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Financial Services

PERSPECTIVES

MIDDLE EAST BANKING: CONTINUED HIGH GROWTH

STRATEGIC IMPLICATIONS FOR RETAIL BANKING

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Middle Eastern banking is in a maturation phase, getting closer to the sophistication of the most advanced economies. We expect banking revenues in the Middle East to quadruple over the next twenty years. Realizing this overall potential will require the continued development of "enabling" institutions and infrastructure, such as credit bureaus. And individual banks seeking to capture a significant share of this upside will need to build capabilities in retail banking and decide upon distinctive go-to-market offering.

In this brief Oliver Wyman Perspective, we sketch the revenue growth potential of the region, the institutional requirements for realizing it and the strategic imperatives for GCC banks specifically, in both their domestic and foreign markets.

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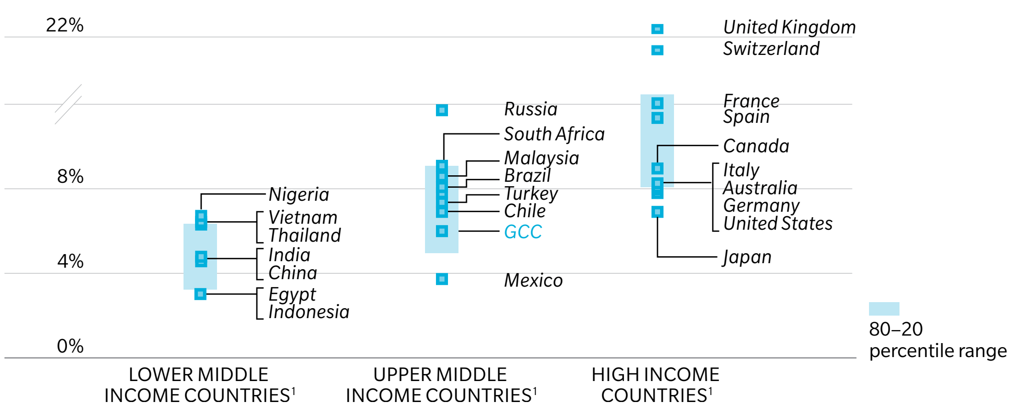
1. BANKING IN THE MIDDLE EAST: CURRENT AND PROJECTED MARKET SIZE

As a country's GDP increases, so do the revenues of banks operating in it – not only absolutely but as a percentage of GDP. The Gulf nations (or GCC, the primary focus of this paper) are currently "upper middle income" countries. Banking revenues are about 5% of GDP, which is relatively low for their peer group (see Exhibit 1). This suggests that there is plenty of room for continued growth in banking revenues in this region.

These growth prospects contrast starkly with those of banking in high income countries, which have already slowed down dramatically (see Exhibit 2).

EXHIBIT 1: BANKING REVENUE – SHARE OF GDP – CROSS COUNTRY COMPARISON

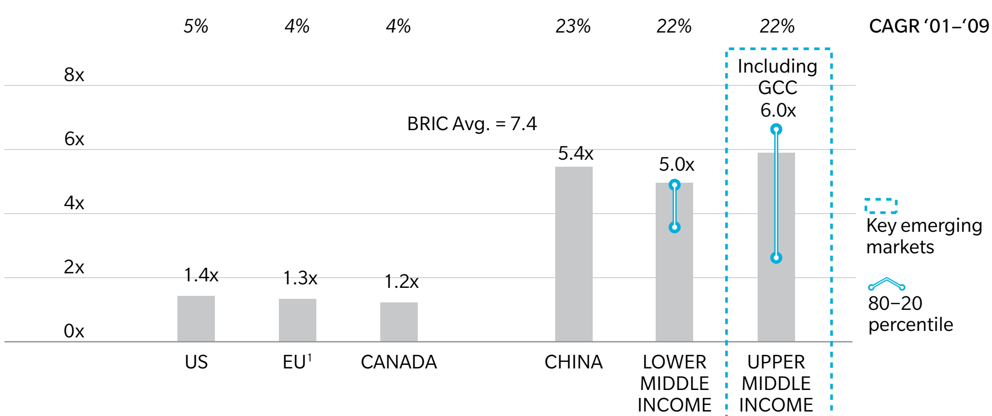
BANKING REVENUE[2] SHARE OF GDP



1. Income categories defined using GDP per capita (PPP) as per World Bank Atlas classification methodology
2. 2009 revenue based on all banking revenue – retail and commercial

EXHIBIT 2: GROWTH IN BANKING REVENUE (2001–2009)

BANKING REVENUE IN 2009/BANKING REVENUE IN 2001



1. Germany, Spain, France, Italy, Austria, Belgium, Denmark, Norway, Sweden, Switzerland

Note: Upper Middle income – Key EMs include GCC, Malaysia, Mexico, South Africa & Turkey,; Lower Middle Income – Key EMs include Egypt, Indonesia & Nigeria; BRIC are Brazil, Russia, India & China

Source: OECD, Bankscope, Oliver Wyman analysis

Oliver Wyman has modelled the growth of banking revenues at the national level. Exhibit 3 shows the five factors to be most predictive.

EXHIBIT 3: THE FIVE BANKING GROWTH FACTORS

DETERMINANTS OF BANKING GRWOTH MULTIPLIER

1. INCOME LEVELS
2. BANKING CONTRIBUTION TO GDP
3. LOW ACCESS TO BANKING
4. ADEQUATE LEGAL PROTECTIONS
5. LOW REGULATORY RESTRICTIVENESS

Growth potential[1]

Key enablers[2]

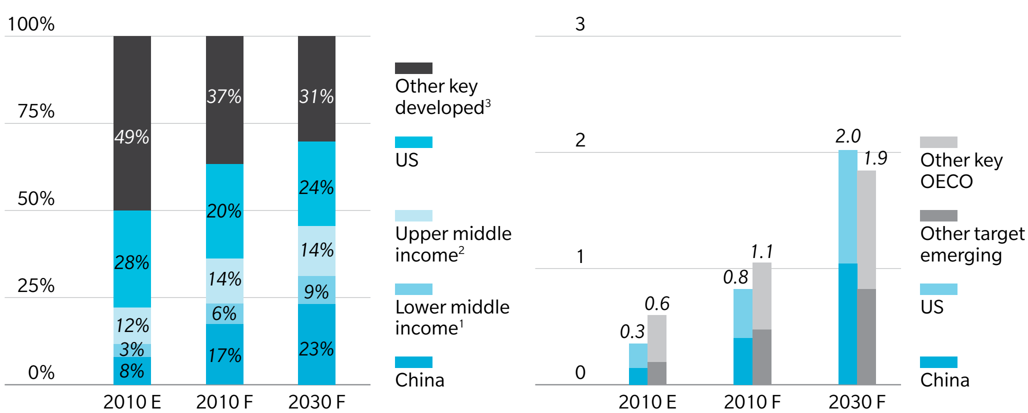
1. Growth Potential is a combined measure of income level, banking revenue share of GDP, banking access levels today
2. Key Enablers measures the evolution of legal protectiveness, non-restrictive regulations

Differences in future growth rates mean that the picture of global banking will fundamentally change. Emerging markets will soon contribute as much banking revenue as developed markets. Developed markets' share of global banking revenues will fall from 77% in 2010 to 55% by 2030 (see Exhibit 4).

EXHIBIT 4: BANKING REVENUE VS. RISK-ADJUSTED PROFIT

BANKING REVENUE AS % OF TOTAL
FOR MODELED EMERGING AND DEVELOPED MARKETS

RISK-ADJUSTED PROFIT (US $TR)
OPERATING PROFIT/EXPECTED LOSS

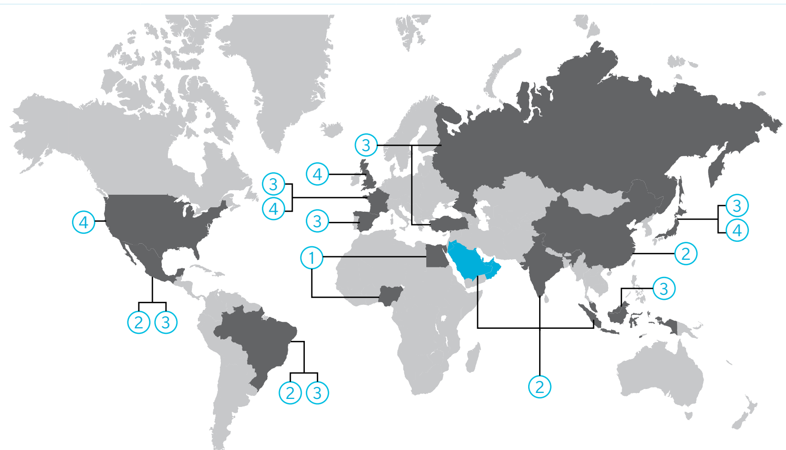


2. THE EVOLUTION OF RETAIL BANKING IN THE GCC

Retail banking will be the largest part of revenue growth in the GCC. Banking in emerging countries has typically been concentrated on commercial clients. As the economy grows, both consumers and small businesses become credit worthy, and retail lending begins to take off (see Exhibit 5). The GCC has already entered that growth phase, though some parts of the retail business remain underdeveloped, such as mortgages and business banking in Saudi Arabia.

EXHIBIT 5: BANKING SECTOR EVOLUTION

SIMPLIFIED BANKING EVOLUTIONARY PATH			
1. WHOLESALE BEGINNINGS	2. RETAIL GROWTH	3. MATURATION	4. COMPLEXITY
• Mainly commercial lending – primarily asset-based/small mortgage market • Traditional brick-and-mortar institutions providing current and savings accounts • Limited SME focus	• Easy lending to low-risk consumer segments, simple credit e.g. credit cards, payday loans • Term deposits with differentiated rates/ packages • Dedicated SME proposition	• Working capital loans, consumer finance, growth in mortgages • Advent of simple investment products, and proliferation of innovative channels e.g. online banking • Differentiated SME offerings	• Complex offerings, well developed mortgage market • Lower risk alternatives for the mass market (e.g. retail structured products) • Well segmented SME offerings



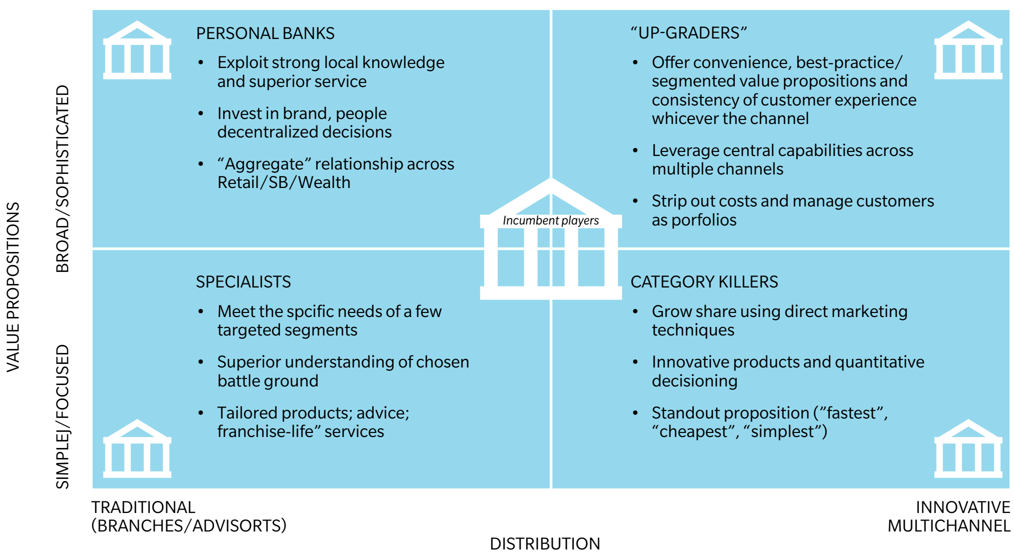
This growth of retail banking in the GCC requires that certain "enablers" are in place. Through our work with local banks and regulators, we have identified five:

1. **Infrastructure**, such as secure payments and credit bureaus
2. **Free competition** that does not disadvantage the most efficient players, which will often be foreign
3. **Rule of law**, including secure property rights and efficient legal processes
4. **Light-touch regulation** that does not artificially drive up the cost of doing business
5. **Political stability** sufficient for confident investment

3. STRATEGIC CHOICES FOR GULF RETAIL BANKS

How to capture this market growth? Most GCC markets are dominated by one or two incumbent banks. What should the others do? There are several possible strategies that smaller players employ (see Exhibit 6).

EXHIBIT 6: TITLE



Differentiation is the key to winning business away from the incumbents. This has been most witnessed in the United Arab Emirates where banks have challenged the largest institutions by, for example, developing product-specific propositions (e.g. specialization on business loans, credit cards, mortgages), pushing a differentiated sales approach (e.g. relying heavily on direct sales force vs. branches) etc.

However, some challenges are common to all GCC banks. As a first step, they should get the basics right in order to make their strategies successful (see Exhibit 7).

EXHIBIT 7: TITLE

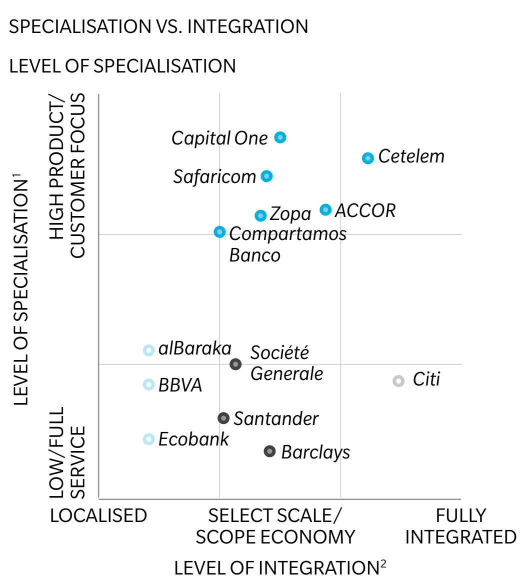
CUSTOMER ↓	1. Invest in customer data
PRODUCT ↓	2. Increase granularity in customer segmentation
	3. Needs-based tailoring of value proposition and delivery
CHANNEL ↓	4. Innovation in serving under/ un-banked and higher risk segments
ORGANISATION ↓	5. Break down the barriers between retail and corporate
	6. Manage your talent
OPERATOINS ↓	7. Run the bank at highest attainable efficiency levels
	8. Upgrade risk management infrastructure

4. COMPETING AT THE REGIONAL AND INTERNATIONAL LEVEL

A number of GCC banks have ventured outside their countries. They first expanded into other Gulf States without going big into retail banking. Some went farther, establishing large presences in countries such as Turkey and Egypt. The Maghreb, Malaysia, Indonesia have also attracted interest and investment. Qatari banks have recently been the most active in terms of international expansion.

As in their domestic markets, GCC financial institutions cannot win on an international scale without a clearly differentiated positioning. We typically see 4 types of approaches for multi-country players (Exhibit 8):

EXHIBIT 8: BUSINESS MODELS FOR MULTI-COUNTRY PLAYERS



THE GLOBAL LOCALISERS
- Local business able to "plug into" global factories
- Focused around global functional excellent and maximizing scale/cscope economies
- High-level of cross-border integration

THE SYNERGIZERS
- Cover multiple markets run usually as a portfolio of banks, generally grown as regional/country operating models adapted to local variations
- Often multiple brands

THE MULTI-LOCALS
- Local decision making and entrepreneurship, Loosely affiliated centres, multiple brands
- Difficult to benefit from scal economies, focus of short term profit maximization

THE RISING SPECIALISTS
- Players with specialist focus, includes card specialists, payment processors
- Sometimes limited footprint due to competitive/regulatory barriers

1. Level of specialization: The product range/focus of a player. At one extreme are the universal banks offering a range of retail products and at the other extreme are the product specialists focusing on single product or limited sets of products.

2. Level of integration: The level of delegation/independence of the seperate business units from fully integrated to fully decentralised, local operations.

More specifically, banks must adhere to four basic principles given the combination of high growth expectations, volatility and evolving market structure (Exhibit 9).

EXHIBIT 9: FOUR PRINCIPLES

A. AVOID FRAGMENTED BETS: Pick a portfolio of focus markets that fit with internal capabilities and overall strategy

B. INVEST FOR THE LONG-TERM to offset volatility effects and capture value demonstrated vis-a-vis developed markets

C. DON'T UNDERESTIMATE LOCAL and regional players

D. DEVEOP STANDALONE "KILLER APPS"

Based on the type of business model, these four principles will mean different actions (Exhibit 10).

EXHIBIT 10: ACTIONS

1. THE GLOBALS	2. THE SYNERGIZERS	3. THE MULTI-LOCALS	4. THE RISING SPECIALISTS
• The big question here is the sustainability of a large international presence • Players need to focus on dealing with stiff competitoin with domestic giants in each of the markets • Being able to resonate with growing retail customer base will be critical to win	• Realize synergies across geograhphies to better manage operational costs • Share product innovations/ lessons learned • Focus on selected markets and aim to gain scale and build operational excellence	• As these players grow, the key is to not be overly fragmented in terms of presence • Eventually, build the capability to realize synergies across multiple country operations	• Players should look to build and maintain a differentiated value proposition • Nimble mobile banking players can prove to be a threat to incumbents (e.g. MPesa in Kenya) • Can be used as a viable model for market entry into more closed markets by large universals

CONCLUSION

The GCC retail market is in a maturing phase. Banks need to invest in developing better customer analytics and more granular segmentations, efficient distribution channels, improved products and better brands. They are also building stronger supporting capabilities, especially in operations and risk management.

But banks should not solely focus on capability building. They should also make clear strategic choices, on their home market as well as on the international scene. We have seen too many institutions implementing me-too strategies, and this certainly does not work over the long term. In this paper, we have outlined a number of strategic options – "Up-grader", "Personal bank", "Specialist", "Category killer", "Localizer", "Synergizer", "Multi-local" etc. – which should be considered by the banks that seek to differentiate themselves.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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