

P E R S P E C T I V E

Future Perfect: Opportunity for Banks in Emerging Markets



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New Nomenclature in a New World Order

When it comes to listing the forces that will influence banking in the coming decade, emerging economies rank right up there along with the digital consumer, mobility and green innovation. The term 'emerging market' was coined in the 1980s as a more positive way to describe what until then were known as 'less economically developed countries'. But neither 'emerging market' nor 'emerging economy'— words that are used interchangeably – do justice to a phenomenon that is not only about a particular geography or its state of economic progress. A better description would be to say that these are regions undergoing an information and communication revolution despite being partially or less industrialized. Semantics aside, what sets emerging markets apart is that they are home to a huge community of new users adopting products and services in non-traditional ways, and a source of innovation in product technologies and platforms.

New Land of Opportunity

The proliferation of IT and BPO companies providing high end, high value, cost effective services as well as much of the innovation happening in these countries caught the attention of well developed nations which for long had dismissed the less developed world as an economic dead-end. The timing of this newfound interest coincided with the realization that it was becoming increasingly harder to do business in the West on account of the high cost of those economies and the limited opportunity offered by their ageing populations. Thus, companies from different sectors including automobiles, retailing and pharmaceuticals stepped out of the highly competitive, low margin markets of the West in search of attractive opportunities elsewhere. It was the same for financial institutions.

Therefore, from a banking perspective, emerging markets are interesting for two reasons, namely, to track the progress of their local banks' domestic operations, and to understand the importance of these burgeoning markets to the financial institutions of the developed world.

The rise of local banks

Of the several factors contributing to the growth of the emerging markets' financial sector, demography and technology are perhaps the most important. There is ample evidence from countries such as China, India and the Philippines of their youthful populations' willingness to adopt new channels and practices that have come by as a result of automation of core banking activity. This openness to new technology is reflected in the high mobile penetration, and even more by the acceleration of mobile communication into mobile banking and commerce. Contrast the success of M-PESA, a mobile money transfer service used by over 10 million Kenyans at last count, with the conservative banking behaviour of American mobile bankers who haven't progressed beyond using their devices for anything other than fulfilling the most basic transactions.

What's more, the ready adoption of technology is not restricted to the urban elite. With mobile operators plying their trade deep within rural areas, banking institutions in South Asia and parts of Africa have leveraged this outreach to advance their financial inclusion agenda in places lacking basic infrastructure and other forms of connectivity. Once again, the inhabitants of these areas have embraced the mobile banking offering – designed for simplicity and viability without compromising security – as a way to channelize their savings and lead a more fiscally responsible life.

Another reason for the rapid spread of banking technology is the fact that unlike their Western counterparts, emerging market institutions were not burdened by legacy systems. Hence, they skipped a whole generation of legacy technology when they migrated their core banking operations to a fully integrated, online, real-time platform. This enabled them to take products and services to market in a quick, lean and cost-efficient manner to benefit their own operations as well as their customers. That the legacy overhang continues to trouble institutions in mature markets is clearly voiced in the response to a survey of 145 banks across 50 countries which Infosys conducted

jointly with the European Financial Management Institution in September 2010: 63% of West European banks said that inflexible IT was a barrier to innovation, versus just 50% of respondents representing banks from the Middle East and Africa.

The entry of foreign banks

The vast population of emerging nations was a huge draw for Western banks which were struggling to find avenues of growth within their limited, greying home markets. However, the destination countries' policy of protecting their domestic industry by restricting foreign banks' branch network and equity ownership meant that the latter did not have a level field to play on. That problem was solved to a great extent by technology, which enabled Western banks to offer sophisticated products and services over alternative non-branch channels to a large, interested emerging market audience. Rather than fight a losing battle against local giants for a share of the vanilla segment, foreign banks smartly piloted their initiatives in the markets' white space, to bring high-end products, new channels of delivery and superior service to their customers' doorstep.

It is important to qualify the above by saying that this would not have been possible had the cost of technology not come down over the years to make it viable for these banks to set up shop in countries that would otherwise entail a high cost of penetration.

Here again, the favourable demographics of emerging markets has added to their attractiveness. Since the citizens of these countries are unafraid to experiment with new products, channels and technology, Western banks know that they have a real chance of succeeding provided they put together a meaningful value proposition. And because these customers are young – there are 830 million people between the ages of 15 and 34 in China and India alone – they are great prospects for building long term relationships with.

That being said, these markets are highly stratified, encompassing a wide variety of customer expectations that must be fulfilled. This is driving the banks to focus on understanding the consumer dynamics through behavioural analyses and predictive analytics so that they can meet future needs perhaps even before they are articulated.

What Next for Emerging Market Banks?

It's fair to say that the limited automation of emerging market banks turned into an advantage when they started to modernize, because they could leapfrog a generation of intractable legacy systems while switching to new integrated technology. Having rapidly upgraded their back end systems, these banks have now shifted focus to the front end in the online space. Hence, they will take their next big leap in Internet and mobile banking as well as mobile commerce.

When the concept of mobile banking was introduced in mature markets, it seemed that their customers only wanted to use their handsets to 'talk, talk, talk'; in contrast, emerging market consumers want to 'shop, shop, shop'. Hence, there is a big opportunity for financial institutions operating in these markets to leverage their mobile platforms to offer commerce, money transfer and wallet services and capture their sizeable population of tech-savvy young consumers for life.

The future looks bright for emerging markets, now widely acknowledged as the world's growth engine and hub of future innovation. But beyond that, the onset of a refreshingly open mindset led by the young citizens of these countries holds much promise for forward-thinking, first-moving banking institutions.

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