New global research series

Growth opportunities for financial services in emerging markets

Selected markets in the Asia Pacific Region:
China, India, Indonesia, Malaysia, Thailand, and Vietnam

Deloitte Center for Financial Services

Reasons to consider emerging markets

For companies with limited international experience, the perceived challenges of expanding into emerging markets may seem daunting. For these companies, here are three reasons to consider establishing a presence in one or more of these countries:

- *Attractive growth rates:* Many emerging markets are expected to grow faster than mature economies. As emerging markets continue on their extraordinary growth trajectory, there is a real need for basic financial services, including retail banking, insurance, asset management, and capital market services. Foreign firms that have established footholds will have the advantage of reaping the benefits as these countries' financial markets are transformed.

- *Limits on domestic growth:* In many advanced economies, organic growth appears mild during tough economic times. And spurring growth through acquisition offers limited prospects in all sectors within the financial services industry. Expansion in emerging countries can offer an alternative to constraints in mature markets.

- *Revenue diversification:* Emerging markets potentially offer revenue diversification for firms in the advanced economies, especially those experiencing stress from burdensome regulation and limited growth in domestic markets.

Growth opportunities for financial services in emerging markets

Emerging markets around the world offer considerable opportunities for banks, insurance companies, and fund managers to increase global market share. According to International Monetary Fund estimates, the economies of such countries "… are expected to grow two to three times faster than developed nations like the U.S."[1]

While many emerging markets are still addressing poverty, their higher-than-average economic growth rates are fueling the emergence of an educated middle class that aspires to achieve a more affluent lifestyle in which traditional depository, credit, insurance, and investment products play an important role. The growth of this middle class is expanding global demand for financial services from established providers and represents a new opportunity for financial services companies looking for growth.

To help financial services companies around the world better understand and assess the opportunities, challenges, and risks that emerging markets present, the Deloitte Center for Financial Services has launched a global research project that focuses on six countries in the Asia-Pacific region: China, India, Indonesia, Malaysia, Thailand, and Vietnam.

We hope that you will find our reports useful as you consider the role that emerging markets may play in your company's growth, and welcome the opportunity to share the knowledge and experience of our global financial services industry group with you.

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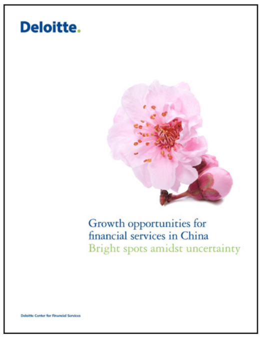
2016 projections:
Nominal GDP, population, and bank deposits

	Nominal GDP ($ billions)	Population (millions)	Bank deposits ($ billions)
China	14,152	1,355	41,904
India	4,420	1,292	4,043
Indonesia	1,600	258	855
Thailand	515	71	582
Malaysia	430	31	416
Vietnam	200	93	477

Source: The Economist Intelligence Unit

[1] "What Makes Emerging Markets Great Investments?", http://www.forbes.com/pictures/eglg45gdjd/why-invest-in-emerging-markets-2/.



Growth opportunities for financial services in China: Bright spots amidst uncertainty

China has been a dominant economic force in the Asia-Pacific region for centuries.

One person in every five on earth lives in the People's Republic of China, and its massive GDP makes it a focal point for expansion by many banks, insurance companies, and asset managers looking for international growth. Moreover, the country has a substantial middle class, estimated to be 300 million people strong.[2]

Although its economic expansion over the next few years is expected to be more moderate than in the recent past, China is still expected to contribute a significant portion to global economic growth. China is in the midst of its 12th Five-Year Plan for National Economic and Social Development, a state initiative that emphasizes a shift from export-led investments to domestic consumption.

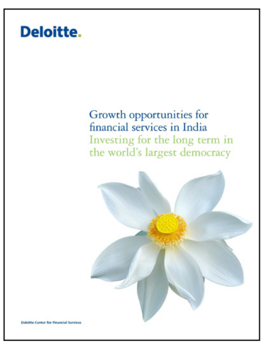
This change in priorities can be a catalyst for faster growth in many sectors of the economy, including financial services. And there are signs that the reforms under way will only gather steam once the new leadership takes power later this year.

Foreign companies recognize, however, that doing business in China has never been easy, and the financial services sector is no exception. The Chinese government maintains strict control over every aspect of financial services, including currency valuation, interest rates, capital flows, and foreign investment. These realities can dissuade even the most aggressive companies from investing heavily in China.

As financial institutions consider how to respond to the new "doing less badly" world order, they will likely find themselves in an environment where they face:

- Expanded complexity of the compliance framework needed to be effective in the increased regulatory environment as a barrage of new rules are enacted
- Increased compliance and risk management costs
- Reduced revenue streams due to caps on fees, limitations on trading, and other activities
- Increased capital and liquidity requirements

Combined, these factors could translate into weaker performance and consequently lower structural return-on-equity (ROE) ratios for the industry as a whole and for individual institutions. As financial institutions embrace a sober future of new rules, regulations, and scrutiny, Deloitte estimates that as much as 25 percent of the banking industry's operating expenses may need to be reduced just to maintain ROEs at reasonable levels.



Growth opportunities for financial services in India: Investing for the long term in the world's largest democracy

Like China, India represents a massive potential market for banks, insurance companies, and asset managers seeking expansion beyond their borders.

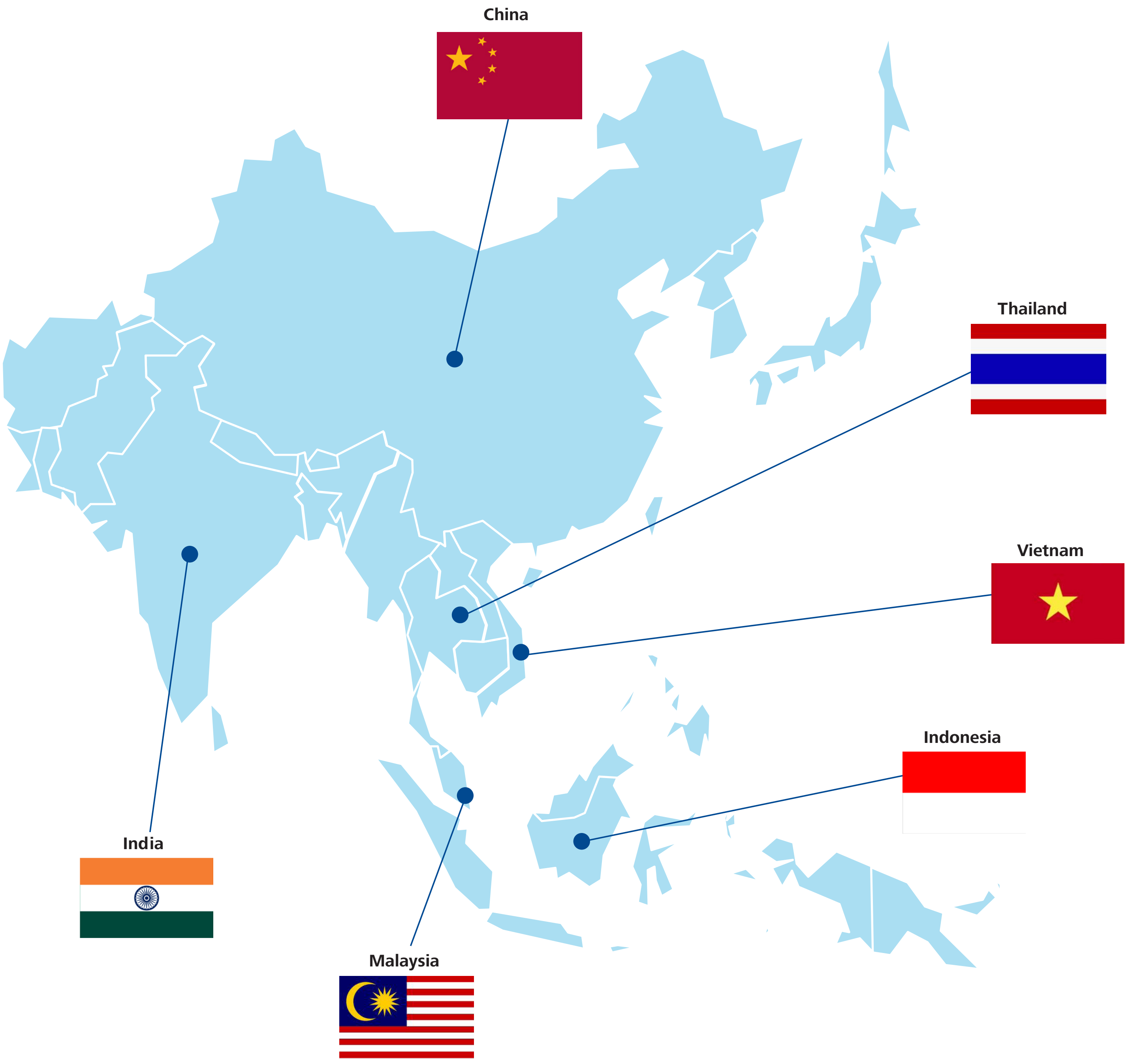
Although state-owned financial institutions will likely continue to dominate India's banking industry and capital markets, the wave of liberalization over the last two decades has opened expansion opportunities for the private sector, including foreign banks and insurance companies.

Foreign banks' market share is small compared to domestic counterparts, with the primary focus being mergers and acquisitions advisory services and trade finance. Despite regulatory restrictions, foreign banks have expanded in India through de novo expansion. Going forward, foreign banks are likely to establish wholly-owned subsidiaries as regulators focus on reducing systemic risk.

The Indian insurance sector is among the fastest growing in Asia, and is expected to increase at a double-digit rate through 2016. Though foreign direct investment is restricted, private firms continue to enter the market, primarily through joint ventures with local insurers.

Both the life and non-life markets are dominated by public-sector firms; however the life market is more highly concentrated. In addition, regulations remain the major entry barrier for the foreign insurers. However, favorable demographic and economic trends provide foreign insurers an opportunity to drive long-term growth in the Indian insurance sector. Carriers need to focus on developing strong local partnerships and effective distribution and product strategies.

[2] Luhby, Tami, "China's growing middle class," CNNMoney, April 26, 2012, http://money.cnn.com/2012/04/25/news/economy/china-middle-class/index.htm.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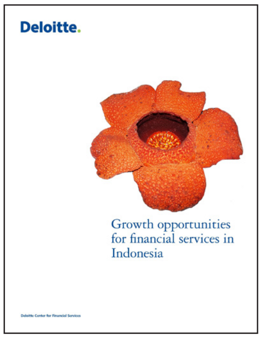

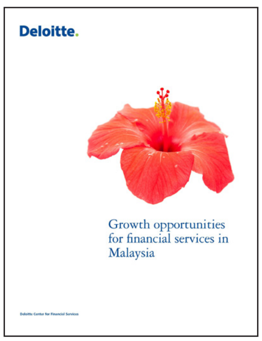

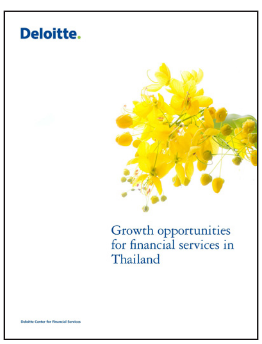

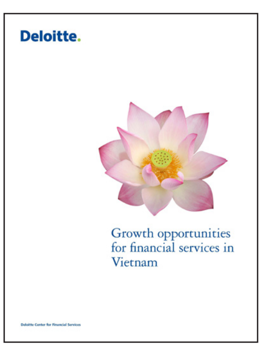

Other Asian markets with emerging prospects

In addition to China and India, Deloitte's new global research series will examine growth opportunities for financial services in Indonesia, Malaysia, Thailand, and Vietnam.

Indonesia: Although economic growth in other countries around the world may be slowing, Indonesia's economy grew at its fastest pace in more than 15 years in 2011.

Indonesia will establish a new Financial Services Supervisory Authority in 2014, which will likely assume the central bank's current supervisory role over the nation's lenders. This new regulatory agency will also oversee capital markets and non-banking financial institutions. As a country with a large Muslim population, Indonesia also offers many opportunities for companies engaged in Islamic finance.

Foreign companies can enter Indonesia by acquiring existing domestic banks or insurance companies, but premiums are usually high. In addition, foreign investors also have to deal with a high level of bureaucracy and many infrastructure issues.

Malaysia: The Malaysian economy is expected to grow by 4 to 5 percent in 2012, according to estimates by Bank Negara Malaysia, the country's central bank. Contributing factors include the government's recent decision to increase civil-service pay, which is expected to spark growth in private consumption, coupled with rising investment spending, driven by foreign direct investment and implementation of domestic infrastructure projects.

The Malaysian government identified the financial services sector as one of 12 National Key Economic Activities under its Economic Transformation Programme initiated in 2010, aiming to increase the sector's contribution from RM59 billion in 2009 to RM180 billion in 2020. Steps to achieve this goal include:

- Deepening and broadening of the scope of services offered by Islamic banks
- Promoting further consolidation and rationalization of the insurance sector, and
- Implementing measures to boost the development of capital-markets subsectors.

Thailand: Among the countries south of China and east of India, Thailand is second only to Indonesia in GDP. Exports account for two-thirds of Thailand's GDP and range from low-tech products like home furnishings and apparel to high-tech products like automobiles and computer disk drives.

However, extensive flooding from the 2011 monsoon season disrupted much of Thailand's industrial and agricultural production and cast a cloud over the country's ability to rebound from an economic casualty surpassed in 2011 only by the earthquake and tsunami in Japan.

The 2011 floods hit Thailand's insurance industry hard, racking up between $16 billion and $18 billion in losses, according to Standard & Poor's Rating Services. Banking, too, has suffered in the short term from the 2011 floods, although loan volume grew by nearly 15 percent in 2011.

Few countries in Southeast Asia, however, can match Thailand's per capita production, and the Thai government is investing in infrastructure to mitigate future flooding.

Vietnam: For more than a quarter century, Vietnam has been evolving from a centralized state economy to a decentralized market economy. While the country has made notable strides towards creating a more capitalistic business environment, state-owned enterprises still account for 40 percent of Vietnam's GDP.

As the government takes steps to foster economic growth, a number of financial services firms see opportunity in Vietnam's future. In the banking and securities sector, there is relatively high demand for strategic overseas partners to support management and technology as well as demand for domestic mergers and acquisitions to meet the needs of commercial and retail customers. At the same time, demand for insurance products and competition from foreign insurers are both growing, while the market for asset management services is still in the initial stage of development.

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Center for Financial Services

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