



Analysis of the Hindering Factors of the Iraqi Banking Sector

Introduction

The widely accepted role of the commercial departments in a bank is to provide the financial and banking facilitation to enable businesses to operate by making payments to suppliers and receiving funds from clients to enable them to grow by providing financial support.

This article looks into the facilitations that any business would require to meet their banking needs, It would also look into their availability and accessibility in the banking sector.

This article uses the PESTL tool to analyze and identify the obstacles from industry-wide to give the readers a good understanding, it, also, uses Porter's five forces tool to analyze an anonymous bank that operates in Iraq.

Background

The banking sector before 2003 was set up and controlled by the government through the Ministry of Finance with six main banks (oligopoly).

However, each of these banks has a role and they do not compete or operate cross departments, such as the trade bank's role is to provide support to trade activity, while the agricultural bank's role is to support the given sector

All these banks' actual role was to deliver the government schemes, these banks depend purely on the government support that also includes paying their salaries (to date).

This led to the lack of improvement and growth of this sector as there was no competition or requirement to improve the services, as well as the lack of demand due to the sanctions that the country endured from 1990 to 2003.

After 2003, the Iraqi economy was about to open up to become a free market, hence we have seen a sharp increase in imported goods floating the Iraqi market from many parts of the world.

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Furthermore, we have seen an increase in the number of international companies entering the Iraqi market and an increase in the number of SMEs and startups, which requires the availability and accessibility of banking services.

The limits of the banking sector in Iraq have held back many of these companies from growing and developing, which in return negatively affected the market and the different industries.

Small and Medium-Sized Enterprises (SMEs)

To the author's knowledge, no bank in Iraq has a portfolio to manage commercial accounts or business banking departments. To elaborate, the specialist department requires to provide the staff and account managers with a specialized focus and to enable them to have a good understanding of the business needs. As the staff expected to be trained and knowledgeable of the business, local economy, and banking services. Thus, they would become a trusted advisor to the business.

Furthermore, if the account manager has a good understanding of the business, he/she would be able to spot growth opportunities and provide banking solutions.

The facilitation for SMEs would become more complicated depending on the complexity of the business, but for basic SMEs, the requirements would depend on the level of the operations and the size of the business, also if the business is trading at local, national, or international level.

Facilitations

A table of services and products available to SMEs in the UK by high street banks is provided below, this would be used to examine the products and services availability in the Iraqi banking sector.

Making and Receiving Payments	Cash Flow	Loans for Growth	FX Services	Services
Bank Transfer	Trade Facilitates	Commercial Mortgage	Spot Rate	Branch Services
International Transfer	Invoice Finance	Business Loan	Forward Booking	Advisor Service
Cheque	Overdraft	Asset Finance	Currency Payments	Telephone Banking
Cash	Revolving Facilities		Currencies Accounts	Internet Banking
Card Processing/ Debit and Credit	Credit Card			Mobile Application
Standing Orders	Corporate Card			Support Team
Direct Debit				

Table 1 Banking services and facilitations: designed and completed by the Author.

In Iraq:

Payment solutions: Some of the payment solutions are available to SMEs in Iraq but others such as standing orders and direct debit are not available to date.

Cash flow: this service is not available or very limited to SMEs except for some of the trade facilities such as a letter of credit.

Loans: are available but not designed for SMEs' needs.

FX Services: only available for currencies account, spot rate and forward booking are not available.

Services: are kept at a minimum and enhancement is required.

The Factors

This article aims to look into the factors that impede the banking sector from providing SMEs with the services they need at a macro level represented by the country and the banking sector, and micro-level at an unnamed bank using PESTL and Porter five forces as a framework.

Macro-Level Analysis

PESTL tool is used to analyze the banking sector at a macro level with a high level of details that is likely to be known to the sector and for those who are interested in banking. In this section, the article aims to have an unbiased view of the issues and what has been done or in the process to resolve them.

Economical Factors

The Economy after 2003 was expected to be an open and free market, which to some extent it was when compared to the past decades. However, the government still controls the majority of the economy starting from the main six banks to all services provided.

The state-owned banks mainly Al-Rafidainn and Al-Rasheed hold the majority of the government deposits (liabilities) and facilitate the majority of the government loans. However, for international trade, the Trade Bank of Iraq (TBI) has taken this role.

As of 2020, 72 private banks operate in Iraq (CBI, 2020). Nevertheless, these banks have a small role or scope of operation for many different reasons which this article will discuss further in the micro-level analysis section.

Social Factors

The Iraqi society is rich and cosmopolitan and the majority of the nation is young. However, society depends heavily on public sector jobs, and they do lack trust in the banking sector.

That being said, for religious reasons, there are 29 Islamic banks in Iraq (Sharia banks) that provide banking services meeting the sharia requirements (CBI, 2020).

Trust is a major issue between the public and the banks across the country, the public does not trust the private-owned banks as they think they are unreliable.

However, recently the central Bank of Iraq (CBI) formed The Deposit Guarantee Company, in this article we would refer to it as (DGC) that has started operating in December 2020, the role of DGC is to enhance the trust relationship between the banks and the public by guaranteeing the deposits of the bank customers.

Technological Factors

Iraq still encounters many technological issues hindering its progress to date, starting with poor infrastructures such as electricity shortage and poor internet facilities, Iraq was still using the third generation of telecommunication (3G) until very recently. The fourth generation was introduced in the beginning of 2021.

In the banking sector, the issues are grave, as there are no FX market, credit reference agency, cheque clearing system, nor payment systems such as standing orders or direct debit collections. While cash machines numbers are very low. Also, there are no international payments nor debt collection agencies.

Front-office technology: full on-line banking, telephone banking, investments risk advisory, money transfer, and other enabling technology.

Back-office technology: such as account opening, monitoring and screening technology, annual account analysis, risk rating, and many others.

Furthermore, banks are unable to access the required information such as land registry and companies registry records.

Legal Factors

Although the legal frame in Iraq is considered good and meets the minimum standard, however, the main issue is the law enforcement regarding companies registration requirements, accounts reporting law, tax reporting, and VAT collections.

It is quite known that a very low number of businesses are registered as companies in the registrar of companies due to the tedious procedures, which leads to only a few companies having accounting and tax reporting records.

The facilitation for SMEs would become more complicated depending on the complexity of the business, but for basic SMEs, the requirements would depend on the level of the operations and the size of the business, also if the business is trading at local, national, or international level.

Micro-Level Analysis

In this section this article uses Porter's Five forces to analyze the challenges facing a given bank, it uses an unnamed private bank, as this article believes the same issue applies to the majority of banks, hence not using a specific bank. Moreover, with each element of Porter's Five Forces, this article highlights the challenges and what could be considered as solutions to overcome these issues or threats.

Power of Suppliers

The main player in the Iraqi banking sector is the government as it holds the majority of the cash and only uses state-own banks for deposits, which is a disadvantage to the private banks competing with state-owned banks.

Other suppliers have strong powers, such as corresponding banks for international payments, international referencing agency for anti-money laundering (AML), and name screening. These agencies have the power of knowledge and information but for known and unknown reasons they do not supply or work with Iraq.

Possible solutions

Private banks should not depend on the cash liquidity supplied by the government. Instead, they should encourage the public to open bank accounts and savings accounts, as this would increase the liquidity in the banks. Currently, only 25% of the Iraqi people have a bank account (IEN, 2020).

The banks in Iraq should come together and use the power of buyers to encourage these providers to support Iraq in increasing its capacity which would not only benefit the Iraqi banking sector but also their partners too.

Power of Buyers

The buyers in the banking industry are the customers who in simple terms would like to use saving and investment facilities or borrow funds. The customers have several options to choose from which include a large number of high street banks including state-owned and Islamic banks.

The customers seem to have a long life memory and experience with the state-owned banks. Thus, individuals would choose them over new banks, mainly since they believe they are more trustworthy.

Possible Solutions

Banks should increase the awareness of the bank facilitates and build trust with the new generations, create bespoke products that meet their requirements, such as online banking accounts, multi-currencies accounts, providing debit cards, develop partnerships with retail shops and mobile phone networks providers, or even service providers such as transportation services.

That would attract new customers, increase their trust in the banking sector, and enable them to build a strong and sustainable relationship with banks.

The Threat of Substitutes

At many levels, people seem to use substitutes to banking facilities, such as using Bureau de Change for money transfer and foreign exchange and borrowing from friends and family.

Possible Solutions

The banks should enhance and increase their services to meet the customers' requirements and needs. The procedure of opening a bank account should be simplified especially for those who never had banking experience before to increase financial literacy. Additionally, banks can increase their market share, they should reach out to the wider public, by opening more branches and increasing the number of cash machines.

Banks can also appeal to younger generations by reaching out to university students to open a student account and have a mobile branch that can go out to the markets and high street shops to encourage them to open a bank account.

New Entry

The barriers to enter the market are considered to be low and this has been exhibited by the number of banks that are already operating in the Iraqi market which approximately reached 74 banks.

Possible Solutions

The CBI could look into changing the requirements to enter the industry and encourage the existing banks to merge to form a stronger bank. As for the banks, they should look into improving and enhancing their products and services to raise the bar for the new entries.

Rivalry Among Existing Competitors

It is only fair to say, that the competition in Iraq is not fair, since state-owned banks control the market by far and have almost 90% of the market share which only leaves the others with just about 10% of the market shares. In addition, the government which is the main buyer and supplier only relies on state-owned banks.

Nevertheless, the competition among private banks is very low as they have not differentiated themselves yet.

Possible Solutions

The government should start to look into reforming the state-owned banks to enable fair competition in the market which would benefit the industry regarding its performance and the quality of its services.

As for the banks, they should differentiate themselves and provide services and products that meet the customers' needs.

Other Challenges

- **Accounting:** The banking sector in Iraq is weak and requires further enhancement and to move from reporting activities solely to providing consultancy for SMEs such as business planning cash flow, forecasting, and tax planning.

- **Human Capital:** the industry expanded very quickly but without having the skilled human capital or trained staff to enable them to meet the objective of the banks.

The solution to this would be by establishing training facilities which would be in charge of providing training in commercial banking, investments, advisory services, customer service, and so forth.

- **Trust:** is a big challenge for all banking sectors in the world. Iraqi banks should prioritize enhancing their products and services to meet their customers' needs and provide them with great well-rounded banking experiences. Moreover, educate the customers of the DGC and insurance facilities, thus having more trust in the banking sector.

Encourage the customer to provide feedback and establish a framework to enable them to raise their concerns and report issues. This way, the customer would trust their banking provider and feel secure about their savings.

Conclusion and Recommendations

As discussed in the macro and micro analysis sections, there are no differences in the basic banking services between the personal and commercial facilities and the challenges that both departments face.

Although, the SMEs would require more understanding of each business to enable the banks to provide them with better banking solutions that meet their needs.

It is only fair to say that the Iraqi banking sector has been through a very long and challenging journey that has witnessed improvements yet to meet the high expectations and customers' needs, the banks need to increase their efforts to enhance and improve their products and services.

Thus, many factors hinder the banking industry from providing the services and products some of them are out of their control but many within their given, and some of them would be a great growth opportunity as discussed in this article.

Recommendations

1. Establish a banking training facility to provide the banking staff with training and education.
2. Establish a regulated FX market.
3. Enforce the law of competition through the CBI.
4. Build trust with the customers by educating them. Remember they are not bankers.
5. Establish a relationship with the International banks to gain knowledge and expertise and learn from their experience to enhance the technologies used.
6. Raise awareness of the CBI schemes such as salary domiciliation, the Deposit Guarantee Company, and the Tamkeen initiatives to support projects.

References

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