
**STUDY**

# Myanmar Banking Sector 2025: The Way Forward

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## Myanmar's banking sector as a key growth driver

In any country, financial services sector occupies a unique place among all business sectors. It plays a vital role as a catalyst for overall economic development, seeding growth in other sectors by providing the necessary funds to various economic agents, namely private individuals and corporations. It is also in itself a key business sector contributing a large number of well qualified and high earning jobs and is arguably the largest sector in the world in terms of revenues.

No developed nation has reached an advanced stage of development without a relatively large, sufficiently successful and reasonably sound financial sector. No developing economy has enjoyed sustainable economic growth without a sound expansion of its banking sector. Ultimately, the banking crisis experienced around the world and its effects rippling through the economy is testimony to the significance of banks in modern economies.

Myanmar will be no exception. The creation of a sound, inclusive and successful banking sector cannot be taken out of the country development equation, no matter what the other priorities may be.

Myanmar's banking sector has atrophied over the years and suffered many ailments. Despite a recent resurgence, it remains small and unable to provide the required financing to support fast paced economic growth. Fixing these shortcomings is a daunting task considering the current inefficiencies.

That said, the underdeveloped state of the banking sector presents an opportunity to put in place the right framework and initiate the necessary adjustments before sheer size makes this kind of rectification more complicated.

Based on market needs and current shortcomings, far-reaching reforms under the stewardship of the Central Bank of Myanmar (CBM) coupled with significant and steady efforts from all stakeholders to implement change (Ministry of Finance, CBM, commercial banks) are a must.

We believe that Myanmar's banking sector has a bright future and we foresee exponential growth for the industry, slated to multiply its current asset base by a factor of eight and create over 120,000 jobs by 2025.

This study discusses and substantiates:

1. The current situation and challenges for the banking sector
2. The short- and medium-term actions necessary to enable banking sector transformation
3. The positive outlook for the banking sector through 2025

# 1. Current situation and challenges for the banking sector

## 1.1 Status quo – Sector at a crossroads

Compared to other ASEAN countries, the contribution of Myanmar's banking sector to the economy is limited. Myanmar's banking-assets-to-GDP ratio of 49% is the lowest among ASEAN peers. However, starting from a very low base, Myanmar's banking sector is one of the fastest growing in the region, a fact highlighted by an asset growth rate of 18% over three years compared to approximately 10% in Vietnam. In addition to pure asset growth, factors such as low financial inclusion, with 30 million or 77% of the population remaining unbanked (without an account with a financial institution) and only 2% holding debit cards, underline the need and the potential for catch-up and growth.

Figure 1: Banking-assets-to-GDP ratio, 2015 [%]

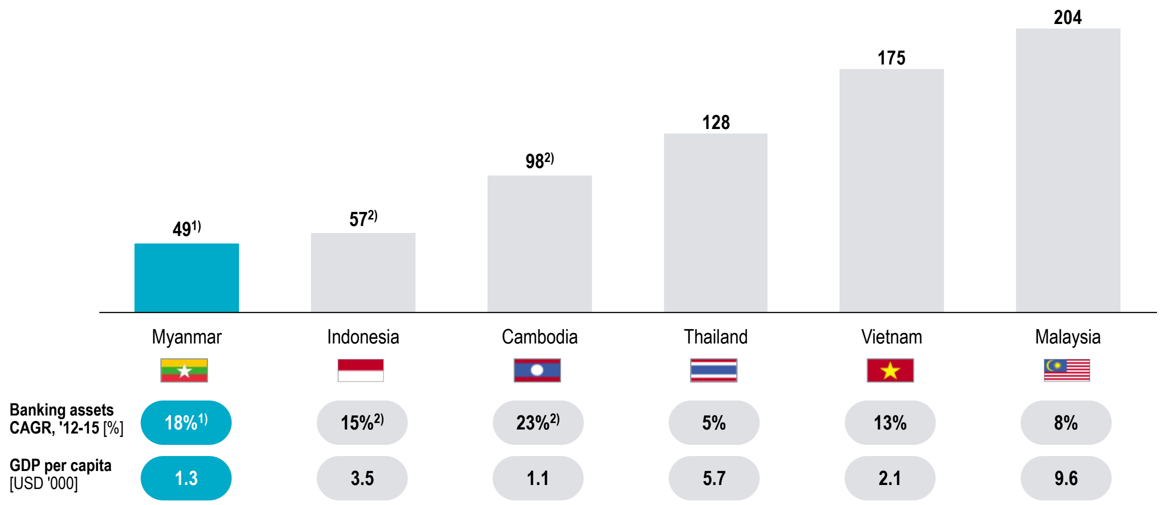
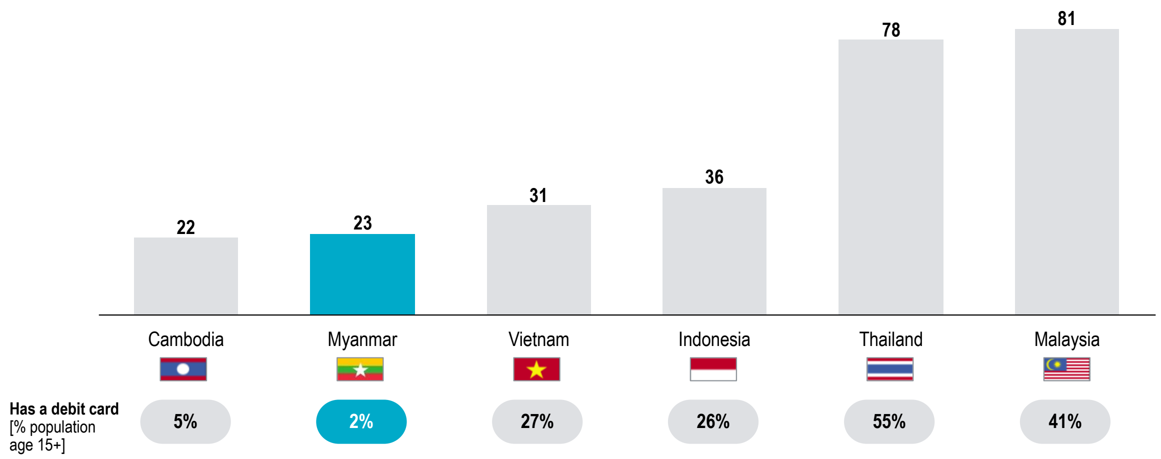



Figure 2: Bank account ownership, 2014 [% population age 15+]




1) 2016 data based on Roland Berger research 2) 2014 data
Source: World Bank Global Financial Inclusion Database, IMF, Myanmar MMSIS, Country regulators, Roland Berger research and data

## 1.2 First steps in the right direction

While the development of the overall financial sector is still in a nascent stage, initial steps have been taken to create a more modern (regulatory) environment and framework. These include:

> The easing of foreign exchange restrictions with the establishment of a new managed floating exchange rate regime (Foreign Exchange Management Law, 2012)

> The Independence of the CBM has been confirmed, thus broadening its scope of responsibilities to include monetary and foreign exchange policies as well as prudential supervision (CBM Law, 2013)

> The laying out of a securities exchange framework, providing the basis for the development of the Yangon Securities Exchange (Securities and Exchange Law, 2013)

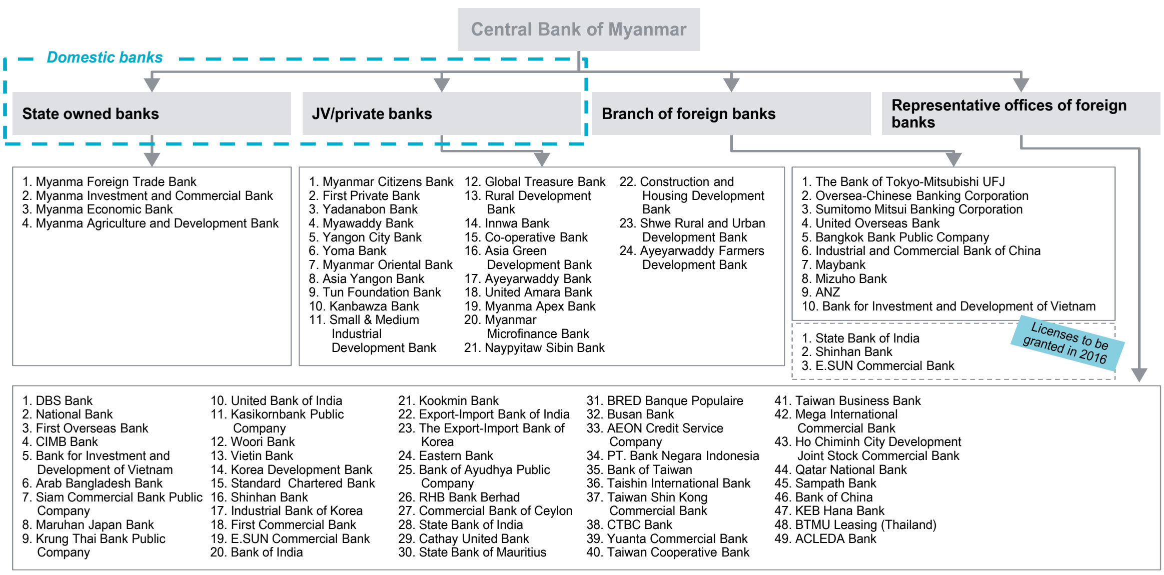
In addition, the passing of the new **Financial Institutions Law of Myanmar** (January 2016) represents a major step forward. It acts as the governing law for both domestic and foreign financial institutions and aims to provide the basis for modernizing the sector over the next 20 years. The new law is in line with common law principles (e.g. promotes accountability of licensed institutions for transparency and good governance, without codifying, for instance, specific publication rules), aims to level the playing field between private and state owned banks, and reaffirms the CBM's regulatory powers over the banking sector.

## 1.3 Diverse range of challenges

A closer look at the structure of the banking sector reveals that each of its three main pillars – namely the state owned banks, domestic private banks and the recently entered foreign bank branches – present their own potentially unique challenges:

1. Large (important) state owned banks with limited capabilities
2. High number of private banks of non-critical scale
3. Foreign banks with strong equity base but restricted scope of operations

**Figure 3: Banking market overview**




Source: CBM

## 1.4 State owned banks – Fighting history

Despite a recent trend showing a strengthening of private banks, **state owned banks** remain important (and in some cases dominant) players in Myanmar's banking sector, holding a significant portion of the banking assets. Based on our research, the relative share of banking assets held by state owned banks declined from 67% in March 2013, to 46% in March 2016 (Figure 4).

In addition to their comparatively high – too high – market share, state owned banks present two key challenges for the development of the banking sector overall.

On the one hand, state owned banks are still operating under their initial mandates, putting them in direct competition with private banks[1]. On the other, state owned banks face significant operational challenges driven by limited capabilities overall, dated (nonviable) lending practices[2], and reliance issues[3]. These challenges clearly demonstrate the need for far-reaching reforms. (See section 2.5 – Reform state owned banks)

Figure 4: Total domestic banking assets [MMK tr]

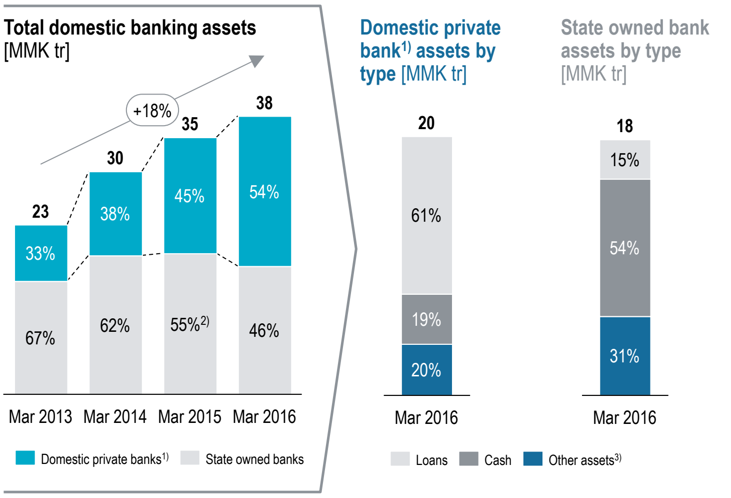
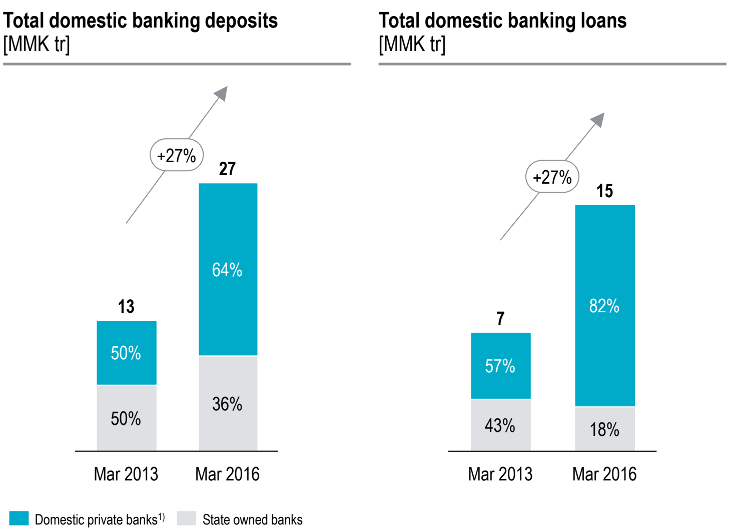



Figure 5: Total domestic banking deposits and loans [MMK tr]




1) Excluding foreign banks 2) Extrapolated based on Dec 2014
3) Other assets include government securities, guarantees, fixed assets
Source: Roland Berger research and data

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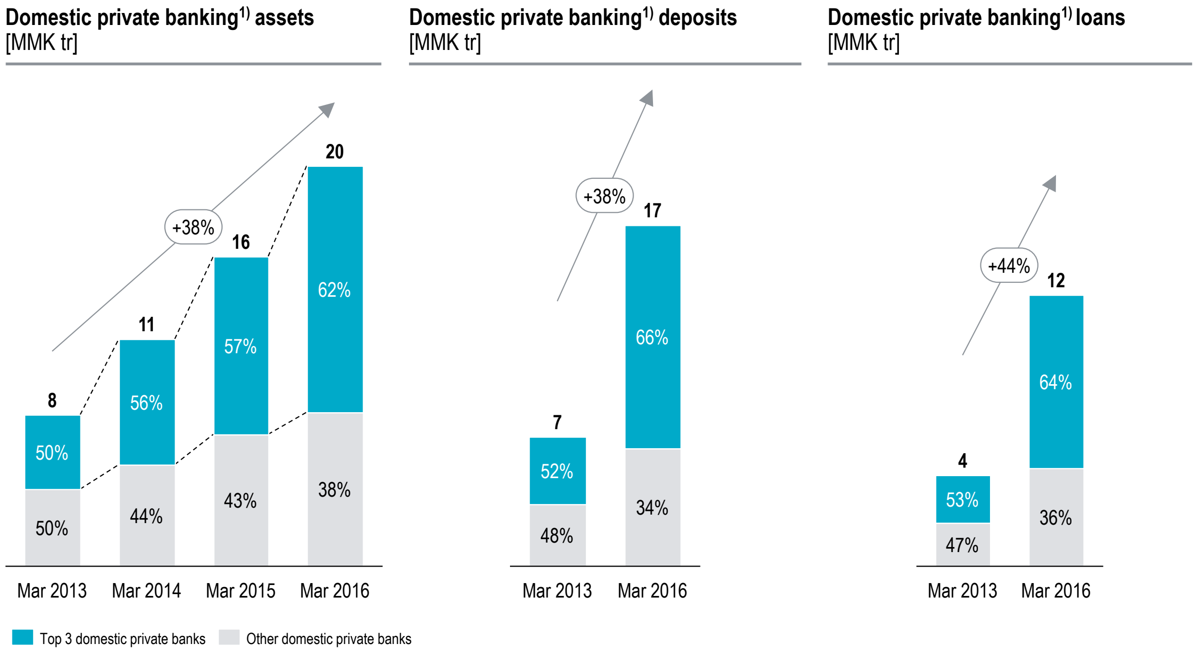
[1] Their mandates date back to when private banks were not able to provide most banking services, and accordingly, state owned banks currently offer almost all classical banking products
[2] Reflected in their relatively ineffective use and transformation of deposits
[3] According to market participants

## 1.5 Domestic commercial banks – Three leaders and the rest?

Focusing on the domestic private banks, it becomes clear that the recent change in relative strength (state owned vs. private banks) has been primarily driven by the top 3 banks (Figure 6). In Myanmar the top 3 banks hold more than 60% of the total banking market and have seen their own share grow in recent years. A concentration of assets within the top banks is not an uncommon pattern in SEA with, for instance, the top 3 banks capturing over 50% of deposits in Thailand and Malaysia (see Figure 7). However, what is specific to Myanmar's current situation and creates an additional challenge for smaller banks is the very limited size of the overall banking market.

The 40% share of market available to smaller banks in Myanmar is equivalent to 10% of the market share available to smaller banks in Vietnam and even less than 3% of what smaller banks are competing for in Thailand.

**Figure 6: Private banks' assets, deposits and loan volumes**




1) Excluding foreign banks
Source: Roland Berger research and data

**Figure 7: Concentration of top 3 private banks in ASEAN countries, 2015**

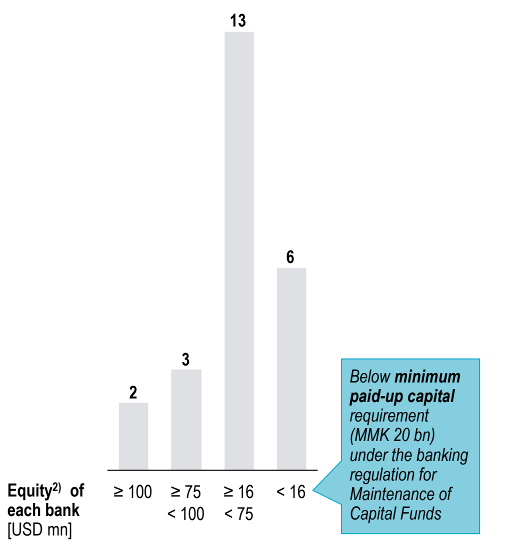
| Country | Number of private banks | Total private bank assets[4] [USD bn] | Top 3 private bank shares: Banking equity | Banking deposits | Banking loans |
|---|---|---|---|---|---|
| Myanmar[1] | 24 | 17 | 36% | 66% | 64% |
| Vietnam[2] | 40 | 261 | 30% | 34% | 36% |
| Malaysia[3] | 59 | 549 | 49% | 53% | 57% |
| Thailand | 19 | 481 | 39% | 50% | 41% |

1) Excluding foreign banks
2) 2014 data; Including Vietnam Joint Stock Commercial Bank for Industry and Trade, Joint Stock Commercial Bank for Foreign Trade of Vietnam, Joint Stock Commercial Bank for Investment and Development of Vietnam
3) Including Islamic banks
4) Exchange rates: 1,190.90 MMK/USD (as of Mar 31, 2016), 21,139.50 VND/USD (as of Dec 31, 2014), 4.29419 MYR/USD (as of Dec 31, 2015), 36.0006 THB/USD (as of Dec 31, 2015)
Source: Annual reports, Roland Berger research

Anticipating an increase in the absolute market size, smaller banks can expect to grab additional volumes, which may enable them to obtain a big enough slice to survive. However, only very few of them will be able to do so and remain competitive on a standalone basis.

Based on current market share and size, we consider only the top 3-5 domestic private banks (and the newly entered foreign banks) to have the minimum scale necessary to shape the market in the short- and medium-term. This is also clearly reflected by the amount of capital (equity) domestic banks hold. Banks in Myanmar suffer from the same limitation as the rest of the economy that they are supposed to help finance, and that is a lack of capital. As of the end of March 2016, only five banks had over USD 75 m in capital and two had over USD 100 m. Six of them did not even meet the new capital requirement of MMK 20 bn (~USD 16 m) decreed in the New Financial Law.

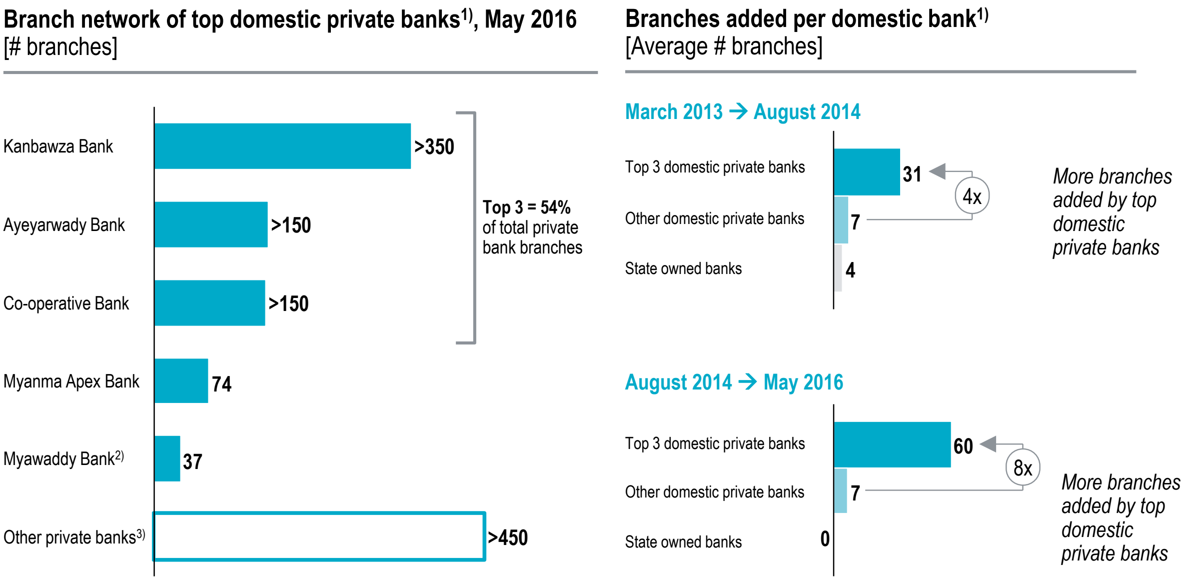
**Figure 8: Domestic private banks[1] by equity, Mar 2016** [# banks]




1) Excluding foreign banks 2) Based on 1,190.90 MMK/USD conversion rate (as of Mar 31, 2016)
Source: Roland Berger research

The dominance of the top 3 private banks is also reflected in the development of the banking branch network across the country. Today, the top 3 banks own more than 50% of all branches in Myanmar and they have added eight times more branches in the last two years than the rest of the domestic banks put together (Figure 9).

Figure 9: Bank expansion levels, 2013-2016




1) Excluding foreign banks 2) As of Aug 2014, updated information not available 3) Other 19 domestic private banks
Source: May 2016 – Roland Berger data, Mar 2013/Aug 2014 – GIZ, Public information, Roland Berger research

Despite experiencing significant growth, it is important to remember that Myanmar is still in the early stages of development. There are approximately four bank branches catering to 100,000 citizens in Myanmar, which is significantly lower than for its ASEAN peers (Figure 10).

However, even though the overall bank branch density is low and can be expected to increase with the development of GDP, geographical coverage remains very uneven with clear signs of overcapacity in some areas. In Chin state, the ratio is less than 1 to 100,000. In West Yangon, the ratio is close to Hong Kong levels (23 to 100,000) (Figure 11).

**Figure 10: Density of bank branch network, 2014**
[# branches per 100,000 capita]

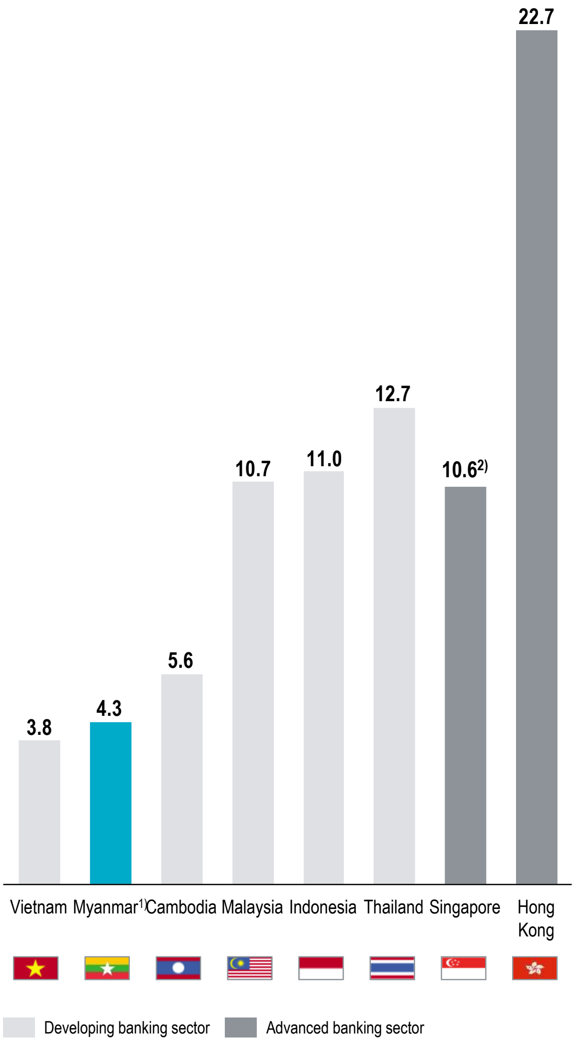
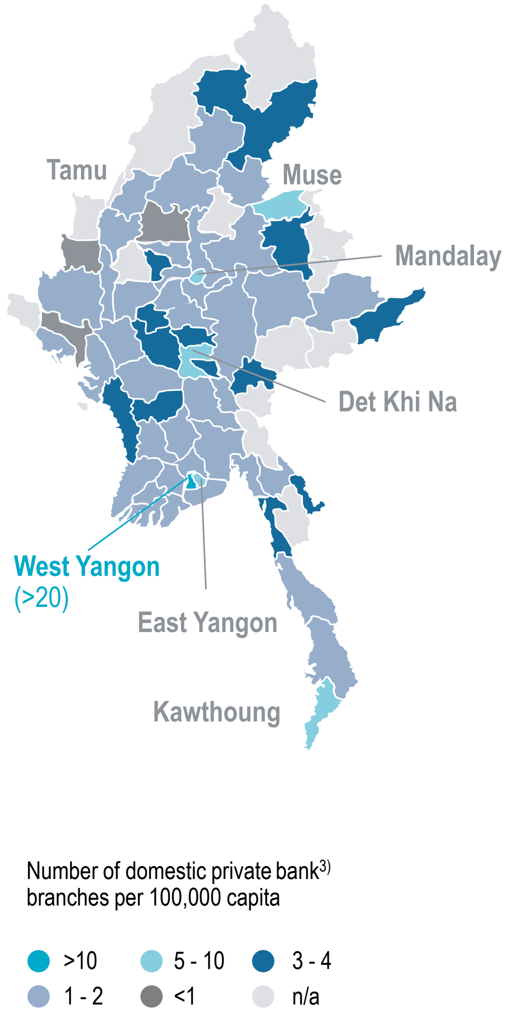



**Figure 11: Branch density of domestic private banks in Myanmar, May 2016**




1) Number of branches as of May 2016 based on Roland Berger data 2) Excluding foreign domestic and construction workers
3) Excluding foreign banks
Source: World Bank, Myanmar MMSIS, Roland Berger research

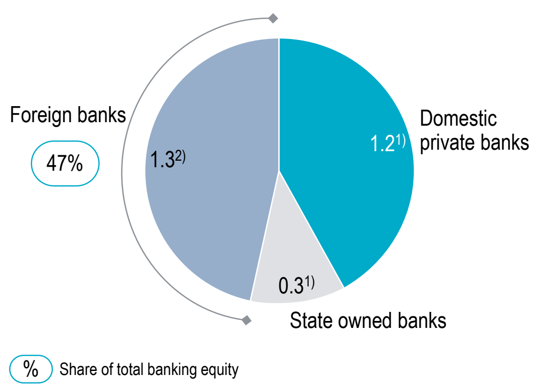
## 1.6 Foreign banks – The (restrained) elephant in the room

While the (expected) entry of thirteen foreign banks (nine in 2014, four in 2016) is a recent development, it has already had a noticeable impact on the overall market structure and is expected to result in more significant changes going forward.

One of the best indicators of the current and potential future relevance of foreign banks for the overall market is the scale of the capital they have committed to the market and thus the potential future lending foreign banks could provide. The entry of the foreign banks has almost doubled the equity available in the banking sector and with it, in theory, the lending capacity.

**Figure 12: Total banking equity – breakdown by type of bank**

**Total banking equity, Mar 2016** [USD bn]




**List of foreign banks with domestic banking license**

1. The Bank of Tokyo-Mitsubishi UFJ
2. Oversea-Chinese Banking Corporation
3. Sumitomo Mitsui Banking Corporation
4. United Overseas Bank
5. Bangkok Bank Public Company
6. Industrial and Commercial Bank of China
7. Maybank
8. Mizuho Bank
9. ANZ
10. Bank for Investment and Development of Vietnam
11. State Bank of India[3)]
12. Shinhan Bank[3)]
13. E.SUN Commercial Bank[3)]

1) Exchange rate: 1,190.90 MMK/USD (as of Mar 31, 2016) 2) Includes foreign banks with preliminary licensing approval
3) Foreign banks with preliminary licensing approval (to enter by Nov 2016)
Source: Roland Berger research and data

Though this change in relative strength (foreign vs. domestic banks) may present a temporary challenge for selected market participants, we consider the impact for the overall system to be overwhelmingly positive.

The entry of the foreign banks provides urgently needed capital for financing growth. Aside from that, foreign banks bring best practices to the market and are sound and stable institutions that can spearhead the introduction of new banking products (together with local bank partners). While the entry of foreign banks may be an opportunity for the overall sector and the top domestic banks to position themselves as reliable partners, the pressure on smaller banks to find their place in this new environment will increase further.

For the time being, the foreign banks have received restricted licenses and the CBM has limited the scope of permitted business, notably based on client types. In the short-term, foreign banks have to focus on wholesale banking services for foreign corporates as well as developing partnerships with domestic banks to service their domestic corporate clients. Balancing the need to let local domestic banks develop their capabilities and grow further with the obligation to finance the economy will be a delicate act for the CBM. Ultimately, relaxation in current lending restrictions and a closer working relationship between key domestic players and foreign banks are inevitable. (See section 2 – Enabling the banking sector transformation)

Looking ahead, Myanmar's banking sector is slated to grow. However, whether the sector will be key in driving overall economic growth will depend on the extent of the reforms and actions taken by the CBM, the banks (domestic and foreign) and other stakeholders in coming months and years.

# 2. Enabling the banking sector transformation

Before examining which key reforms and regulatory adjustments to put in place, it is worth bearing in mind the core functions the banking sector requires to perform efficiently.

1. Mobilization of domestic savings

   This requires an efficient deposit gathering function, which relies on an absolute conviction among the public that any institution duly approved by the regulator will repay deposit balances at par and on demand (or agreed terms). In other words, trust in the system.

2. **Channeling of savings through credit to their most efficient use in the economy**

   This requires rigorous, objective and impartial credit decision-making. An understanding of risk-based credit practices and solid risk management policies are needed to ultimately ensure borrowers can service their debt. This promotes safety for depositors' money within the banking system. In addition, policy lending from government owned and sponsored institutions needs to obey strict mandates and guidelines. These range from clear accounting and disclosure standards, to transparent reflection of subsidy costs in public accounts, to independent governance and management structures.

3. Safe, fast and reliable means of making payments

   This covers retail payments with provisions by the banking sector for diversified and efficient means of payments to the general public (from card-based payments to bank transfers to e-money). It also involves the establishment of reliable payment systems/infrastructure for large value and interbank transactions. Irrevocability and speed of execution (same day) should be the cornerstone of such systems.

Compared to 5 years ago, improvements in the banking sector are noticeable, with significant achievements and a certain amount of leapfrogging. For instance, CBM has developed – with international assistance – a fully functional Real Time Gross Settlement (RTGS) System, introduced standardized T-Bill auctions and dematerialized T-Bills as well as government bonds held by banks, which all are registered within a Central Collateral Registry managed by the Central Bank. Last but not least, the CBM has given preliminary approval to 13 foreign banks to operate in the country and smoothly managed their entry.

Yet against the backdrop of an efficient, inclusive and modern banking sector as described previously, a great deal remains to be done. Critical initiatives should be launched in the short- and medium-term to enable the successful transformation of Myanmar's banking sector.

We see five critical initiatives that need to be implemented in the short- to medium-term:

## 2.1 Steer interbank market development

The interbank market is the backbone of any banking sector. In a nutshell, it allows banks with liquidity shortages to access funding or banks with excess liquidity to invest and earn returns. It can also be a conduit for the transmission of CBM monetary policies and ultimately – together with the government securities market – it is the bedrock of all other money and capital markets.

In Myanmar, most of the above is not yet functional and until very recently (April 2016), interbank lending and borrowing was not only scarce, but discouraged by the regulations, which (intentionally or not) promoted the use of central bank money for funding needs. This was a complete inversion of a sound banking market, where the interbank market should be the source of liquidity in the first instance and central bank facilities only representing a last resort, with differentiated interest rates reflecting this pecking order.

The CBM issued new directives in April 2016 along with detailed operational guidelines encouraging interbank lending and borrowing in Kyat (Directive 26), relaxing collateral conditions and promoting free rate setting in that market (interbank lending and borrowing rate level were previously prescribed). Although interbank lending in USD or other foreign currencies has not been permitted to avoid dollarization of the economy, a second directive (27) was issued allowing interbank swaps in USD with tenure of up to one year.

In our view, one final critical component is still missing and should be introduced to complete the range of instruments available and bolster the interbank market: the repurchase agreement (repo) on government securities. Not only will repo provide a safe, flexible and secured transaction option to market participants through the use of the CBM-operated RTGS and Collateral Registry, it will also provide the CBM with additional, flexible and indirect instruments to conduct monetary operations. Repo tenders are the instrument or mechanism of choice used by central banks, at certain stages of their respective development, to conduct open market operations.

Beyond precise regulation and operational guidelines defined by the CBM, one key step toward the implementation of such transactions is needed. This is the formal approval by the Ministry of Finance for foreign banks to acquire government securities in primary auctions as well as in secondary markets.

A successful repo market can trigger appetite for government securities, which in turn will provide an additional source of financing for Myanmar's fiscal deficit. Domestic and foreign banks will be more willing to acquire such securities if they can mobilize these interest bearing instruments to access liquidity in the interbank market.

Changes in regulation to foster the development of the interbank market are very recent and little impact can be observed in terms of market participants' behavior. Whether they will shift from previous practices such as cross-depositing rather than interbank lending or borrowing, start transacting on several maturity horizons, or actively engage in swaps and repo operations will depend on the CBM. They must be able to create a conducive regulatory environment (a work in progress) and also to take a very operational role to kick-start those practices, including being counterparty to some transactions.

It will also require some flexibility from international financial institutions until best practices can be implemented, which may not be possible from day one of operations and may not be a prerequisite to initiate a significant positive change in market structure. A trial phase with tight monitoring could bring additional comfort as well as training to market participants and the regulator to help foster the development of this critical element of a well-functioning banking sector in Myanmar.

## 2.2 Foster access to credit

One of the commonly heard complaints about the banking system is the difficulty for a vast majority of economic agents to access credit.

To maintain a sound banking system, banks are expected to have responsible lending practices and appropriate risk management expertise. Private banks work for profit and therefore need to carefully assess the creditworthiness of potential customers. They cannot and should not be expected to lend to anyone who asks for financing but lacks the ability to repay.

Nevertheless, the existing banking sector practices and past regulation strongly limits access to financing for a potentially creditworthy part of the population and some adjustments are needed to promote more risk and reward based lending in the system.

A relaxation of eligible collateral rules and the widening of the credit spread (difference between minimum deposit rate and maximum credit rate, currently set at 5% by the CBM) would allow consumers with a higher risk profile, but still creditworthy, to borrow (banks to lend).

The new Myanmar Financial Institutions Law allows banks to provide unsecured loans (without collateral) and leaves it to the CBM to rule on lending terms and define eligible collateral. Based on previous regulation and business practices, domestic bank lending was limited to secured transactions (foreign banks have always been authorized to provide unsecured lending in their license). In addition, eligible collateral was highly restricted, e.g. to land, building, gold and gems and the recently added key agricultural export goods. In practice, banks mostly lent against land and buildings, using a haircut ratio on the collateral value as high as 50% and, as such, behaved more like pawn shops than long-term financiers.

Lending intermediation margins are key for banks to operate profitably and accept customers with higher risk profiles. Full liberalization of interest rates is a complex process, usually requiring a staggered approach, making sure the central bank has the necessary instruments to intervene and monitor the market and the fiscal position of the country. This ensures stability so that borrowing costs can be kept under control. Nevertheless, some relaxation of the upper and lower limits for interest rates set by the CBM should be considered.

The historic cap on lending maturity of one year has to be removed, providing the opportunity to develop multi-year lending practices and fostering the long-term financier role of banks in the economy. Securing longer maturity financing will help borrowers, notably businesses, by providing them with better visibility on the funding of their long-term investments and making periodic installments more affordable.

In the longer run, when the banking sector has made more progress, the CBM may also consider dedicated policies to incentivize banks to lend more actively. For instance, some countries such as Indonesia have set up penalty mechanisms for banks which do not sufficiently leverage their deposit base. Banks which do not put their deposits to use in lending to the economy (i.e. banks with a low loan-to-deposit ratio) are required to hold additional (costly) reserves at the central bank.

As for the remaining large unbankable part of the population, microfinance and policy lending through dedicated state owned institutions or government subsidized schemes administrated by private banks should be the preferred mechanism to grant access to credit. These institutions require dedicated regulation, which is currently being developed.

## 2.3 Build trust in the system

Another much needed element in the policy mix to strengthen the banking sector is the building of trust. Trust in the system is ultimately a matter of perception and a regulator can do much to improve perception.

Although Myanmar banks do report on a regular basis to the CBM, none to date publishes audited financial statements – regularly and in an acceptable timeframe.

The new Myanmar Financial Law passed early in 2016 imposes clear public disclosure obligations on banks, as it should be, for financial institutions seeking general public deposits. Here, the CBM should take a very strong stance to ensure those obligations are met. After a limited grace period of e.g. six months to allow banks to prepare their reports, the CBM should impose significant penalties for lapses and potentially withdraw the license from banks unable to provide audited financial statements in accordance with the law.

Similarly, the reporting by banks to the regulator is still very manual, paper-based and error prone. Some lapses are not uncommon, but clear penalties or enforcement of penalties is lacking. The CBM has recently initiated selected reporting in electronic format for interbank transactions. Currently limited to interbank market transactions, this should be rolled out to the entire reporting needs of the CBM. This would be an opportunity to revisit the existing information and data requested from banks, modernize the process and reduce duplication of data requests which have unavoidably developed over the years.

The CBM should also quickly disclose selected aggregated information based on the reports collected. For instance, disclosure should target both market participants and the general public via the CBM's website.

The creation of a deposit insurance mechanism financed by the banking sector should be considered and studied as it could improve the perception of the strength of the system, notably private banks, by the general public. Despite featuring the word insurance, this should not be placed, as it is today, under the responsibility of Myanma Insurance Agency, but rather administrated by a dedicated agency or institution in close collaboration with the CBM.

Last but not least, setting up a Credit Bureau would provide lenders with the credit history of the borrowers and statistical information to assess their creditworthiness. It also could introduce a more level playing field with all lenders accessing the same information and so driving the cost of borrowing down through competition for less risky customers. Eventually, it limits the presence of nonperforming loans in the system as lenders can take better informed decisions.

Both a Credit Bureau and a Deposit Insurance Agency will take time to implement and are medium-term goals, which can contribute to strengthening the banking system and increasing trust in it. But ultimately they are no substitute for strong regulation, efficient banking supervision and banks' expertise.

## 2.4 Increase capacity and autonomy of the central bank

A strong, independent and efficient central bank is key to foster growth in the economy and develop a stable banking sector. Central banks play a vital role in today's advanced economies and their role has amplified in the last 20 years. The same holds true throughout the region, where certain central banks have been instrumental in helping their country bolster growth and foster the emergence of a strong banking sector since 1997.

In Myanmar, the CBM gained autonomy in 2013 through the Central Bank Law and had its financial sector supervision powers reaffirmed in the new Myanmar Financial Institutions Law earlier this year. It is expected to play a leading role in supporting the transformation of the country's economy. Beyond its monetary and exchange rate policy role, the CBM has a key role to play in the transformation of the banking sector.

The task is even more daunting considering the capacity limitations the CBM is facing. The CBM needs an appropriate human resources and funding strategy for its activities and responsibilities. Both are yet to be developed.

These are not minor adjustments but major injections of know-how, training, project management and execution skills to tackle the challenges ahead. The CBM should build an overall transformation master plan based on previous recommendations from multilateral institutions and current challenges identified. Such a plan will take time to yield results but should be initiated as soon as possible. It should encompass:

> A forward-looking plan for capacity building at least for the next 5 years with a 10-year target in mind
> An exhaustive upskilling strategy for existing employees and identification of training required and potential source for the training including peer central bank secondments, multilateral institutions, external providers
> A recruiting approach including domestic and international university grants, private banks experienced hires, returnees
> Clear and attractive career paths
> A market based and competitive compensation plan

Like all regulators in the world, the CBM will be in competition with the industry it regulates to attract talent and should be in a position to offer attractive compensation and career paths. Moving further from partial autonomy to full independence, the CBM should plan gradually to adjust its attractiveness as an employer.

In the meantime, the CBM will need to rely significantly on external support from its ASEAN peers and technical assistance from multilateral institutions to address immediate capacity restrictions and possible lack of experience. This too, should be planned in order for it to be discussed with potential expertise providers and financial donors.

There is limited policy autonomy when there is limited financial autonomy. Budgets of modern central banks are usually large, distinct from the government's annual general budget procedure and, as a testimony to their independence, approved unreservedly (they are, however, audited and controlled a posteriori since they rely on public money). In some instances, central banks only inform the government of the budget they decide themselves.

It is critical that the budget of the CBM makes accommodations for the significant role it is designed to play. As per the current procedure, it is vetted by the Ministry of Finance and the Parliament and there is a high likelihood that it could be restricted or reduced in the overall efforts to curb government spending.

A proper funding strategy of the CBM should be put in place taking into consideration the investment required and the additional operational expenses that it will inevitably incur, either to recruit permanent staff or temporary external technical assistance. The funding could come from different sources. Although the bulk of it should be borne by the state, ultimately, some fixed-term transformative projects could be funded from international donors and multilateral agencies through development aid grants or loans. In addition, if the CBM plays a more active role in the interbank market, there will be an opportunity to generate income that could be used to cover operational expenses.

## 2.5 Reform state owned banks

For a long time, state owned banks used to play an economically essential role. In a closed economy, they were the only providers of certain banking services in the country, due to political sanctions and limited capabilities of the commercial banks. Their role, therefore, extended far beyond pure policy banks, extending credit to specific sectors of the economy or relaying government social programs. For instance, until very recently, state owned enterprises mandatorily had to bring their business to state owned banks; for products such as foreign currency transaction, state owned banks were the only providers. Today, Myanmar's largest state owned banks operate as commercial banks.

Without anticipating the decisions to be taken further to a detailed review of the various state owned banks' situation, a few key actions are to be considered:

1. Clarify their mandate to focus them on their policy-lending functions

2. Return to the CBM their government treasury operations and/or foreign currency reserve management functions
3. Wind down their commercial banking activities by transferring those activities to commercial banks and/or closing them down in a socially acceptable way
4. Adjust nonperforming loan books and capital requirements and consider merging institutions
5. Upgrade their governance, organization and process to internationally recognized practices. This will require significant effort in a multi-year program, drawing on substantial technical assistance together with investments in their infrastructure (IT systems)

In the event that a bank were to retain selected commercial banking activities, it is essential to make sure it is on a level playing field: no monopoly in any sector (as is de facto the case with agriculture loans); the same regulatory constraints, ratios and supervision as private banks. In that case, carving out the activities into a dedicated legal entity would be advisable, to clearly separate them from the policy-lending mandate.

The reform of state owned banks is a critical element in strengthening Myanmar's banking sector. It is going to require significant effort and time. While the "what to do" might well be identified quickly, the "how to do it" will be a multi-year challenge.

**Takeaway box – Profiles of the four state owned banks:**

Myanma Economic Bank (MEB) has been the largest bank in Myanmar. It is the successor of the State Commercial Bank (SCB) established in 1954, which provided a wide range of commercial banking services across the country including saving deposit accounts, saving certificates, fixed deposits, current accounts, credit facilities, payment order, FOREX services and cross border trade services.

Myanma Agriculture and Development Bank (MADB) is the legal successor of the State Agricultural Bank (SAB), established in 1953, which provided banking services in rural areas. It has been mandated to support the development of agricultural, livestock and rural socioeconomic enterprises in the country by providing banking services. For instance, it provides short- and long-term credit for crop production, salt production, livestock, fish and dairy farming to ~2 million customers. The MADB is authorized to make loans to state owned agricultural organizations, livestock organizations, corporations, private entrepreneurs, village banks, farmers and farm laborers. Since the 1990s, it has targeted the savings deposits of farmers by launching rural savings programs.

Myanma Investment and Commercial Bank (MICB) was established in 1990 under the Financial Institutions of Myanmar Law (1990) and provides financial services to the private sector. The services encompass domestic commercial and investment banking services, including current deposit account, fixed deposit account, savings deposit account, internal remittances, loans and advances, and international banking services such as foreign currency current deposit accounts, foreign currency deposit account, foreign remittances, import and export.

Myanma Foreign Trade Bank (MFTB) was established in 1990 under the Financial Institutions of Myanmar Law (1990). It is the legal successor of the Foreign Department of the State Commercial Bank, which focused on international trade. It offers a wide range of international banking services to its customers through its worldwide correspondent network of +260 banks in more than 50 countries. MFTB serves both private and government entities/individuals. Government departments and state owned enterprises keep their foreign exchange accounts with MFTB.

# 3. Banking 2025: Unprecedented growth to spur sector shakeup

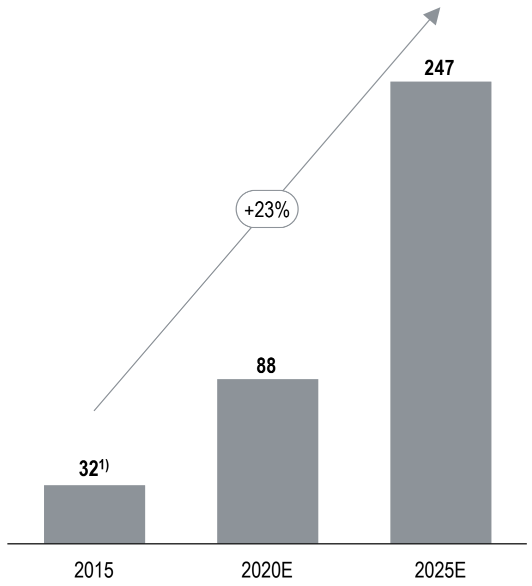
Despite the challenges identified previously, our experience working in Myanmar on a daily basis leaves no doubt in our minds that Myanmar does have the potential, the willingness and the people it takes to become one of the most successful growth stories in recent history. Myanmar has the opportunity to leapfrog for the next ten years to a development level that will put it close to that of most ASEAN countries today.

While we believe this to be a realistic and achievable goal, we want to issue a word of caution that this "best-case scenario" is not a guaranteed development, but can only be the result of a tremendous effort by all stakeholders, including multinational organizations and other external supporters.

By 2025, Myanmar's banking sector may have changed completely:

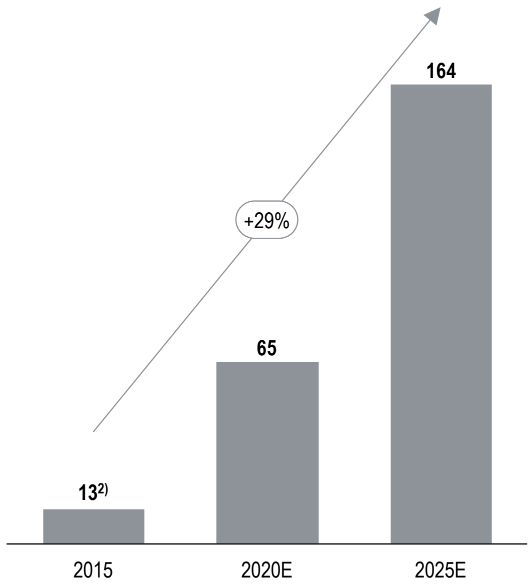
**1. Banking assets will have multiplied by a factor of 8 to reach USD 247 billion (23% CAGR)**

**Figure 13: Total banking assets projection** [USD bn]




**2. Banking loans will have increased more than tenfold to USD 164 billion (29% CAGR)**

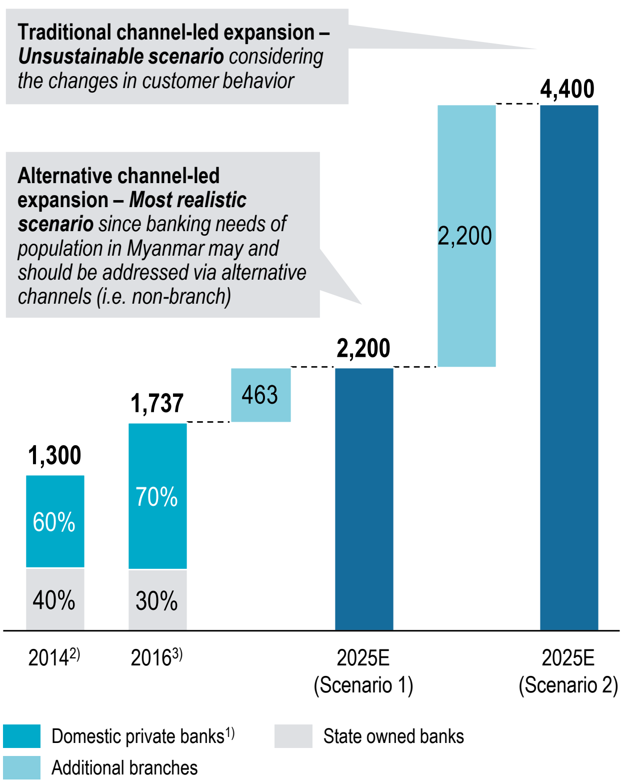
**Figure 14: Total banking loans projection** [USD bn]




1) MMK 38 trillion converted to USD based on 1,190.90 MMK/USD rate (as of Mar 31, 2016)
2) MMK 15 trillion converted to USD based on 1,190.90 MMK/USD rate (as of Mar 31, 2016)
Source: IMF, Central banks, Roland Berger research and projection

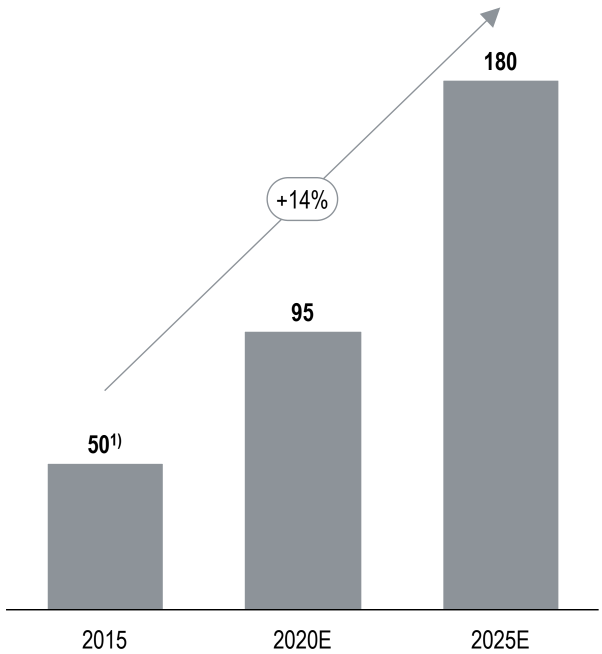
**3. More than 460 additional bank branches will have been opened, expanding the network to at least 2,200 bank branches nationwide**

**Figure 15: Bank branch network projection** [# branches]




**4. Employment in the banking sector will have increased to 180,000 persons (14% CAGR)**

**Figure 16: Banking employment projection** ['000 persons]




1) Excluding foreign banks 2) As of Aug 2014 3) As of May 2016 based on Roland Berger data
Source: 2016 – Roland Berger data, 2014 – GIZ, Public information, IMF, National Statistical Office, Roland Berger research and projection

We currently expect asset growth of eight times the current level, loan growth of thirteen times the current level, relatively limited branch network expansion with growth below 30% and more than triple the employment levels. We anticipate that a significant part of the sector's growth is going to be driven by corporate banking business. In addition, the sector will not just grow, but also go through a set of qualitative changes. For instance, we assume it will not be the number of branches that will have the most significant impact on changing the sector, but their type. Today, most bank branches follow a standardized concept (though some exceptions exist) providing basic transactional services. By 2025, we expect to find a variety of branch models in Myanmar, from flagship concepts in Yangon to mini and mobile branches in more remote areas[4].

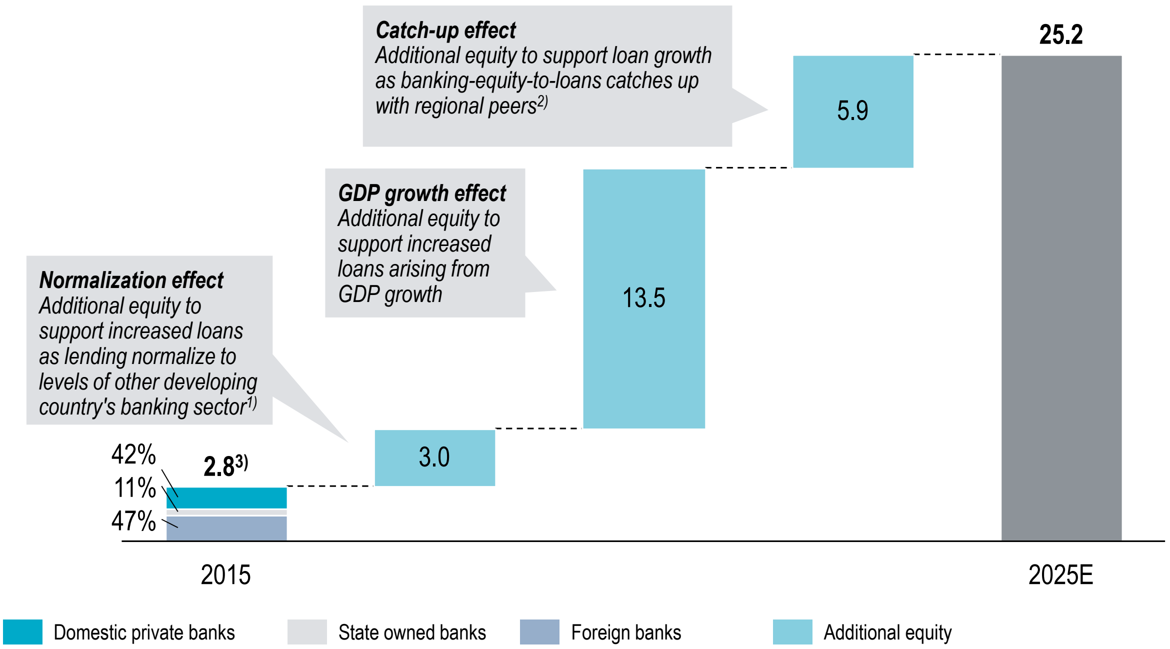
While the development described here may be a dream for any banker in more developed markets, for Myanmar's banks, these

[4] Part of the reason why the anticipated increase in the number of branches will fall significantly short of asset growth is driven by the fact that we expect low touch mobile solutions to be in place to serve the lower mass segment

changes present not just great opportunities, but also significant challenges in preparing for the future.

The first and probably one of the most challenging steps will be to find a way to increase capital levels. The additional capital for addressing key initiatives will need to come from outside the banking sector, as it is not possible to achieve growth at nine times the current levels using retained earnings only or current shareholders' capital injection.

**Figure 17: Total banking equity projection** [USD bn]




1) Banking-loans-to-GDP ratio of developing countries (40%)
2) Banking-equity-to-loans ratio of weighted average for Vietnam, Thailand, Malaysia today (15%)
3) MMK 3.4 trillion converted to USD based on 1,190.90 MMK/USD rate (as of Mar 31, 2016)
Source: IMF, Central banks, Roland Berger research and projection

With the realization that even the larger banks will need to increase their capital – be it via IPO, capital injections by current owners or private placement, or capital injection during acquisitions – domestic private banks can have only one goal from here on forward, and that is to professionalize all parts of their operations to become an attractive partner for potential investors. This has to include:

> Developing dedicated retail and corporate banking strategies

> Challenging current (and historic) processes and modernizing operations

> Developing a mobile banking value proposition to fend off telco operators (or benefit from cooperation)

Defining a competitive **retail banking strategy** for the coming years will be essential. Any strategy should not just focus on increasing the numbers of customers, but also start considering customer profitability and cost of acquisition. To do so, banks will need to review current customer segmentations, products and services as well as channel mix to identify profitable (or potentially profitable) segments and ways to capture them.

Due to the currently limited number of customers in classically attractive segments, from mass affluent to high net worth individuals, customer segmentation cannot rely only on current assets and revenues but will have to consider future potential too. In addition to a forward looking segmentation, the channel mix and how to steer customers in this mix will be vital to ensuring profitability.

Banks will need to find answers to the question of how to service lower mass customers primarily via electronic and mobile channels, while making sure that the growing mass and more affluent segments can be retained by leveraging branches and personal interaction. In that respect, Myanmar banks are facing a unique challenge that most of their peers in other countries have thus far not faced, or are only starting to experience today, with the advantage of already having established operations.

That challenge is competition not only from banks but also from telecommunications operators and potentially other disruptive service providers, given that here, more than anywhere else in the world, the mobile phone is to be the main point of entry to banking services for the majority of the population. Of the ~80% of the population who do not have a bank account, many (if not all) of them are expected to have a mobile phone by the end of 2017; and the vast majority of those phones will be smartphones, which banks could take advantage of to provide app-based services. Cooperation and coopetition with telecommunications operators and FinTech firms, dedicated app-based mobile and banking services, agent networks and partners, and aggressive customer acquisition strategies are key components banks must consider in their quest to reach out to the millions of unbanked customers, who will rise to greater affluence and become the backbone of their clientele in the next decades.

Besides retail banking focusing on network expansion and new customer acquisition, a **corporate banking strategy** may be even more important. Asset growth in the initial years will likely not be driven by retail but by corporate customers, which requires a different approach to be successful.

To define a viable corporate banking strategy beyond captive business and related parties as is predominantly the case today, it will be important to understand the attractiveness of geographies, products and segments as well as specific customer needs to derive the most suitable service portfolio. Based on the type of customer and its development stage, banks will have to be prepared to offer everything from basic investment and financing products to solutions for liquidity management, foreign business banking, and in the medium- to long-term, corporate finance solutions. Addressing these needs and expectations will not just be challenging from a product creation perspective, but also from a sales and distribution perspective. "Selling" more sophisticated products requires qualified specialists, a well-coordinated sales approach and support structures (tools and organization) to enable relationship managers to successfully take on the task.

On top of offering the right product mix and having an effective go-to-market strategy that applies to retail and corporate banking, having the right and modern **operating model** to deliver these services will be vital. With increasing scale, standardized processes and automation are must-haves to enable sustainable growth. In Myanmar, this might even be more important than in more developed markets, since qualified staff is scarce. Having stable operating (especially credit) processes in place by allowing onboarding of new (if perhaps not fully qualified) resources on a bigger scale is the only option.

For most of the smaller banks, the question will not be one of growth and market share but survival, plain and simple. Despite the fact that in other SEA markets, a fair number of smaller banks coexist alongside a few top banks that generally capture more than 50% market share, we believe that this will not be possible in Myanmar. The key reasons for this are the overall limited size of the market (less than 4% of the Thailand market), increasing minimum capital requirements, and an anticipated increase in cost and required sophistication to comply with strengthening reporting and compliance standards.

For smaller banks that need to find a partner, four different strategic options could be considered:

1. **Merger among peers**: Combine resources with other small banks to reach the required minimum scale. This option will only be valid for a small part of the market as its key requirement is a complementary set of resources (e.g. regional coverage, client portfolio). However, even if a complementary partner can be identified, the key challenges of very intense competition from larger domestic banks and limited sophistication in overall operations will remain and crafting a differentiated strategy will be necessary.
2. **Consolidation by larger players already in the market**: Finding larger domestic banks as potential partners may sound like a suitable option for smaller banks. However, smaller banks will find it challenging to position themselves as a relevant partner. For larger banks, the most likely incentive for acquisitions is to add a specific strength, i.e. client segments or regions. Furthermore, as even larger domestic banks may not yet have sound operations (by international standards) or the necessary financial resources (capital notably), their ability to absorb a smaller partner will also be limited. Some licensed foreign banks maybe be natural candidates but a change in regulation will be required to allow further competition from foreign banks and should be weighed up and timed carefully in light of the goal to build strong domestic players.
3. **Domestic equity investors**: Nonbanking partners who become equity investors will be another option to increase the capital base and, as such, take a first step toward organic growth. While this may be an attractive notion for smaller banks as it would enable them to maintain their autonomy, the challenge of improving their operations to become a viable medium-term investment target will be immense, as many other industries in Myanmar are competing for scarce capital and offer potentially higher return.
4. **Foreign investors**: An investment by a foreign bank or possibly nonbank represents the fourth possible scenario for smaller banks to find a partner (depending on the future regulatory framework), as it may be an attractive option for foreign players to enter the market. This will require an evolution in current regulation and, given the recent entry of as many as 13 foreign banks, it is unlikely to be an option in the short-term and certainly not until market practices, experience and depth increase. Otherwise the additional opening of the market might prove more detrimental to the stability of the overall banking sector than anything else.

# 4. Conclusion

Myanmar's banking system is at a crucial turning point. After years of isolation and barely any banking services available in the country, the banking sector has sprung to life with the creation of private banks and the gradual introduction of basic banking services in the last five years: Branches were built, ATMs installed, credit cards distributed and credit extended scantily. At the same time, first steps toward improving the regulatory environment were taken.

Yet today, Myanmar's banking sector has remained one of the most underdeveloped in the world, unable to fulfill its role and fuel the nation's aspiration for fast and inclusive economic development.

The potential for development is huge but it will require decisive, conducive and steady actions from the government and the regulator. The fast-paced development anticipated may stall quickly if the banking sector is not allowed to thrive.

Further reforms should be advanced and the initiatives detailed in this paper launched in the short- and medium-term to complete the building blocks necessary to spur the sector's and country's development.

In the meantime, private banks cannot stay on the sidelines waiting for a protective regulation to solve their shortcomings. They must keep investing in their own future and develop a consistent strategy for guiding their development, improving their current practices and raising their standard to international levels.

With the concerted effort of all stakeholders, we believe Myanmar can build a successful domestic banking sector and we would not be surprised if what seem like bold, aspirational targets today will have in fact turned out to be understated realities in ten years' time.

# 5. Appendix

**Figure 18: Assumptions for 2025 forecast**

| Indicator | Forecast 2015 | Forecast 2025 | Implied growth | Basis of assumption |
|---|---|---|---|---|
| **GDP** [USD bn] | 64 | 175 | 2.7x (11% CAGR) | > IMF estimates to 2020 and extrapolation to 2025 |
| **Banking-assets-to-GDP** [%] | 49 | 140 | 2.9x | > Growth of banking activities will increase banking assets at 23% CAGR to 140% of GDP by 2025 (e.g. Vietnam banking-assets-to-GDP today: 175%) |
| **Banking-loans-to-GDP** [%] | 20 | 90 | 4.5x | > Sum of two effects<br>– Normalization of current level of lending activities to 40% of GDP (e.g. Indonesia banking-loans-to-GDP today: 44%)<br>– Future growth of lending activities at 20% CAGR converging towards ratio of comparable countries (e.g. Vietnam banking-loans-to-GDP today: 111%) |
| **Banking-equity-to-loans** [%] | 12 | 15 | 1.3x | > Shifting from fully collateralized lending to unsecured lending will require higher equity levels (e.g. Banking-equity-to-loans for weighted average of Vietnam, Thailand, Malaysia today: 15%) |
| **Bank branches per 100,000 capita** [# branches] | 4.3 | *Scenario 1:* 5.5<br>*Scenario 2:* 11 | *Scenario 1:* 1.3x<br>*Scenario 1:* 2.5x | > *Scenario 1 – Most realistic:* Alternative-channel-led expansion will increase branch penetration to 5.5 per 100,000 capita<br>> *Scenario 2 – Unsustainable :* Traditional-branch-led expansion will increase branch penetration to 11 per 100,000 capita (vs. 11.3 for weighted average of Indonesia, Thailand, Malaysia today) |
| **Banking employment** ['000 persons] | 50 | 180 | 3.6x | > Growth of banking activities will increase banking employment at a minimum of 14% CAGR |

Source: IMF, Central banks, Roland Berger research and projection

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