

Relationship between micro & macro level economic performance: A case for institutional strengthening in Pakistan?

By

Dr. Mahnaz Fatima¹

Abstract

It is generally believed that micro level organizational performance in general and business level performance in particular is difficult to improve in Pakistan in view of the lacklustre macroeconomic performance. While external factors do influence organizational and business performance, it is the cumulative impact of micro-level organizational and business performance that also feeds into the macro level performance. Due to this intertwined relationship, all responsibility for dismal micro level performance cannot be assigned to the macro economy. For, the macro economy too will be as weak or as strong as its micro constituents are. So, while the macro economy does require sound management, the micro constituents too need to be managed according to the modern principles of management that include anticipation and a response to external factors in general and economic factors in particular as an essential component of organizational management. I wish to explore the possibility of a wider application of this organizational management concept in Pakistan so that the micro and the macro aspects of economic life may eventually enter into a virtuous cycle of growth and development.

My paper is exploratory in nature and is divided into two parts. The **first part** explores the relationship between performance at the micro and macro levels of the economy. In particular, it explores the impact of micro level corporate performance on the macro economy. The **second part** of the paper addresses the issue of micro level corporate performance improvement in Pakistan that would enable the micro and macro levels to operate in sync and enter into a virtuous cycle of growth and development. While this is a conceptual paper exploring the relationship between micro and macro level economic performance as above, it will generate further research proposals and hypotheses for testing in Pakistan.

¹ Dr. Mahnaz Fatima is Associate Professor at the Institute of Business Administration, Karachi (IBA is no longer affiliated with the University of Karachi.....part in parentheses not to be printed)

I. Impact of micro level performance on macro economy

In Pakistan, there is a tendency to blame poor micro level organizational performance on external environmental factors in general and macroeconomic environment in particular.

The converse is that the cumulative performance of micro level organizations feeds into the strength or otherwise of the macro economy. The macro economy will be as strong or as weak as its micro constituents will be. In a classic study carried out by Michael Porter, Professor of Business Administration, Harvard Business School; microeconomic conditions are found to be highly important for corporate and country competitiveness and for economic development.¹ This study presents strong empirical evidence in support of the above relationship and will, therefore, be widely cited herein. As a part of this study, bivariate relationships between the microeconomic variables and GDP per capita are tested. The variables are grouped into company operations and strategy and national business environment. Company variables measured as nature of competitive advantage, value chain presence, production processes, marketing expertise, and breadth of international markets are found to be particularly associated with GDP per capita.² These explain 81%, 74%, 76%, 67%, and 65% of the variance respectively.³ The author suggests, “Monitoring the competitive approaches of companies is a powerful indicator of progress in economic development.”⁴

As for the national business environment, business information availability, information infrastructure, demand conditions, domestic supplier quality, intellectual property

¹ Porter, Michael E. (1999) Microeconomic competitiveness: findings from the 1999 Executive Survey. *The Global Competitiveness Report 1999*. World Economic Forum, Geneva. Oxford University Press. 30-53.

² Ibid., 42.

³ Ibid.

protection, and absence of bribery all explain variations in GDP per capita more strongly than human resource and physical infrastructure do.⁵ If micro conditions feed into macroeconomic strength, some of the business environment variables above would be directly influenced by microeconomic performance. It is the trickle-up concept that remains at work too.

The author concludes, “Political stability and sound macroeconomic policies have long been considered the cornerstone for economic development. The results here suggest that they are necessary but not sufficient.....Taken as a whole, the results again challenge the notion that microeconomic improvement is automatic if proper macroeconomic policies are instituted.....While institutions such as the IMF have strongly pushed macro reforms, our findings suggest that micro reforms are equally if not more important. Without micro reforms, growth in GDP per capita induced by sound macro policies will be unsustainable.”⁶ Porter further emphasizes, “Our results highlight the pressing need to better integrate microeconomic and competitive thinking into the economic reform process. If reform efforts in developing countries remain limited to IMF-style macroeconomic adjustments, we will face a continued succession of disappointments.”⁷

In Michael Porter’s study, survey data were obtained from 58 countries ranging from low per capita countries of Vietnam, Ukraine, and Indonesia to advanced industrial

⁴ Ibid., 32.

⁵ Ibid., 42-3.

⁶ Ibid., 38.

⁷ Ibid., 30.

economies such Sweden and the USA. Even in advanced countries such as Canada and Britain which have appropriate macro policies, micro reform is required to distribute macroeconomic gains.⁸ For this purpose, the private sector is urged to play a role in shaping that very business environment which influences its performance.⁹

It has been empirically established that external environmental factors have impacted macro trends in corporate profitability in Pakistan.¹⁰ A testable relationship, now, is that between micro level corporate performance and macroeconomic performance.

Hypotheses-1 would, therefore, be that there is no relationship between micro level corporate performance and macroeconomic performance in Pakistan. While this hypothesis testing would be of great academic significance and might strengthen the case for micro level reform, the impact of cumulative micro level performance on macroeconomic indicators is not only known generally and commonsensically but is empirically established through the above-cited Global Competitiveness study conducted by Michael Porter. While macro economy should be well-managed, micro level performance should also be steered in parallel in a manner that performance at these two levels is mutually reinforcing.

How might we enter into this virtuous cycle is the next portion of my paper? While external factors do impact organizational performance, state-of-the-art in management

⁸ Ibid.

⁹ Ibid., 31.

¹⁰ Pasha, Hafiz A. and Mahnaz Fatima. (Winter 1998) Macro trends in corporate profitability in Pakistan. *Pakistan Economic and Social Review*. Vol. XXXVI, No 2. pp. 225-242.

equips organizations to respond proactively to external environmental influences on micro organizations.

II. Micro level performance improvement

This brings us to the state-of-the-art in business management which is known as *strategic management* of business organizations. Strategic management of business organizations is to make a response to the dynamic external environment with a view to striking a fit between the internal and external environments so that a firm is able to use its strengths and overcome its weaknesses with a view to exploiting the external opportunities and averting the threats. There are firms that make a response to the external factors as they encounter them. Some others anticipate the external factors and are well-equipped to brave the challenges of the external environment when confronted by them. Still others give shape to the external environment as they lead in their respective business areas blazing new trails for others to catch up with. These are the most advanced and developed amongst the business organizations. However, the least that is now expected of business organizations is to anticipate the external challenges and be geared to respond effectively when it comes time to do so. For, the financial and non-financial benefits of strategic management have been established empirically in the field of management. Practices of high-performing firms reflect a more strategic orientation and a longer term focus.¹¹ A longitudinal study of 101 retail, service, and manufacturing firms over a three-year period demonstrated that businesses using strategic management concepts experienced

¹¹ David, Fred R. (1999) *Strategic Management: Concepts and Cases*. 7th Ed. Prentice Hall. p. 16.

significant improvements in sales, profitability, and productivity compared to the ones that did not use these concepts.¹²

So, it is a poor organization that blames poor performance on external factors. While this appears to be the case in Pakistan barring some exceptions which go to prove the rule of remaining overwhelmed by external factors that successful organizations remain on top of, this is a hypotheses that is worth testing in Pakistan.

Hypotheses-2 would then be that there is no relationship between a proactive response to external environmental factors and company performance in Pakistan.

Practice of strategic management in Pakistan

Many remain skeptical about the applicability of the above concept in Pakistan. Anecdotal evidence would dispel skepticism in this regard. Bukhari Commercial Exporters & Group of Companies won the best FPCCI Export Performance Trophy Award 2001-2002.¹³ They export textile and food products. At Bukhari Commercial, “a systematic process of strategic planning is well in place.”¹⁴ For Bukhari Commercial, “Strategic planning involves the transformation of vision into reality through external and internal environmental scanning and implementation of best suitable strategies.”¹⁵

¹² Ibid.

¹³ *Dawn*, Aug 29, 2003.

¹⁴ Ibid.

¹⁵ Ibid.

If strategic planning brings success to Bukhari Commercial, so should it to other Pakistani organizations. And, if Bukhari Commercial can get near the state-of-the-art in management in Pakistan, so should others be able to in the same country. Some others too are approaching these modern management concepts as discussed below.

Corporate Excellence Awards given out annually by the Management Association of Pakistan (MAP) evaluate organizations on the basis of criteria that define best management practices internationally. The criteria used to evaluate for Corporate Excellence Awards 2001 were, however, changed further to bring them closer to the criteria used for giving international management awards. Consequently, only 30% weightage was given to financial performance and 70% to the quality of management as reflected through corporate governance, strategic direction and leadership, and strategic management of other functional areas.¹⁶ The survey questionnaire was revised to gauge the extent to which the concepts of strategic management were being incorporated by the responding companies. It was found that national companies competed successfully with multinationals for the Corporate Excellence Award 2001.¹⁷ The winning companies included Al-Ghazi Tractors Limited, International General Insurance Company of Pakistan Limited, Colgate Palmolive (Pakistan) Limited, Unilever Pakistan Limited, Bolan Castings Limited, Thal Jute Mills Limited, and Orix Leasing Pakistan Limited.

¹⁶ *Corporate Excellence Awards 2001*. Management Association of Pakistan (MAP).

¹⁷ *Dawn*, April 6, 2003.

'Private/personal gain maximization' as a barrier to organizational strengthening

While the above should dispel the notion of inapplicability of strategic management concepts in the country, it is important to further determine the impediments there might be towards progress in the above direction. It is important to know the structure of Pakistan's corporate sector and the proclivities of Pakistan's public sector.

Out of the top 40 listed companies in the country, 12.5% are MNCs, another 12.5% are government organizations, 22.5% are semi-government, and 52.5% are private family-owned organizations.¹⁸ While MNCs usually follow modern management practices which is one of the factors responsible for their global presence, the same cannot be said for Pakistani organizations whether they are in the public sector or in the private sector. Even though each organization should be driven by its mission that defines its reason for being to provide goods and services for needs and wants satisfaction, our public organizations are driven by empire-building considerations and private organizations by personal gain-maximizing considerations that may work at cross-purposes with the interests of other stakeholders equally important for sustainable business operations and growth.

In majority of Pakistan's family-owned businesses, absolute control is exercised by the family over organizational decision-making.¹⁹ Out of a sample of 32 companies, in 85.8% of Pakistan's textile companies and 55.5% of Pakistan's non-textile companies, the family controls equal to or more than 30% of the total share capital compared to 58.7% companies in Indonesia, 20.1% in South Korea, 45.6% in Malaysia, 18.4% in

¹⁸ Dr Cheema, Ali. (June 2003). Corporate governance in Pakistan: Issues and concerns. *The Journal*. National Institute of Public Administration, Karachi. Vol. 8, No 2. p. 10.

Taiwan, and 54.8% companies in Thailand in which the family controls the same level of share capital.²⁰ More than 40% of total share capital is controlled in 50% of Pakistan's textile companies and in 38.9% of Pakistan's non-textile companies as compared to 35.4% companies in Indonesia, 3.5% in South Korea, 14.7% in Malaysia, 5.0% in Taiwan, and 38.9% companies in Thailand in which the family controls more than 40% of share capital.²¹ In terms of family control of share capital, Pakistan is closer to Indonesia and Thailand than it is to the more rapidly developing East Asian countries of South Korea, Taiwan, and Malaysia.

Family control over decision-making is further consolidated through family domination of the Board of Directors.²² As is generally known and concluded by Dr. Ali Cheema through his research cited herein, increased family control leads to increased private gain-maximization at the expense of the interest of other shareholders and creditors. Family-based controllers would, therefore, oppose corporate governance reforms that would dilute their control.²³

The above structure and disposition of the corporate sector would, therefore, hinder movement towards modern management practices that seek to maximize organizational gain by contributing to the interests of all stakeholders and not just to the owner managers'. The stakeholders extend beyond the shareholders and creditors to also include the customers, employees, competitors, governments, communities, society at large, and

¹⁹ Ibid.

²⁰ Ibid., p. 11.

²¹ Ibid.

²² Ibid., p. 14.

the natural environment or the planet earth. A satisfaction-contribution equilibrium needs to be struck with all providers of inputs without which an organization cannot sustainably add value to the outputs that the end consumers are seeking and for which the society sanctions the organization of stakeholders into corporate entities. A corporation, therefore, comes into being with the explicit purpose of providing goods and services to the society which purpose, if deviated from, would amount to a perverse use of the societal sanction. It is, therefore, important to keep ensuring that the organization remains on the path for which it was established. The Board of Directors is entrusted with this august responsibility. However, it needs to be examined whether corporate governance reform is all there is to reform in the corporate sector. I will revert to this question later on in my paper.

While the private corporate sector in Pakistan has been generally held responsible for private gain maximization, the public sector of the country has been no less so. Public sector organizations in utilities, revenue collection, law enforcement, transportation, education, health, and other public service/administration have been known for intended neglect of the purpose for which they were established. And, while in the private corporate sector, it is the family owners who have maximized their personal gain; in most of the public sector organizations, it is the entire line from top to bottom that have indulged at the expense of both the interests of the organization and the community/society they ought to have served through diligence and sincerity of purpose in a missionary zeal. While this is a requirement of all kinds of service in general and of public service in particular, fulfilling this requirement is actually viewed as silly. Cutting

²³ Ibid., p. 16.

corners and personal gain maximization is viewed as smart. With values turned on the head, can call for “good governance” deliver only by organizational structural changes unless the value system is reversed?

(Dis)value system responsible for organizational decay

If majority are out to make a personal gain at the expense of that of the organization and its other stakeholders, the moral fabric of the society is pretty much ruptured. Pakistan is steeped into third-degree corruption which is “self-destructive” having moved on from the first two stages of “restricted” and “wide-spread” corruption.²⁴ In the third stage of corruption, the lowest income groups too resort to deviant practices to survive. Corruption is thus institutionalized and becomes the norm as cultural goals change faster than the corresponding change in institutionalized means²⁵ which should facilitate goal attainment. In the absence of legitimate means, deviant means are used to achieve the goals which border high materialism and greed in our case. Thus a convergence of highly materialistic goals with whatever means available and possible, as the new ends of material greed now justify all the means—legitimate or otherwise.

Against the above backdrop, it is transformational change that our private and public sector organizations require to get on to a sustainable growth path in harmony with the goals of national development at the macro level.

²⁴ Anwar, Mohammad. (1991) Socio-economic Structure and Corruption: A Case Study of Pakistan in Qureshi, Ejaz Aslam (Ed). *Development Planning in Pakistan*. Ferozsons, Ch-33.

How might transformational change in organizations be initiated?

It is internal environment in Pakistani organizations that requires a quantum change so as to make it internally strong and responsive to the external environmental opportunities and threats. Internal strength comes from the effectiveness with which the functions of the organization are being discharged. Effectiveness is, in turn, a function of the values that are shared within the organization and around which all activity coalesces. If a belief and a value system is at the centre of the organization, then the shared values will provide strength if these work to benefit the various constituents of the society. Otherwise, the organization will get trapped in a zero-sum game with the societal components when sustainably growing organizations should strike a win-win relationship with the society in general and with all stakeholders in particular. For, according to open-systems theory, organizations remain engaged in mutual exchange with the society. Organizational outputs are a function of the quality of inputs they receive from the external stakeholders. Quality of these inputs will be as good as the quality of firm's outputs and returns to the various stakeholders. A win-win relationship is struck only on the basis of mutual trust which is not possible to achieve if the organizational owners and/or managers seek to gain more personally and privately at the expense of the interest of other stakeholders. If trust is breached, organization enters into a zero-sum game tending to blame poor performance more on external environment than on organizational weakness that has grown mainly because of personal-gain maximizing attitude of the firm's managers--- private or public, as discussed in a preceding section.

²⁵ Ibid.

The first step towards organizational transformation is the development of shared values around which strategy, structure, staff, style, skills, and systems revolve. This is the McKinsey's 7-S framework which comprises an organization driven towards needs and wants satisfaction with a missionary zeal. Unless there is consensus on shared values, organizational activity may not lead to organization's sustainable growth and good performance. The role of the Board of Directors (BOD) gains salience in throwing up the values around which company operations should be organized.

The role of the Board of Directors (BOD)

While the corporate governance reform is being undertaken, it revolves mainly around the composition and the criteria for board's membership. While there needs to be definite progress on these two fronts, boards are usually susceptible to falling into the trap of the majority. This tendency is equally pronounced in private as well as public and professional organizations. And, it is this tendency that inhibits open discussion and debate required essentially for the development of "shared values" first at the board's level. Since dissent is discouraged and equated with disloyalty, board members are encouraged to be "team-players" which is actually a euphemism for compliance and submission²⁶ to the dominant group on the board. The upshot is that it is the "value system" of the dominant group that carries the day which may or may not optimize organizational performance as the dominant group tends to maximize its own gain. Since the stakeholders do not lack native intelligence, they lose motivation to work towards the interests of a few if their's have not been factored into decision-making. Efforts towards

²⁶ Sonnenfeld, Jeffrey A. (September 2002). What Makes Great Boards **Great**. *Harvard Business Review*. 111.

sustainable organizational growth are stymied. We are, therefore, experiencing a situation in the country whereby the professionals, businessmen, industrialists have all gained at the individual levels but their respective sectors continue to betray lacklustre performance. Values around organizational gain, therefore, need to be forged at the level of the boards that is, however, possible only through dissent and discussion. It has been found, "...the highest-performing companies have extremely contentious boards that regard dissent as an obligation and that treat no subject as undiscussable."²⁷

It is the board that has to first break out of groupthink so as to then foster an organization-wide culture of open discussion, learning, and spirit of inquiry so vitally required to make a collective creative response to dynamic external environments. Also, it will be only then that "shared values" will be thrown up to provide the nucleus around which all organizational activity will revolve to enter into a win-win relationship with all the stakeholders of the organization. An organizational climate galvanized to "shared values" will present a formidable front to external forces impinging upon the organization.

It is, therefore, important for corporate governance reform to transcend the structural concerns about the boards and move on to also influence the board politics and dynamics.

Corporate governance reform is aiming at bringing in more outside directors on the boards. This may or may not inject the vitality so vitally required on the boards as there will be many outside directors who would either be preoccupied with their own prime responsibilities or would be having too many board memberships to apply themselves or

²⁷ Ibid.

would be simply disinterested. For, a lot of times, board memberships are accepted for reasons of prestige and networking rather than for a desire to make a substantive contribution to the organization on whose board they sit. Under these circumstances, insiders can bring in more fresh issues and ideas to generate the debate so vitally required for organizational health.²⁸

Research area-3 would then be to study how boards function in our private and public sectors so that corporate governance solutions could be customized to the extent possible.

In the absence of situation-/industry-/sector-specific solutions, a reform process may not necessarily be able to reform. If encompassing reform is, however, initiated through specific corporate governance reforms, it will go a long way towards overcoming resistance that will be encountered in reform's subsequent stages. However, there should be a team, at the helm, driving the process. And, effective teams are those that thrive on diversity and not on conformity as has been the belief thus far. Only a diverse group of members committed to "shared values" in harmony with societal interest will be able to crank and propel a change process that will be able to cross the threshold of resistance.

Change management strategies can then be fleshed out provided the first meaningful step has been taken, as discussed above. However, what the "reformists" call "meaningful" should be widely seen as such which will be possible only if diverse ideas are reflected in the direction determined for the organization. Then only will there be understanding, commitment, ownership, and feeling of effectiveness and empowerment that alone can

²⁸ Ibid., 108.

give power to the organization. For, an organization can be as effective as its stakeholders consider themselves to be. Unless the stakeholders are envisioned and energized in the mutually determined direction, there will be a loss of power which, in turn, will make the organization ineffective in making a response to the external environment. For, this response is not possible to make only by the owner managers or those at the helm unless they carry the organization along with them through the process of strategic management that may commence at the corporate governance level whose essential prerequisite is discussed herein.

III. Conclusion

Macro economic reform is not all there is to reform process in the country. This paper establishes the relationship between performance at the micro and macro levels of an economy. The strength of this relationship **may**, however, **be tested in Pakistan as proposed in this paper** for both academic and practical purposes so as to strengthen the case for micro level reform in our country.

The next question focuses on the type of micro level reform and how might it be initiated. The paper argues that micro level reform may need to transcend the realm of corporate governance reform currently being undertaken in the country. The current emphasis in corporate governance reform is structural in nature. We may need to go beyond the current emphasis so as to infuse a new spirit in the private and public organizations that will transform and equip them to make effective responses to dynamic external environments. Based on modern management concepts discussed in this paper, this will

be possible through quantum internal environmental changes that will provide strength through organization-wide commitment to a value system that will be shared by all and will thereby enable the organization to enter into a win-win relationship with the society in general and its stakeholders in particular. **Two further research areas are, therefore, proposed.** One is to test the relationship between proactive response to external environmental factors and company performance in Pakistan. Second is to study how boards function in our private and public sectors so that corporate governance solutions could be customized to the extent possible with a view to initiating a transformational reform process at the various micro-levels in the country.