Pakistani's Banking Sector Privatization Experience

By

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Submitted to: Professor Jin Park
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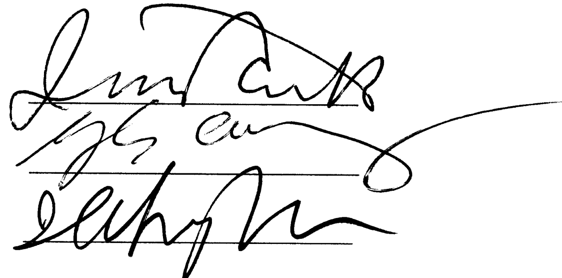

ABSTRACT

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Since at least early 1980s, privatisation has been a popular economic tool and a recipe to ameliorate and rejuvenate the inefficient public sector. Pakistan rode the band wagon and over the successive years, witnessed perhaps the most successful privatization programme in the entire region. Much of this success story was due to the privatization of the banks which showed a palpable improvement in their post privatization history. The paper will try to analyze this generic perception on the basis of professional economic indicators. It will be followed by recommendations and policy guidelines to preempt any complication possibly be faced by anyone contemplating such exercise.

My mother and my wife whose incessant prayers and support never failed me

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TABLE OF CONTENTS

1.	Introduction	01
2.	Privatization In Financial Sector	02
3.	Literature Review	06
4.	Methodology/Research Method	11
5.	Analysis	16
6.	Results	26
7.	Conclusion and Policy Recommendations	29
	Exhibit	31
	Bibliography	33

LIST OF TABLES

1. Banks privatized in Pakistan 5
2. Capital to Risk Weighted Assets (percent) 20
3. Deposit Growth of various banks 23
4. Loan/Deposits 24
5. Bank Indicators 28
6. Growth of ATM 29

LIST OF FIGURES

1. Assets Shares 16
2. Capital Adequacy Ratios 18
3. Profiles of Banks 19
4. Ratio of earning assets of total assets 21
5. Assets Quality of Banks 22
6. Group wise liquidity ratio 25
7. Profitability 26

Pakistan’s banking sector privatization experience

Introduction

Jason defines the Privatization as the incidence or process of transferring ownership of a business, enterprise, agency or public service from the public sector (the state or government) to the private sector (businesses that operate for a private profit) or to private non-profit organizations. In a broader sense, privatization refers to transfer of any government function to the private sector - including governmental functions like revenue collection and law enforcement. (Jason 2009).

Privatization has been an important economic tool in many developing as well as developed economies. While its actual history goes back to Ancient Greek City States, the modern ideological basis was provided by Washington Consensus(1989) which stipulated ten recommendations to salvage the crisis-wracked developing countries by Washington, D.C.-based institutions such as the International Monetary Fund (IMF), World Bank, and the US Treasury Department. As observed by Dani Rodrik, Professor of International Political Economy, Harvard University “Stabilize, privatize, and liberalize" became the mantra of a generation of technocrats who cut their teeth in the developing world and of the political leaders they counseled. This ideological basis was given a practical shape and a wide currency by Margaret Thatcher in the UK and Ronald Reagan in the USA, The crowning achievement was privatisation of British Rail in 1993 by Thatcher's successor, John Major.

The Pakistan’s privatisation was started in late 1970s but was given a real impetus in

the mid-1980s and was formally institutionalized in 1991 with the establishment of Privatization Commission. Since then, it has been a bipartisan policy and each political party regard less of its ideological underpinnings is a consensual supporter of privatisation programme. The inefficiency of public sector and the frequently occurring fiscal hemorrhage has led the economic managers to look towards private sector as a key engine of macroeconomic growth. This in turn has necessitated the establishment of a strong regulatory regime to prevent the unbridled profit oriented economics of the private sector. Pakistan has run a successful privatization programme since late 80s.The programme has been multi-sectorial encompassing industrial units, oil companies, infrastructure, financial sector and telecom sector. While financial sector has been a success story in terms of improved banking services, enhanced revenue and deposit generation, strengthening and deepening of capital markets etc. However infrastructure especially the electric supply has been a mixed story. While the privatization has prevented the fiscal bleeding, there has been no improvement in service. The Thesis will attempt to analyze the overall effect of privatization of banks on their performance as well as overall effect on economy. By extension, it will also try to prove that private banking sector is more efficient than the public one.

Privatisation in financial sector

With the coming in power of Pakistan People's Party (a party with a clear leftist leanings in 1972, there was a wide wave of nationalization. Under Economic Reform Order 1974, the Government nationalized the commercial banks with the main purpose to finance the industrialization development which the government was envisaging as its policy cornerstone. The result was that by 1980s, the share of Nationalized Commercial Banks (NCB) in the entire banking sector was 90%.The central bank of the country, State Bank Of

Pakistan (SBP) had a limited regulatory role with a resultant almost complete subservience of the government's monitory policy to the whims of government .An imprudent lending was resorted to with a result that the government had to make periodical recapitalization of the banks. Taking stock of this situation and with the assistance of the World Bank's Financial Sector Adjustment Loan (FSAL), there was paradigm shift in the politico-economic ideology and it was decided to privatize the NCBs toward the end 80s.

The Banks privatized during this period include Muslim Commercial Bank (MCB), Allied Bank Of Pakistan (ABL), Habib Bank Limited (HBL) and United Bank Limited (UBL).These banks were privatized between 1991 to 2007 through various modes including open bidding limited to prequalified bidders, divestment along with management transfer, Initial Public Offering (IPO),Secondary Public Offering (SPO) and Global Depository Receipts (GDRs). It may be noted that between 2002 and 2008 the Pakistan's privatization process had been extended to an additional bank.

The Allied Bank's privatization needs a certain elaboration here because it is ultimately going an insight for making impact evaluation towards the end of this study. It was privatised in 1991 through selling to an employee management group. Subsequently there took place a split within the group, aggravating gradually, and culminated in the mutual litigation process. The top management witnessed their hiring and firing being done on political whims of the ruling parties. The State Bank intervened removing four top executives and two senior officials from the ABL and were declared unfit for employment in any bank for life. But this was too little and too late. No action was taken against a business group that was trying to lure the employees to sell their shares so that the group might be get management control. The ultimate outcome was a huge loss to the bank that even exceeded the privatisation

proceeds. The original causality of this episode however was the privatisation itself because it vividly vindicated all their concerns about the process. As a matter of fact the privatisation of the Allied Bank proved to be even worse than public sector ownership. The privatizing authorities should always aim to "transfer the majority shares to a private sector financial institution through competitive bidding process" (HussainDr 2006)

One glaring feature of Pakistan's privatization programme as it progressed in post-2002 period is what they call "Privatization for People". The government's aims to make the general public partake in the benefits of privatization thereby executing a series of Public Offerings. They may be surmised as under;

Bank name	Sale price	Date of transfer	Buyer name
Allied Bank Ltd (51%)	971.6	Feb.1991	EMG
Muslim Commercial Bank (75%)	2420.0	Apr.1991	National Group
United Bank Ltd. (51%)	12,350.0	Oct. 2002	Consortium of Bestway and AbuDhabi Group
Habib Bank Ltd.	22,409.0	Dec.2003	Agha Khan Fund for Economic Development
Muslim Commercial Bank (6.8%)	563.2	Jan 2001	MCB Employees-PF & Pension Fund
Muslim Commercial Bank (4.4%)	563.2	Nov. 2001	MCB Employees-PF & Pension Fund
NBP (10%) thru IPO	373.0	Feb 2002	General Public thru Stock Exchange
Muslim Commercial Bank (6.8%)	664.0	Oct 2002	Thru CDC
NBP (10%) thru SPO	782.0	Nov 2002	Thru CDC
NBP (3.52%) thru IPO	604.0	Nov 2003	General Public thru Stock Exchange
UBL (4.2%) thru IPO	1087.2	Aug.2005	General Public thru Stock Exchange
UBL (21.74%) thru IPO	34291.7	June 2007	Thru GDR
Habib Bank Ltd. (5%) IPO	12161.0	July 2007	General Public thru Stock Exchange

In November 2003 the third public offering of National Bank of Pakistan was completed through the floating of its 3.52 shares fetching the proceeds amounting to PKR 604 million.

Habib Bank Limited was privatized in 2002-2003 by selling of its 51% equity to Agha Khan Fund for Economic Development. Subsequently its 5% shares (out of 49% shares currently held by the government) were offered in July 2007 through Initial Public Offering (IPO). The authorities in Pakistan claim this to be largest ever offering in Pakistan both in terms of value and number of successful applicants generating the proceeds of PKR 12.161 billion as against the divestment of PKR 51.75 million.

A month earlier, in June 2007, 25% equity of UBL was divested internationally through Global Depository Receipt (GDR).The processed was completed in two phases through divestments of $565.43 million and $84.81 million. According to official statistics, the GDR was priced at five times the book value per share making it highly successful when compared with similar transactions elsewhere. The complete history of Pakistan's privatization is tabulated below

The privatisation had a positive effect on the privatized banks themselves as well as it had a healthy influence on the financial sector. This paper will attempt to answer the following questions.

- What has been the financial impact of the privatization on the banks in terms of the effect on the Total Assets, deposits, advances, equity of the privatized banks? The paper will also evaluate the effect on their Profit before Tax, Profit after Tax, Return on Assets as well as Return on Equity.

- What has been the Operational Impact of privatization? What, if any, improvements in service delivery have been accomplished. Whether the banks have adopted some innovative techniques for streamlining the service quality and whether such improvements are attributable to privatization.

- Since some of privatizations were made through capital market transactions (IPOs, GDRs etc.),to what extent did the privatized banks contributed towards the development of capital markets in terms the change in their ratings

Literature review

Since the early emphasis of the governments has been on privatizing the infrastructure, most of the initial studies have been focusing on that sector. Nevertheless, gradually when the policy made a shift towards privatisation of financial sector, the area has been optimally analyzed by many experts. has aptly taken up the subject by studying the banking sector between 1990 and 2002 by using the CAMEL* Indictors for the entire banking sector , concluded that although there had been an initial low performance by Allied Bank of Pakistan(ABL) which had been sold to the employees' union the financial sector in totality showed a visible improvement. Mr. Khalid's study ended with an optimistic note since in 2002 privatisation was still an ongoing process, the future of the privatized banks had a lot of promises in its lap (Khalid in his article The Effect of Privatization and Liberalization on Banking Sector Performance in Pakistan 2006). More recently, Mr. Ainul Hassan Qureshi, picked up the thread and brought the evaluation process to 2008 (QureshiAinulhassan 2009).

The above mentioned two studies are different in way that either utilized different evaluation

criteria so that a purist reader may have some reservation about the consistency aspect. As stated above, Mr. Khalid employed the CAMEL indicators using which he attempted to develop a case for privatization through weighing it on a three dimensional touch stone constituting competition, political intervention and corporate governance. "The competition argument states that privatization will improve the operation of the firm and the allocation of resources in the economy, if it results in greater competition. Privatization can improve efficiency even without changing market structure if it hinders interventions by politicians and bureaucrats who would like to use the SOEs to further their political or personal gains. It is also argued that corporate governance is weaker in state owned enterprises than in private firms because of agency problems." The last mentioned factor implies a moral hazard and free rider problem rolled into one.

Qureshi's analysis, on the other hand relies on (a bit controversial) criteria of the Annual Reports of the privatized banks. Mr. Qureshi used the KPIs including Balance Sheet Strength, Returns on Assets, Equity, Operating Margin (net mark ups/interests against advances and loans),Risk Management etc. The study however went a step further by carrying out some hitherto unexplored evaluations e.g. the impact of privatization on employment, capital markets and building of Pakistan's Investor friendly image. While Mr. Qureshi has all the admiration for the effects of privatization on the banks, he did not evince at giving the credit to some other ancillary actors and factors. In this regard he made special mention the soundness of privatization procedures and a prudent regulatory regime employed by the State Bank of Pakistan.

While the above mentioned two studies are more important in being performed in Pakistani context, there is no dearth of studies with an international perspective. In his article,

Privatization of Public Sector Banks, Gurbachan Singh effectively countered the arguments of Mr. Mathur who had developed an anti-privatization case by emphasizing that “an important rationale for public sector banking … is to meet some social objectives like access to credit for the weaker sections of society, development of backward regions, encouraging small-scale industry.” (SinghGurbachan 2002).

Mr. Singh refuted the argument by questioning the exclusivity of banking sector to carry out this social responsibility. He observed that instead an emphasis should be increasing the Tax to GDP ratio; “taxing the relatively richer sections of the society more effectively and using the-proceeds to meet social objectives. Even if public sector banking is useful as far as social objectives are concerned, there is much more scope for policies like improvement in collection of taxes, given that the tax- GDP ratio is very small in India and that there is blatant and widespread tax evasion.”

The conclusion of an earlier study by Barth et al. had a negative slant towards public owned banks which by implication reflects a favorable opinion towards private banks (which may however may not be same as privatized banks at least in the short run) (BarthJ.R., 2001).The study which was based on the data from sixty countries found that the public owned banks does not necessarily preclude the possibility of financial crises as had been earlier defended by the so called proponents of “development view” like Gerschenkron. The latter in his study undertaken in 1962 had postulated that “governments can intervene through their financial institutions to direct savings of the people towards developmental sectors in countries where financial institutions are not adequately developed to channel resources into productive sectors.” Barth et al. (2001), however, proved that instead public owned banking sector is associated with poor performance. On the other hand the problem may be compounded by a retarded growth of the overall financial sector.

Similarly La Porta et al. found positive relationship between public owned banking and "low levels of per capita income, underdeveloped financial systems" (R. La PortaF. 2002)

W.L. Megginson has made a detailed analysis and concluded that Privatization has resulted in "clear performance improvements in OECD countries, as well as in the transition economies" (WLMegginson 2005). The study however associates the beneficial results with the selling of the banks sold to foreign strategic investors because the alternative attempts to make privatizations using vouchers-which essentially entails a continued government intervention in bank lending policies- had not been successful. The study further concluded that although a thorough privatization is the best recipe, if the government does want to retain some ownership, it should be as a "passive investor. To prevent the continuation of past credit-allocation decisions made by the government, usually on some political or central-planning basis". The study also emphasized a need to develop a bank regulatory system which must be sufficiently independent from political influence. This should be coupled with a sound financial reporting system to ensure transparency, especially with regard to asset quality and true profitability. Megginson study also underscored a need to be cautious in setting up 100% deposit insurance schemes lest moral hazard problems may not crop up. Another novel but controversial suggestion made by the study is to exhort the governments to make sales to foreign owners – particularly foreign commercial banks – "in order to attract badly needed capital, expertise, technology, and financial legitimacy."

Bonin et al. attempted to check any improvement in performance by the 10 largest banks in each of the six CEE transition economies over the period 1994–2002. On the basis of more than four hundred parameters in their database they observed a visible improvement after

privatization. The performance of privatized banks in the late 1990s is significantly better than state-owned banks and becomes comparable to foreign Greenfield banks (BoninJ., 2005).

Meyendorff and Snyder (1997) through a counterfactual approach also built a case for privatized banks. The study was focusing on the erstwhile socialist economies of Central and Eastern Europe. Since most of the governments were reluctant to break state control the study concluded that by and large the banking systems of the region remained "weak and noncompetitive. (SynderMeyendroff 1997)"

Lo´pez-de-Silanes and Zamarrita's study is important in another way because it pointed that as to how privatization should not be done. The study was based to Mexican Experience wherein the banks, earlier nationalized in 1982, were sold nine years later with the sole purpose of maximizing the proceeds. The result was the selling of banks to incompetent owners. By letting loose a highly tolerant regulatory regime the government indirectly allowed the new banks to make high profits. The resultant borrowing boom could not however conceal the inherent underlying flaws for a long time.. The devaluation of the Mexican peso in 1994 pricked the bubble to the detriment of ordinary citizen (ZamarritaF. 1995).

Brock (1999) examines the Chilean privatization experience which, though had to be preceded by re-capitalization by Central Bank contrasts quite favorably with other Latin American countries (BrockP 1999).

Gomes found a global commonality that privatisation is positivity associated with improved competitiveness .Contrary to common perception; privatization can be good source for

raising resources for governments besides being a good way of spreading the equity culture (GomesJanina 2002).

A divergent opinion has been given by Otchere (2003) who failed to find performance enhancement in privatized banks. Instead there can be frequent instances of bad loans. As a continuum of public ownership perhaps, these privatized banks are also overstaffed (ChanOtchere 2003)

Methodology

As has been mentioned above, there have been various tools to gauge the effect of privatisation of banks. In this paper, we would attempt to use the Capital Adequacy ratios, the assets quality, profitability and the liquidity positions of the various categories of the banks currently working in Pakistan. It will worth mentioning to note that in 1997 SBP mandated the maintenance of a minimum 8% risk weighted CAR in pursuance of BASEL 1 Convention thereby making the loan classification and provisioning more stringent. With concomitant achievement of capability of SBP to monitor various banks, there is little discrepancy between the factual position and the picture portrayed in the banks' financial statements.

In this regard the data of each bank from the database of State Bank of Pakistan (SBP). It will be prudent to review the basics of the concepts mentioned above.

Capital adequacy

Investopedia explains Capital Adequacy Ratio – CAR – as the one used to protect depositors and promote the stability and efficiency of financial systems around the world (Investopaedia

2007). “It determines the capacity of the bank in terms of meeting the time liabilities and other risks such as credit risk, operational risk, etc. In the simplest formulation, a bank's capital is the "cushion" for potential losses, which protects the bank's depositors or other lenders.

The commonly employed guiding force is the Basel Committee on Banking Supervision and its two frameworks; Basel Accord and Basel II, which provides for the ways to measure the risk weights. However for actual calculation of the capital, each national regulator normally its own method.

Banking regulators in most countries define and monitor CAR to protect depositors, thereby maintaining confidence in the banking system”. It is expressed as a percentage of a bank's risk weighted credit exposures.

$$CAR = \frac{\text{Tier One Capital} + \text{Tier Two Capital}}{\text{Risk Weighted Assets}}$$

Where

Tier 1 Capital is the sum of Equity Capital and Disclosed Reserves; **Tier 2 Capital** is the sum Undisclosed Reserves General Loss reserves and Subordinate Term Debts.

Risk can either be weighted assets or the respective national regulator's minimum total capital requirement. This can be measured in various ways. Khalid (2006) simplified the method by simply dividing the Capital with Liability. An attempt has been made in this study to use alternative methods. The financial indicators used by the SBP to assess the banks’ performance by using three criteria which are basically three ratios; ***Risk Weighted CAR***, ***Tier 1 Capital to RWA*** (Risk Weighted Average) and ***Total Capital to Assets.*** It is however not completely useful for this purpose for two reasons. Firstly, the Data is available from the

year 2005.The second shortcoming is that although the data does make a distinction between Public sector banks and Local privately owned banks, it does not distinguish between the banks which were denationalized/privatized and those established in private sector *ab-initio*. Given the fact that privatized banks enjoy a lion's share the private banking sector, it is still possible to get a fair idea about their relative performance even with the available data. There is however a solace even in this shortcoming. After all this study is also an attempt to establish a case for private *vis-a-vis* public sector banks

Asset quality

It is a measure of the quality of loans in terms of their propensity to be converted into non-performing loans and the likelihood of their recovery. So while Government bonds and T-bills can be deemed as good quality loans, junk bonds, corporate credits to low credit score firms etc. are bad quality loans. The relative prevalence of each category is, quite naturally, of utmost importance to banks' management.

Profitability

In our perspective, for gauging the profitability in banking business, it is the concept of economic profit which is more relevant. Besides being of value due to its intrinsic importance, the concept is also useful due to its repercussions on the capital base of a banking institution. It is measured in terms of returns on assets or capital employed.

Liquidity

A typical measure of liquidity is the ability to sell asset with minimal loss of value. Conversely an illiquid asset is the one that cannot be readily sold due to absence of market depth (the units that can be sold or bought for a given price impact) and market breadth (the price impact per unit of liquidity).The illiquidity can also be due to uncertainty about the value of an asset or the lack of its market. An archetypical scenario of such eventuality is the subprime mortgage crisis where assets' value was not readily determinable despite being secured by real property. In any entrepreneur venture in general and in financial institution in particular, liquidity can be realized by either refers to a situation where it can obtain sufficient funds, either by increasing liabilities or by converting its assets at a reasonable cost.

Currently four types of banks are working in Pakistan and the performance of each from 1990 to 2008 will be taken into account. This study however will not consider the specialized banks/Development Finance Institutions (DFIs) It is because they have been established by the government to finance certain priority sectors. The categories of banks included in this study include the following;

- **Public Sector Banks**

  The banks with the majority shareholding as well as management lying with the government
- **Privatized Banks**

  The banks nationalized in the early 70s and have been later privatized/ denationalized.
- **Domestic Private Banks**

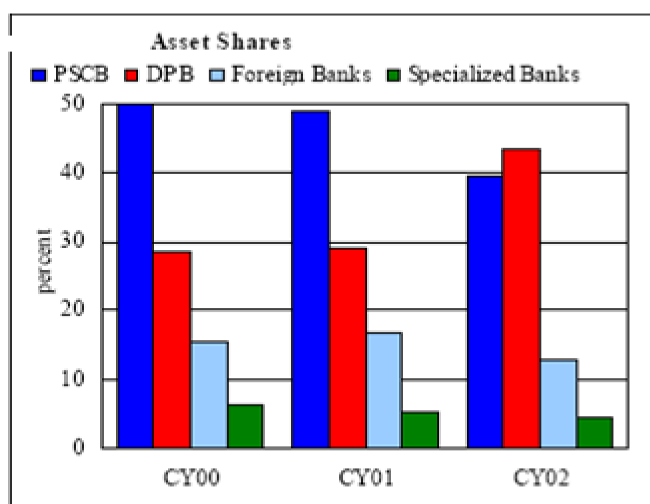
  They comprised of banks established by Pakistan's indigenous private sector as a

result of financial liberalizing measures under taken in early 90s.

- **Foreign Owned Banks**

  These banks are part of international banking houses or are owned/ managed by some non-Pakistanis.

The detailed list of banks included in each of these four categories is attached at **Exhibit 2.**By the year 2003 when privatization had been a well-established reality with HBL also taking its place among the privatized banks by December, the share of the domestic private banks displayed a visible increase (Fig 1)



Fig; 1 Source SBP Annual Report 2003 P. 101).

For the purpose of this study, this fact has an important implication; heretofore any performance indicator will be simultaneous measure of effect of privatization (*vis a vis* nationalization) as well as the performance of private sector banking (*vis a vis* public sector banking).

The study will make use of data provided for in the audited annual accounts of each banks as is available at the official website of the State Bank of Pakistan. The data available in these accounts, which are published at the end of each calendar year, will then be analyzed for parameters as explained in previous Section for the years 1990 to 2008.

Analysis

Capital adequacy ratio (CAR)

Khalid analyzed the post privatization performance of banks by simply dividing the capital with the liability (Khalidumer 2006). Scanning that way **(**Fig 2**)** reveals a downward trend in the Public Sector Banks reflecting the compliance with the overall negative performance of the Entire Pakistani banking sector with the trend encompassing privatized as well as other private sector banks (The only exception being the foreign banks which showed an enhancement in their capital base). However while in case of the privatized banks, it was the poor capitalization which accounted for the poor ratio, in case the other private banks, it the expansion of deposit base which reduced the CAR.

The trend took a graver scenario in 1997, when this ratio crossed the baseline and taking a negative sign. This can be notionally explained by the huge losses incurred by two of the largest public sector banks. Although as a result of immediate rescuing measures by the SBP there was an improvement, it was only by 2000 that this sector could reach the pre-privatization level (Khalidumer 2006).

As stated above even privatized banks could not display any enviable performance during early years when only two banks viz the Allied Bank and Muslim Commercial Bank were part of this group. This is attributable to reduction in capital base of these banks to just 1.3

percent of its liabilities as a result of heavy losses incurred by the Allied Bank in that year. The position however changed by 2002 when the well capitalized United Bank joined the ranks of the privatized banks (Khalidumer 2006).

The most impressive performance during early 90s, when the banking sector was liberalized and opened up, was shown by the Domestic Private Banks and the Foreign Banks with the capital adequacy of former exceeding that of the foreign banks. The subsequent expansion of these banks however resulted in diminishing of their capital to liability ratio to 6.1percent by 1998.

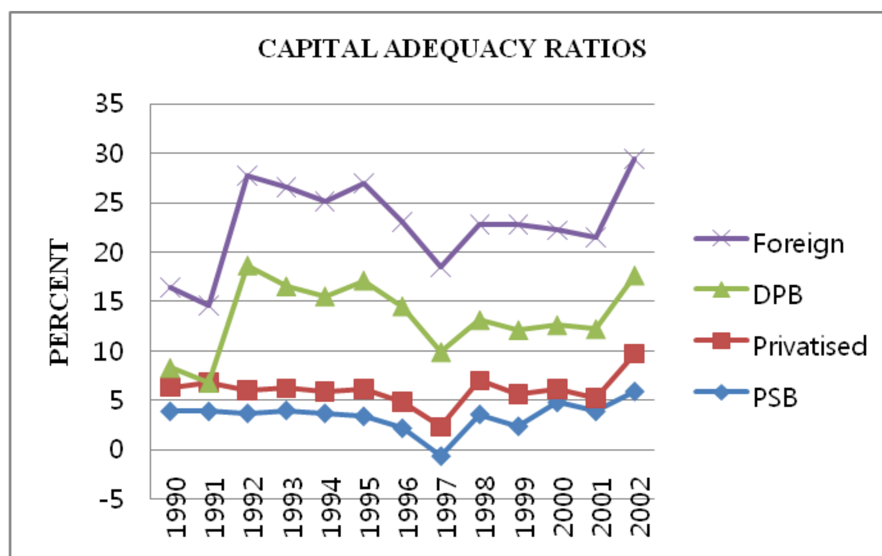


Fig 2 Source; Umer Khalid –Effects Of Privatization And Liberalization On Banking Sector p 410

They were however the Foreign Banks which surpassed all else in their capital adequacy. It did not dip below 7.8 percent in 1990 when the maximum levels attained by the public sector and privatized private banks during same period could not rise above 4 percent.

It will also be revealing to examine the trend in the capital growth (Fig 3). After 2002, there was a downward trend in all types of banks although they were still above the Tier level. It took off after 2003 attaining its maximum in 2006 (in case of private banks) and 2007,in case of Public Sector banks. Foreign banks' story however was dismal during the same period whose downtrend was much steeper. This was more so painful because it started after a miraculous start in early years of the new millennium.

Towards the end of decade, all banking sector showed an increase in the CAR, it was most impressive in the case of Private and the Foreign banks (Fig 3). The single major cause for this was the general wave of risk aversion in the entire banking sector due to the rising tide of Non-Performing Loans during the preceding years (SBP 2007-08).

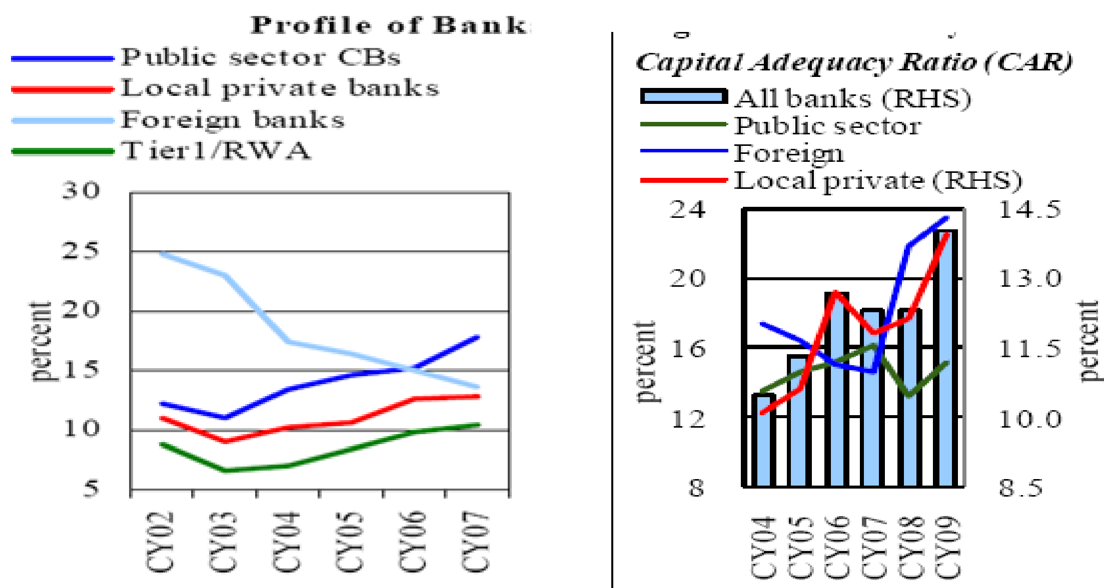


Fig 3 Source SBP Annual Report 2009

This coupled with the increased credit expansion in the public sector reduced the quantum of risk weighted assets. The banks also increased their capital base by siphoning the profits to

the bank reserves. A regional comparison with the peer countries also depicts a favorable positioning of Pakistani banking sector on the basis of this criterion.

TABLE 1

Capital to Risk Weighted Assets (percent)

	2002	2003	2004	2005	2006	2007
Bangladesh	7.5	8.4	8.8	7.3	8.3	10.0 (Dec)
India	12.0	12.7	12.9	12.8	12.3	12.6 (June)
Pakistan	8.8	8.5	10.5	11.3	12.7	13.3 (June)
Malaysia	13.2	13.8	14.4	13.7	13.5	13.2 (Nov)
Thailand	13.0	13.4	12.4	13.2	13.6	14.6 (Sep)
Indonesia	20.1	22.3	19.4	19.3	21.3	21.3 (Sep)
Korea	11.2	11.1	12.1	13.0	12.8	12.7 (Sep)

Source: Global Financial Stability Report April 2008, IMF

Asset quality

Asset quality can either be measured as a ratio of earning assets to total assets or else as a ratio of Non-performing loans to total advances. In this study we will compare the respective ratios of earning assets to total assets. Based on this criterion, the banking sector as a whole did not show any improvement in the early nineties that is in the immediate aftermath of privatizations (Fig 4). In this the most dismal performance was displayed by the public sector banks whose ratio could not exceed 80% and continued its consistent descent reaching its lowest value of about 68 in 1999.Even the subsequent improvement was not spectacular.

On the other hand privatized and still to a greater level, the private sector banks, kept the ratio at fairly higher level, the latter category even touching the impressive figure of 90 in the early years of the decade.

Ratios Of Earning Assets To Total Assets Of Pscb(Series 1),Privatized Banks(Series 2)

DPB (Series 3) And Foreign Banks(Series 4)

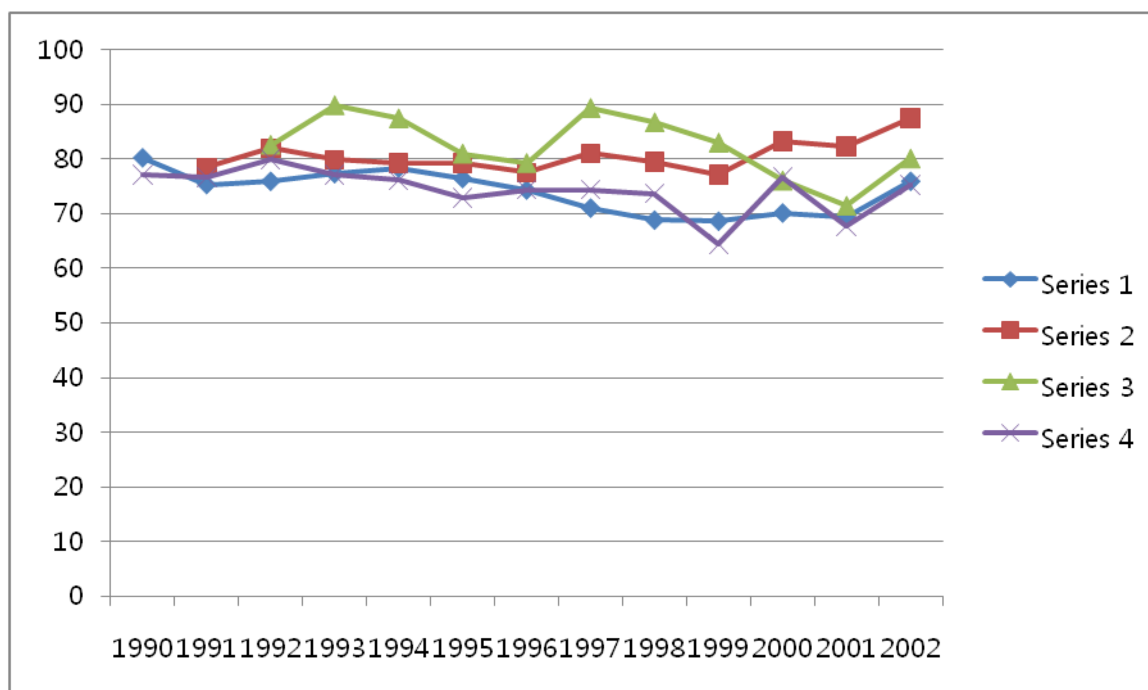


Fig 4 Source Khalid–Effects of Privatization And Liberalization On Banking Sector p 412

As far as the foreign Banks are concerned, ratio of their earning assets to total assets displayed a mediocre even if flatter trend during the decade. Khalid attributed a steep decline in the closing years of the decade to the fall in yield of government securities, which constituted ninety five percent of Foreign Banks' investments (Khalidumer 2006).

For the sake of comprehensively, it is to be noted that asset quality is also a decreasing function of the ratio of Non-performing loans to total advances. As can be seen from (**Fig 5)** the ratio was decreasing from 2003 onwards for three years implying an improvement in the

asset quality of the banking sector the main portion of which by then had belonged to the private sector.

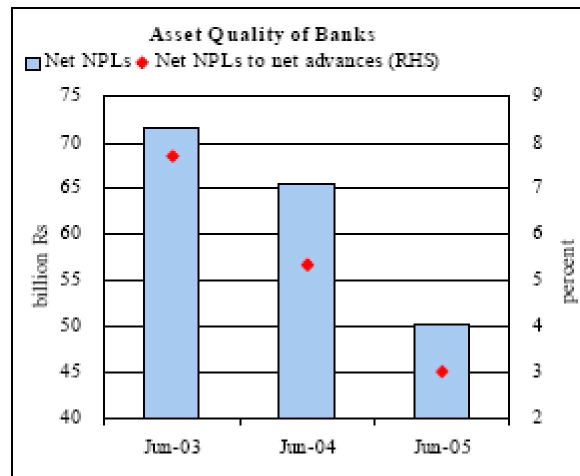


Fig 5; Source SBP Annual Report 20 P. 101.

Deposits of the banking sector

Although 2003 was a year witnessing a visible growth in the deposit growth, it was the private banking sector which was the most conspicuous in this phenomenon which showed an impressive deposit increase of Rs 195.7 billion implying a growth rate of 28.3% (SBP 2007-08).This is partly attributable to merger of some foreign banks with private banks (something which might not have been possible had there been no viable bank(like UBL or HBL) in the private sector) which resulted into transfer of deposits from foreign banks to private banks. The deposit growth is also explainable due to higher rate of returns offered by the private banks, which had been made possible only due to liberalization of the banking sector.

A natural result of deposit growth was an incentive for the private sector banks to invest in toward trade related activities, consumer financing and equity investments. By and large

TABLE 2

Deposit Growth

percent	FY02			FY03		
	Local	Foreign	Total	Local	Foreign	Total
PSCBs	18.1	-1.7	15.9	18.9	-21.9	15.0
DPBs	25.5	-4.3	21.2	35.7	-9.9	30.4
Foreign banks	6.3	-31.1	-7.7	8.0	-29.8	-2.6
Specialized banks	6.0	0.0	6.0	2.4	0.0	2.4
All banks	19.7	-13.7	14.0	25.2	-19.4	19.5

Source SBP Annual Report 2003 P. 101.

domestic private banks recorded the highest rise in net credit expansion of Rs 119.3 billion (SBP 2007-08).

Liquidity

Liquidity is a measure of possibility with which an asset can be sold with the minimum change in its value or the price. For the banking sector, it is commonly measured in terms of the ratio between the loans and the deposits. A high value naturally implies less liquidity and vice versa.

Although the entire Pakistani banking sector shows encouraging fall in the ratio the rates of falls for various categories followed different patterns. The fall was very steep for Public Sector banks from 1990 to 2003 (Table 3), it was more gradual thereafter.

In case of private sector banks, two distinct strands are discernible. While the small private sector banks' liquidity could not score a spectacular improvement perhaps due to a relatively

TABLE 3

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Public Sector Banks													
Loans/ Deposits	61.0	54.0	48.9	55.6	50.6	51.9	50.8	48.4	46.5	50.8	54.0	53.8	44.3
Privatized Banks													
Loans/ Deposits	-	54.7	49.4	48.8	50.0	53.5	53.8	53.6	52.7	54.9	65.8	57.3	52.4
Domestic Private Banks													
Loans/ Deposits	-	-	54.7	53.6	59.3	68.4	62.7	61.6	63.7	67.6	70.0	58.6	53.2
Foreign Banks													
Loans/ Deposits	69.5	57.5	50.6	54.3	56.6	57.5	50.6	54.3	56.6	68.2	71.5	66.8	71.5
Banking System													
Loans/ Deposits	61.6	54.9	49.6	54.2	52.4	54.1	52.2	51.8	51.2	55.9	60.5	56.9	51.2

Source; Umer Khalid –Effects of Privatization And Liberalization On Banking Sector

weaker deposit mobilization, the larger privatized banks turned out to be single most efficient category after 2004 to register the steepest decline in the loan to deposit ratio **(Fig 6**) .

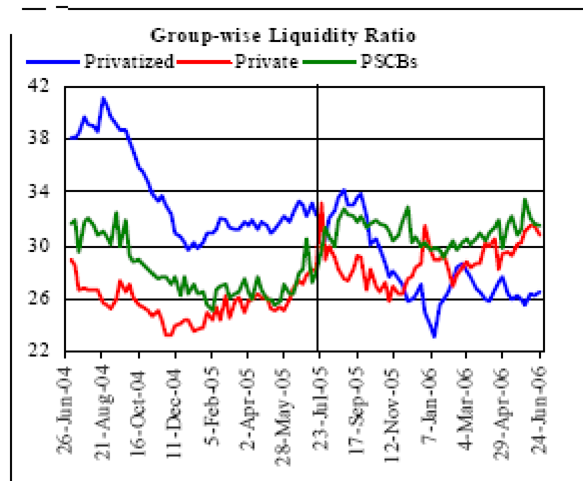


Fig 6 Source SBP Annual Report

Foreign banks however did not share this general improvement in the liquidity position. As rightly pointed out by Khalid, this has been due to the exogenous freezing of FCAs in 1998

after nuclear detonation (Khalidumer 2006). The fact that FCAs constituted the lion's share of foreign banks' assets, the sharp dent to their liquidity prowess is easily explainable.

Profitability

Profitability is the Raison d'être for any financial institution. It can be measured either through Return on Assets(ROA) or through Return on Equity(ROE). Judging on the basis of the former, the banking system in its totality showed a downward trend throughout 90s touching its nadir in the mid of the decade. Public sector banks were truly reflective of this trend with its ROA ratio reaching as low as -5.9.The position could be rescued on as result of capital's injection into the nationalized banks. As rightly pointed out by Khalid it is mostly due to high accumulation of nonperforming loans and increased borrowing which together resulted in the deep profit erosion (Khalidumer 2006).

Profitability of PSCB(Series 1),Privatized Banks(Series 2) and DPB (Series 3)

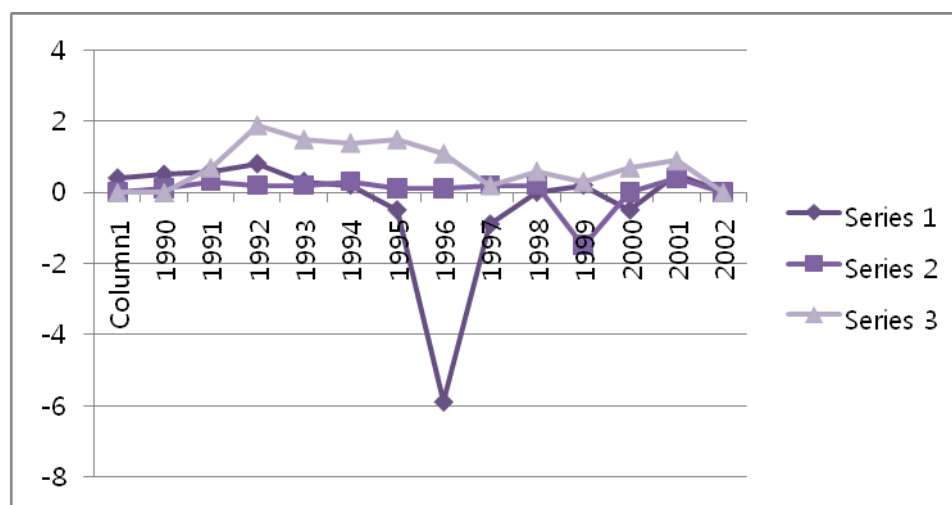
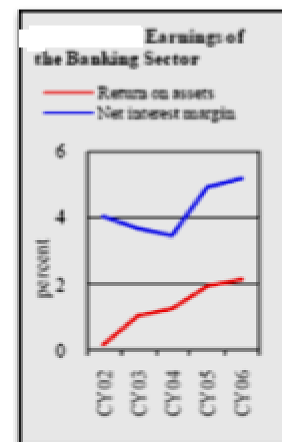


Fig 7 Source; Umer Khalid –Effects of Privatization and Liberalization On Banking Sector

Privatized banks, which in early 90s consisted of ABL and MCB, did not perform well either. It was primarily due to the losses suffered by ABL. It may be noted that the ABL had been sold to the EMG (Employees Management Group) which in the earlier years of their operation could not perform efficiently.

At any rate these losses more than offset the profits made by MCB. In contrast to privatized banks, the private sector banks' performance was much better despite a dip in 1997.There ROA however remained above both the earlier mentioned categories touching the ROA's value of 1.5 in 1996.

From 2002 onwards, the earnings of the banks showed a steady improvement. It may be noted that by this time private banks had a major share in the sector. Not the least, this was due to privatization of HBL in 2002.



Academically, it will be of interest to study the reasons for this profitability especially as it existed in the mid-decade (2005-6). During 2005, most of the profits were due to interests earned on the increased volume of deposits. The dynamics changed in the next year when the main bulk of the profits (81%) were accrued from the increase in the interest rates while only 19% were earned by the increase in volume of deposits (SBP 2007-08).

The profit during 2007 again showed a decrease from Rs 83.9 to Rs 73.3 billion. This can be translated into an ROA ratio of 1.5%.The increased falling rate of the income more than offset whatever retrenchment measures undertaken. Similarly the increase in the return on

advances was nullified by the slowing down of the gross advances slowed down to 11.7 percent from 20.6 percent in the preceding year. The net result was a fall in Interest Income to 22.1% from 45.7% in 2006 (SBP 2007-08)

Results

The above study was an attempt to evaluate the result of privatization on the banking sector, and by extension to carry out the comparative performance of private sector banking against the public sector banking. The evaluation has been carried out using the Capital Adequacy ratios, the assets quality, profitability and the liquidity positions of the various categories of the banks currently working in Pakistan. The conclusion of the study can be boiled down to the following;

Two phased post privatization performance

It transpired that in the early years of 1990s, when the privatization was only extended to three banks, the privatization could not be translated into efficiency enhancement. This might be due the poor performance of Allied Bank which had been sold to EMG. The loss suffered by the ABL nullified whatever performance betterment achieved by the other privatized banks (UBL and MCB).

The turn of the millennium and especially after 2002, entailed a tangible improvement in the performance of the banking sector. Not the least, this was attributable to joining of HBL, a big bank, to the class of privatized banks.

Besides the other private sector banks also gaining the corporate experience, showed a visible improvement. Table 4 gives a synoptic view of what happened to Key performance indicators of the main privatized banks. (TABLE-4)

BANKS / INDICATORS	UBL		HBL		MCB	
	2001	2008	2001	2008	2001	2008
Total Assets	168.7	620	333.7	757.9	36.3	443.6
Deposits	136.3	492	283.4	596	27.7	333.3
Equity(including Reserves)	2.45	49.4	12.8	75.2	1.55	58.4
Profit Before Tax	5.73	14.1	2.2	-	0.16	21.9
Profit After Tax	7.47	8.4	1.1	15.6	0.04	15.4

Operational improvement

In addition there has been improvement in other aspects also.To a common man this is most vividly visible in the operational improvement of the private banks with a pulling effect on public sector banks as well. There has been a modernization in the procedures which are being streamlined and upgraded. The transaction of accounts has been centralized so that the peripheral arms of the banks can concentrate on better service delivery. The procedures are also being automated through ever increasing establishments of ATM machines. This scramble was more efficient in early 2000s (Table 5) and now there is a sufficient network, especially in major urban centers.

TABLE 5

No of ATMs

	CY00	CY01	CY02	Jun-03
MCB	75	103	151	155
HBL	33	50	60	66
NBP	15	16	29	34
Askari	13	14	18	25
S & C	14	15	24	24
Others	56	61	117	141
Total	206	259	399	445

Source SBP Annual Report 2009

Effect on capital markets

Since a lot of privatization has also been made though capital market transactions (IPOs and GDRs) as against strategic sales (Exhibit 1), the net effect is the deepening as well as strengthening of the stock exchanges. Reciprocally, the last few years have also witnessed a clear appreciation in the privatized banks shares. The MCB's and HBL's shares sold at PKR 10 ($0.13) appreciated to as much as PKR 350 and PKR 200 respectively. The privatized banks enjoy a favorable credit rating. As of 2008, the LT Credit Ratings for HBL, MCB and UBL were AA^{+} each.

Effect on industrial growth

There has been an unprecedented growth in the consumer banking including extension of loans to individuals as well as industries. While it also helped in broaden the clientele base, it also helped the industrial growth. The Auto industry is one single most benefitted industry which saw unparalleled increase in sale volume due to car leasing schemes. Construction

industry has also benefitted from housing boom as a result of house building loans. Such banking ventures were unheard of during nationalization times and can therefore is attributed to the privatization.

Conclusion and policy recommendations

Although like any policy affecting a large population, there can't be a final word as whether privatization does have improved performance of banks world over in general and Pakistan in particular. There has been many arguments defending government ownership of banks. They mostly hover around the point in post WWII welfare states; governments should have total control on monetary and fiscal resources so as to assure vertical and horizontal dispensation of distribution.

However save few successful exceptions (South Korea being perhaps the most vivid), State owned banks have failed to translate this idealism into reality. As pointed out by **Clarke** et al (2005), there can be three reasons for this failure namely political intervention, corporate governance problems, and problems associated with competition.

Although privatization provides a good answer to these ills, it should be accompanied with some safeguards;

- Privatizing authorities should perform financial, legal and managerial due diligence of the prospective buyers. In its enthusiasm for prolific privatization, banking assets should not be sold to ill equipped and ill trained parties.

- It is more prudent to have a few strong banks than a mushroom growth of very small banks; balkanization of the banking sector is not recommended.

- Normally the problems confronting the new owner of a privatized bank can be boiled down to a legacy of NPLs from old regime, poorly qualified and ill trained manpower (as a result of recruitment emanating from nepotism or favoritism by the bureaucrats and politicians) and a lousy and archaic equipment.

- The problems can be solved by replacement of new manpower attuned to regular incremental training programmes. In Pakistan this change of management did not raise any employment related issues thanks to generous golden hand shake schemes. This also implies that it may not be possible if privatization has been done through other than equity sale i.e. if privatization has been done through IPOs and GDRs etc.

- However the single most important prerequisite for successful privatization is a concurrent establishment of a strong regulatory regime. In its absence the financial sector can succumb to the vicious exploitation of the profit oriented private bankers. This in the end can be even more pernicious than the inefficiency of public sector banking.

EXIHIBIT

BANKS IN PAKISTAN; SECTOR WISE DIVISION

BANKS IN PUBLIC SECTOR
National Bank of Pakistan
The Bank of Punjab
The Bank of Khyber
First Women Bank Limited
PRIVATISED BANKS
Allied Bank Ltd (51%)
Muslim Commercial Bank (75%)
United Bank Ltd. (51%)
Habib Bank Ltd.
Muslim Commercial Bank (6.8%)
DOMESTIC PRIVATE BANKS
Dawood Islamic Bank Limited
BankIslami Pakistan Limited
Khushhali Bank Limited
KASHF Microfinance Bank Limited
Network Microfinance Bank Limited
The First Micro Finance Bank Limited
Rozgar Microfinance Bank Limited
Tameer Micro Finance Bank Limited
Soneri Bank Limited
SILKBANK Limited
SAMBA Bank Limited
Mybank Limited
NIB Bank Limited
Faysal Bank Limited
Habib Metropolitan Bank Limited
JS Bank Limited
KASB Bank Limited
Bank Alfalah Limited
Bank Al Habib Limited
Atlas Bank Limited
Askari Bank Limited
Summit Bank Limited
FOREIGN BANKS
Barclays Bank PLC
Citibank N.A. - Pakistan Operations
Deutsche Bank AG - Pakistan Operations

HSBC Bank Middle East Limited - Pakistan Operations
The Bank of Tokyo-Mitsubishi UFJ Limited - Pakistan Operations
Pak Oman Microfinance Bank Limited
Oman International Bank S.A.O.G - Pakistan Operations
Albaraka Islamic Bank B.S.C. (E.C.),
Meezan Bank Limited
Dubai Islamic Bank Pakistan Limited
Emirates Global Islamic Bank Limited
The Royal Bank of Scotland Limited
Standard Chartered Bank (Pakistan) Limited

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