<u>Building Trust in Investment Banking</u>

Dr. Izhar-ul-Hasan, Chancellor, PAF Karachi Institute of Economics & Technology, and distinguished Ladies and Gentlemen
Assalam-o-Alaikum,

It gives me great pleasure to inaugurate this conference on **“Building Trust in Investment Banking”.** I am thankful to the organizers for inviting me for the purpose. I would like to take this opportunity to say a few words about investment banking in Pakistan, a perspective on its past performance, its prospects in the coming days, and ways to revive these institutions to our maximum advantage.

Investments banks play a crucial role in the process of capital formation which is imperative for breaking the vicious circle of poverty we are faced with. A conventional investment bank mobilizes the savings and makes them available for investments in longer-term projects and provides a number of ancillary services which are equally instrumental in an economy’s capital formation process. These services, *inter alia*, include securities underwriting, stock and bond trading, facilitating mergers and acquisition, arranging and funding syndicated loans, arranging and managing public issues, and providing financial advice to businesses.

The investment banking started to take roots in Pakistan in second half of 1980s when realizing the need for investment banking services the policy makers first time issued charter to investment banks. A broad range of business services were envisaged that included money and capital market activities, project financing, corporate financial services, and operations in call and money market. Since inception the sector showed strong performance and continued to flourish till the mid 1990s. While this growth was mainly backed by wide ranging financial liberalization measures and favourable economic conditions particularly the boom in the stock market, however, these institutions could not diversify their portfolio and thus failed to built in shock absorber to withstand the twists of changing economic and business environment. Resultantly, most of the investment banks started to face problems. This downturn also exposed the structural weaknesses that investment banks failed to redress during their growth phase. A few of these significant weaknesses are:

- High fragmentation with only a couple of institutions dominating the market,
- Small capital bases with limited ability to absorb significant shocks,
- Failure to develop competencies for delivering non-fund based services,
- Lack of relevant expertise and acumen,
- Failure to develop stable source of long term funds,
- High cost of funds, and
- Limited capacity to expand outreach.

The recent rise of universal banking has further added to the woes of investment banks as the commercial banks are increasingly taking up the activities which were once considered to be the exclusive domain of the former.

Presently the sector is undergoing a transformation process. Under the regulatory purview of the Securities and Exchange Commission of Pakistan (SECP), investment banks are classified as Non-Banking Financial Companies (NBFCs) and are regulated by the NBFC (Establishment and Regulation) Rules of 2003 which provide an enhanced framework of operations for investment banks and have considerably widened their scope of business. Accordingly, they have started to focus their attention on becoming multi-business entities instead of retaining their specialized business status so as to remain commercially viable. Over the last few years, the sector has also witnessed considerable consolidation; the number of banks came down to 9 from 16 in 2000. The total assets of these banks stood at Rs.32.7 billion in FY04 as compared to Rs.34.4 billion in FY03 and Rs.41.5 billion in FY2000. Similarly their total investments declined to Rs.16.4 billion in FY04 as compared to Rs.22.1 billion in preceding year. However, total investment in FY04 increased over its level in FY2000. Over the last couple of years the industry is shrinking and the current scenario reflecting a declining trend calls for concerted efforts by the regulators as well as industry itself to overcome the situation.

Investment banks in Pakistan generally had limited success due to various reasons, primarily due to the weaknesses I have pointed out earlier. But they are not altogether devoid of opportunities. They are very much an integral component of our financial infrastructure. The corporate sector has perennial needs for services such as investment advisory, corporate restructuring, distressed assets acquisition and disposal, merger and acquisitions, equity and debt financing. With the maturing up of economy and financial markets the need for these services will further intensify thus holding good prospects for the investment banks proficient in these areas. Commercial banks will not be able to compete with them on those fronts as they lack specialized expertise in these areas. But the investment banks will have to refocus their current strategy of imitating commercial banks; they should focus on developing competitive advantages in specialized areas of corporate finance and advisory services. Once they have developed these competencies, they can leverage it by forming strategic alliances with commercial banks which lack these capabilities but have a competitive advantage in the form of wider outreach and ability to mobilize national savings with greater efficiency. This strategy not only promises lucrative growth to the investment banks but will also add much needed value to the society.

In the end, I would also like to express my hopes that this moot would carefully analyze the critical challenges being faced by the investment banks and help us in ascertaining the ways to build strong public trust in these institutions.

Before concluding my observations, I would like to thank again the organizers for inviting me to this Conference.