

## **Business Environment**

Commercial banking is one of five sectors under restrictive access control by the Government of Pakistan. Regulations currently in force enable the Ministry of Finance to approve applications from private sector financial institutions for a licence to operate as a commercial bank. However, the requirement for minimum paid-up capital of Pak Rupees 500 million (C\$16.66 million) and 50 percent compulsory public floatation are tantamount to creating financial and legal barriers to operating. It is, however, notable that foreign banks have extensive and profitable banking operations in Pakistan.

The GOP is working in collaboration with the International Monetary Fund and international financial institutions to privatize public-sector financial institutions, to develop a regulatory regime to monitor and maintain fiscal discipline and to allow the State Bank of Pakistan to function as a regulator, free from political influence.

The following is a brief description of the financial sectors and financial instruments used within Pakistan:

### **a) Banking Sector**

This sector is highly regulated through prudential regulations and a fiscal regulatory regime administered by the State Bank of Pakistan (SBP). Financial sector activity in Pakistan is conducted through commercial banks, the leasing industry, insurance industry and investment in Islamic Banking.

Investment in Islamic Banking is done through Modarba, which is a corporate entity operating according to the tenets of Islam, earning returns through leasing, mark-ups and other financing modes. The majority of Modarba firms are involved in leasing predominantly to small and medium-sized enterprises.

Currently there are 52 Modarba companies listed on the Karachi Stock Exchange. The Modarbas were floated originally with the incentive of income tax exemptions. In effect, Modarbas are exempt from income tax for the first three years and are subject to 12.5 percent income tax for the next three years and 25 percent thereafter.

Modarbas' borrowing practices are constrained under approved Islamic modes (i.e. profit and loss basis [Musharikas] and deferred payment basis [Morahabas]). Because not many financial institutions have been willing to extend medium- to long-term financing facilities under these modes, and because of their borrowing constraints, Modarbas face a severe liquidity crunch.

### **b) Leasing Industry**

This industry has experienced a substantial growth in Pakistan over the last few years driven mainly by relatively low capital requirements, demand for long-term financing and the advantages of leasing over other forms of financing. The GOP regulates the establishment of a leasing firm by requiring an application vetted by the Corporate Law Authority (CLA). CLA rules also require that "the minimum period of lease be three years", which means that the key to running a successful operation is procurement of long-term funds. There are 28 leasing firms in operation at present and it is expected that this number will increase.