

SME DEVELOPMENT IN PAKISTAN: ISSUES AND REMEDIES

[I] BACKGROUND TO SMEs AND ITS IMPORTANCE

Introduction

— Today SMEs are widely regarded by experts as the panacea for many economic problems confronting the LDCs. In particular, vibrant small-scale sector—incorporating the informal firms—is expected to solve a variety of problems, including unemployment, low growth and poverty. SAARC region countries too have designed policies for the promotion of this sector, though with uneven results. Yet their faith in SMEs is ever growing. The planners now realize that since the modern production methods are generally more flexible, so manufacturing can be undertaken anywhere, and at any level through inter-firm linkages. At the same time individual country experiences in the SAARC region, and also in other parts of the world, indicate that the real catalyst for the SMEs growth is the general economic environment born of a pro-active industrial policy.

— **For a longtime the mainstay of Pakistan’s industrialization strategy was large scale manufacturing which recorded 8.78% growth rate during 1950-2003 as it was consistently supported by a set of macroeconomic policy measures. The small-scale sector too registered an impressive growth rate of 5.06% during 1950-2003 and that too without benefiting directly from policy support.** It virtually existed in the shadow of the large scale-manufacturing sector. [Table-1 & Table-2]. A distinct feature of Pak manufacturing sector is its product diversification: textile (24.02), Chemicals (15.17%), food (13.77%), followed by others. It needs to be mentioned here that all these sectors comprise of large, medium and small firms, except in cases where economies of scale do not permit small-scale production e.g. automobiles, steel, fertilizer, heavy engineering, etc.

— **The government statistics show that Pakistan’s SMEs sector recorded an impressive growth of 14.7% during 1987/88 – 1996/97 when the estimated value of its output increased from Rs. 19,683 million to Rs 67,541 million. Meanwhile, the number of Small¹ and Household² Manufacturing Industries recorded growth of 5.8% in that period. The contribution of SMEs to Pakistan’s economy, employment and poverty reduction can be seen from**

the fact that 90% of all private sector manufacturing units employ less than 99 workers and the SMEs employ some 78% of non-agricultural labour force. They contribute about 30% to GDP, Rs.140 billion to exports, and generate 25% of exported manufacture [GOP 2005, P293]. This data is based on the assumption that manufacturing units employing less than 100 workers are part of the SMEs.

[2] PRESENT STATUS OF SMEs: TYPES, SIZE AND SPREAD OF ENTERPRISES

— There is no single official definition of SMEs in use in different organizations of Pakistan. In particular, the world of medium enterprises is a grey area. In fact, the CMI (Census of Manufacturing Industries) data include all manufacturing units with 10 or more workers in the category of large scale manufacturing units. Since the official statistics in Pakistan do not have information on the medium enterprises, therefore it is not possible to know about their real size.

— **The SMEs Policy (2005) recommended adoption of a unified legal definition, which would define an SME in terms of either “employment size” or “assets (excluding land and building) [SMEDA, 2005].** It lays down separate bench marks for the small and medium enterprises [Table-3] and would hopefully clear the existing clutter in the policies of various institutions like Federal Bureau of Statistics, Small and Medium Enterprise Development Authority (SMEDA), State Bank of Pakistan, SME Bank, and Small Industries Corporations/departments of provinces. Until October 2005, there was no single criteria to serve as a basis to determine the effectiveness of SMEs policies or the government spending or the development of this sector in Pakistan because nobody knows with certainty the parameters of SMEs.

Size Distribution of Pak SMEs

— Notwithstanding the infrequent surveys of SME sector in Pakistan, the number of such units, especially small, is probably much larger than is officially reported. The surveys normally cover those firms that are registered and a large number of very small firms go unrecorded because they seek to remain hidden or the enumerators are not fully motivated to include them in the data. Most of small firms in Pakistan are very small, with limited employment potential and little chance of growth; their primary concern is survival. In general, the firms with relatively more workers are smaller in number and those with smaller number of workers are in majority. Moreover, most of the firms are owner-managed,

supported by family workers. The hired workers are few and found mostly in growing firms.

— According to the latest Economic Census of Pakistan (2005), there were 2.96 million units in the country, of which 2.8 million (93.9%) were Establishments³ and 0.18 million (6.1%) were Household Units (including all activities of producing goods and services for sale or barter in the market). Further, Punjab had the largest share of 65.26% in the total establishments in 2005, followed by Sindh (17.82%) NWFP (14.21%) and Balouchistan (2.09%) [GOP 2005, P.14].

— Of the total 2.96 million Establishment and Household units, about 53% were in the major industry group of Wholesale and Retail Trade and Hotels / Restaurants, followed by Community, Social and Personal Services (22.3%). Manufacturing is the third largest group with 19.72% share of the total Establishments. [Table-4]. Among the Household units, the highest share is that of Manufacturing sector (66.5%), followed by Community, Social and Personal Services (20.5%), Agriculture, Poultry Farming, Fishing etc. (8.7%), and Wholesale and Retail Trade, etc. (about 4.00%).

— Manufacturing firms' data show that, of the total 5,83,329 units in the census, 117176 were Households units (20.0%) and 466153 (80.0%) in the category of Establishments. The majority of the total manufacturing establishments (43.2%) were in Textile Wearing, Apparel and Leather industries, followed by Food, Beverages and Tobacco (20.9%), Wood and Wood Products (10.8%), Fabricated Metal Products, Machinery and Equipment (10.0%), Other Manufacturing Industries and Handicrafts (8.9%) and the remaining sectors had 11.1 % share. It is also interesting to note that in the largest industrial group of Textile Wearing, Apparel and leather, 31.5% were Households and 68.5% Establishments. The other important group of activities within the Household sector was Non-metallic Mineral Products (28.0%). Another distinct feature identified by the Census is that about 85.0% of the Household Manufacturing Establishments were located in the rural areas. [Table-5]. Further, the Textile, Apparel and Leather segment had the largest share (54.0%) among the rural area Household units. Other Manufacturing Industries and Handicrafts in the rural area Households had a share of 18.0%. In the urban areas, the largest share of the Household Establishments was that of Textile, Apparel and Leather Industries (78.7%), followed by Other Manufacturing and Handicrafts (9.3%), Wood Products including Furniture Manufacturing (3.3% and the remaining industries (8.6%). Overall, in the urban areas the

share of Manufacturing Establishments (other than Households) was the largest (93.8%). Within this category, the share of Textile, Apparel and Leather was 43.0%, Fabricated Metal Products 15.8%, Food and Beverages 12.8%, Wood and Wood Products 11.6%, and the other sectors 16.8%.

Employment in SME Sector

— A known feature of SME sector is its ability to create jobs. Pakistan faces the major challenge of unemployment as its labour supply continues to grow rapidly. According to the Economic Survey 2004-05, Pakistan's labour force increased from 42.39 million to 45.23 million during 2001/02 – 2003/04 (GOP, 2005). Add a backlog of millions of unemployed workers, and one can appreciate the urgent need for promoting small-scale labour-intensive economic activities [Table-6]. On the other hand, because of limited capital availability for business, the size of modern sector is likely to remain small in the coming years. In this situation the small-scale sector is a ray of hope and is luckily growing.

— **The Economic Census (2005) showed that 2.96 million Households and Establishments employed 6.58 million persons. The employment pattern of the Pakistani Establishments was such that of a total of 2.96 million, 2.85 million units (96.6%) employed 1-5 persons, 0.079 million (2.67%) 6-10 persons, 26,000 (0.87%) 11-50 persons, and 1617 (0.054%) over 50 persons.** In the case of Manufacturing Establishments, 5.31 million (91.0%) had employment size of 1-5 persons, 39000 (6.62%) of 6-10 persons and over 12000 (2.05%) had 11-50 employees, and 1122 firms (0.19%) had over 50 workers. Among the 1.56 million Establishments of Wholesale Retail, Trade, Hotel and Restaurants, 1.55 million employed 1-5 persons. Similarly, 0.625 million (or 95%) Establishments in Community, Social and Personal Services sectors were also placed in 1-5 persons group [Table-7].

— **Of the total 6.58 million employed in the Households and Establishments, 0.46 million (i.e. 7.0%) were females. Among the females, 15% were self-employed/proprietors and 30% were unpaid family helpers; while the remaining 55% were paid employees. Out of total employment of 6.58 million, about 0.34 million (5.0%) were employed in Household units and among them 46% were female. [GOP 2005, P-ii and P-iii].**

— **The informal sector (self-employment) data deserves close attention. In 2003-04, informal sector accounted for 70% of the employment in main jobs outside agriculture. The informal sector employment in the rural areas (72.90%) is even higher than that of the urban areas (67.2%) As the trend goes, formal activities are concentrated in urban areas (32.8%) compared to**

rural areas (27.1%) and may continue to remain so. Since the informal activities are predominantly non-agrarian, male workers are more concentrated in informal sector, both urban and rural [Table-8]. Further, informal employment is concentrated most in the Wholesale and Retail Trade (34.4%), Community and Social Services (18.7%), Construction (13.4%) and Transport (11.70%), [Table-9]. Informal sector employment show that a majority (43.7%) were self-employed, followed by employees (43.1%), then unpaid family helpers (11.7%) and finally the employers (1.5%) [Table-10].

Female Managed SMEs

— Some of the urban SMEs are also female owned or managed. In a recent study of the Women Enterprises in Urban Lahore [GCU, 2004] hitherto unknown factors emerged as important variables bearing on their performance. As we move across income groups and firm sizes, the motivating factors of the business women tend to change. In the subsistence income group she acts as a wage earner. The lower income groups operating micro and small enterprises are also wage earners but mostly produce for a middle man. The medium income groups operating micro and small firms tend to be retailers and rely on out sourcing for production; their main concern is generation of income and raising of standard of living. Like in so many other countries of Asia and Africa, Pak female-owned/managed businesses are concentrated in selected sub sectors like fashion-designing, dress-making, knitting, cane work, and food retailing. These activities are mostly home-based and thus go unrecorded in the official statistics.

Diversity of SMEs

— The above details highlight the extent of diversity of SMEs in terms of size, product lines, resource base, management structure, growth requirements and so on. The medium-sized units have their distinct characteristics. They are more resourceful, with better access to market and the supply side inputs, including technology. Accordingly, the two groups of firms, medium and small, are different in terms of their product quality and growth potential. The extent of diversity of SMEs can be gauged from the fact that they operate in the manufacturing, agriculture and services sectors at different production levels despite many institutional and firm-level constraints. Besides they operate in urban and rural areas, though are concentrated more in the former. Despite their heterogeneity, SMEs are generally concentrated in selected activities such as: (i) Metal working, (ii) Furniture, (iii) Agro-based, (iv) Sports goods, (v) Fisheries, (vi) Poultry (vii) Gems and Jewelry and (viii) Food and Catering

— Even among small firms, the extent of variety in terms of production activities is very large. It cuts across all sectors, though may not be fully recorded in the official data. Put together, the SMEs make a much more complex and diverse group of enterprises existing in different sectors of Pak economy. Depending on the type of activity, product, skill and technology required on the one hand and the level of demand on the other, a large number of SMEs operate in different sectors of the economy. However, SMEs are not found in every industry, particularly where the economies of scale act as barrier to their entry. [Aubrey (1951)]

[3] THE REQUIREMENTS OF PAK SMEs

— There can be two ways of assessing the SMEs requirements: (i) where we lump together the Small and Medium firms and record their essential needs; or (ii) disaggregate the group into two (or even more) distinct groups and pinpoint their required inputs. We prefer the second approach because it is more reliable and thus, likely to be amenable to policy measures. The first step in that direction is to know the “binding constraints” i.e. the problems of the two major groups of enterprises: (i) the SMEs; and (ii) the micro enterprises. **At a more general level, every firm — small or medium — requires access to capital, better skills, product design, technology and to market. But every firm, irrespective of its size, may not have full access to these inputs for various internal and external factors which act as virtual barriers on its working. Another critical issue is that the firms’ input requirements differ in various phases of entry, survival and growth. Obviously, the nature and extent of inputs required in different phases will vary and would be industry and product specific. So there is a need to identify two separate sets of requirements of SMEs: general and group-specific and also pinpoint the phase-wise needs of each group of firms.**

3.1. General Requirements

Access to Institutional Finance

— Pakistan has a fairly developed financial system spread over most of the urban and rural areas of the country. There were 6974 branches of commercial banks, in December 2004. On top of these a number of specialized financial institutions working in support of SMEs: (i) the SME Bank, (established 2002); (ii) Khushali Bank, (established 2000); (iii) The First Micro Finance Bank; and (iv) Network Micro Finance Bank and Rozgar Micro Finance Bank (established 2001) [Table-11 and Table-12]. The three types of Micro Finance Banks have the mandate to work nation- wide, province-wide or district-wide with minimum capital of Rs. 500/=, Rs.250/= and Rs.100 million, respectively.

— In addition, all commercial banks have the mandate to provide credit to SMEs and they have their special schemes in place for this purpose. Nonetheless, SMEs are generally found to be short of institutional credit. So they have to rely on their own credit for a number of activities such as upgrading of technology, increase in production, purchase of inputs and better quality materials. In many cases the SMEs rely on personal savings, including financial help of family and friends. This is particularly true of small businesses which may not even approach centers of financial credit for fear of rejection.

Access to Technology

— The SME, in particular the small industries of Pakistan, are known to rely on low and obsolete technology. Associated with this is the lack of technical skills needed for producing quality products. There is a general absence of information on opportunities for technological upgradation. This drawback acts as a major barrier on road to knowledge-based modern economy. A part of the problem is linked to the inability of SMEs to acquire sophisticated equipment and R&D facilities. This is manifested in adoption of labour-intensive production methods associated with lower productivity levels and overall economic efficiency. **A typical Pakistani small firm used indigenous machines of old-vintage and relies on traditional productions methods for survival. They end up producing low-quality, low-priced products and sell it accordingly. A system to correct the existing gaps in technology and skills can be laid down with the help of industrial information network for SMEs. The other and probably more important component is acquisition of new vintage technology through large-small production linkages.**

Skills

— The story of Pakistan's technological resources base and its origin is fairly well known. Lahore, Sialkot, Gujranwala and Wazirabad are old centers of engineering activities. The small firms of these cities produced machine tools, diesel engines, surgical instruments, electric fans etc. even in the pre 1947 years — the time of partition of Indian subcontinent [Kibria, 1998]. With the trans-border migration of millions of people across the Punjab in 1947, many skilled Muslim workers of India arrived in Pakistan and formed the core of skills reservoir in the newly born state. Without this essential input, the old centers of SMEs and the new established clusters of textile firms in and around Lyllpur (now Faisalabad) and sports goods in Sialkot and other places would not have been established.

— Like all less resourceful firms, the SMEs typically have skill deficiencies and are unable to compete with larger firms' better-qualified manpower. Inter-firm transfers of skilled labour is a usual phenomena directly influenced by relative wage levels. In this game the larger firms have advantage over SMEs, especially in a situation of skill shortages as is occasioned in Pakistan as a result of out-migration of labour to Middle East and other countries.

— It is worth nothing that, contrary to the common perception, there is a hierarchy of skills within each category e.g. (mason, plumber, electrician) as per the skill level and they are paid accordingly. As a matter of fact, an excellent worker would get a premium wage from a larger firm which a SME may not find it feasible to pay. So a smaller firm may be out competed because of limited funds despite its need for high skilled workers.

Organizational Structure/Management Level

— Management skills and organizational structure are closely linked across all sizes of firms. The managerial ability influences the performance of the firms. It has been recorded in a number of studies that the economic performance of SMEs of Pakistan is being negatively affected by the insufficient managerial skills, especially of the small firms (Aftab and Rahim, 1986). **The foremost cause of low management skills of SMEs is the low educational and professional training of the business managers. In particular, SME managers are found deficient in bookkeeping, marketing, cost accounting, stock management, production scheduling and quality control. The managers are unaware of the importance of assets valuation and in some cases even adopt personalized management style, all resulting in low economic efficiencies.**

Marketing

— One reason Pak SMEs fail to enter export market, and in some cases even upper segments of the domestic market, is their inability to match products with the new trends in demand. **Successful marketing of SMEs output is influenced by a number of factors like quality of design, finished goods, skill level, raw materials, and after-sales service.** No wonder that SMEs do not manage to get a direct share in the export market. In view of their constraints, SMEs have an option of acting as linkage-partners of the large firms gradually building up their own resource base before becoming direct exporters.

3.2. Specific Requirements of Micro Enterprises

— As discussed above, three types of principal constraints inhibit entry and survival of SMEs in Pakistan: (i) access to finance; (ii) access to inputs; (iii) access to markets for the products. As the micro and small enterprises enter the growth phase, the relative importance of the constraints change. It may be noted that even a micro enterprise can manage to create a small surplus for use on its growth plans. In the case of fast growing micro firms, this constraint is even less significant. Across countries the requirements of micro-enterprises are quite similar [Liedholm and Meade, 1999]. Pakistan's micro-enterprises also face many binding constraints in entry and growth phases. At the entry stage these are: (i) Fixed Capital (ii) Working Capital (iii) Recovery of credit given to customers. (iv) Access to product design. (v) Access to tools, equipments raw materials: particularly for the units in small towns (vi) Access to markets: inadequate demand; more for units in small towns. (vii) Skilled labour. (viii) Taxes. (ix) Transport and communication facilities, and (x) Government regulations. In the growth phase the constraints change and so do their importance as given below: (i) Educational level of entrepreneur; (ii) Family background: (business traditions); (iii) Personal qualities: (attitudes, etc.) (iv) Access to institutional finance. (v) Access to new product design. (vi) Access to modern technology. (vii) Access to raw materials, equipment, tools, etc. (viii) Access to advanced skills. (ix) Access to markets. (x) Tax system and costs. (xi) Government regulations and (xii) Access to modern infrastructure and communication facilities. SME policy will have to design programmes to overcome these constraints and to spell out specific supporting measures for them. This presupposes a proper understanding of the characteristics, requirements and growth pattern and their potential to contribute to the development goals.

[4] PROBLEMS AND CONSTRAINTS ARISING FROM THE CURRENT POLICY ENVIRONMENT

— (A) As discussed in section [3] above, the current SME policy of Pakistan does not take into explicit account the heterogeneity of the sector and, thus, consists of broad recommendations for the entire SME sector. This is the fundamental flaw in the current SME policy in Pakistan. The empirical evidence suggests the need to adopt the group-specific approach, which keeps the special needs of micro, small and medium firms in view for ensuring higher growth of firms of different sizes.

— An interplay of a number factors technical and economic, finally determine the profitability and size of firms. Included among these are the

following major factors with a direct bearing on why some products are preferably produced at small scale level: (1) dispersed resource processes; (2) local markets; (3) service industries; (4) separable manufacturing operations; (5) handmade projects; (6) simple assembly processes, (7) differentiated products; and (8) small market size. **Any worthwhile policy reforms initiative for the sector will have to take into explicit account the static and dynamic (long-term) requirements of SMEs with reference to (a) demand-side and (b) supply-side factors. In other words, enterprise dynamics should provide the basis for policy formulation to meet the short and long run needs of SMEs. [Staley and Morse 1965]. Most of the known constraints of this sector relate to the “static challenges” i.e. survival in a competitive environment or in a shrinking market. These are grouped under the following majors heads: (1) rules and regulations; (2) labour laws, (3) access to institutional finance; (4) tax liability, and (5) trade restrictions.**

Rules and Regulations

— **Businesses face a complex legal, tax and administrative environment in Pakistan, so every firm is anxious to avoid economic obligations associated with the registered status.** For example, among the five major types of business structures (sole proprietorship, partnership, companies, cooperative societies and non-profit associations (trust, etc), the first is the most common in Pakistan. This form particularly suits small businesses for reasons of costs, low complexity and the ease of compliance with regulations. **SMEDA (2001) survey data revealed that 72% of all SME enterprises were sole proprietors, 12% partnerships (registered), 9% partnerships (unregistered), 6% private companies and 1% (other).** It is equally interesting to note that sole proprietorship was also the most favoured form of business organization for micro, small and even medium sized firms. **The sole proprietorships and unregistered partnerships don't legally require registration or prior approval from any Government department or agency.** However, this type of organization doesn't absolve them of obligation to meet labour, taxes and other regulations. But these firms enjoy tax concessions and low fixed costs because their documentations costs are very low. Similarly, micro firms (employing 1-9 persons) operate as sole proprietors with no legal obligations. In the case of partnership too the firms prefer to remain unregistered partnerships, a status which confer freedom from compliance of laws. **Small firms unregistered status has a negative impact on their access to institutional finance, yet they prefer to remain in informal sector.**

Labour Laws

— **Small enterprises operate outside the domain of the labour laws which otherwise are many and fairly complicated to operate. Provisions of Employees Old Age Benefits and Employees Social Security are just two among 76 labour laws, (Provincial and Federal) some being industry specific, in the provinces and are fairly complicated to comply with.** Compliance of labour laws is prohibitive in terms of time and money. Therefore small units prefer to work in the informal sector or try to avoid registration under multiple laws, which are prohibitive for businesses. Besides, there is also lack of awareness of existing labour regulations, especially among the smaller entrepreneurs.

— Even large Pakistani firms would prefer avoidance of Labour Laws. This attitude can be partly changed through proper education on the rights of owners and the benefits of enhanced labour productivity linked with labour welfare impact of laws. However, there has been little improvement in terms of entrepreneurs' acceptance of the 100 odd existing labour laws for various reasons: (i) laws are complicated and written in English; (ii) complexity of the laws; and (iii) cost of compliance. To add to it are the discretionary powers of labour department, which is worsened by the lagging performance of labour courts. [ILO, 2002].

Access to Institutional Finance

— Pakistan's Finance policy is often cited in reports as a major obstacle on the way so much so that even after Banking Reforms in the 1990s, which substantially liberalized banking operations from the regulatory reforms of the State Bank of Pakistan, the micro and small enterprises are unable to access the formal sources of credit [ILO, 2002]. **It is, however, interesting to note that according to the Small and Household Manufacturing Industries data (1996-97) almost 17000 informal firms had obtained credit from the formal credit sources.** On the face of it, this data is somewhat misleading because it probably includes relatively resourceful, including medium-sized units which manage to operate without being officially registered, but have access to institutional credit. Another, important point to note is that in Pakistan, the ratio of actual SMEs units to the registered firms (i.e. with the Businesses Associations like Federation of Chambers of Commerce and Industry) is about 1:3. So what is on record is probably different from the actual and this gives a leeway to manipulations by the resourceful businesses which otherwise may not exist on the record. The Smeda data of 2001 corroborates this information, though the sample configuration in the two sources is quite different. Smeda's sample includes formal firms registered with government departments whereas SHMIs data relate to unregistered

(informal) firms only. However, one noteworthy observation in this case is that firms' access to formal credit sources increases with their size. Accordingly, medium-sized firms manage to get bank credit in over 75% cases for short and long-term needs, but in the case of micro and small enterprises (MSEs) it is very low [Smeda 2001].

— **The biggest stumbling blocks are the State Bank of Pakistan's (SBP) Prudential Regulations and documentation requirements, which the MSEs are just unable to meet. In the recent past, the SBP allowed Collateral-free lending of upto Rs. 100,000/= to promote micro businesses.** As sole proprietors—without legal requirement of documentation—micro enterprises don't maintain regular accounts. Accordingly they face barriers to access to bank credit, though may reap other production related benefits on account of their informal status. **The Clean Lending Limited of Rs. 100,000/= as loan tenable in the case of MSEs under the State Bank's Prudential Regulations offers some relief, though it is insufficient to meet their entire short term capital requirements.**

— Another component of Pakistan's financial sector comprises the non-banking financial institutions, which also operate under SBP supervision. Most of these regulations are similar to those of the commercial banks, with same effect on the MSEs. State Bank of Pakistan regulations require the non-banking financial institutions (NBFIs) to allocate 5% of their total loans to small enterprises. If properly implemented and extended to all regions of the country, such schemes can partially meet the financial requirements of MSEs.

— Government of Pakistan introduced a number of schemes in the past targeted at provision of institutional credit to the MSEs. First Women Bank's micro credit scheme which gives small loan of Rs. 25000/= to women entrepreneurs with an excellent recovery rate of almost 100%. This scheme now covers rural areas as well. Second, Khushali Bank and Micro Finance Banks also provide micro credit to small investors in the rural areas with the objective of poverty alleviation. The initial target of the Bank was to provide Rs. 60.0 billion to small investors over 5 years period. Third, SME Bank has the mandate to provide institutional credit to the small and medium enterprises, but the subsidized credit is availed almost exclusively by the medium exporting firms and does not reach the MSEs — the sub-contractors to the medium and large firms. The solution to this problem lay in removing the subsidy on interest rate admissible on export credit so that the benefits do not reach the unintended group of exporters. Fourth, another policy initiative of the Pakistan Export **Finance Guarantee Agency is aimed at removing the requirements of collateral by the**

banks with upto 80% payment guarantee to exporters, including MSE, The upper limit of each transaction on which 80% guarantee is admissible is US \$100,000. It is targeted at the MSE exporters and firms can have access to pre-shipment export loans. The hiccups of this system can be removed if it is administered with the collaboration of Trade and Business Associations, which have better information on the reliability and credit worthiness of borrowers, as it did in Japan in its early phase of SMEs expansion.

Export Finance Scheme

— Although in operation since 1972, this scheme was improved in 1998 to make it accessible to MSEs in addition to the medium-sized firms with more resources. Consequently this facility is now also available to the small enterprises acting as sub-contractors (so called indirect exporters) for an exporter. It provides finance to the exporting firms at two levels: (i) working capital and (ii) loan equal to 41.66% of the total value of exports in the preceding year, which is provided at a low (subsidized) rate of interest. In reality, however, the small firms hardly have access to the credit of Export Finance Scheme because of either ignorance or inability to avail it for personal reasons or both. Effective measures to take the benefits of this scheme to the small firms are highly recommended.

Fiscal and Taxation System

— **There is sufficient evidence that local tax authorities harass small firms regarding assessment of income tax. This threatens entrepreneurs away from business and even cause revenue loss to the Government. Hence Government should involve local Small Businessmen Associations for assessment of individual firms' tax liabilities. This will get group support for tax collection and also ensure regularity in revenue collection.**

— **The real problem is the common practice of small businesses to avoid regular account keeping.** The entire culture of small businesses is informal which seems to have seeped into the world of small enterprises. In contrast, large firms are offered concessions by government including exemption from tax payments i.e. tax holidays. Similarly, firms exporting goods produced by small units are given substantial tax rebates, but the producers do not receive any benefit for producing exportable goods. Thus there are reasons for the parent firms to avoid payment of tax liabilities as a survival strategy.

— **There is a general perception that Pakistan's fiscal policy supports large firms alone to the neglect of SMEs. Some of the suggestions included in the SMEs Reform Agenda are: (i) rationalization of duties so as to make**

them uniform for all firms; (ii) exchange rate management system be made effective to smooth out rate changes which SMEs find unbearable; (iii) SMEs production should get a “fair share” in government purchases [Roomi, 2000]. These measures can be useful for SMEs growth.

Trade Policy and SMEs

— Pak industry has an oligopolistic structure characterized by dominance of big players wielding influence on policymaking and many SMEs — with little say in economic decisions making meant for their promotion. **In the realm of trade policy too, the SMEs hardly receive their due in real terms:** (i) **The foremost problem with trade policy is its inconsistency reflected in Statutory Regulatory Orders (SROs) relating to trade procedures. Frequent changes in SROs cause distortions in cost calculations, which are less sustainable in the case of smaller units. Second, in some cases special SROs are issued to help one firm over others;** (ii) **Rebates and other concessions hardly reach the small subcontractors (indirect exporters). The financial incentive included in export rebates are entirely availed by the large exporters;** (iii) **Direct exporters exporting 80% of or more of their output, are exempted from the hassle of filing Income Tax returns and this work is done by the Banks for them. By contrast, all vendor firms are obliged to file their tax returns and maintain books, record etc, despite being the direct contributors to the exports by the large units;** (iv) **Government’s export promotion schemes generally focus on the large firms. Large firms in special industrial zones enjoy waiver of customs duty and sales tax on imports of inputs depending on firm size (i.e. firms employing 100 workers or more). This automatically bars micro, small and medium firms from benefiting from this incentive package;** (v) **Similarly some other incentive schemes such as No Duty No Draw back (NDND) and Manufacturing in Bond (MiB) are related to temporary imports for exports but are not designed for MSEs as they do not have the resource base required for the stipulated scale of output to enable them to avail this facility. The small firms are unable to generate the volume, which would make NDND economically and legally viable for them.**

B) Constraints on Medium Enterprises

— **Technological constraints constitute a formidable problem for the small, but much more for the medium firms. Traditional medium firms use the low-quality production methods, resulting in poor quality of their products. These firms rely heavily on old technologies and replicate low-**

quality old products. Obviously they do not find a niche in the world market for those products.

— Though the birth-pangs of a new medium-sized firms are also painful, in fact more because of the much higher demand for various inputs, yet unlike a small firm which is governed by the market size, **a more resourceful medium firm is not dictated by the market forces and, thus, there is a scope for “conscious planning of economic activity” [Penrose 1980, P15].** Making use of its resources and modern (formal) organizational structure, a dynamic medium firm can grow as big as is dictated by the cannon of efficiency. However, these firms do not qualify for any special facility like concessional credit. Their most urgent requirement is access to new product designs and modern technology. **In the light of East Asian experience of rapid industrial development, an effective official channel for technology transfer would definitely promote growth of existing medium firms as well as help in diversification into new and superior product lines.**

[5] REQUIRED POLICY REFORMS FOR STRENGTHENING SME SECTOR

— The two suggested touchstones to assess the efficacy of current SME Policy in Pakistan are: (i) has this policy created the truly enabling environment for sectoral growth, and (ii) how innovative and supportive these policies are for the enterprises?

Finding Suitable Environment for Small Industry

The large size SME sector limits Governments’ and the institutions’ ability to achieve complete coverage by supporting programmes. Moreover, inconsistent economic policies create perpetual managerial problems at the firm level. Rigid bureaucratic controls and legal requirements make the environment unfavourable for business. A number of public programmes, detailed below have been launched for supporting SMEs, though their impact has been subdued so far: (i) supporting institutions and industrial estates; (ii) export processing zones; (iii) technology upgradation fund; and (iv) non-governmental support, particularly for providing funds to the small enterprises. Among these are the National Rural Support Programme (AKRSP), Punjab Rural Support Programme (PRSP), and others.

— Under a revised policy (announced in 2005) the SME support initiatives are now being designed on the pattern of Japanese model, which stresses their importance and provides guidelines for structured SME

development. Pakistan has designed a coherent policy for SMEs promotion through Smeda (established 1998) — an important national institution responsible for spearheading Government’s SME development efforts. It has adopted a sectoral development approach with a focus on a few priority sectors with growth potential: (i) furniture; (ii) gems and jewelry; (iii) sports goods; (iv) surgical instruments and fans; (v) marble and granites; (vi) dairy and (vii) light engineering. The current Smeda policy highlights it and is committed to the provision of six critical services needed for the SMEs of these sectors: (i) business regulations; (ii) fiscal concessions; (iii) trade rules, (iv) labour laws; (v) incentives and (vi) support, (i.e. HRD, technology and marketing). As is well known, factors which make for success in small-scale business are to be found in the set of techno-economic conditions which bear directly on the scale of plant, and how these conditions interact with marketing, financial and managerial factors that influence the size of firms. The ultimate success of small business will be influenced by the interacting effects of production costs, scale economies, market characteristics and location factors.

— We can see why Pakistan’s small businesses operate in selected product markets of children clothing, specialized products, precision hand work such as jewelry, hand printing and metal products. These product lines sustain large number of small producers who have small initial resources. So the lesson of experience is that wherever made possible by the techno-economic factors, **entry-facilitating conditions must be created for small businesses through policy measures, directed to selected product markets. Smeda’s targeted schemes for the priority sectors appears to be the correct approach under present conditions.**

SMEs and Economic Efficiency

— First and foremost, small firms are generally inefficient and have to be made efficient through proper policy support and guidance. Small industry needs to be made buoyant and progressive partner in development process. The best way to do so is to establish strong small-large links in production, wherever feasible. **In this manner economic inefficiencies associated with small-scale as well large-scale production can be reduced through division of labour.**

— **Complementarity of small and large industry is the primary process through which artisan firms are transformed and subsequently from a competitor to a partner with the large producers. Small-large links are of two types: forward and backward.** In some cases small firms use

components/parts made by large firms to make products of their own. In other, a small firm may produce a component or a part for a large manufacturer i.e. subcontracting. This type of arrangement is quite common in Japan, Korea, China, and Taiwan. Generally, small firms are quite dependent on one or a few large customers in these countries. Such production arrangements can serve as a strong basis for ensuring survival, and even growth of small firms in Pakistan [Aftab and Rahim, 1986].

— **Large-Small Links may not get established automatically, they are to be developed with Government policy support.[Staley and Morse, 1965].** Emergence and growth of small industry in Pakistan owes itself to a variety of initiatives started by Government in the early 1950s and later for the promotion of industrial sector. Diffusion of industrial skills through training programmers, import licensing for import of technology, raw materials, cheap machinery, raw materials and concessional monetary and fiscal policy favoured large industry directly and small industry indirectly [Ahmed, and Amjad 1984]. As a matter of fact, the large firms of Pakistan became big centers for the small firms and facilitated growth of this sector in subsequent years.

Promotion of Entrepreneurship

— **Promotion of entrepreneurship through advisory services should be the major objective of SMEs policy in Pakistan. This goal can be reached through training in industrial management for ensuring efficient handling of enterprises.** This strategy can be made more effective through Smeda's supervision of various implementation programmes: (i) helping small firms to be well prepared for meeting quality standards is going to be the foremost challenge to be taken by the government agencies. This will require promotion of production channels between small and large firms to maximize the technical gains to the earlier; (ii) additionally, special incentives to those who subcontract may stimulate some large-small linkages, though it may turn out be more nominal than real development. For example, bogus firms may be set up for the purpose of realizing financial benefits on this account. Genuine and voluntary large-small linkages for manufacturing linkages are based on the principle of mutual benefits; (iii) large firms in manufacturing, trading and services also promote small businesses in their own interest as suppliers or as industrial customers. The Ittefaq Engineering and Beco Engineering companies of Lahore are good examples of large firms investing in small firms as business partners for their long-term economic benefit. [Aftab, 1985]

Modernization and Employment

— Policy measures always aim at encouraging small (i.e. traditional) firms to adopt modern product design, production methods and sales techniques for raising production, incomes and living standards. However, we have to look at the likely impact of modernization on unemployment situation as well. Selection of correct policy measures which help in replacing old with new products, especially qualitatively better and price competitive products, should end up increasing employment directly and indirectly. The SME policy need to ensure that it does not depress employment in the traditional sector. **The key factor in determining the final impact of these developments would be the overall growth in the economy as in a growing economy the employment generating effects of modernization are likely to be greater than the employment reducing effects.** On the basis of the empirical evidence from many countries we can confidently say that modern small industry can contribute to more employment and income provided the major sectors of the economy grow in tandem with the overall economy, [Aftab and Rahim (1986), Berry, et al, (1991)]. The following measures are suggested for inclusion in the new SME policy.

— **Pakistani SMEs need to focus on: (a) development of new products; (b) import replacements; (c) exports goods; and (d) goods with growing demand. It would be appropriate to put the scarce national resources, in particular, capital to use for the production of new products rather than duplicate lines of production that are being carried on, even with inefficiencies. Traditional products require adaptation and modifications in design and quality to meet the current demand trends. SME institutions have to play the role of catalyst in this process.**

— **Government support for setting up a Japan's MITI⁵ like organization in Pakistan would prove extremely useful as it would help in identifying and acquiring appropriate industrial technologies for SMEs. Government policy should create Dispersed Centres of Innovation and economic and social change by locating industry as far from cities as possible, preferably in the rural areas and in small towns.** The deliberate decentralization of small industry is justified on the basis of excessive concentration in the cities like Faisalabad, Lahore, Sialkot, Gujranwala, Multan and Karachi.

Urban Growth Points

— **In view of the strong and old traditions of industrial activity in its many cities, Pakistan's best option for promoting small-scale sector is to turn**

them into Urban Growth Points. The province of Punjab, NWFP and Sindh has had one such scheme or another, though in the form of Industrial Estates. Punjab has 14 such industrial estates in different cities, NWFP has 9 in different cities and Sindh 17 in various cities. These centres have been instrumental in promoting small-scale manufacturing but the results have been uneven.

— **What seems to be of critical importance is the correct assessment of the growth potential of such Centres. These can become real Growth Points only if there exist concrete indications of incipient industrial growth. For example, successful establishment of new industrial units or workshops and new product lines would be good indications of the potential growth of such centres. Success of Urban Growth Points would depend on a number of factors such as: (a) how well integrated are the Urban Growth Centers (UGC) with the big cities and the rural centres; (b) how much other facilities like trade, finance, equipment, maintenance facilities and repair centres, etc are available; (c) how much contribution comes from the local people in the form of leadership for the promotion of these essential services; (d) access to telecommunication facilities, power, materials and markets and (e) how responsive are the supporting services such as educational, training and research because they directly facilitate industrial growth.**

Access to Institutional Finance

— Along with conducive economic environment, access to institutional finance are the core and necessary conditions for the promotion of SMEs. **As stated above, the institutional financing facility hardly reaches the small firms; instead it is availed by the more resourceful medium firms.** This problem has its origin in the absence of a clear and functional definition of small and medium firms. Government has to clearly define the small and the medium on a permanent basis. **Second, the recently established SMEs Division in the SBP should be made responsible for provision of credit to the small firms by including SMEs in the Annual Credit Plan and also apportioning a share for the small within the SME quota. Third, the SBP should monitor the distribution of credit to the SME sector so as to ensure that this facility does not go to the unintended group.** Fourth, the staff of commercial banks be trained in SMEs operations with a focus on sensitizing them about the contribution of this sector to the economy. They should be trained for SME lending to meet their credit needs on cash-flow basis. Fifth, the SBP and Commercial banks should develop collateral-free products for the small firms who often fail to avail this facility for lack of “assets to serve as collateral”. Sixth, special financial

institutions like SME bank, Agha Khan First Micro Finance Bank and Khushali Bank should be strengthened in terms of increased access to funds and operational effectiveness to ensure credit supply at low interest rate. Seventh, the provincial Small Industries Corporations should not be a part of the financial network for the SME sector as their performance does not justify this role. These organizations should preferably focus on advisory services for the small businesses.

Supplies of Materials

— Imported and scarce raw materials are regulated items in developing countries like Pakistan. At times key materials and services produced within Pakistan may also be in short supply. Such items include cement, steel, gas, electricity, water, etc. This results in black market prices which are much higher than the official prices. Such an environment favours large firms, and inefficient small firms which prefer to trade in scarce items rather than produce goods. Genuine small producers should be ensured access to essential materials through removal of trade barriers, tariff and non-tariff.

Labour Laws

— Government laws in Pakistan cover a whole range of activities like labour, social security, old age benefits minimum wages etc. The burden of these laws in Pakistan is more than can be sustained by the level of productivity in the small industry. Hence these laws are not enforced in the small industrial sector. The solution of this problem is adjustment of legal requirements to Pakistan's level of productivity along with even-handed enforcement by well-trained staff.

— **The foremost recommendation in this case is: simplify labour laws. Reduce the number of laws to a level which makes their implementation possible. For the convenience of businesses and employees, the 76 odd laws may be regrouped under one Act dealing with the conditions of work and hiring practices, salary, working hours and other related matters.** The Government, must also develop labour Inspection Policy for this sector to reduce official's interference in the working of firms without compromising on the unhealthy work practices.[ILO, 2002]. The point is that small firms, especially employing less than 10 workers, need to be encouraged to grow at least horizontally.

Tax Policies

— **One notable feature of Pakistan's SME sector is the predominance of Sole Proprietorship in small firms. For reasons of income tax concessions and**

low fixed costs because their documentation requirements are very low, entrepreneurs generally prefer this business structure over partnership, private companies, cooperative societies, etc (ILO, 2002). Tax evasion is rife in Pakistan, especially in the informal sector. Even in the case of small firms, tax laws and regulations discourage growth of firms and even cause artificial fragmentation. In the past, after separation of East Pakistan in 1972 and option of radical labour's laws, favouring labour many businesses split up into small units to avoid imposition of restrictive laws and also to reduce tax liabilities. All the legal task requirements have significant negative influence on the expansion of small manufacturing units in Pakistan.

— **Another delicate issue is the low tax paid by SMEs.** The change in the attitude of tax payees would come through promotion of small industry's modernization, and growth. Spread of education, changes in the attitudes of tax payees, and improvement in the tax administration would help in lowering barriers of growth. This is indeed a good but slow process. **It is highly desirable that one-window facility for the SMEs on the lines of Export Processing Zones is provided.** Payment of government levies at one window would definitely spur production activity by saving time, resources and energy.

— Government financial support is also needed for the purchase and lease of suitable machines for use of the micro enterprises. Small firms may be granted this facility to get these machines. **In addition, small firms may be granted reduction of Corporation and Enterprise (business) taxes, and also exempted from stamp duty, property tax, local rates, etc. same as it was practiced in Japan and Korea for the promotion of SMEs. [Papanek, 1962].**

Global Challenges and SMEs

— Governments' commitment to withdrawal of subsidies, reduction in tariffs, and export duties under WTO arrangements have thrown up new challenges to the small and medium sized firms of Pakistan [Berry, 1999]. The adjustment process is difficult with significant employment implications. Experiences of successful adjustment process in operation in some sectors of the economy leave a trailblazer for others. For example, the Surgical Instruments Manufacturing Industry of Sialkot has the usual oligopolistic market structure. Following the WTO directives for adoption of ISO-9000, the medium firms adopted the detailed production procedures so as to meet the new directives. In cases where less resourceful firms faced practical difficulties in adopting the ISO-9000 procedures, they forged informal production links with the large firms and started working as their "informal subcontractors" and thus managed to avoid the financial burden of

ISO-9000. The new arrangement has also lessened their other financial obligations like business taxes as these firms have opted to become informal and work as the backyard workshops of the large units.

— The post-WTO regime poses adjustment challenges for the Pak industry, particularly for the SMEs, and has brought into focus the significance of the role of clusters in the Known cities like Sialkot and Faisalabad, which are major Centres of surgical goods and textile products, respectively. The fact is that both the small and large firms gain from the “collective efficiency” of clusters. **The dynamic Pakistani firms (i.e. large) have gained the maximum in terms of increased sales under the new system. Collective efficiency is definitely important to the firms working in the clusters, though the gains of small partners are less than the resourceful large partners.** [Nadvi, 1997] points out with reference to Surgical Goods Industry of Sialkot that the dynamic firms are generally run by better-educated persons, use more advanced equipment, and display a greater degree of specialization. The point is that external economies in the markets for labour, inputs, services, and information are important to firms of all sizes. So in the context of global challenges, the SMEs of Pakistan shall have to maximize collective gains of clustering, wherever possible. Collective efficiency has to be seen and generated for dynamic benefits to the entire cluster. **The Pakistani SMEs thus have to build technically interactive relations with external buyers besides linkages with subcontractors to be able to compete with the foreign competitors and also to be able to survive.**

Technology and R&D

— Science and technology policy affects technological development by stimulating R&D, setting up infrastructure and giving preference to indigenous technology and indirectly by regulating access to foreign technologies. Evidence on transfer of technology from abroad and its adaptation and use by Pakistani firms of different sizes involved a significant degree of uncertainty over half a century. The process of assimilating and reproducing technology both from local and foreign large firms require SMEs to solve a variety of problems. **In essence, assimilation and reproduction of technology involves a process of technological change, however insignificant. It results in important changes in the technological path and leads to the modifications of products and processes of the Western countries.**

— It is commonly held view that capabilities of a country pertaining to various aspects of the transformation of inputs into output (i.e. technology) play very important role in economic development, particularly in industrialization.

This process involves a number of steps: search, selection mastering, adoption and innovation. In some Pakistan's sectors like engineering the SMEs have shown significant progress in adopting and innovating production processes [Aftab and Rahim, 1986]. **What is however, missing is the institutionalized search for more innovations with the development of R&D facilities and the basic research. These limitations can be removed by means of (i) acquisition of appropriate technologies; (ii) training of optional use of technologies; (iii) dissemination of technology; (iv) upgradation of skills to match better technology' and (v) establishment of basic technical laboratories for the support of SME industries.**

— Since “know-how” and know-why” capabilities are fundamentally different, therefore Pakistan can learn from the Korean model which relied on “know-how” more than “know-why” to master imported technology and used it even for exports [Lall, 1984]. It is important to recognize that a qualitative jump is required in moving from the “know-how” stage to “know-why” stage, and the ability and constraints of firms and countries to make this jump is critical in determining long-run progress. [Fransman, (1984), Rosenberg, (1982)]. It would be appropriate to design a technological policy which balances between promotion of indigenous enterprises, SMEs and the large, and institutions, and the induction of best technology from abroad. These measures should be combined with policies which enable growth and innovative enterprises and thus help its industries to compete in the world. This aspect of the development process has assumed great importance under the WTO trade regime.

SAARC Region Trade Policies and SMEs

— Foreign trade policies are closely linked with technology policy as the both have direct and indirect affect on the indigenous technological capacity, which influences the performance of SMEs. Pakistan's trade policy has certainly stimulated innovation because of the industrial environment created through controls. Some experts (Kibria, 1986) though believe that much of the technological change was influenced by the government controls which in essence precluded open competition with foreign firms, a poor and unsophisticated market, industrial licensing, and sporadic pressure to improve quality and, thus, inhibited sustained build-up of technology over the long period.

— Regional trade has become the global trend in recent years. SAARC area countries also plan to set up South Asia Free Trade Area (SAFTA) by 2013 aimed at reviving regional trade and economic growth in the region.

However, the current low volume of trade in SAARC region is a barrier of economic growth. SAARC trade remains dismally low at 4.0% as compared to the regional trade of APEC (73%), EU (61%), NAFTA (57%), ASEAN (23%) and so on. [Amin (2004)]. The regional trade in SAARC was \$8.3 billion in 2003, out of which Indian share was \$3.5 billion (42.5%) and Pakistan's share was \$656 million (7.8%). The share of remaining five countries was 49.7% only [IMF, 2004]. Pakistan's exports to SAARC countries constituted 4.3% of the total exports and the imports 2.9% of total imports in 2004-05. Bilateral trade between India and Pakistan was \$746 million in 2004-05 i.e. less than 1% of global trade. It is worth noting that by late 1940s nearly 60% of Pak exports went to India and 1/3rd of Pak imports came from India. [South Asia Monitor, 2003]. In fact, there exist substantial possibilities of bilateral and multilateral trade in the SAARC group of countries, particularly between India and Pakistan. Regional economic cooperation is in fact a key to promotion of regional economic integration which enables countries to benefit from the global trading flows arising from unhindered investment and transfer of technology.

— **Based on the gravity model of international trade, a recent study on the likely impact of bilateral trade on two light engineering industries (i.e. fan and bicycle making) in Pakistan and India explored some important related issues. The results of the study are important in that they reconfirm the commonly held view that trade proves a catalyst for promoting economic growth by benefiting the consumers and producers in both the countries [GCU, 2005]. It was noted that opening up of a new market is likely to be especially beneficial for the manufacturing firms with export potential. But there are also indirect benefits of enlarged trading market: the SMEs can serve as subcontractors to the larger firms, and ultimately may become exporters themselves. Their minimum gain is the SMEs growth associated with dynamic benefits of inter-firm linkages. This evidence reaffirms the positive benefits of trading blocks for the SMEs of the member countries.**

— At the country level, Pakistan and other members of SAARC are recommended to treat SMEs equal to the large firms in matters of policy support. **In addition to a number of suggested measures discussed in section-4 above, the existing discrimination against SMEs for an access to “one-window” facility available to the exporting firms (mostly large) operating in the Export Processing Zones (EPZs) be removed.** Under this facility, the exporting firms pay all government levies in one place and don't have to deal with individual departments to pay social security, employees old-age benefit contributions, etc.

— **Pak SMEs, limited share in direct imports and exports is partly on account of the registration precondition by the Export Promotion Bureau (EPB). All small firms lack access to directly imported production inputs and have to rely on commercial importers despite being expensive. Facilities such as one-window operations can easily draw in innovating persons who are otherwise reluctant to promote SAARC trade regime.**

Gender and SMEs

— A survey of the urban and rural SMEs in Pakistan reveals useful information on female managed/owned enterprises as well as women workers. [Aftab, (1991); GCU (2004)]. **First, large number of women-owned MSEs are concentrated in highly volatile, household-based, low return urban activities where growth prospects are bleak. Second, their activities are concentrated in selected sub-sectors such as dress making, knitting, retail trading. Third, they operate as almost invisible entrepreneurs.** Four, many of the MSEs in Pakistan are new starts because of the low capital and skill entry barriers. It is also interesting to note that the closure rate of women MSEs is also higher than male-enterprises. This is for personal rather than business reasons. Fifth, higher closure rate of female-enterprises is to be interpreted in the light of the motivation behind start-up business: they are mostly motivated to be self-employed and don't take long to close their businesses if this suits their economic or personal circumstances. Sixth, gender-related growth barriers are two types. **Women have to take dual responsibilities: domestic and productive, so there are gender-related differences in "business objectives". For example, females are more risk-averse than men, and are more likely to use business funds for household needs". Hence, they may close their business with relative ease.**

— As for their growth constraints, they are no different from those of male-enterprises. **First, there is a strong case for financial and non-financial interventions, particularly for the non-growing enterprises. This requires identification of growing and more lucrative product lines. Third, female enterprises too should have access to essential inputs. Fourth, acquisition and adaptation of technology becomes a much more difficult process for female managed MSEs because their general inability to handle engineering and technical problems. Fifth, skills availability and training for higher skills is yet another difficult barriers for female managed enterprises to cross unaided. Sixth, like most MSEs marketing of products is a big challenge because an informal producer is disadvantaged operator in the formal market.**

Sub-national Policies and SMEs

— Another important dimension of the current Pak SME policy is its limited concern about the regional disparities and the urban-rural divide in terms of existing enterprises. The future policy shall have to also create favourable environment by adopting special measure to correct the shortcomings.

— As stated in section [2], Pak industries are concentrated in a few big cities, while SMEs are also located along important inter-city roads, and in small towns. Small but informal firms also exist in the rural areas. Although the rural SMEs face similar set of barriers as those in the urban areas, yet their problems are much more complex because of: (i) sharp rural-urban divide in access to infrastructure and essential supplies; and (ii) limited economic opportunities in the rural economy. Hence there is a strong case to set up industrial estates at least in those rural areas where traditions of skills and entrepreneurship exist. To name a few places Daska, Jaranwala, Chichawatni (Punjab), Risalpur, Mardan and Sawat (NWFP) Adam Khel in Tribal Area, Sukkur, and Khairpur (Sindh) and Quetta Chamman-Pishin, Turbat-Mekran (Baluchistan) have the potential to become hub of SME activities, ultimately turning into Growth Points.

— **A major constraint among the barriers of rural small industries of Pakistan is absence of small-large linkages. Such linkages bring benefits of economies of scale of to the production partners and specialist services to each other.** Further, such arrangements foster technical cooperation among firms, encourage industrial integration and reduce technical dualism. **In the rural sector, we witness only limited small-small linkages, but no small-large linkages [Aftab, 1991]. The small-small linkages existing in the rural sector are based on (i) geographical proximity, (ii) technological compatibility; and (iii) favourable market conditions. But the small-large production linkages are constrained on grounds of technical, economic and managerial incompatibility. Vigorous policy support for subcontracting linkages appears to be the need of the hour. The extent of such links shall be determined by the market conditions and government policy.** There is a strong case for promotion of small-large linkages through specific government measures as are likely to change the current dualistic industrial growth pattern where the micro rural firms meet very specific needs, with little possibility of growth. The foremost need of this sector is the establishment of “Linkage Centres” for industrial support which will also be indirectly reducing regional disparities in SME population. **The concept of industrialization need to be modified by shifting the emphasis from rural areas to small towns between rural and**

urban centres. Finally, small industry should be regarded as only one element among several in such an industrial policy

Environmental Problems

— Like the large firms, the SMEs also contribute to environmental degradation because of absence of control on the use of production methods. So there is a strong case to put in place policy-guided mechanism for the education of entrepreneurs and effective control of environmental damage by SMEs. Reducing material waste can be one means of reducing cost. Similarly saving national resources (electricity and water etc.) may translate into competitiveness and economic gains at the SME level.

— The Pak SMEs generally don't manage to effectively utilize the available technology suited to their resources. Identification and acquisition of appropriate technology is a difficult task for SMEs. It is recommended that credit be provided to firms who are looking for opportunities of environmental damage control. The most effective method to reduce environmental damage is to educate entrepreneurs about the cost of environmental damage.

— At the ground level the SMEs and the large firms are equally ignorant and careless about their role in environmental degradation in Pakistan. This is essentially due to poor institutional capacity and little emphasis on environment in fiscal policy and insufficient allocation of funds for environmental protection of forestry, biodiversity, water and sanitation. The Mid Term Development Framework (MTDF: 2005-10) has laid down the long term objective of sustainable economic growth without environmental degradation [GOP, 2005]. Its real success would depend on how effectively the environmental laws cover the National Environmental Quality Standards (NEQS) and whether or not the violators of the laws are made to pay for damaging the environment.

Intellectual Property Rights and SMEs

— Absence of effective laws with respect to Intellectual Property Rights (IPRs) is a known source of subdued foreign and domestic investment in new and emerging areas. Slow resolution of disputes discourages investors from going to challenging new product lines. It adds to the difficulties in obtaining subcontracting or investment in manufacturing as a part of the multinationals. Ensuring intellectual property rights facilitates foreign investment and promotes economic growth. This can draw direct foreign investment in industry and scientific research projects, with all its known benefits.

— On the other hand, Pakistan would benefit by protecting brand names of its export products like Basmati Rice, Kinno, Mitha, etc. The owners of IPRs can use its assets for commercial transactions like distribution agreements, mergers, and acquisitions. All these transactions have training element which is far more valuable than the transactions. More work would be needed to suitably revise IPR laws of Pakistan to bring them in conformity with the international standards to give protection to domestic and foreign producers. We imagine this going to be a difficult task because the large informal economy of Pakistan flourishes aided by the absence of effective IPR laws and the legal practices. We see a trade-off between considerable short-terms losses and gradual long-term gains. However, it appears as if the imposition of IPR laws would be unavoidable under the new trading system and the SME sector shall have to restructure its production strategies to become an active partner in the new trading world. This is going to be a long and an arduous process of transformation, which would result in a shift from static to dynamic preoccupations of Pakistani SMEs.

SUGGESTED SME POLICY REFORMS — SUMMARY

1. There is a need to realize that existing Pak SME Policy is lagging in many respects. The foremost need is to ensure a smooth link between macro (economy-wide) and micro (sectoral) policies through an effective institutional mechanism.
2. Nowhere in the world where SMEs have done well it has been possible without institutional support for: (i) improving business environment, (ii) strengthening of support system; (iii) provision of institutional credit; (iv) facilitating technical and management skills; (v) fiscal concessions; and (vi) designing of an effective legal system.
3. The most effective way of delivering institutional support is to focus on selected sectors with growth potential and make it time-limited.
4. Technical and economic requirements of micro, small and medium enterprises are distinctly different in terms of size, product lines, resources, and growth potential, though they are all a part of the organic whole.
5. SME policy must set up an effective mechanism to address the distinct requirements of micro (informal), small and medium firms in addition to meeting the general needs of the sector.

6. The real challenge of SME policy is to set in process a shift of SMEs from static to dynamic preoccupations. This is possible through technological change which is also influenced by international trade, thus inviting firms to follow the “best practices”.
 - 7) Technology acquisition, diffusion and transfer constantly involve inter-firm production links between small, medium and large, and institutional support. Effective linkages must be put in place by Smeda through establishment and promotion of industrial subcontracting exchange schemes, which would facilitate production and market linkages between producers and also among manufacturers and exporters. Identification of suitable SMEs and arranged linkages with large firms through Business Groups would be extremely useful.
 8. A fundamental question related to SME policy is: is it meant to be a part of development policy or a relief for underdeveloped segment of the economy? The SME policy should stress positive measures for improving the dynamic efficiency of units, thereby increasing the economic contribution of the enterprises and their productive capacity overtime.
- Guiding Principle: make small producers more efficient, and established medium units more productive.

Notes:

- 1) Small means all units which employ upto 9 workers as per the CMI criteria of 1934.
- 2) Household units are those in which the production activity and the residence of entrepreneur share the same premises. They may engage in any kind of activity, not merely for consumption . It includes all activities producing goods and services for sale and barter in the market.
- 3) Establishment as an economic unit under single ownership or control, which produces goods or services.
- 4) Shop/Establishment: All shop/establishments take part in service (such as launders, barber, etc) and trading (such as grocers, meat sellers, clothing, fruit shops, etc).
- 5) MITI: The Ministry of International Trade and Industry was established in 1949 and today covers a wide range of industrial fields. It also deals in specific sectoral issues for basic industries and has been instrumental in upgradation of technology and production standards, including in the SMEs sector of Japan.

TABLE-1: PERCENTAGE SHARE OF MANUFACTURING SECTOR IN GDP (PAKISTAN)

Year	Total	Large Scale	Small Scale
1949-1950	6.39	1.83	4.56
1959-1960	9.91	5.67	4.23
1969-1970	13.44	10.46	2.98
1979-1980	14.51	10.55	3.95
1989-1990	17.59	12.70	4.89
1999-2000	16.66	11.65	5.03
2000-2001	17.66	12.48	5.18
2001-2002	17.94	12.66	5.28
2003-2004	18.39	13.09	5.30
Period Averages			
1950s	8.78	4.38	4.41
1960s	12.41	8.85	3.56
1970s	13.99	10.42	3.57
1980s	16.65	12.26	4.38
1990s	17.68	12.32	5.36
1950-2003	13.37	9.27	4.09

Source: 50 Years of Pakistan Volume-I Summary, Statistical Supplement of Economic Survey, 2002-03 and Economic Survey 2003-04

TABLE-2: GROWTH RATES OF MANUFACTURING SECTOR IN PAKISTAN

Year	Total	Large Scale	Small Scale
1950-1951	8.39	23.42	2.34
1959-1960	2.53	2.75	2.25
1969-1970	11.32	13.95	2.98
1979-1980	10.25	10.96	8.40
1989-1990	5.72	4.73	8.40
1999-2000	1.53	-1.01	5.31
2000-2001	8.21	9.46	5.31
2001-2002	5.00	4.87	5.31
2002-2003	7.67	8.65	5.31
Period Averages			
1950s	7.73	15.75	2.30
1960s	9.91	13.39	2.91
1970s	5.50	4.84	7.63
1980s	8.21	8.16	8.40
1990s	3.88	3.54	5.06
1950-2003	6.78	8.79	5.06

Source: 50 Years of Pakistan Volume-I Summary, Statistical Supplement of Economic Survey, 2002-03 and Economic Survey 2003-04

TABLE-3: DEFINITION OF SMEs — PAKISTAN (2005)

Size	Sector	Employment (Full time employees)	Productive Asset (Rs. Million)
Small	Manufacturing	≤ 50	30.0
	Service	≤ 50	20.0
	Trade	≤ 20	20.0
Medium	Manufacturing	51 – 250	30.0 to 100.0
	Service	51 – 250	20.0 to 50.0
	Trading	21 – 50	20.0 to 50.0

Note: Adopted by the SME Policy, 2005.

Table-4: NUMBER OF ESTABLISHMENTS BY MAJOR INDUSTRY DIVISIONS: 2005

Major Industry Division	TOTAL		ESTABLISHMENTS ¹		HOUSEHOLD ²	
	No.	%	No.	%	No.	%
Pakistan	2	3	4	5	6	7
Total	2958321	100.00	2782051	100.00	1762270	100.00
Agriculture, Forestry, Hunting Mining & Fishing	46378	1.57	30995	1.11	15383	8.73
Mining & Quarrying	713	0.02	713	0.03	0.00	0.00
Manufacturing	583329	19.72	466153	16.76	117176	66.48
Electricity, Gas & Water	124	0.00	124	0.00	0.00	0.00
Construction	1410	0.05	1410	0.05	0.00	0.00
Wholesale & Retail Trade and Restaurants & Hotels	1566722	52.96	15592266	56.05	7456	4.23
Transport, Storage & Communication	51564	1.74	51564	1.85	0.00	0.00
Financing, Insurance, Real- Estate & Business Service	48440	1.64	48366	1.74	0.74	0.04
Community, Social & Personal Services.	659641	22.3	623460	22.4	36181	20.53

Source: Economic Census of Pakistan, 2005, FBS, Statistics Division, Islamabad

Notes:

1. Establishment is an economic unit under single ownership or control
2. Household refers to those in which the production activity and the residence of entrepreneur share the same premises.

TABLE-5: NUMBER OF MANUFACTURING ESTABLISHMENTS BY STATUS AND AREA: 2005 (PAKISTAN)

	STATUS OF ESTABLISHMENTS								
	All Areas			Rural Areas			Urban Areas		
	Total	H.H Estab.	Other than H.H	Total	H.H Estab.	Other than H.H	Total	H.H Estab.	Other than H.H
PAKISTAN	2	3	4	7	8	9	10	11	12
TOTAL	583329	117176	466153	292866	99307	193559	290463	17869	272594
Manufacturing of Food, Beverages and Tobacco	121875	2986	118889	86540	2517	84023	35335	469	34866
Textile Wearing apparel and Leather Industries	252111	79417	172694	120759	65341	55418	131352	14076	117276
Manufacturing of Wood & Wood Products including Furniture	63087	9549	53538	30799	8963	21836	32288	586	31702
Manufacturing of Paper & Paper Products Printing & Publishing	10141	256	9885	284	31	253	9857	225	9632
Manufacturing of Chemicals & Chemical, Petroleum, Coal, Rubber & Plastic Prod.	5781	312	5469	1169	142	1027	4612	170	4442
Manufacturing of Non-Metallic Mineral Products except Petroleum & Coal	15476	4285	11191	10602	3844	6758	4874	441	4433
Basic Metal Industries	1511	47	4464	1122	32	1090	3389	15	3374
Manufacturing of Fabricated Metal Product, Machinery & Equipments	58476	759	57717	15303	525	14778	43173	234	42939
Other manufacturing Industries & Handicrafts	51871	19565	32306	26288	17912	8376	25258	1653	23930

Source: Economic Census of Pakistan, 2005, FBS, Statistics Division, Islamabad

TABLE-6: EMPLOYMENT INDICATORS (PAKISTAN)

<u>Indicators</u>	<u>2001-02</u>	<u>2003-04</u>
Labour Force (millions)		
Total	42.39	45.23
Male	35.57	37.13
Female	6.82	8.10
Employed		
Total	38.88	41.75
Male	33.19	34.69
Female	5.69	7.06
Unemployed		
Total	3.51	3.48
Male	2.38	2.44
Female	1.13	1.04
Employment by Sector (%)		
Total	100.0	100.0
Agriculture	42.1	43.1
Non-agriculture	57.9	56.9
Formal	20.5	17.1
Informal	37.4	39.8
Unemployment Rates (%)		
Pakistan		
Total	8.3	7.7
Male	6.7	6.6
Female	16.5	12.8
Rural		
Total	7.6	6.7
Male	6.1	5.7
Female	14.1	10.9
Urban		
Total	9.8	9.7
Male	7.9	8.4
Female	24.2	19.8

Source: Labour Force Survey 2003-04, Statistics Division, Government of Pakistan, Islamabad

TABLE-7: NUMBER OF ESTABLISHMENTS BY MAJOR INDUSTRY DIVISION AND EMPLOYMENT SIZE.

Major Industry Division	EMPLOYMENT SIZE				
	TOTAL	1-5	6-10	11-50	51 +
PAKISTAN	2	3	4	5	6
TOTAL	2958321	2851061	79291	26352	1617
Agriculture, Forestry, Hunting & Fishing	46378	45164	1037	170	7
Mining & Quarrying	713	363	191	141	18
Manufacturing	583329	531101	38662	12444	1122
Electricity, Gas & Water	124	113	3	7	1
Construction	1410	1287	93	29	1
Wholesale & Retail Trade and Restaurants & Hotels	1566722	1551625	13233	1822	42
Transport, Storage & Communication	51564	49917	1290	330	27
Financing, Insurance, Real-Estate & Business Service	48440	46264	1602	538	36
Community, Social & Personal Services.	659641	625227	23180	10871	363

TABLE-8: DISTRIBUTION OF NON-AGRICULTURE WORKERS INTO FORMAL & INFORMAL SECTOR (PAKISTAN)

Sector	2001-02 (%)			2003-04 (%)		
	Total	Male	Female	Total	Male	Female
Total	100.0	100.0	100.0	100.0	100.0	100.0
Formal	35.4	35.3	37.0	30.0	29.6	34.3
Informal	64.6	64.7	63.0	70.0	70.4	65.7
Rural	100.0	100.0	100.0	100.0	100.0	100.0
Formal	31.7	31.5	34.3	27.1	26.7	30.1
Informal	68.3	68.5	65.7	72.9	73.3	69.9
Urban	100.0	100.0	100.0	100.0	100.0	100.0
Formal	38.9	38.9	39.3	32.8	32.2	38.4
Informal	61.1	61.1	60.7	67.2	67.8	61.6

Source: Labour Force Survey 2003-04, Government of Pakistan, Islamabad

**TABLE-9: DISTRIBUTION OF INFORMAL SECTOR WORKERS:
MAJOR INDUSTRY DIVISIONS (PAKISTAN)**

Major Industry Divisions	2001-02 (%)			2003-04 (%)		
	Total	Male	Female	Total	Male	Female
Total	100.0	100.0	100.0	100.0	100.0	100.0
Manufacturing	20.9	17.3	57.5	20.6	16.9	57.3
Construction	13.9	15.1	1.3	13.4	14.6	1.2
Wholesale and retail trade	34.0	36.5	7.6	34.4	37.3	7.6
Transport, storage and communication	11.7	12.7	1.0	11.7	12.3	0.3
Community, social and personal services	18.9	17.6	32.4	18.7	17.2	33.5
Others (includes mining & quarrying; electricity, gas & water and finance, insurance, real estate & business services)	0.7	0.8	0.2	1.5	1.7	0.1

Source: Labour Force Survey 2003-04, Government of Pakistan, Islamabad

TABLE-10: DISTRIBUTION OF INFORMAL SECTOR WORKERS: EMPLOYMENT STATUS (PAKISTAN)

Employment Status	2001-2002 (%)			2003-2004 (%)		
	Total	Male	Female	Total	Male	Female
Total	100.0	100.0	100.0	100.0	100.0	100.0
Employer	1.0	1.1	0.2	1.5	1.6	0.2
Self-employed	43.6	44.8	31.0	43.7	44.7	34.0
Unpaid family helpers	10.9	10.1	19.1	11.7	10.9	19.5
Employees	44.5	44.0	49.7	43.1	42.8	46.3

Source: Labour Force Survey 2003-04, (a) Government of Pakistan, Islamabad

Note: (a): The 2004-05 Economic Census of Pakistan covers all Establishments and Household Economic Activities throughout Pakistan excluding agriculture. It covered all household units, small and large establishments which were engaged in different sectors of the economy. In agriculture it included poultry farming, fish farming and livestock farming. This survey does not cover mobile units like street vendors and other small businesses without a permanent location.

TABLE-11: PAKISTAN'S BANKING SECTOR

Category	Number
Public Sector Commercial Banks	4
Domestic Private Banks	21
Foreign Banks	11
Specialized Banks	3
Micro Finance Banks	3

Source: Economic Survey 2004-05, Govt. of Pakistan, Islamabad

TABLE-12: PAKISTAN'S NON-BANKING SECTOR

Category	Number
Development Finance Institutions	5
Investment Banks	14
Leasing Companies	25
Modarabas	40
House Finance Companies	4
Mutual Funds	38
Discount Houses	4
Venture Companies	4
Insurance Companies	
(Non Life Insurance)	
Domestic Private	45
Foreign	3
State Owned	1
(Life Insurance)	
Domestic Private	2
Foreign	2
State Owned	1
Reinsurance	

Source: Economic Survey 2004-05, Government of Pakistan, Islamabad

LIST OF REFERENCES

1. Aftab, K (1985) Growth of Agriculture-related Engineering Industry in Pakistan Punjab, An Unpublished PhD thesis, University of Strathclyde, UK.
2. Aftab, K and Rahim. E, (1986) “The Emergence of a Small Scale Engineering Sector: The Case of Tubewell Production in the Pakistan Punjab”, *Journal of Development Studies*. (Vol. 23).
3. Aftab, K and Rahim, E (1989) “Barriers to the Growth of Informal Sector firms: A Case of Study”. *The Journal of Development Studies* (Vol. 25).
4. Aftab, K (1991) Rural Industrialization in Pakistan: Implications for Human Resource Development, PMI-ILO Workshop, Islamabad.
5. Ahmed, V and Amjad, R (1984) *The Management of Pakistan’s Economy 1947-82*, Oxford University Press, Karachi.
6. Amin, K (2004) Promoting Greater Regional Integration in South Asia: Opportunity for and the Role of Private Sector in Pakistan, World Bank/IMF 2004 Annual Meeting Seminar, Washington.
7. Aubrey, H (1951) Small Industry in Economic Development, *Social Research*, Vol.18 (No.3).
8. Berry, A (1999) The Potential Role of the SME Sector in Pakistan in a World of Increasing International Trade, (14th Annual General Meeting, (January 28-31) PIDE, Islamabad.
9. Berry, A. and Deepak, M (1991) “Small Scale Industry in East and South East Asia: A Review of Literature and Issues” in *Asian-Pacific Economic*

Literature, Vol.-5 (2)

10. Fei, H and Ranis, G (1963) “Innovation, Capital Accumulation and Economic Development” *American Economic Review*.
11. Fransman, M & King, K (ed) 1984) Technological Capability in the Third World, McMillan, London.
12. GC University (2004) Women Entrepreneurs in Urban Lahore: A Perceptive of Income Groups and Firm Size: GCU-Strathclyde Higher Education Link Project (2001-04), Lahore.
13. GC University (2005) Pak-India Trade: A Case of Fan and Bicycle Industry, A study of the Economics Department, GC University, Lahore.
14. Government of Pakistan (1999) Survey of Small and Household Manufacturing Industries: 1996-97 (Rural and Urban) Statistics Division, Islamabad.
15. Government of Pakistan (2005) Economic Survey, 2004-05, Ministry of Economic Affairs, Islamabad.
- 16.. Government of Pakistan (2005) Mid Term Development Framework: 2005-10, Planning Commission, Islamabad.
17. Government of Pakistan (2005) Economic Census of Pakistan – Preliminary Report, Federal Bureau of Statistics, Islamabad (Unpublished)
18. ILO (2002) Creating a Conducive Policy Environment for Micro, Small and Medium Sized Enterprises in Pakistan; SEED Working Paper No.29.
19. ILO (2005) World Employment Report: 2004-05. Employment Productivity and Poverty Reduction, Geneva.

20. IMF (2004) Direction of Trade Statistics Yearbook-2004, Washington.
21. Kibria, G (1998) Technology Acquisition in Pakistan: Story of a Failed Privileged Class and Successful Working Class, City Press, Karachi.
22. Lall, S (1984) India's Technological Capacity: Effects of Trade, Industrial Science and Technology Policies in Technology Capability in the Third World: in Fransman & King (ed) McMillan; London.
23. Liedholm, C and Meade, D (1999) Small Enterprises and Economic Development—The Dynamics of Micro and Small Enterprises, Rutledge, London.
24. Nadvi, K (1997) The Cutting Edge Collective Efficiency and International Competitiveness in Pakistan, IDS Discussion Paper 360, Sussex (UK).
25. Papanek, G (1962) The Development of Entrepreneurship, *AER: Papers and Proceedings*, Vol:L11(2).
26. Penrose, E (1980) The Theory of the Growth of the Firm, Basil Blackwell, London.
27. Planning Commission of Pakistan (2004) Report of the Working Group on SMEs (Medium Term Development Framework: 2005-10), Islamabad.
28. Roomi, A (2000) Proposals for Policy Reform for the Establishment and Development of SMEs, in Small and Medium Enterprises in Asian Pacific Countries, Vol II, Abdullah and Baker (ed) Nova Science Publishers, Inc, New York.
29. Rosenberg, N (1982) Inside the Black Box: Technology and Economics, Cambridge University Press,

Cambridge.

Smeda/Gallup Survey of Micro and Small Enterprises, Lahore.

30. Smeda (2001)

SME Led Economic Growth – Creating Jobs and Reducing Poverty, Lahore – SME Policy (Draft)

31. Smeda (2005)

Centre for Strategic and International Studies Washington.

31. South Asia Monitor (1963)

Modern Small Industry for Developing Countries, McGraw Hill, New York.

32. Staley, E and Morse, R (1965)

D:\PERSONAL\SME POLICY OF PAKISTAN-2005-FINAL.doc