# SOEs: an eclectic approach

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**A CONTROVERSY is raging on both mainstream and social media over PIA's recent privatisation. Unless this debate is addressed rationally, future privatisation transactions may also be at risk. Past experience offers a cautionary lesson: the Supreme Court's decision to annul the privatisation of Pakistan Steel Mills did not revive the enterprise; instead, it led to its closure in 2015 and significantly slowed the overall privatisation process.**

The popular binary often advanced — either retain enterprises under government ownership or privatise them — is flawed. Decisions regarding state-owned enterprises should be guided by pragmatic considerations rather than ideological preferences. Pakistan has 85 commercial SOEs for diverse purposes across power, oil and gas; transport and communications; manufacturing, mining and engineering; finance; industrial estate development and management; and wholesale and retail trade. Of these, 51 are currently profitable. The argument that profitable SOEs should never be divested is as untenable as the view that all 34 lossmaking entities must be privatised. Neither ownership per se nor current financial performance should solely determine policy.

The basic principle for deciding whether an economic activity should be undertaken by the government — through its departments or through an SOE — rests on two questions: a) does the activity fall within the government's public policy framework? b) Can it be adequately performed by the private sector?

**Relevance to public policy framework:** The PPF reflects the government's development priorities, as articulated in documents such as the Principles of Policy (Article 3 of the Constitution) and sectoral policies relating to agriculture, industry, trade, etc. In assessing alignment with the PPF, it is necessary to consider whether an SOE is connected to one or more core state functions — i) ensuring national food security; ii) developing and managing large-scale infrastructure; iii) national defence and security-related activities; iv) entities established through government-to-government or intergovernmental arrangements; and v) provision of goods and services of critical national economic interest. If an SOE falls into any of these categories, there is a prima facie case for retaining it under government control. The decision then is whether it should be retained in its existing form or restructured to improve performance.

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**Market failure considerations:** The second question concerns market failure: can the private sector adequately deliver the relevant activity? Each SOE must be evaluated in terms of its operations, functions and market structure, with attention to the following: a) is the SOE a natural monopoly; if so, does an effective regulatory framework exist to ensure socially optimal and cost-effective service delivery under private ownership? b) Does the SOE perform a function that generates significant positive externalities and is, therefore, insufficiently profitable for the private sector to undertake? c) Are there alternative delivery mechanisms to achieve the same objectives?

Where market failure prevents the private sector from maximising social welfare, the government has a strong case for retaining control. Even then, competition can be introduced by dismantling monopolies where feasible and establishing strong, independent regulatory agencies.

**Financial viability:** While several SOEs report accounting profits, financial viability requires more rigorous assessment. The key question is whether the organisation can generate sufficient revenues to cover operating costs, meet debt obligations, and, where relevant, finance investment for growth while maintaining acceptable service standards. The financial viability test should be based on the following: a) Negative shareholders' equity: Any entity with negative equity for the past three years is financially stressed, as its balance sheet is not bankable and it remains dependent on government guarantees or direct budgetary support. b) Continuous losses: Entities incurring losses over the last three years are similarly stressed, as losses either necessitate government support or gradually erode equity. c) Return on assets: While return on equity is a standard metric, ROA is more appropriate when equity is negative. ROA measures how effectively management uses assets to generate earnings. SOEs with an ROA below five per cent for three consecutive years should be considered financially stressed.

In such cases, financial restructuring is the first step. If restructuring fails under government ownership due to extraneous constraints, alternative options — such as outsourcing, leasing, concession agreements, or transfer of managerial control — should be considered. SOEs that don't meet public policy criteria, don't address market failure concerns, or cannot be made viable even after restructuring are prime candidates for privatisation, liquidation, or winding up.

**Lessons from successful privatisation:** Pakistan's main privatisation success stories are the banking and telecom sectors. In banking, the share of assets held by nationalised commercial banks declined from around 80pc to about 20pc following privatisation. Prior to 2003, the government injected Rs46 billion to recapitalise lossmaking banks; non-performing loans stood at 25pc, and financial soundness indicators were weak. Since privatisation, four major banks (HBL, UBL, MCB, and ABL) have contributed Rs245bn in corporate taxes in 2024 with cumulative contributions exceeding Rs1.6 trillion since 2004. NPLs have fallen below 7pc, provisioning exceeds 100pc, and overall financial soundness has improved.

The main weakness in recent years is the growing role of banks as public sector financiers, reflected in a declining advance-to-deposit ratio. Importantly, public sector banks such as the NBP and the Bank of Punjab have also improved under a competitive market structure and rank among the top 15 Asia-Pacific banks. The ideological argument that these institutions must also be privatised ignores the empirical evidence that ownership itself is not the decisive factor.

**PIA's case:** Applying this framework (spelt out in the SOE Triage Report 2021) to PIA leads to a clear conclusion: there were no compelling public policy or market failure reasons for retaining it under government control. The aviation industry is competitive, and private operators have proved their capacity to perform effectively. Despite repeated restructuring efforts, PIA accumulated losses of Rs850bn. The privatisation objective was not short-term maximisation of sale proceeds but elimination of recurring losses and revival of the airline as an efficient enterprise. Over the longer term, improved performance under private management is expected to generate a steady stream of tax revenues rather than drain the exchequer. In sum, Pakistan needs an eclectic, evidence-based approach to SOEs, which transcends ideological divides and focuses squarely on public policy relevance, market structure, and financial viability.

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