Problems Facing the Hayatabad Industrial Estate and their Implications on Policy Formulation

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Abstract

The provinces of Khyber Pakhtunkhwa Province (KPK) and Baluchistan have historically lagged behind other provinces in the race for industrialization because of their geographical disadvantage and the law and order situation prevailing in their regions. Recent figures show that the number of closures and ailing industrial units in KPK has been increasing. Statistics indicate that 55% of firms administered by SIDB[1] and 64% of firms administered by SDA[2] have closed down. In the wake of increase in terrorism activities in KPK and the rampant unemployment, the importance of revival of closed and sick industrial units has further increased. To know the nature and severity of the problems that small industrial units face in KPK, we selected Hayatabad Industrial Estate (HIE), Peshawar as a case study. During the data collection process, we distributed questionnaires and conducted interviews with owners or managers of 48 industrial units in HIE. The survey results indicate that anarchy and terrorism, power outages & energy costs, locational disadvantages, lack of skilled labor force, and inconsistent government policies are major problems as perceived by owners of industrial units. We discuss the implications of these problems and present policy choices to mitigate their impact.

1. Introduction

The importance of a healthy industrial sector cannot be overemphasized, given that industrialization has been the main driver of productivity and higher living standards of the developed countries in the last two centuries (Murphy, Shleifer, and Vishney, 1998). Countries that did not successfully industrialize remained poor. The link between industrialization and poverty-alleviation has attracted attention of policy makers in Pakistan, and to some extent in the US, in the wake of rise in terrorist activities in Pakistan. This is because literature purports that members of the poor class of a society are more likely to join or form violent groups (DFID, 2005), and commit violence (Sambanis, 2004). A reason for this is that poverty breeds feelings of injustice, which are used by the perpetrators of violence to justify their acts. While policy makers in Pakistan and the US recognize the importance of poverty alleviation in combating

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terrorism, they have done much less in installing new industrial units, reviving the ailing ones, and resuscitating those that have closed down. Unfortunately, many of the sick industrial units are in areas with a high poverty ratio and presence of violent groups. The Government of Pakistan and a number of collaborating international agencies have initiated several development programs including the FATA Sustainable Development Plan, the Pakistan's Annual Development Programme Fund for FATA, and US Development Assistance for FATA. However, these programs ignore the revival of sick industrial units in the terrorism affected areas of KPK. Due to worsening business conditions, many businessmen from these areas prefer to either close down or move their businesses to other more stable parts of the country. Aside from terrorism, a confluence of other factors has increased the costs of doing business in these areas, including high risk premiums demanded by both the owners and creditors. This is attributable to the high operational risk, power outages, raw material shortages, unskilled labour force, smuggling, shallow local markets, and uncertain government policies. However, these problems are largely undocumented and further work is needed to determine the extent of their severity and impact on local businesses. This research paper is a step forward in this direction. Particularly, we take the case of Hayatabad Industrial Estate (HIE), Peshawar that is one such zone where businesses face many of the problems mentioned above. Profile information of HIE, Peshawar is given in Table 1.

Although local newspapers and seminars by the industrialists and the Sarhad Chamber of Commerce have been trying to highlight these issues; however, the exact nature of these problems and the extent to which they affect the industries is not known. This might be one reason that concerned stakeholders have been unable to devise a comprehensive solution to these problems. For our investigation, we used a questionnaire and conducted interviews with owners of 48 industrial units covering a wide range of businesses in HIE. It is expected that the findings of this paper will be helpful in identifying the true nature of problems that the industrialist encounter in the course of conducting business. The findings will be of help to policy makers as well as to the Sarhad Chamber of Commerce in future negotiations with policy makers. Towards the conclusion of the paper, we shall discuss several policy choices that may aid in mitigating the impact of the problems that firms face in KPK in general and HIE in particular.

The paper is organized as follows: Section 2 presents literature review on problems faced by small firms in general. Section 3 discusses methodology and the questionnaires and interviews process. Section 4 presents findings and discussions Section 5 concludes the paper by presenting policy choices to overcome or mitigate problems faced by industrialists in KPK.

2. Literature Review

In this section we review literature on problems faced by small firms in developing countries. Small firms, especially when they are in less developed countries (LCDs), face relatively more transactions costs and information asymmetry problems, do not enjoy economies of scale, are more susceptible to economic shocks, and encounter many other problems. These aspects are discussed below.

Sleuwaegen & Goedhuys (2002), working from the perspective of 'organizational ecology', suggests that selection of firms into an industry depends upon the extent to which the organization is deemed legitimate by its environment. Hannan et al. (1990) and Hannan and Carroll (1992) define legitimation as social acceptance of an organization. Legitimacy and reputation help organizations in reducing transaction and information costs. Sleuwaegen & Goedhuys (2002) argue that legitimation and reputations are a function of the initial size of the firm and formal registration. This suggests that large firms have greater chances of social acceptance and registration than smaller firms. As a result, larger firms enjoy benefits such as easy access to the legal system, to the formal banking sector, and publicly administered employee benefits. Furthermore, social acceptance and registration helps larger firms to be in the good books of law-enforcing agencies, suppliers, and consumers etc., (Sleuwaegen & Goedhuys, 2002). Others contend that larger firms get special treatment by using their dominance and influence (Gauthier & Gersovitz, 1997; and Rauch, 1991). In support of these arguments, Levensohn and Maloney (1997) found that the benefits of being formal increase with the scale of operations.

On the other hand, smaller and informal forms of organizations suffer not only in the products markets, but they also face disadvantages in the scarce resource markets. This problem is typically pronounced in LCDs, where imperfections in the input and product markets abound. In this regard, Sleuwaegen & Goedhuys (2002) lists a wide range of issues that firms encounter in LCDs:

"*The lack of credit, management and skilled labour, the lack of access to industrial sites with suitable infrastructure facilities, regulatory constraints, the various kinds of taxes, price regimes, the lack of materials and spare parts are frequently mentioned to be among the growth hampering factors*" (Sleuwaegen & Goedhuys 2002, pp. 120)

In light of the above, we can draw implications for small industrial units that were administered by different bodies and institutions of government of Pakistan. In order to have a balanced basket of economic activities across the four provinces of Pakistan, government of Pakistan embarked upon the introduction of small business units in every province. These small units were given a number of incentives in the beginning such as tax holidays for initial five years and duty-free imports of machinery, among other incentives. These initiatives yielded encouraging results in the form of mushroom growth of small industrial units. However, when the incentives expired, small firms could not compete with large firms on account of problems highlighted in the literature review section.

Besides, even within small-sized firms the nature of problems firms faced in the four provinces varied from region to region. For example, Tariq and Shah (2003) argue that firms in KPK face 23% higher costs compared to their counterparts in Karachi because of locational disadvantages. Moreover, firms in less-developed areas face shallow markets – lower level of local demand, poor quality of raw material and unskilled labor force.

3. Methodolgy and Analysis

We used both questionnaires and interviews to capture the views of owners or managers of firms located in HIE, Peshawar. A total of 48 owners/managers were approached for this purpose. The selection of owners/managers was based on their willingness to participate in the survey. For this purpose, potential respondents were first either contacted over the telephone to seek their willingness or were approached through a third-party reference. The data so gathered through questionnaires and interviews is analyzed using frequency tables and simple percentages.

In our questionnaires and interviews, the owners or managers of firms in HIE, Peshawar were presented with a list of questions that were broadly targeted at knowing the problems they faced and the degree to which resolutions of these problems were considered crucial to the survival of their firms. Table 2 shows the list of these questions in Column 1, severity of the problems as identified by the relative number of respondents that view such problems as not serious in Column 2, and most serious in Column 4, while Column 3 displays relative frequency of respondents who like to sit on the fence.

Results reported in Table 2 indicate that there are four major areas of concern. Among them, the most serious problems perceived by the owners or managers are the existing anarchy and terrorism, followed by power outages, lack of skilled labor force, and inconsistent government policies. Terrorism and anarchy affect businesses and their owners in HIE from several dimensions. Most of firms in HIE are run by owners who have their families living in Peshawar. When the question regarding terrorism was asked from them, the respondents said that they are confused about the current environment. Most of them said that they are planning to move their business setups to other cities and provinces. In fact some of the industrialists have already shifted their businesses and have sold their property in this industrial estate. Some of the respondents said that they are not clear about shifting their businesses but they are waiting for a friendly policy by the government to assist the businesses. Some of the owners said that they will take steps in their own capacity to face the challenges and will concentrate on their services and products to compete in the market and generate profits for themselves. Besides posing a risk for their families, terrorism is viewed as a serious threat to the survival of the firms as well. Our results indicate that 70.8% of the respondents think that terrorism can be a serious threat to the survival of the firms in this area. Several reasons can be behind this apprehension. First, terrorism disturbs normal business activities and causes immediate delays in the production processes. Second, it discourages skilled and competent laborers from entering areas that are prone to terrorism. Those who are not skilled enough to go elsewhere are more likely to stay in risky areas. Third, the real rate of returns to owners in risky areas drops as owners need higher risk premium in such area.

Table 1: Profile of Hayatabad Industrial Estate

1	Location	Jamrud Road (Hayatabad) Peshawar
2	Total Area	50 Acres.
3	Total No. of Plots	168
4	Size of Plots	A/12000 B/6000 C/640 Sq. ft.
5	Total No. of Plots Allotted	168
6	Total No. of Units in Operation	84
7	No. of Units Closed	14
8	Total No. of Units Under Construction.	26

Source: Directory of Industrial Establishments 2007: Published by Industries, Commerce, Labor, Mineral Development: Technical Education Department, Government of Pakistan

The next two issues (i.e. power outages and lack of special incentives) are viewed equal in severity by the respondents. There is no doubt that power outages and load-shedding create numerous problems for small firms. Large firms have more resources and can buy captive power plants (CPP), which are more fuel-efficient than simple electric generators whereas, small firms have no option but to buy small electric generators or wait through the power outages. Thus, putting them at a serious disadvantage in comparison to large firms.

In the case of special incentives respondents added that the increasing tariffs of gas and electricity rates increases the cost of production which renders products uncompetitive in the market. Additionally, there are no subsidies available on tariffs and taxes on duties. As the industrial zone is located far away from a sea-port therefore there are added inland transportation costs and the significant distance from the sea-port is a reason for delay in raw material availability. It is estimated that cost differentials for industrial units operating in Peshawar with those in Karachi are significant. Firms operating in Peshawar incur 23% more cost due to distance from sea-port and other factors (Tariq and Shah, 2003). To provide a level playing field, the federal government provided a number of incentives to small industrial units in KPK in the year 1988, these included waivers on income taxes for eight years and sales tax for five years, and exemption from custom duty on imported machinery. The immediate impact of these incentives was a significant increase in the number of industrial units. However, when these incentives expired, many industrial units found it costly to operate and subsequently closed down. Statistics reported by Sarhad Development Authority (SDA) show that out of the total 646 units constructed under the administration of SDA in KPK, a staggering 415 units have closed down, representing 64% of the total. Similar conditions were found with the units administered by Small Industries Development Board (SIDB). A 2002 survey of SIDB-administered units shows that 247 industrial units out of a total of 449 units (55% closure rate) have been closed down in KPK. Presently, nothing seems to have changed. Higher costs due to locational disadvantage plus terrorism problems still pose a real threat to the survival of the industrial units in KPK province.

Inconsistent government policies are viewed as serious problem by the owners. Corruption in the government departments makes it difficult for the businessmen to operate their businesses; this is complicated further by the existence of unfriendly government policies. In a similar vein, Sleuwaegen & Goedhuys (2002) found in their survey that regulatory barriers including taxes, corruption, practices and unfriendly government polices is one of the four major barriers to firms' growth. Similarly, extensive evidence can be traced regarding regulatory problems and less friendly government policies that hamper firms' growth in developing countries (e.g., Rondinelli and Kasarda, 1992; the RPED survey).

Table 2: The problems faced by firms in Hayatabad Industrial Estate

Factors	Least Serious	Neutral	Most Serious
Problems in accessing credit/finance	12.5%	25%	62.50%
Problems related to production	30.5%	16.7%	52.8%
Problems in marketing products	66.6%	25.0%	8.4%
Power and energy crises	0.0%	20.0%	80%
Afghan transit and smuggling	12.5%	62.5%	25.0%
Government policies	12.5%	29.2%	58.3%
Anarchy and terror	8.4%	8.3%	83.3%
Raw material availability	54.2%	8.3%	37.5%
The freight charges on raw material	43.2%	8.3%	48.5%
Skilled labor force	4.2%	25.0%	70.8%
Afghan transit and smuggling problem	58.3%	12.5%	29.2%
No special incentives	0.0%	20.0%	80.0%
Terrorism as a threat to the survival of the businesses	12.5%	16.7%	70.8%

Additionally, owners and managers reported that they have problems in accessing finance, while some of the respondents showed concern over delay in the production process. Possible reasons might be the distance from the port to this industrial estate, which at times causes delays in the delivery of raw material.

Overall, the findings of our survey are mainly in line with findings of small firms surveys conducted outside Pakistan. For example, A Survey of Small Firms in Upstate New York was conducted by Buffalo Branch of Federal Reserve Bank of New York where it was found that small firms' owners view taxes, non-availability of skilled workers, energy costs, and non-wages workers costs as major challenges being faced by their firms (Federal Reserve Bank, 2002).

Interviews Results

In addition to the close-end questionnaires, the respondents were given a chance to speak about their problems and their recommendations were sought. Almost all of the industrialists responded that the main reasons for the backwardness of industries located in HIE zone are the law and order situation and security problems. Additionally, non-availability of skilled labor is also a big problem when they need to install or troubleshoot problems in the machinery they need to acquire skilled labor from other provinces or abroad. The owners were not satisfied with the quality of education that schools and colleges were imparting, citing a need for greater emphasis on the establishment of vocational educational centers that can impart customized technical education for the unskilled labors. Corruption in the government departments makes it difficult for the businessmen to operate and often is a cause for delays in the business activities. Also the government policies are not friendly and there is no incentive available for this industrial zone. Above all, the government policies are inconsistent and defective and they change frequently which poses threats for the industries. Respondents added that the increasing tariffs of gas and electricity increase the cost of production, which makes the products uncompetitive in the market. There is no subsidy available on tariffs or on tax duty. As the industrial zone is located far away from the sea-port therefore, the transportation cost is high and this is the reason for delay in raw material too. The industrial zone also lacks basic infrastructure which again adds to the problems faced by the industrialists. The lack of potential leadership for industrialization and subsequent employment generation are also the reasons for the backwardness of industries in this zone.

Majority of the respondents demanded that they wanted the government to make policies that are pro-business. The government should lower taxes, custom duties, and interest rates as the province is affected by war. Government departments like SMEDA should play a more active role in facilitating the small and medium size industries and act as a middleman to the government and industrialists. Respondents added that the government should spend more on infrastructure in HIE. Additionally, the respondents pointed out biasness of the banks, which show reluctance in granting loans to businesses in this area.

Conclusion and Policy Implications

Successful industrialization is perhaps the most important driver of economic development. Equal distribution of economic activities across geographic regions is equally important; otherwise economic deprivation in certain regions can make people more susceptible to crimes and violence. It's been a while that the KPK and Baluchistan provinces have not kept abreast with the other provinces in the industrialization process in Pakistan. Recent insurgencies of militancy and terrorism in these two provinces have further lowered the odds in favor of industrialization. To know the nature and severity of problems that small industrial units face in KPK, we selected Hayatabad Industrial Estate as a case study. In doing so, we distributed questionnaires and conducted interviews with owners or managers of 48 industrial units in HIE. According to respondents' views, most serious problem is the existing anarchy and terrorism, followed by power outages and energy costs, locational disadvantages, lack of skilled labor force, and inconsistent government policies. Other problems identified by the respondents include absence of adequate incentives to operate in this region and delays in raw material procurement due to the long distance from the Karachi port to HIE. Terrorism has not only added to the costs of doing business in this area, but has also added to worries of businessmen regarding safety of their investments and their families. Additionally, the lack of skilled workforce is attributable to both terrorism and insufficient training and vocational centers.

In light of the survey results, several policy choices are presented here. First, war-affected areas necessarily warrant preferential treatment in taxes, interest rates, and insurance schemes. These incentives can help mitigate negative effects of terrorism on businesses in HIE and other parts of KPK. Also, these incentives will offset the locational disadvantages of firm in KPK. According to cautious estimates, the locational disadvantages translate into 23% higher costs for firms in KPK compared to their counterparts in Karachi. Incentives will at least offer fair advantage to firms in the war affected areas in comparison to firms in less troubled areas of the country.

Power outages and load-shedding are now a norm in Pakistan and there seems to be no immediate solution forthcoming. To remain in business, small firms need to seek alternative sources of power. Government can encourage these firms to buy relatively large CPPs through the policy of subsidized loans and duty-free imports.

Survey results also showed that owners of small firms are not satisfied with the skills imparted by local schools, colleges and universities. To fill the skills gap, a comprehensive plan of industry-academia-government linkage needs to be developed and enforced. Such a plan might include paid-internships for students; joint research projects of faculty members and industrial experts; inputs from industrial experts in designing curriculums; and sharing of information by businesses with colleges and universities related to new trends and problems. For developing and implementing such a plan, government can use the existing infrastructure of Small and Medium Enterprises Development Authority (SMEDA).

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