

CHAPTER 3

BANKING INDUSTRY: THE EXPECTED TRENDS AND FORCES AT WORK

3.1 Outlook for Banking Industry in Asia

McKinsey & Company, in its book *Banking in Asia: Acquiring a profit mindset* opined that the banking markets of Asia contain some of the greatest opportunities in the world.

The firm, in its analysis, estimated that revenues from personal financial services in Asia will grow to US\$390 billion by 2010, an increase by about 84% from 2001 as depicted in Table 3.1 below:

Table 3.1

Total Personal Financial Services revenues (US\$ billion) in Asia

	2001	2005	2010
Southeast Asia & India	16.96	42.9	152.9
Greater China & Korea	63.6	132.6	108.5
Japan	131.44	214.5	63.2
Total	212.0	390.0	84.0

Note : e – estimates

Source : McKinsey analysis

Southeast Asia and India is expected to contribute about 11% of the total revenues from personal financial services in Asia by 2010 as depicted in the following table.

Table 3.2
Market share of Personal Financial Services in Asia (%)

Southeast Asia & India	8.0	11.0	3.0
Greater China & Korea	30.0	34.0	4.0
Japan	62.0	55.0	-7.0
Total	100.0	100.0	

Note : e – estimates

Source : McKinsey analysis

The following are forces that will drive the future demand for retail banking in Asia:

i) Emergence of modern Asian consumer

There is a noticeable trend that Asian consumers who are relatively young are more open to living on consumption credit compared to their previous generation. This is reflected in the rise of credit card receivables that has tripled from 1995 to 2001. McKinsey estimates that by 2010, unsecured consumer credit balances in Asia shall grow to about US\$5 Trillion, more than double the 2001 level.

ii) Aging Asian population

In about 2 decades, Asia, with its relatively young current population will see a shift in its overall population age. By 2020, 12% of Asian will be 65 years old or over, compared to 7% in 2001. This brings about the concern for post retirement needs, leading to the needs for personal investment and protection banking products.

iii) Growing concentration of wealth

There is a wide disparity of income within economies across Asia. In many of these economies, the gap is growing, resulting in emergence of a narrow segment of affluent consumers. This leads towards the need for wealth management and private banking services across Asia.

iv) Doubling of bankable market.

Over the years, overall income levels across Asia have risen and will continue to rise beyond the US\$1,000 per annum mark. In 2001, it was estimated that there are about 300 million bank account holders in Asia. The number is expected to double by 2010, thus effectively doubling the 'bankable' population in the region.

The challenge lies in the way banks deliver and manage their services to the mass market that in general comprises customers with low account balances. In order to make money in the mass banking market, banks need to adopt business models that can ensure maximum customers reach through the least cost possible means i.e. moving away from the traditional branch approach to ATMs, phone banking and internet banking services.

v) Asians fascination with technology

Asian's love for ICT gadgets could be an opportunity for forward thinking banks to grow their business. This calls for banks to find ways to leverage on technological advancement to deliver convenience as the unique selling propositions to the public at large.

ICT, besides attracting customers, could also helps reduce the banks overall operational cost as banks move from traditional brick and mortar branch banking to electronic/internet based banking services. The following are the cost comparison per banking transaction with various means¹:

Table 3.3

Comparison of banking transaction cost

Over-the-counter	1.07
ATMs (self-service machines)	0.55
Telephone	0.27
Internet (web-based)	0.10

¹ 'Service Quality Evaluation of Internet Banking In Malaysia'. Shanmugam, Bala, <http://www.arraydev.com/commerce/JIBC/0306-06.htm>

3.2 Trends in Banking Worldwide

The following are trends evident in the banking industries across the globe:

Borderless banking: Banking business will be characterized by borderless banking with global sourcing and funding operations taking place through electronic channels. Attaining efficiency in a borderless banking environment calls for strengthening the risk management systems and ensuring efficient return on capital by bringing down transaction cost of banking operations.

Faceless banking: Human interface is going to be minimal as most routine and less-decision-involved transactions are handled through machines or internet.

Stress-free banking: Technological innovations will take care most of the labor of manual banking operations, resulting in stress-free banking.

Tireless banking: In response to the fiercely competitive environment, the focus of banks staffing pattern will shift from back office/ administration office activities to marketing and sales activities. What the banks will be requiring in future is a team of marketing people, relationship managers or sales managers, etc.

Timeless banking: Concept of business hours will no longer hold. Banking transactions will be carried out 24 hours a day, 365 days a year.

Self-service banking: Customers could use ATMs, customer-activated service terminals or the internet via mobile phones, PDAs or other communication devices for banking transactions, information retrieval and funds transfer instructions.

Paperless banking: Development of technology-specific banking products and services, storage and retrieval of bank records/ information through digitized images, etc will lead to paperless banking. Usage of stored-value debit cards in daily transactions will further lead towards cashless economies across Asia.

Branchless banking: Opening branches at metro/ urban centres will be costly. Hence, banks need to develop alternative low-cost channels for cost-effective operations at these centres.

Bank-less banking: Entry of non-traditional, non-banking financial institutions offering the same type of banking products/ services will lead to emergence of financial supermarkets.

Deregulation: With the changing trends, weaker banks will find existence difficult and bankruptcy in banking will become the order of the day. More rigid credit rating of banks will, therefore, become the need of tomorrow.

Business Process Outsourcing (BPO): In the quest to improve the bottom-line, banks will be looking at BPO as the means to achieving their objectives. While outsourcing of back office functions such as IT support, Accounting & Finance and

Human Resources are slowly becoming the norms among multinational banks such as HSBC and Citibank, banks may need to embark on front-end BPO such as loan origination which is becoming popular in advanced countries like the USA.

3.3 Critical Challenges Facing Banks in Asia

The changing demands of consumers, coupled with the changes in the way banking is carried throughout the world bring about a myriad of challenges that need to be recognized and strategically dealt with by all banks to ensure their continued survival. The following are the critical challenges:

i) Globalization

Globalization has brought about liberalization of domestic banking industry in countries across the globe. This has resulted in the need for domestic banks to be more competitive in order to compete with new entrants especially the established international foreign banks.

ii) Pace of ICT development

Computerization and telecommunication have tremendously changed the way banking business is done. Banking is done through other means besides the traditional over-the-counter branch banking. Banking business is no longer confined by geographical/political zone. Neither is it limited by time. As a result, banks have

embarked on branch reconfiguration efforts to constantly explore alternative means for reaching out to customers including electronic channel development, in line with rapid changes in the ICT industry.

iii) Customer supremacy

Banking industry has changed from a seller's market to being a buyer's market. In this information age, whereby information on banking products and services and its prices globally are readily available on-line at all times; customers can shop around and switch from one bank to another at ease. This calls for the need for banks to have effective and efficient customer information management/customer relationship management system that supports new product development, niche market creation, as well as sales and marketing efforts.

iv) Human resource development

In keeping-up with the increased competition in the industry, banks need to invest in human capital that ensures a pool of skilled human resource that is not only well versed in banking practice but also being marketing and sales oriented, as well IT savvy.

v) Profitability

All the afore-mentioned investments in technology and human capital in response to the increased competition brought about by globalisation and customer supremacy put pressure on profitability of banks. In order to ensure continued survival, banks need to have effective and efficient cost management strategy that covers all aspects of their operations.

In short, banks worldwide are facing two critical challenges i.e to become more marketing oriented and at the same time to be cost effective. This calls for banks to strike a balance between 'high touch' and 'high tech' in their quest to achieve their desired bottom-line.

3.4 Change imperatives for Asian banks.

The tasks before banks in Asia to achieve global competitiveness are:

- i) Developing focused customer orientation (redesigning branches, reengineering business processes and building better information systems).
- ii) Coordinating a wider and more fragmented set of channels and products.
- iii) Developing an efficient and fast payment system.
- iv) Massive investments in technology and human resource development.
- v) Bringing about attitudinal reorientation and establishing suitable systems and procedures.

- vi) Competitive pricing.
- vii) Organizational preparedness for faster pace of change and quick response to market signals.

3.5 The Malaysian Banking Industry

3.5.1 Overview.

There are currently altogether 10 commercial banks, local & foreign-based operating with dual system – conventional banking & Islamic banking in Malaysia. This includes 2 full-fledged Islamic banks namely Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad (BMMB).

Despite being governed by different legislation namely the Banking And Finance Institution Act (BAFIA) for conventional banks and Islamic Banking Act (IBA) for full-fledged Islamic banks, all banks are fighting for the same consumer base as Islamic banking is seen as an alternative to conventional banking.

The following Table 3.4 depicts the size of assets and deposits within the Malaysian Banking industry according to category of financial institutions:

Table 3.4

Assets and deposits of Financial Institutions in Malaysia

Commercial banks	29,109	36,824
Finance companies	12,623	17,875
Merchant banks	1,430	1,716
Islamic banks	20,160	20,955
Discount houses	4,748	4,826
TOTAL ASSET	68,070	82,196

Commercial banks	23,476	26,519
Finance companies	9,094	10,965
Merchant banks	684	852
Islamic banks	16,421	17,854
Discount houses	3,631	4,292
TOTAL LIABILITIES	53,306	60,482

Islamic banking

Islamic banking in Malaysia has registered very strong growth since its inception in 1983. Over the last 5 years, Islamic banking has been growing at a rate of 30% per annum. As at June 2004, it grew by 23% over the past one year and is expected to retain the same growth momentum in 2005. The following Table 3.5 depicts the position of Islamic banking system compared to the total banking industry as at end June 2004:

Table 3.5

Islamic banking system's share of the total Malaysian banking industry

Total asset	9.90%
Total financing	11.00%
Total deposit	10.40%

Based on its track record, the Government has expressed confidence that the Islamic banking sector will constitute 20% of the entire banking sector by 2010. It is estimated that by 2010, Islamic financing and deposit markets will grow to approximately RM153.5 billion and RM157.1 billion respectively.

In 2004, the Government has further liberalized the Islamic banking sector by issuing 5 new Islamic banking licenses including to 3 foreign players in order to drive the growth of the Islamic banking sector.

Change imperatives

Changes in the competitive landscape will compel all players (conventional banks as well as Islamic Banks) to become more customer-oriented, efficient and market-driven, and to revise their cost structures as well as to be innovative in order to differentiate them.

Furthermore, in their quest to becoming competitive, banks are expected to be technology driven, not only to meet the demand of more technology savvy customers but also to expand their reach by delivering convenience to customers through non-branch delivery means.

3.5.2 Malaysian Retail Banking Customer Profiles

An independent study on the Malaysian retail banking customers between March 2003 and May 2004 commissioned by the Bank Negara Malaysia (BNM) revealed the following:

Overview

- i) Penetration of banking services is high among Malaysian between 18 to 64 years old i.e 98% has at least a saving/current account.

- ii) Large proportion (65%) of the retail banking customers has a single banking relationship in the form of savings/current account only.
- iii) 25% has either a housing/car loan.
- iv) Penetration of other products is very low.
- v) There is higher incidence of multiple product ownership for customers above the age of 25 years old and for those with monthly household income of RM2,000.

Service quality

- i) Customers place great importance on the quality of interface with banking staff. This includes competency of staff in terms of knowledge and ability to give sound advice and personalized service.
- ii) Turnaround time for services i.e queuing time and loan approval time is of paramount importance that influences customers' choice of banking service provider.

Product

- i) Customers prefer banks that offer a range of innovative product and services.
- ii) Customers value ease of obtaining clear and easy to understand information on products and services offered by banks.
- iii) Customers prefer banks that offer products and services with more flexible terms and conditions that suit their (the customers') needs.

Delivery channels

- i) Ease of access to banks touch points such as branches and ATMs ranked high in the customers' preference list.
- ii) Use of remote banking such as phone banking and internet banking are gaining popularity. However, customers place the following factors high in their wish list in using remote banking services:
 - Security
 - Reliability
 - User-friendliness
 - Capability to handle a wide range of services

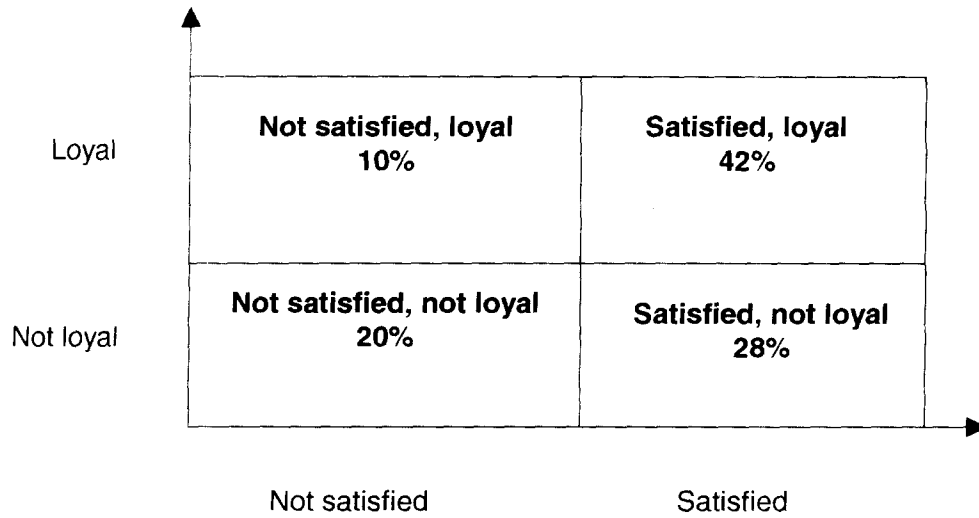
Loyalty

- i) On a whole, 70% of customers are satisfied with services provided by their banks.
- ii) 48% of customers are non-loyal (inclusive of 20% of the customers whom are satisfied with services provided by their banks) indicating a weak relationship between banks and customers and high mobility of Malaysian retail banking customers.
- iii) Incidence of loyalty is more prominent with Islamic banking customers compared to conventional banks' customers.

Loyalty of customers is reflected in the following Figure 3.1 and Figure 3.2:

Figure 3.1

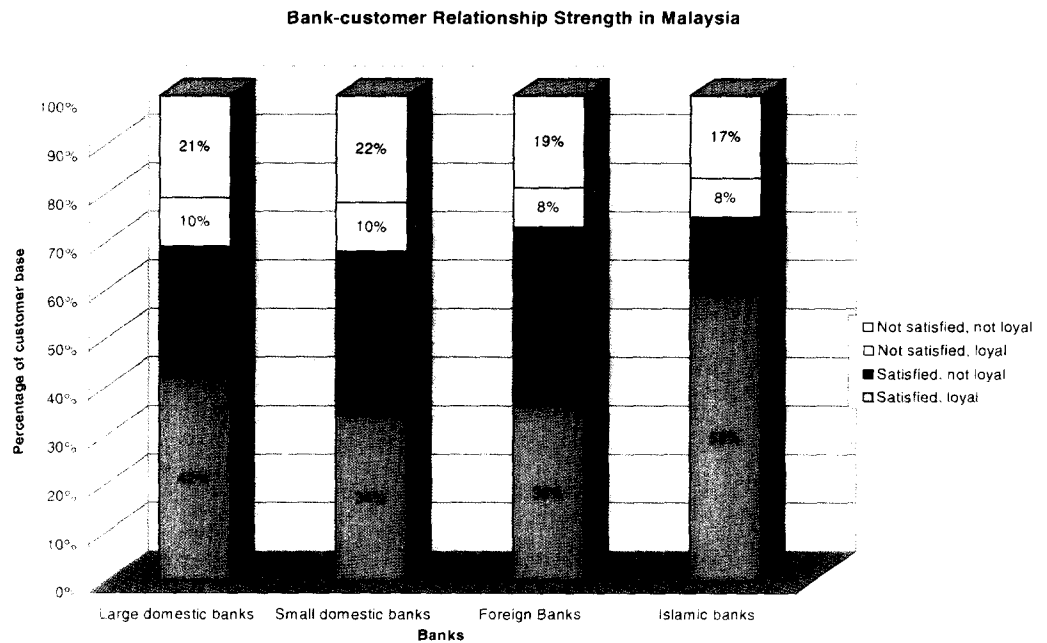
Banking relationship strength in Malaysia (Overall banking industry)



Source: Bank Negara Malaysia

Figure 3.2

Bank-customer Relationship Strength in Malaysia



From the Bank Negara survey, it can be inferred that customers' choice of banks (assuming that the products features and pricing suits the customers' needs) are driven by 2 factors namely:

- i) Convenience i.e. factors that include:
 - Ease of access to delivery channel either through branch, ATM or telephone or internet
 - Quality of interface with banks' staff friendliness
 - Quick turnaround/processing time

Convenience, whilst being a pre-requisite of customers' satisfaction may not necessarily lead to loyalty. This is evident in the case of foreign banks in Malaysia (which are known to deliver customer convenience) that command a 73% customer satisfaction but about 50% of their satisfied customers are not loyal.

- ii) Conviction (shared value)

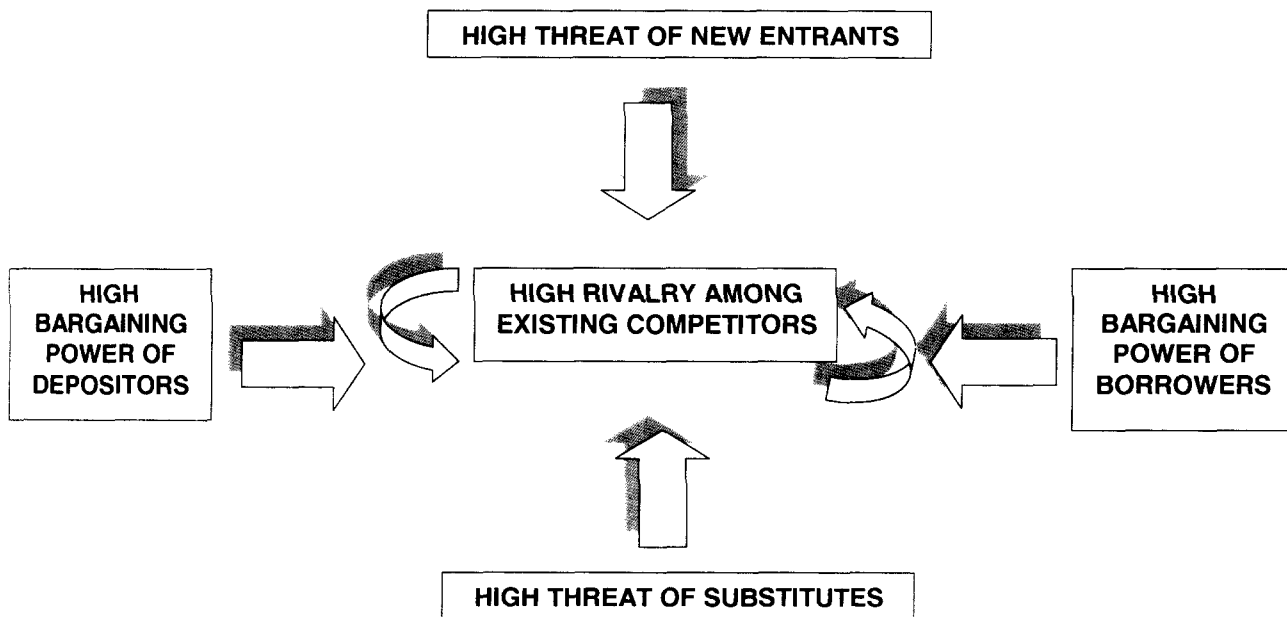
Compared to convenience, conviction is more likely to bring about loyalty. This is reflected in the high customer loyalty commanded by Islamic banks (compared to conventional banks), which is likely to be driven by religious belief eg interest-free principle.

3.5.3 Malaysian Banking Industry Competitiveness.

The Malaysian banking industry is very highly competitive. This is evident in these following Porter's 5 Forces Model of the Malaysian commercial banking industry that depicts the prevalent 'High' strengths of all 5 forces that suppress the profit potential within the industry.

Figure 3.3

Porter's 5 Forces Model of the Malaysian Commercial Banking Industry



Rivalry among existing competitors within the Malaysian banking industry is high as conventional & Islamic banks fight over the same customer base. The level of competition is expected to intensify further following the Bank Negara Malaysia's move to further liberalize the industry through issuance of new Islamic banking

licenses in 2004 and further relaxing the restrictions to foreign banks to open more branches by 2010 as per the Financial Sector Master Plan (FSMP).

Banking products are generic (commodity like) with little/least differentiation possibility. Any differentiation in product features somehow can easily be copied, thus not giving any sustainable competitive advantage to the innovator. As a result, competitors have resorted to competing in terms of price (interest rate).

Price elasticity however does not stand as a sustainable competitive advantage to banks due to the following reasons:

- i) Ability to compete in terms of price shall be limited to the cost of funds for individual banks
- ii) In this era of information age, Information Communication Technology (ICT) enables information on price offered by banks to be accessed by the public at large at the least cost possible. This resulted in the increased bargaining power of existing and potential buyers (borrowers) and suppliers (depositors).

Lately, there has been further threat of substitute products whereby non banking institutions have started offering loans for example fixed rate home loans offered by insurance companies such as AIA, ING etc.

The highly competitive environment has forced banks towards having an outward focus i.e being more sales oriented by having their sales people to market and seek for customers outside of their branches network. Gone are the days when bankers just sit in the branch waiting for potential customers to walk in.

3.5.4 Expected trends

The landscape of Malaysian banking industry is expected to change further and becoming more competitive due to the following reasons:

- i) Globalization that leads to further liberalization of banking rules and regulations governed by BNM. This shall see a higher threat of new entrants and substitute products.
- ii) Further advancement in ICT that shall see more IT savvy customers (borrowers as well as depositors) demanding 24 x 7 x 365 on-line banking services from anywhere in the world.
- iii) Banks will be leveraging on ICT to deliver their products and services through alternative non-branch delivery channels to maximize their customer reach as well as to lower their operational cost.
- iv) As almost all banks strive to deliver convenience to attract customers, convenience offered will not become a sustainable competitive advantage to banks especially when technology used to deliver convenience is non-proprietary. On the other hand, the ability to gain customer loyalty through conviction will be more of a sustainable competitive advantage.

3.5.5 Key Success Factors of the Banking Industry

Due to the expected increased competition within the Malaysian banking industry, the following 4 factors shall become the Key Success Factors (KSFs) that will set the competitors apart in term of their value propositions to the customers:

- i) Convenience of doing business
- ii) Speed of delivery
- iii) Quality of service
- iv) Cost to serve.

The above-mentioned criteria are illustrated in the following table that displays the results of the Customer Perception Survey published by The Asian Banker Research.

Table 3.6
Banking customer perception survey

1.	Easy access to service	86%
2.	Short processing time	78%
3.	Excellent customer service	76%
4.	Low rates and fees	75%
5.	Good image	41%
6.	Extensive range of products	28%
7.	Aggressive advertising and promotions	8%

Importance of the top 4 criteria mentioned in the above-mentioned survey is further supported by the results of self-administered survey conducted by the authors of the study as contained in Appendices 4 and 5.

Further study by The Asian Banker Research shows that in the Malaysian context, customers rank speed of approval above the rest. This is evident in the following table.

Table 3.7

Survey on importance of speed of delivery in banking

1.	Malaysia	91%
2.	Philippines	90%
3.	Indonesia	87%
4.	India	85%
5.	Thailand	83%
6.	Singapore	83%
7.	Hong Kong	80%
8.	Taiwan	76%
9.	Australia	74%
10.	China	69%
11.	New Zealand	66%
12.	Korea	65%
13.	Japan	57%