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**Strategy & Channels**  
**The Global Banking Strategy Summit**  
**7 February 2005**

**GCC Retail Banking Strategies**

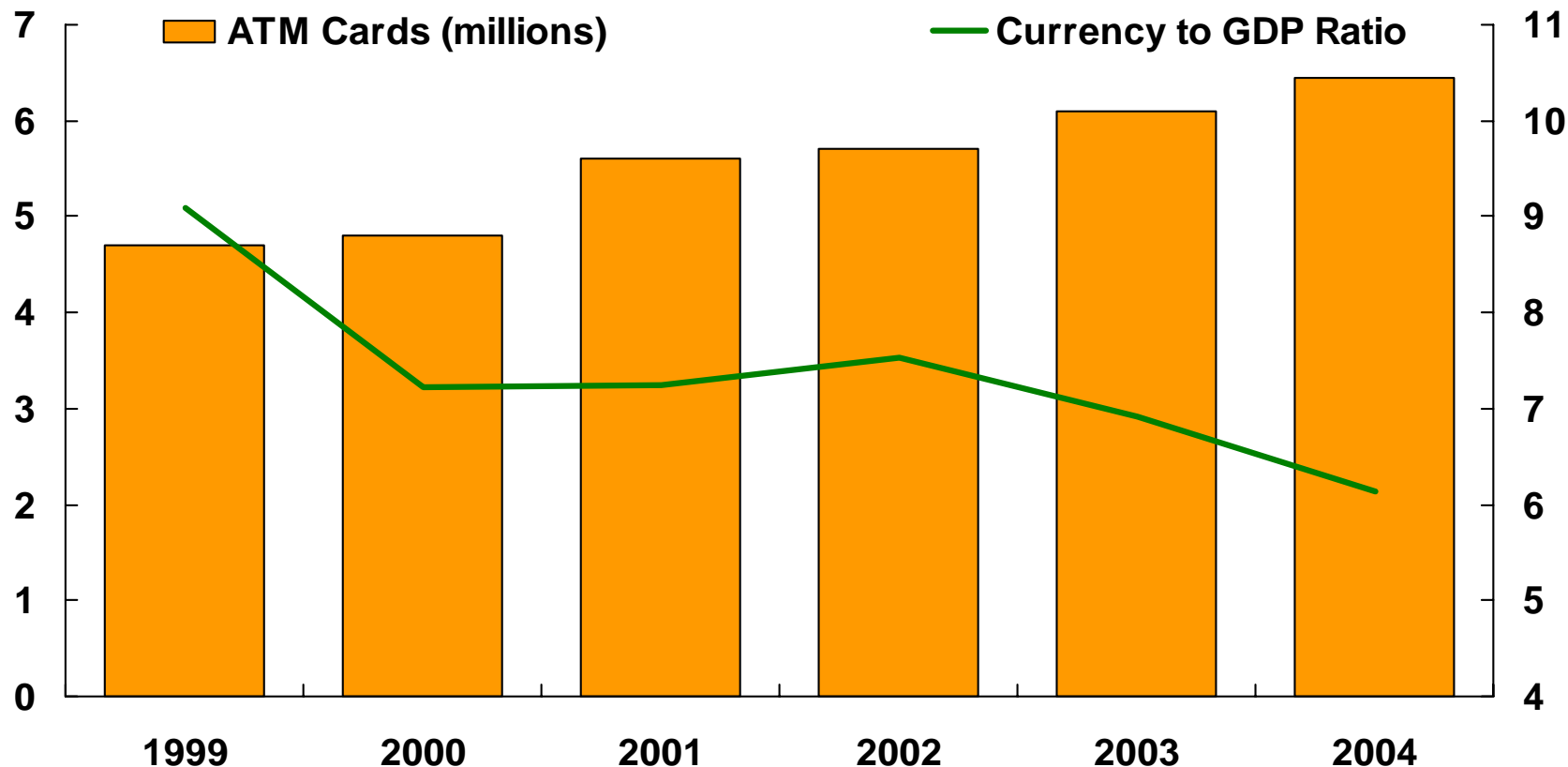
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## Economic and Regulatory Development Driving Retail Banking Activities In the Gulf

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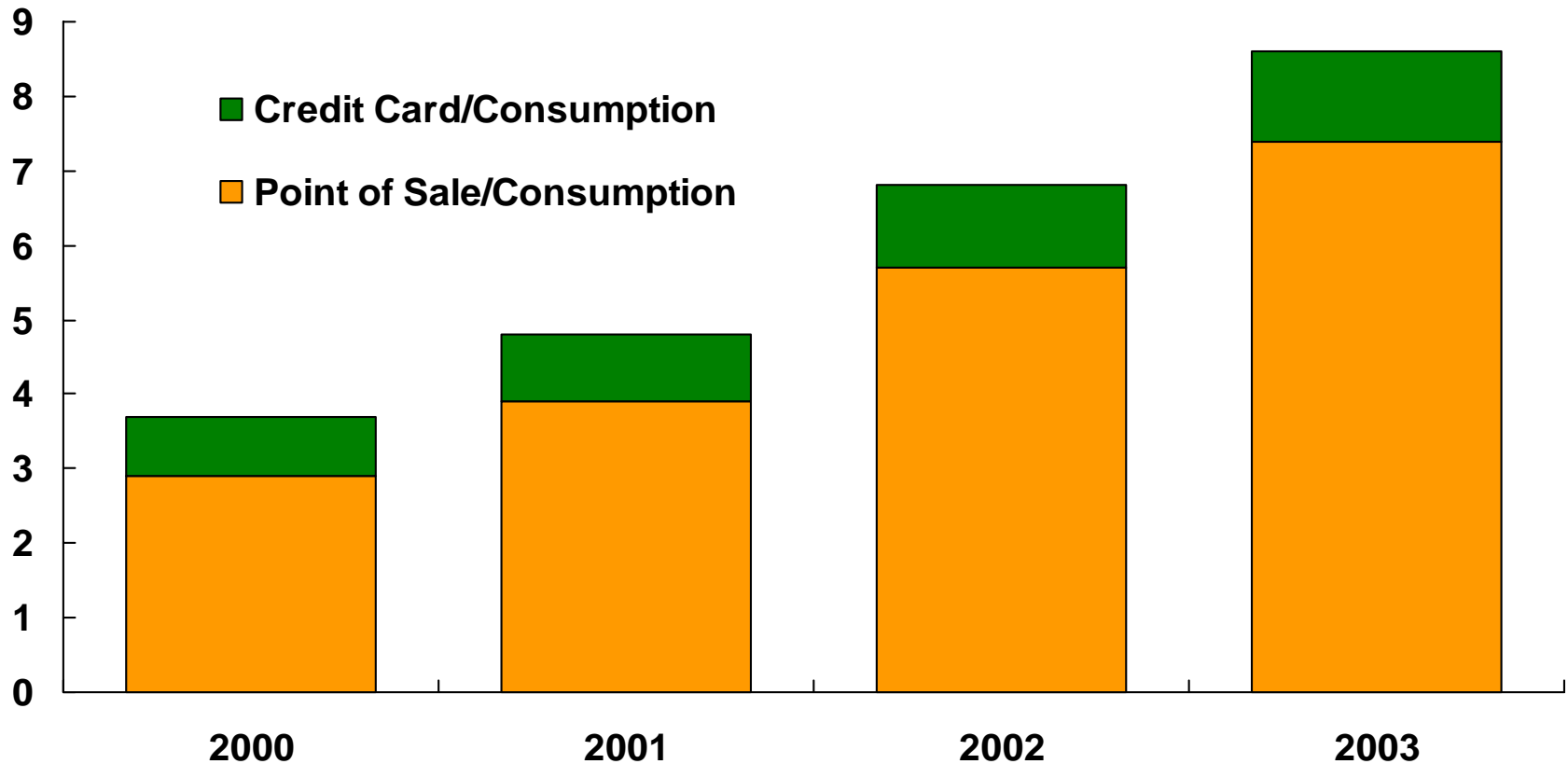
- 1) Retail Banking started in early nineties but accelerated only in the late 90's.
  - 2) Redistribution of oil wealth through wages along with modernization contributed to reducing habit of holding cash.
  - 3) Incentives by authorities to redirect people's savings and salaries to bank;  
*Example:* Saudi government pay salaries electronically directly to employee's bank accounts, through "Saudi Arabian Riyal Interbank Express" (SARIE) system.
  - 4) Rapid development in IT helped to attract more clients and make retail transactions faster & cheaper
  - 5) As salary assignment made mandatory if a loan is granted, banks expand their retail lending.
  - 6) Why? Across GCC Countries, retail loans in total outstanding is in 25% - 40% range.
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## ATM Cards Are Rising As Currency In Circulation Continues To Fall In Saudi Arabia



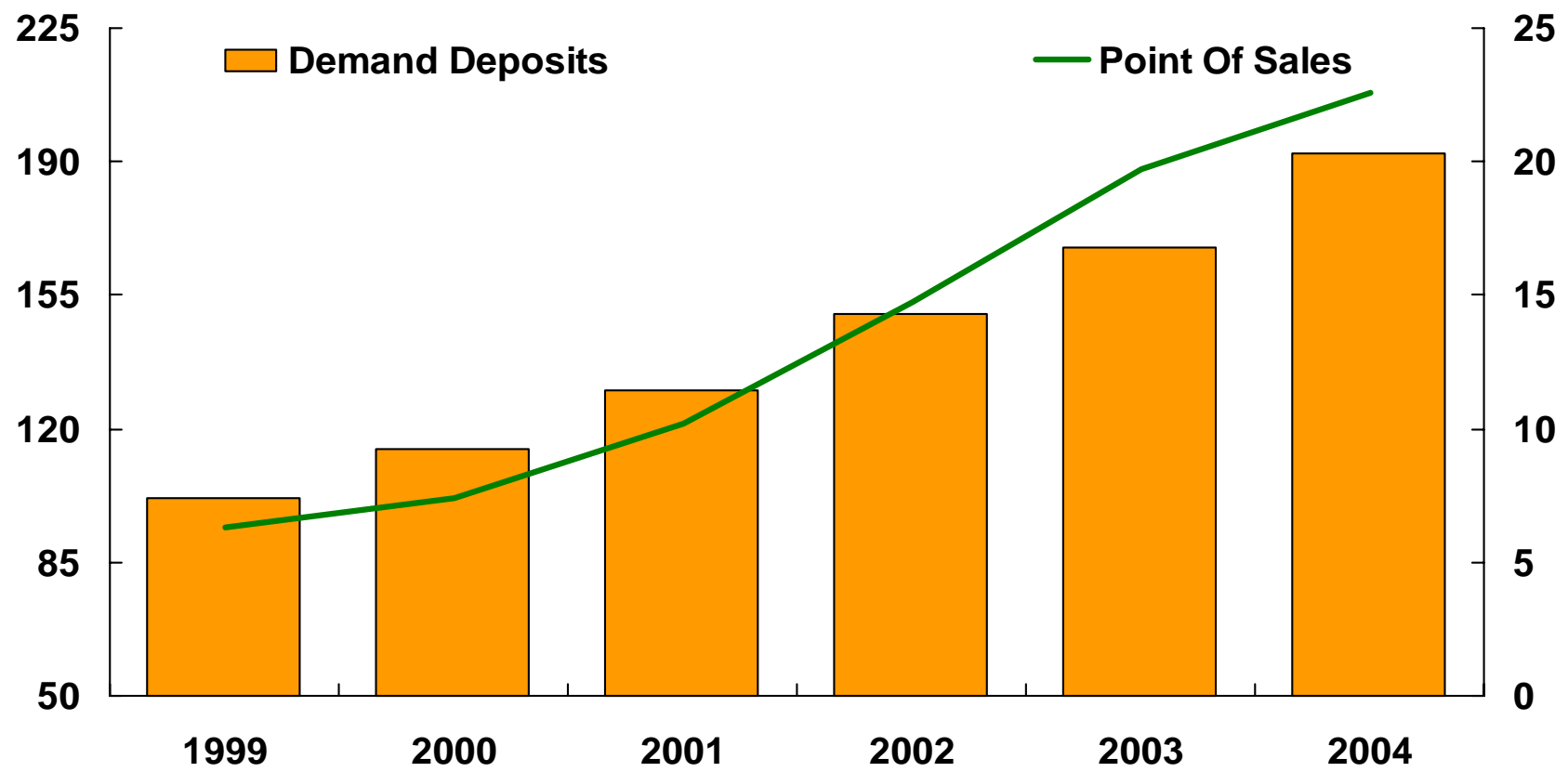
## Migration From Paper-Based Payments Is Sticky Though Is Changing Rapidly In Saudi Arabia

### Percent of Private Consumption

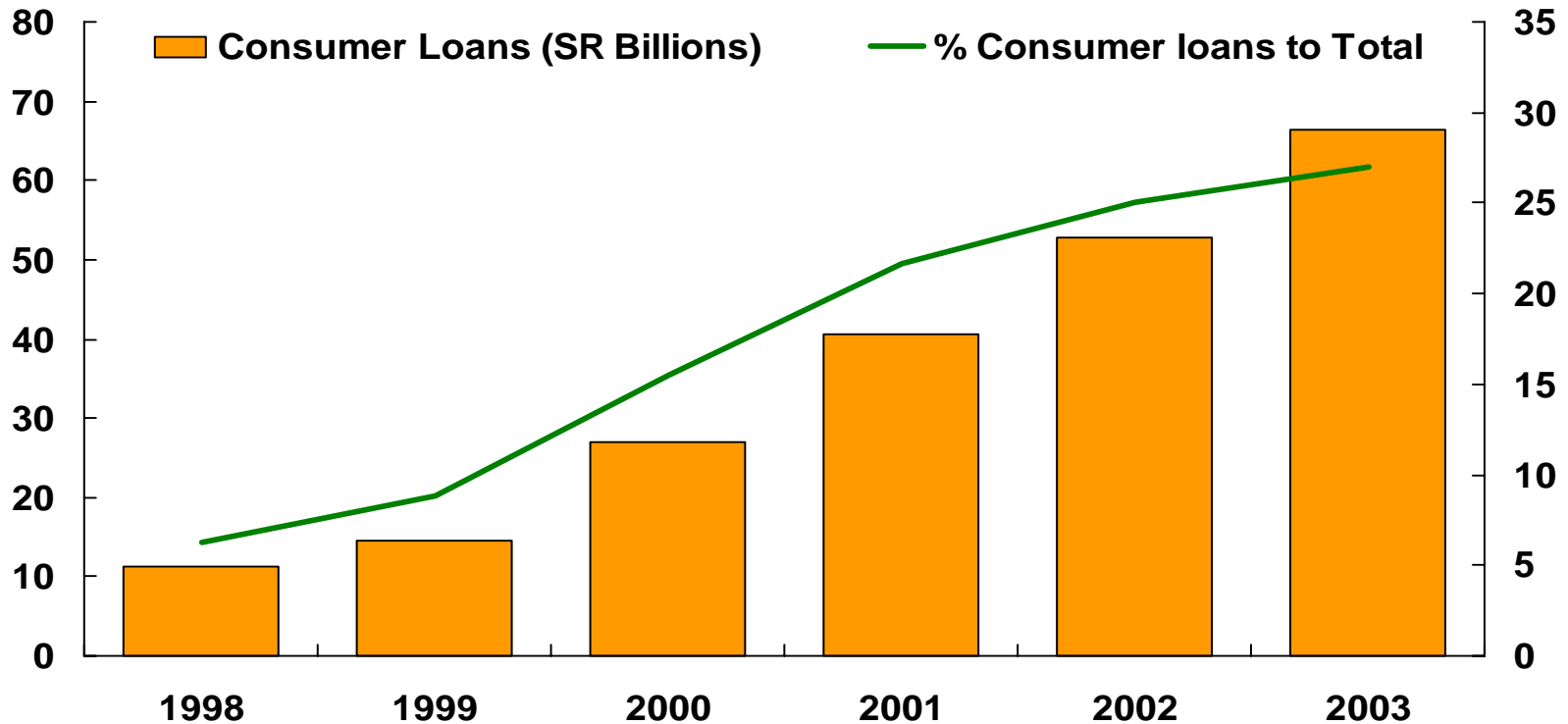


## As Point Of Sales Volume Continues To Rise, Demand Deposits Show Strong Growth

SR Billions



## Introduction Of Saudi Arabia Riyals Inter-Bank Express Enabled Banks To Expand Consumer Loans



## Retail Banking Model In GCC: Business Volume & Limited Risk

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### Choosing Volume:

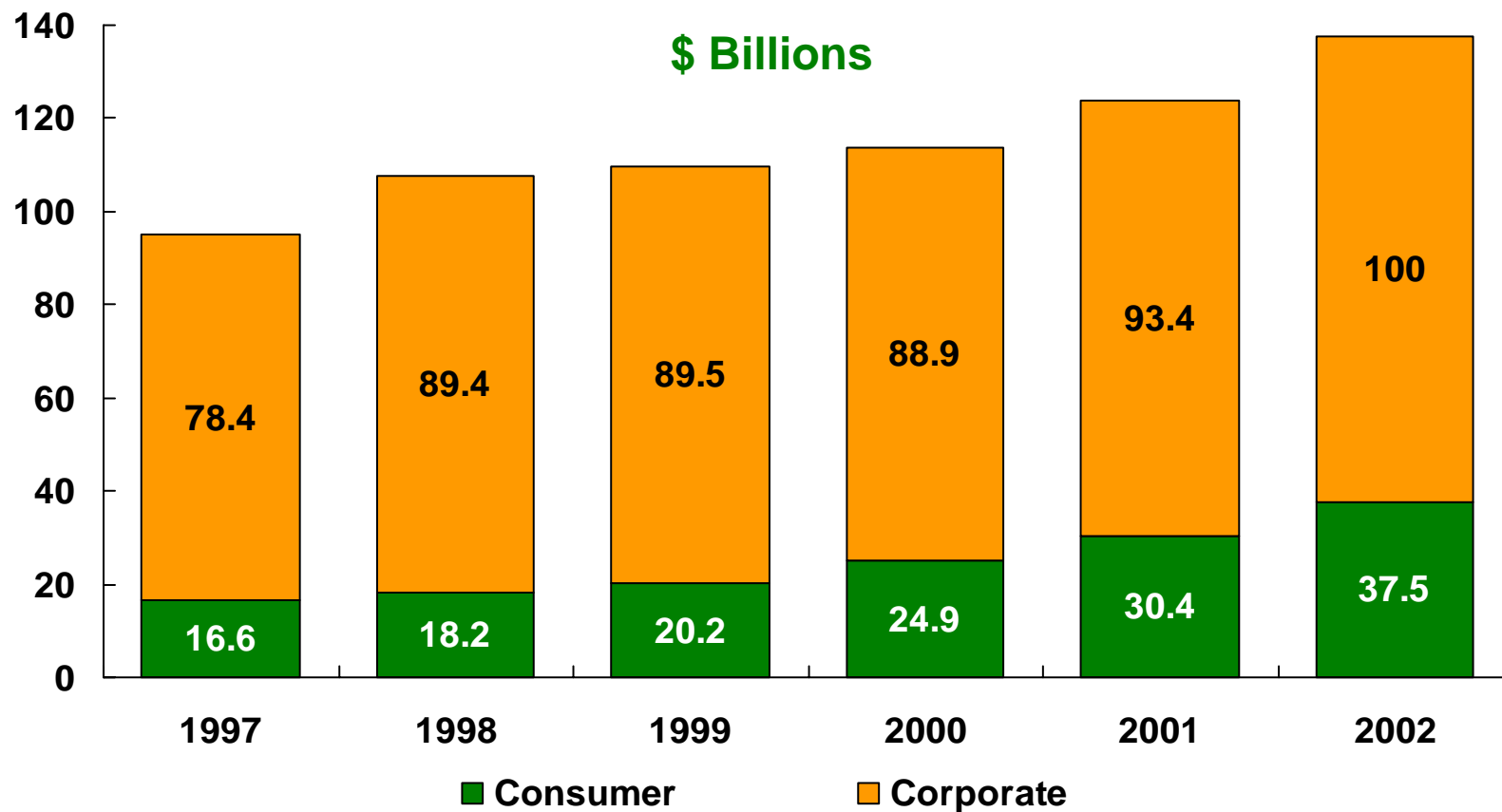
- Dealing with employed nationals and white-collar expatriates.
- Choosing a segment naturally growing and faces limited competition on interest rates.
- Focusing on educated young who tend to be adept at using self banking delivery channels.

### Focusing on Limited Risk:

- Mandatory salary assignment, social status of bankable population, tight collateral conditions ⇒ banks face limited risks.
  - Credit is collateralized by financed asset itself, cash deposits and shares when available, (Banks rely less on real estate as security due to difficulty of foreclosure in case of non-payment).
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## Retail Credit Portfolio has been showing real momentum and high growth rates of demand

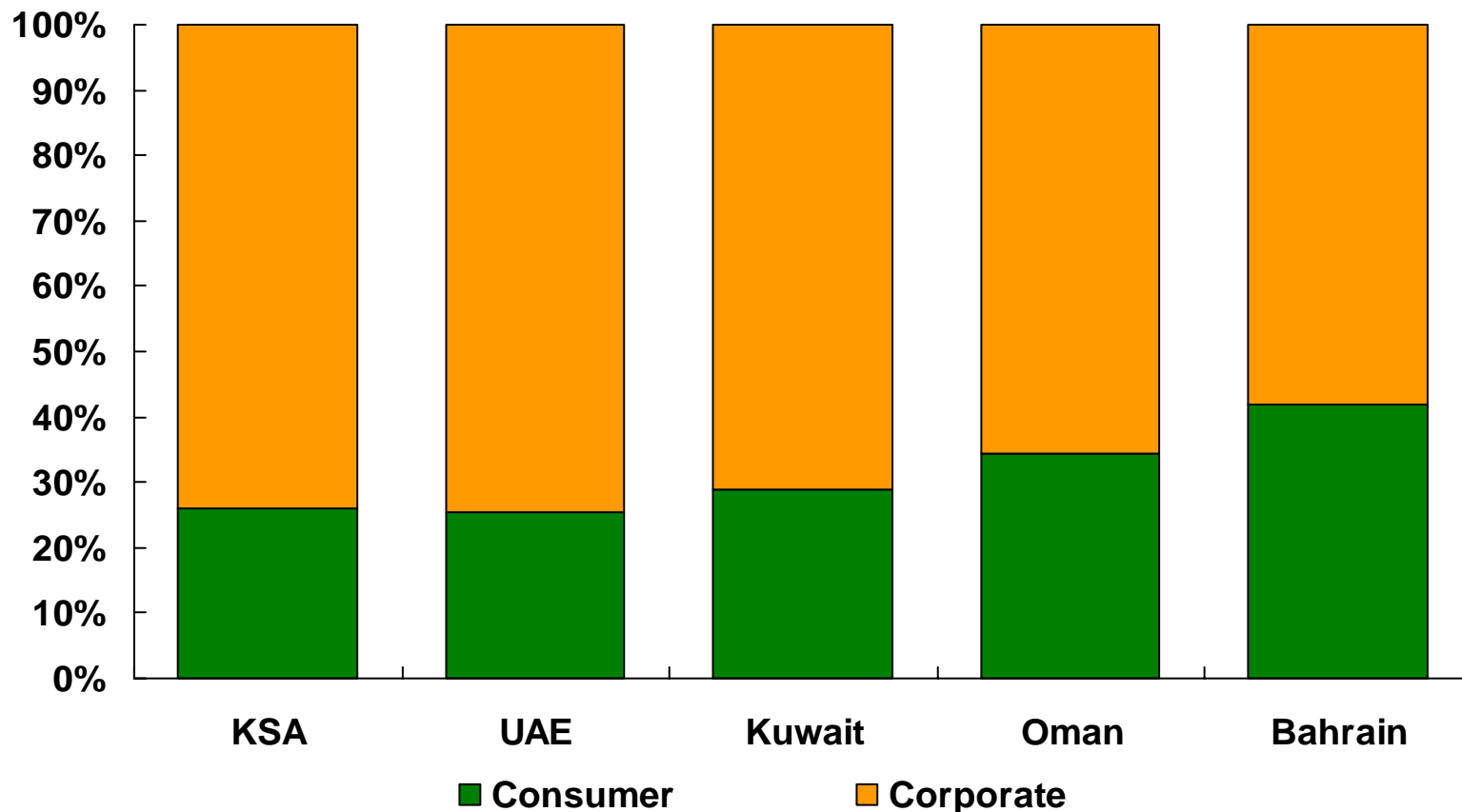
### Credit by Type of Borrowers for GCC Countries





## Banks have been promoting retail products as corporate sector has been lacking momentum

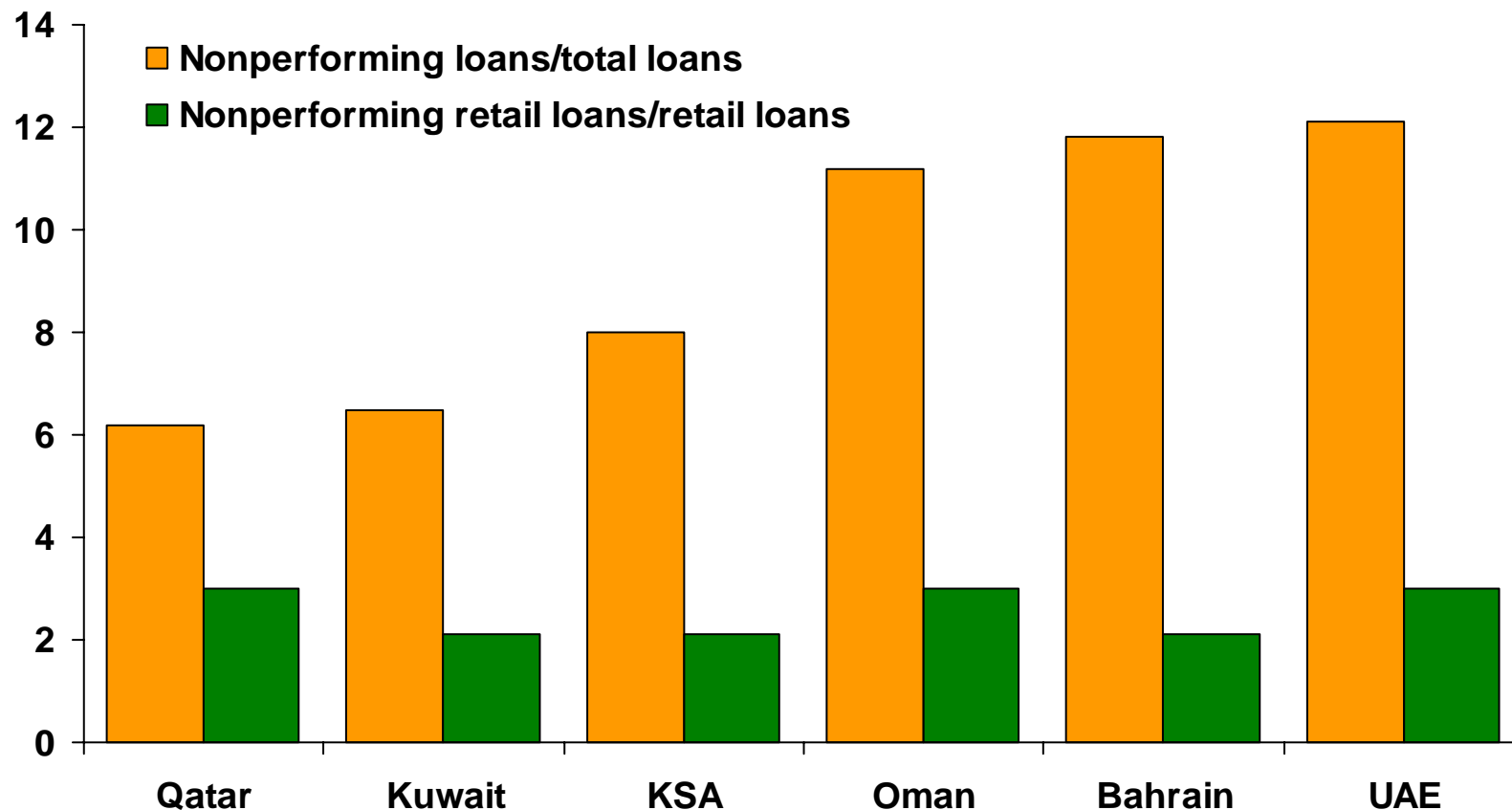
### Credit by Type of Borrowers, 2002



## Credit/Debit Cards and Branch Density in the Six GCC Countries, 2002

	No. of Debt & Credit Cards (000s)	No. of Branches	Population (000s)	Branch Density (No. of Inhabitants per Branch)
<b>Bahrain</b>	200	102	670	6,569
<b>Kuwait</b>	1,200	154	2,270	14,740
<b>Oman</b>	600	330	2,410	7,303
<b>Qatar</b>	153	108	610	5,648
<b>KSA</b>	2,200	1,194	22,700	19,012
<b>UAE</b>	1,300	410	3,440	8,390
<b>Total</b>	5,653	2,298	32,100	13,969

## Non-performing Loans in GCC Banking System, 2002



## GCC Retail Banking Resembles an Oligoporous Structure

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- Banking system in GCC economies is concentrated (Except of Bahrain and UAE)
  - Oligopolistic behavior tends to dominate:
    - Non-price competition prevailing over price competition.
    - Interest charge is close to (11%) in Oman, max authorized by Central Bank.
    - Competition centers on:
      1. Quality of supply
      2. Collateral requirements
      3. Commercial Strength
  - Except for Oman, yield in other countries is 6%-8% on average, trading downward due to lower interest environment.
  - Most price competitive market is UAE with 47 financial institutions.
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## Booming Retail Banking Largely Accounts for Success in Islamic Banking

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- Oligopoly limited incentives to compete on pricing; safeguard margins
  - Strategic issue has become non-price competition ⇒ Differentiation
  - Strategies focused on maintaining or obtaining a large market share.
  - Small banks have to deal with the dilemma of differentiation.
  - Some specialized in niche strategies:
    - Specializing in Islamic Banking
    - Examples: - Aljazeera in Saudi Arabia
    - NBS in UAE
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## Launching Sharia-Compliant products To Be More Effective To Compete Conventional & Foreign Banks

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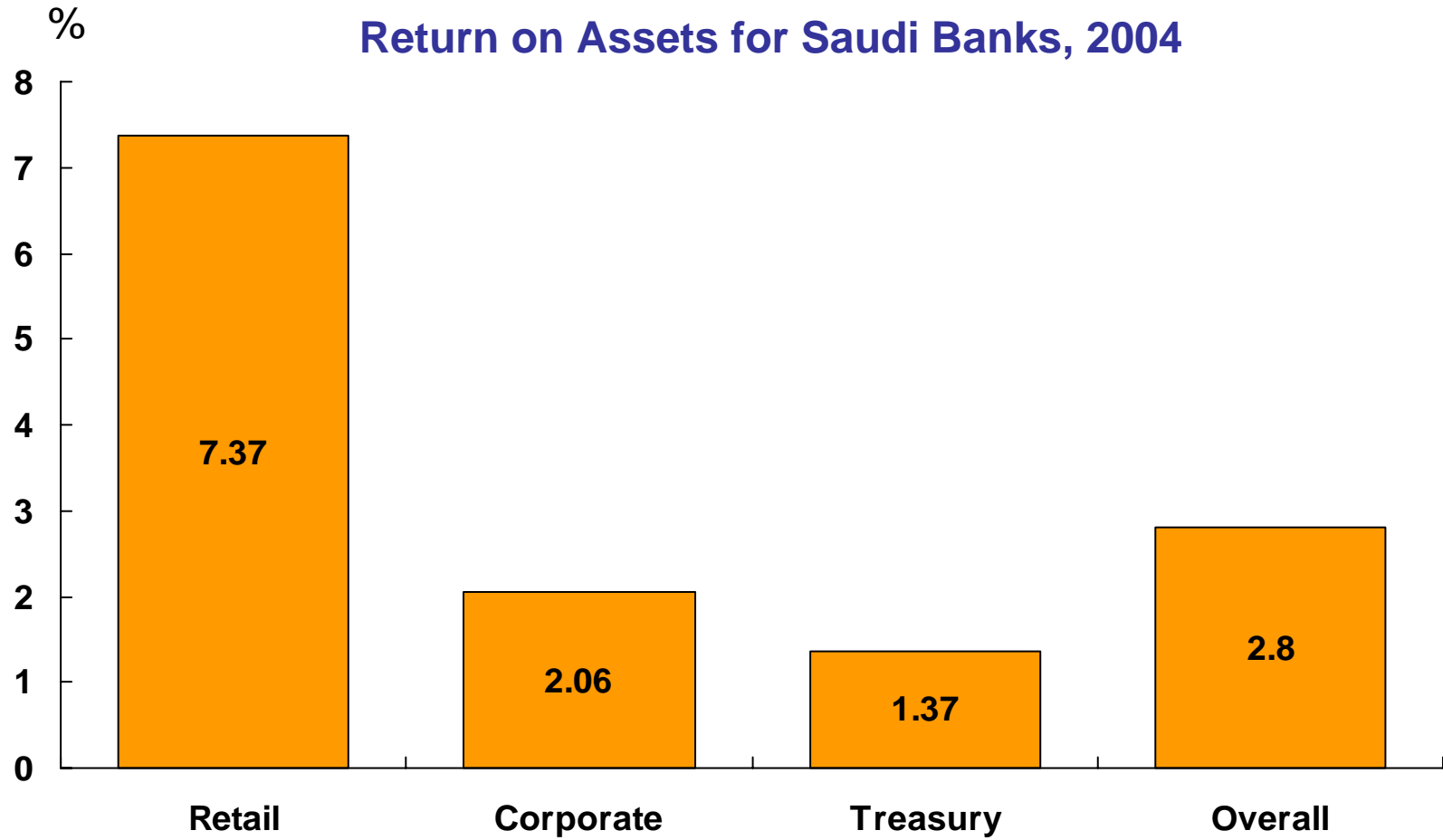
- “ Emirates Model” Setting a subsidiary: MEB, a retail bank, was transformed by Emirates Bank International into Islamic Banking.
- “NCB Model” : Dedicated Islamic branches, but recently has taken a decision to convert all into Islamic banking.
- “Full Islamic Banking:
- Alrajhi in Saudi Arabia
  - Newly established AlBilad (\$800 m) in Saudi Arabia
  - Newly licensed Bubiyan Bank (\$300 m) in Kuwait
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## Islamic Products Are Generally Profitable

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- Demand for Islamically structured products is supporting high profitability of retail banking.
- On the liability side of Islamic bank's balance sheet, a significant portion of deposits is free, thus reduce cost of funding.
- Islamic banking focusing on:
  - 1- Capturing part of rising liquidity
  - 2- Benefiting from gains in regional stock and real estate markets
  - 3- Taking advantage of increasing demand for Sharia Compliant products.

## Supported by higher margins, Retail banking is leading in profitability measures





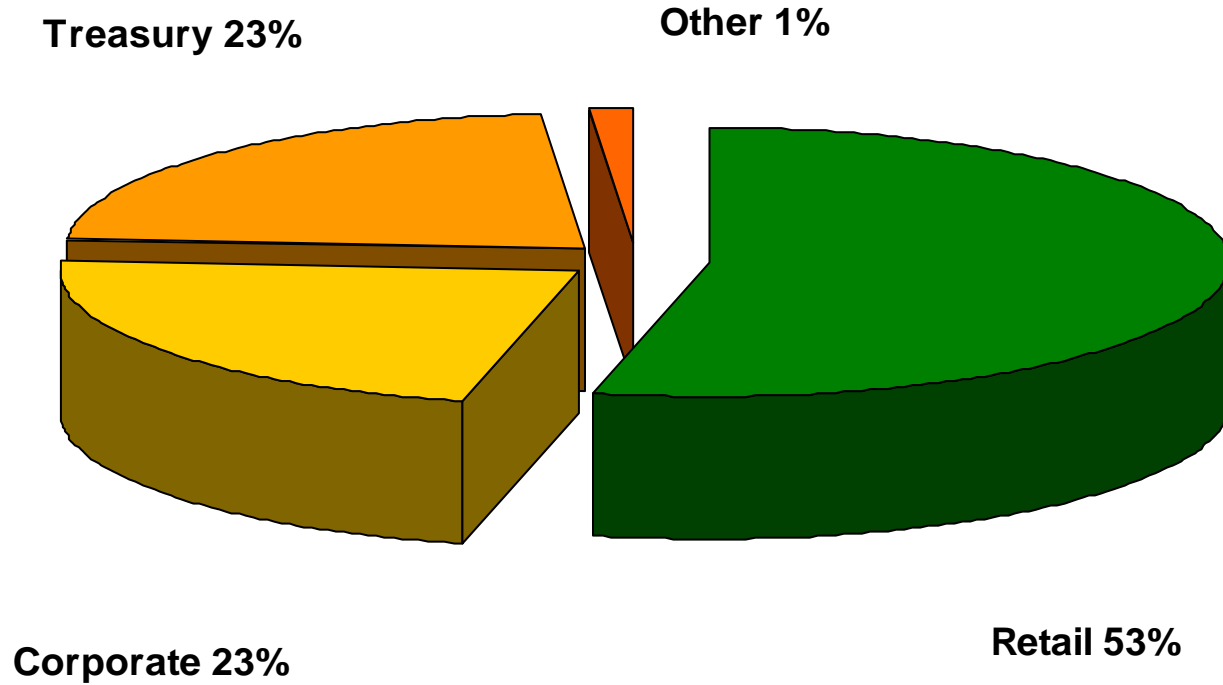
## Retail Strategic Orientation: Evolution Toward Universal Banking in GCC

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- The natural expansion of demand for retail financing
    - Fueled by population growth and demographic transition characteristics
    - A young and fast increasing population finding jobs in the public sector with relatively high wages.
    - Social habits such as early marriage contribute to rising demand for homes and furnishings, also eagerness to improve living standards.
  - As Gulf societies are shifting away from cash, banks continue to capture cheap deposits.
  - Retail banking is a means of revenue diversification away from risky commercial loans.
  - Constitutes a major source of profitability with limited risk.
  - Contributes to the stability of bank's bottom lines through business cycles.
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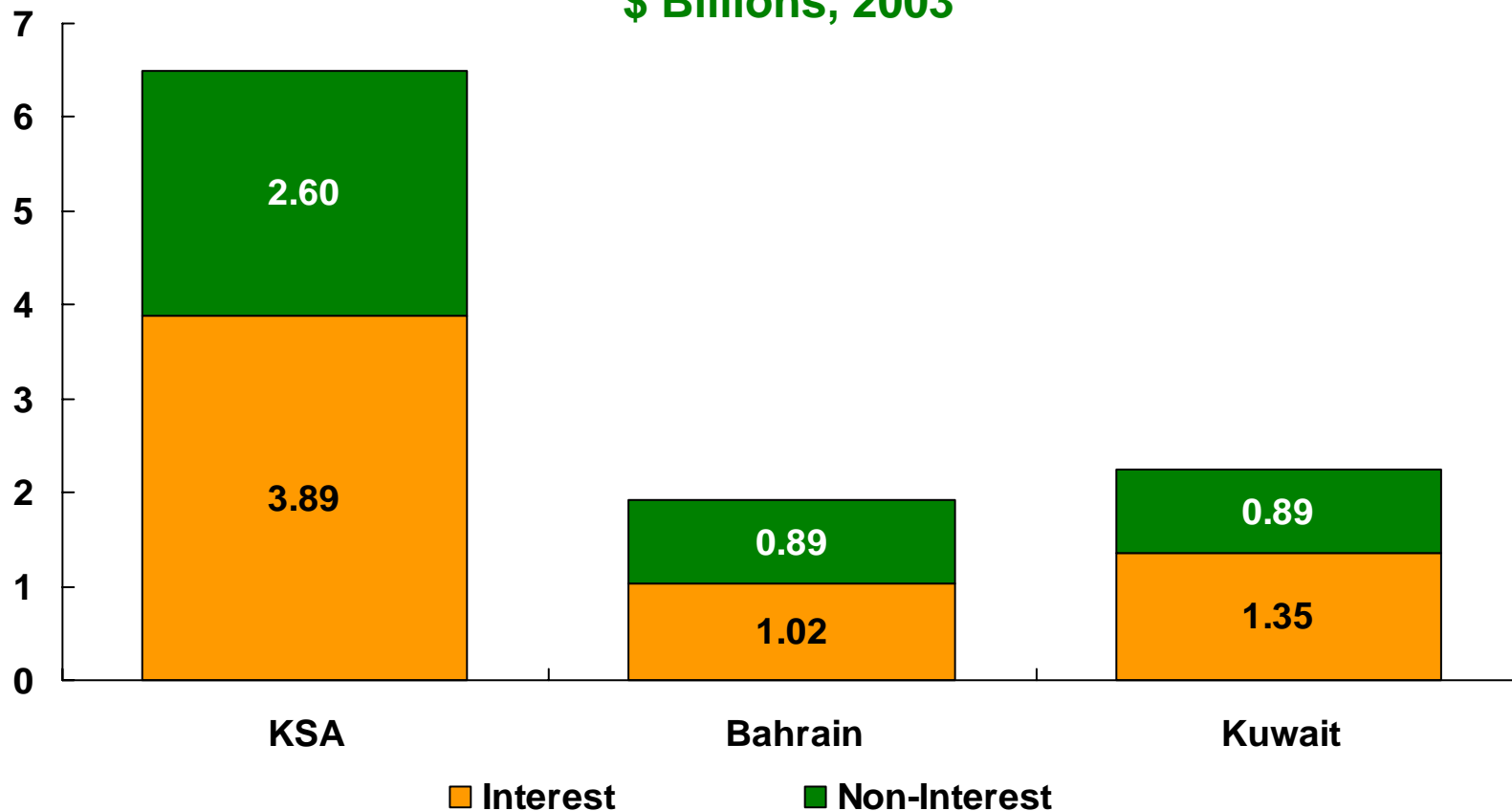
# Booming Consumer Lending Is A Major Source of Income In Retail Banking Segment

## Income Sources for Saudi Banks, 2004



## Attributed to Fee-Retail banking services, non-interest income share is rising rapidly

**Income Mix of GCC Banks**  
\$ Billions, 2003



## Challenges Ahead for Retail Banking

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Is (high-profitability/limited risk) of retail banking sustainable in long run?

- Asset quality deterioration
    - Uncertainty regarding ability of GCC governments to provide stable and well-paid jobs.
    - As retail loan portfolio slowly matures, banks would grant credit to 2<sup>nd</sup> and 3<sup>rd</sup> tier customers.
    - Name lending and margin lending could have a negative impact should an economic downturn occurs.
  - Squeezed Margins
    - Depositors' sophistication may subject cost of funding to upward pressure
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## Challenges Ahead for Retail Banking (contd.)

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- Altering Oligopolistic Structure

Notwithstanding barriers to entry, price competition could rise with new entrants (regional and foreign competitors)

- Regulatory Constraints

Central banks place tight boundaries against retail lending:

Kuwait: Retail loans may not exceed 12% of deposits

Oman: Retail loans cannot exceed 40% of total credit

Saudi Arabia: Retail loans may not exceed 30% of total credit

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## Retail Banking Sustainability

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- Strengthening legal framework  
(apart from UAE & Bahrain, no appropriate mortgage financing in place)
  - Mortgage Credit Could help Commercial banks grow their retail portfolios
  - Except for Bahrain, Gulf banks are still constrained in development and distribution of insurance products
  - This would have a positive effect on non-interest income, diversifying sources of income
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## Retail Banking Sustainability

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- Streamline and modernize internal credit scoring models and customer relationship management tools.
  - Accustoming to the principles and functionality of Credit Bureau
  - Foreign Competition enhance product sophistication and promote cross-selling
  - Islamic structural products is a major source of differentiation
  - Outlook for Retail Banking favorable in the medium term.
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# Thank You

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