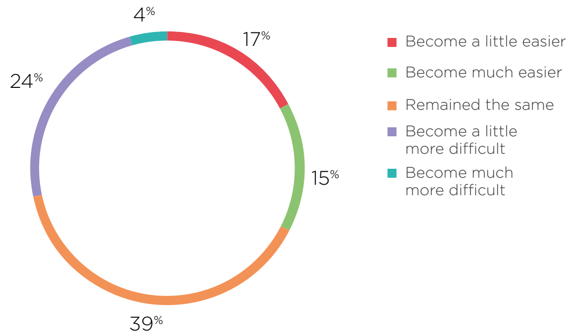
3.0 Access to finance

“18% revenue at risk from alternative financiers and marketplaces.”

Accenture

Most companies (39%) reported little difference in their access to financing in recent years; however, 28% noted that it had become more difficult, while 33% were finding it easier. Collectively, this data reflects the significant volatility and differences in experience across companies depending on their credit quality. It also emphasises that funding conditions can change, so managing liquidity risk should be a priority.

Figure 3: How has your access to financing changed over the past two years



While 20% of companies are able to fund their working capital requirements through surplus cash, 43% use bank financing either through overdrafts and/ or credit facilities. Interestingly, 24% use a combination of bank financing and alternative financing, a trend we expect to continue as companies of all sizes seek to diversify their funding sources and manage their liquidity risk more effectively. Although relatively small, 9% of companies indicated that they had increased their reliance on alternative financing over the past two years, compared with roughly equal numbers that were relying more or less on bank financing (19% and 15% respectively).

Figure 4: How do you currently finance your working capital needs?

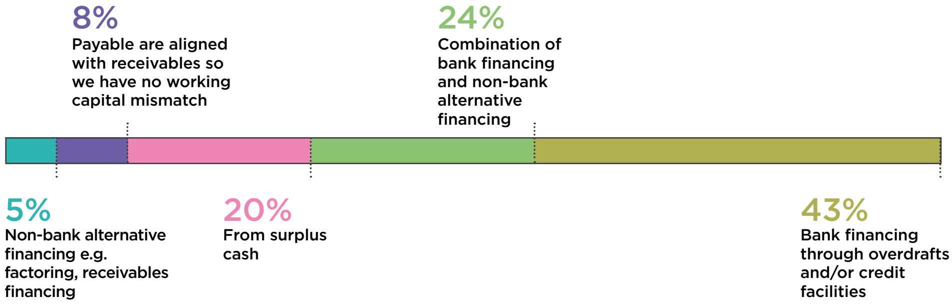
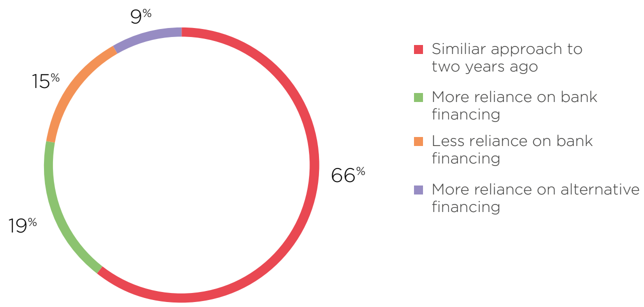


Figure 5: To what extent does this differ compared with two years ago?



Many smaller companies found that their access to bank financing dried up in the immediate aftermath of the financial crisis (18%) but there are signs that with market liquidity improving, bank financing is returning. In other cases, those that have become less reliant are typically those that can either not gain ready access to bank financing or wish to diversify their funding sources.

The importance of SMEs and strategic suppliers: needs related to cashflow and financing

SMEs are attracted by the growth of non-bank lenders, funded by low interest rates and are turning to them for additional sources of finance. Examples are the fintechs and others such as C2FO, government sponsored solutions, or marketplaces like Prime Revenue.

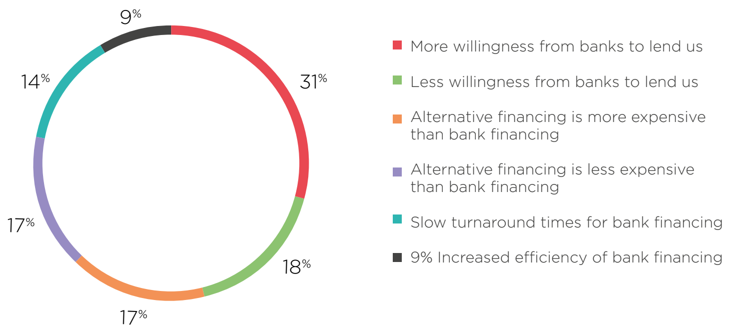
SMEs continue to struggle to establish a good direct relationship with banks as the annual ICC trade survey suggests. 38% should expect finance rejections. But, these businesses do still need good financial advice from financial institutions.

The growth of collaboration between banks and non-banks is highlighted in the press every day. Banks may offer credit facilities for working capital, but in partnership with non-banks which will offer relatively longer term finance for 30 to 90 days. The growth of crowd funding is also proving to be really attractive and opening up access to funds that were not available before.

Here, it is important to separate medium and small enterprises. Business lending by banks is on the rise, but this is primarily still focused on mid-cap enterprises and this space is becoming increasingly competitive.

There is still less risk appetite to finance the 'long tail of suppliers' - typically suppliers to the strategic suppliers of large corporates. This is an area of focus for the large corporates, either directly or indirectly.

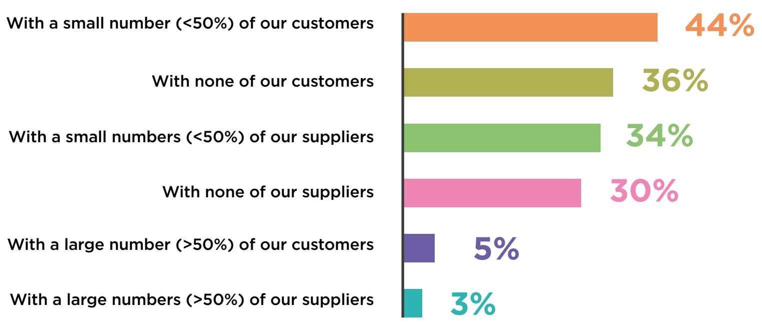
Figure 6: If you are using more or less bank financing than two years ago, why is this?



4.0 Trade financing

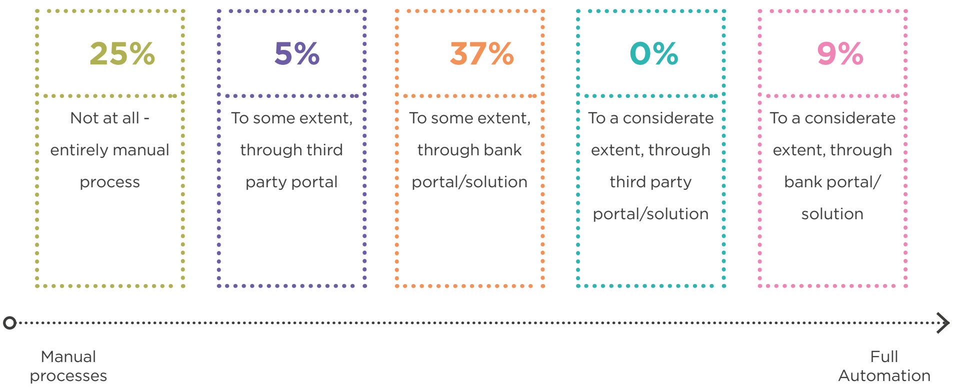
Trade finance instruments are used to finance trade with a minority of customers and suppliers, while around a third of respondents conduct all trade through open account. Many companies would not use trade finance tools to finance trade in their own region, e.g. most commonly CEE and western Europe in the case of this survey, preferring open account, but these tools offer considerable value in the case of customers and suppliers in regions where credit rating tools are less well-developed and customers/ suppliers are less familiar. These include Asia Pacific and Africa, for example, where a material number of respondents noted that they do business. Given the rate of growth in these regions compared with longer-established economies in Western Europe and North America, use of trade finance tools, and the innovative BPO offer considerable risk and liquidity opportunities.

Figure 7: To what extent do you use trade finance instruments e.g. letters of credit?



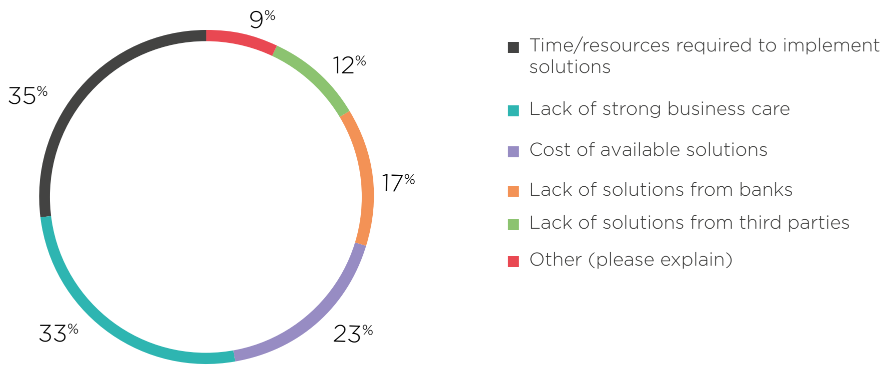
Amongst those using trade finance tools, lack of automation is a considerable challenge, with 25% managing these processes manually, while 37% had partial automation. Note that when the companies that do not use trade finance are omitted, these figures jump to 38% and 49% respectively, illustrating the potential scale of the challenge. Given that most companies have limited resources to support trade financing the lack of automation is likely to be a deterrent to using tools that could be valuable in managing risk and liquidity more effectively.

Figure 8: To what extent have you been able to automate trade finance instrument and documentation processing?



Cost (23%), resources (23%) and cost-benefit (33%) are the biggest challenges to implementing automation tools, while a smaller number were unaware of the availability of solutions.

Figure 9: If you have not largely or fully automated trade finance and supply chain instrument processing, what are the reasons?



Despite these challenges, a large proportion of participants (28%) that are active in trade finance noted that they anticipating automating trade finance processes in the future through the use of MT798 messaging – although this is a medium term, rather than short term plan. Omitting the third of respondents that do not use trade finance, this represents a roughly equal proportion to those that are not planning to use MT798.

Ten percent of respondents already use BPO (bank payment obligation) for trade financing, with a further 24% planning to do so in the medium term. Once again, this is roughly equivalent to the number that are not planning to do so once those for whom trade finance is not relevant are omitted.

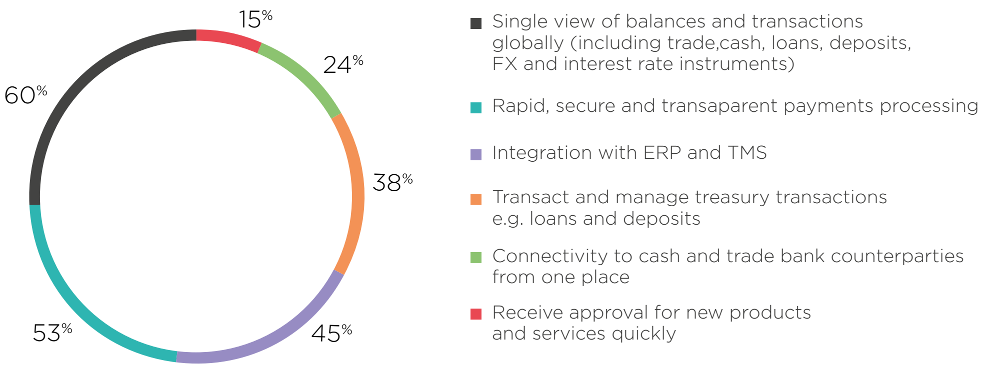
While these figures reflect that there is some appetite for greater automation and efficiency in financing trade, there is also an issue of i) education amongst smaller companies in particular; ii) pricing and implementation models that are commensurate with smaller companies' appetite.

5.0 Electronic banking demands

Companies have a range of priorities in their electronic banking solutions, whether these are accessed through online tools or via mobile apps. Visibility of information and transactions across all instrument types, currencies and accounts is most critical (60%) but this is closely followed by secure, efficient payment processing (53%) integration (45%) and treasury transaction execution (38%).

The latter is interesting in that there is clearly a preference amongst some organisations for single-bank transaction capabilities over multi-bank dealing portals which offer price discovery and support competitive quotes, as well as transaction execution and integration with back end systems. Conversely, 24% are seeking multi-bank connectivity with cash and trade counterparties through a single channel.

Figure 10: What are the most important attributes that you need from your bank's mobile and online banking solutions?



Conclusion

In order to compete with alternative funding and to meet the expectations of corporates, banks must step up to digitise and provide automation and multi-bank connectivity. Banks must elevate digital strategy beyond line of business silos and take an integrated approach to meet the working capital needs of their corporate customers. The alternative is the continued dilution of market share, particularly in vanilla lending and invoice-based financing, as non-bank alternatives seize the market opportunity.

"80% of European banks consider that SMEs will become a potential growth segment over the next few years."

Efma

Mid-sized corporations have been less of a focus for banks from a digital services and process automation point of view but they value working capital efficiency the most. A lack of joined-up multi-bank and multi-channel services impedes these increasingly globalised corporates accessing the information and supply chain connectivity they need to efficiently manage cross-border trade, cash, FX and lending.

From a supply chain finance point of view, increased straight-through processing for banks equals less risk. Using POs as the initiators of funding and using the corporate online platform to turn this into an invoice from the supplier the use of PO data can decrease risk. In some cases, it may also mean no KYC on the supplier is required.

The survey highlights that if banks act quickly with more connected corporate banking they can seize the opportunity and compete in a world where non-bank alternatives are here to stay.

About Misys

Misys

Misys is at the forefront of the financial software industry, providing the broadest portfolio of banking, capital markets, investment management and risk solutions available on the market. With more than 2,000 customers in 130 countries our team of domain experts, combined with our partner eco-system, have an unparalleled ability to address industry requirements at both a global and local level.

FusionBanking Corporate Channels delivers a single digital platform that connects trade, supply chain finance, cash, lending and treasury services for corporate clients. With the most complete suite of best-in-class, pre-integrated applications and flexible delivery options, FusionBanking Corporate is a proven solution for corporate banking growth.

No matter your strategy for corporate banking transformation Misys provides a modular path to achieve your target operating model and evolve client needs and regulatory demands. Banks have reduced total operating costs by 50%, doubled the win rate of corporate business and reduced capital costs by 8-15%.

About TMI

TMI

Treasury Management International showcases topical, pragmatic solutions and strategic insights on treasury, cash management, foreign exchange and other issues affecting treasury and financial professionals, together with treasury and finance news, education and opinion. With real-life treasury management experiences and case studies at its core, TMI provides valuable material for all practitioners - from experienced treasurers and CFOs to those new to the profession.

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