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FORUM FINANCE

Middle East and North Africa



Consolidation Trends: MENA banking sector

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If you are interested in attending, please contact dana.jaber@bain.com for more information

Bain & Company's Forum Finance is a quarterly publication that focuses on the critical issues facing banks, insurance companies and other financial institutions in the Middle East and North Africa.

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In this issue of Forum Finance, we examine the consolidation trends in the MENA banking sector and discuss the ways in which CEOs approach the task of post-merger integration. As the banking sector in the region continues to mature, mergers and acquisitions will be an important avenue of growth.

For those at the helm of banks, it is critical to plan early for how to avoid the missteps that can occur after a deal has been inked. This means carefully preparing for the operational, organizational and cultural challenges of integration.

To shed light on how leading CEOs approach this task, we have featured Rick Pudner of Emirates NBD as our interview in this issue. Mr. Pudner led the merger of Emirates Bank International and National Bank of Dubai to create one of the region's largest financial services institutions. He offers here lessons from his own post-merger integration experience and insights on the future of the banking sector in the region.

We welcome your feedback and questions on these topics. We are also pleased to announce the launch of 'Bain Strategic Afkar', a series of workshops for Heads of Strategy from the region's leading financial services firms. These workshops commenced in March, and our first discussion focused on creating powerful and effective operations in financial services. Please contact us for more information.



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FOR FINANCIAL INSTITUTIONS, AVOID POST-MERGER MISSTEPS



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As the fragile economic recovery picks up momentum, many GCC companies are emerging from the downturn in a strong competitive position: they are cash-rich. Even at the height of the worldwide financial crisis, the top companies on the Dubai Financial Market, Abu Dhabi Securities Exchange and NASDAQ Dubai were sitting on a cash pile that totaled US\$578 billion in 2009. This spells good news for GCC banks whose relatively unleveraged balanced sheets put them in a position to both support and grow with the region's consumers and businesses.

The competition will be stiff, however, as financial institutions in the region race to achieve the scale and breadth required of market leaders. Mergers and acquisitions are one path to realizing greater economies of scale and expanding into attractive business lines that are still nascent in the region, such as asset management, investment banking and private wealth management.

The merger of Emirates Bank International (EBI) and National Bank of Dubai (NBD) to create one of the Middle East's largest banks is perhaps the most dramatic example of merger activity that has gained momentum in other regions and is a

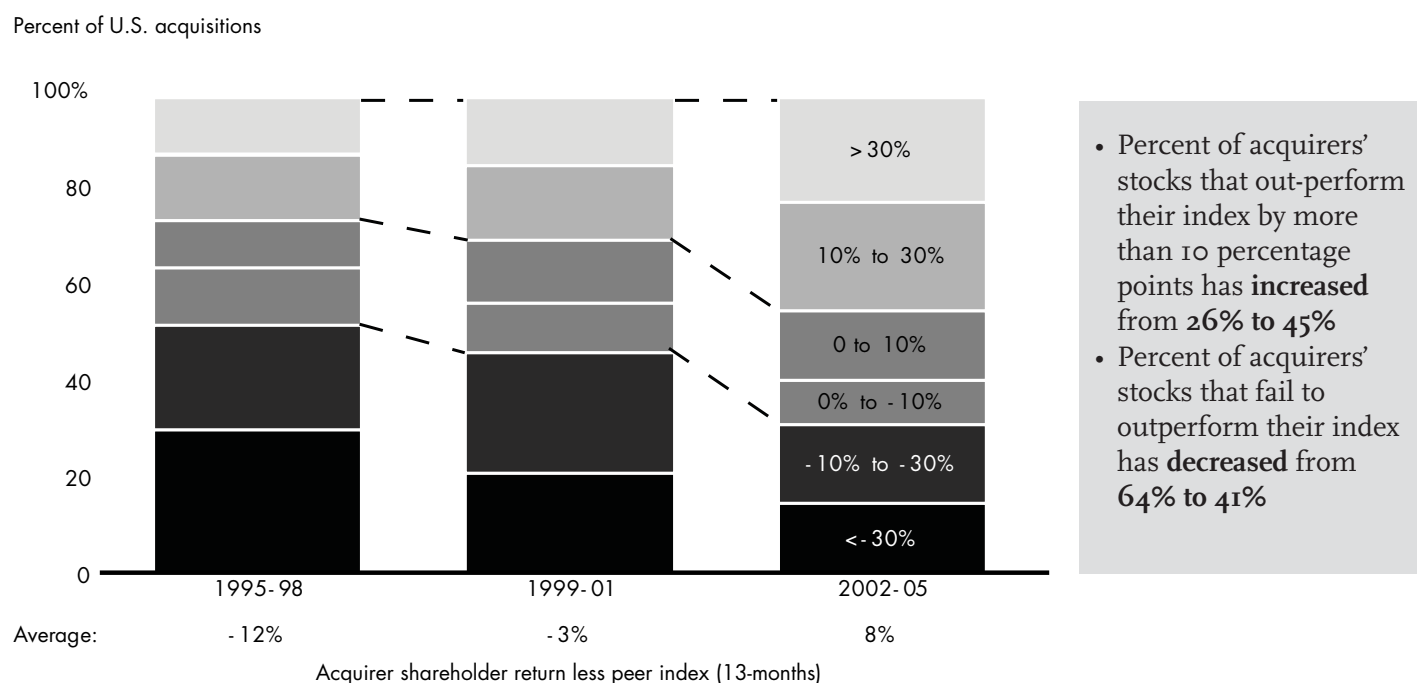
sign of things to come in the GCC. Encouraged by the Dubai Government, the merger created a banking powerhouse with assets of Dh165 billion, combining EBI's strong branding and large retail presence with NBD's strength in corporate banking.

Deals made during turbulent periods often are top performers. Bain & Company recently analyzed 24,000-plus transactions in the ten-year period between 1996 and 2006 – a timeframe that saw the Asian currency crises and a global recession. This analysis shows that acquisitions completed during or just after the 2001-02 recession generated almost triple the excess returns of acquisitions made during the preceding boom years. Excess returns refer to shareholder returns from four weeks before to four weeks after the deal, compared with peers.

▮ Deals made during turbulent periods often are top performers ▮

This was true regardless of industry or deal size. Meanwhile, many companies also are getting better at M&A. In 1995-1998, about 65 percent of US mergers underperformed their industry index. Ten years later, the figure was about 40 percent. We think this is due to more experienced frequent acquirers and the increasing use of cash — instead of stock — to finance deals, which seems to encourage better due diligence and more realistic prices. Seasoned acquirers know that the non-recurring costs of acquisition and integration can be very high, a consideration which they factor into deal pricing.

Figure 1: The odds of success for larger acquisitions for financial institutions have been improving



Source: Bain U.S. Acquisition Success Study (2007)

Even when deals are strategically sound, many fail to live up to expectations. Often, the fault lies in post-merger integration missteps. Many acquirers forfeit large amounts of value by failing to execute in three key areas:

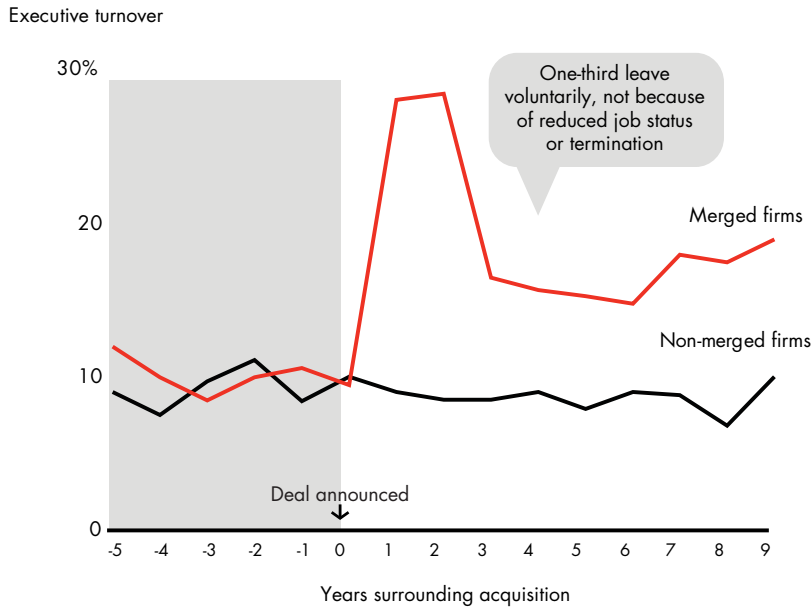
Defining and hitting the right targets. The failure to define a deal's investment thesis — and risks — in crystal-clear terms shows there are no clear integration priorities, leading to missed targets. Understanding whether deals are to boost 'scope' or 'scale' is vital. Scope deals require fostering some capabilities of the acquired company and integrating where it matters most. In contrast, scale deals focus on combining two similar companies for maximum efficiency.

Merging large, complex organizations requires a skillful integration plan to deliver the full benefits of the deal's scope (new markets and product offerings) and scale (combining back-office opera-

tions). On the back end, acquirers need to put in place a fast and efficient process to aggressively reduce costs by consolidating IT, customer-service call centers and clerical work. Front-end integration is just as tricky and no less important, but requires different competencies: the key is striking the right balance between carefully preserving client relationships while also optimizing the product mix, distribution channels and pricing.

Retaining key people. When it comes to HR issues, many companies delay organizational and leadership decisions. In the interim, key personnel are at risk of being hired away by rivals. Experienced acquirers earn a reputation for retaining the best people—and creating opportunities for them. Doing so requires identifying talent early, making sure the organization is appropriately mapped to the needs of the business, and empowering the top employees to lead both the business and the integration process.

Figure 2: Key talent departs because of uncertainty and lack of communication



Drivers of Talent

- Organization decisions not deemed fair/transparent
- Organization decisions made too slowly
 - Key talent lured away
- Heavy-handed imposition of “acquirer’s culture”
 - Triggers conflict and discontent
- Lack of communication about the process and/or the vision
 - Fails to “win the hearts and minds” of both organizations
- Protracted deal approval process
 - Prevents acquirer from clarifying new roles

Source: Jeffrey Krug, “Why do they keep leaving?” published in Harvard Business Review February 2003, University of Illinois, Urbana-Champaign; Bain experience

Linking integration to the business. Poor performance in the core business occurs when integration soaks up too much energy or drags on, distracting managers from the core business. Typically, at least 90 percent of the organization should be focused on its core, with clear targets and incentives to keep those businesses humming. The 10 percent that is focused on integration needs to be tuned in and adaptive to the needs of the business.

Veteran acquirers have the best track record for avoiding these missteps. Our studies show that frequent acquirers consistently outperform infrequent acquirers by getting the integration process right and making it a core competency. If you had invested \$1 in each group, the returns from the frequent-acquirer group would be 25 percent greater than the infrequent group over a 20-year period. Recognizing that experience yields results, firms lacking the former often hire experienced resources to help them execute the integration process.

Meanwhile, Bain research has found that as cross-border deals increase, their rate of success is similar to domestic deals, but integration typically is more complex. Among the unique chal-

lenges: tailoring the integration thesis to each region’s circumstances, quickly tackling actual and perceived cultural differences, accounting for geographically dispersed operations and stakeholders as well as complex legal and regulatory frameworks that can derail integration.

With cash-flush banks and relatively low regulatory barriers, we expect the pace of consolidation to increase across the spectrum of GCC financial institutions, especially amongst retail banks, brokerage houses and asset managers. Consolidation will strengthen the breadth and depth of the industry regionally and afford top players the scale and competencies needed to become pan-MENA operations. Regional economies are back on a growth trajectory, and now is the time to trim non-core assets and position for greater scale and sophistication. While economic growth can erase many post-merger missteps, the winning institutions will be those that work quickly and effectively to ensure smart acquisitions live up to their potential.

Julien Faye and Philippe De Backer are partners based in Bain & Company’s Dubai office.

Figure 3: Align your integration process with your deal type and your deal thesis



“*The main challenge to focus on is always one of culture integration*”

INTERVIEW

Rick Pudner, CEO,
Emirates NBD



Julien Faye: Where do you see the competitive position of ENBD after the merger? Where are the areas where you strengthened your position?

I think the rationale for the merger right from the start was to create scale and look at the start of some consolidation in the UAE banking landscape. From a very simplistic form of 1-plus-1 equals 2.5 or 3, it made very good sense. It was well received by analysts who seemed to say, “Two banks headquartered on the same side of the creek in Dubai, Ok, this makes sense.”

Even though both were Dubai banks, the overlap in distribution was not that great. We didn’t have to close down many overlap branches and we had the advantage of Emirates Bank bringing an Islamic bank subsidiary to which we could allocate some branches rather than close them down. So, it gave us a fantastic distribution capability: we now have over one hundred branches in the UAE and six hundred ATMs. There is no reason why expatriates coming into Dubai would not want to bank with Emirates NBD given the accessibility we give them along with a very state-of-the-art internet banking platform.

In terms of geographies, there have been a number of synergies. Emirates bank was looking to open up in Qatar; NBD already had a branch there. NBD wanted to open an office in Singapore; Emirates Bank had an office there.

▮▮ *Identifying the quick wins and acting on them was critical to the integration* ▮▮

The merged bank also had a more broad set of business lines. NBD brought with it a private bank and an investment bank which they had been building up a year and a half prior to the merger.

Julien Faye: It takes time for the results to appear after a merger and this must have been especially challenging through the downturn. Are they starting to come in?

I keep saying to my team, “If you started the merger of Emirates NBD and somebody put down a list of the most difficult challenges they could think of to put in front of us, I don’t think anybody would come up with the list that actually appeared.” I think our timing was spot on: merging at a moment of rapid growth enabled the combined bank, with a stronger capitalization and larger customer base, to get through the financial crisis in far better shape than two individual banks may have come through.

▮▮ *Making sure you keep the top talent should also be a critical focal point* ▮▮

Right from the word “go,” we identified the synergies both on the cost side and the revenue side. We realized and in fact overachieved on those synergies. Identifying the quick wins and acting on them was critical to the integration.

Julien Faye: For another CEO contemplating a merger, what other advice would you give?

No matter what size of merger you are doing, it’s challenging. The main challenge to focus on is always one of culture integration. I think it was very interesting to see that these two banks had very different cultures despite being on the same side of Dubai creek, separated by only one and a half kilometers. Emirates Bank came from what seemed like a more innovative style whereas NBD was a much more traditional, control-oriented culture. In putting these two together, we

didn't want to just mix the cultures. We wanted to create a new culture for the bank.

Identifying the top talent and making sure you keep the top talent should also be a critical focal point. This is part and parcel of organizing your top team very early.

|| *And communicate - over-communicate - as much as you can* ||

And communicate - over-communicate - as much as you can. The fact that this was the first merger of two major financial institutions in the region and that both had unique histories challenged us to communicate well with staff, investors and other stakeholders. I think there's nothing worse than staff hating uncertainty as to what's happening. You need to make plans clear.

Philippe De Backer: In terms of consolidation trends in the region, what do you see? Do you see Emirates NBD as having a competitive edge by virtue of having the experience, human capital and ability to duplicate what you have already done?

Consolidation is always talked about. I think it's probably more challenging across the GCC than it looks at first sight given complex political and shareholder issues. You never know when it will happen. When I was in the region in 2000, Emirates Bank and NBD were talking about getting together. It's like the Berlin-wall story. I was in Frankfurt when it came down and three weeks before everybody still thought it was going to be another 20 years. So you can never tell.

That aside, it's very evident that, in the past few years, a lot of new banks have been created. Getting to a certain scale will remain a challenge. In the UAE for instance, you have 22 banks involved

in retail banking with a relatively small population. So, if you're looking at the statistics or the numbers game, it's pretty cutthroat.

I think the story from our side is we've done an awful lot of work to get ourselves in an advantageous position. I do anticipate more consolidation and I think we've given Emirates NBD a platform from both an IT and a general infrastructure perspective to be able to look positively at opportunities.

Philippe De Backer: Can one consider, instead of mega-consolidation, expansion through M&A in specific business lines such as asset management or private banking?

Absolutely, I think that's the beauty of the network that we have. We have such a diverse financial services network from asset management to Islamic banking to card processing upon which we can expand. There are many potential opportunities. In the eyes of the market, I think, we are a bank that has successfully been through the merger integration process and therefore technically has the knowledge to go further in this space.

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