# Tapping China's Booming Retail Banking Market

*by Bruno Lannes, Oliver Stratton, Frank Su and Gary Turner*

THE PEOPLE OF China are world-class savers who routinely bank more than a quarter of their incomes. But they are also beleaguered consumers. Long held captive to state-owned banks that haven't invested much in wooing them, they earn virtually nothing on their deposits, have minimal access to personal loans or lines of credit, and they must tolerate long waits at branch offices offering poor service for their trouble. That's all beginning to change.

With the opening in late 2006 of China's financial services sector to global competition consistent with World Trade Organization guidelines, foreign banks will be freer to challenge domestic banks' lock on China's savers and borrowers. Under the new rules, foreign banks are required, like their domestic competitors, to incorporate their Chinese subsidiaries locally, commit a minimum capital of one billion yuan ($127 million) and hold at least 100 million yuan of operating capital in each branch. To be sure, foreign banks are still hamstrung by rules that limit total loans they issue to no more than 75% of the deposits they attract. And they have to have operated in China for at least three years and be profitable for two consecutive years before they become eligible for a domestic retail banking license. Less formal restrictions will likely continue to impede full market access for foreign banks, but these historic opening moves portend a vast new array of choices in financial services for Chinese consumers.

The gradual leveling of the competitive field has banks jockeying for position. The competition pits top foreign-owned banks—which are buying stakes in Chinese institutions—against the four mammoth state-owned national banks, with branches numbering in the tens of thousands. Also in the fray are China's 112 city commercial banks—each operating mainly in the territory surrounding a large provincial city—and 13 domestic joint-stock banks—more market-oriented institutions that are sprouting branch offices in China's major commercial centers.

The prize awaiting the banks that can win Chinese consumers' hearts and wallets will be huge. Chinese savers hold some 325 million individual accounts, totaling nearly $1.8 trillion. Meanwhile, rapidly rising personal incomes are feeding demand for credit and investment products. The total value of mortgage loans is forecast to jump to some $725 billion and generate over $3 billion in banks' after-tax profits by 2010. And a projected fivefold increase in the number of households that can afford to purchase a car is expected to increase the total value of car loans to nearly $50 billion by decade's end.

But what will consumers look for from retail banks as the courtship heats up? To find out, Bain & Company commissioned an exclusive survey based on face-to-face interviews with nearly 7,500 customers of 20 domestic state-owned and publicly traded joint-stock banks in eight major cit-

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ies. The results document respondents' generally low opinions of the retail banking options available to them today. They also point to a long agenda of improvements that banks aspiring to be customer-focused leaders will have to accomplish as a competitive financial-services marketplace takes shape.

*China's banking masses are restless, and their business is up for grabs.*

The key finding: China's banking masses are restless, and their business is up for grabs. Respondents were asked to rate, on a scale of zero to 10, "How likely are you to recommend your bank to a friend or colleague?" Those answering with a top rating of 9 or 10—a group we categorize as "promoters"—were vastly outnumbered by "passives" and "detractors," who answered with scores of 7 or 8 and zero to 6, respectively. Subtracting the percentage of detractors from the percentage of promoters yields a Net Promoter® Score (NPS)—a number that Bain research has found to be the single most reliable predictor of organic growth. With an NPS of just +4%, consumers are delivering a strong declaration of dissatisfaction with business as usual.

The Net Promoter results were not uniformly bleak, however. Beneath the aggregate score lurk big differences from city to city and bank to bank—even from branch to branch within a given institution. We found telling differences among customers by such key demographic characteristics as household income, occupation and age group—with wealthier, more professional, and younger consumers showing up among the most dissatisfied.

With ordinary Chinese customers now beginning to have a large say in which financial service providers will succeed or fail, banks that develop the capacity to cultivate promoters stand to gain a big lead over their rivals. On average, Chinese consumers maintain between two and three accounts at as many different institutions, simply because no one bank can adequately service all their needs. Banks that make convenient one-stop banking possible should reap a bonanza from grateful customers eager to consolidate their accounts.

With so much at stake, foreign and domestic banks should focus on three large tasks: identifying their true customer assets, connecting with affluent consumers and building the foundations of a genuinely customer-centric bank.

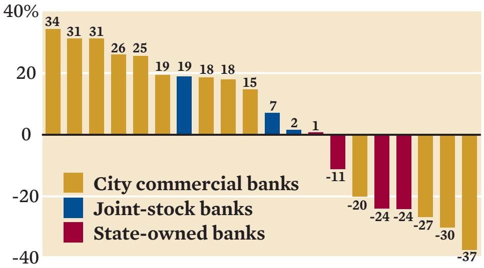
## Find your true customer assets

AS FOREIGN AND Chinese banks scramble to forge alliances, they must be able to identify capabilities in their potential mates that allow them to accomplish as a team what neither can do alone. But it's hard to find the perfect partner; the reality is that each side brings to any collaboration some distinct disadvantages. For their part, foreign banks remain hamstrung by government regulations despite the formal market opening. Ownership stakes in a Chinese bank remain capped at 20% for one foreign investor, and 25% for all non-Chinese equity stakeholders. Thus, international banks will have to work with well-situated domestic allies to assemble anything more than a rudimentary branch network, and they will want to tap their Chinese partners' established relationships with regulators to help open doors to future expansion.

Meanwhile, it may prove difficult to spot any customer-friendly qualities that domestic banks may possess. Even after

**CUSTOMER SATISFACTION**

*Chinese banks varied greatly in Net Promoter Score*




SOURCE: SINOMONITOR BANKING SURVEY, BAIN ANALYSIS

years spent trying to shed nonperforming loans, the balance sheets of most large state-owned banks remain weak. They will be looking to their Western partners for infusions of capital, advanced information technology, management expertise and help developing new products.

Because of the ownership limits that will continue to constrain them, foreign banks will want to place their bets carefully. Identifying domestic banks that score high with customers—or that demonstrate a commitment to invest in cultivating them—should be high priorities for any foreign institution. The odds look best in six East-coast provinces of Guangdong, Shanghai, Shandong, Beijing, Zhejiang and Jiangsu, where China's economic growth is concentrated and which together account for half of all deposits and loans. Among banks based in this region's eight top urban centers, the Bain NPS survey found a wide variation in consumers' ratings of the 20 major banks we examined, ranging from a strong +34% to a deeply disaffected -37% (see chart nearby).

The "Big Four" state-owned giants look like especially poor prospects as partners—all fell far below the average for the banks in the study, and their sheer size makes them unlikely to easily be set straight. More promising are the city commercial banks clustered near the top of the rankings and the joint-stock banks, which are answerable to shareholders. Nine of the 10 top-rated banks in the Bain survey were city commercial banks, underscoring the fact that retail banking remains a local business. Cultivating a strong local partner in a big urban center is helping HSBC establish an early competitive edge, for example. Announcing its goal to become China's "local international bank," the big London-headquartered firm stirred widespread skepticism when it paid $63 million in 2001 to buy an 8% stake in the Bank of Shanghai—one of the first strategic investments made by a foreign bank in China. With its base of more than 200 branches serving some 8 million customers in China's most vibrant commercial center, Bank of Shanghai had plenty of superficial appeal for a newcomer wanting to jump-start its presence on the Chinese mainland. But like most state-owned banks, it was hobbled by antiquated operating systems and no institutional aptitude for customer service.

Since teaming up with HSBC, Bank of Shanghai has reinforced its balance sheet, raising its capital adequacy ratio to a healthy 11.1%. Tapping HSBC's technical expertise, the bank upgraded its core service center to speed up the processing of account transactions. But perhaps the biggest transformation was a fundamental change in attitude about customer service. Instead of forcing customers to settle for the products and services the bank deigned to offer, products are being tailored or redesigned to fit customers' needs. In early 2004, Bank of Shanghai issued the first foreign-currency-denominated credit card co-branded with HSBC, and expects the number of cards in use to increase to one million this year. Bank of Shanghai will also soon begin offering small business loans through all branches in its network. The new focus on pleasing customers has elevated Bank of Shanghai's Net Promoter Score to a healthy +19%, the top rating among the nine banks serving China's second-most populous city.

## Pamper affluent customers

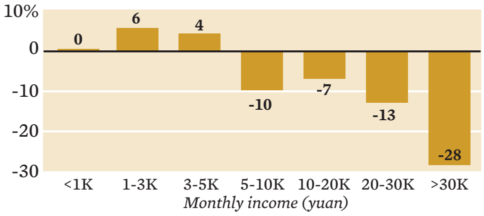
ONE CUSTOMER GROUP that will be squarely in the cross hairs of any retail bank hoping to build a profitable presence is China's newly affluent population. A large and fast-growing group, this segment comprises the wealthiest 20% of Chinese households—some 75 million strong—with annual incomes exceeding 20,000 yuan ($2,500). At the upper reaches of China's widening wealth distribution, the number of Chinese with investable assets of $100,000 or more now exceeds 4.5 million households, a near doubling in the past five years. And at the very top of the ladder, the wealthiest 1.6 million households own assets totaling $820 billion, second only to Japan as Asia's largest market for wealth management services.

What makes the newly affluent especially attractive is their profit potential to banks that win them as customers. Although the well-off make up just 2% of banks' retail customer base, they account for more than half of all bank profits. Banks will have to work for their money. Indeed, as the incomes of respondents in the Bain survey increased, the Net Promoter Scores they gave their current bank plunged, making these discriminating clients the likeliest to switch their financial services provider as choices expand (see chart nearby).

Foreign banks look to be the biggest beneficiaries of such discontent. They bring to China decades of experience serving wealthy clients in their home markets. Moreover, because high-income Chinese are concentrated in the large cities on China's Gold Coast, foreign banks can provide a full complement of services with just a few domestic branches. Finally, their extensive international network of offices makes it easier for foreign banks to connect their Chinese customers to banking services around the world.

**AFFLUENT AND DISSATISFIED**

*Higher-income customers are more demanding and have significantly lower Net Promoter Scores*




SOURCE: SINOMONITOR BANKING SURVEY, BAIN ANALYSIS

Like many big foreign banks, U.K.-based Standard Chartered is making the pursuit of high-net-worth customers a centerpiece of its China strategy. Now with 11 branches and four sub-branches in China's biggest cities, Standard Chartered launched its "Priority Banking" service for its wealthiest customers, who maintain an average quarterly account balance of at least $100,000. The bank cossets these top-tier clients with personal financial advisers, poshly appointed banking centers, a wide range of foreign-currency investment products and a dedicated 24-hour customer-care hotline. Extending its reach to less afluent customers, Standard Chartered also offers a more accessible Integrated Banking Service with lower balance minimums. In early 2006 the bank introduced "Easigo" electronic travel checks, making it possible for Chinese nationals to use an electronic payment card for purchases and cash withdrawal when they travel overseas.

It will not be easy for domestic banks to match their foreign rivals' expertise in catering to wealthy customers. But some are beginning to add convenience and technical innovation in an effort to reach China's newly affluent small-business owners and professionals. For example, Industrial and Commercial Bank of China (ICBC), with 20,000-plus branches and more than 100 million account holders, has invested heavily to develop its online "Banking@Home" service, allowing computer-savvy account holders to bypass crowded teller windows. By the end of 2005, ICBC Internet banking had attracted nearly 15 million personal customers and 325,000 corporate accounts, with a trading volume totaling some $5 trillion. According to a Bain analysis, the penetration of Internet banking services in China will reach 30% of all computer users by 2008—about the same level attained in the U.S. in 2002.

## Build a customer-centric bank

AS DOMESTIC BANKS and foreign strategic investors tackle the large job of sorting out their partnership relationships, they will also have to give customers a prominent place at the table. The Bain survey found that Chinese customers couldn't be clearer about what they want. The list of product and service features that consumers identify as important to their banking experience is a long one—ranging from privacy safeguards and accuracy in handling transactions to the perceived strength of the bank's brand name and the breadth of products offered. But the Bain survey found that about one-half of both promoters and detractors interviewed cited the same three service attributes—a convenient branch network, short waits for service and helpful bank staff—which they said most influence their attitude about their bank.

The benefits that redound to banks that consistently provide an outstanding customer experience are hard to overstate. Among respondents to the Bain NPS survey, promoters were twenty times less likely than detractors to defect to another bank. Promoters were also more than twice as likely as detractors to recommend their bank to a friend or colleague. And they are more willing to concentrate their accounts in a single bank, vastly increasing the lifetime value of the relationship.

The Bain NPS study found early signs of banks that are becoming more customer-focused. China Merchants Bank, one of the new breed of publicly listed, national joint-stock company banks, looks primed to be one of them. Originating as a second-tier bank headquartered in the booming southern city of Shenzhen, China Merchants used to be overshadowed by the giant state-owned banks and the local city commercial bank that dominated corporate lending. Responsive to shareholders since floating its initial public offering in 2002 in Shanghai, the senior management team committed to differentiate their institution by becoming a full-service national retail bank. Over the past three years, China Merchants became one of the first banks to offer fixed-rate mortgages, giving prospective homebuyers—qualified applicants with good credit records and willing to open long-term accounts—the lowest borrowing rates in the industry.

The formula is working. Though the bank is only China's sixth-largest in terms of total assets, it has become one of nation's foremost issuers of credit cards, with five million in circulation. Through the end of 2005, customer deposits grew nearly 24% over the prior year, to some $80 billion, capping two successive years when profits grew at a double-digit rate. China Merchants President Ma Weihua expects retail revenues to double as a proportion of total revenues, to 40% by 2010, and he looks for the bank's branch network to more than double, to more than 1,000 offices.

Even as domestic and foreign rivals scurry for advantage as the regulatory barriers fall, the job of implanting a customer-centric mindset where none previously existed will require a years-long effort. As they build alliances, compete to serve the newly affluent and address a long legacy of service shortcomings, banks that make China's restless consumers their partners will lead the long march to a consumer-friendly—and profitable—future.