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ROLE AND EVOLUTION OF COMMERCIAL BANKS IN SAUDI ARABIA

Rawan AbdulRab¹, Tahar Tayachi²

^{1,2} College of Business, Effat University, Qasr Khuzam St., Kilo. 2, Old Mecca Road. P.O.BOX
34689, Jeddah 21478, Saudi Arabia.

Email: [1rabdulrab@effatuniversity.edu.sa](mailto:rabdulrab@effatuniversity.edu.sa), [2ttayachi@effatuniversity.edu.sa](mailto:ttayachi@effatuniversity.edu.sa)

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ABSTRACT

Commercial banks have evolved in terms of technology and customer service. Mergers and acquisitions with other banks have brought about globalization in the commercial banks of Saudi Arabia. High quality delivered at cheap prices has led them to use more of these bank services. Other factors that are responsible for customers to be satisfied are proper allocation of resources, diversification, innovative products, high security, easy access and high customer care. Evolution of commercial banks in Saudi Arabia has been for good of the people and the economy. This study analyses the factors responsible for the evolution of commercial banks and the roles that banks play in a country over 5 – 10 years by comparing the banks of Saudi Arabia; NCB, Alinma and SABB for variables of “Share price of banks” and “Net income of the banks”.

INTRODUCTION

Banks have now become a vital part of our life. All the transactions and money flow are all through the banks. Earlier, people assumed that the banks were built up only to keep their money safe. But in reality, the banks have a huge variety of functions apart from just keeping the money safe. Banks offer loans and other important credits for investment, purchasing and starting up the businesses on a small, medium or large scale. All the economic decisions of the country now work on the functioning of the banks. Decisions are related to income, investment, wealth distribution and economic growth. For a country like Saudi Arabia, all the money value is estimated through the value of commodity that exist namely oil. Other issues were also brought to notice like government expenditure and the policy making structure [1]. If banks are stable, then the country will have stable financial conditions as well. Basically,

banks are up to looking for a good investment to uplift the economy. The more capital it brings in, the more profitable the bank is. This leads to increment in the share price. Their job is to keep both the consumers and the investors happy by letting them know that the money is now in safe hands. Banks daily interact with the consumers through online transaction, debit and credit card purchase and even loans.

Saudi Arabia had a drastic change in the banking system. It is this country that introduced Islamic banking to the world. The commercial banks in Saudi Arabia follow Shariah laws along with the regular system of banking. Banks earlier were here to deposit money and offer loans. Now, they have different schemes that encourage consumers to enter into different programs like housing, education, share market and investment. This study analyse the factors responsible for the evolution of commercial banks and the roles that banks play in a country over 5 – 10 years by comparing the banks of Saudi Arabia; NCB, Alinma and SABB for variables of “Share price of banks” and “Net income of the banks”. The confidentiality maintained by these banks causing the shortcoming of certain information for publish.

Role of Commercial Banks

Banks changed their nature to bring about change in their system. They brought this change to avoid any kind of risk and survive financial crises. Its basic functions are to deposit money and issue loans on small or medium scale. Apart from that, the other functions are to gather capital, help in investment and any kind of economic activity and regulation of monetary policy. They are not only restricted to local businesses but have expanded worldwide. They have brought about a whole revolution in the world of banking. Banks have changed their functions and roles with the change in period of time. The banks are into leasing, agency functions, have locker facility, managing different types of accounts (savings, current) and providing an interest on deposits which are profitable to people in a sense that they are being paid for safekeeping their money. Commercial banks have a large share in the financial sector due to their promising returns to the customers on deposits as well as timely lending money to people along with supporting small and medium businesses.

With the development of technology, the banks have entered into the world of e – banking system which is more secured and convenient as compared to that of the conventional methods. The accounts are being maintained, taxes are being paid, accounts are secured, and transaction is taking place by just a click or by the tip of your finger anywhere and anytime. Online banking has become a trend and has attained a higher customer loyalty. Azhar et al. (2010) stated that “The financial position of banks, economic benefits, interest on deposits, latest facilities and interest on deposits, reputation and strong global image are the factors that motivates the customers towards the conventional banks” [2]. Banks are now competitive and are presenting more offers, thus attracting more customers to the banks and helping the economy by keeping the money flowing in and out, thus regulating the movement of money.

Earlier people used to store money in their houses itself or used to keep as Amanah in other people's houses. Gaddam, Khathlan and Malik (2009) have discussed that the banks came into existence and were into depositing and lending money to the people [3]. Banks modified soon enough to increase their financial performance and left their old methods in order to attain profitability in the world of banking sector. Banks have become independent and have merged or acquired other banks leading to globalization in the banking world. Innovation has brought about a revolutionary change in the system of banking. Banks have launched new products that have enhanced mobile banking and security system and gathered a huge number of customers. Wide range of services provided at an affordable cost has also caught attention. Banks are now inculcating Islamic practices as well to encourage more Muslims to use their banking services. Meeting customer needs is very important for any bank to grow. Proper allocation of resources, decreasing interest rates and opening up branches for easy access have contributed to successful commercial banks in Saudi Arabia. Profitability of the banks has become better than before. Internet banking has made it really easy for people to connect to the banks easily and due to the fast pace of the world it has been a boon to the people.

Evolution of Commercial Banks in Saudi Arabia

Saudi Arabia has two types of banking – conventional and Islamic. Islamic banking is dominant over the conventional method due to the concept of Riba. People in Saudi Arabia are against it. It is forbidden because it is an additional amount to the money deposited and is not allowed in Islam. Islamic banks follow Shariah law (a law based on Quran and Hadiths) and do not charge interest on loans. Seeing this, all the commercial banks in the Kingdom of Saudi Arabia have adapted to Islamic values and work according to the customers' needs. If the customers are into interest collection, they use the conventional system and if the customers are against Riba, they can use interest free schemes. Safiullah (2010) argued that “The financial performance (solvency and liquidity, business developments, profitability, efficiency and productivity, commitment to economy and community) of both streams of the banks is notable” [4]. According to Alturki (2014), many conventional banks are bringing about Islamic practices into their banks to overcome financial crises that have not only affected people but also the stability of the economy [5].

On a macroeconomic level, banks have really supported this country and helped in maintaining the stability of the economy to a large extent. They have introduced schemes to ensure that the people residing in the country do not panic and start making wrong decisions that will affect the economy as well. The commercial banks have helped in regulating and maintaining the economy. They have brought about growth in the financial sector and increased the GDP of the economy. Money supply also increased and the rates of Saudi riyals also viewed an increment.

METHODOLOGY

The changing share prices of three different banks over a period of 5 - 10 years were collection of data from different sources and carrying out descriptive analysis of the information. The study will focus on variables of “Share price of banks” and “Net income of the banks”.

Saudi Arabia has become one of the world’s largest sources of investment in the world. It has likely formed mergers and acquisitions with other banks from all around the world and thus has gained global impact in other countries too. The banks SABB, Alinma and NCB that have shaped the banking sector of Saudi Arabia differently. The data gathered is current and focuses on how the sector itself changed over a period of time.

RESULT AND DISCUSSION

The banks have seen an outgoing increase in their deposits due to the evolution in their operations and functions where they kept everything according to customers’ interest from making banking online to providing services at home making it more reliable and easier for attracting and addressing a customer. With commercialization of banks, there has been a substantial growth in the number of banks as well as in their performance as seen in the Figure 1.

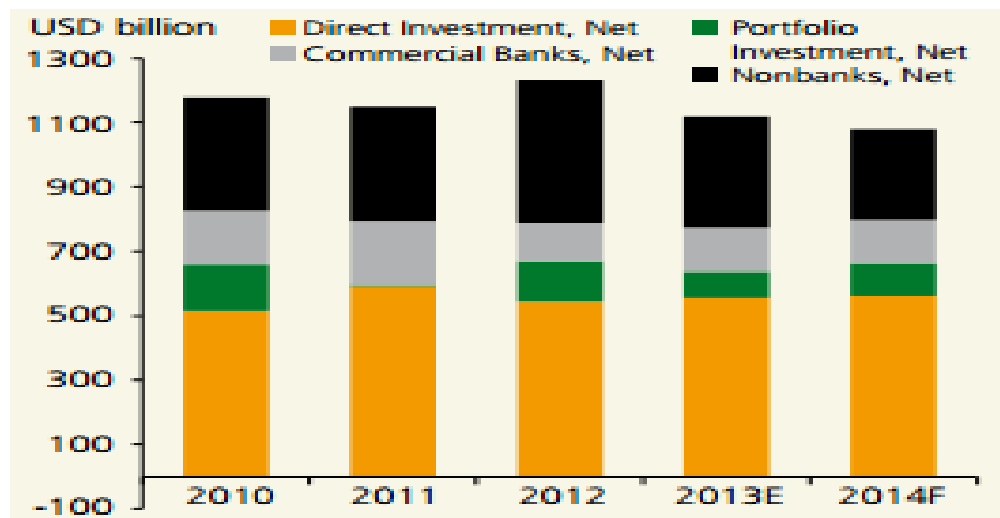


Figure 1. Deposits Done in Commercial Banks

The non – oil sectors that nearly encompass everything that does not require oil saw a huge growth in their fields respectively. They took a tremendous sharp increment in the year 2010 and then after that the growth decreased in 2011 – 2012 and then started increasing again but on a gradual note. From the mid of 2014, the financial crisis hit the country and all the sectors including banking started underperforming but was able to recover due to advancement and improvement in technology. The Figure 2 shows the increase in growth of banking sector.

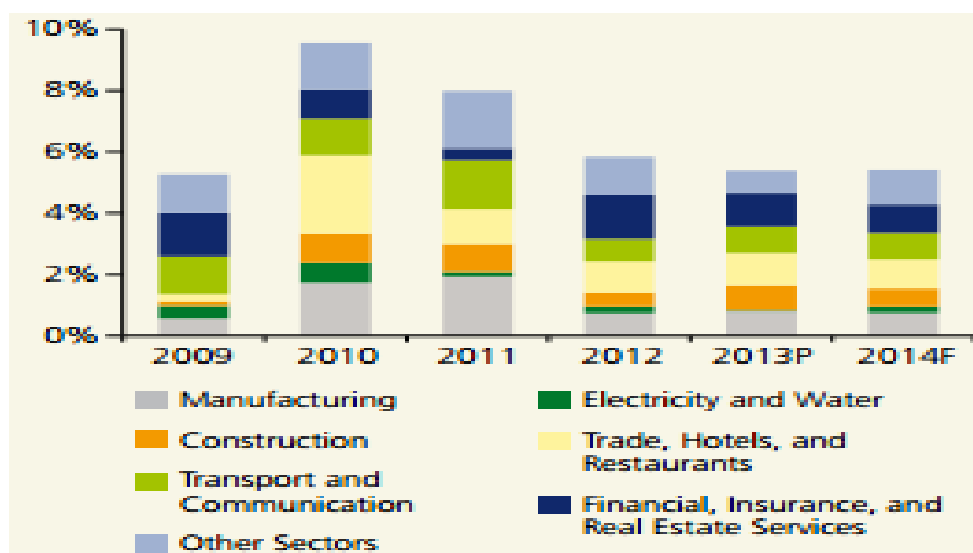


Figure 2. Growth of Banking Sector

Table 1. Data Regarding Deposit from Year 2008 To 2014

Financial Sectors	2008	2009	2010	2011	2012	2013	2014
USD/SAR Exchange Rate	3.75	3.75	3.75	3.75	3.75	3.75	3.75
Growth in Broad Money (M3)	5.0%	13.3%	13.9%	10.9%	11.7%	9.5%	13.3%
Growth in Credit to the Private Sector	4.8%	11.0%	16.4%	12.1%	11.4%	11.0%	12.0%
Average 3M SAR Deposit Rate	0.7%	0.7%	0.9%	1.0%	0.9%	1.2%	1.0%
Average 3M USD Deposit Rate	0.3%	0.3%	0.4%	0.3%	0.3%	0.5%	0.3%
Spread, in Basis Points, SAIBOR-LIBOR	39.8	40.9	55.2	68.7	60.0	70.0	69.4

According to the Table 1, the number of deposits increased for Saudi Riyals over a period of time. The banks played a central role in increasing the rate of Saudi Riyals in the exchange rate. The money supply increased in the period of 2008 – 2009 when the whole world was suffering from financial crisis, Saudi Arabia was one of the countries that had no affect at all by the sudden change. It decreased in 2010 and then it increased again in 2013 up until 2014. But when the financial crisis hit the country in mid-2014, the deposits decreased in banks due to the shortage of money. This piece of information is supported by the graph in Figure 3.

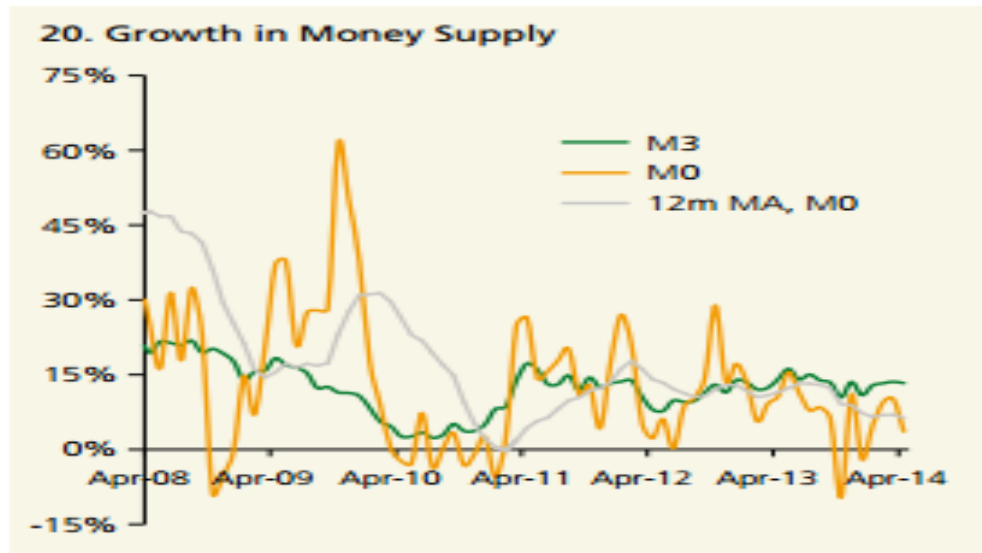


Figure 3. Growth in Money Supply

The inter banks market rates in Figure 4 shows a sudden increase in the value of the Saudi Riyals. Even in the exchange rate market, the rate of Saudi Riyals increased although as compared to the US Dollars, it remained pegged. Many countries saw the sudden increase of the rate because of the performance of the banks present in Saudi Arabia and the schemes and programs introduced by different banks.

The data collected are a prove of the performance of the commercial banks and the study showed their evolution leading to growth in money supply and making banking sector a big one in the financial industry. Not only do they function as local banks, but have gained widespread fame all over the globe. These findings were very important to analyse the role and evolution of the commercial banks present in the Kingdom of Saudi Arabia.

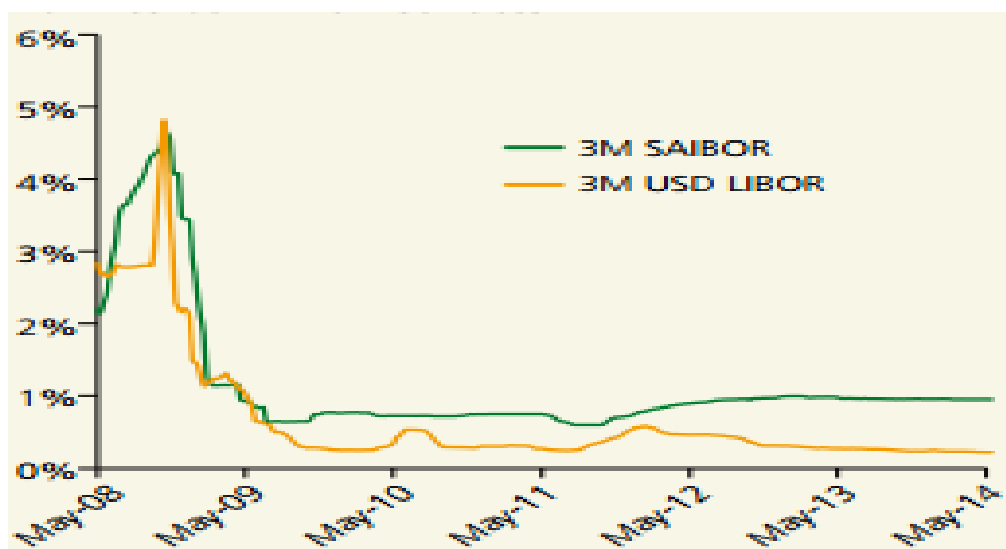


Figure 4. Interbank Market Rates

CONCLUSION

Commercial banks like SABB, Alinma and NCB have a lot of branches spread wide across the country stating their performance in the banking sector. The variables studied showed the share price and net income of these three banks which showed a huge increment in their income and their performance. This is because they not only performed conventional functions and operations but also lent their hands into different businesses and sectors as well. By making the bank public among the people residing all around the globe, they found another new and improvised method of gaining additional income. Lastly, the banks in Saudi Arabia have improvised their roles and involve into commercially giant banks that exist in the Kingdom with a lot of growth in their net income and increase in the share price.

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