

# Performance of Banking Sector of Pakistan amid Global Financial Crisis

**Author Details: Dr Ambreen Zeb Khaskhelly**

Assistant Professor Department of Economics University of Sindh Jamshoro

## **Abstract**

*This study aims at to conduct a performance analysis of six big banks of Pakistan during the global financial crisis during the period of 2008 to 2012 Year 2007 has been selected as base year.*

*Various financial ratios have been calculated to evaluate the performance of the banking sector in terms of liquidity, profitability and stability. This study covers a five year period from 2008 to 2012 where as year 2007 has been considered as base year. The performance has been analyzed by using financial ratios as measurement tool. The financial ratios such as Profit Before tax ratio, Gross spread ratio, Return on Equity, Gross profit ratio Gross Advances to Deposits ratio, Cash & Portfolio Investment to Deposit Ratio are used to gauge the performance of selected banks. Moreover their credit portfolio has been examined to ascertain their performing loans status.*

*While conducting the research it concluded that selected banks have adversely been affected, deposits were withdrawn considerably and cost of deposit increased to maintain the books. Non Performing Loans were also accumulated due to increase in interest rates.*

**Key Words:** *Global Financial Crisis, performance, Conventional Banks, Liquidity, profitability, Non Performing Loans*

## **Introduction:**

The main objectives of this paper is to review the performance of the selected six conventional banks of Pakistan ie National bank of Pakistan ,Habib bank Limited ,United Bank Limited ,MCB Bank Limited ,Allied bank Limited and Bank Alfalah Limited during the global financial crisis which started in US subprime mortgage and engulfed the entire globe. While the degree of economic damage varied across the countries, economists are of the same opinion that the current recession is the worst since the Great Depression of 1930. These are in essence credit crisis which are direct result of collapse of the mortgage market in United States.

The study is basically aimed at to evaluate and analyze the performance of conventional banks based on their age in the business, deposit base, net work and products and services provided. Data were collected from their annual reports. In this era of modern technology and very much competitive financial market it is pretty common to use the technique ratio analysis to gauge the performance.

## **Impact and causes of crisis**

The financial crises got extraordinary impetus during the period from 2004 to 2007, stock markets witnessed slow down and many large banks of the developed economies applied for bailout to evade collapse.

During 2009 global output dropped by 2.2 % percent, the unemployment rate increased by 7 % percent and global output declined by 2.2 per cent resulted into more than 35 million people lay off.

The main causes of crises were imprudent lending for a pretty long period of time, fair value of collateral accepted was ignored, repayment capacity of borrowers was ignored even down payment was ignored. relaxation of regulations by US government particularly repeal of the Glass-Steagall Act of 1933, improper rating was awarded by rating agencies against attractive incentives and risk rating mechanism was totally ignored.

## **Overall Impact on Banking Industry in Pakistan**

Keeping in view the demands of financial globalization, Pakistan's banking system initiated to integrate with the financial markets internationally.

Pakistan's financial sector experienced some shocks as rumours regarding freezing of foreign currency deposit accounts and seizure of bank lockers spread over the country. That resulted into noticeable withdrawals of deposits liquidity crunch. As the currency market turned unstable, the State Bank of Pakistan intervened to ease liquidity and injected about \$20-100 million in the currency market. It also lowered the cash reserve requirement for banks from nine to seven per cent.

### **Review of Literature**

A number of published research papers and reports have attempted to investigate the multi dimensions and implications of Crisis. But there exist a very little empirical literature regarding its impact on commercial banks in the case of Pakistan on the various financial and operational dimensions.

According to T Schuermnn & A.B.Ashcraft, et al, 2007, the root cause of the crisis is the process of collateralization, which gave birth to the global financial crisis. Near about 75 per cent sub prime mortgage loans were linked directly with the securitization process. Financial derivatives played vital role in securitization of the loans in special compartment of CLOs (collateralized loan obligations) and CDOs (collateralized debt obligations)

Dr Umer Chapra -2008 in his research regarding financial crisis has claimed that the current global economic recession is worst than the Great Depression of 1929. He further argued that the growth of banking industry will remain slow and effects of crisis may remain for longer period of time. He further explained on credit problem ,he analyzed that more profit means more lending and high leverage is the reason which makes excess lending possible and results into artificial boom in prices of assets and gives rise in speculative investment and consumption. Such high leverage is difficult to unwind and this vicious cycle of selling ultimately leads to steep decline in prices rather to downturn and outcome is financial crisis.

Lowenstein (2008) explores that the regulators and central banks have allowed the recurrence of crisis who have failed to display financial discipline even forget the past events from which lessons should be learnt. It was need of hour to recognize the early warning signals so that financial derivatives could be managed more firmly and tightly. Rather they promoted such risky business instead by behaving in a speculative manner and looked for bailout.

Bartlett (2008) has expressed his point of view on the causes of financial crisis, he stated that the crises which started with the fall down of sub-prime mortgage industry in states but the intensity was so severe which engulfed the globe. According to him losses on such risky assets (MBOs, CLOs, CDOs and subprime securities) accounted for about US \$945 billion during March 2008 which he confirmed that these losses are biggest one even in comparison of banking crisis of Japan accounted for to US\$ 780 billion approximately during 90s.

Yilmaz (2008) has clearly fixed responsibility on U.S mortgage industry that extended mortgage finance facilities to sub prime clients thus resulted into occurrence of severe nature of financial crisis, initially anticipated the losses in the range of US \$ 300 To 600 billion which later were accounted for about US \$1 trillion.

### **Research Methodology**

#### **Ratio Analysis**

In this study Banks' performance have been measured by using ratio analysis technique, the main advantage of this method is to remove disparity based on their size of deposits ,advances & network and brings the banks at par. This method was also used by other researchers too such as Ahmed & Hassan (2007),Sabi(1996) and Chen & Shimerda (1981).

#### **Highlights of Ratios of Selected Banks**

Type of Ratio	2007	2008	2009	2010	2011	2012
Profit Before Tax	42.85	33.65	29.50	32.73	33.87	34.06
Gross Spread	63.03	56.84	53.76	55.83	53.72	48.98
Return on Equity	25.36	22.15	20.78	20.53	20.35	20.33
Gross Profit	208.8	182.1	171.1	201.1	202.3	205.3
Gross Advances to Deposits	73.01	77.75	71.12	65.31	64.91	56.14
Weighted Average Cost of Deposits	3.10	3.97	5.41	5.14	4.94	4.79
Cash & Portfolio Investment to Deposits	47.35	37.99	45.14	49.01	55.93	59.13
NPL to Gross Advances	6.94	8.41	9.99	11.17	11.73	10.94

## Conclusion

It was revealed that sample banks have been adversely affected in terms of profitability, its profit before tax decreased; Net markup income was decreased due to increase in mark up expense. Return on Equity also indicates that profitability of equity holders was reduced significantly. Gross profit Ratio also tells that total revenue decreased due to significant in cost of deposits. Weighted Average cost of deposits clearly portray that banks tried to maintain their books by mobilizing relatively costly deposits to restore market reputation. Nonperforming Loans also increased due to rise in interest rates by central bank to control the liquidity of banking sector which raised credit risk as the counter failed to pay back the loans along with increased cost of funds.

## References:

Alan Zibel, “Liar loans' threaten to prolong mortgage crisis” (2008)

Ahmed, O. B. (2001). Islamic Financial Instruments to Manage Short-Term Excess Liquidity (2nd Edition ed.). Jeddah: Islamic Development Bank.

Charnes, A. Cooper W W and Rhodes E (1978) Measuring Efficiency of Commercial banks with the use of Financial ratios and Data Envelopment Conventional Banks” IIUM Journal of Economics & Management Vol 10 No 1 pp 1-25

Dar K.H and Shimerda ,T (1981) “An Empirical Analysis of Useful financial ratios “ Financial Management Vol10 No 1 pp 51-60

Muljawan, D.; H. Dar, and M. J. B. Hall (2002), “A Capital Adequacy Framework for Islamic Banks: The Need to Reconcile Depositors’ Risk Aversion with Managers’ Risk Taking” ,Loughborough University Economics Papers,

Tarawneh, M. (2006), A Comparison of Financial Performance in the Banking Sector: Some Evidence from Omani Commercial Banks. International Research Journal of Finance and Economics, Issue (3). ISSN 1450-2887

Yue, P. (1992), “Data Envelopment Analysis and Commercial Bank Performance: A Prime rwith Applications to Missouri Banks,” Working Papers, ICW Institute, University of Texas at Austin.

Zaman, R., & Movassaghi, H. (2001). Islamic Banking: A Performance Analysis. The Journal of Global Business, 12(22), 31-38.