THE STATE OF COMMERCE IN Pakistan

International & Domestic

THE STATE OF COMMERCE IN PAKISTAN

VOLUME 1

RASTA

PIDE Pakistan Institute of Development Economics

THE STATE OF COMMERCE IN PAKISTAN

INTERNATIONAL AND DOMESTIC

VOLUME 1

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ABBREVIATIONS AND ACRONYMS

BKTI	Banking Sector Tradable Index
BOD	Board of Directors
CBU	Completely Built Unit
CDA	Capital Development Authority
CDC	Central Depository Company
CDPR	Consortium for Development Policy Research
CGE	Computable general equilibrium
CKDs	Completely Knocked Down Units
D/E	Debt-to-Equity Ratio
DHA	Defense Housing Authority
EDB	Engineering Development Board
EFS	Export Finance Scheme
EOBI	Employees Old Age Benefits Institutions
EOU	Export-Oriented Units
EPA	Environmental Protection Agency
EPZ	Export Processing Zone
ERP	Effective Rate of Protection
FBR	Federal Board of Revenue

FDD	Franchise Disclosure Document
FDI	Foreign direct investment
FGD	Focus group discussion
FMCG	fast-moving consumer goods
FTC	Federal Trade Commission
GSMA	Global System for Mobile Communications Association
Haq/HAG	Mahbub ul Haq/Harvard Advisory Group
HBL	Habib Bank Limited
HEC	Higher Education Commission
HHI	Herfindahl-Hirschmann Index
HR	Human Resources
HS Code	Harmonized System Code
ILTFF	Islamic Long-Term Financing Facility
IMC	Islamabad Metropolitan Corporation
IPO	Initial Public Offering
ITA	International Trade Administration
KII	Key informant interview
KMI	KSE-Meezan Index

KSE	Karachi Stock Exchange
kWh	Kilowatt Hour
LFS	Labor Force Survey
LOP	Layout Plan
LTFS	Long-Term Finance Scheme
MoC	Ministry of Commerce
NBFC	Non-Banking Finance Company
NEPRA	National Electric Power Regulatory Authority
NOC	No Objection Certificate
NPL	Non-Performing Loan
NTN	National Tax Number
NTP	National Tariff Policy
OGDCL	Oil and Gas Development Company Limited
OGTI	Tradable Oil & Gas Index
ORIC	Offices of Research, Innovation and Commercialization
P/E	Price-to-Earnings Ratio
PBC	Pakistan Business Council
PBS	Pakistan Bureau of Statistics

PEC	Pakistan Engineering Council
PICG	Pakistan Institute of Corporate Governance
PIDE	Pakistan Institute of Development Economics
PIDE RAPID	PIDE Reform Agenda for Accelerated and Sustained Growth
PKR	Pak Rupee
PLI	Production Linked Incentive
PMMP-2020	Pakistan Mobile Manufacturing Policy 2020
PPL	Pakistan Petroleum Limited
PSLM	Pakistan Social and Living Standard Measurement
PSX	Pakistan Stock Exchange
PTA	Pakistan Telecommunication Authority
PWD	Public Works Department
R&D	Research and Development
RAST	Research for Social Transformation and Advancement
RCCI	Rawalpindi Chamber of Commerce and Industry
RDA	Rawalpindi Development Authority
REA	Real Estate Agent
REIT	Real Estate Investment Trust

RLCOs	Registrations, Licenses, Certificates and Other Permits
RLNG	Re-Gasified Liquefied Natural Gas
RMC	Rawalpindi Metropolitan Corporation
ROSCA	Revolving Savings and Credit Association
SAM	Social accounting matrix
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SKD	Semi Knocked Down Units
SME	Small and Medium Enterprise
STPF	Strategic Trade Policy Framework
TDAP	Trade Development Authority of Pakistan
TFC	Term Finance Certificate
UN Comtrade	United Nations Commodity Trade Statistics Database
USAID	United States Agency for International Development
USD	United States Dollar
VAT	Value-Added Tax
WRT	Wholesale & Retail Trade
WWF	Workers' Welfare Fund

PREFACE

Some history

Ever since my short stint at the Ministry of Commerce (MoC) in 2005, I have been trying to get the MoC and the thought community to take the growth of domestic commerce—services and construction—seriously as a policy objective given that it had become the largest sector of the economy. Although the idea gained credence very quickly, little has been achieved yet. My insight was that in our pursuit of mercantilist policies, this sector was neglected.[1] Yet this sector was extremely valuable in any value chain analysis.[2]

Policymakers, especially the international consultant whom we look up to, continue to regard this sector of the economy with suspicion with epithets of "illegal", "informal", and "black". No effort is made to understand their issues, their contribution to the economy and employment, and the large number of problems they face.

Since then, we have seen that this is the fastest-growing sector in the economy.

At that time, I had proposed that the MoC should prepare a State of Commerce report annually to provide an assessment and analysis of commerce—both domestic and international. The Ministry of Finance prepares the Economic Survey as a broad review of the macroeconomy. The state of commercial transactions remains relatively beyond any serious review.

After nearly 2 decades, PIDE has taken the initiative and put together a "State of Commerce" report. We hope that the MoC will review it carefully and take ownership of it and, with or without the collaboration of PIDE, make it an annual

[1] Haque, N.U. (2006). Beyond Planning and Mercantilism: An Evaluation of Pakistan's Growth Strategy. Pakistan Development Review 45(1): 3–48.

[2] Haque, N.U. (2006). Awake the Sleeper Within: Releasing the Energy of Stifled Domestic Commerce! PIDE Working Papers No. 2006:11. Islamabad: Pakistan Institute of Development Economics.

event and provide information on the state of Commerce to investors and other market participants in Pakistan.

The subject

The State of Commerce in Pakistan report is approached with the Smithian (Adam Smith) view that the GDP is the sum of all transactions at any given time or during any period. Transactions are facilitated in markets where information and contracts are speedily processed with full disclosure efficiently. The key to growing the economy lies in facilitating the maximum number of such speedy and efficient transactions. The state of markets, the transactions regime and technology, and the underlying policy regime are, therefore, important to keep under review for both the government and market agents.

Predatory government and poor policymaking are stifling commerce

The report covers all aspects of internal and external trade in Pakistan to understand markets, market players and regulations in the economy. We find that the sector, though vibrant is plagued with government interventions and suspicious. Several entities in these sectors are growing but remain unable to scale up or go international thanks to poor and excessive regulation as well as a volatile policy environment.

PIDE has over the last 3 years estimated the “footprint of the government” at over 70% of the economy. In all areas of trade as well as in most markets, the government has a heavy-handed role which is stifling growth.[3]

PIDE has also calculated the cost of regulation to be over 60% of the GDP. Much of this pertains mostly to this segment—larger than 50% of GDP. Regulation agencies are a growth industry in Pakistan.[4,5]

[3] 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.

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

Several entities in construction, retail, chain stores, food, franchises, and transport are growing despite this hostile policy environment. With better thought-out policymaking, we could expect large enterprises to reach out beyond a national footprint. Such enterprises could lay the basis for a growing and solvent Pakistan.

We have studied conglomerates and large companies to find that family-run business remains the dominant model largely because of a lack of competitive markets and the government's misguided protection and subsidy policies. In a related report on the engineering industries in the industrial triangle of Gujranwala, Gujrat, and Wazirabad, have seen that family businesses lack innovative capability as well as a professional growth culture.[6]

PIDE has presented proposals to the government for deregulation, making markets such as the much-needed real estate market as well as improving tax documentation for creating large multinational businesses. Sadly, the government remains preoccupied with borrowing and letting the lenders decide policy. [7,8]

PIDE has some research on the much-neglected R&D market and how it is dumped upon by the international consultant who is supported by international aid and lenders. This dumping on the local thought industry is seldom talked about or discussed. [9]

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

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

[7] Nasir, M., Faraz, N., & Anwar, S. (2020). Doing Taxes Better: Simplify, Open and Grow Economy. PIDE Policy Viewpoint No. 17:2020. Islamabad: Pakistan Institute of Development Economics.

[8] Haque, N.U., & Qasim, A.W. (2022). Regulatory Bodies: Hurting Growth Huring Growth and Investment. PIDE Monograph. Islamabad: Pakistan Institute of Development Economics.

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

Looking forward

Keeping in view the importance of the state of commerce, especially domestic commerce, the Pakistan Institute of Development Economics, in collaboration with the MoC, has initiated the State of Commerce in Pakistan project. This present report is the first in a planned series of reports. The current volume provides valuable insights into international trade and domestic commerce. This volume presents an in-depth analysis of the state of commerce in Pakistan, with a particular focus on the twin cities. An analysis of the state of commerce in other major cities of Pakistan – Quetta, Peshawar, Karachi, Lahore, and Faisalabad – is in the completion stage and will be published soon.

It is hoped that this report will provide valuable insights into markets and policy while also providing information on the state of transaction technology, competition and market development. The detailed information in the report will assist businessmen and investors alike in making informed decisions regarding their plans and investment activities. The report is also a concise factbook and reference source on commerce in the Pakistan economy for the Ministry's Emerging Pakistan initiative.

PIDE is grateful to various stakeholders who spared their invaluable time to contribute to the report. Special thanks are due to Mr Saqib Rafiq, President of the Rawalpindi Chamber of Commerce and Industry, Mr Asfandyar Farrukh of Hub Leather, Mr Tariq Naeem of Tanti Optics, and several other members of Islamabad and Rawalpindi chambers for facilitating in completing this report.

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EXECUTIVE SUMMARY

CROSS-CUTTING THEMES

- Pakistan lags in 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.

- Pakistan continues to follow the Haq/HAG model of the 1950s, which emphasizes import substitution and manufacturing for exports. However, the import substitution policy has failed. A recent example of the failure of the import substitution policy is the Mobile Phone Manufacturing Policy 2020: all the targets set in the Policy have not been achieved.

- The development of domestic commerce and domestic markets has been neglected in policymaking even though it is a significant source of formal and informal employment and contributes substantially to the GDP. The first-ever domestic commerce policy was formulated in 2021.

- The large size of the informal economy in Pakistan is primarily due to:
  - Too many regulations;
  - complicated documentation and registration processes;
  - complexity and multiplicity of taxes;
  - high cost of compliance;
  - the distinction between filers and non-filers;
  - adverse action by the relevant authorities;
  - fear of penalties;
  - difficult access to formal finance.

- In Pakistan, businesses do not grow and go global because the businesses, even in the formal sector, continue to use traditional methods for inventory and demand management, they do not use market intelligencand forecasting, and they concentrate on traditional products.

- In Pakistan, urban design, zoning regulations, and city planning have adversely affected businesses. There is a disproportionate focus on real estate and construction for housing, a lack of mixed-used buildings, and limited space for commercial activities. As a result, commercial areas are small, and businesses, especially domestic commerce, find it hard to find suitable commercial areas at reasonable rents.

- Pakistani businessmen are characterized by the “Seth” mentality. Most of the businesses are family-owned because the owners want to keep a stranglehold on the management. Even those companies that are listed on the stock exchange are controlled by the owners directly by keeping the bulk of shares. Pakistan’s stock market is dominated by 31 families.

- Pakistani businesses have very little global presence. There are at least two reasons for that. First, Pakistani businesses focus on traditional items and have no brand equity. Second, Pakistani businesses mainly invest in those sectors that offer incentives in different forms, such as subsidies and protection in the form of high tariffs on imports. It is a form of rent-seeking.

INTERNATIONAL TRADE

Exports

Pakistan is second, after Egypt, among the top 20 countries in terms of import duty cascading. Despite the tariff rationalization in recent years, high tariff cascading in Pakistan is a major obstacle to export growth. It makes it more expensive for businesses to produce for exports, and it makes it more difficult for them to compete in international markets.

Vietnam and India have surged ahead of Pakistan in exporting capital goods. Pakistan continues to export consumer goods and industrial supplies with a very small share of the export of capital goods.

From 2003 to 2021, the share of scientific equipment and instruments, which are considered a higher value-added category – has increased marginally from 1.2% to 1.5%.

Pakistan has made little progress in moving up the export product value chain. Pakistan's bottom 10 exports, which consist of high-value-added products, have shown little variation since 2003 showing that

Whatever little diversification that Pakistan has achieved has not contributed to substantial income growth. The 26 products that Pakistan has added to its export basket since 2005 have contributed only USD 4 in income per capita in 2020.

In Pakistan, there is little dynamism and little growth over time. Pakistan's regional comparators – Bangladesh, India, China, and Vietnam – have witnessed an increase in the concentration of export products due to the rising levels of specialization in these economies.

Pakistan still exports 65% of its products to its traditional export partners. Pakistan has made marginal progress in terms of destination diversification –

Under the Circular Debt Management Plan 2023 the rise in energy tariffs will negatively impact Pakistani firms' employment, investment, and sales revenues. The impact will be more pronounced for export-oriented firms in Punjab. **A 1% increase in electricity tariffs will decrease textile exports by 0.5% and other manufactured exports by 0.4%.**

Imports

Despite pursuing the import substitution policy for decades, there has been little to no import substitution industrialization. **On the contrary, the dependence on imported raw materials has increased over time as the ratio of imported intermediate inputs to total intermediate imports increased from 2000 to 2020.**

The effective protection rate – due to high tariffs on imported raw materials and cascading tariff rates – is the highest in the manufacturing sector in Pakistan. The high ERP results in expensive imported raw materials. The ERP is very low in the agriculture sector, while it is negative in the services sector.

Within the manufacturing sector, the automobile sector is the most protected industry. Cooking oil production is also highly protected. Unsurprisingly, it results in high cooking oil prices for consumers.

Eliminating tariffs on the top 10 import items would turn the trade deficit into a surplus by 2032. The trade surplus will increase both investment and GDP, peaking in 2032 at 2.29% and 1.32%, respectively. An across-the-board reduction in tariffs on other items may also have spillover effects on the other areas of the economy, which may result in an even greater increase in economic activity.

DOMESTIC COMMERCE

Dometic Commerce as Engine of Growth

Pakistan continues to follow the Haq/HAG mode of the 1950s at the expense of domestic commerce and domestic market development. The Haq/HAG model emphasizes industrial production, creating foreign exchange surplus through export promotion, and a large government footprint.

Despite being a fundamental and major part of the economy, domestic commerce has been a neglected sector in Pakistan compared to exports-oriented manufacturing: the first-ever domestic commerce policy was proposed in 2021.

As an economy develops, the markets become more complex. **However, Pakistan's market, including the wholesale & retail market, shows very few signs of developing into a more complex market.** For example, graduation from having supermarkets and shopping clusters (stage 2) to department stores (stage 3) requires distribution, wholesale, warehouse activity, and professional management. Although there are signs of the presence of stage 3 in Pakistan, its markets are still characterized by stage 2.

Generally, domestic commerce in Pakistan serves consumers without any convenience and with little consumer protection. The evolution of markets to higher stages requires a change in the policy framework that allows markets and different upstream industries to develop and evolve without a heavy government footprint. Although in Pakistan, chain stores and some brands have emerged, the upstream infrastructure and legal needs do not support the transition of domestic markets to higher stages.

Pakistan's domestic commerce is also hampered by urban planning, city development, and zoning regulations. **The current zoning regulations and urban planning have hampered domestic commerce in Pakistan.** As a result, space for domestic commerce, especially the WRT, is severely limited.

Domestic Commerce in Pakistan and Twin Cities

Employment and Output

Domestic commerce employs 36.02% of the labor force and contributes 52.55% to the GDP. However, despite its significance, **there is sporadic and little information about what kind of domestic commerce is happening in Pakistan is available.** Moreover, there is insufficient knowledge about how various policies and regulations affect this sector and market development.

Informality in the Wholesale & Retail Segment

A major chunk of Pakistan's domestic commerce, especially the WRT sector, is considered to be informal in the sense of offering. For example, small-scale retail stores (such as *kiryana* stores), general stores, paan shops, and other establishments, which are widely dispersed, are mostly informal. **These establishments employ a bulk of informal sector workers: 34.19% of the total informal workforce is employed in the WRT.**

The formal establishments are a very small percentage of the WRT sector. These mostly comprise supermarkets in the urban centers of major cities, major retail stores, large wholesalers, departmental stores, outlets in major shopping malls, chain stores, franchises, and major brands.

The informality in the WRT sector persists partly because of the small establishments, which lack knowledge about registration; the involvement of too many departments and authorities – **there are more than 120 regulatory authorities in the federal government alone;** the multiplicity of taxes and the high cost of compliance; treatment of some products as both goods and services;[10] **tiered taxation system that keeps a large segment of the sector in the informal sector;** fear of penalties, adverse action by FBR officers; **the distinction between a filer and a non-filer** encourages non-filers to remain out of the tax net; the state's inability to perform its fiscal responsibilities causes distrust in the state; accessing formal sector finance is not easy because of collateral requirements; the unavailability of sector-specific financial products, and the high cost of borrowing; and **a lack of space availability in commercial areas, forcing most the WRT sector to operate on the fringes.**

Size of WRT Sector in Pakistan and Twin Cities

Since the major proportion of the WRT is informal, estimating the number of establishments in this sector is a challenging task. **Nevertheless, according to the estimates of this report, there are 2.66 million WRT establishments in Pakistan.** This translates into an annual average growth rate of 4.14% since 1988. The sector's output has grown at 6.50%. **These estimates imply that the WRT sector is efficient and productive.**

The share of NTN holders as a percentage of total WRT establishments is only 17.22% and of these only 5.89% file tax returns. Although one cannot completely absolve the sector from low tax compliance, the authorities must also

[10] It makes it confusing whether the product is taxed by provincial authorities or federal authorities. Goods are taxed by the federal tax authorities, while services are taxed by provincial tax authorities.

equally share the responsibility.

In the twin cities, i.e., Islamabad and Rawalpindi, there are 49,873 WRT outlets. Garments and clothing, automobiles, and food outlets constitute around 39% of the WRT activities.

Size of Establishments

More than 50% of the WRT establishments in the twin cities are small, while less than 10% in both cities. As for age, more than 60% of the establishments are less than 10 years old. **However, the size and age are related: the analysis shows that as the age of an establishment increases, its size also increases.**

Ownership

The majority of the establishments are in rented spaces, while 35% of the establishments are operating in owned spaces.

The WRT establishment owners operate on a sole proprietorship basis as nearly 80% of domestic commerce in the twin cities is based on sole proprietorship. While there are certain advantages of operating on a sole proprietorship basis (fewer legal requirements, lower tax rates or even tax evasion, maintaining informality to avoid regulations and complete control over the operations), **the disadvantages of a sole proprietorship include limited availability of capital to expand the business, dealing with suppliers and wholesalers alone, maintaining records and inventory, and shutting down shops to visit suppliers.**

Going solo is one of the reasons that the businesses in the WRT sector do not grow. After reaching a certain size, it becomes difficult to invest capital to expand the business. Entrepreneurs avoid partnership-based businesses **because of weak contract enforcement**. The majority of businesses, or individuals, for that matter, avoid going into litigation due to high time and pecuniary costs.

Taxes

A staggering 70% of the respondents said that they do not pay any tax. Only 13% of the surveyed establishments said that they pay income tax.

Credit

To substitute for the lack of formal credit due to several reasons,[11] **an integral part of the WRT sector is rotating saving and credit association (ROSCA) schemes, commonly known as the "committee system."** The average daily contribution, as reported by respondents, is around PKR 1,500. **However, in some cases, the pot is as high as PKR 20 million.** Around 55% of the business owners participate in ROSCA schemes.

Business Management

Most of the WRT establishments do not have any system of inventory management. Similarly, the WRT establishment owners procure the products themselves rather than relying on online sources or company distributors. These factors are impediments to the growth of establishments.

Payments to suppliers and wholesalers are done in cash rather than online or other digital means because of various reasons, such as the distinction between filers and non-filers.

Running a WRT establishment is very complex as the majority of establishments think that they do not need any permission or registration, license, certificates and other permits (RLCOs) from any regulatory body because they are not aware of the number of regulators involved.

Business Growth

Financial constraint is the leading constraint stopping the WRT businesses from growing beyond a certain size. To be sure, the majority of WRT business

[11] The establishments do not use formal credit mainly because of wanting to avoid registration. However, the high rate of borrowing and the lack of specialized products for the WRT are also among the reasons.

owners want to expand their business.

While there are regulatory and structural impediments to the growth of WRT businesses, the WRT business owners are also responsible for not growing beyond a certain size. A majority of formal sector industry players, still use dated methods for inventory management and forecasting future trends, demand, and sales. Only recently after the pandemic businesses have started using more aggressive measures to collect data from different resources (such as Google Analytics, etc.) to make informed decisions about the future.

Moreover, the unpredictability of supply and slow inventory restocking cycles result in regular stockouts. Traditional retailers in Pakistan cannot get competitive prices because of being attached to one supplier. **They do not even search for alternate suppliers or products. An average retailer spends a considerable time per week on procurement alone.**

The financial constraint in growth is perhaps due to the working capital restrictions that result from investing regularly in keeping inventory. To avoid being out of stock, retailers invest more working capital into their stores.

The WRT businesses do not engage with formal financial institutions because of stringent documentation requirements and the fear of being approached by the tax authorities once registered with formal banking institutions. Moreover, various actors along the supply chain insist on maintaining undocumented and informal relations.

Since transporting goods across Pakistan is costly, most of the wholesalers restrict themselves to certain geographical locations, which results in a limited customer base. Here, the role of logistics is important, which is one of the key areas of focus in the National Domestic Commerce Policy 2022-24. Rail logistics need to be improved in Pakistan

Pakistani big retail players and brands do not use market intelligence to the extent that the rest of the world uses such tools. Chain stores, big retail companies, supermarkets, etc. do not grow and build international brands because of no access to reliable data for forecasting.

Those who are in the informal sector want to graduate to the formal sector because of the growth opportunities that the formal sector offers but they do not do so because government departments create fear in the business community. Government departments, such as the FBR and the EOBI, create unnecessary problems for traders, which wastes time and resources.

Almost every week, a government official visits the business – 89% in the case of Islamabad. Moreover, many traders are not even aware of the departments that are concerned with retail and wholesale.

Rents

In large commercial areas, a sizable portion – 48% – believe the rents to be high. One of the reasons for the increase in rents is the 2016 Supreme Court ruling disallowing commercial activities in residential areas. **This shows that urban design, zoning regulations, and small areas dedicated to commercial development in mushrooming housing societies stifle domestic commerce and market development in Pakistan.**

Finance and Banking

Stock Market

The PSX may be characterized as a silent market: low volumes, few, if any, IPOs in any year, and few individual investors. The Pakistani stock market is relatively small and illiquid compared to other emerging markets.

The market capitalization-to-GDP ratio was 10.19% in 2022, which came down from 22.11% in 2018. **The declining capitalization-to-GDP ratio is a signal that the PSX has not been an effective or preferred means of raising finances for businesses.** Rather, it is mostly used for speculative purposes.

At the PSX, mostly family-owned businesses are listed. The top 10 owners

account for 37% of the market capitalization of the KSE-100, which reduces liquidity and trade volumes, lowering market efficiency.

31 families dominate with family ownership and control.

Family-owned or founder-owned companies have a low free float because the company's shares are held by the founding family or their close associates, leaving fewer shares to be traded. **Most of the blue chip companies' free float shares ranged between 4.2% and 55% in 2021.**

The single largest shareholder in the PSX is the government accounting for over 12% of market capitalization and controlling substantial shareholding in the KSE-100.

Government and institutional ownership work in favor of family-owned businesses. **PSX's few new listings show that the stock exchange is not used to generate finances, showing Pakistani companies' desire to keep the business within the family.**

Given that most firms are family-owned businesses, it is not surprising that boards of directors are a small club of friends. **USAID created the Pakistan Institute of Corporate Governance, which regulates boards to place entry barriers and ensure that board members rotate between companies.**

Few companies pay dividends regularly.

The PSX is dominated by few big investors due to very low free-float shares compared to international practices, which creates one of the major problems of speculation.

Although debt is used for expansion and gaining a competitive edge, **in the PSX, the debt-to-equity ratio is low.** However, the capital-intensive industries have low debt-to-equity ratios showing a lack of reliance on debt for expansion.

Banking

Banks primarily lend to the government because the government debt management system is positioned in that direction.

Banks focus predominantly on the corporate sector at the expense of SMEs, agriculture, and housing.

Chain Stores

Over the past few years, Pakistan's retail sector has seen domestic brands penetrate the domestic commerce market. Many of these brands operate through the chain store retail model.

At present, there are an estimated 134 retail chain store brands in Pakistan. Out of these 134 chain store brands, 73 (54%) belong to the clothing category.

Chain store brands are mainly concentrated in larger urban centers - Lahore, Karachi, and Islamabad/Rawalpindi. **The chain store model is yet to make inroads into smaller areas as only 34% of the stores operated by chain brands are spread across the rest of the country.**

The size of chain store brands in terms of the average number of stores in Pakistan is still small. On average, the estimated 134 chain stores brands have 15 stores. The largest chain store brand has 466 stores across Pakistan.

Despite growth in the domestic market, Pakistani brands, have not been able to build their international profiles and penetrate the international markets. Only a few clothing and apparel brands have established stores in international locations, but they still only cater to Pakistani and South Asian Diasporas and have ethnic product ranges.

Only 25% of the chain store brands are registered with the Securities Exchange Commission of Pakistan as per the stipulations of the Companies Act, 2017.

Withholding tax continues to haunt businesses in Pakistan as withholding

agents and the chain store sector is no different.

Chain stores face significant costs when it comes to withholding taxes from their suppliers and other parties on behalf of the FBR. They have to hire technically proficient personnel to perform this function. And in case of any procedural or accidental mistake, they are subjected to intense scrutiny by tax authorities.

Because of the limited supply of commercial spaces in cities, it is difficult to find a suitable place at affordable rates for chain store brands to open new outlets. Thus, problems in the availability of suitable commercial space also haunt the chain store segment.

Even though shopping malls have proliferated in Pakistan, these malls are in the majority of cases not operated professionally. The owners/operators do not understand the professional nature of modern and branded retail chain store business. More often than not, services such as maintenance, security, cleaning, and integration of technology are not available in most malls.

Franchising

Pakistan was the first country in South Asia to welcome the franchising of Western companies as a modern business practice. The first franchise of Pizza Hut in South Asia was set up in Pakistan in 1993.

Though several international brands have entered Pakistan in the last two decades, the national brands have failed to go global because business conglomerates opt to invest in traditional businesses that are mostly inward-looking; the scope of marketing is limited to maximizing sales in the domestic market and profit maximization; and a lack of brand equity and no quality/value addition in products.

International brands in the domestic market trump national brands because of superior branding strategies, marketing skills, and product standardization.

More than 200 global brands in Pakistan have a collective revenue of USD 4

billion a year and collect an annual royalty of USD 0.9 billion. On the other hand, Pakistani brands have an insignificant global presence.

Pakistanis spend between USD 6 and USD 9 billion annually on food (Pakistan Food Association), **which signals a potential for Pakistani food brands to make their presence felt first in the domestic market, develop products that sell in the global market, and eventually go global.**

Business Conglomerates

The combined worth of the 42 largest business conglomerates, in Pakistan, which own 421 companies, was approximately USD 48.23 billion in 2020. In comparison, the Tata Group – the second-largest business group in India – owns 30 companies and is worth USD 311 billion. Pakistan's largest conglomerate has a total worth of USD 6 billion.

Pakistani businesses are characterized by the "Seth Culture," with a tight grip on business management. **Out of 421 companies owned by 42 business conglomerates, only 24% are listed on the Pakistan Stock Exchange.** It indicates a scarcity of Initial Public Offerings (IPOs) and limited stock trading activities in Pakistan.

Pakistan's businesses are known to thrive on rent-seeking. For this reason, Pakistan conglomerates invest primarily in conventional sectors – textiles, real estate, financial services, power and energy – because of guaranteed returns: they seek government support in the form of subsidies, tax breaks, subsidized energy tariffs, and high tariffs, among other things. This behavior discourages new entrants and prevents competition.

The export figures of the 42 conglomerates show that these businesses' main interest is in chasing incentives. **The data of the conglomerates' listed companies show that the combined exports of 39 companies of the 42 business conglomerates are USD 2.07 billion (PKR 594.35 billion).** To put things into perspective, India's Reliance Industries Limited, a company owned by India's largest conglomerate, exported products worth USD 22.91 billion in 2017.

Pakistani conglomerates' exports are mostly concentrated in traditional sectors. The value of exports of high value-addition sectors is small. **For example, the exports of the engineering sector are only USD 24.09 million. Similarly, the exports of the chemical sector are only USD 18.38 million.**

Mobile Phones

The Mobile Phone Manufacturing Policy 2020 announced to boost the local production of mobile phones has failed to achieve most of the localization targets.

- No localization of parts so far;
- the sharp decline in the import of CBUs is substituted with a sharp hike in imports of CKDs and SKDs;
- against the target of 0.2 million jobs, only 20,000 jobs have been created;
- against the target of USD 200 million FDI, so far only USD 23.38 million FDI;
- only 16,000 low-end feature phones were exported to the UAE in 2019-20 according to the PTA, while no phones have been exported to the markets identified in the Policy: Africa, Central Asian Republic, etc.

There is no evidence of R&D. Thus, mobile phone manufacturing is another industry that is being used by businesses in Pakistan to chase incentives and maximize revenues.

In the twin cities, retailers and wholesalers of mobile phones contribute significantly to domestic commerce. **The estimated sales of mobile phones in the twin cities are USD 72.1 million per annum.**

Real Estate and Construction

Plotistan – that is what Pakistan has become: the real estate market of twin cities is dominated by plots as 50 % of total real estate available on the market is in the form of plots, i.e., undeveloped land.

Poor urban planning and regulation have encouraged suburban development, leading to the abundance of housing societies and plots.

Commercial real estate, which is considered the backbone of domestic commerce and the domestic market, has a very low share in overall real estate.

Perhaps the real estate market is used for speculation: the real estate market is dominated by sale and purchase and the share of rental activity is very low.

The construction activity in the twin cities is concentrated on small projects with a fixation on housing societies. **A very small proportion of constructors – 8% in Islamabad and 4% in Rawalpindi – are registered to undertake construction projects valued at over PKR 1 billion. An even lower proportion – only 4% of the constructors in Islamabad and 1% in Rawalpindi – are allowed to handle projects exceeding PKR 4 billion.**

Contrary to popular belief, real returns from real estate show a decreasing trend. This is despite the rising prices of real estate in twin cities.

There is a significant wholesale and retail activity related to real estate and construction in twin cities: **PKR 4.9 billion in annual sales in sanitary, almost the same in hardware, PKR 4.7 billion in annual sales in electric stores, and PKR 41 billion annual sales in construction-related material, especially cement, in Islamabad only.**

19-21 tower cranes in the twin cities versus 1,345 tower cranes in Dubai: tower cranes indicate large construction projects but in twin cities, a low number of tower cranes indicates low large-scale construction activity, particularly in high-rise mixed-use buildings.

PART 1

INTERNATIONAL TRADE

1. The State of Exports of Pakistan: Stunted Growth, Lagging Diversification and Sophistication, Never-Ending Subsidization

USMAN QADIR

KEY TAKEAWAYS

- Pakistan's export promotion policy is characterized by, as usual, grand, lofty goals that have rarely been achieved in the past.
- Export facilitation schemes by different institutions always require extensive documentation (sludge) and stringent requirements, which raises concerns about the efficacy of these schemes.
- Import tariffs are used as a revenue source.
- Policy continuity has always been a concern in Pakistan. As a result, investors become wary of investing in the industry. They worry their investment will be in jeopardy if the policy will cease to operate after a change in leadership.
- In the NTP, the private sector is again ignored. The private sector is at the core of development in any economy. In policymaking, their voices should be heard.
- The NTP envisages gradual implementation of tariff rationalization, but Pakistan is at a juncture where it requires quick action.
- Pakistan has been using tariffs as a revenue measure and there is no indication that the NTP will change that significantly.
- What the world and our regional comparators are exporting, and increasingly focusing on exporting, is not what Pakistan exports or appears

to be focusing on exporting

- If Pakistan is keen on tapping exports as a source of growth, firms and the government need to tap the global export product growth markets.

- Pakistan has added 26 new products since 2005 to its export product basket and these products contributed a total of USD 4 in income per capita in 2020. Thus, Pakistan has diversified into many new products, but at too small a volume to contribute to substantial income growth of the country.

- The analysis based on Harvard Growth Lab's data suggests that, given Pakistan's current product space, it is more likely for Pakistan to produce textiles other than what it currently produces but highly unlikely that it will produce machinery, which is a complex product and has high value-addition.

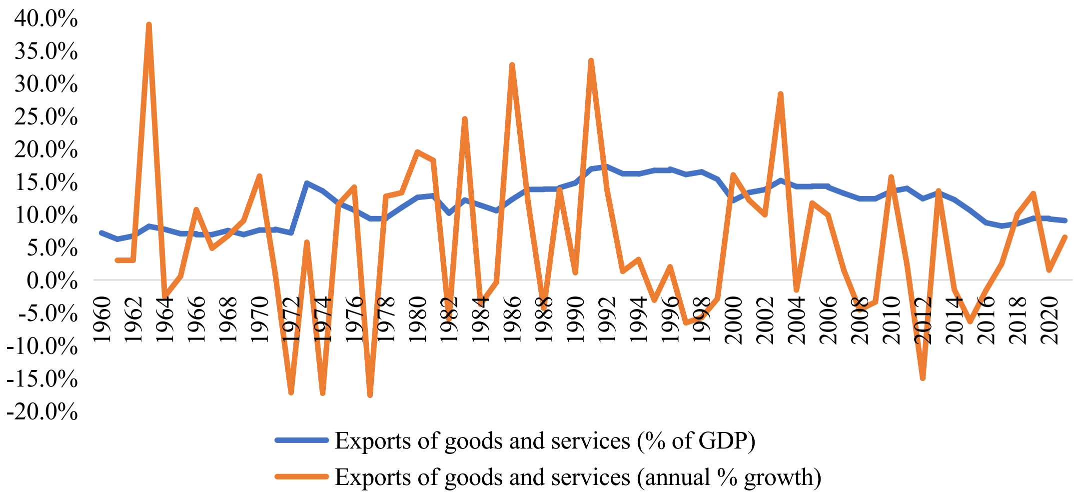
- Pakistan has not been able to make substantial gains in moving up product value chains.

- Pakistan's bottom 10 exports, which include more complex products than Pakistan's top 10 exports, have changed little from 2003 to 2021. It shows that export diversification has not taken place even after 18 years.

EXPORT PROFILE OF PAKISTAN: WHO LIKES PAKISTANI, WHO BUYS PAKISTANI

Pakistan exported products worth USD 38.96 billion in 2021. This was an increase of 29.20% over the previous year. Growth of exports over the years has been highly erratic – spiking one year and bottoming out the next, leading to a persistent trade deficit.

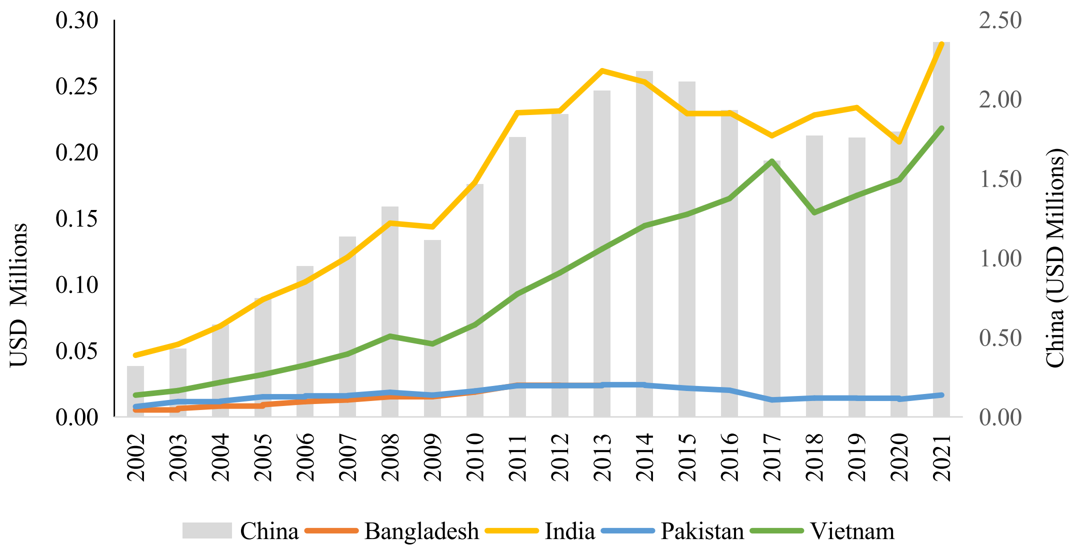
FIGURE 1.1 Historic Weak Export Performance



Source: World Development Indicators online database

Compared to its comparators, i.e., Bangladesh, India, Vietnam and China, Pakistan's exports over the years have been abysmally low. Although China now is way ahead of other countries (China's export figures are presented on the right axis), its exports were lower than Pakistan in the 1960s and the 1970s. Pakistan is behind India and Vietnam as shown in Figure 1.2. Unfortunately, the data for Bangladesh is not available for the entire period (2002 to 2021), but Bangladesh's exports have surged ahead of Pakistan's exports in recent years.

FIGURE 1.2 Lagging Performance vis à vis Regional Comparators

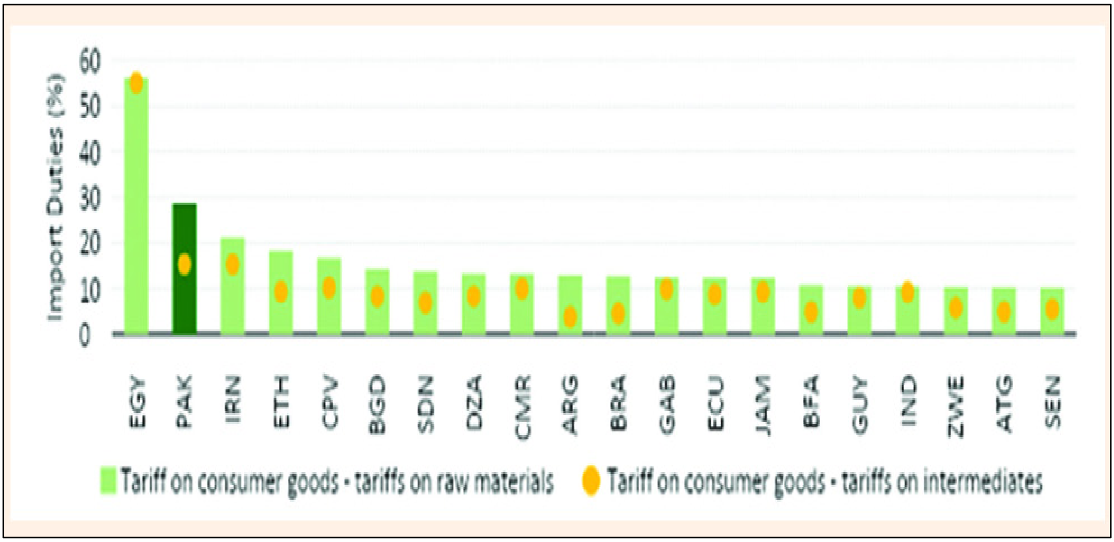


Source: World Development Indicators 2023

Economic theory tells us that import tariffs are intended to encourage the substitution of imports with domestically produced goods. However, they can also have the unintended consequence of substituting exports. When the importing country is an inefficient producer of the products, businesses will end up paying higher duties on the inputs they use, raising costs. These costs will be passed on to domestic consumers, who will end up being worse off than before.

A cascading tariff structure further worsens this anti-export bias because tariffs on raw materials and intermediates are lower than the tariffs on the final good itself. Businesses must pay a tariff for all of the individual parts being imported, effectively paying a much higher duty than would have been paid for just the final product. The high level of tariff cascading in Pakistan is a major obstacle to export growth. It makes it more expensive for businesses to produce for exports, and it makes it more difficult for them to compete in international markets.

FIGURE 1.3 Highest Import Duty Cascading: Top 20 Countries



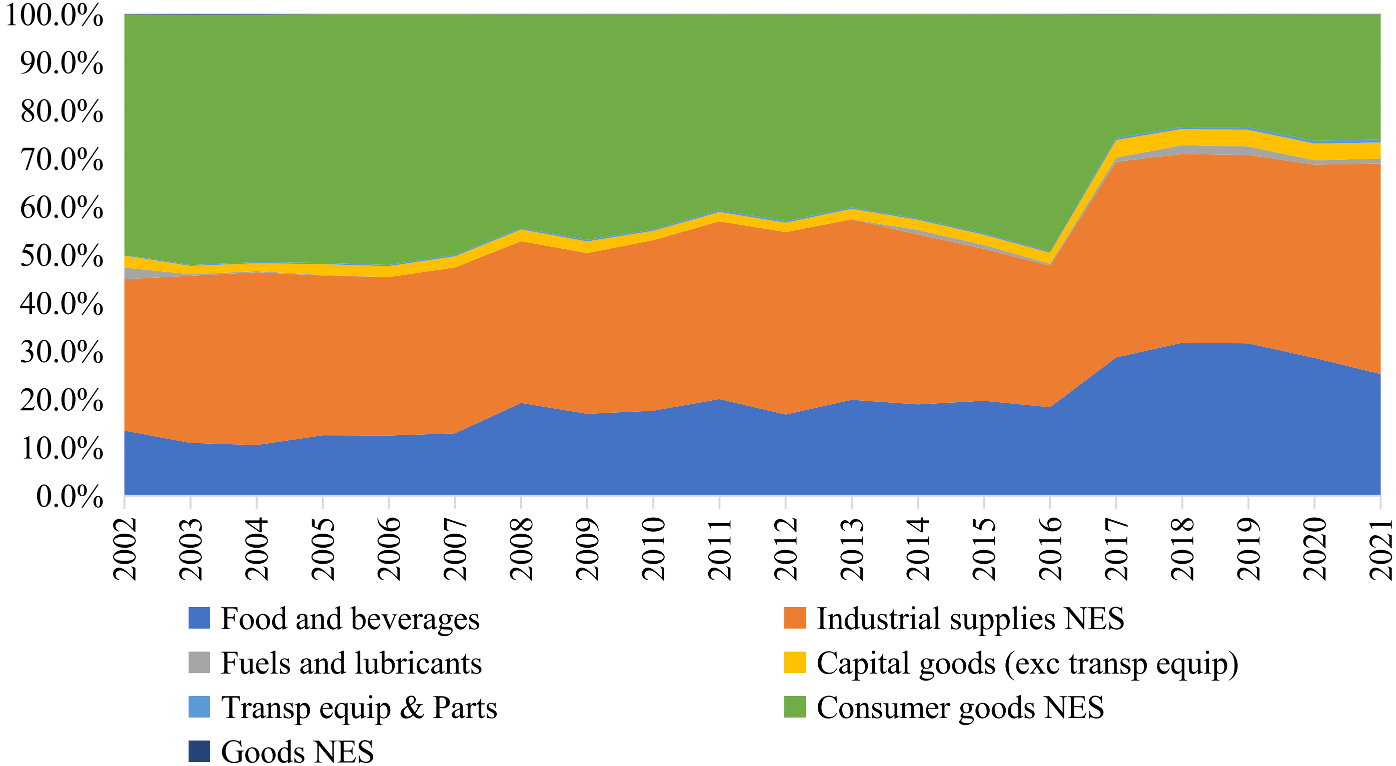
Source: Varela (2022)

Exports by Major Economic Category

Time trend

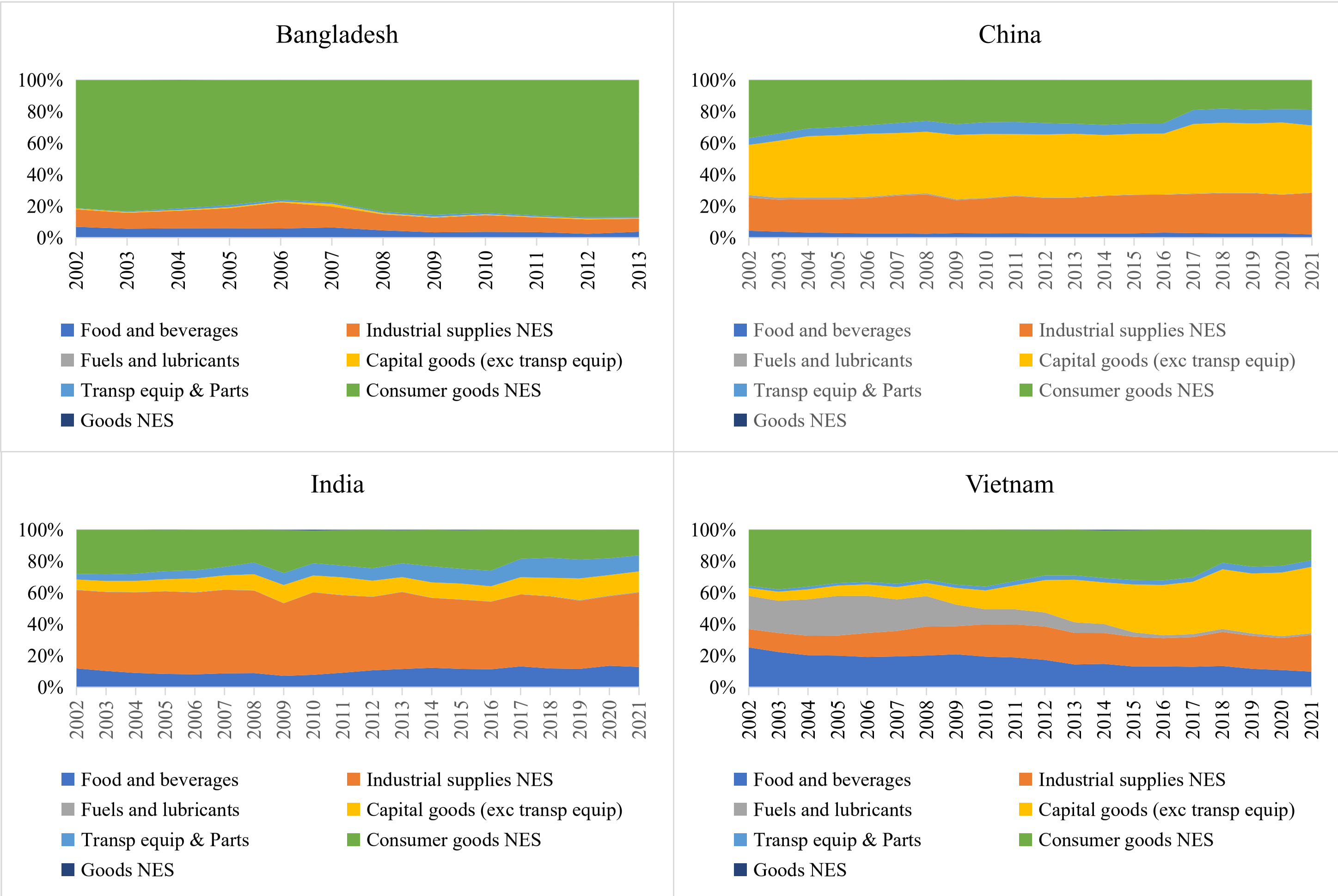
Pakistan's exports by broad economic categories during 2002-21 show food and beverages claiming a bigger share of overall exports in recent years, followed by industrial supplies, while consumer goods experienced a sharp decline between 2016 and 2017, accompanied by a fall in industrial supplies and goods. Fuels and lubricants contributed a negligible share of overall exports in comparison.

FIGURE 1.4 Pakistan Exports by Broad Economic Categories: 2002-2021 (Percent)



Source: Author's calculations based on data from the UN Comtrade online database.

FIGURE 1.5 Comparison with Comparator Nations



Source: Author's calculations based on data from the UN Comtrade online database.

Export Composition

Exports Composition: 2 Digit Level

At the 2-digit product classification level, textile yarn had the largest share (49%) of Pakistan's exports, followed by apparel at 23% and cereals at only 6%. By 2021, the distribution of the top 10 exports of Pakistan has not exhibited a substantial shift away from the traditional products, with over 32% of total exports still comprising textile yarn, followed by apparel with almost 30% share and cereals with 8% share. While the share of scientific equipment and instruments, which can be considered a higher value-added category, increased marginally from 1.2% to 1.5%, no other high value-added category witnessed a substantial gain.

WORLD'S TOP EXPORTS VS. PAKISTAN'S TOP EXPORTS

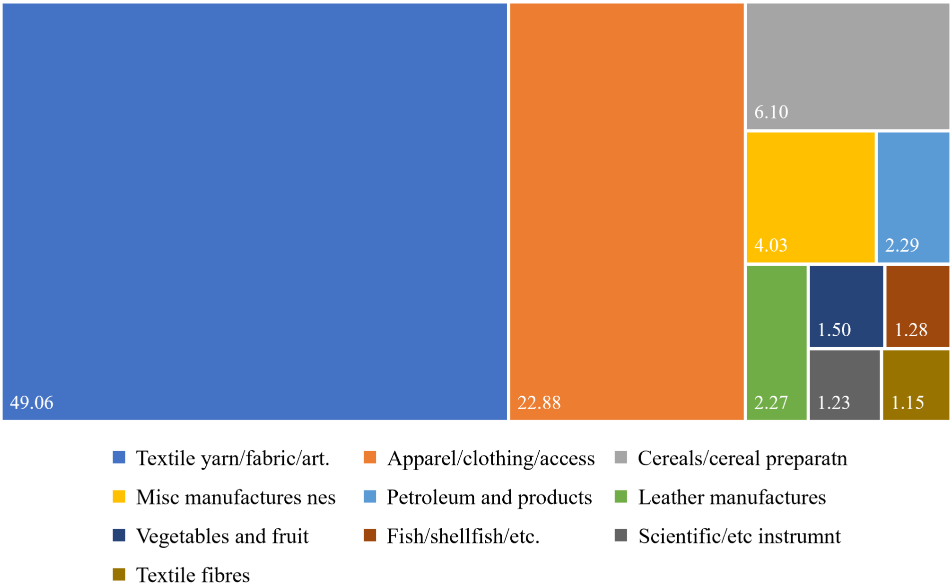
What world exports

- Electrical & electronic equipment & parts
- Machinery and mechanical appliances
- Mineral fuels
- Vehicles

What world exports

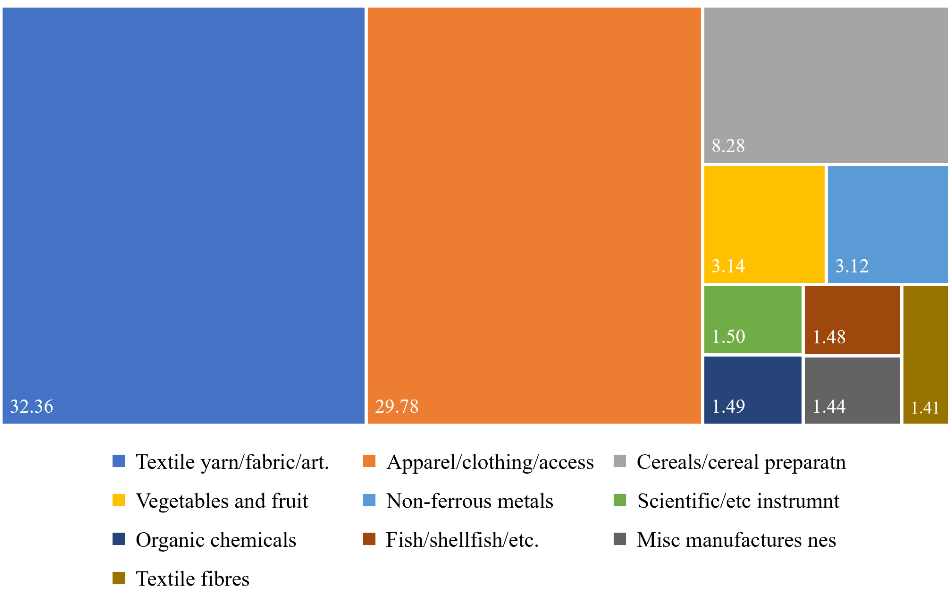
- Textile articles, rags
- Textile apparel (knitted)
- Cotton
- Textile apparel (non-knitted)

FIGURE 1.6 Pakistan's Top 10 Exports 2003: Percent Share



Source: Author's calculations based on data from the UN Comtrade online database.

FIGURE 1.7 Pakistan's Top 10 Exports 2021: Percent Share



Source: Author's calculations based on data from the UN Comtrade online database.

Export Composition: 4 Digit Level

At the 4-digit classification level, the top 10 products that Pakistan exported in 2003 were primarily textile-related products, accounting for 55% of the total exports of the country.

TABLE 1.1 Top 10 4-Digit Level Exports: 2003

Product Code	Product Description
6584	Bed/table/toilet linen
6513	Cotton yarn NES
423	Rice, milled
6531	Woven synthetic filament yarn fabric
8437	Men/boy knitted/crocheted shirt
6522	Woven unbleached cotton fabric NES
6525	Woven cotton blend <200g
8414	Men/boy trousers/etc woven
8481	Leather clothing/accessories
8947	Sports goods

Source: Author's calculations based on the UN Comtrade online database.

Export Basket: Top 10

The export basket of Pakistan in 2003 was dominated by textile yarn/fabric, contributing 49% to the total exports of the country, while experiencing growth of 20.31% for the same year. Apparel contributed almost 23% to exports and witnessed similar annual growth. These two product categories combined made up the bulk (62%) of the country's exports that year, followed by other categories dependent on the agriculture sector as well. On the surface, this suggests a fairly high degree of concentration of exports, but a clearer picture emerges when looking at the detailed, disaggregated trends in the section on export concentration below.

TABLE 1.2 Top 10 Export Product Categories of Pakistan: 2003

Product Code	Product Description	Value (USD Million)	Share in Country Exports (%)	Annual Growth (%)
65	Textile yarn/fabric/art.	5,810.85	49.06	21.32
84	Apparel/clothing/access	2,709.85	22.88	21.62
04	Cereals/cereal preparations	721.94	6.10	9.71
89	Misc manufactures NES	477.38	4.03	2.08
33	Petroleum and products	271.05	2.29	42.44
61	Leather manufactures	268.75	2.27	**-14.20**
05	Vegetables and fruit	177.73	1.50	49.80
03	Fish/shellfish/etc.	151.70	1.28	25.03
87	Scientific/etc. instruments	145.79	1.23	**-3.28**
26	Textile fibers	136.72	1.15	31.63
Total		**11,844.27**	**100.00**	**20.31**

Source: Author's calculations based on the UN Comtrade online database.

By 2021, there had been some transformation in the shares of product categories being exported. While textile yarn still accounts for the bulk of exports (32%), apparel witnessed growth of 37% and a larger share of 30% in two decades. A similar increase in another value-added category, i.e., scientific instruments, was also witnessed, but miscellaneous manufactured products are no longer a top category of exports. China is a major importer of fish and shellfish, but indications are that Pakistan has not been able to capitalize on access to that large market as the product category is no longer among the top 10 exports of Pakistan.

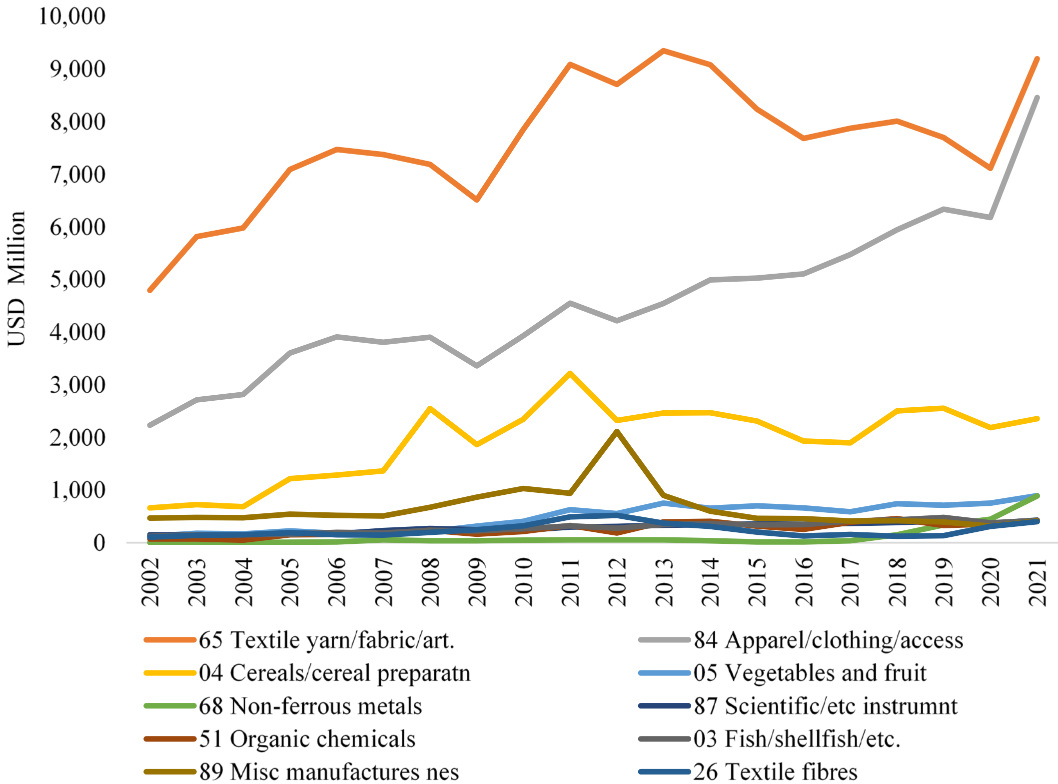
TABLE 1.3 Top 10 Export Product Categories of Pakistan: 2021

Product Code	Product Description	Value (USD Million)	Share in Country Exports (%)	Annual Growth (%)
65	Textile yarn/fabric/art.	9,188.16	32.36	29.20
84	Apparel/clothing/access	8,455.22	29.78	36.99
04	Cereals/cereal preparations	2,351.80	8.28	7.69
05	Vegetables and fruit	890.25	3.14	18.46
68	Non-ferrous metals	885.13	3.12	99.60
87	Scientific/etc. instruments	425.35	1.50	16.32
51	Organic chemicals	422.67	1.49	18.90
03	Fish/shellfish/etc.	421.14	1.48	11.75
89	Misc manufactures NES	409.27	1.44	30.46
26	Textile fibers	398.97	1.41	30.65
Total		**28,390,304**	**100**	**29.36**

Source: Author's calculations based on the UN Comtrade online database.

Pakistan's Top Exports over Time

FIGURE 1.8 Pakistan's Top 10 SITC 2-Digit Level Exports: 2002-21

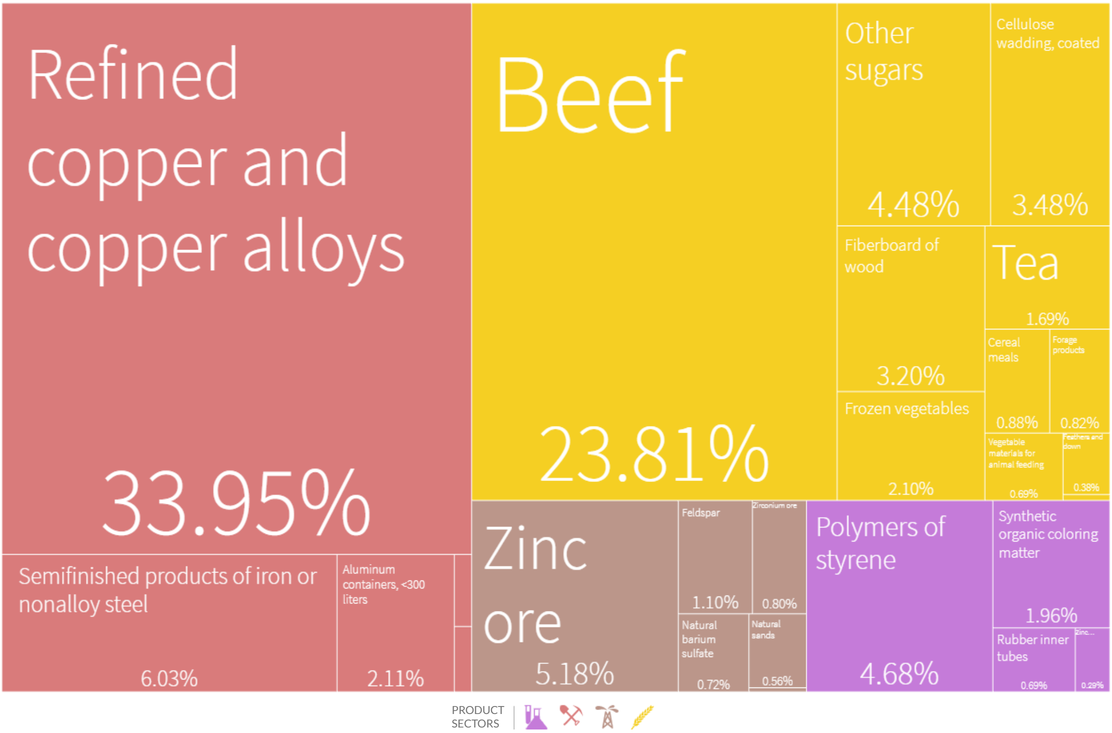


Source: Author's calculations based on the UN Comtrade online database.

Export Diversification

Economic growth is driven by diversification into new products that are incrementally more complex. Pakistan has added 26 new products since 2005 to its export product basket and these products contributed a total of USD 4 in income per capita in 2020. Thus, Pakistan has diversified into many new products, but at too small a volume to contribute to substantial income growth of the country.

FIGURE 1.9 Proportion of New Products: 2020 Export Basket



Source: Harvard Growth Labs Atlas of Economic Complexity website

Export Concentration

Herfindahl-Hirschman Index

Export diversification has many benefits for an economy, especially a developing one such as Pakistan. It ensures the stability of export earnings and dampens the impact of international price changes on the country's terms of trade. Product diversification is an indication of the rising competitiveness of the economy's output and contributes to higher economic growth through enhanced productivity and structural transformation.

PRODUCT CONCENTRATION: HERFINDAHL-HIRSCHMANN INDEX (HHI)

The degree of export product concentration can be judged from a normalized Herfindahl-Hirschmann index of the product concentration of merchandise exports at the country level. It can be calculated according to the formula:

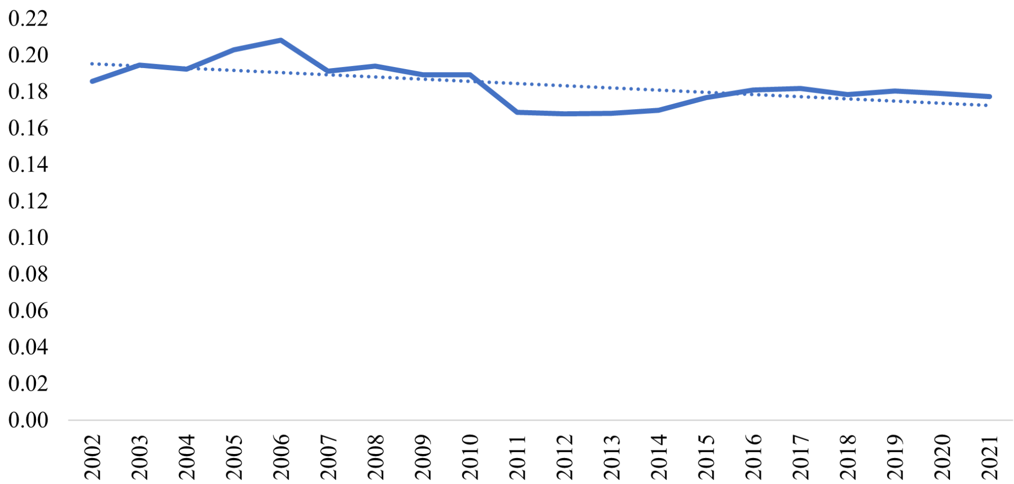
$$HHI_j = \frac{\sqrt{\sum_{i=1}^{N}\left(\frac{X_{i,j}}{X_j}\right)^2} - \sqrt{\frac{1}{N}}}{1 - \sqrt{\frac{1}{N}}}$$

Where HHIj is the product concentration index of exports for country j, Xi,j is the value of exports of product i by country j, Xj is the total value of exports of country j, and N is the number of products exported at disaggregation level 4 of the SITC product nomenclature. The HHI ranges between 0 and 1, with the closer the value is to 1 indicating a high degree of product concentration, and conversely, a value closer to 0 indicating a high degree of product diversification. At the extreme, an HHI of 1 indicates that a country's exports are concentrated in a single product, while a value of 0 indicates that the country's exports are spread equally across all products.

Export Product Concentration: Time Trend

Pakistan's export product concentration trend over the years has become more diversified, albeit very gradually.

FIGURE 1.10 Pakistan's Export Product Concentration: HHI

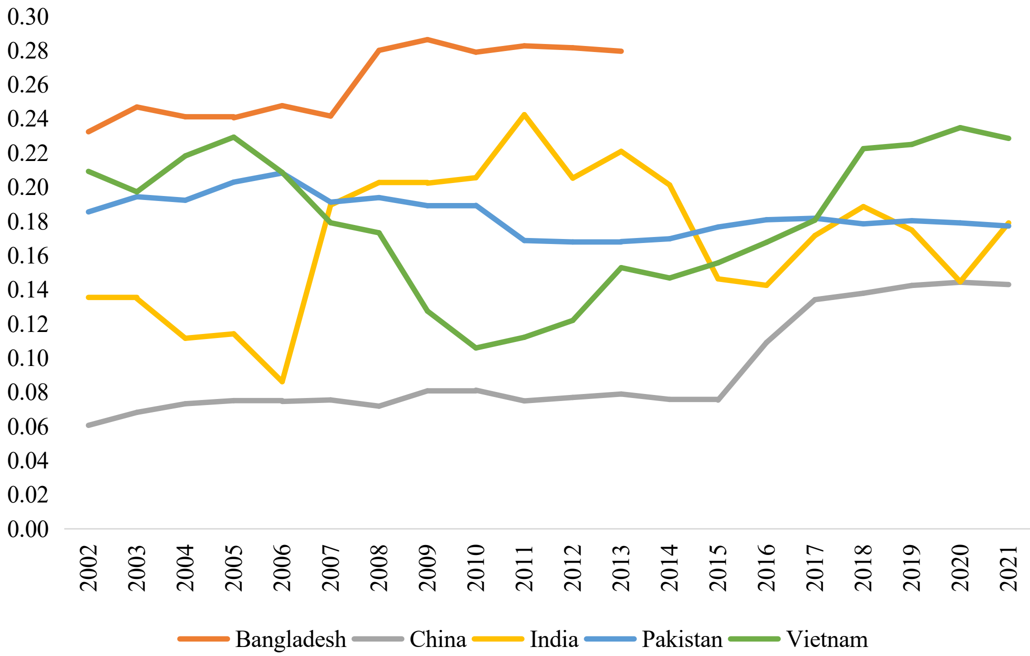


Source: Author's calculations

Comparison with Comparator Nations

In comparison, regional comparators – Bangladesh, India, China, and Vietnam – have, surprisingly enough, witnessed an increase in the concentration of export products. This is likely on account of the rising levels of specialization occurring in these economies. The move towards concentration demonstrates the dynamism of an economy over time. In the case of Pakistan, there is little dynamism and little growth over time.

FIGURE 1.11 Comparative Perspective - Product Concentration: HHI

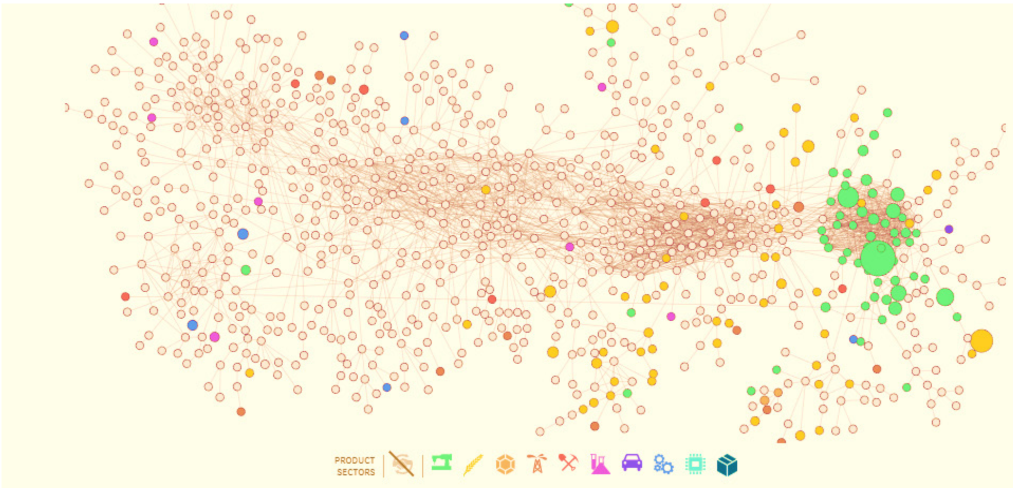


Source: Author's calculations

PRODUCT SPACE & COMPLEXITY

Harvard Growth Lab research suggests that countries tend to diversify by moving into nearby and related products or into those that require similar know-how to build on existing capabilities. Thus, the product space depicts the connectedness between products, based on the similarities of know-how required to produce them. Consider Pakistan's product space shown in Figure 1.12 below. Pakistan produces textiles (green) so it is highly likely Pakistan will be able to produce other textiles but is unlikely to share many links to the know-how required to produce machinery (blue).

FIGURE 1.12 Pakistan's Export Product Space



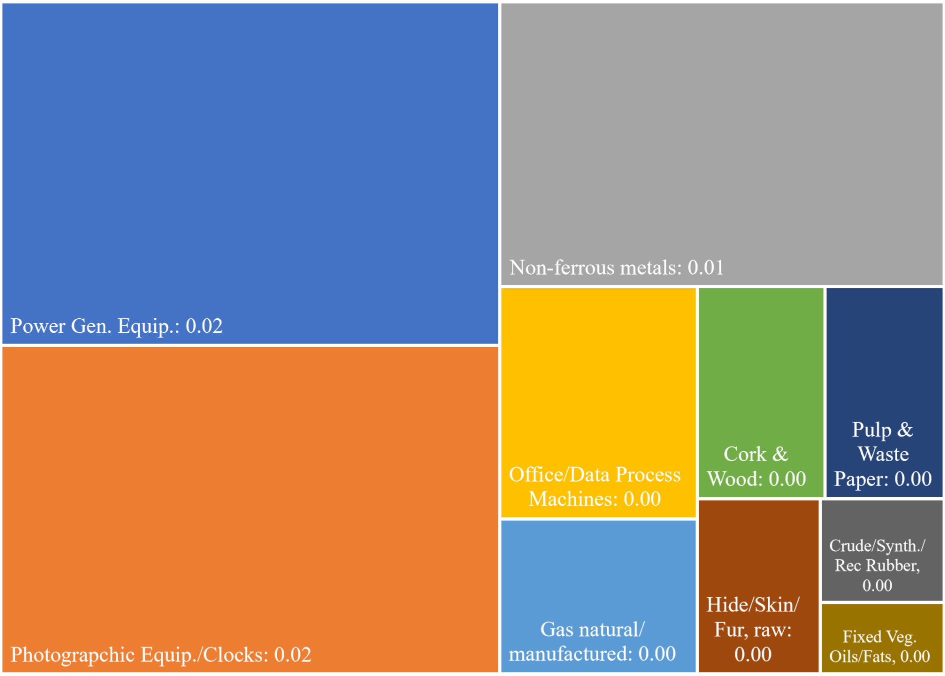
Source: Harvard Growth Labs Atlas of Economic Complexity website

Export Basket: Bottom 10

The mix of products that Pakistan has historically exported more, as represented by the top 10 products with the highest share, has shown little variation over time. Product concentration trends as reported by the Herfindahl Index (Figure 1.11) support this view. The question then is what has happened to the products at the bottom of Pakistan's export basket. Has there been any change in the mix of products that contribute the least to exports (in terms of share in total exports)?

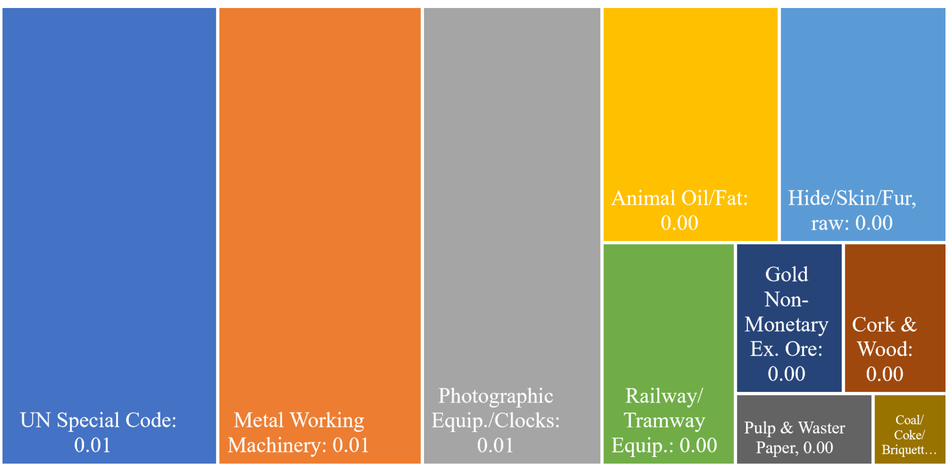
A look at the distribution of 10 products with the smallest shares in Pakistan's exports shows that the basket is dominated by relatively higher value-added products such as power generating equipment, photographic equipment and other machinery, and manufactured products (see Figure 1.13 for the distribution of bottom 10 exports in 2003 and Figure 1.14 for a look at the bottom 10 exports in 2021). In line with the preceding discussion of exports trends, by 2021 there has been little change in the share of goods at the bottom of Pakistan's export basket. This supports the argument that the economy has not been able to make substantial gains in moving up the product value chain.

FIGURE 1.13 Pakistan's Bottom 10 Exports 2003: Percent Share



Source: Author's calculations based on data from the UN Comtrade online database.

FIGURE 1.14 Pakistan's Bottom 10 Exports 2021: Percent Share

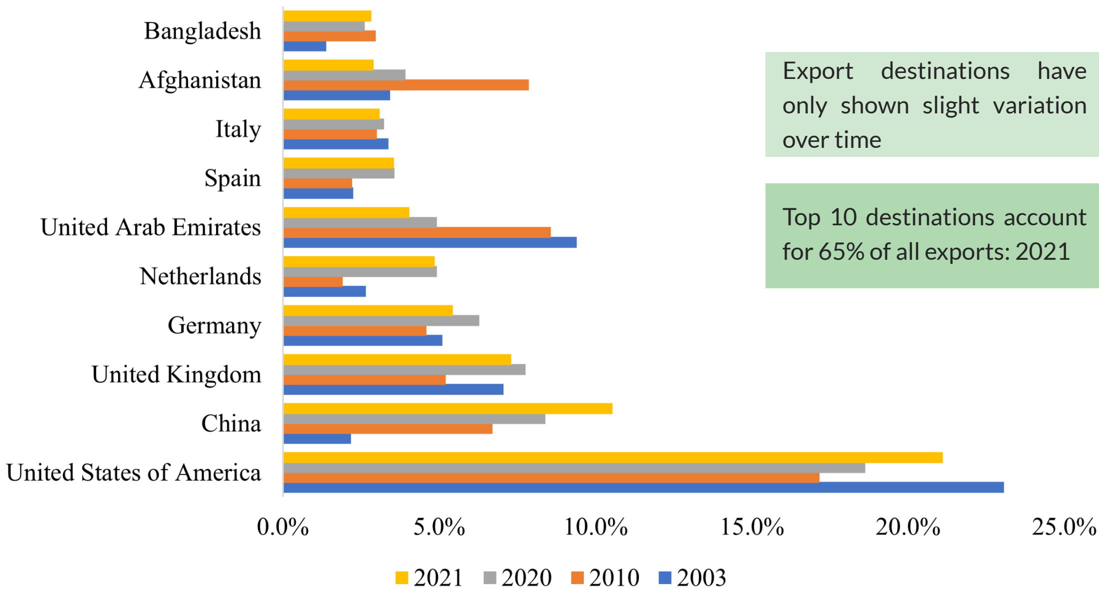


Source: Author's calculations based on data from the UN Comtrade Database

Export Destinations: Top 10

In terms of export destinations, Pakistan's export market has traditionally been the developed countries of the West (the US and Europe), regional economies, such as Bangladesh and China, and the Middle East. However, over time there has been a slight shift in the destinations away from the traditional economies, but the top 10 destinations still accounted for over 65% of all exports in 2021.

FIGURE 1.15 Pakistan's Top 10 Exports Destinations: Percent Share

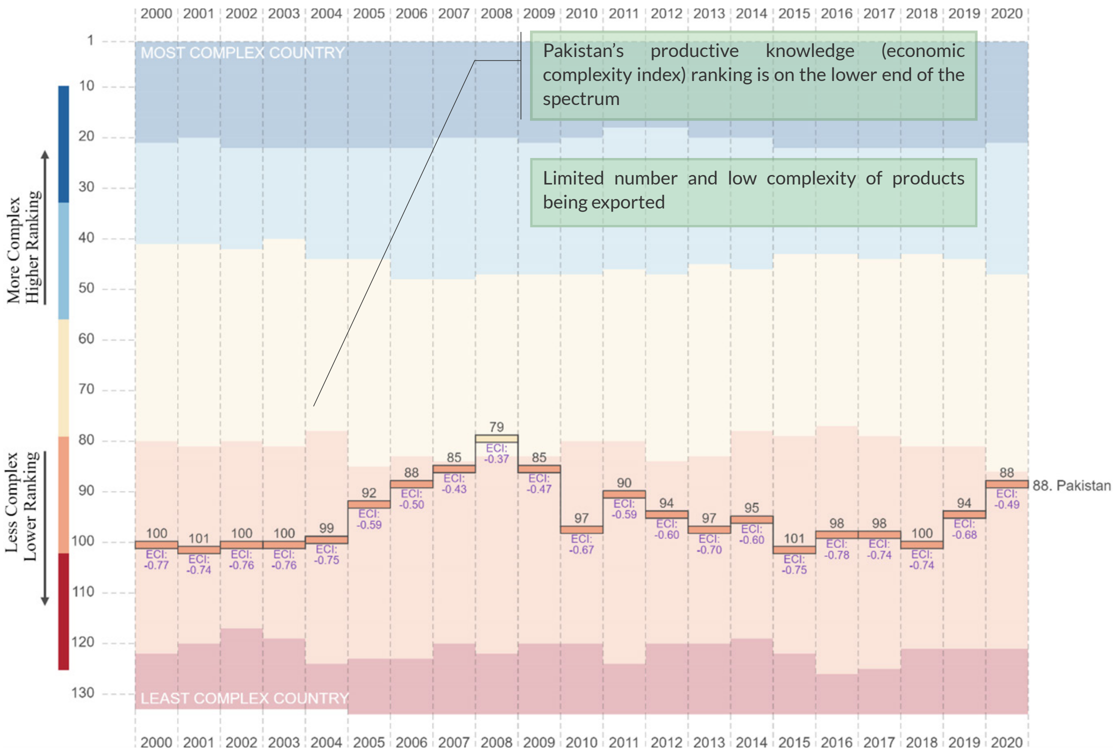


Source: Author's calculations based on ITC Trade Maps data.

Export Product Complexity

According to the Atlas of Economic Complexity maintained by Harvard Growth Labs, and based on the methodology pioneered by Hausman and Hidalgo (2010), the current state of Pakistan's productive knowledge, i.e., economic complexity index ranking, is on the lower end of the spectrum, suggesting that the number and complexity of the products successfully exported by the country are low.

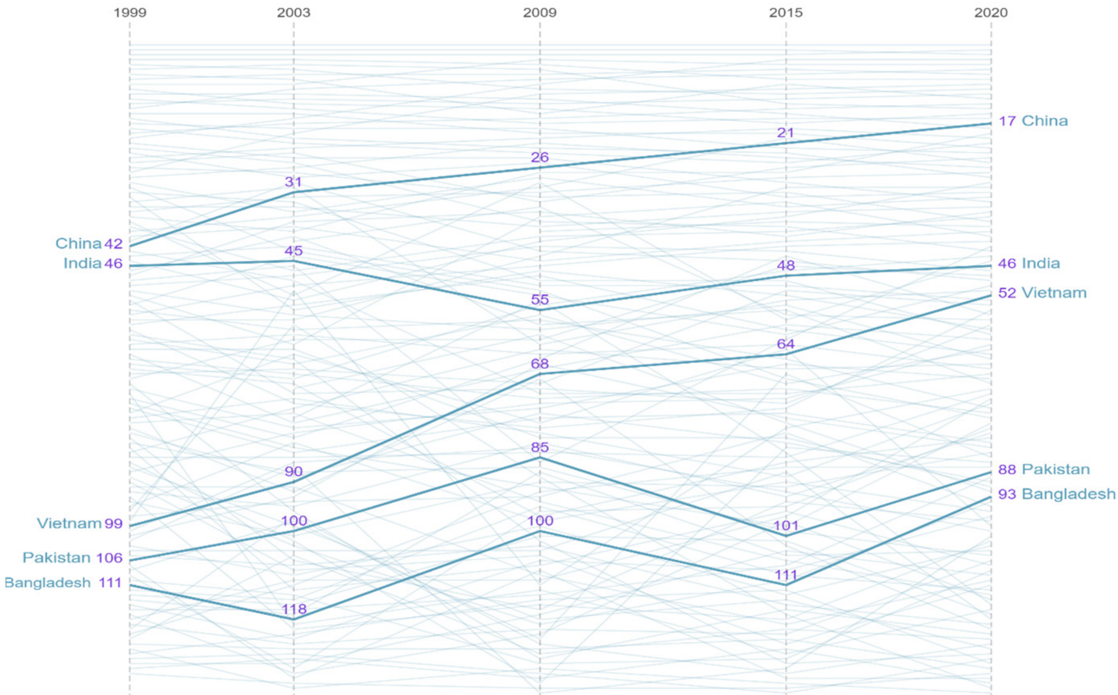
FIGURE 1.16 Product Complexity - Pakistan



Source: Harvard Growth Labs Atlas of Economic Complexity

This trend is also borne out by a comparison of rankings among regional comparators. While India maintained its complexity ranking over the period 1995 to 2020, both China and Vietnam exhibited strong performance, rising 25 points and 47 points respectively. Even Bangladesh posted an improvement of 18 points.

FIGURE 1.17 Economic Complexity Ranking of Exports Over Time: Comparative Perspective



Source: Harvard Growth Labs Atlas of Economic Complexity

BOX 1.1 Pakistan's Exports Dynamics

- Pakistan has not yet started the traditional process of structural transformation.
- The economy has not started reallocating economic activity from low to high-productivity sectors.
- Activities are not moving out of agriculture into textiles, followed by electronics and/or machinery manufacturing.
- Global market share in textile exports in Pakistan has stagnated over the previous decade; electronics and machinery have yet to take off in Pakistan, limiting its income growth.

- Pakistan's export dynamics in recent years have been driven by the agriculture sector.
- Agriculture sector exports are on a decline which is limiting economic growth on account of concentration in a declining sector of global exports.
- Limited opportunities require a Parsimonious Industrial Policy Approach (Harvard Growth Lab) - addressing bottlenecks to allow the country to diversify into related products.

In terms of product complexity, Pakistan's top 10 most complex products range from knives and hand tools at the high end, to electric generating sets at the low end. Bangladesh exports products ranging from vending machines and eyewear frames at the high end to bicycles at the low end, while India exports a variety of complex products from the chemicals group and hot rolled steel.

ENERGY REFORMS FOR EXPORT-ORIENTED UNITS IN PAKISTAN

Pakistan's export-oriented industry is facing many challenges due to an uncertain macro environment and political instability. These things coupled with the high cost of doing business, of which the cost of energy is a major chunk, are gradually eroding the competitiveness of the Pakistani industry in general and export-oriented units (EOUs) in particular.

Changes in energy prices generally have implications for the competitiveness of economies. A more profound concern is the disparity in the availability and prices of energy among the industrial units of some regions might erode their productive efficiency, eventually leading to deindustrialization.

Circular Debt Management Plan 2023

The Circular Debt Management Plan 2023 aims to reduce the country's growing circular debt by discontinuing the electricity tariff support for zero-rated industries. The annual rebasing of nearly PKR 5 per unit for 2023-24 and PKR 7.91

per unit for 2022-23 under the IMF standby arrangement will increase the base tariff (between PKR 3/KWh to PKR 7.50/KWh) for different consumer categories, leading to more than a doubling of the tariff for Bulk Power Consumers (B3 and B4). However, the rebasing will not affect the protected consumers.

Gauging the Impact of Tariff Adjustment

Malik and Mustafa (2023) have explored the efficiency of tariffs and their effect on investment, employment, and revenue for various manufacturing industries. The study examined data from 335 firms divided into two groups, namely, exporting and non-exporting. These groups were further subdivided into seven major manufacturing groups: (i) textile, (ii) petroleum, (iii) chemical, (iv) food, (v) cement, (vi) electronic, and (vii) other manufacturing.

The study has also evaluated the potential impact of removing government electricity tariff support and maintaining varying gas prices on the textile and clothing industry. Moreover, the study has projected the impact of gas/RLNG-based and NEPRA-determined energy tariffs (that is, greater than regionally competitive tariffs) on 47 export-oriented textile firms.

Major Findings

The analysis shows that:

Overall Impact on Firms

The rise in energy tariffs will negatively impact firms' employment, investment, and sales revenues regardless of the firm's export orientation, but the impact will be more pronounced for EOUs in Punjab.

Effect on Industrialization in Punjab vs Sindh

Increasing energy costs will result in layoffs, decreased investment, lower export revenue, and significant profit margin contraction, leading to early deindustrialization in Punjab. However, the change in industrial electricity tariffs will not significantly affect textile EOUs in Sindh as they already benefit from a competitive electricity tariff through local gas-based captive power plants.

Effect on External Competitiveness

To countercheck, the study has also explored linkages between energy (electricity) tariff changes and external competitiveness of EOUs at the macro level and finds a robust negative association between export growth and energy tariff increase. A 1% increase in electricity tariffs will decrease textile exports by 0.5% and other manufactured exports by 0.4%.

Cross-Subsidization

While analyzing the tariff, the study finds that the recent rise in electricity prices is a cross-subsidy from the industry to other sectors. This practice has no legal, economic, or technical justification.

Gas Price Differential

The gas price difference between the EOUs in Punjab and Sindh is causing issues for Punjab's industrial units. The limited availability of gas also affects the competitiveness of Punjab's EOUs. After analyzing the tariffs, it was found that providing cheaper gas to Sindh is not economically efficient due to the depletion of indigenous gas resources.

Policy Suggestions

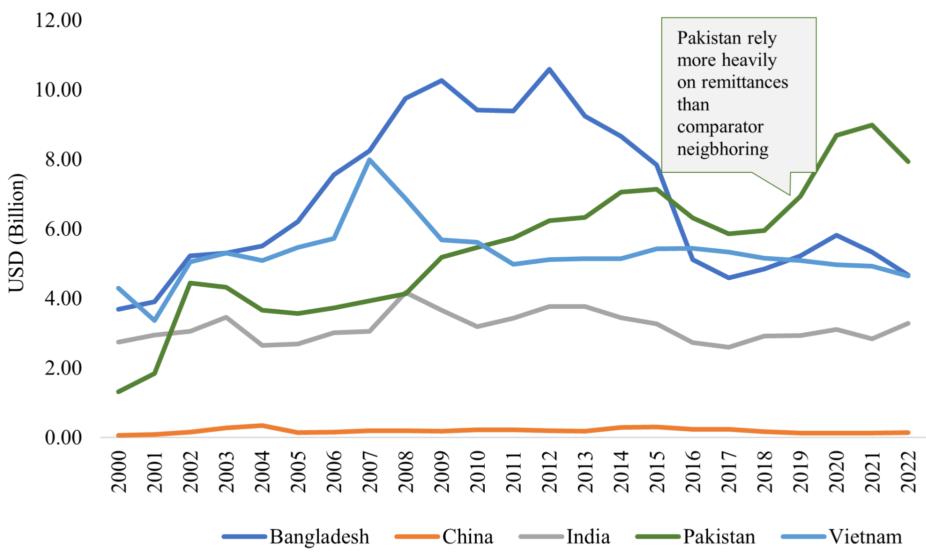
The study suggests that the tariff mechanism in Pakistan needs to be reconsidered to lower electricity prices. The recommended approach is to establish a tariff system based on the service cost for all consumer categories, without cross-subsidies. The most effective method would be to adopt a flat linear tariff but vary it based on the service cost for each consumer category or geographical area. Furthermore, allowing open access to all market participants on a non-discriminatory basis can reduce energy costs and improve supply for industrial consumers in the country.

It is necessary to reconsider the policies for pricing and allocating natural gas in Pakistan. The sector should be deregulated, and the pricing structure should be liberalized, allowing all consumers to compete for market share. A market-based pricing system would also reduce the gas price differential between industries in Punjab and Sindh. The power industry should be prioritized in getting a share of indigenous gas to reduce overall electricity generation costs.

MANPOWER EXPORTS AND REMITTANCES

Pakistan has been grappling with the ongoing challenge of foreign exchange shortages for a long now. This predicament has triggered economic cycles of growth and decline, which raise concerns about growth sustainability. Worker remittances, which reached a substantial USD 31 billion in 2021-22, constitute the primary source of funds that bridge this deficit. To put it differently, the absence of remittances, amounting to a significant 9% of GDP, would have led to external payment defaults several years ago. The share of remittances for comparator economies is much less but has been stable over time, but not so in the case of Pakistan (Figure 1.18).

FIGURE 1.18 Remittances as Percent of GDP: Pakistan & Comparator Countries (USD Billion)



Source: World Development Indicators online database

When dissecting the composition of foreign remittances, it becomes apparent that the majority of funds sent by overseas Pakistanis come from low-skilled workers. These individuals predominantly occupy roles in labor-intensive sectors in oil-rich countries, such as drivers, domestic workers, construction laborers, and retail workers. This trend underscores a lack of government efforts to elevate the skills of these individuals, leaving them with limited alternatives beyond physically demanding work.

BOX 1.2 Pakistan Manpower Exports

- Pakistan's manpower exports touched 0.83 million in 2022, mainly to Saudi Arabia and the UAE.
- The Gulf market has traditionally absorbed around 77% of Pakistan's skilled labor force. Since 1971, over 12.7 million people have been exported to about 50 countries.
- During the COVID-19 pandemic, the overall Pakistani export of manpower suffered when numerous international companies laid off workers.
- Government officials in Pakistani believe country can export up to one million workers per year. This is provided that the labor market improves further, and the effects of the coronavirus pandemic continue to erode.

Remittances are a double-edged sword. On the one hand, they provide much-needed foreign exchange. On the other hand, they also represent the inability of the domestic economy to fully utilize the available labour force to its full potential. Unable to find meaningful work in Pakistan, workers are willing to leave and search for opportunities abroad.

Regrettably, Pakistan has yet to implement effective strategies to address this issue, persistently opting for short-term solutions by relying on external assistance and favorable circumstances to bridge the gap. Reforms must be implemented to reverse this situation, including but not limited to providing more opportunities to the young and the poor. PIDE's research underscores the imperative of involving the youth in the domestic economy and establishing avenues for their engagement and advancement.

POLICY AND REGULATORY FRAMEWORK FOR EXPORTS

Pakistan's strategic trade policy framework is primarily guided by the Strategic Trade Policy Framework (STPF) developed by the Ministry of Commerce and the Trade Development Authority of Pakistan (TDAP). The STPF sets the direction and objectives for Pakistan's trade policy, focusing on promoting exports, enhancing competitiveness, and addressing trade-related challenges.

STPF 2020-25 Review

Targets

According to the STPF 2020-25 document, export projections in the current framework are based on a partial equilibrium econometric model rather than the (seemingly) arbitrarily set targets of past frameworks. The core focus of the framework is on enhancing the country's geographic and product diversification, tariff rationalization, the pursuit of regional connectivity, and Look Africa policy as a means of enhancing market access.

Aims

The guiding principles of the strategic trade policy framework are:

- tax and duty-free exports;
- to make administrative measures simplify, reliable, transparent, and automated;
- introduce a performance-oriented, and time-bound mechanism for export-related incentives to increase exports of the priority sectors; and
- offer regionally competitive energy prices for export-oriented sectors and design an institutionalized mechanism for robust monitoring and implementation of the STPF to minimize the policy implementation gaps,

which have traditionally remained a weak link due to multi-organizational roles in the export ecosystem.

Salient features

Barring unexpected circumstances, it was expected that the export targets set for the next five years would be achievable compared with the targets set in past policies. Exports were targeted at USD 31.20 billion for fiscal year 2022, and actually amounted to USD 31.78 billion, thus exceeding the target set. The framework also identifies priority sectors for export promotion and strategic interventions and designates the STPF as a living and dynamic document subject to changes based on constant monitoring and evaluation.

Drawbacks/Shortcomings

The STPF 2020-25 has the potential to boost exports of Pakistan, but it remains to be seen if the country is committed to learning from past experiences and improving upon them to achieve the goals of the framework. The process of simplification and streamlining the complicated regulatory environment, in particular, is a daunting task given the experience of similar efforts.

National Tariff Policy Review

Aims

The National Tariff Policy (NTP) 2019-24 has been framed to remove specific distortions and boost productivity in the economy.

Objectives

- To improve the competitiveness of manufacturing, including the export sector, through duty-free access to imported raw materials by rationalizing the tariff structure.

- To increase employment opportunities by attracting efficiency-seeking investment in the manufacturing sector by making the tariff regime transparent and predictable.

- To lessen the distortions in the domestic price structure and improve consumer welfare by reducing the burden of excessive protection.
- To remove anomalies in the tariff structure, which is causing distortions between sectors and in the value chain of the same sectors.

Salient features

- The policy recognizes the key role tariffs play in economic activity and identifies specific objectives and principles which are achievable if implemented well.
- The policy is right to shift the focus of tariffs from revenue generation to optimal allocation of resources.
- The policy objective of removing anomalies in the tariff structure is long overdue and should have a positive impact on economic activity with greater transparency and predictability.
- The principle of reducing exemptions and concessions is to simplify the tariff structure and reduce loopholes should reduce unproductive activity in the economy.

Drawbacks/Shortcomings

- The policy assumes that competitiveness will improve because of rationalizing the tariff structure, which might not necessarily happen.
- It is not clear how the policy objective of removing distortions in the domestic price structure will be achieved through tariff rationalization. A mechanism needs to be in place to ensure the benefit is passed on to consumers. There are several examples in the past where the benefit was not passed on.
- The principles of strategic protection and competitive import substitution overlap and could achieve the desired outcome if they are implemented

soundly. This infant industry argument requires a developmental state or development-centric state with credible actions by the state and incentives to be performance-based. However, experience in the past with this approach is not all positive; it will depend on the nature of political settlements and the political landscape in the economy.

- The continuity of the policy is a concern. Productive investment is unlikely to increase if the policy ceases to operate after a change in leadership.

- Implementation and arrangement of the policy need to incorporate and involve the EDB as they have experience in interacting with the private sector for time-bound protection.

- There is no mention of the private sector and whether Chambers or other private sector stakeholders will have any voice.

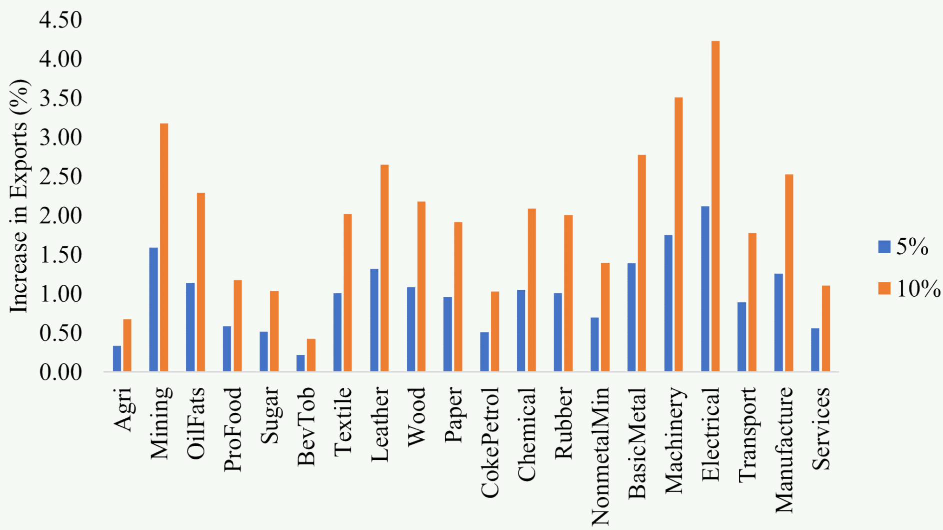
- The power to charge tariffs and impose regulatory duties will be taken away from the Customs Department and it will be placed with a special cell to be constituted under the Commerce Division. Moreover, the NTP states clearly that the power to set tariffs will be taken away from the FBR which has used it more as a revenue measure than one aimed to promote trade and exports. A regulatory issue may arise here and the new cell may take time to absorb the intricacies of policies.

- The government is already passing through difficult economic challenges. The economy is facing recession and to boost the industrial sector and growth, gradual measures are committed. It is time to adopt speedy policy measures.

- The NTP makes no mention of which segments/sectors might be the winners and losers in the whole exercise.

- The NTPF states FBR has used tariffs more as a revenue measure instead of promoting trade and exports. Mostly in developing countries, tariffs are used as a revenue measure. The commitment in this policy shows that, to some extent, tariffs will continue to be a revenue measure.

TARIFF REDUCTION IMPACT ON EXPORTS BY PRODUCT GROUP



PIDE research shows exports increase across the board with a tariff reduction, with greatest benefit to value added product groups – a finding that is consistent with research and findings from other local as well as international researchers.

Source: PIDE research

Regulation and Subsidy Galore

There are several regulations and subsidies in the Pakistan economy related to exports of which three key schemes are highlighted here, namely, Export Processing Zone (EPZ) Rules, Export Finance Scheme (EFS), and Long-Term Finance Scheme (LTFS). These schemes have been pursued to subsidize exports or push exports, but the result of this intervention has been a proliferation of illicit activities including export mis-invoicing. As demonstrated by Mahmood and Azhar (2001), this has resulted in substantial losses to the domestic economy.

FEDERAL BUDGET AND TRADE FACILITATION AND PROMOTION

There are a total of 8 organizations listed in the budget allocation documents whose activities are directly related to trade promotion and facilitation. 55 commercial sections and embassy offices are also listed in the documents, accounting for PKR 5,393 million of the total budget. A stock taking of these organizations must be done to ascertain whether Pakistan is getting best value for our limited and scarce resources.

Category	Budget Heads	Budget Allocation (Million PKR)	
		Total	Shares (%)
Trade Support Organizations	8	3,316	61.48
Commercial Sections	55	2,078	38.52
Total	63	5,393	100.00

Source: PIDE Research

According to Haque and Kemal (2007), the impact of the EFS on exports has been insignificant. The reasons attributed to this weak performance include (i) schemes not being well targeted; (ii) cumbersome administration; and (iii) rent-seeking opportunities. Given the questionable performance of these schemes, it defies logic as to why there has been no systematic evaluation or assessment of these interventions.

Export Processing Zones Rules

Import of goods into the zones

An EPZ shall retain machinery for five years from the date of its import into the zone. The export processing zone shall be allowed to dispose of machinery in the tariff area after filing the Goods Declaration subject to the fulfillment of conditions of the Import Policy Order upon payment of duty and taxes on specific terms (see Table 1A.1 in Appendix 1A for details). Similarly, the import of vehicles shall be allowed without payment of customs duty and other taxes as per the entitlements allowed according to EPZ rules (see Table 1A.2 in Appendix 1A for details).

Subject to a maximum of one motor car of up to 1,600 c.c. within the number of vehicles allowed and shall be further subject to the verification of the amount of investment and completion of the project within three years by the EPZ Authority. Units employing up to 25 workers will be allowed to import or purchase one coaster while units employing more than 25 will be allowed to import or purchase a bus with up to 50 seats. Similarly, units with a turnover of USD 5.00 million or more per annum will be allowed to import or purchase one cargo vehicle or truck.

Export of goods from EPZs

The plants created in the EPZ except for M/s Al-Tuwairqi Steel Mills Karachi may export up to 20% of their entire production to tariff areas in Pakistan, with the remaining 80% going abroad. The supplies made from the EPZ to the tariff area under SRO 492(I)/2009 dated 13.06.2009, the DTRE scheme, the Manufacturing Bond scheme, or the EOUs scheme shall not be counted toward the requirement of supplying 20% of the total production to the tariff area, as these supplies are made to produce goods that will ultimately be exported outside of Pakistan.

Procurement, manufacture, export, and removal of goods by a licensee

The disposal of plant, machinery, equipment and apparatus before the expiration of five years shall be subjected to reduced rates of duty and taxes leviable at an EOU at the time of importation and provided also that the replacement parts of machinery and spares shall be allowed removal after three years from the date of importation from EOU subject to mutilation or scrapping under the supervision of an officer not below the rank of Assistant Collector.

State Bank of Pakistan: Export Finance Scheme

Operations of the scheme under Part-I

Banks shall extend the financing facility under the EFS to direct/indirect exporters for pre-shipment and post-shipment (to direct exporters only) based on the production of the specified documents by the exporter concerned. (The details are given in Table 1B.1 in Appendix 1B).

Submission of required documents

Shipping documents are required to be submitted by the direct/indirect exporters to the bank concerned (see Table 1B.2 in Appendix 1B).

Fines under EFS Part-I

The SBP has detailed the fines that must be paid by exporters according to the nature of the irregularity, but the motivation and purpose of these fines are not readily apparent (see Table 1B.3 in Appendix 1B).

Islamic long-term financing facility for plant and machinery

Islamic Long-Term Financing Facility (ILTFF) is designed for plant & machinery sectors eligible for financing under the scheme. Only new plants, machinery, and equipment to be used by the export-oriented projects in the following sectors for producing exportable goods shall be eligible for financing under the scheme. The categories that can avail the facility include traditional export sectors of the country, ranging from textiles and garments, rice, leather, sports goods and carpets, not to mention surgical goods. Several developmental categories are also defined with specifications of the criteria for availing the facility (see Table 1B.3 in Appendix 1B).

Finally, there is a list of items from other sectors and sub-sectors which are also eligible for the facility, which highlights the extensive degree to which the facility applies to only specific items (see Table 1B.4 in Appendix 1B for further details). Given the limited industrial base and structural transformation in the economy and the stringent requirements of the facility, the number of firms successfully availing the ILTFF is limited. How successful firms would be in securing the financing facility given these stringent requirements remains to be seen.

Long-term financing facility (LTFF) for plant & machinery

Scope and Eligibility

The State Bank of Pakistan (SBP) handles the authorization of Participating Financial Institutions (PFIs) that are eligible to offer this facility to export-oriented sectors. It is reasonable to expect that the market of eligible PFIs will be constrained by the regulator and exporting firms will not be able to secure financing in a fully competitive environment.

DOMESTIC INDUSTRY PERCEPTION REGARDING LAGGING EXPORTS

Case Study: The Engineering Sector

A survey of 328 engineering firms in the country's golden triangle was conducted recently by PIDE. The focus of the survey was on mapping the state of the engineering industry in 3 key cities, namely, Gujrat, Gujranwala, and Lahore. According to the survey of primarily micro and small engineering firms, the industry structure is informal, and the majority of firms do not have quality or standards certifications, so product quality is low. Power supply issues result in more than half of the firms expending resources on power generation and bearing significant operating losses. Most firms (83%) prefer not to export and have to deal with government offices and regulations, nor do 88% of firms undertake any R&D activity for product or process innovation and development. 63% of firms are not gearing for any expansion efforts, likely on account of hurdles in securing a loan or line of credit.

HIGHLIGHTS

- Survey of 328 engineering firms
- Lack of professionalism, R&D
- "*little is enough*" mindset.
- Power supply issues: PKR 1.03 million cost borne by 328 firms for each hour of load shedding
- Government-Business Relations: PKR 6.2 million cost of government compliance.

CONCLUSIONS

Pakistan's trade sector faces challenges and opportunities. Barriers like strained relations with India and political turmoil in Afghanistan have limited cross-border trade. Compared to regional peers (India, China, Vietnam, and Bangladesh), Pakistan's trade performance lags significantly. Its share of trade in GDP grew by 42% from the 1960s to the 2020s, while others achieved much higher growth rates (81% in Bangladesh to 1,066% in Vietnam).

Pakistan mainly exports to developed countries and regional economies. China dominates regional trade, with India and Vietnam following. Pakistan's export base is concentrated in textiles, unlike India and Vietnam, which have diversified into electronics, chemicals, and machinery.

Pakistan's trade policies are more restrictive, hindering progress. Export diversification is vital for stability and growth, but new products have had limited impact due to their small volume. Research has conclusively shown that the exchange rate is heavily biased against exports, and a shift towards market-based exchange rates is essential to ensure domestic firms become competitive and increase exports substantially. The country's economic complexity index ranking is relatively low compared to its peers. In terms of expanding its exports, the engineering industry faces challenges like an informal structure, low product quality, power supply issues, limited export focus, and difficulties in securing loans for expansion. Addressing these challenges is expected to lead to higher output, and more domestic growth and hence promote overall economic growth.

2. Import Profile of Pakistan: Imports, Policies, and Effective Protection Rates

MUHAMMAD ZESHAN

KEY TAKEAWAYS

- Over the past few years, Pakistan has witnessed consistent growth in imports, with an average annual growth rate of 6.5% in the last decade.
- These imports play a crucial role in supporting Pakistan's industrial and manufacturing sectors.
- Pakistan's heavy reliance on imports exposes it to risks associated with global commodity price fluctuations and currency exchange rate fluctuations.
- Pakistan's import-led substitution has failed. using the effective rate of protection (ERP) and the concept of 'on money' to estimate the tariff protection provided to domestic industries.
    - Despite import substitution policies, the ratio of imported intermediate inputs to total intermediate imports increased from 2000 to 2020.
    - The manufacturing has a high ERP, resulting in expensive imported raw materials due to high tariff rates.
- The ERP is small in agriculture and negative in the services sector.
- Industries, such as vegetable and fruit, fish, and cooking oil enjoy higher protection, while the services sector lacks effective protection. unclear
- If we incorporate the 'on money' rate into the existing customs tariff rate, the automobile sector is the most protected industry in the country.

- Both the import substitution and the export promotion policies are ineffective in Pakistan due to high import tariffs.
- Eliminating import tariffs can boost both exports and investment because the new production environment becomes more competitive due to the lower cost of production faced by firms.
    - The impact of eliminating import tariffs on the top 10 import items uniformly will initially lead to a rising trade deficit from 2023 to 2027, but eventually, the deficit will turn into a trade surplus by 2032.
- Due to tariff elimination in the top 10 import items, investment and GDP experience positive growth in Pakistan, with an increase of 2.29% and 1.32%, respectively, by 2032. Industries, where import tariffs are eliminated, will witness increased imports but benefit from cheaper raw materials, leading to overall export growth.

INTRODUCTION

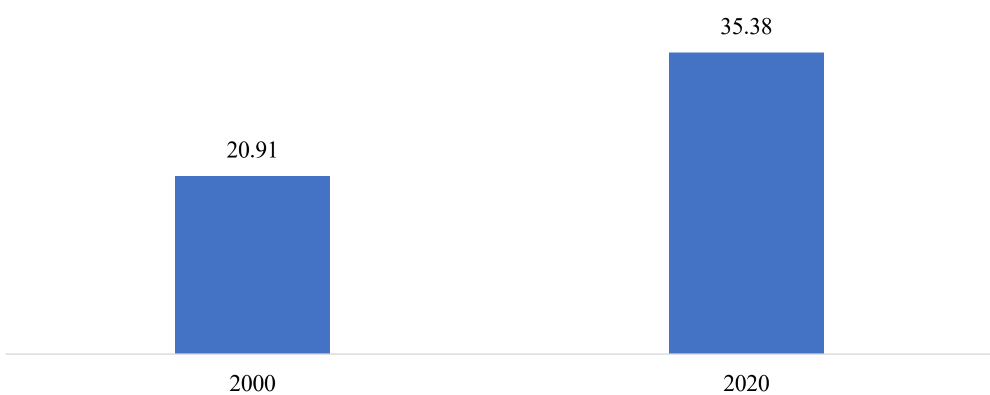
Pakistan imports more goods than it exports. Pakistan's imports have grown by 6.5% per year in the last decade. The country's top imports include petroleum and petroleum products, machinery, electrical equipment, iron and steel, and chemicals. The bulk of Pakistan's imports come from countries including China, the United Arab Emirates, Saudi Arabia, and the United States.

Pakistan's imports have a significant impact on its economy as they help support the country's industrial and manufacturing sectors. However, Pakistan's heavy reliance on imports also exposes the country to various risks, such as fluctuations in global commodity prices and currency exchange rates. To mitigate these risks, Pakistan has implemented various measures such as promoting domestic production and encouraging foreign investment in local industries. Despite these efforts, Pakistan's trade deficit has remained large, and reducing it remains a significant challenge for the country's policymakers.

OVERVIEW OF IMPORTS

During 2000-20, household expenditure on imported items increased by around 69%, from USD 20.9 in 2000 to USD 35.4 in 2020.

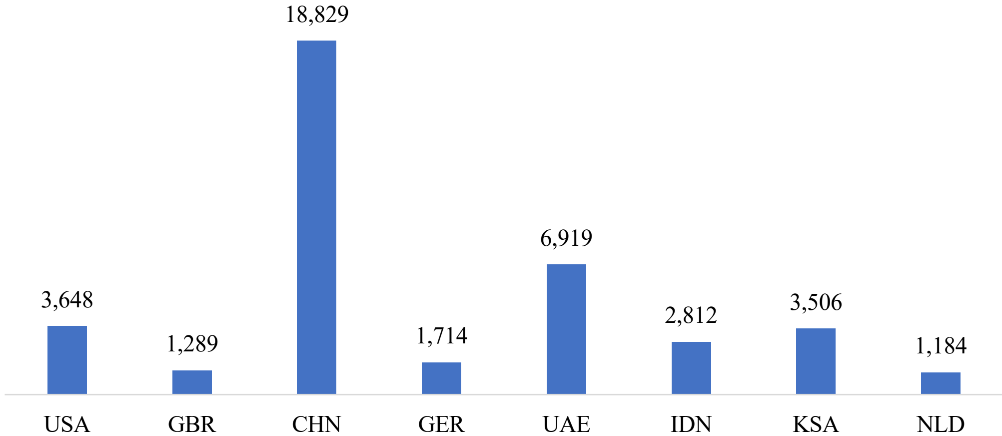
FIGURE 2.1 Final Consumption Expenditure on Imported Items: USD Per-Capita



Source: Author's calculations

Most of Pakistan's imports originate from China followed by the UAE and the USA.

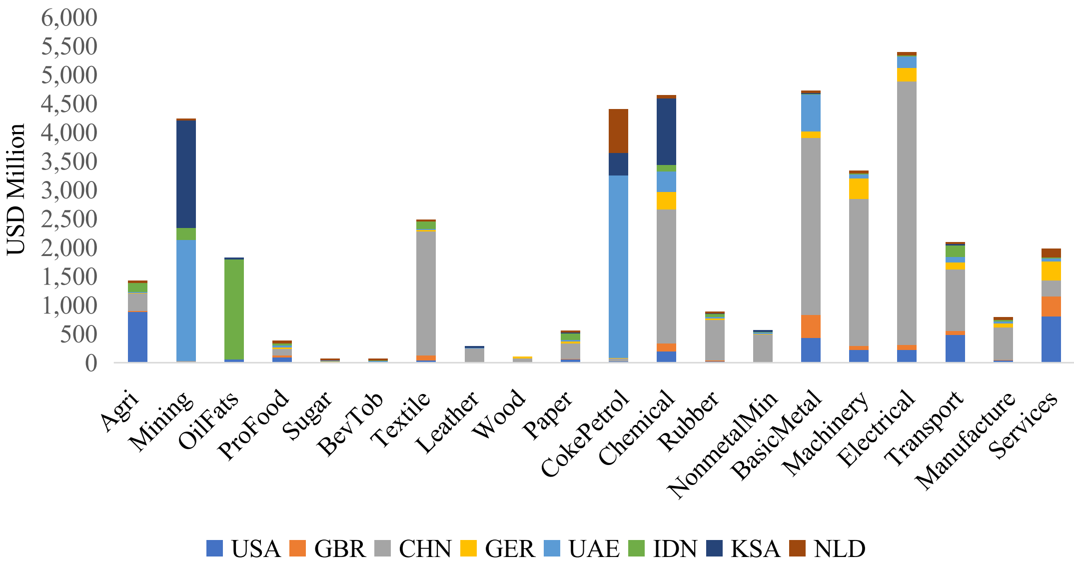
FIGURE 2.2 Imports of Pakistan: By Origin (USD Million)



Source: PIDE calculations

The product breakdown shows that Pakistan's key imports are electrical equipment, basic metals, chemicals, petroleum products, and mining products.

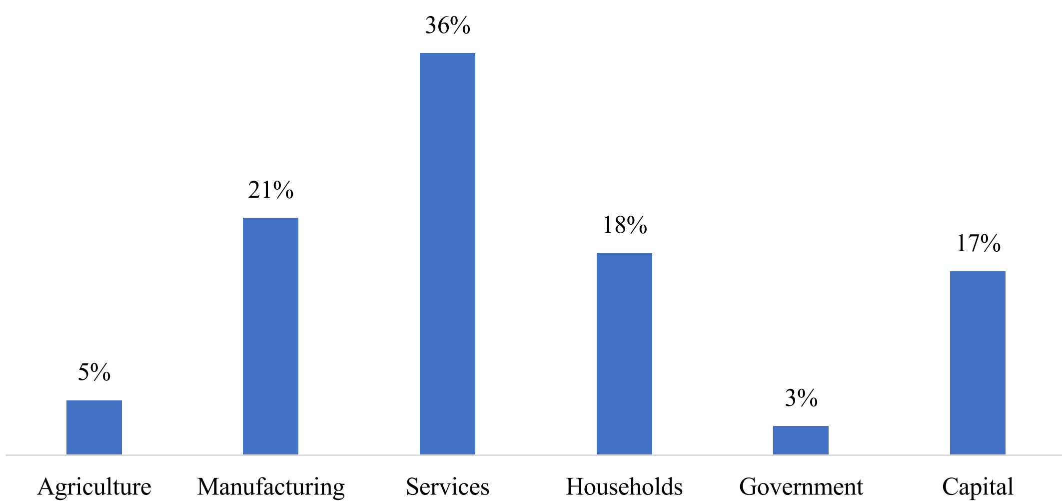
FIGURE 2.3 Breakdown of Imports: By Product (2017)



Source: Author's calculations

Around 62% of the total imports are used by the industrial sector as its intermediate inputs, while the rest are used for final consumption and capital goods. The services sector consumes most of the imports in Pakistan followed by the manufacturing sector. Combined imports for households and government consumption are almost equal to imports by the manufacturing industry.

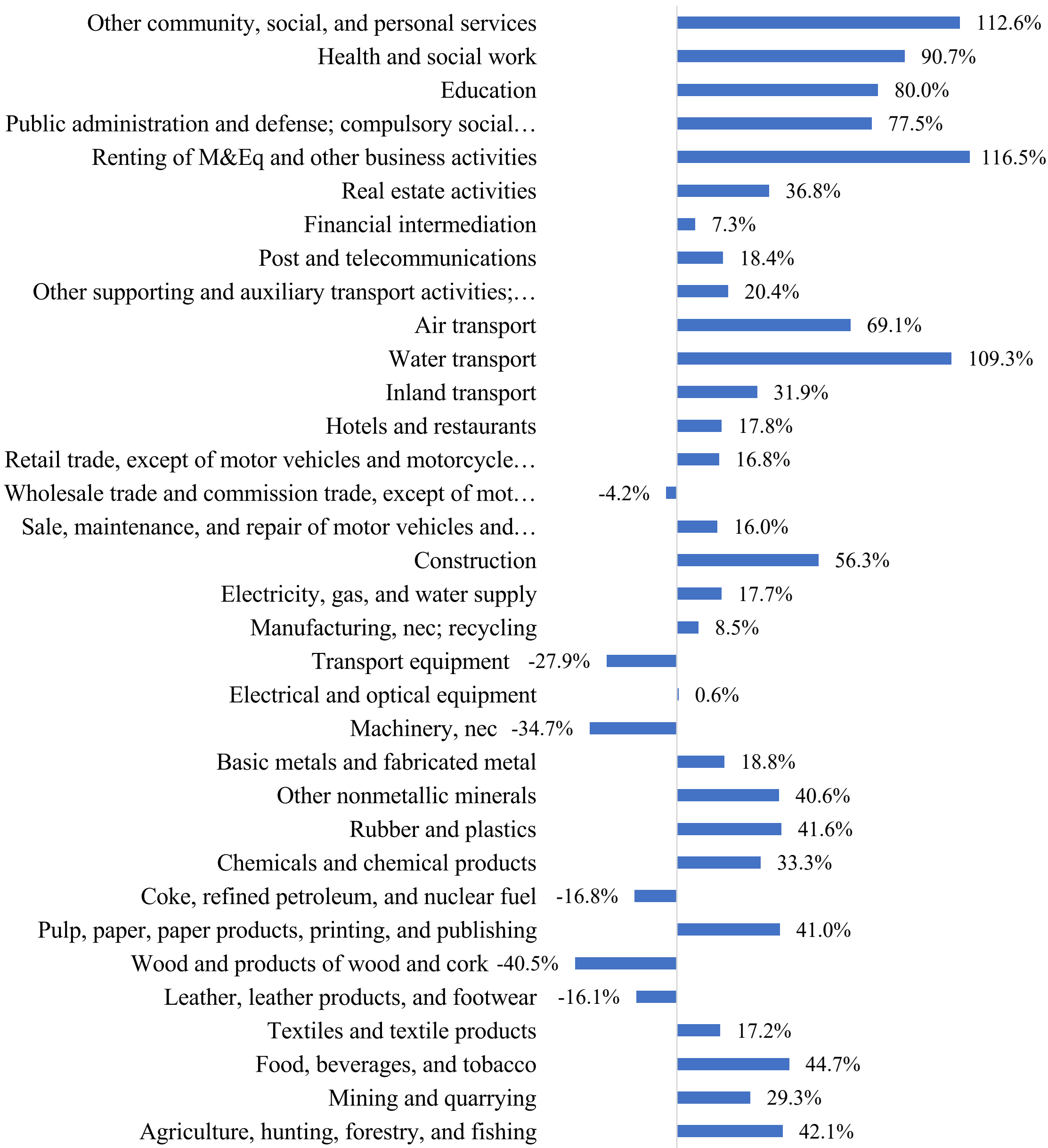
FIGURE 2.4 Import Shares By Sector: 2020 (Percent)



Source: PIDE calculations

From 2011 to 2020, the demand greatly reduced for the imported intermediate inputs for wood, machinery, transport equipment, and leather products. On the other hand, the demand increased for imported intermediate inputs for social services, renting business products, water transport, and health products.

FIGURE 2.5 Firm Demand for Imported Intermediate Inputs: 2011-20 (Percent Growth)

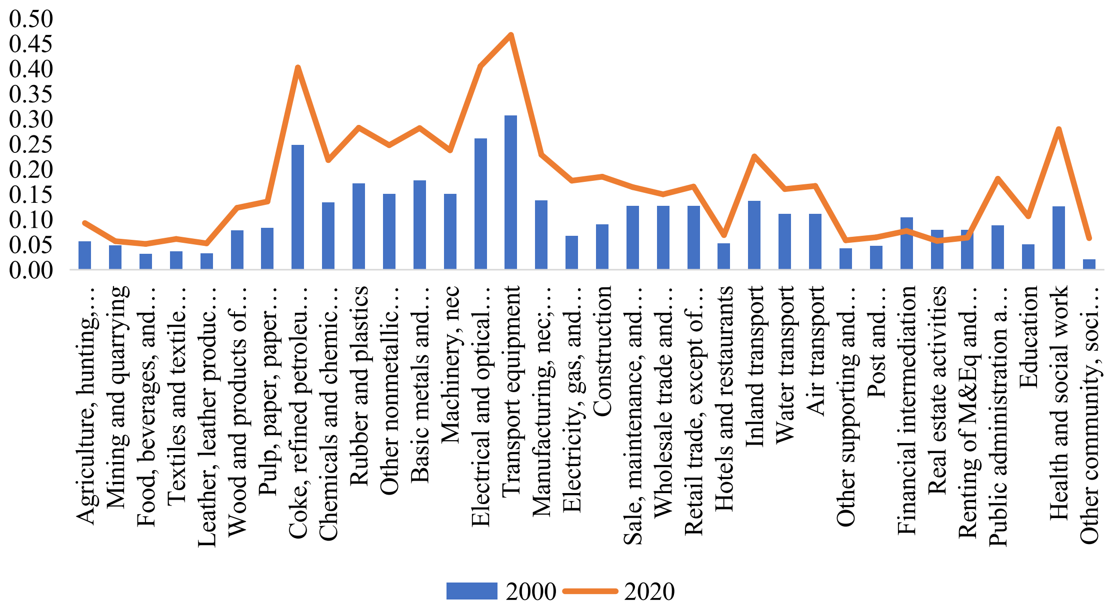


Source: PIDE calculations

IMPORT SUBSTITUTION IN PAKISTAN

Different indicators (Figure 2.6 and Figure 2.7) show that Pakistan has been unable to achieve import substitution industrialization despite pursuing the policy of import substitution almost since the birth of Pakistan. On the contrary, the dependence on imported raw materials has increased over time in most industries. As Figure 2.6 shows, the ratio of imported intermediate inputs to total intermediate imports increased from 2000 to 2020.

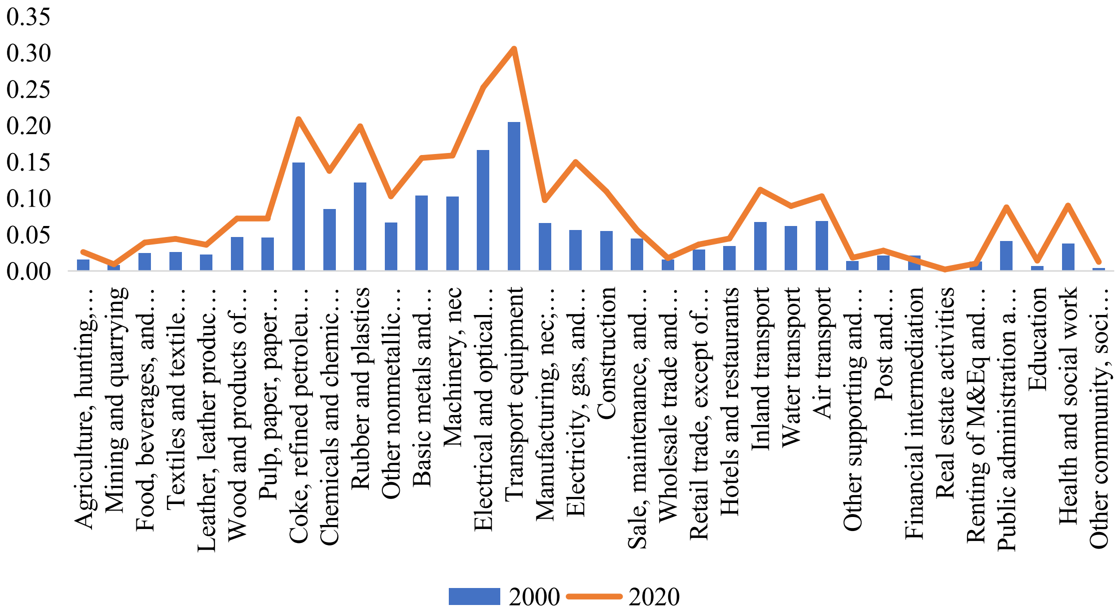
FIGURE 2.6 Ratio of Imported Intermediate Inputs to Total Intermediate Imports



Source: PIDE Calculations

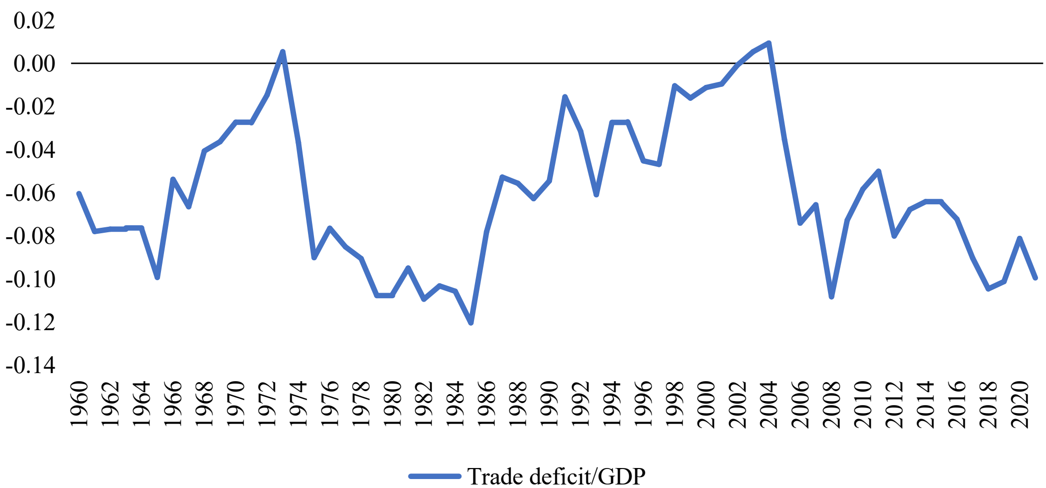
Figure 2.7 shows that the imported intermediate inputs increased to produce the total output. Overall, the rising dependence on imports causes a higher and unsustainable trade deficit as shown in Figure 2.8.

FIGURE 2.7 Ratio of Imported Intermediate Inputs to Output



Source: PIDE calculations

FIGURE 2.8 Trade Deficit-to-GDP Ratio

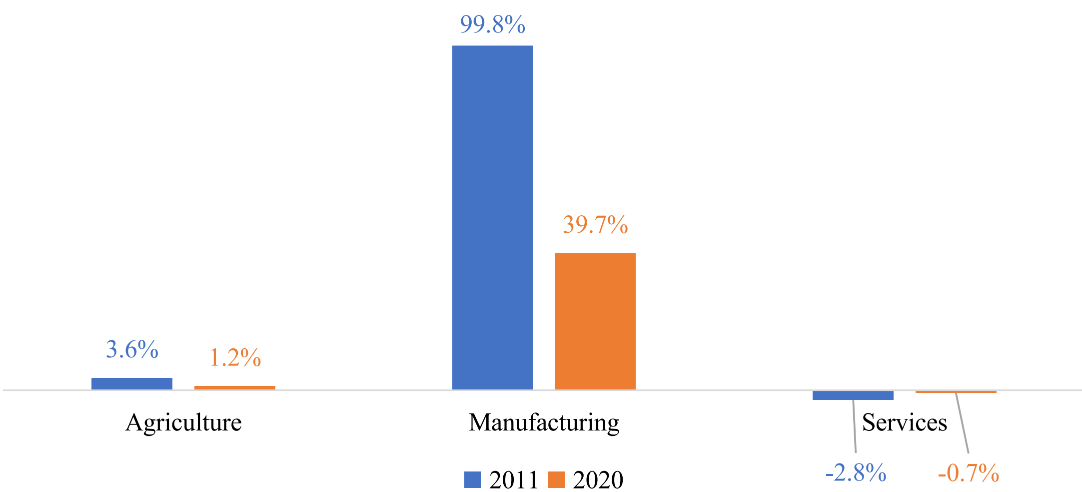


Source: The World Bank

EFFECTIVE RATE OF PROTECTION

The effective rate of protection (ERP) is determined by the tariff protection provided by the government to domestic industries. Due to high tariffs on imported raw materials, especially on those used in the industrial sector, the ERP is high mainly in the manufacturing sector as can be seen in Figure 2.9. Even though the ERP decreased from 2011 to 2020 in the manufacturing sector, it is still high. On the other hand, the ERP is very low in the agriculture sector, and negative in the services sector. The high ERP results in expensive imported raw materials

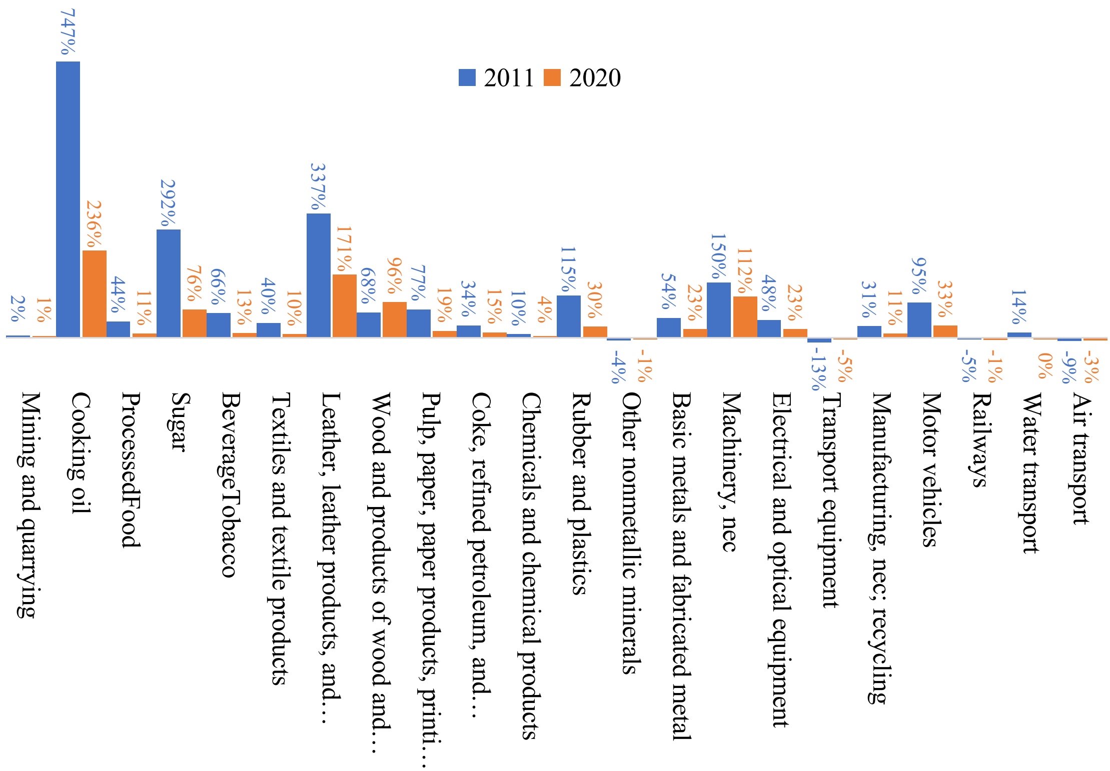
FIGURE 2.9 Effective Rate of Protection in Pakistan 2011 & 2020: Aggregate



Source: PIDE Calculations

In the manufacturing sector, cooking oil is the most protected industry.

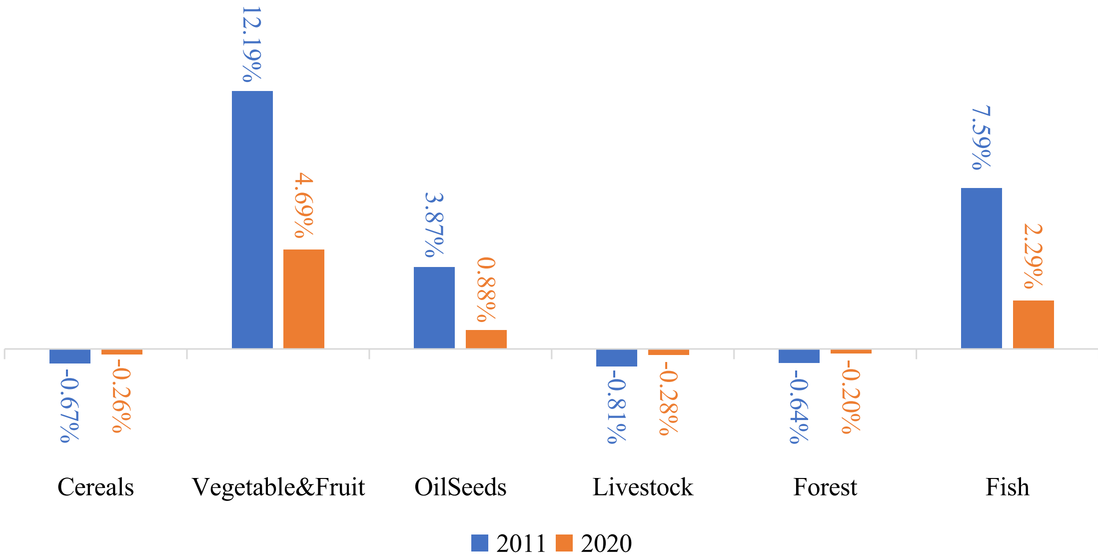
FIGURE 2.10 Effective Rate of Protection in Pakistan 2011 & 2020: Manufacturing



Source: PIDE calculations

Within agriculture, the vegetable, fruit, and fish industries are more protected than others.

FIGURE 2.11 Effective Rate of Protection in Pakistan 2011 & 2020: Agriculture



Source: PIDE calculations

BOX 2.1 Effective Protection Rate in the Auto Industry & On-Money

The effective rate of protection has one limitation, it calculates protection per unit of value-added. Since the value-addition in the automobile sector is much larger than in the edible oil sector, apparently it looks like the edible oil industry is the most protected industry in Pakistan. However, this bias is corrected after incorporating the concept of 'on-money' cost, which clearly identifies that the automobile industry is the most protected industry in Pakistan.

On-money is a premium charged over and above the quoted price of a vehicle for immediate delivery. For instance, the company ABC sets the market price of its vehicle X at PKR 2 million inclusive of all taxes, but the tentative delivery date is six months from the booking date. The buyer is forced to pay a considerable amount and wait for an extended period. This allowed the car dealers to develop the process of own money, where they offer the buyers a way out at the time of booking. As a result, the buyer is given the option to pay an 'm' amount of money, over and above the price quoted by the company, and get the car within a week, even the same day in some cases. By paying this own money, the buyer is then relieved of the waiting time for vehicle delivery and obtains ownership of the car immediately.

Source: Najib & Qadir (2021)

On-Money and Effective Protection Rate

Another definition of tariff protection, based on the concept of on-money, shows that automobile manufacturing is the most protected industry in the country.

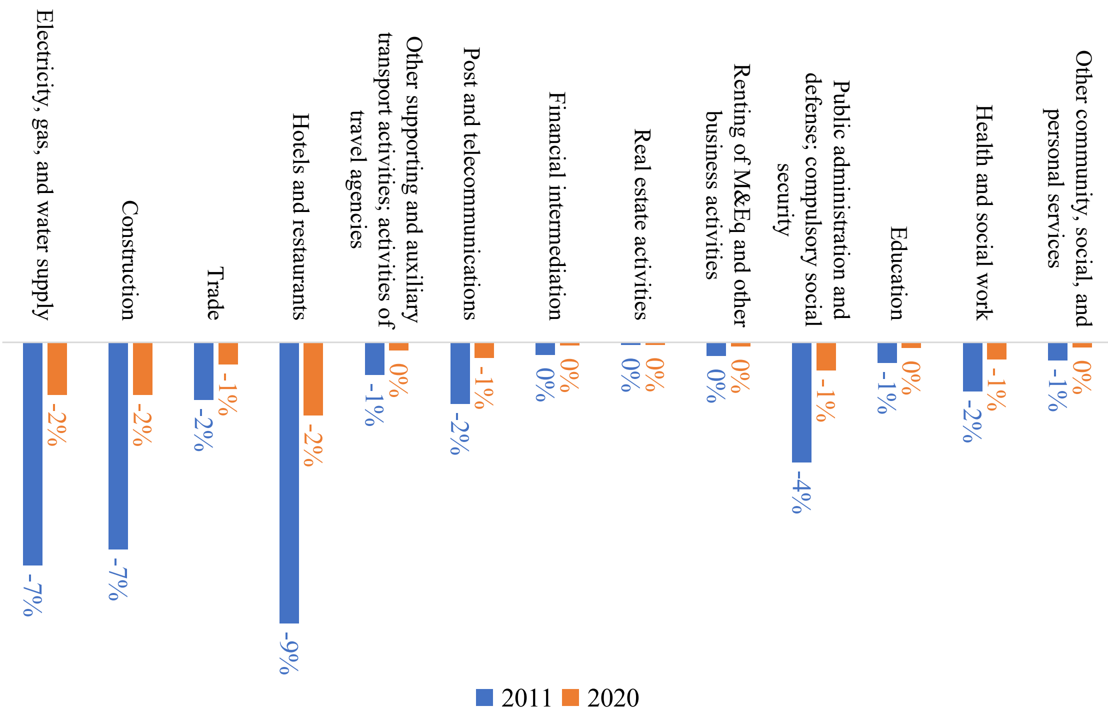
TABLE 2.1 Effect of On-Money on Protection of Automobile Sector

Industries	Import Tarrif Rate	On Money Rate	Overall Protection
Motor vehicles	32.9%	12.5%	45.4%
Electrical equipment	23.0%	--	23.0%
Metals	23.0%	--	23.0%

Source: PIDE calculations

There is no effective protection in the services sector. When the services sector uses raw materials from other protected sectors, it faces negative protection.

FIGURE 2.12 Effective Rate of Protection in Pakistan 2011 & 2020: Services



Source: PIDE Calculations

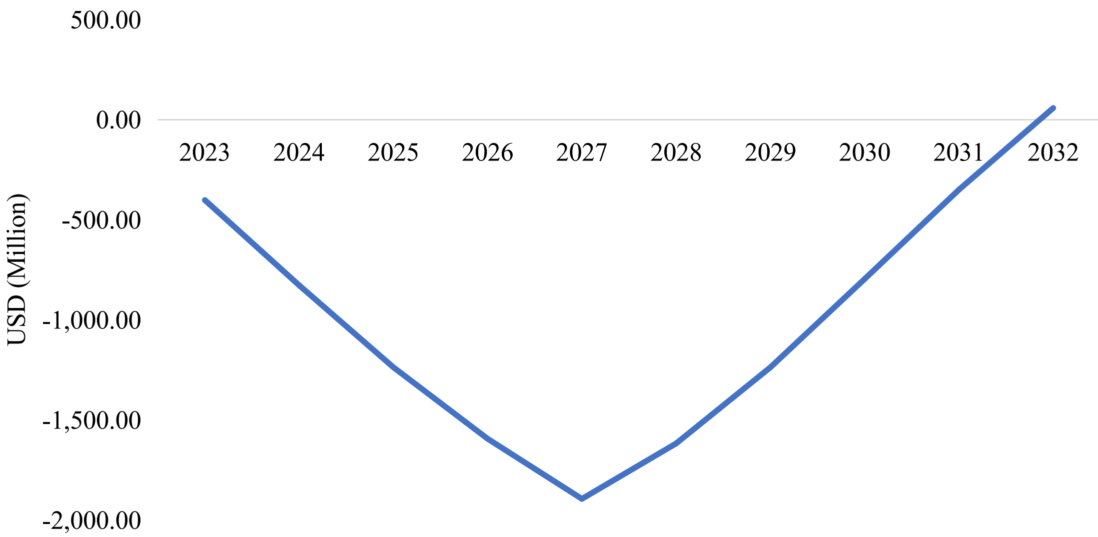
EFFECT OF ELIMINATING IMPORT TARIFFS ON TOP 10 IMPORT ITEMS

The elimination of import tariffs is often seen to make the domestic industry more competitive and, in the long run, may reduce the trade deficit. To gauge the impact of eliminating import tariffs on the top 10 import items,[12] a simulation analysis is carried out using a computable general equilibrium (CGE) model. This analysis has used PIDE's global dynamic CGE model (Zeshan & Ko, 2019), which covers the entire global economy. The CGE model is based on a multi-regional social accounting matrix (SAM) of 141 countries and 65 sectors, which covers

[12] The top 10 import items include cooking oil from Indonesia, textiles, chemicals, basic metals, machinery and electrical equipment from China, mining, coke and petroleum from the United Arab Emirates, and mining and chemicals from the Kingdom of Saudi Arabia.

more than 99% of the global GDP. The SAM was launched in 2023 (Aguiar et al., 2023). The base year for Pakistan's representative input-output table is 2017, which is currently the latest input-output table for Pakistan's economy in this global database. According to the analysis, the trade deficit would rise initially, peaking in 2027. Thereafter, the deficit would turn into a surplus by 2032. Figure 2.13 shows the impact of the elimination of import tariffs uniformly on the top 10 items over five years from 2023 to 2032.

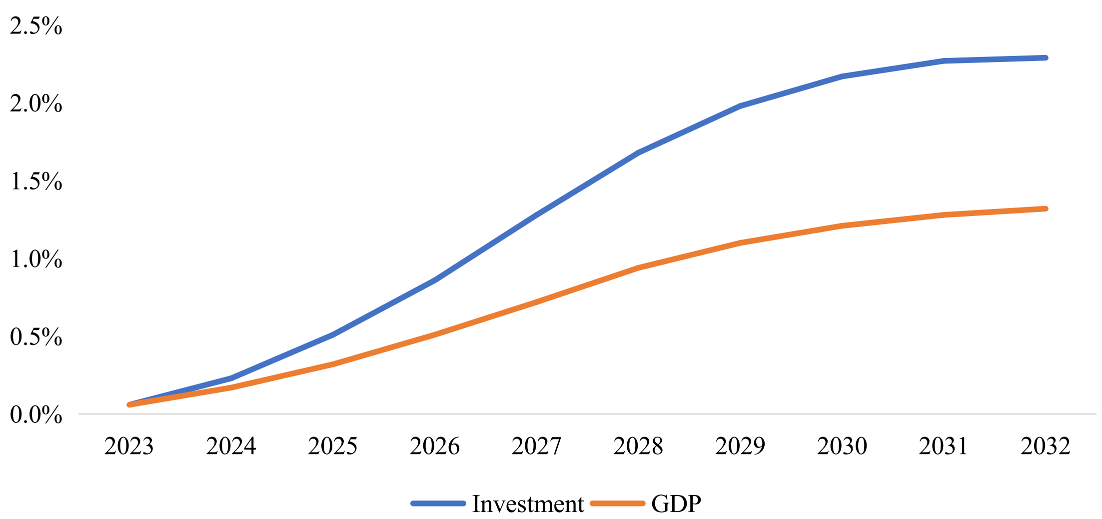
FIGURE 2.13 Effect on Trade Balance of Elimination of Import Tariffs on Top 10 Import Items: 2023-32 (USD Million)



Source: PIDE Calculations

The simulation results of the dynamic CGE model show that the adverse effect of eliminating import tariffs will not be very high during the period of analysis, given a stable and credible trade policy. The long-run decrease in the trade deficit, which would turn into a surplus by 2032, will have a positive effect both on investment and GDP as Figure 2.14 shows. Overall, growth in investment and GDP will peak in 2032 at 2.29% and 1.32%, respectively. It is important to remember that the predicted trade surplus and growth in investment and GDP are likely to occur due to the elimination of tariffs on the top 10 imported items only (see Footnote 1). An across-the-board reduction in tariffs on other items may also have spillover effects on the other areas of the economy, which may result in an even greater increase in economic activity. Hence, if the policy is credible and stable, it will reduce the distortions in the economy increasing economic competitiveness and trade.

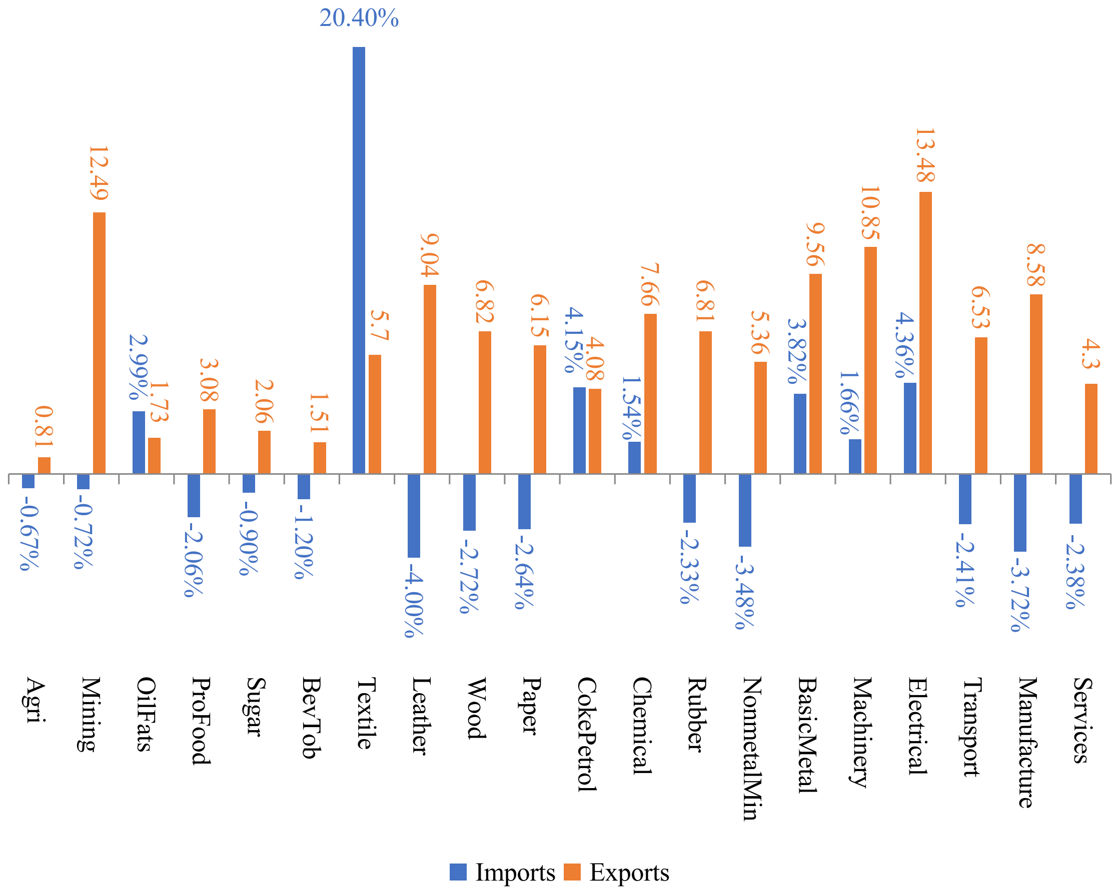
FIGURE 2.14 Effect of Tariff Elimination on Investment and GDP (Percent)



Source: PIDE calculations

Although the elimination of tariffs will increase imports of the industries where import tariffs are eliminated, it will provide cheaper raw materials for the domestic industry. As a result, exports of all industries will rise by 2032.

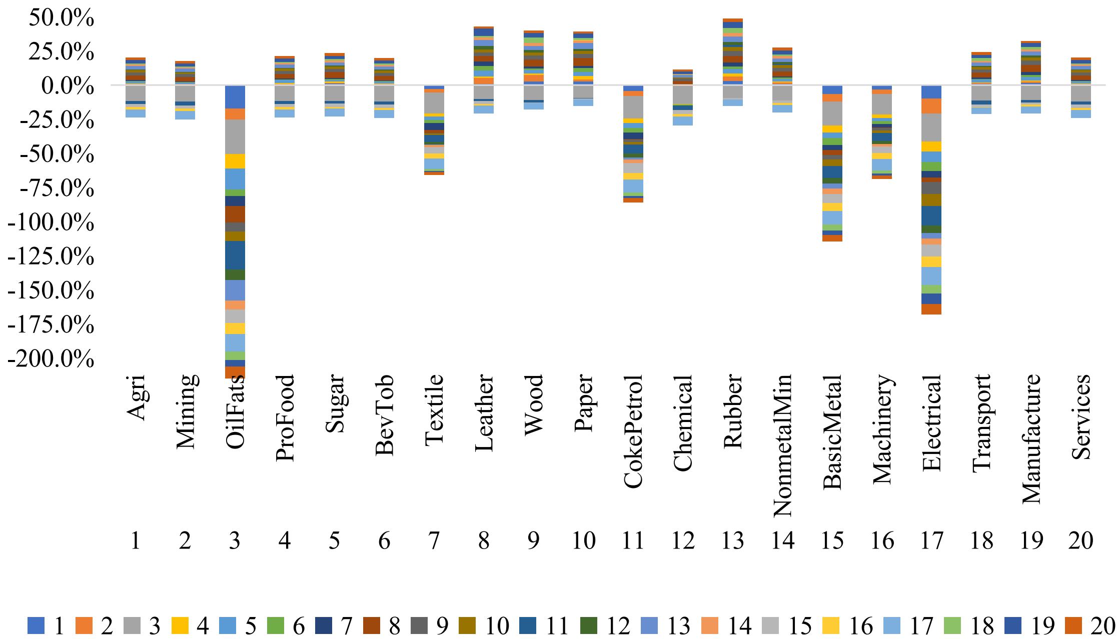
FIGURE 2.15 Effect of Eliminating Tariffs on Overall Trade Performance by 2032 (Percent)



Source: PIDE calculations

The effect of tariff elimination on products produced domestically can be seen in Figure 2.16. Domestic prices of products produced domestically will become expensive when tariffs are eliminated. As a result, the demand for their products by domestic firms will decrease.

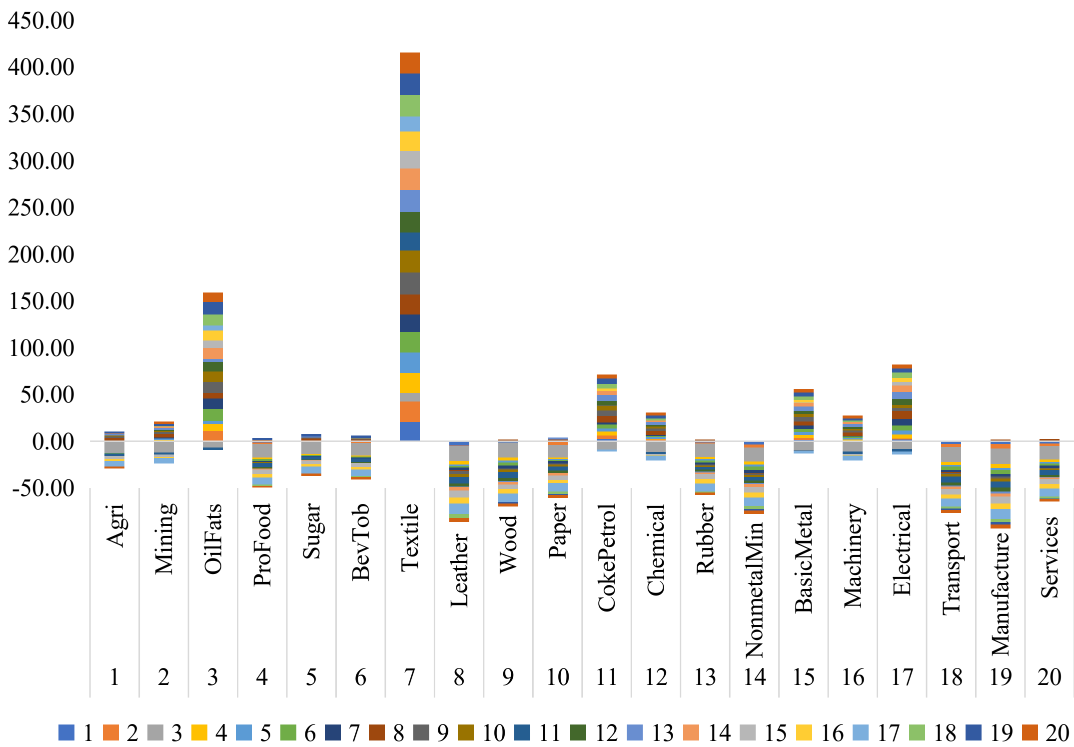
FIGURE 2.16 Tariff Elimination–Demand for Domestic Products by the Domestic Industry by 2032: Percent Change



Source: PIDE calculations

Since the elimination of tariffs reduces products' prices, the imports of these products will rise because they are cheaper in the international market compared to the domestic market. The effects are depicted in the following figure.

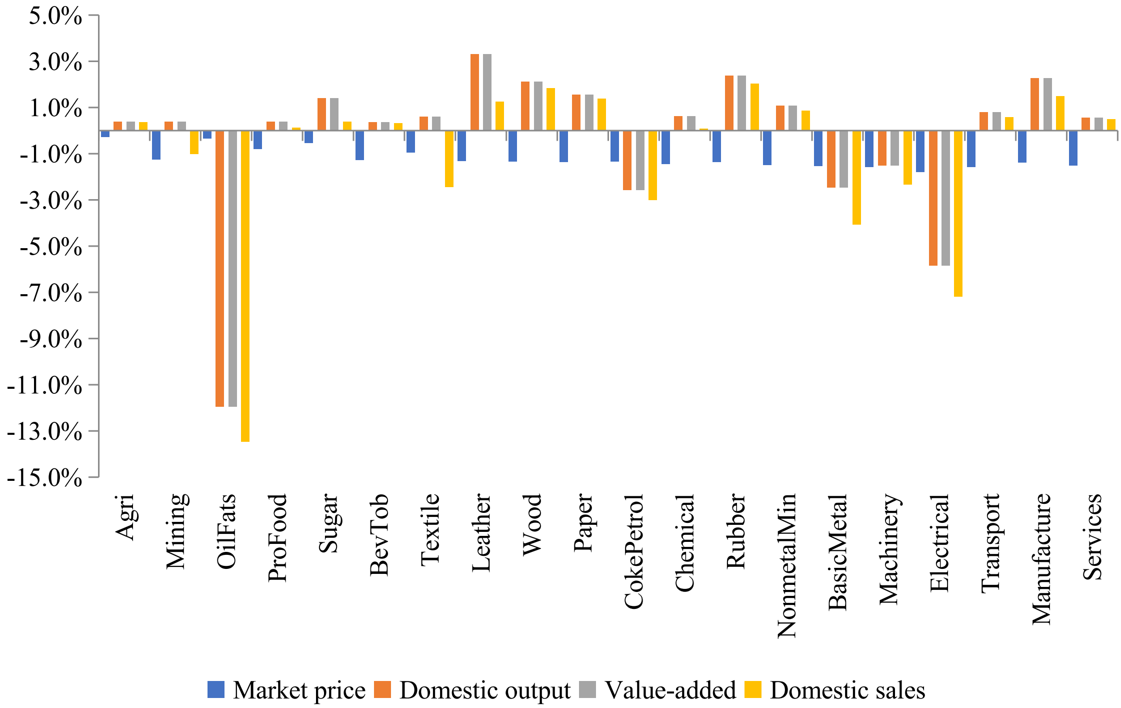
FIGURE 2.17 Tariff Elimination - Demand for Imported Products by the Domestic Industry by 2032: Percent Change



Source: PIDE calculations

After the transition period, the prices of these products will reduce greatly for the industries/products for which import tariffs are eliminated. On the other hand, domestic output, value-addition, and domestic sales will also decrease. In the new environment, domestic products will be expensive in the local market compared to the international market, adversely affecting their demand in the local market. Consumers will be now more inclined to use cheaper imported products. Hence, the local manufacturers will seek better reallocation of resources towards more productive industries where they can secure a comparative advantage.

FIGURE 2.18 Tariff Elimination–Prices and Production by 2032: Percent Change



Source: PIDE calculations

The analysis shows, as mentioned above, that edible oil has a very high ERP in Pakistan. The total availability of edible oil is estimated at 3.214 million tons, where local production contributes 14% while the remaining 86% is imported, increasing the demand for foreign exchange by around USD 3.68 billion (2021-22, July-March). Pakistan meets its excessive demand for edible oil by importing palm oil from Malaysia and Indonesia, which is cheaper than other types of imported edible oils. The local production of edible oil witnessed an expansion in 2022 indicating the potential for oil-seed crops and the import quantity of edible oil is reduced as compared to the last year. The demand for imported edible oil is expected to rise by around 14.3% by 2025.

CONCLUSIONS

In Pakistan, the import substitution and export promotion policies have been rendered ineffective due to high import tariffs. To enhance exports and investment, it is important to rationalize or phase out import tariffs. The elimination of tariffs creates a more competitive production environment with lower production costs. Therefore, the main recommendation is that there should be a long-term strategy of gradually eliminating import tariffs in all industries within a five-year timeframe.

The examination of the impact of uniformly eliminating import tariffs on the top 10 import items from 2023 to 2027 shows that, initially, this action will result in a trade deficit, but it will eventually turn into a surplus by 2032. Pakistan will experience positive growth in both investment and GDP, with respective increases of 2.29% and 1.32% in 2032. Industries that will benefit from the elimination of import tariffs will have higher imports but will also enjoy the advantages of cheaper raw materials leading to overall export growth.

PART 2

DOMESTIC COMMERCE

3. The Potential of Domestic Commerce as a Driver of Growth

OMER SIDDIQUE

KEY TAKEAWAYS

- Pakistan continues to favor manufacturing and exports-oriented growth policy at the expense of domestic market and commerce development. In a balanced development paradigm, the domestic market and external trade support each other.
- The disinterest of the policymaker in domestic in the past is evident from the fact that the first-ever domestic commerce policy was developed in 2021.
- Pakistan's domestic markets and commerce still operate at the initial stages of market evolution.
- Other than pampering manufacturing for exports without the desired results, urban development and zoning regulations have also stifled domestic commerce development.
- The current legal and financial frameworks also do not support activities that encourage product development, brand names, consolidation, and chain stores that can claim to be of international standards.
- There is a need to adopt a policy that encourages the development of domestic markets and commerce because domestic commerce is the place where entrepreneurs can experiment freely to develop products and brands before going global. That's what Coke, Apple, Amazon, McDonald's, and other global brands did before going global.

INTRODUCTION

Domestic commerce, which includes several activities including the wholesale and retail sector (details are provided in Chapter 4), is one of the most important sectors of an economy. In the case of the domestic commerce-led growth paradigm, the development of domestic markets is considered the primary driver of growth. In this paradigm, production in the economy caters to the domestic demand for goods and services domestic consumers are the main focal point for the producers (see Box 3.1 for the domestic commerce-led growth paradigm conceptualized in Haque, 2016).

Several examples from around the world show that this strategy has brought phenomenal growth in the case of large domestic markets and provides an effective way to breed entrepreneurship, risk-taking, innovation, product and brand development, and competitive markets. For example, Jeff Bezos started Amazon in his home's garage in 1994 and now Amazon is the largest online marketplace in the world. Similarly, Nike was founded in 1964 as a distributor of Japanese shoes and it is now the most valuable sports brand in the world. These examples show the conducive business environment in the domestic market facilitates entrepreneurs to grow, thrive, and branch out to exporting (see Box 3.1).

TRANSACTIONS, COMMERCE, AND GDP

- A transaction is the exchange of a single item between a buyer and a seller. All transactions of this item within the geographical boundaries of a country are domestic commerce.
- The GDP can be seen as the sum of all transactions in an economy. Thus, the ease of transactions makes for growth.
- Commerce is a subset of business that focuses on distribution (and exchange) rather than production.
- Pakistani policy has been mercantilist looking to expand exports at the cost of domestic transactions – a self-defeating policy (see Haque, 2006a).

Despite being an intrinsic and major part of the economy, domestic commerce has been a relatively neglected sector in Pakistan compared to exports-oriented manufacturing, which is evident from the fact that the first-ever domestic commerce policy was proposed in 2021.

BOX 3.1 A Shift in Pakistan's Growth Paradigm: The Development of Domestic Markets and Commerce

Haque (2006) has made a strong case for the development of domestic markets and commerce as the key to economic growth and not the current paradigm. According to Haque (2006), domestic commerce in Pakistan is growing rapidly but the continued pursuit of a growth strategy based on production for mercantilist goals has stifled domestic commerce in Pakistan. Unleashing the potential of domestic commerce may be the path to high sustainable growth in the country. 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.

In Pakistan, exports are subsidized, while imports are heavily taxed for import substitution. It means that inadequate investments are made in domestic market development. According to Nobel Laureate Friedrich Hayek, markets where consumer demand is clearly articulated are the nervous system of an economy (Hayek, 1945). Well-functioning markets clear demand and supply through price adjustments, which convey relevant market information to all agents. Consumer markets are, therefore, the 'front end' of the economy where the demand and supply of many products, brand names, new products and new services are all equilibrated through the price system. In such markets, innovations and entrepreneurship thrive through risk-taking and understanding of consumers' tastes and markets. Innovation and entrepreneurship taking place in the domestic market later will move out and lead to higher exports and foreign exchange earnings. Entrepreneurs and innovators need neighborhood markets to perfect their products, brands and recipes, which they will then export. Multinationals like Coke, McDonald's, and Ford all started as domestic industries. Their testing ground was the domestic consumer market.

In the consumer-focussed growth paradigm based on domestic commerce strategy, domestic consumer markets are allowed freedom resulting in the development of entrepreneurship and new products. Many new activities and businesses are developed. These new goods and brand names that are developed are the key to developing new export markets. More importantly, in this model not only goods are exported but there is a greater likelihood of businesses being exported leading to the birth of the Pakistani multinational.

Developing markets and giving all businesses room to compete and grow, will establish entrepreneurship and develop a dynamic comparative advantage (Haque, 2006a). This is the approach that has been followed in more successful economies such as the UAE, Chile, and Thailand. Focusing on markets and consumers instead of production and mercantilism will allow many synergies of development to be exploited. Complex linkages between the various activities of domestic commerce will reinforce growth. For example, large, branch-networked retail needs to be supported by extensive development of distribution and warehouse networks, office space, and transport networks. All this in turn could enable tourism and hotel development. All this reinforces Pakistan's integration into the global marketplace.

For a detailed discussion and growth paradigm based on domestic market development and commerce, see (Haque, 2006).

The growth policy in Pakistan has been based on the Haq/HAG model of the 1950s. The model is based on chasing industrial production, creating foreign exchange surplus through export promotion, and a large government footprint with a suspicion of the market and the private sector (Haque, 2006). Therefore, in Pakistan, the negligence of domestic commerce and too much focus on exports have stifled domestic trade and market development.

Another factor that has stifled domestic commerce in Pakistan is the way Pakistani cities have expanded where space for domestic commerce, especially the WRT, is severely limited (for details, see Haque and Nayab, 2020; Haque, 2015; Haque and Waqaar, 2006). The current zoning regulations and urban planning have encumbered domestic commerce in Pakistan (Haque and Waqaar, 2006).

Because of the neglect of domestic commerce, Pakistan's domestic commercial sector is in a poor state despite the recent emergence of shopping malls, a few brand names, chain stores, and department stores. The state of local retail stores is still the same as they have no inventory, they do not carry quality goods and warranties, and consumer protection is unknown. Domestic markets in Pakistan still lack city centers, warehouses, storage, and community and public spaces of any significance. Moreover, there are hardly any businesses based on domestic commerce listed on the stock exchange.

Box 3.2 Zoning Regulations, Urban Development, and Domestic Commerce

- **Outdated Urban Zoning**

In Pakistan, urban zoning is uninformed of modern city and commercialization needs. The unfriendly zoning laws are perhaps the biggest constraint to serious domestic commercial development.

- **Anti-Commercial Bias**

Urban zoning and city planning have anti-commercial bias. To commercialize residential real estate, large commercialization fees are demanded leaving domestic commercial activity only with residual space. While Pakistan's urban city planning follows the American-style large suburbia, unlike the American model zoners remain unfriendly to large commercial development. There is a particular dislike for mixed-use where the poor and the middle classes can live.

- ### Poor Retailers

Urban zoning is in particular very unfriendly to the poor retailer who lacks the capital to get into structured expensive retailing that in any case is in short supply. Unlike Bangkok, Hong Kong and Singapore, urban zoning allows no space for street vending through kiosks in city centers. This change alone could have a huge impact on poverty.

- ### Clustering of Commercial Activities

Clustering of commercial activities or consolidation of lots for large commercial development can be extremely difficult. Even if the government zones an area as commercial, each lot has to be converted separately through a cumbersome procedure and payment of large fees. For example, the area around all hotels in Lahore, Rawalpindi, and Islamabad remains undeveloped because zoning does not allow lots around these to be converted to commercial space. In other countries such space is used for clustering commerce.

- ### Excess Demand for Domestic Commerce Activities

The flawed urban management policy has created a huge excess demand for offices, warehouses, flats, retail, and other forms of commercial space. Businesses make do by converting the existing housing stock illegally to these required functions. This imposes costs on businesses through increased rent-seeking and the provision of non-standard and non-purposive space.

- ### Excessive Government Ownership

The government owns large tracts of land in city centers for official residences, offices, training institutes and other non-commercial official purposes blocking the productive city center development.

- ### Lopsided Taxation Regime

Due to too much focus on industry and exports, taxation seems to visit this sector more than the favored sectors. Resistance by the sector to unfavorable tax zoning and regulatory policy leads to these businesses being termed 'informal' or 'smugglers'.

- ### High Cost of Doing Business

The cost of doing business for domestic commercial activities is higher because of the above-mentioned constraints. On the other hand, industry because it is favored by the policymaker, and agriculture because it has political clout, enjoy relief in the form of subsidies or tax concessions. Consequently, domestic commerce has not been able to achieve the scale to attain a seat at the policy table.

- ### Weak Contract Enforcement

Domestic commerce expansion requires complex contracting mechanisms as well as delegated management structures. The current state of law and order and especially the contract enforcement regime would need to be seriously strengthened to enable the contracting requirements of say a retail network or a large franchise operation.

Source: Haque and Waqaar (2006)

DOMESTIC COMMERCE: ENGINE OF GROWTH

An economy is a complex network of economic agents and activities and it works best when all participants share the benefits of economic activity. According to Adam Smith, the welfare of economic agents would be maximized when they are free to trade with each other. The mercantilist approach, which incentivizes export promotion and import substitution, is a suboptimal strategy. Export promotion and import substitution inflict costs on domestic markets and consumers, which is the case in Pakistan. For example, exports are subsidized which is essentially a subsidy to the foreign consumer and high tariffs on imports for import substitution make consumer goods for the Pakistani consumer very expensive. The result is inadequate trading at home and welfare loss to domestic consumers. It also means that inadequate investments are made in domestic market development since the products are expensive and consumers are poor. Favoring exports and important substitution results in lopsided development.

In a balanced development paradigm, the domestic market and external trade support each other because it is in domestic markets that innovation and entrepreneurship take place. Entrepreneurs and innovators need neighborhood markets to improve products, build brands, perfect processes, and create recipes, which are eventually exported. The world is rife with such examples: Coke, McDonald's, and Ford. Their testing ground was the domestic consumer market.

Figure 3.1 illustrates the consumer-focused growth paradigm that will develop if the proposed domestic commerce strategy is adopted (see Box 3.1 for further details).

FIGURE 3.1 Consumer Focus

Production
- Good Services

- More Specialized Production
- Less Vertically integrated firms
- More capital for R&D and product development - hence more innovation

Distribution
- Wholesale
- Warehouse & storage
- Transport
- Information & communication networks

- Inventory management and supply chain to conserve capital, increase productivity for increased competitiveness and cheap products
- Innovation will take place at this level if the market is competitive
- Specialized retail and distributional networks
- Requires openness of the economy
- Supporting market development framework
- Possible export of distributional businesses

Retail
- Shops for small poor retailers- *Khokhas (Kiosks)*
- Department stores
- Chain stores
- Shopping malls
- City centers - dense and poor friendly

- Brand names are developed and innovation in products and services is brought to the consumer through retail networks
- Openness is important for bringing international quality at the cheapest price to the consumer
- Markets must be of scale and competitive to ensure quality and price
- Regulation must therefore be light and recognize the need to promote market development
- Export takes place at every level including retail processes and chains
- Reduces poverty if the poor allowed space

Consumer

The ultimate judge of a product: Their demands determine the success or failure of the product, brand name, innovation or process. If successful here, will be exported

Indicates direction of flow of goods and services

Indicates flow of information on consumer demand and tases

Source: Haque (2006)

Box 3.2 CAN THE SERVICES SECTOR LEAD ECONOMIC GROWTH?

A World Bank policy paper argues that the services sector can be a growth-leading sector, especially in low-income countries: "It has been argued for more than 200 years that economic growth is associated with the manufacturing sector. Services have been considered non-tradable, menial, low productivity, and low-innovation."

However, according to the paper, the conventional wisdom that the manufacturing sector is the linchpin of growth and development seems to have hit a snag, especially in low-income countries in Africa and South Asia. At the same time, some countries, such as Tanzania, Ethiopia, and India (see Box 3.4 for the role of the services in India's growth) have witnessed growth driven by services, unlike the East Asian Tigers or the western developed economies.

The argument of the paper is not that the services sector is superior to manufacturing growth and development, rather it argues that the latecomers to development have more opportunities to to exploit offered by globalisation and the Third Industrial Revolution that brought information technology (IT) and information communications technology (ITC).

The paper argues that the services-led Third Revolution can turn around conventional thinking about truisms of economic development:

- It was believed that growth in other sectors drives the services sector growthand it cannot drive growth on its own. This is no longer a valid argument as services can be produced and traded just like manufacturing goods and contribute more than manufacturing to growth and jobs in both low and high-income countries.
- Global trade in services is growing faster than the trade in goods.
- Technology advancement, more open trade, and sophisticated supply chains have increased the services sector's productivity. Innovations in communication and transport have contributed to the global supply chain in

services just like in manufacturing.

- In both low and high-income countries, jobs are now created in the services sector as much as they are created in the manufacturing sector.

Source: Ghani (2014)

Evolution of Domestic Commerce and Markets

The following table shows how markets evolve as an economy develops. As the figure shows, as an economy develops, the markets become more complex. For example, graduation from Stage 2 of market development to Stage 3 requires the development of a value chain and professional management. Similarly, moving higher up requires financial and legal infrastructures that support large-scale commercial activities.

TABLE 3.1 Evolution of Markets

Stage	Type	Characteristics	Upstream Infrastructure and Legal Needs
First	Small shops along well-traveled routes	Limited convenience, high margin, low turnover, limited inventory, high search costs, no consumer protection	Small manufacturers
Second	Supermarkets and shopping clusters especially markets of a similar good, e.g., cloth market, diamond market, etc.	Improvements in convenience, margin, turnover, inventory, and search costs over the first phase as more competition develops but still market participants	Craft and small manufacture

		lack the financial strength to truly benefit consumers	
Third	Department stores	Offering convenient one-stop shopping, brand names that invest in quality and consumer protection. Low search costs as departmental store maintains large inventories	Distribution, wholesale, and warehouse activity. Professional management
Fourth	Chains of stores	Bringing the department store's reliability and consumer benefits close to all consumers. Large turnovers with margins dropping	Growth in distribution, wholesale, and warehouse activity. An open economy supplies this network. Supporting legal framework for long-distance management and contracting
Fifth	Convenience stores and discount stores	Big companies with deep pockets use their buying power and marketing ability to do a high volume, high turnover, low margin business. Consumer welfare enhanced	Supporting financial markets and an open economy that allows a global reach. Warehouse and distribution companies are large partners

Sixth	Shopping malls to house the above activities	Increased convenience makes shopping a pleasant experience	Development of institutional investors who invest in large physical investments such as shopping malls and financial and legal systems that support this form of a specialized multi-contracting business

Source: Haque (2006)

Perhaps the domestic commerce in Pakistan, as the following chapters show, is still in the second stage of evolution, with the signs of the third stage in a few large cities. Generally, however, domestic commerce in Pakistan serves consumers without any convenience and with little consumer protection. The evolution from the second stage requires a change in the policy framework that allows markets and different upstream industries to develop and evolve without a heavy government footprint. Although in Pakistan, chain stores and some brands have emerged, the upstream infrastructure and legal needs do not support the transition of domestic markets to higher stages.

BOX 3.4 The Role of Services Sector in India's Growth

Value Addition

India's services sector of India is the engine of growth and contributed 53% to India's gross value added in FY21-22. The sector has grown at an annual rate of approximately 7% during the last few years. In 2021-22, the sector grew by 10.8%. It is expected that if the WRT continues to at 9-10 %, its size will increase to USD 2 trillion by 2032 (Source: Indian Retail Real estate: Revived, Reshaped and Reinforced)

Exports

India has also a significant share of services sector exports. The sector's share in total exports was 3.5% in 2019 improving to 4% in 2021. In 2021-22, despite the global coronavirus pandemic, the net exports of India's services sector increased by around 25%.

Foreign Direct Investment

India's services sector was the largest recipient of FDI inflows among all the sectors. It attracted FDI worth USD 94.19 billion from 2000 to 2022.

Factors Contributing to Services Sector Growth in India

1991 Economic Reforms

The growth in the service sector in India has been linked to the reforms of the 1990s. Reforms in the service sector led to privatization, the removal of FDI restrictions, and streamlining of approval procedures among others.

Technology and Structural Changes

India's economy has undergone a structural change. Technical advancements have made outsourcing possible, which has contributed to the growth of the Indian services sector. Moreover, due to the IT revolution, India is now the digital hub of the world. According to estimates, 75% of global digital talent is in India. Similarly, skilled IT manpower has made India a global outsourcing hub. India's share in the global outsourcing market is 55%. The development in agriculture and industrial sectors has increased the need for services such as transportation, storage and trade.

Attractive ecosystem

The government is creating an inclusive ecosystem for entrepreneurs and pushing for innovation and the services sector is an integral part of this system. The technology infrastructure required for such an ecosystem has increased the potential for the sector in India. Low setup costs make this sector an attractive investment destination. India also has a reasonably well-developed financial market. The government is also promoting cashless payments to boost modern retail. Retail has been accorded the status of a priority sector by the government in the National Skill Development Mission (Sebastian, V. J., & Gupta, R., 2018).

Indian WRT Sector: A Snapshot

Year	Size (USD Billion)	Sales (INR Trillion)	Combined Turnover: Top Listed Retailers (INR Billion)
2019	650-700	--	--
2020	610-630	17–48	1,780
2021	670-690	46–47	1,460
2022	--	--	1,920

CONCLUSIONS

Domestic commerce has the potential to be the growth driver because of its dynamism. Experiences of other countries show that domestic commercial activities have driven growth. Many brands, such as Coke, Apple, and Nike, were perfected in domestic markets before going big and global. India's recent growth has been based on the services sector, which is predominantly domestic commerce. Domestic markets that are competitive and not highly regulated breed entrepreneurship and product development.

In Pakistan, however, the growth policy has been historically based on encouraging manufacturing for exports at the cost of the development of domestic markets. As a result, domestic commerce has been neglected and has been unable to play the role of the growth driver. There have been various constraints on the development of domestic commerce including the absence of a policy framework for domestic commerce (the first domestic commerce policy was formulated in 2021) and urban zoning and development that discourage domestic commercial activities. For Pakistan to grow sustainability, it will need to change the focus of its growth paradigm from the Haq/HAG mode of the 60s to the one that favors domestic markets and commerce.

4 Domestic Commerce and Wholesale & Retail Trade: Economy-Wide Overview and the Case of Twin Cities

OMER SIDDIQUE AND AHMED WAQAR QASIM

KEY TAKEAWAYS

- The National Domestic Commerce Policy 2022-24 is a step in the right direction, but a domestic commerce policy should be more focused rather than addressing a wide range of interventions. For example, the policy must focus on the issue of zoning laws to allow for mixed-used construction.
- The organized WRT sector has to deal with at least 11 agencies for compliance. Some of these, such as the labor department, only create hindrances. Thus, compliance must be streamlined to reduce the number of agencies that the establishments have to deal with.
- In Islamabad, more establishments are in the organized sector compared to Rawalpindi.
- There is a close relationship between the age of the establishment and its size.
- Most of the retail and wholesale establishments think that the FBR is the main regulator, which shows that they are more concerned about taxes than any other regulatory issues.
- There are approximately 2.66 million retail and wholesale establishments in Pakistan. The greatest number of WRT establishments is in Punjab – 1.49 million.
- According to estimates, more than 90% of the WRT establishments are in the informal sector.

- The WRT establishments have grown by more than 4% per annum since 1988. The sector's output growth in real terms has grown at 6.50% and employment in the sector has grown at 4.84%. It implies that the sector is efficient and productive despite many issues and challenges these establishments face.

- The WRT sector, especially the retail sector, is dominated by single-outlet grocery stores and kiryana stores. Together these two categories constitute 91% of the fast-moving consumer goods (FMCG) sector.

- The informality in the sector is not only due to the unwillingness of establishments to register, but it begins from the start of the supply chain.

- Many establishments want to graduate to the formal sector but cumbersome procedures, too many concerned authorities, and officials demanding their cut stop them from doing so.

- In Islamabad, the majority of the establishments are small-sized, while large establishments are only 5%.

- There is a positive correlation between size and age: with age, the size of the establishment increases – mature businesses learn the tricks of the trade.

- 48% of the traders are dissatisfied with the rents they pay. Following the Supreme Court's ruling of 2016 that stopped commercial activity in residential units/areas, the rents have increased manifold.

- In the twin cities, 45% of the businesses, mostly small, had not sought any approval from any authority to run their business highlighting informality in the WRT sector in Pakistan. A majority of medium and large establishments required approval, which is just as expected.

- In the WRT sector market committees, associations, or unions mostly operate informally on an individual basis. These organizations using their connections, shield the members from tax authorities, excise taxation, the labor department, EOBI, ESSI, and municipal authorities.

- A recent example of the strong political influence of associations and market committees was the resistance to taxation based on monthly electricity bills.
- Most of the businesses operate on a sole proprietorship basis because of fewer regulations, ease of operating informally, and tax evasion.
- Informality is not only not being registered with different regulators, but connections with informal suppliers add to informality in the sector.
- There are roughly 0.2 million Tier-1 WRT establishments in Pakistan. But exemptions given in the latest budget will result in an even lower number of establishments integrated with the FBR.
- According to the report's projections, out of 2.66 million WRT establishments, only 457,676 have NTN numbers and out of these NTN holders, only 156,635 are filers.
- Due to the informal WRT sector, the wages paid are lower than the statutory minimum wage. In some cases, wages paid are as low as PKR 3,000.
- One of the major sources of informal credit is the ROSCA aka the committee system. Nearly 50% of the establishments engage in ROSCAs to finance their business. The pot size, per month, ranges between PKR 0.2 million to PKR 10 million. It shows that finance is perhaps not a major constraint in expanding the business.
- WRT establishments do not grow because they do not use digital platforms.

for inventory; rather they rely on traditional methods, which incur higher costs and consume more time.

- The growth of establishments in the organized sector is hindered by the lack of use of modern inventory management and forecasting methods. The trends are changing albeit slowly.
- Parking space and encroachment are major problems facing traders in twin cities.

INTRODUCTION

Although domestic commerce is critical in employment and income generation in Pakistan, limited information about what kind of domestic commerce is happening in the economy is available. Moreover, there is insufficient knowledge about how various policies and regulations affect this sector and market development.

An analysis of domestic commerce, and the WRT within it, can give insights into the state of the sector, size, policies, and bottlenecks to its growth. Currently, there is limited information available. The only current information available is its total output in the Economic Survey and employment figures derived from the Labor Force Survey (LFS). The Pakistan Bureau of Statistics (PBS)[13] carried out economic censuses during 2001-03 (Economic Census 2005) and 1988 (Economic Census 1988). After these two reports, such an exercise has not been repeated. Besides, the Economic Census 2005 reported figures on the WRT as a whole and not for individual trades (e.g., grocery stores, clothing stores, electronics, etc.).

Given the importance of domestic commerce outlined in Chapter 3 of this report, of which WRT is an integral part, there is a need to look into the sector in detail. This chapter digs deeper into domestic commerce, especially the WRT sector in Pakistan in general and twin cities in particular.[14] The main focus of this chapter is on the WRT sector. The main aspects that this chapter covers are:

- An analysis of the structure of domestic commerce, with an emphasis on the WRT sector. Data from Islamabad and Rawalpindi was collected and analyzed for the WRT sector and segments within it.

- A review of policies, rules, and regulations applicable to domestic commerce.

[13] It was Federal Bureau of Statistics at that time.

[14] An analysis of domestic commerce and WRT in Peshawar, Lahore, Faisalabad, Karachi, and Balochistan will be presented in the second volume of the State of Commerce in Pakistan report.

- A discussion of the problems, issues, and challenges confronting businesses in the sector based on individual interviews and focus group discussions (FGDs).

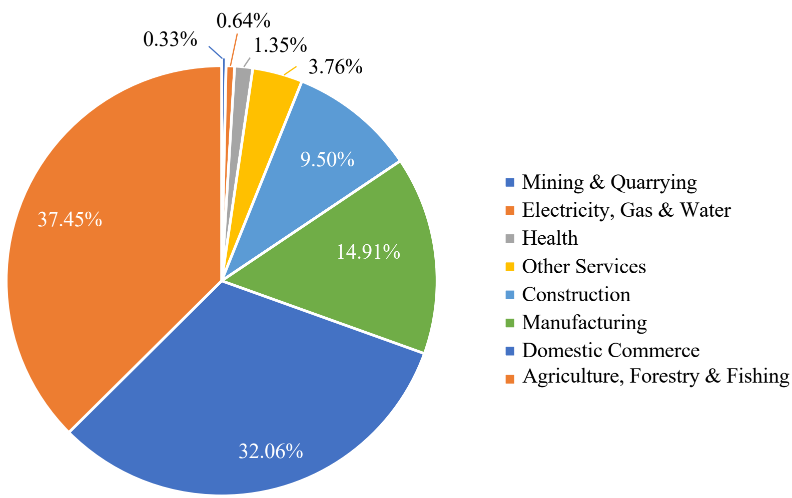
SITUATION ANALYSIS: ECONOMY-WIDE OVERVIEW

Size of the Domestic Commerce and Wholesale & Retail Trade in Pakistan

Employment

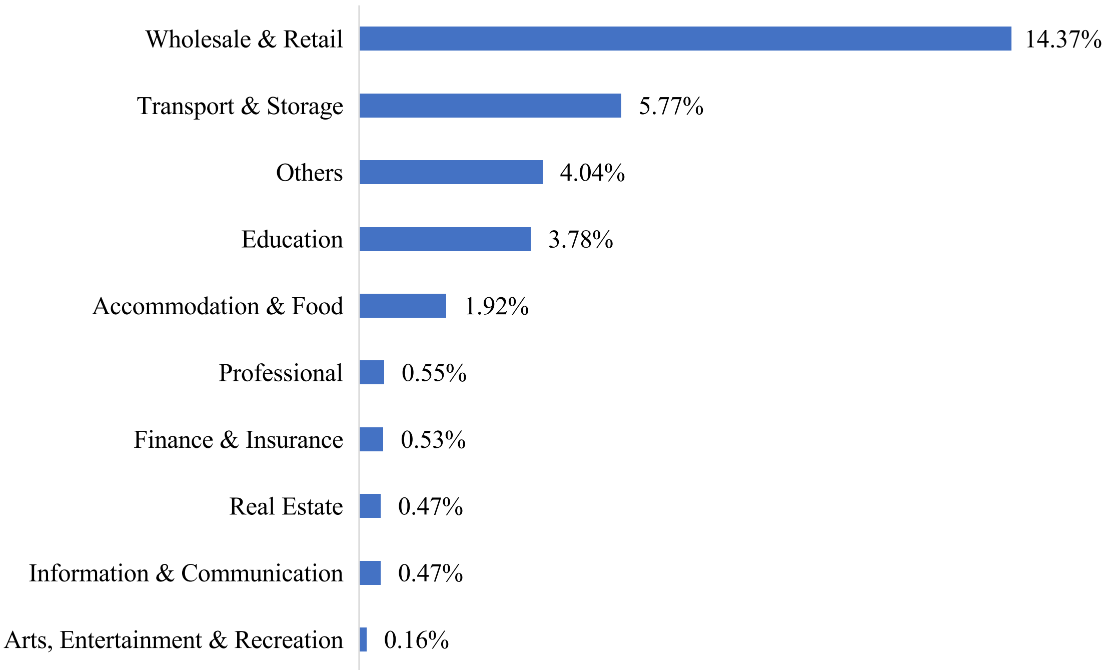
According to the calculations based on the LFS 2020-21 data, domestic commerce's share in total employment is 36.02%. It makes domestic commerce, as shown in Figure 4.1, the second largest sector after agriculture in terms of providing employment. If off-farm agriculture activities are also included, the share of domestic commerce in total employment would be much higher. However, such figures are not available. Among the domestic commerce activities, the WRT has the greatest share of employment in total employment at 14.37%. The shares of other activities that constitute domestic commerce are shown in Figure 4.1. It must be noted that the LFS, or any other official statistics, does not categorize domestic commerce separately. For this report, domestic commerce sectors are selected based on the nature of activities.

FIGURE 4.1 Sectoral Employment Shares (Percent)



Source: Calculations based on Labor Force Survey 2020-21

FIGURE 4.2 Employment in Domestic Commerce Activities (Percent Share in Total Employment)



Source: Labor Force Survey 2020-21

Table 4.1 shows that in four provinces and Islamabad as well, domestic commerce activities employ a sizable number of workers. In fact, in Islamabad, domestic commerce is the largest employer with 50.34% of the employed labor force involved in these activities.

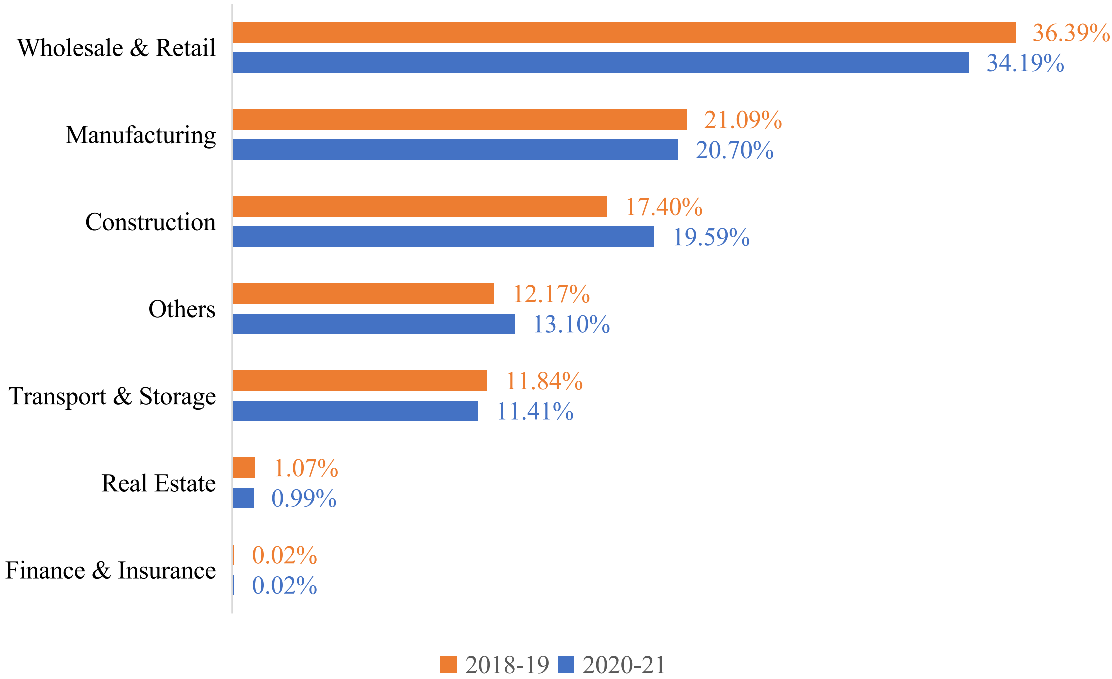
TABLE 4.1 Employed Labor Force: Total, Domestic Commerce and Wholesale & Retail Trade: 2020-21

	Total	Domestic Commerce		Wholesale & Retail Trade	
	Employed (Millions)	Employed (Millions)	Percent of Total	Employed (Millions)	Percent of Total
Pakistan	67.25	21.56	32.06	9.66	14.37
Islamabad	0.70	0.35	50.34	0.09	12.58
Khyber-Pakhtunkhwa	9.41	3.27	34.75	1.36	14.49
Punjab	38.37	11.79	30.72	5.35	13.95
Sindh	15.31	4.98	32.51	2.36	15.42
Balochistan	3.46	1.17	33.94	0.50	14.38

Source: Calculations based on LFS 2020-21

Most of Pakistan's domestic commerce, especially the WRT sector, is considered to be informal in the sense of offering. For example, small-scale retail stores (such as *kiryana* stores), general stores, paan shops, and other establishments are widely dispersed. These establishments are mostly informal. These establishments employ a bulk of informal sector workers, providing livelihood and support to innumerable households. Most of the formal establishments, which constitute a very small percentage of the WRT sector, comprise supermarket setups in the urban centers of major cities, major retail stores, large wholesalers, departmental stores, outlets in major shopping malls, chain stores, franchises, and major brands. As Figure 4.3 shows, 34.19% of the total informal workforce is employed in the WRT.

FIGURE 4.3 Informal Workers by Sector (Percent Share)

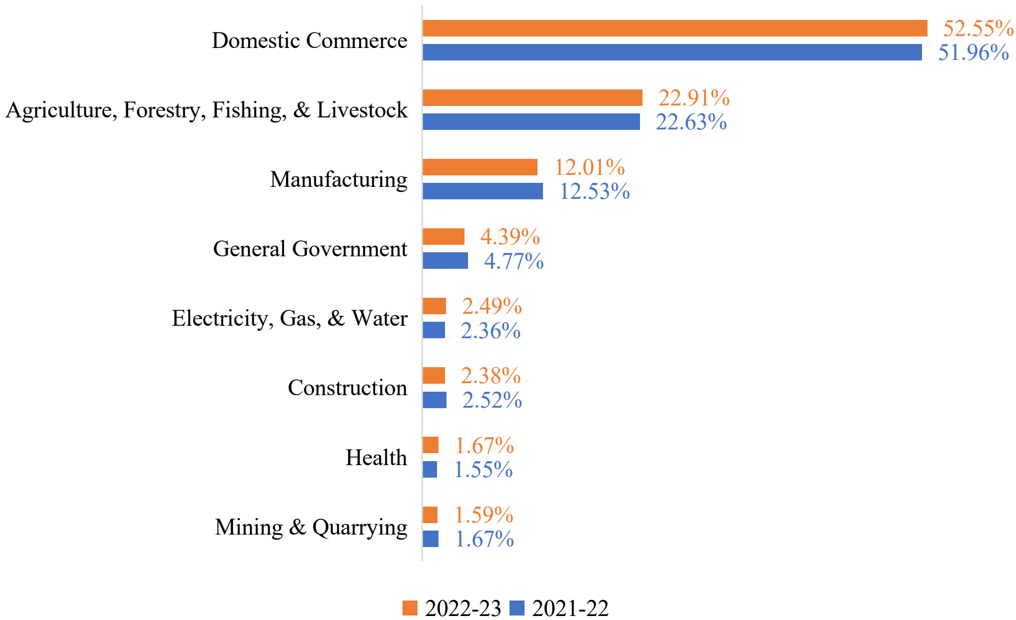


Source: Labor Force Survey 2020-21

Output

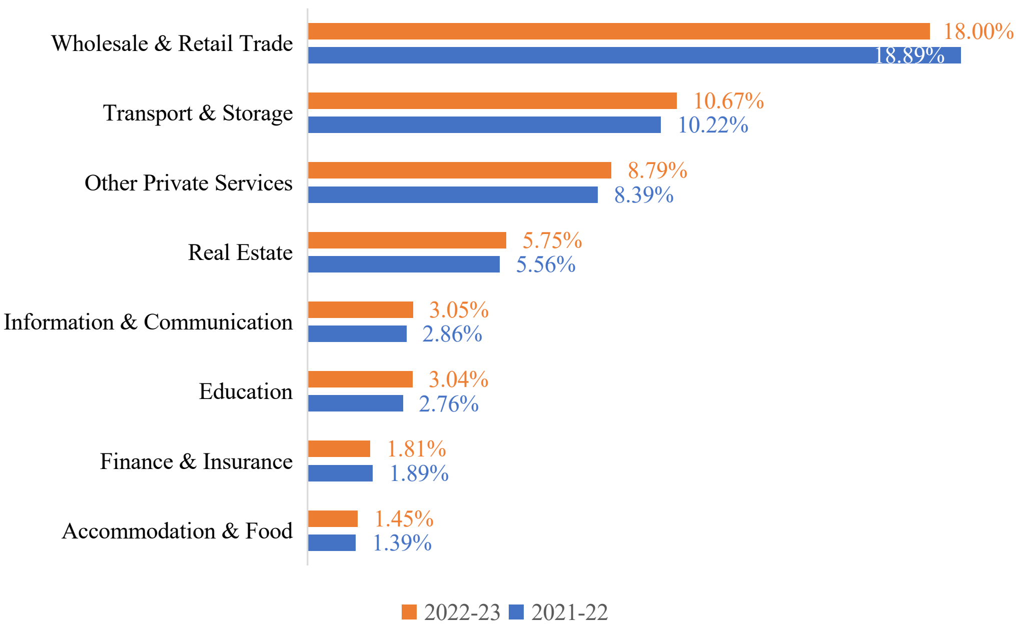
Domestic commerce's share in the GDP is 52.55% in 2022-23, which increased from 51.96% in 2021-22 (Figure 4.4). Among the activities in domestic commerce, the WRT sector's share is the highest at 18% of the GDP (Figure 4.5). Thus, as is the case with employment, the WRT contributes the most to the domestic commerce output.

FIGURE 4.4 Sectoral Shares in GDP (Percent)



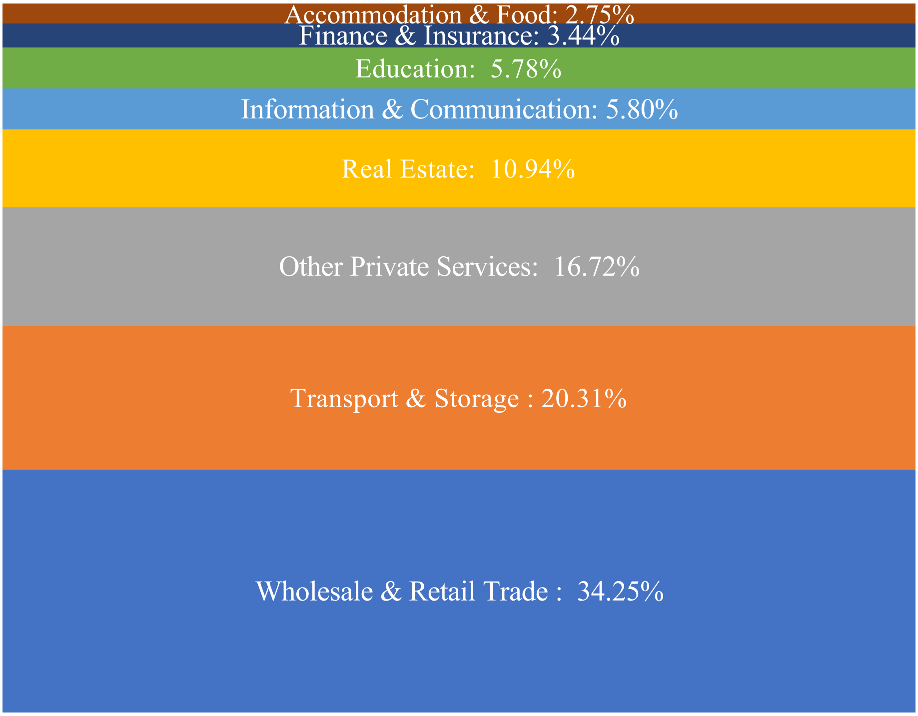
Source: Pakistan Economic Survey 2022-23

FIGURE 4.5 Share of Domestic Commerce Activities in GDP (Percent)



Source: Pakistan Economic Survey 2022-23

FIGURE 4.6 Share of Domestic Commerce Activities in Domestic Commerce Output: 2022-23 (Percent)



Source: Pakistan Economic Survey 2023

The number of wholesale and retail establishments in Pakistan

Since the major proportion of the WRT is informal, estimating the number of establishments in this sector is a challenging task. However, there are some numbers available based on which the number of WRT establishments in Pakistan is estimated.

1988 is the earliest year for which the number of WRT establishments is available as the census of economic enterprises was carried out in 1988. According to the census, there were 1.0028 million WRT establishments in Pakistan (PBS, 2005). The number increased to 1.57 million in 2002 (PBS, 2005).

According to the Pakistan Business Council (PBC) and Consortium for Development Policy Research's (CDPR) report on the WRT sector of Pakistan, there are 2.39 million WRT establishments in Pakistan (PBC/CDPR, 2023). PBC/CDPR (2023) has based the estimates on the number of commercial electricity connections in Pakistan.

According to estimates made for the present report, there are 2.66 million WRT establishments in Pakistan. The projections are based on data collected for this report and use the estimates of the average number of employees per establishment to estimate the total number of WRT establishments in Pakistan.

These numbers show that there has been respectable growth in WRT establishments. The annual average growth rate since 1988 is 4.14%. This growth rate is greater than the population growth rate (1.36%), lower than the employment growth (4.83%), and lower than the sector's output growth (6.50%). The fact that the number of WRT establishments and employment have grown at almost the same rate while the sector's output has grown at a higher rate shows that the WRT sector is efficient and productive.

TABLE 4.2 Number of Retail & Wholesale Establishments (Million)

Region	1988	2002	2022 PBC	2022 PIDE
Pakistan	1.0028	1.57	2.39	2.66
Islamabad	n/a	0.01	n/a	0.05
Punjab	n/a	0.97	n/a	1.49
Sindh	n/a	0.31	n/a	0.66
Khyber-Pakhtunkhwa	n/a	0.23	n/a	0.31
Balochistan	n/a	0.04	n/a	0.14
Source:	PBS Economic Census 2005	PBS Economic Census 2005	PBC/CDPR (2023)	PIDE SoC Report Estimates

Formality in the Wholesale and Retail Sector

Pakistan's WRT sector is predominantly informal. There are various sources of informality in the WRT sector, which are summarized in the following table. Further reasons for informality in the WRT sector are outlined in Box 4.1.

TABLE 4.3 Structure of Informality in the Wholesale & Retail Sector

Business/Establishment Type	Share in Total WRT Sector	Regulatory Regime	Potential Informality	Reasons for Informality
Tier-1 Wholesalers & Retailers	8%	Registration required (FBR, SECP, etc.)	Low but potentially high	Under-invoicing; cash transactions; bogus receipts not registering all transactions; collusion with suppliers (in the case of retailers)
Non-Tiered Establishments	92%	Registration is required but very few are registered with the concerned authorities	Very high	No receipts; not reporting true income; no regulation; bribe to officials; concealing true sales

Source: Adapted from PBC/CDPR (2023)

BOX 4.1 Why a Huge Part of the WRT Sector is Informal?

- The WRT sector comprises mostly small establishments which lack knowledge about registration with relevant authorities and departments.
- Too many departments and authorities are involved in operating a WRT establishment, such as FBR, municipal authorities, Labor Department, and Social Security, among others.
- For an average small-scale WRT entrepreneur, documentation requirements can become, tedious, and confusing. For the record, there are more than 120 regulatory authorities in the federal government alone.
- There is a multiplicity of taxes and the cost of compliance has increased.
- Some products are treated as both goods and services, so there is confusion about whether the product is taxed by provincial authorities or federal authorities because goods are taxed by the federal tax authorities, while services are taxed by provincial tax authorities.
- The tiered taxation system keeps a large segment of the sector in the informal sector.
- It is claimed by the WRT business owners that most WRT establishments do not file tax returns because of the fear of penalties, adverse action by FBR officers for claiming refunds of excess amounts paid, and even correct incomes declared are assessed exorbitantly through audits and other arbitrary actions.
- The distinction between a filer and a non-filer encourages non-filers to remain out of the tax net because they get away with paying higher fees.
- The state's inability to perform its fiscal responsibilities causes distrust in the state, which deters the establishments from moving to the informal sector.

- WRT business owners claimed that accessing formal sector finance is not easy because of collateral requirements, the unavailability of sector-specific financial products, and the high cost of borrowing.
- There is a lack of space availability in commercial areas, which forces most of the WRT sector to operate on the fringes (see Box 3.2 in Chapter3).

It is not easy to determine the extent of informality in the WRT sector, but some estimates can be used. Using the extrapolation that there are 2.66 million WRT establishments in Pakistan, it can be assumed that only Tier-1 establishments, which are 0.21 million (7.78%), are formal. The rest, 2.45 million, or 92.22%, are in the informal sector. While 92.22% may be an overestimated figure, informality does not only mean not being registered with different authorities (e.g., tax, municipal, regulatory). Those who are connected to informal suppliers, despite being registered with different authorities, add to informality in the sector. Some retailers, for example, those in the food business, may not be registered with their regulator.

WHAT IS A TIER-1 ESTABLISHMENT?

A Tier-1 retailer is defined in section 2(43A) of the Sales Tax Act, 1990, to be an establishment that falls in any of the following categories:

- A retailer operating as a unit of a national or international chain of stores.
- A retailer operating in an air-conditioned shopping mall, plaza, or center, excluding kiosks.
- A retailer whose cumulative electricity bill during the immediately preceding twelve consecutive months exceeds PKR 1,200,000
- A wholesaler-cum-retailer, engaged in bulk import and supply of consumer goods on wholesale basis to the retailers as well as on a retail basis to the general body of consumers.
- A retailer whose shop measures 1000 sq. ft. or more.

Source: Federal Board of Revenue

Moreover, dealing in cash, rather than through formal channels, also adds to informality. The high cost of non-cash transactions, such as higher withholding tax on banking transactions for non-filers coupled with the fear of being probed by the authorities deter the WRT establishments from using non-cash alternatives.

TABLE 4.4 Tier-1 Establishments (Numbers)

Region	Total Establishments	Tier-1 Establishments	Tier-1 (Percent)
Pakistan	2,657,715	206,798	7.78
Islamabad	49,837	3,661	7.35
Punjab	1,494,966	150,872	10.09
Sindh	655,419	34,965	5.33
Khyber-Pakhtunkhwa	313,239	14,658	4.68
Balochistan	144,254	2,642	1.83

Source: Estimates based on PIDE State of Commerce Survey. The number of Tier-1 Establishments is taken from the Federal Board of Revenue (unpublished data)

TIER-1 RETAILERS: EXEMPTIONS IN BUDGET 2023-24

In the 2023-24 Budget, some of the Tier-1 retailers who were earlier required to be integrated with the FBR, have been given exemptions. The Finance Bill proposes to exclude the following persons from the definition of Tier-1 retailer:

- Retailers transacting business in shops measuring specified covered area (2,000 sq. ft. or more for retailers of furniture and 1,000 sq. ft or more for other retailers).

- Jewelers.

As a result of the above, such persons (not falling under any other criteria of Tier-1 retailer) will no longer be required to integrate their outlets with FBR's computerized system for real-time reporting of sales.

Source: Federal Budget 2023-24

Taxation in the Wholesale & Retail Sector

Taxation in the WRT sector has always been a subject of discussion because relative to its size, its share in direct taxes is negligible. At the same time, data on the sector's contribution to taxation is very hard to find. The sector-wise share of direct taxes is not available in every FBR Yearbook. The latest year for which sectoral data on direct taxes is available is 2018-19, which is presented in the following table.

TABLE 4.5 Sectoral Shares in Direct Taxes and Real GDP: 2018-19

Sector	Net Direct Tax (PKR Billion)	Share in Direct Taxes (%)	Share in Real GDP (%)	Tax Share and GDP Share Gap
Construction	73.90	5.11	2.78	+2.33
Electricity & Gas Distribution	63.94	4.42	2.25	+2.17
Manufacturing	499.30	34.54	12.33	+22.21
Mining & Quarrying	0.58	0.04	2.12	-2.08
Services	350.32	24.23	17.10	+7.13
Transport	31.93	2.21	11.43	-9.22
Wholesale & Retail Trade	42.85	2.96	18.13	-15.17
All Others	382.70	26.48	--	--

Source: FBR Yearbook 2018-19 and Pakistan Economic Survey 2022-23

Table 4.5 clearly shows that the contribution of the WRT sector to direct taxes in Pakistan is very small compared to its size. On the other hand, the manufacturing sector has a 12.33% share of real GDP but contributes 34.54% to direct taxes. The WRT sector's gap between its share in direct taxes and share in GDP is −15.17, the largest among all the sectors reported in the table.

Moreover, taxation compliance in the WRT sector is very low. The following table shows the sector's profile vis-à-vis national tax number (NTN) holders and tax filers.[15]

TABLE 4.6 Income Tax Compliance in the Wholesale & Retail Sector

Year	WRT Estab-lish-ments (Numbers)	NTN Holders (Numbers)	NTN Holders (% of Establish-ments)	Filers (Numbers)	Filers (% of Establish-ments)	Filers (% of NTN Holders)
2002	1,566,722	37,212	2.38	14,984	0.96	40.27
2007	1,471,062	57,985	3.94	22,219	1.51	38.32
2022	2,657,715	457,676	17.22	156,635	5.89	34.22

Source: Ahmed (2012) for 2002 and 2007. Numbers for 2022 are projected based on Ahmed 2012).

As Table 4.6 shows, although the number of NTN holders has increased from the previous years for which data on the number of WRT establishments is available, their share as a percentage of total establishments is very low at 17.22%. What is even more alarming is that the filers as a percentage of total establishment is even low at only 5.89%. It must be borne in mind that these numbers are projected (see Footnote 15), which shows that tax compliance is low in the sector. Although one cannot completely absolve the sector from low tax compliance, the

[15] The sectoral data on NTN holders and filers is not available for public use, even for research purposes. Therefore, using data reported in Ahmed (2012), in this study the numbers of NTN holders and tax filers in the WRT sectors are projected for 2022. Projections are made using a non-linear projection method.

authorities must also equally share the responsibility for low tax compliance in the sector. The reasons are discussed in Box 4.1 above.

BOX 4.2 Keeping Things Simple: Lessons from Other Countries

Small entrepreneurs including those in the WRT sector, work with limited capital and technology. Moreover, such businesses have little or no access to formal credit. In such a situation, meeting tax and labor obligations is complicated for them. These obligations entail financial costs as well as an administrative burden. For example, in the case of Pakistan, registered businesses have to deal with labor department's rules, EOBI, ESSI, and WWF. Meeting these obligations, in the majority of cases, is beyond the capacity of small businesses and deters them from becoming formal entities. In Peru, according to the private sector, labor laws and legislation are the main obstacles to the formalization of businesses (Schatan et al., 2019).

According to Schatan et al. (2019), modern tax systems take into account the limitations of small entrepreneurs and seek to establish differentiated regimes for them. As the entrepreneurs become aware of the system and their compliance capacity increases, they are gradually exposed to the general tax regime. Such a system aims to encourage entrepreneurship and innovation to achieve a more productive economy. In Latin America, most of the countries have tax regimes that offer differentiated treatment to smaller taxpayers who have smaller productive and managerial capacities.

In Latin America, tax regimes have been made simpler for small businesses to reduce compliance costs. The steps include:

- Substitution of various taxes (presumptive taxes, reduced rates);
- administrative policy (simplified accounting, reduced number of payments).
- simplified regimes segment taxpayers based on their size and often replace the payment of various taxes (usually income tax and VAT) through two mechanisms:

  - A fixed fee (Argentina, Brazil, Bolivia, Chile, Colombia, Ecuador, Peru, and Uruguay).
  - Rate lower than that of the general regime, usually on the gross income of the SME.
- Both tax policy instruments are supplemented with administrative measures that reduce the accounting requirements, the frequency of tax returns, and payments and that simplify the calculation of the tax burden (Schatan et al., 2019).

In Brazil, exemptions and reductions of corporate income tax are provided for businesses in certain less developed areas (Santander, 2023). Moreover, Brazil has simplified the tax regime for the informal sector by allowing multiple federal, state, and municipal taxes to be paid via a single collection form. The idea is to encourage the formalization and improve the performance of micro, small and medium-sized firms (Coelho, 2021).

DOMESTIC COMMERCE: POLICY ENVIRONMENT

The National Domestic Commerce Policy 2022-24

After the National Domestic Commerce Policy 2020-21, the MoC drafted another policy, i.e., the National Domestic Commerce Policy 2022-24. Along with other rules and regulations, this policy document provides or will provide, the guiding principles for the development of domestic commerce in Pakistan. In the following, an analysis of the Policy is presented.

The MoC has taken an important initiative in nurturing the development of domestic commerce, and hence the domestic economy, by formulating a National Domestic Commerce Policy.

Do We Need the Policy?

Conceptualizing domestic commerce in this manner negates the piecemeal approach invariably taken in policymaking, i.e., sectoral policies. It requires "systems thinking," seeking key cross-cutting actions to unleash the synergies of markets, transactions, and cities.

Ideally, the focus of policy should be on making markets work and developing a legal and regulatory framework that will allow markets to develop and specialize. This, in turn, would lead to an increasing number of transactions of incrementally more sophisticated forms.

Denser cities are more productive, richer, entrepreneurial, innovative, creative, greener, and happier. Domestic commerce is more likely to happen in cities, so the agenda for any improvement in this area must be closely tied to city development on the lines of "high-rise, mixed-use, density and walkability."

A Critical Review of the Policy

A coherent, encompassing policy on domestic commerce in the economy is a necessary step in developing the sector to its full potential. The National Domestic Commerce Policy has highlighted laudable steps for developing the sector. However, the policy can benefit from considering the following issues.

The first thing that attracts attention is that there are too many objectives outlined in the Policy, which makes it an ambitious document. A policy should be sharp and focused and not a wishlist. It may be advisable to streamline these and possibly list the priority areas of the policy as well.

The Policy gives the impression that textiles are the only industry/sector of relevance in the economy. There is more to the economy than just textiles. It would be better to consider the needs and demands of key contributors to the national economy, including textiles, ICT, and the engineering sector (for example) as they have competing needs.

Enabling a conducive business environment

One of the objectives of the policy – business enablers – is important because these enablers, such as logistics, are an integral part of the development of domestic commerce and markets. Therefore, these should be treated as unique parts of domestic commerce that need to be developed. Efficient use will be made of these when they are opened to the private sector (market and not the government) and allowed to develop through competition.

Moreover, the key underlying bottlenecks to improving the business environment, as spelled out in the PIDE RAPID Growth Strategy must be addressed. For example, Pakistan has not been successful in improving access to credit. Credit is an important part of any business, but it is not readily available for small businesses. The policy should propose a mechanism for easy availability of credit to small businesses.

Contract enforcement and investor rights

Businesses fail due to a lack of protection for minority investors. Weak contract enforcement is a major hurdle in encouraging economic activity in the country. The policy must cover this aspect and suggest a clear and easy policy intervention in this regard. Haque (2006, 2011) has already provided the reform direction of "Secure Legal Rights and Regulatory Environment."

The domestic commerce policy must focus on building the institutional capacity of Federal and Provincial departments of the government that deal with domestic commerce, rather than the entire government. This is even more pertinent after the 18th Amendment and the devolution of many functions of the state from the federal to the provincial level.

Haque (2007) suggested making domestic commerce pro-poor by allowing the poor some space for entrepreneurship in all Pakistani cities as well as in all the best areas in Pakistani cities. Currently, none of the fancy markets, like Liberty in Lahore, Super Market in Islamabad, or the Defense Market in Karachi, have any space for poor entrepreneurs. Bangkok and Singapore found space, why can't we?

Along with opportunities for the poor, there is a need to generate employment for the country's growing youth bulge. Domestic trade and commerce promotion offers this venue. The domestic commerce policy must be geared towards encouraging and facilitating all entrepreneurs. The relevant ministry can provide actionable and realistic policy interventions for successful gender mainstreaming of domestic commerce.

The draft policy does not specifically address the development of the domestic financial market. This would be essential for the further development of domestic markets and enabling businesses to engage in technology upgradation.

Transport, storage, and warehousing

The Policy rightly emphasizes the importance of storage and warehousing. However, historically storage and warehousing has been an area that has received only peripheral attention. Moreover, the private sector has a limited role and presence at best in Pakistan and must be developed through competition and private sector involvement.

Transportation, storage, and warehouses are the bedrock of the development of domestic commerce. The Policy has identified the sector as one of the priority areas. However, Axle Load Regimes are implemented by Asian Highway Network member countries and Pakistan does not conform to regional norms means we are excluding ourselves from such initiatives.

Similarly, rail transport is widely accepted as being more economical if railways can be modernized. Developing the railway network and allied infrastructure will in itself encourage domestic commerce.

The policy should emphasize the development of a local railway network to allow more cost-effective transportation of goods. Intra and intercity mass transportation systems (bus and rail) need to be developed further to reduce pollution and congestion, as well as the demand for POL imports. Development of access roads and networks for such systems will also be required so they can be utilized to their full potential. These can also serve as a venue for domestic retail and a source of additional revenue generation.

Competitiveness and productivity

One of the objectives of the policy is to enhance the competitiveness of enterprises. However, firms improve their competitiveness by increasing productivity and lowering costs. The focus should be on providing infrastructure (uninterrupted power, roads, water etc.), enabling R&D, and providing policy consistency and continuity. Similarly, the Policy emphasizes international trade. In this regard, the prime focus of the Policy should be on domestic trade and commerce first, and international trade second

Uniformity in costs

The objective of ensuring uniformity in costs is perhaps beyond the scope of the policy. Typically, costs are not a concern of policy. That entails interfering in the market, which creates inefficiency and costs in itself. Predictability should be ensured by promoting transparency and access to information regarding pricing and the market for inputs. Leave pricing to demand and supply. However, distortions that are a result of policy, such as industry-specific incentives, subsidized energy tariffs for specific sectors, etc. need to be removed to provide a level playing field for all the players.

Real estate

The Policy rightly has identified real estate as the key area of domestic commerce. This is a market that must be developed as such with transparency and access to information and in this regard, priority given to the modernization of zoning is a step in the right direction. However, in Pakistan, especially in Islamabad, zoning laws have anti-high-rise building construction and anti-mixed-use buildings bias. PIDE has been arguing for changing the zoning laws for a long now. For example, Haque (2011) has argued that for the development of domestic commerce and economic growth urban management and zoning need to be revisited. The study also highlights excess demand for affordable retail and office space and a low level of business sophistication.

Taxation

While having a one-window facility is convenient for tax filing, etc., the real issue is that if the documentation requirement is also not reviewed and streamlined, the problems would remain. In this regard, PIDE Growth Strategy (2021) has suggested a regulatory guillotine to reduce the regulatory burden on the economy.

Improvement of quality control and testing is essential for enhancing competitiveness. Private sector involvement in this area must be explored and enabled (under the guidance of the Ministry of Science and Technology), to reduce the burden of testing on the government. Currently, there are very few, if any, internationally accredited testing facilities in Pakistan.

The wholesale and retail sector

The policy suggests using goods inventory as collateral and preferring loans. However, it can lead to the indenture of businesses and dampen commercial activity and banks will prefer to finance businesses where they have assured a return. For businesses unable to pay the loan, what will the banks do with the goods inventory? It would be better to explore other financing options, such as transferring ownership of the assets to the bank till the loan can be paid off.

While meeting international standards is important to compete in the global market, initially, it is likely to involve greater costs. In the first stage, it would be better to focus on improving competitiveness, efficiency and productivity, and meeting international standards as a secondary/advanced goal.

Local brand development

Local brand development is an important aspect of any strategy to promote domestic commerce and, later on, exports. To this end, interaction between HEC, ORICs and industry needs to be strengthened through the MoC as academia and software houses are by and large aware of international developments.

Skill development

For skill development, the training provided by the institutes must be in line with the current requirements of the economy to meet the existing demand and must also be in line with emerging global trends so a modern workforce can be created. A major hindrance for businesses is that the graduates in the market do not have the skills that are required on the job and the businesses have to expend time and resources to train them.

Development of e-commerce

The Policy envisages giving special preference to various sectors, such as e-commerce. However, it must be noted that offering special preferences often creates distortions in the economy, for example, in the automobile industry. Therefore, the costs and benefits must be weighed.

Strategy contour

The Policy mentions the Market Reforms Strategy. In this regard, the focus areas can include sensitizing small city and town administrations to the importance of domestic commerce. Haque (2007) suggested making domestic commerce pro-poor by allowing the poor some space for entrepreneurship in all Pakistani cities as well as in all the best areas in Pakistani cities.

Currently, none of the fancy markets, like Liberty in Lahore, the Super Market in Islamabad, or the Defense Market in Karachi, has any space for poor entrepreneurs. Why can other countries have the equivalent of *khokhas* and *rehris* while in Pakistan the activity is discouraged or sidelined?

Will the new policy achieve its goals?

National Domestic Commerce Policy is an excellent attempt by the government to encourage the development of domestic commerce under a holistic framework. Nonetheless, the policy will only achieve its goals if lessons and insights from existing research and analysis are incorporated into the draft. The draft policy should also encourage:

- The use of professional urban management that is sensitive to the mixed-use city center and commercial development.
- A mindset that favors commercial development and middle-class housing over single-family homes for the rich.
- The removal of commercialization fees that penalize commercial development.
- Privatization of city center land and making large tracts of land available for mega commercial projects that include hotels, shopping malls, office space and flats.
- Tax system reform and harmonization at the federal and provincial levels.
- Improved and even alternative dispute resolution systems.

Shops and Establishment Acts

In Pakistan, including Islamabad, the rules and regulations applied to retail and wholesale establishments are enforced by the respective municipal corporations and development authorities. In the case of it is Islamabad Metropolitan Corporation (IMC) and the Rawalpindi Metropolitan Corporation (RMC) in the case of Rawalpindi. However, the businesses located in cantonment areas are overseen by the respective cantonment boards, e.g., Rawalpindi Cantonment Board in Rawalpindi.

The rules and regulations applied to the retail are based on the Shops and Establishment acts of respective provinces. While looking at these acts, one thing becomes evident which is that even though these provincial acts are dated differently, they are almost identical, which shows that all these acts are essentially the West Pakistan Shops and Establishment Act, with minor changes, such as the vaccination of the owner and employees after the COVID-19 pandemic.

These acts deal primarily with the registration of establishments, maintenance of registers, and definitions of holidays, etc. For example, regarding the closure of business at least one day during the week, the Punjab Shops and Establishment Ordinance 1969 says that "The choice of a closed day shall rest with the employer, who shall intimate such choice to the Inspector appointed under section 25 of this Ordinance." However, as it is clear from business practices, such a practice is rarely followed and most of the businesses remain open seven days a week. That shows the weak implementation of even the dated rules and regulations.

BOX 4.3 Procedures and Costs of Getting a Trade License in Islamabad

In Islamabad, getting a trade license to run a retail or wholesale business involves the following steps:

- Find a suitable location for your business and prepare a lease agreement for the business (i.e., retail, etc.).
- Prepare documents.
- Permission to display a signboard.
- Apply with the relevant authority.
- Wait for inspection.
- Processing at the metropolitan municipal authority.
- Get the license.

The whole process takes a considerable amount of time, which incurs opportunity cost in addition to monetary costs on the businessman starting a new business. For example, in Islamabad, it takes an average of 5.3 months to complete, and the monetary cost associated with getting a trade license and registration is PKR 80,185. In the case of Islamabad, the trade license is processed by Islamabad Metropolitan Corporation (IMC) but the application has to be submitted to the Capital Development Authority (CDA).

Source: PIDE Sludge Audit Volume 1 (2022)

Other Departments and Authorities

Other than dealing with the local authorities, the establishments in the organized retail and wholesale sector must comply with other rules and regulations and be registered with the following departments/authorities:

- Labor laws in case the establishment employs workers other than the owner (provincial authority).
- Employees Old-Age Benefits Institution (EOBI) (federal authority).
    - Retailers and traders must pay which includes the Employees' Old-Age Benefits Institution (EOBI) contribution.
- Social security of employees (Employees Social Security Institutions, such as Punjab ESSI, which is a provincial authority).
- Taxation (federal and provincial authorities).
    - In addition to income tax and sales tax, the traders have to pay a professional tax collected by the Excise and Taxation Departments.
- Sectoral regulations relevant to the line of business (e.g., food authority in the case of a restaurant or an eatery, which is a provincial subject).
    - A separate fee is charged by the relevant authority to issue and renew the license to operate the business.
- Consumer protection (provincial authority).
- Signboard (municipal authority and cantonment board).
    - The signboard fee is paid according to the size of the shop and the size of the signboard, hoarding, etc.
- Lease and rent (provincial authority).
- Stamp duty (on all contracts agreements, which is a provincial authority).

TABLE 4.7 Rules & Regulations Applicable to Organized Retail Sector

Business Area	Category	Jurisdiction	Law
Retail Outlets	Labor	Sindh	The Sindh Shops & Commercial Establishments Act, 2015
		Punjab	The Punjab Shops and Establishments Ordinance, 1969
		KP	The Khyber Pakhtunkhwa Shops and Establishment Act, 2015
		Islamabad	West Pakistan Shops & Establishment Ordinance, 1969
	Employees Old Age Benefits	Balochistan	The Balochistan Shops and Establishments Act, 2021
	Social Security	Federal Authority	EOBI ACT, 1976 and amendments
	Consumer protection	Provincial Authorities	e.g., The Punjab Employees' Social Security Ordinance
		Sindh	The Sindh Consumer Protection Act, 2014
		Punjab	The Punjab Consumer Protection Act, 2005
		KP	K-P Consumer Protection Act, 1997
		Islamabad	Islamabad Consumer Protection Act, 1995 & 2011

		Balochistan	The Balochistan Consumer Protection Act, 2003
	Signboard	Provincial/Municipal Authorities/-Cantonments	e.g., Punjab Outdoor Advertisement & Signboard Policy, 2013
	Trade licence/municipal by-laws	Provincial/Municipal Authorities/-Cantonments	e.g., Islamabad Trade Licence & By-Laws
	Lease/rent regulations	Provincial Authorities	e.g., The Punjab Rented Premises Act, 2009
	Taxation on the sale and purchase of goods	Federal Board of Revenue	Sales Tax Act w.r.t. POS Integration (applicable only to Tier-1 Retailers)
General	Taxation on the sale and purchase of services	Provincial Authorities	i.e., businesses receiving a service must also register and file returns
	Stamp duty on all contracts/agreements	Provincial Authorities	The Stamp Act, 1899
	Income taxes, customs duty, etc.	Federal Board of Revenue	The Income Tax Ordinance, 2001

Source: Courtesy Chain Stores Association of Pakistan

THE SIZE OF DOMESTIC COMMERCE IN THE TWIN CITIES

To measure the kind of trade taking place in the domestic market, a mapping of all the major markets in the twin cities was conducted. The outlets mapped were then classified into 32 categories based on the nature of the business. The key highlights of this exercise are:

- There are 49,873 outlets in the twin cities.

- Garments and clothing, automobiles, and food outlets constitute around 39% of the twin cities' WRT activities.

TABLE 4.8 Composition of Domestic Commerce in Twin Cities (Percent)

Category	Percentage Share	Category	Percentage Share
Garments and Clothing	13.97	Meat	1.56
Automobile	13.39	Toys and Gifts	1.33
Food	11.61	Banks	1.21
Others	9.46	Photography	0.86
Grocery	7.27	Sports	0.76
Electronics and Electrics	3.99	Cigarettes and Vapes	0.74
Footwear	3.98	Opticians	0.70
Real Estate	3.53	Goldsmith	0.63
Saloon	3.18	Rent-a-Car	0.63
Hardware	3.04	Courier and Post	0.57
Medical	2.79	Travel Agency	0.57
Mobiles	2.78	Cobbler	0.51
Computer and ICT	2.61	Construction & Allied	0.50
Furniture	2.53	Consultancy	0.46
Tailor	2.20	Locksmith	0.44
Books	1.81	Pan Shop	0.36

Source: PIDE State of Commerce Survey

Category-wise numbers of WRT establishments in the twin cities are presented in Table 4.9.

TABLE 4.9 Composition of Domestic Trade in the Twin Cities (Numbers)

No.	Category and Sub-category	Outlets (Nos.)
1	**Garments and Clothing**	**6,968**
	Garments	1,684
	Clothing Shops	1,360
	Stalls	1,938
2	**Automobile Shop**	**6,680**
	Mechanics	4,025
	Car Wash	367
	Battery Shops	712
	Auto Décor	1,576
3	**Food**	**5,791**
	Restaurants (including pizzerias)	2,604
	Naan Shops	767
	Juice Corners	986
	Vendors (samosa, fries, chaat, etc.)	1,008
	Bakeries	426
4	**Others**	**4,720**
5	**Grocery Stores**	**3,624**
	Kiryana Stores	1,686
	Cash-and-carries	321
	General Stores	1,617
6	**Electronics and Electric Stores**	1,991
7	**Shoe Shops**	**1,986**
8	**Real Estate**	**1,763**
	Real Estate Agencies	1,362
	Developers	200
	Marketing Agencies	201
9	**Salons**	**1,586**
	Barber Shops	809
	Beauty Parlors	777
10	**Hardware Stores**	**1,515**
11	**Medical**	**1,392**
	Medical Stores	797
	Clinics	451
	Hospitals	144
12	**Mobile Shops**	**1,387**
13	**Computer and ICT**	**1,303**
	Computer and Laptop	896
	IT-related	407
14	**Furniture**	**1,262**
	Furniture	609
	Foam	343
	Wood and Plywood	310
15	**Tailors**	1,095
16	**Bookshops**	904
17	**Meat Shops**	777
18	**Toys and Gift Shops**	663
19	**Banks**	604
20	**Photo Studios**	431
21	**Sports Shops**	380
22	**Cigarette and Vape Shops**	368
23	**Optical Shops**	351
24	**Goldsmiths**	316
25	**Rent-a-Car**	312
26	**Courier and Post**	284
27	**Travel Agencies**	283
28	**Cobblers**	255
29	**Construction (cement, bricks, etc.)**	250
30	**Consultancies**	230
31	**Locksmiths**	220
32	**Paan Shops**	182
Total		**49,873**

Mapping based on different zones indicates that in Islamabad Zone-I (F-6 to F-14, G-5 to G-14, H-8 to H-13, and I-8 to I-13) and Zone V, (DHA, Bahria Town, PWD Housing Schemes, etc.) food-related outlets constitute a major share. In the case of Zone IV (Bani Gala, Bahria Enclave, Rawal Town, Shahzad Town, etc.), grocery stores lead the domestic trade. In Rawalpindi, automobile outlets top the list. [16]

TABLE 4.10 Location of Commercial Activity in Twin Cities (Percent Share)

No.	Category	Islamabad			Rawalpindi
		Zone-I	Zone-IV	Zone-V	
1	Garments and Clothing	8.62	7.87	8.92	9.42
2	Automobiles	6.75	4.89	3.57	11.66
3	Food	9.80	8.49	10.18	5.26
4	Grocery Stores	3.43	9.24	4.12	3.73
5	Electronics and Electric Stores	1.33	2.04	1.64	3.52
6	Shoes	2.21	2.38	1.73	2.91
7	Real Estate	3.30	1.85	3.98	1.53
8	Salon	1.66	2.39	3.54	1.81
9	Hardware Stores	2.31	1.97	0.89	1.92
10	Medical Stores etc.	2.31	1.52	2.78	1.41
11	Mobile Shops	2.07	2.39	1.26	1.49
12	Computer and ICT	2.09	1.09	0.95	1.77
13	Furniture	1.11	1.46	1.30	1.98
14	Tailors	1.78	1.41	1.30	1.21
15	Bookshops	0.60	0.60	1.14	1.65
16	Meat Shops	0.87	1.06	1.16	1.00
17	Toys and Gift Shops	0.42	0.42	1.36	1.13
18	Banks	1.10	0.41	2.05	0.50
19	Photo Studios	0.69	0.46	0.69	0.48
20	Sports Shops	0.32	0.28	1.01	0.55
21	Cigarette and Vape Shops	0.21	0.14	1.02	0.62
22	Optical Shop	0.48	0.42	0.67	0.40

[16] A GIS-based mapping was also attempted using open-source data. However, open-source GIS mapping did not give accurate numbers, which was verified by sending survey teams to different markets

23	Goldsmiths	0.33	0.42	0.61	0.40
24	Rent-a-Car	0.68	0.29	0.31	0.31
25	Courier and Post	0.44	0.10	0.37	0.42
26	Travel Agencies	0.53	0.34	0.67	0.23
27	Cobblers	0.43	0.30	0.25	0.30
28	Construction (cement, bricks, etc.)	0.49	0.53	0.19	0.18
29	Consultancies	0.62	0.24	0.15	0.17
30	Locksmiths	0.35	0.15	0.20	0.31
31	Pan Shops	0.14	0.16	0.44	0.27
32	Others	5.70	8.25	3.96	5.79

Source: PIDE State of Commerce Survey

AN ASSESSMENT OF DOMESTIC COMMERCE IN THE TWIN CITIES

To assess the domestic market based on different aspects, a detailed survey was carried out. The objective was to enumerate different aspects of domestic commercial activities in the twin cities. The information was collected from respondents from the subcategories shown in Table 4.8. The survey covered approximately 500 outlets and a category-wise detail of the outlets covered is presented in Table 4.7 while Figure 4.7 contains category-wise percentage distribution.

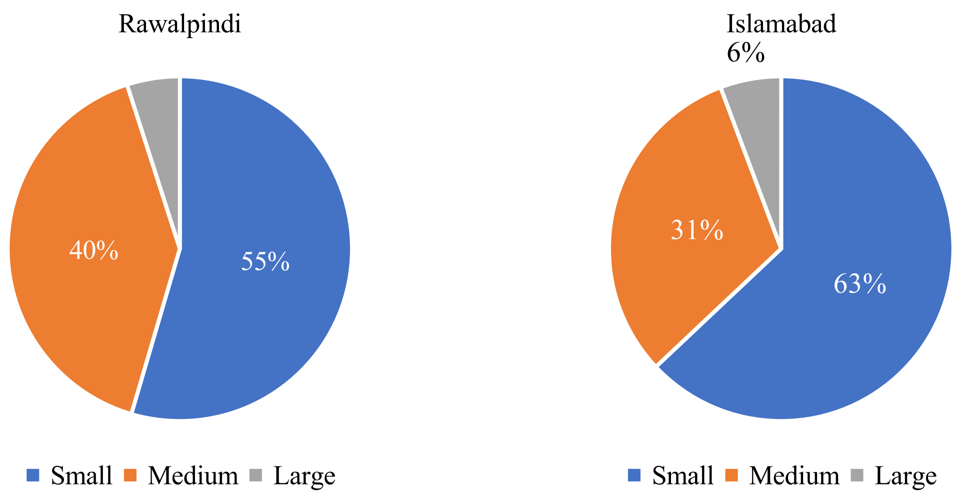
WHOLESALE & RETAIL SURVEY IN TWIN CITIES

The survey was based on convenience sampling because of the reluctance of establishment owners to share information. It is a known fact that in Pakistan, collecting information from businessmen, whether in the formal sector or the informal sector, is one of the biggest challenges. Businessmen are especially reluctant to share financial information as well as the number of workers they employ. The reason is the fear and mistrust of the taxation authorities and labor department.

Size of Outlets

The size of an establishment has been classified based on the size of the shop. A retail outlet having a shop size of less than 125 square feet (sq. ft.) is classified as small, 125 to 300 sq. ft. as medium, and above 300 sq. ft. as large.

FIGURE 4.7 Size of Retail Outlets in the Twin Cities (Percent)

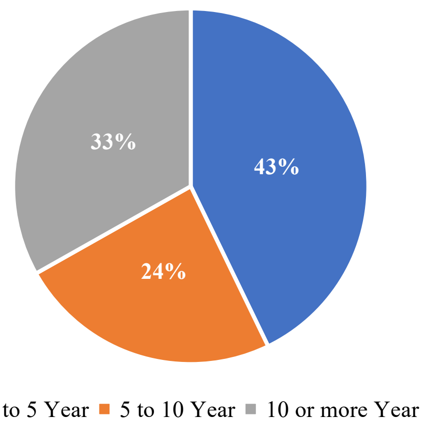


Source: PIDE State of Commerce Survey

Years of Operation

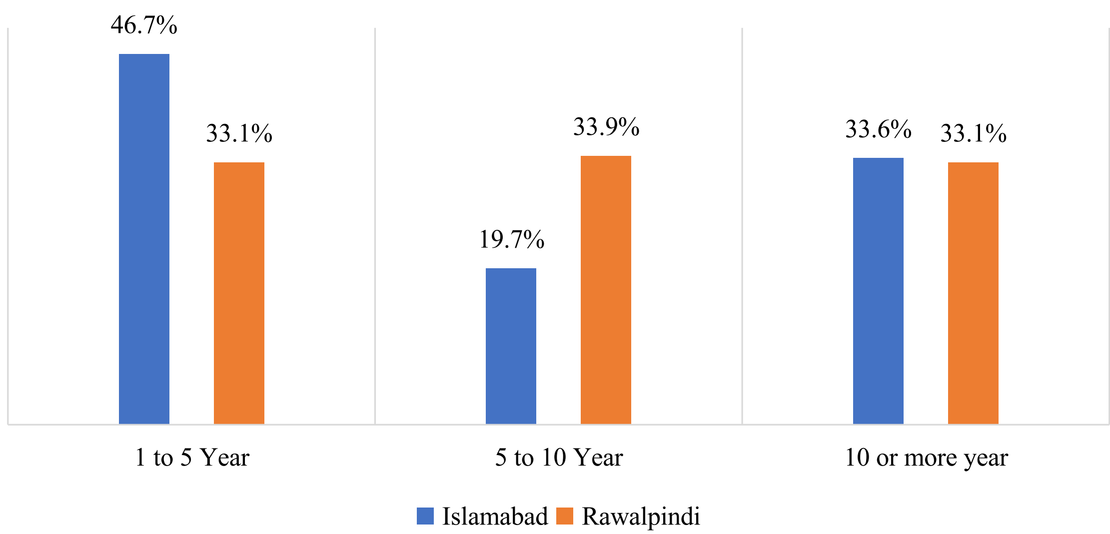
The age of an outlet was determined by asking for the number of years an outlet was operational. Three categories were identified based on the years of operation. Only one-third of the surveyed outlets were operational for more than 10 years. In the case of Rawalpindi, all three categories (small, medium, and large) had almost the same share. In Islamabad, young outlets constituted around 47% of the outlets.

FIGURE 4.8 Number of Years in Operation (Percentage)



Source: PIDE State of Commerce Survey

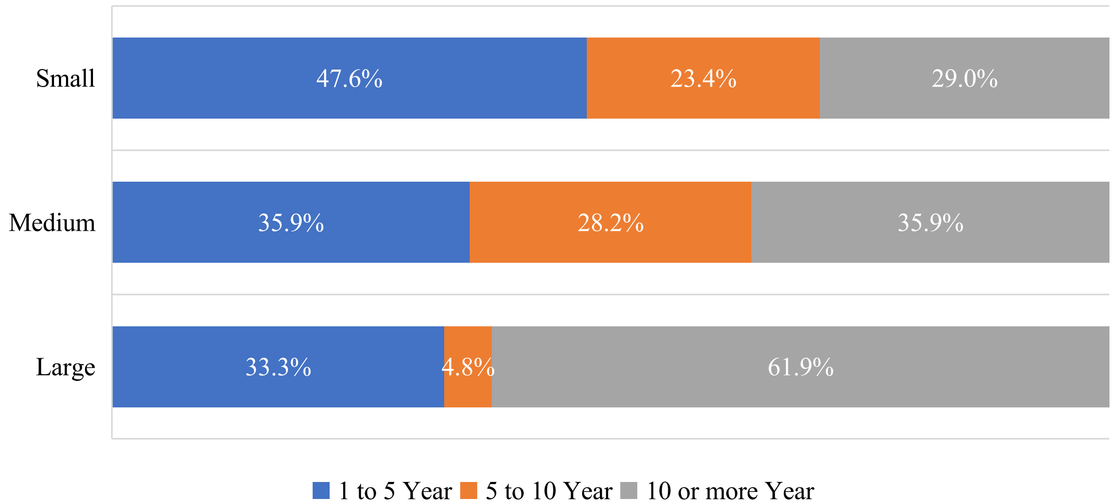
FIGURE 4.9 Number of Years in Operation: Islamabad & Rawalpindi (Percent)



Source: PIDE State of Commerce Survey

The size of an establishment is also related to the age of the establishment. The figure below clearly shows that as the age of an establishment increases, its size also increases. Although the information on the size when the business was established is not available, the results are indicative of a positive relationship between the size and years of operation.

FIGURE 4.10 Years in Operation and the Size of the Establishment (Percent)



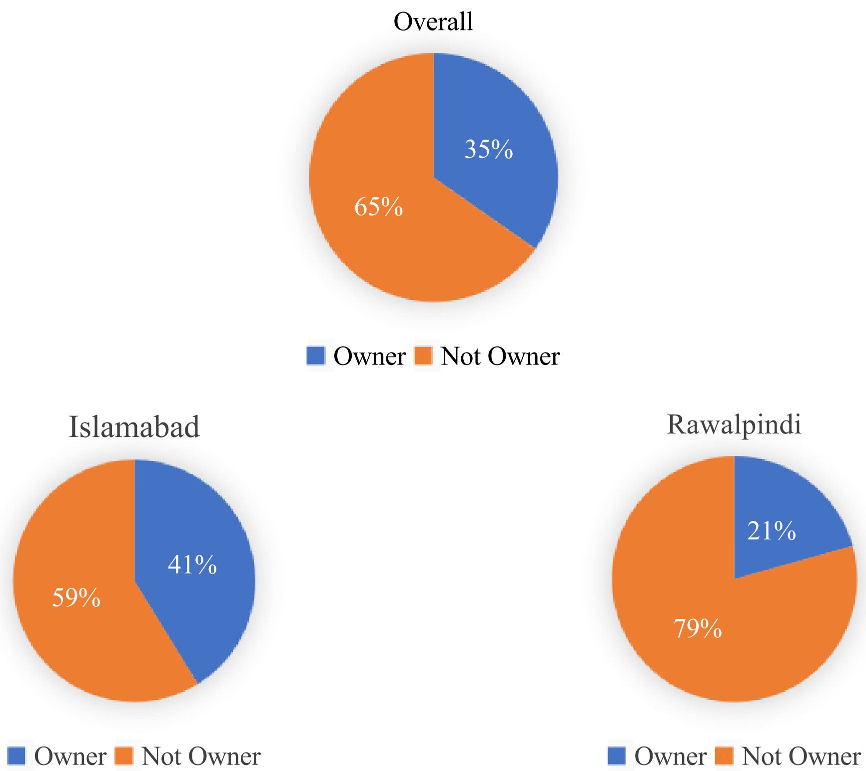
Source: PIDE State of Commerce Survey

According to the figure above, 61.9% of the establishments surveyed that are 10 years or older are large. This shows that although there are many constraints to the growth of WRT establishments in Pakistan, with time an establishment's size grows. It could be due to a variety of reasons including learning the tricks of the trade, i.e., trust development with the suppliers, informal creditors, and the use of informal credit channels, such as rotating saving and credit association (ROSCA), colloquially known as the "committee system."

Ownership Status

The majority of the respondents in our survey did not own outlets, i.e., most of the establishments were operating in rented spaces. Still, a sizeable number, i.e., 35%, owned the shop in which they were operating the business.

FIGURE 4.11 Ownership Status: Owned or Not Owned (Percent)

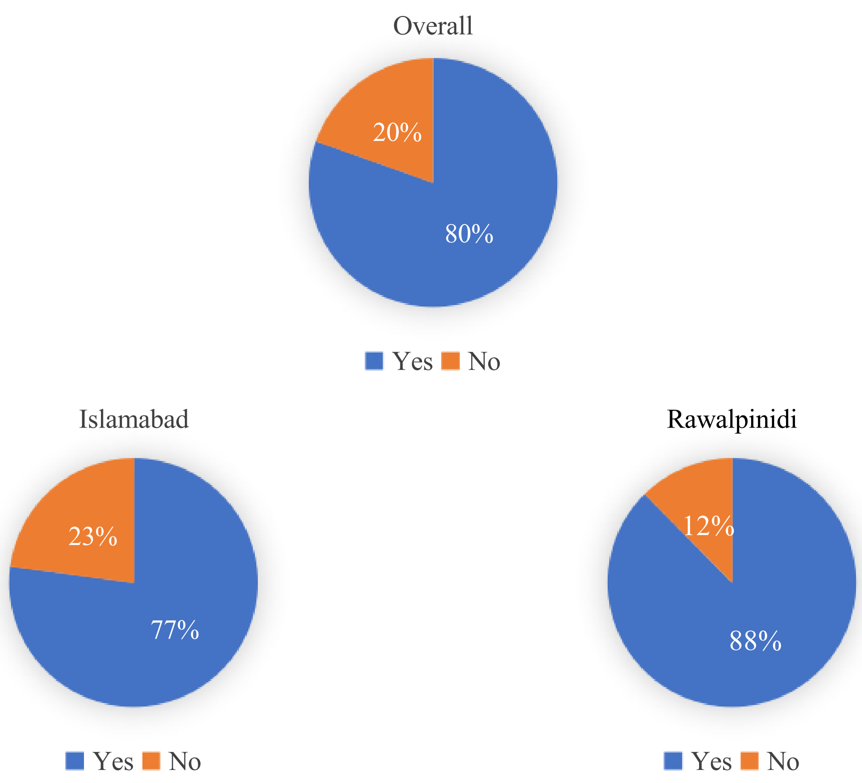


Source: PIDE State of Commerce Survey

Sole proprietorship

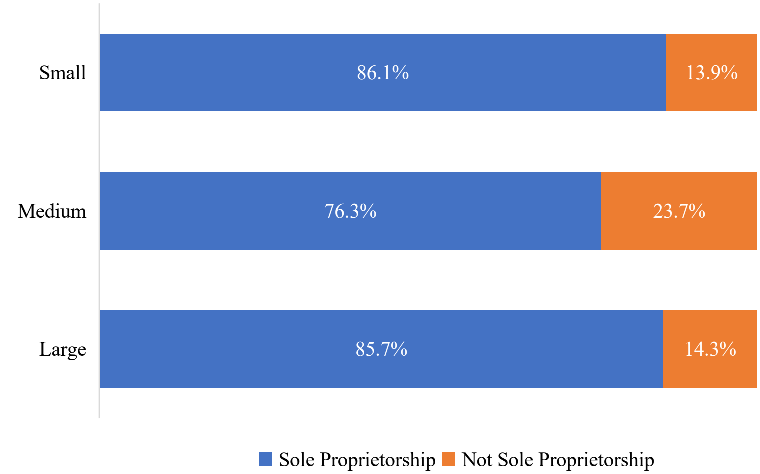
Domestic commerce in the twin cities is mostly based on sole proprietorship and only 20% of the surveyed establishments were not operating as sole proprietors. The trend of a sole proprietorship is almost the same across all sizes, as can be seen in Figure 4.12 below. While sole proprietorship has its advantages such as fewer legal requirements, lower tax rates or even tax evasion, maintaining informality to avoid regulations and complete control over the operations, there are certain disadvantages as well. The disadvantages include limited availability of capital to expand the business, dealing with suppliers and wholesalers alone, maintaining records and inventory, and shutting down shops to visit suppliers. This is one of the reasons that the businesses in the WRT sector do not grow because after reaching a certain size, it becomes difficult to invest capital to expand the business. However, interviews and FGDs revealed that entering into a partnership has its drawbacks, such as conflict resolution because contract enforcement is weak in Pakistan and the majority of businesses, or individuals, for that matter, avoid going into litigation due to high time and pecuniary costs.

FIGURE 4.12 Proprietorship Status: Sole Proprietorship (Percent)



Source: PIDE State of Commerce Survey

FIGURE 4.13 Size of the Outlet and Proprietorship Type (Percent)

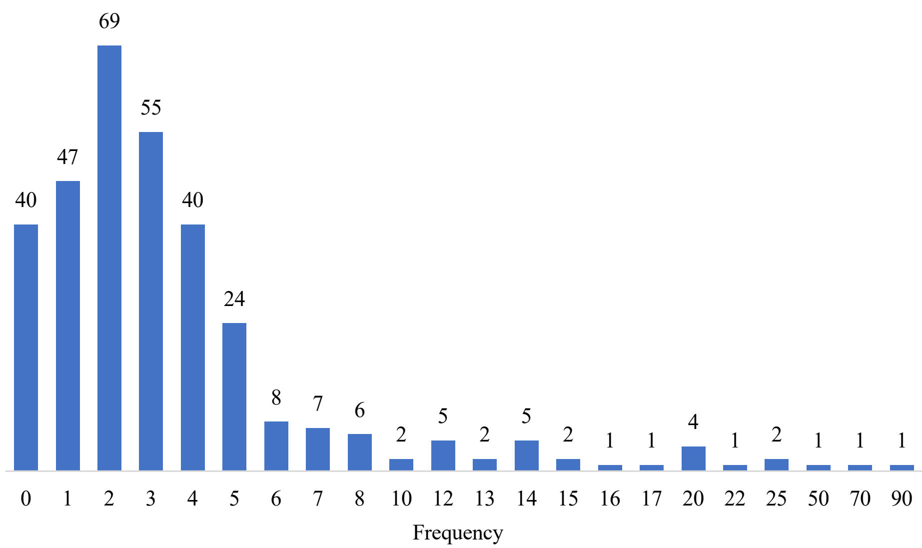


Source: PIDE State of Commerce Survey

Number of Employees and Wages

The average number of employees is 4 per outlet in the twin cities, with a minimum of no employees and a maximum of 120 employees.

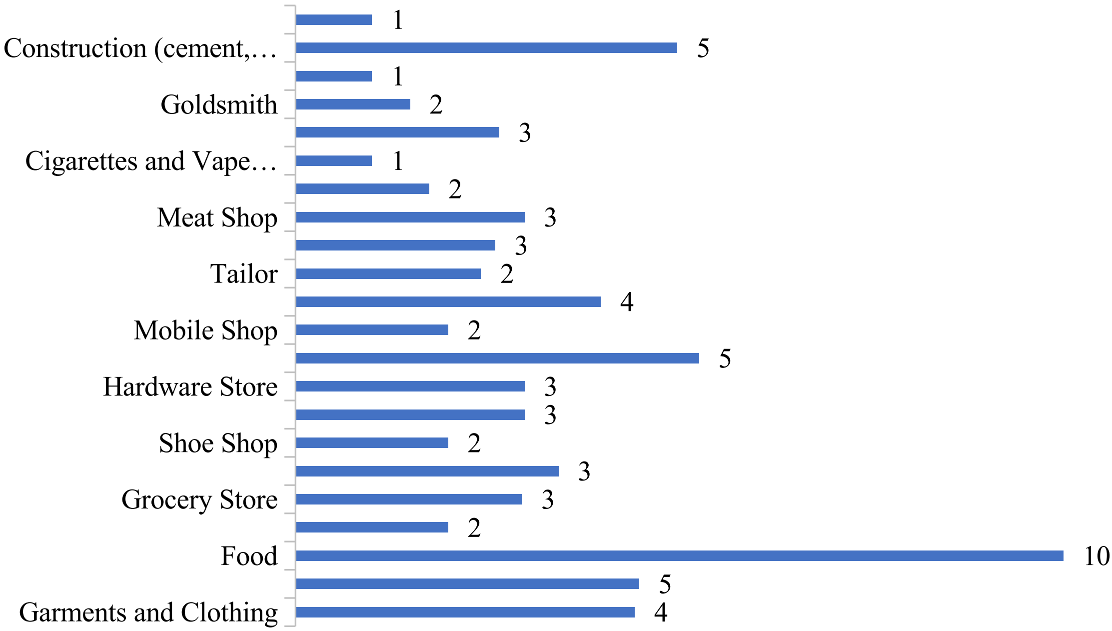
FIGURE 4.14 Number of Employees: Frequency



Source: PIDE State of Commerce Survey

The average number of employees across categories is presented in Figure 4.15.

FIGURE 4.15 Average Number of Employees: Category-Wise (Numbers)



Source: PIDE State of Commerce Survey

The average monthly wage paid was PKR 23,905 overall. The city-wise breakdown shows that the average monthly wage was PKR 23,942 in Islamabad and PKR 23,812 in Rawalpindi. However, the minimum monthly wage paid was PKR 3,000 and the maximum was PKR 50,000.

The common method to pay monthly wages was in cash as 68% of the workers in the WRT sector were paid in cash, whereas only 7% were paid monthly wages through banks or e-wallets. In addition to monthly wages, some of the establishment owners also stated that they incurred approximately PKR 10,000 monthly cost per employee to cover, in some cases, accommodation, daily meals, and travel costs.

Utility Charges

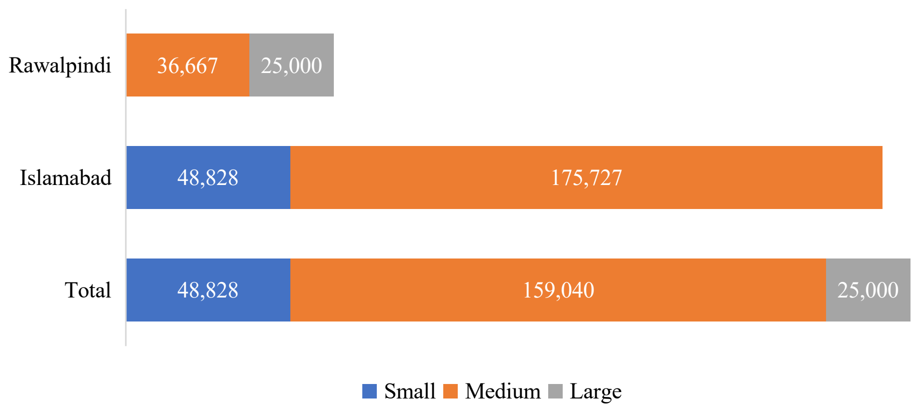
To assess the utility charges paid by each outlet, we focused on expenditures on gas, electricity, generators, and water.

TABLE 4.11 Average Monthly Expenditures: Gas (PKR)

Region	Expenditures
Overall	103,954
Islamabad	111,623
Rawalpindi	45,475

Source: PIDE State of Commerce Survey

FIGURE 4.16 Size of the Outlet and Average Monthly Expenditures: Gas (PKR)



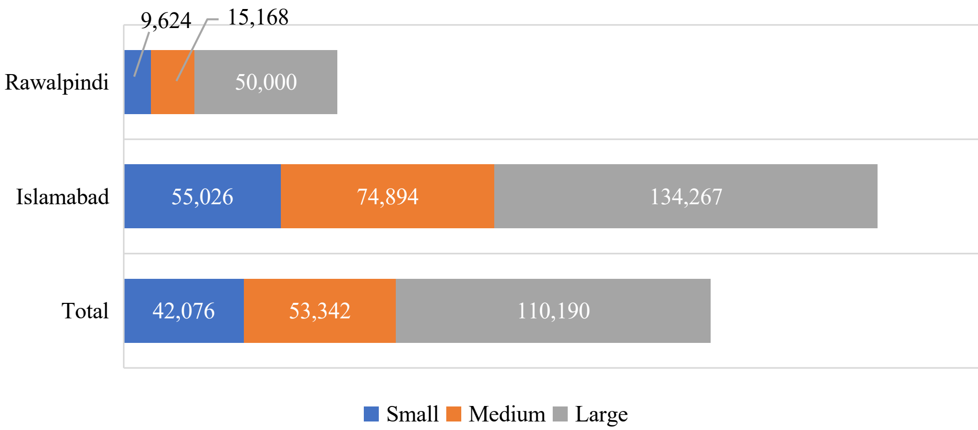
Source: PIDE State of Commerce Survey

TABLE 4.12 Average Monthly Expenditures: Electricity (PKR)

Region	Expenditures
Total	49,615
Islamabad	65,730
Rawalpindi	14,104

Source: PIDE State of Commerce Survey

FIGURE 4.17 Average Monthly Electricity Expenditures According to Size (PKR)



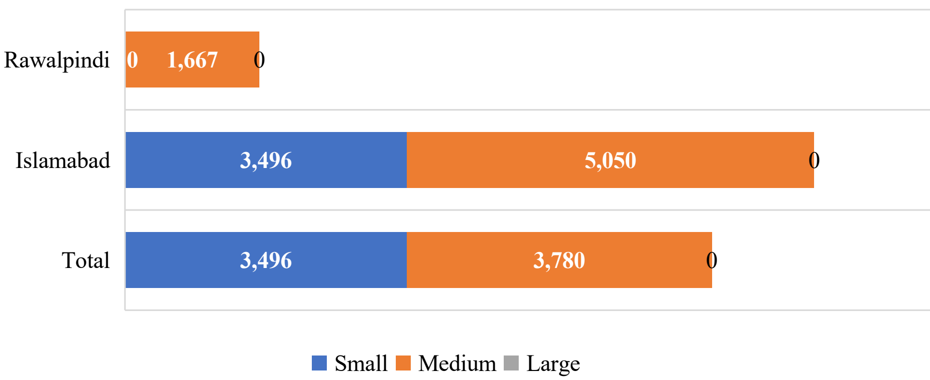
Source: PIDE State of Commerce Survey

TABLE 4.13 Average Monthly Expenditures: Water (PKR)

Region	Expenditures
Total	24,192
Islamabad	26,039
Rawalpindi	2,400

Source: PIDE State of Commerce Survey

FIGURE 4.18 Monthly Water Expenditures According to Size (PKR)



Source: PIDE State of Commerce Survey

TABLE 4.14 Average Monthly Expenditures: Generator (PKR)

Region	Expenditures
Overall	24,192
Islamabad	26,039
Rawalpindi	2,400

Source: PIDE State of Commerce Survey

TABLE 4.15 Average Monthly Expenditures: Other (PKR)

Region	Expenditures
Total	24,192
Islamabad	26,039
Rawalpindi	2,400

Source: PIDE State of Commerce Survey

Sale Revenues

Sales and revenue figures reported by WRT establishments are not reliable because of underreporting. For this reason, the figures reported by respondents have been relegated to Appendix 4A.

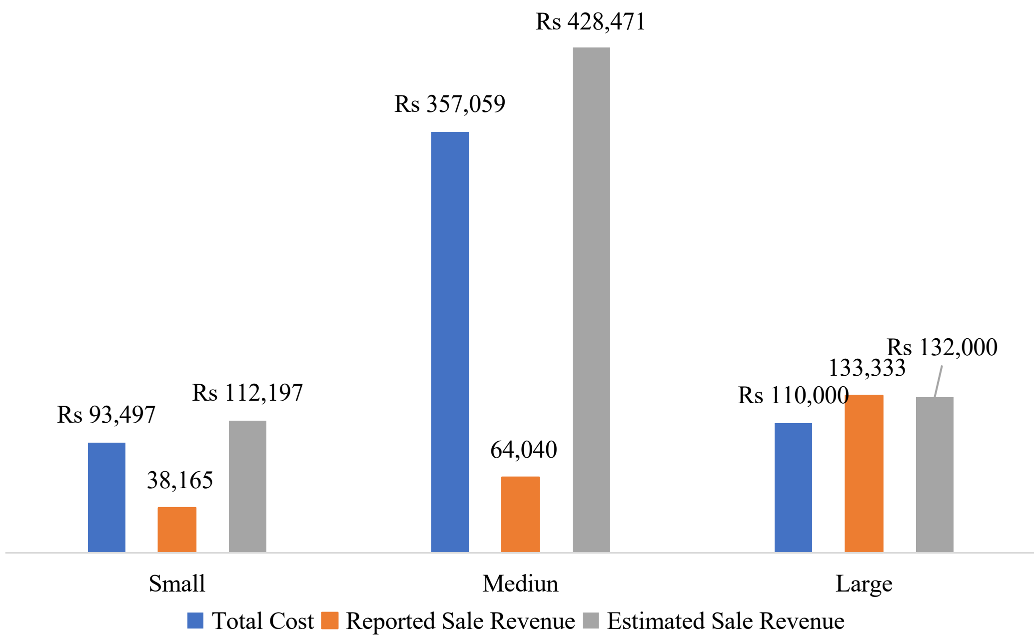
The average monthly sale revenues based on the survey data collected is PKR 85,883 in twin cities. Across cities, Islamabad reported average monthly sales of PKR 98,474, while in Rawalpindi it is PKR 55,362. These figures, when compared with other costs, such as rent and utility bills, clearly show that these figures are underreported. These figures are reported in Tables 4.11– 4.15 and Table 4.20.

REPORTED SALES AND REVENUE FIGURES: A CAVEAT

Collecting reliable estimates from business entities in any sector in Pakistan, especially the sector that is characterized by various forms informality, about the sales revenue is a daunting task. The reluctance to share sales and revenue numbers emanates from the mistrust between businesses and the government. The entrepreneurs see it as the perceived threat from FBR and other regulating bodies. The businesses think that the government tries to elicit revenue through stealth means to impose taxation. A report by the State Bank of Pakistan (SBP, undated) also faced the same problem. Due to these reasons, a few respondents refused to respond to sale-related questions. Even though the majority provided some figures, these figures are understated as the expenditures on utilities, wages, and other expenses overshoot the revenues reported by retailers and wholesalers.

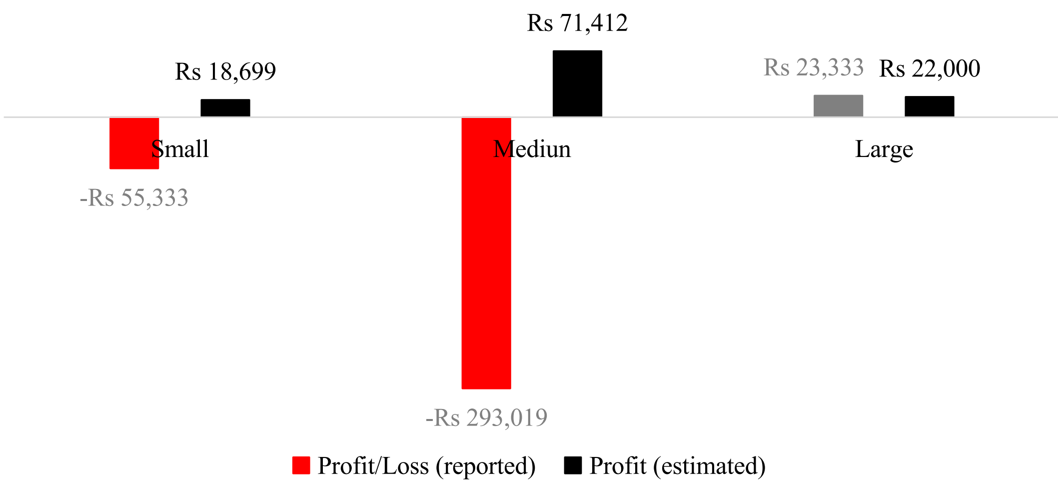
Therefore, to get plausible estimates of an average WRT establishment, it is assumed that an average WRT's gross margin is 20%. Based on this assumption, the profit/loss estimates are presented in Figure 4.20 and Figure 4.21. According to the estimates based on the assumption of a 20% gross margin, small, medium, and large establishments earn a profit of PKR 112,197, PKR 71,412, and PKR 132,000, respectively. These estimates are still on the lower side but it gives an idea that the majority of WRT establishments' finances are in the black. As shown in Figure 4.21, the slightly higher profit based on reported costs and revenues than estimated profit for large establishments implies that larger establishments' profit margin is higher than smaller establishments' profit margin.

FIGURE 4.19 Total Costs and Sale Revenues: Reported vs. Estimated (PKR)



Source: PIDE State of Commerce Survey

FIGURE 4.20 Profit/Loss: Reported vs. Estimated (PKR)



Source: PIDE State of Commerce Survey

Taxation

When asked about taxes paid, around 70% of respondents stated that they do not pay any tax, while 13% responded that they pay income tax.

TABLE 4.16 Types of Taxes Paid (Percent Responses)

Tax	Percentage Who Pay
Income Tax	13.1%
Sales Tax	10.3%
Municipal Tax	6.8%
None	69.7%

Source: PIDE State of Commerce Survey

Based on data collected from the respondents who pay taxes, the average annual tax payment is around PKR 1.3 million per outlet.

TABLE 4.17 Amount of Taxes Paid (PKR)

Range	Amount
Average (Annual)	1,316,333
Minimum	2,000
Maximum	25,000,000

Source: PIDE State of Commerce Survey

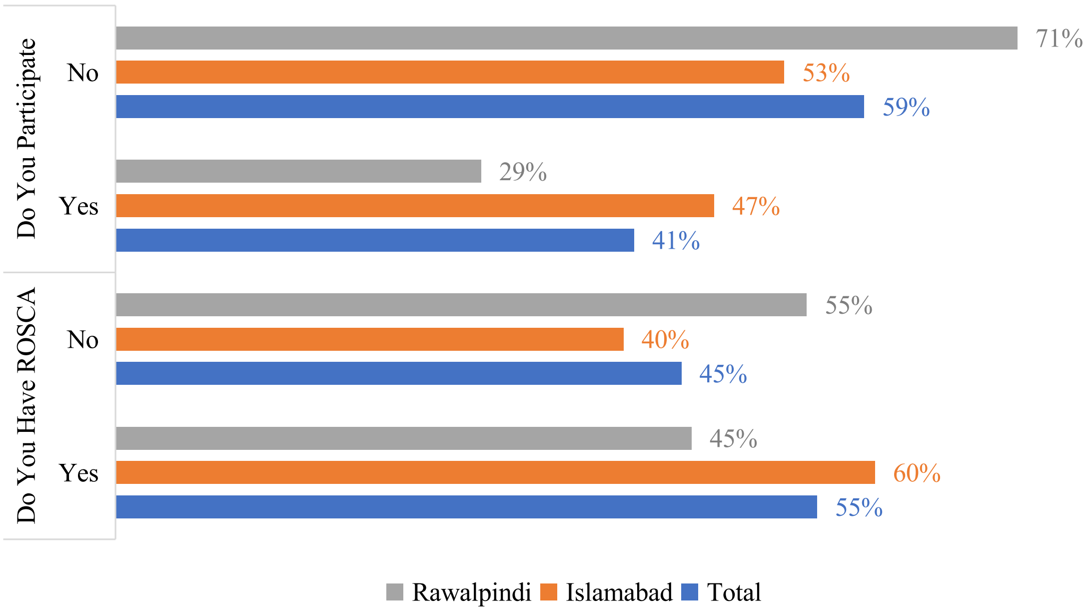
Across categories, medical-related outlets are the highest tax-paying category.

Finances and Financial Transactions

Informal credit

To manage financial constraints and build up savings, the common practice is using informal credit, such as loans from family and friends. However, in the WRT sector, an important source of finance is ROSCA schemes, commonly known as the “committee system.” The average daily contribution, as reported by respondents, was around PKR 1,500. Around 55% of the business owners stated that they participated in ROSCA schemes, while 41% noted that they did not participate in these schemes.

FIGURE 4.21 ROSCA Participation (Percent)



Source: PIDE State of Commerce Survey

Rotating saving and credit association

ROSCA is quite prevalent in retail and wholesale. The size of a committee payment, i.e., the amount that a member of the committee gets in their turn, varies between PKR 200,000 and PKR 10,000,000. The period in which a cycle of the committee is completed is usually between 10 months to a maximum of 24 months. According to KIIs and FGDs, approximately, 45% to 55% of the WRT establishment owners in the twin cities participate in a ROSCA. Almost every commercial market has its own ROSCA.

Participation

It must be noted that not everyone can participate in the committee because there is a risk that a member might default. Therefore, the participants are selected through references and guarantees of the established members, and only those traders are selected who are established, are financially solvent, and enjoy a good rapport with their fellow traders. Having said that, ROSCA is the major source of finance for established businesses in Rawalpindi.

'Boli committee' (auction ROSCA)

There is an interesting variation of the committee system, which is quite common among the traders, which in local jargon is called 'boli[17] committee.' In this system, the trader who initiates the committee gets the first payment. The size of the committee is usually PKR 2,500,000. In subsequent months, the committee is auctioned. Whosoever needs the cash the most offers to "buy" the committee at the lowest price, say, PKR 2,200,000. The forfeited amount, i.e., PKR 300,000 in our example, is kept aside as income earned. In the next auction, the buyer bids to buy the committee at, say, PKR 2,300,000. The amount forfeited, i.e., PKR 200,000 is again kept aside. The process goes on until the last member has received their share, which is the full amount of PKR 2,500,000. The amount forfeited gets smaller each month because the one who buys the committee at a lower price gets a smaller share from the remaining pot. In the end, the total amount kept aside is divided equally among the members. In this way, the first member who forfeited PKR 300,000, recoups some amount he forfeited.

Default rate

There is a problem of fraud as sometimes a participant runs away after getting their share. In case the participant is accessible, such a dispute is resolved through market committees. However, sometimes they leave the country, which inflicts a loss on other members, but such cases are few and the default rate is around 5%. In general, the committee system, especially the boli committee, is a huge success and very useful for traders as it gives them ready cash whenever they need it.

[17] Boli is local terminology for auction.

Borrowing from friends and family

Most traders and small businesses manage cash flow by borrowing from friends and family as getting loans from the formal financial sector is almost impossible for small business owners.

Government policies

Although the government has made efforts to provide financing facilities to small businesses and traders through various schemes. One such scheme is the Kamyab Jawan Program, which provides financing to young entrepreneurs. On the surface, it may appear that getting a loan under these loan programs is a breeze, but nothing can be far from reality. Availing credit facilities should be easy and the requirements for getting loans under government-sponsored schemes should be made easier. In other countries, governments facilitate small businesses to get loans for capital expenditure as well as for current expenditures.

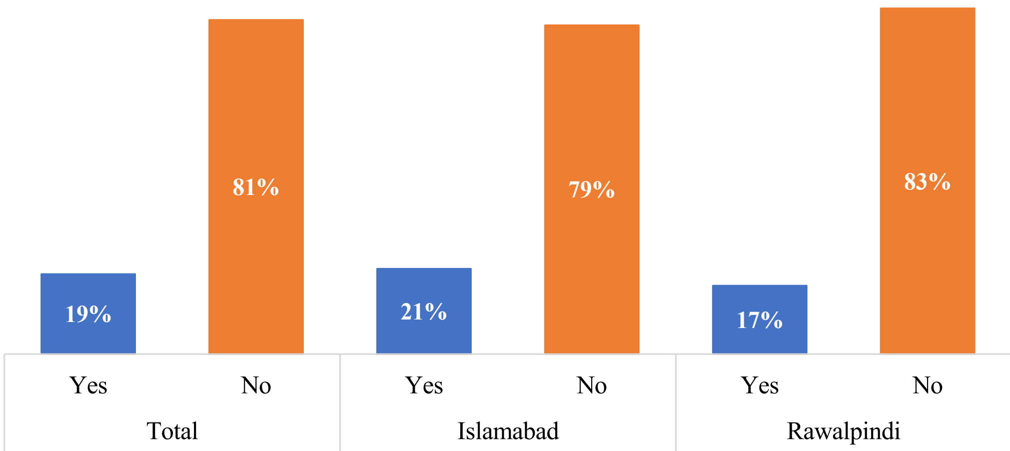
Banks' indifference

Banks do not cooperate with traders, including wholesalers and retailers, to disperse loans despite the State Bank's directives and policies. If a businessman, be it a trader or a manufacturer, approaches a bank to get running finance, the bank requires them to open and maintain an account with it for at least six months. On top of that, it requires the businessman to maintain a certain average balance and if the businessman fails to do so, the bank does not provide them with the facility. The irony is that if the businessman had that much amount, to begin with, they would not need a loan for running finance. Even if the requirements of the bank are completed, it is not feasible for a business to borrow at such high interest rates. Moreover, banks do not develop retail and trade-specific products despite instructions from the State Bank because they do not have any incentive to lend at lower interest rates. They find it more profitable to invest in government paper.

Inventory Management

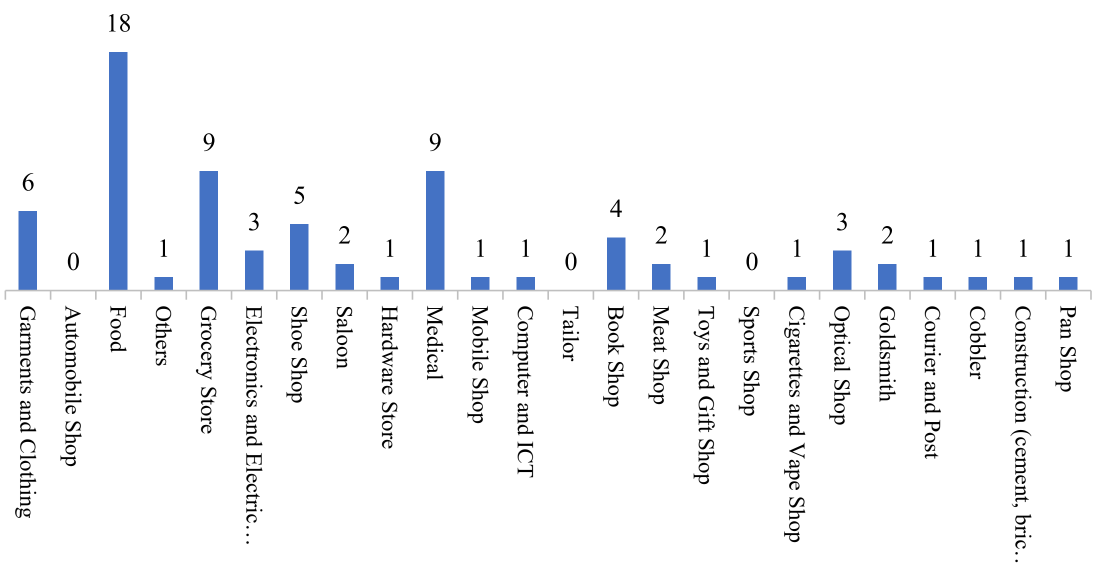
The majority of the respondents do not have any inventory management mechanism.

FIGURE 4.22 Inventory Management Mechanism (Percent)



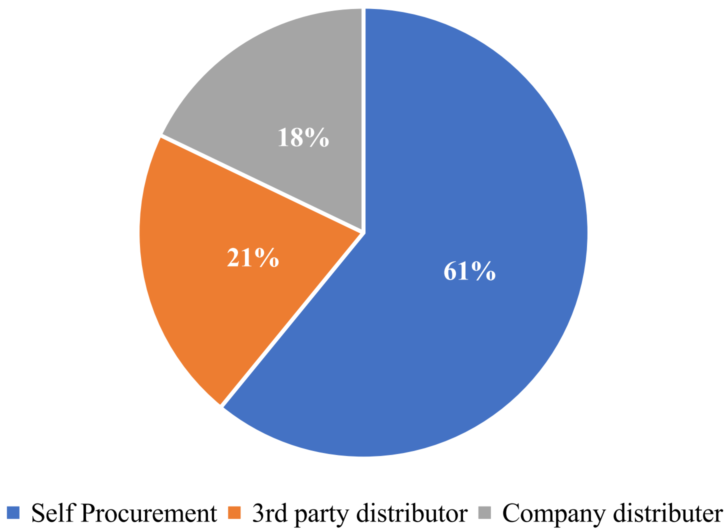
Source: PIDE State of Commerce Survey

FIGURE 4.23 Inventory Management Mechanism: Category-Wise (Percent)



Source: PIDE State of Commerce Survey

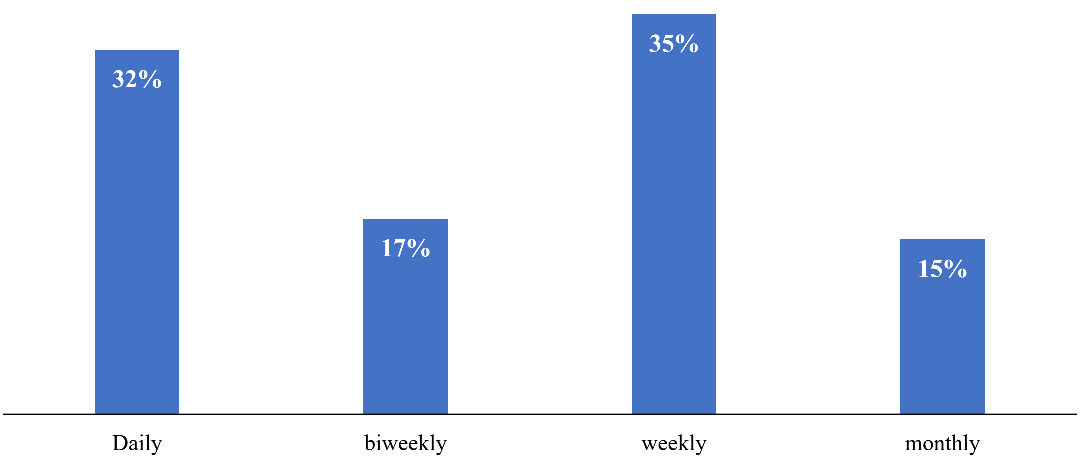
FIGURE 4.24 Procurement Method (Percent)



Source: PIDE State of Commerce Survey

The procurement in most cases was reported to be carried out either on a daily or weekly basis. However, some of the businesses also reported to be making procurements bi-weekly (17%) as well as monthly (15%).

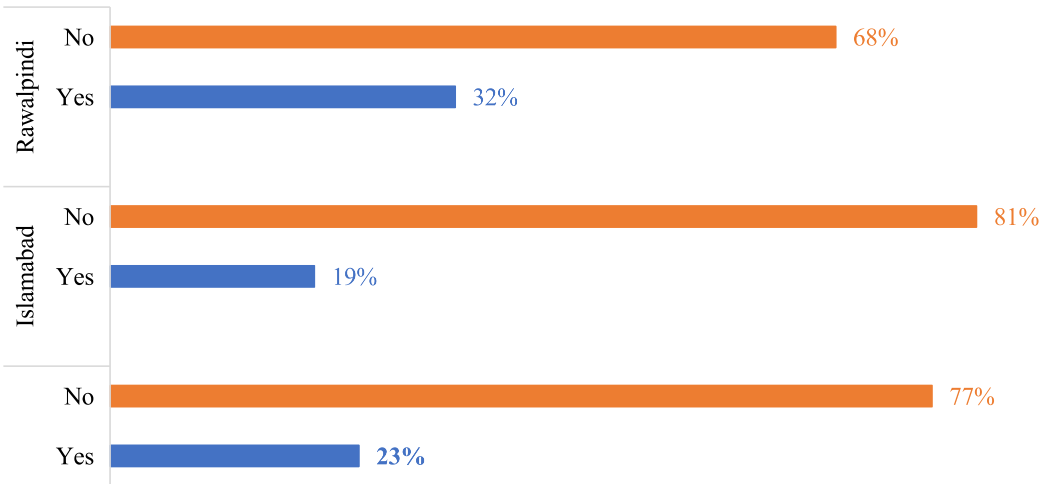
FIGURE 4.25 Frequency of Procurement (Percent)



Source: PIDE State of Commerce Survey

The procurement of the inventory was mostly carried out in cash pointing to the informal nature of the sector. Only 23% of respondents noted that credit-based procurement from the supplier was possible.

FIGURE 4.26 Payment Method: Cash or Credit (Percent)



Source: PIDE State of Commerce Survey

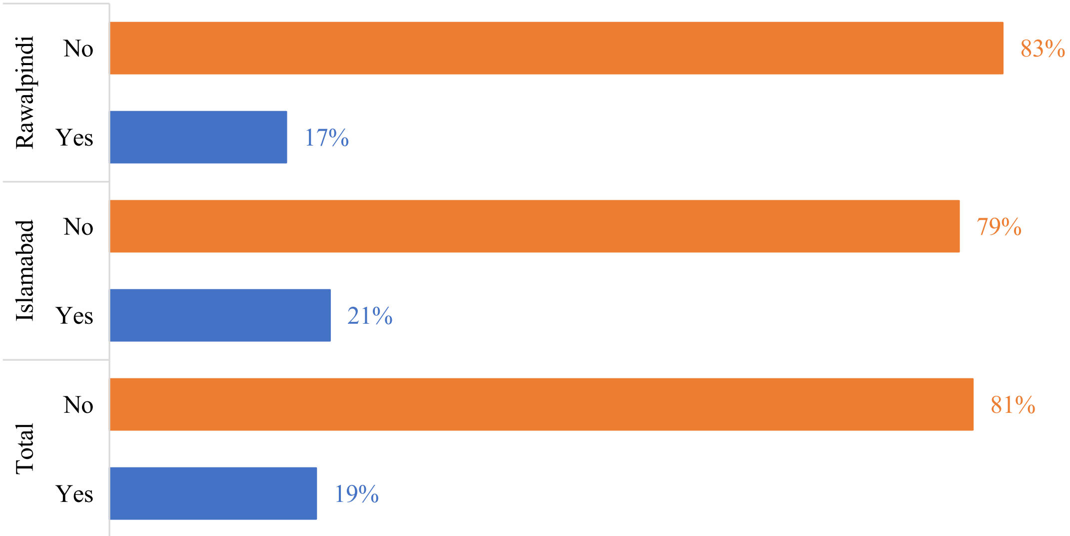
WHY CASH TRANSACTIONS?

In other countries, most of the transactions are conducted through formal channels, but in Pakistan, due to various issues, such as the distinction between a filer and a non-filer, taxation, sales tax, etc., most of the traders make cash payments to wholesalers, vendors, and other segments in the supply chain. This is a good example of regulation and rule that slows down and cuts down transactions and invites informal modes of transaction.

Warehouses

The majority of the respondents reported that they did not have warehouses. Only 14% of the respondents reported having a warehouse other than the shop.

FIGURE 4.27 Warehouse Availability (Percent)



Source: PIDE State of Commerce Survey

WAREHOUSING AND TRANSPORTATION

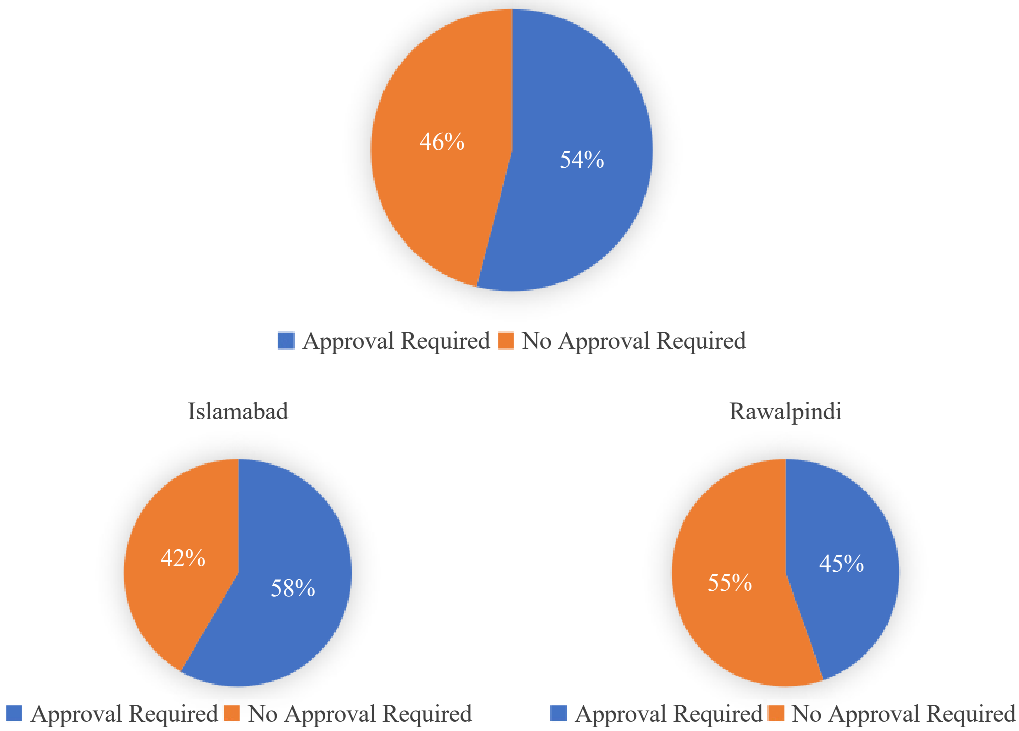
For traders, especially wholesalers, the biggest problem is that of transport. Since most of the wholesalers and warehouses are in congested areas, such as Raja Bazar in Rawalpindi, they face a lot of difficulties in sending and receiving shipments. The administration does not allow the entrance of trucks during the day because of the congestion, therefore, the carriages have to carry the goods during the wee hours of the day. One solution proposed by the traders during an FGD at the Rawalpindi Chamber of Commerce and Industry (RCCI) is the construction of a ring road on an urgent basis. This will not only solve the problem of transport, but it will also open doors for establishing industrial pockets alongside the ring road.

RLCOs and Regulatory Bodies

RLCOs impact the business environment and market operations significantly. To assess the regulatory framework of domestic commerce and regulatory bodies in the market, the surveyed businesses were also asked questions about the required approvals and the regulations that apply to their lines of business.

Surprisingly, more than 45% of the respondents said that they did not need any approval or a license from any authority or regulatory body to start a business. This shows that most of the domestic commerce in the twin cities, and perhaps in Pakistan, is informal. However, in Islamabad, more than half of the respondents said that approvals were needed, whereas in Rawalpindi less than half said the same.

FIGURE 4.28 Approvals Required from Any Authority (Percent)



Source: PIDE State of Commerce Survey

Leading categories in which respondents believed that they did not need approval from any authority to operate belonged to cigarette shops, garments and clothing outlets, mobile shops, cobblers, and tailors.

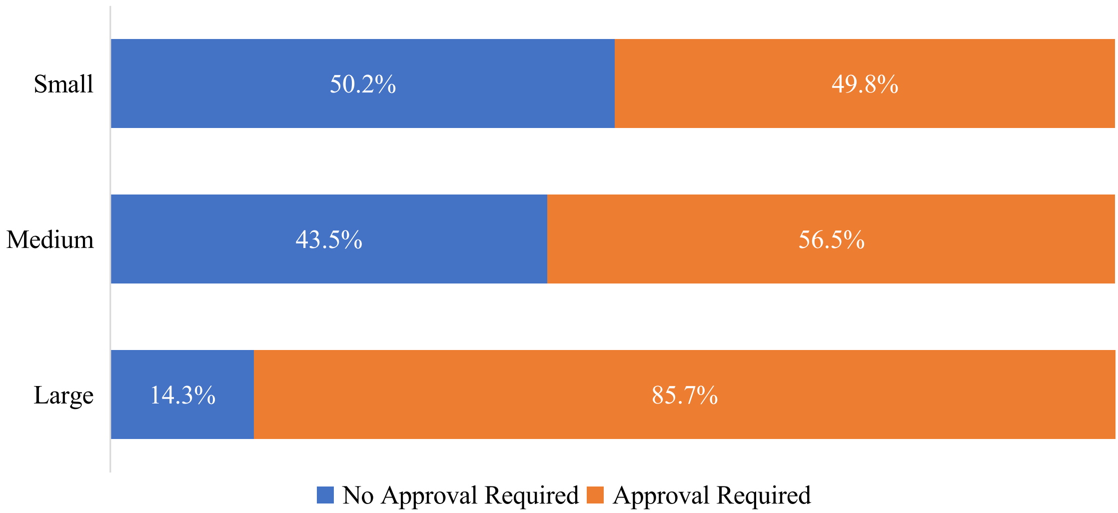
TABLE 4.18 Approval to Operate: Category-Wise (Percent)

No.	Category	Yes	No
1	Garments and Clothing	26.7%	73.3%
2	Automobile Shop	100.0%	0.0%
3	Food	69.4%	30.6%
4	Others	75.0%	25.0%
5	Grocery Store	57.1%	42.9%
6	Electronics and Electric Store	33.3%	66.7%
7	Shoe Shop	40.0%	60.0%
8	Saloon	33.3%	66.7%
9	Hardware Store	100.0%	0.0%
10	Medical	95.8%	4.2%
11	Mobile Shop	27.3%	72.7%
12	Computer and ICT	100.0%	0.0%
13	Tailor	27.8%	72.2%
14	Book Shop	61.9%	38.1%
15	Meat Shop	90.0%	10.0%
16	Toys and Gift Shop	55.6%	44.4%
17	Sports Shop	100.0%	0.0%
18	Cigarettes and Vape Shop	0.0%	100.0%
19	Optical Shop	46.7%	53.3%
20	Goldsmith	60.0%	40.0%
21	Courier and Post	100.0%	0.0%
22	Cobbler	21.4%	78.6%
23	Construction (cement, bricks, etc.)	100.0%	0.0%
24	Paan Shop	100.0%	0.0%

Source: PIDE State of Commerce Survey

The knowledge about the RLCOs varies according to the size of the outlet. Almost 50% of small business owners responded that they did not obtain any kind of RLCOs while starting the business, whereas more than 85% of the respondents operating large businesses had obtained at least one approval.

FIGURE 4.29 Establishment Size and Approval Requirement (Percent)



Source: PIDE State of Commerce Survey

When asked how many regulatory bodies regulate the sector, surprisingly, more than half of the business owners said that not a single regulator had ever approached or regulated them. Out of the remaining respondents, more than 90% believed that there was only one regulating authority that regulated their sector. Businesses in Rawalpindi were more aware of the required regulations compared to the businesses in Islamabad. One possible reason for this unawareness of regulatory bodies could be the involvement of too many actors. Interviews with the business owners revealed that most of them are not even aware of the departments, authorities, and/or regulatory bodies that deal with the WRT sector. Since too many regulatory bodies are trying to regulate one sector and impose huge regulatory costs, businesses may prefer to remain in the informal sector rather than get registered with these bodies.

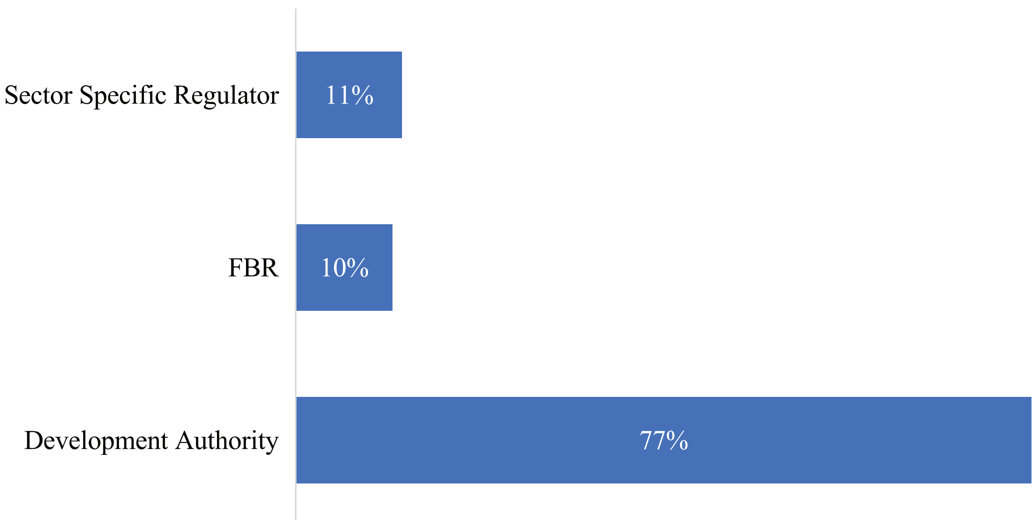
TABLE 4.19 Number of Regulatory Bodies for Approval (Percent)

	Total	Islamabad	Rawalpindi
Single Regulatory Body	42.56	45.80	35.54
Two Regulatory Bodies	5.48	0.76	19.01
Three Regulatory Bodies	0.52	0.00	1.65
No Regulatory Body	51.44	53.44	43.80

Source: PIDE State of Commerce Survey

As shown in Figure 4.30, out of those outlets that had obtained approval from at least one regulatory body, two-thirds responded that the development authority (CDA, RDA, Cantonment Board) is the approving authority. Only 11% had obtained approval from sector-specific regulators, for instance, the Punjab Food Authority in the case of restaurants. The remaining 10% considered the FBR to be the key regulator.

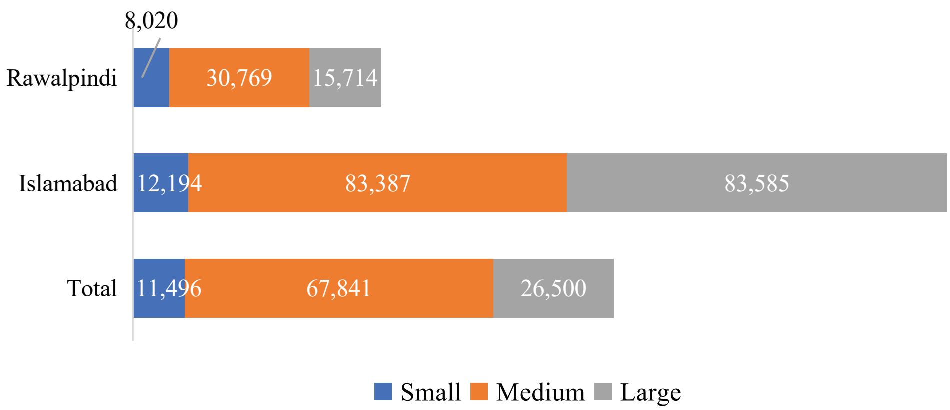
FIGURE 4.30 Regulatory Body from Which Permission is Received (Percent)



Source: PIDE State of Commerce Survey

The average amount of fee paid by the respondents who are registered was PKR 34,090. In Islamabad, it was PKR 37,845, while PKR 21,527 in Rawalpindi.

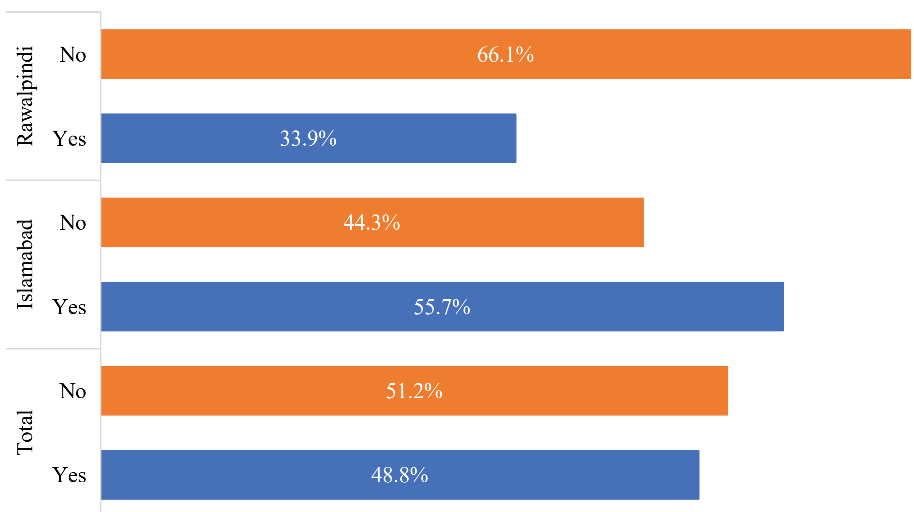
FIGURE 4.31 Average Annual RLCO Fee by Establishment Size (PKR)



Source: PIDE State of Commerce Survey

The authorities identified by the respondents who inspected the establishments include commissioners' offices, development authorities (CDA/IMC, RDA/RMC, the Cantonment Board), excise and taxation departments, and the FBR.

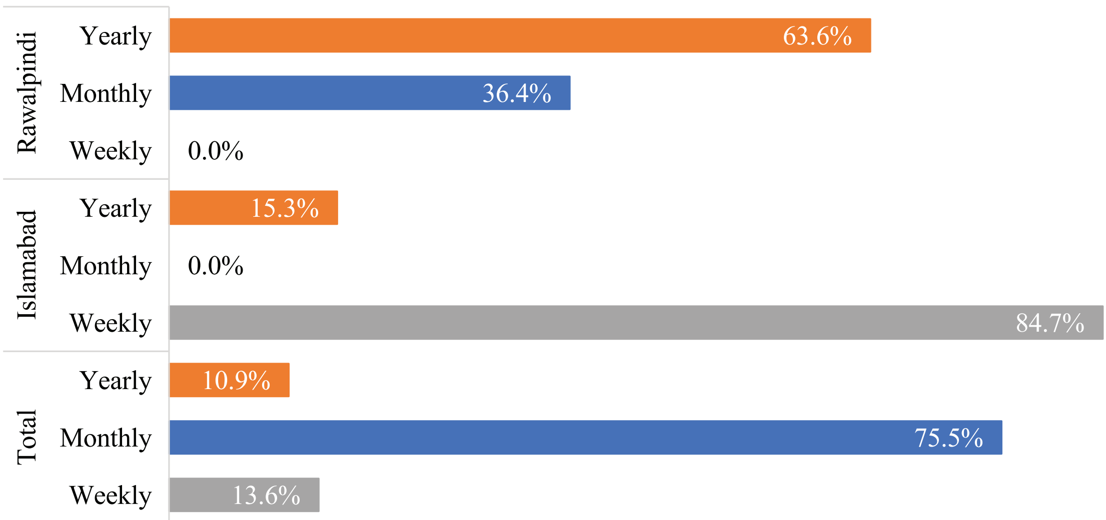
FIGURE 4.32 Inspection Related to Price or Quality During the Last Year (Percent)



Source: PIDE State of Commerce Survey

However, a majority of the respondents, i.e., more than half, stated that they were not subject to any kind of inspection during the last year. In Islamabad, more than 50% of the respondents said that they were subject to inspections at least once during the past year, showing that the WRT sector in Islamabad is more formal than in Rawalpindi.

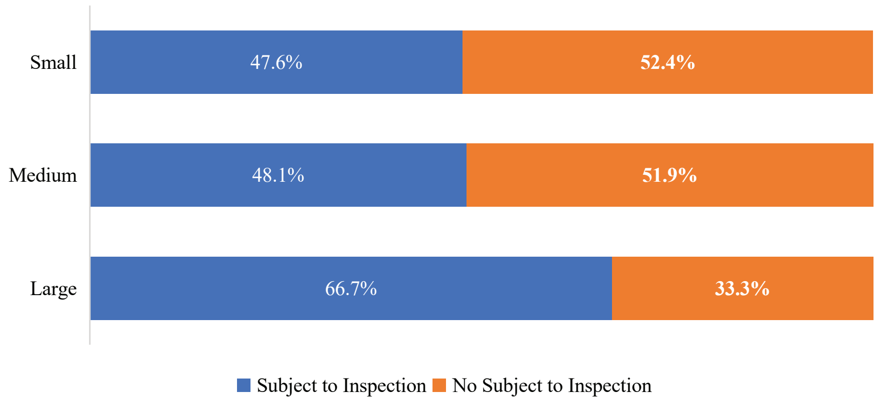
FIGURE 4.33 Frequency of Inspection (Percent)



Source: PIDE State of Commerce Survey

Interestingly, the inspection carried out by an authority of a regulator depended upon the size of the outlet, viz. the larger the outlet, the more chances to be inspected.

FIGURE 4.34 Inspection and the Size of the Establishment (Percent)

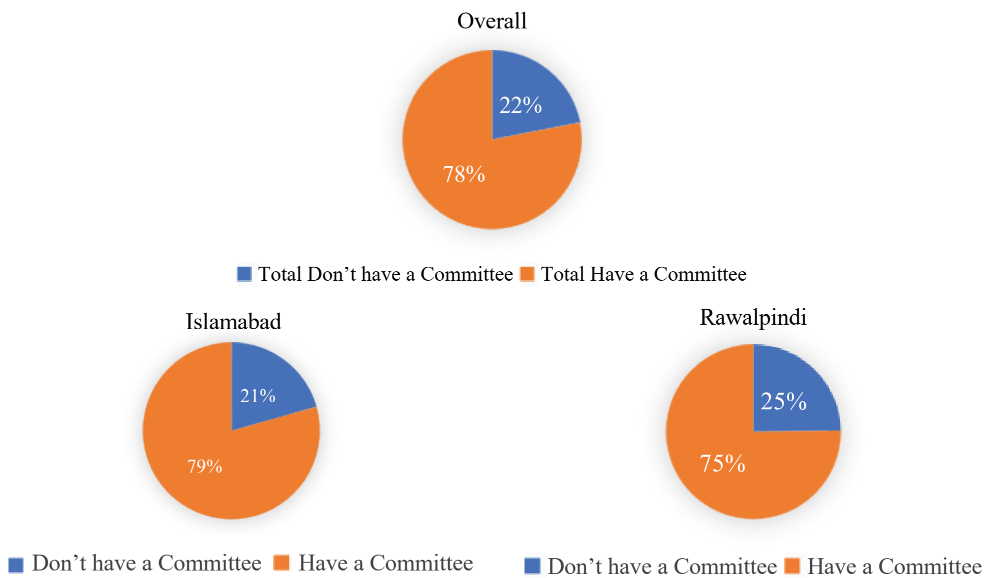


Source: PIDE State of Commerce Survey

Market Committees and Unions

To assess the internal organization of the markets, the respondents were asked about market committees and their functions. Around 78% of respondents stated that they were part of a market committee.

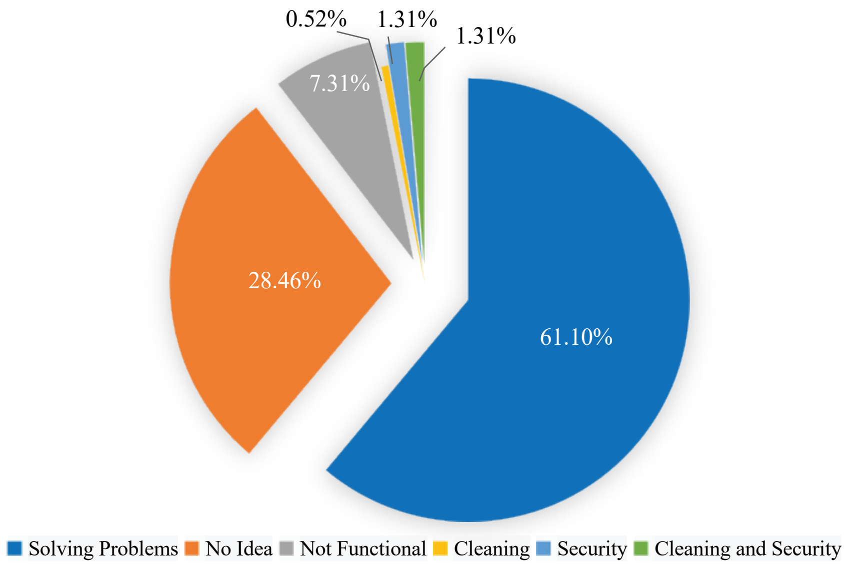
FIGURE 4.35 Membership of the Market Committee (Percent Responses)



Source: PIDE State of Commerce Survey

The major function, as identified by respondents, of the market committees is to resolve market-related issues.

FIGURE 4.36 Functions and Role of Market Committees (Percent)



Source: PIDE State of Commerce Survey

BOX 4.4 Market Committees/Unions: Composition & Functions

Composition and Election

The market committee is composed of representatives of the retailers and wholesalers. The committee office holders, such as the chairperson, president, vice-president, general secretary, etc., are elected by the members of a particular commercial area or market.

Role

According to the stakeholders, the role of market committees is relatively effective in problem-solving. However, market committees are more active in older commercial areas compared to relatively newly established commercial areas, such as PWD and its contiguous commercial centers. Typically, a market committee's functions are the following:

- The resolution of a conflict, such as rent collection, late payment of rent, forced evacuation without notice, etc., between a landlord and a renter.
- Infrastructure development and provision.
- Negotiations with the local administration regarding various issues, such as holidays, timings, etc.
- The organization of strikes as a form of protest.
- Informing fellow businessmen in case of police raids.
- Cleanliness.

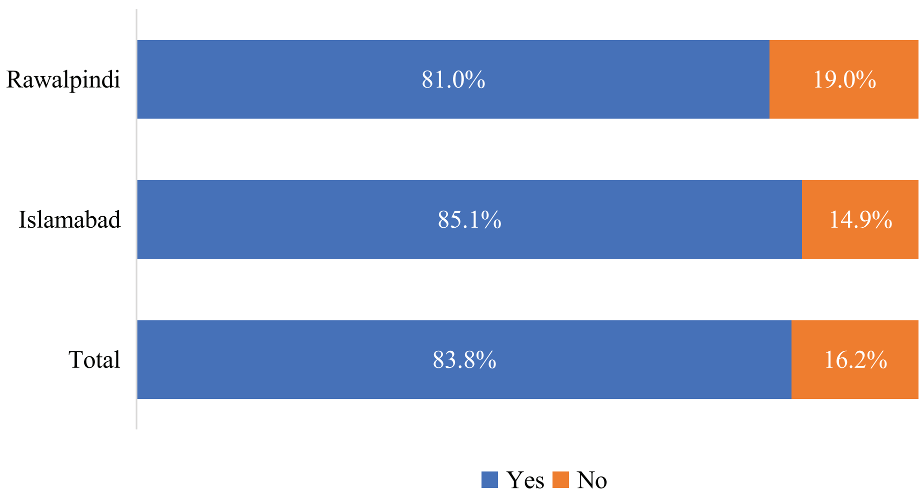
BOX 4.5 Market Committees: Problem Solvers or Pressure Groups?

In the WRT sector, associations, unions, and market committees have mushroomed over the years. Market unions or committees are present in almost every commercial area of the twin cities. Some of these committees are registered with the relevant authorities, but the majority are operated on an individual basis and operated informally. These are formed by large establishment owners who are dominant in the commercial area. Their main purpose is to become dominant and form relationships with government officials. Even the registered committees are criticized for irregular elections. There is political- or ethnic-based factionalism within these associations. Legitimacy and informality of these associations notwithstanding, on paper these organizations are supposed to safeguard the legitimate interests of the wholesalers and retailers. However, in reality, association leaders, using their connections with government officials in various authorities, shield the members from tax authorities, excise taxation, the labor department, EOBI, ESSI, and municipal authorities. One retail outlet owner said that during the time (approximately 11 years) he had an outlet in a commercial area of Rawalpindi, not even a single authority or a regulator visited his outlet. This is what members of the market committees get in return for their support to the leaders. A recent example of the strong political influence of associations and market committees is that of levying a fixed tax on non-Tier-1 retailers based on monthly electricity bills. The traders resisted, threatening shutter-down strikes, and eventually, the proposal was withdrawn. Similarly, various attempts by the government to close down commercial activities by 8:00 p.m., to save energy, have been met with strong resistance, resulting in the withdrawal of the proposals multiple times.

Desire to Expand the Business

More than 80% of the respondents wanted to expand their businesses. The least desire to expand the business was among the automobile and medical establishments.

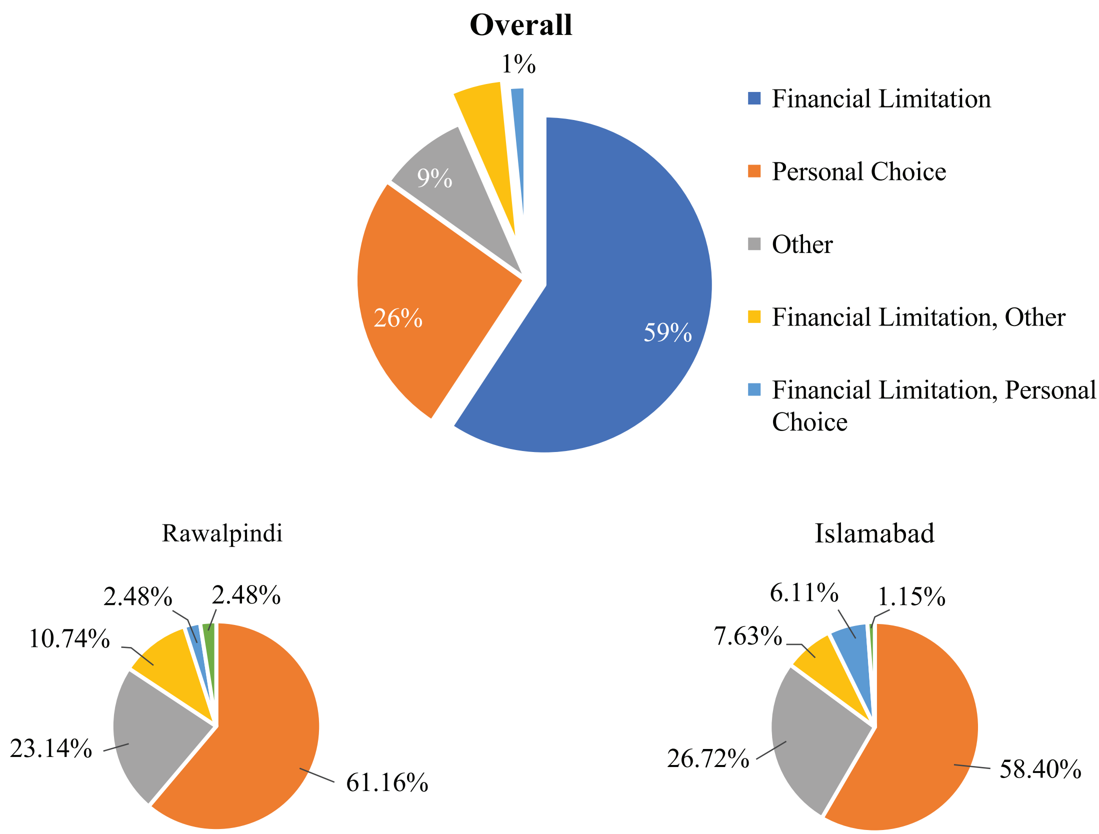
FIGURE 4.37 Scaling-Up the Business (Percent)



Source: PIDE State of Commerce Survey

The major constraints to expansion were identified as financial, personal, and other reasons. However, the financial constraint was the leading constraint cited by the respondents.

FIGURE 4.38 Constraints to Expanding Business (Percent)



Source: PIDE State of Commerce Survey

Across categories, financial constraints remained the leading constraint except for automobile, medical, and courier shops. The constraints identified under the "Others" category include inflation (54%), no customers (11%), high shop rents (16%), economic uncertainty (14%), and regulatory authorities (5%).

Why businesses do not grow in Pakistan?

Small and unorganized retailers

One of the reasons, also discussed elsewhere in this chapter, why WRT establishments do not grow beyond a certain point, especially small retailers, is that they do not engage with formal financial institutions, i.e., banks, for several reasons including stringent documentation requirements, the fear of being approached by the tax authorities once registered with formal banking institutions, and the insistence to maintain undocumented and informal relations with various actors along the supply chain, especially the wholesalers from who they get the supply of the products they sell.

Moreover, small and informal retailers face the unpredictability of supply and slow inventory restocking cycles resulting in regular stockouts. Unlike modern practices, traditional retailers in Pakistan cannot get competitive prices because of being attached to one supplier and they do not even search for alternate suppliers or products, which is also a big hindrance in their growth. An average retailer spends a considerable time per week on procurement alone. This traditional mode of procurement in greater effort and time spent in procurement.

The financial constraint in growth that 59% of the WRT establishments said was the constraint to growth, is perhaps due to the working capital restrictions that result from investing regularly in keeping inventory. To avoid being out of stock, retailers invest more working capital into their stores. This also results in a skewed category mix, since working capital limitations prevent the retailers from increasing their product range.

However, these informal retail businesses have inherent limitations such as a lack of economies due to small-scale operations, lower level of expertise and lack of financial strength. Such restrictions negatively impact the ability of this sector in product display and to convey the brands' message to their customers.

Wholesalers/distributors

As far as wholesalers and distributors are concerned, their lack of growth is because of a limited customer base which is a result of geographical and logistical limitations. Since transporting goods across Pakistan is costly, most of the wholesalers restrict themselves to certain geographical locations. Here, the role of logistics is important, which is one of the key areas of focus in the National Domestic Commerce Policy 2022-24. Furthermore, rail logistics need to be improved in Pakistan but due to a variety of reasons, very few businesses use the railway system to transport goods via the rail network across Pakistan. Similarly, wholesalers and distributors rely more on human resources to generate orders, which results in greater effort to generate orders and increase business.

Chain stores and big retail

One of the biggest reasons that chain stores, big retail companies, supermarkets, etc. do not grow and build international brands is that they do not have access to reliable data for forecasting. Although the practice is changing gradually, a majority of industry players still use Excel manually to analyze sales trends and forecast future sales. The pandemic, however, has forced the industry to take more aggressive measures to collect data from different resources (such as Google Analytics, etc.) to make informed decisions about the future. In short, Pakistani big retail players and brands do not use market intelligence to the extent that the rest of the world uses such tools.

Officials'attitude and rules & regulations

One key informant revealed that even traders in the formal or organized sector have started shifting to the informal sector, to a degree, because of the officials' attitudes (unnecessary notices, the imposition of fines, demanding bribes, etc.). Those who are in the informal sector want to graduate to the formal sector because of the growth opportunities that the formal sector offers but they do not do so because government departments create fear in the business community. Government departments, such as the FBR and the EOBI, create unnecessary problems for traders, which wastes time and resources. Moreover, many traders are not even aware of the departments that are concerned with retail and wholesale. Almost every week, a government official visits the business (89% in the case of Islamabad).

Another key informant revealed that those who used to import products directly have now either shifted to completely domestic products or procure items from informal sources. The reasons are unrationalized customs duties and demurrage charges. The customs authorities do not clear shipments timely which increases demurrage charges exponentially. The customs officials demand bribes to clear shipments. Moreover, there is a mishandling of containers (broken and/or missing items).

BOX 4.6 Why WRT Businesses Do Not Grow in Pakistan?

- Small retailers do not engage with formal financial institutions because of documentation requirements, the fear of being approached by the tax authorities, and the desire to maintain undocumented and informal relations with various actors along the supply chain.
- Small and informal retailers struggle with a lack of supply predictability and slow replenishment cycles resulting in regular stockouts.
- Traditional retailers in Pakistan cannot get competitive prices because of reliance on one supplier and not searching for alternate suppliers or products.
- An average retailer spends a considerable time per week on procurement alone. This traditional mode of procurement in greater effort and time spent in procurement.
- Wholesalers and distributors do not grow because of a limited customer base which is a result of geographical and logistical limitations.
- Furthermore, rail logistics need to be improved in Pakistan but due to a variety of reasons, very few businesses use the railway system to transport goods via the rail network across Pakistan.
- Chain stores, big retailers, and supermarkets do not grow and build international brands because of the lack of access to reliable data for forecasting.
- A majority of industry players still use Excel to analyze sales trends and forecast future sales.
- In short, Pakistani big retail players and brands do not use market intelligence to the extent that the rest of the world uses such tools.

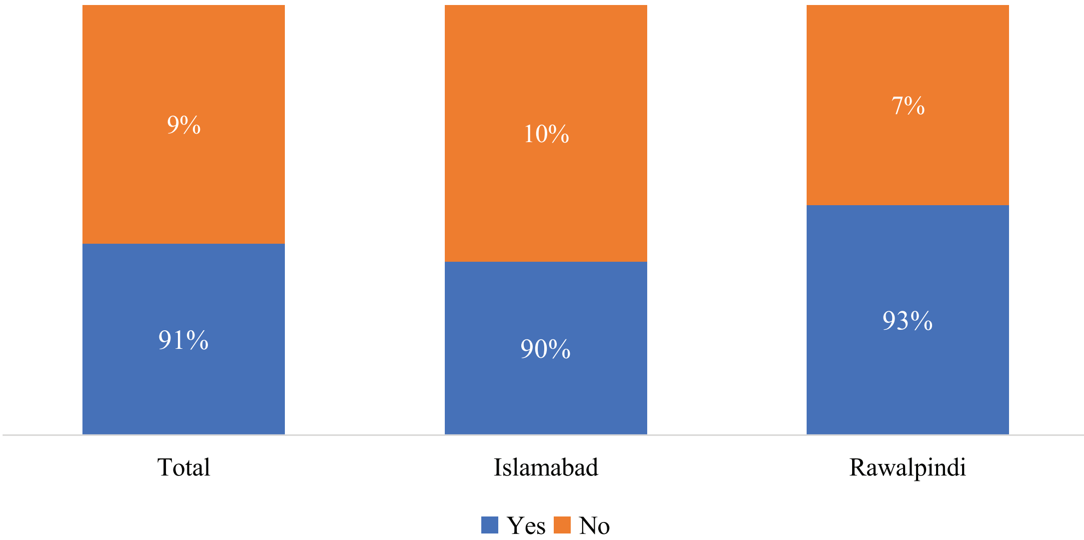
- Even traders in the formal or organized sector have started shifting to the informal sector, to a degree, because of the officials' attitudes.
- Those who are in the informal sector want to graduate to the formal sector but are reluctant to do so because government departments create fear in the business community – the FBR and the EOBI create unnecessary problems for traders, which wastes time and resources.
- Moreover, many traders are not even aware of the departments that are concerned with retail and wholesale.
- Almost every week, a government official visits the business (89% in the case of Islamabad).
- Importers have either shifted to completely domestic products or procure items from informal sources because of unrationalized customs duties and demurrage charges – the customs authorities do not clear shipments timely which increases demurrage charges exponentially.
- The customs officials demand bribes to clear shipments.

Desired Location

Location

Interestingly, locating an ideal shop for the outlet did not seem to be an issue in twin cities as the majority of the respondents stated that they were able to rent the shop for the establishment at a desired location easily.

FIGURE 4.39 Finding a Shop at the Desired Location (Percent)



Source: PIDE State of Commerce Survey

Across categories, respondents from hardware and construction outlets found it most difficult to locate a shop at a desired location. However, when asked if the prevailing shop rents were reasonable or not, the responses were mixed as almost half of the respondents found rents to be reasonable while the other half did not.

Rent

According to the information provided by the respondents, the average monthly shop rent was PKR 78,529. Average rent as well as the maximum rent were higher in Islamabad than in Rawalpindi.

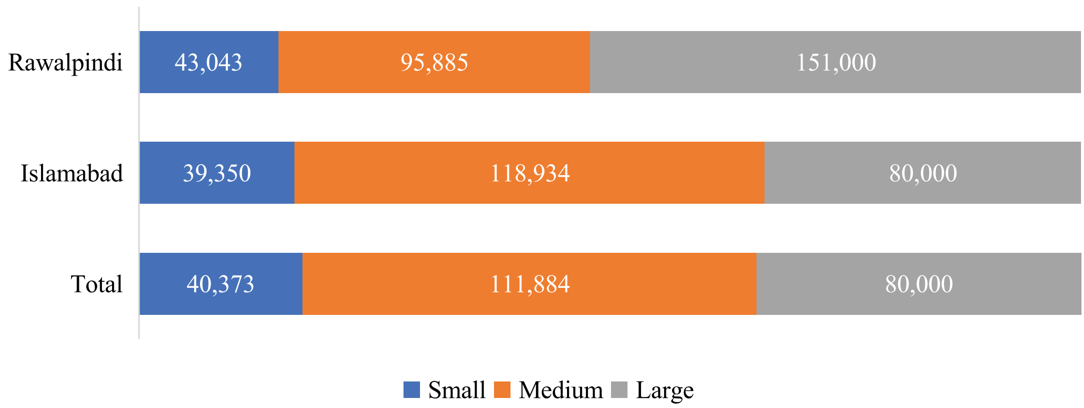
TABLE 4.20 Average Rent (PKR)

Overall	
Mean	**78,529**
Median	40,000
Maximum	900,000
Minimum	3,000
Islamabad	
Mean	**85,007**
Median	45,000
Maximum	900,000
Minimum	3,000
Rawalpindi	
Mean	**65,001**
Median	35,000
Maximum	400,000
Minimum	3,500

Source: PIDE State of Commerce Survey

Since shop rents depend upon the size of the shop, Figure 4.41 shows the average monthly rent for different sizes of establishments.

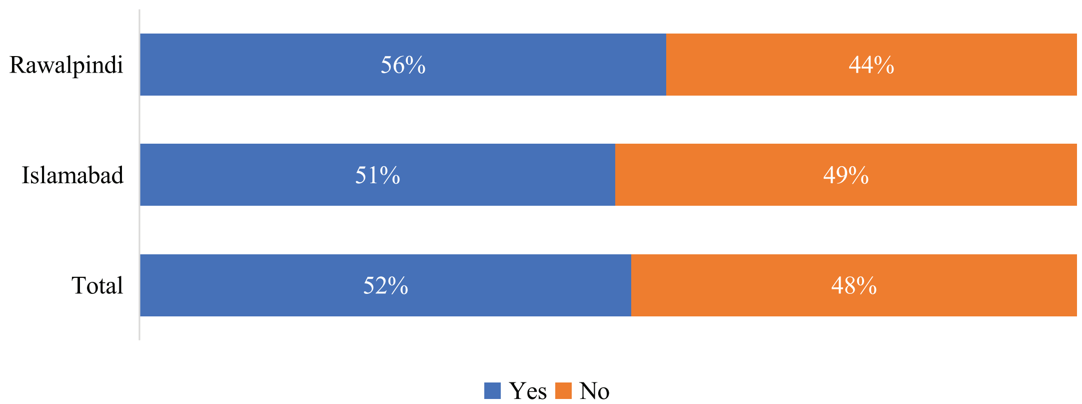
FIGURE 4.40 Establishment Size and Average Monthly Rent (PKR)



Source: PIDE State of Commerce Survey

Domestic businesses often complain about high rents, which add to their cost of doing business. Even though the majority of respondents were of the view that they were satisfied with the rent they paid, a significant proportion, i.e., 48%, said that rents were too high. The responses, in percentage terms, are shown in Figure 4.41 below.

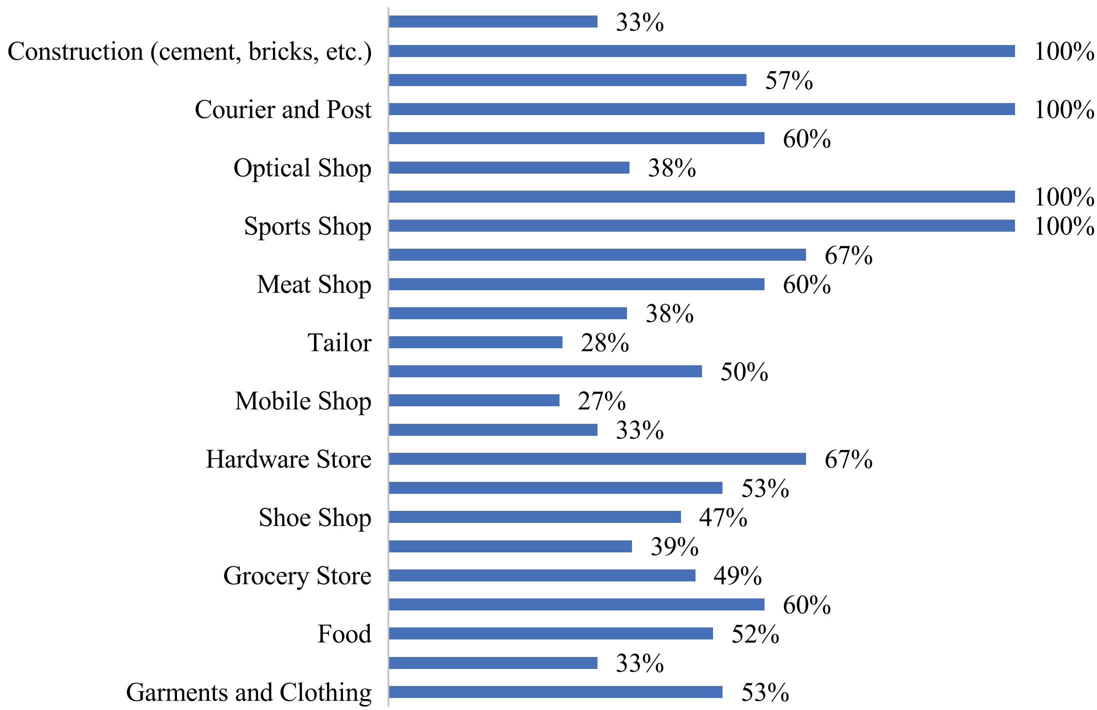
FIGURE 4.41 Reasonability of Rents (Percent)



Source: PIDE State of Commerce Survey

Across categories, the majority of sports shops, cigarette and vape shops, courier services, and construction-related businesses found the prevailing (i.e., the rents they were paying) shop rents to be not reasonable. Figure 4.42 shows the percentage of respondents in each category who found the rents they were paying for the shops unreasonable.

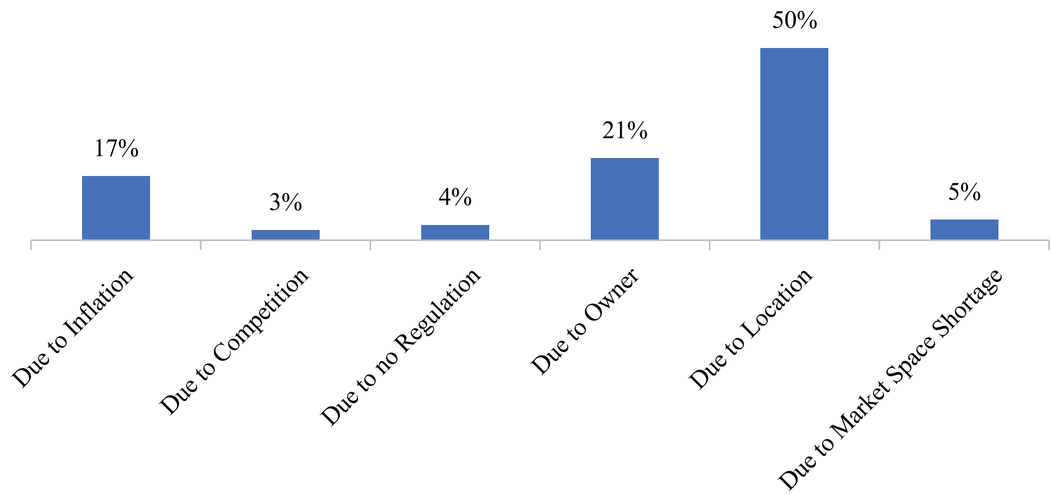
FIGURE 4.42 Reasonability of Rents: Category-Wise (Percent)



Source: PIDE State of Commerce Survey

Of those who said that rents were high, identified high inflation, shop owners raising the rent, and the location as the key reasons for high rents.

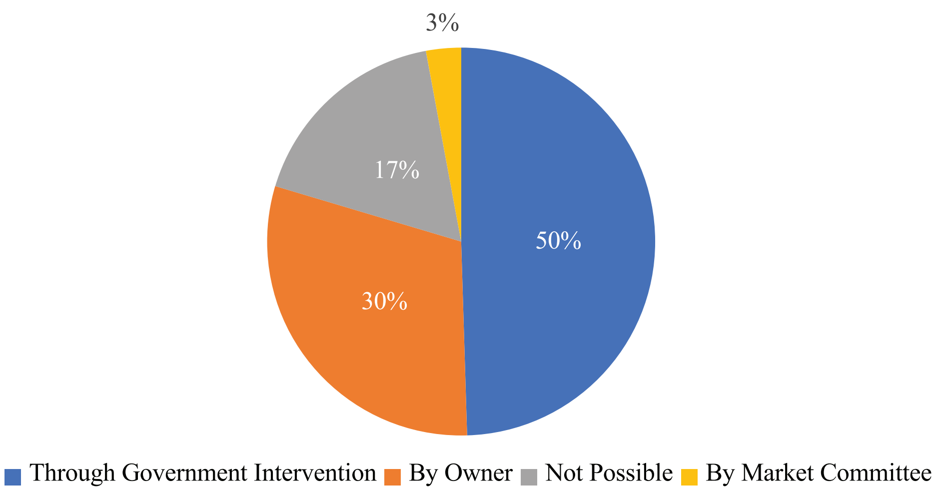
FIGURE 4.43 Reasons for High Rent (Percent)



Source: PIDE State of Commerce Survey

When asked about possible ways to keep shop rents under control or at the perceived level, the majority of the respondents believed that it was not possible without government intervention.

FIGURE 4.44 Means to Control Rents (Percent Responses)



Source: PIDE State of Commerce Survey

BOX 4.7 Why Commercial Rents are High in Twin Cities?

- Supreme Court's 2016 ruling to disallow commercial activity in residential areas has raised commercial properties' rents.
- Zoning regulations discourage commercial construction and mixed-use buildings.
- Islamabad Commercial Rent Control (Amendment) 2021 Act now allows raising rents by 10% every year, which was previously 10% every three years. But in some cases, landlords increase the rent by more than 10% every year.
- Mediation and arbitration in case of rent-related disputes is time-consuming and costly. Mediators normally favor landlords in commercial areas because of their connections with market committees, administrators, and politicians.

According to KIIs and FGDs, the Supreme Court's 2016 ruling to disallow commercial activity in residential units/areas raised the rents. The businesses had to relocate to commercial areas, which led to an increase in rent. Moreover, despite an increase in the number of shopping malls, the rents remain high. Rents in shopping malls are higher compared to other commercial areas because they provide amenities and have high footfall.

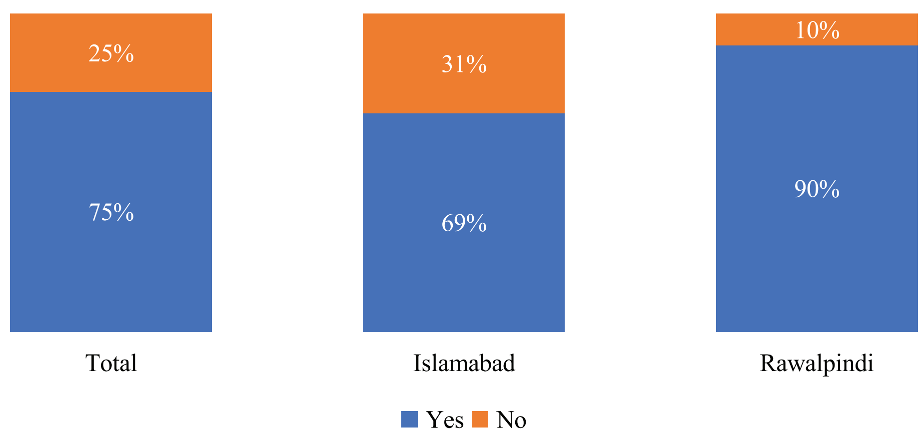
According to the Islamabad Rent Restriction (Amendment) Act 2021, owners of residential and commercial properties are allowed to increase the rent by 10% every year, which was previously 10% every three years. This has also raised the rents and the cost of doing business substantially. In some cases, landlords increase the rent by more than 10%. Tenants do not go for mediation or litigation because of high time and pecuniary costs. In other countries, such as the UK and the USA, although rules and regulations do not restrict commercial property rents, there are some restrictions to the extent to which the rent on commercial property can be increased. Even if the landlord increases the rent, it can be challenged in court and there are arbitration methods to resolve the dispute.

The Supreme Court's 2016 ruling of disallowing commercial activity in residential areas, highlights the need for amending zoning laws and the promotion of mixed-use buildings. In twin cities, especially in Islamabad, commercial spaces are limited and mixed-use construction is almost non-existent. Even in new projects, the allocation of space for commercial activities is minuscule compared to the space for residential construction. Moreover, the data shows that in the real estate sector, transactions, both construction and rental, of commercial properties are low compared to residential properties (see Chapter 10 of this report for details). All these facts stifle domestic commerce.

Parking Space Availability

The majority of the respondents believed that parking was a serious issue in commercial areas and significantly affected their businesses.

FIGURE 4.45 Issue of Parking (Percent Responses)



Source: PIDE State of Commerce Survey

SHOPPING MALLS

In recent years, there has been a steady growth of shopping malls in the twin cities. Shopping malls provide a structured space for retailers. Malls are especially attractive for brand names and chain stores because of the high footfall and amenities provided by mall management. On the demand side, malls are equally attractive to the general public for several reasons, including different brands under one roof, recreational spaces in many malls (e.g., playlands), the availability of different food options, and an airconditioned environment, among other things. Due to these reasons, rents of shops in malls are high but at the same time, sales are also high.

Prominent Shopping Malls in Twin Cities

The following table lists the major shopping malls in the twin cities.

TABLE 4.21 Prominent Shopping Malls in Twin Cities

Mall	Location
Islamabad	
The Centaurus Mall	F-8/4
Safa Gold Mall	F-7 Markaz
Union Gold Mall	F-7 Markaz
Pak-China Mall	G-9 Markaz
The Olympus Mall	F-11 Markaz
The Mall of Islamabad	Jinnah Avenue, Blue Area
Giga Mall	G.T. Road
Al-Jannat Mall	G-9 Markaz
Amazon Outlet Mall	G.T. Road
Rawalpindi	
Pakistan Mall Shopping Centre	Kashmir Road
Gold Point Shopping Mall	Murree Road
City Centre	Saddar
Rabi Centre	Murree Road
Rafay Mall	Peshawar Road
Al-Jannat Mall	Murree Road
Pehchan Mall	Kashmir Road
Midway Centrum Mall	Sixth Road/Murree Road
Malikabad Shopping Mall	Sixth Road/Murree Road

Source: PIDE State of Commerce Survey and various website resources

Category-Wise Shops in Malls

The distribution of category-wise shops is given in the table below.

TABLE 4.22 Category-Wise Distribution of Shops in Malls (Percent)

Category	Percent
Banks	0.74
Cinema	0.37
Cosmetics/Beauty	5.21
Electronics	2.79
Eyewear	1.30
Food & Restaurants	24.02
Garments, Clothing, & Footwear	53.26
Home Furnishing	2.05
Jewelry/ Watches	2.42
Pharmacy	0.56
Sports & Books	3.54
Toys/Gift Shops	3.54
Gym	0.19

Source: PIDE State of Commerce Survey

As Table 4.22 shows, the majority of shops fall in the clothing category, while food and restaurants are second. The table below shows key indicators related to the shopping malls in the twin cities. According to the table, there are 17 malls in the twin cities. However, it must be noted that of these 17 malls, only a few like Centaurus and Giga, are constructed on modern lines and provide all the amenities up to modern standards. In some malls, like Al-Jannat Mall (see Table 4.21 above), all the outlets are completely owned and operated by the owner.

The survey data of shopping malls show that the average sales are higher in these malls compared to outlets in conventional areas, even though the reported figures for conventional outlets are underreported.

TABLE 4.23 Shopping Malls in Twin Cities: Key Indicators

Key Indicator	Estimates	
Number of Malls	17	
Number of Outlets	1,000	
Average Footfall Per Outlet (Per Day)	2,000	
Rent (PKR)		
	Minimum	**Maximum**
Shop (Per Square Foot)	275	850
Kiosk	35,000	200,000
Average Sales (PKR)		
	Minimum	**Maximum**
Per Outlet	500,000	1,300,000

Source: PIDE State of Commerce Survey

PROBLEMS AND ISSUES [18]

Many respondents related to the retail and wholesale business identified three key issues affecting Pakistan's domestic commerce:

Policy Inconsistency & Transaction-Curtailing Policies

The major problem identified by the key stakeholders is unstable and business-unfriendly policies of the government. The policymakers should be cognizant of the problems being faced by traders in Pakistan. Different governments prepare different policies but most of the policies are not made available to the businessmen. Therefore, businessmen, especially traders, are not

[18] The problems are identified based on interviews with retailers/wholesalers and focused group discussions with members of the Rawalpindi Chamber of Commerce and Industry (RCCI).

even aware of those policies. Consistent and long-term policy formulation is a must for the revival and growth of businesses in Pakistan.

Macroeconomic and Political Instability

An example of macroeconomic instability is the fluctuating exchange rate and high inflation. Since most of the raw material is imported, it increases the cost of doing business. Currently, businesses are suffering because of the economic as well as political situation in the country. Specifically, high inflation and a high and volatile exchange rate are creating problems for traders. The situation makes it very difficult for them to plan long-term to invest and expand their businesses.

Local Administration, Tax Administration, and Bureaucracy

The role and attitude of the bureaucracy are allegedly not supportive of businesses in Pakistan. In general, there is a lack of support for the business community, be they traders, manufacturers, or from any other sector. For example, traders want to graduate to the formal sector, but government departments create fear in the business community. Government departments, such as the FBR and the EOBI, create unnecessary problems for traders, which wastes time and resources. Moreover, many traders are not even aware of the departments that are concerned with retail and wholesale. Almost every week, a government official visits the business. There should be a drive to educate the business community by introducing the departments dealing with them.

BOX 4.8 The Mindset Problem?

A common refrain in Pakistan is that the mindset of businesses in Pakistan is such that they look for rent-seeking opportunities rather than becoming more efficient. Thus, one of the biggest problems is the mindset of the business. Is this “mindset problem” exogenous or cultural? Can it be changed? There is a possibility that such a mindset has been built over the years because of the treatment meted out to the business community in Pakistan. During an FGD, the participants expressed their desire to invest in the domestic commerce sector but said that the business community, including traders, is wary of investing because of the unjust intervention and harassment by different departments, such as EOBI, Social Security, FBR, etc. There are at least 14 to 15 departments with whom the traders have to deal with. There is a need to devise a mechanism or legislation so that these fears of the business community are addressed so that they can invest freely.

Cumbersome Registration Process

Many administrative issues have also been highlighted by retailers and wholesalers. The main issue is that the process of opening and registration of a new business is very difficult and cumbersome. Similarly, the process of filing a tax return is very difficult. To make matters worse, the traders have to deal with various departments that deal with different things making it very confusing for a businessman, especially for local traders who are less educated. They do not sometimes know their rights. Sometimes even a literate person is unable to digest processes and formalities.

Transport

The government should facilitate traders and wholesalers in providing transport and solving other transport-related issues. Transport is a problem because most of the traders, especially in Rawalpindi, are located in congested commercial areas that have narrow and encroached roads. In such areas, cargo trucks cannot maneuver easily during rush hours. It compels the traders to load and unload during the early hours or late at night. One solution is the construction of the ring road which has been in limbo for a long time now.

Parking Space and Encroachment

One of the most prevalent problems that came to the fore was the lack of, small, parking spaces even in small markets. One reason cited was the presence of banks in commercial areas. The banks' employees park their cars and bikes in the parking space, which occupies parking space from 8 a.m. to around 6 p.m. Similarly, owners and salesmen working in the retail stores park their vehicles in the available parking spaces. This leaves little parking space for customers, who park their vehicles sometimes almost in the middle of roads. This thing affects retailers' business because when a customer comes and does not find a parking slot, they move to another store or commercial area. Therefore, there is a need for building a proper infrastructure for parking. The retail and wholesale business owners said that encroachment happens when the parking space and public spaces like footpaths are blocked by extended shops or street vendors.

In this regard, PIDE, in collaboration with the CDA, has proposed a paid parking plan (Khawaja, et al., 2023). The plan has proposed to introduce paid parking on a pilot basis in one area in the Blue Area, Islamabad. The plan proposes to install parking meters, and only those will be allowed to park their cars who use the parking meters to pay for the parking

CONCLUSIONS

Estimates show that WRT establishments in Pakistan have grown to approximately 2.66 million, which is 4% per annum growth since 1988, the earliest year for which the figures of the WRT establishments are available. However, the majority of the sector is informal, which indicates a lack of coherent policy support and unsupportive bureaucratic controls and interference. Interactions with traders showed that many traders want to graduate to the organized sector but cumbersome and time-consuming processes and the involvement of too many administrative departments deter them from doing so, which hints at the policy gap in the sector.

The indifferent attitude of the authorities towards domestic commerce, especially the WRT sector, has stifled the potential of the sector. Even though a few brand names have emerged and there is a steady increase in the number of shopping malls, which is a sign of the modernization of the sector, the sector still operates on traditional practices. For example, most of the procurement is done personally by visiting suppliers or waiting for distributors. As for the organized sector, it has only begun to embrace modern methods of inventory management and demand forecasting.

There are many issues and challenges facing the WRT sector, but perhaps the most important is the lack of commercial space availability, which has driven up commercial rents. In Pakistan, the real estate and construction sector's inclination is towards residential plots and housing at the expense of commercial development. This trend, in turn, is a result of flawed zoning laws and the absence of mixed-use buildings. As a result, there is a dearth of warehouses. An adequate supply of warehouses ensures the steady growth of the sector and a smooth supply chain. Currently, in the twin cities, especially in Rawalpindi, the majority of warehouses are in congested areas, which creates problems for the transportation of goods to retailers because of busy roads and restrictions on logistics movement thereby disrupting the supply chain.

Although the WRT establishment owners use informal sources of finance, such as loans from family and friends and ROSCAs to support and even expand their businesses, the financial sector is not very supportive of the sector. There are no specialized products that cater to the needs of the sector. Only recently digital financing has been introduced in Pakistan, but it is still in nascent stages and covers only a handful of establishments. These factors and sectoral statistics indicate that the domestic market has not developed as it should have perhaps due to external sector-oriented policies.

5 Financial Markets in Pakistan

AHMAD FRAZ

KEY TAKEAWAYS

- The Pakistani stock market is relatively small and illiquid compared to other emerging markets.
  - Pakistan Stock Market (PSX) is a silent market: low volumes, few, if any, IPOs in any year, and few individual investors.
  - The low and declining capitalization-to-GDP ratio signals that the PSX has not been an effective or preferred means of raising finances for businesses.
- Family-owned businesses are listed on the PSX
  - The single largest shareholder in the PSX is the Government accounting for over 12% of market capitalization and controlling substantial shareholding in the KSE-100.
  - Top 10 owners account for 37% of the market capitalization of the KSE-100, which reduces liquidity and trade volumes, lowering market efficiency.
  - Few companies pay regular dividends.
  - Most of the blue chip companies' free float shares ranged between 4.2% and 55% in 2021. Family-owned or founder-owned companies have a low free float because the company's shares are held by the founding family or their close associates, leaving fewer shares to be traded.
- 31 families dominate with family ownership and control

    - Free float in the PSX is low because many companies in Pakistan have significant family ownership. Government and institutional ownerships work in favor of the family-owned business. PSX's few new listings show that the stock exchange is not used to generate finances, showing Pakistani companies' desire to keep the business within family.

    - Given that most firms are family-owned businesses it is not surprising that Boards of directors are a small club of friends. USAID created PICG which regulates boards to place entry barriers and ensure that BOD members rotate between companies.

- The PSX is dominated by few big investors due to very low free-float shares compared to international practices, which creates one of the major problems of speculation.

- Although, debt is used for expansion and gain a competitive edge, in the PSX, the debt- to-equity ratio is low. The capital-intensive industries having low debt-to-equity ratios shows a lack of reliance on debt for expansion.

- Financial Repression

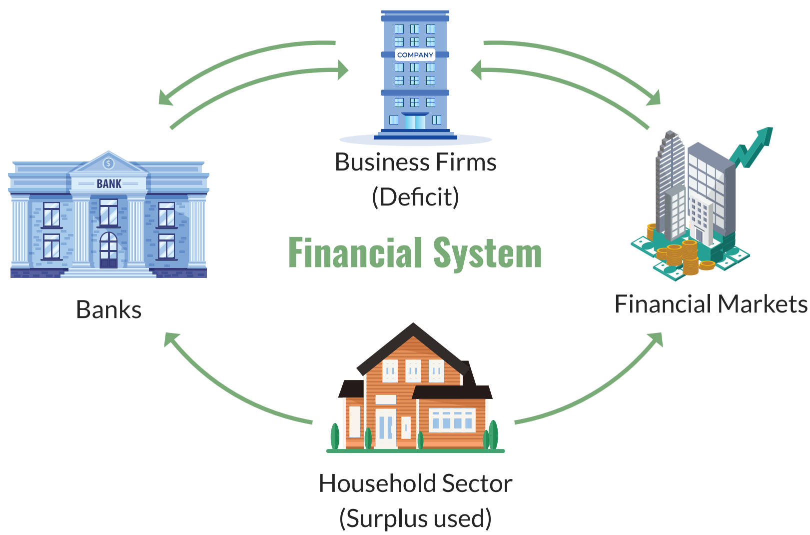
    - Banks primarily lend to the government because the government debt management system is positioned in that direction.

    - Bank focuses predominantly on the corporate sector at the expense of SMEs, agriculture, and housing.

INTRODUCTION

The capital market is a marketplace where individuals and businesses trade financial products/instruments including debt securities (term finance certificates (TFCs), bonds, Sukuks, commercial papers etc.), equities, and government securities. The capital market is an important source of funding for an entity, subject to permission by a corporate regulatory authority because it allows for the easy selling of financial obligations and equity to investors.

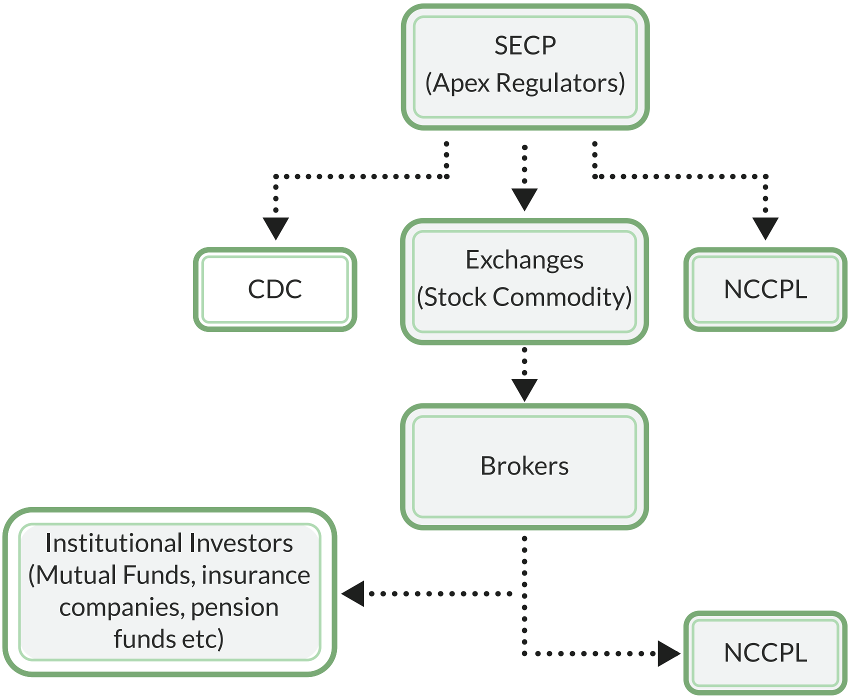
FIGURE 5.1 Financial System of an Economy



Source: https://www.geeksforgeeks.org/financial-market-meaning-functions-and-classification/

Pakistan's capital market structure includes an apex market regulator, the Securities and Exchange Commission Pakistan (SECP), the Pakistan Stock Exchange (PSX), which was formed by the merger of three stock exchanges, Mercantile Exchanges, a Central Depository Company (CDC), and a Clearing and Settlement Company. In addition, the structure comprises intermediaries or market players, such as brokers, who manage share transactions in capital markets on behalf of investors.

FIGURE 5.2 Financial Markets Regulatory System: Pakistan



Source: SECP

REGULATORY FRAMEWORK FOR CAPITAL MARKETS IN PAKISTAN

A capital market regulatory framework is required to safeguard investors, preserve market stability, promote fairness and openness, and permit efficient capital allocation. Regulations promote a fair playing field, prevent fraud and manipulation, and give investors the information they need to make educated decisions by setting norms and standards. Furthermore, rules serve to maintain confidence in the financial system, stimulate capital market involvement, and contribute to general economic growth and development.

The following is the list of governing ordinances for capital market establishment in Pakistan.

FIGURE 5.3 Regulatory Framework for Capital Markets in Pakistan

1. **Securities & Exchange Ordinance, 1969**

   It focuses on the regulation and control of the issuance, trading, and management of securities

2. **Securities & Exchange Rules, 1971**

   A set of rules that support and provide detailed guidance on the implementation of the Securities & Exchange Ordinance, 1969

3. **Companies Ordinance, 1984**

   It provides a comprehensive legal framework for the incorporation, operation, and dissolution of companies in Pakistan

4. **Brokers & Agents Rules, 2001**

   It covers various aspects related to the regulation of brokers and agents

5. **Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003**

   It provide detailed guidelines and requirements for the formation, operations, and regulation of NBFCs in the country

6. **Non-Banking Finance Companies Regulations, 2008**

   The regulation of NBFCs carrying out leasing, investment finance services, housing finance services, asset management services and investment advisory services and their business activities

7. **REIT Regulations, 2008**

   It provides a regulatory framework for the establishment, operation, and governance of REITs in Pakistan

Source: Author's illustration

To offer investors and market players a complete perspective of overall market performance, as well as specialised sectors, asset classes, or investment strategies, different indices are required. Each index reflects a separate fraction of the market, allowing investors to monitor and compare the performance of various areas or themes. The list of indices is given in the table below.

TABLE 5.1 Indices of the Pakistan Stock Exchange

Index	Date of Incorporation	Number of Companies and Base
Karachi Stock Exchange Index (KSE-100)	1-11-1991	100 companies with base 1000
KSE All Share	18-9-1995	All companies with base 1000
KSE-30	30-6-2005	30 companies with a base of 10,000
KSE-Meezan Index (KMI-30)	30-6-2008	30 SC companies with a base of 15,000
KMI All Share	31-12-2014	All SC companies with a base of 15,000
Banking Sector Tradable Index (BKTI)	1-11-2011	Selected banks based on free-float and liquidity
The Tradable Oil & Gas Index (OGTI)	1-11-2011	Selected oil and gas companies based on FF and liquidity

Source: Author's compilation

The availability of many indices on the PSX improves market transparency, allows for better investment decisions, encourages diversification, and attracts a broader variety of investors. It enables players to obtain insights into specific market segments and aids in benchmarking investment performance, which contributes to the stock market's overall development and growth.

STATE OF FINANCIAL MARKETS IN PAKISTAN

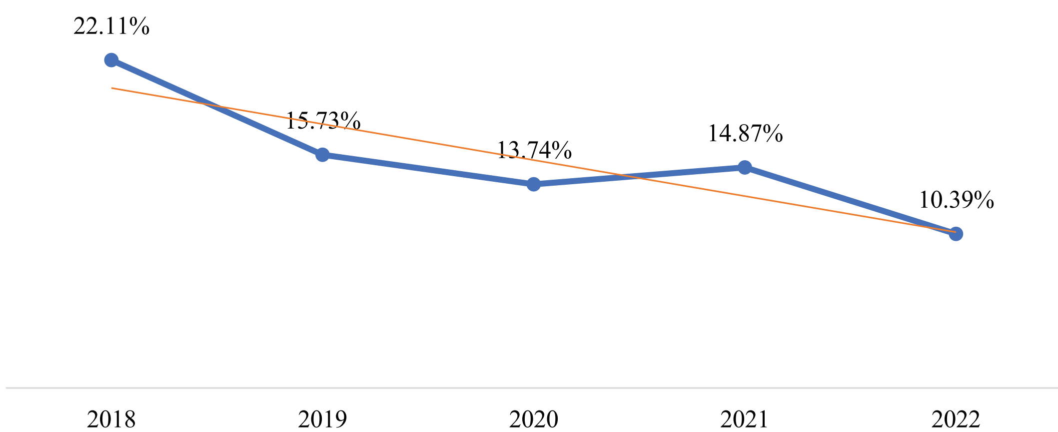
Market Capitalization-to-GDP-Ratio of the Pakistan Stock Market

In the case of Pakistan, the market capitalization-to-GDP ratio has fluctuated over the past five years. Figure 5.4 shows the trend of the market capitalization-to-GDP ratio in Pakistan since 2018.

MARKET CAP-TO-GDP RATIO

- The stock market capitalization-to-GDP ratio, often known as the buffet indicator, is a measure that compares the total market value of all the publicly traded companies in a country to the country's GDP.
- It is a metric that indicates if a market as a whole is undervalued or overvalued relative to the size of the economy.
- A greater market capitalization-to-GDP ratio indicates that the stock market is substantial relative to the size of the economy. This suggests that the stock market is important in channelling capital and investment inside a country.

FIGURE 5.4 PSX Market Capitalization to GDP (Percent)



Source: Author's calculations based on www.ceicdata.com

The ratio, as the orange trendline shows, is on a consistent downward trend, with a noticeable slowing down of the economy in recent years. The low ratio shows that the stock market has not been an effective or preferred means of raising finances for businesses. This can reduce the availability of capital for firms to engage in expansion, R&D, and other growth efforts. Access to finance may stifle economic progress and innovation. The Pakistani stock market is relatively small and illiquid compared to other emerging markets. This limits the ability of investors to allocate capital efficiently and can lead to lower valuations.

The market capitalization-to-GDP ratio of the PSX reached its maximum point in 2018 and has followed a continuous decline since then. The decline is due to the high interest rates to control the money supply. The economic slowdown following COVID-19, regional tensions between neighboring nations, and local political unrest are some of the reasons for the low capitalization-to-GDP ratio below 20%, hitting 10.39% in 2022, the year with the lowest overall market value in the previous five years.

Due to circumstances such as political instability, poor corporate governance, or restricted investment options, investors may see the stock market as less appealing. This might deter both domestic and international investors from entering the sector. Pakistan has faced a range of economic challenges in recent years, including high inflation, a large current account deficit, and a struggling currency. These factors can weigh on the stock market and reduce valuations.

A low capitalization-to-GDP ratio indicates a potential for further investment in productive activities by attracting investors, which would result in economic growth. Furthermore, capital scarcity drives organizations to develop new methods to optimise operations and increase efficiency and production.

Comparison of Major Stock Indices of PSX

The performance of Pakistan's stock market is evaluated by the

PAKISTAN STOCK EXCHANGE INDICES

1. KSE-100 Index

- It is the leading index of the stock market in Pakistan. It serves as a standard for evaluating price changes over time on the Pakistan Stock Exchange.
- It is a market capitalization-weighted and is considered to be a broad representation of the Pakistani stock market.

2. KSE-30 Index

- It includes the top 30 most liquid

KSE-100 Index. KSE-100 Index's performance is also compared with the KSE-30 Index, KSE All Share Index, and KMI-30 Index.

The performance of the Pakistan Stock Exchange (PSX) has fluctuated during the previous five years. This period has seen tremendous volatility, including a severe drop in early 2020, followed by a strong recovery in the later part of the year and throughout 2021. It is critical to recognize that the stock market's performance is affected by several factors, including economic circumstances, laws, rules and regulations, and global events, all of which can cause performance fluctuations over time.

businesses listed on the PSX

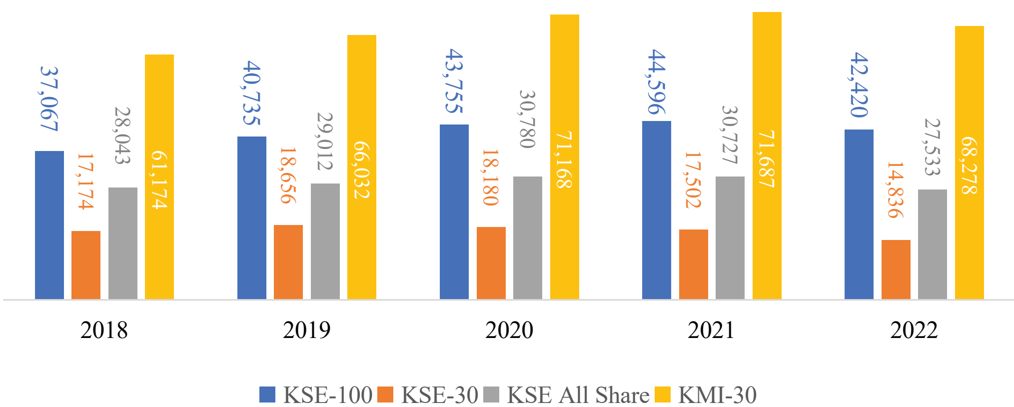
3. The KSE All Share Index

- It is the index of all shares listed on the PSX.

4. The KSE-Meezan Index (KMI-30 Index)

- It is the index for the 30 most liquid Shariah-compliant companies listed on the PSX.
- This index includes companies that are considered Shariah compliant, i.e., the companies that adhere to Islamic principles regarding business practices.
- It is designed for investors who want to invest following Islamic financial principles.

FIGURE 5.5 Comparison of Major Indices of PSX



Source: Author's calculations based on the Pakistan Stock Exchange data.
Note: The values are as of December 30, 2022

The KSE-100 and KMI-30 generally outperformed the KSE-30 and All-Share indices, while all indices provided investors with exposure to different types of securities with varying levels of risk and return. The market grew remarkably in 2017 (not shown in Figure 5.5), marking the KSE-100 Index's all-time high value. The market fell in 2018 as a result of both political and economic uncertainties (2018 was the election year). The market improved somewhat in 2019, but its growth was dealt a blow in 2020 due to the global COVID-19 pandemic. Despite this, the index had a robust comeback in 2021, as evidenced by the KSE-100 Index's value in 2020, setting new records and surpassing its regional competitors.

Total Listed Capital and Total Market Capitalization of PSX

A stock market's total listed capital provides information on the market's size and depth. The total value of all equities listed on a stock exchange is referred to as "listed capital," and it is a crucial indicator of the market's capacity to offer liquidity and investment opportunities. It is also called subscribed capital. A well-established and mature stock market that can support a wide range of investment options for both domestic and foreign investors is often indicated by a high level of listed capital. On the other hand, a low quantity of listed capital may point to a fledgling or small stock market with fewer liquidity and investment options. It might also point to a less hospitable business and regulatory climate, which deters businesses from listing their shares and generating cash.

PRICE DISCOVERY IN THE STOCK MARKET

1. Microstructure Perspective

    - The microstructure approach explores the complex mechanics of trade and market structure, giving insight on how interactions among different market players, order types, and trading processes affect asset prices and market efficiency.

2. Informational Efficiency

- Fame (1970) laid the foundation of informational efficiency which is the Efficient Market Hypothesis (EMH). The EMH proposes that prices quickly reflect all available information, making it impossible for anyone to continually beat the market based on historical data.

3. Role of News and Information

- Price discovery is greatly influenced by financial news, earnings reports, economic indicators, and other information releases. A number of studies have been conducted to examine how market reactions to news effect price changes and volatility.

4. Market Sentiment and Behavioral Factors

- Market sentiment and behavioural variables research in finance investigates the deep influence of human psychology and emotions on asset pricing and market behaviour.

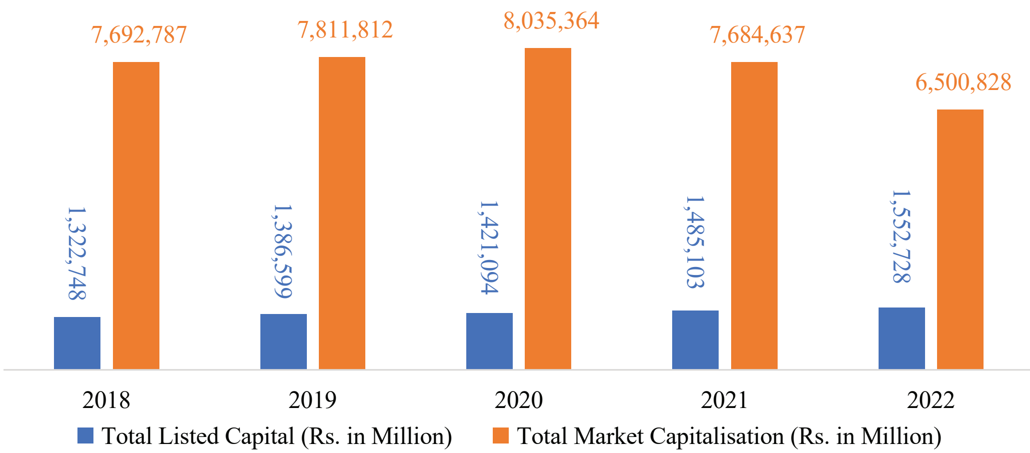
5. Market Transparency and Regulation

- Regulatory changes and improvements in market transparency have an impact on price discovery.

6. Market Integration

- Globalization and technological advancements have led to increased cross-border trading and market interconnections. It contribute to price discovery and transmission of information.

FIGURE 5.6 Total Listed Capital and Market Capitalization (PKR Million)



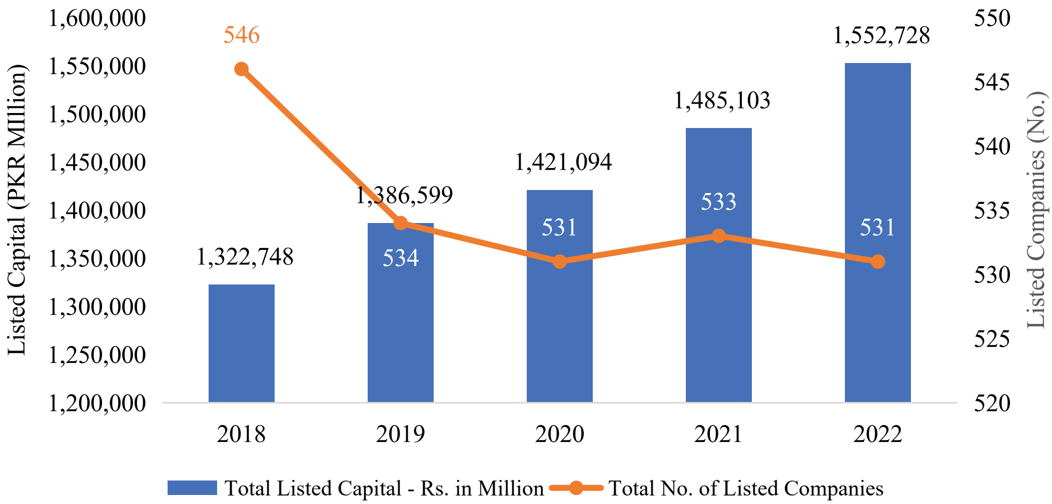
Source: Author's calculations based on the Pakistan Stock Exchange data.
Note: The values are as of December 30, 2022.

The total listed capital on the PSX has increased negligibly over the past 5 years. The total listed capital was PKR 1,322,748 million in 2018 and it continued to grow each year, reaching PKR 1,552,728 million in 2022. The market capitalization trend, however, is not increasing consistently. As shown in Figure 5.6, market capitalization gradually increased from 2018 to 2020, but fell in 2021 and fell even more sharply in 2022.

Comparison of Total Listed Capital and Listed Companies on PSX

A corporation is listed if its stock shares may be bought and sold on a public stock exchange like the PSX. A company's market capitalization represents the aggregate market value of all of its outstanding shares of stock. Listed capitalization refers to the shares that are available for trade.

FIGURE 5.7 Listed Capital and Listed Companies on the PSX



Source: Author's calculations based on the Pakistan Stock Exchange data.
Note: The values are as of December 30, 2022.

BOX 5.1 Why Takeovers Don't Happen in Pakistan?

1. Ownership Structure and Concentration

- In Pakistan, many firms may have concentrated ownership structures, with major holdings owned by families, business groups, or other insiders. This concentration of ownership may make it difficult for outside firms to get a controlling stake or the requisite shareholder approval for a takeover.

2. Lack of Market Liquidity

- Low market liquidity and limited trading volumes in certain Pakistani stocks might discourage potential acquirers, as they may find it difficult to accumulate the necessary shares for a successful takeover bid.

3. Political and Economic Stability

- Political instability and economic uncertainty in the region might discourage international investors from pursuing takeovers in Pakistan owing to worries about the long-term viability of their investments.

4. Lack of Information and Transparency

- The lack of reliable and timely information about firms can raise the perceived risks of takeovers, making potential acquirers reluctant.

5. State-Owned Enterprises

- The existence of state-owned businesses in some industries may reduce chances for takeovers by the private sector since the government may have predetermined goals for who should control and run these businesses.

The number of listed companies on the PSX has declined over the past 5 years. As of December 2022, there were 531 listed companies on the PSX compared to 546 listed companies in December 2018. The number and size of listed firms affect overall listed capital and market capitalization, which, in turn, affect stock market liquidity, trading activity, and investment possibilities.

Although the overall listed capital continuously increased from 2018 to 2022, the market capitalization of individual listed companies on the PSX varied widely over the past 5 years. Large companies, such as Oil and Gas Development Company Limited (OGDCL), Habib Bank Limited (HBL), and Pakistan Petroleum Limited (PPL), contributed significantly to the overall market capitalization. This suggests that existing companies have been able to raise additional capital through the stock market, while new listings have not significantly increased the market capitalization of the stock exchange.

TABLE 5.2 Delisted Firms from the Pakistan Stock Exchange

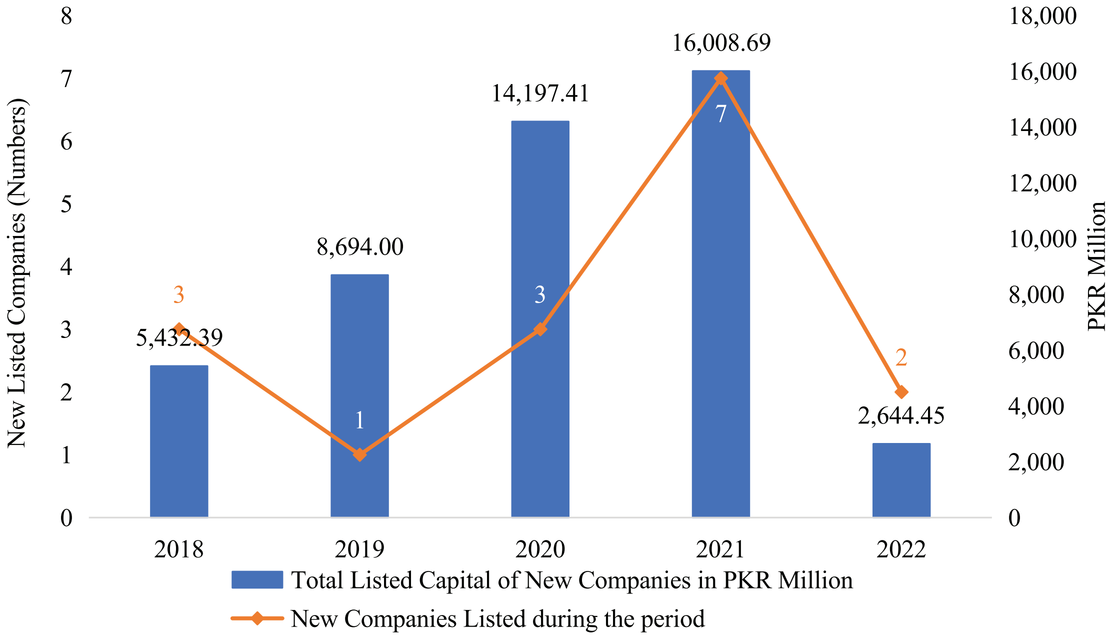
Year	Number of Companies	Reason
2022	01	• Buyback of shares
2021	02	• Violation of various PSX regulations • Voluntarily winding-up
2020	05	• Buyback of shares • Violation of various PSX regulations
2019	12	• Buyback of shares • Violation of various PSX regulations
2018	15	• Buyback its shares • Violation of various PSX regulations • Mergers

Source: Author's compilation

Comparison of Newly Listed Capital and Newly Listed Companies on PSX

Firms issue and sell their shares to the public for the first time on a stock market through an initial public offering (IPO) and the money raised is referred to as newly listed capital. The number of new firms listed and the capital raised from 2018 to 2022 is shown in Figure 5.8 below.

FIGURE 5.8 New Companies and Listed Capital of New Companies



Source: Author's calculations based on the Pakistan Stock Exchange data.
Note: The values are as of December 30, 2022.

In Pakistan, very few new companies list on the stock market each year. As Figure 5.8 shows, during 2018-2022, only 16 firms made IPOs. The highest number of IPOs – 7 – were made in 2021 and the capital raised was USD 0.189 billion. The number declined to only 2 in 2022, with the listed capital of only PKR 2,644.45 million, as a result of political and economic uncertainties. The sector-wise distribution of newly listed capital and companies has varied over the past 5 years. In 2021, the largest amount of newly listed capital was in the technology sector, followed by the materials sector, and the financial sector. Several reasons contribute to very few listings per year, including a complex regulatory environment along with compliance requirements, concerns about market volatility due to economic and political uncertainty, and a limited understanding of the benefits of listing. Addressing these issues is essential if we want to encourage new listings. To do so, the regulatory environment must be improved, investor protection must be strengthened, economic stability must be promoted, and programs for education and awareness must be made available to entice businesses to the PSX. To put things into perspective, a comparison of Pakistan with India and Bangladesh is given in Table 5.3.

TABLE 5.3 IPOs and Listed Capital: Pakistan, India, and Bangladesh

Year	Pakistan		India [19]		Bangladesh	
	IPOs	Listed Capital (USD Billion)	IPOs	Listed Capital (USD Billion)	IPOs	Listed Capital (USD Billion)
2022	2	0.01	40	7.63	8 [20]	0.76
2021	7	0.10	63	16.22	16 [21]	0.19
2020	3	0.09	16	3.59	15 [22]	0.16
2019	1	0.06	16	1.80	9 [23]	0.14
2018	3	0.04	25	4.64	13 [24]	0.07

Source: For Pakistan, the figures are based on the Pakistan Stock Exchange data as of December 30, 2022. For India and Bangladesh, see footnotes 1 to 6. Note: Listed capital is converted to USD using an annual average exchange rate based on monthly averages using data from the World Development Indicators.

[19] Source:https://www.chittorgarh.com/report/list-of-ipo-by-year-fund-raised-success-mainboard/85/

[20] Source:https://www.tbsnews.net/economy/stocks/raising-capital-through-ipo-drops-57-fy22-450678

[21] Source:https://www.tbsnews.net/economy/stocks/raising-capital-through-ipo-drops-57-fy22-450678

[22] Source:https://www.tbsnews.net/economy/stock/13-15-ipos-approved-last-6-months-2020-178795

[23] Source: https://www.newagebd.net/article/93527/fund-raising-thru-ipos-falls-in-2019

[24] Source: https://thefinancialexpress.com.bd/stock/bangladesh/fundraising-thru-ipo-triples-in-2018-1545622866

Free Float Shares and Shareholding of Blue Chips in Pakistan

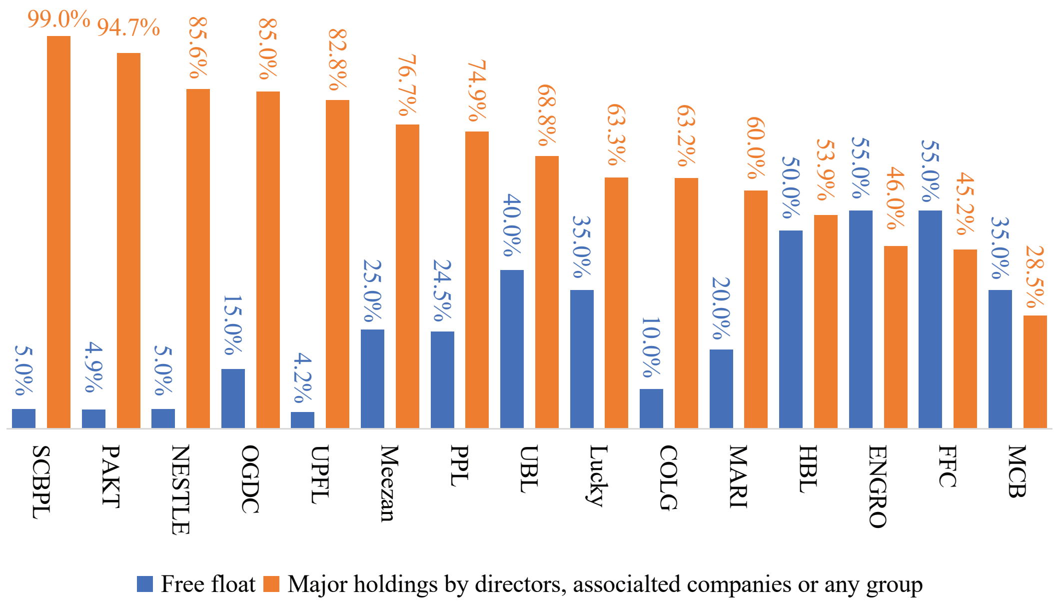
The shareholdings of blue chip companies listed on the PSX reflect the ownership structure of these companies. These companies are typically the largest and most established firms in their respective industries, with a track record of generating significant earnings and dividends for their shareholders.

In Pakistan, many blue chip companies have significant government or institutional ownership, which can reflect the strategic importance of these firms to the economy. For example, OGDCL is majority-owned by the government of Pakistan, reflecting its position as one of the largest oil and gas exploration and production companies in the country. Similarly, the National Bank of Pakistan and the Government of Pakistan have a significant stake in HBL, reflecting its role as one of the largest commercial banks in the country.

FREE FLOAT SHARES

The free float shares refer to the number of a company's shares that can be publicly traded. Controlling stakeholders, such as the company's promoters, founders, or big institutional investors, do not own free-float shares. Individual investors and dealers can buy and sell these shares freely on the stock exchange. The proportion of free float shares varies by firm and can fluctuate over time owing to variables such as new issuances, buybacks, or changes in the ownership structure. The calculation of free float shares typically involves subtracting the number of shares held by insiders or restricted from trading from the company's total outstanding shares. Free float shares are often used as a measure of the liquidity of a company's stock as they represent the shares that are most actively traded in the market.

FIGURE 5.9 Shareholding Pattern of Blue Chip Companies in Pakistan: 2021



Source: Author's calculations based on the balance sheets of respective companies

The free float shares of blue chips ranged from 4.2% to 55% of the total shares in 2021 in the PSX. Many companies in Pakistan have significant government or institutional ownership, which can result in a low free float. The government or institutions may hold a large portion of the company's shares, which are not available for trading on the market.

FAMILY-OWNED COMPANY

"A company is considered a family firm when it is closely identified with at least two generations of a family and when this link has a mutual influence on company policy and on the interests and objectives of the family."

Source: Donnelley (1964)

Most of the blue chips in Pakistan have less the 25% shares in free float. Figure 5.9 shows that family-owned or founder-owned companies may have a low free float if a significant portion of the company's shares is held by the founding family or their close associates. These shares may be restricted from trading or may not be available for trading on the market.

TABLE 5.4 Family-Owned Businesses and Asian Economies

Country	Role of Family-Owned Businesses
China	• Family firms in China emerged after the 1978 economic reforms allowing private ownership (Li et al., 2015). • In China, family businesses account for more than a third of listed firms and over 90% of private firms. (Bennedsen & Mehrotra, 2022). • These businesses provide a significant contribution to the Chinese economy's employment and GDP growth.
Hong Kong	• The main sources of wealth creation in the Hong Kong economy are family businesses (Huang & Yeung, 2018). • During the British colonial era, prominent commercial families arose, which resulted in a large wealth concentration. • The 15 richest families in Hong Kong hold 84% of the country's GDP (Ho & Chalam, 2017).
India	• In India, family businesses account for 85% of all businesses and roughly 70% of the GDP. India is renowned for its significant family-owned companies, many of which have developed into world-class conglomerates, despite their different sizes and industries (Bennedsen & Mehrotra, 2022).
Indonesia	• In Indonesia, family businesses make up roughly 96% of all businesses, spanning various critical sectors such as property, agriculture, energy, and consumer goods (Kumar & Prameswari, 2018). • Indonesia's family firms have a notably higher level of preparedness for succession planning compared to some ASEAN counterparts.
Japan	• Japanese family businesses have a long history; they are the only family businesses in the world that have survived for over a millennium (Goto, 2014, 2021).

	• At their peak, families and insiders held slightly more than 25% of the shares in their firms at the beginning of the 20th century up until 1937 (Franks et al., 2014). • The Zaibatsu structure dominated Japanese industry until the Second World War, with prominent business groups like Mitsui, Mitsubishi, Sumitomo, and Yasuda. • After World War II, Zaibatsus were disbanded under US occupation, leading to the emergence of the Keiretsu system, characterized by cross-shareholding among firms.
Singapore	• A significant portion of Singapore's economy is made up of family businesses, which account for 33.1% of the market capitalization and 52% of the listed companies on the Singapore Exchange. (Bennedsen & Mehrotra, 2022). • In Singapore, family businesses do better than non-family businesses in terms of returns on assets. Family firms especially dominate particular industries such as Construction (81.3%), Hotels and Restaurants (72.2%) and Property (70.7%) (Dieleman et al., 2013).
South Korea	• South Korean economy has been significantly driven by large family-run business groups known as Chaebols, contributing to economic transformation. • Chaebols have strong political ties and dominate the economy, accounting for 84.3% of GDP (Bennedsen & Mehrotra, 2022). • Small and medium-sized family firms form the majority of jobs in the economy.
Taiwan	• Family businesses account for 65% of all Taiwanese businesses and contribute to 55% of the country's total market value (TWIOD, 2018; PwC, 2020). • Founder-led firms accounted for 56%, second-generation-led for 35%, and third-generation-led for 9% in 2019 (PwC, 2019). • Many large Taiwanese family firms are organized into business groups and have expanded internationally.

Cross holdings occur when a company holds shares in another company or vice versa. This can result in a low free float for both companies as the shares held by one company may not be available for trading on the market. It is one of the major reasons for low liquidity in the market. With more shares available for trading, investors may purchase and sell them more easily, increasing trading volumes and lowering bid-ask spreads.

When a certain group owns a large amount of a company's shares, it might limit the availability of shares for trading on the open market. This can lead to larger bid-ask spreads, reduced trading volumes, and more price volatility, making it more difficult for other investors to acquire or sell shares at reasonable prices. Concerns regarding corporate governance and accountability might arise from concentrated shareholdings. The dominant group may have significant power over the company's management, resulting in conflicts of interest, self-dealing, and a lack of openness.

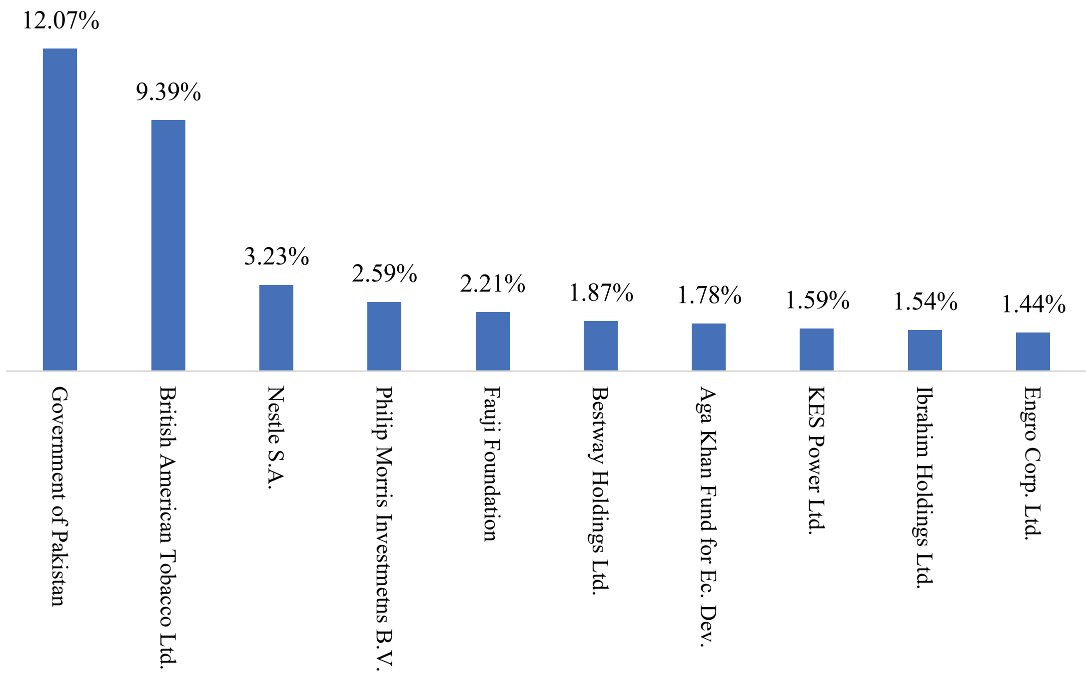
A low trading volume and limited liquidity in the market can also result in a low free float. If there are not enough buyers and sellers in the market, the free float may be low as there are not enough shares available for trading. Higher free float shares help to make the market more efficient. It enables a stronger price discovery process since a greater number of participants may freely trade the shares depending on their valuation of the firm. This can lead to more accurate stock prices that reflect genuine market sentiment. A higher free float attracts a bigger number of individual investors. This can result in greater stock interest, more market awareness, and even a higher valuation for the firm. A larger proportion of free float shares can help to improve corporate governance. It promotes better accountability by allowing a greater number of independent shareholders to utilise their voting rights and express their views on crucial issues during shareholder meetings.

Shareholding Proportions in the KSE-100 Index (Market Cap)

Foreign shareholders and government ownership account for the bulk of shares in the KSE-100 market capitalization, an estimated 61%. The ownership of the

KSE-100 market cap is heavily skewed towards a few large investors. [25]

FIGURE 5.10 Ownership of KSE-100 Market Cap (Percent)



Source: Based on data from Haque & Husain (2021)

The single largest shareholder is the Government of Pakistan, which accounts for over 12% of market capitalization with its controlling/substantial shareholding in the KSE-100. Together, the top 10 owners account for 37% of the market capitalization of KSE-100. Concentrated shareholdings can reduce liquidity and trade volumes, lowering market efficiency.

Real Returns on Blue Chips Listed on the PSX

Blue chip stocks are typically considered to be large, well-established companies

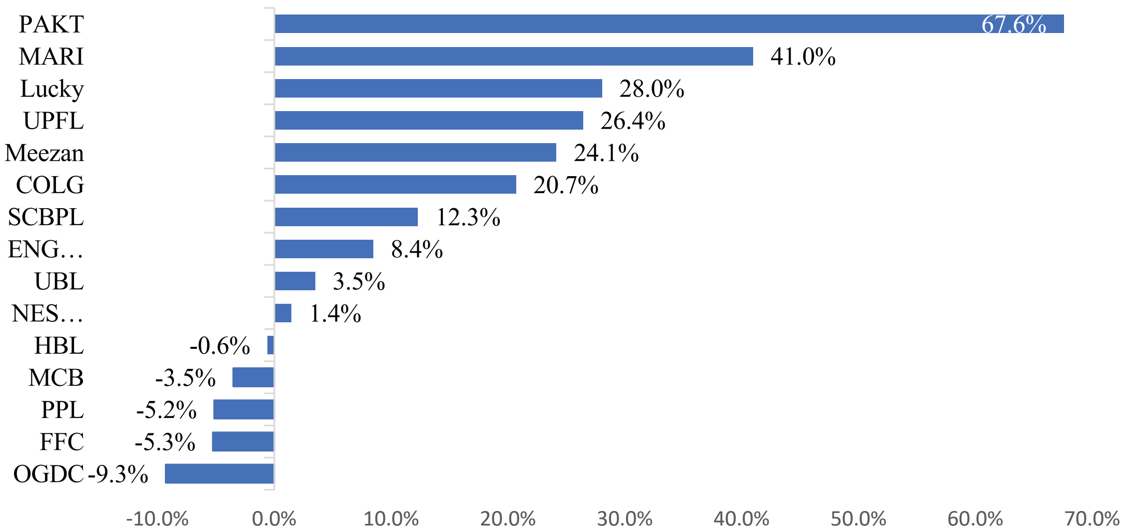
[25] Haque, N. U., & Husain, A. (2021). *A small club: Distribution, power and networks in financial markets of Pakistan* (No. 2021 Pakistan Institute of Development Economics.: 3).

with a long track record of stable earnings and strong financials. Calculating a share's real returns is significant because it offers a more accurate assessment of an investment's true buying power and worth after accounting for inflation. Real returns account for the impact of inflation on investment performance, allowing investors to make more informed decisions and assess the real profitability of their assets. These blue chips have consistently delivered strong financial results over the years, with increasing revenues and profits. These firms have consistently paid dividends to their shareholders, which has likely contributed to positive investor sentiment and increased demand for their shares.

Although blue chip stocks are often considered to be less risky than smaller, less established companies, they are not without risks. Blue chip stocks can still experience volatility and can be subject to various market and economic risks. The PSX real returns may fluctuate, but for strategic investors, each fluctuation represents an opportunity to position themselves for future growth and capitalize on the market's dynamic character.

The average real returns on blue chips listed on the PSX from 2012 to 2021 ranged between a loss of 9.3% to a gain of 67.6%. Oil exploration companies did not progress in real return terms during that period. There has been significant volatility in oil prices, with a sharp decline in prices in 2014 and 2015, followed by a gradual recovery in the subsequent years. This volatility may have adversely impacted the financial performance and stock prices of oil and gas companies. The COVID-19 pandemic has had a significant impact on the global economy and market, including the PSX. The pandemic has reduced demand for oil and gas, disrupted the supply chain, and posed other challenges for the OGDC and other companies in the industry.

FIGURE 5.11 Average Real Returns on Blue Chips: 2012 to 2021 (Percent)

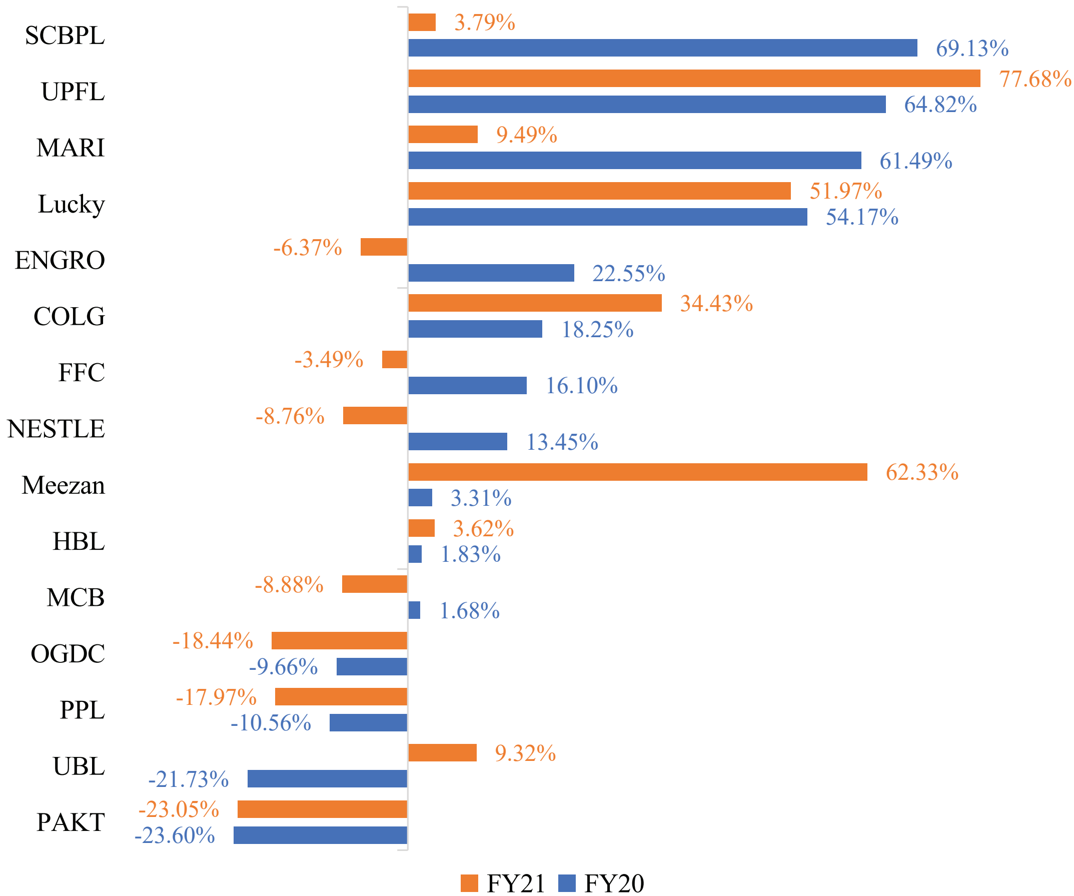


Source: Author's calculations based on the PSX data (returns) and Pakistan Economic Survey (firms)

Real Returns on Blue Chips Listed on the PSX

The year 2020 and 2021 were challenging for many blue chip stocks on the PSX. The COVID-19 pandemic and its economic fallout negatively affected the earnings and revenue of many companies. The pandemic created a great deal of uncertainty in the markets, which led to investor caution and a general decline in market sentiment. This uncertainty was exacerbated by other factors such as political instability, rising inflation, and currency depreciation. The steep depreciation of the Pakistani rupee against the US dollar over the past few years has also negatively affected blue chip companies, especially those that rely heavily on imported inputs or have US dollar-denominated liabilities. Thus, in 2020 and 2021, these blue chip firms did not perform well in real return terms. The real returns for 2020 and 2021 are given below.

FIGURE 5.12 Real Returns on Blue Chips: 2020 and 2021 (Percent)



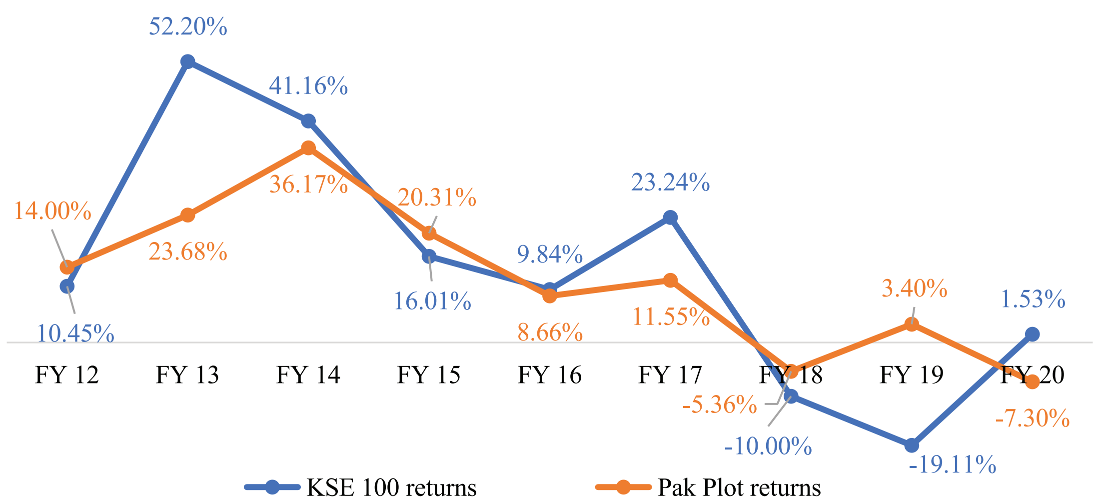
Source: Author's calculations based on the PSX data

PSX AND OTHER MARKETS

Comparison Between PSX and Real Estate Returns

In Pakistan, both the stock market and the real estate market are prominent investment alternatives. Investors frequently consider allocating assets to one of these markets to possibly earn returns on their investments. The performance of the stock market and the real estate market may both be used to gauge the general health and stability of the economy. Comparing the performance of different markets can give clues on larger economic trends, investor sentiment, and Pakistani market conditions. It also allows investors to determine which market may provide higher returns and make more educated investment selections.

FIGURE 5.13 Real Returns on Blue Chips: 2020 and 2021 (Percent)



Source: Author's calculations based on data from the PSX and zameen.com

In Pakistan, the general perception is that real estate is the most attractive investment option in terms of returns and future security and people prefer to invest in real estate. However, data paints a different picture. In general, the PSX has performed better in comparison to the real estate market. From 2018 onwards, due to worries about macroeconomic imbalances, geopolitical tensions, and global market circumstances, Pakistan saw considerable foreign investment outflows. These withdrawals weighed on stock prices and contributed to the PSX's decreasing trend.

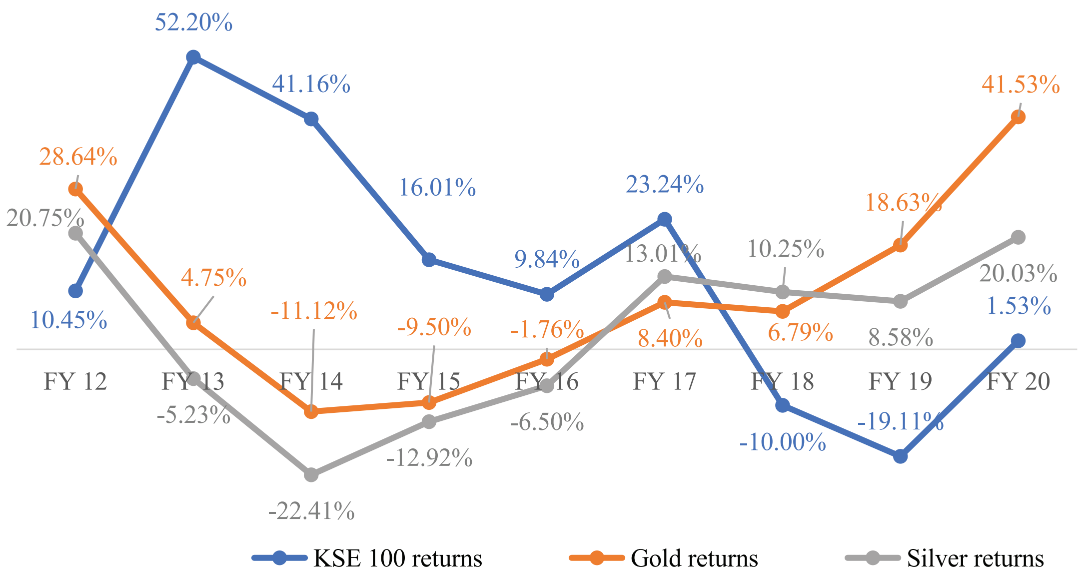
The real estate and stock markets in Pakistan have had a very difficult time after the change of regime in 2018 and faced financial, economic and political challenges, many policy issues and a lack of confidence. The real estate market has hardly managed to survive from recession in the past couple of years, mainly due to massive investments by overseas Pakistanis. This was because of the depreciation of rupees and made property investment cheaper for them due to exchange rate benefits.

Following 2018, the global economy faced several challenges, including trade disputes, geopolitical crises, and economic slowdowns in key nations. These worldwide issues might have influenced investor mood causing risk aversion, and resulting in the downward stock market trend. After 2018, several segments of the PSX encountered many issues. The banking industry, for example, saw a spike in non-performing loans and provisions, while the energy sector suffered cyclical debt and regulatory uncertainty. These sector-specific problems might have weighed on PSX's overall performance.

Comparison Between Returns on PSX, Gold, and Silver

A comparison between stock market returns and returns on gold and silver is often made because gold and silver are frequently seen as safe haven investments, especially during periods of economic uncertainty or market volatility. These precious metals are sought after by investors as a store of value and a hedge against inflation or economic downturns. Diversification is desired by investors to manage risk and also, perhaps, to increase profits. Stocks indicate company ownership, whereas gold and silver are physical things with intrinsic worth. When investors compare the returns of these various asset classes, they may evaluate the benefits of diversifying their investments and allocating funds to both stocks and precious metals.

FIGURE 5.14 Returns on the PSX, Gold, and Silver: 2012 to 2020 (Percent)



Source: Author's calculations based on PSX data and SBP Handbook of Statistics 2021

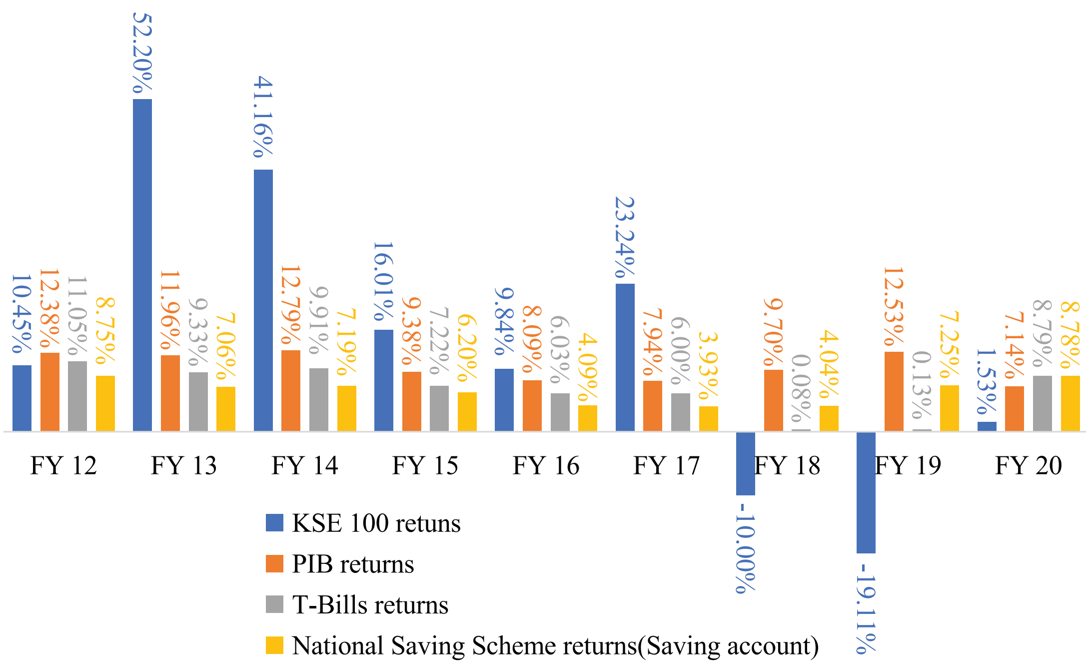
Similar to the relationship between real estate and PSX returns, the Pakistani stock market outperformed the gold and silver market from 2012 to 2020. Rising inflation can influence market sentiment and asset class performance. Because their prices grow during inflationary periods, gold and silver are frequently seen as inflation hedges. If investors are concerned about inflation eroding the value of equities, they may devote more assets to precious metals, resulting in poorer stock market returns.

Similarly, monetary policy and the interest rate environment significantly affect investor behavior and asset class performance. Rate rises and cuts by central banks have an impact on borrowing rates, economic growth forecasts, and market sentiment, which result in an uncertain environment and raise the discount rate (resulting in lowering the present value of the stocks). These effects are reflected in the form of the range-bound PSX index in Figure 5.14 above.

Comparison Between PSX and Government Securities Returns

Government assets, such as treasury bills and bonds, are typically seen as less risky investments than equities. They are backed by the government and are seen to have lower default risk. Comparing PSX returns to those of government securities allows investors to assess the risk-reward trade-off between these two asset classes. Market mood and investor risk appetite can have an impact on the performance of government securities and equities. During times of market instability or economic downturns, investors may transfer to more safe assets such as government securities, which can influence PSX's relative performance. Comparing returns can help investors determine their risk tolerance and preferences.

FIGURE 5.15 Returns on PSX and Government Securities: 2012 to 2020 (Percent)



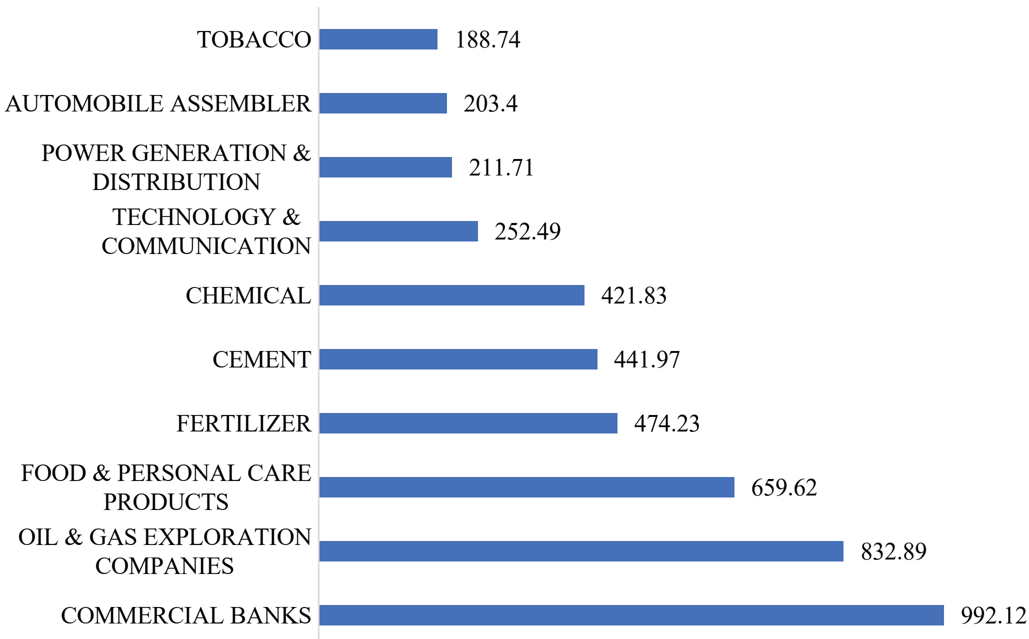
Source: Author's calculations based on PSX data and SBP Handbook of Statistics 2021

The PSX returns followed the fundamental pattern till 2017 as the returns on risky assets outperformed those on risk-free assets. Interest rate fluctuations have an impact on government instruments such as treasury bills and bonds. When interest rates are high, government assets tend to offer attractive yields that can rival or outperform stock market returns. Similar was the case in Pakistan of rising interest rates.

SECTOR SIZE BASED ON THE PSX MARKET CAP

Market capitalization shows a company's or a sector's overall worth based on its share price and the number of outstanding shares. Comparing sectors based on market capitalization provides insight into the relative size and importance of various sectors within the market. Larger industries with larger market capitalization are frequently regarded as more important and have a stronger influence on the whole market.

FIGURE 5.16 PSX Market Capitalization: Top 10 Sectors (PKR Million)



Source: Author's calculations based on PSX data (June 2023)

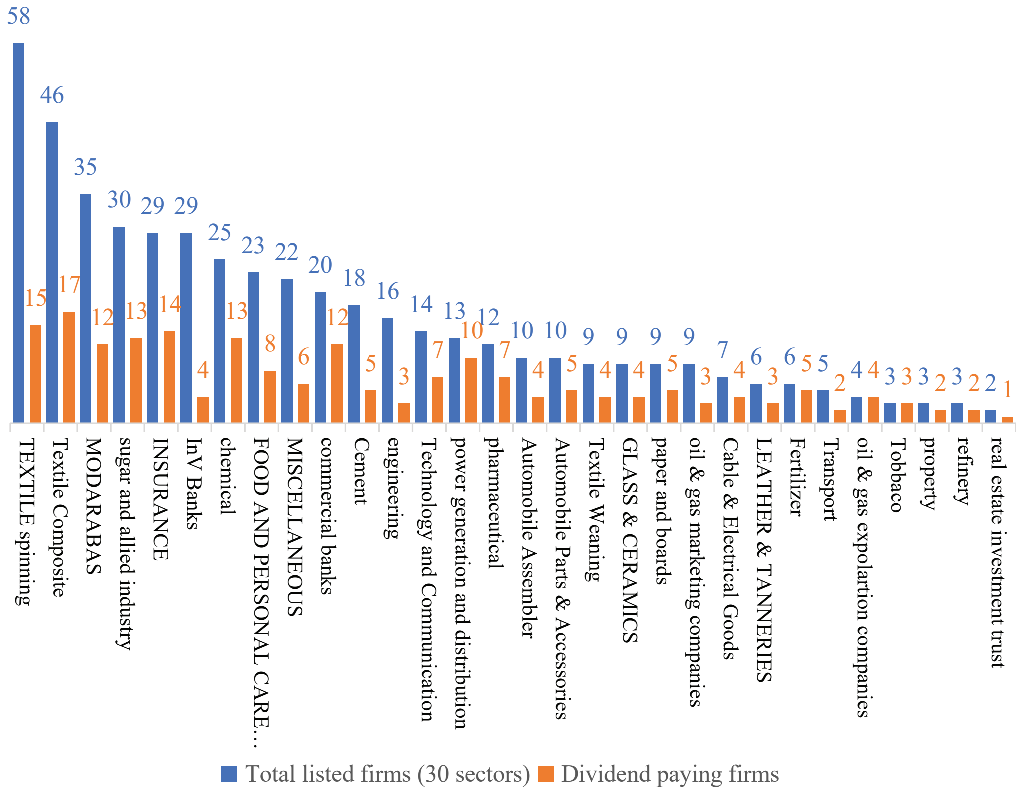
In terms of market capitalization, the banking industry, which consists of both domestic and foreign banks operating in Pakistan, is one of the largest on the PSX with a market capitalization of PKR 992.12 Million. Banks with great financial performance, such as better profitability, good asset quality, and solid balance sheets, attract investors and lead to higher market capitalization. The oil and gas exploration sector has the second-highest market capitalization. When oil prices are high, the market places a higher value on oil and gas firms, leading to increased market capitalization.

On the PSX, dividend-paying industries frequently have higher market capitalization ratios. Because dividend-paying industries are frequently regarded for their steady and predictable income flows, investors seeking consistent income are drawn to these industries, resulting in increased demand and, as a result, larger market capitalization.

SECTOR-WISE DIVIDEND-PAYING FIRMS LISTED ON THE PSX

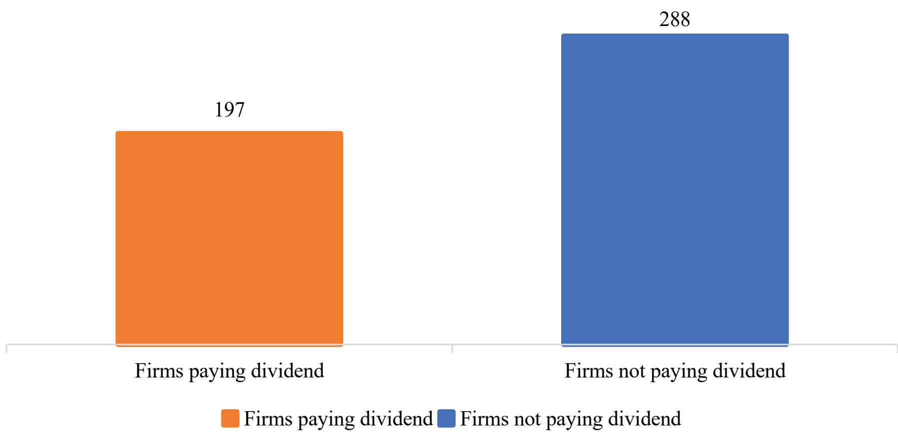
Dividend-paying companies are important in the stock market for various reasons. Dividend-paying companies offer investors a steady source of cash. These frequent cash payments might be very beneficial for investors looking for a consistent income source. Dividend-paying companies are frequently associated with more stability and reduced volatility. They are often well-established businesses that have a track record of earning profits and returning a portion of those proceeds to shareholders. During market downturns, when investors might seek defensive assets, such consistency can be appealing. Therefore, it is important to know how many firms are paying dividends in PSX. Figure 5.17 provides this information.

FIGURE 5.17 Dividend-Paying Firms Listed on the PSX: Sector-Wise (Number)



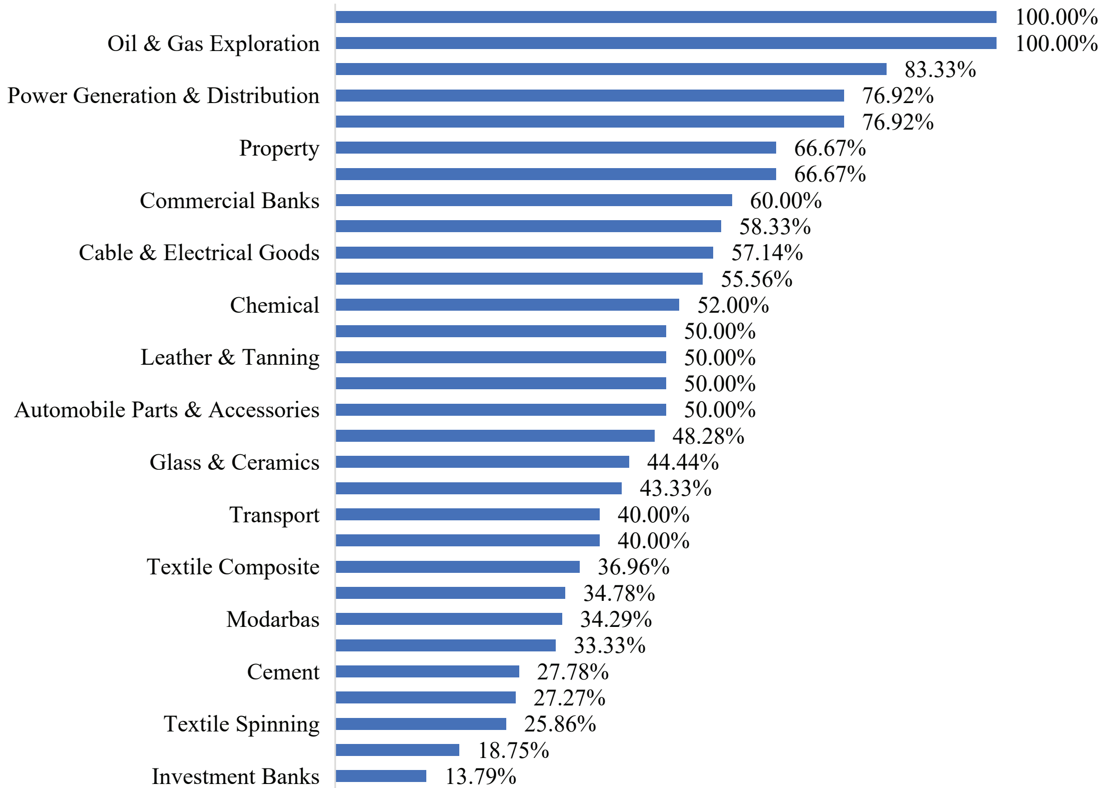
Source: Author's calculations

FIGURE 5.18 Dividend and Non-Dividend Paying Firms (Numbers)



Source: Author's calculations

FIGURE 5.19 Dividend-Paying Firms: Percent of Total Listed Firms



Source: Author's calculations based on the balance sheets of the companies

Banks, chemicals, fertilizer, oil, refinery, pharma, power generating and distribution companies are well-known for paying regular dividends. Out of 485 firms included in the analysis, only 197 firms paid dividends in 2022.

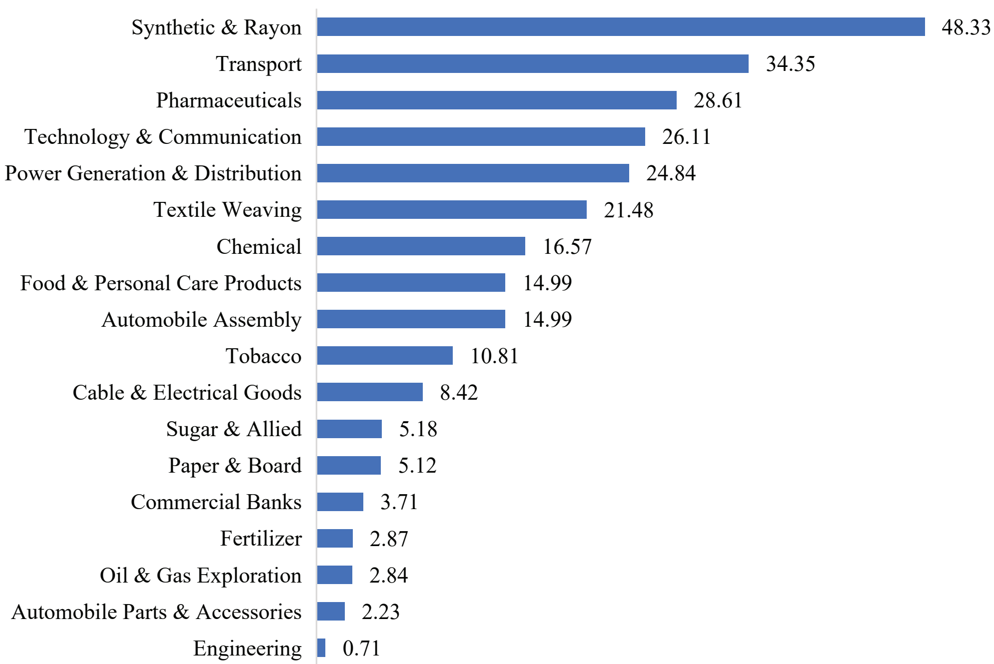
The major reason for paying dividends in chemical, fertilizer, oil, refinery, power generating and distribution sectors was that there has been no expansion in the recent past. Since these firms cannot reinvest in the business due to no expansion activities, these sectors paid dividends.

It is important to note that stock market growth is driven by a complex interaction of numerous factors and dividend payments alone may not be enough to assume the market expansion. The market's expansion is affected by the fluid and complex interaction of various factors such as economic, regulatory, and investor-related forces.

SECTOR-WISE PRICE-TO-EARNINGS RATIO

The price-to-earnings ratio (P/E ratio) gives information about the value of a company's shares in relation to its earnings. It assists investors in determining if a stock is overpriced or underpriced with respect to its earnings potential. A company's relative value may be determined by comparing its P/E ratio to that of its industry peers or the entire market. Market expectations regarding a company's future growth potential might be reflected in the P/E ratio. A high P/E ratio indicates that a company is overpriced and that its price may decrease in the future. A low P/E ratio indicates that a company is inexpensive and that its price may grow in the future. As a result, the P/E ratio is quite helpful in making investing decisions.

FIGURE 5.20 Price-to-Earnings Ratio: Sector-Wise



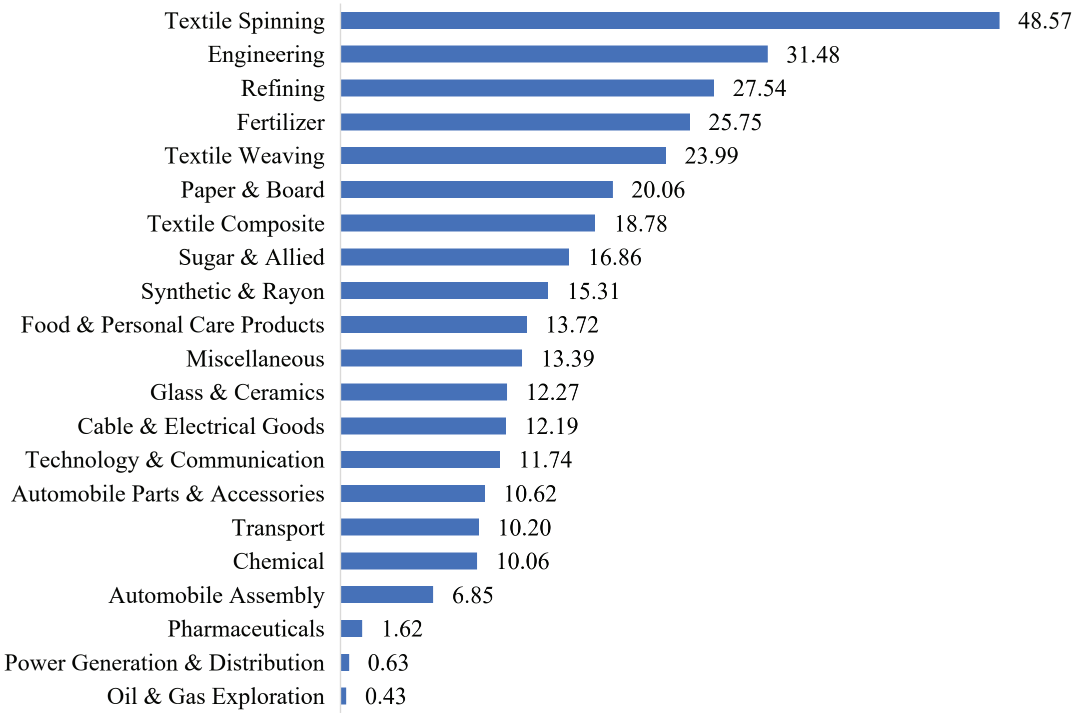
Source: Author's calculations based on PSX data (June 2023)

The P/E ratio of PSX is on the lower side in 2023 owing to poor earnings and low growth of the economy. As Figure 5.20 shows, a lot of opportunities exist for investors due to lower P/E ratios in engineering, oil and gas, and fertilizer and banking sectors. The low P/E ratio indicates potential opportunities such as undervalued stocks, higher earnings yield, growth potential, risk mitigation, and potentially attractive dividend yields. It implies that equities may be selling below their fair value, giving investors the chance to buy them for less and maybe profit from future price increases. Low P/E ratio companies may have greater opportunities for dividend growth. If a company's earnings improve or the market revalues its valuation, the stock price and possibly dividends rise. Low P/E ratio equities may appeal to income and dividend growth investors.

SECTOR-WISE DEBT-TO-EQUITY RATIO

The debt-to-equity ratio (D/E ratio) is an essential indicator for investors. The D/E ratio assists investors in determining a company's financial health and capacity to manage debt commitments. It is the proportion of a company's funding that is provided by debt as opposed to equity. A high D/E ratio may imply a higher level of financial risk since it suggests a larger reliance on borrowed funds to support operations. At the same time, a very low D/E ratio implies that a corporation prefers equity financing over loan financing. While a conservative capital structure is advantageous in terms of decreased financial risk, it can also limit a company's access to new cash for development and expansion. Companies may find it difficult to borrow capital through debt issuance, limiting their capacity to engage in new projects, R&D, or other value-creating efforts.

FIGURE 5.21 Sector-Wise Debt-to-Equity Ratio: 2022



Source: Author's calculations based on the balance sheets of the companies (2022).
Note: The financial sector and sectors with average negative ratios are excluded.

The lowest debt-to-equity ratios were in oil and gas, power generation and distribution, automobile, and chemical sectors due to non-expansion and the repayment of the old debt. When a company's debt is minimal, it may suggest an unwillingness to take risks or seek development prospects. Debt is frequently used to promote expansion and preserve a competitive edge in industries that need significant capital inputs, such as infrastructure, manufacturing, or technology. This element is missing in the PSX and most of these sectors have low D/E ratios.

On the other hand, the sectors with extraordinarily low D/E ratios may indicate that a company's financial structure is not optimized. Debt may be a low-cost source of capital since interest payments are tax-deductible, lowering the overall cost of capital.

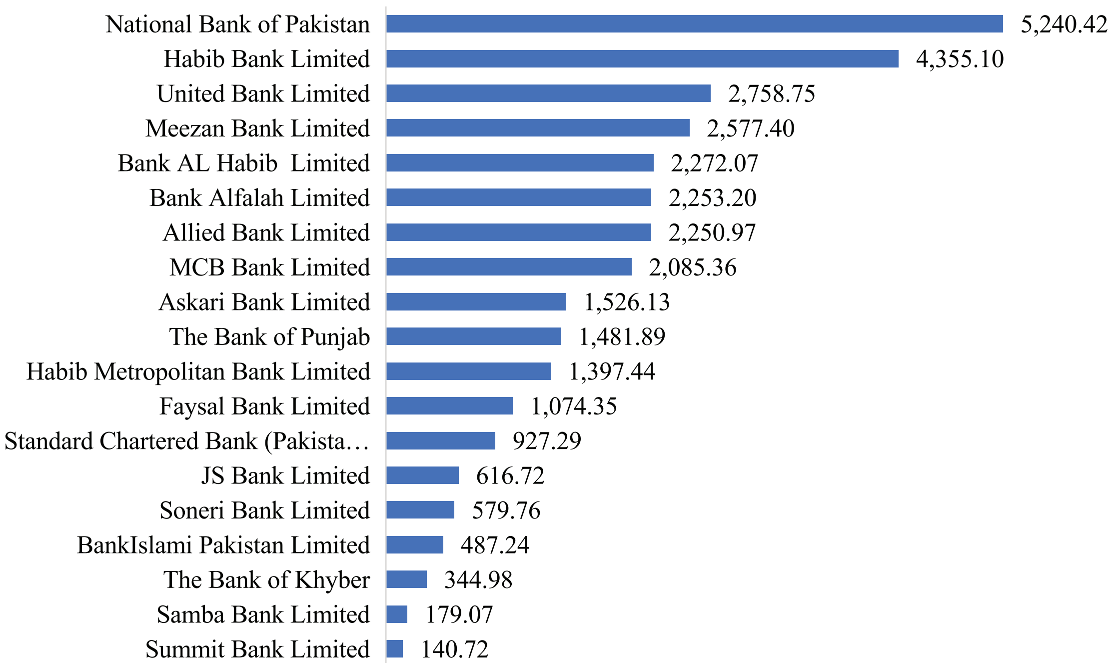
STATE OF BANKING IN PAKISTAN

The banking industry is critical because it acts as the economy's backbone, providing crucial financial services and supporting economic growth. Banks perform an important intermediary function by mobilizing savings from people and organizations and channeling those monies into productive activity via loans and investments. They provide necessary services such as deposit-taking, lending, and payment systems, which ease economic activities and promote financial inclusion. Furthermore, banks assist firms by providing credit facilities, trade financing, and consulting services, all of which contribute to entrepreneurship, investment, and job creation. Overall, the stability, efficiency, and accessibility of the banking sector are critical to sustaining a healthy financial system and encouraging long-term economic development.

Size of Banks Listed on the PSX

Bank size is significant for various reasons. Larger banks often have more diverse portfolios and higher financial resources which can help them weather financial shocks and economic downturns. They are more suited to absorb losses and preserve stability in difficult times. A healthy and stable banking sector is critical to the economy's overall health. While the scale of banks has advantages, it also has drawbacks in terms of risk management, regulatory monitoring, and possible concentration of economic power. To preserve financial stability and safeguard the interests of depositors and the larger economy, regulatory authorities frequently adopt steps to guarantee that major banks are subject to sufficient scrutiny and prudential requirements.

FIGURE 5.22 Total Assets of Banks (PKR Billion)

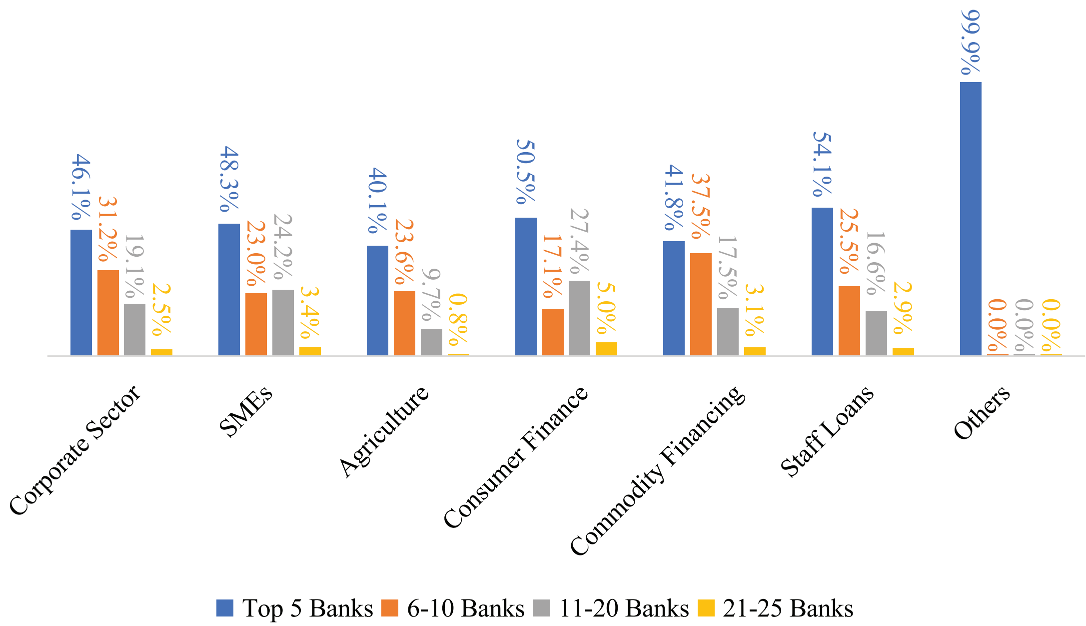


Source: The State Bank of Pakistan

Sectoral Distribution of Loans by Banks

Banks' sectoral loan distribution refers to the allotment of credit to various economic sectors such as agriculture, industry, services, construction, and other sectors. Banks play an important role in economic growth by providing credit to a variety of sectors. Sectoral loan distribution guarantees that diverse sectors of the economy receive the finance they require for development and expansion. This fair distribution helps in overall economic development and diversification. Sectoral loan distribution is critical for banks to control their risk exposure. Different industries have different risk profiles and are more vulnerable to economic volatility. Banks can lessen the concentration risk associated with a certain industry by spreading their loan portfolios across industries. This diversification reduces the impact of sector-specific hazards on the bank's entire loan portfolio while also improving risk management.

FIGURE 5.23 Sectoral Distribution of Loans of Banks: 2022 (Percent)



Source: The State Bank of Pakistan

TABLE 5.5 Advances and Non-Performing Loans (NPLs)/Infection Ratios: Sector-Wise

Sector	Advances (PKR Millions)	Infection Ratio (%)
Corporate Sector	9,022,077	8.0
Commodity Financing	1,260,929	0.6
Consumer Sector	895,908	3.6
SME Sector	532,580	14.1
Agriculture Sector	448,527	12.4
Staff Loans	243,452	1.1
Others	241,883	14.0

Source: State Bank of Pakistan

In Pakistan, bank credit growth is primarily influenced by the top 5 banks, which presently account for almost 50% of the financing to each sector. Bank credit is largely dependent on the corporate sector's lending appetite, which is currently receiving more than 70% of the total banking lending. The second highest financing has been provided for commodity finance with the lowest infection ratio of 0.60%. Banks have marginalized other sectors such as SMEs, agriculture, and housing by focusing solely on the corporate sector. The financial system's systemic risk has risen, as evidenced by its concentration on a few conglomerates.

Infection Ratios of Banks Listed on the PSX

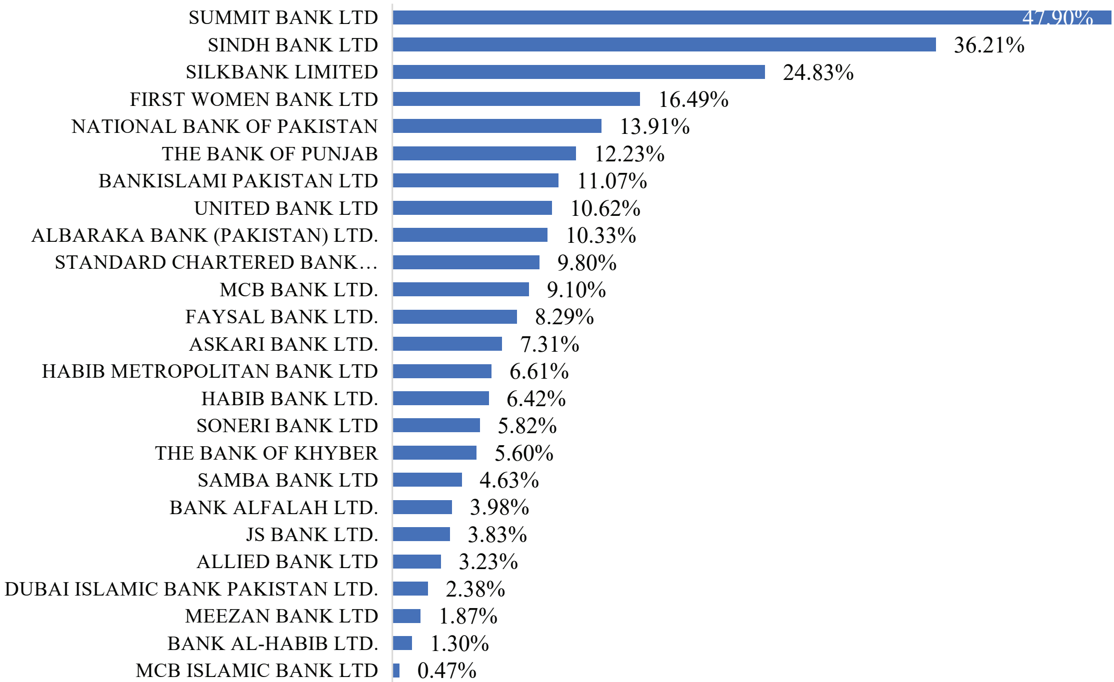
The infection ratio is an important metric for investors and analysts to evaluate the financial health of a bank as non-performing loans can impact the bank's profitability, solvency, and overall financial performance. A low infection ratio suggests that the bank has a low amount of non-performing loans and is better able to manage credit risk. Despite difficult economic conditions, Pakistan's banking sector continues to thrive and earn high profits. The banking sector accounts for roughly 25% of the KSE-100 index. The sector's asset base increased from PKR 26 trillion to PKR 30 trillion, i.e., around a 15% increase in 2021. Bank advances grew significantly by 21% in 2021 and first time reached at the PKR 10 trillion milestone.

INFECTION RATIOS

The infection ratio of banks, also known as the non-performing loans (NPL) ratio, is a measure that indicates the percentage of loans that a bank has issued that are in default or are close to default. The infection ratio of the banking sector is the percentage of NPLs to the total loan portfolio of banks. It is calculated by dividing the total amount of non-performing loans by the total amount of loans issued by the bank. An NPL is a loan that is in default or at risk of default, typically when the borrower fails to make interest or principal payments for 90 days or more. In Pakistan, the SBP monitors the infection ratio of banks and sets guidelines for banks to manage credit risk and maintain healthy loan portfolios.

The rise in advances was mostly brought on by the SBP's numerous programs and incentives as well as rising demand from the industry and consumer sectors. Higher gains were also a result of the second half's strong commodity prices. This growth in advances is predicted to slow down as a result of the recent increase in interest rates, and banks are predicted to invest more in government assets.

FIGURE 5.24 Average Non-Performing Loans of Banks Listed on the PSX: 2017 to 2021



Source: The State Bank of Pakistan

TABLE 5.6 Yearly Infection Ratios of Banks Listed on the PSX

Bank	2017	2018	2019	2020	2021	Average
MCB Islamic Bank Limited	0.00	0.00	0.74	0.89	0.73	0.47
Bank Al-Habib Limited	1.52	1.08	1.46	1.41	1.04	1.30
Meezan Bank Limited	1.54	1.34	1.78	2.81	1.86	1.87

Dubai Islamic Bank Pakistan Limited	1.90	1.89	2.51	2.78	2.81	2.38
Allied Bank Limited	4.64	3.54	3.17	2.78	2.04	3.23
JS Bank Limited	1.74	3.26	4.20	4.61	5.34	3.83
Bank Alfalah Limited	4.21	3.63	4.23	4.30	3.53	3.98
Samba Bank Limited	5.50	4.28	4.17	3.93	5.26	4.63
The Bank of Khyber	5.48	4.70	4.41	5.39	8.02	5.60
Soneri Bank Limited	5.93	5.83	5.13	6.25	5.95	5.82
Habib Bank Limited	7.76	6.61	6.34	6.32	5.07	6.42
Habib Metropolitan Bank Limited	9.71	7.27	6.24	5.82	4.03	6.61
Askari Bank Limited	9.41	7.22	7.06	6.74	6.14	7.31
Faysal Bank Limited	10.68	8.33	9.11	7.72	5.62	8.29
MCB Bank Limited	9.47	8.95	9.15	9.97	7.94	9.10
Standard Chartered Bank (Pakistan) Limited	12.46	9.30	7.54	11.36	8.32	9.80
Albaraka Bank (Pakistan) Limited	10.14	8.80	11.38	9.77	11.58	10.33
United Bank Limited	7.80	8.83	10.95	13.72	11.81	10.62
Bank Islami Pakistan Limited	12.11	11.87	10.63	12.05	8.69	11.07
The Bank of Punjab	14.91	11.60	11.98	12.93	9.7	12.23
National Bank of Pakistan	14.10	12.59	12.92	14.77	15.17	13.91
First Women Bank Limited	16.49	16.49	16.49	16.49	16.49	16.49
Silkbank Limited	6.46	6.45	30.94	40.14	40.14	24.83
Sindh Bank Limited	7.90	31.41	44.23	46.28	51.22	36.21
Summit Bank Limited	17.15	43.57	56.58	60.29	61.89	47.90

Source: State Bank of Pakistan

The infection ratios vary across different categories of banks. For instance, the infection ratio of public sector banks is generally higher than that of private sector banks, and the infection ratio of smaller banks is higher than that of larger banks.

The infection ratio of Summit Bank Pakistan has been a cause of concern for investors and analysts in recent years which is the highest among all the banks listed on the PSX. The five-year average infection ratio of Summit Bank Pakistan was 47.90%, while it was 61.89% in 2021. The high infection ratio was attributed to the bank's exposure to the textile and sugar sectors, which were facing financial difficulties at the time. On the other hand, the infection ratio reported by MCB, which is one of the largest commercial banks in Pakistan, with a wide range of banking products and services, was lower than the industry average and represented a significant improvement from the previous year.

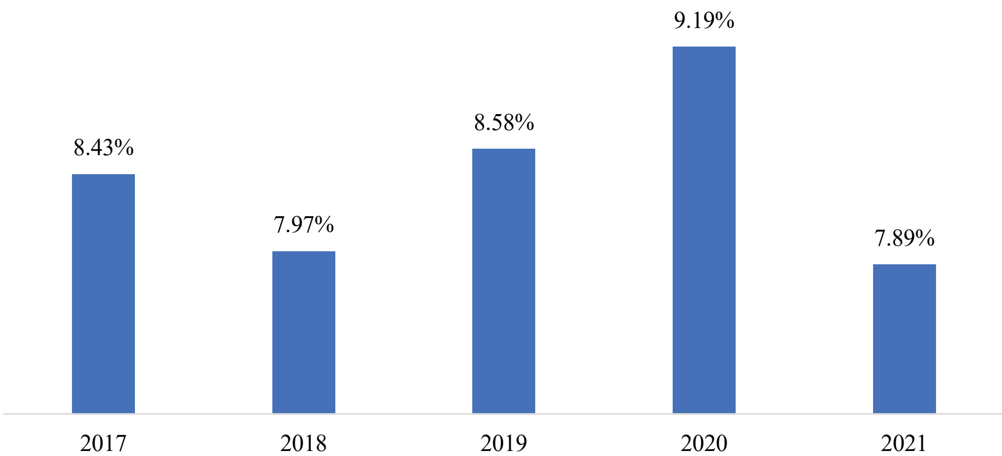
Bank Al Habib is a mid-sized commercial bank in Pakistan that offers a range of banking products and services. The Bank Al Habib also reported an infection ratio, which was lower than the industry average. Meezan Bank is the largest Islamic bank in Pakistan, with a focus on Shariah-compliant banking products and services. The Meezan Bank also reported an infection ratio, which was lower than the industry average.

Regulators can provide technical assistance and training to banks to help them develop and implement effective risk management practices, credit risk assessment methods, and portfolio management strategies for banks having high infection ratios. This can help to build banks' capacity and resilience to credit risk.

Infection Ratios of the Banking Sector of Pakistan

The infection ratio of the banking sector in Pakistan has been a major concern for policymakers, regulators, and market participants in recent years. It reflects the quality of credit risk management and asset quality of banks and has a direct impact on the profitability and stability of the banking system.

FIGURE 5.25 Ratio of Non-Performing Loans to Gross Loans of Banks in Pakistan



Source: The State Bank of Pakistan

The industry's NPL ratio started to improve by about 8% in 2021 (9.2% in 2020) and totaled PKR 860 billion (PKR 829 billion in 2020). The decrease in NPLs was due to rapid growth in advances and a relatively lower infection ratio in the textile sector. A lower NPL ratio indicates that the banks' credit quality is strong. However, this may come under pressure now that interest rates have risen and costs for sectors that rely on imported raw materials will rise.

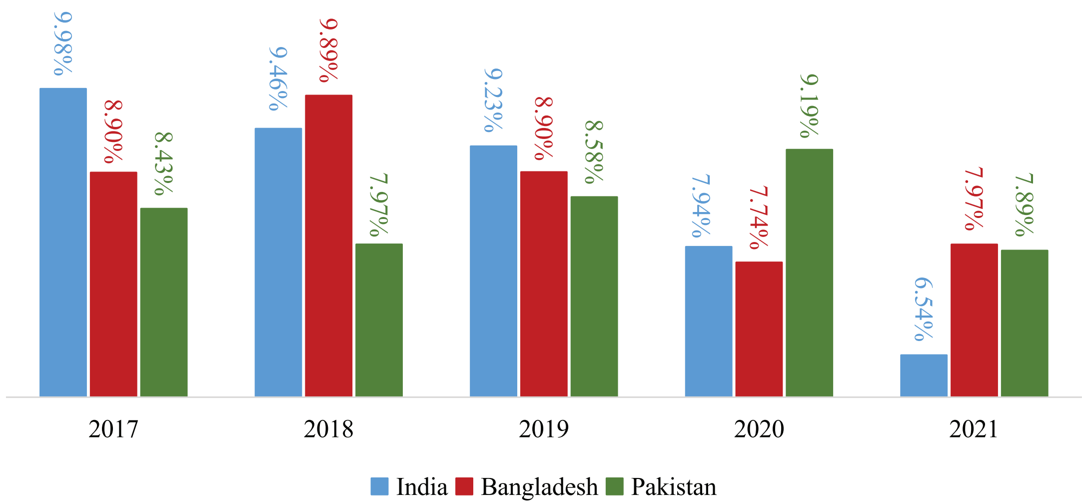
The COVID-19 pandemic has had a significant impact on the infection ratio in the banking sector in Pakistan. The economic slowdown and disruptions caused by the pandemic have led to a rise in defaults and loan losses, particularly in sectors such as tourism, hospitality, and SMEs.

The SBP has taken various measures to address the issue of infection ratio in the banking sector, including regulatory forbearance, restructuring and rescheduling of loans, and the establishment of a credit information bureau. The SBP has also issued guidelines and directives to banks to strengthen their risk management practices and asset quality.

Infection Ratios of Banking Sectors of Pakistan, India, and Bangladesh

NPLs have long been a source of concern for South Asian economies, affecting both the banking and financial sectors as well as the entire economy. NPLs are loans in which borrowers fail to make regular payments or default on their commitments. Infection ratios in all three countries have been affected by the COVID-19 pandemic, with a rise in defaults and loan losses due to economic slowdowns and disruptions.

FIGURE 5.26 Average Ratio of Non-Performing to Total Gross Loans: India, Bangladesh, and Pakistan (Percent)



Source: Author's calculations based on the WDI data.

In June 2021, the infection ratio of the banking sector in Pakistan was 8.43%, down from a peak of 9.19% in December 2020, but still above the regulatory threshold of 7.5%. In December 2020, the infection ratio of the banking sector in India was 7.5%, up from 7.1% in September 2020. The Reserve Bank of India has projected that the ratio may rise to 9.8% by September 2021 due to the pandemic.

As of June 2020, the infection ratio of the banking sector in Bangladesh was 9.31%, up from 8.92% in December 2019. The Bangladesh Bank has taken various measures to address the issue, including the introduction of a stimulus package for affected industries and the easing of credit policies.

All three countries have faced challenges related to loan defaults and non-performing assets in their banking sectors, and efforts are needed to address the issue and promote financial stability. It is important to note that the data is not directly comparable, as different countries may use different methodologies for calculating the infection ratio and have different regulatory thresholds. Therefore, it's difficult to say which country has a better infection ratio.

CONCLUSIONS

PSX is a silent market: low volumes, few, if any, IPOs in any year, and few individual investors. It provides investors and regulators with a variety of opportunities and challenges. The low and declining capitalization-to-GDP ratio signals that the PSX has not been an effective or preferred means of raising finances for businesses. The low capitalization to GDP ratio suggests the possibility of finding new investment opportunities opening up new avenues for growth. The low number of new listings, on the other hand, represents untapped opportunities that require encouragement for capable entrepreneurs to bring their ideas to reality.

The PSX is dominated by few big investors due to very low free-float shares compared to international practices, which creates one of the major problems of speculation. The market's low free-float shares are a serious concern, causing speculation and impeding market efficiency and liquidity. Increased availability of free-float shares can result in increased investor participation and benefits for both companies and their shareholders. While the PSX has struggled, alternative financial choices, such as gold and government securities have risen in popularity, particularly in times of uncertainty and rising inflation. Because of their greater yields than the PSX, government securities offer investors a safety net. Dividend-paying industries on the PSX have better market capitalization ratios and engender investor trust due to their regular cash flows and attractive dividend yields. However, economic, regulatory, and investor dynamics impact the market growth, and non-expansionary policies impede its progress.

The PSX's low P/E ratio signals opportunities for profitable investments, and the government may play an important role in kindling investor interest and boosting trust in economic development. Furthermore, capital-intensive industries such as infrastructure, manufacturing, and technology have limited reliance on debt for development and industry supremacy, as indicated by their low debt-to-equity ratios.

The banking system's focus on a small number of conglomerates while ignoring industries like SMEs, agriculture, and housing poses systemic concerns. Banks focus predominantly on the corporate sector at the expense of SMEs, agriculture, and housing. The infection ratios of various types of banks vary, with public sector and smaller banks having higher ratios. Banks with high infection rates may benefit from technical assistance and training from regulators to improve their credit scoring and risk management procedures.

In a nutshell, the PSX requires active regulatory actions to promote the market, educate investors about market opportunities, and boost investor trust. Addressing challenges such as low free float shares, growing the market, and controlling systemic risks in the banking sector may all help the Pakistan stock market's long-term development and stability.

6 Chain Stores: A Cornerstone of the Formal Retail Sector

RAJA RAFI ULLAH

KEY TAKEAWAYS

- There are an estimated 134 domestic chain store brands in Pakistan. 54% of these belong to the clothing & apparel segment, making it the largest segment in the chain store market. Other major segments are footwear (15%) and supermarkets & departmental stores (11%).*

- The 134 chain stores brands have an estimated 3,911 individual chain stores in total. The median chain store brand has about 15 stores nationwide.

- Small chain store brands** do not have more than 6 stores (25th percentile rank), whereas larger chain store brands have a minimum of 36 stores nationwide (75th percentile rank).

- The largest chain store brand has 466 distinct stores nationwide.

- Lahore has an estimated 23% of all distinct brick & mortar chain stores, followed by Karachi (13%) and Islamabad/Rawalpindi (13%).

- 43 out of the 134 domestic chain store brands (32 %) have stores only in three major metropolitan areas of Karachi, Lahore and Islamabad/Rawalpindi – meaning that they have no stores in smaller cities or suburban and rural areas.

- None of the domestic chain store brands have any international footprint of note.

- Chain store businesses are either sole proprietorships or family-owned businesses.

- Business model and supply chain processes for chain store brands vary based on which segment/industry they are operating in, i.e., clothing & apparel, footwear, supermarkets & departmental stores, etc.

*Restaurant chains are not included in this number.

**Size calculated in terms of their network of chain stores nationwide, not volume of sales.

INTRODUCTION

Over the past few years, Pakistan's retail sector has seen domestic brands penetrate the domestic commerce market. Many of these brands operate through the chain store retail model. Given the growing importance of chain stores within the retail sector in Pakistan, it is important to take a closer look into how these chain stores operate, the segments they operate in, and the spread of their networks

Types of Retail Setups

Small retailers

Usually unorganized and Informal retail setups. Mom-and-pop shops are typical examples of such retailers.

Supermarkets & Wholesale Centers

Organized and formal setups that sell at both retail and wholesale levels. Typically, they sell products from multiple brands under one roof. Examples include Al-Fatah, Imtiaz, Chase Up, Diamond Supermarket, etc.

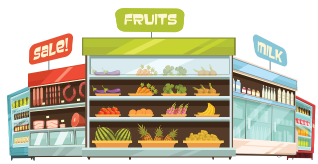
Retail Chain Stores

Although not a strictly mutually exclusive category on its own, chain stores are retail outlets that are part of a larger company and sell either the same or similar types of products.

FIGURE 6.1 Types of Retail Setups in Pakistan

Small Retailers (Mom & Pop Shops)

Supermarkets & Departmental Stores

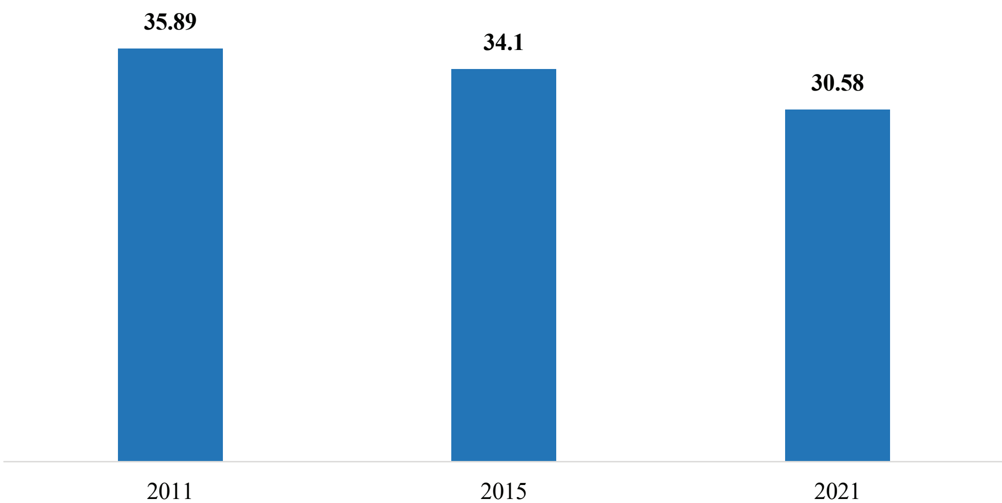


Chain Stores

Retail Chain Outlets/Chain stores

The past few decades have seen several retail chain outlets (colloquially known as chain stores) grow in numbers throughout the country, particularly in major urban centers. These chain stores most often are brick-and-mortar stores that sell products of brands only specific to their own business. Although no separate database on the chain store portion of the retail sector is available, the growth in formal retail in terms of total employment is indicative of the aforementioned trend. Since chain stores dominate the formal retail trade, their gradual growth has meant the percentage of people employed by the formal retail sector has increased versus the share of the informal retail sector. As the figure below shows, despite still being the largest contributor to informal employment in the economy, the retail & wholesale trade sector's share of total informal employment in the labor force has steadily declined over the years.

FIGURE 6.2 Share of Retail & Wholesale Sector in Total Informal Employment (Percent)

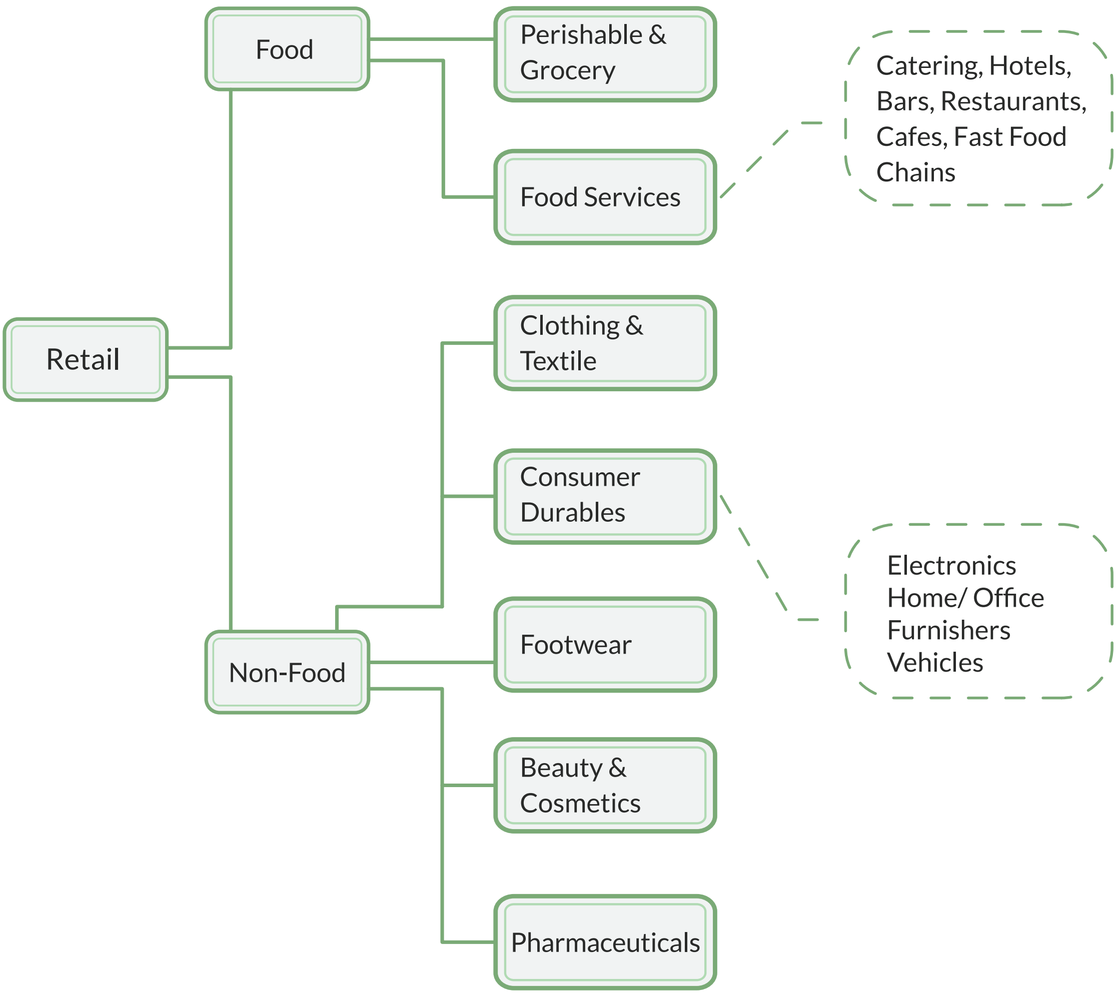


Source: Labor Force Survey 2020-21

RETAIL CHAIN STORES: HOW DO THEY FIT IN?

The retail industry today satisfies a variety of consumer needs. Consumer requirements might be as fundamental as food and related services or as lavish as jewels. Main retail groups are categorized as food and non-food. Sub-segments of non-food retail and wholesale trade include clothing & textiles, consumer durables footwear, pharmaceuticals, beauty and cosmetics, fertilizers, electronics, home and office furnishers, and books and stationery (Punjab Board of Investment and Trade, 2014). The following figure presents a snapshot of the major sectors of retail in Pakistan.

FIGURE 6.3 Major Retail by Product Groups



What are Retail Chain Stores?

Chain Stores are retail outlets that are part of a larger company and sell either the same or similar types of products (Marketing91). Since chain stores for each brand are part of a centralized management system, they often share common "store layout, signage, and product offerings." (Marketing91). Furthermore, each chain store and its staff are subject to a centralized set of corporate policies, rules, and procedures. The financial accounts for each chain store are ultimately handled by the central office and all revenues and profits are for the parent company itself. The key difference between chain stores and other forms of retail setups such as franchises is that the chain stores are owned directly by the parent company, whereas in the case of franchises, the outlets are owned by the franchisee who pays a fee to the parent company that owns the trademark.

CHAIN STORE VERSUS FRANCHISE

Chain Store

Chain Stores are retail outlets that are part of a larger company and sell either the same or similar types of products.

Franchise

Franchises are retail outlets that are licensed to sell and use trademarks by a larger business most often in exchange for a franchising fee and/or share of profit. The franchise outlets are directly not owned and operated by the parent company.

Source: Investopedia

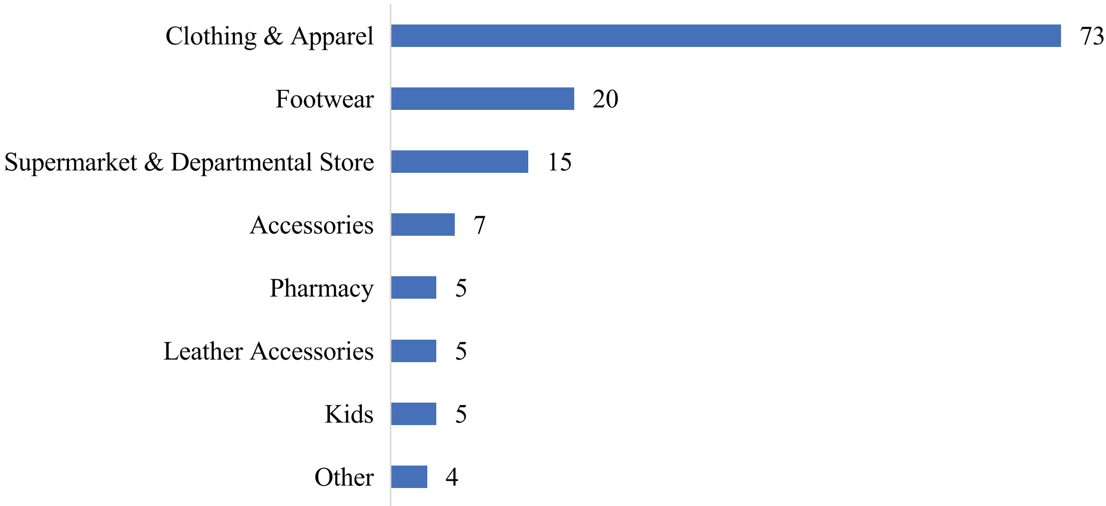
Retail Chain Stores Brands in Pakistan

Over the past few years, Pakistan's retail sector has seen domestic brands penetrate the domestic commerce market. Many of these brands operate through the chain store retail model. There are an estimated 134 domestic chain store brands in Pakistan. [26]

[26] Data courtesy of Chainstore Association of Pakistan and authors' own survey.

Number of chain store brands by segment

FIGURE 6.4 Chain Stores by Segments (Numbers)



Source: Chainstores Association of Pakistan

Out of the 134 estimated domestic chain store brands in Pakistan, 73 (54%) belong to the clothing & apparel segment, making it the largest segment in the chain store market. Furthermore, 20 (15%) belong to footwear, 15 (11%) belong to supermarket & departmental stores, 7 (5%) belong to accessories, 5 (4%) belong to the kids', 5 (4%) belong to leather accessories, 5 (4%) belong to the pharmacy segments, respectively. The details are given in Figure 6.4.

Table 6.1 below lists prominent domestic chain store brands in each segment of the retail industry (Chainstore Association of Pakistan). Refer to Appendix 6C for a list of all 134 chain store brands.

TABLE 6.1 Major Domestic Chain Store Brands in Pakistan

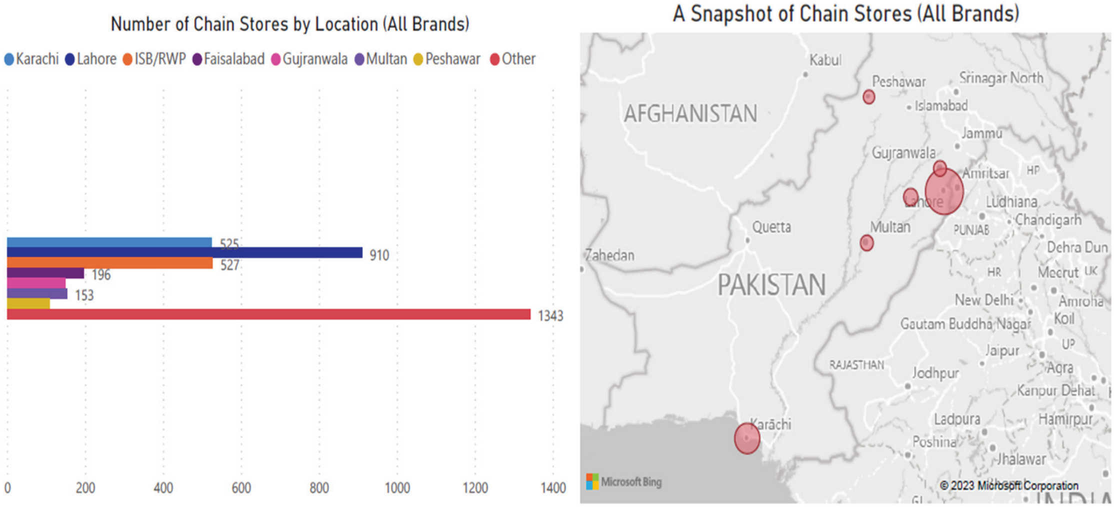
Segment	Brand
Supermarkets & Departmental Stores	Imtiaz, Al-Fatah, Diamond, Chase, Green Valley
Clothing & Apparel	Khaadi, Bareeze, Cambridge, Junaid Jamshed, Sapphire, Sana Safinaz, Lime Light, Uniworth
Footwear	Bata Pakistan, Servis, Ndure, Hush Puppies, ECS, Stylo, Urban Sole, Insignia, Walkeaze
Accessories	Hub, Jafferjees, M.Jafferjees, Make Up City, Tesoro, ENEM
Pharmacies	Servaid, D.Watson, Shaheen, Fazal Din's

Source: Chainstore Association of Pakistan

Stores by location

In terms of the location of individual chain stores across all brands, an estimated 50% of all individual stores are located in three metropolitan areas, that is, Karachi, and Islamabad/Rawalpindi. Lahore has 23% of all stores, followed by Karachi (13%), Islamabad/Rawalpindi (13%), Faisalabad (5%), Gujranwala (4%), Multan (4%), and Peshawar (3%). 34% of the remaining stores are spread across the rest of the country in areas other than the aforementioned metropolitan areas (see Figure 6.5).

FIGURE 6.5 Chain Stores by Location and Numbers



Source: Author's calculations using data scrapped from the web.

Median number of stores

The estimated median number of stores of the 134 listed domestic chain store brands is 15. Furthermore, the 25th percentile is approximately 6 stores, whereas the 75th percentile is approximately 36 stores. The largest chain store brand in terms of its network has 466 stores across Pakistan. Table 6.2 below summarizes the median, 25th & 75th percentiles, and the minimum and maximum for each of the segments within the chain store sector in Pakistan.

TABLE 6.2 Number of Individual Stores by Segment: All Brands

Segment	Brand	Stores	Median	25th Percentile	75th Percentile	Max
Supermarkets & Departmental Stores	15	208	9	5	22	36
Clothing & Apparel	73	1,929	17	7	36	107
Footwear	20	1,235	37	7	67	466
Accessories	7	99	8	6	20	39
Leather Accessories	5	54	8	5	15	25
Kids	5	238	33	21	49	125
Pharmacies	5	137	13	12	15	93
All Segments	134	3,911	15	6	36	466

Source: Author's calculations using data scrapped from the web.

BOX 6.1 Regional Comparison: Supermarket Chains – Pakistan vs. India

- Despite growth in chain store brands and their national coverage, the chain stores segment in Pakistan still is in its early stages of development.
- A key indicator of this is that Pakistan's top 5 supermarket chain brands have an average of 28 stores nationwide. On the other hand, Pakistan's neighboring India's top 5 supermarket chain store brands have an average of 296 stores across the country.
- Since India's population is about six times that of Pakistan, the figures need to be in a common denominator. Therefore, converting the average number of stores per supermarket chain brand, Pakistan's top 5 supermarket chain store brands should have at least 50 stores each (26 is the current average) to be on par with its neighboring India.

Information in Table 6.2 implies the following: [27]

- For all segments of the chain store sector, the medium-sized chain store[28] brands have approximately 15 stores across Pakistan. (The median is indicative of this information).

- For all segments of the chain store sector, the small-sized[29] chain store retailers do not have more than 6 stores across Pakistan. (25th percentile is indicative of this information).

- For all segments of the chain store sector, the large-sized[30] chain store retailers have at least 36 stores across Pakistan. (75th percentile is indicative of this information).

CHAIN STORES IN PAKISTAN: AN IN-DEPTH ANALYSIS

Given the growing importance of chain stores within the urban retail sector in Pakistan, it is important to take a closer look into how these chain stores operate, and the segments they operate in and to analyze their both cost and ease of doing business within the domestic commerce market in Pakistan. PIDE has reached out to many chain store businesses in Pakistan to get further insight into their operations.

BOX 6.2 Pakistani Chain Store Brands in International Markets

Despite its growth as a domestic sector, Pakistani retail brands, on the whole, have not been able to build their international profiles and penetrate the international markets.

- Pakistani department stores/ hypermarkets have not yet been able to penetrate the international markets.

[27] Refer to Appendix 6C for a complete breakdown of stores per each domestic brand.

[28] Size here is in terms of network (number) of stores nationwide, not sales volume.

[29] Ibid.

[30] Ibid.

- A few clothing and apparel brands have established stores in international locations, but they still only cater to Pakistani and South Asian diasporas and have ethnic product ranges.

Source: Chainstore Association of Pakistan

Business Model and Supply Chains

Based on the interviews conducted with the chain stores in different segments, approximate trends and snapshots of the business models and the supply chain involved are sketched. The table below outlines the business model for the three biggest segments in the chain store sector through analysis of their supply chains.

TABLE 6.3 Chain Stores: Business Model & Supply Chain

Segment	Raw Materials	Suppliers	Manufacturing	Distribution	Marketing	Customers
Clothing & Apparel	Threads, unfinished cloth, and other ancillary raw materials 90 % Imported 10 % locally sourced	Textile mills, suppliers of other ancillary raw materials, private import agents	Large brands: 70 % in-house, 30 % outsourced Medium to small brands: 30% in-house 70% outsourced	Warehousing: In-house Freight: Outsourced	Digital marketing: Both in-house and outsourced to media agencies. Outdoor marketing (billboards etc.): outsourced In-store marketing: In-house	Middle to up-per-mid-dle-in-come catego-ries

					and outsourced	
Footwear	Leather, soles, buckles, and other ancillary items. Leather: locally sourced Ancillary raw materials: imported	Local tanneries, and import agents	Large brands: 70 % in-house, 30 % outsourced Medium to small brands: 30% in-house 70% outsourced	Warehousing: In-house Freight: Outsourced	Digital marketing: Both in-house and outsourced to media agencies Outdoor marketing (billboards etc.): outsourced In-store marketing: in-house and outsourced	Middle to up-per-mid-dle-in-come catego-ries
Supermarkets & Departmental Stores	NA	Local FMCG suppliers, and import agents	NA	Warehousing: In-house Freight: Outsourced		Middle, upper-mid-dle-in-come catego-ries

Source: Author's estimates based on key informant interviews

Clothing & apparel

More than half of the domestic chain store brands, approximately 54%, are operating in the clothing & apparel segment.

Raw Materials

The main raw material used by this segment is the thread for making cloth, most of which is imported. However, the chain stores do not import the thread. This task is undertaken by the textile mills (specifically weavers) who then supply cloth to the chain store businesses. Other ancillary products that are used in the clothing & apparel segment, such as fine dyes, are imported, particularly for those brands that have fine-quality finished products. A small percentage of ancillary raw materials is also directly imported by chain stores.

Suppliers

The main suppliers of raw materials to chain store businesses are local textile mills, specifically weavers, who provide the cloth. Other suppliers of ancillary raw materials are both foreign and local. Large chain store apparel businesses typically directly import these ancillary raw materials, whereas medium to small ones rely on private import agents for this service.

Manufacturing

Large chain store brands in the clothing & apparel segment have manufacturing facilities where they manufacture their finished products. However, some tasks, such as embroidery, are outsourced.

Distribution

Warehousing and storage are taken care of in-house whereas transportation and freight are typically outsourced.

Marketing

Chain store businesses rely on a combination of digital, outdoor, and in-store marketing. Most digital and outdoor marketing is typically outsourced.

Customer Base

Chain store businesses in the clothing & apparel segment usually have their customers from the middle to upper-middle income brackets.

Footwear

An estimated 15% of the domestic chain store brands in Pakistan belong to the footwear segment.

Raw Materials

The main raw material used by this segment, i.e., leather, is provided by the local tanneries. Other ancillary products that are used in the footwear segment such as adhesives and processing chemicals are imported, particularly for those brands that have fine-quality finished products. A small percentage of ancillary raw materials is also directly imported by chain store businesses in the footwear section.

Suppliers

The main suppliers of raw materials to chain store businesses are local tanneries. Other suppliers of ancillary raw materials are both foreign and local. Large chain store footwear businesses typically directly import these ancillary raw materials, whereas medium to small ones rely on private import agents for this service.

Manufacturing

Large chain store brands in the footwear segment have manufacturing facilities where they manufacture finished products. Small to medium footwear businesses that do not have manufacturing facilities outsource their core manufacturing to larger footwear businesses.

Distribution

Warehousing and storage are taken care of in-house, whereas transportation and freight are typically outsourced.

Marketing

Chain store businesses rely on a combination of digital, outdoor, and in-store marketing. Most digital and outdoor marketing is typically outsourced.

Customer Base

Chain store businesses in the footwear segment usually have their customers from the middle to upper-middle income brackets.

Supermarkets and departmental stores

An estimated 11% of the domestic chain store brands in Pakistan belong to the supermarkets & departmental stores segment.

Raw Materials

The segment gets most of its sales through fast moving consumer goods (FMCG). These products are sourced as finished products from suppliers.

Suppliers

FMCG goods come from both local subsidiaries of international FMCG manufacturers and indigenous domestic FMCG brands.

Manufacturing

Supermarkets & departmental stores do not manufacture products. Some big supermarkets have officially partnered with other local brands who then manufacture and provide certain finished products that are sold using the trademark of the supermarket.

Distribution

Warehousing and storage are taken care of in-house whereas transportation and freight are typically outsourced.

Marketing

Chain store businesses rely on a combination of digital, outdoor, and in-store marketing.

Customer Base

Chain store businesses in the supermarket & departmental stores segment usually have their customers from the upper and middle to upper-middle income brackets.

Analysis

In addition to supply chain analysis, other relevant information on the ownership structure of chain store businesses, registrations, and employment are summarized below, which was collected from the key informant interviewees.[31]

Ownership and registration

- All the interviewed businesses were either sole proprietorships or family-owned businesses.
- None of the 10 interviewed chain store businesses was listed on the PSX.
- Only one out of the interviewed businesses had female owners, and that too only combined owners along with other male family members.
- Only 25% of the interviewed businesses were registered with the (SECP) as per the stipulations of the Companies Act, 2017.

SECP: REGISTRATION OF COMPANIES

For a company to be considered as a formal part of the corporate sector, they need to be registered with the SECP as an incorporated company. Types of company registrations with SECP include Single Member Company, Private Limited Company, Public Limited Company, and Limited Liability Partnership.

Businesses/Firms can operate without this registration, either as sole proprietorships or partnership firms. But they are not separate entities in a legal sense from their owners and cannot be referred to as "companies".

Source: SECP

- All the interviewed businesses were registered with the FBR for income and sales tax purposes and possessed a valid NTN number.

- All the companies had registered trademarks.
- All the interviewed businesses were registered with the EOBI.

Employment

- Except for one, all other interviewed businesses were medium to large enterprises in terms of human resources; these businesses employed more than 250 employees with up to a maximum of 2,000 employees.
- None of the interviewed businesses had more than 10% female employees. Certain businesses that have departments that deal in female goods, such as female clothing, cosmetics, and lingerie, reported having about 25% of female employees in those particular departments.
- An average manager had 5 to 15 years of experience and a minimum of matriculation level education in the retail stores of these businesses.
- In more technical departments, such as design, HR, and finance, managers had about 10-25 years of experience and a minimum of a Master's degree or equivalent technical qualification.
- All of the interviewed businesses reported having two distinct types of contracts for their core employees and retail store employees. In such cases, the core employees always had more benefits such as gratuity, health insurance, and leaves written into their contracts.

Doing business: Perspectives of chain store businesses

Another important part of the study was to inquire what the businesses feel about doing business in the domestic retail market in Pakistan. Key thematic findings from their responses are summarized below.

[31] See Appendix 6A for the list of key informant interviewees.

[32] https://www.secp.gov.pk/document/companies-act-2017/?wpdmdl=28472

Taxation

- 90% of the interviewed businesses thought that high taxes were a moderate to moderately high issue for their ease of doing business.

- 100% of the business owners said that they face significant costs when it comes to withholding taxes from their suppliers and other parties on behalf of the FBR. Not only did they have to hire technically proficient personnel to perform this function, but they were also subject to intense scrutiny by tax authorities if any procedural and/or accidental mistake was made while collecting these withholding taxes.

- 100% of the interviewed businesses maintained that they are responsible for paying the brunt of the total taxes, while the informal retail setups go under the radar and remain untaxed.

- 75% of the businesses thought that more than the high tax rates, the tax administration system in Pakistan is cumbersome and outdated. A few advocated for a single-window taxation system where a business can pay all its taxes through a single system to multiple agencies.

Inflation

- 100% of the interviewed business owners held the view that inflation was a significant issue affecting their businesses.

- 100% of the interviewed business owners mentioned that they have had to increase the prices of their products to sustain their profit margins. Hence their revenues are similar but the sales volumes have gone down of late.

- 100% of the interviewed business owners mentioned that the cost of utilities has gone up significantly over the past few years which has contributed to their overall cost of doing business.

- 100% of the interviewed business owners mentioned that given the high inflation rates over the past couple of years, they are forced to change their costs and projections which affects their capacity to plan and implement. They maintained that often prices change significantly every month.

Availability of commercial space

- The availability of suitable space for business, particularly for the establishment of brick-and-mortar stores, was rated as a moderately significant impediment to doing business by the respondents 50% of the interviewed businesses.

- 100% of them said that space availability is not an issue, rather the main issue is the availability of space at "affordable rates." According to the respondents, this is because of a generally limited supply of commercial space in the cities.

- 50% of the interviewed businesses also mentioned that when it comes to space availability in shopping malls, these malls in Pakistan are mostly not owned and operated by those who understand the professional nature of modern and branded retail chain store business. More often than not, services such as maintenance, security, cleaning, and integration of technology are not available in most malls.

CONCLUSIONS

The chain stores subsector of the retail sector in Pakistan has outgrown its nascent stages in the past couple of decades. The sector now contributes significantly, both in terms of employment and contribution to government tax revenue, as part of the formal urban retail sector in Pakistan. However, if this sector is to grow and become an integral part of the economic landscape both the chain store businesses and the governmental authorities need to put certain conditions in place.

Recommendations for Chain Store Businesses

- To grow more rapidly, chain store businesses need to move away from sole proprietorship and family-owned business models. The fact that even those interviewed businesses that have 2,000 employees are family-owned and not registered with the SECP as "Companies" is concerning. Although registering with the SECP will increase documentation and compliance costs, for those firms that intend to grow, the costs outweigh the benefits, i.e., through registering as a company the owner(s) can limit their liability, raise capital more efficiently and build a more sustainable brand value.

- Once registered as legal companies, the businesses need to open up to investments in the shape of equity investments from non-family members.

- The chain store businesses need to increase their percentage of female employees at both the managerial level and also in departments that do not directly deal with the retail sale of female-targeted products.

- Some of the interviewed chain store businesses reported that since they agreed to share increased information with FBR through registering as a Tier-1 taxpayer, they have been able to get reduced tax rates, particularly on sales taxes. Other chain store businesses should also explore this possibility.

- Chain store retailers should stop discriminating between the "core employees" and "store employees" [33] in terms of the provision of benefits and job security.

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[33] The term "store employees" stands for those employees that are hired at the retail chain store outlets.

Recommendations for Governmental Authorities

Taxation

- Simplify the tax collection system through the introduction of a single-window taxation portal that allows businesses to submit all their tax returns to multiple agencies through one single avenue.

- The FBR should collect the income tax of suppliers and contractors of these businesses themselves and not transfer the burden of withholding income taxes to the chain store businesses.

Commercial Space

- There is a need to revise zoning laws that divide the majority of the urban space in Pakistan into residential and urban categories. Mix-use of land for both commercial and residential purposes needs to be encouraged through legal provisions in the master plans of cities.

- Since only a part of most cities comes directly under government control, with the rest being under the hold of private societies, these societies also need to be apprised of the availability of commercial space.

- Make it mandatory for all private housing societies to allocate 20% of total land for commercial purposes, with a further minimum of 20 % mix-use of land.

7 Franchising in Pakistan

SAQIB HUSSAIN & MOHAMMAD ARMUGHAN [34]

KEY TAKEAWAYS

- Franchising in Pakistan has witnessed significant growth and diversification, with both national and international brands making their mark.
- Franchising in Pakistan is primarily associated with traditional sectors such as restaurants, hotels, and retail. However, nontraditional sectors, such as healthcare and education, have also started to follow the franchising model.
- The major sectors that have experienced substantial growth in the last decade include telecommunication, food, education, and fashion.
- The opening of large shopping malls in metropolitan cities of Pakistan has also contributed to the expansion of the franchise industry.
- Several national brands have also ventured into franchising, both domestically and internationally, which highlights the increasing prevalence of franchising opportunities and consumer preferences within the country.
- Although some domestic brands have gone global, generally domestic brands struggle to find a niche in the international market due to investments primarily focused on labor-intensive industries, limited marketing scope, and a lack of brand equity and product quality/value addition.
- Franchise consultancy firms have emerged to provide guidance and support to franchisors and franchisees.

[34] With support from Bushra Muzammil.

- In Pakistan, there is no exclusive law or a set of rules and regulations governing the franchise business. The laws are more general, and while there are provisions for disclosure and support, the level of protection for franchisees is not as comprehensive.

- The challenges that franchising in Pakistan faces are due to specific franchise laws and comprehensive data. For further development of franchising in Pakistan, a stronger regulatory framework and better protection for franchisees that is aligned with international standards and best practices is needed.

OVERVIEW OF FRANCHISING

Worldwide, the franchising business did not flourish until after World War II. Afterwards, the franchising business gained significant importance. Since developing countries, including South Asian countries, have the advantage of cheap labor and weak brand marketing the international franchising industry, including renowned brands, has turned to developing and emerging markets during the last two decades.

The current state of franchising in Pakistan and other South Asian countries is given in Table 7.1. Among South Asian countries, Pakistan was the first country to welcome the franchising of Western companies as a modern business practice (Hussain et al., 2020). The first franchise of Pizza Hut in South Asia was set up in Pakistan in 1993.

WHAT IS A FRANCHISE?

- “A franchise is a type of license that grants a franchisee access to a franchisor's proprietary business knowledge, processes, and trademarks, thus allowing the franchisee to sell a product or service under the franchisor's business name. In exchange for acquiring a franchise, the franchisee usually pays the franchisor an initial start-up fee and annual licensing fees” (Investopedia).
- “Three types of franchise arrangements include a single-unit franchise, a multi-unit franchise, and a master franchise. The main costs associated with franchise business include the franchise fee, per-month royalty, and investment” (Francity, 2015).

Franchising in Pakistan has gained wide acceptance, especially in the hospitality industry, including restaurants and food and beverages. In Pakistan, there is no law that regulates franchising and the industry is governed by the general contract law (Hussain et al., 2020).

Though several international brands have entered Pakistan in the last two decades, the national brands have failed to go global because of the following three major reasons.

1. Business conglomerates have opted to invest in traditional businesses that are mostly inward-looking, for instance, real estate, textile, energy, cement, and manufacturing.

2. The scope of marketing is limited to maximizing sales in the domestic market and profit maximization.

3. Lack of brand equity and no quality/value addition in products. As a result, international brands affect national brands in terms of revenue and sales because of superior branding strategies, marketing skills, and product standardization, among other things.

TABLE 7.1 The State of Franchising in South Asia

Country	Franchise Association	Franchise Law	Franchise Data	Franchise Infrastructure	Doing Business Index
Bangladesh	No	No	No	Poor	168
Bhutan	No	No	No	Poor	89
India	Yes	No	No	Initiated	63
Maldives	No	No	No	Poor	147
Nepal	No	No	No	Poor	94
Pakistan	No	No	No	Poor	108
Sri Lanka	No	No	No	Poor	99

Source: Hussain et al. (2020)

Nevertheless, some positive effects of international franchises include employment generation, investment, and the development of competitive markets. Since Pakistan has no franchising law, franchising association, or data,

FRANCHISING INFRASTRUCTURE

Franchising infrastructure means having a legislative framework for how franchises work, the presence of robust franchise associations, a proper understanding of franchising operations rather than an acquaintance with the franchising model and the availability of relevant information.

the reported figures are collected from the official websites of brands that operate as franchises in Pakistan. While this chapter may not have explored every brand operating in Pakistan, it does encompass a significant number of renowned brands within its analysis.

FRANCHISING IN PAKISTAN

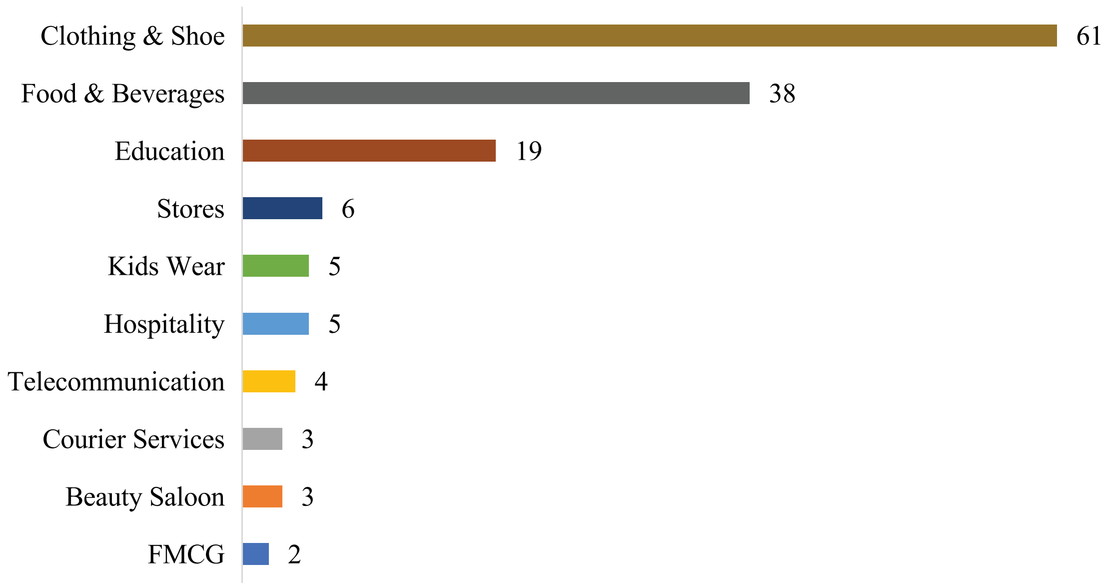
Compared to other entry modes of international brands in the domestic markets, such as licensing, franchising is a quite new concept in Pakistan and gaining acceptance. The major sectors that have many franchises include food & beverages, fashion, education, and telecommunication. According to the International Trade Administration (2022), Pakistan has more than 200 global brands having a collective revenue of USD 4 billion a year and collecting an annual royalty of USD 0.9 billion. Another factor responsible for an extensive increase in the franchising industry in the last decade is the opening of big shopping malls in metropolitan cities of Pakistan. According to the Pakistan Food Association, the annual spending of the general public at restaurants is between USD 6 and USD 9 billion a year, which is 42% of one's earnings (ITA, 2022). Therefore, there is a huge potential for food chain franchises in Pakistan.

Franchise Brands in Pakistan

Franchise brands

In Pakistan, franchising is present in both types of businesses, i.e., traditional and nontraditional. In traditional businesses, the franchising business includes restaurants, hotels, and retail, whereas in the nontraditional sector franchising is present in healthcare and education. Particularly, telecommunication, food, education, and fashion gained significant growth over the last decade. Figure 7.1 represents the industry-wise total number of brands operating in Pakistan.

FIGURE 7.1 Number of Franchising Brands: Industry-Wise

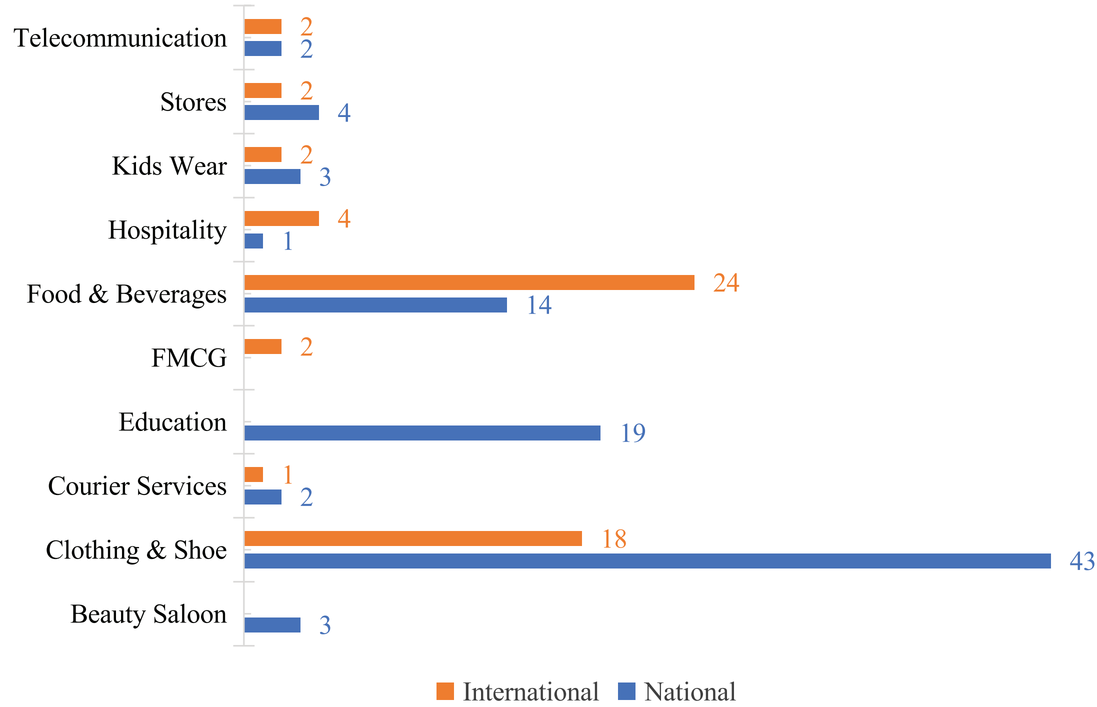


Source: Author's estimates based on websites of different franchises.

National and international franchise brands

Moreover, Figure 7.2 shows the presence of various international brands categorized according to their industry that operate in Pakistan through franchising. The figure also shows the number of national brands that give franchises according to the industry.

FIGURE 7.2 Industry-Wise Number of Franchising Brands: National & International

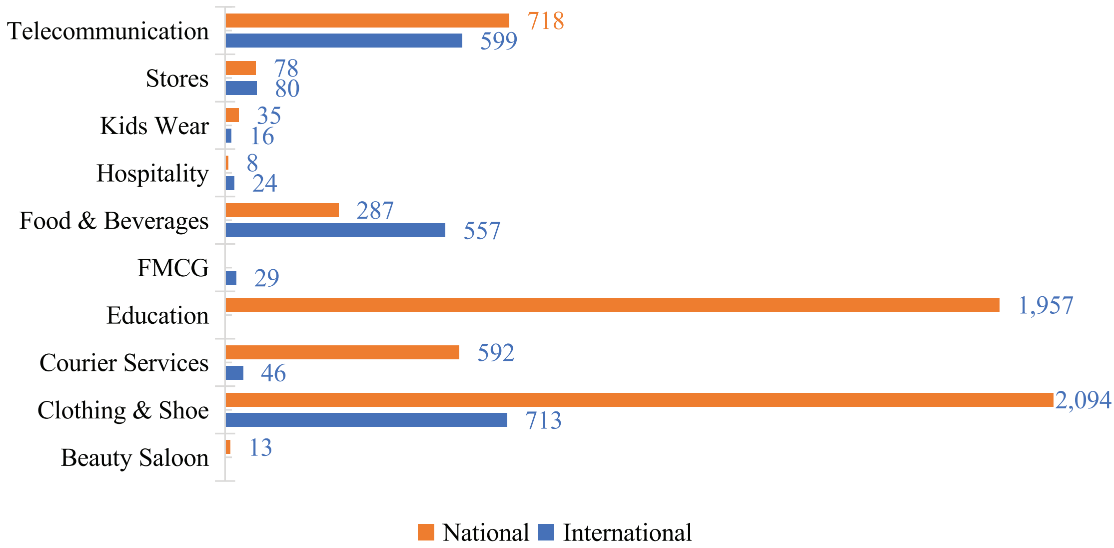


Source: Author's estimates based on websites of different franchises.

Sector-Wise Franchise Brands

Figure 7.3 shows the number of franchisees in each sector or industry according to the origin of the brand, i.e., national or international. It gives an insight into the abundance of franchises within a specific industry, thus revealing the magnitude of business activity in each industry that operates through the franchising mode.

FIGURE 7.3 Industry-Wise Total Number of Franchises: National & International



Source: Author's estimates based on websites of different franchises.

Franchising in Pakistan has evolved over the past decade. Initially, franchising was introduced in Pakistan through international brands, e.g., Pizza Hut in 1993. Now, a decent number of domestic brands have adopted the franchising model. A prominent example of this trend is Chen One, which has emerged as a leading provider of lucrative franchise opportunities.

The existence of renowned international chains alongside a diverse array of domestic brands shows that commercial franchising is a burgeoning phenomenon in Pakistan. This trend exemplifies the expanding landscape of franchising opportunities and consumer preferences for quality, standardized products, and reliability, among other things, within the country. Table 7.2 provides details of national brands operating through franchising in Pakistan. Similarly, Table 7.3 lists international brands operating in Pakistan and their number of franchises operating in Pakistan.

TABLE 7.2 National Brands and Their Number of Franchises in Pakistan

Brand	No. of Franchises
Dar e Arqam	592
Jazz & Warid	436
TCS	397
The Smart School	358
Ufone	282
Leads School System	216
Virtual University	199
Leopard	195
Kayseria	104
Ittehad	90
Service	87
Diners	87
Limelight	81
Bareeze	80
Superior College	78
Ndure	77
Rahat Bakers	60
Uniworth	59
Outfitters	57
Khas store	55
Metro Shoes	54
Breakout	48
Phulkari	46
Charcoal	42
Ethnic	38
Chen One	34
Burger Lab	32
AL-Fatah	29
Explore Ville Schools	27
Cross Stitch	26
Maria B.	26
So Kamal	25
Informatics Group of Colleges	21
Motifz	21
One Dollar Store	20
Enterprise School system	20
Telemart	19
Timmys Pizza	19
Charizma	19
Step Schools	16
Krosskulture	13
BTW	13
Bundu Khan	12
Dayfresh	11
Madina Cash & Carry	10
Howdy Food	10
Del Frio	9
BarBQ Tonight	9
Dhank	8
Ranchers	7
Metropolitan Schools & Colleges	7
Hadiqa Kiani Salon	7
The Savvy School	6
Alley Group of Colleges	5
Askaria Education system	5
Stitch	5
Stylo Shoes	169
Spirit School	163
Gul Ahmed	124
Nishat Linen	115

Aspire College	107
OPTP	73
Chinyere	73
Khaadi	70
Bonanza	68
Progressive Grammar School	65
Alkaram	42
Concordia Colleges	41
Urban Sole	41
Sapphire	40
Engine	40

Orient	25
Little People	24
Almirah	24
MTJ	21
Fri-Chicks	21
Apex Group of Colleges	16
LGS	15
Jafferjees	14
Threads & Motifs	13
Pizza Point	13
BATIK	9
Brumano	8

Cocobee	8
Pearl-Continental	8
Fibbi	8
Royal Junior	3
Café Chai Wala	3
Zara Shahjahan	3
Coral Beauty Salon	3
Nadia Hussain Salon	3

Source: Estimate based on information obtained from industry experts.

TABLE 7.3 International Brands and Their Number of Franchises in Pakistan

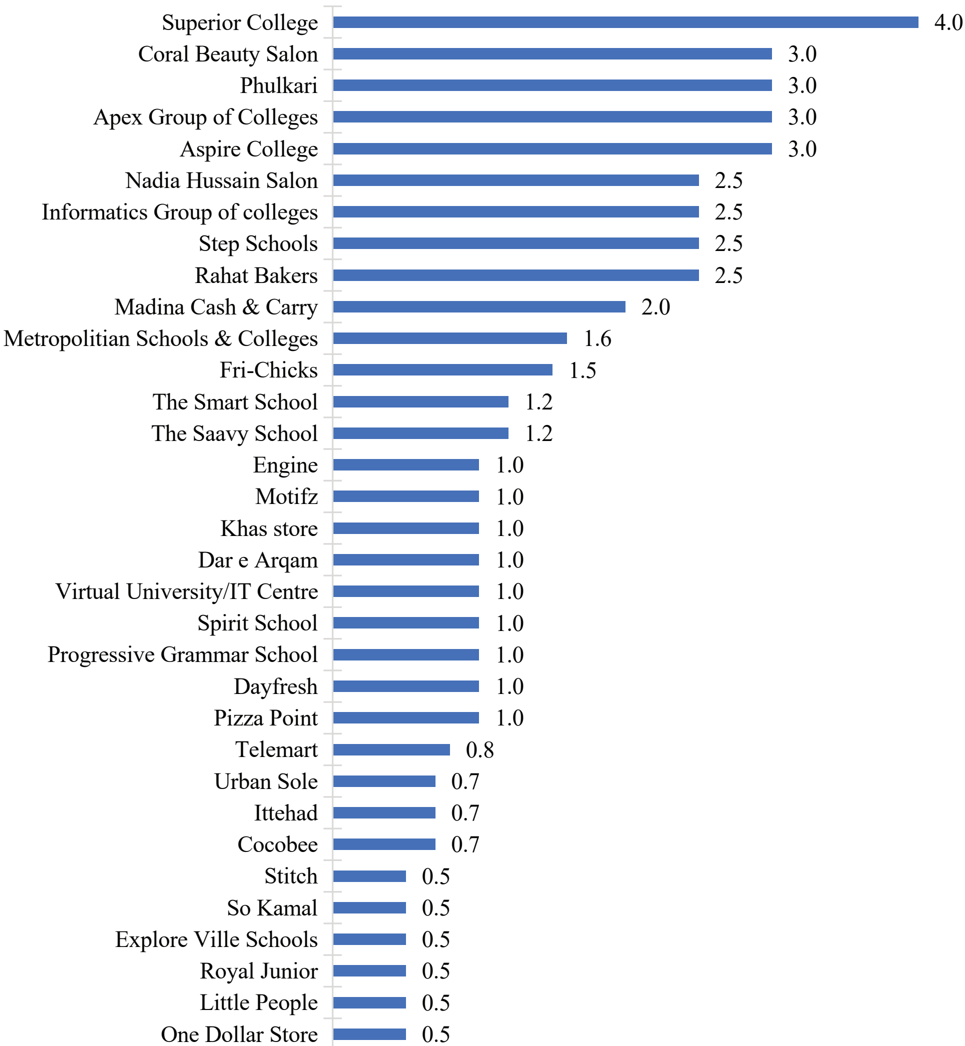
Brand	No. of Franchises	Brand	No. of Franchises	Brand	No. of Franchises
Bata	500	Nike	18	Nestle	7
Zong	305	Papa John's Pizza	15	Giordano	7
Telenor	294	Adidas	14	The Entertainer	6
Pizza Hut	80	Best Western Hotel	13	Ramada	5
McDonald's	73	Nando	12	Texas Chicken	5
Miniso	71	Cold Stone Creamery	11	Fat Burger	5
KFC	68	California Pizza	11	Travelodge	3
Domino's Pizza	60	Ego	11	Marriot International	3
Gloria Jean's Coffee	58	Mother Care	10	Juice Zone	3
Caterpillar	52	Latt Liv	9	Smoothie Factory	3
Subway	50	Chinatown	9	Diesel	3
DHL	46	Cinnabon	8	Damas	3
The Body Shop	31	Charles & Keith	8	Aldo	3
Hardees	26	NEXT	8	Costa coffee	2
Burger King	24	Mango	8	Leo Concept	2
Unilever	22	Pepe's Piri Piri	7	Emporio Armani	2
Levi's	22	Johnny Rockets	7	Pedro	2
Unze London	19			Sarpino's Pizzeria	1
Dunkin Donuts	18			Marble Slab Creamery	1

Source: Estimate based on information obtained from industry experts.

Franchise Fees and royalty

Figure 7.4 gives a visual representation of the franchising fees associated with these national brands, while Figure 7.5 presents the same information for international brands working on the franchising model in Pakistan. [35]

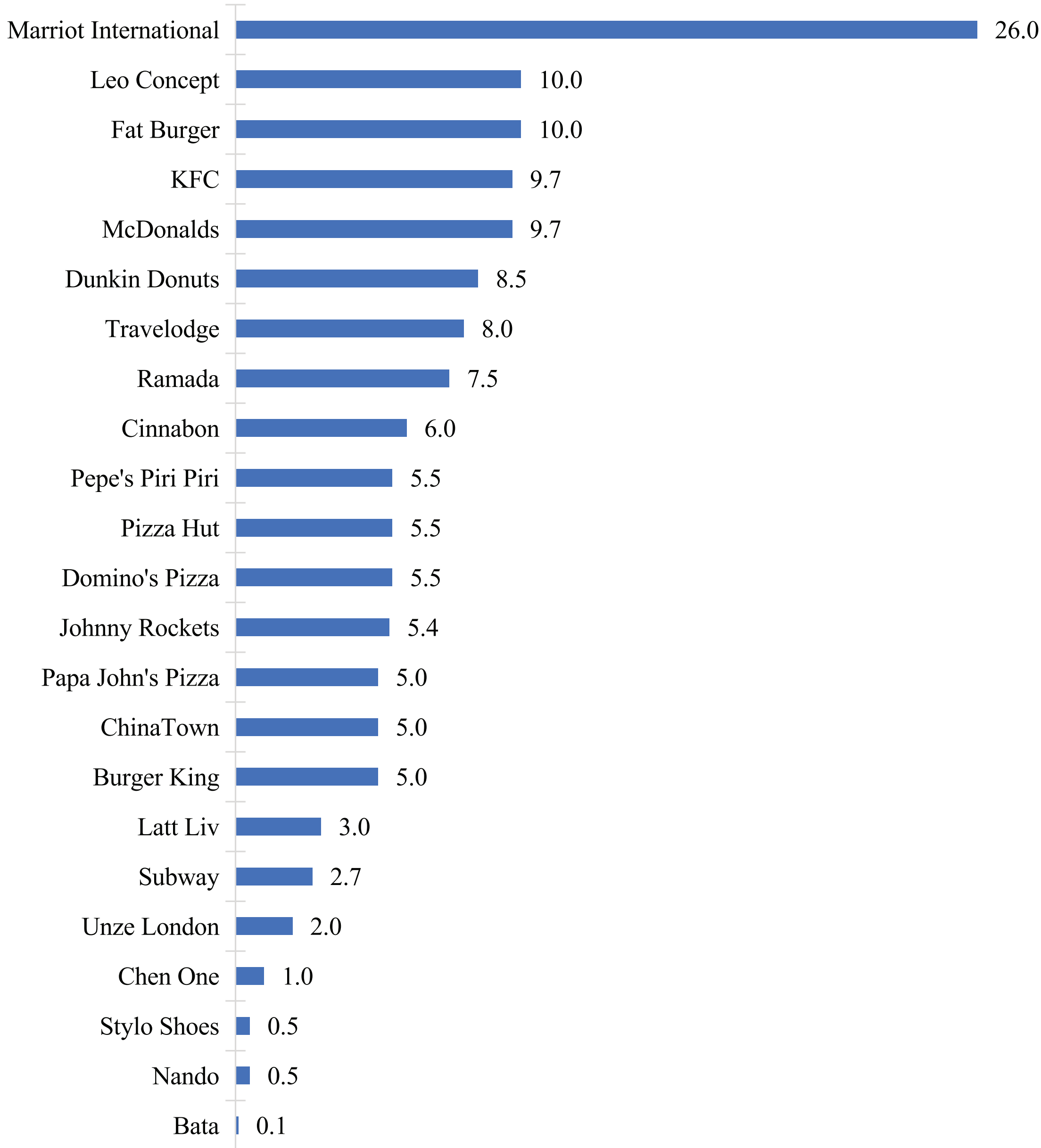
FIGURE 7.4 Franchise Fee: National Brands (PKR Million)



Source: Author's estimates based on websites of different franchises.

[35] A limitation of this analysis is that comprehensive details about the franchise fees for all brands operating in Pakistan are not available.

FIGURE 7.5 Franchise Fee: International Brands (PKR Million)

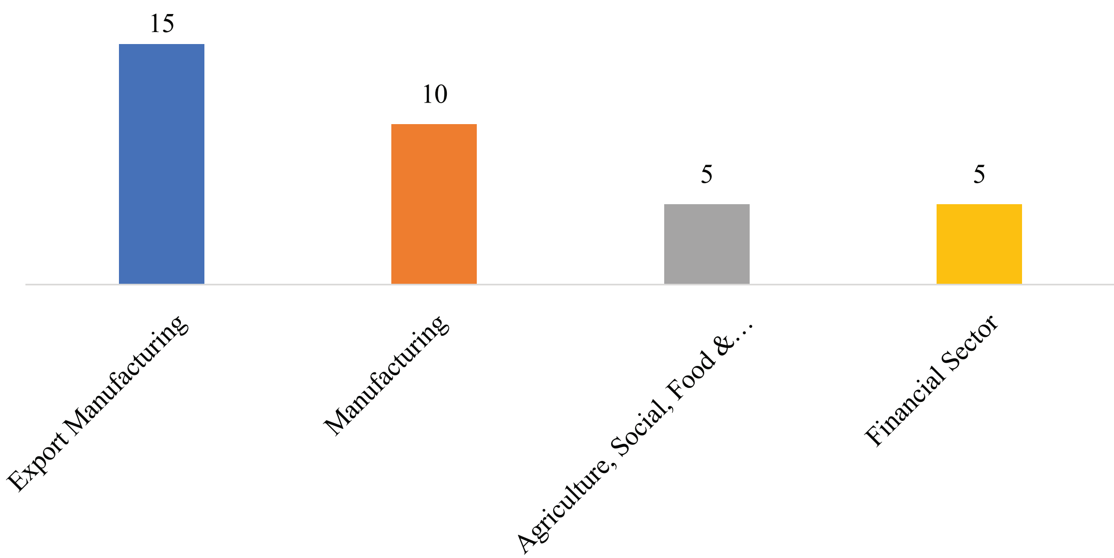


Source: Author's estimates based on websites of different franchises.

The franchise business involves three primary costs. Firstly, the franchise fee, which a franchisee pays to the franchisor. It grants the franchisee the right to utilize the franchisor's business model, encompassing elements such as the brand name, business idea, product design, organization's value chain, and outlet style. This fee is typically paid at the commencement of the contractual agreement. Figure 7.6 depicts the contract duration of franchising in different sectors.

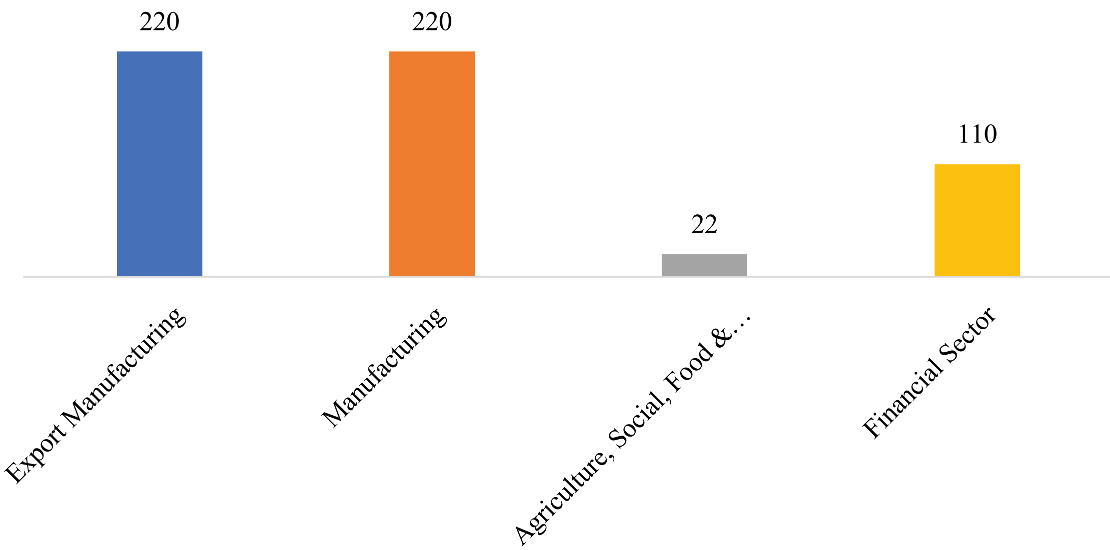
Secondly, a significant cost is incurred on the establishment of the business outlet itself, which includes various expenses associated with setting up the physical infrastructure, procuring necessary equipment and inventory, and ensuring the operational readiness of the franchise. The sector-wise annual franchise fee is shown in Figure 7.7

FIGURE 7.6 Sector-Wise Contract Duration: Years



Source: State Bank of Pakistan (2022)

FIGURE 7.7 Sector-Wise Maximum Annual Franchise Fee: PKR Million



Source: Author's estimates based on websites of different franchises

Lastly, the royalty payment represents a recurring cost that the franchisee is obligated to remit to the franchisor. This payment is typically calculated as a predetermined percentage of the franchisee's generated revenue, serving as a form of compensation for ongoing support, guidance, and utilization of the franchisor's brand and resources. Royalty paid per month in different sectors is shown in Figure 7.8.

FRANCHISE FEE VERSUS ROYALTY

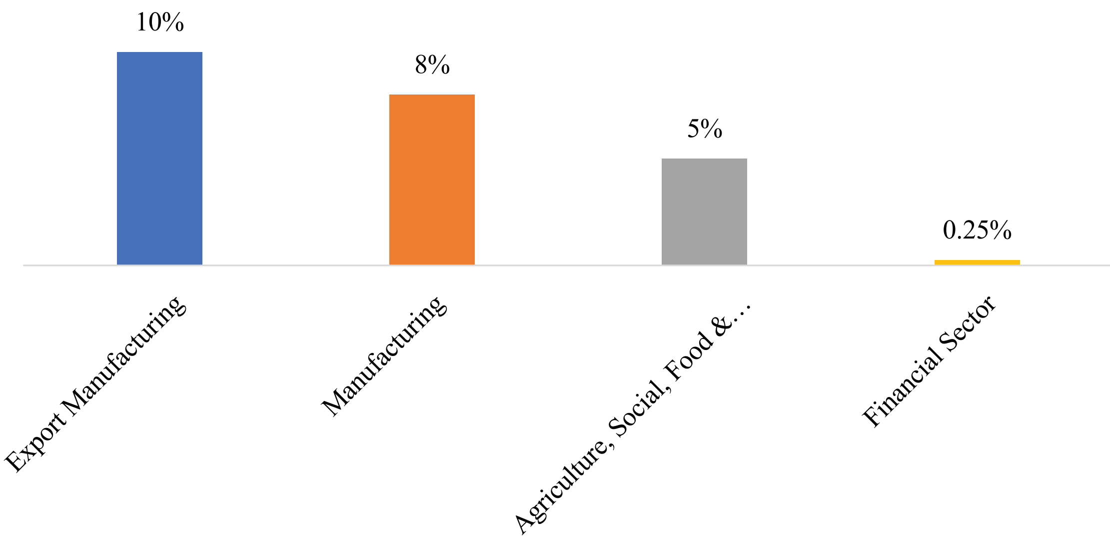
Franchise Fee

It is a fee paid by franchisee to franchisor for using its brand name and business model.

Royality

It is a certain percentage of revenue that a franchisee pays to the franchisor.

FIGURE 7.8 Maximum Royalty Paid Per Month: Sector-Wise (Percent of Revenue)



Source: The State Bank of Pakistan (2022)

REGULATIONS IN FRANCHISING

Franchise business has expanded to more than 160 countries and there are 70 types of different sectors that operate through franchises (FindLaw, 2008; Global, 2021). Although most countries have not imposed strict restrictions on franchises, pre-scale regulations do exist. Currently, at least 24 countries have specific laws applicable to franchising. However, in Pakistan, along with other South Asian countries, there is no specific franchise law, comprehensive franchise data, or an established franchise association. The only official or legal provision dealing with franchising in Pakistan is the Supreme Court of Pakistan's definition of a franchise:

> "A privilege granted or sold, such as to use a name or to sell products or services. The right given by a manufacturer or supplier to a retailer to use his product and name on terms and conditions mutually agreed upon."

In simple words, franchise means allowing the use of a license, trademark, and tradename to produce, manufacture or sell goods under a specific brand name. In addition to the general contract law, foreign exchange regulations are also applicable to foreign franchisors operating in Pakistan. These regulations apply to foreign franchisors in the manufacturing, non-manufacturing, agriculture/social/food, and financial sectors. It is important to note that these restrictions are not part of the statutory law, instead, they are executive orders issued by the SBP. All commercial banks are obliged to follow the SBP regulations. These regulations restrict the remittances of initial franchise fees and royalties to franchisors abroad.

Furthermore, franchisors and franchisees do not have a common code of ethics, they set their own rules and contracts. Finally, several franchise consultancy firms have recently emerged. Some of these consultancy firms have been created by attorneys, while others were started as straight business consultancies. Consulting firms frequently organize franchise exhibitions, fairs, and other social events in major cities of Pakistan to promote franchising. Some of the prominent franchising consultants are Pakistan's First Online Consultants, Franchising Key Pakistan, Brand Franchise, and Consultance.

Franchising Laws in the USA and Pakistan: A Comparison

Franchise laws in the United States and Pakistan are quite different in terms of their legal structure and regulatory requirements. In the US, franchise laws are governed by federal and state regulations, while in Pakistan, there is no specific law governing franchises. However, the SECP has issued guidelines for franchisors and franchisees, which include provisions on disclosure requirements, territorial rights, and advertising standards.

BOX 7.1 Franchise Legal Framework: USA & Pakistan

United States of America	Pakistan
Govern by federal and state authorities	No exclusive governing bodies. SECP issues guidelines for franchisors and franchisees
Franchise Disclosure Document (FDD) a detailed document containing franchise opportunities. FDD is filed by Federal Trade Commission (FTC) and some state authorities	A simple disclosure statement having information related to nature of the business, investment required, support offered, and duration.
Level of protection to franchisees such as unjust termination or non-renewal of agreement and right to sue.	No or limited level of protection to franchisees.

In the US, franchisors must provide potential franchisees with a FDD, which contains detailed information about the franchise opportunity, including financial statements, fees, and other important details. The FDD needs to be filed with the FTC and some states have additional filing requirements. In Pakistan, the franchisor is required to provide a disclosure statement to prospective franchisees that includes important information related to the franchise system, such as the nature of the business, the investment required, the support offered, and the duration of the franchise agreement.

Another difference between US and Pakistan's franchise laws is the level of protection provided to franchisees. In the US, franchise laws are designed to protect franchisees from unfair practices by franchisors, such as unjust termination or non-renewal of the franchise agreement. These laws also provide franchisees with the right to sue for damages if they believe their rights have been violated. In Pakistan, franchise laws do not offer the same level of protection to franchisees as those in the US. However, there are provisions in the law that require franchisors to provide ongoing support and training to franchisees and to ensure that franchisees are not subject to undue hardship or exploitation.

Overall, the franchise laws of developed countries such as the US, Canada, and Australia are more robust than in Pakistan. These countries have specific laws and codes of conduct that regulate the franchise industry and protect the rights of both franchisors and franchisees. In contrast, Pakistan's laws and guidelines are more general and do not provide as much protection to franchisees.

CONCLUSIONS

In a nutshell, the world of franchising in Pakistan is a captivating and dynamic realm that has experienced remarkable growth. Franchising has made its mark across diverse sectors in Pakistan, extending beyond the traditional and nontraditional domains. The rapid growth of sectors such as telecommunication, food, education, and fashion has been fueled by the emergence of urban development in major cities of Pakistan.

Moreover, international and national brands have played a significant role in shaping the franchising landscape in Pakistan. Few national brands have broken free from domestic boundaries and ventured into the global arena, reflecting the preferences of Pakistani consumers and the abundance of franchising opportunities. However, the majority of national brands face obstacles in achieving global recognition, including investment limitations, marketing challenges, and the pursuit of brand equity and product excellence.

Furthermore, financial aspects, such as franchise fees, monthly royalties, and overall investments, must be carefully considered. Nevertheless, Pakistan lacks dedicated franchise laws, data, and relevant associations, which ultimately present challenges to the industry's development. However, the rise of franchise consultancy firms has provided guidance and support to both franchisors and franchisees. Comparatively, the United States' robust franchise laws set a benchmark for Pakistan to strive for. Strengthening regulatory frameworks and enhancing franchisee protection are vital steps for Pakistan to align with international standards and best practices.

8 Pakistan's Business Conglomerates: Who Owns What and Invests in What?

MOHAMMAD ARMUGHAN

KEY TAKEAWAYS

- Globally, business conglomerates add value, innovate, and diversify investment, but in Pakistan, conglomerates prioritize maximizing returns without emphasizing innovation, product diversification, or R&D.
- The historical control of Pakistan's capitalist system by a limited number of families remains largely unchanged. Presently, 42 conglomerates dominate the Pakistani business landscape, owning a total of 421 companies.
- Although these conglomerates own a large number of companies, their net worth, by international standards is unimpressive – the highest-valued conglomerate's worth is USD 6 billion. In comparison, India's second-largest business group is worth more than USD 300 billion.
- Around 76% of conglomerate-owned companies remain unlisted on the PSX, indicating limited IPOs.
- Pakistan's business conglomerates prefer conventional sectors: textiles, real estate, financial services, and power & energy. This "risk-averse" approach indicates reliance on government support, subsidies, and preferential treatment. Rent-seeking behavior further reinforces this risk aversion and a focus on maintaining maximum ownership stakes.
- Around 84% of conglomerate-owned companies primarily operate within the domestic market, with only a mere 11% engaging exclusively in international operations.
- These conglomerates' exports are limited and are concentrated in

traditional sectors, while high-value addition sectors show lower export volumes.

- The dominance of conventional industries, limited listing activity, and low-value exports underscores the need to foster innovation, diversification, and international expansion within the Pakistani business landscape. Understanding these dynamics is critical for driving higher economic growth and capitalizing on new opportunities for progress.

INTRODUCTION

Globally, economic and financial activities are vast and encompass innumerable activities and the share of large business corporations in these activities is large. The role of large business corporations in the world economy is to add value, lead innovations, introduce new products, and diversify investment. In Pakistan, only a few business groups, or conglomerates, control most of the economic activity and own most of the firms. However, the similarity between the global business giants and Pakistan conglomerates ceases at this point. In Pakistan, business conglomerates engage in those economic activities that give them the maximum return without adding much in the way of innovation, product diversification, and R&D.

According to Mahbub Ul Haq (1973), 22 families held the reins of the capitalist system in Pakistan in the 70s. The pattern has not changed much since. Recently, Haque and Hussain (2021) analyzed the pattern of investment in the stock exchange by looking at connections between firms through cross-holdings. They found that 31 families appear in the KSE-100 and the wealth in the stock market may be largely owned or controlled by these 31 families.

This section identifies giant business conglomerates in Pakistan, quantifies the number of companies they own or invest in, and analyzes their investment patterns to see in which sectors or industries they primarily invest. Furthermore, the number of companies that are listed on the PSX is also analyzed.

AN OVERVIEW OF PAKISTAN'S BUSINESS CONGLOMERATES

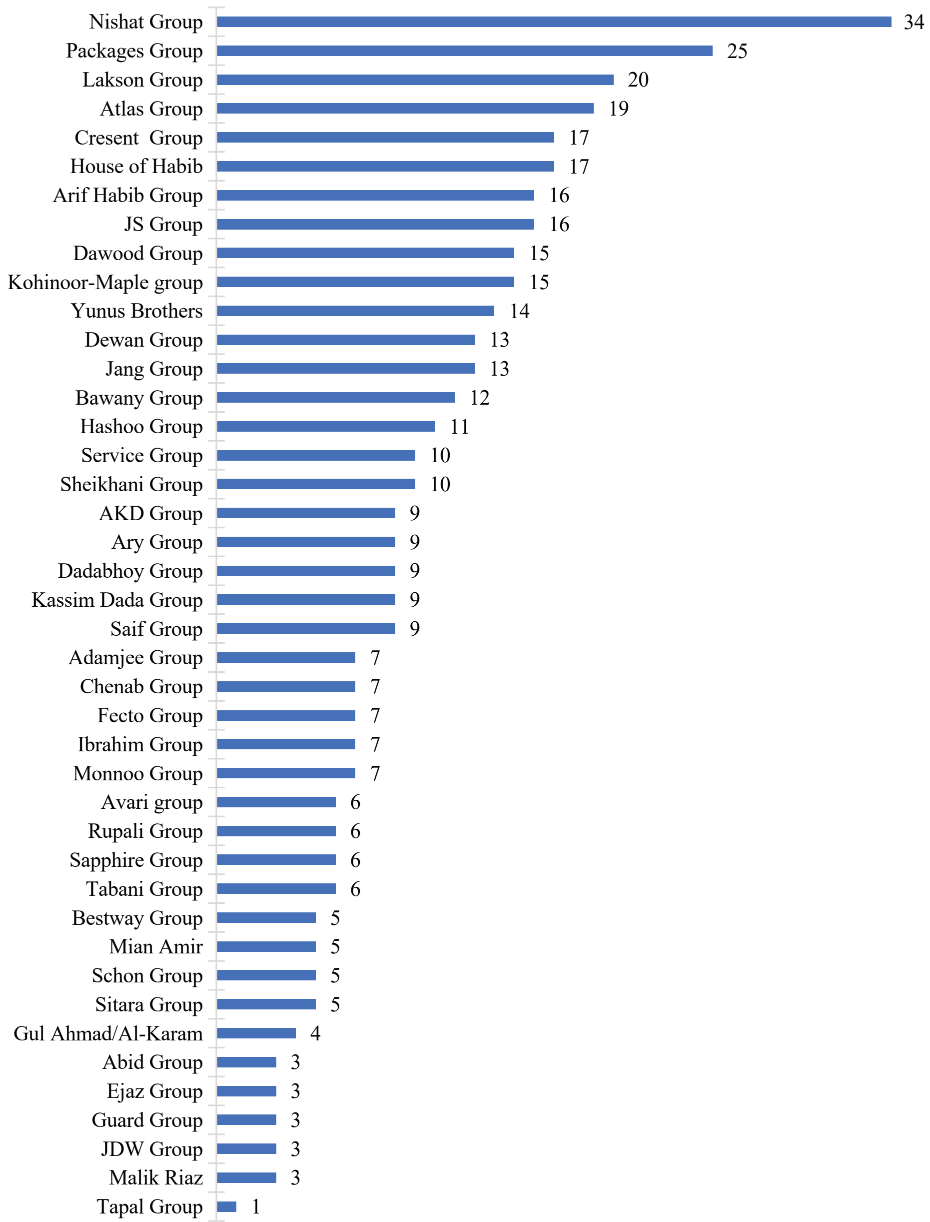
According to our analysis, 42 large business conglomerates own most of the companies in Pakistan. The number of companies that each conglomerate owns is given in Figure 8.1. In aggregate, there are 421 companies owned by 42

WHAT IS A CONGLOMERATE?

Conglomerates are large parent companies consists of multiple diverse independent business entities that may operate across multiple industries.

business conglomerates, which distinguishes this study from that of Haque and Hussain (2021). While their research focused specifically on the KSE-100, this chapter has a broader scope, encompassing the overall business groups in Pakistan.

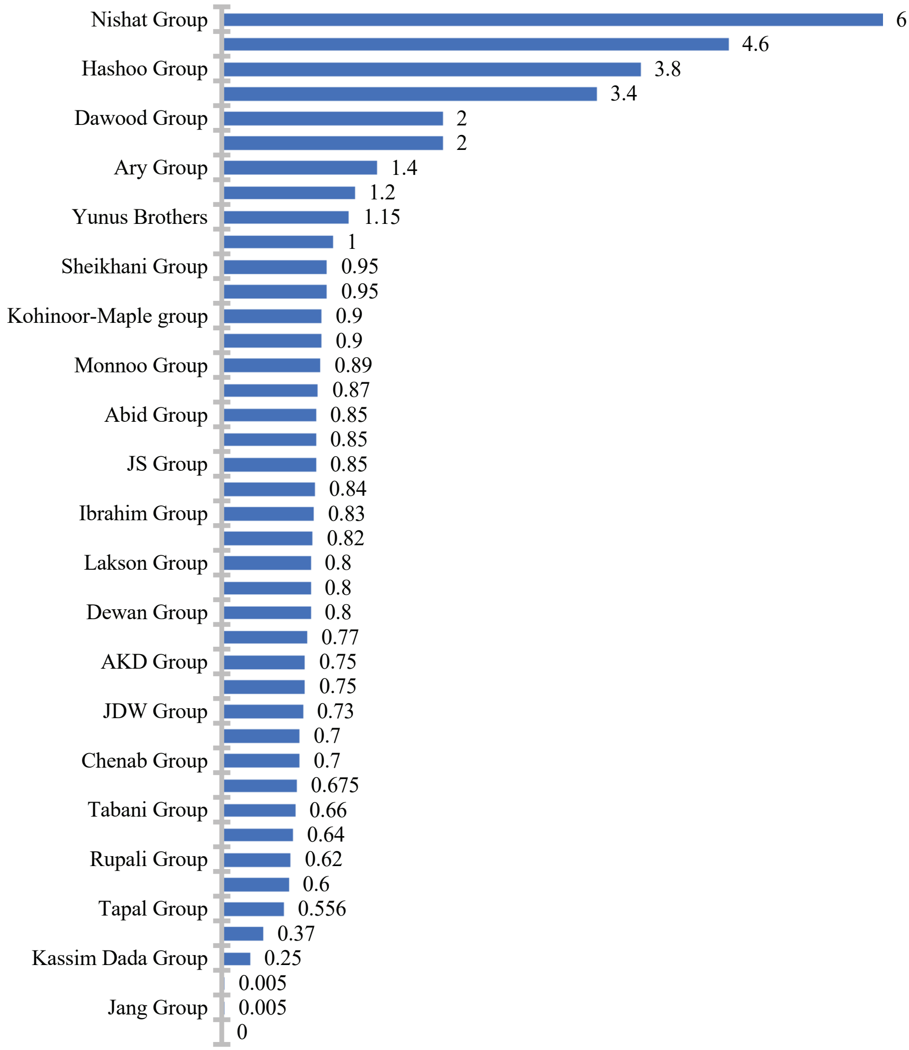
FIGURE 8.1 Companies Owned by Each Business Conglomerate: Numbers



Source: Author's estimates

Figure 8.2 shows the total worth of each business conglomerate. The highest worth of a business conglomerate in Pakistan was approximately USD 6 billion in 2020. In comparison, the Tata Group, the second-largest business group in India, owns 30 companies and is worth USD 311 billion (Business Today India). As the figure shows, the total worth of smaller conglomerates is negligible even though they own quite a few firms. For example, the Kassim Dada Group own nine companies but their total worth is only a quarter of a billion dollar.

FIGURE 8.2 Total Worth of Business Conglomerates in Pakistan: USD Billion

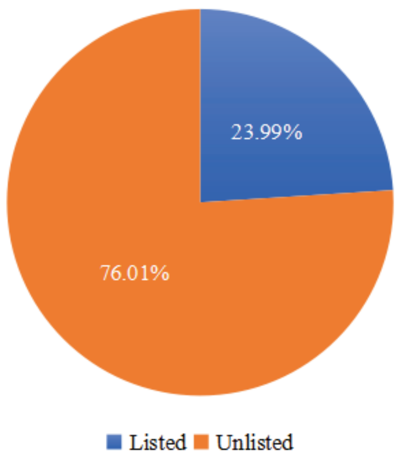


Source: Author's estimations. *Note: Data for Bawany Group is not available.*

LISTED VS. UNLISTED COMPANIES: MISSING OUT ON THE OPPORTUNITY?

Out of 421 companies owned by 42 business conglomerates, only a few companies are listed on the PSX. Figure 8.3 shows that, remarkably, approximately 76% of the conglomerates' companies are unlisted, indicating a scarcity of IPOs and limited stock trading activities in Pakistan. Listing on stock exchanges is a way to generate equity financing to increase the scale of the business and invest in other activities. This shows the myopic mindset of Pakistani businesses that want to keep a tight hold on business activities and, perhaps, conceal various financial indicators. For example, one of the new entrants in automobile manufacturing is a private limited company and does not reveal the number of vehicles it sells during a particular period.

FIGURE 8.3 Business Conglomerates' Companies: Listed Versus Unlisted (Percent)

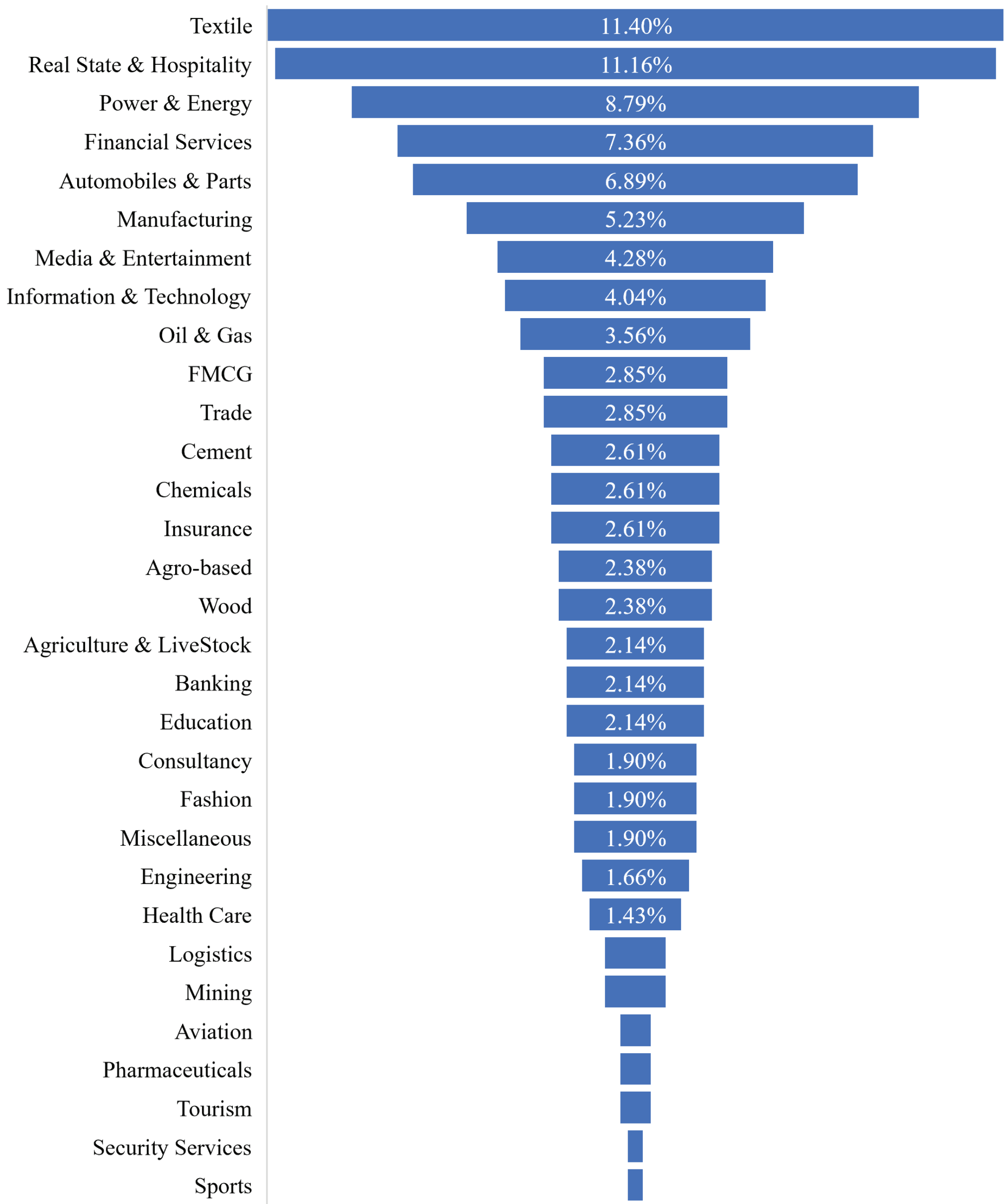


Source: Pakistan Stock Exchange (2022)

INVESTMENT PATTERNS

The investment pattern of Pakistan's business conglomerates is somewhat similar. The majority of their investments are directed towards conventional sectors, such as textiles, real estate, financial services, power and energy, as detailed in Figure 8.4. Understanding these investment patterns is crucial not only for understanding why Pakistan does not grow at a higher rate but also because it enables the identification of gaps and utilization of windows of opportunity. By examining the sector-wise investment patterns, it becomes evident that these prominent entities primarily invest in those sectors that allow guaranteed returns. The underlying reasons driving these investments may include government support in the form of subsidies, tax breaks, subsidized energy tariffs, high tariffs, which prevent competition, and risk-averse attitudes prevalent within the Pakistani business community. Pakistan's businesses are known to thrive on rent-seeking (Haque, 2007).

FIGURE 8.4 Business Conglomerates: Sector-Wise Investments (Percent)



Source: Author's estimates

BOX 8.1 Characteristics of the "Seth Culture"

Autocratic Leadership

In the so-called "Seth Culture," Do-As-I-Say leadership dominates. People at the helm deem their wisdom and logic to be the most rational and most viable.

Bottleneck Syndrome

Top management is the narrowest part of an organization just like a bottleneck. The bottleneck is mostly a point of hindrance and congestion. Bottlenecks occur because, in such organizations, the liberty of decision-making is allowed only to the Seth.

Innovation Inhibitors

The rigidity in Seth Culture makes it harder for him to embrace anything remotely related to "innovation". The culture has natural resistors in it, in the form of little or no investment dedicated to innovation.

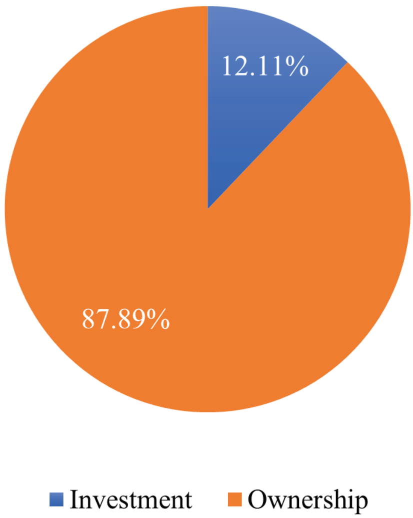
Regressive Vision

The Seth Culture suffers from corporate myopia. Such organizations lack foresight and long-term plans.

Source: Mehmud (2017)

One of the reasons for the risk-averse attitude of Pakistan's businesses is the prevalence of a private bureaucracy, commonly referred to as the "Seth Culture" (see Box 8.1). This culture acts as an obstacle to innovative business processes and tempts businesses to maintain maximum ownership stakes as Figure 8.5 illustrates. The figure demonstrates that business giants exhibit a strong inclination towards retaining large ownership in their ventures.

FIGURE 8.5 Pakistani Business Conglomerates: Ownership and Investment in Firms

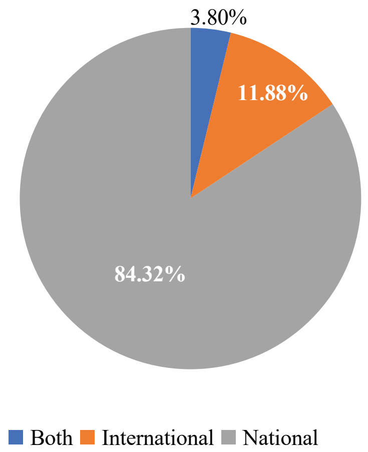


Source: Author's estimates

OPERATIONS: DOMESTIC OR INTERNATIONAL MARKETS

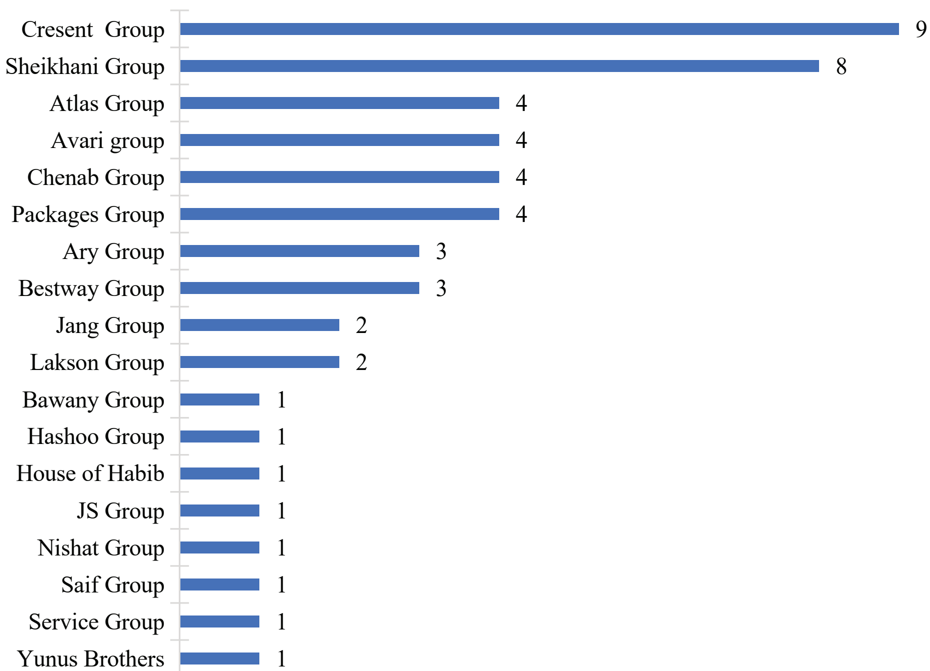
Figure 8.6 reveals that approximately 84% of the conglomerates' companies primarily operate in the domestic market. However, merely 11% of companies of conglomerates operate exclusively in the international market. Additionally, a portion of these conglomerates' companies operate both in domestic and international markets. Figure 8.7 shows business conglomerates and the number of companies operating in the international market.

FIGURE 8.6 Operations of Pakistani Conglomerates: National, International, or Both?



Source: Author's estimates

FIGURE 8.7 Pakistani Business Conglomerates: International Operations (Number of Companies)



Source: Author's estimates

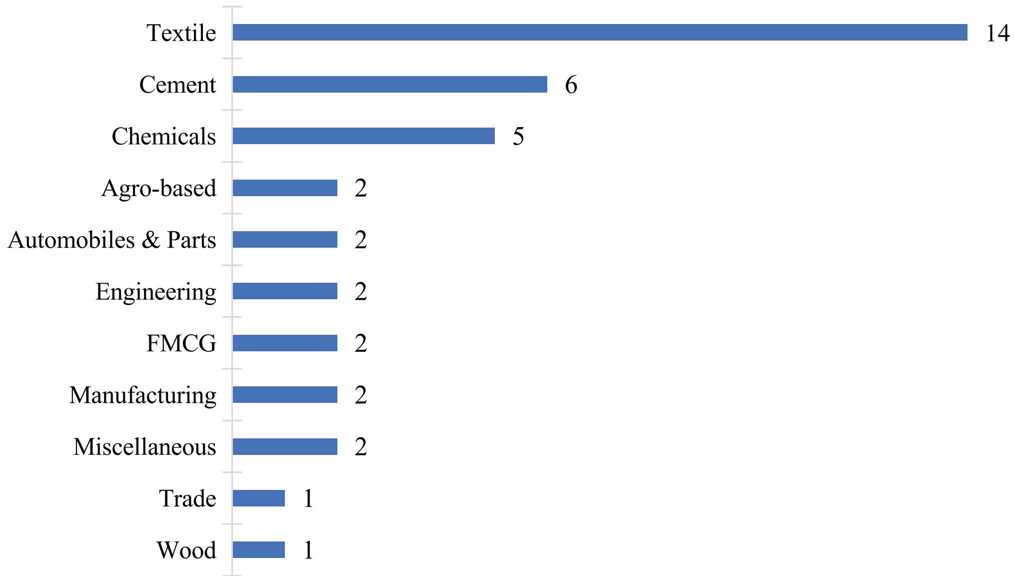
EXPORT OF BUSINESS CONGLOMERATES

It is important to note that the export figures are only for the listed companies since unlisted companies do not declare the value of their exports in financial statements even if they are validating revenue recognition from exports. Even among the 24% of listed companies, which amounts to 102 companies, data regarding exports is only available for 39 companies. Therefore, the following analysis is based on the data availability of 39 PSX-listed firms.

The analysis shows that one of the striking facts about the business conglomerates of Pakistan is the low value of their exports. The combined exports of 39 companies of the 42 business conglomerates were USD 2.07 billion (PKR 594.35 billion). To put things into perspective, India's Reliance Industries Limited, a company owned by India's largest conglomerate, exported products worth USD 22.91 billion in 2017 (Financial Express).

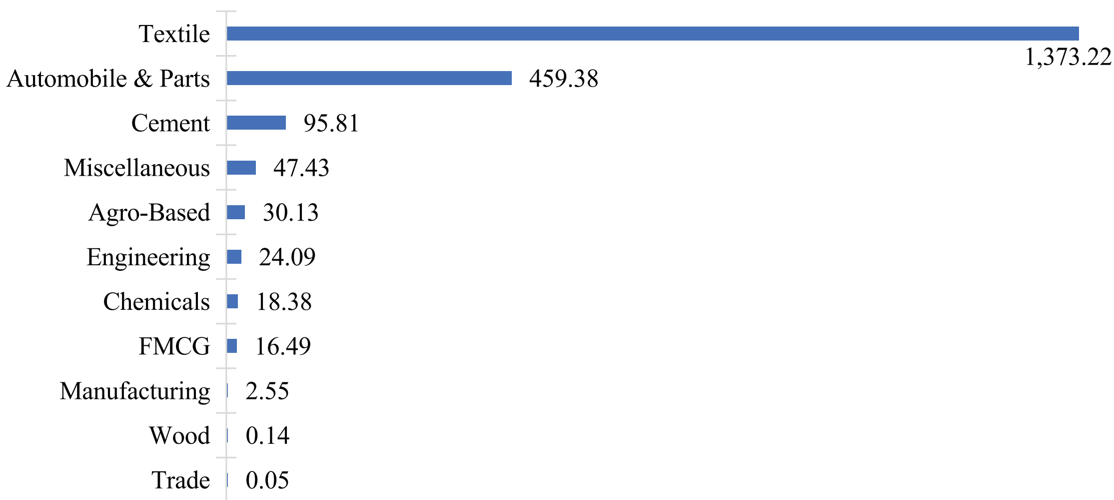
Figure 8.8 displays the sector-wise distribution of companies that export their products. The value of exports of companies in each sector is given in Figure 8.9. Unsurprisingly, the textile sector has the largest export value followed by cement and chemicals. Even a glance at the figure shows that Pakistan's business conglomerates' exports are mostly concentrated in traditional sectors, which is another indicator that Pakistani business giants chase those sectors that enjoy incentives in the form of subsidies, etc. as discussed above. The value of exports of high value-addition sectors is small. For example, the exports of the engineering sector are only USD 24.09 million. Similarly, the exports of the chemical sector are only USD 18.38 million.

FIGURE 8.8 Exporting Companies: Sector-Wise (Number of Companies)



Source: Pakistan Stock Exchange (2022)

FIGURE 8.9 Pakistani Business Conglomerates: Sector-Wise Exports (USD Million)



Source: Pakistan Stock Exchange (2022)

CONCLUSIONS

In conclusion, the behavior and investment patterns of business conglomerates in Pakistan reveal a departure from the global norm. Instead of prioritizing innovation, product diversification, and R&D, these conglomerates prioritize the maximization of returns. This deviation can be attributed to the historical control of Pakistan's capitalist system by a limited number of families, a situation that remains largely unchanged.

Through extensive research, this study has identified the major conglomerates in Pakistan, quantified their ownership and investments, and analyzed their sectoral preferences. The dominance of 42 conglomerates owning a staggering 421 companies demonstrates the concentrated nature of the Pakistani business landscape. Despite variations in conglomerate values, a significant proportion of their companies remain unlisted on the PSX, indicating limited IPOs. Moreover, conglomerates exhibit a risk-averse approach, relying on government support, subsidies, and preferential treatment, which further perpetuates their conservative investment strategies.

These conglomerates predominantly operate within the domestic market, with limited engagement in international markets. Export data, mostly concentrated in traditional sectors, highlights the need for increased focus on high-value addition sectors and diversification of export markets.

The study's findings underscore the imperative of fostering innovation, diversification, and international expansion within the Pakistani business landscape. Encouraging a shift towards an innovation-driven and globally oriented business environment is crucial for unlocking Pakistan's economic potential and promoting sustained and inclusive development. By challenging the status quo, promoting greater competition, and supporting initiatives that stimulate innovation and internationalization, Pakistan can lay the groundwork for a more dynamic and resilient economy, paving the way for prosperity and progress.

9 "Make" in Pakistan: Mobile Phone Manufacturing and Market

ABID REHMAN

KEY MESSAGES

- To meet the rising demand for mobile phones, the government implemented the mobile manufacturing policy in 2020, which offers incentives for local production.
- The target is 49% localization by June 2023, including 10% in key components.
- This policy is intended to boost exports, replace imports (and the associated import bill) and create jobs, and driving long-term growth and elevate Pakistan to a high-income country.
- The Mobile Phone Manufacturing Policy 2020 has failed to achieve most of the localization targets, failed to bring in FDI, reduction in import bills and export to Africa.
- The idea of import substitution through the local assembling of mobile phones has also not materialized as yet and appears to be failing as the sharp decline in the import of completely built units (CBUs) is substituted with a sharp hike in imports of completely knocked down (CKD) kits and semi knocked down (SKD) kits without being localized in mobile phone parts manufacturing.
- Pakistan's Mobile Phone Manufacturing Policy 2020 and India's Production Linked Incentive (PLI) for mobile manufacturing share similar features. However, in Pakistan's case, a lack of R&D and negative net exports indicate insufficient value chain contributions.

- Big business conglomerates that have set up mobile phone assembly plants seem to be chasing subsidies and earning profits, as there is no evidence of R&D.
- The subsidy is not linked with some goal or target.
- Mobile phone retailers and wholesalers contribute significantly to domestic commerce as the survey of retailers and wholesalers in twin cities (Blue Area, Saddar, and Sixth Road) shows that per annum estimated sales of mobile phones are USD 72.1 million.

INTRODUCTION

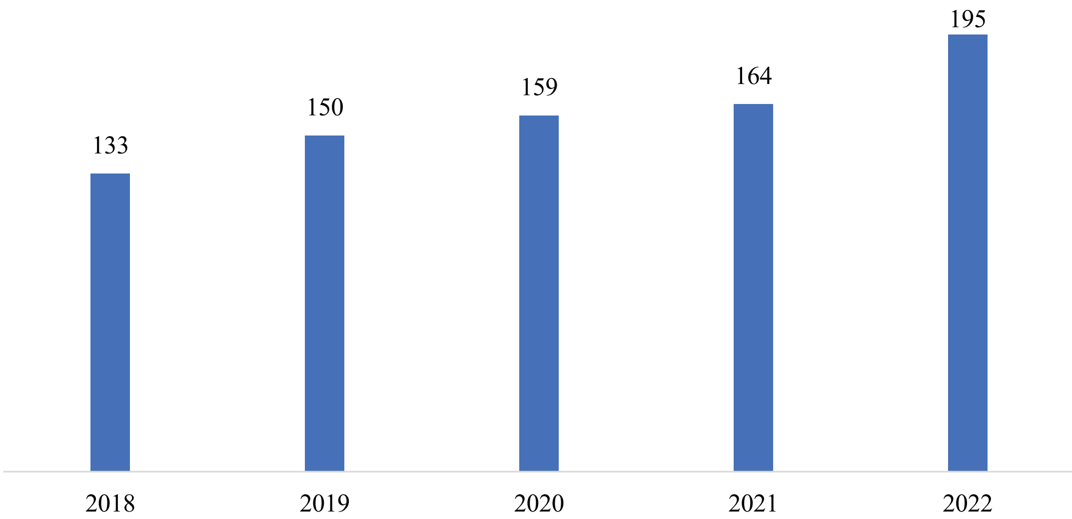
Pakistan is one of the fastest-growing markets for cellular phone users. According to the Pakistan Bureau of Statistics (PBS), the import of cellular phones increased by 51% from USD 1.37 billion in 2020 to USD 2.07 billion in 2021. Keeping in view the growing demand for cellular phones, the government of Pakistan introduced the Pakistan Mobile Manufacturing Policy (PMMP) 2020, which addresses the concerns of mobile device manufacturers and provides them with attractive tariffs and non-tariff measures for local production. This policy set the target of 49% localization by June 2023, including 10% localization in motherboards and batteries. The policy's main objective is export diversification and enhancement, import substitution of value-added engineering goods, and job creation to help Pakistan sustain robust growth over a long time horizon. The country can potentially participate in global value chains if the mobile manufacturing market constraints are addressed.

OVERVIEW OF THE SECTOR

Market Size

Over the past few years, Pakistan has seen tremendous growth in the IT and telecom sectors. The introduction of 3G/4G spectrums has opened up a new path of growth and innovation. With 450 million subscribers, teledensity has reached 86.71%, and 3G/4G penetration has touched 49.94%. The Pakistan Telecommunication Authority (PTA) data shows that only 53% of the population uses smartphones, while the remaining 47% still use 2G devices. Pakistan still needs to catch up with new technology such as 5G. According to the Global System for Mobile Communications Association (GSMA), in 2025, 74% population of Pakistan will be able to use smartphones. The growth in the market size is evident in Figure 9.1.

FIGURE 9.1 Mobile Phone Market Size (USD Million)

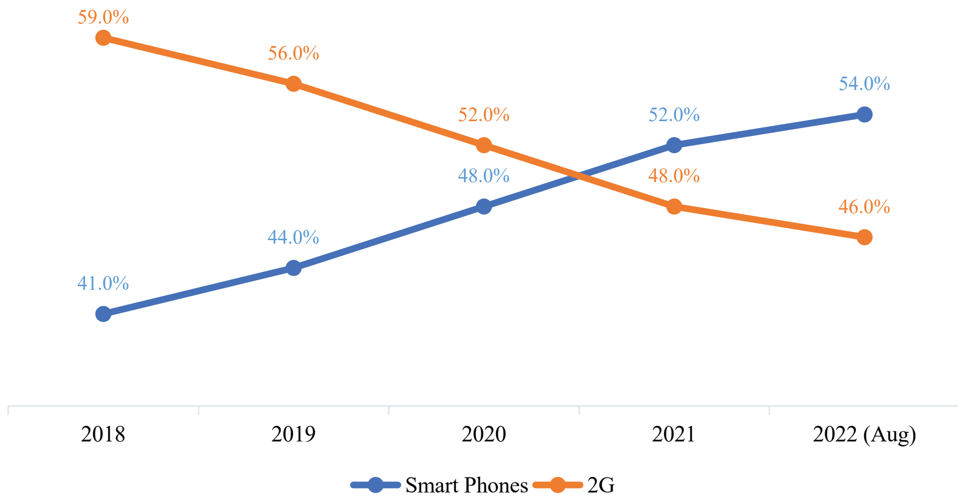


Source: Pakistan Telecommunication Authority

Mobile Phone Production

The PTA permitted 29 local manufacturing companies, of which 19 are currently functional. As a result, mobile phone manufacturing in Pakistan has increased significantly over the last few years. Over 50 million phones are assembled in one year. Figure 9.2 shows that the production of smartphones, i.e., 3G and 4G phones, has increased over time and the production of feature phones, i.e., 2G, has declined. At the same time, however, mobile phone imports increased from 21.6 million units in 2016 to 28.2 million units in 2019, which shows a 30.56% increase in 2019 compared to previous years.

FIGURE 9.2 Mobile Phone Production in Pakistan: Share of Smart Phones and Feature Phones (Percent)



Source: Pakistan Telecommunication Authority

PAKISTAN MOBILE PHONE MANUFACTURING POLICY 2020: AN ANALYSIS

Pakistan has several policies and rules and regulations related to mobile phone manufacturing, including the PTA Technical Regulations for Mobile Handsets, the Pakistan Telecommunication Act 1996, and the recent PMMP 2020.

Key Incentives to Manufacturers

The government has imposed a 15% lower import duty on the CKD kits and semi-knocked down (SKD) kits than completely built units (CBUs). As a result, after the 2020 Policy, approximately 6 million mobiles were

HS CODE 8517.7000

The HS Code 8517.7000 is based on Harmonized System (HS) classification. In this code, “85” denotes the chapter “Electrical Machinery and Equipment,” while “17” denotes the heading "Telecommunications Equipment.” The four numbers after it, i.e., “7000,” are used for further subcategorization that mainly refers to mobile phone parts (CKDs) in this context. According to the FBR, based on section 18 (1A) of the Fifth Schedule to The Customs Act 1969, the customs duty on the import of CKDs of mobile phones is 0%.

assembled locally by using imported CKDs and SKDs under HS Code 8517.7000.

Achievements of PMMP 2020

The following table shows the targets and achievements of the PMMP 2020.

TABLE 9.1 Mobile Phone Manufacturing Policy 2020: Target and Achievements

Category	Target	Achievement
Localization	49% localization target by June 2023, including 10% localization in motherboard and batteries	No parts of the motherboard and batteries are currently being manufactured in Pakistan except for a few casings
Export	Pakistan will export to regional countries such as Central Asian Republics and Africa, UAE,	Exported low-end 16,000 mobiles (i.e., mainly 2G) to the UAE in 2019 & 2020 according to the PTA
Job Creation	Pakistan will create a further 200,000 to 500,000 jobs	Only 20,000 jobs have been created
Foreign/Local investment	Foreign / Local investment of more than USD 200 million	Total FDI is USD 23.38 million with Samsung having the maximum share of USD 8 million

Source: PMMP 2020 and author's analysis

Evaluation of the Policy

The main policy loophole is that it does not provide guidelines for developing the proper value chain and innovation (R&D) to meet the export and localization targets. Furthermore, there is no focus on facilitating foreign investors by providing them with a conducive environment for investing. Investors, both domestic and foreign, have to deal with red tape, regulatory issues, and sludge, such as obtaining unnecessary no-objection certificates (NOCs) and letters of credit (LCs).

IMPORT SUBSTITUTION POLICY

Import substitution is a policy that aims to reduce a country's reliance on imported goods by encouraging domestic production of substituted goods. It is often used to promote economic development and reduce a country's trade deficit. Pakistan has implemented import substitution policies in various sectors, including mobile manufacturing. These policies have had mixed results.

Has the import substitution worked?

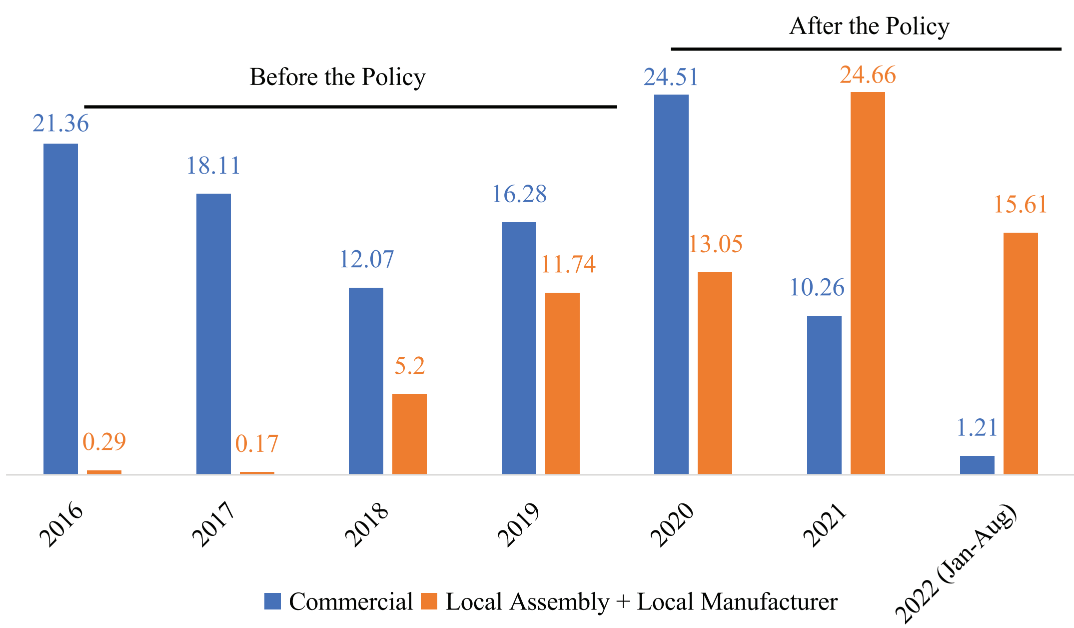
Pakistan has implemented import substitution policies in various sectors, including mobile manufacturing. These policies have had mixed results. Theoretically, the import substitution policy can help to create domestic employment, boost the domestic economy, and stimulate economic growth. However, Pakistan's experience with the import substitution policy has been mixed at best. For example, many industries, such as the automobile industry. The automobile industry has been incentivized so that it can produce locally including parts, but thus far it has not achieved import substitution and the majority of automobile parts are imported.

Is the situation different with mobile phones? The following evaluation will give a clearer picture.

Before and after policy analysis of manufacturing

The local mobile manufacturing policy has helped the telecom sector by increasing its revenue. However, the import of CBUs has declined and the import of CKDs and SKDs has risen. Before the PMMP 2020, Pakistan could not economically manufacture mobile phones. The government, however, established a 15% tariff gap between CBUs and the CKD and SKD parts that the sector imported for production. At least 3 million phones are sold each month, while around 4 million components and CBUs are imported each month due to the policy change in 2020 that cut taxes on the importation of raw materials and CKD or SKD components. It encouraged local cell phone production and assembly within a year. Currently, almost all brands that are sold in Pakistan are produced in Pakistan.

FIGURE 9.3 Mobile Phone Assembling: Before and After Policy (Millions)



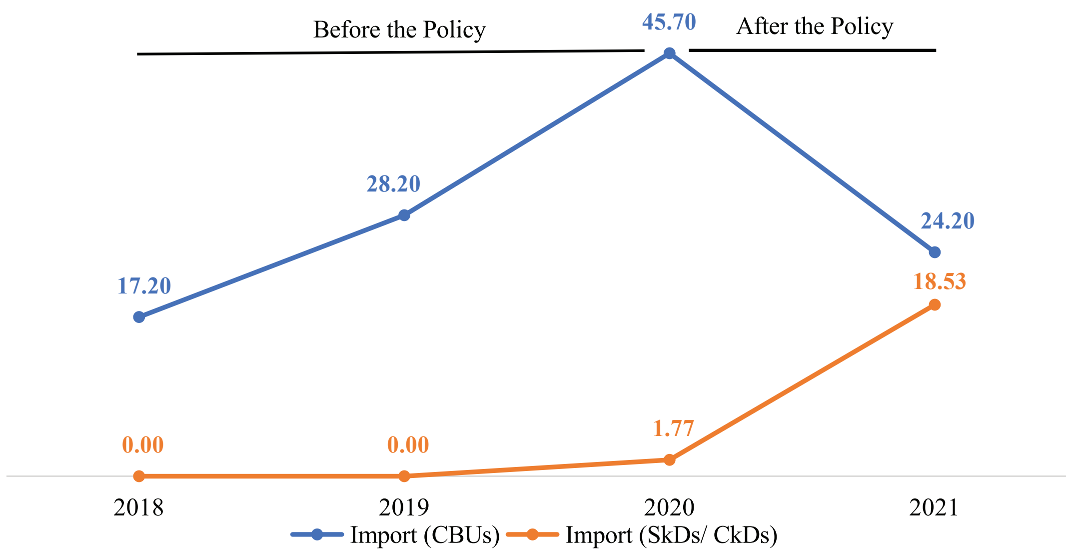
Source: Pakistan Telecommunication Authority

From the analysis, it is evident that mobile phone assembling jumped from 0.29 million units in 2016 to 24.66 million units in 2021 after the introduction of the Policy in 2020. This shows that import substitution has worked to the extent that the import of CBUs has declined, while the production of local mobile phones has increased. However, an in-depth import and export analysis clarifies the picture further.

Imports and import bill before and after Policy

Figure 9.4 shows that the import of CBUs has declined but the import of CKD and SKD kits has risen sharply. It indicates the localization of parts has not happened so far. Thus, the main purpose of the import substitution policy, i.e., localization of parts, which embodies technology transfer, has not been fulfilled.

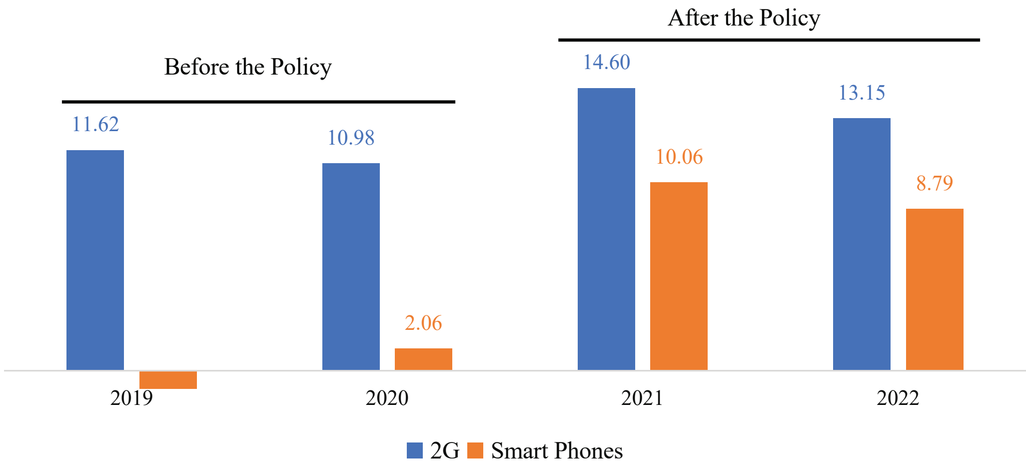
FIGURE 9.4 Import Vs. Local Manufacturing: Before and After Policy (Millions)



Source: Pakistan Telecommunication Authority

The previous Figure 9.3 gives the impression that import substitution is working as the number of local mobile phone assemblies has increased. However, in Figure 9.4 it can be seen that after the Policy, the sharp decline in the import of CBUs is substituted with a sharp hike in the import of CKDs and SKDs without being localized in mobile phone parts manufacturing.

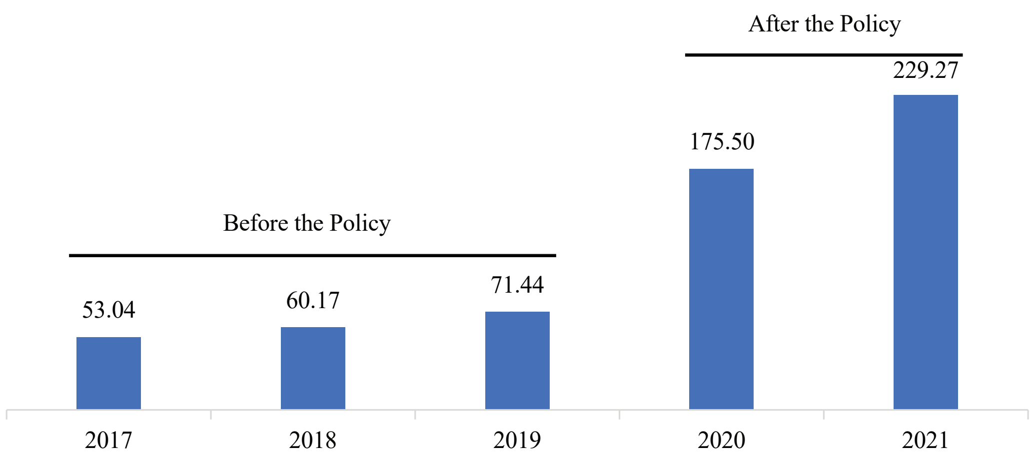
FIGURE 9.5 Spectrum-Wise Mobile Phone Assembly: Before and After Policy (Millions)



Source: Pakistan Telecommunication Authority

Figure 9.5 shows mobile phone assembling in Pakistan according to the spectrum, which, to some extent, depicts the quality of mobile phones being manufactured as smartphones (3G and 4G) require more sophisticated parts. In 2022, 13.15 million 2G and 8.79 million smartphones were assembled in Pakistan. However, currently, mobile phone parts are not being manufactured locally due to no investment in R&D, localization, and technology patents.

FIGURE 9.6 Import Bill: Before and After Policy (USD Million)

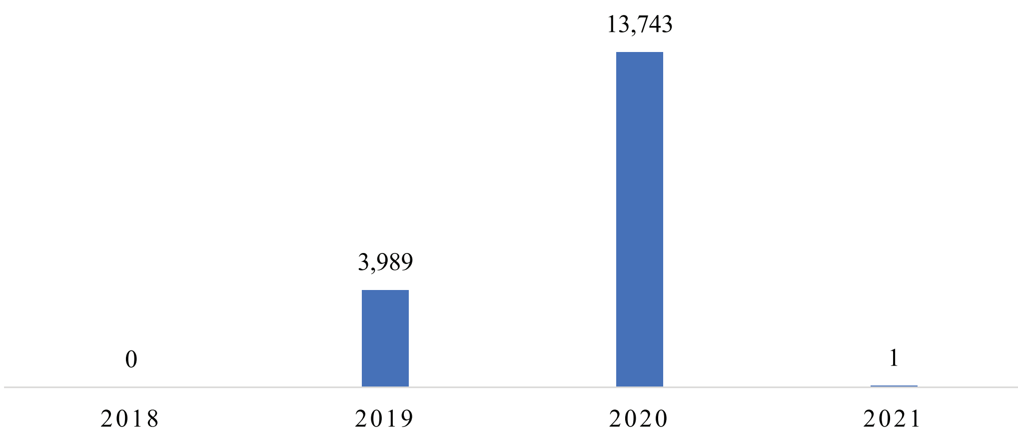


Source: Pakistan Telecommunication Authority

Exports before and after the Policy

As shown below, Pakistan has exported only a few thousand low-end mobile phones to the UAE. However, the local mobile phone makers were not given any target of export linked to the subsidy provided in the PMMP 2020. This unconditional subsidy resulted in policy failure, as this policy neither boosted the exports of Pakistan (Figure 9.6) nor reduced the import bill (Figure 9.7). This shows that the import substitution, which was the purpose of the Policy, has failed in mobile phone assembling in Pakistan.

FIGURE 9.7 Exports: Before and After Policy (Number of Units)



Source: Pakistan Telecommunication Authority

A comparison of Pakistan and India's mobile manufacturing policies

The analysis of Pakistan and India's mobile phone manufacturing policies, summarized in Table 9.2, shows that both policies have the same features. In sum, both countries have failed to contribute significantly to the supply chain as there is no R&D and both have negative net exports. However, one difference is that India assembles mobile phones for Apple, which is one of the largest – and the most valuable – mobile phone brands in the world. Other features of policy incentives, imports, and exports are also summarized in Table 9.2.

TABLE 9.2 Mobile Phone Manufacturing Policies of Pakistan and India: Overview

Indicator	Pakistan	India
Manufacturing Units	29	200+
Yearly Production (No. of units)	24.6 million	310 million
Imports	USD 473 Million	USD 32.4 Million
Exports (USD Million)	USD 23 Million	USD 11.1 Million
Net Exports (USD Million)	USD –450 Million	USD –21.3 Million
Policy Incentive (Tariff)	15%	20%
Localization	Producing simplest parts	Producing simplest parts
Job creation	0.02 Million	0.67 Million
Value Addition	No value addition in the supply chain	No value addition in the supply chain. However, the Apple iPhone is assembled in India

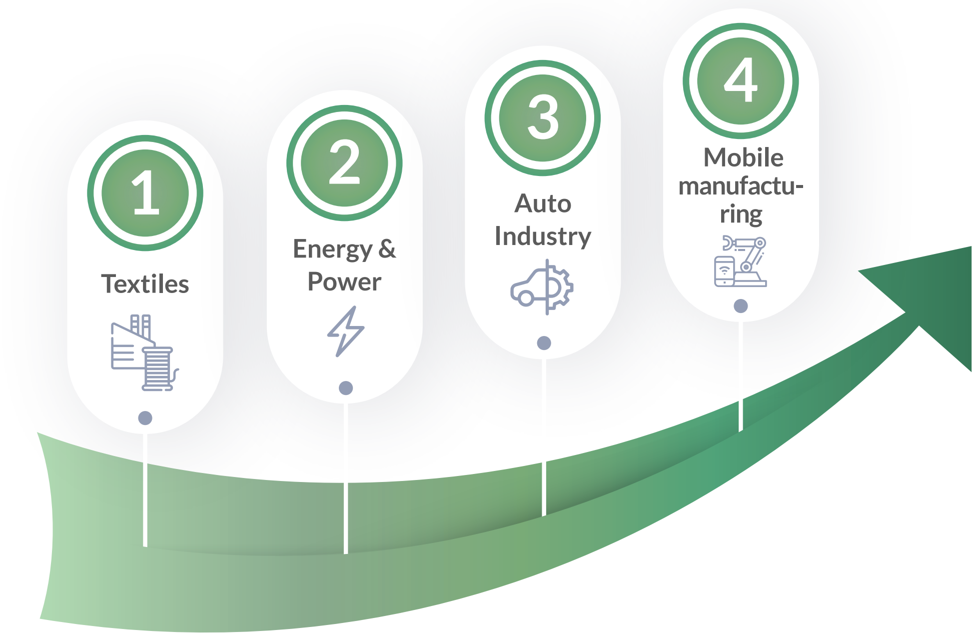
Sources: Pakistan Telecom Authority; Indian Cellular and Electronics Association (ICEA); author's analysis

Are conglomerates chasing subsidies?

The following figure shows that in Pakistan, some sectors or industries are highly subsidized and incentivized through various policy measures, such as tariff and non-tariff measures (for details on business conglomerates, see Chapter 8 of this report). As can be seen from the figure, mobile manufacturing is also subsidized in the form of lower import duties on CKD and SKD units and higher duties on

CBUs. The main motive behind providing incentives in various forms is the import substitution policy. However, the companies or conglomerates that have entered mobile phone manufacturing in Pakistan have merely taken advantage of the protection granted to the industry and have not made value addition. Moreover, these companies also have not engaged in R&D, which can help in the localization of parts. These are the highly subsidized sectors (see Chapter 8).

FIGURE 9.8 Manufacturing Chasing Subsidies



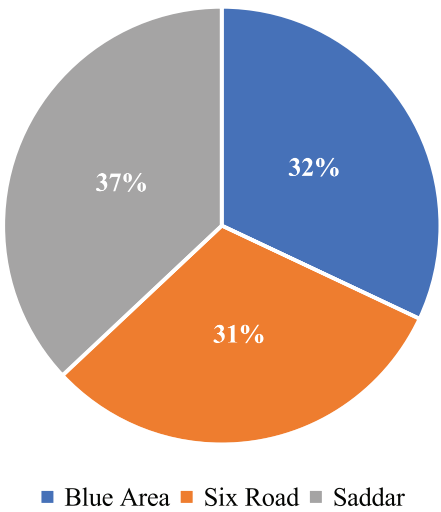
Source: Chapter 8 of this report.

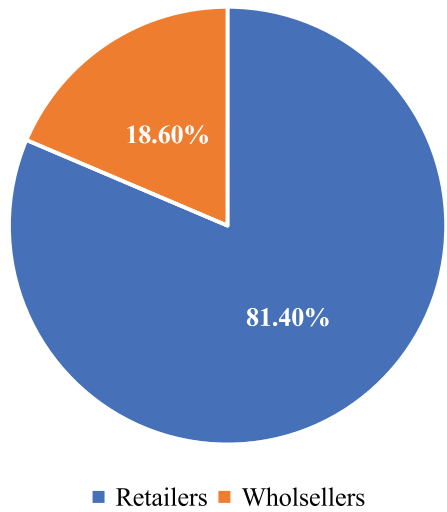
MOBILE PHONE MARKET IN TWIN CITIES

Sample Distribution

To check the domestic market size of mobile phones in twin cities, a survey of 120 mobile phone retailers and wholesalers was conducted in the main hubs of mobile phone vendors, which include Blue Area, Sixth Road, and Saddar, to gauge the state of domestic mobile phone market by obtaining first-hand information from wholesalers and retailers. The sample distribution of the retailers and wholesalers is as follows:

FIGURE 9.9 Sample Distribution



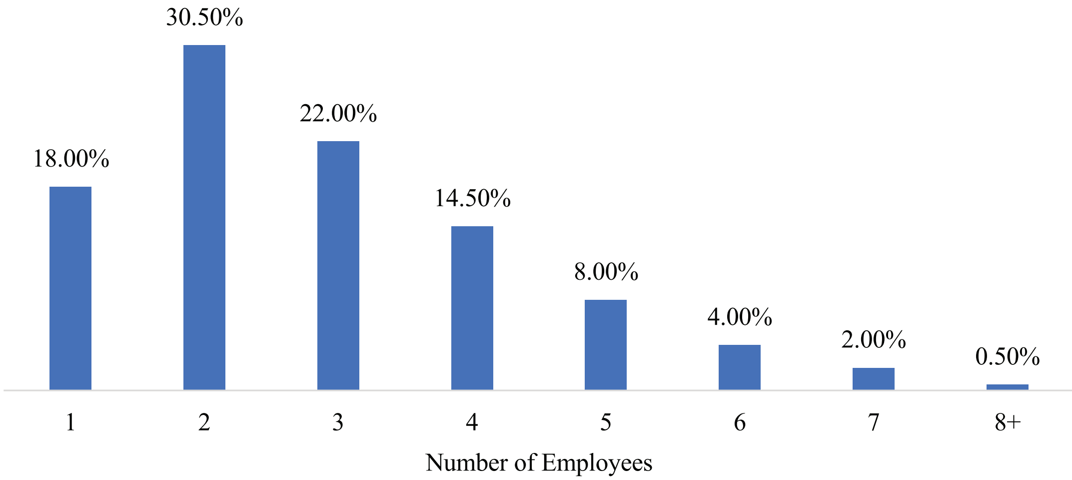


Source: PIDE State of Commerce Survey

Employment

Figure 9.10 shows employment in the mobile phone market in twin cities.

FIGURE 9.10 Employment in Mobile Phone Outlets: Distribution According to Employees



Source: PIDE State of Commerce Survey

Market Size

From the survey, the size of the mobile phone market in twin cities was determined. The information is summarized in Table 9.3 below.

TABLE 9.3 Market Size: Number of Wholesalers and Retailers

Vendor Type	Blue Area	Sixth Road	Saddar	Total
Wholesalers	15-20	35-40	40-50	90 - 110
Retailers	120-150	250-300	350-400	720 - 850

Source: PIDE State of Commerce Survey

Daily and Annual Sales

This survey was also aimed at exploring the sales of locally assembled mobile phones and the types of mobile phones (i.e., smartphones or feature phones) in Rawalpindi and Islamabad. The details are given in the following table.

TABLE 9.4 Distribution of Sales: Units Per Day

Average Sale Per Day (Units)	Percent
1 to 3	19% (23)
4 to 6	33% (40)
7 to 10	15% (18)
11 to 14	12% (14)
15 to 20	7% (8)
20 +	14% (17)

Source: PIDE State of Commerce Survey

Furthermore, the distribution of sales of mobile phones according to the technology is given in the following table.

TABLE 9.5 Sales of Mobile Phones According to Technology

Mobiles Technology	Price Range (PKR)	Percent
Low End/Feature Phone (2G)	5,000-10,000	20%
Medium (3G, 4G)	11,000-25,000	55%
High (3G, 4G, 5G)	26,000 -45,000	35%

Source: PIDE State of Commerce Survey

Value of Total Sales

To estimate the total value of sales, the following assumptions were used.

- Number of wholesalers: 100
- Average sales per day of wholesalers: 25

- Markup of the wholesaler for the retailer: 10%.

Keeping in view the details in Table 9.4 and Table 9.5, we have calculated per day sales of retailers and wholesalers (Table 9.6) from Rawalpindi and Islamabad.

TABLE 9.6 Value of Total Sales: Per Day

Mobile Category	Count	Average Price	Number of Wholesalers	Total Amount (PKR Million)
Low End/Feature Phone (2G)	5	7,500	100	3.75
Medium	13	18,000	100	23.4
High	7	35,000	100	24.5
Overall Sale/ Day	25		100	51.65
Markup (10%)	--	--	--	5.17
Net Sales				56.82

Source: Calculations based on PIDE State of Commerce Survey

CONCLUSIONS

Based on the expanding usage of mobile phones, especially smartphones, the government formulated the PMMP 2020, which offers producers an incentive of 15% lower import duties on CKDs and SKDs compared to CBUs. As local mobile phone assembly grows, it appears that the import replacement is effective. However, no R&D or technology patent indicates that this sector would not localize the mobile phone component in Pakistan at least in the near future. Thus, there is very little potential for the localization of integrated chips (ICs) and batteries due to the unavailability of skilled labor, and semiconductors and we are only making casings of low-end mobile phones.

The players in mobile phone manufacturing, it appears, have entered the industry mainly to benefit from the incentives provided in the PMMP 2020 and maximize revenues thanks to the mobile phone industry's guaranteed subsidies. There is no incentive for innovation and local production of parts because the simple assembly of CKDs and SKDs offer substantial gains. They do not seem to have any intention to localize the production completely by engaging in R&D and acquiring the required technology, which is the raison d'etre of an import substitution policy.

Furthermore, the analysis of the Policy shows that most of the aims delineated in the Policy are hitherto unmet.

- The Policy aimed to attain 49% localization by June 2023, including 10% localization of motherboards and battery parts. However, other than a few cases, the motherboard and batteries have yet to be developed and manufactured in Pakistan.

- There is no local production.

- Just 20,000 jobs have been generated despite the goal of creating 200,000 to 500,000 jobs.

- The initiative aims to export 200,000 domestically made mobile phones to countries like Afghanistan and Central Asian Republics. However, only 16,000 phones were exported to the UAE.

- The strategy intends to reduce the cost of mobile phones to make available affordable smartphones for domestic consumers. However, this does not seem to be happening yet because locally manufactured mobile phones still use imported parts, which are costly to import due to various reasons, such as the depreciation of the local currency.

- India's PLI Scheme and the PMMP 2020 are compared to demonstrate the similar manner in which both policies are constructed. In conclusion, neither country was able to make a major contribution to the supply chain because neither had any R&D, and both had negative net exports.

The failure of these policies and historical patterns demonstrate that import substitution policies are invariably counterproductive, resulting in higher costs and fewer options for consumers. Additionally, local industries cannot be as effective or competitive as those in other countries, which would result in lower-quality goods and a decline in global competitiveness.

10 Real Estate and Construction: Beyond Brick and Mortar

AZWAR MUHAMMAD ASLAM

EXECUTIVE SUMMARY

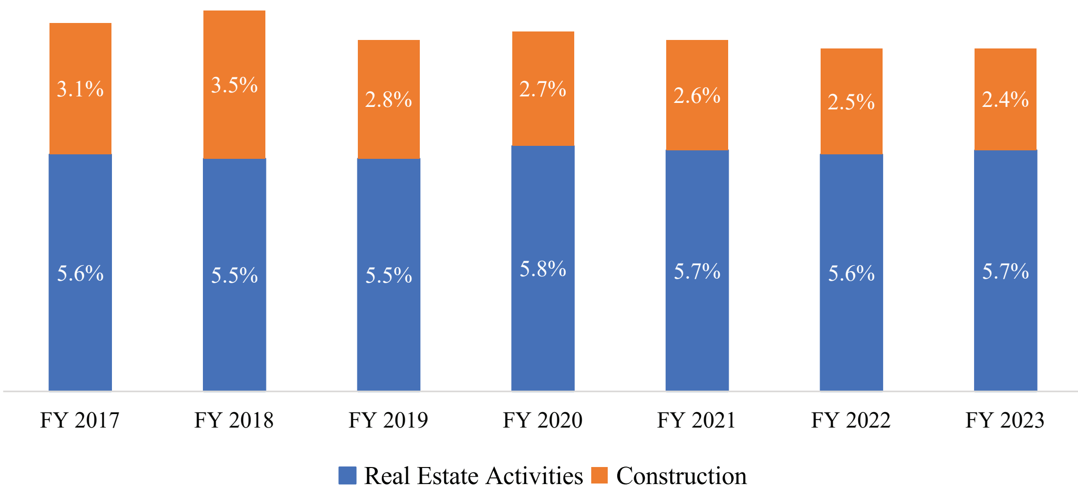
- Among all the housing societies in twin cities, 81% of housing societies are illegal.
- The real estate market of twin cities is dominated by plots – 50 % of total real estate available on the market is in the form of plots, i.e., undeveloped land.
- The share of real estate for commercial purposes is significantly lower – 5% in Islamabad and 9 % in Rawalpindi.
- The real estate market is dominated by sales and purchases, whereas the share of rental activity in the real estate market is very low.
- The capacity to undertake and operate large construction projects is low in twin cities. There are only a few registered constructors and operators.
- A relatively small proportion of constructors, i.e., 8% in Islamabad and 4% in Rawalpindi, are registered to undertake construction projects valued at over PKR 1 billion.
- A lower proportion, i.e., only 4% of the constructors in Islamabad and 1% in Rawalpindi are allowed to handle projects exceeding PKR 4 billion.
- Even though real estate prices are rising, real returns from real estate show a decreasing trend.
- The construction industry and real estate in twin cities employ a significant share of the total employed labour force. i.e., 12% of the total employed labor force.

- There is a significant wholesale and retail activity related to real estate and construction in twin cities: PKR 4.9 billion in annual sales in sanitary, almost the same in hardware, PKR 4.7 billion in annual sales in electronic stores, and PKR 41 billion annual sales in construction-related material, especially cement, in Islamabad only. The majority of the activity is in medium and small enterprises.
- In Islamabad the wholesale and retail activity in hardware, sanitary, electronic and cement stores have a share of 0.35% in the retail and wholesale output in the GDP of Pakistan.
- Poor urban planning and regulation have encouraged suburban development, leading to the abundance of housing societies and plots.
- There is a significantly lower number of tower cranes in twin cities indicating low large-scale construction activity, particularly in high-rise mixed-use buildings. In comparison, there are 1,345 tower cranes in Dubai.

OVERVIEW OF THE REAL ESTATE AND CONSTRUCTION SECTOR

Real estate and construction sectors have been significant sources of economic growth and development in Pakistan in recent years. Due to an increase in population and urbanization, the demand for real estate has observed substantial growth in recent years. These sectors have contributed significantly to the GDP of Pakistan over the years (see Figure 10.1). The sectors have also provided substantial employment opportunities. The share of the real estate sector in total employment was 0.5% in 2020-21 and that of construction was 9.5 (LFS 2020-21).

FIGURE 10.1 Sectoral Share of Construction and Real Estate in GDP (Percent)



Source: Pakistan Economic Survey 2022-23

The real estate and construction sectors are considered to be the most sought-after sectors in recent years. The real estate assets in Pakistan have an estimated worth of USD 300 to 400 billion (Ullah & Najib, 2022). The importance can be ascertained from the attention both sectors have received through various policies and incentive packages, such as housing and construction packages. These incentives aim to increase the output of the sector and the economy at large.

This chapter attempts to evaluate the current state of the real estate and construction sector and related activities in twin cities. The activities that are carried out in both sectors are interconnected, as development in the real estate sector has an impact on the construction sector which, in turn, impacts the allied industries. All these interrelated activities are an integral part of domestic commerce.

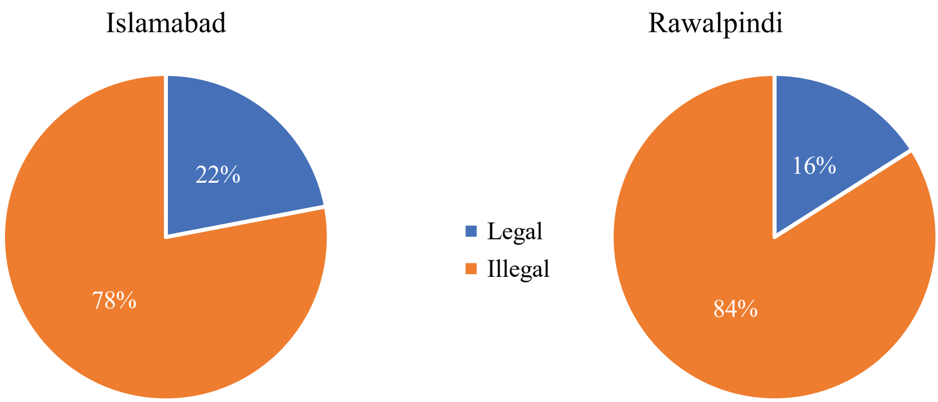
STATE OF REAL ESTATE IN TWIN CITIES

The real estate sector in Islamabad and Rawalpindi, like in any other city, encompasses a diverse range of real estate including, residential, commercial, undeveloped lands (plots), and industrial properties. The demand for real estate has witnessed growth due to factors such as increasing population growth, rural-urban migration, etc. An overview of the size of the real estate sector in the twin cities is given below.

State of Housing Societies in Twin Cities

The present state of the legal status of housing societies in Rawalpindi and Islamabad presents a grim picture, where out of the total, 78% and 84% of the housing societies are illegal in Islamabad and Rawalpindi, respectively. It causes not only financial loss to the state but also makes potential buyers vulnerable to financial risk.

FIGURE 10.2 Legal Status of Housing Societies in Twin Cities



Source: CDA & RDA

Among the total of 527 housing societies in Rawalpindi, 342 of them lack legal status. Additionally, 49 of these societies are categorized as fake schemes, while 53 others remain unapproved. Only 83 housing societies have been approved (see Table 10.1 below).

TABLE 10.1 Legal Status of Housing Societies: Rawalpindi

Status	Number	Percentage
Fake Schemes	49	9
Unapproved	53	10
Illegal	342	65
Approved/Legal	83	16
Total	**527**	**100**

Source: RDA

In Islamabad, out of a total of 210 housing societies, only 46 have legal status. Among these legally recognized societies, only 22 possess the necessary No Objection Certificate (NOC) from the Capital Development Authority (CDA) and

158 of them are operating illegally without any NOC or Layout Plan (LOP) from the CDA. 70% of the housing societies in Islamabad have not obtained any sort of approval from the CDA and are illegal (see Table 10.2 below).

TABLE 10.2 Legal Status of Housing Societies: Islamabad

Status	Number	Percentage
Valid NOC	22	10
Approved LOP, NOC is yet to be obtained	24	11
NOC canceled due to non-conformity with CDA rules. LOP is intact	6	3
Canceled LOP	10	5
Both LOP and NOC are canceled	2	1
Not approached CDA for LOP/NOC (Illegal)	146	70
Total	**210**	**100**

Source: CDA

BOX 10.1 Illegal Housing Societies

Haque & Hasan (2022) state the outdated master plan, low floor area ratio (FAR), the absence of private investment framework and buildings guidelines, and authority's acting as the developer are the factors leading to the development of housing societies in and around Islamabad.

Subsequently the rules and procedures laid out for the development of housing societies for approvals and NOCs are lengthy and time consuming:

- It takes four years to get a construction permit;
- Nine months to get residential construction permit;
- 21 months to obtain permission from EPA (PIDE Sludge audit Vol. I, 2022);

- 9.5 years to approve NOC of a housing society (Hasan et. al. 2022,).

All this sludge ultimately discourages developers from taking approvals from authorities. Only 20 NOCs have been issued by the authority in the 30 years (Hasan, 2021), while no NOCs have been issued in the past 25 years owing to change in layout plans and lack of progress on site.

Irregularities on the part of development authorities have contributed to buregeoning illegal housing societies. LOPs are issued without fulfilling the prerequisites and in a few cases LOPs are issued against fake documents. In the event of irregularity by developers, no action is taken by the authorities against them. The authorities have serious performance issues with little capacity to monitor housing societies (Haque & Hasan, 2023; Hasan & Anwer, 2021)

REAL ESTATE MARKET COMPOSITION

Dense cities are considered necessary for building networks and interactions that are necessary for creativity, innovation, and entrepreneurship (Haque, 2015). Dense cities are livable and provide opportunities for working, studying, shopping, and entertainment without excessive traveling. Density also allows for more efficient use of resources and social inclusion at lower costs (Haque & Rizwan, 2020; Haque & Nayab, 2007). To have cities that are dense and mixed-use the current outdated regulations that promote sub-urban development need replacement with policies that promote high-rise, mixed-use development within the cities, which will also stir more investment. (Haque, 2015). At present non-desirability of dense cities is consuming valuable agricultural land (Haque & Nayab, 2020). Only in Islamabad built-up area has increased by 18% from 1990 to 2020, with a majority of the land consumed being agricultural, i.e., 10.32% (Haider & Anwar, 2022).

A well-functioning real estate market is always based on a balanced mix of residential and commercial properties. However, in the case of twin cities, the real estate market is dominated by plots with half of the properties being plots (50% in Islamabad and 51% in Rawalpindi). Poor urban planning and regulation have encouraged suburban development, leading to the abundance of housing societies and plots (Haque & Khurshid, 2023; Haque, 2015).

An abundance of plots indicates future investment to flow into undeveloped land and remain parked there, instead of being channeled into productive activities. A more worrying trend is that the share of commercial properties is significantly small, i.e., below 10% in undeveloped land. Figure 10.3 suggests a lack of commercial activity. Most of the commercial activity is, therefore, carried out in residential areas since the supply of commercial areas is low.

The plots, in general, are held onto for decades and traded for capital gains (Haque & Khurshid, 2023). Most plots are held by land speculators for capital gains in the short term. The absence of rules and regulations or any policy initiative to discourage undeveloped land holdings spawns speculation and plot market. Holding on to plots for speculation purposes is also motivated, in part, by the regulation in place regarding the construction of undeveloped land as it takes 9 months to get a residential construction permit and 18.5 years to acquire a plot (PIDE Sludge Audit I, 2021). Even housing societies take, on average, 10–15 years to develop (Hasan, 2023). Such cumbersome procedures and regulations cause the plots to remain underdeveloped and in the hands of professional speculators.

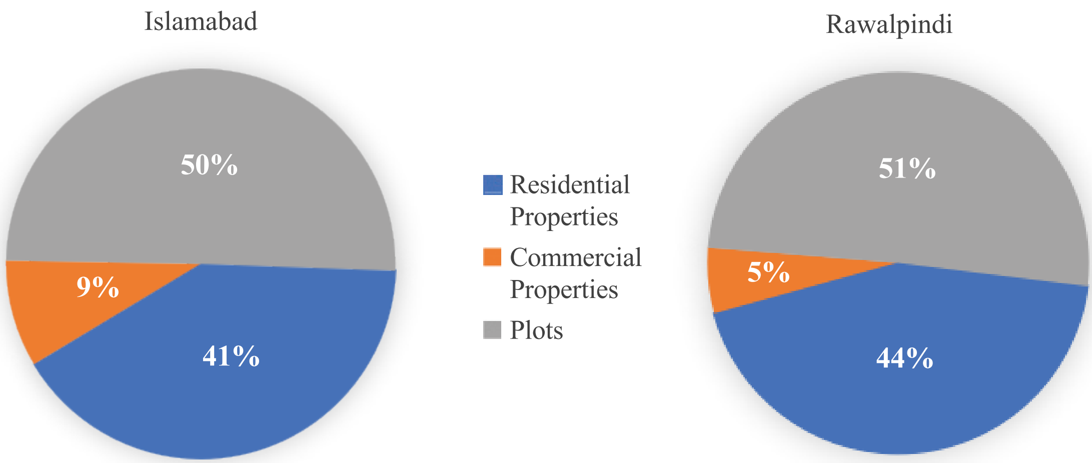
According to estimates, 75% of the plots in Lahore are in the hand of professional speculators allowing the prices of land in Lahore and Pakistan to inflate.

Source: Zaman (2012)

The availability of a high number of plots also suggests the growth in property development and sprawl along with the indication of the expansion of the existing housing societies. Thus, a significant share of investment is absorbed in real estate instead of other productive activities.

Laws and rules and regulations in effect discourage investment in large commercial projects (Anwer et al., 2020). Zoning regulations prioritize residential development, leaving less room for commercial development and bylaws discourage vertical expansion (Haque, 2015 & 2020; Hasan 2022; Hasan, et al., 2020). Even the commercialization of plots is a time-consuming process and business activity and commercial mixed-use are only allowed to develop along designated roads and places (Haque & Khurshid, 2023).

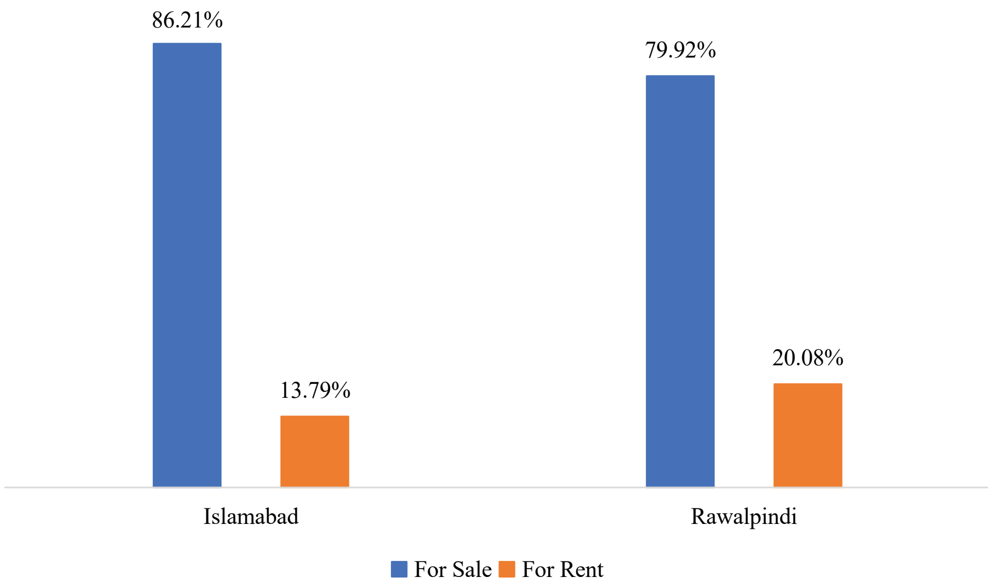
FIGURE 10.3 Classification of Real Estate Market: Twin Cities



Source: Zameen.com

In the real estate market, the majority of properties in Islamabad, i.e., 86%, are available for sale. On the other hand, the portion of properties available for rent constitutes only 13% of the total real estate market. The classification of the market on the supply side is also similar in Rawalpindi with 79.92% of the properties available for sale and the rest 20% for sale. The classification is presented in Figure 10.4 below.

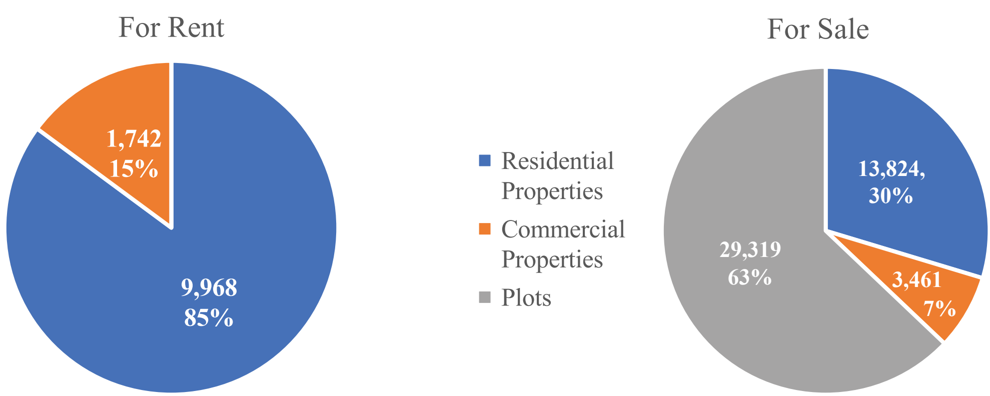
FIGURE 10.4 Real Estate Market Availability By Sale and Rent: Twin Cities



Source: Zameen.com

In Islamabad, out of the total properties that are available on the market for sale, 63% of them are plots followed by 30% residential properties, while only 7% of the properties for sale are commercial. Among properties available for rent in Islamabad, residential properties are 85% and commercial are 15% (see Figure 10.5).

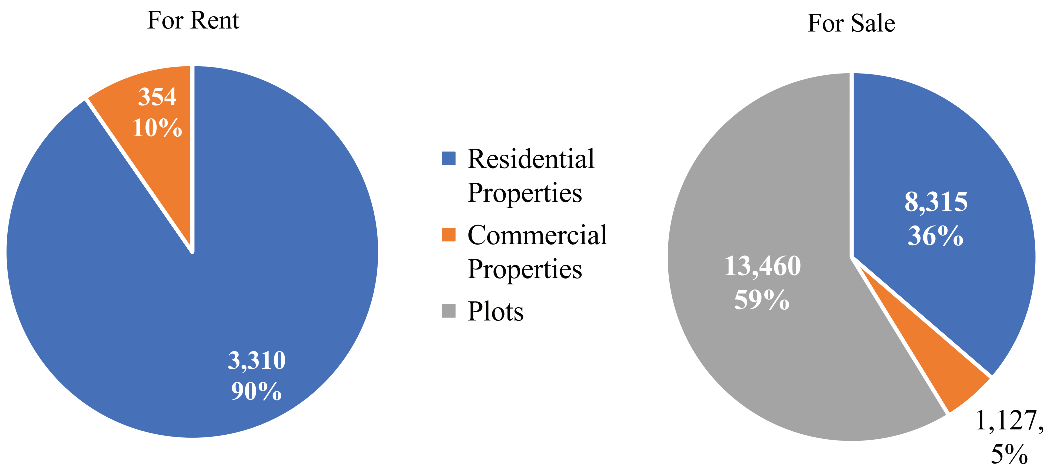
FIGURE 10.5 Real Estate Market Structure – For Sale and Rent: Islamabad



Source: Zameen.com

Among the real estate available for sale in Rawalpindi 59% of them are plots followed by residential properties i.e., 36% and only 5% of the properties available for sale are commercial. 90% of the properties available for rent are residential and only 10% of the properties are commercial. The breakdown is presented in Figure 10.6 below.

FIGURE 10.6 Real Estate Market Structure By For Sale and Rent: Rawalpindi

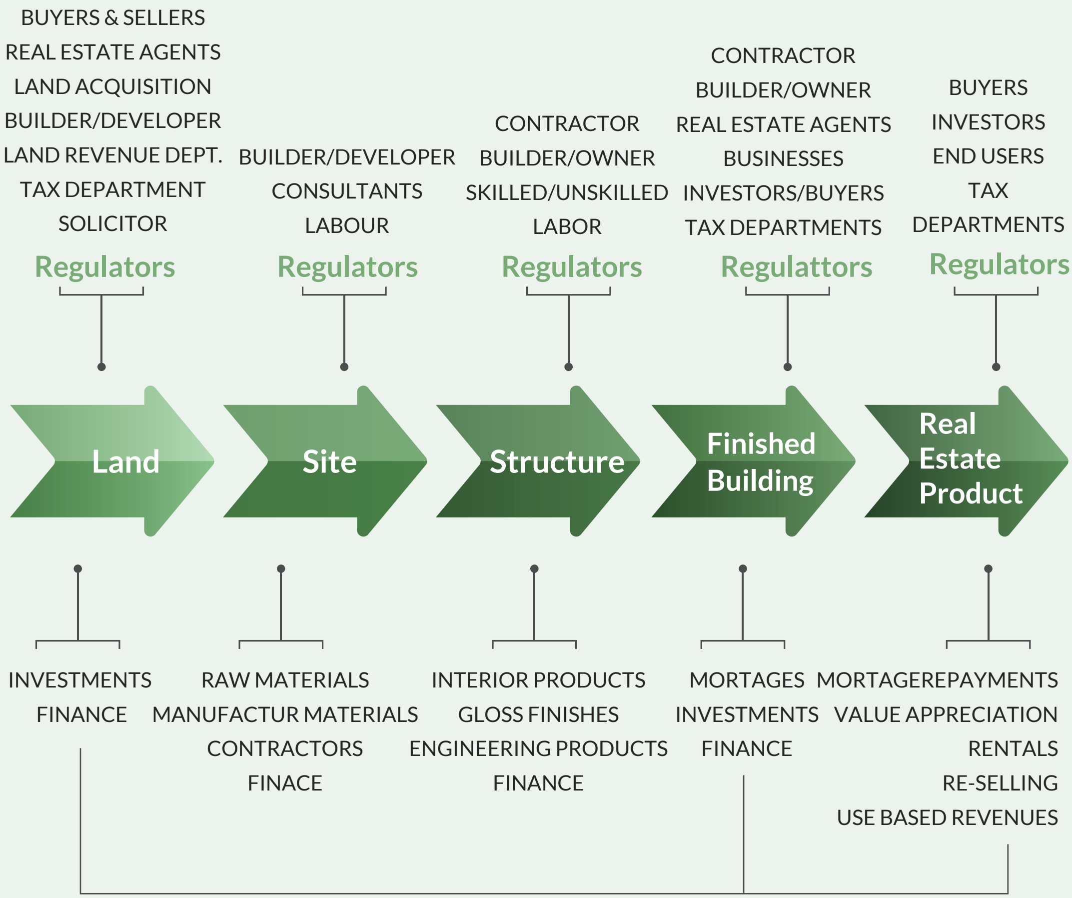


Source: Zameen.com

BOX 10.2 Is Real Estate Mere Plots?

Rules and regulations against high-rise construction within the cities discouraged vertical expansion and resulted in horizontal expansion (urban sprawls) of the cities. The horizontal expansion was facilitated by the development of housing societies, creating an abundance of undeveloped land (Haque, 2015 & 2020; Hasan, 2022; Hasan, et al., 2020).

In Pakistan, real estate is summed under the term “plot,” which is undeveloped land. Perhaps land is only the initial phase of real estate as an asset. The development of land through construction converts it into a real estate asset, which is then traded or rented on the real estate market (Haque & Khurshid, 2023).



Source: Haque & Khurshid (2023)

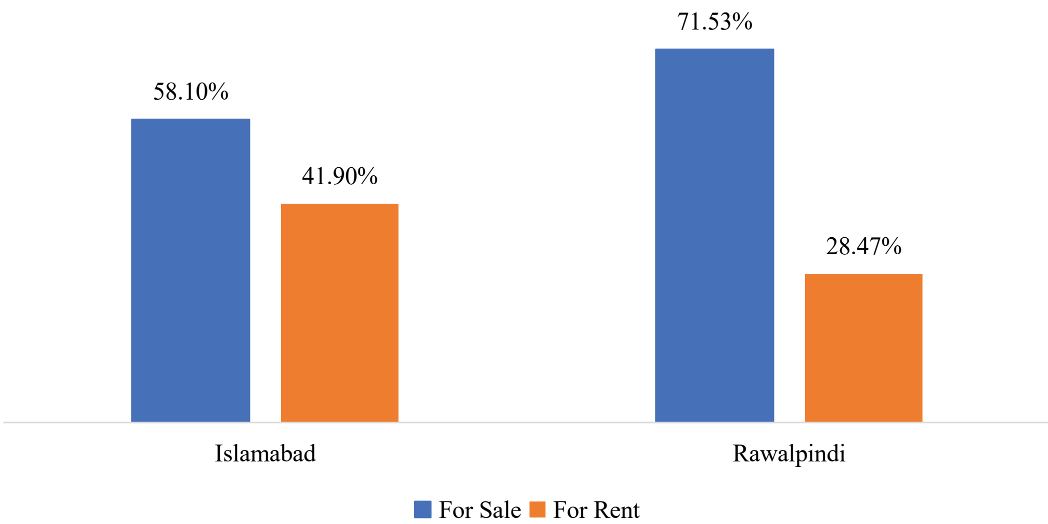
The real estate market that is dominated by plots only indicates a growing sprawl and weak construction sector, as only intense construction activity through large-scale construction works will facilitate the growth of the sector. Unlike the current scenario where land is held onto or traded for speculative gains for decades without any development.

The real estate market is a balanced mix of developed land rather than plots, in the shape of residential properties, commercial properties, industrial properties etc. Therefore, it is important to let go of the outdated policies/regulations and replace them with policies that facilitates the development of land into real estate product.

State of Residential Properties

In the residential real estate market of Islamabad, 58% of the properties are for sale and 42% are for rent. On the other hand, in the residential real estate market of Rawalpindi, the share of properties for sale is higher, i.e., 71.53%, while the properties available for rent are 28.47%.

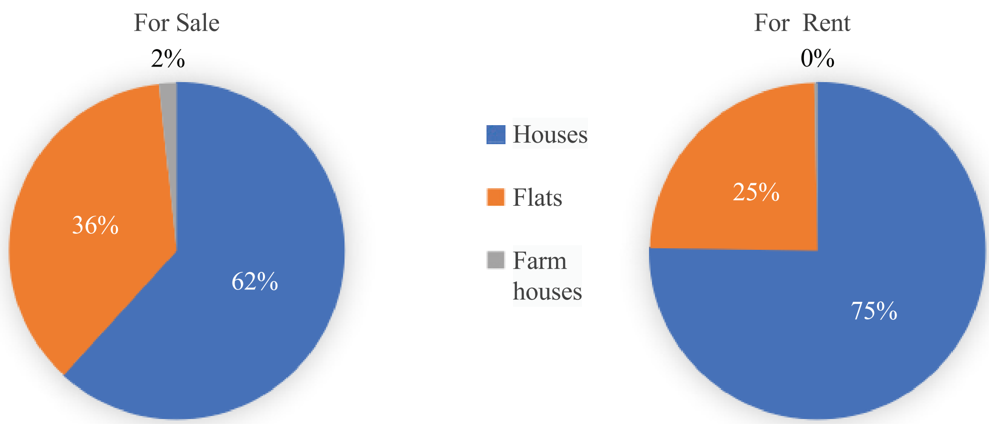
FIGURE 10.7 Residential Property by For Sale and Rent: Twin Cities



Source: Zameen.com

In Islamabad, houses dominate the residential real estate market, comprising the majority of available properties. 62% of available properties for sale are houses and 75% of properties available for rent are also houses. Meanwhile, flats represent a relatively smaller share, accounting for 36% of properties available for sale and 25% of properties available for rent. Figure 10.8 below presents the classification.

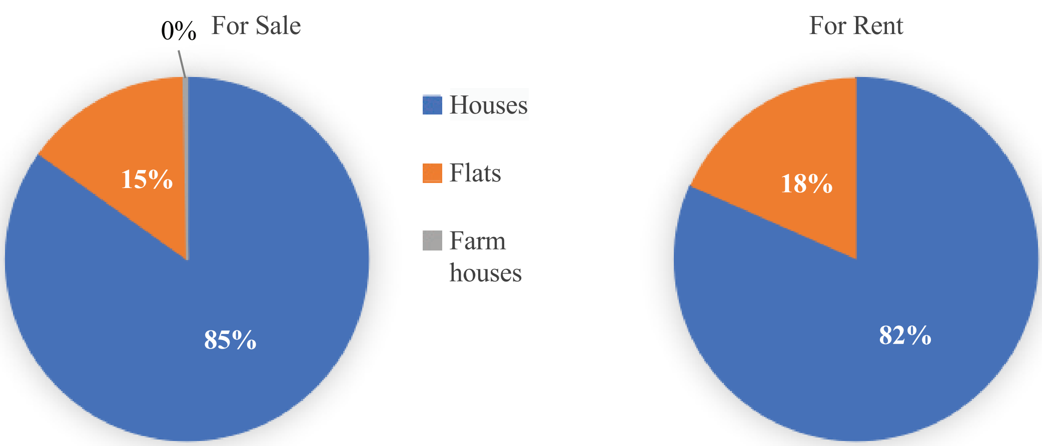
FIGURE 10.8 Residential Real Estate by For Sale and Rent: Islamabad



Source: Zameen.com

Of the residential real estate in Rawalpindi, 85% of the properties that are for sale are houses, while 82% of the properties that are for rent are houses. The share of apartments that are either for sale or for rent is significantly small in both cities. For details, see 10.9 below.

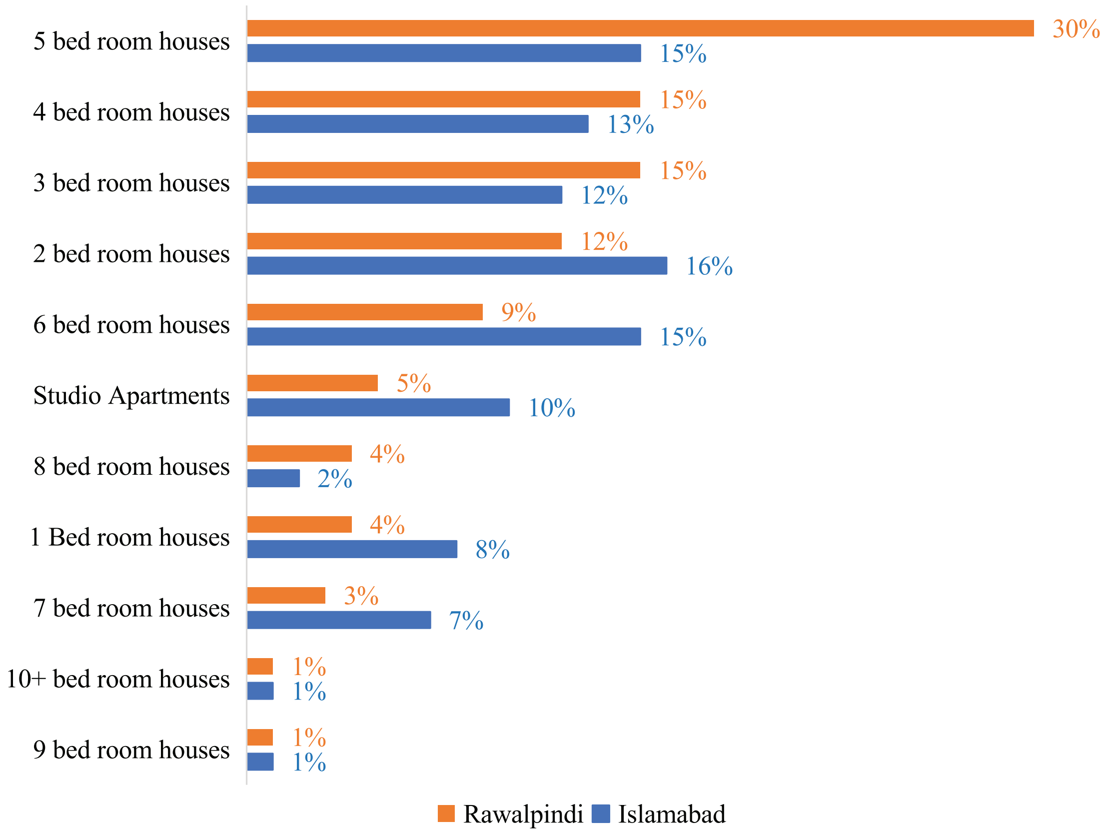
FIGURE 10.9 Residential Real Estate by For Sale and Rent: Rawalpindi



Source: Zameen.com

Two-bedroom houses are more commonly available for sale in Islamabad (16%) followed by 5 and 6-bedroom houses (15%). In Rawalpindi, most houses that are available on the market for sale are 5-bedroom houses (30%).

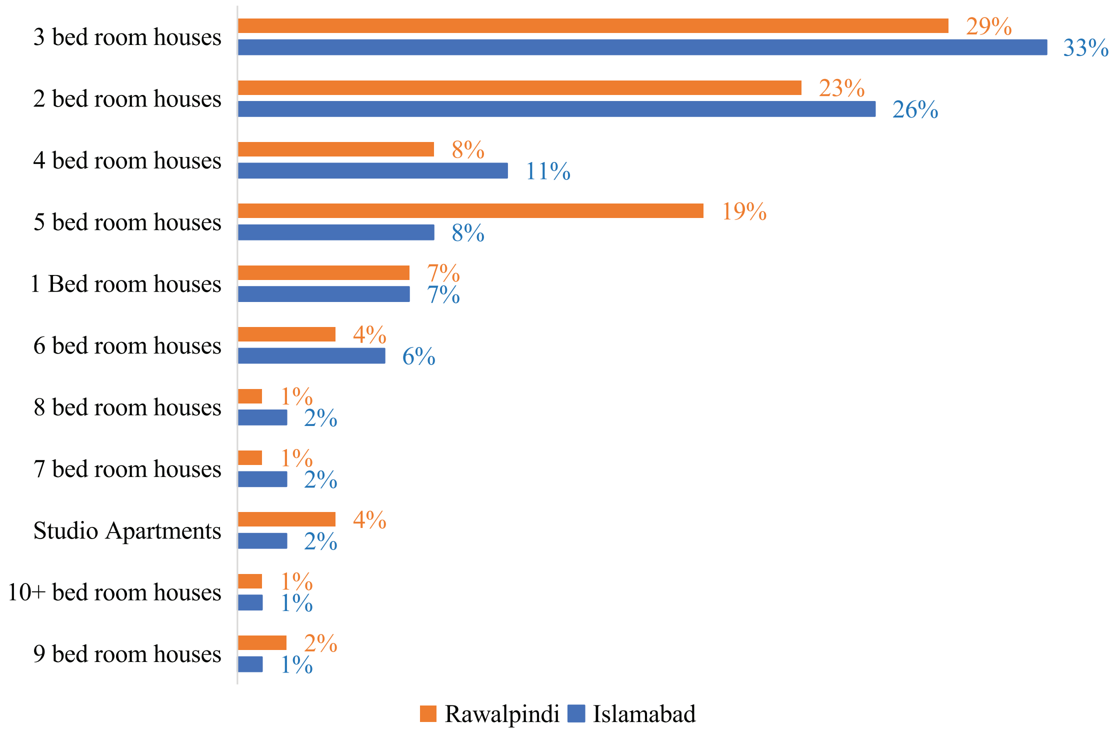
FIGURE 10.10 Houses for Sale by Number of Rooms: Twin Cities (Percent of Total Houses for Sale)



Source: Zameen.com

The majority of available houses for rent in both cities are 3-bedroom houses, having shares of approximately 33% in Islamabad and 29% in Rawalpindi. Two-bedroom houses for rent are 26% in Islamabad and 23% in Rawalpindi.

FIGURE 10.11 Houses for Rent by Number of Rooms: Twin Cities (Percent of Total Houses for Rent)



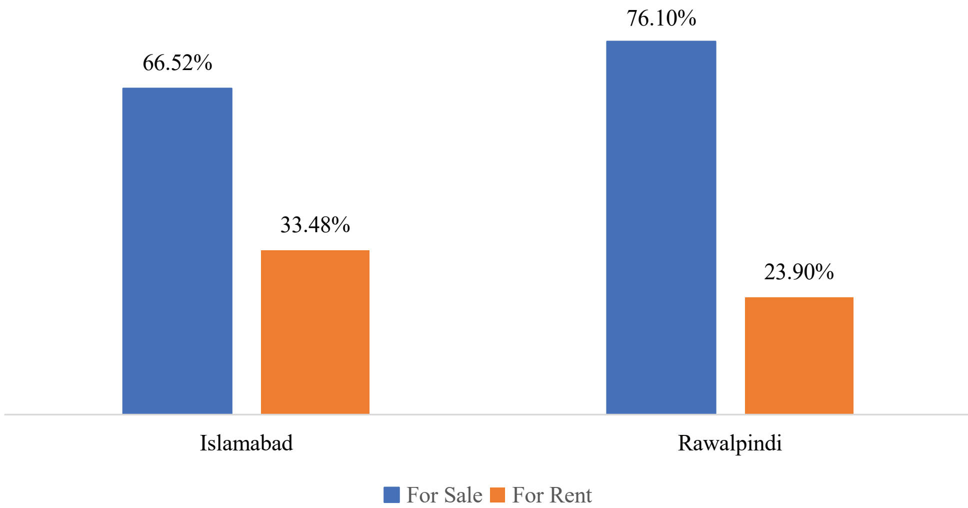
Source: Zameen.com

Classification by room count suggests that the residential real estate rental market is dominated by 2- and 3-bedroom houses, while the residential real estate sale market is dominated by 4- and 5-bedroom houses.

State of Commercial Properties

In the commercial real estate market, the properties that are available for sale are higher than the properties that are available for rent in both Islamabad and Rawalpindi. The share of properties for sale on the market is higher in Rawalpindi compared to Islamabad. The figure below presents the shares of properties for sale and rent in the real estate market of twin cities.

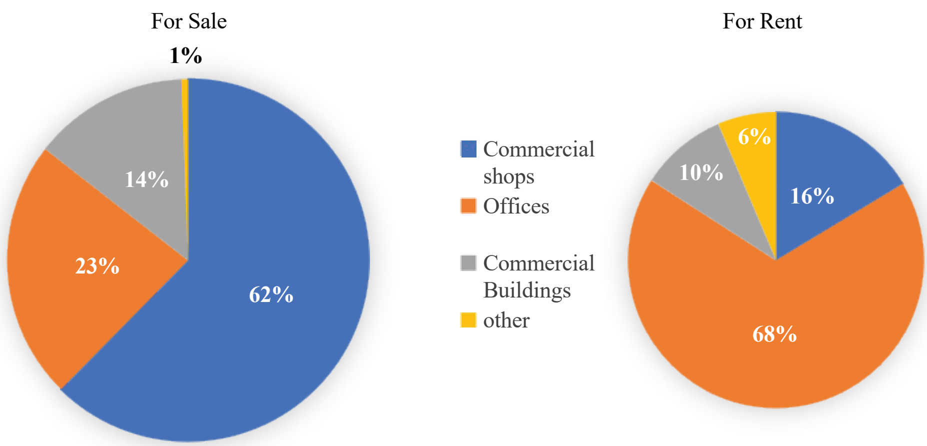
FIGURE 10.12 Commercial Properties By For Sale and Rent: Twin Cities



Source: Zameen.com

In Islamabad, the commercial real estate for sale is dominated by commercial shops, i.e., 62.4% followed by office spaces, which are 23.3%. However, in commercial rental real estate, the composition is different where 68% of the available real estate is for offices and the share of commercial shops is only 16.4%, as presented in the figure below.

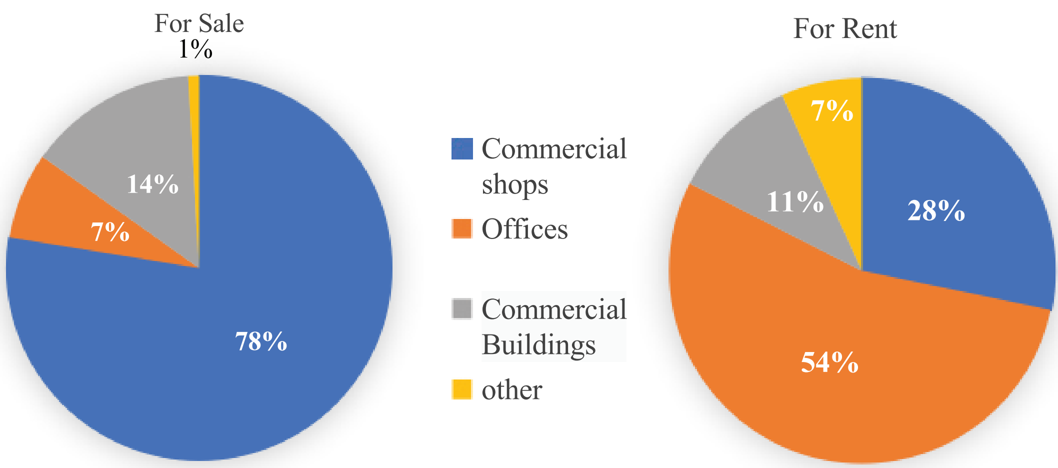
FIGURE 10.13 Commercial Real Estate Classification: Islamabad



Source: Zameen.com

The commercial real estate structure in Rawalpindi is similar to Islamabad. In Rawalpindi, 78% of the available real estate for sale is in the category of commercial shops and 54.2% of the rental real estate is space for offices. See Figure 10.14 for details.

FIGURE 10.14 Commercial Real Estate Classification: Rawalpindi

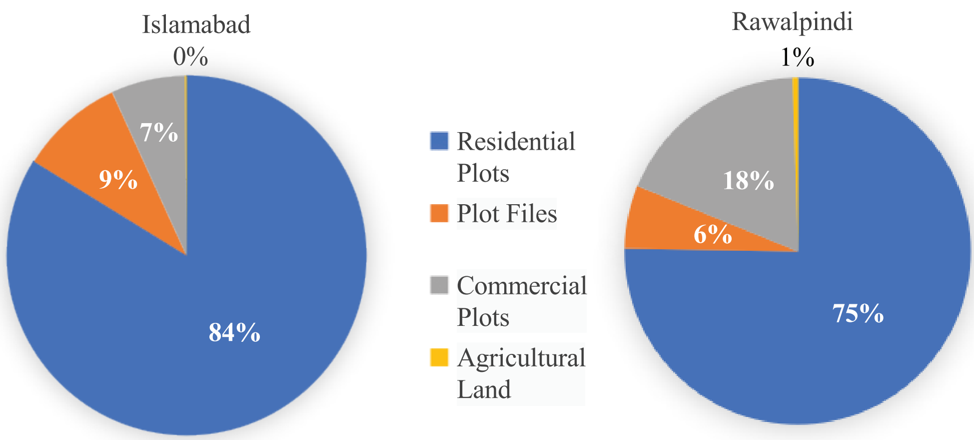


Source: Zameen.com

State of Plots

As discussed above, the real estate market of the twin cities is dominated by plots. In Islamabad 84% of the plots on the market are residential and the emphasis towards commercial and agricultural land is low. It is evident by the significantly small presence of commercial real estate as only 6.7% of the plots are commercial. Similarly, in Rawalpindi, 75% of the plots that are available for sale are residential and only 18% of them are commercial. This also suggests a limited availability of commercially developed properties in future.

FIGURE 10.15 Classification of Plots for Sale: Twin Cities



Source: Zameen.com

BOX 10.3 Dysfunctional Cities – Obsolete Rules

Pakistan cities are designed to promote single houses development, and rules are such that facilitate sprawls. Cities in Pakistan do not allow for the development of commercial centers and downtowns. Rules are laid down to promote housing and facilitate the cars through the development of roads. The space allocated for commercial and recreational activities is significantly low in the cities (Haque, 2015). The analysis presented in the previous section is largely explained by the rules, that allow such lop-sided development of the cities and real estate market. Rules for private housing societies are presented in the table below.

Land Use	Islamabad		Lahore
	Zones 2 & 5	Zone 4	
Residential	50%	50%	54%
Commercial & Parking	8%	5%	5%
Public Buildings	7%	5%	5-10%

Open/Green Space	10%	15%	7%
Graveyards	2%	2%	2%
Roads/Streets	23%	23%	25%
Miscellaneous			2%

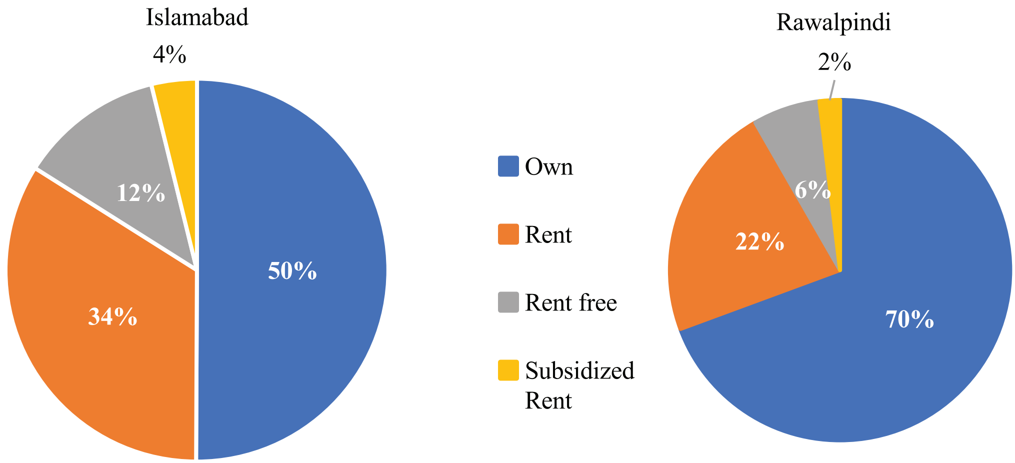
Source: Haque (2015); CDA

HOUSING BY TENURE IN TWIN CITIES

In Islamabad, 50% of households own housing units, while in Rawalpindi, a higher proportion of households, i.e., 70%, are homeowners. In terms of rental occupancy, Islamabad has a higher percentage of households living in rented housing units, with 34% compared to Rawalpindi's 22%. The housing rental market in Islamabad is relatively larger than in Rawalpindi.

Furthermore, rent-free accommodation is such an arrangement where households are residing without any rent, the percentage of households living in rent-free accommodations is higher in Islamabad at 12%, compared to Rawalpindi's 6%. Lastly, when it comes to accommodation provided by the government or any non-government agency on subsidized rent, Islamabad has a higher percentage of households benefiting from it at 4% compared to Rawalpindi's 2%. It indicates a greater presence of subsidized rental programs or initiatives in Islamabad.

FIGURE 10.16 Housing Tenure: Twin Cities



Source: PSLM 2019-20

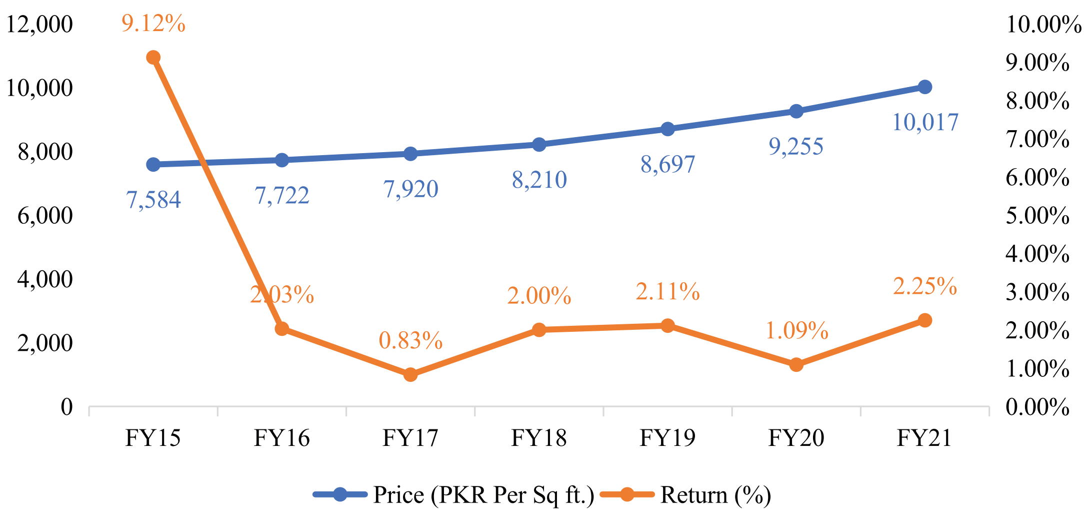
REAL ESTATE RETURNS [36]

In terms of annual returns and prices per square foot, plots and houses in Islamabad and Rawalpindi show similar trends. While the prices of both plots and housing have been increasing continuously, the returns associated with these investments have been declining and exhibit high volatility in Islamabad as well as in Rawalpindi.

[36] Real estate prices and returns in this section are only for Islamabad and Rawalpindi. For estimates for Pakistan on the whole see Chapter 5.

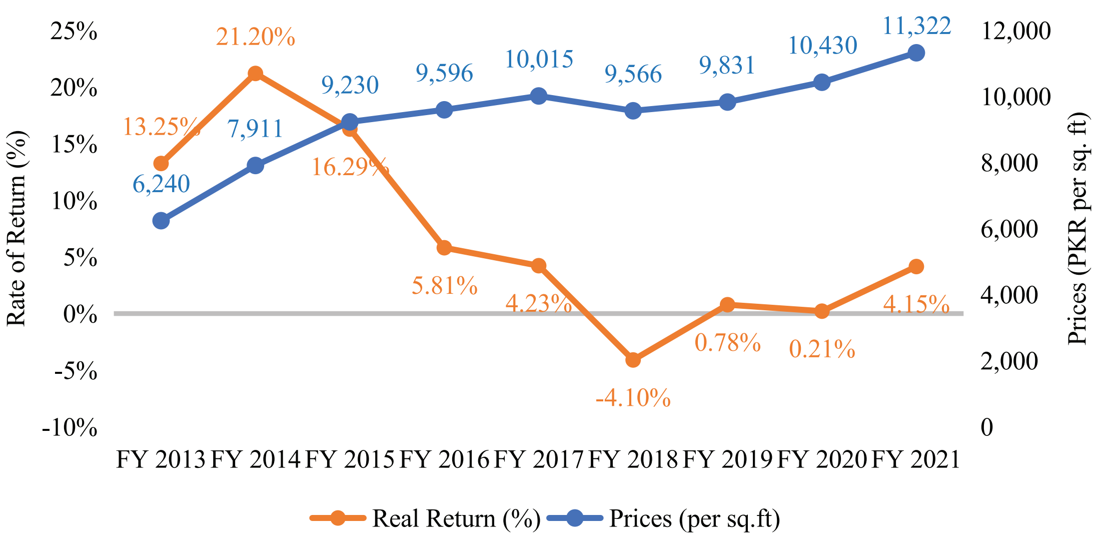
Real Estate Prices and Returns in Islamabad

FIGURE 10.17 Plot Prices and Real Returns: Islamabad



Source: Author's calculations based on zameen.com data.

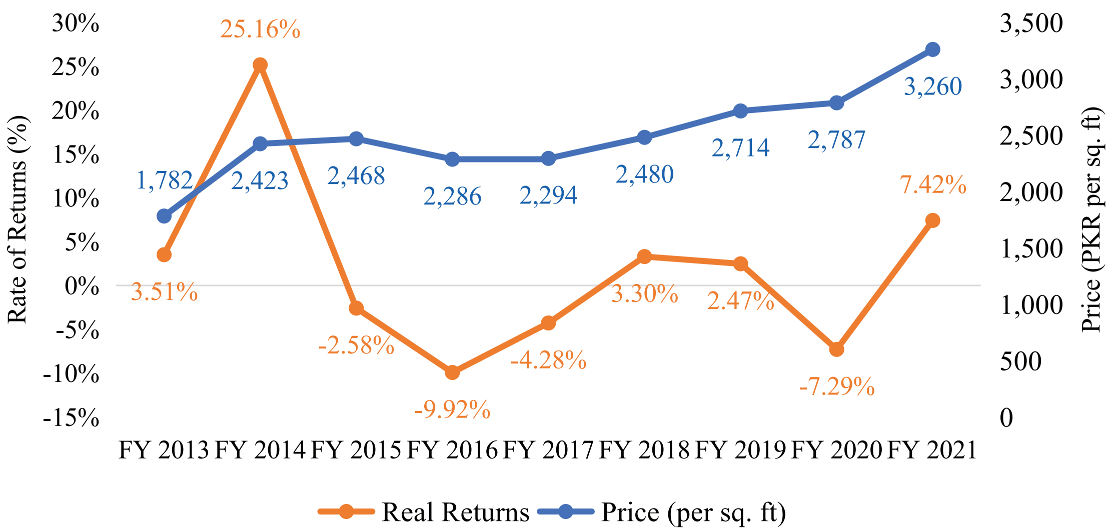
FIGURE 10.18 Housing Prices and Real Returns: Islamabad



Source: Author's calculations based on zameen.com data.

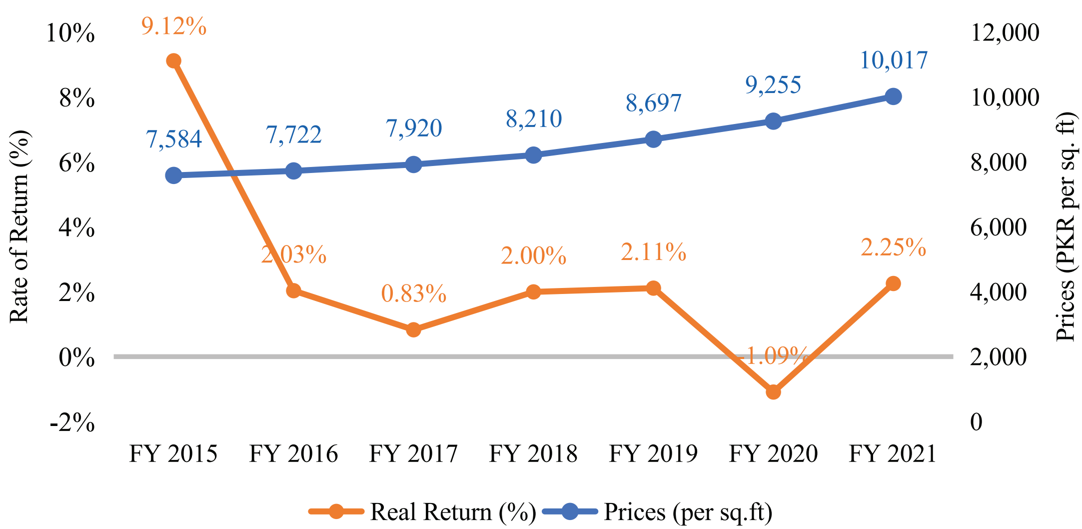
Real Prices Estate Returns in Rawalpindi

FIGURE 10.19 Plots Prices and Real Returns: Rawalpindi



Source: Author's calculations based on zameen.com data.

FIGURE 10.20 Housing Prices and Real Returns: Rawalpindi

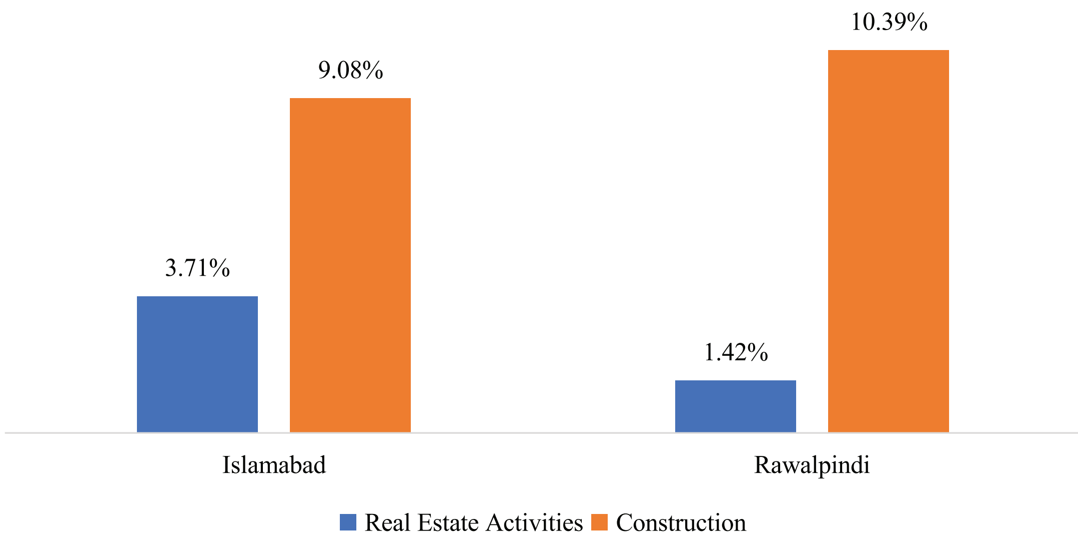


Source: Author's calculations based on zameen.com data.

EMPLOYMENT IN CONSTRUCTION AND REAL ESTATE IN TWIN CITIES

The construction industry employs a significant labor force in the economy. The construction sector in Islamabad employs approximately 9.08% of Islamabad's total employed workforce and the real estate sector employs around 3.71%. Collectively, both these sectors employ approximately 12.8% of the total employed workforce in Islamabad. Similarly, Rawalpindi's construction industry and real estate sector employ 11.81% of the total employed workforce. Of 11.81%, 10.39% are engaged in construction-related activities, while 1.42% are engaged in real estate-related activities.

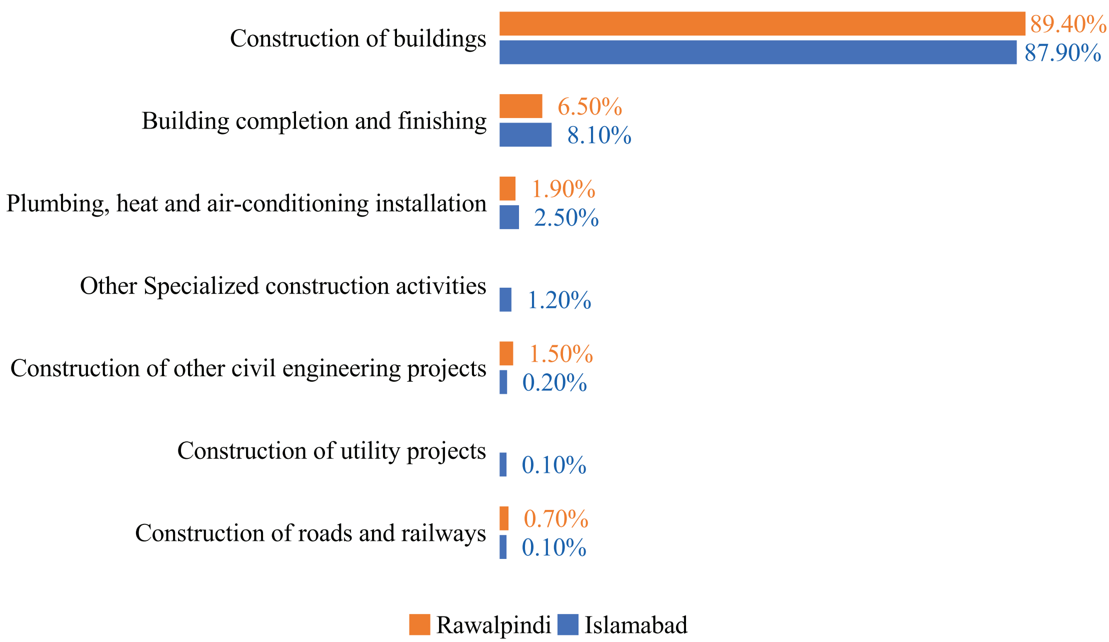
FIGURE 10.21 Employment in Real Estate and Construction (% of Total Employed Labor Force): Twin Cities



Source: PSLM 2019-20

The predominant source of employment within the construction sector in Islamabad and Rawalpindi is the construction of buildings. In Islamabad, 87.9% of the employed labor force in the construction sector is engaged in building construction, while in Rawalpindi, it accounts for 89.4%. Building completion and finishing activities employ 8.1% in Islamabad and 6.5% in Rawalpindi. The details are presented in Figure 10.22 below.

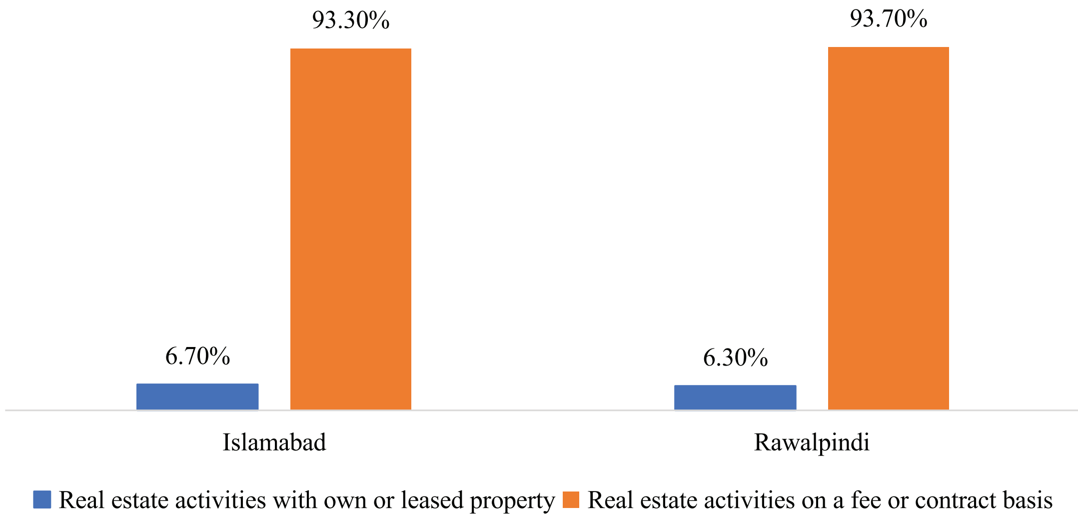
FIGURE 10.22 Distribution of Employment: Twin Cities



Source: Pakistan Social and Living Standard Measurement (PSLM) 2019-20

Among those involved in the real estate sector in Islamabad and Rawalpindi, over 93% are engaged in real estate activities that are conducted for a fee or under a contract, such as real estate agents who provide their services in exchange for compensation. However, the share of realtors who are engaged in real estate operations and services using their properties or properties that are leased by individuals or organizations is less in both the twin cities. See Figure 10.23 below.

FIGURE 10.23 Employment in Real Estate: Twin Cities

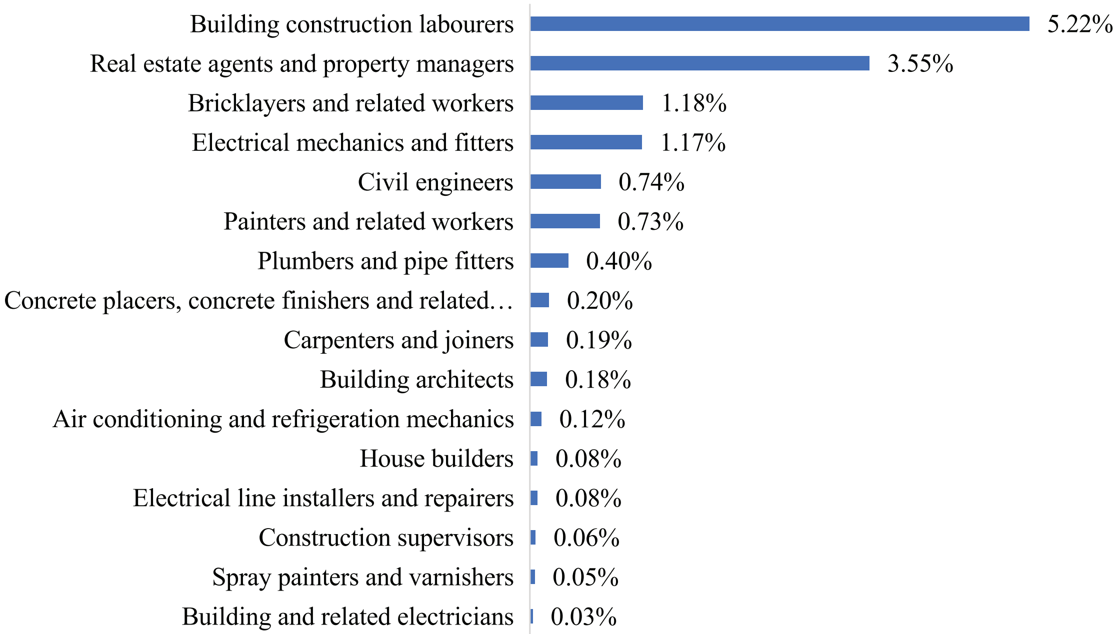


Source: PSLM 2019-20

EMPLOYMENT BY OCCUPATION IN CONSTRUCTION AND ALLIED SECTORS

The real estate and construction sectors employ the labor force in diverse occupations. The majority of the labor force of Islamabad in the real estate and construction sectors are working as building construction workers followed by real estate agents and property managers. Civil engineers account for 0.74% of the workforce and building architects 0.18%. Occupation-wise employment in both sectors in Islamabad is presented in the figure below.

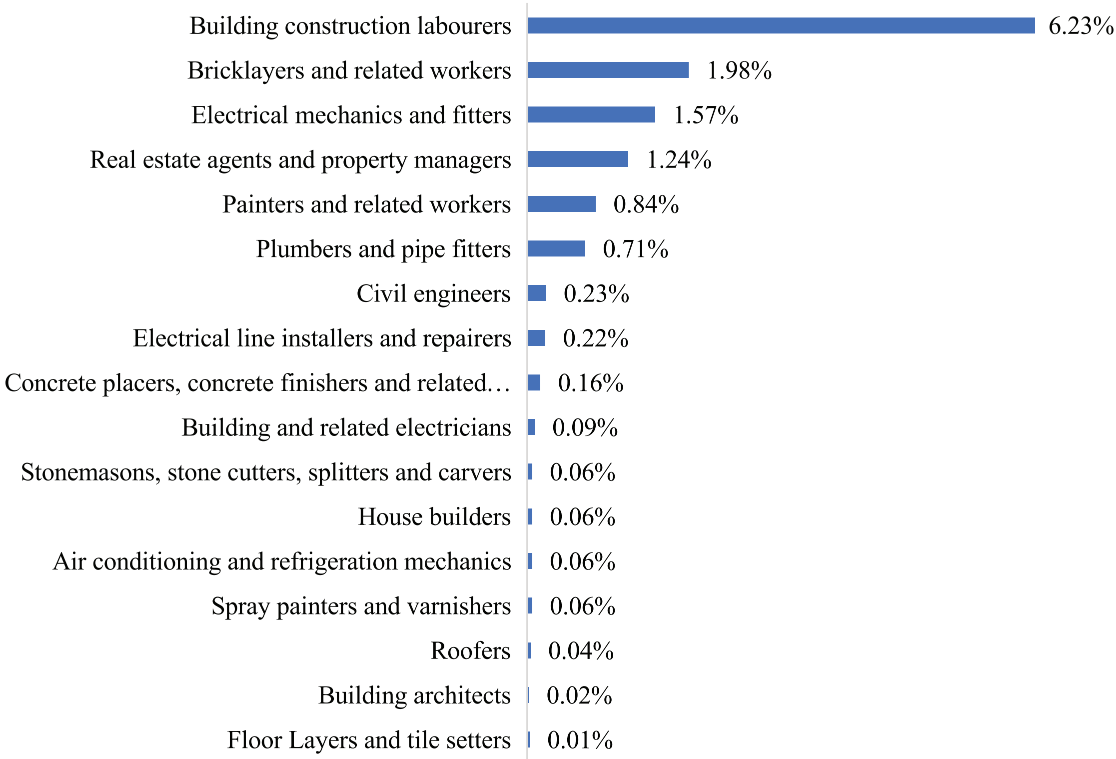
FIGURE 10.24 Employment by Occupation (% of Total Employed Labor Force): Islamabad



Source: PSLM 2019-20

In Rawalpindi, the primary occupation in the real estate and construction sectors is building construction workers, comprising approximately 6.23% of the workforce. On the other hand, the presence of real estate agents in Rawalpindi is significantly lower compared to Islamabad, accounting for only 1.24% of the employed labor force.

FIGURE 10.25 Employment by Occupation (% of Total Employed Labor Force): Rawalpindi

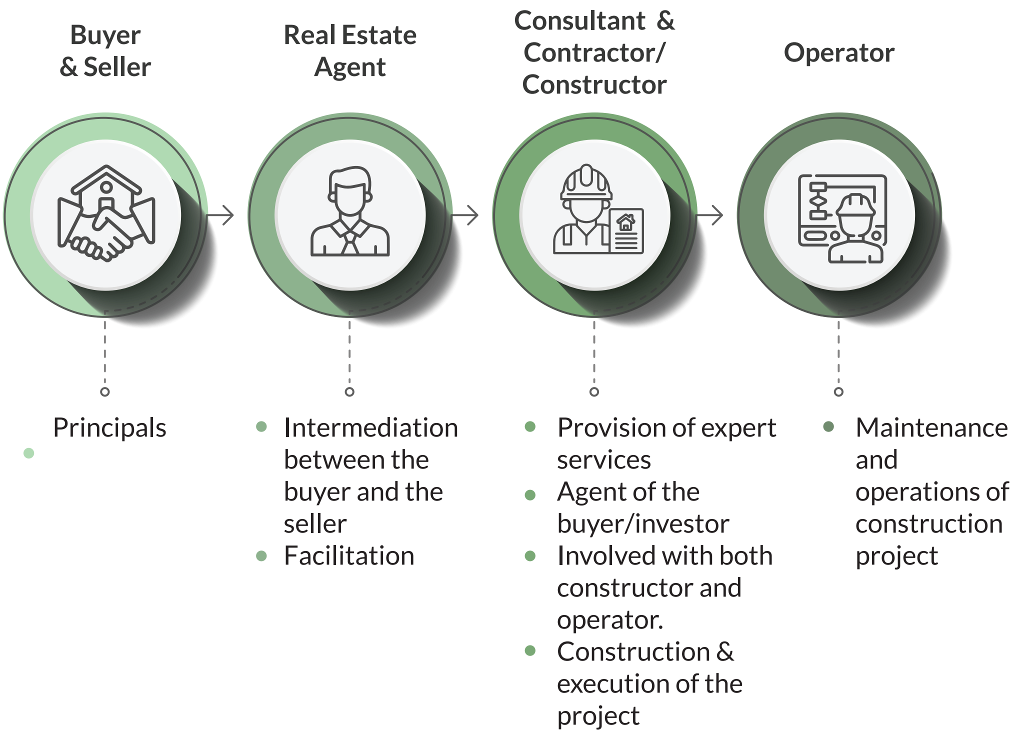


Source: PSLM 2019-20

SIZE OF CONSTRUCTORS, OPERATORS, AND CONSULTANTS IN ISLAMABAD

Constructors, operators, consulting engineering firms, and real estate marketing agencies are all important for the growth of the real estate and construction sectors. A constructor is someone who undertakes a construction project and is responsible for the construction of the project. An operator takes control of the project after the construction and is responsible for the maintenance and operation of the construction project. A consultant acts as an advisor and supervisor and guides the construction project, and a marketing agent advertises the construction project.

FIGURE 10.26 Real Estate and Construction Value Chain



Source: Author's illustration

The categorization and licenses of constructors and operators are approved by enrolment committees and sub-enrolment at the Pakistan Engineering Council (PEC). The categories are based on the work/project experience of the firm or that of the engineer employed in the firm and the net worth of the firm.

The firms owned by engineers need to provide proof of registration with the SECP if registering in category C-3/O-3 and above. Graduating to higher categories can be attained based on projects executed, the experience of the engineer, and the net worth of the firm. The firms that want to upgrade to C-1/O-1 and above categories need to be registered with SECP. The firms are also required to be registered with the tax authorities. The categorization is to ensure that the project is undertaken by the firm which possesses the capacity to do so, categories limiting the size of the project in monetary terms that operators/constructors can execute.

BOX 10.4 Real Estate Brokerage

Real estate agents (REA) play a significant role in buying and selling in the real estate market. REA requires no prior education/training and certification for functioning in the real estate market. The average wage of REA is 29% higher than the average wage of other professionals. As the market is mostly dominated by big developers, and the absence of a proper land pricing system, leaves the sellers and buyers at the behest of REA (Ullah & Najib, 2022). The cumbersome and complex rules for the transition of property and the unavailability of a central platform (Zameen.com has recently emerged as an online marketplace for the buying and selling of property, mostly the quotations on the website are largely by real estate agents) for selling and buying of real estate further necessitate the role of REA in the Market.

The REA brokerage market has limited competition, market inefficiencies and information asymmetry, due to which the real estate market is influenced by REAs. Influencing the prices, demand and supply of properties in the market (Ullah & Najib, 2022). Most properties are brought by these agents for speculative gains, as presented before in the case of Lahore where 75% of the plots were held by professional speculators (Zaman, 2012). REA have cartelized the market, and instead of facilitating the consumers, their sole purpose is profit maximization (Ullah & Najib, 2022).

Real Estate Agent Offices/Marketing agencies

As discussed above, 3.55% and 1.24% of the total labor force are real estate agents in Islamabad and Rawalpindi, respectively. The total number of real estate agent offices and marketing agencies in Islamabad is around 700.

Constructors

A constructor, often referred to as a contractor, is responsible for the physical construction of the project. It manages and executes the construction project. The total number of registered constructors in Pakistan is 21,808. Of these, 2,142 are registered in Islamabad and 964 in Rawalpindi. When it comes to undertaking large-scale construction projects, only 4% of constructors in Islamabad and 1% in Rawalpindi are registered to handle projects exceeding PKR 4,000 million. Similarly, a relatively small proportion of constructors, 8% in Islamabad and 4% in Rawalpindi can undertake construction projects valued at over PKR 1,000 million.

The majority of constructors in both cities fall under category C-6, which limits their capacity to take on projects up to PKR 25 million. This number suggests that a significant portion of constructors are focused on small-scale projects rather than large-scale developments. The category-wise division of constructors is given in Table 10.3 below.

TABLE 10.3 Classification of Constructors According to Project Cost (PKR Million)

Category	Project Cost (PKR Million)	Islamabad	Rawalpindi	Other Cities	Total	Islamabad (% of Total)	Rawalpindi (% of Total)
CA	No Limit	79	13	307	399	4%	1%
CB	Up to 4000	20	6	119	145	1%	1%
C1	Up to 2500	67	20	430	517	3%	2%
C2	Up to 1000	200	68	1,106	1,374	9%	7%
C3	Up to 500	280	80	1,910	2,270	13%	8%
C4	Up to 200	434	175	3,885	4,494	20%	18%
C5	Up to 65	442	237	5,235	5,914	21%	25%
C6	Up to 25	620	365	5,710	6,695	29%	38%
Total	--	2,142	964	18,702	21,808	--	--

Source: Pakistan Engineering Council

Operators

An operator is someone who undertakes the responsibility of ongoing management, maintenance, and operations of a completed construction project.

It is to ensure the efficiency and safety of the constructed project for the purpose it is intended for, mostly relevant in high-rise buildings, transportation infrastructure, utilities, and public facilities.

In Pakistan, the total number of operators is 179, with only 42 registered in Islamabad and 13 in Rawalpindi. These figures indicate a relatively smaller presence of registered operators in the region since only those operators and contractors that are registered with PEC and development authorities can undertake or bid for construction projects based on the specific category they are registered under. The registration with authorities ensures that they possess the capability and capacity required for construction activity. When considering their capacity to handle larger construction projects, the data shows that only 5% of operators in Islamabad and 8% in Rawalpindi are qualified to operate and maintain projects exceeding PKR 2,000 million. This suggests a limited number of operators equipped to handle high-value projects in both cities. The majority of operators in Islamabad, i.e., 24%, fall into the lowest category of O6. These operators are primarily capable of operating and maintaining construction projects up to PKR 20 million. On the other hand, in Rawalpindi, the majority of operators (46%) are classified under the O5 category, which allows them to operate and maintain construction projects up to PKR 30 million.

TABLE 10.4 Classification of Operators According to Project Cost (PKR Million)

Operators	Project Cost (PKR Million)	Islamabad	Rawalpindi	Others	Total	Islamabad (% of Total)	Rawalpindi (% of Total)
OA	No Limit	2	1	5	8	5%	8%
OB	Up to 2000	2	0	4	6	5%	0%
O1	Up to 1000	4	0	5	9	10%	0%
O2	Up to 500	7	1	12	20	17%	8%
O3	Up to 200	4	0	15	19	10%	0%
O4	Up to 100	6	1	23	30	14%	8%

O5	Up to 30	7	6	17	30	17%	46%
O6	Up to 20	10	4	43	57	24%	31%
Total	--	42	13	124	179	--	--

Source: Pakistan Engineering Council

Engineering Consulting Firms

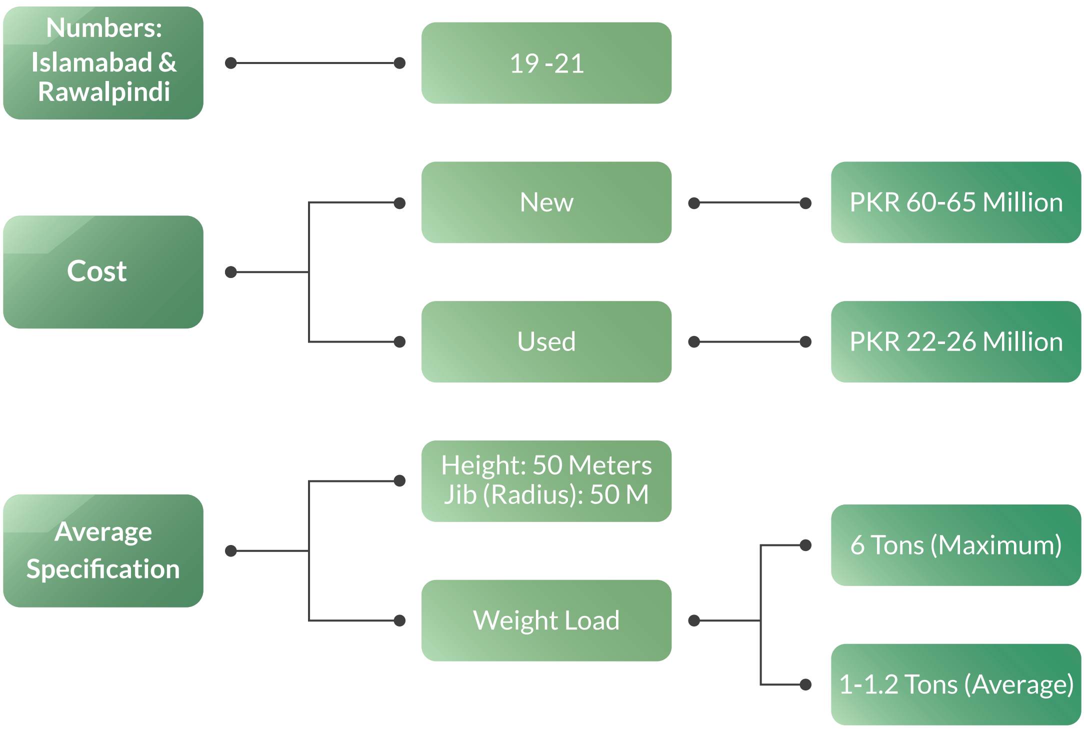
Engineering consulting firms have a significant role in the construction sector. They provide expertize, guidance, and specialized services for the successful execution of construction projects. The consulting firms provide a wide variety of services, i.e., feasibility studies and site analysis, design and planning, regulatory compliance services, construction supervision and quality control, and risk assessment. According to the data provided by the PEC, the total number of consulting firms that can provide consultancy services in Pakistan is 750. In Islamabad, there are 90 engineering firms and 37 in Rawalpindi.

TOWER CRANES

Tower cranes symbolize and indicate the development in construction activity around the world (Haque, 2022), specifically when the construction activity in question is in the form of high-rise vertical construction. Tower cranes are considered an indicator of the construction sector’s development due to their importance in large-scale construction projects, such as high-rise buildings, bridges, etc. The number of cranes offers a simple means to assess the construction sector's overall condition. Employing this indicator can yield insightful observations regarding the health of the construction sector (Bucknall, 2021). Moreover, as they are expensive to maintain and purchase, this also indicates the level of investment involved in the project.

The over-regulation of construction sectors clubbed with outdated masterplan discouraging vertical construction, caused the city to develop horizontally (Haque, 2015; Haque & Khurshid, 2023). This contained large-scale construction activity over the years. This is also evident from the number of tower cranes in the city. The current state of tower cranes in Islamabad and Rawalpindi is given in Figure 10.27 below.

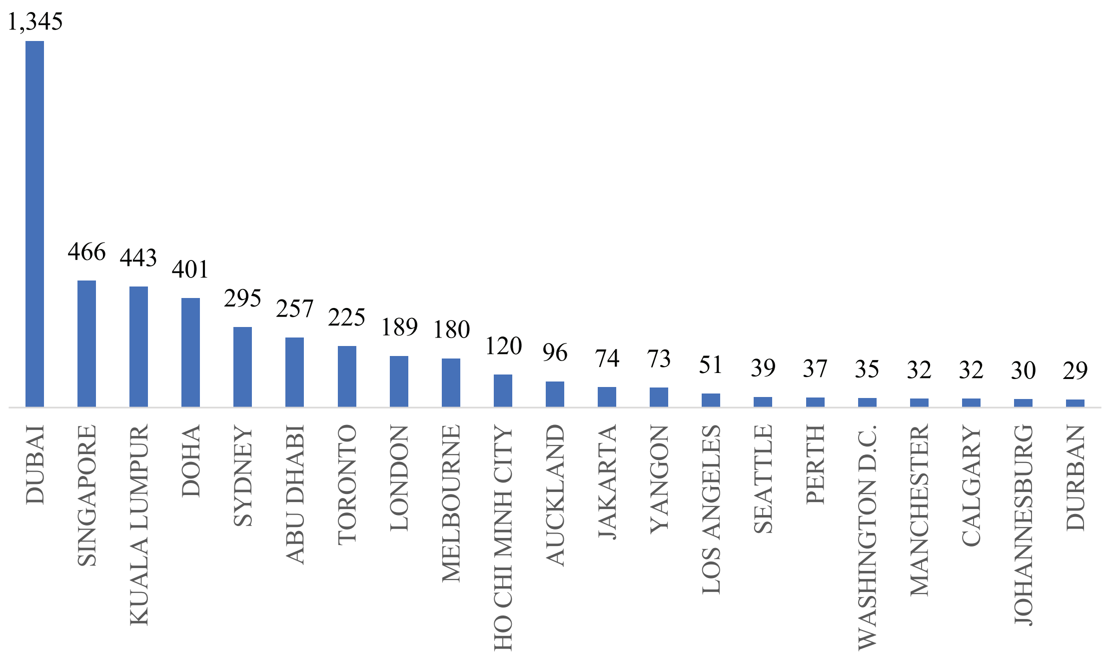
FIGURE 10.27 Tower Cranes in Twin Cities



Source: PIDE State of Commerce Survey

The number of tower cranes in twin cities ranges between 19 to 21, which is significantly low when compared with the number of cranes in cities around the world. The number of tower cranes in cities across the world is presented in Figure 10.27 below.

FIGURE 10.28 Tower Cranes (Numbers): In Cities Across the World



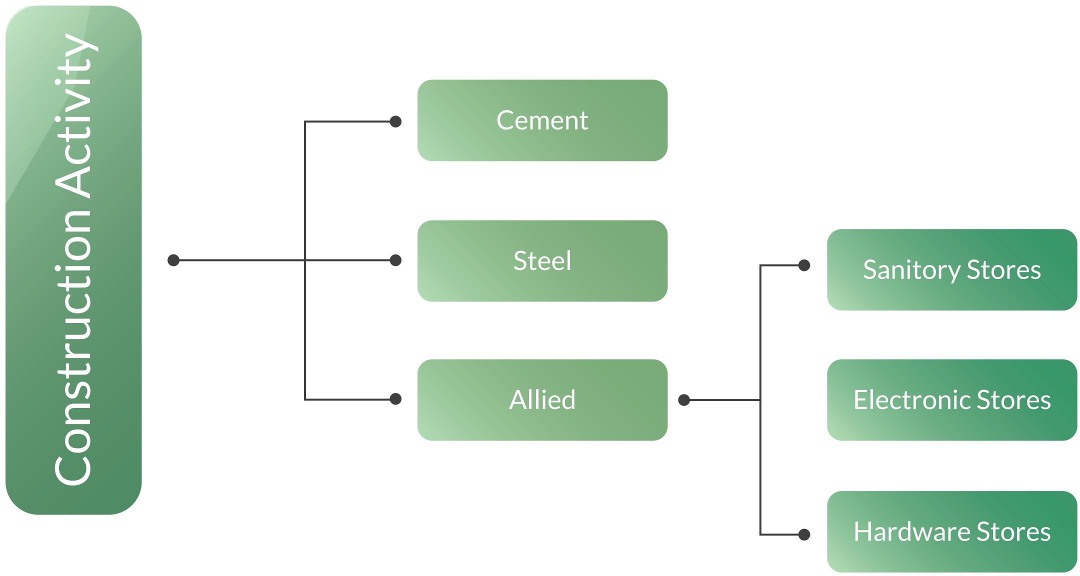
Source: Bucknall (2021)

CONSTRUCTION SECTOR AND ALLIED RETAIL ACTIVITY

The demand for sanitaryware, electronics, and hardware products is significantly influenced by construction activities. These stores are the primary suppliers of essential building materials, including hardware tools, plumbing supplies, electrical fixtures, sanitary fittings etc. Hence, to understand the state of the wholesale and retail in the construction and allied activities, a comprehensive survey of stores in the city was carried out. Data on sales, warehouse, and number of employees was collected. The store size is defined based on monthly sales.[37] The activities covered are presented in the figure below.

[37] Small stores: monthly sales of less than PKR 1 million; medium stores: monthly sales of greater than PKR 1 million but less than or equal to PKR 2 million; large stores: monthly sales of more than PKR 2 million.

FIGURE 10.29 Construction Sector & Allied Activities



Source: Author's illustration

Sanitary Stores

Islamabad

- Small stores account for 27% of the market and have average sales per month of PKR 0.83 million and total annual sales of PKR 541 million.
- Medium-sized stores, which account for 64% of the market, have average sales per month of PKR 1.22 million and total annual sales of PKR 1.9 billion.
- Large stores account for 9% of the market and have an average sales per month of PKR 11.33 million and total annual sales of PKR 2.6 billion.
- The total annual market size of sanitary stores in Islamabad is approximately PKR 5 billion, with a 0.03% share in the retail and wholesale trade sector's output.

- The total number of sanitaryware shops in Islamabad is 201 and the total labor employed at these stores is approximately 548.

TABLE 10.5 Sanitary Stores in Islamabad: A Snapshot

<table>
<tr><th>Size</th><th>Percent</th><th>Average Sales (PKR Million Per Month)</th><th>Total Sales (PKR Million Per Month)</th><th>Average Warehouse Per Shop</th><th>Average Employee Per Shop</th><th>Total Employees</th></tr>
<tr><td>Small</td><td>27%</td><td>0.83</td><td>45.12</td><td>1</td><td>2</td><td>108</td></tr>
<tr><td>Medium</td><td>64%</td><td>1.22</td><td>156.30</td><td>2</td><td>3</td><td>383</td></tr>
<tr><td>Large</td><td>9%</td><td>11.33</td><td>213.56</td><td>2</td><td>3</td><td>56</td></tr>
<tr><td rowspan="2">Total</td><td rowspan="2">100%</td><td>Total Monthly Sales (PKR Million)</td><td>414.98</td><td>--</td><td>--</td><td>548</td></tr>
<tr><td>Total Annual Sales (PKR Million)</td><td>4,979.77</td><td>--</td><td>--</td><td>--</td></tr>
</table>

Source: PIDE State of Commerce Survey

Rawalpindi

- Small stores account for 4% of the market and have average sales per month of PKR 0.83 million.
- Medium-sized stores, which account for 38% of the market, have an average sale per month of PKR 1.55 million.
- Large stores account for 53% of the market and have the highest average sales per month of PKR 3.61 million.

TABLE 10.6 Sanitaryware Stores in Rawalpindi: A Snapshot

Size	Percent	Average Sales (PKR Million Per Month)	Total Sales (PKR Million Per Month)	Average Warehouse Per Shop
Small	10%	0.83	1	2
Medium	38%	1.55	2	3
Large	53%	3.61	2	4

Source: PIDE State of Commerce Survey

Hardware Stores

Islamabad

- The total annual market size of hardware products in Islamabad is approximately 4.9 billion PKR with a 0.03% share in the retail and wholesale trade sector's output.
- Small stores, which account for 42% of the market, have an average monthly sale of PKR 0.76 million and total annual sales of PKR 783 million.
- Medium stores, which account for 50% of the market, have an average monthly sale of PKR 1.20 million and total annual sales of PKR 1.5 billion.
- Large stores account for 8% of the market share and have an average monthly sales of PKR 13.83 million and total annual sales of PKR 2.7 billion.
- The total number of hardware stores in Islamabad is approximately 204 with around 500 workers employed.

TABLE 10.7 Hardware Stores in Islamabad: A Snapshot

Size	Percent	Average Sales (PKR Million Per Month)	Total Sales (PKR Million Per Month)	Average Warehouse Per shop	Average Employee Per Shop	Total Employees
Small	42%	0.76	65.28	1	2	172
Medium	50%	1.20	122.01	2	3	306
Large	8%	13.83	221.33	2	3	48
Total	100%	Total Monthly Sales (PKR Million)	408.62	--	--	526
		Annual Sales (PKR Million)	4,903.47	--	--	--

Source: PIDE State of Commerce Survey

Rawalpindi

- Small stores, which account for only 2% of the market, have an average monthly sale of PKR 0.9 million.
- Medium stores account for 24% of the market and have an average monthly sales of PKR 1.49 million.
- The share of large hardware stores is 73% of the market, with average monthly sales of PKR 4.10 million.

TABLE 10.8 Hardware Stores in Rawalpindi: A Snapshot

Size	Percent	Average Sales Per Month (PKR Million)	Average Number of Warehouses	Average Number of Employees
Small	2%	0.9	1	3
Medium	24%	1.49	2	3
Large	73%	4.10	2	4

Source: PIDE State of Commerce Survey

Electric Stores

Islamabad

- The total annual market size of electric stores in Islamabad is approximately PKR 4.74 billion, with a 0.03% share in the retail and wholesale trade sector's output.
- Small stores, which account for 48% of the market, have an average monthly sales of PKR 0.75 million and total annual sales of PKR 1.1 billion.
- Medium stores, which account for 46% of the market, have an average monthly sales of PKR 1.29 million and total annual sales of PKR 1.84 billion.
- Large stores, which account for 6% of the market, have an average monthly sale of PKR 9.53 million and total annual sales of PKR 1.77 billion
- The total number of electronic stores in Islamabad is approximately 261, with around 656 workers employed at these stores.

TABLE 10.9 Electric Stores in Islamabad: A Snapshot

Size	Percent	Average Sales (PKR Million Per Month)	Total Sales (PKR Million Per Month)	Average Warehouse Per Shop	Average Employee Per Shop	Total Employees
Small	48%	0.75	94.20	1	2	252
Medium	46%	1.29	153.61	2	3	358
Large	6%	9.53	147.53	2	3	46
Total	100%	Total Monthly Sales (PKR Million)	395.35	--	--	657
		Annual Sales (PKR Million)	4,744.18	--	--	--

Source: PIDE State of Commerce Survey

Rawalpindi

- In Rawalpindi, small-sized electronics stores account for 10% of the total electronics stores. These stores have an average monthly sales of PKR 0.78 per million.

- Medium stores, which account for 28% of the market for electronics, have an average monthly sale of PKR 1.55 million.

- Lastly, large electronics stores account for 62% of the market and have an average monthly sale of PKR 4.05 million.

TABLE 10.10 Electronics Stores in Rawalpindi: A Snapshot

Size	Percent	Average Sales Per Month (PKR Million)	Average Number of Warehouses	Average Number of Employees
Small	10%	0.78	1	2
Medium	28%	1.55	1	3
Large	62%	4.05	2	3

Source: PIDE State of Commerce Survey

Cement [38]

Islamabad

- In Islamabad, the market size of cement agencies and outlets per annum is significant, i.e., PKR 41.8 billion with a 0.26% share in the retail and wholesale trade sector's output.
- Out of the total cement agencies and outlets in Islamabad, 8% of the stores are set up in containers [39], 20% sell just cement, and 72% of the agencies or outlets sell cement, bricks, and other construction materials, such as sand, crush, etc. The total number of cement agencies and cement retailers in Islamabad is approximately 65.
- The majority of cement agencies have a warehouse for the storage of stock. On average, each shop has one warehouse. However, the structure of cement outlets is different as 8% of the cement outlets are in temporary containers with a warehouse nearby for storage of cement bags.
- The majority of them are retailers and sell up to 200 bags. In the case of

[38] For the cement stores, the size is determined based on per-day sales.

[39] Regulatory authorities do not allow the sale of cement within developed sectors, therefore, cement agencies have to be set up in a container for the sale of cement in developed sectors of Islamabad.

more demand, the request is made to the cement mill and the requested quantity is dispatched from the mill to the customer's location within 2 days.

TABLE 10.11 Cement Outlets in Islamabad: A Snapshot

<table>
<tr><th>Size</th><th>Percent</th><th>Average Sales Per Day (PKR Million)</th><th>Total Sales (PKR Million)</th><th>Average Warehouse Per Outlet</th><th>Average Employees Per Outlet</th><th>Total Employees</th></tr>
<tr><td>Small</td><td>78%</td><td>0.67</td><td>33.94</td><td>1</td><td>3</td><td>152</td></tr>
<tr><td>Medium</td><td>7%</td><td>1.10</td><td>5.30</td><td>1</td><td>3</td><td>14</td></tr>
<tr><td>Large</td><td>15%</td><td>8.00</td><td>77.04</td><td>2</td><td>3</td><td>29</td></tr>
<tr><td rowspan="3">Total</td><td rowspan="3">100%</td><td>Total Sales Per Day (PKR Million)</td><td>116.28</td><td>--</td><td>--</td><td>195</td></tr>
<tr><td>Total Monthly Sales (PKR Million)</td><td>3,488.33</td><td>--</td><td>--</td><td>--</td></tr>
<tr><td>Annual Sales (PKR Million)</td><td>41,860.01</td><td>--</td><td>--</td><td>--</td></tr>
</table>

Source: PIDE State of Commerce Survey

Rawalpindi

Based on average monthly sales, all the cement agencies and outlets in Rawalpindi are large-sized with an average monthly sales of PKR 7.3 million. The average number of employees working in these stores is 2 and each agency or retail outlet has its warehouse.

Steel

Islamabad

In Islamabad, as per the Pakistan Steel Melters Association, the total number of steel mills in Islamabad is 14. As per PIDE State of Commerce Survey (2022), the average sale per month is 3,257 tons and the average number of employees working at steel mills is around 100 employees per steel mill.

Rawalpindi

In Rawalpindi, according to the PIDE State of Commerce Survey (2022), per-day average sales of still mills in Rawalpindi are 34 tons. These mills, own warehouses of their own and employ 3 workers, on average.

CONCLUSIONS

- The real estate and construction sector of the twin cities presents a grim picture owning to an overwhelming number of illegal housing societies in both cities.

- The real estate market composition is dominated by the presence of plots in the markets, and the share of commercial real estate is significantly small. Less commercial space and an abundance of plots are the result of policies and regulations related to land in twin cities, such regulations encourage sprawl and horizontal expansion of the city.

- Given the high share of plots in twin cities and the inclination of the market towards ownership of residential properties - evident from the housing tenure - the majority of transaction in properties is based on sale, as evident from the high share of properties available for sale in the market.

- Even though the properties available for sale are higher, the real return on investment in housing and plots in the twin cities depicts a decreasing trend, despite that the prices of the properties are increasing.

- In terms of employment opportunities, the share of the labor force engaged in the construction and real estate sectors in twin cities is around 12% of the total employed labor force, with the majority of them working in the construction of buildings. The share of building construction laborers in the total employed labor force by occupation is around 6% in twin cities, followed by real estate agents and property managers.
- The capacity to undertake large-scale construction projects based on value inferred from the number of registered operators and constructors is significantly low in twin cities.
- This is also apparent from the small number of tower cranes, indicating less large-scale high-rise construction in twin cities.
- The construction-related retail activity in twin cities only in hardware, sanitary, electronic and cement stores is enormous, only retail activity in Islamabad accounts for 0.35% of the retail and trade output in the GDP of Pakistan.

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APPENDICES

APPENDIX 1A EXPORTS PROCESSING ZONE RULES

TABLE 1A.1 Terms of Import Policy Order for Machinery in Export Processing Zones

No.	Disposal Period	Duty and Taxes
1	If sold or otherwise disposed of before the expiration of three years from the date of import in the EPZ	Full
2	If sold or otherwise disposed of after three years and before four years from the date of import in the EPZ	75%
3	If sold or otherwise disposed of after four years and before five years from the date of import in the EPZ	50%
4	If sold or otherwise disposed of after five years from the date of import in the EPZ	0%

TABLE 1A.2 Duty-Free Import of Vehicles Subject to Quantum of EPZ Investment

S. No.	Quantum of Investment in EPZ	Vehicles Allowed
1	USD 10 million or more up to USD 25 million	3
2	More than USD 25 million but less than USD 50 million	5
3	Equal to or more than USD 50 million but less than USD 75 million	10
4	Equal to or more than USD 75 million but less than USD 100 million	15
5	Equal to or more than USD 100 million but less than USD 125 million	20
6	Equal to or more than USD 125 million	25

APPENDIX 1B EXPORTS FINANCE SCHEME RULES

TABLE 1B.1 Documentation Requirement for Export Finance Scheme

Nature of Financing	Direct Exporter	Indirect Exporter
A. Pre-Shipment	• Firm export order/contract/letter of credit • Application/undertaking as per Form B • D.P. note	• Inland letter of credit/standardization purchase order • Application/undertaking as per Form C
B. Post-Shipment	• Firm export order/contract/letter of credit along with acceptance from the buyer in case of discrepant documents • Application/undertaking as per Form B • Original duplicate copy of Form E • Bill of lading/airway bill • Invoice	• No facility

Source: SBP, Infrastructure, Housing & SME Finance Department, Export Finance Scheme Guidelines, March 2012

TABLE 1B.2 Shipping Documents Required by Financing Banks

Nature of Financing	Direct Exporter	Indirect Exporter
A. Pre-Shipment	Original duplicate copy of Form E bill of lading/airway bill (non-negotiable copy) OR FCRs provided that document is against L/C and Mate's Receipts (M.R. – where the shipment is by sea) or Export General Manifest (EGM) where the shipment is by air)	• Invoice • Truck/railway receipt. • Goods received Note GRN/Delivery Challan signed by the buyer
B. Post-Shipment	• E.P.R.C. to be submitted within 210 days (270 days for carpet exports) from the date of shipment of an export bill, or within 30 days of the expiry of the period prescribed by our Exchange Policy Department.	NA

Source: SBP, Infrastructure, Housing & SME Finance Department, Export Finance Scheme Guidelines, March 2012

TABLE 1B.3 Fines Under Export Finance Scheme

S. No.	Nature of Irregularity	Rate of Fine
i.	Non-Shipment	Paisa 37 per day per PKR 1,000 or part thereof
ii	Short/Delayed Shipment	Paisa 28 per day per PKR 1,000 or part thereof
iii.	Late adjustment of funds by a bank against repayment made to it.	Paisa 42 per day per PKR 1,000 or part thereof
iv.	Fine for delayed submission of shipping documents by the exporters	PKR 2,000 for the default and PKR100 per day for each day of default
v.	Fine for wrong information and incorrect reporting/entry in any Statement required to be furnished to the State Bank of Pakistan	PKR 100 per such wrong /incorrect reported entry
vi.	Fine for non-submission of EPRC by the bank within the prescribed period.	PKR 20,000, 25% of which i.e. PKR 5,000, would be non-refundable even on late submission of EPRC.
vii.	Fine for irregular availing of pre-shipment/post-shipment export finance facility by exporters	In all pre-shipment/post-shipment loans cases where it has been noticed that shipment(s) was made before/after (in the case of post-shipment) disbursement of finance, the shipment has to be treated as in order subject to recovery of fine at the rate of PKR 2,000 and PKR 100 per day for the period for which the refinance loan remains outstanding on the part of the bank or up to the date of factual position conveyed to

		concerned SBP BSC Office, whichever is earlier.
viii.	Short-fall in performance	In case of non-performance, a fine shall be charged at the rate of Paisa 37 per PKR 1,000 or part thereof (Product). However, where performance is in excess of 50% of the prescribed level, a fine shall be charged at the rate of Paisa 28 per PKR 1,000 of the shortfall or part thereof.
xi.	Fine for any other default by the exporter/bank	Paisa 37 per day per PKR 1,000 or part thereof, however, depending upon the nature of irregularity by the exporter and/or bank or both, in administering the Scheme, such as misuse of the facilities, utilization of the Scheme on fraudulent and or tempered documents etc, SBP may also consider placing an embargo for a period of one year on the bank and / or exporter or both for availing financing facilities under EFS.
x.	Fine for wrong information and incorrect reporting/entry in the statement (EF-1, EE-1 or in any other Forms required to be submitted to SBP.	PKR 100 per wrong entry

Source: SBP, Infrastructure, Housing & SME Finance Department, Export Finance Scheme Guidelines, March 2012.

TABLE 1B.4 Eligibility Criteria for Availing LTFF for Plant & Machinery

Developmental Category	Criteria
Fisheries	Plant & machinery used for boat manufacturing/modifications including chilling equipment.
Poultry & Meat	Plant & machinery used for hatching purposes and equipment for preservation/packing/canning chicken & meat.
Fruits/Vegetable & Processing, Cereals	Plant & machinery used for setting up of units for the purpose of preservations/packaging/canning of fruits/vegetables & producing cereals as well as plant & machinery required for producing material exclusively used in packaging/preservation of food items.
I.T. – Software & Services	Hardware and other equipment for IT & Services sector exports.
Marble & Granite	Plant and equipment used for cutting and polishing of marble & granite products for export and manufacturing of handicrafts thereof. Islamic Long-Term Financing Facility for Plant and Machinery
Gems & Jewelry	Plant and equipment used for cutting and polishing gems and machinery for making jewelry.
Engineering goods	
Generators / Captive Power Plants	Generators / captive power plants, used in the eligible sectors / sub-sectors.
Ethanol	Plant, machinery & equipment used by the export-oriented projects for producing ethanol.
Furniture	Plant, machinery & equipment used in the furniture sector for producing exportable goods.

Pharmaceutical	Plant, machinery & equipment used in pharmaceutical sectors for producing exportable goods.
Spinning and Ginning Sectors	Plant, machinery & equipment used in Spinning and Ginning Sectors.
Regeneration of textile waste	Plant, machinery & equipment used for the regeneration of textile waste into usable fiber for producing value-added exportable products are eligible to the extent of 50%.
Glass Sector	Plant, machinery & equipment to be used by the export-oriented projects in the glass sector for producing exportable goods.
Dairy Sector	Plant, machinery & equipment used for storage, chilling, processing, and packaging of dairy products including machinery used in the conversion/preservation of milk into powdered form.
Soda Ash	Plant, machinery & equipment to be used by the export-oriented projects for producing soda ash.

Source: State Bank of Pakistan (n.d.)

APPENDIX 1C LONG-TERM FINANCING FACILITY (LTFF) FOR PLANT & MACHINERY: SCOPE AND ELIGIBILITY

a. Participating Financial Institutions (PFIs) can offer long-term local currency financing under the LTFF for new imported and domestically produced machinery and plants utilized in export-oriented projects (Sectors allowed as per the Export Policy Order issued by the Ministry of Commerce from time to time are eligible under the scheme).

b. The State Bank of Pakistan's website provides a list of banks and DFIs that have been authorized as PFIs and through which financing can be obtained. Other banks and DFIs may submit requests to the Infrastructure, Housing & SME Finance Department of SBP to inquire about the status of a PFI. These requests will be handled per SBP's standards, which are as follows:

   i. Banks/DFIs should meet the minimum capital adequacy requirements set by SBP from time to time.

   ii. Banks / DFIs should have a minimum of 3 years of experience in in-project financing/long-term financing.

   iii. Banks / DFIs should have had profitable operations during the last consecutive three years.

   iv. SBP would consider the requests of banks/DFIs keeping in view the CAELS ratings assigned by SBP as well as ratings assigned by Credit Rating Agencies in Pakistan.

c. IH&SMEFD Circular No. 01 (dated February 14, 2018), states that SBP has issued the Islamic Long-Term Financing Facility (ILTFF) to offer a Shariah-compliant alternative to the facility through the qualified Islamic banking institutions (IBIs).

d. The amount of financing under the facility will depend on the C&F value of the new imported equipment and the ex-factory/showroom price of the new equipment made in the country that the qualified borrowers must acquire.

e. Export-oriented SME borrowers (as defined by the Prudential Regulations for SMEs Financing) are permitted to buy imported machinery from commercial importers, authorized dealers of foreign manufacturers in Pakistan, and approved suppliers for locally produced machinery and plant.

f. Under the LTFF, banks, and DFIs may only provide up to PKR 5 billion in funding to a single export-oriented firm. But banks and DFIs may offer financing options over the specified maximum level from their resources per their credit rules subject to compliance with relevant Prudential Regulations.

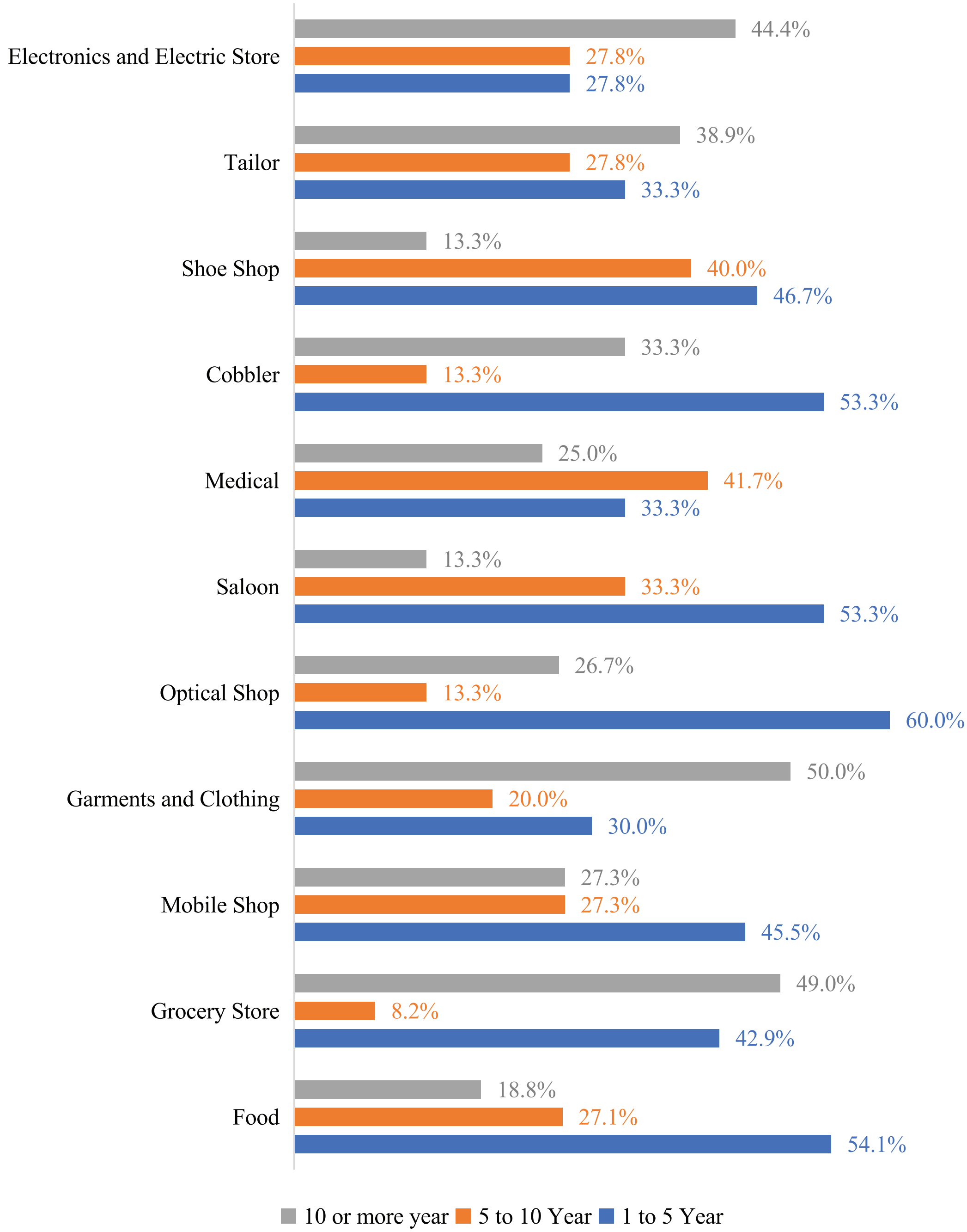
APPENDIX 4A CATEGORY-WISE DOMESTIC COMMERCE IN TWIN CITIES

TABLE 4A.1 Category-Wise Size of Outlets (Percent)

No.	Category	Small	Medium	Large
1	Garments and Clothing	46.7	50.0	3.3
2	Automobile Shop	33.3	66.7	0.0
3	Food	62.4	28.2	9.4
4	Grocery Store	55.1	34.7	10.2
5	Electronics and Electric Store	55.6	44.4	0.0
6	Shoe Shop	46.7	53.3	0.0
7	Saloon	100.0	0.0	0.0
8	Hardware Store	33.3	66.7	0.0
9	Medical	33.3	62.5	4.2
10	Mobile Shop	63.6	36.4	0.0
11	Computer and ICT	0.0	100.0	0.0
12	Tailor	88.9	11.1	0.0
13	Book Shop	47.6	28.6	23.8
14	Meat Shop	60.0	40.0	0.0
15	Toys and Gift Shop	44.4	55.6	0.0
16	Sports Shop	0.0	100.0	0.0
17	Cigarettes and Vape Shop	0.0	100.0	0.0
18	Optical Shop	60.0	40.0	0.0
19	Goldsmith	66.7	33.3	0.0
20	Courier and Post	50.0	50.0	0.0
21	Cobbler	100.0	0.0	0.0
22	Construction (cement, bricks, etc.)	0.0	0.0	100.0
23	Pan Shop	87.5	0.0	12.5
24	Others	100.0	0.0	0.0

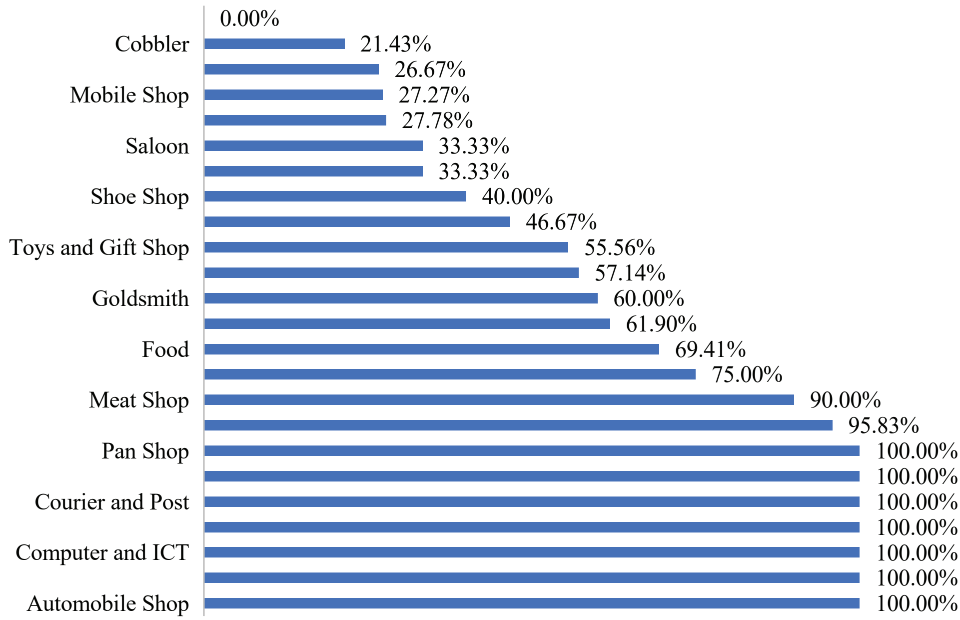
Source: PIDE State of Commerce Survey

FIGURE 4A.1 Number of Years in Operation: Category-Wise (Percent)



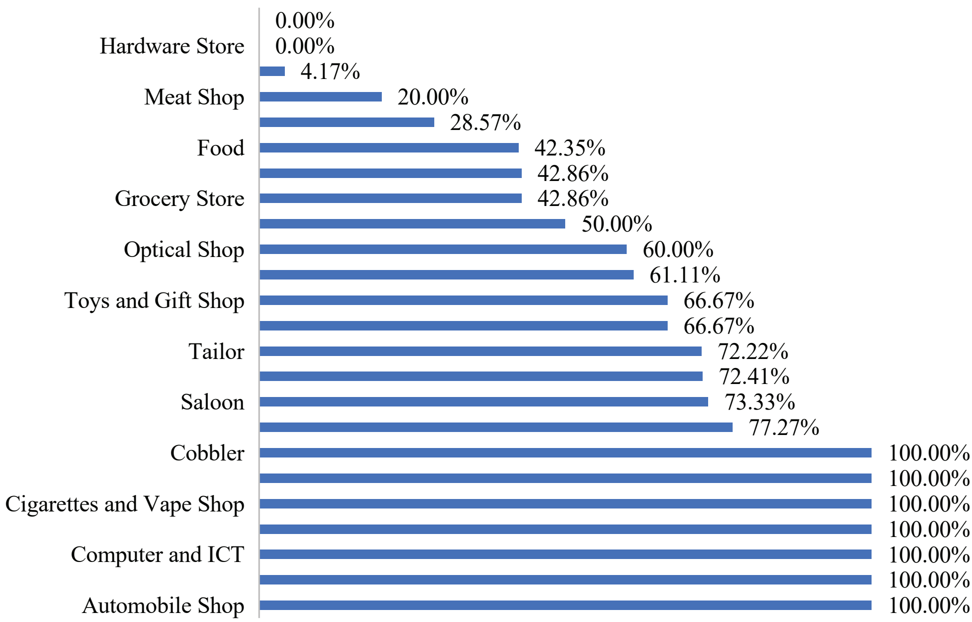
Source: PIDE State of Commerce Survey

FIGURE 4A.2 Sole Proprietorship: Category-Wise (Percent)



Source: PIDE State of Commerce Survey

FIGURE 4A.3 Obtaining Approval from Regulatory Body (Percent)

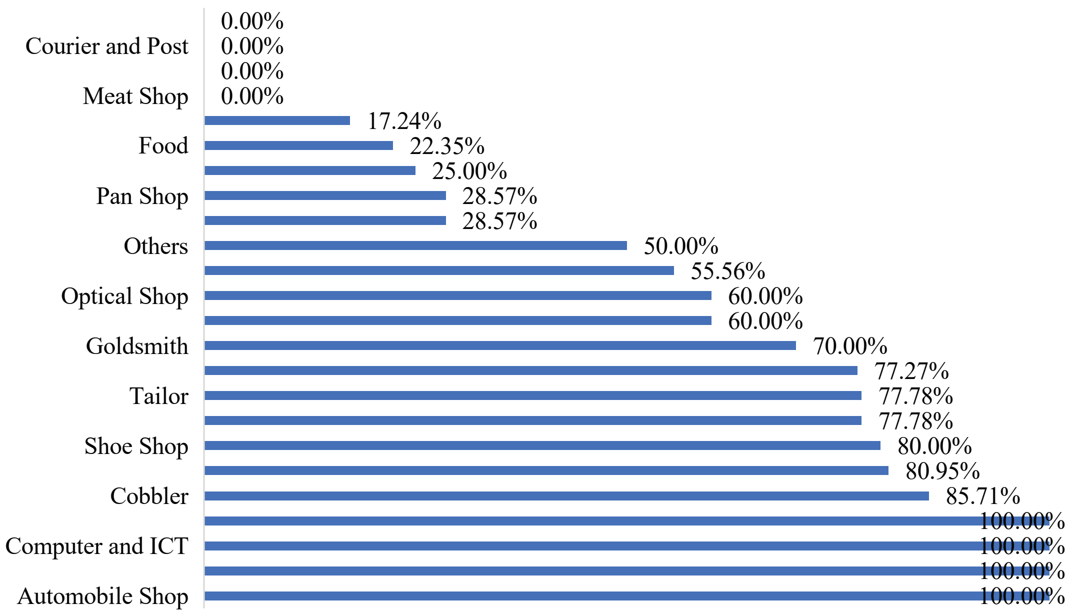


Source: PIDE State of Commerce Survey

FIGURE 4A.4 Average Annual RLCO Fee: Category-Wise (PKR)

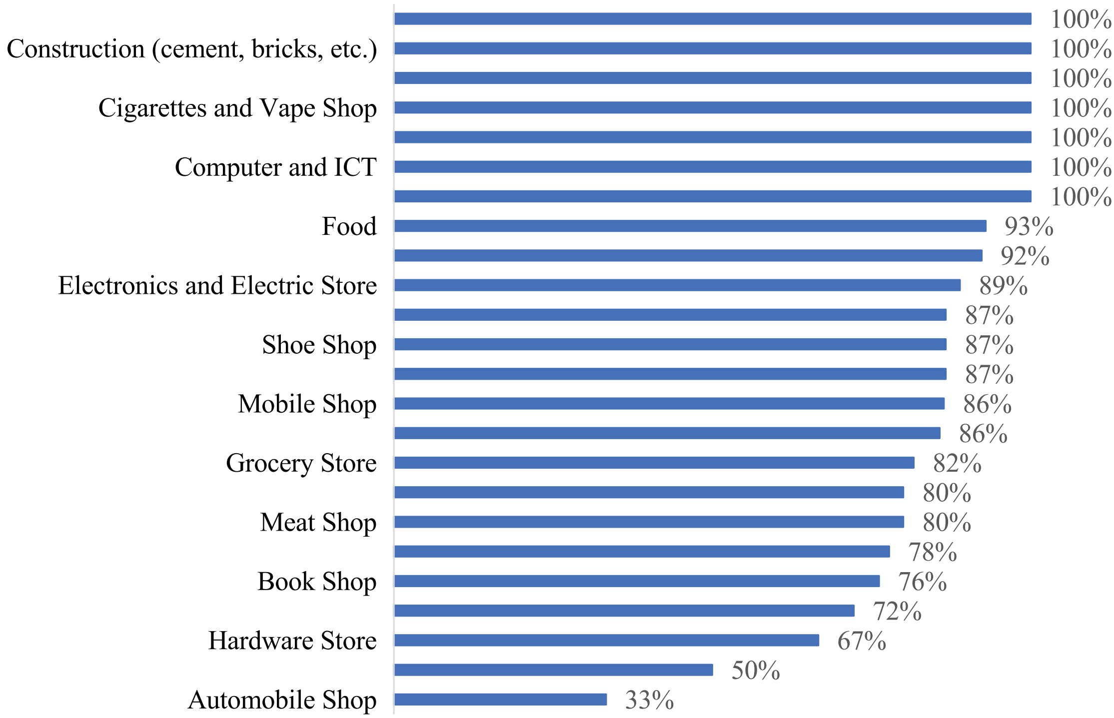
Source: PIDE State of Commerce Survey

FIGURE 4A.5 Inspection: Category-Wise (Percent)



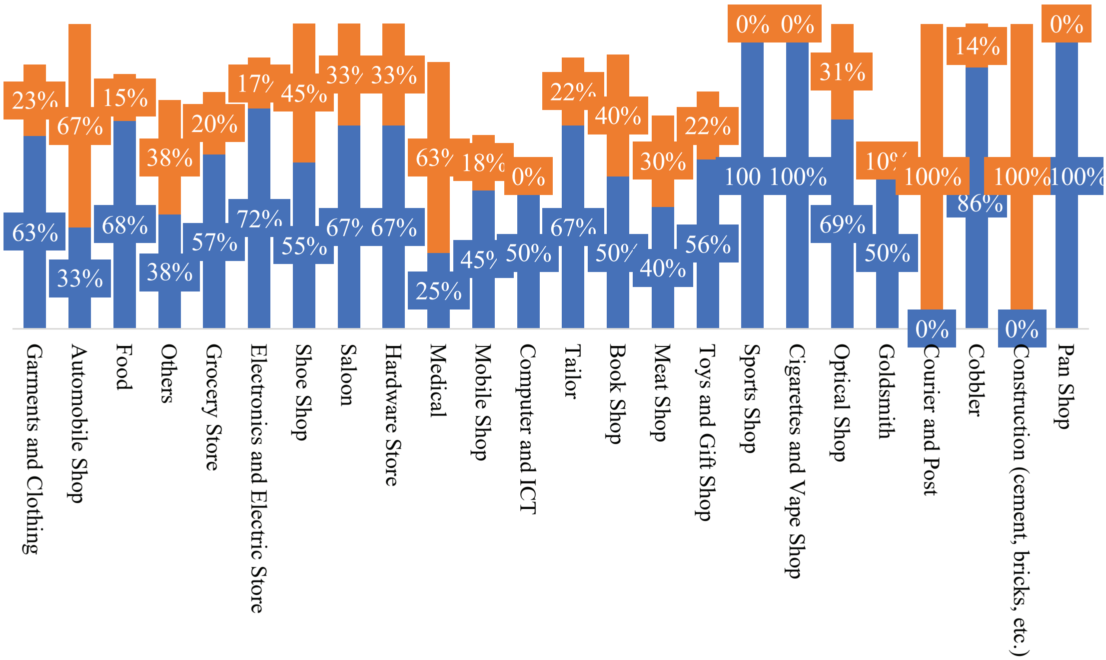
Source: PIDE State of Commerce Survey

FIGURE 4A.6 Scaling-Up the Business: Category-Wise (Percent Responses)



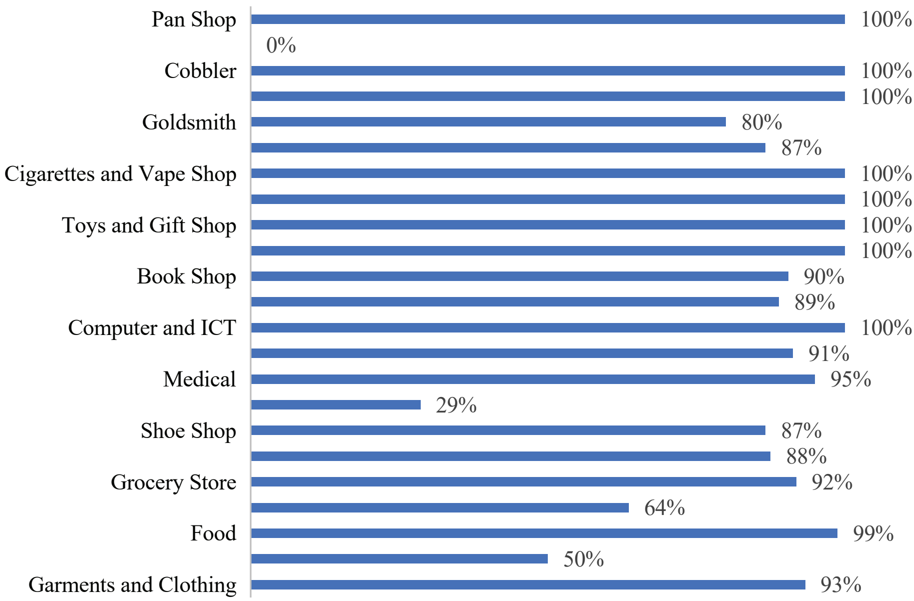
Source: PIDE State of Commerce Survey

FIGURE 4A.7 Constraints to Expanding Business: Category-Wise (Percent)



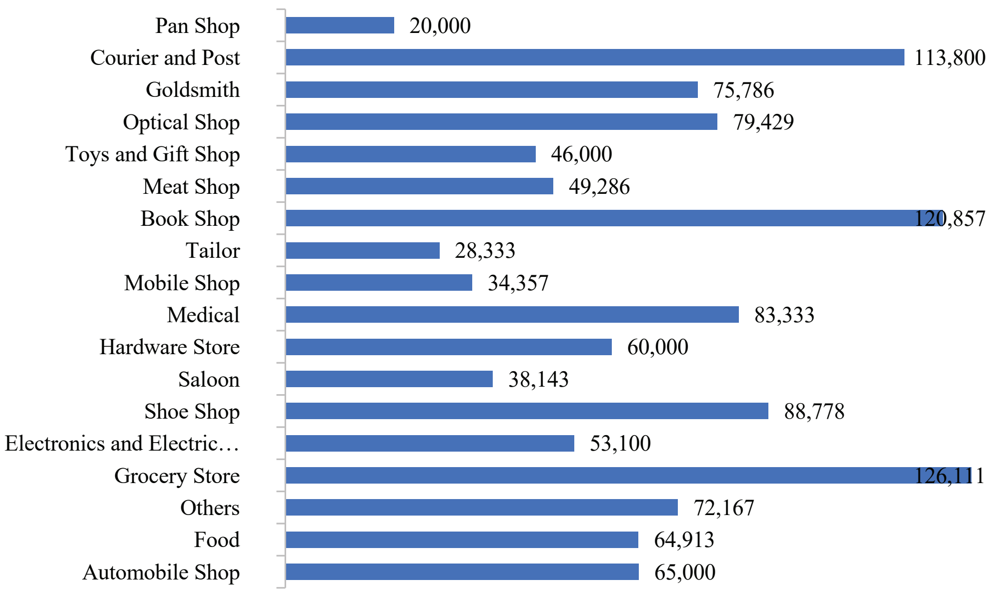
Source: PIDE State of Commerce Survey

FIGURE 4A.8 Finding a Shop at Desired Location: Category-Wise (Percent)



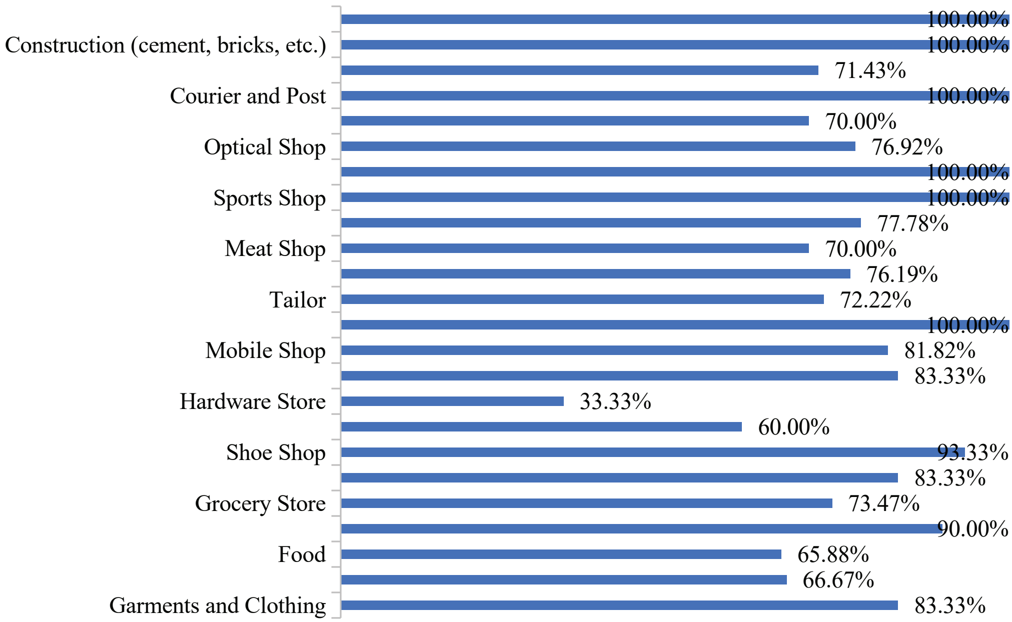
Source: PIDE State of Commerce Survey

FIGURE 4A. 9 Average Monthly Rent: Category-Wise (PKR)



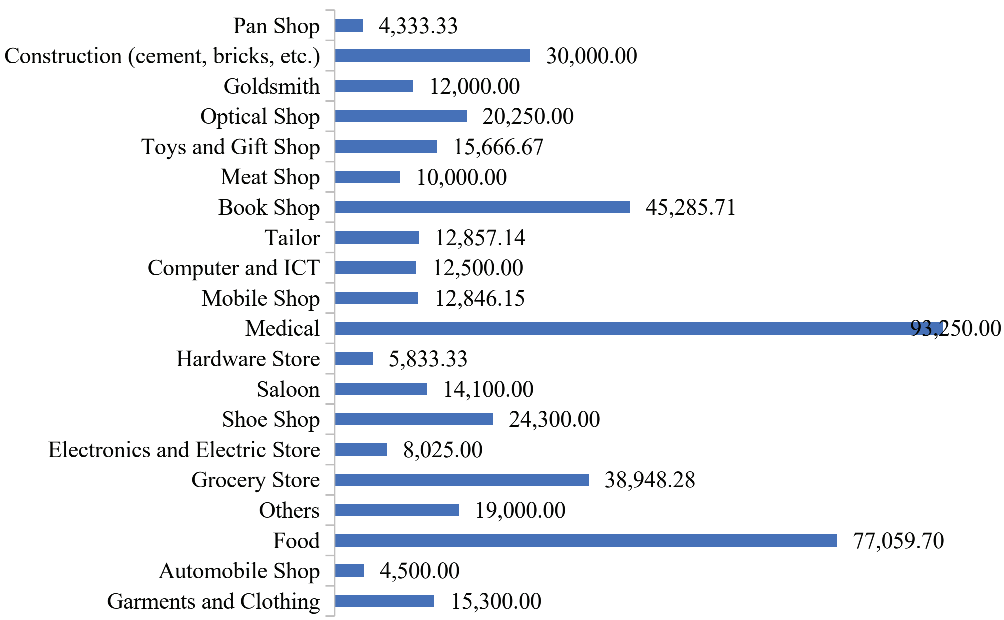
Source: PIDE State of Commerce Survey

FIGURE 4A.10 Issue of Parking: Category-Wise (Percent)



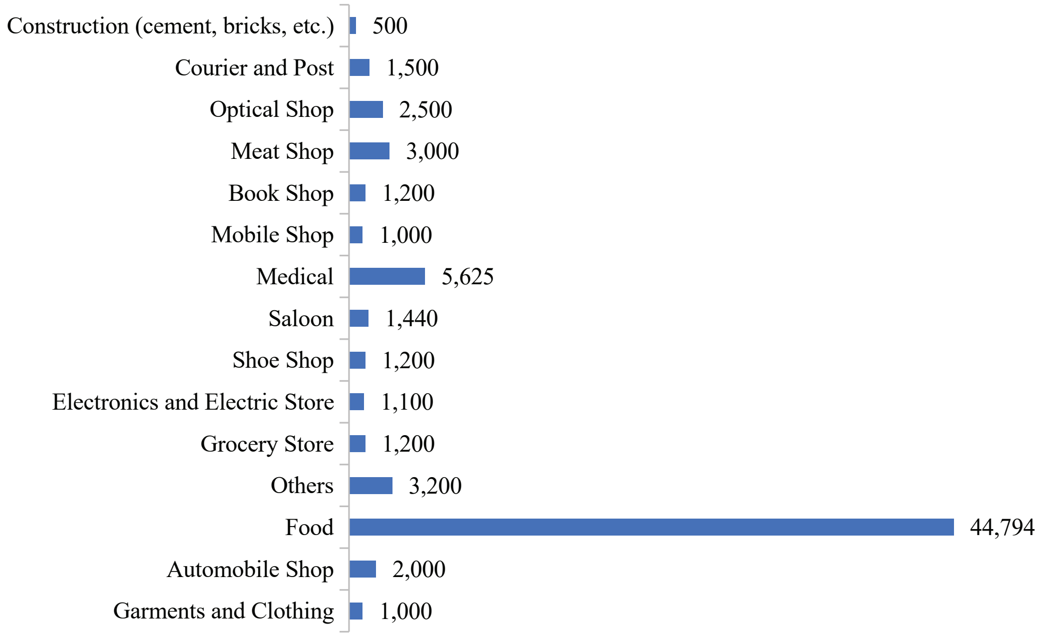
Source: PIDE State of Commerce Survey

FIGURE 4A.11 Average Monthly Electricity Expenditures: Category-Wise (PKR)



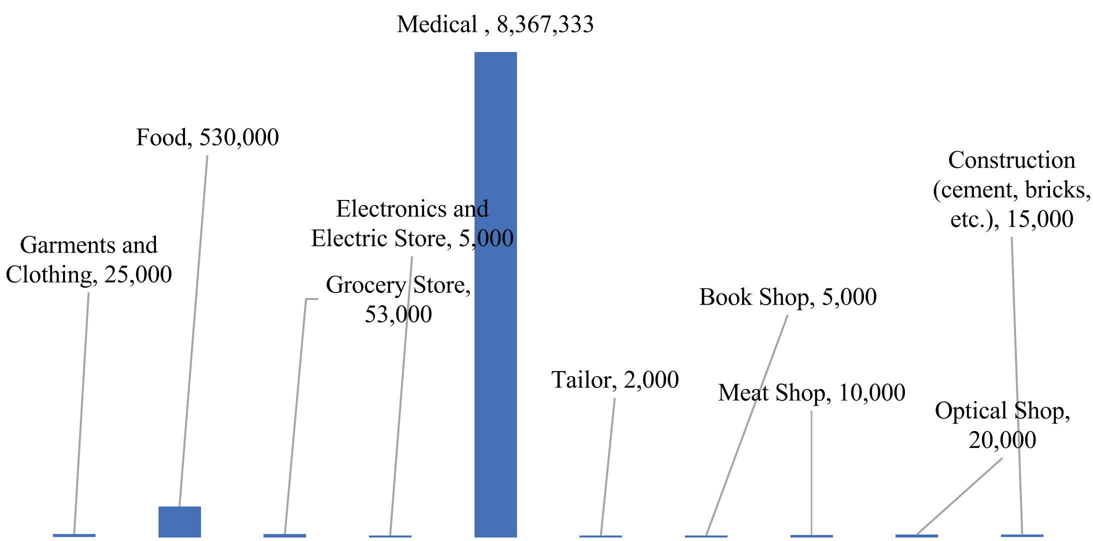
Source: PIDE State of Commerce Survey

FIGURE 4A.12 Average Monthly Water Expenditures: Category-Wise (PKR)



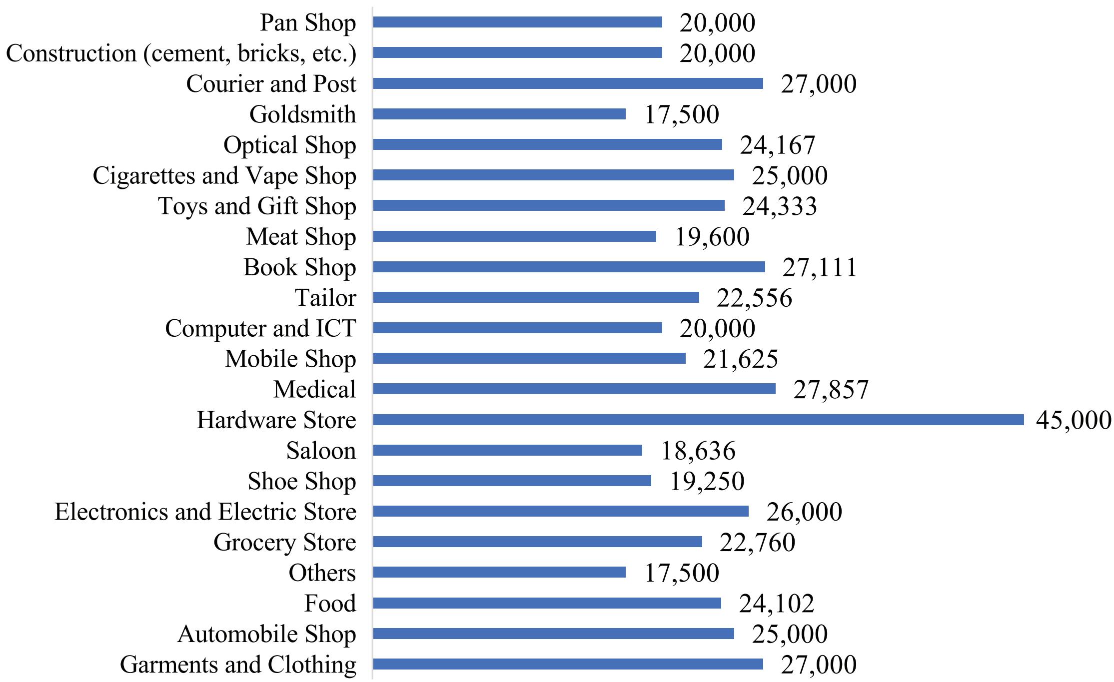
Source: PIDE State of Commerce Survey

FIGURE 4A.13 Average Annual Tax Payment Across Categories (PKR)



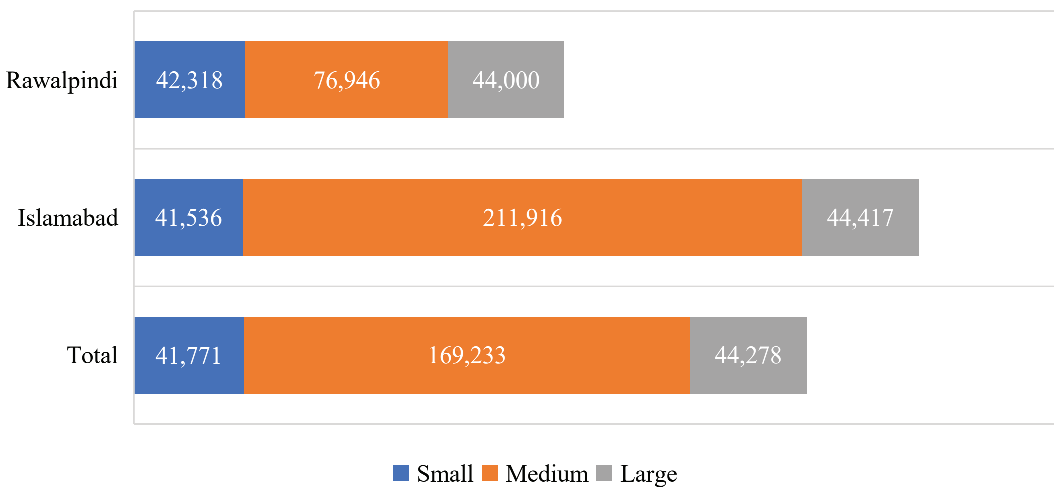
Source: PIDE State of Commerce Survey

FIGURE 4A.14 Average Monthly Wage: Category-Wise (PKR Thousand)



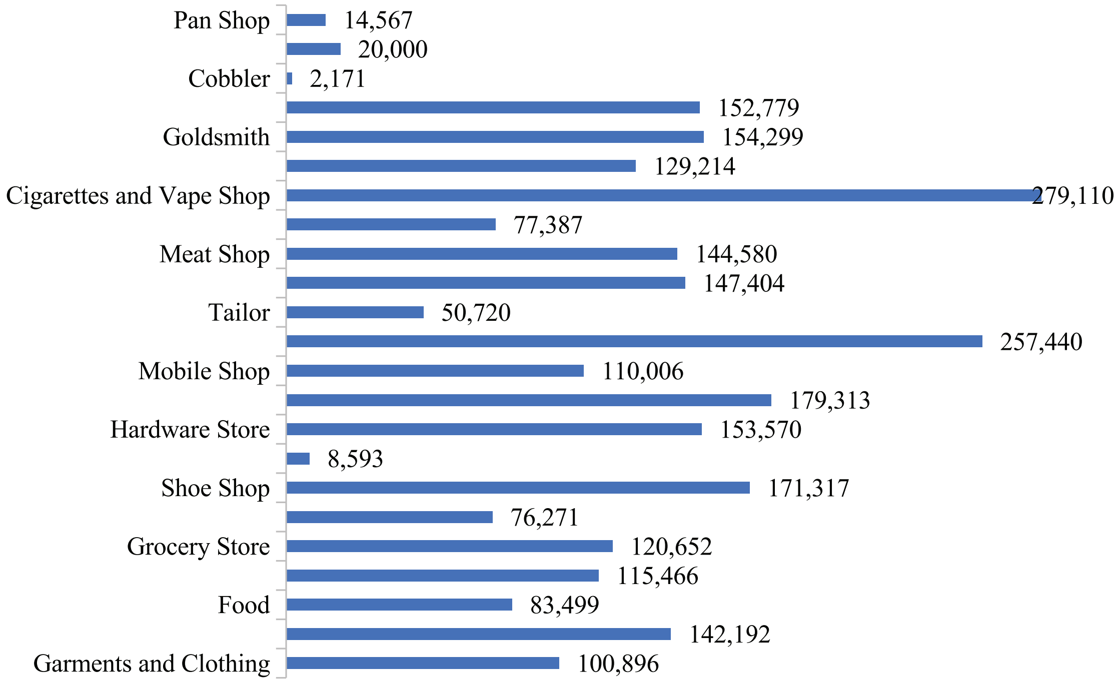
Source: PIDE State of Commerce Survey

FIGURE 4A.15 Average Monthly Sales: According to the Size (PKR)



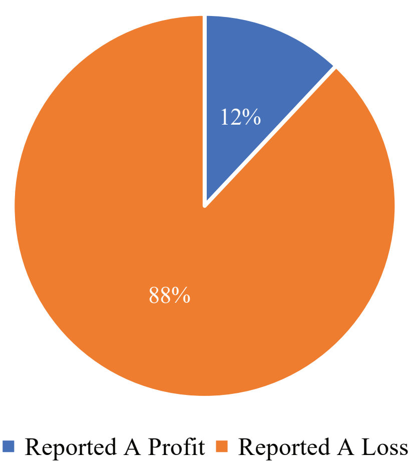
Source: PIDE State of Commerce Survey

FIGURE 4A.16 Average Monthly Sales: Category-Wise (PKR)



Source: PIDE State of Commerce Survey

FIGURE 4A.17 Profit/Loss Based on Reported Sale Revenue and Costs (Percent)



Source: PIDE State of Commerce Survey

APPENDIX 6A INTERVIEWED CHAIN STORES

TABLE 6A.1 Interviewed Chain Stores

No.	Chain Store	Segment
1	Diamond Supermarket	Departmental Store
2	Chase Up	Departmental Store/Super Market
3	Punjab Cash & Carry	Departmental Store
4	Maria B	Apparel
5	Cross Stitch	Apparel
6	Hush Puppies (Firhaj Footwear)	Footwear
7	D Watson	Pharmacy
8	Hub (Urban Brands)	Accessories

APPENDIX 6B SURVEY

Sampling

Spending on food, groceries, and clothing accounts for almost 40% of an average household's total monthly expenditure.[40] Keeping that in mind, a purposive sampling method was used to select segments within the chain store category that are most closely aligned with monthly household expenditure. Chain stores from the following segments were interviewed:[41]

Departmental stores & supermarkets

- Clothing & Apparel
- Footwear
- Accessories
- Pharmacies

Data collection tools

The primary mode of data collection was key informant interviews (KIIs) with either the owner of the business or a senior executive who had a thorough understanding how the processes involved.

[40] HIES 2018-19, https://www.pbs.gov.pk/sites/default/files//pslm/publications/hies2018-19/TABLE_15.pdf

[41] List of interviewed businesses is given in Appendix 6A.

APPENDIX 6C BRANDS AND THEIR STORES

TABLE 6C.1 Chain Store Brands and Number of Stores

Brand/Company	Segment	Karachi	Lahore	Islamabad/ Rwp	Other	Total
Max Fashion	Clothing & Apparel		1		0	1
Ace Galleria	Clothing & Apparel			1	4	5
Afsaneh	Clothing & Apparel		1	2	1	4
Khaadi	Clothing & Apparel	12	10	11	36	69
Batik	Clothing & Apparel		2	6	3	11
Al Fatah	Supermarket & Departmental Store	1	20	3	5	29
Alkaram Studio	Clothing & Apparel	11	9	5	30	55
Almas	Footwear	3	4	2	3	12
Mosajee Sons	Clothing & Apparel	4			0	4
Anaya	Clothing & Apparel		1		0	1
Bachaa Party	Kids	4	3		3	10
Threads & Motifs	Clothing & Apparel	3			0	3
Beechtree	Clothing & Apparel	3	6	4	3	16
Bonanza	Clothing & Apparel	18	12	14	28	72

Breakout	Clothing & Apparel	6	10	8	11	35
By the Way	Clothing & Apparel	1	4		0	5
Zeen	Clothing & Apparel	9	4	5	10	28
Cambridge	Clothing & Apparel	11	10	6	7	34
Charcoal	Clothing & Apparel	2	10	10	16	38
Charizma	Clothing & Apparel	2	3	1	12	18
Chase Up	Supermarket & Departmental Store	5			3	8
Chase Value	Supermarket & Departmental Store	3		1	3	7
Chen One	Supermarket & Departmental Store	2	4	6	19	31
Clive Shoes	Footwear	4	8	2	24	38
Cotton & Silk	Clothing & Apparel	4	2	3	0	9
Cougar	Clothing & Apparel	1	11	7	10	29
Cross Stitch	Clothing & Apparel	5	7	6	14	32
D Watson	Pharmacy			15	0	15
Dhanak	Clothing & Apparel	3	1	1	2	7

Diamond Supermarket	Supermarket & Departmental Store	13			0	13
Diners	Clothing & Apparel	13	11	11	50	85
Servaid	Pharmacy		57		36	93
Dynasty	Clothing & Apparel		1		0	1
Stylo	Footwear	4	21	13	114	162
Edenrobe	Clothing & Apparel	13	15	9	44	81
Ego	Clothing & Apparel	7	1	2	1	11
Starlet	Footwear		8		0	8
ECS	Footwear	5	15	4	54	78
ENEM	Other		1		0	1
Engine	Clothing & Apparel	1	1	1	0	1
Equator	Clothing & Apparel		4	4	9	17
Focus	Clothing & Apparel		3	1	14	18
Forecast	Clothing & Apparel		4	2	7	13
Furor	Clothing & Apparel	3	4	1	0	8
Generation	Clothing & Apparel		2	4	1	7
Hang Ten	Clothing & Apparel	4	7	5	4	20
Heels	Footwear	4	6	2	23	35

Hopscotch	Kids	5	5	7	32	49
Ittehad	Clothing & Apparel	1	7	6	34	48
Hub	Leather accessories	2	3	3	0	8
Hush Puppies	Footwear	13	15	8	27	63
Illusions	Leather accessories	1	1	21	2	25
Image	Clothing & Apparel	4	3	3	1	11
Insignia	Footwear	8	8	7	26	49
IWC	Accessories	11	10	3	15	39
Interwood	Other	2	3	2	1	8
Ismail Farid	Clothing & Apparel	2	2		0	4
Ismail's	Clothing & Apparel		14		23	37
Jade	Clothing & Apparel				1	1
Jafferjees	Leather accessories	4	2	5	4	15
Julke	Leather accessories		1		0	1
Kahf International (Rolex)	Accessories	2	1	1	0	4
M/Jafferjees	Leather accessories	2	2	1	0	5
Lawrencepur	Clothing & Apparel	1	4	2	6	13
Leisure Club	Clothing & Apparel	10	16	10	20	56

Lifestyle Collection	Accessories	3	3	1	0	7
Limelight	Clothing & Apparel	7	17	13	47	84
Logo	Footwear	3	2		0	5
MTJ	Clothing & Apparel	5	3	1	9	18
Makeup City	Accessories	5	6	2	15	28
M/s Mantra	Clothing & Apparel	3	2	2	0	7
Maria B	Clothing & Apparel	5	10	7	16	38
Monark	Clothing & Apparel		5	2	5	12
Motifz	Clothing & Apparel		8	2	5	15
Nahed	Supermarket & Departmental Store	2			0	2
Swera	Supermarket & Departmental Store		3		0	3
M/s The Oaks Pakistan Private Limited	Clothing & Apparel		3	3	2	8
Oxford	Clothing & Apparel	3	3	6	19	31
Pasha Fabrics	Clothing & Apparel		4		4	8
Pie in the Sky	Other	1			0	1
M/s Rainbow Cash & Carry	Supermarket & Departmental Store		5	1	2	8

M/s Raja Sahib	Clothing & Apparel		4		0	4
Reef Land	Footwear		1		0	1
Rios	Accessories	1	8	1	2	12
Roll Over	Kids		11	4	18	33
Royal Tag	Clothing & Apparel	2	11	6	11	30
Sapphire	Clothing & Apparel	8	9	5	17	39
Sitara Studios	Clothing & Apparel			1	14	15
Sana Safinaz	Clothing & Apparel	9	7	5	9	30
Bareeze	Clothing & Apparel	7	18	11	46	82
Bareeze Man	Clothing & Apparel	3	8	3	10	24
Chinyere	Clothing & Apparel	8	28	12	59	107
Kayseria	Clothing & Apparel	7	20	9	61	97
Rang Ja	Clothing & Apparel	3	8	6	13	30
Minnie Minors	Kids	14	34	16	61	125
Bareeze Home Expressions	Other		1		0	1
Walkeaze	Footwear	12	4	1	5	22
Urban Sole	Footwear	6	9	5	21	41
Uniworth	Clothing & Apparel		26	11	23	60

Uniworth Black	Clothing & Apparel			1	0	1
WB by Hemani	Clothing & Apparel	7	6	4	19	36
Saeed Ajmal	Clothing & Apparel				8	8
Warda	Clothing & Apparel	5	11	9	45	70
Saya	Clothing & Apparel	21	10	7	15	53
Shaffer	Clothing & Apparel	4			3	7
Sanaulla	Supermarket & Departmental Store	3			0	3
Unze	Footwear	2	9	2	8	21
Sputnik	Footwear	1	1	1	0	3
Zeitgeist	Clothing & Apparel		3	2	0	5
ShaPosh	Clothing & Apparel	2	4	3	21	30
Zellbury	Clothing & Apparel	5	4	1	18	28
Vohra & Saigol	Clothing & Apparel	2	4		0	6
Imitiaz	Supermarket & Departmental Store	8	2	3	12	25
Zara Shahjahan	Clothing & Apparel	1			0	1
Tradition Stores	Clothing & Apparel		1		1	2

Tesoro	Accessories	1	4	3	0	8
Ultra Club	Clothing & Apparel	1	9	1	9	20
Shams	Accessories			1	0	1
Sulafah	Footwear	5			0	5
Victoria Departmental Store	Supermarket & Departmental Store		1		0	1
Lama	Footwear	1	1	1	0	3
FDPP	Pharmacy		11		1	12
Ehad	Pharmacy	4			0	4
Agha Noor	Clothing & Apparel	5	6	2	0	13
Bata Pakistan	Footwear	38	56	34	338	466
Ndure	Footwear	6	16	12	52	82
Metro Shoes	Footwear		7	7	35	49
Servis Shoes	Footwear	3	18	5	62	88
Zubaidas	Kids	6	3	3	9	21
Shaheen Pharmacy	Pharmacy			13	0	13
Punjab Cash & Carry	Supermarket & Departmental Store		1	17	0	18
Metro	Supermarket & Departmental Store	3	4	1	1	9
Jalal Sons	Supermarket & Departmental Store		34		2	36
Green Valley	Supermarket & Departmental Store	12	2	1	0	15

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