Bankers

Park is the Institute of

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December 2013

**Headwinds on Banking Margins** 

Who is the Arthi?

Understanding the Commission Agent's Role in the Agriculture Supply Chain

**Building with the BITS** 

**Process of Delegation** 

Sovereigns that still have Triple A Credit Rating



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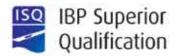
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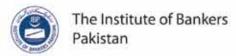
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## First Meeting' IBP HR WORKING GROUP



The Institute of Bankers Pakistan hosted the first meeting of the IBP HR Working Group on November 28, 2013 under the chairmanship of Mr. Naved A. Khan, (President- Faysal Bank) Chairman of IBP's Academic Board and Vice President of the Institute. The meeting was held at IBP and was attended by 30 delegates from 22 banks and financial institutions.

The IBP HR Working Group is an initiative by the Institute to bring together the HR, learning and development teams of banks in an effort to understand their developmental needs along with introduction of various initiatives that the IBP has undertaken.

As per the agenda circulated ahead of the meeting, Chief Executive - IBP provided a comprehensive overview of

the IBP's products and services including the Institute's banking qualification program ISQ which is accredited by Chartered Banker Institute, UK as well as Institute's training design capacity. He specifically discussed the improvements made to the Junior Associateship of the ISQ and shared the accreditation report from Chartered Banker. He proposed that the banking industry may consider making JAIBP a baseline qualification for the banking industry considering its depth, usefulness and impact for bankers (current and prospective). He also explained the efforts undertaken on training revamp at the Institute. He described how the IBP has moved from an instructor-led model to a standardcontent model and discussed the training methodology used. The group was apprised about IBP's efforts to introduce structured and standardized training content for the industry and the training design and delivery catalogue that has been launched by the Institute.

Mr. Naved A. Khan addressed the audience and brought their attention to two key areas of focus and paradigms which will become critical for success of any bank in years to come i.e. Operational Efficiency and Customer Service. Mr. Khan shared his views on the matter and elaborated that skilled human resource will differentiate a bank from its peers. Mr. Khan stressed the utmost importance of alignment of the L&D strategy of the bank with the institutional vision.

The final speaker was Mr. Faisal Farooq Khan, Head of HR, Bank Alfalah Limited (BAFL) who spoke about the HR and training needs of the banks in



THE GROUP WAS APPRISED ABOUT IBP'S EFFORTS TO INTRODUCE STRUCTURED AND STANDARDIZED TRAINING CONTENT FOR THE INDUSTRY AND THE TRAINING DESIGN AND DELIVERY CATALOGUE THAT HAS BEEN LAUNCHED BY THE INSTITUTE.





his view and how BAFL has used IBP's products and services to meet their requirements.

The meeting then began formally and the floor was opened for discussion. Comments and observations received from members of the working group were discussed and noted. The group agreed unanimously that a genuine need for quality content existed and that the content developed by IBP was in line with industry needs. The group also felt there was a need for trained and certified trainers in the industry. A section of the attendees requested IBP's support for e-learning platforms especially for areas where banks are required to train a significant number of employees (such as AML/CFT, etc.).

The meeting was well received and the initiative of the forum was appreciated by the industry as a good platform to share ideas, compare notes and brainstorm on common challenges.

To conclude, the IBP team invited all members to participate in the IBP Prize award ceremony to be held on December 5, 2013. The meeting ended with thanks to the chair with the next meeting scheduled for first quarter 2014.









## IBP PRIZE AWARD CEREMONY

December 5, 2013

The Chairman of the IBP's Academic Board Mr. Naved A. Khan (also Vice President of the Institute as noted above) in his key note address appreciated the efforts of all candidates and encouraged them to strive for further excellence. He also praised the efforts of the Institute for improvements in the qualification and wished the IBP further success. This was followed by the presidential address of the ceremony made by Mr. Wathra, Deputy Governor, SBP. He expressed his delight at being present at the event andelaborated that skilled human resource will differentiate a bank from its peers. He stressed that banks must align their strategies to ensure qualified staff at all levels. He also stressed on the importance of professional qualification for the bankers in Pakistan. He concluded by congratulating the medal winners, position holders and successful candidates. He endorsed the idea of making JAIBP a baseline qualification for bankers in Pakistan.

The Honorable Deputy Governor awarded certificates toqualifying candidates of Winter-2012 and Summer-2013. This was followed by prize awards for

meritorious candidates. A list of the prize winners is available on the following pages. As a tradition- the IBP awards three gold medals to the best candidate in each stage during the year.

#### **SPECIAL PRIZES**

- 1. BOP Award for scoring highest marks in all 3 stages in first attempt

  Omair Muhammad Khan

  Meezan Bank Limited
- 2. Deutsche Bank Award for scoring second highest marks in stage 1 in first attempt *Mehreen Riaz*United Bank Limited
- 3. IDBP Award for scoring second highest marks in stage 2 in first attempt Sundus Ghulam Nabi Faysal Bank Limited
- 4. NBP Award for scoring second highest marks in stage 3 in first attempt

  Tayyaba Rasheed Ahmed

  National Bank Of Pakistan

#### GOLD MEDALISTS FOR 2012

Sadaf Saleem, Habib Metropolitan Bank Limited

> Faisal Feroz Hirani, Askari Bank Limited

Syed Imran Abbas, National Bank of Pakistan

- 5. FWBL Award for scoring highest marks in stage 2 among female candidates in first attempt *Sundus Ghulam Nabi*Faysal Bank Limited
- 6. FWBL Award for scoring highest marks in stage 3 among female candidates in first attempt *Tayyaha Rasheed Ahmed*National Bank Of Pakistan
- 7. JSBL Young Banker Award of the Year for completing all 3 stages of ISQ Syed Talha Alam Soneri Bank Limited







#### PRIZES FOR 2012

1.	SUBJECT	Criteria	Awarding Bank	AWARDEE	AMAD DEE'C
1.					Awardee's Organization
	Business Communication for Financial Services	Scored highest marks	Standard Chartered Bank	Muhammad Tehsin Malik	Dubai Islamic Bank Pakistan Limited
2.	Business Communication for Financial Services	Scored second highest marks	Standard Chartered Bank	Muhammad Rizwan Baig	Standard Chartered Bank (Pakistan) Limited
3.	Introduction to Financial Systems & Banking Regulations	Scored highest marks	Allied Bank Limited	Umar Shahzad Aslam	State Bank Of Pakistan
4.	Introduction to Financial Systems & Banking Regulations	Scored second highest marks	Habib Bank Limited	Sara Rehman	Habib Bank Limited
5.	Information Technology in Financial Services	Scored highest marks	Allied Bank Limited	Umair Ahsan	Bank AL Habib Limited
6.	Information Technology in Financial Services	Scored second highest marks	Standard Chartered Bank	Muhammad Irfan	Bank Alfalah Limited
7.	Branch Banking	Scored highest marks	JS Bank Limited	Farheen Shuja	Askari Bank Limited
8.	Branch Banking	Scored second highest marks	United Bank Limited	Naureen Afzal	United Bank Limited
9.	Accounting for Financial Services	Scored highest marks	Bank Al Falah Limited	Ali Raza	MCB Bank Limited
10.	Accounting for Financial Services	Scored second highest marks	National Bank of Pakistan	Khawaja Jaffer Abbas	United Bank Limited
11.	Lending: Products,Operations and Risk Management	Scored highest marks	National Investment Trust	Muhammad Usman Janjua	National Bank Of Pakistan
12.	Lending: Products,Operations and Risk Management	Scored second highest marks	Standard Chartered Bank	Sheraz Ashraf Bajwa	National Bank Of Pakistan
13.	Human Resource Management and Organization Behaviour	Scored highest marks	United Bank Limited	Talal Shoukat	National Bank Of Pakistan
14.	Human Resource Management and Organization Behaviour	Scored second highest marks	Samba Bank Limited	Sania Imam	Faysal Bank Limited
15.	Economics	Scored highest marks	Standard Chartered Bank	Awais Ahmed Memon	State Bank Of Pakistan
16.	Economics	Scored second highest marks	Standard Chartered Bank	Danish Aslam Bhatti	Habib Metropolitan Bank Limited
17.	Marketing of Financial Services	Scored highest marks	Habib Bank Limited	Saba Sarfaraz	Soneri Bank Limited
18.	Marketing of Financial Services	Scored second highest marks	Allied Bank Limited	Khurram Munir	National Bank Of Pakistan
19.	Finance of International Trade and Related Treasury Operations	Scored highest marks	MCB Bank Limited	Nazia Khalid	MCB Bank Limited
20.	Finance of International Trade and Related Treasury Operations	Scored second highest marks	Citibank N.A.	Iffat Zahra	National Bank Of Pakistan
21.	Management Accounting for Financial Services	Scored highest marks	National Bank of Pakistan	Syed Imran Abbas	National Bank Of Pakistan
22.	Management Accounting for Financial Services	Scored second highest marks	NIB Bank Limited	Tayyaba Rasheed Ahmed	National Bank Of Pakistan
23.	Microfinance	Scored highest marks	Habib Bank Limited	Waqas Iftikhar	Bank AL Habib Limited
24.	Microfinance	Scored second highest marks	United Bank Limited	Ahsan Javed	The Bank Of Punjab
25.	Islamic Banking and Finance	Scored highest marks	Bank Al Habib Limited	Muhammad Komail Jivani	Bank AL Habib Limited
26.	Islamic Finance	Scored second highest marks	Bank AL Habib Limited	Muhammad Majid	MCB Bank Limited
27.	SME & Agricultural Finance	Scored highest marks	Zarai Tariqiati Bank Limited	Qasim Mehmood Khan	National Bank Of Pakistan
28.	SME & Agricultural Finance	Scored second highest marks	Zarai Tariqiati Bank Limited	Usman Hameed	National Bank Of Pakistan
29.	Retail & Consumer Banking Operations	Scored highest marks	Askari Bank Limited	Syed Musab Ahmad	National Bank Of Pakistan
30.	Retail & Consumer Banking Operations	Scored second highest marks	Askari Bank Limited	Rizwana Bashir	National Bank Of Pakistan

## IBP

### PRIZE Award Ceremony























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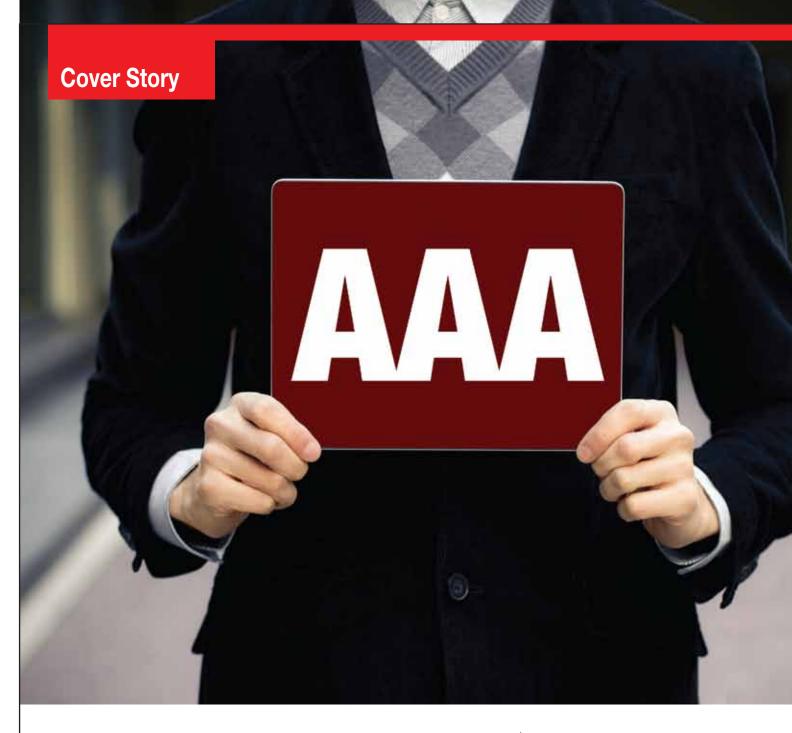
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## SOVEREIGNS that still have TRIPLE CREDIT RATING

By Humaira Jamil

The downgrade reflects our opinion that the Netherlands' growth prospects are now weaker than we had previously anticipated, and the real GDP per capita trend growth rate is persistently lower than that of peers," said Standard & Poor's (S&P) in a statement on November 29, 2013, stripping yet another euro zone member country of its Triple A 'AAA' credit rating. This whittles down the number of euro zone members with a top-notch credit rating to just three - Germany, Luxembourg and Finland.



	SOVEREIGNS THAT ARE STILL AAA				
	S&P	Moody's	FITCH	DAGONG	
	"The	ating Agencies	China		
Australia	AAA	Aaa	AAA	AAA	
Austria		Aaa <b>▼</b>	AAA		
Canada	AAA	Aaa	AAA		
Denmark	AAA	Aaa	AAA		
Finland	AAA	Aaa	AAA	AAA ▼	
Germany	AAA	Aaa ▼	AAA		
Hong Kong	AAA			AAA	
Isle of Man		Aaa			
Luxembourg	AAA	Aaa ▼	AAA	AAA	
Netherlands		Aaa ▼	AAA ▼		
New Zealand		Aaa			
Norway	AAA	Aaa	AAA	AAA	
Singapore	AAA	Aaa	AAA	AAA	
Sweden	AAA	Aaa	AAA	AAA	
Switzerland	AAA	Aaa	AAA	AAA	
UK	AAA ▼				
USA		Aaa	AAA [Rating Watch Negative] <sup>1</sup>		

<sup>&</sup>lt;sup>1</sup> In October 2013, amid a partial government shutdown and an impasse over the debt ceiling, Fitch placed the US's 'AAA' rating on negative watch, citing "political brinksmanship" that increases the risks of a U.S. default.

Source: Sovereign Rating Lists of S&P, Moody's, Fitch & Dagong (As of December 4, 2013)

Two of these mentioned AAAs are weak AAAs considering the fact that Moody's still rates Germany and

Luxembourg as AAA, but with a negative outlook. An outlook is a rating refinement which indicates the probability of a change in rating in the direction of the outlook.

How many Sovereigns are still 'AAA': According to S&P, there are twelve (12) AAAs with one weak AAA - UK. According to Moody's, there are fifteen (15) AAAs with four carrying a negative outlook - Austria, Germany, Luxembourg and Netherlands. Fitch has thirteen (13) AAAs with one carrying a negative outlook - Netherlands.

The debacle in 'AAA' sovereign ratings in the post-2008 credit meltdown era is phenomenal. After USA and France, it was UK, having a 'AAA' credit rating since 1978 from both Moody's and S&P, losing it in February 2013. In announcing the ratings cut, Moody's cited the "challenges that subdued medium-term growth prospects pose to the government's fiscal consolidation programme."

Sovereign credit ratings are a forward-looking assessment of a sovereign's capacity and willingness to honor its existing and future obligations in full and

on time. Sovereigns are assigned two credit ratings: the local-currency sovereign rating reflects the likelihood of default on debt issued (and payable) in the currency of the sovereign, while the foreign-currency rating is an assessment of the credit risk associated with debt issued in foreign currencies.

Typical characteristics of 'AAA' Sovereigns include:

• World's richest and often most diverse economies, with highest levels of human development (SEE FIGURE I). It is

CURRENCY SOVEREIGN RATING REFLECTS THE LIKELIHOOD OF DEFAULT ON DEBT ISSUED (AND PAYABLE) IN THE CURRENCY OF THE SOVEREIGN, WHILE THE FOREIGN-CURRENCY RATING IS AN ASSESSMENT OF THE CREDIT RISK ASSOCIATED WITH DEBT ISSUED IN FOREIGN CURRENCIES.

noteworthy that Luxembourg, by virtue of its growing financial services industry is forecasted to generate GDP per capita almost 50% greater than the USA.

- Entrenched political stability reflected in the form of a legitimate government equipped with a clear process for the orderly transfer of power.
- Strong institutional and governance structure, including respect for property rights and the rule of law, all reflected in a good business climate (SEE FIGURE II).
- Free and unhindered market access, underpinned by deep (large in absolute size with ease of buying and selling) local capital markets.
- Unmarked debt service record post-1930 depression.
- Credible and well-structured policy framework, consistent with a sustainable and balanced macroeconomic position; and shock resilience.

TABLE A:

- Track record of low and stable inflation.
- · Deep and stable tax revenue base.
- Robust Creditworthiness in the face of plausible extreme events.
- · High debt tolerance.

Even though low levels of government debt are positive for creditworthiness and sovereign ratings. 'AAA' Sovereigns defy logic as they do not necessarily have low or even moderate levels of government debt (SEE TABLE A).

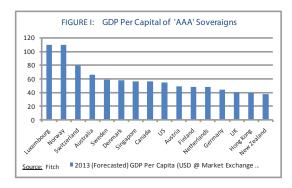
AAAs' other credit strengths compensate them for the potential drag on creditworthiness from public debt. They typically have debt denominated in their own currency and can issue at long maturity; while low interest rates hold down service costs. Hence, they enjoy what is termed financial flexibility.

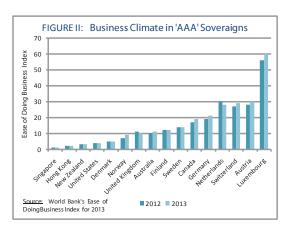
Financing flexibility refers to the capacity that these sovereigns have

75

94

Public indebtedness & Rise and Fall of AAAs





"THE DEBACLE IN
'AAA' SOVEREIGN
RATINGS IN THE
POST-2008 CREDIT
MELTDOWN ERA IS
PHENOMENAL.
AFTER USA AND
FRANCE, IT WAS UK,
HAVING A 'AAA'
CREDIT RATING
SINCE 1978 FROM
BOTH MOODY'S AND
S&P, LOSING IT IN
FEBRUARY 2013"

Country	Rating Action	Rating Action 1	GGGD 2 - % GDP
	Date		@ Rating Action Date
Finland	Aug 1998	Upgrade	48
Ireland	Dec 1998	Upgrade	54
Japan	Sep 1998	Downgrade	110
Singapore	May 2003	Upgrade	41
Denmark	Nov 2003	Upgrade	47
Spain	Dec 2003	Upgrade	49
Sweden	Mar 2004	Upgrade	50
Canada	Aug 2004	Upgrade	74
Ireland	Apr 2009	Downgrade	65
Spain	May 2010	Downgrade	62
Australia	Nov 2011	Upgrade	26
UK	Apr 2013	Downgrade	93
France	Jul 2013	Downgrade	94

<sup>&</sup>lt;sup>1</sup> Upgrade to 'AAA' OR Downgrade from 'AAA'

Downgrade

Downgrade

Source: Fitch, S&P

Netherlands 3

Nov 2013

Aug 2011

<sup>&</sup>lt;sup>2</sup> GGGD stands for General Government Gross Debt. The indicator is defined (in the Maastricht Treaty) as consolidated general government gross debt at nominal value outstanding at the end of the year in various categories of government liabilities

<sup>3</sup> Netherlands & USA downgraded from 'AAA' by S&P

### AAA SOVEREIGN CREDIT RATING DENOTES THE HIGHEST CREDIT QUALITY, HENCE, LOWEST EXPECTATION OF DEFAULT RISK.

to inflate their balance sheets sharply in the short-term to respond to economic and fiscal shocks. One reflection of this is non-resident holdings of their assets, which signify non residents' desire to invest in safe haven benchmark assets and reserve currencies of such sovereigns. Another is the reserve currency status. A strong reserve currency status makes it easier for these sovereigns' central banks to buy their own government debt, for instance, for quantitative easing or potentially to step in as buyers of last resort to prevent a run on the local currency (SEE TABLE B).

In the final analysis, a 'AAA' sovereign credit rating denotes the highest credit quality, hence, lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

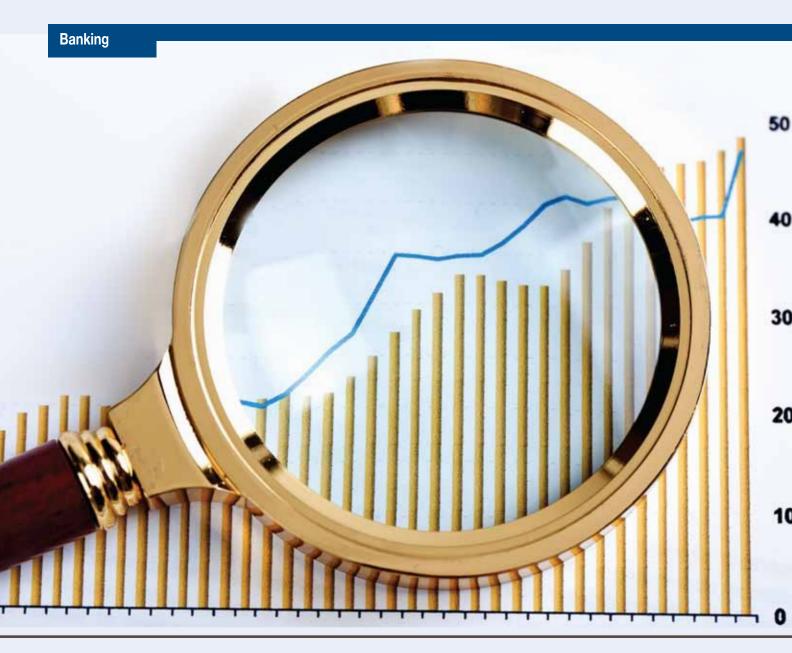
#### TABLE B: FINANCIAL FLEXIBILITY ENJOYED BY AAAS

Countries	GGGD- %GDP	Capital Market Size (USDbln)	Average Maturity of Public Debt (Years)	Non-Resident Holdings (% total)	Reserve Currency Status (Rank) <sup>2</sup>
US	107	53,823	5.3	55	3
UK	90	8,702	14.4	31	3
Germany	81	5,841	6.4	59	3
Canada	86	4,117	5.1	21	2
Netherlands	72	2,988	6.7	54	2
Austria	74	748	7.5	71	2
Australia	27	3,301	5.2	77	2
Sweden	38	1,335	5.6	43	1
Denmark	50	1,145	8	43	1
Singapore	111	708	3.2	n.a.	0
Finland	53	439	5.8	95	2
Switzerland	45	1,310	8.1	11	2
Norway	34	788	3.5	38	1
Hong Kong	33	1,369	n.a.	2	0
New Zealand	38	161	4.9	36	1
Luxembourg	21	808	3.6	n.a.	2

<sup>&</sup>lt;sup>1</sup> All data in this table pertains to 2012

Source: Fitch, IMF

<sup>&</sup>lt;sup>2</sup> Reserve Currency Status Ranks are from Fitch Sovereign Rating Model ['3' is the strongest]



By Saad Hashemy

JAN-SEP"13

FELTER FOR THE STATE OF THE

#### **BANKING SECTOR PERFORMANCE OVERVIEW**

Aggregate deposits of banking sector increased at an average rate of 13.9% year-on-year to PKR 7,011bn during first 9 months of 2013 with Big 5\* banks contributed major portion of the growth. Total advances of banking sector increased at modest rate of 4.8% year-on-year to PKR 3,409bn as banks continued to park more funds in investments, which went up by 6.8% year-on-year to PKR 3,595bn during 9M2013.

Monetary easing and slow private sector credit offtake did not bode well for banking sector. Cumulative profits of the banking sector decreased by 13.6% year-on-year during 9M2013 on the back of reduced Net Interest Income (NII), slowdown in non-interest income growth and increased provisioning expense. Aggregate Profit After Tax

**DEPOSITS UP 13.9%** 

Total deposits of Big 5, Mid-Tier and Small banks increased by 15.8%, 12.1% and 4.8% to PKR 4,213bn, PKR 2,449bn and PKR 349bn respectively during 9M2013. Among Big 5 banks, ABL posted the highest year-on-year growth of 25.3% in deposits to PKR 571bn. SNBL and JSBL outshined their peers by posting

(PAT) of Big 5 Banks amounted to PKR 61.4bn in 9M2013 compared to corresponding PKR70.5bn during period last year, indicating decline of 12.9% year-on-year. Collective earnings of Mid-Tier\*\* Banks stood at PKR 17.6bn during 9M2013, suggesting year-on-year drop of 3.8%, while Small Banks\*\*\* registered large percentage decline of 109.3% year-on-year to post consolidated loss of PKR 0.2bn over the stated period. MCB posted the highest year-on-year earnings growth of 3.8% among Big 5 banks, while BOP took the lead among Mid-Tier banks with profitability growth of 104.8% year-on-year. All the banks in our sample of Small banks underwent year-on-year profitability decline during 9M2013, with BOK exhibiting the smallest percentage decline in earnings at 1.9% year-on-year.

year-on-year deposit growth of 18.6% and 36.6% to PKR 133bn and PKR 74bn respectively. As for the deposit size, HBL, BAFL and JSBL led their respective groups with deposit base of PKR 1,268bn , PKR 493bn and PKR 74bn respectively. Within the deposit mix, the high cost fixed deposits of Big 5 and Small banks grew at 14.3% and 1.8% year-on-year to PKR 1,082bn and PKR 83bn respectively,

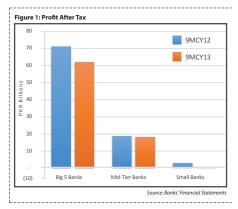
TOTAL DEPOSITS OF BIG 5, MID-TIER AND SMALL BANKS INCREASED BY 15.8%, 12.1% AND 4.8% TO PKR 4,213BN, PKR 2,449BN AND PKR 349BN RESPECTIVELY DURING 9M2013. AMONG BIG 5 BANKS, ABL POSTED THE HIGHEST YEAR-ON-YEAR GROWTH OF 25.3% IN DEPOSITS TO PKR 571BN. \*\*

Figure 2: Profitability Snapshot of Big 5\*, Mid-Tier\*\*& Small\*\*\* Banks

(PKR Millions)	Big 5Banks*		Mid-Tier Banks**		Small Banks***	
	9MCY13	YoY Change	9MCY13	YoY Change	9MCY13	YoY Change
Net Interest Income	140,966	-5.6%	65,508	-3.8%	9,663	-5.3%
Non Interest Income	60,117	3.4%	30,830	5.4%	4,203	-9.4%
Provisions& Charges	15,269	-0.5%	11,286	10.1%	2,076	311%
Profit After Tax	61,424	-12.9%	17,599	-3.8%	(219)	-109.3%
Return on Equity	15%	-3.7%	11%	-0.6%	-0.6%	-7.1%
Net Interest Margin	4.1%	-0.7%	3.3%	-0.4%	3.5%	-0.5%
Advances/Deposits Ratio	46.8%	-5.3%	51.4%	-3%	51%	0.2%
Non-Performing Loans (NPL)	253,628	-2.4%	232,408	0.1%	32,692	-9.4%
NPL Coverage (Specific)	80%	4.6%	66%	4.8%	63.8%	12.8%
Portfolio Infection Rate	11.6%	-0.8%	16.4%	-1%	16.5%	-2.8%
Investment s/DepositsRatio	53.2%	-0.6%	48.2%	-8.7%	49.4%	0.2%
Cost/Income Ratio	47.7%	6.2%	61.3%	1.5%	85.8%	10.4%

ource: Banks' Financial Stateme

"Big 5, Mid-Tier and Small banks displayed increase of 20.1%, 21.1% and 5.2% year-on-year respectively in Current Accounts and Savings Accounts (CASA) in 9M2013."



while that of Mid-Tier banks experienced year-on-year reduction of 10.2% to PKR 604bn during 9M2013. Big 5 banks shored up their cumulative deposits while maintaining the percentage of fixed deposits in the deposit structure. NBP and NIB experienced year-on-year increase of 53.4% and 16.4% respectively in fixed deposits, highest among Big 5 and Mid-Tier banks respectively.

Big 5, Mid-Tier and Small banks displayed increase of 20.1%, 21.1% and 5.2% year-on-year respectively in Current Accounts and Savings Accounts (CASA) in 9M2013. HBL and SNBL registered year-on-year growth of 27.7% and 27.4% respectively in CASA, outperforming other players in their respective categories. MCB and SCB had the highest CASA-to-total deposit ratio of 88.3% and 91.8% respectively. However, the upside from having high percentage of savings accounts in total deposits has been constrained by recent directive of State Bank of Pakistan (SBP) to link Minimum Deposit Rate (MDR) on savings account with SBP repo rate, as it will limit net interest margin expansion and resulting profitability if interest rates go up. However, banks with higher ratio of currents accounts in CASA mix will reap the benefits of interest rate hikes.

ABL and SCB had the highest percentage of current accounts in total deposits at 46.6% and 42.1% respectively in their respective groups.

#### **ADVANCES GROW BY 4.8%**; **INVESTMENTS UP 6.8%**

Advances of Big 5, Mid-Tier and Small banks grew by 4%, 5.9% and 5.2% year-on-year respectively to PKR 1,973bn, 1,259bn and PKR PKR 176bn respectively in 9M2013. Meanwhile, Big 5 and Small banks' investments underwent increase of 14.4% and 5.2% respectively to PKR 2,244bn and PKR 171bn respectively. Mid-Tier banks showed decline of 5.1% in investments to PKR 1,180bn over same period. NBP, NIB and JSBL outshined their peers by undergoing the largest percentage increase of 9.6%, 17.9% and 43.5% respectively in advances in 9M2013. Meanwhile ABL, SNBL and SAMBA posted year-on-year percentage growth of 25.9%, 18.5% and 124.7% respectively in investments, outperforming their peers in respective categories.

Advances-to-Deposits Ratio (ADR) of Big 5 and Mid-Tier banks dropped to 46.8% and 51.4% respectively in 9M2013 from 52.1% and 54.4% respectively a year ago. While ADR of Small banks increased marginally from 50.8% to 51% over the stated period. ADRs of NBP, NIB and SILK stood at 62.7%, 76.9% and 73.6% respectively, highest among respective groups. Investments-to-deposit ratio of Big 5 and Mid-Tier banks declined to 53.2% and 48.2% respectively in 9M2013 from 53.8% and 56.9% respectively during the corresponding period last year, while that of Small banks increased slightly to 49.4% from 49.2% over the same period.

#### NON-PERFORMING **LOANS DOWN BY 1.7%**

Non-performing loans (NPLs) of Big 5 and Small banks underwent year-on-year reduction of 2.4% and 9.4% respectively to PKR 254bn and PKR 33bn respectively during 9M2013, meanwhile that of Mid-Tier banks were maintained at PKR

232bn. ABLposted the highest year-on-year percentage drop of 7.9% in NPLs to PKR 20bn in 9M2013 among Big 5 banks, while NBP had the highest volume of NPLs in the group at PKR 96 bn. Despite undergoing the largest percentage decline in NPLs of 11% year-on-year, BOP had the highest NPLs in the group at PKR 63bn. SILK had the highest percentage decrease of 17.4% year-on-year in NPLs, while KASB's NPLs were largest in size at PKR 12bn among Small banks in 9M2013.

Big 5, Mid-Tier and Small banks had reduced their portfolio infection rates (as measured by NPLs/Gross Loans) from 12.4%, 17.4% and respectively in 9M2012, to 11.6%, 16.4% and 16.5% respectively in 9M2013. ABL, BAHL and FWB had the lowest portfolio infection rates of 7.5%, 2.4% and 6.1% respectively among their peers during 9M2013.

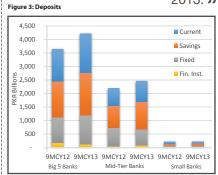
#### INTEREST YIELD AND NIMS **CONTRACT**

Net interest margins (NIMs as measured by Interest Yield minus Cost of Funds) of Big 5, Mid-Tier and Small banks slipped to 4.1%, 3.3% and 3.5% respectively during 9M2013 from 4.8%, 3.7% and 3.9% respectively during corresponding period last year. Monetary easing coupled with restricted private sector lending and SBP directive to pay minimum profit rate on average monthly balance in savings accounts instead of minimum balance (effective April 1, 2013) led to contraction in spreads.

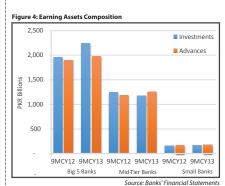
#### Non-Interest Income Growth Slows

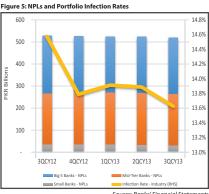
Non-interest income, which comprises of fee/commission income, income from dealing in foreign exchange, capital gains and dividend income, of Big 5 and Mid-Tier banks displayed year-on-year growth of 3.4% and 5.4% to PKR 60bn and PKR 31bn respectively in 9M2013. Meanwhile, non-interest income of Small banks fell by 9.4% to PKR 4.2bn. In Big 5 and Mid-Tier banks, non-interest

4 Advances of Big 5, Mid-Tier and Small banks grew by 4%, 5.9% and 5.2% year-on-year respectively to PKR1,973bn, PKR1,259bn and PKR176bn respectively in 9M 2013. 33

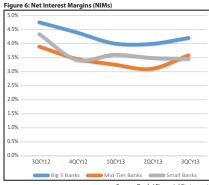


Source: Banks' Financial Statements





Source: Banks' Financial Statement



Source: Banks' Financial Statements

Mon-performing loans (NPLs) of Big 5 and Small banks underwent year-on-year reduction of 2.4% and 9.4% respectively to PKR 254bn and PKR 33bn respectively during 9M2013, meanwhile that of Mid-Tier banks were maintained at PKR 232bn.

income growth was driven by surge in capital gains, which went up by 68.3% and 35.4% respectively to PKR 10.7bn and PKR 6.5bn respectively. MCB, SNBL and FWB showed the highest year-on-year percentage increase of 23.3%, 35.7% and 62.9% respectively in non-interest income during 9M2013.

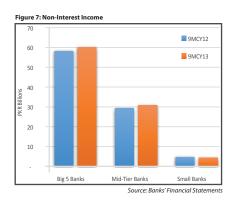
#### COST-TO-INCOME RATIO ESCALATES

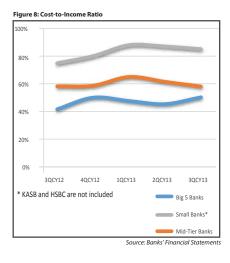
Cost/Income ratios (as measured by Operating Expenses/Sum of Net Interest Income & Non-Interest Income) of Big 5, Mid-Tier and Small banks increased by 6.2%, 1.5% and 10.4% respectively to 47.7%, 61.3% and 85.8% respectively in 9M2013. MCB, SCB and BOK had the lowest cost-to-income ratios of 34.1%,

42.6% and 52.7% respectively among their respective groups.

#### **SECTOR OUTLOOK**

Banking spreads are expected to rebound in 2014 on the back of monetary tightening, however, net interest margin expansion will be constrained as the effective spread on savings accounts has now been fixed at 3% by SBP. Banks will depend on balance sheet growth, increased lending to private sector and non-interest income to increase SBP's profitability. Moreover, commitment to enforce regulations regarding Minimum Capital Requirement (MCR) and Capital Adequacy Ratio (CAR) may prove restrictive for non-complaint banks.





Key:

ney.		
"Big 5" Banks	"Mid-Tier" Banks	"Small" Banks
Allied Bank Limited (ABL)	Askari Bank Limited (AKBL)	First Women Bank Limited (FWB)
Habib Bank Limited (HBL)	Bank Al Habib Limited (BAHL)	HSBC Bank Middle     East Limited (HSBC)
MCB Bank Limited (MCB)	Bank Alfalah Limited (BAFL)	JS Bank Limited (JSBL)
National Bank of Pakistan (NBP)	Faysal Bank Limited (FABL)	KASB Bank Limited (KASB)
United Bank Limited (UBL)	Habib Metropolitan     Bank Limited (HMBL)	Samba Bank Limited (SAMBA)
	NIB Bank Limited (NIB)	Silkbank Limited (SILK)
	Soneri Bank Limited     (SNBL)	The Bank of Khyber (BOK)
	Standard Chartered     Bank (Pakistan)     Limited (SCB)	
	The Bank of Punjab (BOP)	

"Banking spreads are expected to rebound in 2014 on the back of monetary tightening, however, net interest margin expansion will be constrained as the effective spread on savings accounts has now been fixed at 3% by SBP"



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## HEADWINDS On Banking Margins

As a regulatory move, State Bank of Pakistan (SBP)
has linked Minimum Deposit Rate (MDR) on Savings Accounts with SBP Repo Rate,
which is the rate at which banks deposit their excess cash with SBP on overnight basis.
By instructing banks to keep MDR on average balances of Saving Accounts 50 basis points (bps)
below SBP repo rate, effective 1st Oct'13, SBP has attempted to encourage savings and curtail
expansion in banking sector spreads in a rising interest rate environment.

SBP introduced the minimum rate of 5% on categories of Savings/PLS Saving accounts in June 2008 in a bid to address rising level of currency in circulation and promote savings through banking channels. Further, SBP observed that increases in Discount Rate were immediately transmitted through Advances but had little impact on Deposit rates, particularly for small Deposit holders. However, banks were free to use any account balance methodology as long as they were paying minimum rate of 5% per annum. Later, SBP raised the MDR to 6%, effective 1st May'12, stating that rigidity of Deposit rates, especially for small savers, was hurting savings-to-investments ratio of the economy. Increased Deposit rate was expected to incentivize people to save more and use banking Channels. Deposit cost escalated further from 1st Apr'13 when SBP mandated banks to use average monthly balance in savings accounts for profit calculation as banks were predominantly using minimum balance.

SBP, in a landmark regulatory move has set MDR on savings accounts 50bps below SBP repo rate, which in turn is kept 250 bps below SBP Reverse Repo Rate (or Discount Rate). As a result of this indirect pegging, MDR on savings account automati-

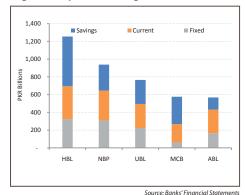
cally increased to 7% after recent hike in policy rate to 10%. This will put pressure on banking sector spreads and affect sector profitability as savings accounts comprise roughly 40% of banking sector deposits, which stood at PKR 6,683 billion as of Dec'12.Of these 40% savings deposits, we estimate that 70% are paid MDR and will cost minimum rate of 7% on average balance going forward. We estimate that banking sector will bear an additional expense of around PKR 15 billion in current calendar year due to increased regulatory prowess of SBP.

Recent reversal in monetary easing will now bring limited upside for banking sector as cost of deposits went up with interest rate hike, limiting net interest margin expansion. Big 5 banks particularly HBL and MCB, which have higher proportion of savings accounts in their deposit mix, will bear the brunt of linking savings account profit rate to SBP repo rate. Banks with high percentage of current accounts will benefit from future interest rate hikes. Currently, banks' earning asset mix is almost evenly distributed between advances and investments with advances-todeposits ratio (ADR) at 55% and investments-to-deposits ratio (IDR) at 52.9% in Oct'13. Banks will depend balance sheet growth non-interest income generation to increase profitability.

Figure 1: Banking Sector Spreads



Figure 3: Deposit Mix of Big 5 Banks



Source: Sams / manetal Statem

Figure 4: ADR and IDR of Scheduled Banks



C------ CDI

Figure 2: Impact of Change in MDR

PKR Billions	2012	2013E
Deposit base	6,683	7,351
Savings accounts	2,673	2,940
Savings accounts at MDR	1,871	2,058
MDR	6%	6.2%
Negative impact on earnings		15
		Source: SBP

MONETARY EASING WILL NOW BRING LIMITED UPSIDE FOR BANKING SECTOR AS COST OF DEPOSITS WENT UP WITH INTEREST RATE HIKE, LIMITING NET INTEREST MARGIN EXPANSION \*\*\*



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# PRACTICAL PROBLEMS ON COMMERCIAL BANKING AND THERSOLUTIONS

By: Syed Sabiri Jaffery

Q. 1 Receiving of valuables for safe keeping is one of the common functions that the banks have been performing since their early days. What precautions a bank has to take while the articles are lodged with it for safe custody for proper discharge of its liabilities?

Ans: In accepting articles for safe custody the banker's position is that of a bailee, and the amount of care that a bailee is required to exercise is precisely defined in section 151 of the Contract Act, 1872 which reads as:

"In all cases of bailment the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed." To transform this legal provision into sound banking practice, a vigilant banker would like to take the following precautionary measures.

Before letting a safe deposit locker, to a person not already well-known to the bank as a customer, the same general enquiries should be made as are expected when a stranger opens an account. There is always a possibility that a thief rents a locker and thus has an opportunity to inspect the inside of the strong room with the intention to commit burglary or theft at a later date. Thus, precautions such as restriction of access to the strongroom to locker holders only are required.

It is in the interest of all concerned that the nature and approximate value of articles are declared at the time of lodging them for safe custody. The value thus declared should be verified with the sum insured.

The banker should see that the customer has taken an insurance policy in regard to the articles deposited with him for safe custody. Articles of substantial value should always be insured. Future payments of premiums must also be ensured.

Deposits in joint names: Where there is a joint account, such as an account of a partnership, or of executors, or of husband and wife, the bank while opening the account would obtain a mandate from all the joint account holders indicating whether one or all of them would withdraw. It must then confine to the mandate.

**Deposit by trustees:** Any articles deposited by trustees are under their

joint control. Hence, a banker should act upon the instructions signed by all the trustees. The decision in Mendes v. Guedalla (1862) requires a banker to take particular care to obtain the authority of all the trustees before he parts with, or disposes of in any manner the property deposited with him.

#### Deposit by agents:

It must be ensured that agents, personal representatives, attorneys, or authorized officials of organizations operate within the scope of the authority granted to them.

#### Death of depositor:

The bank would incur no liability in delivering the valuables to the personal representatives of the deceased against proper receipt, on their producing probate or letter of administration. In case of joint depositors other than trustees, the delivery may however be made to the survivors.

## Q.2. What are the rights and obligations of a banker in conducting safe-custody business?

Ans. The risk to the bank may be either due to negligence or for conversion. If the property is lost, say by theft, or destroyed, usually by fire, while in the possession of the bank, the bank may be held liable for loss due to negligence. On the other hand, if the bank hands over the property to some one not entitled to receive it, or refuse to hand it over when it should have handed over, it can be held liable for damages for conversion. However, in determining whether the bank is liable, the courts pay due regard to normal banking practices.

The law is incorporated in Section 152 of the Contract Act, 1872, which reads: The bailee, in the absence of any special contract, is not responsible for the loss, destruction or

deterioration of the thing bailed, if he has taken the amount of care of it described in Section 151.

(Section 151 has been reproduced above in answer to Question No.1.)

It is rightly presumed from the language of Section 152 that the liabilities of the bailee may by a special contract be altered from what is laid down in Sec, 151. However, legal opinions on this issue are divided. As held in Sheikh Mohomed v. The British Indian Steam Navigation Co. Ltd. (1908), a bailee may by special contract undertake a greater liability but he can not by such means reduce the liability imposed by this section. Conversely, in Jellicoe v. British India Steam Co. it was held that it is open to the parties, by express contract, to restrict this liability even to the extent of wholly relieving the bailee from it.

#### Liability for Negligence:

In any case, however, the banker will be liable only when loss results from negligence on his part. If the property is damaged, destroyed, or stolen, for any reasons, the bank will be liable unless it can show that its safety and security arrangements were up to the desired standard, and had been properly operated at the time. If, for example, a fire spreads from the adjoining building causing damage to the property lodged in safe-custody with the bank, the bank will not be held liable for the loss unless it can be proved its own fire fighting equipment was inadequate or ineffective.

Loss or damage to customer's property may also occur due to the dishonesty or carelessness of bank employee. However, the effect of case law on this point is that an employer is liable for the acts of his employee causing loss or damage to the property of his customer if the employee had acted in the course of performing duties assigned to him, even though

the employee was acting dishonestly for his own benefit. As against this, if an employee makes use of the opportunities obtained in his employment to act dishonestly outside the limits of his duties (a bank officer gaining access to the strongroom without having duties justifying his presence there), the employer may not be directly liable for his act. Nevertheless, the employer may be liable for loose and ineffective control.

Obviously, therefore, it is difficult for the bank to escape liability for theft by an employee. Either he stole while on work, or there were inadequate precautionary arrangements against theft by an employee.

#### Liability for Conversion:

A banker who without authority delivers to third person goods placed with him for safe-custody can be sued for conversion. Hence, he should be extra cautious to verify the authority of the recipient to receive the same.

#### Third Person Owner of the Property:

If a third party gives notice to the bank that he is the owner of the property deposited with him by his customer, the banker may safely deliver it to the true owner, even without customer's authority, after fully satisfying himself as to the third party's title thereto.

#### Q. 3. Which of the following are not negotiable instruments and why?

- (a) An uncrossed payment order
- (b) Negotiable copy of a bill of lading
- (c) Usance bill of exchange
- (d) Bank draft marked 'Not Transferable'

#### **Ans:** Uncrossed Payment Order

A payment order issued in the form of a receipt to be signed by the beneficiary named thereon while receiving the money is not transferable. Hence, it is not a negotiable instrument.

If the payment order is issued in the usual cheque form conforming to the definition of a cheque as mentioned in Sec. 6 of the Negotiable Instruments Act, it will be a negotiable instrument.

The fact that it is drawn on the drawer itself does not defeat its characteristic as a cheque because the definition of a cheque requires it to be drawn 'on a specified banker'. It does not qualify a drawer. Hence it is negotiable instrument as a cheque.

#### Negotiable Copy of a Bill of Lading

A bill of lading drawn to order or assigns is, by trade customs, negotiable by endorsement and delivery, provided that the goods represented by it have been shipped and the voyage has not been completed nor delivery is made. Nevertheless, in the strict sense of the term, it is not a negotiable instrument as the transferee, though bonafide and for value, cannot get a good title from a transferor whose title is defective.

#### Usance Bill of Exchange

A bill of exchange is payable "on demand or at a fixed or determinable future date". A usance bill of exchange, falling under the second category, i.e., payable on a future date, meets the qualification of a bill of exchange as defined under Sec. 5 of the NIA, and is, therefore, a negotiable instrument.

#### Bank Draft marked 'Not Transferable'

As defined under Sec. 14, when an instrument "is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated". Hence, as the transferability of the draft in question is restricted, it is not a negotiable instrument.

Q. 4. 'A' and 'B' maintain a joint PLS-savings account operated by either or survivor singly. Later, 'A' approaches the bank with a request not to allow 'B' to operate the account. Simultaneously, a cheque signed by 'A' is presented for payment. How the bank will act?

Ans. When one of the joint accountholders revokes the authority of another, the original mandate itself stands revoked. Hence, no cheque shall be paid unless both the joint account holders sign, or unless a fresh mandate is given by them under signatures of both the persons, in which case, operation will be allowed according to the fresh mandate.

Q. 5 In the above situation, if 'B' requests the bank in writing to amend the mandate so as to read 'to be operated by A or survivor' how the bank will deal with the request?

Ans. Ordinarily, amendment to the mandate has to be authorized by all the joint accountholders. However, in the given situation, since 'B' himself is surrendering his authority in favour of 'A', bank may accept B's instructions. As an additional precaution, bank should ask 'B' to declare that any cheques signed by 'A' prior to the date of B's request presented subsequently should be honoured, and no cheque signed by 'B' remains to be presented.

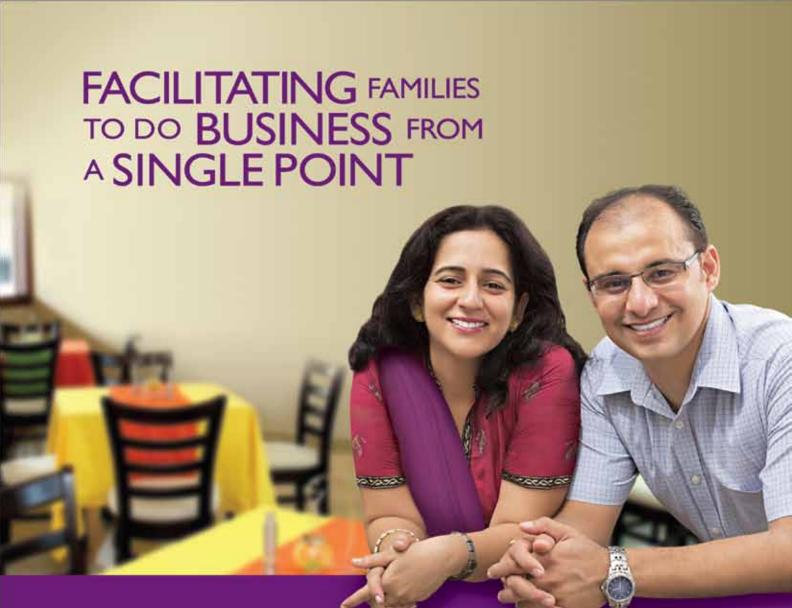
Q.6. A partnership firm with four partners dealing in manufacturing and export of cotton fabrics maintain a highly satisfactory current account at my branch. The account is operated singly by either of the partners. One of the partners has approached me with a request to grant overdraft of Rupees one million in the firm's account in order to purchase in the firm's name a piece of agriculture land to grow cotton thereon.

He further states that all the remaining partners are out of the country in connection with some international exhibition of cotton products, and that he is authorized to operate and overdraw the account singly. The status of the account is fairly good for the accommodation requested for.

Shall I entertain his request?// How should this situation be handled?

Ans. A partner has implied authority to bind the firm by all his acts done in the firm's name, or in any manner expressing or implying an intention to bind the firm, in all matters connected with the normal business of the firm, provided that such acts are carried out in a normal way of business and do not fall beyond the normal scope of the firm.

However, as growing of cotton does not fall within the normal manufacturing business of the firm and as the partner does not have the implied authority to acquire immovable property in firm's name, the request of the partner is not tenable and, therefore, may be politely declined, or at least deferred till all other partners return and jointly amend the partnership deed suitably so as to qualify for the accommodation requested for.



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### **COTTON INDUSTRY OF PAKISTAN**

How To Execute A Murabaha Transcation With An Islamic Bank?

By Usama Bin Tariq

Islamic Banking Industry has always strived to provide appropriate solutions to every business sector of Pakistan not only in accordance to their financial needs but also to organize their business practices aligned to Shariah guidelines. Similarly, Islamic Banking has also played its role in the Cotton Sector of Pakistan to regularize the business practices in conformity to the rulings of Islamic trade. The writer has focused on the business practices of the cotton industry and the anomalies (as per Shariah) present in the system and the role of Islamic Banks to revolutionize the methodology.

#### COTTON OVERVIEW1:

Cotton is Pakistan's main industrial crop grown on 15 percent of the country's arable land. Production is concentrated mainly in two provinces, Punjab and Sindh, and cultivated by 1.6 million farmers mostly with small holdings of less than five hectares of land.

Pakistan is the fourth largest producer and third largest consumer of cotton, in addition to being the largest exporter of cotton yarn in the world. Cotton is the country's foremost non-food cash crop and is considered the backbone of the national economy. The cotton sector, along with the textile and apparel industry, accounts for 11 percent of GDP, and 60 percent of the country's export value, while employing 35 percent of the industrial labor force. Consequently, cotton production supports Pakistan's largest industrial sector comprised of over 400 textile mills, 1,000 ginneries, and 300 cotton seed oil crushers and refiners.

#### **INDUSTRY PRACTICE:**

Cotton is produced in bulk in two regions of the country and goes through different cycles to ultimately turn up in the shape of cotton bales. Raw cotton which is unanimously known as "Phutti" in the local market is procured through farmers, growers and landlords and also through commission agents itinerant in the market by the cotton ginners which are the core buyers for this particular commodity. Following are some important areas of notice:

#### • Order Mechanism:

Ginners have buying relationships with farmers, growers, landlords who delivers the commodity at the doorsteps of their customers, however commission agents wander different commodity markets to help them to purchase the commodity.

#### • Payment Mechanism:

Payments are usually done in advance to the suppliers or either on spot (at the time of delivery) or on credit basis as well.

## "THE COTTON SECTOR, ALONG WITH THE TEXTILE AND APPAREL INDUSTRY, ACCOUNTS FOR 11 PERCENT OF GDP, AND 60 PERCENT OF THE COUNTRY'S EXPORT VALUE, WHILE EMPLOYING 35 PERCENT OF THE INDUSTRIAL LABOR FORCE."

#### • Delivery Methods:

As mentioned above delivery of goods is the responsibility of the supplier and they deliver the goods at the doorsteps of the buyers at their risk.

#### • Measuring Units:

Commodity is available in the base unit of Mounds/Kgs and is always weighed again at the time of receipt of goods at the Ginning Units at their own weighbridge or at nearby rented weighbridge.

#### • Storage Technique:

Goods are received in unwrap form and are dumped all over the place of the warehouse in the shape of heaps depending on the quality of the commodity. Heaps are made to dry out the moisture present in the commodity, once the goods are completely dried and are ready to be used for further processing (ginning) they mix the goods in other heaps which are much bigger in size but again after sensing the quality of the goods.

#### • Ginning Process:

Immediately after the parching process goods are transferred to the ginning units to extract the cotton staple and other by products from the raw product.

#### • Bales Production:

End product which is cotton bales for the ginners are produced after the completion of ginning process and stacks of different weights and quality are produced for sale in the market.

#### INDUSTRY'S NEED OF FINANCIAL ASSISTANCE:

Ginners face shortage of liquidity during their peak season where extensive purchases are done and bulk processing is in process. In the absence of Islamic financial solutions they had their financial lines developed with numerous interestbased institutions or local lenders. They borrowed the funds to utilize them to facilitate their bulk purchasing or to accomplish processing cycles.

Soon after the addition of Islamic Banks in the market, the lending practices and other Non-Shariah Compliant practices had to be stopped by the ginners. Islamic financial institutions comprehended their needs and proposed alternate solutions to the market players fulfilling the requirements of Shariah.

To facilitate the need of purchasing of raw material, Murabaha<sup>2</sup> was proposed by the Islamic Banks to the ginners. But to execute the Murabaha transactions with their complete essence certain rules of sales were necessarily to be followed. For e.g. existence of goods, fixation of price, identification of goods, separation of goods etc. but unfortunately the industry was practicing their business in accordance to their self defined methods which were not in accordance to the rules of trading devised by Shariah. Therefore, a Shariah Compliant transaction of Murabaha was not feasible with the presence of all those non-shariah compliant aspects.

#### ANOMALIES IN THE INDUSTRY NORMS AND IMPEDIMENTS FOUND FOR MURABAHA TRANSACTIONS AS PER THE SHARIAH GUIDELINES OF TRADING:

Pakistani traders have numerous market norms which have been defined ages ago by the market players observing their own differ from industry to industry irrespective of their repercussions and consequences of the transactions. Similar scenarios have been seen in the Cotton Industry where the players have defined their own rules and regulations for the trade of the commodity. Some important areas which were highly acceptable to the stakeholders but are not in conformity to Shariah rulings of trade are highlighted below:

1. Payment Norm: Payment mechanism prevalent in the market is somewhat different in comparison to the routine payment mechanisms. A market practice referred to as Mudda'a is prevalent in the industry in which the price of the commodity is not fixed/defined at the time of delivery or before delivery of goods. But in fact a rate is quoted for each day in the market of Phutti and the sellers are notified at the time of delivery of goods that price of the delivered goods shall be paid in equivalence to the rate of approaching days. For example if goods are delivered on 6th August 2013 accordingly the price of the goods may be paid at the rate of 8th August 2013 on a credit of 2 Days.

Shariah guidelines do not allow such kind of practice for a sale transaction. Indeed it creates a flaw in the sale transaction and the transaction cannot be rendered as a valid transaction (Bai' Sahih)<sup>3</sup>. Fixation of price is a must for any sale transaction and transaction stands inapt till all the rules and conditions of sale are fulfilled. Therefore, all the transactions executed with such practice are considered as erroneous and profit rendered through these types of transactions is unacceptable as per Shariah.

2. Mixing of Goods: Whenever Phutti is purchased, it is received in unwrap or open form and the goods are dumped in the open air areas of the ginning units in the shape of heaps. Immediately after the completion of drying process goods are dumped into bigger heaps of similar quantity. Shariah allows that if the goods are owned exclusively by an individual or a company then the mixing of goods does not create any imperfection in the

transaction, however it is necessary to define the ownership ratios of the goods if the goods are not owned in exclusivity but in joint ownership by two or more partners.

3. Immediate Consumption of Goods: Once the moisture of the goods is dried out and the goods are present in the bigger heaps, they are considered to be as a ready product for production process. Immediately the goods are transferred to ginning units for mechanized processes. As soon as the goods are shifted in the machines they immediately change their shape and value. This transformation of goods is considered as Consumption by Shariah and sale is not allowed for the consumed commodity. As the subject matter for the sale was defined was Phutti but the item to be sold after consumption was not Phutti by any means. Therefore, if the transaction occurs after the start of consumption process this would not be considered as a valid transaction as per Shariah, since the goods have not been existed at the time of sale.

### SOLUTIONS OFFERED AND IMPLEMENTED BY ISLAMIC BANKS – A REVOLUTION FOR THE INDUSTRY:

Islamic Banks have played their role amicably to change the off-putting norms prevalent in the industry. They engaged themselves to understand the business nature and business cycles to offer them a usable structure while remaining in the sphere of Shariah and which have equally produced better results for the industry not even in economic terms but also in social terms. Some significant advancement areas were noticed which are as follows:

1. Payment Flans Rectifications: Industry offers an option of daily quote of rate by the market players. Islamic bank eyed the same and ask the buyers to consider the spot rate of the day for all the transactions either they are based on credit payment or on spot payment basis. Hence, any transaction which shall be executed will fulfill the basic ruling of Shariah to fix the price of the commodity at the time of sale.

- 2. Identification of Goods: Whenever the goods are placed in heaps its mandatory for the buyer to place the goods in accordance to their purchase due to quality issues. Islamic Banks advised them to not to mix the goods with other goods till the execution of sale contract between bank and the customer. Since the goods are not mixed with other goods and are present in separated form and identical in nature therefore, the flaw for the mixing of goods was also detached from the transaction.
- 3. Immediate Consumption of Goods: Usually goods are not being sent for ginning process if the required quantity for the production is not completed. It is very difficult to arrange the complete quantity of goods before the mixing of goods from different purchases. Since the goods are sold to the buyer by the bank before the mixing in the customer owned goods therefore the doubt of consumption was abandoned. However, if the goods are received in ample quantity which is enough for the start of production in such case Islamic Banks and customer have to execute the transaction before the start of consumption process. Customers had been advised to immediately inform the banks and complete the transaction where the banks shall sell the goods to customers and transfers the risk of the goods to customers therefore they can consume the goods as per their needs.

The world considers Islamic Banking as a Banking of ethics and good morals. Islamic Banks have always helped the humanity to better their social and financial practices. A huge number of Pakistani businesses are not following the ethical practices for their businesses. Soon after the addition of Islamic Banks in the market ethics have been formally introduced to each industry which is associated with Islamic Banks. We can see this transformation towards a better society with improved ethical behaviors and superior business market with justified business methods.

http://gain.fas.usda.gor/Recent%20GAIN%20Publications/Cotton%20and %20Praducts%20Annual\_Islamabad\_Pakistan\_4-2-2013.pdf \*Murabahah is a particular kind of sale where the seller expressly mentions the cost of the sold commodity be has incurred, and sells it to another person by adding some profit thereon. Thus, Murabahah is not a loan given on interest; it is a sale of a commodity for cash/deferred price. \*Meezam Banks Guide to Islamic Banking by Dr. Imran Asbraf Usmani

'Meezan Banks Guide to Islamic Banking by Dr. Imran Asbraf Usmani (Meezan Banks Guide to Islamic Banking by Dr. Imran Asbraf Usmani)

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### WHO IS THE ARTHI?

## Understanding the Commission Agent's Role in the Agriculture Supply Chain

By Khadija Ali



It is widely recognized that Pakistan's agriculture sector forms the backbone of the economy, generating up to 21 percent of the GDP and employing 45 percent of the country's labor force. Yet, productivity indicators suggest that yields have stagnated over the past decade and the productivity gap with high performing countries is wide. Additionally, there seems to be a mismatch between the level of real economic activity taking place in agriculture and the flow of formal financial credit to the sector.

n 2010-11, lending to agriculture sector made up only eight percent of the banking sector's total advances and 7.6 percent of private sector credit. Planning Commission estimates for 2011-12 show that demand for agriculture credit stands at PKR 750 billion whereas the flow to the sector stood at PKR 294 billion only (34 percent of total demand). This demand has been growing at a rate of 14.6 percent per annum over the past five years whereas

actual disbursement has increased by only 8.6 percent, creating a widening supply-demand gap that is being met through informal sources.

The informal credit market is active and vibrant in Pakistan, catering to the needs of farmers through a network of financiers referred to as "arthis". A recent study jointly conducted by the Pakistan Microfinance Network (PMN) and National Institute of Banking and Finance

## FLANNING COMMISSION ESTIMATES FOR 2011-12 SHOW THAT DEMAND FOR AGRICULTURE CREDIT STANDS AT PKR 750 BILLION WHEREAS THE FLOW TO THE SECTOR STOOD AT PKR 294 BILLION ONLY (34 PERCENT OF TOTAL DEMAND).

(NIABF) with support from the International Growth Centre - Pakistan (IGC -Pakistan) titled "Who is the Arthi: Understanding the Commission Agent's Role in the Agriculture Supply Chain", provides insights into how arthis use informal networks and linkages to maintain their role in the agriculture supply chain. The study also highlights the potential for banks and formal financial institutions to study arthis in their modus operandi, to better understand how to adapt their own operations, and risk management techniques in order to reach out to rural markets more effectively.

In Punjab, the arthi remains the largest source of informal credit for agriculture-dependent small farmers, generating substantial profits in a market deemed too risky by commercial banks. Operating mainly out of the province's 325 commodity markets, the arthi provides two important services to the farmer:

- 1. Inputs on credit at the time of sowing of a crop.
- 2. Facilitate the sale of the harvested crop in the market, as sales agent for the farmer.

Essentially, by taking advance from the arthi, the farmer becomes bound to sell his produce through the same arthithereby giving the arthicontrol of the farmer's cash flows. The rates charged by the arthi and his portfolio's risk profile demonstrate that there is money to be made in agriculture lending to small and medium farmers. With minimal operational costs (less than 2.5 percent of total volume of lending), nominal write-offs and high interest rates (ranging between

62 and 80 percent), profit margins for the arthi are quite significant. In addition to earning from credit, the arthi also earns commission from the sale of the produce of his borrower (ranging from 2 to 4 percent depending upon the crop and his terms with the client).

In terms of the potential lessons to be learnt for banks and formal financial institutions, it is worthwhile to note that the arthi provides customized services by identifying the right borrower and ascertaining his credit needs accurately. In times of crop failure (due to natural disasters, for example), the arthi provides flexibility vis-à-vis rescheduling the loan, delaying recovery and also extending a new loan to allow the farmer to plan his next crop cycle. On the other hand, bank processes tend to push for scheduled recoveries and classification of default loans as soon as repayments falter. The arthi makes unsecured loans based on traditional relationships with farmers, often passed on from generations; while banks typically rely on physical collateral (such as land titles) and guarantees from third parties. These different modes of operation highlight the potential for banks and formal financial institutions to better understand the needs of the farmers and provide appropriate and cost-effective services.

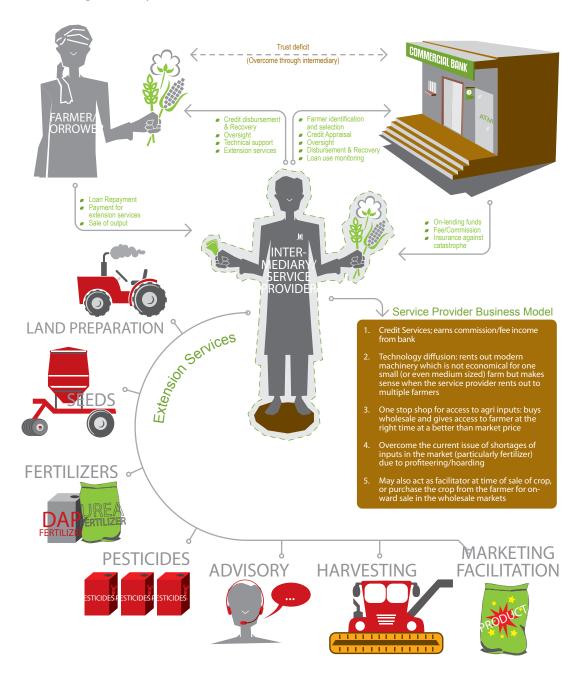
Demand for credit remains continous and is growing with rising prices of agriculture inputs, which means there is potential for the formal sector to tap into this market. Perhaps this can be achieved through 'intermediaries' who would play the role of the arthi, to connect the bank to its clients and provide value -added services (such as access to modern farming equipment, techniques and inputs) that would increase productivity

while reducing credit risk for the banks. The provision of insurance would need to be incorporated into the model to cover for any catastrophic risks to crops.

Pakistan holds great potential for enhancing market-based agricultural growth and higher levels of productivity through scaling up credit provisions, attracting banks into mainstream rural

The arthi provides customized services by identifying the right borrower and ascertaining his credit needs accurately. In times of crop failure, the arthi provides flexibility vis-à-vis rescheduling the loan, delaying recovery and also extending a new loan to allow the farmer to plan his next crop cycle.

**EXHIBIT:** Using an Intermediary to reach the Farmer



finance, enhanced support services and building backward and forward linkages along the productive supply chain.

The **Pakistan Microfinance Network** is an association of retail microfinance providers. Our vision is to extend the frontiers of formal financial services to all and mission is to support the sector, especially retail microfinance institutions to enhance scale, quality, diversity and

sustainability in order to achieve inclusive financial services.

National Institute of Banking and Finance is the training arm of State Bank of Pakistan. Essentially a knowledge organization, NIBAF is committed to human capacity development by imparting quality training to the personnel in the financial sector in order to equip them with necessary skills to meet the

challenges arising from technological advancement and financial sector innovations.

The study, "Who is the Arthi: Understanding the Commission Agent's Role in the Agriculture Supply Chain", can be found at:

http://www.pmn.org.pk/articles/Who% 20is%20the%20Arthi.pdf

## **Keep it Confidential**

We all find ourselves talking about work after hours, but when is it best to bite your tongue? BOB SOUSTER reflects on the legal and ethical ramifications of inadvertently disclosing sensitive information in even the most informal setting.



By Bob Souster

#### THE SCENARIO

hile attending a family wedding reception, Oliver met Lee, a cousin whom he had not seen for over ten years. They were once very close as children, but they have lived a considerable distance from one another for a long time, and had only kept in touch through exchanges of Christmas cards.

Lee had become a successful journalist, and Oliver heard that his career had given him a comfortable and enjoyable life. In turn, Oliver told Lee about how he had been employed mainly in the banking industry since leaving university.

Oliver explained that he started out in retail banking as a customer adviser in a large Edinburgh branch of JKL Bank plc, a prominent financial institution. Here he was able to mix with numerous household names from politics and show business – in the days before internet banking was commonplace, plenty of banking was carried out on a face-to-face basis. Eventually, said Oliver, he transferred to business banking and looked after the accounts of several members of famous rock groups.

"Did you actually meet these people?" asked Lee. "Regularly," replied Oliver, who went on to describe some of the individual personalities whom he had advised, and some outrageous incidents involving these individuals, as occurred in

"For many years, it has been accepted that employees have a common law duty of confidentiality to their employer and to keep the employer's secrets, including those pertaining to clients of the employer."

customer interviews some years earlier. As a young man, Oliver had been somewhat in awe of the rock and roll lifestyle of some of his clients, so he remembered these encounters very well.

"So, what are you doing now?" asked Lee. Oliver replied that for the past five years he had worked as a project manager in a large Glasgow-based bank. "In fact," said Oliver, "I am working on a special project just now, which means I have to visit the premises of an Edinburgh-based bank several times a week. We are looking at the compatibility of my bank's IT/IS infrastructure with that of another large bank. I don't know the purpose of all this, but there is certainly something exciting going on upstairs in the boardroom."

The cousins left the wedding reception and agreed that they should keep in touch on a more regular basis.

Back at work the following week, Lee wrote his regular gossip column for the newspaper where he was employed as a journalist, writing under the pseudonym "Fly on the Wall". He included in his "snippets" section a couple of paragraphs, the first recalling one of Oliver's anecdotes about a famous former rock star now living a secluded life in the Highlands, and the other about "rumblings in the banking sector... are two famous Scottish banks about to merge?"

What are the ethical implications of this scenario?

#### THE ANALYSIS

his scenario is mainly about duties, partially about the law, and a little to do with inadequacies of the law. Industrial psychologists have long confirmed that while we spend a significant proportion of our lives at work, even when we are not at work we talk about... that's right, work.

The need for employees to be careful about what they disclose outside work is not an exclusive feature of the banking industry. For many years, it has been accepted that employees have a common law duty of confidentiality to their employer and to keep the employer's secrets, including those pertaining to clients of the employer.

Even when this is not set out explicitly in the contract of employment, the courts tend to regard this duty as an implied obligation arising from the employer/employee relationship. Furthermore, this duty does not end when the employee leaves to work for another employer. An individual can be held liable for disclosure of information even though the contract of employment has ended.

Though probably acting with entirely innocent intentions, Oliver has failed in his duty on two counts.

Firstly, Oliver has discussed his encounters with famous people, even though these took place long ago. He had already been told that Lee was a successful journalist, but probably did not associate him with a gossip column. The law has something to say in this respect, as Lee now knows the identity of a customer of a specific bank, that a business banking relationship existed and that the person now lives a secluded life in the Highlands.

This is a potential breach of the Data Protection Act 1998. But looking at this from a broader ethical (rather than legal) perspective, Oliver was quite wrong to discuss any details of customers at all, however long ago his meetings with them occurred. It is something that bankers "The ethical implications of Oliver's discussion are that he has breached his duty of confidentiality, disclosing information which should be left within the walls of the bank."



simply should not do. As Immanuel Kant would say, it is a categorical imperative. Morally wrong, ethically wrong.

From a consequentialist viewpoint, the famous former rock star, who has deliberately avoided the spotlight since leaving the music business, now has the prospect of having his peace and serenity shattered by music magazines and celebrity publications.

However innocent Oliver's intentions might have been, he ought to have known how little he should have said as soon as he heard the word 'journalist'. Contrary to common belief, perhaps, many journalists know their own obligations and will be careful with sensitive information of this nature.

For example, a well-known magazine published an article some time ago about Anne Briggs, a folk singer who left the music industry to live in relative seclusion with her family on a Scottish island. The magazine made great efforts to keep the location of her home private. However, bankers can never assume that all publications will act as responsibly as this.

Secondly, Oliver's account of his current work as a project manager included a description of what he was doing, which involved working on the premises of another bank with a view to establishing compatibility of IT/IS

systems between the two organisations. There are few reasons to do so other than if merger or acquisition talks are in the air.

Strictly, if the two banks have their securities listed on a recognised capital market, Oliver could be regarded as an insider under the provisions of the Criminal Justice Act 1993. Information relating to discussions on technological compatibility between the two is price-sensitive information with a potential impact on securities markets if disclosed, so however unlikely it would be given the facts of the case, Oliver has offended the disclosure rules under the legislation. So too has Lee, as a secondary insider. Both could be prosecuted.

But these are legal considerations rather than ethical ones. The ethical implications of Oliver's discussion are that he has breached his duty of confidentiality, disclosing information which should be entirely left within the walls of the bank.

From a consequences viewpoint, having read Lee's column, both banks are placed in an awkward situation, as if there is anything true in the rumour that Lee has published, they will almost certainly have to make a formal announcement ahead of their intentions.

Bob Souster is Module Director, Professional Ethics, Chartered Banker MBA at Bangor University. Do you agree with Bob's verdict in this ethical dilemma? Have your say on the Chartered Banker LinkedIn discussion forum.

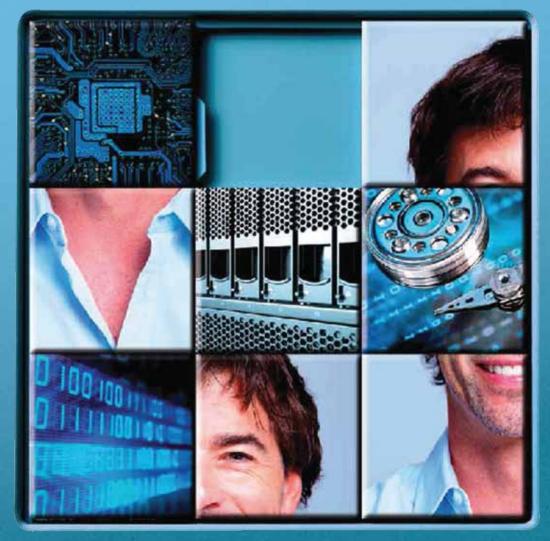
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By Richard Hallt

## Building B 5 with the

Turning fragmented data into customer intelligence could be the key to survival in today's highly competitive market. RICHARD HALLT encourages banks to take a holistic view.

0

ne of the major issues the banking industry is tackling is the use of legacy IT systems. Banks spend 70 to 90 per cent of their IT budget on managing legacy infrastructure but many receive fragmented customer data

held in disparate systems. This is not an effective way of working. In today's highly competitive market, there's greater benefit in gaining a holistic view and turning customer data into truly useful management information to support strategic growth.

Banks are renowned for having the most complex IT systems around. Many have been pieced together over the years and contain ageing mainframes, overlapping systems from mergers and acquisitions and a variety of customer-facing systems bolted on top of other platforms to deliver online and mobile banking. With the right support, of course, these systems will work day in, day out. But it doesn't mean they're working as effectively as possible.

By using disjointed IT systems, customer data is not only fragmented but may also be duplicated, particularly if mergers mean there's no clear view of client records. To offer customers what they want, when they want it, banks need to consolidate data to create the most functional information. Customer details and records must be linked and consistent, to give a complete view of each customer.

#### THE BIG PICTURE

Making the most of customer data also means having a clear mid- to long-term strategic plan. Otherwise, in five to ten years, the infrastructure will be as fragmented as ever. So it's necessary to choose the best-fit solution from existing incumbent systems, or go to market for a solution with strategic longevity.

First, though, banks should take a step back to assess what IT systems they have in place to work with. Only then is it possible to institute a flexible, long-term strategic plan that will streamline operations and ensure customer data is being used effectively.

It's vital to heed the warnings from the high street and be prepared to look at this bigger picture: many retailers have failed to do just that and, as a result, an increasing number are heading into administration or are already there.

#### **BE DATA WISE**

Young enterprises can often get to market faster than established companies, because they come

#### "BY USING DISJOINTED IT SYSTEMS, CUSTOMER DATA IS NOT ONLY FRAGMENTED BUT MAY ALSO BE DUPLICATED."

without the baggage of legacy infrastructure. Established banks need to ensure they make the most of the business opportunities to remain profitable and keep customers happy. Servicing customer needs – rather than just treating them as accounts – is critical, given banks' reliance on existing clients to boost sales.

Banks therefore need a cross-channel, crossproduct view of the customer, and the capability to translate the data into tangible and useful information. There's a wide range of customer data out there, from pensions to saving accounts, insurance to mortgages. Tapping into this resource means integrating all existing data to build a personalised picture of each customer.

With this "softer" side of a customer

- a full view of accounts and spending habits
- it's possible to offer the most relevant upsell and cross-sell opportunities. It's no good offering a student an ISA, for instance, if they clearly have little interest in long-term saving. It's just as unproductive offering an ISA to a customer who already has one.

Banks need to be offering complementary services and avoid irritating – or even losing – a customer through duplicated sales pitches. The key is targeting – getting the most relevant marketing literature to a customer at the most appropriate time. The data can also help shape strategic decisions about what to market in the future.

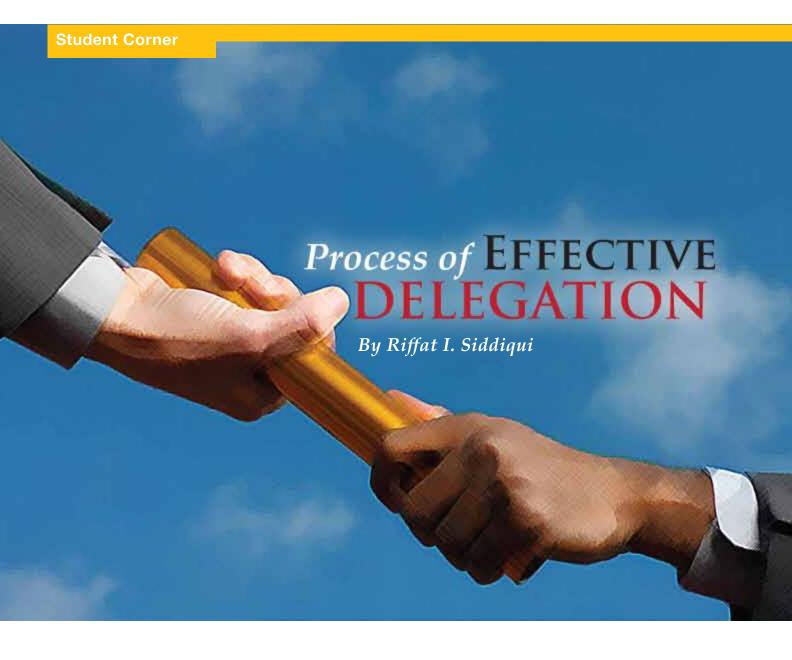
#### **COMPLETE PICTURE**

To remain competitive, banks need this all-inclusive view of customer data. This can only be achieved by scrutinising the legacy systems in place, and by examining ways to achieve improved data consolidation. It's great to have the data to hand

– but it's how it is used that will make a difference.

Banks need the capability to turn data into useful information – that's the key to planned growth. With a flexible long-term strategic plan, a full understanding of what a customer wants and a clear view of the bank's direction, it becomes possible to service the customer better and survive and thrive in a highly competitive environment.

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



Do you feel stressed and overloaded? Or that your career seems stalled? If so, then you may need to brush up your delegation skills. Delegation saves your time, develops your people, grooms a successor and motivates your team.

f you work on your own, there is only a limited amount that you can do no matter how hard you work. However, if you are good at your job, people will want much more from you which can lead to a real sense of pressure and work overload: You can't do everything that everyone wants which can leave you stressed, unhappy and feeling that you are letting people down.

On the positive side, however, you are being given a tremendous opportunity if you can find a way around this limitation. If you can realize this opportunity, you can be

very successful. One of the most common ways of overcoming this limitation is to learn how to delegate your work to other people. If you do this well, you can quickly build a strong and successful team of people, who will be able to meet all kinds of demands. Delegation is an important skill which you should master.

Delegation is a win-win situation when done properly, however that does not mean that you can delegate just anything. To determine when delegation is most appropriate there are five key questions you need to ask yourself:

### DELEGATION IS A WIN-WIN SITUATION WHEN DONE PROPERLY, HOWEVER THAT DOES NOT MEAN THAT YOU CAN DELEGATE JUST ANYTHING.

- Is there someone else who has (or can be given) the necessary information or expertise to complete the task? Essentially is this a task that someone else can do, or is it critical that you do it yourself?
- Does the task provide an opportunity to grow and develop another person's skills?
- Do you have enough time to delegate the job effectively? Time must be available for adequate training, for questions and answers, for opportunities to check progress, and for rework if that is necessary.

If you can answer "yes" to the above questions, then it could well be worth delegating this job. Having decided to delegate a task there are some other factors to consider as well.

#### TO WHOM SHOULD YOU DELEGATE?

The factors to consider here include:

- 1. The experience, knowledge and skills of the individual as they apply to the delegated task.
- What knowledge, skills and attitude does the person already have?
- Do you have time and resources to provide any training needed?

- 2. The individual's preferred work style.
- How independent is the person?
- What does he or she want from his or her job?
- What are his or her long-term goals and interest, and how do these align with the work proposed?
- 3. The current workload of this person.
- Does the person have time to take on more work?
- Will you delegating this task require reshuffling of other responsibilities and workloads?

When you first start to delegate to someone, you may notice that he or she takes longer than you do to complete tasks. This is because you are an expert in the field and the person you have delegated to is still learning.

Be patient: If you have chosen the right person to delegate to, and you are delegating correctly, you will find that he or she quickly becomes competent and reliable.

Lastly, make sure that the team member knows that you want to know if any problems occur, and that you are available for any questions or guidance needed as the work progresses. At first sight, delegation can feel like more hassle than it's worth, however by delegating effectively, you can hugely expand the amount of work that you can deliver.

When you arrange the workload so that you are working on the tasks that have the highest priority for you, and other people are working on meaningful and challenging assignments, you automatically create a recipe for success.

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A wise Chinese man has this to say about the strategies of the warrior of light:

'Convince your enemy that he will gain very little by attacking you; this will diminish his enthusiasm.'

`Do not be ashamed to make a temporary withdrawal from the field if you see that your enemy is stronger than you; it is not winning or losing a single battle that matters, but how the war ends.'

Even if you are very strong, never be ashamed to feign weakness; this will make your enemy act imprudently and attack too soon.'

`In war, the key to victory is the ability to surprise one's opponent.'



#### View on Bankers

on lighter side

You could carve out the inside of a brick and hide your money in it for safe keeping. It's certainly safer than keeping it in the bank!

Nicole McKay

The few who understand the system will either be so interested in its profits or be so dependent upon its favors that there will be no opposition from that class, while on the other hand, the great body of people, mentally incapable of comprehending the tremendous advantage that capital derives from the system, will bear its burdens without complaint, and perhaps without even suspecting that the system is inimical to their interests.

#### The Rothschild brothers

I went to the bank and proposed that they lend money to the poor people. The banker almost fell over.

#### Anonymous

Bankers know that history is inflationary and that money is the last thing a wise man will hoard.

Will Durant

#### **Interesting Quotes**

- A room without books is like a body without a soul. **Cicero**
- In three words I can sum up everything I've learned about life: it goes on. **Robert Frost**
- Each problem that I solved became a rule which served afterwards to solve other problems. Rene Descartes
- No one can make you feel inferior without your consent. **Eleanor Roosevelt**
- Live as if you were to die tomorrow. Learn as if you were to live forever. **Mahatma Gandhi**
- Darkness cannot drive out darkness: only light can do that. Hate cannot drive out hate: only love can do that. Martin Luther King Jr.





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