

## **Impact of Increased Cost of Production in Leather Industry**

**(A case study of leading leather industries in Pakistan)**

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### **Abstract**

In this research paper, the impact of increased cost of production on leather industry is highlighted which has resulted in decline of sales. This study report makes an effort to track the interactions of the most significant factors affecting leather goods sales in Pakistan. This industry has been struggling for many years and is unable to increase its sales. We pay attention to every factor contributing to the drop in leather sales and work to identify its underlying causes. We used primary data sources for this study. As the sampling frame, the questionnaire data from Karachi is used. We have utilized stratified random sampling to determine the effect of increasing manufacturing costs on leather sector sales. And there is a strong correlation between these variables, according to the connection. Our research's conclusion and recommendations are to raise raw material prices and availability in order to increase leather sales. Livestock smuggling needs to cease. Promotion of leather products is required everywhere in the world. In comparison to rival nations like China and India, Pakistan's production costs are extremely high. It has been extremely challenging for the leather industry to compete due to the high cost of numerous inputs including raw materials. If the leather industry increases its sales, it will be advantageous for our nation, and the goal of this research article is to bring innovations in the field of leather industry.

**Keywords: Cost of production, smuggling of livestock, Leather exports, decline of leather sales**

### INTRODUCTION

Due to the Leather sector significant export profits, potential for job growth, and good conditions for long-term expansion, it has played a significant role in the development of our economy. The potential to boost domestic production and exports is significant. A significant portion of the Indian economy is devoted to the leather industry. The leather business currently contributes about \$874 million annually, but there is room for growth.

The leather products sector can be broadly divided into five categories: finished leather, leather gloves, leather footwear, and leather apparel (bags, wallets, and so on). The top three countries that export leather apparel are Italy, India, and Pakistan, with exports of leather clothing reaching \$422.1 million, \$320.6 million, and \$237.5 million, respectively, in 2020. The global production of these goods has, however, been steadily declining over time, with an estimated \$2.3 billion in exports in 2020.

There are 800 tanneries that produce high-quality finished leather from cow, sheep, buffalo, and goat skins in the country. The leather business is divided into several subsectors, including tanning, leather, footwear, clothing, leather gloves, leather shoe uppers, etc. Clothing made of leather, gloves, tanned leather, and footwear are all produced in Pakistan. According to the history of Pakistan's leather industry, there were not many tanneries operating at the time of independence in major cities like Karachi, Lahore, and New Delhi, among others.

The high cost of manufacturing of key inputs, such as utilities and taxes, is a barrier for the leather sector. And as a result, Pakistan's products were unable to compete with those of its foreign rivals. Sales of leather have a poor correlation to production costs. The government is being urged by the

leather sector to outlaw livestock smuggling in order to lower the cost of raw materials. Lack of raw materials in Pakistan causes a fall in leather exports, and there is a direct correlation between the two.

## RESEARCH METHODOLOGY

The majority of the information is gathered through research of conference documents, online resources, research papers, and other publications. Annual reports from various leather industries on the Pakistan Stock Exchange were used. The information was gathered from three sources: the World Wide Web, published documents and reports, and statistical agencies.

This study's primary goal is to examine the effects of rising production costs in the leather industry as a result of rising raw material prices. Pakistan's leather sector is now struggling with high production costs in comparison to its rivals. Consequently, the following is the suggested research project topic:

Leather sales have decreased as a result of rising production costs.

The leather industry of Pakistan is currently facing the issue of high cost of production compared to its competitors. Therefore, the proposed topic for this research project is therefore:

Increased cost of production has resulted in decline of sales due to various reasons as they adds up the problems of the leather sector in Pakistan.

Data Collection:

To support this hypothesis data is collected through both primary and secondary sources. The primary sources were employees and Pakistan Tanners Association. For secondary sources research articles, reports, and other publications were used. To procure more knowledge and to

share detail analysis for this study we also reviewed annual reports of leather industries which is further defining the relationship between advertising and cost of production with raw-materials.

#### Sampling & Research Instrument:

To study the impact of increased production cost and raw material's price on sales which are the independent and dependent variables in this research, I will be evaluating them through a sampling process and for that purpose specific instruments will be chosen according to each source. In this study, sampling will help to obtain reliable findings so I can analyze my variables. The utilization of primary research incorporates immediate information for determining the market's viability and further exemplifies the relationship between the variables-based aspects influencing the overall organizational function.

#### Statement of Hypothesis:

Despite the quantity of cattle, the supply of raw materials is significantly hampered by the export of live animals in illegal quantities. The Pakistan Tanners Association claims that the government's live animal export limit will destroy the leather industry since so many live animals will be sent to Iran and Afghanistan, causing a shortage of raw materials. Furthermore, skin and hides, crucial raw materials for the leather industry, have been seriously impacted by the acute energy crisis. Because skin is perishable, it cannot be stored without first being treated, which requires a continuous power supply, load shedding not only seriously harms the leather manufacturing process but also has a severe impact on leather quality. As a result, the following is the research's suggested hypothesis:

Increase in cost of production is mainly due to increase in prices of raw materials.

### Review of Literature

While researching Pakistan's leather industry, we discovered that this industry has been struggling for a while. The second-largest sector for export earnings, this sector requires attention to address its issues. As we consider the entire situation. We believe that the cost of producing leather goods is really high.

A review of the available studies on leather exports in Pakistan revealed that there is a scarcity of literature depicting the impact of major factors influencing leather exports in Pakistan. However, some relevant literature from other countries is also discussed. Reviewing studies on the export of agricultural products in general and leather in particular, the effect of key factors influencing leather exports in Pakistan may be identified despite the limited and scarce availability of literature. However, there is some pertinent literature accessible regarding nations that export leather. Due to price competition, there is an ongoing shift in the production of leather, footwear, and leather goods from industrialized to developing countries, which benefits these latter nations.

(Sharif and Mainuddin, 2003) says that as such developing countries are trying to increase their capacity in the production and export of leather goods. Jordaan and Eita (2007) examined the determinants of South African exports of raw hides/skins (other than fur skins) and leathers in addition to identifying success criteria. They discovered that the key factors affecting leather exports were the GDP, population, infrastructure, and regional trade agreements of the importing countries.

In a similar vein, Asgedom (2008) discovered that in the long run, the world market unit price/value of exports and the local real exchange rate had an impact on Ethiopian leather exports, while in the short run, domestic consumption pressure and global supplies from major exporters

played a significant role in determining leather exports. The growing leather industry is not immune to global trends; Bekele and Ayele (2008) concluded that in this setting, globalization had made competitiveness and value chain difficulties more essential than individual efficiencies. According to Roy (2012), the Indian leather industry had difficulties keeping up with rising environmental requirements, but as a result of government initiatives, things have changed for the better. Priya and Anthuvan (2012) in the Indian leather sector came to similar conclusions.

Pakistan is not an exception to the evolving global trends, and as a result, the country's leather industry has prospered in response to large profits from the global market (Siddiqui, 2001). Despite having great prospects for growth, the leather industry in the nation faces numerous difficulties. According to Bashar (2003), Pakistan's leather sector has an issue in that it exports high-quality leather rather than high-value leather goods. Most leather used in Pakistan's leather clothing is of low grade and quality.

Due to Pakistan's relatively high cost of production, these clothes are up against fierce competition from Chinese and Indian leather goods. Massood (2009) proposed a number of initiatives for the restoration of the leather sector in Pakistan, including the creation of contemporary production facilities, the supply of sustainable raw materials, and the promotion of leather exports on the global market. In reality, it can be said with confidence that Pakistan's leather sector is a significant exporter. Although it has prospered throughout time, it continues to face numerous difficulties, such as a lack of and poor quality raw materials, ineffective marketing tactics, unstable global prices, etc. Nearly no study that scientifically examines the leather industry as a case study is available, and the majority of research analyzing the performance of the leather industry in Pakistan is qualitative in character. Additionally, there is no literature that examines opportunities and trends in marketing in this regard.

### Role of increased raw-materials price on production cost

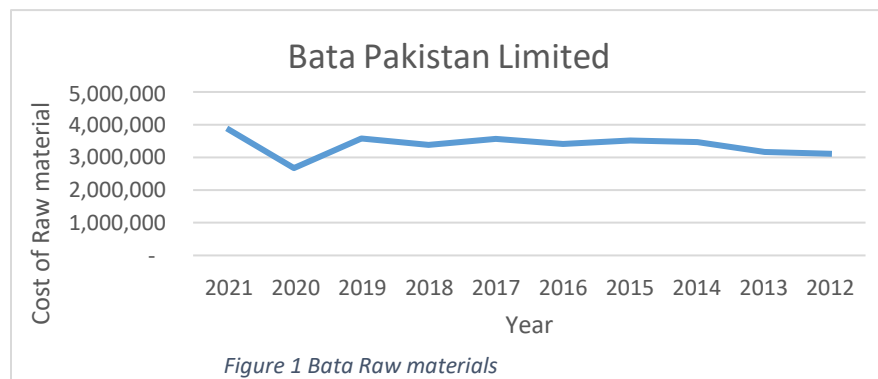
According to the hypothesis stated in response to the problem statement, cost of production is a variable that depends on a variety of different circumstances and in this case, raw material is independent upon increase in prices which has resulted in increase in cost of production. This raises the price of skin and other raw materials, resulting in high production costs and, as a result, the contraction of this sector. High cost of production is making Pakistani exporters uncompetitive in the international market and this is one of the major reason behind the decline of sales in leather industry.

### Results and Discussion

Now we'll have a look at the relationship between the two variables i.e. cost of production and raw- materials. Cost of production is the dependent variable whereas raw-material is the independent one Both these variables have a direct effect on each other, if price of raw-materials increases then automatically production cost increases because it is dependent on the availability and price of raw-materials.

#### Bata Pakistan Limited

To check how our two variables are linked to Bata Pakistan let's look into the line charts of both production cost and raw-materials. Furthermore, it shows the correlation between production cost and raw-materials.



The graph indicates that the cost of raw-materials is constantly on the rise except for 2020 where it can be seen the cost dropped and then again there is an increase in the price of raw materials.

The graph here shows that the because of increased raw-materials price, the cost of production is also on the rise. However, it got decreased in 2020 when there was a

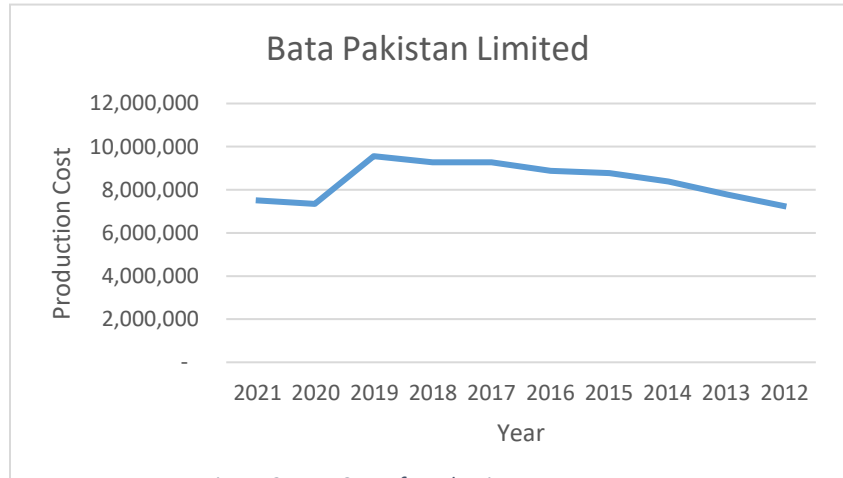


Figure 2 Bata Cost of production

decrease in prices of raw-materials, proving

that these two variables are directly proportional to each other and indicates that increased cost of production is mainly due to increased prices of raw-materials.

Service Industries Limited:

The graph here indicates that cost of raw materials in constantly increasing except for 2020 where we can see a slight change of decline.

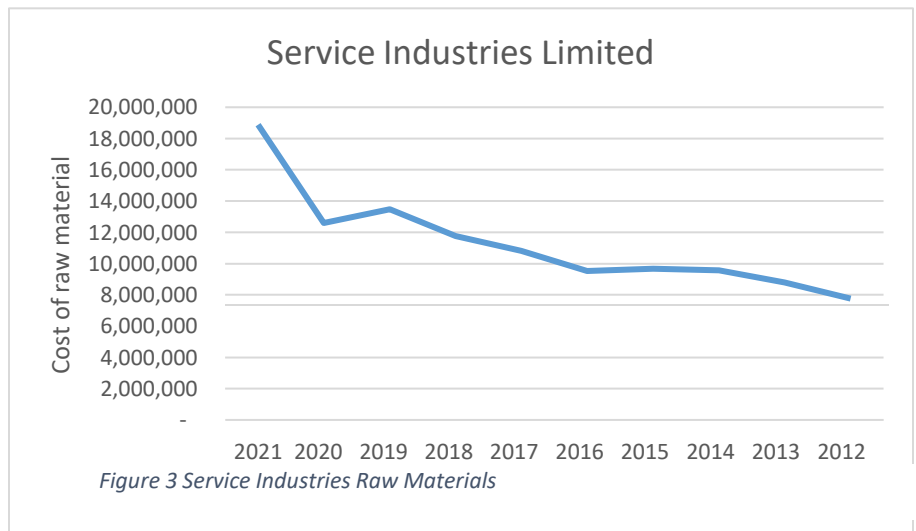


Figure 3 Service Industries Raw Materials



Just like that of Bata Industries, here also the graph shows that because of increased raw-materials price, the cost of production is also on the rise except for year 2020.

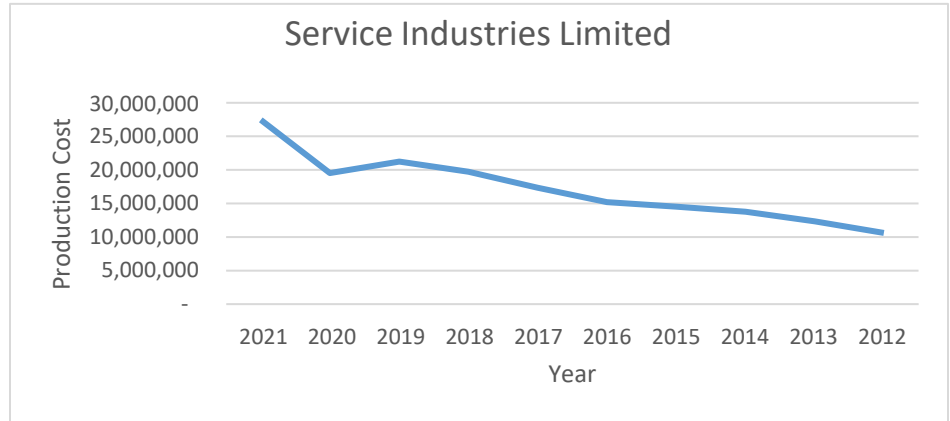


Figure 4 Service Industries Production cost

### Opinion of Employees

As we have collected the primary data from the employees of leather industries, the instrument for the survey was the questionnaire which was made on Google forms and was shared to different employees working in full-fledged leather industries. The questionnaire presented to the employees was based using Likert scaling technique. The data was gathered from the 50 respondents. For the respondents the data is as follows:

Table 1 Descriptive Analysis

	N	MINIMUM	MAXIMUM	MEAN	STD. DEVIATION
The price of leather goods have significantly increased	50	1.00	5.00	3.3200	1.30055
Increased production cost is mainly due to increased raw materials price	50	1.00	5.00	3.04	1.61574
Customer's purchasing power is reduced	50	1.00	5.00	2.82	1.17265
Digital Marketing practices should be extensively used to boost sales	50	1.00	5.00	2.900	1.60675
Decline of sales is due to increased production price	50	1.00	5.00	3.100	1.48805
Increased prices in leather is due to increased production cost	50	1.00	5.00	2.76	1.47855
Due to declining sales, Pakistan will lose a potential source of income	50	1.00	5.00	3.34	1.31878
Leather exports have declined immensely	50	1.00	5.00	3.14	1.26184
Leather sector needs immediate attention due to significant low sales	50	1.00	5.00	2.900	1.41782
Usage of vegetable tanned leather should be common in Pakistan	50	1.00	5.00	3.0200	1.51846
High taxes are being charged on leather goods	50	1.00	5.00	3.0200	1.46371
Leather customers complain a lot about increased prices	50	1.00	5.00	3.0200	1.34756
Due to high prices, the purchase of leather goods is only done by elite class	50	1.00	5.00	3.3600	1.41075
Reduced import restrictions would boost leather exports	50	1.00	5.00	3.1400	1.51199
International for manufacturing leather goods should be followed	50	1.00	5.00	3.0400	1.41364

## **Descriptive Analysis**

The data collected through questionnaires is analyzed using MS Excel and SPSS. Furthermore, the analytical used to inference the findings is mean. Majority of responses agreed that the prices of leather goods have significantly increased over the past few years. More than half of responses agreed that prices have significantly gotten very high and had a mixed opinion about the purchasing power of customers. The employees had a positive response with the usage of vegetable tanned leather that this concept should be common in Pakistan. Due to increased prices, customers complain a lot and the result indicates that half of them agreed to it.

Increased cost of production is the dependent variable here while raw-material's price is the independent variable. Descriptive statistics of variables representing the increased cost of production on sales of leather is mentioned in table 2. The result also shows that 26% of the respondents strongly agree that increased cost of production is mainly due to increased raw materials price giving a mean value of 3.04 and standard deviation of 1.615. Due to such reasons, leather exports have declined significantly.

The study's findings, based on the responses of employees confirm the hypothesis that increased cost of production and prices of raw materials have resulted in decline of sales in leather industry. The results demonstrate a positive correlation between raw material price and cost of production. The clustering of the data around the mean provides significant support for the hypothesis and demonstrates the data's reliability. To add further frequency distribution table will summarize all data, which aids in identifying the frequency of responses and how they appear whether more or less frequently.

Table 2: Frequency Distribution

**Increased production cost is mainly due to increased raw materials price**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	15	30.0	30.0	30.0
Disagree	5	10.0	10.0	40.0
Neutral	6	12.0	12.0	52.0
Agree	11	22.0	22.0	74.0
Strongly Agree	13	26.0	26.0	100.0
Total	50	100.0	100.0	

*Table 2 Increased cost of production is due to increased raw materials price*

**Decline of sales is due to increased production price**

	Frequency	Percent	Valid Percent	Cumulative Percent
Strongly Disagree	9	18.0	18.0	18.0
Disagree	12	24.0	24.0	42.0
Neutral	7	14.0	14.0	56.0
Agree	9	18.0	18.0	74.0
Strongly Agree	13	26.0	26.0	100.0
Total	50	100.0	100.0	

*Table 2 Decline of sales in due to increased production price*

### Opinion of CEO

The major focus of this interview is to investigate the impact of increased production cost has resulted in decline of sales in leather industry. For this purpose, an interview was conducted with the CEO. When questioned if Pakistan's leather sector is currently suffering the problem of high manufacturing costs, he stated that Pakistan's leather business has been failing for some years, but the last two years have been particularly alarming. In these two years, the industry's output declined sharply, resulting in a 9.1% and 26.4% contraction in growth.

When asked why the cost of manufacturing in Pakistan's leather industry is on the rise, he stated that the principal causes are the absence of rapid collection of fresh hides and skins using contemporary preservation techniques and the lack of qualified staff for primary storage. He went on to say that animal smuggling is one of the most significant contributors to the increase in production costs.

To confirm the idea, he was questioned if he agrees that increased production costs are primarily related to the rising cost of raw materials. He responded that this could be one of the causes of rising production costs. But, we cannot ignore other issues such as the rise in chemical and utility prices.

In response to a request for suggestions, he said that raw skin and hide preservation should be promoted through media outlets, seminars, and other such activities. For this reason, continuous research and development should be conducted to keep up with improving techniques.

#### Recommendation

Improving the supply of raw materials is crucial for the leather industry to reverse its dropping sales. Since cattle is the primary source of raw materials for the leather industry, livestock smuggling must be stopped. Through media outlets, seminars, and other similar initiatives, awareness should be raised on the preservation of raw skin and hide. Most essentially, it is important to guarantee that these industries have a constant supply of gas and power.

Products that are exported should have higher quality standards and should be designed with customers' needs in mind. Water and electricity should always be available, and the cost should be reasonable for the sector. The globe needs to promote leather products. The government should reduce the tax rate on the leather industry and work to fix the current tax structure.

### Conclusion

In this research paper, we've covered the key effects of rising production costs on the demand for leather items. The results show that the majority of respondents felt that rising production costs are primarily caused by an increase in raw material prices after taking into account all of the variables. The vast majority of responders also concurred that rising production costs are to blame for the fall in sales. Despite the quantity of cattle, the supply of raw materials is significantly hampered by the export of live animals in illegal quantities. The Pakistan Tanners Association claims that the government's live animal export limit will destroy the leather industry since so many live animals will be sent to Iran and Afghanistan, causing a shortage of raw materials. Furthermore, skin and hides, crucial raw materials for the leather industry, have been seriously impacted by the acute energy crisis. Therefore, this time around rather than providing the leather industry with a broad incentive package, the government must strengthen its resolve to closely monitor the sector's performance and to withhold the incentives if they do not provide results

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### Appendix A: Questionnaire for Leather Industry Employees

S.No	Characteristics	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	The price of leather goods have significantly increased					
2	Increased production cost is mainly due to increased raw materials price					
3	Customer's purchasing power is reduced					
4	Digital marketing practices should be extensively used to boost sales					
5	Decline of sales in leather industry is due to increased production price					
6	Due to declining sales, Pakistan will lose a potential source of income					
7	Increased prices in leather is due to smuggling of livestock					

8	Usage of vegetable tanned leather should be common in Pakistan					
9	Leather exports have declined immensely					
10	Leather sectors needs immediate attention due to significant low sales					
11	High taxes are being charged on leather goods over the past few years					
12	Leather customers complain a lot about increased prices					
13	Due to high prices, the purchase of leather goods is only done by elite class					
14	Reduced import restrictions would boost leather exports					
15	International standards for manufacturing leather goods should be followed					

### Appendix B: Interview Questions

**Question 1:** The leather industry of Pakistan is currently facing the issue of high cost of production, what's your opinion on this?

**Question 2:** Why do you think cost of production in leather industry is on the rise in Pakistan?

**Question 3:** Do you agree that increased cost of production is mainly due to increased raw materials price?

**Question 4:** Do you believe that due to declining sales in leather industry, Pakistan will lose its potential share in the market?

**Question 5:** Please share your suggestions as to what should be done to solve the issues of high cost of production in Leather industry in Pakistan?