Unleashing the potential of the SME sector with a focus on Productivity Improvements[1]

by Shahab Khawaja, CEO SMEDA

Introduction

This Paper begins with an overview of the SME sector. It argues why SMEs' growth Potential for employment, income generation, and poverty reduction remains largely untapped. It also highlights Government of Pakistan's policies for SME growth and their effectiveness with specific reference to constraints faced by firms influencing their productivity and competitiveness. A snapshot of present strategies, adopted for SME growth is also a part of this Paper along with a detailed commentary on the possible avenues for intervention in order to achieve common vision of SME development accruing benefits to the National economy.

An overview of SME Sector in Pakistan[2]

What constitutes the complexion of Pakistan's economy is the direct reflection of its Small and Medium Enterprise (SME) sector. The Economic Census of Pakistan-2005 lists 3.2 million business enterprises nation-wide and SMEs constitute over 99 percent of all. Their share in industrial employment according to an estimate is 78 percent and in value addition approximately 35 percent. Nearly 53 percent of all SME activity is in retail trade, wholesale, restaurants and the hotel business whereas the contribution of industrial establishments and those involved in service provision is 20 percent and 22 percent respectively.

Among the SMEs involved in retail, wholesale etc. 98 percent employ less than 5 persons and 99 percent less than 10 persons. Even within the manufacturing sector the trend is not different and nearly 87 percent employ less than 5 persons and 98 percent less than 10 persons. Similar pattern of employment distribution can be traced among other sectors except for mining where SMEs tend to employ more people. In the mining sector, it averages around 56 percent employing between 6 to 50 persons. On the whole, the percentage of large firms is very small.

Punjab is home to more than 65 percent or 1.9 million businesses in Pakistan. This is even true at the sub-sector level such as agriculture, mining, manufacturing, construction etc. except for electricity gas and water sector, where NWFP is leading with a share of 87 percent. Punjab is followed by Sindh, NWFP and Balochistan with a share of 18 percent, 14 percent and 2 percent respectively. Unlike large enterprises in the formal sector, small and medium enterprises are constrained by financial and other

[1] This paper has been developed for the Pakistan Development Forum-2006 and can be accessed at www.smeda.org.pk

[2] The information in this section has been compiled from the Economic Census of Pakistan as reported in their preliminary report or the information supplied by FBS.

resources. Their capital base remains lean and nearly 100 percent of all reported business investment, excluding land and business, remains less than a million rupees. Sales data for businesses in Pakistan segregated on firm size was not available although according to the most recent economic census report, 84 percent of enterprises have sales below 0.5 million rupees and 93 percent report sales below 1 million rupees.

SME sector in Pakistan is primarily a less formally organized sector; more than 96 percent businesses are owned and managed by an individual as a sole proprietary concern. While 2 percent are partnerships, there are hardly any corporate entities in the SME sector, implying that the inclusion of professional people in business management process is yet to be witnessed. SMEs in an ideal situation should serve as the breeding ground for future corporate sector but this really does not seem to be happening in Pakistan.

These characteristics of SME sector suggest that most of the businesses are in a low growth trap, dealing in traditional products and unable to climb up the technology ladder. They often become vulnerable to various shocks and disappear from the scene. This view gets credence from the fact that 19 percent SMEs are less than 5 years old and only 4 percent are able to survive beyond 25 years. The encouraging sign however, is their mushroom growth which makes it imperative that there should be a mechanism through which they could get support in terms of resources such as capital, finance, trained human resource or services like advice on technology up-gradation, marketing or quality management etc.

Growth and SME Sector - Why SMEs' growth Potential for Employment, Income generation, and Poverty reduction remains largely untapped

SMEs play a key role in providing additional employment and facilitating transformation of economy from low to middle income group. Their allocative efficiencies in resource utilization such as labour, capital and technology synergize the economic development in a socially equitable manner[3]. SMEs do allow a large number of entrepreneurs and self-employed to survive and exist. It is also understood that sectors dominated by SMEs are better able to exploit dynamic economies of scale. More importantly there has been no successful transformation evidence available in the world without the active participation of SME sector in the economic development. The following text evaluates the growth pattern of the SME sector and gives an insight if SME sector in this role has been fully exploited or not in Pakistan.

Table 1 below compares the growth of Large scale vs. SME sector for three consecutive decades. It dispels the common notion that SME sector has been leading the large scale sector in terms of output or investment growth. It can be observed that SME sector has been historically growing at a pace lower than the large scale sector.

[3] Source: Faisal Bari, Ali Cheema & Ehsan ul Haq - Barriers to SME Growth in Pakistan: An Analysis of Constraints - *2002*

Table 1: Key Manufacturing Growth Rates (percent)

	Large Scale		SME Sector	
	Output Growth Rate %	Gross Fixed Capital Formation Growth %	Output Growth Rate %	Gross Fixed Capital Formation Growth %
1970s	4.84	-2.28	4.4	5.5
1980s	8.16	8.15	4.7	10.5
1990s	3.6	-5.02	2.6	7.2

Source: Faisal Bari, Ali Cheema & Ehsan ul Haq - Barriers to SME Growth in Pakistan: An Analysis of Constraints – *2002*

It also explains that difference in growth rate widened during 1980s and becomes comparable during 1990s. The gross fixed capital formation[4] has been high in the sector but not resulting in desirable output growth. For comparing the growth rates beyond 1990s the investment climate survey data was used. The following Table 2 explains the growth in employment against firm size while confirming the highest growth rate in the Large Scale sector. The growth rates are further studied for assessing the output growth and equity growth rates using the similar dataset as shown in figure 1 & 2.

Table 2: Firms Reporting Growth in Employment by Size

	Micro	Small	Medium	Large
Negative Growth	11%	12%	16%	18%
No Change	46%	50%	48%	30%
Growth	39%	36%	35%	51%

Source: Investment Climate Survey 2001

It may not suggest the pattern of the output growth over the decade but does reflect that similar gap of growth between the large scale sector and SME sector continues to exist up till 2001. The above discussion suggests that in Pakistan, the SME sector has not been a leading actor as the engine of growth or a conduit for desirable employment generation. In our view, Pakistan clearly falls into the category of countries where the potential of SMEs has not been fully exploited. The evidence clearly shows that the growth performance of SMEs has not

Figure1 : Growth in Output by Firm Size

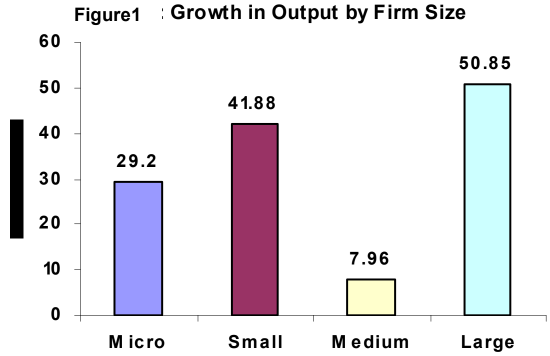
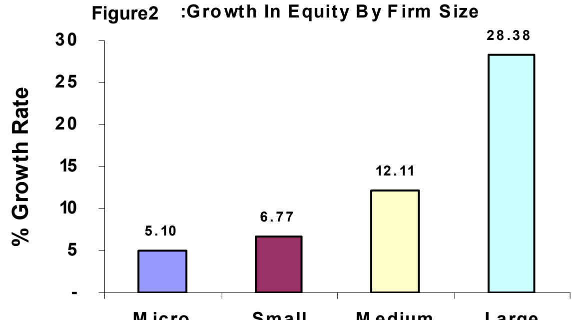


Figure2 :Growth In Equity By Firm Size



Source Investment Climate Survey 2001

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[4] A measure to estimate net investment

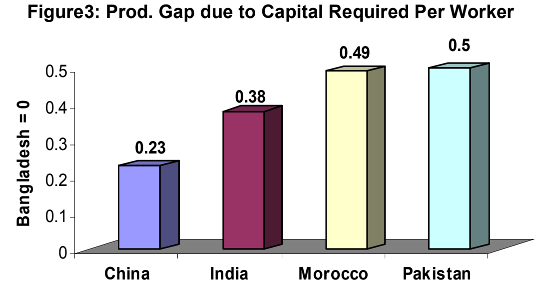
been exceptional in Pakistan. It also suggests that SME growth rates have not matched the growth of the large-scale manufacturing (LSM) sector during the past two decades. As a matter of fact at a national level SMEs have played a very small role especially firms employing between 5 to 99 workers, in the existing manufacturing structure of Pakistan. This also suggests that the potential of these enterprises remain largely untapped in the Pakistan Economy.

There have been many efforts to understand the cause of this low growth trap of SME sector in Pakistan, which is discussion in later part of this paper. However, it is understood that business friendly policy and regulatory environment is a necessary condition for achieving and sustaining high levels of business development and growth. The regulatory environment has however, not very conducive for SME growth. The presence of SMEs in large numbers has not given them any additional bargaining power to influence the policy or regulatory framework to suite their needs. In fact, policies in the past have had only some basic reference towards small business growth and have concentrated on direction and defining broad parameters of activity within the macroeconomic framework. On the whole, small firms are discriminated against large firms and most of the Government's efforts have remained focused on large enterprises development. Consequently, SMEs normally do not get adequate access to business resources, like capital or finance. The number of institutions with a capacity to cater to SME needs for business growth and development remain almost negligible. The adverse influences of the legal environment affect all economic agents. Such an environment does not cater well to innovative activities which come from newly founded, small firms, and the new job creation potential of the economy is thus constrained.

Productivity in Pakistan

The productivity of firms in Pakistan is fairly low when compared at the regional level. The investment climate survey data for 2001 suggest that productivity gap in Pakistan due to average capital required per worker is the highest in Pakistan followed by India, China and Bangladesh (See figure 3). A similar trend of low productivity is observed in figure 4 & 5 due to gaps in labours' skill level and Total Factor Productivity (TFP) shortfalls.

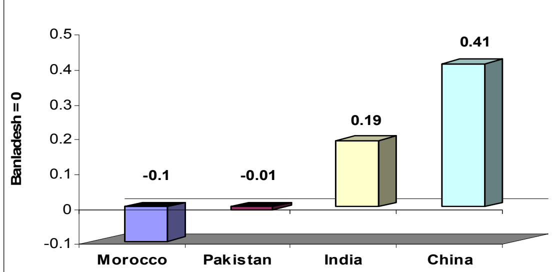
Figure3: Prod. Gap due to Capital Required Per Worker



Source World Bank - Investment Climate Survey 2001

The national competitiveness, report of the World Economic Forum published in December 2004, placed Pakistan's competitiveness in the bottom 15% of countries surveyed. The "Growth Competitiveness Index", which covered 104 countries in 2004, ranked Pakistan at number 91. In 2003, Pakistan ranked 73rd. However, the more recently published Global Competitiveness Report 2005 ranks Pakistan at 87 in terms of "Global Competitiveness"

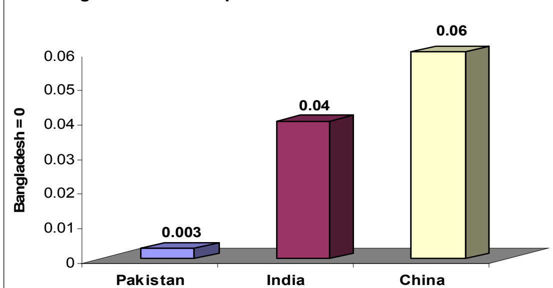
Figure 4: Prod. Gap due to TFP



Source Investment Climate Survey 2001

In countries, where SME sector is non-competitive, industries lose market share both domestically and abroad, and jobs disappear. This has exactly been the case where empirical evidence confirms that one of the reasons for the low growth of SMEs has been due to the low level of productivity in Pakistan. As a result during the economic liberalization during 1990s private sector SMEs fail to respond to those[5]. The common man was affected as economy wide employment growth rate decreases, real pay was lowered and benefit packages were reduced due to squeezed margins. Over time, inability to be competitive added to poverty and to a vicious downward economic cycle which has been observed during 1990s.

Figure 5: Prod. Gap due to Labour Skill Difference



Source Investment Climate Survey 2001

The key ingredient needed to make SMEs competitive is enhanced technical skills and organizational capacity. Earlier attempts in this direction in Pakistan and elsewhere were not very successful, partly due to limited conceptualization of technology and its role in development, and lack of practical experience in project implementation and delivery mechanisms. Choice of content and mechanism of delivery has always been critical to the success of such attempts in the world.

How effective have the Government Policies of the past been in promoting the SME Sector?

The SMEs in Pakistan suffer from a variety of weaknesses, which have constrained their ability to adjust to the economic liberalization measures introduced by the government of Pakistan and to take full advantage of rapidly expanding markets of the world. The policy areas of productivity enhancement, labour, taxation, trade, finance and access to credit are highlighted as main areas of concern and constraint by SMEs to their growth (figure-6). SMEs importance and contribution in the economic activity suggests that there is a significant potential to enhance their growth through appropriate regulations and promotion.

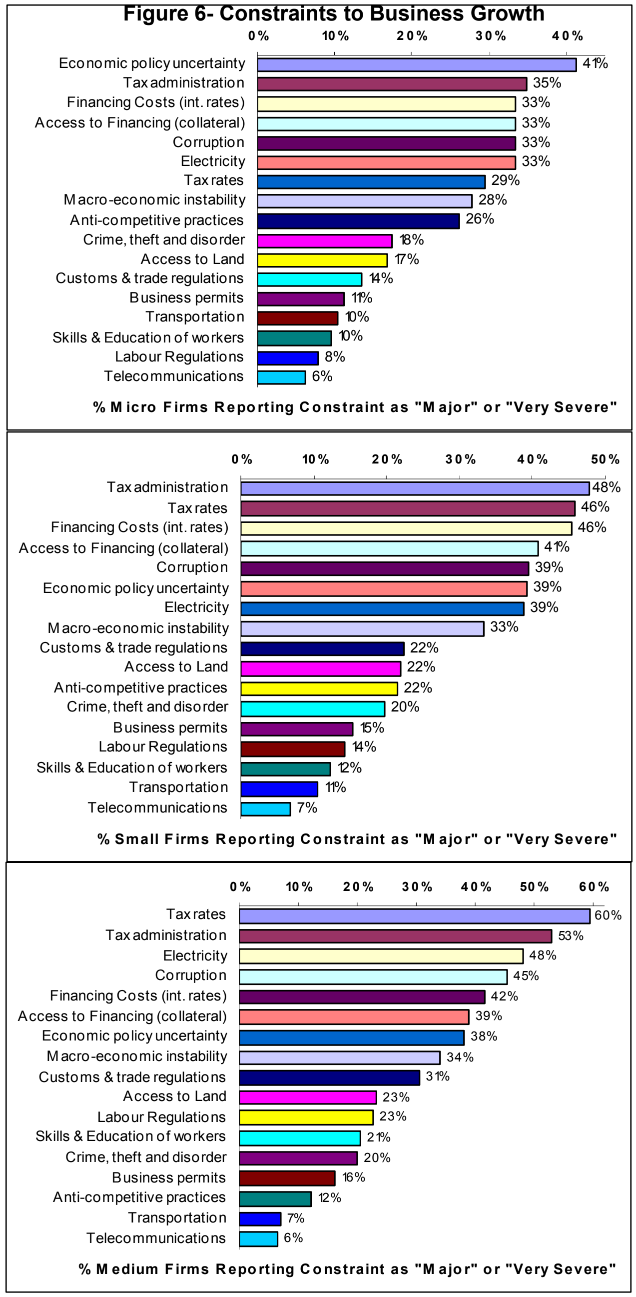
At the same time, the large size of the SME sector (3.16 million enterprises) pose service challenge for the government and business support institutions to achieve complete coverage by support programs. Historically, The Government of Pakistan had been responding to the growing needs of the sector. In 1992, Government introduced Self

[5] Source: Faisal Bari, Ali Cheema & Ehsan ul Haq - Barriers to SME Growth in Pakistan: An Analysis of Constraints – *2002*

Employment Scheme through Small Business Finance Corporation of Pakistan (SBFC). SBFC continued to grant loans to small businesses and had disbursed 12 billion by June 1998, catering to the needs of 157,162 unemployed persons. Other schemes for SME development or employment generation included efforts through Youth Investment Promotion Society, Provincial Small Industries, Awami Tractor Scheme, Prime Minister's Self Employment Scheme and Yellow Cab Scheme. Nonetheless, despite their good intentions, above efforts lacked coherence of vision across institutions for SME development, resulting in disjointed efforts. Accordingly, these efforts remained marginally significant without long lasting effects on the SME sector growth or entrepreneurship development in Pakistan. Secondly, all these schemes were focused on enterprise creation or enterprise financing and were effective in their respective tenor of operation as shown in Figure 7. The increase in the number of SME start-ups during 1990s gives credence to this view. The question of sustainability in terms of competitiveness however, was neither a part of the design of programs nor realized as a major issue. Resultantly, SMEs' graduation to large enterprises remained negligible.

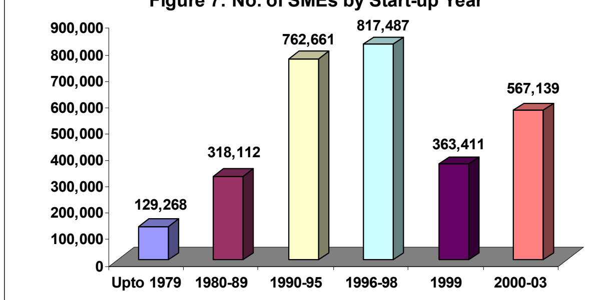
Towards the end of 1990s stagnant exports, rising unemployment and poverty levels were identified as inter-related factors fundamental to economic growth. Motivated by the need to take proactive measures for the development of SMEs, SMEDA was established in 1998. SME as a

Figure 6- Constraints to Business Growth



Source Investment Climate Survey 2001

Figure 7: No. of SMEs by Start-up Year



Source: Economic Census of Pakistan

sector for the first time attracted the attention of policy makers as a potential source of achieving both higher employment and exports. The mandate given to SMEDA is though much broader and encompasses policy making for small and medium enterprises, provision and facilitations in business support services, developing resource base for SMEs, and serving as the voice of small business within the government. The role of provision of financial resources was entrusted with the SME Bank. The ultimate objective was to kick start the economy through an aggressive launch of a Small and Medium Enterprise support program where the private sector growth is led by SME development. This time it was different since both financial and non-financial resources were planned for the development of SMEs.

After its inception, the first challenge for SMEDA was to develop its own understanding about the SME sector. SMEDA initially structured itself into a sector based organization while focusing on nine key sectors of the economy where SME presence was prominent and contribution to GDP was significant. Complete value chain analysis were undertaken to deepen the understanding about each sector on four basic parameters; regulatory environment, local and international market competitiveness analysis, level of technology and competition. These analyses were followed by Integrated Sector Development Strategies for each sector and were submitted to the Government for execution and implementation. This resulted in a better understanding of SMEs, their structure, cross-sector linkages and complex interplay of various government regulations. This also enhanced SMEDA's capacity in two areas; first, to explain the general business environment surrounding an SME, and second, to develop services that can immediately affect their efficiency. These strategies and experiences in service provision are feeding into the national development framework such as Long Term Development Perspective 2001-11 and Medium Term Development Framework 2005-10 and duly recognize the need of productivity improvement as mean to enhance the sustainability of SME sector. At the same time, much can be achieved only by appropriate policy tools and regulations than with support programs. SME development is hampered more by inappropriate regulations than compensated by means of appropriate support programs.

What are the Labour, Tax, Industry Regulations related to SME sector and are they investor friendly?

There is no SME specific regulatory regime in place at present. All the regulations treat firms equally with the exception of few (i.e. SBP's Prudential Regulations, Income & Sales Tax) as discussed in the text below. The equal treatment of the regulations disregarding the specific conditions of firms especially with respect to their size in fact creates a wedge. Formal evidence suggests that small firms are discriminated against relatively large firms[6]. But while large enterprises and established holding structures possess the necessary economic and human resource potential to cope with and

[6] SME Policy Note, the World Bank; ILO SMEDA Study 2001 on MSMEs, LUMS study on SME constraints

overcome these difficulties, SMEs, due to their size and the resulting peculiarities, are far less capable of adjusting and carrying on successful business[7]. While spared of direct statutory or administrative discrimination, SMEs remain subject to unequal treatment, which distorts the competitive environment for business. The economic significance of this kind of institutional bias is apparent in Pakistan (see table 1 & 2 below). As shared earlier, such an environment does not present good preconditions for innovative activities which come from newly founded, small firms, resultantly new job creation potential of the economy is constrained and informal sector tends to grow[8].

Table 1: Average Official Fines by Firm Size & Regulator (in Pak Rs.)

	Micro	Small	Medium	Large	Avg.
CBR	0	2,979	1,304	2,315	2,260
Income Tax	2,160	3,884	3,452	5,393	3,800
Sales tax	763	4,403	1,477	8,194	4,042
Customs	0	512	2,250	3,110	1,054
Excise	85	1,427	1,709	2,025	1,377
Labor & Social Security	25	633	2,496	2,176	1,032
EOBI	215	829	608	1,762	841
ESSI	226	620	702	717	594
Welfare	211	373	159	2,743	635
Fire & Building Safety	18	92	60	555	139
EPA	22	29	44	196	52
All Others	60	55	32	290	83

Source Investment Climate Survey 2001

Economic policy uncertainty emerges to be the biggest constraint in growth of smaller enterprises (Figure 1). Fiscal measures play an increasingly active role in initiating and promoting SME growth in Pakistan and there could be nothing worse than shifting policies. Ideally, there should be a mechanism in place to test the biases against certain class of firms. For instance, it is standard policy practice in UK to “think small first”. Resultantly, *policy surprises* are less frequent. In all cases it is made sure that *to be affected* businesses are *consulted* and *informed* of any forthcoming major policy shifts. They are also allowed an adequate moratorium for the adjustment of economic activity. Special attention is paid towards checking *bureaucratic discretions* while developing policy rules or procedures. All such mechanisms are missing in present policy or legal environment in Pakistan. The absence of a specialized, uniform legal framework for the development of SMEs hampers SME operations.

[7] LUMS in its study on “Barriers to SME Growth in Pakistan: An Analysis of Constraints” compared the growth rates of Large vs. Small scale manufacturing and established that during 1970s both were growing at a comparable rate of over 4% whereas in 1990s during the period of economic downturn small scale manufacturing growth dropped to 2.6% against large scale manufacturing growth rate of 3.6%.

[8] Non-Linear Model to estimate underground economy in Pakistan, SBP Research Department

Table 2: Average Gift Payment to Regulators by Firm Size (in Pak Rs.)					
	Micro	**Small**	**Medium**	**Large**	**Avg.**
CBR	0	785	399	194	548
Income Tax	5259	3923	3459	6120	4323
Sales tax	3959	3613	2840	6632	3958
Customs	18	269	3752	2090	981
Excise	84	654	492	368	519
Labor & Social Security	25	248	574	51	241
EOBI	417	313	596	1688	549
ESSI	377	114	426	355	226
Welfare	369	324	783	645	440
Fire & Building Safety	156	216	324	226	225
EPA	10	16	2	81	21
All Others	26	151	441	90	169
Source Investment Climate Survey 2001					

As evident from above, smaller firms found tax related issues more restrictive than larger firms. SME Policy Note of the World Bank reports that 69% of firms having assets worth less than Rs.1 million faced the greatest of tax related problems. It was not possible for such small enterprises to maintain books of accounts[9] as per law or hire a professional due to cost constraints.

Recent reforms in tax regime are in the advance stage of implementation in Pakistan[10]. Accordingly, there have been considerable improvements in the present tax regime from an ordinary SMEs perspective. Two sectors; retailers and small to medium sized manufacturers were particularly propounding the idea of fixed taxation as remedy to this continued ailment. This concession has been granted in addition to fiscal incentives to small companies. However, prevailing system is non-standardized and offers excessive discretion to the tax authorities. There is little consolidation or rationale in current provincial or local tax structure as well[11]. Hence, there has been a constant tension between tax authorities and the business communities resulting in very slow expansion in tax base[12].

The 10 year (2001-2011) perspective development plan notes that there is a large range of zoning and other regulations imposed by the federal, provincial and local governments and public sector utilities which affect the functioning of SMEs hence, *legislation similar*

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[9] In Japan, in 1949, old taxation system was replaced by a new system to resolve the problem of incomplete bookkeeping and fear of over-taxation of SMEs. The new system allowed certain tax merits if a tax return is made with a "certain formula of quick bookkeeping." This system resulted not only in the improvement of financial accounting but also in strengthening of financing systems for SMEs.

[10] A taskforce on the reform of tax administration was constituted by the government in 2001. Based on Its recommendations a restructuring plan was drawn up by CBR. This restructuring plan is now being made operational with the World Bank's support.

[11] There are 25 federal taxes/levies, 20 provincial taxes/ fees and 20 district taxes/ fees presently levied on businesses in Pakistan, 60 out of these 65 taxes are applicable on industry and there are 25 agencies regulating these taxes; Source: Firm Level Taxation in Pakistan by Asad Aleem, the World Bank

[12] There are 1.05 million active tax filers in Pakistan. In 1999-2000 the number of salaried taxpayers was 440,000 and those filed under old self-assessment scheme were 275,000.

to the US Small Business Regulatory Enforcement Act of 1996, which includes Regional Small Business Ombudsmen, would be considered to ensure the fair and efficient functioning of SMEs. Nevertheless, a "*level playing field*" is one of the cardinal conditions for the rapid private sector led SME development.

Labour Laws and regulations in Pakistan[13] are one of the most complicated areas with which any business enterprise deals. Existing labour laws are the result of chequered initiative of various governments to create a healthy environment for labour. Consequently, enterprises have to deal with fifty six (56) labour laws with some of them being industry specific. Numerous labour inspections under these laws are yet another impediment that retards the growth of small and medium enterprises. The Labour Legislation reforms are at the advanced stage and will bring their benefits to the enterprises. The present focus of the reforms is on the consolidation of laws and development of policies for labour inspection and labour protection with the intention of reducing interface of government officials with businesses without compromising on the unhealthy work practices.

The Labour market dynamics have changed considerably over the years, a higher degree of adaptability and flexibility are essential requirements of new environment. The issues related to reforms of local labour offices and activating them to address the training needs of lower management, low skilled workforce, and vocational training yet requires more attention and resources. The possible interventions may address issues confronting vocational training, active job-broking as well as loans and training programs addressing for those unemployed who want to establish their own small businesses.

How infrastructural (power, transport problems), market (anti-competitive practices) and macro (high interest rates, price uncertainty, exchange rate volatility) constraints influence growth of SMEs?

Sufficient empirical evidence supports the view that firm size matters for the degree of constraint that firms face[14]. The major constraints in SME growth are with regards to tax administration and tax rates, electricity, and access to financing. The list of less constraining issues includes crimes, access to land, labour regulations, and telecommunications. The issues related to financing costs, economic policy uncertainty, corruption, macroeconomic stability, customs and trade regulations, anti-competitive practices, business licensing and operating permits, skills and education of the labour force, and transportation are cross cutting in nature and affect all sizes of enterprises. But regarding tax issues and electricity, medium firms express the strongest complaints,

[13] A committee on Reforms in Regulatory Legal and Policy Environment was set up in the Ministry of Industries & Production in 2000 with the purpose to coordinate, review, identify issues of concern and formulate recommendations on various laws effecting businesses. Some of their efforts have resulted in the consolidation of labour laws as announced in the Labour Policy 2002 and proposed amendments in the Factories Act 1934, Drug Act 1976, Boiler Act 1923, and Explosives Act 1884, and as such it reviewed 101 commercial and labor laws that effect industrial sector.

[14] An Investigation of Firm Heterogeneity in the Constraints to Development and Growth in Pakistan by Wade Pfau and Sajjad Moghal, National Graduate Institute for Policy Studies, Tokyo, Sept. 2005

followed by large firms, small firms, and micro firms. In fact, micro firms generally have fewer complaints, as their only major constraints are economic policy uncertainty and financing costs. Meanwhile, for access to finance, small firms complain most, followed by medium, micro firms.

Table 4 - % of Firms Reporting Constraint as "Major" or "Very Severe" by Firm Size

	Micro	Small	Medium	Large
Economic Policy Uncertainty	**41%**	**39%**	**38%**	**47%**
Tax administration	**35%**	**48%**	**53%**	**50%**
Financing Costs (int. rates)	**33%**	**46%**	**42%**	**44%**
Access to Financing (collateral)	**33%**	**41%**	**39%**	**32%**
Corruption	**33%**	**39%**	**45%**	**45%**
Electricity	**33%**	**39%**	**48%**	**38%**
Tax rates	**29%**	**46%**	**60%**	**54%**
Macro-economic instability	**28%**	**33%**	**34%**	**46%**
Anti-competitive practices	26%	22%	12%	26%
Crime, theft and disorder	18%	20%	20%	**33%**
Access to Land	17%	22%	23%	19%
Customs & trade regulations	14%	22%	**31%**	**36%**
Business permits	11%	15%	16%	13%
Transportation	10%	11%	7%	11%
Skills & Education of workers	10%	12%	21%	12%
Labour Regulations	8%	14%	23%	23%
Telecommunications	6%	7%	6%	14%

Source Investment Climate Survey 2001

The issue of taxation is not related to the fiscal burden or the tax rate as a major constraint for micro firms rather, it is the administrative and corruption costs associated with regulation and taxation. Regarding tax administration, the small and medium firms are not different from large firms. With regard to tax rates, it is observed that micro and small firms complain to a lesser degree than do medium or large firms. Some justification can be observed for this phenomenon if firm responses are analyzed on three parameters: the amount of entrepreneurial time spent in dealing with tax regulators, average fines paid during a year, and average gift payments made to the regulators. SMEDA's analysis of firm responses using Investment Climate Survey data reveals that larger firms must devote significantly more resources in absolute terms for dealing with taxation issues, while small firms are most burdened as a percentage of sales. Micro firms can more easily escape the targets of the government tax authorities using gift payments as tool. These facts are tabulated in table 1&2 above.

Access to financing is an important issue, and analysis of the same data set reveals that large firms complain least and small firms complain most. Access to financing is only a major constraint for small and medium firms. Within the Investment Climate Survey sample it was observed that 57% of new investment for Small and Medium Enterprises and 67% of working capital finance come from internal finance or retained earnings; *only about 7% of funds for investment or working capital come from banks or other financial institutions.* On the other hand, micro-firms believe that they will not be entertained by the financial institutions, and hence they are discouraged to apply in the first place hence are forced to find other sources of financing. Secondly, uncertainty associated with the future of the business (i.e. economic policy uncertainty) as regards to the probability of firms' survival may lead micro firms to avoid taking any additional liabilities in the absence of effective bankruptcy procedures.

The analysis constraints related to crime, access to land, anti-competitive practices, labour regulations, and telecommunications reveals that most likely targets of theft and crimes are the large enterprises. Limited financial resources have translated into the larger complaints by the micro, small and medium enterprises about the access to land. Unlike the usual notion that labour regulations are a real source of trouble for the smaller firms our analysis suggests that labour regulations are major issue for medium and large firms.

Revisiting the discussion above, we propose that to improve the conditions for the SME sector in Pakistan, the key areas for intervention are taxation, where both tax rates and general administration have to be reviewed pragmatically, followed by needs for improvement in the provision of electricity, and an expansion of formal financing for smaller firms. To make the environment even more conducive for micro and small manufacturing, small industrial zones with dedicated access to land may be considered. However, any intervention in other areas would benefit all sizes of enterprises.

Strategy for Productivity Enhancement

The possible strategy for productivity improvement in Pakistan has to follow a four step approach where each step is building on one another. As a first step the cost competitiveness of SMEs has to be addressed. The discussion above and the firm level constraints reported in table 4 entails that SMEs need a conducive regulatory environment. Rationalizing the regulatory burden, provision of adequate infrastructure and business support services, giving access to capital and short to long-term funding, linking SMEs to large firms and allowing knowledge about market opportunities to follow to SMEs can result in significant reduction in their cost of doing business.

Second step should target the quality competitiveness among SMEs in Pakistan. It is understood that SMEs typically suffer from weak entrepreneurial skills as well as deficiencies in accounting, production management, technical know how and business planning. As SMEs grow, they increasingly need connectivity to export markets and capacities to match contemporary quality standards. The weak affordability of SMEs due to lean capital base and low turnover pose a service challenge to the Government and the service providers. The programs thus envisaged should cater for supporting SMEs through resource provision in terms of short to long term funding arrangement along with service provision. Quality training for human resource development and infrastructural support through common facility centres allowing SMEs access to quality acquisition facilities would be important in this regard.

Equally important for the rapid growth of SMEs is the technology competitiveness. It is understood as the third step of the strategy and feeds to the fourth step of ultimately achieving business competitiveness. The basis for these two has to be built by investing into science and technology and related research and development initiatives both at the higher educational institutions and industry level. However, there is no short cut for achieving that and it would at least requires continues support from the government and industry for an initial period of ten years to yield results.

Sustainable SME development nonetheless, requires concerted efforts among all the concerned parties including financial institutions, consulting and training firms as well as local business associations. Government's role in the process should be limited to providing the enabling environment for private sector development, correcting potential market failures and creating a level playing field that will allow SMEs to compete in free markets. Emerging international experience is demonstrating that government is not the appropriate vehicle to implement and coordinate efforts, and that public-private partnerships for SME development are a critical element for the success of these efforts.

At the same time, Business Development Services (BDS) are needed to improve the internal capacity of SMEs. Government's efforts[15] under this approach are directed towards; creating conducive business environment, facilitating SMEs access to markets, enhancing information flow, promoting entrepreneurial culture, facilitating development of services for new enterprise creation, education, and technology development. If and where required, investment in public goods that improves SME competitiveness including infrastructure i.e. common facility centres are carried out. SMEDA is currently reviewing regulations that result in higher cost of doing business for SMEs and proposing solutions.

Presently SMEDA is focusing on four priority areas reflecting its entire spectrum of delivery of activities and services. These areas can be broadly classified as; i) Policy related interventions ii) Business support services related activities with a priority to develop a market for their provision in the private sector, iii) Sector and cluster development programs and, iv) Enterprise development initiatives.

SME Policy

Promotion of Small and Medium Enterprises (SMEs) entails enhancement of the competitiveness of the economy and generation of additional employment. It is shared that despite previous efforts the SME sector has not received due priority[16] on account of segregated efforts and non-consolidation of programs to achieve well targeted results. In order to move forward, we need to develop a common vision for SMEs to be the real engine of growth. Our vision also needs to be achievable so we may find motivation in

[15] For details please see Medium Term Development Framework 2005-10 of the Government of Pakistan

[16] GOP, Planning Commission 2001. Ten Year Perspective Development Plan 2001-11, p.100.

implementing phase. Thus, Ministry of Industries, Production & Special initiatives through SMEDA set out to accomplish the task of developing Pakistan's First SME Policy.

The broader objectives to be achieved by this policy are; across the board recognition for SMEs as a sector requiring separate policy & regulatory space, define SMEs that qualify for support, propose counterbalancing measures to eliminate disadvantage of size, remove unnecessary regulatory burden *targeting the cost competitiveness*, institute SME support mechanism in both public & private sectors, improve support delivery mechanisms and establish policy evaluation and review systems

SME Policy sets out the commitment of the Government of Pakistan towards the development of the SME sector, as expressed in the Policy statement:

The Government of Pakistan is committed to develop the SME sector for achieving higher economic growth and maximizing creation of jobs for poverty alleviation. SMEs will be made more competitive by providing conducive business environment, greater access to formal financing and through provision of support in technical up gradation, human resource development, marketing and innovation. The Government of Pakistan will facilitate establishment of new businesses by developing policies that help in realizing the entrepreneurial potential of the people of Pakistan

Key Policy Reforms to Enhance Competitiveness of SMEs

Cognizant of the importance and need of innovation and promoting public-private dialogue to increase competitiveness and support "second-generation" reform, The Small and Medium Enterprise Development Authority undertook a benchmarking exercise with other successful government SME development authorities to identify gaps and areas to build up SMEDA's capacity and improve its operations. This benchmarking exercise resulted in an urgent need to explore initiatives to upgrade Pakistani industry and stimulate employment and economic growth in Pakistan.

Based on the gaps identified during the benchmarking exercise, and taking into account the current state of the economic development and innovation in Pakistan, -- weak enterprise competitiveness, R&D, science & technology and industry cooperation—a number of initiatives are planned to be launched with an objective to (i) boost enterprise competitiveness based on good strategy and innovation; (ii) finance and support pilot projects that demonstrate the impacts that improved strategy, technology, human resources, and management can have on profits; (iii) support SME incubation and knowledge- based enterprise development; and (iv) bring together the various initiatives needed and those which exist to promote competitiveness.

Role of Donors in enhancing Productivity in Pakistan

Pakistan Enterprise Competitiveness Support Fund (CSF)

Pakistan Enterprise Competitiveness Support Fund (CSF) with the support from USAID has been set up to encourage start-ups and to support existing small and medium size enterprise by enabling them to adapt innovative strategies and technologies and thus compete more effectively at the global level in the post-WTO scenario. The principal outcome of CSF is to upgrade the competitiveness of Pakistani industry, reinforce economic growth, and to create new job opportunities. The Fund will have the following financing instruments:

- Matchmaking Grants
- Equity Financing
- Credit Guarantees
- Technical Assistance

Business Support Fund (BSF)

Business development services (BDS) are a key instrument to enhance competitiveness of Small and Medium Enterprises (SMEs). Business development services are demand driven and include a large variety of services including business planning, production management, product design, quality standards and control, productivity studies, marketing, information systems, and training. Currently, Pakistan lacks a BDS market for SMEs, with constraints on both the supply and the demand side. On the supply side, BDS providers target the larger well established enterprises, while on the demand side SMEs lack access to a wide range of competitively priced services targeted to their business needs. ADB funded BSF shall provide financial assistance for:

- Business Plan Development
- Marketing
- Training
- Research & Development
- Technology acquisition and up-gradation

Pakistan Initiative for Strategic Development and Competitiveness (PISDAC)

Strengthening of **Public-Private Partnership** is a key to enhancing competitiveness of industry. USAID has initiated a project jointly with SMEDA, the objectives of which are: (i) to support self-selected Pakistani industries in developing strategies for upgraded production, and (ii) institute a self-sustaining process by which such industries organize themselves to increase their productivity. The first phase of the project, completed successfully in July 2004 where two sector dairy and gems and jewellery sectors were combed to define their strategy for improvement and now it has led to the initiation of the second larger phase of the project.