Evolving environment

# Dynamic market shift encourages consolidation in banking landscape

**Though the global banking sector saw M&A deal volume drop last year after a modest uptick in 2019, the second half of 2020 saw activity heating up. The early-year slowdown was largely due to broad market uncertainty, and as the picture clears, it appears to have conditions ripe for consolidation.**

There are plenty of reasons to expect increased banking M&A volume in 2021 despite Covid-19, such as a scope of more rescue and restructuring deals, a surge in digital transactions, ease of regulatory transaction barriers, increased collaboration between fintechs and financial institutions, interest of private equities and a thriving NPL market. However, as regions cope with and recover from the economic downturn in different ways, a regional banking sector's specific characteristics may be the biggest determinants in deal activity.

### Regional M&A environment

The GCC is often considered as an overbanked region. While healthy competition is good for a market, too much competition renders banks inefficient and unable to expand into regional players.

Fintechs could further squeeze an already tight sector. Saudi Arabia's young population has a keen appetite for the non-traditional banking sector, and they are gobbling it up as quickly as it develops, shrinking the available pie for banks. Though fintechs have not penetrated the personal finance sector in Saudi Arabia, they have proven adept at quickly winning market share in other countries like China and the U.S.

While vaccination programs have far to go globally, GCC states have jumped ahead of other regions, spelling a potentially quicker economic recovery. More than anything, a return to a semblance of normalcy will give banks some of the clarity needed for major restructuring. When they can better predict economic and asset performance – as well as set a long-term operational strategy – banks will be more comfortable making big decisions.

Combined, underlying market conditions and an early emergence from the pandemic's economic downturn, the Saudi – and regional – banking sector has characteristics prime for deal-making, and the sector should emerge from a spate of activity stronger and ready for the future. Combining operations increases cross-selling, allows a merged bank access to new retail or commercial customers, and creates synergies to enhance financial performance especially in a low-margin environment, all while increasing the combined market share. However, with all their potential benefits, many M&As have failed in achieving their intended objectives or worse, led to the demise of both parties. As such, banks need to be wary of the critical factors that underpin a successful M&A. In this respect, robust merger planning, including a detailed readiness assessment, is fundamental. In addition, management of stakeholder expectations is equally paramount.

> Saudi's new big banks expected to increasingly compete financing regional projects.

### NCB-Samba deal

The biggest driver of change is action, and this year may prove to be action packed in the Kingdom due to a single merger, between National Commercial Bank (NCB)

and Samba Financial Group. The combined lender, now known as Saudi National Bank, will be by far the biggest in Saudi Arabia, with assets of USD223 billion.[6]

The deal is now approved by the shareholders, and the merged entity, Saudi National Bank, will:

- Be the number one bank in the MENA region by net income, at USD1.9 billion
- Be the third largest bank in the GCC, behind Qatar National Bank and First Abu Dhabi Bank (itself created by a 2017 merger)
- Have an approximately 25% market share across all key metrics in the Kingdom[7]

## National project financing

Growing appetite for consolidation is in line with Vision 2030's goals to use home-grown capital to finance major development projects. Merged banks have more capital and know-how to engage in development projects, which have in the past needed to look abroad for financing.

An example of this vision can be found in the funding for The Red Sea Development Company (TRSDC), which is building the Kingdom's new flagship tourism project. Late last year, TRSDC laid out its financing plans, which include a $3.7 billion loan from five domestic banks, paired with funding from the PIF, which owns the project. Without big, sophisticated banks, projects of past have had to turn to international financiers who may be more expensive or require more time, while not having as much local expertise, as domestic banks.

## Regional powerhouses

Further afield, Saudi's new big banks will increasingly compete to finance regional projects. Large-scale regional projects – largely in the construction, transport, or power sectors – are usually financed by syndicates of regional and international banks.

The composition of project finance in the region can include a combination of bonds, loans, and IPOs, in addition to Sharia-compliant facilities like sukuks and murabaha. Having larger Saudi banks allows the sector to be more competitive in both areas – traditional and Sharia-compliant financing.

## Keys to M&A success

Despite integration challenges in the early stages, merged banks will gain market share and benefit from greater pricing power and cost synergies through improvement in efficiencies and rationalization of operations. However, banks should be aware of the critical factors that underpin a successful M&A. In this respect, robust merger planning, including a detailed readiness assessment, is fundamental. Management of stakeholder expectation is equally paramount, especially as it relates to employees and potential staff redundancies, which need to handled appropriately for overall employee morale as well as sustenance of brand image.

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[6] https://www.ncbsambastronger.com/english

[7] Saudi National Bank investor presentation (https://584b4e21-319d-4ba7-8a29-ce17fdf488d9.filesusr.com/ugd/f22955_32fae7faf90c4f059903b1aee5a66ef7.pdf)