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Strategic Alliance within the Sugar Industry of Pakistan: A Resource Dependence Perspective

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Abstract

Purpose: This paper uses the resource-dependency theory to present the case of the Pakistan sugar industry to highlight how the industry uses a strategic alliance to gain a powerful bargaining position over its critical dependencies. The case of the Pakistan sugar industry is well-known and it is common knowledge that the alliance or the cartel within it is responsible for frequent price hikes and sugar supply shortages in the country. **Research design, data and methodology:** We use a case study, qualitative document analysis design to trace how the alliance overcomes its various dependencies, and in doing so, how does it harm various stakeholder interests. **Results:** This paper finds that the sugar industry alliance maintains its bargaining power by manipulating sugar supply through horizontal alliances, political affiliations, underselling and under-reporting sugar stocks, purchasing sugarcane from the black market, and by gaining billions of rupees in export subsidies by hoarding stock and using its political connections. **Conclusion:** The paper concludes by providing a summary of the measures which the government has taken to curb this anticompetitive conduct; the most important of which is the removal of protectionist measures for sugar trade and allowing market forces to control the demand and supply of sugar in the local market.

Keywords: Pakistan sugar market, Resource Dependencies, Strategic Alliance, Anticompetitive Conduct

JEL Classification Code: Q1, Q2, Q5

1. Introduction

In the theoretical field of organizational studies, few theories have had such an influence on the understanding of organization-environment relations than the resource dependence theory.

The theory recognizes the influence of the external factors on organizational behavior, and an analysis of these factors can help practitioners and theorists to understand the power relationships that exist between their organization and other network actors.

Organizations are generally inclined to reduce the environment's power over them and attempt to increase their power over the environment. An organization is dependent upon its environment for the resources needed for

production; these resources include raw materials, labor, capital, equipment, knowledge, and outlets for its products, resources that are essentially controlled by the environment (Hatch, 2018). The environment derives power over the organization from this dependence, which it uses to make demands on the organization such as competitive prices, desirable products and services, and efficient organizational structures and processes on the organization (Hillman et al., 2009). However, the dependence of the organization on its environment is neither singular nor undifferentiated; a complex set of dependencies exists between an organization and the specific elements of its inter-organizational network, this is because organizations take actions to manage these interdependencies and so in this process produce new patterns of dependence and interdependence (Drees et al., 2013).

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It is this interdependence that forms the basis of conceptual analysis undertaken from the perspective of resource dependence theory. A conceptual analysis, therefore, involves identifying and tracing the resource flows to where they begin and how the final output is delivered to the end-users. This process will also identify the supply chain network of an organization and will describe how different network actors such as suppliers, other businesses, and agents influence competition for the same resources in the environment (Fink et al., 2006). Correspondingly, government agencies, lawmakers, and policies that regulate business activities are also part of this inter-organizational network. The next phase of the analysis is to prioritize and identify the organization's responses to these dependencies (Hatch, 2018). Pfeffer et al. (1978) have identified five actions that organizations take to minimize the critical aspects of their dependence: (a) strategic alliances, (b) joint ventures and other inter-organizational relationships, (c) boards of directors, (d) political influence and action, and (e) executive succession. Studies using the resource dependence theory (RDT) perspective, therefore, try to answer one of these questions: how do firms choose to behave through these five actions to escape dependency from their environments?

This paper uses the resource dependence theory perspective to describe the strategies adopted by Pakistan's sugar industry to overcome the dependencies towards its environment. We use a case study design to describe the performance implications for the use of excessive profiteering practices by the sugar industry supply chain. The case of Pakistan's sugar industry is selected for this study because the existence of strategic alliance and cartelization within this industry are well-known, and the industry has been frequently denounced by the government for its anti-competitive behavior. Yet several policy and regulatory failures, as well as close political ties, have ensured that this arrangement continues. The alliance, therefore, continues at the cost of extensive harm to customer welfare but manages to be very lucrative for its members. The results of the study can be used to understand the behavior of industries who operate under these conditions, and how firms are tempted to sidestep regulations in anticipation of high rewards in terms of profits.

2. Literature review

Studies that have employed the resource dependence theories to understand the behavior of firms who operate under political influence have political alliances and those who exert influence over political decisions (Dieleman et al., 2019; Drees et al., 2013). The main assumptions which are tested under RDT are that organizations respond to resource

dependencies by forming inter-organizational arrangements like interlocks, alliances, joint ventures, and insourcing arrangements. These arrangements then allow organizations the freedom to make decisions without outside influence (Pollock et al., 2010) and gives them a presumption of propriety stemming from conformity to social guidelines (Roundy et al., 2019).

The main question addressed by RDT studies is, why do organizations enter into inter-organizational arrangements? External dependencies, in the contemporary business environment, can stem from factors such as increased market competition due to globalization, rising costs of production, shortages of energy, and raw materials (Meyer et al., 2009). Additionally, RDT studies have investigated a variety of inter-organizational arrangements, each of which is accredited with the capacity to mitigate external resource dependencies. For example, board interlocks are conjectured to enhance the cooptation and coordination with important resource providers, primarily by providing a conduit for the exchange of tacit or sensitive information and by providing greater social cohesion between the key decision-makers representing the interlocked organizations (Zona et al., 2018). Similarly, alliances and joint ventures are expected to be formed to facilitate reliable and durable access to the knowledge and resources of partner organizations, resources that would not be available otherwise (Frynas et al., 2016). They might also enhance focal organizations' opportunities for developing capabilities and launching new products without requiring corresponding investments in a complete and exhaustive resource base (Khlif et al., 2017). Similarly, inter-organizational interdependencies have been identified as key drivers of mergers and acquisitions, as acquiring resource suppliers provides durable access to desired inputs, broadens an organization's knowledge base, and facilitates joint strategy formation and implementation. The evidence from RDT studies confirms that resource dependencies are antecedents of all forms of alliances among organizations (Lee et al., 2018; Roundy et al., 2019).

Empirical studies on RDT have been few, to say the least; empirical studies using RDT as leading theory have mostly produced inconclusive results. Rather, RDT has been contested strongly on empirical grounds since these results have always proved to be insignificant or have reported counter-hypothesized findings (Vermeulen et al., 2001). This is largely because such empirical studies do not correct for sampling error, nor do they offer an inferential statistics-based synthesis on all available findings (Combs et al., 2011). These unsatisfactory results have led many to the conclusion that RDT "remains an appealing metaphor than a foundation for testable empirical research" (Casciaro et al., 2005).

In contrast, studies that use the RDT framework conceptually tend to focus on identifying inter-organizational arrangements and the external dependencies which stem from the contemporary business environment. Some of these contemporary business problems highlighted in previous studies include globalization, raw material, and energy shortages caused by geopolitical shifts in production factor demand and supply chain issues due to the global financial crisis (Coupet et al., 2017). Therefore, to trace the effects of such constraints on business behavior, studies try to identify the particular arrangements that enable organizations to maximize strategic control over critical external factors (Santos et al., 2005). In particular, collaboration among organizations aimed at reducing environmental constraints has helped theorists to elaborate on the nature of turbulence and complexities faced by these organizations (Gray et al., 1991).

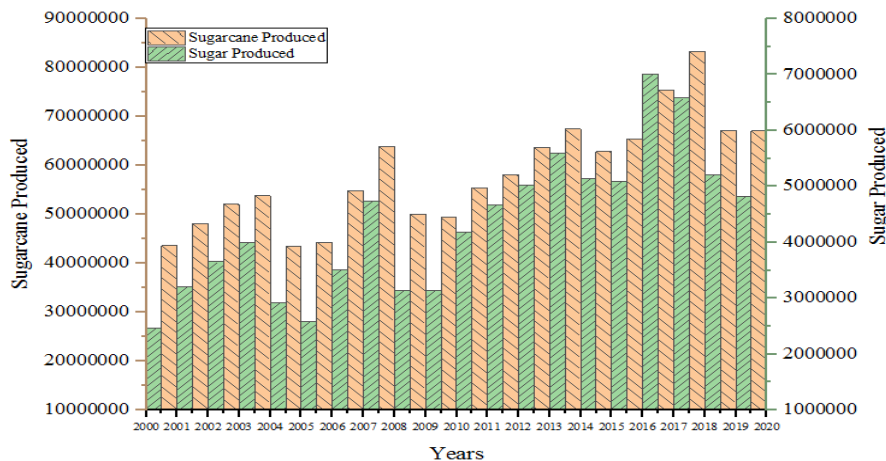
3. Methodology

This paper uses a case study, qualitative document analysis design to present its main argument, which is to answer the question: how does the Pakistan sugar industry choose to behave through strategic action to escape dependency from its environment. The analysis is based on the framework of resource dependence theory where the theory is used to understand the actions used to gain control over the need for resources. The documents and data for this research are gathered from official government sources, national and regional statistics bureaus, news articles, and official publications from Pakistan Sugar Mills Association. The time period for the analysis is the years 2000-2020. In order to accurately trace the influence of the industry over its supply chain, data were collected from the following:

- The quantities for sugar produced, sugar cane produced, and carryover stocks were obtained from Federal Bureau of Statistics (BOS) and from annual publications from the Pakistan Sugar Mills Association (PSMA)
- The data for average retail prices of sugar were obtained from Federal Bureau of Statistics (PBS)
- The support price data were obtained from annual publications of Pakistan Sugar Mills Association (PSMA)
- The data for price overcharges and ex-mill prices were obtained from the following report: Report of the Inquiry Committee constituted by the Prime Minister of Pakistan regarding the increase in sugar prices (2020).

4. Overview of the Pakistan Sugar Industry

Sugarcane represents one of the most important crops for Pakistan’s agriculture-based economy and it ranks sixth worldwide in terms of annual sugar production. Sugar is an important cash crop for the country and the industry is fostered by export and substantial local demand for refined sugar (Raheman et al., 2009). In terms of local consumption, Pakistan ranks as one of the largest markets in the world for refined white sugar and the industry is a significant contributor to the national income from its export earnings. Additionally, the industry is responsible for the employment and livelihood of thousands of farmers and cane growers throughout Punjab, Sindh, and Khyber Pakhtunkhwa. An illustration of the annual sugarcane and refined sugar production of Pakistan is presented as follows:



Source: Pakistan Sugar Mills Association and Pakistan Bureau of Statistics.

Figure 1: Amount of sugarcane and Sugar produced in Pakistan from 2000-2020

This favorable position of the sugar industry means that the sugar mills and their supply chain agents (wholesalers, retailers) enjoy a powerful bargaining position. Since the inception of the Pakistan Competition Commission in 2009, the Pakistan sugar mills association (PSMA) has been accused of being the front-runner for forming this bargaining position and has been charged for collusion and manipulation of stocks resulting in price increases and excessive profiteering. In 2010, the association was penalized by the commission for the sugar price hikes of 2005, 2009, and most recently, that of 2019 and 2020. In 2020, the federal inquiry commission's report into the matter revealed that there was no shortage of sugarcane or sugar production for the years 2019-2020 and that for the year 2019-2020, the PSMA manipulated prices by creating artificial demand by withholding supply (Committee, 2020). The report also implicated the major members of the alliance and named six mills that collectively control more than 51% of the entire production of sugar in Pakistan. These six members were found guilty of manipulating the market by forming an alliance and were subsequently accused of cartelization. More importantly, all six members have powerful political affiliations which have explained why policy and regulations have failed to curb this behavior. An overview of the total sugar production from these mills is provided in the following table:

Table 1: Sugar Produced by Mills

| Name of Mill/ Group | No. of Mills | Production for the year 2019 (tonnes) | Percentage of total national production |
|---------------------|--------------|---------------------------------------|---|
| JDW Group | 6 | 1,040,382 | 19.97% |
| RYK Group | 5 | 637,691 | 12.24% |
| Al-Moiz Group | 5 | 354,231 | 6.80% |
| Tandianwalla Group | 3 | 255,375 | 4.90% |
| Omni Group | 10 | 86,394 | 1.66% |
| Sharif Family Mills | 9 | 236,717 | 4.54% |
| All Other | 51 | 2,599,960 | 49.90% |
| Total | 89 | 5,210,750 | 100.00% |

Source: Federal Inquiry Committee, 2020.

The report also stated evidence that the price overcharges imposed by the cartel amounted to an approximate 16% of the original ex-mill price. However, the lack of forensic data suggests that the actual price overcharges may be much higher. The report also details evidence of underselling and under-reporting by the mills for evading tax and states the need for a forensic audit to determine the amount of taxes owed to the federal government by the association.

The members of this alliance have founded their bargaining position based on various strategic actions, wherein the most favorable is the political affiliation and its

manipulation of the supply chain. The next section describes these actions in greater detail and subsequently discusses the government's actions in response to these activities.

5. Discussion

The first step of the analysis is to address the issue of power and resource dependence faced by the industry in the form of resource inputs and the network actors associated with these resource flows. Since the network is quite complex and highly integrative, it is near impossible to trace every dependent source and network; however, the task is therefore accomplished by assessing the criticality and scarcity of each identifiable source (Drees et al., 2013). The three principal sources of criticality that define the sugar industry are the creation and existence of a powerful sugar cartel, the support prices for sugarcane and export subsidies for the mills. The cartel subsequently uses its influence to strong-arm environmental factors into its favor, including distorting supply and prices through various tactics, exerting formidable influence over the federal and provincial governments, setting roadblocks in the supply chain network and evading regulations meant to keep them in check, a process which begins at the support prices set for sugarcane.

The first and foremost input the sugar mill industry requires is the raw material in the form of sugarcane. The cost of the sugarcane crop is the major factor in deciding the sugar mill's total production costs, which decide the basis for sugar prices. The prices for sugarcane are set by each province to 'support' the farmers who provide the crop. It is at this price that millers are expected to purchase the crop. The networks or agents involved in this important decision include the provincial governments, the Ministry of Food and Agriculture, Agricultural policy institute and local farmers' representatives (Khushk et al., 2008). The principal criteria for setting the support price depends on the recovery rate of sugar from the crop, wherein high recovery rates fetch higher prices. It is for this reason that Sindh's support price for the crop has been set higher than Punjab's support price, with the average recovery rate of Sindh standing at 8.7% while Punjab's stands at 8.5% (Tabassum, 2018). The process is a critical one for the sugar mills association since higher prices mean higher costs of production which are unacceptable to the cartel. This critical aspect is sidestepped by the sugar mills through careful controls on quantity and delays in the crushing of sugarcane, causing deliberate roadblocks in the sugar supply chain. The purpose of delays in crushing is to endanger the crop's viability so that farmers are forced to sell the stock at prices significantly lower than the support price. Or millers collectively delay payments to farmers, report financial issues due to non-payments for

purchase of excess stocks by the government, and demand state relief in the form of subsidies (Khushk et al., 2008). The mills are not eligible for subsidies, yet manage to gain millions from coercive and strong-armed measures, while cane growers continue to suffer losses from these actions. These actions in turn discourage growers to plant sugarcane, resulting in sugarcane shortages, thus making the raw material scarce for the mills. This again creates pressure for the government, which intervenes in the form of granting export permits to mills, importing sugar, and controlling retail distribution through utility stores (Hussain et al., 2006). The use of export permits further gives power to the alliance, which then inflates production in order to deliberately extort export subsidies worth millions of rupees, continuing the cycle of control over critical aspects of production.

The supply chain networks are another dependency for any organization; it refers to the network of actors involved in the entire production and sale process of a product. In a matter of protest to the support prices, the mills decline to purchase the sugarcane at the fixed prices and delay crushing, which causes problems to growers (Krishna, 1963). This creates a roadblock between the growers, and the mills, and creates tension from the risk of a waste of tons of sugarcane. Primarily, this obstruction forces farmers to sell at prices far below the support prices. The alliance accomplishes this task through the use of middlemen, people who cause delays at the mill gates, thus forcing farmers to sell to these middlemen at lower prices (Siddiqui et al., 2012). Another dependency factor in this network is the transportation costs; small farmers often trade-off high transportation costs by selling to middlemen, who buy at price below support prices and sell at a profit to the mills.

Such transactions also allow millers to evade taxes on the purchase of sugarcane, and to under-report production quantities, since purchases and sales through middlemen are largely un-recorded and un-officiated. In other cases, some members of the alliance themselves are prominent growers of the crop, which allows them to control supply at the basic level (Naz et al., 2008). This form of horizontal integration allows small growers to be marginalized and allows the alliance control over production and the planting of the crop. This manipulation at the earliest stage of the supply chain then carries on the pressure of upward prices down the supply chain, as the refined sugar passes through distributors and middlemen to reach the final customer. And because the demand for sugar is largely inelastic, such price shocks become permanent over time.

The use of political intervention by the mills is perhaps the strongest measure of exerting control over its dependencies and environment. Political interventions in the sugar industry occur because some of the most prominent members of the cabinet, senate, and the provincial and federal government are owners of sugar mills, and are

allegedly heavily involved in the collusion (Javid, 2012). This creates an easy pathway for avoiding federal policies governing the sugar supply network, sugarcane prices, and stocks of sugar. Tracing the vast influence of the cartel over government policies is complex, owing to the discreet and covert nature of such actions. Regardless, the influence is evident in the billions of rupees of subsidies awarded to the mills, the apparent tax evasion, the use of blatant intimidation over crushing delays, the refusal to adhere to support prices, and the ease of escape from government allegations and actions for illegal cartel behavior. The existence of this political traction is one of the main reasons why the sugar industry is the second largest industry in Pakistan; the use of political protection through the decades ensured that the industry faced little competition in domestic markets through exorbitant tariffs on imports, was granted billions of rupees in subsidies, and was allowed to easily sidestep the ban on the creation of new mills due to excess capacity (Ali et al., 2009). The fact that this alliance between the mill owners and political leadership is so clear is one reason why the sugar industry became one of the most profitable industries of the country, even without the existence of an alliance. It is also because of this close alliance that the industry evades all charges of anti-competitive behavior, that is, if they are even bought up in the first place. Through obviously covert and intimidation efforts, the industry has remained free of charge until now, and news of misconduct is never grounded in solid, forensic proof (Raza et al., 2013). It is also impossible to trace forensic evidence of misconduct since all agencies responsible for investigating these accounts remain heavily political. It can also be argued if the need for an alliance was necessary given the amount of control over government and policy that the sugar industry enjoys till now. It certainly was not threatened by law and regulations, nor was there any specific checks on production quantities or prices, and it was already getting its fair share of billions of rupees in subsidies. One reason why perhaps the alliance came into existence was to control the retail end of the market, which brings forth another critical dependency.

Once the sugar mills have controlled for every source of dependency there is, from the raw material to the supply chain and regulations, the final dependency to be handled is the issue of pricing and profits. Even with the assurance of being granted millions from the government, there is the need to dominate local markets to control and profit from illicit activities. One example of this is the need to profit from speculation activities, which invariably involves manipulating prices and quantity supplied (Khan et al., 2010). These activities are a sort of forward contracts on the prices of sugar where speculation on future high prices of sugar involves the mills and contract buyers into an agreement where the buyer is allowed to take possession of

the sugar at a later date and is also allowed to make payments at the later date (Ahsan et al., 2011). This activity invites speculation and manipulation into the mix since the millers stand to profit hugely if prices are increased at the date of the expiry of the contract. Although futures contracts are not explicitly illegal, what makes these activities suspicious is that the contracts are not arranged on proper commodity exchange markets where proper rules govern such contracts, such as the Cotton Exchange, but rather are arranged informally, thus making them highly susceptible to deliberate profiteering attempts. Such activities can only be accomplished through the presence of a powerful cartel, specifically in the contracts involving the mills.

However, from a theoretical and conceptual perspective, it can also be argued that organizations and the politics concerning them are deeply intertwined. The politics governing the practices of an organization are essentially part of the environment the organization operates in (Henisz et al., 2003). It is therefore fairly plausible to expect that government regulations would, directly or indirectly, create situations of conflicts of interest for both of the agents concerned. Such conflicts of interest then invite concessions to be made, whether openly or covertly. Indeed, lobbies and influential groups exist for every major and important organization in the world, and the influence of lobbies is deep and impactful (Buschman, 2017). What can be said of the rules of conduct regarding lobbies or alliances remains dubious and uncertain, given the critical aspects of dependency involved from all of the concerned groups. From a puritan perspective, such activities are discouraged and all sorts of regulations are devised to keep the system in check. For developing countries like Pakistan, where the systems are already weak, it is perhaps logical to expect a powerful political coalition to exist. From a macro perspective, the concept of ecological selection entitles an organization to fight to survive, and a political alliance is one genome of its complex multicellular organism (Ries, 2017). Similarly, some industries become very important in terms of revenue generation and the livelihoods which depend on it and in terms of its output. The same can be said for every large-scale industry in Pakistan, including the cotton, flour, livestock, cement, fertilizer, and automobile industries (Hashmi et al., 2018). Conclusively, it can be said that these industries and the government are heavily dependent on one another and are subject to the criticality of their needs, where rules and regulations evolve in terms of immediate and urgent concerns, and so are subject to the environment they operate in (Lowrey, 2017). Regarding and reviewing these arrangements in terms of the developed world's notion of proper systems and legal terms and conditions is unfair and strictly subject to context.

The inelastic demand and high consumption of sugar provide another reason for the manipulation of prices; over

the years the incidence of artificial increases in prices has been incorporated into the overall price structure. Despite this, the prices do remain tightly monitored because sugar is deemed an essential commodity (Iqbal et al., 2014). Apart from artificially inflating prices at various points in time, dominance in local markets is ensured through political influence. The government has imposed high tariffs on the import of sugar, meant to protect the local industry and to ensure that the consumers buy domestically produced sugar. However, this also means that consumers pay more for locally produced sugar than imported sugar since international sugar prices have subsequently declined over time (Connor, 2014). Through this regulation, the mills are secured from both ends: their profits are not threatened by lower-priced imports, and they are awarded subsidies for exports, seemingly at will. Through these strategic actions, the mills have secured both the prices and the profits, and continue to avoid regulations meant to curtail this behavior.

6. Lessons for policy

The strategic actions of the sugar industry have worked well in the favor of the sugar mills because of the improper regulations governing its conduct. This deficit has allowed the mills to dominate and manipulate the domestic markets, evade tax, and extort government to provide billions of rupees in subsidies. The findings of the 2020 Inquiry Commission declared these actions illegal and prompted the federal government to launch a long-term strategy to overcome market manipulations without waiting for Supreme Court approval (S. I. Raza, 2020). Thus, the government introduced the Sugar Reform Committee in 2020 which was tasked chiefly with documenting and regulating the sugar supply chain and to suggest improved sugar policy. According to the committee, the foremost reform needed is to remove the influence of the government from the value supply chain so that the sugar market can become more competitive and can be freed from price controls.

The sugar price controls, as much as these are designed to support sugarcane growers are contra-indicative of their purpose. In order to ascertain the correct market prices, the government needs to have proper forensic records for the cost of production, the ex-mill price, and the quantities of sugar produced by each mill. Currently, the government has designed several committees within federal investigative agencies, all of which are tasked with identifying the extent of the fraudulent practices. The agencies tasked with this objective include the National Accountability Bureau (NAB), the Federal Board of Revenue (FBR), the Competition Commission of Pakistan, the State Bank of Pakistan, the Federal Investigative Agency (FIA), and the

Securities and Exchange Commission of Pakistan (SECP). Based on these forensic proofs, the government will decide on the removal of price controls, removal of restrictions for the establishment of new sugar mills, revisions in the policy for crop movement, and removing the trade protectionist measures for sugar import and export (Paracha, 2020). The price controls for sugarcane allow mills to resort to unfair measures to procure sugarcane at lower prices, thus leading to sale and purchase on black markets, which harms farmer interests rather than protecting them. In addition, the heavy protectionist measures for the sugar export and import allow further distortions in the markets and lead towards misguided outcomes, and the restrictions on imports are ultimately harmful to consumer interests.

Additionally, the government, competition regulation, and intelligence authorities have increased efforts to identify, and track proper records of sugar production and supply; this has included raids on the residence of sugar dealers and sugar storage facilities. The Federal Investigative Agency also revealed in March 2021 that the total amount of tax evaded by the mills association amounted to a staggering Rs 404 billion for the years 2015-2019 (Ansari, 2021). These efforts indicate that despite the existence of a competition authority, its impact is minimal in terms of curbing anti-competitive conduct. To overcome this, the government must devise unique control in exchange of the national antitrust and competition policy. The policy remains ineffective largely because of the semi-judicial nature of the Competition authority. It should have complete legal authority on its orders, or all orders should be investigated and presented in separate antitrust courts (as subsidiaries of the Supreme Court), as in the practice around the world. These courts would function outside the sphere of political influence making them more effective and would lessen the influence of the cartel. In the case of antitrust policy, the role of the Supreme Court cannot be underestimated; when the political process fails, it is up to the Courts to determine the shifts in regulations and policies.

7. Conclusion

This paper traces the influence of the illicit sugar mill alliance within Pakistan through the lens of the resource dependence theory. The strategic methods used by this alliance for control over basic resources extend from the supply chain network to dominance over the retail markets. Thus, using the strategic and resource-based point of view, this paper argues that the use of these methods allows the mills to exert unique bargaining power over the sugar market, and several regulatory failures allow this alliance to continue to exert dominance despite civil and government opinion that this behavior should be penalized. Future

studies can examine these activities in various other sectors and industries (within developing and developed countries) from a strategic and game-theoretic point of view which can yield further interesting insights into the functioning of business behavior which intends to gain a complete advantage over all of its inter-dependencies.

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