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The Economic and Social Barriers to Financial Consolidation: The Case of United Arab Emirates

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ABSTRACT

This paper presents an empirical investigation of the various social and business barriers to bank merger and acquisition in the United Arab Emirates. The investigation contains an assessment of the emerging banking structure and questions the ultimate need to deregulate the banking sector. The study explores the various reasons for the lack of interest in merger and acquisition in UAE, opposite to the general trend in banking industry worldwide. We analyze the performance of major banks and investigate the CEO's perception of banking consolidation and deregulation of this sector. We find that inappropriate market regulations against foreign direct investments, poor internal decision making and governance, high concentration in equity ownership and foreign management dominance are major characteristics of this sector that act against any possible merger attempt in addition to some other factors. Further, short-term benefits seem to act as secondary barriers to strategic consolidation.

I. Banking Structure (Emerging perspective)

In recent years, most literature in the field of banking had been directed toward the study of major alliances in western world without paying attention to emerging markets. This situation has led to much more focus on the various benefits and advantages of consolidation in major banking societies and less analysis of various obstacles to this process since it has not received enough attention from banks in emerging markets. Promoting bank merger (especially the horizontal in-market mergers) was and is still the center of considerable debate in the UAE during the recent years. As we attempt to study the various pros and cons of mergers and acquisitions in banks, we thought that it is important to explore the UAE banking structure. The study is divided into three parts: theoretical analysis of this strategy, financial analysis of this sector, and a field study of the top management.

There are twenty national and twenty-seven foreign banks (subsidiaries), serving a population of 2.9 million. In 1999, the total number of branches has reached 405, out of which 295 are for national banks and 110 are for the foreign subsidiaries. The UAE banking sector is still far away from any serious move towards financial service modernization. Most national banks are facing competition from foreign subsidiaries and other foreign investment banks. Taking advantage of cheap and imported technology, products, and financial support, most foreign banks were able to realize exceptional growth in income and assets in recent years. On the other hand, taking advantage of tax-free business, national banks were able to achieve large profits over the past few years.

Federal and state ownership in many local banks is considered to be a major financial support to these financial institutions as all government financial activities are executed through these banks.

To reap the benefit of long lasting economic expansion in the UAE and the region, recent economic slow down and business restructuring have demonstrated several weaknesses in this sector, notably in credits. Credits distribution among the different economic sectors during expansion years, were miscalculated by some of the widely considered aggressive banks in this business. In the next coming years, this sector is expected to undergo restructuring as the Central Bank is pushing for more consolidated vibrant banks. As local banks

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are no more privileged by some government legislation in the coming few years, there is no doubt that consolidation and rationalization of this sector will be the main issue for the financial authorities, both local and foreign banks were able to accelerate their revenues by concentrating on both interest rate spread and fees. The UAE has the Dirham (dhs) as the official currency 3.68 dhs equal 1 US$.

Major national banks are facing competition from foreign banks. This fierce competition has forced local banks to expand their branches network. Eventually, such situation contradicts rationalization of existing branch networks standard procedures, used by major banks, which face tough competition in developed countries. Since operating costs and increased efficiency are major objectives for most bank mergers, the UAE banking system needs to reevaluate its medium strategies to long-term ones. Therefore, in-market consolidation should lead to a substantial drop in operating expenses. Studies by Keefe et al. (1990) and Houston and Ryngaert revealed that in-market mergers is a tool to cost reduction of at least 30 % in the first year of merger without harming the quality of services provided by both entities before the consolidation to or place.[1]

All foreign banks in the UAE operate as subsidiary banks with restrictive branching and capital adequacy requirements. Those subsidiaries have an advantage over national banks as they easily acquire cheap technology and have a better variety of banking products, foreign financial services and better access to foreign markets. On the other hand, local banks still use traditional banking services that limit future development and the chance for better competition. As local banks struggle to improve banking efficiency without going into strategic consolidation, the possibility of transferring scarce corporate resources from and to one with better abilities to operational efficiency works against the findings by Ravens Cart and Schere in 1987. They argued that traditional merger theory enhance performance through the transfer of resources between a more efficient bank and another one with weak resources. Despite indirect support for in-market merger and other kind of consolidation by financial authorities, there has been a limited number of initiatives by national banks to consolidate. Only a single merger saw the light. This situation is completely different from what is taking place in other banking systems. This study will attempt to shed some light on the different barriers that contributed to banks' failure to consolidate. As it might seem advantageous to some to merge, it is also possible that others will see it as a loss of power, wealth, and prosperity. The failure of entering into such a process might be the result of issues such as: conflict of interest, problems of co-ordination, fear of organizational changes, incompatibility of objectives, and possibly, management resistance to such change. In the wake of global business changes, operational efficiencies, profit performance, employee productivity and structure, and increasing competition are considered challenges that the domestic banks in the UAE should carefully take into consideration consequently. The financial system of this country

Table (1)
Local and Foreign Banks Branches in the UAE (1997 and 1999)

	1997	1998	1999	Deposits Dhs
Local Banks	262	284	295	140 billion
Foreign Banks	110	110	110	69 billion
Population/bank (000)	61.2	62.7	63.04	

Central Bank Annual Report (1999).
Emirates Industrial Bank.

will be deregulated. Board members are locals and the top management, in most local banks is from foreign banking sectors. There is no doubt that there's a large gap between priorities for both shareholders and the managements since management always strives to remain in position by increasing shareholders' wealth. Such achievement would mean that boards of directors are unwilling to see changes in the current structure, as any drastic change would force them to look at the negative side of bank consolidation.[2]

Banks are becoming more concerned about the rapid changes in financial services as the latter poses threats to them. They also find themselves in tougher competition as globalization and deregulation of markets in some countries which have eliminated many business barriers and encouraged cross-boarder banking. This situation raises a major question for banks. Will banks, mostly in developing economies, be able to survive competition without looking at building alliance with foreign or local institutions? As competition increases between domestic and foreign banks in a small country like the UAE in which interest rates are linked to the US interest rates and the local currency has a fixed exchange rate against the US dollar, banks' spread between cost of acquiring funds and interest income from loans is narrowing. Such situation puts pressure on banks to search for other sources of income, which could result in higher charges and fees.

According to Table(2) most banks have suffered a decline in earnings between 1997 and 1999, due to many reasons, mainly competition. The high banking concentration, coupled with falling interest margins (the spread between borrowing and lending rates) make it difficult for banks to sustain high growth. Despite the fact that banking exceptional performance has been relatively high, rates offered on loans have dropped for many banks in the past few years as competition is increasing and the search for liquidity has become a reality after many years of highly liquid economy. Others were able to sustain higher return as they have access to cheap funds (mainly government and public funds). This result is consistent with the existing wisdom that bank merger can be an excellent long-term strategy for banks in the region. Oil revenues are still considered a source of business growth for this sector for many years. Further, banks do benefit from a large portion of deposits in non-interest bearing accounts for religious reasons. In the changed environment of 1998, banks faced immense challenges.

Banking Sector Earnings

(Table 2)	Earnings in dhs			Percentage	Growth
	1999	1998	1997	1999	1998
National Banks:					
1. NBAD	308,905	399,206	409,179	(0.23)	(0.02)
2. NBD	401,452	401,797	384,475	(0.00)	0.05
3. NBS	89,783	72,739	54,212	0.23	0.34
4. NBF	30,040	15,846	53,089	0.90	(0.70)
5. NBRAK	49,320	41,450	38,743	0.19	0.07
6. NBUAQ	57,262	53,106		0.08	
Commercial Banks:					
7. EBI	507,740	472,884	441,910	0.07	0.07
8. ADCB	549,727	505,467	451,717	0.09	0.12
9. Mashreq Bank	350,315	500,532	485,565	(0.30)	0.03
10. CBD	184,900	179,530	163,344	0.03	0.10
11. UNB	106,091	105,831	100,302	0.00	0.06
12. FGB	- 49,325	47,694	25,115	(2.03)	0.90
13. CBI	40,083	29,922	37,262	0.34	(0.20)
14. IB	56,540	71,584	56,591	(0.21)	0.26
15. UAB	55,174	44,264	34,988	0.25	0.27
16. BS	42,600	36,657	32,693	0.16	0.12
Islamic Banks:					
17. ADIB	17,450	103,645		(0.83)	
18. DIB	99,297	-33,754	- 375,180	(3.94)	(0.91)
Total	2,897,354	3,048,400	2,394,005	(0.05)	0.27

* Data was taken from Annual reports and some other sources.

II. Current Issues in Emerging Markets

Emerging financial markets (including the UAE market) are characterized by weak transparency by financial institutions and financial disclosure, which is leading to weak assessment by investors, shareholders and to information crisis. Inadequate disclosure, weak corporate management and control can characterize the financial market. Several outcomes can be cited for harsh competition between banks such as inappropriate business expansion, inefficient allocation of bank credit, and poor internal governance.

This part examines whether bank mergers can lead to superior performance and to more diversified business strategies, and whether banking strategies applied in western countries can be compatible with banking strategies in the LDCs. Obviously, what can be seen appropriate for some developed countries might not foresee suitable for other financial systems. Mergers have been considered a major vehicle for change in the banking industry in different parts of the world. It is believed that mergers have permitted banks to strengthen and expand their banking services.

Despite recent mergers and acquisitions in most developed markets, several researchers (Gary A. Dymski, 1999) still argue that these mergers have benefited neither the public nor the acquiring banks, though management and stockholders of acquired banks seem to have gained some benefits. Despite these arguments, bankers in the US and Europe still perceive mergers as a strategic solution to many of their business difficulties. Within this context, the question to be raised is whether banks in UAE are well structured to perceive mergers as a strategic choice for many of their banking deficiencies. As proposed by Williamson in a (1985) study, the transaction cost theory, the optimal structure of a firm depends on its institutional context. This context looks at stronger capital structure, management, and product markets. In contrast, emerging financial markets are characterized by inadequate disclosure of financial data, few products, and limited market accessibility. The business of financial intermediaries in UAE is still at its preliminary stages. Mutual funds, venture capitalists, and investment banks have not been fully developed in this region. This weak scenario has allowed major international intermediaries to take advantage of the weak financial institutions and allow billions of dollars to be transferred to major financial markets especially the United States stock exchange.[3]

Consequently, the UAE is in the process of deregulating its economy as a means to attract foreign investments. It becomes apparent that the gap is increasing between economic growth and capital flights as an outcome of undeveloped financial structure. The year 2000 official opening of the limited number of listed companies is an indicator of weak financial structure. The non-existence of fixed income market and money market instruments, in international standards, have dramatically reduced investment portfolio for local banks in comparison to foreign banks functioning in the UAE. Further, the absence of advanced financial structure has led to higher cost of acquiring necessary inputs such as technology, products, and efficient management. The risk exposure for most banks because of few investment opportunities has seriously increased due to more credit concentration in certain economic sectors. As a result, many banks have received low credit rating by major rating companies such as Standard and Poors.

There is a general consent that the scale and scope of banks could help banks in handling the cost of replicating the functions provided by financial institutions in advanced financial markets or at least follow their league. Despite the fact that the expansion of the banking structure through mergers can lead to lower cost through diversification, there are various reasons to believe that the cost of merger itself could exceed the potential benefits (see Calomiris, 1999). We could argue that such finding of costs and benefits of bank merger cannot be generalized as we ought to study bank mergers case by case and try to see the various reasons for such alliance. Phenomenons such as special interest groups, family ownership, and government

ownership in most local banks have worked against potential mergers as most of these groups have conflicts of interest. In general, these controlling groups represent between 65-85 % of total shares in some banks in the UAE. Therefore, the speed at which the privatization process will go could play an important role in changing the current share holders' structure and definitely giving banks the ability to reform its business structure and strategic decisions.[4]

There is a great need to examine the economic causes of bank mergers and their differences from one country to another. What are the possible social consequences of the mergers? Several studies in this field argue that bank mergers have failed to show substantial improvements in efficiency, but they were successful in enhancing diversification, reducing operating expenses, and developing a better customer base and relationship (Berger et al., 1993a) [5]. Furthermore, how long would it take stock returns, bank performance prior and after the merger process to show evidence of better efficiency, less operating cost, and better customer relationship? Probably, as we study a banking system where merger cases have not merely taken place in the last decade, it is difficult to come up with an econometric answer to it. On the other hand, it would be beneficial to our analysis to take evidences and conclusions from mergers that took place in the 1990s.

Despite the conflicting results for different studies of the possible outcome of consolidation wave in the 1990s, there had been a general conviction that consolidation is the child of competition and the mother of efficiency (Charles Calomiris, 1999). On one side, it is true that achieving growth through mergers and acquisition requires planning focused on revenue improvements synergies, and on the other hand that cost reduction must be the essence of this strategic merger. Some researchers have argued that cost reduction might not be a building block, as it will not achieve high growth. Nevertheless, in order to maintain long-term growth, it is imperative to acknowledge cost reduction measures as a strategic objective. In the wake of mounting competitions in recent years, a big number of corporations have used restructuring measures to maintain growth mainly through cost-reduction and by eliminating all non-productive activities and just focusing on core business. In fact, a merger aim at improving revenues must also look at cost reduction as an ultimate outcome.

In most recent mergers, financial markets showed little interest in merger news since the stock price reaction to merger announcements was negative. In 1999, two large banks in the UAE have announced interest in merging and the beginning start serious meetings to evaluate each bank. The market reaction to this unprecedented move was more or less indifferent, as investors were unfamiliar with the implication of bank merger and its effect on shareholders' wealth. In sum, it became obvious that the market perception of such deal was unclear at that time. It showed also that investors seemed to be unaware of the wisdom behind this consolidation. At that point, it became clear that the concept of merger was unknown to investors and markets, especially the long-term benefits.

It is also important to point out that in most merges, management on both sides as they announce their alliance, tend not to reveal the true objectives of this alliance and why both boards of directors have accepted to initiate such difficult and lengthy process. Actually, they tend to provide the market with vague analysis. In most consolidation announcements, investors seem to be concerned about the time horizon over which benefits of merger can be achieved. Therefore, their first reaction shows disappointment and less interest in holding the stock. In many mergers, we have seen they were made between two banks that are similar in terms of assets, management, and profitability. However, the true reason had to be the knock- out major competitor. It is possible that this alliance to be announced between two banks, with different sides of the banking business aiming at competing with a third party whose activities are more comprehensive. The market should consider a

merger like this one as a positive strategy for both parties as it contains many synergies. In the case of the UAE banking system, such consolidation has the potential to develop certain synergies, including operating expense reduction and improved management structure as the duplicate functions are eliminated.

A. The Possible Outcome of Strategic Alliance and Merger Barriers in the Emerging Markets

In general, strategic alliances have different objectives and in most cases, there must be a multiple of objectives for each alliance. In the case of the UAE banking sector, the probable objectives can somehow be similar to those in the US or Europe. Nevertheless, other objectives can be added as this sector still functions in an economy where cross-border regulators do not permit consolidation.

Following is a list of possible objectives and forms of bank consolidation:

(Next to each objective, the list will also indicate the type of merger needed, whether domestic or cross-border).

1- The merger has the objective of improving the value drivers in the banking sector as it tends to: provide quality services and management, broad customers' relationship, proprietary distribution, preeminent brands, size and scale, and global existence **(Cross- border alliance).**
2- The merger could introduce a new entity with unmatched origination and better marketing and distribution skills **(Domestic alliance).**
3- The merger would lead to a wider range of products more experienced management that comes from more developed banking systems and enhance private banking as this business is widely dominated by foreign companies and higher productivity due to better expansion **(Require both local and global consolidation).**
4- The merger will build a new entity with a stronger and powerful asset management base. Multiple channels and brands could be created so that business can compete on different levels **(Cross-border expansion).**
5- Concentration can always lead to better management and ability to compete **(Domestic alliance).**

In this context, the process of searching for an international partner is seen crucial to domestic banks since the process would enhance cross-selling synergies, open the way to new markets and products, improve management skills and more importantly reduce operating expense. Undoubtedly, local banks are free to search for a foreign partner to form alliance with, but in reality, there are many economic and social barriers against this strategic move. As the country is preparing to join the World Trade Organization, it is imperative that the federal government tables a massive piece of legislation that will change the entire financial system in general, and the banking sector in particular. This legislation should amend the rules for local and foreign ownership in domestic banks, and allow for more freedom in selecting partners from inside and outside the country. The government should make it clear that it favors strategic consolidation in light of the recent globalization efforts. Probably, nobody wants to think of this issue as long as banks are achieving their best profit rate ever realized. Calomiris (1999) finds that deregulation can be the most important element, affecting merger decisions. By applying the return on equity, interest margin and income on assets, Calomiris was able to show that aggregate bank performance in the 1999s has been substantially productive, as results were much higher.

Obviously, the amendment of ownership rules to simplify the merger and acquisition is imperative for any cross-border alliances in order that such a drastic move would allow banks to diversify their credit portfolio and reduce their risk exposure given the fact that many of these banks are setting on excess liquidity in a financial market where money market instruments are almost non-existent. Merger, in this regard, can lead to what economists called "value creation" through relationship enhancement.

The flow of capital from one side to another, the improvement in customer services, the diversification of banking products, and the multi-dimensional integration between banks through mergers should lead to diverse and continuous source of profits for these institutions.

As for major barriers, several studies were able to show that management can play an important role in favoring and making mergers succeed. It is well known that bank consolidation is set to reduce costs by implementing job cuts especially in the areas where the new entity has duplication of duties and positions. Therefore, in a banking system where 85% of employees are foreigners working without sound social security protection or retirement plan, can never be motivated to support any consolidation plan that would lead to a serious reduction in jobs. In this regard, any talk of merger would launch a series of worries within the parties concerned and the result would be that one of the two managements would realize the threat of such strategic move and know that it has to vanish on a later stage. The biggest obstacle for the banks will be that the merger would not pose a threat to either management. However, it is not the case since the main objective of any consolidation is to trim excess jobs and raise the number of locals joining this sector. Currently, it became obvious to the top management that the medium and lower management create natural barriers against locals who join this sector. The mounting competition is an important indication on how efficient the management is and how effective it can be in handling drastic changes in the banking sector. The existence of mergers would for sure expose weak management as negative financial results start to surface. In the absence of qualified banking management, there are some difficulties in making the proper comparison to see the difference between the current management and the potential one that could be available through consolidation. Clearly, the economic prosperity, the existence of excess cash, and the supportive monetary policy are delaying some banking crisis because of weak management.[6]

It is considered a shocking idea for many shareholders and boards of directors that some banks would have to disappear from the banking arena, as they tend to consolidate with others. This idea had been difficult to accept as many shareholders and public figures do not seem to understand the conceptual factors behind it. Given the exceptional gains in the banking industry in the UAE, it is difficult for many to accept the fact that the long-run outlook for this industry might not be the same in the future when markets definitely open for direct foreign investment. Many bankers take the example of some failure alliances worldwide as a pretext to defend their views of opposing bank consolidation. In fact, inefficient management tends always to reject this strategic decision, as it represents a threat to their existence at the top of institution. Efficient institutions can always acquire inefficient banks.

B. Theory and Concepts

It has been argued that several mega mergers that took place in 1990s have resulted in significant cost reduction in line with pre-merger plans. In contrast, unexpected difficulty in integrating data processing systems and operations was a serious issue to tackle. On the other hand, there are two possible sources of cost savings due to growth in the size of banks: (l) economies of scale, which means that a doubling of bank output for any service or package of service will result in less than a doubling of bank production costs because of greater efficiencies in using the bank's resources to produce multiple units of the same service package; and (2) economies of scope, which imply that a bank can reduce operating costs when it expands the mix of its output because some resources, such as management skill and plant and equipment, are more efficiently utilized in jointly producing multiple services rather than just turning out one service from the same location because fixed costs can be spread over a greater number of different service outputs(see Peter S. Rose). Most recent researches suggest that banks' average cost curve (the relationship between bank size and the cost of production per unit of bank

output) has a U shape but appears to have a fairly flat middle portion. Such concept means that a wide range of banks fall close to being at maximally efficient size with larger banks typically offering many more services. Consequently, some bank cost studies have attempted to show the average costs for smaller banks separately from their cost calculations for larger banks. Researchers like Rose and Calomiris suggest that smaller and medium-sized banks tend to reach their lowest production costs.

There is a need to question the existence of many banks with much larger size than any of these so-called optimal size levels. Banks in recent mergers have claimed substantial "cost savings" flowing from their merger. Indeed, it may be true that the optimal-size operating point in banking is a moving target, increasing as new laws and new technologies come into existence favoring even larger banks. Is a bank, regardless of its size, operating as efficiently as it possibly can? Given the size of a bank, is it operating near to or far away from its lowest possible operating cost? Another way of posing the same question is to ask if the bank is currently situated along what economists would label its cost-efficient frontier, with little or no waste. To date research evidence is not encouraging. This suggests that most banks do not operate at their minimum possible cost. In many cases, banks through the merger strategy were able to reduce overall operating expense. This discussion implies that most banks could gain more from lowering operating costs at their current size than they could from changing their scale of output in order to reach a lower cost point on their average cost curve. Thus, to be sure, larger banks seem to operate closer to their low-cost point than many smaller banks, probably because the larger institutions generally operate in more intensely competitive markets.[7]

In the case of domestic banks in the UAE, the question of improving efficiency through mergers might not be a major concern for many banks as much as the need for substantial cost reduction, new products, and better risk control procedures, hence, it is quite clear that horizontal mergers, the type of merger thought to be the most likely to suit UAE banks, might not assist in achieving banks strategic objectives. The question that should be raised at this point is whether the horizontal merger might not represent the strategic objective for: achieving cost reduction, introducing new products and markets, and improving risk control mechanism. Therefore, what is the possible consolidation mechanism to be considered by banks in question?

Taking into consideration the financial performance of most local UAE banks during the past few years, we can easily point out that the issues of profitability and performance were not a major concern as much as credit control and product development (see financial performance section of study II). Since most of those banks have succeeded in putting up an extraordinary performance, it is worth mentioning that such exceptional performance can be attributed to the high growth Gross Domestic Product and the widening margin between interest earned and interest expense. In contrast, the down trend in economic growth should force a big number of local banks to search for an acceptable equation between over lending and the level of charges against doubtful debts. The harsh competition between local and foreign banks functioning in the UAE market is becoming a point of concern for local banks as foreign banks have free access to products, foreign markets, and technology.

Therefore, in studying the question of major long-term advantages of merger, the other types of merger such as financial, managerial conglomerates or vertical integration in this preliminary stage seem to be the most productive in our case of local UAE banks. As an outcome of such integration, cost cutting especially in operating expenses must be the result of immediate lay-off of unnecessary bank employees, reducing the number of branches, and the selling of all unneeded fixed assets. As a result, the return on assets ratio should increase due to a cut back primarily in fixed assets. Such an outcome might lead to short-term improvement in efficiency and probability, which contradict some of the work done by others on the same issue (Weston, Chung, and Siu, 1998). Others like Linder and Crane (1992)

suggested that in order for efficiency to improve, there must be a substantial decrease in costs that would offset any decline in assets (return). The most direct conclusion we can draw from this discussion is that for a merger of similar size, the question of reducing operating expenses and other costs is considered as short-term strategic decision while the increasing efficiency is a long-term objective. Stephen Rhoades (1998) suggested that economists have concluded after meeting with bankers that:[8]

- On average, 50 % of cost reduction takes place in first year and the rest would be achieved in the following two years.
- Most significant cost savings were achievable without merger.
- All cost reduction and efficiency gains should be observable in public financial data.
- Merger is a strategy that can be considered for more than one possible outcome.

Despite the above results, the expected outcomes of bank mergers might not seem to be as productive as it was hoped to achieve. It is worth noting that the large numbers of mergers we have witnessed in the last ten years do contradict the previous conclusions. In addition, the large number and scale of mergers seem to indicate that the objectives of mergers exceed by far the cost cutting and efficiency improvement decisions. It is important to add as we explained earlier that bank mergers should be analyzed case by case due to the fact that:

- The financial system for each country has its own structure, which could directly affect the outcome of each merger.
- The globalisation of financial activities implies that the needs and duties of banks have substantially changed to match the international standards.
- In most cases, the short-term results of bank mergers do not correspond to pre-set objectives.
- Mergers should always take place when both the acquirer and the target bank are at their best stage of financial performance.
- Most mergers that occurred in recent years were between large banks, which support our assumption that there are more important objectives than just efficiency improvement and cost reduction. Therefore, these two objectives are important although they do not come on the top of bank priorities.

Furthermore, the mergers of large banks with significant office overlap, which took place in the last ten years, were designed to achieve more complex objectives such as: reducing competition, expanding capital and assets, in addition to improving credit structure for both the acquirer and the target bank, and different market concentrations. For those particular reasons, the concept of mergers has evolved over the past two decades. It includes takeovers, related issues to corporate restructuring, corporate control, and change in ownership structure of firms. Therefore, the mergers issue poses important questions for shareholders, the management and public policy formulation.

The merger process is vital for the healthy expansion of banks as they evolve through successive stages of growth and prosperity. Ultimately, bank merger in the United Arab Emirates goes beyond the objective of entering new geographic markets and probably other goals. It is essential to accompany the major economic improvements in the region and the latest business expansion by Multi-National Corporations (MNC's) and trade alliances in the region. As local banks, to some extent, were unable to develop their financial products on the local and international level, they may be left behind in terms of competition as billions of dollars were invested directly through foreign banks. It became evident to many economists (Dymski, 1999) that merger is a strategic process which should lead to stronger balance sheet, use of advanced technology, more efficient management, and substantial cost cutting. On the other hand, others could argue that the previous advantages might not be the reason behind mergers, as most recent mergers have poor place between different banks with equivalent resources and quality (Business week, 1997). This would lead us to the possible conclusion that in most merger cases, there must be a set of objectives that both sides of the process hope to achieve. As we seek to

sort out the different theories, views on the advantages and aims of bank mergers in emerging markets, which are far-off from the European or American models, we will show that each merger should be separately analysed as the aims and benefits are not necessarily comparable to other mergers. Aims and reasons could differ between one merger and another.

C. The True Nature of Bank Merger

From an economic standpoint, the structure and efficiency of bank mergers should not be derived out of the four different categories of merger. The reason for this contradiction is that regardless of the purpose of this strategic decision, what really concerns us most its viability and its outcome. Clearly, the question of whether the immediate decision to merge is related to horizontal vertical, conglomerate, or financial integration, the success of merger rests primarily on the coastlines of market mechanism and contracting. On the other hand, second stage success rests also on the willingness of either party to dispose its managerial and financial structure for the benefit of using the other party management model. Mark Guzman confirms that banking monopolies tend to reduce an economy's social welfare, as they charge higher prices and waste resources through inappropriate expansion. Moreover, even in a more competitive market, banks are still facing two major issues, which are the lack of information concerning individuals requesting financing and the quality and types of projects they wish to undertake. Guzman has used both the partial equilibrium model and the general equilibrium model to focus on the particular aspects of the bank-borrower relationship. Both models are excellent for ascertaining whether the costs outweigh the benefits of monopolistic banking.

From an emerging market perspective, there is a great need for banks to search for a strategic alliance as the banking system is still in transition. One important type of integration can be considered crucial in our case is the "international integration type". The most critical issue that local banks must face in the future will be ceasing funds from moving outside the region. Without going into many details, the international integration could provide various benefits to both local and foreign banks. Such alliance should lead to improvement in: productivity, technology, return, management, and ownership.

The four factors mentioned before can be considered as the most urgent questions to be answered since the regional economy is heading towards globalisation and by nature privatisation. As for the first and second factors, there is no doubt that all-local banks in the UAE were unable to develop their productivity to a level where it could efficiently handle the exceptional business expansion in the last decade. The productivity process is directly related to the type and quality of products used by banks in their approach to promote their services. In this regard, it is important to indicate that most banks were unsuccessful in product development such as design, testing, and making local market suited products. Therefore, most used products are a copy of products implemented in other developed markets. They attempted to copy various products used in foreign financial markets without knowing their long- term effect on their own credit control or customer satisfaction. For the reasons mentioned before, local banks at some point will be in need for both horizontal and vertical integration

Banks were unable to develop their own investment subsidiary as means to penetrate one of the most lucrative businesses worldwide. Consequently, major global investment companies have established base in the UAE market, in which billions of dollars were unable to find the best investment opportunities on the international level through the local banking system. As for the technology factor, the high cost of this factor has forced banks to allocate substantial funds to acquire used technology from different markets. The lack of international integration has prevented banks from having a proper and inexpensive access to art products and equipment. Because of this market structure, local banks did not properly address the risk reduction factor through an efficient and

affirmative credit and investment policy. While banks have salutary effects on consumers' access to credit and on banking costs, these effects are not enough to explain why banks have been merging at a high rate in many markets (Dymski, 1999); hence, the objective of reaching greater operating efficiency is probably not the only priority in bank mergers.

The financial definition for bank mergers, in our case, and according to our previous discussion can be easily identified and distinguished. The question of serious shortage in liquidity has not surfaced in the last two decades for several reasons. We mention: first, the central bank has followed a stable interest rate policy since the UAE's dirham has a fixed rate. The UAE official interest rate is closely linked to the US discount rate. Second, the gross domestic product provided an average GDP growth of 12 % and the central bank did not have a tight grip on money supply. Third, the central bank did not succeed in creating and developing a real money market for having better control on money supply and inflation levels. The Bond market and short-term money market instruments do not exist. As a result of this situation, banks did not have access to other kind of investment opportunities as an addition to direct loans to customers and a few investments with small portfolio in an (over- the-counter) disorganised market.

Therefore, the financial objective of a bank merger can best serve, in our case, as a risk over return ratio through diversification. It could serve other strategic objectives, such as providing better planning and control mechanism by having improved quality of functional and general managerial performance. The concept of economies of scale and ex-efficiency in relation to operating expense control can never be ignored as imminent goals of mergers especially mega ones. (Peter S. Rose, 1999).

D. Organizational Structure and Performance

One of the principle reasons for which a bank is organized in a particular way may not appear to affect its performance significantly, due to the wide variety of management styles and capabilities among banks of all sizes and organizational structures. This is the case of the United Arab Emirates where different managements come from different banking systems and origins. Some bankers are strongly profit motivated and expense-control conscious. They can often push their banks toward earnings success regardless of how their institution's organizational chart looks like. While other managers may prefer greater bank size or possibly greater bank safety on the top of their objectives, and their bank's earnings performance may take a back seat consequently. In fact, there is evidence of considerable expense-preference behavior among some bank managers, who value fringe benefits, plush offices, and ample travel budgets over the pursuit of maximum returns for the bank's stockholders. Such expense-preference behavior may show up in the form of bank staffs larger than required to maximize profits or excessively rapid growth, which causes expenses to get out of control. Some economists believe expense-preference behavior is more likely in those banking organizations where management is dominant and the stockholders are not well organized.

The concept of expense-preference behavior (cost conscious) is part of a much larger view of how modern corporations operate, called agency theory, which analyzes relationships between firms' owners and its managers, who are agents of the owners. Agency theory explores whether mechanisms exist in a given situation to compel managers to act in order to maximize the welfare of their firms' owners. If bank owners do not have access to all information with managers, they cannot fully evaluate how good the management was at making decisions. In commercial banking, ownership increasingly spreads out, and the dominance of individual stockholders in the industry appears to decrease. These two trends are likely to worsen any agency problems that may be present in the banking industry. On the contrary, the UAE banking system is still characterized by great dominance in family ownership and high

concentration in shareholders' base. One way to reduce costs from agency problems is to develop better systems for monitoring management behavior and strong management incentives suiting stockholders wishes. In retrospect, the success of any merger process can never be possible without a comprehensive evaluation of the potential mergers before its official announcement. Banks must always relate the successes of their integration attempts to several conditions that must be satisfied.

Despite the fact that many researchers do not see the economic or financial benefits from the merger decision, there's no doubt that reality contradicts those findings as the number of announced mergers is tremendously increasing specially in the United States and Europe. Kay in (1993) found that: in many merger cases, the levels of profitability prior and after integration were almost unchanged while its objectives have changed. Some of these changes in economic and business structure have created the following concerns: (a) the corporate structure, and mentality evolving during the past 30 years. The globalization factor has forced managements to think global and to adapt different strategies used by companies from different countries. Just by looking at corporate planning, we can clearly see that companies designed their image to fit the global standards rather than the local or regional ones. They currently focus on wider range of strategies such as global strategy, global industry, global management, and global competitiveness. According to Jtusripitak et al. (1985), a major stimulus to this growing emphasis on international planning has come from the 'Oriental challenge' to western business. (b) The resources, competence, capability, and competition are becoming global challenges rather than domestic or regional. According to the school of thought that looks at resources-based theories of strategic management: the success of the management is a result of its ability to manage its resource inputs in developing core competence and distinctive capabilities rather than positioning itself in relation to its industry. The organization must then exploit these competencies in a variety of markets. Outsourcing, joint ventures, and acquisitions were among other strategic decisions many corporations have applied in the1990s. (c) The increasing competition has made it difficult for companies to safeguard their competitive advantage, and for this reason companies are forced to develop and leverage core competence that can provide the new type of customers (mostly sophisticated) with the most highly advanced type of products. (d) The search for growth through undiscovered markets has forced companies to look for strategic alliances. Those alliances do not necessarily exist at home. Therefore, consolidation is seen to become a major concern for shareholders as it could lead to a drastic change in organizational objectives.[9]

Customers are becoming more sophisticated as the level of technology, services, communication, and know how has tremendously improved. Customers everywhere in this globe are becoming similar when it comes to the needs and demands. Although there are similarities, companies must take into consideration some differences in culture and other business factors. The different business barriers can no longer protect domestic businesses from foreign competition as it takes a local customer living in the UAE two minutes to buy shares on Wall Street or to renew a deposit in a bank in Europe or in the United States. There is no doubt that the new technological and communication advancements have created a second kind of competition that did not exist before. [9a]

III. The Issue of Privatization

Despite the severe economic crisis in Asia and in some Middle Eastern countries, the UAE economy exhibited remarkable growth rates in the 1990s.In most recent years, a 12% growth in Gross Domestic Product was easily achieved for two major reasons, the continuous increase in government expenditure, and private sector capital expenditure. Foreign direct investment has participated in this economic expansion as many multinational companies rushed to establish a regional base since the UAE became the center of trade for the whole region. Multinational sourcing became an evident feature of

the UAE economy as foreign corporations established production operations to serve the area. Clearly, the UAE market has provided excellent investment climate, free tariffs and trade barriers, use of barter trade with countries that experience foreign reserve difficulties or restrictions and use of the local market to re-export goods to countries in the region.

On the other hand and similarly to other "emerging markets", the UAE market has failed to develop a highly sophisticated capital market that would help corporations to have access to various sources of financing especially for long term capital expenditure. The creation of the stock market in 1999 did not have much impact on alleviating major weaknesses in the equity market. One of the characteristics of this market is the high volatility caused by high concentration in equity ownership, thinness of trading, and the inaccessibility of this market for 80 % of the UAE population (expatriates living in the UAE). Privatization can improve productivity and efficiency in State-owned enterprise (SOE). The issue of privatization in the UAE is not even open for debate, since the most lucrative sectors of economy are still denied to foreign direct investment. Therefore, it is unlikely that the communication, oil, financial and other sectors would be 100% accessible to foreign investment or fully owned by the private sector before joining GATS in the coming few years.[10]

Obviously, delaying this process is not in the interest of these state-owned companies. The reason for this explanation is that privatization should put ahead few challenges in face of local bank, since the latter must work on improving productivity, efficiency, and reducing expenses, probably through restructuring before they become to a certain degree competitive. Some of the challenges can be summarized as follows:

1- Management needs to redefine their business strategies, as they are no more in a monopolistic market.
2- Management must realize that the privately owned corporations require a complete change in organizational structure as financial performance and productivity is always on the top of their objectives.
3- Management must enhance their performance, as government support is no longer possible under the new market rules and structure.
4- Management must be prepared to face corporate takeover as the new market conditions allow for such consolidation.

Therefore, local banks must conceive the new market conditions as major threat since they compete against large international banks rather than some foreign subsidiaries, as is the case now. Under the new conditions, domestic banks will no more benefit from the tax relief that they currently enjoy.

Some of the points of concern that require elaboration as we attempt to analyze merger and acquisition through the process of privatization are the efficiency of the stock market, and the management structure in the UAE. Given the fact that the UAE stock market was recently established, there is no doubt that the market is not well prepared to handle huge transfers of ownership from the public to the private sector. In addition, rules and regulations would require amendments as they were introduced in a more restrictive market that is closed to any foreign investment. Thin trading and equity concentration are driving the market to its lowest market capitalization level four years of age (almost 145 billion to 85 billion dirhams) $1=3.67 AED.

Therefore, such market conditions can work as an obstacle for any capital formation and the emergence of new companies. Undoubtedly, a strong and efficient market is crucial for all kinds of economic restructuring which can be unachievable without the improvements in business environment in the country. For this purpose, macroeconomic stability must be achieved so that it would show the country as a good spot for healthy investment. In this sense, the country must apply several rules and laws that can be considered contributive to foreign and domestic investment such as: standards for corporate governance and investment protection; better employment and welfare conditions; legal and administrative frameworks for property rights; and clear standards of business ethics. By looking at

some of the laws and rules in the UAE, it is possible to say that some of these business conditions were implemented in the past few years.

Despite its relatively short existence, the UAE stock market was equipped with the most advanced trading techniques. The volume of trading is still very thin as investors are still recovering from a strong decline in all shares traded on the stock exchange. Most of shares have lost all their gains since they have reached the peak in summer 1998, and some are below their intrinsic value. Investors and financial authorities are searching for a solution to this serious decline in shares. Many new companies in the primary market were called off due to the weakness in business performance in general and capital formation. Consequently, the market will not be able to witness any business transfer from private equity into public shareholding companies, as many family-owned businesses are trying to go public.

Economists like (Uhlenbruck and Castro) generally support the idea that transferring state ownership to the private sector should improve the overall performance of the economy. This suggestion seems to be favorable in countries where natural resources and major participants in GDP are heavily owned by the state. In recent years, few governments have turned to privatization as a solution to reduce their high public debt and reduce pressure on their annual budget financing. Unlike the UAE, which benefits from oil revenues, many developing countries find privatization a fast solution to their incremental budget deficit. We should also emphasize that in many cases, the process of privatisation is a forced decision by international financial authorities as part of package financial plan to support a country's ailing economy. In retrospect, there are various reasons for which developing countries would adopt privatization and there is no doubt that privatisation has proved to be effective in solving many financial and management difficulties.[11]

A. The Synergy Factors

Another possible issue that is considered extremely important is the timing of the process of privatisation. Therefore, we could classify privatisation into two categories: forced and voluntary privatization. In most developed financial markets, bank merger is considered a forced one, as market forces, regulation, and particularly tough competition tend to force banks to look for consolidation as a mean of improving their financial structure and market position. On the other hand, in most developing markets, the concept of consolidation might not be seen ideal since it also means loss of power and control to some interest groups. In regard to merger and acquisition, many researchers like Haspeslagh and Jemison (1991) have argued that value capture and value creation are the key and the major objectives in acquisition as the latter should improve shareholders wealth. Firms through privatization have the opportunities to capture value by acquiring cheap assets and even below their intrinsic value, and to explore new markets where competition and productivity are still below the normal standard. In addition, companies looking to create value through mergers often perceive either operational or financial synergy.

Both operational and financial synergy through privatisation can be seen as attractive as the process offers various opportunities such as entry to new markets and the transfer of technology. Management skills will likely improve as a result of merger in post-privatisation performance. Cost control also, would be a major outcome of this process. Although, merger and acquisition decision could carry a pile of positive outcomes behind it, priorities and cost benefit analysis by both management and shareholders in a developing country should differ particularly when top and middle bank management are foreign employees searching for better income. The advancement in technology; the emergence of information age; the globalisation of financial products; the use of sophisticated financial and banking instruments, all of these have combined to precipitate the emergence of banking challenges that have led to a great extent of banking competition as never before in banking history. The advancement of banking services and globalisation have brought

with it an unprecedented global interdependence, and banking competition to an area of this world in which the banking sector has by and large not completely benefited from these developments.

The latest surge in the number of mergers in the banking sectors in different parts of the world have provided a unique opportunity for the banking sector in many Gulf Countries to improve its financial structure and expertise through mergers and acquisitions in an attempt to prepare for the challenges of globalisation. A latest assumption by some economists showed that globalisation is the path for a more integrated equitable world in terms of resources, products, and welfare. Probably, it is this argument that the banking sector in a country like the UAE must grasp in order to understand and prepare for challenges yet to come. Therefore, the merger decision is a phenomenon rather than a creed and the banking sector's response to it will determine the future shape of the UAE economy. Why were UAE local banks so reluctant to follow this strategic approach? There is much to discuss in this regard, as time could show the real cost for some banks to avoid such imperative choice.

B. The effect of Globalization on Merger

Globalisation can be defined as the process of integrating several economies into one global economy. Within this context, financial markets on a later stage will merge to form a huge market where state of the art technology and advanced financial products should provide banks with a high degree of competitive edge. Young financial markets like the UAE market should face serious competition from foreign large investment and commercial banks because the financial structure for local institutions is still in its preliminary stage. In this regard, two major issues must be raised as whether local banks are well prepared to compete, and how can they survive in the global economy? Globalisation means that local banks have to provide competitive prices through advanced services and products. Definitely, arriving to this level of customer satisfaction, banks must employ new competitive standards that are currently unavailable. Despite the fact that some economists and politicians are not in favour of this inevitable global market, there is much to be said in support of globalisation:

1. The concept of monopoly should change, as a nation that has absolute or comparative advantage will be affected somehow by abolition of boundaries and quotas. The absolute or comparative advantage will become more advantageous to one nation compared to another as the economic structure allows for more freedom and better business opportunities.
2. Globalisation can lead to an extensive fall in trade barriers, capital movements, and a wide variety of investment opportunities that do not exist in other parts of the globe.
3. It has spurred on the integration of the global economy, which in turn should lead to better economic developments in poor areas and increase wealth distribution.

As a result, kinds of barriers at a certain level of economic deregulation must lead to more openness and less control on foreign investment in various areas of the economy specifically in the banking system. Understanding differences in cultures and social barriers can also pinpoint some of the difficulties facing the banking system. There is no doubt that the shareholders' structure in the UAE banking system is a major obstacle to bank mergers for the following reasons: First, within the federation of seven Emirates, each local government owns a majority share in more than one bank. Second, in most large banks the majority of shares are in the hands of few investors. Third, the market capitalisation of these banks is extremely low which enforces our idea that family and special interest groups have no interest in changing the status. Fourth, foreign ownership so far is not allowed for non-locals.

IV. UAE Banking Financial Analysis

This section attempts to demonstrate various analytical procedures that can be used to evaluate the data contained in the banking financial

statements (see appendix 1). It is crucial to emphasize the data provided in this section which was somehow hard to get and mostly the only available data to us taken from the usual annual reports. Most details provided here are based on our own analysis. Given accurate financial data, the techniques that we used should provide analysts with considerable insight into: the financial structure of UAE domestic banks, the risk/return characteristics as per bank and for the entire industry excluding foreign subsidiaries.

In combination, the information derived from banks' financial statements, the analysis of key financial and operating ratios, and statements of cash flows can be important to identify major areas of strength and weakness for the banks included in our analysis, given the fact that financial transparency (continuous flow of information to the public) is one of the business essentials that banks in the UAE do not apply in their financial declarations. The aggregate balance sheet of banks operating in the country grew by AED 16.02 billion (6.8%) to reach AED 251.09 billion at the end of 1999. Deposits and cash with the central bank have reached 16.12 billion at the end of the same year. Net foreign assets of banks have reached AED 27.24 billion. Credit extended by banks also increased by AED 12.04 billion (8.9%) to reach 147.16 billion. A great percentage of increase in credit went to residents to reach 132.20 billion (see appendix I, table A1, A-7). Bank's performance must be directed toward specific objective. A fair evaluation of the performance of any bank should start by evaluating whether it has been able to achieve the objectives chosen by its management and stockholder. In the UAE banking sector, it is obvious that all domestic banks except two of them had a single main objective, delivering the maximum earning per share. Certainly many banks have their own unique objectives. Some wish to grow faster and achieve some long-range growth objectives. Others seem to prefer to minimise risk, conveying the image of a sound bank but with modest rewards for their shareholders. Earnings, dividends, and cash flow provided in table (A-1) can easily demonstrate the ideas of different bank objectives.[14]

Obviously, by analyzing banks' profitability, it tells us much about the causes of banks earnings fluctuation and suggests where management needs to look for possible cures for any earning problems that do surface. Since the directive of a stock price is the best indicator of a business firm's performance because it reflects the market evaluation of the bank's performance, this indicator is often unreliable in banking. Interpreting Profitability Ratios, each foregoing ratio looks at a slightly different aspect of bank profitability. Thus, ROA (return on assets) is primarily an indicator of managerial efficiency; it indicates how capable the management of the bank has been converting its assets into net earnings. ROE (return on equity), on the other hand, is a measure of the rate of return flowing to the shareholders of the bank. It approximates the net benefit that the stockholders have received from investing their capital in the bank (UNB Research). The net operating margin, net interest margin, and non-interest margin are efficiency measures as well

Table A-2 Major Profitability Ratios

	Return on Average Assets			Return on Average Equity		
	1999	**1998**	**1997**	**1999**	**1998**	**1997**
National Banks: average	2.70%	3.00%	2.44%	13.1 %	13.44%	14.23%
Commercial Banks: Average	1.98%	2.81%	2.65%	10.00%	16.95%	16.50%
Islamic Banks: avg.	1.00%	3.78%	0.00%	5.62%	1.56%	0.00%
Total Average	**1.80%**	**2.11%**	**1.82%**	**12.95%**	**15.42%**	**13.24%**

Table A-2 is a summary of major ROA and ROE per banking specialization.

as profitability measures, indicating how well management and staff have been able to keep the growth of revenues (which come primarily from the bank's loans, investments, and service fees) ahead of rising costs. The year 1999 has witnessed a substantial decrease in profitability for most local banks.

The decline in profitability was mainly the result of serious decline in capital investments and government spending due to the high volatility in international oil prices. The continuous declines in stock prices and in capital expenditure have both contributed in the decline in profitability. In fact, both ROA and ROE fell in 1999 as shown in appendix (1). The decline in both ROA and ROE has dropped on aggregate by almost 17 %. The analysis of banks' balance sheet in general shows that the biggest drop was due to (1) Decline in net interest income on average assets. (2) Selling and administrative expense increased by almost 7%. (3) Provision for loan losses increased on average by 31% over the past three years. (4) The small growth in assets had little impact on improving ROE. In comparison to many international banking systems, UAE domestic banks still hold a positive ROE and ROA by almost 12% and 2.5% respectively higher than the average of the GCC countries. Banks today are under great pressure to perform to meet the objectives of their stock holders, and to take advantage of an exceptional growth rate that might seem unsustainable for a long period, while keeping regulators satisfied that the bank's policies, loans, and investments are sound.

Undoubtedly, the analysis of banks profitability measures and their respective constituents can indicate much about the reasons of bank high earnings, suggesting that the management must always target long-term goals if they wish to maintain this incredible growth rate in earnings.

Although, banks are not keen to take drastic changes to stay financially sound as the gap between management and owners is widening, there are needs to look for possible remedy for any earnings problems that do surface. The foregoing analysis reminds us that achieving superior profitability for a bank depends on several crucial factors:

1. Careful use of financial leverage (or the proportion of bank assets financed by debt as opposed to shareholders' equity capital).
2. Careful use of operating leverage from fixed assets (or the proportion of fixed-cost inputs the bank uses to boost its operating earnings before taxes as bank output grows).
3. Careful control of operating expenses so that more dollars of sales revenue become net income.
4. Careful management of the asset portfolio to meet liquidity needs while seeking the highest returns from any assets acquired.
5. Careful control of the bank's exposure to risk so that losses do not overwhelm its income and equity capital.

The objective of maximum profitability with a level of risk acceptable to the owners of the bank is not easy to achieve, as the recent upsurge in bank failures around the globe clearly suggests that. Aggressive pursuit of such an objective requires an institution to be continually on the lookout for new opportunities for further revenue growth, greater efficiency, and more effective planning and control. The analysis of reserve/Net loans and advances also gives an indication of the management's perspective of risk. On average, in 1999, 66.2% of assets of local banks were in the form of loans and advance (Table A-7). While a few banks underutilised their assets, others continued to be more aggressive lending. Given the fast changing banking environment, credit risk extends beyond conventional credit products such as loans and letters of credit. Banks are taking on additional risk in the form of transactions in the equity market that expose them to counter-party risk and can be difficult to measure. They may also be engaged in taking on credit risk in its more subtle forms. For instance, banks often underestimate the credit risk that arises from off balance sheet financing, taking into consideration the general economic conditions over the past three years (1997 to 1999). Market risk also remains high. The surge in the UAE equity market over 1998/99 had led to a great deal of

volatility and fluctuations in bank profitability. A large number of investors had borrowed heavily from banks to invest in what they thought was a lucrative stock market. When the market crashed in the summer of 1998, small investors lost billions of dirhams as they were consequently unqualified to handle such situation.

The decline of the UAE equity market has exposed commercial banks to some irrational lending due to the high credit exposure to many customers who invested heavily in the stock market. Those customers have been much more reliant on the utilisation of bank lines of credit to meet their financial obligations. Operational risk is also a growing concern for the banking industry due to the fast growth in business and the mounting concentration of payment, settlements, mainly in large size banks. Those institutions are exposed to the probability of a high risk resulting from an inefficient internal control system. Further, more banks are forced by competition to invest in and more advanced technology as they try to keep pace with foreign subsidiaries in the country. Another obstacle is that of information risk. Another risk factor is the inability to develop and maintain a strong financial surveillance system to control their assets' users. In addition, most banks have lower loan-deposit ratios than required by the Central Bank. The extent to which individual banks gain will depend on their composition of deposits. Therefore, banks whose deposits are large enough or have access to government deposits will benefit most. There exists a tradeoff between liquidity and profitability. Lower or higher liquidity tends to be associated with higher (lower) returns, if banks are able to maintain the quality of their assets. (See Table A- 4).

(Table A- 5) shows that small banks are the most aggressive (high loan-deposit ratios), followed by the medium-sized bank. Small banks are the most aggressive with loan deposit ratios equal one or higher. On the other hand, large banks are the most secured with loan to deposit ratios around fifty percent. In many cases, banks carry more than one risk at the same time, which means that risks can be inter-related similar to market risk that can raise credit risk. Credit risk may derive from operation risks, embedded in complex systems for managing intra-day funding, which requires rigorous internal control environment. The best way for all banks to protect themselves is to identify risk correctly. Risk control can never be successful without banks changing their credit philosophy. The risk of personal loans is mounting everyday. Banks and financial institutions dangle bait in the form of easy loans and people with unending material desire like to get into it. In fact, some people call it "the debt traps" (See Business News). This easy policy of providing personal loans to people residing in the UAE has prompted people to obtain loans to satisfy their luxurious needs. Further, banks offer more loans to UAE nationals because they believe they enjoy better job security and there are fewer chances of fleeing the country. Clearly, high income and better quality life are major reasons for which many consumers feel they should profit from the 4% tax on merchandise and zero income tax, to buy luxurious cars and expensive materials.

What adds to the problem is that banks always come up with new imported ideas to lure more consumers to borrow more. The limit on personal loans can be as high as 30 time the individual's monthly salary. It is obvious that is not strongly enforced by banks. Latest financial statistics have shown that a staggering 93% of UAE national households are in debt. Therefore, failure to repay loans and criminal actions are posing serious threats to social stability in this country. In 2000, the number of defaulters doubled and the total personal loans reached Dhs 31.9 billions out of total loans of Dhs 162 billions. At the same time, loans extended for trade purposes have reached Dhs 17.2 billion. Given the fact that banks are targeting short-term objectives, a particular challenge is to relate credit risk assessment to appropriate capital levels, especially given the aggressive nature of their business. Banks operating in the UAE must maintain a capital adequacy ratio of 10%. Each bank capital requirement will be based on its risk. The risk-based standard requires less capital for loans to

governments and financial institutions than for corporate, and deems lending in GCC and OECD countries less risky than lending elsewhere. One possible explanation is the exceptional economic growth rate in most Gulf countries.

Obviously, the lack of well-defined credit policies in the Emirates has led banks to apply aggressive lending approach that makes no distinction between sectors and not the quality of loan users (firms). This forced banks to lend to riskier borrowers, because while such loans may command higher interest rates, they do not force banks to tie up more of their shareholder capital against it. In other words, some banks are forced to hold more capital than they need, while others are encouraged to hold less. These credit standards should improve credit control and reduce risk. Inspite of that, banks in the UAE were able to meet the minimum capital adequacy of 10%. Small-sized banks seem to be better capitalised than large- sized banks in terms of the equity capital ratio (shareholder equity/ assets), due to their small assets base. On the other hand, banks were successful in reducing capital risk compared to assets as they shifted most of their earnings into retained earnings and later to free shares. (see Table A-5).

Since management and shareholders are giving greater importance to returns, this might be difficult to sustain, if the economy is not growing fast and credit can get riskier. A major solution through which banks can improve returns would be by cutting costs. While most banks were unable to cut operating costs in 1998, a few were able to reduce efficiency ratios (operating cost/total income) by keeping non-interest income levels up. Most banks experienced increase in costs marginally pushing up operating efficiency ratios to 32.1% and 36.7%, respectively. Few banks saw operating expenses decline 8% and consequently operating efficiency declined from 41.2% to 38.3%, leaving them better off than in 1997; hence, bank merger seems to be the ultimate solution to increasing operating expense. Since mergers and acquisitions reduce costs due to economies of scale, they could also reflect the compulsion to seek protection against the prospects of lower earnings and the increased risk factors.

In an effort to diversify their sources of income and assets, various banks have developed their asset management business since it caries less risk and considered relatively lucrative compared to other banking fields such as investment banking. Therefore, banks have begun shifting into asset management, as the shift to private banking seems difficult to reach. Clearly, this expansion is still constrained by the non-active capital market, since the shift towards better transparency and the liberty for foreign investments to flow in is not the major priority for the UAE financial authorities. Further, the corporate bond market is almost non-existent in the UAE.

What could be alarming is the degree of risk taken by banks as off balance sheet business is mostly provided to foreign firms and business people with zero commitment to carry on business in the UAE. In fact, there had been many instances where business people fled the country without paying back their commitments to banks; hence, off balance sheet credits are high for banks based in the UAE, given the relatively high level of international trade in the region. However, the exposure of several banks appears relatively large, banks with low equity capital ratios and a high variability of operating earnings have proven particularly vulnerable to financial distress. Banks do realize that they must strive for capital, not only with their domestic and foreign counterparts, but also with investment funds, asset management firms, investment banks and insurance companies. Banks must recognise that an adequately capitalized institution is a necessary, but not sufficient, condition to compete globally and to attract foreign funds and business.[12]

According to the average price-earning ratio of this sector, most banks if not all, seem to have a low ratio, which shows that share prices are undervalued, since shares have been subdued in the UAE for the past three years, this confirms some of our observations on the banking system which are: first, market

capitalization is very low, which shows that small number of owners who have no interest in selling holds shares. Second, shareholders are more interested in operating earnings more than the capital gain itself and third, despite the very low share prices, owners are not exposed to any business takeover as market rules provide safety to shareholders by not allowing foreign investment in this market.

V. Empirical Study

A market survey of twenty-five-questions was presented to 20 Chief Executive Officers of all the national banks existing in the United Arab Emirates. Undoubtedly, the sample is relatively small but it covers all the national banks in the country. However, there are several observations that we believe they should be clarified before we present our empirical evidence:

- Unlike other studies, we believe that only chief executive officers can give true assessment to our market study as the merger decision is always handled and treated on such managerial level.
- The sample has excluded all foreign banks although they outnumber national banks, they still function as subsidiaries for foreign regional and international banks, and that they have no decision to make on any consolidation strategy.
- Our sample covers all the banks that have the potential to merge (all the population) and for that reason, we believe that there is no need to include branch managers in our sample for the purpose of increasing the sample size. The sample is inclusive to all banks that are considered subject to consolidation.

Through this survey, we attempt to highlight and pinpoint the corporate standpoint on such strategic and vital decision as merger. Previously, most of our discussion has revolved around the various motives of the acquiring bank to initiate a merger. While merger may be directed towards higher efficiency and less cost through either horizontal or vertical integration, and a possible synergistic effect, banks in UAE are still reluctant to initiate any merger deal. Therefore, the coming observations would attempt to determine the possible barriers against strategic alliance. As indicated in the tables provided in this section, the twenty five variables that we presented to national banks' CEO's and through the statistical analysis of variables, we were able to put forward the following observations:

When bankers were asked whether they had a clear idea on the banking laws and their explanation of merger activity in the UAE, it was evident that bankers were not sure if the laws favour consolidation, and some of them were unable to give a better reading of certain banking laws. Inherent in all of our study is the importance of State ownership in many domestic banks and its role as a merger barrier for any future consolidation. The statistical result on this point gave us a mean of 2.88 and a median of 3.00, there's no doubt that in many banks, state ownership represent an obstacle to merger but not a major one.[13]

As for privatisation and its role in restructuring the banking sector, more than 95% of bankers were strongly in favour of considering that without serious privatization decisions, it is mostly impossible to initiate merger attempts. This conclusion seems to point out that government ownership is a major barrier to any potential consolidation. Further, this observation should give more support to the fact that State ownership is a major obstacle rather than a minor one. The study also shows strong and positive relationship between stock exchange performance and market capitalisation. The merger appears to represent a desirable choice for bankers as a mean of (5.412) showed that most bankers admit the high operating cost due to over-branching, which is a major characteristic of the UAE banking system. See appendix II.

As both efficiency improvement and cost reduction are directly related, both observations (6 and 7) confirm that (with both mean and median close to 5.0), most banks strongly agree that the choice of merger can represent best alternative to achieve their long-term goals. To the extent that we

emphasise the importance of merger on improving the competitive edge and profitability, variable (8,9 and 10) confirm that foreign subsidiaries are causing them tremendous loss in revenues and merger decision "should be" a major strategic objective which indicate that so far it has not been considered by shareholders and mainly boards of directors as a possible solution to the high degree of competition. Banks also admit that technology is becoming a heavy burden since competitors (mainly foreign subsidiaries) have cheaper access to it and to other banking products. Although, the observation and the dispersion of answers in variable 11 do not imply that merger is a great solution for the high cost of technology.

Given the fact that the United Arab Emirates is preparing to join the WTO, which must lead to a complete liberalisation of markets, rules, and structure, the answer given by our sample with a mean of (3.235) and a low Standard deviation of (0.664) shows that most banks do not give serious thought to this matter. On the other hand, the sample seemed to support the fact that such drastic change would have an effect on the current shareholders' structure that is characterized by a small shareholders' base. In addition, the variable number (13) did specify that the exceptional growth in revenues realised by all banks in the UAE (in a banking sector where we have no losers), the question of keeping the status quo in ownership and market share per bank seem to pose an important obstacle in the face of any merger attempt. More relative observations to the aim of this research, were directed to the questions of family- ownership and the management of public shareholding businesses as a privately owned firm.

In this regard, the sample which covers all domestic banks have given a strong approval to the fact that most domestic banks in the UAE are still controlled and managed by their founders as a family business given the fact that the shareholders' base is extremely right (see variable 14). Clearly, the ownership structure still poses a major barrier to any potential merger in an emerging market like the UAE. It is possible to add that this observation is general and applies on most corporations in the area and the Arab World in particular. The managerial style and structure always decide the future of any company.

Furthermore, there is a large gap between any management and the board of directors when it comes to strategic planning. The latter is true given the results of two observations: Corporate mentality in the UAE (variable 15), and Management structure in the UAE (variable 16). Both observations indicated that foreign direct investment in most sectors of economy still faces strong rejection. The other point, which also received some support, is the fact that almost most national banks have the control of foreign management. This managerial structure forces the surfacing of management and ownership through agency theory. See table B-3 appendix II.

In regard to many observations related directly to the merger process and the possible barriers, the results given by the sample survey showed that: a) The results gave a strong support (mean 5.106 and St. deviation of 0.114) for the fact that in-market consolidation is the best choice for national banks, b) the sample rejected cross-border consolidation as an absolute success for national banks with a mean

Table (B-6)
Summary of Value Distribution for Descriptive Statistics

Value	Frequency	Percentage	Values
1	0	0%	**Strongly Disagree**
2	2	8%	**Disagree**
3	8	32%	**Certain Extent- Agree**
4	1	4%	**Neutral**
5	6	24%	**Strongly Agree**
6	8	32%	**Agree**

2.412 median 2.000 and St. deviation of 0.150. c) The results showed an absolute rejection to the fact that the banking system is well prepared to face foreign competition in case the UAE joins WTO in the coming future (mean 2.529, median 2.00 St. deviation of 1.007). d) The sample showed that the banking industry still considers the merger and acquisition process (to a certain extent mean 2.882) as an aggressive banking strategy that carries a high degree of risk. The survey also indicated that there is a direct link between the delay in banking consolidation and the less developed (dormant) money and capital markets. This point could also highlight the fact that the financial market is not well prepared to handle and react to any merger attempt. In sum, the sample showed that the structure of the UAE banking system created various kinds of barriers, in a way to stop any possible attempt to break through the current ownership structure in banking consolidation. In sum, the UAE financial structure still rejects foreign direct investments, and for that reason, many economic and social barriers were put in place.

In reference to table (B-6) shown above, we can clearly summarize the following:

First, value number (6=agree) has received 32% approval from the sample mentioned before, and 24% were given to value number (5=strongly agree), which shows strong confirmation to the majority of observations given in our survey. Second, as for the other values, only a small percentage of 8% was given to value number (2=disagree), and 32% to value number (3=agree to a certain extent), which also shows that despite the different origin of those who were included in our sample (CEO's), the study still gives strong positive results to our observations. Third, undoubtedly, even by excluding value number (3= agree to a certain extent) the final result would show 56% to agree and strongly agree against only 8% to rejection (disagree), which by far show better result to this survey. The figures basically show that the majority of CEO's tend to approve our analysis and diagnosis of the current status of the UAE banking system for most of the questions provided in our study. As for the remaining answers, 36% falls between what we considered neutral to agree to a certain extent (see appendix II). Further, in an effort to give more support and accuracy to the previous results, the results given under SE mean clearly indicate that the deviation from the mean on all variables was very minimal, which justify the coherence of most SE mean extracted from our survey. The answers given by the CEO's in the study and their statistical calculations showed strong relevance to our earlier observations. On the other hand, as the spread between the mean and median was extremely tight and since the mean is the indicator that shows more of variation, it was the focus of our previous analysis in an effort to indicate the main concentration in results.

VI. Conclusion

The evidence analyzed in this study comes to several conclusions. First, there is no doubt that the corporate mentality in the UAE has not well evolved, as the short-term benefits are considered more important than any other long-term strategic decision. Second, banks are reluctant to take what they may perceive as pioneering strategic decision without serious liberalisation of the financial system of the country in question. Probably in the future, the notion of mergers and banking integration will become more comprehensible as the deregulation of most financial services; the opening of markets for foreign investments and equity ownership, and finally the fierce competition would all lead to successful banking mergers. Third, the notion of operating efficiency, employee productivity, and cost reduction are not on banks' top list of priorities that can be achieved through merger. This is a manifestation of the banks becoming less adapted to cost control. Fourth, according to our statistical analysis, what might seem, in terms of financial strategies, suitable for most developed banking systems in the west, those strategies are in many cases rejected by less developed banking systems since they pose serious threats to most large shareholders. Deregulation, foreign investments,

and globalisation are notions that are socially and economically rejected in this part of the world.

Boards of directors in many cases have been ineffective in defining the main issues and challenges confronting their business, as the general economic conditions are still in their favor. Management ownership in banks should increase their commitment to long-term strategic objectives, and improve convergence of interests with shareholders. Therefore, deviation from value maximisation would decline, and the question of improving efficiency, competition, and reducing operating expense will require more of strategic planning. In the case of the UAE banking sector, managements can never be qualified to have more participation in strategic decisions as investment laws forbid foreign ownership in public shareholding companies. Equity ownership concentration and market capitalization are two important financial measures that move in tandem. Unlike the most developed financial markets, emerging markets tend to have high concentration in equity ownership and weak management ownership. A simple outcome of this correlation is illiquid stock market and subdued share prices. This is the case of the UAE stock market. UAE domestic banks must reduce their reliance on foreign management to run their local operations. The concept places management in the agency position of making decisions on behalf of shareholders and in their best interest. Therefore, as banks move seriously into merger and acquisition, the agency theory should become more useful in assessing the effectiveness of management in achieving shareholders' long run objectives.

Appendix (I)

Table (A-1) Banking Market Share and Position

	Deposit Gathering			Credit Extension		
	Deposits (AED m)	Mkt Shr. (%)	Mkt. Position	Loans (AED m)	Mkt Shr. (%)	Mkt. Position
National Banks:*						
1. NBAD	25,502,356	21.08%	1	17,501,681	17.19%	1
2. NBD	18,565,542	15.34%	2	6,990,465	6.86%	7
3. NBS	961,390	0.79%	18	1,581,034	1.55%	11
4. NBF	1,502,293	1.24%	11	1,407,743	1.38%	12
5. NBRAK	1,639,783	1.36%	10	1,066,575	1.05%	16
6. NBUAQ	1,261,605	1.04%	14	1,250,761	1.23%	14
Commercial Banks:						
7. EBI	13,916,002	11.50%	5	15,881,981	15.59%	2
8. ADCB	14,739,360	12.18%	3	14,449,068	14.19%	3
9. Mashreq Bank	14,081,652	11.64%	4	13,138,294	12.90%	4
10. CBD	4,715,785	3.90%	8	4,707,054	4.62%	8
11. UNB	8,396,360	6.94%	6	7,075,884	6.95%	6
12. FGB	1,442,007	1.19%	13	1,738,702	1.71%	10
13. CBI	1,243,164	1.03%	15	1,205,720	1.18%	15
14. IB	1,747,191	1.44%	9	1,874,936	1.84%	9
15. UAB	1,042,635	0.86%	17	1,261,452	1.24%	13
16. BoS	1,109,309	0.92%	16	975,249	0.96%	17
Islamic Banks:						
17. ADIB	1,498,667	1.24%	12	272,955	0.27%	18
18. DIB	7,627,124	6.30%	7	9,463,219	9.29%	5
Total	120,992,225			101,842,773		

*Bank names are put in initials only.

Table (A-3) *Banking Sector Stock Ratio Analysis*

Nov. 30th 1999	EPS	BVPS	PS	P/E	P/BV	Divided	Payout	Sustainable
National Banks:				(X)	(X)	Yield	(%)	Gwth(%)
1. NBAD	42,4	267.6	20.0	12.85	2.04	3.7%	47.2%	8.7%
2. NBD	46,2	428.0	40.0	18.49	2.00	4.7%	86.5%	1.5%
3. NBS	1.0	4.2	0.0	11.80	2.75	0.0%	0.0%	26.4%
4. NBF	5.3	149.3	10.0	54.90	1.94	3.4%	189.3%	-3.1%
5. NBRAK	1.7	18.3	1.2	17.49	1.59	4.1%	72.4%	2.7%
6. NBUAQ	21.2	150.8	18.0	13.18	1.86	6.4%	84.7%	2.2%
Commercial Banks:								
7. EBI	1.6	9.6	0.4	17.09	2.86	1.5%	24.9%	13.5%
8. ADCB	40.4	229.0	15.0	11.28	1.99	3.3%	37.1%	11.8%
9. Mashreq Bank	69.9	305.6	25.0	12.16	2.78	2.9%	35.8%	15.8%
10. CBD	4.4	24.3	1.8	19.18	3.45	2.2%	42.1%	11.2%
11. UNB	2.0	13.7	0.0	14.77	2.11	0.0%	0.0%	12.5%
12. FGB	0.1	1.4	0.0	22.64	2.16	0.0%	0.0%	13.4%
13. CBI								
14. IB	2.4	12.1	0.4	11.94	2.35	1.5%	17.5%	17.7%
15. UAB	2.1	13.9	0.6	15.41	2.37	1.8%	28.4%	11.6%
16. BoS	1.7	13.1	0.2	16.20	2.14	0.7%	12.0%	12.8%
Average				**13.18**	**2.40**	**2.5%**	**40.8%**	**9.6%**

Table (A-4) Banking Sector Deposit and Credit Size

	Deposits	Gross L&A		Past Due Loans		
	1999	1999	1999	1998	1997	1999
National Banks:		A	B			A/B
1. NBAD	25,502,356	17,501,681	706,707	647,147	NA	4.04
2. NBD	18,565,542	6,990,465	126,872	138,222	NA	1.81
3. NBS	961,390	1,581,034	220,599	251,020	242,688	13.96
4. NBF	1,502,293	1,407,743	62,350	56,179	23,595	4.43
5. NBRAK	1,639,783	1,066,575	37,532	33,260	32,478	3.52
6. NBUAQ	1,261,605	1,250,761	18,730	13,196	NA	1.50
Commercial Banks:						
7. EBI	13,916,002	15,881,981	461,700	353,796	237,144	2.91
8. ADCB	14,739,360	NA	NA	NA	NA	NA!
9. Mashreq Bank	14,081,652	13,138,294	1,271,441	987,434	816,500	9.68
10. CBD	4,715,785	4,707,054	102,660	89,188	71,930	2.18
11. UNB	8,396,360	7,075,884	335,371	327,081	269,107	4.74
12. FGB	1,442,007	1,738,702	285,907	214,367	221,344	16.44
13. CBI	1,243,164	1,205,720	152,162	143,009	130,876	12.62
14. IB	1,747,191	1,874,936	181,577	168,309	158,829	9.68
15. UAB	1,042,635	1,261,452	69,162	77,289	73,287	5.48
16. BoS	1,109,309	975,249	49,380	44,007	37,615	5.06
Islamic Banks:						
17. ADIB	1,498,667	272,955	NA	NA	NA	NA
18. DIB	7,627,124	9,463,219	690621	620895	453014	7.30
Total	**120,992,225**	**87,393,705**	**4,772,871**	**4,164,399**	**2,768,407**	**5.46**

Table (A-5) Local Bank Profitability Analysis

	Large Banks			Small Banks				Medium sized Banks	
	1997	1998	%change	1997	1998	%Change		1998	%Change
Net Interest Income/Avg Assets	2.80%	2.85	-0.50%	4.10%	4.10%	0.30%	3.60%	3.50%	-4%
Non-interest income/Avg Assets	1.30%	1.50%	13%	1.60%	1.70%	7%	1.60%	1.60%	2%
Overhead expenses/Avg Assets	1.30%	1.40%	5%	2.10%	2.10%	3%	2%	1.90%	-8%
Loans Loss prov./Avg Assets	0.60%	0.90%	34%	1.50%	2.20%	40%	0.50%	0.70%	45%
Int.Income/Avg Assets	6.80%	6.60%	-2%	7.30%	7.30%	0.20%	7.10%	6.90%	-3%
Int.expenses/Avg Assets	4%	3.90%	-3%	3.20%	3.20%	0.00%	3.50%	3.50%	-1%
Int.Inc/AvgEarning Assets	7.25	7.10%	-2%	7.60%	7.70%	1%	7.40%	7.20%	-3%
Int.Exp/Avg Int. bearing liab.	4.80%	4.60%	-3%	4.30%	4.30%	1%	3.80%	3.80%	-0.20%
Spread	2.40%	2.40%	0.20%	3.40%	3.40%	0.40%	3.60%	3.30%	-6%
Operating profit/avg. assets	2.80%	2.80%	3%	3.60%	3.70%	2%	3.10%	3.20%	2%
Operating expense/avg. assets	1.30%	1.40%	55	1.90%	2.00%	3%	2%	1.90%	-8%
Operating Efficiency	31.70%	32.30%	1%	36.30%	36.70%	1%	41.20%	38.30%	-7%
Return on equity (ROE)	19.10%	17.70%	-7%	15.60%	13.70%	-14.50%	18.40%	15.90%	-136

- 1999 Figures are indicated in other tables and if not they are unavailable from the source
- The figures are segmented as per bank size

Source: UNB Research

Table (A-6) Local Banks Capital Adequacy

	Equity capital Ratio	Gwth Rate of Adj. Assets	Gwth Rt of Primary Capital	Cash Dividends/Net Operating income	Capital Adequacy
Large Banks					
NBAD	7.20%	12.80%	0%	41%	17.16%
NBD	15.10%	5.70%	0%	79.40%	54.80%
EBIL	14.30%	12.10%	20.90%	21.70%	23.70%
Mashreq	12.60%	9.50%	25%	21.10%	14.40%
ADCB	13.20%	19.90%	5.10%	30%	20%
Average	12.50%	12%	10.20%	38.60%	26%
Medium Banks					
UNB	12.70%	23.40%	25.10%	0%	13.70%
CBD	16.50%	27.20%	12.10%	35%	18%
Average	14.60%	25.30%	18.60%	17.50%	15.90%
Small Banks					
Invest Banks	18.10%	11.20%	15.40%	14.20%	17.80%
NBF	19.90%	-8.30%	3.21%	49.30%	23.16%
UAB	19.10%	12.80%	2.37%	23%	21.10%
NBUAQ	22.40%	10.5%	5.36%	70.30%	28.50%
NBS	23.10%	9.70%	7.47%	0%	50.19%
NBRAK	27.50%	1.90%	4.46%	57%	39.20%
BoS	18%	15.50%	28.41%	40.20%	32.15%
FGB	33.10%	33.80%	57.45%	0%	30.15%
Average	22.60%	10.90%	15.50%	31.70%	30%
Banking Sector Average	18.20%	13.20%	14.20%	32.10%	26.60%

Source: UNB Research

Table (A-7) Local Banks' Liquidity

	Net L& A/Avg Assets			Loan/Deposit ratio			Liquid Assets/Total assets		
	1997	**1998**	**%Change**	**1997**	**1998**	**%Change**	**1997**	**1998**	**%Change**
NBAD	51.90%	52.20%	0.58%	62.80%	62.40%	-0.64%	42.50%	43.80%	3.06%
NBD	24%	25.20%	5.00%	30.60%	31.80%	3.92%	73.70%	73%	-0.95%
EBIL	69.80%	73.50%	5.30%	90.50%	95.90%	5.97%	19.80%	21.80%	10.10%
Mashreq	63%	60.45	9495.24%	81.20%	82.90%	2.09%	37.70%	33.60%	-10.88%
ADCB	67%	71.90%	7.31%	85.50%	98%	14.62%	35.70%	29.70%	-16.81%
Average	55%	56.60%	2.91%	70.20%	74.20%	5.70%	41.90%	40.40%	-3.58%
Invest Bank	66%	68.70%	4.09%	77.70%	85%	9.40%	33.50%	31.30%	-6.57%
NBF	58.50%	55.80%	-4.62%	80%	87.30%	9.12%	41.40%	37.30%	-9.90%
UAB	67.90%	69.70%	2.65%	83.80%	90.40%	7.88%	33.60%	31.40%	-6.55%
NBUAQ	65.60%	69.60%	6.10%	95%	90.30%	-4.95%	26%	28.40%	9.23%
NBS	69.50%	79.90%	14.96%	89.50%	100.20%	11.96%	31.60%	24.20%	-23.42%
NBRAK	44.00%	59.50%	35.23%	85.90%	92.50%	7.68%	55.50%	37.80%	-31.89%
BOS	64.50%	65.20%	1.09%	74.50%	83.30%	11.81%	38.10%	34.70%	-8.92%
FGB	47.30%	83.80%	77.17%	66.20%	112.70%	70.24%	48.10%	22.30%	-53.64%
Average	60.40%	69%	14.24%	78.20%	92.70%	18.54%	38.50%	30.90%	-19.74%
UNB	75.10%	82.40%	9.72%	81.40%	86.90%	6.76%	18.20%	19%	4.40%
CBD	68.50%	75.10%	9.64%	82.50%	88%	6.67%	32.80%	28.60%	-12.80%
Average	71.80%	78.70%	9.61%	82%	87.50%	6.71%	25.50%	23.80%	-6.67%
Sector Avg	**60.10%**	**78.70%**	**30.95%**	**76.00%**	**85.80%**	**12.89%**	**37.90%**	**33.10%**	**-12.66%**

Table (A-8) Bank Sector Weighting, Assets & Debt utilization Ratios

Date: 24-08-99 Issuing Company	Sector Weighting	P/ B	Equity/ T.A	Debt/ T.A	Debt/ Equity
ADNB	35.47%	3.10	7.4%	92.6%	12.5
NBD	42.29%	2.35	15.8%	84.2%	5.3
NBS	8.33%	7.02	21.3%	78.7%	3.7
N B F	5.43%	2.37	18.8%	81.2%	4.3
RAK	4.09%	1.85	25.6%	74.4%	2.9
NBUQ	4.40%	0.00			
Industry Average	***95.60%***	***3.01***	***13.7%***	***86.0%***	***7.7***
EBI	28.06%	4.70	14.3%	85.7%	6.0
ADCB **	19.79%	3.19	13.7%	86.3%	6.3
Mashreq Bank	17.17%	3.76	10.8%	89.2%	8.2
CBD	10.26%	4.93	17.9%	82.1%	4.6
UNB	7.64%	3.14	14.5%	85.5%	5.9
FGB	7.23%	14.03	24.1%	75.9%	3.2
CBI	3.31%	6.83	15.8%	84.2%	5.3
IB	2.74%	3.69	16.4%	83.6%	5.1
UAB	2.14%	3.43	19.4%	80.6%	4.2
BoS	1.66%	2.34	20.8%	79.2%	3.8
Industry Average	***100.00%***	***4.80***	***15.0%***	***85.0%***	***6.0***
ADIB *	53.70%	2.90			
DIB	46.30%	2.50			

Table (A-9) Summary of Earnings, Dividends & Free cash flow for National Banks

	Earnings (1999)	Earnings (1998)	Dividend	Free Cash Flow
National Banks				
1. NBAD	308,905	399,206	188,320	**3,528,240**
2. NBD	401,452	401,533	344,707	**-511,249**
3. NBS	89,783	72,739	0	**-19,336**
4. NBF	30,040	15,846	21,000	**-162,452**
5. NBRAK	49,320	41,450	37,500	**-167,300**
6. NBUMQ	57,262	53,106	45,000	**57,601**
Commercial Banks				
7. EBI	507,740	472,884	146,945	**805,488**
8. ADCB	549,727	505,467	250,000	**-296,173**
9. Mashreq Bank	350,315	500,532	178,966	**1,316,194**
10. DCB	184,900	179,530	122,980	**229,961**
11. UNB	106,091	105,831	0	**904,541**
12. FGB	-49,325	47,694	0	**40,793**
13. CBI	40,083	29,922	8,629	**-88,572**
14. Invest Bank	56,540	71,584	30,000	**31,873**
15. UAB	55,174	44,264	20,668	**-156,869**
16. BS	42,600	36,657	26,400	**8,077**
Islamic Banks				
1. ADIB	17,450	103,645		**105,707**
2. DIB	99,297	-33,754	50,000	**-231,311**

Appendix (II)

Table (B-1)

Summary of Descriptive Statistics on Bank M&A in the UAE (National Banks' Views)

Variable	N	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1	Q3
1. Banking & business laws governing the banking sector in the UAE *facilitate any attempt by banks to consolidate through merger& acquisition?*	**17**	3.941	4.000	3.867	0.899	0.218	3.000	6.000	3.000	4.000
2. Some believe that State ownership in many domestic banks is too high and considered it as a barrier for any future consolidation	17	2.8824	3.0000	2.9333	0.3321	0.0805	2.0000	3.0000	3.0000	3.0000
3. It is believed that privatization," in general ", is imperative for banking system in the UAE to consolidate through merger and acquisition.	**17**	5.059	5.000	5.067	0.429	0.104	4.000	6.000	5.000	5.000
4. There's a general consensus that privatization should lead to improvement in stock market performance as it tends to increase both the shareholders' base and the market capitalization.	**17**	5.588	6.000	5.800	1.004	0.243	2.000	6.000	5.500	6.000
5. Over-branching is considered one of the major features of the banking system in the UAE.	17	5.412	6.000	5.467	0.712	0.173	4.000	6.000	5.000	6.000

- **Agree=6** **Strongly Agree=5** **To A Certain Extent Agree=3** **Missing Response= 3**
- **Neutral=4** **Disagree=2** **Strongly Disagree=1**

Table (B-2)

Summary of Descriptive Statistics on Bank M&A in the UAE (National Banks' Views)

Variable	N	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1	Q3
6. Efficiency improvement can be achieved through merger and acquisition and it's imperative for domestic banks.	17	5.176	5.000	5.267	1.015	0.246	3.000	6.000	5.000	6.000
7. Merger and acquisition should lead to a substantial decrease in operating expenses in the UAE banking system.	17	5.059	5.000	5.133	0.659	0.160	3.000	6.000	5.000	5.000
8. Merger & Acquisition decision should be on your strategic agenda, because it's considered a strategic alignment that would lead to improvement in competitive edge.	17	5.529	6.000	5.600	0.717	0.174	4.000	6.000	5.000	6.000
9. Merger and acquisition decision should be one of your most strategic objectives as a solution to increased competition and profitability?	17	5.353	6.000	5.467	1.057	0.256	3.000	6.000	5.000	6.000
10. National banks are facing fierce competition from foreign banks and it is expected to increase in the future.	17	5.647	6.000	5.867	0.996	0.242	2.000	6.000	6.000	6.000

- **Agree=6** **Strongly Agree=5**
- **Neutral=4**
- ***To A Certain Extent Agree=3*** ***Missing feedback= 3***
- **Disagree=2** **Strongly Disagree=1**

Table (B-3)

Summary of Descriptive Statistics on Bank M&A in the UAE (National Banks' Views)

Variable	N	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1	Q3
11. Foreign banks in the UAE have better and cheaper access to new products, technology, & other banking services such as off shore services?	17	5.765	6.000	5.933	0.752	0.182	3.000	6.000	6.000	6.000
12. Joining the world trade treaty could cause serious threats to the domestic banking sector and to the current shareholders' structure in particular	17	3.235	3.000	3.200	0.664	0.161	2.000	5.000	3.000	3.500
13. High revenues in the banking sector are a major cause for national banks to avoid consolidation through merger and acquisition.	17	2.941	3.000	2.933	0.556	0.135	2.000	4.000	3.000	3.000
14. Family ownership of many domestic banks is a major cause for these banks to reject consolidation through merger and acquisition.	17	4.765	5.000	4.867	0.903	0.219	2.000	6.000	5.000	5.000
15. The corporate mentality in the UAE still rejects foreign direct investment in national banks and other sectors of the economy.	17	5.706	6.000	5.933	0.985	0.239	2.000	6.000	6.000	6.000

- **Agree=6**   **Strongly Agree=5**
- **Neutral=4**
- **To A Certain Extent Agree=3**   **Missing feedback= 3**
- **Disagree=2**   **Strongly Disagree=1**

Table (B-4)

Summary of Descriptive Statistics on Bank M&A in the UAE (National Banks' Views)

Variable	N	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1	Q3
16. Management can be a major obstacle for future consolidation as foreign management represents in most cases 80 % of banks' employees	17	2.588	3.000	2.533	0.618	0.150	2.000	4.000	2.000	3.000
17. The merger choice can be a perfect remedy for government attempts to nationalize the workforce in this sector?	17	4.176	5.000	4.267	1.704	0.413	1.000	6.000	2.500	6.000
18. The social and economic benefits of banking consolidation are still in their early stage and therefore they are not compelling to shareholders?	17	2.941	3.000	2.800	0.899	0.218	2.000	6.000	2.500	3.000
19. It's believed that 'In-market' mergers and acquisitions can be a considered as the most appropriate choice for national banks.	17	5.106	6.000	5.733	0.470	0.114	5.000	6.000	5.000	6.000
20. Cross-boarder consolidation should be an absolute success for local banks, as they strive to enter new markets and expand their banking products.	17	2.412	2.000	2.333	0.618	0.150	2.000	4.000	2.000	3.000

- **Agree=6**   **Strongly Agree=5**
- **Neutral=4**
- **To A Certain Extent Agree=3**   **Missing feedback= 3**
- **Disagree=2**   **Strongly Disagree=1**

Table (B-5)

Summary of Descriptive Statistics on Bank M&A in the UAE (National Banks' Views)

Variable	N	Mean	Median	TrMean	StDev	SE Mean	Minimum	Maximum	Q1	Q3
21. If the United Arab Emirates were to open its market to foreign competition by joining the world trade organization, the banking system is prepared to face foreign competition and probable takeovers by foreign banks?	17	2.529	2.000	2.333	1.007	0.244	2.000	6.000	2.000	3.000
22. Economists advocate that international alliance should improve the financial structure of the local financial system and reduce local capital transfer to foreign markets searching for better opportunities.	17	5.176	5.000	5.267	0.728	0.176	3.000	6.000	5.000	6.000
23. Bankers consider Merger & Acquisition as an aggressive banking strategy that could carry high degree of risk.	17	2.882	3.000	2.733	0.928	0.225	2.000	6.000	2.000	3.000
24. Financial authorities conceive merger and acquisition as an inevitable Long-run banking strategy, and that banks should be prepared for it.	17	3.412	3.000	3.333	1.004	0.243	2.000	6.000	3.000	3.500
25. As the equity, money and capital markets are not highly developed; it is obvious that these conditions have been delaying any in-market or cross-boarder alliance through merger & acquisition?	17	3.353	3.000	3.267	1.115	0.270	2.000	6.000	3.000	3.500

- **Agree=6** **Strongly Agree=5** **Neutral=4**
- **To A Certain Extent Agree=3** **Missing feedback= 3**
- **Disagree=2** **Strongly Disagree=1**

FOOTNOTE

1. Cost reduction is becoming the cornerstone of most bank mergers as competition is putting pressure on revenues.
2. Local bank employees represent on average not more than 15% of the total banking population. There are 135 different nationalities residing in the UAE.
3. See Gary Dymski's book on merger wave in the 1999's.
4. CALOMIRIS, (Gauging the Efficiency) C. W 1998, Case studies have made the writer skeptical of a great deal of the empirical literature used to measure the average gains from the consolidation wave.
5. For more discussion on this matter, see Berger. et al. 1993.a, and Necmi Kemel Avkiran, 1999 Journal of banking and finance.
6. Equity ownership by managers must balance convergence or an alignment of interest versus entrenchment consideration. Stulz has used a model to show that management and shareholders interest will tend to converge even at a low level of management ownership.
7. Economists like Ravens craft and Scherer advocator that merger is regarded a purging exercise where incompetent management is replaced and translates into a search for efficiency gains through cost saving.
8. Rhoads argues that there is a continuing disagreement between systematic studies and views given by bankers on merger outcomes in particular.
9. Necmi Avikiran has used Sinkey's comments 1983, P.21 on using ROA and ROE as best rules to measure bank's performance, they have looked at the relationship between controlling cost and improving ROA and ROE.

9a. Maintaining the identity and objectives of the company and making sure that they continue to be relevant to the old identity and that objectives are crucial for bankers.

10. We could also attribute the scarcity of bank mergers on the regional and local level, to the difficulty of understanding the long-term advantages of mergers as owners have short-term objectives. Some of these major objectives can be summarized into two points: to reap the maximum financial profits in addition to the socio-economic factors becoming a major cause of concern for companies in this changing environment in which owners can benefit from.
11. Uhlenbruck and Castro, 1998: claim the researchers support the hypothesis that the key issue in privatization in developing countries is not ownership as much as managerial accountability that could fundamentally distinguish public from private enterprise and cause the inefficiency of many state owned firms.
12. It will be a challenge for banks, particularly those with high-risk profiles and financial statements, to prove to the financial market, counter parties and stakeholders that they are operating safely and soundly.
13. As this strategic decision is becoming inevitable for some banks, the response to it is extremely slow despite the public and official support to it.
14. This point cannot be applicable to all cases as some mergers might have efficiency improvement on top of its priorities. Nevertheless, the stock market seems to have reflected its doubts about the outcomes of in-market bank mergers through the heavy selling of the acquirers' shares and consequently the drop in the value of its share price.

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العوائق الاقتصادية والاجتماعية أمام عمليات الدمج المصرفي أو التملك في دولة الإمارات العربية المتحدة

قحافة محاسنة*

ملخص

تتناول هذه الدراسة تحقيقاً عملياً حول العوائق الاقتصادية والاجتماعية التي تقف أمام عمليات الدمج المصرفي أو التملك في دولة الامارات العربية المتحدة. وتتضمن الدراسة تحليلاً شاملاً لهيكل المصارف في الأسواق الناشئة وتلقي الضوء على الأسباب الأساسية لهيكلة القطاع المصرفي في العديد من الدول النامية. وتتناول الدراسة الدوافع الحقيقية وراء عدم رغبة المصارف بالقيام بعمليات الدمج في الدولة وذلك بعكس التوجه العالمي للمصارف نحو الاندماج وإقامة التكتلات المصرفية الكبيرة. كما تتضمن الدراسة تحليلاً مالياً لأداء البنوك الرئيسية بالدولة واستعراض آراء المديرين التنفيذيين وأصحاب القرار حول هيكلة القطاع المصرفي. وتؤكد الدراسة أهمية إيجاد الحلول اللازمة للعوائق التي تحول دون حدوث عمليات الدمج المصرفي ومن أهمها عدم وجود القوانين التي تسمح بالاستثمارات الأجنبية في القطاع المصرفي وضعف القرارات على المستوى الإداري إزاء الدمج وتركز ملكية اسهم بعض المصارف لدى بعض المساهمين. كما تستنتج الدراسة أن المصارف في دولة الامارات مازالت تركز على الأهداف ذات المدى القصير مثل الربحية والتوسع الأفقي وبالتالي فإنها غير مهتمة بمسائل جذرية مثل أعداد العاملين لديها، وتخفيض الكلفة الكلية، وتوسيع قاعدة الخدمات المصرفية.

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