ESG Initiative

Abraaj Group's Integration of ESG Policies into the Turnaround of K-Electric (A)

Witold (Vit) Henisz

Vice Dean and Faculty Director, The Environmental, Social and Governance (ESG) Initiative
Deloitte & Touche Professor of Management
The Wharton School at the University of Pennsylvania

Natalie Peelish

Research Assistant
The Wharton School at the University of Pennsylvania

ESG INITIATIVE CASE STUDY SERIES

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"Stakeholder engagement and community enhancement are at the heart of the model."

Tayyab Tareen, former CEO, K-Electric

"The real success of Karachi Electric is not just operational but also holistic. Managing the expectations of consumers, governments, regulators, NGOs, key opinion leaders, civil society activists, and the media (within sometimes inherent conflicts with each other) is a very difficult task; thus, a fair level of interaction with all stakeholders – without prejudice, and with transparency, firmness, and commitment – was required."

Waqar Siddique (Partner, The Abraaj Group, and Chairman, K-Electric, 2009-2013 and 2015-2018)

"Balancing the interests, needs, and wants of a diverse set of stakeholders is always a tricky proposition for a reformist leader but it is of paramount importance – it should never be a zero-sum game, however; in other words, one stakeholder should not be willfully advantaged at the expense of another. Take a privatized utility company as an example. It would count amongst its stakeholder universe the following segments: (1) customers – residential, commercial, industrial, strategic, etc.; (2) shareholders; (3) employees; (4) lenders; (5) suppliers/vendors/contractors; (6) federal/provincial/local governments and regulators; (7) media – electronic and print; (8) political parties; (9) NGOs/consumer protection lobbies; and (10) law enforcement agencies – all of the above are not in any particular order of importance.

Trying to be consistently fair to all of these stakeholders, especially in a turnaround situation, is a thankless job and whilst there's not a prescribed formula or case study to achieve the right balance, all you can strive for is a degree of fairness that will always remain subjective and qualitative in its analysis."

Tabish Gauhar, former CEO, K-Electric

In late June 2015, a blistering, weeklong heat wave — with 50 percent humidity and daytime temperatures exceeding 110 degrees Fahrenheit (and nighttime temperatures exceeding 90 degrees) — settled over southern Pakistan (including in its most populous

Wharton management professor Witold Henisz and Natalie Peelish, a former research assistant at Wharton's management department, prepared this case study as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The development of this case was financially supported by the Wharton Social Impact Initiative. Abraaj Capital and Karachi Electric provided substantial assistance with phone interviews and a detailed itinerary of interviews (with internal and external stakeholders in Dubai, Karachi, and Islamabad), and shared an extensive library of supporting documents.

Some of the values and numbers (presented in this case study) are disguised or should be considered approximates. Statements and opinions, expressed in this case, are those of the authors. They do not represent the opinions of the Wharton School, the University of Pennsylvania, Abraaj Capital, or Karachi Electric.

city of Karachi). According to a Ministry of Climate Change report,[1] a prolonged air depression over the Arabian Sea (i.e., a novel meteorological pattern) disrupted prevailing sea breezes and formed a high-pressure ridge. This was exacerbated by an urban heat island (UHI) and led to unprecedented peak temperatures of 113 degrees Fahrenheit in Karachi and 120 degrees Fahrenheit in nearby cities, and humidity as high as 95 percent. Before the heat wave lifted, it claimed over 1,300 lives (e.g., homeless and/or elderly people and some individuals who were fasting and had refused water or medical help).

The heat and humidity also triggered multiple technical faults in electricity generation and distribution systems while a loss of interconnection between the southern and northern parts of the country (caused by a sandstorm) limited the capacity to source power from the northern regions (to compensate for the shortages in the south). Repair efforts (for the faults) were undermined when angry residents attacked service centers and assaulted repair workers. This problem was exacerbated by a shutdown of a nuclear generating facility and a shortage of gas or low gas pressure (to power other plants).

Tayyab Tareen — who had become the CEO of K-Electric (KE) only seven months earlier — quickly found himself in the hot seat. Government ministers were (i) publicly blaming KE for power outages (and a resulting water crisis), (ii) claiming that the firm was not utilizing its full generating capacity, and (iii) reintroducing longstanding accusations regarding (a) inappropriate financial concessions by the government to new investors (at the time of the acquisition) and (b) the unfairness of power-purchase agreements that allowed the firm to purchase power produced in the northern part of the country (where demand far exceeded supply) and sell it in Karachi.

Critics claimed that these policies existed because of the close political affiliation of KE with political parties that were in power at the time and now in the opposition; they also focused on the interruption of power supplies to hospitals and other paying customers (e.g., the water company, universities, and other social organizations) who were promised exemptions from load-shedding but were nevertheless affected by a citywide blackout.

The KE management team felt that it was unfairly made the scapegoat for the collective failure of civic agencies, emergency services, disaster management authorities, and weather forecasting services. The firm struggled with the burden of explaining that the blackout was caused by (i) unprecedented increases in demand, (ii) interdependencies of multiple electrical grids (e.g., some that they could not control), and (iii) technical faults caused by record humidity.

KE publicly repudiated many of the accusations as "baseless" and highlighted their accomplishments in terms of new investments and available supply, while also acknowledging that even load-shed exempt customers were experiencing extended blackouts owing to technical faults and the highest-ever recorded demand. They implored customers to cut back on their use of non-essential electric appliances during the shortfall and conserve as much electricity as possible. Protests escalated; indeed, demonstrators, at roadblocks with burning tires, held placards demanding the rollback of the privatization of the power utility.

While such a major policy reversal was not possible (owing to various constitutional and legal protections), the regulator did convene a

[1]Government of Pakistan Ministry of Climate Change (2015) "Technical Report on the Karachi Heat Wave, June 2015" http://www.ndma.gov.pk/site/files/heatwave.pdf

special committee to investigate causes of the power crisis. Ministers publicly and privately chastised the firm and its management team; at times, they literally blamed them for the deaths and despair that were bringing Karachi to its knees. Furthermore, the speaker of the state assembly threatened legal sanction to "punish" the firm for its "failure" to provide uninterrupted power.

Tareen responded by requesting that "consumers show patience and have faith in the power utility in these trying times." He assured consumers that KE was trying its best to overcome the issues so that uninterrupted supply could be made available in minimal time. On what he perceived as "inauthentic" media reports and "baseless" comments in some circles, the CEO added, "We want our consumers not to believe the different reports circulating regarding the performance of the company because they carry zero weight. The power utility is recognized as one of the best in the country and Karachi has seen the difference during the last five years in terms of growth and reduced outages (compared to the rest of the country). We have outperformed other distribution companies over the past five years and comparing this recent blip with our previous performance is wrong. We will stand tall in the end because we believe in the city and in this country and we want our consumers to stay positive."

As Tareen reflected on his latest operational and stakeholder challenges, he pondered on what else he could do to overcome the suspicion of key stakeholders and create a more sustainable turnaround for investors, customers, and other stakeholders. Despite the clear gains that had been attained since 2009, the firm had remained an easy political target. Indeed, the attention of stakeholders was too easily diverted from steady operational gains (that were temporarily undermined by a few weeks of historically bad weather); instead, they tended to focus on the juxtaposition of (i) KE's recent turn to financial profitability, (ii) KE's campaign to recover dues from nonpaying customers (which included public condemnations and criminal prosecutions), and (iii) images (distributed by the media) of hospitals and water-pumping stations without power in 120-degree heat. Recently realigned political forces were partly at fault as they positioned themselves for the upcoming renegotiation of the power-purchase agreement.

Was there more that Tareen could have done to better manage the inherent stakeholder conflict that the firm faced? This episode was yet another reminder of the balance between continuity and change, turnaround and false hope, and successful exit and an albatross.

The Abraaj Group

The first time Tareen visited KE (i.e., Karachi Electric Supply Company, at that time), he was part of a four-person due diligence team that was dispatched by Arif Naqvi, founder and CEO of The Abraaj Group, in response to the personal outreach of a Saudi-Kuwaiti consortium (i.e., Al-Jomaih Group and National Industries Group (NIG)) that had purchased the asset in a privatization program in 2005.

Arif Naqvi

The Abraaj Group was founded in Dubai as Abraaj Capital in 2002. Its founder and CEO Arif Naqvi was born in Karachi; he was — the fourth child of a local business owner. He graduated from the London School of Economics in 1982, began working in the London offices of Arthur Andersen & Co., and then moved to Saudi Arabia where he worked (as the vice president of global business development) for the Olayan Group, which was one of the leading family-based trading businesses in the Middle East. In 1994, Naqvi branched out on his own and founded The Cupola Group in Dubai, a development-capital boutique firm that initially provided financial advisory services and won international franchises (e.g., TGI Friday's, Pizza Express, Viacom, and Thomas Cook).[2] In 2001, Cupola was valued at $150 million; at this stage, Naqvi decided to (i) leave it as an operating company (with various assets) and (ii) utilize the investment arm (of Cupola) as a foundation for what would become a private equity company: Abraaj Capital.[3]

Naqvi is widely recognized not only for building Abraaj into the largest growth-market private equity group but also as a global leader in governance and sustainability. He was appointed by UN Secretary General Ban Ki-moon to the UN Global Compact Board (which has anticorruption as one of its core principles)[4] and also sits on the Board of the Interpol Foundation. Furthermore, Abraaj is a member of the Pearl Initiative (a "leading independent, not-for-profit, by-business for business, institution"), working

across the Gulf Region to influence and improve corporate accountability and transparency.[5] As part of his philanthropic efforts, Naqvi and his family founded the Aman Foundation, which is one of the largest private social sector enterprises in Pakistan. It was "born out of the belief that Pakistanis must take the lead in solving their country's problems"[6] through sustainable development in the healthcare and education sectors.

Naqvi holds many prestigious positions including that as a council member of the Belfer Center for Science and International Affairs at the Kennedy School of Government at Harvard University and as a board member of the Global Leadership Council of Columbia University. Additionally, he has been a recipient of numerous awards, including the Oslo Business for Peace Award (the highest recognition given to individual private sector leaders for fostering peace and stability through business) and the Sitara-i-Imtiaz (a civilian honor awarded by the Government of Pakistan).

Political leaders in Pakistan have also taken note of Naqvi and his efforts to invest responsibly and inspire meaningful change in Pakistan. In 2011, Naqvi, along with a bipartisan group of prominent Karachiites, helped to fund the ransom for the release of the 22 Pakistanis who were taken hostage by Somali pirates.[7] In 2015, Prime Minister Nawaz Sharif invited Naqvi to Islamabad to discuss several key issues with him. Nawaz reportedly "appreciated the Abraaj Group for their investment … and invited its head Arif Masood Naqvi to visit him in Islamabad and put forward suggestions and areas where they could make more investment."[8]

Culture and Philosophy

Naqvi's values are strongly imprinted throughout the Abraaj Group, which prides itself on pioneering what it considers a "Partnership Capital" private equity model (i.e., shareholder returns are primary but "the ability

[2]MacBride, "The Story Behind Abraaj Group's Stunning Rise in Global Private Equity."

[3]Ibid.

[4]"About Us," The Abraaj Group, accessed February 24, 2016 http://www.abraaj.com/about-us/

[5]"About the Pearl Initiative," The Pearl Initiative, accessed February 24, 2016, http://www.pearlinitiative.org/about-pearl-initiative.html

[6]"Overview," The Aman Foundation, accessed February 24, 2016 http://www.theamanfoundation.org/about-amanfoundation/overview/

[7]Danish Rafique, "Warm Welcome as MV Suez Crew Arrives in Karachi," *The Nation*, June 24, 2011.

[8]"Prime Minister Muhammad Nawaz Sharif Unveils Country's Largest Oil Refinery," Prime Minister's Office,Islamic Republic of Pakistan, accessed February 25, 2016 http://www.pmo.gov.pk/news_details.php?news_id=382

to create deep-rooted, sustainable changes in the economic landscape within [their] markets was as critical a benchmark of success as pure financial returns").[9] In an effort to maintain its position as a leader in growth markets via sustainable investment practices and the creation of meaningful social change, Abraaj has integrated environmental, social, and governance (ESG) considerations into its investment-management process.[10]

Thus, Abraaj seeks to leverage opportunities in the ESG domain for value addition; most firms focus on ESG compliance while others incorporate ESG principles for value protection or risk mitigation. Indeed, it believes that (i) firms with stronger environment performance are better suited for growth opportunities in green energy than "reformed incumbents," (ii) firms with stronger employee relations and work practices will enjoy "higher productivity, higher morale, lower staff turnover and absenteeism," and (iii) that stronger governance helps to reduce unexpected surprises and better evaluate opportunities. It is convinced that resilient, long-term financial value can be attained not only through governance and reduced environmental impact, but also through positive social change and inclusive investment models.[11]

These ESG considerations are not only enshrined as Abraaj's values, but they have also been activelypursued via the Abraaj Strategic Shareholder Engagement Track (ASSET). In its time, ASSET drove five distinct programs within Abraaj: social investing, stakeholder engagement platforms, Abraaj thought- leadership, transparency and governance, and partner-company engagement.[12] These principles and tenets help Abraaj maximize value from each investment, maintain its reputation for trustworthiness, and promote its "shareholder-first" approach.

Abraaj also has policies in place to support its corporate governance and sustainability practices. In 2006, Hilton McCann, its senior vice president and compliance officer, implemented a governance and compliance process called the Abraaj Holistic Governance Framework (based on the U.K.'s Combined Code of Corporate Governance). The key component of this framework was the establishment of an advisory board of outsiders whose goal was to assure Abraaj's compliance.

Abraaj also voluntarily adopted the procedures and guidelines of the European Private Equity and Venture Capital Association (EVCA) to increase transparency and information flow to its limited partners (LPs). Furthermore, in September 2007, Abraaj initiated the "Sustainability Leadership" program to help maximize value from its investments, reinforce its reputation, and enhance its ability to attract future funds. Abraaj also seeks to attract complementary talent and has thus implemented long-term compensation incentives to help maintain the quality of work.[13]

Abraaj has published an ESG Manual to (i) assist portfolio firms (i.e., "Partner Companies") in adopting an integrated approach to these issues, (ii) better articulate corporate values and processes to ensure compliance by partner companies (including triggers for the outsourcing of Environmental and Social Impact Assessments), and (iii) outline a methodology for identifying value-capture opportunities (from cost savings, revenue growth, and/or increased efficiency), and (iv) develop plans to achieve them. These include 15 industry-

[9] "Abraaj Capital's Approach to the Stakeholder Society," Abraaj Capital, accessed February 22, 2016 http://www.abraaj.com/images/uploads/newspdfs/Abraaj_Capitals_Approach_to_the_Stakeholder_Society.pdf

[10] "About The Abraaj Group," The Abraaj Group, accessed February 24, 2016 http://www.abraaj.com/sustainability/sustainability-report-2014-15/about-the-abraaj-group

[11] Abraaj Group, ESG Manual, p. 7.

[12] "An Introduction to The Abraaj Group."

[13] Lerner and Bozkaya, "Abraaj Capital."

specific templates that provide an overview of risks and issues, good practices, value-added opportunities, and key performance indicators. The deal-screening process includes the identification of value-added opportunities for specific stakeholders, the development of a value-added plan (e.g., engagement with stakeholders) as part of its due diligence process, and the monitoring of value-added KPIs from that engagement (as part of its annual Partner Company review process). This information feeds into the reporting of the Abraaj Sustainability Index, a proprietary tool to report development impacts over the lifetimes of Abraaj's investments (e.g., economic linkages and sustainability, socioeconomic impacts, private sector development, management and governance, as well as health, safety, environmental, and social performances).

Since its inception in 2002, Abraaj has monitored the social impact of its investments and business practices. Its Social Investing Program has helped direct its social impact investments and Abraaj and its employees invested more than $60 million in social and philanthropic projects from 2005 to 2010, — making them one of the largest donors and a leader in the private equity sector.[14] Abraaj and its employees also seek to create personal value via volunteer and fundraising efforts and philanthropic involvement.[15] Abraaj is involved with various initiatives to enhance the social impact of its corporate governance and business practices. It is also a signatory to both the U.N.-backed Principles for Responsible Investment and the United Nations Global Compact.

Performance

Naqvi has always viewed good governance and sustainability to be complementary to financial returns (vs. in competition with them). When Naqvi founded Abraaj in 2002, it had $60 million in assets under management. Abraaj raised $65 million for its buyout and growth capital fund (the first Middle East-focused buyout fund in the world). By 2008, Abraaj had $5 billion of assets under management and 149 employees. By 2015, those figures would rise to $9.5 billion under management and 300 employees.[16] On the 64 full exits (approximately one-third of its investments to date), it has achieved an average multiple on its costs of 2.7x.

Abraaj had been engaged in numerous transformative deals in the Middle East and North Africa (MENA) region and in other growth markets. Prior to investing in KE, Abraaj had conducted several deals in Pakistan. In 2004, Abraaj took a 50 percent equity stake for $7 million in Pakistan's financial securities firm BMA Capital Management (listed on the Karachi Stock Exchange) through its leveraged buyout fund.[17] Abraaj saw BMA as an attractive investment opportunity given its operations in a high return-yielding market and its well-recognized brand name. By 2005, Bloomberg Financial News Agency rated BMA as the best-performing Pakistani and South Asian investment bank.[18] Abraaj had also invested in the oil and gas company Byco (previously Bosicor) as well as Mannan Shahid Forgings.

In 2012, The Abraaj Group acquired Aureos Capital and consequently created the "leading private equity firm in growth markets."[19] Aureos Capital was a private equity firm, founded when

[14]"Abraaj Social Investments." *Accountability Report 2005-2010* (The Abraaj Group, 2005), accessed February 24, 2016 http://www.abraaj.com/images/uploads/newspdfs/SIP_-_Accountability_Report-05-10.pdf

[15]"Abraaj Social Investments."

[16]"An Introduction to The Abraaj Group," The Abraaj Group, accessed February 22, 2016 http://www.abraaj.com/news-and-insight/insight/the-abraaj-group-brochure/

[17]"The Dubai-based private equity firm Abraaj Capital has taken a 50% equity stake in the Pakistan financial securities firm BMA Capital Management Ltd.," *Asia Private Equity Review*, September 1, 2004, accessed February 23, 2016.

[18]"BMA Capital is Pakistan & South Asia's Top Investment Bank," *AME Info*, July 18, 2005, accessed February 23, 2016.

[19]"An Introduction to The Abraaj Group."

Norfund (a Norwegian government-owned private equity firm) and CDC Group (a development private finance institution owned by the UK government) joined forces in 2011. The Aureos acquisition gave The Abraaj Group $7.5 billion of assets under management a global network of more than 30 offices. In 2015, Abraaj was the leading private equity manager with investments in global growth markets (with $9.5 billion of assets under management) and the largest investor in emerging markets outside of Brazil, Russia, India, and China.[20] Abraaj has 300 limited partners including Hamilton Lane Associates, the IFC, and the European Investment Bank. The Group has 20 global offices and five regional hubs in Dubai, Istanbul, Mexico City, Nairobi, and Singapore.

Abraaj relies heavily on local offices and associated connections to local businesspersons. For example, Naqvi believes that having professionals experienced in local business customs has been the key to negating deals in far-flung regions, and that this has helped the firm to avoid dealing with corrupt governments in such countries; it has utilized a "boots-on-the ground" network of small local offices to help it navigate around such corruption. Abraaj's staff of about 300 includes people from 50 nationalities, — and most of those working in local offices have local roots.[22] "There were so many opportunities that could be beneficially altered by applying governance and transparency and following a stakeholder-driven process of engagement towards investment activity," Naqvi said on investing in these growth markets. "If you did it properly, then you could positively change the futures of not just companies but also of countries. That's what got me started."[23]

Such ambition was at play in the deal to acquire KE, but some believed that emotions might have played a role as well. Naqvi, as a Karachiite and Pakistani, sought not only to take over KE but also to rejuvenate the failing utility.[24] Naqvi (and the CEOs who managed KE) understood the Pakistani context extremely well, but this context posed enormous challenges in their quest to produce the returns that Abraaj's investors expected.

Pakistan, Sindh, and Karachi

In August 1947, the Muslim state of East and West Pakistan was created out of the partition of British India. Its current population of 200 million is extremely heterogeneous ethno-linguistically (see Figure 1, top panel), and is homogenous religiously (e.g., 96 percent of its population identify as Muslim and 85-90 percent of these individuals identify as Sunni Muslim).[25] Sindh is one of Pakistan's four provinces, accounts for nearly a quarter of the nation's population and less than 18 percent of its total land. Sindh is also a relatively heterogeneous province (see Figure 1, middle panel). About 91 percent of the individuals in the Sindh province identify as Muslim and 8.5 percent identify as Hindu. However, Sindh is home to 93 percent of Pakistan's total Hindu population and is more

[20]Elizabeth MacBride, "The Story Behind Abraaj Group's Stunning Rise in Global Private Equity," *Forbes*, November 4, 2015, accessed February 22, 2016, http://www.forbes.com/sites/elizabethmacbride/2015/11/04/the- story-behind-abraajs-stunning-rise/#708ab0045be3

[21]Dan Dunkley, "Financial News: Naqvi Forges New Buyout Brand in Growth Markets," The Abraaj Group, accessed February 23, 2016 http://www.abraaj.com/news-and-insight/news/financial-news-naqvi-forges-new- buyout-brand-in-growth-markets/

[22]MacBride, "The Story Behind Abraaj Group's Stunning Rise in Global Private Equity."

[23]"Investing in Africa; The Abraaj Story," Ventures Africa, accessed February 24, 2016 http://venturesafrica.com/investing-in-africa-the-abraaj-story/

[24]Sehgal, "KESC Needs Breathing Space."

[25]"People and Society: Pakistan," CIA World Factbook, accessed February 3, 2016 https://www.cia.gov/library/publications/the-world-factbook/geos/pk.html

urban than Pakistan overall with nearly 50 percent of all residents living in an urban area (vs. about 35 percent of Pakistan's total population);[26] about a third of Sindh's regional population lives in Karachi. Karachi is Pakistan's largest city in terms of population and the third-largest city in the world; it is — home to 23.5 million people (as of April 2013).[27] Karachi is similarly an ethno-linguistically diverse city (see Figure 1, bottom panel).

Business Environment

Pakistan has failed to live up to its growth potential, largely owing to an inhospitable foreign and private investment climate that ranks 126 out of 140 countries on the Global Competitiveness Index.[28] Investors, both foreign and private, face numerous challenges when entering Pakistan (e.g., bureaucratic red tape that makes opening a business lengthy and costly, a complex and esoteric tax code, and security threats. Additionally, investors face a high level of taxation, which significantly increase operating costs; government regulation is inefficient, complex, and enforced only sporadically and property rights are rarely effectively enforced. Furthermore, corruption and a lack of accountability and transparency pervade all levels of government and create additional investment barriers.

While the government has begun to privatize some state-owned enterprises, many enterprises still remain under state control. Furthermore, security concerns are a huge deterrent and potential investors fear both international and domestic terror threats (see Figures 2 and 4.[29] Indeed, conflict spiked from 2002 to 2004 and Pakistan's ranking dropped on both the GCI and the Ease of Doing Business Index (EDBI).

Foreign direct investment (FDI) inflows remain limited in Pakistan, compared to those in India and China, owing to myriad factors including security threats, political instability, inefficient and arbitrary enforcement of laws and regulations, and administrative resistance [see Figure 3].[30] In an effort to attract FDI inflows, the Pakistani government has implemented a foreign investment promotion policy and undertaken several economic liberalization measures such as tax incentives to set up industrial units in certain sectors such as energy and ports, and established special export-oriented zones that offer tax exemptions.[31] These reforms have led to modest improvement in the ratings of Pakistan's business environment (see Figure 4).

Energy Sector in Pakistan

Pakistan possesses abundant natural energy resources; however, it faces a severe energy crisis and is largely dependent on foreign sources of energy. Specifically, demand for power has increased dramatically in recent years owing to growth in the industrial sector, urbanization, and all-round increases in economic activity.[32] But supplies have not kept pace with growing demand, leading to the energy crisis (see Figure 5).

The country faces perennial power shortages of up to 7,000 megawatts (MW), which is 31 percent of peak demand and contributes to up

[26] 1998 Census Data.

[27] Khawaja Amer, "Population explosion: Put an embargo on industrialization in Karachi." *The Tribune*, October 6, 2013, accessed February 4, 2016 http://tribune.com.pk/story/614409/population-explosion-put-an-embargo-on- industrialization-in-karachi/

[28] "Pakistan," *World Economic Forum*, accessed February 4, 2016 http://reports.weforum.org/global-competitiveness-report-2015-2016/economies/#economy=PAK

[29] "2016 Index of Economic Freedom: Pakistan," *The Heritage Foundation*, accessed February 4, 2016 http://www.heritage.org/index/country/pakistan

[30] "Pakistan Foreign Investment," Santander Trade, accessed February 2, 2016 https://en.santandertrade.com/establish-overseas/pakistan/investing

[31] "Pakistan Foreign Investment."

[32] Omer Rauf et al., "An Overview of Energy Status and Development in Pakistan," *Renewable and Sustainable Energy Reviews* 48 (2015): 913.

to 15 hours per day of blackouts.[33] In a report on Pakistan's energy crisis, Michael Kugelman argues that Pakistan's energy problems are rooted more in shortages of governance than in supply constraints. He notes that the country's energy sector suffers from widespread inefficiencies, including (T&D losses that exceed 20 percent, several billion dollars in debt, and a flawed pricing policy – tariffs are low but few customers pay their bills.[34] Pakistan has the capacity to produce 20,000 MW of power; however, it is unable to produce more than 15,000 MW because of fuel shortages, operational problems in public sector thermal power plants, and limitations of the T&D system.[35] Fuel costs are also high because of an expensive fuel mix; oil, which is expensive and has price volatility, accounts for 37 percent of the fuel mix. While Pakistan has abundant coal and natural gas reserves and hydroelectricity potential, little investment has been made in recent decades in these areas. Furthermore, within the next few years as Pakistan's economy continues to grow, peak power demand is likely to exceed installed capacity by nearly 10,000 MW; total energy demand is expected to nearly double in the next decade.[36]

This energy crisis has had disastrous consequences for Pakistan's economy as a whole. Power shortages have cost the country up to 4 percent of GDP, hundreds of factories have been forced to close, and Moody's has warned that energy shortages will damage Pakistan's creditworthiness. Additionally, frequent blackouts have sparked violent demonstrations and militants have targeted gas lines and power stations.[37]

K-Electric

KE is one of the few remaining vertically integrated power utilities globally.[38] It has an exclusive franchise license to generate (renewal between 2018 and 2025), transmit, and distribute (expires 2023) electric power to a service area of 6,500 square kilometers in and around Karachi. KE's 2.5 million consumers are distributed across four major sectors: residential (47.4 percent of consumption and 41.8 percent of revenue); industrial (32.3 percent of consumption and 32.7 percent of revenue); commercial (7.9 percent of consumption and 12.6 percent revenue); and government (12.4 percent of consumption and 12.9 percent of revenue).[39]

Historical Origins

KE is one of the oldest companies in Karachi; it was incorporated on September 13, 1913 (under the Indian Companies Act of 1882) as a privately owned joint stock company to serve the needs of "a small port town called Karachi."[40] At the time of Pakistan's independence in 1947, KE's installed generation capacity was only 35 MW and its annual generation was 12,000 kilowatt-hours (kWh), with line losses of 21.4 percent.[41] After severe losses from 1951 to 1952 and an inability to fund sufficient infrastructure investment to accommodate a post-independence population surge (demand increased from six million kWhs in 1948 to

[33] Michael Kugelman, *Pakistan's Interminable Energy Crisis: Is There Any Way Out?* (Washington DC: Wilson Center, 2015), https://www.wilsoncenter.org/publication/pakistans-interminable-energy-crisis-there-any-way-out

[34] Ibid.

[35] Ibid.

[36] Michael Kugelman, "Pakistan's Other National Struggle: Its Energy Crisis," *The Wall Street Journal*, July 9, 2015, accessed February 3, 2016 http://blogs.wsj.com/washwire/2015/07/09/pakistans-other-national-struggle-its- energy-crisis/

[37] Kugelman, Pakistan's Interminable Energy Crisis.

[38] Aziz, *From KESC to K-Electric*, 29.

[39] http://www.ke.com.pk/pdf/financial data/KE_Investor%20Presentation_April%202016.pdf

[40] "Our Journey," K-Electric Corporation, accessed February 14, 2016 http://www.ke.com.pk/our-company-2/our- journey/index.html

[41] Arshad Abbasi, "Pakistan Power Sector Outlook: Appraisal of KESC in Post Privatization Period." *Report for Ministry of Water and Power*, (SDPI, July 2012), accessed February 20, 2016.

50 million kWhs in 1957), the Pakistan government nationalized the company in 1952, promising to ensure the necessary investment in the company's infrastructure; however, investment continued to lag far behind demand growth.

Nationalization initially improved the health of the company: net earnings improved to the extent that the firm could issue dividends again. KE's earnings and sales record was satisfactory until 1965; sales declined after that as hostilities broke out between India and Pakistan. From 1953 to 1980, it added eight new generating plants were added with a total capacity of 513 MWs to meet growing demand from industrial, commercial, and residential consumers.[42] KE's power supply was initially able to keep pace with growing demand, but by the late 1960s, it began experiencing severe supply gaps.

The firm's financial health also eroded; indeed, the firm (i) experienced a negative net profit margin in the 1970s and 1980s; (ii) experienced worsening performance, on all counts, in the 1990s; (iii) consequently failed to generate sufficient cash flow to meet its capital expenditure requirements, debt service obligations, and operational expenses;[43] (iv) had to cope with an old and poorly maintained T&D system (which thus became prone to technical faults), and (v) had aging generating facilities that became increasingly unreliable. Technical losses (which included unpaid bills) increased over time from 27.4 percent of supply in 1993-1994 to 41.4 percent in 2001-2002).[44]

The rate of expansion in KE's capacity slowed to less than 3 percent annually while power demand grew 8 percent annually.[45] Power shortages emerged as one of the principal supply-side, growth-related constraints, leading to significant losses of output, employment, and exports. KE's financial health continued to deteriorate, and the firm was insolvent by 2003 after — defaulting on its debt service and payments to fuel and power suppliers. KE's losses in fiscal year 2000 alone were equal to 70 percent of the government's annual expenditure on social services, 144 percent of national expenditure on education, and 250 percent of expenditure on public health.[46]

The Army, which took control of KE's management in May 1999 (from Pakistan's Water and Power Development Authority, or WAPDA), was directed to stabilize the firm's operational and financial health and charged with improving administration (thus reducing T&D losses) and levels of receivables.[47] However, the Army was unable to remedy the severe performance issues of KE. The Pakistan government privatized the firm in November 2005 in an attempt to remedy its disastrous financial and power- supply situation.

Politicization and Corruption

In the 1990s, KE (i) had a highly politicized labor force, with strong union representation and activism;[48] (ii) suffered from pervasive corruption and mismanagement of resources, and (iii) struggled with its lack of a uniform, ethical operational framework to govern the organization. A 1992 report conducted by the consulting firm PricewaterhouseCoopers

[42] "Our Journey."

[43] Abdul Ghafoor and John Weiss, "Performance of the Public Electric Power Industry: Evidence from Pakistan," *The Pakistan Development Review* 40 (2001), accessed February 12, 2016.

[44] David Parish, "Evaluation of the Power Sector Operations in Pakistan." *A Report to the Operations Evaluation Department* (Asian Development Bank, 2006), accessed February 12, 2016 http://wcm.adb.org/sites/default/files/evaluation-document/35932/files/power-sector-operations-pak.pdf

[45] "Equal Investment and Loan Karachi Electric Supply Company Post-Privatization Rehabilitation, Upgrade, and Expansion." *Extended Annual Review Report* (Asian Development Bank, 2014), accessed February 21, 2016.

[46] "Special Evaluation Study of Cost Recovery in the Power Sector." (Asian Development Bank, 2003), accessed February 21, 2016.

[47] Aziz, *From KESC to K-Electric*, 29-30.

[48] "Our Journey."

stated: "The participation of the [government of Pakistan] in the management of the Company has created a highly politicized management structure and labor force, which in turn has severely limited the successful operation of the company" — illustrating the negative effect of the politicized labor force on its productivity and efficiency.[49] This politicized environment created a chaotic workplace (e.g., there was a breakdown in discipline and the management was largely seen as having no control over the bloated and politicized labor force). Furthermore, because of this politicization, the management was not free to disconnect politically powerful customers with large overdue balances, driving the firm further into debt.[50]

Bribery was also rampant in KE. Illegal fees constituted almost one-third of the cost of an electrical connection. Furthermore, survey results found that the majority of people surveyed (i.e., 61 percent) paid bribes to KE officials to expedite both legal and illegal works (e.g., getting a new connection, restoring failed electricity, making alterations to electric meters, obtaining illegal and unpaid connections, and correcting bills).[51] Indeed, numerous officials throughout KE were involved in this bribery (e.g., from billing employees to meter readers).[52] In a January 2016 interview, a prominent local journalist highlighted the widespread based negative perception of the previously state-owned enterprise:

> *KESC was a great example of how mismanaged a company can become when government runs the business. How far it can rot and how infected it can become. Subsidies, government interference, political management, military management, and no financial returns. It was a monopoly, how is it possible that it failed to earn a good return!?!*
>
> Kamran Khan (Journalist, Dunya Network)

Privatization in 2005

In this first round of privatization, nearly three-quarters of KE's ownership was transferred to a consortium (comprising the Saudi Al-Jomaih Group of Companies and Kuwait's National Industries Group), with the government of Pakistan retaining a minority stake of 26 percent). Al-Jomiah partnered with Siemens, designating them as the technical and operational partner and charging them with the responsibility of maintaining KE's transmission lines, which essentially amounted to Siemens managing all of KE.[53]

This round of privatization did not turn KE into a profitable entity; instead, by June 2008, the firm had incurred PKR 35.5 billion in losses.[54] Furthermore, in 2006, the city still faced a power deficit of 1,064 MW of electricity.[55] The Pakistan government had hoped that privatization would improve the reliability and efficiency of KE's T&D system. But in this case, privatization had the opposite effect. The firm became embroiled in internal problems and failed to meet the rising demand for electricity. Indeed, KE experienced significant management instability under Siemens, including multiple CEOs whose approaches did not complement each other and left "staff unsure of the future of the organization or of their future within it. This chaos and ambiguity made it difficult for people to cope."[56] For many years, Siemens had built

[49] PriceWaterhouseCoopers, "Feasibility Study for the Privatization of the Karachi Electric Supply Corporation (KESC)."

[50] Abbasi, "Pakistan Power Sector Outlook."

[51] Muhammad Masood Rafi, et al, "Corruption in Public Infrastructure Service and Delivery: The Karachi Case Study," *Public Works Management & Policy* 17 (2012).

[52] Roohi Ahmed, "Corruption and Inefficiency in the Delivery of Public Utilities: Case Study of Electricity Services," *Public Policy and Administration Research* 2 (2012).

[53] Aziz, *From KESC to K-Electric*, 30.

[54] Ibid.

[55] "Equal Investment and Loan Karachi Electric Supply Company."

[56] Ibid, 32.

infrastructure and operated in Pakistan; however, it lacked any experience in the operation and management of a power utility.

Additionally, there were severe power outages and many disgruntled customers who "attack[ed] K- Electric offices due to long power outages in their area. Mobs ransacked some sections of the Elander Road office in 2006, assaulted the staff, and escaped before police arrived at the scene."[57] Further, on August 4, 2006, people staged demonstrations against KE, perturbed by the lingering power crisis; they "chanted slogans against K-Electric, lit bonfires, and burnt tires."[58] The relationship between Siemens and Al-Jomiah broke down in 2008. Soon thereafter, the firm's CEO, CFO, and indeed all functional management executives resigned. This left the organization without any senior managers for nearly eight months. Furthermore, there were widespread calls for the government to reconsider the decision to privatize KE. Finally, The Abraaj Group, which had turned down an offer to buy KE for $1 in 2005, entered the picture and evaluated the prospect of assuming a majority stake in the firm.

Many Karachi residents and political leaders resented the privatization of KE and blamed the energy crisis (e.g., load-shedding and all-too-frequent power outages) on the government's decision to privatize the utility company. In July 2008, Ejaz Durrani, the spokesman of the Pakistan People's Party (PPP) cast blame on the former military government; he alleged it had "minted billions through kickbacks and commissions in the privatization of K-Electric" for the current power crisis.[59] He also stated that "the corrupt officials [members of the military government] thrust on K-Electric during the last ten years were also behind the power crisis as they did nothing except filling in their personal coffers."[60] In September 2008, the City Council of Karachi adopted a unanimous resolution demanding that the government immediately renationalize KE, suggesting that its private owners had "completely failed to provide smooth electricity supply to Karachiites" and that those responsible of ruining KE-Electric "should be tried in court."[61]

Due Diligence

Abraaj's due diligence report — associated with the initial $411 million investment required to acquire 35.75 percent of KE — highlighted both the associated, potential opportunities and risks. KE was an integrated, legally protected monopoly provider of an essential service to the third-largest city in the world where demand for the service had been growing at 7 to 8 percent per annum; however, it had been experiencing significant management issues in diverse areas (e.g., operations, finance, and external stakeholders). While associated improvements would lead to rapid improvements (in financial and operational performance), the firm was still losing $30 million per month at this time.

The turnaround would require $900 million of new capital over three years to (i) expand generating supply, (ii) reduce T&D losses, and (iii) significantly restructure human resources. Thus, KE was relying on the government to follow through on its commitments to (i) rationalize tariffs, (ii) increase the supply of gas by over 50 percent, (iii) enable closure of the gap between supply and the rapidly growing demand of electricity, and (iv) allow offsetting

[57] Ibid.

[58] Ibid.

[59] Staff Reporter, "Privatization of KESC Created Electricity Crisis," *The Nation*, July 29, 2008.

[60] "Privatization of KESC Created Electricity Crisis."

[61] "City council demands re-nationalize of KESC," *Pakistan Press International*, September 2, 2008.

of non-payments by state-owned entities against payments made to the government.

The hope was that the new investments and potential opportunities would allow T&D losses to be reduced and revenue to increase while cost increases were contained, according to scenario analyses; however, the financial turnaround depended heavily on factors outside of KE's direct control (e.g., success in reducing T&D losses, the implementation of tariff changes and gas allocations, and continued transfers from the Government of Pakistan).

Many elements of the turnaround strategy were highly technical, and therefore the success of the implementation hinged upon a proactive communication strategy and consensus-building exercises (involving key external stakeholders). This effort would engage (i) a disillusioned workforce with shattered morale that was partaking in sabotage and theft; (ii) industrial, commercial, and residential consumers; (iii) suppliers of fuel, finance, and equipment; (iv) key national, provincial, and city-level political and regulatory actors; and (v) civil society organizations and opinion leaders.

Turnaround Strategy

Ultimately, Abraaj made the decision to go forward with the acquisition. In fact, the rate of deterioration (in financial performance) and lack of management presence led to a decision to take over management control on September 16, 2008, via a management-service contract — while the terms of the acquisition and negotiations with the government continued. (See Figure 6 for a summary of the deterioration of the financial and operational performance leading up to, and in the immediate aftermath of, the takeover.)

Senior Management Team, 2008-2015

Abraaj assembled an accomplished group of senior managers with extensive experience in the utility sector, Pakistan's leading regulated companies, and with leading multinational corporations

Naveed Ismail. Chief Executive Officer, 2008-2009. A native Pakistani with a master's in mechanical engineering from MIT and an MBA from Boston College, Ismail worked at AES Corporation for 14 years, leading turnarounds of utility companies (in Kazakhstan, Georgia, Great Britain, Argentina, and Chile). He was hired away from AES in Pakistan (by Abraaj), specifically to lead the turnaround at KE. Despite this strong vitae, Ismail was unable to make much headway in the turnaround at KE; therefore, less than a year after assuming office, he turned the reins over to Tabish Gauhar.

Tabish Gauhar. A partner at Abraaj, Gauhar served as the CEO of KE from November 2009 until February 2013 and as chairman of the board of KE from February 2013 until October 2015. He earned a scholarship to study at King's College London and subsequently graduated, with a degree in electrical engineering, in 1992. Gauhar joined the Hub Power Company ("Hubco"), the largest independent power producer in Pakistan, as assistant manager of finance. During his time at Hubco, Gauhar became critical of the PML-N's decisions with regard to securing foreign investment.[62] He left Hubco for AES Corporation and then joined Abraaj in 2008.

[62]Saad Hasan, "KESC Turnaround: A Success Story We All Missed," *The Express Tribune*, January 4, 2014, accessed February 27, 2016 http://tribune.com.pk/story/654546/kesc-turnaround-a-success-story-we-all-missed-i/

Tayyab Tareen. Prior to taking on the role of CEO in 2014, Muhammad Tayyab Tareen held multiple senior executive positions at KE including as Group Head Human Resources Management [2009-2010], Chief Financial Officer [2010-2011], Chief Advisor [2011-2012], and Chief Strategy Officer [2012-2013]. Tareen is a chartered accountant from England and Wales. He began his career as the CFO of Coca-Cola Pakistan and had 21 years of experience in business turnarounds, financial management, planning, and business acquisitions with MNCs).[63] He joined Abraaj in 2006.

Jalil Tarin. Chief Financial Officer and Chief Operating Officer (Support Services) 2008-2011. Tarin studied at the Institute of Chartered Accountants in the U.K. and previously worked as the Executive Director for Finance at Pakistan State Oil (where he led a major restructuring program).

Syed Moonis Abdullah Alvi. Chief Financial Officer & Company Secretary 2011-present. Alvi previously served as Head of Treasury for KE and, in a similar position, at a bi-industrial conglomerate. He started his career at KPMG.

Naveed Ahmed. Head of Corporate Strategy 2008-2011. Chief Business Development Officer 2011- present. Ahmed previously worked for Enron as a Director, Generation Investment and as a Manager at HUB Power in Pakistan. He has a Ph.D. in chemical engineering from the Colorado School of Mines, an MBA from Cornell University, and an M.S. and B.S. in chemical engineering from Oklahoma State University.

Nayyer Hussain. Chief Strategy Officer, Distribution 2008-2009. Chief Distribution Officer 2009-2013. Chief Executive Officer 2013-2014. Hussain previously managed Retail Risk at Mashreq Bank and Citigroup (where he worked in Pakistan, Saudi Arabia, and Russia).

Ovais Naqvi. Naqvi served as the Chief Marketing and Communications Officer at KE from 2008-2010. He received his B. Sc. (Economics) from the London School of Economics in 1987 and a certificate from the Wharton School in 2000. Before he joined Abraaj, Naqvi worked for The Cupola Group in Dubai (between 1996 and 2000) and had leadership roles in the marketing services industry in Europe.

Jan Abbas Zaidi. Chief Operating Officer, Distribution. 2008-2012. Zaidi had 18 years of experience in the utility sector including the roles of COO and President of AES Kazakhstan.

Syed Muhammad Taha. Chief Distribution Officer 2013-2015. Since Abraaj's arrival, Taha had worked in Operations within Distribution at KE. He previously worked at the Pakistan State Oil Company and Shell Corporation.

Arshad Zahidi. Chief Strategy Officer, Generation & Transmission 2008-2015. Zahidi previously worked (for almost 15 years) at Engro Chemical Pakistan, in a number of project management and operational roles.

Dale Sinkler. Chief Operating Officer, Generation & Transmission 2008-2010. Sinkler has more than two decades of power-sector experience, serving as the CEO of AES Pak Gen and Lal Pir as well as of Haripur Power Limited in Bangladesh. He was also the construction manager of AES Medway in London.

[63] "Our Leadership," K-Electric, accessed February 27, 2016 http://www.ke.com.pk/our-company-2/our- leadership/

Khalid Javed. Chief Operating Officer, Generation & Transmission 2010-2012. Javed previously worked in operations at Haripur Power and Meghnaghat Power in Bangladesh as well as at AES Lal Pir and Pak Gen.

Eram Hasan. Chief Supply Chain Officer. Hasan has 16 years of international general management experience with Abraaj Capital and previously worked for Coca-Cola Beverages Pakistan (where he served as Chief Operating Officer) as well as Unilever and Alcoa.

Asir Manzur. Chief Human Resource (HR) Officer 2011-2015. Manzur previously had 26 years of HR experience at a variety of firms (e.g., Union Bank, Saudi Bank, Mashreq Bank, PepsiCo, and Coca Cola Pakistan).

Muhammad Aamir Ghaziani leads the Corporate Planning and Regulatory compliance function at KE. A chartered accountant and a cost and management accountant with 15-plus years of experience. Previously, he worked in the telecom sector and at A. F. Ferguson & Co. (PwC).

The senior management team has identified four major work streams:

Overcoming the Infrastructure Gap

When Abraaj assumed control, there had been no real investment in capital expenditure by KE for 11 years — in a city of 18 million people and 6 to 7 percent annual population growth. In 2009, commercial operations began at a new 220 MW combined cycle plant — and two new 90 MW gas-fired plants followed shortly thereafter. The commissioning of these facilities had been delayed repeatedly under the previous management team. In 2010, KE broke ground on a new 560 MW combined-cycle power plant. By 2015, a total of 1,037 MW of generating capacity was added (and 475 MW was decommissioned) for a total of a 33 percent increase. Furthermore, the generating facilities increased their efficiency from 30.4 percent to 37.3 percent or 23 percent.

Substantial investments were also made in T&D as well as customer-facing infrastructure (described below). These translated into dramatic improvements in operational performance. Transmission losses fell 65 percent, transformer trips fell 60 percent to 85 percent, transmission-line trips fell 21 percent, actual trips fell 59 percent, and theft in transmission fell 96 percent. T&D losses fell from 36 to 23 percent (i.e., a 36 percent reduction).

In a 10-year plan presented to regulatory authorities, KE outlined the potential for 4,283 MW of new generating capacity, 3,370 megavolt amperes (MVA) of transmission capacity enhancement, 1,000 new distribution feeders, and a 51 percent increase in 11kV distribution lines — together with improved system maintenance and the installation of smart meters (which would allow for further reductions in line losses). The successful delivery of this business plan would enable (i) total generating capacity to increase to 5,349 MW (with the ability to generate 25,462 GWh), thereby erasing the electricity deficit; (ii) fleet efficiency to increase to 43.3 percent; and (iii) T&D losses to fall from 23.7 to 13.8 percent.

Internal Stakeholder Alignment: Right-Sizing, Reorienting, and Empowering

The KE workforce had increased substantially (e.g., from approximately 7,500 prior to privatization in 2004 to more than 17,500 in 2008). This was part of the political deal of privatization and, previously the culture of *Safarish,* or employment gained by nepotism.

> *Amongst all of the internal and external challenges faced by K-Electric, the one on top of my list was how to change the mindset of our thousands of employees (18,000 then; 11,000 now) to share our vision of becoming a more customer-centric service provider. To put it*

> *mildly, that's easier said than done. If the DNA of an organization is designed to take customers for granted, it's a quantum leap to change such a mindset…*
>
> Tabish Gauhar, former CEO, K-Electric

> *K-Electric became a soft corner for people through Safarish, as they were employed as a favor.*
>
> Tayyab Tareen, former CEO, K-Electric

> *When we started, there were 43 people in Treasury, including a driver, a sweeper, a messenger boy, … Now we are 23. As we downsized, I tried to understand who was working hard and who was not, but the union leader told me no. He told me that I have to treat everyone equally. If I followed his advice, how could I distinguish between good and bad, between who stays and who goes? We had more gardeners, drivers, and guards than engineers. It made no sense.*
>
> Syed Moonis Abdallah Alvi, CEO, K-Electric-

In contrast to the norm of a 50:50 ratio, associated with white- and blue-collar workers in a public utility, the ratio at KE was less than 1:2. A lack of monitoring or incentives — which included perceptions of lifetime employment guarantees — led workers to decide in the morning whether they wanted to (i) show up, (ii) collaborate with customers (to steal from the firm), and (iii) to show deference, above all, to union and political officials who reigned above managers (in terms of control of and information on operations). On the other side, managers did not offer employees training or vision (regarding their purpose and role in the broader organization) and worker safety was not a particularly high priority.

In response, Abraaj worked to develop a plan not only to reduce overemployment but also for employee engagement. Together, the CEO, CMO, and HR leader developed and executed an internal communications vision called "AZM" ["resolve"], which was designed to become a rallying call for a new beginning (based on a clear values system) for all staff, irrespective of rank at KE.

The implicit goal was to reduce the least productive and often fake political appointees who were (i) lowest in productivity and (ii) impediments to the organizational change effort; thus, the firm decided to eliminate 78 non-core functions and outsource jobs (e.g., those of security guards, drivers, office attendants, sanitary workers, typists, masons, bookbinders, plumbers, and gardeners). In the process, they discovered that they were paying gas pump attendants (even though they owned and operated no gas pumps), cooks (even though they were outsourcing food services already), and furniture-repair workers (even though facilities maintenance was also already outsourced). The hope was that these workers would accept a voluntary severance package. The amount offered for redundancy for an employee on staff for one year was 700,000 rupees — rising with seniority up to a maximum of 5 million rupees (which, if invested, would generate a minimum of 7,000 rupees per month or the statutory minimum wage up to a maximum of 50,000 rupees). The program was announced publicly on December 31, 2010. Indeed, it was intended that approximately 30 percent of the 4,459 targeted workers would accept the terms. In fact, only 8 percent did so (prior to its expiration on January 15, 2011).

Tabish Gauhar, the CEO at the time, made the decision to move ahead with the Voluntary Separation Scheme on January 19, 2011, sending letters to 3,800 workers including 500 security guards. During that evening, weapons were covertly withdrawn from the laid-off guards and new outsourced security guards were hired (and immediately put to the test).

> *"We knew that retrenchment was like pressing the nuclear button" Asir Manzur, former Chief Human Resources Officer, K-Electric*

> *"All hell was bound to break loose, and it did. It was a clash of ideas – between the new and old K- Electric, of ideologies, conflict of interests, competing power centers within the same company, challenges to the status quo etc. The resistance was violent, as expected.*
>
> Tabish Gauhar, former CEO, K-Electric

Violence immediately ensued. Nearly 250 labor union members, accompanied by more than 10 times as many supporters, converged on the company headquarters the next day. Some protestors were armed with weapons and others with sticks and iron rods. The new guards were too unfamiliar with the property to mount a proper defense — especially given the leading role in the attack played by some laid-off guards. Police and Rangers, standing by with water cannons and guns, failed to intervene; flying rocks and debris smashed windows; furniture, laptops, computers, and other equipment were damaged; employees took shelter; and the crowd converged in the parking lot where they damaged 131 cars, burning three of them. The head security coordinator and numerous outsourced guards were injured.

Cabinet members of the Sindh and federal governments jointly descended upon the protests and brokered a compromise that enabled Gauhar (under direction from the government) to reinstate the workers. He did so reluctantly — only when the government made it clear that it was unable, or perhaps unwilling, to protect them, absent a decision to reinstate the workers. Gauhar complied but immediately made his displeasure known. Media reports quoted him as "temporarily bowing to pressure from the state" but asserting that "weeding out black sheep is both our right and our responsibility." He highlighted that the government had "no legal grounds for this reinstatement" and asserted that "law enforcement was complicit in the ransacking of our offices." Next, he made sure that none of the reinstated workers had jobs to do (as their positions were under contract with external providers). Some workers fasted in protest; however, another round of political negotiations brokered an end to their protest and led to a series of negotiations on February 22-25, 2011. During those meetings, protestors damaged company facilities, vehicles, and employers' vehicles. The union presented its demands to the management who responded that the negotiations would not resume without a cessation of the violence and damage (by the union). The union promised to rein in the violence but was unable to do so. Negotiations were suspended and never resumed.

In April and May of 2011, the protestors established a hunger-strike camp in front of the Karachi Press Club. This was part of a broader strategy of pressure, harassment, coercion, and intimidation in the public eye; indeed, (i) pickets were set up at key physical infrastructure, (ii) fliers (defaming KE) were distributed, (iii) staff members (e.g., repair and maintenance teams, bill distributors, and senior management) were threatened and even attacked, and (iv) physical infrastructure was damaged and stolen — leading to increased blackouts. Violence festered and occasionally escalated — particularly in the summer months. While facilities and materials were stolen or damaged, managers were accosted in the streets, attacked at knife point, threatened at gunpoint, kidnapped and tortured, and even shot at.

On July 26, 2011, the protestors laid siege to the headquarters a second time, holding approximately 500 employees hostage before the provincial government was able to reach a compromise. On August 29, 2011, the protestors attacked the company headquarters for a third time. Police made 27 arrests. In the midst of these protests, the firm re-launched its Voluntary Separation Scheme . Despite ongoing efforts at intimidation (both physical and legal), this time 3,259 employees accepted. Thus, only 1,200 employees remained at the company and 500 more would subsequently accept voluntary separation (based on the terms provided).

The confrontation yielded the desired outcome with a total reduction of 37 percent in headcount (i.e., from over 17,000 in 2009 to 10,830 in 2015) and the ratio of management to non-management improved from 34:66 to 58:42. The average age of lower management also declined from 46 to 27.8 years of age. However, these reductions (and compositional shifts) came at a significant cost: (i) voluntary severance payments would total 6 billion rupees (US$ 67 million), which would take three to four years to pay back in wage savings; (ii) the ratio of payroll to revenue only declined from 3.9 percent to 3.4 percent when it incorporated the higher wages that were paid to retain and attract qualified managers; and (iii) the image of a firm at war with its employees was now part of the firm's reputation forever.

> *We went through arguably the longest industrial action strike in the country's history…[and] the most difficult HR transformation in the corporate history of Pakistan. We took a lot of body blows, but stayed the course – we had no choice, we weren't here to maintain the equilibrium but to change the system … I think we now have a workforce that's core to our organizational needs and through continued induction of fresh talent, we have hopefully set the foundation for a more productive and satisfied workforce.*
>
> Tabish Gauhar, former CEO, K-Electric

The remaining workers were more willing to take on the new organizational culture (e.g., the formal monitoring and work-practice guidelines). Indeed, employees now (i) clocked in and out (which the unions had opposed) and (ii) could be summarily dismissed when they were absent for more than 10 days without cause. Company cars had tracking devices installed, which led to a drastic reduction in the unauthorized use of vehicles and damage to the company fleet. Additionally, an internal anti-corruption and whistle-blowing program was initiated at this stage. Indeed, a host of monitoring and procedural changes were designed in order to identify corrupt workers. Early in this process, the security team acted on an internal tip and attained film footage of an employee (with 20 years of service) taking a bribe. Anonymized footage was shared with the media — as was the dismissal of the employee (which withstood a legal challenge). The goal was to highlight that new policies were in place and the old way of doing business had to change. The selection of inspectors (to a given location within a given time period) was randomized, thereby reducing the ease of relationship formation with customers with illegal lines. From 2011 to 2012, the number of departures from the KE workforce (following disciplinary action) more than doubled (from 52 to 107). This number would fall back to 76 temporarily in 2013; however, it would rise again (to 155 in 2014 and 150 in 2015).

The monitoring devices and incentive-based mechanisms (meant to elicit compliance) were paired with the AZM internal alignment program implemented by Ovais Naqvi and a cross-functional team: “We are One. Our AZM (resolve) is One and together we will restore our city to its former glory as the City of Lights.” The program kicked off with a workshop session for the top 200 managers in 2010 and across 2011. Over the next year, 11,300 employees would participate in 46, similar, one-day sessions, each chaired by a member of the leadership team. Each employee would commit to companywide values with personal thumbprints in green ink.

Thus, the workshops clearly communicated the firm’s values (internally); employees who demonstrated particular enthusiasm (or passion) for the values could participate in a longer three-day workshop and assume a formal role as an AZM Champion. This training included role-playing (i.e., enacting the corporate values in difficult situations) and highlighting the power of individual employees to address issues and challenges in ways that would reinforce these values, help the company, and help their country. A total of 198 individuals would serve to strengthen the connection between senior leadership and the workforce. Helping the effort was a regular newsletter with information on conferences, training events, project updates, results from corporate sporting teams, safety reports, staff achievements, and stories consistent with the firm’s new values (e.g., rewards received for associated actions). The new culture also included a central role for worker safety. Amir Zia, a Chief Health, Safety, Environmental and Quality Officer, was hired (with a support staff of 50 employees), and safety training was made mandatory for all employees — during induction and through daily talks and reminders. Regular safety audits were undertaken, and cash bonuses were provided for safety-promotion activities.

The new culture was also projected externally. Full-page advertisements apologized to the family of KE employees: “If your loved one has been consumed with work lately and the family feels neglected …” The advertisements highlighted the difficulty of the job to be done and KPIs that enabled stakeholders to evaluate their progress. The indicators would be regularly updated via press releases and public advertisements.

This combination of hard-edged incentives and behavioral reinforcement led to notable changes in performance as well as culture. Indeed, payroll costs increased substantially — almost doubling from 2009 to 2015 — despite the reduction in workforce, as the retained workers were, on average, more highly compensated. Nevertheless, the revenue per worker still increased by 50 percent from 2011 to 2014; at the same time, (i) accident rates fell by 76 percent, (ii) accidents (resulting in asset damage) fell by 83 percent, and (iii) employee engagement rose to 66 percent, which (while only in the 26th percentile overall in Pakistan) was best in the energy sector and suggested that a larger cultural change was indeed occurring.

> *When we first came to it, it was just a transaction. Within eight months it was a passion, after eight months it was a craze. It was the pride of doing something for our country, to make an impact in Pakistan. The green color has taken us over. I feel fortunate to be in a place that is making a difference.*
>
> Arshad Zahidi, former Chief Generation and Transmission Officer, K-Electric

Change was a herculean task in the face of a massively unionized workforce that was led by hooligans. Union leaders called the shots on hiring and postings. While it seemed like an almost impossible task, Abraaj showed tangible results within about a year. Four thousand layoffs are simply without precedent in our society.

Kamran Khan (Journalist, Dunya Network)

When I started, no one would come and interview for a job at K-Electric. I would call and people would laugh at me. Today you name any company, any school, any multinational in Pakistan and I can identify someone who left there to work here. Abraaj will exit, management will change and the upside potential for local managers is real and understood. That is the transformation we have achieved.

Eram Hasan, former Chief Supply Officer, K-Electric

Reducing Transmission & Distribution Losses: Technical, Reputational, and Legal Strategies

"A big issue for us was dealing with customers who perceived free electricity to be a right. We had to educate them. They were our most important stakeholders…When we came in, K-Electric was the most hated organization in the country. It was OK to steal from it. Everyone [was] stealing — even ministers, the police, and the army. If they stop, we will stop, people would say. We [even] cut off the power of the Minister. We showed that we mean it.

Waqar Siddique former Chairman, K-Electric

As the quality of data improved within KE, it became obvious that theft was an even larger problem than previously perceived. Estimates of losses rose from 35 percent during the due diligence process to 40 percent by the end of 2008. The operations team catalogued 20 schemes customers used to avoid payment, which included (i) the attachment of hook connections, known as *kunda* to overhead cables (providing free power); (ii) the introduction of magnets into meters; and (iii) underground connections.

Numerous initiatives were implemented to address this shortfall; some involved capital expenditures on technical solutions. These included the installation of meters for some industrial, commercial, and high- consumption residential customers and at feeder and transformer levels. These meters allowed for loss calculations and the creation of loss profiles at a more fine-grained level. Some overhead bare copper conductor lines (which were highly prone to theft via *kunda* lines) were replaced with aerial bundled insulator cables, which are far more resistant to illegal hook connections. Old grid equipment and cables were replaced with new meters that were less subject to tampering (e.g., the pilot installation of some "smart meters" allowed for automated information collection and remote disconnection in the event of nonpayment). Also, new transformers and feeders were installed to segregate the load and relieve system overload.

Once systems allowed for the collection and analysis of data on energy losses (i.e., unbilled energy due to technical reasons and theft) and recovery losses (i.e., unrecovered portions of amounts billed to consumers due to default), the firm could initiate various performance-management initiatives. Furthermore, (i) the firm made a commitment to supply power to all of its customers from midnight to 8 a.m. daily (and 24 hours a day on holidays); (ii) a decision was made to exempt customers in industrial zones that received electricity on dedicated feeders that are subject to load-shedding, with the hope of supporting economic development, employment, and earnings in the industrial sector; and (iii) relationships were built with major trade associations and executives.

The remaining (available) power supply would be rationed to the remaining feeders based on aggregate technical and commercial losses at the feeder level. For feeders with less than 25 percent losses, there would be no load-shedding (and thus a 24-hour power supply). For feeders with losses of 25 percent to 35 percent, load-shedding would occur for three, one-hour blocks. For feeders with losses of 32 percent to 50 percent, load-shedding would double to three, two-hour blocks. Finally, for feeders with losses above 50 percent, load-shedding would occur three times a day during 2½-hour intervals. Every three months, losses would be reviewed such that lower losses (i.e., higher payments and lower theft) would translate into higher supplies. Indeed, a dramatic increase in lower-loss feeders was observed since the system was introduced in 2010. Twenty-four percent of feeders were exempt from load-shedding in 2009; however, over 60 percent of the city was exempt from load-shedding by 2015. The program was so successful that it became part of national energy policy.

Another initiative focused on enhancing the customer service reputation of KE by enabling customers to utilize a single point of contact who full accountability for the customer experience, thereby replacing an archaic and confusing web of contact points (for technical, billing, and service issues). Previously, employees in various functions would pass along complaints to (or even publicly blame) their peers without ever addressing the customer's complaint.

Also, the Integrated Business Center (IBC) placed associated team members (e.g., meter readers, billing specialists, customer service experts, and repair teams) under a common management team. They were (i) housed in refurbished offices, (ii) had access to a common dashboard with local KPIs, (iii) received special training (to facilitate the coordination of their activities), and (iv) received bonus pay (based on their collective performance). The teams worked together to develop a process manual, delineating how the work should be managed (so as to have the best impact on performance).

The new IBC model outperformed its predecessors not only on customer service but also on meter-reading reliability and theft reduction. Additional points of customer contact included a 24-hour call center, SMS monitoring of 28 million messages, 4.36 million email communications, 10,000 tweets, and 18 open houses (*khuli kutcheries*) where senior management would make themselves available to provide feedback and discuss grievances (with approximately 4,500 attendees at a time). In these various personal interactions, managers emphasized the reciprocal nature of the relationship. KE assumed responsibility for providing the best possible service; customers had a responsibility to pay for that service. Such communication was reinforced by a door-knocking project; first-time defaulters were warned, in person, to stay current on their bills.

> *"The CEO and a number of us went out every Friday afternoon to a different locale for khuli kutcheries (open houses). This did more than anything else to change public opinion towards us. Leadership appeared now to come from the top. It provided a rich contrast with a hierarchical (even feudal) culture. It was much more democratic and in one gesture, made us*

look 21st century vs. post-war and industrial.

We were now visibly talking the talk and walking the walk.

Ovais Naqvi, Managing Director, Abraaj Group and CMO K-Electric 2008-2010

A variety of strategies was required since resistance to efforts to recover payments was exacerbated by migrations into regions that lacked urban planning and/or formal governance, high unemployment, and inflation. In such areas, physical access was often limited by the threat of (and actual) violence against KE employees (as well as against police and other government representatives). In collaboration with local leadership and community and welfare organizations, KE would launch community-engagement and development initiatives focused on core community needs (e.g., drinking water, health, education, hygiene, and waste removal). These social programs would be accompanied (or followed) by (i) anti-theft awareness messaging (delivered to schools, mosques, and community centers), (ii) the installation of aerial bundled cables, and (iii) the frequent operation of one-stop application and payment camps. Subsidized new connections were offered with minimal documentation. Amnesty and rebate schemes were also offered to chronic defaulters. Program-related costs were recouped via fewer non-payments within one year, including conversions of some very high-loss feeders to low-loss feeders.

(1) One case involved the community of Lyari where KE employees could not previously enter without getting beaten. Thus, the utility sponsored a development program for local youth (i.e., under 16 years of age) via newly incepted ESG and sports functions that sat under the CMO, and a newly created football team, resulting in a platform for the youth of Lyari to represent Pakistan at national and international matches. Community members have since been more willing to convert from illegal to legal connections and KE employees can more freely enter the community and talk about theft and illegal lines without conflict. (2) In Altaf Town, an ESG program (i) focused on garbage cleanup, eye camps,

and skin camps; (ii) offered subsidies to those that connected legally; (iii) and guaranteed that 10 percent of (received) revenue would be reinvested in social programs for the town. Subsequently, KE was able to regularize and legally connect 85 percent of the area, convert 100 percent of the community to aerial bundled cable (ABC), reduce consumer complaints by 95 percent, increase payments by 290 percent, and reduce non-payments from 77 percent to 17 percent of billing. The Altaf Town project paid back its initial costs in 11 months. Based on this success, similar programs in very high-loss areas (i.e., Korangi-Pak town, Surjani-Shahnawaz Colony, Aurangabad, Orangi, Baldia, and Bilal Colony) were also launched. In each case, community-engagement initiatives were paired with a commitment to pay back 10 percent of revenue to community-development projects once customers replaced their illegal connections with subsidized legal lines.

Under the ESG function at KE, regular meetings were held with NGOs, consumer groups, social action groups, and thought leaders. Deeper engagement was pursued with a wide range of educational institutions and included the sponsorship of 16 events, 39 visits to plants (by 8,000 students in school or university groups), and 350 visits by employees to various educational institutions (that have involved 25,000 students to date). One hundred thousand school children (i) were encouraged to pressure their parents to save electricity and (ii) developed competitive poster campaigns to promote peer-level awareness (e.g., to enhance energy conservation and stigmatize theft). In the environmental domain, KE partners with the World Wildlife Fund (WWF), the Pakistani Navy, and local NGOs to plant 80,000 trees (with another 150,000 planned in 2016) and invests in solar and biogas alternative energy technology. During crises (e.g., fires, summer heat waves, the 2015 earthquake, and the 2010-2011 floods), KE also mobilized support, waived billing, and helped to address community needs (e.g., financially, materially, and via the provision of volunteers). By 2015, KE donations have included 73 million rupees of financial assistance, 3,000 tents, 117 truckloads of food, two water purification plants, free medical treatment (to 18,500 patients per day), and free electricity to relief camps. KE also organizes national forums on subjects such as sustainable development.

All 16 major hospitals in Karachi were provided with 24/7, uninterrupted electricity. In addition 14 institutions have been qualified as members of an "empowerment program," which enables KE to provide subsidized or free electricity (at an annual cost of 70 million rupees) to 3.45 million citizens. Membership requirements include (i) a physical address within the KE service territory; (ii) registration as a charity in the health or education sector; (iii) service to general public, with at least 70 percent of services offered for free to the indigent; (iv) no affiliation with corporate or family foundations; and (v) a history of full and timely payment of electricity bills and high probity.

From 2009-2012, KE issued 1,050 press releases, held 85 press conferences, and its managers made 200 appearances on various television programs (and placed hundreds of paid advertisements to reinforce KE's positioning on safety, AZM, anti-theft, anticorruption, and national pride). Media outreach sought to explain new initiatives and actions. Naqvi and his team took on consumer marketing best practices and created a YouTube page for KE in 2009, which launched with a series of videos entitled "Inside K-Electric" and included key members of the KE management team describing why they joined the firm ("to improve Karachi") and the achievements at KE. These actions seemed as though they were aimed at improving KE's public image and reputation (which KE cited as a key priority of the new leadership team). In his introductory video, Naqvi stated that "the biggest thing that we've accomplished so far with many people is giving them a confidence that this company is in the right hands, that we have a very clear vision of what we want to achieve, that we have quality management, a strong focus on the customer, and a very genuine commitment to fixing this company and improving Karachi."[64]

Furthermore, there was a clear emphasis on the role of KE management in improving Karachi, "to help build a customer relationship … and to transform the opinions of the public."[65]

Naqvi and his team also emphasized the commitment of the department (which by 2010, included 30-plus team members across ESG as well as brand, PR/communications, and sports/community programming functions) to increase KE's transparency with the public and wider stakeholders. Naqvi noted that KE's marketing campaigns, in the coming months, would feature actual team members from across the business and would be directed at increasing transparency and illustrating KE's goals and achievements. In December 2009, he wrote an open letter to the media that described Abraaj's rationale for taking over the management of KE and requested that the media cover the

[64] "Inside KESC: Ovais Naqvi." YouTube video, 4:42. Posted by "KESC," November 18, 2009 https://www.youtube.com/watch?v=Yo7oGkKSq4Y

[65] "Inside KESC: Ovais Naqvi." YouTube video, 4:42. Posted by "KESC," November 18, 2009 https://www.youtube.com/watch?v=Yo7oGkKSq4Y

situation in a balanced manner.[66] CMOs after 2010 seemed to continue these communication and transparency efforts, at least to an extent, (e.g., they created a KE Facebook and Twitter page and continued to upload KE YouTube videos). Also, print and television advertising campaigns reflected some key focus areas including (i) the commitment of workers to providing reliable power, (ii) public awareness of safety protocols (e.g., the danger of touching downed power lines), (iii) anti-corruption and theft awareness, (iv) energy conservation, and (v) pride in KE, Karachi, and Pakistan.

The impact of this broader stakeholder engagement on opinions was systematically tracked across eight waves of polling by Nielson from 2010 to 2014. The sample size ranged from (i) 100-292 in each of four regions and (ii) 114 to 258 across five socioeconomic strata. The survey included respondents in 23 of the 28 IBCs although the sample size in eight (of the centers) was under 20 respondents. The results showed that the number of respondents who preferred KE to other utilities increased dramatically in the first 18 months of Abraaj's ownership (i.e., from under 10 percent to approximately 30 percent and then more slowly to 36 percent by 2014). The percentage of respondents who would recommend KE rose from 1 percent to 17 percent and of recommenders who preferred it rose from 11 percent to 47 percent. The ratio of respondents who believe that KE (i) "is being run by a Management who know what they are doing" rose from 2 percent to 84 percent, (ii) "is a contemporary/modern up-to-date company" rose from 3 percent to 82 percent, (iii) "is trustworthy" rose from 16 percent to 61 percent, (iv) "promptly resolves complaints" rose from 6 percent to 54 percent, and (v) "has efficient customer service" rose from 6 percent to 55 percent. The number of respondents who "will extend help and support to KE" rose from 21 percent to 76 percent and the percentage who "will do [their] part to stop wastage of electricity" rose from 30 percent to 88 percent.

Despite the technical and reputational gains, some consumers remained unconvinced and refused to pay for their electricity. The firm's own police force conducts 20 to 40 raids per month against theft and identifies illegal activity 95 percent of the time. Approximately 50 percent of the consumers settle their debts on the spot (signifying their ability to pay) and 25 percent settle their debts before prosecution. Ten percent of recovered funds have been reinvested into equipment and offices for the firm's police force and police behavior is now carefully monitored, audited, and provides a strong incentive for police to recover funds (vs. capture them). Recovery efforts remain, however, primarily focused on industrial and high-net-worth customers (vs. on poorer regions).

In May 2015, these efforts were branded as Operation Burq, an electricity-theft and default crackdown campaign, executed in collaboration with law enforcement agencies. A legal ruling transformed electricity theft into a non-bailable offense, opening the door for a more stringent crackdown on nonpayers. Penalties of up to three years of imprisonment, 10 million rupees, and property confiscation for unpaid bills were combined with public naming and shaming of violators.

Aggressive television ads (featuring gun-toting representatives of the Federal Investigation Agency, Rangers and the Police were heavily publicized via a combination of mass media, one-to-one, and below- the-line media (e.g., pamphlets, handbills, banners, and placards), and digital media. For 15 days, an offer of amnesty was widely disseminated; it was

[66]Ovais Naqvi, "An open letter to the media," *Business Recorder*, December 22, 2009.

followed by an announced and aggressive crackdown that included 3,373 raids, the confiscation of 55,213 kilograms of illegal wires, and the disconnection of 178,063 nonpaying customers (including prominent restaurants, politicians, and celebrities). Credit Suisse First Boston reports that the recoveries from the campaign equaled 14 percent of annual forecast earnings. The program cost 95 million rupees but recovered 1.4 billion rupees. The program was viewed as a huge success with (i) a substantial decline in power theft and (ii) an increase in payment recoveries (of overdue bills). These aggressive visuals highlight efforts by KE to emphasize the criminality of electricity theft and publicly shame non-payers.

Government and Regulatory Affairs: Transactional Successes Coupled With Ongoing Political Posturing

During the seven-week period of due diligence, Abraaj made substantive headway in:

(1) rationalizing the tariff structure to allow full recovery of variable costs (vs. having increases capped at 4 percent per month);

(2) formalizing existing gas and power purchase agreements; and

(3) agreeing to offset government receivables and payables against each other such that non-payments by strategic state-owned customers and differences between the tariff that the government allows KE to charge customers and the agreed-upon formula (in 2002) — that was implemented in 2005 — could be offset against payments due for power.

Over the ensuing seven years, the formal transactional elements of the governmental and regulatory relationship never posed material challenges. In fact, the KE office in the capital of Islamabad was just a two-man operation; however, it still successfully managed the adjustment and reconciliation of the (i) original power purchase agreements, (ii) allocation of gas to KE generation plants, and (iii) the negotiation of subsidies for village electrification programs in Sindh and Balochistan.

The new Abraaj management team hoped to build on this strong foundation in its public relationship with the government. However, despite broad-based private support, the public face of the political parties was much more hostile. As one politician explained, "We are with you, but I might have to criticize you on TV."

The company repeatedly faced not only criticism but also a "venting of fury, of loud ranting as government representatives unburdened their frustrations" (Aziz: 65) and demanded the impossible (e.g., an immediate end to load-shedding). KE was also publicly rebuked for favoring industry over voters in its load-shedding scheme; however, privately, the same people agreed with the rationality of providing manufacturing and financial employers and hard-currency earners with uninterrupted power. At some point, a combination of frustration at the inconsistencies and internal contradictions of stakeholder demands led to the adoption of a more abrasive government affairs strategy.

> *"Never to back down on any issue of principle, never to give an inch, to do things the right way on merit and principle"*
>
> Eram Hasan, Former Chief Supply Chain Officer

For example, "senior managers [of K-Electric] would receive calls that the officials from various government ministries are visiting Karachi, and that accordingly, they should arrange a car, hotel, accommodation and other facilities for him. K-Electric's response was that … they are no longer part of the government, and … it is not in the best interests of the organization, so "no can do!"" (Aziz: 63)

Reflection on Performance Gains and Reputational Gaps

The four-pronged approach had, at one level, proven to be a dramatic success. Since 2009, KE's annual revenue has increased by 75 percent (9.6 percent per annum). Thus, KE had achieved (i) operating profitability in 2011; (ii) net profitability in 2012; (iii) rising earnings before interest, tax, depreciation, and amortization (EBITDA) of $339 million in 2015 from -$87 million in 2009 (with margins of 18 percent); and (iv) net income that has increased from -$197 million in 2009 to $280 million in 2015 (with margins of 15 percent). See Figure 7 for a summary of this financial and operational turnaround. KE accomplished this via (i) new capital expenditure, which has enabled greater output; (ii) internal stakeholder alignment (based on right-sizing, reorienting, and empowerment); (iii) reductions in T&D losses (due to technical, reputational, and legal strategies); and (iv) continued solid relations with government and regulatory authorities (despite public posturing).

However, this narrative has differed dramatically from the one depicted by the media and many Karachiites. Indeed, the layoffs, acrimony surrounding the VSS, public attacks by politicians and regulatory officials, and Operation Burq, became the enduring memories. Thus, many positive aspects were ignored, including the (i) substantial investments in capital expenditure, (ii) importance of changing an entitlement culture (and culture of corruption) at the employee level, (iii) substantial investments in employee training and capacity-building, (iv) success with crafting a customer-oriented culture via IBCs,

khuli-kutcheries, (vi) various community-engagement and development initiatives, (vii) need to shift the culture of entitlement within the government towards private sector firms, (viii) successes with receiving payments and gas supplies, and (ix) the government's own efforts to use the success of KE to attract investors for subsequent privatizations. Thus, it was as if only half of the story was being told — and it was always the wrong half.

Perhaps, control of the narrative was too ambitious a goal when the firm's very survival had been at stake. When the firm was just trying to survive, tactical victories were sufficient. From 2008-2015, the management team was focused on survival.

> *"Just trying to get oxygen; they had to focus on firefighting and what was urgent right now. There was no time for a strategy. But some managers had gotten too comfortable in that firefighting mode. They wanted to come in and fight something every day — not stop, think, and plan ahead."*
>
> Eram Hasan, former Chief Supply Chain Officer

One issue of particular concern was political opposition to segmented load-shedding — on the basis that KE imposed higher load-shedding in higher-loss areas that happen to be the poorer regions. There was also a perception (by the new national government) that KE was taking power from the northern part of the country and giving it to the southern region. Indeed, it was inevitable that the question of power purchases, gas purchases, and subsidies to strategic government enterprises would take on a new political edge.

Efforts to highlight that segmented load-shedding was a solely commercial decision with the slogan "They steal, you pay" were of limited effectiveness despite the national governments adoption of a similar policy in state owned utilities. Similarly, explanations that the power and gas transferred from the North to the South were immaterial at a national-level but highly significant to Karachi which was itself vital to the national economy were met with apathy or disbelief.

At some level, the company had survived the crisis of the voluntary separation scheme and achieved an operational turnaround but had yet to proactively engage stakeholders, tackle agendas and vested interests. Absent a concerted plan to do so, there was a risk that the gains could easily be reversed.

Negative perceptions were still widely held by stakeholders including that KE manipulated its tariffs, chose when to load-shed and have breakdowns).

Despite the efforts to date, many customers (especially in high and very high load-shedding areas) still see KE as an adversary. The opposition party even has a proactive communication strategy to criticize the government and the firm. KE has tactically responded with a mix of hard and soft strategies in its relations with employees, customers, and the state. Indeed, this mix of carrots and sticks was contributing to a financial and operational turnaround. The problem was that only the sticks were remembered (or publicized) and absent broader-based, stakeholder support, the turnaround might not be sustainable.

Discussion Questions

Imagine that you are Tayyab Tareen, the CEO of KE. Your goal is to sustain the operational, financial, and stakeholder turnaround initiated by Tabish Gauhar. The initial work streams (i.e., addressing CAPEX shortfalls, reducing T&D losses, and shifting the tenor of both workforce culture and external stakeholder relations) have each yielded tangible results. Financial and operational results continue to show stark improvement. However, do the 2013 change in government and political and media reactions, associated with the 2015 summer heat wave, suggest a need for adaptation? Or should KE simply stay the course? If you believe a change in strategy is needed, be specific regarding the elements of this change. Would you alter the structure of segmented load-shedding? The marketing and communications plan? CSR expenditure? Government and regulatory affairs? Be prepared to back up your arguments with quantitative or qualitative evidence.

Important links:

https://en.wikipedia.org/wiki/Arif_Naqvi

https://www.pelawreport.com/4104316/the-collapse-of-abraaj-resolved-and-pending-cases-in-the-us-and-dubai-against-the-former-pe-giant.thtml

https://www.dfsa.ae/news/dfsa-action-against-abraaj-founder-mr-arif-naqvi-and-former-coo-mr-waqar-siddique-referred-financial-markets-tribunal

https://abcnews.go.com/International/wireStory/dubai-regulator-issues-massive-fine-abraaj-founder-82504562

https://www.ke.com.pk/our-company/our-leadership/

Figure 1: Ethno-Linguistic Composition of Pakistan, Sindh, and Karachi

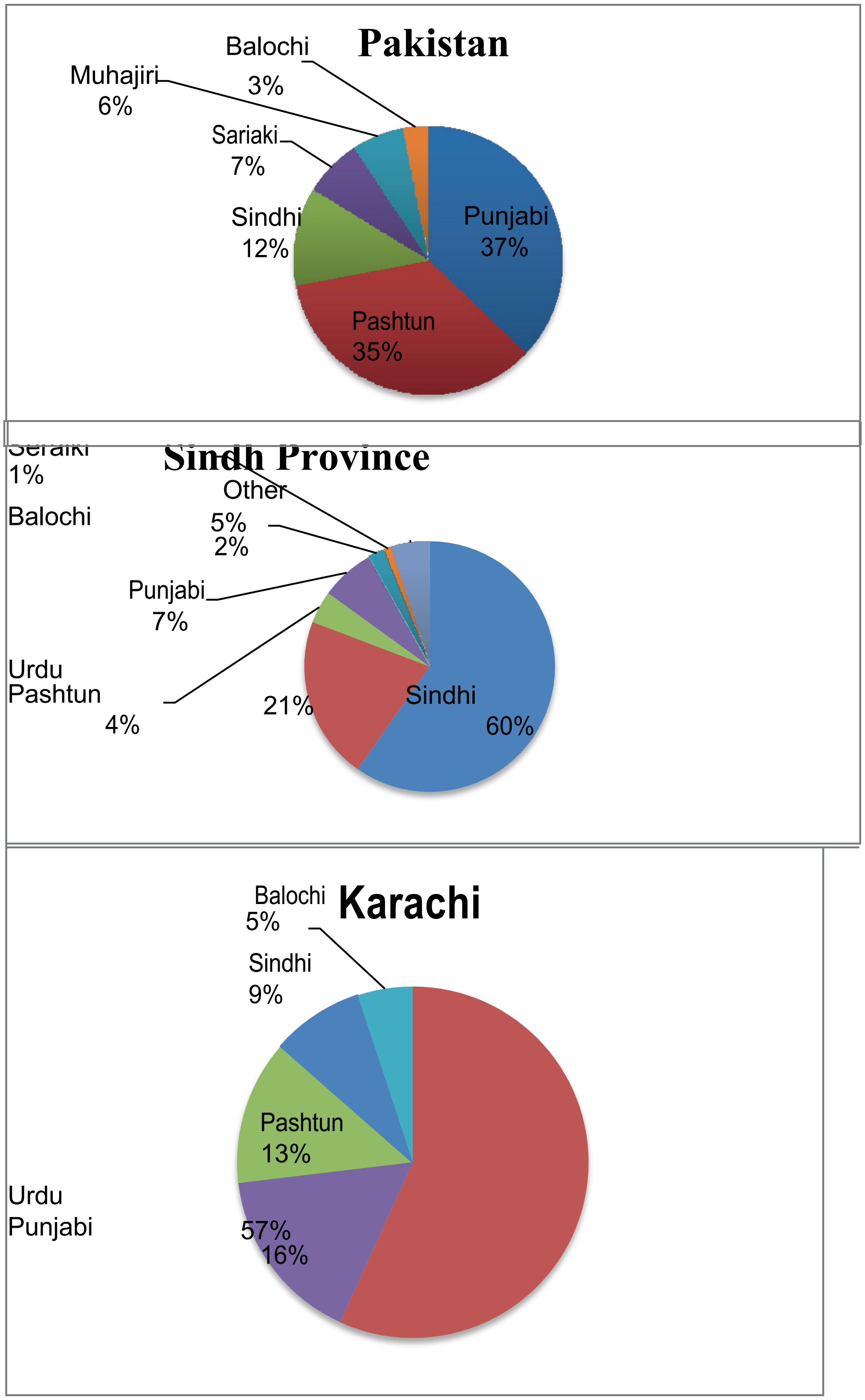


Figure 2: Media-reported Conflict in Pakistan, Sindh, and Karachi

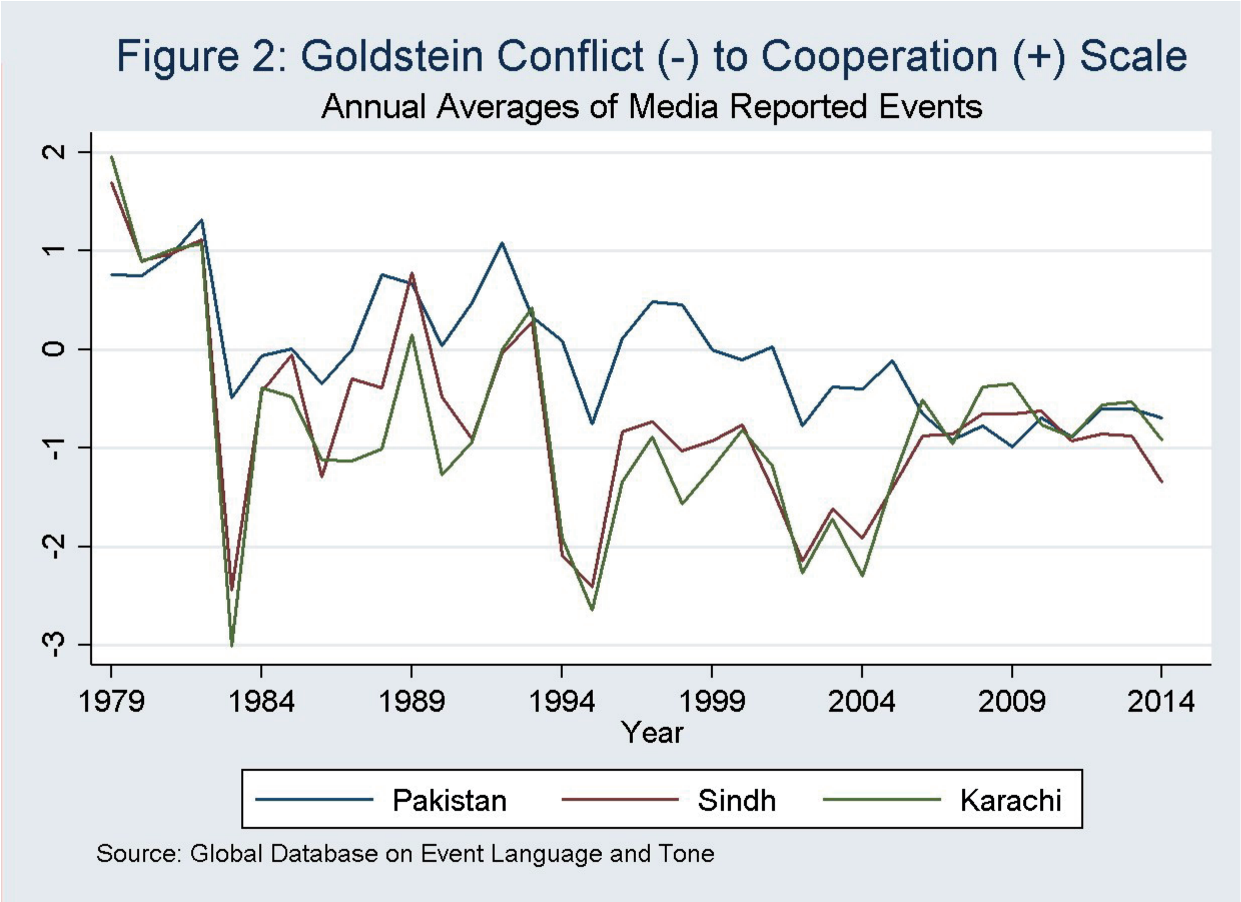
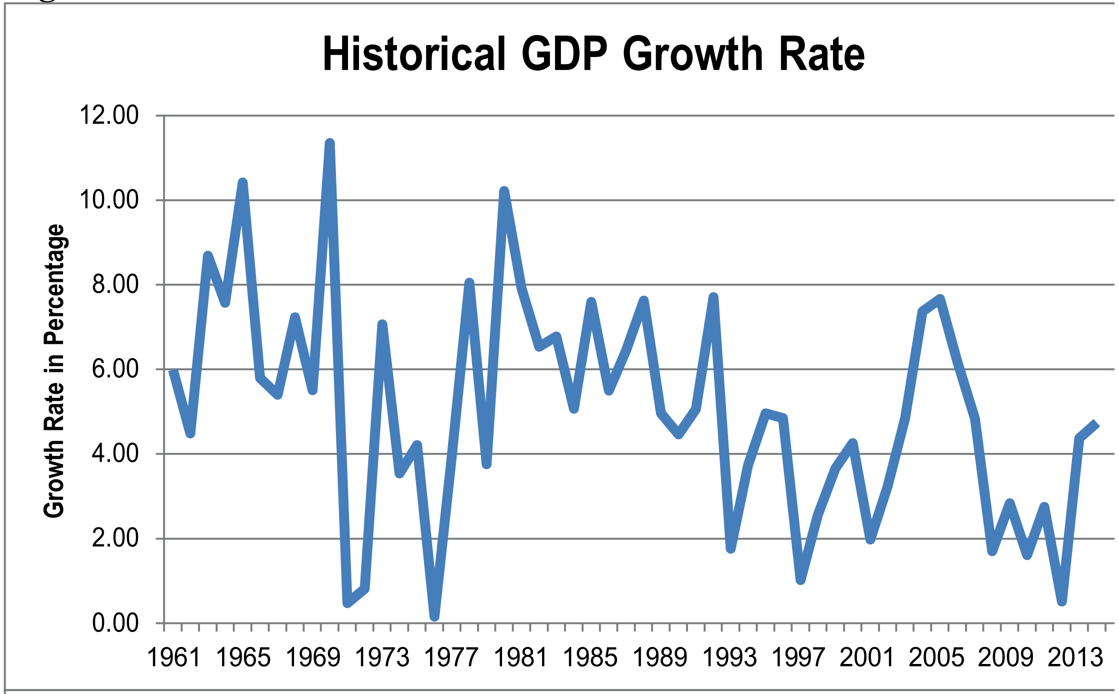


Figure 3: Pakistan's Economic Indicators



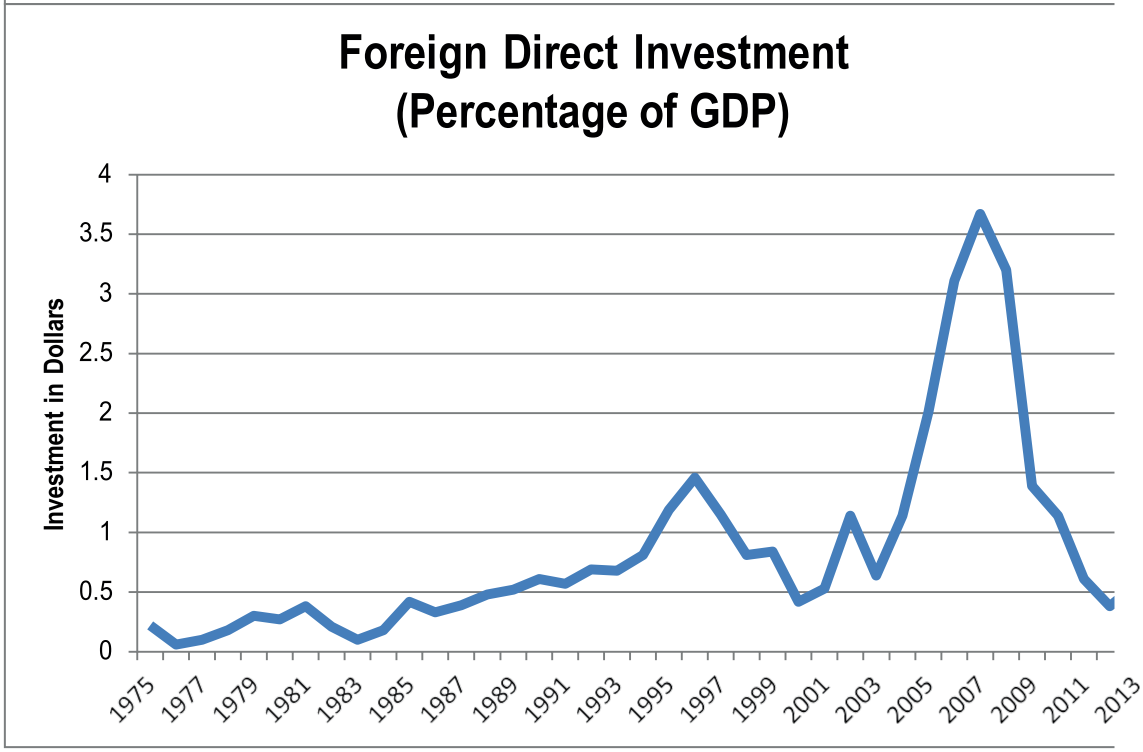


Figure 4: Ease of Doing Business

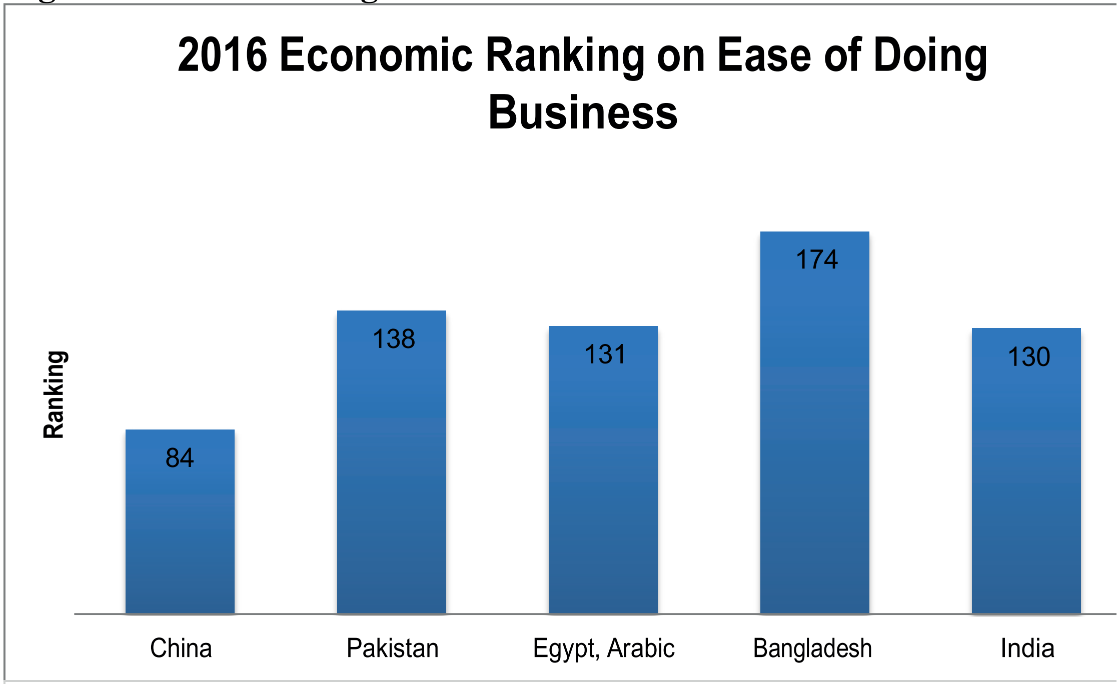


Figure 5: Structural Imbalance in Power Sector

Power Generation: Peak Demand and Actual Production (Megawatts by Fuel/Source)

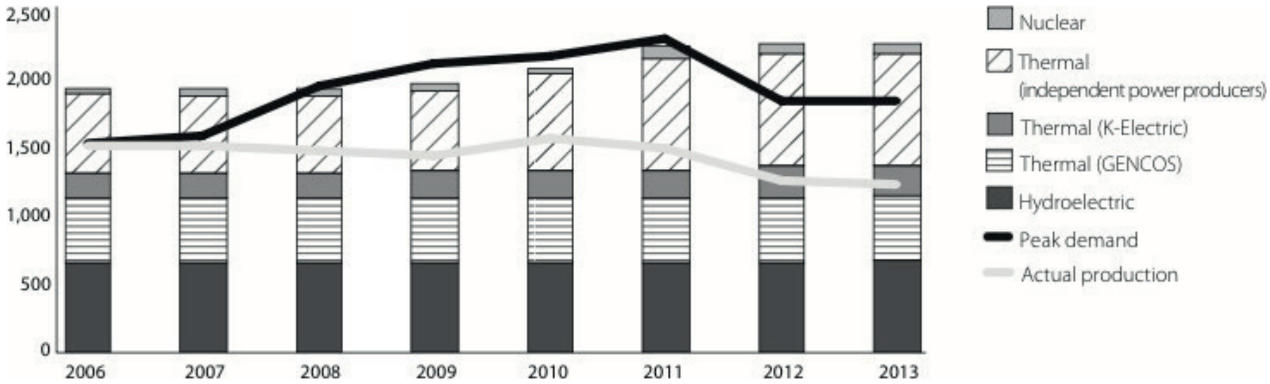
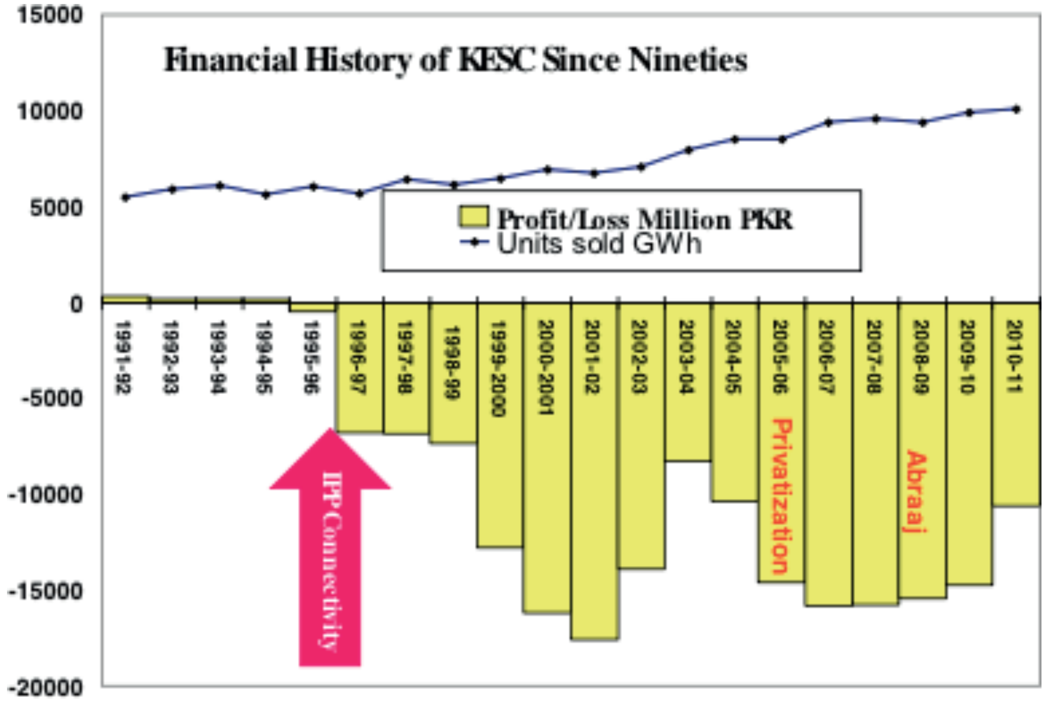


Figure 6: Historical Performance of K-Electric



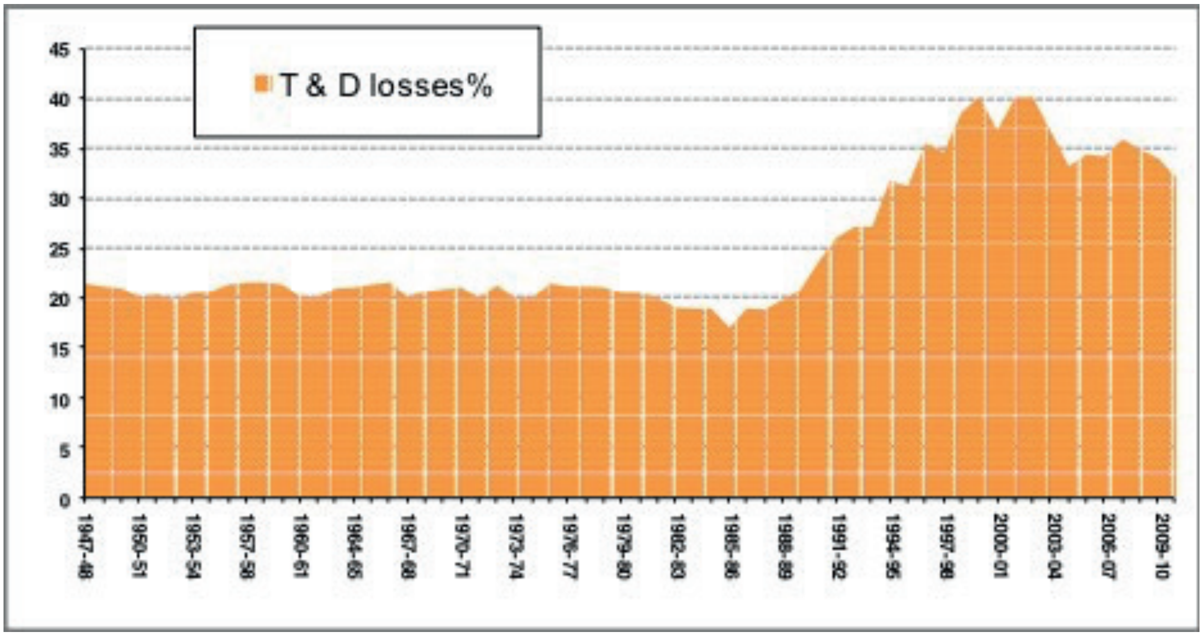
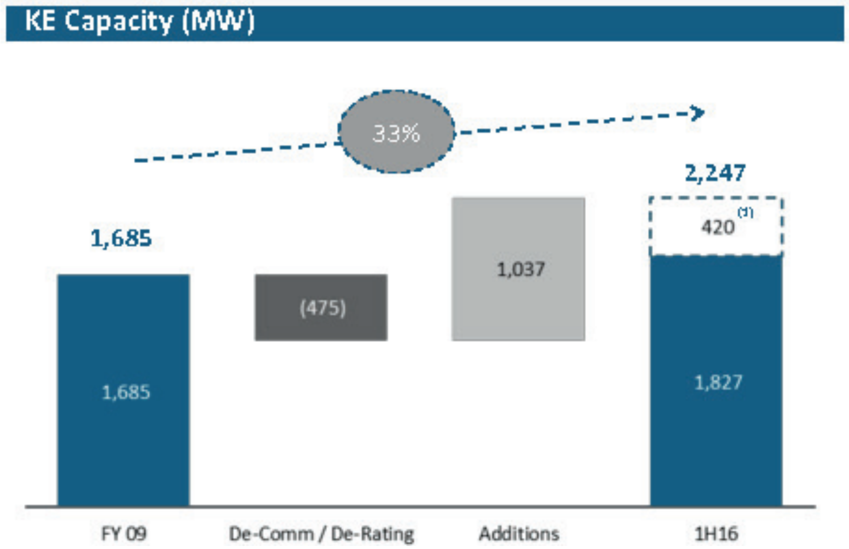
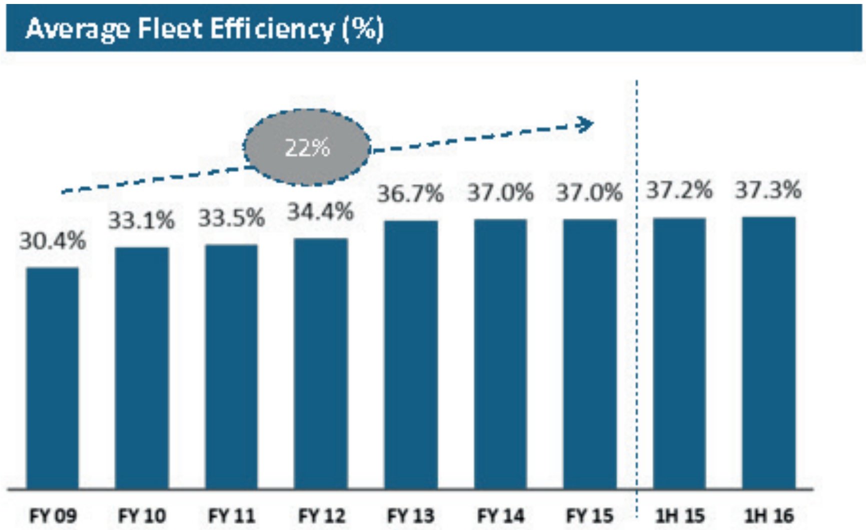
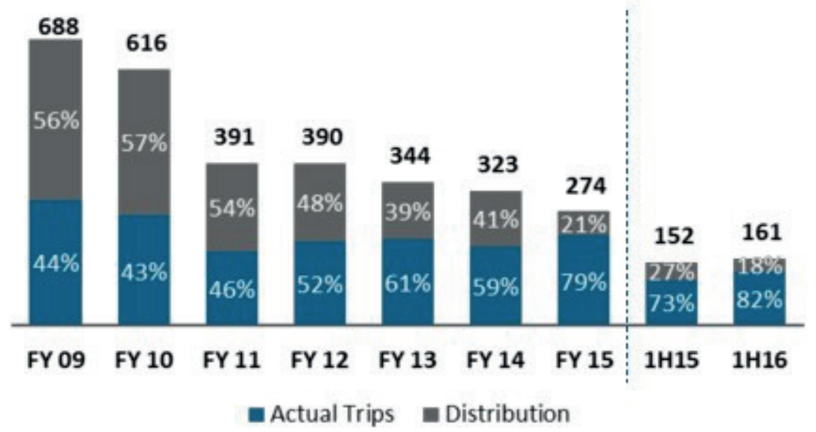


Figure 7a: Operational Turnaround: Generation and Transmission





Transformer Trips



EHT Line Trips

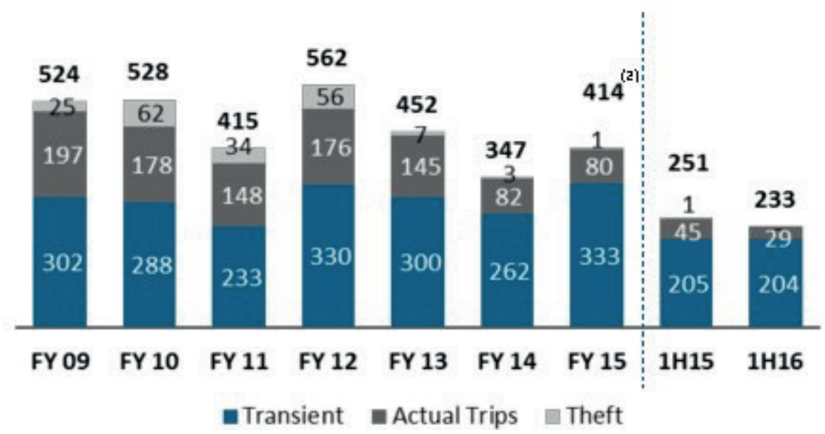


Figure 7b: Operational Turnaround: Distribution

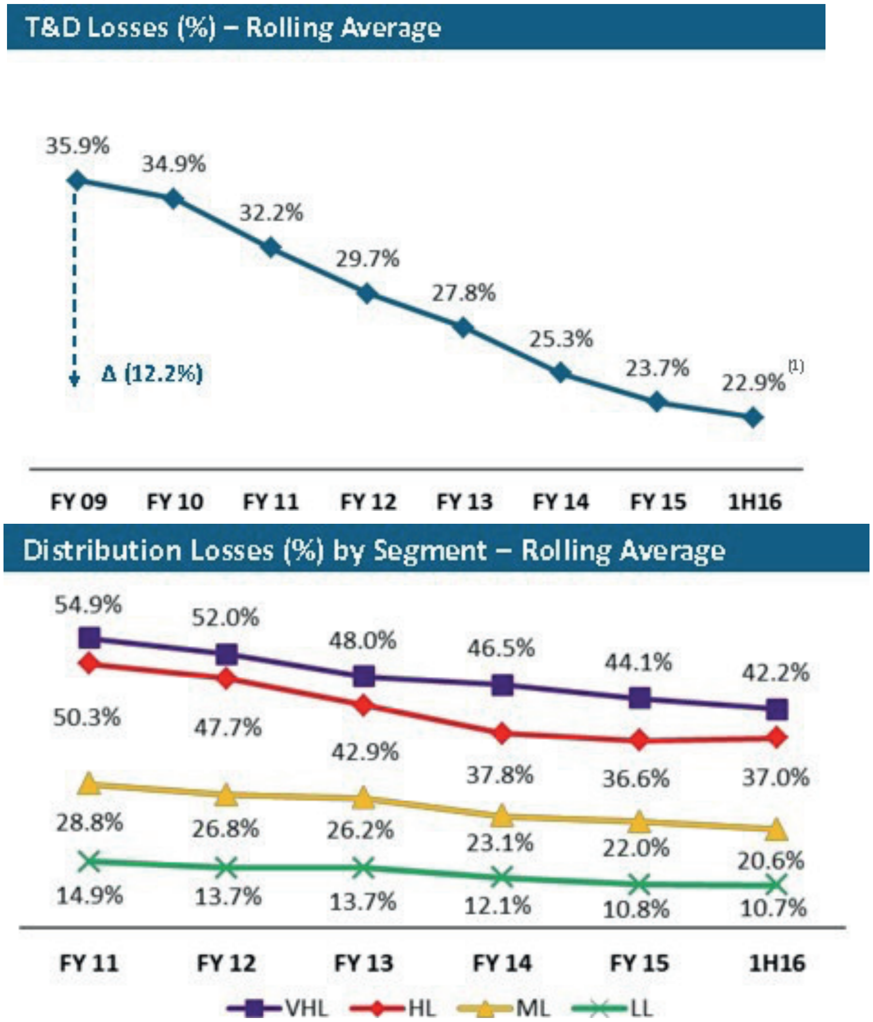


Figure 7c: Financial Turnaround

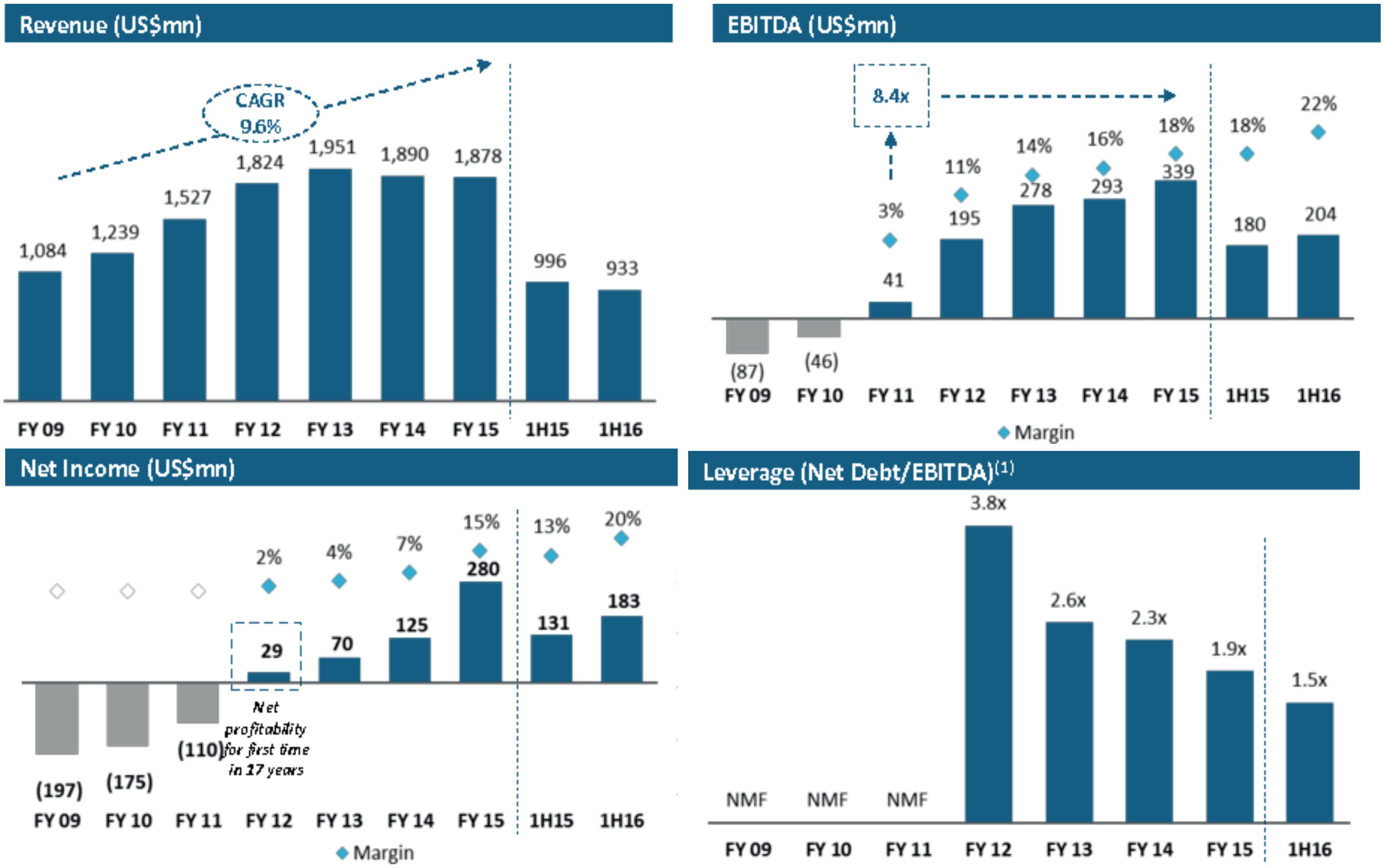
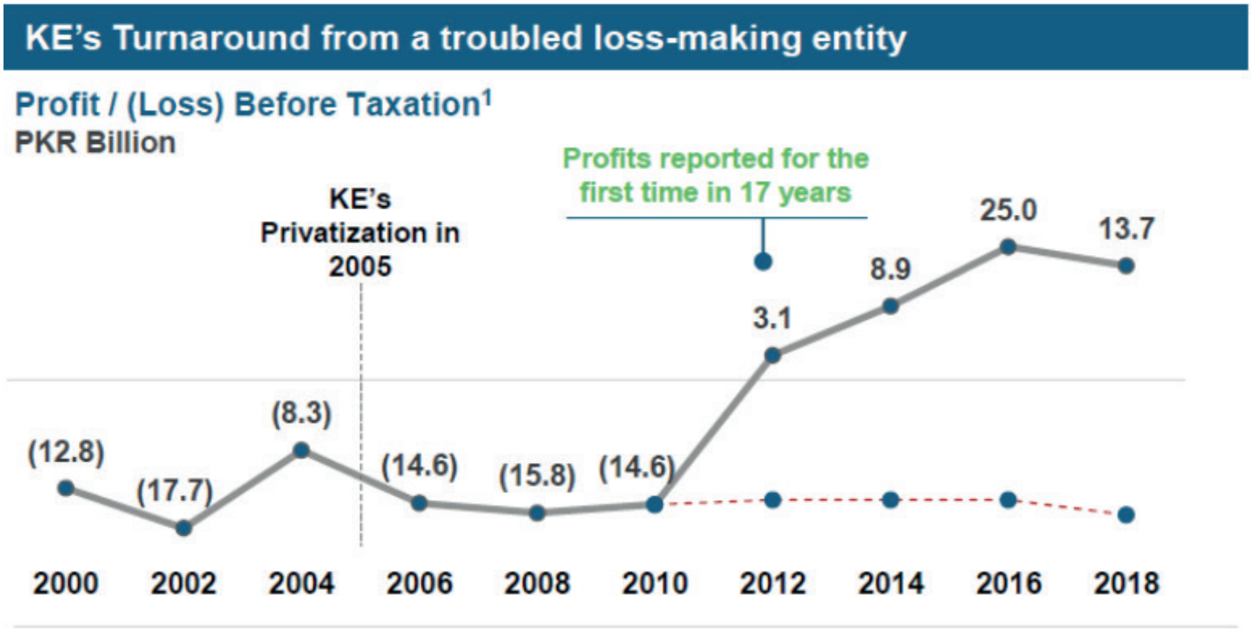


Figure 8


KE's Turnaround from a troubled loss-making entity
Profit / (Loss) Before Taxation1
PKR Billion
KE's Privatization in 2005
Profits reported for the first time in 17 years
(12.8)
(17.7)
(8.3)
(14.6)
(15.8)
(14.6)
3.1
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2000
2002
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2012
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2016
2018

ABOUT THE: *ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) INITIATIVE*

The Environmental, Social and Governance Initiative conducts academically rigorous and practically relevant research with industry partners and across all Wharton departments that investigates when, where, and how ESG factors impact business value. Informed by research, we offer 30+ courses that MBA and undergraduate students can assemble into a major or concentration, over a dozen co-curricular experiences, and three Executive certificate programs. Led by Vice Dean Witold Henisz, the ESG Initiative advances Wharton's best-in-class education of current and future leaders, enabling them to serve a world undergoing tremendous change.