



# International experience: Strategies for Rural Banks

February 2014

# Introduction



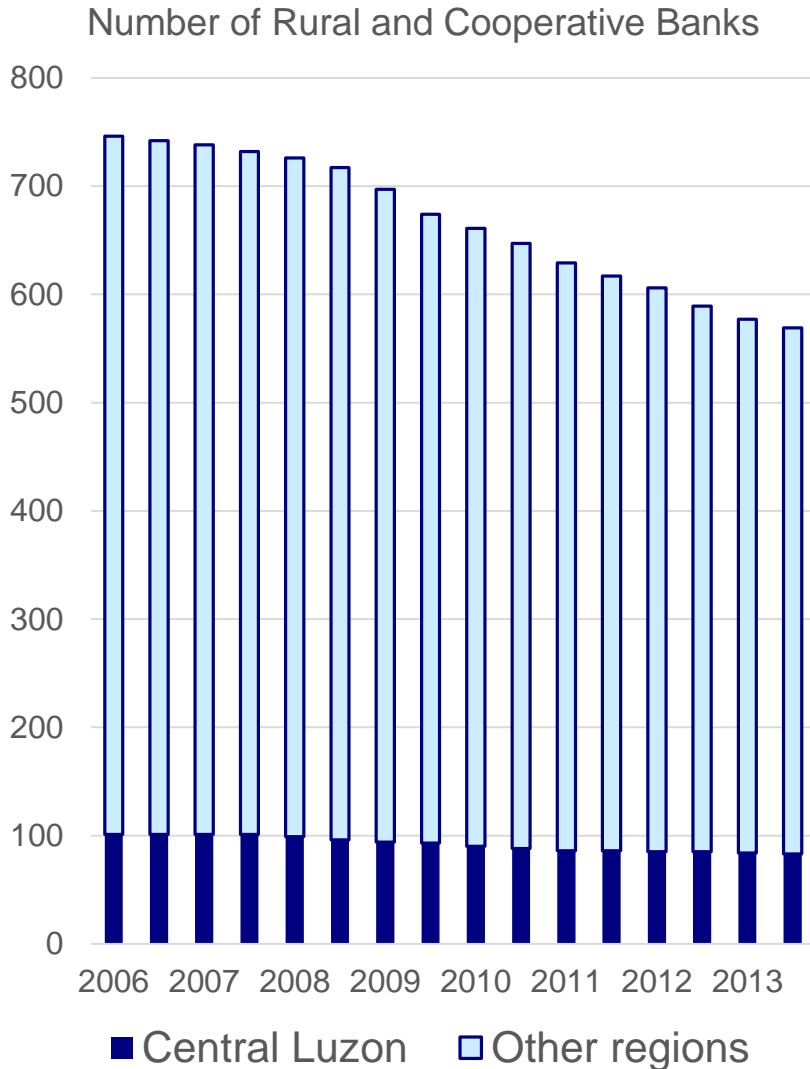
- **Network of innovative, dynamic and dedicated rural banks** – supporting 3 million rural Filipinos by 2020
- Socially motivated investment company: Raised P1bn from FMO, DEG, Accion Bamboo in 2013
- Focused on Rural and rural-focused Thrift Banks in the Philippines
- Stakes of 35% - 60% + capability building
- Based in Manila, with a team of experts building capabilities
- Open to range of investment options

## Gus Poston



- Former Head of Strategy for Barclaycard
- Advisor to major Asian banks on transformation, strategy & operations
- Micro-finance, rural banking and social development
- Product, consumer credit, I/T, Operations, Change management
- 18 years experience in banking, 17 years living in developing countries
- 4 years in the Philippines

# Today: focus on options for 'Majority Rural Banks'



Annual change

-4.4%

-2.8%

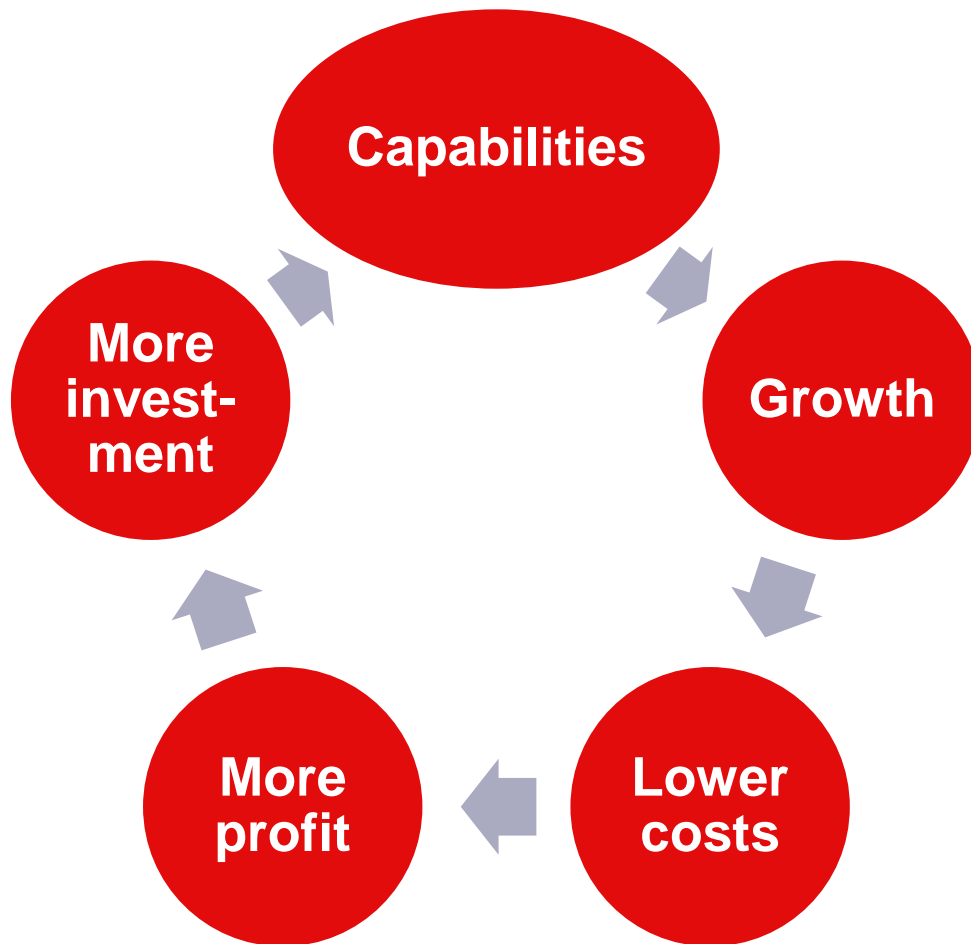
**Significant consolidation**

- Mergers
- Closures

**... but large numbers of smaller banks remain**  
**569: Nationwide**  
**83: C Luzon**

# Know what we are up against: *Benefits of scale*

## 'Virtual cycle' of scale



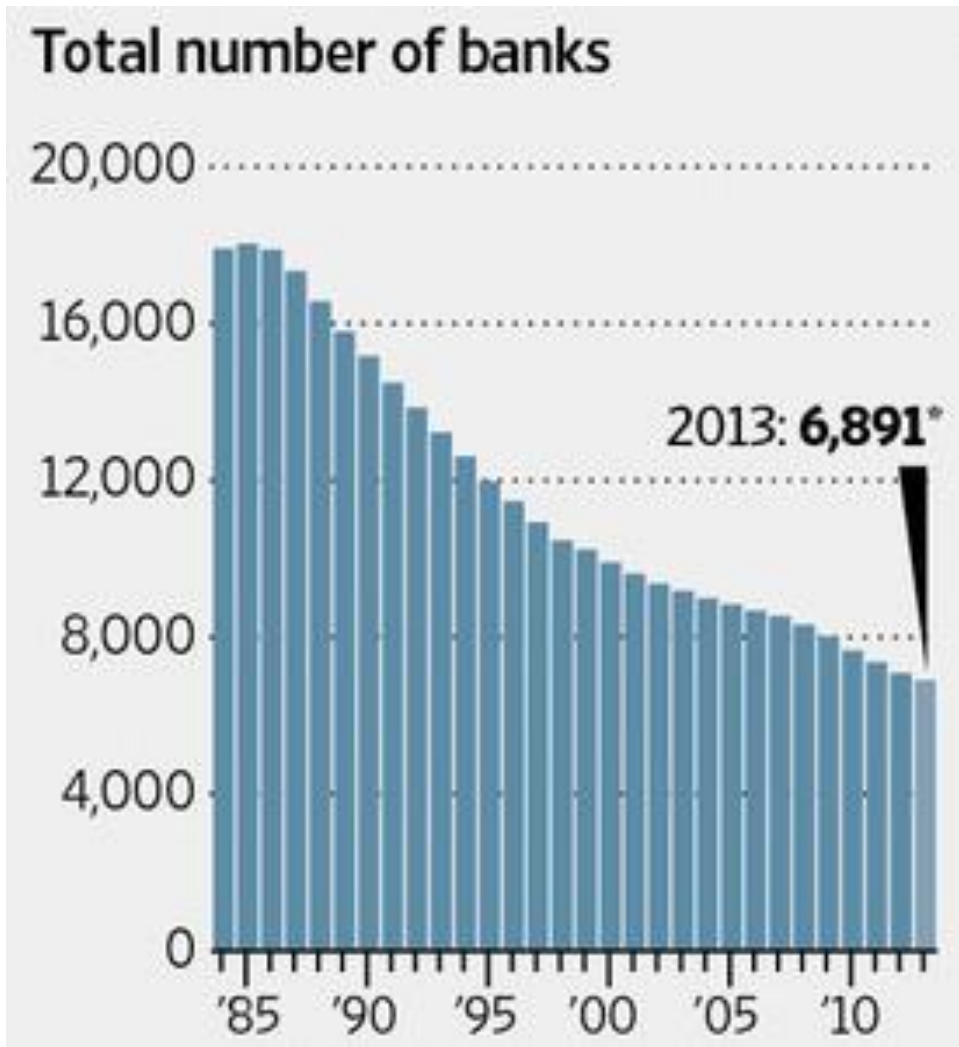
## What is driven by scale?

- Costs (e.g. processing costs)
- Investment returns (e.g. IT systems)
- Cost of funds
- Product range
- Customer perception

## What is local?

- Relationships
- Local understanding
- Adaptability / flexibility

## *Example of the US.* Question is: what to do to survive?



- The US still has very many banks: 6,891: 22 banks per million people (compared to 7 in the Philippines)
- The number is falling fast:
  - from ~17,500 in 1985
  - reduced every year for the past 28 years
  - 3.3% of the banks close / yr
  - ... i.e. 60% have closed over the past 28 years
- **Question: What have the survivors done?**

# *Contents*

**Things to avoid**

**Things to try**

# *Don't expect things to stay the same*

## Things we did not expect

- **Instability**

- 2/3 of UK banks need government bail out in 2008
- 60% of US banks close since 1985

- **Technology disruption**

- Kenyan customers prefer to bank with their mobile than their bank
- 50% increase in mobile banking in 2013 (in US)
- % of clients buying personal loans online goes from 8% to 24% in 2013 (in US)

- ***Remember the Sony Walkman?***



# Don't go head to head with commercial banks: *Learn to be different*

## Commercial Banks

- Are increasingly entering rural areas
  - No growth opportunity in Manila
  - Learning that it is possible to lend in rural areas
- Can live with lower interest rates on loans:
  - Have lower cost funds
  - Make more money from fees and services

## Rural Banks

- Are limited in their product set
- Cannot compete on interest rates
- Have issues with reputation and trust



**Rural Banks that have depended upon 'traditional' lending need to find new strategies / products / specialties**



# Don't expand lending too fast: *ensure you can manage the risks*

## Rural Bank experience

- Expanding to new lending areas has been painful for some banks:
- Lack of product understanding / capabilities has led to significant losses
  - Credit appraisal
  - Loan monitoring
  - Collections capability
- Unsecured lending: particular issue
- Also, banks have not been able to manage the activities of loan officers



**Rural Banks need to spend time understanding a market, piloting, training before expanding into a new product**

# Don't take too many (high-cost) deposits: *Adapt to Interest Rate change*

	Balance sheet	Av Cost / Yield	P&L impact
Deposits	100	8%	-8
Loans	80	22%	17.6
Costs (10% of loans)			-8
Profit			1.6
ROA			1.3%

**Historic situation:** banks were able to make enough margin on loans to afford to pay high interest rates on deposits

	Balance sheet	Av Cost / Yield	P&L impact
Deposits	150	6%	-9
Loans	80	14%	11.2
Costs (10% of loans)			-8
Profit			-5.8
ROA			-3.2%

**Commonly seen:** banks are too slow to reduce interest rates on deposits, so deposit balances go up, loan margins get squeezed and Return of Assets falls / bank makes a loss

	Balance sheet	Av Cost / Yield	P&L impact
Deposits	100	3%	-3
Loans	80	14%	11.2
Costs (10% of loans)			-8
Profit			0.2
ROA			0.2%

**Better solution:** Drop deposit rate fast, so limiting the growth of balances and reducing expense cost

# Don't ignore leadership / governance: *Don't wait too long!*

## Rural Bank experience

- It is common to see board members / Presidents who continue to lead the bank well into retirement
- Experience and relationships is very important for banks
- ... but older leaders need to also have younger staff to drive change in the bank: the sector is undergoing rapid change
- Many banks fail because 'there is nobody there to run the bank'

**Rural Banks need to seriously consider who will drive the development of the bank  
.... And bring in younger leadership in time for them to be trained**

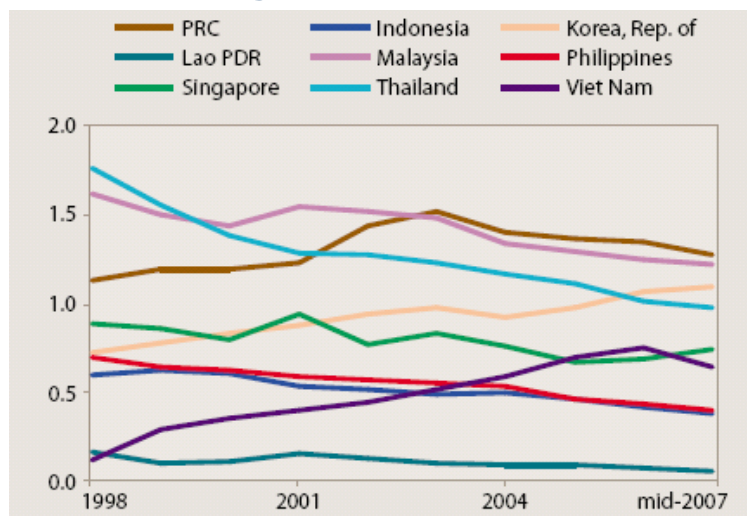
# *Contents*

**Things to avoid**

**Things to try**

# Focus on attractive segments: *Philippine Business Bank*

## Total lending in the Philippines is low



## And even lower in Rural Areas

Some banks have grown rapidly by identifying an attractive segment and grown the loan book fast



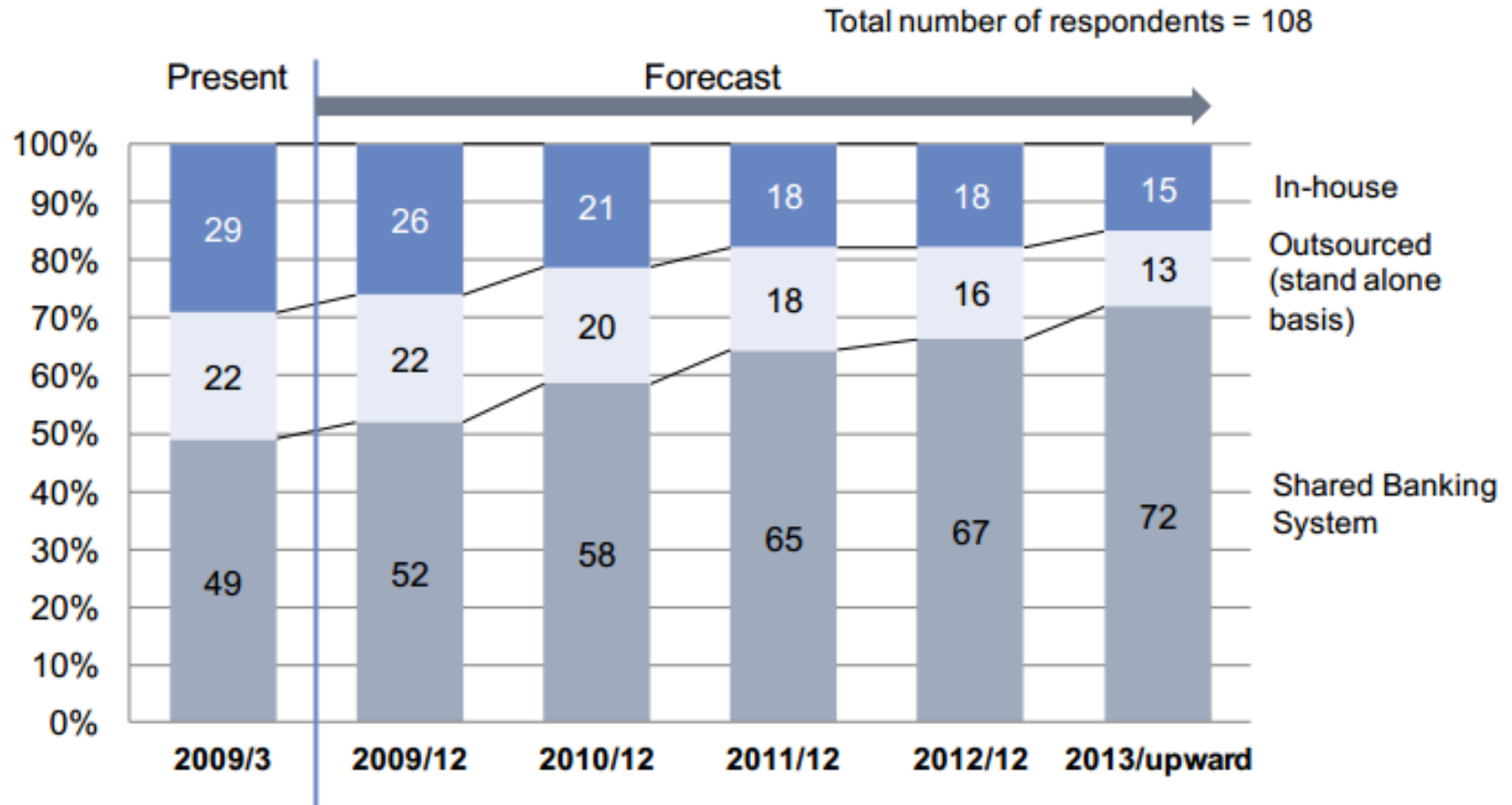
1 branch in 1997  
17 years, 100  
branches,  
Listed  
Focus on SMEs

## Questions for Rural Banks

- What sector to focus on?
  - Less competition
  - Significant borrowing needs
- Do you have the capital and capabilities required to grow?
  - Should plan to be large enough to fight off competition in your target segment
  - Will need focused work to build the skills

# Find new technologies: *Shared IT systems are common in Japan*

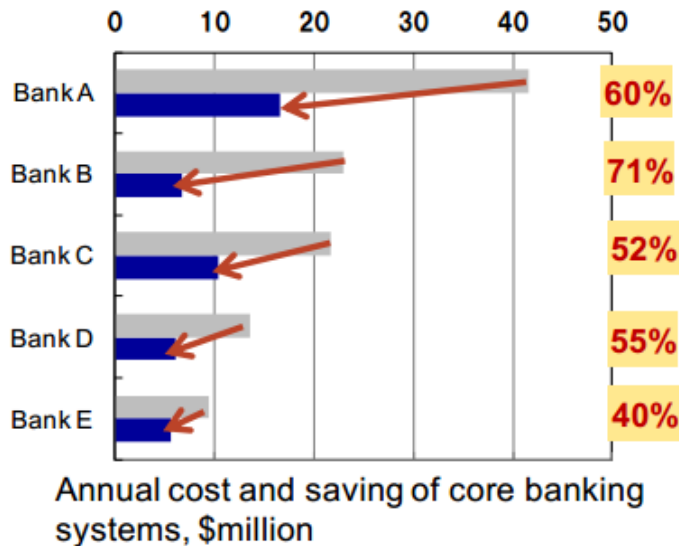
Figure6 : Situation of employing shared banking system in Japan



Source: "Current Status and Challenges in Shared Banking System"  
Released by the bank of Japan in June 2009

# Find new technologies: ... *resulting in lower costs (but coordination difficulties)*

## Cost impact of using cloud based solutions in Japan

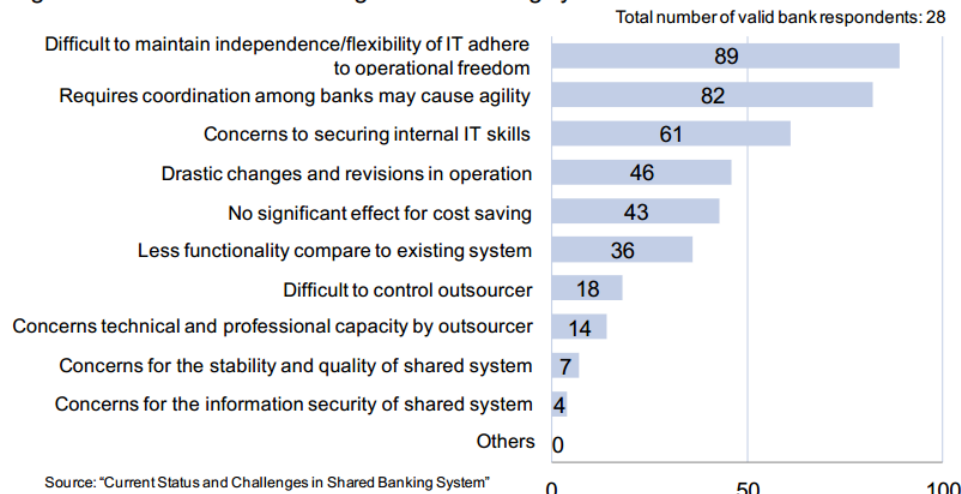


## Questions for Rural Banks

- How to coordinate across banks?
- Who will lead?
- Are you willing to give up flexibility?
- When will it happen?

## Issues raised in cloud based solutions

Figure 8 : Concerns for choosing shared banking system



# Focus on local relationships

## From a survey in the US

Only 36% of the consumers believed their bank understood their needs.

e.g.: reactions to major life events (such as getting married, having a child, nearing retirement or moving to a new home)

Banks had only contacted 18% of customers (who had such an event within the last 12 months) to offer appropriate products.

Yet, 70% of those contacted by a bank liked it.

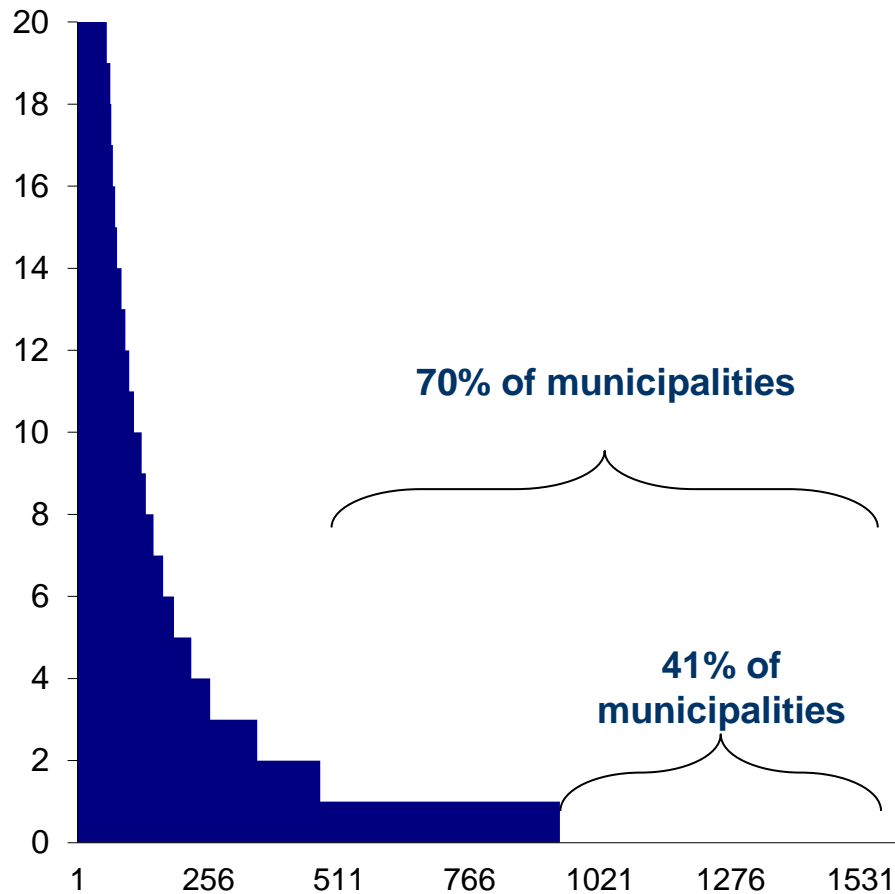
## Questions for Rural Banks

- Are you actively building relationships with your customers?
- Are you better at this than your competitors?



# Move to less competitive areas: *Many people are still unserved*

~ 20% of the population (~16m people)  
live in areas with *no bank branch*

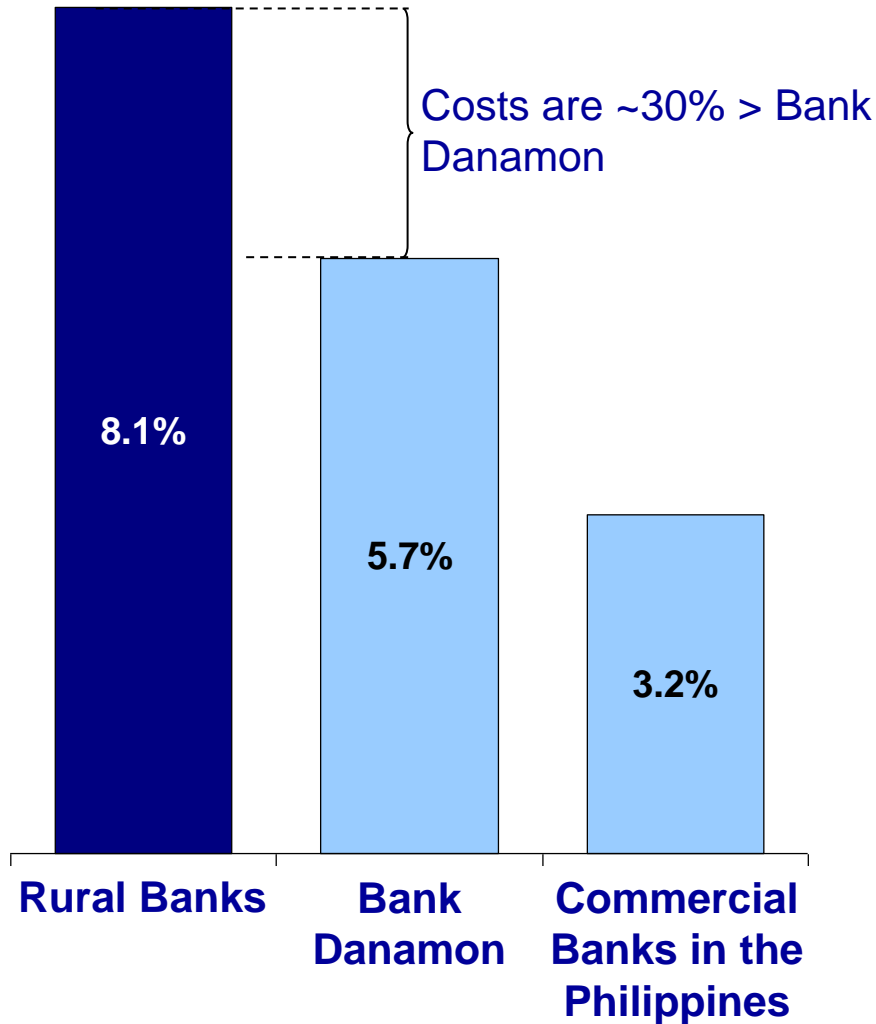


## Questions for Rural Banks

- Are you located in remote areas where there is little completion?
- Are there areas nearby that do not have sufficient branch coverage?
- Do you have the products required for these areas?

# Be aggressive on lowering costs: *Analyze your cost to asset ratio*

(Non-interest) Expense / Asset



**Rural Bank costs range from 5.6% to 13% of assets**

## Questions for Rural Banks

- What is your current cost to asset ratio?
- Are there ways to minimize your costs?
- Are all the staff productive and needed?
- Will this be enough to survive?

**Partner / merge:**  
*History of Barclays Bank*



Assets of \$2.4Tn (\$2,384,000,000,000)  
 = P107Tn (PhP107,280,000,000,000)

(or 110 x size of BPI)

History of Barclays bank	No
• 1690: Founded as goldsmith bankers in Lombard Street, in the City of London	1
• 1896: joins 19 other private banking businesses to form Barclay & Company Limited, with 182 branches	20
• 1905: acquires the Consolidated Bank of Cornwall	21
• 1916: acquires United Counties Bank in the Midlands (already the result of a merger)	22
• 1918: amalgamates with the London Provincial and South Western Bank	24
• 1925: Merges with the Colonial Bank, the Anglo Egyptian Bank and the National Bank of South Africa	27
• 1940: acquires Union Bank of Manchester	28
• 1969: amalgamates with Martins Bank	29
• 1987: sponsorship of the Premier League	

## Partner / Merge: *First Consolidated Bank*



- **Founded in 1982**
- **Result of merger of 16 (?) rural banks in Bohol**
- **Following merger, has grown rapidly. Now has 65 branches, 20 marketing outlets**
- **10bn in assets, ~15% growth per year**

### Questions for Rural Banks

- Are there benefits from mergers?
- Are you aware of other rural banks who you can merge with?
- Could you create a large coalition?
- Can you do this internally, or would you need a third party to facilitate?
- Who will lead?

## *In summary: we have discussed a number of issues for your consideration*

### Things to avoid

- Don't expect things to stay the same
- Don't go head to head with commercial banks
- Don't expand lending too fast
- Don't take too many (high-cost) deposits: adapt
- Don't ignore leadership / governance

**... because this leads to bank collapse**

### Things to try

- Focus on attractive segments
- Find new technologies
- Focus on local relationships
- Move to less competitive areas
- Be aggressive on lowering costs
- Or: Partner / merge

**... to achieve stability**

# *What is your future?*

## **Find a niche / specialism?**

- Find a product area different to commercial banks
- Manage risk, grow with controls

## **Locally focus?**

- Focus on regions where there is less competition
- Focus on relationships (commercial banks cannot provide)

## **Lead the partnerships?**

- Find others to work with
- Merge, join in IT systems, etc.
- Move early to be part of the structural change

- Aggressively manage costs
- React fast to market changes
- Be entrepreneurial

**Thank you**

**I am here today and tomorrow: happy to  
answer any additional questions**



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