

Impact of Privatization in Banking Sector: A Case Study of MCB and ABL

Muhammad Rizwan¹, Sohail Pasha², Humera Asrar³, Kashif Hasan Siddiqui⁴

Institute of health Management, Dow University of Health Sciences, Karachi 74200, Pakistan

Abstract: Privatization Is Considered To Be A Useful Tool To Enhance The Productivity And Growth Of A Nation. It Was Initiated In 1991 In Banking Sector Of Pakistan And Since Then Seven Public Sector Banks Have Been Privatized By The Government Of Pakistan. The Current Study Critically Analyzes The Impact Of Privatization On Two Of The Large And Firstly Privatized Banks Namely Muslim Commercial Bank And Allied Bank Of Pakistan. The Overall Study Reveals The Growth And Prosperity Of Mcb Bank And Abl In The Post Privatization Era Of Study (2008-2012) In Comparison With The Pre Privatization Era Of Study (1987-1991). The Study Analyzed Two Major Impacts Of Privatization On Selected Banks In Terms Of Efficiency And Financial Growth.

It Has Been Found A Very Encouraging Effect Of Privatization Towards The Productivity And Financial Sector Development Through Financial Ratio Analysis. The Ratios Taken For Study Are Earning Assets To Total Assets, Return On Earning Assets, Interest Margin To Average Earning Assets, Equity Capital To Total Assets, Loans To Deposit Ratio, Deposit Time Capital And Loan Loss Coverage Ratio.

Key Words: Performance, Banking Privatization, Efficiency, Return On Assets

I. Introduction

Raising inflation patterns, low foreign exchange reserves, high uneven external accounts, industrial business decline and fiscal deficit actually brought drastic changes in the financial sector to set up liberalization and flexibilities in 90s.

None of the country can operate effectively unless it has well established and efficient functioning financial sector. Efficient activities of financial sector demonstrate the financial growth, access to fund to gain outcomes, export and employment. The core objective of denationalization and privatization is to make financial sector more effective to fulfill the requirements of national economic growth. (Levine, 1997)

It has been proved in today's economy that instead of huge economic reforms minor developments in economic system produces significant results. This is also notice worthy that better supervision of financial services produce improved, efficient and successful sectors. When a government provides better supervision to different financial services to free market the quality and quantity of market improves a lot especially it generates competition in exports of a country and it is obvious that exports always increase savings and lead to effective use of savings. Research reveals that effective financial services lead to an increase in economic growth and this gives exposure of new concepts and technologies. (Baumol, 1996)

The researcher will discuss the efficiency and affectivity of privatized banks and their effect on free markets and financial growth. In total there were seven Banks in the Public sector and seventeen in the Commercial sector at that time. The privatization was first initiated in the year 1990 and up till now seven governments operated banks have been privatized with different share ratio. Prior to privatization, the public sector banks had the major share of the market and catering almost all the banking needs of the national economy. The chief characteristics of these public sector banks were:

- Huge operational Costs
- Un planned expansion and Hiring
- High Rate of NPLs
- Inadequate provisions of Services
- Shortage of Investment
- Inefficient Management
- Poor financial processing for Short and Medium Enterprises /housing & other divisions
- Unnecessary External involvement in Loan processing

This study critically analyzes the positive and negative impacts of privatization on MCB and ABL, being the major names in the banking sector of Pakistan.

The financial industry particularly the banks were aimed to process for being privatized with the following vision:

- x To take on reorganization of monetarily distraught Banks.
- x To reduce fiscal Deficit of banks
- x Wide-ranging owner investment
- x To enhance saving function and increase productivity of loan processing
- x To breed financial investments
- x To diminish the contribution of NPLs.

Objectives

There is a common belief in the world that privatizing a bank is a big deal. In Pakistan the privatization of banking sector is being done with the aim to acquire better financial results, efficient market oriented growth and improved efficiency. In this study, the main focus was to find the effect of privatization on the financial status of banks in terms of growth and development. Followings are the core objectives of research.

- x To explore the effectiveness of privatization in getting productivity by the banking industry in pre and post privatization phases.
- x To find out a positive relationship between privatization and financial growth of banks.

II. Litration Review

As cited by Kemal (2000) the Privatization is considered to be a vital part of the economic growth as it provides a positive economic atmosphere for industrial growth and accelerates economic development of a country, despite the fact that in many countries due to their inherent problems the SOEs were failed to fetch desired results.

Privatization doesn't mean to damage the public and private sector contracting; in fact it is the liquidation of public sector. (Starr, 1988)

As cited by Fatima (2012) privatization is the shifting of ownership of public assets to private sector the shifting of ownership of assets from public to business enterprise depends on the given areas:

Improve Efficiency

The purpose of privatization is to foster competition within the industries to decrease the state financial load. It is meant to increase the overall productivity of private enterprises that are supposed to get privatized.

Generate Revenue

Government has to provide subsidies to the public organizations there by creating a burden on the state financing. Therefore privatization is the best solution to eliminate this financial load by ensuring private enterprises to generate their own debt or capital resources to maintain their survival. Hence, it encourages the revenue generation by the business enterprises.

Broad Base Ownership

A privatization increase the domain of ownership by offering organizational shares in front of the general public thereby minimizes the hoarding powers of private sector. It is very important to increase the horizon of ownership as the business enterprises enjoy the liberty of self control after being privatized.

Develop Capital Markets

Privatization results in more capital investment in the local and international market because of its attractiveness of profitability's by the private enterprises to the business investors. (In few cases)

Privatization Currently

The success story of privatization in Asia starts from South Asia; it also produced good result in Middle East as well as Central Asia. In Pakistan Up till now, 167 transactions has taken place fairly, transparent and in terms of revenue over 9 Billion Dollar which means 476,421,000,000 Pak rupees.

100% SOEs in the nitrogen industry, chemical industry, units of Phosphate fertilizer, textile industry, fertilizer industry, cement industry, roti plants, rice industry and light engineering have been privatized. Moreover automobile with 98%, ghee industry with 96% have also been privatized. A considerable impact of privatization is found in banking sector with 80% under the hands of private enterprises. (Downloaded from www.sanoconsultants.co.uk)

If we discuss success story of banking sector we have a list of such successful transactions. On 29th of December, 2003 about half of the HBL shares were sold against the tender of Rs. 22,409 Hundred thousand being the top most offer by AKFED, whose management took charge of HBL in the last of February, 2004. 23.2% shares of NBP were floated through Primary Markets to liquidate in the month of November 2001, whereas during the month Feb 2002, Nov 2002 and Nov 2003 the divestment of Rs 373 hundred thousand, Rs

782 Hundred thousand and Rupees 604 Hundred thousand took place respectively. In the month of Oct 2002 UBL was privatized against Pak Rupee 18,525 Lacs with 51% Shares. Privatization of Habib Credit & Exchange Bank Limited currently named as Bank Alfalah Limited took place in the mid of 1997 against a payment of Rs. 164,000 Hundred thousand for 70% shares where employees were considered for 2% and 28% shares were offered collectively for a sum of rupees 1226.0 million, even the part of shares refused by employees was also meant to offer by the bank, further more a sale deed in the month of Dec on the day of 13th, 2002 was finalized. National Group took about 26% shares for MCB Bank during April 1991 against Pak rupees 838,800 thousand whereas during Feb 1992 about 25% were sold in primary market moreover further liquidation of shares Rupees 1287.2 million was done in Jan 2001, Nov 2001 and Oct 2002. In 1991 AMG being an employee group of the same took over 26% shares of ABL whereas, in the year 1993 further 25% shares were considered to sell to the Allied Management Group. LTV consortium took over 51% shares of Bankers Equity against the payment of Pak rupees 618.73 Million in the mid of 1996. (Husain_policies)

Productivity and privatization

According to the Cobb-Douglas production functions, 53.5% to 54.3% is the most efficient range in the technical scores gained by the banks. Banks are considered as a connection between trade and commerce to carry out all financial activities, therefore banking efficiency has a major role in the entire financial system. (Atsushi Iimi, 2002) A research study by Jessica and Isac (2004) explained two methods for securing NPLs in Italy and Sweden markets. The researcher considered Sweden as small market where financial institutions should handle NPLs themselves whereas assets management company's auction is more productive method for large market like Italy. Both methods are equally important and applied with respect to the particular financial situations in the countries. Moreover Non Performing Loans market is increased by past governmental strategies, managerial decisions and credit culture.

Islam, S, M (2005) examined the factors and significances of NPLs to be handled in an efficient way and should not be ignored. Loans are not recovered because of inappropriate risk handling, decrease borrowers focus, movement within the risk curves and inadequate models. However early risk evaluation, appraisal, security conditions, agency aids, increased restrictions establishing particular models, actual time training, periodic controlling and trade off are few of the ways to recover NPLs.

Khalid, U (2006) concluded the significant effect of privatization in the banking sector of Pakistan in terms of deposits, profitability, liquidity ratios and non-performing loans. Pre privatization and post privatization impact is significantly observed.

Umer (2006) applied CMELS model to explain the impact of privatization on banking performance in Pakistan. The results showed financial growth but the privatized banks performance is seemed unsatisfactory because of ABL where a group of its own employees has physical possession and ownership.

Imran and Tariq (2009) used secondary data to observe the impact of privatization on NPLs and banking performance from 1990-2004. It has been found that two large banks were artificially privatized during the said period. The researcher used SPSS to calculate the positive effect of privatization on NPLS and performance through exploratory and descriptive research.

As cited by Mukherjee, et al (2002), they studied the quality of banking sector of India focusing on the relationship between financial institutions performance with the management groups. Variables includes net profits, advances, deposits, interest spread and non- interest income are used against the inputs of borrowing, no of staff, net worth and no of operational units.

Privatized Banks

Following are the banks that have been privatized since 1991 up to the era of study.

Muslim Commercial Bank Limited

MCB bank was privatized through National Group, and general public with 26% shares against Rs. 838.8Million in the month of April 1991 and 25% shares in the month of Feb 1992 respectively, While from 2001 to 2002 three financial transactions in January November and October of next year, against the rupees 1287.2million were taken into account with the rest of the shares.

Allied Bank of Pakistan Limited

Allied bank of Pakistan is considered to get privatized in the year 1991 to its own management group namely AMG with 26% shares, another transaction was recorded in 1993 by the same group holding 25 % shares.

Bankers Equity Limited

LTV group purchased 51% shares of Bankers Equity in the month of June 1996 with a amount of Pak rupees 618.73million.

Bank Alfalah Limited

State received a sum of Rs 1,640 million in the month of June 1997 against the selling of 70% shares of currently Bank Alfalah (previously Habib Credit and Exchange bank Limited at the time of privatization) being the top most tender. Further on a collective selling of 28 % shares against rupees 12.26 billion and 2% was allocated to the employees of the bank where those denial shares were considered for reselling. For all these transactions a sell deed on 13th of Dec 2002 was approved by the parties concerned.

United Bank Limited

UBL was privatized with 51% shares against the amount of rupees 1,852.5 million during October 2002.

Habib Bank Limited

State got a sum of rupees 22,409 million against the selling of 51% shares to AKFED on the day of 29th December, 2003 where the handing over charge was held on the day of 26th of Feb, 2004.

National Bank of Pakistan

Four transactions were passed to privatize NBP with 23.2% shares, rupees 373.0 million, rupees 782.0 million and rupees 604 million in Nov, 2001, Feb 2002, Nov 2002 and Nov 2003 respectively.

The first two banks that were privatized by the Government of Pakistan in 1991 was the ABL and MCB bank. In this study these two banks are selected to determine the success or failure of privatization by recording the pre-post indicators such as efficiency and financial growth.

III. Methodology

The aim of study is to know the impact of privatization on the efficiency and financial growth of the banking sector of Pakistan. The study is based on two major banks namely; MCB and ABL with their pre privatization (1987-1991) and post privatization (2008-2012) phases. It is a descriptive research where the researcher is using secondary data in the form of annual reports for the respective years of study. In this study the researcher is using five different ratios to calculate and interpret the impact of privatization on the performance and valuation of Banks. Financial statements are used to take required data for these ratio analyses.

Data Analysis

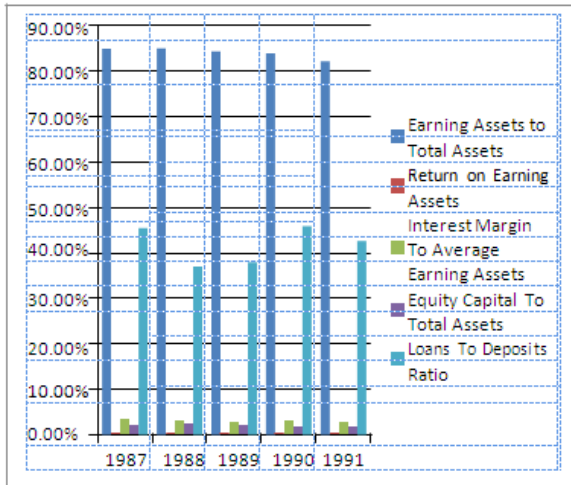
The data analysis comprises of graphical analysis where the researcher used MCB and ABL financial statements to prove the objectives of the study. Ratios used in the study are:

- x Earning Assets to Total Assets
- x Return on Earning Assets
- x Interest Margin to Average Earning Assets
- x Equity Capital to Assets
- x Loans to Deposit Ratio

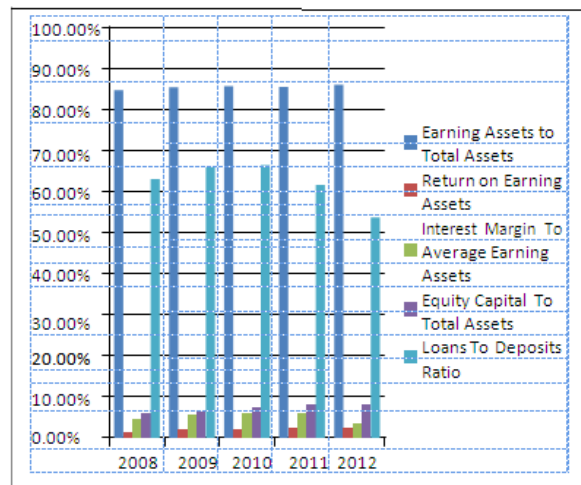
Graphic Analysis

ABL MERGE GRAPHS (1987-1991 “Pre-privatization and 2008-2012 post privatization period)

Ratios	Pre- Privatization Years					Post Privatization Years				
	1987	1988	1989	1990	1991	2008	2009	2010	2011	2012
Earning Assets to Total Assets	84.99%	85.02%	84.41%	83.98%	82.20%	84.83%	85.56%	85.83%	85.57%	86.18%
Return on Earning Assets	0.42%	0.39%	0.36%	0.34%	0.47%	1.43%	2.12%	2.21%	2.45%	2.35%
Interest Margin To Average Earning Assets	3.56%	3.17%	2.79%	3.09%	2.76%	4.57%	5.57%	6.06%	6.09%	3.71%
Equity Capital To Total Assets	2.22%	2.42%	2.19%	1.92%	1.68%	6.15%	6.66%	7.59%	8.21%	8.20%
Loans To Deposits Ratio	45.48%	37.02%	37.93%	45.92%	42.62%	63.13%	66.13%	66.54%	61.74%	53.79%



ABL's Merged Graph before Privatization



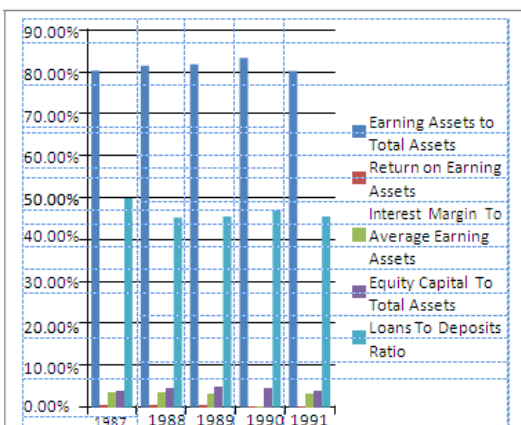
ABL's Merged Graph after Privatization

The above charts are expressing performance, utilization of assets and financial decisions of ABL's pre privatization era from 1987 onwards and also for post privatization era from 2008 onwards. The data of five years before privatization and five years after privatization is selected to measure the impact.

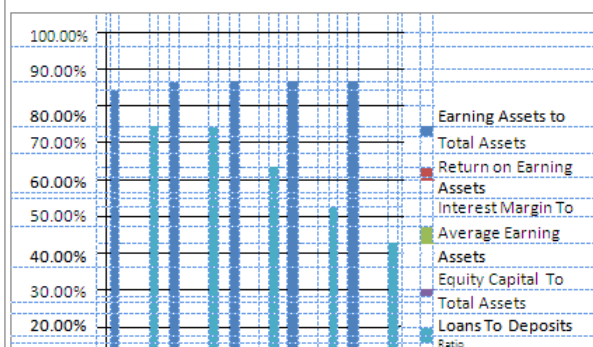
The graphs is expressing insignificant growth in the post privatization performance with more or less same values however, in comparison with pre- privatization performance the share value has significantly increased as evident by loan to deposit ratio, return on earning assets and equity capital to total assets values. The reason for this static growth in post privatization era could be its acquisition by its own employees. In short the privatization decision is found to be valuable for the years of study and for the future growth of the bank as well.

MCB MERGE Graphs (1987-1991 Pre-privatization and 2008-2012 post privatization period)

RATIOS	Pre Privatization Years					Post Privatization Years				
	1987	1988	1989	1990	1991	2008	2009	2010	2011	2012
Earning Assets to Total Assets	80.28%	81.45%	81.84%	83.34%	80.25%	84.69%	86.52%	87.19%	87.29%	86.98%
Return on Earning Assets	0.70%	0.56%	0.67%	0.13%	0.21%	4.25%	3.76%	3.59%	3.65%	3.39%
Interest Margin To Average Earning Assets	3.65%	3.67%	3.10%	0.13%	3.30%	7.88%	8.68%	7.85%	8.36%	6.62%
Equity Capital To Total Assets	3.75%	4.58%	4.74%	4.46%	3.88%	13.30%	13.45%	13.83%	13.76%	13.43%
Loans To Deposits Ratio	49.82%	45.24%	45.47%	46.83%	45.48%	76.57%	74.01%	64.45%	52.85%	45.21%



MCB's Merged Graph before Privatization



MCB's Merged Graph after Privatization

The above charts are showing decisions made by MCB during the pre privatization era (1987-1991) and post privatization era (2008-2012) of study regarding operational, financial and resource utilization in order to get efficiency and financial growth.

There is a considerable growth shown during the post privatization phase as compared to the era of pre privatization. The interest margin, Equity capital to Total Assets and Return on Earning Assets are observed with substantial development within the five years of study moreover Loan to Deposit ratio is even found a significant increase in the trend. Hence the performance of MCB after being privatized is highly evident from the above graphs indicating a marked future success.

IV. Conclusion

A comparative study was carried out to evaluate the performance of two banks MCB and ABL. The focus was to measure the impact of privatization on the performance, strength, productivity and net worth of the banks during the era selected for study. The results were very clear and attractive. The analysis presents an assessable change in Assets, Investment, Deposits, Profitability, and Equity after privatization. The results have proved the importance of privatization towards all the dependent variables of study. It is significantly evident from the empirical values that privatization is a valuable process for the prosperity of banks and eventually for the nation.

V. Findings

After a detailed ratio analysis of MCB and ABL's financial statements the study discovers the following findings:

- x The rate of equity increased with respect to time after privatization in 2008-2012 as compared to before privatization trend.
- x The Return on Earning Assets is found to be quiet raised in the post privatization phase in contrast to the pre privatization era.
- x The rate of Interest Margin to Average Earning Assets showed a significant percentage change positively.
- x The Loans to Deposits Ratio has also been visualized as a fruitful change after privatization process.
- x A constant and sustained growth is observed, while considering Earning Assets to Total Assets before and after the privatization.

VI. Recommendations

After a comparative analysis of privatization impact on two large banks selected for the study, the followings are the recommendations:

- x When the income is increasing the bank inject it bank in shape of re-investment to develop institutions and improve productivity and efficiency.
- x The state bank should act as a guiding body rather than a directive body for the institution.
- x The financial sector should work in close collaboration with the state bank to over come the discrepancies.
- x The banking sector should be expanded more within the international borders to make the financial world as a global village.

References

- [1]. Annual Report for Allied bank of Pakistan Limited for various years, 1986-1991 and 2007 to 2012
- [2]. Annual Reports of Muslim Commercial Bank of Pakistan Limited for various years, 1987-1991 and 2007-2012
- [3]. Annual Reports of Privatization Commission of Pakistan for 2012
- [4]. Annual Reports of Privatization Commission of Pakistan for various years, 1998 and 1999, 2000 and 2001.
- [5]. Atsushi Iimi 2002, Efficiency in the Pakistani Banking Industry: Empirical Evidence after the Structural Reform in the Late 1990s Development Policy Research Division Japan Bank for International Cooperation (JBIC) Institute
- [6]. Baumol, William J. (1996): "Rules for Beneficial Privatization: Practical Implications of Economics Analysis", Islamic Economic Studies, June.
- [7]. Gohar Fatima and Wali ur Rehman, (2012), "A Review of Privatization Policies in Pakistan", Vol. 3, No. 9
- [8]. Husain, Ishrat (2004). Policy Considerations before Bank Privatization: Country Experience. Paper presented at the World Bank, IMF and Brookings Institution Conference on Role of State-owned Financial Institutions Policy and Practice, April 26-27
- [9]. Islam, Shofiqul.M, Chandra.N & Mannan (2005). non-performing loans-its causes, consequences and some learning, American international university,7708,1-13.
- [10]. Kemal, A. R. 2000. "Privatization in Pakistan." Privatization in South Asia: Minimizing Negative Social Effects through Restructuring. Gopal Joshi, ed. New Delhi: ILO. 143- 74.
- [11]. Khalid U (2006), "The Effect of Privatization and Liberalization on Banking Sector Performance in Pakistan", SBP Research Bulletin, Vol. 2, No. 2, pp. 403-425.
- [12]. Levine, R. (1997), "Financial Development and Economic Growth: Views and Agenda"
- [13]. Journal of Economic Literature, January, 35, 688-726
- [14]. Mukherjee, A., Nath, P. and Pal, M. N. (2002) Performance benchmarking and strategic homogeneity of Indian banks. International Journal of bank Marketing, 20, 3: 122-39.
- [15]. Peterson.J & Wadman.I (2004). Non performing loans-the markets of Italy and Sweden, UPPSALA University, A1207, 1-30.
- [16]. S Arohi, K.I. (2009). Has privatization reduced the proportion of non-performing loans and increased bank performance in Pakistan, Umea school of business, 1-72.
- [17]. Starr, P. (1988). The Meaning of Privatization. Yale Law and Policy Review, 6, 6-41.