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Weathering the storm: Asia–Pacific Banking Review 2016

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Our annual report finds an industry facing challenges to maintain its growth, but significant opportunities remain.

Over the past decade, the Asia–Pacific region has propelled global banking. Of the industry's $1.1 trillion global profits in 2015, some 46 percent came from the region, up from just 28 percent in 2005. The bulk of this increase was the result of growth linked to dynamic economies throughout Asia–Pacific, especially China, which accounted for about half of the region's banking-revenue pool in 2015.

Yet our annual report, *Weathering the storm: Asia–Pacific Banking Review 2016*, finds that the momentum from this golden decade is already fading. Margins and returns on equity are shrinking—for instance, the Asia–Pacific banking industry's ROE slipped to 14 percent in 2014, from 15 percent a year earlier. The region and its financial industry seem to be settling into a new era of slower growth and greater challenges in generating economic profit.

Of course, Asia–Pacific is diverse, and each national economy has its own advantages and challenges. For example, the level of connectivity ranges widely, with smartphone penetration in Singapore at 73 percent in 2015, compared with just 15 percent in India.[1] In 2014, income per capita ranged from $47,745 (Australia) to $1,352 (India). While each of the region's countries presents a unique situation, three threats now taking shape will affect banks in all of them:

- Slowing macroeconomic growth. The economic slowdown rolling across the region will affect banks and their customers, especially in the corporate sector. In China, for example, the growth of real gross domestic product fell to 6.9 percent in 2015, dropping below 7 percent for the first time since 2000. We also expect the growth of banking profits to slow from 10 percent annually (2011–14) to 3 percent (2016–21).

- Disruptive attackers from outside the financial-services sector. Traditional banking territory is being encroached upon by fintechs—start-up technology companies offering financial products such as payment systems and lending platforms—and by established companies from outside the industry, such as Alibaba.

[1] *Global smartphone user penetration forecast by 88 countries: 2007–2020*, Strategy Analytics, December 2015, strategyanalytics.com.

- Weakening balance sheets. An increasing volume of nonperforming loans is putting added stress on banks, as interest-coverage ratios decline at large companies throughout the region, especially those in China and India. Our analysis indicates that by 2020, banks in Asia need to raise $400 billion to $600 billion in additional capital to cover losses from nonperforming loans while maintaining capital-adequacy ratios.

These three threats may come together in a powerful storm that could cripple ROEs by 2018. Indeed, banks already see the impact of the changing environment. Our analysis of 328 banks in the region showed that while 39 percent posted an economic profit in the period from 2003 to 2006, only 28 percent did so from 2011 to 2014.

Banks that simply try to wait out the storm will probably find themselves struggling for survival, but those that take action can uncover growth opportunities and measures that could help rekindle their momentum. Our analysis and experience suggest that banks must understand and address four imperatives to gain strength amid the turbulence:

- Pursue focused growth. Banks should explore three clear pockets of growth: the unbanked and underbanked; an expanding, affluent middle class; and small and midsize enterprises, which are increasingly important for corporate banking. The choice will depend largely on an institution's capabilities and strategy. Some universal banks will pursue all three.

- Drive a value-focused digital transformation. With margins under pressure, banks must pursue digitization rapidly, especially to control costs—for example, by building new digital businesses and using digital technologies to transform existing systems and customer journeys.

- Strengthen balance sheets. Banks must also find ways to strengthen their balance sheets by addressing the growing volume of nonperforming assets. They can explore creating asset-management companies as a short-term solution while working to improve risk management in the longer term.

- Enable the organization. Banking organizations must adapt to the new environment. In particular, they should build partnership skills and form alliances with fintechs and other players to create and enable a digital ecosystem. These organizations must also become more flexible and nimble, to bring out new products and services much faster than they did in the past. Finally, banks must revise their approach to talent and culture by creating room for innovation.

Although the coming storm is a potent and clear threat to most banks in the Asia–Pacific region, it may also provide the kind of significant industry disruption that creates opportunities for those that recognize it. The most aggressive banks will not merely survive the turbulence but also be strengthened by it. □

Download the full report on which this article is based, *Weathering the storm: Asia–Pacific Banking Review 2016*, on McKinsey.com.

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