BUSINESS RECORDER
Founded by M. A. Zuberi

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PIDE 'identifies' zombie firms operating in Pakistan

ABDUL RASHEED AZAD

ISLAMABAD: A research study of the Pakistan Institute of Development Economics (PIDE) has revealed that 25 percent of the companies operating in Pakistan are zombie firms and this has serious implication for the lost tax potential due to persistent declaration of losses.

The report identifies that approximately, 25 percent of the companies in Pakistan are zombie firms also involved in huge tax evasion due to persistently declaring losses.

According to the study, which is completed in collaboration and Directorate General Strategic Planning and Reform & Statistics (SPR&S-FBR) for the FBR Biannual Review report, efficient allocation of capital plays a key role in economic development by nurturing innovation and increasing industrial productivity.

However, the reallocation of capital towards less productive firms at the expense of more productive ones harms the growth of industries.

The FBR report on, "Zombie Firms in Pakistan and Tax Revenue Drag" explains the phenomenon of these firms.

The FBR has included PIDE's research on the zombie firms, which was originally written by Dr Naseem Faraz and Dr Mahmood Khalid, senior research economists at the PIDE.

Recently, economists have indicated the existence and rise of zombie firms, which slowed down growth in several countries including South Asia.

A zombie firm is characterised as a loss-making firm that has lost the ability to generate enough profits to cover its interest payments.

These firms survive only by repeatedly refinancing their loans.

In the competitive market, zombies have to either exit or restructure, the report revealed.

Research further stated that the rise of zombie congestion potentially crowds-out growth opportunities for more productive firms.

Because banks have to keep financing to keep them active on their loan portfolios.

This also has huge implications for the lost tax potential as well from two channels. The first one is direct where the firms are not earning or doing business at their potential level, hence a tax revenue loss.

Second is the tax lost in terms of the opportunity cost where the more productive firm is denied the right for financing because of financing compulsion towards these zombie firms.

Hence, when these deprived companies are unable to produce what they could have based on the availability of adequate financing it will also create a potential loss of tax resources.

According to the PIDE study, the notion of zombie firms was applied for the first time to Japanese firms during the period of the Lost Decade (1991-2000 – a period of economic stagnation in Japan).

In that period, Japanese banks kept injecting new loans to unprofitable firms to keep them alive.

The Japanese economy did not begin to recover until this practice of misallocation of capital had ended.

Recent literature has revisited this connection and shown that misallocation of capital is emerging as a vital explanation for the fall in productivity of several OECD and Asian economies.

It is evident from the research that those countries who have been able to manage these crises by not overlooking the active loan indicators only have achieved greater economic growth through efficient credit allocation.

It raises many important questions as to; Is it the regulatory under sight by the SBP? Or the SECP? Or the tax pressures to report oneself as a zombie? Or the natural rate of businesses in an economy being above the shutdown point but below normal profits. Especially, it has been reported in newspapers often that firms are running in loss but still running, how? Second, if a non-profit making firm is still making the loans repayments then should the banks be concerned at all becomes a potential question for the banking business as well.

The FBR report, however, reiterates that the role of regulators is the key to break this ongoing debt cycle.

Devising effective regulatory measures to capture the non-viable firms in the marketplace, regulators can generate larger space for the more productive and small-medium enterprises (SMEs) to access credit.

Priority in credit access to productive firms, as well as small-medium and innovative enterprises, would improve the health of financial markets and may reap higher investment, employment, and revenue generation in the country.

INTERNATIONAL
THE NEWS

TAX EVASION

25pc companies show up as 'zombie firms'

By Mehtab Haider

ISLAMABAD: One-fourth of public and private sector companies in Pakistan are 'zombie firms', involved in tax evasion as they are always in loss, a report said on Tuesday.

"Our estimates suggest that approximately 25 percent of firms show up as 'zombie firms' in Pakistan" showed a study by Pakistan Institute of Development Economics (PIDE) in collaboration with the Federal Board of Revenue (FBR).

"Furthermore, roughly 47 percent of these nonviable firms exist in textile, 19 percent in chemical, and 10 percent in the cement sector." It further stated the concentration of these firms was not limited to any particular sector as they existed both in the private and public sectors.

According to the report's estimates, roughly $3 billion short-term bank credit flows to these firms annually.

It said in a resource scarce country such as Pakistan, it was reasonable to assume the efficient allocation of this credit could improve performance of the industrial sector.

"It raises many important questions as to: is it the regulatory undersight by SBP or SECP or the tax pressures to report oneself as a zombie or the natural rate of businesses in an economy being above the shutdown point but below normal profits?" Especially, given the phenomenon that firms were reported as running in losses, but they continued to run (survive), the report said adding, second, how were non-profit making firms were making it possible to repay their loans?

"Efficient allocation of capital plays a key role in economic development by nurturing innovation and increasing industrial productivity. However, the reallocation of capital towards less productive firms at the expense of more productive ones harms growth of industries." According to the study, recently economists have discussed the existence and rise of 'zombie firms' which slowed down growth in several countries including some in South Asia.

A zombie firm is characterised as a loss-making firm that has lost the ability to generate enough profits to cover their interest payments. They survive only by repeatedly refinancing their loans. In the competitive market, zombies have to either exit or restructure. The rise of zombie congestion potentially crowds out growth opportunities for more productive firms because banks have to keep financing them to keep them active on their loan portfolios.

It has huge implications for the lost tax potential as well from two channels. The first one was direct where the firms were not earning or doing business at its potential level hence there is a direct tax loss, the study said.

Second is the tax lost in terms of the opportunity cost where the more productive firm is denied the right for financing because of financing compulsion towards these zombie firms, it added. "Hence when these companies are unable to produce what they could have based on the availability of adequate financing it will also create a potential loss of tax resource," the report said.

THE NATION

Approximately 25pc of companies in Pakistan zombie firms

FAWAD YOUSAFZAI
ISLAMABAD

Approximately 25 percent of the companies in Pakistan are zombie firms, a huge implication for lost tax potential due to persistently declaring losses, said the FBR Biannual Review Report.

This was stated in the latest research produced by the Pakistan Institute of Development Economics (PIDE) and Directorate General Strategic Planning and Reform & Statistics (SPR&S-FBR) for FBR Biannual Review report. Efficient allocation of capital plays a key role in economic development by nurturing innovation and increasing industrial productivity, said the report. However, the reallocation of capital towards less productive firms at the expense of more productive ones harms the growth of industries, the report maintained.

Recently economists have indicated the existence and rise of zombie firms, which slowed down growth in several countries including South Asia. A zombie firm is characterized as a loss-making firm that has lost the ability to generate enough profits to cover its interest payments. These firms survive only by repeatedly refinancing their loans. In the competitive market, zombies have to either exit or restructure, the report revealed.

The report identifies that approximately 25 percent of the companies in Pakistan are zombie firms that are also involved in huge tax evasion due to persistently declaring losses. FBR report on "Zombie Firms in Pakistan and Tax Revenue Drag" explains the phenomenon of these firms. FBR has included PIDE's research on the zombie firms, which was originally written by Dr. Naseem Faraz and Dr. Mahmood Khalid Senior Research Economists at Pakistan Institute of Development Economics (PIDE).

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Research further stated that the rise of zombie congestion potentially crowds-out growth opportunities for more productive firms. Because banks have to keep financing to keep them active on their loan portfolios. This also has huge implications for the lost tax potential as well from two channels. The first one is direct where the firms are not earning or doing business at their potential level hence there is a tax revenue loss. Second is the tax lost in terms of the opportunity cost where the more productive firm is denied the right for financing because of financing compulsion towards these zombie firms. Hence when these deprived companies are unable to produce what they could have based on the availability of adequate financing it will also create a potential loss of tax resources.

According to the PIDE Study, the notion of zombie firms was applied for the first time to Japanese firms during the period of the Lost Decade (1991-2000 – a period of economic stagnation in Japan). In that period, Japanese banks kept injecting new loans to unprofitable firms to keep them alive. The Japanese economy did not begin to recover until this practice of misallocation of capital had ended. Recent literature has revisited this connection and shown that misallocation of capital is emerging as a vital explanation for the fall in productivity of several OECD and Asian economies.

It is evident from the research that those countries who have been able to manage these crises by not overlooking the active loan indicators only have achieved greater economic growth through efficient credit allocation.

It raises many important questions as to; is it the regulatory under sight by SBP? or SECP? or the tax pressures to report oneself as a zombie? or the natural rate of businesses in an economy being above the shutdown point but below normal profits. Especially it has been reported in newspaper often that firms are running in loss but still running; how? Second if a non-profit making firm is still making the loans repayments then should the banks be concerned at all becomes a potential question for banking business as well.

The FBR report however reiterates that the role of regulators is the key to break this ongoing debt cycle. Devising effective regulatory measures to capture the non-viable firms in the marketplace, regulators can generate larger space for the more productive and small-medium enterprises (SMEs) to access credit. Priority in credit access to productive firms, as well as small-medium and innovative enterprises, would improve the health of financial markets and may reap higher investment, employment and revenue generation in the country.

INTERNATIONAL
THE NEWS

25pc companies show up as ‘zombie firms’

By Mehtab Haider
November 17, 2021

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“Furthermore, roughly 47 percent of these nonviable firms exist in textile, 19 percent in chemical, and 10 percent in the cement sector.” It further stated the concentration of these firms was not limited to any particular sector as they existed both in the private and public sectors.

According to the report’s estimates, roughly $3 billion short-term bank credit flows to these firms annually.

It said in a resource scarce country such as Pakistan, it was reasonable to assume the efficient allocation of this credit could improve performance of the industrial sector.

“It raises many important questions as to: is it the regulatory under-sight by SBP or SECP or the tax pressures to report oneself as a zombie or the natural rate of businesses in an economy being above the shutdown point but below normal profits?” Especially, given the phenomenon that firms were reported as running in losses, but they continued to run (survive), the report said adding, second, how were non-profit making firms were making it possible to repay their loans?

“Efficient allocation of capital plays a key role in economic development by nurturing innovation and increasing industrial productivity. However, the reallocation of capital towards less productive firms at the expense of more productive ones harms growth of industries.” According to the study, recently economists have discussed the existence and rise of ‘zombie firms’ which slowed down growth in several countries including some in South Asia.

A zombie firm is characterised as a loss-making firm that has lost the ability to generate enough profits to cover their interest payments. They survive only by repeatedly refinancing their loans. In the competitive market, zombies have to either exit or restructure. The rise of zombie congestion potentially crowds out growth opportunities for more productive firms because banks have to keep financing them to keep them active on their loan portfolios.

It has huge implications for the lost tax potential as well from two channels. The first one was direct where the firms were not earning or doing business at its potential level hence there is a direct tax loss, the study said.

Second is the tax lost in terms of the opportunity cost where the more productive firm is denied the right for financing because of financing compulsion towards these zombie firms, it added. “Hence when these companies are unable to produce what they could have based on the availability of adequate financing it will also create a potential loss of tax resource,” the report said.

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Abdul Rasheed Azad 17 Nov 2021

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The FBR report, however, reiterates that the role of regulators is the key to break this ongoing debt cycle.

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https://www.brecorder.com/news/40133833

THE NATION

Approximately 25pc of companies in Pakistan zombie firms

Fawad Yousafzai

November 17, 2021

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https://nation.com.pk/17-Nov-2021/approximately-25pc-of-companies-in-pakistan-zombie-firms

Pakistan
OBSERVER

FBR makes a shocking revelation about Zombie firms in Pakistan

By
News desk
-
November 17, 2021

Observer Report

Islamabad

The Federal Board of Revenue (FBR) has estimated that approximately 25 percent of the companies in Pakistan are zombie firms involved in tax evasion due to persistently declaring losses.

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https://pakobserver.net/fbr-makes-a-shocking-revelation-about-zombie-firms-in-pakistan/