Growth Cap

Building SME-focused capacity

DECEMBER **2015**

PROJECT TECHNICAL NOTE

UNDERSTANDING THE SME CUSTOMER

Dinah Bennett, Pat Richardson and Esther Nyauncho

INTRODUCTION

Banks and other providers of financial services world-wide, are increasingly aware that their future profitability and prosperity lies with the small and medium sized business sector. As opportunities to generate returns from government securities and corporate lending diminish, success in the SME segment becomes increasingly important for the future profitability and growth of banks and other financial institutions (FIs). However, banks need to improve their understanding of smaller businesses and become more engaged, proactive and innovative in this sector if they are to attract and serve these businesses more effectively.

This technical note (TN) looks at how to better understand SMEs and their owners and aims to help staff in banks and other FIs get a better feel of what it is like to be an entrepreneur. The note explores the ways in which bankers and FIs as a whole, can better appreciate why and how their SME customers want to develop in order to better support such entrepreneurs to achieve their business goals.

This TN should be read in conjunction with other GrowthCap technical notes and guides on segmentation, value proposition, focus groups and market research as well as SME relationship management. These documents are all listed at the end of this TN.

About GrowthCap

Over the past few years FSDK has been at the forefront of SME banking development through conducting market assessments and studies in areas such as trade finance and SME equity funds, as well as supporting development of the credit reference bureau. Through its partnerships with its Action Research Partners (ARPs), FSDK's GrowthCap initiative is supporting adoption of SME best practices by individual financial service providers.

This paper is part of a series of Technical Notes and Resource kits that are being developed out of work with the ARPs. These provide detailed information about the best practices and are intended for use by financial service providers and those supporting such institutions which are entering the SME market.

Abstract

This technical note (TN) looks at how to better understand SMEs and their owners and aims to help staff in banks and other FIs get a better feel of what it is like to be an entrepreneur.

About the authors

Dinah Bennett is an international expert to GrowthCap

Dr Pat Richardson, is an international adviser to GrowthCap

Esther Nyauncho is an associate at GrowthCap

FSD Kenya
Financial Sector Deepening

QUANTITATIVE DEFINITIONS ARE NOT ENOUGH

The first thing to clarify when discussing any issues surrounding SMEs is to clarify what we mean by an SME? Definitions of small and medium sized enterprises vary widely from country to country but most look to numbers to help categorise different sized businesses and these numbers usually involve the business turnover and number of employees. In Kenya, the MSE Act of 2012 uses employment and annual turnover to define micro and small enterprises as shown in Figure 1.

Even using basic quantitative data, it is clear that there is no commonly held definition of who constitutes a small or medium business client.

Findings from a 2014 survey conducted by FSDK on the supply side of SME finance in Kenya[1] showed that banks using sales turnover to define SMEs saw small businesses as falling between KSh 1 to 30 million, whilst those using loan size saw small business as those requesting loans between KSh 1 and 50 million.

1 FSD Kenya, 2015 'The Kenyan SME Financial Landscape' Research Report

> "Having a common definition would be a useful starting point in trying to break down and understand the different types of businesses that sit within this collective group called 'SMEs'.

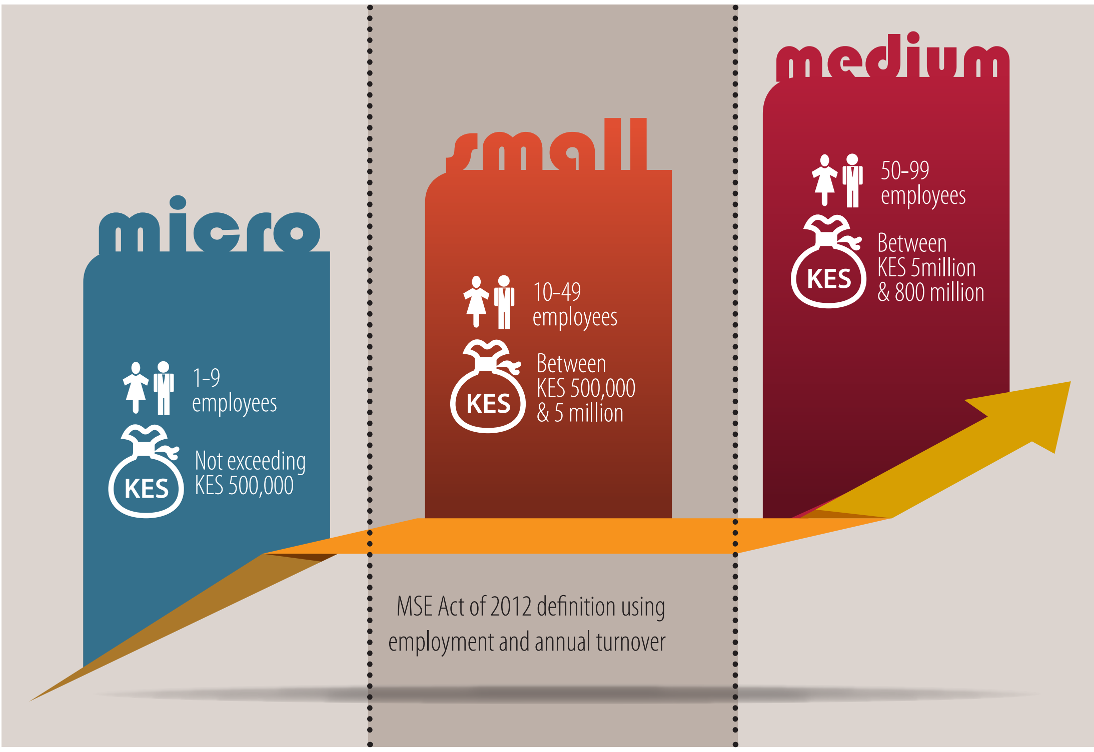
Having a common definition would be a useful starting point for the banks, in trying to break down and understand the different types of businesses that sit within this collective group called 'SMEs'.

However even commonly held quantitative definitions would not provide much insight into how these small businesses actually operate and it is this insight that FIs need, if they are to design products and services that meet the needs of this client group.

They need to understand what drives these business owners to start and grow their businesses, what are the typical problems they face and what type of financial support can help them when they need it.

This TN discusses 6 factors that FIs will need to consider to better understand and their serve smaller growing business clients.

Figure 1: The Kenyan government definition of smaller businesses



HELPING TO BETTER SERVE THE NEEDS OF THE SME CUSTOMER

I. Recognise that SMEs are not mini corporates

A common error in SME banking is the assumption that SMEs are 'mini corporates'.

SMEs are smaller in size than a corporate but unlike corporates, SMEs are owner-centric, with an owner manager who is actively involved in all aspects of their business. Typically the owner is the finance department, the head of operations, the human resources department and the marketing and sales team all rolled into one. Given their heavy involvement in all aspects of the business, the owner manger knows how the business is doing on a day to day basis. At the same time a typical SME has few formal structures or systems and record keeping is usually at a minimum. The owner started their business with a certain goal in mind, they are determined to succeed and are always seeking new opportunities to grow the business. However they rarely capture this vision and aspiration in a documented format - such as a business plan and or set of accounts -that a bank likes to see.

When a business approaches a FI, or vice versa, the information required by the bank is often not written down, and there may not be a company accountant who can prepare the necessary documentation. FIs need to engage more actively with these clients; bank officers need to work with these business owners closely, visit their premises, get to know the businesses, see what the businesses need and then develop solutions that have the needs of the owner manager in mind and are appropriate for the business.

II. Bankers and entrepreneurs tend to be different character types

One reason why bankers and business entrepreneurs often find they do not seem to speak the same language is because they don't. This difference operates at two levels.

Firstly, bankers tend to use banking terminology that many owner managers do not understand. The FSDK mystery shopping research on banks in Nairobi was conducted using small business owners acting as potential customers[2]. The research showed the disconnect between potential customers and banks, where the shoppers felt that many of the bank

officers talked at them, using terminology and acronyms that would be quite foreign and confusing to your average small business owner.

Secondly, bankers and entrepreneurs are typically quite different kinds of people.

Psychometric tests often show that while bankers tend to have a keen eye when it comes to detail, entrepreneurs are likely to take a broad-brush approach and look at things related to their business from a more strategic/holistic perspective. No approach is better than the other, both have strengths and weaknesses.

'*Sensing*' and '*Intuiting*' are preferences used in the Myers-Briggs Type Inventory (MBTI)[3]. The naming is unfortunate as sensing is more than simply touch and vision, and intuiting is not merely about a 'gut-feel'. These indicators are about how we take and create meaning: from immediate data or after deeper thought. For example, those with a sensing preference pay attention to data gleaned from their five senses and from their own direct experiences. They create meaning from conscious thought, rather than trusting their subconscious, limiting their attention to facts and solid data. They will happily dig into the fine detail of the situation; they focus on what is immediate, practical and tangible and they like logic and tend to pursue things in a clear sequence. At work, they will have a clear schedule and like to use their proven skills in tactical situations. Many individuals in FI's often come up with a preference for sensing.

FIs need to engage more actively with clients; bank officers need to work with business owners closely, visit their premises, get to know the businesses, see what the businesses need and then develop solutions that suit those needs.

2 FSD Kenya 2015 'The Kenyan SME Financial Landscape' Research Report

3 www.myersbriggs.org/my-mbti-personality-type/mbti-basics & www.16personalities.com/personality-types

By contrast many owner managers of SMEs, when undertaking an MBTI type test, appear to have a preference for intuition. Those with an intuitive preference, process data more deeply than sensors and are happy to trust their subconscious and 'sixth sense', gut feel or intuition. They are good at spotting patterns and taking a strategic holistic view, as opposed to focussing on the detail. They tend to like ideas and focus on future opportunities. They are sometimes perceived as impractical and unrealistic by their sensing colleagues. It is apparent that these two types can have issues when trying to understand the other's perspective and communicate effectively. This may help to explain many of the misunderstandings that often occur in a bank's dealings with its business customers.

A lot of research with owner managers shows that, in the main, they have the following characteristics, many of which are in contrast to your typical banker. Owner managers tend to:

- Be optimistic.
- Not to write things down – unless they have to.
- Learn by doing, and making mistakes.
- Be very independent – with what is termed a "High Locus of Control."
- Find it difficult to analyse their own businesses – they are too close to it.
- Treat symptoms and not causes.
- Constantly manage change and chaos – often fire-fighting.
- Be very strategically aware, but . . . don't plan strategically

Bankers need to keep these characteristics in mind when they are interacting with their SME customers.

III. Bankers and small business owners live in different life worlds

The average banker and entrepreneur live in different worlds of work on many fronts and these bring different perspectives which in turn can, again, lead to misunderstanding and miscommunication thus hampering any effective banker customer relationship.

Organisationally

The banker and SME are operating in completely different organisational environments which shape how they view business life.

As Allan Gibb, a longstanding small business researcher notes this organisational cultural divide leads to different ways of seeing things between the corporate/bureaucratic organisation and the small entrepreneurial business[4]. In Figure 2 Gibb provides

4 Gibb, A.A. (2002) 'In pursuit of a new entrepreneurship paradigm for learning: creative destruction, new values, new ways of doing things and new combinations of knowledge' International Journal of Management Reviews Vol. 4 No. 3 pp 233-269 www.allangibb.com/expertese_culture_and_educ_PUB1.htm

Figure 2: The different organisational worlds of bankers and SME owners

The Bureaucratic /Corporate /Bank		Entrepreneurial /Small Business
'Looking for'		As being
order	←→	untidy
formal	←→	informal
accountability	←→	trust
demarcation	←→	overlap
planning	←→	intuition
corporate strategy	←→	strategic awareness
control	←→	autonomy
standards	←→	personal observation
transparency	←→	ambiguity
position	←→	ownership
performance appraisal	←→	customer/network appraisal

Source: Allan Gibb 2002 - see footnote 5

Figure 3: Factors that characterise the life world of the typical entrepreneur or small business owner

▪ Greater freedom. ▪ Greater control over what goes on. ▪ Gibb's model – entrepreneurial paradigm greater responsibility – more of the 'buck' stops with you. ▪ More autonomy to make things happen. ▪ Doing everything – coping with wider range of management tasks. ▪ Rewards linked more directly/immediately to the customer. ▪ Personal assets and security more at risk. ▪ The ego more widely exposed. ▪ Living day to day with greater uncertainty.	▪ Greater vulnerability to the environment. ▪ Wider interdependence on a range of stakeholders. ▪ Know who' becomes more important – to build trust. ▪ Working longer and more variable hours. ▪ Social, family and business life more highly integrated. ▪ Social status tied more to business status. ▪ More learning by doing, under pressure (more tacit than explicit). ▪ Loneliness.

a number of distinctions that show bankers typically sit within organisations which have bureaucratic/corporate cultures, whereas owner managers typically sit within organisations that could be described as untidy, informal and somewhat chaotic. Gibb has deliberately polarised these cultures in Figure 2 but this polarisation can be useful as a basis for learning and better understanding as to how bankers see entrepreneurs and vice versa; and again how these different perspectives flavour the nature of conversations and relationships between the two.

Entrepreneur life-world

Bank managers need to be able to put themselves in their business customers' shoes, if they are to fully understand the realities faced by SMEs and as a result the financial needs that business owner's face. Again we emphasise that bankers and small business owners tend to *'walk in very different shoes'*.

One aspect of this involves recognising the values of the entrepreneur which are shaped by their 'way of life' as a business owner – also termed the 'life world of the entrepreneur'. It has been argued that the key components of 'this way of life' include factors that are set out in Figure 3.

This 'way of life' shapes the way in which knowledge is perceived and understood by entrepreneurs. For example, the entrepreneurial ego is intimately entwined with the business, through financial and psychological ownership. This sometimes leads entrepreneurs to 'externalise' the causes of business problems (government regulation, banks, etc.) rather than admit to any internal deficiency in their management of the business.[5]

5 AA Gibb 2002 www.allangibb.com/expertese_culture_and_educ_PUB1.htm

By contrast the life world of the typical banker is very different as illustrated by listing some typical features of their 'banking world or work'. Bankers:

- Come to work in organisations and cultures where their livelihoods are not so directly "on the line" in the same way those of owner managers.
- Come from a world of specialists which is alien to most small business owners, who tend to be generalists in business, although often experts in their particular type of business.
- See the bank (their employer) from the point of view and needs of the bank, rather than through the eyes of the customers and hence tend to focus on selling.
- Have rarely had the opportunity for hands-on experience of business development within a small firm.

Figure 4 captures how these very different sets of cultural contexts and practices can, once again, bring very different perspectives to a funding discussion between a banker and an owner manager.

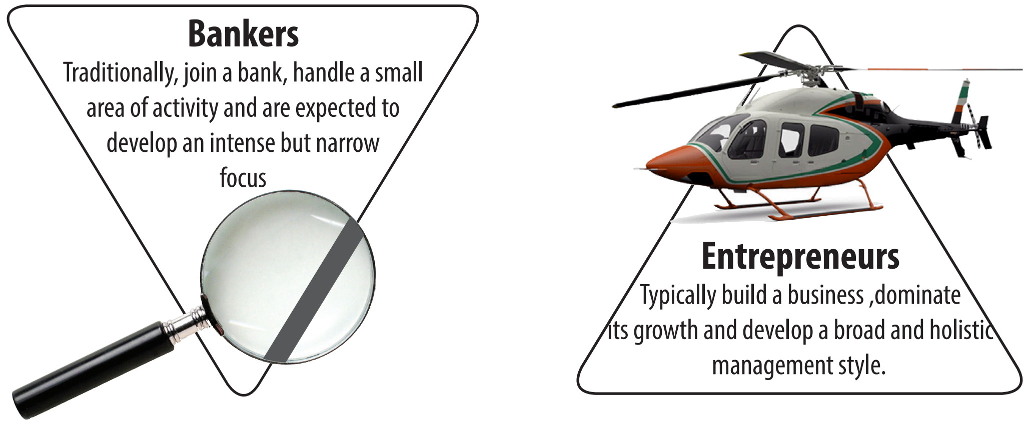
IV. Banks are only one of many stakeholders for the business owner

One of the ironies of small business ownership is that while most individuals are driven to set up their own firms by a strong desire for independence, entrepreneurs quickly discover that to survive and prosper they must learn to manage a complex network of external relationships and interdependencies.

Indeed, most businesses be they small or large, can now be seen as "more of a node in a complex network of economic

“ **Bank managers need to be able to put themselves in their business customers' shoes.**

Figure 4: The differing views of bankers and entrepreneurs



relationships, dependencies and mutual obligations than a production function seeking internal efficiency Gibb 1987".[6]

Moreover, competitive advantage for a business has become a function of their ability, in the case of smaller businesses the owner manager themselves, to manage these interdependencies. Business owners need to interact with and juggle the needs of a large number of very different groups of people to make their business work.

Figure 5 shows a network of some typical stakeholder groups that a small business owner must manage and develop in order to develop and grow their business. The survival and success of the business depends on how well the owner manager can do this. Moreover, business owners are frequently managing these stakeholders under conditions of uncertainty ambiguity and ongoing change.

In every small business's 'network' one of its most important external stakeholders is the bank or provider of financial services. Accordingly, every small business recognises that they must nurture this relationship if they are to develop the confidence, trust and mutual understanding that will help them maximise the benefits of the relationship for their business and avoid unnecessary conflict.

Figure 5: A typical stakeholder network for running a business

Source: Allan Gibb 2002 - see footnote 5

6 Gibb, A.A. (1987)'Training Owners and Managers of Small Firms' in 'Small Enterprise Development: Policies and Programmes'. (edit. by P. A. Neck and R. E. Nelson) Revised Edition ILO, Management Development Series. Chapter 9. No.14. Geneva

The key point to note for bankers is that the bank is only one of these many stakeholders that the business owner needs to work with and there is often only one person – the entrepreneur them self – to undertake this task'.

V. Small business owners' banking expectations

Research on owner managers throughout the world, consistently shows that, in an ideal world, owner managers want more than funding from their banks. This is particularly so for those business owners that have survived beyond start up and seek to further develop and grow their businesses .

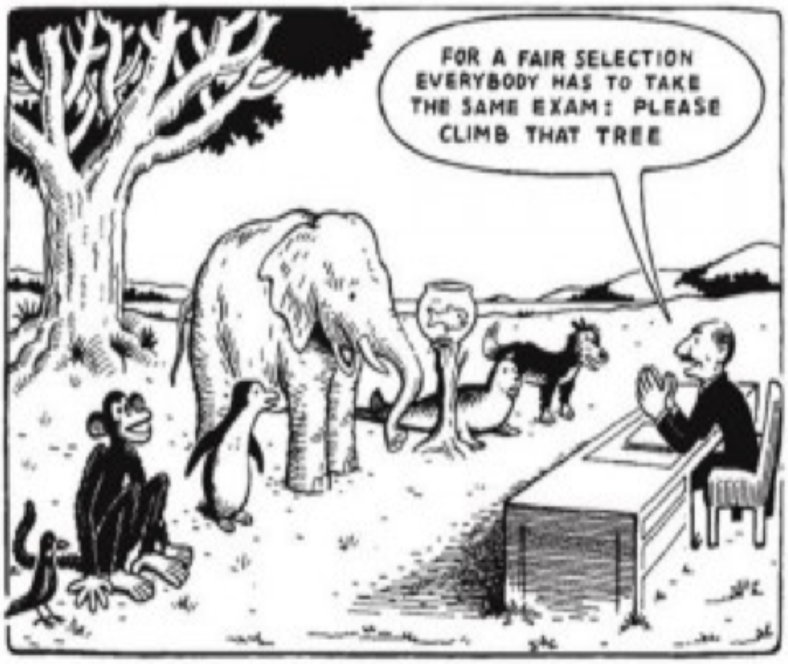
As well as wanting money small business owners typically mention the following, as things they would also like to get from their bankers and banking relationships:

- Continuity of a relationship with the same person rather than seeing different people each time they visit the bank.
- Understanding and appreciation of the pressures that they, as business owners, face in the business on a day to day basis. This relates back to recognising the small business owner's 'life-world'.
- Clear terms and conditions for any financial services, which mean there are no unpleasant surprises for the business owner after they receive financial support from the bank.
- Quick turn-around times to loan requests.
- Quick responses to enquiries in jargon-free language.
- Thorough knowledge of local business networks and access to the banks networks to help the business owner build their own business networks.

Yet so often this doesn't work. Bankers see SMEs as people to simply sell products and services to. In Kenya, as in many other countries, small businesses demonstrate their dissatisfaction by multi banking and spreading their custom (and risk) amongst several banks.

VI. SMEs are not a homogeneous group

So far in this TN we have talked about SMEs and small business owners as a collective term. However, SMEs are by no means a homogeneous group and banks that develop and offer products and services targeted at this group of 'all SMEs' are unlikely to be successful.



To serve SMEs effectively, banks need to identify different segments or subgroups within the overall group of SMEs. Segmentation is a process of breaking the SME market into smaller like pieces, grouping customers with similar or common behaviours, so that they can be better approached and served, with products, staff, and processes that are appropriate for business needs and at appropriate price points.[7]

As Figure 7 shows, groups or segments of SME customers can be differentiated in a variety of ways and how a bank chooses to do this will depend very much on the profile of their existing SME portfolio and which new SME customers they wish to attract.

Gender has often been considered as a means of segmentation. For example it has been well documented, that women face particular gender specific problems accessing appropriate funding and financial advice when setting up and running their own businesses.[8] These problems include issues of credibility when dealing with bankers – especially those with no history of business ownership in their peer groups. Also modes of meeting and venues used by banks are often not appropriate for

7 Miller, M.M. An introduction to segmentation. GrowthCap Financial Sector Deepening Kenya 2015

8 See for example the IFC program' Banking on women' http://www.ifc.org/wps/wcm/connect/9be5a00041346745b077b8df0d0e71af/BOW+FACT+SHEET+NOV+1+2013.pdf?MOD=AJPERES

Figure 7: Ways of segmenting the SME business market

women. Consequently, women potentially miss opportunities for developing their networks as well as doing business. Some banks have recognised these issues and have developed specific products and services for their women business customers. CHASE Bank in Kenya is one such example with their 'CHASE Women' unit, that at the very least markets services directly to women.

In order to undertake any form of segmentation[9] and identify target clients in this way, banks need to understand their existing customers. This involves a review of their existing portfolio to better understand the characteristics of the businesses they serve; but should also involve talking directly with their customers through focus groups[10] or other means of communication such as one to one interviews and surveys. Talking with SME customers about their problems and needs is the only way in which banks can develop customer centric products and services.

9 Miller, M. M. A guide to implementing segmentation. GrowthCap Financial Sector Deepening Kenya. 2015.

10 C Mwazi 'Tools for Developing Focus Group Discussions' GrowthCap Financial Sector Deepening Kenya 2015

IN SUMMARY

There is mutual benefit in banks helping smaller businesses to grow. Many banks are recognising that a gulf in outlook exists between their managers and their small business customers, and are anxious to bridge it. They are encouraging managers to establish relationships with their small business customers so that they can understand their needs better and build a partnership that benefits them both.

It is important for bank managers to develop empathy with their small business customers. The relationship between the business owner and the bank manager should be based on trust, continuity, regular contact, a common language and shared objectives. It is essentially a synergistic relationship, since both parties stand to gain when the relationship succeeds.

To help establish and develop that relationship, it is important for bankers to remember that small businesses are varied and complex exhibiting diverse behaviours, skills and attributes from when they first start up through how they grow and develop. These complexities need to be understood and taken into consideration if banks are to serve such businesses effectively.

So as a banker remember:

I. Recognise that SMEs are not mini corporates.

II. Entrepreneurs can be quite different character types to yourself and this means you can see things quite differently.

III. You live in quite different worlds of work and the norms and practices of these very different cultures can impact negatively on how you communicate with each other

IV. The business owner has expectations of you and your bank that go beyond selling them money.

V. You as a bank are only one of many stakeholders that the business owner has to develop and manage.

VI. Last but not least SMEs are not a homogeneous group- you need to get to know your SME customer and their particular needs.

REFERENCES

Bennett, D and Richardson, P and Nyauncho, E (2015) *Approaches to SME Relationship Management* FSD Kenya 2015

Gibb, A.A. (1987) *'Training Owners and Managers of Small Firms' in 'Small Enterprise Development: Policies and Programmes.'* (edit. by P. A. Neck and R. E. Nelson) Revised Edition ILO, Management Development Series. Chapter 9. No.14. Geneva

Gibb, A.A. (2002) *'In pursuit of a new entrepreneurship paradigm for learning: creative destruction, new values, new ways of doing things and new combinations of knowledge'* International Journal of Management Reviews Vol. 4 No. 3 pp 233- 269 *www.allangibb.com/expertese_culture_and_educ_PUB1.htm*

Growth Cap FSD Kenya (2015) *The Kenyan SME financial Landscape* 2015

Miller, M.M. (2015). *An introduction to segmentation*. Nairobi, Kenya: FSD Kenya August 2015

Miller, Mary M. (2015) *A guide to implementing segmentation.* Nairobi Kenya FSD Kenya. August 2015.

Mwazi, C., Miller, M. and Oyaro, D. (2015) *'Tools for Developing Focus Group Discussions'* Nairobi Kenya FSD Kenya August 2015

Van Swinderen. A. M. (2015) *Market Research for SME Finance* Nairobi Kenya FSD Kenya June 2015

About the authors:

Dinah Bennett is a freelance consultant with extensive international experience of working with SMEs and banks. She is director of www.consult-ice.com and www.wisedevelopment.com; Pat Richardson is also an International consultant, who is the learning and knowledge development adviser to the GrowthCap project (see www.richardsonhowarth.com) and Esther Nyauncho is a full time associate with FSDKenya.

The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.

Government of Kenya

UKaid from the British people

EMBASSY OF SWEDEN Nairobi

BILL & MELINDA GATES foundation

FSD Kenya Financial Sector Deepening

info@fsdkenya.org • www.fsdkenya.org

FSD Kenya is an independent trust established to support the development of inclusive financial markets in Kenya

5th Floor KMA Centre • Junction of Chyulu Road and Mara Road, Upper Hill

P.O. Box 11353, 00100 Nairobi, Kenya,

Tel +254 (20) 2718809, 2718814 • **Cell** +254 (724) 319706, (735) 319706