Impact Of Global Financial Crisis On The Performance Of Commercial Banks Of Pakistan –A Case Study Of MCB Bank Limited

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Abstract:
Objectives: *The objective of study is to investigate the effect of global financial crisis on the efficiency & performance of MCB bank Ltd. The crisis were basically started in United States after the collapse of subprime mortgage market but engulfed the entire globe though the level of severity was different from country to country*

Data Collection Methodology*: Data were collected from various secondary sources and data were analyzed by using various financial ratios meant for liquidity, profitability & solvency. The banks play an important role of financial intermediation; channelize savings of public to investors hence basic key performance indicators for this research were deposits, profit, advances and capital*

Results/Findings: *An attempt has been made to examine the growth and sustainability of sample bank through its performance from 2003 to 2012, before and after crisis. The main findings are (I) the profitability was affected adversely (II) Non Performing Loans were increased significantly after tight control and management for several years. (III) It was explored that costly deposits were mobilized to maintain the book size and restore the confidence of depositors and all stake holders. (IV)The stability of the system remained unquestionable due to maintenance of Capital Adequacy Ratio well above the targeted ratio of 8 % in terms of Basel accord.*

Practical Implications*: This research attempts to address the issue of banking crisis and has practical implication in the Pakistani banking industry.*

Key Words*: Global Financial Crisis, Commercial Banks, Deposits, Liquidity, profitability, Non Performing Loans*

1. Introduction:

A research study has been conducted to evaluate the effects of global financial crises over the financial performance of commercial banks of Pakistan. The global financial crisis started with collapse of mortgage industry in USA which engulfed entire world however severity of shocks and losses sustained varied country wise. The crisis were termed as great recession even more than great depression of 1930s

The crisis emanated as a result of collapse of house loan industry in the US due to extending of loans on unjustified ground even basic lending criterion was ignored at large. In most of cases repaying capacity of prospective borrowers was not ascertained even banks relied on the supported documents provided by borrowers without verification of genuineness. Such loans were also termed as liar loans.

The scope of this study covers to examine and evaluate the performance of MCB Bank over the period of 10 years from 2003-2012,year 2008 has been taken as base year hence performance was measure before and after crisis.

All the performance indicators were taken to evaluate the performance like deposits, advances, Stability, profitability, Network, products and services so provided and tenure of presence in the industry. Data were taken from annual financial reports. The technique of financial ratios was used to evaluate the efficiency and performance of sample bank. In the era of technology it is very common to use this method of financial ratios to investigate and evaluate performance of Bank.

1.1. Causes of Crisis

The main cause of the crises was improper lending by financial institutions for a long term, formal lending procedures and practices were ignored. The key factor "Repayment capacity" of borrower, credit history and character, cash flows and disposal of collateral was totally borrower ignored. Moreover the role of rating agencies also fueled the fire ,as they did not correctly and accurately assessed the borrower and collaterals for the sake of financial benefits. An important element was de-regularization, repeal and relaxation of the Glass-Steagall Act of 1933.

1.2. Impact of Global Financial Crisis

In 2007 the financial crises got momentum and stock markets of the world witnessed slow down big financial and insurance institutions collapsed such as Lehman Brothers, American International Group Inc (AIG), Fannie Mae, Freddie Mac etc. Central banks of weaker economies such as Ice Land declared bankruptcy and many big banks applied for bailout packages to avoid liquidation.

This resulted into credit squeeze, severe liquidity crisis and recession in financial market. The home prices shapely declined almost by 20 % from its highest price of 2006, the home equity have been evaluated $13 trillion. In 2008 reached to lowest level of $8.8 trillion. In 2009 global declined by 2.2 %, around 35 million people lost their jobs.

1.3. Impact of Global Financial Crisis on Pakistan

Foreign Direct Investment (FDI) was declined by 47.5 % during July 2008 to April 2009 mostly due to outflow of private portfolio investment amounting to US$ 1 billion.

The import bill during the period increased by 43 % amounting to US $ 10.5 due to rise in oil prices internationally which eventually raised inflation rate and widened the current account deficit.

Trade deficit increased by 57.4 % amounting to $ 15.3 billion in spite of surpassing the export target of $$19.2 billion. This increasing deficit trend continued further and trade deficit was increased by 38 %, trade deficit of $ 7.55 billion was recorded during July-Oct 2008 against US $ 5.47 corresponding period of last year. However remittances from overseas workers were not affected but Pakistan failed to raise funds from the capital markets abroad as entire globe was already in recession.

1.4 Impact on Banking Industry in Pakistan

Despite bad governance prevails in the country particularly after 9/11, war on terror remained as permanent phenomenon but the banking industry not only flourished but is tightly regulated by central bank of the country particularly after autonomy of SBP.

Keeping in view the demands for economic globalization, banking sector of Pakistan also participated in global financial market. Foreign banks have also mobilized one tenths of share in deposit of the country was mobilized. Therefore the effects of global financial crisis were also felt while the level of severity was not so much severe. The ripple effect of crisis was witnessed on credit and liquidity on financial sector.

The data on banking system confirms a slowdown in 2008 after year long continuous growth, deposits declined to 3.67 trillion from 3.77 trillion by, provisioning of non performing loans by 3 %. .The interest rates jumped up to 20 % .Rates on T Bills were raised by 5 per cent; the interest rates were raised to combat liquidity in system which added in NPL particularly in consumer finance. Monetary growth (M2) was also higher than preceding year, which created fears of inflation to creep in the economy; inflation was doubled and was recorded around 20 %.

2. Review of Literature

A lot of research work has been carried out to explore the root causes and possible consequences of the crisis but there is negligible empirical literature available of impact of crisis on economy and banking in Pakistan.

Therefore an attempt is made to explore the consequences of Global financial Crisis on performance and efficiency of commercial banks operating in Pakistan.

National Bureau of Economic Research has made the subprime mortgage meltdown responsible for recent global crisis. (Aubuchon 2009).Recent crisis gripped entire globe and caused liquidity problem, credit contraction and recession in financial market. The subprime mortgage was the riskiest sector thus losses could not be overlooked. (Caballero 200 Morgan et al, 2007)

A.B.Ashcraft and T Schuermnn, et al, 2007 held the securitization process for such unprecedented losses and caused financial crisis. especially CDOs & CLOs.

Dr UmerChapra in his recent research regarding financial crisis he explored and argued that the global financial crisis has severely affected the overall growth of banking sector which was observed very slow and was worst than Great depression of the century and further forecasted that the effects of the recession are long lasting. He further explained on credit problem, he analyzed that more profit means more lending and high leverage was the reason which made excess lending possible and resulted into artificial boom in prices of assets and gave rise in speculative investment and consumption. Such high leverage was difficult to unwind and this vicious cycle of selling ultimately lead to steep decline in prices rather to downturn and outcome was financial crisis.

JP Morgan et al,2006 explored that Mortgage-Backed securities which were highly risk bearing had shown extra ordinary credit expansion after 1998 although theses were started to increase in 70s but were limitedly involved and used in mortgaged business till late 90s.Sudden rise was the reason of global financial meltdown of 2008.It touched to US $ 45500 billion in 2007 against the figures of US $ 1500 billion in 2002 ,a record growth of US $ 44000 billion in five years around 2933 %, Moreover the figures of securitization in % terms against submortgage loans were 54 % in 2001 and 75 % in 2007.

Lowenstein (2008) observed that regulators and Central Banks could not learn the lessons from past events and thus have allowed repetition of events again and again which recurred in shape of Global Financial crisis which was claimed as failure banks as well as their regulators. It was needed to recognize the importance of early warning signals and tight regulation of financial derivatives was made instead of allowing riskier business behaving in speculative manner and seeking for bailout from government.

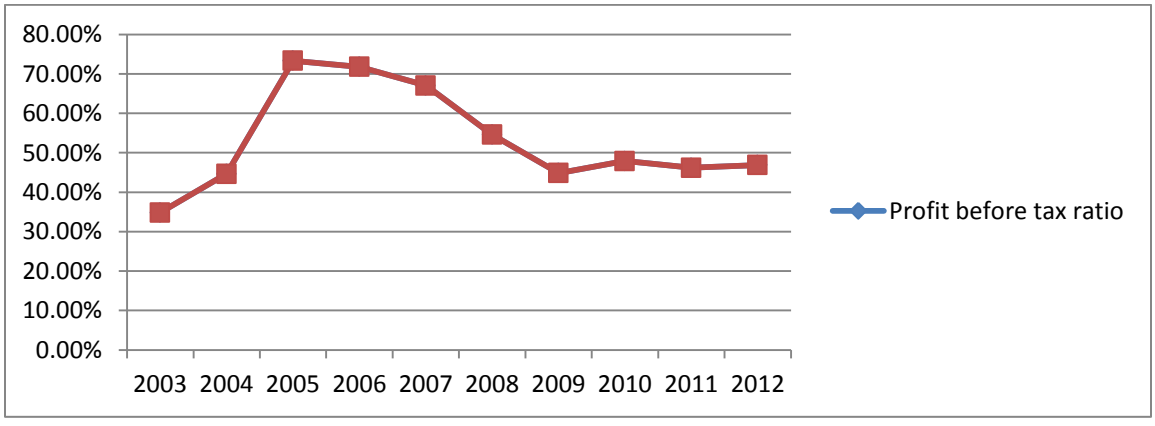
3. Research Methodology

3.1. Ratio Analysis

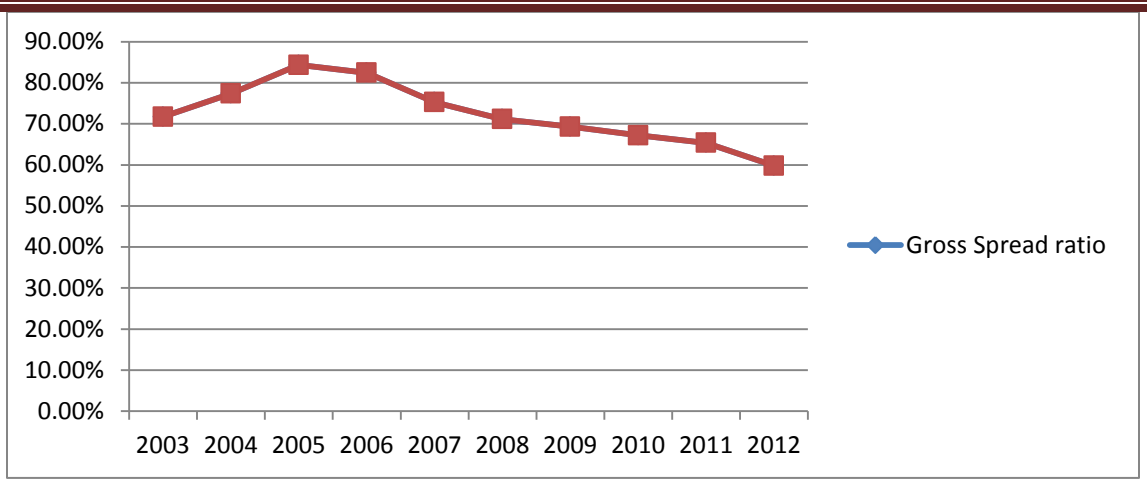
In this research study performance of sample bank was analyzed by using financial ratios as measurement tool. Ratio analysis technique was also used by several research scholars to evaluate the efficiency and performance of banks as and Chen & Shimerda (1981) Sabi(1996) and Ahmed & Hassan (2007), .

Financial Analysis by using Ratios

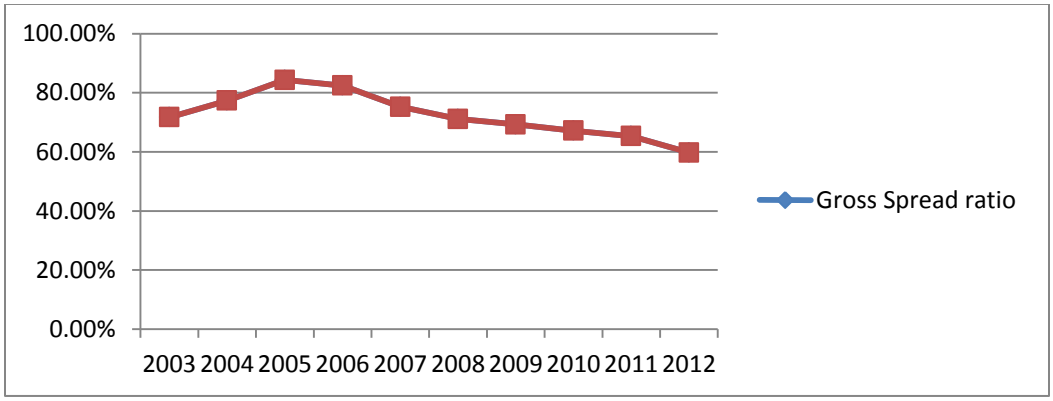
Profit before tax ratio



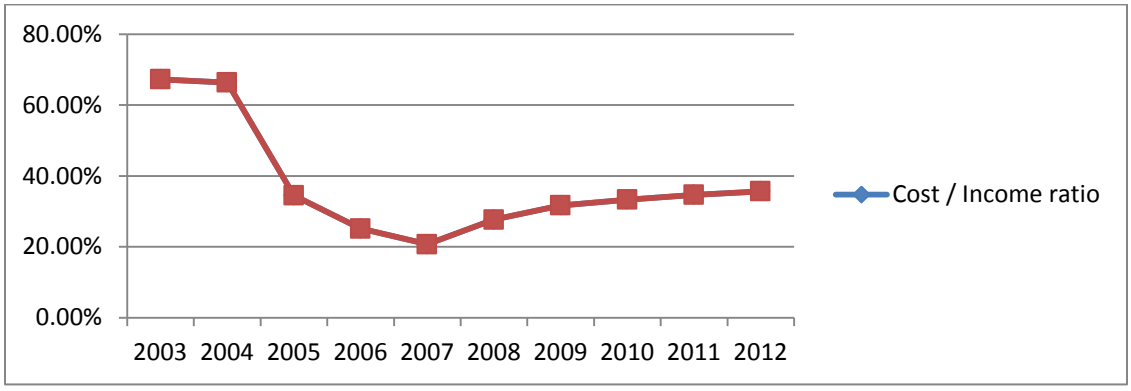
Gross Yield on Earning Assets



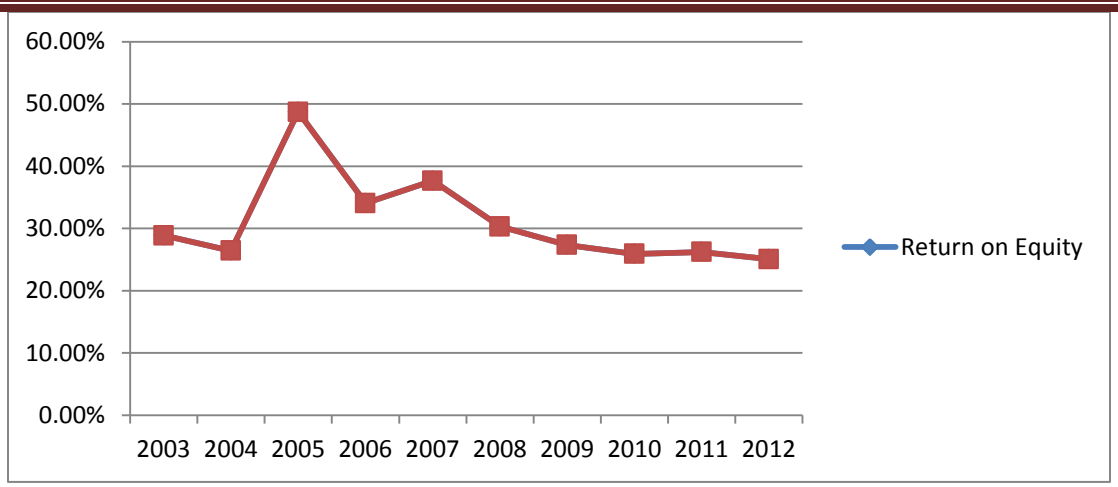
Gross Spread ratio



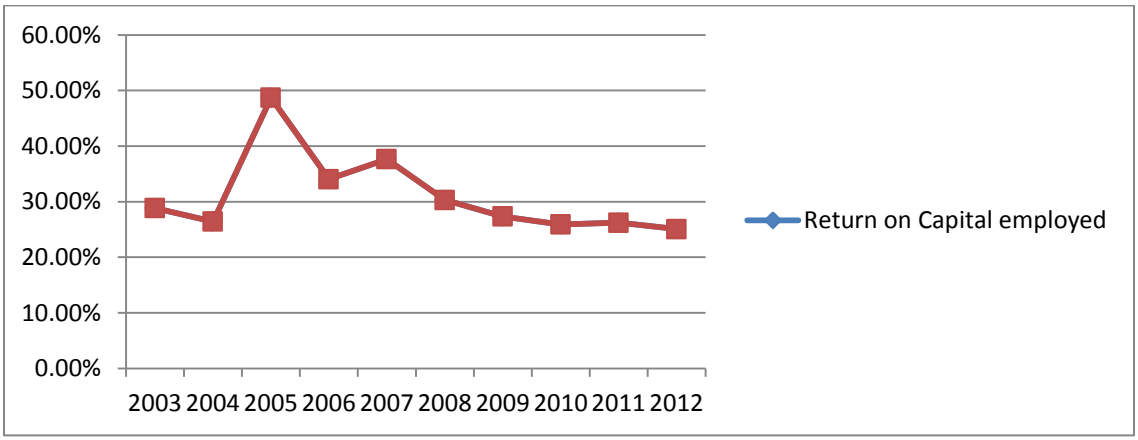
Cost / Income ratio



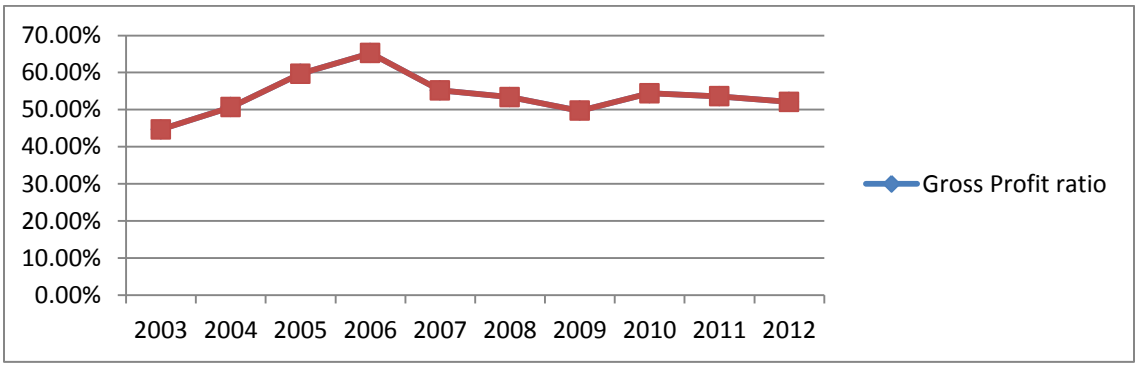
Return on Equity



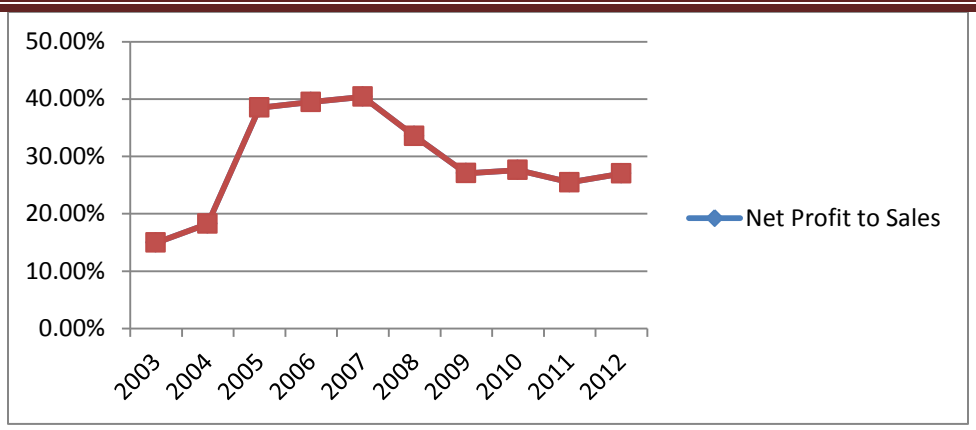
Return on Capital employed



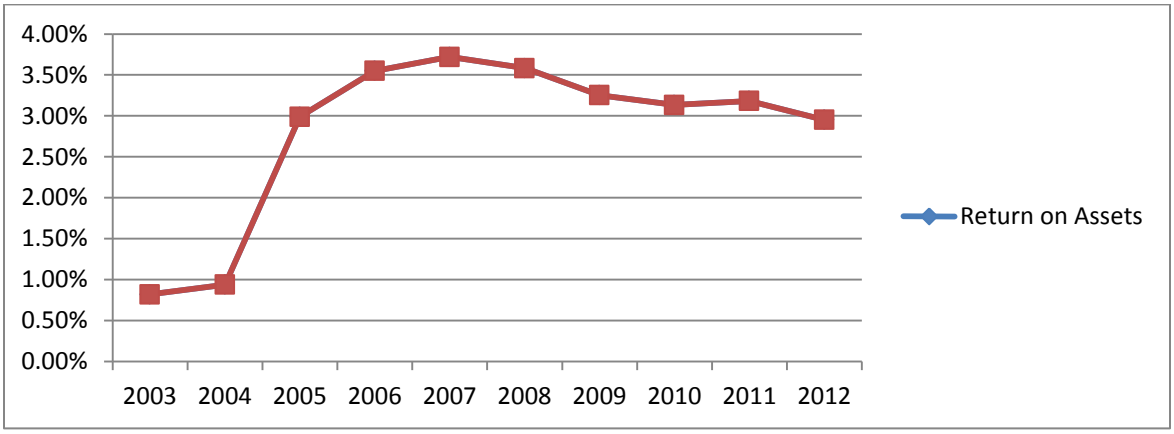
Gross Profit ratio



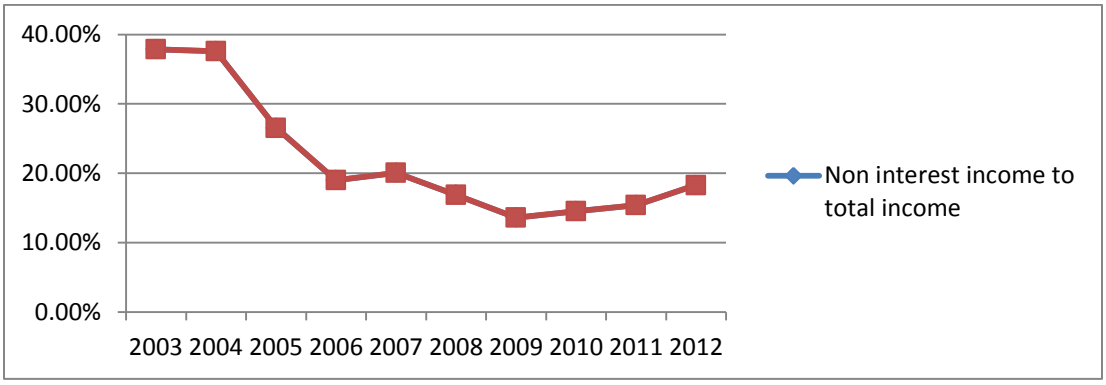
Net Profit to Sales



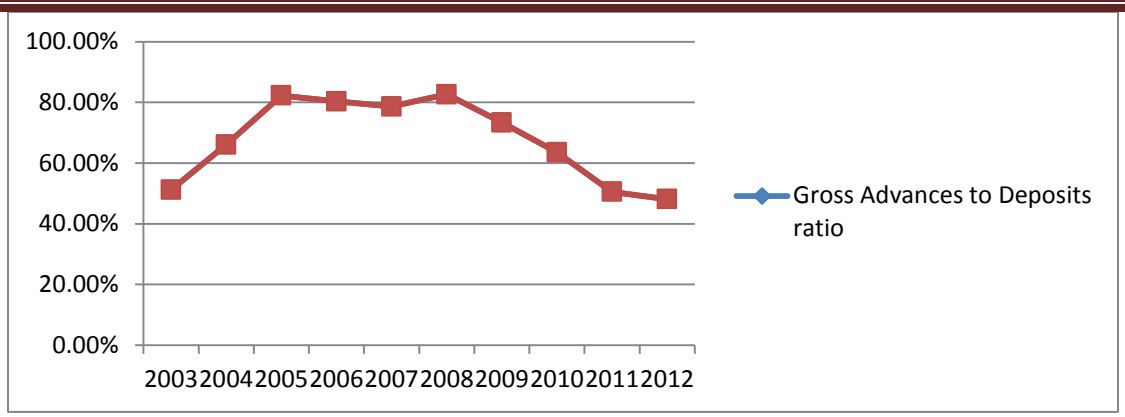
Return on Assets



Noninterest income to total income

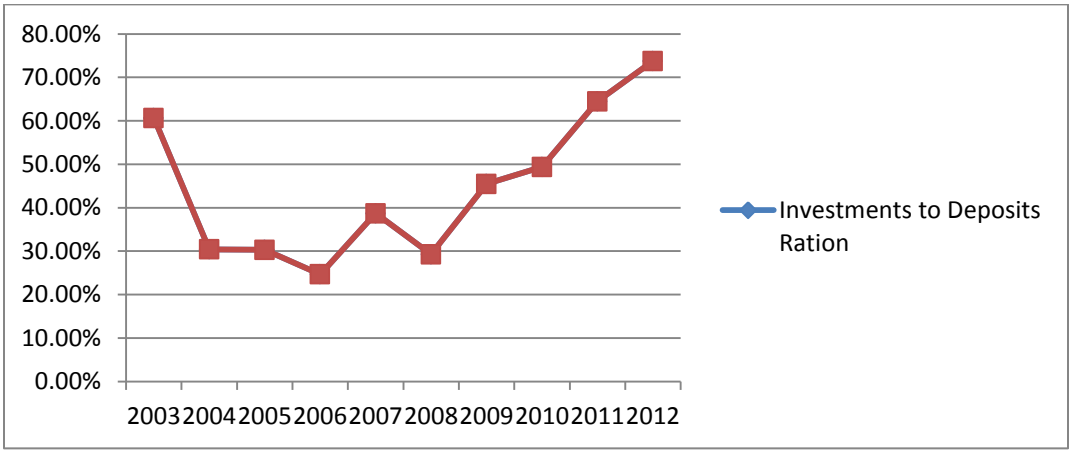


Gross Advances to deposits ratio

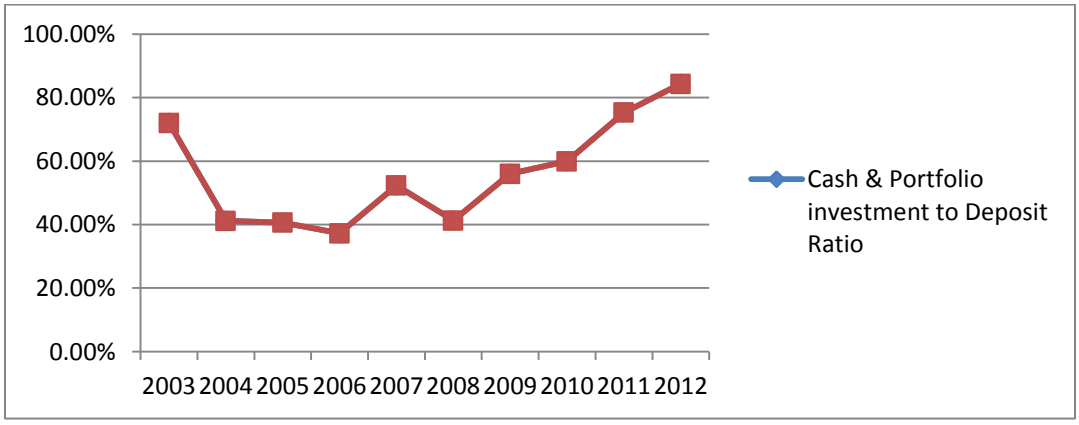


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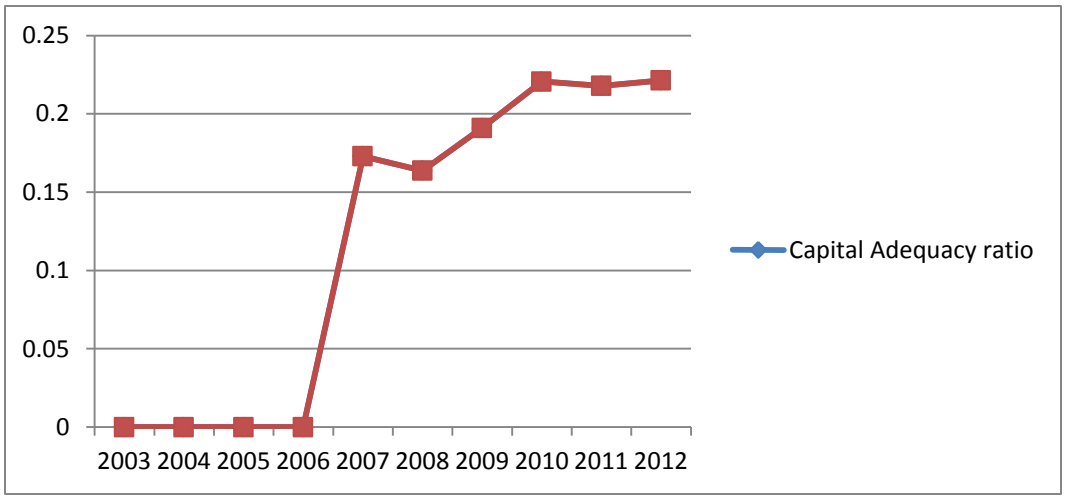
Investments to Deposits Ration



Cash & Portfolio investment to Deposits ratio

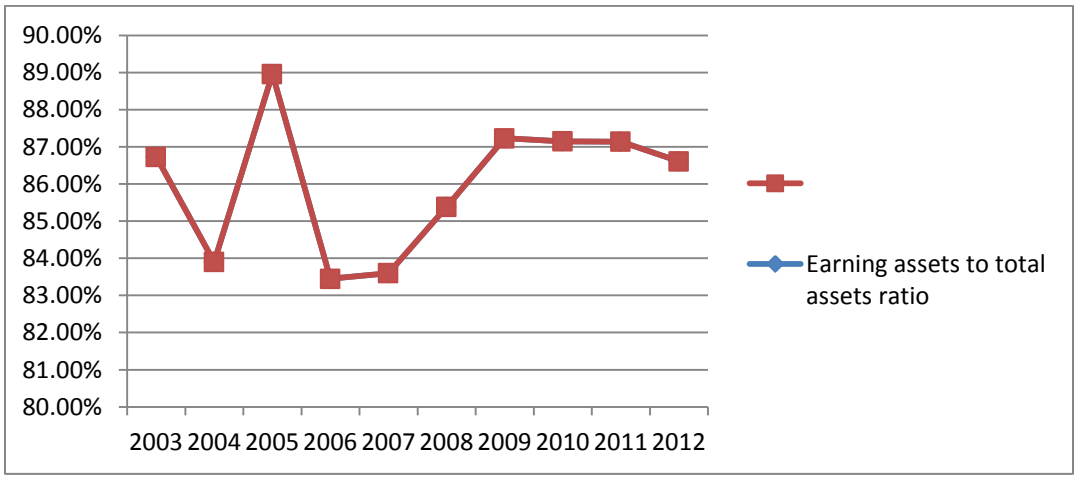


Capital Adequacy ratio

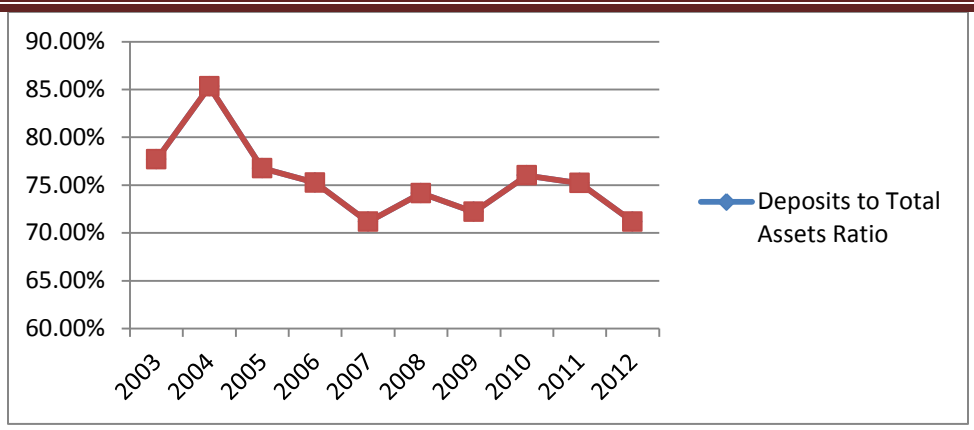


Data for 2003 to 2006 was not readily available

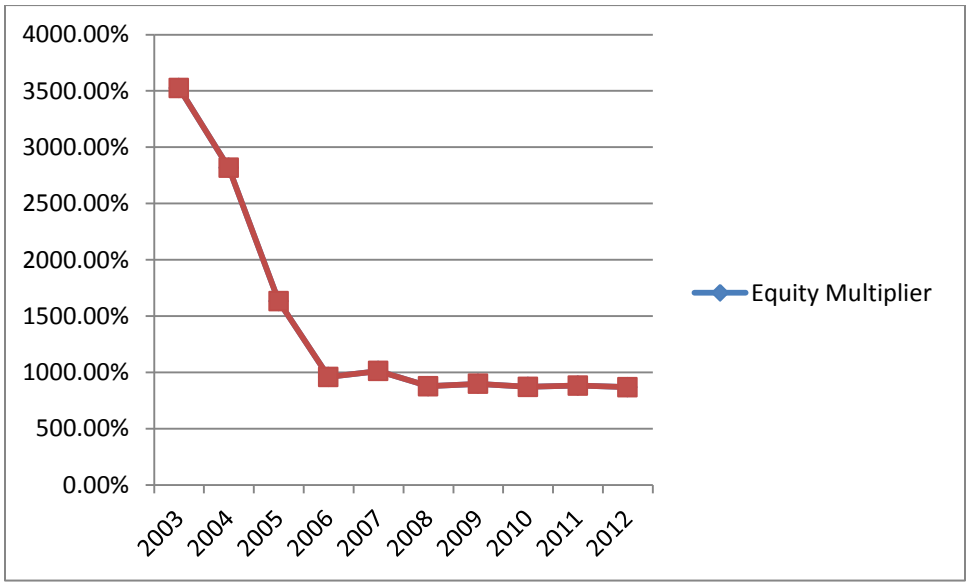
Earning Assets to total assets ratio



Deposits to total Assets ratio



Equity Multiplier



Comment:

While going through the performance of MCB Bank limited since 2003 to 2012 it was revealed that bank is performing on sound footing, all key performance indicators show the tremendous growth with stability. However ratio analysis reveals that

- Cost of deposit is increased especially after crisis
- NPL increased during crisis
- Advances decreased
- Investment increased in government papers to earn steady income
- Gross mark up income slightly decreased
- Gross profit ratio decreased due to rise in mark up expense (COD raised)
- Return on equity somehow decreased
- Gross Advances and Deposits Ratio tells about how a Bank utilizes its deposits in extending loans, low ratio contributes low profit but higher liquidity and vice versa
- Capital Adequacy ratio tells that bank is very much solvent as it has set aside sufficient capital to safe guard against any loss on assets.

4. Conclusion& Results:

4.1. Conclusion:

In general bank quite solvent, liquidity during the period immediate upon emergence of crisis was on increasing trend but it could further be managed if cost of deposit is further controlled. Non Performing loans increased. Advances were decreased and funds were invested in government papers to earn risk free stable income.

4.2. Recommendations:

Bank should invest in advances so that private sector could flourish and economic development of country be accelerated.

Non performing loans must be vigorously followed to recover public money which will resultantly improve profitability. Rate of interest should not be changed during validity of loan so that borrower may be able to repay loans easily

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