



Capturing growth in emerging markets through lean

By learning to serve low-income customers profitably, lean financial institutions can open up new markets in the regions that will drive the next wave of global growth.

**Marco Breu,
Francisco
Ortega, and
Roeland Vertriest**

Having established itself within the financial services industry in developed markets, lean management is rapidly gaining traction in emerging markets. In Asia, South America, and Africa, we have seen banks undertake lean transformations that repaid their costs within 12 to 15 months, and raised profits by 10 to 20 percent within a year. Now some leading institutions are using lean management to streamline their operations and expand their business.

Lean banks operating in emerging markets are adopting transformative approaches to product development and distribution that make financial services accessible to low-income customers who have never been able to afford them before. The need is acute: many poor families who resort to borrowing from pawnbrokers or other informal channels are paying five or even ten times as much as they would pay for a bank loan. And for banks, the value at stake is enormous: fully 70 percent of global banking revenue growth in the next 3 years is expected to derive from emerging markets.

As well as reaching out to new customers, lean banks are deepening the penetration of their current customer base. One African bank managed to boost the average number of products per customer by more than 70 percent in a year.

Moreover, when a bank wants to extend its geographic coverage, having standardized lean retail formats enables it to roll out new branches quickly and easily. For the many leading developed-market banks that are now seeking M&A opportunities in emerging markets, lean can offer huge benefits when it comes to incorporating acquisitions into existing networks. Lean provides a mechanism for banks to ensure that best practices are spread systematically across all their operations.

Reaching untapped markets

With few exceptions, banks operating in emerging

markets have traditionally regarded large numbers of customers at the lower end of the market as beyond their reach (Exhibit 1).

About half of the world's adult population—some 2.5 billion people, most of them in Africa, Asia, Latin America, and the Middle East—have no access to banks for savings or loans. Yet they still have a need for financial services. A survey conducted in three areas of South Africa in 2003–2004 showed the average low-income household uses 17 different financial instruments over the course of a year (11 for credit, 4 for savings, and 2 for insurance). This reliance on the informal economy for these products comes at a huge cost: an emergency short-term loan might incur an interest rate as high as 50 percent, compared with the 14 to 16 percent charged for a personal loan at a bank.¹

The challenge banks face is to develop a low-cost offering that will meet the needs of poorer customers yet still make a profit. To do so, they will need to make drastic cuts in their cost-to-serve. Thanks to lean, many institutions are already systematically stripping out inefficiencies and centralizing processes (see box, “New takes on classic lean methods,” p. 87). If banks take these efforts a step further by developing simplified product offerings and leveraging alternative delivery channels, we believe they could find a way to serve these huge low-income populations for the first time.

A simplified product offering

Developing a simplified product offering makes products much cheaper to deliver. Following the lean principle of eliminating waste—seen as anything that does not add value for the customer—banks can pare products down to the bare essentials so that they are within reach of people who cannot afford the usual range of features or service levels.

One such product has been developed by a South African microfinance bank. It keeps costs

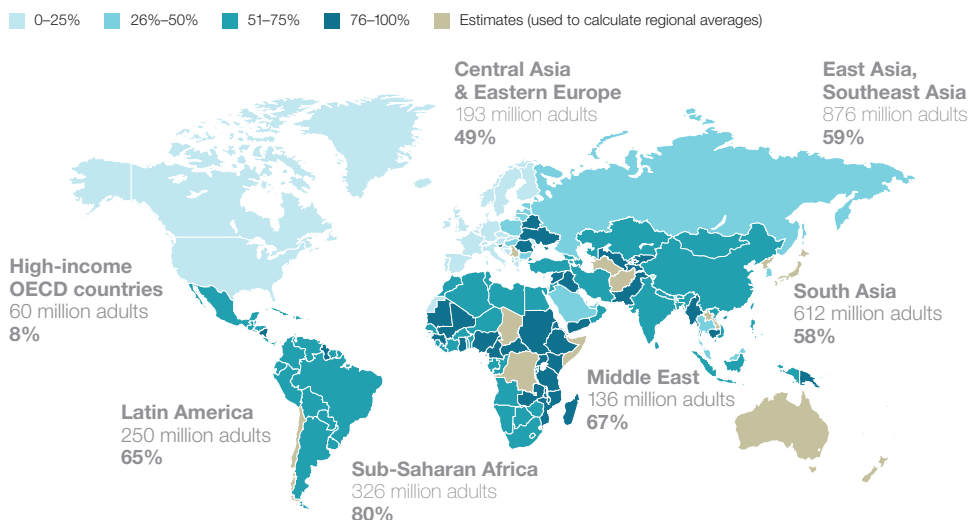
This article is adapted from Erin Ghelber et al., “Achieving operational excellence through lean: New perspectives for banks in emerging markets,” McKinsey & Company, 2009. For the purposes of this article, emerging markets are defined as countries with low GDP per capita, large low-income populations, and low labor costs.

¹ From “Focus note: Financial instruments of the poor,” Center for Social Science, University of Cape Town, available at www.financialdiaries.com.

Exhibit 1

Half the world is unbanked.

% of total adult population who do not use formal or semiformal financial services¹



¹Those not using credit or saving products from formal financial institutions such as fully regulated banks or from semiformal financial institutions such as partially regulated or unregulated microfinance institutions

Source: McKinsey research conducted in partnership with the Financial Access Initiative; financial usage data from Patrick Honohan, "Cross-country variation in household access to financial services," *Journal of Banking & Finance*, Volume 32, Number 11, 2008, pp. 2493–500.

ultra-low by having no cash or paper processes in its branches, using biometric authorizations (fingerprints and photographs) instead of identity cards (which would need to be validated), and offering unlimited free debit-card usage for transactions. To obtain cash, customers pay a small fee to use ATMs or take advantage of the free cash-back service when using their debit card at certain retailers.

To reach a wider range of customer segments without the cost of providing a suite of products, banks can offer a select set of extras for customers with higher account balances. The South African bank supplements its basic account by offering one savings and three loan products. The process for applying for one of its micro loan products takes less than

4 minutes. The teller enters the customer's details into the system, receives an electronic authorization, and issues the loan on a single-use ATM card that can be used immediately to withdraw the money.

One South American bank streamlined its mortgage origination by eliminating certain process steps to reduce cycle times. The changes created a more customer-friendly experience and reduced the cost of mortgage origination substantially. The bank was thereby able to target 70 percent of the population: 60 percent who could afford existing mortgages and an additional 10 percent with below-average incomes.

Alternative delivery channels

Leveraging alternative delivery channels is

a crucial ingredient in any attempt to deliver products and services to customers at the lowest possible cost, since branches are expensive to open and to run. Banks can take steps to minimize customer use of branches for basic transactions so as to reduce the cost-to-serve and free up branch employees to spend more of their time on opening new accounts and on active selling.

One South American bank has reduced the volume of transactions in its branches by following a

strategy to migrate customers systematically to ATMs and internet banking. For cash transactions, it helped customers learn how to use ATMs and provided visual instructions, while also reducing teller availability so that customers soon found it more convenient to use automated channels. After just 3 months, the use of ATMs and internet for teller transactions was up 15 percent. For service transactions, the bank directed customers to “migration spots”—kiosks equipped with phones and internet terminals where they could check account

New takes on classic lean methods

Many banks operating in emerging markets find that lean approaches need to be applied in different ways than in developed markets. In some places, these banks are able to take lean to a whole new level; in others, they face specific challenges that require innovative solutions.

Reducing waste

Reducing waste is a core principle of lean. Eliminating needless form-filling, opening fewer teller windows at slow times, and moving electronic rather than paper documents between the branch and the back office are common steps to most bank transformations. But some emerging-market institutions have been able to take waste reduction a step further. Unimpeded by the layers of legacy systems and processes that their developed-market counterparts often have to negotiate, they are free to design their lean operations from scratch and implement state-of-the-art solutions.

A South African microfinance bank, for example, has managed to move to paperless processes, streamlined from the point of entry onwards. New customers do not have to fill in an application form; instead, they sit with a staff member who enters the necessary details directly onto the system while they watch the screen to check

whether the information is correct. By minimizing errors, omissions, and rework in the data-entry process, this approach reduces risk as well as cost.

Centralized processing centers

Setting up centralized processing centers (CPCs) to handle core processes is standard practice for many banks, enabling them to capture economies of scale, develop deep expertise, and implement best practices systematically. Banks in the remoter regions of Africa, Asia, and Latin America, however, often encounter challenges in setting up CPCs. The lack of reliable infrastructure and the shortage of skilled employees make it difficult to collect and process data and send the results back into the branch in a secure, accurate, and timely manner.

Both incumbent banks and entrants from developed markets have seen good results by adopting a gradual approach to introducing CPCs, in which processes are first moved into local hubs and then centralized in national or regional centers. Such situations also offer great scope for integrating lean concepts with the large-scale IT systems projects that often accompany centralization efforts.

balances, print statements, pay bills, and use other services. The service-related workload for branch staff fell by almost 90 percent, much of the freed-up capacity was diverted into selling, and conversion rates increased substantially.

Perhaps the most ambitious example of leveraging alternative delivery channels is that of a Mexican bank that is working in partnership with the national government and the community-owned Diconsa retail network to reach 15 to 20 million low-income people in isolated rural areas. Diconsa's vast infrastructure—four times the size of other Mexican retail networks—spans more than 22,000 “mom & pop” stores that are now starting to offer basic banking

services as well as basic foodstuffs. Most of these stores are located in rural communities with fewer than 2,500 inhabitants, where access to financial services is virtually non-existent. The aim is to introduce a full suite of financial services to meet the needs of low-income customers, starting with government payments, then savings accounts and payments of utilities and other services, and finally remittances, credit, and insurance. Recipients of government benefits are given a card with a chip that stores personal information and a digital fingerprint. These cards could also be used in the future for banking transactions. Payments are delivered through a point-of-sale device that reads the cards and customers' fingerprints.

Exhibit 2

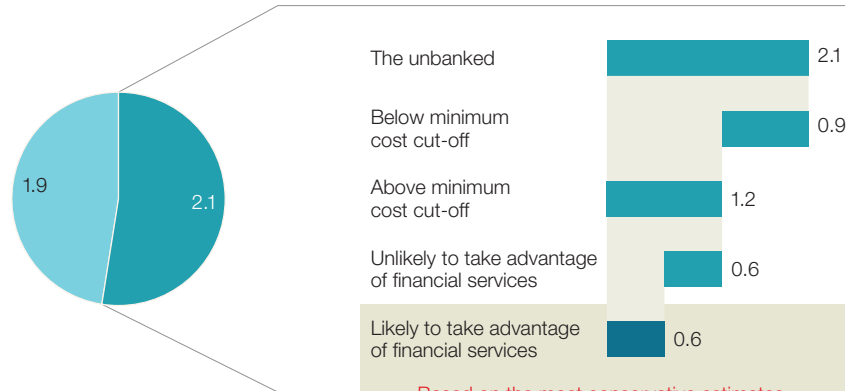
By greatly reducing costs, banks could profitably reach 30% of the world's “unbanked” population.

Potential market available to banks with a cost-to-serve that is 65% lower than average

Economically active population worldwide

Billions of people

- Access to financial services
- The unbanked



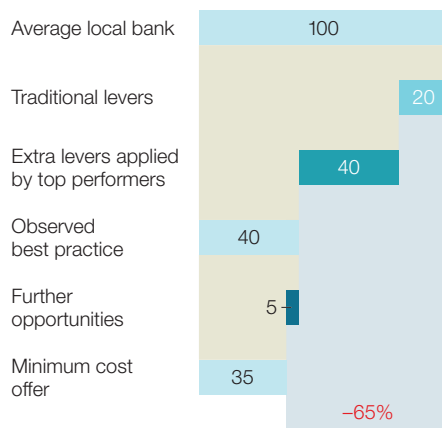
Based on the most conservative estimates, this segment would yield additional bank revenues of more than US\$ 35 billion and profits of more than US\$ 8 billion.

Source: CGAP; World Bank; Global Insight WMM; Euromonitor; McKinsey Global Banking Pools

Exhibit 3

One African bank is operating at a cost-to-serve 60 percent lower than competitors.

2008 cost per customer, indexed



Sample actions

- 1 Redesign workflows and processes
- 2 Centralize back-office processes
- 3 Radically simplify the product
- 4 Use alternative distribution channels
- 5 Radically simplify the branch design
- 6 Optimize IT investment
- 7 Maximize teller productivity (e.g., by training tellers to cross-sell and make sales calls during idle time)

The opportunity for banks

The opportunity is significant for banks that manage to combine world-class operating efficiency with a radical rethinking of standard industry practices in product development and delivery. By reducing their operating costs to 65 percent below local industry averages, we believe banks could open a vast new global market. Its size is hard to fix precisely, but it could involve 600 million people, generating revenue of US\$ 35 billion, with potential profits to banks of US\$ 8 billion (Exhibit 2).

But is achieving a 65 percent cost reduction attainable? We think so. One emerging-market bank we know already operates at a cost-to-serve that is 60 percent lower than the average local bank, and still has scope for economies that could deliver an extra 5 to 10 percentage points in savings (Exhibit 3). We are convinced that reaching hitherto “unbankable” customers is a realistic prospect for truly lean banks that adopt the innovative

product development and delivery strategies described above.

Deepening relationships with existing customers

Using lean to reduce costs and reach new customers is not the whole story. When banks eliminate waste in processes, the freed-up time can be diverted into more productive sales activities. The scope for cross-selling in emerging markets is considerable: for instance, the average Indian bank customer holds only one and a half products with her bank, and the average Chinese customer holds two and a quarter, whereas the average UK customer holds between five and six.²

Lean provides systematic ways for banks to boost their cross-selling; indeed, some of the most effective cross-sell programs we have seen came as part of lean transformations (see “Boosting sales in branch and agency networks through lean,” p. 112). One Nigerian bank capitalized on the 30 percent productivity gains from its lean

²Estimates for average number of products held by customers from the top four banks in each country in 2007–2008, based on “Growth for Knowledge” survey, “Partners for Financial Stability” survey, and the World Bank report *Finance for All?: Policies and pitfalls in expanding access* (2007).

program by training its tellers to use their freed-up time for cross-selling. Within a year, it had increased the average number of products per customer by 70 percent. At another bank that has recently embraced lean, more than 60 percent of customers noticed significant improvements in branch service. A better in-branch experience is a powerful inducement for customers to expand their relationship with their bank.

Preparing for geographic growth

A bank that has developed a scalable, cost-effective operating model and focused its employees on the constant search for further improvements is ready to redeploy valuable resources towards winning more business. That might mean extending its geographic coverage by opening

more branches, or pursuing M&A and quickly absorbing acquisitions.

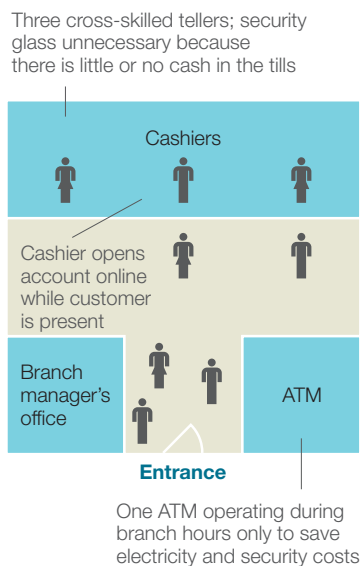
A Middle Eastern bank capitalized on its lean operations to improve the performance of a new acquisition quickly. The acquired bank's branches were paired with existing lean branches to enable rapid peer-to-peer skills transfers. In addition, experienced lean change agents were deployed to coach branch managers through the changes, and were equipped with a set of standard processes and tools that had been developed at lean showcase sites. A senior manager from the acquired bank reflected, "When I saw what they were able to do with their performance management tools and daily performance meetings, there was no doubt any more that this was the way to

Exhibit 4

Creating highly efficient design-to-fit branch layouts.

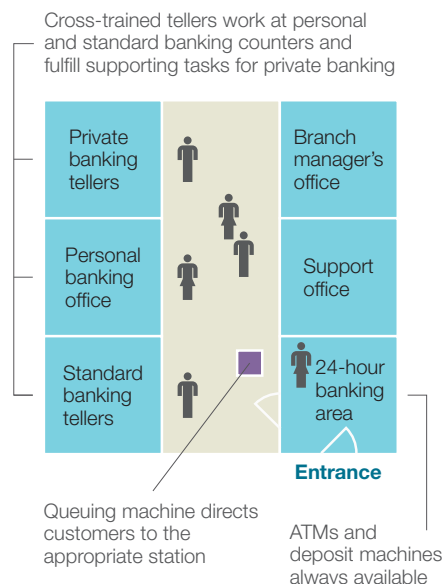
Low-cost offering

African example



Multi-segment offering

Middle East example



go.” Sales in the acquired branches rose by 150 percent, and average queuing times fell by 85 percent.

Lean is helpful not just for banks with an aggressive acquisition strategy, but also for those pursuing organic growth. As one client recalled, “Once we had designed our standard branch, we could replicate the building process in the same way that retailers replicate their stores. It took all of the complexity out of the process.”

Bridging the market divide

While it is undeniably challenging to devise a delivery model that serves both the low and high ends of the market, the benefits of doing so are formidable. Operating separate offices for private banking and other services adds cost and complexity to a bank’s network. To serve a wide variety of customers in one branch, some banks are using formats like those illustrated in Exhibit 4.

The branch model depicted on the left is for a bank targeting the low-income market, where profitability depends on keeping the cost-to-serve as low as possible. The model on the right uses an advanced queuing system to provide appropriate service at both ends of the market. When customers enter a branch, they swipe their debit or ATM card to identify themselves and the machine directs them to the part of the branch that will serve them. Low-end customers are sent to the regular teller queue or to a floor manager who can show them how to use the ATM or deposit drop-box. High-end customers get a priority place in the queue or are sent to relationship managers and higher-skilled sales people.

Leading players are likely to experiment further with mixed models. Introducing elements from extremely low-cost models offers considerable promise: for instance, distributing cash

exclusively through ATMs means that branches need fewer tellers and there is no need for security barriers between customers and staff. At the same time, the growing middle class in emerging markets is increasing the demand for personal and private banking services. The ability to offer a wide variety of banking experiences in one branch is likely to be a key element in cost-efficient banking in the future.



For local or global banks operating in emerging markets, lean management offers more than just an opportunity to play catch-up with best practices in developed markets. For institutions that can develop an ultra-low cost base and radically innovative products and distribution, emerging markets are rife with opportunities. And a few leaders will be able to leapfrog their counterparts in developed markets by taking lean to a whole new level in their pursuit of efficiency and growth. ○

Marco Breu is a principal in McKinsey’s Hanoi office.

Francisco Ortega is a principal in the Buenos Aires office, and **Roeland Verriest** is an associate principal in the Johannesburg office. Copyright © 2011 McKinsey & Company. All rights reserved.

Further reading

Alberto Chaia, Tony Goland, and Robert Schiff, “Counting the world’s unbanked,” *McKinsey Quarterly*, March 2010.

Gabriela Zapata Alvarez, “Turbocharging the client proposition through proximity: Agency banking in Latin America,” Bill & Melinda Gates Foundation, November 2010.

Vipul Agarwal, Tab Bowers, Renny Thomas, and Toshan Tamhane, “Winning in Asia in the next normal,” McKinsey & Company, 2010.