Innovate to differentiate

Retail banking product development and structuring

2017

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Overview of the banking sector in the UAE

The banking industry in the UAE has undergone some significant changes in 2016. Despite the challenging environment and intense competition, the outlook for the UAE banking system remains stable supported by the recent stability in oil prices, leading to a revival in economic activity, and the growth in UAE's non-oil economy.

Nevertheless, banks and financial institutions are under immense pressure to boost their returns. At the forefront of this pressure is **declining Net Interest Margin** ("NIM") which is driven by **high cost of funds** and **intense competition** in the sector.

With the decline in low-cost government and government-related deposits, as a result of lower oil prices, banks have been forced to raise funds through costlier channels, resulting in additional pressure on their margins. As the cost of funds for banks has been increasing, the compression in margins is expected to continue in 2017. Given the rising intensity of competition in the sector, passing on this cost to the customers would prove difficult. In this stormy environment, it is crucial for banks and financial institutions to re-consider their strategic direction in relation to product offering and identify new pockets of demand to increase profitability.

Retail banks and financial institutions

Despite the high number of market participants offering retail banking services in the UAE, there is very limited differentiation in product offering, particularly with mortgages. Currently, most players are offering "plain vanilla" products where differentiation is primarily through rates. This forces them to adopt aggressive sales tactics and promotions on existing products. However, this is not an effective solution, as it further decreases their profitability and increases their customer acquisition cost.

Differentiation through rates alone is not a sustainable proposition, especially with the increasing number of digital aggregators and comparison engines which makes rates offered on different products easily comparable and transparent for customers online.

All of these factors further push retail banking products, set at uncompetitive rates, away from customers. This raises a very important point, how else can banks and financial institutions differentiate their retail product offering?

Over 50 banks & FIs

6.2% 2015-16 deposits growth

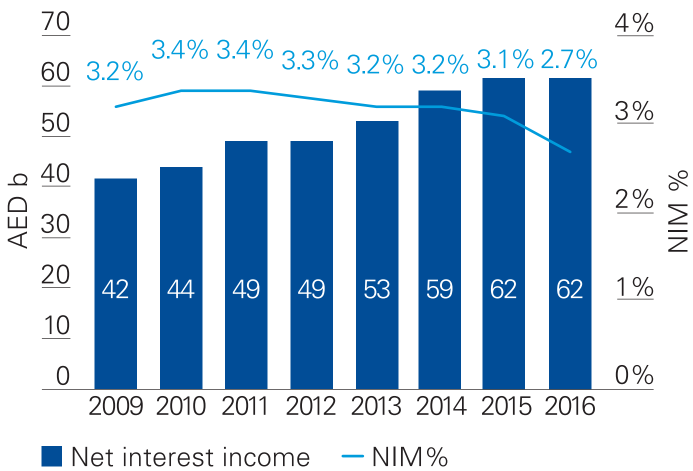
30 offering retail banking services

6.0% 2015-16 credit growth

2.7% NIM in 2016

3.5m bankable

9.3m population



Source: UAE Central Bank and secondary research

Routes to differentiation

%

Price (Interest rate)

The majority of market participants differentiate their product offering by competing on pricing alone. In addition to other routes of differentiation, **benchmarking analysis** and **pricing review of product portfolio** can help them maximise returns by having an optimal pricing range along with an attractive payment plan.

Value added services & features

Promotional packages that include rewards and additional services are being offered with various products such as credit cards, auto-loans and mortgages. However, there is still room to further **enhance product offering** by **adding new product features** and **value added services.**

Efficient credit policies & procedures

Many retail banks have suboptimal internal processes which results in high costs and longer application turn-around time. In addition, certain segments of the population still struggle to secure financing due to rigid credit risk review process. With the introduction of Al Etihad Credit Bureau, banks can now **re-assess their policy requirements** and **credit risk mechanisms** which will result in improved turn-around time, lower cost and higher origination within acceptable parameters.

Optimising retail banking product portfolio may need adapting the offering based on the three routes of differentiation, which require careful consideration of the risks and returns offered by each. Overall, the tailored approach of combining all three routes of differentiation, ensuring products are priced competitively, offer value added features to customers, and attract new pockets of demand through efficient credit policies and procedures, is crucial in order to have a viable sustainable profitable product portfolio.

KPMG's recent case study

What was the situation?

- One of our clients in the financial services sector engaged us to support them with devising a roadmap to implement their corporate strategy. Among other operational challenges, the client was struggling with origination, amidst the increasing cost of funds and low NIM, which made its retail product offering uncompetitive in the market.

How did KPMG support the client?

- Conducted a diagnostic review to assess the completeness and implementation progress of the corporate strategy.
- Devised an implementation roadmap to execute the corporate strategy.

- Developed and structured a set of innovative retail products using all three routes of differentiation to increase the client's market share and profitability.
- Recommended improved internal processes to reduce processing time of applications and increase conversion rates.

- Conducted a market assessment.
- Developed the client's 5-year financial plan and model as per the updated business strategy and new product portfolio.

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