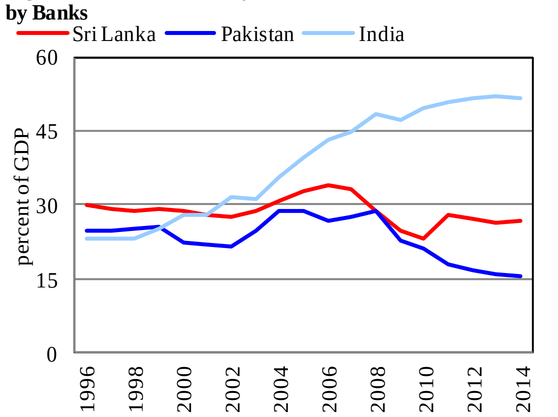
Special section: Comparative assessment of corporations in light of credit to private sector

Domestic credit to private sector extended by banks (as a percentage of GDP) has fallen sharply in Pakistan from 2009 onward, relative to peer countries (**Figure S1.1**).[1] This is a disconcerting trend, because a key channel of spurring economic growth appears to have been under-utilized. This section helps disentangle factors that explain the steep drop in credit off-take.[2]

Figure S1.1: Cross-Country Domestic Credit to Private Sector by Banks

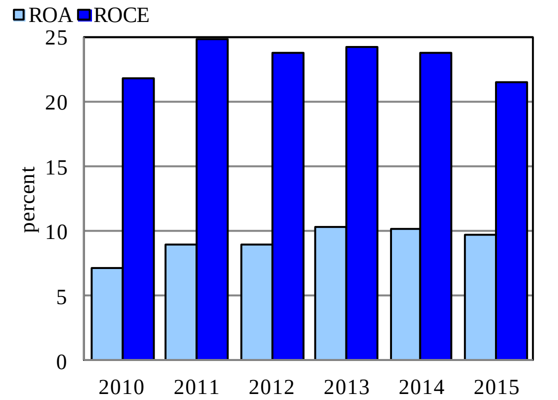


Source: World Development Indicators

<u>Is credit off-take low because Pakistani firms are unprofitable?</u>

The shortlisted Pakistani non-financial corporations (NFCs) have, in fact, generated impressive returns over the analysis period – particularly from 2011 onward – as indicated by return on assets (ROA) and return on common equity (ROCE) ratios (**Figure**

Figure S1.2: Profitability Ratio, Pakistani NFCs



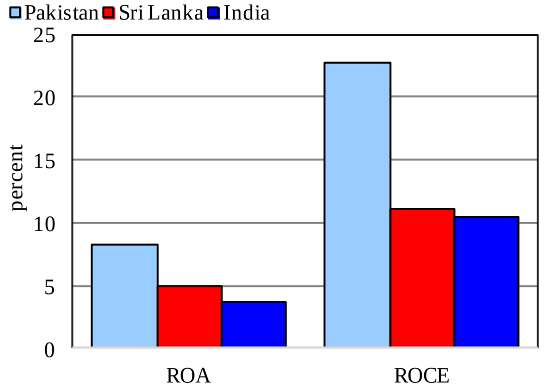
Source: Bloomberg/Analyst's Calculation

[1] Domestic credit to private sector by banks refers to financial resources provided to the private sector by deposit-taking corporations (except central banks) such as through loans, purchases of non-equity securities, trade credits and other accounts receivable, that establish a claim for repayment.

[2] Data was extracted from Bloomberg. A total of 68 large NFCs were shortlisted from Pakistan, India and Sri Lanka, based on the magnitude of total assets. The original shortlist targeted the largest 75 firms from each country. However, while cleaning the data, some firms were removed on account of missing data for multiple years, leaving 68 firms in the final sample. Subsequently, their financial ratios were taken from Bloomberg, comprising ratios reported from 2010-2015 on annual basis for the Pakistani analysis over time, and as reported on March 2015 for cross-country comparison. March 2015 was chosen on the grounds that latest comparable ratios (with least amount of missing entries) for firms of all three countries at the time of extraction pertained to this quarter end. A weighted average of ratios was then used in the analysis.

S1.2).[3] Furthermore, in terms of country comparison, **Figure S1.3** reveals a favorable trend for Pakistan's largest NFCs, which surpass Sri Lankan and Indian firms in terms of both ROA and ROCE.

Figure S1.3: Cross-country Profitability Ratio (as of March 2015)



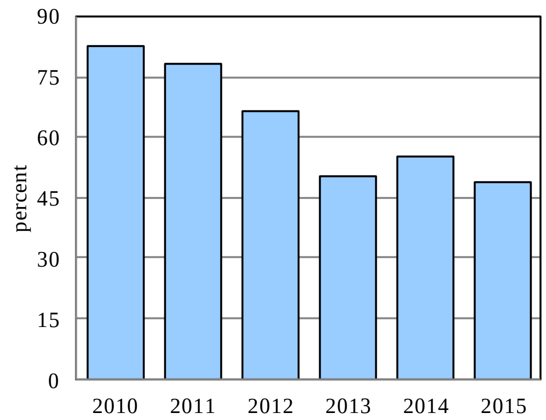
Source: Bloomberg/Analyst's Calculation

Essentially, these profitability ratios dispel the notion that large Pakistani NFCs are not performing well. In fact, such firms have, on average, consistently posted strong returns in the last few years. One would expect that, in these circumstances, the country's dominant corporations would be in an upbeat mood regarding their prospects, and might readily avail credit in order to finance aggressive expansion.

Many corporations have opted for deleveraging

However, many large Pakistani corporations have opted for deleveraging in the six year period, as indicated by the debt to common equity ratio (**Figure S1.4**).[4]

Figure S1.4: Debt to Common Equity Ratio, Pakistani NFCs



Source: Bloomberg/Analyst's Calculation

Meanwhile, **Figure S1.5** indicates that the shortlisted Indian firms are more highly leveraged by comparison. Having said that, there is no universally recommended leverage ratio, and the relevant benchmark can vary considerably by industry and firm size. So while we refrain from reading too much into the ratios for Indian corporations, we nevertheless deduce that Pakistani firms have a low degree of

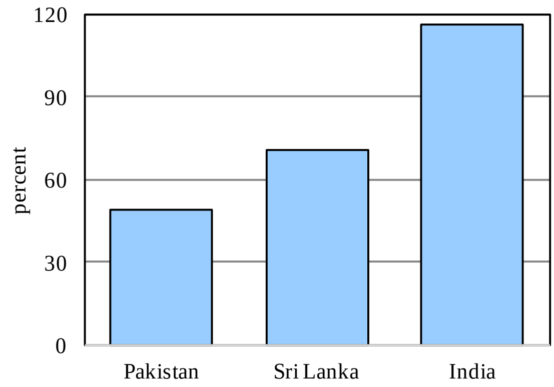
[3] **Box 1** contains definitions and formulae employed for the ratios.
[4] Deleveraging, at firm level, is the act of reducing the proportion of borrowed capital in relation to share capital

leveraging at present compared to their regional peers. This leads to a follow-up question: are these corporations also cash strapped, in the absence of borrowed funds?

Large Pakistani NFCs tend to be fairly liquid

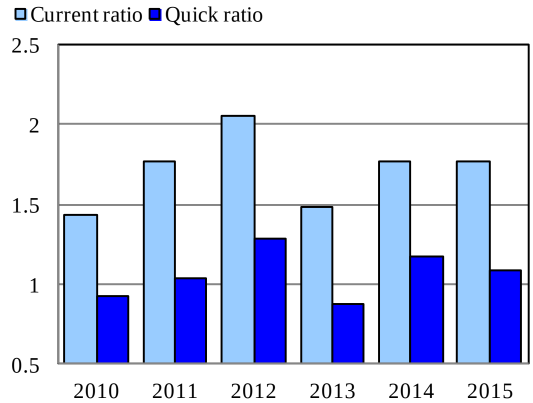
The shortlisted sample of Pakistani firms posted consistently healthy liquidity ratios – i.e. current and quick ratios – from 2010 to 2015 (**Figure S 1.6**). The current ratio averaged 1.7 over six years, while the quick ratio was around 1.1 on average for the period.

Figure S1.5: Cross-Country Debt to Common Equity Ratio (as of March 2015)



Source: Bloomberg/Analyst's Calculation

Figure S1.6 : Liquidity Ratio- Pakistani NFCs



Source: Bloomberg/Analyst's Calculation

Meanwhile**, Figure S1.7** reveals that the weighted average current ratio for the sample of Pakistani corporations is most favorable compared to large Indian and Sri Lankan corporations. A similar pattern is mirrored in the quick ratios, with the largest Pakistani firms being the most liquid, on average.

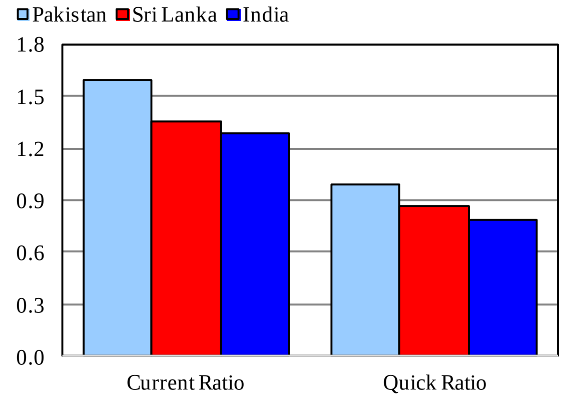
The findings suggest that large companies in the country might increasingly be opting for inter-corporate financing to diversify their businesses (by equity investment in subsidiaries), rather than acquiring bank loans.[5] These firms are relatively liquid and thus have lower need to resort to borrowed finances.

[5] SBP's Financial Statements Analysis of Companies, 2009-2014, indicates that long term investments of private firms, as a proportion of total assets, rose from an average of 5.4 percent during 2009-12 to 7.1 percent and 7.3 percent in 2013 and 2014 respectively. Further probing of individual firms' annual reports revealed substantial inter-corporate financing by various large

Conclusion:

Overall, the analysis suggests that the performance of Pakistan's largest corporations is fairly robust. In fact, given that the country ranks lower in the World Bank's Doing Business 2016 rankings compared to India and Sri Lanka, Pakistan's large NFCs deserve credit on the whole for the resilience they have shown while operating in a relatively more challenging environment.[6]

Figure S1.7: Cross-Country Liquidity Ratio (as of March



Source: Bloomberg/Analyst's Calculation

Going forward, the deleveraging trend in particular has increased the future potential appetite for credit by NFCs in Pakistan. Also, in addition to blue chip companies, there are opportunities to tap into the demand for credit by niche segments, which remain largely underserved – such as SMEs, housing finance, agriculture and microfinance. If commercial banks are able to capitalize on this demand in the near future, we may see significant and quick growth spurts in the country. In fact, latest available data for FY16 already reflects that credit to private sector expanded by Rs 249.4 billion (6.2 percent) from 1st July 2015 to 3rd June 2016, which is notably higher than expansion of Rs 146.3 billion (3.9 percent) during the same period a year earlier. In light of historic low interest rates – together with improvements in energy supply, law and order, business sentiments and overall macroeconomic stability – there is good reason to expect further expansion in private sector credit off-take and resultant growth.

companies and groups (as of December 2014), including but not limited to: FFC, PTCL, Engro, Hubco, Nishat, Packages Ltd., Ibrahim Fibres Ltd., Attock Refinery Ltd., Lucky Cement etc.

[6] Country ranking in Doing Business 2016: Pakistan - 138; India - 130; Sri Lanka - 107

Box S1: Definitions and formulae of financial ratios

1. Profitability ratios

$$i. ROCE = \left(\frac{T12\ Net\ Income\ Available\ for\ Common\ Shareholders}{Average\ Total\ Common\ Equity}\right) \times 100$$

where T12 Net Income Available for Common Shareholders = The trailing 12 month net income available to common shareholders, calculated by adding the most recent four quarters

$$ii. ROA = \left(\frac{Trailing\ 12M\ Net\ Income}{Average\ Total\ Assets}\right) \times 100$$

where Trailing 12M Net Income = sum of net income for last four quarters, two semi annuals, or one annual period.

2. Leverage ratio

$$i. Debt\ to\ common\ equity = \left(\frac{Total\ Debt}{Common\ Equity}\right) \times 100$$

3. Liquidity ratios

$$i. Current\ ratio = \frac{Current\ assets}{Current\ liabilities}$$

where Current assets = sum of cash and near cash items, short term investments, account receivables and inventory.

$$iii. Quick\ ratio = \frac{(Cash\ and\ Near\ Cash\ +\ Short\ Term\ Investments\ +\ Account\ Receivables)}{Current\ Liabilities}$$