

# Promising Progress of Modaraba Sector of Pakistan

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## Abstract

Over the last three decades in Pakistan, the Islamic Financial Services have evolved as a prime component of the financial sector by growing in size and diversity. Within the universe of Islamic financial industry, the Modarabas have remained pioneer Islamic Financial Institutions in Pakistan. The development of Modaraba as a Shariah compliant mode of business and its transformation into an institutional framework with proper legislation, regulatory and monitoring structure, and operating guidelines is a sole feature of Pakistani Islamic Financial market. In fact, Modarabas as Islamic financial institutions are the forerunners in flourishing the Islamic financial sector of Pakistan.

The Securities and Exchange Commission of Pakistan (SECP) recently introduced reforms and strengthened the regulatory framework of Modaraba sector that enlarged the Modaraba sector asset base to PKR 41 billion (US\$ 380.0 million) by the end of December 2016. At present, the sector has low level of leverage, growing quality assets and healthy dividend payouts.

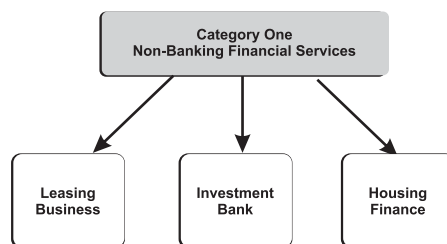
The progress in the sector is largely due to strengthening of governing laws particularly the guidelines for Sharia compliance issued by the Registrar Modaraba. Effective monitoring and strong surveillance by the office of Registrar Modaraba has also supported a lot for better performance of the sector and enhancement of confidence of investors. At present 25 Modarabas are operating in Pakistan's financial market as listed entities and are engaged in various Shariah compliant business activities.

In the last three decades, Modarabas emerged as a main segment within the sector of non-banking Islamic financial institutions. It is a viable and reliable source of medium term financing with an opportunity to earn Riba-free income. Recently, many good corporate entities have made their debuts into Modaraba business and the market experts foresee a significant number of new entrants in the sector which will further strengthen this segment and find their way to set new milestones in coming years. The following article covers current status and progress of the sector, its challenges and future business opportunities.

## 1. Introduction

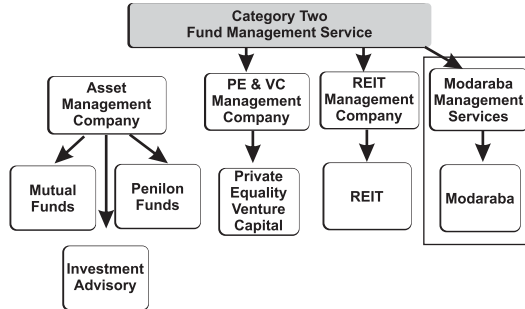
“NBFI Sector of Pakistan includes non-banking finance companies (NBFCs) and Modaraba companies managing Modarabas. The NBFCs include investment finance companies, leasing companies, housing finance companies, asset management companies (managing mutual funds, pension funds and also providing investment advisory services), fund management companies providing private equity and venture capital fund management services, REIT management companies managing REIT funds” (Annual Report 2014 by SECP).

“The NBFCs can be broadly divided into couple of categories, i.e., lending NBFCs (engaged in the business of deposit taking and financing) and fund management of NBFCs” (Annual Report 2014 by SECP).P).



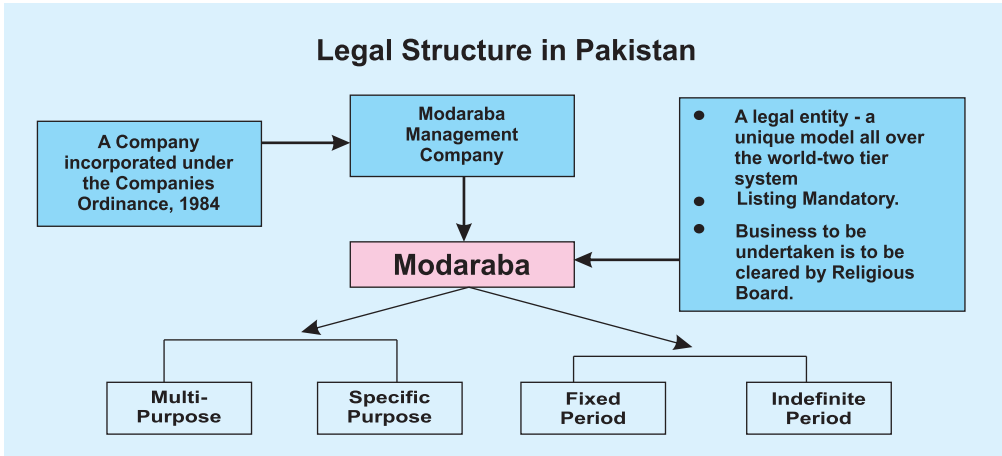
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Banks may offer set of financial services as a package deal, NBFIs unbundle these services, tailoring their services to particular groups. Furthermore due to diversity a single segment of NBFIs may specialize in particular sector which can cater the need of different categories of customers.



2. Literature Review

The model of Modaraba as a Shariah compliant mode of business was institutionalized in Pakistan in 1980 through legislation, proper structure of regulation and monitoring, and operating guidelines. This was a major step that transformed the concept of “Modaraba” into an Islamic financial institution to operate as legal corporate entities. This transformation of theory into an institutionalized regulated corporate structure is exclusive to Pakistan. In fact, Modarabas as Islamic financial institutions are the forerunners in flourishing the Islamic finance. The “Modaraba” Companies and “Modaraba Flootation and Control Ordinance” were



brought forth in 1980. The workplace of the “Registrar Modarabas” is a part of the “Securities and Exchange Commission of Pakistan (SECP)” and it monitors and controls the sectors by designed rules and guidelines. Like all the financial institutions, Modarabas are also subject to reporting requirements, prudential disciplines and audits. A formally constituted religious board of renowned Islamic scholars endorses and directs the practical reliability of Modarabas to remain compliant of Shariah (NFBI and Modaraba Association of Pakistan).

Modarabas are playing a significant role to promote Islamic finance in the Country. These Modaraba were not only the trend setters of modes of Islamic financing in a predominantly traditional financial system in Pakistan but also gave confidence to general public regarding practice of Islamic modes of financing. (NFBI and Modaraba Association of Pakistan).

Unique features of Modaraba concept

- Halal Business – “Modaraba is a business model in the financial sector which is based on true Islamic practices duly inspected and endorsed by the Religious Board. It provides profitable investment opportunities to the stakeholders who are looking for Halal profits on their investments according to Islamic Shariah” (Annual Report 2013 by SECP).

- Diversified Business – “The diversity of the Modaraba concept provides a exclusive array of business opportunities to the sector including financing, trading, manufacturing, equipment – rental, project management, portfolio management, imports and exports and distribution business” (Annual Report 2013 by SECP).

Over the years, Modarabas have emerged as a major sector within the segment of non-banking financial institutions. It is a viable and reliable source of medium term financing with an opportunity to earn Riba-free income. Currently, Modaraba sector is performing well and now all set for a faster expansion with improved regulatory and monitoring framework.

11 YEARS SUMMARY OF MODARABA SECTOR											Rs in Million
Financial Data	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
Assets	36,806	30,736	30,212	30,549	28,320	25,191	23,390	25,191	24,156	21,106	17,498
Equity	20,439	15,894	14,488	13,824	13,186	12,421	11,849	10,839	11,456	9,715	7,606

Source: Year Books of NBF and Modaraba Association of Pakistan

3. Modaraba sector - Market Capitalization

With the passage of time, Market perception and investors' confidence on Modarabas have also been improved. This can be witnessed from the chart of market capitalization of Modaraba of last 8 years. Market Cap of Rs.4.6 billion in 2009 enhanced to Rs.23.19 billion up to December, 2016.



Having large Shareholders base as listed Islamic Financial Institutions

At Pakistan Stock Exchange, around 25 Modarabas are listed. These Modarabas are engaged in diversified Shariah compliant business activities and distribute handsome profits to these shareholders in shape of cash dividends (Website of Pakistan Stock Exchange).

Besides financial numbers few members within the Modaraba sector have been continuously receiving awards and recognitions from different prestigious associations and forums such as:

- Best report award from ICAP

	Jun-14	Jun-15	Jun-16
Nos. Shareholders	٤٥٤	٤٥٤	٤٥٤
٤٥٤	٤٥٤ to 50%	٤٥٤	٤٥٤
٤٥٤	٤٥٤	٤٥٤	٤٥٤

- Corporate Excellence Award from “Management Association of Pakistan”.
- Best report award from South Asian Federation of Accountants, an apex body of SAARC
- Award from FPCCI for best corporate entity
- Rental power operational excellence award

Within the sector few Modarabas are also enjoying credit rating of AA+ and A1+ for long term and short term respectively which also shows strong financial and soundness of the sector.

#### 4. Conclusion

Islamic banking and finance in Pakistan has significantly gained volume during the last decade and now comprises about 15 percent of the country's conventional financial size. Nevertheless, there is a huge market of Islamic finance that is still untapped in Pakistan; and along with other Islamic finance institutions, the Modarabas also have great possible potential for further growth within the domain of Islamic financial industry.

Modaraba business model in Pakistan with a corporate standing is a distinctive business model over the globe. It provides an opportunity of Halal business/investment to general public and its supervision by the skilled managers. It can carry out a universe of Shari'ah compliant businesses encompassing financial products and services, local and international trading, manufacturing, distribution and various corporate functions under one umbrella with one license. Recently, two new Modarabas have become operational and two more new Modaraba entities are also in process of public floatation.

Recently SECP has introduced major modifications to the regulatory framework through a separate regulatory supervision to encourage small and mid-sized lending NBFCs with considerably reduced equity requirements. Furthermore, office of Registrar Modaraba is in process to change regulatory framework of Modarabas such as Modaraba Ordinance, Modaraba Rules and Prudential Regulations. Most of the proposed changes will further strengthen the quality of monitoring, good governance and strong compliance culture which ultimately lead to progress and development of the Modaraba sector on solid footing.

The SECP has also introduced a range of incentives to promote Islamic finance at a large scale in the country. Under the vibrant leadership of Mr. Zafar Hijazi, Chairman SECP, the commission has become very dynamic for promotion of Islamic Finance. It is expected that with the vibrant approach of regulators to address the issues in the competitive environment, there is no doubt that Modarabas would definitely find their way to the glorious future and to set new milestones in coming years.

**Acknowledgement:** CJIF is grateful to Mr. Samar Kamal Fazli in improving the write-up of the manuscript.

#### References

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