7 Capital Market

7.1 Introduction

Pakistan's capital market showed a mixed trend during FY01 (see **Table7.1**). The benchmark KSE-100 index shed 10.1 percent since the beginning of FY01 and closed the year at 1366.4. This downturn can be attributed to a host of factors including the lack of concrete progress on privatization, uncertain investor confidence, the continuous depreciation of the Rupee and friction between SECP and the bourses. While equity market remained bearish, the corporate bond market showed encouraging movements. The growth in this market was encouraging, as ten new TFCs issues were floated during FY01 alone, compared to ten in the last five fiscal years.

7.2 Stock Market Performance

The Karachi Stock Exchange (KSE) maintained its dominance in the country (see **Table 7.1**). Primary market activities in KSE remained slow, as only four new companies (with paid up capital of Rs 3.6 billion), were listed during FY01. Similarly, only two companies were floated on the Lahore stock exchange, of which Hubco was already subscribed. Like the KSE-100 index, the LSE-101 also declined by 98.8 points (26.5 percent) to 273.2 by end-FY01.

Table 7.1: Key Indicators of Capital Market

	FY99	FY00	FY01
Karachi Stock Exchange			
KSE-100 index	1054.7	1520.7	1366.4
SBP General index	106.4	128.8	118.7
Paid up capital (billion Rs)	215.0	229.3	239.9
Turnover of shares (billion #)	25.5	48.1	29.2
Lahore Stock Exchange			
LSE-101 index	288.9	372.0	273.2
Turnover of shares (billion #)	9.8	16.4	7.8
Paid up capital (billion Rs)	186.9	207.7	226.2
Islamabad Stock Exchange			
ISE-Network index	4498.7	5327.1	4374.3
Turnover of shares (billion #)	3.3	2.0	0.7
Paid up capital (billion Rs)	150.68	162.2	183.3
NBFIs[1]			
Deposits (billion Rs)	70.4	57.3	56.2
Sanctions (billion Rs)	16.1	17.0	20.4
Disbursements (billion Rs)	15.7	13.5	15.0

[1] For details please see **Table 7.6** and **Table 7.7**

7.3 Operations at Karachi Stock Exchange

As discussed in the *Annual Report* for FY00, positive expectations from the new government regarding privatization and the textile sector powered the KSE-100 index to a 28-month peak of 2054.4 on 22nd March 2000. Nevertheless, this rally was short lived as investors realized that a quick privatization of state-owned utilities and the liberalization of margins for Oil Marketing Companies (OMCs) were unlikely. Moreover, concerns about the un-sustainability of carry-over transactions (*Badla*), undermined confidence in the operations of the stock market. The worst fears materialized as a settlement crisis erupted, which forced the closure of important markets in end-May and early-June 2000. This downward spiral wiped out a significant portion of the KSE-100 index, which closed the fiscal year at 1520.7.

The impact of this crisis lingered on for the first four months of the current fiscal year. The KSE-100 index started the current financial year at 1519.6 and remained confined within a tight range of 165 points till the first week of November (see **Figure 7.1**). Likewise, the average daily trading volume remained low, down nearly 43 percent over the last quarter of FY00. This sluggish behavior can be attributed to a number of factors ranging from rising interest rates and the depreciating exchange rate, to the drawn out impact of tax survey and faltering hopes of an early end to Hubco-WAPDA dispute.

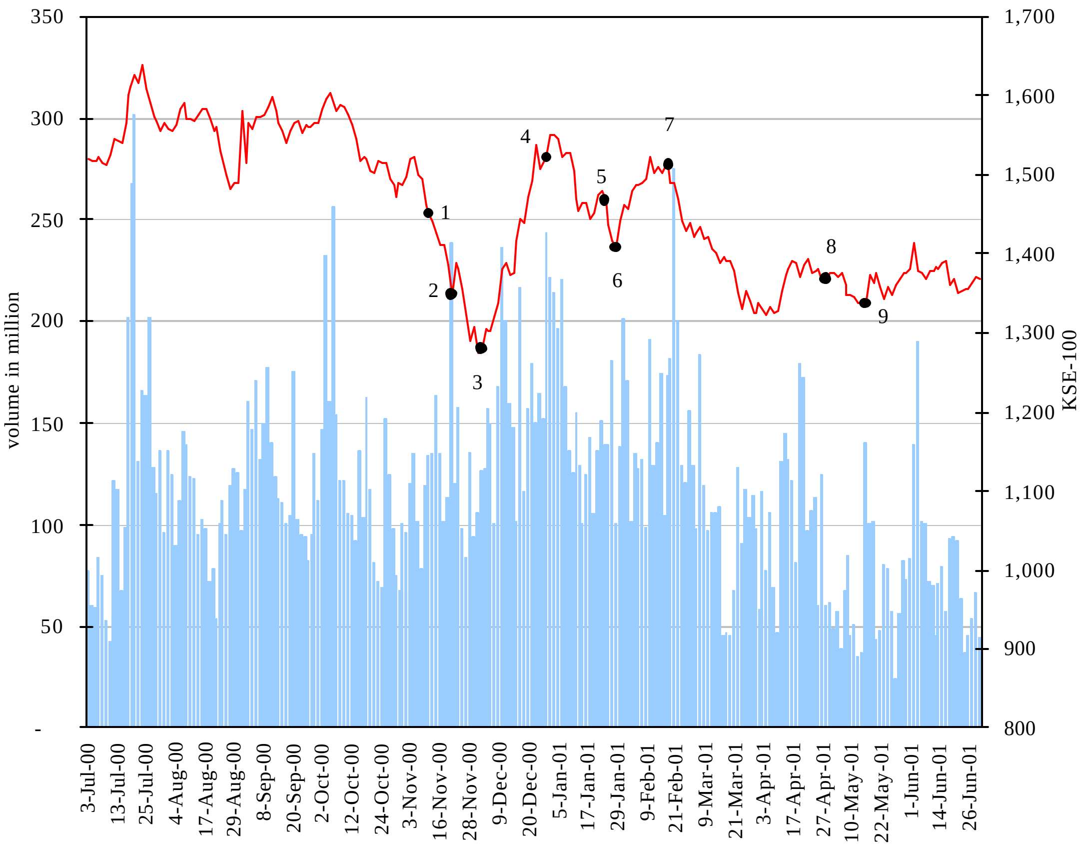
Although, privatization of small Liquid Petroleum Gas (LPG) business of public sector gas utilities did go through during the first quarter, it failed to provide the required impetus, as these unlisted units do not have much of a spillover in the equity market. Even the promulgation of a new privatization

Figure 7.1: Movement in KSE-100 and Volume Traded

Volume of trade-mln (LHS)

KSE-100 Index (RHS)

1. Less than expected results of PSO announced on November 13
2. Restriction on short-selling by SECP on November 22
3. Pakistan manages to secure SBA (end-November)
4. SECP orders change in the Article of Association (of KSE) on December 31. This creates friction between SECP and KSE
5. Weak financial results of PTCL by end-January
6. Turn around due to good results of Engro Chemical Ltd. Also, anticipation of good dividends by Hubco sustain this upward movement
7. A report by Merrill Lynch on February 19, depicting negative sentiments regarding Pakistan's inability to remain on track with the SBA, worsens the investment climate. This results in selling pressure which remained throughout the later part of FY01
8. T+3 settlement system was initially introduced on April 2, in two scrips (Telecard and Ibrahim Fibre)
9. Decision to defer the implementation of T+3 settlement system for a couple of months, sparked a short recovery



law at the end of September 2000, on the face of limited progress towards privatizing larger listed entities (PSO, PTCL, etc.), failed to galvanize the market.

In mid-October 2000, outlook for a settlement in the Hubco-WAPDA dispute turned unpleasant, as events had taken a turn for the worse. By early-November, the market started sliding, as investor expectations concerning certain blue-chip companies and the textile sector, turned sour.

Poorer than expected results of Pakistan State Oil (PSO) for financial year 2000 dampened the index, as it became evident that bonus shares were not likely. These bonus shares are historically a large part of the overall return on the scrip; investors take position in PSO in anticipation of these returns. The absence of bonus shares dwindled the overall takings, undermining its attractiveness. This absence was attributed to a decline in profitability due to low inventory gains. Since PSO has the largest storage capacity in the country, and holds inventory depending on existing and future oil prices, inventory holdings were low on account of high international oil prices and the likelihood that prices will decrease in the later part of the year. Besides, ICI (the index-heavyweight) unveiled it's proposed plan for restructuring its Pure Terephthalic Acid (PTA) business, which did not meet the market expectations. This compounded the downward adjustment in the KSE-100 index.

In term of the textile sector, an upward trend in domestic cotton prices signaled an end to the abnormal profits realized during FY00 (see **Figure 2.9**). This in turn downgraded the outlook for this sector. As a result, SBP general index for cotton and textile declined by 4.6 percent, while market capitalization for this sector fell by 12.3 percent during FY01 (see **Table 7.2)**.

Table 7.2: SBP General Index of Stock Prices & Market Capitalization

percentage changes

	SBP General Index			Market capitalization		
	FY99	FY00	FY01	FY99	FY00	FY01
Cotton and other textiles	-2.1	28.9	-4.6	10.7	57.9	-12.3
Textile spinning	-10.3	37.6	13.0	-6.6	32.1	6.9
Textile weaving & composite	5.7	53.9	-26.9	7.2	79.0	-16.4
Other textile	1.6	5.8	-0.6	34.6	65.3	-22.2
Chemicals & pharmaceuticals	-9.7	12.7	-4.5	3.7	15.6	-14.4
Engineering	-2.0	18.7	-3.1	-6.2	11.7	-2.0
Auto and allied	-0.9	27.7	-3.6	6.2	21.0	-1.5
Cables & electrical goods	-9.8	8.5	-5.2	-16.3	24.3	0.0
Sugar and allied	0.6	-2.1	21.5	-3.2	-8.2	17.5
Paper and board	-14.5	34.8	-8.9	14.9	37.8	14.2
Cement	5.8	53.0	-17.9	-5.5	69.6	-0.1
Fuel and energy	12.1	35.8	-12.3	17.5	63.6	-8.9
Transport and communication	35.2	-6.4	-22.7	23.7	31.7	-33.3
Banks & other financial institutions	3.0	7.8	-8.2	6.9	20.7	6.4
Banks and investment companies	1.8	9.4	-11.8	10.9	21.3	6.5
Modarabas	2.9	9.9	-11.6	1.3	12.5	2.3
Leasing companies	-9.2	3.3	-7.9	-6.7	8.4	-0.8
Insurance companies	2.8	0.9	-4.5	8.1	28.8	10.7
Miscellaneous	-0.8	14.0	11.6	0.9	24.2	1.6
Jute	21.7	4.7	-10.8	15.4	23.3	-18.9
Food & allied	-3.7	36.3	-4.6	1.0	31.0	-11.5
Glass & ceramics	-0.8	26.8	38.2	-8.1	8.8	21.6
Vanaspati & allied	2.3	-6.8	-13.1	12.5	8.3	-48.7
Others	1.1	6.5	5.9	0.8	7.5	46.9
Overall	7.7	21.1	-7.8	11.5	35.5	-13.4

During this downward movement in November 2000, heavy speculation in the form of *short selling* compounded the fall.[1] In order to minimize this speculative activity, on November 21, SECP prohibited carry over transaction of sale position in PSO, PTCL, Hubco and ICI.[2] This restriction was subsequently imposed on all scrips. Although, the market resented this move citing too much interference by regulators, this action temporarily boosted the prices of affected scrips, which in turn supported the KSE-100 index (see **Figure 7.1**). In addition, by the beginning of December, the KSE-100 index started moving upwards in response to Pakistan's agreement with the IMF. Also, investor concerns regarding the lingering issue of Hubco-WAPDA eased as both parties reached an agreement on December 16, 2000.

However, by the start of January 2001, friction between SECP and KSE management on the issue of amendments in Article of Association of the Karachi Stock Exchange set off a fall in the index (see **Figure 7.1**).[3] According to SECP, these amendments were aimed at strengthening investor confidence by improving transparency in KSE operations, and were in line with the recommendations of the Inquiry Committee, which looked into the market crash in May/June 2000 (later in the month, both SECP and KSE amicably resolved this matter).

Although the slide in early 2001 was triggered by the dispute between KSE and SECP, the tight liquidity position in the money market at the beginning of the quarter pushed up *Badla rates*, which in turn reduced trading volumes in carry-over transactions (see **Box 7.1** and **Figure 7.2**).[4] In addition, a 17.1 percent fall in net profits of heavyweight PTCL in the first half of FY01, (announced on January 25), added to this slide.[5] For the whole year, PTCL under-performed in comparison with the KSE-100 Index (see **Figure 7.3**). Market Capitalization for this sector (Transport & Communication) fell by 33.3 percent, compared to a rise of 31.7 percent during FY00 (see **Table 7.2**).

Figure 7.2: Badla rate per annum

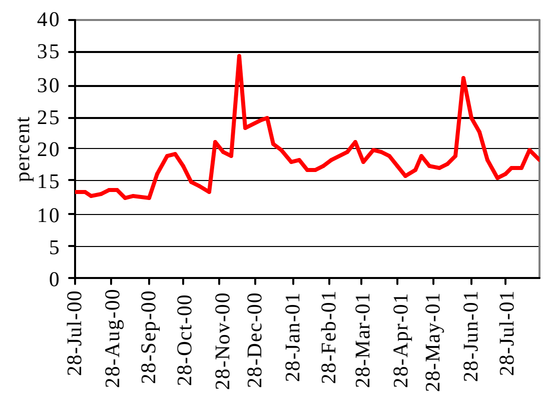
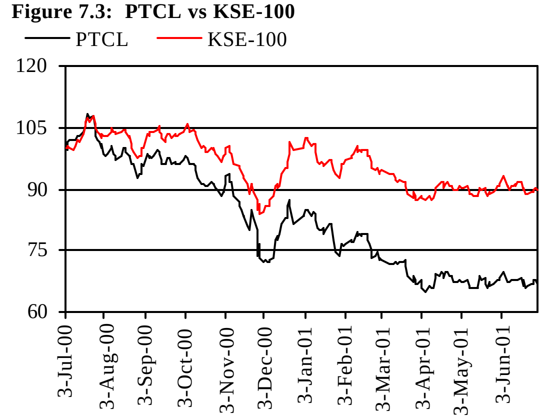


Figure 7.3: PTCL vs KSE-100



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[1] When investors sell scrips they do not own, it is referred to as short/blank selling. This is done in the hope of buying the scrip in the future at a lower price. Short selling is a tool for sophisticated traders who are quick and predict future price movements with precision. For detail, please see **Box** on *Short Selling* in SBP's second **Quarterly Report FY01**.

[2] In term of trading volumes, just these four companies account for 70 percent of total trading in KSE during FY01.

[3] These amendments were made binding after 31st December 2000 (For detail, please see next page).

[4] An absence of foreign inflows from IFIs forced government to increase its dependence on SBP for budgetary support during FY00. Given this sharp increase in government borrowing from SBP, the target this year was to reduce central bank lending during the course of FY01. More specifically, the performance criterion on SBP's NDA was to show a net decline of Rs 26.3 billion by end-December 2000. For this, government had to shift its borrowing from SBP to scheduled banks. This transfer had caused significant shortage of liquidity with scheduled banks. For details, please see **section** on *Money Market*.

[5] In fact, any change in sentiments regarding PTCL or Hubco, have a profound effect on the index, as both accounted for 50 percent of KSE's traded volume during the year. This is a clear indication of high market concentration.

Nevertheless, this negative market trend turned positive, as Engro Chemicals Ltd. announced strong financial results by end-January. The positive outlook regarding Hubco's results and expected dividend payouts, sustained this upward movement throughout the first week of February. Although the company had declared good results, it delayed dividend payouts till its agreement with WAPDA was fully ratified.[6]

However, this upward trend was short lived. A negative report by Merrill Lynch on the investment climate in Pakistan started a clear downward trend in the index after February 19, 2001. These views were based on its assessment that Pakistan would not be able to stay with the IMF program due to CBR's inability to meet revenue targets for end-March. Furthermore, lower than expected GDP growth (due to drought), tight monetary policy against an international easing, and continuous depreciation of rupee during the fiscal year, created a negative outlook for Pakistan. Moreover, during the third week of March, Morgan Stanley Dean Witter announced the liquidation of its Pakistan Fund by end-May or June. This created immense selling pressure in the market. While foreign investors kept selling from their portfolio during the year, the pace increased sharply during Q3-FY01.[7] This phenomenon did not allow market to recover during later half of FY01.

From March on, the index remained depressed till end June 2001. One important factor that kept the bulls at bay was the introduction of T+3 settlement system.[8] This was introduced on April 30, by the KSE in two scrips (Telecard Ltd and Ibrahim Fibres). It was also intended that this would be implemented in phases. However, this arrangement became contentious, as market players were skeptical about the success of this new system. In mid-May, SECP and KSE agreed to defer the implementation of T+3 system for a couple of months to allow some preparation time for brokers.

Box 7.1: Badla Transaction

Badla is an informal source of financing, widely used in the Pakistan's stock exchanges. This transaction is made when an investor, who lacks funds, commits himself to buy certain shares. Badla *financer* provides financing against such shares at market-determined premium (rate of interest). This short term collateralized lending is very similar to a repurchase agreement (repo) used in the interbank market. In simple term, badla is a credit line against securities: usually brokers and financial institutions provide such badla funds.

After the introduction of T+3 settlement regime, daily badla transactions are carried out. Previously, in T+5 settlement regime, badla transactions were usually executed on weekly basis, thereby enabling investors to square themselves by the end of the clearing period. The increase in the holding period leads to higher premium as the price risk on the collateral rises over a longer time frame. Interestingly, once a badla contract has been passed on to the clearinghouse system, the risk of default on payment of the funds falls on the clearinghouse, as it becomes the liability of the stock exchange.

Although, the badla transaction provides an easy source of financing the investment, it is more vulnerable to a sudden fall in the market. In fact, the value of stocks, artificially raised by the hype created by badla financed buying, ends up being wiped out. Consequently, investors will find themselves unable to liquidate their positions in a falling market. Since, the Pakistan's equity market is quite shallow, with restricted liquidity, the badla transactions are highly risky, as large price movements could occur very quickly.

[6] Hubco announced an interim dividend payment in mid-May 2001.

[7] US $140 million flowed out during FY01, as against an inflow of US $ 73 million during FY01 (**see Table 9.1**). Out of this outflow, US $64 flowed out during 3Q-FY01.

[8] In the T+5 settlement system, any trade conducted between Monday-Friday would have to be settled on next Wednesday. Hence, there was ample time between actual trade and settlement. However, this also provided investors space for speculation. Although, speculation is an integral part of equity markets, an excess of it amplifies settlement risks. The introduction of T+3 settlement system (Monday trade settled on Thursday) in bourses is a step towards mitigating such risks, which in turn safeguard retail investors. There were initial speculative concerns that this system will not facilitate the badla system. However, the badla system was modified and it is now compatible with T+3. But investors regard this system more expensive than its predecessor due to a higher carry-over (badla) cost.

For this purpose, KSE announced an implementation schedule in the first week of June (see **Table 7.3**). SECP regards this an integral part of reforms to bring KSE operations in line with international norms. T+3 has the following benefits: (1) speculative and over-trading beyond the financial capacity of brokers will be contained and monitored, (2) settlement risk will be lower between execution of trade and settlement, and (3) these changes will provide greater comfort to foreign investors.

On a final note, the dividend declaration record of companies listed in KSE showed no significant improvement over last year (see **Table 7.4**). Summary statistics concerning the Karachi Stock Exchange are shown in **Table 7.5**.

Table 7.3:
T+3 Implementation Schedule

2-Jul-01	
	Synthetic & rayon
	Mutual funds
	Modarabas
	Leasing
	Woolen
	Jute
	Sugar & allied
	Tobacco
16-Jul-01	
	Fuel & energy
	Engineering
	Auto & allied
	Cable & electrical goods
	Paper & board
	Vanaspati & allied
	Construction
	Leather & tanneries
	Food & allied
	Glass & ceramics
	Miscellaneous
6-Aug-01	
	Investment companies/banks
	Insurance
	Textile weaving
	Cement
20-Aug-01	
	Textile spinning
	Textile composite
3-Sep-01	
	Transport & communication
	Chemical & pharmaceutical

7.4 Measures Taken by Securities and Exchange Commission of Pakistan

Continuing on its policy of reforms, SECP has taken a number of policy decisions to further improve the operations of Pakistan's capital market during the year. These should go a long way in revamping the overall structure of the bourses and create an investment friendly environment to broaden the investor profile in the equity market. These include the introduction of various laws for the protection of small investors, measures to impose transparency in trade, curbing the practice of insider trading and bringing operations to international standards. Some of these measures are briefly discussed below:

?? *Governance of Stock Exchanges:* In order to strengthen investor confidence and improve transparency, SECP ordered some amendments in the Article of Association of the Karachi Stock Exchange. The changes that are binding after 31st December 2000, include the following:

  ?? Only the Board of Directors of KSE will choose the Chairman, as against the existing procedure whereby the General Body (members of KSE) choose the Chairman.
  ?? The office of Vice Chairman has been removed.
  ?? Out of the existing eighteen directors in the Board, the present system allows SECP and the Board to nominate two each, large institutional investors (NIT, ICP, etc.) can nominate three, and the General Body nominates the remaining members. In the proposed change, SECP would nominate seven *outside* members to the Board.
  ?? SECP would have final say on the appointment, removal/termination, and non-renewal of the Managing Director of KSE, and
  ?? To restrict the Board's authority in operational issues, the bulk of these responsibilities were moved to the Managing Director.

?? *Listed Companies (Prohibition Of Insiders Trading) Guidelines:* To protect small investors against excessive price volatility due to the use of privileged information, SECP issued a draft of the proposed law to solicit public opinion in the first week of October 2000. After due deliberation, SECP implemented the "Listed Companies (Prohibition Of Insiders Trading) Guidelines" on March 27, 2001. This law will increase the degree of transparency in the market and protect small investors from possible losses. These guidelines list the following individuals to be insiders:

?? A person who is a director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company. Also, beneficial ownership (direct or indirect) of more than 10 percent of the shares of a listed company are thereby classified as insiders; or

?? A person who is or was connected with the company, or is deemed to have been connected with the company, and who is expected to have access to unpublished price sensitive information, or who has received or has had access to such unpublished information in the past.

Table 7.4: Number of Companies Declaring Dividend at KSE

	Cash dividend	Bonus shares	Right shares	Total
FY01				
Up to 20%	211	45	3	259
Above 20%	157	27	28	212
Total	**368**	**72**	**31**	**471**
FY00				
Up to 20%	281	34	4	319
Above 20%	117	14	20	151
Total	**398**	**48**	**24**	**470**
FY99				
Up to 20%	168	51	-	219
Above 20%	70	13	19	102
Total	**238**	**64**	**19**	**321**

Table 7.5: Profile of Karachi Stock Exchange

	FY97	FY98	FY99	FY00	FY01
Total number of listed companies	782	779	769	762	759
Total listed capital (billion Rs)	206.7	211.2	215.0	229.0	239.9
KSE-100 index	1,565.7	879.6	1,054.7	1,520.7	1366.4
KSE all share index	1,057.0	586.8	675.4	942.7	870.4
Number of initial public offering (IPO)	7	2	0	3	4
Number of new debt instrument listed	1	3	2	3	2
Trade volume during the year (million shares)	8,095.1	14,992.4	25,524.8	48,097.0	29,165.3
Value of shares traded (billion Rs)	233.2	509.6	605.3	1,877.8	1,073.0
Average daily turnover (million shares)	34.0	63.9	103.0	194.3	119.5
Number of trading days	239	235	247	249	244
Foreign investment (during the year)[1]					
Inflow (million Rs)	8,392.6	31,122.4	8,869.9	7,433.8	2149.7
Outflow (million Rs)	8,618.7	27,831.9	9,997.8	8,562.4	7061.9
Net (million Rs)	-226.2	3,290.6	-1,127.9	-1,128.5	-1128.5

[1] Numbers for FY01 are up to May 2001.

Source: Karachi Stock Exchange

Such persons are now explicitly prevented from either dealing directly or indirectly in the securities of the said listed company. Moreover, SECP has listed the following as insider information:

?? Unpublished financial results of the company (both half-yearly and annual);
?? Intended declaration of dividends (interim and final);
?? Information on shares issued by way of rights, bonus, etc.;
?? Major expansion plans or execution of new projects;
?? Strategy on amalgamation, mergers and takeovers;
?? Exit strategy for either the entire company or a part thereof;
?? Any information that may affect the earnings of the company; and
?? Any changes in policies, plans or operations of the company.

In order to implement these new rules, SECP has been authorized to investigate and inspect the accounts and records of individuals deemed to be insiders and associated members of the stock exchanges.

?? *Stock Exchanges Members (Inspection of Books and Records) Rules, 2001:* These rules were enforced on April 26, 2001. According to these, SECP can order the inspection of books and record of any member of the stock exchanges. These inspections can be conducted any time and for any purpose, giving SECP discretionary powers. These rules will help monitor brokers and strengthen SECP's surveillance capabilities.

?? *Brokers and Agents Registration Rules, 2001*: These rules were notified on May 10, 2001, and should enable SECP to exercise direct control over brokers and agents. It is hoped that this will facilitate smooth operation of exchanges and act as a safeguard for investors. These rules also empower SECP to cancel the registration of a broker, if he:
?? Is engaged in insider trading;
?? Has been found guilty of fraud;
?? Has had his membership cancelled by a stock exchange; or
?? Has not complied with the directives of the SECP.

7.5 Credit and Recovery Operations of NBFIs

Sanction of term loans by DFIs and specialized banks in FY01 stood at Rs 20.4 billion, which was higher than last year's Rs 16.8 billion. However, in terms of actual disbursement there is marginal improvement (see **Table 7.6**). Increasing financial weakness due to the volume of non-performing loans and the formulation of an IFI endorsed strategy for NBFIs, adversely impacted their financing ability. The sharp increase in the volume of non-performing loans (NPLs), forced DFIs to consolidate their operations by reducing their gross lending. NPLs that were 21.9 percent of the total assets of DFIs in FY90 grew to 41.6 percent in FY00. This in turn put a squeeze on the earning of these institutions. Capital to liability ratio also deteriorated from 14.8 percent in FY90 to negative 5.1 percent in FY00. This worsening position of DFIs warranted bold decisions. The government is currently in the process of restructuring these institutions to make them financially viable. As shown in **Tables 7.7**, the outstanding level of deposits of the larger DFIs are declining over past years.

Table 7.6: Credit Indicators of DFIs[1]

million Rs

	Sanctions			Disbursement			Recoveries		
Institutions	**FY99**	**FY00**	**FY01**	**FY99**	**FY00**	**FY01**	**FY99**	**FY00**	**FY01**
NDFC	598	127	1,180	592	225	570	4,868	4,497	4,824
PICIC	-	988	2,185	324	193	1,030	3,200	2,926	3,264
BEL	17	-	-	209	15	-	1,313	1,389	-
IDBP	45	135	27	91	91	47	785	1,161	1,304
PLHC	236	490	335	231	401	273	3,417	528	428
PKIC	1,474	1,443	1,381	1,468	1,147	1,248	20,330	3,624	2,724
SAPICO	673	965	1,334	418	798	652	538	1,238	1,473
ICP	-	-	-	-	-	-	137	219	174
RDFC	-	-	-	-	-	-	362	238	157
SBFC	2,429	15	19	2,142	207	3	1,736	1,583	1,789
NDLC	914	890	1,490	914	890	1,490	316	1,134	1,425
ADBP	8,457	10,365	12,327	8,165	8,342	8,830	25,845	30,129	32,103
HBFC	1,205	1,315	-	1,121	1,174	760	2,770	2,476	2,602
FBC	29	36	80	29	35	60	5,550	5,135	5,558
Total	**16,075**	**16,769**	**20,356**	**15,703**	**13,516**	**14,964**	**71,166**	**56,276**	**57,827**

[1] Excluding working capital.

Operations of modarabas, leasing companies and investment banks are shown in **Table 7.8**.

7.6 National Investment Trust

NITL was incorporated as an unquoted public limited company in 1962. The principal activity of the company is to manage an open-end mutual fund. The fund is the largest in Pakistan with the objective to provide investors a balance between their regular income needs and long-term capital investment. This fund provides investors with a one-window entry to Pakistan's equity markets.

Table 7.7: Deposit Mobilization (Outstanding) by Selected DFIs

million Rs

Institutions	FY98	FY99	FY00	FY01
NDFC	27,827	29,593	28,338	28,595
PICIC	3,263	3,038	3,572	5,031
BEL	4,725	4,710	3,895	-
IDBP[1]	7,194	12,535	13,476	15,116
PLHC	2,746	1,731	1,633	1,780
NDLC	706	637	557	679
RDFC	901	689	601	615
PKIC	23,745	17,494	5,214	4,363
Total	**71,107**	**70,427**	**57,286**	**56,179**

[1] Excluding call deposits.

As more than 95 percent of the NIT portfolio consists of shares of listed companies, its performance is correlated with the performance of the equity market. Since, the stock market largely remained depressed during FY01, NIT also experienced a slow down in sale/purchase of its units. Gross sales of NIT units fell by 31.4 percent to 480 million shares for the year. Nevertheless, NIT declared higher dividends than last year (Rs 1.2 in FY01 against Rs 0.55 in FY00). Since the fund has significant strategic holdings in some of Pakistan's best managed and high profile companies selected for privatization (Pakistan State Oil, Sui Northern, Sui Southern, Pakistan Tele Communication Limited etc.), higher dividends earned from this portfolio translated to higher dividend payouts on NIT units.

Table 7.8: Credit Indicators of Modarabas, Leasing Companies and Investment Banks

billion Rs

	Sanctions			Disbursements		
	FY99	**FY00**	**FY01**	**FY99**	**FY00**	**FY01**
Overall assistance	**37.2**	**32.9**	**38.6**	**36.3**	**35.2**	**37.4**
Fixed industrial financing	13.8	19.8	23	13	20.7	22.7
Modarabas	2.6	3.7	2.8	2.5	5.1	2.8
Leasing companies	8.2	12.8	18.3	7.8	12.4	18.3
Investment banks	3	3.3	1.9	2.7	3.2	1.6
Working capital loans	23.4	13.1	15.6	23.3	14.5	14.7
Modarabas	1.6	2.5	3	1.6	4.6	3
Leasing companies	0.3	0.3	0.2	0.3	0.3	0.2
Investment banks	21.5	10.3	12.4	21.4	9.6	11.5
Changes (percent)						
Overall assistance	**25.0**	**-11.6**	**17.3**	**-6.0**	**-3.0**	**6.3**
Fixed industrial financing	3.1	43.5	16.2	-43.5	59.2	9.7
Modarabas	30.0	42.3	-24.3	-10.7	104.0	-45.1
Leasing companies	-10.9	56.1	43.0	-57.4	59.0	47.6
Investment banks	57.9	10.0	-42.4	42.1	18.5	-50.0
Working capital loans	41.8	-44.0	19.1	49.4	-37.8	1.4
Modarabas	-5.9	56.3	20.0	-46.7	187.5	-34.8
Leasing companies	0.0	0.0	-33.3	50.0	0.0	-33.3
Investment banks	48.3	-52.1	20.4	72.6	-55.1	19.8

7.7 Corporate Debt Market

The domestic corporate debt market remained bullish following last year's reforms. Most prominent were changes in National Saving Schemes (rationalizing rates and banning incremental institutional investment), and the launch of the Pakistan Investment Bonds (PIBs). In addition, the bearish trend in equity market shifted investors towards more secure investment in Term Finance Certificates (TFCs). Hence, the growth witnessed in the private debt market during FY01 is encouraging, as ten new issues were floated in the market (see **Table 7.9**). However, secondary market transactions in TFCs remained negligible as most of the investors prefer to buy and hold.

The future outlook for TFCs looks optimistic for both investors and issuers. Companies that previously relied heavily on Development Finance Institutions (DFIs) for term borrowing are now looking at the bond market to meet their future financial needs.[9] These DFIs, in turn received

[9] In the past, DFIs provided the bulk of term funding for leading Pakistani companies.

considerable funding from International Financial Institutions (IFIs), as part of their past strategy of directed development. Since, this strategy has largely failed, the IFIs no longer support DFIs (particularly leasing companies).

Table 7.9: Corporate Debt

Security	Issue Date	Maturity	Issuance size million Rs	Coupon rate
ICI	30-Sep-96	Sep-01	1000	18.70
Gatron	17-Jun-98	Jun-03	274	18.00
Inter-Bank	1-Dec-98	Dec-03	300	17.50
SPLC	28-Jan-99	Jan-03	250	18.25
DSFL	24-May-99	May-04	863	19.00
NDLC	1-Dec-99	Dec-04	550	17.00
PILCORP	21-Dec-99	Jan-05	287.5	18.00
Sigma Lease	18-Jan-00	Jan-03	100	17.00
Paramount Lease	2-Aug-00	Aug-04	250	16.25
Atlas Lease	27-Sep-00	Sep-05	200	15.00
Network Lease	4-Oct-00	Oct-05	100	16.25
Al-Noor Sugar	31-Oct-00	Oct-05	204	Discount rate + 250bps (16.5-18.5)
PILCORP (2nd issue)	2-Mar-01	Mar-04	325	15.60
Orix leasing	7-Apr-01	Apr-05	745	14.00
Shakarganj	10-Apr-01	Apr-01	250	Discount rate + 200 bps (15.5-18.75)
SSGC	31-May-01	May-01	1000	Yr 1-2: Fixed at 14.15, Yr 3-5: Discount rate + 110 bps (13.0-18.0)
Engro Asahi	15-Jun-01	Jun-01	500	5 Yr PIB + 150 bps = 14.5 (13.0-17.0)
DSFL	22-Jun-01	May-05	1,816.35	16.00
ICI/PTA	2-Aug-01	Aug-06	1600	5 Yr PIB + 300 bps = 16.00
Atlas Lease	16-Aug-01	Aug-06	100	15.0
Packages	27-Aug-01	Jan-05	700	13.50%-17% 3-day discount rare +1.25% pa
Inter-Bank	15-Sep-01	Sep-06	500	13.75-16% 3 yrs = 13.75% pa monthly, 3 yrs 6 months = 16%

For this reason, most of the TFCs are being launched by Leasing Companies. This is because of the fact that leasing companies need long-term funds to match their lease portfolios. Interestingly, however, not all the funds generated through TFCs are channeled to industrial sector to finance its expansion. A growing chunk is used to finance consumer durables like cars, motorcycles, electronics etc.

Pakistan's corporate debt market has come a long way since 1995. In order to make issues more flexible and affordable, issuers are adding different features from shelf registration to the green shoe option to TFC structure. [10] Use of shelf registration implies that the issuer can split the TFC issue into tranches, which is useful for periodic financing requirements of the issuer and also allows optimal pricing of the individual tranches. [11] Similarly, the green shoe option allows the issuer the right to retain the over subscribed portion of the initial public offer (IPO). However, the issuer has to specify the amount it would retain under this option in advance.

[10] Other options available with the issuers are Floating Coupon Rates, Asset Securitization and Call & Put option. A call option on TFCs gives the issuer the right to retire the debt prematurely. Likewise, a put option on a bond allows the investor the right to redeem his/her investment prematurely (commonly at fixed option dates).

[11] The shelf registration option is valid for a maximum period of twelve months for an issue amount of Rs 250 million and a maximum period of three years for an issue greater than this.

Despite these positive developments, there are still issues that need to be resolved. SECP, is actively streamlining the process for issuance of TFCs by reducing costs and simplifying the procedure for approval. On similar lines, KSE in collaboration with the Central Depository Company (CDC) has reduced the annual listing fee for TFCs. The KSE has also reduced broker commission from 1.0 to 0.25 percent, and the fixed service charge of Rs 25,000 has been revoked. Additionally, the initial listing fee has been reduced from a maximum of Rs 1.0 million to Rs 0.5 million. Also, the CDC has reduced its annual registration fee for TFCs by 25 percent effective November 1, 2000. These changes would lower the issuance costs for TFCs, which should help develop this market. Furthermore, the government has continued its policy of reducing stamp duties and withholding tax on profits.[12]

However, despite healthy appetite of TFCs by institutions and retail investors, supply is still limited. Major institutional investors would welcome additional investment opportunities for TFC issues, subject to acceptable profit rates. Moreover, many investors (especially retail investors) do not fully understand debt securities.

Additionally, intermediaries, have difficulty participating in the market due to the lack of short selling. Market makers are therefore unable to provide two-way quotes to secondary market players, which would strengthen and deepen this market. However, the approval of short selling is unlikely in the near future because of limited TFC issues.

[12] Withholding tax on TFC profit was removed in 1995 but reinstated in March 1998. However, the 1999 Federal Budget again exempted payment of withholding tax to all persons, including companies.