Challenges Facing Arab Banks In light of the globalization of banking services

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With the entry of the third millennium, the banking sector in the Arab countries is facing radical changes, as the distinction between banks, brokers, insurance companies and investment funds will become less than before with the provision of financial and banking services via the Internet, as customers today prefer to use self-service channels to complete their banking business.

Arab banks are expected to focus on maximizing the return on equity, which requires phasing out activities whose returns do not cover the cost of capital allocated to them and transferring more capital to banking businesses whose returns are rising over time. Profitability can be increased by reducing operating expenses through the effective use of modern technology such as the Internet if it is to face fierce competition from abroad. If there is any doubt about the impact of this competition on local markets, just take a look at what has happened in online stock trading in recent years.

1. Structural changes in international markets for goods, services and capital:

In recent decades, the global economy has undergone major structural changes and international markets for goods, services and capital have become increasingly interconnected. In light of these changes, Arab economies face major challenges, most notably the shift in economic thought and forms of cooperation and economic bloc. Arab countries cannot remain immune from interaction and integration into the new global economy. The Arab region, with its strategic location, various riches and potential future markets, will not be able to isolate or close, and therefore cannot remain outside the global economy. While emphasizing the importance of the banking sector in the Arab countries, which has witnessed significant changes in the regional and global financial sector, it is expected to have a significant impact on the banking sector, namely:1

2- Liberalization and globalization of banking services:

It seems that joining the World Trade Organization requires Arab countries to grant foreign banks the same treatment as local banks, and foreign banks will be able to enter Arab markets and attract customers with advanced banking services that may not be available in the local market. Globalization and banking liberalization have also made it easier for banks in industrialized countries to enter and exploit the expected growth of these markets, with Spanish banks, for example, expanding in Latin America, German banks in Eastern Europe, and American banks in East Asia.

The liberalization of financial and banking services in the world raises concern in the Arab banking sector due to the fear that foreign financial institutions are more efficient than Arab financial institutions and are therefore able to gradually control the local banking sectors. However, this concern is not always true, as foreign banks may excel in some investment banking, technology and private banking, but Arab banks' knowledge of their local markets and their strong relationship with their customers will provide them with a significant competitive advantage over foreign banks, in addition to the fact that the World Trade Organization allows the application of financial liberalization in stages if local banks need more time to adapt their conditions to the new competition.

3 - Transformations in the administrative philosophy of Arab banks:

In light of the emerging global changes in the banking sector, Arab banks should prepare to implement a new management culture

[1] - See, Henry Tawfiq Azzam, Chief Economist and Managing Director of the Middle East Investment Group, Arab banks and their ability to adapt to emerging changes, liberalization and globalization of banking services, Middle East, Issue 13751, dated 4/11/2000, page 13.

that takes into account the continuous change in market conditions, is based on a network of lines of communication between work centers rather than a rigid functional pyramid, and relies more on the principle of partnership with other financial institutions rather than working alone. Banks will increasingly rely on support operations, research and technology, financial products and other external institutions that can provide these services more efficiently. Such a partnership exists now, but it will be needed even more under new management cultures and managing complex networks of partnership and external relations will become as important as managing banks' internal operations.

In light of the new management culture, banks will realize that technology not only enables them to do business more efficiently, but also gives them the ability to develop their business continuously, and it is about using the latest versions of computer programs as well as the prevailing culture and mindset. Technology should not become an end in itself but a factor in increasing efficiency for the bank, and senior management should be an inspirational department that values the outstanding performance of employees and encourages them to innovate new banking ideas and services.

4 - Spread of online banking:

Self-banking or direct distribution channels have become a favorite among customers, and are offered by all banks in the world. As for Arab banks, they have invested millions to develop their ATMs, points of sale and the talking bank, and most of them are now moving towards providing services via the Internet (Bank Online). Therefore, we find that the use of branches is gradually declining, and the cost of completing the banking transaction through an ATM is estimated at only 10% of the cost of completing it through the branch, and this cost drops to 1% if it is completed through the phone or the talking bank, and if the service itself is provided through the Internet, the cost drops much lower. With just 10 branches in India and using ATMs and a talking bank, Citigroup has become the largest issuer of credit cards in India.

Arab banks still lag far behind American and European banks in providing Internet banking services, mainly due to the lack of Internet penetration in these countries, as less than 10 percent of the Arab population uses the Internet compared to more than 50 percent of the population in America. All U.S. banks have websites, and many offer their services through this network, including managing current accounts, including bill payments, issuing credit cards, providing personal housing loans, brokerage services for the purchase of stocks and bonds, as well as mutual funds.

In the Arab region, a consortium composed of National Bank of Kuwait (NBK), National Bank of Dubai (NBD), Commercial Bank of Egypt (CIB), Arab Bank of Jordan (ARIB) and Saudi American Bank (SBD) has formed a regional online marketplace for business-to-business (B2B) and a region-wide payment network.

5 - Increasing need for mergers between Arab banks:

Arab banks will face stiff competition from giant international banks that are offering online banking services. These banks do not need to have a physical presence and they offer their services in more than one language, which will help them attract the best customers. Arab banks today have only the option of merging to create banking entities that are competitive in liberalized global financial markets, and the merger will help reduce operating costs, reduce the number of branches, reduce business similarity and redundancy, distribute high-tech expenses on a larger base, and allow for the advantage of economies of scale.

(The Arab banking sector is expected to witness more mergers and acquisitions over the next few years, whether between local banks seeking to gain greater market share, or between banks from different Arab countries aiming to expand outside their local market.

The past few years have also seen a number of M&A deals, but most banks that talk about mergers and life remain dead letters, as few successful mergers have been achieved so far. It seems that banking consolidation in Arab countries will only succeed if monetary authorities intervene and force weak banks to merge.) 2

6 - Establishing advanced control systems to be more effective:

It has become necessary to establish advanced regulatory systems to be more effective and able to keep pace with developments in international financial markets, and the increasing demand for transparency in international markets will accelerate the development of supervision systems in the countries of the region. Monetary authorities will feel that their ability to control the size of the monetary mass has been weakened with the spread of online banking and the expansion of the use of electronic payments in online commerce.

Central banks can implement their monetary policies by controlling interest rates rather than affecting the size of the monetary mass. This is why it has become necessary for countries in the region to develop domestic bond markets as the availability of a secondary market for government bonds will allow the central bank to use open market operations to set interest rates even in an economy where it is difficult to control the monetary mass in circulation. Arab countries need to develop the corporate bond market to form another source of financing when needed, in order to compensate for the decline in the lending activity of banks when economic crises occur to reduce the effects of these shocks, as the existence of an effective corporate bond market leads to reducing the impact of crises, and the presence of non-banking sources of

[2] - Henry Tawfiq Azzam, previous source.

financing for companies leads to mitigating the impact of crises that operating banks may be exposed to (in the event of a crisis or price collapse in the real estate market). Conversely, countries where companies rely mainly on bank financing and very little on the bond market have taken longer to resolve their financial crises.

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