



## Banking, Finance and Economic Growth



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. To understand the importance of the banking sector and its role in the economy, Pakistan Institute of Development Economics organized a webinar to get the answer of some specific questions from the top bankers of Pakistan.

### Key Messages

- If we talk about the banking system of Pakistan in terms of caliber, quality and so on, they were far behind foreign banks in the past. There were some important factors which made foreign banks superior over Pakistani banks: delegation of authority, promotion of training and skills, and merit based system.
- On the contrary, in Pakistani banks there were monetary issues, political games and the lack of upper mentioned factors. However, after the privatization of our banking sector, many foreign banks exited and our local banks selected a plethora of people from the pool of foreign banks which were appropriate in terms of all the factors mentioned above.
- 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.
- Now the question is why the public sector fails to attract the talent and the reason may be is the governance standards have been influenced by the ability to choose the right team. The issue is there is more bureaucracy and intervention of NAB, FIA and judicial activism in the public sector which creates maladjustment to attract and retain the talent.
- Conversely, in the private sector decisions are made more professionally and the delegation of authority also exists. Although, it has been impacted by the Seth culture as the bigger banks were more professional and benefitted by attracting talent.
- However, now there are more opportunities to attract talent due to the economic instability and pressure on banking jobs overseas throughout the Middle East and beyond.

- At present, the banking system lacks the concerted efforts to train employees as there is no shortage of talented people, they are only required to be trained. Since the foreign banks left, the national training grounds have reduced. Unfortunately, the domestic banking sector has not taken up that challenge and did nothing in terms of training; in fact, there is a tendency to cut down the training budget.
- As long as government's fiscal deficits are there and they are the major borrower in the banking system, there is no incentive for banks to train people. First, we have to accept that we are behind and there is dire need for within organization mentorship and learning culture.
- Local banks need to fill this training gap by spending a fair amount of money on it; otherwise, they will lose regardless of the public or private sector. Likewise, boards and the sponsors have to support this because it is a business and an industry where the long-term real asset is people.
- By the same token, wage is the prominent factor which attracts the talent in any organization irrespective of the locale. In Pakistan, the employees on a high grade or coming from foreign banking system are getting a lot of facilities and incentives as compared to the lower graded staff. This discrimination is discouraging the talent heading towards banking sector.
- In the current banking system, banks collect deposits from the customers and invest them into government papers and in return they earn a lot of extra money and it's risk free. When the interest rates come down, they will be sitting on huge capital gains for the next four to five years and there are fewer incentives for banks to invest in human resources.
- 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%. We are not expanding the banking sector, we are doing debunking as cash leakage mutes the capacity of banking multipliers to expand deposits. To overcome this, 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.
- Competition is an essential factor for the growth and efficiency of any industry. In 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. 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.
- Besides, 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 numbers of state banks, 10 percent of the total deposits come 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.

At last, the banks are not only the large user of technology but also the large investors. Unfortunately, in Pakistan, the banking sector is not so innovative because we lack talent development which is the essential element for innovation.



[https://www.youtube.com/watch?v=XhkNVlzahHs&feature=emb\\_logo](https://www.youtube.com/watch?v=XhkNVlzahHs&feature=emb_logo)

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