Forging the new regional powerhouses: Strategies for success in Southeast Asia

Southeast Asian markets offer Japanese banks huge potential for expansion. But making the most of these opportunities is going to require a new strategy, mindset and way of running the business.
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Introduction: Embracing a new future

We’re pleased to introduce Forging the new regional powerhouses: Strategies for success in Southeast Asia.

The paper looks at how your bank can capitalise on the opportunities for expansion in Southeast Asia. It draws on our experience of working with a range of Japanese banks, our knowledge of their target markets across Southeast Asia and what we can learn from US and European banks’ moves into the region in the 2000s.

Although Japan is enjoying renewed economic momentum, the impact of a shrinking working-age population heralds slowing growth over the longer term. For the Japanese banks operating in a mature and saturated home market, the prospects for domestic growth are especially limited. At present, three of the five Asian groups on the 29-strong list of global systemically important banks are Japanese, reflecting their size and international importance. However, sustaining this position is going to demand a much stronger push into fast growth markets.

The rapidly expanding markets of Southeast Asia offer huge commercial potential and are already attracting considerable interest from Japanese banks. Yet, to make the most of the potential, banks will need to broaden their focus from providing largely yen-denominated lending to Japanese corporate clients to building a stronger local presence. This would include providing local currency lending and other sophisticated financial products to both local corporate and retail customers.

We believe that developing an effective platform for international growth will also require a new approach to managing group operations. Business development would be spearheaded from regional hubs – several banks have already adopted this approach. The hubs would be staffed with experienced international teams, with the local knowledge to identify acquisition targets with the right strategic fit, along with the key personnel needed to take the enterprise forward. To make this work, real power needs to be delegated to regional offices to allow them the autonomy they need to execute an acquisition strategy and then deliver the returns.

1 Update on global systemically important banks, Financial Stability Board, 11 November, 2013
To encourage scarce local talent to choose to work for the acquiring business, it will be important to make sure they have access to the same career development opportunities as their Japanese colleagues. To strengthen intragroup communication and broaden access to talent in target markets, it may even be necessary to follow the lead of some of Japan’s multinational internet retailers by making English the working language of the organisation. These will be significant cultural leaps. But the more agile, entrepreneurial and multicultural groups that emerge are going to be better able to compete on the regional and wider global banking stage.

We hope that you find the paper useful and interesting. If you have any queries or would like to discuss any of the issues in more detail, please feel free to contact us or one of the other authors listed on page 18.
Opportunities on your doorstep: The rationale for regional expansion

Japan’s banks will have to look beyond their domestic markets to sustain their place in the global elite. Some of the most valuable emerging opportunities are close to home within Southeast Asia.

With the world’s third largest economy and GDP per capita of more than $45,000 a year, Japan continues to be a hugely valuable domestic banking market (ranked second by assets in the world)

Yet, despite monetary stimulus and some recent growth in the credit market, many businesses and consumers remain reluctant to borrow. Over the longer term, the combination of an ageing baby-boomer generation and low birth rate means that the country’s working-age population is set to decline by more than 30% by 2050 (Figure 1 highlights the scale of the decline by comparing Japan with India and China).

The impact of a shrinking working-age population on Japan’s economy and banking market is highlighted by comparisons with India, whose demographic dividend will help propel its GDP and the size of its banking market past Japan’s within the next 20 years (Figure 2 sets out our forecasts of comparative future growth).

Figure 1 Comparison of working-age population (16–65)

Sources: United Nations Population Division, PwC analysis
Notes: 1970 and 2010 is historic data. 2050 is the medium variant projection

2 World Bank GDP per capita 2009–2013 average
3 Banking in 2050, PwC, 2011
In contrast, Southeast Asia offers significant scope for investment and growth by Japanese banks as the region emerges as the ‘third pillar’ of the Asian economy (see Figure 3).

With the world's third largest economy and GDP per capita of more than $45,000 a year, Japan continues to be a hugely valuable domestic banking market.
It’s not just the growth in GDP and wealth within the individual Southeast Asian markets that makes them attractive to Japanese banks, but the surge in trade between them and with China. As Figure 4 highlights, intra-regional trade is growing much faster than with the EU and US.

The burgeoning intra-regional trade is exemplified by the Greater Mekong, a subregion with a population greater than the US.\(^4\) From its core in Thailand and Vietnam, significant investment in infrastructure is helping to spread industrial development and connectivity into Myanmar, Cambodia and Laos.

The development of the financial services infrastructure is helping to support the growth in intra-Southeast Asian trade. Much of this infrastructure is clustered in regional hubs including Singapore, which provide crucial expertise and capabilities in key areas such as risk analysis, trade finance and commodities trading.

Japan has significant bilateral trade with Southeast Asian markets (see Figure 5) and Asia as a whole is the destination for around 60% of the country’s exports (see Figure 6). But, an increasing proportion of intra-regional trade bypasses Japan and hence may not be seen by its banks. The model that has seen Japan and China as the main regional trade hubs, with spokes reaching out into the region, is giving way to a mosaic of fast growing trade relationships. Only by positioning your bank on the ground within local markets and seeking to attract local customers will you be able to fully tap into the increasingly valuable trade flows of the future. The emergence of ASEAN as a trading block to be reckoned with also means that it will play an increasingly important part in trade pacts with other regions, especially the Middle East.

As Japanese companies extend their reach across the fast growth economies of South America, Africa, Asia and the Middle East (what PwC terms as ‘SAAAME’), banks’ ability to tap into this intra-SAAAME trade is going to be increasingly important. These developments are explored further in PwC Project Blue (www.pwc.com/project blue).\(^7\)
The model that has seen Japan and China as the main regional trade hubs, with spokes reaching out into the region, is giving way to a mosaic of fast growing trade relationships.

**Figure 5 Bilateral trade**

![Bilateral trade chart](chart1.png)

**Japan’s trade flow with Asia**

- Key Industry Exports (CAGR)
  - Industrial machinery (6%)
  - Office and telecom equipment (5%)
  - Chemicals (5%)
  - Textile (9%)
  - Other products (9%)

- Key Industry Imports (CAGR)
  - Fuels (11%)
  - Road and transport equipment (25%)
  - Office and telecom equipment (-2%)
  - Other products (9%)
  - Chemicals (-1%)

**Key Industry Exports (CAGR)**

<table>
<thead>
<tr>
<th>Country</th>
<th>2013</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>350</td>
<td>450</td>
</tr>
<tr>
<td>China</td>
<td>200</td>
<td>300</td>
</tr>
<tr>
<td>South Korea</td>
<td>150</td>
<td>250</td>
</tr>
<tr>
<td>Taiwan</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>50</td>
<td>150</td>
</tr>
<tr>
<td>Thailand</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>Singapore</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>Malaysia</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

**Key Industry Imports (CAGR)**

<table>
<thead>
<tr>
<th>Country</th>
<th>2013</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>60</td>
<td>110</td>
</tr>
<tr>
<td>China</td>
<td>45</td>
<td>90</td>
</tr>
<tr>
<td>South Korea</td>
<td>30</td>
<td>60</td>
</tr>
<tr>
<td>Taiwan</td>
<td>15</td>
<td>30</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>10</td>
<td>20</td>
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<td>Thailand</td>
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<td>10</td>
</tr>
<tr>
<td>Singapore</td>
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<td>5</td>
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<tr>
<td>Malaysia</td>
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<td>2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.5</td>
<td>1</td>
</tr>
<tr>
<td>Vietnam</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

**Figure 6 Japan’s evolving trading relationships**

![Japan’s evolving trading relationships](chart2.png)

- 2007: Japan’s exports to its major trading partners in 2007 and 2012 (In USD bn)

<table>
<thead>
<tr>
<th>Region</th>
<th>2007</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>81.4</td>
<td>106.7</td>
</tr>
<tr>
<td>China</td>
<td>129</td>
<td>144.2</td>
</tr>
<tr>
<td>Korea</td>
<td>54.3</td>
<td>61.5</td>
</tr>
<tr>
<td>ASEAN</td>
<td>86.8</td>
<td>128.9</td>
</tr>
<tr>
<td>Africa</td>
<td>10.6</td>
<td>54.3</td>
</tr>
<tr>
<td>USA</td>
<td>142</td>
<td>148</td>
</tr>
<tr>
<td>Taiwan</td>
<td>44.9</td>
<td>46.1</td>
</tr>
</tbody>
</table>

Source: WTO
Credit growth

The surge in economic growth is mirrored in credit markets. Lending in Asia (excluding Japan) rose by more than 60% between 2007 and 2012 to reach $1.66 trillion. In a further indication of the market potential, the bank with the largest growth in profit in Asia in 2013 was from Thailand (United Overseas Bank) and the institution with the highest return on equity was from Indonesia (Bank Rakyat Indonesia).

The longer term prospects for growth in the Southeast Asian banking market are bolstered by relatively youthful populations, a fast growing middle class and increasing demand for broader and more sophisticated financial services products. By 2030, we forecast that domestic banking assets in Indonesia and Vietnam will have grown more than sevenfold to reach some $1,400 billion and $900 billion, respectively.

Renewed appetite to lend abroad

Japan has a strong deposit-funding base (savings as proportion of GDP are 22% and more than half of this is held in bank deposits).

With the domestic credit market still subdued, local banks’ determination to put these large funding reserves to work has spurred a renewed appetite for international lending. The increasingly international outlook is reflected in the fact that Japanese banks are now the biggest cross-border lenders in the world (13% of global total, ahead of the US, UK and Germany) and more than 40% of their profits are generated overseas, compared to less than 10% ten years ago.

Yet this cross-border lending is still a fraction of Japanese banks’ 36% global share in 1989. Moreover, nearly 70% of this credit is going to advanced economies. As Figure 7 highlights, recent years have seen a strong resurgence of lending within the region. But, Asia-Pacific still only makes up around 10% of Japanese banks’ overall cross-border lending and its banks trail their US and UK counterparts in the region, highlighting the potential for further growth.

At present, most Japanese credit in Southeast Asia is denominated in yen and targeted at large companies and major projects. Building up the loan book in the region to its full potential will require a greater readiness to lend in local currencies and to a broader customer base. This includes targeting retail and SME customers. This, in turn, is going to require a stronger presence on the ground and more extensive credit evaluation, currency hedging and other risk management capabilities.

By 2030 we forecast that domestic banking assets in Indonesia and Vietnam will have grown more than sevenfold to reach some $1,400 billion and $900 billion, respectively.

Figure 7 Foreign claims profile by Japanese Banks in Asia-Pacific

By 2030 we forecast that domestic banking assets in Indonesia and Vietnam will have grown more than sevenfold to reach some $1,400 billion and $900 billion, respectively.

5 Wall Street Journal, 22 April, 2013
6 The Asian Banker Performance Rankings 2013
7 World Bank savings as a percentage of GDP 2009–2013 average
8 Bank of Japan statistical update, 31 March, 2013
9 Bank of International Settlement Quarterly Review, September 2013
10 Standard & Poor’s Ratings Direct, 21 October, 2013
What Japanese banks can bring to regional markets

The surge in credit demand and decline in savings in many Southeast Asian markets is leading to a growing shortage and higher costs of funding. Many local banks are therefore keen to attract investment from Japan to help finance further growth. In some markets, notably Vietnam, it may also be necessary to secure extra funding to help meet tougher capital demands.

Japanese banks’ experience of their own country’s rapid boom in the 1960s, 1970s and 1980s provides them with invaluable first-hand knowledge of how to respond to fast growing and evolving markets.

Building on their support for Japanese industrial groups’ expansion into local markets, Japanese banks can offer a knowledgeable long-term view of market development. They can also take advantage of the Trans-Pacific Partnership (TPP) and other trade agreements in the region.

Japanese banks can offer local customers a broader product range (e.g. greater choice of mortgage options) and the technical capabilities to offer faster and more responsive service.

Japanese banks have longstanding economic and cultural ties with the region, which can help in the development of relationships with customers and regulators. Japanese banks’ risk appetite may also be more compatible with local market conditions than some other international lenders. In particular, some US and European banks operating in the region have been reluctant to offer credit and other services to a large proportion of local clients as they don’t match their centrally imposed risk criteria, which has cut out much of their growth potential. Japanese banks might be prepared to take a less black and white and more locally attuned approach to business growth versus risk management.

Japan continues to be the largest provider of business investment and economic aid in the region. Backed by the government’s foreign policy on Southeast Asia, Japanese banks are recognised as important contributors to the growth of the economy and financial markets in the region. Many regional governments are more open to Japanese banks that wish to partner with local banks to accelerate economic development and to provide project financing to improve their infrastructure.
Set up to succeed: Making the most of the market potential

A presence on the ground is vital. Yet, experience shows that simply following a ‘me too’ expansion strategy, which fails to take account of the strategic fit and local market demands, is likely to fail. How can your bank develop the targeted business development strategies and sharper organisational capabilities needed to succeed?

Many of Japan’s major corporations, notably those in the automotive and electronics industries, are highly globalised. But banks are less so. While their international strategies have in the past sought to support Japanese corporate clients as they move into new markets, there is now a growing need to target a local corporate and retail client base.

Given historical and political issues, the focus of investment is looking beyond China and South Korea to include Thailand, Vietnam, Malaysia and Indonesia, with Singapore positioned as an important regional hub. A number of frontier markets are also moving onto the radar including Myanmar and the Philippines.

Significant recent deals include Mitsubishi UFJ FG’s (MUFG) $5.31 billion acquisition of a controlling stake in Thailand’s Bank of Ayudhya in 2013, the biggest acquisition by a Japanese bank in Southeast Asia. MUFG sees the takeover as an opportunity to build a strong retail and SME banking platform in Thailand, which is also able to reach out to other parts of the Greater Mekong. 2013 also saw Sumitomo Mitsui Financial Group’s initial purchase of what could eventually be a 40% stake in Indonesia’s Bank Tabungan.

The combination of market opportunities and the right conditions are likely to spur further deal activity, though exchange-rate movement may affect the appetite for overseas investment in the short-term.

Acquisition allows banks to gain market share much quicker than greenfield options. Some territories have restrictions on foreign ownership, though strategic stakes and joint ventures would still allow your bank to leverage its influence and capabilities.

11 Reuters, 18 December, 2013
12 MUFG investor presentation, 2 July, 2013
13 Bloomberg, 9 May, 2013
Developing a strong platform for future growth

However, these can be challenging markets and a sizeable proportion of regional acquisitions and investments, both by Japanese and other foreign buyers, have failed to realise the anticipated returns.

Identifying the right strategic fit is clearly crucial. While an overall Southeast Asian strategy is important, this should take full account of the variations in development, preferences and regulatory systems within each market.

Your bank could see a big change in its customer base and business model as a result of moves into Southeast Asia. Examples might be a move from primarily corporate to consumer lending. It’s therefore important to make sure there are sufficient synergies to generate value from the deal and that you have the necessary expertise to manage the new business operations.

Attracting and keeping hold of local talent is equally crucial, but may not always get sufficient management attention. It’s vital to retain and motivate the people who have built up the business and know the local market. But they can quickly become disillusioned and leave if they feel they no longer have a real say in the running of the business and can’t see a long-term future for themselves within the wider group.

The risk of losing key people is heightened by the competition for talent within markets where qualified personnel are in short supply. Particular pressure on supply stems from the fact that some senior positions including heads of risk, finance and compliance, may need to be staffed by locally licensed professionals in certain markets.

The underlying challenge is how to adapt existing business, operational and governance models to the very different demands of these economically and culturally distinctive markets.
Forging the new regional powerhouses: Strategies for success in Southeast Asia

Using regional hubs to target and coordinate the execution of a growth strategy

Rather than planning and managing regional expansion from Japan, a more effective route is to set up regional hubs to develop and coordinate strategy and execution.

The people within the hub should have the deal expertise and local market knowledge to assess the strategic fit of potential acquisitions. As part of this, they should be able to identify and make plans to secure the specific personnel from within the business and from outside who are most critical in taking the business forward.

Developing a playbook for expansion and integration

Some Japanese banks have already implemented successful expansion strategies in the US and other developed markets. It will be important to make use of this ‘playbook’ as you look to develop your business in Southeast Asia.

The most successful strategies have followed a phased approach. This has included acquiring minority strategic stakes as a way to gain an initial feel for the local market, before committing more investment and eventually taking control further down the line.

Governments may be reluctant to allow national champions to be acquired, so targets are likely to include smaller banks. Customers and regulators want to see evidence of long-term commitment. This includes investment in the market and a readiness to build relationships and support businesses as they grow.

Creating the right balance between autonomy and control

There may be a temptation to let the local business run itself, but then quickly move in to take control if things go wrong. At the other end of the spectrum, there may be too much central control, with people from head office put in place to shadow local managers. However, this can impede strategic flexibility and alienate local management. There therefore needs to be a balance between setting a clear overall strategy and objectives the one hand and allowing enough entrepreneurial flexibility on the other hand.

Local management teams need to be given full autonomy to make strategic decisions to the extent allowable, without the need to obtain approval from the Japanese home office. This in turn requires an international cadre of personnel, who can help integrate newly acquired businesses into your group and apply developed market expertise in areas such as risk and product design. Rather than spending their careers solely within Japan, the best talent would form part of this international cadre and this experience would form an important element of their preparations for senior positions.

**Giving your business the edge**

Looking at both Japanese and other international banks’ experience, we believe that the business development strategies that have worked best have been underpinned by the following targeting, integration and organisational capabilities:
Experience of other international banks’ moves into the region demonstrates that achieving profitable growth is a long-term process. Acquisition can provide quick access to market share and new capabilities. But steady organic growth that builds on core business strengths and seeks to develop relationships over the longer term is also crucial. For example, you might target customers in new markets from an industry around which you already have strong experience and expertise from supporting domestic clients.

When entering a new market, banks typically begin by opening a representative office before obtaining the licence to operate as a branch. Some see advantages in establishing a bank subsidiary, though careful analysis of cost and benefit are essential for the long-term, as the potential gains may come with heightened risk and cost. For example, while a subsidiary may be viewed by customers as a long-term commitment to the local market, it would require higher and less flexible capital funding. It would also require a more robust local governance structure and many key leadership positions to be filled locally.

The ability to compete on physical size alone is no longer compelling. Digital technology will accelerate the pace of change and open up innovative ways to pursue profitable growth. This includes using digital interaction and social media to enhance brand affinity with local customers. Such technology can also help your bank to gain a better understanding of client needs and provide more accessible and responsive services. Further opportunities would come from developing partnerships with non-traditional banking players, which would generate new revenue streams and ultimately increase share of wallet for banking products. Examples include having post office services in bank branches in Japanese tourist areas (and vice versa) or offering real estate agent services.

To retain the best local talent, they should feel they have a strong future within the wider group. This could include seconding them to regional hubs or head-office teams, which would help to share expertise and develop group-wide solidarity. They would also need to feel that there are no ‘invisible ceilings’ that would prevent them from moving up into senior group positions. As an international organisation, Japanese banks cannot afford to have dual career tracks between Japanese and non-Japanese employees. Local employees need to feel comfortable that their performance is measured and evaluated fairly against a single set of KPIs. Language can create barriers. Few people in the businesses on the ground will speak Japanese, but many at middle and senior levels will have a command of English. There may therefore be an argument for making English the international language of business across the group. Internet shopping group Rakuten and the Fast Retailing Company, the owner of Uniqlo, have led the way by switching from Japanese to English as their official language, even in domestic offices. As Rakuten and Fast Retailing’s main focus of growth shifts overseas, they believe that using English will help them to strengthen intragroup communication and attract more foreign resources. As relatively young enterprises, it may be easier for them to make this switch than more long-established banking groups. But if your group is committed to international growth, you may need to make this leap.
Key questions for your organisation

As your domestic market continues to mature, Southeast Asia offers huge potential for long-term growth and could eventually be as important as your home market to the fortunes of your bank. You can help provide the capital and expertise needed to take regional markets to the next stages of development. In turn, Japan’s longstanding ties and cultural affinity with the region would give your business an important edge over other international competitors.

But making the most of the market potential is going to require new skills and challenge long-established assumptions about how your business should be run. We believe there are five key questions that you will need to address if it’s to emerge as one of the new regional banking powerhouses:

- How can you position your group to tap into growing intra-regional trade?
- How can you develop the local knowledge needed to identify the best acquisition fits and the local talent that will be crucial in taking the business forward?
- What is the right balance between autonomy and central control within the newly acquired operations?
- How can you attract and retain scarce local talent?
- What changes in management and career development will be needed as your bank becomes more internationally focused and culturally diverse?

The banks that are in the strongest position to succeed recognise the need for patience in developing market understanding and building a platform for growth. They will have the right teams in place in their regional hubs to evaluate and integrate acquisition targets. They will be bringing in and developing people with international management expertise. Ultimately, they will recognise and be prepared to embrace the changes that will be necessary in the culture and ways of working within the group.
As your domestic market continues to mature, Southeast Asia offers huge potential for long-term growth and could eventually be as important as your home market to the fortunes of your bank.
Contacts

If you would like to discuss any of the issues raised in this Report in more detail, please speak with your usual PwC contacts or anyone listed below.

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