Chapter 6

Non Bank Financial Institutions (NBFIs)

NBFIs observed moderate growth during H2FY13, due to improved performance of mutual funds at the back of strong performing equity markets. Rest of the sector observed a marginal contraction. NBFIs continued to focus on deposits mobilization for funding their business activities, while shedding borrowings from financial institutions. The core financing activities including leasing and Ijarah financing gained some momentum in Modaraba Companies and leasing companies. The overall profitability of NBFIs, improved markedly due to strong earnings of Modarba Companies and DFIs, however it failed to subside the growing solvency concerns of IFCs and few leasing firms.

Figure 6.1

Growth Trend in Non-bank Financial Sector (percent)

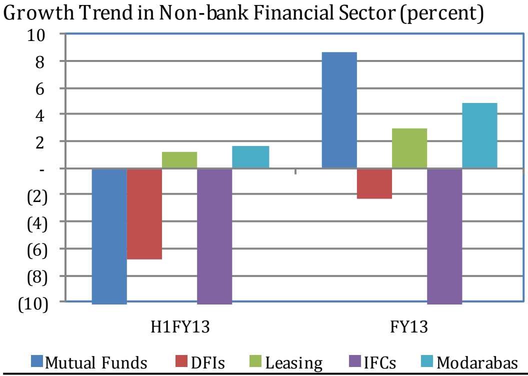


Table 6.1: Profile of NBFIs						
	FY10	FY 11	H1FY12	FY 12	H1FY13	FY13
	Assets in PKR billion Share - Growth Rate and Share in percent					
Assets (PKR Billion)	421.9	478.2	511.6	609.5	550.5	576.5
Growth rate	(10.2)	13.3	13.8	19.2	(9.7)	4.7
Share in Assets (percent)						
Mutual Funds	47.6	55.4	56.4	62.4	60.5	62.7
DFIs	26.8	25.7	28.1	24.7	25.5	23.8
Leasing	8.8	7.4	6.6	5.4	6.1	6.0
Investment Finance	6.2	5.4	3.7	2.6	2.5	2.1
Mudarabah	6.1	5.9	5.2	4.8	5.4	5.5

Overview of the NBFIs Sector

The Non-Banking Financial Institutions (NBFIs) in Pakistan constitute a diverse set of financial intermediaries[53]. However, net asset value (NAV) of Mutual funds, which represent 63 percent of NBFIs, remained the driving force behind change in growth pattern of the sector. During H2FY13, asset base of NBFIs observed a moderate growth of 4.7 percent mainly attributable to increase NAV of Mutual Funds, followed by growth in asset base of leasing and Modarba Companies (**Figure 6.1**).

The NAV of mutual funds, which dipped by 28 percent during the first half, revived on the back of robust performance of equity markets (**Table 6.1**). This coupled with downward movement in interest rates shifted the investors' interest from more risk averse money market funds (MMFs) to equity funds. Additionally, the interest in Islamic funds continued to increase, that led to 20 percent growth in its NAV during the period under review.

The NBFIs (excluding mutual funds) observed a contraction of 1 percent in the half year under review due to net reduction in assets base of Investment Finance Companies (IFCs) and Development Finance Institutions (DFIs) (**Figure 6.1**). Meanwhile, growth in Leasing and Modaraba Companies resulted from gradual revival of lease and Ijarah financing that was funded by reasonable growth in deposits and partly by borrowings from financial institutions[54]. However, on overall basis NBFIs continued to decrease reliance on borrowing from financial institutions either due to improved deposit mobilization or due to consolidation/restructuring of operations in the wake of challenging business environment.

[53] Non-Bank Financial Institutions (NBFIs) include Non-Bank Finance Companies (NBFCs), Modarabas and Development Finance Institutions (DFIs)where NBFCs include Investment Finance Cos.(IFCs), Leasing Cos., Mutual Funds, Venture Capital Cos.(VCCs).and Housing Finance Cos(HFCs). The analysis of NBFCs and Modarabas is based on annual audited accounts, data provided by the SECP, NBFIs and Modarba Association of Pakistan and MUFAP website.

[54] As per monthly statistics on *Credit/Loans Classified By Borrowers* on SBP website, advances to NBFIs increased by 5.5 percent during Jan-Jun-2013.

Table 6.2 :Performance of NBFIs

(Amount in PKR million, Ratios in %)	FY11	H1FY12	FY12	H1FY13	FY13
Profit after tax	1,704	933	907	3,926	3,823
DFIs	1,158	1,577	1,793	3,275	2,034
other NBFIs	546	(644)	(886)	651	1,789
Expense	12,683	9,645	13,510	9,082	14,229
Expense to income	745	1,034	1,489	231	372
ROA	1.36	0.13	1.18	2.03	2.70
ROE	3.77	0.36	3.36	5.71	7.29

Operating performance of the NBFIs exhibited marked improvement…

The profitability of NBFIs sector substantially improved during FY13 particularly in the second half of the year. It posted after tax profit of PKR 3.82 billion during FY13; compared to PKR 0.91 billion in FY12, showing more than 4 times increase YoY basis. Modaraba Companies, with profit of PKR 2 billion (YoY growth of 73 percent) followed by DFIs and Leasing Companies, while IFCs posted losses. Review of earning highlight varied reasons for increase in profitability of NBFIs like improvement in core leasing activity enhanced the earning of Modarabah and leasing companies, while lower provisions charge and gain on sale of investment added to the non-markup income of DFIs and Modarabas. Similarly, expense control due to decreased reliance on borrowings from financial institutions also jacked up earning of leasing companies. Accordingly, the return indicators observed a marked improvement over the year [55](**Table 6.2**).

Compliance with equity requirements remains the major challenge

The NBFIs sector has been facing solvency issues for some time. Though improved earning provided for shortfall in some of the NBFI, most of the leasing companies and IFCs still fail to meet Minimum Equity Requirements (MER). Furthermore, going concern status of some of these companies is also elusive due to deficit equity[56]. This is despite the fact that regulators allowed extension of couple of years to these companies for meeting the enhanced equity requirements.

Mutual Funds

NAV of mutual funds picked up …….

Mutual fund industry, after observing a dip in first half of the year, picked up again in H2FY13. The strong performing equity markets and changing interest rate scenario shifted the interest of the investors from more risk averse money market funds to equity funds. Islamic funds primarily contributed to overall growth followed by conventional equity funds. A record-breaking upturn in equity market not only increased investor's interest in equity funds but also boosted the NAV of Islamic and pension funds. Interest in money market funds continues to fade due to downward movement in interest rates **(Figure 6.2 and 6.3)**.

[55] Figures have been annualized for return indicators ROA and ROE.
[56] As pe annual reports of the some of the NBFIs, SECP has not renewed licenses of some these companies for sometime.

Figure 6.2

Profile of Mutual Fund Industry

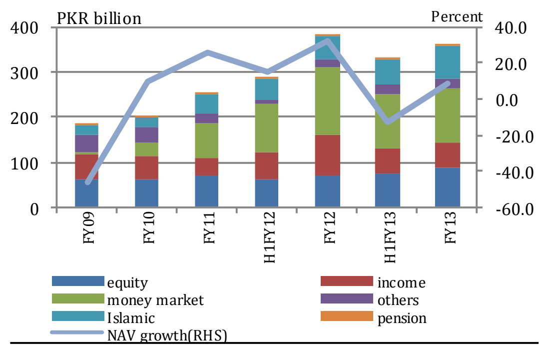


Figure 6.3

Performance of Mutual Funds

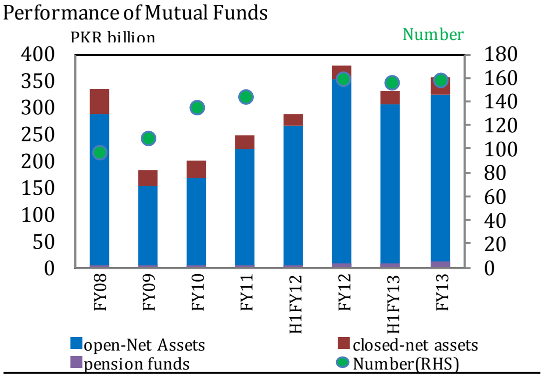


Figure 6.4

Investment structure of mutual funds (share in percent)

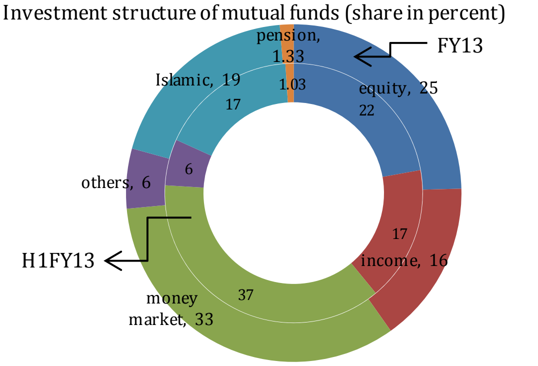
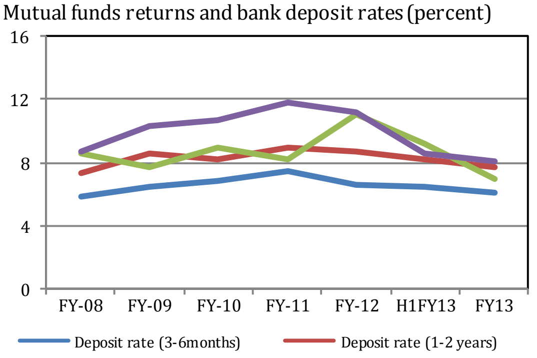


Figure 6.5

Mutual funds returns and bank deposit rates (percent)



Mutual funds industry saw a moderate growth of 8.6 percent in H2-FY13 at the back of sparkling performance of stock market. This was in sharp contrast to first half when NAV of the funds industry declined substantially. Though the growth was broad based, it was more pronounced in close ended funds which surged by 24.5 percent. The interest in close-ended mutual funds resurfaced during FY13, after remaining on downhill for few years, which enhance its share in the NAV of the funds by 111bps to 8.7 percent.

… due to stellar performance of equity market

Over the last few years, growth in NAV of money market funds (MMF) provided for most of the increase in value of the funds industry. Similarly, income funds, with an investment mix of government securities, debt instruments (TFCs, Sukuks, etc) and banks deposits, supported the overall growth. However, investment strategy saw a shift during last half year where it tilted towards equity funds due to strong equity market performance and this trend continued in second half too. The equity funds, with a growth of 22.8 percent, drove the overall performance of the MF sector. The growth in equity funds was broad based, though with a varying extent; Islamic equity funds grew by 37.9 percent, while conventional equity funds with 85 percent share in NAV of equity funds also saw a healthy increase of 20.6 percent.

At the same time, decrease in NAV of the money market funds (conventional and Islamic) slowed down the momentum of fund industry. As a result, NAV of MMFs saw another dip of 1.8 percent during H2-FY13 (19.1 percent for FY13). Though, factors (substantial borrowing needs of the Government, providing risk free investment avenue and consistently growing equity market) responsible for surge in mutual fund industry during the previous half year still existed, dip actually took place due to expectation of slow demand of Government borrowing in future and decline in discount rate. Despite decline in the NAV, MMF still held a top seat in the market share followed by equity and income funds **(Figure 6.4).**

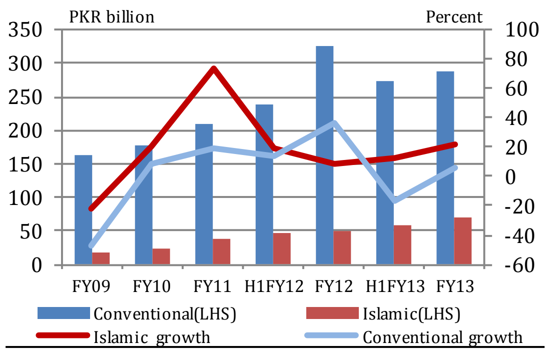
Declining variance in returns on interest based mutual funds and deposits affected the performance of funds industry…

Returns seem to be another factor that played part in dip in NAV of the interest based funds products. Traditionally, the gap between return on mutual funds and bank deposit was quite high (on average 4 percent between money market funds and short term (3-6 months deposit rates). This phenomenon of attractive and consistent returns, with investment in safe haven, remained the key reasons behind increasing interest in the mutual funds over the last 3 years. However, market saw a shift in trend in H1FY13 as returns offered on MMF declined from 11 percent to 8 percent due to 4.5 percent cut in policy rate over the last 18 months. As a result the gap between return on bank deposits and mutual funds narrowed[57] **(Figure 6.5)** which ultimately affected the attractiveness of interest based fund products.

Healthy growth in Islamic funds to some extent offset deceleration in overall NAV .....

Figure 6.6

Islamic Mutual funds accelerated growth



The Islamic Fund industry, like overall Islamic financial industry, has seen stable growth over the years[58]. The Islamic fund industry, with 22 percent growth enhanced its share to 20 percent in the second half of FY13 **(Figure 6.6).** Growth pattern of various categories of Islamic funds considerably outpaced that of the industry trend. Islamic equity funds exhibited 38 percent growth while Islamic income funds registered 17 percent growth. Further, a marginal pickup of 0.1 percent in asset value of Islamic money market funds was in contrast to conventional money market funds. With the booming equity markets and huge potential in Islamic funds, this segment expects to show substantial growth and gains in the periods ahead.

Future prospects of growth in both conventional and Islamic pension funds are bright...

Pension funds though hold nominal 1.3 percent share in fund market yet they are slowly surfacing as an important segment of market. The growth mainly resulted from favorable tax treatment[59] available to this segment of funds and also due to increased awareness among the investor and public regarding this attractive avenue for long-term savings, particularly in old age. Pension funds showed a growth of 40 percent in the half year period which is more of a low base effect as market stands at PKR 4.8 billion in H2FY13.

57 MUFAP quarterly newsletter, Sep-Dec2012. In June 2013, the annualized return of open end money market funds was 8.1 percent while income funds exhibited a return of 6.9 percent (compared with weighted average return on deposits ranging between 6.1 to 7.7 percent with a maturity of 3 months to 2 years period).

58 In terms of Islamic Financial Services Industry Stability Report, 2013 published by IFSB "Islamic asset and wealth management is a niche segment of the IFSI that has experienced stable growth since 2004. Islamic funds have grown from 285 in 2004 to 1,029 as at end-2012. As at end-2011, assets under management of Islamic funds grew to USD60 billion from USD 29.2 billion in 2004, representing a CAGR of 10.8%. This increased to USD64 billion as at end-October 2012".

59 Under section 63 of income tax ordinance, pension fund investments are eligible for tax credit up to 20% of one's taxable income. Additional catch-up incentives are provided to participants over 40 years, with a maximum tax credit on 50% of taxable income for participants who are 55 years or older.

Figure 6.7

Pension Funds Performance

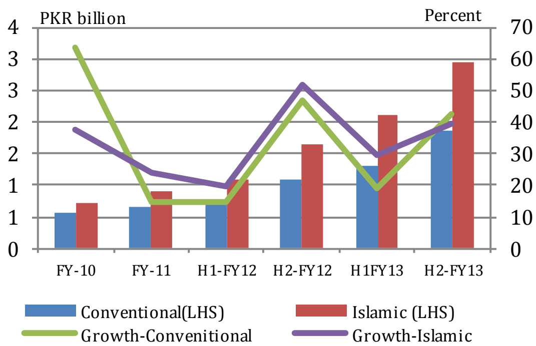
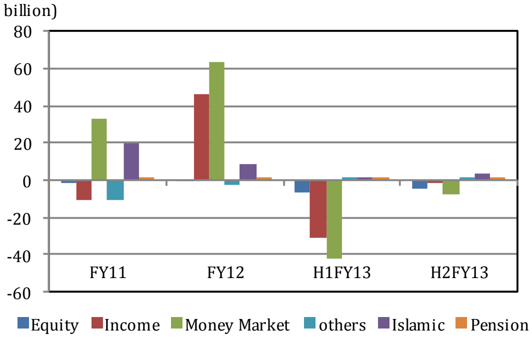


Figure 6.8

Industry observed net redemption except Islamic funds (PKR billion)



Currently there are 11 players operating in pension fund market and majority of these funds are subsidiaries or associates of large banks. In the wake of growing demand of shariah based products, Islamic pension funds hold 61 percent of market share relative to conventional funds **(Figure 6.7).** Keeping in view the long term nature of their fund base, these funds can provide for long term funding needs of market with stable returns. However, they should be wary of going into risky ventures owing to dependency of large number of old aged population on them.

Industry observed net redemption due to heavy redemption in money market and income funds

Sales and redemption pattern of mutual funds over the years have seen sales outpaced redemption except in 2009 due to liquidity crunch faced by market in the aftermath of freezing of stock exchange. In FY13, funds market again observed redemption pressure in both halves yet second half was relatively better than first half as market observed net redemption of PKR 9.18 billion as against 76.4 billion in first half **(Figure 6.8).** Overall in FY13, major redemption was seen in money market and income funds where investors offloaded their investment of PKR 83 billion. On the other hand, Islamic mutual funds including pension supported the industry by adding PKR 6.55 billion new funds across different categories of mutual funds.

In the backdrop of growing demand of Islamic financial products[60], SECP has announced formulation of Shariah Advisory Board (SAB) which is entrusted with the ascertainment of Islamic law for the purpose of development and promotion of Islamic financial institutions namely; Islamic mutual funds, pensions funds, Takaful operators and other FIs regulated by SECP. This move will play a crucial role in bringing an effective and efficient Shariah governance system enhancing the credibility of Islamic financial institutions.

[60] In H2FY13, ten new mutual funds were launched. Out of those, seven funds are established under Islamic category.

Figure 6.9

Earning Assets of DFIs (PKR billion)

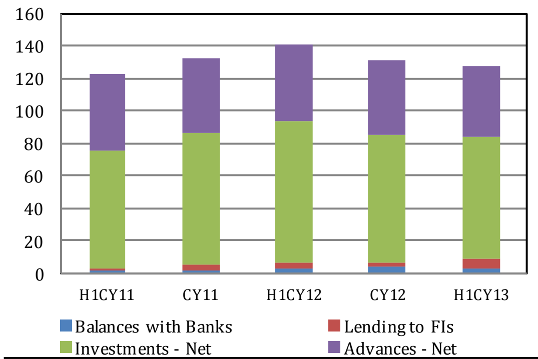


Figure 6.10

Investment composition of DFIs (PKR billion)

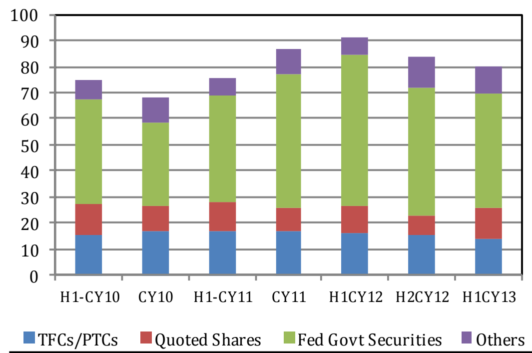


Figure 6.11

Investment Anatomy

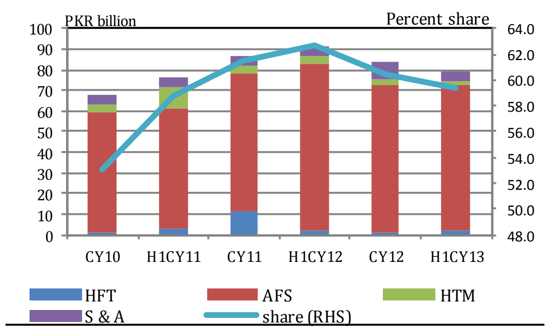
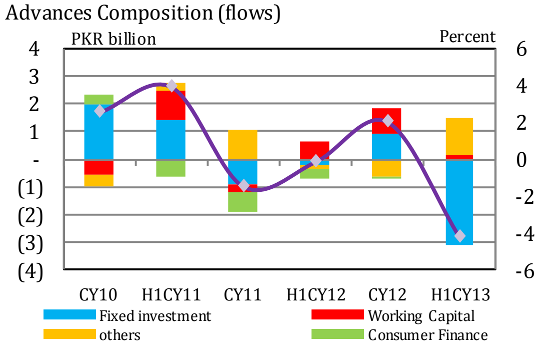


Figure 6.12

Advances Composition (flows)



Development Finance Institutions (DFIs)

Asset base of DFIs observed contraction…

Assets bases of DFIs declined by 2.3 percent during H1CY13, due to squeeze in investment and advances portfolio. On the funding side, deposit of DFIs picked up and showed a healthy 15 percent growth in period under review, after observing a decline in previous half year. The borrowing which remained the main funding source of DFIs kept on declining for the second consecutive half; reducing its share in financing by 450 bps to 36.9 percent. The DFIs posted 13 percent higher earning in June-13 due to decrease in provision charge, increase in dividend income and gain on sale of securities. On solvency front, DFIs remained sufficiently capitalized with a high CAR of 54.6 percent, despite a marginal drop in the ratio during the half year. Some companies do fall short of MCR.

Over the last three years, consistent increase in investments in Federal Government securities boosted the assets base of the DFIs. The trend reversed in second half of CY12, which continued during the H1CY13 as investments portfolio further dropped by 4.2 percent. Despite 110 bps drop in share, investments still holds the top seat in DFIs balance sheet **(Figure 6.9).** The DFIs channelized PKR 4.4 billion into stock market, which also exhibited industry expectation regarding declining interest rates in near future **(Figure 6.10).**

With investments being the main earning source of interest/mark-up income, DFIs opted flexible investment strategy of placing major chunk of investments in Available for Sale (AFS) category. This allowed the DFIs to off-load substantial portion of investment during the period under review. However, despite this decline, DFIs still holds 88 percent of their investment portfolio in AFS **(Figure 6.11).**

…while advances saw a nominal growth

In line with trend in the banking sector, lending portfolio of DFIs contracted by 4.2 percent in H1CY13. Breakup of incremental advances[61] reveals reduction in corporate sector advances mainly in fixed investment category. SMEs, the most affected sector due to prevailing economic and business environment made net retirement of PKR 9 billion. Consumer finance, the second largest

[61] Sectoral and segment based analysis of advances in this section is based on Un-audited quarterly data.

Figure 6.13

Asset quality of DFIs improved (Percent)

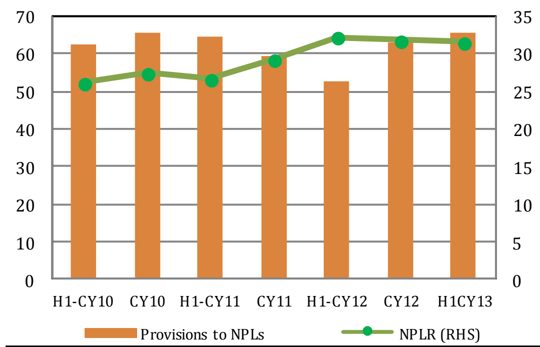


Figure 6.14

Funding structure (Percent)

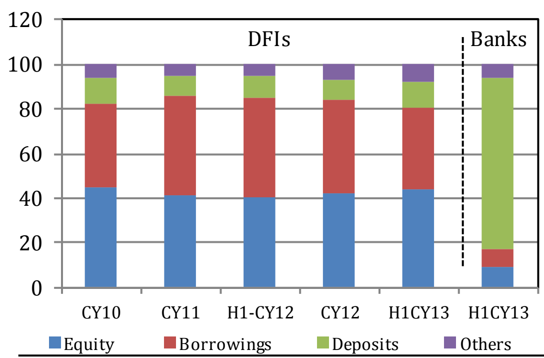


Figure 6.15

Profitability of DFIs

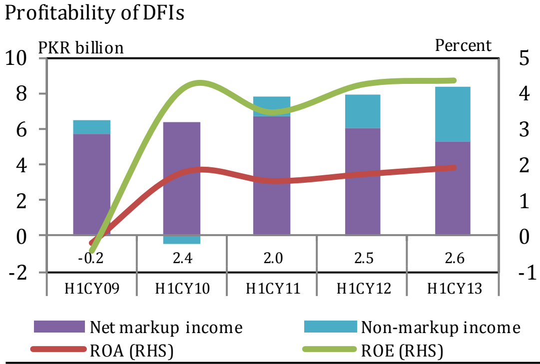
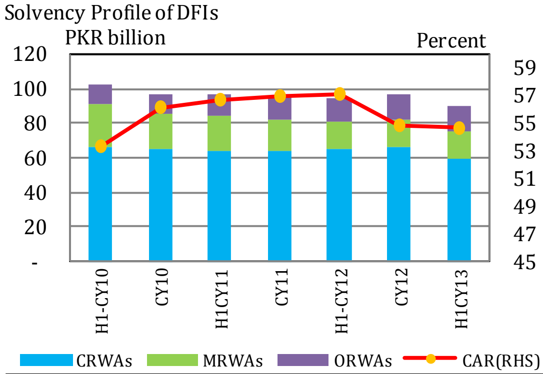


Figure 6.16

Solvency Profile of DFIs



segment in DFIs loan portfolio, lost further shares due to decline in all financing categories **(Figure 6.12).** Sector-wise analysis demonstrated net payoffs in all sectors except sugar sector.

Asset quality indicators remained contained due to stagnant NPLs

Due to smaller loan portfolio and sluggish economic growth over the last couple of years, the credit risk of DFIs kept a contained profile. This trend continued as asset quality saw a marginal improvement during the half under review. Infection ratio, with a marginal change stood at 32 percent. Excluding housing finance company, infection ratio of DFIs declined by 72 bps to 24.3 percent; clearly indicating that relatively higher impact of NPL in special mortgage finance institution contributed to a high infection rate of DFIs. Provisions coverage ratio also improved due to upgrade of NPLs into doubtful category leading to decline in net infection rate to 13.7 percent in H1CY13 down from 14.7 percent in H2CY12 **(Figure 6.13).**

Funding structure observed a positive tilt towards deposits

Unlike banks, which rely on deposits as main funding sources, DFIs dependence remained on capital and borrowing, which jointly fund 78.9 percent assets **(Figure 6.14).** However, DFIs borrowings dipped by 13 percent during H1CY13 mainly due to decline in secured borrowing under repo category. Deposit base on the other hand surged by 15 percent, inching up their share in funding to 11.4 percent; an increase of 170 bps. Equity of the DFIs also improved on the back of healthy profit made during H1CY13.

Operating performance of DFIs improved during H2FY13

Operating performance of DFIs improved during June-2013. The sector posted after tax profit of PKR 2 billion mainly due to healthy 58 percent growth in non-markup income that more than off-set the decline in core income. The deceleration in mark-up income resulted from shrinking income on advances and investments and higher borrowings cost. Most of the increase in non-mark-up income was contributed by gain on sale of investments and healthy growth in dividend income. In addition, improvement in asset quality led to reversal in provisions, which also improved the earning of the DFIs. These healthy gains reflected in improved return indicators as both ROA and ROE inched up to 3.8 and 8.7 percent respectively in H1CY13 **(Figure 6.15).**

Figure 6.17

Asset concentration in Leasing sector

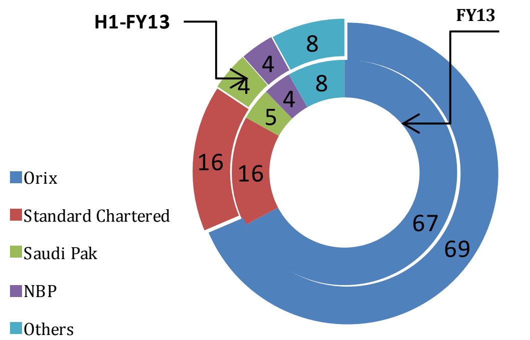


Figure 6.18

Profile of Leasing sector (PKR billion)

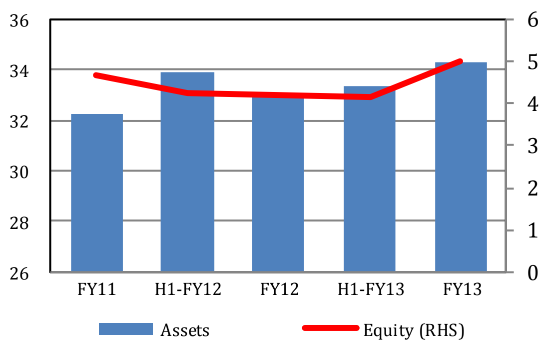


Table 6.3: Leasing sector ratios (Percent)

	FY11	H1-FY12	FY12	H1-FY13	FY13
Leases and Advances to Assets	80.5	77.6	84.5	76.7	83.1
Investments to Assets	8.0	8.1	9.4	2.3	11.8
Borrowings to Liabilities	51.2	30.3	42.6	47.7	39.4
Deposits to Libilities	17.7	18.3	21.6	24.5	30.4

Solvency remained strong though CAR observed some decline

The DFIs maintained strong solvency profile over the years due to risk adverse behavior. This phenomenon is evident from substantial drop of 9.6 percent in credit risk weighted assets followed by market and operational risks. Further, eligible capital also declined due to carry on impact of higher provisioning charge by a single institution. As a result, CAR of industry marginally dropped by 37 bps, however it still stands at comfortable 55 percent level **(Figure 6.16).**

Leasing

The focus of the leasing business in Pakistan is on corporate segment and consumer finance, with most of the disbursements for machinery, equipment, and vehicle leasing. In addition, leasing companies are also trying to venture into other segments for business diversification, though the pace remains slow. The ownership structure show that 5 out of 8 companies are part of the local or foreign banking groups and hold majority share in asset base of the sector (**Figure 6.17**).

Performance of leasing companies improved ….

The leasing companies sustained the performance of the first half of the year and registered a moderate growth of 3 percent in asset base during H2-FY13 (4.2 percent during FY13) (**Figure 6.18**). Most of the increase came from core leasing business largely supported by healthy growth in deposits. The operating performance improved considerably with ROA and ROE inched up further. However, performance remained confined to a couple of large companies. The solvency of the sector improved at the back of healthy profits, however, majority of the companies still fall short of the required minimum capital requirements.

Continuing increase in mobilization of retail funds…

The leasing companies have generally been relying on the borrowing from financial institutions for funding their operation. Over the last two years, this trend observed some shift as leasing companies, particularly major player, augmented efforts for deposit mobilization through Certificates of Deposits (CoDs) and Certificates of Investments (CoIs), while decreasing reliance on borrowings. Their deposits base surged by 17.5 percent during H2-FY13 (34 percent during FY13), which enhanced its share in liabilities to 30.4 percent (**Table 6.3**).

Though, continuous growth in deposits is a good omen, most of the increase was limited to a couple of large leasing companies. Whilst, borrowings from financial institutions observe drop of around 20 percent due to host of factors including prevailing business environment, risk averse attitude of both lenders and leasing companies, improved access to retail deposits and slow demand for funding needs.

….improved lease-financing disbursements

The lease financing revived with a growth of 4.1 percent in the half year under review (2.4 percent for FY13). Fresh disbursements mainly financed vehicles, followed by machinery and equipments. Importantly, some of the leasing companies initiated Shariah based lease financing under various Islamic modes including Musharaka, Diminishing Musharaka and Ijarah modes. This new avenue of leasing will not only allow these companies to provide Shariah based products, but also enable them to diversify their products through taping this underserved avenue of financing. In terms of assets structure, lease financing and advances remained the major financing activity of the leasing companies representing 83 percent of the total assets[62] (**Table 6.3**).

Table 6.4 : Leasing sector performance indicators

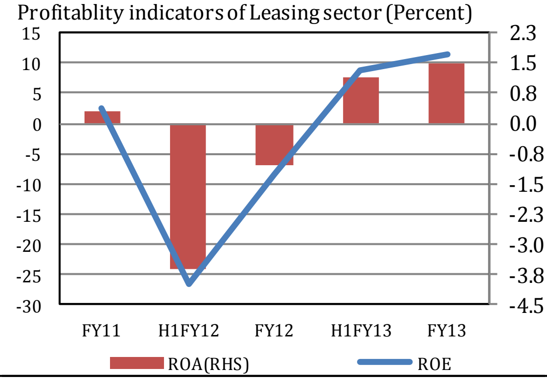
	amount in PKR milion, ratio in percent				
	FY11	H1-FY12	FY12	H1-FY13	FY13
Profit after tax	106	(600)	(371)	179	498
Income from lease operations	3,369	1,877	3,481	1,820	3,475
Income from investment	2	19	56	35	49
Expense	3,757	2,454	4,394	2,075	3,889
Expense to income	97.0	111.2	99.3	97.0	86.2
Financial expense to income	55.8	56.1	52.7	53.0	46.0

Operating performance improved markedly…

The profitability of the leasing sector observed considerable improvement mainly attributable to decline in total expenses. The sector posted profit after tax of PKR 498 million during FY13 compared to loss of PKR 371 million in FY12. Though income from lease business remained stagnant for the year, 11 percent YoY decline in overall expense boosted the overall earning of the leasing sector (**Table 6.7**). The decrease partly resulted from lower cost of borrowing and partly from lower provisions charge. The earnings performance was broad based as 6 out of 8 leasing companies posted profits. Improved profitability further increased the ROA and ROE[63] to1.5 percent and 12.9 percent respectively during FY13 **(Figure 6.19).**

Figure 6.19

Profitablity indicators of Leasing sector (Percent)



…however, leasing sector continued to exhibit solvency concerns

The equity base of the leasing sector observed 21 percent growth during H2FY13, due to accumulation of earnings and substantial

[62] NBFC and NE regulation, 2008 (Para 28a) requires Leasing companies to invest at least 70 percent of their assets in the business of leasing.

[63] Leasing sector review is based on data for half year ending Jun-13. However for two companies' financial year ends on December instead of June. To calculate ROA and ROE, profitability is annualized for overall sector.

Figure 6.20

Capital of leasing companies (PKR million)

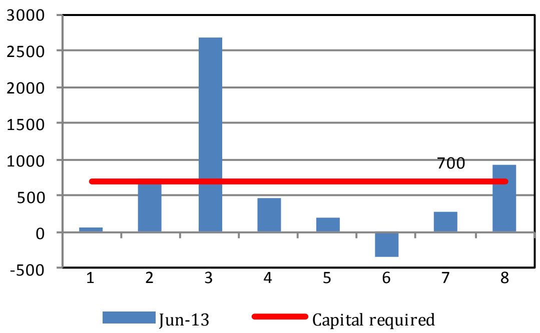


Figure 6.21

Assets and Equity of IFCs (PKR billion)

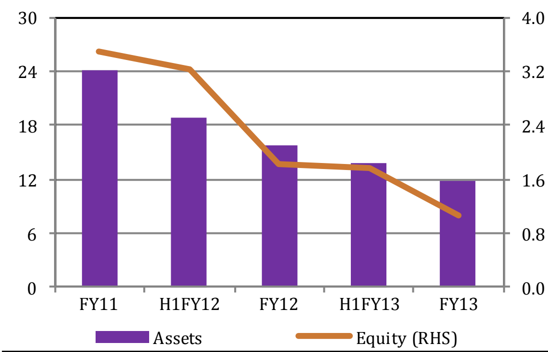
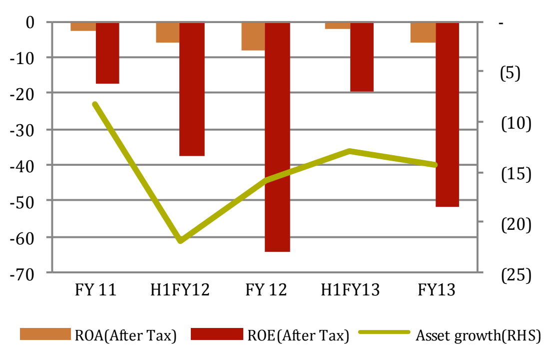


Figure 6.22

Profitability Indicators and Asset growth(percent)



capital injection by one of the leasing companies[64] Despite improved equity base, leasing sector remained under-capitalized as only 3 out of 8 operative leasing firms complied with the existing minimum equity requirement (MER) of PKR 700 million set forth by SECP[65] **(Figure 6.18).** Earlier, SECP extended the period for meeting the MER of PKR 700 million by two years to end June 2013[66]. However, most of the non-compliant companies failed to meet the capital requirements within prescribed timelines, which made going concern status of some of the companies uncertain.

Investment Banks

The IFCs share further declined in NBFCs.....

The investment banking sector, comprising only seven companies, continued to face difficulties in improving its performance. The sector shed 14 percent of assets during H2FY13, which was observable across the sector, however, restructuring of the largest IFC was largely responsible for this substantial decline (**Figure 6.21**). In addition to challenging economic environment, stiff competition from the banking sector and other institutions, offering similar services, also adversely affected the performance of the IFCs.

...due to funding constraints and shrinking business

With continuing liquidity issues facing the IFCs, it largely focused on managing liability mix through either settlement or restructuring. The deposit dipped by 11 percent, while borrowings from financial institutions decreased by about 20 percent. Given the funding constraints, investment banks failed to generate new business, which led to balance sheet squeeze. The lease and advances portfolio decrease 18 percent, while the investments declined by 28 percent.

..while solvency concerns continued due to deteriorating earnings

The operating performance of the Investment banks continued in red due to shrinking business activity. The sector posted loss of

[64] During H2FY13, Saudi Pak Leasing issued non-cumulative non-redeemable/convertible preference shares of PKR 10 each aggregating to Rs 528.209 million against conversion of debt.
65 For MER of PKR 700 million required to be met by end June 2013, number of non-compliant firms stays the same.
[66] Non-Banking Finance Companies and Notified Entities Regulations, 2008 (amendment vide SRO 764, Dated September 2nd 2009) require fresh licensed leasing companies to hold Rs. 700 million capital while existing companies to maintain Rs. 350 million by June 30,2011 , Rs. 500 million by June 30,2012 and Rs. 700 million by June 30,2013).

Figure 6.23

Minimum equity required and maintained (PKR million)

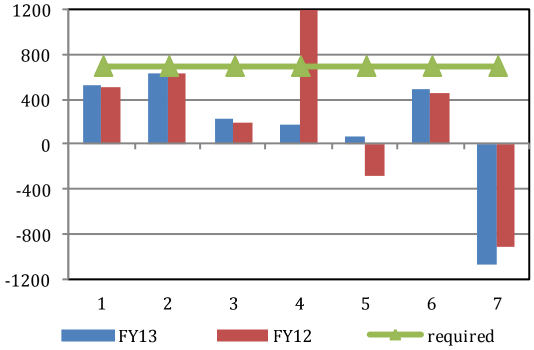


Figure 6.24

Profile of Modaraba Sector

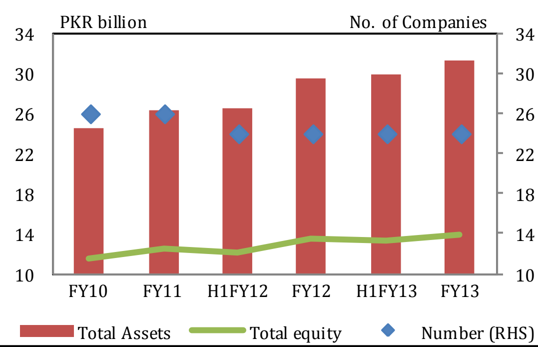
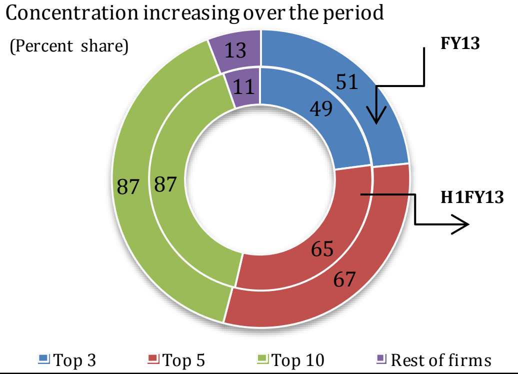


Figure: 6.25

Concentration increasing over the period



PKR 803 million during FY13. The waning business reflected in decreasing revenues, financing cost and administrative expenses, which kept the ROE and ROA negative for last many years **(Figure 6.22).** The persistent losses further eroded the already weak equity of the sector and at present none of the IFCs meet the Minimum Equity Requirements set by the SECP[67] **(Figure 6.23).**

The dismal state of affair of the sector merits the attention of the key policymakers. Towards that end some steps were taken recently including allowing the brokerage business to IFCs, there is still a sufficient space for further measures. To this end, strategy for NBFIs under preparation is expected to provide roadmap for growth and performance of the IFCs' sector.

Modaraba

Modaraba, the Islamic finance product, launched in the 1980s has come a long way to its present position. The sector, over the years, has seen consolidation and now comprised 24 Modaraba Management Companies. It primarily catered the unbanked sections of economic activity like rental services, small scale manufacturing and trading, as well as small scale retail and wholesale activity; a domain where the mainstream banking entities are reluctant to step in.

Modaraba Companies continue gradual and consistent growth…

Modaraba Companies assets, though count for very small **percentage** of the total financial sector, continued gradual and consistent growth over the last three years and with 4.8 percent increase during H2FY13 almost matched the asset base of leasing sector (**Figure 6.24**). Most of this growth resulted from increase in Ijarah assets and increase in investments in government securities. The growth however remained dependent on the performance of the top three firms, which now hold more than 50 percent of the asset base of the Modaraba Companies (**Figure 6.25**).

… while exhibiting robust operating performance

Modaraba Companies posted a healthy profit of PKR 2 billion during FY13 compared to PKR 1.2 billion in the FY12. Total of 20 Modarabas declared profits and 17 Modarabas announced cash

[67] Minimum required equity for leasing was Rs.700 million and for IFS it was Rs.1000 million for June 30, 2013, and onwards, as per NBFC & NE Regulations 2008

Table 6.5: Performance Indicators of Modarabas

PKR billion and ratios in percent

	FY08	FY10	FY11	H1FY12	FY12	H1FY13	FY13
Profit after tax	*0.8*	*0.8*	*1.1*	*0.6*	*1.2*	*0.6*	*2.0*
Income	*5.5*	*7.9*	*8.1*	*3.3*	*9.0*	*3.7*	*10.2*
Expenses	1.8	7.1	*6.5*	*2.7*	6.9	*3.1*	*8.2*
ROA	*3.6*	*3.4*	*6.7*	*4.2*	4.3	*4.3*	*6.7*
ROE	*7.9*	*7.2*	*9.4*	*9.3*	9.2	*9.8*	*15.0*

dividend with two Modarabas declaring bonus issued to their certificate holders.

The earning resulted from mix of improved Ijarah rentals and gain on sale of investments. As a result, ROA and ROE improved by 220 bps and 580 bps to 6.7 percent and 15 percent respectively during FY13. Healthy earning also improved the total equity of the Modaraba sector, which went up by 2.5 percent to Rs.13, 824 million during FY13 (**Table 6.5**).

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