The Economist INTELLIGENCE UNIT

>>WHOSE CUSTOMER ARE YOU? THE REALITY OF DIGITAL BANKING IN ASIA-PACIFIC//

Who needs Silicon Valley?

China leads Asia's diverse digital banking markets

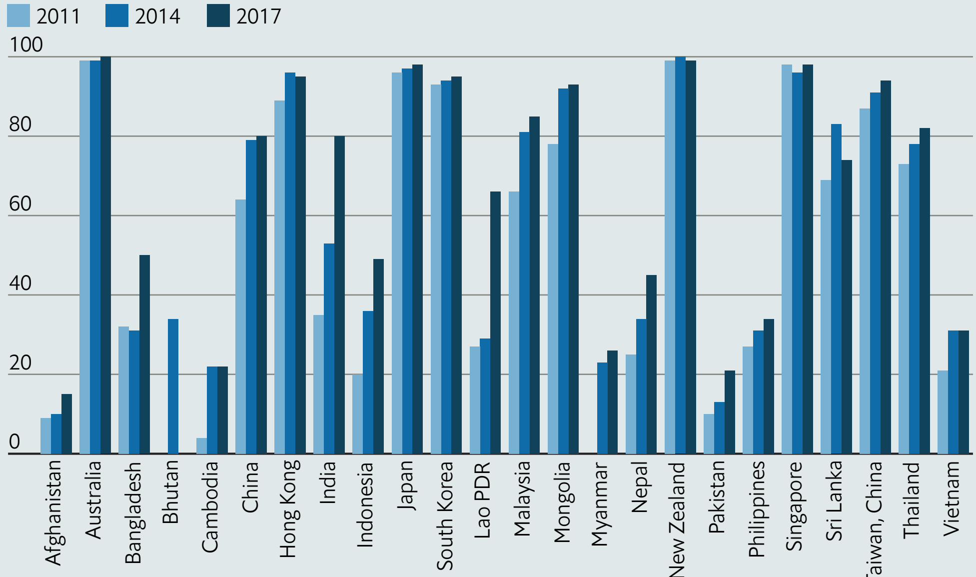
If you want to see what universal digital banking looks like, skip Silicon Valley or London's fintech hubs. China's Alipay and WeChat Pay show how to do smart, mobile-based banking on a massive scale. Regulators are now adapting to new customer demands.

The Asia-Pacific retail banking market is diverse, reflecting the different levels of social, economic and financial institutional development. It ranges from the near universal coverage found in the more developed markets of Australia, New Zealand, Singapore and Hong Kong to the emerging market of

Chart 1

Account holders

(%; age 15+ years)



Source: Global Findex, World Bank 2018.

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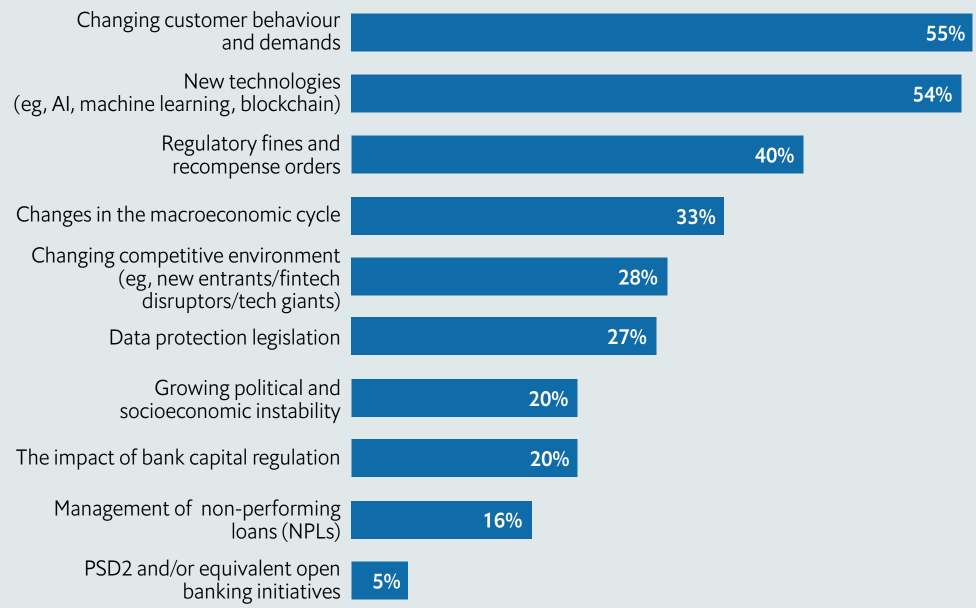
The banking software company

Cambodia, where only 21% of people over the age of 15 have a bank account. It also includes India, where government policies have pushed inclusion by shifting state transfers, pensions and benefits directly into accounts or onto biometric smartcards. Accordingly, Indian account ownership has jumped from 35% in 2011 to 80% today.[1]

However, bankers in The Economist Intelligence Unit's survey see common themes. Within the Asia-Pacific region, changing customer demand will have the biggest impact on retail banking in the next three years.

Chart 2

Which trends will have the biggest impact on retail banks in your country in the years to 2020?
(% of respondents)



Source: The Economist Intelligence Unit.

Regulatory trends are less of a concern in Asia-Pacific (40%), compared to Europe (46%) and North America (56%). Bankers in Hong Kong and Singapore seem to benefit from the more tech-friendly "try it and see" approach of their own regulators. Both the Hong Kong Monetary Authority (HKMA) and the Monetary Authority of Singapore (MAS) have opted to create "regulatory sandboxes" to encourage innovation. These sandboxes allow banks and fintechs to trial their ideas while involving only a limited number of participating customers. However, the situation is very different in Australia, where bankers have come under fire from the regulator due to poor risk management, high fees and widespread mis-selling.

An April 2018 report by the Australian Prudential Regulation Authority into the Commonwealth Bank of Australia (CBA) made clear that "a widespread sense of complacency has run through CBA, from the top down".[2] The subsequent loss of 20m customer account details only compounded the likelihood of significant reputational damage.[3]

[1] Global Findex, World Bank, April 2018 http://globalfindex.worldbank.org/#data_sec_focus

[2] Australian Prudential Regulation Authority http://www.apra.gov.au/AboutAPRA/Documents/CBA-Prudential-Inquiry_Final-Report_30042018.pdf]

[3] ABC News, May 2nd 2018 http://www.abc.net.au/news/2018-05-02/commonwealth-bank-confirms-loss-financial-records-20m-customers/9720928

Although Australia has not been Asia-Pacific's leading example of customer-centric, innovative, fast and frictionless banking to date, this may change with new competition from smaller players. New competition should accelerate the digitalisation process that could help restore the reputation of Australia's bigger banks. The environment will also change with the federal government's required phased implementation of open banking commencing in July 2019 by the big four: the CBA; the National Australia Bank; the Australia and New Zealand Banking Group; and Westpac. (see box)

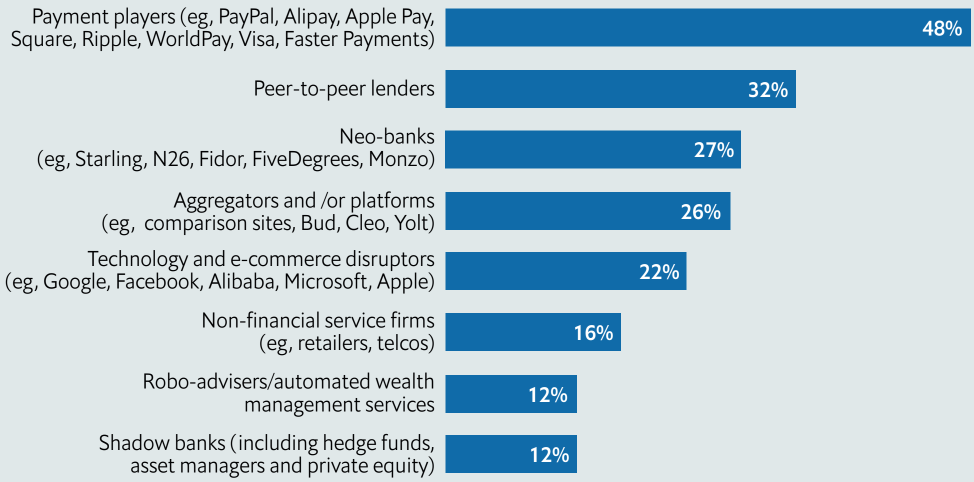
Payments: the great disruptor

Across the region, new payment players are driving the shift to digital services. Interestingly, the competitive pressure in payments and transactions is not felt as heavily in Europe (61%), North America (61%) or even Latin America (51%), despite the looming presence of Alipay and WeChat that now dominate smartphone payments in China.

Chart 3

Which non-traditional entrants to the retail banking industry will be your company's biggest competition in the years to 2020?

(% of respondents)



Source: The Economist Intelligence Unit.

India too has adopted mobile payments at a rapid pace. Launched in 2016, the Unified Payment Interface (UPI) allows users to download the app and start making payments and transfers at zero cost, without the need for e-wallets.

When 86% of hard currency notes by value were rendered useless overnight in 2016, India's shock demonetisation prompted a surge in use as desperate shoppers struggled with everyday transactions. Banks have had to launch cashbacks to keep users from defecting to Paytm or Google's Tez, a UPI-based service that launched in September 2017.

Hong Kong and Singapore are also experimenting with countrywide payment platform ideas. The Singapore Quick Response Code (SG QR) is expected to be rolled out sometime in 2018, which will

[4] *Financial Times*, May 4th 2018 https://www.ft.com/content/6d756d0e-4f9f-11e8-9471-a083af05aea7

[5] Bloomberg, May 7th 2018, https://www.bloomberg.com/news/articles/2018-05-07/jack-ma-s-too-big-to-fail-finance-giant-faces-a-china-clampdown

allow customers to tap and pay. But system outages left phone users unable to make any payments and reminded many to keep a card or cash handy just in case.

In both countries, banks are keen to spread digital payments, even if that means working in harmony with competitors on the infrastructure side. Across the region, banks are deploying artificial intelligence (AI) to differentiate their brand and services. They must keep customers on board and the experience engaging, as they may simply jump ship to a rival app and platform.

Different strokes for different folks

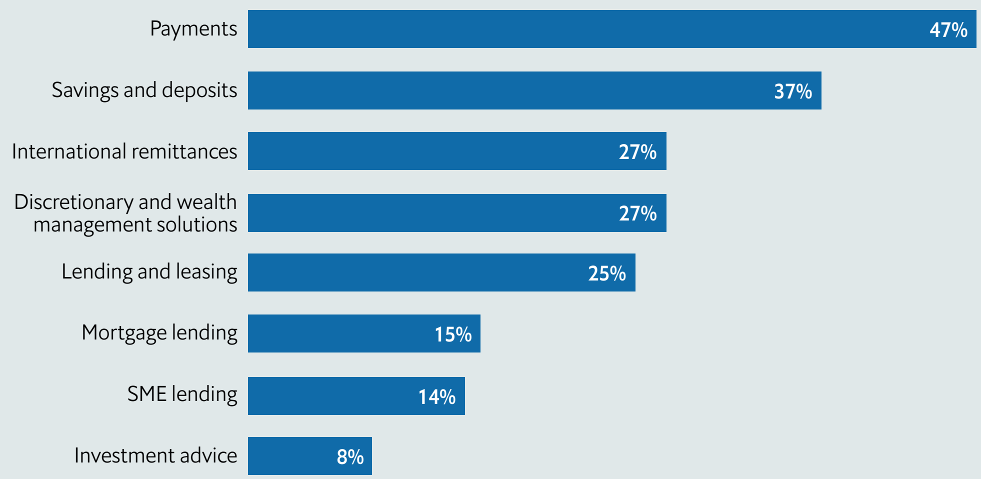
With so much changing so fast, banks are challenged to keep up with new products and service updates that can change consumer preferences overnight.

Google's Tez has already introduced a chat function, in preparation for WhatsApp's imminent arrival in the already crowded Indian payment market.

However, other bank products cannot be forgotten. The differences in wealth and customer needs across the region reflect the relatively high scores for international remittance services—primarily used by those who have to seek work in other countries—and discretionary and wealth management for those who have already done well for themselves.

Chart 4

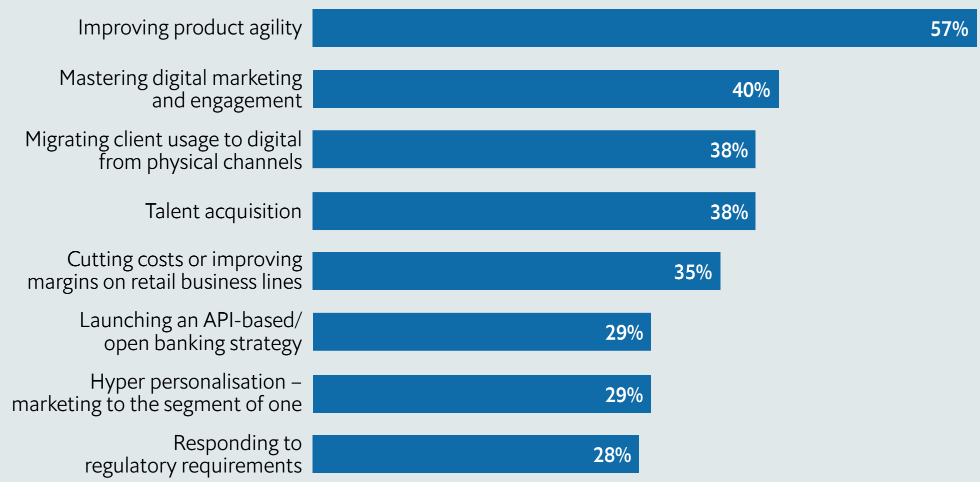
What is the main area where you expect new entrants to gain the most market share?
(% of respondents)



Source: The Economist Intelligence Unit.

Chart 5

What are the top strategic priorities for your company in the years to 2020?
(% of respondents)

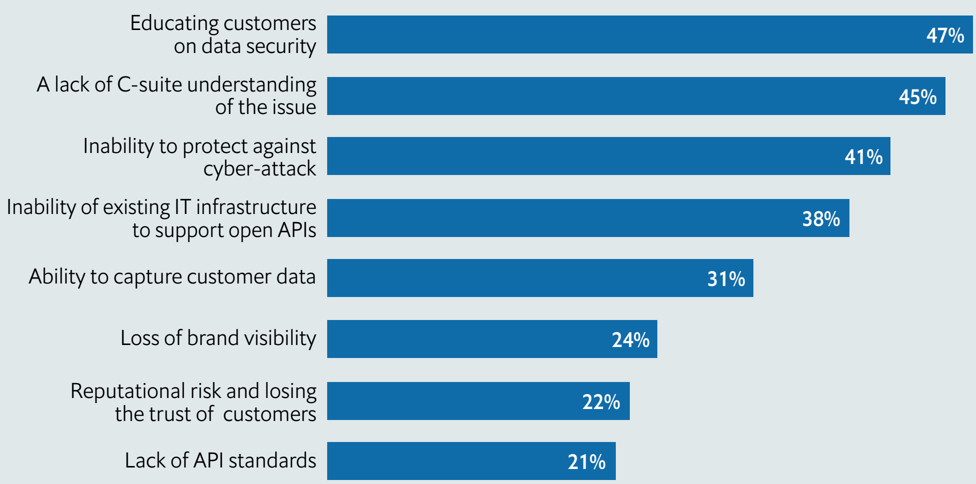


Source: The Economist Intelligence Unit.

As banks are fending off low-cost, high volume services at one end of the spectrum, and trying to bolster their high-value service proposition at the other, product agility remains a strategic priority for 57% of bankers in Asia. And in a region with high smartphone usage, but patchy literacy levels in places, mastering digital engagement is also a strategic priority for 40% of respondents.

Chart 6

What are your main concerns in relation to API-based Open Banking?
(% of respondents)



Source: The Economist Intelligence Unit.

Banks are also focused on security. The fast spread of technology based on application programming interface (API) is a boon to the previously unbanked. But a lack of familiarity means that 47% of respondent bankers believe educating customers about data security is the key concern in relation to open banking. Cyber-security and resilience are also more important for 41% of Asian bankers versus 35% globally, when banks have little choice but to open to third party apps and payment initiators.

The pace of change should open up a treasure trove of customer insights based on digital transactions, location and other traits that can be deduced from smartphone use. But predictive analytics (cited by only 21% of respondents) and turning data into selling opportunities are not the most important priorities. Deploying AI for micro segmentation was not considered to be the most valuable use of AI for retail banks for only 4% of survey respondents.

Speed and simplicity trump sophistication and segmentation, it seems.

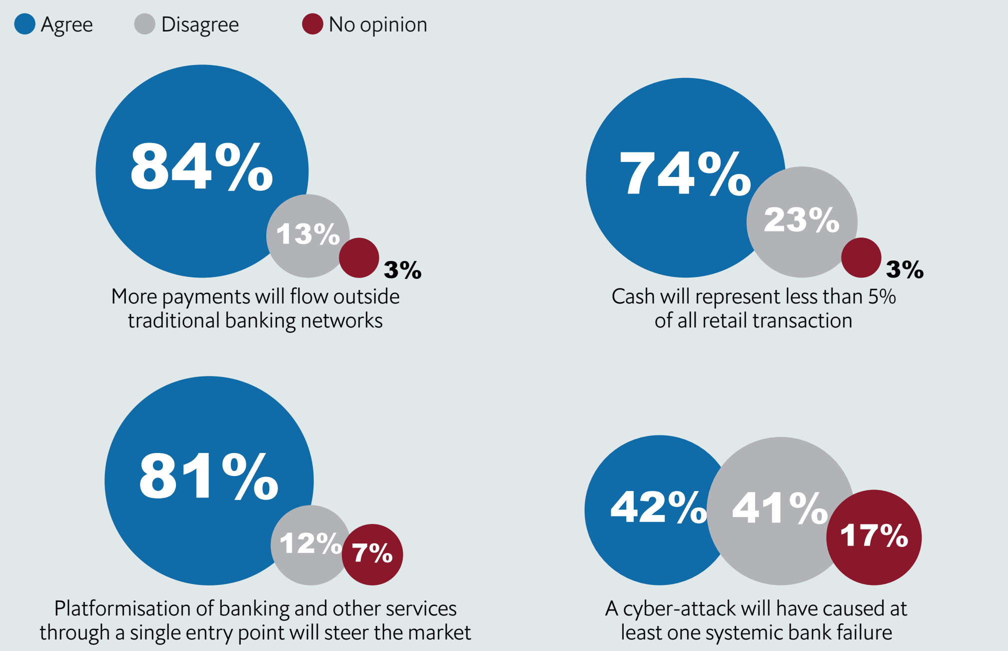
And this is clear in their response to where banks in Asia-Pacific are focusing their digital investment. Rapid reaction requires fast, scalable IT solutions. Asia-Pacific banks are spending heavily both on cyber-security (cited by 76% of respondents vs 71% globally) and on cloud solutions (55% v 48% globally).

Standing out in a social crowd

But with so much riding on digital payments, banks may have to rethink their strategies. Asia-Pacific bankers are the most likely to say that payments will flow outside the traditional banking system by 2020.

Chart 7

Do you agree/disagree with the following statements? By 2020……
(% of respondents)



Source: The Economist Intelligence Unit.

But the ability of their social media-led rivals to turn huge volumes of chat, photograph and contacts data into real selling opportunities should not be underestimated.

The platformisation led by Alipay and WeChat is likely to spread quickly across other markets, particularly where open banking regulation beds in. The overwhelming majority (81%) of bankers surveyed believe that users will expect a single entry point to all their financial needs. When your chat app does that already, banks have a heavy task ahead if they want to remain relevant.

BEWARE OF THE ANT

Only 14% of survey respondents in the Asia-Pacific region think that small business lending is a priority. They may have to revise their strategic plans fast.

Ant Financial, parent to Alipay, made a loss in the first quarter of 2018,[4] ahead of a fund-raising round that could value it at US$150bn, bigger than Goldman Sachs.

The company is spending heavily as it battles rival Tencent, owner of WeChat Pay, and enters into new markets. In Asian digital banking, the spoils often go to those who enter a market first and fast, whether for basic transactions, insurance or wealth management.

Ant Financial handles US$2.4trn in mobile payments every 90 days.[5] No wonder that Eddie Qiulin Deng, senior manager at Ant Financial, says that most tier one and two cities are virtually cashless already.

South-east Asian expansion follows a standard pattern. Ant Financial will often acquire a third-party payment company, revitalise the back office and add in risk management, robo-advice and credit services to wow retail users and leave competitors standing.

Retailers have to follow suit, as customers want to pay by phone. So the next step up is business to business, where lending and cash flow management are natural progressions.

With so many "mom and pop" shops and more formal retailers using Ant Financial technology, the company can go one step further.

"Our anti-fraud technology could help companies fight cyber-attacks. Technology is the product, not just for the back office," says Mr Qiulin Deng.

Turning its own technology into new banking products and services could leave traditional banks floundering—and not just in China. Other markets where small businesses are underserved are equally vulnerable, including Latin America and Africa. Beware the Ant indeed.

The digitalisation of retail banking in Asia-Pacific opens up a world of opportunities for established banks as well as new players. The rapid digitisation and platformisation in countries like China demonstrate the huge potential that exists in this diverse and growing market. It also demonstrates the challenges posed to regulators who will want to encourage innovation that contributes to domestic and regional growth, while protecting consumers.

AUSTRALIAN DIGITALISATION BEHIND THE SCENES

Customer trust and loyalty through technology

Australia's Prudential Regulation Authority is keen to break the stranglehold of the country's big four: the Commonwealth Bank of Australia; the National Australia Bank; the Australia and New Zealand Banking Group; and Westpac. The regulator recently granted the first restricted retail licence to a start-up, Volt bank, to spice up the competition.

Smaller established players are also upping their game. ME Bank, owned by local superannuation pension funds, has been digitalising its business and products for the past three years.

The bank's press representative, Matthew Read, says the banking system was rebuilt a few years ago. Some services have already been completely digitised, including applications for new deposit and transaction accounts.

"Our back-end systems are well down the digital track and we will continue to digitise these to increase our business efficiencies," says Mr Read.

The mortgage application process is next. Over 70% of ME Bank's new mortgage business comes through a network of independent brokers. The bank only entered the broker market six years ago. It is rightly pleased the channel has grown so fast, helping to double loan volumes since then. Direct customers will not be forgotten either as the bank plans to allow direct online mortgage applications too, if it can.

"It's possible but there are significant hurdles in Australia due to the legal and regulatory framework," says Mr Read.