

Challenges Facing Gulf Banking During the Nineties: Reality and Ambitions

This conference, which is to discuss the challenges facing GCC banks and review strategies that could be adopted during the nineties to face them, covers many issues that together reflect the significance of banking in our economies. It also shows the concern of the banking sector's executives and officials to strengthen that sector, particularly at a time when we are witnessing rapid and frequent changes in the international banking and financial market. These changes will have a profound effect at both local and regional levels.

It goes without saying how important the banking and financial sector is, one of the sinews of the economy. With other economic sectors, it has a crucial and fundamental role in encouraging economic development, thus coordinating the performance of the banking and financial sector with that of the economy as a whole. Within the framework of the efforts exerted by the GCC toward comprehensive economic reform, and the part it can be expected to be played by the banking sector in these efforts, the need to convene this conference became evident in 1990, but then had to be postponed to 1991. However, due to the unfavorable circumstances following the Iraqi invasion of Kuwait, the conference was again postponed.

This conference is being held today, more than three years after the liberation of the State of Kuwait, a period in which the GCC economies have shouldered heavy responsibilities. The brutal Iraqi invasion of the State of Kuwait had damaging effects on most economic sectors but particularly on the banking and financial sector. This brutal invasion created a very severe challenge to the GCC economies and their banking

and financial sector. Indeed, it is probably the most dangerous challenge to confront Gulf banking sector since its advent.

The invasion increased the risks in the region, which had an adverse effect on banking business with regard to both the cost of funds and a decline in confidence in the banking sector. This has affected Gulf monetary stability. Now again, the Iraqi regime is repeating its attempts to undermine the security of the State of Kuwait and the stability of this region. But, God willing, the aggressive plans of this regime shall fail, and peace and stability shall return to this region.

The challenges confronting Gulf banks are comprehensive. Some of them are related to the general economic climate, and others are related particularly to the banking business. They are not restricted to this region, as they also involve the international community.

The coming challenges of this decade, arising from regional and international economic developments and events, are likely to come from the international trend towards the creation of economic and regional blocks and consolidation of the concept of the regional state in international economic relations. This movement towards globalization of trade and free capital movement is such that it makes the world one vast highly competitive market. This competition will include financial services and there will be no place for weak or small economic entities, or those functioning in isolation. It will be necessary to consolidate their ties with existing economic blocks or cooperate with other countries to create a large economic block.

An important part of the economic challenges in the Gulf region has been caused by structural imbalances produced by

certain macro economic policies adopted previously under more favorable economic and financial conditions. The most prominent of these challenges is public sector dominance over economic activity in the GCC countries. Public expenditure has played the main role in motivating economic activities and generating growth in various non-oil economic sectors.

Undoubtedly, the dominant role of the public sector in economic activity in the GCC countries has sometimes become so large that it deprived the private sector of profitable and promising investment opportunities that would have enabled it to participate more effectively in economic activities. Too often, this has restricted private investments to marginal available areas, and has led, on occasions, to its recourse to speculation on financial and real assets in order to make quick returns. The limited availability of investment opportunities has weakened the demand for banking services, including bank financing, which has adversely affected the loan portfolios of banks as well as affecting bank performance in general. On the other hand, the expanded public sector role has placed increasing obligations on public finance, thus reducing the ability of general budgets in the GCC countries to cope with decreasing oil revenues in the wake of prices, which have been falling since the early eighties.

During the nineties, the GCC countries have to face the challenges of restructuring their economies, diversifying their sources of income, and adjusting expenditure to conform with developments in public revenues. The private sector needs to assume a larger role in economic activities through privatization programs that will reduce the public sector role and stimulate economic activities and development by increasing the contribution from the private sector. Here again, the importance of the banking sector is clear: it is needed to mobilize national savings to finance these reforms. It has to

provide the necessary funding, and increase the efficiency and effectiveness of its financial services to ensure the success of privatization programs.

In order that Gulf banks can successfully meet these challenges, the right conditions and a favorable investment climate must be created to facilitate the flow of new resources to banking units, so that they can provide proper funding for economic sectors that address existing imbalances and adjust the current economic course.

The problems that will confront Gulf banks during this decade do not differ greatly from those facing banks in most industrial countries, as they are not confined to the region where they occur. Gulf banks are neither immune to them nor isolated from them. It can be said that the biggest challenge is to acknowledge that they exist, and lay down appropriate strategies to confront them.

It may be useful at this point to shed some light on the most obvious global issues, and propose some strategies that could be adopted to overcome them. These main issues can be summarized as follows:

- First: Overbanking
- Second: Technology Advancement
- Third: Increasing Customer Awareness, to Increase Customer Sophistication
- Fourth: Cost

Overbanking is a phenomenon in the GCC, where there are currently more than 160 banking units, of which 41 are national banks, whose number has fallen by only one since 1987. Other countries have moved to create new larger banking units via mergers. This has helped these large units increase

and improve the quality of their assets and strengthen their financial positions, thus becoming better able to compete regionally and internationally. In this regard, we see that although the number of banks is declining in many countries, they are nevertheless experiencing a significant increase in the value of their assets and continuous improvement in their performance. For example, in the USA, the number of US banks listed in the World Top 500 Banks dropped from 104 banks in 1987 to 84 banks in 1993, but the value of their total assets increased from US\$ 1909 billion to US\$ 2642 billion respectively. Similarly, the number of banks in the UK declined at a rate of 15 banks a year during the same period.

The second challenge is the rapid advances in technology in the banking industry. Particularly relevant is the rapid progress that has taken place since 1980 in settlement and payment systems.

For the customer, technology provides a modern means for carrying out transactions through telephone or computer terminals, giving him the freedom to easily affect capital movements. Therefore, unless GCC banks keep pace with technological advances, they stand to lose their major clients, and this would translate into capital flight to external markets.

Although Gulf banks are aware of this challenge and are trying to introduce modern technology to their operations, investment in the area of technology is still painfully low in too many Gulf banks.

The third challenge, namely growing customer sophistication as a result of increased customer banking awareness, is linked with the second challenge. For the Gulf banks to succeed in satisfying customers' increasing banking awareness and needs, they must increase their ability to keep pace with advances in technology.

Gulf banks' tendency to focus on the traditional products of their home markets has meant that they have not always developed the necessary experience to offer non-traditional products. Therefore, customers continue to place their funds with those foreign banks better able to provide the services and instruments customers require.

It can be said that this lagging behind in technological progress and modern customer services, in addition to the limited nature of the Gulf markets and their inability to welcome promising investment opportunities, has greatly contributed to widening the gap between internal and external Arab investments. Recent statistics from the Inter-Arab Investment Guarantee Corporation show that while internal Arab investments amounted to US\$ 11.9 billion, external Arab investments ranged between US\$ 650-700 billion. Therefore, Gulf banks have to invest in advanced technology to be able to offer non-traditional services; otherwise they will lose a large number of their customers.

Among the most serious challenges facing banks is that of cutting their total cost, especially in the area of wages and salaries, too great a proportion of their revenues. Many international banks have realized this and embarked upon downsizing their staffs in certain areas of customer services, as these banks have adopted modern technology. This policy has brought a considerable decline in labor costs in these banks. For example, British banks were able to cut their wages and salaries from 48.5% of total revenues in 1987 to 35.1% in 1993. Certain Gulf banks lack a clear strategy for reducing the ratios of wages to total revenues. To confront this challenge, these banks will have to take serious and practical measures to cut their labor costs to a lower proportion of total earning in

order to reduce their expenditure and raise efficiency and profitability.

Having set out the international banking challenges that confront banks in the Gulf area, we need to consider: What can be done? The answer can be found from the approaches adopted in the rest of the world, namely:

- First: Rationalization
- Second: Merger
- Third: Specialization
- Fourth: Diversification

Rationalization means not only reducing expenditure or investing in advanced technology, but in some cases also extends to considering the rationale of banks themselves. This phenomenon explains why many banks disappeared in certain industrial countries during the eighties.

In this context, bank mergers can be seen as an important instrument of rationalization. Besides the economies of scale and other economic benefits that merged units may reap, mergers, especially among Gulf banking units, will help expand the range of banking services and allow the merged units to provide financial services throughout the Gulf region. Therefore, the merged units can provide a lead in developing the efficiency of financial intermediation within the GCC, and in addition help ward off international competition. Mergers should not be just an issue for endless debate; procedures must be initiated to make them a reality.

Gulf banks will need to continue to specialize in those areas where they have a niche, but not at the expense of the diversification of the customer banking services necessary to retain their customer base and increase their earnings. Gulf

banks need to strike a balance between specialization in certain fields and diversification of banking services based on professional and objective criteria, particularly efficiency and profitability.

Having discussed some of the international banking challenges facing the GCC, and some possible solutions, we should point out that the challenges faced are not exclusive to the Gulf area. One of these involves bank confidentiality, which means nondisclosure of customers' banking, financial or economic information either by banks themselves, through their systems or staff, or by those who receive such information by virtue of their profession. There are some who carry out money laundering operations in the Gulf area by exploiting bank confidentiality, a problem that must be faced and overcome.

However, the need for cooperation regarding the exchange of information between supervisory authorities in the home country and the host country, according to international supervisory standards as determined by the Basle Committee, raises a question about the breaching of bank confidentiality that may result from such an exchange of information with respect to either bank customers or positions of banks themselves.

Bank confidentiality is fundamental for building confidence in the banking business and for creating a stable banking environment. It leads to neutrality and objectivity for banks in any dispute. Therefore, confidentiality must be maintained. At the same time, Gulf banks should abstain from performing any suspicious operation on behalf of their clients. The supervisory authorities, taking into account the forty recommendations declared by the International Financial Committee fighting money laundering, should issue necessary instructions to banks

to help them counter money laundering. This will maintain the good international reputation of Gulf banks.

Breaches of bank confidentiality arising from cooperation among supervisory authorities of the GCC and other countries require more study. We need to accurately define the aspects of such cooperation and the means of exchange of information with other supervisory authorities, to ensure that this will not involve any unjustifiable amendments to banking legislation or breaches of bank confidentiality.

Gulf banks must realize the gravity of the challenges before them and identify their own weaknesses and strengths in order to meet them. With the help of efficient management at all levels, banks can draw up strategies for this decade and go beyond identifying challenges, and assessing the real benefits of confronting them, to recognizing their reality and dealing with it objectively by taking decisive and timely decisions. Since Gulf banks are not isolated from the world and operate in a vast, highly competitive banking market where only strong banks survive, there is no room for slackness or reluctance in taking appropriate decisions or for boasting of past achievements. The better we understand the challenges and confront them bravely, the better we maintain strong Gulf banking institutions.

Equally, strengthening existing coordination among monetary authorities and central banks in the GCC, especially in the fields of supervision and removal of legislation that hinders the movement of people, funds and trade, would be another positive factor in the convergence of performance and style in the banking business in the region. It would facilitate greater cooperation among Gulf banking units.
