

Do the right thing

Do Middle Eastern banks need to have more of an international outlook if they are to succeed in a crowded local market and what will they need to do to stay in top at a retail and commercial level? **Sanjiv Anand** gives **Mike Gallagher** some tips on how a bank can use a combination of positioning, branding, and intent to stay ahead of its rivals



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Sanjiv has driven over \$700 million of foreign direct investment into Asia and has assisted private equity firms in over \$300 million in investments. His articles appear in a wide range of publications and he has been a keynote speaker at global conferences.

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Is the Middle East overbanked?

The banking and corporate culture by its very nature and the history of the region, is very transactional. If, from a short-term perspective the transaction seems to make sense then they go ahead and do it. I don't think the medium and long-term implications were ever fully understood.

I think that is true for almost everything. If I go back even seven to 10 years and I look across industry sectors, the region has always had overcapacity. If I looked at, for instance, the manufacturing capacity of glass bottles, it was six to seven times demand. There was also overcapacity in the banking sector.

What happens when the banking sector reaches saturation point?

What happens when there is an excess of liquidity in the market is that it generally creates excess capacity. When you have excess capacity, you have 15 banks chasing one customer, rather than three, then discipline goes out the window. What happens then is that surrogate lending comes into play. That is the essence of the challenge for retail banks.

If you look at other markets, like India, or the US, for instance, and you look at retail lending, whether it was credit cards or personal loans, at least 30 to 40 per cent of the lending was surrogate lending. That meant that one bank was saying, 'If another bank has lent to them, that credit approval is good enough for me.'

When you have excess liquidity, you get overbanking and when you are overbanked, the banks are chasing customers aggressively and in order to complete their transactions quickly, and rather than do a real credit assessment they do surrogate lending. All of a sudden you end up with a portfolio that is subprime in nature.

Then how can banks get out of this mess?

There have been some short-term responses. If the bank had a mortgage book, they basically shut it down. If the loan to value ratios were running at 85 to 100 per cent, they brought them down to around 60 per cent, which is what I think they are running at right now. The banks are trying to secure their mortgage books and the same time they have been trying to shut down their unsecured lending, which is really around cards and personal loans.

Isn't this sort of thing counterproductive?

That is partly true. If you don't segment your book carefully, then it is counterproductive. The market in the US is very mature. The segmentation and sophistication of the customer, both from a risk management perspective and a pricing perspective (because then you price differently), and from a service level perspective, is at a very mature.

A number of players in this market were starting to understand the market

in terms of segmentation, but had not completely institutionalised it. If you haven't got the segmentation sorted out correctly, then you won't know where to tighten up and where not to tighten up. Some of the actions being taken then become more of a machine gun approach.

Banks have also been trying to increase the effectiveness of their liability books because they need the liquidity. Most of that, in my view, has been attempted on pricing or interest rates, but that is a double-edged sword.

Also banks have not internationalised in the way they should have; they should not have been so dependent on localised liquidity. Everybody was chasing the same assets and the same liquidity.

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What do banks need to do?

They need to figure out what to do when it comes to dealing with the headcount. If you are doing a headcount reduction, then the organisation is going to be traumatised and in that case, very few will be worried about the customers because they will be more worried about their jobs. At the same time, the structure is still going to be sorting itself out and some people will be taking on new roles.

One of the things I have noticed about headcount reductions is that they are often not very rational. It is just a numbers game sometimes. Once the organisation has settled down, the bank can think about doing a transformational service piece for its customers.

Some banks are attempting to strengthen the wealth management side, but if you look at the liability books of a lot of banks in the region, even when they did not have strong wealth management offerings, their liability books were very skewed. Some banks might have, five, eight per cent or more of the liability book accounting for 80 per cent of deposits. That is why every bank felt it needed some form of wealth management.

Are things any different today?

If you look just at the deposit book today, you will see a significant amount of skewing. Of course you will need to make sure the wealth management section is being taken care of, but you will also need to watch the mass retail liability side because if the skewing is significant, then you need to address it. I would rather see more short-term successes than some longer-term plays. Everybody wants to be a private bank, but to be a private bank; you need a global footprint

to mitigate risk. You also need the ability to manufacture products. Banks need to be more realistic about their ability to be a true private bank.

Another area that I would have hoped that banks would have dealt with more aggressively is an understanding of how to deal with workout accounts.

In any normal market, such as the US, Europe etc, banks have the experience and the tools to monitor their assets carefully to determine whether the account is likely to turn into a workout account. If there are signals that it may happen, then they need to take whatever actions are necessary before it becomes a workout account. If it turns into a workout account, then the skills required to handle a workout account are very different from those of a traditional banker because it is a turnaround situation.

Is that because of a lack of familiarity with workouts in the region?

If you look at the pedigree of the bankers which have operated in the region (which has had significant growth), many of the bankers are part of a young banking team. They don't have the experience of managing workout accounts. What happens when the market dips is that people start to default, payments are delayed and they don't really know how to handle that sort of situation. They are in new territory. They can't do a call on the money because their clients don't have the money to give them.

What will happen in another market is when there are receivables from a client's customers, or there are payables, then the workout team has the ability to (sometimes) literally sit down alongside their clients and negotiate either with the receivable or payable counter parties so that the funding improves.

This will need to happen on the corporate and commercial side. They are going to need to figure out how to manage existing workouts and they are also going to have to make better predictions so they don't end up in a similar situation during the next economic cycle.

How can they best execute this?

Some international banks have dedicated workout teams, so it will be in a bank's interest to create a workout team. You could have 20 corporate or commercial bankers, so pick three or four from that group and bring in someone from the outside that has a lot of experience of running workouts.

It is, in a broader context, what an asset reconstruction company does, but on a smaller scale. The bank will have to bring in some skill sets from the outside and it will have to segregate the team. If you leave it to the existing relationship managers and expect them to handle it, then I think they will be challenged.

Does that mean banks will have to be prepared to move away from their domestic comfort zones?

From a long-term strategy standpoint, I think the crux of the solution is the internationalisation of the book. If you are excessively dependent on a small country such as the UAE, Bahrain or wherever it might be, then you will not get any diversity; you will not get sustainable growth. In some banks the book is 90 per cent domestic and some of those banks still have not done an adequate job of fully leveraging the local opportunity (e.g Abu Dhabi), let alone any international opportunity.

The banks give various sorts of reasons for it, but I don't totally believe the rationale they are offering. Some people wonder why, for instance, banks from Dubai have not fully exploited the opportunities in Abu Dhabi. There is a

perception that clients in Abu Dhabi prefer to deal with local, Abu Dhabi-based banks. That is not true.

We have been talking about it for years; we have to become more international. Now there is no choice. Whether it is Sudan, Morocco, Libya, Algeria, Egypt, there are at least 10 countries than one could list where there are significant opportunities. Sometimes the opportunities exist because those countries are under-banked; or because the banking standards and products are not as sophisticated.

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It goes back to a comment that somebody made to me last year that a normal tower in Dubai is like an iconic tower in another country. The same is true for banking. In spite of all the opportunities to improve customer service in the UAE, compared to some of the above markets I mentioned, the services and product levels are quite good. Therefore, there are a number of countries where if you put those levels of service or products into place, you will be pretty competitive.

Banks have, historically, looked at Saudi Arabia, but it is not an easy one because the Saudi banking system is relatively well developed. Some of the other countries have reasonable populations, some with around 30 million or more. These are not small countries. It is a combination of intent, positioning, and execution. ■