A NARRATIVE DESCRIPTION OF BANKING SECTOR IN PAKISTAN

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Abstract
This paper focuses on narrative description of banking sector in Pakistan. It includes literature review and data on banking sector of Pakistan. Conclusions are drawn on the basis of data and literature at the end.

Keywords: NARRATIVE DESCRIPTION ; BANKING SECTOR ; PAKISTAN

1. Introduction
Bank is an institution transacting the business of accepting, for purpose of lending, of deposits of money from the public, repayable on demand otherwise, and withdraw able by cheque, draft order or otherwise and includes any post office saving bank. Banks are financial intermediaries. The role of a financial intermediary is to sell its own obligations with attractive features, at higher prices than paid to buy. Bank acquires some interest on selling its obligations and bears the same on buying.
Pakistani banking sector has witnessed drastic changes over a period of 63 years since country’s independence in 1947. Initially it suffered from acute shortage of resources and uncertainty due to prevailing political and socioeconomic conditions. Lack of trained human resource and professionals resulted into poor quality of products and services. State Bank of Pakistan was established as the central bank on July 1, 1948 to control the financial sector. Subsequent amendments were made to extend the control and functions of SBP through State Bank of Pakistan Act 1956. SBP encouraged the private sector to establish banks and financial institutions in the country. It resulted into unhealthy competition and unlawful practices due to bribe and corruption during the decades of 1950s and 1960s.

In 1974, all the existing banks were nationalized by the Government. The performance of nationalized banks deteriorated due to government protection to employees, resulting into the provision of inferior products and poor services. It also discouraged the private investors and foreign financial institutions. The poor performance of nationalized banks caused the reforms/privatization of banking sector in early 1990s.
Table.1 High Lights of Banks

<table>
<thead>
<tr>
<th>Highlights of the banking system</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>3,660</td>
<td>4,353</td>
<td>5,172</td>
<td>6,628</td>
<td>6,916</td>
</tr>
<tr>
<td>Asset Growth in % (Year over Year)</td>
<td>20</td>
<td>17.1</td>
<td>18.8</td>
<td>8.8</td>
<td>15.8</td>
</tr>
<tr>
<td>Investments (net)</td>
<td>800</td>
<td>833</td>
<td>1,276</td>
<td>1,087</td>
<td>1,737</td>
</tr>
<tr>
<td>Advances (net)</td>
<td>1,991</td>
<td>2,428</td>
<td>2,688</td>
<td>3,173</td>
<td>3,240</td>
</tr>
<tr>
<td>Deposits</td>
<td>2,832</td>
<td>3,255</td>
<td>3,854</td>
<td>4,218</td>
<td>4,786</td>
</tr>
<tr>
<td>Equity</td>
<td>292</td>
<td>402</td>
<td>544</td>
<td>563</td>
<td>660</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>94</td>
<td>124</td>
<td>107</td>
<td>63</td>
<td>81</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>63</td>
<td>84</td>
<td>73</td>
<td>43</td>
<td>54</td>
</tr>
<tr>
<td>No. of banks in loss</td>
<td>7</td>
<td>7</td>
<td>10</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>Non performing loans</td>
<td>177</td>
<td>218</td>
<td>218</td>
<td>359</td>
<td>446</td>
</tr>
<tr>
<td>Non performing loans (net)</td>
<td>41</td>
<td>39</td>
<td>30</td>
<td>109</td>
<td>134</td>
</tr>
<tr>
<td>Capital Adequacy Ratio - CAR (All banks)</td>
<td>11.3</td>
<td>12.7</td>
<td>13.2</td>
<td>12.3</td>
<td>14.0</td>
</tr>
</tbody>
</table>

Source: State Bank of Pakistan

Today, the Banking sector of Pakistan is playing pivotal role in the growth of country’s economy. In accordance with the State Bank of Pakistan Act, the banking system of Pakistan is a two-tier system including the State Bank of Pakistan (SBP), commercial banks, specialized banks, Development Finance Institutions (DFIs), Microfinance banks and Islamic banks. As of June 2010, the banking sector comprised 36 commercial banks (including 25 local private banks, 4 public sector commercial banks and 7 foreign banks) and 4 specialized banks with a total number of 9,087 branches throughout the country. Among the banks, there are 6 fully fledged Islamic banks as at end of June 2010. Following is the detailed historical development of banks in Pakistan.

1.1. 1940 - 1959

Before the Indian partition in 1947, British banks and banking system prevailed and subjugated the system of local banks all over the India. The independent banking system
was launched locally for the first time in year of independence of Pakistan from Britain. The banks included were the ABL (Allied Bank Limited formerly Australasia Bank), the HBL (Habib Bank Limited), the MCB (Muslim Commercial Bank Limited), and the NBP (National Bank of Pakistan). The prominent merchant families founded and operated these banks except the NBP. The first government of Pakistan in 1948 established a central bank with name of State Bank of Pakistan on the basis of Indian State Bank. An ordinance was issued in 1955 expounding the key role of State Bank of Pakistan. The UBL was another bank which was established in 1959.

1.2. 1960 - 1974

In the course of the second five-year plan (1960-65), the SBP opened six new offices. The number of other bank branches increased from 430 to 1591 over this period. Total deposits increased from Rs. 2943 million to Rs. 6883 million while total advances increased to Rs. 5759 million from Rs. 1458 million. During this period, comprehensive banking laws were also formulated. During the third five year plan (1965-70), the total number of bank branches increased to 3133 with a 91% increase in deposits and a 64% growth in advances.

The newly introduced banks such as IDBP (Industrial Development of Pakistan) and ADBP (Agricultural Development Bank) were regulated direct by State of Pakistan or by central bank of Pakistan. All the domestic commercial banks were nationalized by the government in the first government of Zulfiqar Ali Bhutto by 1974. Along with the State Bank of Pakistan there was another supervisory body PBC (The Pakistan Banking Council) with limited powers. During 1997, this council was also dispelled leaving the
State Bank exclusive body to control banking system in Pakistan. This step of nationalization opened a new Pandora box of banking economy. The branches of the state owned banks were opened throughout country irrespective of knowing the business capability of the area where the branch was opened.

1.3. Islamization of Banks 1979-1992

In Egypt the first modern Islamic bank was established in 1963 according to the principles of Islamic finance. The Organization of Islamic Conference (OIC) also supported the Islamic financial system in 1973 at Jeddah, Saudi Arabia. Similarly a number of Islamic banks were established as Philippine Amanah Bank in 1973; Dubai Islamic Bank in 1975; the Faisal Islamic Bank of Sudan in 1977; the Faisal Islamic Bank of Egypt in 1977; the Bahrain Islamic Bank in 1979, and Meezan Islamic bank of Pakistan in 2002. In Malaysia, Islamic Banking Act was passed in 1983 to transform the interest-based conventional banks into Islamic banks.
Highlights of Islamic Banks

(Billion Rs.)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets of the Islamic Banks</td>
<td>44.1</td>
<td>71.5</td>
<td>119.3</td>
<td>205.9</td>
<td>276.0</td>
<td>366.3</td>
</tr>
<tr>
<td>Deposits of the Islamic Banks</td>
<td>30.2</td>
<td>49.9</td>
<td>83.7</td>
<td>147.4</td>
<td>201.6</td>
<td>282.6</td>
</tr>
</tbody>
</table>

| Share in Bank Assets (in percent) | 1.45  | 1.95  | 2.79  | 3.98  | 4.90  | 5.60  |
| Share in Bank Deposits (in percent) | 1.26  | 1.75  | 2.62  | 3.82  | 4.78  | 5.90  |

Source: State Bank of Pakistan

1.4. 1991 – 1997

The Sharif Government announced the second set of banking sector reforms after the initialization of the Pakistan economy. Deregulating the financial sector and capital markets led to expanding growth of banking companies in the private sector. Several big industrial groups set up their own banks which to date remain relatively small compared to the national commercialized banks and other larger foreign banks. In 1991, the
privatization commission of Pakistan privatized MCB and ABL. A scheme of yellow cab launched by the government of Nawaz Sharif in 1992 took Rs. 10 billion from the local banking sector. A Saudi based group bought all the shares of UBL in 1995 but the SBP canceled the privatization of the United Bank instantaneously. In 1996, the privatization commission called for bids to privatize the HBL. In the same year, the caretaker government of Meraj Khalid introduced new financial sector reforms. Second period of government of Nawaz Sharif took the measures to implement the banking reforms introduced by him in his previous government.

1.5. Privatization of Banks 1992-2000

Financial liberalization and deregulation during 1990s encouraged local investors and motivated foreign banks to start their operations in Pakistan. It stimulated the competition among banks due to an expansion of the banking industry. A large number of banks has initiated their operations in Pakistan and try to attract the maximum number of customers. It is reported that government ownership of banks could be discouraged due to slower financial development, low productivity and slow economic progress (La Porta et al. 2002). Similarly, State Owned banks are unable to monitor their progress due to absence of clear objectives and responsibility (Clark et al. 2003). However, it is found that privatization may not be successful due to the limitations and environmental constraints of a specific economy. It is reported that privatization of banks in low and middle income countries did not created improvements due to overstaffing and debt burden (Otchere, 2003). Interestingly, it is found that there is lesser improvement in the financial health of banks as result of financial liberalization and privatization in Pakistan (Khalid, 2006).
Figure 1.1 Financial Structures in Pakistan

**Structure of Financial Sector in Pakistan**

Scheduled Banks

NBFIs

Commercial Banks Specialized Banks

Domestic Banks Foreign Banks

Modarabas Leasing Companies DFIIs Investment Banks Housing Cos’

2. **Current Status of Banks in Pakistan**

Pakistani banking sector is continuously improving with diversified pattern of ownership due to an active participation of foreign and local stakeholder. It resulted into an increased competition among banks to attract a greater number of customers by the provision of quality services for long-term benefits. Now there are 6 full-fledged Islamic banks and 13 Conventional banks offering products and services according to principles of Sharia’h in different parts of the country. They are competing in a highly competitive environment for the provision of quality services according to customers' expectations. It is reported that customers of Islamic bank have greater perception of service quality as compared to customers of conventional bank in Pakistan (Ahmad et al., 2010).
Top ten banks in Pakistan by their size of assets:
End December 2009, in thousand Rs.

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Name of Bank</th>
<th>Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>National Bank of Pakistan</td>
<td>944,232,762</td>
</tr>
<tr>
<td>2</td>
<td>Habib Bank Limited</td>
<td>820,981,347</td>
</tr>
<tr>
<td>3</td>
<td>United Bank Limited</td>
<td>619,744,051</td>
</tr>
<tr>
<td>4</td>
<td>MCB Bank Limited</td>
<td>509,223,058</td>
</tr>
<tr>
<td>5</td>
<td>Allied Bank Limited</td>
<td>418,374,331</td>
</tr>
<tr>
<td>6</td>
<td>Bank Alfalah Limited</td>
<td>389,070,055</td>
</tr>
<tr>
<td>7</td>
<td>Standard Chartered Bank (Pakistan) Limited</td>
<td>312,874,212</td>
</tr>
<tr>
<td>8</td>
<td>Askari Bank Limited</td>
<td>254,327,466</td>
</tr>
<tr>
<td>9</td>
<td>Bank Al-Habib Limited</td>
<td>249,806,600</td>
</tr>
<tr>
<td>10</td>
<td>Habib Metropolitan Bank Limited</td>
<td>237,412,230</td>
</tr>
</tbody>
</table>

Source: State Bank of Pakistan

Now bank customers are much concerned regarding the quality of services due to increased awareness. They continue to deal with their current bank only if they feel satisfied; otherwise they feel no hesitation to switch to other banks. Islamic banks work within the limits prescribed by Sharia'h to stimulate business and trade activities. It experienced an expansion in its network, size and structure due to beautiful
blending of commercial banks, micro finance institutions and Islamic banks in the country.

### Segment-wise distribution of Loans

(Percent share in total loans)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Growth 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>56.3</td>
<td>63.2</td>
<td>61.9</td>
<td>2.5</td>
</tr>
<tr>
<td>SMEs</td>
<td>16.2</td>
<td>11.7</td>
<td>10.4</td>
<td>-7.2</td>
</tr>
<tr>
<td>Agriculture</td>
<td>5.6</td>
<td>4.9</td>
<td>4.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Consumer</td>
<td>13.8</td>
<td>10.4</td>
<td>8</td>
<td>-19.1</td>
</tr>
<tr>
<td>Commodity</td>
<td>5.5</td>
<td>7.4</td>
<td>12.5</td>
<td>77.8</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2.7</td>
<td>2.4</td>
<td>2.5</td>
<td>5.1</td>
</tr>
</tbody>
</table>

**Percent share in Consumer Loans**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Growth 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Cards</td>
<td>12.6</td>
<td>12.3</td>
<td>11.6</td>
<td>-23.3</td>
</tr>
<tr>
<td>Auto Loans</td>
<td>30</td>
<td>28.7</td>
<td>24.7</td>
<td>-30.5</td>
</tr>
<tr>
<td>Durables</td>
<td>0.3</td>
<td>0.1</td>
<td>0.1</td>
<td>-51.8</td>
</tr>
<tr>
<td>Mortgage</td>
<td>18.1</td>
<td>20.2</td>
<td>22.9</td>
<td>-8.1</td>
</tr>
<tr>
<td>Personal loans</td>
<td>38.9</td>
<td>38.8</td>
<td>40.7</td>
<td>-15</td>
</tr>
</tbody>
</table>

Source: State Bank of Pakistan

### Conclusion

This study describe a historical background of Pakistani banking sector since its independence. It signify the passage of Pakistani banking sector from the
establishment of SBP on July 1, 1948 as central bank to support and monitor the banking sector. During 1950s and 1960s banking sector got expansion due to development projects and an active participation of private sector. In 1974, banks operating in Pakistan were nationalized and came under the direct control of the Govt. of Pakistan. Nationalized banks have shown poor performance due to Govt. protection job protection and lack of competition. The Govt. of Pakistan is required to eliminate interest based transactions from the country according to all the constitutions (first constitution 1956, second constitution 1962 and the third constitution 1973). Similarly, in 1992 the Supreme Court of Pakistan also ordered to stop interest based transactions from the economy.

The Govt. of Pakistan has started financial liberalization process by privatization and deregulation of the financial sector especially banking sector in 1992. The inception of 21st century came with Islamic banking practices across the globe to facilitate the different segments of the economy. SBP developed detailed criteria in 2001 and registered Meezan Bank as the first Islamic bank in 2002. The inception of Islamic banking practices in Pakistan came with blending of opportunities and challenges in the existence of conventional banks to reap the long term benefits.

Finally, Islamic banking practices in Pakistan proved a successful experience due to growth and expansion of the banking sector. This study reflects an updated picture of Pakistani banking sector since its creation. It enables the readers, academician and bankers to have a look about banking developments in Pakistan as the journey from conventional banking to Islamic banking to enhance their understanding.
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