Performance Of State Owned Bank Of Pakistan In The Perspective Of Global Financial Crisis

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Abstract:
This study aims at investigating the performance of one and only state owned commercial bank ie National Bank of Pakistan during recent financial crisis.The key performance indicators for this purpose were liquidity, profitability and stability. This study covers a period of five years from 2008-2012 and the Year 2007 was taken as base year on the basis of that the impact and performance was gauged by using financial ratios as measuring tool .The financial ratios meant for Profitability, liquidity and capital structure were calculated. Also impact on performance of loans was evaluated to relate it with globalization.
Primary data was also collected through survey by using a closed ended questionnaire. The main findings (I) there seems significant impact on liquidity and profitability of banking system. (II) Non Performing Loans were accumulated significantly after multi year better performance of healthy loans. (III) It was also revealed that the cost of deposits were increased which has adversely affected the profitability of well established five big banks of the country.
Key Words**: **Global Financial Crisis, Commercial Banks, Liquidity, profitability, Non Performing Loans

Introduction:

The main objective of this paper is to evaluate the performance and growth of state owned commercial bank i.e. National Bank Of Pakistan (NBP) Pakistan during the recent global financial crisis which basically started in United States but engulfed the entire world. While the scale of economic loss varied from country to country, the renowned economists agree that the current downturn is more than that of Great Depression of 30s.These are basically credit crisis which are direct consequence of fall down of the mortgage market in United States.

The study is mainly aimed at to analyze & evaluate the performance of state owned commercial bank-NBP for the period 2007-2012. Data were collected from their financial reports. In this age of sophisticated technology and competitive financial market it is very common to use this method of investigation for evaluating Banks performance.

Causes of Crisis

The foremost causes of crises were imprudent & careless lending for a long period of time, fair value of collateral so accepted was ignored, repayment capacity of borrowers was not checked in most cases even down payment was relaxed, improper rating was awarded by rating agencies against attractive incentives, relaxation of regulations by US government especially repeal of the Glass-Steagall Act of 1933..

Impact of Global Financial Crisis

The financial crises got unusual momentum during the period from 2004 -2007, stock markets of the world witnessed slow down. It caused collapse of Financial Institutions including giant financial & insurance institutions such as Lehman Brothers, American International Group Inc(AIG), Fannie Mae, Freddie Mac etc. Central Banks in weak economies such as Ice Land turned out as bankrupt, so many large banks applied for bailout to avoid collapse. Investors lost huge amount worldwide. This resulted into severe liquidity crunch and credit squeeze in the financial markets.

Impact of Global Financial Crisis on Pakistan

A strained global economic recession has seized FDI (Foreign Direct Investment) which declined by 47.5 % during the period July-April2008-09 However remittances by workers' from abroad remained unaffected which were around US $ 6.4 bln. Pakistan was unable to raise funds from capital markets of the world as entire globe was gripped due to such unprecedented global financial crisis. Literally Pakistan's presence was very much limitedin the international capital markets during 2008-09.

Overall Impact on Banking Industry in Pakistan

Keeping in view the demands for financial & economic globalization, Banking system of Pakistan also initiated to link itself with global financial market.

Consequent upon rumours spread over the country regarding Seizure of Lockers and freezing of Foreign Currency Accounts (FCY) Pakistan's financial sector experienced some shocks, which resulted into noticeable withdrawals of deposits liquidity problem. To lubricate the market suffering from liquidity crunch the central bank of Pakistan injected round about $ 100 million in the market and also lowered its statutory requirements by 4 %.

Review of Literature

An attempt has been made to analyze and explore the causes and consequences of Global financial Crisis on various dimensions of Banking industry in Pakistan particularly performance of sample bank with respect to their liquidity, solvency& profitability. The existing literature explores the causes globally is reviewed as under.

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 subprime 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 hasclaimed that the current global economic recession is worse 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 morefirmly and tightly. Rather they promoted such risky business instead by behaving in a speculative manner and looked for bailout.

Nicholson, 2008 confirms that global financial crisis which gets start from United States has engulfed the entire world. The crisis was so severe that it not only affected US financial industry but crashed stock exchanges of many countries of Asia & Europe. Global Financial crisis also affected Socialist economies apart from capitalist, Russian stock Market also dropped significantly during May 2008.

Bartlett (2008) has expressed his point of view on the causes of financial crisis, he stated tha losses were unprecedented in the history ,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

Performance Highlights of NBP

biggest one even in comparison of banking crisis of Japan accounted for to US$ 780 billion approximately during 90s,During Asian crisis the losses were accounted for around US $ 420 billion during 90s and Saving & Loan Disaster of United States were around US $ 380 billion during 1986-95

JPMorgan et al, 2006, explored that Mortgage-Backed securities which were highly risky has witnessed a tremendous expansion after 1998 although it initiated growth in 70s but its use was very much limited in mortgaged backed industry before late90s.

Wim Naude has very clearly expressed that there were several causes of global financial crisis which include inter alia weak regulatory checks ,easy access to cheap money, Irresponsible, imprudent & aggressive lending ,rise in housing prices with the start of the century which unduly facilitated the mortgage backed loans around one trillion US dollars particularly to those households who otherwise were not entitled to avail the facility on the basis of very little repaying the risk so arising was covered by securitization. The predictable income from such infected finances were packed with other securities like CDO (Collateralized Debt Obligations) & were sold onward by getting required rating of AAA from world fame rating agencies for which they were offered handsome incentives. Moral Hazards & Conflicts of interest were common all over in the system.

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 $ 300To 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).

Profitability Ratios	Years Ration Data					
	2007	2008	2009	2010	2011	2012
Profit before tax ratio	55.49%	37.74%	28.61%	27.60%	27.29%	23.24%
Gross Yield on Earning Assets	10.39%	11.28%	12.08%	12.91%	12.96%	12.43%
Gross Spread ratio	66.50%	60.81%	49.34%	48.85%	49.11%	43.63%
Cost / Income ratio	33.47%	44.12%	50.51%	52.77%	54.72%	61.98%
Return on Equity	27.48%	19.00%	19.21%	16.93%	15.93%	13.93%
Return on Capital employed	27.48%	19.00%	19.21%	16.93%	15.93%	13.93%
Gross Profit ratio	45.09%	33.72%	27.62%	31.34%	32.68%	28.79%
Net Profit to Sales	29.69%	19.98%	18.78%	16.55%	15.35%	13.04%
Return on Assets	2.72%	1.96%	2.07%	1.77%	1.61%	1.31%
Non interest income to total income	28.71%	30.70%	33.24%	29.82%	29.84%	36.73%
Liquidity Ratios						
Gross Advances to Deposits ratio	63.31%	73.21%	73.00%	64.91%	63.87%	70.36%
Net Advances to Deposits ratio	57.50%	66.04%	65.32%	57.38%	56.95%	63.73%
Investments to Deposits Ration	35.67%	27.38%	29.91%	36.18%	34.45%	33.10%
Cash & Portfolio investment to Deposit Ratio	51.70%	44.41%	45.95%	50.08%	48.65%	48.36%
Capital Structure Ratios						
Capital Adequacy ratio	17.72%	16.61%	17.24%	17.23%	16.80%	16.98%
Earning assets to total assets ratio	83.49%	80.50%	83.63%	77.55%	75.25%	74.85%
Weighted average cost of deposit	2.91%	3.69%	5.53%	5.53%	5.19%	5.33%
Deposits to Equity ratio	854.49%	768.55%	767.49%	801.96%	839.54%	894.38%
Deposits to Total Assets Ratio	84.72%	79.16%	82.58%	83.97%	84.80%	84.41%
Equity Multiplier	1008.61%	970.88%	929.41%	955.06%	989.96%	1059.57%

Financial Analysis by using Ratios

Profit before Tax Ratio %

Bank	2007	2008	2009	2010	2011	2012
NBP	55.49	37.74	28.61	27.6	27.29	23.24

Profit before Tax ratio is clear indicator that the sample bank has been adversely affected in terms of profitability. Its Profit before Tax has decreased in terms of Gross Mark up Income due to maintenance of Advances Deposits Ratio which was fixed as 70 %.

Gross Spread Ratio %

Bank	2007	2008	2009	2010	2011	2012
NBP	66.5	60.81	49.34	48.85	49.11	43.63

Gross Spread ratio also confirms that big established state owned bank remained adversely affected during period under review. It tells that Net Markup income is decreased and Markup expense increased which also reflects from Weighted Cost of deposits.

Return on Equity %

Bank	2007	2008	2009	2010	2011	2012
NBP	27.48	19	19.21	16.93	15.93	13.93

Return on equity also indicates that equity holders' profitability was reduced significantly. Efficiency can be measured through this ratio i.e. higher ratio means better performance and vice versa

Gross Profit Ratio %

Bank	2007	2008	2009	2010	2011	2012
NBP	45.09	33.72	27.62	31.34	32.68	28.79

Gross Profit Ratio also confirms that performance was deteriorated to considerable extent. It means that Gross profit has been decreased as a result of decrease in Total revenue due to significant increase in cost of Funds/deposits.

Weighted Average Cost of Deposit %

Bank	2007	2008	2009	2010	2011	2012
NBP	2.91	3.69	5.53	5.53	5.19	5.33

Weighted Average Cost of Deposits increased to 5.53 in 2009 as compared to base figure 2.91 in 2007 which clearly depicts that Bank was under pressure to maintain its books that's why they borne extra cost to mobilize costly deposits.

Gross Advances to Deposits Ratio %

Bank	2007	2008	2009	2010	2011	2012
NBP	63.31	73.21	73	64.91	63.87	70.36

Gross Advances and Deposits Ratio also confirms liquidity pressure on banks as the advances were increased in comparison to deposits. This ratio indicates that how a Bank utilizes its deposits by extending loans, relatively low ratio contributes higher liquidity and results in low profits and low ratio creates stress for managing liquidity but higher profits. To address the liquidity issue SBP reduced SLR+CRR from 34 % to 30%

Cash & Portfolio Inv to Deposit Ratio

Bank	2007	2008	2009	2010	2011	2012
NBP	51.7	44.41	45.95	50.08	48.65	48.36

Cash & portfolio Investment to deposit ratio tells that there was decrease in cash & Portfolio investment and liquidity was relatively tight ,higher ratio is better for liquidity but inversely affect profitability on idle cash. It was suddenly decreased, a clear signal of tight liquidity prevailed in the market.

Non Performing Loans (NPL)

(Fig in Billion)

Bank	2002	2007	2008	2009	2010	2011	2012
NBP	26.32	374.73	457.83	530.86	538.61	592.37	730.14

NPLs increased from the highest figure of 2002 which was managed to large extent as at 2007 that shows that counter party failed to meet its obligation (Credit Risk)

NPLs/Gross Advances Ratio

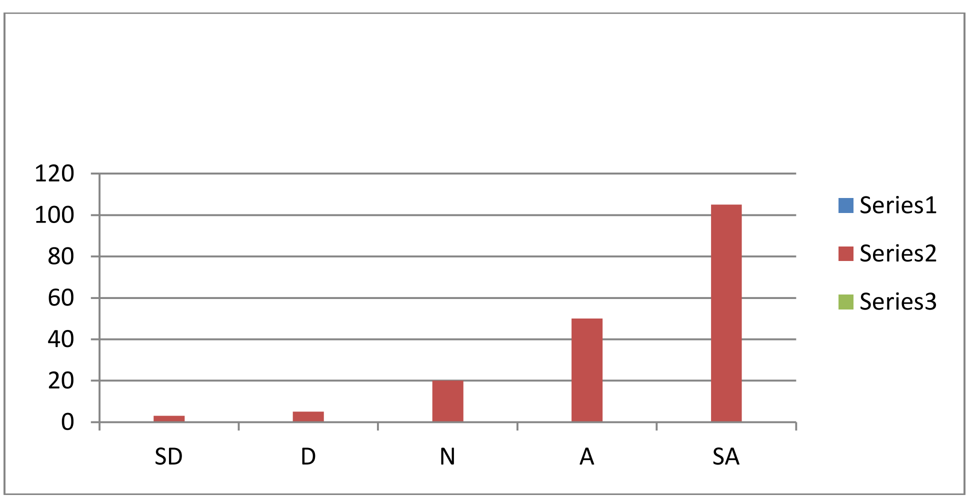
Bank	2002	2007	2008	2009	2010	2011	2012
NBP	26.32	10.23	12.33	13.36	16.09	14.88	12.6

NPLs to Gross advances ratio also confirms credit risk position prevailed during the period under review it was only due to rise in interest rates, borrowers were unable to meet their obligations.

Primary Data

Primary Data was collected from management of commercial banks and from SBP officials ,a closed ended questionnaire was developed and results were analyzed , A five point Likert scale was used as tool to gauge all the factors (1 for strongly disagree & 5 for strongly agree).

Overall Response –By 183 /200 respondents



Results

Primary data were collected from 183 out of 200 respondent also confirms that the Global Financial Crisis has affected the conventional banking industry of Pakistan in terms of Profitability ,liquidity and NPL increase.

Conclusion

This study is aimed at investigating the performance of commercial- state owned bank of Pakistan was studied in terms of financial ratios.

The current research highlighted the performance of NBP during the financial crisis. Results showed that Investments have increased due to decrease in advances (a zero sum game). The funds remaining idle from lack of advancing opportunities are being utilized in investments (mostly in government papers) .The higher portion of available funds is being used in money market due to low risk. Results from CAR have improved indicating better management of risk weighted assets. Due to implementation of BASEL requirements and tight monitoring by SBP, the banks have been providing more capital to cover risk weighted assets.

It was revealed that commercial banks even state owned bank remained under pressure to maintain their deposits position, mobilized costly deposits which badly affected its profitability. Moreover liquidity was tight for which SBP reduced SLR+CRR from 34 % to 30% besides injecting$ 20-100 millions to lubricate the financial sector. Islamic banks were not affected as much as conventional due to investment in real assets instead of cash which was limited exposure.

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