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   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

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CHALLENGES FACED BY BANKING INDUSTRY IN UAE: REENGINEERING THE OPERATIONAL EFFICIENCIES

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ABSTRACT

Banks in UAE primarily belong to two categories, national (local) and foreign, with the latter being restricted from operating more than eight branches. Currently, there are 46 banks operating in UAE, including branches and offices of foreign banks. There are 2national banks in UAE, all of which are listed either on Abu Dhabi Securities Market (ADSM) or Dubai Financial Market (DFM).Total assets of UAE banks grew by 13.1 per cent to Dh2, 025 billion in 2013 compared to Dh1, 791.6 billion in 2012, enabling the country's banking sector to remain the largest in the Arab world in terms of assets. Total deposits increased from Dh1, 167.8 billion in 2012 to Dh1,278.9 billion in 2013, according to a statement of UAE Banks Federation. Among GCC countries, UAE has highest number of banks after Bahrain. Another notable feature is the rapid stride that Islamic banking has made in the UAE. A range of Sharia-compliant products was introduced in the market and Islamic finance deals like Ijara transactions have become common in property purchasing deals. The region has witnessed Islamic Sukuks attracting large investor volumes with subscriptions exceeding expected issuance, even in big issues. This paper attempts to unfold all the major operational aspects and challenges that continue to prevail in UAE banking system.

KEYWORDS

Banks, competition, Economy, Government, Interests, Pressures.

INTRODUCTION

The biggest and strongest beneficiary of the strong economic growth of UAE is the banking sector. Due to relatively low interest rate environment, high oil prices and a flourishing economy, banking sector assets witnessed strong growth. The UAE has a remarkably high number of banks. UAE has 21 local banks, 25 foreign banks, two specialized banks and around 50 representative offices of other foreign banks. UAE is under pressure from the World Trade Organization to open up the banking sector more to foreign competition. In late 2004 the Central Bank of the UAE indicated that it will issue new licences, although none has so far been issued. Moreover, large stakes held by the government underline the significance of this sector, more so because of the government control on the macro-economy, which predominantly relies on oil revenues and trade. The UAE Central Bank is the primary financial regulatory authority. It is mandated to direct monetary, credit and banking policy and supervise over its implementation in accordance with the state's general policy and in such ways as to help support the national economy and stability of the currency. The banking sector of UAE is highly resourced to deal with global and domestic stress.

REENGENEERING THE OPERATIONAL EFFECIENCY

Dubai hosting the World Expo in 2020 will definitely have a positive impact on GDP and employment growth, and we will also see further expansion of the private sector leading to an increase in credit growth. The banking industry is safe and secure in the UAE and the overall confidence in the UAE banks is justifiably strong.The UAE's banking sector is seen as highly liquid with the banking system's liquid assets-to-total assets ratio of 30 per cent as of December 2012 as well as a loans-to-deposit ratio of 93 per cent (down from 108 per cent in 2008). Clearly, the recovery of asset values is also boosting the liquidity of banks.

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The banking sector in the UAE is quite fragmented, with the market currently being served by 23 domestic banks and 28 foreign banks. Banks incorporated in Abu Dhabi and Dubai hold the lion's share of total domestic assets. In view of the ambitious outlook of the economy and the expansionist program of the country, is the banking sector able to support the pressure?

Analyzing the gravity and intensity of the competitive scenario some of the measures that will possibly ease out the challenges in wake of this competition are as under:

LIQUIDITY AND GOVERNMENT SUPPORT

Funding and liquidity pressures remain on the banking system, with the average loan/deposit ratio for some major banks above 100% and in some cases above120%. The rising cost of domestic deposits in a competitive market and reduced access to the international debt capital market are also major contributors to the challenge in fueling the banking sector with resources to match the ambitious development plans of the country. Federal liquidity support measures greatly helped to stabilize the banking system in 2009. Over and above the federal support to UAE banks, the Abu Dhabi-based banks had received Tier 1 capital funding amounting to AED 16 billion, distributed among the four major banks, which contributed to liquidity in the sector. Capital adequacy ratios of UAE banks strengthened in2009 following government actions and greater retentions of net income by the banks and, in some cases, lower risk-weighted assets. According to the International Monetary Fund (IMF) reports, the UAE banking sector was able to pass stress tests, and became more flexible and more prepared, compared to previous years. This was due to the overall improved capital adequacy of State's banks in general, the supported quality of capital and the good management by the banks of their provisions in a more feasible manner under the supervision of the Central Bank.

ASSET QUALITY

Asset quality deteriorated significantly and the trend continued in 2010 with average NPL to gross loans ratio of banks increasing to 4.3% in 2009 from 1.7% at end-2008. The deterioration in the asset quality of banks will increase the impairment charge and will put pressure on the profitability of banks, which might cause an increase in the cost of funding on debtors as a compensation mechanism to sustain profitability. That, in turn, will have a direct impact on the profitability of debtors and their ability to meet their obligations as per original terms and conditions hence it is a vicious circle.

FALLING MARGINS

Banks are facing the challenges of falling margins. Margin compression is real and that is across the entire banking sector. Higher levels of liquidity in the market are putting pressures on the margins itself. So banks are changing their route of strategy to tackle this situation.

PROFITABILITY

The UAE banking sector's profitability suffered in 2009 as the global economic crisis impacted the region more significantly and year-on-year comparatives in Q1 2010 were generally disappointing, although core interest and fee revenues are holding up relatively well. Impairment charges are still rising in both, retail and corporate portfolios. With Dubai World and other GREs(Government regulated entities) and the remainder of the troubled Saudi corporate exposures to provide for, sector profitability in 2010 is unlikely to be any better compared to 2009 levels. Not surprisingly, profits are expected to stagnate, or at least not decline, for some banks as a result of the key factors mentioned above. Increase in the cost of funding will put pressure on net interest margins. The decline in trade finance, IPO business and other operating income will have similar negative impact on fee and commission income which will eventually impact banks' profitability. Stagnation in loans and advances growth as a result of higher funding cost and/or lower customer demand will also impact banks' profitability. In such a competitive market, it is vital for banks to understand how customers and market sectors contribute towards profitability, and to what extent relationships with particular customers are profitable. More focus on client satisfaction, quality of service and innovation in products offered, will lead to the creation of new categories of interest income, charges, and commissions.

CONCLUSION

As UAE leaves behind the recovery phase and steadies itself to a new phase of economic growth, banks, while seeing a big jump in consumer business, are facing the challenge of margin compression in the wholesale arena mainly due to depressed credit growth in the market. "Margin compression is very real and that is across the banking sector," said Morris. "Banks are chasing volumes. What the industry is seeing is that volumes are up substantially; however, the high levels of liquidity in the market, is putting pressure on margins. Trade finance and foreign exchange volumes are both up in the high teens, which is reflective of the economy and in particular, Dubai's economic improvement." "For banks to deliver sustainable performance you need topline growth and because of the current challenges in growing income, particularly in the Wholesale business, some banks are changing strategy and looking to expand overseas as well as developing new products and services. Banks need to revisit their operational efficiency because competition is both from local as well as foreign banks. Meanwhile, asset quality of the UAE banks are set to improve over the course of 2014 with the decline in non-performing loan (NPL) ratios and improving coverage ratios supported by asset and profit growth, Standard & Poor's said in its UAE banking sector outlook for 2014.Most UAE banks' NPL ratios have been stabilizing over the past 12 months, after a significant deterioration in asset quality over the past few years. The banks continue to generate strong pre-provision earnings and increase their coverage of reported NPLs, and the incidence of new NPLs has slowed substantially. Asset quality will continue to improve, although the cost of risk is unlikely to reduce further. Banks' robust funding levels and good-quality capital should help them withstand adverse market developments, such as tighter liquidity and higher funding costs.

TABLE 1

Description0	Number
Number of Commercial Banks operating in UAE	51
Number of National Banks operating in UAE	23 (including 8 Islamic banks)
Number of Foreign Banks operating in UAE	28 (including 6 GCC Bnaks)
Number of Business Banks	4
Number of Finance Companies	25
Number of Representative offices	117
Number of finance investment exchanges	23
Number of Money exchanges	122

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