Asian Banking

EMERGING DEVELOPMENTS IN GROWTH, STRUCTURE AND EFFICIENCY

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Among the emerging economies, Asian banking is the most energetic and expanding one. In the aftermath of the Asian economic crises, banks in South East Asia were the worst to get affected, but they are clawing back to normalcy with aggressive pace, quite often strongly supported by the their governments. Despite impressive growth of capital markets in the Asian region, banking remains a strong anchor supporting economic growth.

This paper discusses in brief three major aspects of Asian banking. Growth, Structure and Efficiency. Growth depicts the growth of banking activity in the region; structure describes features such as who owns banking and efficiency profiles recent operational performance of banks across the Asian region. In all these aspects suitable comparisons with banking systems in other emerging economies is also done. Data used in the paper is sources from secondary sources. This paper restricts the use of the data in describing the features and it does not contain analytics.

Banking Industry in Emerging Economies: An Overview

Asia has a strong banking presence. Table 1 given below shows how banking industry is spread across major regions in the world. In the emerging economies, Asia has the largest number of deposit taking institutions and banks, despite closure of a fairly large number of institutions following the 1997 economic crises. The size of banking assets in Asia is more than the double that of Latin America and several time larger than that of central Europe. Its capital ratios are fairly higher.

In emerging economies, banking sector is the single most important source of finance for corporates in the private sector. During the five year period, 1997-2001, of the total corporate domestic funding for the private sector in major emerging markets, a large chunk (63 percent) came from bank loans, though the share of domestic bonds (22 percent) has been growing more rapidly than the equities (15 percent). In respect of international funding too, bank lending (41 percent) dominates bonds (37 percent) and equities (22 percent). This trend is also evident in the private sector domestic funding in the Asia Region where banks loans are the prominent source (78 percent) of funding

Table-15

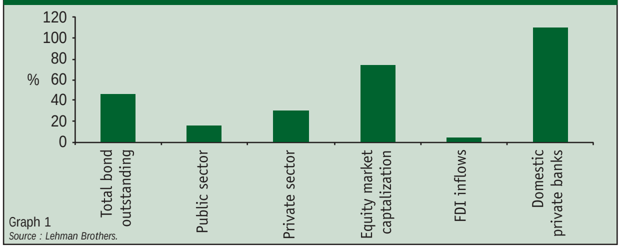
Trends in Banking Systems

	East Asia[1]		Latin America[2]		Central Europe[3]		Advanced[4]	
	1990	1999	1990	1999	1990	1999	1990	1999[5]
Number of deposit-taking institutions[6]	10,100	11,761	1,344	1,741	2,087	1,154	39,766	30,361
Of which banks	1,148	1,059	323	302	1,819	929		
Concentration[7]	44	43	47	59	70	55	39[9]	42[9]
Employment in DTIs[6] ('000s)	303[8]	344[8]	943	773	...	252	5,638	5,477
Assets of DTIs ($bn)	835	1,917	364	766	105	188		
Branches of DTIs ('000s)	17	24	26	24	...	15	275	286
Banks' return on assets (%)	0.9	- 1.6	1.4	0.5	2.5	1.8		
Banks' simple capital ratio	4.9	10.9	9.0	8.8	8.2	7.6		
Banks' risk-weighted capital ratio	...	11.7	...	12.6	9.0	13.9		

[1]Sum or simple average of Korea, Malaysia, the Phillipines and Thailand. [2]Sum or simple average of Brazil, Chile, Colombia, Mexico and Peru. [3]Sum or simple average of the Czech Republic, Hungary and Poland. [4] Sum or simple average of Australia, euro area, Hong Kong, Japan, Singapore, Switzerland, the United Kingdom and the United States. [5] 1998 data, other than for Hong Kong and Singapore. [6] Including commercial, savings and various types of mutual and cooperative banks, and similar intermediaries such as building societies, thrifts, savings and loan associations, credit unions, postbanks and finance companies but excluding insurance companies, pension funds, unit trusts and mutual funds. [7] Percentage share of DTIs' assets held by five largest institutions. [8] Excluding the Philippones. [9] Excluding Singapore.Sources : BIS questionnaire; British Bankers' Association; Building Societies Association; national data

but the share of equities (12 percent) are more than bonds (10 percent). In international funding for Asia region, all these three are proportionally represented. In respect of the public sector funding however, it is the bonds that is most prominent both in domestic (91 percent) and international (73 percent) sources. As compared to other regions, banks loans, as a source of funding in the Asian region is more than other regions. For both the sectors bonds contribute significantly in funding to the extent of 69 percent, followed by bank loans with 26 percent and equities (5 percent)

G-118 The Size of the Market Segments of the Financial Sector in Asia 1998-2002. As Percent of GDP.



Graph 1
Source : Lehman Brothers.

Another evidence to show that growth of banking is more stronger in Asia than the capital markets could be evidenced from the fact that domestic private credit as a percent of gross domestic product in Asia grew from 90.6 percent in 1996 to 113.7 percent in 2002, where as equity market capitalization inched from 64.8 percent to 71.9 percent and total bonds outstanding from 31.4 percent to 48.7 percent.

More than 40 percent of the world's population still lives in countries in which the majority of bank assets are in majority-owned state banks. Government ownership tends to be greater in poor countries. Total assets of banking system in about one third of all countries is smaller than $1 billion; another third have banking systems smaller than $10 billion.

Asian Banking Growth

Asian banking showed significant growth in the last three decades. Domestic credit provided by banking as a percent of gross domestic product, reflects the significance of the banking sector in the economy. From the table 2, it is evident that Asian economies showed the largest spurt in this ratio, and always growing in contrast to the banking systems in other emerging economies. Bank credit/gdp ratio growth was much faster and spectacular in East/South East Asia as compared to South Asia, as most of the countries in South Asia, namely India; Sri Lanka only made marginal gains in this ratio during the decade of the 1990 where as in countries like Pakistan this ratio actually fell. Bangladesh perhaps scored well in the South Asian region in this regard. Despite severe economic crisis that plagued the entire East Asian region, this ratio remains to be rather high. Bank credit/GDP ratio in many of the Latin American and African countries fell sizeable during this period, reflecting on the anemic economic growth these countries had throughout the last decade, which was evident in the growth of the banking system as well.

Structure of Banking in Asia:

More than 40 percent of the world's population still lives in countries, which the majority of bank assets are in majority owned state banks. Government ownership tends to be greater in poorer countries; Arguments in favor of state control (a) better allocation of capital, (b) private ownership may restrict access to banking sectors for many parts of the society (c) private banking is more crises prone. Achievement of the goals of the state ownership has been elusive. Greater ownership of banks to associated with higher interest rate spreads, less private credit, less activity on the stock exchange, and less nonblank credit, even after controlling for many other factors. One study revealed that countries that had greater state ownership of banks in 1970 tended to grow more slowly since then with lower productivity, especially in poor countries . While abrupt and premature privatization (Mexico in the early 1990s, Chile in the late 1970s) can be dangerous, so too can be a strategy of hanging on to state ownership.

Table-16

Country	Domestic Credit provided by banking Sector	
	% of GDP	
	1990	2001
Argentina	32.4	37.3
Australia	71.5	94.0
Bangladesh	23.9	38.7
Botswana	- 46.0	- 73.5
Brazil	89.8	59.2
Canada	82.3	91.0
Chile	73.0	73.4
China	90.0	140.6
Hong Kong, China	156.3	142.5
Egypt, Arab Rep.	106.8	103.6
Ethiopia	67.0	58.2
France	104.4	108.0
Germany	103.4	147.5
India	51.5	54.7
Indonesia	45.5	60.6
Israel	106.2	95.2
Japan	259.7	317.5
Kenya	52.9	42.8
Korea, Rep.	65.7	110.4
Lao PDR	5.1	15.3
Malaysia	75.7	155.3
Mexico	36.6	24.7
Mongolia	73.4	12.5
Nepal	28.9	46.2
New Zealand	80.6	114.9
Nigeria	23.7	18.0
Pakistan	50.9	45.5
Philippines	26.9	63.1
Russian Federation	—	24.3
Singapore	75.6	102.0
South Africa	97.8	166.9
Sri Lanka	43.1	47.1
Thailand	91.1	112.0
Uganda	17.8	10.2
United Kingdom	121.2	140.5
United States	110.9	163.9
Venezuela, RB	37.4	15.5
Vietnam	4.7	39.5
Zambia	67.8	51.6

Asian banking is significantly either state owned or family owned. This is also one of the biggest challenges facing the Asian banking system in the background of globalization and financial liberalization which envisages holding of greater share of banking assets by foreign entities. In the last twenty years, ownership of banks in China, which has been predominantly state- owned barely changed and even in India, where both public and private sector co-exist, a large chunk of it is owned by the former. In some Asian economies such as Korea and Thailand, state-ownership declined in the early 19980s, but owing to serious problems in the banking sector in the aftermath of the economic crises in the late 1990s, the share of state owned banking once again surged. In Latin America wide swings are evident, between high to low state ownership, owing the to the vast changes in the state of the economy and banks and the degree of state intervention required to overcome the crisis. Central European nations which came out of the socialist fold in the early 1990s experienced dramatic reduction in the state ownership and more important is that in these countries the growth of foreign ownership of banks is rapid and dramatic.

While state-ownership is predominant is some countries, family ownership is sizeable in some others. State and family ownership are not particularly viewed favorably from the point of view of emerging international financial policy that puts greater thrust on promoting private sector with greater responsibilities on corporate governance in terms of transparency and disclosure. A great deal of pressure is being mounted on this type of ownership by international and domestic policy to transform into a more responsible and accountable private sector.

Table-17

State Owned Banks Assets as a percentage of total bank assets

	1980	1990	2000
China	100	100	99[1]
India	91	91	80
Russia	…	…	68
Hong Kong	0	0	0
Singapore	0	0	0
Indonesia	…	55	57[2]
Korea	25	21	30
Malaysia	…	…	0
Philippines	37	7	12
Thailand	Na	13	31
Argentina	Na	36[3]	30
Brazil	33	64	43[2]
Chile	23	19	12
Colombia	27	45	13[2]
Mexico	0	100	0
Peru	65	55	3
Venezuela	…	6[4]	5[2]
Czech Republic	…	87[3]	28
Hungary	…	81	9[2]
Poland	…	80[4]	23
Israel	…	…	45[2]
Saudi Arabia	0	0	0
South Africa	…	5[3]	2[1]

Note : State-owned banks are defined as those where the government has a majority of the equity. [1] 1998. [2] 1999. [3] 1994. [4] 1993. [5] Simple ratio. Sources : World Bank; Hawkins and Turner (1999), p 79; central banks; Barth, Capro and Levine (2000). Table 1.wnership by foreign entities. Asian banking also has been largely restrictive in opening up for quite some time, though this trend is changing in the recent period.

Asia's large family-owned banks Table-18

Family	Country	Bank	Stake
The Koo family (Koos Group)	Taiwan	Chinatrust	10.0%
The Tsai family (Fubon Group)	Taiwan	Fubon Commercial Bank	15.0%
The Wu family (Shin Knog Group)	Taiwan	Taishin International Bank	15.0%
The Fung family	Hong Kong	Wing Hang Bank	32.0%
The Wu family	Hong Kong	Wing Lung Bank	43.0%
The Wong family	Hong Kong	Dah Sing Bank	38.0%
The Li family	Hong Kong	Bank of East Asia	40.0%
The Wee family	Singapore	United Overseas Bank	32.1%
The Lee family	Singapore	Overseas – Chinese Banking Corporation	22.7%
The Lien family	Singapore	Overseas Union Bank	15.7%
Azman Hashim	Malaysia	Arab – Malaysian Merchant Bank	8.4%
The Kwek family (Hong Kong Group)	Malaysia	Hong Leong Credit	71.7%
The Hong Piow	Malaysia	Public Bank	28.0%
Rashid Hussain	Malaysia	RHB Bank	23.9%
Tan Teong Hean	Malaysia	Southern Bank	22.0%
Sophonpanich family	Thailand	Bangkok Bank	15.0%
Lamsam family	Thailand	Thai Farmers Bank	10.0%

***Notes :**Market Cap as of July 28, 2001.Taiwan family ownership numbers are estimates based on industry data.Singapore family ownership numbers based on deemed interest and other indirect holdings by family.Kwek family stake in Hong Leong Credit includes Guoco stake of – 20.9%.Family ownership of Thai banks estimated based on industry data.JP Morgan sourced this data from Company annual reports; Industry data; Bloomberg*

One view that is put increasingly by international financial policy as a better option to reduce the state and family ownership to encourage ownership of financial institutions by foreign entities. Since many of the foreign banks taking state in domestic banking systems come from mature economies with fairly standardardises and stringent regulatory norms, it is envisaged a greater share of foreign ownership will bring in greater transparency and efficiency in the domestic banking systems. There are however serious concerns in many emerging economies on the entry and expansion of foreign banks .

Arguments against foreign banks: destabilize the local financial system; put local financial out of business etc., However there is no hard evidence local presence of foreign banks in this regard. 1990s have been remarkable in enhancing the presence of foreign banks. For instance in Central Europe, the proportion of bank assets controlled by foreign owned banks rose from 8 percent in 1994 to 56 percent in 1999. In some Latin American countries, almost one-half of total bank assets are now controlled by foreign institutions.

Foreign Ownership of Banks Assets as a percentage of banks assets Table-19

	1980	1990	2000
China	0	0	1
India	4	5	8[2]
Russia	…	6[4]	9
Hong Kong	…	89	72
Singapore	86	89	76[2]
Indonesia	…	4	7
Korea	6	4	3[2]
Malaysia	38	24	18
Philippines	8	9	15
Thailand	…	5	12
Argentina	…	10[4]	49
Brazil	…	6	23[2]
Chile	…	19	54[2]
Colombia	9	8	26[2]
Mexico	…	0	24[5]
Peru	2	4	40
Venezuela	…	1[6]	42[2]
Czech Republic	…	10[3]	66
Hungary	…	10	62
Poland	0	3[6]	70
Israel	…	2[4]	9[2]
Saudi Arabia	0	0	0[5]
South Africa	…	1	1[2]

[1] Banks where more than 50% of equity is held by foreigners.
[2] 1999. [3] 1994. [4] Average 1988-95 from Claessens et al (2001). [5] Including those where foreign banks have effective control without holding more than 50% of equity, the proportion would be over 40%. [6] 1993..Sources : Central banks; World Bank; BIS estimates.

Major factors inducing the growing pace of foreign ownership of banks are; globalization of financial services, lower costs of information and communication that lead to greater economies of scale to expand internationally, surge in telephone and internet banking in which foreign banks are already market savvy, Another important development in the recent years is the emergence of regional financial centers that focus their activities in the region, such as German banks expanding in central Europe, Spanish banks in Latin America and Japanese banks in South East Asia. Korean Banks to made a foray in the South Asian region, particularly India in the early 1990s, but the economic crises in the late 1990s has abruptly halted this expansion.

Nevertheless evidence is growing on the importance and usefulness of foreign ownership in banks. Using bank level data for 80 countries for 1988-95, Claessens, Demirguc-Kunt, and Huizinga of the World Bank, examine the extent of foreign ownership in national banking markets on the basis of net interest margins, overhead, taxes paid, and profitability of foreign and domestic banks. It is found that in developing countries foreign banks tend to have greater profits, higher interest margins, and higher tax payments than do domestic banks. In industrial countries, it is the domestic banks that have greater profits, higher interest margins and higher tax payments. Increase in the foreign share of bank ownership does indeed reduce profitability and overhead expenses in domestically owned banks. Local bank competition gets affected more on entry of foreign banks rather than after gaining a substantial stake

Foreign control of domestic banks in Asia has not been that particularly easy. Attempt to sell Seoul Bank to HSBC failed, In Malaysia in 1950s foreign banks controlled of assets to the tune of 94 percent, which is drastically reduced now. Prior to the financial crisis of 1997, Thailand has been relatively closed to foreign banks but this situation is gradually changing. China has withdrawn the sale of Shenzhen Bank, which is almost finalized to a foreign private capital group. Though Thailand increased the limit of foreign ownership from 25 percent to 100 percent and several others made significant relaxations in foreign ownership major banks which went into foreign ownership so fare very few, such as Bank of Asia, Nakorthorn, Thai Danu and Radhanasin which were, were sold in 1998-99 to ABN Amro, Standard Chartered, Development Bank of Singapore, and United Overseas Bank respectively. Despite a series of liberalization measures on most of the Asian countries the share of foreign ownership in banks is rather limited. In India post-liberalization the number of foreign banks expanded rapidly. Foreign banks in India in a short span nearly doubled and much more than the additions made in the last three decades, but the share of these banks in assets is barely 7 percent, though they have a much higher share in the profits, largely due to their intensive focus on retail and private banking.

India's experience also provides a perspective on the role of private sector banks. Of the ten new private sector banks that opened shop in India after 1992, hardly two or three have some significant presence and operations with remaining desperately seeking new additions to the capital or carrying excess burden of bad debts. An interesting perspective Indian banking provides is that with positive intervention of the State, turnaround in banking sector could be gradual but more concerted, though how far this strategy will be sustainable is a big question.

Bank wise shares of total assets in India for the year ended March 2002 shows that Nationalized banks account for 46 percent of assets and 42 percent of net profits, State Bank Group accounts for 29.3 percent of assets and 29.8 percent of net profits, Old Private Sector banks account for 6.1 percent of assets and 8.7 percent of net profit where foreign banks account for 7.2 percent of assets and 12.9 percent of net profit where as new private sector banks account for 11.4 percent of assets but only 6.7 percent of net profit.

Asian Banking: Efficiency

The data published by the International Monetary Fund, for the latest year 2002, shows that the median Return on Assets is highest in Central Europe (1.4 percent), followed by Latin America (1.3) and Asia (0.8 percent). Asia showed sizeable recovery since 1997, when its Return on Assets was -0.8 percent that fell further in the next year to -1.4 percent, but has been gradually recovery since then to reach 0.8 percent by the year 2002. Differences in the ROA of banks in Asian economies as measured by the standard deviation which was at 8 percent in 1998 gradually declined to 0.5 percent by 2002. India has been maintaining a ROA of about 0.5 to 0.8 percent throughout the six year where as Indonesia showed rapid improvement in the last two years. Korea, Malaysia, Philippines and Thailand too showed gradual recovery in the ROA in the last two years.

Table-20 Return on Assets: Banks in Asia

	1997	1998	1999	2000	2001	2002
India	0.7	0.8	0.5	0.7	0.6	0.8
Indonesia	—-	-19.9	-9.1	0.1	0.8	1.8
Korea	-0.9	-3.3	-1.3	-0.6	0.8	0.8
Malaysia	—	—-	1.1	1.1	0.8	—
Pakistan	-1.2	0.5	-0.2	-0.2	-0.5	—
Philippines	1.7	0.8	0.4	0.4	0.4	0.7
Thailand	-0.8	-5.1	-5.4	-1.6	-0.2	0.7
Memorandum Items						
United States	1.3	1.1	1.3	1.2	1.1	1.4
Japan	0.0	-0.6	-0.5	0.2	0.0	-0.4
Canada	0.7	0.5	0.7	0.7	0.6	0.5
United Kingdom	0.9	0.8	1.0	0.9	0.6	0.7

Recovery of bank revenues is evident across the region. If SARS does not continue to be a major problem threatening China and East Asia, with the growth prospects currently foresee, banking industry in Asia could see further growth in the immediate term.

Risk management will however be crucial to realize and sustain gains. Median levels of Non Performing Assets of Asian Banks in 2002 remained more or less similar what it was six years ago. It does not mean that bad debts stopped growing in these banks, but only that they have managed to bring down from about a median level of 20 percent they have reached in 1998. The latest data puts bad debts of Asian banks at 10.3 percent of the assets, similar to Latin America but 2 percentage points than Eastern Europe. Non performing assets in India, Indonesia, Philippines, Thailand, Pakistan remain at higher levels, the problem of which could be further compounded by any setbacks in the economy either owing to developments in the domestic sector or international economy.

Table-22 Non Performing Loans to Total Loans: Banks in Asia

	1997	1998	1999	2000	2001	2002
India	15.7	14.4	14.7	12.8	11.4	10.4
Indonesia	—	48.6	32.9	18.8	12.1	10.6
Korea	5.8	7.6	11.3	8.1	4.9	3.8
Malaysia	4.1	13.6	11.0	9.7	11.5	10.3
Pakistan	20.1	19.5	22.0	19.5	19.6	—-
Philippines	4.7	10.4	12.3	15.1	17.3	16.4
Thailand	—-	42.9	38.6	17.7	10.5	10.4
Memorandum Items						
United States	1.0	1.0	1.0	1.2	1.5	1.6
Japan	5.4	5.8	6.1	6.6	7.4	8.9
Canada	1.1	1.1	1.2	1.2	1.5	1.6
United Kingdom	2.9	3.1	2.8	2.5	2.4	—-

Banks in Emerging economies have always been prone to crises. From 1980 to 1995 more than three-quarters of the members of the International Monetary Fund experienced serious and costly banking crises. In 69 of these countries, losses exhausted the networth of the entire banking systems. The cost of saving the banking system is anywhere between 10 to 50 percent of the gross domestic product. The experience of the last three decades shows that banking systems are prone to crises, and that these could happen in both rich and poor countries. But the ability of the emerging countries in swinging back to the strength and sustainability is an issue that continuously bothers international finance regulation from the point of view of stability and sustainability. Poverty rates rose faster from about 25 percent to 40 percent in Indonesia, from 15 percent to 25 percent in Korea and 10 percent to 15 percent in Thailand in the aftermath of the financial crises. Most of the Asian economies in the late 1990s experience severe and intense crises in the banking sector along with currency crises and major imperative emerging from this experience is that banks should be particularly careful in not only managing risk but also strategies for overcoming and combating the effect of contagion. Banking crises in some countries not only wiped off their entire net worth but also cost the governments almost of the size of the gross domestic product to put them back in business.

Table-21 Banking Crises

		Peak non-performing loans as % of total loans	Cost of restructuring : as % to GDP
Chile	1978-83	19	41
United States	1984-91	4	5-7
Norway	1988-92	9	4
Finland	1991-93	9	8-10
Sweden	1991-93	11	4-5
Mexico	1995-97	13	14
Argentina	1995	…	2
Brazil	1995	15	5-10
Thailand	1997	47	24
South Korea	1997	25	17
Indonesia	1997	55	58
Malaysia	1997	25	10
Philippines	1998	12	7

Sources : IMF, World Economic Outlook, May 1998; JP Morgan, Asian Financial Markets, 28 April 2000; World Bank, Global Economic Prospect and Developing Countries, Table 3.6; Barth, Caprio and Levine (2000), Table 12; central banks.

One encouraging feature is that banking systems across all the regions in emerging economies possess capital adequacy levels that are considered safe and sound.

The median levels of capital adequacy levels in banks in Asia, Latin and Central Europe are around 10 percent and these have been consistently showing improvement. Korea in the Asian region tops the regulatory capital as a percent to risk weighted assets, a trend which is evident in most of the countries, in particular Philippines, Malaysia etc.., Capital adequacy levels in Asian countries are much higher even compared to the banking systems in the mature economies. In India in the last six years this capital adequacy ratio hovered around 10 to 11 percent and given the subdued growth of assets, it remains pretty significant.

Regulatory Capital to Risk Weighted Assets in Percent : Banks in Asia	1997	1998	1999	2000	2001	2002
India	10.0	11.5	11.2	10.7	11.2	11.8
Indonesia	—	-13.0	-2.4	-18.2	19.2	23.7
Korea	—-	8.2	10.8	10.5	10.8	10.6
Malaysia	10.5	11.8	12.5	12.5	13.0	13.1
Pakistan	4.5	10.9	10.9	9.7	8.8	—
Philippines	16.0	17.7	17.5	16.2	15.4	17.5
Thailand	9.4	10.9	12.4	11.9	13.9	14.3
Memorandum Items						
United States	11.5	11.6	11.6	11.7	12.4	12.6
Japan	9.1	9.4	11.5	11.9	10.9	10.5
Canada	10.0	10.7	11.7	11.9	12.3	12.6
United Kingdom	13.6	12.4	13.6	11.8	12.2	12.5

Table-23

Source: International Monetary Fund

Despite overall improvement in various aspects of operational efficiency, the financial strength of banking systems remains a matter of great concern. The median level Moody's financial strength index for Asia in 2002 stood at 16.7 percent as against 30.2 for Eastern Europe,20.9 percent for Latin America. The position of India is much above the Asian average but as compared to the banking systems in mature economies (excepting Japan), it is far lower.

Moody's Bank Financial Strength : Asia	2001	2002
India	25.8	27.5
Indonesia	1.7	5.4
Korea	14.2	16.7
Malaysia	30.4	31.7
Pakistan	2.1	5.0
Philippines	17.5	20.4
Thailand	15.8	15.8
Memorandum Items		
United States	77.1	75.0
Japan	16.7	12.9
Canada	77.1	75.0
United Kingdom	83.8	83.8

Table-24

Constructed according to numerical scale assigned to the different weighted average bank ratings by country.

Asian Banks: A Snapshot

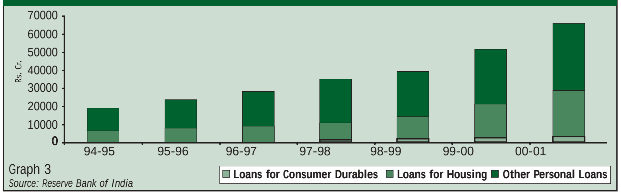
Emerging Issues

Recent trends in banking across the world, which is evident in Asian banking also, are (a) growth of personal banking and credit (b) corporates increasing accessing bond markets for their resource requirements (c) increasing use of technology and growth of online banking (b) shifts in revenue stream from being interest income based to fee based and (c) a greater degree of consolidation to achieve economies of scale. A brief discussion on each of these is given below.

Growth of Personal Banking

Asian banks experienced enormous growth in personal banking in the recent period fuelled by expansion in household credit, online banking, credit cards etc., In Korea, household credit now accounts for about half of the total outstanding bank loans and this trend was evident in several other Asian economies. In China as per a recent report of the Lehman Brothers, mortgage and consumer credit in China grew by 70 percent in 2001 and already reached 10 percent of the total bank loan outstanding. Korea, Thailand, Malaysia, Taiwan and Philippines experienced growth in credit cards in the range of 20 percent in 2002 and China's credit card market is expected grow between 75 percent to 100 percent in the next three years. In Korea value of credit debt now accounts for about 16 percent of the total household borrowing and about 11 percent of the total private credit outstanding. In 2002, Value of credit card debt outstanding has registered a growth of 47 percent in Korea, 34 percent in Philippines, 30 percent in Thailand, 28 percent in Taiwan, 21 percent in Malaysia and as a percentage of total domestic credit, it ranges from 3 percent in Malaysia to 11 percent in Korea.

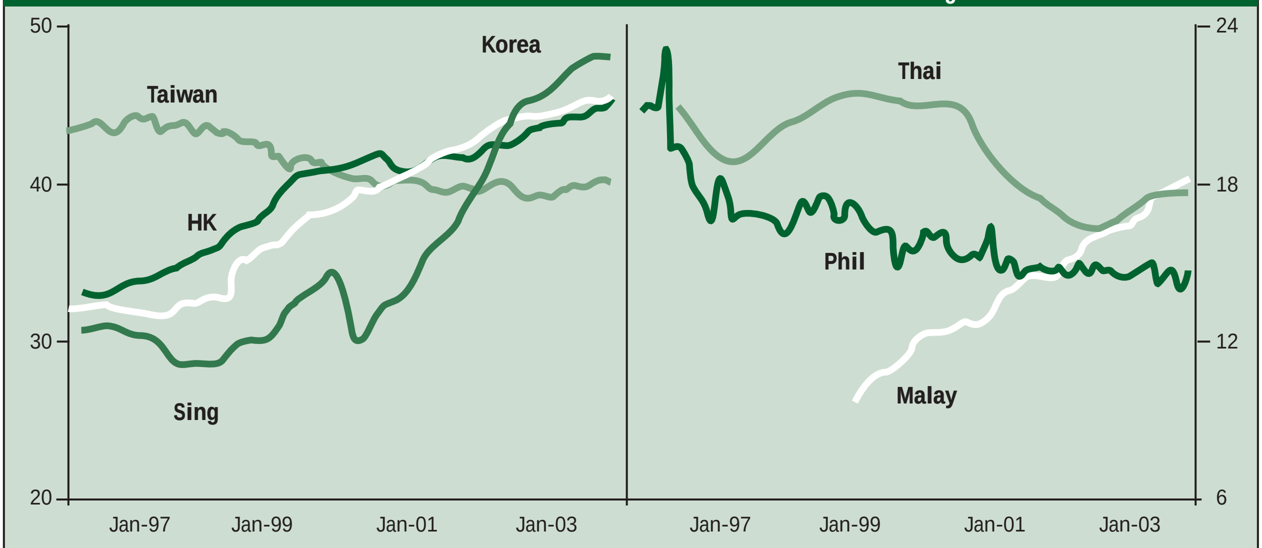
G-119 Growth of Personal Loans: India



Graph 3

Source: Reserve Bank of India

G-120 Banks Loans to the Household Sector: Percent Loan Outstanding



Graph 2

Source: CEIC Data Co. Ltd. and Lehman Brothers

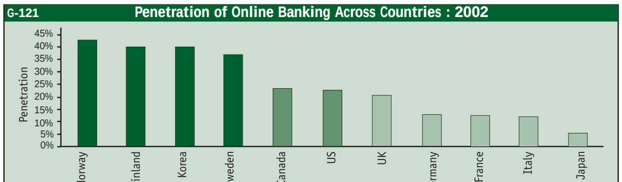
Growth in the household credit/personal loans was further accentuated by a number of relief measures announced by the governments to promote housing loans, use of credit cards and supplemented by additional measures announced by banks such as fee waivers, higher credit limits etc.,

With growth of personal banking and household credit, banks are transforming from a transaction-based activities to process based activities that requires sophistication in risk management. While growth of personal loans is expanding consumerism in many Asian economies, which is fine for the regional economies

Online Banking

Online banking is expanding at rapid rate in Asian economies. According to a recent report released by AC Nielsen Online. Active online banking population in the five major Asian ecno0mies of of South Korea, Hong Kong, Singapore, China and Taiwan, grew 63 percent in 2001 taking the regional total from 6.5 million to 10.6 million during 2000-01. The report also shows that 38 percent of regular internet users across now use online banking services, compared to 29 percent a year ago and 16 percent two years ago. South Korea tops online banking population with 5.3 million, followed by China 2.6 million, Taiwan 1.7 million. Of the top 20 internet banks, South Korea has 12, China 5.. Levels of customer satisfaction are found to be higher among the customers of Internet banking. The percentage of internet users in favour of switching over to internet banking is high thought the region from 76 percent in Taiwa to 93 percent in China and 65 percent in Korea. In countries such as United States, online banking adoption will rise from 22 percent in 2002 to about 38 percent by 2010. Details of Internet penetration in major banking systems are given in the graph. In the 1990s banks laid great thrust on Internet banking drawing from the estimates of very lower cost of transactions in Internet banking. (A US Department of Commerce estimates notes that cost of a transaction on Internet banking is $0.01 as compared the $1.07 for physical branch and 0.52 for phone banking and $0.27 for Automated Teller Machines).

G-121 Penetration of Online Banking Across Countries : 2002



Graph 4
Source: Celent / Nielsen

An interesting development of the growth of Internet banking is that it could promote more of brick and mortar banking as well. A recent report of the Nielsen/Net Ratings observed, " In virtually every market, it is the traditional, established brick and mortal banks that are attracting the biggest audiences. A large majority of online customers are most likely also customers of the in-person bank branches".

A recent report in the Business Week says that in the height of Internet boom, big banks declared bank branching dead and were aggressively investing in technology instead. They hoped to win over customers to their new electronic systems and cut back on expensive bricks and mortar. So they spent heavily on call centers and website and also opened less costly minibranches in grocery and discount stores. For seven years, Bank One discouraged customers from patronizing its branches by slapping a $3 fee on any transaction involving a teller. At the same time, it invested $150 million in WingspanBank.com, its separate, Internet only bank. Despite a growing array of online options, customers continue to open 80 percent of new checking and savings accounts at branches. After a decade of slow, growth in deposits, banks are now benefiting from the stock market slump as customers stash money their banks. Multiproduct offerings are hoped that will enable branches sustainability. US's six largest banks have opened just 120 branches in 2000 which increased, to 158 in 2001 to 242 in 2002, and expected to open 486 in 2003 and 550 in 2004. Washington Mutual now is opening branches with a radically different look, serving coffee in the café like settings, providing play areas for kids. WaMu opened 144 branches last year and is planning 230 this year. ATMs in early 1980s and Internet in late 1990s. This trend could flow to the Asian banking systems too soon.

Consolidation

Asian economic crises brought in several changes in the banking landscape. Not only the prudential regulation was stepped up but the consolidation of banks too followed in order bring in greater efficiencies and financial stability. While bank mergers in the mature economies were more market induced and to gain greater synergies between different market segments (such as Citibank/travelers) in the emerging economies, policies too supported the consolidation of the banking industries to enhance strength of the banking system and its sustainability. This trend was evident in many of the emerging economies. Though not much progress took place in foreign acquisitions of domestic banks in Asia, consolidation within the domestic banking institutions is significant and sizeable.

The Pace of Bank Consolidation in Asia.

Table-25

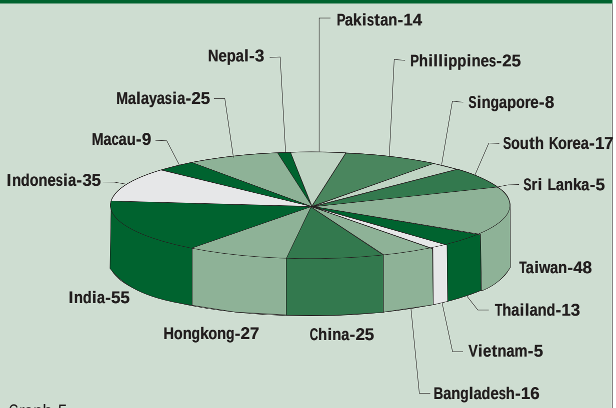
Country	Number of Banks	
	1994	2000
Korea	30	13
Malaysia	25	10
Philippines	41	27
Thailand	15	13
Argentina	206	113
Brazil	245	193
Chile	37	29
Mexico	36	23
Venezuela	43	42
Chechoslavakia	55	42
Hungary	40	39
Poland	82	77
Turkey	72	79

Source: Gaston Gelos and Jorge Roldos; 2002, Consolidation in Market Structure in Emerging Markets Banking Systems. International Monetary Fund. May 2002.

Consolidation is taking place at a rapid pace in Asia and the most targeted banks for acquisition are the family owned banks. According to a recent report JP Morgan says that about 60 percent of the bank M&A in Asia are targeted at family owned banks. Great scope exists for further bank consolidation in Asia and also in several countries in the region.

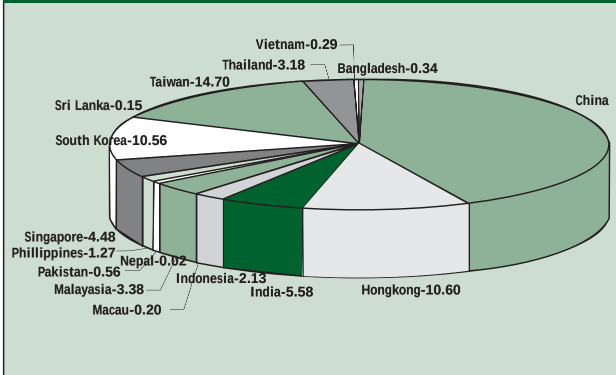
The size and strength of banking systems in Asia is vastly varied. In the top 330 Asian Banks, as compiled by Asia Week 500 (excluding Japan, Australia and New Zealand) China's 25 banks account for 42 percent of the bank assets, where as Taiwan's 48 banks account for 15 percent of the bank assets. India with 55 banks represented in the top league accounts for just less than 6 percent of the bank assets. Bank consolidation in South Asia has been relatively at a slow pace as compared to South East Asia.

G-122 **Country-wise Banks in AsiaWeek 500**
(Excluding Asutralia, Japan and New Zealand)



Graph 5
Source: AsiaWeek

G-123 **Share in Assets (percent)**
(Excluding Australia, Japan and New Zealand.



Graph 6
Source: AsiaWeek

A brief business profile of each of the Asia's banking system as compiled from The Banker's Top 1000 Banks in the World in the last decade is given below. The data presented in this table might differ from the data on banks given above, since the table below is compiled from the list of the banks featured in the top 1000 banks from each of these countries and their respective assets and pre tax profits.

Table-26

Country	Number of Banks			Tier One Capital			Assets			Pretax Profit		
	1990	1995	2001	1990	1995	2001	1990	1995	2001	1990	1995	2001
East Asia												
China	9	6	15	17035	33218	87346	297991	1016667	1802004	2572	3958	4042
Hong Kong	9	20	13	8205	10754	19699	173886	120479	322053	N.A.	1779	5679
Singapore	5	6	3	5063	14367	16032	54674	126449	188995	232	2182	1913
Taiwan	16	37	41	7896	26255	36444	215503	469909	584203	2324	3559	2045
Malaysia	4	10	13	1564	6613	9567	29069	104735	134336	261	1903	1400
Indonesia	9	14	5	2795	5967	2442	55536	104209	54886	599	1086	3656
Korea	24	30	14	19987	28692	23489	303000	482105	553266	1545	1998	7808
Philippines	8	10	13	1324	4209	4695	11427	37678	45949	345	676	164
Thailand	12	12	8	4308	11758	5949	70443	171260	112472	878	3907	-167
South Asia												
India	8	13	20	2772	5123	9415	86384	103971	220176	340	-288	1677
Pakistan	4	2	2	746	445	292	15307	13801	11873	88	111	55
Eastern Europe												
Czechoslovakia	—	4	—	—	2655	—	—	43473	—	—	416	—
Hungary	5	3	6	1202	633	1329	19916	11459	18315	652	164	415
Poland	—	7	—	—	2586	—	—	34359	—	—	1091	—
Latin America												
Argentina	6	10	12	2633	5970	8453	19648	44008	91119	509	399	218
Brazil	20	29	22	9844	26495	24061	147144	293315	280134	2325	872	5371
Mexico	7	9	6	4197	4460	7774	88054	110452	137454	1236	372	1437
Chile	3	4	8	858	1767	3588	11820	25628	54532	124	409	739
Middle East												
Israel	5	5	6	4176	6492	8864	93462	121999	174194	486	892	1008
Saudi Arabia	10	10	10	4947	9416	12797	67018	89148	123762	711	1472	2179
Africa												
South Africa	5	6	6	3380	6629	7074	69418	115016	127942	838	1744	1403

Issues and Imperatives

Major aspects that the above data and description brings out is that banking in Asia is expanding and diversifying.

In operations, banks continue to be major forces in financial intermediation, though the recent period witnessed a sharp growth in consumer credit, as corporate sector are moving more towards bonds and equities for their financing. Online banking is rapidly growing across all countries in the region and so as the card business. Growth of personal credit is also considered for responsible for reviving domestic economic growth in some economies. But already concerns about growth of personal debt are increasing in many countries. Financial Service Authority of UK in a recent paper discussed at length various issues involved in the growth of personal debt and in Korea, which witnesses sharp surge in household credit recently announced several measures to reduce the rate of its growth In June 2002, Korean authorities increased the loan loss provisioning requirement for consumer loans, lenders are advised to share customer information on borrowers with large credit limits and outstanding, reduced loan to value ratios for housing loans, increased risk weightage for home loan mortgages etc., Growth of personal banking gives scope to new types of risk that banks should be well handled to assess and monitor.

In efficiency, banks are once again slowly returning to healthy rates of return and containing bad debts though, Asian banks have yet to go a long way to reach the desired and established standards that are evident in stronger banking systems. South East Asia had addressed to issue of resolution of non-performing assets in a much more focused manner and creating suitable asset reconstruction mechanisms. Most of the banking systems are now suitably capitalized which should not be a major constraint for the continuation of banking growth. In view of the rapid decline of the interest rates in the recent period, there could be some pressure on the margins, but more of consumer credit would mitigate this problem to certain extent as long as the risks are managed. These changes move banks more towards to fee based earnings (see box for shifts in revenue patterns of banks in mature economies) on line with the trends evident in developed banking systems, but the transformation from transaction based to process based activity will give rise to new types of risks which banks should ready to assess and cope up with.

In structure, significant consolidation is taking place, though the growth of foreign ownership is not sizeable. With continued pace of international coordination on creating strong and sustained financial architecture, initiatives for giving more access to foreign ownership and consolidation within the domestic institutions could gain speed. Already in much of Asia family owned banks are increasingly targeted for acquisition. More or less the pace of globalization and removal of controls and barriers which could gain further momentum could also give to rise to large regional banks

The contribution of banking in the economic growth is immense in respect of Asia, its role has been significant and sizeable Strong and sound banking systems are critical for sustaining the pace and momentum of growth of real sector and also ensure welfare of the society. A World Bank report on Finance For Growth observes, "It is obvious that advanced economies have sophisticated financial systems. What is not obvious, but is borne out by the evidence, is that the services delivered by these financial systems have contributed in an important way to the prosperity of these countries. They promote growth and reduce volatility, helping the poor. Getting the financial systems of developing countries to function more effectively in providing the full range of financial services-including monitoring of managers and reducing risk-is a task that will be well rewarded with economic growth. At the same time, it is the banking systems that have the evidence of becoming most vulnerable at the first signs of opening up or financial liberalization. The World Bank report sums up " If finance in fragile, banking is its most fragile part". The most important aspect of managing better banking is through responsibility of major constituents of the banking systems, right type of regulation and quality of response in a crises (see box 2) The last two decades of financial liberalization, equipped banks with enormous experience and expertise in dealing with a wide range of challenges and crises. This hopefully would be handy for them in charting new areas of growth in the background of next generation reforms. Then banking could generate and sustain long-term prosperity.

Who is Responsible for Banking Safety

Owners, including the Board and Senior Management of the bank, whose networth should depend on the prudent performance of the institution

Markets, meaning all nonofficial outside creditors and counterparties, who should not be under the presumption that they will be bailed out

Official Supervisors, who should operate within a well-constructed incentive structure

Right Type of Regulation

Works with the market, but does not leave it to the market

Keeps authorities at arm's length from transactions, lessening the opportunities for conflicts of interest and corruption

Promotes prudent risk-taking, meaning risks borne by those most capable of bearing it, for example, removing distortions that lead to too little direct investments, too little equity finance, too little long term finance, and too little lending to small firms and the poor

Response to Restrict Banking Crisis.

Screen out imprudent, incompetent, dishonest bank owners:

Fit and Proper Tests that bank owners and managers must pass to quality for banking license

Prudential Supervision that covers both leverage and asset quality

Capital adequacy, risk management, restrictions on connecting lending etc.m

Termination Authority in case of excessive insolvency exposure

Regulation disposition of bank before it exhausts its networth and causes losses to depositors

Deposit Insurance

To protect depositors from loss and remove the incentive for depositors to run from other banks thought to be jeopardy

Lender of the Last Resort

To enable solvent institutions to meet the claims of liability holders by borrowing against assets rather than selling illiquid assets at firesale prices

Protection of Monetary Authority from Cumulative Collapse

By neutralizing any shift in the public's demand for cash thus protecting the volume of bank reserves

Richard Herring, Anthony Santomero:2000- What is Optimal Financial Regulation, The Wharton School, University of Pennsylvania, Financial Institutions Center

Box 1: Shifts in Banking Revenues: Experience of Developed Nations

Richard Herring, Anthony Santomero, of the Wharton School, University of Pennsylvania, Financial Institutions Center in their recent paper "What is Optimal Financial Regulation" present some interesting perspectives on the shifts in the liabilities and asset side of banks in US and Europe, a few of which are reproduced below.

Banks time and savings deposits relative to fixed income mutual funds during the period 1980-97 declined from about 98 percent to 70 percent, and during the period 1974-98, checkable deposits relative to money market mutual funds declined from about 100 percent to less than 60 percent. Between 1990 and 1995 the relative share of commercial banks in total financial intermediary assets declined from about 55 percent to about 30 percent, where as the share of the pension, trust and investment companies rose from about less than 20 percent to about 30 percent, that of thrift and finance companies from slight over 10 percent to 15 percent. Commercial and industrial loans which formed about 80 percent of the short term business finance in 1960 fell to about 50 percent and the share of finance companies loans rose from 20 percent to about 30 percent. Market share of banks in credit card receivables also showed a significant fall from about 95 percent in 1986 to about 25 percent in 1998. Banks lost market share to non banks such as AT&T, GMAC, GE etc.,About 80 percent of the credit card transactions are processed by non banks such as First Data Resources.Securitised mortgages as a percent of total mortgages between 1980 and 1998 rose from about 10 percent in 1980 to about 45 percent in 1998. Net Interest income less charge offs as a percent of financial sector GDP declined from about 0.4 percent in 1977 to less than 0.3 percent in 1997. Although intermediation business has declined, banks have managed to prosper nonetheless by shifting from traditional intermediation functions to fee producing activities such as the trusts, annuities, mutual funds, mortgage banking, insurance brokerage and transaction services. Non Interest Income as a percent of financial sector GDP in the US rose from about 0.1 percent in 1977 to about 0.2 percent in 1997. Despite structural changes in the asset liability mix and income streams, banks value added as a percent of gross domestic product remained more or less same during the twenty year period 1977-97 (with minor variations in between) at about 0.5 percent. The authors sum up" Overall, banks are holding on their own, but with a very different configuration of earnings. Spread income accounted for about 80 percent of bank earnings only a decade ago. Now most large regional and money center banks ear more than half of their income from fees and trading income.

Despite European banks being universal and having permitted to undertake a much broader range of services than the American counterparts (such as underwiritng, direct purchase of equity in the industrial sector, investment management and wide array of securities activities) shifting trends in revenue streams were evident. The ratio of interest income to fee income during the two periods; 1986-88 and 1993-95 of Belgium declined from 3.60 percent to 2.57 percent, in Germany from 4.04 percent to 3.70 percent, in France from 4.17 percent to 1.40 percent, in Spain from 4.68 percent to 3.24 percent, in United Kingdom from 1.73 percent to 1.30 percent and in Sweden from 2.22 percent to 1.30 percent. Fee income relative to interest income during these two time periods has shown an increase of 29 percent in Belgium, 67 percent in France, 31 percent in Spain, 25 percent in United Kingdom, 42 percent in Sweden.

Formerly a bank originated, funded and services the mortgage until it was repaid. Now one firm may originate the mortgage. Another firm may fund the mortgage or pool the mortgage with others and partition the anticipated flow of income from the pool into marketable securities that will appeal to particular groups of investors around the world. Another firm many insure the pool of mortgages to facilitate the process. The servicing of the mortgage may be allocated to yet another specialist firm that has data processing expertise. The consequence is that mortgages will be funded at lower cost that if firms were obliged to hold mortgages to mature and what was once an illiquid bank asset is transformed into a highly marketable security. This unbundling can be executed smoothly that the mortgage may be entirely unaware that it has taken place. These techniques have been successfully applied to many other kinds of credit transactions including credit card receivables, auto loans and small business loans.