

AN EVALUATION OF SMALL AND MEDIUM ENTERPRISES DEVELOPMENT IN PAKISTAN

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Abstract: Small and medium enterprises are the backbone of Pakistan's economy. They are an efficient user of the scarce resources and has better linkages with other sectors of domestic economy. However few researcher studies examined their development, challenges and future prospects. Therefore the aim of this paper is to examine and analyse the structure, growth, impact and problems in financing SME issues affecting SME sector and suggest a strategic framework for enhancing the competitiveness of Pakistan SME in regional and global market. The major conclusion drawn from this paper were the SME sector in Pakistan is facing many problems and challenges both domestic and better prospects in marketing their products at international market. This paper recommend some measures as a positive step towards addressing the above problems and challenges so as to guarantee a sound future for SME in Pakistan.

Keywords: Growth, migrant worker, Small Medium Enterprises, public private partnership,

I. INTRODUCTION

In the economic development of a country the importance of small and medium enterprises SME cannot be overemphasized. The SME constitute nearly 90% of all enterprises in the formal sector. The promotion of small scale industry can help in achieving many objectives and in particular it can help in reducing the problem of wide spread unemployment in Pakistan (Zaidi, 2005).

This problem is expected to aggravate with the inflow of returning migrant workers from the middle east. Small industry uses relatively more labour intensive techniques and important source of foreign

exchange earnings, as it intensively uses the relatively abundant factor of production by relying on domestic inputs, it also economizes foreign exchange. The SMEs are an efficient user of the scare factor capital and has better linkages with other sector of domestic economy (Saeed, 2007).

This inherent characteristics of SMEs makes it imperative that there should be a mechanism through which it may get support in different functions of business including technical upgradation, marketing, financial and human resource training and development. The small and medium enterprises development authority SMEDA is the flagship organization of Pakistan which is providing the necessary services to help SMEs overcome the weaknesses that are endogenous in nature (Anka, 2009).

SMEDA, envisions to become a model of public private partnership for better facilitation of the small and medium enterprises in Pakistan.

The government recognizes that SME led private sector development needs further strengthening of the regulatory environment adjustment in prudential policies and provision of support services for enterprise establishment development of quality improvement and export marketing in the short to medium term (Saleh, 2006).

The importance of cottage industry and small industries has long been recognized but from practical point of view very little headway has been made. In view of the above therefore this paper shall examine government policies of SMEs, structure and growth and impact of SMEs in Pakistan enhancing the competitiveness of Pakistan SMEs in regional and global market.

II. GOVERNMENT POLICIES ON SME SECTOR

In the fifth year plan it was stated that the small industries sector has considerable potential for growth but it suffers from a number of problems relating to organization financing, technology and marketing. To facilitate the development of this sector, there is a need to have a closer look at the constraints under which this sector operates and to remove the hurdles which inhibit its healthy growth. Fiscal and commercial policies will be given due consideration to these factors during the plan period. The major task of the development of these industries was to be carried out through the small industries corporations. In this connection the following special incentives will be provided to small scale industries.

- A combination of fiscal incentives to ease initial cash flow problems.
- Preferential access to credit through stronger specialized institutions.
- Assistance in training for the required skills.
- Organization of advisory marketing boards.
- Encouragement for integration with the large scale sector through sub contracting and
- Provision of adequate infrastructure and measures to make it accessible to the small scale investors.

In addition to the above the government had set out the following principles for the development of small industries:

- Adopt small industries to changing technological, economic and social conditions.
- Stimulate production of implements and equipment required for agriculture.
- Encourage the processing of indigenous raw materials.
- Create additional employment opportunities.
- Modernize such existing units that have sound economic prospects.
- Preserve and promote traditional arts and crafts.

III. ISSUES AFFECTING THE SMALL SCALE SECTOR

Khalid Nadvi in his comprehensive study of the small scale informal sector is presented here: The informal sector consisting of small enterprises and household units appears to be expanding more rapidly than the formal sector and already provides employment to the majority of those engaged in urban manufacturing in Pakistan. Furthermore, capital intensity is in real terms growing more rapidly in the formal sector leading to a net displacement of labour. As a result labour productivity is greater is inversely related to unit size. He argued that a focus on the informal small scale sector unit would appear to lead to the most socially efficient allocation of capital this have the greatest potential for generating productive employment.

One of the more interesting findings of the work on small scale sector has been its close links with the large scale manufacturing sector. Khalid Aftab and Eric Rahim believes that one of the reasons for the success of Punjab firms was the overall environment of economic expansion along with small firms proximity to large enterprises. For the individual small producer the external economies generated by the large were as important as those it obtained through the evolution of vertical specialization within the small scale sector.

Furthermore the above research scholars argue that government policy in Pakistan did not assign any important developmental role to small scale enterprises in the past. It was never thought that small scale producers were capable of exhibiting any dynamism. According to them government policies give more importance to large scale sector and it received special privileges.

The single most important constraint faced by the small scale sector has been the availability of credit. All surveys consistently came up with this finding. Khalid Nadvi in his survey of 328 small scale enterprises found that only two of them had been able to obtain credit from the formal banking sector and both of the loans were of very small amounts.

Alongside the daunting procedures respondents stated that the banking bureaucracy was actively unhelpful and discouraging to small scale informal sector. The small scale and informal sectors therefore have to find credit for working and fixed capital from other sources.

There is no denying the fact that the small scale sector plays and is going to play an increasingly important role in Pakistan economy. Rashid Amjad for example argues that as much as 25 percent of Pakistan export earnings are generated from the small scale industrial sector. The dynamic growth of this sector has taken place because the state has kept away from it and let it function largely on its own.

IV. STRUCTURE AND GROWTH OF SMEs

The potential for further research of small and medium enterprises sector is immense and with its numerous advantages including the Islamic aspect. The small and medium enterprise sector is believed to be a good source of employment generation. The government has not only established small and medium enterprise banks but also introduced Humdard Pakistan Scheme for facilitating self employment. By 2008 these initiatives have been able to provide employment to 47,213 persons and financed 6,745 small and medium enterprises as well as the microfinance has proved to be an effective tool for poverty alleviation and job creation.

It was discovered by policy makers and entrepreneurs that it was not the large scale manufacturing sector that provide employment to most workers in the industrial sector but the small scale or informal sector

that dominates our lives. The small scale sector is by far is more dynamic, exhibiting impressive growth rates in employment, output and contribution to value added.

Table 1: Gross fixed capital formation for private and public sector 1963-2002

	1963-4	1971-2	1976-7	1980-1	1987-8	1994-5	2001-2
Total	5,055	6,813	27,856	42,972	111,266	320,896	476,113
Private sector	2,870	3,546	9,214	16,874	51,769	165,807	303,574
Public sector	1,523	2,350	12,637	17,131	34,886	96,556	102,152

Source: Government of Pakistan Economic Survey 2001-2002

Table I shows the contribution of both private and public sector to gross fixed capital formation GFCF the shift towards the private sector in most fields is quite noticeable. Large scale manufacturing now

takes place in the almost exclusively in the private sector and with pro-private sector policies and denationalization the private sector is playing a much greater role in construction, electricity and gas sector.

Table 2 : Export items in total manufactured goods 1994-2003

Year	Total exports	Ready made	Carpets and rugs	Leather	Surgical instruments	Sports
1993-94	206	34	5	7	3	6
1994-95	251	41	6	8	3	8
1995-96	295	46	7	9	4	8
1996-97	325	56	8	9	4	12
1997-98	373	62	9	9	5	17
1998-99	390	70	10	9	5	13
1999-20	444	86	14	9	6	15
2000-01	539	102	17	14	7	16
2001-02	561	106	15	15	9	19
2002-03	652	131	13	14	9	20

Source: Pakistan Economic Survey 2002-2003 Page 154-157

Table-2 is self explanatory dealing with growth rates between large scale manufacturing and small scale manufacturing. It is clear that for the last four years,

small scale manufacturing has been growing steadily and at a greater rate than large scale manufacturing.

Table-3 : Growth in industrial sector 2007-2008

Industry	Annual growth		Contribution to growth	
	2007	2008	2007	2008
Manufacturing	8.2	5.4	5.9	3.9
Large scale	8.6	4.8	4.4	2.5
Small scale	8.1	7.5	1.3	1.2
Slaughtering	4.1	4.2	0.2	0.2

Source: State Bank of Pakistan Annual Report 2007-2008

Table 3 above presents the annual growth of SME in

comparison to large scale is 11.7 i.e. including slaughtering 4.2.

Table-4 : Service Sector Performance

	Annual growth		Contribution to growth	
	2007	2008	2007	2008
Whole sale and retail	5.4	6.4	32.7	32.1
Transport storage	6.5	4.4	19.6	18.9
Finance and insurance	15	17	11.3	1.2
Ownership of dwellings	3.5	3.5	5.2	5
Admin and defence	9.1	10.9	11.9	12.2
Community social and personal services	8.8	9.4	19.3	19.5

Source: State Bank of Pakistan Annual Report 2007-2008

Table 4 shows growth rate of whole scale and retail is 6.4 percent in 2008 and against the last years 5.4

2006-07 their share in the services sector is 32.1 in 2007-2008.

Table-5: Employment by formal and informal sector %

Sector	1999-2000			2006-2007		
	Total	Urban	Rural	Total	Urban	Rural
Agriculture	48.4	5.7	65.9	43.6	6.5	59.9
Non agriculture	51.6	94.3	34.1	56.4	93.5	40.1
Formal	17.7	34.1	10.9	15.8	27.4	10.8
Informal	33.9	60.2	23.2	40.5	66.1	29.3

Source: Labour Force Survey, 2006-2007

Table 5 highlights that the small and medium enterprise sector is labour intensive and provide

employment upto 83% to the workforce of the non agricultural labour in Pakistan.

Table-6 : SMEs present in Pakistan

Provinces	Number of SMEs
Punjab	65%
Sindh	18%
NWFP	14%
Baluchistan	2%

Source: Pakistan Economic Survey 2007-2008

Table 6 above shows that more than 65 percent of the small and medium sized enterprises exist in the

Punjab, 18 percent in Sindh, 14 percent in NWFP and 2 percent in Baluchistan.

V. IMPACT OF SMES ON PAKISTAN'S ECONOMY

According to available statistics although the contribution of SMEs sector to GDP does not appear to be very high but it is an important sector in many other respects especially in terms of employment generation, export and better linkages with other sectors of the economy.

Employment: The performance of Pakistans small scale industry has been very impressive in terms of employment generation. It is estimated that above 80 percent of the total industrial labour force is currently employed in this sector. The employment elasticity which measures responsiveness of employment to changes in output also shows that the small scale sector has relatively greater potential for employment generation. This shows that the employment elasticity in the small scale sector was higher than the large scale sector.

Capital: It is argued that the small sector is an efficient user of scarce factor capital. Normally the capital value added ratio is employed to check the efficiency of capital. The incremental capital output ratio also shows that the small scale industries proves to be more efficient user of capital than the large scale sector.

Exports: Small scale industries in Pakistan have great potential for earning foreign exchange. It is stated in the six year plan that the engine of growth will be agro-based industries. The plan envisages a 15 percent per annum increase in the exports of output of the small scale and cottage industries. The share of manufactured goods in total exports has increased considerably overtime. We have identified few items which are mainly produced by the small scale industry. These includes ready made garment and hossery carpets, and rugs, foot wear, surgical instruments and sports good. The small scale industry is not only an important source of foreign exchange earning but it also economises on foreign exchange by relying mainly on domestic machinery and other inputs.

Linkages with other sectors of the economy: Small scale industries in Pakistan has better linkages with domestic economy in terms of employment generation and use of other inputs. The growth of this sector creates demand for domestic capital goods industry. Small scale industry also acts as a training centre both for workers and entrepreneurs. As it uses less sophisticated machinery, workers get training easily and in a shorter period. Entrepreneurs with their acquired skill in small business can move to bigger business and proves themselves as better managers.

VI. PROBLEMS IN FINANCING SMES IN PAKISTAN

1. Shortage and inadequate financial institution for SME support

This is a major problem for SME development. In rural areas private sector remain handicapped due because most financial institutions are not well equipped to serve the SME sector. Most of these institutions lack strong financial backing and cannot recruit skilled manpower, train and pay reasonable salaries.

2. High interest rates, high collateral requirements Commercial banks diseriminate against SMEs because they are considered high risk clients with little or no resources to provide collateral. They provide collateral conditions that most SMEs cannot afford.

3. Lack of effective coordination mechanism to centralize information for financing SMEs

There are many government, banks and NGOs involved in supporting SMEs but there is lack of an effective co-ordination mechanism to centralize SME related information.

4. Concentration of finance in urban areas

Due to long distances between major cities and rural settlements, the delivery of cost of credit scheme is expensive for SME operators in rural areas.

5. Access to finance remain a major problem for SMEs in Pakistan. Most entrepreneurs have to rely entirely on their own savings and money borrowed from friends and relatives.

6. Microfinance banks and SME bank and NGO have presented an alternative source of finding. But the small size loans remains insufficient for SMEs technological capability bulding and competitiveness.

GENERAL PROBLEMS

1. Lack of skilled and talented workers which affects the quality of production as well as efficiency and productivity.
2. There is inadequate data and information on the development of Pakistan SMEs.
3. There is low level of research and development.
4. Lack of access to innovative technology has affected the efficient and productive operations of SMEs.

VII. A STRATEGIC FRAMEWORK FOR ENHANCING THE COMPETITIVENESS OF PAKISTAN SMES IN REGIONAL AND GLOBAL MARKET

The international experience suggest the following lesson for effective services to SMEs (Albaladejo, 2000, ILO, 1998).

1. Service providers should be located close to the industries they serve. Close location to SMEs

- means reduced transaction costs and a quicker response to technical problems.
2. Service providers should benefit SMEs more than large firms especially in Pakistan where the difference is more acute.
 3. Service centres should adopt an approach focused on groups of small firms rather than individual firms. This collective effort reduces transaction costs.
 4. Service providers should be responsive to industry's demands reacting to the needs of their customers but also acting as industry leaders and encouraging firms to change their technology and organization according to their perception of best practice.
 5. Service providers should be run on a business. Like and demand led basis to ensure sustainability.
 6. Support policies designed and implemented with the help of SME representatives will result in more practical cost effective and realistic

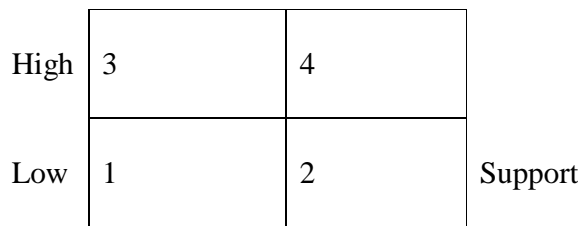
7. Service providers should foster the innovation and production capabilities of local firms making good and rational use of external sources i.e. facilitating the transfer and use of appropriate technology in SMEs.
8. Focusing on research and development intensive services to encourage SMEs to move towards more innovative and higher value added products.
9. Another demand oriented and tested measure is support through partnerships between large firms and their small suppliers. To upgrade the capacity of small firms large customers could be used as entry point to reach the small suppliers (ECA, 2001).

SMEs MARKET CHALLENGES AND POLICY SUPPORT

Figure 1 provide some guidance to policy makers and show the fact that good governance is about finding the right balance between challenge and support.

Challenge

Fig. 1



Source: Adopted from ECA 2001 Economic Commission Support for Africa Strategic Framework Report 2001

The horizontal axis shows the degree of SME support and vertical axis shows the severity of the challenge. The above figure differentiate only between low and high challenge most SMEs in Pakistan found themselves in quadrant 1 the challenge they confronted was low due to protection from outside competition but the institutional support they receive was also low. Important liberalization of the 1990s pushed them into quadrant 3 which meant sudden high challenge but continuing low support. The most quadrant to be targeted is quadrant 4 which represent high challenge and high support for Pakistan SMEs. This combination will most likely leading to successful SMEs for Pakistan.

VIII. SUMMARY CONCLUSION AND RECOMMENDATIONS

This paper examine and analyse the structure, growth, impact and problems in financing SMEs in Pakistan. The paper further reviewed the issues

affecting SME sector and suggest a strategic framework for enhancing the competitiveness of Pakistan SME in regional and global market.

The major conclusion drawn from this paper were the Pakistan SME sector is facing many problems and challenges both domestic and international in achieving economics of scale and better prospects in marketing their products at international market. Among the challenges are shortage of financial institutions for SME growth, high interest rates and collateral requirements, lack of effective coordination for financing SMEs and concentration of finance in urban areas. The following recommendation would go along way in addressing various problems and challenges confronting the SME sector.

RECOMMENDATIONS

1. Foreign markets should be surveyed periodically and small manufacturers should be informed of the demand for their product.

2. Local entrepreneurs should be informed of acceptable design and quality products so that they can compete in foreign market.
3. There is a need to establish a training centre for small manufacturers a few basic courses on management, marketing and quality control should be offered at these centres.
4. There is a need for regular periodical surveys of small scale industry at national level this will help policy makers work out future plans for small scale industries.
5. There is a great need for homogeneous development policy for small scale industry at national level. It is suggested a committee should be appointed by the federal and provincial governments to formulate a result oriented policy for the promotion of small scale industries.
6. The timely resolution of trade disputes is essential for maintaining the goodwill and trust of foreign buyers. There is a need to improve the working of commercial courts so that small entrepreneurs can get justice.
7. Government also has an important role to play in assuring a conducive environment capacity building, infrastructure, regulatory and legal framework.
8. There is a need for continuous enlightenment campaign by state bank of Pakistan and the banking industry.

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