Business Case: Pak Orient – Formalization Journey

1. 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.

2. 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.

3. 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.

4. Comparative Analysis: Pre vs Post Formalization

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

5. 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.

6. 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

7. 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

8. 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.

9. 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.

10. 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.