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# Service Delivery by Bureaucracy in Pakistan

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## Abstract

*This paper examines the role of a Bureaucrat as Provider of Services to the People of Pakistan. It is the perception of the people that bureaucracy has earned a negative name and has failed to play an Efficient & Effective role towards Service Delivery in Pakistan. The very orientation and organizational structure of bureaucracy in Pakistan, was not attuned towards Service Delivery. This paper thus specifically looks in to the historical role of bureaucracy towards social change and development in Pakistan.*

**Key Words:** Bureaucracy, Service delivery, role of Bureaucracy, social change.

## **Introduction**

The term bureaucracy, meaning the holder of Bureau, the French word for office, in every day usage of the expression, refers to the state functionaries. It though carries and communicates more of negative vibes, conveying the impression of a hinderer, who is there to thwart and impede rather than aid and assist. This negative image is perhaps particularly true in the context of Pakistan, where 'bureaucrat is held responsible for everything bad happening in the country, from a road-side accident to a crop failure or a deadlock with the NATO countries over the supplies to their troops stationed in Afghanistan. Is the bureaucrat actually responsible for everything going wrong or this negative perception is simply a natural response to the efforts at restricting and regulating one's behavior, other than and external to those ensuing out of his/her own volition, a remnant of our predatory instinctual make up? This is what this paper is going to explore.

## **Research Questions**

The study will address the following Research Questions and it is around these issues that the inquiry will revolve.

1. Was Service Delivery ever a policy agenda item for the successive governments and their bureaucratic apparatus in Pakistan and were there some systematic efforts made towards that?
2. What role has bureaucracy played towards Efficient & Effective Service Delivery in Pakistan: positive, negative or none? What were the major forces/factors conditioning that role.

## **Objective of the Study**

As is evident from the above Research questions, the objective of the study is to assess the commitment, capacity and performance of the bureaucratic apparatus in Pakistan towards efficient, effective and client friendly service delivery for the people of Pakistan.

## **Significance of the Study**

The study is significant from the perspective that it will try to ascertain whether the Bureaucratic performance in Pakistan is actually as poor as is usually rather universally portrayed or is it a perceptual or Projective Identification issue accruing out of external factors such as,

- i- Low level of Literacy in the Country
- ii- Frequent Military Takeovers
- iii- Corrupt and incompetent Politicians-Blame Game
- iv- Non-Development of Political Institutions
- v- Low level of Socio Political Participation by majority of Population-Voice issues
- vi- Non-existence of Genuine and Effective Accountability Mechanism

## **Theoretical Framework**

### **Variables of the Study**

The following are the various variables being addressed and explored in the study:

Constant Variable – Bureaucracy

Independent Variables – People, Politicians, Armed Forces

Dependent Variable – Service Delivery

### **Hypothesis**

The following **Hypothesis** is being envisaged for this Study:

The very orientation and organizational structure of bureaucracy in Pakistan, was not attuned towards Service Delivery. Its colonial grounding with maximum emphasis upon law and order maintenance and revenue collection remained a dominant influence and kept conditioning its functioning. Bureaucrat in Pakistan thus continued to be the Ruler of ‘illiterate’ and ‘ignorant’ masses rather than becoming a provider of services to people.

### **Research Design & Methodology**

#### **Data Sources**

To assess the role/performance of Bureaucracy towards Efficient, Effective and Client Friendly Service Delivery in Pakistan, this study has predominantly drawn upon the following sources for data.

1. Available Literature
2. Official View Point i.e. Published/unpublished documents of the government of Pakistan

3. Independent Observers
  - a) Reports by International Agencies e.g. the World Bank
  - b) Intellectual forums/think tanks/academia
  - c) Civil Society i.e. NGOs/NPOs.
  - d) Media, local/international (though local media in Pakistan is known to be critical of every thing coming out of the public sector)

### **Structure of the Study**

The study will start with a review of the Bureaucratic Performance in Pakistan, for the period 1947-2000, to ascertain the forward movement and mileage done, if any.

To assess the performance of Bureaucracy in the Service Delivery, we first need to know its organizational structure, institutional make up and behavioral patterns as well as the historical, socio-cultural and political forces shaping these. We will thus specifically look in to the historical role of bureaucracy towards social change and development in Pakistan. The major will be to explore the forces and factors, which facilitated or militated against this role.

We will have a discourse with the existing theory on Service Delivery and the desired Role of Bureaucracy towards its Management and will try to reach some conclusion based on empirical evidence.

### **Literature Review**

The Literature Review for this study focuses upon the following;

- 1) Popular understanding and perception about Bureaucratic Organization, with particular reference to bureaucratic culture, orientation and motivational factors
- 2) Origin and Development of Bureaucratic organization in Pakistan.
- 3) Bureaucrat as Provider of Services to the People of Pakistan

Since Max Weber is considered to be the “founder of systematic study of bureaucracy”<sup>1</sup>, it is appropriate that the literature review on bureaucratic organization starts by looking at what he perceives of it. We will however confine ourselves to only a few references as his main theme of an ‘ideal/rational organization’ is rather very well known and can be discussed further only at the cost of needless repetition. One point which needs careful attention is Weber’s analysis of bureaucratic organization is that while calling it an ‘ideal type’ he never insisted on its infallibility. What he emphasized was that this is the best administrative arrangement from amongst the possible options in terms of orderly, organized, predictable and professional conduct of business in public or private spheres and no matter how much “people may complain about the evils of bureaucracy, it would be sheer illusion to think for a moment that continuous administrative work can be carried out in any field except by means of officials working in offices,” the choice is only that between bureaucracy and dilettantism in the field of administration.”<sup>2</sup>

Weber finds ‘technical knowledge’ to be the main factor behind the superiority of bureaucratic organization. “Bureaucratic administration means exercise of control on the basis of knowledge”<sup>3</sup>, which is acquired as much through training as through long experience.

Weber’s concepts of, superiority based upon knowledge, is further discussed by Reinhard Bendix in the context of bureaucracy’s relations with other forces wielding economic and political power in a modern state. Discussing various assumptions about bureaucratic power, he observes that possibility of bureaucratic ‘monopoly of skill’ developing in to monopoly of power’ depends upon the presence of some irreplaceable ‘high administrative officials’, who exercise a ‘high degree of administrative autonomy’. He however finds it difficult ‘to conceive a strictly irreplaceable group of sellers of managerial skill’, and postulates that “ the men of managerial skill are powerful not

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<sup>1</sup> Merton R. K., Gray, A. P., Hockey, B. and Selvin, H.C (Edit 1952), Bureaucracy, P.17. New Press, New York

<sup>2</sup> Weber, Max, “The Essential of Bureaucratic Organization: An Ideal Type” in Merton et al (Edit 1952), Bureaucracy, Pp.24-25, New Press, New York

<sup>3</sup> Ibid, P.26

because their skill makes them irreplaceable but rather because, and to the degree that, their education and social derivation induces in them a common social philosophy” and that “administrative autonomy is a matter not of skill but of derived power i.e., of the power delegated to the administration through the organized representation of social groups”.<sup>4</sup> Bendix thus tends to believe that bureaucratic identification with abuse of government power is misleading because “the governmental monopoly of power (in so far as it exists) is derived”.<sup>5</sup>

Robert K. Merton(1952), another often-quoted name in discussions on bureaucratic development and functioning, too ranks bureaucracy as an ‘ideal type of formal, rational organizational social structure’ with such characteristics as clearly defined patterns of activities, calculability of behavior, impersonal relationships and technical efficiency. He however thinks that inbuilt in the very fabric of this otherwise ideal structure, are some negative aspects, which he calls the ‘Dysfunctions of Bureaucracy’.

He names these dysfunctions or negative aspects by borrowing such terms used by some other social scientists, in different contexts, as “trained incapacity” and “occupational psychosis”. Trained incapacity he elucidates as “that state of affairs in which one’s abilities function as inadequacies or blind spots” and where one’s actions based upon training and skills which have been successfully applied in the past may result in inappropriate responses under changed conditions”. Occupational Psychosis, he explains as those “special preferences, antipathies, discriminations and emphases” which result out of one’s daily routines and practices”<sup>6</sup>. Further elaborating these ‘dysfunctions’ of bureaucracy, Merton says that the habit of strict observance of procedures leads to behavioral rigidity, inflexibility and ‘inability to adjust readily’. “Formalism, even

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<sup>4</sup> Bendix Reinhard (1945) Bureaucracy and the Problem of Power”, in Merton, et al (Edit 1952), Bureaucracy, Pp.118-32, New Press, New York p-131-132

<sup>5</sup> Ibid, P.132

<sup>6</sup> Merton, Robert K. (1952) “Bureaucratic Structure and Personality”, in Merton et al Bureaucracy Pp 361-371, Free Press, New York.

ritualism, ensues with an unchallenged insistence upon punctilious adherence to formalized procedures.”<sup>7</sup>

Merton is thus of the view that the very characteristics of bureaucracy, which otherwise distinguish it as an efficient and objective organization may sometime lead to non-productive and negative performance. One may thus conclude that without saying it in the very many words, Merton does not believe this ideal type of organizational structure to be that ideal

As is reflected from the writings referred to above, most of the classical writers on Bureaucracy have envisaged it as an hierarchical organization, let us review some of the studies, which have looked at the functional requirement of bureaucratic organizations as service providers and agents of development.

A fairly comprehensive reading on the subject is The World Development Report of 1983. A detailed discourse on the functioning of public sector in the context of Development Management, “it examines the role of the state, stresses the importance of appropriate incentives- to foster development, and discusses the institutional arrangements needed to formulate a consistent strategy and carry it out.”<sup>8</sup>

Management of Development, the study points out, requires a somewhat different mix of skills and abilities than those needed for physical projects and other tangible undertakings. While in the physical project, where the out-put can be measured, “ the main managerial requirements are to train and motivate staff and to strengthen operational control,” the management of development, since it takes place in an environment of uncertainty demands “experimentation, flexibility, and a willingness to work closely with program beneficiaries to learn about and respond to local needs.”<sup>9</sup>

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<sup>7</sup> Ibid, P 265

<sup>8</sup> World Development Report 1983, P.4

<sup>9</sup> Ibid, P.88

Now how to render the bureaucracies; responsive to the need of the people, willing to undertake the painstaking and difficult tasks of development in a committed and conscientious manner, the study recommends, 'persistent but selective efforts' at institutional and administrative reform, guided by 'vision, tenacity and strong political leadership'.<sup>10</sup>

Allen H. Barton in his effort to make a diagnosis of Bureaucratic Maladies, observes that it is very important to look in to systemic characteristics of a bureaucracy, which according to him consist of "the personal traits of the bureaucrats, the structural arrangements of public bureaucracy, and the political system which has ultimate authority over the bureaucracy."<sup>11</sup> Barton believes that the structure of a professional bureaucracy, with all "the red tape, redid rules and lack of manger discretion, prevents efficient and innovative action by public officials."<sup>12</sup>

Barton also believes that the structural maladies can be aggravated or otherwise, by the nature of the political environment in which a bureaucracy operates. "In an oriental despotism, the bureaucracy is part of a largely exploitative state, serving a dynastic family, an aristocratic class, and the bureaucrats themselves at the expense of the great majority. It may be providing some useful services, but its main function is exploitation and oppression.

Pakistan according to LaPorte "inherited a system of government highly dependent upon the civil bureaucracy", a bureaucracy which, "had not been trained to accept the concepts of citizens participation in government decision-making, the domination of elected leadership in government policy making, or public scrutiny of government operations."<sup>13</sup> The needs and demands of socio-economic development of a newly independent country however were very different from that of a colony ruled for

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<sup>10</sup> Ibid. P.p.125-126

<sup>11</sup> Barton, Allen H. (1979) "A Diagnosis of Bureaucratic Maladies" in Weiss, Carol H. & Barton Allen H (edit) *Making Bureaucracies Work*, Sage Publications Ltd California

<sup>12</sup> Ibid. P.54

<sup>13</sup> LaPorte, Robert Jr. (1984) 'Administering Development' in Burki, S.J. & LaPorte, R. Jr. (edit) "Pakistan's Development Priorities: Choices for the future" Oxford University Press, Karachi, P. 240

the benefits of the colonial ruler, and required 'significant modifications in the administrative system'.

Charles H Kennedy in his rather detailed and comprehensive discourse on the bureaucratic development and culture in Pakistan holds on to the generally accepted view that the Pakistani Bureaucracy in its organizational make up as well as work ethos continues to display its colonial orientation and grounding.

According to Kennedy the distinct features of Pakistani bureaucracy are 'The Secretariat System of Bureaucratic Authority', 'A Systematic Preference for Generalists', 'Cadre system of Organization' and 'Rigid and Formal Patterns of Rank Hierarchy'. And all these features trace their origin to the colonial days and contribute towards the continuation of an organizational structure, jealously guarding its power and privileges against all outside 'encroachments' and influences positive or negative, and very rigidly divided even within its structural boundaries in competing groups with varying cadre affiliations.<sup>14</sup>

General Arif who himself has been at the helm of affairs during Zia days says that "senior bureaucracy plays an inconsistent role in administration. While some civil servants excel in professionalism, other are neither civil nor servants. They are arrogant to the public and submissive to their political masters in power who do not draw distinction between public servants and private servants"<sup>15</sup>.

The ruling elite what Mushahid and Akmal call the bureaucrats, have failed to either deliver the goods to the poor or to involve them in economic and political decision making. They believe that "Pakistan's Bureaucracy has undergone a gradual process of institutional decay."<sup>16</sup>

## **Findings/Analyses**

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<sup>14</sup> Kennedy, Charles H. (1987) "Bureaucracy in Pakistan" Oxford University Press, Karachi

<sup>15</sup> Arif, M.M. (2001) "Khaki Shadows: Pakistan 1947-1997", Oxford University Press, Karachi, P. 337

<sup>16</sup> Hussain, Mushahid & H, Akmal (1993) "Pakistan: Problems of Governance", Vanguard Books PVT Ltd, Lahore, Pp. 10-11

It transpires from the available Literature Review as well as through the other data sources that bureaucratic organizations are predominantly considered and understood as a system of rules and regulations, where an absolute and impersonal adherence to these rules is imperative, with no room for emotion, pathos or any kind of personal consideration in the transactions of official business.

This view of bureaucracy however objective, does not visualize much role for it towards service delivery and managing development, which on the other hand entails; active involvement rather than impersonal behavior, flexibility and resilience rather than strict adherence to pre-determined procedures, learning through experience rather than rigid application of rules and working together toward change and development by the state functionaries and the people rather than an interaction of command and obedience between the rulers and the subject.

Does it postulate then, that by the very make up of its organic fabric, the bureaucratic organization is unsuitable for developmental work?

The debate on the role of Bureaucracy towards managing development and social change is in fact intertwined with the historical experience of most of the underdeveloped countries and is as well a by-product of their changed socio, political and economic imperatives. It gained currency and universal attention mainly during the post war period and as a result of the independence movements all across the then colonized Asia and Africa. A popular slogan, the freedom movements raised all around, including in the sub-continent, was that state machineries were not meant only to maintain law and order and to extract revenue for the rulers, as the colonial bureaucracies were doing for the mother countries, but to work for the socio-economic development of the people as the public servants will do in the freed countries. Accordingly the understanding and perception about the design and functioning of bureaucracy underwent substantial change. It is no more envisaged as an instrument of coercion but is envisioned as an agent of facilitation. The distinct feature of most of post-war work on bureaucracy is thus this shift of emphasis from rigid and uncompromising application of rules and procedures to flexibility and learning and from impersonal and detached administration to participatory management.

In the context of Pakistan the bureaucratic apparatus the country inherited, had been developed by the colonial rulers. Its origin specifically for the Indian sub-continent goes back to the Macaulay Reforms, which envisaged preparing, officers for the service of the Raj, who will be English gentleman in their language, training and behavior and Indian, only in color. Accordingly the members of top bureaucracy hardly had any incentive to develop any understanding of development needs and dynamics; neither did their career prospects nor their job requirements demanded them to focus upon service delivery. Trained as generalist, they continued with that mode, assuming that making policies and taking decisions is what they are to do and not to go into the nitty-gritty of development and service delivery.

Accordingly the bureaucrat in Pakistan continues to work under a colonial orientation to this day and does not seem to have felt the need to change that behaviour. The World has gone ahead; the communication revolution has diminished all geographical distances and informational barriers. People in every part of the globe, even in the remotest corners, are well aware of their rights and know what the minimum ingredients of a decent living are, and hold their state functionaries for providing that. That is what they are paid for. But unfortunately the administrative landscape in Pakistan has witnessed very little, if any change. And this is because the bureaucrat in Pakistan has never been groomed for Service Delivery; he lacks the basic capacity for developmental work. And neither has he made any effort nor his bureaucratic environment and culture allowed him to cover any decent mileage towards that goal.

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# Gender Differences and Occupational Stress

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## ABSTRACT

As a matter of fact that many organizations providing equal job opportunities to female employees so this study investigates the relationship between gender and work stress. For this study, convenience sampling technique is used and data is collected from 94 middle level managers from different organizations. Occupational stress is operationalized into organizational security, organizational satisfaction, behavioral symptoms, physical symptoms, relationship, control, personal responsibility, drive, life-work, work load and job satisfaction. Chronic Work Related Stress Evaluation instrument is used with cronbach alpha value 0.623. The result shows that that female and male employees experience same work stress.

**Key words:** gender, occupational stress, private and public organizations.

## INTRODUCTION

Since the mid of 2000, World is facing economic recession because of huge investment on war budget and activities. This affects directly and indirectly to society which in turns affects organizations and employees. To sustain in this environment organization are reducing its man power that creates work stress in them. Employees are struggling hard to meet the expectations of the employer and retaining their living standards. This phenomenon creates work stress among them and has impact on productivity of the organization.

Stress is not a new phenomenon it was derived from the Latin word stringere. It was adopted in English in the 17<sup>th</sup> century to describe hardship, pressure, torment and difficulties (Mesko et al., 2010). Ingram & Pilla (2007) state that job stress directly affects the performance of the employees as well as the organizations. The main cause of job stress is occurred when job requirements don't go with the capabilities, resources or needs of the workers. Unhealthy organizations do not get the best from their workers and this may affect not only their performance in the increasingly competitive market but eventually even their survival.

When affected by work stress people may:

- Become increasingly distressed and irritable
- Become unable to relax or concentrate
- Have difficulty thinking logically and making decision

- Enjoy their work less and feel less committed
- Feel tired, depressed, anxious
- Have difficulty sleeping
- Experience serious physical problem such as heart disease, increases in blood pressure, head aches.

Work stress thought to affect organization by:

- Increasing absenteeism
  - Decreasing commitment to work
  - Increasing staff turn-over
  - Increasing complaints from clients and customers
  - Increasing unsafe working practice
  - Adversely affect staff recruitment
  - Damaging the organization image both among its workers and externally
- (Leka, 2003)

Stress can suffer any employee regardless of demographic variables such as age, status, gender, ethnicity or disability (Palmer et al., 2004). Stress assumes to be seriously exists in Pakistani context. Because of inflation in economy every individual is facing how to accommodate basic necessities of life to facilitate his family.

## **PROBLEM STATEMENT**

This study investigates the influence of occupational stress on demographic variable i.e. gender. Literature provides evidence that male experience more stress as compare to female. But few studies show that there is no statistically significance difference based on gender and work stress.

## **OBJECTIVE OF THE STUDY**

- To find out the impact of occupational stress on male and female employees of an organization.

## **SIGNIFICANCE OF THE STUDY**

As stated earlier employees experience work stress and have impact on productivity. This study provides corner stone for the managers and organizations to manage their employees work stress. Work stress is operationalized into organizational security, organizational satisfaction, behavioral symptoms, physical symptoms, relationship, control, personal responsibility, drive, life-work, work load and job satisfaction. It gives management an overview to analyze these factors and will organize different workshop to overcome this problem.

## **HYPOTHESIS**

H<sub>0</sub>: There is no significant occupational stress difference experienced between male and female employees of an organization.

## LITERATURE REVIEW

For analyzing the impact of occupational stress on demographic variable such as gender different studies are reviewed. Afza, Mujtaba and Habib (2011) conduct comparison research on the stress perceptions of Pakistani and Americans. In their study, 231 Pakistani and 288 Americans managers and workers are convenience sampled. Hyde and Allen's overload stress inventory is used rating 1 (never) to 5 (always). The results imply that older respondents and male do have higher stress scores.

Kauts and Saroj (2010) investigate the relationship between occupational stress and emotional intelligence in relation to gender of the teachers. For this study, 600 teachers are selected from government and private school. The results show that male teachers are found to be more stressed than female teachers. Holmstrom (2008) states the difference of work related stress among gender, industry workers and medical service personnel. Labor unions representative and managers of Northern parts of Sweden are sampled. Result shows that gender and occupational has a substantial impact on work stress.

Morash et al. (2006) compare the predictors of work related stress. In 11 police departments, 2051 officers are sampled and regression analysis is used to test the relationship of stress and gender. Results indicate that workplace problems explained more male's than female's stress. Autoniou, Polychroni & Vlachakis (2006) conduct research on occupational stress and the professional burnout experience by 493 teachers working in Greek primary and secondary schools. The results find that female teachers experience significantly higher levels of occupational stress specifically with regards to interaction with students and colleagues, workload, student's progress and emotional exhaustion. Gyllensten and palmer (2005) evaluate role of gender in the level of workplace stress. They conduct systematic review and conclude that much of researches indicate that women reported higher levels of stress compared to men. However, several studies report no difference between the genders.

Al-Omar (2003) determines relationship between the socio-demographic variables and the level of work stress. 700 questionnaires are distributed in MOH hospitals by using simple random sampling. T test, ANOVA, correlation and multiple regression are used to analyzed the hypotheses. Results indicate that work stress level is not influenced by gender.

Dick & Wagner 2001 (as cited in De Nobile & McCormick, 2007) gender has frequently been investigated as a biographical variable in studies of occupational stress. Laughlin (1984) (as cited in Nobile & McCormick, 2007) state that female teachers experienced more stress than males. Guthrie (2006) (as cited by Nobile & McCormick, 2007) reports that females employ in education and related sectors account for more work stress related claim than their male colleagues. Miller et al. (1999) examine the interaction of gender and culture in managers' experiences of work stress. For this study, data is collected from Collaborative International Study of Management Stress. Sample is composed of 822 managers from four countries. ANOVA and t test are used to analyze the difference between males and females. Results indicate that no differences in the stressors experienced by men and women.

Makhbul & Hasun examine the gender differences in discussing the stress outcomes. Questionnaires technique is used to collect the response from 1668 all commercial banks and public higher learning providers in Malaysia. Data is analyzed by using t-test analysis and find that there is no significant difference in the stress outcomes experienced by male and female employees. A study by Marini et al. (1995) (as cited in Layne, 2001) concludes that males score significantly higher stress as compare to females.

## **METHODOLOGY**

This research is descriptive in nature as it relates the occupational stress with the demographic variable i.e. gender. For this study, 94 middle level managers from different public and private organizations are selected by convenience sampling because they are playing the role of liaison between the executives and operational level. For this study, chronic work related stress evaluation instrument is adopted. Organizational stress variable is operationalized into organizational security , organizational satisfaction , behavioral symptoms , physical symptoms , relationship , control , personal responsibility , drive , life-work , work load and job satisfaction . Each variable is measured on 5 point scale assigning always =1, often= 4, sometimes =3, infrequently= 2 and never=5 with cronbach alpha of 0.623 indicating that the questionnaire was consistent and reliable. For analyzing the data SPSS 16 is used.

## **RESULTS AND DISCUSSION**

From the table 1 (attached in an appendix), as standard deviation for both groups are same so results of “equal variance assumed” are selected. From table 2 (attached in an appendix), results indicate that there is a statistically insignificant as  $p > 0.05$ . Therefore, null hypothesis is not rejected and it is concluded that male and female practice same level of stress ( $t = -1.490$ ,  $p = 0.916$ ).it is concluded that female and male experience same level of work stress. The result of current study is aligned with the previous literature. As Al-Omar (2003), Makhbul & Hasun, Gyllensten and Palmer (2005) and Miller et al. (1999) state that male and female employees experience same level of occupational stress.

## **CONCLUSION**

As it is well saying that happy employees are the productive employees so more and more organization become aware about the well being of their employees.. This study basically investigates the impact of work stress on gender. Different studies show that male experience more stress as compare to female because they are the bread earner and look after their house. But now a day's more organizations are providing equal job opportunity to female. So, this study investigates the impact of work stress on genders. Results show that female and male experience same level of work stress work stress.

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# Capturing the Effect of Efficiently Managed Working Capital on Profitability

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## Abstract

This study captures the effect of efficiently managed working capital on profitability in textile sector of Pakistan from 2001 to 2006. A sample size of fifty listed companies has been selected for this research pertaining to textile industry which has three hundred observations. Statistical tools including Correlation and regression are used in this research. It is depicted from the results that there is a positive association between CR and NOP, negative association between ITD and profitability, positive relationship between APP and NOP and CCC has a negative association with NOP. This shows that expended CCC tends to reducing profit margin of the firm.

**Keywords:** Net Operating Profit (NOP), Inventory Turnover in Days (ITD), Receivables Turnover in Days (RTD), Payables Turnover in Days (PTD)

## 1. INTRODUCTION

Corporate finance has a great importance in business organizations. Working capital management absorbs a major share of finance managers time and efforts because it is a major contributor to profitability. It turns out that efficiently managed working capital is a function of credit policy adopted by the finance manager. It has been observed that improving efficiency of accounts receivables could generate bad debts whereas allowing for discounts may improve the collection of receivables. Fast collection of receivables could also result in some lost sales due to a strict credit policy. Therefore, a sound working capital management policy is usually structured on consideration of these realities.

This study captures the association between efficiently managed working capital and profitability of textile industry. It examines whether a positive relationship between profitability and working capital management exists for the textile sector or not. The financial analysis of the textile sector could reveal extra caveats relating to liquidity and profitability. Additionally, a number of interesting questions could be asked in this context; whether a particular working capital strategy is more rewarding for local business firms? How many days of working capital, firms of textile industry hold? Could some relations be established between effective working capital management, profitability of local non-financial corporate firms? The scientific analysis of these questions would reveal relative significance of working capital management in Pakistan.

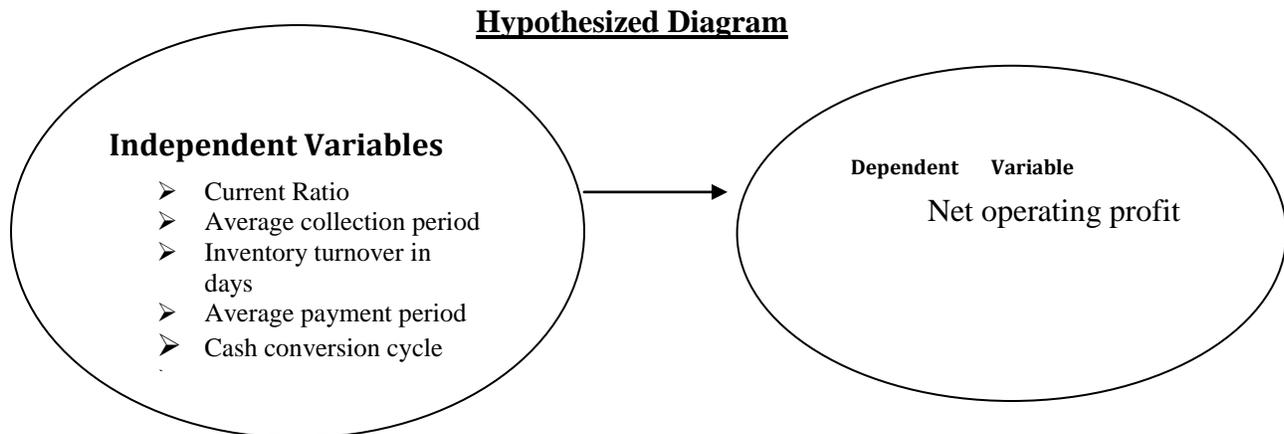
For this purpose the study develops a working capital efficiency index for the textile companies in Pakistan. The index is able to rank companies on the basis of their working capital management. Such an index could be a metric for the evaluation of managerial practice of managing working capital.

The findings of the study will help the finance managers for improving working capital management which will lead to profitability of the textile sector. Through it financial managers become more specialized in handling of day to day operations. The study is focusing on the practices pertaining to current assets and current liabilities and their effect on profitability. This study deals with the knowledge of efficiently managed working capital of textile sector in Pakistan and the findings could be extended to other sectors like trading, services etc. The main objectives of the study are to develop quantitative benchmarks in working capital management to give input to textile industry to manage its working capital more efficiently and thus create firm value.

The study covers the period between 2000 and 2005 for 50 textile companies. Secondary data is collected for the three main types of textile companies operating in Pakistan i.e. spinning, weaving and composite.

### **RATIONALE OF STUDY**

The present research discovers the effect of efficiently managed WC on Net Operating Profit by establishing four independent variables like CR, ACP, ITD, and APP. Effects of these variables is measured on dependent variable that is net operating profit for textile industry of Pakistan from 2001 to 2006.



This hypothesized diagram is derived from the study of Anand M. and Gupta P.C. (2002). They have identified those variables which are effecting the profitability of an economic entity. In the light of that study this research has been conducted which includes these independent variables: CR, ACP, ITD, APP CCC and the net operating profit is a dependent variable. Anand M. and Gupta P.C. (2002) have identified the core variables determining working capital management in an investigation of working capital performance in corporate India. They have concluded that the cash conversion efficiency,

day's working capital and days operating cycle are the core variables for chief financial officers to make their decisions for higher profitability.

The following equation is used for calculating the net operating profit.

$$NOP_{it} = \beta_0 + \sum_{all}^n \beta_i X_{it} + \varepsilon$$

The components of this equation are explained below:

$NOP_{it}$  : NOP of firm  $i$  at time  $t$ ;

$\beta_0$  : Intercept

$\beta_i$  : Coefficients

$X_{it}$  : IDVs for efficiently managed WC of firm  $i$  at time  $t$

$t$  : Time = 1, 2,.....,6 years.

$\varepsilon$  : Error term

The above model according to our specified variables is:

$$NOP_{it} = \beta_0 + \beta_1 (ACP_{it}) + \beta_2 (ITID_{it}) + \beta_3 (APP_{it}) + \beta_4 (CCC_{it}) + \varepsilon$$

## STUDY OBJECTIVES

First and foremost objective of the research is to capture the effect of efficiently managed WC on profitability in the textile industry operating in Pakistan for the period of 2001 to 2006. Based on this objective, the paper investigates the dynamic relationship among independent and dependent variables by using the Regression and Correlation Models.

## TESTING HYPOTHESES

This study examines the relationship between NOP and efficiently managed working capital in textile industry in Pakistan.

### Hypothesis 1

$H_0$ : There is no association in efficiently managed WC and NOP of Pakistani textile industry.

$H_1$ : Efficiently managed WC and NOP of textile industry in Pakistan have a positive association.

### Hypothesis 2

$H_{02}$ : There is no association in CR and NOP of textile industry operating in Pakistan.

$H_{12}$ : There is a negative association between CR and NOP in textile industry operating in Pakistan.

## LITERATURE REVIEW

The literature on efficiently managed WC and its effect on NOP of the business organizations have significantly grown in recent years. Majority of the research articles

have found a positive effect of efficiently managed WC on NOP. Lot of studies had been conducted on this subject and in concluding researchers are giving different views.

Shin, and Soenen , (1998) researched net trade cycle of a firm and its profitability. A strong negative association between the length of net-trade cycle and its profit margin has been observed in this research. Anand, and Gupta, (2002) have identified in their study the core variables determining WCM in an investigation of working capital performance in corporate India. They believe that the cash conversion efficiency, days working capital and days operating cycle are the core variables for chief financial officers to make their decisions for higher earnings. Deloof, (2003) recommended in his research that managers can add value for their principles through different financial tools like: reducing RTD and inventories up to an efficient level. Deloof finds a negative association between gross income and WCM.

Khan, et al. (2006) investigated association in WCM and earnings. They have conducted this research on non financial industry. The study analyzed the effect of WC on earnings which showed a significant negative association between firms' GP and ITD, PTD and CCC. Lazaridis, and Tryfonidis, (2006) in their work have found that if the CCC is correctly handled and if RTD, PTD, and inventory are efficiently managed, then earnings increases hence, value of the organization also increases. Padachi, (2006) found in his research that if a firm is investing huge in stocks and debtors then the profitability of that firm decreases. Padachi has concluded that WCM has a positive effect on earnings.

García-Teruel, and Martínez-Solan, (2007) have used 8872 SME, s from Spain from 1996 to 2002 for finding a relationship between WCM and profitability. They conclude that by reducing their firm's RTD ITD and by shortening the CCC firm's profitability could be improved.

To wrap up it is stated that the topic is well-tested and well researched around the world and with varied conclusions. One group of authors has reported a significant positive relationship between profitability and WCM while others have not found such a relationship. As far as the research on the topic in Pakistan is concerned, one sector specific study conducted on the energy sector of Pakistan has established a positive relationship between WCM and profitability. The other two general studies taken random samples from manufacturing sector, they have reported a positive relationship.

## **DATA AND METHODOLOGY**

The sample for this research comprises of fifty (50) Companies from textile sectors of Pakistan. The data is collected from the books of accounts for the period of two thousand one (2001) to two thousand and six (2006) comprising of two hundred and forty-nine (249) observations. The convenient sampling is used for this study. Different ratios have been calculated from the data, which is extracted from the books of accounts for the period of two thousand one (2001) to two thousand six (2006) comprising of two hundred and forty-nine observations. Those observations, which were having negative or zero values in the sample, are discarded.

## EMPIRICAL RESULTS

The data set comprises of the net operating profit, current ratio, ACP, ITD, and APP and CCC of fifty (50) companies. The time period for analysis ranges from two thousand and one (2001) to two thousand and six (2006) consisting of two hundred and forty-nine (249) observations.

### MULTIPLE REGRESSION ANALYSIS RESULTS AND INTERPRETATION

Data analysis is done by using multiple regression and descriptive statistics like mean, standard deviation, correlation and coefficient of variation. Ultimately the research is aim at capturing the effect of efficiently managed working capital on profitability.

*Table 4.1 Correlation between dependent and independent variables*

Dependent Variable	Definition
Net operating profit	Gross Profit - Overhead and other expenses

Explanatory Variables	Definition	Correlation with earning per share
CR	Short term assets ÷ short term Liabilities	0.210
ACP	365 days ÷ Debtors turnover	0.041
ITD	365 days ÷ stock turnover	0.393
APP	365 days ÷ Payable turnover	0.064
CCC	(ITD+RTD)-PTD	0.357

#### *Descriptive Statistics of dependent and independent variable*

Below table presents descriptive statistics for 50 companies from textile sector of Pakistan from 2001 to 2006 and for a total 249 firms year observations.

Dependent Variable	Definition	Mean	SD
Net Operating Profit	G.P - Overhead and other expenses	0.184	0.434

<b>Explanatory Variables</b>	<b>Definition</b>	<b>Mean</b>	<b>SD</b>
Current Ratio	Current Assets ÷ Current Liabilities	91.28	99.08
Average collection period	Days in the year ÷ Receivable turnover	469.25	632.30
Inventory turnover in days	Days in the year ÷ Inventory turnover	112.06	331.21
Average payment period	Days in the year ÷ Payable turnover	1.84	9.08
Cash conversion cycle	(ITD+RTD)-PTD	170.89	356.10

Note: Definition and descriptive statistics for variables used in analysis of dividend per share. The sample generally consists of 168 observations for 30 firms at the end of 2001 to the end of 2006. Financial statement variables were obtained from data of annual reports.

**SUMMARY  
 OUTPUT**

<i>Regression Statistics</i>	
Multiple R	0.542698049
R Square	0.294521172
Adjusted R Square	0.280005147
Standard Error	133.0824269
Observations	249

ANOVA					<i>Significance</i>
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>F</i>
Regression	5	1796719.301	359343.8603	20.28938134	6.56216E-17
Residual	243	4303756.56	17710.93234		
Total	248	6100475.861			

	<i>Coefficients</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	46.81921504	3.791136396	0.000189227
CR	0.1384139438	1.900988777	0.058486658
ACP	-0.001020	-0.763175	-0.446098
ITD	-0.402902	-5.473490	-1.09756E-0
APP	8.931933538	6.160482145	2.98635E-09
CCC	-0.037896	-0.635790	-0.525511

On the basis of results it is reported that Current Ratio has positive (0.1384) association with NOP and is statistically insignificant (t 1.9009) at confidence level of 95% and P-value is 0.0584. The value of ‘significance F’ is less than 0.05 and ACP has negative (-0.001020) association with NOP and is statistically insignificant (t-0.763175). ACP measure the speed with which receivables are converting into cash; less number of days to collect receivables will positively contribute toward NOP.

Inventory Turnover in Days (ITD) has negative (-0.402902) association with NOP and is statistically significant (t-5.473490). Less number of days in average age of inventory will curtail companies’ costs. It is observed that textile sector in Pakistan is managing their inventory levels at optimum. It is reported that APP has positive (8.931933538) association with NOP and is statistically significant (t6.160482145). As the number of days payment will be delayed it will be a kind of spontaneous financing. As long as the payables will be stretched it will be interest free financing and that amount can be used to maintain working capital and it will be more beneficial for the companies. By this behavior of companies NOP will increase if the companies can afford (liquidity position) to delay their payments.

Cash Conversion Cycle (CCC) has negative (-0.037896) association with NOP and is statistically insignificant (t-0.635790). Negative CCC will be preferred reason being the companies have more short term investment opportunities. Because they have ample time to pay their short term liabilities.

## SUMMARY AND CONCLUSION

This research is conducted to measure the effect of efficiently managed WC on earnings. Study sample size comprises of fifty firms of the textile sectors of Pakistan for the period of two thousand and one to two thousand and six. The data is collected from books of

accounts to calculate different ratios. The analysis is initiated with the application of descriptive statistics comprising of mean, median, standard deviation, and coefficient of variance, skewness and kurtosis. The study concludes that there is positive association between efficiently managed WC and earnings in Pakistan textile industry over the period 2001-2006. The infrastructure in Pakistan is very poor and there is delayism in government agencies, tax collection and tax refund is not satisfactory and efficient which cause a serious cash flow/ liquidity problems to the textile industry and increasing electricity rates are the key problems of the textile industry in Pakistan. This can be improved by focusing on value addition, reduction in cost, technology up-gradation, image building of Pakistan in order to attract FDI and accreditation and certification.

It is suggested that textile companies should strictly and efficiently manage their working capital because efficient working capital management leads to profitability in shorter run and leads to productivity in the longer run.

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# Empirical Evaluation of Entrepreneurial Intensity of Small & Medium Enterprises (SMEs) in KPK, Pakistan

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## ABSTRACT

Organizations across the globe are embattled with competitive environments. Organizations are therefore compelled to be proactive than mere reactive. All these pursuits within the organization then turn potentials into profits. Entrepreneurial orientation is the breeding ground for sustainable competitive advantage. The appropriate exercise of entrepreneurial activities raises the levels of entrepreneurship. It is called entrepreneurial intensity (EI). This can be measured quantitatively. Studying the entrepreneurial behavior within organizations is termed as corporate entrepreneurship (CE). The principle basis for selection of this particular field of enquiry was grounded in the verity that there is a dearth of CE research in Pakistan. The research was carried out to find the entrepreneurial intensity of SMEs (Small & Medium Enterprises) taken as organizations in KPK, Pakistan. The instrument was administered in 30 SMEs in KPK. The data were analyzed using statistical techniques. The EI of SMEs in KPK, Pakistan reflected a buoyant view.

*Keywords: Keywords: Entrepreneurial intensity, Competitive Advantage, Corporate Entrepreneurship*

## 1. INTRODUCTION

We are fleeting through the times of entrepreneurial revolution. The rate of innovative product and service introduction is at record levels in the majority organizations. The growth and enhancement of new technologies are taking place at an incredible rate. The pace at which these changes are being felt is forcing majority of organizations to reassess their strategies so as to maintain their competitive positions (Morris and Kurakto 2002). Corporate entrepreneurship (CE) has been proposed as countermeasure to the sluggish organizational growth and a novel way to maintain sustainable competitive advantage (Morris *et al.*, 2008).

Albeit there is a realization for importance of CE over the globe, the overall entrepreneurial practices in Pakistan seem to be precarious. Pakistan Global Competitive Index stands at 123 out of 139 countries (Schwab, 2010). For Pakistan to go up the ladder of development, it is essential for the country to have an impressive entrepreneurial ecosystem. Ireland et al. (2006) developed a CE health audit instrument to assess CE activities in the organizations. The purpose of this study is to make use of the CE health audit instrument to assess the CE levels in the SMEs in KPK, Pakistan. The entrepreneurial health of a given organization is assessed by measuring its entrepreneurial intensity (EI). EI is a function of degree of entrepreneurship and frequency of entrepreneurship.

The SMEs as segment of organizations are selected to gauge their entrepreneurial health and discuss the corporate entrepreneurship in the SMEs as organizations in Khyber Pukhtunkhwa (KPK). These organizations are strategically vital on various counts in the entrepreneurial backdrop of Pakistan.

## **RESEARCH PROBLEM**

The importance of CE is evident. Academic research on CE is growing (Bailey and Clarke, 2000). The entrepreneurial landscape of Pakistan is precarious. In view of the foregoing discussion a logical research gap vis-à-vis Pakistan with further focus on SMEs in KPK has been identified that culminated in the following research problem:

*Where does the entrepreneurial intensity of SMEs stands in KPK?*

## **RESEARCH OBJECTIVE**

The objective of the study is to find the entrepreneurial intensity of SMEs as organizations in KPK i.e. to expose and discuss the entrepreneurial intensity (EI) in these organizations.

## **SIGNIFICANCE OF CE RESEARCH**

The research will contribute to the Entrepreneurial Ecosystem of Pakistan. Therefore, this research will be instrumental for the executives and managers for their understanding of the significance and impact of CE in the organizations. There is dearth of CE research in Pakistan and this endeavor is expected to set a direction for CE research in Pakistan.

## **LITERATURE REVIEW**

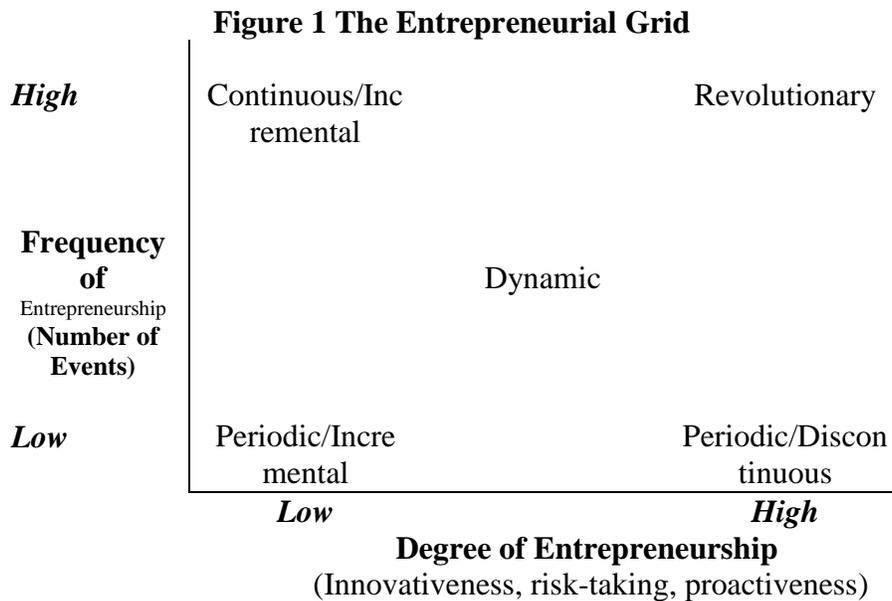
The term **Entrepreneurship** has been in use for long (Morris *et al*, 2008). The concept of **Corporate Entrepreneurship (CE)** has existed for years before the academics gave it wider visibility (Knight, 1967). The definitional facet of **CE** is entrenched in the defining the term **Entrepreneurship**. Entrepreneurship is “the process of creating value by bringing together a unique combination of resources to exploit an opportunity”

(Shepherd, 2004). CE is the term used to describe entrepreneurial behavior in an organization (Kuratko, 2007).

Entrepreneurship is a capricious phenomenon (Morris 1998; Morris *et al.*, 2008). All categories of organizations exhibit some level of entrepreneurship. The natural investigation is that how much entrepreneurial is the given organization. There are three fundamental dimensions i.e. innovativeness, proactiveness and risk-taking through which a firm’s entrepreneurial posture can be judged (Miller, 1983; Knight, 1967; Zahra *et al.*, 1999; Schilling, 2007).

Innovativeness is the aspect that captures entrepreneurial orientation. Drucker defines innovation as an effort to create purposeful focused change in an enterprise’s economic or social potential. Proactiveness is to view as *acting on* rather than *reacting* to the environment (Miller, 1987). Risk-taking is implicated in all forms of entrepreneurship (Kreiser *et al.*, 2002). The three dimensions (innovativeness, proactiveness, and risk-taking) can take various combinations. The extent to which events are innovative, risky, and proactive is called degree of entrepreneurship (Morris, 1998; Morris *et al.*, 2008).

Frequency is ascribed to the number of entrepreneurial events occurred. Firms vary considerably, moderately or relatively little in terms of the frequency of entrepreneurial events (Morris & Sexton, 1996). Function of the degree and frequency of entrepreneurship is called Entrepreneurial Intensity (EI) (Morris, 1998; Morris & Kuratko 2002; Morris *et al.*, 2008) illustrated in Figure 1.1 called “Entrepreneurial Grid”.



Source: Morris, 1998.

## RESEARCH METHODOLOGY

The methodology specifies the approach that how the research has been conducted to reach the spelled out research objectives. The objective is to carry out the entrepreneurial health audit of SMEs in KPK, Pakistan.

### *Population and Sample*

The population is a set of total number of entities and sample is the subset of population through which inferences or estimations are deduced. The population focused for this research was SMEs as organizations operating in the KPK.

### *Data Collection Method*

Small and Medium Enterprise Development Authority (SMEDA) office in KPK was approached to administer the instrument in KPK. 30 SMEs in private sector responded to the questionnaire and we may suggest that judgment sampling had been made to gather the data vis-à-vis likelihood of getting response and covering varied size and time of existence parameters of SMEs in KPK. The key executives of SMEs remained the key respondents.

Summary of the total number of responses received, the responses rejected and accepted are given in Table 1.1. The reason of rejection remains the same i.e. the incomplete response against the instrument.

Table 1 Summary of Responses, Acceptances and Rejections

Total Responses	Total Responses Rejected	Total Responses Accepted	%age of rejection	%age of acceptance
35	5	30	16.6%	83.4%

### *Measurement Instrument*

The measurement instrument called Entrepreneurial Health Audit (EHA) (Ireland et. al; 2006) was used in this study. EHA assess the organization's entrepreneurial intensity which is a combination of degree of entrepreneurship and frequency of entrepreneurship. The entrepreneurial health of an organization at a given point in time is reflected in its entrepreneurial intensity score.

It involves 21 questions (Q1–Q21, Section B; Appendix) on 5 point likert scale. Degree of entrepreneurship is measured through (Q1-Q12, Section B; Appendix) and frequency of entrepreneurship is measured through (Q13-Q21, Section B; Appendix). Distinctive factors include; existence time (in terms number of years of existence of SME), and size (in terms number of employees in the SME) are described through (Q3–Q4, Section A; Appendix) respectively. Analysis of the data was carried out using statistical package SPSS (Version16) and Microsoft Excel (2002).

## RESULTS AND DISCUSSIONS

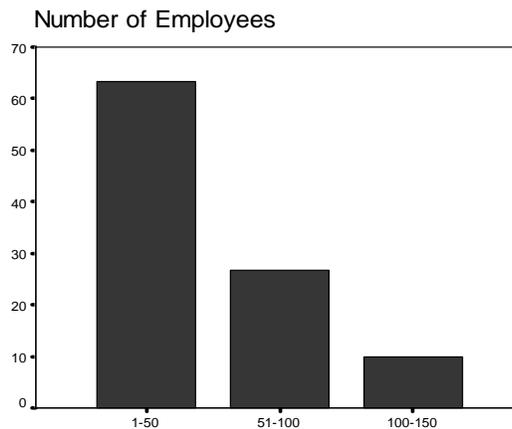
### Participation Statistics in Terms of Size of SMEs

The size of SMEs was determined by total number of employees in the SME. The responses in terms of size were captured on three bands as i) SMEs having number of employees from 1 to 50 ii) SMEs having number of employees from 51 to 100, and iii) SMEs having number of employees from 101 to 150. The participation in terms of size of SMEs is presented as follow:

**Table.2 Summary Statistics of Participation in Terms of Size of SMEs**

Size Bands (in terms of number)	Frequency
1-50	19
51-100	8
101-150	3
<b>Total</b>	<b>30</b>

**Figure.2 Pictorial Representation of Participation w.r.t size of the SME (in Percentage Terms)**



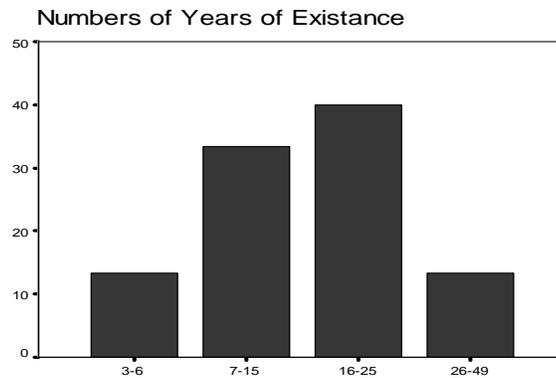
### Participation Statistics in Terms of Existence Time of SMEs

The existence time of SMEs was determined by taking their year of inception of operations in Pakistan. The responses in terms of outreach were captured on bands as i) SMEs having existence time less than 3 years, ii) SMEs having existence time between 3 to 6 years, iii) SMEs having existence time between 7 to 15 years, iv) SMEs having existence time between 16 to 25 years, v) SMEs having existence time between 26 to 50, and vi) SMEs having existence time more than 50 years. The participation in terms of existence time of SMEs is presented as follows:

**Table 3 Summary Statistics of Participation in Terms of Existence Time of SMEs in KPK**

<b>Existence Time (in terms of year of inception of</b>	<b>Frequency</b>
3-6	4
7-15	10
16-25	12
50+	4
<b>Total</b>	<b>30</b>

**Figure 3 Pictorial Representation Number of Years of existence in Percentage Terms**



**Reliability Tests**

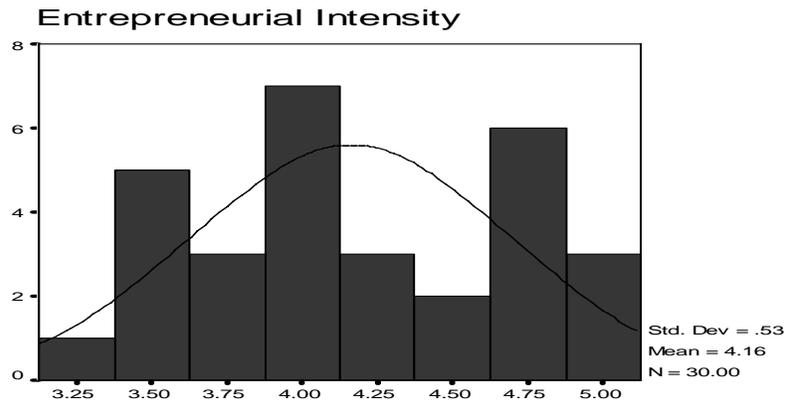
12 questions (Q1-Q12; Section B, Appendix) were used for evaluating the reliability of degree of entrepreneurship. The Cronbach’s Alpha of items used for degree of entrepreneurship was found to be 0.725. Therefore, items are reliable for further analysis.

9 questions (Q13-Q21; Section B, Appendix) were used for evaluating the reliability of frequency of entrepreneurship concept. The Cronbach’s Alpha of items used for management was found to be 0.742. Therefore, items are reliable for analysis.

**Analysis of Entrepreneurial Intensity**

The entrepreneurial intensity score on the basis of N=30 responses was 4.16 which was the mean of the 30 responses on 5 point likert scale. The visual impression of distribution of responses is illustrated through histogram in Figure 4.3.

**Figure 4. Visual Impression of Distribution of Responses**



## **FINDINGS OF THE STUDY**

The EI Score of the SME organizations in KPK, Pakistan is 4.1625. This single average at the scale of 5 is reflecting a posture that entrepreneurial health of SMEs in KPK is not precarious.

## **LIMITATIONS AND SCOPE FOR FUTURE RESEARCH**

On the basis of results drawn and the limitations encountered in this research the scope for future research is summarized as follows.

The analysis of SME sector in KPK, Pakistan is based on the responses from 30 SMEs only which was due to time constraint therefore the results of research work cannot be generalized to other types of similar institutions widely. Moreover, significant increase in sample size would bear different results.

## **CONCLUSION**

Despite precarious entrepreneurial landscape of Pakistan the SME sector as one of the segment of organizations in KPK, Pakistan reflected buoyant view of entrepreneurial health. This has framed an optimistic view. The revelation of entrepreneurial health of SME sector in KPK, Pakistan does not indicate that the results can be generalized for other institutions also. This limitation is also an opportunity for the future researchers in the field of CE in Pakistan.

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## Appendix

### MEASUREMENT INSTRUMENT\*

#### Section A

1	Name of SME	
2.	Position of respondent	

3. Indicate SIZE of SME in terms of the number of employees.

<b>1</b>	<b>2</b>	<b>3</b>
1-50	51-100	101-150

4. Indicate the *EXISTENCE TIME* (i.e. the number of years of presence in the market) of SME:

Less than 3	3-6	7-15	16-25	26-49	50+
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#### Section B

##### SME Orientation

For the following statements, please circle the number that best corresponds to your level of agreement with each statement. The number '1' indicates that more emphasis is placed on the left and '5' more emphasis on the right.

##### Our SME is characterized by:

Sr. No.		Strongly Disagree		Sam e	Strongly Agree	
01	A high rate of new product/service introduction, compared to our competitors (including new features and improvements)	1	2	3	4	5
02	An emphasis on continuous improvement in methods of production and /or service delivery	1	2	3	4	5
03	Risk taking by key executives in seizing and exploring chancy growth opportunities	1	2	3	4	5
04	A "live and live" philosophy in dealing with competitors	1	2	3	4	5
05	Seeking of unusual, novel solutions by senior executives to problems via the use of "idea people" brainstorming, etc.	1	2	3	4	5
06	A management philosophy that emphasises proven products and services, and the avoidance of heavy new product development costs.	1	2	3	4	5

##### In our SME, top-level decision making is characterized by:

Sr. No.		Strongly Disagree		Sam e	Strongly Agree	
07	Cautious, pragmatic, step-at-time adjustments to problems.	1	2	3	4	5
08	Active search for big opportunities	1	2	3	4	5
09	Rapid growth as the dominant goal	1	2	3	4	5
10	Large, bold decisions despite uncertainties of the	1	2	3	4	5

	outcomes.					
11	Compromises among the conflicting demands of owners, government, management, customers, employees, suppliers, etc.	1	2	3	4	5
12	Steady growth and stability as primary concerns.	1	2	3	4	5
<b>II. New product Introduction</b>						
		<b>Significantly Less</b>		<b>Same</b>	<b>Significantly More</b>	
13	What is the rate of new products your organization introduced during the past two years?	1	2	3	4	5
14	How many product improvements or revisions did you introduce during the past two years?	1	2	3	4	5
15	How does the number of new product introductions at your organization compare with those of your major competitors?	1	2	3	4	5
<b>Not at all</b> <span style="float: right;"><b>To great extent</b></span>						
16	To what degree did these new product introductions include products that did not previously exist in your markets (“new to the market”)?	1	2	3	4	5
<b>III- New Service Introduction (for those who sell services)</b>						
17	What is the number of new services your organization introduced during the past two years?	1	2	3	4	5
		<b>Significantly Less</b>		<b>Same</b>	<b>Significantly More</b>	
18	How many existing services did you significantly revise or improve during the past two years?	1	2	3	4	5
19	How does the number of new service introductions your organization made compare with those of the competitors?	1	2	3	4	5
<b>Not at all</b> <span style="float: right;"><b>To a great extent</b></span>						
20	To what degree did these new service introductions include services that did not previously exist in your market?	1	2	3	4	5
<b>IV. New Process Introduction</b>						
21	Please estimates the significant new methods or operational process your organization implemented during the past two years. Examples of process innovations include new systems for managing customer service or inventories, an improved process for collecting receivables, major new sales or distribution approach, etc.	1	2	3	4	5

**\*Source:** Measurement Instrument is adapted from Morris, M.H; Kuratko, D.F & Covin, J.G(2008), *Corporate Entrepreneurship and Innovation: Entrepreneurial Development within Organizations*, second edition. SOUTH-WESTERN CENGAGE-Learning. Pp. 326-335.

# A Historical Re-count of the Factors Affecting Foreign Direct Investment Decisions

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## Abstract

*This paper examines the impact of different factors on Foreign Direct Investment (FDI) with special focus on Pakistan. Over the last decade Pakistan has experienced a drastic reduction in FDI from different countries of the world. Pakistan is a stage of economic development where FDI play a critical role to move to next stage. But due to internal unrest, both politically and law and order situation, multi-national corporations (MNCs) and individual investors are not willing to invest here. This paper re-counts the factors which play important role in attracting FDI. This will help the policy makers to design a policy which will attract FDI and put Pakistan on the way of economic development. This study classifies the factors into four major categories: Political, Supply, Demand and Environmental factors and gives detail analysis of each.*

**Key words:** Foreign Direct Investment, Political Factors, Legal System, Trade Policy, Corporate Taxes, Supply Factors, Demand Factors, Environmental Factors

## Introduction

Foreign Direct Investments (FDIs) or Direct Foreign Investments (DFIs) are investments which give active controlling of domestic property, assets or companies foreign firms or investors. FDI exists when an MNC or individual investor has significant influence either potentially or actually, over the key policies of a firm. Commonwealth statistician has indicated that FDI exists where a foreign individual or foreign enterprise has an equity interest in the resident of at least 10 percent. An equity interest refers to holding of voting shares or equivalent beneficial equity interest.

FDI can be classified into two forms namely horizontal and vertical FDI. The former is also known as “market-seeking” or “resource-seeking” FDI. Horizontal FDI refers to an arrangement where a firm maintains production facilities in multiple countries, and each production facility transforms raw or intermediate inputs into finished products for sale in the local market. Vertical FDI is also known as "efficiency-seeking" FDI which refers to an arrangement where firms take advantage of cross-national differences in factor endowments.

## **Significance of the study**

In the modern world the importance of FDI cannot be ignored. Developing countries, like Pakistan, are striving hard to attract FDI to boost their economies. The government of Pakistan is taking steps to attract FDI but these efforts are not materializing. In Pakistan, FDI has decrease drastically in the recent few years and is currently around its historical minimum level. Therefore today there is a dire need to investigate the reasons behind this unprecedented decrease in the level of FDI and identify some important factors on which the government can focus to attract FDI. The current study will help the policy makers to work on those factors which can bring back FDI to Pakistan.

## **Factors influencing FDI decisions of MNCs and individual investors**

Numerous factors may influence firms' and individual investors' decision to undertake FDI in particular country. But these factors can, broadly, be classified as Political Factors, Supply Factors, Demand Factors and Environmental Factors.

### **(a) Political Factors**

“Even the best plans can go awry as a result of unexpected political or legal influences...” (Czinkota, Ronkainen, and Moffett, 1994, p. 237). Firms may invest in a foreign country to avoid host country trade barriers or to take advantage of host government economic development incentives. While making decisions about target country for FDI, MNCs focus on political factors. Political instability in the host country has been a major consideration because it affects the safety of MNCs investment. Political instability is difficult to define precisely. There are many different definitions and measures of political instability exist without convergence around a single acceptable definition. But the possible changes in policies may be a better indicator of political instability and not the changes of political parties or individuals in power.

Domestic political institutions play an important role in the political stability of a country. Having less possibility of changes in policies is considered conducive for FDI. Some studies have examined the effect of a country's regime type on FDI. The results about democratic elected governments and authoritarian governments to attract FDI remained mixed. In Pakistan, particularly, FDI remains high during non-democratic governments. But based on the recent developments around the world, environment is particularly supportive of democratically elected governments therefore Pakistan needs to provide political stability to increase FDI in the country.

### **3.1.1 Legal System**

Legal system of a country provides security to a foreign investor and its strength makes the country favorable for FDI. Copy Right rules and Intellectual Property Rights are considered as positive incentives for FDI. Some countries have very strong legal system and make them attractive for FDI. But in some countries these rules are not strictly implemented. For instance, “piracy is still considered legal in Indonesia, Malaysia, and Thailand ...” (Carroll and Gannon, 1997, p.27). All these weaknesses, if exist in a country, make it unfavorable for FDI. But even the advanced countries have

some of these problems therefore the final decision of many MNCs is not totally dependent on these issues. Pakistan has to improve its legal system to give confidence to foreign investor to come here and do FDI. Intellectual property rights and copy rights laws need to be implemented strictly to encourage foreign investors to invest here.

### **3.1.2 Trade Policy**

Since ‘the fundamental cause of trade, be it domestic or foreign, is that all factors units are not alike’ (Vaish, 1996, p. 575) therefore countries do investment in foreign countries to enjoy the benefits of comparative advantage. To protect its domestic industries, the host country forms a trade policy. Trade policy of a country means the government intervention in the market and affecting the trade and investment decisions of a foreign investor. ‘Host countries adopt policies designed both to restrict and to encourage inward FDI’ (Hill, 1994, p. 211). Pakistan needs to pay more attention to a balance trade policy to attract FDI. The interest rates are comparatively high which needs to be decrease so that it becomes less costly for firms to invest here. Inflation should be countered with better governance and interest rate should not be used for this purpose because it has a negative impact on FDI. Due to tight monetary policy, the interest rate will rise and the loan availability to businesses will be limited or will increase the cost of doing business in Pakistan. Similarly, foreign exchange rate needs to be stabilized. Due to the constant depreciation of Pak Rupee against major currencies of the world make Pakistan an unattractive region for FDI. The policy makers need to pay attention to these issues and resolve them by forming a balanced trade policy to support local investors as well as attract foreign investors to invest here.

### **3.1.3 Corporate Taxes**

Tax incentives are not an effective means of attracting foreign investors. Foreign investors consider peace, law & order, economic and political stability first and other incentives including tax incentives second when deciding on where to locate their investments. But as a part of the trade policy, ‘taxation can be used to increase control by the host government over foreign businesses (Matsuura, 1991, p. 140). A tax on corporate income is one of the indicators of a country trade policy. Corporate taxes vary from country to country but the degree of difference is not very high. Along with differences in corporate taxes, different governments signed a double tax agreement with other countries. This is a positive incentive for foreign investors to invest in country with which their home country had signed a double tax agreement. Pakistan needs to work with other countries to sign double tax agreements to provide incentives to foreign investors to invest here.

## **3.2 Supply Factors**

For many MNCs, FDI decisions are based on efforts to control their own production cost. Production costs, availability of natural resources and access to advance technology are major supply factors that are taken into account when MNCs make their FDI decisions.

### **3.2.1 Production Costs**

MNCs make FDI in foreign countries to decrease their production costs. Foreign production facilities may be less costly as compare to domestic production because of

lower input costs. Doing FDI is sometimes also attractive because of the availability of better and lower cost labor force availability. The factors determining the choice of production center change over time. For example, when Ansell, a subsidiary of Pacific Dunlop, found out that Australia was uncompetitive as a base for supplying surgical and household gloves to Europe, it initially moved its manufacturing base to Malaysia (Mahoney, *et.al.* 2001, p. 125). In Pakistan the cost of production is low but recently it is on the increasing trend mainly because of the unavailability and increasing energy prices.

### **3.2.2 Availability of Natural Recourses**

Firms may make FDI to access natural resources that are critical to their operations. Often MNCs negotiate with host governments to obtain access to raw material in return for FDI. Pakistan is resource rich country where abundant natural resources are available throughout the country, especially natural energy resources like coal and natural gas. FDI can be directed into these sectors to get benefit from the expertise of foreign firms and solve the energy crisis in the country domestically.

### **3.2.3 Access to Technology**

Access to technology advance technology in a foreign country sometimes influence FDI decisions of MNCs. MNCs may find it more beneficial to acquire existing technologies and knowledge based workers instead of developing it themselves. For example, when Malaysian authorities sought to privatize the container section of Port Klang, it sought technological expertise from elsewhere in the world. Pakistan is working on this area to get better technologies. Many foreign firms are investing here bringing advance technology along with them. Local communities are getting benefit from these technological developments. Pakistan is on the way of technological development which will encourage FDI. But the current state of technological development is far below the developed world therefore Pakistan needs to pay attention to technological development in the country.

## **3.3 Demand Factors**

### **3.3.1 Customer Access**

Many of the MNCs are required to have physical presences in the markets around the world. For example, fast-food franchises such as McDonald, KFC and Burger King and must provide easy access to its target customers domestically rather than attempting to supply from centralized kitchens. Only their presence in the local market makes this possible. If they are exporting it from a central place the quality will not be up to standard. Pakistan has a huge customer base with a population of more than 180 million which offers a unique advantage to firms doing FDI here. Services related MNCs are particularly encouraged to do FDI here because their local presence is vital.

### **3.3.2 Achieving Competitive Advantages**

FDI is one of the best means for an MNC to achieve a competitive advantage abroad which that enjoys domestically. A well known brand name MNC may choose to operate in foreign countries by doing FDI rather than to export its products from a central production facility. Often this decision depends on the product's nature. MNCs like McDonald, KFC and Pepsi could not successfully achieve the competitive advantage by exporting their products from their parent country because of the high cost of

transportation. So these MNCs have to do FDI for establishing production facilities internationally (Mahoney, *et.al.* 2001, p. 128). Pakistan offers a number of competitive advantages to MNCs in the form of lower production costs and market access to the rest of the world through roads, rails and water channels. Due to the increasing energy prices it no more feasible for many MNCs to export their products from a central location. Therefore Pakistan offers competitive advantage to MNCs to do FDI here.

### **3.3.3 Customer Mobility**

FDI of some of the MNCs may also be motivated by the FDI of their customers or clients. If an existing customer of an MNC builds a foreign factory, the MNC also decides to locate a new facility of its own nearby, thereby enabling it to continue to supply its customers promptly and attentively. Of equal importance, it reduces the possibility that other competitors from a different country will step in and become the new suppliers of the MNC. Similar firms confront firms in service sector. As one MNC do FDI in a foreign country, it existing suppliers are also compelled to do FDI in the same country to meet their customer requirements at lower cost. Therefore Pakistan need to attract FDI of some of the major MNCs and then other firms will follow the suit.

### **3.4 Environmental Factors**

In today's FDI decisions of MNCs, environmental factors have gained considerable attention from environment activists worldwide. Firms doing FDI in a country are strictly required to consider the environmental implications of their new FDI projects on natural environment. MNCs are currently more and more conscious of the environmental factors, both in the terms of reputation and clean up, of FDI projects which go bad. This factor is much debatable because lower environmental regulations can attract FDI but this has negative implications not only for the local communities but also for the whole world. Therefore environmental activists are voicing their concern about the deterioration of environmental conditions around the world. To attract FDI, Pakistan needs to pay attention to the environmental issues in the country. Foreign firms, especially firms from Europe and USA, are very much concerned for these factors. To provide a level field to all the firms in the country, Pakistan has to develop environmental code for all the firms operating in Pakistan.

### **Conclusion**

Based on the above discussion it is concluded that Pakistan has to take a number of steps to attract FDI. To boost up its economy, Pakistan needs to substantially improve the law and order situation in the country. This is the minimum requirement for getting any attention of international investors. Political stability, in terms of trade policies, is required to encourage foreign investors to invest here. Legal system in general and corporate legal system in particular needs a lot of improvements. Trade policy has to be FDI conducive. A number of steps were taken in the years from 2000-2007 but those proved short term oriented therefore trade policy needs a major review to make it more sustainable and long term oriented. Those steps were particularly encouraging for foreign portfolio investment but were not supportive of FDI. Governance and infrastructure play an important role in attracting FDI therefore Pakistan has pay attention to these issues. Pakistan is a resource rich country, both natural and human, but it has to improve the skills level of its workforce. MNCs will be attracted if a low cost labor is available with

sufficient skills level. Pakistan has large consumer market therefore MNCs are willing to invest here. Pakistan has to impose restrictions on imports, especially on finished consumers' goods, so that MNCs should get advantage of their FDI in Pakistan.

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