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Burn the rulebook

How to succeed in low-income banking

Asia-Pacific's low-income banking segment is hyped as a vast opportunity with billions in untapped revenue. But the deeper story isn't about revenue. Shareholders want high profitability and efficiency, both of which are impossible using conventional products and operating models.

However, the prospects for the segment are shifting as low-cost, digital-first models—leveraging unconventional partners, micro-branches, agent networks, data analytics, mobile and emerging technologies—now allow banks to derive strong earnings from the underserved segment of Asia's major emerging markets—India, China, Indonesia, Malaysia, Philippines, Thailand and Vietnam.

These models are squarely focused on business efficiency and scalability. Used effectively, they sidestep the largest historical obstacles to profitability in this sector—slashing the cost of operations, distribution and collections.

Banks can now realistically target cost-to-income (CI) ratios in the thirties within some of the world's fastest-growing markets, transforming the return on investment equation and making this customer segment significantly more attractive to shareholders.

Banks are already showing profitability gains Many of Asia-Pacific's banks have already taken steps to increase the profitability of their low-income customer segments, which are often loss-making and subsidised from more profitable, mainstream segments.

BRI, for example, one of Indonesia's largest banks, has built a self-funded micro-banking business that is now more profitable than its other business units. In 2015, BRI generated pre-tax profits of Rp17.9 tn (US$135 m) from its micro-banking sector with a CI ratio of 52.[1] While new entrants should target a lower number (particularly as Indonesia has only recently permitted branchless banking[2]) the result is still significantly lower than the bank's combined retail and corporate banking CI ratio of 67.[3]

A major part of BRI's success is in its "BRILink" agent network. The bank has enlisted more than 20,000 field agents, mostly sourced from its customer base. This low-cost model helps the bank to reach more customers and enables highly efficient expansion.

In India, ICICI Bank boasts one of the lowest CI ratios of all the major banks in the Asia-Pacific region—just over 40.[4] The bank uses a model called "Tab Banking," which eliminates paperwork from the account-opening process. One of the bank's representatives will visit a customer with an internet-connected tablet and use it to collect details, take the customer's photograph, and scan know-your-customer (KYC) identification documents. The accounts are activated on the same day. ICICI says Tab Banking costs just one-tenth of branch banking.[5] Other banks in India are increasingly using micro ATMs—handheld devices with 'e-KYC' capabilities incorporating biometric verification—which reduce operations requirements by enabling straight-through processing when onboarding low income customers.[6]

Innovative thinking can protect profitability

Fully digital, branchless banking will be an option in some regions. But in some markets, branches remain important to comply with anti-money laundering and KYC regulations.[7] They could also remain important for other reasons—for example, where in-person advice is highly valued, or when banks need to emphasise the trust factor that physical locations convey to consumers.

But here, too, innovative thinking can protect profitability. With banking operations now close to fully digitized, banks can have storefronts at a fraction of the cost of traditional branches. For example, RHB Bank, the fourth largest in Malaysia, has developed a high-tech branch network called "Easy," which costs just 15% of traditional branches and achieves payback twice as quickly.[8]

Markets with high mobile penetration and a widely dispersed population are well suited to a digital-only model. This is where a new entrant with a low-cost base and a compelling digital offering could disrupt the market. Leaner operations allow banks to offer the best rates—crucial for any online bank, but especially for foreign banks with unknown brands and no branch network.

Symbiotic partnerships can be key

Examples of innovative banking models for the low-income sector are emerging across Asia-Pacific. In India, Janalakshmi Financial Services, a major microfinance provider, uses cards for disbursement, cash for collections, psychometric testing for credit scoring and outsources operations for efficiency and rapid scaling.

Singapore's DBS Bank has collaborated with AMP Credit Technologies to help provide short-tenor loans to small businesses. Typically, small businesses are underserved because credit assessments require audited accounts and personal income statements. DBS's solution, dubbed "mLoan," instead analyses electronically verifiable cash flows (e.g. card payments) to assess creditworthiness against a model.[9] The innovation has given DBS a new set of customers and a significant competitive edge.

Profitable models will often rely on unconventional, mutually beneficial partnerships. For example, India's HDFC Bank partners with dairy cooperatives and farmer producer organizations to provide banking services to dairy farmers.[10] And in Kenya, Safaricom, a telecoms provider, has launched "M-Shwari," which offers interest-earning accounts and 30-day loans from its partner, Commercial Bank of Africa (CBA), a major Kenyan bank. The key strength of the partnership is that Safaricom's existing data means customers do not have to visit the bank or fill in paperwork. CBA signed up one million customers in the 40 days after M-Shwari's launch, and had signed up three million after five months.[11]

Watch the blind spot

The most powerful innovations in banking today are made possible by fast-maturing transformative technologies—most notably data analytics, artificial intelligence, automation, 4G mobile networks, internet of things and the as-a-service economy. These are now mature enough to unlock greater profitability at the bottom of the pyramid. They are also increasingly exploited by agile fintechs and disruptive competitors from other industries.

These new entrants range from payment and microfinance providers to less obvious industries such as the e-commerce, telecoms or internet/technology sectors. And they are rapidly taking traditional retail banking opportunities in Asia-Pacific. For example, in the Philippines, Globe, a major telecoms service provider, has developed the "GCash beep MasterCard," which functions as an ATM card, a prepaid card for purchases, and a public transport ticket.[12]

Meanwhile, banks and micro-lenders in China are under threat from the nation's biggest internet and e-commerce companies. Alibaba, Tencent and, most recently, Baidu—often known as China's Google—have all launched digital banking services.[13] These firms have several advantages, including enormous customer bases and vast financial, technological and human resources. Alibaba, for example, has leveraged big data analytics over transactions in its marketplace to successfully market targeted micro-loans to customers.

Regulatory barriers are falling

New competitors can outmanoeuvre banks through greater agility, superior innovations or access to established customer networks. Many are also free from entrenched procedures, legacy IT systems or corporate bureaucracy.

But they have challenges too, including customer trust and regulatory constraints. The latter, however, are being relaxed across the region. In early 2016, the Philippines ended a 17-year moratorium on new banking licenses.[14] The Reserve Bank of India has also opened up the banking sector, granting 23 banking licenses to new participants since April 2014. These have included two universal banking licenses, 11 payment bank licenses and 10 small finance bank licences.[15] Several non-traditional firms were among them, including Airtel and Vodafone (both telecoms) and Paytm (e-commerce).[16]

Efficient disruption

Rather than react to disruption from new competitors and technologies, banks need to become agile disruptors themselves—seizing the opportunity to invent all-new operating models and highly targeted value propositions.

This may demand more creativity and agility than many banks are used to. But banking is quickly growing more profitable in Asia-Pacific's vast low-income segment. Banks that can master the right models for the right markets will secure the real value from this much-hyped opportunity.

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About the report

For senior executives of banks looking to expand into Asia's major emerging markets, notably Indonesia, India and Thailand.

For more information

Sonali Kulkarni

Sonali.kulkarni@accenture.com

Steve Pemberton

steve.pemberton@accenture.com

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16-1391