Impact of Sector Level Variables on Political Scenarios in Pakistan

Suresh Ramakrishnan¹, Agha Amad Nabi²*, Zulkarnain Daud³, Melati Ahmad Anuar⁴

¹Faculty of Management, Universiti Teknologi Malaysia, Malaysia, ²Faculty of Management, Universiti Teknologi Malaysia, Malaysia, ³Faculty of Management, Universiti Teknologi Malaysia, Malaysia, ⁴Faculty of Management, Universiti Teknologi Malaysia, Malaysia. *Email: ammadagha786@gmail.com

ABSTRACT

Pakistan has a long history of involvement in politics. Since independence in 1947 the country has experienced four coups that directly rule of the country over time. Most recently in 1999 the armed forces took over the democratic government. Accumulated political and economic crunches that shaped the situation in which the armed involvement would get extensive public support. In the recent period from 2008 onwards democrats are ruling the country and there has been an extensive criticism of financial administration of the preceding government but no positive amendment has been seen in financial plans in this period either. This paper wants to compare the performance of sectors in different political regimes. Sector level variables are munificence, dynamism, Herfindahl-Hirschman index and uniqueness has been used to check the impact of sectors in different political regimes. Data has been segregated between two eras (i.e., 2004-2008 dictatorship periods and 2009-2013 democratic period). Paired sample t-test will be used to check the impact of sectors nature in two different regimes.

Keywords: Sector Level Variables, Political Periods, Democratic, Dictatorship

JEL Classification: G3

1. INTRODUCTION

The best system that politicians depict to rule in a country is a democracy. One has to look both ways in order to compare or check the system. The finest mechanism about democracy is that in democracy individuals pick their governance themselves. If headship doesn’t execute well they can change it themselves and get different governance. Regrettably in Pakistan communal fabric is alienated on many origins like language, traditions, cast, clique, community and illiteracy rate is very high. People eagerly or reluctantly do not become able to pick easily and brings same leaders over and over again. So country has to face only disadvantages on the structure instead of positive points. In addition of political, financial and armed emergencies that shaped the framework in which the army involvement ought to get wide community support. Pakistan was on the border of default in 1998 on its global debt. While decent relationship with the International Monetary Fund and global financiers were mandatory for financial salvage, government inconveniently selected a bout with these organizations over energy plans, abolishing the confidence of overseas financiers. The consequential financial slump, along with rising religious conflict, anarchy and administration dishonesty fuelled unvarying anti-government protests in the months earlier the coup (Barracca, 2007).

The problem is twofold as the sectors were facing problems due to the vivid decisions of the government regarding the hikes in prices of petroleum and other raw materials it also faces the problem of the shortage of the gas through which sectors were getting affected as it sets huge losses, also the political instability in the country which creates a huge impact on the country. Particular state has been adopted from developing markets that has remained affected by political crisis. The devastating political periods affected the financial and industrial sectors of Pakistan (Ali and Afzal, 2012).

Research till date has tended to focus on firm and country level factors (Booth et al., 2001; Frank and Goyal, 2003; Kayo and Kimura, 2011). However less attention has been paid towards
sector/industry level factors which have the tendency to affect firm’s decision making in different political eras. As these sector level variables have a great impact on the sectors in different political eras as these variables shows risk and return. The firm operates in sectors/industries which have different business environment and carrying different level of growth, risk, competitiveness. This requires firm to look into sector level factors, i.e. munificence, dynamism, Herfindahl-Hirschman index (HHI) and uniqueness that can influence decision making under different political regimes, thus the study firstly highlights the impact of sectors/industries in different political regimes.

Bhattacharyjee and Han (2014) explained academic and experiential microeconomic works pointing to the significance of firm- and industry-specific issues on monetary distress and defaults. As stated by Kayo and Kimura (2011), that external environmental factors should not be ignored which have the power to influence the firm-level factors. According to Ramakrishnan (2012), researchers in developing countries have faced the problems of measurement of industry-level variables and data limitation. As a result, they used industry dummies to capture the effect of sector/industry on firm. In the line with these arguments, the study highlights the differences of significant determinants of default prediction across sector/industries in developing countries. Sectors operate differently during political periods as for the developing countries firms used short term debt instead of long term as short term seems to be beneficial for the financial institutions. According to Barracca (2007) poor legal agendas and bureaucratic skills with respect to revenue extraction; dishonesty in the system of a predatory period that privileges certain sectors and conferred benefits with baseless tax “immunities;” and leaders who breach agreements with the government to evade taxation, made conceivable by an anemic agriculture income tax. Research recommends that with a more extensive, clear, liberal, and unbiased tax structure; government revenue might certainly be double, thus finishing the enormous gap among protection and growth expenditures. Sectors differ in different political periods because of the leverage that relates strongly to the nature of industry. In political periods the study carried on default prediction highlighted the role of sectors/industries in explaining the firms financing patterns (Zarebski and Dimovski, 2012). Generally political instability provided excessive teachings to financial institutions in both established and developing economies. The new consequence of these periods was to ease the size of obligation and equity financing that can be accessible to industries and distress monetary market.

2. LITERATURE REVIEW

One of the extreme historic problems to the constancy of equality in developing nations has been subordinating the armed to civilian rule. The best high profile appearance of this brawl has remained the occurrence of armed coups. Though, with the third movement of democratization and the completion of the cold war, researchers have claimed that we have arrived a new period of civil-military associations in which positive armed coups beside democracies will be mutual and less of a menace (Yaqub, 2010). On the other hand, in the situation of Pakistan the 1999 armed forces took an end to a more considerable 11 years era of democratic regime. The most recent incident held in Thailand in September 2006 where armed coups took the power and brings the end to democratic period that has been there for 14 years.

As in 1999 as the military took over the democratic government and took charge over the power and in 2002 elections were held and military comes in power. From 2002 corrective measures and actions were taken in the dictatorship era and sectors started to gain and achieve profits. In 2008 elections were held and democratic government comes to power again the same problem occurs that due to high interest rates, inflation all the sectors were badly affected and situation becomes worse. Though, a substantial part of the literature concerning bankruptcy predictions have dealt with issues regarding the determinants of leverage at the firm’s level and a few studies dealt with the explanatory power of institutional differences across developed, emerging and developing countries (Ali and Afzal, 2012). The role of sectors/industries in explaining the firm’s financial behavior remained less-investigated. Thus, the sectors effect gained the importance which is needed to assess that how the nature of the sectors affects the bankruptcy prediction of firms across sectors/industries. Barracca (2007) explained that during the democratic period lending was greatly reduced by financial institutions and equity issuance by firms. Therefore as a consequence of different political eras there was significant increase in the level of debt in firms. Financial flexibility is important in firm’s decisions especially in political periods. The political periods had a main influence on the monetary markets. It greatly reduced safety issuance by companies and loaning by monetary institutions. From 1996 democrats were in the power and due to bad governance and bad financial policy all the firms were affected and financial deficit was up surging.

Though, these studies create noteworthy consequence of political periods on company’s business processes and investments. However, the outcome of worldwide financial crunches on default prediction determinants of the firm across industries/sectors in political period remained unexplored. As the industry/sector exact behavior may contrarily disturb the firm’s leverage through different political periods (Ahmad et al., 2012). Thus, the study highlights the differences of determinants across sectors/industries during different political periods (Democratic and Dictatorship periods). Small and medium enterprise play vital roles that have been progressively predictable over the last 20 years, both in an extensive literature which highlights that role and in the strategy rhetoric of many developing countries. The gap among where policy is and wherever it ought to be has numerous reasons. One is a bequest of strategy indifference in the sector, a rather ordinary result of its nonappearance from the key models used to help project the economic plan and of the frail organization, political voice and bargaining power of the sector. In those several countries confronted with macroeconomic catastrophes or strains, this unsuccessful bequest has frequently been compounded by the overwhelming focus on things that are in exclusion from sectoral questions understandable enough but nonetheless something which needs alteration. Though, the research
initiates a significant consequence of political periods on firm’s business procedures and investments. However, the effect of sector level determinants of the firm across industries/sectors in political period remained unexplored. As the industry/sector specific behavior may differently affect during different political periods. Thus, the study highlights the differences of determinants across sectors/industries during different political periods (Democratic and Dictatorship periods).

The present research adopts a nation from developing markets that has remained pretentious by political crisis. The devastating political periods affected the financial and industrial sectors of Pakistan (Ahmad et al., 2012). In the military regime from 2002/03 to 2006/07 sectors started to do better as Pakistan’s financial position during this sub-period has been inspiring in terms of employment of labor, per capita, and scarcity. As a consequence of sensibly high gross domestic product (GDP) growing rate of around 6.3% a year for 5 years the income per capita in present dollar position has increased to around $1000. GDP progressed significantly from 3.1% in 2001/02 to 7% in 2006/07. There is a broad agreement that deficiency was condensed in this phase but the degree of decline differs among 5 fraction to 10. Redundancy percentage has also dropped from 8.4% to 6.5% (Pakistan Economy, 2011). External debt of stock and obligations as fraction of overseas exchange rates has been condensed to 125 from 224% in 2001/02. As a proportion of GDP it is dejected to 28 from 46%. The nation’s debt servicing volume upgraded extensively as debt servicing of overseas exchange rates weakened abruptly to 9% as it was 26%. US $ 14 billion overseas exchange assets rose from $6.4 billion in FY02 casing 6 months’ imports. Transfers of goods and services went up from $13.6 billion to $21.2 billion recording arise of 55%. Low interest rates that affected as low as 4 to 5% invigorated private investment and powered growth. Industrial sector noted arise in its portion of GDP from 14.7% to 19.1% by FY07. In fruitful subdivisions development was broad-based. The segment of cultivation weakened from 26% in FY00 to 21% in FY07 though that of manufacturing sector to 27% from 23% over this era. Investment rate rose to 23% in FY07 after averaging about 18.6% over the preceding 3 years reflecting a 4.4 fraction point growth in investment/GDP ratio. The telecom segment ($4.6 billion), finance sector ($2.7 billion) and oil and gas subdivision ($1.4 billion) were the main heritors of overseas direct investment. Though, inflation mark due because of the inclination in the worldwide product costs as well as inadequacies of wholesale and trade markets. Prices on imports middling to 7.6% and tariff on imports of plant, equipment and apparatus for industrial subdivision has been abridged to 5% and for agriculture segment to 0% while 50% preliminary devaluation grant is allowable. Free trade contracts have been settled with China, Malaysia, Sri Lanka, Iran and Mauritius. From 2008 onwards in democratic regimes the sectors were badly affected. As a result of these political disturbances, the GDP growth reduced from 7% to 1.7% in 2008-2009 to 3.1% in 2009-2010, followed by 3% in 2010-2011. The political periods had a main influence on the financial markets. It significantly reduced safety issuance by companies and loaning by financial institutions. From 1996 democrats were in the power and due to bad governance and bad financial policy all the firms were affected and financial deficit was up surging. From 2002 Army took over the country and martial law rule was imposed. From 2008 onwards democrats again came to power through elections and again sectors were affected badly and economy becomes worse. 2008 was even a crises period and the effect of financial crises on investment and firms operations were investigated by the studies (Forsberg, 2010; Zarebski and Dimovski, 2012). The sectors/industries have different temperaments in different political periods. However the effect of different political periods on firm’s behavior across sectors/industries remained untapped. The study secondly highlights the differences of default prediction determinants across sectors/industries during political periods. The purpose of the study is to gain important insights into how industry/sector behavior affects the relationship between leverage and default prediction determinants at firms, sector and country-level. With these perspectives, this study examines the significant default prediction determinants of Pakistani firms listed on Karachi stock exchange (KSE) across sectors with respect to firm’s size and different political periods.

The impact of political disturbance and the outbreak of global financial crises 2008 varied widely across countries, and even across firms within a country (Mittoo and Bancel, 2011; Zarebski and Dimovski, 2012). The evidence also suggests that these cross-sectional differences provide unique sample to examine that how different political periods affect the firm’s financial structure. As the impact of political instability that is connected with each country’s institutional settings, therefore, in line with the objectives of the study, this phase of study analyze the impact of different political periods (dictatorship period and democratic period) on firm, sector and country-level determinants of default prediction across sectors of Pakistan.

In the presence of political instability and the outbreak of global financial crunch firms regulate their financial decisions infrequently; as a result the firms face difficulties in raising funds to finance their investments (Fosberg, 2010). Based on past literature, a few studies (Deesomsak et al., 2004; Ariff et al., 2008) provide insights into global financial crises that affect the firm’s financing behavior during different economic periods. So far, Barracca (2007) highlighted the importance of institutional differences to understand the impact of financial crises during different political periods. To the best of researcher’s knowledge, the consequences of sectors behavioral affect that may influence the direction and extent between determinants of default prediction during political crises periods remained untapped. Therefore, this segment of study explains the impact of different political eras on default prediction determinants across sectors in Pakistan. The sample periods are divided into two sub political periods. The first period is dictatorship period starting from 2004 to 2008. The second period is democratic period starting from 2009 to 2013.

### 3. INDEPENDENT VARIABLES

Sector level variables were incorporated as independent variables to show the effects of sectors in different political eras (Democratic and Dictatorship).
3.1. Munificence

According to Beard and Dess (1984), the ability of an atmosphere to preserve a constant expansion is called munificence. These sectors/industries therefore, benefits from bigger profitability due to less competitive environment. Hereby, consistent with these advices, the impact of sector/industry is visible, as firms creates greater profits; those function in sectors/industries with high level of munificence (Ramakrishnan, 2012).

3.2. Dynamism

Generally, the environmental dynamism describes the rate and instability of changes in a firm’s external environment (Beard and Dess, 1984; Simerly and Li, 2000). It can be documented that high dynamism creates more uncertainty; therefore, it reduces the level of leverage. Consequently, the firms operating under dynamic environment may tend to use equity financing to lessen the transaction cost occurring from increased level of risk. On the other hand, firms operating under the environment with lower dynamism tend to use more debt financing. In a study across emerging markets, Kayo and Kimura (2011) found a positive but insignificant relationship between leverage and environmental dynamics.

3.3. HHI

The HHI is used to measure the firm size in relation to sector or industry. The level of industry concentration measures the level of leverage employed by firms. Generally, in terms of their characteristics, both types of industries greatly vary (Almazan and Molina, 2005). In simple words, low concentration industries (competitive industries) are exposed to high risk and high volatility in profitability; therefore, they use lesser amount of leverage.

3.4. Uniqueness

Shahjahanpour et al. (2010) enlighten uniqueness in their research that research and development and selling expenses are at the first and at the end of the production value chain. It is claimed by Titman and Wessels (1988) that firms that generate specialized or unique products experience comparatively higher costs in the incident that they liquidate. Since their suppliers and workers almost certainly have job-specific expertise and capital, it is not easy for them to change to other operations or to cash out (Kuang-Hua and Ching-Yu, 2011).

4. METHODOLOGY

Independent variables have been designated in accordance with the theoretical work. Therefore, procedure has been described here to test dissimilar hypotheses and examine those variables empirically. To build the model, panel data methods have been used. Panel data contains both the time series essentials and cross-sectional essentials; time series elements replicate the time period of the study (2003-2013) and cross-sectional essentials reflect (156) non-financial companies.

\[ t = \frac{Z}{(s / \sqrt{n})} = \frac{\bar{X} - \mu}{(\sigma / \sqrt{n})} \]

Where \( X \) is the sample mean from a model \( X', X'', \ldots, X'\) of size \( n \), \( s \) is the proportion of sample standard deviation over population standard deviation, \( \sigma \) is the population standard deviation of the data, and \( \mu \) is the population mean.

The assumptions underlying a t-test are that:

- \( X \) trails a normal distribution with mean \( \mu \) and variance \( \sigma^2 \)
- \( s^2 \) trails a \( \chi^2 \) distribution with \( p \) degrees of freedom underneath the null hypothesis, where \( p \) is a positive constant
- \( Z \) and \( s \) are independent.

4.1. Data Collection

The paper contains non-financial firms of Pakistan which are listed on KSE. The study relies on secondary data, which will be extracted from various reliable sources (e.g. State Bank of Pakistan, KSE and Federal Bureau of Statistics). This study will focus on the non-financial firms listed on KSE. In order to bring into focus how political regimes affects industry/sector of Pakistani listed firms, the study utilizes 10 years panel data from 2004 to 2013.

5. EMPIRICAL RESULTS AND DISCUSSIONS

Table 1 depicts the paired sample statistics the descriptive Table 1 presents the mean, sample size, standard deviation, and standard error for both groups. It is stated from the Table 1 that mean in dictatorship era of munificence and dynamism is better

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>N</th>
<th>SD</th>
<th>SEM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pair 1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Munificence (2003-2008)</td>
<td>8.8923</td>
<td>149</td>
<td>7.66243</td>
<td>0.62773</td>
</tr>
<tr>
<td>Munificence (2009-2013)</td>
<td>4.2577</td>
<td>149</td>
<td>3.54012</td>
<td>0.29002</td>
</tr>
<tr>
<td>Pair 2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dynamism (2003-2008)</td>
<td>1.2917</td>
<td>149</td>
<td>1.44799</td>
<td>0.11862</td>
</tr>
<tr>
<td>Dynamism (2009-2013)</td>
<td>0.6248</td>
<td>149</td>
<td>0.67714</td>
<td>0.05547</td>
</tr>
<tr>
<td>Pair 3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HHI (2003-2008)</td>
<td>826.7127</td>
<td>149</td>
<td>475.3360</td>
<td>38.94085</td>
</tr>
<tr>
<td>HHI (2009-2013)</td>
<td>852.4020</td>
<td>149</td>
<td>405.58952</td>
<td>33.22719</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variables</th>
<th>N</th>
<th>Correlation</th>
<th>Significant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pair 1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Munificence (2003-2008)</td>
<td>149</td>
<td>0.994</td>
<td>0.000</td>
</tr>
<tr>
<td>Munificence (2009-2013)</td>
<td>149</td>
<td>0.979</td>
<td>0.000</td>
</tr>
<tr>
<td>Pair 2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dynamism (2003-2008)</td>
<td>149</td>
<td>0.979</td>
<td>0.000</td>
</tr>
<tr>
<td>Dynamism (2009-2013)</td>
<td>149</td>
<td>0.979</td>
<td>0.000</td>
</tr>
<tr>
<td>Pair 3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HHI (2003-2008)</td>
<td>149</td>
<td>0.477</td>
<td>0.000</td>
</tr>
<tr>
<td>HHI (2009-2013)</td>
<td>149</td>
<td>0.477</td>
<td>0.000</td>
</tr>
</tbody>
</table>

SD: Standard deviation, SEM: Standard error mean, HHI: Herfindahl-Hirschman index
and sectors were prospering in dictatorship era whereas mean of HHI in democratic era is better and for uniqueness it is almost equal in both regimes, The standard deviations for pre- and post- dimensions reveals that dictatorship era is better for two variables.

To the best of researcher’s knowledge, the consequences of sectors behavioral affect that may influence the direction and extent between determinants during political crises periods remained untapped. Therefore, this segment of study explains the impact of different political eras on default prediction determinants across sectors in Pakistan. The sample periods are divided into two sub political periods. The first period is dictatorship period starting from 2004 to 2008. The second period is democratic period starting from 2009 to 2013. Table 2 shows the paired samples correlation for ready reference.

The Pearson correlation between the munificence dynamism and HHI in dictatorship era and democratic era weight measurements is 0.994, 0.994, and 0.979 which shows high correlation. Unlike uniqueness, as uniqueness is almost equal in both eras. Table 3 depicts the mean column in the paired-samples t-test.

Table 3 shows the average variance among dictatorship and democratic regimes. The standard deviation column shows the standard deviation of the normal difference score. The SEM delivers an index of the inconsistency one can assume in recurrent random samples in this study. The 95% confidence interval of the variance delivers an approximation of the limitations among random samples in this study. The 95% confidence interval of the difference delivers an index of the inconsistency one can assume in recurrent random samples similar to the ones contributing in this study. The t-statistic is attained by dividing the mean difference by its standard error. The significant (two-tailed) exhibits the chance of gaining a t statistic whose absolute value is equal to or superior to the achieved t-statistic. Though, the significance value >0.10 for democratic and dictatorship level shows that the regimes are significantly equal in case of the sectors. As stated from Table 3 that munificence, dynamism and uniqueness are better in dictatorship period, whereas HHI is better in democratic period.

6. CONCLUSION

The results indicate that most of Pakistani listed firms across sectors are highly responsive to political and economic conditions. It is clearly evident that the amount of impact and mechanism among sectors and financial distress determinants changes as the firms operate in different political periods, such, dictatorship and democratic period. The element of political periods elucidates that most of firms across sectors retorted contrarily to both different political periods. The sector-wise analysis confirms the effect of different political periods on the relationship among each sector level. Based on overall dataset, the impact of munificence, dynamism, HHI differs during political period and it seemed to be significant which means munificence, dynamism, HHI shows that dictatorship period is better and sectors were in a profitable venture.

REFERENCES


Ramakrishnan, et al.: Impact of Sector Level Variables on Political Scenarios in Pakistan

Economic Review, 30(2014), 244-262.