



## Asian Financial Sector – Rocks and Hard Places

How financial institutions in Asia are adapting to a complex and fast-moving environment - a guest article from Terry Leeworthy.

### 1. SITUATION

Despite optimistic market and media hype about global financial markets, there are currently very few businesses and industries that are not experiencing tough and volatile trading conditions. The Asian financial services sector is undergoing a particularly tough time – despite its strength only a few years ago.

Just over a decade ago, banks were rushing to Asia to establish a foothold or expand existing business. China's economy was comfortably the fastest-growing economy in the world. Asia was booming, and all corners of the financial world were looking to join the party. And what a party it was – in 2015, almost half the banking industry's global profits originated in Asia!

### 2. HEADWINDS

However, having survived the global financial crisis of 2008, the Asian financial sector is now facing strong global and regional headwinds that have developed over a relatively short period. These forces have put intense pressure on players in the Asian financial services sector, with companies experiencing the following challenges.

- **Higher skill costs:** There are skill shortages within Asia, with expanding businesses driving competition for talented staff.
- **Lower revenues:** Margins in wealth management are shrinking. Global banks are losing their share of new issue businesses in the region, particularly the China-related transactions.
- **Increased capital requirements:** Global regulators are implementing new capital requirements.
- **Operational complexity:** Many new compliance regulations have been introduced by regulators, with more regulations to follow. Banks are more sensitive to compliance and reputational issues, both of which generate operational complexity.

- **Restrictions in China:** China's capital markets are not really open to non-Chinese institutions. To curb capital flight, authorities are restricting capital flows, making business more difficult and unpredictable.
- **Disruptors:** Robo-advisors, external asset managers and exchange-traded funds (ETFs) are disrupting the financial services space.

#### Slowing macroeconomic growth

Historically, one of Asia's biggest attractions to global markets has been its high gross domestic product (GDP) growth rates. Growth expectations are now much lower; however, Asia is likely to remain one of the fastest-growing regions in the world. For banks with operations in Asia, this is a double-edged sword – each institution will fiercely defend its shrinking revenue pool as much as possible, but will also appreciate that existing business models are unlikely to deliver the results expected in Asia. Regional managers must develop and implement strategies that are adapted to the Asian market – indeed, their boards will expect nothing less.

### 3. THE PRIMARY RESPONSE OF BANKS

As is to be expected, the banks have responded to the situation in the Asian financial sector – but, while these responses have had a positive impact, they have generally not been revolutionary. Banks have:

- Shed expendable members of staff.
- Actively reduced the total compensation of remaining staff.
- Implemented 'low-hanging fruit' projects (the lowest expenditure for the greatest impact).

Banks in Asia now generally find themselves between the proverbial rock and a hard place. They have taken some painful actions to mitigate the difficult business conditions; however, these headwinds are not dying down – in fact, they are looking more like a permanent feature than a cyclical phenomenon.

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Just over a decade ago, banks were rushing to Asia to establish a foothold or expand existing business. China's economy was comfortably the fastest-growing economy in the world. Asia was booming, and all corners of the financial world were looking to join the party. And what a party it was – in 2015, almost half the banking industry's global profits originated in Asia!

The financial industry is now in the process of making tough decisions about the actions required to continue to operate profitably in Asia's changing financial environment. These deliberations require the development and implementation of some, or all, of the following:

- A revised or updated strategy that aligns with banks' core capabilities and strengths.
- Lower-cost client interactions.
- Projects and changes that will deliver more efficient infrastructure.
- The process of growing business by expanding scale, introducing new products and/or providing new services.

Of course, some organizations will not have the luxury of having large capital investments at their disposal – so these players would have fewer potential future strategies available.



#### 4. INDUSTRY OUTLOOK

Due to the ever-changing global financial landscape, banks operating in Asia will need to develop revised strategies and implement new business platforms to help them stay ahead of the curve. This may require seeking advice from experienced consultants or perhaps investing in additional project staff. But, before doing so, there are some important trends to consider.

##### **Established or evolving trends**

There are several business trends that currently face the Asian financial services industry, each of which further complicates the development of a successful business model in Asia.

- **Insurance distribution:** Insurance companies are urgently expanding their sales and distribution networks. Bancassurance partnerships with banks are popular; however, it is not clear whether both parties will end up with what they originally desired!
- **Client segmentation:** Several global banks have enforced stronger client segmentation. These measures create client differentiation and some operational efficiencies, but do not offer big changes to operating models.
- **Security trading:** Global banks with big security trading operations have trimmed costs. The bigger equity operations have more than 70 percent of orders processed as non-touch orders, and efficiency gains are increasingly difficult to achieve. Bond trading operations have been drastically cut due to increased capital requirements.
- **Private banks:** A lack of critical mass in Wealth Management is an issue – several businesses in Asia have already been sold, with more expected to be sold in the future. A common view is that private banks with client assets less than USD 20b are not profitable.

##### **Paths of least resistance (risk)**

Some banks that are operating in Asia may consider major backbone IT investment projects to reduce costs; however, the time, risks and capital costs of these projects will deter many institutions from going down this road. Several banks have chosen to use their IT investment budget by developing new client engagement tools and models, justified by their lower project risks. They are developing, for example, front office, mobile banking and client analytics tools – offering new client experiences and developing internal efficiencies. With Asian populations being relatively e-friendly, this is becoming a popular strategy amongst banks.

There is also much discussion around resource sharing; some deals that extend client offerings have been announced, as well as discussions relating to banks sharing operational centres to reduce costs.

Banks in the region have not seriously adopted any robo-adviser, regtech or fintech models. They are certainly not pushing the boundaries, but the bigger players keep a close watch on the space as they could grow into a threat. These new business models are taking root in other parts of the world – they will also come to Asia in the near future. When considering the China heavyweights – Alipay, WeBank, Lufax, etc. (large existing businesses that have capital in abundance and a growing desire to expand beyond China) – these changes could take place very quickly, transforming the banking landscape in Asia.

Financial institutions in Asia are now adapting their business models to work between these many rocks and hard places in this complex and fast-moving environment. There is a natural preference for implementing lower-risk models, but the question is whether banks can do enough to slow the profitability erosion. For banks in Asia, their own future wellbeing is bound into these decisions. We are in for a momentous and exciting few years ahead.



Here at a-connect, we believe that, with the guidance of a team of specialist independent professionals, banks can overcome the challenges posed by the Asian financial sector. **Contact us** today to find out more.



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