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November 25, 2020

**Why does Pakistan need large firms?**

One of the striking features of the industrialized nations is the number of large firms that dot their economic landscape. Data released by the US Census Bureau, for example, suggests that the US has six million firms, with 20,000 of these employing more than 500 people. Cumulatively, these account for approximately 53 percent of the total employment in these six million firms. Put another way, only 0.33 percent of the total number of firms was providing employment to 53 percent of the total employed, a staggering figure even for the world’s largest economy.

We observe similar numbers in the case of other large, industrialized economies. For eg, by end 2018, China had 34.8 million registered enterprises. Although exact statistics on employment by size of firms in China is not available, the 10 largest industries in China employ approximately 265 million workers as of 2020, which comes to 35 percent of the total number of employed people in China (775 million). Ali Baba, China’s largest e-commerce company is employing 117,600 full-time employees at present. In contrast, Pakistan’s largest online market place employs 89 full-time employees for its operations.

In terms of numbers of registered firms, SECP data indicates that by end-April 2019, there were a total of 99,291 firms registered in Pakistan, which increased to 105,000 by April this year. Just in terms of numbers, comparison with regional peers casts a poor light. Iran, which has been under international sanctions since the late 80s, had a total of 1.6 million registered firms as of end-2018. India’s number stands at two million as of end-June 2020.

So why larger firms? There is considerable literature on the kinds of advantages that are offered by large-sized firms, summed up in the World Bank’s recent publication (‘Making it big: Why developing countries need more larger firms’) regarding the need for developing countries to have large-sized firms.

In the Executive Summary of the report, the authors argue that: “These distinct features of large firms translate into improved outcomes not only for their owners but also for their workers and for smaller enterprises in their value chains. Workers in large firms report, on average, 22 percent higher hourly wages in household and labor surveys from 32 low- and middle-income countries – a premium that rises considerably in lower-income contexts. That is partly because large firms attract better workers.

“But this is not the only reason: accounting for worker characteristics and nonpecuniary benefits, the large-firm wage premium remains close to 15 percent. Besides higher wages – which are strongly associated with higher productivity – large firms more frequently offer formal jobs, secure jobs, and nonpecuniary benefits such as health insurance that are fundamental for welfare in low- and middle-income countries”.

Clearly, larger firm sizes impart considerable advantages that range from higher productivity and higher R&D to secure jobs with better pay and spawning value chains that create further job opportunities (thus acting as an employment multiplier). Aside from the economic and financial aspects, they also impart ‘social value’, courtesy of their operations. Briefly put, firms optimize upon available resources (capital, labour, knowledge, geography, etc), and coordinate them in a manner that the end result is a product that the society wants (thus catering to the aggregate demand). In pursuing its own objective (profits), it not only creates jobs, but also supports a whole value chain through its acquisitions. It follows that the larger the firm, the larger will be its production pursuits, and thus a larger positive impact upon factors like jobs and support to businesses.

So why is there a dearth of large-sized firms in Pakistan? The above cited study as well as PIDE’s recent webinar on the hindrances to business growth in Pakistan (‘Why businesses don’t grow in Pakistan?’) clarify to a large extent why Pakistan does not have large business establishments. These range from regulatory burdens, lack of policy continuity and cultural factors (family business culture, etc) that prevent the expansion of business ventures.

The way governments regulate businesses and industry can have a telling effect upon the size and operations of a firm. In a competitive environment, there are no guaranteed profits or returns and firms have to vie with one another to capture market share. Larger market shares mean reasonable returns. For that to happen, firms have to expand their capacity to cater to market demand.

The majority of the firms in Pakistan that employ around (or more than) 500 employees tend to be concentrated in sectors that enjoy government support in one form or the other, thus inhibiting the need to grow capacity beyond a certain point, and beyond the domestic market. For eg, a large number of sugar mills employ 500 or more employees. This a highly protected, highly subsidized sector that has enjoyed generous government support that helps generate risk-free, guaranteed returns. And given significant protection that it enjoys (through high tariffs), it faces little competition, and thus little need to expand beyond the domestic market.

The way markets are regulated is another critical factor. In general, markets where the government plays the role of facilitator tend to act as an incentive for firms given that there are no limits to a market’s expansion potential. But when the government becomes a direct player in the market or regulates in a manner that market size remains subdued, the incentive to expand operations is limited. The wheat storage market in Pakistan, for example, has huge potential. Yet there are not many private firms that venture into it since the government, through PASSCO, acts as a direct buyer and storage agency. A similar example of obverse regulations is found in Pakistan's pharmaceutical sector. With a global market valued at more than $1 trillion, Pakistan’s market is hardly $3 billion despite having an industrial structure that has the capacity to grow big. But market size is severely restricted by regulations related to pricing and lack of consistency in policies, etc.

What can be done, especially in terms of policy? The successful founding and functioning of a firm depends upon factors like financial plus human capital, market conditions, technology and government policies (ie the regulatory framework governing the economy). While financial capital may not be as severe a restraint in Pakistan, competitive, unhindered markets, technological prowess and government policies do tend to be lacking in terms of incentive for firm functioning and expansion.

In light of the above, a few policy recommendations are as follows: the government needs to revisit its role in economic affairs, especially the questionable need for its direct intervention in various sectors through regulations. It should limit its role to that of a facilitator. The protection afforded to select industries should be done away with. Competition is not a zero-sum game. Not only would the resulting competitive pressures (internally and externally) bring an element of efficiency, they would also open new markets to Pakistani producers.

The government should do away with running businesses. Pakistan’s power sector, for example, is a potentially large market that is set to grow even further in the future but suffers from serious deficiencies due to the government acting as a single buyer and running distribution companies in a bureaucratic manner.

Improve the quality of institutions that coordinate and deal with matters pertaining to firms, ranging from tax matters to legal issues. Put another way, good governance should be ensured to lessen the transaction costs of establishing and running firms.

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