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Critical Analysis of Pakistan Automobile Industry From 1995 to 2005

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Abstract: *The automobile industry is one of the most important industries in large scale manufacturing sector. The automobile industry in Pakistan performed very well during the period of 1995 and 2005. However, there were many areas where the performance of industry was not up to the mark. This paper identifies the areas where this sector needs improvements. The analysis reveals that the industry did not have proper capacity utilization facility, it failed to offer competitive environment, it worked with low level of indigenization, it was suffered from inconsistent policies, it could not properly exploited consumers' demand and it failed to protect consumers' sovereignty.*
Keywords: *automobile industry, capacity utilization, consumers' demand, inconsistent policies, indigenization*

I. Introduction

The vehicle Industry in Pakistan emerged as one of the rapidly growing sectors during last couple of years. The sector affected the economy positively from various aspects. The industry contributed a lot to GDP, it generated direct and indirect employment, it gave birth to many subsidiary industries. Apart from these positive aspects, there are many questions on the performance of this industry. For instance, the industry was unable to achieve adequate indigenization level in spite of high protection rate. In addition to this, the role of regulatory authorities (such as PAMA, PAAPAM and CBR) was ineffective and the bodies are unable to provide a proper direction to the sector. The industry was also not able to protect consumers' sovereignty as the industry has an oligopoly structure. The objective of this paper is to analyze the progress of the automobile industry critically from the period of 1995 to 2010.

II. Problems In The Automobile Industry

There are following issues and problems faced by the automobile industry:

2.1 Less Competitive Structure

The behavior of a firm depends upon the structure of market to a great extent. For instance, the performance of a firm in a laissez fair market would be different if the firm is working in a closed economy. Likewise, a firm may book large amount of returns in monopoly and may fail to sustain the profit level in a monopolistic competition market. All of these variations are applicable for the automobile industry in Pakistan.

As far as the Automobile Industry of Pakistan is concerned, the sector had enjoyed good protection against the foreign competition by means of tariff and non-tariff barriers. Therefore, the Original Equipment Manufacturers could not offer a competitive environment as there was a very tight monopoly or oligopoly structure in the market. For instance, Pak Suzuki Company enjoyed monopoly in the manufacturing and supply of 800 cc and 1000 cc vehicles during 1995-2005. Whereas Toyota and Honda companies formed a duopoly in the manufacturing of above 1000 cc cars. Hino Pak Motors appeared as a dominant firm in the trucks and buses sector while Millat Tractors claimed a lion share in the manufacturing and supply of the Agricultural Tractors. This picture is portrayed by the above table 1. The table depicts that the automobile market was governed by very few Original Equipment Manufacturers and the market lacked a free and healthy competitive environment.

Table 1: *Market share of leading companies (2005)*

Vehicle type	Vehicle name	Company	Market share
Car-1300 2000cc	Toyota Corolla	Indus Motors	42.99%
Car-1000cc	Cultus	Pak Suzuki	45.85%
Car-800 cc	Mehran	Pak Suzuki	66.31%
Jeep-4*4	Potohar	Pak Suzuki	73.12%
Pick up/L.C.V.	Shehzore	Hyundai	49.15%
Motorcycle	Honda	Honda	68.85%
Truck	Nissan Truck	Nissan	39.64%
Bus	Hino	Hino	80.56%
Farm Tractor	Massey Ferguson	Millat	51.44%

Source: Pakistan Automaitve Manufacturers Association [1]

At this point of time, it would be pertinent to use the Herfindahl Index (HHI) in order to find out the degree of competition in the sector. The index is used as measure of the size of firms and amount of competition between the firms. When the HHI was calculated for Pakistan's automobile industry, the following results were derived [2]:

- HHI for Cars =4,948
- HHI for LCVs = 5,400
- HHI for Trucks and Buses = 3,950
- HHI for Tractors = 4,250

Analysis of HHI suggested that the industry had a tight oligopoly market structure with very high concentration ratios. Due to the high values of HHI, it is concluded that the auto market lacked free competition environment.

2.2 High Protection Rate

Trade liberalization is very important in today's open market environment. This enables the economies of large scale, optimum use of world resources, rise in demand for goods, increase in world's GDP and massive growth in investment level. Although the infant industry argument is valid for the economies like Pakistan, high protectionism is very difficult due to World Trade Organization. Moreover, it also rightly believed that long term trade barriers are just like slow poisoning to the industry that kill the production and innovation capabilities of the forms.

The automobile sector in Pakistan had been sheltered by many trade barriers to avoid foreign competition. Despite the high rate of protection, the import bill for the sector was quite substantial. Table 2 reflects that from 1996-97 to 2004-05, there was an upward movement in the import of automobile as the size inclined to 5.2% in 2004-05 from 2.44% nine years ago. The import of vehicle was Rs.17,391.65 million in 1996-97 which reached the level of Rs. 63,494.67 million after nine years. The situation was not apparently favorable for the country and certain concrete measures were required to curtail the import bill on account of motor vehicles.

Table 2: ***Imports of automobile (in Rs. million)***

Year	Road Motor vehicles	Road vehicles other than motor vehicles	Total imports of vehicles	Share in total imports
1996-97	14,883.715	2,507.938	17,391.65	2.44%
1997-98	13,087.189	2,015.812	1,5103	3.46%
1998-99	13,518.813	2,158.495	15,677.31	3.36%
1999-00	15,534.822	2,358.808	17,893.63	3.35%
2000-01	16,180.616	2,554.737	18,735.35	2.99%
2001-02	17,567.650	2,654.938	20,222.59	3.19%
2002-03	25,791.307	3,494.758	29,286.07	4.1%
2003-04	32,467.918	5,108.477	37,576.4	4.2%
2004-05	56,836.478	6,658.192	63,494.67	5.2%

Source" FBS [3]

2.1 Effective Protection Rate (EPR)

Effective Protection Rate states how much an industry is protected from the foreign competition. The automobile industry is assumed to be one of the most protected industries in the country. The industry comparatively enjoyed a very high effective protection rate. The table 3 reveals the effective protection rate for the industry in 1997.

Table 3: ***Effective protection rate to auto industry***

Vehicle type	Import % CKD/ RM	Tariff CBU	Tariff CKD/ RM	EPR
1500 CC	70%	150%	32%	425%
800 CC	40%	110%	32%	162%
Tractrors	20%	35%	32%	36%
Vendors using S-form	30%	45%	20%	56%
Without S-form	30%	45%	65%	36%
Without S- form and competing against smuggled items	30%	20%	65%	1%

Source: Pakistan and Gulf Economist

In the beginning of 21st century, the effective protection rate (EPR) for automobile industry increased sharply which ranged from 701 per cent to 5,000 per cent [4]. The objective of such protection rate was to enable the industry to achieve the desired level of indigenization. However, the industry could not achieve the set target and it indulged in short term objectives of maximization of profit.

The high EPR made the local industry dull, uncompetitive and profit oriented. One important example in this regard is that Pak Suzuki Motor Company booked the profit of Rs.148.716 million in 2002 as against Rs.52.97 million in 2001 [5]. As a result, the experts and analysts charged the sector for creating monopoly, offering few choices to consumers, selling vehicles on higher prices and booking very high margin of profits. Further, the industry also entered into the post WTO scenario especially with the provisions of Trade Related Investment Measures (TRIMS) and Trade Related Intellectual Property Rights (TRIPS). In those circumstances, the sector was not likely to afford such a high rate of protection and the industry had to face a very difficult time from the giants of world's auto manufacturers. Regardless of the threats from WTO regime, there was immense pressure from the dealers of used cars who persuaded the authorities to allow the import of old and reconditioned vehicles. The dealers had always been attempting in the past to influence the authorities to get a favorable decision. Once they succeeded in their efforts, the government would be forced to allow the import of used vehicles with certain relaxed conditions. Therefore, the industry was required to take serious measures so as to stand confidently on its own toes to cope with the challenges.

2.3 Low Indigenization Level

During the period of 1995 and 2005, the industry could not achieve indigenization level. In this way, the industry would be able to reduce the reliance on import by producing more and more local contents for vehicles.

Table 4:*Indigenization level in 1995*

Vehicle	Indigenization level
Suzuki Mehran 800cc	58%
Suzuki Khyber 1000cc	44%
Suzuki Margalla 1300cc	35%
Suzuki Pick up 800cc	52%
Suzuki Potohar 1000cc	35%
Suzuki Van 800cc	47%
Toyota Corolla	28%
Honda Civic	28%
Tractor Massey Ferguson	84%
Tractor Fiat	84%
KIA Ceres	26%
Honda Motorcycles	70%
Yamaha Motorcycles	70%
Suzuki Motorcycles	65%

Source: Pakistan and Gulf Economist [6]

The performance of the industry pertaining to indigenization had never been very good since 1949. During 1960s, the indigenization level was just 40% for trucks & buses and 20 % for cars. In 1995, the deletion level for parts in different vehicles is depicted in Table 4.

In 1995, the government established a new body i.e. Engineering Development Board with a view to formulating the long term policies for the industrial sector. The board formed a committee called indigenization committee so as to prepare and monitor the new type of deletion program called "Industry Specific Deletion Program" (ISDP). The committee set the targets for the industry to achieve indigenization level up to a certain time period .

As against the targets set by the committee, the performance of the industry in 2002-03 was not up to the marks as shown in table 5. The industry was apparently far behind from achieving the desired targets in 2002-03 in most of the vehicles.

Table 5: *Achievement of maximum local content levels* (2002-03)

S.No.	Vehicle	Percentage
1	Cars	56-70
2	Tractors	63.5-85.5
3	Motor cycles	81-88
4	Light Commercial vehicles	42.7-55
5	Buses / Trucks	46.5-48.5

Sorces: Ministry of Industries and Production [7]

As far as the localization of parts was concerned, the status of the vendors for different companies was as under:

Table 6:*Company wise vendor information 2004*

Name of the company	Total Vendors	Deletion status	No. of parts localized	Models
Indus Motor Co.	61	38% - 55.5%	1,100	(All models)
Pak Suzuki	180	70%	2,800	(All models)
Honda Atlas Cars	77	60.00 %	699	
Dewan Farooq Motor	107	37% - 58%	1,311	
Total	425		5,910	

Sorces: Ministry of Industries and Production

During 2004-05, the indigenization level for different vehicles was improved slightly as shown below:

Table 7: *Level of Indigenization 2005*

Type of vehicle	Indigenization level
Passenger cars	Up to 72%
Light commercial vehicles	Up to 52%
Buses	Up to 52%
Tractors	Up to 85%
Trucks	Up to 52%
Motor cycles	Up to 89%

Source: Indus Motors Company [8]

In spite of many efforts made by the authorities during different periods, the vehicles assembled in Pakistan were not competitive enough in the global market. Despite the implementation of Industry Specific Deletion Policy, the industry relied upon the imported contents for vehicles in form of completely knocked down (CKD) kits.

The state of industry in the manufacturing of automobile parts was not up to the mark. For instance, the basic component for the production of automobile was engine, but the industry used to import the engines in Completely Built up (CBU) condition. Similarly, most of the body components were imported in completely knocked down (CKD) form. However, the indigenization level for motorcycles and tractors was very much in accordance with the expectations.

2.4 Under-Utilized Capacity

The industry could not succeed to utilize 100% capacity. As depicted by table 8, the unused capacity for cars was 9.9% and for heavy commercial vehicles, it was 64% and for Motorcycles it was 44%.

Besides the capacity utilization according the type of vehicle, the company wise detail for under-utilized capacity is also given in table 9. Gandhara Industries and Sind Engineering Ltd were on the top pertaining to the idle capacity.

Table 8: *Vehicle wise-capacity utilization*

Vehicle	Capacity (units)	Production (units)	Idle capacity (units)	% of Idle capacity
CARS & LCV	215,000	193,695	21,305	9.90
HCV & Buses	15,000	5,343	9,657	64.38
Tractors	50,000	48,887	1,113	2.22
Motorcycles	925,000	520,124	404,876	43.77

Source: PAMA

Table 9: Company wise-capacity utilization

Company	Capacity (units)	Production (units)	Idle capacity (units)	% of Idle capacity
Pak Suzuki	100,000	99,734	266	0.26
Indus Motors	50,000	41,552	8,448	16.89
Honda Cars	50,000	30,464	19,536	39.07
DFL	15,000	17,972	-2,972	-19.81
Sind Engg.	1,000	68	932	93.20
Hinopak	2,000	2,167	-167	-8.35
Ghand.Nissan	3,000	1,652	1,348	44.93
Ghand. Ind.	1,800	48	1,752	97.33
Master Motors	8,050	2,239	5,811	72.18
Millat Tractors	25,000	24,313	687	2.74
Al-Ghazi	25,000	24,574	426	1.70
Atlas Honda	500,000	360,561	139,439	27.88
DYL	200,000	74,423	125,577	62.78
Suzuki Bikes	65,000	16,954	48,046	73.91
Pakistan Cycle	60,000	14,804	45,196	75.32
Plum Qinggi	100,000	17,198	82,802	82.80
Fateh Motors	50,000	34,018	15,982	31.96

Source : PAMA

2.5 Inconsistencies in Policies

A consistence in policy framework brings about growth and prosperity. As far as the automobile sector of Pakistan is concerned, there were more than 30 policy changes from 1994 to 2000 as shown in figure 1. Due to the volatile policy framework, the industry could not attain the prosperity. In 2000, the government adopted uniform policy framework for the sector which brought about tremendous growth in the sector.

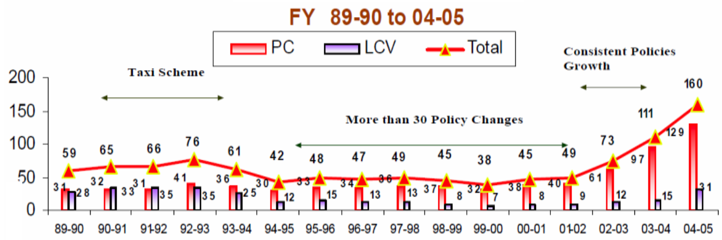

Figure 1. **Policy Change and Growth**

Source: Indus Motors

2.6 Lack of Consumers' Sovereignty

The automobile assemblers failed to offer vehicles at competitive price during the research period. The prices of units were comparatively higher than the price in the neighbor countries. The manufacturers had been giving some justification for charging high price such as high cost of raw material, increasing cost of energy and depreciation of domestic currency. All of these justifications were considered to be inevitable by the local companies. However, another important factor for high price was the cartel of the companies and their greed to maximization of profits. The assemblers were not willing to compromise on their high levels of profit. Hence, they used to create oligopoly and left few choices to the consumers. Further, the assemblers influenced the authorities to formulate such policies which were more beneficial to producers rather than consumers. In such a competitive global environment, the vehicle producers might not sustain their dictating position over the authorities and consumers in the long run.

2.7 Poor Exploitation of Potential Demand

Pakistan is one of those countries where there were around 8 cars per individual available for every 1000 persons. The ratio was very low as compared to other countries. The comparison between the status of motorization in Pakistan and other countries is depicted by following figure 2 which clearly depicts that the country had immense potential and demand for the automobiles.

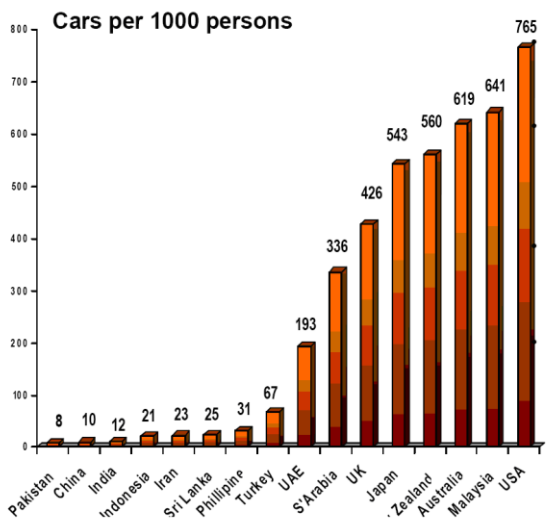

Figure 2 **Motorization potential in Pakistan**

Source: Indus Motors

Since transportation was becoming the need for daily life, the Original Equipment Manufacturers had a great opportunity to use the potential demand by means of effective marketing strategy, by improving quality of vehicles and by paying due respect to consumers. The automobile assemblers could not exploit the potential demand in the past sixty years properly.

III. Conclusion

On the basis of above analysis, we conclude that the automobile industry during the period of 1995 and 2005 faced many issues and problems. They include, under utilization capacity, low level of indigenization, lack of consumers' sovereignty, inconsistent policy framework and high protection rate. The responsibility lies on the shoulders of original equipment manufacturers, regulatory authorities and policy makers to realize the deficiency and take measures to cope with the situation.

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