

## **Ishrat Husain: Vision for Pakistan's financial service industry**

Address by Dr Ishrat Husain, as the chief guest at the ceremony held to announce the joint venture partnership between BMA Capital and Abraaj Capita, Karachi, 29 July 2004.

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I am extremely happy to be present here this evening on the occasion of the signing of the joint venture partnership agreement between BMA Capital and Abraaj Capital. This partnership will raise the capital of the company to a level where it can get into new areas of business. I would like to congratulate the sponsors, management and staff of both these companies on their successful transaction and hope they will use this expanded platform to launch new products and services which will be focus of my remarks this evening.

Securities and investment banking by its nature is more risky than the traditional retail banking. Large firms are protected by the diversity of their income streams and are more able to withstand exogenous shocks and unanticipated disturbances than small firms in this field. To that extent this transformation of BMA into a large firm provides us, the regulators, a little bit of comfort.

My vision for Pakistan's financial sector envisages a continuum on the domestic front with well functioning capital markets at one end, the banking system in the middle and Microfinance institutions at the other end. I stress the word 'continuum' in which all constituents are interlinked and a lot of flexibility exists throughout the value chain rather than vertical silos or compartments which stand in isolation with each other. Capital markets cater to the need of well-established, highly reputed, credit worthy large issuers of capital who are trusted by both the retail and institutional investors and to whom they are willing to provide their savings at competitive prices. Banks are then left to meet the demand of the bulk of the population in the middle market i.e., the whole host of medium and small enterprises, firms, farmers, individual businesses, partnerships, unlisted companies on one hand and millions of households seeking different kind of consumer financing on the other. They will be fed by millions of small and medium depositors who have neither the inclination nor the appetite to do anything else with their savings but to entrust them to the vast network of banks with which they are quite familiar and comfortable with. At the other extreme of the spectrum are small microfinance institutions that can be set up even at the district level with very little capital to serve the poor, the landless, the small artisans, the semi-skilled who can use small amounts of capital to transform their labour into marketable products and earn a decent living.

Globally, I envision that Pakistan's financial services industry will be integrated with the international financial markets and will remain an active participant in mobilizing and raising resources at highly fine prices in adequate volumes for the sovereigns, agencies and corporates. At the same time it is my endeavour that Pakistan becomes an exporter of financial services first to the Middle East, Central Asia and North Africa and then to the rest of the world.

How can this vision be translated into reality? We have to work together on an action plan to achieve both these objectives in a time bound manner with specific milestones and deadlines.

To achieve the first objective the financial service industry and the Government have to take a number of actions:

- (a) Broaden retail investor base in equity and debt markets. The present policy of the Government to privatize the large public enterprises through IPOs on the stock market has done wonders to expand and attract several hundreds of thousands of retail investors. The industry has to consolidate this trend and make future private floatations on a continuing basis making it possible to retain the attraction of retail investors.
- (b) The contractual savings institutions in Pakistan are highly segmented, narrowly focused and making sub-optimal returns on the assets they manage. It is the joint responsibility of the Government, regulators and the industry to mobilize and manage these savings in an optimal and professional manner. As we develop and manage private pension funds,

provident funds and endowment funds the overall domestic savings rate in the country will rise.

- (c) There are billions of rupees worth of distressed loans lying with the commercial banks. Investment banks can acquire these loans at a discount, restructure the underlying assets by creating sustainable debt capacity and make the units operational. This will help the revival of the industry and clean up the balance sheets of the banks.
- (d) A large number of corporations and listed companies in Pakistan are not realizing their full potential and unearthing the value for the shareholders. Financial service providers should advise them as to how these hidden values can be realized.
- (e) The economies of scale and scope dictate that many corporate entities will improve their financial performance if mergers and acquisitions take place. This is a neglected area in Pakistan which begs the attention of every one of us present here today.
- (f) The financial service industry has to design and introduce long-term infrastructure and municipal bonds to supplement Government's efforts in upgrading the basic infrastructure facilities and encourage participation of private sector and in some cases public-private partnership in these projects.
- (g) High standards and practices of corporate governance should be observed by all players in the industry so that the confidence of small and minority shareholders is restored and maintained, integrity and ethics become the hallmark of our financial sector.
- (h) Private equity funds have played an extremely useful role in several developing countries in efficiently mobilizing private funds, placing them in undercapitalized companies making them highly profitable and either taking them public or exiting from the scene after reaping handsome returns. Pakistan does not have such vehicles which need to be nurtured. I am confident that Abraaj being the largest private entity firm in the Middle East would disseminate this experience in Pakistan through their new JV.
- (i) As mortgage loans assume a significant proportions of the banks' portfolios they will need to offload them from their balance sheets to make headroom for new originations. Mortgage based securities will be needed to enable this to happen through active assistance of financial service providers.
- (j) We have not seen many transactions so far which involve structured finance, acquisition finance, takeout finance and multilevel finance. As corporate treasuries acquire more sophistication there will be demand for such products.
- (k) Derivatives markets are just beginning to take hold but they are integral to risk management and risk mitigation strategies of the borrowers. Banks will have to play a key role in educating their counter parties in all the intricacies of derivatives.
- (l) Cross selling services have not been popular in Pakistan's financial industry so far. We seem to have an obsession with proprietary and own managed and controlled products and services. We are losing sight of the enormous synergies which are being missed by pursuing the current business model.

To achieve the second objective i.e., export of financial services from Pakistan there are a number of steps we have to take. These are:

- (a) Develop, attract, retain and motivate high quality skills who can carryout world-class professional work relating to technical, marketing and management of these institutions in third countries.
- (b) Acquire core competencies which are needed to compete in an integrated and globalized financial market.

- (c) Focus on business areas and niches which allow a competitive edge to our exporters of financial services.
- (d) Concentrate on innovation, speed, responsiveness and tailoring to meet the specific customer needs in credit delivery.
- (e) Use technology as an enabler to digitally secure product access and service delivery, reduce transaction costs and provide convenience to customers.
- (f) Introduce control mechanism for cost structure and operational efficiency.
- (g) Build high quality research, market information gathering and analysis capacity to keep in continuous touch with the changing trends and demand patterns.

Let me conclude by submitting that the agenda I have sketched out above is quite demanding but it is doable and not implausible. The road ahead of us is long and arduous but it seems to me that this joint venture that has been established today is the first step in that direction. We all have to work hard and long to achieve these goals.