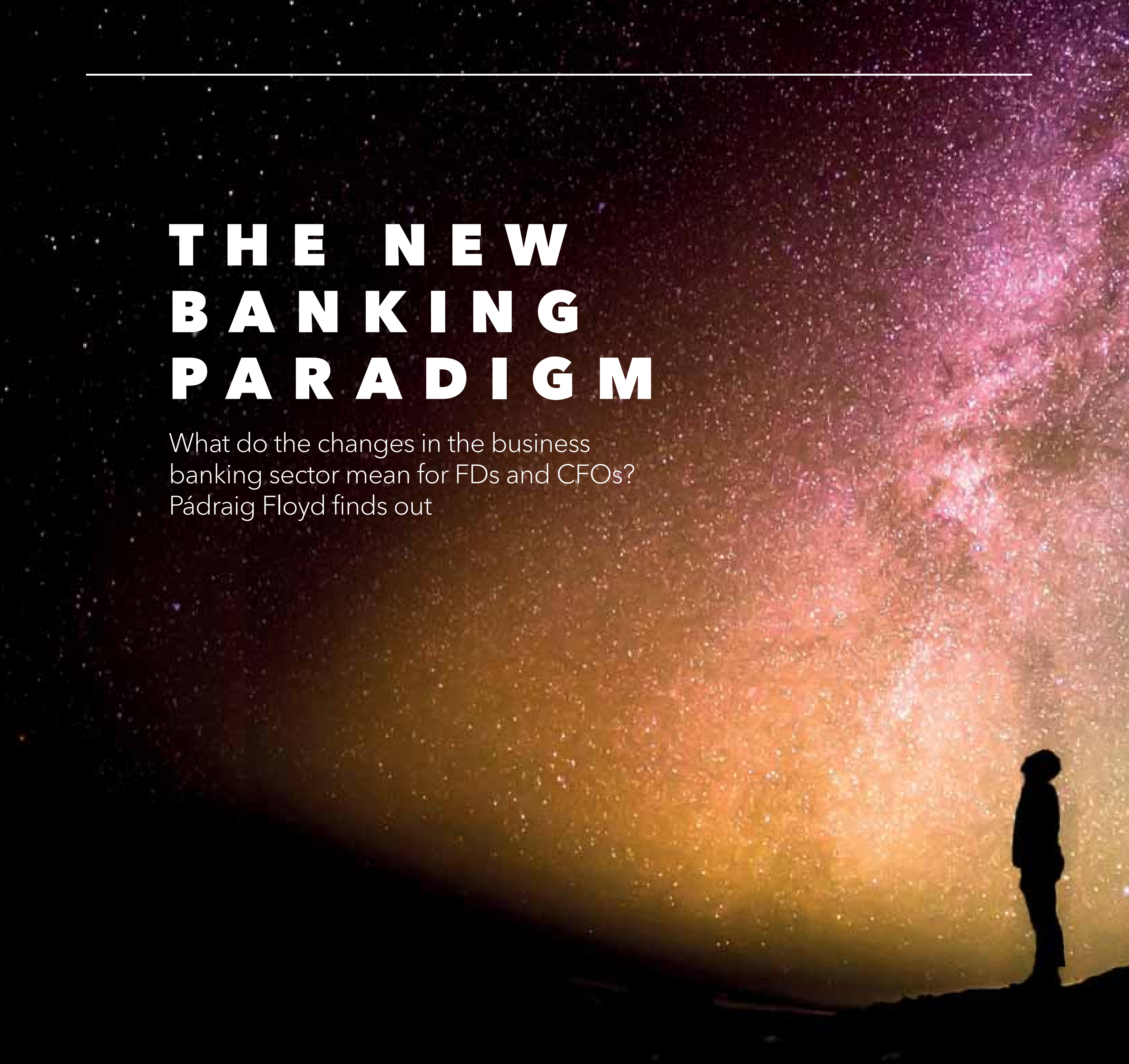

THE NEW BANKING PARADIGM

What do the changes in the business banking sector mean for FDs and CFOs? Pádraig Floyd finds out

Since the financial crisis a decade ago banks have been slowly rebuilding their reputations. Alongside that there has also been a massive project to update the sector's creaking IT infrastructure, following years of neglect that resulted in the RBS computer failure in 2012 and contributed to the meltdown at TSB in April of this year.

After banks adopt new technologies, they have reassessed how they wish to interact with customers. On the personal banking side most punters have chosen to go online with mobile-based apps. In 2017 alone 38 million adults chose to use online banking, according to *The Way We Bank Now 2018*, a report compiled annually by UK Finance, the banking industry trade body.

In response to this, banks are closing hundreds of local branches as their business goes digital, with momentum provided by regulatory reform in the shape of open banking and the European Payments Services Directive 2 (PSD2), which will force greater digital interaction and control to the customer. But what do these changes mean for chief financial officers, finance directors and their businesses?

Digitising the banking world is no different from the projects many businesses have undertaken themselves in recent years. Adoption of cloud computing, application programming interface (APIs), mobile technology and security using biometrics and voice are transforming the way we bank. This clearly has an impact upon the business community.

"The increase in choice and the better information to support comparison and ease of accessing alternatives is good news for CFOs and FDs looking to get the best service and value for their companies," says Stephen Pegge, managing director of commercial finance at UK Finance. "Enhancements are not limited to the new entrants, but are also being developed by traditional players, sometimes in collaboration with fintechs."

Open banking is largely being aimed at the small business end of the market, says Pegge, but larger companies may also benefit in the long run. As technology replaces some of the back-office drudge work, they will be free to spend more time delivering value to customers.

Mark Mullen, chief executive at mobile-based challenger Atom Bank, who sits on the open banking steering committee, says the biggest factor is the need for change.

Even challengers only have a modest impact on large traditional banks. After all, 95% of all business banking is held among the five big UK banks.

Open banking is an agenda being driven by the regulator, not the customer. Until such time as there is something interesting to show customers to prove exactly how it may change the way they do business, it is unlikely to make a significant impression.

However, Mullen agrees that the environment has changed to such an extent that the old strategies banks used to deploy are no longer relevant. He says this lack of certainty about the future "presents a clear and present danger to their business".

CHALLENGERS ARE SHOWING THE WAY

"Business customers generally want support with working capital," says Mullen. "There are now many options, but there is a stress on working capital – that it should be available fast, fairly priced and transparently. That's why there is so much opportunity for new competitors in securing business customers."

Where the challengers are making inroads on the stranglehold of the big banks is around debt and transactional banking, says Paul Riseborough, chief commercial officer at Metro Bank.

It is harder to access – or at least more expensive to provide – face-to-face advice, and this is driving the move towards digital business. That may be all well and good, but closing branches and pulling out of communities comes with a cost.

"It is changing, but not always for the better," says Riseborough. "When branches close, lending drops materially in local areas. Banks need a more joined-up framework."

This lack of a relationship with customers precedes the advent of fintech and has been a long time coming, says Russell Snowdon, managing director of independent banking consultants IBC. "Since the advent of Barclaycard, banks have invested in products and tools that make the customer more self-sufficient, pushing the customer away from them," he explains.

His firm helps businesses access debt finance and he says that CFOs should disabuse themselves of any notion that they have a personal relationship with their bank. Gone are the days when a bank manager was heavily involved in the finances of the businesses they serviced, and businesses should be wary of that. Just because you have a long-standing arrangement with a bank, don't confuse that with a relationship or it could cost your business a lot of money.

"Nature abhors a vacuum," says Snowdon, "and after the credit crunch, banks withdrew to a large extent from the lending markets. A void was created and was filled by alternative finance lenders."

Although these alternative lenders and IBC, which has a database of more than 350, comprise a relatively small part of the market, it is growing. In some areas, such as residential property development, it may be the only source of funding for many borrowers.

Snowdon gives the example of a London company that was in special measures with one bank where, by switching its borrowing to another, the business saved more than £1m over 10 years on a borrowing of £9m.

"The challenge, though, is not just whether you can get access to finance that is cheaper, but is on terms that are more beneficial to the business," he says.

But cost is not the only benefit, as you may find a lender that is prepared to accept less security or less restrictive covenants and terms and conditions. Many lenders offer 'unsecured' commercial loans, but in fact demand personal guarantees from directors to back them. In some cases it may be preferable to pay a little more and have more palatable terms.

However, CFOs shouldn't assume they must move banks to get better terms. IBC worked with a care home operator a couple of years ago who wanted to borrow £2m, but did not like the terms offered. It was taken to market by IBC and the net saving was £250,000 – with the current lender. Snowdon observes that such situations are very common.

Digital banking may be removing the personal relationships in business banking, but businesses are receiving far better connectivity between their bank accounts and other systems.

MAKING TAX DIGITAL

Open banking may not be playing a role just yet, but there is another piece of game-changing reform that is driving this – the introduction of making tax digital (MTD), which is "the biggest corporate tax shakeup in a generation", according to Nadya Hijazi, global head

DIGITAL BANKING MAY BE REMOVING THE PERSONAL RELATIONSHIPS IN BUSINESS BANKING, BUT BUSINESSES ARE RECEIVING BETTER CONNECTIVITY BETWEEN THEIR BANK ACCOUNTS AND OTHER SYSTEMS

of digital, global liquidity and cash management and business banking at HSBC.

MTD requires business to make tax payments more regularly throughout the year. For this to happen, banks must provide both their business customers and the tax authorities with accurate, compatible and standardised data.

That's all very well, says Hijazi, but that will prove difficult when only 15% of businesses use accounting software packages, while only 20% even use accountants. "Many large companies manage cash flow forecasting on spreadsheets," she says. "This is a major change from the banking perspective. A direct account API feeds through to the system every day, automatically updating their systems. It's much easier to deal with third parties and there will be a greater range of products."

Hijazi says greater digital connectivity is as much of an opportunity for traditional banks as it is for challengers or other third-party providers. It will turn banking into a one-stop integration process, offering providers the opportunity to differentiate themselves through their offering in the way they used to through personal service.

Allowing access to third parties under open banking will mean banks can no longer control that aspect of a customer's banking, but it also allows banks to restructure their whole offering and focus on optimising customer experience.

By partnering with best-in-class fintech applications, traditional banks can offer a comprehensive and seamless process for their CFO clients. Hijazi believes banks may choose to focus on core competencies and, where there are clear market leaders, associate those APIs on their system, rather like many accounting systems do today with credit control or invoice factoring.

She compares that process to going to a specialist instead of a GP, because they have spent a very long time working out how to complete a particular process really well.

A SEAMLESS EXPERIENCE

A banking process that links seamlessly with corporate systems will give CFOs far greater control over their finances and, says Pegge, better value from working capital. This is because real-time automated management of surpluses and borrowing requirements, combined with an increasing use of invoice finance and asset-based lending, can help businesses unlock the cash from their working capital cycle and manage receivables – and other short-term assets – more effectively.

"Some great benchmarking tools are offered by banks and finance providers to ensure you are operating at best-in-class standards," says Pegge. "The cons may be that there is less time to spot and recover losses from financial crime. Bank technology and control systems are getting better, but the company and its whole financial team are a key part of the fight against fraud."

"FDs and CFOs will also need to develop new skills and understanding," notes Riseborough. Standardisation reduces costs and can improve security. Business needs to focus not only on cyber risk and protection of data, but where data is located and how secure it is.

TECHNOLOGICAL RISKS

"As we move more into technology and the digital world, you need to be confident you have the right controls, even that your teams can't be easily socially engineered within the bank," says Hijazi. "We see this every day and can advise clients."

Technology presents new risks and CFOs need to balance flexibility with security. As artificial intelligence and machine learning become more commonplace, transactions will become more highly automated. That's a boon for efficiency, transparency and potentially, pricing, but you shouldn't become too dependent on it.

"You still need to know what the machine is doing, because technology is not perfect," says Hijazi. "Leverage it, aggregate accounts, but always know what is going on. There is absolutely no substitute for due diligence or sense checking the numbers."

THE RISE OF THE CHALLENGER BANK

Challenger banks – and non-bank financial institutions – are trying to steal customers from many traditional providers. They are doing this through innovative product offerings and a different approach to service, but it is always underpinned by new financial technology – fintech.

The £425m settlement reached by the UK government with the EU for the state support of RBS during the financial crisis has been placed into a fund. It will be used to develop businesses that will increase competition in the UK banking sector. Here are a few examples of challengers that are making a name for themselves:

£425m

UK government's settlement for the state support of RBS during the crisis

INTERNATIONAL PAYMENT REVOLUTION

Revolut launched as a money transfer service in July 2017 and has added loans and insurance to its portfolio since then. It was fully functional by December of the same year with 50,000 companies on the system, making use of a groundbreaking model for making international payments.

For a single monthly membership fee – priced according to size – members can make instant money transfers across most of Europe that are free of fees and offering intra bank rates.

Membership fees can be quickly recouped for those regularly sending money abroad and within three months, the platform will have gone global with the launch into Australia, New Zealand, Hong Kong, Canada and the US.

Within six months, Revolut intends to launch competitive business finance, says Chad West, head of global brand and communications at Revolut.

"Our members want to be in control," says West. "Knowing where every transaction was spent helps them to budget, whether they are companies, students or travellers. By ending the fees, we've ended the exploitation."

SMALL, BUT PERFECTLY FORMED

When Atom Bank launched as an app-powered bank exclusively for tablets and phones in 2016, it was something of a novelty. It launched a series of fixed saver accounts and mortgage offers that have proved extremely popular. Being online only, it rejected a presence in one of the main cities of the UK in favour of taking an office in Durham.

Institutional investors like the cut of its jib, with asset managers and Spanish lender BBVA continuing to invest for continued growth.

NEW BANK, OLD ATTITUDES

METRO BANK

Metro launched in the UK in 2010, but has become established very quickly. Rather than withdrawing from the high street, Metro Bank has been opening branches across the south of England.

"New players need to demonstrate trust, reputation and brand," says Paul Riseborough, chief commercial officer at Metro Bank. "We think the way to do that is by having a physical presence."

The bank scooped most trusted financial provider category in the Moneywise awards in 2016 and 2017. ●