Car Financing, its Significance and Impact on Automobile Industry and Some Trace of Impact on Economy

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CHAPTER – 1
Background of the Subject/topic and Statement of Problem

INTRODUCTION

Purchasing a car is often the second most expensive yet important purchase, after buying a home. While doing so, an individual has two options available: either to make a hands' on cash purchase or to go for car financing. However, due to the exorbitant car prices and lack of the funds available, many individuals prefer the latter option and approach the various financial institutions, which provide this facility at different rates. Car financing enables the customers to get the car of his/her own choice in affordable and convenient installments.

After the instructions from the central bank to the commercial banks to allocate a specific of their total credit extension under consumer financing, there seems to be a big boom. Initially commercial banks were a little reluctant to undertake these activities, through part of their mandate, due to lack of sufficient legal cover. However, this was merely an excuse because the demand for funds was always more than the supply. Commercial banks were contended with extension of credit under working capital financing arrangement. Bulk of their investment was also in government securities offering very high rate of return. Therefore, they were not keen in undertaking consumer/car financing.

After 9/11 situation has changed altogether. Commercial banks are suffering from 'surplus' liquidity crisis. With the re-profiling of Pakistan's external debt and reduction in government borrowing, bulging deposits and lower credit off take banks are setting on tons of money. Due to the policy of State bank of Pakistan, to lower the interest rate, the return on government securities has also gone down substantially. Therefore, most of the financial institutions had no option but to enter in car financing. It offers very attractive return to the financial institutions.

Most of the financial institutions are now actively involved in car financing to expedite the approval system; most of the institutions have established help/credit approval desks at the leading car showrooms. This strategy has enabled both the car manufacturer and the financial institutions in achieving turnover. According to some sector experts, vehicles sold under financing arrangement have to around 45% shares in the total sales of vehicles.

The second thing that comes in car financing is Leasing. Which is more common and have more market share in car financing than banks financing schemes?

The concept behind leasing is to facilitate the lessee in generating enough profits, by allowing him/her to use the equipment/car, without making full cash payment. The ownership of the car remains with the leasing company (lesser). By paying rental fees to lessee has the right to use the equipment as he wants.

During the last year Pakistan's automobile industry has posted a growth of 25% and the demand of new cars has increased by 50%. The increase in sales of cars is due to availabilities of easy credit to customers, which has come through commercial banks and leasing companies.

Today there are four active car producing companies in Pakistan which include Suzuki, Indus Motors, Honda, Dewan Farooque; the producer of Korean Kia Cars in Pakistan. These four car producers are competing against each other in both the small and big car segments of the market. The competition has invited the leasing companies to open their offices in showrooms/car dealer shops. Commercial banks on the other hand are also connected to these companies and providing financing when required.

Another important development in automobile financing is interest free car financing schemes based on Islamic financing mode of Ijarah or Islamic Leasing, which increased the demand for interested individuals.

Economic significance of Car Financing Schemes

As Pakistan is one of the third world country of the world, our economy is suffering great depression since our independence. But during the last few years Pakistan Automobile industry is really booming due to car manufacturing at the country level. Companies like Honda, Suzuki, and Kia Motors (Korean Company) are playing great role in producing great amount of revenue for the country. But for the most part Pakistan import spare parts for cars and assemble them in the country, after that selling them allover Pakistan. Due to the increasing number of cars in Pakistan more commercial banks and Leasing companies are providing cars on easy terms on the basis of Car Financing Schemes to eligible individuals.

Car Financing Schemes and cars given on Lease basis have improved the Pakistan economic health a little from the past. According to the latest facts and figures extensive sales by commercial banks and leasing companies had produced great amount of money, which is a positive sign for the economy. In October 10, 2005 in Daily news, according to an analyst at Jahangir Siddiqui and Co. "With car assemblers enhancing their production capacities, the car sales will touch 150,000, up by 18 percent, in 2005-06," he said. These schemes are positive steps towards better tomorrow and a prosperous Pakistan.

STATEMENT OF PROBLEM

This report focuses on five aspects 1) Car financing schemes of Commercial Banks of Pakistan, 2) the increase in sales volume of auto industry due to financing schemes by banks, and 3) Economic Significance of Car Financing Schemes.

In fast running life, where no one can neglect the importance of the transport in his or her life, especially the personal transport is a dream of everyone to make the life more easy, accessible and fun. Higher portion of Pakistan population belongs to lower middle class and middle class. It is really heard and most of the time impossible for lower middle class to have a batter car postpones the purchase decision tell then they have more savings. To leasing companies first came up with the solution and later the commercial banks followed their footsteps.

Leasing companies and Commercial banks does not only facilitate to the individuals but also provide opportunities to the car manufacturers to boost their sales. In the last three years the car industry showed a positive sign of growth in the sales. This happened to a large extent due to the energizing entrants of leasing as well as banks by their car financing schemes. They are offering attractive interest rates, down payments, installments that are affordable and flexible to individuals and corporations.

SIGNIFICANCE OF STUDY

This study is intended to focus on car financing of commercial banks and leasing companies, which facilitate to individuals and corporations, who are reluctant to buy a car because of cash flow constraints. In Pakistan new and even old cars are very expensive, also in Pakistan the value of old cars does not seem to deprecate. They are not affordable to an average income Pakistani.

If one look in the past, he/she can clearly see the price of cars in Pakistan has been high and has increased with increasing trend. This is to a large extent due to depreciation of Pak. Rupee against the U.S. Dollar, duties on different cars and auto parts and government taxes etc. Now, thanks to commercial banks and leasing companies, things are quite different from the past, where one, which didn’t have enough saving only dreams of buying a car and dies dreaming.

Leasing companies provide the option of taking home a brand new car or a moderately used car with the facility to pay rental payments. Also commercial banks have different schemes of installments and down payments to meet the individuals’ needs.

The focus should be on the aspects of car financing that this does not only facilitate the individuals but also contributes for the boom of car industry. Therefore, now-a-days, everywhere whenever people talk about the explosion of the car industry performance with respect of the sales they never neglect the contribution of leasing companies and commercial banks.

After the completion of this research report everyone who needs to understand the contribution to car financing in Automobile industry and the economy of Pakistan can see the clear picture of the facilities provided by the car financing. Therefore, this report will be beneficial for both individuals and corporations.

CHAPTER – 2
Research Methods and Procedure

RESEARCH DESIGN

This research is conducted in Karachi. It is a descriptive research; also it is a co-relational study because the research describes all the variables and their characteristics for the increase in sales volume of auto industry. While interpreting data there is to some extent some manipulation that I had done according to my knowledge and abilities.

Overall the research is designed with the consideration of the issue under studies with respect to requirements of the research and data obtained from different sources with adequate selection of data collection methods.

RESPONDENTS OF THE STUDY

The respondents are the executives of different financial institutions, and Commercial banks;

The following commercial banks were visited to conduct this research and to collect the required data;

1. Standard Chartered Bank
2. Bank Al-Falah
3. Soneri Bank
4. United Bank Limited (UBL)

Car Dealers
Suzuki
Indus Motors
Honda
Dewan Farooque

RESEARCH INSTRUMENTS

The data gathered for the reliability of the study are from the primary data and secondary data. Thus a variety of instruments were employed. The details of the instruments are as follows;

Face-to-Face Interview
Face to face interviews were conducted with the managers of Commercial Banks and executives of leasing companies and car companies.

Telephonic Interviews
This instrument was used when I couldn't reach the respondents due to time constraints and limited resources.

Questionnaires
Open Ended questionnaires were distributed to people who has bought a car though car financing schemes and who are willing to buy a car through car financing schemes.

SOURCES OF DATA

Primary Data
The method adopted in the primary data collection comprises of both the qualitative as well as quantitative information. Mixtures of structured and unstructured questionnaires were presented to manager and executives of financial institutions and general public. Qualitative approach constitutes more prominent part of this report.

Face-to-Face interviews and telephonic interviews were the main sources of data gathering. Interviews were conducted with different tactics as to dig out the necessary information from the respondents who are reluctant to provide relevant and reliable information due to their own constraints, which resist them to provide information.

Secondary Data
Secondary sources of data collection included;

1. Newspapers
2. Brochures from Banks
3. Web sites of different Commercial Banks.
4. Magazines

TREATMENT OF THE DATA

The data obtained through questionnaires were calculated and concluded according to the index method and other statistical procedures including frequency distribution, relative frequency, mode and mean of data accumulated.

The data obtained from secondary sources was scattered and unmanageable, after obtaining the data; I carefully examined and sort out the relevant data with careful deliberation. The data collected through secondary sources has been represented by charts and graphs to make the reader more convinced to understand the results of the study more adequately.

CHAPTER – 3
Review of Literature and Study
Related Literature

Article - 1
BRIDGE THE GAP OF SUPPLY AND DEMAND IN CARS
July 2005

The current demand of passenger cars in Pakistan market is estimated at a little over 200,000 units per annum, which is likely to gear up despite increasing interest rates on car financing. With an average 10% growth in demand around 450,000 units will be required by the year 2012. The rising sales are attributed to extensive car financing schemes, significant influx of capital into the country and increase in consumer wealth due to economic turnaround.

The local car production in 2004-05 although jumped by 28 percent to 126,403 units from 98,461 units in 2003-04, yet it is far behind the demand of consumers. Despite an enhanced production capacity and double shift in the automobile producing units, the gap between demand and supply however, indicates the market appetite justifying the policy of the government to import cars to meet the growing requirement. The share of imported cars is likely to increase as local carmakers have also started importing cars and trying to benefit from it.

Despite impressive sale figures and double shift production by all the assemblers, problems of late deliveries and high premiums on locally assembled cars remained a hot issue for the genuine buyers. These issues are likely to loom large in the new fiscal too as demand for cars are still higher as compared to current production of cars. Currently almost all leading models are being sold at a premium ranging from Rs.80,000 to Rs.150,000 while the delivery time by and large is estimated from 8 to 9 months.

In this backdrop, the arrival of one to three years old models of used cars could easily overcome the shortage problem as the condition of those cars would not be bad but the price structure could easily bring down the premium culture on local assembled cars. On the other hand, gap in overall demand and available supply of locally assembled cars would be easily fulfilled.

Apprehensions are being expressed that the arrival of used car would seriously threaten the local assemblers as well as the vendor industry besides creating a stiff competition between locally assembled cars and imported cars. It goes without saying that used cars will consume less foreign exchange than new cars. **(SOURCE: MOBILE WORLD Magazine)**

Article – 2
IMPORTED USED CARS FLOOD MARKET – FEBRUARY 6, 2005
By ALI UMAIR

During the last three to four years, Pakistan's key macroeconomic indicators have shown some very positive developments. GDP growth rate has touched 6% and is projected to go to 8% this fiscal year, remittances have crossed $4 billion, per capita income is now above $625, foreign investments have touched nearly $1 billion while car leasing and financing rates have come down to 7% from 22%, four years ago.

These macro economic indicators have direct bearing on the automobile demand and accordingly, automobile market in Pakistan has experienced unprecedented and unexpected growth in the last three to four years. Sales of passenger cars and Light Commercial Vehicles have gown up from 45,000 units in 2000-01 to 115,000 in 2003-04 and are expected to go upto 150,000 in 2004-05. This phenomenal growth in demand was not anticipated by anyone; not even by the government not the car manufacturers or the vendors.

As a result of this tremendous growth, all the manufacturers are continuously increasing their production capacities and the gap between demand and supply is reducing. It has to be understood that increase in production capacity requires heavy investment, transfer of technology, hiring and training to additional manpower, product development and trails etc.

In order to reduce the demand-supply gap in the short-term, the GoP substantially reduced duties on imported cars in the 2004-05 budget, with a view to resolve the issue of late deliveries and premiums that were being charged by the investors and resellers plaguing the auto market. In the small car (up to 1000cc), import duties have come down to 50% only. The most affected is the medium car segment (1001 – 1300cc) where duties have been slashed from 100% to 50%. Duties have been reduced by 30% for 1301 – 1600cc category and by 45% for the 1601 – 1800cc category. In the luxury car segment, duty has been reduced by 50% from 150% to 100%.

If we add upto 50% depreciation allowed by customs on used cars imported under the baggage scheme, the landed price of used cars has reduced substantially.

This it is not surprising that even though only 5 months have passed since the announcement of duty reduction in the budget and while it takes at least 3 – 4 months for imported cars to reach Karachi after opening of LC, the flood of imported cars has already started. Compared to only 306 units for the 2nd quarter, there has been a 300% increase in import of new cars to 1063 units in the 3rd quarter.

This does not include another 600 used cars that have reached Karachi port on October 19 and are under customs clearance. On condition of anonymity, it has been disclosed by customs insider that 90 percent of the used vehicles have been imported under the name of female owners, with obvious under invoicing for tax evasion. These vehicles have inundated the roadside dealers of Khaled Bin Waleed Road, Karachi and Jail Road, Lahore.

Encouraged by reduction in duties of imported cars in Pakistan as compared to other regional countries, Dewan Motors has recently launched its network of dealerships across the country for selling fully imported Mitsubishi cars with no local value addition or local assembly. This is an indication of a CKD manufacturer opting for CBU business over the local manufacturing. If other manufacturers follow suit, then there will be a substantial loss of jobs, revenue to the government will be reduced and the local auto parts industry will be worst affected.

What eventually forms the basis of such business decisions is the consistency in government policies. If policy changes render mammoth projects such as those of the auto manufacturing economically nonviable, the reason for sustaining investment, expansion, employment, technology transfer, human resource training and production is nullified.

Looking at markets that possess similarities with Pakistan, the Indian policy on import of used cars is one case in point. We find the Indian car manufacturers are protected through tariff as well as non-tariff barriers. Imported vehicles need to be evaluated by testing agencies setup in India to ensure that poor quality and fuel efficient old vehicles do not enter the country. Moreover, registration charges for improved vehicles are higher compared to locally manufactured vehicles. Other non-tariff barriers include conditions such as rejection of cars that are more than three years old from the date of manufacture and submission of pre-shipment certificates by the importer, which conform to regulations specified in the Motor Vehicles Act 1988 of India and to the Original Homologation certificate issued at the time of registration.

On the other hand, NTN certificate is not required for purchasing imported cars in Pakistan, which paves the way for under invoicing and fake documentation. This importers and buyers of imported cars are still exempt from documentation and tax net while all sales of locally manufactured cars are fully documented with NTN certificate.

While there is no equity or investment of the government at stake in case of local auto manufacturing establishments, the revenue through duties and taxes paid by OEMs amounts to almost 30 percent of the vehicle price in Pakistan. Of this, 15 percent is just sales tax, which amounts to more than 100,000 rupees for 1300cc vehicle. While taking straight benefits from the industry, at least the GoP should devise a policy framework in response that supports auto sector and safe guards their interests to foster expansion, growth and further investment.

Therefore, when we look at the recent policy change, it is necessary that there is an initial assessment of the positive and negative affects on the market, the industry and the country's economy.

Apparently the recent policy decision of the government not only aims at slashing its own revenues, but also impedes future investment and expansion plans of the auto manufacturers who are already under lot of pressure due to government's strict regulations on localization and price control. On one hand auto manufacturers have been asked to increase production and maintain quality, while on the other hand, no incentives have been offered to facilitate expansion and quality assurance. It may be noted that a car may have 7,000 – 10,000 parts, and with government enforced localization targets of 50% to 75% for cars, there is a lot of pressure on local auto parts venders to increase production and also maintain quality.

Contrary to the government's expectations of a positive impact through duty reduction of import of reconditioned cars, Pakistan has already begun to face the aftermath of the government's inconsistent policies. As one industry expert said, it is for the government to choose if they want Pakistan to develop a strong industrial base and make cars locally, or convert the Pakistan market into an international dumping ground for used cars and reconditioned vehicles. In the long-term, actually even in the short-term the later is not in the interest of the consumer or the country.

SOURCE: Pakistan and Gulf Economist

Article – 3
ROLE OF FINANCIAL SECTOR IN AUTO INDUSTRY
(Financing of auto products substantially increased the demand for personal and commercial use of vehicles in the country)
By MUHAMMAD SHAKEEL

Auto sector was passing through severe crises before 1999 due to low demand & resultantly non-performing at optimum capacity. Though there was an ample potential available in the market for financing auto products but the presence of a few financial institutions were not enough to feed the market.

Usually there are two principles behind the concept of financing arrangement, when a person/business does not have cash outlay for an outright purchase future cash flows allow to meet subsequent obligations or when cash flow saving is the objective instead of cash outlay.

Citi Bank was the pioneer in consumer banking due to their conventional financing approach; only a little market was explored. Thought various leasing companies were also in the market but a major change had been observed with Askari Leasing started its auto financing product “asKar” in 1999 with relatively aggressive approach from its competitors already in the market. asKar was launched as non conventional weapon tailored for semi documented & non documented segment in the market. Idea was rightly conceived & it received tremendous response from the market. Success of the product also opened a new window for other players in the market. In the era of 2002 – 2004, consumer financing especially auto financing was talk of the town.

Entrance of new players in the market not only created an atmosphere of competition but also equally benefited the borrowers. As a result financing of auto products substantially increased the demand for personal and commercial use of vehicles in the country. Local auto manufacturing plants not only achieved their optimum capacity but also made various expansions and replacements to meet the growing demand of the industry. Another factor that further added to this trend was lowering of interest rate by government by 2004 which further increased direct and indirect flow of the market towards auto products in the country. Auto sector in Pakistan has market tremendous growth during the past few years and this growth is a legitimacy of aggressive public demand for auto products in the country.

GDP contribution of the sector has been visibly improved. All these favorable trends also contributed a lot for allied industry and as a result demand of fuel/CNG, spare parts, skilled labor, workshops, and auto insurance has been reasonably increased. Similarly, respectable revenue has also been generated for the government in the shape of sales tax, registration and route permit fees.

Suzuki & Toyota both brands grabbed major market share, especially Suzuki Mehran came up as hot selling brand in the light vehicle category. Cars belonging to Honda family also attracted their selective market and made respectable profits. Besides these local brands, some imported personal use brands i.e. Mitsubishi Lancer, Chevorlet, used Mercedez & Land Cruisers were also slightly absorbed in the market. In commercial use category, branded vehicles of Hino, Nissan & Sindh Engineering were hotly demanded by the market whereas used imported chassis of Hino & Nissan were slightly absorbed in the market. Local new entrants in commercial fleet "Zabardast" of Adam Motors & Star Truck of Delta Innovations also attracted & showed their presence in the market.

Presently auto financing has become a regular feature for almost every financial institution, besides their other conventional arms. These banks/NBFIs are playing vital role by providing financial facilities for the purchase of personal and commercial use assets of their borrowers. More realistically, if it is said that financial institutions revived this sick industry, it will not be wrong. No doubt due to all these positive signs an economic activity in the country has been started for some past years, but it seems that the entrance of financial institutions and to some extent speculators (person who is not a real purchaser of the product) have put this sector to an abnormal growth whereby many question arise in mind with respect to the future of this sector in the light of following:

1. Is our local auto sector capable enough to meet the prevailing demand in the market with an affordable price for a common purchaser?

2. Is the quality of the vehicle produced up to the mark in growing demand scenario?

3. Does our infrastructure allow such large volume of vehicles?

4. Do financial institutions need market segmentation and differentiation of product for their profitability & continuous support for the sector?

5. How can speculation be eliminated from this sector to eradicate artificial shortage.

As far as first question is concerned, no doubt about speculative buying and change of trend both lead any product to an abnormal growth until enough supply is not provided to end the situation. Low interest rate regime served as incentive for automobile products and auto financing emerged as a new trend in the market which visibly increased the demand of auto products in the country. Though our local manufacturers were not fully ready to face the situation in the past but after passing 3 to 4 years it seems we are still on the same road were we stand. No sincere efforts by the government and private auto sector to resolve this situation led to price hike and many other issues. Extra ordinary delay in delivery time for a new vehicle with 100% up front payment has another bad element i.e. premium money (an additional amount asked for ready delivery with respect to vehicle demand and its marketability).

It has been observed that most of the local auto manufacturers are taking 06 to 08 months and in some cases around 10 months for delivery of their new vehicles with 100% upfront payment. For example if we take the delivery schedule of Suzuki Mehran VX CNG by Pak Suzuki Co. Ltd. we see the vehicle's ex-factory price is Rs.345,000/- whereas it is available with a dealer at a price of Rs.415,000/- or more for instant delivery, which clearly shows that the manufacturer capacity is not enough to produce a vehicle in a justified time to avoid bad elements like premium from the market. This behavior can be observed with all brands in the market, difference is the premium with respect to marketability and delivery time of a brand. In the case of corolla an additional amount of more than Rs.150,000/- is demanded by the dealers for prompt delivery of vehicle.

Present delivery time by the local manufacturers is totally unjustified and allows bad elements like premium in the market. After 100% payment and delivery of the asset with this timeframe is totally unjustified, immoral and against the basic consumer rights. All these facts are good enough to prove the manufacturing capacity of our local vendors is not matching with the growing auto demand in the country. Similarly, now a days a new practice has emerged that dealers are not talking out right booking or asking black money of Rs.20 to 30 thousands reasoning short of the quota or closing of booking by the manufacturer. As per law of demand low manufacturing capacity with aggressive demand lead over pricing, which throws out a large segment of common purchasers from the market and their dream of a car cannot come true till the time situation changes or some other alternative comes.

It is also important to mention here that our neighboring country Suzuki Mehran is being manufactured at around Rs.150,000, which is big question mark for all relative quarters in the government. Current trade policy signal for foreign imports in the country is one step to end this issue but efforts should be made for more auto plants in the country, which will result in an economic activity and reduce severity of unemployment in the country as well. Financing of auto products has become a permanent feature in the market, which demands more plants in the country instead of imports to save the country's foreign reserves.

As far as second question is concerned, quality of a vehicle with respect to its performance and material used is another question mark with some vendors who are frequently changing their prices with reasoning some external factors but totally ignoring value of the money returns to their customers. If we compare an old model of a specific vehicle with its present version, this can be easily proved that some vendors are producing only quantity to avail maximum benefit of the situation ignoring what they are delivery to their customers.

As far as third question is concerned our infrastructure is not fully supporting present volume of vehicles in the country and there is an immediate need for more roads and expansions of existing roads especially in populated cities. Increase in auto products result heavy traffic and increase in traveling time. Non awareness of basic traffic rules and irresponsible attitude of traffic authorities both lead to another mess. Development of existing infrastructure is the one solution, whereas ban on older vehicles more than five years is another option to end severity of the issue.

Regarding fourth question, I think yes because auto financing is now facing regurgitate scenario and financial institutions need to rework their long term strategies with respect to their market share and consistent growth. Non availability of lending products of banks and especially leasing companies in rural areas adversely affects the market potential there in shape of ex-Pakistanis, agriculturists & farm owners, that can be explored more effectively with the presence of such products there. Similarly, there is an immediate need for product differentiation exclusively catering to business executives, corporate employees, owners of SMEs and financing of light commercial use assets to fresh & small earning segments of society on relatively soft terms.

As far as fifth question is concerned, speculation can only be eliminated from the market by providing enough supply of vehicles as per demand because we have already seen the results of fresh booking on national tax number basis. Another way to removed these elements from the market is awareness of society, which should not be expected at least 50 years or more in our prevailing situation.

SOURCE: Pakistan and Gulf Economist

SUMMARY OF ARTICLES

Article – 1
BRIDGE THE GAP OF SUPPLY AND DEMAND IN CARS

This articles highlights the increasing demand of passenger cars in Pakistan despite increasing interest rates on car financing schemes. The local car production increased by 28 percent in 2003-04, yet there is big gap between the consumers demand and supply of cars in country. Despite an enhanced production capacity and double shift in the automobile producing units, the gap between demand and supply however, indicates the market appetite justifying the policy of the government to import cars to meet the growing requirement.

Article – 2
IMPORTED USED CARS FLOOD MARKET

In order to reduce the demand-supply gap in the short-term, the government of Pakistan substantially reduced duties on imported cars in the 2004-05 budget, with a view to resolve the issue of late deliveries and premiums that were being charged by the investors and resellers plaguing the auto market.

Article – 3
ROLE OF FINANCIAL SECTOR IN AUTO INDUSTRY
Financing of auto products substantially increased the demand for personal and commercial use of vehicles in the country. Another factor that further added to this trend was lowering of interest rate by government which further increased direct and indirect flow of the market towards auto products in the country. Auto sector in Pakistan has market tremendous growth during the past few years and this growth is a legitimacy of aggressive public demand for auto products in the country.

Websites Visited for further References and Additional Material

www.AutoIndustry.com

This website shows growth in automobile sector, it gives figures of the growth rate, units and compares it with latest facts and figures. It also shows the figures of cars sold during the year 2004-05.

www.ubl.com.pk **(United Bank Limited – UBL DRIVE)**

This website explains UBL DRIVE in detail, the reason for visiting this website is that it give most of the information about how customers can contact the bank to finance a car and method calculation for installments.

www.bankalfalah.com **(Bank Al-Falah: The caring Bank)**

The reason for visiting this website is gather some information about the Bank Al-Falah car financing scheme and benefits offered to customers. Further it give information about the procedures and the documents required for the car financing scheme.

www.StandardChartered.com/pk/ **(Standard Chartered Bank Pakistan)**

The Standard Chartered Bank website give some more incisive information about their auto financing scheme plus their interest rates and back end calculation of installments for the scheme.

www.soneribank.com **(Soneri Bank of Pakistan)**

The Soneri Bank website provides the information relating to its car financing scheme with interest rate and installments payment scheme for customer satisfaction and ease of service and low rates.

Print Sources

Pakistan & Gulf Economist Magazine
2 Articles

Mobile World Magazine & Website
1 Article

Dawn Newspaper
For Additional information on car financing schemes

The News Newspaper
Articles and additional material

CHAPTER – 4
Presentation Analysis

BANKING INDUSTRY

Banking industry is one of the most sensitive businesses all over the world. Banks play very important role in the economy of the country is no exception. Banks are custodians to the assets of the general masses. The banking sector influences and facilitates many different but integrated economic activities like mobilization of resources, poverty elimination, collection and distribution of public information.

Pakistan has a well developed banking system, which consists of wide variety of institutions ranging from a central bank to commercial banks and to specialized agencies to cater for special requirements of special factors. The country started without any worth while banking network in 1947 but witnessed phenomenal growth in the first two decades. By 1970, it had acquired a flourishing banking sector.

The commercial bank thus lost their assets management equilibrium, initiative and growth momentum. They ceased to be a business concern and become big bureaucracies. This was accomplished by discreet loaning under political pressure. They suffered from three terminal diseases: non-performing loans, higher intermediate cost; and loss of initiative and entrepreneurship. The rise of labor unions and officers associations made life tough and working condition ugly to honest, dedicated and industries worker in the realms of domestic banking industry.

The era of nineties was the climax of privatization, deregulation and restructuring in the domestic banking industry and financial institutions. The Muslim Commercial Bank was the first bank to privatized, followed by the Allied Bank Limited, the United Bank Limited and now the Habib bank Limited. One thing good for that particular period was the recruitment of fresh officers in the domestic banking industry through well though out policies of the banking council. With the decay of the banking council there was flood of insincere, nonprofessional, incompetent candidates directly appointed/recruited in all the domestic banks of the country.

Many domestic banks have increased their general standard. Ours is the age of plastic money. Internet-based services are constantly increasing the number of ATM machines, either by installing their own machines or making arrangements with other networks. The number of Debit cards has also been increasing at an unprecedented rate. All the domestic and foreign banks vigorously institutionalizing consumer financing in their country and earned handsome profits.

The borrowing by the private sector has also increased which ultimately boosted the profitability of all the domestic banks of the country. In the last three or four years many domestic banks have been suffering from surplus liquidity. Crisis mainly due to low demand for credit and slowdown of the manufacturing sector in the country.

Almost all the banks are now busy in investing in capital markets to increase their exposure in equities. To stop the risky trend the Stat Bank of Pakistan issued instructions to follow the prudential regulations in letter and spirit and not invest in the capital market beyond the limits.

Emerging Markets: Islamic banking is getting popularity in the country. Many efforst are being made to make it workable in the era of conventional banking. The SBP had initiated the process of converting the conventional banking system into Islamic banking. Government of Pakistan has initiated a parallel banking strategy of promoting Islamic banking alongside conventional banking. There is a big scope for Islamic and Moderaba Banking system in the country.

COMMERCIAL BANKING

Bird Eye-View of Pakistan Economy

Today the financial sector of Pakistan is far stronger than that of nineties. The growing strength is attributed to the overall improvement in the macro economic conditions. However, it is also true that the central bank has been following a very pragmatic approach, with the aim that only a strong financial sector can help in ushering economic growth in the country.

Pakistan's track record in macroeconomic management and governance during the 1990s was dismal. However, the present economic managers led by General Pervez Musharraf, which came to power in October 1999, embarked upon a serious program of macroeconomic stabilization, structural reforms, good governance and the establishment of credibility with international financial institutions. Despite several major exogenous shocks, including September 11, the mobilization of troops on the Indian border, severe drought and incidents of terror attacks, the country has been able to make a dramatic turn around in its economic indicators.

The positive indicators include increase in GDP growth rate and a primary surplus on budget, inflation rate effectively managed and the current account pointing a surplus. The debt servicing has become sustainable and foreign exchange reserves grown from as low as US$1 billion to well above US$12 billion. All this amply demonstrates the seriousness of efforts made.

The GDP growth has very encouraging. The sustained growth rate of about 6 percent had a positive impact on the level of poverty, which had doubled during the decade of the 1990s. The progress in the trade and tariff reforms, tax administration, financial sector, privatization and deregulation was quite significant, but it has still some way to go before it makes a visible difference. Corruption at higher levels of decision making has come down significantly. The strong accountability mechanism was able to secure successful convictions of politicians, senior bureaucrats and businessmen who were previously considered untouchable. Poverty targeted interventions and social sector developments were given high priority and poverty reduction was recognized as a major policy objective.

Commercial Banking in Perspective

Pakistan offers a wide spectrum of financial institutions – commercial banks, specialized financial institutions, national savings schemes, insurance companies, development finance institutions, investment banks, stock exchanges, corporate brokerage houses, leasing companies, discount houses, micro-finance institutions and Islamic Banks. All these offer a wide range of products and service both on the assets and the liabilities side. Financial deepening intensified during the last several years but the commercial banks are by far the predominant players accounting for 90 percent of the total financial assets of the system.

The commercial banks, both foreign and domestic, together hold bulk of the banking system assets a feat that is unparallel among developing countries. Foreign banks enjoy the same facilities and same access as the domestic banks and there is no preferential treatment for domestic institutions. Unlike many other countries, foreign banks are allowed to have 100 percent ownership, can open their branches or establish local subsidiary with full ownership. Foreign companies are also provided level playing fields as they can raise all types of finances and tenures from the domestic banking system.

The banking sector which was fully dominated by Nationalized Commercial Banks (NCBs) until a few years ago, has been opened up to the private sector. The ownership and management of the banks by private sector in one pillar of the reforms, the other pillar is a strong regulatory environment. Private banks are prone to taking excessive risks in their lending as their own capital is much lower in relation to the depositors' money. They can realize the larger upside potential from high-risk assets while the defaults and losses in case of downside scenario are disproportionately higher for the depositor. It is the responsibility of the central bank as a regulator to be extremely vigilant and take prompt timely action to prevent the bank managers and owners from assuming excessive risks. The central bank in Pakistan has strengthened its capacity by acquiring new skills, upgrading the quality of the existing human resources base, adopting technology and re-engineering business processes.

The financial soundness indicators show a healthy and sound banking system with high degree of financial stability. The banking sector has now diversified its product base and carried out a lot of innovation. They have expanded their out reach to agriculture, SMEs, mortgage financing and consumer financing. Not only that this diversified lending portfolio mitigates risks but it also raises the purchasing power of a large segment of population that was completely shunted out from the credit markets. One of the exhibits of the success is Pakistan's auto industry, which has expanded its car production by a multiple of five times over the years. The auto financing enabled a vast number of middle class income earners to purchase the cars on monthly installments.

At this juncture, it is necessary to examine the role of the State Bank of Pakistan to evaluate its performance. The State Bank of Pakistan has four major functions to perform under law: 1) Ensuring soundness of the Financial Sector, 2) Maintaining price stability with growth, 3) Prudent Management of the Exchange Rate and 5) Strengthening of the Payment System. The State bank of Pakistan as a regulator and supervisor as well as advisor to the Government, the SBP carried out diagnostic studies, prioritized the constraints facing the banking sector, designed the reform strategy and action plan, sought the assistance of the government of Pakistan and International financial institutions, monitored the progress and made policy, regulatory and institutional changes to facilitate the process. The continuity of reforms and sound policies that transcend political partisanship and survive political regime changes has yielded positive results.

Following are the reforms that were implemented after the privatization of NCBs and they are yielding good results in their financial processing.

Corporate Governance

Strong corporate governance is absolutely essential if the banks have to operate in a transparent manner and protect the depositors' interests. The SBP has taken several measures in the last four years to put in place and enforce good governance practices to improve internal controls and bring about a change in the organizational culture.

Capital Strengthening

Capital requirements of the banking sector have to be adequate to ensure a strong base, ability to compete and withstand unanticipated shocks. The minimum paid up capital requirements to the banks have been raised from Rs500 million to one billion and have again been raised to Rs2 billion (by Dec 31, 2005). This has already resulted in mergers and consolidation of many financial institutions and weeding out of several weaker banks from the financial system.

Liberalization of Foreign Exchange Regime

Pakistan has further liberalized its foreign exchange regime and set up foreign exchange companies to meet the demands of Pakistani citizens. Pakistan's corporate sector companies have also been allowed to equity abroad. Foreign registered investors can bring in and take back their capital, profits, dividends, remittances, royalties, etc. freely without any restrictions.

Consumer Financing

By removing restriction imposed on nationalized commercial banks for consumer financing, the State Banks of Pakistan has given a big boost to consumer financing. Middle class employees can now afford to purchase cars, TVs, air conditioners, VCRs, etc. on installment basis. This, in turn, has given a large stimulus to the domestic manufacturing of these products.

Mortgage Financing

A number of incentives have been provided to encourage mortgage financing by banks. The upper limit has been raised from Rs5 million to Rs10 million. Tax deduction on interest payments on mortgage have been allowed up to a ceiling of Rs1 million. The new recovery law is aimed at expediting repossession of property by the banks. The bank have been allowed to raise long term funds through rated and listed debt instruments like TFCs to match their long-term mortgage assets with their liabilities.

Legal Reforms

Legal difficulties and time delays in recovery of defaulted loans have been removed through a new ordinance i.e. the Financial Institutions (Recovery of Finances) ordinance, 2001. The new recovery laws ensures the right of foreclosure and sale of mortgage property with or without intervention of court and automatic transfer of case to execution proceeding. A Banking Laws Reforms Commission is reviewing, revising and consolidating the banking laws and drafting new laws such as bankruptcy law.

Prudential Regulations

The prudential regulations in forces were mainly aimed at corporate and business financing. The SBP in consultation with the Pakistan Banking Association and other stakeholders has developed a new set of regulation which cater to the specific separate needs of corporate, consumer and SME financing. The new prudential regulations will enable the banks to expand their scope of lending and customer outreach.

Micro Financing

To provide widespread access to small borrowers particularly in the rural areas the licensing and regulatory environment for Micro Credit and Rural financial institutions have been relaxed and unlike the commercial banks these can be setup at district, provincial and national levels with varying capital requirements. There is less stringency and more facilities thrust embedded in the prudential regulations designed for this type of institutions. Khushali Bank and the First Microfinance Bank in the private sector have already started working under this new regulatory environment. Khushali Bank has already reached a customer base of 125,000 mainly in poorer districts of the country its recovery rate is above 95 percent.

SME Financing

The access of small and medium entrepreneurs to credit has been a major constraint to expansion of their business and up gradation of their technology. A small and medium Enterprise (SME) Bank has been established to provide leadership in developing new products such as program loans, new credit appraisal and documentation techniques, and nurturing new skills in SME lending which can then be replicated and transferred to other banks in the country. Program lending is the most appropriate method to assist the SME financing needs. The new prudential regulations for SMEs do not require collateral but asset conversion cycle and cash flow generation as the basis for loan approval. The State Banks is also contemplating to develop capacity building among a selected group of banks for SME lending. This will revitalize the lending to SMEs particularly export-oriented ones.

Taxation

The Government has already reduced the corporate tax rate on banks from 58 percent to 41 percent during the last four years and it is envisaged that the rate will be reduced gradually and brought at par with the corporate tax rate of 35 percent in the new two years. This will, in turn, help in reducing and spread between the deposit rate and lending rate and benefit financial savers.

Islamic Banking

Pakistan has introduced Islamic banking system to operate in parallel with the conventional banking providing a choice to consumers. A large number of Pakistanis have remained withdrawn from commercial banking because of their strong belief against riba-based banking. These individuals and firms --- mainly middle and low class --- will have the opportunity to invest in trade and businesses by availing of loans from Islamic banks and this expand economic activity and employment. A full-fledge Islamic bank has already opened the doors for business and several banks have branches exclusively dedicated to Islamic banking products and services.

Human Resources

The banks have recently embarked on merit-based recruitment to build up their human resource base – an area which has been neglected so far. The private banks have taken lead in this respect by holding competitive examinations, interviews and selecting the most qualified candidates. The era of appointment on the basis of sifarish and nepotism has almost come to an end as the private owners want to attract and retain the best available talent which can maximize their profits. This new generation of bankers will usher in a culture of professionalism and rigor in the banking industry and produce bankers of stature who will provide leadership in the future.

Credit Rating

To facilitate the depositors to make informed judgments about placing their saving with the banks, it has been made mandatory for all banks to get themselves evaluated by credit rating agencies. These ratings are then disclosed to the general public by the SBP and also disseminated to the Chambers of Commerce and Trade bodies. Such public disclosure will allow the depositors to choose between various banks. For example, those who wish to get higher return may opt for banks with B or C rating. But those who want to play safe may decide to stick with only AAA or AA rated banks.

Payment systems

Finally, the country's payment system infrastructure is being strengthened to provide convenience in transfer of payments to the customers. The Real-Time Gross Settlement (RTGS) system will process large value and critical transactions on real time while electronic clearing systems will be established in all cities. These reforms will go a long way in further strengthening the banking sector but a vigilant supervisory regime by the State Bank will help steer the future direction.

CONSUMER FINANCING BY BANKS AND LEASING COMPANIES

Most of the commercial banks have ventured into consumer finance. They provide funds for the purchase of consumer durables, computers, automobiles, and even housing. Automobile are covered either through leasing or auto loans, being undertaken by leasing companies and modarabas or separate divisions within financial institutions. Housing finance is mostly confined to two companies, namely House Building Finance Corporation and International Housing Limited.

- Scope of the investment banking is very much there and bright as said by the finance minister of the country. Concrete efforts should be made to imitate investment banking operation in the region.

- Money laundering and white-collar crimes are on the rampant. Aggressive and comprehensive mechanism should be set up to save the domestic banking industry of the country.

- General working conditions ought to be improved.

CONSUMER FINANCE

Consumer financing refers to any financing allowed by individuals by financial institutions to meet their personal needs. It gives individuals the ability to generate funds for their personal consumption by borrowing again future income. It can range from financing a vacation, to buying a car or a house etc. Commercial banks in Pakistan financial sector have traditionally focused on meeting the financing needs of the corporate sector in their normal course of business, and until the recent past, it had remained confined to fully secured loans against tangible liquid securities (usually government securities, bank deposits etc.) in line with SBPs margin requirement on such collateral.

Consumer financing in a broader sense remained a relatively less explored avenue (due to its high risk nature) for revenue generation for banks until a few years ago, when surplus liquidity and slow credit growth for the corporate sector forced the banks to focus their attention on previously ignored areas for the growth of their asset base. Consumer financing has now gained accelerated momentum. SBP has also recognized the need to promote economic growth through the viable avenue of consumer loans as part of its demand inducement policies and has made requisite provisions in its regulatory framework to guide financial institutions accordingly. As a result of these measures consumers financing assumption stands at around 7.6 percent of the total credit off-take, as at June 05. Initially, credit cards were introduced by Citibank in 1994, and since then a variety of products have inundated the market in the form of auto financing, mortgage loans, personal loans (both secured and unsecured).

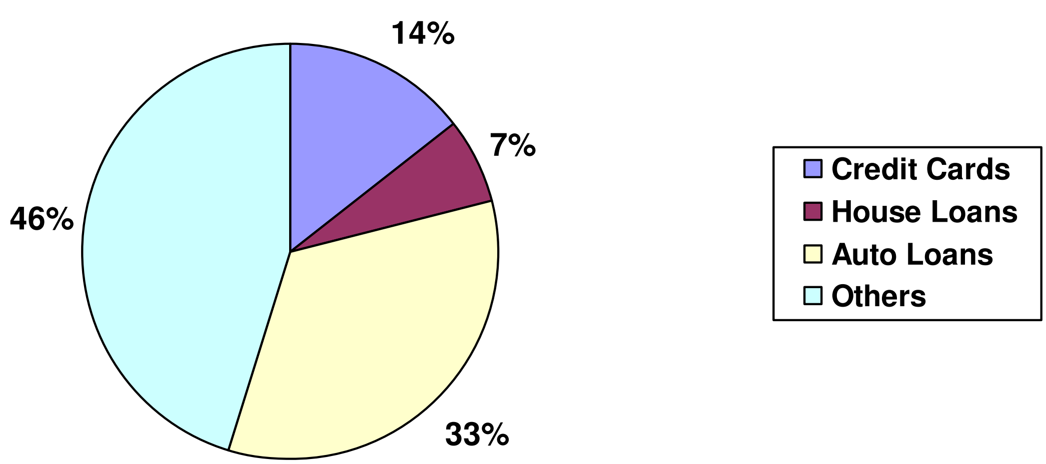
Table-1 shows that consumer financing has grown at a rapid pace since June 2004, with an increase of 128 percent up to June 2005. whereas the pace of growth has stabilized from quarter-ending September 2004 onwards, the largest share belongs to "Other" category which consists of personal loans, both secured and unsecured, as well as financing for consumer durable.

TABLE - 1 **Rupees in Billions**

	Jun-2004	Sep-2004	Dec-2004	Mar-2005	June-2005
Credit Cards	6.7	8.0	8.9	9.7	11.2
House Loans	3.8	3.4	4.1	5.5	8.3
Auto Loans	15.8	16.9	22.2	27.6	33.1
Others	18.7	25.6	30.3	40.2	50.0
Total Consumer Finance	45.0	53.9	63.5	83.0	102.6
Growth rate (%)	69.8	19.8	21.5	29.7	23.6
TOTAL LOANS	1,043.1	1,040.2	1,152.0	1,205.4	1,350.9
C.F as % of Total	4.3	5.2	5.7	6.9	7.6

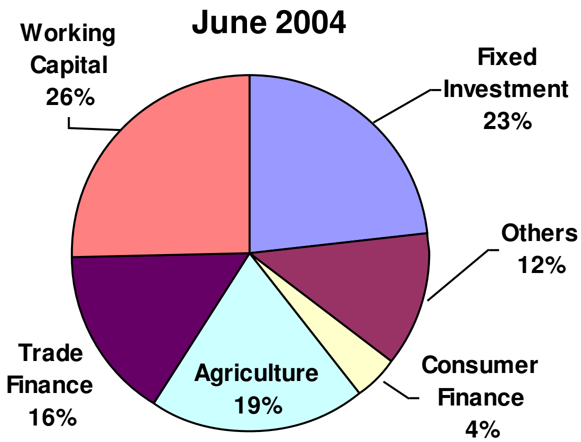
Source: Banking Supervision Department (SBP)

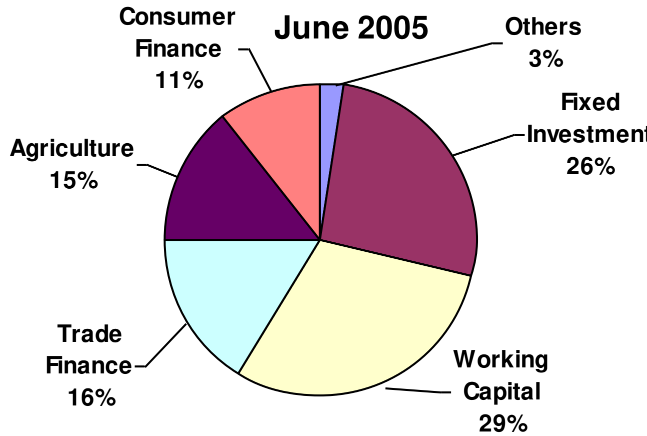
Graphical Representation of Consumer Financing Sector



Source: Banking Supervision Department (SBP)

A comparative analysis of the consumer financing portfolio of year end FY04 and FY05 shows that the share of credit cards have been taken over by personal loans. The "Others" category which currently has largest share at 46% of total consumer financing.



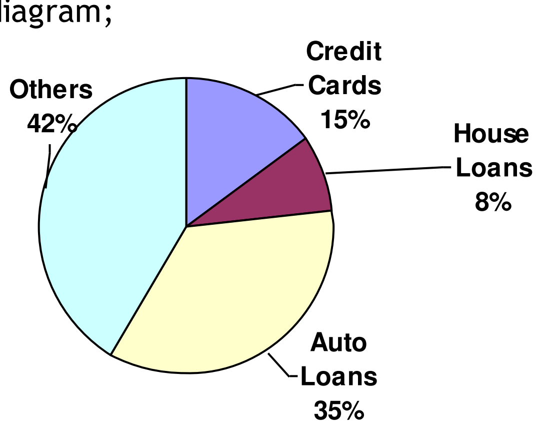


Consumer financing products are designed to cater the needs of the middle class segment, both salaries and self-employed people, who can demonstrate an ability to service the loan facilities in line with their recorded cash flows. These financing opportunities have gradually changed the mindset of the target market regarding "Debt", which was previously considered taboo. With the availability of such products the average consumer can now fulfill his/her immediate financing requirements instead of first saving up the requisite amounts.

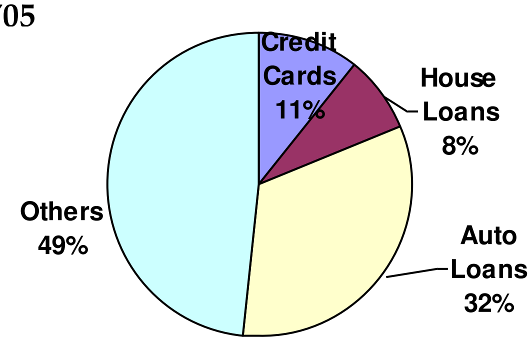
CAR FINANCING

The auto loans have the second largest share in outstanding loans. Prudential regulations allow these loans for the purchase of vehicles for personal use only. As mentioned in the Pakistan's Financial Sector Assessment that auto loans were largely the domain of the leasing companies in the early 1990s, whereas the foreign banks entered this market in the later period of 1990s. Currently this area of consumer financing is very popular for both lenders and borrowers, and the auto demand thus created have been the driving force behind the strong growth of the automobile industry.

The figure shows the portion of auto financing on the consumer financing diagram;



FY05



CAR FINANCING SCHEMES BY DIFFERENT BANKS OF PAKISTAN

BANK AL-FALAH CAR FINANCING

Bank Al-Falah is one of the leading bank in Auto Financing. Its car financing scheme is specially designed for you with easily affordable and flexible installments.

Following are the benefits and procedure of their scheme.

BENEFITS and FEATURES

- Quickest Processing
- No hidden charges
- Minimum down payment
- Complete repayment at any point of time.
- Balance transfer facility (BTF) for existing as well as new clients from other banks.
- Tenure period ranging from 1 to 5 years.
- Financing of all brand new locally assembled vehicles and used cars.
- Financing Limit ranging between Rs200,000/- to Rs2,000,000/- for brand new cars.

MARK-UP RATES

Pak Suzuki Cars	11.9%
All other locally assembled cars	12.9%
Imported Cars	13.9%

SECURITY

Hypothecation of vehicles in the name of the Bank Al-Falah Limited.

BANK AL-FALAH CAR FINANCING

DOCUMENTS REQUIRED

- Two passport size photographs
- Copy of National Identification Card (NIC card)
- Bank statement for the last six months
- Salary certificate {for salaried individuals}
- Business Proof {for a business person}
- N.T.N certificate
- Co. Borrower's NIC copy {if the car is to be in the name of the co-borrower}

ELIGIBILITY CRITERIA

- Yes you get a car loan from Bank Al-Falah Limited to purchase a brand new car if you are:
- Pakistani National Identity card holder
- Over 20 years of age (Maximum 60 years in case of salaried and 62 in case of a business person at the time of maturity of the loan)
- Salaried Businessman of self-employed

STANDARD CHARTERED AUTO FINANCING

Standard Chartered Auto Loans are extremely flexible and designed to meet the customers need.

BENEFITS and FEATUREES

- Hassle-free processing
- Personalized service
- Insurance Financing
- Easy repayment options
- Flexible Tenors – up to 07 years
- Advance Payment
- New and Used Vehicles

ELIGIBLITY CRITERIA

Minimum Age	= 23 years
Maximum age at End of Loan	= 65 years or retirement age (which ever is higher)
Minimum Full-time work experience	= 1 year confirmed Employee
1 year Confirmed Employee	Rs12,000/-
Minimum Loan Amount	Rs150,000/-
Maximum Loan Amount	Rs1,500,000/-
Purpose of Loan	= Purchase of Non-commercial Private vehicles

CHARTERED AUTO FINANCING

Standard Chartered Pakistan

ELIGIBLITY CRITERIA (Continued…)

Down Payment	⦿ 0% if customer deposits 20% (minimum) worth of government securities with the bank which will be returned once the loan tenor finishes ⦿ 20% for all others – new cars ⦿ Those who make a down payment of 40% will have to provide no documents (Bank Statement will be required)
STANDARD	
Types of Vehicles	New Automobiles
Tenor	Minimum 12 months Maximum 84 months (based on loan amount)
Re-Payment Method	⦿ Standing instructions for transfer from salary account ⦿ Post Dated Cheque
Processing Fee	Rs5,000/-
Early Settlement Charges	5 – 10% of outstanding amount.

Standard Chartered

UNITED BANK LIMITED – UBL DRIVE

UBL call their financing scheme UBL Drive. It is a unique car financing product, which offers customer features, options and flexibility unmatched by any other bank, for the very first time in Pakistan. They say at UBL "customer comes first".

NEW CAR FINANCING

UBL Drive allows you to drive away in your own car by making a down payment of just 10% and to top that with low monthly installments.

USED CAR FINANCING

With UBL Drive you can buy your favorite used car (up to 5 years old) at the most affordable rates.

CASH YOUR CAR

UBL Drive is not just a car loan; it's a financing facility that gives you Cash on your car, you can get up to 75% of your car value. Drive in with your car and drive out with cash.

NO DOWN PAYMENT BEFORE APPROVAL

UBL Drive is the quick and hassle free route to the car of your choice. Offering you for the first time in Pakistan, No Down Payment and processing charges till your application is approved. After approval, you can take your Purchase Order to any of our authorized dealers, pay the Total Cash Outlay amount and simply drive away with your preferred car.

NO DOCUMENTS REQUIRED

UBL Drive offers you the option of auto financing without requiring any income documents/proof at 5% additional equity.

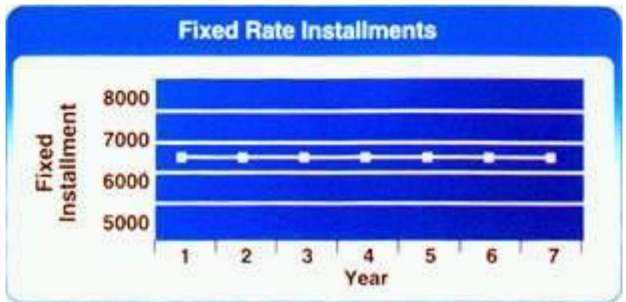
NO PRE-PAYMENT PENALTY

For the first time in Pakistan, UBL Drive offers you the option to pay-off your loan amount anytime after the first year of financing without incurring any extra charge (different financing rates will apply for this option).

UNITED BANK LIMITED – UBL DRIVE

LOW INSTALLMENT & FLEXIBILITY

In our fixed plan, you are offered a variety of affordable rates and installment plans, suiting your needs.



PAYS (Pay as you select)

For the first time in Pakistan, UBL Drive allows you to choose from different repayment options to suit your present & future expected cash flows:

Pays-up

You can design your own repayment plan with installments increasing every year, starting with low installments to suit your cash flows.

The graph below indicates the increasing trend of monthly installments you will be paying over the life of the loan.

Pays-down

Step down allows you to pay higher at the beginning with your installment reducing in subsequent years. Your total payment during the duration of the loan remains very affordable.

UNITED BANK LIMITED – UBL DRIVE

The graph below indicates the declining trend of monthly installments you will be paying over the life of the loan.

FREE CAR TRACKING DEVICE

Enjoy security and complete peace-of-mind as UBL Drive becomes the only auto finance product which offers you a free Tracker device installed in your car!

INSURANCE OPTIONS

UBL Drive offers you the following insurance options:

- Comprehensive insurance
- Insurance financing for the first year
- Deductible insurance (risk beyond a certain amount covered at discounted insurance rates)
- Discounted rates with Tracker car security device installed at customers' cost

PROCESSING CHARGE

A processing charge of Rs4,000 will apply.

SONERI BANK CAR FINANCING SCHEME

FEATURES AND BENEFITS

- Avail our low mark-up rate of just 12%p.a
- Financing Amount: Maximum Rs.2 Million for Brand new Un-registered Cars
- Minimum Down Payment: Up-to Rs.1.0 M.
- Minimum 15% of the official price of the car being financed.
- Minimum Down Payment: Over Rs.1.0 M.
- Minimum 20% of the official price of the car being financed.
- Term: 1 to 5 years.
- Processing fees: Rs.2,000/-

Insurance:
The applicant will arrange insurance of the car through an approved insurance Company of Soneri Bank.

ELIGIBILITY CRITERIA

- Confirmed Permanent Employee/ Self Employee Professionals / Business person.
- Minimum length of confirmed service with present employer must be at least for 2 years.
- Applicant's age must not be more than 60 years at the time of maturity of the finance being applied for.
- Monthly repayment installments not to exceed 40% of the net take home salary / 40% of declared monthly income.
- Should have no over due track record from any bank in Pakistan.

To calculate monthly repayment installment multiply finance amount by the applicable factor given here under:

Year 1	Year 2	Year 3	Year 4	Year 5
0.088848789	0.047073472	0.03321431	0.026333835	0.022244448

ECONOMIC SIGNIFICANCE AND IMPACT OF CAR FINANCING SCHEMES ON PAKISTAN ECONOMY

The automobile industry, which led the rally of growth to an unprecedented height of over 90 percent during the recently concluded financial year 2003-04, has shown new directions for sustainable economic growth in Pakistan.

The commendable role played by the banking sector, which came out with innovative auto-financing products, no doubt was equally appreciable for cultivating a rich crop of buyers by floating innovative auto financing products at attractive and reasonably low interest rates. The financial managers also deserve a word of appreciation for their commendable job for giving a sturdy look to Pak Rupee and a stable exchange rate, which played a pivotal role to ignite a spark of comparatively a subdued and stagnant consumer market persisting only a few years back in Pakistan.

In fact, it is the growth of the engineering sector, which subsequently nurture to the growth of the auto sector as the single largest contributor for the global economic growth. While substantiating his statement he referred to the 68 percent global economic growth grabbed by the engineering sector while 13 percent share goes to the credit of the world auto sector, as against 6 percent share of the textile sector in the global perspective.

While looking at the market potential one finds that there are 7 cars per 1000 people in Pakistan, 12 cars per 1000 in India as against the world average of 120 per thousand people. Despite availability of a huge consumer market, which speaks about the future growth of the auto sector in Pakistan, the only gray area, which needs serious attention of the economic managers of this country, is the eroded buying power of the people.

Concerns shown by certain quarters in the automobile sector that the budgetary measures for reduction in duty on the import of cars may cast an evil affect on the growth of the automobile industry in Pakistan. Auto assemblers or manufacturers producing cars of different makes in Pakistan collectively produced 98,000 units, which are almost double the industry, had produced a year back. The reduction in duty may not have any fall out on the market because even after reduction in duty the landed cost of the import cars will be identical to the local prices. Hence majority of the people will stick to the locally produced cars after an improved delivery situation. As far as the quality of the locally produced cars was concerned it is as good as the imported ones. This may not be taken as an exaggeration because the spare parts and other accessories produced by the local vendor industry are in demand even in the United States, United Kingdom and the Germany as these highly developed and the choosy markets imported auto parts worth $25 million during 2003-04, which deemed fit to the satisfaction of the fastidious.

The changing exchange rates, especially depreciation of Pak rupee against Japanese Yen, drastic cut in duty on imports of CBU from 65 to 15 percent, and exorbitant increase in steel prices were some of the genuine concerns of the booming auto sector in Pakistan. Otherwise, the vibrant automobile industry was giving strong signals for impressive growth in production in the wake of capacity enhancement program being carried out by all the major players.

In fact, things taking shape in the auto sector, it continues to attract investment in all segments of the industry of modernization, expansion and replacement of increase production capacity to the level of 300,000 units per annum. Obviously, easy access to liquidity provided by the banking system under consumer financing is the major factor in making the auto sector a growing concern. The government looks comfortable with the performance of the automobile sector due to contribution of increased revenues by this important segment of the large-scale manufacturing sector.

The auto industry in fact needs a direction to achieve motorization level within the country as the first step and to grab the market share available in the Central Asian States and Africa in the second phase.

So far Pakistan’s economy has to heavily rely on cotton and textile and despite efforts made to diversify our economy by the government in the past, cotton textile continues to enjoy the status of the mainstay of the economy. There were hopes that the much talked about information Technology may assumed the role of another leading contributor to the economy couple of years back, however, despite all hue and cry, either the IT sector failed to produce the desired results or our economic manager could not deliver the job.

The automobile sector after remaining idle for over a decade has made an impressive comeback and the way it is striving, this labor as well as technology-intensive industry has the strength to provide a strong economic base with the spread in the downstream and extending the arms into export sector, provided the government plays as the real facilitator with a clear vision and the direction.

Japan, which is the most valuable partner in the growth of the auto industry in Pakistan, can contribute significantly to make auto sector a booming industry in the real sense. The auto market in Pakistan is mainly dominated by the Japanese technology being its friendly nature and economical. However, despite having a major share in Pakistan, there is a lot of room for transfer of technology as the auto sector has yet to rely on imports for basic parts and accessories. Indus Motors which is producing prestigious Japanese automobile models of Toyota, Corolla and Cuore, claims to be the best in terms of quality and aiming to take lead in the production as well as eyeing to be the most respected and successful enterprise in Pakistan.

ECONOMIC SIGNIFICANCE AND IMPACT OF CAR FINANCING SCHEMES ON PAKISTAN ECONOMY

TAXES AND DUTY

Under the new scheme of things, the government has fixed consolidated customs duty, Sales Tax, Withholding Tax, and Capital Value Tax (CVT) on the import of new cars (CBU) in terms of dollars.

The customs General Order (CGO), issued by the CBR recently, will facilitated the clearance process and prevent any manipulation in the prices of imported vehicles including new cars, jeeps, buses, coaches and trucks. The potential importers will be required to pay the customs duty, sales tax, withholding tax and CVT in terms of dollars.

Depreciation has been allowed on used cars and second hands cars in the form of reduction in the fixed amount of customs duty and taxes in dollar terms at the rate of one percent for each complete month or 10 percent per annum calculated from the date of the first registration abroad up to the date of the entry into Pakistan. This is subjected to maximum 50 percent depreciation on vehicles more than five years old.

DEMAND AND SUPPLY

Despite an impressive increase in production i.e. 53 percent in segments of car and light commercial vehicle production last year and against over 46 percent growth in the current fiscal taking to cumulative growth of 102 percent in two years, the industry was unable to meet the demand which was also taking a quantum jump much higher than the growth in production. The growing demand was of course a good omen for the growth of any business on the stable and sound footings. The growing market appetite was essentially good for economic stability, as the stagnation dampens the spirit of growth in any segment of the economy. It is the increasing demand that has reactivated the Raja Group, which had come out with a plan to produce FIAT cars in Pakistan but was lying idle for quite sometime.

The demand dominating over the production capacity of the automotive industry has started casting a magic sell on the investors as well. There are visible signs of investment in the down stream industries, which are also generating tremendous economic activities. See the remarkable growth in consumption of steel, which is essentially a basic raw material for the engineering sector in general, and automobile sector in particular. It only because of rapid growth in steel consumption, not only the Pakistan Steel has started taking concrete steps for capacity building of the National Steel complex from existing 1.1 million to a prestigious level of 3 million tons a year. Besides expansion in Pakistan Steel, a Saudi group has also signed an agreement to setup a steel plant with a capacity of one million tons within the close vicinity to the Pakistan Steel. Obviously the capacity expansion will significantly address the issue of unemployment in our country.

As far as the contribution of the automobile industry was concerned for creation of job opportunities in Pakistan, the total strength of the workforce directly engaged with the industry was estimated to over 25,000 besides its impressive contribution worth over Rs31 billion to the government exchequer in the form of duty and taxes.

IMPORTS

The government has reduced the gap between CKD and CBU duties with the objective to ease the mounting pressures on the automobile companies for timely deliveries which usually take even more than 8 months for the models which are much in demand. Though the impact of the import cars was not so severe during the current year but the size of CBU imports is likely to take quantum jump in the coming days because the manufacturers have also shift their interest in the trading as well. As an immediate impact, the government step for reducing duties may provide a cushion against the pressing market demand yet it may become a gray area for the industry and the economy as well in the long run. It may be in the interest of the economy and to pave the way provided a strong base to the auto industry as well as the downstream vendor industries to provide duty protection when the dust settles down with the increase in volume of production of the companies which are currently in process of expansion of their production capacity.

MOTORIZATION

According to an assessment, to reach Motorization level of countries in the region, Pakistan needs to cross 500,000 units mark a year. Currently, Pakistan was on the bottom line with a Motorization level of 8 cars per 1000 persons. Motorization figures available from other countries indicate China has 10 cars per 1000 persons, India 12, Indonesia 21, Iran 23, Sri Lanka 25, Philippine 31, Turkey 67, UAE 193, Saudi Arabia 326, UK 426, Japan 543, New Zealand 580, Australia 619, Malaysia 641, and the USA 785.

The opening up of the banking system for consumer financing was of course the brainchild of our economic managers which deserve appreciation. In fact, it was due to continued access to credit, which played as the key driver especially for the large scale manufacturing growth in the current economic scenario. The direct impact is more evident in the robust growth of automobile sector in Pakistan.

Auto loans or car financing schemes launched by the banking sector saw an even larger jump in the current financial year, accounting for approximately 32 percent of consumer loans.

According to official figures released by the State Bank of Pakistan, 40.2 percent YoY growth by the automobile manufacturing was on top of 48.4 percent growth recorded last year.

Despite having comprehensive expansion plans in hand by all the major automobile manufacturers aiming at double their existing capacity, the leading auto assemblers were compelled to import completely built units (CBU) as they are cheaper than the units produced within the country. The import of cars is likely to take a quantum jump next year, said representative of a leading car manufacturing company in Pakistan.

Although the government has decided to reduce duty on imports of car to bridge the gap between demand and supply, as the addition arrival of imported cars may ease the situation especially for timely delivery and root out the malaise of premium being extorted by the middleman and profiteers, yet it would ultimately affect growth of auto industry in the wider terms and in the long run.

INVESTMENT

It is heartening to note that the auto sector has assumed a position where the market forces are determining the stretch of investment as compared to other sectors where the efforts have to be made to attract investment. According to figures released by Pakistan Association for Automotive Parts and Accessories Manufacturers (PAAPAM), the target of investment in car manufacturing segment was projected at Rs.42 billion, Motorcycle manufacturing Rs13.75 billion, tractors Rs5.50 billion, while investment in the vendor industry is projected at Rs171 billion during next five years.

The Indus Motors has suggested some corrective measures to discourage investors and the resellers which include detailed scrutiny of PBO, customer details and copies of NIC, only one vehicle should be allowed against one NIC. Indus Motors have further recommended for mandatory registration for all vehicles for 6 months in the name of original buyer. An effective provision is required to be evolved through the Central Board of Revenue and Income Tax authorities can investigate NTN buyers who order vehicles. NAP may also investigate investors charging premium as well as the customers paying the premium to the middleman or the investors.

CHAPTER – 5
Findings, Conclusion, and Recommendations

FINDINGS

After conducting this research if found out number of things which are listed as under;

- The reasons for increase in automobile financing
- Role of auto financing in the economy
- Auto finance playing an important role in the success of the Automobile industry in Pakistan.
- Why consumers are paying highest for the product.
- What is the impact of auto finance on automobile sector.
- How it is effecting directly/indirectly on the other sectors (steel etc).
- What role is it playing in the GDP growth.
- What threats auto industry is facing
- How it is beneficial for the sector.

CONCLUSION

The automobile financing is playing a crucial role in the growth of the economy. It has increased by 114% in fiscal year 2004-05 hence showed a tremendous growth. Still automobile sector is growing and there is great demand of cars and auto loans in Pakistan. The auto financing schemes by commercial banks are playing a key role in improving the infrastructure and economy of the country. The auto industry in playing a significant role in the growth of the economy in terms of consumption level of people and in the GDP of the country. The industry in paying a huge amount to the government of Rs.25 billion annually in terms of taxes and duties.

Because of the boom in the industry, it needs to increase the production by means of expansion. Which will increase the opportunity of employment in the country. Because of the expansion the related industries are also increasing their capacity.

So easy picking option which is available to the consumer is playing role in terms of;

- Living standard of the people
- Revenue for the government
- Employment opportunities
- Expansion in the capacity

RECOMMENDATIONS

The auto industry of Pakistan is one of the growing industries of Pakistan. It is playing a great role in the growth as a whole.

- The rapid growth in auto financing has made consumer financing more attractive for banks as Rs.50 billion in car loans in December 2004 against Rs.22 billion in December 2003 and less than a billion a few years ago. The banks should make their financing schemes more flexible and attractive so it can capture the remaining customers.

- The auto industry should take serious measures for reducing the booking to delivery period.

- There should be consistency in the government's policy and regulations, as more stable government policies and regulation will positively effect the auto financing.

- The fluctuation of interest rate can harm the growth of auto financing. There should be more consistent interest rates in the country.

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