CASE STUDY

PAKLAND CEMENT LIMITED

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Executive Summary

Pakland Cement is a rag-to-riches chronicle of a popular and a leading Pakistani cement company. However due to imbalanced financial structure, imprudent leadership and speculative decision-making became a candidate for a takeover in 2004. Most successful CEO's who are not personally committed to any one set of beliefs but are able to shift gears quickly in face of rapid succession of events make their names in history. Family owned businesses need to determine a cogent succession path for the continuing prosperity of the company.

It is primarily for this reason that the Code of Corporate Governance has been institutionalized the world over equally applicable to a private concern which turns public. The need for the hour is the enforcement of this Code in letter and spirit not only to safeguard the public interest but also to ensure good health of the company. It would not be a tall order to recommend a member from the regulating bodies on the Board of Directors.

1.0 Introduction

Pakland cement is a sad saga of a booming cement industrial unit which crumbled in just two decades due to strategic blunders, inappropriate control measures and inept managerial culture. From being a market leader in southern Pakistan in the late 1980's the firm is acquisitioned by another business magnate in 2004.

Pakland Cement came into being in 1980 as a public limited company due to visionary direction of its founder Mr. Mohsin Siddiqi who later also became a senator in the Government. Within a short period, the company became a leading cement producer in the southern region of Pakistan. By 1990 the worth of the company soared to Rs. 2500 million. Though lady luck also favored Pakland since it was a construction boom period in Pakistan but prudent policies also paid dividends. It is tragic that these soaring heights were extinguished abruptly by a gunmen attack on Mr. Mohsin Siddiqi on 7 Feb. 1990.It was at this juncture that the mantle of leadership fell on the shoulders of Mr. Tariq Mohsin the eldest son of the founder member. He inherited an empire well entrenched as a leader in the cement industry. It is

common in family owned businesses in Asia that succession is transferred to siblings and boards of directors are little more than rubber stamps (Lamb, R.B. 1987

The case study examines how inappropriate management practices result in quick demise of a stable industrial concern. The importance of succession planning in family based businesses, balanced financial structure and participative management are also some lessons drawn from this study.

2.0 History of Cement Industry

Cement manufacturing in Pakistan has witnessed oscillations of growth and decline in the past few decades. During periods of growth, unrealistic optimism brought expansion and profitability while in slumps the units braved the environmental threats. Growth of cement industry is rightly considered a barometer for economic activity. In 1947, Pakistan had inherited 4 cement plants with a total capacity of 0.5 million tons. Some expansion took place in 1956-66 but could not keep pace with the economic development and as such the country had to resort to imports of cement in 1976-77 and continued to do so till 1994-95. The industry was privatized in 1990 which led to setting up of new plants. Although an oligopoly market, there exists fierce competition between members of the cartel today. More than 26 firms (23 in the private and 4 in the public sector) compete for the domestic market of over 19 million tons (Table 1). The northern region has over 87% in total cement dispatches while the manufacturers based in the southern region only contributes 13% to the annual sales. The production of cement has been rising steadily, growth fluctuating between 5% and 20% per annum during the last two decades. In 1991 it was 7 million tones which had increased to 16 m tones in 2006 (growth rate 9.75%). (Federal Bureau of Statistics, 2006)

Table –1

Province	Number of Cement Units in Pakistan	
	Operating units	Installed Capacity in Millions
Islamabad	1	0.625
Sindh	8	3.643
NWFP	6	5.324
Baluchistan	1	0.63
TOTAL	24	17.113

Source: Cement Manufacturing Association Report 2004.

The Mohsin family (owners of Pakland) had migrated from Lucknow, India in 1947 and had no previous business background. However prudent investments and disposals in real estate helped built equity to set-up a cement plant. Pakland Cement was established in 1985 located near Dhabeji a town about 50 miles north of Karachi. The project of Pakland was funded through allocation of 128.25 million French francs through the National Development Finance Corporation (NDFC). It also syndicated a financing package. About 75% of sales are in the southern region while the remaining in

the rest of the country. Undoubtedly Pakland was a popular brand and a market leader in the early 1990's. The production of cement varied between 400000 tons to 450000 tons between the period 1998 to 2003 with some slump in the demand in 1999, 2000 and 2001 however it never operated near its maximum capacity. The sales represented 4 % of the market share in 2003. The management of the company though inexperienced managed the firm well but later fell prey to domineering, and idiocy leadership style of the family icon.

Tariq Mohsin remained associated with Pakland since its inception. It would not be wrong to say that this venture was actually his brain-child. Tariq is remembered as an easy going person who led a life in opulence, surrounded himself with coterie of senior managers who were more the yes-man kind. Their advices were unprofessional yet Tariq trusted them. Today ex-employees whisper that many of them indulged in rampart corruption. Tariq's managerial style reflected a Zeus kind of image, believed in centralization, one man decision and rewarding people magnanimously beyond their performance and expectations; style no wise businessman will recommend. Wastage of finances and indulgence in petty projects are two major accusations against the CEO. His routine was another major idiosyncrasy, an employee had to attune himself with; start work very late and leave office in the wee part of the night. Pakland was a tall organization where decisions were made at the top therefore could not evolve a culture of excellence in-spite of fame and earnings.

3.0 **Production Process**

Pakistan's main sources of energy are fuel gas, oil and petroleum products for all industries. Coal only contributes 5.4% to the energy needs of Pakistan, although its proven reserves exceed 4000 million tons. Until 1970 the cement plants were installed on wet or semi-dry process technology, sophistication came in 1980 when switch was made to dry process. The process is to a large extent determined by the condition of the raw material. The production of cement is a continuous process and is highly energy intensive. Lime stone, clay, iron ore and gypsum are used as major raw materials for different categories of cement. These minerals are in abundance in Pakistan.

The cement manufacturing process begins with Calcinations; decomposition of limestone at very high temperature. This is followed by Clinkering where additional compounds are added in different proportions. These compounds are then milled together with gypsum and other additives to form cement (Figure 1). The energy costs in form of fuel (now coal) and electricity represents 50% of the production cost. The products as a result of this process are ordinary Portland cement (OPC), sulphate resistant cement (SRC), blast furnace Slag cement (BFSC) and white cement.

4.0.0 Problems of the Industry

Unprecedented increase in the furnace oil and electricity prices had crippled the cement industry in the late 1990's. The low demand of cement and high interest rates coupled with overall economic crises left the entire industry to a meager growth of 3% from the earlier growth of 7%. Consequently the entire cement industry was running much below its capacity despite having a strong industry base.

The real entrepreneurs (Pioneer Cement) took some bold and timely decisions when they decided on the conversion of the cement industry from oil/gas to coal fired system in Pakistan. This proved to be the point of turnaround in 2002. However the conversion of fuel was not the only contributor for bringing this turnaround; expansionary economic policies of the government and export demand from Afghanistan also acted as catalysts. In the year 2002, most of the units had recovered their losses and net earning of Rs. 948 million was reported by the industry. The switching from fuel to coal requires substantial capital investment. It is reported that approximately Rs. 160 million is the conversion cost. However the saving in the production is around Rs. 250 per ton or 12% of the production cost

Another problem faced by the Industry was the high taxation. The general sales tax (GST) is 186% higher than India. The impact of this tax and duty structure has resulted in almost 40% increase in the cost of a cement bag (50 Kg). A bag in India costs Rs. 160 as compared to Rs. 220 in Pakistan. In the budget of 2003-04 a duty cut of 25% was permitted to the cement sector with assurance from the cartel to pass on this benefit to the consumers. In 2006, the price of a bag went up to Rs. 430 however in 2007 it has stabilized at Rs. 315/ bag. The export of cement has opened new opportunities for the cement industry. In 2007, the exports to Afghanistan, UAE and Iraq touched 2.13 tones.

5.0.0 Expansion in late 90's

We find Pakland well entrenched in 1994-95 with net profits exceeding 15%, debt to equity ratio is under control and working capital is adequate. At this juncture the cement industry was doing well and it was anticipated that there is room for expansion therefore Pakland set up another line of production at their Dhabeji facility; subsequently they also planned on setting up the Saadi cement at Taxila. This expansion was through a consortium of leasing companies and financial institution like PICIC and leading banks. .

The pricing mechanism was regulated by State Cement Corporation of Pakistan (SCCP) till the early 90's. Being the market leader it maintained a balanced price structure and a cement bag of 50 kg was priced between Rs. 80- 90. With the privatization of cement industry in late 1990's SCCP lost its control over the supply side of cement and prices soared. This high demand and expectations of high earnings also prompted the industrialists to invest in this sector, leading to setting –up of five additional plants throughout the length of the country in late 1990's. The fact that the government was also reducing the size of the Pakistan Social Development Program (PSDP) each

fiscal year was not taken into account which eventually led to excess capacity in 2001 and thereafter.

Pakland remained a popular brand name in southern Pakistan in late 1990's and a strategic decision was taken to expand into the northern part of the country by setting up another plant. This decision was probably based on the assumption that export orders from Afghanistan would be forthcoming and this opportunity should be capitalized. Furthermore the construction boom was more evident in Punjab as compared to the southern part of the country.

Saadi cement commenced its implementation in 1999 with an asset base of Rs. 5380 million financed 64% through loans and financial leases obtained from banks and other financial institutions. Saadi cement was set-up in Taxila near Rawalpindi catering to the demand of the northern part of the country. One of the major decisions affecting the profitability of Pakland was the investment in Saadi cement in 2000.It invested Rs. 800 million in this venture and it was anticipated that the plant will go into operations in 2001 but the production got delayed till 2003. The plant was financed through a loan of 65% which swelled up to Rs. 391 million in 2004. The financial liabilities also included redeemable capital of Rs. 5 billion. In 2004 Saadi was also taken over by the Dewan Mushtaq Group. Saadi project by Pakland was beget with certain flaws:-

- The project was financed through a loan of 64% through leasing and financial sector at excessively high mark-up (KIBOR) on the assumption of speedy completion and commencement of operations. This did not materialize and resulted in accumulation of interest.
- Equity/ Debt ratio in this project is subject to lot of debate. It is highly improbable that the operating profits after operations, even under best of conditions would have taken care of the paid up interest.
- It was highly unlikely that that the production would commence in 2001, however when it did in 2003, production did not cross 250 thousand tonnage; a figure very petty compared to plant capacity.
- Operational difficulties were not visualized professionally nor meticulously, e.g. sufficiency of land, access to the quarries and power requirement for the plant.
- The land acquired for plant was inadequate which hindered the production facilities.
- The bureaucratic hurdles in shape of sanctions, feasibilities and power politics led to delays in erection of plant. The advantage which Pakland once had in the lifetime of founder chairman and senator was no more there! Tariq Mohsin was a non entity in the political arena and had not nurtured old social linkages.

6.0 Financial Imbalances at Pakland

Pakland's choice of sources of funds for expansion as well as investments in Saadi cement was not based on plausible assumption. The capital structure of equity versus debt was highly leveraged in an industry which is labor intensive

where rewards or returns are not assured. This soundness proved correct and the company could not honor its financial liabilities

The financial health of the company reflects gross mismanagement during the period 2000- 2003. The financial reports for this period are attached as Table 2 and 3. ICON international consultants reveal that Pakland is a highly leveraged firm as compared to the industry. There is an imbalance in the Pakland balance sheet structure as compared to global benchmarks. Questions like whether the firm should hold more cash and short-term assets or does it concentrate on physical plants and equipment? Professor Parker of INSEAD comments that, “we are intrigued by the wide variations in the financial and the productivity measures between Pakland and other companies” (Icon consulting press release, 2004)

Marketing experts speak of assembling a blend of different strategies as marketing-mix. Likewise, effective corporate finances require a financing mix, an effective blend of financial sources matched to a variety of different uses. Instead of locking on long term financing, Tariq Mohsin increasingly tied the firm to short term credit arrangements at higher interests. Could Pakland clean-up the balance sheet by re-engineering strategies like joint ventures; rather than accumulating debt and becoming a takeover candidate?

Financial controls and cost benefit analysis are common studies in manufacturing concerns. It is surprising that the auditors of the company failed to alert the management during the period 2000- 03 of the impending disaster due to accumulation of loans. The company was also listed on the Karachi Stock Exchange since long yet no cognizance was taken by any authority to ensure that it operates within the purview of Code of Corporate Governance?

7.0 Managerial Inefficiencies

Pakland’s tall organizational structure remained overstaffed most of the time. The remuneration offered to senior executives were magnanimous supplemented with additional perks. The PCL statement of accounts for the period 1999- 2003 reflects that the general and administrative expenses kept increasing despite non- profitability. The top echelon was mostly subservient to the intuitive instructions of the CEO. Before the acquisition of Pakland by the Dewan Group the finance director embezzled and fled abroad who was one of the trusted deputies.

Asset management control is the acid test of a CEO. In this instance after the strategic decision to set up the Saadi cement, the performance of Pakland kept deteriorating. An analysis of balance sheets bears testimony to this fact. Inventory turnover, cash flows and other turnovers were the main effected areas. All these indicators reflect the inefficiencies of management, noncommittal attitude of the middle management and incompetence at all levels. It is a classic case of “Group think” where no conflict or criticism emerged in planning or decision making to turn-around events. Family businesses turned public need to determine their succession training in a more professional manner; can the Board of Directors make an effort in this

direction when majority shares are held with party who may be acting detrimental to firm interests?

Tariq Mohsin experimented akin an entrepreneur however never planned like one; in 1990's with much liquidity generated from cement operations he indulged in petty projects like diversifying into cosmetics, pharmaceuticals and even farming. Feasibility studies were conducted by amateurs and lacked determination. At the factory premises in Dhabeji, promises were made to local inhabitants of free electricity against sale deeds which could not be honored. This resulted into law and order situation later. At the time of expansion of plant in 1999 loan was negotiated at preposterous terms. The Saadi plant feasibility lacked important details like access to plant facility, time scheduling and political pressures.

At one stage religious fervor gripped him intensely and many employees used to go to perform Hajj rituals at company expense every year while at times grand "mushairas" used to be conducted in main cities of Pakistan. Corporate social responsibilities of such kind were not compatible to the financial health of the firm.

8.0 Take over by Dewan Mushtaq Group

The sales revenue of Pakland kept increasing at an improved price level (Rs. 1031.199 million in 2003 against Rs. 927.551 million in 2002) however the accumulated losses broke their backs. (Rs.72 million in 2003). Under these conditions the creditors refused to reschedule the loans and prompted the Dewan Group to take over the firm in May 2004. The company did not pay any dividends since 2000 and the shares slid downwards to a dismal level of Rs.84 per share. The current liabilities of the company exceeded its current assets by Rs. 148 million and the company was unable to redeem its TFC on maturity and the internal auditors in their annual report 2003 expressed their concern that " the company's ability to continue as a going concern is doubtful." The affairs of the company in virtually every area of operation had been mismanaged for years and there was a strong possibility that the company stood on the brink of impending disaster lest it agreed to a takeover. Had Tariq Mohsin negotiated a deal with the creditors and got himself some breathing space, could the management change be avoided?

Dewan Group is one of the leading conglomerates with diversified business interest ranging from fiber to sugar, from textile to trading and automobiles for over 8 decades. The DMG decided to diversify in yet another sector which always had a potential for expansion and profitability if managed in a business like manner instead of whimsical aberrations. The new management and the creditors negotiated a package for re-structuring the debt obligations of Pakland Cement. These negotiations resulted in revision of terms and conditions and some waiver of debts by the financial institutions. These confidence measures brought confidence amongst the creditors and the change of management was accepted by them and the company was renamed as Dewan Cement Limited in the memorandum and articles of association in 2004.

One of the first steps the new management took in 2004 was to stabilize and improve the efficiency of the plant. The plant was being operated at a very low inventory of coal and the kiln had deteriorated. 42 tons of bricks were airlifted to save the downtime of the plant. Similarly Sui gas connection was restored and 40% of the power requirement is now met from gas. This has resulted in reduction of coal consumption and has brought in substantial saving. The management also took notice of unscheduled shut-downs and now maintains adequate reserves of store items. PCL cost of goods always hovered between 82-86 % of sales which have been controlled by the new group to 72% in 2006.

In 2006 the prospects of Dewan Cement have improved tremendously. The brand name of Pakistan has now been changed to Dewan Cement. The production level has increased to 654,000 tons (increase by 55% since 2004), financial liabilities of up to Rs. 500 million have been discharged in the preceding two years and thus the Pakistan Credit Rating Agency Limited (PACRA) has assigned the long term as well as the short term credit rating of "A" to the company; denoting a low expectation of credit risk and strong capacity for timely payments for financial commitments and EPS has risen to Rs1.86. The firm is now in safe hands.

ISSUES

1. What succession policies can a family based business follow in order to ensure perpetuity of the firm?
2. Had the CEO negotiated a deal in 2004 with the creditors and got himself some breathing space, could the management change be avoided?
3. What is the responsibility of Board of Directors when majority shares are held with party who may be acting detrimental to firm interests?
4. What are the responsibilities of auditors, corporate bodies and SECP to ensure that that a public limited company operates within the purview of Code of Corporate Governance?
5. Could Pakland clean-up the balance sheet in 2004 by re-engineering strategies like joint ventures; rather than accumulating debt and becoming a takeover candidate?

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FIGURES / TABLES

Figure – 1

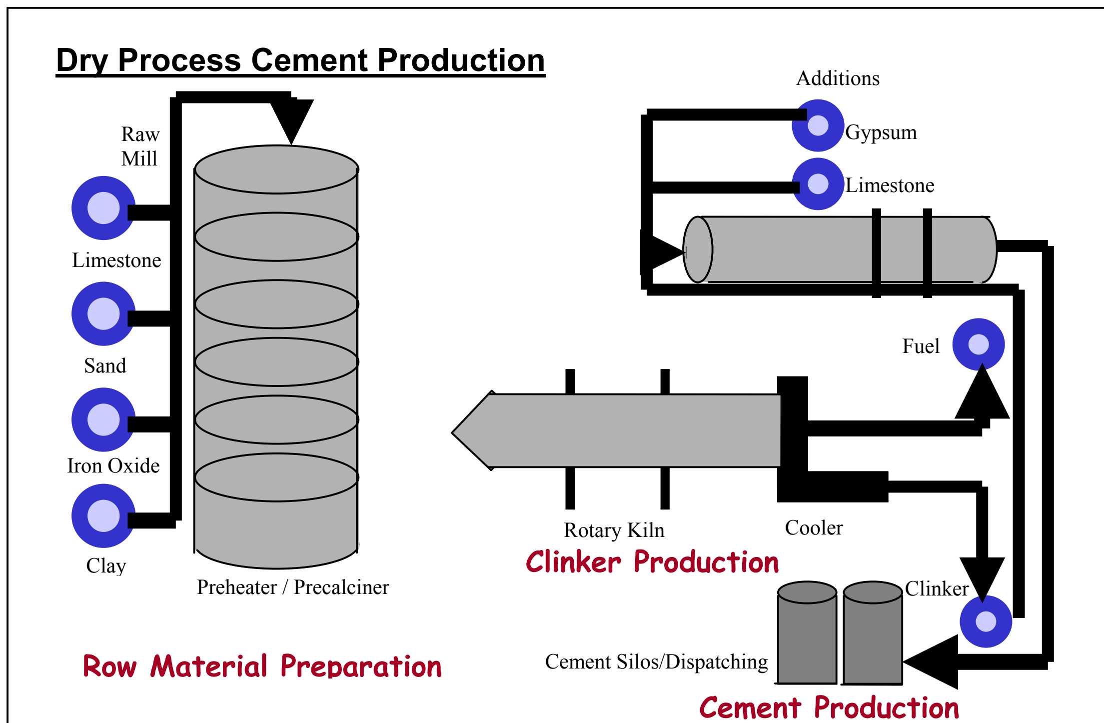

Table -2

	2006*	2005*	2004	2003	2002
NON-CURRENT ASSETS					
TANGIBLE FIXED ASSETS					
Operating fixed assets	6125013	5475863	5,057,069	405,897	442,099
Capital work-in-progress			347,193	6,761,838	5,898,360

NON-CURRENT ASSETS	6,125,013	5,475,863	5,404,262	7,167,735	6,340,459
LONG-TERM INVESTMENT	951,273	911,296	800,000	800,000	800,000
LONG-TERM LOANS	1,329	824	1,092	1,846	423
LONG-TERM DEPOSITS	21,415	2,105	2,524	7,086	8,530
DEFERRED COSTS					
CURRENT ASSETS					
Stores and spares	346,435	225,766	183,744	209,912	212,787
Stock-in-trade	186,703	132,279	28,916	26,417	46,410
Trade debts	81,841	87,087	30,463	26,828	29,282
S	125,102	122,849	47,677	84,762	130,793
Deposits, prepayments and other recievables	16,072	11,303	7,498	251,425	251,850
Short-term investment	9,034	4,121	6,044	8,812	-
Cash and bank balances	76,751	108,067	22,070	2,984	1,980
Current Portion of Long Term Loans			528		
Due from an associated undertaking			16,803		
				54,874	29,658
	1,144,090	966,182	343,743	666,014	702,760
TOTAL ASSETS	**8,243,120**	**7,356,270**	**6,551,621**	**8,642,681**	**7,852,172**
EQUITY AND LIABILITIES					
SHARE CAPITAL AND RESERVES					
Authorized capital					
150,000,000 (1999:150,000,000) Ordinary shares of Rs.10/- each	2,243,157	1,088,554	1,500,000	1,500,000	1,500,000
Issued, subscribed and paid-up capital			825,000	825,000	825,000
Revenue reserve			23,540	393,444	322,711
			848,540	1,218,444	1,147,711
NON-CURRENT LIABILITIES			813,408		
LOANS FROM DIRECTORS AND OTHERS				6,356,811	5,516,713
REDEEMABLE CAPITAL	2,629,795	3,028,869	3,346,933	44,672	44,672
LONG-TERM LOANS	715845	499843	44,672	185,137	192,144
LONG-TERM DEPOSITS AND RENTATION MONEY			18,981	23,592	25,496
OBLIGATIONS UNDER FINANCE LEASES					
Liabilities against assets subject to finance lease	28,791	264	4,907		
Security Deposits			134,215		
IMPORT BILLS PAYABLE					
CURRENT LIABILITIES					
Short-term loans			92,400	-	201,084
Short-term finances				124,734	-
Current portion of long term liabilities	533,311	308,376	651,204	689,291	723,929
Income tax payable	20,403	29,697	20,194	-	423
Creditors, accrued and Liabilities			651,204		
	1,286,146	933,925	834,837	814,025	925,436
CONTINGENCIES AND COMMITMENTS					

TOTAL EQUITY AND LIABILITIES	8,243,120	7,356,270	6,551,621	8,642,681	7,852,172

NOTE: 2005 and 2006 statistics relate to Dewan Cement.

Table -3

	2003	2002	2001	2000	1999
QUANTITATIVE DATA					
Clinker Production	426	420	280	341	281
Cement Production	447	429	332	354	325
Cement Dispatched	448	428	333	357	332
ASSETS EMPLOYED					
Fixed Assets	7,168	6,340	5,667	4,463	4,095
Long term Investments, Advances Loans, Deposits & Deferred Costs	809	909	802	934	935
Current Assets	666	703	549	762	753
Total Assets Employed	**8,643**	**7,852**	**7,018**	**6,158**	**5,782**
FINANCED BY					
Shareholders Equity	1,218	1,148	1,116	1,213	1,186
Redeemable Capital	6,357	5,517	5,086	75	77
Long-Term Loans, Liabilities, Deposits & Import Bills Payable	253	262	278	1,900	1,888
Obligations under Finance Lease & Deffered Income	-	-	-	1,839	1,634
Current Liabilities	814	925	538	1,132	998
TOTAL FUND INVESTED	**8,643**	**7,852**	**7,018**	**6,158**	**5,782**
TURNOVER & PROFIT					
Turnover (Net)	1,031.20	927.55	717.64	860.15	732.36
Operating Profit/(Loss)	112.16	88.33	-24.43	86.48	64.38
Profit/(Loss) Before Taxarion	72.19	43.75	-91.84	31.13	6.49
Profit/(Loss) After Taxation	70.73	31.4	-96.4	26.83	2.83
Transfers to Reserves	-	-	-	-	-
Accumulated Profit/(Loss) c/f	-1.56	-72.29	-103.69	-7.29	-34.12

Table -6
COMPARISON OF CONSUMPTION- ASIAN COUNTRIES

Country	Annual Consumption	Per Capita
	(000) tonse	Consumption (kg)
China	512	422
Taiwan	20.8	960
Malaysia	11.5	530
Sri Lanka	2.2	118
Indonesia	19.3	95
India	85	89
Pakistan	9.1	72

Source: Cement Manufacturing Association Report 2004.