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Market Rationalization in the Middle East

The banking sector in the Middle East has enjoyed a steady recovery and will post solid results in 2018. The Governor of the Central Bank, Mubarak Rashed Al Mansoori, emphasized that the industry is liquid and strong, with credit growth for the private sector increasing 6.5% during the first 9 months.

However, the region, specifically the United Arab Emirates (UAE), are deemed to be overbanked. The UAE, which has a population of just under ten million people, currently has 51 local and international banks serving the market. While the economy is still growing faster than most western countries, the question of how sustainable such a diverse network can be in the long-term remains.

What's happening in the market?

Large banks vs. regional banks
There are currently merger dialogs going on between banking entities in Saudi Arabia, the United Arab Emirates, Oman, and Qatar. These talks all have common themes and are bolstered by the recent successful creation of First Abu Dhabi Bank from two smaller entities.

Simply put, size matters in this market. The larger banks are better positioned for the future and more equipped to absorb the ups and downs of this regional roller coaster, where the economic fortunes of the banks are closely linked at a macro level to the price of oil and government spending patterns.

The regional banks are also dealing with increasing costs bases to keep up with rising regulatory burdens. Saudi Arabia's regulatory agenda continues to grow because of the country's Tadawul exchange moving from frontier status to emerging market status. This shift led to a capital in-flow, while at the same time heightening the need for transparency and better governance.

The impact of technology
Regardless of size, all banks are desperately scrambling to invest in technology in order to grab a share of the ever-expanding youth market. While the region certainly has familial wealth, more than 60% of its population is below the age of thirty. It is this burgeoning youth demographic, where mobile penetration rates are among the highest in the world. Banks are therefore under pressure from digital disruptors and the governments themselves to embrace all things digital. The UAE, for example, has stated its goal to be a cashless society by 2023. With the present considerable wealth and ambition of the federal government, banks must be ready to embrace the digital world.

A growing Islamic banking sector
Lastly, while the traditional retail banking sector will see private sector credit grow by 6.5% in 2019, the Islamic banking sector is growing at 9% per annum. This specialist sector now accounts for 20% of the local UAE banking

market. Interestingly, several of the mooted mergers see non-Islamic banks strengthening their appeal by coupling with Islamic banks.

Preparing for mergers and acquisitions

With all this market activity, the HR community is seeking advice on how to prepare for being on the acquiring or acquired side of the mergers and acquisitions equation. While financial gains tend to be the primary driver for mergers, the resulting costs and implications can be far greater than simple economics would suggest. In many cases, human capital—the people who comprise an organization—is just as important as calculating traditional capital assets to understand the true value of a deal.

Having the right levels of HR involvement can reduce costs and ensure that cultural and organizational integration runs smoothly. However, if the human element is neglected, initial costs could increase and strategic intentions of the deal could also fail to materialize. So, what role can HR play in the success of the proposed M&A deal and why is it important to quantify the value of human capital? Organizations that fail to consider how employees factor into M&A, both in the valuation and post-merger phases, can risk potential under-evaluations and talent drains.

An M&A deal may seem to make perfect financial and strategic sense, but the organizations involved also need to assess and manage integration and the complexities behind it. This goes beyond systems, processes, and operations. Companies are only as good as their people, so making the most of talent on both sides of the deal can be just as critical as other strategic assets. A successful M&A transaction requires identification of potentially damaging talent flight and the proper alignment of rewards with organizational success.

How can businesses plan for a smooth organizational and cultural integration following an M&A deal? Below, we've outlined eight clear points to help get your internal conversations off the ground.

Factoring in the human capital elements of M&A in 8 steps

While there is no magic formula to ensure a successful post-merger and acquisition integration, businesses can take several steps to better understand the people aspect of a deal:

1. **Assess cultural differences:** Possibly one of the biggest mistakes companies involved in M&A make is their heavy focus on similarities and differences between the organizations' cultures. Focus instead on creating a combined culture with elements from both firms that can help execute a winning strategy.
2. **Include the cost of integration:** Organizations repeatedly neglect sufficiently estimating the costs of integrating employees and teams in the deal model. As a result, businesses don't always allocate the right budget to successfully blend disparate organizations, cultures, and systems. Involving human capital experts early can help price the deal appropriately, allowing you to achieve the strategic intent of the transaction.
3. **Factor in benefits:** It's not just the cost of physical integration that needs to be considered. Buyers also should evaluate the target organization's compensation and benefits programs to quantify financial liabilities. Start by preparing an inventory of everything you must conduct a side by side analysis. The analysis should cover elements ranging from grading systems to vacation allowances.

4. **Prioritize change management:** Firms often overlook the fact that a successful merger requires access to the appropriate management resources. By designating in-house experts who understand the strategic vision of the deal as ambassadors, businesses can create tools for change management. It's important to note that there must be accountability in the integration process, and all employees should be aware of who holds the authority for strategic decision-making. Successful HR leaders should remain proactive and take the initiative to create a plan now.
5. **Consider legal obligations to staff:** Employees' rights can have a significant influence on whether a deal is successful. What actions will you take if redundancies are necessary? Are you prepared and can you quantify the cost?
6. **Address employee concerns:** M&A inevitably leads to job losses. Simply knowing that they have a job in the new organization is often not enough to satisfy the needs of many employees. During an M&A deal, first and foremost, people look for safety and security. They ask themselves, "Do I have a job in the new company that can sufficiently provide for me and my family?" As companies talk about the new organization, people also need to understand what's in it for them. Be proactive on this front and get ahead of this now.
7. **Communicate, communicate, communicate:** Businesses often fail to understand the importance of openly communicating with employees during a merger. Connecting with leadership becomes one of the key drivers of employee engagement during a change like this. Uncertainty makes people want to know who their leaders are, if they are worthy of followership, and how they will make decisions.
8. **Seek advice:** Organizations that fail to seek advice on M&A issues are often guilty of trying to reinvent the wheel. Getting assistance from third party firms or using individuals that are experienced in how these processes work can save valuable time and resources. Doing so will also help you identify issues before they become problems. Without the proper guidance, your business will be at risk and even close to possible failure.

Maximizing the impact of HR in M&A

HR should play an important role in the process of determining the quality, capability, fit, and valuation of its new and existing human assets. After all, human capital is often a large component of what the firm is buying. By fully considering the people aspects of a deal, organizations can gain an invaluable employee endorsement for the new business and its strategic vision, enhancing the chances of success. Given the number of mergers anticipated for 2019 in the Middle East, our regional HR community must start following the longstanding motto, *Be Prepared*.

To learn more about future market activity in the Middle East and how to prepare your firm for possible mergers and acquisitions, please contact our team.

Author Contact Information

Martin McGuigan
Partner, McLagan
Aon
+9 714 389 6355
martin.mcguigan@mclagan.com

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