

ORIGINAL RESEARCH

Failing Factories, Fearful Finance: Reimagining Pakistani Banking Through the German Hausbank Lens

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Abstract

This paper compares Pakistan's commercial banking sector and Germany's universal Hausbank model in order to determine why Pakistani small and medium enterprises suffer from credit starvation while large corporations secure adequate financing. Legal constraints, court recovery bottlenecks (judicial liquidation delays), and high fiscal borrowing force Pakistani commercial banks to rely on heavy physical collateral and low-risk sovereign securities such as Treasury bills rather than industrial lendings. The feasibility of implementing the Hausbank model in Pakistan is discussed by gathering data collected from qualitative interviews involving high-ranking banking officers and from secondary sources. It highlights why some senior bankers reject the Hausbank model, referring to opaque family-owned businesses that dominate Pakistan's corporate governance. Similarly, it explores how government debt causes the banks to shift their liquidity, removing financial incentives to extend credit to the private sector. Regardless, the paper discusses a third approach to tackle the risky, complex economic climate of Pakistan.

JEL: G30, G32, J21, O1

1. Keywords & Definitions

Non-Performing Loans (NPLs): A loan where the borrower has not made scheduled payments for a set period, typically 90 or 180 days, depending on the type of loan. (*Investopedia*)

Hausbank Model: Primary relationship banker to a company, providing or arranging a variety of credit related services (*The Law Dictionary*)

Sovereign Crowding-Out: It occurs when the government borrows a large amount of money, which drives up the interest rates and leaves less money for the private sector.

T-Bills & PIBs (Treasury Bills & Pakistan Investment Bonds): They are low-risk debt instruments which are sold by the government to fund government deficits, offering banks risk-free, tax-efficient yields.

Credit Guarantee Schemes: They are state-backed or third-party financial arrangements where a government entity compensates commercial lenders for a predetermined percentage of losses if a borrower defaults.

Multi-Banking: It is the practice where a business has active credit lines and transactional accounts across several commercial banks, at the same time, rather than relying on a single bank.

2. Methodology

This research paper adopts a method to combine secondary documentary analysis with primary qualitative field data to evaluate the extent to which the German **Hausbank model** can be implemented in Pakistan's banking sector. Macroeconomic data such as the SBP regulatory frameworks and central bank working papers helped establish the basic constraints like **sovereign crowding-out**, credit rationing, and strict collateral requirements, which affect this implementation. Furthermore, qualitative interviews with senior Pakistani commercial bank officers helped further cement these constraints.

There were a total of two interviews conducted. The first interviewee was Mr. Shaid Malik, Head of Financial Product Design and Implementation and Digitization Initiatives for SMEs at Bank Alfalah. The second participant, referred to anonymously as Bank Officer X to maintain anonymity, is the Vice President of the Special Assets Management Group department at one of Pakistan's top five commercial banks, referred to as "Bank Y" in the paper. I contacted these bank officers via online networking and each interview lasted for about 45–60 minutes and were conducted between the months of August and October. The pre-written question consisted of standard loan underwriting practices and legal recovery bottlenecks which are listed in appendices. I took detailed notes of each of their answers and only quoted parts of the answers they consented to. All quotations within this research paper are the interviewees' however, the statements made are my own inferences made from said quotations.

While these exclusive interviews paved the way to evaluate loan underwriting practices and legal recovery bottlenecks and the feasibility of adopting the same principle of universal banking, they had limitations too. Since these qualitative interviews relied on only two banking officers they may not represent the view of the entirety of the Pakistani commercial banking sector. These insights are intended to highlight frontline institutional mechanics instead of serving as an in-depth industry-wide consensus.

3. Introduction

Corporate cronyism, credit collapses, and failed factories—Pakistan's banks chose caution over creation. While German giants weaponized retail wealth to power an industrial revolution, Pakistan's divided system suffocated its own growth, leaving a multi-billion-dollar engine completely untapped. Pakistan has consistently failed to build large manufacturing and export powerhouses like U.S. Steel (Heavy Manufacturing & Metals), BASF & Bayer (Chemicals & Pharmaceuticals), and Vickers & Armstrong Whitworth (UK Engineering & Shipbuilding). Thus, the economy remains trapped, and imports constantly outweigh exports. This failure is directly linked to Pakistani banks. Whenever there is a recession or economic shock, factories and businesses fail to pay back short-term loans, which leads to NPLs.

According to Troy Seagle, "a Non-Performing Loan (NPL) is a loan classified as default because the borrower has missed scheduled payments for a defined period, typically 90 to 180 days. The lack of payments includes both principal and interest. NPLs can significantly affect borrowers' credit score and complicate future borrowing. They often arise during economic downturns when many borrowers face financial difficulties. Since banks keep getting burnt by companies in the private sector who aren't able to repay their loans, they start parking their money in Government **Treasury Bills (T-Bills)**. According to Ben Aris from Intellinews, "Government paper now makes up 62% of banking-system assets, up from 55.5%." This 'crowding out' leaves Pakistani manufacturers starved of capital and prevents them from becoming a world-class company.

The nationalisation drive of the 1970s and then the privatisation of the 1990s altered the mindset of the Pakistani banks, and they abandoned long-term development and instead opted for short-term risk-free banking models aimed towards attaining a quick balance sheet growth. As a result of this historic shift, these banks stopped funding private business over time. On August 21, 2026, Governor Jameel Ahmad commented that "commercial banks lending to the private sector remains well below levels seen in peer economies in the emerging markets, while the private sector credit-to-GDP ratio declined significantly over the past three decades in the country." Pakistani banks today only offer short-term loans secured against heavy collateral instead of long-term loans required to build large industries. For example, UBL Bank provides a "financing facility available up to Rs. 40 million (Rs. 4 crore) and a

borrowing facility up to 75% of your property value.” When interest rates rise, sudden policy changes by the banks cause monthly payments to increase, destroying companies’ cash flows and triggering defaults, as was seen when the State Bank of Pakistan raised its benchmark policy rate from 7% (2021) up to a peak of 22% (2023) to combat inflation and balance-of-payments pressures. As a result, the cost of borrowing almost tripled, and companies’ profit margins were almost completely wiped out. Since investing in the private sector carries risk, banks take the easier, more profitable route of lending directly to the federal government.

The government relies heavily on domestic debt to finance long-term goals and public expenditures. This demand creates an environment where banks are able to earn risk-free returns which are hassle-free. Bank loan managers face severe penalty risks for NPLs but zero to none when purchasing **treasury bills**. Even the introduction of the Interest Rate Corridor in 2009 failed to prevent private crowding out, as crippling government debt consumed most of the central bank’s liquidity. SBP Working Paper Series No. 83, February 2017, found out that “for every 1 percentage point increase in the growth of government borrowing from the banking system, there is, on average, an 8 basis point decrease in private sector credit growth in four months.” Pakistani banks are purely money lenders. Most banks do not hold equity in the businesses; however, none of them actively sit on the board of directors of these very businesses, which creates a stark disconnect between bank profits and the businesses’ growth.

Pakistan should aim to look towards economies that have successfully built giant industrial conglomerates such as the German bank Deutsche and its client Siemens AG. Pakistan’s inability to build giant manufacturing powerhouses is directly linked to the transactional banking system, which refuses to involve itself in long-term risks. To break this cycle, Pakistan needs to adopt the **Hausbank model**.

4. How do banks in Germany operate?

In Germany, a business doesn’t just open a standard checking account; instead, it forms a long-term partnership with a single bank, which is known as the **Hausbank**. The law dictionary defines **Hausbank** as “a bank acting as the primary relationship banker to a company, providing or arranging a variety of credit-related services.” **Hausbanks** often wield additional power by directly holding large shareholdings in client companies and by voting proxies on behalf of investors who leave their shares in bank custody.” Germany has a bank-based financial system that revolves around three types of banks that differ considerably; they are recognized as the three-pillar system.

Patrick Behr and Reinhard H. Schmidt commented in their book, *The Palgrave Handbook of European Banking*, that these pillars are made up of private credit institutions. These institutions are privately owned and are more profit-oriented. They consist of two primary subgroups: large banks and smaller regional banks. These banks make up about 40% of the total banks in Germany. Pillar two consists of saving banks. These are divided into two tiers: local savings banks and larger regional banks. Instead of trying to maximize profits, they serve local communities and regional enterprises. Pillar three is the cooperative banking group, which has two parts: the local cooperative banks and the central financial and non-financial institutions of the group.

The bank manages all financial needs under one roof. It takes everyday savings from the public, issues 10–15-year-long loans to heavy factories and industries, holds equity in the company, and exercises voting rights. For example, Deutsche Bank acted as a universal bank for Siemens. Siemens & Halske was a German electrical engineering firm founded in 1847 by Werner von Siemens and Johann Georg Halske (MIT museum, n.d.). It helped convert Siemens & Halske into a publicly listed stock exchange company in 1897 and provided long-term financing, handled foreign exchange, and held equity stakes. Through this universal banking framework, Deutsche Bank held seats on Siemens’ supervisory board for decades, cementing its role as a core financial partner. Since the bank owns a piece of the firm, its profits are tied to the company’s performance, so instead of seeing short-term profits, it stays patient while the factory grows.

During the 19th-century German industrialization, firms faced deep economic backwardness. Unlike the US or the UK, German industrialization faced significant capital market deficiencies and dispersion of

capital. (Gerschenkron, 1962, Economic backwardness in historical perspective). To fix this, large credit banks acted as universal banks supplying long-term capital and developed close relations with industrial enterprises to fund heavy industrial expansion (Tilly, 1986, Financial Institutions and Economic Growth in Industrializing Germany). Bank representatives sit directly on the client company's supervisory board. This builds deep trust between the bank and the business. This setup protects businesses during recessions. Instead of panicking, the **Hausbank** provides "patient capital": long-term funding, smoothing interest rates, and preventing defaults (Bank Relationships, Financial Integration, and Monetary Policy, Deutsche Bundesbank Monthly Speeches Series, 2005).

5. How does the Pakistani Model vary from the German Banking Model?

Pakistan's short-term transactional model differs from Germany's long-term relationship-based universal banking model. Germany's model focuses on corporate growth through direct partnership, whereas Pakistani banks operate as a credit supplier heavily tied to state debt financing. German universal banks direct credit towards middle-sized markets. According to The German Banking System by Patrick Behr and Reinhard H. Schmidt (February 2016), "Today, many large and medium-sized firms that belong to the so-called *Mittelstand* have a main bank or a house bank, which is, however, now more often a savings or a cooperative bank rather than a large private bank."

However, Pakistani commercial banks overwhelmingly prefer to invest in risk-free **treasury bills**. According to Pakistan: Selected Issues: IMF Country Report No. 24/311, "In an effort to mitigate interest rate risk, banks exhibit a preference for shorter-duration investments, such as **Treasury bills** or floating-rate notes, positioning themselves towards the lower end of the yield curve. This effectively constrains designing and implementing an effective debt management strategy. While issuance in short-tenors and through floating rates has helped avoid locking in long-term costs at current high rates, this results in a more frequent need to roll over domestic debt, which increases gross financing needs and their associated risks." Supporting this, in 2026 alone, the State Bank of Pakistan reported that banks came out with huge liquidity, over PKR 2 trillion, to invest in government paper, which is a risk-free mechanism to earn profits.

5.1 Comparative Mechanics: Debt Facilitation vs. the Hausbank Partnership

As per Universal banks and German industrialization: a reappraisal by Jeremy Edwards and Sheilagh Ogilvie German, universal banks were represented on corporate boards since they controlled voting rights by owning shares or through proxies gained through people who had deposited shares with them. On the other hand, Pakistani banks operate strictly from the outside, relying on the State Bank of Pakistan's regulation and agreements without taking a position on the corporate board or owning equity in the company.

German banks provide "patient capital," which refers to providing long-term loans with a duration of 10–15 years. These agreements are designed for factory construction and long-term growth. For example, in 1870–73 and again in 1895–1914, industrial joint-stock companies raised long-term investment finance via share issues organized by universal banks (Edwards and Ogilvie, 1996). Conversely, Pakistan banks restrict industries and companies to short-term working capital against heavy collateral, often not enough to kick-start companies or build factories. Highlighting this fact was the merging of KASB Bank Limited with BankIslami Pakistan Limited caused by a pileup of multiple NPLs (judgement of the high court). This pileup of NPLs severely depleted its asset base, and KASB failed to maintain the state bank of Pakistan's minimum Capital Adequacy Ratio. As a result, the central bank invoked Section 47 of the Banking Companies Ordinance (1962) to force a merger. This case illustrates how a **Hausbank**-style model might have prevented this pileup of NPLs.

Since Pakistani banks do not have supervisory oversight or internal access to corporate operations, they rely heavily on fixed asset collateral rather than the operations' cash flows. During recessions this alliance leads to bad loans and drives up NPL ratios, which leaves the credit-to-GDP ratio much lower than Germany's. Based on data from the World Bank, domestic credit to the private sector (% of

GDP in Pakistan was reported at 11.42% in 2024 and for Germany 77.3% in 2023. Small and medium enterprises in Pakistan suffer from credit starvation. Because emerging businesses do not have the real estate for collateral, they cannot maintain formal credit lines and export diversification as compared to Germany's thriving, bank-backed *Mittelstand*. Short-term debt instruments in Pakistan expose loanees to severe interest rate fluctuations whenever the State Bank of Pakistan hikes the policy rate to combat inflation, contrasting sharply with the interest rate smoothing and debt protections offered by German *Hausbanks*.

While close bank ties do bear fruitful outcomes, that is not always the case since they can also create severe conflicts of interests. The **Hausbank** acts simultaneously as a lender and a shareholder; its priorities can get blurred during times of financial distress. If a partner is near bankruptcy, acknowledging it and writing off the loan means that the bank must immediately recognize a capital loss on their balance sheet. To avoid declaring a total loss, the bank is forced to engage in evergreening to keep the company alive. These companies are known as "zombie firms" that survive only by constantly having to seek bailouts from the bank.

5.2 Operational Realities: Collateralized Credit, Alternatives, and Feasibility Barriers

Economics assume that court delays force banks to adjust up-front loan terms, like increasing the amount of collateral. The risk officers at the front lines treat underwriting and post-default court as two different things. These risk officers enforce strict collateral requirements to mainly satisfy SBP regulations (Regulations R-9 and R-17). Bank Officer X at Bank Y states that "Undoubtedly, delay due to litigation is one of the major concerns of banks, yet it has nothing to do with loan underwriting decisions. At the time of loan sanctions, the role of risk management is always to ensure proper collateral coverage for each and every borrower. Nevertheless, no matter how sound the collateral is, its liquidation is dependent on a time-consuming legal process, which cannot be shortened by the nature, value, or any other strength associated with that collateral." The processing speed of courts does not actively change the underwriting policy at banks; rather, the risk managers require hard collateral as a safety net regardless of the courts' processing speed. High-quality collateral can shorten the legal timeline. For example, a property asset is stuck in banking courts for several years, turning collateral into a post-default liquidity trap rather than a risk-prevention tool.

During Japan's post-bubble crisis, the heavily indebted retailer was supported by 3 major creditor banks. In 2002, they provided around 460 billion yen in financial assistance rather than allowing it to fail. By 2004, Daiei still had more than 1 trillion yen in interest-bearing debt, eventually requiring state-backed restructuring and around 400 billion yen in debt forgiveness. The **Hausbank model** was initially created for traditional industrial manufacturing, where firms possess physical collateral to secure debt. However, modern startups contain fewer tangible assets. Banks can only earn at a fixed rate but can lose all their money if the firm defaults. Therefore, bank risk officers naturally reject these asset-light and high-failure-rate tech startups. In this sector the German financial system has historically underperformed relative to market-based systems like the US.

Mr. Shaid Malik from Bank Alfalah, position Head of Financial Product Design and Implementation and Digitization Initiatives for SMEs, stated that, "For the past four years, banking has transformed within Pakistan, and more than half a dozen banks have started to dish out financial facilities with collateral-free. They take into account other hedging tools, like **credit guarantee schemes** rather than going in for the collateral of the business, and that has proven to be a very successful venture."

While German banks place their banking officers directly on the supervisory boards of enterprises, The officers I interviewed described maintaining a strict supervisory boundary. Based on the interviews, frontline risk officers view the bank's role purely as a financial facilitator rather than an active participant in the firm's governance. As stated by Bank Officer X, "Banks have other oversight checks which provide early warning signals to take remedial measures. Like market intelligence, financial statement analysis, which is done periodically, studies on particular industries, etc. The role of the banks, currently being performed, is not to be involved in business decisions of the clients but to be their facilitator." Pakistani commercial banks explicitly resist intervening in their clients' operations,

leaving corporate governance entirely to family ownership structures, especially within SEs and MEs. The bank's reliance on financial statement reviews and market rumors creates a severe information lag. By the time the bank finds out that the corporation is in distress, the business is often already heading towards a non-performing status.

Collateral-free lending decouples credit approval from hard physical assets. Instead, financial institutions evaluate cash flow predictability, transaction history, and third-party credit guarantee umbrella schemes. This has several implications in Pakistan. It lowers the barrier to entry for asset-light SMEs and technology firms. Moreover, it shifts commercial bank risk management from physical asset liquidation towards cash flow modelling and algorithmic credit scoring and reduces the historical problem where cash-generating companies were denied capital simply because they lacked the physical assets to request loans against. The Pakistani collateral-free scheme differs from the German **Hausbank model** on a credit basis, governance role, and legal architecture as well as on a capital basis. Collateral-free lending seems sufficient, as Pakistani SMEs can successfully unlock capital without requiring physical assets, finding a functional market-driven solution without having to force a complex **Hausbank model**, which requires several overhauls to the Pakistani legal system. However, **credit guarantee schemes** act as temporary financial cushions that provide short-term relief rather than financing multi-decade capital expenditures (e.g., building heavy industrial factories). In addition to this, when an asset-light SME faces high interest spikes or inflation, a Pakistani bank will immediately freeze its credit line to cut its losses. Conversely, a German **Hausbank** acts as a long-term equity partner sitting on the firm's board and providing emergency liquidity. The **Hausbank model** internalizes risk management rather than leaning on state guarantee schemes.

5.3 Global Banking Practices in Pakistan and Systemic Reform Barriers

Interestingly, they exist in Pakistan, but they do not follow the **Hausbank model**. Deutsche Bank has operated in Pakistan since 1962. Deutsche Bank first established itself in Pakistan through the Deutsch-Asiatische Bank (a specialized joint venture). It formally opened its commercial banking operations in 1962 in Karachi and later expanded to Islamabad and Karachi. Post-independence Pakistan was building its industries, importing heavy machinery from Germany, while requiring trade finance lines for textile mills to export goods to European markets. Major German industrial conglomerates established deep supply-chain footprints in South Asia, and Deutsche Bank entered to act as their primary cross-border transaction, foreign exchange (FX), and cash management bank. Deutsche Bank AG operates in Pakistan as an institutional wholesale bank. Currently it maintains two primary commercial banks in Karachi and Lahore and employs around 100 professionals and focuses mainly on German and European multinationals. Leading examples are as follows: Siemens, focusing on infrastructure, automation, and energy systems; the renowned Metro Cash & Carry, which is operating large wholesale centers across major Pakistani cities; and Merck Group & Bayer, who are prominent German pharmaceutical and life sciences companies as well as large Pakistani conglomerates and financial institutions requiring global correspondent banking services.

The absence of the **Hausbank model** is not due to a lack of German bank presence but is owed to the lack of structural and legal feasibility within the Pakistani banking system. Section 23 of Pakistan's Banking Companies Ordinance strictly limits banks' ability to hold equity in non-banking commercial companies. The **Hausbank model** relies on owning shares in a company and sitting on its corporate board, and this section severs this relationship between the bank and the company. Prevented from becoming a long-term industrial partner, Deutsche Bank started leaning towards Global Transaction Banking (GTB), cash management, trade finance, and foreign exchange sales. Moreover, Pakistani banks are heavily tilted towards funding fiscal deficits, which compels foreign banks to channel their liquidity into the low-risk **Treasury Bills** and SBP paper rather than long-term industrial ventures. Therefore, German banks are forced to limit their scope to corporate banking, abandoning this 'patient capital' entirely. The Global **Hausbank model** aims to leverage its global network and local expertise in 56 markets. The bank integrates Pakistan into this network by delivering global transaction banking, trade finance, and foreign exchange clearing rather than domestic equity-based financing.

To evaluate whether Pakistan should push towards a German-style **Hausbank model**, we must first analyze the line between equity ownership and traditional lending. Mr. Shaid Malik from Bank Alfalah asserts, “Under no circumstances would a commercial bank be inclined to acquire equity, as purchasing businesses falls outside the core scope of banking operations. A bank’s fundamental purpose is to extend credit and secure an interest return, not to enter into corporate equity partnerships. Financial institutions operate as debt facilitators rather than equity partners. Even if an institution such as Bank Alfalah were granted the option to acquire equity stakes in a commercial enterprise, it would prefer to provide debt financing rather than taking an ownership position.”

Debt facilitation limits a bank’s role and claims fixed interest without taking equity stakes, voting power, or board-level control in the borrowing firm. This ensures that banks do not suffer direct capital losses on their balance sheets if the borrowing enterprise incurs a loss. Moreover, it preserves arm’s-length credit separation and prevents banks from becoming over-leveraged in large corporations. The bank is strictly limited to financial liquidity and collateral management rather than participating directly in large corporations. On the contrary, a **Hausbank** takes up a dual role—acting both as a primary creditor and stakeholder. Furthermore, it practices active governance: the bank executives sit directly on the enterprises’ board of directors, where they exercise their proxy voting rights, being able to elect bank representatives to the board, monitor management, block hostile takeovers, and hold discretionary policy influence. As opposed to Pakistan’s debt facilitation model, which relies on asymmetric payoff, the **Hausbank model** is more aligned towards a shared risk-reward.

Supporters of the Pakistani banking model argue that restricting a bank’s interference in corporations can avoid losses and protect depositors’ funds. True to some extent, this model creates a severe deficit for long-term industrial expansion. As highlighted in the quote, a bank’s core strength lies in risk management and liquidity facilitation, not in managing commercial enterprises. Forcing banks to act as stakeholders can risk severe conflicts of interest, having them extend into industries where they lack the right expertise. Under this view, keeping the banks as strict facilitators can protect depositors and maintain financial stability within the Pakistani banking system. While arm’s-length debt facilitation avoids the common risks associated with the universal banking model, it creates a fundamental capital deficit for long-term industrial expansion. Pakistani banks profit at fixed interest rates but can incur a total default loss.

As a consequence, banks refuse high-risk, long-term capital expenditures (such as building factories and large industries) without heavy physical collateral. In times of economic stress, Pakistani bank collectors call in loans and seize collateral, which puts heavy pressure on industries and drives enterprises into bankruptcy. In contrast, the **Hausbank model** works actively with management to restructure debt, provide emergency capital, and guide the business through rough terrain. A pure debt model forces growing companies to rely on short-term low working capital rather than high ‘patient capital.’ Without equity-backed bank support, as is the case in the **Hausbank model**, asset-light or rapidly expanding firms stop growing because they run out of physical assets to offer as collateral.

There has been some skepticism raised by some senior banking officers themselves. With the **Hausbank Model**, one senior officer I interviewed struggled to visualize how the **Hausbank model** could be implemented in the current Pakistani environment. There are several concerns about the firm’s behavior and the economic environment that make a direct institutional transition difficult. Pakistani banks deliberately divide their banking relationships among several institutions to maximize trade finance lines. Forcing a shift towards a single, **Hausbank**-type of relationship would force these banks to abandon these different trade lines and would risk them being locked with a single client. The vast majority of SMEs struggling to remain profitable amid the unpredictable policy rates, energy tariffs, and freight costs could be pushed over the edge rather than gain benefit from this new relationship. While the **Hausbank model** offers viable theoretical solutions to many of the problems faced by Pakistani banks, in actuality the officers I interviewed described remain deeply unconvinced that the current macroeconomic climate in Pakistan can handle such a transition. If a full-scale **Hausbank** transition is too structurally disruptive for Pakistan’s current economic climate, is the country trapped in constant credit starvation, or can a new hybrid framework bridge the gap without forcing a total system overhaul?

6. Conclusion

The Pakistani and German systems differ in regard to their banking traditions and the legal framework that forces their specific strategies. The Pakistani way, highlighted by Mr. Shahid Malik from Bank Alfalah, operates as a debt facilitator rather than taking equity and shares in corporations. Collateral-free SME schemes and SBP credit guarantee tools provide short-term liquidity for businesses without requiring large physical collateral. Keeping banks as strict liquidity facilitators avoids conflicts of interest and maintains financial stability.

While Pakistani banks protect bank balance sheets, it creates a severe deficit of the multi-decade ‘patient capital’ needed by large industries to grow and expand. Commercial lenders operate on fixed interest margins while at the same time risking full default losses. This naturally pivots them to avoid uncollateralized, high-risk industrial projects and motivates them to react to mild recessions by freezing credit lines, calling in loans, and liquidating corporate assets. Section 23 of the Banking Companies Ordinance (1962) is the primary legal barrier that prohibits banks, especially German banks like Deutsche Bank, from holding equity in companies. This is proof that foreign institutions stay away from their traditional **hausbank model** and instead focus mainly on trade finance and FX clearing. Without owning direct corporate equity stakes or sitting on supervisory boards, Pakistani banks remain passive creditors unable to guide corporations in times of economic stress.

While the Pakistani banking system provides financial stability, it heavily relies on short-term loans and physical collateral, which cause enterprises to stunt their growth once their mortgages are depleted. While a full implementation of the German universal banking model is unfeasible, maintaining the current short-term collateral-heavy loan system restricts national industrial productivity. However, a hybrid system might be feasible where SBP **credit guarantee schemes** are used to handle short-term liquidity while establishing a financing window that allows equity-backed governance and long-term capital for large industrial sectors.

7. Tables and Figures

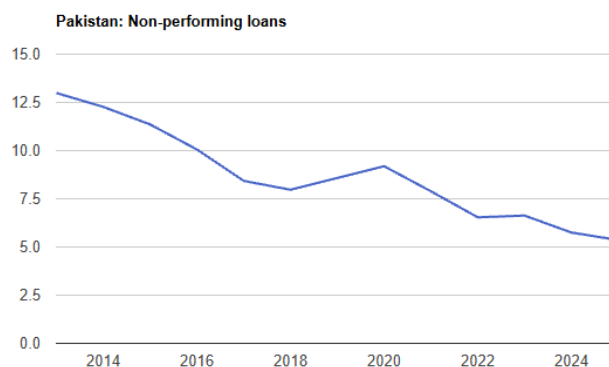


Figure 1. This is a line graph titled “Pakistan: Non-performing loans.” For the Horizontal Axis (X-Axis): the component is time, which is measured in years. It covers a window of 12 years from 2013 to 2025. Time is an independent variable. For the Vertical Axis (Y-Axis): The component is non-performing loans, and it scales up from 0.0% to 15%. It is the metric that fluctuates over time. When a commercial bank issues a loan, it expects regular payments. If the borrower fails to make these payments for 90 days the loan becomes “infected”. Near 2013 the NPL was near 13%, which was the highest point on the chart. Between 2013 and 2018, bad debts fell sharply from 13% to around 8%. During the pandemic in 2019, it rose back towards around 9.2% and eventually reached 5.4% by 2025. This historical exposure to bad debt explains why Pakistani banks are hesitant to issue large-scale loans to industries and demand physical collateral before lending. The drop in NPLs demonstrates that schemes that reduce risks such as risk-sharing credit guarantees can allow banks to safely deploy credit. *Source: the global economy, Pakistan’s Non Performing Loans.*

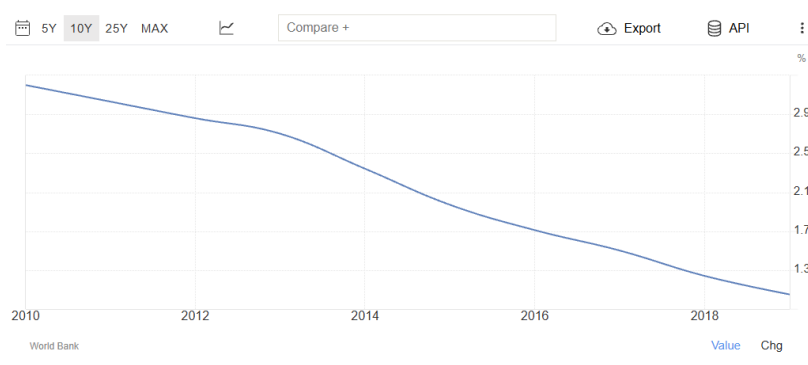


Figure 2. *Trend of Germany's Non-performing loans (2010–2019).* While Pakistan's NPL ratio has improved down to around 5.4%, it remains much higher than Germany's Hausbank model. This is a line graph titled "Trend of Germany's Non-performing Loans (2010–2019)." For the Horizontal Axis (X-Axis): the component is time, which is measured in years. It covers a window of 10 years from 2010 to 2019. Time is an independent variable. For the Vertical Axis (Y-Axis): The component is Non-Performing Loans, and it scales up from 1% to 3.3%. It records how the loan default rates fluctuate over time. Germany's NPL ratio fell smoothly from around 3.2% to around 1.1%. This low rate is a direct result of the German Hausbank model. Because main banks hold equity and sit on supervisory boards of borrowers, they can spot financial distress early and restructure debt before the loans become infected. While Pakistan's NPL ratio was wavering between 8% and 13% during the same decade, Germany's worst point on this chart was 3.2% in 2010, which is lower than Pakistan's best point of 5.4% in 2025. This chart shows why in the Hausbank system banks can afford to issue large, long-term loans without requiring large physical collateral. *Source: tradingeconomics, Germany's Non-Performing Loans.*

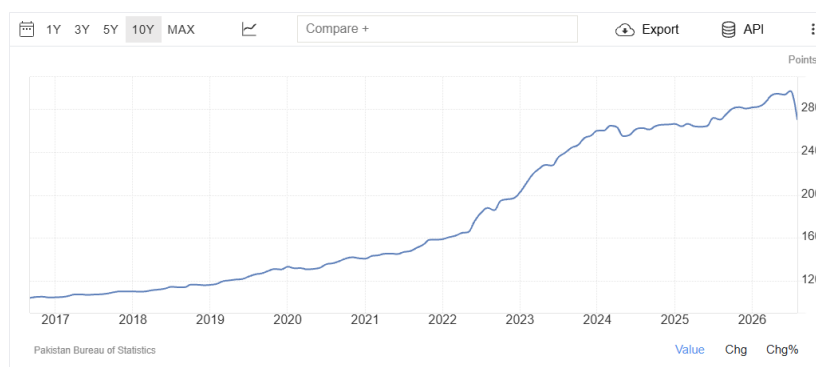


Figure 3. This is a time-series line graph sourced from the Pakistan Bureau of Statistics (PBS) tracking Pakistan's Consumer Price Index (CPI) over a 10-year view. For the Horizontal Axis (X-Axis): the component is time, which is measured in years. It covers a period of 10 years from 2017 to 2026. Time is an independent variable. For the Vertical Axis (Y-Axis): The component is index points, and it scales up from 100 points to over 280 in increments of 40. It measures the cumulative level of prices in the economy over time. The Consumer Price Index (CPI) tracks the average price change over time of a group of goods and services purchased by households. The steeper the upward line is, the faster inflation is accelerating. The index rose gradually from ~100 to ~140 points between 2016 and 2021, indicating stable, single-digit inflation during this period. Between 2022 and 2024 the curve bent upwards, climbing from ~160 to over ~260 points. This reflected severe domestic inflation due to currency devaluation, supply chain disruptions, and global commodity shocks. The line flattened between 260 and 280 points in 2024–2026 before showing a sharp downward turn in recent 2026 readings. The rapid surge between 2022 and 2024 forced the State Bank of Pakistan to aggressively raise policy rates (peaking at 22%) to stabilize the high rate of inflation. When the index points almost double within two years, commercial banks shorten loan maturities to avoid high inflation risk. Accordingly, high and volatile inflation rates make enterprise cash flow unpredictable, which makes government paper appear more appealing to Pakistani commercial banks. *Source: tradingeconomics, Pakistan Consumer Price Index (CPI).*

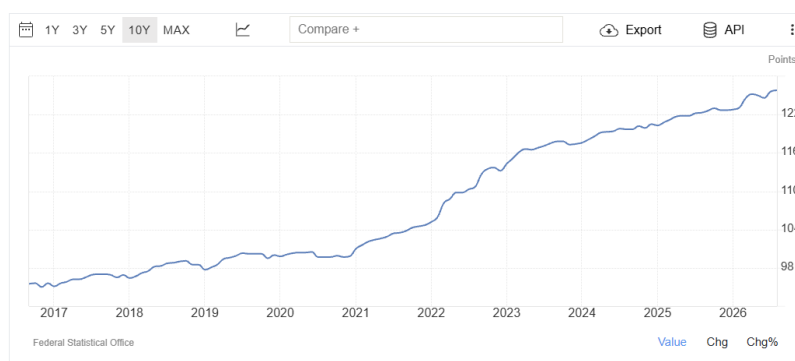


Figure 4. This is a time-series line graph sourced from the Federal Statistical Office of Germany (Destatis) tracking Germany's Consumer Price Index (CPI) over a nearly 10-year view. For the Horizontal Axis (X-Axis): the component is time, which is measured in years. It covers a period of 10 years from 2017 to 2026. Time is an independent variable. For the Vertical Axis (Y-Axis): The component is indexed points, and it scales up from 98 points to over 122 in increments of 6. It measures the cumulative level of price burden in Germany's economy relative to the base year. Between 2017 and 2021 the line remained flat around 96–100 points, showing Germany's low, predictable inflation. The curve bent upwards from ~102 to ~116 between the 2021 and 2023 points, reflecting Europe's energy crisis following the supply shocks post-Pandemic. Between 2023 and 2026, the German line flattens into a gentle upward trajectory between 116 and 125 points as European Central Bank rate hikes re-anchored inflation near target levels. German banks operate in an environment of low long-term price risk. This stability allows them to grant 15–20 year loans to large industries without the fear that inflation will affect real asset values drastically. Because the price shocks in Germany were contained, the ECB only needed to raise the rates to a peak of 4.5%, in contrast to Pakistan's 22%. These stable levels keep NPL risks low and reinforce the Hausbank's long-term corporate partnerships. *Source: tradingeconomics, Germany Consumer Price Index (CPI).*

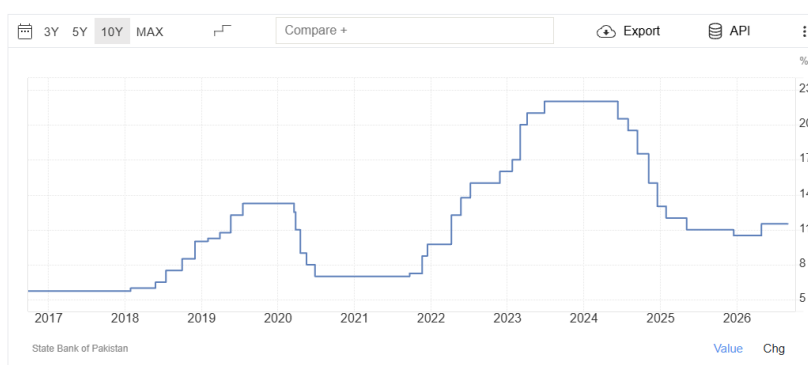


Figure 5. This is a step-line graph sourced from the State Bank of Pakistan (SBP) titled “Pakistan interest rate.” The component is time, which is measured in years. It covers a period of 10 years from 2017 to 2026. Time is an independent variable. For the Vertical Axis (Y-Axis): The unit of measurement is SBP Key Policy Interest Rates, and it scales up from 5% points to over 23% in increments of 3%. The policy interest rate is set by the central bank. It decides the cost at which commercial banks borrow money from the central bank. When it rises, lending becomes expensive, borrowing slows down, and when it falls, borrowing becomes cheaper. From 2017 to 2020, the policy rate started low at around 5.8% and rose sharply to ~13% in 2019 and dropped back to 7%. To combat severe inflation, the SBP executed a sharp rise in 2022 from 7% all the way up to a record peak of 22% in 2023–2024. As inflation began to slow down, the SBP cut down the rate, bringing it down towards 11% by 2025–2026. At a 22% rate, borrowing costs for large industrial firms became unviable. Instead of risking long-term corporate loans, Pakistani commercial banks parked their money in T-Bills and PIBs. While Germany's policy rate moved between 0.0% and 4.5% over the decade, Pakistan's policy rate experienced extreme volatility between 5.8% and 22%. This unpredictable environment explains why Pakistan cannot deploy the German Hausbank model to its full extent. *Source: trading economics, Pakistan Interest Rate.*

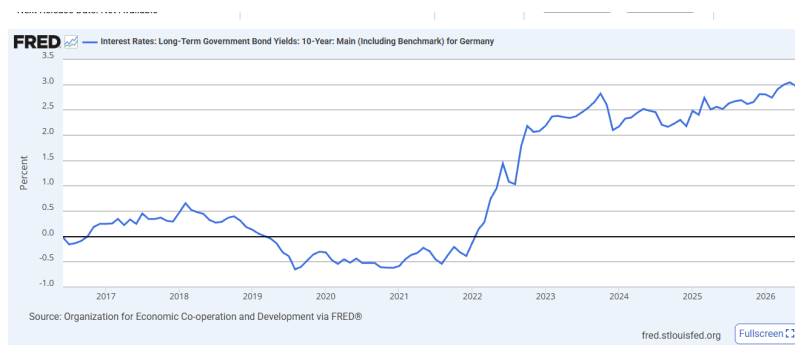


Figure 6. This is a time-series line graph sourced from the Federal Reserve Bank of St. Louis (FRED) tracking Germany's 10-year Government Bond Yields. It covers a period of 10 years from 2016 to 2026. Time is an independent variable. For the Vertical Axis (Y-Axis): The unit of measurement is the long-term government bond yield, and it scales up from -1% points to 3.5% in increments of 0.5% . A government bond yield is the annual return an investor receives for holding a country's 10-year debt securities. When yield falls below zero, the rates are so low that investors are paying the government to hold their capital safely. They reflect long-term borrowing costs for banks and corporations. From 2019 to 2021, the line dips below the x-axis, reaching near -0.7% . This was caused by aggressive monetary easing by the ECB. Post-Pandemic between 2022 and 2023 the yield surged past 2.5% by late 2023 as the ECB raised policy rates to combat Eurozone inflation driven by energy costs. The yield stabilized between 2.0% and 3.0% by 2026. Between 2016 and 2022, the interest rates hovered between -0.7% and $+0.5\%$. This predictable cost allowed the Hausbank to issue large industrial scaled loans without taking on risks associated with high-volatile interest rates. While Pakistani commercial banks faced skyrocketing policy rate spikes, which peaked near 22% , Germany's rate peaked between a finer $2.8\text{--}3.0\%$. Source: *Interest Rates: Long-Term Government Bond Yields: 10-Year: Main (Including Benchmark) for Germany, FRED.*

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Conflicts of Interest

The author declares that there are no conflicts of interests related to this work

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A. Interview Transcript 1

Purpose: An in-depth qualitative interview with a senior risk officer at a leading commercial bank in Pakistan pertaining to the research paper brought a lot of information to light. The goal of this fieldwork was to bridge the gap between macroeconomic data and frontline credit decisions and the implications of implementing a **Hausbank** style of model in Pakistan.

Below are the key questions that were asked during the interview along with specific reasons behind each inquiry as well as the Bank Officer's exact answers.

Question 1: When a commercial borrower defaults, what is Bank XYZ's first priority—working with the company to restructure the loan so the business survives, or seizing and selling their land/factory collateral?

Rationale for asking question:

I asked this to test whether Pakistani commercial banks act as long-term parents like German **Hausbanks** or strictly as collateral recovery agents. I anticipated that bankers would have leant towards restructuring firms in distress but the response revealed that severe legal delays and firm regulatory guidelines make asset liquidation the default risk mitigation strategy.

Bank officer X's answer:

Banks presume themselves to be the strategic partners of the businesses they work with as it is the business which shares its profits with Banks in the shape of markups, commissions etc. Thus, the intention always is that the business should remain a going concern so that it may share the due benefits and contribute to the economy. That's why loan rescheduling, restructuring and rehabilitation is always the bank's foremost priority. Litigation is the last option on the list when no other hope remains workable.

Question 2: How big of a barrier are Pakistan's banking courts when trying to recover bad debt? Does the fear of 5-to-10-year court delays force banks to demand excess collateral upfront?

Rationale for asking question:

This question examines how the 5 to 10 year judicial enforcement delays affect upfront risk management. It also confirms whether the fear of slow court enforcement forces risk officers to demand excessive real estate collateral.

Bank officer X's answer:

Undoubtedly, delay due to litigation is one of the major concerns of Banks yet it has nothing to do with loan underwriting decisions. At the time of loan sanctions, the role of risk management is always to ensure a proper collateral coverage for each and every borrower. Nevertheless, no matter how sound the collateral is, its liquidation is dependent on a time-consuming legal process, which cannot be shortened by the nature, value or any other strength associated with that collateral.

Question 3: In your portfolio, what causes more defaults: macro shocks like high interest rates and inflation, or internal issues like bad family governance and hidden financial records?

Rationale for asking question:

It helps determine whether business defaults arise from uncontrollable economic instability or lack of active institutional monitoring over corporate management. It helps isolate the root causes of credit risk in Pakistan's private sector.

Bank officer X's answer:

There is always a mix. Some defaults are willful which are of course intention based. While some are circumstantial which normally are due macro-economic factors, poor business planning, lack of succession planning etc.

Question 4: If banks were allowed to sit on corporate boards to monitor cash flows early, could your team prevent high NPLs before loans turn bad, or would business owners resist bank oversight?

Rationale for asking question:

While I expected the bank officer to highlight the information asymmetry, this response showed me that the deep-seated family control and the lack of government transparency make local businesses

particularly resistant to external banking interference in their operations. This helped me understand the extent of cultural and the structural feasibility of adopting German-style supervisory board representation in Pakistan.

Bank officer X's answer:

Banks have other oversight checks which provide early warning signals to take remedial measures. Like market intelligence, financial statement analysis which is done periodically, studies on particular industries etc. The role of the banks, currently being performed, is not to involve in business decisions of the clients but to be their facilitator. Major segment comprises SEs and MEs, where their decision making is normally within the family.

Question 5: Why are non-performing loan rates so much higher in small/medium businesses (SMEs) compared to large corporations? Is it harder to restructure SME debt when physical assets are limited? SME Sector NPL Rate: 16%–18% Large Corporate Sector NPL Rate: 6%–7% (Financial Stability Department, State Bank of Pakistan)

Rationale for asking question:

It clarifies whether higher default rates in smaller firms are due to inherent business fragility or because they lack the financial documentation and the high-value real estate collateral to navigate bank workouts. It explores the structural mechanisms behind SME credit starvation, an element that is fundamental to the research at hand.

Bank officer X's answer:

The corporate sector is more documented, structured with better sustainability as compared to SEs and MEs.

Question 6: In Germany, banks often convert bad corporate debt into company equity (shares). Is converting defaulted loans into equity a practical option for Pakistani banks, or do local tax and regulatory rules make it impossible?

Rationale for asking question:

This question checks whether Pakistani banks can legally hold equity in corporate clients like the **hausbank model**. It highlights specific challenges such as central bank holding limits and tax liabilities.

Bank officer X's answer:

The debt equity swap is a type of restructuring which is done for selective clients that remain going concerns, show sound potential of rehabilitation, repayments through business cash flows and are not willful defaulters.

Question 7: Do State Bank risk-sharing schemes and credit guarantees actually help SAM recover problematic loans, or do borrowers treat government-backed loans with less discipline?

Rationale for asking question:

It tests whether government moral hazard reduces borrower compliance or if commercial banks maintain identical, strict recovery standards regardless of state guarantees.

Bank officer X's answer:

The Govt backed loans are disbursed through counters of commercial banks, which follow their own risk management criteria to secure repayments over these loans. The schemes are normally subsidized, in terms of markup by the Govt but the recovery procedure, in case of NPL, has no difference.

Question 8: When the SBP policy rate spiked to 22% in 2023, how drastically did your team's workload increase as corporate interest burdens doubled?

Rationale for asking question:

The answer to this questions measures how severe monetary tightening affects the risk departments in banks. It analyses how the rapid rise of interest rate expenses lead previously profitable corporate borrowers into defaults.

Bank officer X's answer:

It was a challenging time for the business to survive. The ones less dependent on high cost loans proved to be more resilient.

Question 9: From a risk management standpoint, is the bank's pivot toward buying risk-free government bonds (T-Bills) a direct reaction to the high cost and difficulty of recovering bad private sector debt?

Rationale for asking question:

In order to confirm **sovereign crowding-out** directly from a practitioner, I asked this question and while I expected an answer related to managing liquid reserves, the response admitted that high risk-free yields combined with zero to none legal recovery problems make lending to the state much more profitable and hassle-free than lending to the private sector.

Bank officer X's answer:

Banks normally have a mix of their investments placed in Government Securities and loans to the private sector. The decisions are under the cover of regulations and within the thresholds settled by the regulator.

*Question 10: State Bank priority targets try to force banks to lend to SMEs, but banks still prefer buying risk-free government bonds. Can government targets alone solve credit starvation in Pakistan, or is a German-style **Hausbank model** where banks take equity stakes and sit on company board a better system for funding local businesses?*

Rationale for asking question:

This response provided a reality check. It allowed me to test my thesis against real-world practices. Pakistani banks use multiple banks to split credit lines and negotiate better rates, making a single main-bank system unviable under current market habits.

Bank officer X's answer:

Though bank dominance appears to be a similarity in German and Pakistani financial systems, conversion to the **Hausbank model** is a whole different phenomenon, which would require a complete structural change. Below realities, amongst a lot other, would require to be addressed:

- The main business mix of Pakistani industry comprises SEs and MEs, which are less documented, normally family oriented, not listed, where decision making revolves around one or two key persons. Can they tolerate involvement of an independent body in their controlled decision making roles?
- Majority of the businesses in Pakistan prefer a diversity in their relations with multiple banks so as to take respective service benefits. The **Hausbank** model however is more of a bilateral approach, which would be a sacrifice to the diversity benefits.
- Is our economy currently in a position to survive any major structural change?
- With exception of some, is it still viable for small segment businesses (80–85%) to generate as much profits enabling them to bear their interests, high energy costs, freight and survive?

B. Interview Transcript 2

Purpose: To further deepen the primary qualitative analysis, a second expert interview was conducted with a senior executive at Bank Alfalah. The objective was to evaluate theoretical assumptions regarding collateral reliance and equity-based relationship banking and the viability of the **Hausbank model** in Pakistan. Below are the specific research questions that were asked during the interview along with particular reasons behind each inquiry.

Question 1: In Germany, banks don't demand land or property papers to give a loan. They just take a small ownership percentage in the business and wait years to profit. In Pakistan, why do banks refuse to give long-term loans to small businesses or farmers unless they hand over land papers or physical assets as security?

Rationale for asking question:

An admission of strict collateral dependance was anticipated however, the response revealed that banks are rapidly expanding their collateral-free SME lines using several credit guarantees, but at the

same time reject holding equity due to lack of operational capacity to manage the business. It expands on the idea whether Pakistani banks are as rigidly collateral-dependent as commonly portrayed.

Mr. Shahid Malik's answer:

For the past four years, banking has transformed within Pakistan and more than half a dozen banks have started to dish out financial facilities with collateral-free. They take into account other hedging tools, like **credit guarantee schemes** and stuff like that, rather than going in for the collateral of the business, and that has proven to be a very successful venture. Right now, with Bank Alfalah, we've got a portfolio of about, good 18 to 20 billion, which is collateral-free. So, you can very well imagine how things have changed. So, that would be totally, I would not call it a false statement. Yes, banks within Pakistan are perceived to be more collateral, greedy rather than going in for clean facilities. And, taking into account ownership within the company, I doubt the majority of the banks do that. There are specialized banks who are in development, only they do the partnership, arrangement with the business. So, not all banks are like that. If you take up a typical commercial bank, I doubt they would have the time, space, and resources to go sit within a business and operate and wait for it to become profitable.

Question 2: when Bank Alfalah builds new loan products for farmers and small business owners, what scares you more: the fact that these owners keep fake, messy accounting books, or the fear that they will run away with the money if you don't hold their land or factory papers?

Rationale for asking question:

The response revealed that macro-level volatility far outweighs the individual borrower default risk. This highlights the idea that economic instability is the primary barrier to credit expansion. This idea was in contrast to the assumption that the primary driver of credit risk was financial opacity.

Mr. Shahid Malik's answer:

None of the above. My concern is basically my macroeconomics or the prevalent circumstances within the country. They are more scary as compared to the business running away. So, right now the scare is not for the small business owner to run away or shy away or vanish out. Right now, the scare is what is going to happen to gas, fuel prices, gas prices, electricity prices. So, all of these things combined are more scarier as compared to the business running away or drying away. There are no small businesses which actually run out. They don't operate that. For year one, if there are 100 businesses, once they step into year two, only 30 would survive. There's a huge die-out ratio for the startups. And as they go on, as they enter from second year to third year, out of those 30, another about 20 to 25% or rather more than 25% would fall through again. When they work out, you're going to be left with only 25 businesses who are able to survive. And once you cross over that three-year mark, only then the businesses tend to normally go profitable. So, that's the regular die-out ratio. And internationally, if I look at it, standard, it would be out of 100 businesses, 30–35 would wipe out the first year, another 30–35 would wipe out the second year. So, by the time the third year comes in, out of those 100, only 25–30 businesses will survive. And that's what happens in a macro process as well.

Question 3: If the State Bank allowed Bank Alfalah to buy 15% of a promising local business instead of just giving them a short one-year loan, would the bank actually do it, or is owning a piece of Pakistani business too dangerous because local owners hide profits?

Rationale for asking question:

The response proved that even if regulations permitted the idea, the banks would refuse to hold equity in corporations in order to avoid the operational burden and responsibilities that come with managing the business. It clarifies the idea whether legal barriers are the sole reason banks hesitate from holding equity in businesses.

Mr. Shahid Malik's answer:

Under all circumstances, no, the bank would not be interested because the bank is not into the business of buying a business. That's not the bank's business. A bank's business is to lend and to get the return back. They are more concerned with finding out or to create viable business ventures where they can lend something. They don't want to be partners, they want to be facilitators. Even Bank Alfalah is given

the option to buy stakes within a business, I doubt they would still do that. They would prefer to finance the business rather than to buy a stake in there. They don't have the time and the energy and the resources to go and sit in the business. That's not banking. That's the partnership concern and you've got loans, loan sharks, venture capitalists and all of those, intermediaries which would step into such businesses, and they would be interested to buy a stake within a business. It's not the bank's business. So, you can't redefine a banking business within an ecosystem.

Question 4: German banks send their own managers to sit inside the companies' board meetings to watch how money is spent. If a Pakistani bank tried to sit on the board of a family-owned textile factory or a farm, would the family accept it, or would they refuse to share control?

Rationale for asking question:

This question was designed to evaluate whether the **Hausbank** style supervisory boards could function in Pakistan. The response confirmed that family-owned businesses strongly resist outside board members to protect corporate secrets and retain family control.

Mr. Shahid Malik's answer:

Our businesses, They are the least... conducive businesses where they would let people sit down and... sit within their... board. Majority of the businesses which operate within Pakistan are family-owned, you know. Just like Nishat, Mansha, and rest of the big names. Do you really think they would let their family secrets out to anybody else other than the family? No. So, operating systems are different. They... their so-called corporate businesses, but they are not corporate in actuality. They are SMEs businesses run with a mindset of, "It's a family business, no secrets to be leaked out."

Question 5: If the State Bank created a new universal banking license tomorrow that allowed you to fund brand new factories using both loans and ownership shares, what rules or protections would you need from the government before Bank Alfalah would actually use it?

Rationale for asking question:

Banks require state-backed credit guarantees and viable export markets before taking on industrial debt. This helped identify the key requirements needed to encourage long-term lending to large industries.

Mr. Shahid Malik's answer:

Would it be attractive enough for the bank? Yes, it would be attractive enough for the bank, if it has a viability existing abroad. We tend to be more focused on businesses which are exporting. Recently, the banks have moved into the venture of small & medium and agree zones. Why do you think they are doing that? You've got a population of 150 million approximately. So, you need resources to feed that 150 million as well. So, you've got a huge target market whether it is available within the boundaries of the country. You don't have to go overkill for that. Not everything should be focused on the export base. Yes, if State Bank comes up with something, my viability, my options, my returns, my... income calculation would be purely based on how lucrative the business is, rather than asking for guarantee. Yes, there is a new... trend which is taking shape, which is called credit guarantee. Credit guarantee is something you are offered if the loan goes bad. If I lend to Asad, and if the loan goes bad, whatever Asad owes, that credit guarantee company will give me money or compensate me for the amount. So, do you really think banking can stay handicapped? No. Yes, there are certain avenues which are very nice... which are... more prone to accidental or environmental or climatic changes, because now there's a new offshoot which is coming in, which is the climatic change. You refer to Germany, there is no climatic change factor over there; whereas if you look at our surroundings, you'll find climatic changes taking place about a zillion in a day. So, every environment is different, every circumstance is different. No matter what anybody offers, the viability, the lucrativeness, the attractiveness is purely based on what the supply and demand is

Question 6: Why aren't small businesses getting long-term expansion loans in Pakistan? Is it because banks refuse to lend, or because bank owners are too scared of the economy to ask for, or build big, multi-year loans?

Rationale for asking question:

The question posed to determine why credit remains locked in short-term trade financing. It highlights the fact that Pakistan's economy is dominated by imports rather than manufacturing which creates very little demand for multi-year capital loans.

Mr. Shahid Malik's answer:

Question 7: When your bank can earn a guaranteed 15 to 20% profit doing zero work by just lending money to the Pakistani government, how hard is it for you to convince your boss to lend that same money to risky farmers or small shopkeepers?

Rationale for asking question:

Designed to assess how **sovereign crowding-out** affects internal bank strategy, the response explains how senior management in banks balance the risk-free government yields and private sector lending through strategic portfolio planning.

Mr. Shahid Malik's answer:

You know, it all depends on policy. As I said, the government makes the policy, the policy is inculcated down the line and it reaches State Bank, and from State Bank, it goes down to the actual... banks, and in their 5-year strategy, they incorporate. Now, convincing a boss, it depends what position you are at. Like at my position, I sit down with all the stakeholders and we decide what kind of investment should be there. Should we invest in **T-bills** with the government, should we invest in industries, or should we be in export-oriented industries? So, we try to create a mix-up of those and come up with the best possible logical plan which our directors or BODs or key stakeholders... can approve, and then we move forward with the plan. So, it's not hard enough. It's basically getting logic out of it... within management.