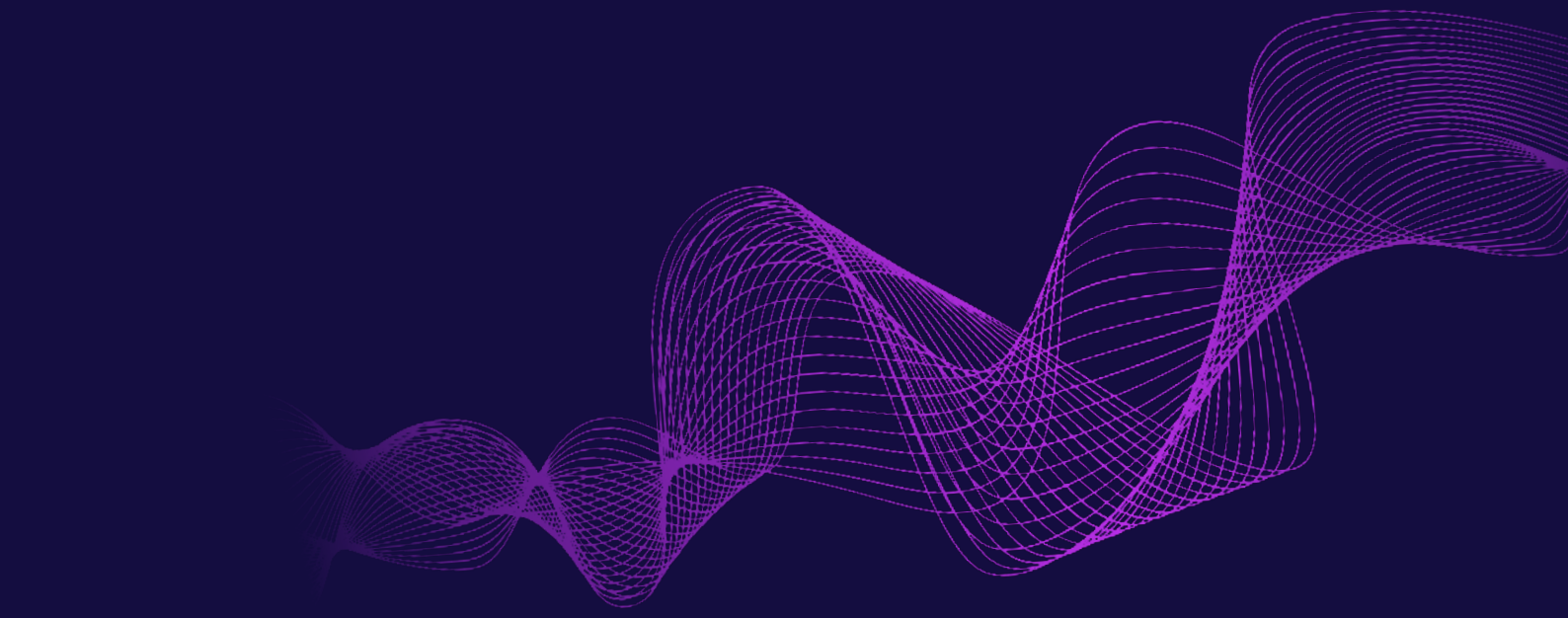
codat

Open for business

The case for a new approach to Open Finance that works for SMBs



Executive summary

Small businesses are consistently a secondary consideration in discussions and debates around Open Banking and Open Finance.

Although small businesses have benefited from Open Banking initiatives in some ways – for example, through automated banking data feeds into accounting platforms – they are not able to capitalize on the immense potential of Open Finance. Largely this is because their central source of financial data is in their accounting and eCommerce platforms, not bank accounts.

Currently, conversations on extending Open Banking into a broader form of Open Finance center around datasets such as pensions and investment, energy, and telecoms. This however, ignores the most vital financial data to small businesses.

It's time to rethink

This manifesto makes the case for a fresh approach to Open Finance that will benefit SMBs and their financial service providers, and in turn fuel economic growth.

The framework for considering which datasets should next be incorporated into Open Finance and Open Data policy must take into consideration the frequency with which the data is shared or moved between systems and the value the sharing process offers.

Under this framework, it is clear that to best benefit small businesses, accounting and sales data should be considered next, versus for example, mortgage, investment, telecoms, or energy data.

Policy design across the globe varies greatly. Australia's approach to open data regulation is broadest in concept, with the most potential to benefit SMBs, but in focusing on energy and telecoms data after banking data, they also stand to overlook the needs of businesses.

"Open Banking regimes to date have focused on consumer needs as default. As the conversation develops to address finance more broadly rather than banking, the needs of these two groups will diverge further and therefore, it's critical that lawmakers consider the distinct requirements for small businesses when designing Open Finance policy."

- Gavin Littlejohn
Chair, FDATA Global

Introduction

SMBs are the lifeblood of the economy, contributing more than 50% of global GDP, and with their number globally increasing by 75% in the last 20 years. Yet they have been historically underserved by financial service offerings and represent just **2% of a bank's balance sheet**. These two statements are widely acknowledged and nothing new.

The same trend is now playing out in relation to Open Finance. To give just one example, **only 35% of current Open Banking offerings in the UK cater to businesses**, despite them being just as willing as consumers to utilize third party solutions, if not more so.

For providers, the opportunity is clear. Even the smallest SMBs have significantly more complex needs than individual consumers. They must calculate and file their own taxes, pay wages, dividends and expenses, as well as manage customers and suppliers, and any industry specific regulation.

63%

Research conducted by Codat found that as many as 63% of small businesses believe the time spent on accounting administration of this nature takes them away from growing their business.

Because of this very complexity, SMBs stand to benefit more than consumers by any initiative to open up financial data. But to do this, their needs must be prioritized in policy making.

This report underlines that this has not been the case to date and puts forward an alternative framework for developing Open Finance in the best interests of SMBs.

Methodology - We have used a combination of publicly available research and private survey findings to substantiate this report. The private survey was carried out by Attest on behalf of Codat in November 2021 and involved a total sample size of 1,200 small businesses (0-500 employees) based in the United States, United Kingdom, and Australia.

What do we mean by Open Banking and Open Finance?

Across the globe, Open Banking has consistently been the first iteration of Open Finance. Open Banking refers specifically to the ability to freely share financial data relating to bank accounts and transactions. Open Finance is a broader term that could relate to open sharing of any financial data. A nascent term, it is yet to be narrowly defined.

The benefits of Open Banking for small businesses

To say that there have been limitations to Open Banking for small businesses does not mean that they have not benefited at all.

Two key areas that businesses have benefited to date:

Automated bank feeds into accounting software

Previously, bank statements had to be uploaded by CSV or manually keyed in daily. The introduction of automated feeds from bank to accounts saves businesses many hours and increases productivity. As this used to be a cumbersome process, it was done much less regularly, and therefore, small businesses lacked up-to-date information and insight on the performance of their business.

This transition to data sharing had already been started by providers before Open Banking came into force, led by platforms like Xero and QuickBooks.

Open Banking has greatly simplified the SMB business case and the implementation process for accounting platforms. The advantages are no longer limited to firms using the leading banks and accounting platforms. Many more businesses globally are benefiting from time savings and a more up-to-date view of their business.

Incremental improvements in accessing finance

The ability to digitally share bank statements as part of a loan application hasn't fundamentally changed the type of data used for decision-making. But with Open Banking, it can provide a lender with a live view across different bank accounts, helping compose a clearer real-time picture of entire finances. This live access can give banks a true understanding of changing financial needs rather than reliance on historical data which captures a single point in time.

For the vast majority of financial products, management account information is needed, which is generated via accounting processes. This data is already available in a business's accounting system.

70%

70% of businesses surveyed by Codat agreed that financial integrations make business operations faster and more efficient.

The limitations of Open Banking for small businesses

Workflow automation

One of the key differences between a consumer and an SMB is that a business has many more processes in place for managing their finances and many more systems to help them do that. In fact, according to **Blissfully's 2020 Annual SaaS Trends report**, the average small business uses 102 different apps.

The accounting system needs to contain all transaction information for the purpose of submitting taxes and therefore has always acted as the central source of information for a business.

Therefore, for a small business, having their accounting system connected with the other tools they use, is of far greater value than their bank account being connected.

21%

In a survey conducted by Codat, 21% more respondents stated that they would not use an application that didn't integrate with their accounting software vs. their bank account.

In addition, the fact that accounting systems like Xero have over 1,000 integrated apps shows there is great demand and potential benefit to small businesses.

Nowhere in the world is this regulated. The opportunity to connect is limited to a handful of the top accounting platforms and red tape, hidden requirements.

Alternative credit scoring

New forms of credit scoring, based on live, up-to-date financial data was one of the areas of promise for Open Banking, but in 2022, the global norm is still for business credit scores to be based on out of date, annual financial reports. For newer businesses, particularly those forming in the aftermath of the pandemic, public records of this kind don't exist which means that they are often unable to access the finance needed for growth.

A credit score is designed to measure how likely a business is to repay debt. Historically, this has been calculated based on the assets and liabilities on a business's balance sheet as well as indicators like the credit history of the Directors and court judgements. The data found in the bank account does not help to assess repayment history given that it is only a reflection of what was paid, not what was due. Nor do bank accounts reveal anything about credit actions taken against Directors.

The easiest way to increase the accuracy and usefulness of business credit scores would be to replace the out-of-date balance sheet information from publicly filed accounts, with the most recent balance sheet found in the business's accounting platform. Beyond this, a much more useful indication of repayment history than Director credit history or bank transactions, is the history of supplier invoice payments. This information is also contained in the business's accounting platform, not the bank account.

Ranking Open Finance data sources by relevance to SMBs

Open Finance is the addition of more sources of financial data to the recognized scope of Open Banking. The key datasets at the forefront of conversation around Open Finance are Mortgage, Investments, Savings, Pensions, Telecoms and Energy data. But what is clear is that open access to any of these datasets will benefit consumers and not SMBs.

Mortgages

For **consumers**, the house purchasing process is famously painful and usually the largest, most significant purchase an individual will make in their lifetime.

Open access to mortgage data would not benefit **small businesses** because the vast majority will only rent premises, if they have premises at all.

Investments

Consumers that invest often tend to invest money in multiple locations. To manage finances effectively it's useful to be able to get a single view of money available.

Small businesses rarely have investments, they tend to invest any excess cash back into the business or take it out of the business as dividends.

Savings

Technically under the remit of Open Banking rather than Open Finance, access to savings data for **consumers** will be a key component of money management applications.

Businesses rarely have separate business accounts, they either invest back into the business or pay out as dividends.

Pensions

For **consumers,** visibility and understanding of pension contributions and how this translates to future pay-outs is critical to financial wellbeing in later life.

For **businesses,** there may be scope for open pension data to simplify workflows around employee benefits, but this is a small fraction of what is needed to meaningfully reduce administrative burden for SMBs.

Energy and telecoms

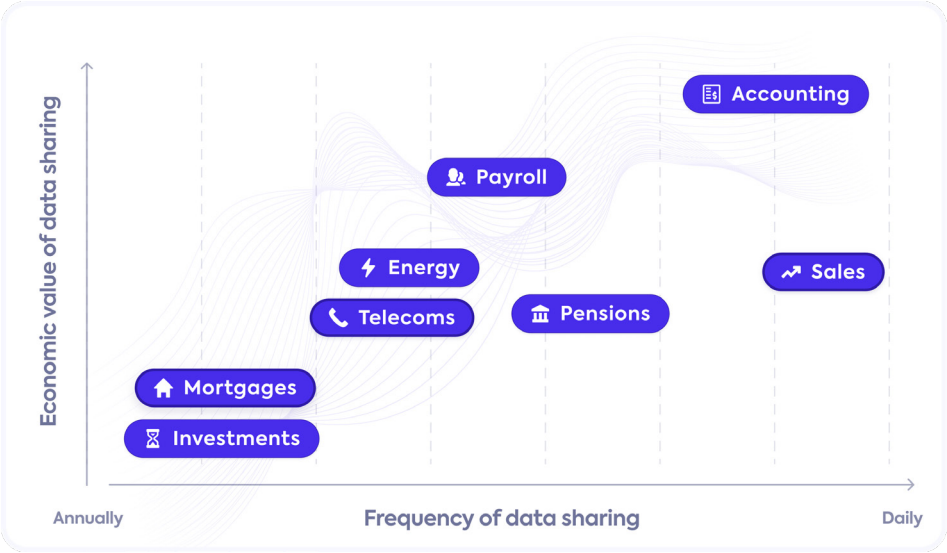
Where consumers have a lack of credit history, data from energy and telecoms providers is useful evidence of good payment behavior to prove creditworthiness.

Access to telecoms and energy data could be marginally useful to businesses, for example to automating reconciliation and payment of bills, but this is a very small piece of the overall administrative burden.

Accounting and sales

Accounting and sales data have not yet been discussed as part of Open Finance policy as these platforms are not used by consumers.

Businesses stand to benefit considerably from the inclusion of accounting and sales data in Open Finance policy. For example, this would enable them to automate bookkeeping processes and gain improved access to financial services. This is further explored in the example on page 12.



chartered developments

The reality for small businesses

Case study: Chartered Developments

Ruth Jones, CEO of UK-based telemarketing firm, Chartered Developments, knows first-hand what it takes to run a successful small business. Since setting up shop in 1997, the business has continually evolved, starting out as an accountancy firm before transitioning into a lead generation and business development organization for professional services. Today, Chartered Developments comprises 25 team members, with clients including legal practices, asset managers, venture capital firms, and high street banks.

As a seasoned CEO, Ruth is all too familiar with the many challenges and distractions business owners must contend with. She identifies staff planning and invoice preparation as particularly time-consuming and resource intensive tasks.

"Effectively allocating staff to clients and accurately recording that time is incredibly important to ensuring we're paid correctly, as this information forms the basis of our invoices."

- Ruth Jones
CEO, Chartered Developments

"Effectively allocating staff to clients and accurately recording that time is incredibly important to ensuring we're paid correctly, as this information forms the basis of our invoices."

"The entire process is a real headache. Our client services team is responsible for invoice preparation. They spend a minimum of one day every month compiling data from disparate sources just so we are able to invoice our clients. This distracts them away from growing their accounts."

The wider team also spends about four days every month working on financial models using Excel. Ruth agrees that using a tool that incorporates information straight from her accounting software would make the task simpler.

"Had I been presented with the option to securely connect my accounting system I would have definitely done so. I would've felt confident that the bank had thoroughly tested the service and would be happy to place my trust in the process."

- Ruth Jones
CEO, Chartered Developments

Some years ago, the firm applied for an overdraft from an incumbent bank to cover the cost of IT equipment. Ruth recalls an "excessive amount of information" being requested in order to process the application, including detailed company accounts which she had to manually compile. Had the bank used a secure API connection to the business's QuickBooks Online account, this process could have been fast, frictionless, and pain-free for both parties.

Unfortunately, it took well over a month for Chartered Development's overdraft application to be approved, something that Ruth identified as "ridiculous because the funds were required to meet a short-term need meaning the moment had almost gone by the time we received the money".

"If I'd been presented with the option to securely connect my accounting system, I would have definitely done so. I would've felt confident that the bank had thoroughly tested the service and would be happy to place my trust in the process."

An alternative approach to Open Finance that works for SMBs

The benefit of fit for purpose Open Finance for SMBs is evident. But if many SMB financial platforms already have open APIs, why is regulation necessary? The reality is that open doesn't always mean open. Significant costs, restrictions around use cases, and other forms of red tape are widespread and are preventing providers from developing innovative solutions that would benefit SMBs. Regulation would also help to level the playing field, ensuring that it's not just the small businesses using the top financial software that benefit from Open Finance.

Focusing on the right data

The next datasets to be included and begin to be regulated under Open Finance should go beyond consumer applicability and be decided based on two factors:

1. The economic value of sharing a piece of data – the money gained or saved, and time saved
2. The frequency with which the data is shared

Let's compare two examples – the opening up of accounting data and telecoms data.

Accounting data

There are two broad use cases starting to gain traction.

1. Boosting internal efficiency: Sharing accounting data between other internal tools – for example, tax filing systems, forecasting applications, and payroll software.

   With a typical small business using 100+ applications and the workflows of many of these being intertwined with accounting and bookkeeping processes, there are huge efficiency gains to be made.

   Rekeying or uploading transactions manually can take many hours and the data needs to be shared with high frequency, usually multiple times every day.

2. Accessing improved financial services: Sharing data with third-party providers, for example, to apply for finance or insurance.

   Applying for finance is a much less regular occurrence, perhaps once a year at most, but the value of sharing the data on an individual occasion is far greater.

   If richer, more accurate data via the digital sharing process makes the difference between approval and rejection, the data sharing process, in the most extreme case, could prevent a business from folding.

Both of these use cases, therefore, carry significant value to a business.

Telecoms data

This data is not accessed widely and no existing applications enable businesses to digitally share this data.

In theory, there could be three use cases:

1. To automatically reconcile bills.
2. To switch providers more easily and explore cheaper options.
3. To evidence good payment behavior when applying for credit.

However, telecoms bills are monthly at most and only a very small proportion of the total bills that a business must reconcile. Therefore, the time that a business could save through doing this, and therefore the potential value of the sharing process, is marginal.

Equally, in the context of business spending, as opposed to personal finances, the cost savings through switching telecoms providers are small and it's an infrequent process – perhaps once every two years.

Finally, because telecoms bills are a small fraction of total expenditure of businesses, it is not a very powerful marker of payment behavior. Since the vast majority of invoices for businesses have 30-day payments or longer, accessing payment history of invoices found in the accounting system would be a much more valuable indicator of willingness to repay credit.

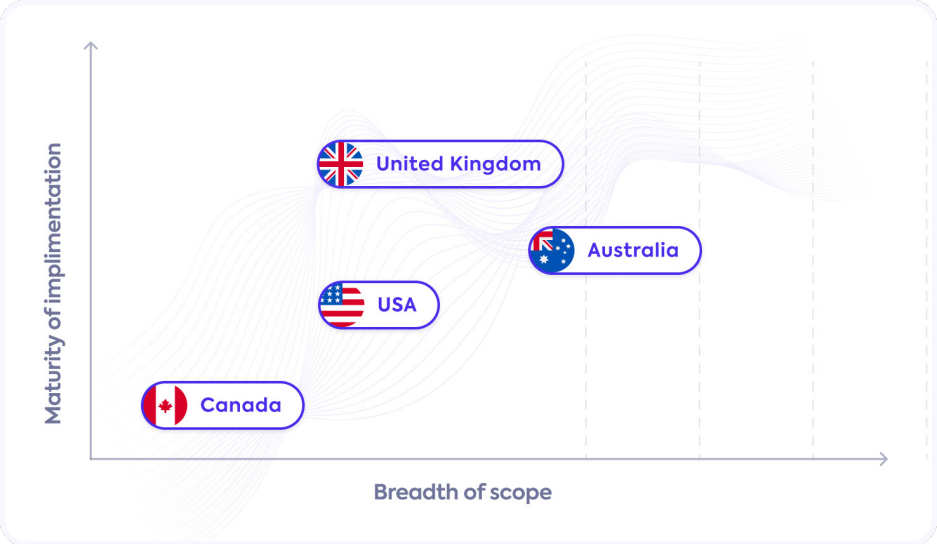
This leads to the conclusion that while for consumers, everything from telecoms to pensions to mortgage data could be a valuable extension for Open Banking, for businesses, sales and accounting data should be considered the priority.

Evaluating regional progress toward Open Finance

Policy design across the globe varies greatly, mainly over four parameters: breadth of datasets and institutions included; depth of data types within a particular data source; single versus bi-directional data flow; and timelines for policy introduction.

Regions are at different stages in their evolution of Open Banking and Open Finance, but none yet recognize the needs of SMBs and the associated economic growth opportunity.

Regional progress toward Open Finance



The graph above illustrates the maturity of open finance policy in four key regions; the USA, Canada, UK and Australia.

Region	Timing	Scope
UK & EU	• PSD2 introduced January 2018. • Initial deadline for public access set as September 2019 and later moved to December 2020.	• Only largest 9 banks (CMA9) included • Read and write access to banking data included in scope. • As of December 2020, UK has issued 200 third party provider licences, vs 40 in France and Germany.
Australia	• Consumer Data Right (CDR) came into force in July 2020. • 1st July 2021 set as deadline for compliance, with recent 6 month extension agreed.	• Concept of CDR applies broadly to data across finance, energy and telecoms sectors, but banking data is the first to be implemented. • Scope of data wider than Europe, including personal accounts, mortgage accounts, business finance, scheduled payments and more.
USA	• There is no regulatory framework for Open Banking in the US currently although adoption is advanced. • Fragmented nature of banking industry (more than 4,000 commercial banks) and state-based regulation make legislating difficult. • President Biden has recently encouraged law-making in this area via an Executive Order.	• There has been a market driven approach to Open Banking. **30% of the US population** use applications that combine financial data from more than one source. • Industry body, the Financial Data Exchange, has created a universal standard for banking APIs, but screen scraping is still prevalent.
Canada	• Initial phase of Open Banking is set to commence in January 2023. • Market driven approach, similar to the US, means that 4 million Canadians are already accessing budgeting and account aggregation tools via screen scraping.	• Initial scope is limited to read-only activities and excludes derived data. • All federally regulated banks are included. Provincial credit unions have the option to join.

Conclusion

As it stands, plans for Open Finance are not being made with small businesses in mind. In the UK and Europe, with some of the most mature regulation, the approach to date has been narrow. Conversations on Open Finance are either still in the realm of Open Banking – such as savings accounts – or are not relevant to businesses – for example, with mortgages.

Conceptually, Australia's broader approach to Open Data – rather than strictly Open Banking – is beneficial for small businesses. However, in choosing the next iterations of Open Data to be telecoms and energy, they have chosen two categories that do not stand to benefit businesses. They can go further.

The United States and Canada's approach to regulation in this space is still in its infancy, and yet to be clear. They, in particular, have a real window of opportunity to act now to improve on the approach of others.

Recommendations for improved frameworks

1. The needs of small businesses and consumers will diverge further when it comes to Open Finance than Open Banking. When the Competition & Markets Authority in the UK, the CFPB in the United States and other regulatory bodies address and consult on Open Finance, small business needs should receive separate consideration.
2. The next data sources for Open Finance should be prioritized based on the economic value and frequency of the data sharing process.
3. Unquestionably for businesses, accounting data should be next.

About Codat

Codat is the universal API for small business data. The real-time connectivity that we provide enables software providers and financial institutions to build integrated products for their small business customers.

Our clients range from lenders to corporate card providers and business forecasting tools and use cases include automatic reconciliation, business dashboarding, and loan decisioning. Codat was founded in 2017 and we have offices in London, New York, San Francisco, and Sydney.

We have raised over $60M to date from investors including Tiger Global, PayPal Ventures, Index Ventures, and American Express Ventures.

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