Banks miss US$100m yearly by failing to tap into wealth, SME lending segments

Wealth management and SME lending have pent-up demand in underserved markets, argued McKinsey.

Whilst Asia-Pacific banking could appear to be strong and growing, closer scrutiny reveals that tapering growth is the most obvious sign of a weakening environment for Asia-Pacific banking. Notably, in 2018, Asia Pacific banking generated revenues of approximately US$1.6tr. The region’s profits (before taxes) topped US$700bn in 2018, representing 37% of global banking profit pools.

However, whilst the region’s banks enjoyed double-digit annual growth from 2010 to 2014, from 2014 to 2018, annual revenue growth shrunk 5%, and growth in profit pools slowed down to 3%.

Whilst there was a slight recovery in banking profit pools in certain markets from 2017 to 2018, the longer trend of slowing GDP growth in China and India, Asia Pacific’s two largest emerging economies, has weakened economic expansion for the entire region and dampened demand for banking services.

The average risk cost provision for the Asia-Pacific market was approximately 0.30% in 2018. This is the highest level of loan losses for the region since 2002, when the average risk cost provision for emerging and developed Asia-Pacific markets hit approximately 0.31%.

With new competitors entering the field even as growth is slowing, banks must act promptly to capture the US$100bn annual opportunity for new revenue. This opportunity is spread across four business lines—wealth management, retail lending, SME lending, and transaction banking—each buoyed by pent-up demand in underserved markets.

To win in wealth management, banks need to strike the right balance between self-guided digital tools and high-touch consultation, according to the distinct needs of each segment.

Personal financial assets (PFA) in Asia Pacific are expected to total US$69tr by 2025. Growth in the region’s PFA is driven primarily by the increase in retirement assets in developed markets (as the population ages) and the expansion of the entrepreneurial class (especially mass affluent and high-net-worth segments) in emerging markets.

Wealth management opportunities
At the current annual growth rate of 9%, Asia Pacific will account for three-quarters of global PFA within six years. At present, however, this is a largely untapped market—an estimated 80% of Asia Pacific’s

US$100bn of revenue can be unlocked via wealth management, retail lending, SME lending, and transaction banking.
SMEs contribute 54% of GDP in Asia but generate only 25% of total banking revenues before risk costs.

The automated review is completed within minutes, and customers can access funds immediately upon approval. Third parties provide additional services by linking to the platform through APIs, helping to increase activity on the platform. In 2018, CMB’s NPL ratio was 1.36%, compared to an average of 1.8% for China.

Banks can tailor platform solutions for SMEs and use them both to acquire new customers and deepen existing relationships. CBAs Wise, for example, is a cloud-based business management platform designed especially for SMEs. Services on the platform, which integrates seamlessly with CBAs invoicing platform, include accounting, payroll and banking.
human resources, and inventory management.

In addition to helping banks reduce loan losses among SMEs, the vast and diverse types of customer data generated on an SME platform can enable banks to craft timely offers for investing excess cash, payroll management, accounting and reconciliation processes, etc.

**Growth in transaction banking**

Not only does transaction banking account for approximately a third of all banking revenues in the Asia Pacific, but the region also captures more than half of transaction banking revenues globally. During a decade of lacklustre growth in other regions (5% in the Americas and 2% in EMEA), transaction banking in Asia Pacific has grown 17% annually.

Finally, supply chain finance (SCF), which is expected to grow 14% annually, not only enables a bank to embed use cases within corporate treasury and trade operations, but also to strengthen relationships with corporate clients’ suppliers, many of which are SMEs. There are various initiatives to establish SCF platforms using distributed ledger technology. These include IBM’s partnerships with logistics and shipping companies, as well as government-led industry consortia, such as the Global Trade Connectivity Network, led jointly by the Monetary Authorities in Hong Kong and Singapore.

**Industry consolidation incoming?**

Given the competitive advantages that come with scale and being fast to market, some banks are finding that mergers and acquisitions—along with strategic partnerships—are an efficient way to enhance their customer propositions.

Findings show that 79% of leading banks have partnered with a fintech to foster innovation in payments, lending, investment, or other areas. Thailand’s Kasikornbank and Grab have teamed up to launch GrabPay by KBank, a mobile wallet. BRI has partnered with Alipay to expand point-of-sale acceptance of mobile payments for Chinese tourists visiting Indonesia.

OCBC Bank has joined forces with personal finance portal MoneySmart to offer low-rate mortgages. UOB has partnered with OurCrowd, which enables consumers to invest small amounts in startups. Acting as an orchestrator or as one of several lead partners, a bank may establish a platform or digital ecosystem, developing APIs that enable third parties to link to the platform and introduce relevant services.

Banks should also improve the way they develop and deliver solutions by implementing the latest DevOps tools and methods across the development pipeline, which can speed up time-to-market by 80%, reduce time spent on diagnostics by 75%, and cut FTE by 75%.

**Amping up competitiveness**

A special push is required to go the last mile and embed analytics in the everyday work of tens of thousands of employees. Breakaway analytics firms generally devote at least 50% of analytics investments to developing visualisation tools and training frontline staff, product managers, and others on the use of analytics insights in customer interactions.

Moreover, 50% of banking jobs could see half of their activities automated by 2030. Investing in leaders is another critical element in building the workforce for a digital-first, data-driven organisation.

Top digital talent is scarce, and companies from all industries are competing to fill fast-growing needs. Demand for digital capabilities is estimated to outstrip supply by a factor of four, and demand for big data talent is expected to be between 50 and 60% greater than the projected supply over the next three to five years.
How banks in Asia-Pacific can survive in an age of declining profitability

Cutting down branches and migrating banking services to online and mobile channels are key to keeping costs down.

There was no way it could have lasted forever. After enjoying double-digit annual revenue growth from 2010-2014, banks in Asia-Pacific are starting to witness tapering growth trends with annual revenue growth slowing to 5% in 2014-2018 and growth in profit pools easing to 3% over the same period, according to McKinsey’s annual banking review.

The average return on equity for Asia-Pacific fell from 12.4% in 2010 to 10.1% in 2018, signalling what some argue to be the end to the Asian miracle, although the region’s profitability still ranks above the global average of 9.5%. The negative trend can be observed across developed and emerging markets in the region with only lenders in Singapore, South Korea and Vietnam turning the tide and posting improved ROAEs in 2014-2018.

In an interview with Asian Banking & Finance, Joydeep Sengupta, Asia-Pacific banking practice leader at McKinsey and one of the primary authors of the report highlights best practices for banks in the region to survive the fintech threat as well as the four growth areas that banks can embrace to shift the narrative in their favour.

The conversation has been shifting towards cost efficiency and brand rationalisation with Japanese banks shutting down branch after another and Chinese ATMs gathering dust amidst the popularity of AliPay and WeChat. How do you see this trend developing?

If you look at a return on equity, and the pressure on return, this has come largely from declining margins across most product categories virtually across all markets. The other factor has been deteriorating risk environment, where the risk costs have systematically gone up across many markets.

Even though we’ve seen a lot of effort made by banks that have been in part successful in containing costs, in aggregate, the cost efficiency gains have not been sufficient to overcome the declining margins and the increasing risk costs - which is why we’ve seen this kind of decline.

Although the situation for Asia is fragmented, what’s their regulatory situation like and how do they weigh in on earnings outlook for banks across the region?

By and large, regulators have been largely very progressive, meaning there is a lot of encouragement for innovation. You’ve seen a lot of regulatory interfaces, open banking, changes in payment systems and the creation of regulatory sandboxes. At the same time, we are also seeing regulators beginning to worry about systemic risk given the world that these players are creating and the disruption they bring. They’re worried about data privacy and cyber security. The regulatory environment, whilst being progressive, will see more debate on how to ensure that institutions are allowed to provide the best deal for the customer whilst making sure that the system itself is stable. That is the fine line which many regulators are beginning to walk.

Fintech and bigtech have proven their merit in targeted areas although they have yet to fully capture the full-lending cycle. How do you see this landscape developing, especially when the conversation is shifting towards competition and cooperation?

Fintechs and bigtechs have had a profound impact on the market and the consumers. They have very strong analytical tools and capabilities and use data more intelligently and pro fusely in their lending models than many of the banks.

As a consequence, they have been driving digital lending into retail and the small business segment, but at the same time, putting a tremendous amount of pressure on bank margins, because their cost of acquisition is much lower than traditional banking models.

However, the quality of the loans need to be tested through a down cycle. Unlike the traditional banking model, which has gone through many up and down cycles over decades, I think this is a relatively new phenomenon that hasn’t been tested in an economic down cycle. We’re not saying that they won’t hold true or they won’t be solid but to confidently declare victory of fintechs, they need to be tested through a down cycle. From a banking point of view, their ability to claim a segment will depend a bit on the partnerships with fintechs, bigtechs, or other ecosystem players with whom it can access customers, and information at a much lower cost. We will certainly see some element of coexistence between the two.

Do you believe bank branches will remain relevant?

If you go back historically, the role of the branches, to a large extent had been threefold. One is really acquiring customers, a second is enabling and helping the transactions that customers do and a third is offering advice and cross selling other products.

What’s happening with the whole digital plays is that a large part of the transaction business is disappearing. Most banks are seeing a sharp drop in transaction volume happening at their branches so many banks are trying to find a way of moving the transactions out to a call centre, to digital channels or even to the ATM. For many banks, today, 95-98% of transactions are done outside of branches.

In more mature markets, banks are also reorienting branches to focus on customer acquisition since there aren’t that many new customers to acquire but are shifting towards advisory. This means that the look and role of the branch is shifting from an acquisition and a transaction point to advisory point. The role of the branches are changing and the kind of people that need those branches also change. That’s the dynamic which we will see happen, as opposed to just a blind a shot at cutting the branches.