6 Financial Performance of NBFIs

Pakistan's financial sector represents a well-developed integration of institutions of a diversified nature including commercial banks, specialized institutions and the Non-Banking Finance institutions (NBFIs). The NBFIs sector, which includes DFIs, Modarabas and Non-Banking Finance Companies (NBFCs), has undergone considerable structural changes in recent years under the regulatory purview of the Securities and Exchange Commission (SECP).[1] With particular reference to the year 2004, NBFIs have shown a remarkable resilience to the changing market dynamics, with increased competition from the banking sector. The total assets base of the NBFIs increased by 21.6 percent during the year which is marginally higher than the growth rate of 21.2 percent of the previous year.[2] The share of NBFIs' assets in the total assets of the financial sector is 7.1 percent at end-FY04, as against 6.7 percent in the previous year. While the share has increased since the previous year, the most interesting feature to note is the pace of increased activities in the Mutual Funds industry which has undergone a drastic change in terms of ownership of assets from the public to the private sector in 2004, in addition to the mushrooming of a number of new funds during the year.

6.1 Recent Developments in the NBFIs Sector[3]

The 8 sub-categories of the NBFIs sector, which have traditionally been defined in line with their main business focus, are listed in **Table 6.1** with their respective asset shares. Whereas Development Finance Institutions (DFIs) continued to maintain a dominant share of assets in the NBFIs sector until FY03, Mutual Funds have taken over their leading position in FY04 by registering a growth of over 83 percent in their asset base, with a total share of almost 33 percent in the total assets of the NBFIs. Interestingly enough, the rest of the categories in the NBFIs sector have maintained their ranking in the share of assets in comparison with FY03. It should be noted that the level of asset shares is influenced both by the pace of business activities, as well as the ongoing process of consolidation of financial institutions within and across sectors.

Table 6.1: Assets of NBFIs (share in percent)

Million Rupees	FY00	FY01	FY02	FY03	FY04
Assets	239,977	202,168	213,144	258,280	314,145
Growth rate of assets		15.8	5.4	21.2	21.6
Asset share					
DFIs	38.1	30.2	32.2	30.5	29.8
Leasing companies	17.0	23.7	21.7	18.1	14.2
Investment banks	17.3	13.9	12.7	13.9	10.4
HFCs	9.3	11.7	10.5	8.3	6.2
Modarabas	6.4	7.7	8.2	6.2	5.8
VCCs	0.4	0.2	0.1	0.3	0.3
Mutual funds	10.7	12.0	13.8	21.8	32.7
Discount houses	0.8	0.7	0.7	0.7	0.4

On the face of it, DFIs' share in assets has marginally decreased in FY04, but the elimination of the base effect shows that their assets have actually grown by around 19 percent during the year. However this growth rate cannot be matched with that of the Mutual Funds' assets which have grown by over 83 percent, the reasons of which are discussed in detail in section 6.2.6.

Whereas Investment Banks, Leasing Companies, Housing Finance Companies and Discount Houses registered a decline in assets during the year, DFIs, Mutual Funds and Modarabas recorded healthy increases, in addition to Venture Capital companies whose assets have increased by 16.5 percent due

[1] DFIs come under the regulatory purview of State Bank of Pakistan, whereas Modarabas and NBFCs are regulated by SECP. Data in this chapter is based on Annual Audited Reports of NBFCs, DFIs and Modarabas.
[2] This analysis takes into account the organizations which were in operation as at 30.6.04.
[3] Total figures for NBFI assets will not match the consolidated figure in Chapter 1 which also includes MFIs.

to the launch of a new company in FY04. Industrial dynamics of each of these categories are discussed in their respective sections.

Focusing on the financing activities of NBFIs, **Table 6.2** shows a growth of 16.4 percent in the total advances over FY03. A major contribution to this increase comes from DFIs (with around 61 percent growth in advances), whereas the rest of the growth is attributed to Investment Banks, Modarabas and Housing Finance Companies.

Table 6.2: Advances of NBFIs

	FY00	FY01	FY02	FY03	FY04
Advances (mln Rupees)	112,962	86,684	80,945	84,821	98,707
Growth rate		23.3	6.6	4.8	16.4
Advances Share (in percent)					
DFIs	40.1	24.4	24.5	21.0	29.0
Leasing companies	23.8	36.6	37.4	41.1	34.5
Investment banks	17.7	14.4	12.4	12.6	12.6
HFCs	10.1	13.3	13.1	13.1	12.2
Modarabas	8.3	11.3	12.6	12.2	11.7

Deposits signify the ability of the NBFIs to mobilize savings, which in turn fund their business activities. Resource mobilization activities, which had shown considerable improvement in FY03 over FY02, have just grown by a little over 6 percent in FY04 (see **Table 6.3**), entirely due to the growth in the deposits of DFIs and Modarabas. Reasons for the increase in advances without a proportionate increase in the deposit base are discussed in the individual sections.

Table 6.3 : Deposits of NBFIs

	FY00	FY01	FY02	FY03	FY04
Deposits (mln Rupees)	81,051	37,505	38,824	47,771	50,674
Growth rate		53.7	3.5	23.0	6.1
Deposit share (in percent)					
DFIs	53.6	29.2	32.8	35.1	44.5
Leasing companies	13.1	38.4	35.1	33.9	30.5
Investment banks	32.1	29.9	28.5	26.8	19.6
HFCs	0.2	0.2	0.1	0.1	0.1
Modarabas	1.0	2.4	3.5	4.1	5.3

6.1.1 Structure and Consolidation process during FY04

The consolidation process across and within sectors picked up pace in 2004 as a number of Investment banks, Leasing companies and Modarabas merged to form stronger entities (see **Table 6.4**) in line with minimum paid-up capital requirements.

Table 6.4: List of Mergers & Acquisitions in the NBFIs sector

Name	Merged into / taken over by
Investment Banks	
Fidelity Investment Bank (FIBL) and Trust Investment Bank	Doha Bank renamed as Trust Commercial Bank
Leasing Companies	
Paramount Leasing, First Leasing and Pacific Leasing	First Standard Investment Bank renamed as Crescent Standard Investment Bank
KASB Leasing	KASB Bank
Modarba Companies	
First Hajveri Modaraba	First Fidelity Leasing Modaraba
First National Modaraba	First Paramount Modaraba
Mutual Funds	
ICP Fund No. 4	ABAMCO Growth Fund
ICP Funds No 1,3, 8,11,12,15,19, 20	ABAMCO Capital Fund
ICP Funds No 21, 23, 25	ABAMCO Stock Fund
ICP SEMF	PICIC Growth Fund
Across sectors	
First General Leasing Modaraba, Industrial Capital Modaraba and Dawood Leasing	First Dawood Investment Bank

6.2 Performance of NBFIs in 2004

In 2003, SECP implemented the Rules of Business for Non Banking Finance Companies (NBFCs), and with effect from January 21, 2004, introduced a uniform set of Prudential Regulations. This has provided the NBFCs with a uniform platform for conducting their operations, improving their risk management capabilities and promoting corporate governance in the non-banking financial sector. Some of the key indicators of the NBFIs (excluding Mutual Funds) are discussed below.

As shown in **Table 6.5**, the NBFIs sector, as a whole, relies on borrowings more than deposits to fund their business activities, as can be seen by comparing the borrowings to liability ratio with the deposits to liability ratio. However the average cost of deposits and borrowing has declined which is an outcome of the low interest rates prevalent in the previous year. The equity to liability ratio has improved marginally, whereas the ratio of earning assets to total assets is roughly at the same level as FY03 at around 79 percent. Non-interest income constitutes 33.2 percent of total income, whereas net interest margin remained the same at 5.8 percent. Return on average assets (before tax) has decreased to 4 percent, as compared to an improvement of 4.7 percent in FY03.

Table 6.5: Performance Indicators of NBFIs (excl. Mutual Funds)
percent

	FY00	FY01	FY02	FY03	FY04
Equity (excl. surplus/deficit) to liability ratio	8.1	25.7	30.6	32.4	34.8
Equity to liability ratio	8.1	24.6	32.3	36.2	37.0
Borrowings to liability ratio	42.3	52.9	48.5	47.1	49.5
Deposits to liability ratio	40.9	26.0	27.5	31.8	32.3
Average cost of deposits and borrowing	8.4	11.0	10.5	6.8	4.3
Average return on advances and investments	12.2	14.1	14.3	10.8	9.1
Average spread	3.8	3.1	3.9	4.0	4.7
Net interest margin	3.7	4.8	6.1	5.8	5.8
Non-interest income to total income	33.0	23.5	23.7	36.8	33.2
Return on average assets (before tax)	-0.3	1.1	3.3	4.7	4.0
Return on average assets (after tax)	-0.7	0.6	3.8	5.8	4.9
Earning assets to total Assets	76.1	75.2	73.2	78.9	78.8
Liquid assets to total assets	32.5	35.5	37.9	43.4	38.6

The performance of each sub-sector is discussed individually in the following sections.

6.2.1 Development Finance Institutions

In order to assess the current status of the DFIs, it is important to understand how these institutions have evolved over the years.

Development Finance Institutions first came into being in Pakistan in the late 1950s with the objective of providing long term investment capital to the industrial sector in order to develop the industrial base of the country, constituting financing activities which did not fall under the scope of operation of commercial banks.

As a brief history, Pakistan Industrial Credit and Investment Corporation Ltd (PICIC) was the first DFI to be formed in 1957 with the help of the World Bank, for the purpose of providing finance to medium and large industries and to act as a channel for foreign currency funds from multinational agencies for industrial projects. Industrial Development Bank of Pakistan (IDBP) was formed in the early 1960s, and National Development Finance Corporation (NDFC) in the 1970s to provide investment capital to state enterprises.[4] National Investment Trust (NIT) and Investment Corporation of Pakistan (ICP) were established in 1962 and 1966 respectively, and since their inception, have shown a strong commitment to the development of capital markets in Pakistan. Pak Kuwait Investment Company (PKIC), Pak-Libya Holding Company (PLHC) and Saudi Pak Investment Company (SAPICO) were incorporated in the late 1970s with joint sponsorship from Kuwait, Libya and Saudi Arab respectively. Several other DFIs such as Regional Development Finance Corporation (RDFC), Small Business Finance Corporation (SBFC), Banker's Equity Ltd (BEL) etc were also

[4] Pakistan Financial Sector : Perspective, Issues and Reforms – Zamir Hasan, Asian Development Bank (1997). This was the time when the government had adopted 'nationalization' as a policy.

formed during these years. Another DFI by the name of Pak Oman Investment Company was formed in 2002 with sponsorship from Oman.

At the initial stage, DFIs served as a conduit of foreign exchange resources made available by the International Financial Institutions (IFIs) to the real sector. During the 1960s and the 1970s, these institutions remained true to their calling in terms of accelerating the pace of industrialization in the country. However, given that most of them were formed in the public sector, they were heavily influenced by political elements in their lending decisions, and faced ongoing interference in their operations from the various ruling regimes in the country which resulted in poor governance issues, and at a micro level, a poor recovery rate on their loans.

Weak loan recovery was further aggravated by the significant deprecation of the Rupee due to which some of their clients, especially those who had used these loans to set up import substitution units, were unable to service their debt.[5] On the other hand, due to their reliance on foreign exchange funds, most of the DFIs failed to develop domestic sources of funds with the result that when the inflow of these funds finally reduced over time, they were faced with a resource squeeze. With the passage of time these factors contributed to their weak economic performance, especially in the 1990s during which their financial indicators reflect an inadequate level of capitalization, poor asset quality, deteriorating liquidity position and an unimpressive profitability profile.[6]

The inception and growth of Investment Banks in the late 1980s further impacted the business activities of DFIs given that the broad objective of these institutions was also the promotion of long-term investments in the country. Due to these problems, DFIs underwent a broad-based restructuring program in the late 1990s. BEL was liquidated in 1999, whereas NDFC was merged with National Bank in 2001. Subsequently, RDFC and SBFC were merged to form SME Bank also in the year 2001. Consequently the size of the industry gradually started to shrink, and as of end CY-04, there were 6 DFIs[7] in operation, as compared to 10 in 1997. PICIC and the foreign-sponsored DFIs have generally maintained sustained business operations through the major upheavals faced by the industry due to the strong support of their sponsors, sound capital structure and consistent profitability.

Despite the shrinking size of the industry, and the restructuring and consolidation process that these institutions have undergone, DFIs have maintained a dominant position in the NBFIs sector in terms of their scope of business, their large capital base and their share of assets and deposits.

Being single-product entities in the past, these institutions are now trying to diversify and expand their business activities. In order to aid this process, SBP has allowed them to establish subsidiaries for asset management or core brokerage business.[8]

In terms of diversification of operations, a few DFIs have acquired commercial banks, in addition to investing in subsidiaries for leasing and insurance business. Some DFIs are now strongly focused on investment banking activities, whereas one has also introduced consumer financing as part of its product package. One of the leading DFIs has recently expanded its corporate finance activities to Lahore in addition to Karachi, and is focusing on enhancing its advisory and syndication business in addition to considering the possibility of acquiring a commercial bank in order to undertake SME and

[5] Same as footnote 3.
[6] For details, please see “Pakistan : Financial Sector Assessment 1990-2000”, State Bank of Pakistan.
[7] However SME Bank has obtained a commercial banking license from SBP, which will further reduce the number of DFIs to 5 in CY05. SME Bank is expected to be privatized by June 2006.
[8] Please see BPD Circular No. 1 dated January 28, 2005. This is a consolidated circular which supersedes previous instructions issued in this regard.

Consumer Financing activities. Pak Kuwait Investment Company has also launched the first ever *Takaful* (Islamic Insurance) company in May 2005.

Performance in 2004

The year 2004 has been a year of achievements for DFIs. Not only have they extended their capital base in line with SBP's minimum paid-up requirements,[9] their assets have grown by around 19 percent, and advances by almost 61 percent. This is a major achievement given the dismal growth in advances of a little less than 5 percent in CY03.[10]

As shown in **Table 6.6**, the capital to liability ratio has inched up to 47.1 percent in CY04 from 46.3 percent in CY03. Growth rate of capital on the other hand, while still healthy, has slowed down to 20.4 percent as compared to 46.3 percent in CY03, which was due to the formation of Pak Oman in CY02.

Table 6.6: Performance Indicators of DFIs

Percent

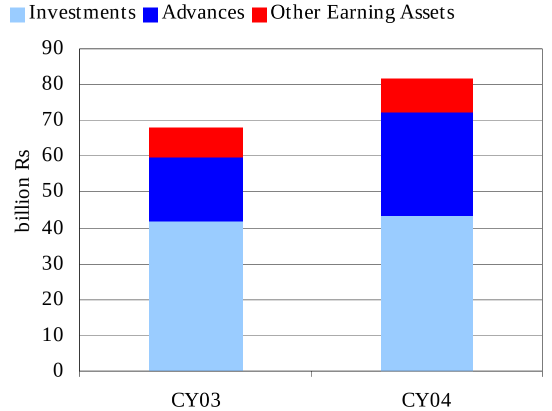
	CY00	CY01	CY02	CY03	CY04
Capital Adequacy					
Capital to liability ratio	19.0	18.9	34.9	46.3	47.1
Growth rate of capital	2.8	0.1	82.6	40.2	20.4
Growth rate of assets	-6.0	0.3	3.6	14.7	18.9
Asset Quality					
Equity to total assets ratio	15.9	15.9	28.1	31.6	32.0
Earning assets to total assets ratio	74.9	75.2	86.6	86.1	87.0
Lease finance to earning assets	0.6	1.5	3.9	1.0	0.8
Advances to earning assets	58.0	44.5	32.4	26.2	35.1
Investments to earning assets	41.0	47.7	55.1	61.6	53.3
Investments in govt securities to earning assets	2.3	10.5	11.8	18.0	14.4
Investments in govt securities to total investments	5.5	21.9	21.4	29.2	27.1
Investments in shares to total investments	34.9	32.4	31.6	29.1	26.1
Investments in subsidiaries to total investments	6.2	11.7	9.1	7.6	21.3
Management					
Expense to total income	57.0	63.8	58.6	34.4	35.9
Expense to total income (with provisions)	80.8	80.3	45.7	42.4	32.5
Intermediation cost	2.4	2.8	4.0	3.6	2.1
Intermediation cost (with provisions)	6.1	5.5	1.8	5.3	1.6
Administrative expense to total expenses	19.9	20.2	50.5	41.0	44.3
Provisions to total expense	29.5	20.6	-28.2	18.8	-10.2
Earnings and Profitability					
Return on average assets	2.1	1.8	6.8	7.3	5.9
Return on average equity	13.8	11.0	30.6	25.3	18.6
Interest rate spread	3.9	5.4	4.6	2.7	2.0
Net interest margin	3.7	5.4	5.4	3.7	2.8
Liquidity and Sensitivity					
Liquid assets to total assets	15.1	17.8	17.4	22.9	18.4
Loans to deposits ratio	326.8	258.7	204.7	147.0	163.0
RSA to RSL	98.1	99.8	117.0	139.2	137.4
Gap to assets ratio	-1.4	-0.2	12.6	24.3	23.7

[9] Please see BSD Circular No. 12 dated August 25, 2004.
[10] Financial reporting for DFIs is on a calendar-year basis.

Despite the immense competition by commercial banks, DFIs managed to successfully expand their business activities as reflected in the increase of total assets to Rs 93.7 billion by end-CY04. Earning assets as a component of total assets have seen an increasing trend since CY00, and now constitute 87 percent of total assets. Earning assets, which are a source of a predictable and stable income streams, are considered quality assets; however it is important to examine the composition of earning assets into core (loans and advances) and non-core (investments) assets in order to interpret the reasons for this growth.

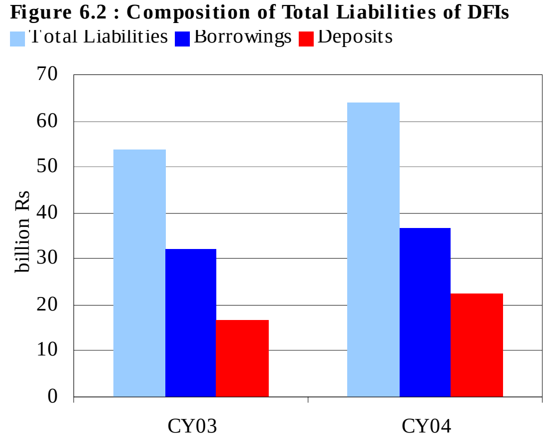
As opposed to CY03 when investments led the growth in assets, a healthy growth in the advances to earning assets ratio (from 26.2 to 35.1 percent), with a corresponding decrease in the share of investments in earning assets (from 61.6 to 53.3 percent), shows an increased focus on the core business function and less reliance on investments to generate income (see **Figure 6.1**). The growth in advances primarily stems from extending long-term financing to the manufacturing sector, due to the high credit demand in response to low interest rates and increased economic activities. Whereas investments still constitute a substantial portion of earning assets, it is more important to note the decrease in their share in CY04.

Figure 6.1: Composition of Earning Assets of DFIs



On the funding side, DFIs continue to have a strong reliance on borrowings. As can be seen in **Figure 6.2**, borrowings form a large portion of total liabilities in comparison to deposits even though deposits have increased by over 34 percent in CY04. Despite the high growth of deposits, the loans to deposits ratio has increased from 147 to 163 percent which shows the aggressive behavior of DFIs in expanding their loan portfolios.
In terms of composition of investments, DFIs continued their active involvement in the stock market, however the share of investments in shares has come down to 26 percent as compared to 29 percent in CY03.

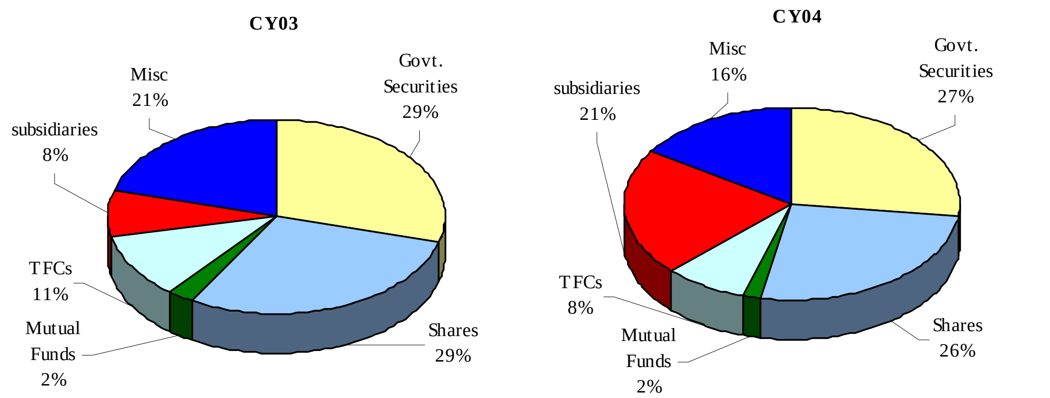
Figure 6.2 : Composition of Total Liabilities of DFIs



As shown in **Figure 6.3**, shares and Government securities together constitute 53 percent of the total investment portfolio in CY04. It is also important to note the increased share of investments in subsidiaries, which is in line with their efforts to diversify operations as discussed above.

From a management perspective, DFIs seem to have made concerted efforts to reduce intermediation cost from 3.6 in CY03 to 2.1 in CY04. Whereas the total expenses to total income ratio has reduced considerably to 32.5 percent, administrative expenses to total expenses has increased to 44.3 percent in CY04 from 41.0 percent in CY03.

Figure 6.3: Investment Portfolio of DFIs

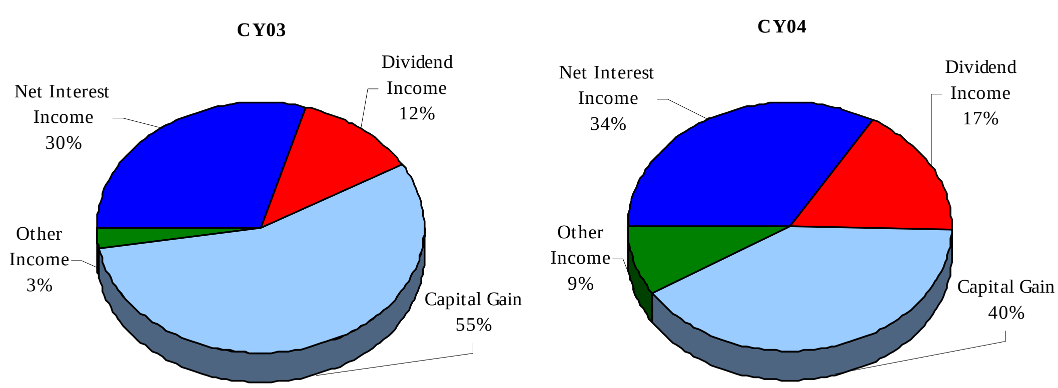


Income distribution of DFIs shows a large reliance on non-interest income in CY04 (see **Figure 6.4**), emanating from both capital gains and dividend income, which together contributed 57 percent of total income, as opposed to 67 percent in CY03. However the share of net interest income has improved from 30 percent in CY03 to 34 percent in CY04, as shown in **Figure 6.5.**

Profitability of DFIs has declined marginally by 0.4 percent mainly due to the declining non-interest income, from Rs 5.9 billion in CY03 to Rs 4.3 billions in CY04. The reduction in non-interest income is mainly because of a huge decline in the net gains on the sale of securities (capital gains) to Rs 2.8 billion against Rs 4.7 billion in the previous year. As a result, the return on average assets reduced from 7.4 to 5.9 percent, and return on average equity declined from 25.5 to 18.6 percent.

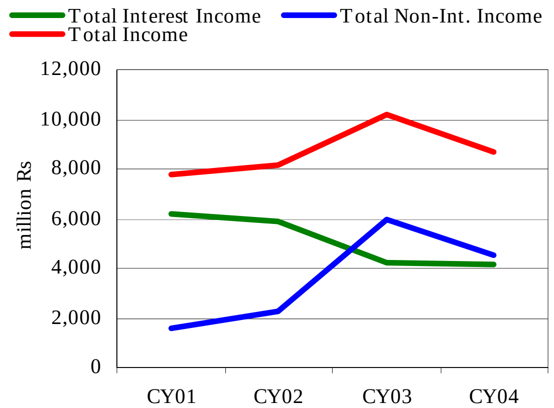
On an overall basis, DFIs seem to have re-aligned their business strategy with their core business functions and are more strongly focused on diversifying their business activities. Their improved financial performance also indicates that DFIs have overcome the governance issues which were a problem for them in earlier years.

Fig 6.4: Investment Income of DFIs



6.2.2 Investment Banks

Figure 6.5: Composition of Total Income of DFIs



Investment Banks, which in their initial phase served to provide corporate finance and project financing facilities for infrastructural development and long-term projects in the industrial sector, have gradually moved away from this *core* function. The core function of Investment Banks, which are now classified as Non-Banking Finance Companies,[11] has been redefined by the NBFC framework, which allows companies to undertake different types of business activities by fulfilling the minimum paid-up capital criteria laid out for each type of business. This in a way is a commercially viable option for Investment Banks to expand their business activities in line with the current emphasis on 'universal banking'. However in striving to become multi-business entities, providing facilities related to project financing should also constitute a part of their total business activities, given that these organizations are actually classified as 'Investment Finance Companies'.[12] Having said that, a major impediment in providing long-term finance is the ability to mobilize long term resources to fund such business activities which, unfortunately, has been one of the weak areas of this industry.

The size of the industry, in terms of number of organizations, continues to shrink given that a few Investment banks have either merged into commercial banks, or have opted for voluntary liquidation. However, whereas previous years were characterized by the absence of fresh capital injection, a positive recent development is the establishment of Dawood Investment Bank, formed by the merger of First General Leasing Modaraba and Dawood Leasing in May 2004.

This development however does not reflect in the growth rate of capital which has declined by 0.6 percent, as compared to an increase of 27.5 percent in FY03 (see **Table 6.7**) given that the inadequate capital base and negative profitability of one of the banks continues to affect the consolidated capital base of the entire industry. The capital to liability ratio has however increased to 17.1 percent in FY04 as compared to 15.4 percent in FY00, due to a reduction in total liabilities.

With a strong concentration on leasing business, most of these institutions are now competing with leasing companies, modarabas and commercial banks, with only a few organizations focusing on providing investment finance services. One of the leading Investment Banks has acquired an equity brokerage license, the operations of which are expected to contribute to the non-fund based revenues of the bank. A few banks are targeting expansion of operations in niche markets such as SME Financing. Very few banks in the industry are focused on promoting genuine Investment Banking activities, and in doing so are looking to expand their capacity for providing advisory services and other fee based activities. One of the banks for instance has opened up fully-equipped investment finance services centers (brokerage business) in 3 major cities of the country, due to which its share of fee-based income in total revenues is increasing steadily.

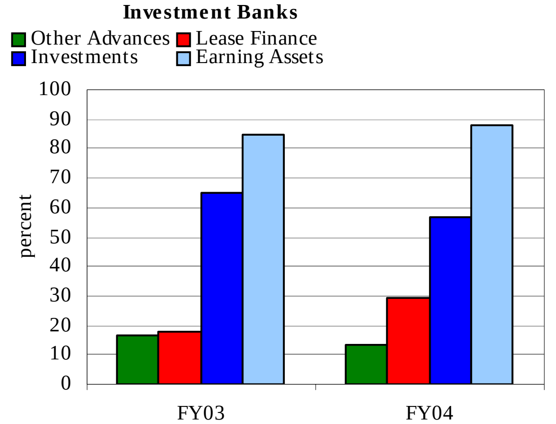
[11] For a detailed background discussion, please see "Pakistan : Financial Sector Assessment 2003", State Bank of Pakistan.
[12] Please see Rule 14 of "The Non-Banking Finance Companies (Establishment and Regulations) Rules, 2003" which specifies the business activities of an Investment Finance Company.

Table 6.7: Performance Indicators of Investment Banks
percent

	FY00	FY01	FY02	FY03	FY04
Capital Adequacy					
Capital to liability ratio	18.1	11.0	20.0	15.4	17.1
Growth rate of capital	0.7	-12.6	43.8	27.5	-0.6
Growth rate of assets	-1.2	34.8	-14.3	59.5	-9.4
Asset Quality					
Equity to total assets ratio	15.3	9.9	16.7	13.3	14.6
Earning assets to total assets ratio	79.4	86.7	82.4	84.9	88.2
Lease finance to earning assets	7.7	25.5	25.1	18.1	29.4
Short-term finance to earning assets	27.2	21.1	15.3	12.1	6.5
Investments to earning assets	57.3	47.7	55.2	63.5	56.9
Long-term investments to earning assets	6.0	3.1	6.0	17.6	11.1
Short-term investments to earning assets	37.6	29.3	33.2	32.8	24.5
Management					
Expense to income ratio	76.5	115.3	81.6	71.1	54.7
Expense to income ratio (with provisions)	86.7	123.9	87.3	84.3	58.0
Operating expense to total expense	14.7	13.4	17.0	18.9	36.1
Intermediation cost	3.5	3.2	3.9	2.7	3.3
Intermediation cost (with provisions)	6.7	4.9	5.4	5.3	3.8
Earnings and Profitability					
Return on average assets	2.1	-4.0	1.6	3.2	3.9
Return on average equity	13.9	-32.6	12.1	22.3	28.0
Interest rate spread	-1.0	-2.5	3.8	4.2	6.6
Net interest margin	0.2	-1.6	5.4	5.6	7.4
Other indicators					
Long-term liabilities to total liabilities	48.0	49.0	39.6	31.9	32.1
Long-term assets to total assets	21.8	29.5	31.0	37.2	39.5
Long-term liabilities to long-term assets ratio	186.4	149.7	106.4	74.4	69.3
Short-term liabilities to short-term assets ratio	56.3	65.2	73.0	93.9	95.9

Total assets of Investment Banks have decreased by 9.4 percent in FY04, as compared to a growth of over 59 percent in FY03. While the earning assets to total assets ratio continues to gain strength (see **Figure 6.6)**, a break-up of earning assets shows that over 86 percent of these assets (over 83 percent in FY03) constitute of lease finance and investments, with the share of other advances at 13.7 percent (almost 17 percent in FY03). Lease finance has in particular increased considerably, from 18.1 percent in FY03 to 29.4 percent in FY04. Investments on the other hand have reduced to around 57 percent of total earning assets as compared to 65 percent in the previous year, but are still a major component of total earning assets. This composition of the asset portfolio has strong

Figure 6.6: Composition of Earning Assets of Investment Banks

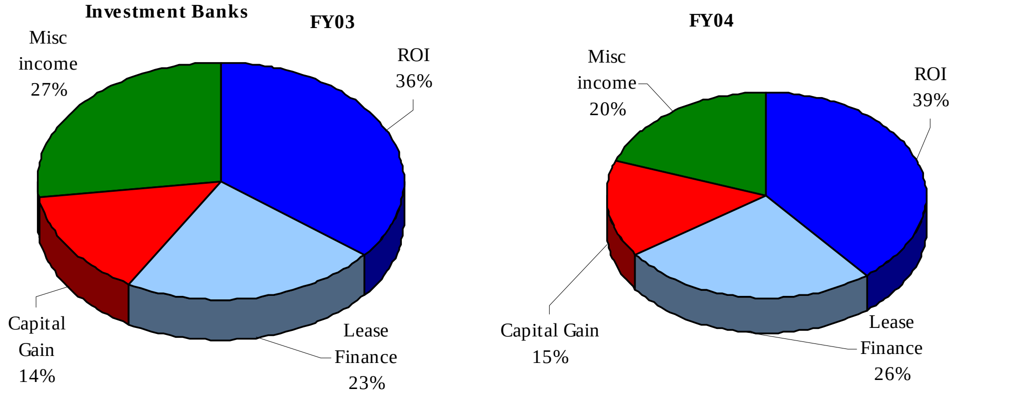


bearings on the future earnings, profitability and business focus of the industry.

As mentioned earlier, resource mobilization continues to be a weak area, and a look at the deposits and borrowings of the industry shows that deposits have declined by over 22 percent and there is a growing reliance on borrowings to fund business activities. This translates into a higher cost of funds as shown in the increased intermediation cost of 3.3 percent, as compared to 2.7 percent in FY03. This further leads to operating inefficiencies, as reflected in their management ratios, where the operating expense ratio has increased to 36.1 percent in FY04, as compared to 18.9 percent in FY03.

In line with the asset composition, a look at the total income (see **Figure 6.7**) shows that the bulk of Investment Banks' income comes from return on investments (37.6 percent) and leasing operations (24.8 percent), whereas a negligible contribution is made by fee-based income (around 1.0 percent). On the positive side, return on average equity and average assets both have increased on the back of increase in net profits by over 40 percent.

Figure 6.7: Composition of Income of Investment Banks



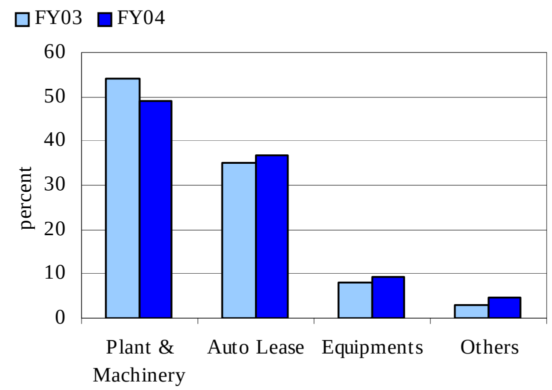
Investment Banks *per se* continue to be profitable entities, but the *source* of their profits does not say much about their contribution to the financial sector, or about their future direction. Their profit generation activities are enough to keep them afloat but these organizations need to re-strategize their business focus in the coming years if they want to continue operating as Investment Finance Companies.

6.2.3 Leasing Companies

As opposed to other NBFCs which have expanded operations in other areas in the ambit of the NBFC framework, the leasing sector, as the name implies, is single-mindedly focused on providing lease financing. Lease finance constitutes 85 percent of the total earning assets, with the rest consisting of investments. It is important to note that the leasing sector has now reached a level of maturity where it has become crucial for it to re-align its business strategies in line with competitive pressures from commercial banks, modarabas and investment banks. Commercial Banks' distinct edge over other institutions in terms of a lower cost of funds and a well-spread branch network has forced leasing companies to diversify their business into previously untapped areas, with an added focus on the SME sector. In doing so, one of the prominent leasing companies has also started to provide lease financing to the agriculture sector. The impact of such sector-wise diversification efforts will be more clearly visible in the coming years (see **Figure 6.8**).

One of the positive developments during the year under assessment was the formation of a National Register and Credit Bureau for small lessees, which is expected to safeguard the interests of the leasing sector in terms of preventing multiple lease finance facilities to a single entity, in addition to providing a centralized source of information on defaultors.

Figure 6.8: Business-wise Break-up of Lease Finance

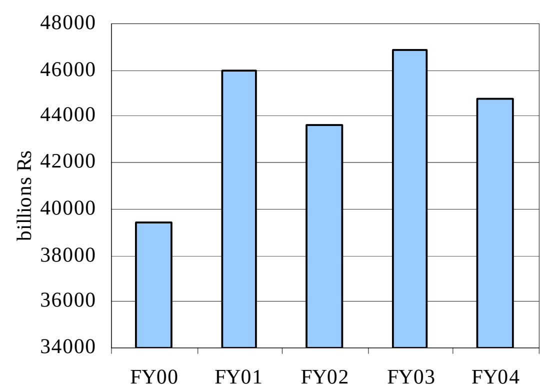


SECP's minimum paid-up capital requirements speeded up the pace of consolidation in FY04.The main objective of leasing companies for consolidation was to expand their business activities with an enhanced asset base to benefit from high economies of scale and increased market share. These consolidation activities reduced the number of companies from 27 in FY03 to 22 in FY04.

Performance in 2004

If compared with the leasing industry in FY03, the leasing sector in FY04 has witnessed negative growth in assets by 4.3 percent to reach Rs 44.8 billion as compared to a growth of 1.3 percent in the preceding year, which is entirely because of the base effect caused by the reduction in the size of the industry (see **Figure 6.9).** However, in a market swamped with banks and other financial institutions offering competitive financing schemes, the existing leasing companies have exhibited considerable resilience in facing up to competitive pressures and recording an increase in Net Profits of almost 18 percent.

Figure 6.9: Assets of the Leasing Sector



The overall financial performance of the leasing sector can be seen in **Table 6.8**. Whereas the capital base registered a negative growth of 10.5 percent due to the reduced number of companies in the industry, liabilities also reduced by over 3 percent, resulting in a declining capital to liability ratio from 19.7 to 18.1.

One of the areas of concern for the leasing sector is its exposure to interest rate risk as most of its borrowings are based on KIBOR plus, whereas lease finance is mostly extended on the basis of fixed rates. In the current environment of rising interest rates, some of the leasing companies with a heavy reliance on borrowing will find themselves in a disadvantageous position in the near future. On an overall basis, deposits have decreased by 4.6 percent in FY04, constituting around 41 percent of total liabilities.

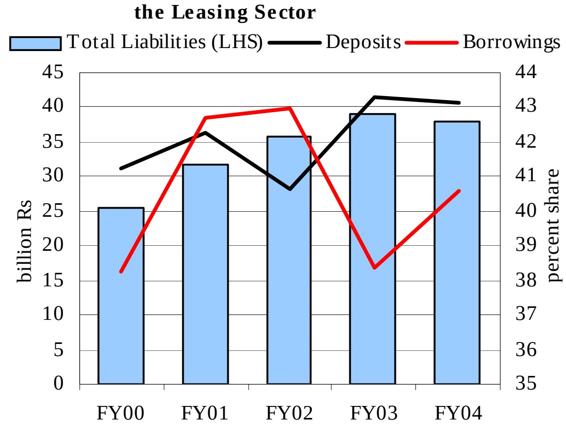
Table 6.8: Performance Indicators of the Leasing Sector
percent

	FY00	FY01	FY02	FY03	FY04
Capital Adequacy					
Capital to liability ratio	21.1	18.8	17.3	19.7	18.1
Growth rate of capital	2.3	7.8	2.7	2.5	-10.6
Growth rate of assets	5.4	21.1	11.4	8.1	-4.4
Asset Quality					
Earning assets to total assets	69.8	71.5	71.4	86.9	86.0
Lease finance to earning assets	90.3	90.6	89.8	80.9	85.0
Investments to earning assets	5.3	7.6	8.2	14.4	11.5
Management					
Expense to income ratio (excluding provision)	79.2	83.0	86.1	75.9	70.8
Expense to income ratio (including provision)	86.4	91.5	98.1	82.2	76.0
Administrative expense to total expense	16.9	16.5	17.0	24.6	32.7
Intermediation cost	4.6	4.4	4.7	4.5	4.6
Intermediation cost (with provisions)	6.6	6.4	7.5	5.7	5.5
Earnings and Profitability					
Return on average assets	1.6	0.9	0.1	1.9	2.2
Return on average equity	7.5	4.6	0.5	11.4	14.0
Interest rate spread	2.5	2.7	3.3	3.6	4.5
Net interest margin	6.9	5.7	5.9	6.1	6.1
Liquidity and Sensitivity					
Liquid assets to total assets	11.3	12.2	13.4	3.2	2.5
Current ratio	1.4	1.3	1.2	1.4	1.3
RSA to RSL ratio	1.3	1.2	1.2	1.4	1.3
Gap to assets ratio	17.6	13.8	12.4	22.4	21.4
Other Indicators					
Total assets to net worth	4.7	5.3	5.8	6.1	6.5
Earnings per share	1.3	0.7	0.1	1.9	2.4
Revenue per share	12.0	12.4	12.0	7.9	7.8
Dividend per share	1.0	0.6	0.5	0.6	0.8
Break-up value (NAV)	17.4	16.8	15.4	13.9	15.1

On the other hand borrowings have grown marginally by 2.4 percent in FY04, at a little over 40 percent of total liabilities (see **Figure 6.10**). Intermediation cost remains roughly around the same level as FY05.

A positive feature on the management side is the declining trend of the expense to income ratio, both with and without provisions, mainly because of a significant decline in financial expenses. However, the administrative expenses to total expenses ratio increased from 24.6 percent to 32.7 percent in FY04, which is an area of concern.

Figure 6.10: Composition of Liabilities of the Leasing Sector



Overall, leasing companies have performed well in terms of facing up to the challenges in their operating environment. However it has to be borne in mind that a complete focus on only one product area is not a feasible long-term business strategy given the increasing emphasis on universal banking and an increasingly competitive environment along with rising interest rates. It would be in the benefit of the leasing sector to re-strategize its business focus in order to remain an active constituent of the financials sector, in addition to retaining its market share.

6.2.4 Modaraba Companies

Modarabas provide a Shariah compliant mode of financing and investment, and have played a vital role in the development and growth of the economy and capital markets since their inception.

The Modaraba sector continues to work in close alliance with the regulators, and a number of measures have been taken over the years to promote corporate governance in the sector. With improved monitoring and surveillance methods instituted by the SECP, adherence to prudential regulations for Modarabas has improved. Also, enhanced disclosure requirements have helped in maintaining greater transparency in the sector.

The modaraba sector has chronically suffered from the problem of resource mobilization resulting in limited opportunities for growth. Realizing this problem, SECP has recently allowed Modarabas to raise funds through the issuance of Musharika based Term Finance Certificates (TFCs), in addition to opting for schemes for issuance of Certificate of Musharika (COM) to overcome the problem of liquidity. Modaraba Ordinance and Rules have been reviewed and necessary amendments are underway which would improve the regulatory and operating environment of the sector leading to better performance on an overall basis. Acquisitions and voluntary mergers are being encouraged in order to strengthen the sector. The recent mergers in the sector are indicative of a general strategic shift towards consolidation which is needed to usher in greater financial stability and operational flexibility.

The Modaraba sector continues to be the largest group among the NBFIs in terms of the number of companies, which currently stand at 35, whereas their share in total assets has decreased to 5.8 percent in comparison with 6.2 percent in FY03. As indicated in our previous analysis,[13] the sector is inundated with a number of small entities, so much so that almost half of the companies have a share of less than 1.0 percent (each) of total assets, and only 2 modaraba companies have a share of more than 10 percent each. As shown in **Table 6.5**, a number of consolidation transactions have materialized during the year and further consolidation is expected in the future.

Performance in 2004

Performance indicators of Modarabas are detailed in **Table 6.9**. It can be seen that whereas capital has grown by around 9 percent, the capital to liability ratio has come down from 99.9 percent in FY03 to 91.8 percent in FY04.

Increased activities in the Modaraba sector during the year led their assets to grow by 13.7 percent, with a growth in advances of 11.7 percent. Earning assets to total assets constitute 78.2 percent of total assets, an increase of 0.5 percentage points over FY03.

[13] Please see "Pakistan : Financial Sector Assessment 2003", State Bank of Pakistan.

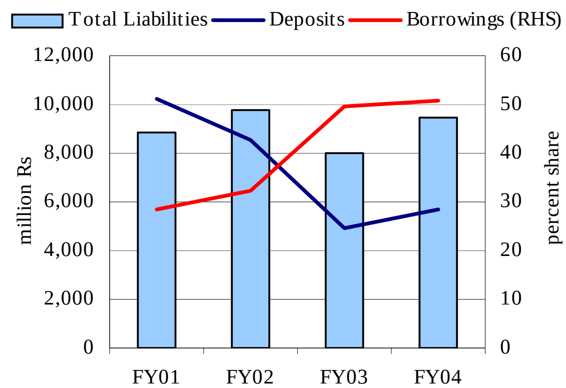
Table 6.9: Performance Indicators of Modarabas

percent

	FY00	FY01	FY02	FY03	FY04
Capital Adequacy					
Capital to liability ratio	92.9	75.6	78.1	99.9	91.8
Growth rate of capital	7.3	-11.4	14.4	4.6	8.9
Growth rate of assets	5.7	-0.9	12.3	-8.3	13.7
Asset Quality					
Earning assets to total assets	79.6	80.7	73.2	77.7	78.2
Long-term earning assets to total earning assets	65.3	68.8	71.7	70.0	70.1
Lease finance to earning assets	50.9	54.1	57.8	57.6	62.1
Morabaha and Musharaka to earning assets	24.7	21.7	22.3	23.6	18.6
Investments to earning assets	21.8	22.1	19.2	15.9	17.3
Management					
Expense to income ratio (excluding provisions)	74.5	75.9	82.9	85.5	75.2
Expense to income ratio (including provisions)	76.5	84.2	82.3	74.4	77.0
Administrative expense to total expense	11.3	34.6	35.9	11.8	12.7
Earnings and Profitability					
Return on average assets	5.9	3.5	4.4	6.9	5.7
Return on average equity	12.3	7.7	10.0	12.9	11.6
Liquidity and Sensitivity					
Liquid assets to total assets	7.0	6.5	7.6	5.9	9.6
Current ratio	1.5	1.3	1.2	1.1	1.2
Net working capital (million Rupees)	2,515.8	1,637.2	914.5	680.6	1,069.1
Other Indicators					
Total assets / Net worth	2.1	2.3	2.3	2.0	2.1
Earnings per share	1.3	0.9	0.9	1.4	1.3
Revenue per share	4.0	4.4	4.0	3.9	3.9
Dividend per share	0.8	0.7	0.7	0.9	0.8
Break-up value (NAV)	10.0	8.9	8.9	9.8	10.8

Modarabas are strongly focused on Leasing business, and lease finance constitutes more than 62 percent of total earning assets, whereas Musharika and Morabaha finance have a share of 18.6 percent. Investments on the other hand have increased to 17.3 percent as a percentage of total earning assets as compared to 15.9 percent in FY03. Modaraba's funding options, despite the regulatory room given by SECP, are strongly tilted towards borrowings as compared to deposits (see **Figure 6.11**) which is a cause of concern in a rising interest rate environment. In line with the composition of assets, income on lease finance has the biggest contribution to total income at 71.5 percent, however net

Figure 6.11: Composition of Liabilities of Modarabas



profit has decreased by almost 16 percent in FY04, as compared to an increase of over 53 percent in FY03. This is attributed largely to the fact that the total number of companies have reduced from 38 to 35 in FY04.

A look at the management ratios shows that the administrative expenses as a percentage of total expenses constitute less than 13 percent, and the expenses to income ration has also been brought down 75.2 percent in FY04 from 85.5 percent in the previous year.

Modarabas have considerable potential to carve out a niche for themselves in the corporate sector of the country. However instead of having numerous organizations with a low share in total business activities, the Modaraba sector should, in consultation with the regulators, work in the direction of increasing their market share by joining hands with each other in order to emerge as stronger entities.

6.2.5 Housing Finance Companies

The Housing Finance sector is primarily dominated by House Building Finance Corporation (HBFC) with a 97 percent share in total assets. HBFC has the distinction of being the first institution in the financial sector to provide housing loans, and has been doing so for the last 53 years. Although recent years have seen increased competition in the housing finance sector given the active role of commercial banks in this area, HBFC continues to retain a prominent role in terms of providing housing finance to the low and middle income sections of the population. HBFC has the added advantage of an extended outreach given its country-wise network of 60 district offices and 12 zonal offices.

In the recent past there have been some changes in its regulatory purview. HBFC initially used to be grouped with the DFIs. However, with the establishment of other housing finance companies during the 1990s, HBFC and the other companies were categorized as Housing Finance Companies (HFCs), which were regulated by the State Bank.[14] However the supervision and regulatory responsibilities of the HFCs were transferred to the SECP with the rest of the NBFIs in 2002. HBFC, however, is currently under SBP's regulatory supervision for the purpose of restructuring. At present this institution is categorized as a DFI by the State Bank.

In its effort to re-align its business strategies, HBFC is now strongly focused on SMH Finance (Small and Medium Housing Finance) with the purpose of providing affordable housing opportunities to the common man.

HBFC relies heavily on SBP for credit lines to extend fresh loans, therefore it is difficult for the company to rapidly expand its business activities. In FY04, a heavy provisioning amount has severely impacted the bottom line of the business. These provisions were made by the company as a matter of prudence to cover the uncertainty with respect to realizable values of mortgaged properties. Moreover it is facing increased competition by commercial banks whose mortgage finance portfolio is growing rapidly, and has reached an amount of Rs 21.7 billion by end-March FY05.

Despite the immense competition by commercial banks, HFCs successfully maintained their share in core operational activities of housing finance as evidenced by an increase in the outstanding housing finance by an amount of Rs 895 million to reach 12.04 billion (see **Figure 6.12**).

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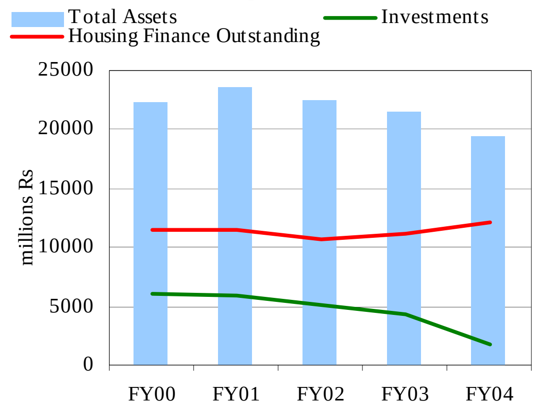
[14] SECP had asked the Ministry of Finance to issue a notification to place HBFC under its regulatory supervision, however this notification was not issued and instead in February 2005, the Ministry of Finance issued a notification whereby HBFC was handed over to SBP for regulatory supervision.

Performance in 2004

The financial analysis of HFCs on a consolidated basis mainly reflects the performance of HBFC given its pre-dominant share of the Housing Finance sector.

Figure 6.12: Assets Composition of HFCs



Financial indictors of HFCs are summarized in **Table 6.10**. As can be seen from the table, the capital to liability ratio has declined by 0.6 percentage points, and is 28.7 at end-FY04. HBFC's net loss due to the huge provisioning made during the year has impacted the growth of capital, which has declined by over 11 percent. The high provisions also accelerated the increase in total expenses enormously which led expenses (including provisions) to income ratio to go up from 70.1 percent in FY03 to 173.6 percent in FY04. However if provisions are excluded, the expenses to income ratio registered a marginal growth of only 1.2 percentage points. Earning Assets constitute 70.8 percent of total assets, and have shown a generally declining trend since FY00 which is a cause for concern. Advances form a healthy portion of earning assets at 87.2 percent which is a considerable improvement over the FY03 level of 71.8 percent. Investments' share in earning assets has decreased from 28.0 percent in FY03 to 12.8 percent in FY04.

Table 6.10 : Performance Indicators of Housing Finance Companies

percent

	FY00	FY01	FY02	FY03	FY04
Capital Adequacy					
Capital to liability ratio	20.6	23.6	27.7	29.3	28.7
Growth rate of capital	13.8	18.6	7.8	0.5	-11.1
Growth rate of assets	3.3	6.0	-4.9	-3.9	-9.6
Asset Quality					
Earning assets to total assets	78.2	73.9	70.3	71.8	70.8
Advances to earning assets	65.4	66.0	67.8	71.8	87.2
Investments to earning assets	34.6	34.0	32.2	28.0	12.8
Management					
Expense to income ratio	32.0	61.2	66.3	70.1	71.3
Operating expense to total expenses	84.4	46.6	53.6	70.1	173.6
Provisions to total expenses	1.8	1.2	0.0	0.0	59.0
Earnings and Profitability					
Return on average assets	4.5	3.6	1.5	0.9	-3.2
Return on average equity	46.4	33.5	12.6	3.9	-14.4
Liquidity					
Liquid assets to total assets	35.6	37.4	37.7	13.2	15.6
Borrowing to advances ratio	148.2	135.4	135.0	129.6	108.5
Borrowing to liabilities	91.4	81.7	82.1	86.4	86.2

It can be seen from the overall financial indicators that HBFC needs to capitalize on its strong points to overcome a few problem areas in order to remain commercially sustainable in the coming years. It has to be noted that HFCs have exhibited a remarkable resilience to changing market dynamics given the adequate level of capitalization, and a competitive level of growth in advances.

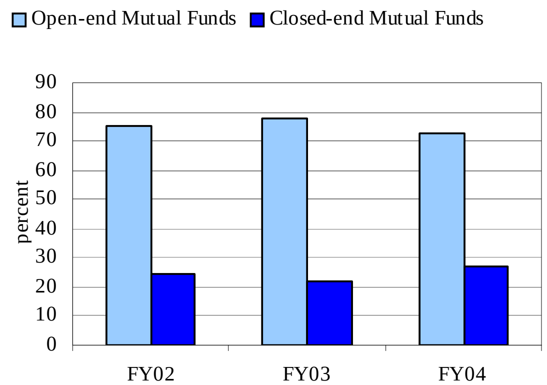
6.2.6 Mutual Funds

In basic terms, Mutual Funds enable investors to pool their savings and place it under professional management. The portfolio managers trade the funds' underlying securities, realizing a gain or loss, and collect the dividends or interest income. The investment proceeds are then passed along to the individual investors.

In a developing country like Pakistan there is a strong need for lucrative investment avenues for small and fixed income investors, especially since government bonds, until the recent past, were the primary mode of investments for individuals and institutions alike. Due to their reliance on government securities, investors remained largely risk-averse and were also reluctant to explore the feasibility of various other investment options in light of limited awareness and knowledge of such issues. In this environment, an active participation of the private sector, with the relevant professional expertise in offering and managing such investment options, was direly needed. The development of the mutual funds sector serves to meet this need more than adequately given that most of the asset management companies which are managing these funds are subsidiaries of large financial groups and have the relevant professional acumen to manage portfolios which offer investors a rate of return in line with market dynamics. Moreover, Mutual Funds provide the facility of spreading risks and providing diversified investments, and in doing so they also add liquidity to the stock market.

The Mutual Funds sector in Pakistan has undergone a dramatic change in recent years, both in terms of change in ownership and increased activities due to a booming stock market. Where previously institutions like ICP and NIT used to be the pre-dominant players in the areas of closed-end and open-end funds respectively, previous years has seen an active role of asset management companies in the private sector to the extent that the share of the public sector, as in the rest of the financial sector as well as in the economy, has gradually increased over time (see **Table 6.11** and **Figure 6.13**).

Figure 6.13: Percent share of Net Asset Values



As shown in **Table 6.11**, the impact of this trend is more visible in closed-end mutual funds where the public sector's share has been completely taken over by the private sector. The main reason behind this is the privatization of ICP's funds during 2004 through an open competitive bidding process, as a result of which the various funds were amalgamated and taken over by ABAMCO Asset Management and PICIC.[15] Net Assets of the Mutual Funds, on a consolidated basis, have increased by 83.7 percent in FY04.

It is interesting to note that while the share of the public sector shows a declining trend in open-end Mutual Funds, NIT (the sole public sector player) continues to have a dominant share at 73.3 percent of total open-end funds at end-FY04. The increased interest of individual investors in NIT can be gauged by the growth of 12 percent in the number of investors in FY04.

[15] The 4th ICP Mutual Fund is now called ABAMO Growth Fund. Some of ICP's funds (1, 3, 8, 11, 12, 15, 19, 20) have been amalgamated into ABAMCO Capital Fund, whereas ABAMCO Stock Fund is the amalgamation of ICP Fund nos. 21, 23 and 25. PICIC Investment Fund consists of ICP Funds 2, 5, 6, 7, 9, 10, 13, 14, 16, 17, 18, 22 and 24, whereas ICP State Enterprise Mutual Fund (SEMF) is now PICIC Growth Fund.

Incidentally ICP is now under the regulatory purview of SBP, and plans are underway to restructure and corporatize it. It is expected that the company will be privatized as an NBFC and will be transferred back to SECP for regulatory purposes.

Since most of the Mutual Funds invest in listed shares, they have benefited tremendously given the exceptional performance of the stock market in the last few years (see **Figure 6.14 (a)** and **(b)**),[16] as evidenced by the growth in their Net Asset Values in FY04.

Table 6.11: Net Asset Values (NAVs)
billion Rupees, share in percent

	Net Assets of Mutual Funds					
	FY02	**Share**	**FY03**	**Share**	**FY04**	**Share**
Open-end Mutual Funds						
Public sector	17.4	92.1	31.6	80.4	49.5	73.3
Private sector	1.5	7.9	7.7	19.6	18.0	26.7
	18.9	**100.0**	**39.3**	**100.0**	**67.5**	**100.0**
Closed-end Mutual Funds						
Public sector	4.8	77.4	8.7	78.4	0.0	0.0
Private sector	1.4	22.6	2.4	21.6	25.1	100.0
	6.2	**100.0**	**11.1**	**100.0**	**25.1**	**100.0**
Total Mutual Funds NAVs	**25.1**		**50.4**		**92.6**	

Open-End Mutual Funds

The Mutual funds sector in Pakistan is divided quite uniformly, in terms of the number of active funds, into open-end and closed-end funds. Within these broad categories, the funds are divided into several types, as detailed in **Table 6.12** and **Table 6.13.**

Figure 6.14 (a): Performance of Stock Market

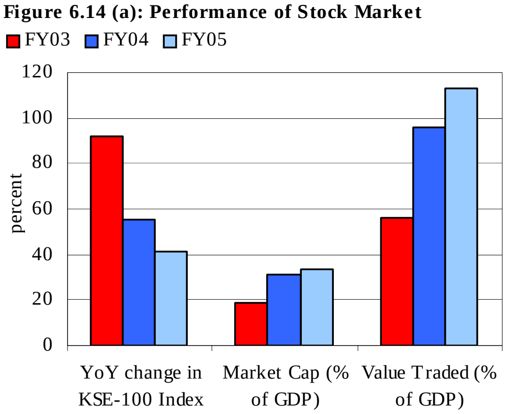


Figure 6.14 (b): Performance of the KSE Index

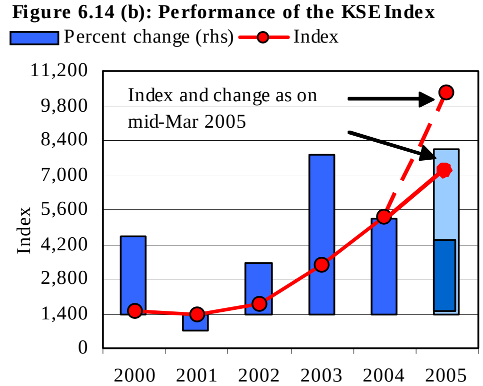
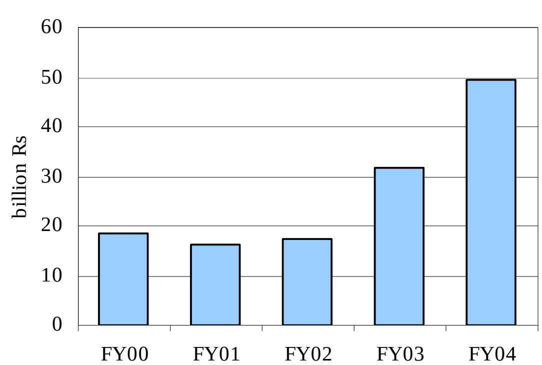


Table 6.12 shows the growth in Net Asset Values (NAVs) of the various open-end funds, in addition to the new funds which were launched during the year under assessment. It also gives the payout ratios (cash and bonus) of the funds. Both the NAVs and the payouts show the exceptional performance of the funds during the year. The NAV of NIT, which is an open-end equity fund, has grown by over 56 percent from June FY04 to June FY05 (see **Figure 6.15**).

Figure 6.15: Net Asset Value - NIT



[16] Figure 6.14 (b) is shown to highlight the impact of the market correction of mid-march FY05 on the growth of the KSE Index.

Table 6.12 : Open-End Mutual Funds
million Rupees, share in percent

	Net Asset Value					Payout (FY04)	
	FY03	**Share**	**FY04**	**Share**	**Growth**	**Cash**	**Bonus**
Balanced Fund							
1. Unit Trust of Pakistan	1.67	4.1	3.30	4.9	97.7	-	30.0%
2. Faysal Balanced Growth Fund	0.00	0.0	2.00	3.0	new	-	-
Bond/Income Fund							
1. Metrobank - PSF	0.00	0.0	0.46	0.7	new	-	-
2. Metrobank - MSF	1.50	3.7	0.47	0.7	68.7	-	-
Equity Fund							
1. Crosby Dragon Fund	0.00	0.0	0.37	0.5	new	-	2.0%
2. Pakistan Stock Market Fund	0.78	1.9	1.05	1.6	34.1	-	60.0%
3. National Investment Trust	31.63	78.4	49.51	73.3	56.5	17.5%	-
Islamic Fund							
1. Meezan Islamic Fund	0.00	0.0	1.31	1.9	new	-	15.0%
2. UTP Islamic Fund	0.46	1.1	0.64	1.0	41.0	-	17.0%
Money Market Fund							
1. Dawood Money Market Fund	0.60	1.5	1.31	1.9	119.1	-	7.0%
2. Pakistan Income Fund	1.50	3.7	3.40	5.0	126.7	-	9.0%
3. UTP Income Fund	0.38	1.0	1.29	1.9	235.3	-	6.2%
4. United Money Market Fund	1.82	4.5	2.03	3.0	11.3	-	4.7%
5. Atlas Income Fund	0.00	0.0	0.37	0.6	new	3.8%	-
Total Open-End Funds	**40.34**	**100.0**	**67.51**	**100.0**	**67.4**		

It is also interesting to note that the customer can now choose between various types of funds, as opposed to just equity funds which dominated the market in the past. In brief, a balanced Mutual Fund is one which invests in a balance of common stocks and government and corporate debt bonds with the objective of income provision and some capital appreciation with low risk. Equity Funds are invested in equity stocks, and Money Market Funds, as the name suggests, are invested in money market instruments.

Closed-end Mutual Funds

A large proportion of closed-end Mutual Funds is concentrated on investments in equity stocks, as shown in **Table 6.13**. Most of these funds have recorded a tremendous growth in NAVs, in addition to providing healthy payouts.

With increased investors' interest in this area and a corresponding demand-lend growth reflected in the number of mutual funds on offer, this sector will continue to grow in the coming years.

6.2.7 Discount Houses

Discount houses serve the purpose of meeting short-term liquidity needs of the financial and corporate sector, by discounting a wide variety of instruments such as bonds, bills receivables etc. Given the fact that banks also provide discounting facilities, and the bond market in Pakistan is still in the process of development, the scope of activities for Discount Houses has generally been limited. Due to this reason they have been unable to carve a significant niche for themselves as reflected by the shrinking size of the industry, which currently has only one company in operation, as compared to four in FY03.

Table 6.13 : Closed-End Funds

Amount in million Rupees, share in percent

		Net Asset Value					Payout (FY04)	
		FY03	Share	FY04	Share	Growth	Cash	Bonus
	Balanced Fund							
1	BSJS Balanced Fund	0.66	29.7	1.62	6.5	145.4	-	12.5%
	Equity Fund							
1	Al-Meezan Mutual Fund	0.47	20.9	1.13	4.5	142.0	10.0%	15.0%
2	Asian Stock Fund Ltd	0.06	2.6	0.16	0.6	173.3	-	-
3	ABAMCO Stock Market Fund	0.13	5.9	1.19	4.8	810.5	-	25.0%
4	ABAMCO Composite Fund	0.00	0.0	3.02	12.1	new	-	-
5	ABAMCO Capital Fund	0.24	10.5	2.39	9.6	918.1	-	20.0%
6	ABAMCO Growth Fund	0.06	2.7	0.57	2.3	836.0	-	25.0%
7	First Capital Mutual Fund Ltd	0.04	1.8	0.12	0.5	191.6	-	-
8	Golden Arrow Selected Stock Fund	0.03	1.1	0.19	0.8	644.5	17.5%	20.0%
9	Prudential Stock Fund Ltd	0.00	0.1	0.02	0.1	643.3	-	-
10	PICIC Investment Fund	0.21	9.3	5.09	20.3	2,357.1	25.0%	-
11	PICIC Growth Fund	0.32	14.5	6.37	25.4	1,864.9	45.0%	-
12	Pakistan Premier Fund Ltd	0.01	0.5	1.22	4.9	10,336.6	12.5%	25.0%
13	Pakistan Capital Market Fund	0.00	0.0	1.50	6.0	new	8.3%	-
14	Safeway Mutual Fund	0.00	0.2	0.43	1.7	10,436.7	-	25.0%
15	Tri-Star Mutual Fund	0.00	0.1	0.03	0.1	2,184.3	-	-
		2.23	**100.0**	**25.06**	**100.0**	**1,023.5**		

* Source : KSE daily Quotation sheet

NBP Capital Ltd is an unlisted subsidiary of National Bank and until the last financial year, its principal activity was to invest, discount and trade in negotiable instruments. However, being a single-product entity in an area with a limited scope of business growth has led the company to obtain a leasing license in December 2004, in order to diversify its business operations. Even though the asset base and profitability of the company has increased in comparison with FY03, however only 10 percent of its total income comes from discounting operations, whereas the rest comes from investments.

6.2.8 Venture Capital Companies

This is another area which has generally seen limited activities, however a new company by the name of AMZ Ventures has started operations in May 2004, and there are 3 companies operating in this area, which undertake Venture Capital Investments. The principal objective of these companies is to undertake and promote the business of venture capital financing, investments and other related services. Even though this sector has seen a growth in assets of 16.5 percent in FY04, its share in total assets of the NBFIs sector remains diminutive at 0.32 percent.

Since most of the companies have started operations in the recent past, a better assessment of their performance can be made with the passage of time if and when there is a development in the financing of Greenfield projects.

6.3 Future Direction of NBFIs

With the increased emphasis on universal banking, the ‘specialized financing’ services’ niche carved out by the Non-Banking Finance Institutions in previous years has gradually disappeared with time. The evolving regulatory framework for commercial banks has also enabled them to take up a host of activities which they were not allowed to venture into previously due to which their scope of operations has expanded enormously. All this bodes well for the implementation of universal banking in the coming years, but it is to be noted at the same time that these developments have considerably reduced the competitive edge of specialized services provided by the NBFIs. Banks and NBFIs are now largely operating on a uniform platform in terms of providing an array of services to their clients.

In order to remain commercially viable entities, NBFIs in general need to re-align their business strategies, focus on their core business functions, diversify their product base, and devise new methodologies of mobilizing savings to fund their business activities by reducing their reliance on borrowings. This is especially important in a rising interest rate environment which translates into a higher cost of doing business.