Out of the shadows

LOCAL LENDERS IN EMERGING ECONOMIES ARE INCREASINGLY STEALING MARKET SHARE FROM THEIR RIVALS BASED IN DEVELOPED NATIONS, EXPLAINS JASON KARAIAN

For decades, banks in emerging markets punched below their weight. Bank accounts were scarce. Credit penetration was low. Corporate and investment banking services were basic. Now, although banks based in developing countries are still catching up with rivals from developed markets in terms of their coverage and sophistication, the balance of power is shifting. As banks in the West scale back their ambitions in fast-growing, far-flung markets, local banks in these regions are stepping in to fill the void. In many cases, they are deploying business models that set them apart from the practices typically employed by the rich world's banks.

As recently as 2004, banking assets in emerging markets accounted for less than 10% of the world total. By 2016, developing-country assets will account for more than 35% of global assets, according to the Economist Intelligence Unit (see Global bank assets chart, opposite). Asset growth will average 20% per year in emerging markets over this period, outpacing the 5% growth registered in developed markets.

Buffeted by troubles at home, the retreat of Western banks – particularly European lenders – from several emerging markets provides their local rivals with a prime opportunity to build scale in their home regions. More than a quarter of foreign-owned banks are run by parents based in emerging markets, according to the International Monetary Fund. This share will grow as a number of 'regional champions' emerge from the global financial crisis. In the year to March 2012, emerging-market banks boosted cross-border claims in other emerging markets by nearly 30%, according to the Bank for International Settlements. Over the same period, eurozone banks cut their exposure to these markets by 7%.

Room to grow

On their home turf, emerging-market banks generally benefit from stronger local deposit bases than foreign rivals. Combined with more conservative asset portfolios, this provides a considerable funding and capitalisation advantage over many banks based in developed countries. As a result, they have scope to grow both at home and abroad, often at the expense of developed-market banks that need to raise fresh capital to bolster their balance sheets by limiting loan growth or selling sought-after operations in fast-growing markets.

Even considering recent strides, there remains enormous scope for growth for a wide range of financial services in emerging markets. In China, some 64% of adults have or share a bank account, with lower levels of bank penetration in Brazil (56%), Russia (48%) and India (35%), according to the World Bank. Usage levels for savings, loans and insurance services are generally even lower. Burgeoning capital markets, large infrastructure programmes and an expanding web of trade relationships between developing countries offer further opportunities for nascent corporate and investment banks.

Recent deals show how the competitive balance is shifting. Spain's Santander has raised nearly $5bn over the past two years in sales of various operations in Latin America, with local players often the buyers. Chile's CorpBanca took control of the Spanish group's Colombian operations earlier this year, with subsequent moves in the country including the agreement to buy Bogotá-based lender Helm Bank in October. Meanwhile, Peru's Credicorp is busy building a pan-Andean investment bank, amassing stakes in firms in Colombia and Chile. Brazilian banks like BTG Pactual and Banco Itaú have also been active acquirers across Latin America.

> South of the Sahara, Togo-based Ecobank remains a pioneer in frontier markets, where few foreign banks fear to tread

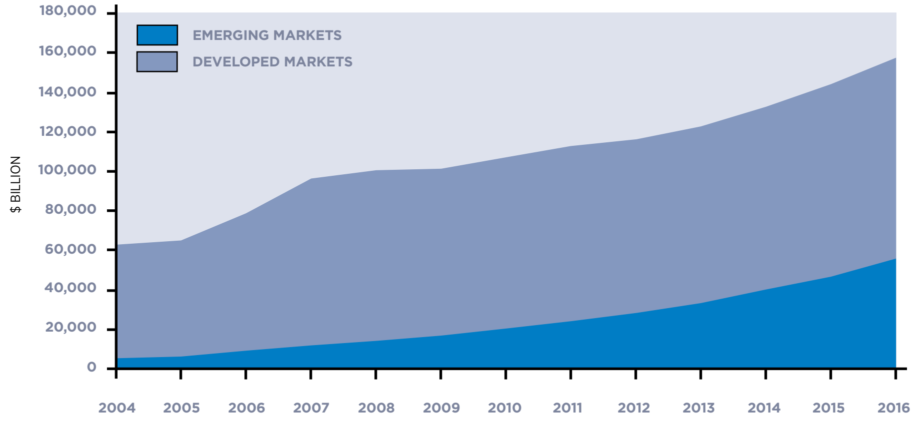
In the Middle East and North Africa, banks from small, but resource-rich, Qatar are emerging as key consolidators. Qatar National Bank is close to acquiring a majority stake in Société Générale's Egyptian unit, adding to stakes it recently purchased in lenders from the United Arab Emirates (UAE), Iraq and Morocco. HSBC recently announced that it would stop offering retail Islamic banking services in the UAE and Bahrain; the National Bank of Abu Dhabi, meanwhile, aims to triple the amount of profit it derives from Shariah-compliant products in the UAE and other countries in the region. South of the Sahara, Togo-based Ecobank remains a pioneer in frontier markets, where few foreign banks fear to tread, with a presence in more than 30 countries across Africa, including the recent addition of a unit in Equatorial Guinea, and plans for entry into Angola, Mozambique and South Sudan.

In Asia, a retrenchment by French banks, in particular, is presenting new opportunities. China's Citic Securities is in the process of buying Crédit Agricole's Hong Kong-based brokerage CLSA, an unusually ambitious takeover among China's generally inward-looking banks. The league table for trade-finance providers in Asia is also in flux. Where French banks once played a major role, credit agencies such as the Export-Import Bank of China are now much more prominent. The key role of the dollar in trade finance transactions is also spurring more business for US-based banks, with easier access to dollar-based finance. As China gradually liberalises its currency, however, its banks should continue to rise in the rankings.

China's central role in the global economy, particularly its appetite for natural resources, is also forging more far-flung financial alliances between emerging-market players. Bank of China, for example, has recently expanded in Brazil and launched joint operations with Akbank in Turkey. Although these ventures primarily serve the specific trading interests of select clients, with time they may develop in more fully fledged financial institutions. In the near future, however, the rise of emerging-market banks will be predominantly a regional affair.

GLOBAL BANK ASSETS*

*ESTIMATES AND FORECASTS FOR 60 COUNTRIES ACCOUNTING FOR OVER 95% OF WORLD GDP



SOURCE: ECONOMIST INTELLIGENCE UNIT

Beyond branches

These new regional champions are not building franchises that simply mimic banks in developed countries. Most notably, their low-cost business models rely to a much lesser extent on the traditional branch. More transactions take place via mobile phones, the internet, at partner outlets and even via home visits. In Kenya, around 40% of people have a bank account, but 70% use their mobile phones to send and receive payments. The asset-light, low-cost business model is also evident in corporate and wholesale banking businesses, where cost-to-income ratios at most emerging-market investment banks are below their developed-market peers, despite rapid labour-cost inflation.

What does this mean for corporate treasurers doing business in emerging markets? Deleveraging by developed-country lenders puts all but the most long-standing bank relationships at risk, particularly in markets where these institutions lack strong deposit bases. New relationships may need to be forged with local or regional providers, and because many of these emerging players lack the scale of the large American and European banks, several relationships may be necessary to achieve the same coverage once provided by a single global institution. The universal nature of many emerging-market banks also informs the pricing and bundling of services, in contrast with the narrower range of products that global specialists often provide.

For consumer-facing businesses, the most important financial firms in some developing countries may not be banks at all. From large supermarkets to urban kiosks, retailers are a crucial channel for basic financial services, either in partnership with banks or via their own financial operations. Telecoms operators and technology firms are central cogs in the financial systems of countries where mobile payments are easier for people with phones but not bank accounts. The experience of non-profit microfinance providers is also useful for companies looking to reach customers with modest but fast-growing incomes.

As the grind of austerity limits growth in developed countries, the global economy is relying to a large extent on the resilience of emerging markets. The local and regional financial firms native to these markets are taking advantage of the situation to bulk up, making them much more formidable competitors than before.

Jason Karaian is senior editor, financial services at the Economist Intelligence Unit in London. For more information about the research cited in this article, visit www.eiu.com/beyondbranches