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The Model

A valuable executive tool to examine the profit dynamics of a bank is the "Asset Radar". In general terms, the radar depicts how much operating income a bank generates from its assets (Return On Assets - RoA*), versus how much these assets cost the bank to acquire and maintain (i.e. Cost Of Assets - CoA*). The larger the spread between the two ratios, the more profitable the bank is.

Simply put, a bank of an RoA of 1.5% and a CoA of 0.5%, asserts that for every dollar of assets the bank holds, the bank generates 1.5 cents in operating income, and spends 0.5 cents of expenses to originate, maintain and protect that same dollar of assets.

The diagram depicts the "Asset Radar" for Key 9 saudi banks during the period 2019 (Orange Color) to 2023 (Blue Color). Each data point represents the performance of a specific bank in a given year. Banks are anonymously tagged as B1-B9.

This 4-year period hosted a replete of mega events- rise and set of Covid-19 health care crisis, the peak of Vision 2030 rollout journey and the swing from "*Quantitative Easing*" to "*Inflation Brakes*".

The Catch

The diagram demonstrates – among other observations - a deterioration in the RoA indicators across most Saudi Banks compared to 2019 levels!

Specifically, on the horizontal axis of RoA, banks generally migrated from East to West during the period 2019 - 2023. The weighted average RoA of the 9 banks examined dropped from 4.1% (in 2019) to 3.6% (in 2023).

This 12% drop intriguingly comes in contrast to some economic tail winds during the same period. To name a few-

1. The average oil prices** in 2019 were $57-61 per barrel, while in 2023 it climbed up to $77.6-80.26.
2. The double-digit growth in KSA visitors reaching circa 27 Millions in 2023.
3. The KSA public revenues** in 2019 were SAR 975 Billion, while in 2023 it climbed up to SAR 1,200 Billion.
4. The fed rates** in 2019 swung between 1.5-2.25%, while it shot up in 2023 to 4.5-5.5%.

This observation holds true despite the latest surge in profits reported by most banks. Such growth was often expressed in absolute value compared to last year, not as a return on asset!

The Bright Spot

Despite the drop, Saudi Banks are generally frog leaping their global counterparts, considering the former's inherent focus on national and regional sectors.

The 2023 RoA ratios of global banks - *re-calculated in line with above diagram* - were: Bank Of America (0.9%), Citi Group (0.53%) , Barclays (0.44%), JP Morgan Chase (1.59%), Development Bank Of Singapore (1.26%), HDFC India (2.57%) and Bank Of China (1.34%), to name a few.

The SAR 2 Billion Opportunity At Hand

Should the Saudi Banks take advantage of the economic tail winds and claw up to the weighted average RoA of 2019, then saudi bank can collectively generate an additional SAR 1.9 B in operating income without having to increase their asset bases, at least theoretically!

Alternatively, should saudi banks continue their organic asset growth march while restoring the 2019 RoA levels then, the additional operating income opportunity manifests in a whopping SAR 2.07 B.

Simply put, Saudi Banks can sweat their assets further to the benefit of shareholders taking a 2-prong approach of- Asset Growth and RoA Growth.

The Next Step

Seasoned bankers know too well that sweating an asset base is a “*Devil In The Detail*” game of "Asset Liability Management", "Pricing", "Micro-Segmentation" and "Field Work". However, the journey is worth the effort as demonstrated above.

In our part 2 of this 3-part series, we will delve further into the various revenue dynamics of the Saudi Banks during the same period.

Stay tuned!

Notes:

* This article is based on the calculation of RoA as Operating Income / Total Assets, and CoA as Operating Expenses (Including Provisions) / Total Assets

** Sources: Published Banks Financial Statements, Bloomberg, MegaTrends, KPMG, Forbes, KSA Authority Of Statistics and OilPrice.

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