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Banking Finance and Economic Growth

Guest Speakers

Atif Bajwa
(President and CEO, Bank Alfalah)

Zubyr Soomro
(Chairman, National Bank of Pakistan)

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(Former Governor, State Bank of Pakistan)

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(Ex, Citibank) and

Shahzad Dada
(CEO, Standard Charted Bank Pakistan)

Key Questions

- What role do our banks play in our economy?
- Are they merely bankers to the government?
- How do we get more consumed and investment focus?
- Are deposit coming from the poor areas and going to rich areas?
- Are they helping or slowing down technology adaptation and digitizing payments?

Banking system plays a pivotal role in human resource building and economic development. If the banking system is not well organized and efficient, it creates obstacles and instabilities in economic growth and development. In the past, foreign banks in Pakistan had an important role as they were allowed to operate at the time of nationalization. Foreign banks had three factors that gave an edge over Pakistani banking system: delegation of authority, they promoted training and skills and followed the merit. When we privatized our banking sector, a lot of foreign banks exited and our local banks selected a plethora of people from the pool of foreign banks which were appropriate in terms of delegation of authority, perception of merit, and in terms of training. At present, our banking system faces serious hurdles in attracting talent both domestically and overseas for the public sector banks as well as for the private sector.
In the context of public sector banks, the question is, why does this sector have to face difficulty in attracting the talented people? The answer may be the governance standards which impacted the ability to choose the right team, it means, there is more bureaucracy in it. The issues in the public sector are harassed by the NAB, FIA, the judicial activism all these things create maladjustments to attract and retain the talent in public sector banking.

On the other side, in the private sector there is delegation of authority and decisions made on purely professional terms. Although, it has been impacted by the Seth culture as the bigger banks were more professional and benefitted by attracting talent. However, now the opportunities to attract talent are vast because the banking sector overseas throughout the Middle East and beyond, there is a pressure on banking jobs as the economy is suffering. Another serious barrier in attracting the talent back to the country is unhealthy emphasis on dual nationality and trust issues, as it discourages required talent. Although, we still can attract the talent but with more difficulty.
In the past, our domestic banks attracted that talent and created some of the best bankers even though they did not always come from foreign banking community. The institutions that went through the process of producing best bankers globally blame nationalization or other forces that brought professionalism down. The situation in the current banking system is the lack of concerted efforts to train people. It is crucial for us to address the merit of talent in our current banking sector in particular training efforts. As there is no shortage of talent but the training of talented people is required. Moreover, training

was a dominant factor in foreign banks to stand out in terms of creating talent, since the foreign banks left, the national training grounds has reduced; unfortunately, the domestic banking sector has not taken up that challenge and did nothing in terms of training. If we look at our training budgets and the development of training centers, we will be disappointed as our banking system has the tendency to cut the training budgets. Local banks need to fill this gap, need to spend a fair amount of money on training; similarly, boards and the sponsors have to support this due to the fact that it is a business and an industry where the long-term real asset is people. We have also seen some great examples where the quality of management, longevity of management and management strategies have shown success, such as Meezan Bank.

The development is not something that comes naturally and Pakistan is far behind in it. Although, banks are privatized now. They are earning by investing in PIBs and lending to the government. Despite all these, there is no incentive for banks to train people. Our banking sector is not capable of producing leaders like Zubyr Soomro and Salim Raza. There is dire need for within organization mentorship and learning culture. Banks that do not do this will be the net losers regardless whether the public sector, private sector, state or non-state sector because this is the biggest asset of any economy.

By the same token, wage is the prominent and first factor which attracts the talent in any organization irrespective of the locale. The employees on a high grade are getting a lot of facilities and incentives as compared to the lower graded staff. In Pakistan's banking system the professionals who come from the foreign banking community paid highly relatively to the domestic staff. This discrimination is discouraging the talent heading towards banking sector.

In any economy, the banking sector invests a huge amount of money in project financing, they give incentives to the line of business, exclusively to SMEs, training, product development and the like. In the current banking system, banks collect deposits from the customers and invest them into government papers and in return they earn money. Now when the interest rates come down, they will be sitting on huge capital gains for the next four to five years. So, the question is why they should invest in human resources or in product development, when they can earn by doing nothing? It's convenient for banks to make money being bankers to the government because it's risk free. Government pays more for three months paper treasury than the banks pays in the market, therefore, it is the market failure. Furthermore, there are two alarming developments in the last four to five years in the banking system. One is, our banking system is very small and only accounts for 33 percent of GDP as compared to India's 64% and Bangladesh's 47% part of GDP. Hence, against our small banking system we have a massive ramp up in cash in circulation which is 43% whereas a decade ago it was 27%, 14%, and 16% in India and Bangladesh, respectively. Cash leakage or cash not coming to the banking sector mutes the capacity of banking multipliers to expand deposits. We are not expanding the banking sector, we are debunking as when cash grows faster than deposits, we potentially debunking. To address this problem, fiscal policies have to take necessary measures and interest rates must not be in a soaring trend. The second unfavorable development in our banking system is our two-thirds deposits go to government securities and guarantees. Resultantly, there is no project financing and no product development.

Glaringly, competition is an essential factor for the growth and efficiency of any industry. In the banking system of Pakistan, the smaller banks do not have the capability of raising deposits at the same cost at which the larger banks can because larger banks have bigger branch networks. The cost of network expansion is too high so the smaller banks cannot afford this. Likewise, the larger banks have the low deposit cost, they can easily lend to the large corporates as it is agreeable by everyone at the finite rates because of the low the risk; vice versa is true for the smaller banks. The ability of small banks to attract talent in the risk management department is very difficult, at that time it becomes expensive and they are not financially capable of doing this. Thus, this scenario is in favor of large banks and not in the small banks. In the same way, the interest of the big banks in the market is putting money in government papers to earn money with zero risk, so, the competition for the rest of business is not a great competition. Additionally, the state bank of Pakistan has vetoed the issuance of further banking licenses from the past 15 to 20 years, which is also a hindrance in the way of the competitive banking market.

In addition, our current banking system still has commodity financing but the corporate financing has not changed yet. The issue on the equity side is that there is not a huge incentive for issuers to issue equity because the p-ratio in the market is around four and half. When the cost of raising funding by issuing equity is multiples by what can raise money in the banking sector, in other words, debt is cheap in terms of cost. As far as the equity market is concerned, there is great desire by the issuers at this time to issue equity. So, there is a dire need of the venture capital and corporate bond market because it can develop project finance and long-term loans will be offered. At present, our saving institutions, pension funds and insurance companies do not have a reliable long-term market to invest.

In Pakistan, there is a perception about the banking sector that the deposits come from the rural areas and go to the urban areas through large corporates. Admittedly, it's true, according to the State bank, 10 percent of the total deposits comes from the rural sector and only 4 percent of that lend to the rural areas; this is clearly a mismatch. It's easy to blame banks for that, but we cannot neglect the fact that finding credible borrowers in those areas is not easy because they are not structured and also the local environment, commercial banks do not support them. To make it clear, banks lend where the risk is lower and due to the lack of legal framework banks do not invest in SMEs as the risk is higher and there are still pockets of the economy dominated by the financial sector and by the state which just distorts things and those are things which cause amongst other distortions of the system. So, in the current time there is a problem with the lending system.

At last they highlighted the innovative and technological aspects that the advancement in these two considered as an imperative tool that affected the banking sector. Ostensibly, the banks are not only the large user of technology but also the large investors; however, they are not great innovators of technological solutions. The lethargy that comes from the large institutions reflects itself in the ability to innovate quickly and therefore partnering with FinTech is absolutely an essential element of the future strategies. The Pakistani banking sector is not so innovative because we lack in talent development which is the essential element for innovation. As far as technological solution concerns, there are things coming from technological solutions: digital banking and structuring credit. The biggest issue in the current banking system is mispricing of risk and in its presence, creating a market and environment is difficult where the development of products can be intermediate between the suppliers of money and the demand for the money.