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DYNAMICS THAT CONSTRAIN INVESTMENT IN PAKISTAN'S STOCK EXCHANGE

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Abstract

In Pakistan's financial sector, a variety of factors, including intuition, anxiety about risk, investments, corporations, and daily experience, have a substantial effect on investors' decision-making. The purpose of the study is to increase investor confidence and equity investing awareness among a broad spectrum of investors. In this article, the institutional, legal, and political barriers to investment in Pakistan are examined. It talks about the practical challenges investors encounter, such as dispute resolution, legislative lobbying, and retention tactics. Additionally, taken into account are elements like the informal economy, shallow financial markets, and low savings rates. The study also addresses the administrative shortcomings in tax collection, which impede investment and growth. It highlights the significance of SME growth and the difficulties of expanding operations in Pakistan. This article also covers current policy changes that aim at enhancing the investment environment through the introduction of certain novelties through the introduction of capital strategies and skill-building programs into practice. The key objective of this article is to show that the Securities and Exchange Commission of Pakistan's effectiveness in regulating securities markets for investor protection needs to be improved to protect investors from fictitious, abusive, or fraudulent transactions such as confidential trading, competitiveness, or trading ahead of customers, and customer asset misappropriation. During this research, an analytical approach along with descriptive methodology will be applied. The current laws and regulations on Effectiveness in Regulating Securities Markets for investor protection of SECP will be analyzed critically and this paper includes systemization.

Keywords: corporations, investment, investor, factors, strategies.

Introduction

East Asia and China, two emerging markets, have been successful in luring sizable investments through free trade and investment policies, concentrating on export-oriented sectors. Successful capital development has also occurred in nations like Turkey, Indonesia, and India. Reduction in the capital has resulted in a lack of confidence among the public and private sectors. This led to a decrease in investment which caused restrictions on human capital, transportation, energy, and technology. Limited local savings and a reliance on foreign savings for expansion and employment are the results of infrastructure restrictions and unreliable macroeconomic conditions. Because of this structure, the economy is less equipped to resist economic cycles since periods of expansion frequently coincide with significant inflows of foreign savings, which slows down economic growth. Foreign inflows are still dominated by loans and grants. Pakistan's investment rate has been declining for three decades, making it Asia's only nation with declining development potential. Pakistan's foreign direct investment for the year of 2022 was \$1. 34B. it was a 37.63% decline from 2021. Pakistan's foreign direct investment for 2021 was \$2.15B which was an increase of 4.38% from 2020. Pakistan's foreign direct investment for 2020 was \$2.06B, a 7.92% decline from the previous year i.e. 2019. The World Bank predicts a difficult transition to a middle-income nation in 30 years due to current growth rates of 15%. Attracting foreign capital is challenging, as other nations are expanding faster than Pakistan. This investment finance system has increasingly reduced the economy's capacity to endure economic cycles. Demand for all services and goods in the nation has been rising much more quickly than supply, necessitating an increase in imports, especially due to rises in consumption-driven surges (Garg, 1999). The fact that almost all of Pakistan's times of strong economic expansion have been accompanied by substantial inflows of foreign currency should thus not come as a surprise; each time these inflows have stopped; economic growth has slowed. (Kemal, 2002) Due to the state's difficulties in luring significant, continuous investments overseas, with loans and grants making up the majority of the inflows, even the alignment of foreign influxes has become negative. (Masood, 1973). Investors are safeguarded in Pakistan against both direct and indirect expropriation, and they are also permitted to fully repatriate their earnings. The 48 bilateral investment treaties (BITs) Pakistan has signed with foreign nations have also helped to foster this open environment. However, investors frequently complain that they don't receive all of the advantages listed in the recognized BITs. It's also important to keep in mind that Pakistan recently accepted BITs with provisions for which its investment rules and regulations are either entirely silent or just moderately acceptable. (Alces, 2013).

Problem Statement

There is always room for improvement in rules and regulations governing the efficiency of securities market regulation for investor protection. There are significant holes that must be filled. The efficacy of the SECP in regulating securities markets for investor protection must be addressed immediately since failure affects the public at large. States can legislate on issues that have long been overlooked or disregarded. The current study aims to highlight the fact that, in the absence of adequate procedures and precise methods of execution, SECP's usefulness in regulating securities markets for investor protection may be only rhetoric on paper. Effective processes and implementation techniques aid in the implementation of the SECP.

Significance of the Research

The goalmouths of this research are to provide a thorough evaluation of Pakistan's investment climate as well as to highlight

Pakistan's institutional, legal, and political barriers to attracting the domestic and international capital that is needed to fulfill its full potential. It focuses on the practical and legal challenges that domestic and foreign investors face, particularly in dispute resolution, public policy advocacy, and investor retention measures. This research looks at issues other than traditional macroeconomic explanations, such as reduced investment amounts, constrained financial markets, and a significant informal sector. It emphasizes the flaws in the tax collection system, including the time-consuming administrative procedures and onerous paperwork requirements. Pakistan's investment rate has been continuously declining in recent years.

Research Objectives

i. To explore, assess, and stress the efficacy of SECP in regulating securities markets for investor protection.

ii. To develop a mechanism for effectively regulating securities markets for SECP investor protection, as well as to propose specific legislation to hold them accountable as it threatens our whole corporate legal framework. Because there has been no research on the subject, the researcher hopes to elicit some useful information that will assist the public. This research will be utilized as a comprehensive resource to help academia, policymakers, diplomats, politicians, and other students and scholars assess the efficacy of securities market regulation.

Research Methodology

While writing this article author came across many primary and secondary sources to conclude this research. The research strategy which is adapted for this research is quantitative. The researcher relied on books, various research articles, and internet searches while writing this article. Among many other sources, the author relied on instruments related to laws and rules that control stock market investment. The researcher will carefully examine in detail the laws and rules that control the stock market.

Hypothesis:

Investors play a vital role in the progress of a country. In Pakistan, this prime class is neglected. There are no laws and rules that protect investors. This in return loses their confidence. After 1976 there is no talk on this important issue. This article identifies reasons why investor lost their confidence in investing in stocks. This article will analyze the reasons in detail the reasons due to which economy of Pakistan is not growing from an investment perspective. When laws and rules are legislated in a way that protects investors, it will ultimately increase investors' confidence in the market. This in return will help increase investment so ultimately the economy of the country will move towards a better side.

Literature review

The researcher studied a range of publications while doing a study on the subject. These resources are really helpful and informative. It is vital to establish laws that are non-discriminatory anywhere in the world. Due to the potential of gaining 100 percent ownership in the majority of the companies as well as the lack of any limits on currency conversion and profit repatriation, investors are drawn to the vibrant and expanding local market. The government should develop a huge network of free trade and foreign investment agreements that also offer, at least on paper, effective and prompt dispute resolution, the adoption of fundamental norms of treatment, and protection against expropriation for future investments. (Perry, 2000) Investor interest and confidence in an economy decline when sector-specific strategies are unknown, regardless of the macroeconomic stability environment. To make informed decisions about investments and development, new information must be taken into account as it becomes available.

The ability of investors to incorporate fresh information into their planning and decision-making suffers as policy uncertainty rises. Investments may find it challenging to swiftly recover to their prior levels if there is a sudden change in policy or a delay in the announcement or implementation of incentives and tax relief, particularly if the investments are irreversible. (Subedi, 2006) A change in business strategy is the primary driver of multinational corporations leaving a nation, but financial instability concerns are close behind. Uncertainty over the strategy is seen as a significant barrier to further investment. Because of ongoing changes to incentive structures and the implementation of division-specific regulations, which oftentimes are not well received by investors, the overall investment climate is difficult. (Baker & Holmes, 1991). Investors cited a lack of understanding and asset appraisal as the main causes of a 25% decline in worldwide investment, followed by security concerns, image problems, and increased tax compliance on tax-compliant enterprises. Investors also cited strategy ambiguity and irregularities as important factors. Furthermore, there is no framework in place to assess or track the effectiveness of the measures taken to increase current levels or introduce new capital creation activities. (Kay Hoang, 2018). Management problems may be the major barrier to the development and growth of small enterprises worldwide. There is a persistent risk of manufacturing as well as job abandonment since marketplaces are often informal and agreement execution and patent laws are seldom regulated. As a result, business owners and top executives typically don't delegate much and keep their business goals to themselves. Even though businessmen benefit from the accessibility of inexpensive labor, the skills gap significantly surpasses the former's benefits. (Zeidman, Young, Harrison & Elliott Davis, 1996)

Theoretical Framework

While writing the Literature review author analyzed many important theories that are related to investors' protection for investing in stock exchanges. Ashwini k. Agrawal's theory "The impact of Investor Protection Law on Corporate policy" holds a major role in where he describes the impact of investor protection Laws on Firms and corporate policies. Recent studies have placed great emphasis on how investor protection laws will impact corporate behavior and value. Relying on this theory author analyzed that increased investor protection will lead to an increase in investment. The conclusion of this article strongly supports theoretical models that predict investor protection law has a significant impact on the increase in investment.

Critical Analysis and Results

The grounds for obstructions to enforcement include Legal challenges, Operational challenges, and systemic challenges

Legal challenges

Legal challenges include the risk of erroneously enforcing rules and regulations, which can lead to loss. Opacity, ambiguous terminology, inconsistent application, and lack of availability can also pose risks. Unexpected legislation, postponing asset seizures, or freezing holdings can also result in financial loss due to legal actions. (Martin & Mercurio, 2018)

Lack of Proper laws

In Pakistan, the investment environment is defined by the Protection of Economic Reform Act of 1992 and the Foreign Private Investment Act of 1976, with the investment policy largely acting as a marketing tool. Investors find it challenging to comprehend the complete economic inducement structure and acceptable investment operations because of these parallel laws. They differ in the types of sectors that are available for investment, the minimal domestic input standards, the expropriation and dispute settlement procedures, and the national and equitable treatment of foreign investments. These differences discourage investors from participating in capital creation activities. (Choi, 2000)

Long durations of court proceedings

Investors are reluctant to invest in Pakistan due to the country's lengthy judicial processes for settling commercial disputes. According to a 2017 poll, one-fifth of defendants claimed a three- to five-year turnaround time for disputes, while more than half of investors indicated a five-year turnaround time. Governments have been forced to examine and renegotiate investment treaties as a result of high-profile disputes between the government and foreign businesses that have reduced public faith in Pakistan. (Staats & Biglaiser, 2011)

Operational challenges

Pakistan's liberal investment policy has been criticized for not delivering on its promises, resulting in a poor business-friendliness score. The inclusive comfort of doing business (EODB) has dropped by 62 points compared to other countries. Pakistan's ranks have not significantly improved due to a lack of changes, such as resolving energy shortages and high trading prices. Foreign investors can start operations before obtaining a no-objection certificate, but this takes two to three months. The 2013 World Bank enterprise survey revealed higher levels of bribery and corruption among firms. (Littell, 2014)

The Unfavorable Tax Environment

The tax system of a country, including its rates, structures, and payment choices, has a significant impact on the investment environment of that country. Fairness, sufficiency, simplicity, transparency, and administrative simplicity are prerequisites because their primary objective is to draw investors and increase business profitability. The tax administration in Pakistan has battled to broaden the tax base, stop changes, and promote a fair and well-structured system. The inability to completely record businesses, widespread corruption, and onerous documentation requirements are the main factors contributing to the growth of the informal sector. It has been challenging for Pakistani officials to strike a balance between providing tax breaks to businesses and increasing revenue. (Schneiderman, 2010)

Administrative trade barriers

An important obstacle to investment is a lack of administrative effectiveness. Managerial obstacles to trade, such as documentation preparation and customs processes, must be paid for by the trading firm. By sending fewer but larger shipments to regions with high administrative fees, which regularly happen after each shipment, the corporation will be able to lower these costs. Such a persuasive response could help partially explain the lumpiness of business transactions. Since there is a pronounced disparity between the duration of consumption that is experienced and the period that is predicted, fewer shipments lead to welfare losses. In this study, the impacts of per-shipment fees on shipment frequency, shipment size, pricing, and well-being were investigated using a straightforward circular city discrete choice model without inventories. (Calcagnini & Iacobucci, 1997)

Slack Supervision Procedures

An organized combative administration and association survey involving more than 2,000 Punjabi institutions found that poor management practices in small enterprises are a key factor in performance stagnation. Decentralized decision-making, data-driven evaluation, goal-setting, and statistical application are typically weak points for small organizations. Due to a lack of entrepreneurial experience and a low-risk tolerance, expansion is frequently neglected, which reduces costs for new product development, employee skill development, machinery replacement, and operational process modernization. This implies a direct connection between managerial style and decentralized decision-making in Pakistani firms. (Zeidman, Samue, Young, Harrison & Elliott Davis, 1996)

Administration and Organization issues

The most significant barrier to the expansion and success of Pakistan's small businesses may be management issues. Since markets are frequently unregulated, agreements are seldom carried out according to law, and patent laws are rarely enforced, there is a constant danger of manufacturing as well as job displacement. As a result, business owners and senior executives rarely delegate and tend to keep their corporate objectives to themselves. Although the availability of cheap labor favors Pakistani enterprises, the latter's advantages are vastly outweighed by the former. (Herring, 1999)

Lack of Coordination Between The Federal And Provincial Governments

The cooperation between the federal and provincial governments also has to be improved, especially since funds are subject to provincial oversight as a result of the 18th Amendment. The resulting reduction in regulatory authority conflicts would be beneficial. The issues may be remedied with improved cooperation, and talks between investors and the provincial and federal governments might be easier. In this circumstance, the IPAs can offer a means of recording investor concerns about the obstacles and difficulties posed by the law to contract enforcement, and they can subsequently bring these complaints before the appropriate authorities for settlement. (Littell, 1999)

Systematic challenges

The Stock Exchange's securities regulations themselves, nevertheless, may be in danger of a systemic collapse if one or more members fail to perform as expected and prevent other participants from making payments when they are due. In such circumstances, there are likely to be several "knock-on" effects, and the Securities Regulations' inability to compensate sufficiently may have a detrimental effect on the markets it supports as well as the nation's overall budget. Negative effects might result from, among other things, a delay in the settlement or completion of guaranteed transactions, the cancellation or reversal of payments or deliveries, the quick liquidation of indemnification, boundaries, or more resources at fire transaction amounts. (Jian, & Zhou, 2013)

Threat of credit risk

In the context of the stock market, credit risk refers to the potential for a counterparty, contributor, or individual to fall short of their financial obligations. It frequently has relationships with the main risk, the risk associated with pre-settlement, and other hazards. Losing unrealized gains on uncompleted transactions with a counterparty is a form of replacement-cost risk. A rival losing the entire amount on the line in a trade is the greatest danger. A credit risk is also the incapacity of settlement banks, custodians, or securities regulators to pay their debts. (Honohan, 2008)

Liquidity risk

Liquidity risk, as it pertains to stock exchanges and participation, is the possibility that an adversary would lack the resources to fulfill its anticipated monetarist commitments. It entails the potential for late payments, the requirement to borrow money, or the requirement to liquidate assets to satisfy other debts. Liquidity risk also affects asset consumers since they may not get their money on time or may need to borrow it. Liquidity issues may result in systemic issues, solvency concerns, and effects on nostro agents, guardian banks, reimbursement banks, liquidity benefactors, and related Stock Exchange laws. (Staats & Biglaiser, 2011)

Investment and custody risks

The stock exchange may be subject to custody and investment risks concerning the assets it owns and holds on behalf of its participants. Custody risk is the chance of having assets taken into custody lost in the event of bankruptcy, negligence, fraud, poor administration, or insufficient paperwork on the part of the custodian or sub-custodian. Investment risk is the likelihood that a security regulator would suffer a monetary loss while investing its own resources or participant money, such as collateral. These risks may affect the price of upkeep and resource investment, the dependability and security of a securities regulation's risk-management systems, and other factors. If a securities regulator can't adequately protect its assets, it stands at risk of losing credit, liquidity, and other resources. (Staats & Biglaiser, 2011)

Delimitation

Due to the quicker rise of other nations' economies, Pakistan has difficulty recruiting international investors. Both the public and private sectors require enough investment, but structural challenges with tax collection and inadequate domestic savings hinder private sector investment activity. As a result, Pakistan now relies on foreign savings for economic development and job creation. This investment finance structure has reduced the economy's ability to sustain boom cycles over time, with consumption-driven surges resulting in quicker demand expansion and higher imports. As a result, practically all times of rapid economic expansion have been accompanied by significant foreign savings influxes; nevertheless, when these influxes cease, economic growth slows. Due to the state's challenges in obtaining large outside investments, foreign influxes have been negative, with loans and grants accounting for the majority of incoming funds.

Conclusion

Worker productivity and capital position in Pakistan may be increased by putting capital strategies and skill-building programs into practice. Sindh, Punjab, and Khyber Pakhtunkhwa have all enacted labor policies to boost employment and get their workforces ready for a changing market. Only 8% of Pakistani employees, many of whom lack certification, attend vocational institutions for employment training. To defend suggested processes and provide explanations for acts, the government must step up its proclamation efforts. It is essential to identify and reward enterprises with development potential since wasteful expenditure and unequal resource distribution may be factors in the widening output gaps in developing countries. In further discussion, it should be noted that, even though investment is occasionally viewed as a risk that must be taken to achieve cost-effective expansion, the major emphasis should be on selecting businesses that have a good potential for growth and then properly providing support. To reward ambitious enterprises and further inspire them to increase productivity as well as generate significant amounts of funding to compete with their more affluent competitors, lending restrictions and tax benefits need to be reconsidered. The state's involvement needs to be increased if it is to drive investments in important economic areas. Particularly in a developing nation like Pakistan, the "environment" must first be fully created by the government to permit the innovative activities that private investors are expected to carry out.

Recommendations and Innovation

The enforcement barrier can be removed by executing some measures, such as the disclosed capital plan, which should be implemented concurrently. To increase the country's capital position and, as a result, worker productivity, effective coordination is essential. A comprehensive plan is required to drive the skill-building process in the direction of national goals. Labor policies in Sindh, Punjab, and Khyber Pakhtunkhwa have recently been implemented to increase employment, ensure a safe and vigorous working environment, ensure masculinity equivalence in the workforce, and prepare their respective manual labor forces for the needs of a changing economy. In addition, just 8% of Pakistani workers receive job training from vocational institutes, the vast majority of which are uncertified. To have a greater impact, the training programs will need to be actively marketed. While it is encouraging to see that government management is implementing the majority of the necessary tax strategy changes, it is also important to note that the government must explicitly increase its proclamation struggles to defend all proposed mechanisms and explain the justifications for the actions taken. This is essential to properly implement the tax policy. The primary purpose should be to identify and reward enterprises with significant growth potential. Excessive spending and poor resource allocation to small businesses in emerging economies may lead to increasing dynamic production gaps in financial prudence. Investors should choose firms with high growth potential and deploy resources wisely. Reviewing loan restrictions and tax benefits may reward and push ambitious enterprises to enhance their output. To lead investments in key economic sectors, the role of the state must be strengthened, particularly in developing nations like Pakistan, to completely build the environment for private investors to engage in innovative activities. This will contribute to a more competitive environment for rising economies. Foreign Private Investment (Promotion and Protection) Act of 1976 is the only law available in Pakistan to protect investor's rights. It needs time to legislate new laws for the protection of investor's rights.

1. Investors should be educated about the market. Comprehensive policies should be devised to educate investors. Transparency in the provision of information to investors will increase the confidence of investors.
2. Stock Exchange should arrange webinars, seminars, and workshops to conduct awareness programs for market participants. This will lead to the Investor's information about the futures contracts offered. Stock Exchange should regularly upload guidelines on its website to raise awareness among investors.
3. The Stock Exchange should establish an alternate dispute resolution mechanism to redress the aggrieved investor.
4. Provisions should be added in the Pakistan Penal Code 1860 for punishing frauds committed by investors.

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