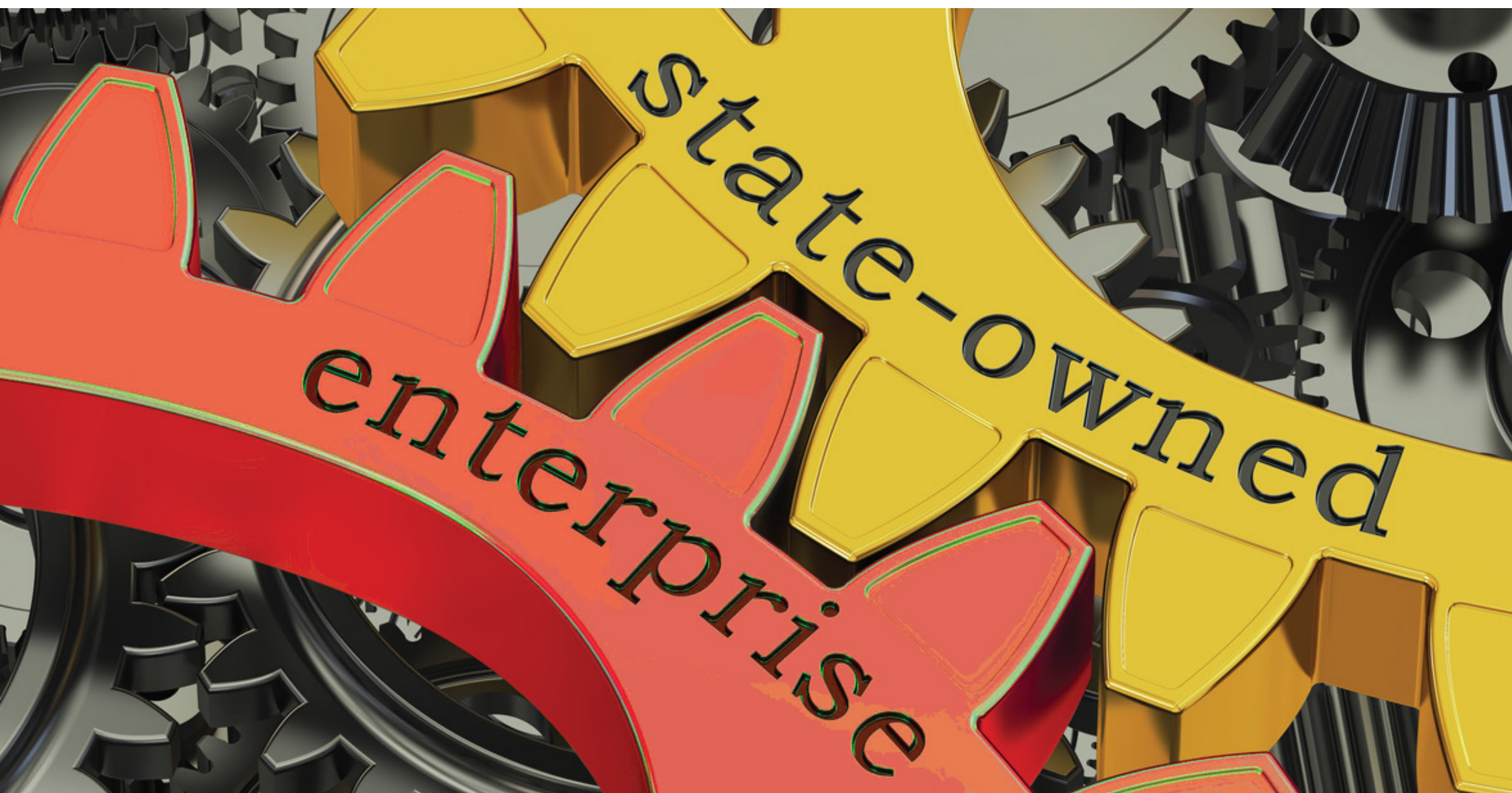
STUNTED SETH-STATE OWNED COMPANIES



Anjeela Khurram

In Pakistan, the business milieu is retarded owing to multiple factors. Among various factors like institutional and structural barriers, political unrest, government footprints etc., the stagnancy of the business landscape in Pakistan can equally be attributed to a longstanding family centric control of the wealthy business magnates normally called “Seths” and their families. This Seth culture has eroded the business landscape in Pakistan. With roots embedded in the colonial system, the dominance of seths and their families in Pakistan's business sector is deeply embedded in the social stricture. Partition (1947) has consolidated power in the hands of a few influential business families. Wealth and opportunities are concentrated within a small group of the population, thus exacerbating income and social inequalities. When the economic prowess of the nation concentrates in the hands of a few families, it results in monopolistic or oligopolistic practices in the market, thus slowing down the economic growth. This oligopoly offers friction to new entrepreneurs, particularly those without the family or political influence. Some 22 families were controlling 66% of industrial assets in Pakistan in the 1960s. Now, this control is in the hands of 31 families constituting a small “elite club” (Haque & Husain, 2023). In Pakistan, the corporate culture has the dominance of Seth mindset, which puts bars to innovation and expansion. This Seth mindset does not let the owners to think beyond the box and venture into new avenues to grow and expand. The lack of innovative ideas stalls efficient management of resources, impeding the investment in research and development (Mukhtar, 2021, PIDE Webinar, 2023).

The supremacy of Seth mindset slays innovation and growth, efficient management of resources, and effective use of human resources in a country (Haque et al., 2023; Mukhtar, 2021).

The prevalent stagnation in the Pakistani market is primarily due to this lack of competition, which restricts the prospects of innovation and new ideas and business models to emerge. Unlike its regional counterparts, Pakistan could not achieve competitiveness and growth targets owing to market stagnation and other factors like political upheavals, regulatory burdens, limited human capital development and financial constraints etc. (Sattar & Urooj, 2023). The fate of business milieu in the hands of the elite club has hampered the country's productivity and competitiveness. The rein of economic power in their hands limits the economic opportunities for others, making entrepreneurialism hard to grow. The low number of high-growth firms and superstars in terms of exports (top exporters) signifies Pakistan's inability to compete in the global market and attract foreign investment (PIDE Webinar, 2020; Sattar & Urooj, 2023). Pakistan's average GDP signifies a miserable rate of economic growth leaving Pakistani consumers with less disposable income to spend. This subsequently adversely affects the business environment by decreasing the overall market demand. Besides, the tendency of local businesses to avoid risks and low prioritization of R&D has resulted in limited innovation and product development, underscoring the absence of an entrepreneurial culture in Pakistan—an element integral to trailblazing innovations (Haque et al., 2023; Abbas, 2024). The presence of platforms like "Shark Tank" is pivotal to promote entrepreneurship in a country[23], which is non-existent in Pakistan. In nature, the economy of Pakistan is cyclic. The authority centered within a small hub of people allows them to influence the policy making in their favor to dispense the national resources for their self-interests, limiting competition in markets, thus, retarding entrepreneurship. This in turn, restricts economic growth of the people, thus, lowering their purchasing power and limiting the demand. The need is to break this cycle.

Admittedly, Pakistan is a politically captured economy (Moosvi, 2023). Pakistan's growth model relies heavily on the government's (political) interventions and provision of import substitutions, subsidies and protectionist policies by the government. All this has over-protected the businesses making them too crippled to compete in the international markets. Businesses make cartels to get market power to exploit opportunities at low cost, discarding any possibility of an equity market for growth and making the business environment less conducive (Anjum, 2020). The members of family-owned businesses have strong ties with the political figures. These coalitions are symbiotic in nature, where business owners can influence policy making to facilitate their profit margins exponentially. Likewise, rent seeking is the by-product of the elite-controlled business culture in Pakistan. Pakistan needs policy reforms to promote competition and innovation for their organic growth. In this perspective, research in PIDE (Khan, 2022) proposes to re-orient the subsidized credit from financing working capital to long-term financing for investment expansions and innovations. Besides, political interference should be minimized to free the market to ensure steady economic growth. A free-market mechanism could lead to a win-win situation for all stakeholders, i.e., consumers, producers and the government (Anjum, 2020).

[23]https://yourstory.com/2024/02/shark-tank-india-startup-impact

Seth-occupied business culture is fostering an environment favorable for tax evasion for their owners, who deliberately do not list their companies on the stock. This practice of undocumented economy retards an adoption of efficient corporate culture in Pakistan. The Seths are unwilling to declare their accounts. This culture should be revitalized to allow domestic business to compete and grow organically. The barriers like onerous and expansive tax policies should be revisited to attract more investments- domestic and international (PIDE Webinar, 2020; PIDE Webinar, 2023; Ahmed et al., 2022). Extant research establishes that in an economy investment and productivity are key drivers of growth (Haque, 2020; PIDE, 2021; Qadir & Ullah, 2021; Haque & Hussein, 2022). Unfortunately, these two parameters are not only quite low but have been in a downward spiral over the years (Haque & Hussein, 2022).

Pakistani businesses have very little global presence for various reasons. One reason these companies do not venture into international markets can be attributed to their exorbitant local profit margin; they earn from the domestic consumption led economy of 25 crore Pakistanis. Pakistan's largest conglomerates operate in industries like fertilizer, energy, cement, sugar, automotive – all meant for the local population, where they can hold and exercise their network influence. They invest in the sectors that promise incentives like protection and subsidies in the form of high tariffs on imports, tax breaks, subsidized energy tariffs etc. (RASTA-PIDE, 2023). The government policies incentivize these companies to compete domestically through protection and opportunities such as IPPs, privatization, subsidies etc.

The over-protection has also crippled these Seth companies so much so that their failure to go into the value-added segments at the right time had allowed new entrants like India, Bangladesh, Turkey and Vietnam to share the market. Pakistani companies lag way behind the international competitors in terms of high-tech, value-adding, and capital goods production and exports. There is an across-the-board failure to diversify be it manufacturing, exports, or domestic markets (RASTA-PIDE, 2023). Pakistani industries primarily rely on basic production capabilities and unlike the global practice do not invest in superior production and marketing strategies. Pakistani businesses should focus on the value-added chain rather than on little value-added commodities (RASTA-PIDE, 2023). This depicts the failure of following the Haq/HAG model, emphasizing more on import substitution and manufacturing for exports and loan borrowing. The failure to achieve the set targets in the Mobile Phone Manufacturing Policy is a recent example (RASTA-PIDE, 2023).

The need is that the government should give incentives to companies by lowering the high tariff cascading in Pakistan despite the tariff rationalization to promote export growth. Pakistan is second, after Egypt, among the top 20 countries in terms of import duty cascading. Similarly, in Pakistan, businesses even in the formal sector still use the traditional methods for inventory and demand management and do not use market intelligence and forecasting (RASTA-PIDE, 2023). This behavior discourages new entrants and prevents competition. Likewise, Pakistan has made marginal progress in terms of destination diversification, since it still exports 65% of its products to its traditional export partners.

The monopoly control authorities (MCA) and Pakistan competition commission (PCC) should incentivize Pakistani companies to set their profit margins proportionately to spur the stunted growth of Pakistani companies. Poor government policies and the lack of interest of investors have also inhibited the spirit of market competition. Thus, many Small and

medium-sized enterprises (SMEs) have failed to provide value added services (Mahmood, 2024). Globally, SMEs are billion-dollar companies. But in Pakistan, this is not the case. No nation can grow without growing their companies. The growth policies in Pakistan should provide the conducive milieu for a stable growth of its companies through a diligent implementation mechanism in place (PIDE Webinar, 2020; Ahmad et al., 2022). Now the common practice is that profit margins of Pakistani companies are too high i.e., internationally profit margins are very narrow but volumes are high, whereas domestically profit margins are high and volume is low (Mahmood, 2024). Likewise, many companies do not invest in R&D to develop a brand name with a known product. Pakistani companies have no brand equity (RASTA-PIDE, 2023). R&D is a much-neglected market and has mainly been dumped upon by the international consultants who are being supported by the international aid agencies and lenders, depriving the local thought industry to present local solutions for local problems (Haque, 2020; PIDE Webinar, 2023). A liaison among the major stakeholders like the government, industrial sector and academia can facilitate developing educational programs in domains like international marketing, project management, overseas customer support and service, product design, development and foreign languages and finally cultural awareness. Research proposes domestic commerce as an engine of growth (Haque, 2006). This stance is augmented by PIDE research in the following words that "A vibrant domestic commerce sector is the core of the economy facilitating intermediation between supply and demand, entrepreneurial development, risk-taking, innovation, and competitive markets. Such an economy transitions from commodity exports to brand names, process, and capital exports, all of which command a higher rate of return" (RASTA-PIDE, 2023).

The business activities of the companies greatly affect the stock market of an economy. In the current circumstances, the Pakistan Stock Exchange (PSX) is shrinking. The PSX is thin with few Initial Public Offerings (IPOs) and limited stock trading activities in Pakistan. Out of 421 companies owned by 42 business conglomerates, only 24% are listed on the Pakistan Stock Exchange (RASTA-PIDE, 2023). Even after 60 years of financial market development, the local companies are still a small part of the market at about 30% (PIDE, 2024). The KSE-100 is predominant by 31 Seth-owned companies (Haque & Husain, 2023; PIDE, 2024), where the owners keep stranglehold on the management. A bulk of shares held by these owners lower the liquidity, trade volumes and market efficiency. This leaves fewer free float shares to be traded. Most of the blue-chip companies' free float shares range between 4.2% and 55% in 2021(RASTA-PIDE, 2023).

The export figures of the 42 conglomerates listed companies depict that the combined exports of 39 companies of the 42 business conglomerates are USD 2.07 billion (PKR 594.35 billion) (RASTA-PIDE, 2023). Their main focus is to chase incentives by securing gains in the traditional sectors with less or no value-addition. For instance, the exports of the engineering sector are only USD 24.09 million, while those of the chemical sector are only USD 18.38 million (RASTA-PIDE, 2023). It is noteworthy that of all the listed companies, only seven (07) listed companies in Pakistan have a market value above $1 billion and the OGDCL with the highest valuation has a market cap of around $2 billion. This fact reflects the dearth of multi-billion-dollar companies in Pakistan. Even in Bangladesh, which has been going through different kinds of economic crises at present, eight business conglomerates have entered the billion-dollar club. No doubt, single Indian Tata's market capitalization alone with $365 billion stands larger than Pakistan's entire economy in February 2024. Compared to regional peers, Pakistan's business market is shackled. High protectionism,

permit and licensing requirements, stringent government footprints and regulations are the mucks that have restricted the prospects of business expansion and productivity in Pakistan. The "footprint of the government" plays a heavy-handed role to stifle the growth in all areas of trade as well as in most markets and costs over 70% of the economy (Haque & Ullah, 2021). Similarly, the burden imposed by the regulatory bodies retards the parameter of "ease of doing business" in Pakistan. The cost of regulation calculated in research by PIDE is over 60% of the GDP (Haque et al., 2022; Haque et al., 2023). Despite these hurdles, many sectors like construction, retail, chain stores, food, franchises, and transport are growing, showing that a better thought-out policymaking can help these businesses to embark on the global markets (RASTA-PIDE, 2023). The dominance of the conglomerates and family-run businesses can be attributed to a lack of competitive markets and the government's misguided protection and subsidy policies leading towards lack of a professional growth culture (Haque et al., 2023).

In this scenario, PIDE (2024) has proposed to incentivize listing with a tax incentive of 1–3% in corporate income tax for each 10% listed on the stock exchange for 5 –10 years (PIDE, 2024). Double taxation should be avoided. The market should be allowed to determine the takeover price. The holding companies should be allowed to operate and develop a market presence (PIDE, 2024; Ali, 2024). The policy should focus on developing large, exporting, listed, outward-looking, professionally-run corporations driving the economy (PIDE, 2024; Ali, 2024).

One core element highly linked to the family-owned businesses is the phenomenon of ownership and composition of the board of directors in these businesses (Khurram, 2022; Haque & Husain, 2023). Unlike the private sector, where a competitive environment ensures that the most competent flawlessly gets promoted to take charge of key decision-making roles, the leadership in Seth owned companies is the product of network clustering. The business ecosystem is dominated with the members of 31 primary families holding directorship positions to steer the market conditions. One common practice prevalent in these Seth owned companies is connectedness to their network (Moosvi, 2021). The board of directors (BODs) of the family-owned companies are controlled by a small group of interconnected people, who do not allow outsiders like the accomplished people in the country on their board. The network analysis depicts that individuals occupying directorship are part of their elite club (Haque & Husain, 2023). This study shows that each director in the central position holds or held the identical positions in parallel companies at least 10 times, some have or had as many as 17 times (Haque & Husain, 2023). This signifies that these companies do not bother to ensure adequate procedures to appoint the key board positions in an independent way (Moosvi, 2021). There is a dearth of democratic norms, transparency measures, accountability mechanisms, and meritocratic practices in the corporate sector (Haque & Husain, 2023) and the companies hardly adhere to the Code of Corporate Governance (CCG) (Khurram, 2022). The board members are predominantly male, with disproportionate female presence (Khurram, 2022; Haque & Husain, 2023; PIDE, 2024). The color of the colonial remnants of the 'Seth' culture is so deeply inherent that a major part is unwilling to professionalize their management and wants to maintain the status quo to extract the maximum benefits (Moosvi, 2021). The management of these companies has a regressive vision. Their culture suffers from corporate myopia, lacking foresight and long-term plans (Mehmud, 2017). The boards normally consist of the members from the elite club like are made up of similar individuals: corporations, family membersof business founders, retired and active civil servants, the armed forces, and a sizable portion of

non-executive directors with prior government experience (Haque & Husain, 2023; Fraz, 2024).The appointment of designating bureaucrats and government officials as independent directors on business boards creates a mismatch in priorities, strategies, knowledge, capabilities, and perspectives between the corporate and bureaucratic domains. These officials once appointed cannot navigate the competitive and dynamic corporate (Faraz, 2024). This is also against the State-Owned Enterprises Act of 2023, which forbids the appointment of bureaucrats as independent boards of directors (Fraz, 2024). There is always an economic cost related to poor governance (PIDE Webinar, 2023a). Therefore, there is a need to restructure the governance mechanism (PIDE Webinar, 2023b; PIDE Webinar, 2023c) to cater to corrupted practices in Pakistan (PIDE Webinar, 2023c). In these family-owned businesses, boards of directors are part of this consolidated elite club (Haque & Husain, 2023). To regulate boards, USAID created Pakistan Institute of Corporate Governance (PICG) to ensure rotation of board members between companies.

In short, the causes of the prevalent doldrums in economic activities are multifaceted and are embedded in structural, institutional, and cultural factors (Abbas, 2024). Pakistani companies are mainly Seth-owned, showing stunted growth and are mostly unlisted. Only a few companies are valued over $2 billion in the stock market. Whereas, the presence of many multibillion-dollar companies globally is a point to pause and ponder about the ineffective business policy making and poor governance practices prevalent in Pakistan (Haque, 2022). The major reason can be attributed to the presence of the government footprints and burden of unnecessary and redundant regulations (Haque & Ullah, 2021; Haque & Qasim, 2022). The easy breaks provided by the government through import substitution, opportunities and subsidies make them crippled to compete globally. Markets with less regulations can provide an arena for fair competition to companies to grow and develop (RASTA-PIDE, 2023). There is a dire need for reforms at all levels to ensure a stable economic growth in the country (PIDE, 2024). To pave the way for sustainable economic growth and development, the need is to learn from international best practices, to promote competition, privatization, credit provision, and R&D etc. The industry-academia linkages should be fortified to tap the great potential for entrepreneurial activities of the 60% youth population.

REFERENCES

Abbas Maken, 2024. Stunted Growth: The Economic Stalemate of Pakistan's Business Landscape. PIDE Discourse 2024, Policy and Research. https://pide.org.pk/research/stunted-growth-the-economic-stalemate-of-pakistans-business-landscape-2/ https://www.brecorder.com/news/40312122

Abbas Moosvi, 2021. Pakistan's corporate sector and 'seth' culture. PIDE. https://pide.org.pk/research/pakistans-corporate-sector-and-seth-culture/

Abbas Moosvi, 2023. Economics is always political. PIDE in Press. https://pide.org.pk/research/economics-is-always-political/

Abedullah Anjum, 2020. Does Free Market Mechanism Offer a Win-Win Situation to Wheat Consumers and the Government? PIDE Knowledge Brief.

Ahmad Fraz, 2024. Corporate Window: Bureaucrats on Soe Boards. PIDE in Press. https://pide.org.pk/research/corporate-window-bureaucrats-on-soe-boards/

Anjeela Khurram, 2022. Corporate Governance: Compliance with the Selection Criteria of Board of Directors in Public Sector Companies. PIDE Knowledge Brief https://pide.org.pk/research/corporate-governance-compliance-with-the-selection-criteria-of-board-of-directors-in-public-sector-companies/

Farhat Mahmood, 2024. Essential Steps for Pakistani Companies to Compete Globally. PIDE Discourse 2024, Policy and Research. https://pide.org.pk/research/essential-steps-for-pakistani-companies-to-compete-globally/

Haque, N. (2020, March). Doing Development Better: Analyzing The PSDP – PIDE.

Haque, N. U., & Husain, A. (2023). A Small Club. The Pakistan Development Review, 62(2), 281-299.

Haque, N.U. & Ullah, R.R. (2021). Estimating the Footprint of Government on the Economy. PIDE Working Papers No. 2020:26. Islamabad: Pakistan Institute of Development Economics.

Haque, N.U. & Waqaar, I. (eds.) (2006). Domestic Commerce – The Missing Link. Islamabad: UNDP/Ministry of Commerce.

Haque, N.U. (2020). Macroeconomic Research and Policy Making: Processes and Agenda. PIDE Working Papers 2020:172. Islamabad: Pakistan Institute of Development Economics.

Haque, N.U. et al. (2023). Engineering Horizons: Unraveling the State of Industry in Pakistan. Islamabad: Pakistan Institute of Development Economics.

Haque, N.U., & Qasim, A.W. (2022). Regulatory Bodies: Hurting Growth and Investment. PIDE Monograph Series 2022:4. PIDE

Haque, N.U., Qasim, A.W., & Khan, F.J (2023). PIDE Sludge Audit Volume II. Islamabad: Pakistan Institute of Development Economics.

Haque, N.U., Qasim, A.W., & Khawaja, I (2022). PIDE Sludge Audit Volume I. Islamabad: Pakistan Institute of Development Economics.

Karim Khan, 2022. Pakistan's Structural Economic Woes. PIDE in Press. https://pide.org.pk/research/pakistans-structural-economic-woes/

Mehmud, T. (2017). The Quagmire of Seth Culture in Businesses. LinkedIn https://www.linkedin.com/pulse/quagmire-seth-culture-businesses-talhamehmood/

Muhammad Faisal Ali, 2024. Islaah beyond IMF. PIDE in Press. https://www.brecorder.com/news/40314947/islaah-beyond-imf

Mukhtar, A. (2021, March 21). Corporate Culture in Pakistan. Tribune.Retrieved from https://tribune.com.pk/story/2291951/corporate-culture-in-pakistan

Nadeem Ul Haque & Saddam Hussein, 2022. PIDE's Charter of the Economy. PIDE Knowledge Brief

PIDE Webinar (2020), Retail-The Neglected Sector, PIDE Website. https://pide.org.pk/webinar/retail-the-neglected-sector/ https://www.youtube.com/watch?v=mN3xWkIK5Nk

PIDE Webinar (2020), Unpacking Investment Crisis in Pakistan, PIDE Website. https://pide.org.pk/webinar/unpacking-investment-crisis-in-pakistan/ https://www.youtube.com/watch?v=MEqd351vejw&t=5s

PIDE Webinar (2020), Why Businesses Don't Grow in Pakistan, PIDE Website. https://pide.org.pk/webinar/why-businesses-dont-grow-in-pakistan/ https://www.youtube.com/watch?v=Rl3D5EybA5o

PIDE Webinar (2023), Markets And Regulations: Why Investment Remains Low In Pakistan? PIDE Website. https://pide.org.pk/webinar/markets-and-regulations-why-investment-remains-low-in-pakistan/ https://www.youtube.com/watch?v=LexYatRp_jw

PIDE Webinar (2023), The Big Con: How the Consulting Industry Weakens our Businesses, Infantilises our Governments & Warps our Economies. PIDE Website. https://pide.org.pk/webinar/the-big-con-how-the-consulting-industry-weakens-our-businesses-infantilises-our-governments-warps-our-economies/ https://www.youtube.com/watch?v=5lVNiyudZM4
PIDE Webinar, 2023a. Book Launch: Political Economy of Bad Governance. PIDE Website. https://pide.org.pk/webinar/book-launch-political-economy-of-bad-governance/
PIDE Webinar, 2023b. Restructuring the Governance of Pakistan. PIDE Website. https://pide.org.pk/webinar/restructuring-the-governance-of-pakistan/
PIDE Webinar, 2023c. Market Institutions Governance & Development. PIDE Website. https://pide.org.pk/webinar/restructuring-the-governance-of-
PIDE Webinar, 2023d. Corruption & Anti-Corruption in Pakistan: An Introspection. PIDE Website. https://pide.org.pk/webinar/corruption-anti-corruption-in-pakistan-an-introspection/ https://www.youtube.com/watch?v=XWnB3eXhHeY
PIDE, (2021). The PIDE Reform Agenda for Accelerated and Sustained Growth – PIDE.
PIDE, 2024. Immediate Reform Agenda: IMF & Beyond. https://pide.org.pk/research/immediate-reform-agenda-imf-beyond/
Rafi Ullah, R., & Qadir, U. (2021). Increasing Space for Investment & Entrepreneurship through Reducing the Footprint of Government on the Economy In Pakistan – PIDE.
RASTA-PIDE, 2023. The State of Commerce in Pakistan: International & Domestic. Rasta Research Report. https://pide.org.pk/research/the-state-of-commerce-in-pakistan-international-domestic/
Shahid Sattar & Amna Urooj, 2023. Why Scale Matters. PIDE. Discourse 2023-03, Policy and Research https://pide.org.pk/research/why-scale-matters/
Usman Ahmad, Amena Urooj, & Uzma Zia, 2022. Business and Investment Issues in Pakistan. PIDE. Webinars Brief