# *Project Blue*

# Capitalising on the rise and interconnectivity of the emerging markets

*Rapidly accelerating growth within South America, Africa, Asia and the Middle East (SAAAME) is leading to a radical shake-up in the competitive environment for financial services businesses, both within the SAAAME region and beyond. How will the industry landscape be transformed? Where do the real opportunities lie and how can your business capitalise on them?*

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# *Contents*

# Foreword

*Welcome to 'Capitalising on the rise and interconnectivity of the emerging markets', the first in a series of papers being published as part of Project Blue.*

Project Blue explores the major trends that are reshaping the competitive and investment landscape for financial services (FS) businesses. It draws on the perspectives of industry leaders and PwC's network around the world. It also brings together a huge amount of research into the forces shaping the global economy, customer expectations and government policy. The key aim of Project Blue is to provide a framework to help CEOs assess the implications of these trends and use this analysis to drive sustainable strategic and operational advantage.

The rise and interconnectivity of the emerging markets is in many ways the most far-reaching of the developments facing FS organisations, worldwide. This paper looks at the opportunities for business development created by the accelerating growth in South America, Africa, Asia and the Middle East (together forming what PwC terms 'SAAAME') and how to sustain relevance in the new global economic order. The paper is designed to be relevant to organisations based within SAAAME markets and those based outside.

There could be no universally applicable formula for success when countries and even regions within countries within SAAAME are so markedly different. Indeed, those that have ignored the considerable cultural and commercial complexities of doing business in these markets have very quickly come unstuck. What this paper does seek to provide is a stable starting point and clear set of considerations for strategic evaluations, both now and in the future.

I hope you find this paper interesting and useful. If you would like to discuss any of the issues raised, please feel free to contact either me or one of my colleagues listed on pages 29–31.

**Nigel Vooght**
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***The rise and interconnectivity of the emerging markets is in many ways the most far-reaching of the developments facing FS organisations, worldwide.***

# *Introduction*
## The real story behind the headlines

*In December 2011, it was reported that the GDP of Brazil had overtaken that of the UK.[1] For many observers, this news marked another major milestone in the accelerating shift in global economic power from developed Western states to the emerging markets of South America, Africa, Asia and the Middle East (SAAAME). Yet, the 'real story' is not so much the speed of growth within SAAAME, but how interconnected the trade flows between these markets have become.*

As intra-SAAAME trade proliferates, an ever-greater proportion of global commerce is set to bypass the West altogether, leaving Western financial institutions at risk of being cut out of the loop. They need to find ways to tap into this emerging-to-emerging market commerce if they are to sustain competitive relevance.

The window of opportunity that allowed some FS groups to rapidly build up their international footprint prior to the global financial crisis now appears to have closed. All international groups are likely to face restrictions on foreign ownership and entrenched competition from dominant local rivals, especially within the most promising SAAAME markets. Even if some market share is available for acquisition, the price may be prohibitive for groups affected by the crisis. A more targeted growth model is emerging as a result, in which the ability to differentiate, develop niche markets and gain access to new digital distribution networks is critical.

Institutions based within the SAAAME region have the advantage of being closer to the new epicentres of global trade and growth. But the development of financial infrastructure, governance and regulatory practices may still have some way to go before the potential of the different markets can be fulfilled. As markets develop, FS organisations will need to contend with rising consumer expectations, a more complex risk environment and the growing battle for talent. Failure to keep pace could leave established players at risk of losing business to sharper competitors including ambitious start-ups and Western organisations.

Five out of the top ten banks by market capitalisation are based within SAAAME.[2] Yet, their global footprint is far less extensive than their leading Western counterparts. The big question is: Do they have the opportunity or appetite to begin to rival the globally operating players? Do they simply follow the international expansion of their domestic customers, or limit their ambitions to being regional players as most have done to date? Alternatively, do they seek to acquire or partner with Western institutions as they look to develop the technological capabilities, product expertise and management experience needed to compete on the global stage? How would such strategies affect the business plans and prospects for today's globally active elite?

As the Project Blue framework highlights, the backdrop to these developments is a rapidly changing social, demographic, environmental, political and technological landscape. What could prove disruptive and even threaten the existence of some FS businesses could provide others with a once-in-a-generation opportunity to leapfrog their competitors. All organisations will need to consider how these coalescing trends will affect the commercial potential and risk profile in their current operating territories and those they're targeting for the future.

1 Centre for Economics and Business Research/BBC News Online, 26.12.11

2 Financial Times Global 500 and PwC analysis

***What do we mean by SAAAME?***

*'SAAAME' refers to South America, Africa, Asia and the Middle East. SAAAME doesn't include Japan as this is a large G7 developed economy. Mexico is excluded as it trades mainly within the North American Free Trade Agreement zone and less with SAAAME. For now, Russia and the Commonwealth of Independent States (CIS) are also excluded from SAAAME as trade is largely internal or with Europe, though trade is increasing with SAAAME from its previously low base and it may not be long before Russia is included to form 'SAAAMER'. To provide an indication of future trends, many of the forecasts in this publication compare the 'G7' developed markets with an 'E7', which brings together the seven largest emerging economies (China, India, Russia, Brazil, Turkey, Mexico and Indonesia).*

# *Section 1*
# The shake-up ahead: Why SAAAME is so important

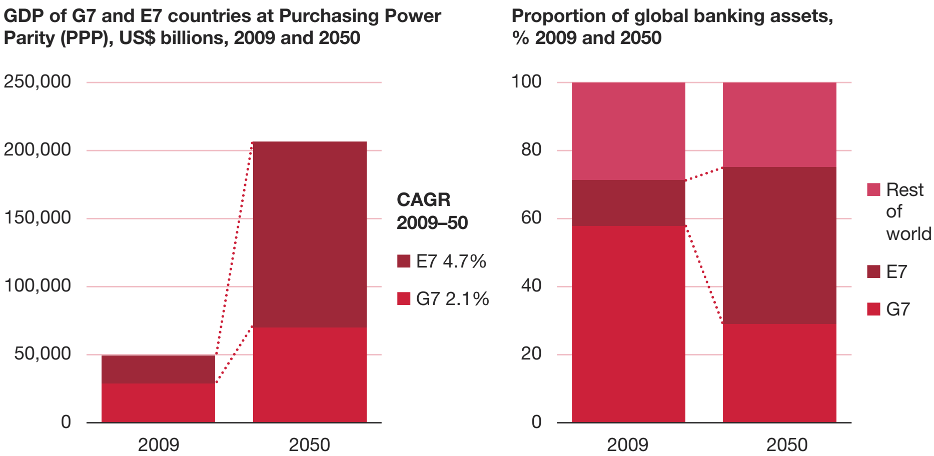
*Both domestic and foreign financial institutions see clear growth potential in SAAAME.[3] While a simple extrapolation of economic growth and the relatively low market penetration as a proportion of GDP provides some indication of the market potential, the way these markets develop and the implications for the FS sector may be more complex and competitively far-reaching, as we explore in this section.*

## *The shifting centre of gravity*

**Rapid rise: Financial crisis accelerates shift in global economic power**
The financial crisis has accelerated the rise in economic importance of SAAAME markets as they continue to expand, while growth in many developed markets has stalled. This shift is reflected in projections for the growth and eventual size of the financial services markets within the major E7 emerging economies, which are set to overtake their G7 counterparts over the next 20 years (see Figure 1).

The world's two largest banks by market capitalisation are based in China.[4] Looking ahead, China's banking assets could overtake the US by around 2023.[5] India has particularly strong long-term growth potential and could become the third largest banking sector by assets after China and the US, by 2050.[5] In turn, Brazil could rise to fifth place in the global banking rankings by 2050.[5] Two of its banks already feature in the global top 20 in terms of market capitalisation and are seeking to follow the country's fast growing multinational corporations by developing their presence in Asia, Africa and South America.

### Figure 1: Emerging markets overtake G7




Sources: PwC World in 2050 (January 2011); Banking in 2050 (May 2011); PwC analysis
Notes: G7 = US, Japan, Germany, UK, France, Italy, Canada; E7 = China, India, Brazil, Russia, Indonesia, Mexico, Turkey

3 More than half of the 368 FS leaders in PwC's 15th Annual Global CEO Survey (published in January 2012) see emerging markets as more important than developed markets to their company's future
4 Financial Times Global 500 and PwC analysis
5 'Banking in 2050', 2011 update, published by PwC on 18.05.11

## Figure 2: Insurance penetration in selected SAAAME markets

| Country | Total life and non-life insurance premiums 2010 (US$bn) | Change on 2009* (%) | Premiums as a percentage of GDP | Premiums per capita (US$) |
|---|---|---|---|---|
| **Latin America and the Caribbean** | **128** | **8.1** | **2.6** | **219** |
| Brazil | 64 | 10.7 | 3.0 | 329 |
| **Asia**** | **1,163** | **7.3** | **6.1** | **282** |
| India | 74 | (0.4) | 4.7 | 61 |
| China | 215 | 26.2 | 3.8 | 158 |
| Hong Kong | 25 | 7.9 | 11.3 | 3,599 |
| Indonesia | 12 | 16.1 | 1.6 | 50 |
| Singapore | 17 | 6.9 | 6.1 | 2,823 |
| South Korea | 114 | 7.5 | 11.1 | 2,332 |
| **Middle East and Central Asia** | **34** | **7.1** | **1.5** | **107** |
| Saudi Arabia | 4 | 6.5 | 1.0 | 166 |
| UAE | 6 | 8.4 | 2.0 | 1,268 |
| **Africa** | **62** | **(8.3)** | **3.6** | **61** |
| Egypt | 2 | (9.4) | 0.7 | 19 |
| South Africa | 49 | (9.9) | 13.4 | 962 |

*In real terms, i.e. adjusted for inflation at local consumer price indices. **Includes Japan
Source: Swiss Re Sigma No. 2/2011, Statistical Appendix, January 2012

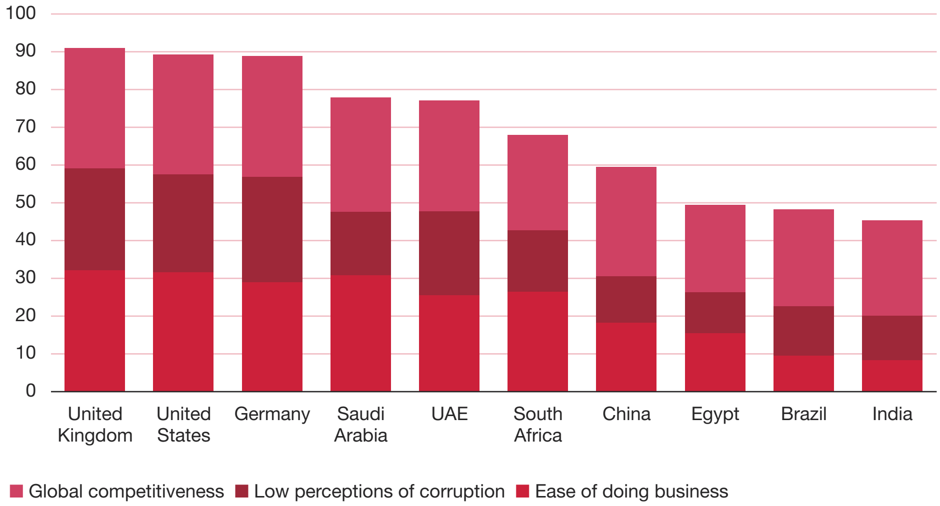
As the centre of gravity within global FS continues to shift, Hong Kong and Singapore have come to rival London and New York as the world's leading financial centres. Regional centres such as São Paulo are also seeing a rapid rise. As the global FS market becomes more multipolar and SAAAME institutions look to expand overseas, their Western counterparts could become targets for acquisition. Western businesses could be especially attractive to SAAAME giants that are looking to acquire the technology, product expertise, or management experience that would allow them to compete on the global stage. Takeover prices in some developed markets are generally favourable for now, especially within the mid-market, but may not be so for long.

### *Challenges ahead: Creating the platform for continued growth*

SAAAME is clearly not a homogeneous region. Countries vary in economic growth, social indicators and wealth distribution, which is reflected in the levels of FS development and penetration. Figure 2 highlights the variations by comparing insurance penetration in different regions around the world. As Figure 3 highlights, countries also vary in their competitiveness, safeguards against corruption and ease of doing business.

## Figure 3: How favourable is the location?

**The chart gauges relative levels of competitiveness, safeguards against corruption and ease of doing business, giving each a score out of 33.3, to arrive at an overall percentage rating**



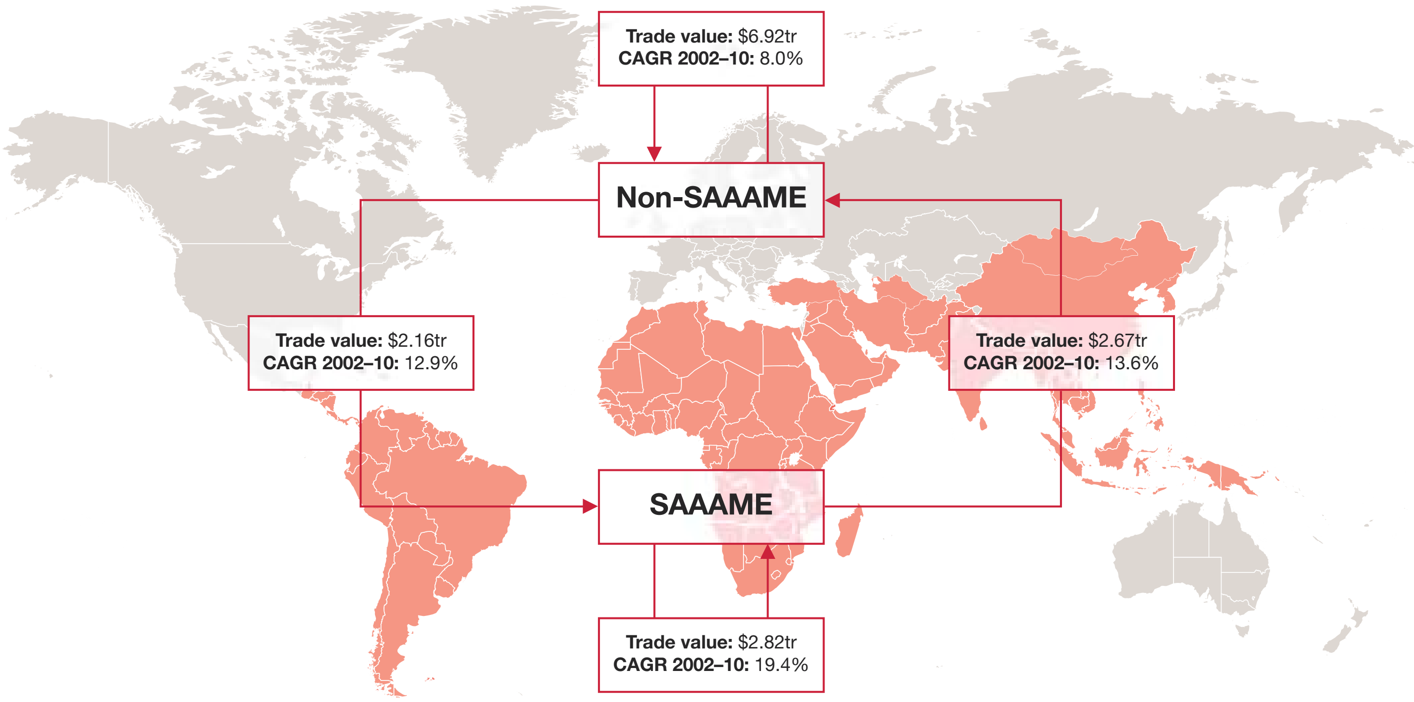

Sources: Ease of Doing Business, World Bank, 2011; Global Competitiveness Index, World Economic Forum, 2011–2012; Corruption Perceptions Index, Transparency International, 2010; PwC analysis
Notes: Low perceptions of corruption derived from the Corruption Perceptions Index: a high score suggests low perceptions of corruption within a country

The challenges ahead include increasing market penetration, putting in place an appropriate legal and regulatory framework, developing the financial infrastructure in areas such as credit evaluation and customer service, and establishing the low-cost distribution needed to increase financial inclusion. Businesses from countries further along the development curve have faced these challenges and will therefore be able to help local partners tackle them and provide the systems and expertise to support this.

### Increasing interconnectivity: Rapid expansion of intra-SAAAME commerce transforms global trade flows

The increasing interconnectivity of intra-SAAAME trade and investment flows is as significant as the growth and projected size of the emerging markets. These flows are growing much faster than the traditional routes from developed-to-emerging and developed-to-developed markets (see Figure 4). Within SAAAME, there are pockets of particularly high trade growth, notably between Asia and Latin America and between Africa and the Middle East (see Figure 5).

## Figure 4: Transformation in global trade flows




Sources: WTO and PwC analysis
Note: Russia and the Commonwealth of Independent States (CIS) have not been included in SAAAME definition because trade is largely international and/or with Europe. Mexico is excluded as it trades mainly within the North American free trade zone and less with SAAAME. Both areas remain very important growth markets and should be considered in relation to the SAAAME region.

## Figure 5: Trading hot spots (growth in value of imports and exports)

| ORIGIN \ DESTINATION | N America | Europe | CIS | South and Central America | Africa | Asia | Middle East |
|---|---|---|---|---|---|---|---|
| N America | 5.4 | 8.0 | 13.4 | 13.7 | 13.5 | 9.1 | 12.9 |
| Europe | 4.5 | 8.6 | 17.5 | 11.3 | 12.6 | 12.0 | 11.7 |
| CIS | 17.7 | 18.8 | 17.2 | 5.4 | 16.4 | 19.3 | 16.4 |
| South and Central America | 8.8 | 13.6 | 16.0 | 16.8 | 17.9 | 25.6 | 18.0 |
| Africa | 19.2 | 12.6 | 21.2 | 21.6 | 19.0 | 24.5 | 27.8 |
| Asia | 8.7 | 14.7 | 29.9 | 24.1 | 22.5 | 15.2 | 18.7 |
| Middle East | 10.0 | 12.8 | 24.1 | 15.1 | 15.7 | 18.9 | 20.2 |

**CAGR % 2002–2010:** <5 5–10 10–15 15–20 20–25 >25

**SAAAME**

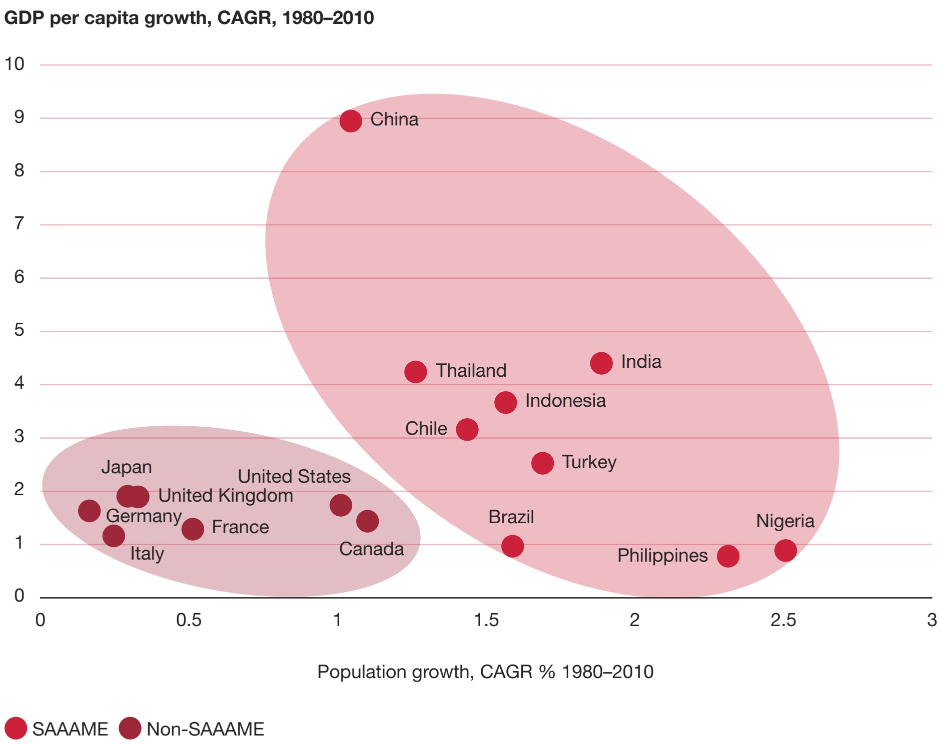
Sources: WTO and PwC analysis
Notes: North America includes Mexico; Asia includes Japan, Australia and New Zealand

At present, these intra-SAAAME flows are dominated by commodities, but as consumer markets continue to expand on the back of rising affluence (see Figure 6), the pattern of trade will be increasingly focused on manufactured goods. SAAAME has established substantial manufacturing capabilities and access to the labour to support this. Services are also set for significant development, taking advantage of the growing talent base and focus on innovation within SAAAME, with both the number and quality of university graduates within many emerging markets now beginning to rival the West (see Figure 7).

The development of financial infrastructure, greater access to long-term funding and the ability to tap into fast growing sources of liquidity and investment such as Islamic finance will also play a key role in sustaining this expansion in trade and provides an important opportunity for FS businesses.

At present, the US dollar remains the primary global exchange currency. However, as intra-SAAAME trade develops, bringing currency usage into line with trading relationships will help to reduce exchange-rate risk and overcome barriers to commerce. Key developments include the increasing use of the Renminbi in cross-border trade between China and its neighbours, along with a series of bilateral currency swap agreements between China and international trading partners including Japan, Turkey and the United Arab Emirates (UAE).

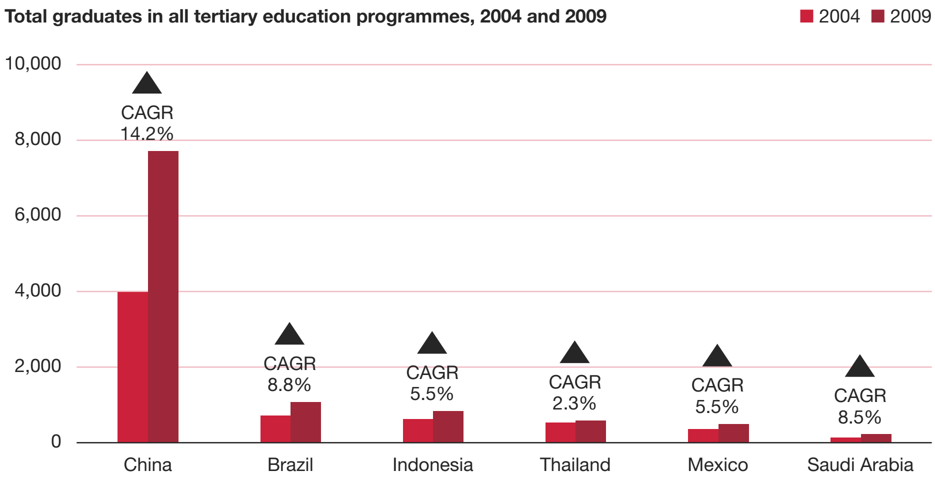
## Figure 6: Rising middle class



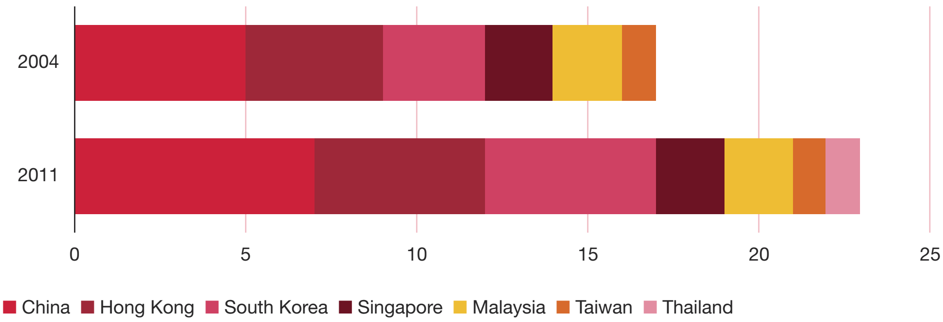

Sources: United Nations Population Division; World Bank World Development Indicators and PwC analysis
Notes: GDP per capita is in constant 2005 US$

## Figure 7: Nurturing talent

**Total graduates in all tertiary education programmes, 2004 and 2009**




**Asian universities, excluding Japan, within the top 200 of the QS world university rankings, 2004 and 2011**




Sources: QS University Rankings; The Times; PwC analysis

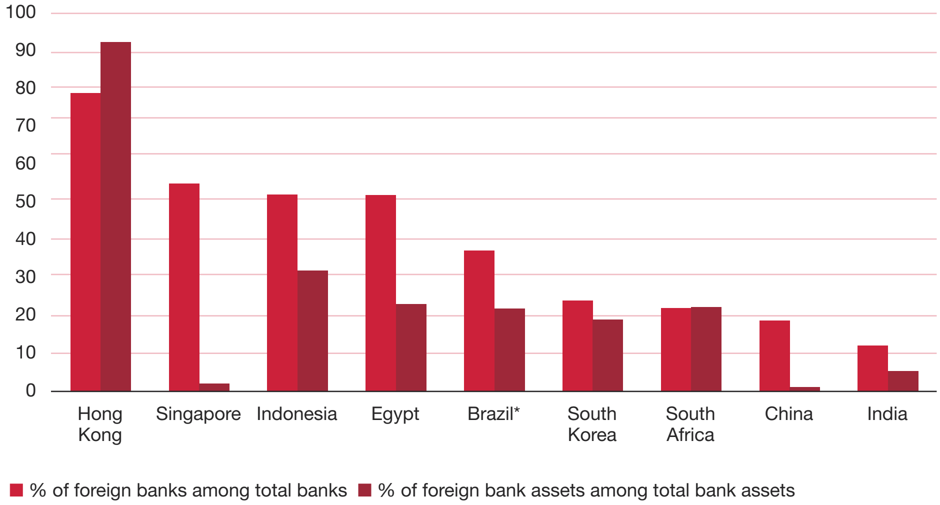
Many SAAAME markets are already highly concentrated and the leading players may need to look overseas if they want to expand their market share. Many will be looking to take advantage of their growing scale and dominance at the manufacturing end of global trade flows by banking both ends of the 'pipeline'. What remains to be seen is how far they want to build on these foundations. Some of the larger Brazilian, Indian and Chinese banks are seeking to provide global services for their corporate customers around the world. Yet, no SAAAME-based banks have so far sought to build a global presence comparable to one of the European or North American giants.

Foreign penetration within SAAAME varies (see Figure 8, overleaf). In some markets – including China – it's almost negligible. Even in an open market like Brazil, further acquisition may be prohibitively expensive, even if targets were to come up for sale. Yet, while a new entrant may find it difficult to achieve a leading position in a SAAAME market, they may still want to tap into the growth prospects. Indeed, they may conclude that they can't afford not to be present in some of the leading SAAAME markets. Even a relatively small market share in a large and fast expanding market like China, India or Brazil would still provide a significant source of business and long-term growth.

## *Questions for the board*

- What is an achievable goal and what is the most feasible route to business expansion in markets that may effectively be closed to foreign acquisition?
- How can primarily domestically focused groups develop or acquire the necessary capabilities including talent, strategic agility and deep cultural understanding to operate effectively across multiple territories?
- How can banks in developed markets make inroads into intra-SAAAME trade flows they may never physically see? What can they offer that their SAAAME competitors can't?

**Figure 8: Penetration of foreign banks within SAAAME markets, 2009**




Sources: IMF, 'Foreign Banks: Trends, Impact and Financial Stability' working paper, Jan 2012
Notes: *Latest available year, 2008. Note: 'Foreign' is defined as more than 50% holding by an investor based outside the country (minority holdings including those in countries that do not permit holdings above 50% are not included). Bank sample draws together all active banks reporting to Bankscope including commercial banks, savings banks, co-operative banks, investment banks and private banks.

# *The new battlegrounds*

### Growth and innovation is changing the playing field for financial institutions

Growing SAAAME middle classes are demanding more differentiated and tailored banking, insurance and investment products, putting pressure on domestic institutions to keep pace. This will offer Western institutions possible openings for investment and partnership.

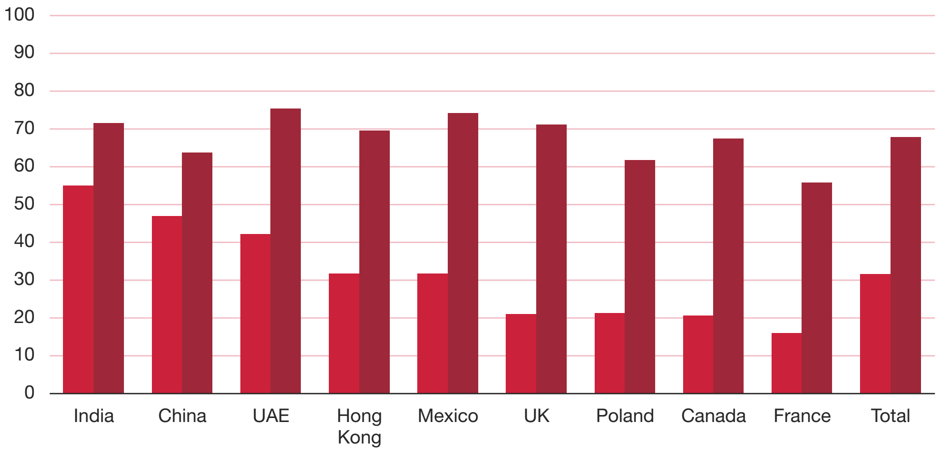
At the other end of the spectrum, many poor or remote communities have until recently had little or no access to financial services. The penetration of mobile networks is now bringing financial services to these once unbanked SAAAME populations. A notable example is M-pesa in Kenya, which provides access to payment and deposits via the mobile phone network and now has 15 million customers, more than all of the country's banks put together.[6] The GSM Association – a global group of mobile phone operators – estimates that around 300 million previously unbanked customers will be using some form of mobile banking by the end of 2012.[7]

As mobile banking takes hold as a distribution channel within SAAAME, its usage within FS has leapfrogged developed markets (see Figure 9) and created pockets of innovation in particular countries that others could follow. Indeed, rather than following the path to maturity seen in the West, it's likely that SAAAME markets will create their own patterns of development, leading innovation in many areas and creating a new DNA for financial services worldwide. Regulatory barriers could present a potential challenge to innovation and so one of the keys to making the most of these opportunities is how quickly market controls evolve.

6 www.thinkm-pesa.com, 16.04.12

7 Mobile banking for the unbanked, Harvard Business Review, 27.09.10

**Figure 9: Global use of internet and mobile phone channels in banking**




■ Percentage who currently use mobiles to purchase financial products
■ Percentage who currently use the internet to purchase financial products

Source: 3,800 consumers were polled for 'The new digital tipping point', a report published by PwC in January 2012

## *Influx into cities opens up critical battleground for competition*

Economic development will accelerate the move from rural areas to cities. Over the next 30 years, some 1.8 billion people are expected to move into cities, most of them in Asia and Africa, increasing the world's urban population to 5.6 billion[8] and creating one of the most important competitive battlegrounds for FS businesses.

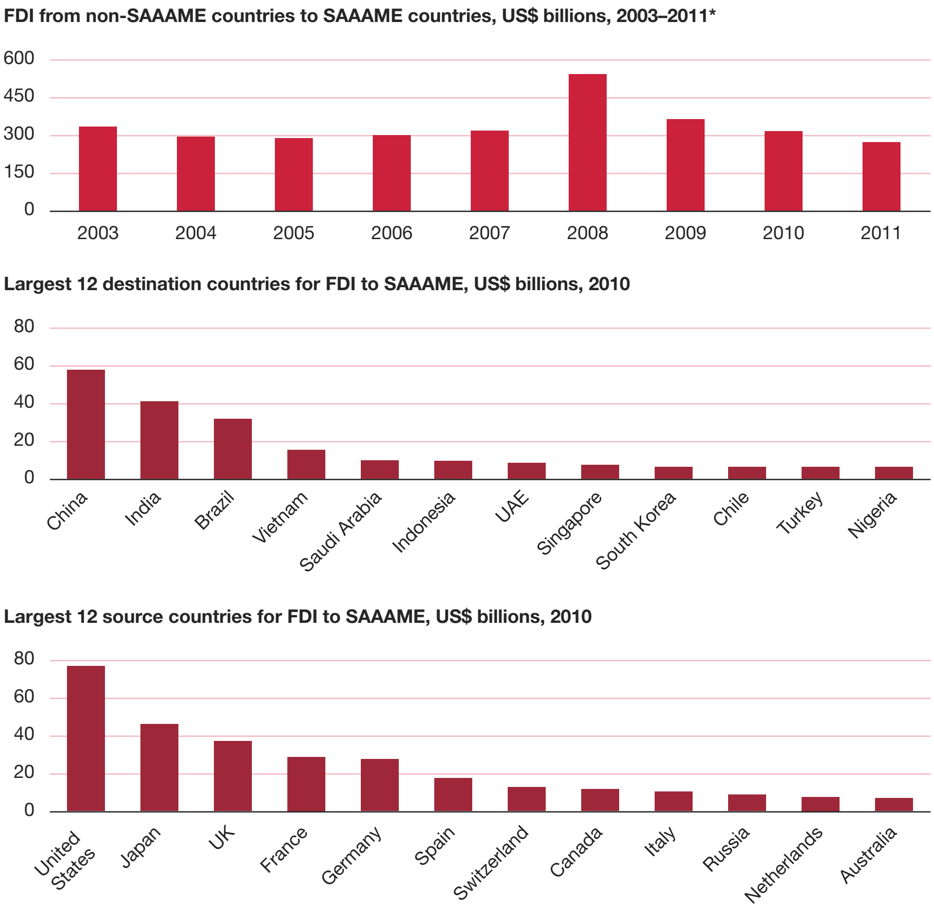
Urban expansion creates significant housing and infrastructure investment opportunities for financial institutions. On the retail side, city dwellers' average wealth and demand for financial products and services are generally much higher than their rural counterparts.Indeed, some observers now see the real distinction in the FS sector as no longer emerging and developed markets, but rather, city and rural areas. The challenge will be how to capitalise on urban growth, while developing profitable services for rural customers in areas such as mobile payments, micro-credits and micro-insurance.

## *Imbalances remain to be ironed out*

Credit continues to flow from Western to SAAAME markets (see Figure 10), even as the relative capital strength of the latter increases. Much of this SAAAME capital is still managed in the West. These anomalies are unlikely to endure and the eventual rebalancing will have a strong impact on financial markets and other businesses that operate within them.

8 United Nations, Department of Economic and Social Affairs, Population Division, 2009 Revision

## Figure 10: Foreign direct investment (FDI)




Sources: The Financial Times and PwC analysis
Notes: *2011 data is year to date, available as of 7 December 2011

# *Section 2*
# The CEO Agenda: Aligning your business with the new global dynamics

*Financial services organisations must find ways to differentiate and make themselves relevant within their target markets and trade routes.*

## *Shaping the future*

### Creating a more stable financial system

The financial crisis highlighted the vulnerability of many smaller and less developed markets to asset bubbles and destabilising short-term investment flows.

Many of these 'hot flows' of foreign capital were directed towards banks, with the market values of many emerging market banks multiplying up to ten times in a matter of years. The repatriation of much of this capital following the collapse of liquidity in many developed markets in 2007–08 meant that the credit lines for many 'frontier' market institutions were quickly withdrawn, leaving them high and dry.

In some countries, further difficulties have been created by the inability of relatively underdeveloped or overstretched operational infrastructures, governance systems and supervisory controls to cope with the rapid increase in FS demand, penetration and complexity.

Crucial priorities in creating a more stable financial system include identifying, monitoring and managing the risk of asset price bubbles. A number of governments have introduced more stringent capital controls to prevent hot flows. More timely financial information and strengthening IT and payments' systems would also help FS organisations to meet growing demand and provide more effective support for customers.

### *Questions for the board*

- How robust is your 5-, 10- or even 15-year vision for the evolution of the market?
- How developed are payment systems, credit checks, recovery and other key aspects of financial infrastructure in the target market?
- How strong are the governance and controls within companies targeted for partnership or acquisition?
- How susceptible is growth to fluctuations in international commodity prices?
- What is the best model of governance to follow in each SAAAME market and how far will local rules need to change as international regulation becomes more aligned?
- Will the need to comply with many different regulatory rules and approaches in various operating territories put international groups at a disadvantage to domestic competitors?

## *Gulf Cooperation Council*

Monetary union within the Gulf Cooperation Council (GCC) would provide a further spur for the development of financial services in one of the world's fastest growing regions.

The GCC was formed in 1981 to promote political and economic collaboration between Kuwait, Oman, Bahrain, Qatar, Saudi Arabia and the UAE, and to help these countries to address security challenges collectively. The Council reflects the close cultural, linguistic and religious ties within the Gulf and is seen as giving the GCC states greater influence within the Middle East and globally. It includes a joint military force and a common market applying to most sectors apart from financial services at this stage.

Investment in diversifying the economy beyond oil and gas is a key priority in these countries, with growth in the non-energy sector predicted to be around 5% a year over the next five years.[9] A significant feature of the economy is the importance of family-owned companies and corporations. We estimate that the combined assets of these businesses make up around 75% of the private sector and that they employ some 70% of the workforce in the Gulf States.

The development of international centres for banking, insurance and asset management is a key part of the diversification of the economy. Within the GCC itself, banking sector assets have risen rapidly over the past decade to reach $1.4 trillion at the end of 2011[10] and the insurance sector has been growing at an average of more than 5% a year in the past decade,[11] albeit from a low base. The GCC is also the world's largest Islamic financial services market. Furthermore, its sovereign wealth funds are major investors in FS businesses worldwide.

Most GCC currencies are currently pegged to the US dollar. The exception is the Kuwaiti dinar, which since 2007 has been aligned to a basket of currencies. According to the Central Bank of Kuwait, the basket peg provides more room for manoeuvre in monetary policy and helps to insulate the economy from external inflationary pressures linked to exchange rate fluctuations.[12]

Monetary union has been a longstanding ambition within the GCC. If enacted, it would create the second largest single currency after the euro and is likely to provide a number of benefits to FS organisations. These include promoting regulatory harmonisation. Monetary union could also make it easier to develop common products and to operate in any of the member states.

In 2009, the GCC Monetary Council was established – the precursor to a common central bank and an important step towards monetary union. Yet, the road to a single currency continues to be challenging. One of the points of contention has been the location of the central bank, with the UAE withdrawing from the single currency project in 2009 following the announcement of plans to site the bank in Riyadh. Oman has also opted out for now as it would like more time to develop its financial infrastructure, though it is likely to rejoin the process in the future. The remaining four states are pressing on with the project, though it could take some time before the union comes to fruition.

9 Economist Intelligence Unit, 30.10.10 and National Bank of Kuwait, 28.01.12
10 NBK GCC Brief, 30.04.12
11 Swiss Re Sigma World Insurance in 2010
12 Arab Times, 08.04.10

## *China*

China 2030, a recently published report, sponsored through a collaborative effort between the World Bank and the Chinese Government, highlights the challenges facing China as its development moves into a new stage.[13]

China 2030 identifies the key emerging trends that will fundamentally affect China's economic development. It also provides recommendations for changes to the country's policy and institutional framework as it seeks to achieve sustainable and socially responsible economic growth through to 2030.

While these trends and recommendations are comprehensive, China 2030 highlights a number of key policy and institutional priorities for sustaining stable economic growth. These include the liberalisation of interest rate controls and the internationalisation of the Renminbi. Although these changes must be carefully managed to avoid unintended consequences, they, along with others, will provide benefits to the Chinese economy which include widened sources of funding and more efficient capital markets. However, Chinese banks will need to develop the systems and processes required to manage the more complex market risks that will accompany these developments.

The relevant trends, both domestic and global, discussed in China 2030 are as varied as China's economy. However, they will define the domestic financial services market through to 2030. Perhaps most significant and pervasive among these trends is the Chinese Government's keenness to transform domestic economic demand, which is currently reliant on exports and domestic infrastructure investment, to include a significantly higher proportion of retail consumption.

The discussion of trends also includes the effects of an ageing population, growing urbanisation and the increasing scarcity of the natural resources needed to fuel China's economic growth. These developments present a myriad of implications for China's banks. Among these will be the opportunity to create asset management products that will enable Chinese consumers, who already have one of the highest savings rates in the world, to more effectively fund their retirement needs. The Government is also looking to banks to invest in cleaner technologies and other forms of green development.

These, along with the other China 2030 recommendations and trends, foreshadow fundamental and inevitable changes for both the Chinese economy and its FS organisations. Those with the foresight to envision the impact of these changes and transform their businesses in response will claim the competitive high ground for the next generation.

13 China 2030 – Building a Modern, Harmonious, and Creative High-Income Society, 2011, The World Bank and Development Research Centre, the People's Republic of China.

## *Questions for the board*

- How adaptable are your people, products and business development strategies to local needs?
- How can you develop the necessary relationships with regulators, governments and distribution partners?
- As you look for a way-in to key target markets, what opportunities are there in helping governments to support economic development plans or bridge their pension, welfare and healthcare gaps?
- What would be the most efficient distribution networks? Could digital developments help bypass the need for well-established branch or agent networks?

## *Rethinking your strategy*

### Adapting your model

Traditional 'Western' financial services models may have little relevance in some SAAAME markets. While certain innovations can be adapted for local markets, strategies must reflect the local culture, distribution preferences and relative levels of sophistication in demand and technology. Even within countries themselves, there are likely to be marked regional distinctions.

As FS organisations move into new territories, they will need people on the ground who understand the local markets and can forge the all-important personal relationships – such people know their importance and understand their value. In certain SAAAME markets, the customer relationship is almost entirely personal and takes many years to develop, which requires patience and puts obvious pressure on employee retention. In turn, a crucial part of the 'licence' to operate is convincing local and national governments that the company's development plans can complement and augment their own. Governments are also likely to be crucial customers in their own right as investment in urban and infrastructure development accelerates and the public/private partnerships that support this proliferate.

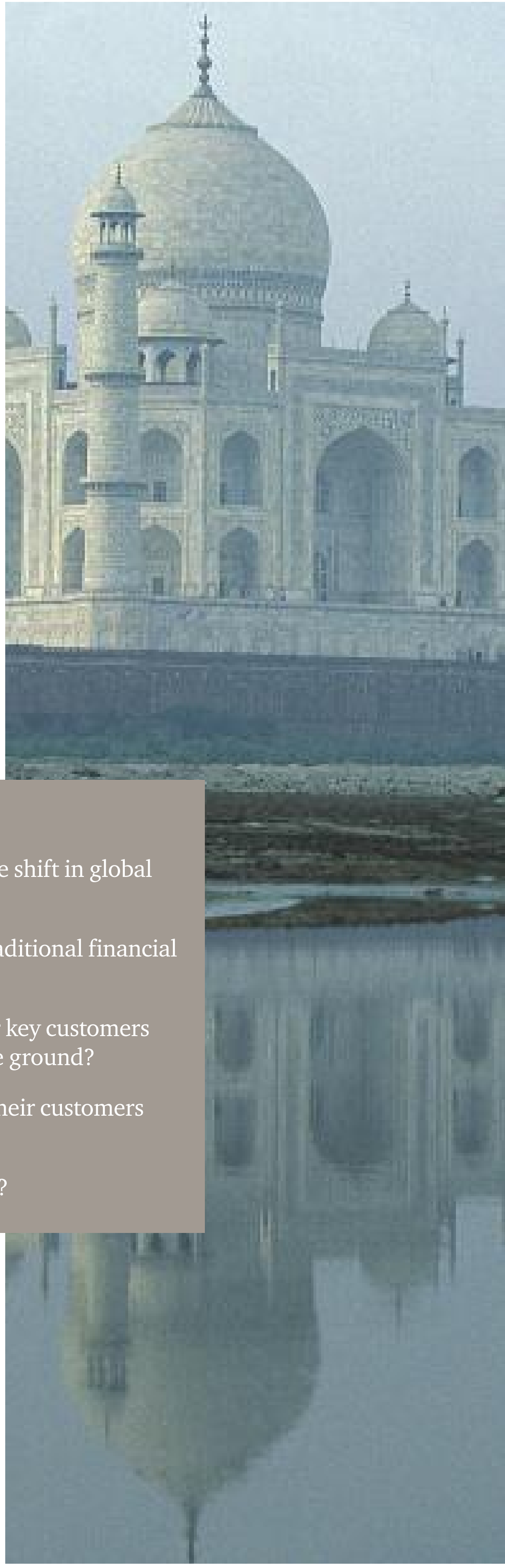
Demographics will have a powerful influence on economic growth and demand for financial services within each of the SAAAME markets. In India, for example, the relative youth of the population is sometimes described as its 'demographic dividend', stimulating long-term growth, offering huge potential for lenders and providing a strong spur for acceptance of technology and innovation. In contrast, China has an ageing population and its public pension, health and welfare systems are likely to require much greater support from the private sector. As greater affluence spurs continued increases in life expectancy in China and many other parts of Asia, meeting the demands of an older population presents a huge and, as yet, largely untapped commercial opportunity.

## Following your customers

The international FS groups that will have the strongest prospects within SAAAME are actively following the evolving global trade flows and seeking to support domestic clients in developing their overseas' reach. This could equally apply to a developed market group setting up a branch within the SAAAME region, or a SAAAME institution seeking to extend its presence to its clients' key supply or customer markets.

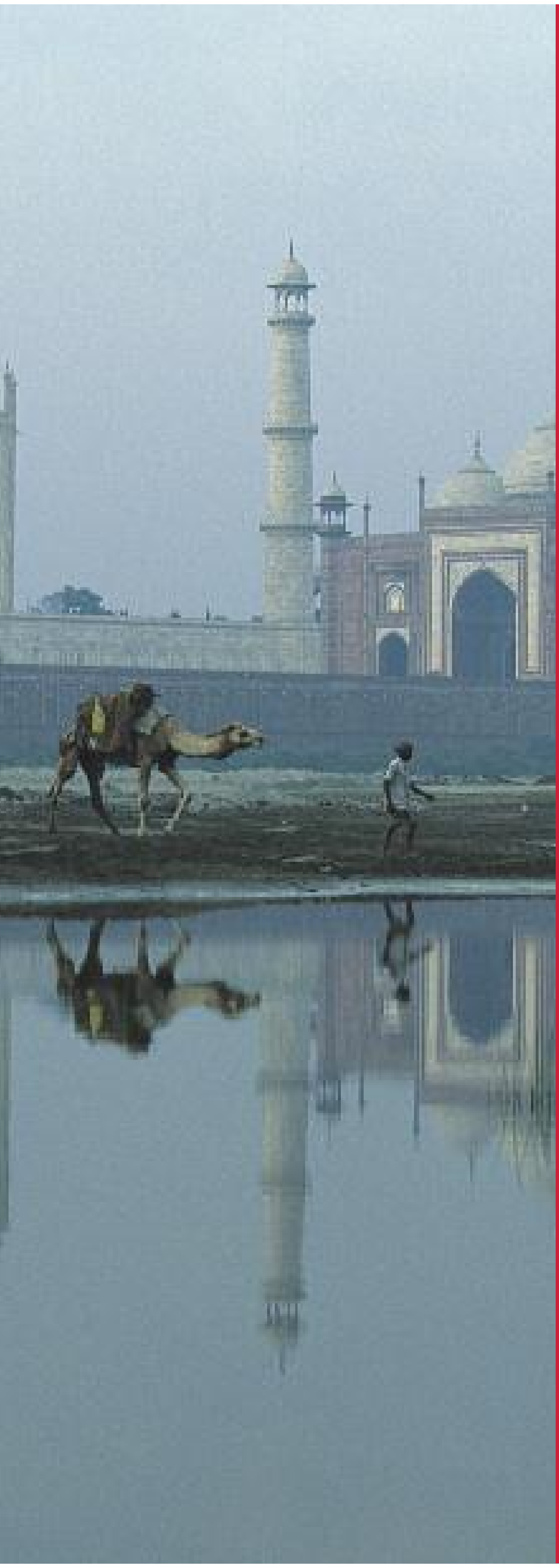
The ability to target investment and meet customer needs demands effective trade flow projections and the ability to discern where clients are planning to invest and develop their businesses. Organisations can then work with their clients to help bridge any potential gaps in the local financial infrastructure and overcome challenges in areas such as financing, risk management, currency convertibility and repatriation of revenues.

Few financial institutions are going to be able to sustain a global infrastructure covering all the necessary corporate services, so partnerships with local providers and even competitors will be necessary ('coopetition'). This will, in turn, demand more effective partner analysis and greater expertise in managing commercial networks.



### *Questions for the board*

- Do your investment and business development plans reflect the shift in global trade flows?
- How can you identify and tap into business that may bypass traditional financial centres and trade flows?
- Are you able to serve both ends of the trading pipeline for your key customers and, if not, how can you develop the necessary presence on the ground?
- Will leading SAAAME groups need to become global to serve their customers and sustain competitive relevance?
- Can models developed in one country be replicated in another?



## *India*

India is home to a fast-growing and often, innovative, though still under-penetrated, financial services market.

India's large and increasingly affluent millennial generation is changing the outlook and opportunities for FS businesses in the country. A key opportunity is developing investment products for a generation that may be prepared to take more risk than their older and more conservative counterparts. The challenge is how to make sure that pursuit of these opportunities doesn't lead to mis-selling, or risk creating a market bubble. This will require both effective regulatory controls and a more mature distribution structure led by a well-supported independent financial adviser network. The underlying requirement is for a deeper and broader based capital market, with a robust governance architecture encouraging retail investors to access these markets. One factor effecting development in the securities markets is that unlike most other countries, bank deposits pay higher rates of interest as compared to other investments.

The second key market opportunity is financial inclusion. Banks are developing 'no frills' accounts to draw in unbanked customers and help develop the habit of participating in organised financial services and investing in financial assets. The country's well-developed mobile phone network also provides a platform for bringing services into remote and poorer communities quickly and efficiently. The challenge is how to deliver consistent profits from these operations.

For Indian banks, the presence of Indian communities (the Indian diaspora) worldwide is providing openings for international development and expansion. The Government is also keen to develop international financial centres within India itself. The necessary expertise and technological infrastructure are developing rapidly. However, more robust ownership and contract laws will be needed before these centres can begin to develop in earnest and attract international participants.

Although India's banking sector is growing rapidly, difficulties in securing licences, tight restrictions on foreign ownership (5% limit for each firm and 74% overall) and restricted voting rights have deterred inbound investment in the sector. A more favourable route is investment in non-bank financial institutions, which allow 100% foreign ownership and offer access to fast-growing segments such as mortgages, vehicle finance, credit cards and stockbroking.

Foreign groups can also acquire full control of an asset management company. With assets under management more than tripling between 2001 and 2010 to top €100 billion in 2010.[14]

India doesn't have a state-sponsored social security system and therefore further development of the pension and annuities sectors is vital. Businesses in these sectors can also contribute to the development of long-term money markets and help fund the infrastructure development.

14 Association of Mutual Funds of India, 18.05.11

## Breaking into new markets

Many SAAAME governments have strategic plans for their economies, which could include favouring domestic institutions, directing investment priorities and dictating how far foreign organisations can compete. In turn, many Western governments will want to promote their own financial centres and encourage domestic institutions to direct investment into the local economy rather than overseas, especially if they've received state aid in the crisis.

Protectionist barriers to foreign ownership and licences are making it difficult for some foreign institutions to penetrate SAAAME markets, though investors from other SAAAME states may in some cases be favoured over their Western counterparts. The financial crisis may make some SAAAME governments more reluctant to embrace market liberalisation and foreign ownership.

Even if there are no such ownership or licensing restrictions, entrants may face entrenched domestic competition, or find it difficult to differentiate themselves from increasingly capable local counterparts. For most, the route to market is therefore going to be through start-ups and joint ventures. It's therefore vital that financial institutions think about what they can offer customers and potential partners that their competitors cannot. This may be particular risk management or product expertise. It may also be international coverage. Other key opportunities include helping local partners to develop their operational capabilities in areas such as foreign exchange and international payments. To compete, banks will need to secure a stable source of funding in local currency. This will be hard without a retail presence, which is expensive and difficult to build in the face of established local competitors with extensive branch networks.

Globally, Islamic finance continues to grow faster than conventional finance, with sharia-compliant assets worldwide passing a trillion dollars at the end of 2011.[15] Islamic banking, insurance and asset management are attracting people who haven't used financial services before. It's also providing a diversified source of funding for infrastructure development through the renewed interest in Islamic bonds (sukuk). Interest in such instruments is coming from both Islamic investors and non-Islamic investors looking to diversify their holdings. Notable recent developments include the sukuk issued in February 2012 to help finance the expansion of Jeddah's international airport, which at $4 billion was the largest single tranche Islamic bond.[16] Yet, differences over financial reporting and interpretations of sharia law remain and will need to be resolved before the market can begin to reach its full potential.

### *Questions for the board*

- How can you make sure your business development plans are aligned with long-term domestic and target market government agendas?
- What strengths and innovations would help to differentiate your offering from local competitors?
- How can you ensure a stable and reliable source of local currency funding?
- If many of the best joint venture and strategic investment opportunities have already been taken up, could there be openings for partnerships within other sectors, for example with telecommunications firms?
- Will greater foreign competition in specialist and niche areas take away business and erode the margins for domestic players? What market segments are under greatest threat and how fast will be the impact?

15 Financial Times, 14.12.11

16 Financial Times, 08.02.12

## *Brazil*

Brazil is experiencing its most prosperous economic period in 30 years and has arguably emerged stronger and more attractive from the global financial crisis.

A small number of international FS groups were able to develop a strong market presence in the years leading up to the financial crisis. However, further entry opportunities are limited by the lack of available acquisition targets and a long and complex licensing process. A number of FS businesses that have attempted to break into Brazil in recent years have also faltered through lack of a distinctive competitive proposition in a market that is already relatively concentrated and sophisticated, albeit under-penetrated in certain market segments. Areas with significant market potential include serving the country's rapidly expanding middle class.

Partnership could provide access to distribution, which is the major challenge in establishing a local presence. Partnership would also provide access to local funding and market knowledge. In return, local institutions would be looking for product and operational expertise. Crucially, within a market where several FS groups are looking to provide global services for their domestic and regional clients, they might favour foreign partners that could provide access to their international platform.

Most local FS groups already have a number of joint ventures in place and will only be attracted if the potential foreign partners can offer new or, as yet, untapped market potential. Top domestic banks are already working in partnership with telecommunications' companies to develop mobile banking, an area where penetration is currently limited, but has significant promise.

Challenges within the market as a whole include the need to develop longer term lending facilities for both consumer and corporate clients, amid pressure to lower spreads. This will affect the profitability of financial institutions.

## *Reinventing the organisation*

Designing the organisation of the future is a crucial part of the CEO agenda as financial institutions seek to create more nimble and adaptive operational capabilities and make sure their talent, structure and board composition reflect the changing market environment.

### *Questions for the board*

- Do the bases and structures of your global and regional operations reflect the changing centre of gravity of your business?
- Does your board have the right skills and are your current governance arrangements equipped to deal with multiple partnerships and extended global operations?
- Does the composition of your board provide you with sufficient business know-how, relationships and cultural understanding in your target markets?
- Are information flows timely and reliable enough to support your evolving operations?

### Adapting operating models and governance structures

As business models evolve, so will the demands on governance, organisational and operating models.

Operating models will need to reflect what may be a changing geographical focus of the business. They will also need to deal with more extensive partnership and coopetition arrangements and be sufficiently agile to respond quickly to evolving and possibly unfamiliar market conditions, distribution channels and cultural preferences. In turn, reporting and controls will need to adapt to reflect these more extended operations.

Legal and physical structures will evolve as new growth markets come to the fore and groups look at how to operate in the most tax- and capital-efficient way.

The composition and qualifications of the board are also likely to change as groups and their customers become more culturally diverse and partnership with government becomes an evermore crucial feature of FS businesses.

### Securing the talent to meet your objectives

As SAAAME becomes evermore crucial to growth, local and incoming firms will need to train, hire or relocate unprecedented numbers of skilled people in markets where suitably qualified and experienced people are already in short supply. As emerging market organisations expand their footprint and become more global in scope, they will also need to integrate and manage people from many different cultures within their businesses.

Yet, many organisations are still relying on short-term approaches, be this seeking to lure key people from competitors, or bringing in large numbers of expatriate personnel, even though this is likely to prove excessively costly and may still fail to provide the people needed to meet their strategic objectives.

A more systematic and forward-looking workforce plan, capable of anticipating and meeting skills needs could reduce costs, give financial institutions the edge

### *Questions for the board*

- Could shortages of talent impede or even derail your growth plans?
- How are you planning to bridge gaps in talent in key growth markets?
- Are you doing enough to encourage your staff to seek out international opportunities and make the most of this experience when they get back?
- Are you doing enough to develop the right skills and behaviour to take your business forward?

### *Questions for the board*

- How much freedom will you have to operate in a particular country? What kind of restrictions might you face?
- How vulnerable is your investment in a particular country to political instability, regulatory risks, a change of government, or consumer boycotts of particular countries or groups?
- What environmental risks does the country face and how could this affect stability and asset prices?

in a competitive job market and allow them to build a more sustainable platform for business development. A further priority is more effective communication and collaboration across markets.

Promoting diversity within the management of the organisation and creating career paths that extend across all its geographical operations are going to be crucial in competing for the best people against domestic companies in emerging markets. It sends a clear message that advancement is open to all rather than just people from the home market.

As they seek to attract top talent, SAAAME groups have advantages over competitors from outside the region. Following the financial crisis, many of the best graduates are favouring local over international groups as they believe the business and career development prospects are superior. Yet, challenges remain. With international groups setting ambitious targets for developing their presence in the region, salaries could rise further and retention is going to be more difficult.

### Managing a new and unfamiliar set of risks

The pace of growth of financial services within many SAAAME markets creates its own inherent risks. There may also be limited credit data or systematic checks to manage the risks in a way that would be possible in a more mature market.

The broader risk profile and how it's assessed and priced are also going to be very different. SAAAME countries have varied legal and regulatory frameworks, political systems, business ethics, cultures and sometimes, non-Western views on capitalism. It's important for incoming institutions to make sure they understand the ways of working required to operate in these jurisdictions.

The pace of development is also heightening pressure on natural resources. The competition for access is already going beyond oil and minerals to include water and land as countries seek to secure guaranteed food supplies. Helping businesses to manage commodity, supply chain and other risks provides a clear opportunity; financial institutions will need to take account of the associated shifts in investment risks and asset prices.

Country risk profiles are also changing. The Arab Spring highlights how a combination of demographics (a young population, disaffected by unemployment and its limited political voice) and technological development (protesters' use of social media to communicate) can quickly ignite and fan the flames of instability.

## *Africa*

Africa is at the centre of the SAAAME opportunity, both in its geographical position and in its still largely untapped economic and commercial potential. A strategy for Africa is set to form an important part of the long-term planning for financial services groups.

Africa is home to more than 800 million people and has total purchasing power of nearly two trillion dollars.[17] Its GDP has been increasing by more than 5% a year over the past decade, with the continent accounting for six out of ten of the fastest growing economies in the world over this period.[18] According to the IMF, these buoyant economic trends will continue over the next five years, bolstering the case for further investment by financial services businesses.

Africa continues to offer significant opportunities for resource and infrastructure companies, with a large amount of investment coming from India and China as the needs of their economies increase. For FS businesses, the attractions include Africa's increasing access, to and integration into, international capital markets. Other important developments include regulatory reform and privatisation, and the increases in demand created by expanding populations and urbanisation.

Lack of infrastructure presents one of the largest challenges for companies seeking to do business in Africa, but also an investment opportunity. The continent currently lags in the availability of paved roads, telephone lines, electricity coverage and sanitation. There is also significant room for IT development. The Global Competitiveness Index (GCI) provides potential investors with useful information on the most pressing infrastructure shortfalls. According to the GCI, countries offering the biggest opportunities for infrastructure development (South Africa, Nigeria, Angola, Ethiopia, Uganda, Tanzania and Ghana) will have to spend money on electricity and railways infrastructure to improve their competitiveness. Additionally, Nigeria, Angola, Tanzania and Uganda will have to develop their roads, ports and air transport.

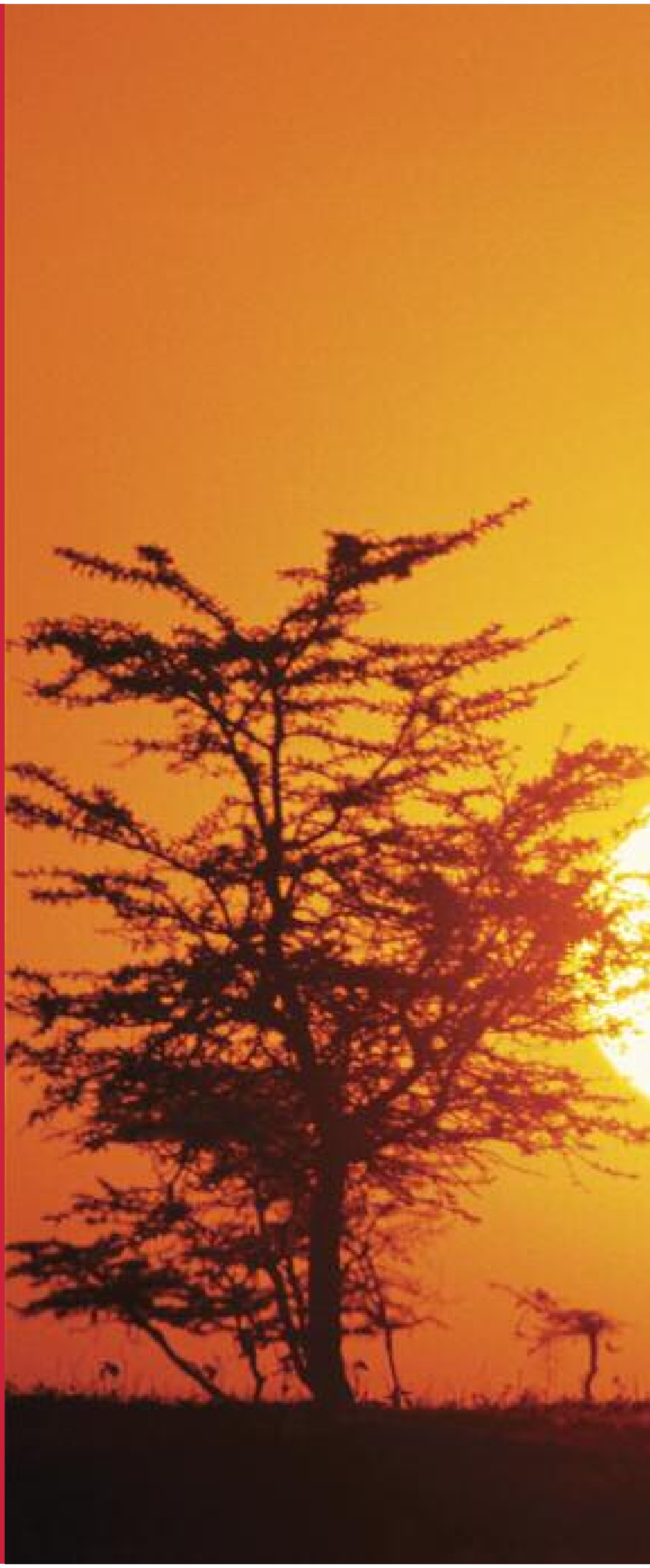
Companies considering investment in Africa need a thorough understanding of the business environment. They should also consider areas of heightened risk. Risk of nationalisation is a particular concern in some countries and sectors. A recent example is Zimbabwe's new mining regulation, which requires companies to hand over a 51% stake in their shares to local designated entities.[19]

So while FS businesses will need to weigh up the risks and rewards, the case for investment in Africa is growing and the continent is set to become an important competitive arena from FS organisations in the coming years.

17 RMB media release, 15.08.11

18 IMF World Economic Outlook, April 2012

19 Mining Review, 10.03.11




*For FS businesses, the attractions include Africa's increasing access, to and integration into, international capital markets.*

# Conclusion
## A new DNA

*Western economic pre-eminence is a relatively recent phenomenon. Rather than looking ahead to the emergence of some new dominant country or region, we're actually seeing a return to the equilibrium of a multipolar global economy that has prevailed throughout most of the past 500 years.*

The overriding questions for all FS groups are how to keep pace with the rapid rise and interconnectivity of the emerging markets and what will be the profile of successful international groups as the industry landscape evolves. New strategies, operational models and ways of measuring success are set to emerge. New countries, notably Russia, may eventually be brought into the SAAAME fold as they trade more widely, creating an even more prolific trading region.

As SAAAME-based groups look to follow their customers and take advantage of their growing financial strength, the key question they face concerns whether they develop in cautious incremental steps, or seek to follow the more ambitious model of global expansion, developed by their Western counterparts, prior to the financial crisis. Most have so far chosen the former. Could they lose out to faster moving competitors as a result? Acquiring Western businesses would provide a foothold in local markets and access to some of the capabilities they will need to sustain expansion and competitive relevance. The acquisition prices for some developed market targets are much lower than before the financial crisis. But this window of opportunity could be short-lived.

In an increasingly globalised FS sector, the impact of the rise and interconnectivity of the emerging markets will be felt in the West as much as SAAAME itself. Western businesses can't simply assume they'll be able to transfer investment and growth into new markets. They're going to face growing competition from SAAAME-based international groups and could become targets for acquisition themselves.

Establishing and developing a global footprint are only part of the challenge. Success is also likely to depend on being able to anticipate and respond quickly to the changes in customer expectations, behaviour and use of technology that are shaping SAAAME and wider global markets. Further priorities include effective analysis of what may be unfamiliar and increased risks, their impact on the business and how this squares with overall objectives and risk appetite. Strategies will need to be finely tuned to the cultural, technological and regulatory realities on the ground. FS businesses will also need to take account of the influence of governments on how their sector develops and what they can offer in support of social, economic and environmental objectives.

In the face of these challenges, executives will need to consider how they can sufficiently differentiate their business to win over customers, investors and governments. They will also need to consider how to foster the cultural diversity, international experience and succession planning needed to ensure the organisation remains agile enough to meet the required business changes as they arise.

Smart businesses are already moving quickly to anticipate and adapt to the new industry DNA, while managing the risks. For others, simply relying on tried and trusted models developed in the pre-crisis era will no longer be enough.

# Making sense of an uncertain future

*We're working with a range of financial services organisations to assess the impact of the mega-trends shaping their industry and where and how they can compete most effectively. If you would like to discuss any of the issues raised in this paper, or the impact of other trends examined in Project Blue, please contact any of those who are listed, or your usual PwC contact:*

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# Project Blue framework

*The Project Blue framework considers the major trends that are reshaping the global economy and transforming the behaviour of consumers, businesses and governments.*

The Project Blue framework seen here begins with the considerations needed to adapt to the current instability. It then goes on to assess what businesses need to do to plan for, and ideally take advantage of, the changes ahead.

One of the main things we've been looking at is the extent to which these developments could disrupt existing business models. We've also been looking at how these trends are feeding off each other. A clear case in point is the extent to which rapid growth in emerging markets is spurring a mass influx of people into the cities.

Our clients are using the framework to help them judge the implications of these developments for their particular business, and look at how to take advantage of the changes ahead. Will business and operational models still be viable in this new landscape? What strengths within the business would allow it to develop a leading position? What talent and investment will need to be put in place now, to prepare for the changes ahead?

## Figure 11: The Project Blue framework

Project Blue Framework

Adapt

| Global instability | | |
|---|---|---|
| Regulatory environment | Fiscal pressures | Political and social unrest |

Plan

| | | |
|---|---|---|
| **Rise and interconnectivity of the emerging markets (SAAAME)** | • Economic strength<br>• Trade<br>• Foreign direct investment | • Capital balances<br>• Resource allocation<br>• Population |
| **Demographic change** | • Population growth discrepancies<br>• Ageing populations | • Changing family structures<br>• Belief structures |
| **Social and behavioural change** | • Urbanisation<br>• Global affluence<br>• Talent | • Changing customer behaviours – social media<br>• Attitudes to financial institutions |
| **Technological change** | • Disruptive technologies impacting FS<br>• Digital and mobile | • Technological and scientific R&D and innovation |
| **War for natural resources** | • Oil, gas and fossil fuels<br>• Food and water<br>• Key commodities | • Ecosystems<br>• Climate change and sustainability |
| **Rise of state-directed capitalism** | • State intervention<br>• Country/city economic strategies | • Investment strategies<br>• SWFs/development banks |

Source: PwC Project Blue analysis

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