Beyond branches
Innovations in emerging-market banking

A report from the Economist Intelligence Unit

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Introduction

Banks in emerging markets are increasingly weighty in global finance and still enjoy plenty of room to grow in their home markets. But they will do so in innovative ways that set them apart from the lenders of the developed world.

The continuing rise of emerging markets will boost the importance of banks in developing countries in the coming decades. These financial firms will not follow the same business models as their developed-country counterparts, however. Instead, they will rely much less on the branded branch, the traditional outlet for banking services.

New technologies, innovative low-cost business models and supportive policy changes will permit lenders to engage ever greater numbers of consumers in sustainable and profitable ways. Many of these individuals will become users of formal financial services for the first time in their lives.

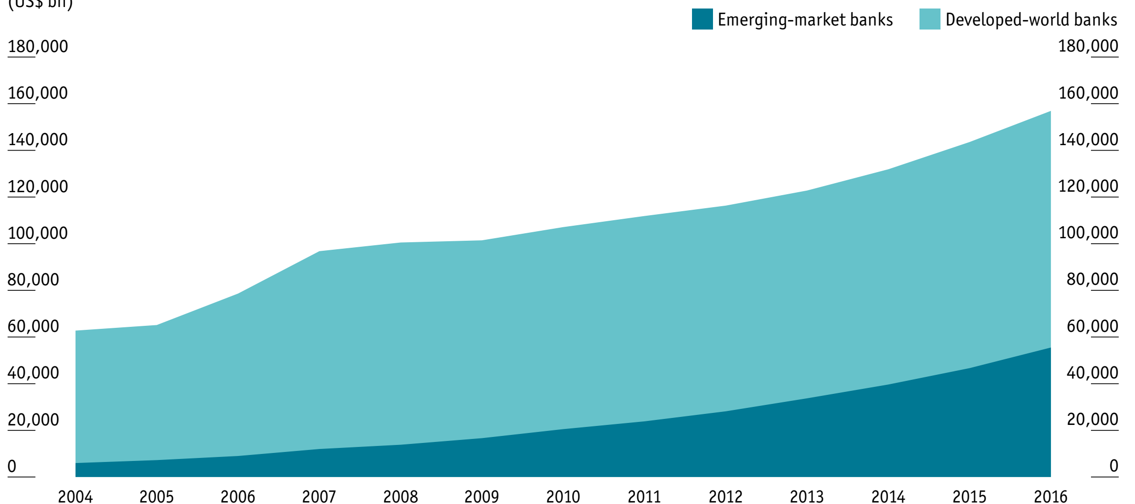
Unlike the storefront travel agent or video rental shop, the bank branch on the street corner is unlikely to disappear entirely. But such outlets will become increasingly irrelevant as routine financial transactions take place more frequently on mobile phones, over the Internet, in partner retail locations and even through home visits. A gradual decline in the use of cash will also make branches and automated teller machines of steadily declining importance.

Why emerging-market banking matters

A decade ago, few took notice of this trend. After all, rich-country banking systems accounted for over 90% of worldwide industry assets as recently as 2004, according to Economist Intelligence Unit data.

Emerging-market banks began to cut into their rivals' dominance only slightly before the financial crisis of 2008-09, which marked the beginning of a global shift in the industry. Developing-country

Global bank assets, 2004-16
(US$ bn)



Source: Economist Intelligence Unit estimates and forecasts for 60 leading economies.

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lenders now account for about 24% of global banking assets, and this share will increase to over 35% by 2016, according to our forecasts.

Moreover, most growth in the banking sector worldwide in terms of customers, deposits and lending now takes place in the developing world. About half the world's adult population lacks an account at a formal financial institution—that is, at a bank, a savings and loan association (building society) or a credit union—according to a recent series of household surveys by the World Bank and Gallup. Although they differ among themselves, many developing countries have only low levels of bank usage and thus offer the greatest potential to reach new customers and deepen financial sectors. For example, in China some 64% of adults have or share an account, with lower levels in Brazil (56%), Russia (48%) and India (35%).

By contrast, in developed markets most adults have accounts, and any growth in customer numbers depends on population growth and immigration (which are themselves often stagnant). For example, in the United States 88% of adults hold accounts, with even higher rates of bank usage in Japan (96%), the United Kingdom (97%) and Germany (98%). The industry has recently been shrinking in many rich countries as banks trim loan books, sell off assets and realign their capital ratios to meet regulatory requirements.

In short, financial firms can no longer ignore developing countries if they want to expand in growing markets. Those lenders that insist on carrying on as usual are likely to be reduced to the low profit margins that come from fighting over market share in stagnating or declining markets.

A mix of forces

New technologies are an important driver in the rise of emerging-market banks. Mobile banking and mobile payments have received the most attention, particularly in Africa, where few people have bank accounts but many own mobile phones. Other breakthroughs are important as well: widespread wireless Internet access now allows banks to reconcile financial transactions as they take deposits, honour withdrawals and grant loans nearly anywhere. Meanwhile, new payment systems increasingly allow for instant, cash-free transactions.

Low-cost business models are another key driver. Financial firms in developing countries are accustomed to serving many low-balance account holders. To do so, they have created appropriate systems for customer service and account maintenance. They often save money by reducing their own costs for expensive staff and locations, instead relying more heavily on technology, the outlets of their partners, and even mobile branches on lorries (in India) or riverboats (in Brazil).

Information spreads rapidly in our age. This means that ideas, good or bad, in banking are quickly diffused around the global industry. New approaches in areas such as banking on mobile devices or through partner retailers are now being studied and adopted rapidly in places far from their origin.

In addition, policymakers are increasingly aware of the ways in which financial inclusion promotes economic and social progress. The wide availability of low-cost savings accounts, transfers and credit leads to greater economic activity, improved income security, and arguably to better outcomes in nutrition, health and education. Access to finance does not figure in the UN's Millennium Development Goals, but it can assist in achieving those targets. As a result, officials are adopting policies that bring larger proportions of their populations into the fold of formal finance.

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This report argues that another key factor is the return to respectability of profits. Not-for-profit microfinance has flourished for several decades and has helped to lift many people out of poverty. However, its operations are likely to remain too limited to bring formal financial services to the 2.5bn adults currently outside the system.

In the past decade a number of these non-profits converted into listed commercial companies in pursuit of this business opportunity. At the same time, traditional banks in emerging markets have increasingly sought out new customers further down the income pyramid. The chapters of this report examine the activities of both types of enterprises.

The rise of emerging-market banks is a long-term trend that will surely include surprises impossible to foresee today. This collection of articles, originally published on the EIU's Financial Services Briefing website in the first half of 2012, highlights some of the key experiences and trends so far. They focus primarily on commercial ventures that are generally overlooked by both equity analysts and economic development practitioners. The chapters also tend to highlight the positive, in the hope that good ideas become more widely adopted.

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Innovative financiers

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A successful formula in Peru

Microfinance has grown by leaps and bounds in Peru, a market that combines sound regulation and private-sector participation.

In the current age of bank scandals, it is odd to hear about a well-regulated financial industry that contributes positively to economic development. However, such a feel-good story can be found in Peru, where a pioneering microfinance sector has made great strides towards extending credit that is helping to lift millions of people out of poverty.

The success of Peru's microfinance sector is the result of a mix of sound regulation and the participation of the private sector in areas that governments are inclined to monopolise, such as poverty reduction. It serves as a model for other countries that want to implement market-based models to improve the quality of life of their inhabitants.

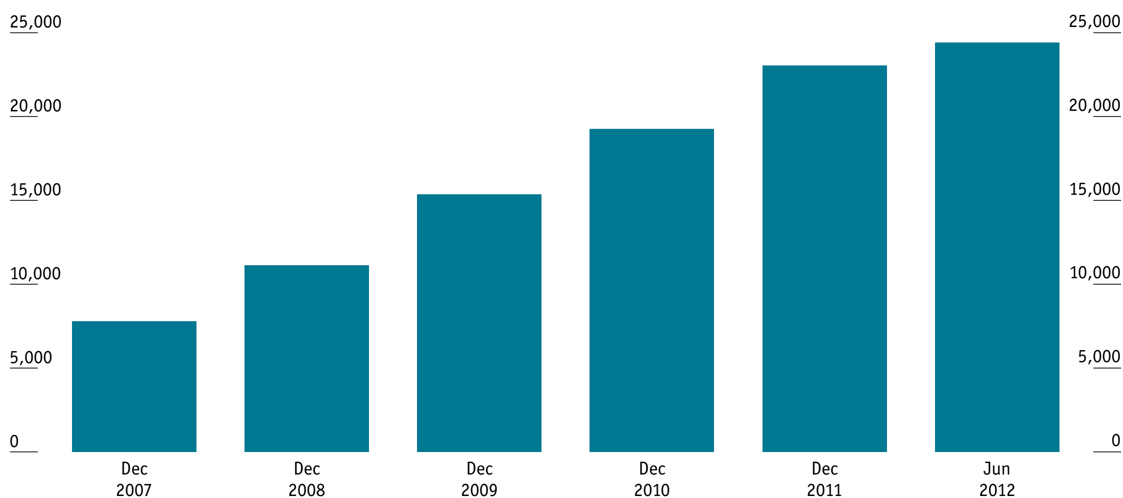
Rapid growth in little loans

Microfinance institutions, or MFIs as they are more commonly known, are lauded as important facilitators of the progress of poor Peruvians towards the middle classes. They are crucial in financing the activity of micro and small companies and the fast-growing consumption of families who previously could hardly put food on the table.

A public that is hungry for credit has gradually embraced the microlenders. As a result, rates of microcredit growth have been steep. According to Asomif, an industry association, the volume of loans increased by nearly 17% in the year to June 2012 and have more than trebled since end-2007.

The growth of the sector in the three decades it has existed has been solid. More than three dozen entities offer microfinance in Peru, and they already account for about 16% of the money lent in the country. Since MFIs focus on small-value loans to individuals and small businesses, their market share of total borrowers is much higher than that.

Peruvians embrace microcredit
(Value of outstanding loans, Ns million)



Source: Asociación de Instituciones de Microfinanzas del Perú.

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The industry has even given birth to a not-for-profit, diversified financial group with international ramifications in the form of Grupo ACP, which owns the local heavyweight Mibanco, with outfits in Argentina, Mexico and Uruguay, plus a bank in Ecuador.

A strong economy, and good rules too

The success of MFIs in Peru is to some extent attributable to the strong performance of the Peruvian economy, which was among the fastest-growing in the world in the past decade. Innovation has been a key factor too, as firms developed techniques to assess the creditworthiness of clients with little, if any, financial history and introduced them to new forms of managing their money: some have started to deal with mobile banking (m-banking), for instance. Many take deposits and offer insurance policies.

It also helps that the rules of the sector, as well as the supervisory bodies that guarantee their enforcement, are seen as world-class. In fact, Peru has topped for three years in a row the "Microscope on Microfinance", an annual ranking of the business environment developed by the Economist Intelligence Unit.

According to our study, Peru has well-defined rules which apply to the different kinds of MFIs that operate in the country. Supervision by the financial markets regulator (Superintendencia de Banca, Seguros y AFP—SBS) has struck a balance between easing access to credit and promoting proper management of the consequent risks.

MFIs which provide a wider range of services, including the taking of deposits and money transfers, have to meet strict capital rules, provide periodical financial information, undertake external audits, and follow high-quality accounting standards. Regulation for simpler operations, such as rural savings banks, tends to be less burdensome. Non-governmental organisation (NGOs) which lend money at their own risk are outside the scope of the regulator.

Avoiding danger

Proper supervision is important as Peru tries to avoid the mistakes committed by countries such as India, which saw microfinance stumble because of high default rates, limited capital availability, shifts in regulations and other problems. The soundness of the Peruvian system could be put to the test in the future too. The rate of non-performing loans among Peru's microlenders has been steadily on the rise, reaching about 5% of total loans.

That does not sound too frightening compared with the plight of the banking sectors in countries such as Spain, which is often the standard against which Latin American countries measure themselves. But it is more than double the average of the Peruvian financial system as a whole. Bad loan ratios have increased as the Peruvian economy has lost some of its verve, and they could get much worse if the economy makes a hard landing. That said, the EIU expects the good times to continue, with real growth of 5.6% in 2012 and 6.1% in 2013, following an expansion of 6.9% in 2011.

Migrating from country to town

In general, the development of the industry has been remarkable. MFIs at first focused on small towns and villages in rural areas, where access to banking services is scarce. But after a while they also

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started to target cities such as Lima, the capital, competing with retail banks for the custom of low-income but striving urban dwellers.

Their most important group of clients is composed of small and microbusinesses, which account for most of the country's economy. Almost 80% of all loans provided by microfinance entities go to this group, while around 12% are granted to individuals. Even mid-sized companies sometimes employ the services of microlenders, with firms of this size representing slightly more than 5% of all loans.

Some supporters of the model argue that it is working because, if they want to, operators can try and make a profit out of microcredit. Some surely seem to be aiming at the most promising markets from a business point of view, rather than simply targeting destitute regions. Data from Asomif show that almost one-third of all the money lent by microfinance companies has gone to the Lima region, which is the economic heart of the country.

Becoming more commercial

Financial firms have woken up to the potential of the sector, sometimes employing a strategy of moving microfinance clients to other parts of the group that provide higher margins as customers climb the socioeconomic ladder. The largest operator in the market, Mibanco, traces its origins back to the work of NGOs and continues to operate as a non-profit organisation, international operations notwithstanding.

But the second in the ranking, Crediscotia Financiera, is a unit of Scotiabank, a Canadian banking group. BBVA, a Spanish bank with strong Latin American operations, is also active in the market. Banco de Crédito del Perú, the country's largest bank, has invested in the development of its microfinance business since its acquisition in 2009 of a specialised company that was partly owned by the World Bank.

The interest of commercial outfits in the industry has raised concerns among operators such as Mibanco that the sector could end up losing sight of the social mission of financial inclusion that motivated its creation in the first place. However, others argue that profits can provide a motivation for capital to flow towards microfinance and keep the sector expanding. Profit-seeking or not, the industry has succeeded in democratising credit and allowing poorer Peruvians to pursue their economic ambitions.

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Going mobile in India

Banks and mobile operators are competing, and co-operating, in a proliferation of handset-based financial services. Once wary regulators have eased rules as they seek to broaden access to finance.

India's largest mobile operator, Bharti Airtel, launched an ambitious nationwide mobile-wallet service, Airtel Money, in February 2012. The initiative is the latest of many efforts by banks and mobile operators—sometimes in cross-industry alliances—to extend basic finance to the broad swathes of the Indian population that lack ways to save, transfer and borrow money.

Bharti Airtel's new service allows users to load cash onto their mobile devices securely and spend it to pay utility bills, make mobile recharges, shop at retail outlets and transact online through multiple channels. It is also the first mobile-based service to offer instant money transfers from one Airtel Money wallet to another or to bank accounts countrywide.

Airtel Money is available across 300 cities and through merchant partnerships with over 1,800 brands, including providers of gas, electricity and telecommunications utilities, insurance companies, mutual funds, established retailers and small local grocery stores and pharmacies. Airtel Money can be used at over 7,000 merchant outlets.

Airtel has been ramping up these services since gaining its "mobile wallet" licence in September 2010, when the Reserve Bank of India (RBI, the central bank) first began giving out such licences, creating mobile money payments as a new category. Mobile wallets allow customers to load virtual cash and use their phones like credit cards to make payments, instead of paying through third-party gateways or by accessing the Internet on their mobile.

Customers of these services make transactions either by using the phone like a smart card, with a chip embedded in the phone's SIM card, or by sending a short message service (SMS) code to the vendor. Airtel's licence is for a "semi-closed wallet", meaning that the virtual money can be redeemed only at merchants that tie up with the company to offer that service. The RBI has now given out 17 wallet licences, and the category is growing quickly.

Who is better at mobile finance, lenders or telecoms?

Mobile wallets are a key part of a drive for financial inclusion, a campaign that is RBI's main motive in giving out these licences. Despite the spread of financial services in India in recent decades, one-third of the country's 1.2bn population remains completely outside the formal banking system. Under 10% of India's 630,000 villages have a commercial bank branch. Only 55% of the population has a bank deposit account, and only 10% of Indians have life insurance cover. Over 90% of the population still uses cash to pay for their daily needs, while money orders and cheques continue to dominate everyday fund transfers.

In recent years the RBI has introduced several initiatives to make finance more inclusive. In early 2010 it required all banks to submit three-year financial inclusion plans and allocated 73,000 villages to various banks, which had to establish some presence in them by March 2012.

Banks have made rapid progress: by early December 2011 they had met 62% of this target, covering 45,000 unbanked villages, while in the year to June 2011 they opened 80m new accounts in over

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100,000 villages. Yet sceptics point out that only about 15m of these accounts are active, and that racing to meet such targets may not actually expand financial inclusion. Bankers quietly complain that this expansion is expensive and unprofitable.

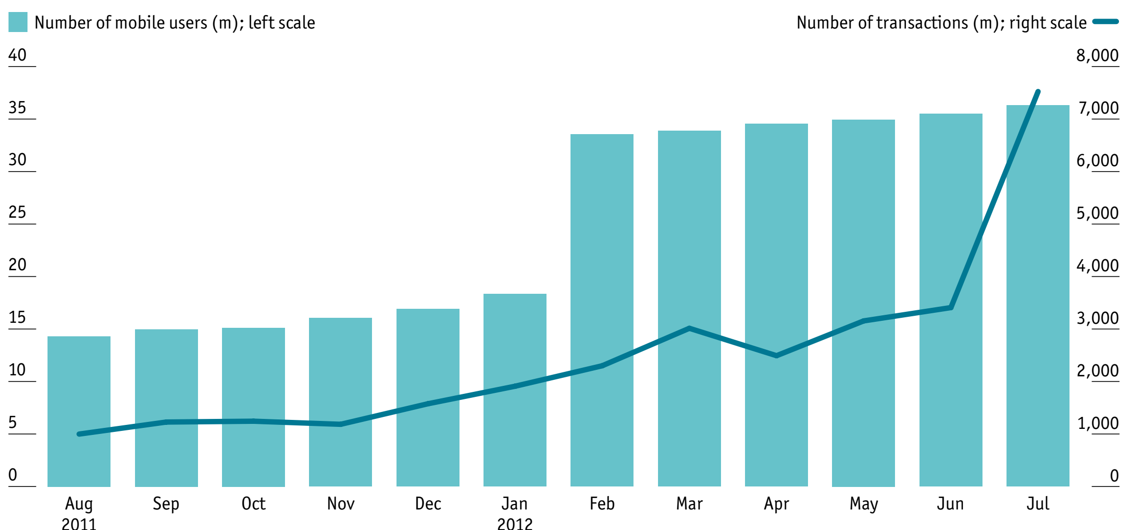
In sharp contrast, non-banks, particularly telecoms companies, are champing at the bit to provide financial services to these very same customers. Mobile operators have already turned India into a telecoms success story. With a huge base of 900m mobile users, one-third of whom are in rural areas, India is the world's fastest-growing mobile market.

While continuing to drive for greater penetration in untapped markets across the country, mobile operators are also keen to raise average revenue per user, which is falling as a result of competition. They want to leverage their widespread distribution networks and large customer bases to offer m-banking and a variety of financial products. Already highly skilled at handling large volumes of low-value transactions while turning a profit, mobile companies are confident that they can replicate that success in financial services.

Regulators' reluctance begins to ease

Regulators are keeping a wary eye on the mobile operators' sales pitch. The RBI has clearly stated that it prefers the bank-led model of mobile banking, where banks handle the monetary leg of transactions and the payments end to provide security and regulatory comfort. The RBI has approved over 50 banks to provide mobile banking services, which have grown rapidly. In June 2012 the monthly volume of m-banking transactions was 3.44m, valued at Rs3.07bn (US$55m), more than double the level of a

India's boom in mobile payments



Source: National Payments Corporation of India.

year earlier.

The National Payments Corporation of India (NPCI), a firm owned by Indian banks, piloted an interbank mobile payment system in November 2010 that allows customers of partner banks to remit funds to each other's accounts using mobile phones. By June 2012, 36m users had registered with the NPCI for interbank mobile transactions. With 16.3m users, the private-sector ICICI Bank had by far the

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greatest number, followed by the privately owned Axis Bank (7m users) and the public-sector State Bank of India (4.4m).

The RBI recognises that banks are limited by the cost of expanding their networks, while mobile operators and related companies, with their enormous existing reach and low transaction costs, could be very effective in advancing financial inclusion. Consider, for example, the Finnish mobile handset maker Nokia, which has a market share of about 40% of the Indian mobile-phone market. Nokia has 200,000 dealers across the country, compared with India's total commercial banking network of some 75,000 branches. In December 2011 Nokia launched Nokia Money, a nationwide electronic-wallet service that allows customers to load cash onto their mobile phones at Nokia dealers and use it to pay for services, without a bank account.

Allowing dealers to act as Nokia Money agents will rapidly extend the reach of simple financial services. The new Nokia Money service is independent of any particular mobile network and specifically targets semi-urban and rural markets, as well as below-average-income urban markets.

Giving alliances a chance

Hoping to have the best of both worlds, the RBI allowed telecoms companies to team up with banks for mobile banking in 2008. Several partnerships and models have emerged since then. Some such partnerships are using the banking business correspondent (BC) model, which the RBI introduced in 2006. BCs are retail agents hired by banks to provide services at locations other than a branch, allowing lenders to extend their reach without the cost of opening new branches. BCs largely operate through mobile phones to synchronise with the bank. However, given the model's limited success, the RBI subsequently expanded eligibility for becoming a BC from non-profit organisations and individuals to for-profit organisations. It has also allowed multiple banks to share the same BC.

Taking advantage of this change, in November 2011 the mobile operator Vodafone announced the launch of its M-Paisa service nationally, operating as a BC of HDFC Bank, a domestic private lender. As a result, Vodafone's network of retailers and sub-agents will open and operate accounts in areas beyond the reach of HDFC Bank's 2,150 branches in 1,141 towns.

Customers of the service must first open a so-called MobileBank Account at HDFC Bank and will then be able to deposit and withdraw cash and transfer money. In its pilot stage, the service signed up 2,200 retailers across 320 villages and 54 towns in one state. HDFC hopes to take this service nationwide and eventually acquire 10m customers through its financial inclusion initiatives.

Similarly, in September 2011 the state-owned Bank of India appointed mChek India Payment System, a company that runs a secure mobile payments platform, as the BC to manage its financial inclusion programme. mChek has already signed up thousands of customers for no-frills accounts on behalf of the bank and is now expanding across the country, hoping to appoint more than 3,000 individual outlets.

Mobile operators hope that the RBI will continue to give them greater freedom to offer financial services, especially since this helps to fulfil the RBI's own financial inclusion goals. In one form or another, mobile services are pushing back the frontier of financial inclusion in India.

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The allure of transfers

Simple mobile payments can serve as the gateway to more sophisticated financial products for the poor. Examples come from Kenya and the Philippines, and more recently Afghanistan.

Visitors to Afghanistan quickly discover a simple truth: nothing gets done without cash. Debit and credit cards are virtually non-existent in this Central Asian country, where only 9% of adults have access to a bank account and some 70% are illiterate. It is therefore a little surprising that Afghanistan is also on the leading edge of mobile banking.

The Afghan national police began a trial project to pay salaries using mobile payments in 2009. Benefits were immediate, with costs dropping by 10% owing to the removal of phantom payments to non-existent officers. The rest of the national force assumed they had been given a raise because corrupt middlemen were no longer able to skim money off the top.

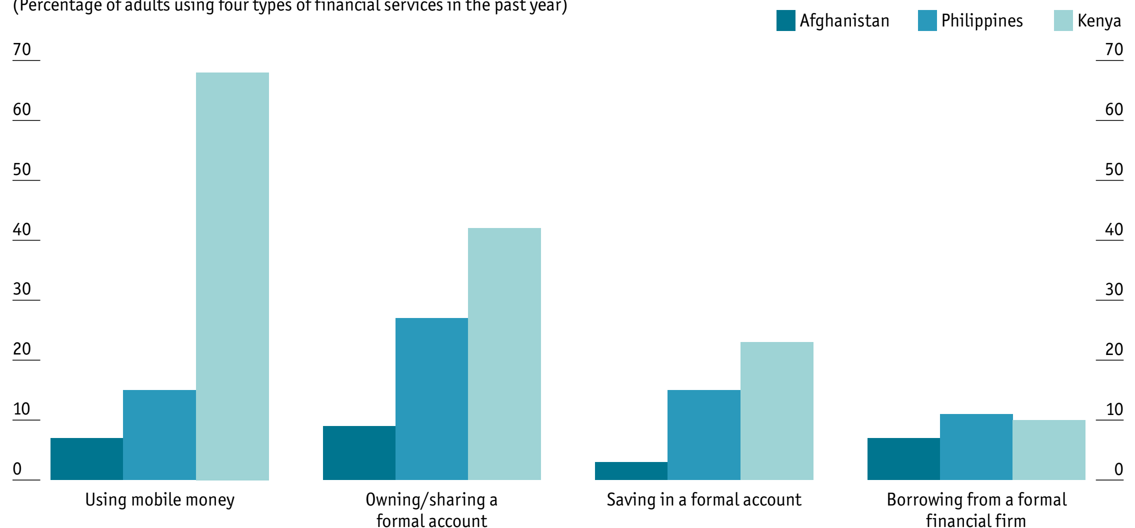
With more than 60% of Afghans owning mobile phones, the country's mobile banking solution, known as M-Paisa—a partnership between local operator Roshan and Vodafone—has signed up more than 115,000 subscribers in the years since its pilot launch. With luck, this adoption could lead to the more widespread use of formal financial services.

Beyond payments

In Afghanistan, as in most countries outside North America and Europe, mobile-phone penetration outstrips the availability of conventional banking services. As a result, the idea of using mobile phones as the gateway to financial inclusion and improvement is gaining rapid momentum in the developing world.

Juniper Research, a UK-based telecoms analyst, predicts that global m-banking transactions will reach US$670bn by 2015, while the US-based Yankee Group projects US$545bn in payments by the

Mobile money is a first step
(Percentage of adults using four types of financial services in the past year)



Source: Asli Demirguc-Kunt and Leora Klapper, "Measuring Financial Inclusion: The Global Findex Database" (World Bank, April 2012).

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same year. Either way, these are colossal figures, but the question is: can m-banking move beyond simple money transfers to embrace more sophisticated financial products and services?

The short answer appears to be yes. Perhaps the best indication of where m-banking is headed in the developing world can be found in Kenya and the Philippines.

The killer app in Kenya

M-Pesa, the leading mobile service in Kenya, is generally considered to be one of the most successful m-banking solutions in the world. Introduced by the communications operator Safaricom in 2007, M-Pesa today has an impressive 14.9m subscribers, the largest number of any mobile service in the developing world.

A key reason for this high level of adoption is that while about 60% of Kenyans do not have a traditional bank account and cannot obtain credit, 80% have a mobile phone.

M-Pesa began modestly by enabling remittances from individuals working in cities such as the capital, Nairobi, and Mombasa to family members in rural villages—a service widely regarded as "the killer app" that first gets people interested in the technology in developing countries. But it has since then morphed into what is nearly a full-service bank branch.

Central to this transformation has been a sister service launched in 2010 known as M-Kesho, which means "mobile tomorrow" in Swahili. It enables Equity Bank, Kenya's biggest lender by the number of bank accounts, to tap into Safaricom's network of almost 20,000 M-Pesa agents to offer mobile banking services to clients.

For example, users of Safaricom's M-Kesho can deposit money into interest-bearing accounts over their mobile phone, or apply for 30-day loans of up to US$62. Insurance products, ranging from coverage for accidents or medical and funeral expenses to comprehensive life insurance policies, can also be purchased through M-Kesho.

Equity Bank has introduced its own m-banking service as well, which is connected to all four Kenyan telecoms firms. By end-March 2012 its Eazzy 24/7 service had attracted 1.55m customers, who use it primarily to make deposits, according to the bank's figures.

Meanwhile, Barclays Bank of Kenya has entered into a partnership with Safaricom to use the M-Pesa platform and network of agents as a means of extending the reach of its own banking services quickly and cheaply.

Cash goes by mobile in the Philippines

In the case of the Philippines, the m-banking service Smart Money has signed up more than 8.5m subscribers (the second-highest number globally after M-Pesa) since opening for business in 2003. It is a venture of Smart Communications, the country's leading mobile provider.

Smart Money partners with Banco de Oro, which handles mobile accounts in exactly the same way as interest-bearing savings accounts opened at one of its retail branches. Smart Money also issues a physical MasterCard debit card and partners with Travelex for international money transfers. Its success can be attributed to an extensive agent network, made up of some 700,000 retailers.

Globe Telecom operates a competing mobile money service known as GCash. With more than

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1m subscribers since launching in 2004 with government assistance, GCash enables clients to manage bank accounts in addition to more standard services, such as domestic money transfers and merchant payments.

Filipinos have long been keen to migrate to improve their standard of living, moving both to their country's main cities and to strong economies in North America, the Middle East and the rest of Asia. Since many adults leave children and elders behind, one key concern has been to send much of their improved earnings back home. Mobile transfers now capture some part of the payment flows that once moved in the form of physical cash or through informal channels.

In countries like Afghanistan, m-banking is helping to fight corruption by offering a sophisticated but easy to use alternative to cash. More advanced countries like Kenya and the Philippines have crossed the money transfer threshold to deliver sophisticated banking services such as credit and insurance, which helps to raise the standard of living for the developing world's unbanked masses.

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Profits among the poor

Publicly traded lenders to poor people have succeeded in mixing profits with social missions in such diverse places as Bangladesh, Kenya and Mexico.

On the face of it, offering banking services to the developing world's poor does not seem like a brilliant money-making strategy. In fact, in recent years a handful of firms have recorded steady profits by using stockmarket listings to fund loans for low-income customers.

Although somewhat controversial, stockmarket listings in 2006-07 bolstered the funding bases of four organisations that were previously not-for-profit NGOs or building societies. This allowed the lenders—BRAC Bank (Bangladesh), Equity Bank (Kenya), and Compartamos and Financiera Independencia (both Mexico)—to seek new customers for savings accounts, small loans and cash transfers. Their experiences stand in marked contrast to the more recent, better known case of India's struggling SKS Microfinance.

The key is stable funding

The transition from an NGO or building society into a listed, commercial enterprise secured for each of these successful lenders an improved mix of financing. It provided them with easier access to equity capital, a type of funding that is more stable than borrowing in wholesale markets or charitable grants and loans.

Having listed shares makes it easier for private investors and funding organisations to enter and exit their ownership rosters. Each firm's list of key shareholders now typically includes a mix of foundations, private equity and angel investors, and investment funds. The additional transparency required for traded shares has probably also made it easier for the lenders to raise debt through bonds and commercial loans.

By raising their profiles in local markets, stockmarket listings may also have attracted additional deposits to those with banking licences, although this impact is difficult to separate from their generally rapid expansion in recent years. Compartamos and Equity Bank now figure in their countries' benchmark share indices, while BRAC Bank shares a high profile with its namesake parent, an NGO that runs businesses, relief efforts and a university. Financiera Independencia (Findep) and SKS are finance companies that do not take deposits.

Double-bottom lines

These firms typically say that they have a dual mission, or double-bottom line: to earn profits for shareholders while also improving the lives of the poor through access to finance. Such ideas were popularised a decade ago by books such as "The Fortune at the Bottom of the Pyramid" by an Indian business professor, CK Prahalad.

It is fair, then, to measure these organisations' performance over the past five or six years on these two dimensions. Equity Bank and BRAC Bank, which both joined their national share markets in 2006, have proved most lucrative for investors. They have both earned solid profits in recent years. Equity Bank's shares now trade at over six times their listing price; BRAC Bank's share price has also advanced, although it now trades below its peak levels (see chart).

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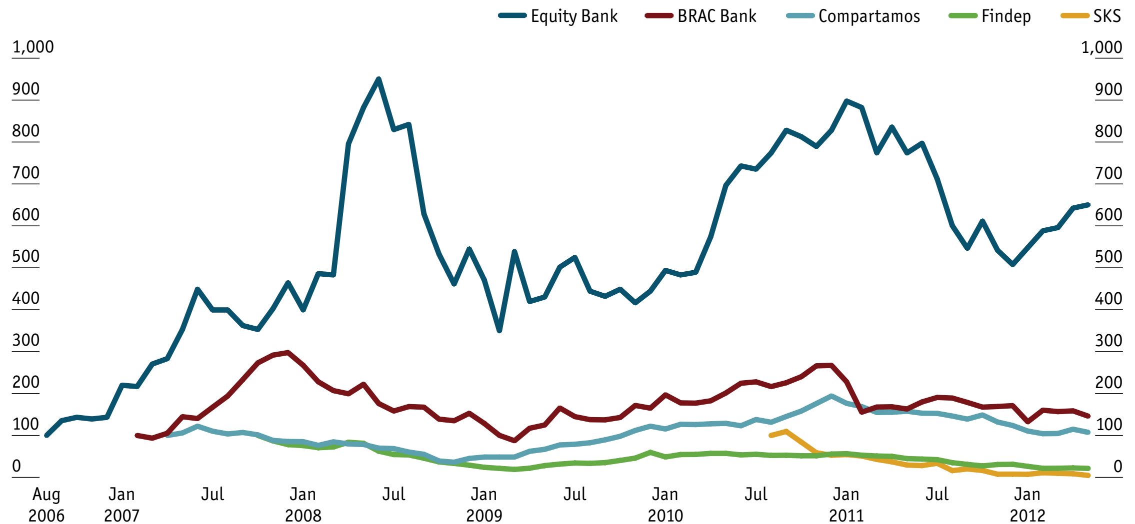
Uneven advances
(Share prices of publicly traded microfinance lenders; IPO price = 100)



Sources: Bloomberg; Bursatil.
Note: Compartamos prices are split adjusted.

Investors in the Mexican lenders have done less well since their market debuts in 2007. Although both Compartamos and Findep remain profitable, their earnings have slipped in recent reporting periods. Compartamos's stock now trades at approximately the listing price, adjusted for a share split and corporate reorganisation in 2010. By contrast, Findep's shares are worth only about one-fifth of their initial public offering (IPO) value. It is only fair to add that the last few years have been a difficult period for all types of financial firms around the world.

Increasing numbers of customers

Stockmarket debuts appear to have benefited the firms' customers as well, whose numbers have increased dramatically in recent years. The lenders have boosted the ranks of their borrowers, who take loans through a variety of programmes designed to improve their homes, bolster their small businesses, or make key household purchases (see chart on next page).

Many of these borrowers are women, who tend to be more trusted by their lenders than men. Some of them are participants in the group lending popularised by organisations such as Bangladesh's Grameen Bank, although urban borrowers tend to take out individual loans.

The operations with banking licences have also fortified their deposit bases. Equity Bank touts its novel model of attracting many small depositors, managing accounts at low cost and maintaining high margins between deposit and lending rates. It also uses modern methods, such as sophisticated risk models, agents in widespread retail locations and a mobile banking service. It is now Kenya's largest bank measured by numbers of accounts.

Newly bolstered lenders have also been able to expand to neighbouring countries, either via acquisitions or organic growth. Since its listing Equity Bank has set up branches in Rwanda, South Sudan, Tanzania and Uganda. Compartamos has expanded to both Guatemala and Peru. Findep has made an acquisition allowing it to apply its lending model in northern Brazil and in Latino communities in California.

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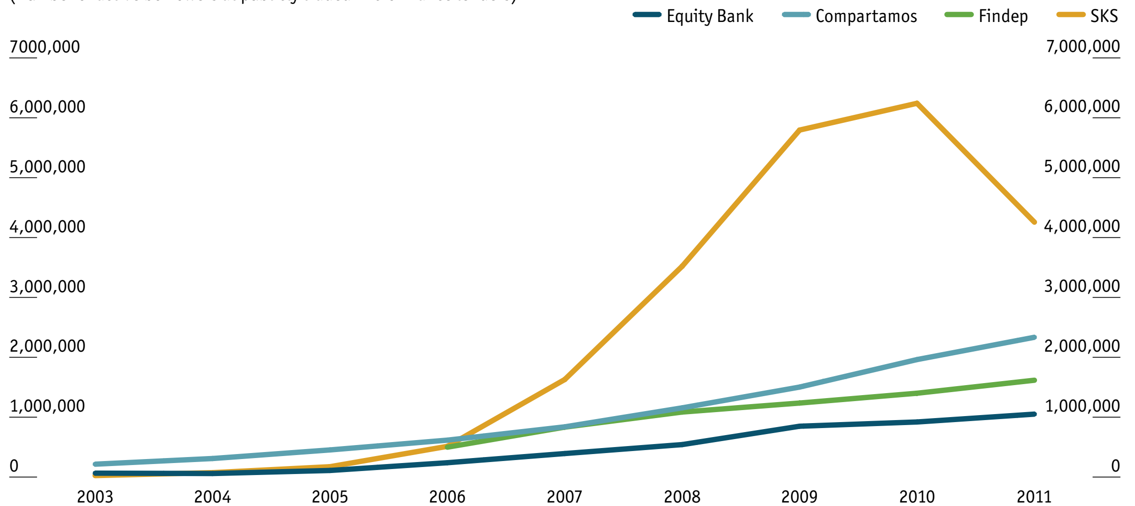
Steady growth wins the race
(Number of active borrowers at publicly traded microfinance lenders)



Sources: Mix Markets and company reports. Equity Bank data is for number of loans outstanding.

A strategy that usually succeeds

The exception which proves the rule is India's SKS Microfinance, which expanded at breakneck speed before turning into a profit-making firm with an IPO in July 2010. SKS slipped into crisis soon afterwards amid allegations of forceful loan-collection efforts leading to borrower suicides. Andhra Pradesh, the state that was its key market, then imposed strict curbs on all microfinance lenders.

SKS has since recorded heavy losses on loans in that state, although it claims that operations carry on as normal elsewhere in India. Overall, it lost customers and slipped into losses in the year to March 2012. Its stock has fallen by 95% since its IPO. SKS announced in May that it would trim its workforce by 1,200 in Andhra Pradesh, some 35% of its total payroll. That same month it welcomed government plans to regulate microfinance at the federal level from New Delhi, a move that could strip Andhra Pradesh of authority over the business.

However, the SKS story is an exception. Other listed microlenders continue to accumulate international awards and accolades. Equity Bank and BRAC Bank, in particular, have been richly rewarded with honours for expanding access to finance and spurring economic development. More than a decade after Professor Prahalad coined the term, these banks are finding that there is indeed a fortune at the bottom of the pyramid.

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Banks extending their reach

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Riverboat lenders in Brazil

Lenders in the Amazon pioneer the use of branches on boats to offer banking and related services to riverside residents.

Amid a credit boom, Brazil's banks have avidly pursued new customers and opened outlets in recent years. The expansion drive has become so intense that three of the country's leading lenders now compete to offer services from boats that ply the upper reaches of the Amazon River.

A mixture of factors has spurred the banks' push into once-neglected parts of the rainforest. They employ low-cost systems appropriate for the generally modest incomes and account balances of local inhabitants. Satellite technology permits real-time updating of centrally managed accounts. And crucially, each of the banks, enjoying solid profits, has sought the good publicity as well as added business that goes with extending services to swathes of the vast Brazilian interior.

Hitching a ride

Banco Bradesco, one of the country's top private banks, started the boat-bank (barco-banco in Portuguese) trend in late 2009. It installed a branch on a river vessel that delivers goods and passengers along a 1,600-km route between Manaus, the capital of Amazonas state, and Brazil's western border. As a result, Bradesco was able to claim to be the first lender to provide services in every one of Brazil's 5,564 municipalities.

To reach 11 municipalities in the far western part of the state, Bradesco installed a staffed banking centre, including an automated teller machine (ATM), on Voyager III, a triple-decker cruiser which serves as a means of transport and floating retail market for 50 communities along the Amazon (a section of the river that Brazilians call the Solimões).

Voyager III takes seven days to make the upstream journey from Manaus to Tabatinga, on the Brazilian side of the border with Colombia and Peru. Travelling downstream, the trip takes only three days. No roads connect the towns of this section of the rainforest. The branch allows the bank to accept deposits, make benefit payments and provide loans to the heavily indigenous inhabitants of the region.

A bank with its own boat

Caixa Econômico Federal launched its own boat, devoted exclusively to banking and related services, in early 2011. The state-owned lender's floating branch has five employees who open new accounts, handle deposits and withdrawals, and provide home loans, business microcredit, credit cards, payroll-linked credit and insurance policies. They also administer a number of government programmes, such as pension and severance payments, unemployment benefits, and the family welfare allowances of the well-known Bolsa Família social-integration scheme.

Caixa's squat, blue triple-decker vessel plies the Amazon between Manaus and the river town of Coari some 400 km to the west. The route includes seven municipalities and some 250,000 citizens. The boat-bank takes 23 days to make a round-trip, stopping to provide services at the towns on its way out and back.

The bank says its boat, named the Chico Mendes after an assassinated leader of the local rubber

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tappers union, had served customers 23,000 times by February 2012. The project won a prize for best new initiative in providing access to banking from the Inter-American Development Bank in March.

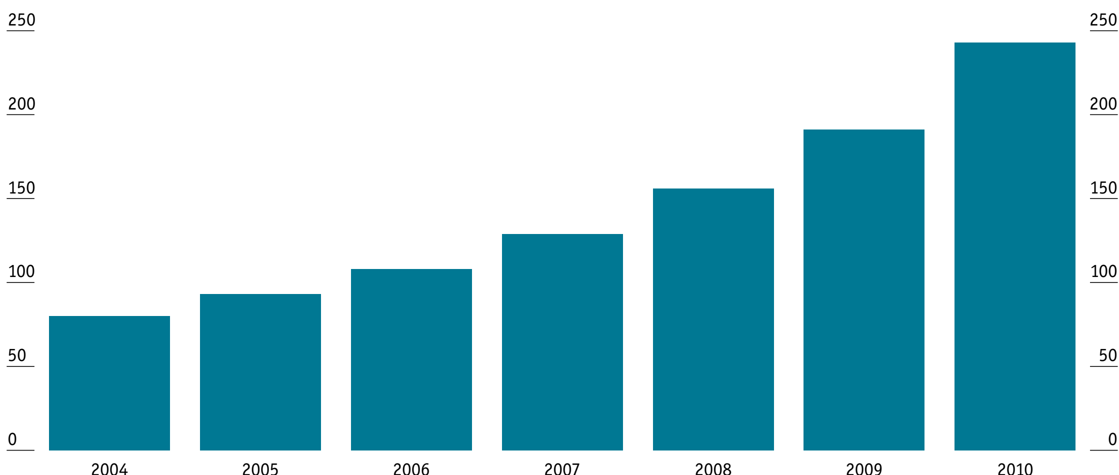
Working with the governor

Banco do Brasil (BB), the country's largest bank, has taken its own approach to riverine financial services. The federal government-controlled lender has installed branches on three boats that navigate the river, providing health and social services in isolated Amazon communities.

The vessels, sponsored by the local governor, reach out to settlements as far as 1,136 km up the river from Manaus in a state programme know as Mobile Emergency Care (Pronto Atendimento Itinerante). Trips are sometimes planned for the annual high-water periods, when the boats can reach otherwise inaccessible settlements on the river's tributaries.

Like those of its rivals, BB's outlets can open new accounts, accept deposits, pay pensions and benefits, and offer withdrawals. The boat-based services complement BB's running of bank branches in the country's post offices, which are also important locations for the extension of financial services in Amazonas state and other lightly populated regions.

Brazilians get their hands on credit
(Number of borrowers per 1,000 adults)



Source: IMF, Financial Access Survey.

Nearly half the population remains unbanked

Brazil's riverboat bank branches are part of wider efforts, both public and private, to bring banking services to the country's poor. Banks have also opened branches in urban slums, partnered with retailers to offer outlets, and expanded the postal banking network. Innovative techniques, such as linking loans and their repayment to public-sector salaries and pensions, helped to more than triple the number of borrowers between 2004 and 2010.

Some 56% of the country's adults had or shared an account at a formal financial firm in 2011, according to a recent household survey by the World Bank and Gallup. That is the highest level in Latin America, apart from a number of English-speaking Caribbean island states.

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Small loans prove profitable in Indonesia

Bank Rakyat Indonesia, a government-controlled lender, has built an increasingly profitable business in lending to, and taking deposits from, poor people and small businesses.

Earlier this year Bank Rakyat Indonesia (BRI) received some good news. Standard & Poor's (S&P), a rating agency, assigned to the Jakarta-based lender BB+ long-term and B short-term credit ratings, adding that the bank's "stable outlook reflects our expectation that BRI will manage its loan quality so as to limit its credit costs and maintain strong profitability".

This is a more positive outlook than that faced by European banks caught in the downward spiral of the euro zone and the economic malaise experienced by the struggling peripheral Mediterranean countries, including Greece, Spain, Italy and Portugal. It is also a surprising move, considering that BRI is a bank specialising in microfinance—lending small amounts of money to poor and lower- to middle-income entrepreneurs mainly in rural Indonesia.

The fact is that microfinance—a key source of economic development and wealth creation in emerging economies—is a booming industry in the world's fourth-biggest country by population. BRI has plenty of room to grow at home: only 20% of adults share an account at a formal financial institution, according to a recent World Bank study.

Indicators of financial inclusion in selected developing Asian countries

(% of adults unless otherwise indicated)

	Thailand	China	Malaysia	India	Philippines	Indonesia	Pakistan
Domestic credit to private sector (% of GDP)	132	127	116	51	32	32	18
Have/share an account at a formal financial institution	73	64	66	35	27	20	10
Saved at a formal financial institution*	43	32	35	12	15	15	1
Saved using a community-based method*	5	2	7	3	7	14	3
Originated a new loan from a form financial institution*	19	7	11	8	11	9	2
Originated a new loan from family or friends*	8	25	20	20	39	42	23
Used mobile money*	3	2	3	4	15	1	3
Have a credit card	5	8	12	2	3	0	1
Have a mortgage	5	5	13	2	4	1	2

*In the past year.
Sources: World Bank, World Development Indicators; Asli Demirguc-Kunt and Leora Klapper, "Measuring Financial Inclusion: The Global Findex Database" (April 2012).

Good prospects in a fast-growing economy

Indonesia's GDP, which grew by a healthy 6.5% in 2011, is on track to expand by 5.9% in 2012. BRI, Indonesia's second-largest bank by assets, reported a 31% increase in profits to US$1.65bn in 2011, supported largely by loan growth in its microfinance division. According to S&P, BRI is expected to "maintain its strong franchise and competitive advantage in microfinance within Indonesia".

BRI serves about 30m retail clients through its network of 4,000 branches and rural service posts. Indeed, it is considered to be one of the best microfinance institutions in the world, having transformed itself from an ailing government-owned commercial bank into a leading financial

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intermediary. It is currently 57% government-owned, having gone public when it sold 30% of its shares through an IPO in 2003. Large private investors include big mutual-fund managers like Fidelity International and Vanguard Group.

For nearly a decade, more than 80% of BRI's outstanding loan portfolio used to be channelled to small and medium-sized enterprises. During this period the bank recorded an average return on equity of 45%, nearly twice the average return recorded by any other bank in Indonesia.

Commercial microfinance

BRI's success—based on self-financing loan expansion by attracting deposits from small savers—reveals how microcredit can be the key to a developing bank's long-term stability and profitability. In the case of BRI, its core microbanking business has been profitable since 1986, and it is now an integral part of Indonesia's financial system.

Even at the height of the Asian financial crisis in 1998, BRI's microlending unit recorded a pre-tax profit of US$89m. By contrast, most of its domestic counterparts were stung by lending in foreign currencies or exposure to large corporations that had been borrowing heavily overseas.

BRI's track record of profitability provides a model for other developing countries in South-east Asia and elsewhere, which want to harness the power of commercial microfinance to spur social and economic development without outside assistance.

This is in part because Indonesia has the oldest tradition of commercial microfinance among developing countries, dating back to Dutch colonial rule in the 19th century. BRI, for example, was the first bank in the world to provide commercial financial services—savings, and loans and other financial products—to millions of people at the bottom of the economic pyramid.

Although most advanced in countries such as Indonesia and Bangladesh, commercial microfinance has emerged in all major regions of the developing world as a force for change. In particular, it has proved to be an effective mechanism for raising the living standards of the poor without the handouts required by traditional aid.

Still, like all industry leaders, BRI faces challenges to staying on top of its game. The markets, the risks, the players, as well as the skills and strategies needed to gain and maintain significant market share in microfinance are changing as competition increases. For example, demand for micro- and small-business credit in rural Indonesia could double or triple in the next ten years. Some of that demand may be met by foreign banks copying the BRI model.

To this end, BRI is expanding its presence outside the country's main island of Java. It is working to shift older microfinance customers to regular commercial loans and lines of credit. It is also developing debit cards for its microcredit customers.

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Attijariwafa looks south in Africa

A leading Moroccan bank continues to build its network in underserved markets of Sub-Saharan Africa.

A growing number of African banks are looking beyond their national borders to build assets and market share. They are keen to profit from a number of business-friendly developments, including the fact that many of the continent's Sub-Saharan economies are expanding at annual rates of 6% or more.

Meanwhile, emerging technologies—led by mobile banking—have begun to bridge the chasm that once separated rural Africans from traditional branches. This has permitted banks to deliver sophisticated financial services at a distance by mobile phone to the continent's unbanked masses.

Moving to pan-African lending

Perhaps the best example of this shift away from play-it-safe parochial banking to international pan-African lending is Morocco's Attijariwafa Bank. It has become Africa's biggest lender by assets outside South Africa, thanks to rapid expansion throughout francophone West and Central Africa.

Citing strong growth potential offered by low banking penetration in the region, Mohamed El Kettani, the bank's chief executive, says that he wants to include all Economic Community of West African States (Ecowas) and North African countries in his company's business footprint.

The potential for billions of dollars in deposits from people earning less than US$10 per day is the Holy Grail for banks like Attijariwafa. By some estimates, 95% of the nearly 500m adults in Sub-Saharan Africa earning less than US$10 per day do not possess a bank account. If they did, the formal banking system would have access to as much as US$59bn in new deposits, thereby freeing up a torrent of capital for lending to businesses and for infrastructure development.

Attijariwafa has been using income from domestic operations to expand in Africa over the past decade, establishing subsidiaries in Tunisia, Côte d'Ivoire, Senegal, Mauritania, Mali, Cameroon, Gabon and Congo Brazzaville. The bank has also planted its flag in Europe, with branches catering mainly to Moroccan expatriates. It operates additional offices in Dubai, Riyadh, Shanghai and Tripoli.

Most countries in Sub-Saharan Africa have only weak levels of usage of formal financial institutions, according to a recent series of household surveys by the World Bank and Gallup. However, in many of these markets populations are eager users of mobile money and community-based savings schemes. This may indicate pent-up demand for simple, low-cost formal accounts.

Controlled by a conglomerate in which the Moroccan royal family is a key shareholder, Attijariwafa is Africa's sixth-biggest lender by balance sheet and listed on the largest stockmarket in North Africa, the Casablanca Stock Exchange. It reported a 12% increase in its net income, to US$630m, in 2011. At present its financial investment in African totals US$800m, or about 25% of consolidated equity.

South-to-south co-operation

Attijariwafa is pursuing a diversification strategy that relies heavily on what it describes as "south-to-south co-operation" to develop and consolidate its presence in Africa. This largely means targeting ventures overlooked by bigger multinational banks, including France's BNP Paribas and Société

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Générale. It acquired part of its African network via a 2009 acquisition from Crédit Agricole. But the strategy also means working the softer side of banking by leveraging similar cultural experiences and challenges, including a common French colonial history, with its African partners.

Although Attijariwafa's Africa strategy is anchored in reaching out to the unbanked masses, its initiatives include partnering with small and medium-sized enterprises and financing large-scale development and infrastructure projects. For example, it has underwritten a power plant in Mali, an international airport in Mali's capital Bamako, a major mining project in Gabon, and highways and power plants in Senegal.

Operating in Africa requires steady nerves and a long-term horizon. For example, in Tunisia Attijariwafa acquired La Banque du Sud, a 65-year-old state-owned bank with 90 branches. In just four years it doubled the number of branches to 180 despite the challenges posed by the Arab Spring, which ignited in Tunisia and has since swept through much of North Africa and the Middle East.

In Côte d'Ivoire, Attijariwafa stayed the course through the recent social unrest and managed to double its banking network.

Poor access to infrastructure hinders improved bank usage in certain countries, however. In some remote regions of Africa telecoms operators do not offer wireless services. This has forced Attijariwafa to postpone launches or rely on more costly satellite communication systems.

Economic storm clouds

In the past three years Morocco has achieved average annual GDP growth of 4.5%. But its economy has shown signs of slowing as a result of the banking crisis in the euro zone, the country's leading export market and main source of both tourism revenue and migrant transfers. In addition to slowing growth in GDP, the euro zone crisis could result in a domestic liquidity squeeze as the North African country struggles to bring a soaring trade deficit under control.

The economic storm clouds building over Europe and perhaps at home only serve to validate Attijariwafa's diversification strategy in the rest of Africa. The bank plans to continue investing on its home continent, working to increase its presence from 12 to 20 countries by 2015. The bank's pan-African strategy is not only helping to strengthen its balance sheet and bottom line, but also serves as an engine of modernisation, a spur to international commerce, and a boost for economic development.

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Betting on savings in Colombia

Banks have turned to correspondents to extend their Colombian networks since a reform six years ago. The government has spurred a state-run bank to reach rural areas and pursued additional reforms.

Those dreaming of riches often have to choose between playing the lottery in the expectation of a huge, although unlikely reward, or saving smaller amounts consistently. Thousands of Colombians face this dilemma in a more acute way than most people—they can buy a lottery ticket and put money into a savings account in one and the same business location. The banking sector is hoping that increasing numbers of Colombians will chose the second, wiser path.

More than 3,000 shops owned by Lotería Bartolo, a chain of bet takers spread all around Colombia, have been offering financial services from Citibank and other groups since 2006, when the government put in place a system of banking correspondents. The measure aimed to spur more Colombians to make use of banking services, thereby reducing the informal economy and raising tax revenue. The results have been encouraging, but there is still some way to go, not only in expanding banking services, but also in encouraging competition among lenders in the most remote parts of the country.

A long recovery after a banking crisis

Colombia had one of the highest levels of usage of banking services in Latin America until 1997, when a severe domestic financial crisis, created by the bursting of a property-driven credit bubble, sapped public confidence in the industry. The ratio of bank credit to GDP fell from 35% when the crisis started to around 20% a mere six years later.

Since 2004, however, the industry has been recovering gradually, and some significant progress has been made in the past few years to take the ratio back above 1997 levels. But the country still lags behind the likes of Brazil and Chile. In general, Colombia is above average in the region for the amount of credit available, but lags in the number of its citizens with financial accounts.

Indicators of financial inclusion in selected Latin American countries
(% of adults unless otherwise indicated)

	Chile	Brazil	Colombia	Mexico	Peru	Venezuela	Argentina
Domestic credit to private sector (% of GDP)	89	61	45	26	26	20	17
Have/share an account at a formal financial institution	42	56	30	27	20	44	33
Saved at a formal financial institution*	12	10	9	7	9	14	4
Saved using a community-based method*	3	2	6	5	4	6	2
Originated a new loan from a form financial institution*	8	6	12	8	13	2	7
Originated a new loan from family or friends*	9	16	18	15	14	10	7
Used mobile money*	2	1	3	6	4	3	1
Have a credit card	23	29	10	13	10	10	22
Have a mortgage	4	1	3	3	1	0	0

*In the past year.

Sources: World Bank, World Development Indicators; Asli Demirguc-Kunt and Leora Klapper, "Measuring Financial Inclusion: The Global Findex Database" (April 2012).

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As in other large, middle-income countries, the key to attaining higher levels of bank usage has been the creation of banking correspondents. They are non-financial firms, such as retailers, corner shops and utilities, which provide a number of financial services under agreements with banks. The Colombian financial regulator has given banks and their non-bank partners greater leeway than in other countries, as clients can pay utility bills and cash cheques, as well as open savings accounts and deposit money into them.

As in neighbouring Brazil, banks and clients alike have embraced correspondents in Colombia. In just five years their number reached more than 16,000 around the country, which helped to expand the reach of financial services considerably. Meanwhile, the number of bank-run branches has varied little in recent years.

More than half of the banking groups operating in Colombia employ correspondents, according to the market supervisor, the Financial Superintendent of Colombia. Commercial banks have used them mostly to expand their presence in the big urban areas, where almost two-thirds of all Colombians live. The strategy appears to make sense: compared with smaller towns or rural areas, urban incomes are higher, economic activity is more dynamic, and economies of scale are easier to achieve.

A state-assisted boost in rural areas

Correspondents have also enabled the industry to take services to people who live in far-away places. But as the private sector has shown little interest in reaching out to such customers, the state has had to play a significant role, especially via state-owned Banco Agrario. As a result, the number of localities without access to banking services fell to a mere 11 by the end of 2011, from 309 in 2006.

The challenge was to create competition by convincing lenders that it was worthwhile extending their networks to the remotest corners of the country. This was not an easy task, considering that large swathes of Colombia's territory are covered by the Amazon forest, and many localities can only be reached after many days of travelling by boat. Soon after the 2006 law on correspondents was approved, 122 localities lacking financial access were added to the banking network. But the authorities believed that coverage remained far from satisfactory.

The government proceeded to design an incentive package to help fund the implementation of correspondents in towns with fewer than 50,000 inhabitants, the most neglected group of potential clients. However, the only bank to apply for the aid was Banco Agrario, which specialises in agricultural loans and other services for rural areas. The bank promptly added 187 new localities to its network of correspondents. The incentive was subsequently extended to credit co-operatives and NGOs, which helped to stretch the system even further and in some cases provided an alternative to Banco Agrario.

The Colombian law enables banks to offer a significant range of services via correspondents, which is not always the case in other countries. But most lenders still prefer to channel just a narrow set of products and services, and most of the transactions remain restricted to the payment of taxes and other public service fees. The financial services regulator has pointed out that a major challenge for the sector in the future is to find ways for lenders consistently to make money out of correspondents based in small localities. The development of a model of "universal correspondent" that would provide a larger variety of products could go some way in this direction, the regulator believes.

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Additional efforts

Efforts to bring more Colombians into the banking system have included other kinds of measures as well. In 2009, for instance, the government created a type of low-cost electronic savings account that has few bureaucratic requirements, offers some tax advantages, and is aimed at lower-income families. It has helped to increase considerably the number of savings accounts, but the accounts generate little income for banks, and Banco Agrario has been the only bank to really embrace the innovation, not least because it is used by the government to funnel payments from social programmes.

Another possibly important measure has been a change in the rules that had previously prevented banks from charging higher interest rates for loans to riskier clients. As a result, more Colombians have gained access to credit, especially in the microfinance sector, albeit at higher costs.

Commercial banks, which have been doing very well in recent years, argue that other measures should be implemented to draw more people into the system. They have asked the government to abolish, or at least reduce, a tax of 0.4% on financial transactions (although not those in budget electronic savings accounts). They would also like to have more freedom to set interest rates for their credit operations, as some restrictions remain despite an easing of the rules.

Easier access to credit would go some way towards helping poor Colombians to get richer. And if their bankers reject a loan application, they can always buy a lottery ticket without even leaving the room.

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Partnerships with retailers

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A shopping trip to the branch in Latin America

Chile's retail chains have branched out into financial services under their own brands. They are now introducing the model in neighbouring markets.

For the contemporary shopper it is not unusual to find an ATM or a financial services counter in a chain store or retail location. However, it is somewhat rarer that the chain store itself operates the banking services, as opposed to providing them in a partnership with a financial firm.

Starting in the late 1990s, Chilean retailers began to expand beyond simple store cards to offer a full range of consumer financial services. Most of the country's big shopping groups now offer such products, but Falabella, one of its leading store chains, is the most active, providing credit cards, savings accounts, insurance policies and a range of household loans. More recently the firm has exported this model in its expansion up the Andes mountain range to Colombia and Peru.

Steady expansion in finance

Falabella gained its first banking licence in Chile in 1998, after over a century as a retailer and nearly 20 years of running its own credit card, branded CMR. The firm now operates financial outlets in most of its more than 150 retail locations across the country. These include department stores, supermarkets, malls and home-improvement shops under the Sodimac name.

The company's push into finance has made it a competitor in banking, although it is still dwarfed in this area by the country's big domestic and foreign-owned banks. Banco Falabella has about 1% of the overall national credit portfolio, while the unit operating CMR holds a slightly larger share. The company says it has more then 2m cardholders in a country of about 17m.

Taking advantage of its regular contact with customers shopping for groceries or consumer goods, Falabella has expanded beyond its origins in consumer credit. It now also offers home and car loans. Investors can choose among its savings accounts, fixed-term deposits and mutual funds. An affiliate operates as a broker for a line of property, casualty and life insurance products. The parent company also offers holiday packages and serves as the property developer for many of its locations.

Falabella's stores generally range from middle-market to up-scale. This means that it has probably had only a limited impact in bringing financial services to the poor. But its wide geographical reach has brought branches and ATMs to remote locations in the country's lightly populated far northern and southern regions. The company has also increasingly made its products available over the Internet.

Target markets in the Andes

As at home, Falabella began its international expansion in retail, but then gradually developed its financial offerings over time. It received banking licences in Peru in 2007 and in Colombia in 2010. In both markets it now offers a similar mix of credit cards, consumer credit, savings and investment options, as well as working as an insurance broker.

In both countries Falabella has only a small position in the banking market, with assets of around 1% of the national total, according to data from the respective regulators. However, it has made good progress in attracting cardholders, with some 872,000 CMR accounts in Peru and 614,000 in Colombia.

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Meanwhile, in Argentina it has some 490,000 CMR accounts through retail outlets, even though it holds no banking or insurance broking licences there.

These markets may ultimately offer greater financial services opportunities than Chile, where some 42% of adults have or share an account at a formal financial institution and 23% have a credit card, according to a recent World Bank report. The corresponding figures for accounts are lower in the other markets: 33% in Argentina, 30% in Colombia and 20% in Peru. Ownership of credit cards is even more limited at 22%, 10% and 10%, respectively.

Although still controlled by descendents of the founding family, Falabella is a listed company on the Santiago exchange. As a result of a recent tie-up of regional equity markets, its shares are also traded in Colombia (Bogotá) and Peru (Lima).

Occasional pitfalls

Other Chilean retailers are also pursuing ambitions in finance. The store chains Ripley and París run banking operations and offer similar credit, savings and insurance products in Chile. Ripley has expanded its stores and financial offerings to Peru as well.

Mixing retailing and finance has proved profitable for Chile's retailers. But it holds dangers as well. In mid-2011 Polar, a smaller store chain with a card franchise, reported a large loss in its credit operations. Its management appears to have been rolling over delinquent balances in an effort to report positive financial results. This sparked a temporary scare across the entire sector.

Falabella itself had to take a US$40m loss in April 2012, when a vendor working as a credit collector failed to pass on customer payments. Although investors are generally bullish about the company's shares, they were recently spooked by increases in credit provisions in all four country operations in Falabella's first-quarter results.

Among new technologies in finance, mobile banking is the snazziest, with its mix of handsets and wireless connectivity. However, the simple innovation of tying together bank branches and retail stores may ultimately prove a better way to bring customers into the formal financial system.

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Retail channels in Mexico

Bank outlets have flourished in Mexico in the past three years, as financial firms have formed alliances with retailers and other chain stores.

Mexicans, and especially those in rural areas, are little accustomed to using formal financial services. People keep their savings in bills or valuables at home, make most local transactions in cash, and use money-transfer offices for long-distance remittances.

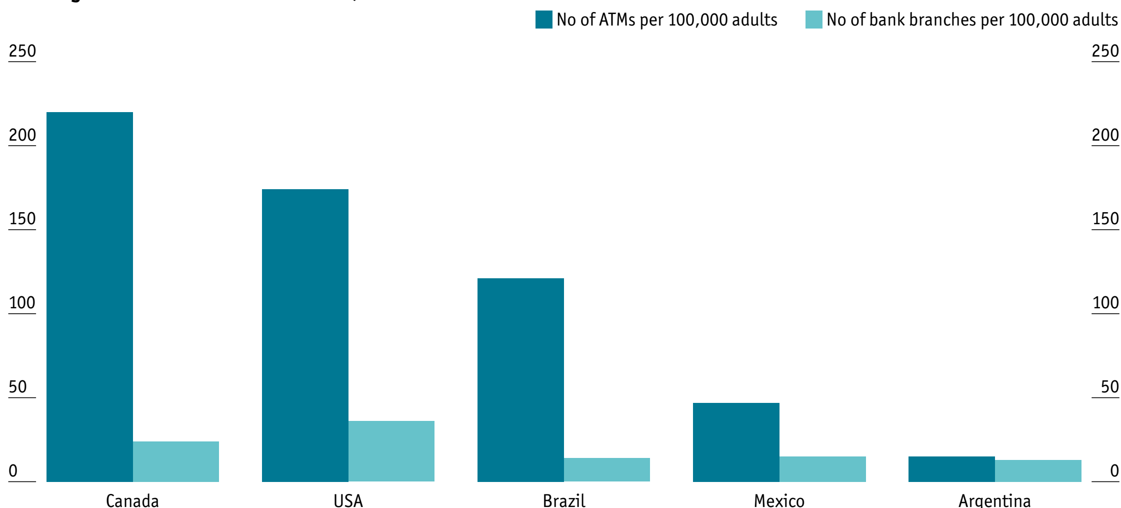
However, in the past three years Mexico has put in place a new system designed to broaden the reach of formal finance. The main tools of this initiative are new, miniature branches, often in existing business facilities. Banks have been allowed to sign agreements with non-bank entities that provide a number of services in places where fully-fledged branches are frequently not viable. These so-called banking correspondents provide a new distribution channel that aims to replicate in Mexico successful experiences elsewhere to increase the use of financial services.

Chain outlets will handle transactions

These correspondents are businesses, such as retailers, utility firms and hotels, which agree to add a number of banking services to their daily activities in exchange for commissions. Thanks to the spread of communication technologies like the Internet, they can stay connected to their banking partners even if they are located in the kind of inhospitable, far-away places that are so common in a large country like Mexico. Although the initiative is still young, it is mostly seen as an opportunity to integrate millions of new banking costumers.

Mexico has the potential for a substantial broadening of the market. The banking network has so far been unable to service hundreds of small towns and villages around the country. The main lenders have instead focused their attention on Mexico's large cities, and according to CNVB, the industry supervisor, by September 2010 there were only 1.3 bank branches for every 100,000 people who lived

Banking facilities in selected countries, 2010



Source: IMF, Financial Access Survey.

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in rural communities, compared with 26.6 in the region around the capital, Mexico City. Even urban agglomerations are often poorly served: 12 towns with more than 50,000 inhabitants had no bank branches at all at the time CNVB released its latest financial inclusion report.

Part of the industry has given the initiative only a lukewarm reception, as there are doubts about whether banks can make much money from such schemes. But other banks have embraced the idea enthusiastically, with plans to use it to reach a large, untapped market. The results, in terms of spreading banking services around the country, are beginning to show.

New legislation

The legislation that enabled the use of banking correspondents was approved in late 2008, and the next year the government granted the first licences to interested banks. More than 600 agreements between banks and non-financial firms were signed in the subsequent months, providing the banking industry with over 21,000 new access points around the country by February 2012, according to the latest statistics released by the CNVB.

The number is likely to be considerably higher today. Banamex, the Citigroup-owned financial group, had around 2,724 banking correspondents by the time of the CNVB report, and now boasts more than 4,800 on its website. BBVA Bancomer, which has been most active in this new approach, has unveiled plans to gather 20,000 correspondents all by itself by the end of 2012. As an executive recently pointed out, in the previous 80 years of the bank's operations it had opened only about 2,000 branches.

Most banking correspondents are retailers, with banks striving especially eagerly to sign agreements with companies that have their operations spread all around the country. The supermarket chain Soriana now provides banking services on behalf of Banamex, while Walmart will take customers' instalment payments on loans from Bancomer or American Express. Oxxo, a huge chain of convenience stores, operated nearly one-half of the banking correspondents counted by the CNVB in February 2012.

Other options are also available, such the network of offices maintained by a state-owned telecoms provider, Telecomunicaciones de México (Telecomm), which has opened more than 1,500 access points for seven different banks. Pharmacies, hotels and even restaurants have been drawn into the new scheme, and the latest target for a number of banks are petrol stations, a kind of commercial facility that can be found virtually anywhere in the country.

A wide range of transactions

The range of services the agents offer remains limited. But Mexico's cautious regulators have gradually given banks more room to manoeuvre, so that the arrangements become more attractive for all parties concerned. Clients of the Banamex Aquí system, for instance, can make payments of up to Ps10,000 (US$790) via correspondents, as well as withdraw cash of up to Ps6,000 with their debit cards, or as much as Ps25,000 in the case of money sent to their accounts by relatives working abroad.

Just over three years into the experiment, banking correspondents look like a valuable tool for financial inclusion. This is especially so when their activities are coupled with other recent novelties, such as the creation of basic bank accounts that can be opened by simply presenting an ID card.

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Policy initiatives

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Take it from their salaries in Brazil

An innovation in credit markets known as payroll-linked lending has led to a boom in consumer credit in Brazil in the past eight years.

Brazil's consumers have been eager spenders in recent years, helping to fuel an economic growth spurt that has only tapered off in 2012. They bought new homes, cars and a wide variety of household goods. They were able to generate this surge in domestic demand in large part because they enjoyed credit in quantities that were unthinkable in Brazil a decade ago.

Credit for households has increased from very low levels since 2004 as a result of innovative lending methods, together with an easing of still-high interest rates. One successful lending reform the government pioneered was a system that allows loans to be linked to the payrolls of workers and pensioners. This has helped consumers to obtain credit while at the same time reducing the risk to banks of defaults.

A government initiative

The coalition government, led by the ruling left-wing Workers Party, passed legislation in late 2003 permitting payroll-linked loans (Crédito Consignado) in an effort to boost the country's underdeveloped credit markets. The system works by removing a level of uncertainty on the lender's side, as payments of instalments on a loan are made even before borrowers get their hands on their wages.

Under the system, employers sign agreements with banks that provide loans with better than average conditions with a guarantee that the money will be repaid so long as workers keep their jobs. The instalments are deducted directly from monthly salaries and paid to the bank. If a worker is laid off, part of the mandatory compensation payments, which are relatively generous in Brazil, are used to reduce the debt.

To a considerable extent this has produced a win-win situation. Banks can make loans to customers that carry less risk than many loans made through a branch. Borrowers enjoy interest rates that are much lower than those charged on credit cards and other consumer loans.

The scheme started with workers employed by the government and state-owned companies, who continue to account for about 85% of all payroll-linked lending. Banks were later allowed to sign agreements with private companies and trade unions, expanding the advantages of this type of lending to anyone who had a formal employment contract. More recently, even retired people who receive monthly payments from the INSS, the state security system, became eligible to borrow against their future pension earnings. Like employers, the INSS deducts the loan instalments from pensions before paying them out.

A boom in credit, and cheaper than before

The rules the government gradually implemented succeeded in making credit more widely available and increasing competition among providers. A large army of emerging consumers, who have been able to find formal-sector jobs but have little credit history, have benefited hugely. Previously, a lender

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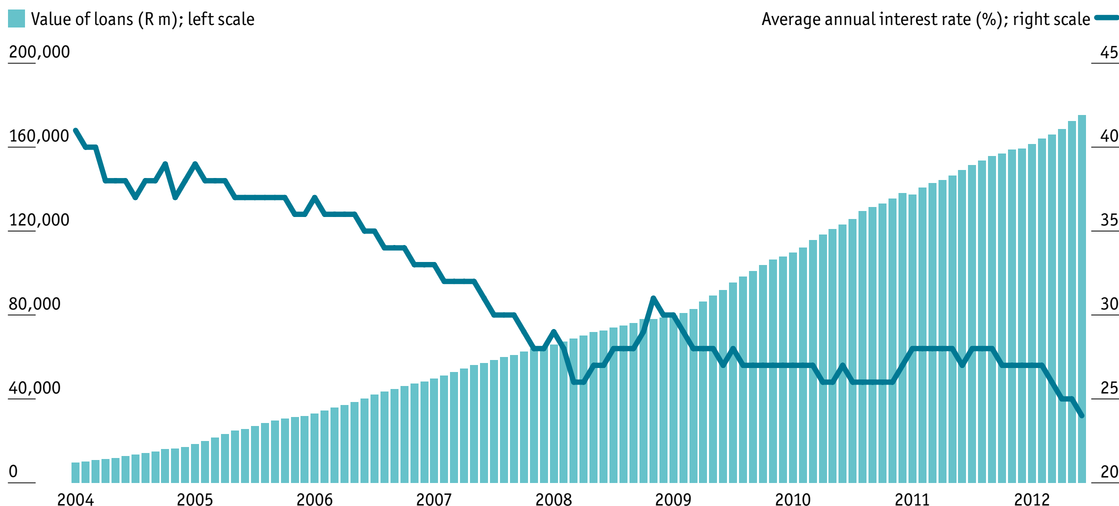
would offer better-quality loans to customers who were paid their wages by direct deposit in accounts held at a bank. The reforms allowed employers and unions to sign deals with more than one bank, as they try to get the best possible conditions for employees and members.

The result has been a spectacular rate of growth of loan operations. The volume of payroll-linked loans surged ahead to make up nearly one-fifth of all loans to individuals by June 2012. At that time, they amounted to R175bn (US$84.3bn), the equivalent of 58.8% of the total volume of personal consumer credit in the country, according to data from Banco Central do Brasil (BCB, the Central Bank).

Interest rates on payroll-linked loans have also fallen over the last eight years. The average rate stood at an annualised 24% in June 2012, down from 41% when the scheme began in early 2004. This trend has run in parallel with a general easing of Brazilian rates; the Central Bank's Selic base rate fell to 8.5%, from 16.5%, over the same period.

Brazil's boom in payroll-linked loans



Source: Central Bank of Brazil.

A bright future

Payroll-linked lending should continue to grow in popularity in Brazil, although there have been recent signs that its extraordinary growth is flagging. Banks surveyed by their industry association earlier this year said they expected the value of loans to expand by more than 16% in 2012, and around 15% in 2013.

These are remarkable numbers, considering that Brazilian banks have begun reporting a steady increase of non-performing loans. From the point of view of the authorities, the main argument for boosting payroll-linked loans is that they reduce the risk of consumers defaulting on their debts.

Other forms of credit are much riskier, and more expensive, in Brazil. The latest survey of interest rates by Anefac, an association of finance executives, found that banks charged an average interest rate of 10.69% a month—the equivalent of 238.3% a year—on credit card loans. Overdrafts cost an average of 8.22% a month, and consumer financing by retailers, 4.72%.

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Payroll-linked credits cannot carry rates of more than 2.14% a month, and some offer rates as low as 0.7% for short-term loans, according to the Central Bank. Not surprisingly, a growing number of Brazilians have decided to consolidate other kinds of debt by taking out a payroll-linked loan.

Smaller lenders stumble

With the market so strong, it comes as a surprise that banks specialising in payroll-linked loans, which mushroomed in recent years, have struggled recently. In general, they lack the strong deposit base that more traditional retail lenders enjoy and, as a result, some have adopted a strategy based on raising money abroad, to lend it out in Brazil. This business model worked well as long as liquidity was plentiful abroad and interest rates remained sky-high in Brazil.

But the combined effect of the enduring malaise in global financial markets, new accounting rules for Brazilian banks and lower domestic interest rates has revealed the shortcomings of such strategies. The result has been large holes in the balance sheets of many payroll lenders. Scandal-ridden Banco Panamericano was one of them. Banco Cruzeiro do Sul, which was seized by the central bank, also focused on payroll loans, as did Banco Matone, which ended up being acquired by a food-based conglomerate.

One of the pioneers of the market, Banco BMG, has also struggled of late, but it found a way out of its troubles by agreeing in July 2012 to enter into a joint venture with Itaú Unibanco, one of the country's top three retail banks. The resulting firm, owned 70% by Itaú, will enable the two banks to operate together in the market for payroll-linked loans. Itaú Unibanco will provide much of the money to be lent to customers, while BMG will take care of the operational aspects of the business.

The move has been lauded as a coup for Itaú Unibanco, which had fallen behind its main rivals in the fast-growing market. Now the bank expects to carve out a leadership position, while at the same time reducing its exposure to riskier types of loans.

It is easy to see why Itaú has decided to be more aggressive in the segment. One of its main rivals, Banco do Brasil, says its giant payroll loans operation deserves much of the credit for its positive results so far this year. The state-owned lender claims to control almost one-third of the segment, with a portfolio of R52.6bn.

Prodded on by its bosses in the government, who want Brazilians to carry on consuming to keep the economy going, Banco do Brasil and other state lenders, such as Caixa Econômica Federal, are pushing down interest rates charged on consumer loans. They are also likely to redouble their efforts in payroll-linked credit.

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Push for Islamic finance in Malaysia

Kuala Lumpur plans to spur the Islamic capital market to double-digit annual growth rates over the course of the decade. The agencies involved in the push are likely to achieve this goal despite significant challenges.

Some policymakers set sky-high goals and then quickly lose interest in pursuing them. That is not the case in Malaysia, where officials are accustomed to making ambitious economic plans and going on to achieve them. One of their key aims for this decade is to solidify the country's lead in the burgeoning market for Islamic financial services.

Over the years Malaysia has emerged as a world leader in this industry segment. The total size of its Islamic sector grew by 13.6% annually through the ten years of the first Capital Market Masterplan (2001-10), according to the Securities Commission (SC). Most aspects of Islamic finance have been expanding faster than the overall financial services sector. By 2010, the total assets of the Islamic finance sector amounted to M$1,050bn (US$340bn), which included bank assets and stocks as well as *sukuk* (bonds that are structured so that they comply with Islamic prohibitions on interest).

By many standards, the Islamic sector is already an important part of the overall local industry. For example, Islamic banks held nearly 20% of total bank assets at the end of May 2012. *Sukuk* comprised over 40% of local bonds (see table).

Malaysia's Islamic finance sector

Selected data

Total bank assets as at May 31st 2012:	M$1,769bn
Of which, Islamic banks:	19.3%
Total bank loans as at May 31st 2012:	M$1,042bn
Of which, Islamic banks:	20.1%
Total bank deposits as at May 31st 2012:	M$1,310bn
Of which, Islamic banks:	20.6%
Total life insurance premiums in 2011:	M$26,498m
Of which, *takaful* operators:	14.0%
Total non-life insurance premiums in 2011:	M$12,018m
Of which, *takaful* operators:	9.6%
Total stockmarket capitalisation, end-2011:	M$1,285bn
Of which, Islamic-compliant stocks:	62.8%
Total value of the bond market, end-2011:	M$841bn
Of which, *sukuks*:	41.6%

Sources: Bank Negara Malaysia and Securities Commission.

Malaysia is also important in the overall global market. The SC suggests that, around the world, banking assets and Islamic-compliant securities amount to around US$1.3trn, having grown by 15% annually over the last decade. Malaysia therefore accounts for over one-quarter of the worldwide total. As of 2011, Malaysia was the domicile of 68% of the US$210bn in *sukuk* outstanding. It accounted for

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US$67bn, or 73%, of the US$92bn in *sukuk* issued last year. Bursa Malaysia, the local bourse, is the leading stock exchange for listed *sukuk*.

A decade-long plan

Bank Negara Malaysia (BNM, the central bank) and the SC have worked with other government agencies to promote the development of finance in general, and the Islamic market in particular. Under the current, and second, Capital Market Masterplan (2011-20) the authorities expect that the total assets of the Islamic finance sector will achieve growth of 10.6% per year. By end-2020 they should amount to around M$2.9trn (about US$1trn).

In its latest annual report, the SC highlighted various steps that had been taken to promote the development of Malaysia's Islamic capital market, such as the launch of innovative products and provisions in the 2012 budget tax for deductions for expenses incurred in the issuance of particular *sukuk*. The SC has issued new and clearer guidelines for the issuance of such bonds. The SC's Shariah Advisory Council ensures that there is consistency across the entire market in terms of *shariah* rulings. The SC also plays a very active role in the training and development of Islamic finance professionals.

Challenges for the industry

This is just as well, because a lack of suitably skilled staff has been identified by consultants Ernst & Young in their latest World Takaful Report as a challenge for the global *takaful* sector (an Islamic insurance system compliant with *shariah* law). In some countries labour costs have been relatively high in Islamic banks compared with conventional banks, according to Ernst & Young.

There are other headwinds. Ravi Menon, the managing director of the Monetary Authority of Singapore (MAS), suggests that the global Islamic finance sector is vulnerable to the ongoing crisis in the euro zone. Nevertheless, he believes that the crisis provides an opportunity for Islamic banks to expand, given that they are not excessively leveraged.

Mr Menon also argues that Islamic financial institutions need to do more to diversify into growing areas such as trade and infrastructure financing. He believes that what is most important, though, is that the global Islamic finance industry is still too small and too fragmented. Given that it accounts for less than 1% of the total assets of the global financial system, too few institutions have economies of scale.

Markets need to go international

In short, there needs to be growth in crossborder flows of money and products within the global industry. The SC recognises this. According to the commission's Zinal Izlan Zainal Abidin: "The next phase of growth of the Islamic capital market will be characterised by greater internationalisation, which entails, among others, a growing number of product issuers and service providers expanding beyond their home market, more investors seeking products or instruments with international exposure, as well as greater diversity in terms of currencies used in issuing shariah-compliant instruments."

In Malaysia, both Islamic banking and the *takaful* market are reasonably concentrated, in that the top five players account for well over half of overall activity. Major banks that may go global include

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Maybank Islamic, CIMB Islamic, Bank Islam Malaysia, Public Islamic Bank and AmIslamic Bank. Key *takaful* operators which could head in that direction are Etiqa Takaful and Syarikat Takaful Malaysia.

A year from now it should be clear whether or not Malaysian officials are making progress in promoting the internationalisation of Islamic finance. Given their track record so far, it is reasonable to expect success.

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