# Digital banks powering SME growth

## Introduction

The digital transformation of banking services represents a shift in how Small and Medium-sized Enterprises (SMEs) access and manage financial services. Digital banking platforms have emerged as crucial enablers of SME growth, offering enhanced operational efficiency and improved financial accessibility. These innovative new banks whilst introducing new challenges, presents fresh opportunities to address the persistent SME financing gap.

Digital banking solutions provide SMEs with real-time financial visibility, streamlined invoice management, and diverse payment capabilities, fundamentally altering their operational dynamics. The success of digital banking platforms hinges on their ability to establish trust and provide personalised service delivery while delivering efficient and innovative solutions that address SMEs' evolving needs.

Digital-first institutions' inherent agility enables rapid adaptation to emerging business models, including the sharing economy and increasingly digitised SME operations. Furthermore, digital banks are catalysts in accelerating SMEs' digital transformation, contributing to improved financial literacy and infrastructure development.

This was discussed at the roundtable "Digital Banks: Powering SME Growth" held at the Global SME Finance Forum 2024. Moderated by Liliana Pozzo, AS/Upstream Mgr. LAC and Europe, IFC, the roundtable brought together key players from global digital and traditional banks to tackle the challenges of SME financing. The discussion centred on innovative approaches, such as partnerships with traditional financial institutions. Participants include Aria Widyanto, Chief Risk and Sustainability Officer, Amartha, Ayodele Olojede, Divisional Head, Retail and SME, Wema Bank, Nigeria, Alexander G. Sotiriou, Senior Financial Sector Specialist, CGAP, Gabriel Ribenboim, CEO & Co-Founder, Impact Bank, Rogério Stallone, Senior Partner, BTG Pactual, Manu Rajan, Division Chief Executive Officer, Wing, Mariane Takahashi, CEO, ABStartups, Wendy Delmar, Chief Executive Officer, Caribbean Association of Banks Inc, Rajeev Chalisgaonkar, Head of Business Banking and NeoBiz, Mashreq Bank, and Dr Vincent Zheng, Deputy General Manager, WeBank.

This report examines how digital banks are reshaping SME finance across emerging markets, highlighting innovative solutions, challenges, and successful adaptation strategies.

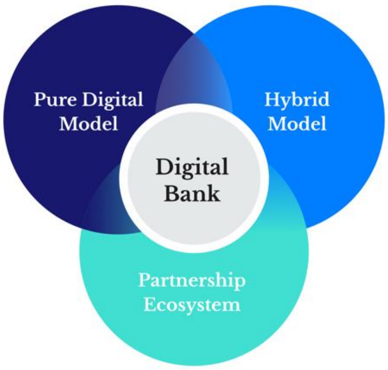
# Today's digital banking landscape for SMEs

SMEs represent 80% to 90% of businesses globally. In Brazil for example, SMEs contribute 30% of GDP and provide over 50% of formal employment. However, these businesses face significant challenges in accessing credit through traditional banking channels.

Digital banks have emerged as potential solutions to address the SME financing gap, offering streamlined services to improve accessibility to credit and digital banking services. These institutions leverage technology to transform traditional banking processes, enabling rapid account opening that reduces waiting times from months to days. Through digital platforms, SMEs gain access to real-time financial visibility, automated payment systems, and data-driven lending decisions. The reduction in operational costs through digital delivery channels allows these banks to serve previously unreached customer segments and create new opportunities for financial inclusion.

The experiences of digital banks across emerging markets reveal that successful digital banking models must address not just technological capabilities, but also cultural preferences, infrastructure limitations, and varying levels of digital literacy. These considerations have resulted in digital banks adapting their approach to suit the individual market. Three common approaches include pure digital models, a hybrid approach, and creating a partnership ecosystem.

Diagram 1




Pure digital banks target a specific customer segment that has emerged with technological advancement, as displayed by WeBank. WeBank serves younger entrepreneurs who are comfortable with technology, particularly those operating in service industries and technology sectors. While this model offers significant efficiency advantages, some digital-first banks still need to adapt their approach to meet market realities, especially in emerging economies where digital literacy and infrastructure may be limited. This prompted some financial institutions to adopt a hybrid approach.

Hybrid models combine digital services with strategic physical presence or physical branches. Wing Bank, a Cambodian digital bank built for all Cambodians, takes this approach through its comprehensive network of franchise agents located throughout the country. This model has enabled Wing Bank to increase market penetration, serving 100% of provinces and districts in the country through a combination of digital services and physical touchpoints. The bank's success demonstrates how digital capabilities can be effectively combined with human interaction to build trust and facilitate adoption.

Wema Bank in Nigeria has pioneered another hybrid model through its digital platform, ALAT. By maintaining traditional branches while developing digital-only services, ALAT serves both digitally savvy customers and customers who require traditional banking support. This enables the bank to leverage existing infrastructure while offering digital lending products that combine automated processes with human oversight.

NeoBiz, the digital arm of Mashreq Bank in the UAE, has transformed SME banking by operating virtual relationship managers from cost-effective locations while maintaining a minimal but strategic physical presence. This model has helped NeoBiz capture 15% of UAE's SME market share, solving specific market pain points while maintaining necessary human connections through virtual channels.

Beyond a blended approach, digital banks are creating partnership ecosystems, forming a collaborative approach with traditional financial institutions. Amartha, an Indonesian digital bank, does this by acting as a facilitator between traditional banks and underserved markets. They leverage traditional banks' capital and infrastructure while providing the technological bridge to reach previously untapped market segments.

WeBank in China expanded beyond traditional lending by recognising that SMEs, particularly in the technology sector, require more than just credit. By collaborating with venture capitalists in China, WeBank is able to provide different forms of capital based on customer profiles, effectively leveraging the country's digital ecosystem to offer comprehensive financial solutions.

Through collaboration with digital banks, traditional banks can leverage these technological innovations to enhance service delivery, allowing each entity to focus on its core strengths.

## Challenges and use cases

While digital banks aim to serve SMEs, the Consultative Group to Assist the Poor (CGAP), a World Bank think tank, reveals a more nuanced reality in its research. Smaller SMEs, such as micro-enterprises and firms run by women or located in rural areas, are frequently excluded from digital banking services despite being technically within the bank’s target market.

Different markets require distinct approaches to digital banking. CGAP's analysis indicates that outside of China, where WeBank and Ant Financial have achieved significant scale in microcredit, most digital banks and lenders have struggled to reach excluded segments. Simply having access to data is insufficient; banks need viable business models specifically designed to serve financially excluded customers.

# Infrastructure challenges

Rural areas in emerging markets often struggle with limited internet connectivity, making access to digital banking services a challenge. In the Brazilian Amazon, SMEs often lack reliable internet access, though they may have mobile phones with limited connectivity. This impacted the SMEs' access to credit, stunting the business potential to grow and develop. Between 2013 and 2018, SME credit in Brazil decreased by 30-40%, highlighting the persistent financing gap in this sector. Impact Bank has addressed this through a blended finance model, combining concessional and commercial capital to make financing feasible for very small operations. This approach provides technical assistance for local organisations and indigenous people, adapting digital banking to serve communities in infrastructure-constrained regions while supporting broader social and environmental objectives.

The varying levels of digital readiness among SME owners present another crucial challenge. SMEs, particularly in rural areas, need to be more comfortable with digital-only services. Amartha in Indonesia addresses this challenge by maintaining ground staff who educate first-time borrowers about their platform's features and capabilities. This human-centred approach helps bridge the gap between traditional banking habits and digital services while building essential trust in technology-driven solutions.

The widespread use of Unstructured Supplementary Service Data (USSD) technology in Nigeria enables digital banking services even in areas with limited internet connectivity. Through USSD short codes, customers can open accounts, conduct transfers, pay bills, and even access loans. Agency banking networks have become crucial for extending financial services to rural areas, while mobile money integration facilitates broader financial inclusion, particularly among the Micro SME (MSME) segment.

The government also plays a significant role in helping digital banks manage infrastructural challenges. China's digital banking success is built on extensive government investment in both data infrastructure and connectivity. The Chinese market benefits from exceptionally high coverage rates, with the government playing a pivotal role in building comprehensive data infrastructure and frameworks. This foundation allows digital banks like WeBank to leverage existing infrastructures and data for enhanced risk management and online marketing activities.

# Risk management

In some markets, digital banks face information asymmetry when dealing with unregistered businesses or those without formal financial records. In Cambodia, among approximately half a million SMEs, 98% are micro-enterprises and 95% unregistered. These businesses typically lack financial statements, registration documents, and proper accounting books, often using personal accounts for business transactions.

Wing Bank has adopted a top-down approach to address risk management. They partnered with established brands and corporations that have existing relationships with micro-enterprises so that banks can access transaction data about buyers through their sellers. This approach has enabled them to extend credit to retailers who would otherwise be excluded from formal financial services.

Amartha in Indonesia has adopted a similar approach, serving 2.5 million women-run SMEs across 50,000 villages by utilising alternative data for credit scoring. Its approach removes traditional documentation requirements while maintaining effective risk management. This innovation has enabled them to process over 200,000 loans per month, demonstrating the scalability of alternative credit assessment methods.

NeoBiz in the UAE manages risk with transaction-based credit assessment models. They analyse six months of bank statements using advanced algorithms that can process and evaluate transaction data in seconds rather than days, allowing them to make informed lending decisions while maintaining regulatory compliance.

Strict compliance and documentation requirements pose another significant challenge for account opening and verification in Middle Eastern markets. SMEs in the UAE faced extensive delays in account opening. Processing times ranged from 90 to 120 days due to stringent documentation requirements and compliance checks, particularly for startups and SMEs.

NeoBiz addressed these challenges by creating current accounts that function like prepaid mobile phones, with built-in transaction limits. The accounts automatically trigger warnings at one million Dirhams in turnover and implement hard stops at two million Dirhams, requiring additional verification for continued use. This risk-based approach satisfied compliance requirements while making account opening more accessible for typical SME customers who operate at much lower transaction volumes.

The bank has further streamlined operations by leveraging the UAE's digital infrastructure, including state-sponsored facial authentication systems that enable remote customer verification. This has allowed NeoBiz to open accounts for more than 50% of their customers without any physical meetings.

The cost of micro-lending, or managing small-ticket loans, presents another significant challenge for risk management. Digital banks have responded by developing automated systems that reduce processing costs while maintaining effective risk controls. WeBank in China has successfully scaled its micro-lending operations through risk management systems that combine alternative data sources with traditional credit evaluation methods.

## Trust and cultural barriers

Building trust remains a fundamental challenge for digital banks, particularly in markets where traditional banking relationships are deeply ingrained. The need to balance digital efficiency with human interaction has led some digital banks to develop virtual relationship managers, dedicated contact centres, and educational initiatives to help maintain the human element while leveraging digital capabilities for operational efficiency.

Wing Bank's experience in Cambodia illustrates this challenge. Despite offering efficient digital services, research indicated that customers associated trust with physical buildings and branches. In response, Wing Bank strategically established 22 premium branches. While these branches are barely used for transactions, they help to build credibility and trust in their brand.

While operating as a digital bank, Amartha maintains ground staff who serve as crucial intermediaries between the technology and first-time users. These staff members educate customers about the platform's features and capabilities, helping bridge the gap between traditional banking habits and digital services. This human element softens the introduction of technology to first-time users who may lack trust in digital systems and could be vulnerable to exploitation or cybersecurity risks without proper guidance.

Similarly, NeoBiz in the UAE has developed a hybrid approach to customer service. While maintaining their digital-first model, they created a team of virtual relationship managers based in Bangalore, India, who each manage approximately 3,000 customers. These managers operate reactively, reaching out when specific needs arise, such as responding to compliance queries about transactions. This model allows NeoBiz to maintain the human touch essential for relationship banking while achieving the cost efficiencies of digital operations.

# Conclusion

Digital banking has demonstrated significant potential in improving SME access to financial services, particularly in emerging markets. The sector's continued evolution will depend on maintaining flexibility in service delivery models while building trust through transparent operations. As digital banks mature, their ability to combine technological innovation with market-specific adaptations will determine their success in bridging the SME financing gap.

The experiences of digital banks across different markets demonstrate that success requires more than just technological capability. It demands a deep understanding of local market conditions, creative solutions to infrastructure challenges, and careful attention to building trust. Collaboration between traditional and digital banks, supported by appropriate regulatory frameworks, will be crucial for sustainable growth and enhanced financial inclusion for SMEs.