Impact of globalization on the banking performance of Pakistan

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Abstract
Data from 18 banks have been concluded during the span of 2001-2010 is to examine the impact of globalization, credit risk, capital strength, efficiency of management, network embeddedness, size, economic globalization, social globalization and political globalization on profitability of these banks. Findings suggest that variable credit risk, capital strength, efficiency of management, network embeddedness, size, social globalization, economic globalization and political globalization have a positive impact on profitability whereas profitability is not affected by globalization.

Keywords: Globalization, ROA (profitability), Credit risk, Capital Strength, Network Embeddedness, Fixed Effect Model

Introduction:

World has become a small village, in which happening of the one neighboring country has direct impact over the activities and operation of other countries. Globalization has affected our lives in different ways, cannot be ignored; same is the case with finance. The impact of globalization can be seen over the internet shopping or call centers where one places the order and only interacts with the delivery system (Boyd & De Nicolo, 2005). Sophisticated technology has tremendously changed the world's commodity and the money market. The impact of globalization over the banking sector has been seen when the debt crisis arrived in Ireland, Greece, Portugal, Spain and Italy, (Berger, Allen, Nathan, Mitchell A, Raghuram, & Jeremy, 2005). Internationalization of the financial markets and banking system has brought many limitations. Banks of Europe Union and Central Banks have to encounter many constraints. The influence of globalization over these banks cannot be mapped put as these corporations are accounting for 33% of the world output and 66% of the world trading (Kenawy, 2009). Globalization allow the movement of foreign trade in capital, goods, technology, labor and service market, around the borders of the globe, (Martens & Raza, 2010). Moreover the economic development has led to the improved allocation of the resources. According to (Claessens & Van Horen, 2009), globalization has also welcomed threat for the world. It has power to accelerate the gap among the poor and rich, it established the financial volatility and cultural insecurity (Falk, 2000).

Baking industry has gone through many changes in the last twenty years. These changes can be seen in the regulatory, information technology and acceptance of the economy by the former non-integration of the international financial markets. There have been challenges and opportunities for international banking system and Pakistani system, as well. Banking industry has to face challenge of competition, due to globalization. Many international banks have been opened in Pakistan and this has caused drastic competitive impact over the local banks. However the advantage has been offered to the citizens of Pakistan, in shape of flexibility, accessibility, low interest rate and some other benefits, (Kashyap & Jeremy, 1995).

Globalization is perceived to be the gain in the global level phenomena, according to many researchers, (Bhagwati, 2004). Globalization has welcomed the competition in the market. Immense competition has reflected the banks to perform well. They will only sustain when they will have their efficient operations. This has motivated many researchers to explore the role of globalization and the way it has affected the performance of banking sector. Banking sector is extremely important for the economic growth and stability and thus it has grasped the attention of the researchers. With this present research, the aim is to study the performance of banks with respect to level of globalization.

The study is designed to explore the effect of credit risk (CR), capital strength (CS), efficiency of management (IEM), network embeddedness (NED), size, economic globalization (EG), social globalization (SG) and political globalization (PG) on prosperity of Pakistani Banks. The research will explore value added findings in the ongoing research in business sector. This study is required to be led in order to be advised by the financial counselors that what can be adapted to globalize their varieties. It is as well as very supportive for the monetary counselors in transporting more active habits of execution of commercial processes. It can also lead to be very profitable in order to know about the newest machineries accepted for ornamental the presentation of the banks. Separate bank features like internal factors or the external factors are well-thought-out as causes of bank's effectiveness in Pakistan. Many readings have examined the influence of Banking Presentation on good deal of Pakistan in which revised tests the causes of Non-Performing Loans and Interest level on the economy of Pakistan by using time sequence or panel statistics, (Farooq, Afridi, & Alam, 2010). The Eastern European knowledge with distant sets is contended to have helped loaning to all companies, (Giannetti, Assunta, & Ongena, 2005).

Literature review:

Globalization is the process in which allows the movement of foreign trade in capital, goods, technology, labor and service market, around the borders of the globe, (Martens & Raza, 2010). Howsoever, it has added many new threats for the environment. It has been keenly observed that banking sector has got tremendously affected by the act of globalization. They have gone through deregulation, economical integration and the advances in the adoption of communication technology. This important aspect has grabbed the attention of the researchers to examine the influence of the globalization over the growth of economy and profitability of the banks.

Banking industry has gone through many changes in the last twenty years. These changes can be seen in the regulatory, information technology and acceptance of the economy by the former non-integration of the international financial markets. Banking sector has direct impact on the present firmness of the country. This is the reason, the performance of financial institutions and banks are extremely crucial, (Williamson, 2010). Due to the economic size, economic power and economic performance, larger banks have put high influence over global growth and market trends of the world. Banking expansion has been noticed due to enhanced economic growth and globalization.

According to the (Berger, Allen, Nathan, Mitchell A, Raghuram, & Jeremy, 2005) there have been challenges and opportunities for international banking system and Pakistani system, as well. Banking industry has to face challenge of competition, due to globalization. Many international banks have been opened in Pakistan and this has caused drastic competitive impact over the local banks. However the advantage has been offered to the citizens of Pakistan, in shape of flexibility, accessibility, low interest rate and some other benefits. Globalization has welcomed deregulations. There are no barriers to entry for the other financial institutions, like brokerage houses, leasing companies, insurance companies, etc. As a result, efficiency in banking industry has been encountered, (Aurangzeb, 2012) investigated about the contributions of banking segment in the growth rate of Pakistani economy. Their research focused on role of banking segment in financial development of Pakistan.

According to (Kashyap & Jeremy, 1995), globalization has welcome privatization of banking industry. Privatizations has made the efficient performance, companies employee more devoted, customer become more loyal. Another aspect of Privatization due to globalization is the adoption of new computerize system. This has caused reduction in delivery of services. Now customers do not need to wait too long for their work. This is done with the fraction of second with just few clicks. Online banking is also attributed due to the adoption of new technology. Customers can opened their own online account and make their online transactions, without actually visiting the banks.

The literature results have revealed that economic and social globalization may impact the performance of organizations in several respects. In this regard, the number of prior studies have revealed that economic globalization impacts performance of organizations, (Dreher, Gaston, Martens, Williem, & Pim, 2008(a)) (Srinivasan & Wallack, 2004); (Dreher & Gaston, 2008);and (Patti, Dario, & Navarra, 2009). All these studies have revealed that economic globalization impacts the economy in a positive way by improving performance of individual organizations. Contrary to this, there are also studies which reveal relationship between performance of firms and economic globalization (Arribas, Ivan, Francisco, & Tortosa, 2009).

(Chiak, Martin, Andrea, & Kalus, 2009) Have reported analyzed the financial performance of organizations in perspective of globalization indicators. In this regard, they used financial performance indicators such as profitability, leverage measures, return on assets (ROA), average equity to assets (ETA) and volatility of firm's returns. All these financial measures have been interrelated and analyzed in perspective of globalization in the economy. Moreover, they have also indicated that economic globalization has regressive impact on the efficiency of banks. In this respect, (Sufian & Habibullah, 2012) have revealed that economic globalization has positive relationship with actual cash flows, cultural proximity, bank efficiency, and political globalization. On the other side, this study also revealed that restrictions to trade and capital flows across economies may inhibit to reduce efficient and operating performance of banks. However, it is important to mention that this relationship in perspective of Indonesian banking sector only.

Relating to impact of globalization on the performance of organizations, (Karadagli, 2002) has revealed that capital strength of banks is always positively related with the financial market conductions, globalization, macroeconomic indicators and other factors impacting the economy. These results of research are in alignment with the study conducted by other researchers such as , (Isik & Hassan, 2003) , (Goddard, Philp, & John, 2004), (Staikouras, Wood, G., & C., 2004), (Kosmidou, 2008). All these studies have also supported that the banks which are effectively capitalized are less likely to undergo bankruptcy. In addition, they are less likely to bear cost of bankruptcy and cost of funding. These impacts ultimately lead to high levels of efficiency in the banks. The major contribution (Karadagli, 2002) was that capital strength of banks is highly crucial for competing in the market and attaining positive performance and he also supported that having high capital strength is more likely to provide safety to depositors through micro and macroeconomic indicators.

(Berger & Deyoung, 1997), suggested that banks which maximize the long term profits have rational attitude towards lower costs and in short run, they are more likely to devote loans by monitoring and underwriting. However, they also face risk of losing investment if loans have not performed appropriately. In addition to this, the authors have also found that network embeddedness impacts bank profitability in several levels which is always positive. In this way, it supports findings made by (Lim, Ranghawa, & Dipinder, 2005). They revealed that extensive branch network of banks may attract more volumes of credit which impacts high profitability in banks. (Sufian & Habibullah, 2012) Network embeddedness impacts positively on the presentation of banks. In the same vein, (Lim, Ranghawa, & Dipinder, 2005) have also supported this stance. One of the reasons in this regard can be the banks which have more branch network and have huge base of depositors and they are more likely to attract cheaper sources of funds. and they are more likely to attract cheaper sources of funds. In addition to this, the banks which have extensive network of bank branches are more likely to attract more loan transactions in which interest rate spreads and profitability of banks enhances (Sufian & Habibullah, 2012) Contrary to this, banks which have limited branch network have limited depositor base and may have option to interbank market. In this way, banks with limited branch networks get expensive or costlier funds which ultimately reduce their profitability, (Sufian & Habibullah, 2012).

(Sufian & Habibullah, 2012) Suggest that total loan loss is a quantify of credit risk (CR). CR can be used to examine its impact on profitability of an organization in perspective of globalization. They further evaluated that ratio of loan loss provisions to total loans serves as proxy to credit risks. The conclusion of study revealed that ratio of loan loss provisions to total loans produce negatively significant on the performance of banks. In the same vein, (Miller & Noulas, 1997) suggested that greater exposure of banks to risk leads to greater accumulation of loans and this ultimately will lead to lower profitability of banks.

Capital strength (CS) has been regarded as a measure of capital strength of financial institution. This can be calculated by dividing total equity with total assets of an organization. If capital ratio is high, it identifies low leverage and lower level of risk to the organization. (Sufian & Habibullah, 2012), suggested that capitalization or capital strength is an indicator of influencing profitability of organizations. Lower capital ratio suggests that risky position of the organization is low. Contrary to this, increase in capital results in increasing earnings of organization by reducing the risk of bankruptcy and cost of expected financial distress.

Efficiency is also another important indicator which may impact the profitability of organizations to a greater extent. (Sufian & Habibullah, 2012) Suggest that poor efficiency identifies poor management practices which are related with day to day operations of organization. In this regard, he also suggested that efficient cost management improves profitability and performance of organizations.

(Athanasoglou, Panayiotis, Brissimis, Sophocles, Delis, & Mattaios, 2008), suggested that size of banks also influence their profitability and performance. Specifically, they explored that cost of savings can be obtained by increasing the size of the bank which ultimately improves their profitability. In the same vein, (Eichengreen & Gibson, 2001) have also evaluated that growing size of banks may positively influence the performance of banks to some extent. Beyond a certain limit, the impact of bank's size can be negative on the performance of banks because of bureaucratic reasons (Sufian & Habibullah, 2012)

(Sufian & Habibullah, 2012) have suggested that economic globalization influences economic growth and also influence organizational performance in a positive manner (Dreher, 2006) (Dreher, Strum, Jan-Egbert, Ursprung, & Heinrich, 2008). In this essence, prior studies have suggested that various measures of economic globalization (EG) have positive influence on economic growth. However, globalization can be linked with inequality in income in some countries,(Dreher & Gaston, 2008). In this context, economic globalization may result in positive results to globalization, but also, at the same time, it results in losses to some partners of globalization, (Gaston & Khalid, 2010).

(Sufian & Habibullah, 2012), have evaluated that social globalization (SG) also influences performance of organizations. They have further evaluated that personal contacts, information flows and cultural proximity are some measures of evaluating extent of social globalization. in this regard, they have found that social globalization positively influences performance of banks. (Sufian & Habibullah, 2012), evaluated that political globalization can be measured through Embassies of different countries in our country, International Organizations membership, and Participating in the U.N Security Council. Missions are important measures of political globalization. Greater exposure of political globalization has positive influence on the profitability of banks.

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Methodology

Sample

Paper utilizes data of Pakistani banks from 2001 to 2010 retrieve on balance sheet analysis from state bank of Pakistan we obtain un balanced panel of 18 banks because of some missing values in our data . Globalization index is obtained from KOF index of globalization. The following variables are used in the analysis.

ROA (return on assets)

Taken as proxy of profitability

ROA=Net income after tax / Total assets

Credit Risk (CR)

Taken as a proxy for credit

Credit Risk=Provisions & Bad Debts Written Off Directly /Lending to financial institutions+ Investments**.**

Capital strength (CS)

Taken as a proxy for strength of bank regarding their capital.

Capital Strength = Equity / Total assets

Efficiency of management (IEM)
Information regarding the efficiency of management.
Efficiency of management = Total Non-Markup/Interest Expenses/ Total Assets
Network embeddedness (NED)
Taken as a proxy for number of branches of a bank.
Network embeddedness = log of Deposits and other Accounts
Size
Taken as a proxy for size of bank.
Size = log of total assets
Economic globalization (EG), Social globalization and Political globalization (PG)

Index for EG, SG and PG is obtained from 2013 KOF globalization of index.
EQUATION
ROA=$\alpha + \beta_1 CR + \beta_2 CS + \beta_3 IEM + \beta_4 NED + \beta_5 SIZE + \beta_6 EG + \beta_7 SG + \beta_8 PG$

Data is converted into panel and after the application of Haussmann Specification we select Fixed Affect Model are reported in table 1

Variables	COEF.	Std. Err.	t-stats	P-Value
Capital risk	-.0812787	.0095845	-8.48	0.000
Capital strength	-.0544454	.006814	-7.99	0.000
Efficiency of management	-.2502766	.1429062	-1.75	0.082
Network embeddedness	-.1245925	.0335945	-3.71	0.000
Size	.111307	.0383256	2.90	0.004
Economic globalization	.0010914	.0009086	1.20	0.232
Social globalization	-.0041249	.0025192	-1.64	0.104
Political globalization	.0041702	.0031084	1.34	0.182
Constant	-.1744638	.1520416	-1.15	0.253

We found that profitability of banks decreases with increase in credit risk the reason behind this may be that bad loans may exert a reverting impact on the profitability of banks. Similar results found by the researchers like (Miller & Noulas, 1997). They argued that exposure of banks to high credit risk loans are directly proportional to accumulation of unpaid loans which will decrease the profitability of the firms.
From the result we observe that profitability of the banks decreases when the Capital Strength of banks increases because we measure the capital strength as portion of equity in total assets.
The variable used in the analysis that is Non Interest Expenses/ Total Assets represent the portion of non-interest expense as compared to total assets. This variable may be a good measure of fluctuation in the bank operating cost. The non-interest expense may include salaries, other expenses to run the bank. From this variable we can conclude that if non-interest expense increases then the profitability of bank will decrease.
We found that network embeddedness has significant impact on profitability of the bank but the network embeddedness decrease the profitability of the firm.
Size of the bank is found be significantly influencing the profitability of firm due to large size the banks may have large economy of scale which leads to the cost minimizing and increase in profitability.

Result showed that globalization variables Economic, social, political globalization tends to be insignificant which means that Pakistani banks are in affected by the globalization.

Descriptive statistics of the variables are shown in Table 2.

Variables	Obs.	Mean	Std. Dev.	Min	Max
ROA	173	.0024299	.0513694	-.5285242	.0451902
Capital risk	173	.1018636	.3138329	-.0770965	2.673917
Capital strength	173	-.0445781	.7152871	-5.421489	.5397294
Efficiency of management	173	.0265794	.0159174	-.1094473	.0849545
Network embeddedness	173	7.70673	.7638685	6.154867	8.920202
Size	173	7.927501	.621842	6.606016	9.014951
Economic globalization	173	40.43543	2.435077	36.01246	44.67089
Social globalization	173	34.68714	1.131381	33.14321	36.50955
Political globalization	173	87.80459	1.38481	85.80961	89.59515
Index	173	50.72691	1.362259	48.19315	52.54271

Conclusion

Our research conclude that profitability of the banks decrease with the credit risk(CR) so the bank should take appropriate measures to reduce the profitability of default otherwise it has to face reduction in profitability. Banks also have to reduce administrative expenses to accelerate profitability. Increase in the non interest bearing expenses affect financial performance of the banks. The research also conclude that if more equity is used in the investment then profitability will decrease it may be because the reason that fixed amount of interest on debt is paid. Whereas irrespective of the level of profit. Banks with larger size are more profitability as compared to smaller size because banks with larger may have economics of scale. The study also concludes that none of the globalization variables that is, social globalization (SG), economic globalization (EG) and political globalization (PG) has affected the profitability on the banks.

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