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The lackluster economic activity is indicating signs of rejuvenation in FY14; agriculture production will play a significant role in continuing economic stimulation in FY15, with the Large Scale Manufacturing (LSM) sector expected to continue being mired by prevailing energy issues and capacity constraints. The economy will also have to cope with lower domestic and international prices and slower exports growth prospects in the textile sector.

Trade deficit is a concern on the balance-of-payments front, along with declining private capital inflows and foreign direct investments – an area in which the issuance of dollar-denominated Eurobond/Sukuks can provide much-needed economic relief. The recent IMF Review meeting has resulted in the expectation of the realization of USD 1.1 billion payment in the first half of December 2014. This, in addition to the issuance of USD 500 million Sukuk bonds in this month, is expected to increase foreign exchange reserves to USD 15 billion.

International oil prices have demonstrated a decline; this trajectory revision has been awaited for long and heralds a fortuitous reduction in the imports bill – an occurrence that would have been excellent for the trade position had it not been for the ailing exports segment.

Our exports have been struggling and need to be revived in order to complement the positive developments of imports curtailment. Implementation of initiatives and policies to boost Pakistan's exports must be directed at product/service development and enhancement, as well as market optimization /expansion. Within product development, enhancing value addition of traditional exports through calculated investment, well-directed Research & Development and modern technology is of paramount importance. Talent/skill development through vocational education and dedicated institutions for counseling and training can also make a vast difference by attracting and harnessing a synergetic talent pool.

Stimulation of SMEs will go a long way in boosting economic activity. Financial focus and access to credit, when extended to small and medium enterprises, has proven to boost economic productivity, which can be reasonably expected to translate into greater export of products. China is an excellent case study of transformative economic growth being sustainably enjoyed through a dedicated focus on SMEs – a model that Bangladesh is keenly following.

With reference to exports market optimization and development, it is time to take stock of the demand realities of our

traditional export markets such as US & EU, where slow growth in demand can be witnessed and further projected. It is therefore a natural choice to penetrate opportunities in Russia, Africa and Asian markets such as China and India.

Duty-free access to European markets, made possible by the GSP Plus status awarded to Pakistan earlier, boosted textile garment exports by approximately 31% within the first two months of the Status coming into effect. Trade concessions through the GSP Plus status will benefit the country's textile industry the most by providing it with competitive stamina against regional rivals Bangladesh and Sri Lanka, which already possess duty-free access to the European Union.

Leather and carpet manufacturers have also benefited from the GSP Plus with an increasing share in the European market, and shipments growing by 15.20 percent & 12.79 percent in January & February 2014 alone.

As per projections, this trade preference scheme will continue to benefit our export flow of trade. The GSP Plus will result in almost 20 percent of Pakistan's exports entering the EU market at zero tariffs, in addition to 70 percent of the exports entering the subject market at preferential tariff rates.

It is important to note, however, that preferential trade status and concessions, while being a great advantage without any doubt, should not give us any sense of complacency. Exports are not going to augment in any sustainable manner through preferential access. As mentioned before, sustainable development of our exports portfolio will come through superior products targeted at diverse and well-selected markets.



Sirajuddin Aziz
Editor-in-Chief

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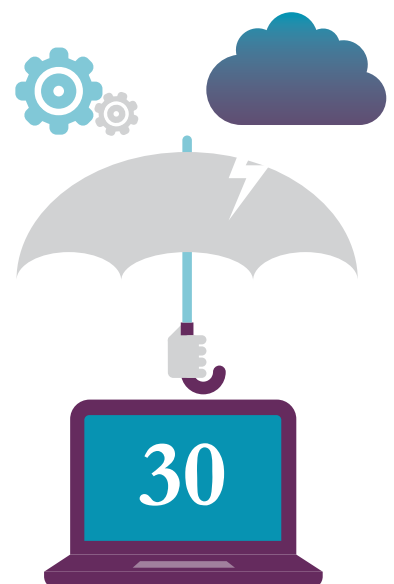
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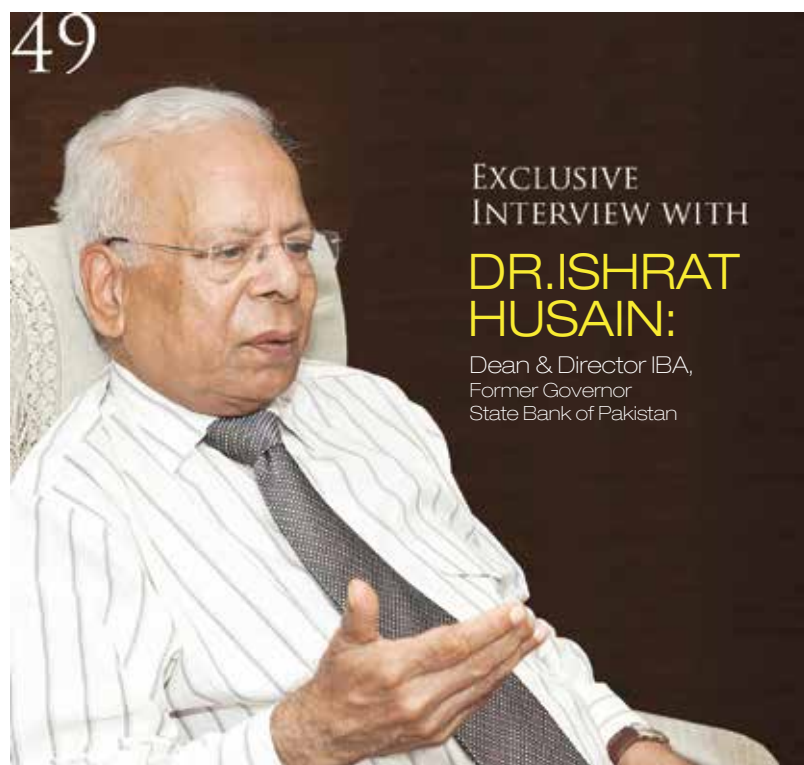
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Marketing of FINANCIAL SERVICES

By Dr. S. Sabir A. Jaffery

A major problem related to marketing of financial services as opposed to marketing of tangible products is that services are not physical being. They are abstract in nature, solely conceptual and metaphysical. Unlike goods, these can neither be touched nor tasted nor stored nor purchased in bulk.

Certain writers claim that financial services also include some tangible items, such as, statements of accounts, cheque books, debit/credit vouchers and so on. The claim, however, does not carry any substance. The items quoted here are not 'service' in themselves. What constitutes service and determines its quality is how regularly statements of accounts are made available to the customers, how promptly cheques are collected or paid, how quickly and accurately vouchers are made and released.

No doubt certain services are time consuming, such as, advances against mortgage of immovable property or ascertaining credit worthiness of a tentative customer proposing to establish a letter of credit. The decision-making process in such cases is lengthy. It is the role of personnel handling such cases

on which satisfaction or dissatisfaction of customers depend.

This intangible nature of services coupled with their other characteristics makes all the difference. Resultantly, marketers of financial services face challenges which are alien to the marketers of tangible products.

CHARACTERISTICS OF SERVICES

The typical characteristics of services that distinguish them from tangible goods are:

Simultaneity - Services are created simultaneously when they are needed and used while tangible goods are produced well before they are put on sale. Moreover, marketing and sale of financial services are usually undertaken by the same individual



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simultaneously. A bank official operating in the field serves both as marketer and salesman of the services offered by his bank.

Heterogeneity - Despite the fact that all the banks render same services, the quality of service rendered varies from bank to bank. As against this, quality of, say a particular brand of toothpaste put on sale at different retail outlets, is exactly the same. Quality or the standard of service, however, depends upon the individual or team of individuals who render the service. Since these individuals represent the bank, the quality of service rendered by them is assigned to the bank to which they belong.

Intangibility - Since services are intangible, it is the quality of service alone that determines the level of satisfaction of customers.

Perishability - Financial services cannot be stored or carried forward. They are time constraint i.e. they are not generally available after declared business hours.

In the wake of the above analysis of services, it can be concluded that selling of financial service is far more complex than selling of tangible products.

SELLING OF FINANCIAL SERVICES

A good service in the hands of a poorly trained salesman fails to attract a customer. Identically, a most proficient salesman cannot push the sale of a shabbily designed and highly priced service. Hence, for the sale of a financial service to be successful, selling efforts are needed to be made in a highly systematic and organized manner by well-trained sales force.

CHARACTERISTICS OF SUCCESSFUL SALESPERSON

There is a long list of traits usually attributed to a bank official assigned to sell the services of the bank. But, ironically, all those individuals who possess these qualities are not successful salespersons. Likewise, all the successful salesmen do not necessarily possess all these qualities. Undisputedly, however, personality, in depth knowledge of the services offered and the selling skills enrich the performance of a salesperson.

Personality: The personality of a successful salesman consists of inter alia, self-confidence, intelligence, hard work, impressive communication skills and ability to get along smoothly with antagonism. Experts have recommended two more qualities - empathy and ego drive, for superior salespersons.

Self-Confidence: The demarcation line between self - confidence and over-confidence is very thin, which is sometimes unintentionally crossed. A sales - person suffering from over-confidence becomes stubborn in his behaviour during interaction with others, particularly in dealing with disgusted customers. Thus, self-confidence coupled with self-control only yields positive results.

Intelligence: Intelligence is another prerequisite for meeting any challenge. Salespersons have to counter the hostile activities of competitors operating in the same market without jeopardizing their own interest. This is practicable only with above average intelligent retaliation.

Hard work: It is the basic need of any daring enterprise and has no substitute either. Its importance, therefore, cannot be overemphasized.

Communication Skill: Effective communication alone makes the message go. It does wonders in winning over a reluctant tentative customer, particularly in the wake of fierce competition.

AIDAS: AIDAS is aide-memoire for effective communication process model that tends to generate sales. It is elaborated as follows:

- Gain prospective customer's attention **A**
- Arouse his interest **I**
- Stimulate desire for the product **D**
- Get on the buying action **A**
- Create satisfaction in the deal **S**

Ability to get along with antagonism: A dynamic salesperson has to face many vulnerable situations which can successfully be met with prudence, patience, perseverance and planning. Without these attributes no salesman can survive in a volatile competitive market.

Empathy: This is the capability of identifying oneself mentally with another,

i.e. the customer and comprehending and sharing his feelings. An officer who is capable to read customer's mind is infallibly competent to differentiate between a desirable and an unwanted customer.

Ego Drive: It means the intense desire to accomplish a sale transaction for the sake of sale itself and not merely for monetary gains.

KNOWLEDGE OF THE SERVICES OFFERED

The bank officials operating in the field are supposed to know anything and everything about the services they offer. A potential customer, practically being in business for long and having held detailed discussions with other banks also is supposed to be aware of the minutest detail of the business deal he is negotiating. The bank official on the other side of the table should be ahead of him in the knowledge of the subject at discussion. On-the-job exhaustive training can provide proficiency in this area of knowledge.

At times, lack of sufficient knowledge may have unfavourable repercussions. A glaring example of such mishap can be witnessed at accounts opening desk of banks.

Opening of account is the first step where a tentative customer comes in contact with the bank. This is the point at which the customer gets first impression about the bank which normally lasts long. Usually banks underestimate the significance of this position and assign most junior officers or even probationary officers on it who can't face shrewd businessmen. While what is needed is that an experienced officer who is well versed to answer the expected queries by an incoming customer should receive him in the bank as a potential customer.

A dynamic salesperson has to face many vulnerable situations which can successfully be met with prudence, patience, perseverance and planning.

SELLING SKILLS

Selling as a branch of knowledge is a recent addition in the banking operations. With the increase in the range of services offered by a modern bank, exhaustive training covering both 'selling skills training' and 'product knowledge training' have become all the more necessary. Further, since majority of bank personnel are not "born sales persons", they have to be trained and groomed as salespersons to gain proficiency in all the relevant areas of banks' activities.

Selling vis-à-vis Marketing: Selling is finding customers for what one has; marketing is making sure one has what customers want. In view of this, banks have to ensure that marketing ethos pervade throughout their operational mechanism and thus creates and develops an all-round marketing culture.

Sales skills training program should acquaint the salespersons at least with the knowledge of:

- *the customer* - This means that the marketer / salesman should have first-hand knowledge of customer's needs, his buying behaviour and his problems, if any. With this knowledge in hand, he will be well equipped to win over the tentative customer and also to retain the existing customer.
- *the bank* - bank's market share and promotion and pricing policies vis-à-vis the competitors'. Meaningful market research can help achieve these objectives creditably.
- *the product* - Exhaustive Product Knowledge Training Program is the answer.
- *the competitors* - up to date knowledge of their market shares and sales policies. Market research should serve this purpose adequately.
- *New sales opportunities* - Market research will serve this purpose.

"The more services a Customer uses, the less likely it is for him to change the bank. This helps retain a Customer for many more"

"TO WIN OVER A POTENTIAL CUTOM-ER IS PRETTY DIFFI-CULTBUT TO RETAIN AN EXISTING ONE IS REALLY CHALLENG-ING.



SALES TRAINING PROGRAM

As stated earlier, bankers are not born salesmen. They have to be trained for this purpose. A comprehensive training program has to pass through the following stages:

- To begin with, training objective will be set keeping in view the future development plan of the bank.
- Desired level of knowledge commensurate with the objective will be prescribed.
- Target group of staff will be identi-

fied and its existing knowledge about salesmanship will be assessed.

- The difference between the desired and the existing levels of knowledge will be worked out and training program will be chalked out to meet this requirement.
- Once the program has been designed and target group of staff is identified, the training would commence.
- Result of training will be assessed periodically from the feedback as to the performance received from the branches.
- Refresher courses may also be needed at times.

RETENTION OF CUSTOMERS

To win over a potential customer is pretty difficult but to retain an existing one is really challenging. It is a matter of common experience that during the last week of December every year heavy deposits are secured by bank staff to meet their targets under the bank's development program. These deposits remain with the bank hardly for a fortnight or for a month. Banks also connive at this 'window dressing' practice because they get sufficient support to artificially inflate their balance sheets. In any case, this is not a healthy practice

In order to retain a valued customer for long, which indeed is vital, many more services have to be offered to him at competitive cost. The more services a customer uses, the less likely it is for him to change the bank. This helps retain a customer for many more profitable years. It is a banker's prime duty to make his customers feel that their decision of selecting his bank was most appropriate.

If the bank commits an error, these should be rectified immediately as detected and an apology is offered to the aggrieved customer. If the mistakes are not rectified promptly, the customer might feel disgusted. A vigilant banker ought to know that one disgruntled customer causes more damage than what other one hundred customers may regain.

BITCOIN

An Emerging Trend in the Digital World

By Saddam Siddiqui



Cryptocurrencies (Crypto Currencies) are a subset of alternative-currencies or Digital-currencies. They are produced by Cryptocurrency system collectively, at a predefined and publically known rate. The first Cryptocurrency was BitCoin which was created in 2009.

Until Bitcoin's discovery, online transactions needed a trusted third-party intermediary. For example, if Ali needed to send \$50 to Khan over the Internet, he would have had to rely on a third-party service like MasterCard or PayPal. Third Parties like PayPal keep ledger balances of account holders. When Ali transfers Khan \$50, PayPal deducts the amount from Ali's account and adds it to Khan's account. Without the third party, digital money could be spent twice. Bitcoin's creation is ground-breaking because for the first time 'double-spending problem' can be solved without the need for a third party. BitCoin performs this operation through distribution of concerned ledger among miners, Bitcoin's network user and for time stamping and proofing/verification through a peer-to-peer network. Every deal which occurs in the economy of BitCoin is registered in a public distributed ledger, known as "block chain". New transactions are checked against the block chain to ensure that the same BitCoin haven't been previously spent, thus eradicating "double-spending problem".

Remember, transactions on the BitCoin network are not denominated in USD, Euro or/and Yen etc. as they are on PayPal but are instead denominated in "BitCoin". This makes it a virtual currency in addition to a decentralized payments network. The value of the currency is not derived from gold or government fiat but from the value that people assign to it. The dollar value of a BitCoin is determined on an open market just as the exchange rate between different world currencies.

Because there is no third-party intermediary, it is cheaper and quicker than traditional payment networks. Therefore, BitCoin makes micropayments and other innovations possible. BitCoin also has the potential to improve the quality of life for the unfortunate. As M. Yunus argued, 'Improving access to basic financial services is a promising antipoverty technique'. According to one estimate of World Bank's (Policy Research Working Paper 2011), 64% of people living in developing countries lack access to basic financial services in rural areas. Lack or absence of Branch Banking in

poor areas has led people in developing countries to use mobile banking services for their financial needs. The closed-system mobile payment services such as Easy paisa, UBL Omni, Timepay etc. has been particularly successful in Pakistan. Many Entrepreneurs are moving to this model. These services can be further augmented by the adoption of BitCoin. As an open-system payment service, BitCoin can provide people in developing countries with inexpensive access to financial services on a global scale.

BitCoin is an exciting innovation that can create a payment system which could lower transactions costs in business and remittances, reduce poverty, improve financial privacy online and encourage new financial innovations.

On the other hand, as "digital cash," BitCoin can be used for money laundering and illicit trade. Banning/avoiding BitCoin is not the solution to end such crimes. Today, the BitCoin economy is larger than the economies of some of the world's smaller nations.

The Importance of **SME STIMULATION** **Dubai Case Study**

By Nida Naqvi

Globally, SMEs are playing a high profile role in engendering a quality of growth in emerging economies which is diverse, equitable, sustainable and fast-moving. In developed markets, SMEs are the backbone of national economy. In developing markets, with the right kind of incentives for SME growth, they are forming the foundation to support long-term economic growth.

When SME growth is encouraged, the benefits can be realized relatively quickly. Returns on capital for SMEs can be approximately 20-30% per month, (which is typically higher than interest rates), thereby increasing output, profits and value-add, which harmonize to create an overall positive effect on GDP. Further, if taxed appropriately, the government revenue increases. From a macroeconomic perspective, a strong SME sector diversifies the economy, which fortifies the country's ability to withstand fluctuations and crises on the international scale. ¹

Most significantly, when SMEs are encouraged, it leads to a quality of growth with the right kind of composition, spread, distribution and sustainability. ² In the previous article, I observed that an active SME sector can embolden the socio-political landscape by democratizing economic and social life and promoting social cohesion.

We can look at the examples of other emerging markets, which have tapped into their SME potential and shown positive results, in order to determine the types of policies which would embolden SME growth at home.

One such example is Dubai, which is making a well-heeled recovery from its downturn in 2009 and showing a growth rate of 4.7% in 2014. SMEs account for 95% of all businesses in Dubai. Dubai's positive growth outlook is reflected in the Dubai SME Q32013 Quarterly Pulse, which shows a strong business confidence index reading of 127.2 for Dubai's SMEs. 95% of businesses expect either an increase or no change in the volume of sales in the next quarter. Overall, 65% of the companies in the sample reported no hindrances to their business operations this quarter. ³

In Emirates, access to finance remains the main barrier to SME growth. According to the 2013 Dubai SME Survey, where approximately 80% of SMEs indicated that personal savings were the main source of finance for initiating their business operations in

Dubai. Moreover, only 23% of Dubai SMEs said that they have accessed bank finance in the last five years.

A new law (Federal Law No. 2 of 2014) aims to address the financing shortfall and also build the general regulatory framework for SMEs. Reports indicate that officials began drafting SME-friendly laws in 2009, after the economic crisis, modeling the laws after similar legislations in South Korea, Singapore, and Sweden.

The operational provisions of the law provide incentives to SMEs while the institutional factor is a dedicated council which will be responsible for overseeing and formulating the policy over time.

Incentives include mandated SME business from federal authorities and ministries, which must contract at least 10 percent of their procurement budget for purchasing, servicing and consulting SMEs. Government-related firms, defined as having an interest of over 25% by the federal government, are required to ensure at least 5 percent of contracts with SMEs.

The most significant financing incentive is Emirates Development Bank, which is a sovereign lending body holding AED 10 billion in capital and has been brought in as an SME partner, having to dedicate at least 10 percent of its loans to SMEs. Commercial banks will also be stimulated to lend more to SMEs through the assistance of the Central Bank, which will issue technical guidelines on lending.

Business owners will also benefit from land grants for industrial or agricultural purposes and receive support for promoting their companies at exhibitions around the world. It is important to note that the definition of SME under the law has been drafted in a way which requires ownership by a UAE national or a company owned by UAE nationals.

Other incentives include exemptions from certain custom duties, reduced licensing costs, and assistance regarding other regulatory hurdles which may prevent SMEs from starting up.

According to the 2013 Dubai SME Survey, where approximately 80% of SMEs indicated that personal savings were the main source of finance for initiating their business operations in Dubai. Moreover, only 23% of Dubai SMEs said that they have accessed bank finance in the last five years."

Overall, the law represents the acknowledgement by the UAE government that SME growth is crucial to overall economic growth and is part and parcel of an overall development plan. It represents a broad-based effort at stimulating the SME sector through a variety of channels.

Those countries that are not doing well in their SME sector can look at this law, along with similar plans implemented in countries such as China, Japan, South Korea, India and Thailand, where SME growth potential has been tapped into and the benefits have materialized.

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IN FOCUS: ISLAMIC BANKING

a case study of *Meezan Bank*

By Ahmed Ali Siddiqui & Obaid Usmani

The Shariah compliance function is the core differentiating factor between an Islamic Bank and a conventional Bank. Over the years, the global Islamic Banking industry has witnessed rapid growth with particular focus on improvement of the Shariah compliance mechanisms currently in place. With focus on the awareness of the Islamic Finance consumers, the Islamic Finance industry is rigorously working to provide more authentic and reliable mechanisms of Shariah compliance so that the system is preferred by its customers to fulfill their banking needs.

Islamic banks are playing an active role in this aspect by putting comprehensive Shariah controls and mechanisms in place. The Pakistani Islamic Banking industry, particularly, Meezan Bank has made notable efforts and progress in this area. In the year 2013, Meezan Bank was recognized as the 'Best Research & Development' institution by the Global Islamic Finance Awards. This achievement goes onto show the support of the central bank which has led Meezan Bank as being referred to, a benchmark of Shariah Compliance in both local & global Islamic Finance industry.

ISLAMIC BANKING IN PAKISTAN

Pakistan, in recent years has showed strong inclination towards Islamic Banking. The first Commercial Islamic Bank in the country was established in 2002 and within 12 years, the Islamic Banking share became more than 12% of the entire banking industry. Over the last decade, Islamic Banks have been successful in providing end to end Shariah compliant alternatives to all conventional banking products. The robust regulatory framework of Islamic Banks in the country is one of the major success factors which have supported this rapid growth. With more than 1300+ Islamic Banking branches and more than 30% annual growth in deposits, assets, financing and investments, the Pakistani Islamic Banking industry is set to become the hub of Islamic Banking of the region.





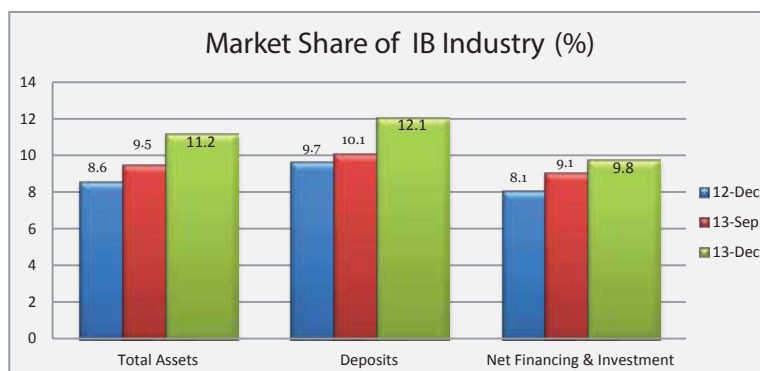
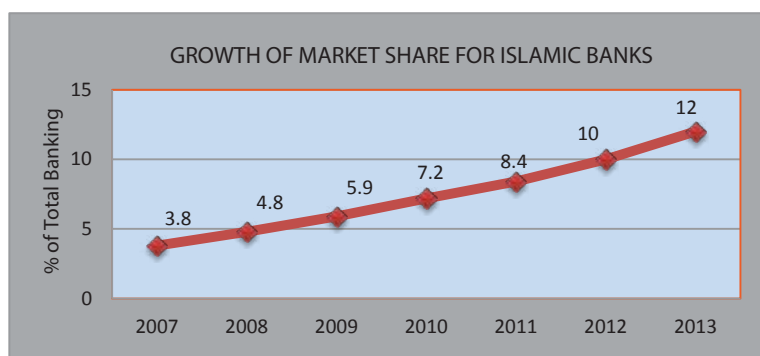
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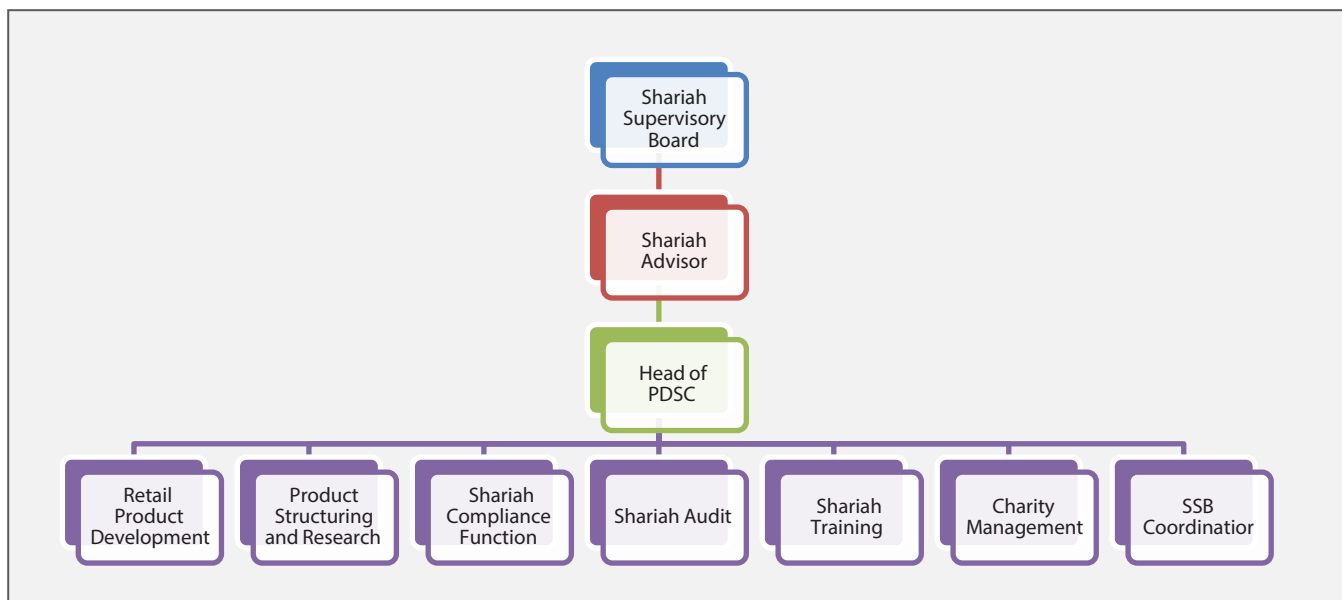
SHARIAH SCHOLARS

The presence and guidance of Shariah scholars is the backbone for any Islamic Bank. Pakistan is one of the most resourceful countries in this regard. The presence of eminent scholars, like Sheikh Muhammad Taqi Usmani, world's leading and most respected scholar on Islamic finance gives a major boost to the cause of Islamic banking and its global acceptability. There are many other Pakistani Shariah scholars who are part of Shariah boards across the globe. Fortunately, the Pakistani Islamic Banking industry has been working under the supervision of world's renowned scholars which have made Islamic Banking very sound and reliable.

Training

Quality human resource is a key component of a successful venture. When it comes to Islamic banking it bears the same importance, in fact the nature of the industry demands highly skilled and





technically sound employees to carry the prestigious label of Islamic banking. The Pakistani Islamic Banking industry, over the years has developed technical expertise with the ability to conduct training sessions at various forums. In order to help establish Islamic banking in other countries, training and development of human resources is a necessity. Pakistan can play a vital role in fulfilling the need of quality human resource. There are many distinguished speakers who regularly participate in national and international conferences, seminars, workshops and other platforms. Eminent scholars conduct Islamic Banking courses at various academic institutes and provide services for course structuring, curriculum development and testing services.

Development Of Regulatory Framework And Initiatives From The Central Bank

The regulatory framework of banking industry must be technically sound and Pakistan is one of those few countries, where central bank has devised a robust regulatory framework with the support of Islamic banks. The State Bank of Pakistan has also established a separate department to support and monitor Islamic Banking in the country. Although, the Islamic banking industry is just a decade old, its regulatory framework is quite comprehensive which covers almost all aspects of Islamic Banking. Specific regulations for Shariah compliance are one of the major highlights of SBP along with a separate

comprehensive Shariah governance framework for Islamic Banks.

Besides working on the Shariah compliance framework, the State Bank has also taken a major initiative by bringing all stake-holders on a single platform for launching a joint media campaign to promote the Islamic Banking Industry in the country.

The Shariah Compliance Framework at Meezan Bank

Meezan Bank has a separate department for Shariah compliance known as the Product Development and Shariah Compliance (PDSC) department, with the mandate to ensure Shariah compliance, conduct Shariah Audit of the Bank, Research for new product development through innovative ideas, Charity Management and Shariah Training. PDSC Department has more than 35 professionals which is a large team for Shariah compliance across the globe.

Product Structuring & Research (PSR)

The Product Structuring and Research is the origination point of innovation of new products and services as per Shariah guidelines. Various financial products and services have been developed to fulfill previously addressed financial needs of the customers. Besides developing new products, the PSR function also conducts research in order to refine, modify and redefine existing financial products. Providing customized Shariah compliant financial solutions to Corporate,

Commercial, SME Clients and development of Liquidity management and treasury related products are highlights of the PSR function.

Customized Shariah compliant financial needs for all segments of business are done by analyzing the following:


- Customer's business cycle
- Tenure (short term or long term)
- Existing alternatives present in the market
- Rate of financing (fixed or variable)
- Payment flexibility (possibility of early repayment)
- Tax concerns
- Accounting treatment
- Regulatory aspect
- Risk mitigation measures
- Mode and nature of the Assets
- Basic Shariah Principles

Once the idea and the structure of a new product are finalized, they are presented before the Shariah Advisor who may either approve, decline or suggest modification in the product.

In cases where the Shariah advisor may not approve or decline the product but rather give instructions for the presentation of the same in the next Shariah Supervisory Board (SSB) meeting, the SSB will then take the final decision on the product.

Shariah Compliance Function (SCF)

The Shariah compliance function has a broad scope in terms of its involvement with all departmental functions in the bank. The basic purpose of SCF is to

A photograph of a modern interior hallway. On the left, there is a large window with horizontal blinds, partially open, allowing natural light to enter. The wall to the right of the window is made of light-colored, textured stone or concrete blocks. The ceiling is dark with recessed lighting. The floor is dark and reflective. The overall atmosphere is clean and contemporary.

Meezan Bank's Shariah Advisor report is considered as the most informative and comprehensive report in the global Islamic banking industry and also referred as a benchmark.

ensure and monitor Shariah compliance related to:

- Corporate, Commercial and SME financing (assets of MBL)
For each customer a separate process flow is devised. Hence, Murabaha Process Flow for a textile concern will be different from that designed for a sugar mill, leather tannery, fiber producer, power station etc.
- Investment banking transactions related to Sukuk and syndicated financings.
- Funding, financing, investment, foreign exchange related as well as other activities conducted by the department of the bank.
- Pool Management and profit distribution of deposit products.
- Development of bank wide policies, procedures and guidelines for ensuring Shariah compliance and vetting policies of other departmental functions such as HR, marketing, admin etc.

The importance of SCF can be judged from the fact that the bank's management has designated the authority to approve or disapprove any financing proposal so that nothing is compromised on Shariah principles. For example, upon review if SCF holds the opinion that facilities proposed in the financing proposal are not practical as per Shariah then SCF will not approve the limit and will propose a different solution/product to the business unit. In 2012 alone, the SCF function reviewed more than 1300 financing proposals.

Besides reviewing all financing transactions and bank policies, the SCF also serves as the coordination unit with

the Shariah Supervisory Board which includes planning the meetings of the Shariah board, preparing agenda items to be presented in the meeting, rolling out the decisions taken in the Shariah board meeting across the bank as well as ensuring proper implementation of the rulings.

Shariah training also falls in the ambit of SCF which conducts all Shariah related trainings within the bank and among the customers, covering concepts of Islamic finance, product training in light of Shariah rulings and refresher courses to reinforce the concepts of Islamic Finance along with any further updates regarding the development in the Islamic finance industry. Different modules of trainings are designed in order to cater to different kinds of audiences. The period of training may vary from one day to as long as 4 months based on the complexity of the course. Trainings may be focused on a single product or may cover the entire ambit of Islamic Finance.

Shariah Audit

The objective of Shariah audit is to ensure proper execution of transactions as per the guidelines laid out by product development and Shariah compliance team. The Shariah audit team reports directly to the Shariah Supervisory Board and works under the supervision of the in-house Shariah Advisor. The Shariah audit of a branch/department is conducted by a particular team assigned, based on which the Shariah audit report is prepared and assigned a rating taking into consideration the audit observations raised. In 2012, more than 250 branches were audited and reports issued.

In case of financing branches, if an audit observation is raised on transac-

"THE OBJECTIVE OF SHARIAH AUDIT IS TO ENSURE PROPER EXECUTION OF TRANSACTIONS AS PER THE GUIDELINES LAID OUT BY PRODUCT DEVELOPMENT AND SHARIAH COMPLIANCE TEAM."

tions of a particular customer and if it is of serious nature with respect to Shariah compliance then charity may be imposed. Based on the seriousness of the audit observations, Shariah audit may refer the case to Shariah compliance team for the revision of the process flow. Until the process flow is revised no future disbursement may be made. The Shariah Audit team also ensures proper fresh hiring throughout the bank by taking interviews of the candidates by testing their basic Shariah knowledge.

The Shariah Audit team works closely with the Shariah Advisor in preparing the Shariah Advisor report each year. Meezan Bank's Shariah Advisor report is considered as the most informative and comprehensive report in the global Islamic banking industry and also referred as a benchmark. The report entails all activities of the bank and provides information of the Shariah activities, new product development and areas of improvement as well in the banking activities, if required.

Advisory Services

Meezan Bank has developed alternatives of all types of assets and liability products which any conventional bank may offer. Having a well established

Year	Number of training sessions	No-of Employees Trained
2010	76	1750
2011	100	2786
2012	109	3314

Year	Number of Seminars	Attendance
2009	24	1955
2010	38	4370
2011	39	4540

“The importance of SCF can be judged from the fact that the bank’s management has designated the authority to approve or disapprove any financing proposal so that nothing is compromised on Shariah principles”

product catalogue, Meezan bank offers its counterparts assistance in developing products. Meezan bank has provided consultancy services to international banks such as Amanah Banks which is in the process of formation, ensuring Shariah compliance not only at startup but also making it certain that there are no loopholes which may pull the bank towards being non-Shariah compliant in future. Another important function to provide consultancy is Shariah audit and Shariah compliance as well strengthening and streamlining the internal operations of its client organizations from the Shariah Compliance perspective.

Retail Product Development

Retail product development is another vibrant function of the Product Development & Shariah compliance department. The unit functions in developing innovative deposit products, consumer financing products and is also involved in the profit distribution and pool management system of the bank. This unit plays a vital role in re-vamping existing products to retain existing customers and also to attract new customers to the bank. Recently, Meezan Kafalah, a saving plan with takaful benefits was developed by this unit which received an overwhelming response from the market.

Charity Management

At Meezan bank, charity management is done through Ihsan Trust which was founded in January 2010. Ihsan Trust Fund is a Waqf, made through a separate Waqf Deed. There are two sources through which Ihsan Trust raises funds which include charities from customers and donations from other Islamic Banks and Islamic Asset Management companies.

Ihsan trust has been focusing particularly in the areas of health and education

by providing medical equipment to hospitals and by providing interest-free loans (Qarz-e-Hasn) to students who lack financial resources to continue their higher educations. Till now, Ihsan Trust has helped more than 1000 students to pursue higher education in leading universities like IBA, LUMS, NUST, GIKI and others.

Shariah Supervisory Board Coordinator

The Product Development & Shariah compliance department plays another important role in the bank by acting as the coordinator with the Shariah Supervisory board. Coordination including arranging meetings, follow up and implementation of the directives of the SSB is also the responsibility of this department.

The Shariah compliance functions has become a critical driving factor for not only performing well but also as a survival mean in the Islamic Finance industry. Meezan Bank, in this regard has emerged as a role model for other banks both locally and globally, which can be proved by its unmatched success which has led Meezan Bank to win the award of the best Islamic Bank of the country on regular basis on different forums. Recently, Meezan Bank was named as the ‘Best Research & Development in Islamic Finance 2013’ by Global Islamic Finance Awards.

The entire banking industry of Pakistan is currently facing challenging times due to the declining discount rates which has squeezed the banks’ margin of profits and in this situation, Islamic Banks face further challenges of not only maintaining their performance in terms of profitability but also maintain it without any compromise on Shariah compliance.





Practical Problems on **COMMERCIAL BANKING** and their Solutions

By Dr. Sabir Ali Jaffery

Q.1 Mercantile Adventures is a partnership firm with Mazahir, Saeed and Mufti as its partner. The firm maintains a current account at your branch. You purchased a cheque for Rs. 68,000/- drawn payable to M/s Mercantile Adventures. However, the cheque was returned unpaid. Mazahir is the only affluent partner who could meet the liabilities of the firm. But, he avoids accepting any liability towards the dishonoured cheque on the plea that he had retired from the partnership of the firm before the cheque was purchased. How would you take up the situation?

Ans. Under the Partnership Act, all the partners are severally and jointly liable for the debts of the firm. However, if any partner retires from the partnership and adequately notifies his retirement so that all the stakeholders are ordinarily expected to have known it, then he will not be held accountable for the deeds of the firm undertaken after his retirement.

The question, however, suggests that Mazahir had not notified his retirement which therefore does not bind the creditors of the firm to accept his relinquishment from the liabilities of the firm owing to his retirement. Resultantly, Mazahir does not cease to be liable towards the liabilities of the firm although incurred after his retirement.

Q.2 M/S Trade Links is a partnership firm with two partners Athar-ul Haque and Azhar-ul Haque. The firm deals in hardware and is operable by either of the two partners. Azhar has gone abroad to attend an exhibition of the products of the firm and allied materials and is expected to be back not earlier than after four weeks. In the mean time, Athar approaches you to grant an overdraft against a bill already sent for collection. The OD is reportedly needed to retire a consignment of the products in which the firm primarily deals. State whether one of the two partners has implied

authority to borrow on behalf of the firm and to pledge the bill sent by the firm for collection?

Ans. A partner has implied authority to do all such acts as may be required to carry on the business of the firm. As the OD is needed to finance the business products of the firm, Athar has implied authority to make such borrowing on firm's account provided there is no specific bar against it in the partnership deed.

Athar, under partner's implied authority, can also offer the bill sent for collection as security against the required OD.

Q.3 A partnership firm has three partners, namely, A, B, and C. Of these, C is minor and B is out of the country. 'A' wants to open an account in the name of the firm. Will you accede to the request of A? If so, what precautions would you take?



Ans. A minor being incompetent to contract cannot be a partner. However, he can be admitted to the benefits of an existing firm with the consent of all other partners. Nevertheless, the minor shall not be held liable for the debts of the firm beyond his share in the profit and property of the firm. In other words, unlike other partners, neither the minor shall be held personally liable for the debts of the firm nor these debts shall have any bearing on his ex-firm property. Hence, account of the firm may be opened with the minor admitted to the benefits of the firm.

Under the implied authority of a partner, A can open the firm's account even in absence of B. But, the account shall not be allowed to be overdrawn until the absentee partner also signs all the relevant documents.

Q.4 Messrs Jaffer Sons, a firm of accountants, and Messrs Hashmi Associates Ltd., a public limited company of solicitors, accountants, and tax consultants, are pursuing to jointly undertake a mega project and therefore desire to be formed into a partnership firm in the name and style of Jaffer Hashmi Enterprise and wish to open its bank account. Your Operations Manager who is in-charge of Commercial Banking Operations is not agreeable to the proposal on the plea that a limited company cannot join a firm as partner. What will be your advice in this matter?

Ans. The Operations Manager is partly true and partly untrue. Of course, the account cannot be opened but not for

the reason put forth by him. A limited company is a legal entity and, therefore, can join a partnership firm as a partner. On the other hand, a partnership firm is not a legal person and therefore cannot join another firm as partner.

As an alternative, partners of Jaffer Sons in their individual capacities can form a partnership firm along with Hashmi Associates Ltd., who will be treated as one partner irrespective of the number of its shareholders.

Q.5 You have at your branch a partnership account in the name and title of "Ali Brothers" with three partners, namely, Sajid Ali, Tahir Ali, and Abid Ali with any of them authorized to operate the account singly. Mr. Sajid Ali has been adjudged insolvent. A cheque signed by him bearing the date prior to the date of the order of adjudication is presented in clearing. How would you handle the situation?

Ans. The firm stands dissolved on the insolvency of a partner. However, the solvent partners may continue operating the account for the purpose of winding up the business. In order to

determine the liabilities of the insolvent partner, the account should be broken to avoid operation of the rule in Clayton's Case. Further, fresh mandate should be obtained for future operation on the account.

Cheque drawn by the insolvent partner should not be paid unless confirmed by the solvent partners.

Q.6 Azad Trading Co. has a current account at your branch with Usman Azad and Sultan Azad as partners with Usman Azad alone authorized to operate the account. You receive a notice from Mr. Sultan Azad that Usman Azad should no more be allowed to operate the account. Later, a cheque signed by Mr. Usman before his authority was revoked is presented on the counter for cash payment. How would you deal with the situation? Whether the cheque will be paid as ostensibly it was signed by Usman well before his authority was withdrawn?

Ans. Since the account of the firm was opened by both the partners, instructions received by any of them will be binding on the other and also on the bank. The account will be stopped forth with and any further withdrawal will be allowed only under signatures of both the partners. Preferably, the partners will be asked to open a fresh account with fresh mandate. The cheque signed by Mr. Usman Azad will not be paid.

Statutory REFORMS

in Banking in Pakistan

By Dr. S. Sabir A. Jaffery

Some of the laws that relate to banking operations in Pakistan suffer with certain anomalies and drawbacks. These need to be examined critically and amended as and where required to bring them in harmony with the entire legal frame work and the banking practices. A few examples of infirmity, as noted by the author, are reproduced below which hopefully will receive due attention.

NEGOTIABLE INSTRUMENTS ACT, 1881 (NIA)

BANKING COMPANIES ORDINANCE, 1962 (BCO)

Sec.3 (b) of NIA versus Sec.5 (b) of BCO

Section 3(b) of NIA reads: “banker” means a person transacting the business of accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, and includes any Post Office Savings Bank.”

At the same time, Sec.5 (b) of The Banking Companies Ordinance, 1962 as substituted by Ordinance 58 of 1980 (BCO), defines ‘banking’ as follows:

“Banking’ means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.”

Post Office Savings Bank

The additional clause “and includes any Post Office Savings Bank” incorporated in Sec. 3 (b) of NIA was abandoned while drafting Sec.5 (b) of BCO without simultaneously amending Sec.3 (b) of NIA. Obviously, this provision of Sec.3 (b) of NIA is infructuous and repugnant to the BOC, and is also incompatible to the case law and banking practices both at home and abroad. Hence, there is no point in retaining it in Sec.3 (b) of NIA.

Banking, Banking Companies, Banker:

There are three expressions, namely, ‘banking’, ‘banking companies’ (banks), and ‘banker’. Of these, Sec. 5 (b) of BCO defines ‘banking’ while the term used in NIA is “banker” whereas the more appropriate expression is “Banking Company” or “Bank”. The two acts should be amended accordingly.

Banking to be the Main Business:

In carrying out the views of renowned scholars, such as, Dr. Hart and Sir John Paget, and in pursuance of the case law developed over time, it has been established that no person could be a banker unless banking was his main business.

It was initially held in an Irish case *Stafford v. Henry*, 1850 that a person carrying on more than one business including banking business was not a banker since banking was not his chief business, but was only ancillary. The view was cited with approval in a later case *Shields v. Bank of Ireland*, 1901.

In yet another case, *Ex parte Coe*, 1861, the businesses of the company were to receive deposits, to grant loans

Other Businesses which a Modern Bank Performs:

Section 7, Sub-sections (a) to (o) of BCO:

Besides accepting of deposits and paying of cheques, a modern bank performs many other functions and renders several services to its customers which have assumed the status of an integral part of modern day banking functions. These functions have been specified in section 7, sub-sections (a) to (o) of Banking Companies Ordinance. Still, this is not the end. Many more functions may be added to the list with the passage of time. Luckily, this aspect of “lack of finality” has also been taken care of in sub-section (o). Moreover, Section-7 also acts to prohibit banks from performing functions which do not fall within its

“Banking’ means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.”

on security, and to conduct emigration business. Money could not be drawn by cheque, and could be withdrawn only after notice. It was held that it was not a banking company.

In view of the foregoing, it is immensely desirable that the words “main business” or “chief business” should be added to the definition.

Withdrawable by Cheque, Draft, Order, or Otherwise:

The words “draft, order” in the two definitions are simply redundant and should therefore be abandoned. The long established banking practices also do not call for these terms. Further, if the need arises in any unforeseen situation to include instruments other than cheque, the words “or otherwise” would adequately cover it.

purview. Hence, limitations prescribed in this section should necessarily be stipulated in section 3(b) of NIA and also in section 5(b) of BCO.

Purpose of Lending or Investment:

The two definitions require a banking company to accept money on deposit from public for the purpose of lending or investment. This restricting of purpose to ‘lending or investment’ is contradictory to the basic nature of banker-customer relationship as debtor and creditor.

The debtor and creditor relationship was formally recognized in *Foley v. Hill*, 1848, and was quoted with approval in the later case of *Joachimson v. Swiss Bank Corporation*, 1921, thereby enabling the banker to use his deposits

“The debtor and creditor relationship was formally recognized in *Foley v. Hill*, 1848”

as he may wish, being the money borrowed by him from the customers and lying in his full control, subject always to his liability to repay the depositor on demand. Resultantly, this restrictive clause needs to be given up. In view of Sec.7 of the BCO also, specifying functions that a bank may undertake, the clause “for the purpose of lending or investment” becomes all the more redundant and infructuous.

Repayable on Demand:

No amount of deposit is ever repaid except on demand. Hundreds and thousands of inoperative accounts lying in the books of the banks with substantial balances bear testimony to this contention.

Generally speaking, demand is made by way of presenting a cheque for payment. Occasionally, however, an account may be debited on receiving a request in writing from the accountholder, other than by drawing a cheque, say, for issuance of a draft or a pay order, or for affecting mail or telegraphic transfers, or for meeting any other liability of the accountholder. This is tantamount to making of demand. Thus, in any case whatsoever, a demand seeking repayment, in one form or the other is always there.

Nevertheless, there seems to be one exception to this phenomenon when the bank decides to close an undesirable account and, after completing necessary formalities, issues a pay order in favour of the accountholder for the entire balance in his account, and mails this pay order to him (to the accountholder). However, in this case also, the amount is

not ‘paid’ in the true sense of the word until the pay order is presented demanding payment.

It can be inferred from this analysis that the words “repayable on demand” in both these definitions are adequate enough, and the additional adjoining words “or otherwise” are simply redundant.

Moreover, the words “withdrawable by cheque or otherwise” should also be self-sufficient. “Draft, order’ as modes of repayment of the amount of deposit are totally irrelevant and completely non-existent, and should, therefore, be struck off the above two definitions.

Proposed Revised Version of Ss.3 (b) of NIA & 5(b) of BCO:

Consequent upon the aforesaid observations, Section 3 and sub-section 3[b (1)] of NIA and Section 5 and sub-section 5(b) of BCO may be amended to read as under:

Sec. 3 of NIA and Sec. 5 of BCO:

“Banking’ means mainly the accepting of deposits of money from public, repayable on demand, and withdrawable by cheque or otherwise, and undertaking of any or all such other activities as specified in section 7, sub-section (a) through (o) of Banking Companies Ordinance, 1962”

S. 3[b-(1)] of NIA & 5(c) of BCO:

“Bank’ or ‘banking company’ means organization of persons, not being employees of the bank who are not directly associated with banking

operations, and includes professionals offering support and supervisory services to main banking operations, which transacts the business of banking in Pakistan”

Section 18 of Negotiable Instruments Act, 1881

As required under section 18 of NIA, if the amount undertaken (as in case of promissory note) or ordered to be paid (as in case of bill of exchange and cheque) is stated differently in figures and in words, the amount stated in words should be paid, provided that if the words are ambiguous or uncertain, the amount may be ascertained by referring to the figures.

Contrary to this legal provision, certain schools of thought are of the opinion that should such situation arise, lesser of the two amounts should be paid. Whereas in most of the countries of the world including Pakistan, payment of such cheques is refused straightaway. This practice gains support from section 10 of NIA according to which Payment in Due Course requires the payment to be made, inter alia, according to the apparent tenor of the instrument and without negligence. Since the tenor is not “apparent” when the two amounts differ, and as the payment of such cheque can not be proved to have been made ‘without negligence’, it shall not be payment in due course. Resultantly, the paying bank will be deprived of the legal protection otherwise available to it.

On top of everything else, the two different amounts appearing on the same instrument cannot be a “certain sum of money” within the meanings of Ss. 4 & 5 of the same Act, with the result that such instrument shall not be a cheque.

Hence, Section 18, which in its present form defeats the provisions of two other important sections of the same Act, and which also does not conform to the long established banking practices, should be suitably amended so as to bring about harmony between law and practice. The desired amended version of this section may be as under:



18. If the amount undertaken or ordered to be paid is stated differently in figures and in words on an instrument, such instrument shall not be deemed to have been drawn for a certain sum of money within the meanings of sections 4 and 5.

Section 123-A [2(b)] of NIA

This sub-section requires that the proceeds of a cheque crossed “account payee” shall be credited only to the account of the payee named in the cheque. As against this, our every day experience is that cheques drawn payable in favour of husbands and crossed ‘account payee’ are freely credited into the joint accounts of husbands and wives.

In order to make the law more realistic, and to bring it in conformity with the banking practices, it will be in the fitness of things if this sub-section is suitably amended so that proceeds of such cheques could also be credited into the account of the authorized agent of the payee, and in the joint account in which one of the joint accountholders is the payee named thereon.

The proposed revised version of sub-section 123 A(2) may read as under:

123 A (2) When a cheque is crossed “account payee”

- (a) It shall cease to be negotiable; and
- (b) Its proceeds shall be credited into the account of the payee named therein, or in the account of his authorized agent, or in the joint account in which one of the joint accountholders is the payee named therein.

Discharge given by the collecting bank on the reverse of the cheque, such as, “payee’s joint account will be credited on realization” or like, should reflect the situation.

Section 25 of NIA: Maturity of Bills and Notes

According to this section, when the day on which a note or a bill is at maturity is a public holiday, the instrument shall be deemed to be due for payment on the next preceding business day. This section drawn in conformity with the English Law and, without taking note of the conditions prevailing here, has since been retained. Our holidays are not well planned. At times, a holiday in our country is declared at the last moment,

i.e. at the end of the next preceding business day, thereby disturbing the entire schedule of maturity of commercial papers.

Another example is that of the citing of moon which is always uncertain and “appears” on two different days on the horizon of the same country, causing massive dislocation in our business activities.

Moreover, in England also ‘leave’ has now been classified as ‘public holiday’ and ‘bank holiday’. In the former case, instrument is payable on the next preceding business day, while in the later case, it is made payable on the succeeding business day.

The disaster consequent upon our holiday culture can be mitigated by simply substituting the words “preceding” by “succeeding”, without causing any damage to any party.

Obviously, these submissions are neither complete nor final. Quite a few more such exercises may have to be undertaken as a result of continuous review of our legal framework with a view to synchronize it with the demand of time which is fast changing.



A look into
**FEDERAL
BUDGET**
2014-2015

By Saad Hashemy

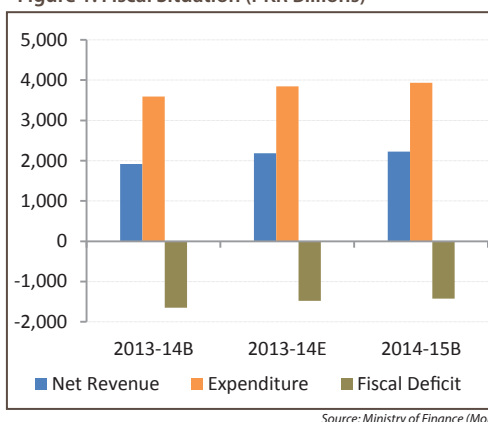
FEDERAL BUDGET: STABILITY NOW, RECOVERY LATER?

We believe that the recently announced budget may not go down well both economically and politically. Aggressive tax targets proposed in the budget will be difficult to achieve as has been the case in previous years where annual targets were revised downwards. Further, additional taxes and reduced subsidies will test the political strength of the current government and will be inflationary. There is some good news as GDP growth has improved backed by rebound in industrial sector, stabilization of foreign exchange rate, and rebuilding of foreign exchange reserves on the back of multilateral flows. The overall theme of Federal Budget 2014-15 is on fiscal consolidation through limiting current expenditures and enhancing the tax base where the focus this year is on documentation (withholding taxes) and gradual withdrawal of concessions.

SALIENT FEATURES

For the year 2014-15, the government envisages GDP growth to increase to 5.1% backed by 44% higher allocation for total Public Sector Development Program (PSDP), while keeping annual inflation in check at 8% compared to estimate of 8.5% this year. Under commitment with International Monetary Fund (IMF), the government aims to curtail budget deficit by 0.9% of GDP to 4.9% of GDP (PKR1.4tn) backed by resource pool of PKR4.1tn, which is 35% higher than budgeted last year. This includes an ambitious tax collection target of PKR3.1tn, which is based on 24% growth in FBR tax revenues to PKR2.8tn. Out of 6% higher total expenditure outlay of PKR4.3tn, the allocation for current spending has been restricted at PKR3.1tn, up 7% from current year's revised estimate with significant drop in untargeted subsidies. With only 70% utilization of budgeted PSDP this year, the materialization of proposed 44% increase in total PSDP in coming year remains doubtful, given ambitious revenue targets

Figure 1: Fiscal Situation (PKR Billions)



Source: Ministry of Finance (MoF)

Figure 4: Financing of Deficit

(In PKR Billions)	2013-14	2014-15	
	Estimated	Budgeted	%Δ
Net External	407	310	-24%
Domestic	1,069	914	-15%
Non-Bank	693	686	-1%
Bank	376	228	-39%
Privatization	-	198	-
Total	1,476	1,422	

Source: MoF, ABL Research

Figure 2: Medium Term Budgetary Framework

Indicators	FY14P	FY15B	FY16B	FY17B
Real GDP Growth (%)	4.1	5.1	6.1	7.2
CPI (%)	8.5	8.0	8.0	8.0
(As Percent of GDP)				
Total Revenue	15.1	14.5	14.6	15.1
Tax Revenue	10.6	11.5	12.1	12.9
FBR Tax Revenue	9.0	9.7	10.4	11.1
Total Expenditure	20.9	19.4	18.6	19.0
Current Expenditure	16.2	15.2	14.1	14.2
Develop. Expenditure	4.7	4.2	4.4	4.8
Fiscal Balance	-5.8	-4.9	-4.0	-4.0
Total Public Debt	62.0	58.7	55.3	51.5
Nominal GDP (PkRbn)	25,402	29,078	33,667	39,250

Source: Ministry of Finance (MoF)

Figure 3: Fiscal Situation

(In PKR Billions)	2012-13	2012-13		2013-14	
	Budgeted	Estimated	%Δ	Budgeted	%Δ
Revenue					
Tax	2,671	2,514	-6%	3,129	24%
FBR Revenue	2,475	2,275	-8%	2,810	24%
Non Tax	749	1,083	45%	816	-25%
Gross Revenue	3,420	3,597	5%	3,946	10%
Less: Provincial Share	1,502	1,413	-6%	1,720	22%
Net Federal Revenue	1,918	2,184	14%	2,225	2%
Expenditure					
Current	2,829	2,935	4%	3,130	7%
Interest Payment	1,154	1,187	3%	1,325	12%
Defense	627	630	0%	700	11%
Subsidies	240	323	34%	203	-37%
Federal PSDP (Net)	540	425	-21%	525	24%
Net PSDP	1,155	815	-29%	1,175	44%
Less: Provincial Share	615	390	-37%	650	67%
Other Develop. Exp.	172	289	68%	162	-44%
Net Lending	50	195	288%	120	-38%
Federal Expenditure	3,591	3,844	7%	3,936	2%
Federal Budget Deficit	-1,674	-1,661	-1%	-1,711	3%
Provincial Surplus	23	183	692%	289	-
Overall Fiscal Deficit	-1,651	-1,478	-10%	-1,422	-4%

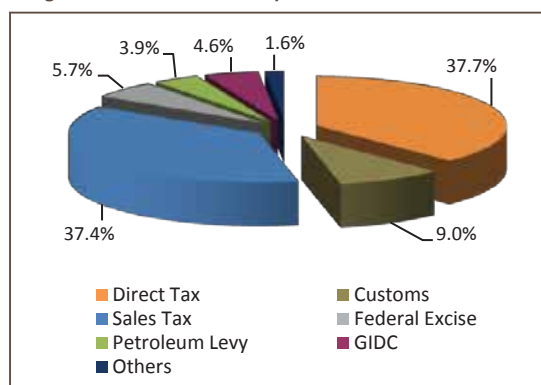
REVENUES – RIDING ON AMBITIONS

Although total tax collection is estimated to be 6% below budgeted target in ongoing year, falling tax to GDP ratio amid ballooning budgetary gap compelled tax machinery into imposing further taxes (GST, GIDC etc) last year, which increased tax to GDP to 10.6% from a dismal 9.8% in previous year. For the coming year, the government aims to enhance tax to GDP target to 11.5% based on phased elimination of concessions/ exemption fetching PKR100bn-150bn in coming year and other revenue mobilization measures through higher withholding taxes on non-complaint entities and bringing retail sector into tax net. Given only 14.5% growth in nominal GDP, the proposed 24% increase in tax collection appears to be aggressive and inflationary, where political backlash may limit the anticipated growth of 32% in direct taxes and increased taxes on energy (natural gas). Unlike this year when substantial increase in non-tax revenues (45%) from budgeted estimates proved to be a saving grace for government, actual materialization next year could be lower than curtailed target of PKR816bn (down 25%) barring any one-offs.

KEY REVENUE MOBILIZATION MEASURES:

- Advance Tax of 3% on tax filers and 6% on non-tax filers on first/business class airline tickets
- Advance Tax of 1% on tax filers and 2% for non-tax filers on purchase of immovable property (for value above PKR3million). Further, 1% adjustable Capital Gains Tax (CGT) proposed from previous 0.5% for non-filers
- Advance Tax on automobile purchase/ import/registration proposed
- Additional advance Tax of 5% on dividend and interest income for non-filers

Figure 5: Tax Revenue Composition 2014-15



- Additional withholding tax of 0.2% on cash withdrawals for non-filers
- Bonus shares to be taxed at 5% on ex-price
- CGT raised to 12.5% for securities held up to 1 year, 10% for those held between 1 to 2 years
- Tax-rate on inter-corporate dividends at 10%, 12.5% on stock funds and 25% on non-stock funds, which ends arbitrage on mutual fund investment
- Corporate companies to be taxed on corporate tax or the proposed Alternative Corporate Tax (ACT) of 17% on accounting income, whichever higher
- Tax rate on services enhanced to 8%/10% in corporate/non-corporate cases from 6%/7%
- Advance tax of 7.5% on monthly electricity bill of PKR100,000 and above

- NTN compulsory for seeking non-residential electricity/ gas connections
- 40% imports exempt from customs duty will be charged at 1% (minimum slab) except for sensitive items
- Retailers taxable under a two tier system; exemption of PKR5mn removed
- Foreign institutional investors to be brought under withholding tax regime

KEY RELIEF MEASURES:

- Corporate Tax rate reduced by 1% to 33% as scheduled
- Income Support Levy abolished
- Corporate tax rate of 20% for foreign equity investment of at least 50% till 2017 only on investment in construction or housing project
- 10% ad hoc relief for govt. employees
- Minimum wage increased from PKR10,000 to PKR11,000

Figure 6: Non-Tax Revenues

(In PKR Billions)	2013-14		2014-15
	Estimated	Budgeted	
Profit from SBP	260	270	4%
Foreign Grants	204	35	-83%
PTA (3G Licenses)	89	56	-37%
Defence Receipts	119	140	18%
Dividends	78	82	6%
Interest (PSE & Others)	83	39	-53%
Others	251	194	-23%
Total	1,083	816	-25%

Figure 7 – Tax Revenues

(In PKR Billions)	2013-14		2014-15	%Δ
	Budgeted	Estimated	Budgeted	
Total Tax Revenue	2,671	2,514	3,129	24%
Direct Taxes	976	891	1,180	32%
Income Tax	949	877	1,164	33%
Indirect Taxes	1,499	1,384	1,630	18%
Customs	279	241	281	17%
Sales Tax	1,054	1,005	1,171	17%
Federal Excise	167	138	178	29%
Petroleum Levy	120	108	123	14%
GIDC	38	88	145	65%
Gas Dev. Surcharge	35	39	46	19%
Others	3	4	5	21%

- Minimum pension raised from PKR5,000 to PKR6,000
- Maximum general customs tariff rate reduced to 25% from 30%
- Sales tax on tractors proposed to be reduced from 16% to 10%
- 10% FED on purchase of motor vehicles above 1,800CC withdrawn
- FED on telecom services withdrawn in provinces which collect GST on services. Otherwise, FED reduced by 1% to 18.5% while WHT also reduced by 1% to 14% on telecom services
- Withholding tax on marriage and function halls reduced to 5% from 10%
- Capacity tax on Aerated water is withdrawn
- PKR118bn allocated for income support programs
- Tax liability for disabled persons having income up to PKR1.0mn to be reduced by 50%.

EXPENDITURE – IT'S ALL DEBT AND DEFENSE

The estimated expenditure outlay of PKR4.1tn for ongoing year depicts growth of 17% from previous year, where it largely remained centered on meeting current expenditures (interest payments, defense and subsidies). Development expenditure, specifically federal PSDP, constituted only a little over 10% of total outlay. Fiscal consolidation agreed under IMF's program came into play in setting next year's expenditure outlay, which is raised by only 6% to PKR4.3tn. This is based on capping current expenditure at PKR3.1tn, which is up 6.6% from estimate of current year with over 37% reduction in untargeted subsidies. Historical trends suggest that target for power sector subsidies, which has been cut by 40% will be difficult to achieve as it would require further increase in power tariff, given no allocation for circular debt in the budget. While allocation for Defense services is likely to remain on higher side as proposed given volatile security situation, increased allocation for interest payments particularly domestic component will likely

remain within target. Fiscal discipline on expenditures side especially power sector subsidies coupled with delivery on tax revenue is crucial towards achieving the enhanced development outlay of PKR1.3tn. While pressure on provinces to keep surplus budgets may hamper full utilization of allocated provincial PSDP of PKR650bn (less than two-third is to be utilized in current year), federal PSDP budget of PKR525bn is viewed skeptically as well due to ambitious revenue targets.

BUDGET DEFICIT & FINANCING

The government has estimated budget deficit for ongoing year at 5.9% of GDP, which is within budgeted target of 6.3% of GDP led by significant underutilization of development expenditure and substantial budget surplus from provinces. In order to put the economy on 5%+ growth trajectory as underlined in MTBF, full utilization of budgeted development outlay in coming year has become important, which demands tight controls on any slippages such as power sector subsidies and tax revenue targets. Increased taxes on retail sector, energy (GIDC, GDS) coupled with proposed increase in minimum wage to PKR11,000 and likely increase in power tariff will be inflationary, in our view. However, projected external flows of PKR869bn (up 22% from current year) coupled with any one-off grants during the year will help keep borrowing from banking sector within budgeted target of PKR228bn, which not only helps offset inflationary pressures but also supports private sector credit offtake. Successful entry into international capital markets and privatization process started this year will be key catalysts in external budgetary financing.

Figure 10 – Current Expenditure

(In PKR Billions)	2013-14	2013-14		2014-15	
	Budgeted	Estimated	%Δ	Budgeted	%Δ
Current Expenditure	2,829	2,935	4%	3,130	7%
Interest Payment	1,154	1,187	3%	1,325	12%
Domestic	1,065	1,109	4%	1,225	10%
Foreign	89	79	-12%	101	28%
Pension	171	188	10%	215	15%
Defense Services	627	630	0%	700	11%
Grants & Transfers	337	336	0%	371	10%
Subsidies	240	323	34%	203	-37%
Civil Govt. Affairs	275	271	-1%	291	7%
Pay & Pension Reforms	25	0	-	25	-

Figure 8: Current Expenditure 2014-15

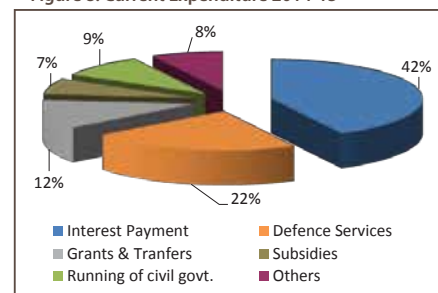


Figure 9: Subsidy Allocation

(In PKR Billions)	2013-14	2014-15	%Δ
Subsidies	323	203	-37%
WAPDA / PEPCO	245	156	-36%
KESC	64	29	-55%
USC	6	7	17%
PASSCO	7	8	23%
Others	1	3	182%

Figure 11: Historical Fiscal Deficits (PKR Bn)

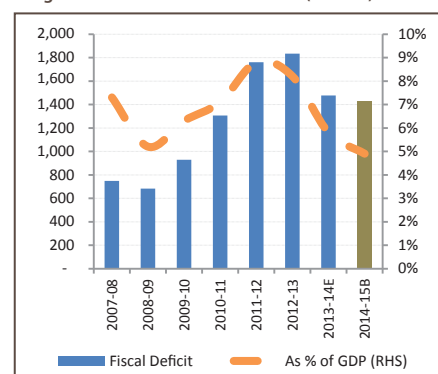
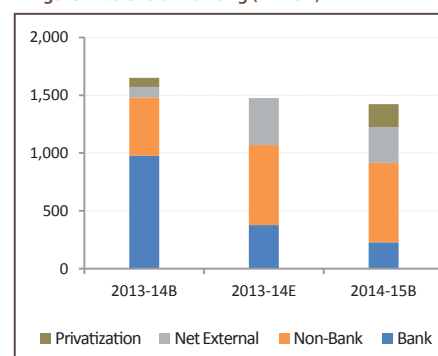


Figure 12: Deficit Financing (PKR Bn)





Quality Service **STANDARDS** Setting The Benchmark

By M.A Khan

Benchmarking is a process of learning, emulating, and exceeding the world's best practices to significantly improve product and service quality. Like any other industry; in banking, benchmarking is also used as a management tool. While banks are striving to expand their service menu, their clients are also raising the performance bar for their banks by expecting more and more from them.

STANDARDS

Benchmarking serves as a barometer for progressive financial institutions to assess customer's needs and set relevant benchmarks in order to retain and or increase their market share. If a bank fails to recognize the importance of benchmarking, it may possibly fall victim to a dangerous sense of complacency and false comfort that is meeting customer's expectation level while many of them are contemplating to consider other options. Banks which do not seek continuous improvement through benchmarking are bound to suffer a dent in their customer base and sales rapidly and irreversibly.

What exactly do we benchmark and how do we set them? We may divide them into two broad categories,

certain processes that are much better than ours. Finally, we may consider benchmarking with companies outside our industry whose processes can be adapted to our organization.

In other words, benchmarks are derivatives of the practices, process targets or service standards set by the best performing competitors, whether or not they have been achieved. Benchmarking tells us how much harder we have to work in order to increase our gap or advantage from the second best player in the market.

It is not difficult to assess whether we are at par with, above or below these prevailing market standards. For instance, loan processing is a major area for benchmarking for banks because customers' expectations are

delay. At a bank where I once worked, the standards defined that telephone calls must be picked up within two rings and defaulting staff had to pay a small token penalty.

Information technology has changed the economics of financial transactions making the transaction cost an important benchmark affecting the future of your bank. A survey of Internet Banking in the year 2011 by Booz-Allen & Hamilton, a well - known USA management consultant firm, showed that the cost of an average teller transaction is eight times higher than that of a typical payment transaction using the internet. The cost benchmarks should spur banks to improve efficiency, cut wastage, and adapt new technologies to match the benchmark leader.

“It is only after benchmarking that we are able to find out if we are slow or below par in certain key processes”

i.e. qualitative and quantitative benchmarks. Qualitative benchmarks are related to processes and performance goals, i.e. turnaround time (TAT) which matters to most customers, rather than financial performance like sales, assets and volumes which matters to the management. Qualitative benchmarks make it easier to assess how far you have gone in closing the gap with the best players.

The next important question - with whom do we benchmark? We should first benchmark against our competitors or the best performing financial institutions at local or international level. Then, affiliates and subsidiaries which may be following

very high from these products. The benchmarks here are size of the loan and corresponding processing time. An article stated that a certain bank once released a mid-size consumer loan within a day. It might not be possible to replicate this feat on a regular basis; however, it does give us a target to aim at.

Tellers and front office services are other areas where aggressive and strict standards can be benchmarked. Certain banks in China for instance have set a time limit of two minutes for any current account transaction, six minutes for foreign currency transaction. Customers processed beyond these times were to be paid (US\$: 0.12 cents) for each minute of

Significance of benchmarking can be gauged from the fact that last year the UAE's Bank Federation (UBF), which has representation of all banks in UAE, decided to introduce a code of conduct for all its members, to regulate service quality. The said code consists of standards that should be followed by banks while serving customers, dealing in interbank transactions, recruitment, market conduct, relations with regulators, etc.

It is only after benchmarking that we are able to find out if we are slow or below par in certain key processes. The perceived gap with the best performer should be the basis of our continuous improvement programs and goals. Even if one is found to be the best in certain areas, one would still benefit from knowing how far behind the second best in the industry is.

It keeps one on a continuous learning curve which, after all, is the key to progress.

SMARTER *with* SECUR1TY

Ensuring data security is now a key goal for banks, as Andrew Stone explains in the third of our series on restoring trust in the industry.

By Andrew Stone



The widespread damage wreaked by the Heartbleed software vulnerability that emerged in the spring of 2014 was a reminder to the world of the threats faced by every organisation with data to protect.

Preventing customer data falling into the hands of malicious hackers and fraudsters is fundamental to the trust between customers and their banks. Happily, it seems the bug has not compromised the banks' security. "The banks' systems are robust and have held up well to comparable external threats over the years," says Stephen Bonner, Head of Information Protection and Business Resilience, KPMG.

But Heartbleed and vulnerabilities like it are a concern because they have affected both computer and some mobile phone operating systems alike. And it is the retail banking sector, where fraudsters try to steal customer information, often through malware and viruses, that has been the most vulnerable area in the past.

The rapid rise of computer banking and, even more rapidly, of mobile banking on smartphones would seem to increase the risks. Mobile logins exceeded internet logins last year.

But paradoxically perhaps, far from creating new vulnerabilities to protect against, the rapid migration to mobile banking now underway looks like being a boon for the banks in security terms and could even be an invaluable way for the banks to improve substantially their standing with customers by giving them back a sense of control as well as trust.

The fraud figures certainly seem to suggest there's good news here. "As more people are moving to mobile banking, we are seeing a 20 per cent drop in online banking fraud from last year to this year," says Bonner. "Of course, attackers will innovate and move on but computing from a desktop is easier for fraudsters to target than from a mobile. From an

organised crime point of view, the story is a very good one.

"The move to mobile has also allowed banks to reinvent themselves, to start from scratch and ask what features and capabilities they are looking for. In the early days we saw some errors but they are good at monitoring and fixing them rapidly. Generally they are making the right choices.

"Smartphones offer many ways to improve security, not least thanks to the richness of information they provide. For example, the location capabilities of smartphones allow the banks to feel comfortable about who they are talking to. There are good capabilities being deployed by banks at the back end too, analysis of trends and behaviours offering richer insights into how data theft and fraud happens and how it can be prevented.

"Innovation in mobile banking methods and technologies is abundant the world over and banks in the UK and beyond can learn from each other," says Niklas Olsson, a Senior Consultant at Mapa Research, in a report for e Consultancy.

Giving customers a sense of control over their data security is emerging as a powerful incentive for them. Olsson cites New Zealand's [my]bank, which allows customers to personalise the level of functionality available in its banking app depending on their security preferences such as password and PIN, and the option to use two-factor authentication or not. Balancing security with ease of use is becoming a key consideration as smartphone

banking grows. A growing number of banks no longer require customers to login using the same credentials as for internet banking, as this often proves lengthy and cumbersome. "This has certainly sped up processes and we believe it is one of the key reasons why mobile banking usage has accelerated at such a pace," says Olsson in the report.

In the Netherlands and Belgium, a number of banks allow customers to set daily or weekly payment limits as part of their app registration. This enables them to use a PIN and then carry out transactions without the need for further authentication or a card reader.

Convenience, control and security for the customer and efficiencies for the banks can also go hand in hand. Enabling users to block a debit or credit card can save the bank money and give the customer a sense of control.

Educating customers and making them part of the process is happening in other ways too. "More and more banks communicate with customers via text message or push notifications to confirm sensitive tasks and keep customers up-to-date on the latest developments," says Olsson. "This brings customers closer to their finances and enables them to quickly take action.

"Biometrics is another emerging means of verifying customers and protecting their data from prying eyes. And it seems retail customers are eager to try it. Ericsson's "10 hot consumer trends 2014" report revealed that 52 per cent of smartphone users want to use their fingerprint instead of passwords. Biometric options are coming on a range of smartphones, including the iPhone 5 and Samsung's new Galaxy 5 (although, worryingly, the latter's fingerprint reader was

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TAKE A STAKE

There's more to protecting data than making mobile banking secure from cyber fraud with new technology. A particular vulnerability when it comes to data security also comes from within, and banks need to implement the right internal technologies and, just as important, processes and culture if they are to protect their data.

So says Jamie Graves, CEO of ZoneFox, which specialises in helping customers protect their data and IP by providing "next generation" data monitoring and analytics. "It's typical of any organization to focus on the external, to create a strong wall around the organisation, but neglect the internal systems," says Graves.

"Securing your data and other information assets is entirely to do with culture in the organisation in any sector, not just the banks. Without a security-minded culture, they will not have the right processes to protect their data. They also need a good idea of where the risks lie, which in part relies on knowing where their critical assets lie."

From a security-minded culture will stem the right processes, including an "ongoing feedback process", says Graves. "They also need to make staff feel they have a stake in security with clear ideas about roles and responsibilities and

training so that they know what is normal and what is not normal behaviour.

"Without these things, the insights on data leaks and policy violation provided through technology from the likes of ZoneFox are of limited or little use, says Graves.

**"WITHOUT A SECURITY
MINDED CULTURE, THEY
WILL NOT HAVE THE RIGHT
PROCESSES TO PROTECT
THEIR DATA."**

And the fact is that culture and processes are often found wanting. One UK bank only learned of employee fraud through a story in a national newspaper that some of its customer data had been sold to and used by fraudsters.

It was an indictment of the bank's culture, says Graves. "They should have known pretty quickly through their whistleblower programme but it took the whistleblower to go to a newspaper.

"There are a lot of organisations not getting it right but many also recognize that this is another business - critical process they need to implement. It's not scary. If banks can understand financial market risk they are capable of understanding data security risks from a high level."

reportedly hacked just days after its release). Voice biometrics are already being used by Barclays (UK) Wealth and Investment Management in its call centres, with 93 percent of customers awarding the bank nine out of ten for speed, ease of use and security.

Biometrics is even becoming a point of competitive advantage, says Bonner. "We are seeing banks, like Spain's INSA Bank, marketing security biometrics features, and of customers being proud of the way they protect themselves, and in the process attracting 100,000 new customers. There's competitive advantage in being the bank that is seen as the most secure yet still accessible.

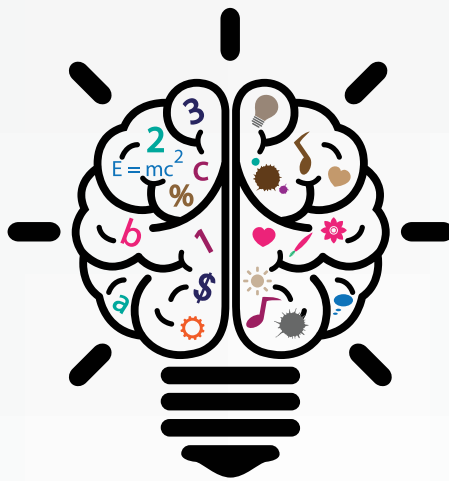
"There is a growing recognition from the banks that they need to think more about the customer in this way. For many the historical approach was how to protect bank assets. Now it's about how to protect customers and their experience and their trust. That has led to much of the innovation we are seeing now," Bonner adds.

"But there is a trade-off. Customers want to check their balance and perhaps do small transactions in seconds rather than get a second security device out. But for larger transactions, they welcome greater security and are happy to jump through more hoops. It tells them 'the bank cares about me'.

Should the industry be worried that no single secure mobile banking model or technology has emerged, and should those who have yet to fully engage perhaps wait for one to emerge? Bonner thinks not. "There are several emerging models but they all seem to be working well.

"It's very difficult to see what the standard will be and it may be that diversity will make the sector stronger because fraudsters have to do more research and work to break the various systems."

This article was first published in Chartered Banker, the magazine of the Chartered Banker Institute



CREDIT RATING OF BANKING SECTOR

DEBUNKING MYTH

AND

ESTABLISHING FACT

By Saira Rizwan

Glancing at Pakistan's rating universe, it is observed that the financial sector, particularly commercial banks enjoy higher ratings. In this article, the author tries to validate the common observation:

**'BANKS ENJOY HIGHER RATINGS
MYTH OR FACT?**

Ratings have two fundamental and unique features which are used by stakeholders to their benefit. Firstly, they reflect, and in turn, define credit risk of an underlying entity and secondly, place the entities on a relative scale to highlight their positioning for drawing comparisons. Notably, the Rating Universe comprises of a diversified pool of rated entities irrespective of their businesses and operating geographies. There is an extensive list of benefits enjoyed by rated entities. However, rating's significance is of paramount

importance in case of banks as they are trusted with our money – the deposits.

Pakistan's banking sector includes 28 commercial banks, both public and privately owned, categorized into large, medium and small on the basis of deposit base. The commercial banks, when placed on the rating scale with respect to their outstanding ratings at end-Jun14, depict that most of them came in AA (Very Strong) category. On the other side, all other rated entities mainly concentrate in A (Strong) category. The trend has been upheld with banking sector in terms of maintaining its relative positioning and distance from other sectors in the past as well.

Expanding our canvas and probing further, an interesting observation can be seen. Over the years, there has been a demonstrated stability in the banks' ratings.

Taking the discussion ahead, we will identify and rationalize key reasons to corroborate the above conclusion:

A SECTOR WITH TACIT MONOPOLY

Banking, among other various economic businesses, has travelled a long way and eventually evolved as a mature industry of today's world. Presently, in most of the developing economies including Pakistan, the sector enjoys stability-led-growth phase as depicted by sector's characteristics including:

- Products on offer are mainly standardized with established markets
- Competition hovers around pricing offered, volume of transactions and quality of service

Although the sector has correlation with economic growth, it is capable of finding green pastures in tough times

business risk of banking industry has come down to fit an equation of medium risk-return. At the same time, sizeable profits mitigate the impact of economic volatility. As a result, the sector has developed a tacit monopoly despite having number of players.

BANKING – A REGULATED SECTOR

Locally, banking is a highly regulated sector which is rigorously monitored by the Central bank – the State Bank of Pakistan (SBP). The Regulator places stringent regulations/directives including guidelines mainly to protect the interests of depositors. This, while serving the key purpose, has had a positive impact on the sector. Banking sector's standing on account of high degree of documentation in comparison to other sectors of economy, its contribution to national exchequer, provision of business and trade solutions and rendering employment opportunities at all levels across the country is considered strong.

Being regulated, the sector enjoys the following key advantages:

a) Independent Performance Review:

SBP, apart from external auditors, conducts annual financial and quality control review including physical inspections to ensure adherence with regulations and guidelines. Along with strong regulation, monitoring and enforcement capacity of the SBP, a number of measures have been taken to put best corporate governance practices in the banking system. 'Fit and proper' criteria has been prescribed for Chief Executives, members of the Boards of Directors and top management positions.

b) Expanded Business Scope:

Given the inherent nature of banking business, banking services are not limited to Pakistan. Catering for export and import transactions, the banks are exposed to a wide array of regulations

applicable in different geographical regimes. This gives the sector opportunities to adopt best practices and bring efficiencies in their operating platform.

c) Up gradation in Technological Infrastructure:

Banking technology has been revolutionized in the recent years. Thanks to the Regulator, which due to its focus to protect and facilitate the key stakeholder (depositors) has brought mandatory reforms through technological infrastructural up gradation. As a result, the quality of customer service has improved notably in terms of access to online banking, internet banking, ATMs, mobile phone banking and other modes of facilitation. Added advantages to the banks include reduction in transaction costs and enhanced business volumes.

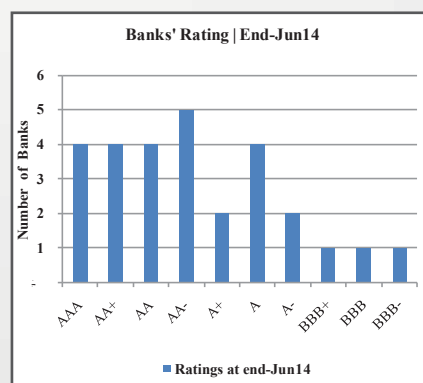
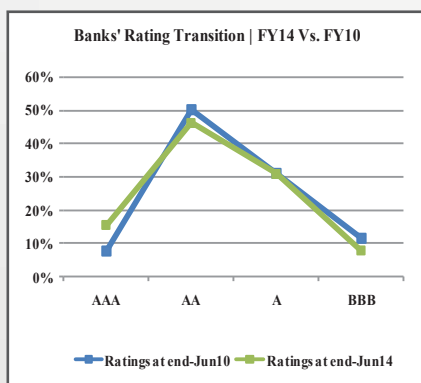
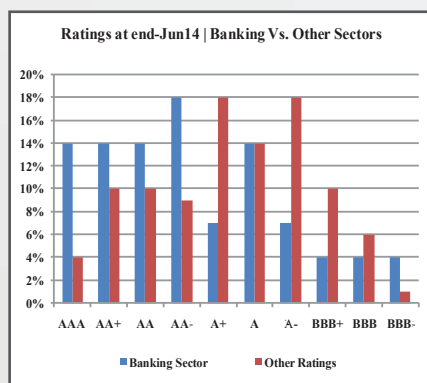
d) Reduced Competition

The Regulator has defined a Minimum Capital Requirement of PKR 10bln for any commercial bank operating in Pakistan. This implicitly creates a barrier for new entrants, thereby limiting further competition.

e) Documentation Benefits

In terms of maintaining robust data bank for diversified usage including economic and emerging trends, performance analysis and evaluation, streamlining processes and bringing efficiencies to overall structure and timeliness.

It can be concluded that (i) ratings uniquely capture the relative differences, both quantitative and qualitative, among banks despite the fact that they are rated higher in the rating universe and (ii) the structural formation of banking sector, well augmented by an independent and strong regulator, supports higher ratings of the sector in the rating universe. This trend is expected to continue in the future.



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Frequently Asked Questions of **RELATIONSHIP MANAGEMENT** In Corporate Banking

By Kashif Sohail

The high end corporate clientele of any bank, usually consisting of top-tier borrowers is handled by the Corporate Banking Division of the bank. Like all other segments, specialized people, tagged as Relationship Managers are hired to understand and entertain the clients' present needs as well as emerging banking requirements.

The relationship management starts with the understanding & assessment of client's needs, its business model, product life cycle, industry dynamics and above all, the actual/ genuine financing requirements. As somebody said "A well thought-out problem is half solved".

Apart from purely quantitative evaluation techniques/ tools like ratio analyses of financials, projection of sensitized scenarios, peer group studies, correlation tests with industry benchmarks, security cushion calculations etc., there are some fundamental subjective/ qualitative questions which should be pondered over by each & every credit chain member and especially by the originator i.e. Relationship Manager, before the initiation of relationship and proceeding with the financing proposition:

- Am I internally convinced over the proposition?

Besides using the analytical techniques, RM should attune himself to the use of intuition. Strong intuition is one of the traits of a good RM which he should keep on grooming with the passage of time. Use of intuition, in return, not only provides an insight of the account but also gives the vibes about any unforeseen detrimental aspects of the relationship. After satisfying the internal question-marks, if any, one should move ahead with the proposition, internally convinced, after accounting for the impact of the offhand factors.

- Will the funds be used for the intended purpose?

This question should also be on top of the list while initiating any credit proposition. Straight lending leads to the misuse of funds which in

turn gives birth to the hardcore accounts. Raising propositions for vanilla facilities open-up the blanket way which may even ditch the low leveraged clients in the long run like slow-poisoning. Hence, it's also a matter of self-accountability which an RM should especially assume while initiating a proposal so as to ensure that the funds, if obtained, will be used for the intended purpose. Structured and transactional facilities are therefore encouraged and recommended, keeping in view the captioned factor in mind.

- What will be the bank's position in case of any externality?

This is an important question on my list which should be answered, prior to moving ahead. Some readers may push to attach this factor with traditional principles of lending claiming that the recourse of the bank would be towards those areas like Cash-flows, Capital, Collateral, Character etc.

However, keeping in view the certain associated risks while realizing the above factors, one may tilt towards finding some other way-out:

- Cash-flows become negative/ insufficient for servicing the debt in case of deterioration in the financial health of a company.
- Capital erodes/ dilutes over the passage of time if the company is

either incurring persistent losses or is not used to plough back the profits.

- Collateral may not be easily realizable in case of economic meltdown or hard to confiscate in the present sluggish judicial system.
- Character dies with the sponsors in case of death.

What is the thing which can be relied upon in case on an externality? The right answer is commitment. If the company carries the culture of commitment from top to bottom i.e. from sponsors to management team, then this question or question-mark could be eliminated to a large extent. Precisely, the culture of commitment should have been appearing in the core values of the company and must have also pass down to the 2nd generation & 2nd line management. This sort of determination would only keep the company committed to serve its obligation in every thick and thin. A good test of this factor could be the views of the company's long-time associated unsecured creditors.

Conclusively, the above views are largely inspired by few quotes of some legendary bankers which in turn, can also be used in support of this:

"Credit is nothing but common sense."

“Lending is not an art but prudent lending is”

what the future holds for the USE OF CASH

By Brane Bertonce & Laura Godler

The future is inherently uncertain and unpredictable. Answering the question of what the future holds for cash usage calls for an interdisciplinary approach. Experts have been predicting the “cashless society” ever since the introduction of the first payment cards. However, over 50 years later, an assessment of the situation shows that we are no closer to reaching this stage. Nevertheless, over the last 20 years the number of cashless payment instruments has more than doubled, the growing volume of e-business being the driving force for their increased frequency.

Paying by card has become an everyday practice, while e-banking services have become increasingly important, so it is not surprising that the market share of cash usage is falling, albeit slowly, and it now accounts for a declining proportion of the overall payments structure. The scope of cashless payment is growing worldwide, which indicates the gradual shift of money usage from cash to cashless payment instruments.



INTRODUCTION

Cash still remains the most frequently used payment instrument, accounting for 8-9 out of every 10 transactions (World Payments Report, 2011). According to an European Central Bank (ECB) analysis, a European citizen performs 300-400 cash transactions annually, collectively accounting for over 100 billion transactions (ECB, 2013). However, competition between emerging alternative payment instruments and cash is becoming increasingly fierce. We live in an electronic era, consequently cash as a payment instrument is becoming costlier and more of a security risk. Making payments in cash is slower (although, according to a survey in Germany consumers answered that cash payments are the fastest) and consequently less welcome. The question that arises in this context is whether the more recent payment instruments will in time partly or completely eliminate cash usage, or whether cash will remain a significant payment instrument in the future due to its special attributes¹.

ASSESSMENT OF THE SITUATION

The table 1 shows data from four of the most prominent payment markets: Brazil, euro area, South Africa, and the United States of America (USA). The table indicates a substantially higher share of cash relative to GDP in the euro area (9.25%) compared to other economies. The cost of cash usage rises in line with its increased circulation (average growth rate of euro cash stood at 10.6% in the period 2002–2011; Figure 1). The euro area is also

notable for the number of commercial bank branches (180,639), which did not significantly change in the period 2006-2010.

This also holds true for the remaining three markets. The number of ATMs (of which the USA has the most) grew in all four markets during the same period. Due to new technology and economies of scale, cash centres are being established, and these contribute to the greater centralization of the cash cycle (counting, sorting and transport of cash). However, the number of bank branches is expected to be approximately halved by 2020, in particular due to the centralisation of the cash cycle (AGIS, 2012)².

The USA represents the largest cashless payment market in the world (accounting for a 40% share in 2009), so it is not surprising that this is where the largest number of electronic transactions per person is recorded.

Growing demand for cash in the euro area over the last decade (euro cash in circulation has more than tripled in the 2002-2013 period) can be mainly attributed to the growing economy and private consumption, increased demand from non-residents (this is the most important factor), together with the reminder from the financial crisis in 2008³ that cash remains an important element of the modern financial system (according to ECB data the additional demand for cash caused by the financial crisis, in September and October 2008, stood at €35 billion). In addition, cash is of key significance for the operation of certain segments of the economy, particularly payments for small

purchases of goods and services, evidenced by the fact that cash is used more frequently for transactions of lower value. Cash usage is strongly linked to way of life, with the place where people usually shop being particularly important (e.g. in small shops cash operations are prevalent, while the majority of payments in department stores are made using payment cards). An increasing number of purchases are made over the internet, which reduces cash usage, however it should be noted that certain e-tailers have also started offering the option of payment in cash for goods and services. In this case consumers pay in cash at a nearby sales outlet for the goods they have bought online. This also allows individuals without a payment card to purchase items over the internet, enabling online companies to reduce the number of outlets and so keep down their operating costs.

Figure 1 shows the value and structure of euro cash in circulation in the period 2002 – 2011. Euro cash in circulation, since its introduction in 2002, has been rising constantly, and by the end of March 2013 reached €896.4 billion (a total of 15.2 billion banknotes).

Cash usage differs from one country to another. Spaniards, Austrians and Italians are considered intensive users of cash, while cash is used less frequently in France, Finland, and the Netherlands. The Netherlands is an example of a country where the number as well as the value of cash transactions declined over the period 2007-2010. A possible explanation for this phenomenon could be the promotion of payment card usage by banks, retailers and the central bank, which consequently increased the scope of card transactions. The effect of the aforementioned campaign declined in 2010, meaning that a certain threshold exists, up to which individuals consider it worthwhile (are willing) to replace cash with payment cards. Once this threshold is passed, the reduction in cash usage becomes less practical or too expensive.

ADVANTAGES AND DISADVANTAGES OF CASH USAGE

What are the main reasons people still most often use cash despite the emergence of other forms of payment?

- Acceptability. Cash is a universally accepted payment instrument that can be used by anyone (even people without a bank account, children, the illiterate, is

Table 1. Significant data for Brazil, the euro area, South Africa, and USA

	Brazil	Euro area	South Africa	USA
GDP 2010 (in USD billions)	2,088	12,140	364	14,587
Population (in 2010, in millions)	195	331	50	309
GDP per capita (in USD in 2010)	10,707	36,566	7,280	47,207
Banknotes in circulation (in USD billions, 2010)	81	1,113	11	942
Banknotes in circulation (in millions of units, 2010)	4,815	14,171	962	30,350
Cash in circulation/GDP in %	3.88	9.25	3.02	6.09
Commercial bank branches	31,657	108,639	3,429	110,465
Number of ATMs	155,566	319,717	23,259	425,000
ATM density (ATM per million people)	712	966	429	1,359
Number of electronic transactions per capita	102	166	44	320

Source: AGIS, 2012.

etc.). Buying goods or services with cash requires no special technology; its use is quick and simple, facilitating a wide range of transactions – from low value to high value transactions that may exceed the limits on credit cards. There are restrictions in some countries that above certain thresholds cash payments are not allowed, e.g. above €1,000 in Italy.

- **Anonymity.** It is the only payment instrument where no data needs to be exchanged between the transaction participants, preventing potential identity theft, invasion of individual privacy, etc. Nevertheless the anonymity of cash is limited, as the law requires reports on certain transaction be sent to government authorities. In addition certain countries limit the use of cash to prevent tax evasion.
- **Trust.** This attribute derived from the fact that cash is a legal means of payment issued exclusively by a central bank and guaranteed by the government. Trust also depends on the quality of the banknote and coin production and detection of counterfeits.
- **Payment in cash also enables proper control over their own consumption, as individuals have the sense that they have a good overview of their finances⁴.** This advantage of cash is one of the drawbacks of many of its substitutes, e.g. payment cards, which can allow consumers to spend more funds than are available. Furthermore, payment in cash

is more comprehensible and “tangible” than paying by credit card. This is particularly an issue for older individuals who are far more inclined towards cash usage than the younger generation (Seitz, 2013).

Therefore cash has a number of special attributes that set a lower threshold on the decline in its use by consumers. Once individuals reach that threshold, replacing cash with other payment instruments no longer makes sense, as it is too expensive or less practical, for instance (such as in the Netherlands’ case). The location of this threshold and time within which it is reached by an individual depends mainly on the availability of alternative means of payment.

Like any means of payment, cash also has certain drawbacks. It is often considered inconvenient, and it gets dirty after lengthy use. Moreover, counterfeits and security issues can also be problematic. In substituting cash, e-business plays a prominent role, and its global significance is growing all the time. There are therefore constraints on cash payment, which are making cashless instruments increasingly appealing to consumers. Cash costs, particularly processing, transportation, security and insurance costs related to cash work in favour of cashless payment instruments. In addition we have to consider the opportunity cost of holding cash and the infrastructure costs required for the normal distribution of cash to end-consumers. These costs should continue to grow (AGIS, 2012).

CASH DEMAND FACTORS

Psychological view of cash usage

Given that sight deposits at a credit institution are a totally liquid instrument, the question arises as to why people wish to physically hold cash. The psychology of money is a fascinating topic, as many people express strong emotions on the question of cash. To some, money is the most important thing in the world, while others despise it or associate it with power, and the list could go on. All this affects the never-ending discussion about the true significance of money, and how much it contributes to people’s happiness.

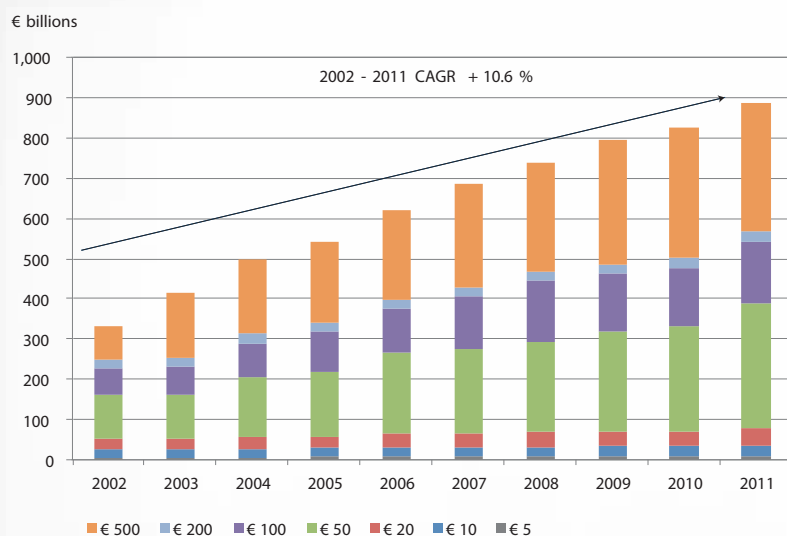
Psychologists have found that cash has a much stronger psychological impact on individuals than wealth in the form of deposits or shares. Interestingly, the power of cash in terms of its impact on behavioural patterns is not defined by cultural, geographical or other factors. The impact of cash on an individual’s psychological processes is always mainly positive. Individuals start feeling more secure and self-confident, and get the sense that they can achieve more. In simple terms, a wallet stuffed with banknotes represents external confirmation of worth.

Demand for cash

Several theoretical economic models as well as econometric approaches exist that try to capture the motives and factors affecting cash demand. Economic theory suggests that cash demand is influenced by transactional, speculative and precautionary motives. Transactional demand relates to consumers’ need cash for to settle everyday transactions, speculative demand relates to the opportunity cost of holding cash, while precautionary demand covers the economic entities’ need for additional liquidity to meet unexpected expenses. Demand for cash may be both domestic and foreign, and in both cases it may be used for transactions and hoarding purposes.

Despite the substantial differences between the models, all of them assume that the volume of money in circulation is negatively linked to interest rates as a measure of opportunity costs (speculative part⁵) and positively linked to a transaction variable, e.g. consumption (transaction part). Consequently, empirical analyses are also founded on this presumption. If we discuss money in a narrower

Figure 1. Demand for euro cash



sense (banknotes and coins), it makes sense to include variables relating to the use of alternative payment instruments in the analysis, i.e. number of payment cards, number of traders who accept payment cards, number of ATMs and point of sale (POS) terminals, etc. Econometric analyses have mostly found a negative relationship between payment card usage and cash demand, while the results are slightly more ambiguous in terms of the effect ATMs have on cash usage. Boeschoten (1992) studied the impact of various alternative payment instruments on cash usage in the Netherlands and came to the conclusion that payments using debit cards are negatively correlated to cash usage (ATM withdrawals). Based on data derived from the US economy, Duca and Whitesell (1995) found a negative correlation between the ownership of credit cards and the volume of cash and cheques individuals held. The results of the analyses conducted by Snellman, Vesala and Humphrey (2001) based on data gathered from ten European countries showed a negative impact of the number of POS terminals and ATMs on the volume of cash held by individuals. Rinaldi (2001) came to similar findings based on data gathered from Belgium. On the other hand, based on data for 16 OECD countries, Drehmann, Goodhart and Krueger (2002) found no statistically significant impact of the number of POS terminals and ATMs on cash demand. Based on data for Italy, Attanasio, Jappelli and Guiso (2002) also came to similar conclusions.

Bertoncelj and Miklavičič (2006) assessed the cash demand function relative to economic, technological and criminal factors. They found that the considered elements of the model only hold a partial explanatory power and clarify most of the variability part only for economic variables. The two explanatory variables that best explained the trend in the proportion of cash in GDP, are interest rate and consumption per capita, which is in line with the cash demand theory. Two more noteworthy authors deserve a mention, namely: Janssen (1998), with the portfolio model that is generally used in analysing demand for money in the wider sense; and Seitz (2003), with the money model assuming the utility function. The money demand model above takes into account the grey economy or tax evasion and foreign demand for domestic money.

From the above broad spectrum of empirical studies, it is evident that their results fail to demonstrate truly reliable indicators on the basis of which we could draw conclusions (make forecasts) about the future of cash usage. It would be interesting to study the effect of state coercion or legislation (e.g. cash usage on the account of an individual, limitation of cash transactions, etc.) on cash usage.

GREY AND ILLEGAL ECONOMY

The term grey economy relates to any form of illegal activity directed towards generating profit for a person's own benefit and on his/her account, to the detriment of other economic agents. The broadly used and accepted term "grey economy" is difficult to define accurately, since it appears in various forms of economic and other activity. There are at least two manifestations of the grey economy: (firstly) as a non-formal economy (a deviation from legal norms) and (secondly) illegal economy (conducting operations outside the legal framework and applicable regulations).

The size of the grey economy cannot be measured precisely, and can only be estimated, since countries have no accurate data available to them on the phenomenon in question. Essentially, a continual 'game' of avoiding the legal rules takes place between specific legal and natural persons on one hand and national legislation on the other.⁶ In practice the scope of grey economy is often assessed through the money approach. This approach assumes that the majority of payments within the grey economy are settled in cash. This could imply that the development of events in the grey economy or in its most significant components may also be reflected in the development of cash demand [Fischer et al. (2004), p.28]. This theoretical model shows that a positive correlation

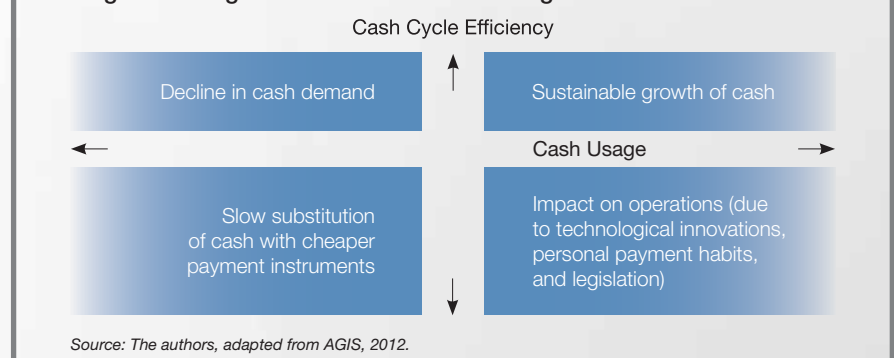
between cash in circulation and a marginal tax rate implies that an increase in taxes boosts cash demand and thus its usage rises, which may be linked to tax evasion. In this case the scope of grey economy may grow within a specific economy.

According to Fischer's model, the unemployment rate is positively correlated to cash in circulation. There is a background assumption that when unemployment rises, cash usage also increases, as the unemployed try to partially substitute lost income with undeclared work that is usually paid in cash.

LONG-TERM SCENARIOS FOR THE FUTURE OF CASH USAGE

With the development of alternative payment instruments, the proportion of cash payments, and thereby the global significance of cash, is diminishing. Replacement of cash does not occur by itself but depends on consumer decisions on cash usage and its substitutes in the future. It should be taken into account that the majority of consumers are conservative regarding their payment habits. The elderly are a prime example, since some cannot use certain payment instruments (for example, many of them have no access to a computer and therefore cannot purchase goods online). The study carried out by Deutsche Bundesbank (2012) showed that almost 60% of Germans intend to continue using payment instruments familiar to them and that they have used in the past. This leads us to believe that cash will remain a prominent payment instrument in the future. Nevertheless, we cannot overlook several deficiencies of cash usage, which have been successfully compensated for by some of its substitutes. Authors of the study "The Future of Cash" (AGIS, 2012) identified three likely and one less likely scenario relating to the future of cash, and these

Figure 2. Long-term scenarios of cash usage



Source: The authors, adapted from AGIS, 2012.

depend on the (i) efficiency of the cash cycle and (ii) cash usage in the future.

Figure 2 shows all four scenarios in terms of the aforementioned variables.

- Decline in cash demand. The efficiency of the cash cycle would be adequate, however it would not be reflected in increased cash demand. This scenario is less likely.
- Slow substitution of cash with cheaper payment instruments. The realization of this scenario would imply stronger competition between cash and its cheaper substitutes, which could lead to gradual elimination (usage reduction) of cash as a means of payment. This is unlikely in the near future, so this scenario is purely long-term.
- Sustainable growth of cash. This scenario corresponds to increased cash usage as well as to its greater efficiency in the future, resulting from appropriate organisational and social and economic developments.

It remains to be seen which of the scenarios will prevail, however it is very likely that despite fierce competition, cash will continue to play an essential role due to its fundamental attributes (acceptability, anonymity, trust, and control). Given the increase in the number of cash “competitors”, reduction in the costs of its production, processing and distribution to end-consumers will be vital, and this can be achieved through the use of new technologies, improving processes, and through the optimisation of cash inventories, etc. Innovations will most likely benefit cash usage, as they increase its accessibility and expand its availability in addition to improving its efficiency and convenience.

TECHNOLOGICAL INNOVATION: BIOMETRIC CERTIFICATION “PAY-BY-TOUCH”

When we think about the future of cash, it is worth mentioning a cashless payment system that has gained in significance in recent years: a technological innovation in the form of biometric authentication of payment. It is based on automatic identification of a person based on physical attributes (fingerprints, palm structure, iris pattern, etc.) and behavioural characteristics (hand-writing, voice structure, etc.).

The most common biometric payment method is the fingerprint payment. Often two-factor authentication is applied where a Personal Identification Number (PIN) code needs to be entered as well as finger scanning to authorise a transaction [Search Security: Biometric Payment (2013)].

The biometric authentication system as an alternative payment system brings many benefits. It raises the level of security by adding an extra authentication factor - “something that you are” that can be added to the “something that you know” (PIN code) and “something that you have” (smart card). This minimises the possibility of misuse. Research shows that users generally trust identification using their physical attributes more than password-based identification. Use of biometric authentication as a payment instrument also represents an advantage for merchants, since it results in lower costs for payment transactions compared to payment cards [Biometric Payments, Morpho (2013)]. Critics of biometric authentication are concerned that through the adoption of this system various governmental institutions could access data on payments by individuals that are private in nature. It should be noted that the biometric payment system (like any system that accesses sensitive information) is only as safe as the databases and transactions associated with it.

One question that arises is whether such a payment system represents competition for cash or cashless operations and why its availability is not more widespread if it is in fact appropriate? Is this due to biometric payment systems being too expensive, risky and an invasion of privacy, or is it due to the slow spread of payment innovations and persistence of payment habits, or both?

CONCLUSION

Money was never a silent and passive instrument, and never “stuck” for long at one place or in the same hands. Cash is a form of money which allows to settle a liability immediately and definitively and is therefore inherently absolutely liquid. Cash payment is simple, since the payer hands over a banknote (or coin) to the payment recipient, thus completing the transaction. Given the cash in circulation trends, the two authors believe that we are no closer to a completely cashless society, indeed this scenario is actually becoming increasingly remote.

The future is always somewhat uncertain and the future of cash is definitely no exception. There is a trend towards substituting cash with alternative payment instruments, but it should be noted that this is not a self-propelling process, since each consumer decides how he or she wishes to settle financial liabilities. However, we must take into account the conservative nature of many consumers in terms of their payment habits. All this leads us to believe that cash will remain a prominent payment instrument in the future. Nevertheless, numerous advantages of other payment instruments cannot be overlooked.

Recently a number of studies have been carried out that have tried to answer the question of the future of cash. The authors of these studies find that competition between cash and cashless payment is becoming stronger, which is also reflected in the increased frequency of payment card use, electronic payment, mobile payment, etc. However, they believe that cash will remain an effective and appropriate mechanism for doing business in the future. In order for cash (particularly banknotes) to remain as useful in the future as it is today, it is necessary to ensure its simple and low-cost availability and usage for individuals. We believe that this issue will be decided by consumers, as the most prominent point of reference in this case. They will determine the volume of cash they wish to hold.

1. *The usage of digital money in the form of Bitcoins was one of the most recent attempts to replace cash.*

2. AGIS Consulting (Boissonas Eric, Jean-Yves Ray, Christopher George), (2012). *The Future of Cash*, p. 6, 7, 10, 16, 19, 20, 34, 35, 41-43. [URL: <http://www.agis-consulting.com/documents/AGIS-Consulting-Future-of-cash-2012.pdf>].

3. *Priority use of cash when natural disasters occur (e.g. tsunami in Japan) or when a financial crisis develops (e.g. Cyprus).*

4. *See for example Stix, Schmidt and Kalkkreuth (2011). Using cash to monitor liquidity - implications for payments, currency demand and withdrawal behavior, ECB Working Paper No. 1385.*

5. *Also transactions demand, see Baumol-Tobin model.*

6. *For some estimates on the amounts of grey economy see for example Schneider: Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2013: A Further Decline, 2013.*

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Social **SUCCESS**

By Lisa Drysdale

More and more businesses are harnessing social media to drive customer growth strategies. Lisa Drysdale examines the financial services brands making an impact with the channel and leading the way for the rest of the industry.

Businesses everywhere are using social media to drive acquisition, retention and customer growth strategies in ways they'd never have imagined just a few years ago. Even in the financial services sector, there seems to be a greater acceptance of the mixing of "business" and "social".

While US entities still lead the way, banks and financial services companies across mainland Europe are increasingly using a range of channels - from Facebook and Twitter to YouTube and LinkedIn - to connect more closely to people's financial lives. Yet there's still a reticence among many UK banks and financial services companies to use social media to its full potential.

Nordea, Northern Europe's largest financial services group, is doing great things with social media. Rune KibsgaardSjohelle is Head of Brand Management and Social Media for the Nordea group and Head of Communications for Nordea in Norway. After initially just dipping its toe in the water to see who was talking about the bank online, Sjohelle says that Nordea now takes a very proactive stance on social media.

The bank's wake-up call came a few years ago when it suffered what Sjohelle calls a "social media attack" initiated by the NGO Avaaz. This was in response to its concerns

around Nordea and other banks potentially funding a major pulp mill in Tasmania, a project deemed to have dire environmental consequences. Nordea was inundated with messages from its banking customers via Facebook, Twitter and email, inspiring the bank to think again about financing the project.

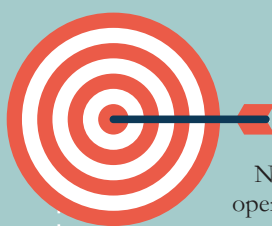
"That was an eye-opener, and at that point we were able to convince the management of the bank that we needed to be reactive and also proactive on social media, because the customers are there."

CUSTOMER SERVICE CHANNEL

Seeing how fast the airlines got information out to passengers via Facebook amidst the disruption caused by the Icelandic ash cloud chaos in 2010 served as further inspiration for Nordea to establish a social media presence, beginning with Facebook.

"We set up a system where our contact centre colleagues answer all incoming questions and comments on our Facebook pages," says Sjohelle.

"I've always said to my colleagues to take an hour and listen in to a customer service representative, because that's really a place to learn something about this bank. Having it now on Facebook really shows what kind of service our colleagues give and how dedicated they are to the customers."



Nordea now runs its customer service operation on Facebook 24/7, with the bank's contact centre answering questions and keeping the dialogue with customers alive while its marketing and communications teams take care of engagement-building activities.

Twitter is another priority channel for Nordea, but Sjøhelle recognises its differences – not least because people tend to follow tweets from other people rather than from brands.

This doesn't appear to be an issue for TSB, however. Since it split from Lloyds, the bank has been pursuing a marketing campaign that extols openness and transparency. A Twitter feed with 30,000 followers very much ties in with this positioning – and, like Nordea's Facebook page, serves as a complaints department. It's a good example of a UK bank using social media to its advantage, says Guy Garside of Consensus Research, a market research consultancy specialising in the financial sector.

"People are going to vent online; it's the way people air their frustrations nowadays," Garside explains. "So it's a way of turning the reactive strategy on its head, by getting something else out of it for the bank. TSB is able to demonstrate its transparency at the same time as reacting to something that it has to react to anyway."

"Everyone knows that people make mistakes and nobody's perfect, but the bank is being

"SOCIAL MEDIA IS NEVER GOING TO REPLACE A BANK MANAGER OR AN INVESTMENT MANAGER, BUT IT JUST GIVES YOU ANOTHER TOUCH POINT ON THE CLIENT JOURNEY."

really open about it and because of that you want to trust it."

BRAND BUILDING AND ENGAGEMENT

Garside still hears the criticism that banks are very distant and hard to relate to, with difficult-to-understand products. But he points out that if you go on Twitter and say that, TSB will respond – either over a few tweets or by inviting a direct message.

"One very nice touch is that replies carry a real person's initials," he says. "The bank isn't pretending to be just one person the whole time."

"SOCIAL MEDIA IS A WAY OF BUILDING A BRIDGE BETWEEN CUSTOMERS AND BANKS, WHICH SOME PEOPLE STILL THINK OF AS BIG IVORY TOWERS."

"Social media is a way of building a bridge between customers and banks, which some people still think of as big ivory towers. TSB is being proactive in that it wants to do as much as it can, and while there might not be a measurable, tangible benefit for the business, I think that it can really change people's perceptions of a bank."

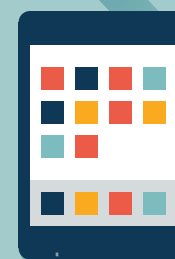
Even some smaller UK banks are getting behind social media as a way to talk more regularly to clients both new and existing. Duncan Lawrie, a small private bank with about 4,000 clients, began around three years ago to develop a broader strategic communications plan, in which digital in general and social media in particular play an important part.

"Our target market covers a more mature demographic, but they're really embracing social media now," says Jane Parry, Director and Head of Marketing and Business Development at Duncan Lawrie Private Bank. "So actually what we were finding was while our peer group weren't necessarily active on social media, some of our clients and target market were."

"People want to check you out quite early if they're thinking about moving banks, and social media is quite an early entry into the client journey. We felt we needed to go beyond our website to have a wider digital presence because that's what people search for now."

As well as being a means for Duncan Lawrie Private Bank to increase brand awareness and communicate its very human brand values, social media provides the bank with a platform for thought leadership – whether content originates from Duncan Lawrie Private Bank or elsewhere. What's key is that any item highlighted by the bank should resonate with its audience.

"Because our relationship managers are so close to their clients, we understand what they're worried about and what they're talking to their friends about," Parry says. "It means that we can highlight items we feel will be of



interest and relevant to them. If a client trusts the Duncan Lawrie Private Bank brand, it can act as a bit of a shortcut for them to useful information in the social media space.

“We are a small bank with few branches, but social media provides a cost-effective way to create presence, so you can punch above your weight. It’s never going to replace a bank manager or an investment manager, but it just gives you another touch point on the client journey.”

MITIGATING RISK

While Sjøhelle says he rarely sees anyone who is against social media, he’s aware that many people still don’t understand it. This includes employees of banks, of course, and so Nordea trains and monitors all those who serve as its official voice. For everyone else, there are useful guidelines, for example, around how to manage work-related and personal social media accounts, and the importance of observing Nordea’s confidentiality agreement.

Says Sjøhelle: “Everything is open and as long as you are an employee you will be connected to your workplace, regardless of whether you call it personal or not. There is no such thing in my view as private tweeting.”

It’s important to put controls in place to ensure that social conversations are real, authentic and safe. Restricting access too much, however, can be counterproductive. Social media should give a voice to individuals at all levels so that they may share good

“WE NEEDED TO GO BEYOND OUR WEBSITE TO HAVE A WIDER DIGITAL PRESENCE BECAUSE THAT’S WHAT PEOPLE SEARCH FOR NOW.”

news from across the organisation.

“Ultimately, it’s brand advocacy,” says Andy Holmes of Actiance. “If I work for a bank and I like working for that bank, and I’ve got 500 followers, then I’m effectively sharing the name of the bank and I’m hopefully building new customers.”

Actiance is one of a new breed of tech companies set up to respond to the inherent risks associated with a wider user base. Focused chiefly on the needs of the financial services industry, Actiance offers a compliance platform for social media – in essence a safety net, so that inappropriate or ill-advised tweets are moderated or blocked, or at least captured on record. It’s a means of controlling what’s said about an organisation in a way that satisfies the business and the marketing objective as well as the regulator.

Holmes explains: “What we have is this at times conflicting point of view between the business and marketing, which really want to work very hard to get everybody social, and compliance or content owners, who perceive a risk more than the benefits.

“Some of it is generational and some of it is wholly understandable, because it goes hand in hand with responsibility, inappropriate use and all sorts of regulatory issues. In a lot of cases what we’ve seen as the outcome is a very limited authorised user base.”

CONSTANTLY EVOLVING

Quantifying the value and business impact of social strategies across the customer journey is not without its challenges. But although the return may be intangible, the investment need not be considerable. According to Sjøhelle, Nordea in Sweden typically fields around 8,000 phone calls a day and just 20 or so questions posted on Facebook.

“Social media has matured,” says Sjøhelle. “You still find updates about what people are eating for dinner, but people have realised that it can be used for so many different things.

“Facebook has developed into quite an effective marketing tool where you can reach a highly targeted number of people. If you want to reach men aged 35 to 40 living in the Oslo area, who own a car and are interested in sports, you can find them on Facebook, and you can have very targeted advertising. I think we’re just seeing the tip of the iceberg of how that’s going to develop.”

As social media continues to evolve, each change brings with it new opportunities and risks. Critically, it’s becoming increasingly clear that social media is here to stay – and that it’s no longer possible to opt out altogether.

“The thing about social media is you can’t say you’re not on it, or it’s not something you do,” says Garside. “Because if people are on Twitter and Facebook talking about you, then you are on social media. You can either choose to ignore that or you can do what some banks are doing now and actually engage with these people.”

This article was first published in Chartered Banker, the magazine of the Chartered Banker Institute

BENEFIT OF HINDSIGHT

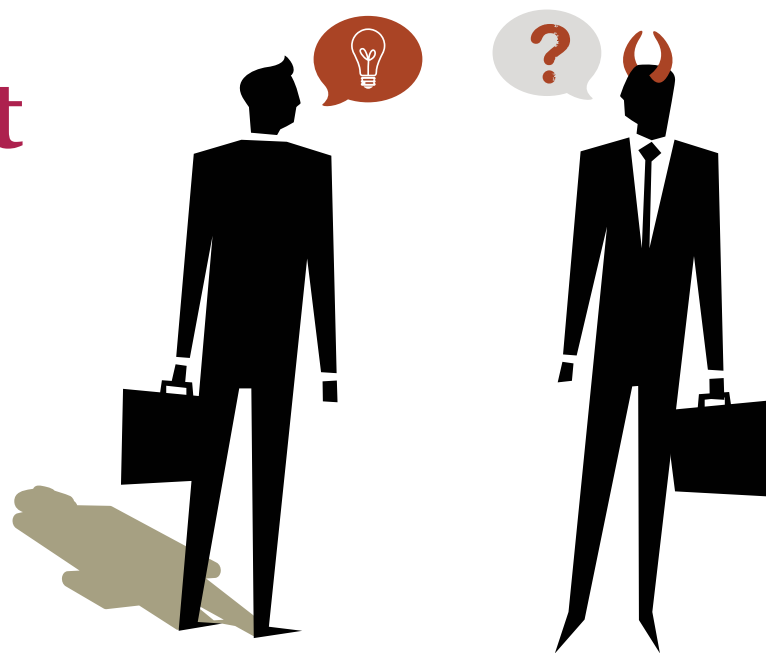
Some now famously short-sighted predictions about technology, as recounted by Rune Kibsgaard Sjøhelle of Nordea at his address to the Financial Services Club, Oslo, in March 2014.

- “I think there is a world market for maybe five computers.”
Thomas Watson, IBM, 1943
- “Computers in the future may weigh no more than 1.5 tons.”
Popular Mechanics, 1949
- “There is no reason anyone would want a computer in their home.”
Ken Olsen, Digital Equipment Corporation, 1977
- “The Internet is a fad.” Clifford Stoll, 1995
- “Next Christmas the iPod will be dead, finished, gone, kaput.”
Sir Alan Sugar, 2005

Why Conduct is Critical

By Bob Souster

With the banking industry still on the road to restoring trust, BOB SOUSTER examines the highly-charged issue of business conduct.



THE CHALLENGE

Tom is a retail operations manager working for ZYX Bank plc, and heads a team of customer relationship managers across 25 branches. Their role is to develop new business and maintain lasting customer relations.

In recent months, Tom has come under some pressure from his general manager because his team has under-performed against targets set by head office as well as in comparison with teams in other regions.

In the last month, two of Tom's customer relationship managers have left the bank to pursue other business interests, and he has decided to recruit replacements who will adopt a more pro-active, and perhaps more aggressive, style when working with customers. He feels that this is the quickest way to address the disparity in performance between his team and those working for his peers. Tom has considerable discretion in recruiting and selecting new managers, including setting the rewards offered to them, provided these remain broadly within limits set by senior management.

Unusually, two external applicants work for a subsidiary of the bank's parent organisation – within a consumer finance company that offers personal

loans for home improvements, cars, holidays and debt consolidation purposes. The applicants stood out from others at the first interviews, and displayed ambition, positive attitudes and a willingness to take on the new challenges offered. Both came across as extremely extrovert and even aggressive, with strong opinions on how business should be done. When comparing them with other candidates, Tom instinctively considered these two to be those most likely to help him achieve his own targets. However, he also knew that the company for which they currently worked "sailed close to the wind" in relation to compliance with selling standards, and had on occasions been subject to intervention by the regulator in respect of treating customers fairly. The interviewees brushed these concerns aside, taking the view that financial services products are sold, not bought, and that customers often needed to be told what was best for them.

"The applicants stood out from others at the first interviews, and displayed ambition, positive attitudes and a willingness to take on the new challenges offered."

Tom was faced with a dilemma, in that the two candidates who stood out were culturally very different in attitudes and behaviours to his own colleagues in ZYX Bank plc. Just as the bank empowered Tom to use discretion in doing his own job, in turn the bank permitted customer relationship managers considerable freedom in developing their own contacts in the way that best suited their personalities. An added concern was that both applicants sought salaries at the very top end of the grades offered by ZYX Bank plc. Tom knew that the best prospect of achieving his own targets was to employ these individuals, but at the same time he worried that their attitudes to business in general, and their embedded views on customer relationships, could come at a high price financially through high salaries, and with some danger of adversely affecting the standards currently adopted in ZYX Bank plc. Either way, Tom had to act now and was mindful that his own position would be at risk if he could not turn around the performance of his team very quickly.

What are the ethical threats arising from Tom's dilemma, and how should he act?

THE ANALYSIS

The scenario concerns business conduct, and also organisational culture. Both have crucial relevance to ethical standards in banking.

Business conduct is firmly in the spotlight, and it is significant that one of the earliest initiatives of the Financial Conduct Authority (FCA), when established in 2013, was to address conduct risk in the context of financial services providers meeting their obligations to treat customers fairly. Financial services providers occupy many diverse markets in which their approaches to business development and the ways in which customers are treated vary widely. Historically, the market for consumer finance has been highly competitive and in some cases much more aggressive than the world of retail banking. This is not to say that consumer finance organisations are “bad” and banks are “good”; the competitive environment is entirely different, and it is no coincidence that retail banks that offer consumer finance often do so through subsidiaries that operate quite autonomously within the marketing group. It should not be surprising to Tom that those who are expected to sell financing packages to car dealerships, or negotiate with repossessions companies, or set up debt consolidation contracts with heavily-indebted borrowers, will have a totally different approach to their business than customer relationship managers in a retail bank.

One theoretical model that explores how these cultural dimensions apply to different organisations is that proposed by Deal and Kennedy. Their model, published in 1982, considered two

dimensions of organisational culture: the risk involved in making a poor decision and the time it takes to discover whether the decision was right or wrong. The world of consumer finance belongs to the typology that Deal and Kennedy refer to as “tough guy, macho”... decisions are high risk, and there is quite rapid feedback on whether the decision paid off or not. This is one reason why ineffective business developers are unlikely to last long if they cannot meet their targets. If risk is high and feedback is slower, this can give rise to a “bet your company” outcome, as the company will sit on risks that remain inert for some time. By contrast, retail banking conforms rather more to lower risk (due to parameters set by centralised decision makers) and longer feedback horizons, a typology dubbed by Deal and Kennedy as “process”. This being the case, Tom should have expected some fundamental differences in approaches to business from the two applicants. It is no coincidence that it was Deal and Kennedy who first defined organisational culture as “the way things get done around here”.

Tom has no short-term formula through which he can judge whether the applicants will be truly suitable customer relationship managers in ZYX Bank plc. He knows that they offer the best prospect of improving his own team’s performance, and ultimately of keeping his own job. But will these new personnel be prepared to take on board and maintain the standards expected of them? Much would depend on factors such as induction, training, how values are reinforced and maintained and so on. Some of these factors would be within



Tom’s influence, while others would not. In this case, the risk is exacerbated by the decentralised approach of ZYX Bank plc and the freedoms afforded to its managers.

The most basic definition of ethics is the study of right and wrong. Tom’s duty is to do what is best for the bank, not for himself. If he is confident that the standards expected of his new colleagues will be aligned to the expectations of the bank, he may go ahead and recruit these candidates. If he feels that they cannot handle the cultural shift necessary without compromising the bank’s values, he may discover belatedly that he has done irreparable damage to both bank and customers. And they will have paid more for the privilege through the higher salaries demanded and offered.

The candidates were right to the extent that financial products are sold, not bought. However, customers usually find this out for themselves only when it is too late, and the reputation that has taken years to build has been sacrificed in a moment.

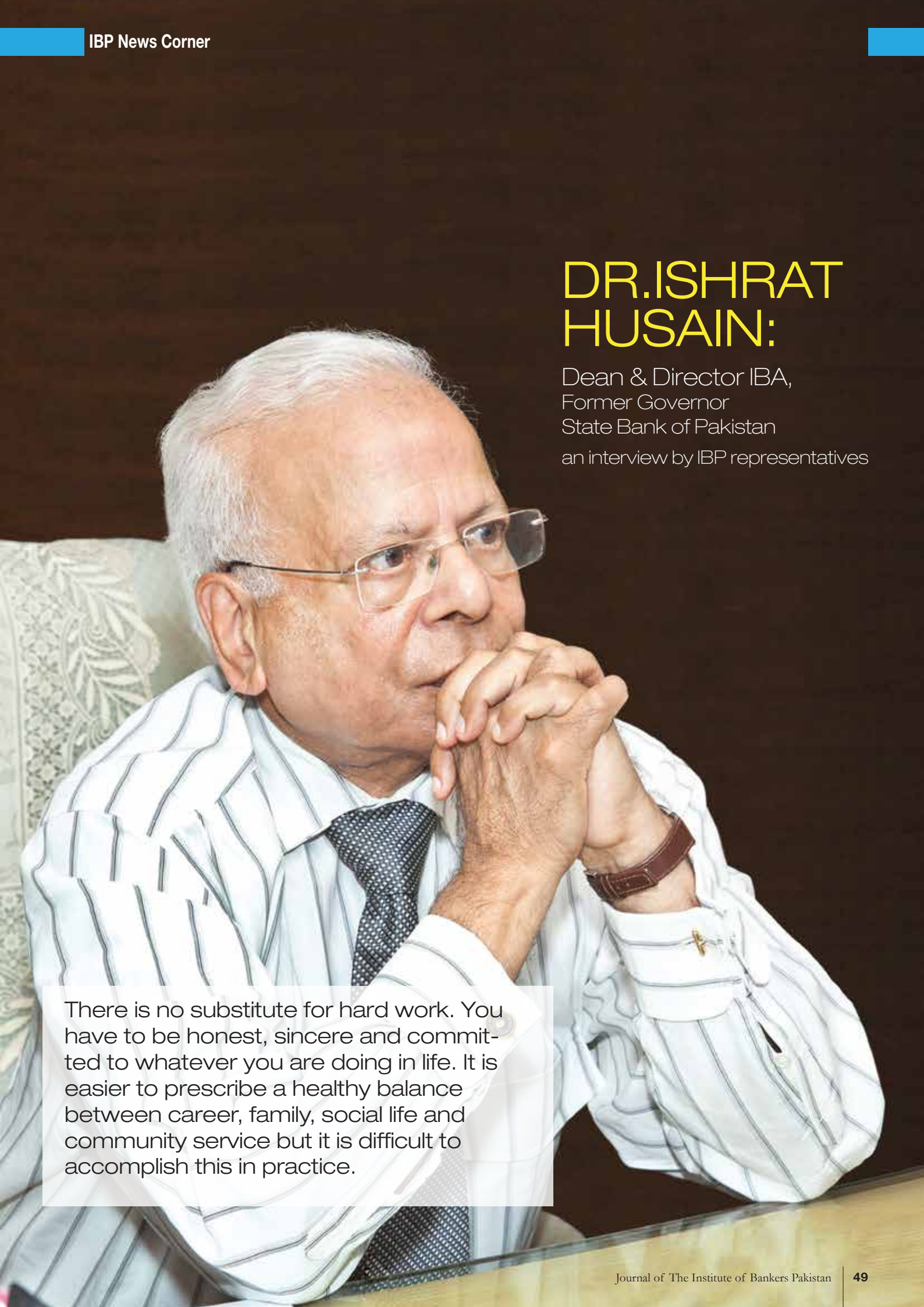
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Historically, the market for consumer finance has been highly competitive and in some cases much more aggressive than the world of retail banking.”

DR. ISHRAT HUSAIN:

Dean & Director IBA,
Former Governor
State Bank of Pakistan

an interview by IBP representatives



There is no substitute for hard work. You have to be honest, sincere and committed to whatever you are doing in life. It is easier to prescribe a healthy balance between career, family, social life and community service but it is difficult to accomplish this in practice.

We have seen an increased awareness of Islamic Banking in Pakistan during the last decade, what scope do you see of such an expansion?

Dr. Ishrat: Pakistani customers of banking services have been given the option of choosing between the conventional and Islamic banking. The share of Islamic Banks has reached 10 percent of total assets today and is growing quite rapidly. In my view, the scope of expansion of Islamic banking in Pakistan is quite wide.

What, in your idea, is the reason that some foreign banks are wrapping up their businesses from Pakistan?

Dr. Ishrat: The economies of scale and scope, the large network, low cost deposit base all favor big banks. Small banks with a few branches and limited services and products will not be able to compete in this market.

State Bank of Pakistan (SBP) has always been putting its efforts to encourage the savings at consumers' end, but general public is not fairly aware of the purpose of various schemes offered. How to educate such consumers?

Dr. Ishrat: It is the responsibility of the banks, insurance companies, asset management companies, National Savings Schemes, Pension Funds, Brokerage houses to work together on public awareness and consumer Education and coming up with easy to understand materials through

electronic and print media. They have to develop new liability products for those at the bottom of the barrel.

IBP has been serving the banking industry since its inception in 1951 to provide for a recognized qualification in

The economies of scale and scope, the large network, low cost deposit base all favor big banks. Small banks with a few branches and limited services and products will not be able to compete in this market.

banking. How effective has our qualification been in meeting the challenges banking industry is facing and in what areas we need to further improve?

Dr. Ishrat: The challenges the banking industry face do change from time to time. IBP has to be responsive in the range of its offerings to the dynamic needs of the industry at various levels. IBP has to play a leading role in promoting Financial Inclusion – both through field studies and training the bankers.

What contribution do you think Institute of Bankers Pakistan (IBP) has made while developing a human base for financial industry?

Dr. Ishrat: In my view, the IBP has met the requirements of the industry at the entry level but it has to cater to the middle and higher levels of human resources. Even for those at the entry

level they have to be trained in tools and techniques of SME financing, housing finance, agriculture credit etc. the sectors that have been neglected so far but have great potential for income generation of the poor and thus poverty reduction in the country.

Institute of Bankers Pakistan (IBP) has been working in association internationally with Chartered Bankers of U.K and locally with various universities including IBA. How it can further serve the banking industry in the academic area including in area of research?

Dr. Ishrat: The Collaboration with the Chartered Banking of UK is indeed welcome but it has to be deepened as that those who qualify here are able to be treated at par in international financial markets. The IBP- Universities in Pakistan collaboration has not produced much and needs to be reviewed and solidified.

IBP has collaborated with IBA in BS program in Accounting and Finance, whereby students are able to gain the JAIBP (Junior Associate-ship of IBP) qualification by studying the requisite subjects during their studies at the



IBA. Similarly, IBP should collaborate with other top universities as well.

Despite the lack of education, unemployment and the arising inflation, what contribution our youth can play in making the economy better?

Dr. Ishrat: We have a skill mismatch-abundance of unemployable matriculates, intermediates and degree holders and at the same time unfulfilled demand for nurses, technicians, mechanics, electricians, plumbers etc. Education and training for vocations, technical skills and para medical, para engineering and allied subjects has to be given great boost.

You have been honored with countless awards nationally

and internationally. Can you share few of the major achievements?

Dr. Ishrat: I was bestowed the honor of Hilal-e-Imtiaz by the President of Pakistan. The Banker Magazine, London (a subsidiary of Financial Times) gave me an award of the Central Bank Governor of the year for Asia'. The Asian Banker Magazine of Singapore conferred the Life time Achievement award, Jinnah Society selected me for the Jinnah award.

You have been a role model for a lot of people, as a successful banker, economist, academician and person. What recipes of work life balance would you share ensuring the successful career simultaneously?

Dr. Ishrat: The only recipe I would suggest is that there is no substitute for hard work. You have to be honest, sincere and committed to whatever you are doing in life. It is easier to prescribe a healthy balance between career, family, social life and community service but it is difficult to accomplish this in practice.

How do you think the current political unrest in Pakistan is going to affect the economy?

Dr. Ishrat: It is difficult to make precise quantitative estimates but political unrest and the floods will affect the economy adversely.

Interview conducted by Institute of Bankers Pakistan

VIEWS ON BANKERS ON A LIGHTER SIDE

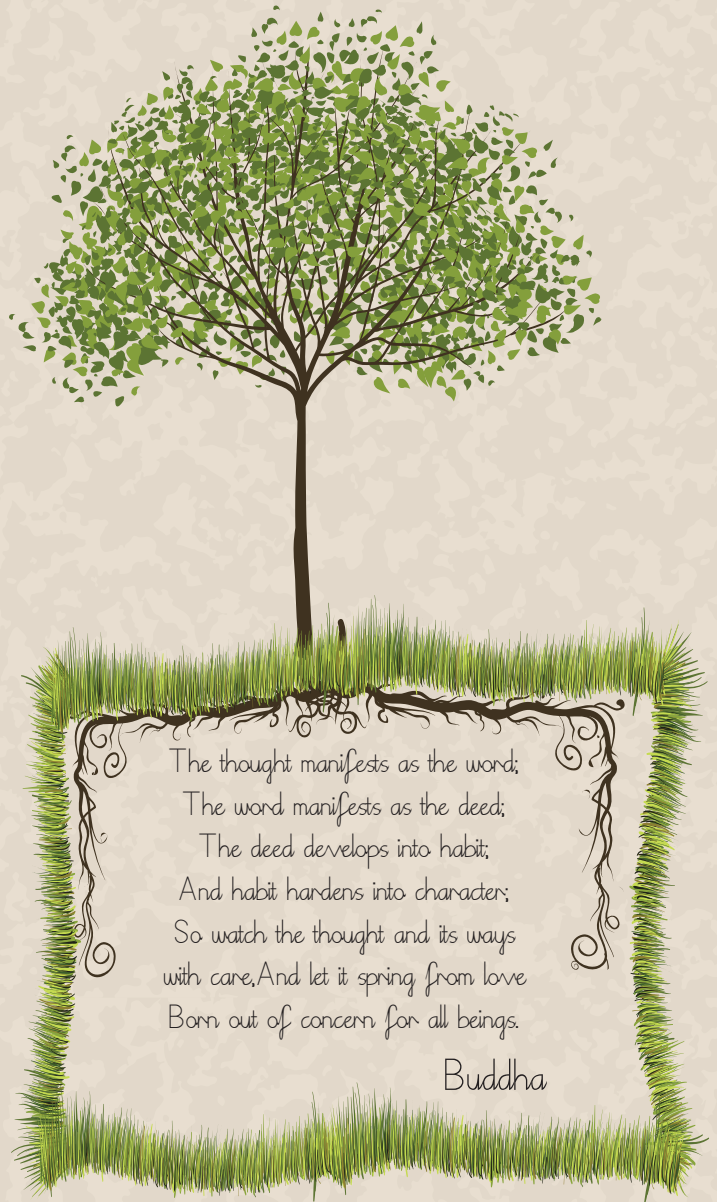
A bank is a place that will
lend you money if you can
prove that you don't
need it. **Bob Hope**

That's the policy

A customer moves away from a bank
window, counts his change, and then
goes back and says to the cashier,
"Hey, you gave me the wrong change!"

"Sir, you stepped away from the
counter," said the cashier. "We don't
make corrections after you leave.
There's nothing I can do about it now.
That's the policy of this bank."

"Well, ok," answered the customer.
"Just thought you'd like to know that
you gave me an extra twenty. Bye."



The thought manifests as the word;
The word manifests as the deed;
The deed develops into habit;
And habit hardens into character;
So watch the thought and its ways
with care, And let it spring from love
Born out of concern for all beings.

Buddha

Interesting Quotes

I don't count my sit-ups; I only start counting when it starts hurting because they're the only ones that count. - Muhammad Ali

The world is a dangerous place to live; not because of the people who are evil, but because of the people who don't do anything about it. - Albert Einstein

"I'm bored" is a useless thing to say. I mean, you live in a great, big, vast world that you've seen none percent of. Even the inside of your own mind is endless; it goes on forever, inwardly, do you understand? The fact that you're alive is amazing, so you don't get to say 'I'm bored' - Louis CK

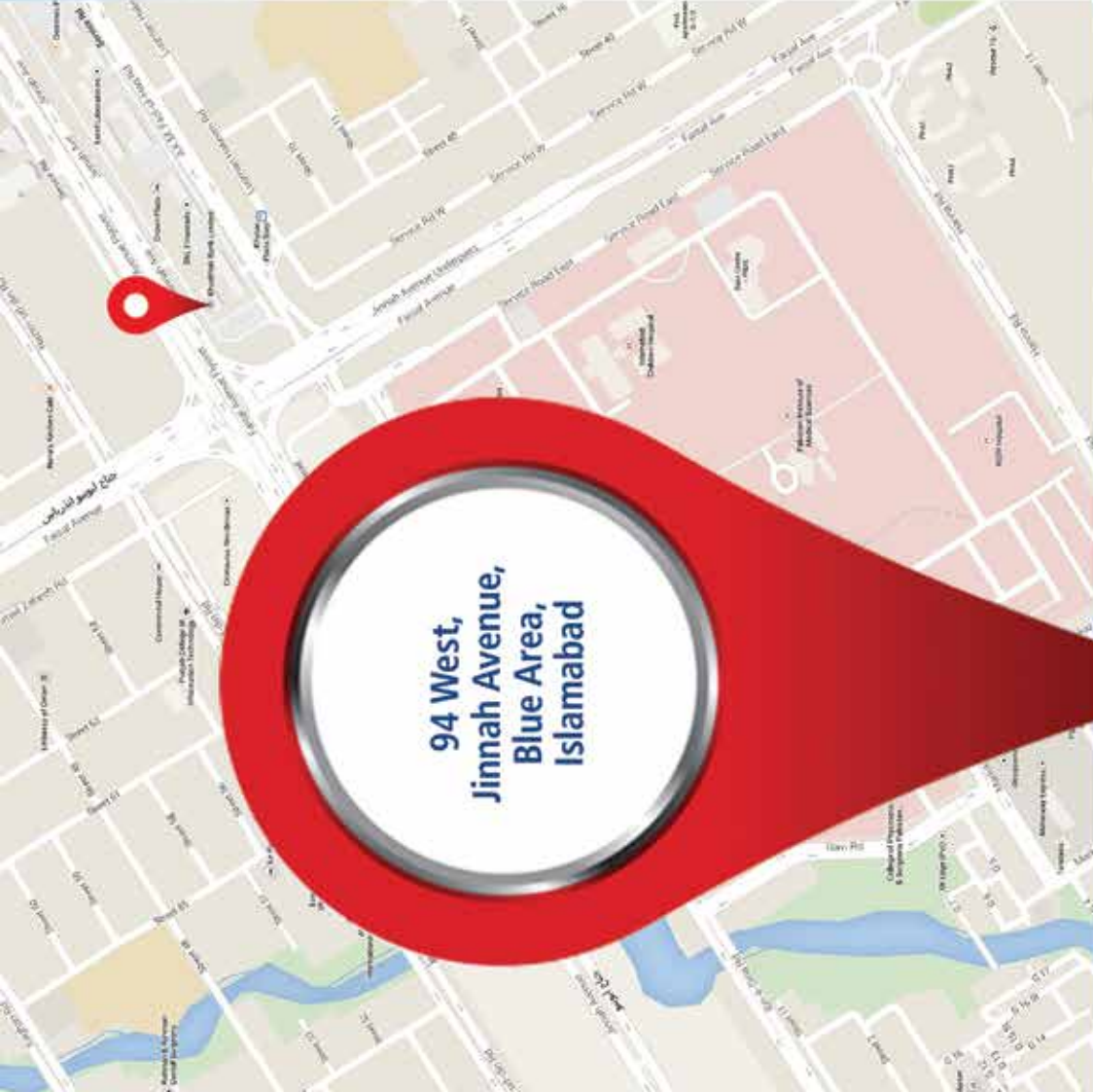
Elegance is achieved when all that is superfluous has been discarded and the human being discovers simplicity and concentration: the simpler and more sober the posture, the more beautiful it will be. --Paulo Coelho

A society grows great when old men plant trees whose shade they know they shall never sit in. Anonymous



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