

Non-Performing loan and their Effect on the Economy

Author's Details:

⁽¹⁾**Syed Abdul Sattar Shah**, Asst. Prof. IBA University of Sindh, Jamshoro, ⁽²⁾**Tania Mushtaque**-PhD Student Department of Environmental, Social and Spatial Change (ENSPAC) Roskilde University, 1, 4000 Denmark. ⁽³⁾**Mushtaque Jareeko**-Student of PhD-Institute for Learning & Philosophy / Department of Learning and Philosophy Aalborg Universitet København / Aalborg University Copenhagen AC Meyers Vænge 15,3.sal 2450 København SV ⁽⁴⁾**Faiz Muhammad Shaikh**-Assistant Professor-SZABAC-Dokri -Muhammad Shaoiab Operation Manager-UBL-Jacobabad

Abstract

This research paper deals with the basic concept of loans and non-performing loans (NPLS). The causes and consequences of non-performing loans, how these loans affect the economy of country and how these loans affect the liquidity of institutes? As we know that Pakistan witnessed the bankruptcies in past, institutes like IDBP, NDFC, PICIC went bankrupt. Furthermore, the State Bank of Pakistan (SBP) maintains a comprehensive databank on 'Financial Soundness Indicators' of all banks under its jurisdiction. In 2008, non-performing loans to loans stood at 10.5 percent. By September 2011, the same had increased to 16.7 percent. Over the same period, non-performing loans have gone up from Rs359 billion to a colossal Rs613 billion, an increase of over 70 percent in three years (Saleem F, 2012). Therefore, this research paper addresses the solutions and remedies for the institute that how to overcome the problem of NPLS.
Key words: NPLS, CAUSES OF NPLS, EFFECT ON ECONOMY

1.1 Introduction

No one can deny the importance of financial institutions in any developed or developing economy these financial institutions not only ease the credit flow in the economy but also enhance the productivity by revitalizing the investment (Richard, 2011).

Investment is requirement for achieving economic growth. From a country's prospective capital formation positively supports this investment function once a satisfactory level is achieved. The option of sound investment means flow additional capital in the future. The banking sector of an economy generally performs the core function which includes facilitation of payment system. Mobilization of savings and allocation of funds to shareholders i.e. Government, Investor, consumer and business community, who may utilize them for the generation of economic activities. The banking sector can exert its positive influence by various segment of economy. The banking industry has been significantly affected by some crisis. One of the crisis that is faced by National and Commercial banks and the DFIs are non-performing loans(NPLs) as a result most of the financial institutions capital base was affected by increased losses from loans, defaults requiring them to seek recapitalization. Economic growth in any country is not possible without a sound financial sector (Rajaraman and Visishtha, 2002). Good performance of these financial institutions is the symbol of prosperity and economic growth in any country or region and poor performance of these institutions not only hamper the economic growth and structure of the particular region but also affects the whole world (Khan and Senhadji, 2001).

In the last few decades we can see many banking failures all over the world (Brownbridge and Harvey, 1998), and due to these banking failures many banks have been closed by regulatory authorities (Brownbridge, 1998). These banking failures negatively affect the economy in many ways, firstly these banking failures caused banking crisis by harming the banking sector, secondly it also reduces the credit flow in the country which ultimately affects the efficiency and productivity of the business units (Chijoriga, 1997; Brownbridge and Harvey, 1998). According to Brownbridge, (1998) many empirical researches have shown that most of the time banking failures or banking crisis are caused by non-performing loans.

Non-performing Loans (NPLs) have gained world's attention in the last three to four decades as these increasing non-performing loans are causing banking crisis which are turning into banking failures (Barr and Siems, 1994). Non-performing loans are one of the main reasons that cause insolvency of the financial institutions and ultimately hurt the whole economy (Hou, 2007). By considering these facts it is necessary to control non-performing loans for the economic growth in the country, otherwise the resources can be jammed in unprofitable projects and sectors which not only

damages the financial stability but also the economic growth. In order to control the non-performing loans it is necessary to understand the root causes of these non-performing loans in the particular financial sector

(Rajaraman and Visishtha, 2002).

It is important to understand the phenomena and nature of non-performing loans; it has many implications, as fewer loan losses is indicator of comparatively more firm financial system, on the other hand high level of non-performing loans is an indicator of unsecure financial system and a worrying signal for bank management and regulatory authorities, if we look into the causes of great recession 2007-2009 which damaged not only economy of USA but also economies of many countries of the world we find that non-performing loans were one of the main causes of great recession (Adebola, Wan Yusoff, & Dahalan, 2011). As High risk loans were granted to the unqualified borrowers and these loans were secured against overestimated resources or against nothing, and when this economic boom “went bust” those high risk loans turned into non-performing loans and as loans were given to unqualified borrowers those turned into non-performing loans, as a whole this collection of non-performing loans irrespective of its causes was one of the main factor of great recession which not only hampered the American financial sector but also economy of the whole world (Clugston, 2009)

As far as the banking system of Pakistan is concerned it is facing a lot of problem like the banking sectors of other underdeveloped economies and the most destructive problem faced by the Pakistani banking sector is the enormous amount of non-performing loans which not only harming the Pakistani banking sector but also hampering country's economy.

Objective of research

Following are the objectives of this research:

- To present the notion of non-performing loans
- To find the key determents of non-performing loans
- To find the effect of non-performing loans on economy
- To find the reason behind the merger of financial institutes with other institutions
- Impact of amalgamations on country's economy
- Remedies to reduce the excess amount of non-performing loans

2.1 Non-performing Loans

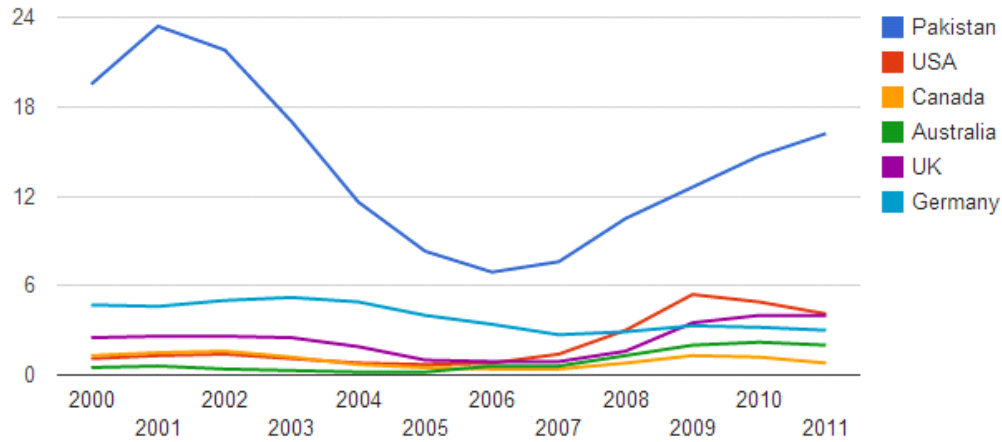
The deterioration in the quality of the loan portfolio of banks was the main cause of problems in the banking system and in financial crises in developed economies. Indeed, the increase in loan defaults. The theme of "non-performing loans" (NPL) has attracted more attention in recent decades. . Therefore, the large amount of bad loans in the banking system generally results in a bank failure.

Most developing economies that undergo the process of financial liberalisation have banking systems that are burdened by a large proportion of bad loans and risky credits. The most common cause of bad loans is directed lending to preferred individuals or favoured sectors of the economy. These loans have created several problems for financial sectors and have seriously hindered the growth of developing economies. State-owned banks (SOBs) rely on government interventions to protect them against their large risk exposures to the enterprises to which they have lent. That weakens their bargaining power and ability to control borrower.

2.2 Non performing Loans with Respect to Other conutries

Non Performingloans of other countries are given below Unitd kingdom has Npls ratio of 2.5 in 2001 and 4 in 2011 and Germoney has 4.6 in 2001and 3 in 2011.Austerila has npl rati0 in 2001 was 0.6 and in 2011 2. canada 2001 0.8 and maximam in 2011 1.3 .and Npl ratio of Pakistan in 2001 was 23.4 and in 2012 itsnpls ratio is 17.5

Pakistan Non-performing loans: Compare to other countries



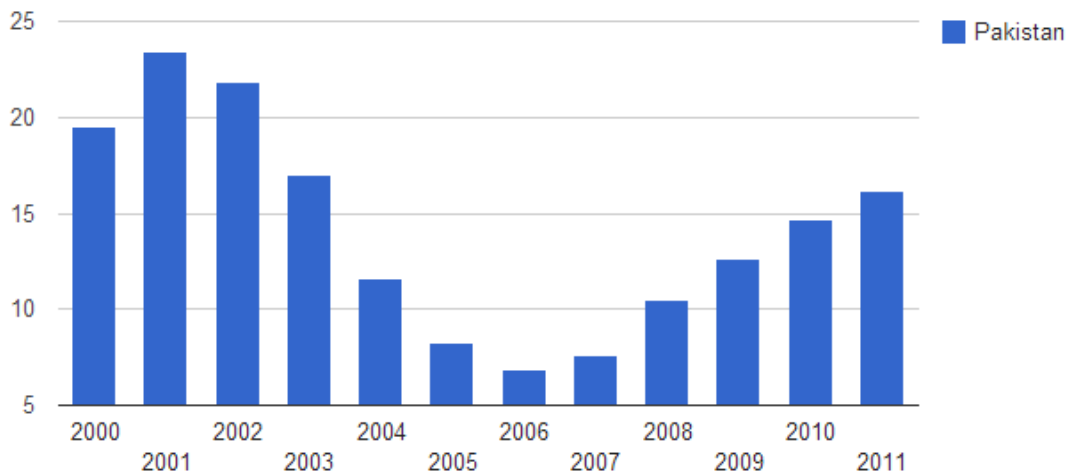
if we through fully analyze the economic struture of pakistan right from separation today we can see obivious shiffling efforts, It also expands from extrem of nationalization to massive effort of privatization .The seed of privatization is not new to the policy makers of the country .History prolong more that 60 year ago in 1952 Pakistan Industrial Development Corporation was establish to boost up their managerial and production effort of more than 50 industerial undertakings ,when it did not nourish .

.Government decided to sale these industries to private sector.second phase of privatization was 1986 when Banker Equity Limited was privatized.and in year 1990 to 2001 are consider as 3rd phacse of privatization in this the commerical bank and National Devlpmnt finance Corporation NDfC were merge to National Bank of Pakistan .PICIC were held by other financial institutions. These hard decisions were taken by the state because of large proporatio of these non performing loans on their balance sheets.

World Bank provides data for Pakistan from 2000 to 2013. The average value for Pakistan during that period was 14.18 percent with a minium of 6.9 percent in 2006 and a maximum of 23.4 percent in 2001. percent non-performing loans in Pakistan reflects the health of the banking system.

| Country | Code | year | Non-performing loans as percent of all bank loans |
|----------|------|------|---|
| Pakistan | PK | 2000 | 19.5 |
| Pakistan | PK | 2001 | 23.4 |
| Pakistan | PK | 2002 | 21.8 |
| Pakistan | PK | 2003 | 17 |
| Pakistan | PK | 2004 | 11.6 |
| Pakistan | PK | 2005 | 8.3 |
| Pakistan | PK | 2006 | 6.9 |
| Pakistan | PK | 2007 | 7.6 |
| Pakistan | PK | 2008 | 10.5 |
| Pakistan | PK | 2009 | 12.6 |
| Pakistan | PK | 2010 | 14.7 |
| Pakistan | PK | 2011 | 16.2 |
| Pakistan | PK | 2012 | |

The volume of non-performing loan is rising every year as we can see that non-performing loans of Pakistani banking sector were Rs. 176.77 billion and having infection ratio of 7.28 percent and these have risen to Rs. 608.748 billion in march 2012 having infection ratio of 17.75percent (State Bank of Pakistan, 2012). In order to reduce non-performing loans it is necessary to find the root causes of these loan



A non-performing loan is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms.

“A loan is nonperforming when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full” (International Monetary Fund).

it is typically by product of financial crisis because of non performing loans NPLs an investor may bring down his confidence in banking sector.

In Pakistan, non-performing loans are common in the agricultural sector where the farmers can't pay back the loan or the interest amount mainly as a result of losses due to floods or drought., during the year 2010 and 2011 Pakistan witness the very high non-performing loans. The flood in Pakistan has changed the trend of Non-Performing Loans (NPLs) as most of the NPLs are being reported from agriculture sector which may hurt the government's as well as State Bank's move to persuade banks for greater participation for the recovery of agriculture sector

The State Bank estimates that flood has displaced 20 million people, devastated 78 districts across the country, destroyed crops, livestock, roads, infrastructure while the direct losses to major crops was in the tune of Rs280

Unlike previous quarters, the increase in credit off-take was widely shared by different sectors of the economy.

2.2.1 Non-performing Loans and their Classification

According to Obamuyi (2007) a loan is considered to be as non-performing loan (NPL) if its principal and markup is not being paid by the borrower in accordance with the agreed terms and conditions of loan payment. As far as Pakistan is concerned non-performing loans are divided into three main categories by State bank of Pakistan (SBP). According to the BSD circular No. 02 dated 3 rd June 2010 regarding the prudential regulations of State Bank of Pakistan, excluding agriculture loans, a loan whose principal or markup repayment is overdue for 90 days is classified as “Substandard”, the loan is classified as “Doubtful” if being overdue for 180 days and a loan is classified as “Loss” if it is overdue for 01 year.

. A higher percent of such loans shows that banks have difficulty collecting interest and principal on their credits. That may lead to less profits for the banks in Pakistan and, possibly, bank closures. The NPL are among the main causes of the problems of economic stagnation. Each impaired loan in the financial sector increases the possibility to lead company to difficulty and unprofitability

The minimization of NPL is a necessary condition for improving economic growth. When NPL retained permanently, these will have an impact on the resources that are enclosed in unprofitable areas. Thus, NPL are likely to hamper economic growth and reduce the economic efficiency.

Causes and Economic Determinants of Non-Performing Loans

3.1 Energy Crises

Energy is one of the most important components of development in any economy, irrespective of any sector of economy cheap and constant flow of energy is necessary for the development of economy of any country, because energy is an essential and complementary part of production (Sahir and Qurashi, 2007, Lee,2005). As far as relationship of energy crisis and economic development is concerned there is a lot of empirical work has been done in the world and studies have found positive relationship (Wolde-Rufael, 2004, Lee, 2005).

Keeton and Morris (1987) conducted a research in America to identify the factors which are causing non-performing loans in the banking sector of this country by taking the data from 1979-85 and according to them bad performance of agriculture and energy sectors along with poor economic settings/conditions are the main factors causing non-performing loans, according to the authors energy crisis leads to bad loans in the economy. As far as Pakistan is concerned it is facing energy crisis since 2006 as the production and distribution of energy (gas and electricity) has decreased rapidly and giving birth to long lasting energy crisis in the country (ESP 2007–2008, ESP 2006–2007). These energy crisis have damaged the economy in many ways, energy crisis leads to reduction in production of firms and affects the revenues which ultimately leads to bad loans.

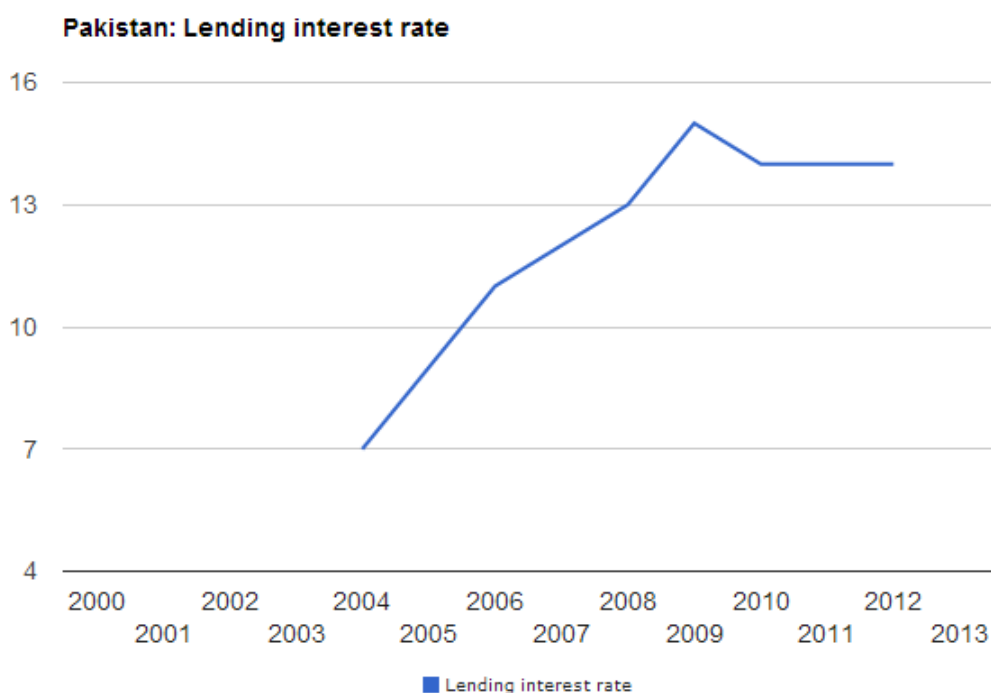
Energy crisis is one of the biggest problem faced by Pakistan, due to this energy crisis (load shedding of electricity and

gas, high cost of energy and high cost of replacement resources of energy) has destroyed many industries of Pakistan, these crisis have caused a huge amount of bad loans in the Pakistani banking sector as these sick/closed business units are unable to pay their loan obligations. One objective of this research paper is to highlight this important determinant of non-performing loans in the Pakistani banking sector

3.2 Interest Rate

Lending rates/ interest rates are one of the primary economic determinant of non-performing loans/bad loans. : Lending rate is the bank rate that usually meets the short- and medium-term financing needs of the private sector. This rate is normally differentiated according to creditworthiness of borrowers and objectives of financing. The terms and conditions attached to these rates differ by country, however, limiting their comparability.

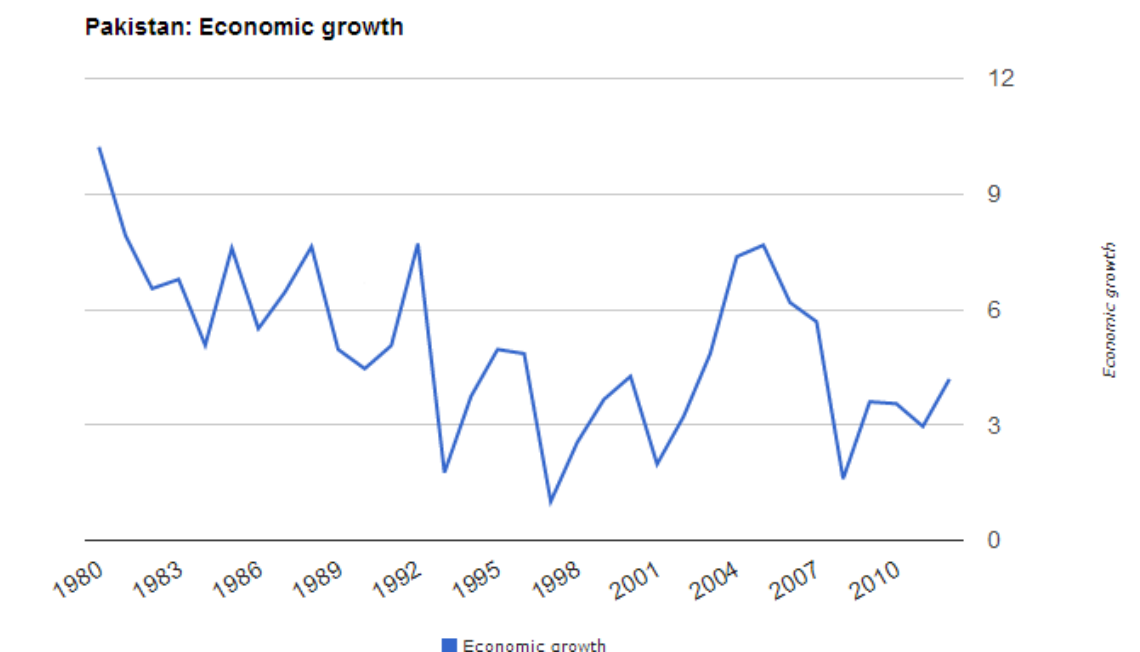
The interest rate of Pakistan in 2004 was 7%. In 2009 it was at the peak point of 15%, and in 2012 it was 14%.



is an empirical evidence of positive correlation between the interest rate and non-performing loans (Nkusu 2011; Adebola, Yusoff, & Dahalan, 2011; Louzis, Vouldis and Metaxas, 2011; Berge and Boye, 2007). An increase in interest rate weakens loan payment capacity of the borrower therefore non-performing loans and bad loans are positively correlated with the interest rates (Nkusu, 2011). As far as interest rate policy is concerned it plays very important role in NPLs growth rate in a country/economy, Hoque and Hossain (2008) examined this issue and according to them non-performing loans are highly correlated with the high interest rates which enhances the debt burden of the borrowers and causes loan defaults. Espinoza and Prasad (2010) examined the macroeconomic determinants of non-performing loans in the GCC banking system according to them high interest rates increases loan defaults but they did not find statistically significant relationship. Bloem and Gorter (2001) studied causes and treatment of NPLs, according to them frequent changes in the interest rate policy causes an increase in the bad loans. Asari, et al. (2011) also found significant relationship between loan defaults and interest rates they also found that an increase in loan defaults also causes asset corrosion of banks and subsequently capital erosion. According to Dash and Kabra (2010) the banks with aggressive lending policies charging high interest rates from the borrowers incur greater non-performing loans. Collins and Wanjau (2011) also found interest rate as a primary factor boosting non-performing loans.

3.3 Economic Conditions

World bank definition: Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.



Growth in Gross Domestic Product (GDP)

There is a significant empirical evidence of negative association between growth in gross domestic product and non-performing loans (Louzis, Vouldis and Metaxas 2011, Khemraj

and Pasha (2009), Salas and Suarina, 2002; Rajan & Dhal, 2003; Fofack, 2005; and Jimenez and Saurina, 2005). If we look into the explanation of this negative relationship provided by the literature we find that growth in the gross domestic product usually increases the income which ultimately enhances the loan payment capacity of the borrower which in turn contributes to lower bad loan and vice versa (Khemraj and Pasha, 2009).

3.4 Inflation

World bank definition: Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. generally

There is an empirical evidence of positive relationship between the inflation in the economy and non-performing loans (Khemraj and Pasha, 2009, Fofack 2005). While Nkusu, (2011) has explained that this relationship can be positive or negative according to the author inflation affects loan payment capacity of borrowers positively or negatively, higher inflation can enhance the loan payment capacity of borrower by reducing the real value of outstanding debt; moreover increased inflation can also weaken the loan payment capacity of the borrowers by reducing the real income when salaries/wages are sticky, moreover by highlighting the role of inflation in the presence of variable interest rate Nkusu

further explains that in this scenario inflation reduces the debt servicing capacity of the loan holders as lenders adjust the lending interest rates to adjust their real return.

In 2000 the inflation rate in Pakistan was 4.4. and in 2008 it was 20.3, which was its maximum rate, and in 2012 the inflation rate reached at 9.7.

So according to literature relationship between inflation and non-performing loans can be positive or negative depending on the economy of operations.

3.5 Unemployment

There is an empirical evidence of positive relationship between unemployment in the economy and non-performing loans (Nkusu, 2011, Vogiazas & Nikolaidou , 2011; Bofondi and Ropele, 2011; Berge and Boye, 2007; Rinaldi and Sanchis-Arellano, 2006; Gambera, 2000). As far as theoretical explanation of this relationship is concerned an increase in the unemployment in the country negatively affects the incomes of the individuals which increases their debt burden, it is obvious when a person losses his source of income how he can return his loan, similarly an increased unemployment in the economy also negatively affects the demand of the products of firms which ultimately affects the production/sales of the firms, this ultimately leads to decline in revenues of the firms and a fragile debt conditions (Louzis, Vouldis and Metaxas, 2010).

3.6 Exchange Rate

As far as relationship of the exchange rate is concerned literature provides mixed reviews. According to Khemraj and Pasha (2009) there is a positive relationship between real effective exchange rate and non-performing loans. An appreciation in exchange rates may have different implications i.e. it can adversely affect the loan payment capacity of export oriented firms (Fofack, 2005) on the other hand it can positively affect the loan payment capacity of those borrowers who borrow in foreign currency, the relationship between Nominal effective exchange rate (includes inflation) and non-performing loans is indeterminate.

4.1 Developmental financial Institution (DFIs) and their role in economy of country

The Development Financial Institutions (DFIs) were created in Asian and other developing countries mostly after 1945 being the post- world war era. The DFIs in the Asian countries had greatly been supported by the International Agencies such as the World Bank and the Asian Development Bank who not only extended Lines of Credit but also helped in the development of institutional framework and criteria for viable project appraisal.

State Bank of Pakistan has also played a pioneering role to structure these financial institutions and was in the past responsible for providing Rupee lines of Credit. Some of the DFIs established in the country are listed

| Sr. # | Segment | DFI | Current Status |
|-------|------------------------|--|---------------------------------------|
| 1. | Financial Institutions | Industrial Development Bank of Pakistan | Active |
| 2. | | Pakistan Industrial Development Corporation of Pakistan | Active |
| 3. | | Pakistan Industrial Credit and Investment Corporation | Acquired by a private Commercial bank |
| 4. | | National Development Finance Corporation | Merged in a National Bank |
| 5. | | Investment Corporation of Pakistan | Acquired by private sector |
| 6. | | Small Business Finance Corporation | Amalgamated into SME Bank |
| 7. | | Regional Development Finance Corporation | Limited |
| 8. | | House Building Finance Corporation | Active |
| 9. | | Zarai Tarqiati Bank (formerly Agricultural Development Bank of Pakistan) | Active |
| 10. | Capital Market | National Investment Trust | Acquired by private sector |
| 11. | | Equity Participation Fund | |
| 12. | | Banker's Equity Limited | Under winding up |
| 13. | Joint Venture | Pak Libya Holding Company (Private) Limited | Active |
| | | Pakistan Kuwait Investment Company (Private) Limited | Active |
| 14. | | Saudi Pak Industrial and Agricultural Investment Company Limited | Active |
| 15. | | Pak Oman Investment Company Limited | Active |
| 16. | | Pak Brunei Investment Company Limited | Active |
| 17. | | PAIR Investment Company Limited | Active |
| 18. | | PAIR Investment Company Limited | Active |
| 19. | | Pak China Investment Company Limited | Active |

DFIs are different from commercial Banks by definition and scope of operations, the former assume the role of stimulating the development with emphasis on industrialization and growth of the economy or social objectives. Most of the industries, small

, medium, and large, in developing countries were financed by DFIs.

Historically DFIs in Pakistan have common features; most of them were started with seed money from the Government of Pakistan and support from the International Financial institutions.

4.1.1 Industrial Development Bank of Pakistan:

it was set up in 1961. It was an important source which supplied the funds for development. It provided medium term and long term credit facilities. The loans were granted for the establishment of new Industrial units and for the replacement needs of the old units. The major objective of this bank was to spread the benefit of industrialization in all the classes of the people. It issued the loans on behalf of the government and provided finance in the form of equity. It also encouraged the establishment of industries in the less developed areas of the country. It paid due regard to the export oriented industries and those industries which were based on domestic raw materials. It was also acting as a monitoring agency of World Bank and Asian development mostly after 1945 being the post- world war era.

4.1.2 Pakistan Industrial Credit and Investment Corporation (PICIC):

The Pakistan Industrial Credit and Investment Corporation were established in 1957 with the help of Government of Pakistan and World Bank. The private domestic investors held 65% shares and the remaining 35% was taken by foreign investors from Japan, UK, West Germany and

4.1.3 Investment Corporation of Pakistan:

It was set up in 1966. Its major objective was to develop the capital market in the country. The Corporation had floated 25 Mutual Funds and a State Enterprise Mutual Fund with a view to offer opportunities of pooled investment to investors. The Corporation's market transactions for its own portfolio, investors' portfolio and Mutual Funds' portfolios contributed towards strengthening activity on the stock markets.

4.1.4 National Investment Trust (NIT):

The NIT was set up in 1963 as a Trust. It has acted as an open end mutual fund it was established to mobilise the savings to invest in stock exchanges.

4.1.5 Equity Participation Fund (EPF):

It was established in 1970. Its major objective was to improve the growth of small and medium size industry in the private sector. It had given priority to the less developed area.

4.1.6 Banker's Equity Limited:

It started functioning in 1980. Its objective was to improve the private sector investment and capital market.

4.1.7 Small Business Finance Corporation:

It was set up in 1972. Its main aim was to provide financial aid to the small business to increase the rate of production and employment in the country to those people who had some technical know-how but they were financially poor.

4.1.8 House Building Finance corporation:

The House Building Finance Corporation now known as House Building Finance Company Limited) was established in 1952 to promote mortgage finance in the country.

4.1.9 Pakistan Industrial Development Corporation of Pakistan (PIDC):

This was established in 1950 with the sole objective to promote industrialisation of the country .It was created to establish various industries and then resale these to the private sector.

4.1.10 Agricultural Development Bank of Pakistan

(Zarai Tarqiati Bank): The Zarai Taraqiati Bank Limited (ZTBL) (formerly known as Agricultural Development Bank of Pakistan) is the largest public sector financial development institution. This was established in 1952.

4.2 Role of Development Financial Institution In Economic Development of Country

These DFIs were major channels for routing development funds to the private manufacturing sector and achieving the desired socio-economic objectives, such as encouraging new entrepreneurs, promoting industries in less developed areas and wider diffusion of industrial ownership.

The DFIs were also assisting the Government in screening new development projects, framing economic development plans or policies, rehabilitating sick or problem projects, administering or supervising special loans provided by the government or foreign institutions and participating in the promotion of other DFIs for achieving related socio-economic objectives.

Besides promoting establishment of import-substitution industries, the DFIs encouraged capital formation by directly investing or underwriting shares and debentures issued by the local companies. They also assisted Pakistani entrepreneurs in obtaining suitable foreign investment, attracting foreign investors in formation of joint ventures with local partners and assisting in obtaining technical / managerial advice for businesses and industries.

Many industries were made operational, enormous jobs were created both in the operational and service sectors and the country was on the road to economic and social progress. However many DFIs ran into problems stemming basically from poor management and excessive loans without proper due diligence. Unlike the cases of certain commercial banks, neither there were efforts to inject fresh equity or soft loans into problem DFIs, nor there was a serious attempt to restructure them. The problem DFIs, were merged into other DFIs/commercial banks or were liquidated.

Pakistan, still a low income, developing country, badly needs the services and facilities offered by the DFIs for achieving socio-economic objectives and well-being of the people, particularly in the underdeveloped areas.

In Pakistan, IDB and PCICI were two premier DFIs at a time when we in Pakistan had DFIs like PICIC and NDFC. Unlike Pakistan, the role of these two institutions has been substantially enlarged over the period. In order to further enforce their role, to supplement their low cost funding sources and enhance their profitability they were granted licenses for commercial banking business.

Both the institutions were restructured to keep them in line with changing market conditions. IDBI Bank and ICICI Bank are profitably financing infrastructure and other development projects in India whereas we have allowed PICIC and NDFC to wither away.

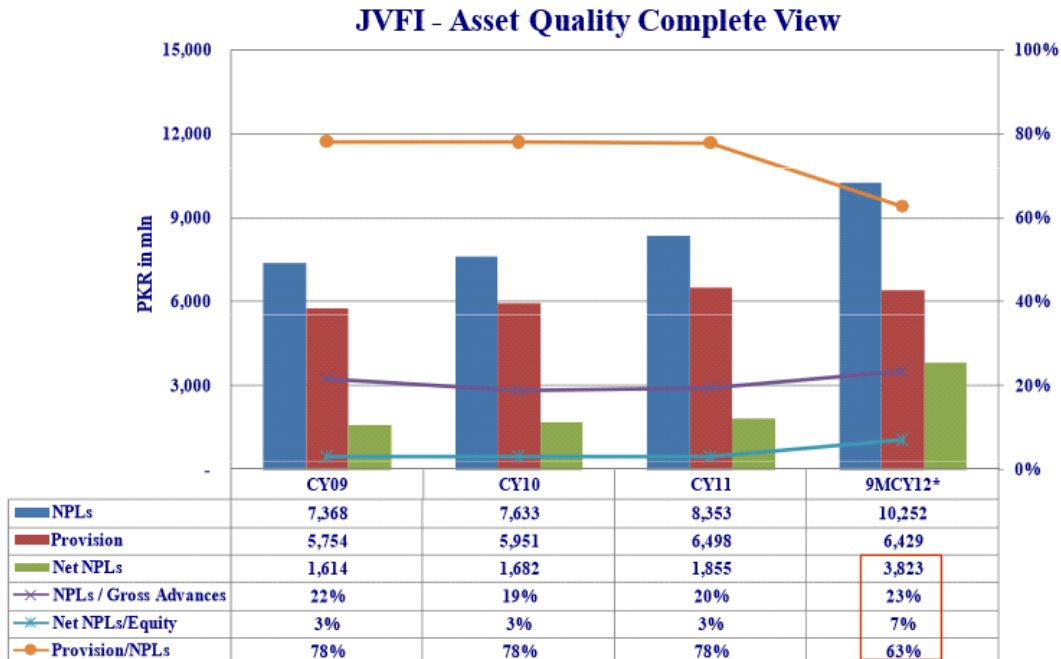
The financial sector in Pakistan comprises of Commercial Banks, Development Finance Institutions (DFIs), M

Currently following DFIs are being regulated by state bank of pakistan.

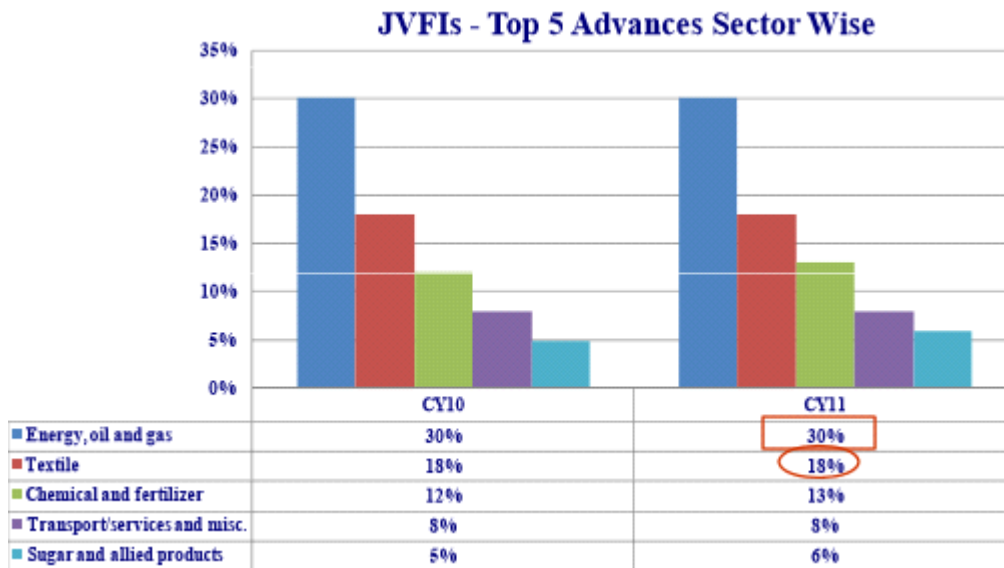
- Pak burni Company Limited
- Pak China Investment Company Limited
- Pak Iran (PAIR) Investment Company Limited
- Pakistan Kuwait Investment Company Limited
- Pal Libya Holding Company limited
- Pak Oman Investment Company Limited
- Saudi Pak Industrial and Investment Company limited

The above 7 Development Finance Institutions (DFIs) operating in Pakistan¹⁸ are all joint ventures between the Government of Pakistan with Governments of Saudi Arabia, Iran, Brunei, Kuwait, Libya, China and Oman. Both Pak-China Investment Company and Pak-Iran Investment Company are relatively newer DFIs, having started their operations as recently as 2008. These DFIs operate under the broad objective of facilitating investment in the country and improving bi-lateral relations.

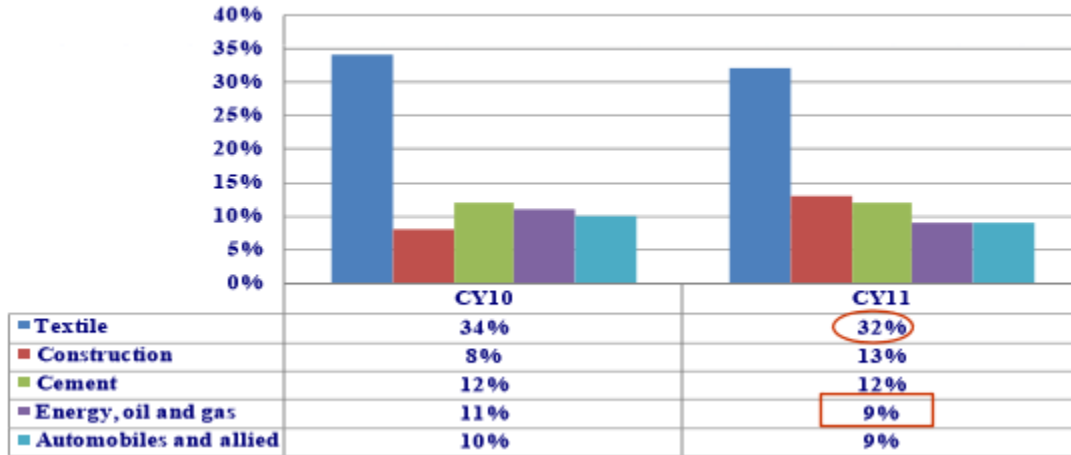
Key financial indicators of DFIs are presented in the table given below. In 2009, despite the slow economic activities in the country, aggregate assets of DFIs grew by 33.7 percent to Rs 113.8 billion, as against negative growths in the previous two years. This growth was largely broad based where almost all DFIs showed significant improvement in their assets (average growth 45 percent) in 2009.



sector wise contribution of npl of dfis

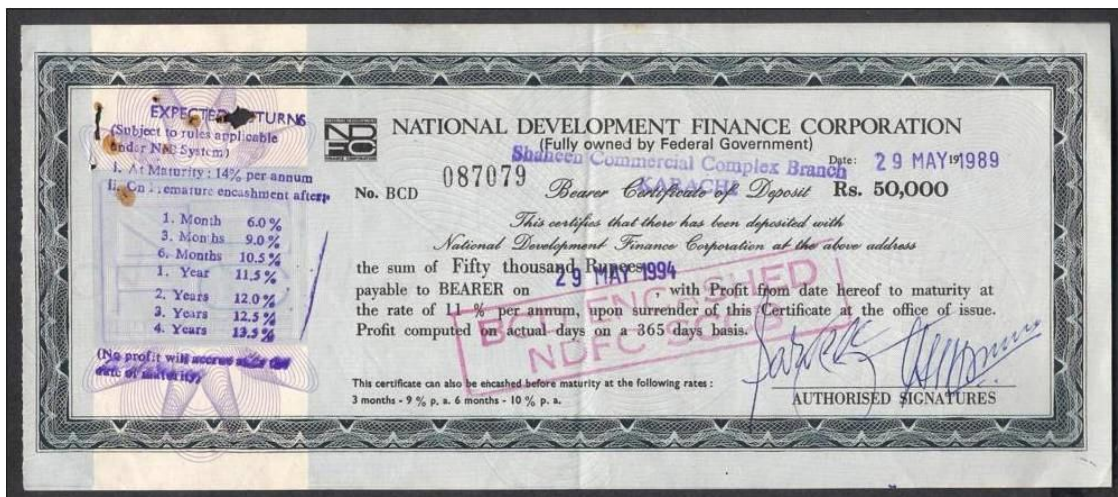


JVFI's - Top 5 NPLs Sector Wise



4.2.1 National Development Finance Corporation

National Development Finance Corporation (NDFC) is based Karachi, Sindh, Pakistan was founded by Zulfikar Ali Bhutto.



National Development Finance Corporation is the largest development finance institution of Pakistan performing diversified activities. It was set up as a joint venture of National Development Finance Corporation (NDFC), International Finance Corporation (IFC), Asian Development Bank (ADB) and the private sector. Activities in the field of industrial financing and investment banking.

National Development Finance Corporation in Pakistan in its Merchant Banking and Project Finance Divisions.

National Development Finance Corporation is the largest development finance institution of Pakistan performing diversified activities in the field of industrial financing and investment banking. It was established through an Act of Parliament in 1973 to finance public sector industrial enterprises but, later on, its charter was modified to provide finance to the private sector as well. The Corporation's resources consist of funds generated through its own deposit schemes, lines of credit from the State Bank of Pakistan and multilateral credit agencies. Besides providing term finances, it also provides diversified banking services, including lease financing, consultancy services, underwriting of public issues and

equity support as well as working capital finance (WCF).

During the last five years, 1989-93, NDFC credit volume increased from Rs. 12,153 million to Rs. 19,040 million which gives an annual compound growth rate of 11.9 per cent. Profit before provisions during 1993 enhanced to Rs. 702.2 million showing an increase of Rs. 27.6 million over the preceding year.

4.2.2 Contribution to National Development

Economic Import of NDFC-financed projects:-

*\$Projects assisted by the Corporation have continued to make a significant contribution to the country's economic development in terms of value-added, foreign exchange earnings/savings and additional employment opportunities. In aggregate terms, 42 projects financed by NDFC have contributed Rs. 10,761 million to Pakistan's GDP and generated Rs. 690.0 million after-tax profits and 40,465 jobs.

* NDFC is actively engaged in the identification and promotion of new indigenous, and transfer of, technology and in this respect it has organised conferences in association with international agencies and has also conducted a number of studies on engineering, plastics, electronics, paper, sugar, leather textiles etc.

4.2.2.1 Promoting Local Technology

Currently major parts of sugar and cement plants are being manufactured in Pakistan and they have provided financial assistance for the export of sugar plants to Bangladesh and Indonesia. Similarly, NDFC has provided assistance to export engineering goods against credit provided by the multilateral institutions.

4.2.2.2 Private Sector Energy Development Fund

* NDFC on behalf of Government of Pakistan is administering the Private Sector Energy Development Fund (PSEDF) since 1988 - a pool of resources amounting to US \$ 578 million. Additional funding of US \$ 300 million is expected to be available during 1994. The co-financiers of the fund, besides the World Bank, the Export Import Bank of Japan and USAID/USEX 17 Bank, includes the Governments of France and Italy, the Nordic Investment Bank, the Overseas Development Agency of UK etc.

* Substantial progress has been made on the execution of Hub Power Project, the largest thermal power project in the private sector with a capacity to produce 1,292 MW power per year. The World Bank in February, 1993 cleared the NDFC appraisal report for the project and in April a loan agreement of US \$ 425 million was signed between NDFC and Hub Power Company (Hubco) and approval given for US \$110 million as mobilisation payment. In addition to the foreign currency loan NDFC has sanctioned advance out of its own resources and is arranging a syndication of Rs. 4.5 billion from the local market.

4.2.2.3 Domestic Resource Mobilisation

NDFC mobilises its own local currency resources. The funds generated through its various deposit schemes, constituting NDFC's single largest local currency resource, have increased to Rs. 16.0 billion. This service was a great innovation and has been copied by a large number of institutions all over the world.

4.2.2.4 Development of Capital Marketing Pakistan

NDFC has made a significant contribution in the development of capital market in Pakistan. The Corporation as a consultant/agent of Water and Power Development Authority (WAPDA), successfully floated long-term bonds of over Rs. 8.7 billion from the local market during 1988 and 1989.

Moreover, in order to develop a secondary market for the bonds, NDFC has established the First Credit and Discount Corporation (FCDC) to provide discounting facilities for the WAPDA bonds. NDFC is the first Pakistani financial institution to have floated a privately-subscribed bond in a foreign capital market and raised Japanese Yen 3.0 billion in 1987 (US \$ 20.0 million).

During eighties NDFC has promoted a number of financial institutions. Among others. the Regional Development Finance Corporation (RDFC), the National Development Leasing Corporation (NDLC) and Capital Modaraba and the Youth Investment Promotion Society (YIPS) are good names which have created a lot of impact on the Pakistan economy.

In pursuance of the Prime Minister's programme for the promotion of computer literacy in the country, NDFC has established a most modern Computer Training Institute at Nawabshah, which was inaugurated by the Prime Minister Benazir Bhutto on July 13, 1994. This institution has been established with the most modern software tools, using state-of-the-art hardware computer training. The institute will be a centre of high excellence where highly educated and experienced professionals are imparting training.

NDFC has a number of competitive advantages - range of product line, extent of reach through its branch network, correspondent relationships, consultancy services etc. All the available resources will be effectively leveraged to bring in more and better business in the coming years. However, with the changed economic environments emerging from de-regulation of the financial market, there is, a need for innovation in the services being provided and developing new lending instruments.

The NDFC is currently the largest development finance institution of Pakistan performing diversified activities in the field of industrial financing and investment banking. 42 projects financed by NDFC have contributed Rs. 10,761 million to Pakistan's GDP and generated Rs. 690 million after-tax profits and 40,465 jobs. By the mid-1990s NDFC had a pool of resources amounting to US \$ 878 million. The Bhutto government increased the level of investment, private and public, in the economy from less than Rs. 7,000 million in 1971–72 to more than Rs. 17,000 million in 1974