4 Performance of Non-bank Financial Institutions

Non-bank financial institutions (NBFIs) have undergone a significant structural change during FY01-FY02. A number of mergers and acquisitions have been witnessed not only within and across different groups of NBFIs but with the banks as well (see **Section 1.1.4**). Consolidation of small and under capitalized NBFIs was mainly induced by increase in minimum paid-up capital requirement by the State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP) for both the banks and NBFIs. The impact of mergers/ acquisitions is visible in the asset holdings of these groups of institutions. Specifically, overall assets of the NBFIs saw a sharp decline of Rs 32.6 billion to Rs 206.6 billion by the end-FY02; mainly explainable by the liquidation of BEL and mergers of NDFC with the NBP and Al-Faysal Investment Bank with the Faysal Bank Limited. Although the operating NBFIs continued to grow over the same period; this growth was masked by the impact of mergers and acquisition on overall assets.

The structure of NBFIs is expected to change further in near future not only due to the ongoing process of mergers/acquisition within and across the sectors, but also largely due to the introduction of the concept of non-bank finance companies (NBFCs). A NBFC can undertake most of the financial services, except commercial banking and insurance. Specifically, a NBFC can provide investment finance, leasing, housing finance, venture capital investment, discounting, investment advisory and assets management services. However, how many of these services a NBFC may provide will depends on the compliance of prescribed criteria. It is expected that the introduction of NBFC will not only help to consolidate the fragmented services of NBFIs at one platform, but also to minimize the operating cost of this sector. Moreover, consolidation of a heavily fragmented sector under the umbrella of NBFCs is likely to lead to the emergence of strong companies that have a sizeable capital base to absorb unexpected shocks to their businesses.

4.1 Structure of NBFIs

NBFIs are classified into eight different groups of institutions, primarily according to their business activities.[1] A quick glance at **Table 4.1** shows that asset holdings of various groups of NBFIs have significantly changed over the last couple of years. However, asset distribution remained considerably skewed towards the DFIs. The DFIs, despite recording a notable reduction in their assets, still hold more than 30 percent of overall assets of NBFIs (see **Figure 4.1**). Within rest of NBFIs, while investment banks saw a massive erosion in their asset holdings, mainly due to mergers with the commercial banks,[2] it was the leasing companies that recorded a rise of Rs 4.2 billion in their assets. As a result, the share of leasing companies jumped up from 16.5 percent in FY00 to 21.1 percent in FY02.

Table 4.1: Assets of NBFIs
billion Rupees

	FY00	FY01	FY02
DFIs	91.5	61.1	68.7
Investment banks	41.5	28.0	23.3
Leasing companies	39.4	45.9	43.6
Modarabas	15.6	15.5	17.4
Housing finance companies	22.3	23.6	22.4
Mutual funds	25.6	24.2	29.4
Discount houses	1.8	1.4	1.5
Venture capital companies	1.0	0.3	0.3
Total assets	238.7	200.1	206.6

Despite significant decline in overall assets of NBFIs, most of the key financial indicators witnessed visible improvement (see **Table 4.2**). Capital to liabilities ratio climbed to 43.9 percent by end FY02 compared to 19.5 percent in FY00,[3] primarily explainable by: (1) liquidation and mergers of major,

[1] It should be noted that the specialized banks, despite being scheduled banks, were aggregated with DFIs in the **Pakistan: Financial Sector Assessment 1999-2000**, SBP, 2002, due to similarity in their functions and objectives. However, institutional definition is used in the present study, therefore these banks have been included and discussed in **Chapter 3**.
[2] Please see **Section 4.4.1** for mergers/acquisitions of investment banks.
[3] Equity to liability ratio for NBFIs is considerably high due to modarabas and mutual funds.

but financially weak institutions (like BEL and NDFC); (2) increased minimum paid-up capital requirement for most of the NBFIs; (3) boom in equity markets that led to massive rise in net-worth of mutual funds; and (4) emergence of a new DFI with strong capital base.

While the earning assets to total assets ratio remained above 75 percent during FY00-FY02 (without recording any visible changes), expense to income ratio witnessed substantial improvement over the same period. This improvement is also visible both from return on assets and equity; largely attributable to above-mentioned factors. Interestingly, average spread for NBFIs seems considerably low, compared to banks in particular. This lower average spread is understandable; while lending rates of both banks and NBFIs are approximately same, the cost of fund mobilization for NBFIs is quite high due to non-availability of cheaper deposits.[4] This is also evident from both the high loans to deposit and borrowing to liability ratios. Keeping the overall performance of the NBFIs in view, a detailed analysis of various groups of institutions will be more instructive.

Figure 4.1: Asset Shares of NBFIs for FY02

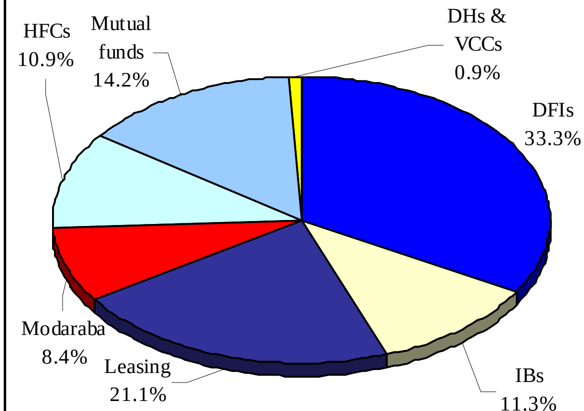


Table 4.2: Key Financial Ratios of NBFIs

percent

	FY00	FY01	FY02
Capital to liability ratio	19.5	37.2	49.3
Earning assets to total assets	77.4	78.1	77.8
Expense to income ratio	101.9	88.9	73.3
Intermediation cost	7.3	5.3	7.0
Average spread	1.8	2.5	2.5
Return on average assets	-0.6	0.8	2.8
Return on average equity	-3.5	3.6	9.3
Loans to deposit ratio	128.0	197.0	181.9
Borrowing to liability ratio	39.1	48.0	45.1

4.2 Development Finance Institutions

The financial health of DFIs had significantly deteriorated during the 1990s. Capital bases of a few big public sector DFIs were eroded by heavy losses incurred during second half of 1990s. These losses primarily stemmed from heavy provisioning against the classified loans. As a result, huge capital injections were urgently required to make these institutions financially viable. Keeping all these problems in view, the government chalked out a broad-based restructuring program of the financial system as a whole. DFIs were no exception and most of their restructuring work has been completed over the last couple of years.

4.2.1 Mergers/acquisition of DFIs

Within DFIs, Banker's Equity Limited (BEL) was a special case because it was first privatized in 1996 and then liquidated in 1999. This liquidation was followed by merger of NDFC, one of the largest public sector DFIs, with National Bank of Pakistan on October 31, 2001.[5] Subsequently, RDFC and SBFC were merged to form SME Bank with effect from October 19, 2002.[6]

[4] Most of the NBFIs do not have established sources of funds, therefore, heavily rely on borrowing, which are generally expensive as compared to deposits.

[5] Due to heavy losses incurred during second half of 1990s, the equity of NDFC became negative in 1999. Therefore, financial restructuring of this institution was urgently required.

[6] Both, RDFC and SBFC were dealing with small and medium sector enterprises. It is, therefore, envisaged that amalgamation of these two institutions will help to eliminate duplicity of financial institutions, pool available resources at one place, realize operational economies of scale and effectively serve the SME sector.

PICIC and foreign sponsored DFIs performed relatively better during 1990s. However, keeping in view the limited ability of DFIs to mobilize deposits, these institutions have also considerably changed their business strategies. PICIC has substantially increased its operations over last couple of years in the areas of term financing of industrial assets, capital markets, fund management, lease finance, and commercial banking operations. While its lease operations followed the permission from SECP to undertake leasing business in 1999, commercial banking operations commenced in 2001 as the corporation acquired a commercial bank as a subsidiary (PICIC Commercial Bank Limited).

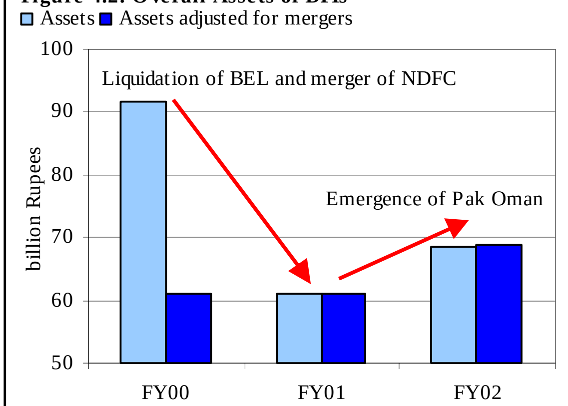
All three foreign sponsored DFIs are adequately capitalized and performed considerably well during 1990s. However, in the wake of consolidation in the financial sector and with a view to widening the narrow and limited operations, Saudi Pak Industrial & Agricultural Investment Company (Pvt) limited (SPAICO) has acquired a commercial bank (Saudi Pak Commercial Bank) with effect from 5th November 2001. The company also has considerable investment in Saudi Pak Leasing Company Limited. Compared to SPAICO, Pak Kuwait Investment Company (Pvt) Limited and Pak Libya Holding Companies (Pvt) Limited have not taken such measures to expand their business activities.

As a joint venture between Pakistan and Oman, a new financial institution Pak Oman Investment Company was established in 2001, with the objective to promote industrial development and economic cooperation between two countries. The company is performing the full range of DFI and investment bank functions, and therefore offering a wide range of products. Initial data indicate that the company is performing well.

4.2.2 Financial Position of DFIs

Overall assets of DFIs dipped down to Rs 61.1 billion in FY01 from Rs 91.5 billion in FY00 (see **Figure 4.2**). This erosion in assets was mainly on account of the liquidation of BEL and merger of NDFC with NBP. However, subsequent rise in assets in FY02 was largely explainable by the emergence of Pak Oman Investment Company and increase in business activities of PICIC and other joint ventures. Besides traditional businesses, DFIs actively participated in lease finance activities following the permission from SECP to undertake lease business in 1999.

Figure 4.2: Overall Assets of DFIs



Since changes in overall assets of DFIs take into account the effect of (1) liquidations, (2) mergers of different institutions, and (3) any change in business activities of existing DFIs; we will concentrate only on the operating DFIs to disentangle the effect of former two points.

Assets of operating DFIs have increased from Rs 61.0 billion in FY00 to Rs 68.7 billion in FY02, recording 6.1 percent compound annual average growth. This indicates that business activities of the DFIs continued to grow over the period of analysis mainly due to lease operations and increasing investment activities (particularly investment in stocks). Key statistics of these DFIs are reported in **Table 4.3**.

Capital to liabilities ratio that remained almost unchanged in FY01 as compared to FY00, climbed up to 34.9 percent in FY02 primarily due to the establishment of Pak Oman Investment Company. Since the business activities of this company are yet to flourish, it simply carries its equity for the time being, which led to a rise in capital to liabilities ratio for the whole sector. Moreover, increased capital base and decline in liabilities of one of the old joint venture financial institution also heavily contributed to this rise. Other indicators of capital adequacy also saw a jump in FY02 due to the same reasons.

Table 4.3: Performance Indicators of DFIs
percent

	FY00	FY01	FY02
Capital adequacy			
Capital to liability ratio	19.0	18.9	34.9
Growth rate of capital	2.8	0.1	82.6
Growth rate of assets	-6.0	0.3	3.6
Asset quality			
Equity to total asset ratio	15.9	15.9	28.1
Earning assets to total assets ratio	74.9	75.2	86.6
Lease finance to earning assets	0.6	1.5	3.9
Advances to earning assets	58.0	44.5	32.4
Inv. to earning assets	41.0	47.7	55.1
Inv. in Govt Securities to earning assets	2.3	10.5	11.8
Inv. in share to total investment	34.9	32.4	31.6
Inv. in subsidiaries to total investment	6.2	11.7	9.1
Management			
Expense to total income	57.0	63.8	58.6
Expense to total income (with provisions)	80.8	80.3	45.7
Intermediation cost	2.4	2.8	4.0
Intermediation cost (with provisions)	6.1	5.5	1.8
Administrative expense to total expense	19.9	20.2	50.5
Provisions to total expense	29.5	20.6	-28.2
Earnings and Profitability			
Return on average assets	2.1	1.8	6.8
Return on average equity	13.8	11.0	30.6
Interest rate spread	3.9	5.4	4.6
Net Interest Margin	3.7	5.4	5.4
Liquidity and Sensitivity			
Liquid assets to total assets	15.1	17.8	17.4
Loans to deposit ratio	326.8	258.7	204.7
RSA to RSL	98.1	99.8	117.0
Gap to asset ratio	-1.4	-0.2	12.6

Encouragingly, earning assets of these DFIs have also increased in relation to total assets over the period of analysis. However, earning asset composition has significantly changed, as the share of advances in earning assets plummeted to 32.4 percent by FY02 as compared to over 50 percent just two years ago. Instead of relying on conventional businesses, these institutions are taking more exposure in leasing finance and in government securities.

Management indicators also paint a good picture over the period of analysis. Expense to income ratio (with and without provisions) remained well below 100 and even edged down to 45.7 percent if the reversal of provisions against earlier classified loans is taken into account. Only worry is the rise in administrative expense to total expense ratio. Fortunately, this rise was not seen across the industry, as just one institution explains a greater portion of this increase.

Strong earnings and profitability of these institutions also reflect that assets and liabilities were prudently managed over the period of analysis. Most of the indicators of earning and profitability and liquidity recorded some improvement over time.

In short, overall financial health of existing DFIs has slightly improved over the last two years. Increasing focus toward lease finance, changes in investment portfolio and steps to reorganize their businesses, primarily supported this improvement.

4.3 Investment Banks

Investment finance companies, generally known as Investment Banks are relatively new entrants in the financial system as compared to other NBFIs, especially to leasing and modaraba companies.[7] These companies were allowed to undertake a wide variety of business activities, which included money and capital market activities, project financing, corporate financial services, and operation in call money market. Furthermore, companies were allowed to issue their papers to mobilize funds, but of not less than 30 days maturity. Rules of Business of NBFIs, issued by State Bank of Pakistan, also provide clear guidelines for safe operation of these companies.[8]

[7] Legal framework to investment companies was provided in 1987 through SRO 585(1)/87 dated July 13, 1987 issued by Ministry of Finance.
[8] Rules of Business for NBFIs were issued by the SBP in 1991.

Since inception, these companies grew sharply, particularly, in late 1980s and early 1990s, and benefited from wide ranging financial liberalization measures and boom in stock markets. However, many small investment banks also emerged with small capital to take advantage of favorable business environment. As a result, industry was highly concentrated towards two big investment banks.[9]

Most of the investment banks started facing problems in the second half of 1990s, mainly due to overall slowdown in the economy and relatively weak performance of capital markets.[10] The situation was further intensified, as these banks were unable to absorb any significant shock due to their small capital bases. This deteriorating financial health together with increased fragmentation called for a major restructuring and reorganization of business. Financial consolidation drive that led to mergers/acquisition of the investment banks was a natural consequence of fragmentation with poor financial health. As stated earlier, this drive was primarily brought about by regulatory increase in minimum capital requirements (see **Section 1.4.1**).

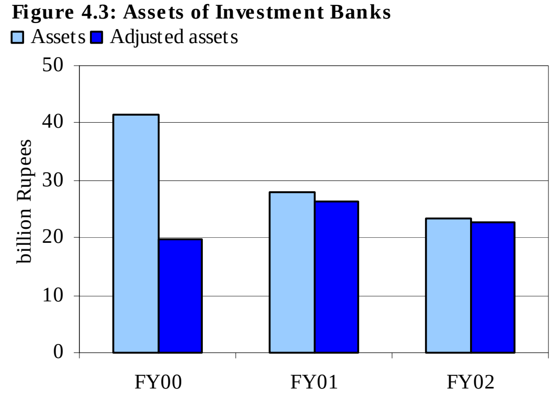
4.3.1 Mergers/Acquisition of Investment Banks

In connection with the drive for financial consolidation, Al-Faysal Investment Bank Limited (the biggest investment bank) was merged with Faysal Commercial Bank with effect from January 1, 2002. Later on, Al-Meezan Investment Bank Limited acquired a foreign commercial bank 'Societe Generale, The French and International Bank' operating in Pakistan, and merged its functions to form Meezan Bank Limited with effect from April 30, 2002. Recently, Crescent Investment Bank has acquired Mashreq Bank psc, another foreign bank, and reorganized its business activities under the name of Mashreq Bank Pakistan Limited. The amalgamation scheme has become effective from July 9, 2003. Besides these mergers and acquisition, three investment banks are under liquidation and one bank is seriously contemplating to merge with or acquire a commercial bank. All these developments suggest that more mergers/acquisition are expected due to increasing competition from strong financial institutions and consequent increasing need to reorganization of the businesses. Moreover, there are few banks, which are serious to continue their functions as investment finance companies and trying to strengthen their capital base and business activities. While others are planning to have mergers with commercial banks or to opt for voluntary liquidation.

4.3.2 Financial Position of Investment Banks

Investment banks have witnessed drastic changes in their overall assets over the last couple of years. Specifically, overall assets saw a steep slide of Rs 13.5 billion during FY01 and relatively small dip of Rs 4.7 billion in FY02 (see **Figure 4.3**). Both declines are largely attributed to the mergers/ acquisitions of investment banks with commercial banks over the same period. Moreover, three investment banks are in process of liquidation, therefore an almost absence of or limited fresh business activities of these banks is also affecting the overall business of the industry.

Figure 4.3: Assets of Investment Banks



[9] This can be realized from the fact that two out of 16 investments hold over 60 percent of overall assets as on end-June 2000.

[10] Actually these banks were unable to build their quality human resource base. Therefore, mostly banks remained active in money ad capital markets activities, instead of undertaking whole range of business lines available to them.

To disentangle the impact of mergers/ acquisitions from the overall performance of the industry, [11] adjusted data set comprising of only existing investment banks is utilized to gauge the financial health of the industry. The adjusted data show that overall assets of existing investment banks saw a considerable rise of Rs 6.8 billion to reach Rs 26.4 billion during FY01, before dipping down to Rs 22.6 billion in FY02. While the sharp rise in FY01 was primarily attributed to increasing lease finance activities of investment banks and the merger of two leasing companies with investment banks, decline in FY02 was largely underpinned by slowdown in business activities of Crescent Investment before its merger with a commercial bank and poor performance of two weak institutions.[12] Key indicators to gauge the performance of investment banks are reported in **Table 4.4**.

Capital adequacy indicators of the existing investment banks have witnessed considerable variation over the last two years. Capital to liability ratio that edged down to 11.0 percent in FY01, bounced back to 20 percent in FY02. This wobbly pattern is the upshot of absorption of heavy losses that stemmed from provisioning against classified loans of one of the biggest investment banks.

Table 4.4: Performance Indicators of Investment Banks
percent

	FY00	FY01	FY02
Capital adequacy			
Capital to liability ratio	18.1	11.0	20.0
Growth rate of capital	0.7	-12.6	43.8
Growth rate of assets	-1.2	34.8	-14.3
Asset quality			
Equity to total asset ratio	15.3	9.9	16.7
Earning assets to total assets ratio	79.4	86.7	82.4
Lease finance to earning assets	7.7	25.5	25.1
Short term finance to earning assets	27.2	21.1	15.3
Investments to earning assets	57.3	47.7	55.2
Long term investments to earning assets	6.0	3.1	6.0
Short term investments to earning assets	37.6	29.3	33.2
Management			
Expense to income ratio	76.5	115.3	81.6
Expense to income ratio (with provisions)	86.7	123.9	87.3
Operating expense to total expense	14.7	13.4	17.0
Intermediation cost	3.5	3.3	3.9
Intermediation cost with provisions	6.7	5.1	5.5
Earnings and profitability			
Return on average assets	2.1	-4.0	1.6
Return on average equity	13.9	-32.6	12.1
Interest rate spread	-1.0	-2.5	3.8
Net Interest margin	0.2	-1.6	5.4
Other indicators			
Long term liabilities to total liabilities	48.0	49.0	39.6
Long term assets to total assets	21.8	29.5	31.0
Long term liabilities to long term asset	186.4	149.7	106.4
Short term liabilities to short term asset	56.3	65.2	73.0

In the absence of infection and coverage ratios, asset quality indicators suggest that the portfolio of these banks have significantly changed over the period of analysis. While earning assets to total assets ratio stayed at a considerably higher level, the investment banks have diverted their attention to lease finance by curtailing their short-term financing and investments. This change in asset portfolio has a strong bearing for the earnings and profitability of these banks.

Earning indicators also witnessed similar changes; poor performance in FY01 followed by strong re-bounce in FY02. This was primarily explainable by the erosion of profits due to heavy losses incurred by one of the biggest bank on the sale of its investments. Absence of any such major shock in FY02 led to improvement in earning indicators.

In sum, although performance indicators that significantly deteriorated in FY01 have considerably improved during FY02, the overall financial position of these banks seems still away from normalcy. The fact is that these banks are in the process of restructuring, mergers, acquisitions and liquidation and hence controlling their business activities according to their business reorganization plans. Therefore, it is difficult to comment on the performance of overall industry with

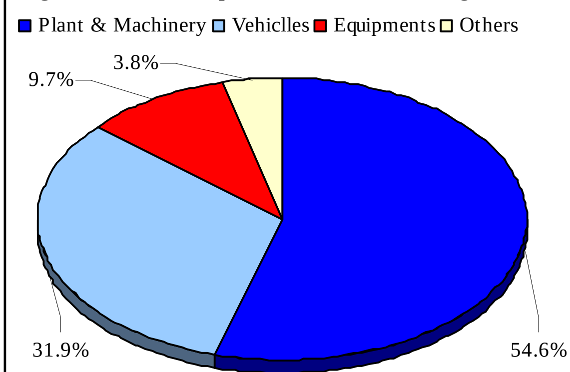
[11] While Pakistan Industrial Leasing Corporation Limited (PILCORP) merged with Trust Investment Bank Limited, Atlas Lease Limited merged into Atlas Investment Bank Limited.
[12] Crescent Investment Bank was controlling its operations as an investment finance company because of its amalgamation scheme with a commercial bank.

a greater degree of confidence. As mentioned earlier, most of the investment banks are disappearing from financial landscape. Only a few are trying to expand their business activities. However, it is further hoped that these banks may become Non-bank Finance Companies or seek mergers with commercial banks in near future.

4.4 Leasing Companies

A large number of leasing companies with small capital base were incorporated in early 1990s in response to the opening up of financial markets, increasing demand for corporate credit, and fiscal incentives in terms of depreciation allowance.[13] Many financial institutions and business groups set up their own leasing companies (as subsidiaries) to take advantage of favorable business environment and fiscal incentives. As a result, the number of leasing companies jumped to 33 by end June 2000 before coming down to 25 by end December 2002.

Figure 4.4: Break-up of Lease Finance during FY02



Since inception, leasing companies played an important role in the development of the economy, particularly small and medium scale textile manufactures. These companies were focusing on the lease of plant and machinery in early 1990s, but the slowdown in overall economic activities and increasing number of sick units (particularly in textile sector) during second half of 1990s eroded the already small capital base of many leasing companies. Furthermore, poor performance of the manufacturing sector over the same period forced these companies to change their business lines. As a consequence, leasing companies became active in extending vehicles lease financing. By end June 2002, the share of vehicles lease financing in overall lease disbursements increased to 31.9 percent (see **Figure 4.4**). Due to increasing focus toward vehicle lease financing, these companies were able to record a modest growth in assets even in the second half of 1990s. However, with the increasing competition in vehicles lease financing from well established financial institutions, particularly banks, and permission to DFIs and investment banks to undertake lease business indicate that leasing companies will have to target non-traditional areas (like agriculture, small and medium enterprises etc.) in future.

4.4.1 Policy Initiatives

Leasing companies were established under the Companies Ordinance, 1984 and were falling within the regulatory ambit of Ministry of Finance (MOF). Later on, as a result of amendments in Banking Companies Ordinance, 1962, regulatory and supervisory responsibilities of these companies came under the purview of the State Bank of Pakistan in 1991. However, these responsibilities were transferred to SECP (CLA at that time) in 1997. Since then SECP is solely responsible for the regulatory and supervisory activities of these companies.

SECP has taken numerous policy measures over the last couple of years. The most significant ones include: (1) increase in minimum paid-up capital requirements; (2) issuance of Leasing Companies

[13] Realizing the importance of leasing business, a public limited company named National Development Leasing Corporation (NDLC) was established in June 1984 with the help of International Finance Corporation (IFC) and Asian Development Bank (ADB). This was followed by the establishment of a private limited company (Natover Lease & Refinance Limited) in December 1984.

(Establishments and Regulations) Rules, 2000; and (3) measures taken for the effective monitoring of leasing companies.

Minimum Paid-up Capital Requirement

As already mentioned that the capital base of many leasing companies was already small and subsequently eroded by losses incurred due to slackening overall economic activities. Meanwhile, SECP increased the minimum paid up capital requirement for leasing companies to Rs 200 million in 1997 from previous level of Rs 100 million.[14] This specific measure was designed to improve financial stability, reduce fragmentation, and to increase economies of scales and operational synergies. Leasing companies were advised to meet this minimum requirement by 30th October 1999. However, this time limit was extended to June 30, 2001 due to weak capital market conditions and almost stagnation in economic activities. Since then, SECP has been dealing with a considerable number of cases for the extension of time limits on a case-to-case basis. The status of compliance as on end June 2002 indicates that 18 leasing companies have met the minimum paid-up capital requirement and remaining are expected to achieve this level by end-June 2003.

The increased paid-up capital requirement together with the growing need for business reorganization helped to reduce fragmentation in the leasing sector through mergers and acquisitions. **Table 4.5** shows that mergers and acquisitions have been seen not only within the leasing sector but across different NBFI groups as well.

Table 4.5: Consolidation in the Leasing Sector

Institution	Merged into/acquired by	Effective Date
Within the Sector		
Mercantile Leasing Company Limited	Universal Leasing Corporation Limited	March 30,2001
International Multi Leasing Corporation Limited	Capital Asset Leasing Corporation Limited	March 4, 2003
Across the Sectors		
First Ibrahim Modaraba	Ibrahim Leasing Limited	May 18, 2001
Pakistan Industrial leasing Corporation Limited	Trust Investment Bank Limited	July 1, 2001
Atlas Lease Limited	Atlas Investment Bank Limited	November 23, 2001
Ghandhara Leasing Limited	Al-Zamin Leasing Modaraba	December 5, 2001

Leasing Rules 2000

To provide a comprehensive legal framework, SECP notified the Leasing Companies (Establishment and Regulation) Rules, 2000 with effect from September 25, 2000. These Rules were heavily drawn from the Leasing Companies (Establishment and Regulation) Rules 1996 and SBP's Rules of Business for NBFIs applicable to the Leasing Companies. These Rules together with Companies Ordinance, 1984 empowered SECP to ensure operation of leasing companies in a safe and sound manner. Subsequently, in exercising its regulatory and supervisory powers, SECP has suspended the licenses of 8 leasing companies during FY01 and FY02 to issue certificates of investment due to poor credit rating. It is therefore envisaged that such measures will not only force the leasing companies to improve their financial health, but to safeguard the interest of depositors or holders of certificates of investments.

Monitoring of Leasing Companies and Disclosure Standards

For the effective monitoring of leasing companies, SECP reviews annual and interim accounts in the light of Leasing Rules 2000; International Accounting Standards; and the provisions of the Companies Ordinance, 1984. In case of any deficiency, the report is discussed with the management of the relevant leasing company and necessary actions including the conduct of special audit are initiated to

[14] This was done through an amendment in Leasing Rules, 1996.

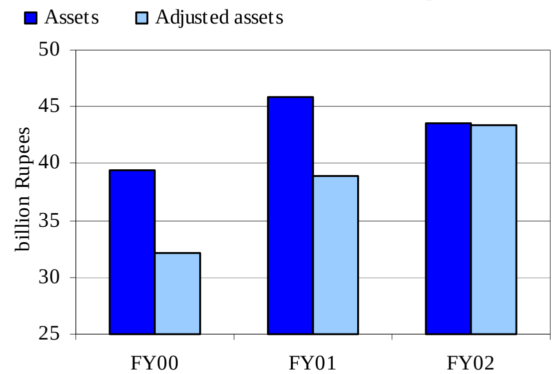
rectify the problem. Furthermore, Companies Ordinance, 1984 demands to hold an Annual General Meeting with shareholders and publish their account for public information.

Fiscal Incentives
In addition to above policy measures initiated by SECP, the government has also provided fiscal incentives in a bid to improve the financial health of leasing sector. Two noteworthy measures are (1) an upward revision in cost of vehicles for the calculation of depreciation allowance,[15] and (2) the permission of first year allowance.[16] Besides these measures, the government has also provided fiscal incentives to facilitate mergers and acquisitions. These include: (1) acceptability of different tax rates to the banking and non-banking activities of merged institutions; (2) tax admissibility of expenses on mergers; and (3) facility to carry forward and set-off losses of merged institution.

4.4.2 Performance of Leasing Companies
Following above policy developments, particularly mergers/acquisitions, overall size of leasing sector has witnessed notable changes over the last two years. Overall assets jumped to Rs 45.9 billion in FY01 primarily due to increasing business activities of the leasing companies, while decline in the subsequent year is largely attributed to merger of two leasing companies with investment banks.

Compared to this, overall assets of the existing leasing companies jumped up from Rs 32.1 billion in FY01 to Rs 43.3 billion by FY02 (see **Figure 4.5**). This good-looking growth in assets of leasing companies is the upshot of increasing business activities due to fiscal incentives provided through budgets. Moreover, relatively stronger capital base also helped them to expand their businesses over the same period. The growth is even more impressive, if we adjust for those companies, which have been barred to mobilize funds through COIs due to their poor credit rating. Having said this, important indicators based on consolidated data of existing leasing companies are reported in **Table 4.6**.

Figure 4.5: Overall assets of Leasing Companies



A quick glance at performance indicators of leasing sector shows that although capital to liabilities ratio has declined over the previous two years, it remained at a considerably high level. This decline, despite of increased requirement in minimum paid up capital, is mainly attributed to: (1) weak capital position of few leasing companies, and (2) sharp rise in liabilities to finance increasing leasing activities. The later point is reinforced as the assets of leasing companies witnessed double-digit growth over the same period. Besides other factors, this growth was supported by fiscal incentives provided by the government over the same period. Growth in assets is even impressive when seen in the context of increasing competition from banking sector and permission to DFIs and investment banks to undertake lease business.

While most of the other indicators remained relatively stable, earnings and profitability of leasing sector has declined over the period of analysis. This decline is largely explainable by the poor

[15] In Finance Ordinance 2001, cost of vehicle for the calculation of depreciation allowance was increased from Rs 0.60 million to Rs 0.75 million. This ceiling was further increased to Rs 1.0 million in Finance Ordinance 2002.
[16] The Government through Finance Ordinance 2001 allowed First Year Allowance for depreciation of leased assets at 30 percent and this rate was increased to 50 percent in Finance Act 2002.

performance of a few weak leasing companies, declining interest rate scenario, increasing competition from strong financial institutions, increase in administrative expenditures and higher provision against bad assets.

Table 4.6: Performance Indicators of Leasing Companies

percent

	FY00	FY01	FY02
Capital Adequacy			
Capital to Liability ratio	21.1	18.8	17.3
Growth rate capital	2.3	7.8	2.7
Growth rate of assets	5.4	21.1	11.4
Asset Quality			
Earning assets to total assets	69.8	71.5	71.4
Lease finance to earning assets	90.3	90.6	89.8
Investments to earning assets	5.3	7.6	8.2
Management			
Expense to income ratio	79.2	83.0	86.1
Expense to income ratio (incl. provisions)	86.4	91.5	98.1
Administrative expense to total expense	16.9	16.5	17.0
Intermediation cost	4.6	4.4	4.7
Intermediation cost (with provisions)	6.6	6.4	7.5
Earnings and Profitability			
Return on average assets	1.6	0.9	0.1
Return on average equity	7.5	4.6	0.5
Interest rate spread	2.5	2.7	3.3
Net interest margin	6.9	5.7	5.9
Liquidity and Sensitivity			
Liquid assets to total assets	11.3	12.2	13.4
Current ratio	1.4	1.3	1.2
RSA to RSL ratio	1.3	1.2	1.2
Gap to asset ratio	17.6	13.8	12.4
Other Indicators			
Total assets/Net worth	4.7	5.3	5.8
Earning Per Share	1.3	0.7	0.1
Revenue Per Share	12.0	12.4	12.0
Dividend Per Share	1.0	0.6	0.5
Break-up value (NAV)	17.4	16.8	15.4

In sum, the financial health of these companies remained near satisfactory over the last two years. Nevertheless, leasing companies may face tough challenges in the near future, particularly due to increasing interest of banking sector in entering lease finance business. Mergers and acquisition of leasing companies is expected to continue in the coming years. However, it is hoped that leasing sector will continue to contribute its due share in the development of the economy, as a considerable number of leasing companies are performing well and trying to expand their businesses.

4.5 Modarabas

Modaraba is a form of Islamic corporate financing in which one party contributes its skills and the other provides capital or funds, and the profits are shared according to a fixed proportion. It was in 1979 when this concept got its importance in Pakistan following the government's initiative toward the Islamization of the Economy. Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 was promulgated to provide a comprehensive legal framework for organizing the modaraba business. In the light of this ordinance, Modaraba Rules were framed in 1981.

Since its inception, modaraba sector has witnessed notable changes in its market performance. Despite their earlier establishment in 1980s, modaraba companies could not carve their market niche until 1990. It was the period of early 1990s when real impetus came to modaraba business in response to wide-ranging financial liberalization measures, fiscal incentives in terms of tax-free status, growing need of the corporate sector, and boom in the stock exchanges. As a consequence, overall assets of modarabas increased to Rs 11.8 billion by end June 1994. This sharp rise in assets is attributed to the proliferation of small modarabas, as the number of modarabas jumped from 10 in 1990 to 47 by end June 1994 due to positive expectations of business growth in early 1990s. Various leading banks like ANZ Grindlays Bank, Habib Bank Limited, Habib Bank AG Zurich etc. established modarabas as subsidiaries to take advantage of tax exemptions.

However, this impressive growth of modarabas in early 1990s was eclipsed by the partial withdrawal of tax exemptions available to modarabas,[17] and increased competition from leasing companies and investment banks. Deteriorating position of stock exchanges, inability of managements to tailor diversified products for their business, and concentration of power in the hands of managers led to the loss of investors and certificate holders' confidence in modaraba companies. As a result, total assets of modaraba companies could only rise to Rs 17.4 billion by end FY02.

4.5.1 Policy Initiatives

In a bid to promote Islamic Shariah compliant mode of financing and to improve the deteriorating financial health of this sector, SECP and the government took various steps over the last couple of years. While the government restored the tax-free status of non-trading modaraba companies with effect from 1st July 1999, SECP issued Prudential Regulations for the modarabas in April 2000. Furthermore, SECP is encouraging voluntary mergers to reduce fragmentation in the sector. Fragmentation can be gauged form the fact that a large number of modarabas are in operation with an average capital base of around Rs 160 million and assets holding of only Rs 378 million. The point is reinforced as top ten modarabas hold over 70 percent of total assets and around 65 percent of total equity. This indicates that a considerable number of modarabas having insignificant capital base are unlikely to absorb any major shock to their businesses. All this highlights the fact that consolidation in this sector is inevitable in near future.

Over the last two years, mergers, acquisitions and takeover of modarabas have been seen within and across the other sectors (see **Table 4.7**). This will help to improve the overall performance of this sector.

Table 4.7: Consolidation in the Modaraba Sector

Institution	Merged into/Acquired by	Effective Date
Within the Sector		
First Confidence Modaraba	First Crescent Modaraba	December 21,2000
Guardian Leasing Modaraba	First Provident Modaraba (renamed as Guardian Modaraba)	September 14, 2001
Second Prudential Modaraba	First Prudential Modaraba	August 26, 2002
Third Prudential Modaraba	First Prudential Modaraba	August 26, 2002
Across the Sectors		
First Ibrahim Modaraba	Ibrahim Leasing Limited	May 18, 2001
Ghandhara Leasing Limited	Al-Zamin Leasing Modaraba	December 5, 2001

On operational side, issuance of prudential regulations is expected to help modarabas in managing their risks in prudent manners at one hand and to restore and protect investors and certificate holders' interest on the other. Moreover, increased disclosure requirements, quarterly submission of accounts within a set time limit, special audit of selected modarabas, and the concept of annual review meetings will strengthen the regulatory and monitoring framework of modarabas.

In addition to above policy measure, SCEP is considering a proposal to allow modarabas to issue Musharika-based term finance certificates (TFCs) for the mobilization of funds. This particular development will help modarabas in mobilizing cheaper funds, instead of costly borrowing from the banks.

4.5.2 Performance of modarabas

Overall assets of modaraba companies reached Rs 17.4 billion by end FY02 as compared to Rs 15.6 billion during FY00. Interestingly, the entire rise in assets came during FY02, as overall assets

[17] In Finance Act 1992, modaraba companies were brought under tax net by partial withdrawal of the exemptions. However, these companies remained exempted from tax for the first three years.

slightly declined during FY01. This FY02 growth in assets seems to be largely contributed by relatively good showing by the capital market during that year. To be more specific in measuring the financial health of modarabas, key financial ratios are reported in **Table 3.8**.

Capital to liability ratio has significantly declined in FY01 as compared to FY00, before recording some improvement in FY02. Decline in FY01 was primarily due to: (1) losses incurred by the few modaraba companies over the same period, and (2) poor performance of stock markets. The losses eroded the equity of these modarabas, which exerted downward pressure on the capital to liability ratio. While improvement in FY02 is largely explainable by improving position of capital during FY02.

Although most of the indicators have witnessed considerable changes over the last two years, the rise in expense to income ratio is especially noticeable. A closer look on income and expenditure components revealed that variations in dividend income, capital gains on investments and income from COIs largely underpinned the changes in former. While higher operating expenses, provisions for doubtful receivables and changes in the value of investments explained most of the variation in expenses.

Table 4.8: Key indicators of Modarabas
percent

	FY00	FY01	FY02
Capital Adequacy			
Capital to Liability ratio	92.9	75.6	78.1
Growth rate capital	7.3	-11.4	14.4
Growth rate of assets	5.7	-0.9	12.3
Asset Quality			
Earning assets to total assets	79.6	80.7	73.2
L. term earning assets to earning assets	65.3	68.8	71.7
Lease finance to earning assets	50.9	54.1	57.8
Morabha and Musharaka to earning assets	24.7	21.7	22.3
Investments to earning assets	21.8	22.1	19.2
Management			
Expense to income ratio	74.5	75.9	82.9
Expense to income ratio (with provision)	76.5	84.2	82.3
Administrative expense to total expense	11.3	34.6	35.9
Earnings and Profitability			
Return on average assets	5.9	3.5	4.4
Return on average equity	12.3	7.7	10.0
Liquidity and Sensitivity			
Liquid assets to total assets	7.0	6.5	7.6
Current ratio	1.5	1.3	1.2
Net working capital (million Rupees)	2515.8	1637.2	914.5
Other Indicators			
Total assets/Net worth	2.1	2.3	2.3
Earning Per Share	1.3	0.9	0.9
Revenue Per Share	4.0	4.4	4.0
Dividend Per Share	0.8	0.7	0.7
Break-up value (NAV)	10.0	8.9	8.9

4.6 Housing Finance Companies

The business of housing finance companies dates back to early 1950s, when House Building Finance Corporation (HBFC) was established under the House Building Finance Corporation Act No. XVIII of 1952. Since than, HBFC remained the largest institution to finance house-building activities. Up to 1990, this corporation was grouped with DFIs. However, with establishment of other housing finance companies in the private sector in the wake of financial liberalization drive in early 1990s, the corporation together with newly established companies was grouped under Housing Finance Companies (HFCs).

Business activities of these companies were guided by the Housing Finance Building Act, 1952; relevant provisions of Companies Ordinance, 1984; and Rules of Business for NBFIs. Furthermore SRO No. 1356 (I)/90 dated December 24, 1990 also provides regulatory framework for these companies. Specifically, these companies are authorized to extend loans for the construction, reconstruction, repair and for the purchase of houses. Upto 30th November 2002, HFCs were falling within the supervisory ambit of the State Bank of Pakistan. However, like other NBFIs, supervision and regulatory responsibilities of the HFCs have also been transferred to SECP following the changes in supervisory functions.

By end-December 2002, total assets of HFCs were Rs 22.4 billion as compared to Rs 22.2 billion in FY00. This marginal rise suggests that these companies were unable to expand their business activities over the last couple of years. The reasons behind this insignificant rise in overall activities were: (1) all three private sector HFCs were unable to establish their market niche. Two of them are facing severe problems. Moreover, one of these two is under the process of liquidation; (2) HBFC heavily relies on credit lines available from SBP to extend fresh loans. Therefore, it is difficult for HBFC to rapidly enhance its business activities; (3) funds recovered from previous loans generally form a considerable portion of resources available for further loaning. These companies were unable to utilize this source effectively in the presence of huge non-performing loans; and (4) increasing interest of banking sector in housing finance activities is providing stiff competition to these companies.

Table 4.9: Indicators of Housing Finance Companies
percent

	FY00	FY01	FY02
Capital Adequacy			
Capital to liabilities ratio	20.6	23.6	27.7
Growth rate of Capital	13.8	18.6	7.8
Growth rate of assets	3.3	6.0	-4.9
Asset Quality			
Earning assets to total assets	78.2	73.9	70.3
Advances to earning assets	65.4	66.0	67.8
Investment to earning assets	34.6	34.0	32.2
Management			
Expense to income ratio	32.0	61.2	66.3
Operating expense to total expense	84.4	46.6	53.6
Provisions to total expense	1.8	1.2	0.0
Earning and Profitability			
Return on average assets	4.5	3.6	1.5
Return on average equity	46.4	33.5	12.6
Interest rate spread	4.1	2.3	7.0
Net interest margin	4.1	2.3	7.0
Liquidity			
Liquid assets to total assets	35.6	37.4	37.7
Borrowing to advances ratio	148.2	135.4	135.0
Borrowing to liabilities	91.4	81.7	82.1

To be more specific, the key ratios to analyze the financial health of these companies are reported in **Table 4.9**. Capital to liability ratio has not only increased over the previous couple of years, but also remained considerably high. This rise was facilitated by both increase in overall capital and decline in liabilities. However, earning assets to total asset ratio has seen a reduction of 7.9 percentage points over the period of analysis. This decline, if remained unchecked, may result in lower profitability of these companies in near future.

Management indicators witnessed considerable change over the last two years. Expense to income ratio sharply increased to 61.2 percent in FY01 primarily on account of provisions made for bad debts, leave encashment and group insurance by HBFC.[18] Another indicator, operating expense to total expense ratio saw a steep slide in FY01, not because of reductions in operating cost, but primarily due to the prior years' adjustment.

Earnings and profitability show that while interest rate spread and net interest margin remained almost unchanged,[19] ROA and ROE witness substantial decline over the period of analysis (see **Table 4.9**). Stability in former reflects that in reality profitability of these institutions remained intact, while substantial variation in other indicators is mainly attributed to extra ordinary adjustment on account of provisions and prior year arrears.

In sum, although most of the financial ratios have considerably changed over the period of analysis, the overall financial health of these institutions looks satisfactory. These institutions, particularly HBFC, enjoy certain privileges, which are not available to other institutions. Specifically, HBFC has

[18] In the past, the HBFC was not making provisions against non-performing loans according to the prudential regulations issued by State Bank of Pakistan. The basic difference in opinion was due to the reason that either these are non-performing assets of the institution or are bad loans against which provision is required. Now this difference is resolved and HBFC is making provisions according to the Prudential Regulations.
[19] These indicators, in fact, witnessed minor changes over time, which vanished due to rounding off to single digit.

secured lines of credit from SBP on profit and loss sharing basis. Furthermore, the business of housing finance contains a minimal risk of default if financing is done prudently.[20]

In response to the ongoing changes in financial sector and business reorganizing needs, a considerable number of commercial banks have started marketing housing finance loans. These banks have tailored their products according to the targeted market.[21] Therefore, the HBFC may face tremendous competition in near future. Moreover, small housing finance companies are expected to come under severe pressure due to their limited ability to face competition from strong financial institutions.

4.7 Mutual Funds

Importance of mutual funds as one of the most effective means of mobilizing and channeling savings into productive sectors of the economy can hardly be over emphasized.

In an effort to create an environment conducive to collective investment schemes, particularly over last couple of years, SECP exerted a notable positive impact on mutual funds industry in Pakistan. Following these developments, the net-worth of the mutual funds industry, which declined to Rs 20.8 billion by end FY01 from Rs23.1 billion in FY00, surged up to Rs 25.1 billion by the end of FY02. While relatively poor performance of capital market largely explains the decline in net-worth during FY01, the declining interest rate scenario, increasing business confidence and subsequent improvement in capital market performance primarily helped to increase the net-worth of the industry during FY02. Increase was seen in both open and closed-end mutual funds (see **Table 4.10**). The table also shows that net-worth of public sector and private sector mutual funds has increased over the period of analysis, however the rise in former was more pronounced.

Table 4.10: Key Statistics of Closed-end Public Sector Mutual Funds

billion Rupees

	Assets			Net Assets		
	FY00	**FY01**	**FY02**	**FY00**	**FY01**	**FY02**
Public Sector						
Open-end	20.6	18.7	20.7	18.6	16.1	17.4
Closed-end	3.0	3.3	5.5	2.8	2.8	4.8
Sub total	23.6	22.0	26.2	21.4	18.9	22.2
Private Sector						
Open-end	0.6	0.9	1.7	0.5	0.7	1.5
Closed-end	1.4	1.3	1.6	1.2	1.2	1.4
Sub Total	2.0	2.2	3.3	1.7	1.9	2.9
Grand total	**25.6**	**24.2**	**29.5**	**23.1**	**20.8**	**25.1**

A business-wise breakup of mutual funds industry shows that the share of open-end funds in overall industry has slightly declined during FY01 and FY02. Despite this decline, industry remained skewed toward open-end mutual funds mainly due to (1) the presence of NIT (the largest open-end mutual fund), and (2) the establishment of new open-end mutual funds in private sector.

Further analysis on these lines provides interesting insights. While the share of public sector open-end mutual fund has declined in publicly managed mutual funds, the share for privately owned mutual funds has significantly increased. This indicates that decline in the former may be largely attributable to relatively better performance of ICP managed closed-end mutual funds. Moreover, increase in the share of private sector open-end funds may be attributable to: (1) emergence of new open-end funds, and (2) mergers and acquisition of weak mutual funds.

[20] If the market value of any real estate project is correctly specified and sufficient margin is maintained, there will be little risk of credit, as the stake of the borrower will start increasing with the passage of tine. Therefore, risk of default must go down.

[21] To facilitate banks in developing and marketing housing finance credit, State Bank of Pakistan has issued revised credit policy for housing finance vide BPD Circular Letter No 18 of dated June 13, 2003.

4.7.1 Performance of Open-end Mutual Funds

Although three open-end mutual funds have been established in the private sector by end FY02, NIT remained the largest with a net-worth of Rs 17.4 billion. Out of three, two private sector funds were established in March 2002. It is, therefore, expected that the private sector mutual funds may increase their worth in subsequent years.

Key indicators of open-end mutual funds show that net asset value (NAV), which saw a dip in FY01 not only bounced back in FY02 but also crossed the par values of the respective units (see **Table 4.11**). Furthermore, dividend payouts were in double digits for FY01 and FY02. These returns were not only higher than the weighted average deposit rates of the banking sector, but also higher than the profit rates on NSS for the first year. This relatively better return on investments in trust units along with the upsurge in capital market may help in attracting more investment in mutual funds industry.

Table 4.11: Open-end Mutual Funds

Rupees

	Par Value	Net Asset Value			Dividend Payouts (percent)*		
		FY00	FY01	FY02	FY00	FY01	FY02
Public Sector							
National Investment (Unit) Trust	10	10.69	9.16	10.89	5.50	12.00	12.00
Private Sector							
Unit Trust of Pakistan	5,000	5,300.20	5201.34	5,397.42	22.50	12.00	15.00
Pakistan Stock Market Fund	50	n.a	n.a	50.31	n.a	n.a	n.a
Pakistan Income Fund	50	n.a	n.a	51.94	n.a	n.a	n.a

*: Dividend payouts are calculated on par value.

4.7.2 Performance of Closed-end Mutual funds

While the performance of ICP managed closed-end mutual funds witnessed a notable improvement during FY01 and FY02; private sector funds could not manage to show any positive sign (see **Table 4.12 and 4.13**).

Table 4.12: Performance of Private Sector Closed-end Mutual Funds

Rupees

	Par Value	Net Asset Value			Market Value			Dividend Payout		
		FY00	FY01	FY02	FY00	FY01	FY02	FY00	FY01	FY02
1 Security Stock Fund limited	10.00	9.00	10.09	n.a	5.00	5.30	n.a	32.50	4.00	0.00
2 Dominion Stock Fund Limited	10.00	3.28	2.71	3.16	1.05	1.55	1.60	0.00	0.00	0.00
3 Tri-Star Mutual Fund Limited	10.00	3.32	3.07	3.21	1.00	0.50	0.35	0.00	0.00	0.00
4 Safeway Mutual Fund Limited	10.00	3.21	2.78	3.18	3.00	2.70	2.90	0.00	0.00	0.00
5 First Capital Mutual Fund Limited	10.00	6.16	5.84	5.71	3.00	2.50	2.60	5.00	0.00	0.00
6 BSJS Balanced Fund Limited	10.00	10.30	10.25	12.35	5.75	10.25	9.00	31.00	11.00	15.00
7 Golden Arrow Fund Limited	10.00	4.54	4.73	5.45	3.00	2.80	2.65	0.00	0.00	0.00
8 Al-Meezan Mutual Fund Limited	10.00	9.77	9.84	10.68	10.00	7.30	7.05	21.00	6.60	16.00
9 KASB Premier Fund Limited	10.00	7.73	8.20	9.46	4.00	4.10	6.00	0.00	3.50	5.00
10 Prudential Stock Fund Limited	10.00	3.61	2.99	3.10	1.75	1.60	0.85	0.00	0.00	2.50
11 Asian Stock Fund Limited	10.00	5.76	3.83	3.51	4.00	2.25	1.50	10.00	0.00	0.00
12 Growth Mutual Fund Limited	10.00	0.92	0.83	-0.13	1.40	1.15	1.90	0.00	0.00	0.00
13 Confidence Mutual Fund	10.00	10.30	n.a	n.a	6.50	n.a	n.a	0.00	n.a	n.a

*: Dividend payouts are calculated on par value.

Out of 26 ICP managed mutual funds, NAV of 21 funds was higher than their par value (PV) of Rs 10. While 24 funds have announced dividends during FY01 and FY02 as compared to 15 in FY00, 10 funds have the market value above their PV (see **Table 4.12**). These indicators suggest that the financial health of ICP managed mutual funds have considerably improved during last couple of years. A major factor responsible for better performance of these funds is relatively better portfolio purchased at low prices in the past.

In sharp contrast to improving performance of ICP managed funds over last two years, closed-end private sector mutual funds could not take advantage of positive developments in capital market. By end June 2002, only two out of 13 funds have the NAV above their PV (see **Table 4.12**). Moreover, there was no single fund, which has its market value over the PV. Furthermore, only 4 funds announced dividend in FY02 as compared to 5 funds in FY00. This relatively poor performance of privately managed closed-end funds has its roots back to commencement of their businesses. As already mentioned that most of funds were established in early 1990s when the capital market was at its boom. Therefore the portfolio of these funds generally consists of high priced scrips. In other words, the difference between the purchase price and the market price of their portfolios is quite low or even negative in some case. As a consequence, NAV of most of the funds is lower than the PV and their profitability remained under pressure.

Table 4.13: Performance of Public Sector Closed-end Mutual Funds

Rupees

	Par Value	Net Asset Value			Market Value			Dividend Payout (percent)		
		FY00	FY01	FY02	FY00	FY01	FY02	FY00	FY01	FY02
1st ICP	10.00	10.68	10.76	12.86	7.00	4.25	9.95	12.00	13.00	17.00
2nd ICP	10.00	10.09	10.18	10.93	6.75	4.95	6.95	0.00	12.00	18.00
3rd ICP	10.00	10.40	10.49	15.56	10.00	7.25	11.60	10.00	16.00	29.00
4th ICP	10.00	10.75	11.13	31.66	19.90	15.00	20.40	30.00	37.00	45.00
5th ICP	10.00	11.87	11.91	12.58	8.00	4.25	8.00	0.00	11.00	17.00
6th ICP	10.00	10.64	10.88	22.99	14.00	12.50	14.50	10.00	25.00	30.00
7th ICP	10.00	10.60	10.66	13.94	9.90	10.00	6.45	0.00	9.00	15.00
8th ICP	10.00	11.19	11.45	20.07	16.00	10.20	16.00	20.00	32.00	48.00
9th ICP	10.00	12.30	12.85	17.45	27.50	21.50	33.50	50.00	60.00	165.00
10th ICP	10.00	10.26	10.42	12.93	9.00	10.00	13.00	15.00	18.00	60.00
11th ICP	10.00	10.51	10.69	16.45	9.50	6.55	12.90	15.00	17.00	28.00
12th ICP	10.00	10.86	11.02	15.69	9.00	5.05	9.50	0.00	19.00	23.00
13th ICP	10.00	10.87	11.07	34.11	20.00	13.75	17.25	20.00	28.00	35.00
14th ICP	10.00	11.89	12.02	13.18	8.50	8.00	7.75	10.00	18.00	13.00
15th ICP	10.00	11.05	11.16	13.80	8.10	4.30	6.75	0.00	10.00	17.00
16th ICP	10.00	10.17	10.21	10.33	7.50	4.00	4.20	7.00	7.50	10.00
17th ICP	10.00	10.48	10.53	14.08	7.05	4.75	7.20	12.00	10.00	16.00
18th ICP	10.00	10.73	10.75	10.46	7.10	3.00	4.60	0.00	9.00	12.00
19th ICP	10.00	10.15	10.26	16.76	10.75	6.05	9.90	0.00	17.00	23.00
20th ICP	10.00	10.63	10.70	16.66	9.00	5.25	9.50	0.00	16.00	21.00
21st ICP	10.00	4.79	4.81	4.82	1.80	1.35	2.40	0.00	5.00	9.00
22nd ICP	10.00	8.05	8.12	8.92	3.10	2.15	3.75	0.00	6.00	11.00
23rd ICP	10.00	4.00	4.03	4.64	1.70	1.35	1.95	3.50	0.00	0.00
24th ICP	10.00	4.92	4.94	5.15	1.80	1.35	1.80	4.50	0.00	0.00
25th ICP	10.00	8.67	8.77	8.59	3.10	2.05	3.75	0.00	6.00	7.50
SEMF	10.00	10.14	10.29	26.95	16.20	13.40	18.85	12.00	22.00	26.00

*: Dividend payouts are calculated on par value.

Due to poor performance of private sector mutual funds, mergers and acquisitions of mutual funds have been seen during last couple of years. During FY01, BSJS Balanced Fund limited acquired Confidence Mutual Fund limited. Later on, Security Stock Fund Limited has a merger with BSJS Balanced Mutual Fund Limited in FY02. Further consolidation in the mutual funds is expected in the coming years.

Despite the fact that most of the ICP managed funds were financially viable, the government has privatized these funds to create greater space for the private sector. Moreover, privatization of NIT is also expected in near future.

4.8 Discount Houses

Discount houses, specifically established for discounting bills and issuance of guarantees, could not carve their market niche over the history of more than two decades. The size of discounting sector, which steadily increased to Rs 1.8 billion by end June 2000, saw a reversal in trend and declined to Rs 1.5 billion by end June 2002 (**Table 4.14**). The institution-wise data shows that decline in overall size is almost entirely attributed to plummeting business activities of two weak institutions. Moreover, both of these institutions are under liquidation.[22]

Table 4.14: Asset Shares of Discount Houses

percent

Name of Discount Houses	FY00	FY01	FY02
First Credit and Discount Corporation (Pvt) Limited	34.9	43.4	42.0
Prudential Discount and Guarantee House Limited	5.8	7.2	6.3
National Discounting Services Limited	31.9	41.4	40.0
Speedway Fondmetal (Pakistan) Limited	27.3	8.0	11.7
Total Assets (million Rupees)	1,805.4	1,395.4	1,497.4

Table 4.15: Major Indicators of Discount Houses

million Rupees

	FY00	FY01	FY02
Capital	1,011.9	1,038.3	1,171.5
Assets	1,805.4	1,395.4	1,497.4
Income	566.4	1,140.6	1,036.8
Expenses	108.6	140.1	101.8
Profit (after tax)	77.6	54.5	77.5
ROA	4.3	3.9	5.2

Interestingly, despite negative growth in overall assets of discount houses, the profitability (after tax) of these institutions remained intact. Overall net profit of these institutions, which saw a dip in FY01, bounced back in FY02 to Rs 77.5 million (see **Table 4.15**). This apparent anomaly, i.e. decline in overall assets and impressive profitability, may be largely attributed to (1) lower financial charges, as two major discount houses support their business activities largely through their strong capital base; (2) good quality assets; and (3) strict control over operating expenses. Moreover, discount houses also benefited from increasing investment activities in equity and bond markets.

However, relatively slower growth in overall business activities of discount houses is understandable in the presence of (1) shallow bond market and (2) big commercial banks.[23] The first point is reinforced, as business activities of one of the discount houses are limited to WAPDA Bonds only. It is, therefore, expected that new issuance of corporate debt instruments during FY03 will help to strengthen the business activities of remaining two discount houses in future.

4.9 Venture Capital Companies

Venture capital companies (VCCs) and venture capital funds[24] are relatively new entrants in the financial sector, as their history dates back only to early 1990s. Only two VCCs were established during 1990s and total assets of these companies were Rs 1027 million as on end June 2000. This smaller size of VCCs in absolute terms along with their

Table 4.16: Major Indicators of VCCs

million Rupees

	FY00	FY01	FY02
Capital	367.9	278.5	227.5
Venture Investment	645.6	167.4	82.0
Assets	1,027.4	345.7	271.6
Profits (after tax)	-126.8	-89.0	24.3

[22] Lahore High Court has appointed liquidator for Prudential Discount and Guarantee House Limited, while Speedway Fond-metal Pakistan Limited in also in the process of liquidation.

[23] Banks provide discounting facilities, particularly to exporters.

[24] VCC are allowed to (1) invest in venture projects through equity or other instruments, (2) provide managerial or technical expertise to venture projects, and/or (3) act as a management company for the management of venture capital fund.

tiny share (less than 0.5 percent) in overall business activities of NBFIs suggest that venture business is yet to take off in Pakistan.

The performance of VCCs has considerably deteriorated during last couple of years (see **Table 4.16**). Investment activities of VCCs saw a steep slide during FY01 and FY02 mainly due to the liquidation of one big venture company.[25] As a result, assets of VCCs also dipped down during the same period. This poor showing may improve in future as one new company has obtained license to carry on the venture business in February 2002. However, its operations had not started till June 2002. The company has the paid up capital of Rs 5 million and has a business orientation towards the Information Technology related projects.

To promote venture business in the country, SECP has notified Venture Capital Companies and Venture Capital Funds Rules, 2001 (known as VCC & VCF Rules) with effect from 1st July 2000. These rules provide legal framework to govern, license, operations, resource generation and investment avenues of the VCCs. Moreover, the regulatory and supervisory responsibilities of VCC & VCF have been transferred from the State Bank of Pakistan to SECP with effect from 1st December 2002. Besides these policy changes, the government has exempted VCCs and VCF from income tax for a period of seven years, i.e. from 1st July 2000 to 30th June 2007. In this background, it is envisaged that venture business may increase in coming years.

[25] Pak Emerging Venture Limited is under Liquidation.