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Advisory

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Globally, Hummus had its allure as a staple delicacy of the Middle East. Yet, the name itself is not necessarily a guarantee of a favorable culinary experience, once you pick-up a Hummus ramekin off the shelf of a supermarket or a food store.

Similar to Hummus, we at Alberta Advisory hypothesize that Neo Banks in the Middle East may have their culinary lapse as a viable mid-to-long term unique business model given the circumstances of the region.

Before we dig in, we caution that our article is not meant to throw a "*Wet Blanket*" on the regional achievements such as- STC Pay (or Bank), Fawry, Tabby, Paytab, etc.

Rather, we surmise that the majority of Neo Banks will eventually parish, morph into classical banks and/or stay trapped as payment acquirers / processors with few value-added services and diminishing margins.

Now let's roll out the dice on our earlier hunch.

FUNNY ECONOMICS

The leading economies in the Middle East in no particular order are- KSA, UAE and Qatar. The average GDP per capita across these economies is USD 54 K per annum.

Hence, assuming that the best Net Interest Margin is 4%, the "Service Debt Ratio – SDR" is 40% and the average Merchant Discount Rate (MDR) is 2% then, we can easily calculate the average income per customer of a bank (whether *Neo* or *Classical*) as-

1. Interest Income = GDP Per Capita X SDR X NIM = ~USD 860.

2. Non Interest Income = (1 – (GDP Per Capita X SDR)) X 0.02 = ~USD 650

The average annual income per client is USD 1,500 at best. The above layman calculation embodies many assumptions that are not congruent with Neo Banks. Let's examine few-

1. The client is a white-collar averagely paid and employed person. In contrary, many Neo Banks appeal to teenagers, students and non bankable low income population.

2. The bank has acquired 100% of the client's annual income and banking transactions. In contrary, Neo Banks gravitate towards low value, low risk transactions such as- current accounts, digital payments and short-term personal loans.

3. The bank has no capital constraints and operates as both Card Issuer and Payment Acquirer. In contrary, Neo Banks typically focus on Card Issuing and waive many fees to lure in clients.

IRRELEVANT SOPHISTICATION

Neo Banks often differentiate their offerings through reduced fees, easy onboarding, a plethora of white labeled offerings (e.g. brokerage, insurance) and joyful user interfaces.

That level of sophistication is irrelevant to many customer segments, especially in the "*mass affluent*" and "affluent" segments. These segments already enjoy upscale services from their classical banks and typically revert to Neo Banks for marginal services such as- "Buy Now Pay Later", "Parentally-controlled eWallets" and "Paying For Errands".

Many Neo Banks executives told us that customer loyalty is not that deeply rooted and old playbooks are still in full swing. Depositors would flee to higher rates, flexible withdrawal options and cross-currency arbitrage. Depositors do not care if you are a *Dinosaur* Bank, a *Progressive* Bank or a *Neo* Bank.

For instance, in Hong Kong, the eight virtual banks collectively lost an average of $148 million each between 2020 and 2022. Their combined customer base reached 2.1 million in the first half of 2023, but the annual growth rate decelerated from 200% in 2021 to 28% in 2023, according to EuroMoney.

In 2024, the Earning-Per-Share (EPS) of main Hong Kong Banks, namely- ZU Bank (800 K customers) and AirStar Banks (> 2 Million Customers), dropped year-on-year by 85% and 27% respectively.

CROWDED SCENE

The KSA Market is often considered the jewel of the crown across the Middle East in terms of- GDP Size, Native Population and Economic Diversity. In 2024, KSA had +200 FinTech companies, +35 local and international banks, +50 money exchange companies and +30 registered stock brokers.

KSA's largest FinTech (STCPay) is transforming into a Neo Bank (STC Bank). In the past 4 years, unsolicited reports circulated that the company is valued at USD 1 B and holds 12 million customers. Using a reverse DCF 5-Year estimation model, we could foresee STCPay generating USD 15-20 per customer per annum. This is a measly wallet share compared to our "*Funny Economics*" above.

LIMITED POPULATION

Except for Egypt (115 Million), countries in the Middle East are not as populous as other parts of the world. You can easily ponder how much did the large China population (1.4 Billion) and protective regulations contributed to the success of the Ant Group. Or perhaps the population of Brazil (210 Million) to the success of NU Bank.

Egypt's largest FinTech is Fawry, reported in Q1'2024 an "eye popping" active customer base of 51 Million. Yet, the quarterly gross profits were circa USD 14 M. Hence, the average annual yield per customer is USD 1.1.

You know what's coming! Compare the USD 1.1 to the "*Funny Economics*" above. It seems that what Egypt makes up for in terms of population, loses on in terms of yield per customer.

MIGRANT LIQUIDITY

The GCC region is bustling with working expats who are used to wire a hefty portion of their monthly earnings back home to support their families. The annual remittances outflows is estimated to be USD 45 B for each of KSA and UAE in 2024. While regional Neo Banks swagger on their market share of these remittances, little they track the lost income opportunities associated with this migrant liquidity, should it be re-invested locally!

Let's revert to our "*Funny Economics*", the USD 90 B migrant liquidity could generate USD 2.5 B of interest and fee income per annum.

Thanks!

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