

P E R S P E C T I V E

Banking in the Philippines: A Close-up



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Just over 7,100 islands covering a land area of about 300,000 sq. km. make up the Philippines, a country that is home to 94 million Filipinos descended from an amalgam of several races. Unfortunately, its geographic location renders it vulnerable to natural disasters, especially earthquakes and typhoons, both of which occur frequently.

The Philippines has a chequered political history. The end of over 3 centuries of Spanish rule was followed by about 50 years of U.S. control. The country became independent in 1946, and since then, has gone through phases of military as well as democratic rule. With a political structure modeled on that of the United States, the Philippines has a presidential system of government and bicameral legislature.

The last election, conducted in May 2010, was won by Benigno Aquino III, the son of Corazon Aquino, the Philippines' first woman President.

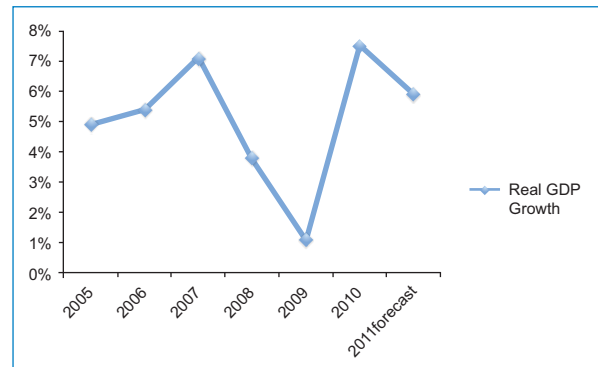
Economy Looked up 2010 Onwards

It is fair to say that economically, the Philippines has not fared as well as many other countries in its region and also to its true potential. In the last twenty years, the economy has grown steadily, but not inclusively; hence, reducing poverty, along with making progress towards the Millennium Development Goals are some of the key challenges of the present government.

The Philippines economy, which touched US\$ 189 billion (at market exchange rates) in 2010, stands out for its dominant services sector, and large private consumption which has attracted several global consumer goods companies to set up local manufacturing operations. Large-scale domestic unemployment has forced the well-educated, English speaking masses to migrate overseas, and today, foreign remittances contribute more than a tenth of GDP.

The nation's public finances are straining under its fiscal deficit, which narrowed marginally to 3.7% of GDP in 2010. The government is faced with the tricky problem of reining in this deficit, while increasing much needed expenditure on education, healthcare and infrastructure.

GDP Growth Rate



Source: Development Research News, Jan-Feb 2011, Philippines Institute for Development Studies

That being said, in 2010, the economy experienced its sharpest growth since 1986 thanks to the remittances sent by Filipinos working overseas, which fuelled domestic demand.

Business of Banking

The Philippines banking industry weathered the global financial crisis of 2008-09 reasonably well, owing to a numbers of factors – very little exposure to the U.S. sub-prime markets, banks' inherent resilience and strong balance sheets, conservative risk management and disclosure practices, and regulatory reform. The industry's income touched a high in 2007 before the crisis broke, and although it dipped the following year, by 2009, even while the crisis was underway, Filipino banks registered a healthy performance all-around: in lending, capital adequacy and profitability. The well-being of the industry is reflected in the 8.6% compounded annual growth in outstanding loans between 2006 and 2010 (latest available data). The outlook remains bright as young, educated, upwardly mobile Filipinos embrace banking products and services to add to the number of bankable households.

However, some risks prevail. Over the years, political instability and governance have put a dampener on the banking industry's progress. The new government has a clear mandate to ensure stability and root out corruption, themes that resonate among the youth and promise hope and optimism in the coming years to this wonderful country.

Not having undergone any significant consolidation, the Philippines banking landscape

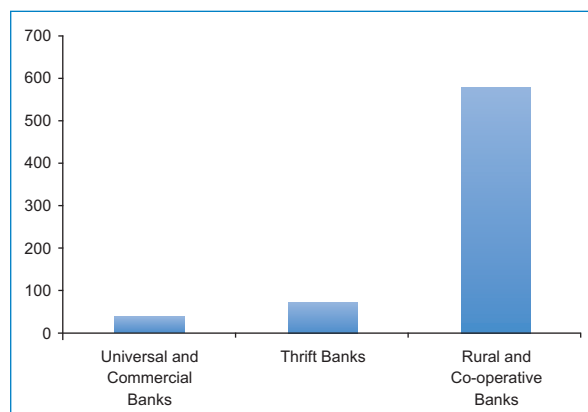
is both fragmented and variegated as described below:

- 38 Universal and Commercial Banks together hold nearly 90% of the total resources of the Philippines' banking system. Similarly, these banks command a lion's share of the industry's total deposits. Universal banks comprise private domestic or government owned banks, as well as a few branches of foreign banks. Commercial banks are either private domestic institutions, or the branches or subsidiaries of foreign banks.

Universal and Commercial Banks offer a wide range of services ranging from retail, corporate and wholesale banking to trade, treasury and investment services. Besides these functions, universal banks are also engaged in underwriting and investment activities. The top banks by assets are Banco de Oro Unibank, Metropolitan Bank and Trust, Bank of the Philippine Islands, Land Bank of the Philippines and Philippine National Bank.

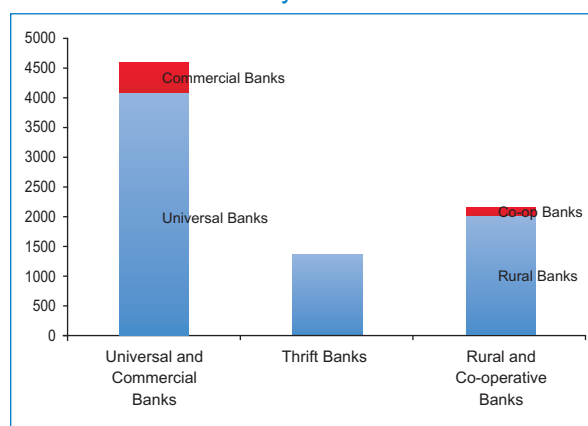
- The Philippines has 73 Thrift Banks, which could be any of the following: savings and mortgage banks, private development banks, stock savings and loan associations and microfinance thrift banks. These institutions are primarily engaged in gathering deposits from small savers and investing them. Thrift banks also provide trade financing to various small and medium businesses as well as individual business owners.
- The nation's 647 Rural and Co-operative Banks, as the name suggests, are responsible for developing the rural economy through the provision of basic financial services to the nation's majority rural population. The main difference between these two types of financial institutions is the pattern of ownership – rural banks are privately owned, whereas co-operative banks are owned by co-operatives.
- Besides the above, there are a number of specialized, development banks as well as non-banks with quasi-banking functions operating in the Philippines. The entire banking sector is supervised by BangkoSentral Ng Pilipinas, the Central Bank of the Philippines.

Number of Banks



Source: Bank Savings Climbed by over 10% in end-February—BSP Data, Roderick T. dela Cruz

Size of Physical Network



Source: BangkoSentral Ng Pilipinas Statistics

Emerging Business Segments

- **Microfinance:** As one of the fastest growing businesses, the Philippines microfinance sector is not only attracting interest and investment but also the world's admiration. Recently, The Economist Intelligence Unit (EIU) ranked the Philippines' microfinance regulatory framework as the world's best, and the industry's performance second best in terms of overall business environment. As per the latest statistics released by the Central Bank, 203 institutions lent nearly US\$ 226 million to over 930,000 micro-borrowers in 2010.
- **Bancassurance:** In recent years, the Central Bank has received a number of applications to conduct Bancassurance from both local and foreign banks. A 2007 report on the banking industry predicted that Bancassurance would account for 65% of total insurance products sales by 2011.

- **Mobile banking:** Mobile communication is well entrenched in this market, with penetration nearing 80%. Analysts estimate that there will be 126 million mobile subscribers in 2015; one in eight will opt for 3G services. There is a strong demand for mobile money services among the unbanked sections. As per different estimates, the number of mobile banking users will rise to 11 million either this year or the next. Besides traditional banking players, telecom companies are also participating in this opportunity by offering several new services.
- **Retail wealth management:** With young investors showing interest in mutual funds and related products, retail investment advisory and wealth management services are showing signs of growth.

Counting on Technology

The Philippines banking sector has been far more open to technology than many of its counterparts in the region. In fact, the industry is an early adopter, having upgraded its systems 10 to 15 years ago to state of the art technology of that time. Since then, several banks have revamped their technology platforms and as a result, improved customer service, reduced time to market, created right selling opportunities, and enhanced efficiency etc., on the way to competitiveness and profitability.

The trend of core banking renewal, which started in 2004, prevails even today with maybe 30 to 40 percent of universal banks actively considering a change.

Currently, the microfinance industry is propelled by a solid distribution network of agents and intermediaries; however, as microfinance institutions renew their core banking platforms and consequently enlarge their options of electronic channels, they could leverage technology (especially mobile devices) to reach their services to the last mile.

Banks are also looking at social media with interest as a channel to engage the country's younger, technology-savvy generations. In future, banks may integrate social media with their regular services to improve customer engagement, render customer service, draw insight, co-create and perhaps even facilitate banking transactions.

Clearly, these are interesting times for banks operating in the Philippines and with the new government, fresh hope and aspirations the time could not better!

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Author

Mahesh Dutt Kolar

Regional Manager - Asia Sales, Finacle
Infosys Limited



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Infosys Limited

Plot No. 44, Electronics City, Hosur Road, Bangalore - 560100. India
Tel.: + 91 80 28520261, Fax: + 91 80 28521747, e-mail: finacleweb@infosys.com
www.infosys.com/finacle

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