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" Challenges and Opportunities faced by the Banking Sector in Pakistan in the wake of Covid-19 Pandemic "

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BUSINESS PROJECT

Challenges and Opportunities faced by the Banking Sector in Pakistan in the wake of Covid-19 Pandemic

ABSTRACT:

The economic impact of the COVID-19 crisis is very different from other past financial crises or business-cycle downturns. The purpose of this project is to develop an understanding particularly in the management field, through exploring implementation of distinct banking strategies to cope with an evolving crisis. The research conducted for the purpose of this project was through a combination of narrative and objective literature review and primary interviews of senior level management from top Banks of Pakistan using a semi structural guide. The findings of this project strive to develop the importance of the role Banks play in the overall economy of the nation and how the strong regulatory environment and the overall socio-economic setting of Pakistan's financial markets have allowed the Banks to be one of the most stable sectors of this economy. Rather than being part of the problem in the previous global financial crisis, Banks had a much greater role in the solution to safeguard the economy and the livelihood of the population in Pakistan's perspective through course of Covid-19 pandemic. The initial responses of the Banks were primarily enforceability of the healthcare SOPs laid out by the government and regulated by SBP. A big part of it was also the business continuity for uninterrupted delivery of banking services digitally where technology played the most significant role. This also came as a blessing in disguise as the pace of digital transformation really picked up pace which might have caught up several years later otherwise.

The second part of the findings highlight the interventions by the regulator and government of Pakistan in safeguarding the economy and keeping the financial sector robust. The interventions were implemented through commercial Banks of Pakistan and played the most crucial role in keeping the financial sector completely immune to the adverse impact of Covid and aided towards kickstarting the economy and achieve unexpected GDP growth when the other countries in the region contracted significantly.

Lastly, the findings also establish the future expectation in the sector and the role technology will be playing. It finds out how the consumer patterns have shifted on digital medium through the course of pandemic and how post covid banks can capitalize on this to adopt complete digital transformation suggesting the ways that can be done. Through this, Banks can reap the benefits of first movers in this space going forward emphasizing on the role of big data analytics. The world during covid has changed significantly and by the time it is completely over, the world will be different place with no place for complacency especially for the banking sector.

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INTRODUCTION:

The outbreak and spread of COVID-19 pandemic posed unprecedented and unique set of challenges to all walks of life that brought the global economic as well as domestic environment to its knees putting its very existence at stake. Financial institutions within the Banking sector of Pakistan, considered as the backbone of the formal economy, were no different to these ruthless challenges. Banks were confronted with the double jeopardy when the economic impact of the pandemic spread across the businesses worldwide. Juggling between strategic & operational priorities which included keeping their distribution channels (Branch and Digital) operational while maintaining social distancing SOPs, maintaining its human resource safety, and complying with the regulatory frameworks (that was never designed for such a situation), to mitigating the hit on its revenues while meeting customer expectations despite a standstill in economic activity within a falling interest rate environment. These challenges also brought with them new set of opportunities for the Banks changing the way things will work in the future. Along these lines this business research project envisages to explore the banking industry's confrontation with these challenges, it management & future opportunities brought to light.

Financial industry is the most important pillar of the economic system of a country. The outbreak of virus not only posed major threat to the financial sector, but its impact trickles down to all other businesses associated in terms of its depositors, its borrowers and its suppliers having colossal impact on the overall economy.

Employing a significant workforce in the private sector and having one of the highest levels of physical customer interactions, business continuity of Banks amidst efforts of looking out for the safety of its employees and customers is of critical importance for future crisis strategies.

Developing the understanding of how Banks managed to focus on business continuity in such a situation could serve as a guiding light for other businesses throughout Pakistan in the wake of current as well as future such unforeseen circumstances.

This crisis also represented an opportunity for the emergence of new services or the development of existing ones which need to be understood to look at the future of banking sector post pandemic.

OBJECTIVE:

This project aims to develop an understanding on how the banking industry is coping with an evolving crisis in the wake of Covid-19 Pandemic in Pakistan and to identify how complex crises challenge managerial practices in the banking industry. It shall further provide insights into how the banking sector perceives the future coming out of this pandemic by looking at the opportunities that have arisen consequently.

LITERATURE REVIEW:

(Deloitte, 2020) in their latest survey conducted through questioning and interviewing 69 bank chief risk officers' states that Banks have come far in terms of their asset quality post the global financial crisis of 2008. They had worked greatly towards improving their capital buffers, liquidities, and management controls to equip themselves in a better position to face any future crisis. This survey was carried out around five main areas. Which included Economic Recovery, Loan Dynamics, Asset Quality, Non-Performing Loans & Restructuring. It was found that majority of the respondents of the survey expected a prolonged economic U shaped recovery. The measures taken by federal reserve Banks were found to be most effective in mitigating the economic impact of the overall pandemic compared with the steps taken by the governments. New Loan disbursements in the years of pandemic are expected to see a significant dip as the respondents foresee tightening of retail as well as Corporate credit policies. The most severely hit sectors of the economies were hospitality, transport and storage. Interestingly, the survey does not see any significant deterioration in the asset quality of Banks. The prime reason could be the timely monitory policy measures along with effective stimulus put in place by the federal Banks. As a result of this and the relief provided to businesses which helped mitigate the hit on the financial sector, debt restricting is expected to see significant rise. With this comes another challenge of weather the Banks have the human resource to deal with such colossal amounts of restructuring. 64% of the respondents according to the survey believe they do.

In its latest report, (International Finance Corporation, 2021) says that if the current Covid-19 crisis prolongs, will lead to substantial structural changes in terms of E-Commerce expansion such as e-government, telework, teleconferences, online education and contraction of business travel etc. The impact of Covid pandemic is different from that of any previous financial crisis. While the previous global financial crisis affected financial intermediation and had by virtue a deflationary characteristic, the current pandemic started as a health crisis which is translating into a demand and supply side shocks converting it into an unprecedented economic crisis. According to the World Bank, about 150 million people will be impoverished by the end of 2021. The SME's ability to repay debt will be severely restricted in the short as well as medium term. Businesses that have dependency on imports for its input or on exports for its revenue will be affected most significantly. Business continuity will be mainly dependant on digital channels where SME's or informal sectors will be badly affected since digital outreach to these sectors is minimal. The report says that 81% of the informal workers i.e 2.7 billion have already been affected due to lockdowns from time to time. Due to Covid, the existing challenges that were being faced by the Banks have become even greater. The traditional banking channels will feel great challenges on their revenues, tight regulations and competition from digital entrants (fintech). To overcome the effects of these challenges, Banks need to develop strategies towards digitization of processes & products, online customer services, restructure existing loans, provide support to affected customers, utilize the government support, waive fees and penalties and provide grace periods and extensions to its customers that are in financial distress as a result of current pandemic. It also suggests that regulatory response in six major categories has been quite helpful towards the financial sector in meeting these challenges. These include, Credit repayment moratoriums, support for restructuring of loans, relaxation in classification and provisioning regulations, injection of liquidity and easing out the monetary conditions, relaxing the capital buffers and giving out interest rate and tax rate cuts.

(MARCU, 2021) in her paper on banking strategies implemented during the Covid-19 pandemic found that during the financial crisis of 1930's and 2008, Banks were found at the middle of the problem whereas this time, the case has been otherwise. Banks are a part of the solution if economic crisis stemming from this pandemic is to be mitigated. The strategies that the banks have adopted impact the entire economies. Although, the banks have been in constant evolution to meet their customer requirements and expectation, the current pandemic has pushed them towards speeding up the digitization of their processes and products. The larger banks were at an advantage when the crisis first broke as they had bigger capital buffers to absorb any financial shock. For the first time in the history, Banks have moved towards remote working as a result of covid pandemic. As a result of these developments, Banks will have to bear the burden of heavy investments in IT infrastructure not far from now. The managers in the banking sector changed their work environment with special emphasis on health, wellbeing and flexibility. Banks have transitioned into new operational models which is aligned with the current environment and have accordingly redesigned their offices spaces. Entering the pandemic, Banks had more capital and better liquidity. Hence, it helped them cope with the current crisis to date by supporting the socio-economic eco system. Banks successfully passed the lockdown period. The immediately adapted technological innovation and digitization which helped them with their business continuity during the crisis. Transformation towards e banking and successfully dealing with the digital security challenges is a text book example for other businesses to follow in such a crisis and beyond.

(Tazetdinova, 2020) examined the banking sector of Kazakhstan in the wake of recession caused by Covid-19 coupled with a more than significant drop in the oil prices. The paper finds that entering the recession with a better position, having cleaned their books and having better liquidity, Banks are to be greatly affected as a result of poor financial health of their borrowers in the wake of Covid-19 pandemic. Accordingly, this increased the credit risks and consequent capital adequacy challenges. The monetary policy measures should be aligned with the credit growth policy of the banks and should not provide the wrong incentives to the Banks. It is a standard practice to ease out the macroprudential buffers in such period by the regulator, the macroprudential tools (credit risk weights and framework) should not be revised to give a realistic future outlook of the sector. A realistic review of credit holiday withdrawal which was targeted towards individual and SME borrowers needs to be made to exactly ascertain the credit quality. With this comes the most important regulatory framework for adequate and timely recognition of problem loans. The paper also finds that the expansion of low interest state subsidy programs as stimulus/assistance package, reduces efficiency & competitiveness of banking sector as well as the economy as a whole.

(Ewa Kulińska-Sadłocha, 2020) analysed the direct and indirect impact of Covid-19 on the Polish Banking sector. The research carried out in this paper both empirically and theoretically evaluated the activities which allowed the banking sector to fund the economy during the crisis with the held of government, central bank & banking regulators. The paper finds that the mitigating measures taken by the banking sector rather lead to a rise in write offs for provision of receivables, increasing operating costs & decrease in receivables from debt instruments. Expected to fresh credit off take, the banks on the contrary tightened their credit policies and worked only with existing clientele that had established creditworthiness. This was primarily due to absence of incentives given to the banks to increase their risk appetites and resultant operating costs during the crisis. The paper found that the polish banks had historic capital and liquidities at the time of outbreak of pandemic having strong immunity to external shocks such as the likes of an economic crisis caused by the pandemic. Due to overall adaptability towards e banking and digitization, Banks were able to implement social distancing SOPs with relatively unhampered provision of services. The papers also establishes that the impact of pandemic on the banking sector shall be short lived and wear off as the pandemic subsides. However, in the long term, the banking operations as a whole may evolve and adapt from its functioning during the pandemic (such as changes in business models, remote work and digitization etc).

The Governor Banco de Espan (Cos, 2021) believes that the banking sector has shown great resilience and ability to handle unexpected risks because of international best practices and foreign policy reforms. The Spanish economy saw a YOY decrease of 11% in its GDP in 2020 as which can also be attributed to a consequence of corona virus pandemic. The governor believes the resilience is the result of restructuring of the Spanish banking sector which reduced the number of banks operating there. The NPL ratio of the sector fell from 9% to 4.8% in 2020. This was due to strong economic policy measures including monetary, financial & fiscal. The monetary policy of emergency purchase program which offered easy financing conditions along with targeted Long-Term refinancing operations have helped the sector to avoid liquidity problems. While the crisis in ongoing, the report states that the importance of maintaining targeted stimulus is of utmost importance for the health of financial and economic system. Extension in emergency purchase program and use of capital buffers by the Banks is to be encouraged. In the longer run, the resilience of the banking sector to any new array of risks is to be ensured through successful implementation of Basel III reforms. Banks needs to adapt to new technologies and innovate. Fintech is to be promoted to make the sector robust and adaptable.

The customer expectation of banking has seen a great rise as the banks work towards accelerated digitization as a result of the pandemic. (Nigel Moden, 2020) reveals that during lockdown periods during the pandemic, 72% rise has been witnessed in Europe alone in the usage of fintech applications. However, only 16% of European customers believe that the banking practices will change for good in the long run as a result of Covid-19. This has been primarily due to the generational gap. The people who are beyond 55 years of age have found to be least likely to adapt to change and the way they bank. The article says that the speed of the change is going to be of most importance here. Banks need to identify and resolve the issues in the digital framework for banking quickly to make the end user experience hassle free avoid any reputational challenges. Establishing of application programming interfaces which are equipped with advanced artificial intelligence and analytics can offer great scale of personalization of customer experience. E&Y's 2020 Global Corporate Divestment study reveals that 60% of Banks are already looking towards divestment to fund the investments in digital space. The success of digital initiatives however would be reliant on four key areas; Redefining the customer experience with keeping their requirement at the top of the list, taking a mobile first view to promote a contactless banking, developing data strategy using analytics for personalization and lastly selecting the correct technological platforms. Hence, the prospective change that has been given birth due to Covid-19 outbreak, can really aid Banks in dealing with highly regulated operational requirements and can be a great step towards achieving better profitability in the longer run.

The current pandemic being one of the most serious challenges that the financial sectors have faced in over a century can be dealt with if concrete steps are taken by the Banks, a few of which have been suggest by Price Water Cooper's (PWC, 2020). The foremost is to focus business continuity planning on issues of survival. This recommendation revolves around the hub and spoke model where main branches with a greater customer footfall to remain operational in the times of crisis whereas the smaller ones can be closed. The clients shall be offered to use digital channels for their banking needs while branch visits can be mad on appointments for needs that are not being addressed digitally. Let the back operation teams work remotely and utilizing third party support where required. A framework for controls and policies to work under such protocols shall be defined to avoid any ambiguity. Secondly, give customers the temporary relief by not reporting their overdues for a period of 90 days to the credit information bureaus. Manage their perceptions through targeted promotional efforts to manage banks image. Thirdly, rethink the challenges to the financial book of the Bank while keeping abreast with asset quality and customer sensitivity. Fourthly, finding ways to trim costs is of utmost importance in such crisis. These can be easily defined in the back-office spaces, procurement, marketing, and customer services. Let the essential function operate while others can be alternated, outsourced or trimmed down. Use digital technology wherever applicable. Fifthly, rethink the revenue numbers and budgets to have a realistic approach and targets accordingly. Analyse the hit to the asset book of the bank. Anticipate the interest rate cuts in such environment and shred bank's high-cost deposits accordingly to align yourself properly. Lastly, plant and prepare, a post covid strategy. Onboard new customers that have latest business models that are modern and contemporary. Rethink the reasons that create brand loyalty. Tap into new areas and markets to achieve growth. Work strongly on establishing sustainable business continuity plans for times of adversity and crisis. Revalidate the business assumptions and reallocate capital accordingly.

(Asli Demirguc-Kunt, 2020) find that disease control SOPs with social distancing coupled with partial and total lockdowns affected economies worldwide. Banks were expected to absorb the immediate shock and intermediate the financial credit to corporations, individuals and institutions for reinvigorating economic activity in times of adversity. Governments and banking regulators around the globe took numerous policy measures to aid the role of a Bank in such a crisis. However, this gave birth to the most important question of future of banking sector as a result of these countercyclical lending policies. In the research, stock prices of 53 Banks from around the world was used to determine the impact of Covid-19 shock. The results show that the hit to the stock prices of Banks were more pronounced and long lasting compared with other corporates. The bigger banks with greater capital saw greater decrease in their stock prices on the anticipation of their greater role in the crisis management. The research also reveals that liquidity support and monetary policy measures analysed through more than 400 policy announcements worldwide resulted in positive returns for the banks during the pandemic. However, the abnormal increase in Bank returns as a result of these were still not able to increase the stock prices of the Banks. Summing it up, the expectations from the Banks during such a crisis for intermediation and being a driver of growth through credit extension put the banking system around the globe in stress. The policy measures aided Banks deal with this stress but the smaller banks with lower capital remained affected. Going forward, the withdrawal of these policy measures will need to be carefully planned in phases so as to not trigger a financial sector crisis.

(Sengupta, 2020) publishes in their paper that the Indian economy pre-covid was already witnessing a downward growth trajectory since 2015. During the time of the crisis, the financial sector was expected to play a pivotal role in mitigating the risks to the economy that stemmed out from covid outbreak. However, the banking system in India was already at a disadvantage due to the poor performance of public sector banks that already had poor asset quality and were suffering from loan loss provisioning. Hence, expected credit growth at the time of outbreak was already affected. The overleveraged & inadequately capitalized banks operating in India which have poor asset quality multiply the risk of economic failure in the time of a crisis such as the current pandemic. The corrective actions taken by the state prior to covid-19 outbreak to strengthen these Banks lead towards reluctance in credit growth by the stronger Banks under risk aversion. This as a result was already hurting the debt markets. The outbreak of the virus put the economy under immense pressure due and unlike other countries, the commercial Banks could not absorb these shocks and come to the aid of economy by extending credit to severely hit sectors of the economy. Hence, going forward, the revival of these sectors critically depends on the intermediation by the commercial Banks of India and the government interventions.

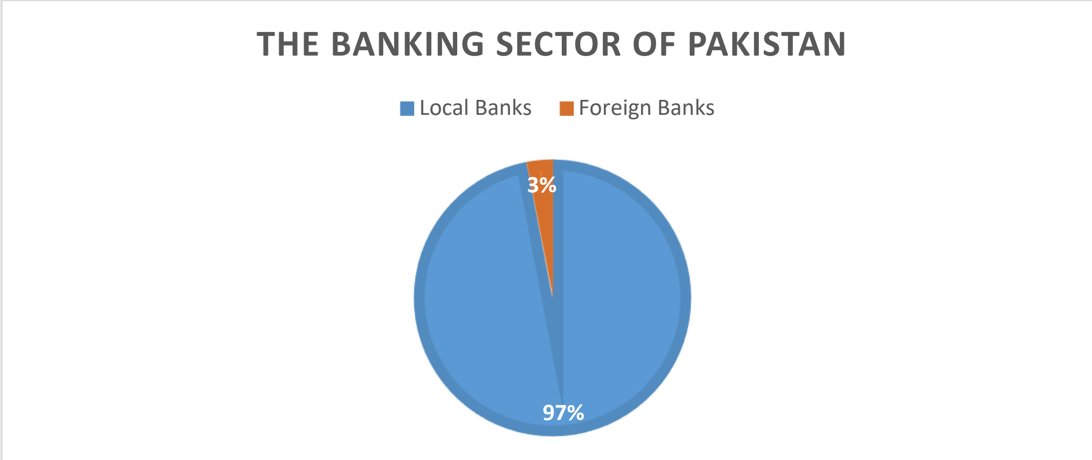
METHODOLOGY:

This project intends to present an opinion based on a narrative literature review and interviews of senior management from top banks of Pakistan which have been conducted using a semi structural interview guide. Most of these individuals are above the Cadre of Senior Vice Presidents and are serving their institutions as regional and country heads in their respective domains which ranges across Corporate & Investment Banking, Risk Management Group, Retail Banking, Human Resource Group and a couple of current and Ex- Presidents of Banks.

FINDINGS:

THE BANKING SECTOR OF PAKISTAN

The Banking sector of Pakistan is considered one of the most stable sectors of the economy over the years especially post privatization in 1990's. Banking sector comprises of both local and foreign banks. Local banks are constituted by a mix of private sector, public sector and specialized banks & hold around 97 % share of the banking industry whereas remaining 3% is represented by Foreign Banks.

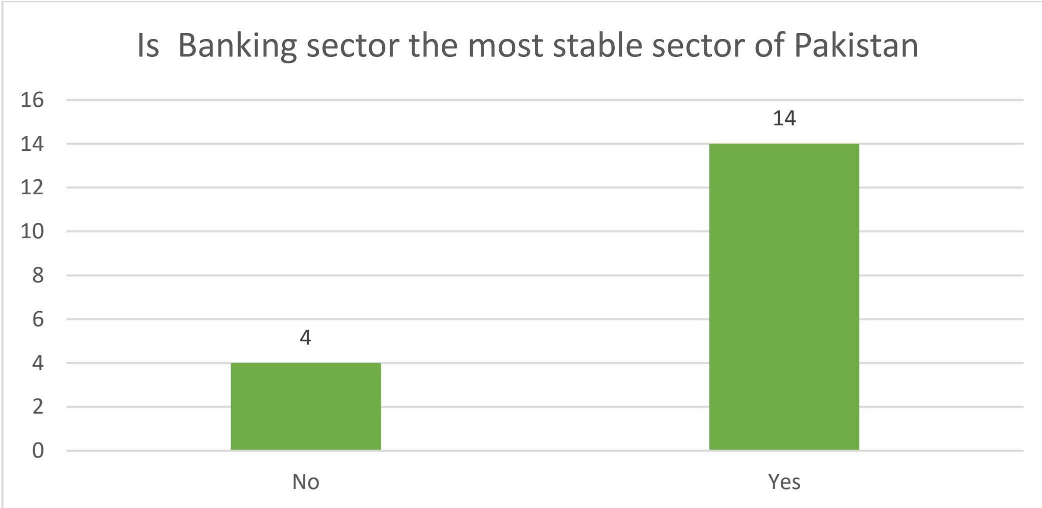


If we compile and analyse the data obtained from State Bank of Pakistan as tabulated below, we can see that the Equity, Liabilities in terms of Deposits, Assets (majorly comprising of Advances/Loans and Investments in government Paper) and Profitability of the sector has been going up on the past 5 years consecutively which is a testament to the financial stability of the sector.

All Banks - Overall (Thousand Rupees)

Items	2016	2017	2018	2019	2020
A.Total equity (A1 to A3)	1,175,498,718	1,149,807,067	1,261,395,703	1,383,706,620	1,577,651,475
1.Share capital/head office capital account	534,612,611	413,014,554	432,521,958	445,984,289	449,006,837
2.Reserves	304,936,372	341,413,315	388,513,190	417,791,143	458,084,578
3.Un appropriated profit	335,949,735	395,379,198	440,360,555	519,931,188	670,560,060
4.Others	174,822,622	238,908,131	193,599,547	281,889,801	317,751,482
B.Total liabilities (B1 to B4)	14,539,437,305	17,151,321,267	18,587,376,827	20,454,859,062	23,173,656,646
1.Bills payable	211,162,200	264,242,205	290,266,630	233,127,774	306,229,767
2.Borrowings from financial institutions	1,928,723,371	3,091,646,420	3,028,011,600	2,974,983,362	3,153,253,160
3.Deposits and other accounts	11,764,688,240	12,930,256,100	14,295,218,772	16,021,241,977	18,504,835,539
4.Other/misc. liabilities	634,863,494	865,176,542	973,879,825	1,225,505,949	1,209,338,180
C.Total assets (C1 to C4 + C8 to C10)	15,889,758,645	18,540,036,464	20,042,372,077	22,120,455,483	25,069,059,602
1.Cash and balances with treasury banks	1,186,502,771	1,295,237,258	1,578,417,094	1,986,366,071	2,007,563,324
2.Balances with other banks	158,026,748	150,155,990	151,400,809	215,636,891	271,412,445
3.Lending to financial institutions	542,138,720	580,383,714	898,973,651	970,479,084	1,068,610,922
4.Investments	7,512,974,884	8,684,912,973	8,005,224,324	9,025,623,894	11,804,264,958
5.Gross advances	5,997,009,849	7,045,906,738	8,563,285,299	8,903,222,149	9,079,701,591
6.Advances-non-performing/classified	552,131,134	595,011,025	648,764,870	732,123,076	787,802,557
7.Provision against advances	512,292,695	531,592,658	564,399,933	607,487,637	699,130,123
8.Advances net of provision (C5 - C7)	5,484,717,154	6,514,314,080	7,998,885,366	8,295,734,512	8,380,571,468
9.Fixed assets	296,878,467	369,102,820	420,325,292	554,466,659	585,816,114
10.Other/misc. assets	708,519,901	945,929,629	989,145,541	1,072,148,372	950,820,371
D.Profit & loss account					
1.Markup/interest earned	934,072,694	991,557,513	1,157,982,242	1,853,396,430	1,917,875,768
2.Markup/interest expenses	453,676,143	500,547,007	617,087,228	1,173,638,378	1,081,674,275
3.Net markup/interest income	480,396,551	491,010,506	540,895,014	679,758,052	836,201,493
4.Provisions and write-offs	7,335,018	42,719,477	33,463,894	61,347,485	130,770,132
5.Net markup/interest income after provisions	473,061,533	448,291,029	507,431,120	618,523,916	705,431,361
6.Non-markup/interest income	200,231,724	197,915,100	190,754,806	202,006,234	237,892,504
7.Non-markup/interest expenses	363,532,224	390,564,403	440,161,416	500,877,411	529,154,836
8.Administrative expenses	356,619,079	384,308,753	435,173,394	492,847,705	518,008,584
9.Profit/(loss) before taxation	309,738,983	255,641,725	258,009,420	319,539,390	414,169,029
10.Profit/(loss) after taxation	187,913,637	152,523,602	158,971,799	183,589,266	248,731,474

Similarly, from amongst all the people we interviewed, 78% of the respondents feel Banking sector is amongst the most stable sectors of our economy as shown below.



The reasons for the stability of this sector have found to be multiple which include but are not limited to the following:

- Strong Regulatory environment which entails minimum capital requirements, Cash Reserve requirement and statutory liquidity requirements which are in line with latest recommendations of BASEL-III accords.
- Banks generally don't have risk exposures or concentrations in any one sector rather it is diversified across all sectors of the economy. Furthermore, most of the Banks advances portfolio comprises of 70% Corporate & Institutional lending which have low risk compared with SMEs etc.
- Non-existent large-scale competition from hedge funds, private equity markets and DFIs.
- Government borrowing has constantly been increasing over past many decades against issuance of its papers. Banks have excessively invested in these for lucrative risk-free returns.
- Strong governance structures
- A great part of our population is unbanked; hence the country has a lot of room to grow as every year the number of people brought into the banking system increases through several means. Hence, the size of the pie increases which aids to the overall well-being of the banking sector.
- Strong collateral base.

ECONOMIC CRISIS THE INDUSTRY FACED IN RECENT HISTORY

The banking sector is a unique sector which is aligned and connected to all sectors of the economy. If any of the sectors of the economy are hit, its impact ultimately trickles down to the Banking sector which can then play the most important role of either reviving that sector or completely move away from it. In the recent history, Pakistan has been witnessing economic crises every now and then due to the structural inefficiencies and poor governance of the country. The boom and bust cycles have been ever prevalent especially in these last two decades. The economy of Pakistan has been more informal than formal historically, hence more prone to internal shocks than external. However, lately the policies towards import substitution have led the economy prone to external shocks in terms of imported inflation etc.

However, our internal economic shocks have been playing a heavy hand on the financial performance of the sector historically. The economy performs well for a five year term and GDP growth surpasses 5% and suddenly the country's import bill also increases, the current account deficit increases and to fund the gap, the country enters IMF economic reforms plans which contracts the economy initially while in the correction phase, then stabilizes and finally as the economy enters the growth phase, the cycle repeats itself. This is the classic tale of boom bust cycle of Pakistan's economy on the back of structural inefficiencies that have been left unaddressed for long now.

For the larger part, Pakistan's banking sector has not come across any major crisis in the recent past post privatization of the sector. However, recalling the history, the power crisis along with terrorism which took birth in President Musharraf's era affected the exponential growth the sector could have achieved back then. The Textile sector which was thriving under President Musharraf's regime especially catering to the export market was badly affected due to energy crisis. Banks that had higher concentration of exposure on the sector when it was doing wonders took a severe hit when the Textile Sector's performance went down as a result. Consequently, the banking sectors had a record high non-performing loans and had to provide for them in their profit and loss statements. As much as 20-30% of the Banks advances books took a hit. For instance, Askari Bank had a concentration of around 28% in the textile sector and when the textile sectors performance went down, the Bank had NPL's of PKR 34 Bln whereas its yearly average profitability ranged between PKR 4-6 Billion.

COVID-19 CORONAVIRUS PANDEMIC – Initial Response & Business Continuity

Prior to the outbreak of Covid-19 Pandemic, Pakistan's economy was already phasing into economic reforms under IMF's Extended Fund Facility. Due to the economic reforms, FYE 2019 already ended on a lower note with a GDP growth rate of only 2% as against 5.53% in its preceding year. Amongst number of steps taken by the government under economic reforms program were the increase in interest rates to as high as 13.25% to offset demand and induce contraction in the economy for curtailment of inflation. This was coupled with induction of a free float market-based exchange rate system which was necessary to deal with the external imbalances and building up of foreign exchange reserves which did put a lot of inflationary pressure as Pakistan had a current account deficit that exceeded USD 10 Billion at the time. While the overall pace of economic growth was brough down multiple notches, the Banks kept reaping fruits of earning better yields on their investments in government papers and also from its advance's portfolio. At an average, the Banks had an advances to Investment ratio of

43:67. So whenever the interest rates went up, Banks had better yield on their risk free investments in Government paper. Similarly, post the textile sector crisis in the earlier part of previous decade, Banks became very cautious and maintained concentration limits for each sector so in case they were confronted with similar crisis, the risk could be mitigated. However, the risk of infection in the advance's portfolio went up significantly since the finance costs of borrowing entities got inflated considerably so Banks were already gearing up to take the hit and provide for bad debts in the coming days. It will however be pertinent to mention here that following 2008 global financial crisis, the minimum capital requirements and implementation of recommendations made under Basel accords were effectively being implemented in Pakistan which gave the banks capacity to absorb any financial shocks at least in the short to medium term.

Come March 2020, the Corona Virus outbreak is declared a global pandemic by the WHO. The measures of containment of the virus both globally and locally, brought the world as well as local economy to its knees. Manufacturing, retail, transport, and trade-related activities were all disrupted, causing a severe contraction of economy.

Immediately, the Government of Pakistan announces a lockdown of initial two weeks. Banks were classified under essential services segment and had to keep operating however, under new Covid-19 protocols. These involved:

- Operating at 30% strength in the Branch networks
- Wearing of protective Masks and gloves at all times
- Keeping a social distance of at least 6 ft from others
- Reduced work timings from previous 9 am - 5.30 pm to 9 am – 1 pm.
- To manage the work strength, alternative weeks were given off to Bank employees ensuring only 30% attendance at work-place

Now unlike any of the previous financials crisis or business cycle downturns, the covid-19 pandemic started off as health crisis, however it quickly transpired into a demand and supply side shock as a result of measures taken to curtail the health crisis in saving people's lives. There was always going to be a tradeoff between health and livelihoods. As per estimates of World Bank, around 150 Million people are expected to be pushed into poverty due to the ongoing pandemic despite the relief measures by countries world over.

During the initial period of pandemic, Banks in Pakistan became increasingly worried over tradeoffs. Weather to give more priority to the safety of its employees and customers or to keep worrying about the profitability of the bank so that at the end of it, Bank does not end up laying people off. The entire sector was looking towards the

State Bank as the regulator and the Government to direct the banks on how to deal with the crisis as the biggest threat of Loan infections was looming which if materialized could have completely put the sector to rest and buried the economy. Banks on their own could not do much rather than ensuring means of service delivery to their clients or to jot down their heads and give suggestions to State Bank for strategy formulation in dealing with this unprecedented event.

On the internal front, Firstly, the Banks bifurcated certain roles of their departments as primary and secondary. Branch banking was considered primary as operating branches with full scale of operation but with minimum workforce was advised by the regulator and had to be adhered to. Accordingly, the support functions were classified as secondary and were mainly allowed to work remotely or from home by allowing them access to certain non-crucial applications of the Bank.

Since majority of the organizations and individuals were working remotely or through their homes, Banks had to tailor their policies immediately to meet the customers' expectations. These included provision of full scale digital services to its individual customers so that their footfall in branches could be curtailed as much as possible under the safety precautions. Increasing the per day transaction limits for digital banking, allowance of additional features through digital banking which included issuance of Cheques and pay orders, Cash over the counters, Inter Bank fund Transfers, making all sorts of utilities and other payments etc.

For all its corporate & institutional clientele, the Banks had to make arrangement for doorstep cash delivery (where required) and accessibility to Digital banking portals having full scale services including but not limited to the following:

- Cheque Printing
- Pay Order issuance
- Money Transfer (both Inter Bank & Intra Bank)
- Payroll processing
- Dividend disbursements
- Utilities payment
- Vendor Management etc.
- Cash Management
- MIS

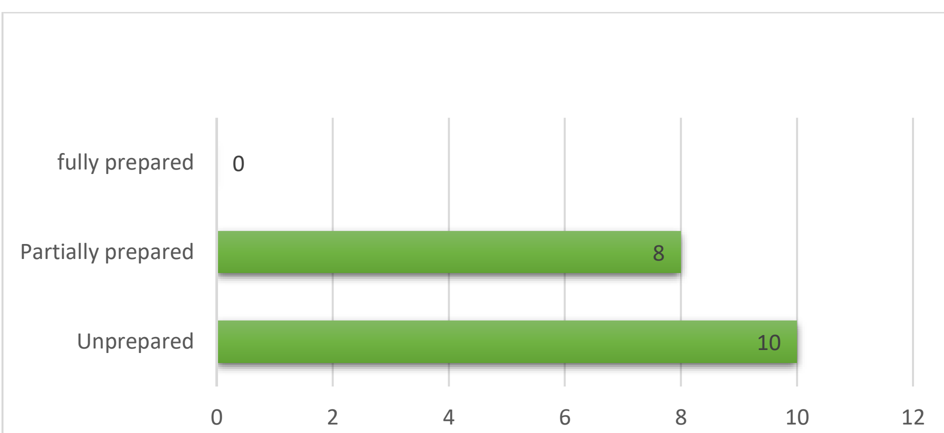
Apart from this, internal SOPs had to change as well where Banks had to ensure that their executives which have a certain level of authority are given remote access through their laptops to banking applications through virtual private networks so that the workflow could be maintained while they work from home or remotely. For this to happen, Banks immediately scrambled to improve their encryptions so as to ensure external vulnerabilities were mitigated from any possible unauthorized access to these systems etc.

Majority of the Banks over the years had developed an automated work-flow which was technology driven rather than old manual systems. Hence, to come to terms with the new normal when the pandemic broke out was not that difficult. However, Banks that were still reliant on old paper based work-flows found it very difficult and time consuming to come to terms with the new setting and had to adapt modern & conventional ways to conduct their operations internally be it credit assessment, account opening, deposit mobilization, managing investments, HR or any other function.

Every Bank, under the guidelines of the regulator, is supposed to have a Business Continuity Plan in place for disaster situations to avoid business operations disruptions during which may include floods, earthquakes, fires, strikes & riots etc. However, corona virus outbreak was an unprecedented event where no amount of prior planning could have anticipated something like this could happened which would put the survival of humanity at stake let alone banking operations. Hence, Bank's had to learn and adapt as the events unfold every passing day after the outbreak of pandemic.

Banks major focus remained on implementing digital banking to its full potential in shortest time possible. Ensuring cyber security controls and enhancing user-awareness and education on cybersecurity and improving the security monitoring, detection, and response capabilities Banks.

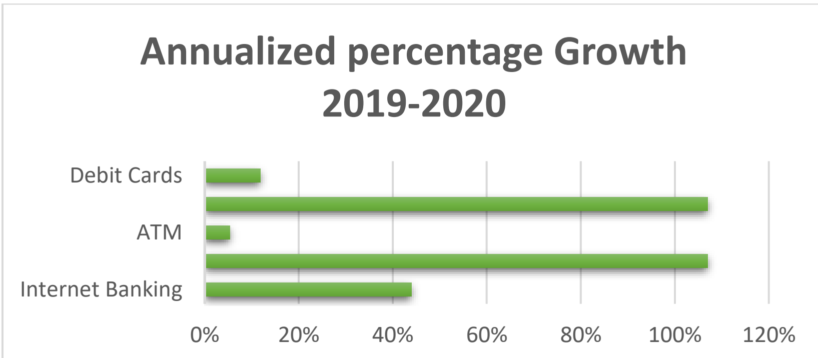
When the respondents were asked how prepared their Banks were in terms of business continuity planning in the wake of such events, the following results were obtained:



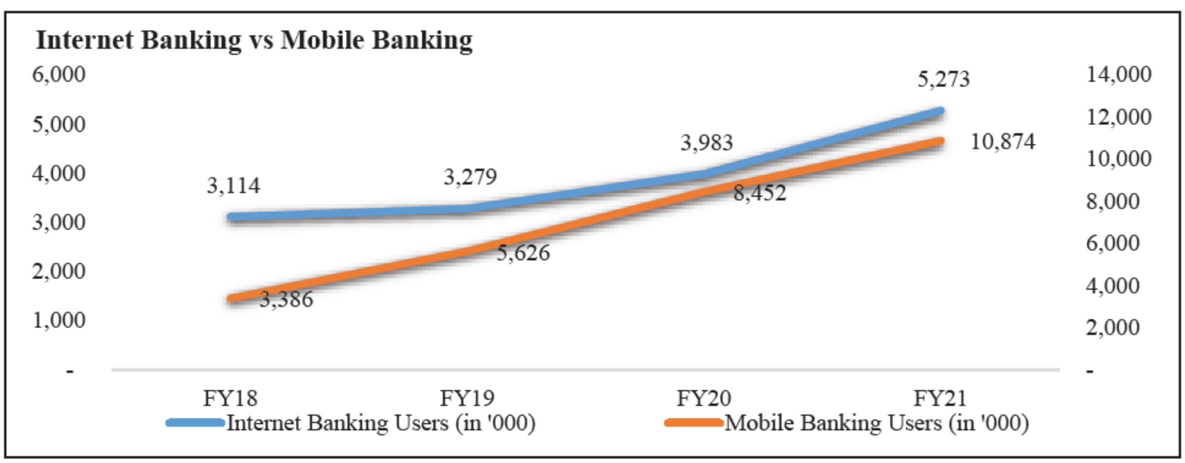
ROLE OF TECHNOLOGY IN BUSINESS CONTINUITY

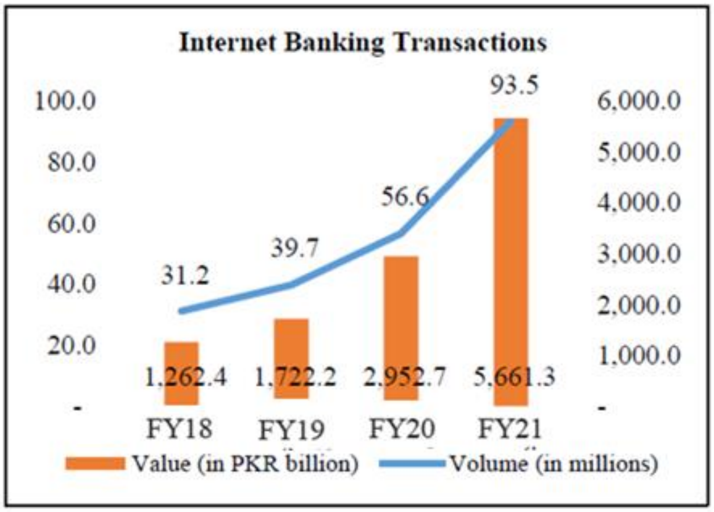
Technology played pivotal role in business continuity at the outset of corona outbreak till date. The implementation of digital payment and financial services in the country over the past few years helped Banks keeping their operations afloat on the outbreak of virus keeping human safety intact and meeting customer expectations. Over the past few years, SBP as the regulator played a very important role to promote digital banking by developing payment infrastructure, issuance of enabling regulations and establishment of financial technology firms (FINTECH).

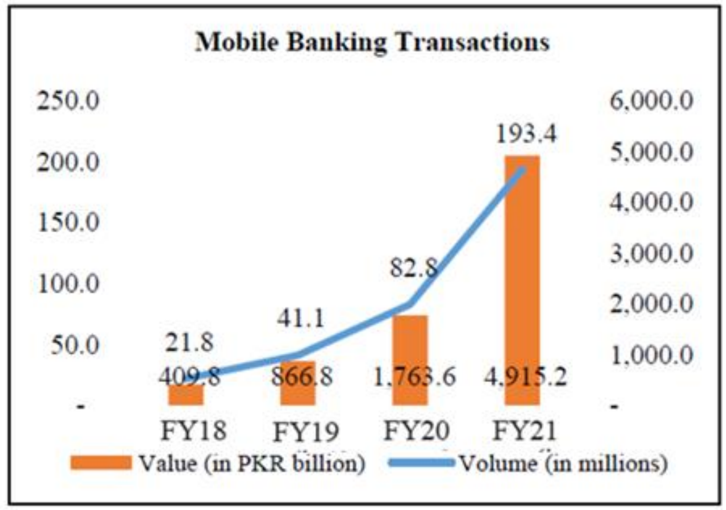
The digital banking industry in Pakistan showed a very robust growth in volumes as well as values which his evident from data below:



From the above figure, we can see how phenomenal the growth in the figures of digital banking tools was during the last year which shows how the banks clientele reverted to these mediums in corona times more than ever for meeting their banking needs. Furthermore, emphasis was made by the regulator to keep these services affordable during such tough times and so SBP waived off all charges on digital transactions for a period of 12 months from the outbreak of corona virus in 2020. The trend in the wide acceptability of internet and mobile banking over the last four years as shown below also depicts the confidence of the clients towards its security and convenience.

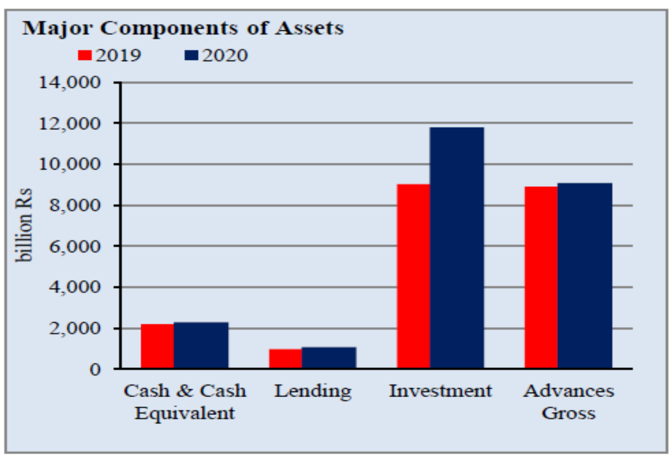






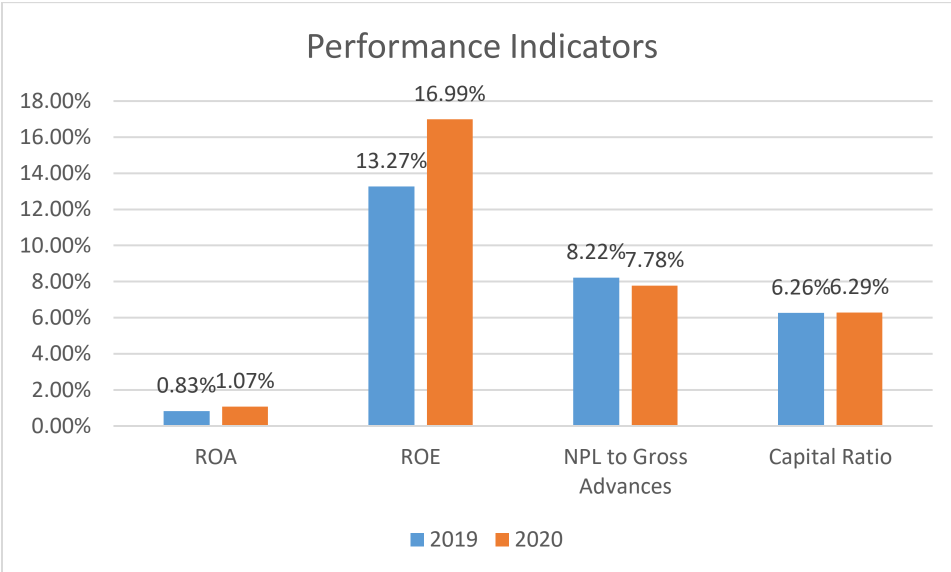
ASSET QUALITY AND PROFITABILITY OF BANKING INDUSTRY DURING COVID YEARS

The asset quality and overall profitability of the banking sector grew and remained robust despite several challenges. The main constituents of Bank's assets and resultant growth in them can be witnessed in the figure below as reported by SBP.

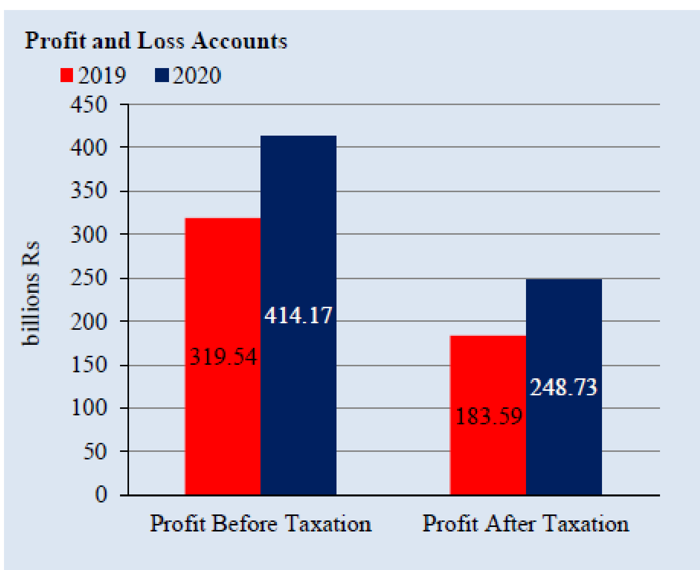


While the investments are mostly secured and risk free as they are made up Government bonds i.e. PIBs, Floating rate Sukuks, T-Bills etc., the advances show the risk appetite of banks. Hence, normally, we see investments to advances ratio almost always slightly tilted towards investment rather which is understandable given the risk free returns bank get on those. However, what's interesting to note here is that while the total assets of the sector grew 13.33% YOY touching PKR 25.07 Trillion, the gross advances merely grew by 1.98% touching PKR 9.08 Trillion as against PKR 8.9 Trillion in the preceding year. This shows that the banks remained wary of lending and rather invested more money in Government paper in such crucial times.

The infection ratio i.e. the bad loans from the total gross advances portfolio which stood at 8.2% in FY2019 dropped to 7.78% in FY2020 (the Covid year). This shows that the asset quality of the Banks remained solid despite the pandemic which was due to timely intervention by the SBP & Government to safeguard the economy and the financial sector which will be touched upon in the next section.



On the profitability side, the net profit before and after tax both grew for the banking sector as a whole. The PAT of the industry saw an increase from PKR 184 Billion in FY 2019 to PKR 249 Billion in FY 2020.

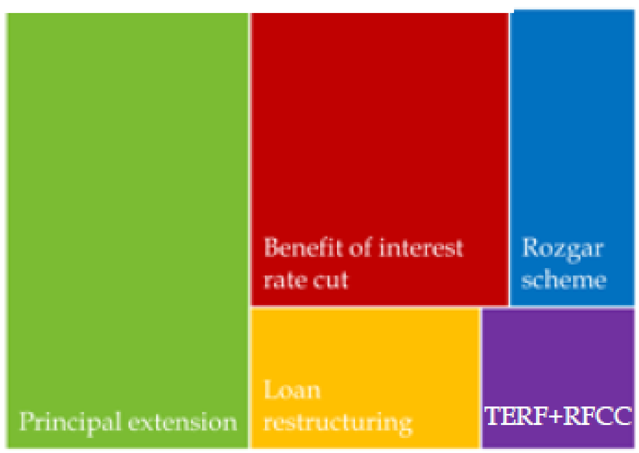


The increase in profitability of the sector can be attributed to an increase of PKR 156 Billion (23%) in the net interest income of the banks. This is because prior to covid, the incumbent Government constantly raised interest rates to 13.25% under IMF EFF program. This was further supplemented by additional PKR 36 Billion (18%) no non-interest income generated from non-credit banking services.

INTEERVENTIONS BY REGULATOR AND THE GOVERNMENT TO SAFEGUARD ECONOMY

Right at the outset of corona virus break down, the government and the regulator i.e., SBP took timely and effective measures that helped businesses and households deal with mobility restrictions and supply chain disruptions. The initial lockdowns badly affected the manufacturing concerns due to factory closures which lead to unemployment under such hard times. The next badly affected segment were the services concerns, especially in the hospitality industry, such as event management, catering, restaurants, food deliveries, salons/barber shops, and travel and ticketing. The agriculture sector remained mainly away from Covid-19 impact directly as major crops had already been harvested in Pakistan, the repayment risk in farm sector especially under microfinance banking began to show major signs of default as the infection ratios of microfinance industry increased beyond 10% which always averaged between 1-2%.

Thus, after immediate consultations with all concerned stakeholders including presidents of Banks, SBP & the government announced a special multi relief package as shown below:

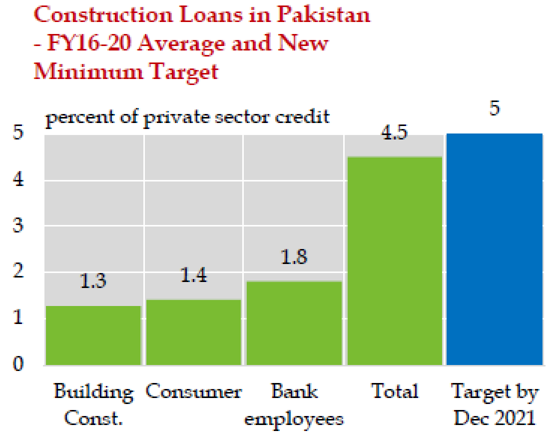


- Principal Extension: Allowed for principal re-payments deferral for a period of 12 months of becoming due without being reported in the Electronic Credit Information Bureau (ECIB) report thus not affecting the credit history of the borrowers. A total of PKR 657 Bln in loans were deferred under this.
- Interest Rate Cut: Interest rates were immediately cut by 625 basis points and dropped from 13.25% to 7% to infuse growth, reduce finance cost burden on businesses.
- Loan restructuring: Those businesses that foresaw that in the coming years, despite principal repayment extension, they would not be able to service their debt were given relaxed loan restructuring according to their projected cashflows.

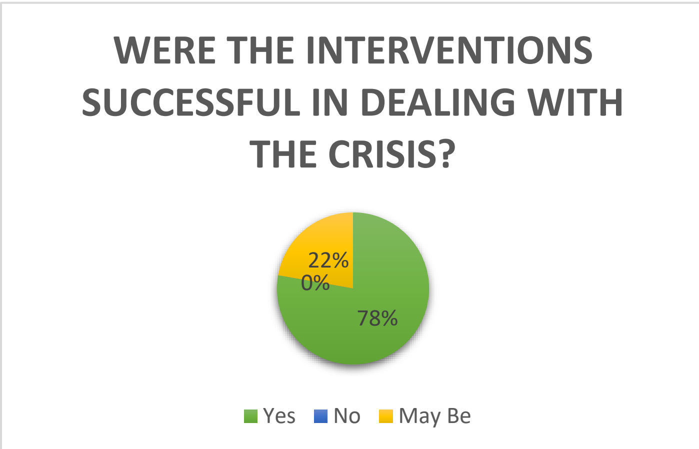
- <u>Rozgar Scheme:</u> This scheme allowed businesses to avail pay roll financing of up to 6 months on subsidized rates (under 3%) on risk sharing basis with SBP for period April 2020 till September 2020 on undertaking retention of their existing employees. To total of PKR 238 Bln was disbursed under this.
- <u>Temporary Economic Refinance Scheme & Refinance Facility for combating Covid:</u> These schemes were intended to infuse investment in the country. The first was for setting up of a new manufacturing projects or for capacity expansion of existing projects having financing of upto PKR 5 Billion per project for a period of 10 Years with 2 years grace period and on a subsidized pricing of maximum 4%. The latter scheme was for the healthcare sector. Those willing to modernize or upgrade their medical facilities or willing to set up new ones were being financed by the Banks under RFCC scheme having subsidized rates. A total of PKR 436 Bln under TERF and PKR 17.8 Bln under RFCC has been disbursed to date.

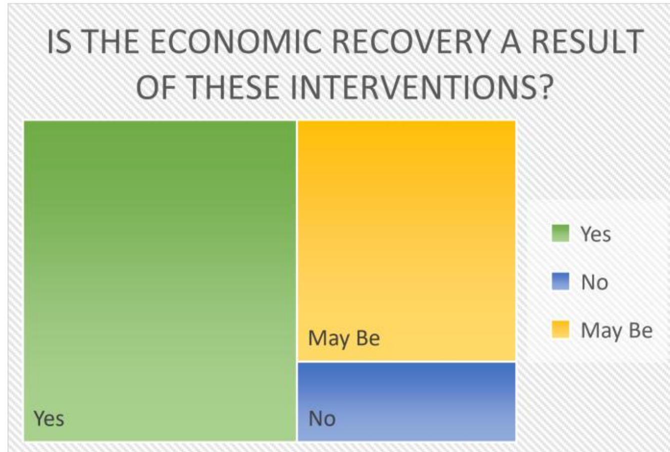
It was due to the above timely measures which ensured employment generation, infused business growth, protected businesses from losses and financial burdens, that the financial sector was remained immune to the negative impact of pandemic. Unlike the history, the banking sector was a part of the solution this time rather than the problem itself. All the above schemes were implemented through the banking sector and lead the economy toward the path of growth as the GDP growth of close to 4% in June 2021 reflects the efficacy of these measures.

Furthermore, the Government of Pakistan opened the economy at the earliest compared with rest of the world by implementing smart lockdowns strategy only in specific areas with high prevalent covid-19 instances identified using hotspot technology. Also, it laid out the construction & real estate sector policy which was a comprehensive policy aimed at kickstarting the sector which helped lay the foundation of economic recovery. Under the policy, government ensured through the regulator that by the ongoing calendar year end, 5% of Bank's advances book was comprised of Loans to real estate and construction related industries including consumer mortgage financing under Naya Pakistan Housing etc.



Majority of the interviewees believed the interventions stated above were successful in dealing with the crisis and the economic recovery we saw thereafter was a result of these interventions.





WHAT FUTURE HOLDS

Empirical evidence as well as the theoretical frameworks developed through decades and centuries of hard work find the importance of financial sector in harnessing economic growth as pivotal. While we have witnessed significant improvement in the efficiency and profitability of the sector, the credit growth remained below par both in terms of penetration and access. Guided by the risk appetites and commercial benefits, the commercial banks remained lackluster towards developing an institutional infrastructure for project financing. Till date, as emphasizes earlier in our research, the prime focus of commercial banks has been the large corporates. A prime reason could be lower capital charge against lending to Corporates under Basel rules and a considerably lower risk. Agriculture, SME & Consumer Mortgage have remained exclusive in the overall lending policies of commercial banks due to a higher risk profile, lack of credible information availability and a complete gap in the prevalent infrastructure & expertise to lend to these sectors.

However, if Banking sector is to really revolutionize and grow, it needs to rethink its policy assessments in terms of data systems, technology adaptation, internal risk assessment frameworks and organizational capacity which is inclusive of all sectors of the economy and does not majorly rely only on large Corporate clientele. Technology can play a major role going forward towards national inclusion of the unbanked population and thereby increasing the size of the entire pie that the banking industry can grow from.

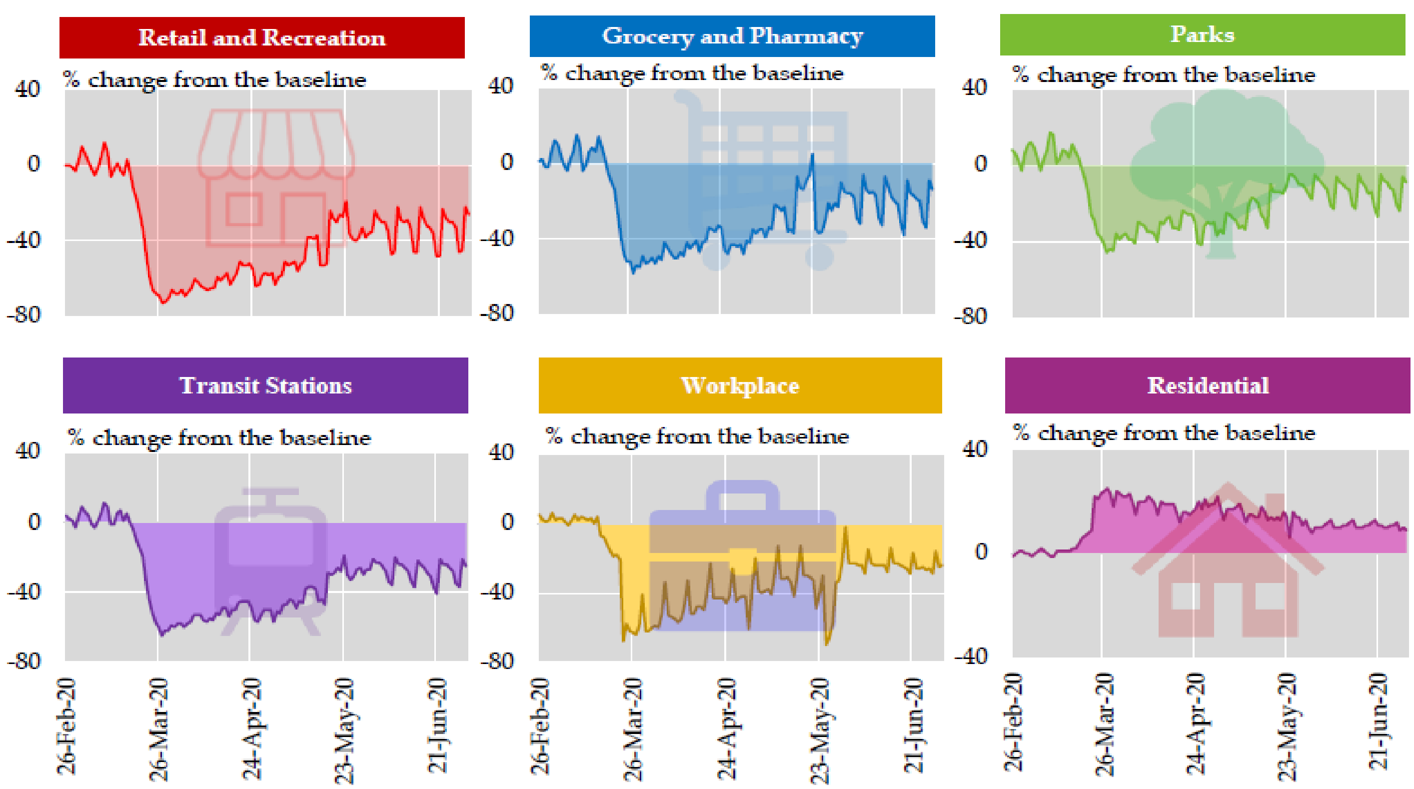
The pandemic has accelerated the digital transformation in the industry. The preventive lockdowns and the social distancing SOPs have served a on the go trial and test for commercial Bank's preparedness and resilience. Many of their clients shifted to teleworking overnight while individual consumers adapted to digital banking for their domestic needs. The digital strategies that were being planned for long term had to be implemented immediately by Banks and their clients alike in the wake of such a disaster both under B2B, B2C, B2G and G2G segments. Governments are now relying more on contactless delivery of social services after covid – 19.

Hence, digital transformation has not only played an immense role in business continuity during covid-19 for the private as well as public sector including Banks, it will also be playing the most crucial role in global recovery going forward changing the way things work. For this to happen, effective connectivity and sound digital infrastructure is required.

E commerce, which was already showing signs of great progress over the years saw an unprecedented growth post Covid-19 outbreak. This has been done due to several reasons including the following:

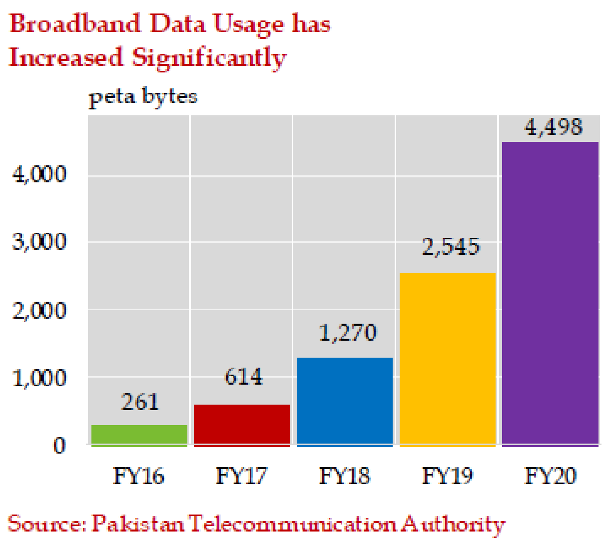
- Digital penetration
- Lowering Costs by relying on digital medium compared with old brick and mortar models.
- Increased awareness about e platforms.
- Shift in purchasing patterns

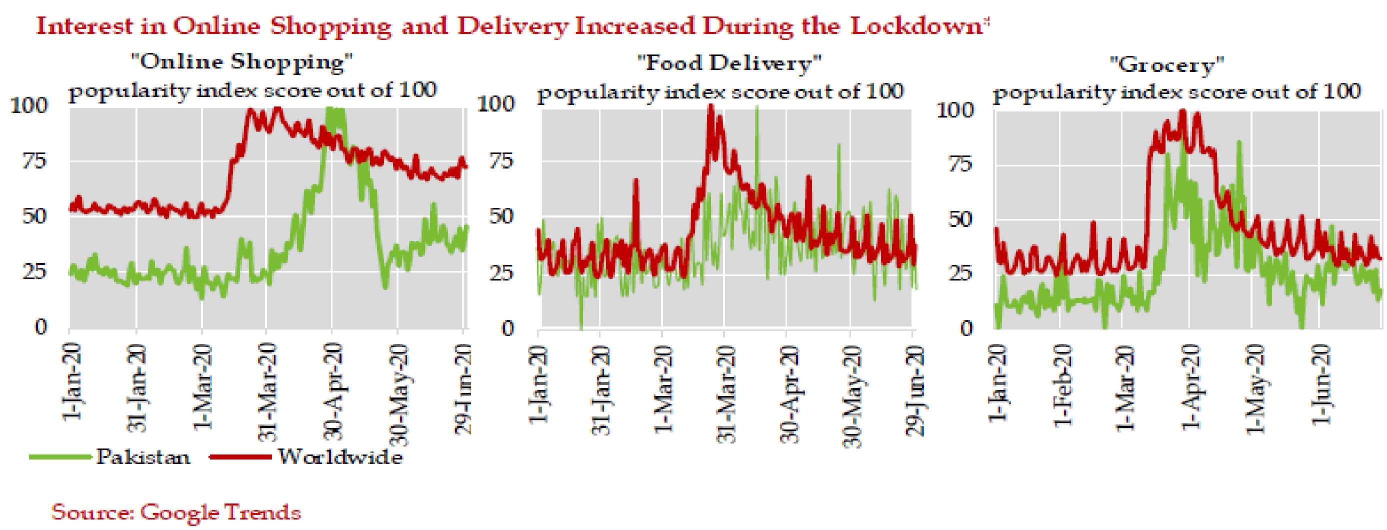
Mobility Remained Restricted in Pakistan Amid Covid-19

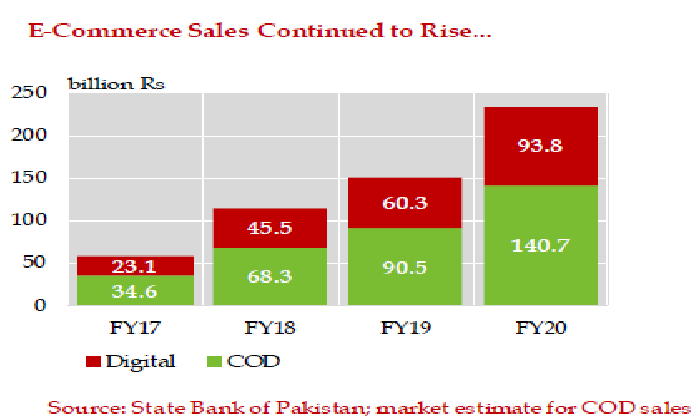


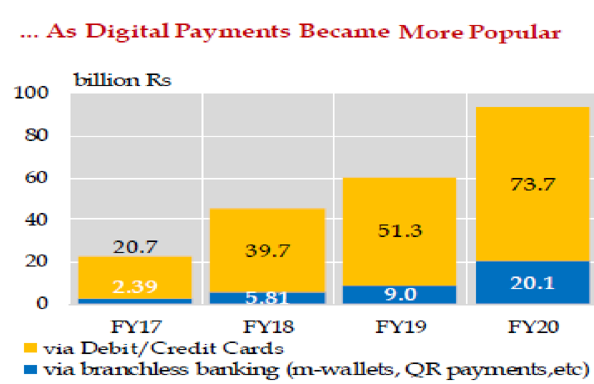
Source: Covid-19 Community Mobility Report (Google)

Just as mobility got restricted on the outbreak of the Corona Pandemic as shown above, the usage of broad band data usage surged. Accordingly, the Pakistani consumers also adapted to this change and started looking for online solutions ranging from online shopping on non-essentials, to groceries and food deliveries & resultantly digital payment rose as shown below.







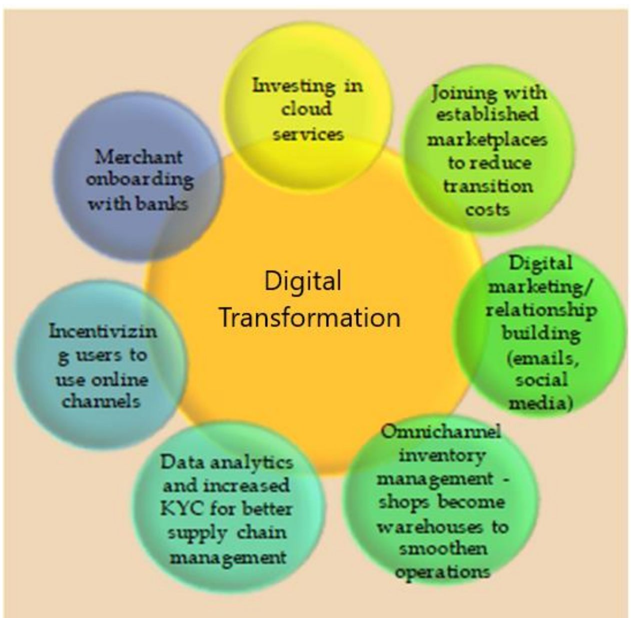


Hence, it is safe to say that the digital adoption seen during covid is likely to persist if not accelerate due to its convenience, lower costs, development of medium stage digital infrastructure during covid, increased awareness and resultant and shifting of consumer patterns. Accordingly, this shift requires digital payment platforms where Banks are already playing a role and could really capitalize on it to make huge cost effective gains over time.

Banks will need to look at the new world post covid where the world "DIGITAL" will rule the norms. We are already seeing Banks like Standard Chartered closing its conventional Branch network in Pakistan and only relying on digital presence offering full scale digital provision of services including on the lending front to its clientele. This will result in massive costs curtailment while effectively meeting the customer expectation in terms of service delivery which is convenient, cost effective and digitally driven.

CONCLUSION AND RECOMMENDATION:

The future strategy of Banks should depend significantly on the digital world post covid. Just like Standard Chartered Bank, local banks will have to do away with old conventional ways of managing their operations and delivering services. Instead, they will have to adopt digital delivery channels on both internal as well as external front. While the Government is excessively transforming its essential services on digital platforms and we are witnessing a huge rise in e commerce and new ventures in the technological space, the Banks will have to do the same. From account opening to payment solutions, from credit appraisal to loan disbursements, from cash management to deposit mobilization, all will have to be done digitally. This can be done through a combination of several steps as suggested below.



Merchant Onboarding with Banks: Banks need to onboard more and more retail merchants on its digital platform so that POS and digital payments through I net applications and mobile banking can be made.

Investing in Could Services: Banks need to invest more in cloud services rather than conventional servers for their data storage. This is convenient, secure and ensures business continuity in time of adversity.

Jointing with established marketplaces to reduce transition costs: Telecom operators in Pakistan like PMCL/Jazz, Telenor etc. have already established sound networks with microfinance banks at back end for establishing digital payment network and movement of micro-funds. Banks can partner with such companies with established networks to capitalize on their front end expertise and use Banking networks for processing of digital payments and funds with bigger caps.

Digital Marketing: The cheapest and most convenient marketing medium these days is digital marketing. Just by tapping social media networks to create awareness on digital banking can produce unexpected results. The newer generation can be made aware through means that they are used to. We have already seen a mushroom growth in usage of social media sites in Pakistan over past few years. This can be put to use by the banking industry just as retail businesses are capitalizing on this.

Omnichannel inventory Management: Imagine a world where banks are integrated with retail outlets and data is being processed in real time in Pakistan. The biggest advantage of this would be accurate management information systems which will aid in accurate estimation of demand. If the demand is accurate and other supply chain is integrated from end to end, no more will there be a requirement for having storage spaces and warehouses for any player in the entire value chain including Banks.

Use of Data Analytics: Banks are sitting on most valuable commodity in the modern world i.e. data. This data ranges from personal information of their clientele, to their spending patterns, their income levels, their savings and their preferences. This has majorly been obtained due to usage of digital banking platforms over the years. Using this data appropriately can allow banks to develop into the most significant driver of demand in the world.

Incentivize users to come to online platforms: Banks could incentivize their clientele by offering free of cost digital services so that more and more of their customers prefer to use digital mediums instead of conventional banking. Once most of its customers are onboarded on digital mediums, Banks could make the model sustainable not only by earning income from usage of these platforms, but from the data that is generated through it.

The sooner banks adopt technology and completely evolve towards digital way of doing things, the more benefits they can reap and fill the space which otherwise might be taken by the telecom sector and new FINTECH startups. Banks already have huge amounts of data on their customers. Running a big data analytics on the same can allow them to target each of their customers very differently catering to their personalized banking and financial needs. Rather than asking the customers, Banks will be in a position to tell the customers what they need just by looking at their income patterns, spending patterns, buying patterns and most of all behavioral patterns. Banks can partner with so many other businesses in this tech space and utilize the amount of big data generated through their huge existing clientele to remain pivotal to economic activity in the future.

APPENDIX: SEMI STRUCURAL INTERVIEW GUIDE

1. What is your name and your current role in the organization you are working for?
2. How long have you been working for in the banking sector?
3. Do you think that the banking sector of Pakistan can be considered among one of the stable sectors of our economy over the past few decades?
    - Yes
    - No
4. If yes, what in your opinion are the reasons for this stability?
5. Being a part of this industry, can you mention a significant economic crisis that the industry faced in the modern history?
6. How in your opinion has the out-break and spread of Covid-19 Pandemic impacted the Banking Industry of Pakistan?
7. How in your opinion is the current crises different from the previous ones?
8. What was the initial response of Pakistani Banks towards the outbreak of Covid -19?
9. How prepared was your organization in terms of business continuity planning in the wake of such events, pick one from the options below?
    - Un-prepared
    - Partially prepared
    - Fully prepared
10. What role is technology and digitization playing in making business continuity planning and implementation more robust in the wake of such events?
11. How has pandemic affected the asset quality and profitability of the banking industry?
12. Has the regulators intervention been effective in dealing with the crisis?
    - Yes
    - No
13. Briefly elaborate on your choice above.
14. Do you see the economic recovery in Pakistan a result of these interventions by the regulator and GOP?
    - Yes
    - No
15. What opportunities do you think can the banks in Pakistan capitalize on coming out of this crisis?
16. How can the Banks trim their costs for a sustainable revenue outlook in the wake of current pandemic?
17. What according to you shall be the future strategy of the banks post Covid-19?

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