Policy Brief

FIRMS FINANCIAL INCLUSION AND EXPORT PERFORMANCE: EVIDENCE FROM MANUFACTURING SECTOR FIRMS IN PAKISTAN

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INTRODUCTION

Financial indicators, such as the credit-to-GDP ratio and financial access of firms, enhance economic growth, innovation, and job creation, and help reduce poverty and income inequality. It is imperative to investigate and determine the impact of "not enough finance" in developing countries where usually the banking sector plays little or insignificant role in the development of the financial sector and plays no significant role in economic growth. Specifically, in economies with low financial development and a credit-to-GDP ratio lower than 14 per cent, financial development plays little role in determining economic growth.

The finance literature provides limited empirical evidence on developing economies' financial depth and growth nexus. A firm's financial inclusion has serious implications for the firm's export potential. In the case of Pakistan, very few studies have investigated firms' financial inclusion and export performance.

Pakistan's export performance has remained low and unimpressive despite several remedial measures. Moreover, export statistics show that Pakistan's exports persistently lag behind other regional and developing countries. The imbalance in the trade deficit and the decline in export performance have been areas of concern over time. The limited and restricted availability of external financing, especially long-term financing for business enterprises that increase a firm's export capacity, is one of the key impediments to the country's export performance.

Limited literature, SDGs' financial inclusion commitments, and the lacklustre export performance of the manufacturing sector provided the motivation to analyse Pakistan's manufacturing sector's export performance. The study highlighted the impediments undermining large firms' export performance in Pakistan's manufacturing sector. The study employed System GMM and quantile regression analysis, using 427 firms' balance sheets to obtain the data from 1999-2020. The study is relevant at the policy level as the export performance of firms, financial underdevelopment, and firms' limited access to external finance have serious implications for the country's export performance and overall economic growth.

METHODOLOGY

The empirical estimation technique for the study was selected based on the data properties.

1. Descriptive statistics of the variables.
2. Panel data's slope homogeneity and cross-section dependence. This study employed slope coefficient homogeneity (SCH) test and the cross-sectional dependence test to determine whether a phenomenon is homogeneous or heterogeneous.
3. Fisher test for the stationarity of data

FINDINGS

Firm's Total Assets

The positive impact of larger assets and resources on a firm's exports implies that firms with larger resources/assets tend to have higher exports. Firms having larger assets and resources enable them to increase exports. On the other hand, small firms are less likely to export due to financial resource constraints.

Assists Tangibility Ratio

The study's finding regarding Assets tangibility indicates that the capital formation of fixed assets concerning a firm's total assets undermines export performances. The inverse impact of assets tangibility may be that the firm more probably diverts its financial resources from financing export activities toward larger fixed assets development. To secure an external loan, relying on fixed assets to secure a loan may be costlier than depending on intangible assets that back up an external loan.

Gearing Ratio

Gearing shows the firm's financial inclusion and access to external financial resources. The results imply that firms relying more on external debt to finance assets and activities are more likely to enhance exports.

Debt-to-equity Ratio

The debt-to-equity ratio is the relative ratio of the creditor's fund versus shareholder equity. The construct shows the firm's total debt concerning shareholder equity. The reported results indicate that for firms acquiring higher debt in comparison with shareholder equity, the acquired debt has the potential to encourage export performances.

Macro Environment

The study controlled for macro variables, such as trade openness, industrial production, risk premium, and exchange rate. Several studies have investigated the macro environment's role in determining a country's economic growth and export performance. For instance, a macro variable trade openness is positively associated with economic growth and export performance. The study considered the importance of exchange rates in the context of export performance and proposed future studies on exchange rates and firms' export performance. Theory, literature, and the study's findings conclude that a sound macro environment is equally crucial for better export performance. Specifically, exchange rate stability, trade liberalisation and openness, sound industrial production environment, human capital accumulation, political stability, and the firm's financial inclusion lead to higher export performances.

RECOMMENDATIONS FOR STAKEHOLDERS

For State Bank:

- Policies such as the Export Finance Scheme (EFS) and Long-Term Finance Facility (TFS), which were in place for two years by the SBP, under which loans were given to exporters at low policy rates, are needed.
- It is high time that TERF, which was extended to exporters and local manufacturers during COVID-19, is resumed for exporting manufacturers, if not for all.

- Diaspora bonds for industries in the Far East (3 years-5 years)
- Establish a more predictable exchange rate regime for exporting firms. East Asia has had a dual exchange rate for a long time as they want to facilitate exports).

For the Board of Investment

- There is a need to focus on the availability and ability to raise the debt and equity
- Planning Commission and BOI must sit together and bring regulatory reform that OFDI must go to exporting firms.
- There must be a sound investment policy that creates room for the FDI for exporting firms and joint ventures with exporting firms.

For the Finance Ministry and the SECP

- They need to look into why is the asset base of the enterprise sector locked and why it does not grow in terms of GFCF (gross fixed capital formation).
- A 'sandbox' by SECP is needed.
- Further, a burning issue is that the accumulation of debt is not allowed by 'crowdsourcing,' while raising equity from crowdsourcing is allowed even though debt is much cheaper than equity.

For Finance Ministry

- Since the phenomenal increase in the policy rate, the private sector has been shedding credit. Also, 80% of domestic borrowing is by the government. So loanable funds are reduced from two angles, viz., domestic borrowing and less supply of loanable funds
- Since exports pick up at a floating rate, when the policy rate increases, loans become expensive and the exporter returns credit. This also hinders asset creation.
- The SBP may increase the rate but must manage exporters at a lower rate.
- The issue of EXIM Bank: The EXIM Bank (The Export-Import Bank) was established for this purpose by the World Bank to smooth the business cycle. However, no single entity can continue export financing.

For the Ministry of Commerce

- National Tariff Policy (Component of tariff on imported inputs): This policy has an anti-export bias as tariff rates are too high for imports. If textile sector dyes are to come, then the tariffs must be at least at the level of Bangladesh.
- Further, the 3-year trade policy by the Ministry of Commerce (STPF) focuses on increased asset creation and size. However, considering the current crisis that Pakistan is facing, this policy needs to be reviewed/revised. It had very little focus on a few sectors. The number of focused sectors needs to be increased.

The Ministry of Industries and Production

- There are two organisations under the MOIP:

1. EDB (Engineering Development Board): The ratio of input/output is decided by the EDB, i.e., how much of an imported input is allowed to exporters. This input-output

assessment, again, has an anti-export bias. Some can import, others cannot, which is discriminatory and needs to be deliberated upon for manufacturing exporters.

2. SMEDA: SMEDA should partner with PIDE on the issue of why only established exporters and not exporters are present in manufacturing after 2013 and why this list has not changed over time. SMEDA must look into barriers to entry, i.e., why SMEs do not become exporters, and what are the challenges to new entrants in the export segment.

CPEC LTP (Long-Term Plan)

- It is time to review why the goals outlined in LTP have not been fulfilled, such as China-bound goals.
- There is a need to rethink CPEC LTP
- Overlapping is another issue. Provincial P&Ds, in their development budgets, allocate budget for "Industrial Development," and there is considerable misalignment and duplication, e.g., in the Hattar Industrial Estate, KPK, is already established, and the Federal placed STZA.
- There is a need to look into why the Cabinet Committee on Export Promotion is dormant.