Strategic Management of Financial Institutions-Survival in the 21st Century

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Introduction

The financial sector in Pakistan is largely dominated by the nationalized commercial banks (NCBs). The NCBs still control most new financial flows. Stock markets do not raise much financing for firms and the number of shares actively traded is limited. Thus financial sector reform should focus on building more robust banking systems and restructuring, modernizing and privatizing NCBs. However, it is very difficult to build robust financial systems. Many countries have experienced a banking crisis in recent decades[1]. The increased frequency of crisis reflects global structural changes. Domestic deregulation and liberalization of financial services have increased competition. Advances in telecommunications and information systems have further enhanced competition-increasing the capacity to exploit the opportunities offered by the liberalized environment-both within and cross borders. These developments have dramatically changing the structure and nature of financial services, operations and economics of banking around the world. Financial services are highly dependent on technology and the advent of Internet and related technologies could accelerate financial sector development by lowering costs, increasing breadth and quality, and widening access to financial services. Developments in the use of technology have changed the ways in which organizations interact with their customers and promote their products. The number of people willing to purchase financial services and products with the use of modern technology is increasing around the world. The use of ATM is now commo practice as is the purchase of home and car insurance over the telephone. Another growth area is the Internet. Many institutions operate websites, and with the Internet affecting an estimated half a million new users a month worldwide. Hence, its use must be a consideration for any marketer (Khan, 2002). Information technology developments mainly affect banking in two ways. First, they contribute to reducing costs associated with the management of information by substituting paper-based and labour intensive procedure with automated processes. Second, they alter the ways in which customers have access to the banks services and products through automated distribution channels such as, internet banking, telephonic based banking, interactive T.V. banking and ATMs (Khan, 2002).

Deregulation of financial services market has enabled new competitors to enter the market, bringing with them innovative distribution methods. This revolution in the financial sector could be considered as a means of cutting costs and optimizing efficiency. In this new environment, the development of new distribution channels of financial services and products has become a key strategy in improving value added and satisfying customer requirements for developing countries like Pakistan.

[1] Thailand being the latest example-with significant economic costs.

In Pakistan the traditional branch network has been largely evolutionary, unplanned, expensive, uncompetitive and inflexible to adapt to changing market conditions. Hence, currently the traditional branch network is under the threat. So the banks must quickly redefine avenues of distribution if they want to keep their place in the market. The former marketing philosophy of "the right product must be available at the right time" should be replaced by "any product must be available at any time, anywhere".

During the past decade, several significant and impressive changes have been taken place in the role expected to be performed by the financial institutions in Pakistan. There have been significant changes in the environment, economic conditions and in the financial sectors of the country. Financial sectors have tended to become more complex involving leasing, merchant banking, venture capital, credit card, sponsorship etc. The scope of financial institutions has enlarged tremendously since the onset of liberalization. The liberalization and globalization of the capital markets has forced the financial institutions to redefine themselves. A well-integrated financial structure involved over the years to suit the varied needs of the capital markets. The financial institutions have been taking several steps to reorient their business strategies in response to the growing needs of the various segments of industry and the on-going changes in the financial sector. Moreover, the financial institutions have entered into new areas of business such asset-based financing merchant banking, equipment leasing, investment banking, debenture trusteeship and forex-service to cater to the varied needs of the foreign and domestic investors.

The intense competitive pressure in the financial market has resulted into tremendous variety of products and services to meet the specialized needs of millions of customers. The crucial difference between the banks today and those of the not-too distant past is that the risk information process today lies closer to the core of the banking business in the international arena. The critical results of the recent innovations in the blurring of distinctions between the traditional forms of financial intermediaries such as commercial banks, investment banks, insurance companies and specialized finance companies. Advances in computerization and communications have created a paradigm shift for financial markets; the financial services industries and the management of financial risks. Today, it is possible for the financial engineers to devise financial instruments and strategies, which help to create enabling environment for the strategic management of financial institutions.

The objective of the essay is to propose some policy measures which can be used for the effective management of financial institutions in Pakistan. These measures are essential for the survival of these institutions in the 21st century. The organization of the essay is: section 2 represents recent world financial trends. Section 3 discusses new challenges to financial sector in the 21st century. Section 4 proposes some strategies for the management of financial institutions while some concluding remarks are given in the final section.

2 Recent World Financial Trends

The globalization of financial markets as well as technological and structural changes in financial services can provide guidance for the strategic management of financial institution for developing countries like Pakistan. These changes include:

A. Globalization

(i) Increased Financial Integration

The globalization of financial markets has increased financial integration, mergers and acquisitions within and cross borders and lowered barriers between markets. Reduction in trade barriers, transportation costs and advances in telecommunication technology have accelerated economic integration. The complementarity of trade in financial services with a greater ability to trade goods and services across borders has increased the demand for financial services. Because of globalization the financial institutions in one country can provide a loan or facilitate security issues to an entity in another country. Moreover, a financial institution also can obtain physical presence in another country by acquiring a financial institution or by opening a branch of subsidiary. As the costs of establishing a physical presence have declined, cross border entry has increased which enhance not only the capital flows but also increased the competition.

(ii) Increased Mergers and Acquisitions

The Governments have removed entry barriers through legal and regulatory measures. Aided with technological developments, these changes have lowered entry barriers and encourage bank consolidation and mergers and acquisitions among financial institutions. For example, Argentina, Brazil, Chile, the Republic of Korea and Mexico have seen a significant decline in the number of domestic banks in recent years.

(iii) Lower Barriers Between Markets

The dismantling of regulatory barriers separating banking, insurance and securities activities is also deriving consolidation. Boundaries between different financial intermediaries are becoming blurred and integrated banking becoming the norm. The merger of Citigroup and Travelers Group are the most dramatic example of this trend.

An important market incentive for the reduction in barriers has been disintermediation of bank assets and liabilities by capital market transactions. Commercial paper and corporate bonds have substituted for bank loans, and mutual funds and securities have substituted for bank deposits. These forces pressure banks to expand their financial services to cater to all customer needs and preferences. Advances in information and communication technology further facilitate the delivery of a broad array of financial services through one provider (Glaessens et al, 2001).

B. The World of New Financial Services

Technology is revamping the ways in which financial services are produced and delivered. In addition, technology is fundamentally changing the industrial structure of the financial services industry worldwide.

iv) Technological Advances

Internet banking, Telephonic-based banking, Interactive T.V. banking, ATMS and related wireless technologies have profound effect on financial services. Unlike traditional channels of distribution, they are a completely different way of providing financial services. Using the credit scoring and other data mining techniques, providers can create and tailor products over the Internet without much human input and at a very low cost. They can better stratify their customer base through analysis of internet-collected data and allow consumers to build preference profiles on-line. This not only permits personalization of information services, but also allows much more personalized pricing of financial services and more effective identification of credit risks. At the same time, the Internet allows new financial service providers to compete more effectively for customers because it does not distinguish between traditional "bricks and mortar" provider of financial services and those without physical presences. All these forces are delivering large benefits to consumers at the retail and commercial levels.

(v) Changes in Industry Structure

Technological developments are also changing face of the financial services industry. New types of services providers are entering the market including on-line banks, brokerages and so-called aggregators. Non-financial entities also entering the market, including telecommunication and utility companies that offer payment and other services through their distribution networks and customer relationships. To reap the benefits of the new technology and in response to new entry, banks, insurance companies and like are joining in the electronic delivery of financial services by setting up in-house on-line activities or completely new ventures such as virtual banks.

Thus, the delivery of financial services is moving away from a brick and mortar delivery channel to a multitude of electronic and other channels with portals and aggregators offering new channels of distribution and advertisement for financial services. Electronic finance is now spreading quickly around the globe including to emerging markets. Through various delivery channels (computers, call phones, and Kiosks), penetration of e-finance has grown quickly everywhere. Although there is some variation by markets, regions, types of financial services and the rate of penetration, but there is significant commonality across the globe. Several emerging markets have leapfrogged to the new technologies including Brazil, Korea and some transition economies like Estonia. One might well see a rapid convergence in e-finance across many countries near future.

Finally, one can conclude that combined with globalization, these forces are putting pressure on incumbent stock exchanges and self-regulating organizations, the pressure for change come from within industry.

Effects of the changes

- The case of entry barriers has been particularly strong element in financial services that could be easily unbundled and commoditized and offers attractive initial margins. These include many non-banking services including brokerage and trading systems, some retail banking services and new services such as bill presentment or even payment getaways for business-to-business (B2B) commerce. Because these services are subject to less regulation, new entrants can easily innovate with new technology. These new entrants gain market share, consolidate their position and start to diversify highly regulated banking services. Moreover, e-trade's acquisition of a bank provides the full range of financial services to its retail clients. The availability of market information lowers the costs of financial services by easing uncertainty, mitigating asymmetric information and reducing transaction costs associated with paper processing. Furthermore, search costs have fallen for consumers and new entities, providing financial services.

- Increasing revenue and value added by correctly combining customers, products and distribution.

- Cost reduction allows competitive pricing policies.

- Quality and level of services satisfy customer demands.

- No need to travel to a traditional high street banking site near which customers no longer work and where parking is difficult.

- E-finance allows non-deposit taking financial institutions to reach for more borrowers including small and medium-size enterprises.

3 New Challenges to Financial Sector in 21st Century

At the beginning of the new millennium, the banking and non-bank financial institutions in Pakistan have to face some new challenging issues, which are critical to the growth and health of the financial sector. As a result of very rapid increases in telecommunications and computer-based technologies and products, a dramatic expansion in cross-border financial flows and within countries has emerged. These technology-based developments have so expanded the breadth and depth of markets that governments, even reluctant ones, have felt they have had little alternative but to deregulate and free up internal credit and financial markets. Changes in communications and information technology, and the new instruments and risk management techniques enable financial and non-financial firms today to manage their financial risks more effectively. They can now concentrate on managing their economic risks associated with their primary businesses.

The solid profitability of new financial products in the face of their huge proliferation attests to the increasing effectiveness of financial market in facilitating the flow of trade and direct investment, which are so patently contributing to ever-higher standards of living around the world. Complex financial instruments are being developed to take advantage of the gains in communications and information technology. Such instruments would not have flourished without the technological advances, high-powered data processing and communication capabilities.

The new technologies and new instruments have posed new challenges. However, new technologies, new instruments and techniques have made possible to strengthened interdependencies between markets and market participants, both within and across national boundaries. As a result, disturbance in a one-market segment is likely to be transmitted far more rapidly throughout the economy. In order to meet these challenges effectively, the financial sector needs to bring radical changes in the way business is conducted today.

4 Strategies for the Management of Financial Institutions

The strategic management of financial institutions is long and complicated process. The successful management depends on the wide range of financial, economic, managerial, political and social factors. It also determined by the prompt identification and resolution of insolvent banks, the amount of resources committed by the government and private investors to recapitalize viable financial institutions, the rapid disposition of non-performing assets, and the speed of macroeconomic recovery of a country, especially if debtor's capability to repay their loans needs to be restored. Furthermore, the successful management will also depend on the institutional capacity of government to manage it, the sequence and timing of reforms, the willingness to reform and implement painful and unpopular measures, and the social and political constraint faced by the decision makers[2]. Among all these factors, the adoption of modern computer, telecommunication based technologies and human resource management have great impact for development, and widening of financial sector in Pakistan.

However, taking the lesson from world financial trends (section 2) and currently changing world financial environment enable us to propose some key measures which are essential for the strategic management of financial institutions in Pakistan during the 21st century.

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2 Although the SBP have been undertaken the financial sector reforms in the late 1990s for overhauling the previously repressed financial system and to make it more attuned to the development needs of the country is well documented (see Husain, 2003). Hence, there is no need to elaborate here

Key Strategies

(i) Need for Designing Information Technology (IT)/Information System (IS) Architecture.

Development taking place in IT, have changed the functioning ways of banks and other financial institutions today. The relationship between technologies, economic and social conditions are becoming an important for ensuring return on investment in technology. Therefore, technological issues need to be incorporated into strategic business planning process with full understanding of its organizational implications.

Market segmentation of the customers and the role that technology plays in offering different products and services becomes very important. Reforms in the Pakistan's financial sector has made it a pre-requisite to relook at the IT and IS architecture particularly in the light of competition that the banks would be facing in the 21st century. The technology-based transaction required the development of database and data wire-house at corporate offices to innovate new products and services to combat the competition on the others. In the 21st century, the performance of the financial institutions depends on the efficiency of payment systems, credit delivery channels, control on non-performing assets, treasury and asset-liability management, controlling of frauds apart from good housekeeping and customer services, and in each of these areas IT has a very vital role to play. Therefore, future success of banking industry will really depends on how effectively management would be able to use IT as a strategic response.

The applications of IT/IS have gone much beyond online transaction processing viz. electronic payment systems, electronic fund transfer, computerized decision-support system, expert system, artificial intelligence programmes, virtual terminals and many other applications have forced banks to change their organizational hierarchical structural and processes. The applications of these changes are evident not only for external customers but more on internal customers in terms of their skills, knowledge, attitudes, team spirit and ability to learn at every stage of their career on a continuous basis. A quotation from Bill Gates is worth mentioning here "Competition from players in the market has resulted into products and services offered by traditionally monopolized banks and financial institutions, are now being offered by non-banking organization more efficiently and effectively, viz. electronic payment systems through credit, debt, smart, e-cards, leasing, hire-purchase services, e-commerce and buy-now-pay-later product ranges, internet-based shopping - delivering goods and services in the comfort of one's home and billing-n-debiting customer's bank accounts directly and swiftly."

In the present context of global competition, information technology becoming one of the major strategic variable because:

- No business or corporate strategy is complete without information strategy.

- Planning for information system should be an important and integral part of the organization's competitive strategy development process.

- Information systems strategic planning needs involvement of IT professionals, end-users, auditors and marketing experts so that through deeper understanding of customers, new products and services are innovated and delivered at a competitive price at different locations.

- The usage of e-mail services, the communication costs of telephones, faxes, telex and travel costs can be minimized.

- Development of modern computerized system can improve managerial efficiency, productivity and profitability.

IT essentially, can be used to play crucial roles in the following areas of business.

(a) Substitutive Role

It can be used to play substitutive role where manual processes are translated into automated (computerized) form and IT become a driving force to improve efficiency.

(b) Complementary Role

IT can be used in improving productivity and employee effectiveness by enabling the job to be performed in an efficient and speedy manner. Computerized MIS, DSS, expert system, etc, are the basic factors in the complementary role of IT. Foreign banks, newly opened private sector banks and a few public sector banks are using IT to play this role with varying degrees of success. IT also plays a major role to develop risk management systems relevant to credit and investment portfolios.

(c) Innovative Role

IT helps the organization to gain a competitive edge by developing new or changing existing products and services or creating new markets in an innovative manner. Products and services of developed economies viz. ATMs, Credit/Debit/Smart Cards are effectively used by some Pakistani banks. However, due to many factors such as the absence of adequate market effort, appropriate pricing policies, non-availability of relevant MIS, etc., not much success has been achieved in this innovative role of IT.

(d) Credit Management

Expectations of corporate and mid-corporate customers have undergone major changes due to quick delivering of credit and related facilities with attractive interest rates from competitors of public sector banks. IT can play a major role in meeting these expectations. Moreover, retail customers are also attracted to the competitors the "network of branches" as competitors encounter the strength of public sector banks in cities with "network of ATMs". Consumer loan facilities for housing, home appliances, cars and trade finance can also becoming the focus areas of competitors. IT can also be used for a quick disposals of credit proposals of customers, market efforts can be intensified both for identification of "good" customers and for better recovery management. IT-based databases can be segmentation and by appropriate costing and pricing of products.

(e) Asset-Liability Management (ALM)

Reform processes have transformed banking into a market-driven business. Opening of economy has created many options available to investors. IT has given easy access for assessing options and making the optimum choice for present day alert investors. Interest rate sensitive banking now depends heavily on how effectively asset-liability management is handled. This implies that to meet the requirements of managing risks in the ALM framework, banks must be significantly strengthen their MIS using IT.

In addition, presently banking industry heavily depends on the availability of effective and secured telecommunication network. Competitors have established such networks through SWIFT, corporate networks, Internet and intranets by creating efficiently managed websites.

(f) Investment Portfolio Management

Traditionally investment portfolio managed by only few executives. But, presently investment portfolio becoming effective when computerized modeling management science approaches and techniques can be adopted which are available and well established universally.

(g) Non-fund Based Services

Such as EFTs, bills discounting, cash management, credit card business and investment counseling are totally dependent upon IT based innovations in products and services.

(h) New Portfolios

Infrastructure financing, project management SW venture capital financing, financing SW exports, electronic industry, etc., need new approaches, alert market intelligence and the latest information system along with new skills and techniques for assessment of such proposals.

The Pakistan's banking and financial system has witnessed the phenomenon of change over the last decade and the policy formulators engineered varying responses, the top management of banks and society at large. This phase was termed as the era of big-push, the era of consolidation and the era of liberalizations or the era of reforms and re-reforms. Reforms and re-reform processes have resulted in fierce competition in the financial sector of the country. The strategic importance of IT and IS can be judged by the figure 1 (appendix A).

The public sector banks have a challenging task ahead to remain competitive in an environment of ever advancing technology levels. They will need new banking solutions to replace their existing legacy systems and to network their branches. Government and the State Bank will need to facilitate this transition by determined actions within the coming few years. Further, there is need to create an Apex Body with statutory powers to develop, disseminate and regulate technology for interbank networks and payment systems so as to enable the banks to reach the globle standards.

(ii) Need for Human Resource Management

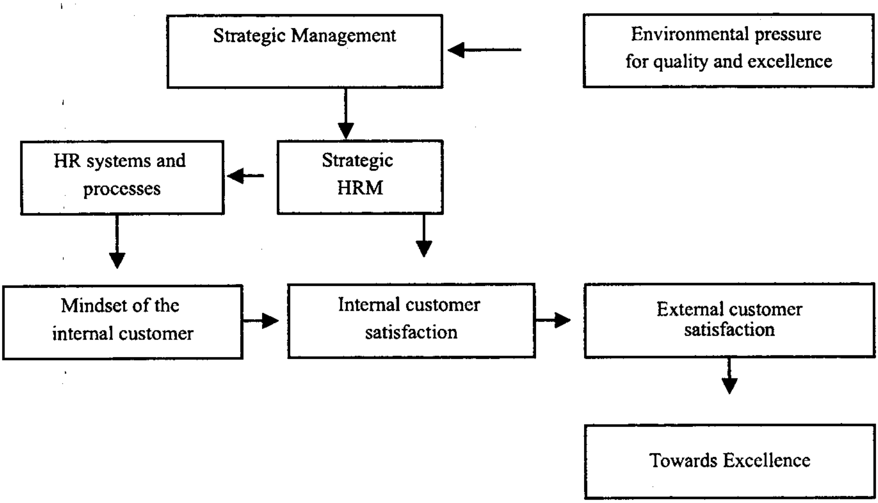
Modernizing banking systems require the development of infrastructure related to human skills. Organization all over the world are now confronted with major challenges arising out of globalization, concern for profitability and rapid technological advancements coupled with the emergence of the new intellectual capital organizational survival and success will invariably depend on how they respond of these challenges. For effective management response, organizations have to evolve internal capabilities for enhancing speed, quality, learning and building employee competencies. Human Resource Management (HRM) is fundamental to generating and affecting these capabilities. According to Ulrich (1998), "Human Resource (HR) has never been more necessary. The competitive forces that managers face today and will continue to confront in the future demand organizational excellence. The efforts to achieve such excellence through a focus on learning, quality, teamwork and engineering are driven by the way organization get things done and how they treat their people. These are fundamental issues. To state it plainly achieving organizational excellence must be the work of HR".

According to Bertrand (1988), "Successful Organizations are those which organize HRM as a key corporate strategic issue rather than simply as an outcome of a strategic decisions". In recent years strategic management has evolved an important dimension in organizational management. For effective performance, HRM has to be directly linked to the strategic management of an organization and this strategic HRM, would then, be complementary to the business activities of the banking sector. Moreover, HRM is integrated with the strategic decision-making process that directs organizational efforts to cope with the new challenging environment. Strategic HRM primarily deals with developing HR system and practices, which will be in consonance with the changing business realities.

Performance excellence of bank organizations depends on customer's "delight" and customer "surprise". A delighted customer will not only return for continued business but also will bring with him more customers. When the customer base increases and is sustained, one can say that organization is moving the direction of excellence.

Satisfaction and delight of the ultimate customer (external customer) is related to the satisfaction of customer who is internal to the organization. These internal customers (employees) are the people who deliver the multifarious services to external customers. The level of satisfaction of the internal customers, therefore, will decide the quality of services, the external customer receives. The frustration and dissatisfaction reflected in the way, he/she treats the customers. To enhance the level of satisfaction of internal customers, HRM and related issues must be addressed. The working of internal, external customer satisfaction framework can be depicted in figure 2.

Figure 2: Internal-External Customer Satisfaction Framework



This figure shows that a continuous pressure from the environment on organizations to provide high quality and excellent services. As competition in business increases, organizations like banks have no choice but to response to these environmental demands. Under such circumstances strategic management should encompass strategic approach to HRM, which bring positive impacts on the midset of the employees and their level of satisfaction.

With the technological advancement, banking industry need knowledge-based skills. Efficiency and profitability cannot be achieved without enlightened employment policies, continuous training from top to bottom. The survival and success of banking industry in this fast-changing world based on the highly qualified devoted and motivated work force. Success in seizing opportunities in a fast changing competitive market is directly related to the well experienced, qualified staff at all levels, and the capacity of the management to how effectively and profitably incorporate changes.

The present complex environment require developing team building, which is crucial for survival of an organization. A team of average individuals pulling together can move mountains. Working as teams will produce better results but will also cater to certain fundamental psychological needs such as identification, companionship, understand and support. Satisfaction of these needs will facilitate greater involvement of employee in organizational efforts. Organizations of tomorrow will necessarily have to accept the inevitability of teamwork at all levels including cross-functional teams. The concept of empowerment coupled with teamwork can enhance organizational effectiveness.

The survival of financial institutions in the 21st century depends on the adoption of balanced approach to manage businesses. They must try to hold on well-trained and highly qualified staff and computer friendly skilled personnel, equipped with sophisticated information technology and information system. It would enable identification of customer needs and ensure provision of efficient services. To beat the future competition, the existing training activities can be made more meaningful by linking training to strategic HRM, and learning can be made a continuous activity where all managers will develop the skill and mindset to learn and teach. Such continuous competence building process becomes a vital element of effective HRM.

Although the Institute of Bankers, Pakistan has been playing a key role in improving professional skills of bankers through holding seminars, training sessions and professional examinations without compromising the standard of excellence and standard of banking services. But with the rising expectations about the quality of banking services, the institute must set its goals higher and higher over the years ahead to meet the challenges of 21st century. Furthermore, in the current fast-changing world of worker mobility and value systems, the public sector banks will need the freedom not only to hire the right talent at market related compensation but also the shed surplus manpower. Bank-centric wage negotiations should be allowed. All this calls for a close relook of service statutes as well as management practices of the banks and other financial institutions.

(iii) Developing Securities Markets

The most complex and challenging issue facing by the Pakistan economy is further developing the securities markets. Better securities markets are needed because they can be a competitive force for improving banking systems and because banks and securities markets are complementary sources of finance. Improved securities markets will lead to more balanced and more robust financial system. The development of securities markets requires pension reforms, introducing new pension schemes, streamlining of provident funds, development of housing and infrastructure markets, secondary markets for mortgages etc. For further development of securities markets, the authorities must undertake the above issues.

Supplementary Strategies

(iv) Development of New Instruments, Products and Diversification of Portfolios

The banking and non-banking financial institutions (NBFIs) must shift their managerial attention from an exclusive preoccupation with recovery of defaulted loans to a more multi-dimensional and balanced approach. Under this approach, the institutions should explore new products, new markets and innovative channels to revive and finance private sector fixed investment and working capital. The authorities must ensure that the quality of these new assets does not be compromised in any way. The recovery of non-performing assets is not slackened and that the efforts at improving the profitability and service standards should maintained. However, this is a gigantic task and poses many difficult challenges including some trade- offs.

Furthermore, diversification is an important not only to minimize risk but also as a way to achieve a pioneering role in seeking out new market needs and introducing innovative products and services to meet them. Through diversification, the financial institutions can broaden their asset base functionally, sectorally, geographically and by size. Banks and NBFIs try to move away from investing government paper, public sector securities and other risk-free instruments, because there is urgent need to provide loans to the corporate clients in the private sector fixed capital as well as working capital, trade financing, revolving lines of credit and other services for reviving economic activities in the country. Banks must develop new consumer products and expand their customer base. Instead of concentrating simply on textiles, sugar, cement and other saturated industries, provide finances to other non-traditional manufacturing and services industries. For export financing, the banks must develop independent lines of pre-shipment, post-shipment credit and assist the indirect exporters and suppliers involved in the export value chain. Moreover, there is over-banking in the big cities such as Islamabad, Lahore and Karachi; the banks must expand their network in medium size town, mandi town and market towns[3]. The banking industry make good profit if they extend

[3] China's industrial success in the last two decades owes a great deal to the town and village enter-prices which are spread all over the country.

their network to other emerging commercial activity centers. Besides expanding the scope of their funding activity, the institutions must diversified into newer fee-based services such as merchant banking, debenture trusteeship, forex services, commercial banking, mutual funds etc.

(v) Broadening the Small and Medium Enterprises (SMEs)

A large number of borrowers in the country have pre-empted more than ¾ of the banking assets in the country. From a pure risk management point of view this is not such a smart move. The SMEs are an important segment of our economy in view of its potential to generate opportunities and to correct the regional imbalances, besides its notable contribution to GDP. While adequacy of infrastructure, availability of raw materials, marketing facilities and gaps in entrepreneurial and technical training are major hurdles in fostering SMEs. Keeping in mind the fast changes taking place in the rural economy, the growth of this sector has greater significance. Hence, the banks and other financial institutions provide their products and services to promote SMEs on priority basis because the repayment record of SMEs is much better than that of large borrowers. Furthermore, this not only make good business sense for the banks and non-bank financial institutions, but also increase purchasing power of a large segment of population which will than translate itself into higher demand of goods and services produced in the country. Empirical evidence shows that the pattern of demand exhibited by lower middle classes and SME is less import intensive and more strongly linked to labour intensive domestic economy.

Moreover, public sector banks have to adopt a financial engineering approach to rural banking and the delivery systems have to be made cost effective. Therefore, there is a need for redesigning the rural banking system to deliver new products and services and to make the priority sector more receptive and productive. In this connection, the regulatory constraints on bank's allocation of credit flows also need a relook. Commercialized agriculture should be considered as a potential avenue for new business. There is also need for a paradigm shift in rural finance and in both mobilization and allocation of resources through other intermediaries including NBFIs. In this context, agro-processing, agro-export and hi-tech agriculture open up wider opportunities for the development of small-scale industries. Upgrading as well as updating the financial services to meet the location-specific needs are quite vital. Activating some of the services like counseling, guidance cell, etc. are in noteworthy in this context. In addition, banks can explore the prospects of providing housing finance to poor segment of the society in the rural areas on a participatory basis. Furthermore, participatory banking is necessary for domestic decentralization, because it initiate changes in the organizational culture of the banks in the designing, implementation, monitoring and evaluation of the projects. Under participatory development approach, people participate through local self-government institutions. In rural areas, participatory banking can play greater role in the development projects. It is imminent that banks involve themselves in invoking people's participation through Self Help Groups (SHGs) and Union Councils. Hence, there is an imperative need to evolve a system of working with the Participatory Rural Institutions (PRIs)

(vi) Creating incentives for Self-Regulation Organizations (SROs)

The other important area is that the prudential regulatory and legislative frameworks needed modernization. To modify legal and regulatory frameworks in way that creates stronger incentives for market participants to monitor the behaviour of banks and other providers of financial services. Both research and experience suggest that good design and strong enforcement of key prudential regulations in such areas as capital requirements, valuation guidelines, regulatory accounting principles and disclosures can create incentives for self monitoring by market participants. Moreover, the modern best practices in regulation of capital markets consider SROs of market participants as partner with government in regulating financial markets. The regulatory authorities in Pakistan need to work in collaboration with the board of stock exchanges and associations of financial institutions. To make this mechanism effective, restructuring and capacity building of these SROs is essential. In this context, international experience suggest that the central bank should encourage such transparent, disclosure-base. and market-based regulations that the financial institutions themselves have to the incentive to comply with the regulations for their own protection. To bound the banking failure (such as the collapse of Mehran bank and BEL) the regulators must introduce "put in place systems", procedures and internal controls whereby the management and supervisory board of banks discourage their responsibilities in a more prudent and cautions manner. The external auditors have also played their professional role in verifying the accuracy of the financial statements and reports prepared by the institutions. Efforts should also be made to permit the further development of institutions[4]. that will demand higher-quality financial information, improving the quality of financial information by raising the standards of key professions (auditing, accounting, financial analysis), and raising standards for self-regulating organizations such as clearing houses, stock exchanges and secondary mortgage institutions. These efforts help to improve market discipline. Hence, there is urgent need to address these and related issues.

(vii) Strengthened Internal Audit and Related Issues

Although the SBP carry out periodic inspections at regular interval. It is quite conceivable that in a few instances the information provided during the inspection may be partial, incomplete tampered with or outright forged. Misreporting of financial information is the worst offence any bank and non-bank can commit. But the paradox is that the SBP has to rely on the reports prepared by the management of these institutions.

Banks have been entrusted by millions of depositors with their hard earned money and the banks thrive and survive in an atmosphere of trust. Undue haste or discloses information without due verification of its accuracy or opinions-based expressions and incomplete information can soon destroy this trust. It is important for the bankers to make a distinction between those handful of willful defaulters who unscrupulously used their connections and influence to borrow huge amount of money from the banking system with

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4 Such as rating agencies

no intention of servicing them and those who fell victims to poor business decisions, adverse external circumstances, unanticipated and inconsistent macroeconomic policies, arbitrariness, misuse of discretion and harassment by corrupt government officials, delays in decision making by bankers, red tapism and other unfortunate events. Under such circumstances, no financial institution follows any personal agenda and should perform their professional duties and obligations without any fear of reprisal. Moreover, poor supervision, limited disclosure lending, weak corporate governance, bad macroeconomic policies, high credit growth rates, inadequate payment systems can increase systemic risks. Although SBP took a number of steps to strengthened its capacity to supervise and regulate the banks and NBFIs. However, we have a long way to go and much more required in coming years.

(viii)Consolidation of Financial Sector

Financial markets all over the world are becoming integrated as restrictions on capital movement are released. Moreover, the technological advancement facilitating quick information and financial flows and reducing the transaction costs. This market integration has introduced volatility and fluctuations in the international financial markets and thus increased the systemic risk to domestic financial institutions. Credit risk has become more difficult to manage, as the domestic financial institutions have to face competition by relatively strong cross border institutions. To participate in this environment and contribute in economic development, financial institution needs to operate as viable commercial enterprises.

In the 21 century, pressure on banking industry will come from increased competition because of deregulated and liberalized financial structure. Competition leads to both risk and efficiency. Margin of profit is likely reduced and chances of failure increased. Under such a situation, survival of small and weak banks will become more allowed difficult. In principle, if a private bank fails, it should be allow to die. As a matter of fact, government and central bank cannot afford the collapse of banks. A part from political consideration 'systemic risk' is a more serious threat associated with bank failures. That is the danger that sudden and unexpected demise of one bank could have domino effect leading to the collapse of other banks or of the system as a whole. It can also have potentially devastating effects on real sectors of the economy. To contain such type of risks, the authorities must adopt incentive-compatible approaches including (i) foster sound risk management within the institutions rather than compliance with narrow rules and regulations (ii) minimize the burden through the use of new examination approaches and internal risk measurement systems; and (iii) reinforce market discipline.

To avoid failure of small banks and to strengthen their balance sheets, serious consideration should be given to enhance the minimum capital requirements together with necessary amendments in the banking laws. The financial sector in Pakistan is too much fragmented so we cannot take the advantages of the economies of scale. Our financial sector requires mergers and restructuring, massive infusion of capital and reviewing the legal and regulatory frameworks.

To reach international standards of capital adequacy, risk management and accounting practices, the right talent at appropriate levels of management needs to be inducted laterally and the banks should have necessary freedom to do so.

(ix) Management of Non-performing Assets

There are several impediments including statutory, legal and political in the recovery of bank loans and advances. Therefore, restructuring of borrower accounts should be left to individual bank decisions subject to full transparency. Then only the public sector banks can better function as business organizations in pursuit of excellence and sound financial performance.

5 Conclusions

In this essay an attempt has been made to propose some strategic measures, which can be implemented for the effective management of financial institution in Pakistan. These measures are so important for the survival of financial institutions in the 21st century. The essay pointed out that the liberalization and globalization have offered an opportunity to the financial institutions to provide a wider range of financial and advisory services and also undertake a variety of promotional activities relating to consultancy services for SMEs, programmes for new entrepreneurs, venture capital finance, debenture trusteeship, forex services, etc. Furthermore, the study suggested that 21st century is the era of competition, technological and communication advancement and the new channels of financial services distribution. In this era, in order to improve profitability, risk management, liquidity management procedures, gaining efficiency and reducing cost, some of the following critical areas, which need immediate consideration:

- The banks and NBFIs in Pakistan must use the modern means of communication including information technology and information system if they want to keep their place in the market.

- Human resource management should be strengthened on priority basis along-with the technological up-gradation.

- The authorities should focused on SMEs, rural banking, participatory banking and infrastructure finance as they are the engine of the economy and funds should be disburse quickly in the areas of projects relating to power, telecom, roads, ports etc. Furthermore, development of new instrument, products, portfolios diversification, working with SROs, strengthening the internal audit and related issues are also needed special attention.

- Consolidation of financial sector and management of NPAs, further development of securities markets and related issues should also be taken in to account.

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Appendix A

Figure 1: Strategic Management of IT/IS for Pakistan's Banking