Impact of Production Cost and Product Value on the Exports of Pakistan Leather Footwear Industry

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Abstract

Pakistan leather footwear sector possesses the share of 10.03% of overall exports of leather industry. The overall leather industry has been contributing 5% to the GDP of country annually. The potential and chances of growth in the industry have been investigated in this research and the impact of production cost and product value on the export of Pakistan leather footwear sector has been analyzed. Production cost and product value have been considered as two independent variables. Three factors of production cost i.e. raw material purchases from local market, raw material purchases from international market and utility expenses and two factors of product value i.e. product quality and prices offered in international market have been focused due to time constraint. Deductive research approach and survey strategy has been used for the execution. Questionnaire and interview were used as a research instruments. Sample respondents were the members of Pakistan Tanners Association and Pakistan Footwear Manufacturers Association. The data has been analyzed by measuring certain averages and frequency distributions. The results draw out the conclusion that the production cost and product value both have a very strong impact on export of Pakistan leather footwear. Certain recommendations have also been given on the basis of the findings of this research.

Key Words: *Production Cost, Product Value, Leather Exports, Footwear Sector*

Introduction

After a brief overview of the study in this section, the reader will find an overview of the leather industry. This part is about all the highs and lows of leather industry of Pakistan and its subsectors. The reader will also learn about the challenges that have been faced by the industry during the last decade in detail such as existence of highly competitive regional players and policies of government regarding export of leather and its subsectors. Moreover, the changing international and local market dynamics have also been elaborated in detail along with some important and updated facts and figures. It is impossible to understand the international market scenario for leather industry without considering the Cost of production and Product Value. These two has been identified as crucial element of this research and considered as independent variables of the study.

To draw timely conclusion in precise manner, only certain factors of cost of production and product value are included to analyze and for deeper understanding of these factors, it is essential to read the literature review section where conceptual framework and some prominent discussions will elaborate them in detail. The article further includes problem statement based on the literature reviewed which later transformed into hypotheses under the section of methodology. This part also defines the size of the population and sample along with the detailed discussion on chosen sampling technique. The extracted data has been analyzed, on the basis of which results, conclusions and recommendations can be found at in the sections included afterwards.

Literature Review

According to Rana (2018), the trade deficits have reached to the peaks for the country and made the highest mark in the history of Pakistan. This has recorded a huge debt on public i.e. the addition of PKR 1.190 trillion. The increase in export deficits has remained consistent for the last five years. On the other side, the overall export revenues of the country increased; possibly due to the cause

of devaluation of the currency. The exports increased by $2.8 billion as compared to last year i.e. 13.7% increase; however, imports substantially increased by 15.1% comparative to the last year i.e. $8 billion. The export of leather sector of Pakistan has been affected for several years. According to The Express Tribune (2016), the competition in the international market has grown like never before. The leather export of neighboring countries have grown with great margin. However, the export of leather products; that are high in quality, is declining consistently in Pakistan. The massive growth of leather industry in the countries like China and India is highly dependent on the policies of their governments.

The local manufacturers in the industry are not satisfied with profitability on the industry as well. They believe that the production cost of leather products is high in Pakistan. Therefore, the trend is shifting buyers from made in Pakistan products to the relatively cheaper imported product (Yasin, 2019). The quality of the leather products produced by Pakistan is also not supreme so that they could attain the value of export from the market. Moreover, the structure of tariffs on exports and imports is not likely to support to economic benefits of the country either (BR Research, 2019). The higher import tariffs are also affecting the cost of production and exports of Pakistan. Cost of raw material that most of the leather manufacturers import to produce the efficient and quality leather products does not favor productivity due to high tariffs on import. This eventually results into lower rate of exports or quality sacrificed products otherwise (DAWN, 2018). The overall export of the industry increased in terms of volume considering some major leather products such as gloves, garments and footwear. On the other hand, the prices for the products declined for the product or the exporters were compelled to export on lower rates due to insufficient demand for Pakistan leather products in the market. Shortage of raw hides which is fulfilled by the imports increase the cost of production. This creates problems for the industrialists to compete in the

international market where the government policies are more facilitating (BR Research, 2018). Pakistan has been dealing in five major sub-sectors in terms of exports. This include, leather footwear, leather gloves, leather apparel and clothing, finished or tanned leather and other leather products. The shares of respective leather subsectors in terms of exports are mentioned in **Figure – 1** for the year 2017-18. Finished or tanned leather has the biggest share of 34.82% in total exports of leather. The shares of leather gloves and leather apparel
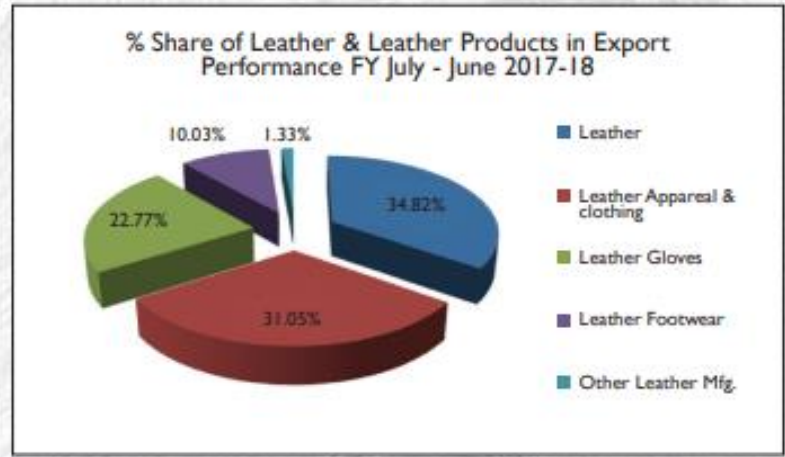

Figure 1 – Share of leather and leather products in Exports
Source: Pakistan Tanners Association (2018)

are 22.77% and 31.05% respectively. Leather footwear sector possessed a share of 10.03%. Other leather products captures the share of 1.33% (Pakistan Tanners Association, 2018).

According to Ghafoor, Aslam & Rasool (2012), leather industry of Pakistan has been considered as the most contributing industrial sector after textile. It has been contributing 5% to GDP in terms of manufacturing and 7% in terms of fetching foreign exchange from exports. The sector has been proving its importance by providing employment to 200,000 people. 90% of the goods manufactured in the sub-sectors mentioned above are exported. The sector has been established with a notable progress over the last fifty years and showed the growth of 11% approximately every year on an average. The count of tanneries and footwear manufacturing units is 2500 across different cities.

Leather industry heavily relies on livestock as the leather is manufactured after processing the hides and skins of the animals through different steps. Hence, the population of the animals is

crucial for the manufacturing of leather and leather products. The livestock sector had been affected by the floods and eventually showed the decrease in growth rate in the past, like the growth rate reduced from 4.3% to 3.7% in the year 2011. The growth of the sector is vulnerable to weather conditions too; however, animals were immune to it. However, raw hides and skins are available in a large quantity within the country. The types of raw material commonly used in the industry include; hides of buffaloes and cows and skins of goat and sheep. Moreover, the low cost labor availability also supports here as the industry is labor intensive in nature (Ghafoor & Zafar, 2014).

According to Hashmi, Dastageer, Sajid, Ali & Faheem (2017), the country has made the mark as 21st position holder among all the leather producing countries. Pakistan had been considered as the number one leather gloves producing country in international market. Footwear sector earned the sum of $131.2 million according federal bureau of statistics. As per Pakistan Tanners Association (2018), leather industry managed to earn 948 million US dollars during 2017 and 2018 from its exports. Furthermore, the growth in exports were 3.2% this year. The hefty amount of raw material for the industry is available within the country.

The industry heavily relies on the supply of raw material i.e. the hides and skin obtained from livestock. The population of livestock has been increasing on the basis of regular intervals. However, livestock industry of Pakistan has been facing challenges such as drought, animal diseases, heatwave and pollution (Ministry of National Food Security & Research, 2018).

The world has been transforming into one community since the globalization started. It has been facilitating trade to a great extent by reducing restrictions and making the transit for moving goods smoother (Syed, Shaikh, Mehmood, Afridi & Shaikh, 2011). It has been observed that major leather manufacturing has been shifting to developing countries from developed countries due to the cost effectiveness that developed countries have found by importing finished leather products

from developing countries. Countries such as India and China have been actively competing in the international market with the advancement in manufacturing processes and means of unconventional marketing of their leather products. As far as leather industry of Pakistan is concerned, it has a great importance for the economic growth of the country as it has all capabilities to bring foreign exchange within the country (Rafiq, 2016). The dynamics of international trade is favoring the developing countries all over the world and they all are enjoying comparative advantages over each other. The potential in the country like Pakistan is higher. However, some external factors are creating resistance in growth of the country such as political and economic factors (Shahab & Mahmood, 2012). However, in a competitive environment like never before, close monitoring of market trends and performances of the organizations have become essential. Moreover, it has become important for countries to support the industry by providing subsidies and transforming general attitudes. Leather industry has been influenced consistently due to the changes in social, technological, political, cultural and legal factors. All these factors are needed to be taken care of by leather companies to compete in the market. Moreover, the appropriate use of conventional and unconventional marketing and promotional tools in the age of electronic and digital media has become more complex for leather industry. Therefore, adopting the advancement from IT industry is crucial for the organization to survive and progress in highly competitive leather industry. Research and Development can help in a great manner for the adoption of certain advancement. However, survival in industry in the absence of promotion is not possible (Yamamoto, Şekeroğlu & Bayramoğlu, 2011). Leather has been considered as a commodity that is traded the most across the globe. The increasing cost of production in China opened the gates of growth for other countries to grow in leather industry. Major shares of the industry have been

occupied by Italy, France, Hong Kong and China. Major consumers of leather include France and the USA (Bhatti, Sheikh, Asgher, Mansha & Zafar, 2016).

The leather industry has been declining and is under performing to its capacity. The issues such as smuggling of animals, production of inconsistent quality leather and high production costs are needed to be resolved on immediate basis. Pakistan has a very small share in international market in comparison to other neighboring countries and with greater comparative advantage the right and timely initiatives can reverse the direction of this sector towards growth (Bhatti, Sheikh, Asgher, Mansha & Zafar, 2016). According to Yamamoto, Şekeroğlu & Bayramoğlu, (2011), most of the leather production across the world occurs in SMEs. Furthermore, leather industries of developed countries are the leaders in global market and emphasize on branding. However, leather industries of developing countries progressing with a high pace and emphasize on cost effectiveness of production. Potential in sales, ranks China first which is followed by Italy, India, Turkey and Argentine. Moreover, different countries are specialized in different sub-sectors of leather. Germany produce high quality leather chemicals for instance and Brazil, Portugal and UK have the competitive edge in footwear. Italy and Turkey are specialized in leather apparel. Changing dynamics of market demands the innovative and unconventional marketing strategies and advancement in IT can play an important part to promote industry as a brand in international arena. On the basis of the literature reviewed, certain variables have been identified that have been elaborated earlier. On the basis of those identified independent and dependent variables, the conceptual framework of the study has been formulated (See **Figure 2**). The conceptual framework provides better understanding regarding analytical part of the research in a comprehensive manner. Two main independent variables are bound by rectangles in figure 2 which are cost of production and product value. The arrows shows that the impact of these two variables is said to be tested on

dependent variable which is bound by bigger rectangular box i.e. export of Pakistan leather footwear sector. Furthermore, the factors of variables have been connected by simple lines and are

bound by ovals. For example, the factors of cost of production can be observed in ovals as raw material from local market, raw material from international
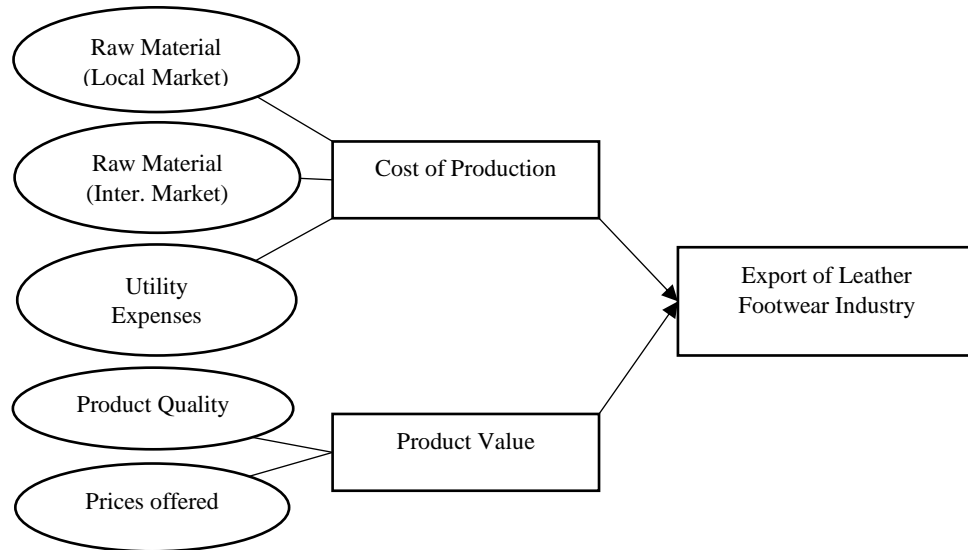

Figure 2 - Conceptual Framework

market and utility expenses. Factors of product value can be observed in ovals as quality and prices offered in international markets by the manufacturers of Pakistan leather footwear sector.

Methodology

Research philosophy used for the thesis is positivism. The research approach considered is deductive. Certain research philosophy and approach is used as the study was based on the assumptions by the researcher that has been observed and obtained from the literature reviewed and industry analysis. Considering survey as a research strategy, certain survey group was identified as respondents. A group of organizations were found appropriate to collect the desired data as these organizations have been dealing with leather and leather footwear industry. Hence, the population selected to collect primary data were the organizations that were part of the associations, namely, Pakistan Tanners Association and Pakistan Footwear Manufacturers Association. For the quantitative part of the research, two organizations were selected namely,

Bata Pakistan Ltd. and Service Industries Ltd. The quantitative data for the selected organizations the data was extracted from annual reports of respective organizations and was analyzed.

The mentioned respondents are selected due to their close association and knowledge regarding Pakistan leather footwear industry. These organization are tend to be aware of export dynamics and the changing scenario of leather footwear sector over the years and therefore, the data extracted from them is meant to be authentic and reliable. Probability sampling technique has been used for the sample of corporate and associate members of Pakistan tanners association and Pakistan Footwear Manufacturers Association. The technique has been used as the population was known for both the associations. Random sampling technique is used to provide equal chance to be selected for all the cases. Questionnaire has been used as research instrument to collect data from them. 13.5% of the total populations of both the associations have been selected as the sample size i.e. 40 organizations. All the organizations were approached by the researcher through emails and phone calls and get the questionnaires filled all across Pakistan as it was impossible for the researcher to visit the organizations due to both time and financial constraints. Interview as a research instrument has also been used to collect data from the organizations selected for this study. For interview, respondents are selected by non-probability sampling technique on the basis of judgment as it was required for the respondents to have sound knowledge about the current export scenario of Pakistan leather footwear sector. The questionnaire was designed by using google forms considering the factors of the variables mentioned earlier. The response rate were mature enough to go for further analyses. However, the interview was telephonic, the questions were open ended and was conducted from the member of Pakistan Tanners Association. The data has been analyzed by using Microsoft Excel software. Considering certain factors of the variables, the averages and graphical representation of the data has been discussed afterwards.

Problem Statement

> ***"Exports of Pakistan leather footwear industry has been declining and its contribution in GDP of the country is lesser than its potential for the last ten years."***

Hypotheses

H1: The export of Pakistan leather footwear sector has been facing challenges due to production cost during last 10 ten years.

H2: The export of Pakistan leather footwear sector has been facing challenges due to product value during last 10 ten years.

Data Collection

The process of data collection began by identifying the appropriate respondents from whom the data could be collected. It was identified that the organizations that belong to the leather footwear industry and are exporting the like goods can provide most authentic responses. Therefore, it was essential to find out those organizations which can provide timely responses and are reachable. Hence, the member organizations of two prime associations were identified as respondents of the research namely Pakistan Tanners Association (PTA) and Pakistan Footwear Manufacturers Association (PFMA). Before reaching to all the respondents and take their opinions, the pilot study was conducted. Two member organizations from the mentioned associations were randomly selected in order to validate the questionnaire. Later, all the ambiguities from the questions which could result into possible errors were removed and the whole questionnaire was revised.

Limitations

The execution of this research is time bound and therefore it creates certain limitations to it. The research is restricted to one subsector of leather industry i.e. leather footwear. Other subsectors

can be considered in future researches for the industry. Not all the demographic, social and geographic aspects are taken into consideration as it had required a great deal of time to collect data. Leather industry of Pakistan is spread all across the country, however, this study is restricted to certain units of leather manufacturers only. However, there are other large and small organization that can be selected in future researches and can also utilize this gap to conduct researches on similar topics.

Matters of Manufacturing

Export performances of Pakistan leather footwear sector has been analyzed in this section. The performance in terms of both volume and sales from the sector has been evaluated. The data has been extracted from the sources such as the reports of Pakistan Tanners Association and Pakistan Footwear Manufacturer Association. The primary data has been extracted from the members of mentioned institutions. It was observed from the data analyzed that, 7 respondents claimed that the impact of raw material purchases from local market has a very high impact on export sales of industry. 23 respondents claimed that the impact is high on export sales. Only 2 of them believed that the impact is average and 3 believed the impact is low. The value of mean observed was 2.029 and the scale set for analyzing the questionnaire is 1 for Very High, 2 for High, 3 for Average, 4 for Low and 5 for Very Low. The value of mean is lesser than 3 i.e. average. Therefore, it can be interpreted as the impact of raw material purchases from local market on export sales of Pakistan Leather Industry is strong.

Hence, the hypothesis H1; the export of Pakistan leather footwear sector has been facing challenges due to production cost during last 10 ten years, has been accepted in terms of raw material from local market.

Similar analysis conducted for the second factor of cost of production (See **Figure 3**). It shows the frequency of the responses that are collected from different organizations. 20 respondents claimed that the impact of raw material purchases from international market has a very high impact on the export sales of industry. 12 claimed that the impact is high

Production Cost: Raw Material (International)
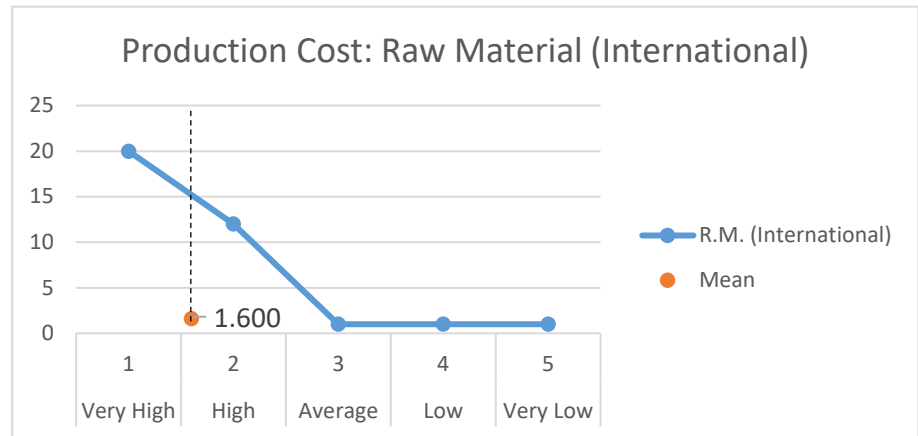
Figure 3 - Raw Material Purchases from International Market

on export sales. Only one of the respondents believed that the impact is average, low and very low for each option. In the above mentioned graph, the dashed line on x-axis and a dot represents the mean of total responses. The value of mean is 1.6. The scale set for analyzing the questionnaire is 1 to 5 in a way that 1 for Very High, 2 for High, 3 for Average, 4 for Low and 5 for Very Low. The value of mean is lesser than 3 i.e. average. Therefore, it can be interpreted as the impact of raw material purchases from international market on export sales of Pakistan Leather Industry is strong. Hence, the hypothesis H1; the export of Pakistan leather footwear sector has been facing challenges due to production cost during last 10 ten years, has been accepted for this factor i.e. raw material from international market.

Similarly, it was observed that 22 respondents claimed that the impact of utility expenses has a very high impact on the export sales of industry. 11 respondents claimed that the impact is high on export sales. Only 1 of them believed that the impact is average on export sales, 1 believed that the impact is low and none claimed that it has a very low impact on exports of Pakistan leather footwear industry. The value of mean is 1.45. Considering the same scale mentioned earlier; the

value of mean is slightly lesser than 3 i.e. average. Therefore, it can be interpreted as the utility expense has a strong impact on export sales of Pakistan leather footwear industry. Hence, the hypothesis H1; there has been a significant impact of production cost on export of Pakistan leather footwear, has been accepted for this factor i.e. utility expenses.

Product Value Magnet

The graph (See **Figure 4**) shows the frequency of the responses that are collected from different organizations and it was observed that 25 respondents claimed that the impact of product quality offered in international market has a very high impact on export of leather footwear industry. 7 respondents claimed that the impact is high on export sales.
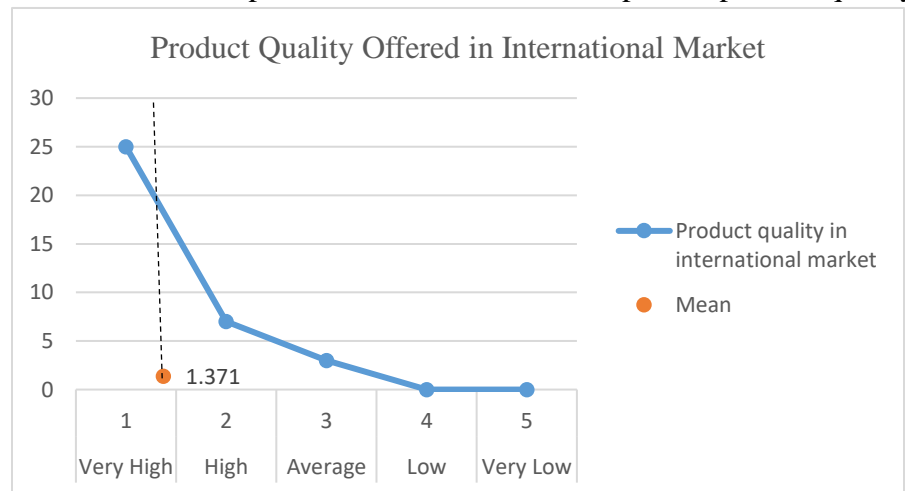

Figure 4 - Product Quality Offered for Exports of Leather Footwear

Only 3 of them believed that the impact is average and no one believed the impact is low or very low. The dashed line on x-axis and a dot represents mean of total responses for raw material purchases from local market. The value of mean is 1.371. The scale set for analyzing the questionnaire is 1 for Very High, 2 for High, 3 for Average, 4 for Low and 5 for Very Low. The value of mean is lesser than 3 i.e. average. Therefore, it can be interpreted as the impact of raw material purchases from local market on export sales of Pakistan Leather Industry is strong. Hence, the hypothesis H2; the export of Pakistan leather footwear sector has been facing challenges due to product value during last 10 ten years, has been accepted in terms of quality offered in international market.

Similarly, it was observed that 27 respondents chose very high, 6 respondents chose high and 2 respondents chose average for the impact on export of Pakistan Leather Footwear Sector. None of the respondents believed that the impact is low or very low. The value of mean is 1.286. Considering the similar scale, the value of mean is lesser than 3 i.e. average. Therefore, it can be interpreted as the impact of raw material purchases from local market on export sales of Pakistan Leather Industry is strong. Hence, the hypothesis H2; the export of Pakistan leather footwear sector has been facing challenges due to product value during last 10 ten years., has been accepted in terms of prices offered in international market.

In response to the interview questions regarding product value, it was learnt that the international market is highly competitive and labor in Pakistan is comparatively more expensive than some other regional countries. For question regarding raw material, it was said that the available raw material is not sufficient for the production and therefore, manufacturers are required to import it. Hence, these factors increase the prices offered in international market and sometimes result into compromising the quality offered.

Conclusion

After testing the respective hypothesis, it was observed that export of Pakistan leather footwear sector is unsatisfactory. For the first hypothesis which is regarding production cost is tested considering three of its factors i.e. raw material purchases from local market, raw material purchases from international market and utility expenses. The first hypothesis of production cost has been accepted for all the three factors and shows a strong impact. Second hypothesis which is regarding product value has been tested for two factors. One of the factor was quality and the other was prices. Both the factors have a very strong impact on the export of Pakistan and therefore the respective hypothesis was accepted.

Moreover, it has been concluded from the study that export sales and volume both are underperforming and generating unsatisfactory revenues from the international market. Furthermore, it has been concluded that the literature on this industry is scarce especially for Pakistan. It has also been observed and concluded that the large part of the sector is based upon SMEs and their performance evaluation are difficult and in most cases impossible to observe. Hence, it is difficult to analyze the potential and performance of the overall sector. It is also concluded, that there is a great opportunity for Pakistan industry to better compete in the market due production shift from developed countries to developing countries. In addition to that, as leather industry is labor intensive and therefore can play a vital role in creating employment in case industrial expansion.

Recommendation

It is recommended to future researchers to conduct future researches on the same industry in order to improve the industry dynamics both locally and internationally. Furthermore, the city specific researches on leather footwear sector would also provide more specific data and would highlight more specific areas of improvement. It recommended to the organizations to invest in livestock farming. As the investment in livestock farming would help leather and leather product manufacturers to extract quality raw material in lower prices as compared to imported raw material in the form of hides. Production of quality products in market competitive prices is the need of the industry to maximize the size of export. And therefore, it is essential for the manufacturers to monitor the process of neighboring countries such India, China and Bangladesh. Moreover, it is recommended to the government of Pakistan to encourage leather and leather product industries in terms of providing incentives and reducing duties. This is because, they are generating a good part of the GDP of the country and has great potential to contribute in the economy.

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