The Future of Asian Banking
Volume 1.

The Shaken and the Stirred: How regulation and economic policy will transform Asian banking
The Asian banking industry is on the cusp of great change. It survived the financial crisis of 2007-8 relatively unscathed, but it cannot avoid the impact of the deluge of new regulations emanating from North America and Europe, nor the impact of Asian governments’ policies regarding regulating international financial flows and developing local capital markets.

Some outcomes of these changes are relatively clear, such as a tilting of the playing field in favor of Asian banks due to the new capital and liquidity rules. However, other outcomes that could fundamentally reshape the regional banking sector are unpredictable, such as the pace and extent of domestic liberalization. The way in which Asian banks respond to the challenges of determining the right international strategy and an appropriate breadth of business model across financial services activities will determine their prospects in this new environment.

This is the first in a series of articles that addresses the future of the banking industry in Asia. Here we consider the regulatory drivers of change, using scenario analysis to capture the key uncertainties. In subsequent articles we will analyze the strategic implications of these uncertainties in greater detail.
The Shaken and the Stirred

Introduction

Two years on from the depths of the financial crisis, governments in the United States and Europe are in the midst of the biggest overhaul of financial sector regulation in more than 70 years. In much of Asia, by contrast, the regulatory discussion has returned to where it was a few years ago, focused on whether the Asian economies are overly dependent on banks for financial intermediation, and on whether local financial sectors should be more or less integrated with global capital markets. While the banking sector in the West has been shaken, the financial markets of the East are stirring.

The Dodd-Frank Act in the US, the global Basel III accord, and numerous regional and national initiatives in Europe have resulted in a complex mosaic of financial sector regulatory reforms aimed at preventing a recurrence of the crisis conditions of 2007-8. These new rules fall into four broad classes: solvency and liquidity rules (Basel III), structural industry reforms (e.g. the Dodd-Frank provisions aimed at narrowing the scope of bank proprietary trading activities), capital markets reforms, and increased protection of investors and consumers.

These regulatory changes will play to the advantage of the Asian banking industry. High levels of local savings and conservative bank regulation and management over the last decade in Asia mean that many Asian banks find themselves in a strong position compared to foreign banks operating in the region, typically enjoying superior capital and liquidity positions. As shown in Exhibit 1, once Basel III is implemented and drives up the required levels of bank capital and liquidity, Asian banks will generally find themselves less financially constrained than their Western peers.
Exhibit 1: Comparison of banking sector positioning for Basel III rules

Estimated Basel III liquidity ratios
Average of largest banks

Source: Oliver Wyman analysis

Note: Based on December 2009 company financials. Basel liquidity requirements were assumed to be fully phased in

More extreme structural reforms of the industry – such as the potential separation of retail and wholesale banking activities in the UK, the Volker rule in the US, or bank levies in Europe – are unlikely to be implemented in many Asian jurisdictions. Asia’s crisis experience was less harrowing, its political and public dialogue is more focused on growth than crisis avoidance or “punishment” of the banking industry, and its banking culture is perceived to be fundamentally more conservative – all of which make such radical measures seem unnecessary.

However, the advantages that may accrue to the Asian banking sector from this tilting of the playing field will not be shared equally. Asia remains engaged in its own ongoing process of financial sector development and regulatory reform. The key uncertainties that face the industry in Asia today are the same it has been grappling with since the crisis of 1997. To what extent will banking and liquidity pools become more or less integrated across borders? And to what extent will Asian capital markets deregulate, grow and develop in breadth (of instruments) and depth (of liquidity and participants)?

These uncertainties are likely to drive considerable divergence in growth and performance among Asian countries and financial institutions. Local and foreign banks will need to respond to these uncertainties by making some bold decisions about business models and strategies, particularly with regard to international growth and expansion into non-banking activities.
Key uncertainties – cross-border flows and local capital market liberalization

Cross-border flows

Liquidity can be transferred across borders in several ways. At its simplest, it can be intermediated through private sector banks via their short-term treasury operations and currency exchanges in support of client transactions. Other, longer-term ways of deploying liquidity overseas include buying overseas equities or bonds, medium- to long-term lending to overseas borrowers, and FDI or offshore M&A. As shown in Exhibit 2, and as substantiated in other independent studies\(^1\), Asian markets have significantly more barriers to such cross-border flows than do markets in Europe and North America. These barriers can be explicit (such as limited currency convertibility and restrictions on ownership or activities for foreign institutions), or implicit (such as difficulties in getting takeovers approved, oligopolistic behavior by incumbents, or close inter-relationships between domestic corporations and banks).

Exhibit 2: Restrictions on cross-border liquidity flows

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Currency exchange</th>
<th>Short-term money market</th>
<th>Listed equity/bond investment</th>
<th>Medium/long-term bank lending</th>
<th>FDI and M&amp;A</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>⬤</td>
<td>⬤</td>
<td>⬤</td>
<td>⬤</td>
<td>⬤</td>
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<tr>
<td>Japan and South Korea</td>
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<td>✓</td>
<td>✓</td>
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<td>✓</td>
</tr>
<tr>
<td>South East Asia (ex Singapore)</td>
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<td></td>
<td>✓</td>
<td></td>
<td></td>
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<tr>
<td>Hong Kong &amp; Singapore</td>
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<td></td>
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<tr>
<td>US and Europe</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>

Increased “stickiness” of cross-border flows

Source: Oliver Wyman analysis

1 See the following papers for further analysis of cross-border restrictions:
   “Manning the Barricades – The return of capital controls and the implications for global markets”, HSBC Global Research, 2 November 2010
Asian governments erect such barriers for a variety of reasons, ranging from managing macro-economic imbalances (such as trade surpluses), to protecting local markets from the potential instability associated with “hot money” flows (especially following the 1997 crisis), to the explicit or implicit protection of the local financial industry.

The effect of these barriers can be seen in the limited international exposure of Asian financial sectors compared with those in the West. With the exception of the international financial centers of Hong Kong and Singapore, Asian banks typically have a low proportion of offshore assets and liabilities, as shown in Exhibit 3.

Exhibit 3: Loan to deposit ratios vs. cross-border banking activity (2008)

Exhibit 3 also highlights the fact that most Asian markets have very low loan to deposit ratios. This indicates that the supply of local deposit liquidity exceeds the lending opportunities available to the domestic banking sector, ultimately constraining bank profitability. The issue is particularly acute for the largest local banks in each market, as they typically have a disproportionately high share of low cost core deposits compared to other local banks, and so capture a disproportionately high share of local liquidity.
The challenge today for Asian banks is that while they have excess liquidity domestically, opportunities to deploy that liquidity are becoming more constrained. Basel III will make interbank lending less attractive from both a supply and a demand perspective, while the “quantitative easing” (QE) of Western central banks is further depressing returns to liquidity in the short-term. Moreover, in many Asian countries, official efforts to prevent currency appreciation in the face of Western QE are likely to constrain the opportunities for Asian banks to deploy their excess liquidity elsewhere in Asia too.

Barriers to liquidity transfer also limit the ability of Asian banks to expand abroad, to develop pan-regional or global platforms and thus to derive benefits of scale and scope. While Asian banks are increasingly looking to tap into growing regional markets, barriers to cross-border expansion, particularly M&A, stand in the way.

The restrictions to cross-border flows are understandable from a macro-economic policy perspective. They can help insulate an economy from cross-border contagion and from volatility in exchange rates and monetary conditions. Memories of the Asian financial crisis remain fresh and such controls are returning to vogue in parts of Asia as a way of limiting the spillover effects of expansionary Western monetary policy. Liquidity controls also simplify the process of regulating the local banking sector by reducing the exposure of local institutions to offshore risks. This is a key concern for regulators in the absence of effective cross-border bank resolution mechanisms, as the experience of Lehman Brothers and Iceland showed in the financial crisis.

However, such restrictions also prevent the local banking system from efficiently allocating capital to available opportunities, creating a deadweight loss that ultimately is passed on to local borrowers in the form of a higher cost of capital, and to savers in the form of lower deposit yields. Trapped liquidity can also contribute to volatility in local equity indices, property prices and inflation rates.
Local fixed income markets

Asian, and particularly Chinese, banks increasingly dominate lists of the world’s largest banks by market capitalization, and Asian international financial centers are becoming increasingly important. Yet local capital markets, particularly fixed income markets, remain under-developed. As shown in Exhibit 4, the bond markets of North America, Europe, Australia and Japan are significantly bigger relative to the size of the economy.

Exhibit 4: Locally issued bonds outstanding as % of GDP (2009)

The causes of Asian bond markets’ underdevelopment have been much discussed since the 1997 crisis starkly highlighted the dangers of the region’s heavy dependence on bank financing. To summarize, the local bond markets suffer from a plethora of challenges, including:

- Insufficient market infrastructure
  - Limited government borrowings to provide benchmark rates, especially around the longer-end of the yield curve
  - Under-developed multi-lateral electronic trading facilities
  - Lack of a bond futures market, outside a small number of markets such as South Korea
  - Under-developed repo market for many emerging Asian countries

Source: BIS, EIU. Note: International debt includes money market securities
- Regulatory and legal obstacles
  - Onerous and opaque issuance processes
  - Weak creditors’ rights in the event of default
  - Withholding or transaction taxes
  - Inability to short bonds

- Information asymmetries
  - Limited development of rating agencies
  - Limited credit assessment/analysis capabilities among investors
  - Issuer reluctance to disclose financial performance information
  - High monitoring costs for bond investors compared to bank lenders

What Asian fixed income markets do not lack are potential bond buyers. Local retail investors – both middle-income Asian households with their high savings rates and rapidly growing affluent investors – lack a “middle option” between low interest bank deposits and high risk equity and real estate markets. Asian pension systems, especially defined contribution schemes, are growing rapidly. Insurance companies in the region forecast a strong growth in demand for whole life, annuity and retirement savings products. But producing these products requires a deeper fixed income market, and one with a greater supply of longer-maturity instruments and spread assets such as corporate bonds and asset backed securities. Finally, international institutional investors are keen to diversify their holdings into more stable Asian currencies.

There have been positive developments in some Asian bond markets. The ASEAN + 3 governments have identified a range of policy reform objectives as part of the Asian Bond Market Initiative. The Korean bond market has rapidly developed since the 1997 crisis due to extensive government efforts (as discussed in the boxed text on the next page).
Case study: Korean bond market development

South Korea is a good example of how government policy can rapidly stimulate fixed income market development. Since the Asian crisis of 1997-8, the South Korean government has undertaken several measures, including:

- Substantially expanding the supply of government bonds while aiming to establish a robust benchmark yield curve for longer maturities
- Introducing 10-year inflation linked bonds to foster more sophisticated product development appetite across the industry
- Working with the local exchange and central securities depository to electronically register and introduce exchange traded government bond futures
- Accelerating the development of government-backed securitized mortgage market
- Working with quasi-government agencies to shift traditionally indirect debt-financing towards a balance of local and offshore DCM markets
- Investing in a number of targeted policies to develop the local asset management market, deepening demand for local fixed income products

As a result, bond issuance in South Korea has expanded substantially over the past decade. Over the last three years the secondary market has dramatically deepened, led by local securities houses trading on their own account and selling bonds to retail customers as a substitute for equities or mutual funds. Banks are now looking to take the secondary market for credit to the next level by using it to more actively manage their credit portfolios.
Another market to watch is China. The bond market has been developing rapidly in recent years, both in terms of available instruments and the diversity of participants (including international banks). Recent highlights include the launch of CDS contracts and the opening up of the RMB bond market to issuance in Hong Kong, which has attracted substantial interest from domestic and international issuers.

Nevertheless, regional fixed income markets remain limited, with little liquidity, few products and a paucity of participants. Local institutional investors, such as life insurers across Asia, struggle to find the assets to match their long-term liabilities, while local banks struggle to manage increased risk concentrations within their lending portfolios.

The key question is therefore how Asian bond markets will develop. Liberalization could be held back by conservative policy responses to recent problems in the US and European markets, by local banks' reluctance to change their traditional business models or by simple inertia. Yet successful liberalization would support more resilient securities, pensions, insurance and investments sectors, allow more liquidity to be absorbed domestically outside the banking system, increase options for local investors, and reduce the concentration of risk in the banking sector.

For this to happen, policymakers must be willing to accept a more complex and hard-to-supervise financial system, and one with more diverse risks but, ultimately, less systemic risk than the traditional bank-dominated model.
Two uncertainties, four scenarios

Considering both of the above sources of uncertainty allows us to describe four broad future scenarios for Asian banking. Our framework has two dimensions. The first, shown on the vertical axis of Exhibit 5, represents the extent of integration in cross-border liquidity flows. This ranges from weak integration, with cautious financial regulation and macro-policy limiting cross-border liquidity flows, to deep integration with benign local funding regulations, relaxation of currency controls and expansion of cross-border activity. The horizontal axis represents the degree of liberalization of domestic financial sectors in Asia. “Slow” liberalization implies that Asian markets remain predominantly bank-centric, with relatively shallow fixed income markets. “Rapid” integration represents the removal of constraints on capital markets and the rapid growth of domestic fixed income and related markets, such as swaps, bond futures and repos.

Exhibit 5: Future scenarios for Asian banking

1. Polarization – domestic players dominate lending while foreign banks lead in capital markets

If fixed income and other securities markets are slow to develop, domestic financial intermediation will continue to be dominated by the traditional banking model. If global bank regulation moves towards mandating significant increases in local funding and subsidiarization, foreign banks, whether Western or other Asian, will be hampered in
their ability to enter the market, especially in local currency lending to the dynamic SME and retail sectors. This represents a continuation of the current local bank-centric financial systems of much of Asia. While it may be the most comfortable scenario for many Asian banks, it also limits long-term opportunity.

Many emerging Asian countries have rapidly growing economies, high savings rates, limited investor sophistication and relatively under-developed investment industries. These factors will continue to support the profitability of the dominant domestic core banking franchises. However, Asian banks’ lack of access to domestic or international capital markets will hinder their ability to expand into other asset gathering activities – such as securities, asset management and life insurance. And easy profits from their domestic franchise will reduce the incentives for such banks to extend their footprints across Asia.

In such an environment, only the most courageous and forward looking banks will be able to build the broader mix of businesses and capabilities that will reduce their exposure to the risk of a domestic economic downturn or the unexpected opening of their domestic financial market.

Meanwhile, these countries will remain sources of profit for many Western financial firms. Private banks, multinational insurers and securities firms will profit from demand for the variety of sophisticated assets and financial products that the local markets are unable to support. And they will remain the preferred employers for top local talent. Yet these players will be restricted to providing “intellectual capital” and access to external markets, unable to compete in core balance sheet activities. The big winners in this scenario will be the leading “glocal” banks (Standard Chartered, HSBC and Citibank), who will be able to combine the advantages of their strong local deposit bases, business customer franchise and global product expertise. They will also be the best positioned for any eventual market liberalization.
2. Liquidity export – Asian wholesale bank ascendency

The second scenario creates several opportunities for Asian banks. In the absence of well-developed local capital markets or associated institutional investors, they still have access to an abundance of liquidity. But they are now able to deploy this more effectively across borders, whether by originating and funding loans directly or by acquiring or cooperating with overseas institutions that are long on assets and short of liquidity.

This scenario would require Asian regulators to take a more liberal attitude towards the export of liquidity from home markets. And currency, capital and direct financial services investment controls would need to be scaled back across the region. Both developments would require regulators to have confidence in domestic banking sector stability and competence, as well as the passing of current regional and global tensions over exchange rates and macro-imbalances.

In this scenario, Asian banks may export liquidity by several mechanisms. Securitization was designed to facilitate such transfers of assets into pools of greater liquidity. However, the financial crisis demonstrated challenges with securitization related to moral hazard, opacity and complexity. For the time being, Asian banks and regulators are unlikely to embrace it as a major avenue for deploying liquidity in other markets. It is more likely in the medium-term that Asian banks will engage in direct lending businesses requiring long-term balance sheet commitments, such as high grade corporate credit, fixed income, asset finance and structured finance.

A challenge for Asian banks in this scenario will be to ensure they use the easy access to funds to invest in high value parts of the financial services industry (such as lead relationships) rather than becoming mere liquidity providers (so-called stuffees). This will require investment in capabilities and cultural changes that only a few Asian banks will be able to achieve.
The relative capital strength of many Asian banks may allow them to acquire Western banks and provide them with opportunities to internally transfer liquidity across borders, as illustrated by MUFG’s recent acquisition of RBS’s project finance portfolio. However, this will involve strategic, operational and cultural challenges. For example, Japanese banks’ attempts to expand by acquiring Western banks have met with disappointing results to date. A more likely scenario is that additional cross-border M&A will be concentrated within Asia, predicated on building up region-wide wholesale banking franchises supported by a strong funding position and enhanced by initiatives that deepen the liquidity of Asian FX markets, such as the Chiang Mai Initiative.

While Asian banks seek ways to profitably deploy their Asian liquidity, Western banks may seek to gather some of it themselves. The glocal banks have been aggressively growing their deposit businesses – Standard Chartered in South Korea, for example, with its push into high-interest core deposit products, and HSBC in China. At the high end, global private banks have been hiring Asian relationship managers as fast as they can and are increasingly asking their bankers to target deposit gathering as well as promoting investment products. In this scenario Asian banks will have a valuable resource in domestic liquidity, but it may be one they will need to defend.

3. Domestic consolidation – vibrant local markets but foreign players squeezed into niches

The third quadrant is the most nationalistic. In this scenario, Asian governments may conclude that the global financial crisis is evidence that international financial integration and unfettered financial flows entail greater risks than benefits. They may also conclude that Asia’s current stability demonstrates that their prudent supervision has been successful and that they can safely continue on their pre-crisis paths towards domestic capital markets liberalization. Asian financial markets will therefore develop to include active fixed income, derivative, interbank and, possibly, limited securitization markets. However, cross border activity will be restricted by controls on currency, capital movements, foreign bank licensing or other rules.
Capital markets deregulation and the growth of the derivative markets will create a more diverse domestic financial ecosystem and stimulate the emergence of domestic universal banking franchises. Simultaneously, structural barriers to the entry of foreign players, whether implicit or explicit, will restrict cross-border activity and guarantee that wholesale markets are dominated by “national champions”.

Nevertheless, foreign players will maintain a market presence, targeting advisory or agency activities, such as intermediating cross-border investments in traded securities that do not require a balance sheet. They will also form partnerships with local universal banks to gain access to local balance sheets and distribution.

This scenario represents a comfortable position for the winning domestic institutions in the short term. However, in the medium-term growth constraints and the lack of an international network will limit their ability to serve their increasingly multinational corporate clients and high net worth customers. Over time, they will have to decide whether to “downshift” and focus on their retail and commercial operations, using international partners to complement their domestic offering, or whether to take the plunge and expand overseas via acquisition, incurring all the risks this entails.

The largest institutions in the most mature Asian markets will have the greatest incentive to expand internationally. Yet, even among these, only a fraction will have the capabilities to be successful. Even culturally less ambitious cross-border acquisitions have a history of destroying shareholder value.

4. Asian giants – the emergence of Asia-based regionals and globals

The final scenario assumes fundamental reform and liberalization of cross-border flows and domestic capital markets. Local banking sectors will be transformed and the scene set for the rise of a new breed of Asian champions.
For such a scenario to eventuate, Asian policy makers will have to believe that capital markets can be liberalized without undue risk, and that domestic issuers, investors, and intermediaries are sufficiently sophisticated to thrive in a more complex environment. Much of the heat will also need to come out of the currently strained dialogue between Western and emerging countries over currency valuations and global macro-economic imbalances. Otherwise Asian governments will not seriously entertain moves to support the unimpeded flow of liquidity across borders.

Local capital market deepening will drive the further growth of universal banking models. Securities investors, intermediaries and infrastructure providers will thrive and many will integrate with the larger commercial banks in search of synergies across the investment and financing spectrum.

While many large banks in Asia today already incorporate securities activities, the key development will be scaling up what are mostly stand-alone retail brokerages into wholesale securities arms tightly integrated with the banking business. Banks will also focus on gaining access to asset management and insurance capabilities (either internally or via partnerships) to support asset gathering and wallet capture as clients diversify their holdings away from deposits.

Cross-border investments and transactions will proliferate, driven by the export of Asian liquidity to other regions and the entry of capital markets specialists seeking to deploy their capabilities in a high growth environment. Yet strong balance sheets and superior access to Asian clients will advantage emerging local universal banking powerhouses, leaving foreign banks confined to niche and agency roles based on specialist expertise.

The long-term outcome of this scenario would likely be the emergence of a new breed of Asia-based global giants. After reaching critical mass domestically or regionally, these Asian universals will look across the rest of Asia and beyond for growth opportunities, often following their own clients’ increasingly global activities and investments. A new wave of mergers, acquisitions and substantial organic investments will provide them with platforms in North America and Europe, thus transforming the competitive landscape in these markets too.
Outcomes will vary across Asia

The drivers of change we have identified around liberalization of cross-border flows and capital market development will play out in different ways and at different speeds across the Asian markets. This means that each economy in Asia will trace its own path across the scenario framework we have laid out. While precisely predicting these paths is impossible, we provide our estimate of where each Asian market stands today in Exhibit 6, and discuss potential trajectories below.

Exhibit 6: Current scenario positioning of Asian markets

As major financial centers, Hong Kong, Singapore and Japan are the most globally integrated markets, and all have healthy fixed income markets. All three, however, maintain some obstacles to the free flow of liquidity via various forms of exchange rate management. South Korea has also been rapidly liberalizing its domestic financial sector, especially with recent reforms that allow the integration of banking and securities activity. However, formal and informal barriers to cross-border financial services M&A remain in place, limiting South Korea’s international integration.
China and India are gradually migrating from left to right as local capital markets are liberalized. But substantial change on the vertical dimension is unlikely to occur in the near-term, particularly in China given the highly political nature of the question of currency convertibility.

The Southeast Asian nations have the potential to liberalize along both dimensions, but the pace of their development will depend upon ASEAN integration efforts and the success of the Asian Bond Market Initiative.

Taiwan currently represents an interesting outlier, with a bank-centric financial sector that exports significant liquidity abroad, primarily through purchases of US Treasury and agency debt. As the barriers to cross-strait investment and financial flows are further lifted, a key question will be the speed and extent to which China supplants the US as a destination for Taiwanese flows, and whether the flows shift from being purely financial towards being commercially-linked.
Winners and losers

Each scenario will create different winners and losers. While quality of execution and operational performance will still be the primary drivers of individual bank performance, strategy and business model will become increasingly important as the effects of these scenarios play out.

What kind of effects do we expect these scenarios to have on individual banks? To answer this question, we need to distinguish between the five general business models that have begun to emerge for banks in Asia:

- Glocals: banks (typically Western) with operations around the world, and a strong onshore presence in Asia, especially in local funding
- Western wholesalers: Western banks that have limited geographical footprints in Asia but with a wholesale presence, typically focused on international financial centers such as Hong Kong and Singapore and, perhaps, other large financial centers such as Tokyo or Shanghai
- Pan-Asian aspirants: Asian banks that are building out regional footprints in multiple countries, and which aspire to have pan-regional wholesale capabilities
- Asian domestic universals: Asian banks that dominate their domestic markets and expand into dominant positions in non-bank financial services, especially securities, asset management, wealth management and insurance
- Asian domestic narrow banks: Asian banks that have strong positions in core retail and commercial banking within their home market, but which have neither extensive non-banking activities nor an international footprint
Exhibit 7 summarizes the broad impact of each scenario on the key categories of bank competing in Asia.

### Exhibit 7: Strategic impact of Asian banking scenarios by business model

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Foreign bank models</th>
<th>Asian bank models</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Polarization</td>
<td>Glocals</td>
<td>Regional aspirants</td>
</tr>
<tr>
<td></td>
<td>Western wholesalers</td>
<td>Domestic universals</td>
</tr>
<tr>
<td>2. Liquidity export</td>
<td></td>
<td>Domestic narrow banks</td>
</tr>
<tr>
<td>3. Domestic consolidation</td>
<td></td>
<td></td>
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<tr>
<td>4. Asian giants</td>
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</tbody>
</table>

In each scenario, glocal business models benefit from their combination of local balance sheet and global capital markets access and capabilities. Under the “Polarization” scenario, Western wholesale players will be relative beneficiaries as they continue to play a key role intermediating global and local capital markets flows, most likely on a hub-based offshore basis, rather than from local footprints. However, in scenarios where local capital markets develop and liquidity barriers are removed, they will likely see their advantages eroded by ambitious local players unless they are able to establish a stronger local presence themselves.

Domestic banks will find that the ideal business model depends upon which scenario their market follows. Regional or global expansion efforts will be more likely to pay off where liquidity barriers are removed. Universal banking will in general trump narrow strategies domestically where local financial sectors continue to liberalize because these players unlock synergies across business lines and reap the benefits from their funding advantage. Smaller local banks pursuing narrow banking models will face stiff headwinds under most scenarios. To prosper, they will need to either target specific customer segments or business line niches or have market-leading operational efficiency. However, they may flourish in unliberalized markets, particularly if their larger peers are distracted by the difficult tasks of expanding across borders or business lines in an unfavorable regulatory environment.
Conclusion

The Asian banking landscape is poised for a period of great uncertainty and, potentially, great change. New opportunities for profitable growth, both domestic and international, are emerging. But where and how these opportunities will emerge remains unclear. The bases of competitive advantage are also shifting. Asian banks are likely to be net beneficiaries, but they will need to address gaps in their capabilities and infrastructure, and will most likely need to embrace a degree of cultural change if they are to capitalize fully on their new advantages.

The time is clearly right for Asian banks to think about their offensive strategies. But it is easier to talk about going on the offensive than to actually do it. For Asian banks, all growth options require tough decisions:

- Expanding internationally or into wholesale banking requires capabilities, talent models and a culture that can be hard to reconcile with those of a domestically-oriented retail-centric operation. International expansion also creates a much greater need for pro-active management of supervisory relationships, particularly given the increased importance attached to cross-border resolution regimes and home-host regulatory coordination.

- Exporting liquidity requires enhanced credit management capabilities, both at the individual asset and portfolio levels. It also requires upgraded ALM and treasury capabilities, because optimizing the bank’s liquidity profile and managing funding mismatches become key sources of value and risk.

- Building a universal banking franchise will involve a significant increase in management complexity – from acquiring and integrating non-bank subsidiaries, to articulating the governance and risk management responsibilities throughout the enlarged group, to ensuring that cross-business synergies are effectively realized.

- Dominating the core domestic banking market will require a differentiated positioning, based on either market-leading efficiency (cost leadership and tight risk management) or a superior client proposition. Both routes to differentiation will require stricter prioritization in segment or business focus, simplification of business processes and systems, more granular understanding of customer and product economics, and stronger execution discipline.
Foreign banks will need to decide on the scale of their ambition in Asia, bearing in mind the potential effects of the evolving regulatory and political landscape in Asia and in the West. They must ask themselves if they have the investment appetite and patience required for their given level of ambition. Most importantly, they must decide on the funding model for their Asian activities – whether they should pursue an onshore or offshore model in each market, how they will manage the tension between global lines of business and local legal entities, and how they will deal with the legacy cultural and business challenges of integrating newly acquired local banks into a global organization.

In short, the environmental uncertainties facing banks in Asia, whether domestic or foreign, make it more than usually difficult to formulate strategies. Each of the broad business models we describe above gloss over a myriad of sub-options. Yet the opportunities to be seized as the Asian financial architecture and competitive dynamics are reshaped will be enormous. Banking leaders in Asia must embrace the uncertainties these changes represent and have the courage to take the bold decisions that will be needed to position themselves as winners in the stirred and shaken post-crisis financial landscape.
Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development.

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