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Effect of Privatization on Banking Sector Performance in Pakistan

HamnaShafiq
MS Scholar, Department of Management Sciences,TheIslamia University of Bahawalpur (Pakistan)
Hamna.shafiq786@yahoo.com

Abstract
The purpose of research is to discover the effects of Privatization on banking sector performance in Pakistan.The tactic applied for conducting current research is quantitative research. I have adopted ratio analysis method, common size and vertical analysis to find effects of privatization on banking sector performance in Pakistan. From the research the result concluded that HBL is in a progressing condition after privatization than other banks, or we can say that privatization has a good effect on HBL because before Privatization banking sector facing such a problems like politics involvement in banking decisions, over staffing etc. Other banks should follow HBL policies and strategies to move their financial institution towards progress and success.The management should try to decrease job insecurity among the employees.There should be transport facility for the employees.The bank charges high service charges as compared to the other banks, so these should be lowered down.Surveys must be conducted regarding customer satisfaction level at all levels.Quick response to customer queries is necessary to maintain a healthy relationship with the customer.Other Banks shouldfollow the policies of HBL.
Keywords: Banking, privatization, performance, financial analysis, management.

INTRODUCTION

For the stable economy there is a need to take steps with which direct investment and foreign investors feel safe and easy to invest without facing any kind of trouble relate to their precious investment or savings. The economy condition after the independence of Pakistan face many turns. In 1958 Pakistan was under army control, at that time the economy condition was little stable but in 1971 there was inverse change in economy of Pakistan when Bhutto take a charge firstly the division in two parts was a big shock and this government take many private institutions in the public authority which cause a large reduction in foreign investment. Then in 1978 Gen. Zia governance comes and that tenure was said to be good for economy because many institutions were firstly privatize in Pakistan to attract foreigner investor. **(SBP Research Bulletin,2000)**

On June 31, 2002 Pakistan privatization commission announced that government of Pakistan granted 51% rights of Habib bank limited of Pakistan, the first commercial bank of Pakistan to Agha khan fund for economic development against investment of PKR 22.409 billion (USD 389 million) and it continued to dominate in banking sector with a major market share in inward foreign remittances (55%) and loans to small industries, traders and farmers.Throughout the decades, HBL has held the mantle of a dynamic leader, by adding value to the lives of its customers with a domestic market share of over 40%.

The main objective behind privatization:
1. To reduce the Fiscal Deficit
2. Increase the efficiency of investors Savings
3. To make easy the foreign direct investment
4. To increase the effectiveness of institutions

COMPARISION OF HBL BEFORE ANDAFTER PRIVATIZATION

Ratios	HBL (Average) Before Privatization	HBL (Average) After Privatization
Return on Assets (%)	0.27	0.377273
Return on Deposits (%)	0.314275	0.179843
Return on Equity (%)	20.06	18.04045
NPL to Advances	1.1588	2.345227
Provisions to NPLs	-14.8625	-12.5915
Non-Performing Loans Billion	-6.5825	-7.93932
NPLs Growth (%)	-31.784	-16.0597
Price to Earnings	3.1825	4.652045
Market Value to BookValue	1.285	3.805909
Debt to equity	-3.425	-2.35045
Deposit times capital	2.01	-0.45545
Debt to asset	0.2175	0.227045
Earning assets to assets	2.9075	-13.4572
Advance to deposit	-39.6472	-25.3925
Yield on earning assets	3.6	5.542955
Cost of funding earningasset	0.615	1.800745
Equity to assets (%)	1.14875	1.91429
Equity to deposits (%)	-5.61	3.19143
Earning assets to deposits	31.825	20.0957

Figure 1 (Impact of Privatization, 2012)

INDUSTRY ANALYSIS

Banking sector is rapidly and most promising sector in Pakistan economy it shows growth rate of 6.4% major reasons of this progress is consumer financing, Islamic banking and micro financing. Major competitor in this industry is National bank of Pakistan, UBL, Punjab Bank of Pakistan and Allied Bank Limited. According to porter's five forces model the rivalry and competition among these banks increasing but entry and exit is not easy.

RATIOS OF HBL

Year	2008	2009	2010	2011	2012	2013
Return onAssets (%)	1.65	1.78	1.85	1.42	1.32	1.44
Return on Deposits (%)	1.48	0.0125	0.0244	2.54	2.63	2.12
Return on Equity (%)	13.52	16.25	0.25	22.3	24.21	22.47
NPL toAdvances	8.5	11.45	0.1235	13.14	14.54	12.15
Provisions to NPLs	14.25	22.12	0.0765	10.25	11.02	12.25
Non-Performing Loans Billion	25.02	1.98	20.25	19.86	16.98	13.65
NPLsGrowth(%)	25.62	41.25	0.3328	25.21	45.25	44.1
Price toEarnings	9.65	9.52	14.25	12.35	14.25	12.74
MarketValue to Book Value	4.25	4.12	5.25	11.25	9.36	8.71
Debt to equity	13.25	9.36	10.45	8.25	7.36	4.1
Deposittimes capital	8.88	8.2	9.45	4.52	8.14	7.25
Debt to asset	0.78	0.96	0.78	0.88	0.96	0.95
Earningassets	88.25	0.7715	0.982	88.65	45.69	47.25
Advance to deposit	84.36	75.68	68.25	55.58	89.558	75.65
Yield onearning assets	10.25	11.25	0.1425	14.22	12.36	14.25
Cost offunding earning asset	4.25	4.22	0.0322	3.89	5.25	5.211
Equity to assets (%)	9.55	11.36	0.072	8.15	9.25	10.25
Equity todeposits(%)	11.47	13.78	0.1098	16.25	12.35	14.25
Earning assets to deposits	0.7425	0.7925	0.8025	95.25	94.36	91.25

Figure: 2 **(HBL2008 to 2013, Annual reports)**

COMPETITOR

MCB Bank Limited (formerly Muslim Commercial Bank) previously named as a (Mansoor Co-operative Bank) was incorporated by the Adamjee Group on July 9, 1947, under the Indian Companies Act, VII of 1913 as a limited company. The bank was established to provide banking facilities to the business community of South Asia. The bank was nationalized in 1974 during the government of Zulfikar Ali Bhutto. This was the first bank to be privatized in 1991 and the bank was purchased by a consortium of Pakistani corporate groups led by Nishat Group. As of June 2008, the Nishat Group owns a majority stake in the bank. The president of the bank is Imran Maqbool.(**Annual report MCB)**

FINANCIAL ANALYSIS

2012 ratio analysis

RATIOS	HBL	MCB
Current ratio	1.20	1.25
Debt/ Equity Ratio	0.68	0.49
Net Profit Margin	14.72	14.75
Price/Earnings Ratio	20.97	17.50
Book Value Per Share	25.30	14.61
Return on Equity	24.21	16.31
Return on Asset	9.25	7.54
Asset Turnover	0.56	0.51

Figure 3 (HBL & MCB, 2012Annual report)

There is no major difference between HBL and MCB's current ratio. It means both have enough current resources and assets to meet their current liabilities. MCB has slightly more current resources than HBL.

Quick ratio cannot be calculated as both banks are working in service sector and don't have inventory. Same is in inventory turnover ratio, Debt equity ratio of HBL is greater than MCB that means HBL has more debt financing than MCB which makes HBL more leveraged and riskier.There is no major difference between Net profit margin ratios of both Banks. Both has approximately same profit margin. The Price earnings ratio of MCB is much better that shows the earning ability and stability of MCB as well as the investor attraction towards the shares of MCB. It shows that the earning potential of MCB is much better than HBL. Book value of HBL share is almost double than MCB shared. It shows the strength of HBL share as well as wealth maximization and growth in HBL. MCB is earning more return on its equity than HBL. It will be favorable condition for MCB as investor will prefer to invest in MCB rather than HBL.HBL has a nominal edge in return on assets ratio over MCB but overall both are performing well and there is no major difference. The both banks are earning almost equal return on their assets employed. Assets turnover of both the banks is almost equal. Both are not fully utilizing their assets to generate sales and revenue.While talking about overall financial ratios and health of both banks, we can say that MCB has an edge over HBL in some areas and MCB is performing better than HBL especially in Current ratio, debt equity ratio, price earnings ratio and return on equity ratio.

SHORT TERM LIQUIDITY

Short term liquidity can be measured by current assets and current liabilities; due to nature of business we have taken total assets and total liabilities. By checking horizontal analysis we can see that in 2012 total assets of company increased much higher than total liabilities, which indicates that company is in good position to meet its obligations, graphical representation of this analysis has been given below.

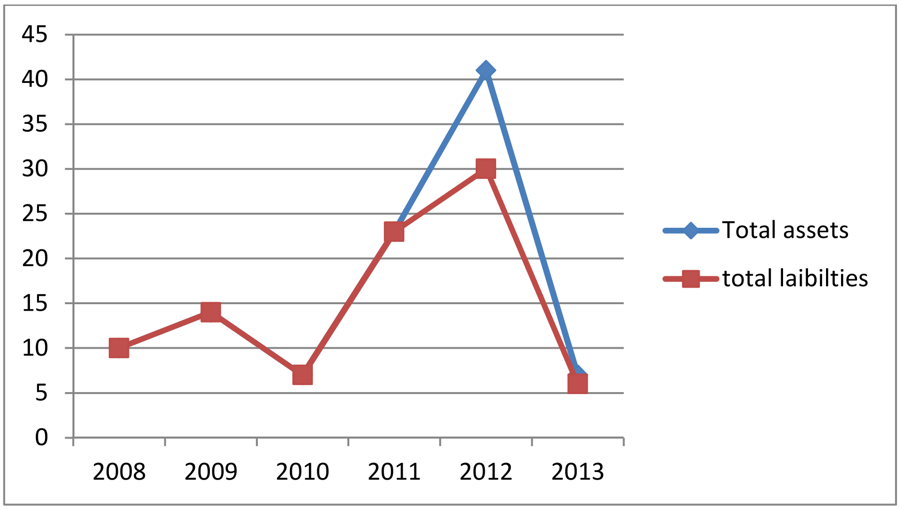

Figure: 4

COST MANAGEMENT

To check that how much efficient is management of company to manage the cost, we can use CGS and operation cost. Due to nature of business we have used only operating cost because there is no CGS of banks. From 2008 to 2010 company management is very effective to manage cost but after that cost of company goes upward, which indicates that company management is failed to control increasing cost. The reason behind this can be the hiring of unproductive staff.

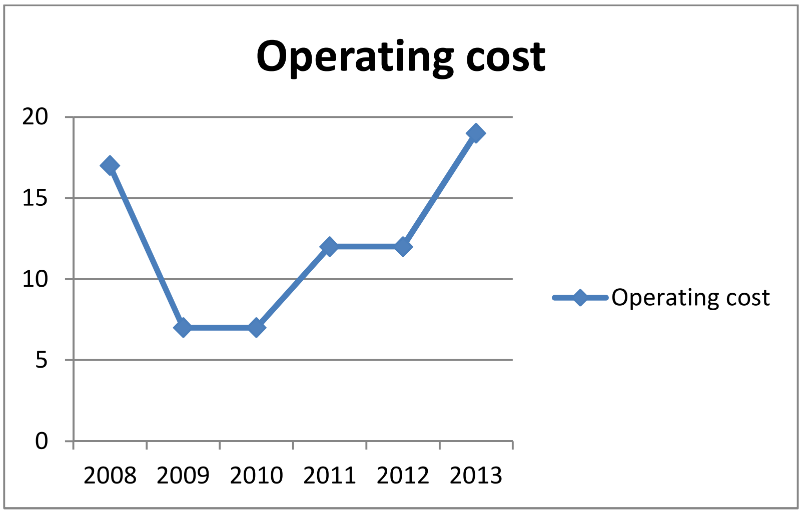

Figure 5

PROFITABILITY

Horizontal analysis shows that company's net profit is increasing year by year except in 2012. In 2012 company profit goes down from compared to last year. This might be due to inefficient management. Company's interest earnings also go down in 2012 and in 2013. Ratios of that company are unable to use its assets efficiently for generating profits.

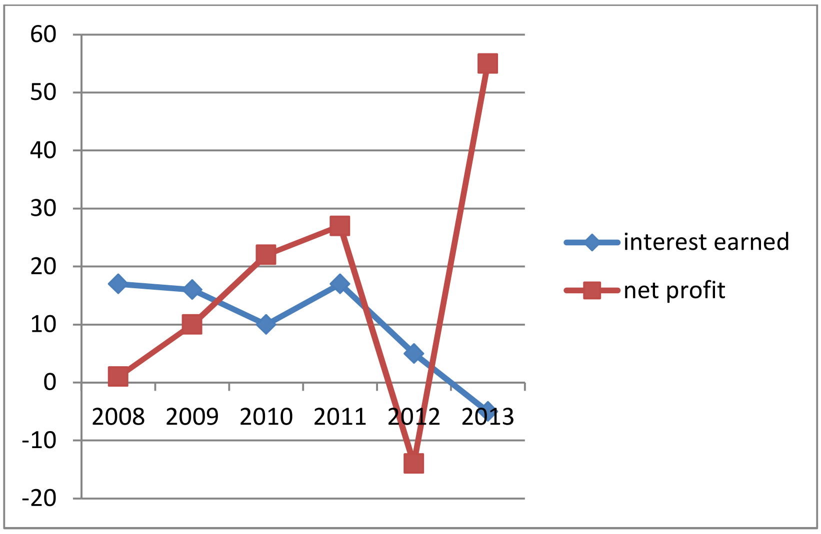

Figure 6

CAPITAL STRUCTURE

Company is heavily relying on equity which is very good for the company because heavy debt can leads toward heavy losses. This shows that investor has strong believed on the company and they are willing to invest in this company. Graphically representation for that have been shown below

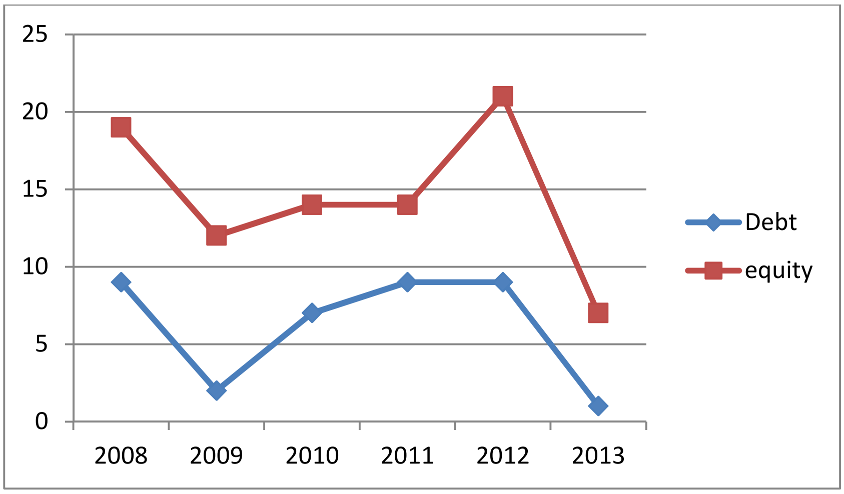

Figure 6

CONCLUSION

From the research the result concluded that HBL is in a progressing condition after privatization than other banks, or we can say that privatization has a good effect on HBL because before Privatization banking sector facing such a problems like politics involvement in banking decisions, over staffing etc. I recommend other banks to follow HBL policies and strategies to move their financial institution towards progress and success. With the advent of the new administration and management, Habib Bank Limited has gone through a Human Resource crisis. New employees have been taken on board and older ones have been made to leave. There have been sharp pay cuts and fringe benefits that had been previously offered have been reduced. Pensions and staff loans have been abolished altogether, as have deal accounts, advance rent payment benefits and medical facilities for parents been abolished. Inefficient people had been made to resign through golden handshakes, wherein employees were paid a sum of money and asked to retire permanently which were introduced whilst ShaukatTareen was in office, but have now been replaced with Voluntary suppression scheme which offers lesser benefits. Hierarchy has increased and there is an ever widening gap between the management and the employees. The employees are demoralized because of the new unfriendly Human Resource policies. Despite winning the Best Bank in 2010, Habib Bank Limited has a number of cases pending against it in the Supreme Court, most of which pertain to Human Resources. Approximately 17000 employees have been laid off in the last eleven years. Although the bank's reputation has risen in the last few years, as have its profits and efficiency, the fact that the bank was privatized at a time when foreign investment was being heavily poured in, and that the value of the net assets as of 2003 superseded the value that the Agha Khan Fund for Economic Development paid for the network by more than Rs 1 billion has raised a lot of questions in the mind of the stakeholders.

FACTORS THAT LED TO PRIVATIZATION:

According to official sources, two main factors led to the privatization of the largest and the most lucrative banking network of Pakistan.

1. Over Staffing:

Like many other government institutions, HBL also had a problem of over staffing. In the year 1996, more than 31000 employees worked for the Habib Bank Limited. This figure is inclusive of both clerical and non-clerical staff. This over staffing caused shrinkage of profits because of the salaries and wages payable to staff that was not needed. Paradoxically, while this problem had been one of the root causes of privatization, it also acted as the toughest barrier against the decision of privatization.

2. Political Pressure

The economic policies of Pakistan had a trickledown effect on the policies of the bank and thus the policies of the bank had to be synchronized with the policies of the government. Pakistani politics is an unstable arena, and policies are modified with the advent of every new office bearer. Thus there is lack of consistency. This inconsistency, according to the proponents of the privatization decision led to inefficiency. The intent behind the privatization decision was to make Habib Bank Limited an independent organization so that it could function and perform to its maximum potential.

RECOMMENDATIONS:

- The management should try to decrease job insecurity among the employees.
- There should be transport facility for the employees.
- The bank charges high service charges as compared to the other banks, so these should be lowered down.
- Surveys must be conducted regarding customer satisfaction level at all levels.
- Quick response to customer queries is necessary to maintain a healthy relationship with the customer.
- Other Banks show follow the policies of HBL

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Balance sheet Horizontal analysis

Assets	2013	2012	2011	2010	2009	2008
Cash and bank balance with treasury bank	(14)	52	27	2	41	2
Balance with other Banks	20	1	27	(7)	3	45
Lending to financial Institution	42	(40)	37	467	(14)	280
Investments	4	90	64	18	57	(22)
Advances	13	9	(1)	1	(0)	19
Operating Fixed Assets	9	23	19	(4)	14	7
Defferd Tax Assets	(16)	(17)	(24)	4	(18)	70
Other Assets	24	20	28	(15)	16	30
Total Assets	7	41	23	7	14	10
Liabilities						
Bills Payable	3	36	42	(3)	1	(36)
Borrowings	(45)	398	(2)	(23)	12	(21)
Deposits	15	30	25	9	14	12
Sub ordinate Loans	(52)	8	18	2	7	28
Other liabilities	1	9	43	(12)	20	25
Shareholder Equity	7	21	14	14	12	19
Total Liabilities	6	30	23	7	14	10

Balance sheet Vertical analysis

Assets	2013	2012	2011	2010	2009	2008
Cash and bank balance with treasury bank	7.898265	9.763937	9.073691	8.828842	9.241526	7.458902
Balance with other Banks	3.343014	2.979555	4.15509	4.045983	4.672477	5.186152
Lending to financial Institution	2.056321	1.541832	3.648886	3.280995	0.619599	0.817199
Investments	48.15928	49.49949	36.73403	27.5667	25.05629	18.22675
Advances	32.86365	31.03864	40.13566	49.71886	52.62756	60.2109
Operating Fixed Assets	1.498673	1.467565	1.682031	1.747086	1.940756	1.946259
Defferd Tax Assets	0.297508	0.376107	0.638485	1.035169	1.065596	1.480673
Other Assets	3.883293	3.343173	3.932126	3.776363	4.776197	4.673166
Bills Payable	1.234859	1.2819	1.219293	1.05711	1.162317	1.312031
Borrowings	6.857953	13.30325	3.463957	4.375461	6.081893	6.180662
Deposits	89.08931	82.21742	81.92954	80.82354	79.02888	78.77928
Sub ordinate Loans	0.167412	0.368173	0.441936	0.463052	0.487552	0.521807
Other liabilities	2.650462	2.797689	3.328619	2.871965	3.473487	3.287017
Shareholder Equity	9.055881	8.981906	9.616654	10.40887	9.765873	9.9192

Profit n loss Horizontal Analysis

ITEMS/YEARS	2013	2012	2011	2010	2009	2008
Mark-up/ return profit/interest earned	3	21	19	7	20	25
Mark-up/ return/ profit/interest Expensed	10	42	21	3	26	38
Net mark-up/profit/interest income	(5)	5	17	10	16	17
Provision against loans and advances	(78)	13	(15)	(14)	27	(16)
Charge against off-balance sheet obligations	220	(110)	(322)	(160)	(114)	(782)
Reversal against diminution in the value of investments	(53)	(155)	(1939)	(114)	(82)	(2365)
Net mark-up/profit/interest income after provisions	5	7	21	17	22	19
Fee, omission and brokerage income	22	33	(6)	2	18	32
Dividend income	55	30				
share of profit of associates and joint venture	6					
Income from dealing in foreign currencies	(10)	(26)	9	67	(19)	60
gain on sale of securities	70	220				
gain on held for trading securities	(151)	(1840)				
other income	28	11	(1)	(17)	7	18
Total non-mark-up/ interest income	21	32	(5)	14	(32)	63
Non-markup/ interest income	9	12	14	17	2	32
Administrative expenses	19	12	12	7	7	17
other provisions/write offs-net	(117)	(348)	(163)	(15)	5	(172)
other charges	27	(76)	(57)	4948	(95)	(24)
workers welfare fund	1	9	25	31	23	
Total non-mark-up/ interest expenses	17	13	10	8	6	21
Profit before taxation	2	11	18	26	(3)	45
current	(17)	27	4	20	(7)	20
prior years	(128)	139	(72)	(157)	(570)	(86)
deferred	(664)	(147)	(407)	(133)	(140)	(35)
Taxation	3	13	13	25	24	27
Profit after taxation	1	10	22	27	(14)	55

Profit n loss Vertical Analysis

ITEMS/YEARS	2013	2012	2011	2010	2009	2008
Mark-up/ return profit/interest earned	**110.67030**	**107.37371**	**94.07485**	**94.12196**	**99.77041**	**98.34319**
Mark-up/ return/ profit/interest Expensed	**60.02598**	**54.26253**	**40.54087**	**39.73231**	**43.81009**	**41.20696**
Net mark-up/profit/interest income	**50.64432**	**53.11118**	**53.53399**	**54.38965**	**55.96032**	**57.13623**
Provision against loans and advances	**1.47539**	**6.66083**	**6.27975**	**8.79873**	**11.53364**	**10.72666**
Charge against off-balance sheet obligations	**0.02065**	**0.00645**	**(0.06684)**	**0.03576**	**(0.06740)**	**0.57882**
Reversal against diminution in the value of investments	**(0.20740)**	**(0.44492)**	**0.85506**	**(0.05517)**	**0.45441**	**2.96697**
Net mark-up/profit/interest income after provisions	**49.35568**	**46.88882**	**46.46601**	**45.61035**	**44.03968**	**42.86377**
Fee, omission and brokerage income	**7.63286**	**6.23951**	**4.96037**	**6.28757**	**6.97230**	**7.01926**
Dividend income	**0.69901**	**0.45076**	**0.36719**	**0.00000**	**0.00000**	**0.00000**
share of profit of associates and joint venture	**1.64360**	**1.55407**	**0.00000**	**0.00000**	**0.00000**	**0.00000**
Income from dealing in foreign currencies	**2.11645**	**2.36138**	**3.38447**	**3.69119**	**2.50896**	**3.68846**
gain on sale of securities	**2.13000**	**1.25108**	**0.41520**	**0.00000**	**0.00000**	**0.00000**
gain on held for trading securities	**(0.01180)**	**0.02322**	**(0.00142)**	**0.00000**	**0.00000**	**0.00000**
other income	**3.57781**	**2.79548**	**2.66494**	**3.19457**	**4.37107**	**4.84146**
Total non-mark-up/ interest income	**17.78792**	**14.67549**	**11.79077**	**14.77067**	**14.63529**	**25.44418**
Non-markup/ interest income	**67.14361**	**61.56431**	**58.25678**	**60.38101**	**58.67496**	**68.30795**
Administrative expenses	**33.24070**	**27.93567**	**26.40898**	**28.06929**	**29.83021**	**33.16374**
other provisions/write offs-net	**(0.04455)**	**0.25548**	**(0.10912)**	**0.20618**	**0.27565**	**0.31095**
other charges	**0.02133**	**0.01681**	**0.07568**	**0.20682**	**0.00464**	**0.10059**
workers welfare fund	**0.66382**	**0.65692**	**0.63763**	**0.60379**	**0.52349**	**0.50267**
Total non-mark-up/ interest expenses	**33.88130**	**28.86489**	**27.01317**	**29.08609**	**30.63399**	**34.07795**
Profit before taxation	**33.26230**	**32.69942**	**31.24361**	**31.29492**	**28.04097**	**34.23000**
current	**9.76701**	**11.78131**	**9.87304**	**11.22494**	**10.61704**	**13.45493**
prior years	**(0.10817)**	**0.38731**	**0.17180**	**0.72881**	**(1.43650)**	**0.36212**
deferred	**2.40602**	**(0.42632)**	**0.96719**	**(0.37366)**	**1.28601**	**(3.84314)**
Taxation	**12.06486**	**11.74230**	**11.01203**	**11.58009**	**10.46654**	**9.97391**
Profit after taxation	**21.19744**	**20.95712**	**20.23159**	**19.71483**	**17.57443**	**24.25609**