Indonesian Banking Survey 2014

32%

of the respondents are of the view that rising of inflation and interest rate will have major impact on Indonesia's economy in 2014.

51%

of the respondents expect the loan growth in 2014 will be lower than 2013.

pwc

www.pwc.com/id

Welcome to PwC Indonesian Banking Survey 2014!

Jusuf Wibisana
Partner

Over the past five years, PwC Indonesia has asked the views of senior banking executives across Indonesia to gather and synthesise their diverse opinions for our Indonesian Banking Survey.

The survey endeavours to share bankers' insights on business strategies for growth and challenges; discuss bankers' views on major business areas; and promote mutual understanding across the Indonesian banking industry.

Our yearly surveys focus on three principle areas:

1. Growth outlook
2. Operational matters
3. Risk management, corporate governance and regulation

This year, after considering last year's survey outcomes, we have enhanced the 2014 Survey by adding two new focuses:

4. Retail banking customer perspectives
5. Talent management.

The results of the Survey are based on completed questionnaires from over 80 senior banking executives working in the Indonesian Banking sector. More than 80% of the top 30 banks are represented in the survey.

We would like to take this opportunity to extend our sincere thanks to the respondents for their time and effort in contributing to this Survey. We are confident that this report will provide readers with an understanding of the professional opinions of senior banking executives.

We welcome any feedback you may have on the PwC Indonesia Banking Survey so that we can incorporate it into future surveys and provide you with most relevant information. Do contact us.

Contents

01
Macroeconomics and banking challenges in 2014| page ***2***

02
Regulations | page ***6***

03
Risk Management | page ***10***

04
Customer Satisfaction | page ***14***

05
Talent Management | page ***20***

01

Macroeconomics and banking challenges in 2014

Macroeconomics outlook

After strong Gross Domestic Product (GDP) growth in the past couple of years, Indonesia's economy is expected to experience a slowdown in 2014. The increase in GDP may even slow to its lowest level since 2009 as a direct result of the government's ongoing effort to curb the current account deficit and the Bank Indonesia's tightening of monetary policy. Interest rates were raised to 7.5% in 2013 which has helped to address the current account deficit target of 2-2.5% of GDP in 2014.

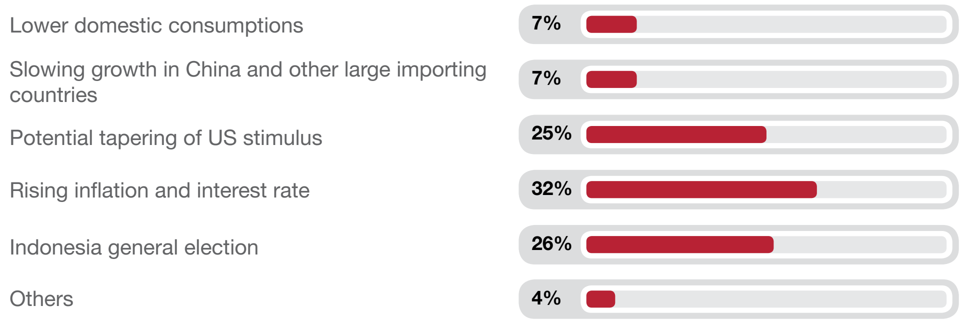
Almost one-third of bankers surveyed (32% of respondents) think that rising inflation and interest rates will have the biggest impact on Indonesia's economy. Against this backdrop, approximately 60% of bankers predict that the Bank Indonesia will continue to increase interest rates in 2014, possibly up to between 8 and 9%.

Given the high interest rate environment, 78% of bankers anticipate lending growth to be sluggish.

By contrast, 26% of respondents believe the 2014 general election will have major impact on Indonesia's economy and 25% said that the potential tapering of the US stimulus package will be the major factor. Sixty percent of bankers expect the general election to cause many investors to hold back on their plans for expansion, resulting in lower demand for new or additional loan facilities in 2014.

Figure: 1

Q: Which factor below causes major impact on Indonesian economy in 2014?



Bankers split on target markets for 2014

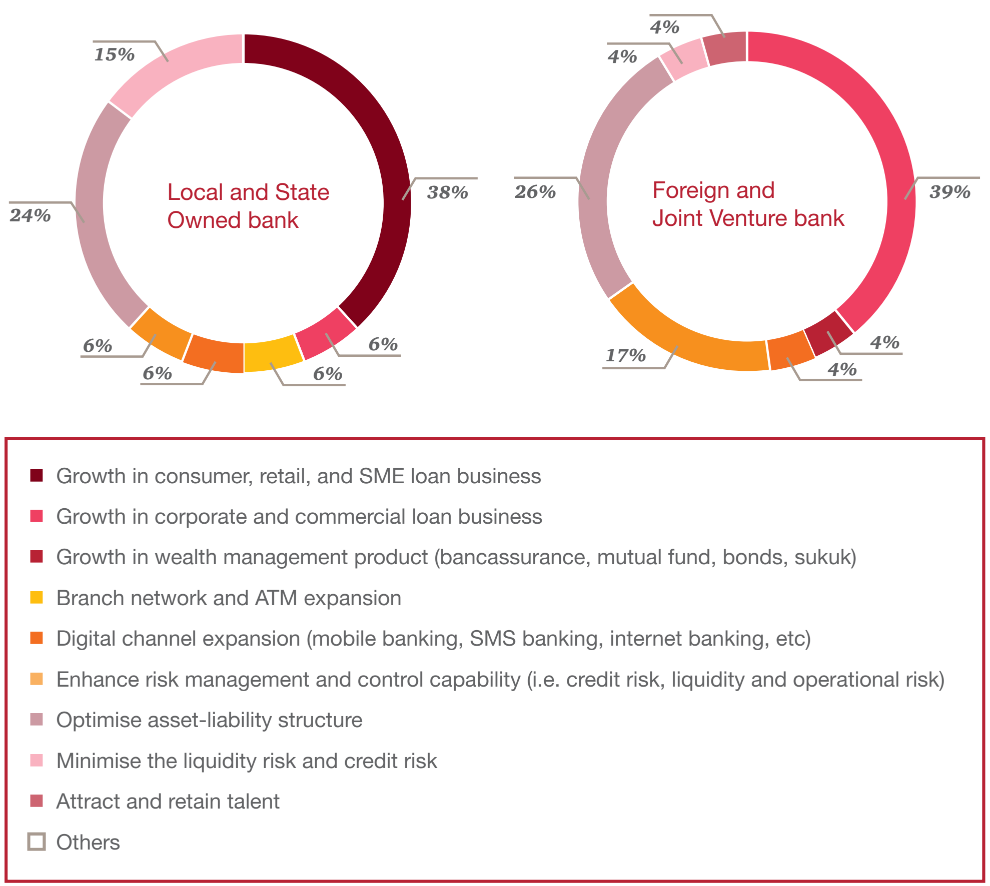
We asked bankers about their top strategic goals for 2014 and noted a wide range of target areas. However, two contrasting themes seemed to appear when we analysed responses from local or state owned banks compared against the opinions of foreign and joint venture banks.

Local and state owned bankers are of the view that the growth in their consumer, retail and small and medium enterprise (SME) business is their key target for 2014. They saw these sectors as the backbone of Indonesia's economy and expected them, at least for the present, to provide a relatively high net interest margin. An obvious factor in local and state owned banks targeting growth in these areas is the Bank Indonesia statement of 2013 that requires banks operating in Indonesia to direct at least 20% of their credit portfolio to the consumer, retails and SME sectors by 2018.

On other hand, foreign and joint venture banks are more focused on growing the corporate and commercial loan segments. However, both groups shared the view that the second top strategic goal in 2014 is managing assets and liabilities, in either a defensive or aggressive manner.

Figure: 2

Q: What is your top strategic goal for 2014?



Defensive control refers to the isolation of the NIM from interest rate fluctuations, with no regard over the course of these variances (positive or negative). Aggressive control focuses on maximising the NIM by altering the balance sheet structure. Both cases analyse the bank's balance sheet's positions that are sensitive to changes in interest rates. The ability to forecast interest rates is an important factor, especially for aggressive control, in ensuring the success of strategy.

More intense competition for funds, customers and talent

Having gone through 2013, Indonesian banks are facing an even more challenging environment in 2014 given the tight economic conditions.

Bankers surveyed said that the top three challenges for the year are margin pressure, tougher competition and increased credit risk related to their loan portfolio.

As expected, most bankers anticipate that business will be slower in 2014 compared to previous years. 51 % of bankers expect loan growth to be around 15-20% this year following actual loan growth of around 21.8% in 2013.

This view is in line with many economists and analysts as well as estimates by the government and Bank Indonesia. The consensus is that the Indonesian economy will not fully recover in 2014 but it will show signs of improvement.

On the funding side, survey respondents expect third party funding will rise by 15-20%, which is stronger than its growth in 2013 of around 14%.

Competition for funds will result in overall higher costs impacting banks' performance. 53% of respondents said that net income growth in 2014 will only around 10% - 15%, which is lower compared to the actual net income growth of around 15% in 2013.

Indonesia has one of the largest number of financial institutions of any country, with over 120 banks in operation. And as Indonesian consumers are offered more choices, they are increasingly demanding more from their banking relationships and willing to shift their business based on price and the quality of customer service. According to the survey findings, the most competitive areas of the business is in funding sources and the war for talent.

Figure: 3

Q: What is the top three major challenges for achieving your growth targets in 2014?

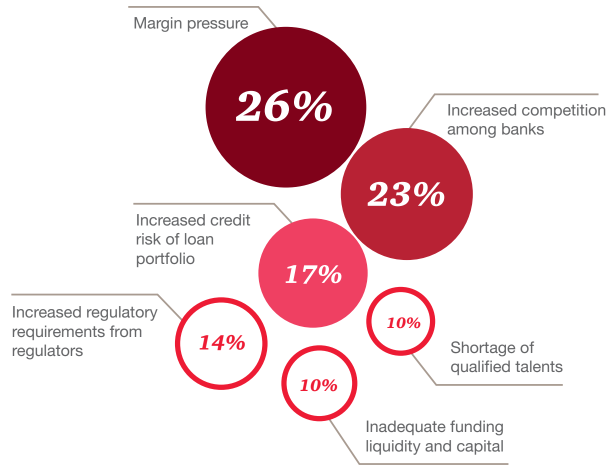
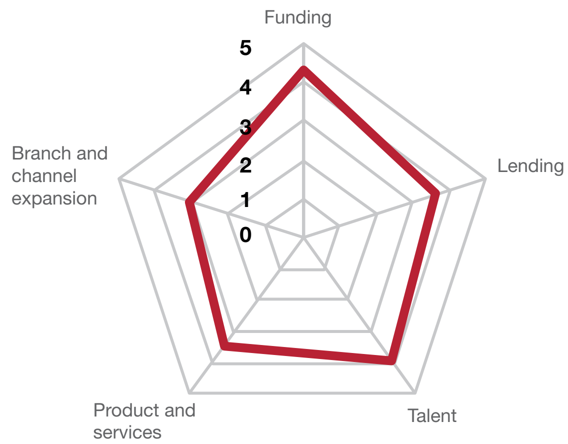


Figure: 4

Q: What is your view on Indonesia banking competition ("1" being less competitive while "5" being highly competitive)



02

Regulations

FATCA deadline approaching

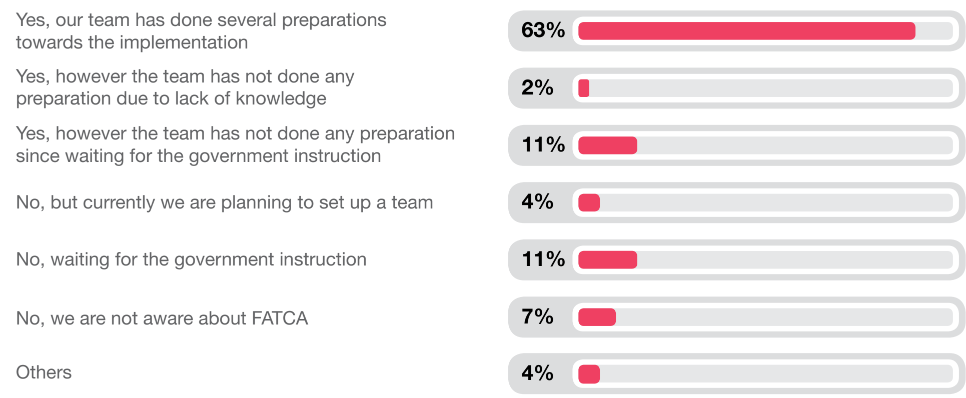
Foreign Account Tax Compliance Act (FATCA) compliance is a pressing concern and financial services companies should define what is required for their business as soon as possible. The regulations and Inter Governmental Agreements (IGAs) list a variety of one-time deadlines and due dates that will repeat on a periodic basis. However, most notably, companies with withholdable payments must have processes and procedures in place to identify and categorise non-US payees for the purposes of FATCA, report such payments to US Internal Revenue Service (IRS) and potentially withhold the 30% tax by 1 July 2014.

As part of our survey we asked respondents about awareness and readiness of FATCA registration and implementation and are pleased to note that many banks (63%) in the survey are prepared for implementation.

However 22% of respondents are still waiting for government instruction. The Indonesian government is still preparing for FATCA implementation. Based on the most recent advice, we understand that the Indonesian Financial Authority (OJK) is preparing the draft regulation for supporting financial institutions In Indonesia for implementing FATCA. The draft of regulation is still in its early stages but OJK believe the Indonesian Government will sign an IGA with the IRS before July 2014.

Figure: 5

Q: In relation to FATCA, does your bank have a specific project (team) to manage the implementation?



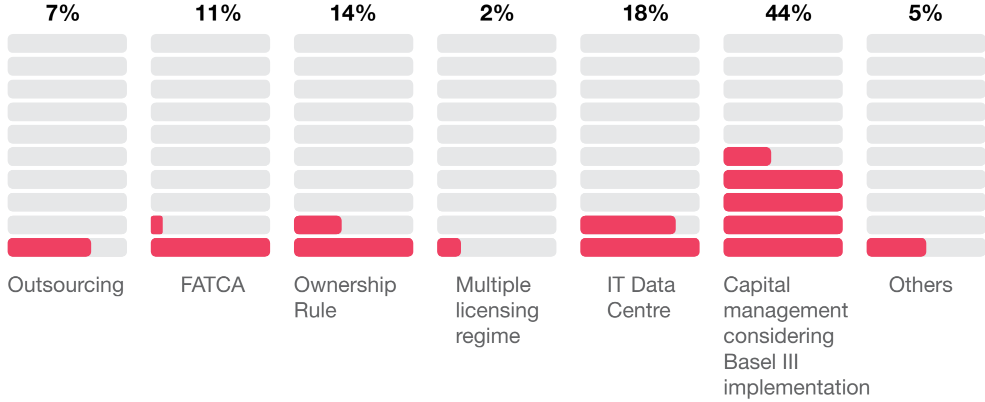
Clarity on several regulations

With the growing volume of regulations, banks are routinely challenged by the need to interpret them correctly.
The survey shows that the regulation related to Basel III and Capital Management need the most attention from the regulators to be able to provide more clarity.

Bankers also need more clarification from regulators regarding the regulations related to the IT data centre, the ownership rule, FATCA and outsourcing.

Figure: 6

Q: In which of the following area of regulation would you like the regulators to provide more clarity?



Mixed results for BASEL III regulatory reforms

In August 2013, the Basel Committee on Banking Supervision published its fourth report to the G20 Leaders on the implementation of Basel III regulatory reforms.

This latest report noted substantial progress with respect to:
the adoption of the Basel standards by Basel Committee member jurisdictions;
the harmonisation of capital regulations across member jurisdictions; and
the finalisation of remaining post-crisis reforms that form part of the Basel regulatory framework.

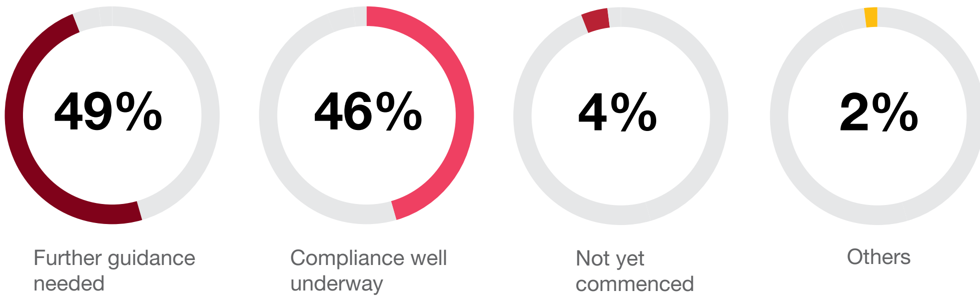
The regulations place a number of demands on banks in 27 different countries to be met by 2019, including the need to hold certain amounts of capital as well as low-risk assets on their balance sheets.

In response to BASEL III requirements, the OJK announced in December 2013 a new regulation (15/12/PBI/2013) concerning the Minimum Capital Adequacy Requirement for financial institutions, including an additional capital requirement as a buffer. This regulation has applied since 1 January 2014.

We asked bankers about Basel III implementation as part of our survey and whilst 46% responded that compliance is well underway, another 49% need further guidance. This suggests that for banks in Indonesia the capital management guidelines based on BASEL III still require more clarity and explanation from regulators.

Figure: 7

Q: How prepared do you consider your Bank to comply with and implement Basel III?



03

Risk Management

Credit and liquidity risk are the main risks anticipated by Indonesia banks in 2014

Credit and liquidity risk have become the top risk management challenges in 2014 for most banks in Indonesia, although it is worth noting that for state owned banks credit risk is of less concern.

Compared to our past three annual banking surveys, credit and liquidity concerns have increased significantly among local and foreign bank executives this year. Credit risk is the most serious risk for 39% of bankers and liquidity risk comes as second for 33% .

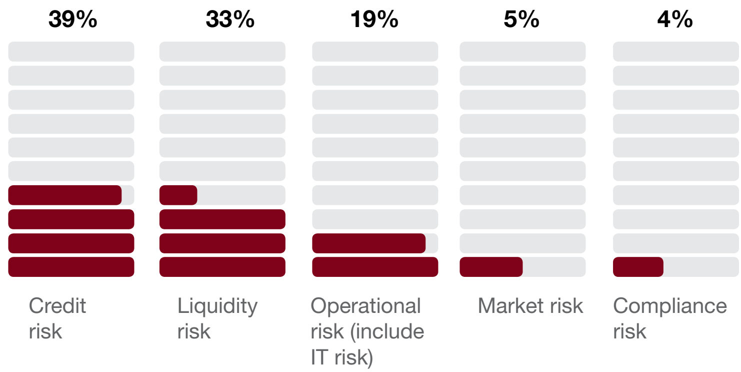
These findings may be a consequence of the challenging business environment in 2013 continuing into 2014 as economic conditions are still difficult and monetary policy remains tight.

The benchmark interest rate has risen by 175 basis points since June 2013 and there are concerns about the ability of businesses and consumers to absorb the higher rates.

Triggered by domestic interest rate hikes, a weakening rupiah, slower economic growth and the pressure of the current account deficit, bankers have acknowledged that they will need to deal with tougher liquidity conditions and strong competition for third party funds. The result will be higher costs of funds and lower net profit margins for this year.

Figure: 8

Q: Which risk area is on top of your risk management agenda in 2014?



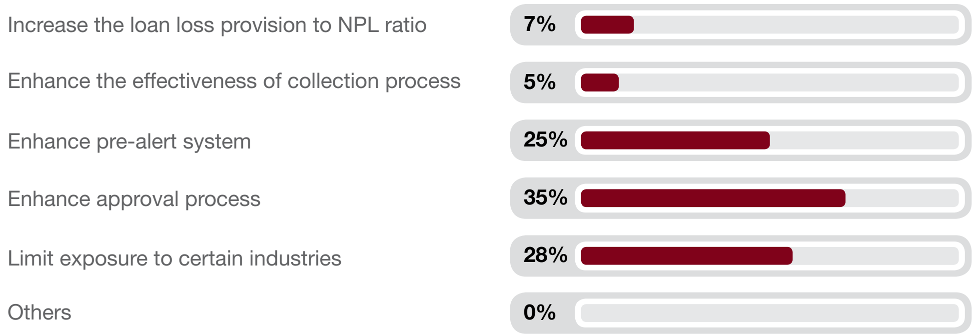
03

Several initiatives may be needed to reduce the risk of bad debts in banks' credit portfolios.

The top three strategies to be taken by bank executives to counter credit risk are to enhance their approval processes, limit the exposure to certain industries and enhance their pre-alert system.

Figure: 9

Q: What is your strategy to manage credit risk in 2014?

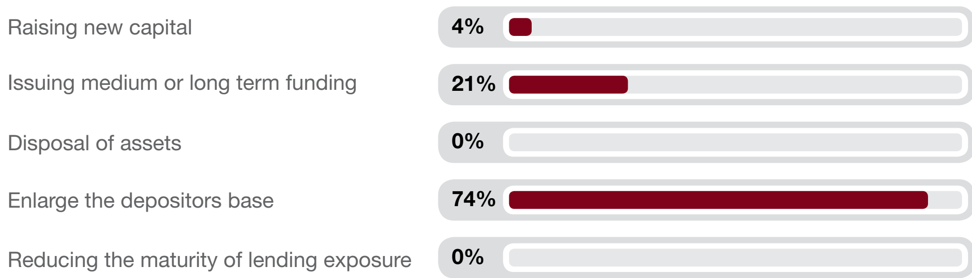


Bank Indonesia has predicted that in 2014 liquidity will continue to be a challenge as a capital outflow back to developed countries is expected, exacerbating the increases in the domestic banks' cost of funds.

In addressing liquidity concerns, 74% of respondents have said that their key strategy is to grow their depositor base.

Figure: 10

Q: What is your strategy to manage the liquidity risk in 2014?



Operational Risk

We asked bank executives to indicate their key strategy in managing operational risk.

It is no surprise that enhancing risk control self assessment has become the top priority for 47% of respondents in 2014. It shows that understanding and self awareness is critical when dealing with operational concerns. The complementary strategy of improving standard operating procedures was cited as the key strategy for another 26% of executives.

Operational risk management still needs improvement

Consistent with last year survey results, respondents believe their capability in responding to operational risk is less robust compared to other risk areas. We believe that this can be partially attributable to the increasing complexity of banking businesses as new and more complex products, transactions and activities are undertaken.

Of all the different types of risks financial institutions face, operational risk can be the most devastating and the most difficult to anticipate. Its appearance can result in sudden and dramatic reductions in the value of a bank.

Figure: 9

Q: What is your top priority of strategy to manage the operational risk (include IT risk) in 2014?

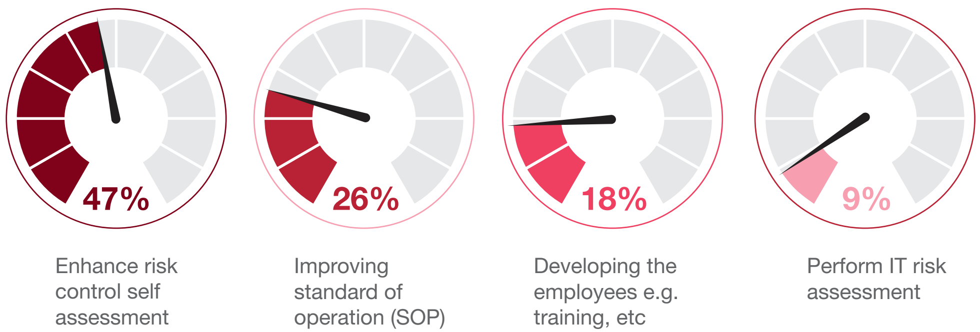


Figure: 10

Q: How well do you think your Bank manages each of these risks? (“1”: satisfied, “5”: very satisfied)

04

Customer Satisfaction

Customer satisfactions

It is increasingly clear that customers are taking greater control over their banking relationships. As they are exposed to a more varied array of banking products and services and given the opportunity to use online and other delivery channels, customers are more aware of alternatives and so form views and opinions about their banking partners. As a result, their traditional loyalties weaken and they demand improvements or switch to rival service providers.

In response to this trend, banks need to re-evaluate their assumptions regarding customer relationships and fundamentally change how they interact with their customers. Successful banks will embrace change by giving their customers greater flexibility, choice and control, and by reconfiguring their business models around customer needs.

Giving more "power" to customers may make bankers feel uncomfortable, but in the long run banks that do so will position themselves ahead of the competition in the future.

Bankers regularly seek customer feedback and analyse customer satisfaction, so as part of our survey, we asked respondents to give their opinions about how their customers choose a banking provider.

Interestingly there are clear differences in opinions between local and foreign banks.

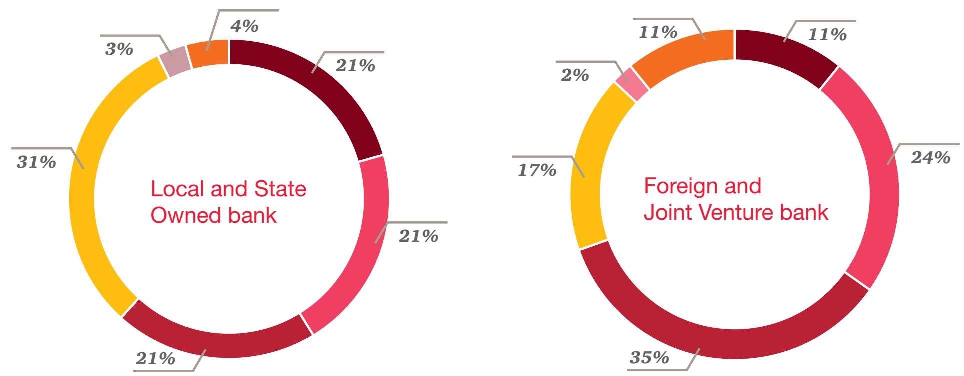
The greatest proportion of foreign and joint venture bankers (35%) said that giving the best deal (such as lower charges, higher interest and/or gifts) is the top factor for curtomers in choosing a bank.

In contrast, 31% of local and state owned banks think that having a strong banking channel (ATM, branch, internet banking, mobile banking) is the most important.

Customer service, cited by 21% of respondents from local banks and 24% of foreign bank respondents, is the second most important factor overall.

Figure: 11

Q: Provide your opinion what are the key factors for customer in selecting the banking provider?



- Brand
- Excellent customer services
- Giving me a best deal (e.g. lower charges, higher interest, gifts)
- Have strong banking channel (ATM, branch, internet banking, mobile banking)
- Others
- Have good corporate social activities)
- Existing banking relationship with your family
- Helping me to achieve my financial goal

Customer services

In recent years, banks have made significant strides in the area of enhancing customer services. Customer service has been evolved from the single services desk in a bank's branch to full telephone and online contact centers with dedicated teams answering and resolving diverse queries and complaints.

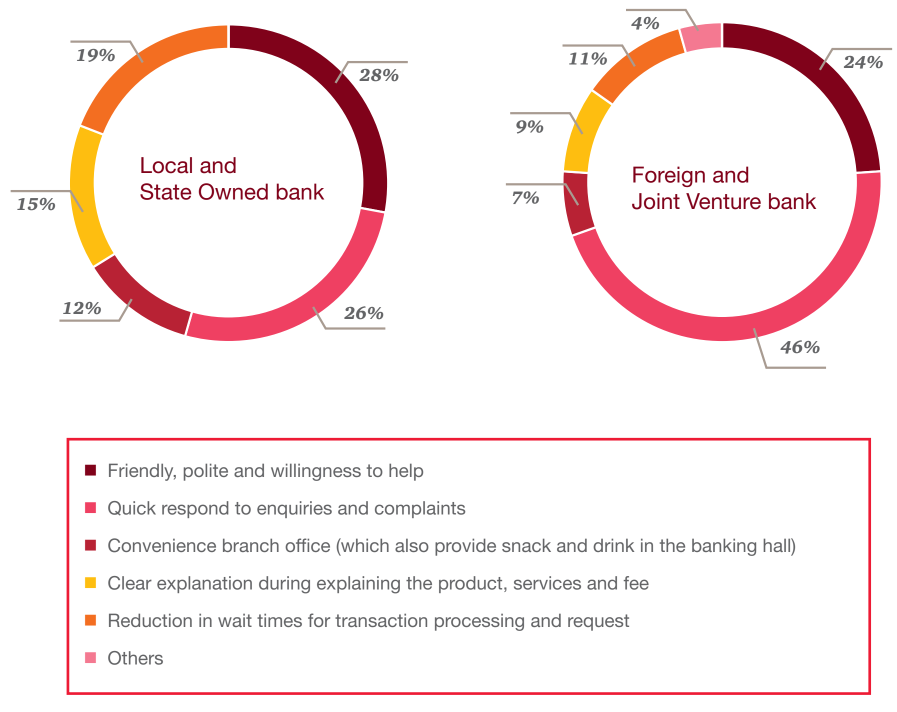
As customers interact with staff in different ways, banks need to be able to identify key touch points for each interaction in order to improve customer services. For instance in the case of a branch visit, a bank can enhance the customer's experience on many levels (including queuing time, convenience of location of services, willingness to help) so that the customer leaves the branch with a positive view. Proactively anticipating customer needs and expectations and offering suitable alternatives can further cement good relationships.

Maintaining a high quality of service also requires a talented workforce. Investing in staff training in order to equip them with the right tools and knowledge to communicate clearly and effectively with customers will provide banks with a competitive edge.

Our surveyed bankers overwhelmingly view speedy responses to enquiries and complaints along with a willingness to help as being most valued by customers. Foreign and joint venture banks perceive quick responses as more important (46% of respondents) while local and state owned banks placed 'friendly, polite and to help' as almost equally important as response times.

Figure: 12

Q: What do the customers value the most from bank services?



Easy access to banking needs

Ensuring customer can utilise banking services efficiently through a number of different channels is integral to keeping customers happy. Customers are getting used to the convenience and shorter turnaround times that online and mobile devices can offer in their daily lives and they are now demanding similar levels of speed and ease of access from banks.

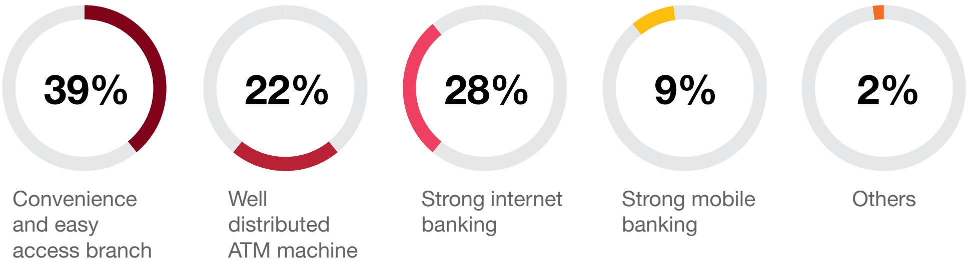
Increasingly, banking channels must provide full functionality and maintain high levels of availability, reliability and security to meet expectations. Customers want to be able to process near-instant transactions from their mobile devices or computers whether they are at work, at home or traveling. As they migrate to self-service channels such as ATMs, the internet and mobile networks, banks have an opportunity to leverage technology to deliver efficient and more personalised services.

Although ATMs have been fastest growing channel in Indonesia in recent years, there have been significant investments in mobile and internet banking by many banks.

Despite these technological advances the largest percentage of bankers surveyed (39%) still consider that a convenient and easily accessible branch is most valued by customers.

Figure: 13

Q: What do the customers value the most from bank's channel?



Customers turn to friends and newspapers for information

Customers place the greatest value on information and advice that comes from sources they know and trust.

As personal recommendations are the most important source of information it is not surprising that when it comes to seeking advice on banking products and services, 35% of bankers surveyed believe customers consult friends first.

Although social media are becoming important sources of information, in emerging markets such as Indonesia bankers believe customers still receive information about banking product and services from newspapers and magazines (cited by 25% of respondents as the main source of information) rather than social media, websites and branches or call centres. Brochures and parents are not seen as primary information sources.

In term of bankers' views on customer satisfaction with regard to pricing, turnaround times, customer service and transparency of products, respondents predict that Indonesian customers are most satisfied with service and transparency.

Bankers believe that there is still room for improvement in making processes more efficient and meeting customer expectations in terms of interest rates and fees.

Figure: 14

Q: From whom do the customers received information about banking product and services?

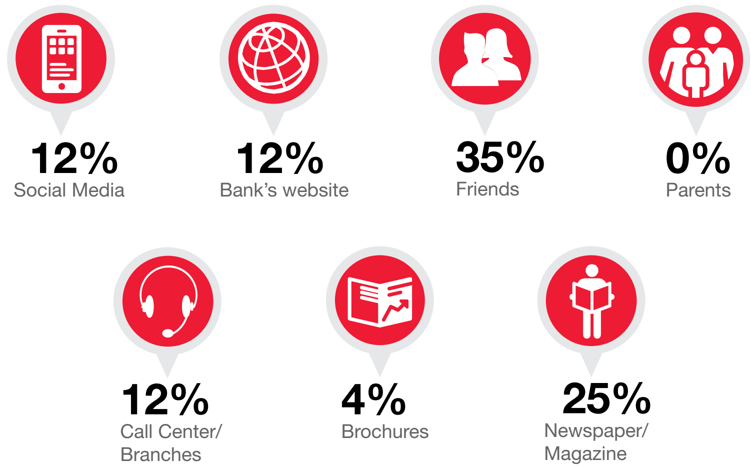
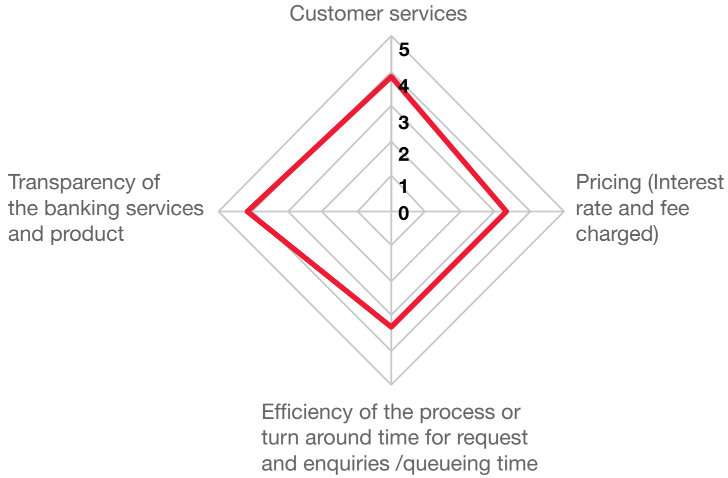
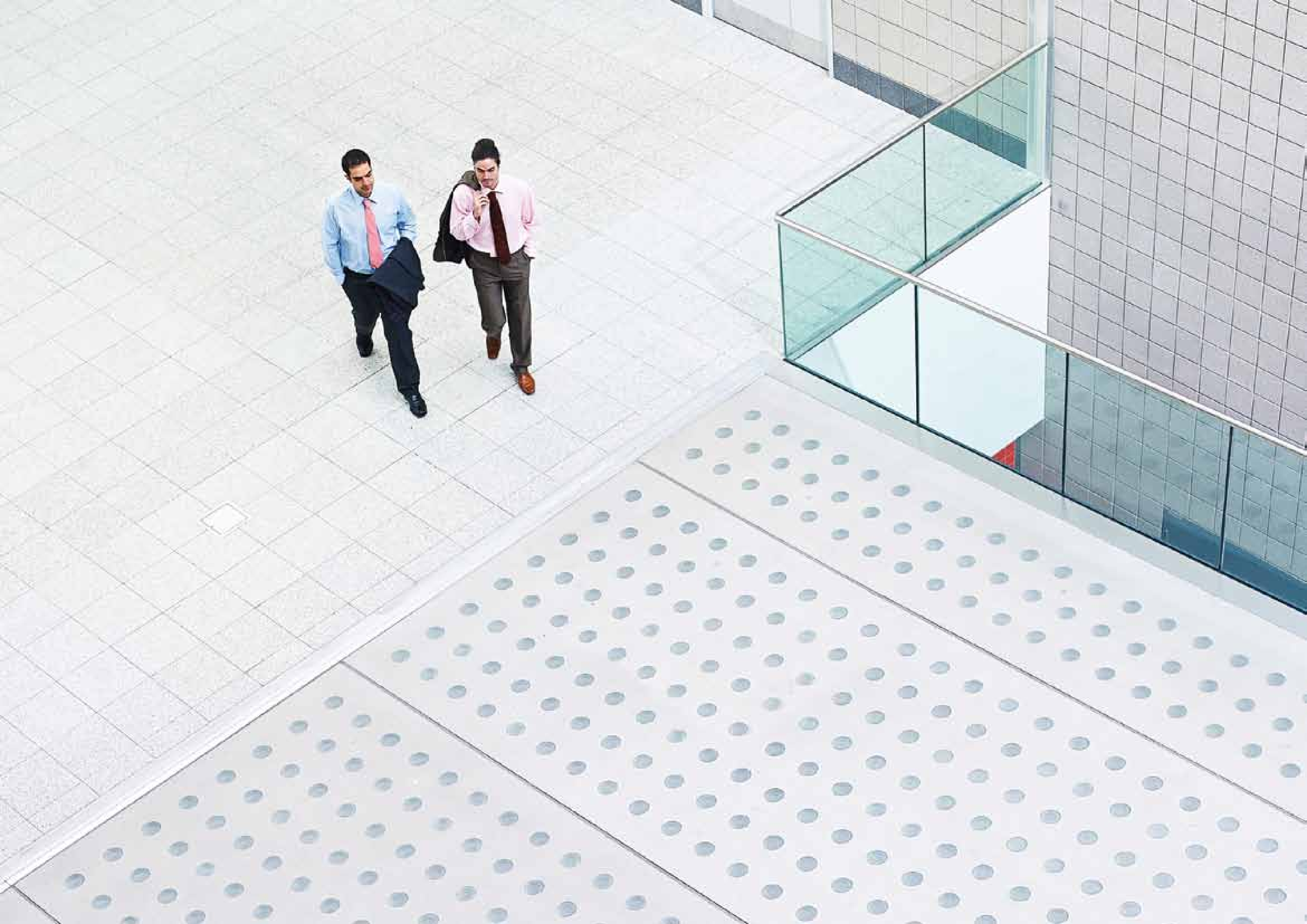


Figure: 15

Q: How satisfied are your customers with aspects below ("1" being dissatisfied while "5" being very satisfied)?





05

Talent Management

War for talent continues

Given the large number of local banking institutions and the expansion of foreign banks, the shortage of qualified staff in the Indonesian market continues to be a major issue for banks. 44% of respondents said that the scarcity of quality talent was the biggest challenge in talent management.

In a continuation of the trend reported in our 2013 survey, 37% of respondents indicated that the voluntary turnover rate in their organisation remains above 10%. The relatively high level of workforce mobility in the industry is reflected in the average tenure of employees. More than two-thirds (68%) of respondents said that average tenure in their company is between two and ten years of service and 35% said staff stay with the company on average for between two and five years. Only 2% of respondents cited average tenure rates of more than 20 years.

Figure: 17

Q: Why is it difficult to find qualified talent?

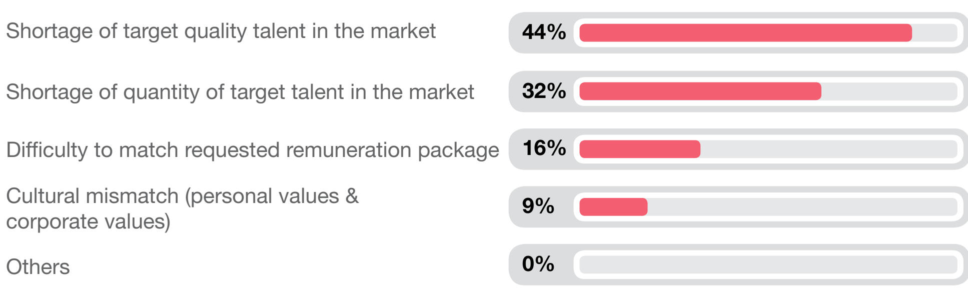


Figure: 16

Q: What is the biggest challenge for talent management in your Bank?

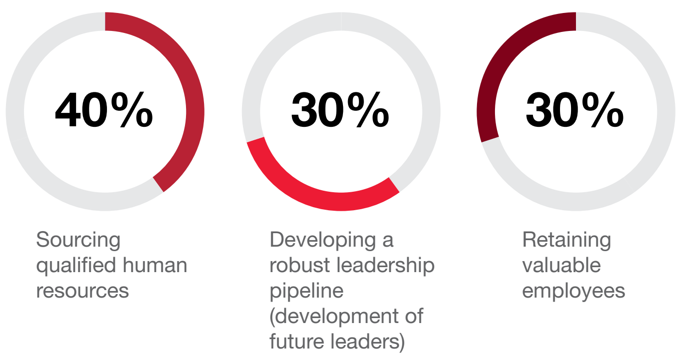
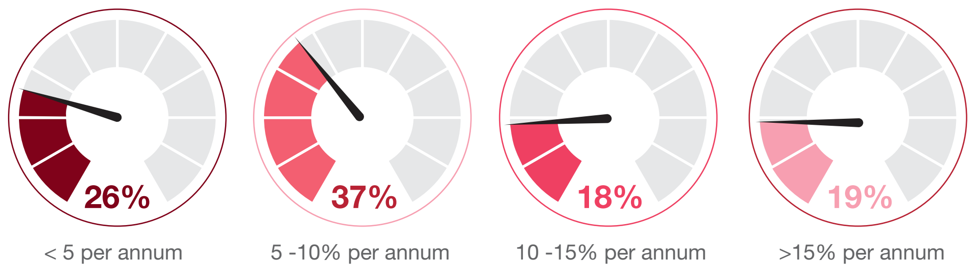


Figure: 18

Q: How high is the voluntary turnover rate in your Bank?



Talent mobility is highest in foreign banks: 87% of the respondents said average tenure in their company was 2 to 10 years where 64% of local bank respondents reported average tenure for their bank at between 5 and 15 years.

As ever, talent seeks higher pay and promotion

The demand for talent with expertise in funding increased significantly and turnover in this area has also accelerated.

There is also a significant increase in mobility for operations staff, yet a significant decrease for IT professionals.

Employees with experience and expertise in micro-banking are now in high demand given the expansion of that business at local banks in particular.

Figure: 19

Q: What is the average tenure of your employees?

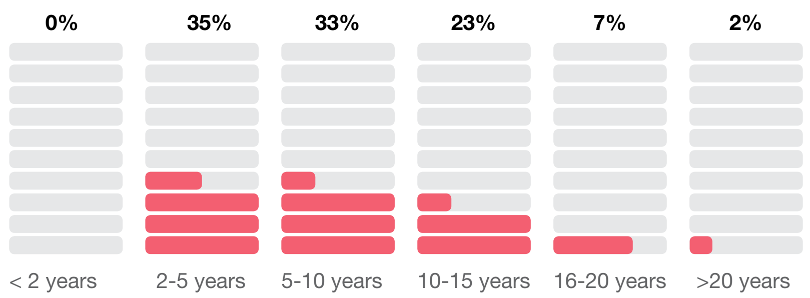
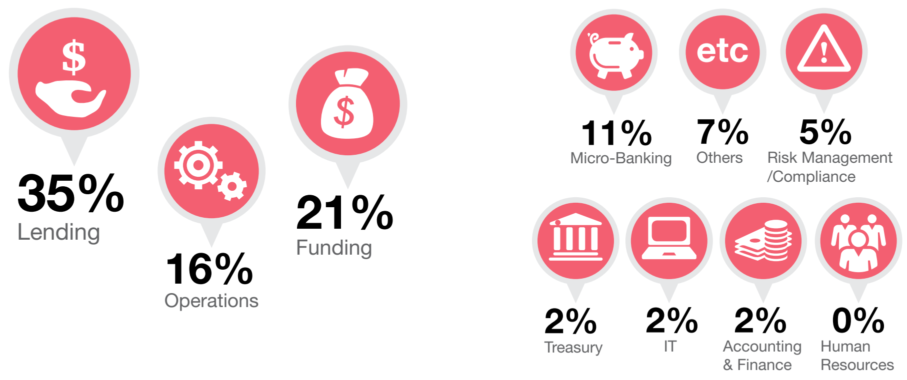


Figure: 20

Q: Which area in your Bank has the highest turnover rate?

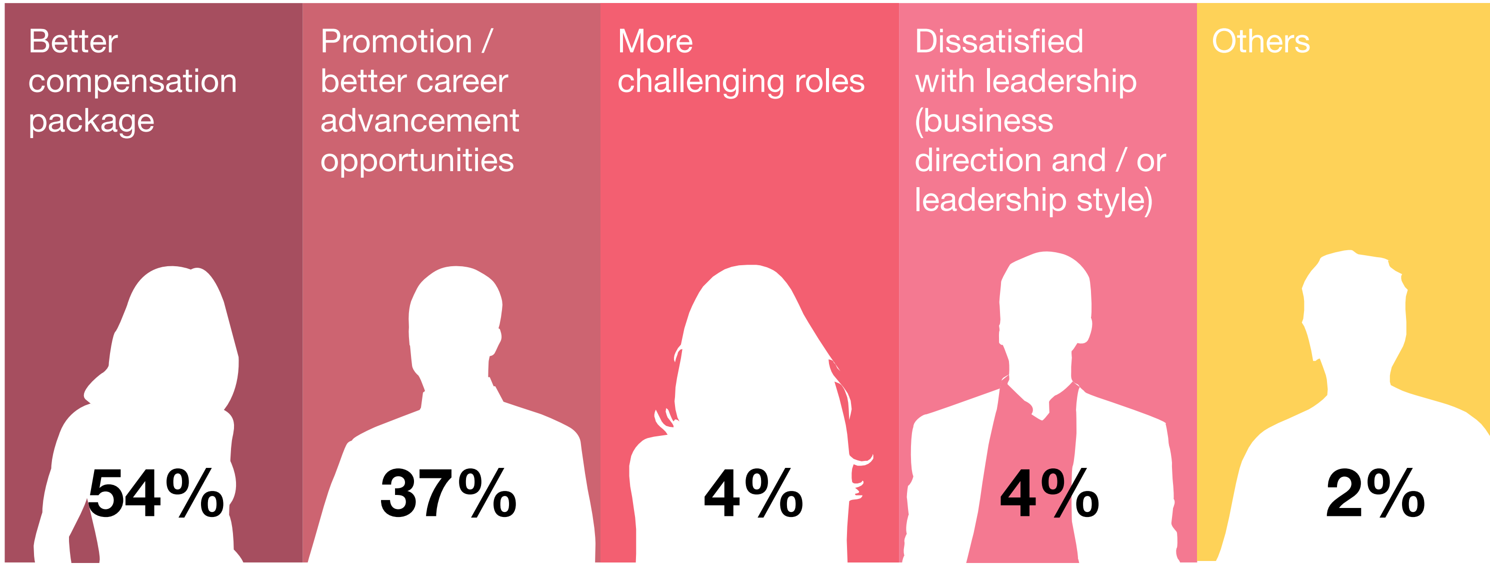


As found in previous surveys, higher compensation (54%) and improved career prospects (37%) are the main reasons cited by employees when they change employers.

In almost all cases, employees are moving to other banks (82%) or other financial services institutions (16%).

Figure: 21

Q: What is the reason most employees give when leaving the organization?



Winning the war for talent

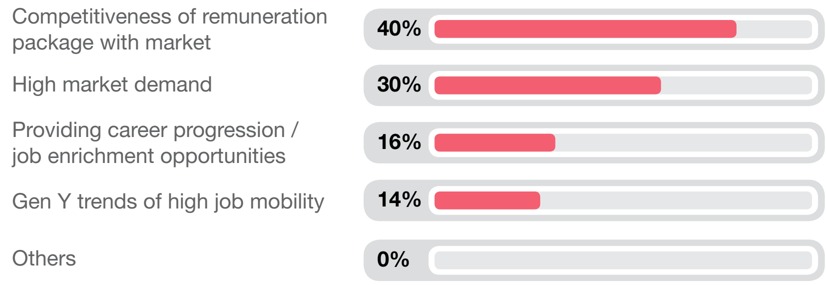
When there is high demand and a mobile talent pool the company best equipped to not only attract but also retain talent will win the war for talent.

The strategies deployed by banks to address these challenges primarily focus on two areas :

- implementing performance-based reward systems 82% to address immediate and short term needs
- providing comprehensive development and growth opportunities 61% for longer term retention.

Figure: 22

Q: What is your biggest issue in managing employee retention?



Breaking out of the talent spiral requires creativity

Despite the challenges, there are still opportunities for organisations to take bold steps to revisit their approach to talent.

1. Attracting Talent

The ability to attract the right talent is fundamental to executing your growth strategy. Therefore, ensuring sound hiring and on-boarding processes are critical.

2. Retaining & Rewarding Talent

As the competition for external talent intensifies, it is increasingly important for banks to focus on the retention of existing talent. Strategies and initiatives for building talent from within has the added advantage of improving engagement through increased development opportunities for employees. Higher employee engagement will provide a basis for improved employee productivity, achieving the organisation's business objectives in addition to setting the foundation for improving the talent pipeline.

High market competition and demands for business growth can lead banks to apply short term solutions by driving up salaries to beyond appropriate market levels. Banks therefore need to look beyond financial incentives to reward employees.

There also appears to be an increasing gap between what employees want and what employers are offering. While employees are placing increasing importance on non-financial and lifestyle focused incentives, employers have been slow to respond. For instance, many companies do not use flexible benefits as part of their reward model. In addition, instilling a deeper sense of ownership by offering company shares to employees is becoming a more common retention tool.

3. People, Processes & Systems

Organisations need to take a systematic and analytical approach to talent management in order to increase their attractiveness to the most highly sought after talent available.

PwC Indonesia Contacts

Cliff Rees
+62 21 521 2901 ext 90550
cliff.rees@id.pwc.com

Lucy Suhenda
+62 21 521 2901 ext 76060
lucy.suhenda@id.pwc.com

Jusuf Wibisana
+62 21 521 2901 ext 75600
jusuf.wibisana@id.pwc.com

Andry Atmadja
+62 21 521 2901 ext 90635
andry.d.atmadja@id.pwc.com

Angelique Daryanto
+62 21 521 2901 ext 75636
angelique.daryanto@id.pwc.com

Benson Cheng
+62 21 521 2901 ext 75488
benson.cheng@id.pwc.com

Margie Margaret
+62 21 521 2901 ext 75862
margie.margaret@id.pwc.com

Michael Goenawan
+62 21 521 2901 ext 90340
michael.goenawan@id.pwc.com

Cornelis Poelman
+62 21 521 2901 ext 75683
cornelis.p.poelman@id.pwc.com

Brian Arnold
+62 21 521 2901 ext 75861
brian.arnold@id.pwc.com

Samuel Ong
+62 21 521 2901 ext 75480
samuel.ong@id.pwc.com