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BAILOUT AND FIRM PERFORMANCE; AN EVIDENCE FROM INDUSTRIAL SECTOR OF PAKISTAN

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The current study investigates the industrial performance of Pakistani firms by taking in to account Bailout as an independent variable. ROA (return on assets), ROE (return on equity), ROS (return on sales) and EPS (earning per share) are used to measure firm performance. Historical Data from 373 industries from 2009- 2014 are used to deduce the findings by applying linear Regression analysis and Hausman test. Results proved that Bailout have negative impact on the performance of the firms operating in Pakistan. Study also includes valuable recommendation for the future researchers.

KEYWORDS: Financial Performance And Bailout.

Many institutes: government and non-government, have fought financial battles throughout their existence for survival. Institutions look for external support in order to run successfully. Bailouts are one of the sources of rescue or recapitalization for a firm which is struggling for endurance. Various researches have been conducted around the world discussing the bailouts of banks, corporates and governments both central and regional. In a recent study Lender of Last resort borrowing was studied during European sovereign debt. Researchers observed that weakly capitalized banks took more loan from LOLR as compared to strongly capitalized banks and used riskier collateral (Drechsler, Drechsel, Marques-Ibanez, & Schnabl, 2016). To survive in this world these weak banks have to go an extra mile reason behind keeping riskier assets as collateral. In another study it was reported that a distressed financial sector go for government bailouts and cost of these bailouts in turn increase the sovereign risk (Acharya, Drechsler, & Schnabl, 2014).

It was also established that decline in bank CDS spread after the announcement of bailout packages by European government in 2008 resulted in increase in sovereign CDS spread as investors perceive that bailouts are transfer of risk to public sector from the private sector (Ejsing & Lemke, 2009). Political connection and bailouts relation was also studied in a firm's scenario. It was noted that firms that lobby or have political connections get more economic benefits (Benjamin M. Blau, 2013), (Hill, Kelly, Lockhart, & Van Ness, 2013). Researchers have shown that involvement in politics can give assurance of rescue in economic crises (Faccio, Masulis, & McConnell, 2006). It has also been observed that politically connected publicly traded firms have higher leverage ratios (Faccio, Masulis, & McConnell, 2006). Other studied the effect of bailout on taxes and social consequences of a collapsing bank (Vaugirard, 2005). Another study was conducted on TBTF institutes (too big to fail), researchers are of the view that TBTF institutes take risks as they expected to be bailed out in case of insolvency (Gong & Jones, 2013).

Bailout are not restricted to corporates or banks only, around the world government also look for financial aids in case of shortage of

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fund. Globally there are financial institutions which provide support to countries on conditional or unconditional agreements. Various researches have been conducted to analysis different aspect of bailouts to governments. It has also been observed that local governments when they are bailed out tend to improve their financial situation quiet rapidly (Allers, 2015). Governments can reduce their soft budget constraints through bailouts (Fink & Stratmann, 2011) In countries where the financial and economic institutes are not well developed or underdeveloped there is less evidence that IMF programs would increase private market access (Eichengreen & Mody, 2000).

Research conducted under the topic of bailout are restricted to financial support from an external source. According to (Adams & Brock, 1987) bailout from government can be direct cash infusion in the form of loans or financial credit or indirect in the form of protection from foreign competition, regulatory delays and dispensation, privileged government procurement practices, state sponsored promotion, tax favors and exemption from prosecution for illegal acts and practices. In this research the main objective would be to study the indirect government bailouts for different industrial sectors of Pakistan. There is a gap regarding the indirect form of government bailout. The basic aim of bailout is to safeguard a collapsing firm from insolvency or bankruptcy. When facing a financial dilemma institutes look out for support both in financial and economic footings. In this research it will be analyzed that whether these bailouts help the institutes grow better in the future and perform efficiently. Pakistan Steel Mill is one example where direct bailouts are frequently done. There are example of TARP funds, which is Troubled Assets Relief Program to buy the toxic assets and equity of the troubled financial institutions in order to strengthen them. This program was initiated as a direct bailout by US government in 2008 after the financial crisis. This program not only fulfilled its objectives but also helped the collapsing institutions a strong base which is supporting them till now. So here in this scenario bailout package in the form of TARP is a success. There are so many other examples as well supporting the phenomenon of bailout.

This study on indirect bailouts provided by Pakistan government would help in analyzing the impact on performance followed by bailouts done in several cases to rescue industrial sectors. Moreover, this study would help to identify whether bailout are useful for the struggling sectors as many researchers are asking for no bailout strategy because of the moral hazards concomitant with them. As researchers have identified moral hazards related to bailout as well, so this research would help to observe the impact of bailouts on the respective sectors.

LITERATURE REVIEW

Businesses can never go through a linear path: ups and downs are part of a business cycle. There are good times and there are bad times just like a product life cycle. Businesses play an important role in the betterment of the economy. Risk management is vital for the business to survive but at times a bad decision starts a chain reaction which results in the bankruptcy of that firm. At this stage those businesses look for bailouts. These bailouts can be done by the government, corporates or through any foreign intervention. In 1970 when Penn Central Transportation Company in US went bankrupt (Stover, 1997). Penn Central was created to support the railroad problems of New York and Pennsylvania. This company was too big to fail as it was part of the infrastructure of US. Since then many financial and non-financial institutions had been bailed out for good. After the financial crisis of 2008 US developed an Emergency Economic

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Stabilization Act 2008 commonly referred to as bailout of US financial institutions, $700 billion dollars were allotted to US Secretary of Treasury to purchase distressed assets to control the subprime mortgage crisis (White House Press Release, 2008). This literature review will be divided into five sections, first would explain the researches related to bailouts of financial institutions like banks, mortgage firms etc., second would discuss the researches related to bailouts of non-financial institutions like corporates, third part would be about the bailouts of different governments, the fourth part would discuss the researches which are not supporting the idea of bailout and the fifth part would highlight the researches done in Pakistan regarding bailouts.

BAILOUTS OF FINANCIAL INSTITUTIONS

Banks and other financial institutions play an important role in the economy being the intermediaries between the borrowers and lenders and they play an important role in the development of an economy (Demirguc-Kunt, Feyen, & Levine, 2011). Bailouts of Bear Stearns, Freddie Mac and Fannie Mae and bankruptcy of Lehman Brothers had a great impact on the economy (Sjostrom, 2009). American International Group AIG collapsed in 2009 because of collateral obligations it first tried to raise funds in private market but could not succeed and then forced to take the government bailout of $182.5 billion (Sjostrom, 2009).

Price / Earnings (2016)

Source: www.nasdaq.com

Source: www.nasdaq.com

Still AIG after seven years of bailout is trying to compete with the industry. These two ratios gives a positive impact of bailout on the company for it is survival and then for competing with in the industry. The following table shows the bailout amount given to different units of AIG:

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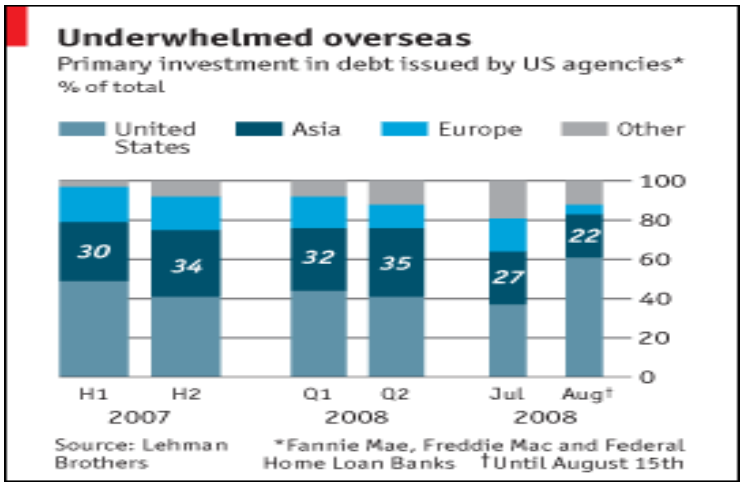
	Amount Authorized (in billions)	Amount Borrowed/Used (in billions)[209]
Fed Credit Facility	$60.0	$42.0
TARP Investment	$40.0	$40.0
RMBS Purchase Facility	$22.5	$19.8
Multi-Sector CDO Purchase Facility	$30.0	$24.3
Equity Capital Commitment Facility	$30.0	$0
Total	**$182.5**	**$126.1**

Source: AIG Bailout

Bailouts are common in banks, governments around the world respond to bank crises (Rosas, 2006), (Hakenes & Schnabel, 2014), (Vaugirard, 2005), (Taliaferro, 2009), (Acharya, Drechsler, & Schnabl, 2014), (Drechsler, Drechsel, Marques-Ibanez, & Schnabl, 2016), (Ejsing & Lemke, 2009), (Benjamin M. Blau, 2013).

In one of the many researches done (Acharya, Drechsler, & Schnabl, 2014) observed that bailout is a pyrrhic victory as because of bank bailouts the sovereign credit risk increases. In another research (Drechsler, Drechsel, Marques-Ibanez, & Schnabl, 2016) studied that banks which are weakly capitalized go for lender of the last resort loans and put risky assets as collateral as compared to strongly capitalized banks. Systemic risk associated with the financial institution affect the probability of a bailout, moreover financial institutions which are too big to fail enjoy the incentive to be bailed out in case of insolvency (Gong & Jones, 2013). Actively restructuring banks can provide the bailer with an opportunity of attaining social optimal allocation (Osano, 2002). Active restructuring is related to restructure the bad loans in the presence of managerial compensation contract with stock options. These bailouts by government are not all the time useful for the financial institutions, poor government policies and wrong timings can create more problems (Kane, 1987). (Sprague, 2000) discussed the government intervention in the form of bailouts in US. The crash of Paris stock market in 1882 forced the bourse to adopt common funds to guarantee liquidity, Bank of France came out as the lender of the last resort and offered credit to the derailed stock market (White, 2007)



Source: The Economist 2008

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Financial institutions are not only bailed out by the country's government but also by foreign government and institutions. In August 2008, about 35% to 40% of the total debt of the US mortgage agencies (including Fannie Mac and Freddie Mac) were held by foreigners (Economist, 2008).

(Miller & Vallée, 2011) studied how Central bank of China is investing in foreign investment markets. Recently a trend has been developed to invest in the US agency based debt.

BAILOUTS OF NON-FINANCIAL INSTITUTIONS

"Roughly speaking if you are in trouble and big enough, you will be rescued and recapitalized in one way or another by the government."

John Kenneth Galbraith

Bailouts are also done to corporates which are the non-financial institutions in an economy. Researches have been done to observe the bailouts in non-financial sector. Corporate bailouts are affected by the political connections. (Faccio, Masulis, & Mcconnell, 2006) observed 450 politically connected firms in 35 different countries and concluded that politically connected firms are more likely to get bailed out than similar non-connected firms. Corporate theory is affected by the government control after the TRAP bailouts as observed by (Verret, 2010). Corporates which are sure to be bailed out when in distress, engage in excessively risky investments (Corsetti, Pesenti, & Roubini, 1999). Governments around the globe have helped out the corporates but the fact that corporates too big to fail are always being the favorites, same happened in Korea in 1997 when Korean industry was working under the guidance of the government (Dohyung, 1999). Giant Corporates can be rescued through direct government bailout, which is when government pays direct cash, financial credit or loan guarantee (Adams & Brock, 1987). Bailout has been supported in other researches (Allers, 2015), (HorvaTh & Huizinga, 2015).

BAILOUTS OF DIFFERENT GOVERNMENTS

Governments also suffer from financial constraints and look out for assistance (Nicolini, Posadas, Sanguinetti, Sanguinetti, & Tommasi, 2002). IMF is one such body which provides support to governments facing financial distress (Calomiris, 1998). Interstate or inter provincial bailouts are also common to reduce the soft budget constraints (Fink & Stratmann, 2011). Here again provinces or states with high political influence are preferred on the ones with lesser influence. Mexico government also faced financial crisis in 1995 called the Tequila crisis which occurred because of reckless credit expansion and with a sharp increase in interest rates as a result of that crisis central government bailed out sub national governments (Trillo, Cayeros, & Gonzalez, 2002)

RESEARCHES SUPPORTING NO BAILOUT POLICY

Researchers are of the view that bailouts are often portrayed as regressive wealth transfer from taxpayer to bankers as the result of crony capitalism (Rosas, 2006) (Stiglitz, 2008). IMF intervention at government level is also questioned in different researches as for countries with poor credit show limited evidence that IMF programs enhance private market access and in many countries the commitments entitled by IMF are not credible (Eichengreen & Mody, 2001). Bailout can enhance the inflation in the country and threaten the common currency of the country or the region (Eichengreen & Hagen, 1995).

(Feld, Kalb, Moessinger, & Osterloh, 2013) observed that no bailout regime showed reduction in risk premia by 25% in Switzerland.

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Bailout are extra burden for the taxpayers as the debt of the government is paid by the taxpayer, US government has also a dark face as far as the bailout decisions are concerned (Barofsky, 2012). (Sprague, 2000) in his book said that bailout is bad word carrying connotation of preferences and privileges. (Murphy, 2008) in his paper regarding financial crisis 2008 suggested that there can be other less costly solutions.

RESEARCHES REGARDING BAILOUTS IN PAKISTAN

Financial crisis of 2008 also had an impact on the Pakistan economy. Pakistan suffered balance of payment crisis and looked for US and Europe for help but then that region was suffering from financial crisis. Pakistan tried to seek help from Saudi and China but to no avail. Finally IMF rescued Pakistan with $7.6 billion arrangement (Ali, 2016). Pakistan has been looking for financial support very often but literature regarding researches focusing on bailouts in Pakistan is missing. So there isa vast gap which needs to be filled. Gap can be identified relate to bailouts in financial institutions, non-financial and government bailouts as far as literature is concerned. But in this research we will focus on the bailouts of non-financial institutions in Pakistan.

Based on the above literature following hypotheses are developed:

- ***H1:*** Indirect Bailout done by the government has a positive impact on the ROA.
- ***H2:*** Indirect Bailout done by the government has a positive impact on the ROE.
- ***H3:*** Indirect Bailout done by the government has a positive impact on the ROS.
- ***H4:*** Indirect Bailout done by the government has a positive impact on the EPS.

DEPENDENT VARIABLES

FIRM PERFORMANCE

Firm performance is the dependent variable in this study which is measured by different financial ratios: ROA (Return on Asset), ROE (Return on Equity), ROS (Return on Sales) and EPS (Earnings per Share). These ratio are used over the period of many years to study the financial performance of the firm (Amouzesh, Moeinfar, & Mousavi, 2011), (Becker & Huselid, 1998), (Chakravarthy, 1986), (Coltmana, Devinney, & Midgley, 2011) and many more.

There are number of ways a firm's performance can be studied but in this research the focus would be on the financial performance of the firm that's why financial ratios are used to assess the firm. Financially firms are studied in number of studies (Hatem, 2014), (Amouzesh, Moeinfar, & Mousavi, 2011), (Cho & Pucik, 2005), (Gul, 1999), (Venkatraman & Ramanujam, 1986).

RESEARCH METHODOLOGY

The main objective of this study is to observe the impact of various financial determinants on the different industrial sectors operating in Pakistan. The research method adopted for this study is secondary data. Sample for the study consists of data for the industrial sector of Pakistan. Which involves 373 firms' data for the period of 2009-2014. So total there are 2238 observations for the whole six years. Data is collected from all the Industrial sectors of Pakistan, which includes: textile; sugar; cement; food products; chemicals, chemical products and pharmaceuticals; manufacturing; mineral products; fuel and energy; information, communication and transport services; coke

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and refined petroleum products; paper, paper board and products; electrical machinery and apparatus and other services. Seven firms were deleted from the list of total firms due to the lack of data availability. These firms included Noor Silk Ltd., Kohinoor Spinning Mills Ltd., Saleem Denim Ltd, S.G. Fibres Ltd., Shakarganj Food Ltd., Morafco Industries Ltd., and Ishtiaq Textile Mills Ltd.

Classification of the sample:

Table 1

Industrial Sector	No. of Firms	No. of Years	Total Observations
Textile	146	6	876
Sugar	31	6	186
Food Products	13	6	78
Chemicals, Chemical Products & Pharmaceuticals	43	6	258
Manufacturing	30	6	180
Mineral Products	8	6	48
Cement	20	6	120
Motor Vehicles, Trailers and Auto parts	20	6	120
Fuel & Energy	15	6	90
Information, Comm. and Transport Services	12	6	72
Coke & Refined Petroleum Products	9	6	54
Paper, Paperboard and Products	9	6	54
Electrical Machinery and Apparatus	7	6	42
Other Services Activities	10	6	60
Total	**373**		**2238**

According to (Adams & Brock, 1987) governments around the world bailout corporates directly or indirectly. In this study indirect bailout done by the Pakistan government for the industries operating in Pakistan is taken as an independent variable and its impact over firm performance is observed.

Firm performance is measured using four ratios:

- ROA: Return on Assets: Net Income over Total assets
- ROE: Return on Equity: Net Income over Equity ratio
- ROS: Return on sales: Net Income to total sales
- EPS: Earnings per share.

THE MODELS

The following models are developed for the study:

- ROA= $\alpha 0 + \alpha 1$ Growth + $\alpha 2$ Size + $\alpha 3$ Bailout + $\alpha 4$ Cash Ratio + $\alpha 5$ Age + εi
- ROE= $\alpha 0 + \alpha 1$ Growth + $\alpha 2$ Size + $\alpha 3$ Bailout + $\alpha 4$ Cash Ratio + $\alpha 5$ Age + εi
- ROS= $\alpha 0 + \alpha 1$ Growth + $\alpha 2$ Size + $\alpha 3$ Bailout + $\alpha 4$ Cash Ratio + $\alpha 5$ Age + εi
- EPS= $\alpha 0 + \alpha 1$ Growth + $\alpha 2$ Size + $\alpha 3$ Bailout + $\alpha 4$ Cash Ratio + $\alpha 5$ Age + εi

Control variables are used in this research to get the complete picture. A dummy was created for bailout to measure it. Those industries which are getting indirect bailout from government were taken as 1 and the others were marked as 0. The criterion selected

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for this exercise was the budget document provided by the federal government which is an official and authenticated document.

ANALYSIS

The following section would explain the results.

DESCRIPTIVE ANALYSIS

Table 2

Dependent Variable |	Obs	Mean	Std. Dev.	Min	Max
wroa |	2238	4.035366	9.542493	-10.79	20.63
wroe |	2238	10.94759	22.53183	-28.62	47.88
wros |	2238	.0055251	.0924083	-.1957348	.1317815
weps |	2238	5.152158	10.77233	-8.66	28.18

Table 3

Independent Variable |	Obs	Mean	Std. Dev.	Min	Max
bailout |	2238	.4307417	.4952907	0	1

There are in total 2238 observations from all the sectors of industries in Pakistan. Descriptive statistics for dependent and independent variables are given in the tables above. Standard deviation for return on equity is high as the firms operating in Pakistan have different equity ratios. Standard deviation for age is also on the higher side as few firms are operating since the inception of Pakistan and some are quiet young comparatively.

In this section the results of hypotheses tested are shown. Analysis is done by using Stata on which regression was run to see the common effect, fixed effect and random effect. Hausman test was conducted afterward to see which estimation method is ok, if they are not similar.

ANALYSIS FOR ROA

Common effect for ROA

- Number of obs = 2238
- F(5, 2232) = 209.58
- Prob > F = 0.0000
- R-squared = 0.3195
- Adj R-squared = 0.3180

Table

wroa |4	Coef.	Std. Err.	t	P>|t|
bailout |	-2.174556	.3376993	-6.44	0.000

Fixed Effect:

Table 5

wroa |	Coef.	Std. Err.	t	P>|t|
bailout |	-2.614468	.2907872	-8.99	0.000

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Random Effect:

Table 6

wroa |	Coef.	Std. Err.	z	P>|z|
bailout |	-2.530344	.2822799	-8.96	0.000

Now Hausman Test was conducted with a hypothesis that if the significance value is less than 0.05 than fixed effect is taken or otherwise.

Table 7

---- Coefficients ----				
|	(b)	(B)	(b-B)	sqrt (diag (V_b-V_B))
|	fe	re	Difference	S.E.
bailout |	-2.614468	-2.530344	-.0841234	.0698229

b = consistent under Ho and Ha; obtained from xtreg

B = inconsistent under Ha, efficient under Ho; obtained from xtreg

Test: Ho: difference in coefficients not systematic

chi2(5) = (b-B)'[(V_b-V_B)^(-1)](b-B)

= 13.70

Prob>chi2 = 0.0176

According to the tests performed above results from fixed effect are accepted as the significance level is less than 0.05. Bailout shows negative relation with the dependent ROA and the relationship is significant with ROA.

Analysis for ROE

Table 8

wroe |	Coef.	Std. Err.	t	P>|t|
bailout |	-5.723834	.8837247	-6.48	0.000

Common effect shows bailout has negative impact on the dependent variables and the relation is significant among all the variables. Again, fixed effect, random effect and Hausman effect are conducted on ROE. Hausman test shows the result Prob>chi2 = 0.0002 which shows that results from fixed effect are accepted. The table showing the fixed effect is given below:

Table 9

wroe |	Coef.	Std. Err.	t	P>|t|
bailout |	-8.066377	.8424982	-9.57	0.000

The results shows that bailout has negative impact on ROE. The variable is significant. Bailout show highly negative impact on ROE with t = -9.57. So indirect bailout by government has negative impact on the ROE of the firms operating in Pakistan.

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Analysis of ROS:

Common effect for ROS:

Following the results for common effect on ROS:

Table 10

wros |	Coef.	Std. Err.	t	P>|t|
bailout |	-.0166556	.0036231	-4.60	0.000

Firms show negative impact of bailout on ROS which means government indirect help is not assisting in generating return on sales. Bailout is significant with independent variables.

Hausman test is conducted to see whether to accept the results from fixed effect or random effect. The significance value came out to be Prob>chi2 = 0.4556, which shows that for ROS results for random effect are acceptable.

Table 11

wros |	Coef.	Std. Err.	z	P>|z|
bailout |	-.0190761	.0030892	-6.18	0.000

Here again age shows an insignificant p value of 0.9. Bailout again shows negative significant relation with ROS with the value of -6.18. Relation among the dependent and the independent variables is significant accept for age.

Analysis for EPS:

Common effect for EPS is as follows:

Table 12

weps |	Coef.	Std. Err.	t	P>|t|
bailout |	-1.984557	.3997568	-4.96	0.000

Variable share significant relation with EPS. Bailout again is showing negative significant relation t= -4.96 with significance level of 0.000 with EPS. Which means bailout decreases the earning per share ratio. Hausman test results shows Prob>chi2 = 0.1004 which means random effect results are acceptable for EPS. The results are as follows:

Table 13

weps |	Coef.	Std. Err.	z	P>|z|
bailout |	-2.320092	.3030823	-7.65	0.000

Again bailout has a negative impact of t= -7.65 with significance level of 0.000. This shows that indirect government bailout is impacting the EPS in a negative way the greater the bailout the lesser will be the EPS.

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SUMMARY OF HYPOTHESES

Hypotheses	t value	significance	Accepted	Rejected
H1: Indirect Bailout done by the government has a positive impact on the ROA.	-8.99	0.000		✓
H2: Indirect Bailout done by the government has a positive impact on the ROE.	-6.48	0.000		✓ ✓
H3: Indirect Bailout done by the government has a positive impact on the ROS.	-6.18	0.000		✓
H4: Indirect Bailout done by the government has a positive impact on the EPS.	-7.65	0.000		✓

Above table shows the summary of hypotheses which are part of this research.

DISCUSSION AND IMPLICATION

This study has given some interesting results. First the significant negative impact of indirect government bailout on the dependent variables ROA, ROE, ROS and EPS shows that in Pakistan government support for industries is not boosting the industry in fact it is playing a negative part. There can be number of reasons for this; political connection can play an important role (Faccio, Masulis, & Mcconnell, 2006), inefficient firms with political connections are bailed out easily here. Another reason can be that these industries are back bone of Pakistan's economy or corporates too big to fail (Gong & Jones, 2013) that is the reason why government giving them favorable environment to maneuver. Bailout has also been considered as a pyrrhic victory (Acharya, Drechsler, & Schnabl, 2014) where tax payers are paying the money for bailout but the result is not very satisfactory in terms of returns.

CONCLUSION

This study observed the impact of different financial determinants on performance of the industries in Pakistan. Dependent variable firm performance was measured by ROA, ROE, ROS and EPS, whereas independent variable is bailout. The effect of each independent variable was studied on the dependent variable. Bailout however turn out to have an interesting impact on the firm performance. Bailout is significantly negatively related to each of the dependent variable. Which shows that indirect government support to industries is not enhancing the performance of that industry.

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