How to turn challenges into analytics-led innovations?

Future of SME financing

October 2022

Strategy realized

The better the question. The better the answer.
The better the world works.

TransUnion

EY Parthenon
Building a better working world

Contents

Foreword by TransUnion

As the first consumer credit reference agency in Hong Kong, TransUnion has been serving Hong Kong businesses and consumers since our establishment in 1981. We've been working closely with more than 160 financial institutions to design and deploy insights-driven solutions for better risk and customer relationship management. In addition, we've empowered millions of Hong Kong consumers to better understand their credit profiles and achieve their financial goals — while preserving their privacy.

Today, there are over 340,000 small- and medium-sized enterprises (SMEs) in Hong Kong, contributing to more than 98% of business establishments. The SME segment remains the cornerstone of the Hong Kong economy — given over 45% of the private sector workforce is employed by SMEs. Despite its significance, we observed there are still unmet financing demands within the SME segment, providing sizeable opportunities for financial institutions to capitalize on.

The COVID-19 pandemic widely disrupted SMEs' day-to-day business operations, accelerating their needs for greater access to financing. It also highlighted the need for financial institutions to enhance their capabilities in predicting customers' creditworthiness, and thus, minimizing financial exclusion by extending financing to the largely untapped, underserved SME segment.

To ensure we're meeting the needs of all parties, we've partnered with EY-Parthenon — the leading advisory firm on financial services — to publish this report. It shares timely, relevant insights on the current SME financing market in Hong Kong, including the needs of SMEs and how financial institutions can reimagine their SME financing journeys to fulfill them. This partnership — and more broadly, our insights-driven solutions which enable businesses and consumers to transact with confidence — is consistent with our purpose of using Information for Good®.

We trust you'll find the information valuable in helping you better understand the potential of and current gaps within the SME financing space — opening new avenues for you to provide innovative financial solutions to this important yet largely underserved segment.

Marie Claire Lim Moore
TransUnion
Regional President, Asia Pacific and Hong Kong CEO

Executive summary

The small and medium-sized enterprises (SMEs) segment is a fundamental part of the Hong Kong economy. With the economy beginning to move past the pandemic, we expect this segment to remain a key contributor to Hong Kong's economic recovery and continuous expansion — meaning the need to support and finance these enterprises has never been more vital.

The pandemic brought about a myriad of changes across different industries, with many companies pivoting their business models in a bid to adapt to the changes brought forward in the new normal. A recent EY survey indicated over 50% of the SMEs in Hong Kong were looking to change or modify their business models, with many seeking to increase their presence in e-commerce and offer subscription-based models. These changes will bring about a strong growth in demand for SME financing — a significant opportunity for financial institutions to tap into.

As SMEs also begin to embrace digital transformation in every aspect of their business and operating model, their expectations toward financial institutions in providing a digital, streamlined experience during the credit journey have also intrinsically increased. With this in mind, we ask the questions: Are financial institutions well-positioned to address the issues faced by SMEs, and how can they improve their service offerings to capitalize on this ever-growing market?

In this report, we investigate the SME financing journey from the perspectives of both the demand and supply sides. On one hand, we explore specific challenges faced by SMEs in recent years, and the roadblocks encountered when seeking external financing from banks and money lenders alike. On the other, we look at issues facing financial institutions when managing their onboarding, screening, credit decisioning and monitoring processes to identify gaps — and potential tools and digital enablement options for improvement.

We're pleased to collaborate with the experts at TransUnion in this report, and believe you'll find it insightful and helpful in further understanding the latest trends and developments in the SME financing market, such that you'll be able to reimagine your SME credit journey and better serve the needs of SMEs in Hong Kong.

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Introduction to the SME market landscape in Hong Kong

Introduction

Small and medium-sized enterprises are the foundation of Hong Kong's economy. With more than 340,000 SMEs in Hong Kong, this segment contributes to 98% of the business establishments and employs 45% of the workforce in the private sector. There is no doubt that SMEs are a critical driving force in Hong Kong's business development and economic expansion.

Nevertheless, SMEs are also the hardest hit when crises emerge, including the ongoing pandemic, leading to significant challenges in daily operations. A recent EY survey revealed that nearly 75% of small businesses have been negatively impacted by the pandemic, with revenue, profitability and sales taking the biggest hit. To tackle these challenges and remain resilient, SMEs need greater access to finance and external support in order to recover from the disruptions and achieve sustainable growth going forward.

The Hong Kong SAR government has launched an array of measures to support SMEs to weather the challenges faced. Various funding schemes have been established for SMEs, such as guarantees for bank loans and funding for SME development projects. Financial organizations in the private sector, including banks and money lenders, are also reevaluating their proposition to become business partners with SMEs and capture the potential business value from this segment.

However, SME financing is still a process filled with common roadblocks. On the demand side, SMEs often lack sufficient credit history or readily available financial reports. On the supply side, banks and money lenders may not be equipped with analytics solutions that can enable efficient and accurate credit decisioning. New forms of banking services powered by advanced analytics and digitalization are still lacking in order to fill the financing gaps for SMEs who are currently underserved.

This report aims to provide an in-depth review of the current SME financing market in Hong Kong. We have highlighted the financing needs from SMEs, and how banks and money lenders could potentially adapt to fulfill such needs. Bucking traditional banking offerings and adopting innovative solutions to respond to SMEs' fundamental needs will be critical for banks and money lenders to unlock the business opportunities. This will not only help financial institutions revolutionize their current relationship with SME customers, but also promote greater financial inclusion for the SME segment that underpins the Hong Kong economy.

Source: Trade and Industry Department

Scope of study

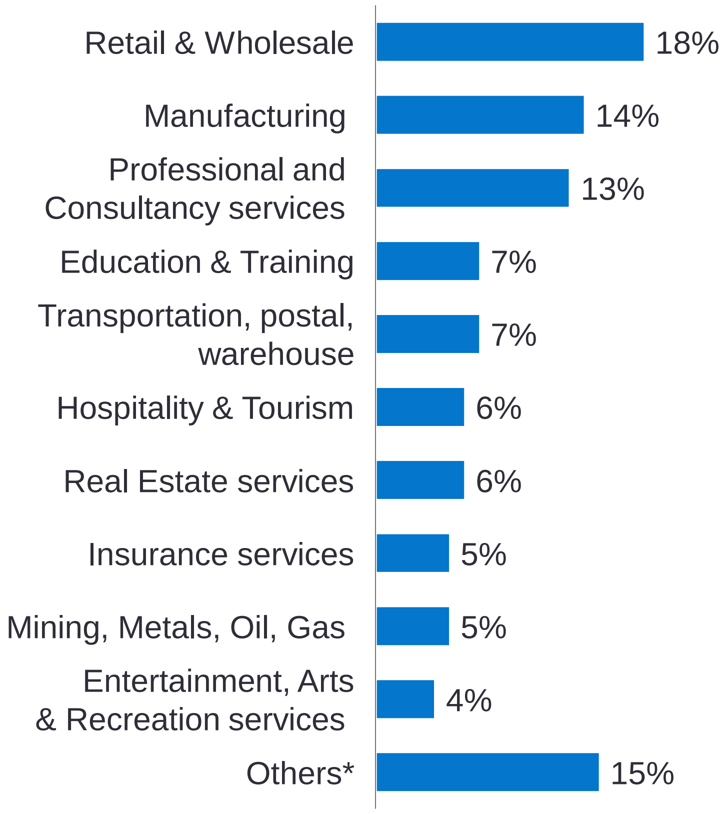
This report has been prepared jointly by EY Parthenon and TransUnion. It examines the SME financing landscape to identify the current market gaps and define the blueprint of SME solutions banks and money lenders should leverage.

The report presents findings based on proprietary research, interviews with market participants and industry leaders, as well as surveys distributed to SMEs and SME lenders in Hong Kong. Robust qualitative and quantitative data were gathered and analyzed throughout the study.

Two surveys (covering 100 SMEs and 200 banks and money lenders) were conducted as part of the market research to gather insights from their perspectives on current challenges and how SME digital solutions can help financial institutions better serve SME customers' financing needs. Additional interviews with subject matter experts were used to validate findings and gain further insight into the specific challenges faced by banks / money lenders along with their current adoption of digital solutions.

Industry

Most of the SMEs surveyed are operating in the Retail & Wholesale, Manufacturing, and Professional and Consultancy services sectors.

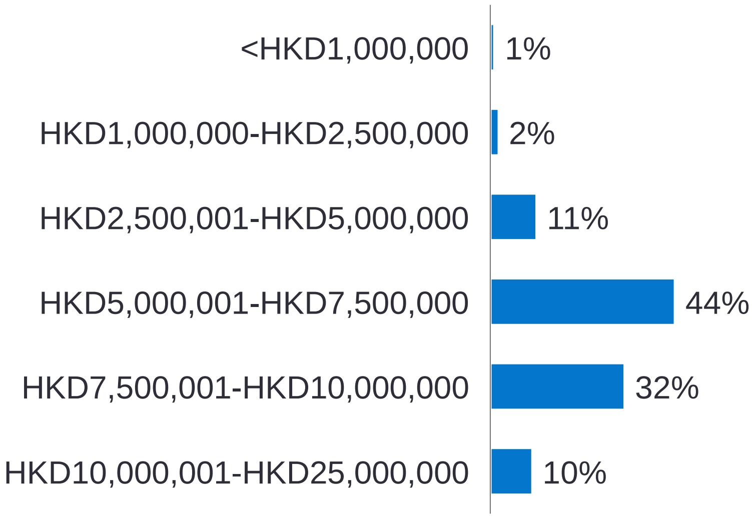


Base: (n= 100)
Q. What sector does your business operate in?
* Others include health care & social assistance, media and telecommunication, power, utilities, water & waste services, agriculture, forestry, fishing, life science, banking, capital markets, private equity and technology

SME survey

Business size

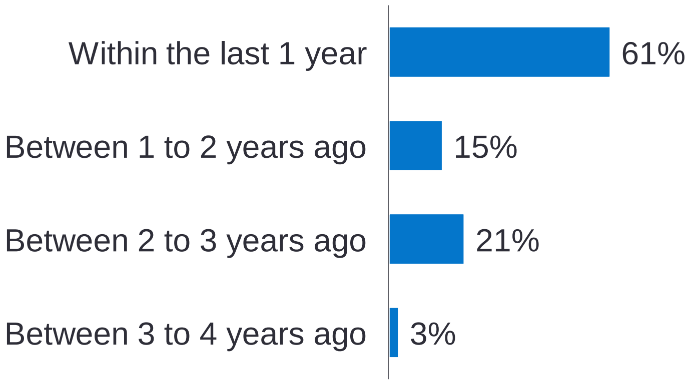
The majority of SMEs surveyed generated business revenue of HKD5m–HKD10m in the last financial year.



Base: (n= 100)
Q. What is the business' total revenue in the last financial year (HKD equivalent)?

External financing

Over 60% of the SMEs surveyed indicated that they have required external financing within the last 12 months.

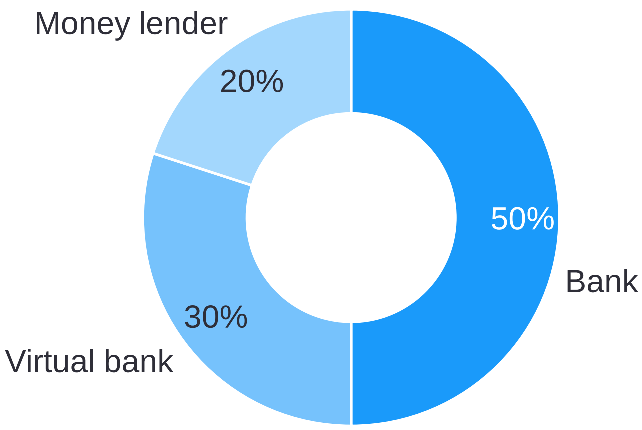


Base: (n= 100)
Q. When did the company last require external financing?

SME financing survey

Types of financial institutions

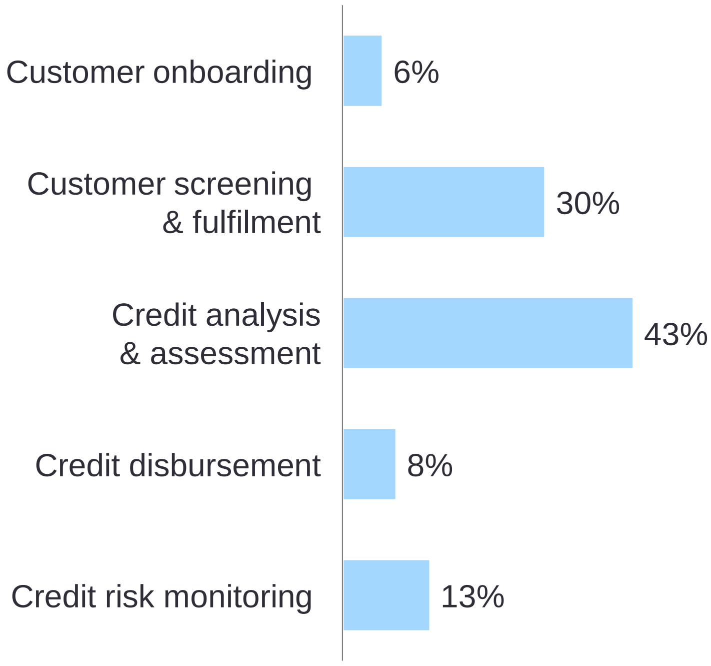
Bank is the major source of financing for SMEs in Hong Kong, while virtual bank is increasingly becoming an alternative financial institution that SMEs begin to rely on.



Base: (n= 200)
Q. Which of the following financial services sectors do you currently work in?

Roles in serving SME customers

Most of the financing professionals surveyed are responsible for credit analysis & assessment along the SME credit lifecycle.



Base: (n= 200)
Q. What is your role in your company to serve SME customers?

In the sections followed, we will analyze the research results on SME financing in details, which have been structured to answer the following questions:

- **Voice of SME customers: What are the credit needs and how has the overall experience been to access financing?** Working capital remains to be the main reason for SMEs to seek finance to cover daily expenses and operations, especially in response to disruptions from the pandemic and social distancing restrictions. However, SMEs continue to face various difficulties in obtaining loans at each stage of the financing journey. Speed of credit decision making and lack of a streamlined digital experience were identified as key drivers of dissatisfaction.

- **Are the financial institutions well-positioned to address the financing issues faced by the SMEs?** From the perspective of SME lenders, the lack of available and reliable data for SME customers, and operating inefficiency due to legacy IT systems are identified as major bottlenecks for banks and money lenders to upgrade their services and fulfil the SME financing needs. We observe that there are still gaps in the adoption rate across different organizations and SME lenders often find it difficult to source solution vendors who truly understand the market needs.

- **The future of SME financing: What is the blueprint of future SME financing and what innovations are needed to achieve that?** To fully unlock the enormous opportunities from the SME segment, banks and money lenders need to accelerate the digital transformation. It is imperative for SME lenders in the market to establish a data and analytics driven, end-to-end process to provide better financial support for SME customers.

Voice of customers – SME market overview

SMEs as the bedrock of the economy and provide immense potential

COVID-19 impacts on SME business

The pandemic has widely impacted people's lives around the world with various social distancing, travel restriction and quarantine measures in place that led to significant economic impacts on businesses and SMEs alike. In the supply side, SMEs experienced significant disruptions in supply chains, resulting in shortage of inputs and cessation of production. In the demand side, customers' loss of income and economic uncertainty have destructed consumption confidence, and SMEs' topline were heavily affected as a result.

In light of business contraction, we are seeing an increasing number of SMEs revamping their business models with the aim of lowering operational costs, increasing efficiency and improving customer experience. From a prior EY SME survey, over 50% of the SMEs[1] surveyed indicated that they are exploring a digital shift of their current business model such as marketplace and e-commerce.

SMEs are highly sensitive to economic and market volatility

SMEs have been going through a sustained period of business challenge in areas such as finance, growth and technology, with satisfying finance needs being a key issue to be overcome.

Based on the SME survey result, SMEs indicated that rising operational costs (e.g., rental, payroll, utility) and lower consumer spending are the top two business challenges. The outbreak of COVID-19 has further exacerbated SME difficulties in overcoming such challenges given their exposure and sensitivity to macro-economic impact.

Top business challenges

High and rising costs	14%
Reduced consumption demand	13%
Increased market competition	8%

Setting up SMEs for restart and recovery

The Hong Kong government has offered various funding schemes catered to SMEs of different industries and sizes including the SME Financing Guarantee Scheme, rental concessions and fee waivers to relieve their financial burden and accelerate post-pandemic business recovery.

In conjunction with the implementation of Consumption Voucher Scheme, a robust recovery in consumer spending and demand are likely to be seen in Hong Kong during the short to medium term. The sign of emerging SME business recovery has also been reflected by the current diffusion indices of SMEs on business receipts increasing from 30.0 in July 2020 to 43.4 in July 2022.

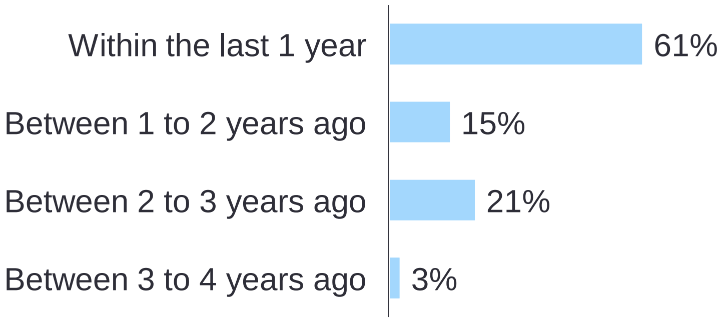
Note: 1) Results based on a sample size of 300 SMEs in Hong Kong, survey data as of March 2021
Source: Hong Kong government website, Censes and Statistics Department

SME financing needs

As the Hong Kong economy begins to recover after periods of pandemic related disruptions, the SME sector will play a pivotal role in driving this recovery. Market observations suggest that SMEs have already resumed their expansion plan in order to adapt to the "new normal". The growth potential of this sector cannot be understated as the demand for financing in supporting their continuous operation and ambitions is greater than ever.

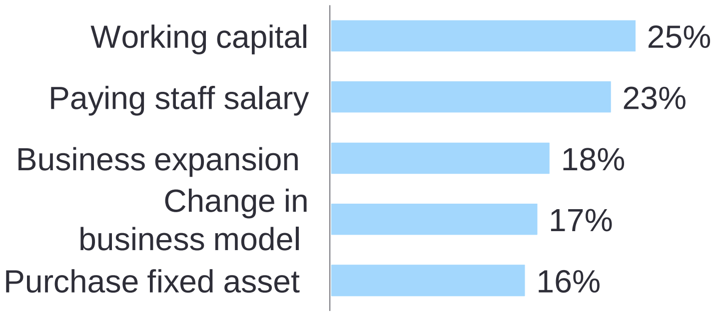
SME financing demand

As reflected in the SME survey result, over 60% of the SMEs surveyed required external financing within the last one year.



Base: (n= 100)
Q. When did the company last require external financing?

SMEs seek financing for a variety of purposes across different stages of the business lifecycle. Most common reasons include startup funding, business expansion, working capital and asset purchase, etc. Based on the SME survey result, SMEs mainly fund their business for working capital to cover day-to-day operations. To sustain long-term business growth, it is critical for SMEs to have sufficient capital to meet short-term cash flow needs and cover unexpected costs for unforeseen events.

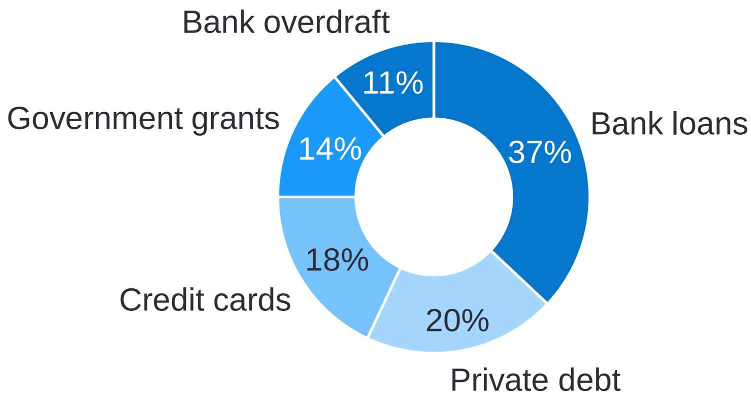


Base: (n= 100)
Q. What were the main reasons for seeking finance during that period?

Financing source

In view of the huge potential in the SME financing market, there are a number of financial institutions that offer SME financing solutions to fill the financial gap. It is not surprising that traditional banks continue to be the major financial institutions for SMEs with 95% of the respondents obtaining financing from traditional banks.

In line with the choice of financial institutions, SMEs opt for banking financial products as the key financing facilities to fund their business operation and settle various business expense. Among the banking products, bank loans play a significant role in fulfilling SME financing needs.



Base: (n= 100)
Q. What kind of financing facilities did your company opt for in the past 18 months?

There are a variety of bank loan products available in the market and some are tailored to the business needs of SMEs. The most common types of SME loan that SMEs opt for include:

- Business installment loan
- Loan guarantee scheme
- Trade finance
- Business revolving loan

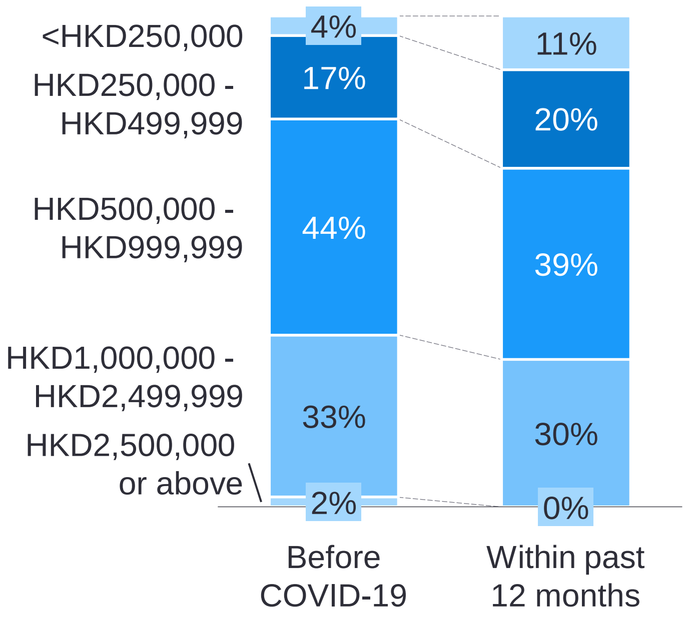
Base: (n= 100)
Q. Which kind of SME bank loan product did you opt for?

SME financing challenges

Despite the apparent demand for financing from the SME sector, they remain significantly underserved by financial institutions. Access to financing continues to be one of the major barriers for SMEs on running and growing their businesses.

Trend of SME financing

Even with disruption to their business activities, the average total financing size of SMEs have trended downward in the past 12 months as compared to before COVID-19. The survey results indicated that whilst their demand for financing didn't change, many struggled to obtain the same financing amount as they were unable to meet the higher credit requirement imposed.



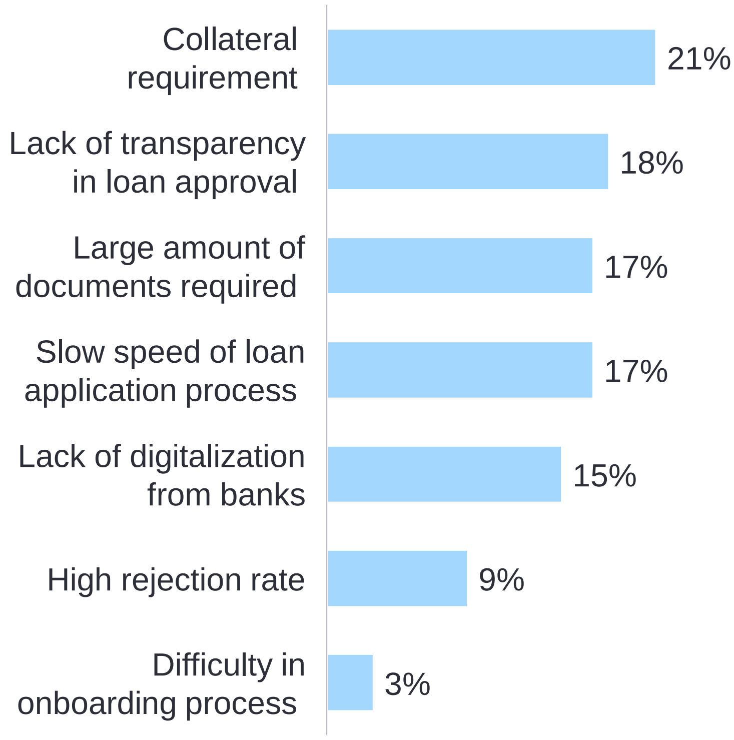
Base: (n= 100)
Q. What was the total value of the financing / debt obtained in a year on average before COVID-19 ?
Base: (n= 100)
Q. What is the average total value of financing / debt obtained within the past 12 months?

Key pain points in the financing journey

In consideration of the undersupply of credit, the unmet financing needs of SMEs remain a key issue to address, which could be further investigated by looking into the key pain points along the SME financing journey.

The biggest pain point for accessing funding is the collateral requirements attached to the loan. SMEs generally find it difficult to secure collateral-based loans or extend the credit limit due to the lack of tangible or insufficient collateral. Such strict collateral examination has hindered financial institutions from lending to SMEs especially during a period of declining top line and economic uncertainty.

Other major pain points revolve around the processing of loan applications and the overall customer experience. The transparency of the loan approval process remains opaque, leaving customers frustrated for weeks waiting for the outcome of the application. In addition, the supporting documents and information requirements have also hindered the speed of the credit decisioning given multiple rounds of back and forth between the applicant and the bank.



Base: (n= 100)
Q. What do you think is the key pain point in your financing journey? (select all that apply)

Are the financial institutions well-positioned to address the issues faced by SMEs?

The SME lending journey

Taking onboard the issues identified from the SME's perspective, this section seeks to take the perspective of financial institutions in understanding how well-positioned they are in addressing the issues faced by the SMEs, along with highlighting potential roadblocks which have hindered their ability to address these issues.

Current SME lending journey from the perspective of financial institutions

Historically, SMEs have been especially vulnerable to the changes in the macroeconomic environment. The drastic drop in consumption demand and tightening in credit terms have severely increased pressure on business cash flow. In spite of that, SME lending is often seen as a low priority business for financial institutions as the operational cost of serving the SMEs is relatively disproportionate to the potential gain. The existing inflexible business models, rigid processes and legacy technologies have incurred comparable operational costs as those of larger corporates. Coupled with the severe information asymmetry and capacity of SMEs, these have imposed particularly high risk but low return for financial institutions to manage the risk of SME lending.

Key roadblocks identified across the SME lending journey

Significant high manpower cost incurred when financing professionals are trying to spend more time and effort to overcome the challenges along the SME lending journey. The greatest barriers to process SME loan application include:

1) Lack of SME specific data

Since SMEs are either new to the market or have a relatively small scale of operation, most of them have fragmented financial, transactional, operation performance and risk data. The quality of information becomes an issue as it does not provide sufficient details for decisioning, which in turn incurs extra manpower and time costs to explore alternative ways in understanding SME's business drivers and risk holistically.

2) Lack of adequate credit analysis tools

Owing to the diversity of SME's businesses, there are distinct approaches in assessing the credit risk of SMEs based on different industries, business models, etc. However, the lack of holistic SME credit database has hindered the development of SME-specific machine learning tool and dynamic risk analytic model to assess the creditworthiness of SMEs, which have deteriorated the consistency and efficiency of credit assessment.

3) Highly manual and antiquated processes

The processing of SME loan applications remain mostly manual and paper-intensive as information collected are diverse in nature, leading to a highly time-consuming documentation and reviewing process along with the high risk of human error.

Current processes remain highly manual

In the light of these operational roadblocks, additional manual tasks are required throughout the end-to-end financing journey to maximize lending to SMEs whilst mitigating the financial risk associated with them. For that reason, manual processes remain prevalent and take up a significant portion of the loan origination processes, particularly in the screening and credit assessment stages suggested by the SME financing survey.

% of financing professionals involved in medium to high level of manual work[1]

Screening & fulfilment	**41%**
Credit analysis & assessment	**44%**

Base: (n= 200)
Q. What is the level of manual work required in your role when processing SME credit facilities?

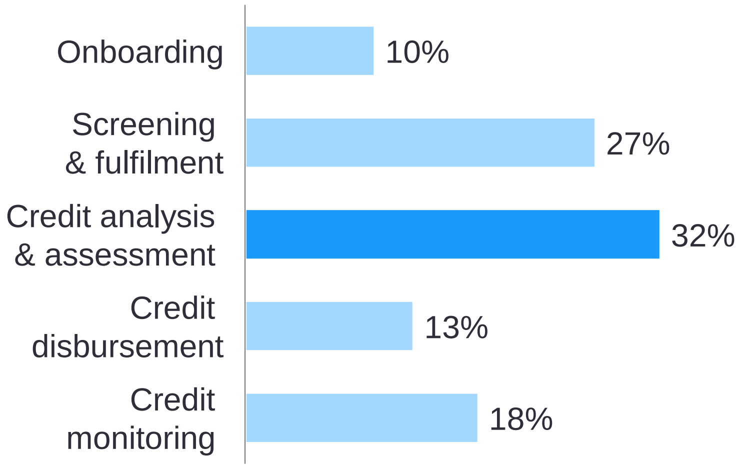
Some of the most time-consuming manual steps that add costs and create delays include:

- Manual collection and synthesize of data from various sources
- Manually track and follow up on missing documents
- Manual data entry in multiple unintegrated systems
- Manually going through a massive amount of paper-based documents
- Interview key personnel of SMEs and carry out field visits
- Manual computation of financial ratios and credit scoring

Digital adoption by financial institutions

These common and long-standing challenges within the SME lending market have prompted some financial institutions to alleviate this by accelerating the adoption of data and technology solutions.

Based on the SME financing survey, 62% of the financing professionals have leveraged on third-party digital solution, among which credit analysis and assessment have the highest adoption rate along the SME lending journey. Many of these credit assessment executives, however, mainly leverage on the SMEs data (e.g., credit report, asset valuation report) provided from third parties to understand the credit status and verify the ownership and value of a specific asset instead of adopting technologies to automate and digitalize the loan origination process.



Base: (n= 200)
Q. Does your company use third-party digital solutions related to the SME credit lifecycle? If so, which area is this third-party digital solution applicable to? (select all that apply)

Although the pronounced benefits of digitalizing SME lending are widely reported, a digital adoption gap remains, mainly attributed to the short comings of existing solutions including:

- Application limited to specific SME industries
- Difficult to verify and validate the accuracy of information/inaccurate information provided by third parties
- Incomprehensive information provided
- Slow implementation and inefficient solution deployment
- Lack of customization/unbundled solution option
- Incompatibility of market solution with existing operating procedures and tools

To effectively tap into the SME lending market, financial institutions need to rethink their approach which is typically dragged down by legacy processes, systems and ways of working. Rebuilding and revamping these existing processes through the use of emerging and innovative digital enablers will help them achieve a more agile and better targeted lending process which would translate into revenue realization, cost savings and efficiency gains.

Note: 1) Medium to high level of manual work is defined as financing professionals who spend 41% or above working hours on manual tasks in a given week and assuming 40 hours work week.

The future of SME financing

Unleashing the potential of SME lending

Current state | Future state

Onboarding	Screening & fulfilment	Credit analysis & assessment	Credit monitoring
Paper-intensive document collection and manual progress tracking	Manually source, reconcile and merge data from various sources	Undefined and opaque credit assessment criteria and underwriting	Ineffective manual management of credit risk with periodic reviews
Completely touchless onboarding experience and streamlined data collection process	Single source of truth with automated workflow to distribute data capture	Unbiased and comprehensive credit scoring model to support decisioning	Early warning signal and automated portfolio monitoring process

SME lending re-imagined

Our research indicates that the current SME lending process remains mostly manual resulting in inefficient, inconsistent and costly business operation. In addition, the adoption of digital solution remains siloed with application tied to only a small part of the lending process. To generate more opportunities and realize revenue potential from the SME lending business, it is crucial for financial institutions to realize the synergies of different digital solutions. This helps to enhance the information visibility, improve data management and enable workflow automation through straight-through processing along the end-to-end lending journey.

<u>Onboarding</u>

The initial touchpoint of customer engagement is important for establishing good customer relationship and customer retention. Onboarding process for SMEs can be complex due to the diversified nature of onboarding requirements. From the perspective of SMEs, an online platform that allows them to upload document digitally along with simple user interface to capture and verify SME's information with minimal inputs and face-to-face interaction (e.g., document authentication through optical character recognition, identity match and authentication through unique biological attributes) could create a seamless digital onboarding experience for SMEs.

From the perspective of financial institutions, a centralized data aggregator (e.g., Know Your Business (KYB)) to retrieve various reliable source of information of SME (e.g., certificate of incorporation, business registration certificate, profits tax return, shareholder structure) digitally with application programming interface (API) integration support could help to shorten the processing time of document collection with minimal to nil paperwork. This will lessen the upfront document requirements and allow to onboard new SMEs quickly and conveniently.

Screening and fulfilment

Compliance check during customer due diligence process requires tremendous human effort to identify high-risk SMEs by manually going through a massive volume of records and transactions, causing extensive delays to SMEs onboarding. In order to accelerate the compliance risk assessment process, leveraging real-time compliance screening (e.g., PEPs, sanction list, adverse media) by batch against a local or global database could help to reduce the time required in switching across different database and number of manual search required to remain compliant with anti-money laundering (AML) and counter-terrorist financing (CTF) regulatory requirements. Batch screening can be supported by natural language processing and machine learning technology which help to minimize false positive without compromise on true match.

Credit analysis and assessment

As illustrated earlier in the report, credit analysis and assessment is considered one of the most labor intensive processes along the SME credit journey. Given the heterogeneity nature of SMEs, along with the inconsistency of bookkeeping standards, it remains a highly tedious process for banks to review and underwrite loans efficiently. Furthermore, the credit risk assessment frameworks used by banks are sometimes not tailored to account for SMEs in different industries or SMEs with unique business models, meaning a large amount of the assessment relies heavily on judgement calls which could lead to certain biases in the underwriting process. To establish a common baseline for credit analysis, a single SME credit score generated from a robust model that takes various factors and information of SMEs and corporate associates into account (e.g., loan overdue, bankruptcy, proposal, trade and other credit information) could provide an instant view on the creditworthiness and default risk of the SMEs. This type of SME score could act as a simple way in identifying the potential SMEs to grant credit, saving the time to manually read through a vast amount of data which helps to make the credit decisioning process quicker, more accurate and consistent.

Credit monitoring

Despite sound initial due diligence, the default risk of SMEs loan can change before loan repayment due to internal business management decision or a change in broader economic environment amongst other factors. Periodic monitoring of SME's financial health thus becomes crucial in managing the banks' credit risk in order to minimize the possibility of default loan. The ongoing risk monitoring tasks such as reviewing SME's financials, loan repayment, changes in organizational structure, risk profiles, however, remain very manual, repetitive and time-consuming. As the compliance requirements become more stringent and the penalties of compliance failure become more severe, financial institutions have to reduce human intervention in order to provide a better monitoring and control. A SME score can help to provide early warning signal on change in credit risk and keep the financial institutions informed when there is a change in the underlying factors that deteriorated the SME score. In addition, the on-going monitoring process can be automated by real-time risk profile assessment and adopting digital tools to automate the scheduled screening against a real-time local or global database. Risk managers will receive immediate alert if there is any change in compliance risk. This enables them to take remedial action without delay and eliminate financial loss and reputational damage due to non-compliance.

Case in point: potential benefits brought about through digital adoption

From the information gathered in the interviews, EY Parthenon has constructed a theoretical case study supported with a benefits analysis that illustrates how operations of a bank can be improved through digitalization. The composite bank is a representative of the interviewees' experiences, and it is used to present the total benefit gained from end-to-end digital adoption along the SME lending journey. The composite bank has the following characteristics:

<u>Description of the composite bank</u>

The bank is a multinational bank that offers various types of loan, business card and other services for SME customers. The bank has a strong reputation in the Hong Kong market with a customer base of 10,000 SMEs. To support its SME lending business, the bank has a group of dedicated employees that focus on processing SME loan application from onboarding to credit analysis and monitoring.

<u>Solutions deployment characteristic</u>

In recent years, the Hong Kong Monetary Authority (HKMA) has introduced the Open API Framework as one of the key initiatives for the banking sector to facilitate the exchange of information between financial institutions. Beside that, financial institutions have begun to roll out digital initiatives and embrace technologies to meet SME's evolving needs and enhance their financing experience. It is likely that with the FinTech push and support from HKMA, financial institutions will accelerate their digital transformation to better serve the SMEs. Accordingly, the composite bank has adopted a hybrid model (semi-automated digitalization with minimal human intervention) and deployed different kinds of robust digital solutions along the lending journey to streamline and digitalize end-to-end processes where possible.

<u>Revamped SME credit journey</u>

Onboarding: After adopting digital authentication technology and KYB database, the bank can authenticate the identity of customer remotely and have instant access to reliable digital documents to verify and validate the legitimacy of the SMEs. This allowed the bank to onboard new customer more efficiently without compromising compliance and fraud risk, therefore reduced onboarding costs and paperwork drastically.

Screening and fulfilment: By automating the compliance screening process against real-time database, the bank can identify high-risk SMEs within seconds with the visibility of ultimate beneficial ownership. This also allow for faster compliance checks and reduce duplicate and frequency of screening request, lowering screening cost.

Credit analysis and assessment: SME score is representative of the financial health of SMEs. By using the SME score as part of the credit analysis framework, the bank can execute credit assessment quickly and make instant credit underwriting for small loans (below HKD2 million) or urgent cases. Alternatively, the bank uses the SME score as a baseline to grant or extend credit limit, improving prospect, sales and operational efficiency and reducing cost of vetting loans for SMEs.

Credit monitoring: By using SME score to monitor the change in credit risk, the bank can better target SME loans that require deeper investigation during periodic review. Furthermore, automating compliance screening can minimize human error in monitoring loan portfolio, allowing efficiency gains in compliance risk review, in turn saving human resources for other revenue-generative activities.

Key ROI improvements
with end-to-end digital adoption

90% Time saved on end-to-end loan application to disbursement

20% Increase in extent of automated onboarding & screening process

35% Manpower hours saved on each loan case

Case study 1 – Adopting KYB solution for customer onboarding by a leading virtual bank in Hong Kong

Background

The virtual bank currently focuses on servicing Hong Kong incorporated companies, with an aim to assist SMEs in overcoming their business constraints. The bank offers both tailored revolving and installment loan to SMEs based on their business needs.

Before deploying KYB solution, the onboarding or account opening process for SMEs remains manual with high level of human intervention. Financing executives conduct multiple company search, land search and other risk screening tasks on separate databases to look into the structure, beneficial owner and validate information.

Application of digital solution

KYB enables semi-automation of screening process which is particularly useful for small-scale SMEs with single-layer organization structure. KYB supports API integration, allowing for instant access to company search information (e.g., ultimate beneficial owner, other share ownership or role of existing shareholder and director) in completing first line of compliance checking and information validation.

Benefits realized[1]

- Directly retrieve company information within hours from single database
- Holistic view of company identity and organization structure
- Increase customer conversion rate with streamlined process
- Lower SMEs onboarding costs

70% Reduction in customer onboarding time

10x Increase in no. of onboarding case handling

40% Reduction in supplementary client queries

Case study 2 – Automating end-to-end credit journey from onboarding to credit decisioning by a multinational bank in Hong Kong

Background

The multinational bank's Business Banking unit mainly serves HK-incorporated companies and supports SMEs with business involvement in Mainland China or Greater Bay Area (GBA).The bank offers various lending solutions, amongst which instalment loan is the key products that SMEs apply for.

Before automation, the bank had a high manually end-to-end process flow. Relationship managers authenticate identity face-to-face whilst financing executives unwrap company's structure through manual company search and make judgement-based credit decision.

Application of digital solution

The launch of digital platform enables the bank to support digital customer onboarding, e.g., automate remote identity authentication, one-stop instant view of company's structure and related shareholder and director information with API integration. In addition, the bank adopted programmatic credit decisioning approach for low-risk loans which allows for automated risk rating, credit underwriting and approval based on parameters set upfront for smaller sized loans.

Benefits realized[1]

- Reduce operational cost with a paperless and automated credit journey
- Reduce SME drop-off rate due to shorter waiting time compared to other lenders
- Alleviate human capital constraint in initiating and processing loan application

10+% Increase in lead generation

60% Reduction in turnaround time for end-to-end loan application

50% Time reduced in credit decisioning

Note: 1) Results based on interviewers' experience and could vary dependent on level of integration and maturity of existing processes
Source: Expert interview

What does this mean for financial institutions in Hong Kong?

The past few years have seen vast growth of some of the local SMEs and their corresponding financing needs in reaching their potential. Nonetheless, SME remains an underserved segment compared to larger corporate where timely access to finance remains as one of the key roadblocks on their business growth.

The lack of standardization for SME financial reporting means more due diligence and assessment work is required from the perspective of different financial institutions when providing loans. Banks are in need of a streamlined credit assessment approach that can better suit their business requirements whilst minimizing operational cost. As a consequence, data and technology remains the largest pain point for all financial institutions. Banks are lacking digital tools to enhance their visibility of SME's business, in order to quickly develop a thorough understanding of SME's actual financial status and other underlying risks. Continue following the antiquated, fragmented and labor-intensive process will simply delay credit decisioning and miss the potential profitable business opportunities.

The outbreak of COVID-19 has been the digital catalyst across industry sectors. There is no better time than now for financial institutions to build up their digital capabilities. Advanced FinTech development alongside with the policy initiatives and programs support from the government have cultivated a mindset and environment for digital transformation. Financial institutions should start to embark on revamping their end-to-end SME credit journey by looking into various aspects of the current SME lending business, particularly on:

- The current credit process and key pain points to streamline the end-to-end credit journey
- Operational efficiency and effectiveness in loan processing against other leading SME lenders
- Credit underwriting capabilities and critical digital adoption gaps to identify potential areas for automation and digitalization
- Data that is captured by the existing process and additional or alternative data that are useful for credit decisioning and compliance purpose
- Potential realized business value attributed to each digital initiative
- Prioritization of digital initiatives for quick wins and ease of implementation based on strategic goals and impact

To enable digitalization along the SME credit journey, banks can seize this opportunity to rethink and redesign their current processes and assessment framework with SMEs evolving needs in mind. By optimizing processes, data analytics and digital capabilities, established financial institutions can set themselves up for future success and ready to capture the rapidly growing SME financing market.

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