THE NEWS The future of SOEs [Part – III]

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A detailed and rigorous exercise was undertaken to examine each SOE based on the ownership rationale and its financial performance as explained earlier, and all the commercial SOEs were categorized into two broad categories: (a) to be retained under state ownership; and (b) to be privatized or liquidated.

The first category includes those performing core functions and fall within the scope of public policy framework. These SOEs are further sub-divided into two parts according to their financial performance: one, those which are profitable and financially viable – 25 SOEs were profitable in FY2018-19. Using a more stringent criteria to evaluate their financial viability four SOEs are categorized as financially viable – GHPL, Pak-Arab Refinery Company, Pak-Kuwait Investment Company and Pakistan Revenue Automation Ltd. Another 19 entities have been consistently profit making during the last three years; however, their ROAs have been lower than the threshold required. Another two SOEs – CPPA and Pak-Iran Investment Company – have positive equity and were profitable in FY2017 and FY2019. Although these SOEs are financially self-sustaining, their financial performance needs improvement through institutional reforms, like governance improvement through ownership and management policy, to be enacted as part of an SOE bill.

Apart from sector-specific reforms that will be undertaken, a well-structured and institutionalized mechanism of performance monitoring and reporting shall be put in place with the objective of bringing the financial outcomes of these SOEs to the required threshold level.

The second subdivision is to retain but restructure and reform. There are 14 entities which are planned to be retained under government ownership but require immediate reforms and major restructuring for improved financial performance. Among them Pakistan Railways and Pakistan International

Airlines, which were collectively making a loss of Rs88 billion in FY19, are already under an active restructuring and reform process, explained below.

Pakistan Railways is currently implementing a comprehensive restructuring plan to enhance operational and financial efficiency to curtail losses and improve service delivery. The plan envisages formation of an infrastructure company under government management, a freight company to be operated by the private sector to expand freight operations and generate additional revenue, and a passenger train company also under the private sector. The office of GM/CEO of Pakistan Railways would be strengthened, and the existing workforce rationalized to ensure work efficiency among its employees. Steps have to be taken by addressing the core issue of pension liability that equals the amount of losses incurred.

Pakistan Railways improved its performance by curtailing its losses during FY2018-19. However, the Covid-19 pandemic has negatively affected its operations since March 2020.

Pakistan International Airlines has initiated a reform process by route rationalization and bringing efficiency in human resource management. The restructuring plan recommends the split of PIA into two companies, a holding company that assumes the liabilities and assets and a new company that starts with a fresh balance sheet, one half of the current workforce, route rationalization, outsourcing non-core functions and induction of new aircrafts.

During FY19, collective losses of the rest of the SOEs in this subcategory were around Rs17 billion out of which Pakistan Post had the largest losses of over Rs9 billion. A major source of losses of this entity is the annual pension liability. The establishment of a pension fund for Pakistan Post is also under consideration.

SOEs to be privatized or liquidated: this category includes SOEs not performing core functions as covered in the Public Policy Framework and therefore are recommended either for privatization or liquidation. Accordingly, these SOEs are grouped into following four sub-categories.

i) Already under privatization. There are 10 SOEs which are on an active privatization list and are at various stages of the privatization process. The Pakistan Steel Mills is an important entity on the active list and is at an advanced stage of the privatization process. SME bank is another loss-making SOE which is on the active privatization list. In addition to these, partial divestment of shares of OGDCL and PPL through the capital market is also underway.

ii) Under the next round of privatization: 24 SOEs are identified for the next batch of privatization, 12 of which were loss making in FY19 with a combined loss of Rs156 billion. Among the loss-making SOEs proposed for privatization, the major loss-making entities are eight DISCOs (HESCO, IESCO, PESCO, SEPCO, MEPCO, LESCO, FESCO and QESCO), one GENCO (Jamshoro Power Company) along with Pakistan Textile City Ltd, State Engineering Corporation and Telephone Industries of Pakistan.

iii) Potential Privatization or liquidation candidates: Ten SOEs have been identified as potential privatization or liquidation candidates and due consultations with line ministries had already been initiated. Six entities were loss making with a combined loss of Rs38.5 billion mainly emanating from ZTBL (Rs18 billion), SSGC (Rs14.8 billion) and USC (Rs5 billion).

iv) The Industrial Development Bank of Pakistan is already under the process of liquidation. Steps should be taken for early completion of the liquidation process.

To sum up, 25 out of the total 84 SOEs (excluding NHA from the list) would be retained under the state ownership as they are performing public policy functions or for the reason of market failure or externalities. They also meet the criteria of financial viability. Another 14 would be retained but they have to go through major restructuring and that includes PIA and Pakistan Railways. The restructuring plans of both these entities have already been approved by the cabinet but require urgent implementation. In all, 39 out of 84 SOEs would be retained under the state ownership.

The remaining 44 would be privatized. Ten are already in the process of privatization; that includes Pakistan Steel, one of the top loss-makers. Twenty-four are poised for the next batch of privatization; this subset includes 12 of the big loss-making entities with cumulative losses of Rs156 billion originating mainly from the five loss-making power DISCOs. Another ten are potential candidates for privatization or liquidation and includes six loss-making SOEs that together make losses of Rs38 billion. One would be liquidated but others can also be considered if they don't meet the performance indicators.

The Steel Mills has an innovative transaction structure. The assets, including land, would be held by a holding company owned by the government which would enter into a long-term lease agreement through an open transparent process in which the winner of the bid would commit investment to raise the capacity from one million tons to three million tons. In case of DISCOs, the infrastructure, land and assets would remain with the government, but the day-to-day management and operations would be contracted out to the private sector based on key performance indicators. Therefore, the popular fear that the family silver is being sold to the cronies would be allayed through this innovative model of privatization. The resistance therefore ought to be minimal.

The clear and loud message that comes out of the above analysis is that if there is one area of priority that would make a substantial difference to the economy, it is the power-sector SOEs. The government should take immediate action in respect of these companies which are putting stress on public finances, adding to the circular debt, making the industries non-competitive, giving rise to loadshedding and raising the burden on the households.

Concluded