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# Baseline Study

## To Prioritize Incentives and Develop Business Cases for Supply Chain Formalization in Pakistan

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Textiles | Automotive | Agricultural Implements

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## ACRONYMS

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<b>ACAAP</b>	Air Cargo Agents Association of Pakistan
<b>APCAA</b>	All Pakistan Customs Agents Association
<b>APTMA</b>	All Pakistan Textile Mills Association
<b>BOI</b>	Board of Investment
<b>EDB</b>	Engineering Development Board
<b>EDF</b>	Export Development Fund
<b>EOBI</b>	Employees Old Age Benefit Institution
<b>ESSI</b>	Employees Social Security Institutions
<b>FBR</b>	Federal Board of Revenue
<b>FGD</b>	Focused Group Discussion
<b>ILO</b>	International Labour Organization
<b>KII</b>	Key Informant Interview
<b>MoC</b>	Ministry Of Commerce
<b>Moi&amp;P</b>	Ministry of Industries and Production
<b>MoH</b>	Ministry of Health
<b>NADRA</b>	National Database and Registration Authority
<b>PAAPAM</b>	Pakistan Association of Automobile Parts and Accessories Manufacturers
<b>PAMA</b>	Pakistan Automobile Manufacturers Association
<b>PASPIDA</b>	Pakistan Spare parts Importers and Dealers Association
<b>PRGMEA</b>	Pak Readymade Garments Manufacturers & Exporters Association
<b>PLGMEA</b>	Pakistan Leather Garments Manufacturers & Exporters Association
<b>PSIC</b>	Punjab Small Industrial Corporation
<b>SBP</b>	State Bank of Pakistan
<b>SECP</b>	Securities And Exchange Commission of Pakistan
<b>SMEDA</b>	Small And Medium Enterprises Development Authority
<b>SMEs</b>	Small And Medium Enterprises
<b>SOW</b>	Scope of Work
<b>TDAP</b>	Trade Development Authority of Pakistan
<b>ToRs</b>	Terms of Reference

# Executive Summary

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This Final Report consolidates the findings of the project “*Baseline Study to Prioritize Incentives and Develop Business Cases for Supply Chain Formalization in Pakistan*,” jointly implemented by the International Labour Organization (ILO) and the Small and Medium Enterprises Development Authority (SMEDA). The project aimed to understand the dynamics of informality within Pakistan’s manufacturing value chains and to identify the barriers, incentives, and institutional measures that can accelerate the transition of enterprises and workers from the informal to the formal economy.

The study was initiated in the context of Pakistan’s ongoing economic transformation, where informality continues to dominate employment and enterprise structures. A significant proportion of the country’s industrial activity is conducted by small and medium-sized enterprises (SMEs), many of which operate partially or entirely outside formal regulatory and social protection frameworks. This not only limits their growth potential but also restricts the creation of quality jobs and reduces fiscal revenues. Recognizing these challenges, the ILO and SMEDA collaborated to generate evidence-based insights and practical business cases that could inform future policy design, institutional reforms, and incentive mechanisms for formalization.

The study primarily focused on two key sectors “*Textiles & Automotive*” which together account for a large share of industrial employment, output, and exports in Pakistan. In addition, an exploratory case study was developed for the *Agricultural Implements* sector, a subsector that remains predominantly informal but demonstrates strong potential for technological upgrading, rural employment generation, and value chain development. These sectors were strategically selected to capture both export-oriented and domestic-market industries, thereby offering a comprehensive understanding of the structural and operational realities that influence formalization decisions across different types of enterprises.

A mixed-methods approach was adopted, combining secondary research, enterprise surveys, stakeholder consultations, and field-based interviews with owners, managers, and workers. The study documented nine detailed business cases representing enterprises that have either transitioned to formal operations or are in varying stages of that process. These cases reflect diverse motivations and pathways from pursuing export market access and financial inclusion to adopting improved labor standards, workplace safety, and productivity-enhancing technologies.

Findings from the study reveal that while most enterprises acknowledge the long-term benefits of formalization such as access to finance, enhanced productivity, workforce

retention, and participation in structured supply chains, many continue to operate informally due to high compliance costs, complex registration processes, multiple taxation regimes, and weak institutional trust. For smaller enterprises, the perceived risks and administrative burdens of formalization often outweigh its potential benefits. In many cases, informality is not a deliberate choice but rather a survival strategy in response to limited institutional support, unstable demand, and inconsistent enforcement mechanisms.

The study also found that informal employment practices are deeply embedded in value chain structures, especially among subcontractors and suppliers serving large firms. This perpetuates a low-productivity equilibrium where enterprises underinvest in technology, skills, and quality improvement. As a result, Pakistan's manufacturing competitiveness, export diversification, and job quality remain constrained. Women and youth, in particular, are disproportionately represented in informal employment segments, facing limited access to training, social protection, and secure income opportunities.

Despite these challenges, the study identifies clear opportunities for formalization-led growth. Evidence from the documented business cases demonstrates that enterprises which formalize tend to achieve better financial management, more stable client relationships, improved working conditions, and enhanced access to domestic and international markets. Formalization can thus serve as a catalyst for productivity enhancement, technology adoption, and inclusive economic growth, provided that enabling policies and support systems are in place.

The report emphasizes that formalization should not be viewed solely as a compliance burden but as an economic transformation strategy integral to Pakistan's broader industrial and SME development agenda. When supported through appropriate incentives and simplified regulatory frameworks, formalization can expand the tax base, enhance job quality, and strengthen institutional linkages between enterprises and the state.

To advance this focus point, the report recommends a comprehensive and coordinated policy response that combines regulatory simplification, fiscal and financial incentives, and targeted institutional support. Key enablers include:

- Streamlined registration and taxation processes through digital platforms;
- Scaled-up awareness and capacity-building initiatives for SMEs;
- Incentive-linked compliance schemes that reward early adopters of formalization;
- Stronger linkages between enterprise formalization and access to finance, social protection, and export facilitation services; and
- Strengthened collaboration among federal and provincial institutions to ensure policy coherence and continuity.

Overall, the findings reaffirm that formalization is both a pathway to and an outcome of sustainable industrial development. It requires sustained policy attention, institutional coordination, and trust-building measures that align enterprise incentives with national economic objectives. The ILO–SMEDA partnership, through this study, has laid a critical foundation for evidence-based policymaking by presenting a clear picture of where Pakistan’s industrial sectors stand and what strategic actions can unlock their potential for formal, productive, and decent work-driven growth.

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# **CHAPTER 1**

## Introduction

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A recent study conducted by the International Labour Organization (ILO) in partnership with Pakistan's Small and Medium Enterprise Development Authority (SMEDA) identified key barriers to SME formalization. These include a lack of clear perceived benefits to formalization and the high costs of compliance, which often outweigh the advantages of operating in the formal economy for SMEs. Furthermore, the uneven enforcement of supervisory systems, which focus primarily on sectors like manufacturing while allowing others, such as trade and agriculture, to operate informally, exacerbates the challenge.

With Pakistan's GSP+ status and the impending EU Due Diligence and EU Green Deal legislation, there is increasing pressure on the country's federal and provincial governments, as well as social partners, to improve Labour conditions, formalization and compliance by enterprises throughout the value chains of export-oriented sectors. Additionally, climate change and the associated mitigation efforts in Pakistan's main export markets are set to reshape the products and production processes of SMEs and HBWs engaged in these value chains. However, these enterprises and workers often operate in an un conducive business environment and lack the skills and capacity to adapt to such transitions.

The transition from the informal to the formal economy, alongside the just transition to environmentally sustainable economies, is a key priority under Pakistan's Decent Work Country Programme (DWCP) and the United Nations Sustainable Development Cooperation Framework (UNSDCF) for 2023-2027. The formalization of enterprises is also a critical focus of the national SME Policy 2021, which emphasizes promoting women's entrepreneurship.<sup>1</sup>

The overall objective of this study was to provide an evidence-based framework for promoting the transition of informal enterprises towards formalization in key manufacturing sectors.

Specific objectives included:

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<sup>1</sup> Terms of reference of the Baseline Study to Prioritize Incentives and Develop Business Cases for Supply Chain Formalization in Pakistan.



1. **Assessing the existing situation** of formal and informal enterprises within the textile and automotive sectors.
2. **Identifying key challenges and barriers** that prevent small enterprises from registering, complying with regulations, or accessing support programs.
3. **Documenting business cases** of enterprises that successfully transitioned towards formality to illustrate benefits, lessons, and replicable models.
4. **Proposing incentive mechanisms** and policy reforms to motivate informal enterprises to formalize.
5. **Strengthening institutional coordination** among regulatory and support agencies such as SMEDA, SECP, EOBI, ESSI, FBR, and provincial labor departments.



# **CHAPTER 2**

## Background and Methodology

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In Pakistan, the informal economy accounts for a large share of industrial activity, particularly in the textile and automotive sectors, which are labor-intensive, fragmented, and heavily dependent on informal business practices. Despite their contribution to employment and GDP, enterprises in these sectors face major constraints, including limited access to finance, weak enforcement of labor standards, and inadequate integration into formal value chains. Formalization is therefore not just an administrative process but a comprehensive economic and social transition requiring incentives, compliance facilitation, and institutional trust.

This study explores the underlying reasons why many enterprises remain informal, identifies mechanisms that can ease their transition toward formality, and highlights policy measures and incentive frameworks to encourage both enterprises and workers to participate in the formal economy. The findings aim to guide policymakers in designing practical, evidence-based incentives that align enterprise behavior with national development goals.

The study adopted a mixed-method approach, combining qualitative and quantitative techniques to capture the realities of formalization in Pakistan's manufacturing ecosystem. The methodology included:

- **Literature and Policy Review**

An extensive review of national and international literature on formalization, SME development, and decent work was conducted. Relevant legal frameworks, such as the Companies Act 2017, Labour Laws, Social Security Acts, and Environmental Regulations, were analyzed alongside institutional programs (e.g., SMEDA's support schemes, FBR's simplified tax regimes, and EOBI's registration processes).

- **Key Informant Interviews (KIIs)**

40 KIIs were conducted with representatives from enterprises, business associations (PHMA, PREGMIA and PAAPAM), regulatory bodies, and financial institutions. These provided first-hand insights into registration barriers, compliance challenges, and enterprise perceptions of formality.

- **Validation Workshops**

Four FGDs were organized — two in Lahore and two in Karachi — engaging representatives from small, and medium enterprises (MSMEs). Discussions focused on mapping the costs and benefits of formalization, and identifying incentives that could make registration more attractive.

- **Enterprise Case Studies**

Nine business cases (Eight from textiles and automotive, and one from agricultural implements) were developed. These capture the journeys of enterprises that successfully transitioned from informal to formal operations. Each case documents the enterprise's challenges, strategies, outcomes, and lessons learned.

- **Dissemination Events**

Two dissemination events were held jointly by ILO and SMEDA to discuss baseline findings, Incentives and business cases with industry stakeholders, enterprises, policymakers, and worker representatives.



# **CHAPTER 3**

## Sectoral Overview

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### Textile Sector

The textile sector is a cornerstone of Pakistan's economy, contributing around **9%** to GDP and nearly 60% of total exports. It is the country's largest industrial employer and a vital source of foreign exchange, anchored in a strong cotton base and an integrated value chain extending from raw material processing to garment manufacturing. Its performance directly influences employment, exports, and macroeconomic stability.

The sector is diverse and multi-tiered, ranging from large, formal composite mills to small, informal units and home-based workers. Broadly, five tiers define its structure:

**Tier 1 – Composite Units (Formal):** Large integrated firms involved in spinning, weaving, dyeing, and garment production. These are export-oriented, compliant with regulations, and major contributors to foreign earnings.

**Tier 2 – Cut-to-Pack Units (Mostly Formal):** Medium to large factories focused on cutting, stitching, and packaging. Operating as subcontractors to exporters or brands, they are generally formalized but less integrated.

**Tier 3 – Domestic Brands (Formal) & Vendors (Largely Informal):** Medium-sized vendors and local brands with mixed levels of compliance. Some are registered, while many operate semi-formally, sourcing from informal stitching and embroidery clusters.

**Tier 4 – Distributors & Retailers (Mostly Informal):** Wholesalers, traders, and shopkeepers dealing largely in cash and functioning outside tax or registration systems, yet crucial for domestic textile circulation.

**Tier 5 – Logistics & Labor (Largely Informal):** Transporters, port handlers, and a vast workforce of contract and home-based workers, especially women, with little social protection or job security.

Institutionally, the sector is represented by associations such as APTMA, PHMA, and PRGMEA, which play key advocacy roles but primarily serve large exporters. Small and informal firms remain underrepresented, limiting access to support programs and policy influence. Major clusters in Lahore, Faisalabad, Sialkot, and Karachi foster industrial growth but also allow informality to persist amid weak enforcement and overlapping federal–provincial jurisdictions.

This structural imbalance, where formal and informal enterprises coexist under vastly different operating conditions; constrains productivity and competitiveness. For smaller firms, formalization is often viewed as costly and risky, given complex procedures and limited trust in institutions.

To address these challenges, tier-specific and incentive-driven approaches are required. Simplified regulations, fiscal incentives, awareness campaigns, and capacity-building measures can help integrate informal actors into formal systems. Strengthening institutional coordination and inclusivity within industry associations will be key to enabling a more competitive, sustainable, and formalized textile sector that supports both growth and decent work.

### Trends and Challenges

Challenge	Description	Typical Consequence
High compliance costs	Taxes, audit procedures, multiple inspections	Enterprises avoid registration
Lack of awareness	Poor understanding of regulatory benefits	Missed access to finance and markets
Supply-chain pressure	Brands demanding compliance	Small vendors risk exclusion
Technology gaps	Obsolete machinery, low productivity	Reduced competitiveness
Workforce informality	Unregistered workers	No social protection

### Drivers for Formalization

- Export linkage requirements under GSP+ and EU Due Diligence.
- Access to finance through formal banking.
- Buyer-driven compliance programs (e.g., GAP, Levi’s, H&M).
- Productivity and quality gains from certified management systems (ISO 9001, WRAP, SA 8000).

## Automotive Sector

The automotive sector contributes around **3%** to Pakistan’s GDP, serving as a key driver of employment, technology transfer, and industrial linkages. Though smaller than textiles, it holds strategic importance for value chain development and industrial modernization. The sector spans from raw material processing and component manufacturing to logistics and retail, creating strong backward and forward linkages across the economy.

In 2023, automotive exports were valued at USD 22 million, comprising mainly auto parts, plastic moldings, and engineering components destined for Europe, North America, and the Middle East. While modest, these exports reflect significant untapped potential in value addition and localization, particularly within the auto parts and engineering segments.

The sector is represented by PAAPAM, PAMA, and PASPIDA, which facilitate policy dialogue, skill development, and industry coordination. However, their reach remains limited to formal enterprises, leaving a large base of informal workshops, suppliers, and traders outside institutional support structures.

The sector operates through a multi-tiered value chain, reflecting sharp contrasts between formal and informal actors:

**Original Equipment Manufacturers (OEMs) (Formal):** Large-scale assemblers of cars, trucks, buses, tractors, and motorcycles, operating under full regulatory compliance and often linked to international brands. They set quality benchmarks and drive demand for local vendors.

**Tier 1 Vendors (Formal):** Registered part makers supplying OEMs with certified components under strict standards. They benefit from finance, technology transfer, and institutional support, forming the formal backbone of the industry.

**Tier 2 Component & Raw Material Suppliers (Mostly Informal):** Numerous small-scale units in Lahore, Karachi, Hyderabad, and Gujranwala produce subcomponents and materials, often without certification or regulatory compliance. Their informality affects quality control, traceability, and integration into formal value chains but keeps costs low for smaller producers.

**Tier 3 Workshops & Retailers (largely Informal):** A vast network of mechanics, workshops, and spare parts traders operating in cash economies. They sustain affordable vehicle maintenance and employment but rely on informal apprenticeships and unregulated parts markets.

**Tier 4 Logistics & Labor (Largely Informal):** Comprising loaders, drivers, and delivery agents, this tier operates without contracts or protections yet remains essential for sectoral mobility and operations.

Automotive production is clustered around Karachi and Lahore, while informal repair and retail markets are dispersed across urban and semi-urban areas. This dual structure formal manufacturing versus informal service and supply creates both resilience and inefficiency within the sector.

To enhance competitiveness, tier-specific formalization measures are critical. Simplified registration, fiscal incentives, access to finance, quality certification support, and vocational training can help align informal suppliers and workshops with formal production systems. Regulatory reforms must focus on enabling compliance rather than penalizing informality, fostering gradual integration and trust.

A progressive, inclusive approach e.g. linking informal enterprises to value chains through supportive institutions will be central to achieving a competitive, innovative, and export-oriented automotive sector in Pakistan.

### Major Challenges

Category	Description	Effect
<b>Regulatory duplication</b>	Federal & provincial registrations	High transaction costs
<b>Technology obsolescence</b>	Manual machining lines	Low productivity
<b>Finance access</b>	Banks require documentation	Credit constraints
<b>Workforce skills</b>	Informal training only	Quality defects
<b>Market power asymmetry</b>	OEMs dominate price setting	Low margins for SMEs

### Incentive Potential

- Link formalization incentives with vendor development programs.
- Preferential procurement for registered vendors.
- Technology-upgrade grants conditional on tax and social-security registration.

## Agricultural Implements Sector

Agricultural mechanization is central to enhancing farm productivity, reducing manual labor, and improving the competitiveness of Pakistan’s agriculture. The agricultural implements manufacturing sector, though traditionally based on small workshops, represents one of the most important yet highly informal industrial segments of the economy. It serves the expanding domestic demand for farm mechanization; from land preparation to harvesting and contributes significantly to rural employment and local innovation.

Production is concentrated in Punjab, home to about **500** manufacturing units, mainly clustered in Daska, Faisalabad, Okara, and Mian Channu, with smaller operations across other provinces. These enterprises are mostly micro or small-scale, employing informal labor and relying on traditional fabrication methods. Despite their informality, they play a crucial role in sustaining the rural economy and enabling affordable access to farm machinery.

The marketing and distribution system combines direct manufacturer–farmer interaction with a network of service centers offering affordable mechanization services. This dual system supported by both private and public actors has helped expand market outreach across provinces. The value chain remains short and localized, involving raw material suppliers, component makers, and assemblers. Institutional stakeholders include provincial agriculture departments, the Pakistan Agricultural Machinery & Implements Manufacturers Association (PAMIMA), and small-scale exporters. Pakistan also supplies low cost implements to regional and African markets, though exports remain inconsistent due to lack of certification, branding, and standardization.

## Why the Sector Deserves Incentivized Formalization

Recognizing its economic promise and high informality, the Ministry of Industries and Production’s Technical Working Group has identified this sector as a priority area for formalization. Field consultations with PAMIMA Daska revealed that despite contributing to agricultural modernization and employment, most enterprises remain outside formal registration, limiting their access to finance, markets, and institutional support.

Key reasons for incentivized formalization include:

1. **High Informality, High Impact:** Thousands of informal workers could benefit from improved safety, social protection, and better working conditions.
2. **Export Potential:** Formalization can help manufacturers meet international standards and access new markets.
3. **Productivity Gains:** Evidence shows formalized enterprises achieve up to **20–40% higher efficiency** through improved systems and quality control.
4. **Access to Finance:** Registration enables participation in subsidy schemes, public procurement, and bank financing.
5. **Fair Competition:** Simplified taxation and credit support would level the playing field for compliant enterprises.
6. **Cluster Development:** Formalization encourages the creation of shared testing, training, and technology facilities.

Incentivizing formalization will not only boost enterprise competitiveness but also generate broader socio-economic benefits, including enhanced productivity, exports, and employment quality. Development partners such as ILO, SMEDA, UNIDO, USAID, EDF and EDB can play a catalytic role by introducing matching grants, challenge funds, and targeted capacity-building initiatives to accelerate this transformation.

### Major Challenges

Category	Description	Effect
<b>Regulatory duplication</b>	Multiple federal and provincial registrations and inspection requirements.	Increased compliance burden and high transaction costs.
<b>Technology obsolescence</b>	Use of outdated machinery and manual fabrication techniques.	Low productivity, inconsistent quality, and high material wastage.
<b>Finance access</b>	Absence of registration and formal records restricts access to credit and subsidy schemes.	Capital constraints and inability to upgrade equipment.

Category	Description	Effect
<b>Workforce skills</b>	Predominantly informal, on-the-job learning without certification.	Poor quality control and limited adoption of modern techniques.
<b>Market linkage gaps</b>	Weak integration with large farm machinery firms or exporters.	Limited scalability and low market visibility.
<b>Quality and standardization</b>	Lack of testing, certification, and branding infrastructure.	Constrains domestic credibility and export potential.

### Incentive Potential

To unlock productivity and competitiveness, the sector requires incentive-based formalization mechanisms that link compliance with tangible business benefits. Key opportunities include:

- **Integration of Formalization with Vendor Development:** Encourage registration through inclusion in public and private vendor programs, ensuring formal SMEs can supply to larger agricultural machinery manufacturers.
- **Preferential Procurement:** Prioritize government and institutional procurement from registered and certified manufacturers of agricultural implements.
- **Technology-Upgrade Grants:** Introduce matching grants or low-interest loans for equipment modernization, conditional upon tax and social security registration.
- **Cluster-Based Support:** Establish common testing and training centers within industrial clusters (e.g., Daska, Faisalabad) to strengthen collective compliance and competitiveness.
- **Export Readiness Support:** Provide technical assistance and branding support to formalized firms to meet international standards and access regional markets.



# **CHAPTER 4**

## Formalization Challenges in Pakistan's Textile and Automotive Sectors

The ILO’s baseline study revealed that enterprises in Pakistan’s textile and automotive sectors face multifaceted challenges in transitioning from informality to formality. Predominant barriers include complex registration procedures, high compliance costs, limited awareness of regulatory requirements, and weak institutional coordination among government bodies. Many small enterprises operate with thin profit margins, making it difficult to bear the financial burden of taxation, social security contributions, and documentation requirements. Moreover, the lack of tangible incentives—such as access to finance, market linkages, and public procurement opportunities—reduces the perceived value of formalization. In both sectors, the absence of a structured policy framework to reward formal behavior has perpetuated informality within supply chains, underscoring the need for targeted incentives and simplified regulatory mechanisms to encourage transition. The below table illustrates more specifically;

No.	Challenge Area	Description	Effect / Implication	Sector Intensity
a	<b>Complex Regulations</b>	Overlapping registrations, multiple licensing authorities, and procedural ambiguity increase compliance burden.	Raises cost of doing business; discourages informal enterprises from registering; promotes partial informality in formal units.	Both (High)
b	<b>High Tax Rate and Audit Fear</b>	Complex tax structure, unpredictable audits, and retrospective penalties increase perceived risks.	Leads firms to stay informal to avoid financial unpredictability and harassment.	Both (High)
c	<b>Informal Supply Chain Dependency</b>	Heavy reliance on unregistered suppliers and subcontractors.	Sustains informality across value chains and limits traceability.	Textile (High)

No.	Challenge Area	Description	Effect / Implication	Sector Intensity
d	<b>Labor Registration Cost</b>	High administrative and financial burden for registering workers; corruption exacerbates compliance fatigue.	Firms retain informal labor to avoid extra cost and bribes.	Both (High)
e	<b>Worker Resistance to Formal Employment</b>	Workers prefer cash payments and fear deductions for taxes and social security.	Supply-side resistance to formal payroll inclusion.	Both (Medium)
f	<b>Informality and Job Instability</b>	Lack of written contracts or records for informal workers.	Excludes workers from EOBI, SESSI, and health insurance; weakens social protection.	Both (High)
g	<b>Fear of Losing Work or Reduced Wages</b>	Workers fear registration may reduce wages or lead to job loss in informal setups.	Reduces willingness of labor to demand formalization.	Both (Medium)
h	<b>Limited Access to Finance</b>	Banks avoid lending to semi-formal firms due to lack of documentation and collateral.	Restricts enterprise growth and investment in modernization.	Both (High)
i	<b>No Visible Short-Term Benefits</b>	Formalization often raises costs without immediate advantages or incentives.	Firms see no near-term gain in registering; remain informal.	Both (High)
j	<b>Uneven Enforcement against Informal Competitors</b>	Informal firms operate freely while formal ones face heavy compliance obligations.	Creates unfair competition and disincentives compliance.	Both (High)
k	<b>Corruption in Regulatory Bodies</b>	Bribes, harassment, and misuse of authority by inspectors and officials.	Undermines trust and pushes firms toward informality.	Both (High)
l	<b>Fragmented Policy and Agency Coordination</b>	Weak coordination between federal, provincial, and local bodies.	Duplicated requirements and inconsistent enforcement.	Both (High)

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# **CHAPTER 5**

## Enterprises' Response - Strategies to Resolve

Despite structural and regulatory hurdles, many SMEs in Pakistan's textile and automotive sectors are gradually adopting practical strategies to overcome barriers to formalization. Enterprises are increasingly leveraging digital registration platforms introduced by SECP, FBR, and provincial authorities to simplify compliance. Collective action through industry associations and cluster-based networks has also helped SMEs share resources, access advisory services, and engage with government initiatives. Some firms have pursued gradual formalization—starting with tax registration or social security enrolment—to spread costs over time. Additionally, participation in buyer-driven compliance programs and vendor development schemes has motivated SMEs to adopt formal practices to secure long-term contracts with OEMs and export-oriented buyers. These evolving approaches reflect a growing realization that formalization enhances competitiveness, stability, and access to new business opportunities.

Sr.	Strategy to Resolve Challenges	Description	Adoption Level by Enterprises (%)
1	<b>Partial Compliance: A Hybrid Approach</b>	Enterprises selectively formalize parts of their operations (e.g., tax registration, basic labor documentation) while keeping others informal to balance benefits and compliance costs.	<b>50%</b>
2	<b>Passing on Compliance Costs to Customers</b>	Businesses transfer additional regulatory costs (taxes, benefits, consultancy fees) into product pricing to maintain profitability, though it risks competitiveness in price-sensitive markets.	<b>85%</b>
3	<b>Leveraging Chambers and Associations</b>	Firms rely on associations like APTMA and PAAPAM for policy advocacy, compliance training, and mediation with regulatory bodies—reducing the burden of individual engagement.	<b>40%</b>

Sr.	Strategy to Resolve Challenges	Description	Adoption Level by Enterprises (%)
4	<b>Utilizing Personal Networks to Navigate Bureaucracy</b>	Entrepreneurs use informal networks involving officials or intermediaries to ease documentation, delay enforcement, or gain guidance, often reinforcing informality.	<b>40%</b>
5	<b>Delaying Formalization until Business Scaling</b>	Many SMEs remain informal during early growth, formalizing only when business expansion requires access to finance, export markets, or credibility with clients.	<b>60%</b>
6	<b>Hiring Consultants for Minimal Compliance</b>	Enterprises outsource compliance and documentation tasks to consultants to meet minimum legal requirements cost-effectively, avoiding internal administrative burdens.	<b>100%</b>



# **CHAPTER 6**

## Voice of Enterprises: Prioritization of Incentives

Enterprises consulted during the ILO baseline study emphasized that a balanced mix of fiscal and non-fiscal incentives is essential to make formalization both attractive and feasible. On the fiscal side, they recommended simplified tax regimes for small firms, reduced registration and renewal fees, and tax rebates for those contributing to social security or adopting digital compliance systems. Enterprises also called for easier access to subsidized credit and financial instruments tied to formal registration status. Non-fiscal incentives highlighted by respondents included priority access to public procurement, participation in government-supported training and productivity enhancement programs, and recognition through certification or grading systems that enhance market credibility. Collectively, these recommendations underscore that formalization will accelerate when enterprises clearly see tangible benefits that outweigh compliance costs.

Sr.	Policy Area / Intervention	Rationale / Challenge Addressed	Proposed Policy Action	Expected Outcome/ Impact
A.	<b>Centralized Digital Portal for Tax &amp; Compliance</b>	SMEs face fragmented procedures across FBR, EOBI, and ESSI leading to high transaction costs and errors.	<ul style="list-style-type: none"> <li>Develop a unified mobile-accessible platform integrating tax, labor, and social security registrations.</li> <li>Provide dashboards, reminders, multilingual support, and helpline.</li> <li>Introduce digital labor cards with self-contribution options.</li> </ul>	Simplified entry for new businesses, reduced compliance burden, transparent and efficient data system, improved labor registration.

Sr.	Policy Area / Intervention	Rationale / Challenge Addressed	Proposed Policy Action	Expected Outcome/ Impact
B	<b>CNIC or Utility-Based Auto NTN + Tax Holidays</b>	Paperwork and early taxation discourage registration.	<ul style="list-style-type: none"> <li>• Auto-link CNIC or commercial utility connection to NTN issuance.</li> <li>• Offer 2–3 years tax holiday for new entrants meeting basic compliance.</li> </ul>	Increases first-time registrations, lowers psychological barriers, and brings micro-entrepreneurs into formal net.
C	<b>Graduated Taxation for Formalized SMEs</b>	High tax rates immediately after registration deter compliance.	<ul style="list-style-type: none"> <li>• Apply tiered tax slabs for 3–5 years (0–5%, 7%, 10%).</li> <li>• Link tax progression with turnover growth and compliance milestones.</li> </ul>	Smoother transition to formal taxation, improved revenue predictability, sustained business growth.
D	<b>Certified Third-Party Digital Audits</b>	Arbitrary inspections and corruption undermine trust.	<ul style="list-style-type: none"> <li>• Replace physical inspections with risk-based digital audits.</li> <li>• Certify independent third-party auditors under strict protocols.</li> </ul>	Transparent system, reduced harassment, enhanced business confidence in regulatory institutions.
E	<b>Incentivizing Withholding Tax Agents</b>	WHT agents lack motivation and administrative support.	<ul style="list-style-type: none"> <li>• Offer 1–2% revenue-linked commission to compliant WHT agents as tax credit.</li> </ul>	



# **CHAPTER 7**

## Public and Private Sector Enablers

The following tables outline the respective roles of public and private sector organizations in the design, approval, and implementation of the proposed fiscal and non-fiscal incentives. Public sector institutions i.e. the Ministry of Industries and Production, FBR, SECP, and SMEDA are central to policy formulation, regulatory simplification, and fiscal support mechanisms. Meanwhile, private sector entities, including chambers of commerce, industry associations, and large formal enterprises, play a critical role in advocacy, capacity building, and promoting compliance within supply chains. Effective coordination between these actors is essential to ensure that incentives are practical, inclusive, and aligned with the needs of small enterprises transitioning towards formality.

Sr.	Recommendation	Challenge to be Addressed	Lead Agency & Associated Organisation
1	Digital Portal	Regulatory & Structural Barrier	FBR, SECP, SMEDA, Associations
2	CNIC as NTN	Informal sector transition	NADRA, FBR
3	Graduated Taxation	Broaden the tax base	FBR, SMEDA
4	Cluster Development	Improved vendor development Enterprises	SMEDA, BOI, PSIC etc.
5	Awareness Campaign	Change the perception of formalization and regulatory regimes	ILO, SMEDA
6	Matching Grants	Technical advancement and transition towards formalization	EDF, SMEDA, Donor Agencies
7	SME Financing	Financial inclusion	SBP, Microfinance Banks
8	Private Health Option	Better tangible incentives to the labor	EOBI, SESSI, MoH,
9	Third-Party Audits	Avoid bribe, fear of undesired control and inspection environment	Consultants who have similar nature of work experience
10	Informal labor inclusion & Family Incentives	Social compliance	EOBI, SESSI, MoH, Education sector



# **CHAPTER 8**

## Pathways to Formalization: Business Cases

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Informality remains a defining feature of Pakistan’s economic landscape, particularly in the textile and automotive sectors. These industries are highly labor-intensive and critical to national GDP, exports, and employment, yet their supply chains are fragmented and dominated by informal business practices. While informality offers short-term flexibility, it limits enterprises’ ability to access the finance, structured value chains, or ensure compliance with labor and environmental standards.

To address this gap, a baseline study was undertaken with 40 enterprises in Lahore and Karachi. The study explored why many enterprises resist formalization, what mechanisms could facilitate their transition, and which policy incentives might encourage greater compliance. Findings of the baseline validated in four high-level sessions e.g. Lahore Chamber of Commerce & Industry; SITE Association Karachi; the ILO Office Karachi with all the stakeholders, and Technical Working Group of the Ministry of Industries & Production, highlighted that formalization is not merely administrative. It is a multidimensional process of building trust, simplifying compliance, and creating tangible incentives for SMEs.

The final stage of this assignment is the documentation of ten business cases, five from textiles and five from automotive. These cases capture the lived experiences of enterprises that have undergone, or are undergoing, the transition from informal to formal operations. Each case outlines:

- **Milestones in formalization** (company registration, taxation, social security, certification).
- **Stages of compliance** and enterprise interactions with regulatory authorities.
- **Challenges** encountered in regulatory, financial, and behavioral domains.
- **Benefits realized** post-formalization, including access to finance, contracts, and credibility.
- **Support systems** leveraged from chambers, SMEDA, ILO, donor programs, or peer networks.

## AUTOMOTIVE SECTOR

### CASE 1 MEHRAN COMMERCIAL ENTERPRISES

#### About the Enterprise

Mehran Commercial Enterprises, established in 1985 in one of Pakistan's key industrial hubs, is a medium-sized auto parts manufacturer specializing in precision components and assemblies for the automotive sector. Initially operating informally without registered labor or structured systems, the company made a strategic shift in 1997 by registering with FBR, EOBI, SESSI, and SECP, marking its transition toward formalization. Over the years, it expanded capacity, improved quality, and gained recognition as a certified vendor for leading OEMs such as Pak Suzuki, Indus Motors, FAW, and HINO, while also exporting selected components to the Middle East and Southeast Asia. Today, Mehran manufactures a wide range of products including sun visors, door trims, spare wheel covers, and floor mats, and holds ISO 9001:2015 certification. The company employs 45 workers, of which 7 are registered with FBR and 15 permanent employees are enrolled with EOBI and SESSI, while the remaining workforce is engaged on contractual or daily wage terms depending on seasonal production needs.

#### Pre-Formalization Status

Prior to 1997, Mehran operated largely under informal business arrangements:

- Workforce unregistered with labor and social protection institutions.
- Financial transactions handled manually without formal accounting system.
- Limited compliance with tax and environmental regulations.
- Minimal investment in new machinery or process improvements.
- Reliance on verbal agreements and local suppliers for materials.

The company's reliance on an informal operating model posed significant limitations to its growth and competitiveness. While it allowed the business to function with flexibility in the short term, it restricted access to vital opportunities such as long-term supply contracts, institutional financing, and participation in large-scale tenders. These constraints meant the company often remained confined to smaller markets and short-term transactions, preventing it from building sustainable relationships with larger buyers and stakeholders who required compliance with formal standards.

Recognizing both the challenges and the opportunities, the company gradually committed itself to a path of formalization. This was not an overnight transformation but a deliberate, step-by-step process. The leadership realized that adopting formal systems in areas such as financial management, regulatory compliance, and human resource practices would not only unlock access to institutional finance and government tenders but also improve credibility in the eyes of clients and partners.

### Decision to Formalize

Several internal and external factors compelled Mehran to formalize:

- Market Access Requirements – OEMs required documented compliance and certifications
- Export Potential – International buyers demanded legal status and traceability
- Access to Finance – Banks and FIs required audited financials and formal registration
- Strategic Vision – Leadership recognized the limitations of informality and aimed for long-term growth

The company's transition toward formalization was strongly influenced by external market requirements. Original Equipment Manufacturers (OEMs) demanded documented compliance and certifications to qualify as suppliers, while international buyers required legal status and traceability to ensure reliability and accountability across the value chain. Without meeting these conditions, the company risked being excluded from both local supply chains and lucrative export opportunities. The leadership recognized that informality not only limited immediate market access but also diminished credibility in the eyes of global clients, thereby restricting long-term growth potential.



## Comparative Analysis: Pre vs Post Formalization

Aspect	Pre-Formalization (Before 1997)	Post-Formalization (After 1997)
<b>Market Access</b>	Local buyers, informal contracts	Certified OEM vendor, export markets
<b>Technology</b>	Manual processes, outdated machines	Automation, precision tools, QA systems
<b>Workforce</b>	Unregistered workers, low training	Registered with EOBI/SESSI, regular training
<b>Finance</b>	Limited to personal funds	Banks and institutional finance access
<b>Reputation</b>	Low credibility with formal buyers	Trusted by OEMs, global buyers through exports
<b>Productivity</b>	Inconsistent output	Quality and standards increase post formalization due to vendor's compliance mechanism.

## Challenges Enterprise Faced

- Regulatory ambiguity with frequent changes in compliance requirements from the regulatory regimes and sometimes from OEMs.
- High cost of compliance including taxation and audits e.g. consultant fee, documentation charges, procurement from informal set-ups etc.
- Shortage of skilled labor to operate new machinery.
- Raw material price volatility without formal contracts
- Uneven competition from informal operators avoiding compliance costs
- Need for significant capital investment in modern technology

## Strategies Adopted to Overcome Challenges

- Hiring professional consultants to handle registrations and compliance
- Gradual technology upgradation to spread costs over time
- Workforce training programs by OEMs and formal labor registration in phases
- Standardization of processes and quality control systems
- Active participation in industry associations for advocacy and networking

## Outcomes of Formalization

- Certification as an official supplier for Pak-Suzuki, Indus Motors, FAW, HINO etc.
- Enterprise earned reputation in the market and have more access to OEMs, and by maintaining quality standards has, since 2020, successfully entered export markets, through trade fairs and B2B platforms
- Improved access to credit lines and investment capital
- Enhanced employee welfare with social security, EOBI and Children Education Support
- Elevated brand reputation and trust among clients and regulators



## Recommendations from the Enterprise

- Trust Building measures amongst the regulator and SMEs. Regulators should trust on Industry and likewise.
- Ensure consistency in industrial and tax regulations to build investor confidence
- Modernize the tax system through digital integration and one-stop solutions for greater efficiency and ease of compliance.
- Provide vendor support schemes for easier and cheaper import of raw materials
- Develop cluster-based industrial zones with shared services like testing labs and logistics
- Join industry bodies for advocacy and market linkages
- Engage in training programs, exhibitions, and study tours

- Daily wage earners and contractual employees should also be integrated into EOBI, Social Security, and other welfare schemes through a minimal contribution model, shared between the employee, the SME, and relevant institutions. This can be facilitated by issuing a standardized labor or employee card that ensures their enrollment and provides them access to social protection benefits, regardless of the nature of their employment contract.

## Lessons Learned

- Formalization, though costly at first, yields long-term benefits, however, trust between industry and regulators is a key success factor.
- **Gradual Transition Yields Better Outcomes**  
SMEs that adopted a step-by-step approach—beginning with basic compliance, then improving financial transparency, and eventually pursuing certifications—were able to sustain formalization without disrupting operations.
- Partnerships with industry association will facilitate the transition.
- Partnerships with development stakeholder e.g. SMEDA, TDAP, EDB, ILO will smoothen the transition.
- ILO, and employee welfare institutes should elaborate responsibilities of employees along with their rights so that productivity may also increase.

## Conclusion

The transformation of Mehran Commercial Enterprises illustrates the practical lessons an SME learns when shifting from informality to formalization. One of the most important realizations was that while the initial costs of registration, audits, and compliance felt burdensome, they ultimately created credibility in the eyes of clients, banks, and regulators. The company learned that proper documentation and transparency were not just external requirements but also tools that strengthened internal decision-making and long-term stability.

Another lesson was the value of a phased approach. Mehran discovered that gradual steps—such as starting with financial record-keeping, then moving to certifications, and later engaging with export requirements—allowed the business to adapt without disrupting daily operations. The leadership also learned that formalization required cultural change within the organization. Staff needed to understand the importance of systems, processes, and compliance for the business to grow sustainably, which demanded patience, training, and consistent communication.

Last but not the least, due to the formalization of Mehran Commercial Enterprises, employees also experienced significant improvements in their welfare and professional development. They became entitled to social protection schemes such as **EOBI** and **SESSI**, ensuring long-term security and access to healthcare facilities. The company also facilitated skill development opportunities through **training programs offered by OEMs**. These measures not only enhanced the financial and social wellbeing of employees but also strengthened their motivation, loyalty, and productivity, making the workforce a key beneficiary of the formalization journey.

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## **CASE 2** SKY HIGH INDUSTRIES (PVT) LTD.

### **About the Enterprise**

Sky High Industries (Pvt.) Ltd., established in 2008 and located in Karachi, is a medium-sized auto parts manufacturer registered with the Securities and Exchange Commission of Pakistan (SECP). Since inception, the enterprise has maintained its formal status by fulfilling all procedural and regulatory requirements. The company employs 150 workers, of which 10 are registered with the Federal Board of Revenue (FBR), 100 are enrolled with Social Security and Employees' Old-Age Benefits Institution (EOBI), while the remaining are engaged on contractual or daily-wage arrangements.

Sky High Industries is an approved vendor of Honda Atlas, supplying precision auto components in compliance with OEM requirements. The company maintains strong linkages with its supply chain, where more than 70% of vendors are registered and formal. However, due to limited availability of formal raw material suppliers, the enterprise is sometimes compelled to procure from informal sources, creating challenges in record-keeping and compliance.

### **Pre-Formalization Status**

Unlike many SMEs that begin informally, Sky High Industries formalized from the outset. Registration with SECP, FBR, EOBI, and Social Security laid the foundation for structured operations. Despite this, partial informality persists within its labor structure and in segments of the supply chain. The reliance on contractual labor and informal procurement reflects systemic challenges rather than strategic choices, as compliant suppliers are often unavailable in certain product categories.

## Why They Formalized

Discussions with the company director highlighted several benefits of maintaining formal status:

Benefit Area	Description / Impact
<b>Market Access</b>	Formalization allowed the company to qualify as a vendor to <i>Honda Atlas</i> , a leading OEM, and made it ready to comply with any OEM requirements.
<b>Business Opportunities</b>	Registration enabled participation in government procurement processes and vendor development programs.
<b>Credibility &amp; Growth</b>	Documented compliance improved trust and credibility with banks, regulators, and large buyers, facilitating business expansion.
<b>Supply Chain Integration</b>	Over 70% of inputs are now sourced from registered companies, enhancing traceability and transparency. The share of formalized supply chain increased from <b>50% to 70%</b> over the last two years.

## Challenges Enterprise Faced

Despite its commitment to formality, Sky High Industries faces several structural hurdles:

- **Partial Informal Procurement** – Limited availability of registered suppliers for raw materials forces reliance on informal vendors.
- **Employee Registration Gaps** – Contractual and daily wage workers often remain outside EOBI and Social Security coverage.
- **Tax Burden & Compliance Costs** – Advance taxation, multiple audits, and digital system inefficiencies increase operational costs.
- **Access to Finance Constraints** – High interest rates and lengthy loan processing reduce SMEs’ ability to expand and modernize.
- **Weak Institutional Support** – Corruption and poor facilities for the labor in ESSI and EOBI discourage workers from seeking formal registration.



### Strategies Enterprise adopted

- Engaged professional consultants to handle registrations and compliance
- Workforce training programs by OEMs and formal labor registration to bring them in the system
- Introduced processes and quality control systems

### Recommendations from the Enterprise

The director of Sky High Industries emphasized several incentives and reforms that could accelerate SME formalization:

- **Tax & Finance Reforms**
  - Reduction in advance taxation for SMEs.
  - Lower interest rates and simplified loan processing.
  - Awareness programs on tax schemes and compliance.
  - Incentives such as rebates on international travel, trade fair participation, and school fee discounts for registered taxpayers.
- **Employee Welfare & Social Security**
  - A tri-party contribution model (employer–employee–government department) for EOBI and Social Security.
  - Issuance of standardized employee cards to ensure registration and benefit access.
  - Institutional reforms in EOBI and ESSI to curb corruption and improve service delivery.

- **System Improvements**
  - Digitalization of FBR and related processes for ease of compliance.
  - Introduction of third-party audit systems for transparency.
  - Awareness campaigns for SMEs on the benefits of formalization.

### Outcomes of Formalization

- Recognition as a trusted OEM vendor (Honda Atlas and others).
- Increased credibility with banks, regulators, and industry stakeholders.
- Enhanced competitiveness by sourcing mostly from formal supply chains.
- Steady employment opportunities for 150 workers with partial social protection coverage.
- Readiness to expand further into government procurement and potential export opportunities, subject to improved financing and compliance environment.

### Lessons Learned

- **Starting formal brings long-term advantages:** By registering with SECP and complying with regulations from the outset, Sky High Industries gained early credibility, avoided later transition shocks, and positioned itself for OEM contracts.
- **Partial informality limits efficiency:** Even when the enterprise is formal, reliance on unregistered suppliers or contractual labor complicates record-keeping and weakens compliance. A fully formal supply chain and workforce improve consistency and accountability.
- **Employee welfare drives loyalty:** Workers are more likely to value formal systems when social security and EOBI actually deliver benefits. Weak services reduce employee trust and push them toward informality.
- **Incentives matter more than penalties:** The enterprise learned that supportive measures—such as easier access to finance, lower interest rates, and recognition for tax compliance—are more effective than punitive approaches in encouraging SMEs to stay formal.
- **Partnerships are essential:** Collaboration with OEMs, industry associations, and institutions like ILO can strengthen advocacy, training, and awareness, making the formalization journey smoother for SMEs.

### Conclusion

The journey of Sky High Industries demonstrates how early adoption of formalization can enable SMEs to integrate into structured supply chains and attract high-value clients like OEMs. However, the persistence of informal practices in labor management and procurement reveals systemic gaps in Pakistan’s regulatory and institutional framework.

If supported with incentives such as reduced taxation, accessible financing, and stronger employee welfare mechanisms, companies like Sky High Industries can become role models for SME formalization, contributing to employment generation, value addition, and integration into national and global value chains. Development partners such as the ILO, alongside government institutions, can play a pivotal role in designing incentive-driven systems that bring both employers and employees into the formal economy.

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### **Case 3** Pak-Orient

#### **About the Enterprise**

Pak Orient, an auto parts manufacturer located in Karachi, was originally established in 2005. In 2016, following the separation of partners, the company was restructured and registered as a sole proprietorship. Since then, it has been formally registered with the Federal Board of Revenue (FBR), Social Security, Environmental Protection Agency (EPA), and Employees' Old-Age Benefits Institution (EOBI), and has consistently maintained compliance with regulatory requirements.

The company employs 70 workers: 6 are registered with FBR, 40 are enrolled with Social Security and EOBI, while the remaining workforce is engaged on contractual or daily-wage arrangements. Pak Orient has invested in developing its own Enterprise Resource Planning (ERP) system, integrating internal and external processes to enhance efficiency and compliance.

Pak Orient supplies components to leading OEMs, including Honda Atlas and Pak Suzuki, leveraging its formal status to secure long-term contracts. However, about half of its supply chain remains informal, particularly in the procurement of raw materials and components where registered suppliers are scarce, creating compliance and record-keeping challenges.

#### **Pre-Formalization Status**

Before restructuring and registering in 2016, Pak Orient operated informally with limited documentation and unregistered workers. Business processes relied on manual record-keeping, and procurement was largely through informal suppliers. The lack of formal status restricted access to OEM supply chains and institutional financing, while dependence on informal procurement created inconsistencies in production and compliance.

### Why They Decided to Formalize

The owner shared that the decision to formalize was deliberate and strategic. The company recognized that formalization was essential to:

- **Access OEM Contracts** – Compliance and documented registration were prerequisites for becoming a supplier to Honda Atlas and Pak Suzuki.
- **Streamline Operations** – ERP and formal documentation allowed better record-keeping and reporting.
- **Business Growth** – Formalization positioned the company for government procurement opportunities.
- **Credibility & Finance** – Registration improved trust with financial institutions, enabling potential access to credit lines.

The owner emphasized that formalization made the business “hassle-free” by reducing risks associated with informality and building credibility in the market.

### Comparative Analysis: Pre vs Post Formalization

Aspect	Pre-Formalization (Before 2016)	Post-Formalization (After 2016)
<b>Market Access</b>	Local buyers, short-term contracts	Recognized vendor for OEMs (Honda Atlas, Pak Suzuki)
<b>Technology</b>	Manual processes, paper records	ERP system adopted, digital compliance
<b>Workforce</b>	Mostly unregistered workers	40 enrolled with Social Security/EOBI, balance contractual
<b>Finance</b>	Reliance on personal funds	Eligible for institutional financing
<b>Reputation</b>	Limited credibility	Trusted by OEMs and regulators
<b>Supply Chain</b>	Largely informal suppliers	50% formalized suppliers

### Challenges Enterprise Faced

- **Partial Informality in Supply Chain** – Reliance on unregistered raw material vendors makes compliance difficult.
- **Uneven Competition** – Informal operators avoid compliance costs, creating price pressures.
- **Employee Coverage Gaps** – A significant share of workers remain outside formal social protection systems.

- **Compliance Costs** – Advance taxation, certification fees, and multiple audits add to operational expenses.
- **Institutional Inefficiencies** – Corruption and weak services in EOBI and ESSI discourage workers from enrollment.

**OEM Practices** – The Input Output Ratio Certificate (IORC), introduced as a facilitation tool for manufacturers, was originally designed to enable duty and tax concessions on imported raw materials by linking input quantities with output production. However, in practice, OEMs often retain the benefits of IORC without transferring them to their vendor network. As a result, smaller suppliers like Pak Orient are unable to access the intended relief on raw material costs. This creates an uneven playing field where vendors continue to face high input expenses, while OEMs enjoy the concessions, reducing the competitiveness and margins of SMEs operating within the supply chain.

### Strategies Enterprise Adopted

- Professional consultants to handle registrations and compliance
- ERP system to manage and control supplies, it helped bringing the informal sector into formalization

### Recommendations from the Enterprise

The owner of Pak Orient suggested reforms that could strengthen SME formalization:

- Tax & Financial Incentives
  - Relaxation of advance taxation for SMEs.
  - Lower interest rates and simplified loan procedures.
  - Awareness campaigns on tax schemes and compliance.
  - Rebates for taxpayers such as discounts on international travel, exhibition fees, and school tuition for formal SMEs and Employees.
- Technology & Capacity Support
  - Matching grants for certification programs.
  - Technology transfer initiatives to enhance competitiveness.
  - 3rd party audit systems for transparency and accountability.
- Employee Welfare Reforms
  - Improved services in EOBI and ESSI to restore worker confidence.
  - To strengthen social protection, Pak Orient suggests introducing a **tri-party contribution model** where employers, employees, and government departments share responsibility for funding schemes such as EOBI and Social Security. In addition, the issuance of **standardized employee cards** would ensure that all workers, regardless of their employment status, are

formally registered and able to access benefits in a transparent and traceable manner. Together, these measures could expand coverage, reduce informality, and build employee confidence in the system

### **Outcomes of Formalization**

As a result of formalization, Pak Orient has earned recognition as a certified vendor for leading OEMs such as Honda Atlas and Pak Suzuki, which has strengthened its standing in the automotive supply chain. This recognition has enhanced the company's credibility not only with OEMs, but also with banks and regulators, making it easier to build trust and explore financing options. The adoption of an ERP system has further improved internal controls, compliance, and overall operational efficiency. Formalization has also expanded opportunities for participation in government procurement processes, creating new avenues for business growth. On the workforce side, a significant portion of employees has been integrated into social protection systems, enabling them to access benefits such as EOBI and Social Security, though some contractual and daily wage workers remain outside these schemes. Together, these outcomes highlight the tangible benefits of formalization in improving competitiveness, credibility, and employee welfare.

### **Lessons Learned**

- **Willing formalization pays off:** Proactively registering with regulatory authorities made compliance smoother and opened doors to OEM supply chains.
- **Technology integration strengthens compliance:** ERP systems help SMEs manage both internal operations and external reporting requirements.
- **Institutional gaps discourage employees:** Weak facilities and corruption in EOBI and ESSI reduce employee willingness to enroll in formal schemes.
- **Level playing field needed:** Competition with informal operators remains a barrier; incentives and reforms are necessary to balance compliance costs.
- **Shared responsibility works:** Social protection must be supported through joint contributions from employers, employees, and the state to sustain coverage.

### **Conclusion**

The journey of Pak Orient demonstrates that formalization is not just about compliance, but about enabling growth and building credibility in competitive markets. By adopting ERP systems, registering with multiple authorities, and securing OEM contracts, the company has positioned itself as a credible and efficient supplier.

However, systemic challenges such as informal competition, gaps in social protection, and inefficiencies in regulatory institutions remain barriers. Incentives like reduced taxation,

easier access to finance, and improved employee welfare systems could encourage more SMEs to embrace formalization. Development partners, including the ILO, can play a vital role by advocating for reforms and supporting SMEs in their transition to sustainable, formal operations.

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## **Case 4** National Automotive (Pvt) Ltd. (Automotive Lahore)

### **About the Enterprise**

National Automotive (Pvt) Ltd, a Lahore-based leading auto parts manufacturer, was originally established in 1993 and formally registered as a private limited company in 1998 with SECP, FBR, Social Security, EPA, and EOBI. The enterprise has grown into a highly capable and committed manufacturer of diversified, high-standard auto components for Pakistan's automotive industry. With in-house research and development (R&D) supervised by experienced engineers, the company not only improves its technical expertise but also contributes to the broader advancement of the engineering industry in Pakistan.

The company is ISO 9001:2015 certified, which strengthens the confidence of customers and vendors in its products and processes. National Automotive is a registered vendor for all major OEMs in Pakistan, including Honda, Toyota, FAW, and Suzuki. The enterprise employs 200 people, of which 50 are registered with tax authorities, and all employees are registered with Social Security and EOBI. Furthermore, the company has developed and implemented its ERP system to ensure compliance with internal and external business requirements.

### **Pre Formalization Status**

Before its formal registration in 1998, National Automotive (Pvt) Ltd functioned as a small-scale, family-run workshop established in 1993, operating largely in the informal sector. The enterprise employed around 40–50 workers without social security or pension coverage, relied on manual production methods with limited quality controls, and maintained cash-based financial practices without structured accounting systems. Its market access was restricted to local traders and small workshops, with no linkages to Original Equipment Manufacturers (OEMs). The absence of regulatory compliance, certifications, and formal documentation constrained its credibility, access to finance, and potential for growth, reflecting the typical pre-formalization challenges faced by many small and medium auto parts enterprises in Pakistan.

## Why They Decided to Formalize

During discussions, the owner shared that the company willingly pursued formalization and found it a relatively smooth process. Formalization unlocked significant opportunities, particularly in becoming a trusted vendor for OEMs, which would not have been possible otherwise. It also enhanced business credibility, legal protection, and compliance with industry standards. However, despite the benefits, the company faces immense competition from informal sector players, who undercut prices by avoiding compliance costs. Currently, about 70% of National Automotive’s supply chain consists of formal, registered companies. Nonetheless, the lack of formal raw material suppliers compels the enterprise to rely partly on the informal sector, creating hurdles in record-keeping and supply chain traceability.

## Benefits of Formalization

Aspect	Before Formalization (Informal Practices)	After Formalization (Compliant & Certified)
<b>Market Access</b>	Limited to small/local buyers, no OEM access	Recognized vendor for Honda, Toyota, Suzuki & FAW
<b>Customer Trust</b>	Low credibility, vulnerable to disputes	ISO 9001:2015 certification, legal protection, global confidence
<b>Supply Chain</b>	Heavy reliance on unregistered suppliers	70% supply chain formalized, better traceability
<b>Finance &amp; Investment</b>	Restricted access to bank loans	Improved credibility with banks, easier financing opportunities
<b>R&amp;D &amp; Technology</b>	Limited innovation capacity	Formal R&D under engineers, tech transfer opportunities
<b>Employee Benefits</b>	Informal employment, no structured welfare	100% employees registered with Social Security & EOBI
<b>Exports &amp; Growth</b>	No export potential, confined to domestic	Due to <b>ED tech and robotics, 30% sales increased</b>



### Challenges Faced by the Enterprise

The enterprise highlighted several challenges in sustaining growth and competitiveness:

- Intense competition from the informal sector undermines the benefits of compliance.
- Limited availability of registered suppliers for raw materials and components.
- Lack of government support in export facilitation, testing, and standardization labs.
- Bureaucratic inefficiencies and corruption within ESSi and EOBI, discouraging employees from engaging with these institutions.
- Financial constraints and high-interest rates limiting access to affordable credit for SMEs.
- Limited awareness of tax schemes and slow digitalization of FBR processes.

### Strategies to overcome these challenges

To address these challenges, National Automotive (Pvt) Ltd emphasized the need for stronger government facilitation and sector-specific reforms. They proposed measures such as stricter enforcement against the informal sector to ensure fair competition, along with incentivizing and expanding the pool of registered suppliers to strengthen formal supply chains. Establishing testing and standardization laboratories within Pakistan, coupled with export facilitation programs, would enhance competitiveness in

international markets. Streamlining ESSI and EOBI through transparency, digitalization, and improved employee benefits would restore trust and encourage participation. Moreover, easier access to finance through lower interest rates, SME-friendly credit schemes, and matching grant programs for certification and technology adoption would help reduce financial constraints. Finally, accelerating the digitalization of FBR processes and conducting awareness campaigns on tax schemes would simplify compliance and motivate other enterprises to transition towards formalization.

### **Outcomes of the Formalization**

The formalization of National Automotive (Pvt) Ltd enabled the enterprise to transition from a small informal workshop into a recognized and trusted manufacturer within Pakistan's automotive industry. By registering with SECP, FBR, ESSI, EOBI, and EPA, the company gained credibility with regulators, financial institutions, and major OEMs such as Honda, Toyota, Suzuki, and FAW. Compliance with labor and social protection laws enhanced employee welfare and retention, while ISO 9001:2015 certification and the adoption of ERP systems improved operational efficiency, quality assurance, and transparency. Formalization also opened access to structured finance, long-term partnerships, and broader markets, positioning the company as a competitive player in both domestic and export-oriented value chains. These outcomes not only strengthened the company's growth trajectory but also contributed to building industry-wide confidence in the benefits of formalization.

### **Recommendations and Incentives**

To overcome these challenges, the company stressed the need for government incentives, including:

- Relaxation of advance taxation, easier loan processing, and lower SME interest rates.
- Certification programs through matching grants and technology transfer initiatives.
- Greater awareness campaigns on tax compliance and schemes.
- Independent third-party audit systems to ensure transparency.
- Establishment of testing and standardization labs in Pakistan to support quality compliance.
- Joint ventures with regional vendor industries to boost exports of locally manufactured auto parts.



### Lessons Learned

1. **Compliance Builds Credibility:** Formal registration and adherence to regulatory requirements enhanced the company's reputation, making it a trusted partner for major OEMs and financial institutions.
2. **Employee Welfare Strengthens Workforce:** Registering employees with ESSI and EOBI improved retention and productivity, proving that investing in worker welfare pays off in the long run.
3. **Technology Adoption Drives Efficiency:** Implementing ERP systems and achieving ISO certification streamlined operations, improved quality, and enabled transparency in business processes.
4. **Formalization Unlocks Growth Opportunities:** Transitioning from informality to compliance opened access to structured finance, long-term contracts, and entry into competitive markets, ensuring sustainable growth.

### Conclusion

The case of National Automotive (Pvt) Ltd demonstrates that formalization provides clear benefits; access to OEM supply chains, enhanced credibility, and improved compliance. However, sustaining competitiveness requires a supportive business ecosystem. With targeted policy reforms, R&D investments, workforce training, and the establishment of quality infrastructure, Pakistan's auto parts industry can not only reduce its reliance on informal practices but also emerge as an exporter in global markets. Institutions like ILO and associations such as PAPPAM can play a critical role in addressing governance gaps,

ensuring employee welfare, and advancing sector-wide reforms to foster sustainable growth.

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## **Case 5** Bajwa Agro Industries (Pvt) Ltd.

### **About the Enterprise**

Bajwa Agro Industries (Pvt) Ltd, based in Lahore, is among the pioneering auto parts manufacturers in Pakistan. Established in 1975, the enterprise operated informally for its initial years, gradually strengthening its systems and practices before being registered as a private limited company in 1990. Over this 15-year period, it steadily progressed on the path of formalization and was subsequently listed with SECP, FBR, Social Security, EPA, and EOBI. This journey reflects its long-term commitment to structured growth and to producing high-quality, diversified auto components for the country's automotive industry.

With a dedicated R&D function led by skilled engineers, the company not only enhances its internal technical expertise but also contributes significantly to the development of Pakistan's engineering industry. Bajwa Agro has also invested in a modern machine shop equipped with Capstan lathes, milling machines, boring machines, radial drills, and vertical lathes. To support mass production, the company designs and builds special-purpose machinery in-house.

The enterprise employs 40 people, all of whom are registered with Social Security and EOBI, though only 5 employees are registered with tax authorities. Bajwa Agro has developed its own ERP system and is working towards full compliance with internal and external regulatory requirements.

### **Pre Formalization Status**

Before its formal registration in 1990, Bajwa Agro Industries operated as a small-scale auto parts workshop established in 1975, functioning largely within the informal sector. The enterprise relied on traditional manufacturing methods and limited machinery, with around 20–25 workers engaged without social protection coverage or formal wage structures. Financial practices were informal and cash-based, restricting access to institutional credit and banking facilities. Market linkages were confined to local traders, mechanics, and replacement parts dealers, with little opportunity to engage directly with OEMs due to the absence of certifications, documented systems, or regulatory compliance. The lack of formal recognition also limited its ability to expand operations,

attract skilled engineers, or invest in modern technology. Like many enterprises of its time, Bajwa Agro's growth potential was constrained by informality, highlighting the challenges faced by early auto parts manufacturers in Pakistan before transitioning towards formalization.



### **Why They Decided to Formalize**

The owner emphasized that the company willingly embraced formalization and found it relatively hassle-free. Transitioning to the formal sector provided new business opportunities, especially access to OEMs such as Millat Tractors and Al-Ghazi Tractors. However, the enterprise continues to face stiff competition from the informal sector, which can undercut prices by bypassing compliance costs. Approximately 50% of Bajwa Agro's supply chain is formalized, but the limited availability of registered suppliers compels reliance on informal procurement for raw materials and components, creating challenges in record-keeping and compliance.

The owner further noted that being a registered enterprise often puts businesses "on the hit list" of FBR and intelligence wings, leading to additional scrutiny compared to informal competitors.

### **Benefits of Formalization**

Aspect	Before Formalization (Informal Practices)	After Formalization (Compliant & Certified)
<b>Market Access</b>	Restricted to small/local buyers	Access to OEMs (Millat Tractors, Al-Ghazi Tractors)
<b>Customer Trust</b>	Limited credibility, vulnerable to disputes	Improved credibility with OEMs & regulatory authorities
<b>Supply Chain</b>	100% reliance on informal suppliers	50% supply chain formalized, improved traceability
<b>Finance &amp; Investment</b>	Limited access to formal financing	Better credibility with banks, potential for SME loans
<b>R&amp;D &amp; Technology</b>	Limited product/process innovation	In-house R&D by engineers, ERP adoption
<b>Employee Benefits</b>	Informal workforce, no structured welfare	100% employees registered with Social Security & EOBI
<b>Business Growth</b>	Restricted market opportunities	Expanded growth potential, entry into OEM vendor base

### Challenges Faced by the Enterprise

- Unfair competition from informal sector enterprises avoiding compliance costs.
- Limited availability of formal raw material suppliers, forcing partial reliance on the informal sector.
- Scrutiny from FBR and intelligence departments, creating compliance pressure.
- Corruption and inefficiency in ESSi and EOBI, discouraging employee engagement.
- Financial constraints, particularly high interest rates and limited SME loan access.
- Lack of testing and standardization labs in Pakistan to support compliance and exports.

### Strategies Adopted to Overcome Challenges

- Certification programs supported by matching grants to enhance competitiveness from SMEDA etc.
- Technology transfer initiatives and ERP adoption support.

- Awareness on tax schemes and compliance processes to employees.
- Participated in domestic exhibitions to enhance outreach.
- Engage ESSI and EOBI for improved employee services.

### Outcomes of Formalization

The formalization of Bajwa Agro Industries (Pvt) Ltd transformed the enterprise from a modest auto parts workshop into a recognized and credible player in Pakistan’s automotive industry. Through registration with SECP, FBR, Social Security, EPA, and EOBI, the company gained legitimacy that enhanced its reputation with regulators, banks, and major customers. This credibility enabled stronger market linkages, particularly with OEMs, while compliance with labor and social protection laws improved employee welfare and workforce stability. Investment in modern machinery, an in-house R&D function, and the development of ERP systems further strengthened operational efficiency, product quality, and transparency. As a result, the enterprise was able to scale production, diversify its components, and position itself competitively for both domestic demand and future export potential.



### Recommendations from the Enterprise

Bajwa Agro Industries believes that the government needs to make it easier for SMEs to become formal businesses. For this, there should be stricter action against informal enterprises so that fair competition exists, and more registered suppliers should be added to make supply chains stronger. The company suggests faster digitalization of FBR processes and reforms in ESSI and EOBI to cut down on corruption and delays. It also

recommends setting up testing and standardization labs in Pakistan so that exporters can meet international requirements.

To ease financial challenges, Bajwa Agro calls for simpler access to loans, lower interest rates for SMEs, and grant programs to help companies with certification and new technology. Finally, it proposes incentives for businesses that pay taxes regularly, such as discounts on school fees or support to join international exhibitions, which would encourage more enterprises to formalize and stay compliant.

### **Lessons Learnt**

Bajwa Agro's journey towards formalization demonstrates that compliance, while initially challenging, creates long-term benefits for enterprises. Firstly, regulatory registration enhances credibility, helping companies build trust with customers, regulators, and financial institutions. Secondly, investing in workforce welfare through Social Security and EOBI strengthens employee loyalty and productivity, even in the face of institutional inefficiencies. Thirdly, the adoption of technology, including ERP systems and certifications, plays a critical role in improving efficiency and ensuring quality assurance. Lastly, the experience shows that while the informal sector poses competitive challenges, enterprises that embrace formalization are better positioned for sustainable growth, international competitiveness, and industry-wide recognition.

### **Conclusion**

The case of Bajwa Agro Industries (Pvt) Ltd highlights how formalization opens avenues for growth, credibility, and access to OEMs. Yet, sustaining competitiveness requires systemic reforms—fair enforcement against informal players, improved access to finance, transparent labor institutions, and investment in quality infrastructure. Institutions like the ILO and sectoral associations can play a crucial role in addressing governance gaps, advocating for worker welfare, and creating an enabling environment for SMEs. With targeted government support and collective industry reforms, enterprises like Bajwa Agro can not only thrive domestically but also strengthen Pakistan's position.

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## Textile Sector

### Case 6 Sun Flower Industries

#### About the Enterprise

Sunflower Industries, established in 1975 in Karachi, is a large garments manufacturer specializing in apparel exports to the US and EU markets. Starting with just 4 sewing machines, the enterprise has grown steadily through formalization and today operates 500 machines with a workforce of 800 employees. Within two years of inception, the company registered with FBR, Social Security, EPA, and EOBI, and has consistently maintained compliance with these institutions. The enterprise is now managed by the third generation of its founding family and has developed its own ERP system to ensure transparency and operational efficiency.

Currently, 120 employees are registered with tax authorities, 500 are enrolled in social security and EOBI, while the remaining workforce is engaged on contractual or daily wage terms. Despite challenges in the wider environment, Sunflower Industries has positioned itself as a reliable supplier through compliance with international clients' audit requirements and by maintaining over 80% of its supply chain in the formal sector.

#### Pre-Formalization Status

During the small period of transition towards the formalization, the company faced following challenges;

- Informal workforce with no access to social protection or registration.
- Minimal accounting and documentation; manual transactions dominated.
- Limited compliance with labor and tax regulations.
- Restricted market access, dependent on local middlemen.
- Small production capacity, limiting growth and global outreach.

#### Why They Decided to Formalize

- **Market Access** – Export to the US/EU, and North America required compliance with buyer standards, certifications, and transparent systems.
- **Long-Term Growth** – Leadership viewed formality as essential to scale operations beyond local markets.
- **Institutional Finance** – Access to banking channels and working capital demanded financial documentation and audited accounts.

- **Credibility** – Registration with authorities enhanced trust with buyers and employees.

### Comparative Analysis: Pre vs Post Formalization

Aspect	Pre-Formalization	Post-Formalization
<b>Market Access</b>	Local buyers, limited contracts	Export to US/EU, North America markets via buying houses, and directly
<b>Technology</b>	4 sewing machines, manual processes	<b>500+ machines, ERP-enabled operations</b>
<b>Workforce</b>	Mostly informal, no protections	500 enrolled in EOBI/SESSI, 120 in tax system
<b>Finance</b>	Owner’s equity, informal credit	Access to institutional finance and trade facilities
<b>Reputation</b>	Limited recognition	Recognized exporter, trusted by global clients
<b>Productivity</b>	Small-scale, inconsistent	Scalable, quality-driven production

### Challenges Enterprise Faced

- Uneven competition from informal vendors (collar makers, embroidery, printing, raw material suppliers).
- Difficulty in maintaining compliance records when purchasing from informal supply chain actors.
- High logistics costs and shipment delays.
- Shortage of skilled workforce and quality raw material.
- Unclear and inconsistent government policies, like EFS is completely out and that makes us less competitive.
- Corruption and inefficiencies in ESSi and EOBI, discouraging workers’ trust in formal enrollment.

### Strategies Adopted

- Development of ERP system for digitized financial and operational management.
- Gradual workforce registration with EOBI and Social Security.
- Alignment with international clients’ compliance audits.  
Formal vendor partnerships where possible (80% of supply chain).
- Investment in modern machinery and phased expansion.

## Outcomes of Formalization

- Expanded production capacity **from 4 to 500 machines**.
- Sustained export linkages with US and EU markets.
- Improved workforce welfare through social security and EOBI.
- Enhanced trust with international buyers due to compliance and transparency.
- Increased organizational resilience and intergenerational continuity.

## Recommendations from the Enterprise

- **Tax & Finance** – Relaxation in advance taxation, digitalization of FBR, and lower SME interest rates.
- **Skill & Technology** – Certification programs through matching grants, technology transfer initiatives, ERP and digital production support.
- **Access to Finance** – Easier loan processing, awareness of tax schemes, and 3rd-party audit support.
- **Market Access Incentives** – Rebates on international travel, exhibition participation fees, and education discounts for taxpayers' families.
- **Labor Protection** – Reform and digitalize ESSI/EOBI to ensure transparency, reduce corruption, and restore employee confidence.
- **Supply Chain Formalization** – Incentivize raw material suppliers and vendor industries to register and adopt compliance.

## Lessons Learned

Formalization has proven to be a catalyst for scaling and exports, enabling Sunflower Industries to evolve from a small family-owned unit into a globally competitive supplier. A phased and voluntary approach supported sustainability while keeping compliance costs manageable, and the adoption of ERP and digital systems enhanced transparency, efficiency, and credibility with international buyers. However, partial informality in the supply chain remains a persistent bottleneck, requiring broader ecosystem reforms. Most importantly, employee confidence in institutions such as ESSI and EOBI is critical; when these institutions fail to deliver benefits, workers prefer to remain outside the formal system, which undermines the overall impact of employer compliance.

## Conclusion

Sunflower Industries' journey reflects how formalization, though challenging and costly, provides a pathway for sustainable growth, market access, and generational continuity. By investing in compliance, digitalization, and workforce welfare, the enterprise has established itself as a globally competitive garment exporter. However, its case also

highlights systemic barriers—such as informal supply chains, institutional inefficiencies, and policy uncertainty—that need to be addressed through government and donor-supported reforms. If tackled effectively, these reforms could not only empower Sunflower Industries but also incentivize thousands of SMEs in Pakistan’s garment sector to transition toward formalization.

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## **Case 7** Creative Apparels (Pvt.) Ltd.

### **About the Enterprise**

Creative Apparels (Pvt.) Ltd., established in 2003 and formally registered as a private limited company in 2006, is one of Pakistan’s notable garment manufacturers located in Lahore. The company is registered with SECP, FBR, Social Security, EPA, and EOBI, fulfilling all procedural and regulatory requirements on a regular basis. Starting as a cut-to-pack garments facility, the enterprise evolved significantly and, in 2017, added a state-of-the-art knitting unit with 30 advanced machines, marking a transformative step toward vertical integration. The enterprise employs 250 workers, of which 44 are registered with FBR, while all employees are enrolled with Social Security and EOBI. Equipped with an ERP system, Creative Apparels ensures transparency, compliance, and efficiency across its operations. Today, the company exports garments to the US and EU markets, supplying global brands such as Zara, Bershka, ENZA, and Pull & Bear through buying offices, meeting all international compliance requirements.

### **Pre-Formalization Status**

Before its registration in 2006, Creative Apparels operated as a small-scale informal garment unit, catering primarily as vendor for the exporters. The workforce was largely unregistered and without access to social protection, while transactions were handled manually with limited record-keeping. Procurement was heavily dependent on informal suppliers, leading to inconsistent quality and weak traceability. With no certifications or compliance mechanisms in place, the company lacked credibility with financial institutions and international buyers, which restricted its market reach. Like many informal enterprises in the garment sector, Creative Apparels faced barriers in accessing institutional finance, long-term contracts, and export opportunities until it embraced formalization.

### **Why They Decided to Formalize**

The leadership of Creative Apparels willingly pursued formalization, viewing it as a pathway to business growth, employee welfare, and entry into global value chains.

International buyers required documented compliance with labor, environmental, and quality standards e.g. ISO 9001, ISO 45001 / OHSAS 18001 ISO 14001, WRAP etc., making formalization essential for accessing export markets. Although the process involved multiple approvals, documentation, and delays due to bureaucracy, the company gained legal protection, enhanced credibility with suppliers and customers, and the ability to secure larger export orders. The management also stressed that Pakistan’s regulatory regime and institutions such as ILO, ESSI, and EPA should benchmark regional competitors, focusing not only on employee rights but also clearly defining responsibilities and offering workable solutions for both employers and employees.



### Comparative Analysis: Pre vs. Post Formalization

Aspect	Pre-Formalization	Post-Formalization
<b>Market Access</b>	Local traders, small buyers	Exports to US & EU (Zara, Bershka, ENZA, Pull & Bear)
<b>Workforce</b>	Mostly unregistered, no social protection	250 employees fully registered with Social Security & EOBI
<b>Finance</b>	Cash-based, no institutional support	Access to institutional financing and legal protections
<b>Technology</b>	Manual production, limited capacity	ERP system, knitting unit with 30 advanced machines

Aspect	Pre-Formalization	Post-Formalization
Supply Chain	Informal, unregistered suppliers	60–70% formalized supply chain established
Reputation	Limited credibility	Trusted exporter recognized by global brands

### Challenges Faced by the Enterprise

- Unfair competition from informal sector players avoiding compliance costs.
- Limited availability of registered raw material and accessory suppliers.
- Bureaucratic delays and multiple approvals in compliance processes.
- Corruption and inefficiencies in ESSI and EOBI discouraging worker trust.
- High logistics costs and inconsistent government policies hindering growth.
- Poor infrastructure including road networks, power supply, and digital connectivity.
- Weak performance of trade bodies in promoting exports and product diversification.
- Lack of industry-focused R&D to identify new markets, products, and global trends.

### Strategies Adopted to Overcome Challenges

To address unfair competition from informal sector players, the company positioned itself as a reliable and compliant partner for global buyers, emphasizing quality, certification, and traceability. The scarcity of registered raw material and accessory suppliers was mitigated by nurturing long-term partnerships with compliant vendors and selectively developing in-house capabilities. Bureaucratic delays in compliance processes were handled through professional consultants, digital record management, and proactive engagement with regulators to reduce approval time. To counter corruption and inefficiencies in ESSI and EOBI, the company built worker trust by directly extending welfare benefits such as healthcare, insurance, and skill development programs. Rising logistics costs and inconsistent government policies were managed through bulk shipments, efficient route planning, and flexible business models. Infrastructure gaps were bridged with backup power systems, digital solutions, and investments in private logistics arrangements. Recognizing the weak role of trade bodies, the company sought direct representation in export forums and strengthened its own marketing networks abroad. Finally, the lack of industry-focused R&D was overcome by investing in market intelligence, global trade fairs, and collaborations with research institutions to identify new products, markets, and evolving trends.

## Outcomes of Formalization

Formalization enabled Creative Apparels to build trust with suppliers, buyers, and regulators, opening access to export markets in the US and EU. By achieving a 60–70% formalized supply chain, the company improved quality consistency, traceability, and record maintenance, even though reliance on informal vendors persists in some areas. Registration with SECP, FBR, and social protection institutions provided legal security and credibility, while the ERP system enhanced operational transparency. The integration of a knitting unit not only expanded production capacity but also demonstrated the company's commitment to adopting best business practices. Formalization positioned Creative Apparels as a trusted partner for international brands and laid the foundation for future growth and competitiveness.

## Recommendations from the Enterprise

The enterprise emphasizes the need for stronger government and donor support to sustain formalization and competitiveness. Suggested measures include reducing advance taxation, increasing access to finance, and lowering SME interest rates. Accelerated digitalization of FBR processes, along with reforms in ESSI and EOBI, are necessary to improve efficiency and restore trust. Establishing accredited testing and standardization labs, promoting industry-led R&D, and developing product diversification strategies are essential for enhancing global competitiveness. Additionally, employee training programs, gender balance schemes, and public-private collaboration on workforce development would create new jobs and improve sectoral capacity. Incentives for taxpayers—such as travel rebates, exhibition discounts, and school fee concessions—could further encourage compliance.

## Lessons Learned

- **Compliance Strengthens Trust:** Formalization builds credibility with buyers, suppliers, and regulators, enabling access to premium export markets.
- **Employee Welfare Improves Stability:** Registering all workers with Social Security and EOBI fosters loyalty and productivity, despite institutional weaknesses.
- **Technology and Integration Drive Growth:** ERP systems and vertical integration (knitting unit) enhance efficiency, transparency, and competitiveness.
- **Supply Chain Formalization is Critical:** Although challenging, moving suppliers into the formal economy ensures consistency and record-keeping.
- **Systemic Support is Essential:** Sustainable growth requires government facilitation, industry-specific R&D, infrastructure improvement, and effective trade bodies.



## Conclusion

The case of Creative Apparels (Pvt) Ltd illustrates how deliberate formalization and strategic investments can transform a mid-sized garment unit into a recognized global exporter. By adopting ERP systems, integrating knitting facilities, and complying with international standards, the enterprise has earned the trust of leading brands such as Zara, Bershka, ENZA, and Pull & Bear. Despite systemic challenges such as high logistics costs, poor infrastructure, and weak trade facilitation, Creative Apparels demonstrates that formalization provides legal protection, credibility, and access to global value chains. The journey highlights the importance of enterprise commitment, government incentives, and institutional reforms in driving sustainable growth across Pakistan’s textile and garment sector.

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## Case 8 Ayesha Knitwear (Pvt.) Ltd.

### About the Enterprise

Ayesha Knitwear (Pvt.) Ltd., established and registered in 1996 as a private limited company, is a leading garments manufacturer based in Lahore. The company is fully registered with SECP, FBR, Social Security, EPA, and EOBI, and has consistently maintained compliance with regulatory authorities. It employs 250 workers, of which 50 are registered with tax authorities, while 110 employees are registered with Social Security and EOBI. Equipped with an ERP system, the company ensures compliance with both domestic regulations and the requirements of international buyers. Ayesha Knitwear

exports garments to Australia, the US, and EU markets through buying offices and direct clients, supplying globally recognized brands while meeting stringent compliance requirements.

### Pre-Formalization Status

Before formal registration in 1996, Ayesha Knitwear operated informally as a small garment unit serving fabric suppliers and vendor to the exporters. The majority of its workforce was unregistered and lacked social protection coverage, while procurement and transactions were managed through informal systems. Limited documentation and absence of certifications restricted the company’s ability to access institutional financing, develop credible supplier networks, or compete for large-scale export orders. Reliance on informal suppliers for raw materials further undermined product consistency and traceability. Like many small units in Pakistan’s garment sector, its potential for growth was limited by informality and absence of compliance structures.

### Why They Decided to Formalize

The leadership of Ayesha Knitwear recognized formalization as essential for growth, credibility, and entry into international markets. Global buyers demanded documented compliance with labor, environmental, and quality standards, making registration with SECP, FBR, Social Security, and EOBI a prerequisite. Although the process was time-consuming and involved multiple approvals, documentation, and bureaucratic delays, the enterprise gained significant benefits. These included legal protection, improved trust with suppliers and customers, and the ability to work with bigger clients and access premium export markets. The management also emphasized that institutions like ILO, ESSI, and EPA should benchmark regional competitors, focus on both employee rights and responsibilities, and provide workable solutions for both employers and workers.

### Comparative Analysis: Pre Vs. Post Formalization

Aspect	Pre-Formalization	Post-Formalization
<b>Market Access</b>	Local traders, small-scale buyers (5000 pcs first order)	Export to Australia, US & EU markets via direct clients & buying offices. Now producing 120,000 garments in a month
<b>Workforce</b>	Mostly unregistered, no social protection	Started with <b>20 employees, now 300+, including 15 female</b> employees registered with Social Security & EOBI

Aspect	Pre-Formalization	Post-Formalization
<b>Finance</b>	Cash-based, no institutional access	Eligibility for institutional finance & legal protection e.g. working through LCs, having access to loan etc.
<b>Technology</b>	Manual operations, limited oversight	ERP system ensuring compliance & transparency
<b>Supply Chain</b>	Informal vendors, low traceability	70–80% supply chain formalized
<b>Reputation</b>	Limited credibility with buyers	Recognized supplier for international brands



### Challenges Faced by the Enterprise

- Competition from informal enterprises avoiding compliance costs.
- Dependence on informal raw material suppliers due to limited registered vendors.
- Bureaucratic hurdles, delays, and multiple approvals in compliance processes.
- Corruption and inefficiency in ESSI and EOBI, discouraging worker trust.
- Poor infrastructure, unreliable electricity, and weak digital connectivity.
- High logistics costs and frequent delays in shipments.
- Weak role of trade bodies in promoting innovation, product diversification, and global competitiveness.
- Limited R&D support for SMEs to identify new markets, products, and global value chain opportunities.

## **Strategies Adopted to Overcome Challenges**

- Implemented ERP systems to digitize operations and improve record-keeping.
- Advocated for relaxation of advance taxation and digitalization of FBR processes.
- Pursued certification programs supported by matching grants to enhance competitiveness, e.g. ISO, WRAP, ACCORD, BSCI etc.
- Worked for stronger vendor collaboration and shared inventory systems to reduce input costs and strengthen supply chains.

## **Outcomes of Formalization**

Formalization enabled Ayesha Knitwear to build trust with customers, suppliers, and regulators, significantly improving its market credibility. By complying with SECP, FBR, Social Security, and EOBI, the enterprise gained legal protection, access to finance, and long-term export opportunities. With 70–80% of its supply chain formalized, the company enhanced product quality, consistency, and traceability, although some reliance on informal procurement remains due to vendor gaps. The adoption of ERP systems further strengthened transparency and efficiency, while compliance with international standards opened doors to premium markets in Australia, the US, and the EU. Overall, formalization positioned Ayesha Knitwear as a competitive exporter with a sustainable growth path.



## **Recommendations from the Enterprise**

The company recommends that Pakistan’s regulatory regime benchmark regional competitors to streamline compliance and improve competitiveness. Incentives such as

relaxation of advance taxation, SME-friendly financing, and lower interest rates would encourage further formalization across the sector. Accelerated digitalization of FBR processes and reforms in ESSI and EOBI are necessary to improve efficiency and restore worker trust. Establishing accredited testing and standardization labs would support exports, while investment in R&D, workforce training, and gender balance initiatives would enhance competitiveness and job creation. Public-private collaboration is also needed to strengthen vendor networks, supply chain reliability, and access to global value chains.

## Lessons Learned

- **Formalization Builds Credibility:** Registration with regulatory authorities creates trust with buyers, suppliers, and financial institutions.
- **Employee Welfare Improves Productivity:** Social Security and EOBI registration strengthens workforce stability and loyalty.
- **Technology Strengthens Competitiveness:** ERP adoption enables transparency, efficiency, and alignment with global compliance standards.
- **Supply Chain Formalization Adds Value:** Shifting vendors into the formal economy improves traceability and record maintenance.
- **Systemic Reforms Are Needed:** Sustainable growth depends on improved infrastructure, efficient institutions, and effective trade facilitation.

## Conclusion

The case of Ayesha Knitwear (Pvt.) Ltd demonstrates how formalization transforms a medium-sized garment manufacturer into a credible exporter with access to global markets. By registering with regulatory authorities, implementing ERP systems, and formalizing most of its supply chain, the company gained trust, legal protection, and competitiveness in international markets. Despite challenges such as reliance on informal suppliers, bureaucratic hurdles, and poor infrastructure, the enterprise continues to maintain best business practices and supply globally recognized brands. The experience highlights that while enterprise-level commitment is critical, supportive government policies, industry-wide reforms, and effective institutions are necessary to ensure sustainable growth and wider formalization in Pakistan's garment sector.

## Agricultural Implements

### Case 9 Green Land Engineers, Daska

#### Introduction and Rationale

Agricultural mechanization plays a vital role in enhancing productivity, reducing drudgery, and improving the competitiveness of Pakistan’s farming sector. The manufacturing of agricultural implements and tools, though traditionally rooted in small-scale workshops, constitutes one of the most significant yet largely informal segments of the national industrial base. This sector caters to the growing domestic demand for farm mechanization and supports a wide range of agricultural activities; from land preparation and planting to harvesting and post-harvest handling.

In Pakistan, the production of agricultural implements is concentrated primarily in Punjab, which not only fulfills the provincial demand but also supplies to Sindh, Balochistan, and Khyber Pakhtunkhwa. Around 500 manufacturing units are engaged in this sector, clustered mainly in Daska, Faisalabad, Okara, and Mian Channu, with smaller concentrations in other provinces. These units are typically micro or small enterprises operating through workshop models, employing informal labor, and relying on traditional techniques. Despite their informal nature, they make a substantial contribution to the rural economy, employment generation, and local innovation.

The marketing and sales system of agricultural implements in Pakistan follows a mixed “push and pull” model. Farmers usually approach manufacturers directly—often through personal referrals or word of mouth—while a parallel network of public and private service centers provides affordable mechanization services such as land leveling, sowing, and harvesting. This dual model has expanded market outreach and generated sustained demand for agricultural implements.

The value chain of the sector is relatively short, involving raw material suppliers, specialized component manufacturers, assemblers, and final fabrication units. Key institutional actors include provincial agriculture departments, the Pakistan Agricultural Machinery & Implements Manufacturers Association (PAMIMA), business development service providers, and exporters. Pakistan also participates in the global low-end market for agricultural implements by exporting to neighboring and African countries. However, exports remain inconsistent due to lack of standardization, branding, and certification.

## Why This Sector Deserves Incentivized Formalization

Technical Working Group of Ministry of Industries and Production that is looking for the development of National Roadmap and Enterprise Formalization, recognized the agricultural implements manufacturing sector as a critical area that remains highly informal but economically promising. Based on this direction, a team visited PAMIMA Daska–Sialkot to gain on-ground insights into the sector’s structure, challenges, and opportunities. It was observed that while the sector contributes significantly to agricultural modernization and rural livelihoods, most units operate outside formal registration and compliance frameworks, limiting their growth potential and access to institutional support.



The rationale for incentivizing formalization in this sector is anchored in several interrelated factors:

1. **High Informality, High Impact:** The sector employs thousands of workers, mostly informal yet plays a key role in rural industrialization and farm mechanization. Formalization would enhance worker welfare, ensure occupational safety, and expand access to social protection programs like EOBI and Social Security.
2. **Untapped Export Potential:** Pakistan has a comparative advantage in producing low-cost implements suitable for developing markets. However, due to informality and lack of certifications, many manufacturers cannot access export contracts or participate in trade fairs. Incentivizing formalization would bridge this gap and help brand Pakistan’s agricultural machinery internationally.

3. **Technology and Productivity Gains:** Experience from donor-led programs such as the **USAID Firms Project (2013–14)** demonstrated that enterprises adopting formal systems achieved tangible productivity improvements up to 21% higher output, 40% reduction in waste, and 20% increase in sales. Expanding such interventions through incentive-based programs could multiply these gains across the cluster.
4. **Improved Access to Finance and Procurement:** Formalization enables enterprises to meet bank documentation requirements, qualify for government subsidy schemes, and participate in public procurement. SMEs with FBR and SECP registration can leverage institutional finance for technology upgrades and expansion.
5. **Level Playing Field:** Currently, formal enterprises face unfair competition from informal operators who avoid taxes and compliance costs. Incentivizing formalization—through reduced advance taxation, simplified digital systems, and access to low-interest finance—would create equitable market conditions and strengthen fiscal revenues in the long term.
6. **Sustainability and Cluster Development:** Formalization fosters the creation of industrial clusters with shared facilities such as testing laboratories, training centers, and common manufacturing services. These investments enhance competitiveness, enable quality assurance, and attract private investment.

Incentivizing formalization will not only strengthen enterprise-level competitiveness but also generate wider economic and social benefits e.g. higher productivity, enhanced exports, and improved working conditions. Donor agencies such as SMEDA, ILO, UNIDO, USAID, and EDF can play a catalytic role by designing challenge funds, matching grant schemes, and capacity-building programs targeting this sector.

In this context, *Green Land Engineers of Daska*, an ISO-certified and partially formalized enterprise, has been selected as a representative business case to illustrate the benefits of transitioning from informality to formality. The case builds on lessons learned from previous case studies conducted in the automotive and textile sectors, thereby providing a comparative perspective on how formalization drives competitiveness, sustainability, and resilience across diverse industries.

### About the Enterprise

Green Land Engineers, established in 1975 in Daska, Punjab, is one of the pioneering manufacturers of agricultural implements in Pakistan. Originally starting as a small workshop catering to local farmers, the enterprise grew steadily to meet rising demand for farm mechanization. During the 1980s, to qualify as a supplier under provincial

agricultural subsidy programs, the firm registered with the Federal Board of Revenue (FBR) as a sole proprietorship. Over time, it extended formal registration to Social Security and EOBI, reflecting a gradual transition from informality toward a structured business model.

By 2013, the enterprise's formal status enabled its selection for a USAID vendor development program, which marked a major turning point. Through this initiative, the company implemented lean manufacturing, upgraded its welding and machining processes, introduced product development practices, and participated in international exhibitions and study tours. These interventions resulted in significant improvements e.g. productivity increased by **21%**, wastage and rework dropped by **40%**, and overall sales rose by **20%** etc.

Building on this success, Green Land Engineers won a Challenge Fund program under USAID in 2018, installing its first laser cutting machine, a transformative technology in the local industry. By 2025, the enterprise had expanded this capacity to three laser cutting machines, offering precision services to peer manufacturers and becoming a hub of innovation within the agricultural implement cluster. The company now operates under ISO 9001:2014 certification, ensuring quality assurance and compliance with international standards.



## Journey of Formalization

Before formalization, the enterprise operated in a typical informal workshop setup characterized by:

- Cash-based transactions and manual bookkeeping
- Unregistered labor and absence of social protection coverage
- Minimal compliance with tax or environmental standards
- Low technology adoption and productivity constraints
- Dependence on informal suppliers for raw materials
- Limited market access beyond local buyers

While such informality provided flexibility, it also restricted Green Land Engineers from accessing formal supply chains, institutional finance, and large-scale government tenders. The absence of certifications, compliance documentation, and traceability meant the enterprise could not compete for contracts with OEMs or export buyers requiring documented assurance of standards and ethical production.

## Benefits of Formalization – National Automotive (Pvt) Ltd

Aspect	Pre-Formalization (Before 1980s)	Post-Formalization (After 1980s)
<b>Market Access</b>	Local workshops and informal buyers	Qualified supplier for public sector and OEMs
<b>Technology</b>	Conventional welding and machining	Laser cutting, lean manufacturing, ERP system
<b>Workforce</b>	Informal labor, no training or safety	Registered workers with Kaizen, safety, and skills training
<b>Finance</b>	Personal savings and informal credit	Access to institutional finance and challenge funds
<b>Quality Systems</b>	No certification or documentation	ISO 9001:2014 certified processes
<b>Productivity</b>	Low efficiency, high rework	+21% output, -40% wastage, +20% sales growth

## Challenges Faced by the Enterprise

The enterprise highlighted several challenges in sustaining growth and competitiveness:

- **Uneven Competition:** Informal enterprises avoided tax and compliance costs, creating unfair price competition.
- **Regulatory Complexity:** Multiple registrations (FBR, SECP, EOBI, SESSI) required extensive documentation.
- **High Cost of Compliance:** Consultant fees, audit charges, and technology costs burdened small manufacturers.
- **Informal Supply Chain:** Around 70% of suppliers remained unregistered, complicating record-keeping and tax claims.
- **Limited Access to Finance:** Collateral-based lending and high interest rates constrained investment capacity.
- **Skilled Labor Shortage:** Advanced machinery required technical expertise not readily available locally.

### Strategies to overcome these challenges

To address these challenges, Green Land Engineers emphasized;

- Phased registration with FBR, Social Security, and EOBI to manage compliance gradually.
- Collaboration with **USAID** and local industry associations for capacity building.
- **Lean manufacturing and Kaizen** training to enhance workforce productivity.
- Introduction of **ERP system** for inventory and quality control.
- Networking with OEMs for vendor qualification and joint product development.
- Offering laser cutting services to other firms to diversify revenue and sustain technology investments.

### Recommendations and Incentives

The management of Green Land Engineers emphasized several policy measures to encourage sector-wide formalization:

- **Incentivized Taxation:** Introduce advance tax reliefs and lower interest rates for SMEs adopting formalization.
- **Access to Finance:** Simplify loan processes, introduce guarantee schemes, and encourage digital financial services.
- **Technology Upgradation Support:** Expand matching grant programs for machinery and certification.
- **Testing and Standardization Labs:** Establish local labs for quality testing and product certification.

- **Market Linkages:** Facilitate participation in OEM vendor programs and export trade fairs.
- **Awareness Campaigns:** Increase SME understanding of tax, compliance, and digital record systems.
- **Cluster-Based Approach:** Develop industrial clusters with shared services (training, testing, logistics).
- **Partnership with Donors:** Encourage SMEDA, ILO, and development partners to revive challenge funds and on-site training programs like those under USAID.

## Conclusion

The journey of Green Land Engineers demonstrates that formalization is not merely a regulatory requirement but a catalyst for competitiveness, sustainability, and innovation. The enterprise's gradual and deliberate transition from informal operations to a registered, ISO-certified manufacturer proved that adopting compliance systems, documentation, and certifications can unlock market access, improve productivity, and enhance credibility with both domestic and international buyers. The company's experience also revealed that successful formalization depends on a step-by-step approach; beginning with registration, followed by financial transparency, and then capacity building through technology and workforce training. Moreover, partnerships with development programs, donor agencies, and OEMs played a crucial role in enabling access to resources, technical expertise, and new markets.

At the same time, the case highlights broader lessons for policymakers and the industry. Formalization initiatives are most effective when accompanied by incentives such as tax relief, affordable financing, and simplified digital processes. Trust and collaboration between regulators and enterprises are vital to reduce compliance burdens and ensure sustainability. The experience of Green Land Engineers also emphasizes that supply chain formalization and skill development must move in parallel with enterprise-level reforms. When supported through coordinated efforts by institutions like SMEDA, ILO, and donor-funded programs, such transformations can drive competitiveness, create decent work, and position Pakistan's agricultural implement manufacturing sector for integration into global value chains.



# **CHAPTER 9**

## Lesson Learned and Conclusion

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The transition from informality to formality in Pakistan's manufacturing supply chains is not merely a matter of regulatory compliance, it represents a broader economic transformation. Formalization serves as a critical enabler of competitiveness, productivity, and decent work. It integrates enterprises into the documented economy, strengthens fiscal capacity, promotes fair competition, and ensures that workers access social protection and skill development opportunities. This transformation, however, requires more than policy directives; it demands institutional coordination, behavioral change, and trust-building among all stakeholders i.e. enterprises, workers, and government institutions.

The findings of this study, reinforced by nine enterprise-level business cases, clearly demonstrate that the willingness to formalize exists across Pakistan's textile, automotive, and agricultural implement sectors. Entrepreneurs understand the long-term advantages of becoming part of the formal system e.g. access to finance, enhanced productivity, and integration into structured value chains. Yet, their hesitation stems from the short-term costs, procedural complexity, and perceived lack of institutional fairness. The prevalence of overlapping regulations, high compliance costs, and inconsistent enforcement mechanisms continues to reinforce the informal ecosystem, where enterprises often survive but rarely scale.

At the same time, the study shows that formalization cannot be achieved through punitive or coercive approaches. Instead, it must be incentivized through facilitation, simplification, and inclusion. When enterprises perceive tangible benefits e.g. easier access to credit, simplified taxation, lower cost of compliance, and visible improvements in market credibility they voluntarily move towards formal status. The same applies to workers: when formality is associated with better working conditions, healthcare access, and family benefits, resistance to registration diminishes. Hence, the transition to formality must be positioned as a mutually beneficial journey for both employers and employees, rather than a regulatory imposition.

The evidence gathered from field consultations and enterprise interviews highlights that the most successful cases of partial or full formalization emerged where supportive ecosystems existed. These included strong linkages with business associations, access to

advisory services, presence of enabling infrastructure such as SME industrial clusters, and digital integration of administrative processes. In many instances, it was the demonstration effect one enterprise formalizing and benefiting that inspired others to follow suit. This peer learning underscores the importance of showcasing success stories and establishing champions of formalization within industrial clusters.

Moving forward, the path to sustained formalization in Pakistan requires coherence across three interconnected pillars: regulatory simplification, financial inclusion, and social alignment.

- **Regulatory simplification** ensures that multiple registrations, inspections, and tax filings are consolidated under a single digital window. Simplifying procedures not only lowers transaction costs but also rebuilds trust between enterprises and the state.
- **Financial inclusion** enables enterprises, particularly SMEs, to access affordable credit and insurance products using formal business data and performance metrics. This fosters investment, technology adoption, and productivity improvement.
- **Social alignment** guarantees that formalization brings visible gains for the workforce through healthcare, skill development, and welfare access, thus making compliance socially desirable and sustainable.

To translate these pillars into tangible results, a coordinated institutional framework is indispensable. The joint efforts of the International Labour Organization (ILO) and the Small and Medium Enterprises Development Authority (SMEDA) have already set a precedent for evidence-based policy development and multi-stakeholder engagement. Building on this foundation, collaboration must expand to include the Federal Board of Revenue (FBR), Employees Old-Age Benefits Institution (EOBI), Social Security Institutions, and sectoral chambers and associations. Such inter-agency coordination can harmonize fragmented incentives into an integrated national framework that supports formalization across all tiers of enterprise operations.

Equally important is the behavioral dimension of reform. Awareness campaigns, peer-to-peer learning, and digital outreach must accompany policy changes to shift perceptions. Enterprises and workers should view formalization as an opportunity one that enhances their legitimacy, stability, and growth potential. The inclusion of family-centered incentives, such as school vouchers and health insurance schemes, can embed formalization within social and community contexts, thereby extending its appeal beyond the enterprise gate.

In the long term, formalization must be seen as a national competitiveness agenda, not just a compliance goal. It contributes directly to productivity enhancement, export diversification, fiscal stability, and decent work outcomes the very foundations of sustainable development. By bridging the gap between policy design and ground-level realities, Pakistan can create a virtuous cycle of growth: formalized enterprises generate better jobs, which in turn strengthen consumer demand, fiscal revenues, and innovation capacity.

In conclusion, the transition from informality to formality is a shared responsibility and a shared opportunity. With joint leadership from ILO and SMEDA, and the commitment of relevant government bodies, industry associations, and the private sector, Pakistan can transform its informal economy into a productive, inclusive, and resilient one. A unified approach, anchored in facilitation, incentive alignment, and digital innovation can make formalization not just attainable, but aspirational. This will mark a turning point in Pakistan's journey toward a competitive, equitable, and sustainable industrial future.



# **ANNEXES**

# ANNEX 1

## List of Enterprises and Stakeholders for KILs (Lahore)

Sr.	Sector	Company Name	Focal Person for Meeting
1	Textiles	Style Textiles	Mr. Shahzad Asghar, CEO
2		Creative Apparels	Mr. Abdul Hameed, CEO
3		Comfort Knitwears	Mr. Ifkikhar, Head Global Merchandising
4		Ayesha Knitwears	Mr. Naseer Butt, CEO
5		Bali Tex	Mr. Amanullah, CEO
6		Matrix Sourcing	Mr. Azfar Hasan, CEO
7		H&A Traders	Mr. Haris, Director
8		Sec. PHMA	Mr. Ayyoub
9		Saad Textiles	Mr. Habib Anwar, CEO
10		Star Knitwears	Mr Muhammad Akram, Owner
11	Auto	RK Gears	Mr. Mumshad Ali, CEO
12		Bajwa Agro Industry	Mr. Mueenuddin Bajwa, CEO
13		Alpha rubber & plastics	Mr. Usama Usman, CEO
14		Automotive Components	Mr. Naeem Ul Haq, CEO
15		Infinity Engg	Mr. Gohar, CEO
16		Cavico Engineering	Mr. Taqir Jamaluddin, CEO
17		Hybrid Technics	Mr. Mohsin Syed, CEO
18		National Automotive Comp	Mr. Salman Saleem, CEO
19		Unitech Auto Ind	Mr. Javed Hafiz, CEO
20		Honda Atlas Union	Mr. Anwar Khan

### List of Enterprises and Stakeholders for KILs (Karachi)

Sr.	Sector	Company Name	Focal Person for meeting
1	<b>Textiles</b>	Peliket knitwear	Mr. Fawad, CEO
2		Karsaz Knitwear	Mr. Aslam Karsaz, CEO
3		Global Synergies LLC	Mr. Fawad Khan, CEO
4		Zahid Abid & Co.	Mr. Mujtaba Zahid, Director
5		Sherpak Knitweares	Mr. Azmat Masood, Director
6		Nexus Tex. Sourcing	Mr. Siddiq Hussain, CEO
7		Nizamia Apparel	Mr. Shaffy Hassan
8		Chottani Industries	Mr. Amir Chottani, Owner
9		Aadam Textile	Mr. Usman Bin Khalid, Director
10		Tag Logistics	Mr. Aslam Bashir, Mng Corp.
11	<b>Auto</b>	Pak Orient	Mr. Shuja, Owner
12		Mehran Commercial	Mr. Mashood Khan, CEO
13		Shahid Engg. Works	Mr. Faheem, MD
14		Japanwala Group	Mr. Sohail, CEO
15		Indus Autos	Mr. Asad, CEO
16		SkyHigh Auto	Mr. Shakil Paracha, CEO
17		Logistics for Japanwala	Abdul Kareem Adhia, CEO
18		Tecno Pak Ind	Mr. Kashif Ahmed, Plant Manager
19		Sigma Industries	Mr. Furqan Hussain, Director
20		Fazaz Industries	Mr. Muhammad Farhaj, Operations

## ANNEX 2

Validation Sessions for the baseline findings:

Sr.	Session details	Held on	Participants
1	Lahore Chamber of Commerce and Industries, Lahore, in collaboration with SMEDA and ILO	July 09, 2025	Executive committee, Members from Auto part and textile Sectors
2	SITE Association, Karachi in collaboration with SMEDA and ILO	July 29, 2025	Executive committee, Members from Auto part and textile Sectors
3	ILO office, Karachi	July 30, 2025	Associations of Auto part and textile Sectors, Labor Unions, SESSI, Labor Department etc.
4	TWG Meeting, SMEDA H.O.	August 07, 2025	TWG members

## ANNEX 3

List of Enterprises for the Business cases

Sr.	Company Name	Focal Person	Sector	Region	Unit Size	No. of Employees	Formal Since
1	Mehran Commercial Enterprises	Mr. Mashood Khan, CEO	Auto Parts	Karachi	Medium	50	1995
2	Pak Orient	Mr. Shuja, Owner		Karachi	Medium	70	2016
3	Sky High Industries (Pvt.) Ltd.	Mr. Shakil Paracha, CEO		Karachi	Medium	160	2008
4	National Automotive (Pvt.) Ltd.	Mr. Salman Saleem, CEO		Lahore	Medium	200	1993
5	Bajwa Agro Industries (Pvt.) Ltd.	Mr. Mueenuddin Bajwa, CEO		Lahore	Small	40	1975
6	Sunflower Industries (Pvt.) Ltd.	Mr. Faisal, CEO	Textiles	Karachi	Medium	500	1997
7	Creative Apparels (Pvt.) Ltd.	Mr. Abdul Hameed, CEO		Lahore	Medium	250	2006
8	Ayesha Knitwear (Pvt.) Ltd.	Mr. Naseer Butt, CEO		Lahore	Medium	250	1996
9	Green Land Engineers		Agricultural Implements	Daska			1975



## Baseline Study To Prioritize Incentives and Develop Business Cases for Supply Chain Formalization in Pakistan

The Baseline Study To Prioritize Incentives and Develop Business Cases for Supply Chain Formalization in Pakistan was jointly initiated by the International Labour Organization (ILO) and the Small and Medium Enterprises Development Authority (SMEDA) to examine how informality shapes Pakistan's manufacturing value chains and to identify practical pathways for transitioning enterprises and workers into the formal economy. While small and medium-sized enterprises (SMEs) account for a significant share of industrial output and employment, many continue to operate outside formal regulatory and social protection systems, limiting productivity, job quality, and fiscal contributions.

The study focuses on the textile and automotive sectors - two central pillars of Pakistan's industrial and export economy - while also presenting an exploratory case study of the agricultural implements sector, a largely informal industry with strong potential for technological upgrading and rural employment. Through enterprise-level assessments and documented transition cases, the study identifies key barriers to formalization, including high compliance costs, limited perceived benefits, and uneven enforcement.

Set within the context of Pakistan's GSP+ commitments, emerging EU due diligence and green transition requirements, and national priorities under the Decent Work Country Programme and SME Policy 2021, the study offers evidence-based business cases, incentive mechanisms, and institutional recommendations to support inclusive, competitive, and sustainable supply chain formalization in Pakistan.

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