



**The Hashemite Kingdom of Jordan**

**Ministry of Planning**

# **Banking Cluster**

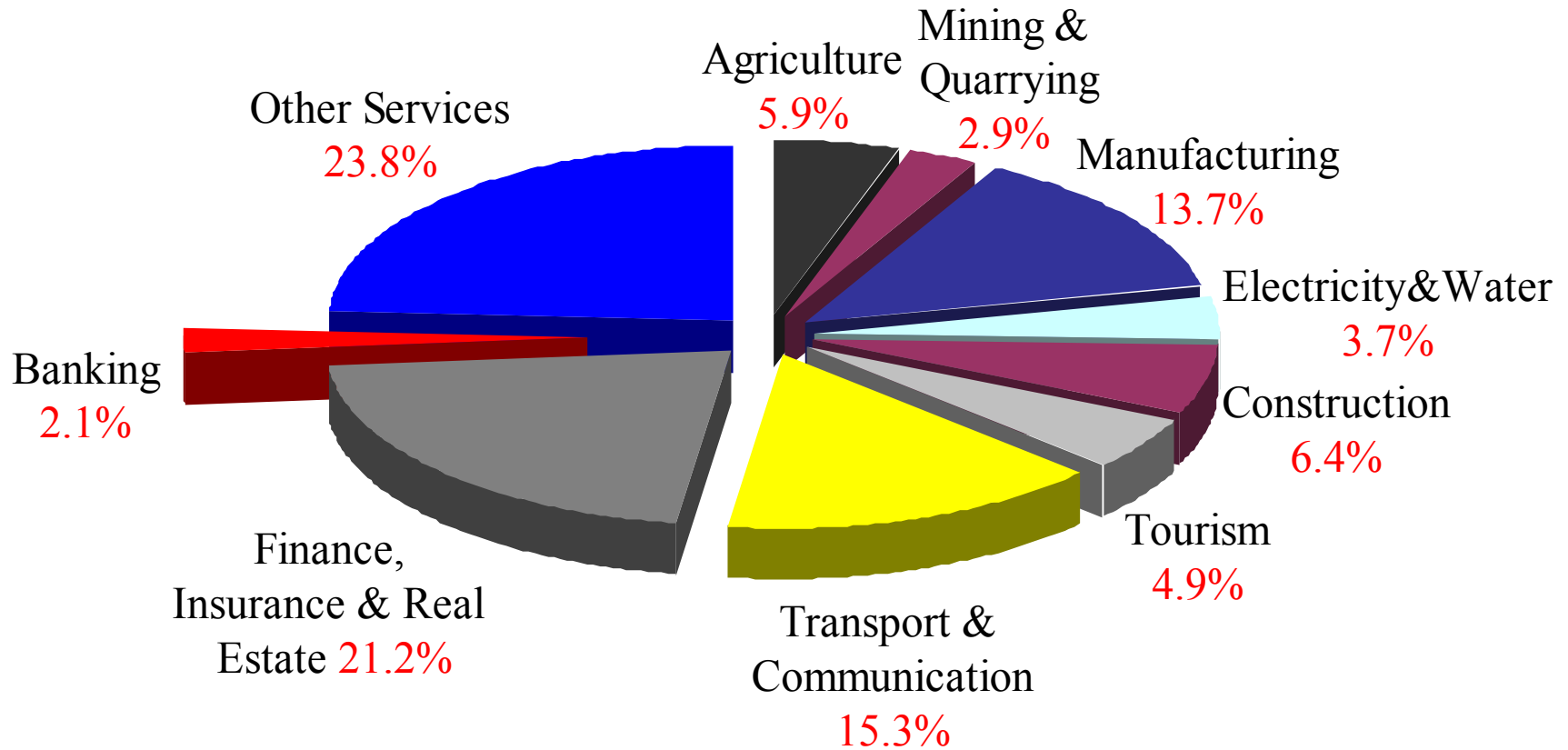
**National Competitiveness Team**

**2000**

# Agenda

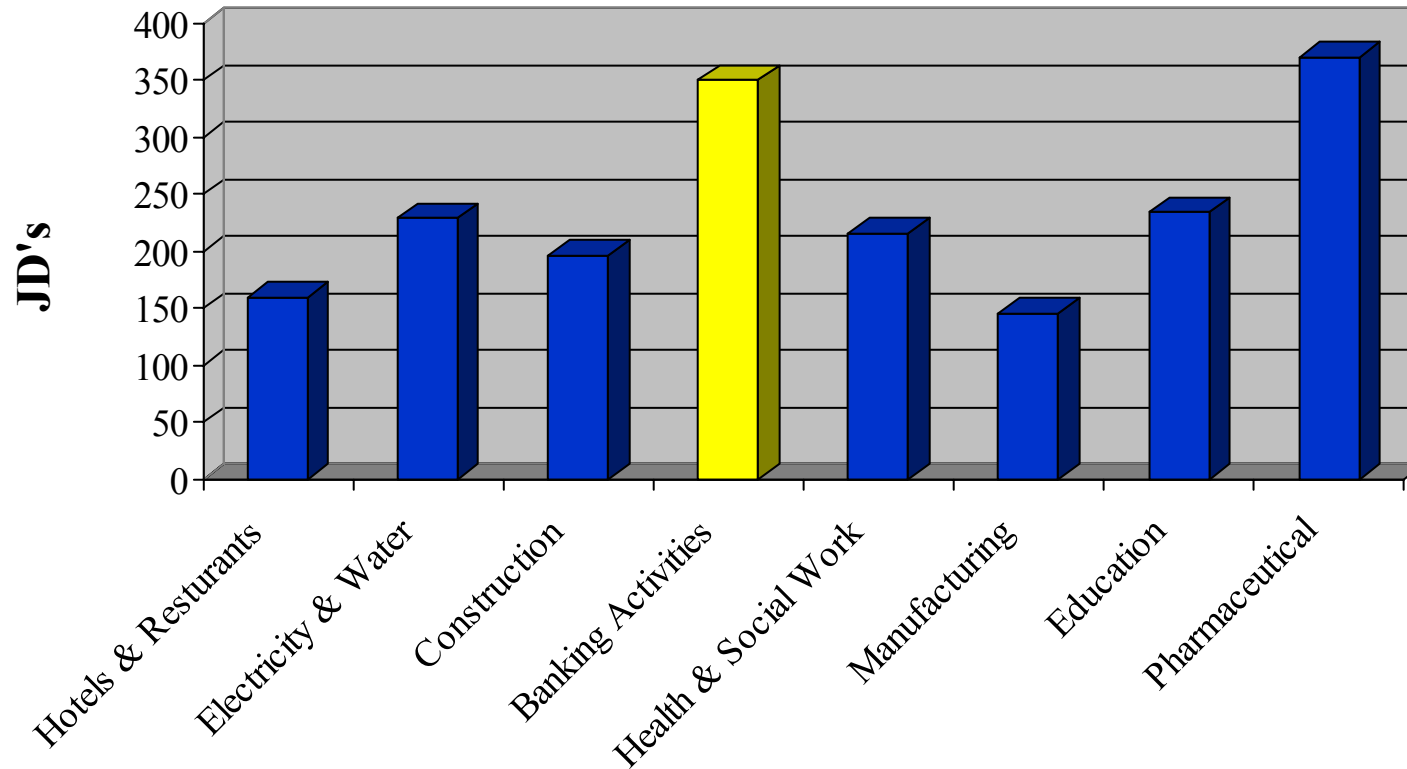
- **Major Indicators**
- Cluster Map
- Diamond Analysis
- Current Strategy
- Options
- Globalization

# Contribution to GDP 1998



Direct contribution of the banking cluster 2%  
“Indirect contribution (exceeds) 20%”

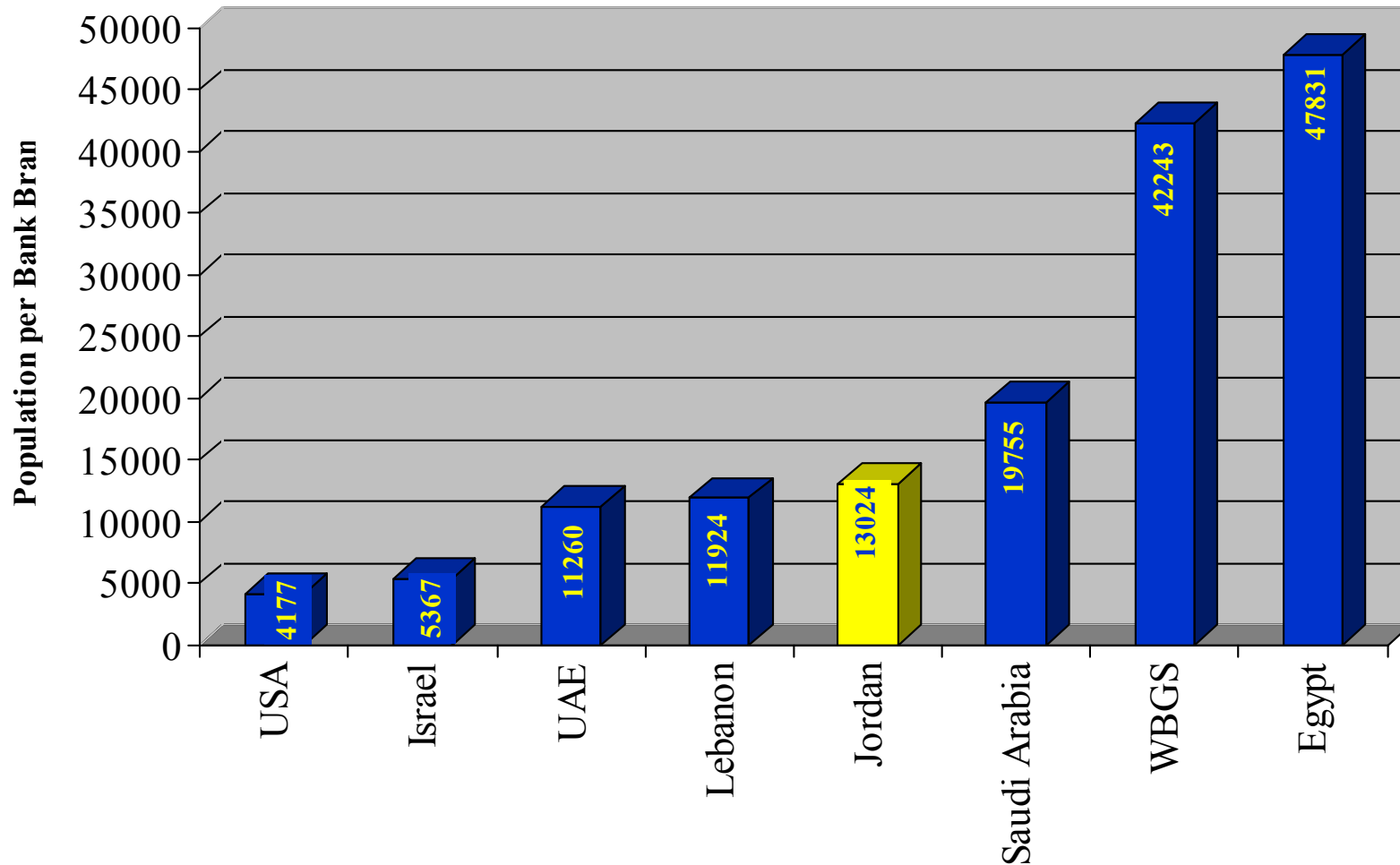
# Average Monthly Wages Per Employee (JD)



Monthly wages of the banking sector are among the highest in Jordan:

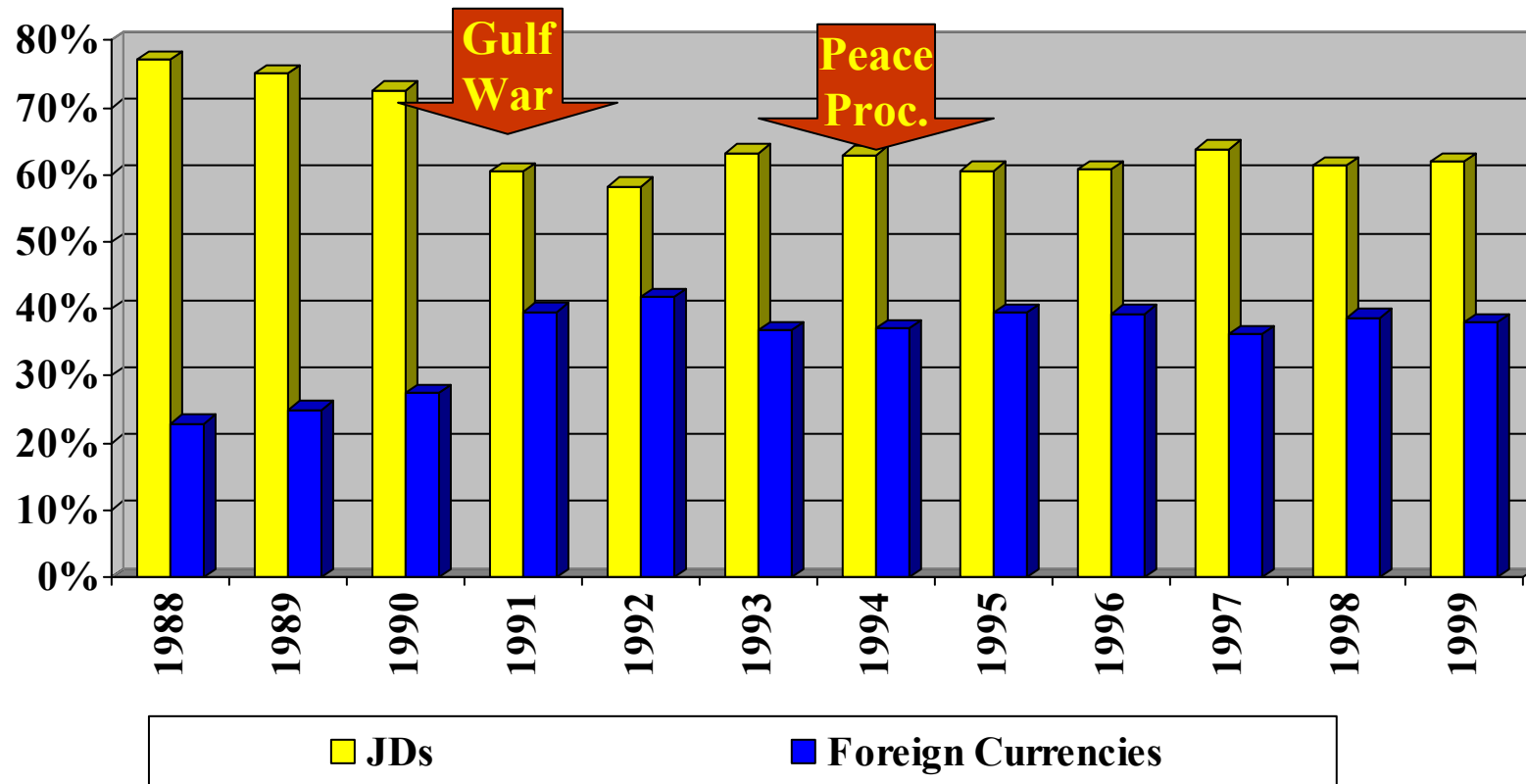
- Requirement of highly qualified labor
- High level of competition among banks (locally and regionally)

# Population Per Bank Branch 1999



Jordan is considered to be over-banked, yet some bankers believe that the absence of strategies related to the number of branches is creating problems for new branches.

# Relative Importance of Deposits: Jordanian Dinar Vs. Foreign Currencies



**Dollarization has been the main challenge facing the Jordanian currency. There is an increase in banks' foreign liabilities since most of the lending is in JD's and most banks lack proper investment opportunities.**

•In 1999 lending(credit facilities) in foreign currencies formed only 13% of total lending

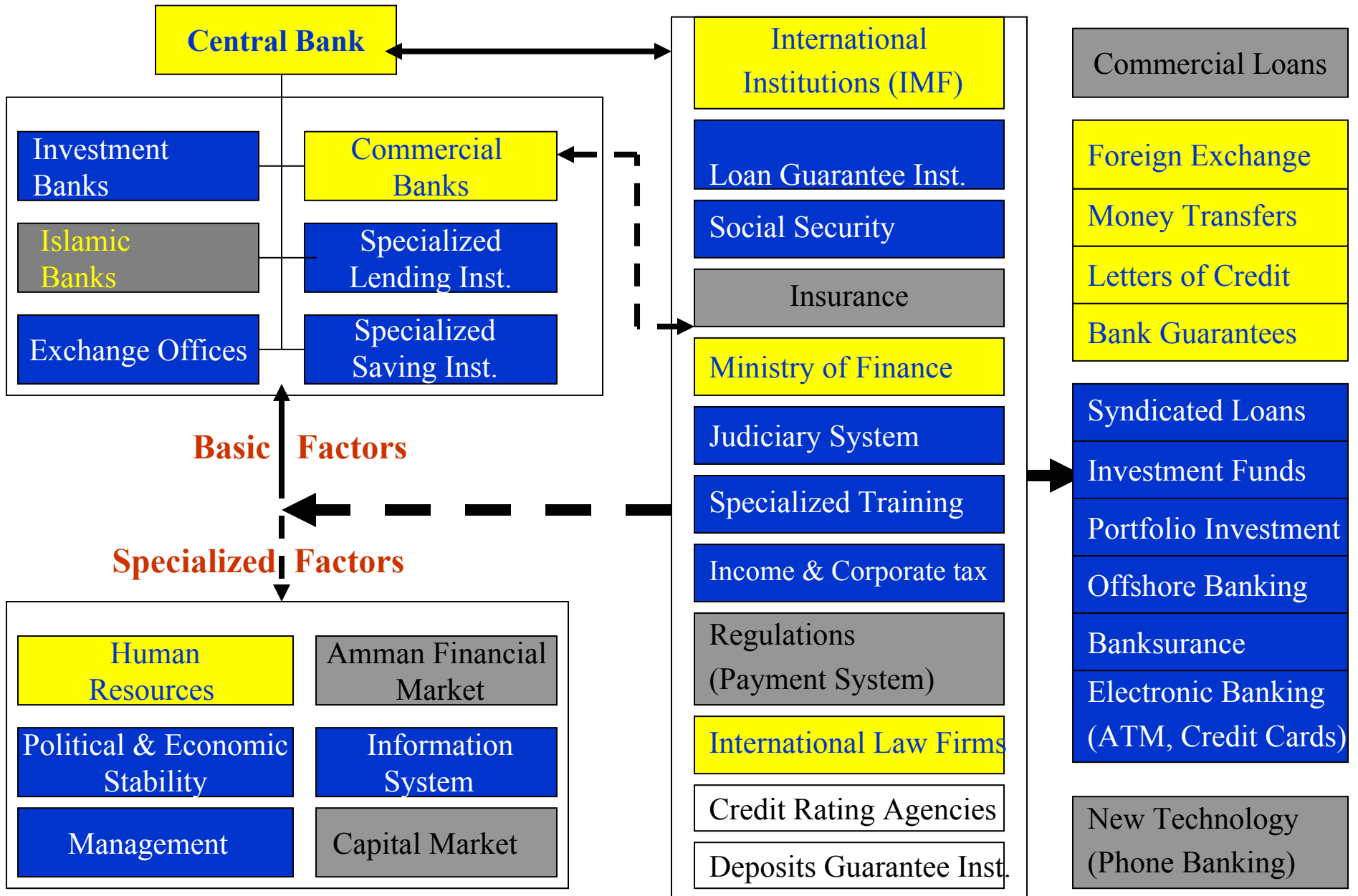
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# Institutions and Inputs

# Related and Supporting

# Outputs



Satisfactory
  Weak
  Under Improvement
  Absent
  Strong Relation
  Weak Relation

**“Jordan’s banking sector is not as strong as most bankers believe. This reflects the strong supervision imposed by the CBJ, the existence of monopolistic banks, and the absence of true competition.”**

**“The weak parts which appear within the cluster could become the graves of Jordanian banks when it’s a free market with full access to foreign competitors.”**

# Foreign Competition

Not only is competition on local level, but foreign institutions are also competing by either sending representatives or setting up branches.

What is apparent however, is that there is already existing competition from these counterparts over large local tenders without having to establish their branches in Jordan through their overseas representatives.

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# Diamond Hypothesis: The Competitive Environment

## Government

- + CBJ Indirect monetary control
- + The Govt. is following a new reform program consisting of new banking law, insurance law, monetary liberalization, and the establishment of some supporting corporations.
- + Strong supervision by the Central Bank
- + Incentives to merger are presented
- +/-The Govt. contributes in five banks, yet shares does not exceed 15%
  - High tax rate imposed on the banking sector

## Basic Factors

- + Good internal training programs
- Moderate information system

## Specialized Factors

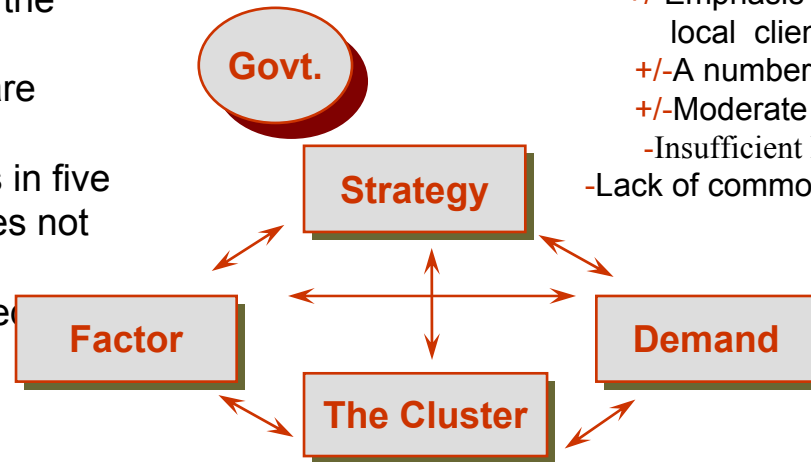
- + Specialized training centers
- + Abundant qualified labor
- Imbalance relations among capital, shares, and bond markets

## Firm Strategy, Structure, and Rivalry

- Rivalry**
- +/-Strong competition among the big six banks
  - Unfair competition between commercial banks and specialized lending institutions in some sectors
- Strategy**
- +Majority of Banks are well prepared for both the launching of the Euro and the computer 2000 crisis
  - Weak role for banks in the capital market
  - Weakness of the financial system in Jordan at financing long term loans
  - +/-Emphasis on marketing by focusing on increasing number of local clients through opening new branches, awards and prizes
  - +/-A number of small sized family banks
  - +/-Moderate use of new banking techniques
  - Insufficient R&D
  - Lack of common vision related to future strategies to meet the expected global competition

## Local Demand

- + Growing demand on new banking services and Islamic banking
- + Small and medium projects suffer from
  - high guarantees required by banks
- + Strengthening the role of Loans Guarantee Company
- +/- Local demand on deposits concentrates
  - mainly on short-time savings
- In Amman Financial Market local demand concentrates on big sized companies or companies with concession's or monopoly



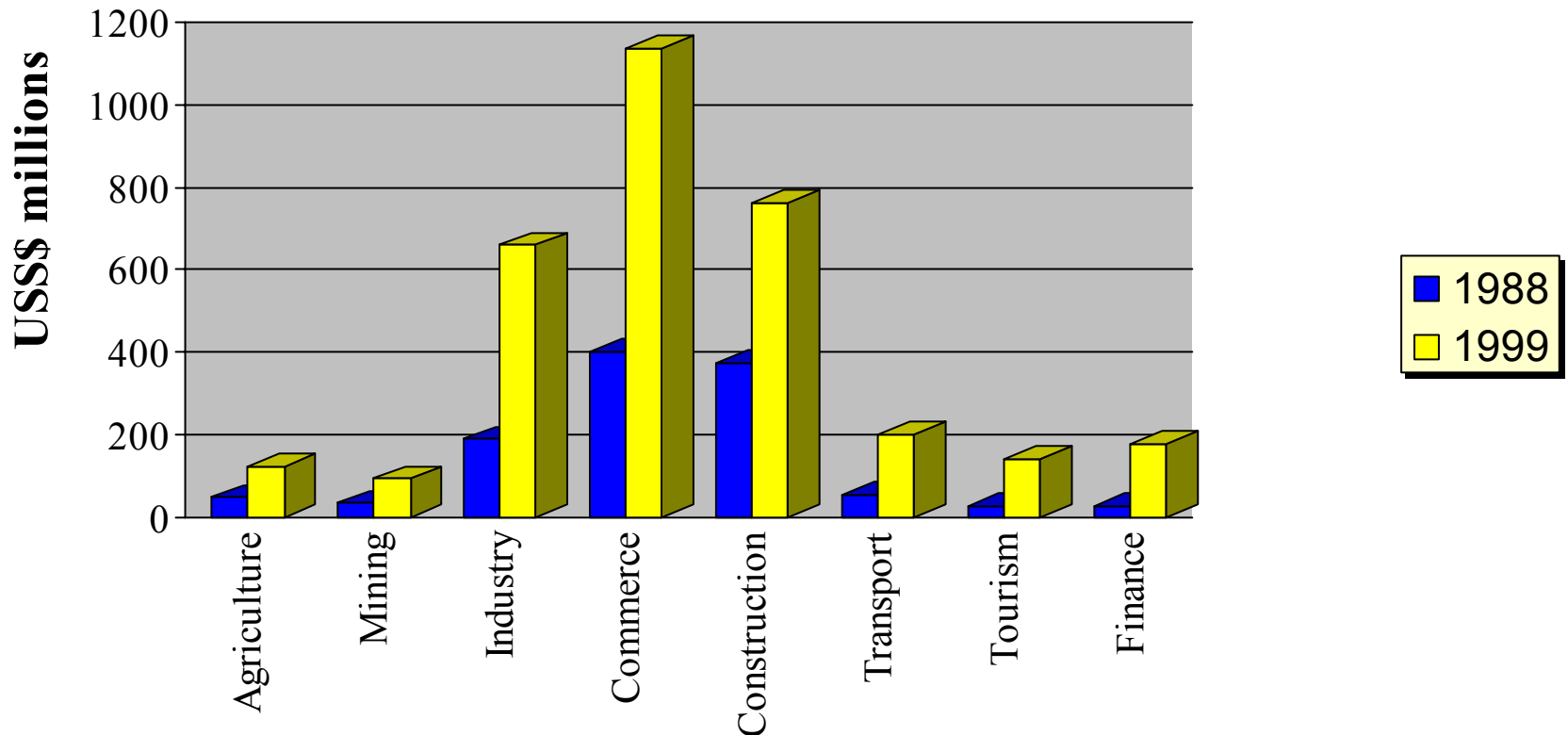
## The Cluster

- + One major training centre
- + Good coordination between CBJ and MoF.
- + Establishing new finance support Inst
- + 22 working banks
- +/-Weak role for Banks Associations
- +/- Moderate communications between banks
- Weak insurance market
- No credit rating agencies

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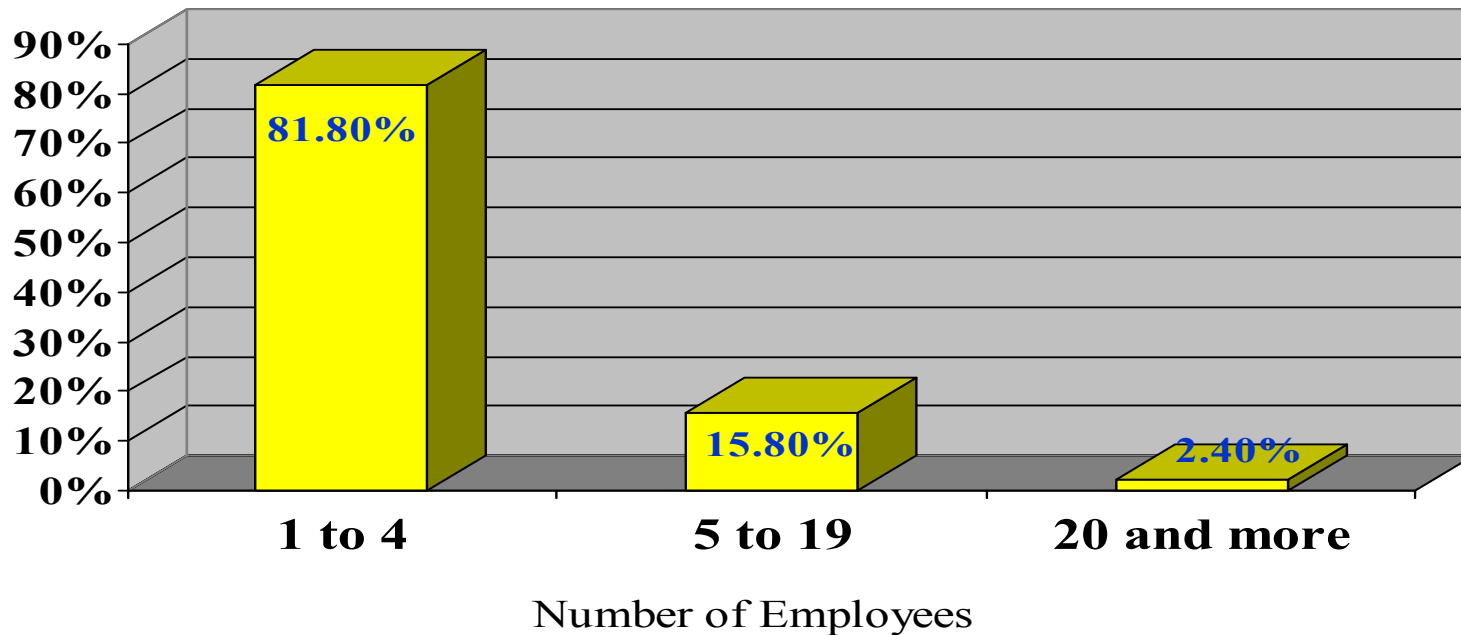
# Credit Facilities Extended by Licensed Banks According to Economic Activity 1988-1999



Most of the loans forwarded to the commerce sector reflect the fact that local banks have a “short-term” lending strategy. In the meantime, long-term loans are needed for more industry and manufacturing activity.

# Small & Medium Projects in Jordan (Inadequate Financing to SMEs)

Industrial Establishments in Jordan by Number of Workers



Small and Medium enterprises dominate Jordan's economy. However, the banking sector in Jordan, to avoid any risk related to bad debt, is reluctant to lend to such enterprises.

# Structural Changes in the Financial Sector

## Loan Guarantee Corp. (Capital JD10 mil.)

- 1- Loans extended to S&M reached JD36 mil. (19 banks involved)
- 2- Banks are increasing their loans dramatically through this institution.
- 3- Feasibility studies are being conducted, which decreased the bad debt problem to 3% of total loans Vs. 10% average.

## Secondary Mortgages Corp.

Loans into housing sector will increase.

Creating more activity for the declining construction sector.

## Deposits Insurance Corp.

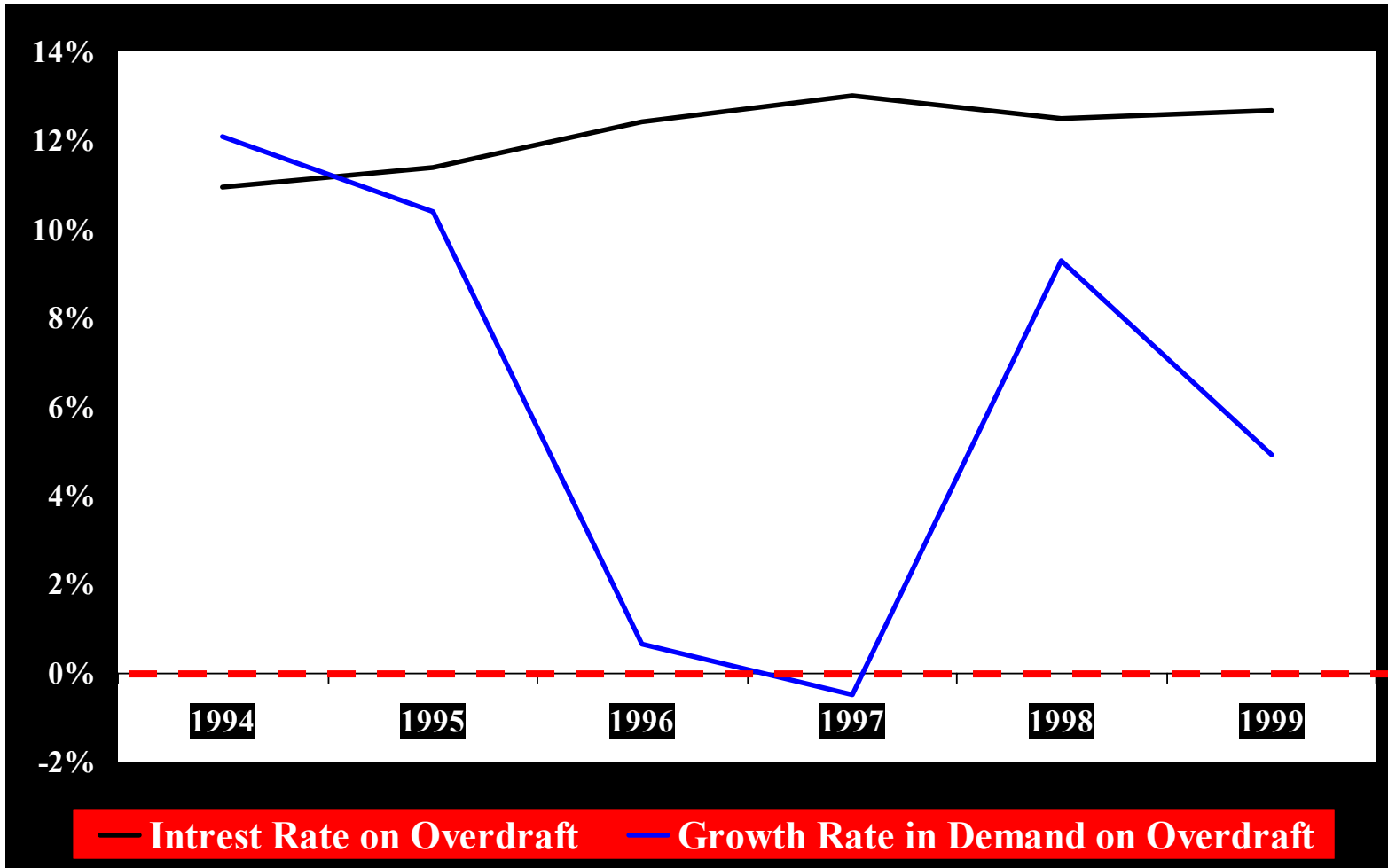
The Institution law is under preparation

Banks will have much longer term deposits, enabling them to offer long-term loans.

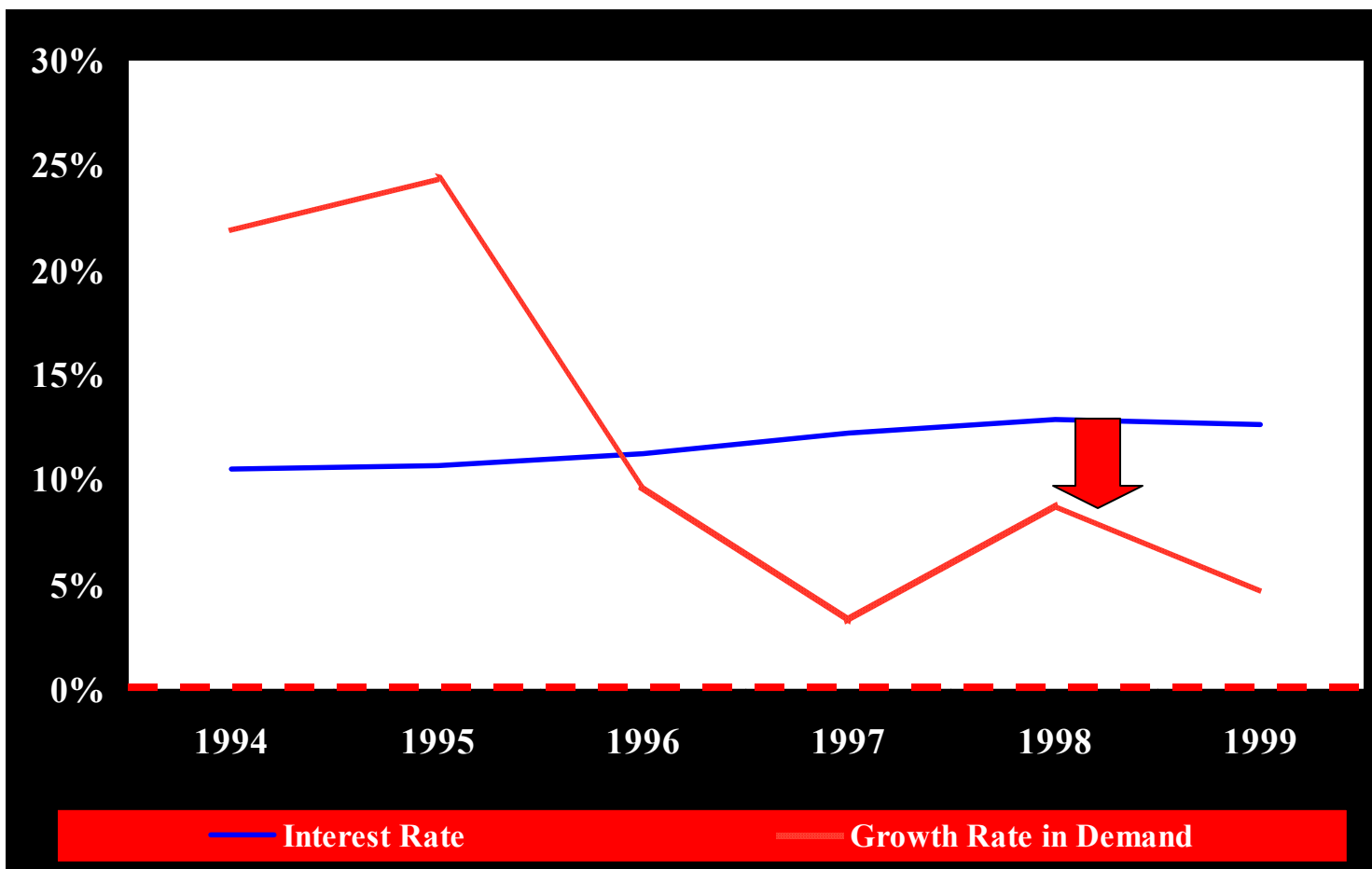
**Local banks will be alone facing any banking crises**

These corporations will fulfil only a small portion of the total needs of the Jordanian market.

# Demand on Overdraft Loans Vs. Interest Rates

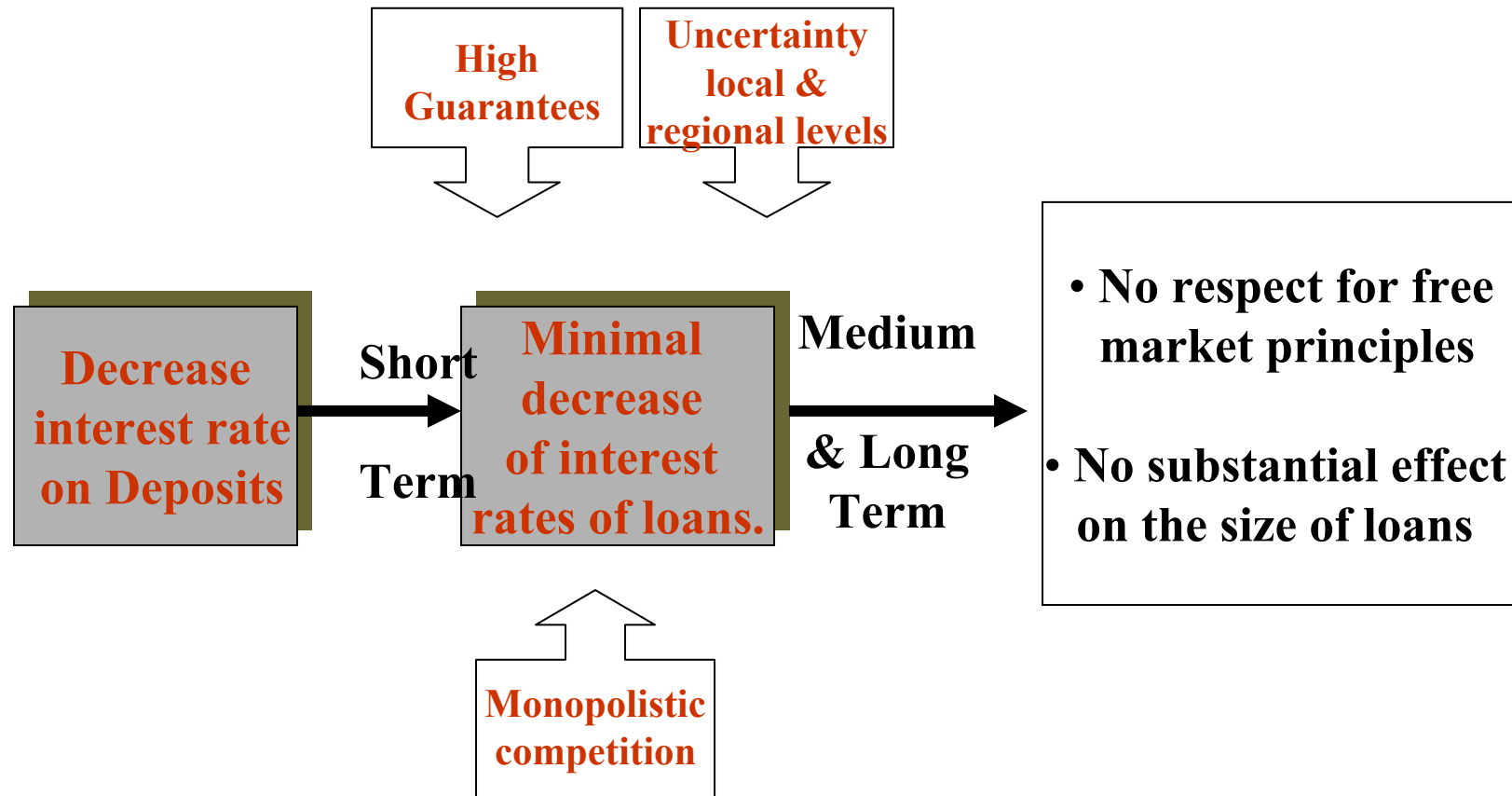


# Demand on Loans and Advances (Growth Rate Vs. Interest Rates)



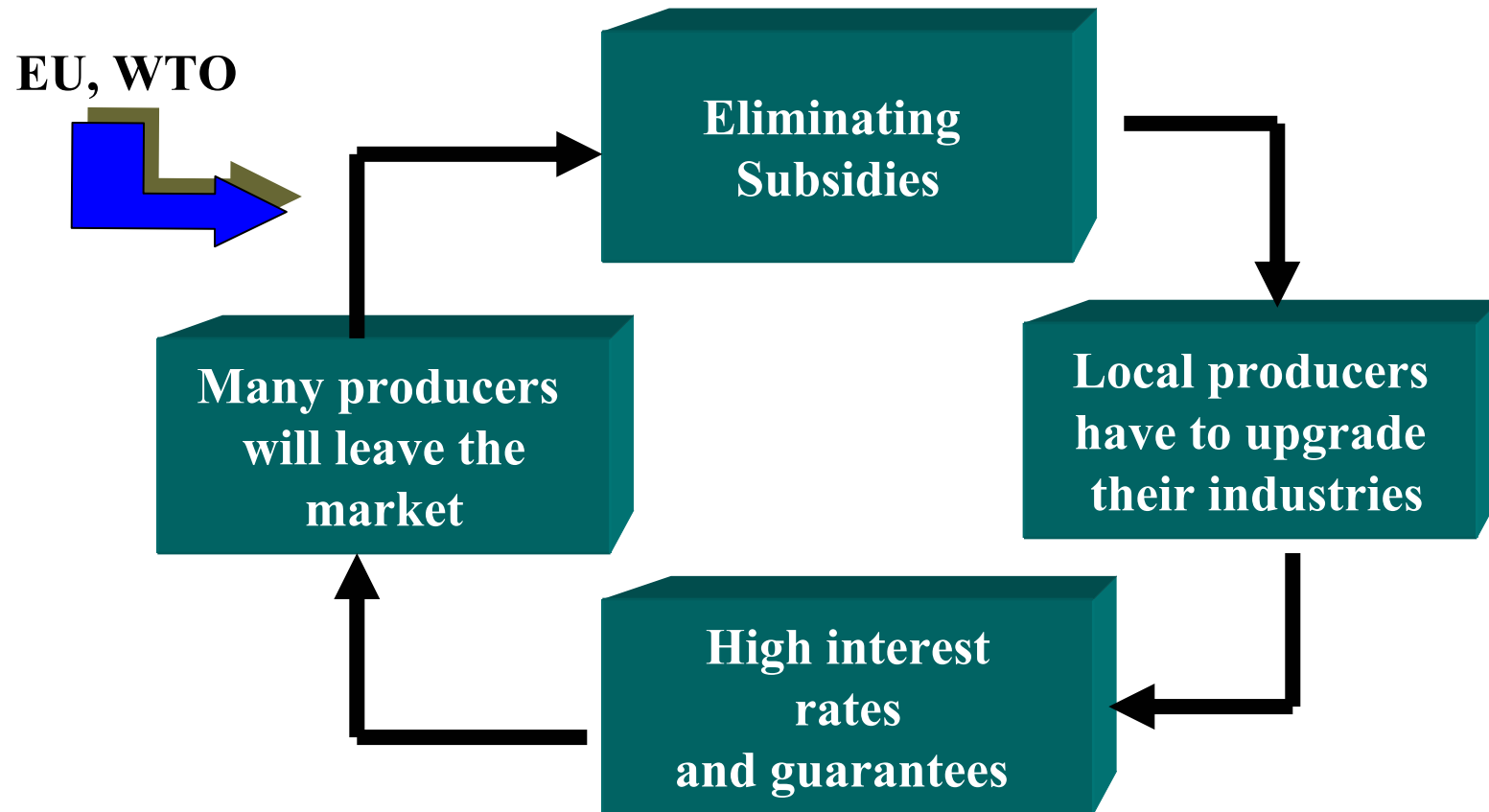
The positive relation between the interest rate and the increase in demand in 1998 was due to the US\$ 120 m. in government loans.

# Decreasing Interests on Deposits, What Will Happen Next?



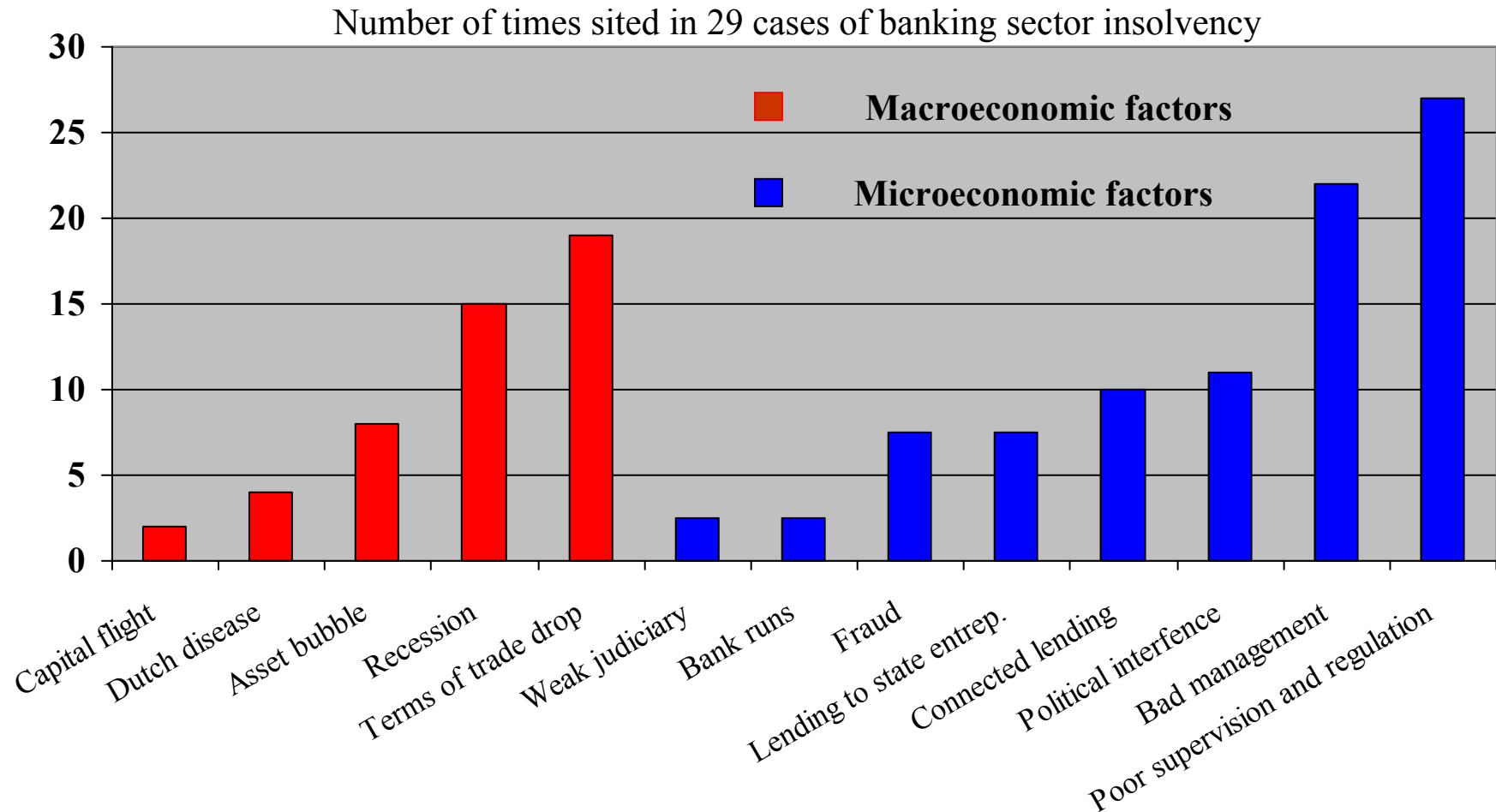
**In the medium & long term, these kind of procedures are not effective. Small and medium-sized banks will not be committed to such an agreement as they think it helps monopolistic banks only.**

# Interest Rates & Globalization



The current level of interest rates does not offer local companies incentive to upgrade themselves. (*Average return on investment vs. Interest rates levels*)  
**“High interest rates is the worst nightmare for all local producers when we think of globalization,” a local producer claims**

# Macro and Micro Economic Factors Responsible for Recent Banking Crises



**Microeconomic factors played the biggest part in recent banking crises**

•Source: Caprio and Klingbeil, 1997

# Banks Failure in Jordan

Some banks in Jordan went bankrupt due to corruption, bad loans, lack of transparency and most importantly managerial failure. Such as:

- 1- National Islamic Bank
- 2- Petra Bank
- 3- Amman Bank for Investment

Other banks failed because of external factors, Such as:

- 1- Al-Mashreq Bank
- 2- Bank of Credit and Commerce International (BCCI)
- 3- Syria Jordan Bank

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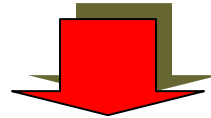
# What Options Do Jordanian Banks have ?

**In order to compete in local, regional, and international markets, local banks should be:**

- 1- Big enough in assets, capital ...etc).
- 2- Technologically advanced.
- 3- Moving to new banking services

**In order to be specialized banks, local banks should be:**

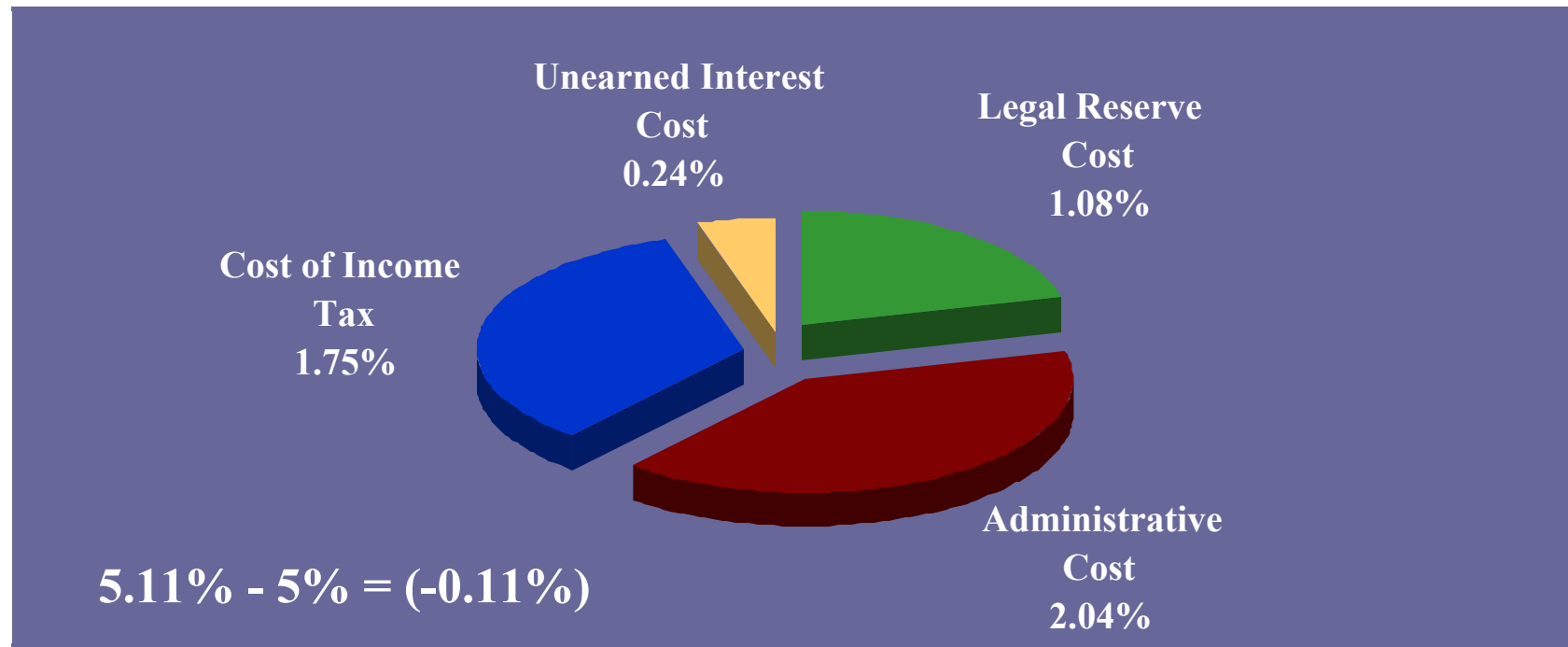
- 1- Big enough in assets, capital ...etc).
- 2- Technologically advanced.
- 3- Moving to new banking services



**Whatever the strategy is, the same requirements are needed**

# Do Banks Make Profits by Differences in Interest Margins

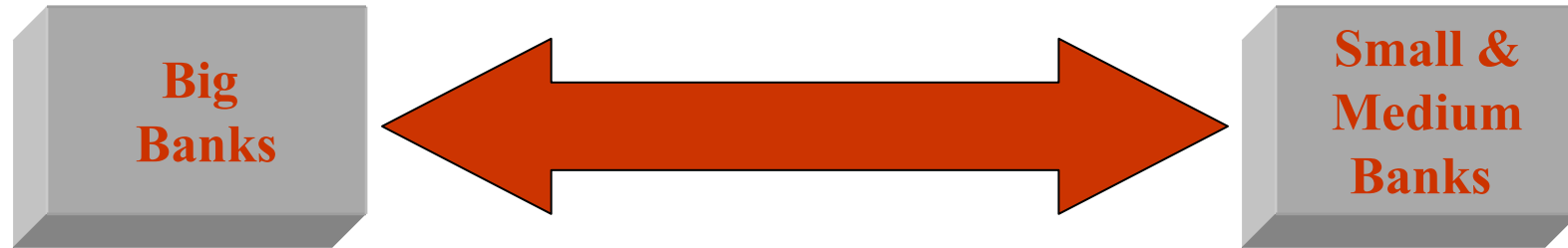
- Average interest rate margin 5%
- The 5.0% profit is called “the mirage profit” due to the fact that banks have to pay:



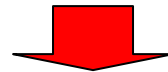
*“Actual tax rate reaches 60-65% over banks”*

*Financial Manager*

# New Technologies: High Cost Vs. Cooperation

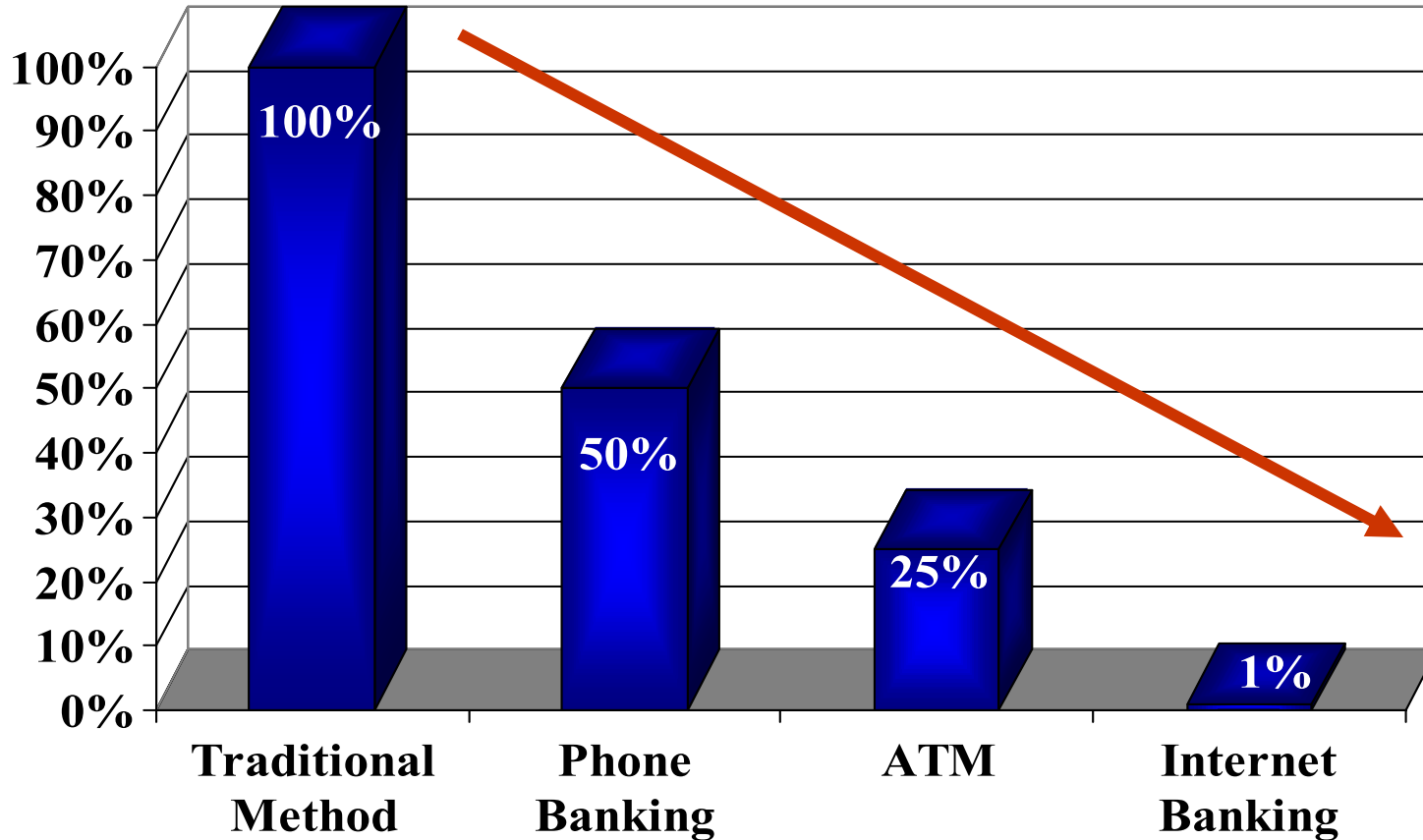


- Small & Medium-sized banks can not afford the high cost required for adding new services. New services and products must be supported by: Internet Banking (On Line Banking) & Phone Banking.
- Foreign banks operating in Jordan have an advantage over local banks due to the fact that these banks can get their needs from main branches



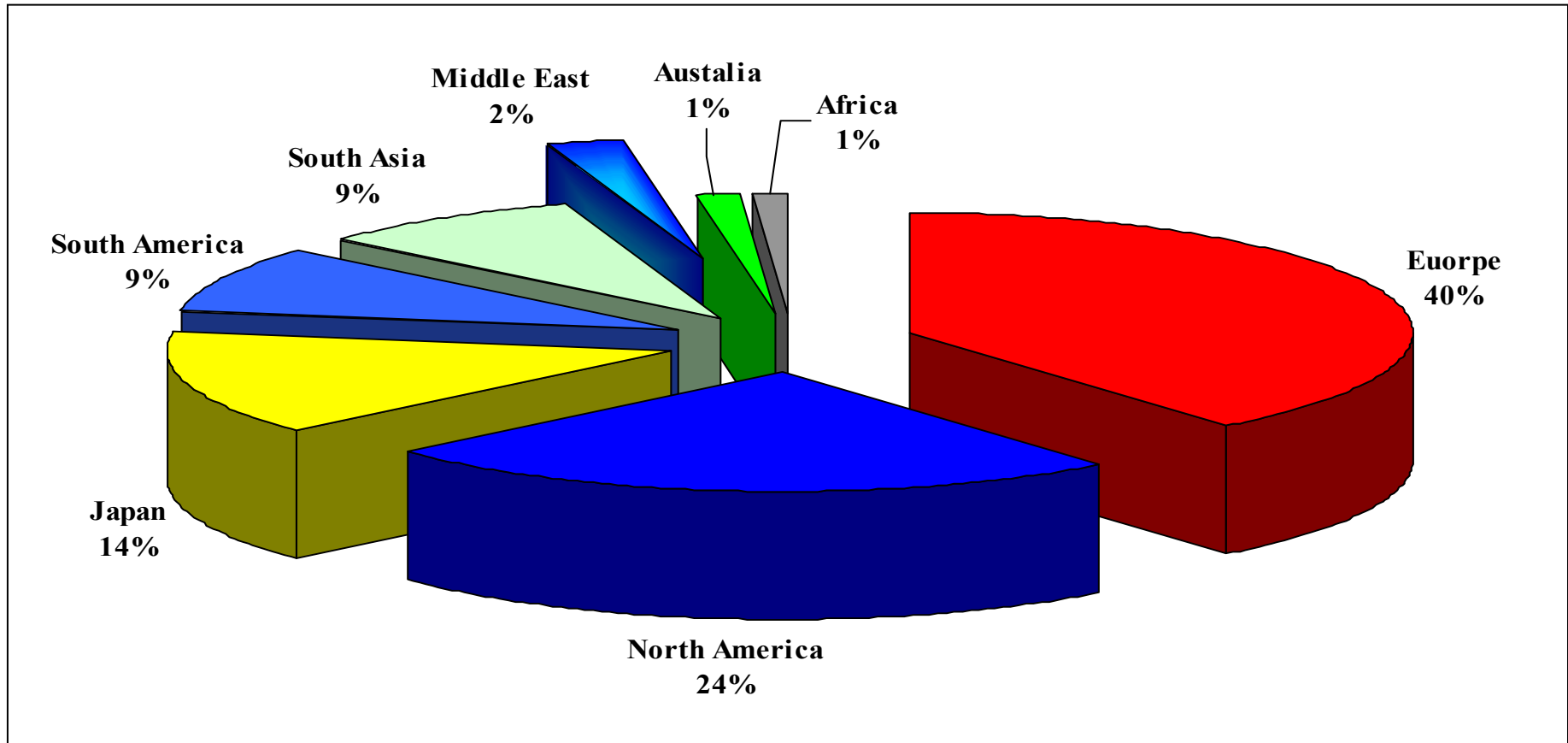
**In other countries: Small and Medium-sized banks are using the technology of other big banks to deliver the new services. Nowadays, 80% of banking services in developed countries are done without visiting the bank.**

# Comparative Cost of New Banking Services



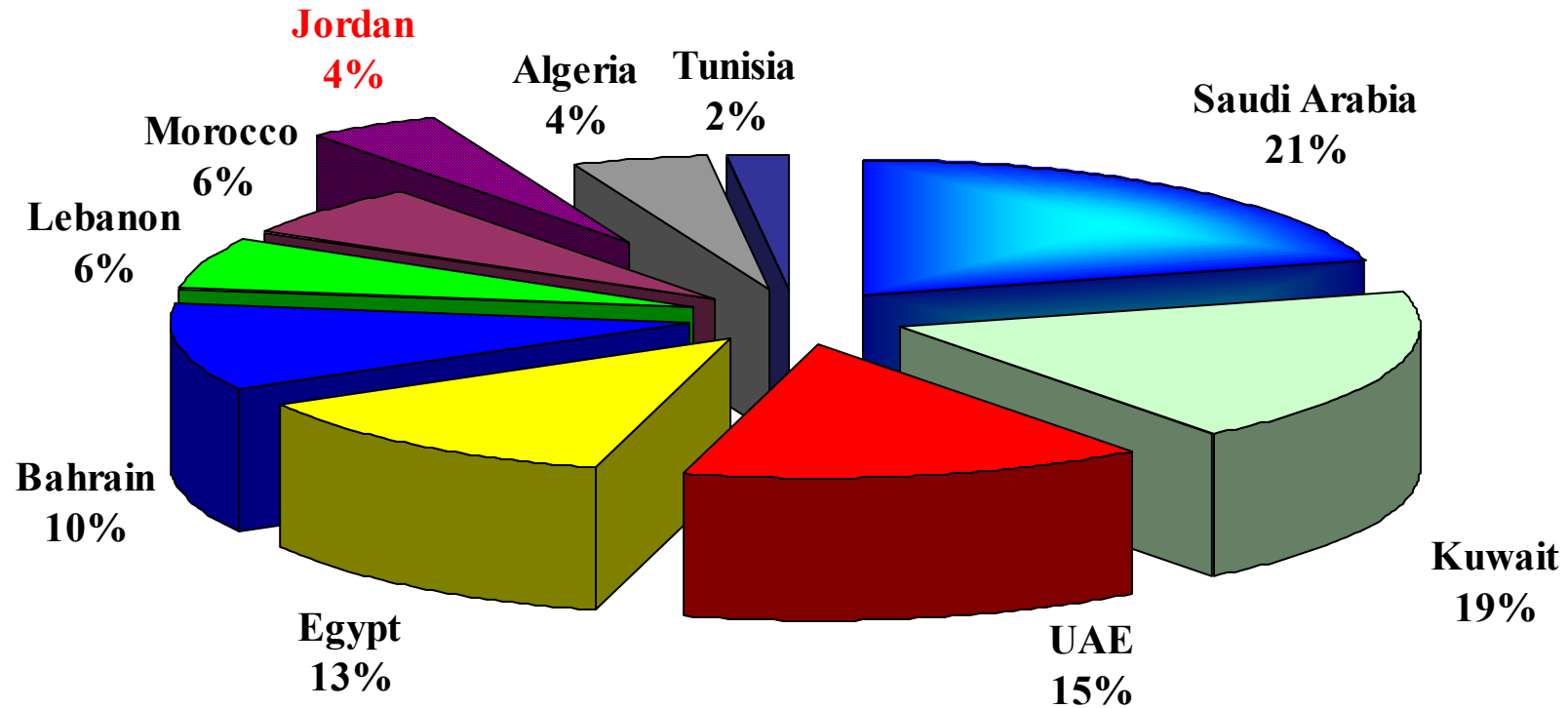
**New banking technologies will help banks  
reduce their high costs**

# Distribution of the World 200 Leading Banks by Region 1998



“Even the largest Jordanian Banks are not among the 200 leader banks in the world. However, there is a Saudi bank and 2 Israeli banks among these leaders.” *Euromoney/ Fitech IBCA Association*

# Distribution of the 50 Leader Arab Banks by Country, 1998



**“Out of 15 leader banks in the Arab world, 11 banks are Saudis.”** *Euromoney/ Fitech IBCA Association*

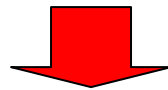
**In Saudi Arabia there are 15 operating banks**

# Missed Opportunity: *Local Industry Needs*

**In general,  
banking sector  
in Jordan is  
considered  
small**

**Jordan is in the process of signing more than 10 projects. These projects require long-term financing of about JD100-700m. for each. (1 billion total needs)**

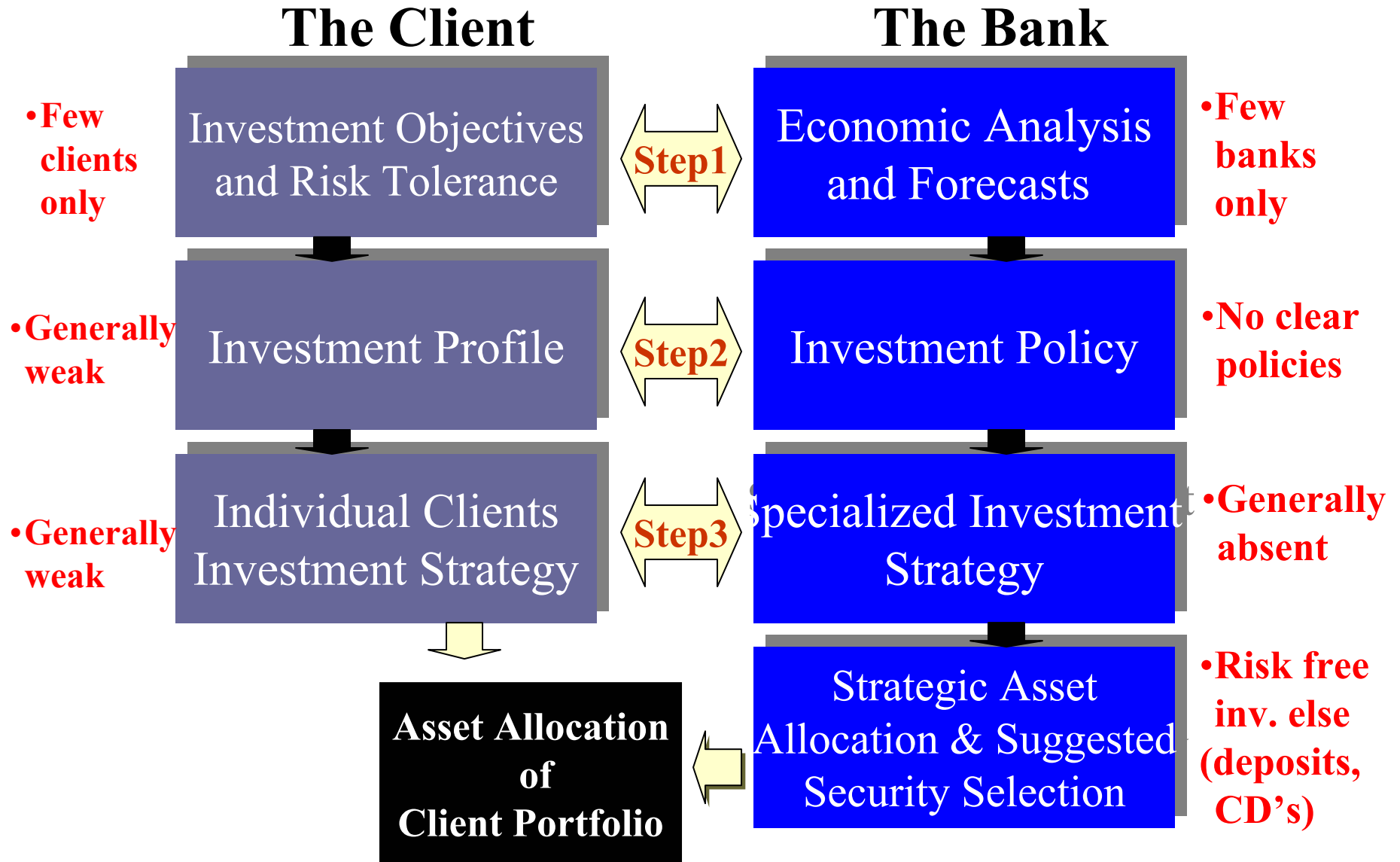
**“Maximum lending capacity for local bank does not exceed US50 millions.”**



**Since Jordanian banks only provide long term loans with high guarantees and high interest rates, foreign competitors are expected to dominate such projects.**

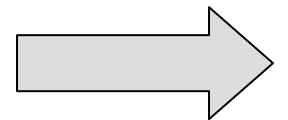
# *Future Horizon: Development of Investment Culture*

## **Investment Process and the Clients Needs**



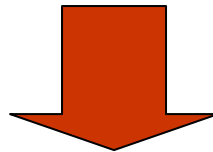
Even on a regional level, Jordan banks are considered small...

On the other hand, and in addition to the urgency of increasing capital, Jordan's banking cluster still lack



# Institute of Banking Studies

- Due to the fact that:
  - the average percentage of the employees who work in this sector with a “Tawjeehi” degree or less, exceeds 30%.
  - Banking technologies and techniques are changing rapidly. Therefore, it is a necessity for all banks to keep their employees and managers updated and exposed to such changes.



*The Institute of Banking Studies had conducted 855 seminars and training Courses from 1977-1998 related to various banking subjects. HOWEVER,.....*

# Fragmentation in the Training System

*“The institute is being criticized for not publishing the results of the seminars it holds.” Source: Interviews*

*weaknesses (as indicated by local banks):*

*1- Primitive training system*

*2- Lack of qualified trainers*

*3- Bad timing: training seminars are mostly conducted after work time, which minimizes benefit to participants (local banks refuse to send their employees during working hours).*

*4- Weak and fragmented training system; no coordination among related institutes.*



**“Currently, big banks are conducting training courses. Their courses are more practical and satisfy the needs of local banks.”** *Local banks managers*

# Educational System is Incompatible with Market Needs

Most graduates from Jordanian universities with banking specialty lack:

- Practical knowledge of banking activities and services,
- Up-to-date knowledge regarding banking activities,
- Computer skills,
- Linguistic skills (especially, English)



*“ I prefer to hire Jordanian graduates from either the United States or United Kingdom ”*

*Bank manager*

# Banking Employees: Stability Vs. Low Wages

*“Three of my colleagues, who worked with me in this bank for seven years had left to work in banks in Dubai. Lately I have sent my c.v., hoping to be accepted there.” Interview: Jordanian Bank employee*

- 1- Banks in Jordan are competing with each other to attract qualified and expert personnel by offering higher wages.
- 2- Due to insecurity about the ability to retain employees, decision making is restricted to senior management, without the involvement of other concerned parties within the bank.
- 3- Due to low wages, many qualified Jordanians are currently working abroad, particularly the Gulf area.
- 4- Jordanian Labor law does not protect employees in banks since, banks are allowed to release employees for restructuring purposes.



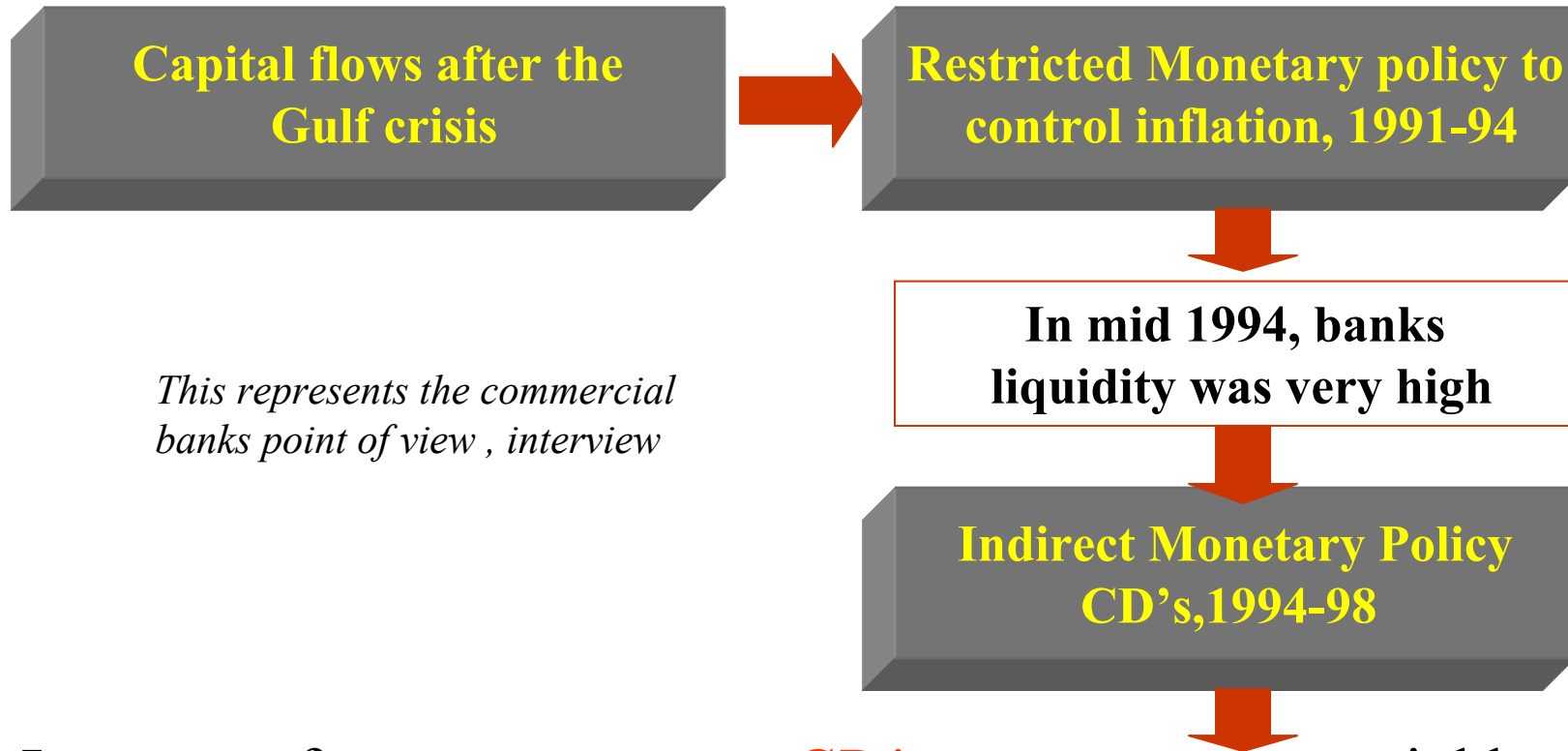
**Pooling training resources, to create high quality outputs**

# Minimal Investment in Human Capital

- Incentives given to employees to attend training seminars abroad are weak. Such training courses are limited to senior management only, even if it does not apply to their administrative needs.
- By regulations, every bank is required to spend 1% of the net profit on Research and Development (R&D). Yet, those funds are spent on other unrelated purposes, such as travelling expenses and per-diems.
- “Shareholders impede the allocation of net profits to training courses to increase their share of net profit.”

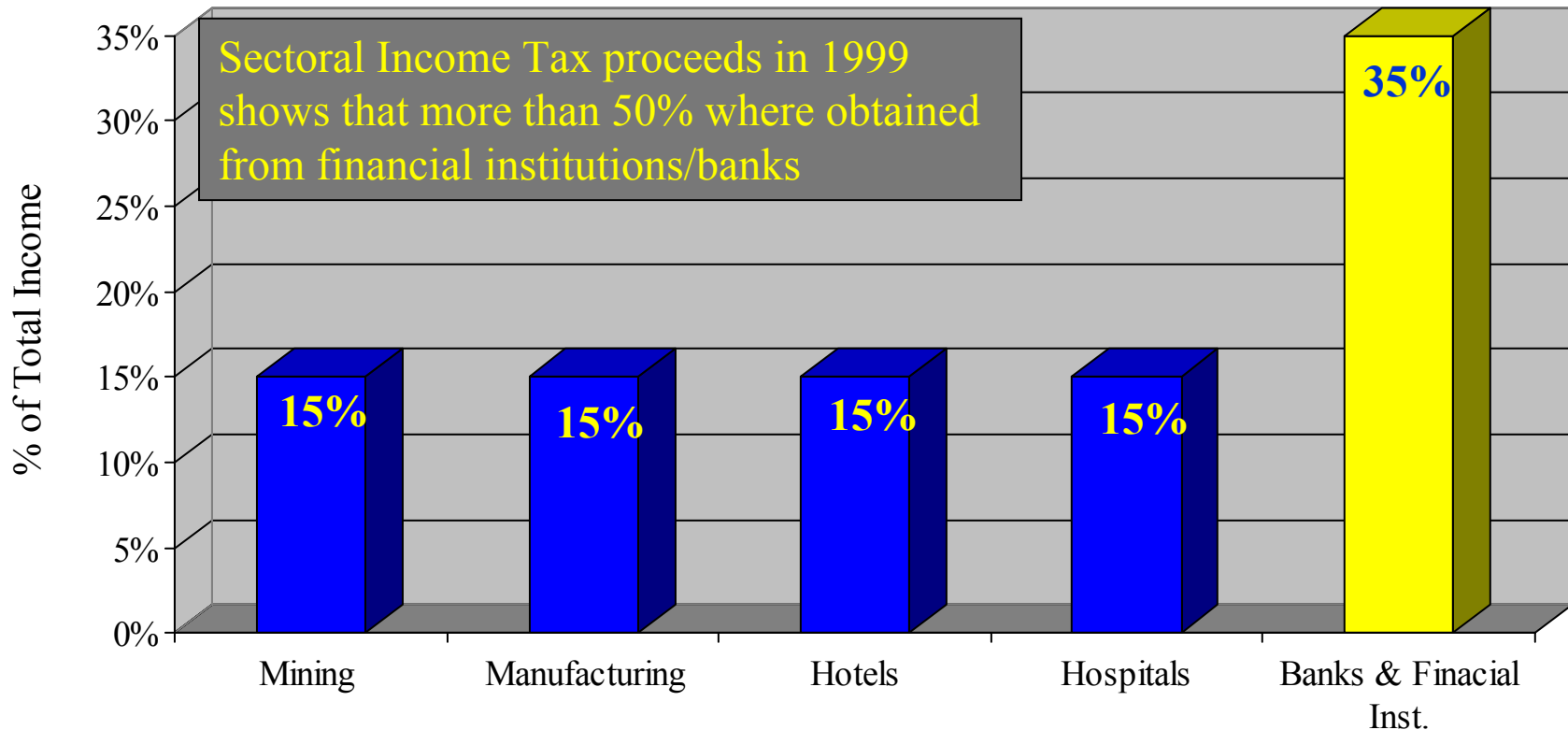
*Bank Manager*

# Is the Monetary Policy Responsible for the Current Economic Recession in Jordan ?



Increase of *interest rates on CD's* attracts commercial banks to invest more in CD's rather than promoting local money market transactions.

# Income Tax: Banks vs. other Sectors



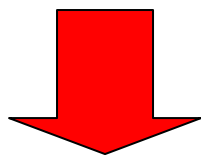
Taxes imposed on banks, effect negatively their ability to invest in developing human resources or adopting new technologies. (35% of taxable income or 25% of profits, which ever is higher income). Yet, *Legal Reserves Ratio* is an additional tax that no one talks about.

# Taxation: Systematic Approach

“Once, the CBJ offered commercial banks to buy certain financial papers. In order to sell them and make them more attractive, the CBJ decided to exempt these papers from taxes. Yet, at the end of the year, a representative from the tax department imposed such taxes saying:

“make the party which gave you the exemption return it back to you!”

*Bank Manager*



*Taxation is ruled by the mood of the representative  
in the Department of Income Tax*

# Lack of Coordination

- **There is still an evident lack of co-ordination among counterparts in the banking sector, (commercial banks and and the decision making)**

(as a result of lack of trust among institutes operating in this sector, coordination is still minimal, specially when publishing new laws (Leasing laws, Banks law, JSC Law, Aqaba offshore banking, etc..))

Bank manager

# Quotations

“If you compare between the customer oriented strategy of the bank I am dealing with and the HSBC, you will notice the difference. Soon I will be shifting to HSBC”. *Client*

“Easy deposits, withdrawal procedures and new technology services provided by the Citibank will make me shift to it”. *Client*

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# Reasons Behind Consolidation Trend

## Dis-intermediation

- increased information flow
- deregulation

## Economies of Scale

- technology investment
- marketing
- increased processing capacity

## Financial Policy

- non-inflationary environment
- low interest rates

*“the last decade has witnessed more than 200 mergers in the banking services all over the world”*

Leading  
to

•Global  
Competitiveness

•Cost Discipline

•Excess Capacity

# Merging: Different Strategies

## **Political Decision**

In Japan and Malaysia, banks were forced to merge.

## **Unifying Branches Network**

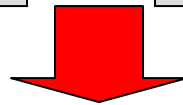
Creating a separate company to manage a group of banking branches. This was witnessed in Germany

## **Overall Merger**

Model in the USA and Europe

## **Mergers between Banks and other Financial Institutions.**

All over the world



Merging will enhance marketing, reduce costs, and increase international competitiveness

# Foreign Banks & Competition

*“ if we study closely the way foreign banks compete in countries with open economies such as the gulf, a similar competition should be expected from these foreign banks when operating in Jordan.”*

*Bank Manager*

“Corporate Financing”  
Segments

“Investment and  
private Banking”

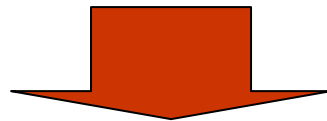
Joint ventures with some  
local banks to serve  
traditional needs



**Since ownership is unlimited, globalization will create huge competition among every possible segment in the banking sector,**

# WTO and the Regional Competition

*“ We, the Saudi bankers, think that the WTO will offer us a big opportunity to expand our businesses to include other regional countries with less developed banking sectors. ”* *Saudi Bank Manager*



**The globalization will offer other Arab countries with strong banking institutions, such as Saudi banks, a chance to compete strongly in Jordan's local market.**

# Where the Banking Sector is Heading to?

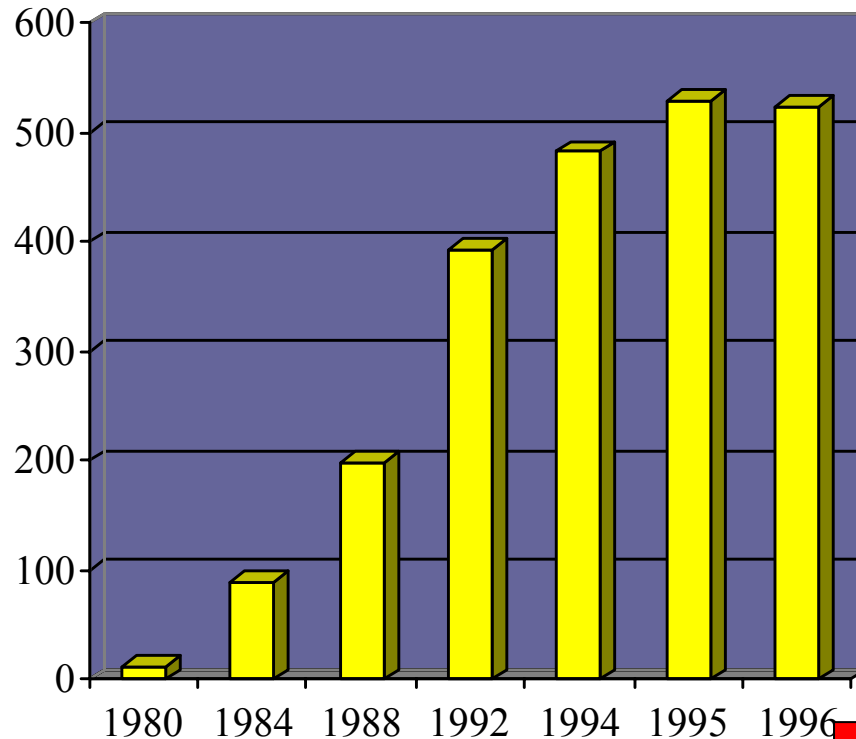
Is the Jordanian Banking Sector capable of being a Regional Hub ?

- ✓ • Stability
- ✓ • High number of emigrants
- ✓ • Emerging telecommunications services
- ✓ • Emerging capital market
- ✓ • International credibility: only three banks with international ratings.

**Jordan could be a hub for financial services if our comparative advantages are well utilized and build upon.**

# Islamic Banking

**Total deposits in Jordan Islamic Bank,  
JD's**



- The growth in deposits reflects the growth in clients deposits which form 98% of total deposits
- Two Islamic banks are operating in Jordan, one of which started late 1997
- Local commercial banks offer some Islamic services upon the client's request

**The number of players in the sector is growing rapidly. To date, there are more than 200 Islamic banks. Some international financial institutions, such as CITIBANK and ANZ Grindlays have entered this market segment.**