PalArch's Journal of Archaeology of Egypt / Egyptology

INVESTIGATING THE IMPACT OF FOREIGN BANKS ON DOMESTIC BANKING INDUSTRY IN SAUDI ARABIA

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Asma Babatin, Rozina Shaheen. Investigating the Impact of Foreign Banks on Domestic Banking Industry in Saudi Arabia -- Palarch's Journal of Archaeology of Egypt/Egyptology 18(13), 1274-1283. ISSN 1567-214x

Keywords: Banks, Domestic, Foreign, Performance, Margin, Assets, Economy, Saudi Arabia

ABSTRACT
The entry of foreign banks into Saudi Arabia is likely to have a significant impact on the domestic banking market. In addition, foreign banks operate on local markets and have felt the impact on the economy as a whole. Financial performance may include aspects such as the level of profitability and net interest margins. Thus, this paper has examined the impact of foreign bank on domestic banking industry in Saudi Arabia. This work was carried out based on quantitative research method. Comparison was done three major domestic banks and three major foreign banks in Saudi Arabia. The comparison was done based on returns, margins and growth rate from 2014-2018. Thus, based on the comparison result, the outcome showed that domestic banks are stronger and better financially. Finally, the result of this study shows that there are not effects of foreign banks on domestic banking industry because of strong economic in Saudi Arabia.

INTRODUCTION
The international banking system is part of the conventional banking system that is spread all over the world and has business links all over the world [1]. Most of the world is doing business in the traditional banking system, and they're totally relying on that. The market value and products that international banks have are much more than those of local banks in Saudi Arabia. The limitation of Sharia and Islamic laws does not allow Saudi banks to adopt areas where investment is prohibited. Furthermore, Saudi banks are not allowed to invest in any industry dealing with gambling, gaming, pork, alcohol or any other such prohibited line. This is the main reason that international

banks are slowly gaining market share in Saudi Arabia, but still need to do a lot to catch up with Saudi banks [2].

One reason why the international banking cartel has not taken over the domestic market in Saudi Arabia is that it is prohibited by law to launch programmes and investments that are illegal and prohibited [3]. International banks must comply with the law of the country, so that their activities are on the same level as domestic banks. These banks can easily take over any country or domestic market due to their sheer investment capacity and support from other regions. International banks are part of a larger venture or a group of many other banks that are trying to invest in a country and enter their local market. After entering the market, they advertise on mainstream media to get the public's attention and simultaneously launch a number of attractive packages. These packages include car loans, education, home loans, personal loans and other investment options. These are options that are interesting, and people have no idea how much they have to give to get the product [4].

After their integration into the local market, the international market can compete easily there. There are more than a dozen international licensed banks in Saudi Arabia, all of which have branches, ATMs and POS across the country [5]. These banks are working closely with local investors and governments, and the government is making sure that local and international banks have the same playing field. These banks are also providing all sorts of products and packages that local banks are providing to local banks such as National Bank, Al Bilad and AL-Rajhi [6].

Today, the country is trying to diversify its economy by moving away from the oil-based economy. This requires a lot of investment from outside the world, which is why the government is giving international banking players more freedom to invest in the country [7]. This foreign investment is sure to bring a lot of fruit to the country, while GDP is rising every year. This investment has acquired stability in investment and increased diversification in the economy.

The presence of international banks also fluctuates the market over and over again. Inflation and sudden deflation are not good for the local market, as the market reduces the operating space [8]. Some local banks are unable to sustain such large investments, as their capital is not as large as other international banks. The recent example is the merger of SABIC and Saudi Aramco, which will provide the bank with more capital to invest and get back on track [9]. The SABIC bank has lost a lot of market share, causing a severe loss and calling its integrity into question. The acquisition is the best example of how banks are being hit by international banks.

According to Al-Maghzom et al. [10] the entry of foreign banks into the economy of a less developed country has increased the share of foreign banks' total assets in the domestic banking sector. Furthermore, the work of Kamarudin et al. [11] found that when foreign banks enter other countries, there are numerous changes that have always been experienced, and the financial performance of domestic banks ultimately improves considerably. In addition, the study by Oraby [12] found that the entry of foreign banks has resulted in numerous advantages for the host nation, including improving the financial sector and influencing the economy at large. However, the study by Alsharif [13] found that, when the number of foreign banks increases, the profit margin for domestic banks would decrease.

Before the arrival of international banks, Saudi citizens and expatriates relied solely on the services provided by the Saudi Bank. In the absence of any competition, Saudi banks have thrived a great deal and have been able to attract everyone's attention [14]. Today, the number of international banks in Saudi Arabia is increasing. The lack of competition is what the Saudi banks have benefited from, but there is now a tough competition [15]. There is a need for competition on the market so that local banks can compete and improve services. Thus, this work has examined the impact of foreign bank on domestic banking industry in Saudi Arabia.

METHODOLOGY

This study was done based on quantitative method, whereby a systematic data comparison was done. The sample used for this study is the domestic and foreign banking rating data. The data were collected from Bloomberg and different website that shared banking financial historical data and reports. There are three domestic banks included in this study, which are National Commercial Bank (NCB), Al Rajhi Bank (ALRAJHI), and Albilad Bank (ALBILAD). Furthermore, the study incorporated three foreign banks, which are National Bank of Bahrain (NBB), National Bank of Kuwait (NBK), and Emirates NBD Bank (NDB).

RESULT AND DISCUSSION

Domestic Banks

For the National Commercial Bank (NCB), in terms of its returns from the year 2014 – 2018, it is evident that the mean of returns on common equity, assets, and capital are 18.51, 2.174, and 9.06 respectively. Moreover, across the five years the minimum return includes 17.36, 2.06, and 8.23 whereas the maximum includes 20.09, 2.38, and 10.94. Furthermore, based on Figure 1, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 52.924, 67.6475, 52.592, 52.592, 51.912, and 50.77 respectively. Thus, the results in Figure 1 indicate that all margins are at stationary level except the incremental operating margin. Notably, the 0 incremental operating margin in 2017 is due to lack of data.

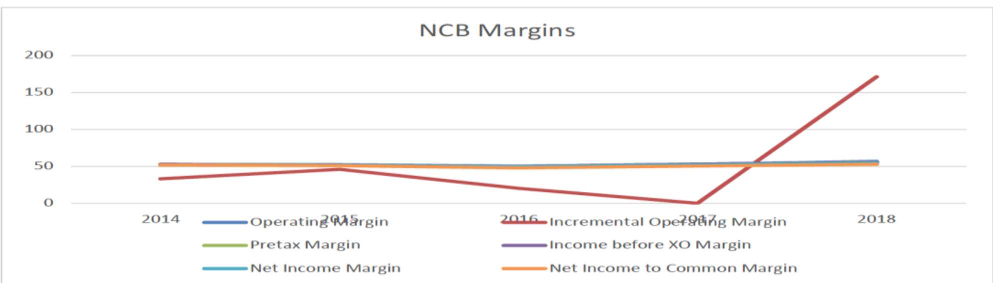

Figure 1. National Commercial Bank Margins (2014-2018)

For Al Rajhi Bank (ALRAJHI), in terms of its returns from the year 2014 – 2018, it is evident that that the mean of returns on common equity, assets, and capital are 17.258, 2.536, and 15.572 respectively. Furthermore, Based on Figure 2, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 50.862, 23.728, 50.932, 50.932, 50.932, and 50.932 respectively. Thus, the results in Figure 2 indicate that all margins are at stationary level except the incremental operating margin.

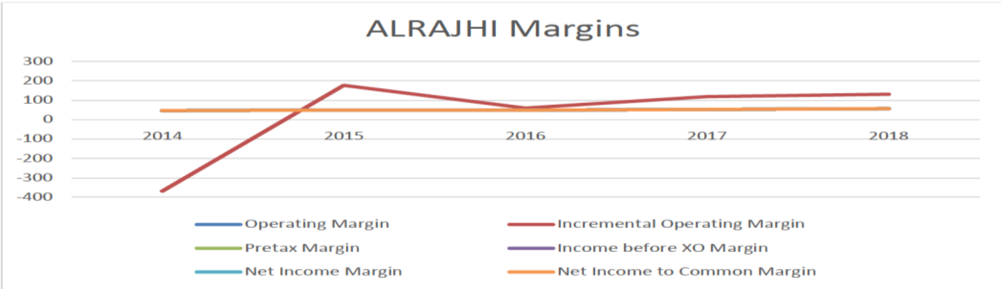

Figure 2. Al Rajhi Bank Margins (2014-2018)

For the Albilad Bank (ALBILAD), in terms of its returns from the year 2014 – 2018, it is evident that the mean of returns on common equity, assets, and capital are 13.528, 1.704, and 9.51 respectively. In addition, based on Figure 3, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 32.246, 36.1975, 32.246, 32.246, 32.272, and 32.272 respectively. Thus, the results in Figure 3 indicate that all margins have a gradual decrease across the five year. Notably, the 0 incremental operating margin in 2015 is due to lack of data.

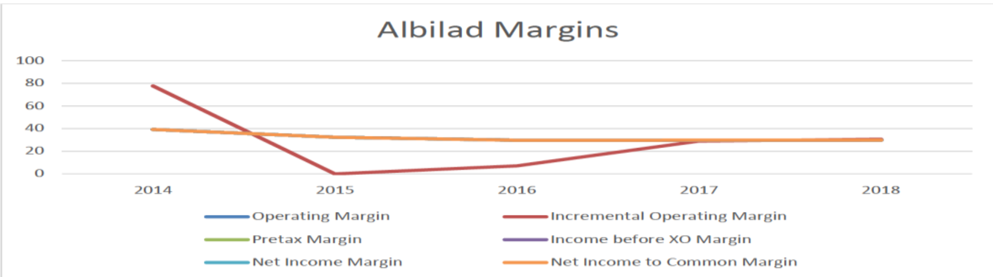

Figure 3. Albilad Bank Margins (2014-2018)

Foreign Banks

For the National Bank of Bahrain (NBB), in terms of its returns from the year 2014-2018, it is evident that the mean of returns on common equity, assets, and capital are 14.708, 2.012, and 7.954 respectively. Furthermore, based on Figure 4, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 58.61, 55.836, 58.61, 58.61, 58.61, and 58.61 respectively. Moreover, the results indicate that all margins except incremental operating margin are at stationary level across the five year. The bank recorded a high level incremental operating margin in 2016; however, the margin drastically reduced in the succeeding year (2017). Notably, the bank did not record its successive sustainable growth across the five years.

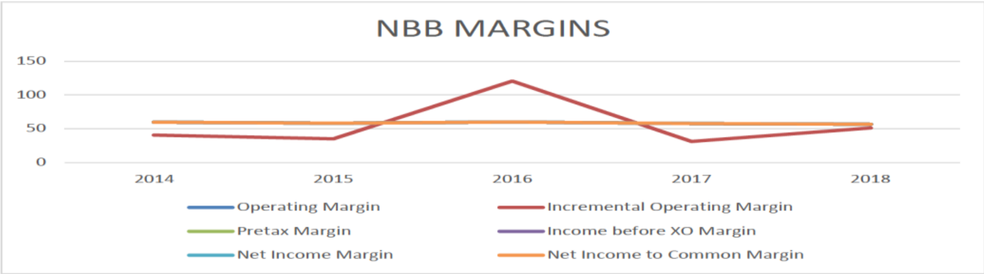

Figure 4. National Bank of Bahrain (NBB) Margins (2014-2018)

For the National Bank of Kuwait (NBK), in terms of its returns from the year 2014-2018, it is evident that the mean of returns on common equity, assets, and capital are 10.44, 1.28, and 3.108 respectively. Furthermore, based on Figure 5, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 44.384, 57.864, 44.618, 40.868, 38.714, and 37.51 respectively. In addition, the results in Figure 5 show that all margins except incremental operating margin are at stationary level across the five year.

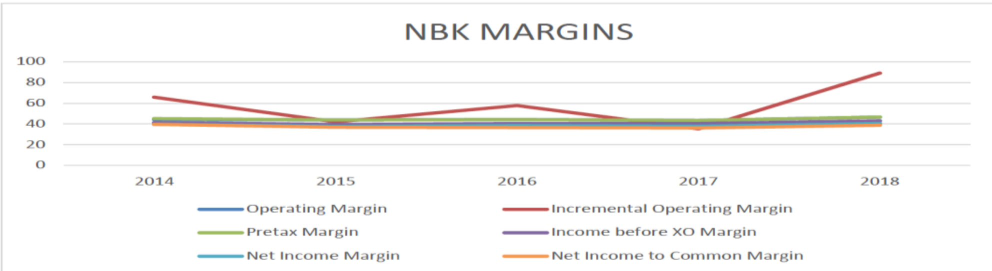

Figure 5. National Bank of Kuwait (NBK) Margins (2014-2018)

For the Emirates NBD Bank (NDB), in terms of its returns from the year 2014-2018, it is evident that mean of returns on common equity, assets, and capital are 15.94, 1.778, and 6.796 respectively. In addition, based on Figure 6, it is evident that the mean of margins Operating, Incremental, Pretax, Income before, Net Income, and Net Income to Common Margin are 45.874, 132.98, 46.768, 45.956, 45.948, and 42.428 respectively. Thus, the results in Figure 6 indicate that all margins except incremental operating margin have a gradual increase across the five year. Likewise, the Incremental operating margin has been on a fluctuating trend since 2014 with a high of over 200 and a low of 0.

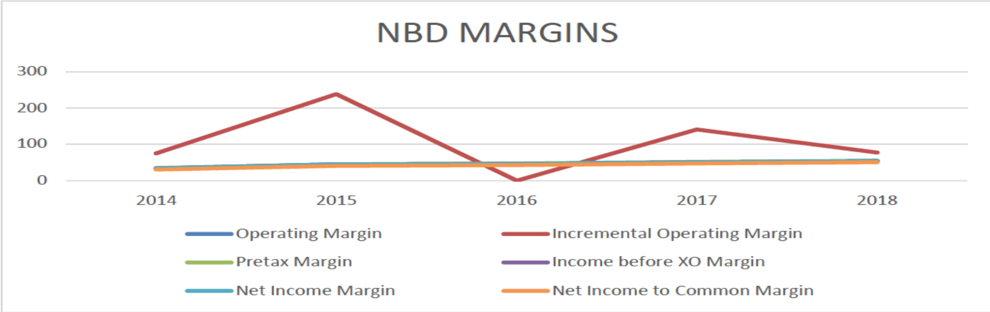

Figure 6. Emirates NBD Bank (NDB) Margins (2014-2018)

Comparison Between Domestic and Foreign Banks

Figure 7 exhibits the comparison between the mean values of the domestic and foreign banks. It is evident that the domestic banks recorded higher rates in all returns compared to the foreign banks. However, the foreign banks recorded higher levels of margins compared to domestic banks. Moreover, the sustainable growth rate of domestic banks is higher than foreign banks.

The return on equity shows the ability of a company to generate income from its shareholders funds. The return on common equity indicates the effectiveness at which the management is utilizing the shareholders finance to grow and fund operations of a firm. The return on equity of the domestic bank is at 16.432 while that of foreign bank was 13.696. this shows that the domestic banks are performing better in relation to the foreign bank. The domestic banks are able to generate more profit using the shareholders equity, which is the common equity of the bank.

	NCB	ALRAJHI BANK	ALBILAD	NBB FROM BAHRIN	NBK FROM KUWITE	NBD from U.A.E	DOMESTIC	FOREIGN
Return on Common Equity	18.51	17.258	13.528	14.708	10.44	15.94	16.432	13.696
Return on Assets	2.174	2.536	1.704	2.012	1.288	1.778	2.138	1.692667
Return on Capital	9.06	15.572	9.51	7.954	3.108	6.796	11.38066667	5.952667
Operating Margin	52.924	50.862	32.246	58.61	44.384	45.874	45.344	49.62267
Incremental Operating Margin	67.6475	23.728	36.1975	55.836	57.864	132.98	42.52433333	82.22667
Pretax Margin	52.592	50.932	32.246	58.61	44.618	46.768	45.25666667	49.99867
Income before XO Margin	52.592	50.932	32.246	58.61	40.868	45.956	45.25666667	48.478
Net Income Margin	51.912	50.932	32.272	58.61	38.714	45.948	45.03866667	47.75733
Net Income to Common Margin	50.77	50.932	32.272	58.61	37.51	42.428	44.658	46.18267
Sustainable Growth Rate	11.138	6.813333	10.148		4.422	10.88	9.366444333	7.651

Figure 7. Comparison Between the Mean Values of The Domestic and Foreign Banks

Return on assets refers to the ability of banks to generate income or profit by use of their assets. The return on assets indicates the capital intensity of a given firm, which is dependent on the industry at which the firm is operating. Based on Figure 7, the return on asset for the domestic bank is 2.138 while that of the foreign bank is 1. 692667. The two types of banks have a great difference, which is about 0.4. The return on asset for the domestic bank is higher than that of foreign banks. This means that domestic banks have a higher ability of generating income and profit from its assets than the foreign banks. The domestic banks having more knowledge on the profitable assets in their country thus able to invest in them may attribute this. The foreign bank may be limited by the possession of less profitable assets or outdated assets that do not give high returns to the bank thus less return on assets.

Return on capital refers to a measure of profitability and potential value creation of a company after taking into consideration the initial capital invested. Return on capital is found by dividing the operating income after tax by the debt and equity capital less the cash and cash equivalents. Based on Figure 7, the return on capital for domestic bank it was 11.38 while that of the foreign bank was 5.95. the return on capital for domestic banks was very high compared to that of foreign bank. This indicated that the domestic banks were performing much better than the foreign banks. The domestic banks are also able to create very high profits and create more value compared to the foreign banks. This may have been attributed by high number of shareholders of domestic banks compared to the low number in the foreign banks, as most citizens are likely to prefer domestic banks.

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Operating margin is used to measure the amount of profit made by a company after making a one-dollar sale when the variable cost of production has been deducted. The variable cost of production includes the wages, and raw materials the operating margin is found after dividing the operating profit by the net sales. Based on Figure 7, the operating margin for domestic bank is 45.344 while that of foreign bank is 49.623. From this, the operating margin for the foreign ban is more favorable than that of domestic bank. This shows that the foreign banks are able to make higher profit from its sales after subtracting the variable costs.
Incremental operating margin refers to the decrease or increase of income that results from continuing operation that are there before the stock-based compensation which may be dividends, expense of both interest and tax between two periods of time and is dividend by revenue increase and decrease in revenue in the same period. Based on Figure 7, the incremental operating income for domestic bank is 42. 52 while that of foreign bank is 82.22. The incremental operating income for the foreign bank is almost double that of domestic bank. This shows that changes in the operating margin occurs at high

rates in foreign banks and the operation of foreign banks are not stable in the country.
Pretax margin is used to measure operating efficiency of a firm. The ratio gives that portion of sales that have been converted into profits. The pretax margin is used in comparing the profitability of firms operating in the same industry. Based on Figure 7, the pretax of domestic bank is 45.26 while that of foreign bank is at 49.62. The pretax margin of the foreign bank is higher than that of domestic bank by about 4. This shows that the foreign bank is more efficient in the banking industry than the domestic banks. The foreign bank is able to convert more sales into profit than the domestic banks

Based on Figure 7, the income before XO margin for domestic bank is 45 while that of foreign banks is 48.478. The income before XO margin for the foreign bank is higher compared to that of domestic bank by about 3. This shows that the operations of foreign bank are generating more income to that of domestic bank. This may be as a result of large-scale economies experienced by the foreign bank. The foreign banks are able to generate more income as they are able to attract more customers to their services.

Based on Figure 7, net income margin for the domestic bank is 45.03 while that of foreign bank is at 47.75. The net income margin for foreign bank is higher than that of domestic bank. This shows that the foreign bank has the ability to generate higher income than the domestic banks, which are actually operating in their own countries. The foreign banks are able to provide extra services that may not be offered by the domestic banks and this leads to increased net income margin for the domestic banks.

Based on Figure 7, the net income to common margin for domestic bank is 44.658 while that of foreign bank is 46.18. the net income to common margin for the foreign bank is higher than that of domestic bank. A higher ratio shows that the bank is generating high income in relation to its common margin and this therefore means that foreign banks have been achieving high income than domestic banks.

Based on Figure 7, the sustainable growth rate for the domestic bank was 9.366 while that of foreign bank is 7.651. The domestic bank has a high rate of sustainable growth than that of foreign bank. This shows that banks rate of sustaining its growth for a long time more than the foreign banks. This may be due to the ease of operation for domestic banks as they are operating in their home country unlike the foreign banks that are operating in a foreign country.
Thus overall, throughout of analysis of foreign and local banks during the past 5 years, it was discovered that there is no financial impact, and this indicates that the country economy is strong so there is no effect and that local banks are only affected when there is financial crisis.

CONCLUSION

Banking sector are becoming more international and globalizing. This paper studied how foreign banks affects domestic banks in Saudi Arabia. It is analyzing and comparing between 6 banks all of them are operate and has many branches in Saudi Arabia three of them are foreign banks and three are domestic banks. The comparing was based on returns, margins and growth rate from 2014-2018. During our analysis and comparing we found that domestic banks better and stronger than foreign banks. Also, it provides evidence that banking industry in Saudi Arabia is strong and it is not effects of entry of foreign banks at all in Saudi Arabia. In some cases, it has seen that most of Saudi citizens are prefer local or domestic banks more than foreign banks. In Saudi Arabia, the citizens are more than foreigners so because of that domestic bank are still taking place even of increasing number of foreign banks.

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