SME Sector
Genesis, Challenges and Prospects

Small & Medium Enterprises Development Authority (SMEDA)
Ministry of Industries and Production
Government of Pakistan

Turn Potential into Profit

Small and Medium Enterprises Development Authority
Government of Pakistan
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Preface

SMEs constitute bulk of industrial and economic populace of this country. By that token, they are also the largest employment providers after agriculture. Their significance, therefore, has to be viewed not only from the economic but also from the social angle. There are also no two opinions about the imperative of a sound SME sector to buttress the backbone of our economic structure. That being so, it is a bit strange that SME support initiatives, translating into accrual of genuine benefits on ground, in the history of this country have been just few and far between. This publication attempts to trace the history of SMEs from the archives of public policy and planning, and the long way they have come from just another item on the development agenda of the Government to the main policy imperative over the past six decades. It is hoped that the analysis and recommendations presented in this publication will further help focus our policymakers on SME development as a key priority and provide requisite resources to effectively pursue its implementation.

Shahid Rashid
CEO SMEDA

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Overview

The purpose of this publication is to discuss SME issues and problems, with a view to arrive at a set of recommendations to be pursued over the short to medium term. It contains six chapters in all. Chapter I introduces the concept of SME and its locus standi in our economic setting. It goes on to explore, the way growth of the sector has shaped, amidst the uneven economic history of the country. Interestingly, an uplift plan for Small Scale Industries (SSIs) was made part of the very first Five Year Plan of the country and the theme kept on echoing in subsequent Plans, but the situation on ground remained more or less dormant. Consequently, Pakistan missed the opportunity for fast track economic growth driven by a resurgent SME sector, as demonstrated by some of the East Asian economies. Chapter II fittingly gives a depiction of the current landscape of SME sector, which of course is a result of the policies pursued in the past.

The next Chapter outlines issues and constraints impeding the progress of SMEs in Pakistan, as enumerated in various research and diagnostic studies, supplemented by SMEDA's own insight based on its experience of working with SMEs over the past decade. Three basic deficiencies pointed out here are, constrained access to formal finance and other input resources, the regulatory bind and absence of linkages and the resulting state of disarray in the sector. Chapter IV dilates on the National SME Policy 2007 and the vision of a vibrant SME sector it enshrines, followed by a depiction of other initiatives preceding the SME Policy or running parallel to it. Chapter V tries to size up the situation on the policy horizon with a view to strengthening a coordinated perspective and policy approach towards this diverse development. Chapter VI takes up an analysis of the donors’ contribution and the inventory of output generated through that, followed by a conclusion.

Chapter I

The Story So Far

Small and Medium Enterprise (SME) is a term interpreted in various ways in different countries across the world. In Pakistan, the definition given in the National SME Policy 2007, defines SMEs as businesses with an employment size up to 250, paid up capital of PKR 25 million and an annual turnover of PKR 250 million.

Pakistan's economic landscape presents a mix of rural and urban economies. The rural economy is broadly divided into big land holdings, medium to small enterprises and tenant farmers or peasants. Interestingly, the pattern of ownership in the urban economy, particularly its industrial part, is more or less similar. There are large industries, small to medium and very small or cottage industries. The economics of small enterprises is almost similar to that of tenant farmers; they are dependent on middlemen for working capital and subsequently have to sell their produce through them, as their own direct linkages with the market are negligible. Moreover, there are no strategic assets to act as bulwark against eventualities. While the lack of economic depth limits their choices in the risk- return matrix, absence of social status and recognition excludes them from the corridors of power, privilege and patronage. Access to the resource base of society is constrained and interface with the regulatory world is tenuous.

The overall state of affairs regarding SME businesses has continued more or less unabated through out our checquered economic history. Small wonder, the issues identified for SMEs in the country's first Five Year Plan[1] are as relevant today as sixty years ago.

This chapter explores different phases of evolution of SME phenomenon as a subset of the overall economic and industrial development of the country.

In the Backyard (1947 – 1980)

At the time of independence, Pakistan inherited a thin industrial base. Traditionally, this part of the subcontinent served as a granary besides providing cotton for mills located in industrial areas elsewhere in the subcontinent. Pakistan at that time had industrial assets worth only PKR 580 million (aprox. $112 million)[2]. Despite being confronted with the twofold challenge of dealing with the influx of refugees and repairing a fragmented system of governance, Government of Pakistan laid down its strategy for industrial development at the very outset. It was decided to make public sector investment in areas of defense, hydroelectricity, telephone & telegraph etc. while the private sector would be provided a level playing field for investments in other industrial sectors.

The economic planning process was formalized with the initiation of the First Five Year plan (1955-60). The objectives set out in the First Plan were somewhat modest perhaps underestimating the growth potential of the economy. However, Industrial sector development was assigned high priority, followed by water and power development. The Plan envisaged increase in industrial output by about 60% in major industrial sectors. Besides economic initiatives, the Plan also included various social sector development programmes such as education, housing and health. A

[1] First Five Year Plan (1955-1960), Chapter 23, Planning Commission of Pakistan.
[2] Pakistani Entrepreneurs: Their Development, Characteristics and Attitudes – Altaf Zafar , 1983

resume` of subsequent Five Year Plans, particularly with reference to the actions proposed for Small and Medium Sector Industries makes part of the later part of this chapter.

The first two decades of Pakistan's history saw considerable transformation of economy at the macro level; size of the National Product grew substantially, its structure became more diversified and developed, and the practices and techniques of production became modernized. Inflow of foreign assistance helped finance mounting development outlays. However, this phase of development had its own limitations. The rate of population growth stepped far above historical rates and much of the gain in output was wiped out in the process, with little improvement in overall economic prosperity. During the period, although, concentration of wealth increased, large expansion in the provision of social services proved insufficient to satisfy the needs of the populace. There was a growing disenchantment with the inequitable nature of the growth pattern; an acute impression that the development process had discriminated against poorer regions and income groups.

The 1970s experienced a kind of u-turn in our economic thinking, as large scale nationalization of industries in steel, sugar, textile and cement etc. was undertaken. Later, flour, rice and textile mills were also nationalized. This eroded public confidence in the system. From 1980s onward a system of mixed economy was put in place, encouraging private sector to invest in all business related activities and generate jobs, while the public sector confining itself to the provision of essential services and maintaining a conducive environment for business.

Manufacturing Sector, the Evolving Trajectory

The importance of manufacturing sector in any economy cannot be over stated. A robust and diverse manufacturing sector provides the basis for self sufficiency. Pakistan possessed very few manufacturing establishments at the time of its creation. The value added in large-scale manufacturing accounted for a mere 1.4 percent of GNP. By 1968-69 this ratio had risen to 8.8 percent. The average growth rate of 14 percent achieved in large-scale manufacturing over the two decades was one of the highest in the developing world, albeit over the low base from which Pakistan initially started. Even in the sixties the growth rate, over a substantially enlarged base, was 12 percent per annum.

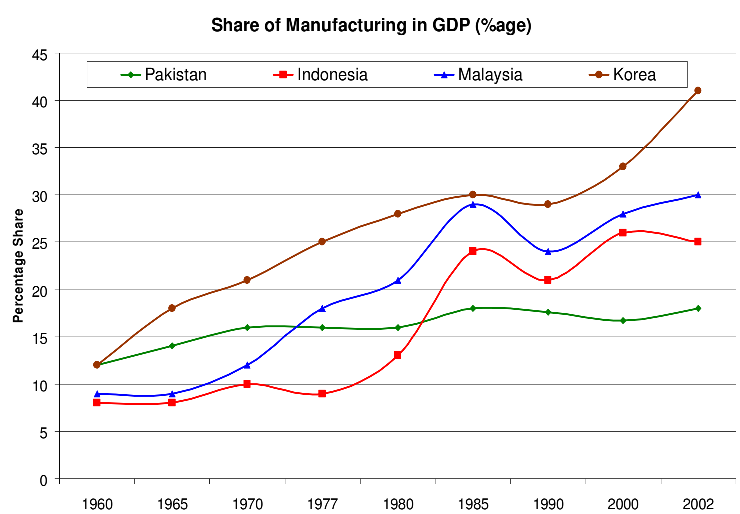
From initial concentration on cotton and jute textile, the industrialization process gradually encompassed sugar, vegetable ghee and cement and later on more sophisticated chemical and engineering industries. By 1970s, Pakistan had substantial capacity in textiles, vegetable ghee, sugar, cement, paper, fertilizers and other chemicals and some progress had been made in engineering industries. The country's dependence on imports of basic consumer goods had diminished and manufacturers had started to contribute substantially to the growth in exports. This sizeable build-up in industrial capacity occurred largely because of the strong incentives provided to the private sector supported with a wide range of promotional activities by the Government. Fiscal concessions were strengthened by a sizeable allocation of foreign exchange resources at subsidized prices to the industrial sector, which also gained through beneficial terms of trade vis-à-vis the agriculture sector and a gradual decline in real wage. The results achieved were impressive but excessive protection and extra liberal concessions also led to the establishment of many inefficient industries and neglect of productivity in general. Cost consciousness did not develop and labour productivity rose only marginally over the years and was amongst the lowest in the world. While import substitution occurred in consumer goods, there was little headway in production of capital goods. The country had yet to develop managerial and technical personnel necessary to conduct industrial operations in a modern scientific manner. While a great deal was accomplished in building up an industrial sector from scratch, the more complex and challenging tasks of creating a balanced, efficient and modern industrial sector still lay ahead.

A comparison of share of manufacturing in GDP of Pakistan with some of the developing and developed countries shows that Pakistan was unable to increase its share of manufacturing to GDP as much as other economies.

Table 1.2

	1960	1965	1970	1977	1980	1985	1990	2000	2002
Selected Asian Countries									
Pakistan	12	14	16	16	16	18	17.6	16.7	18
Indonesia	8	8	10	9	13	24	21	26	25.1
Malaysia	9	9	12	18	21	29	24	28	30
Korea	12	18	21	25	28	30	29	33	41
Developed Countries									
Sweden	27	28	-	24	-	-	-	26	28.2
Germany	40	-	38	38		-	26	28	29.6
UK	32	30	33	25	-	-		25	26.4
Japan	33	32	36	33	29	-	28	24	32.3

Graph 1.2



Source: The World Bank - World Development Reports

As evident from the graph above, the share of manufacturing to GDP over the years did increase, yet the increase was not as substantial as witnessed by other developing Asian economies. In the 1970s, wide spread nationalization of industrial units and banks took place while large areas of investment were reserved exclusively for the public sector. However, during 1978-83[3] a marginal shift occurred in the public-private sector relationship. Partial denationalization and the demarcation of areas for private sector investment were carried out in this period. In 1983-88, the Government[4] adopted a laissez-fair philosophy, limiting the role of the State as a facilitator of private initiative and as an investor of last resort. The central theme of the Sixth Five Year Plan (1983-88) was deregulation and privatization. The objectives of the private sector investment programme were to increase the share of private investment in total investment and within this-share, to shift the emphasis, from secondary & tertiary sectors, to main productive sectors of agriculture and industry. In addition, the objective was to diversify investment towards capital goods production and to ensure balanced regional development.

Despite an impressive overall rate of expansion, industrial investment during the 1983-88 did not follow the priorities stipulated by the Government, nor the subsequent Industrial Policy statement[5]. New investment had mostly gone into import substitution and consumer goods industries that enjoyed high protection, required less capital investment and yielded high margins of profit. The development of export-oriented and basic engineering industries was less than adequate. Nor did industrial investment move towards the less industrialized regions. However, the liberal environment of the eighties brought about a sharp increase in aggregate private investment particularly in the large-scale manufacturing sector.

As evident from the narration given above, the story of Pakistan's industrial development is a tale of missed opportunities, unfulfilled expectations,

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[3] Fifth Five Year Plan (1978-1983), Planning Commission of Pakistan
[4] Sixth Five Year Plan (1983-88), Planning Commission of Pakistan
[5] ibid

half baked initiatives, policy u-turns and misgivings, hatched in an overall environment of mistrust between public and private sectors.

Through the Side Alley (1980-98)

As mentioned earlier, faced with the challenge of developing an industrial base almost from scratch, development planners in this country, focused on developing large industry. The trend continued for almost four to five decades, notwithstanding intermittent efforts and piecemeal incentives for small businesses.

Interestingly, a programme for development and uplift for Small Scale enterprises did figure up in the very first Five Year Plan, this country developed. For this purpose, the term "Small Scale Industry" included any manufacturing enterprise which either used no power, or employed less than 20 persons and was thus not subject to registration under the Factories Act 1934. This definition included "village industry", whether producing for local consumption or for wider markets, and "cottage industry", which was carried on in homes, usually with the help of members of the family. Highlighting the handicaps of small scale industry i.e. weakness in marketing; shortage of raw materials, spares and equipment; credit difficulties, lack of standardization, and deficiencies in production facilities, the Government proposed to facilitate their growth and development by way of providing a facilitative environment. Provisions were also made for research & development, credit, promotion, education & common facilities. Implementation, however, fell far short of goals, and the major problems of small industries remained unsolved due to, among other things, lack of concerted effort to tackle them.

The second Five Year Plan, building upon the objectives set forth earlier, also emphasized upon small industries development. Government investment was earmarked for setting up of small industrial estates, common facility centres, and technical and management services centres. The governing principles[6] for the development of small industries were to:

i. adapt small industries to changing technological, economic and social conditions
ii. stimulate production of implements and equipment required for agriculture
iii. encourage processing of indigenous raw materials
iv. create additional employment opportunities
v. modernize existing units having sound economic prospects
vi. promote speed of modernization by encouraging growth of small industries in rural areas generally, and in particular wherever resources and markets are available
vii. bring about a closer relationship between the small and larger industries
viii. preserve and promote traditional arts and crafts

The Central Government had a pivotal role to play in development of small industries in terms of determining national policies, coordination of activities and fixing priorities of development, seeking foreign assistance, conducting research, arranging training programmes and for dissemination of information. Provincial Small Industries Corporation were established to address the needs of small industries by way of undertaking on ground interventions. Their activities also included technical and management services and commercial services.

[6] Second Five Year Plan (1960 – 1965), Planning Commission of Pakistan

Following the second Five Year Plan, emphasis on development of Small Scale Enterprises became a recurring theme in the subsequent Plans. However, the efforts launched in this direction did not prove effective enough to lift the trajectory of Small Scale Industries. The strategy of developing Small Industrial Estates did not yield expected results because of its overt reliance on providing tax incentives without developing ancillary infrastructure facilities for small businesses. Also, it was confined to the manufacturing sector alone. Lack of political will resulted in inconsistency in implementation of programmes/projects and weak coordination between various implementing agencies slowed down the pace of reforms in this important sector of the economy. In short, Pakistan did not capitalize on the potential of the SME sector in order to generate employment for its growing populace and tackling the problem of poverty.

Realization of the need for a different economic paradigm and development strategy befitting the conditions of Small and Medium Enterprises came only gradually. Over the years, the basic difference between the economics of Large Enterprises (LEs) and Small Enterprises (SEs) came to fore. It was realized that LEs though small in number, benefited from economies of scale while SEs heavily relied upon their ability to adapt to changing business environment, providing employment opportunities across regions, in the process. However, in order to develop this initial surmise into a conviction at policy level there was a need of credible data and statistics. Lack of statistical data, especially because of different definitions of SME, has inhibited understanding of dynamics of the SME sector since long. Dovetailing a system of data gathering, stratified to yield segregated statistics on LEs and SEs, has therefore remained a daunting task all along being grappled with even today. In the absence of an agreed framework for collection & collation of data, one is left to explore secondary sources of information and rely on one's better judgment, based upon direct interaction with SMEs and certain agreed parameters.

Opposed to this, during post world war II period, economies of the Asian region leveraged the potential of their SMEs for pursuing fast track industrial growth. Economic and industrial development of countries like Japan, Korea and Malaysia is attributed to their dynamic SME sectors. The process of SME development gained strength in these countries from formulation of legal frameworks and enactment of laws facilitating SME growth & development. As part of measures for SME development and to prevent economic centralization, small and medium enterprise agencies and departments were established for focused and well coordinated pursuit of SME development.

Towards the Front (1998—onwards)

By 1990s it had become evident that success of the newly developed economies of Asia was attributable, to a large part, to the resilience of their Small & Medium Enterprises. Pakistan too, following international development trends realized that sustained economic growth was possible only through strengthening the bulk of economic establishments in the economy, i.e. small & medium sized enterprises. The need to establish institutional support structures for their development was therefore eminent. Small & Medium Enterprise Development Authority (SMEDA); created in 1998 was an offspring of this need. SMEDA had a broad and multi-pronged mandate. Institutionally organized as the model of a corporate entity, it drew its strength from the apex authority in the public sector. This unique feature of the Institution gave it enough muscle to leverage resources of both public & private sectors towards the betterment of SMEs. A multi-pronged strategy was adopted to address diverse issues of SMEs that included;

- the creation of a conducive and enabling regulatory environment
- development of sectors & industrial clusters
- provision of Business Development Services to SMEs in all areas of business management
- direct interventions through Common Facility Centres & Demonstration Projects[7]

Adhering to a clear mandate and a logical path to achieve quantitatively verifiable targets, SMEDA carried out comprehensive analyses of international trends, national policies and other macro-economic factors affecting SMEs in Pakistan, to initiate steps towards creating a favorable business environment for its key clients – SMEs. At the same time, direct interaction with SMEs in industrial sectors such as Marble & Granite, Gems & Jewellery, Furniture, Surgical, Fisheries, Textiles, Leather, Light Engineering and others led to identification of their problems and development of all encompassing strategies for implementation.

At the policy level, problems related to Governmental, policy/regulation were taken up with concerned authorities for resolution or smoothening. Side by side, SMEDA provided support to SMEs by creating networks and match-making opportunities amongst concerned stakeholders or by directly initiating development projects in clusters.

More recently, SMEDA has realigned its focus towards sector development. In this case, priority sectors are identified for developing

[7] List of Projects annexed

comprehensive sector development strategies in light of international best practices. Projects are implemented through dedicated sector development companies, established on a basis of public-private partnership. Alongside, SMEDA is also building projects to serve as Common Facility Centres and Demonstration projects in order to catalyze adoption of state of the art technologies by SMEs besides providing vital marketing links by establishing display centers and other such facilities.

Chapter II

Developing a View

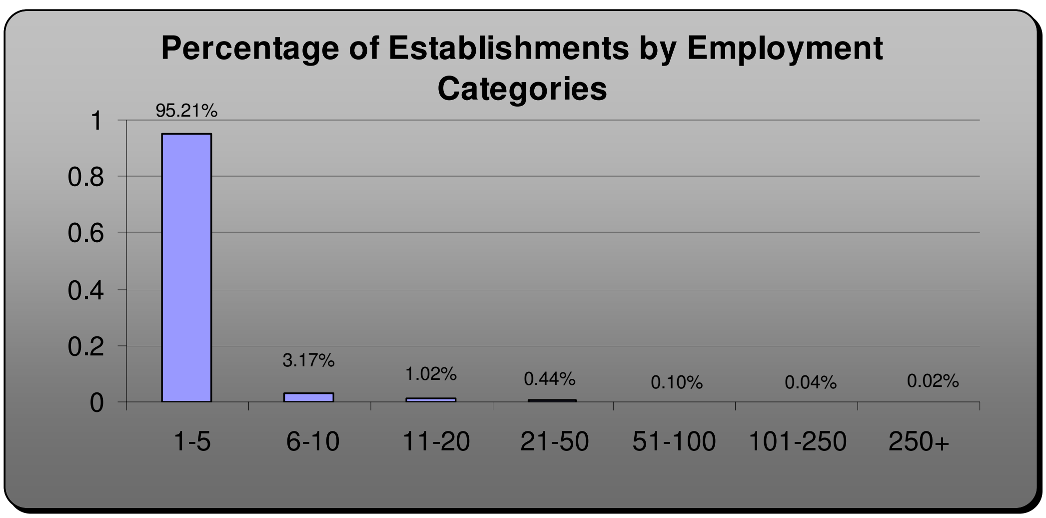
"A new perspective for Small Scale Industry (SSI) development that ostensibly seeks to remove 'the official fetters' under which it has been operating until now is also to facilitate its ascendancy to the level of medium enterprises is the introduction of the composite concept SME. Putting small enterprises in the company of their medium counterparts under the new SME dispensation is an innovation which is still evolving and has yet to acquire final official authentification. More importantly its workability and positive outcome will get established after it has worked for some years". The above excerpt from Indian economist G.K. Chadha is significant in more than one ways. First, it attributes the origin of SME as a term or nomenclature to the pursuit of a "perspective" and second it goes on to trace the motive or objective behind this new perspective, which is to stimulate and urge small enterprises to think of growing into medium. This objective could be served well, by coining a definition which proximates Small with the Medium unfettering their imagination from the self limiting vision of smallness and enticing them to step into the footprints of their medium counterparts. Thus the definition of SME has a positive rather than just a normative tone. It is not a definition *per se* but a proposition. There has to be a movement from small to medium in a sector, in order to qualify for the term SME. How has it worked out in the case of a country like Pakistan? Has there been a trend for graduation from Small to Medium or the two are completely disparate. This question needs to be analyzed in the context of the physiognomy of the SME sector as depicted by the Economic Census 2005, conducted by the Federal Bureau of Statistics. The Census presents information on the

Economic Establishments in the country on regional and sectoral basis against different parameters upto tertiary level. The census document itself doesn't make a distinction between Small, Medium or Large, however, a picture of the SME sector has been developed by congregating the prevailing SME definition on the Census data. The information presented below portrays the SMEs in terms of employment size, regional and sectoral distribution, mode of incorporation, volume of turnover and asset size etc.

i. Structure

The Census of Establishments 2005[8] provides the basis for statistical analysis of the sector.

Graph 2.1[9]



Source: Economic Census 2005, Federal Bureau of Statistics

As shown in graph-1, as many as 95.21% economic establishments have an employment size of 1-5, which is the lowest rung of the SME ladder, usually termed as Micro or Cottage Industry, though there is no official definition of these two terms in our country. Taking into account rest of the distribution categories, hardly one percent economic establishments fall beyond the 250 employee size, meaning thereby that 99% of the

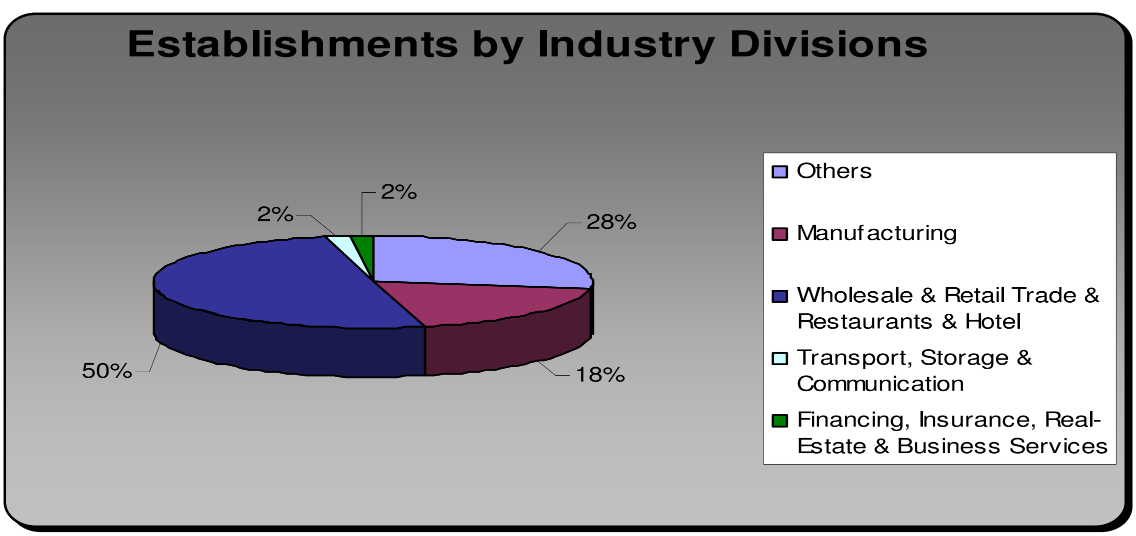
[8] Census of Economic Establishments 2005, Federal Bureau of Statistics
[9] Does not include establishments for which employment data is not available

businesses in this country are SMEs. Due to their sheer numbers, size and nature of operations, this segment of the economy promotes endogenous sources of growth and strengthens the infrastructure for accelerated economic expansion and development.

ii. Sectoral Distribution

The nature of economic activity organized in the shape of different sectors largely determines the character of the SME sector and the economy at large. As the following graph shows, 50% of economic activity is concentrated in wholesale, retail trade, hotels and restaurants sector. While large hotels are but few and far between in number, smaller street side hotels and restaurants provide employment to a large number of work force. The category 'Others' include all establishments in i) Agriculture, Live stock & Hunting, ii) Mining & Quarrying, iii) Electricity, Gas & Water, iv) Construction, v) Community, Social & Personal Services, and vi) Other establishments and accounts for 28% of total establishments. Manufacturing accounts for 18% of total establishments followed by Transport, Communication, Financial and Real Estate and Business Services.

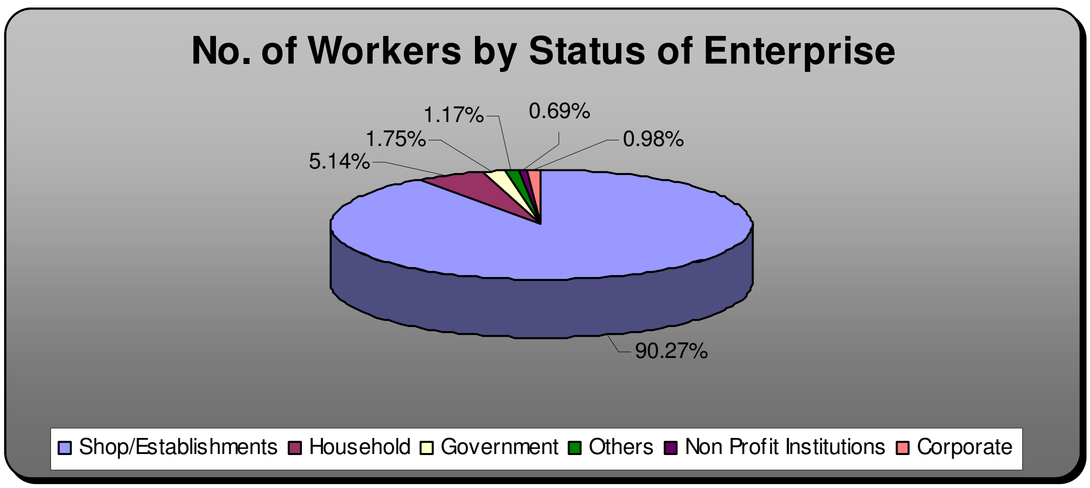
Graph 2.2



Source: Economic Census 2005, Federal Bureau of Statistics

As the retail businesses, hotels and restaurants account for a major part of economic establishments so they do in terms of size of employment of work force. Graph 2.3 shows the share of employment provided by different sectors of economy. The Workforce employed across the 2.89 Million[10] economic establishments is approx 6.5 million out of which 5.9 million are employed in the shops/establishments industry.

Graph 2.3



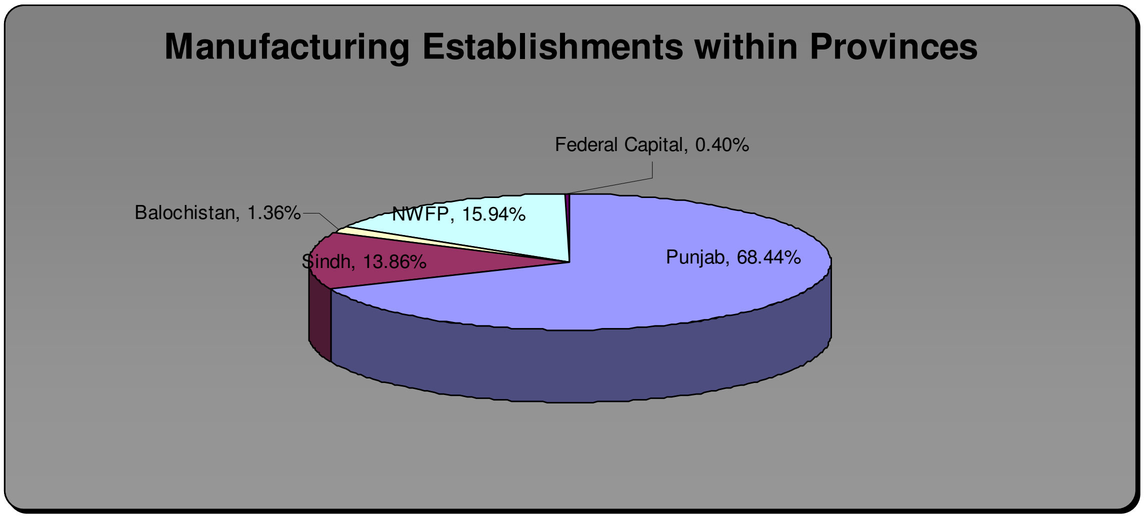
Source: Economic Census 2005, Federal Bureau of Statistics

A look at the manufacturing sector brings forth interesting facts. At sub-sectoral level, out of a total of 583,329 manufacturing establishments, manufacturing of textile wearing apparel and leather industries account for 252,111 economic establishments (43.22%), followed by manufacturing of food, beverages and tobacco at 121,875 establishments (20.09%). Interestingly, the number of establishments in the manufacturing of fabricated metal products, machinery and equipment are 58,476 and basic metal industries are 4,511. Hence the ratio between the primary metal industries and their counterparts in the value added manufacturing is almost 1:15, indicating a lopsided industrial structure. Given below is the

[10] Establishments that provided complete information in the Census of Economic Establishments 2005, conducted by the Federal Bureau of Statistics

sub-sectoral provincial distribution of manufacturing establishments. It is interesting to note that despite Sindh housing 17.82 percent of all economic establishments, NWFP has a greater number of economic establishments in the manufacturing sector i.e. 15.93 percent.

Graph 2.4

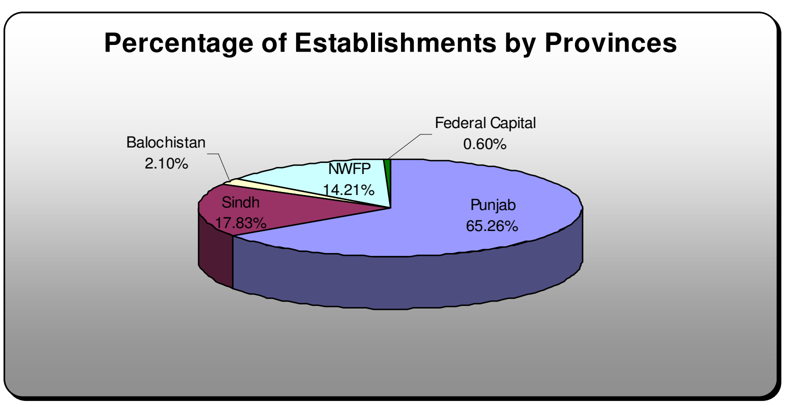


Source: Economic Census 2005, Federal Bureau of Statistics

iii. Regional Distribution

Studying the demography of businesses, Punjab has 65.27% economic establishments followed by Sindh 17.83%, NWFP 14.21% and Balochistan 2.10%.

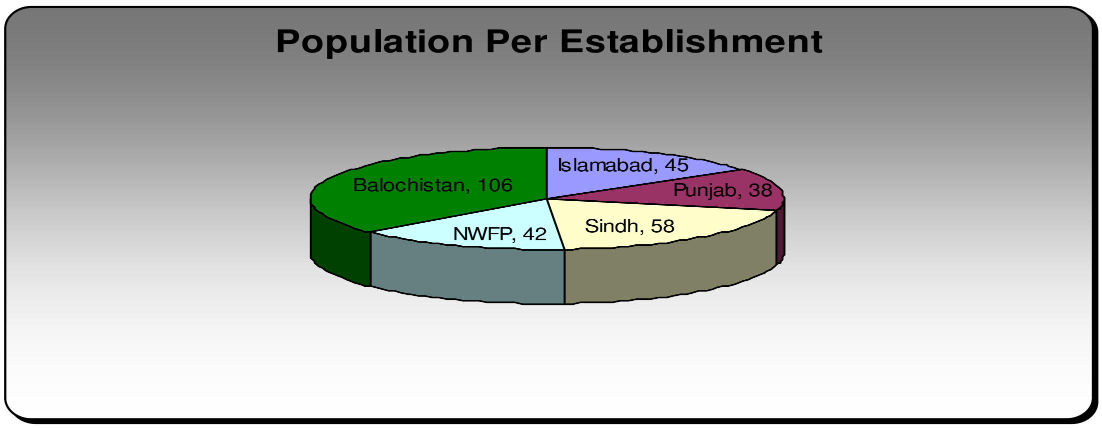
Graph 2.5



Source: Economic Census 2005, Federal Bureau of Statistics

The ratio of population per economic establishment presents an interesting view. As shown in Graph 2.6 there are 38 people per establishment in Punjab, 58 in Sindh, 42 in NWFP and 106 in Balochistan. Hence NWFP has a better population to SME density ratio compared to Sindh.

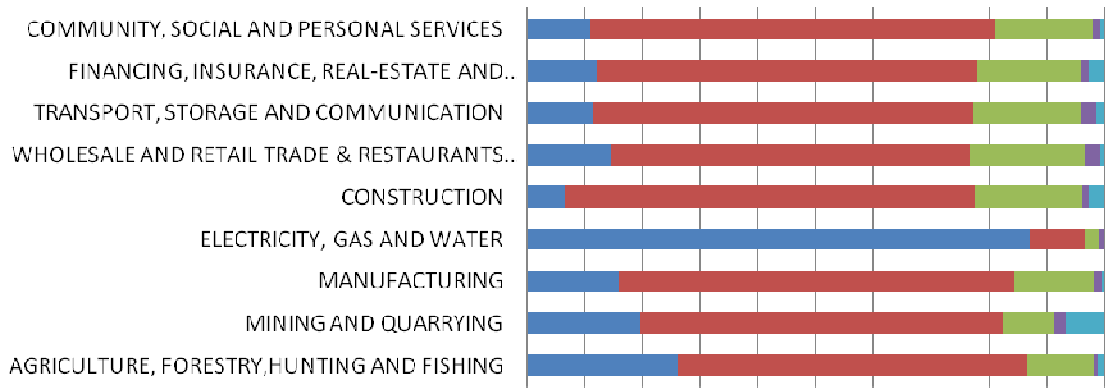
Graph 2.6



Source: Economic Census 2005, Federal Bureau of Statistics

Following graph shows the relative distribution of various categories of Economic Establishments provinces and the federal capital. Sindh slightly lags behind NWFP in terms of Manufacturing, while in case of Construction the case is vice versa with Sindh way ahead of NWFP. Punjab of course has almost the lion's share in all the activities except of course Electricity, Gas and Water where NWFP has as much as 87% share.

Graph 2.7

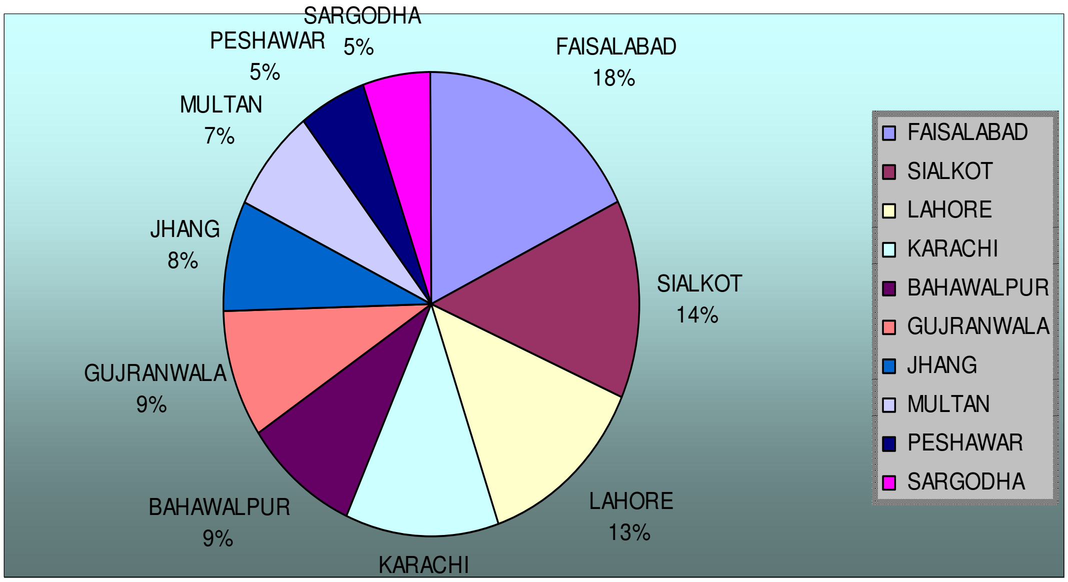


	AGRICULTURE, FORESTRY,HUNTING AND FISHING	MINING AND QUARRYING	MANUFACTURING	ELECTRICITY, GAS AND WATER	CONSTRUCTION	WHOLESALE AND RETAIL TRADE & RESTAURANTS AND HOTELS	TRANSPORT, STORAGE AND COMMUNICATION	FINANCING, INSURANCE, REAL-ESTATE AND BUSINESS SERVICES	COMMUNITY, SOCIAL AND PERSONAL SERVICES
NWFP	26.12%	19.83%	15.94%	87.10%	6.74%	14.59%	11.54%	12.33%	11.28%
Punjab	60.65%	62.59%	68.45%	9.68%	70.99%	62.23%	65.90%	65.81%	69.92%
Sindh	11.57%	9.00%	13.86%	2.42%	18.58%	19.88%	18.75%	18.03%	16.82%
Balochistan	0.66%	2.11%	1.36%	0.81%	1.06%	2.73%	2.61%	1.21%	1.36%
Federal Capital	1.00%	6.47%	0.39%	0.00%	2.62%	0.57%	1.20%	2.62%	0.62%

Source: Economic Census 2005, Federal Bureau of Statistics

Graph 2.8 is a depiction of top ten manufacturing districts of Pakistan with Faisalabad topping the list with 18% share followed by Sialkot 14%, Lahore 13%, Karachi 12% and other districts in single digit figures. The analysis however is based on the number of SMEs in each districts rather than the sale or production volume etc.

Graph 2.8

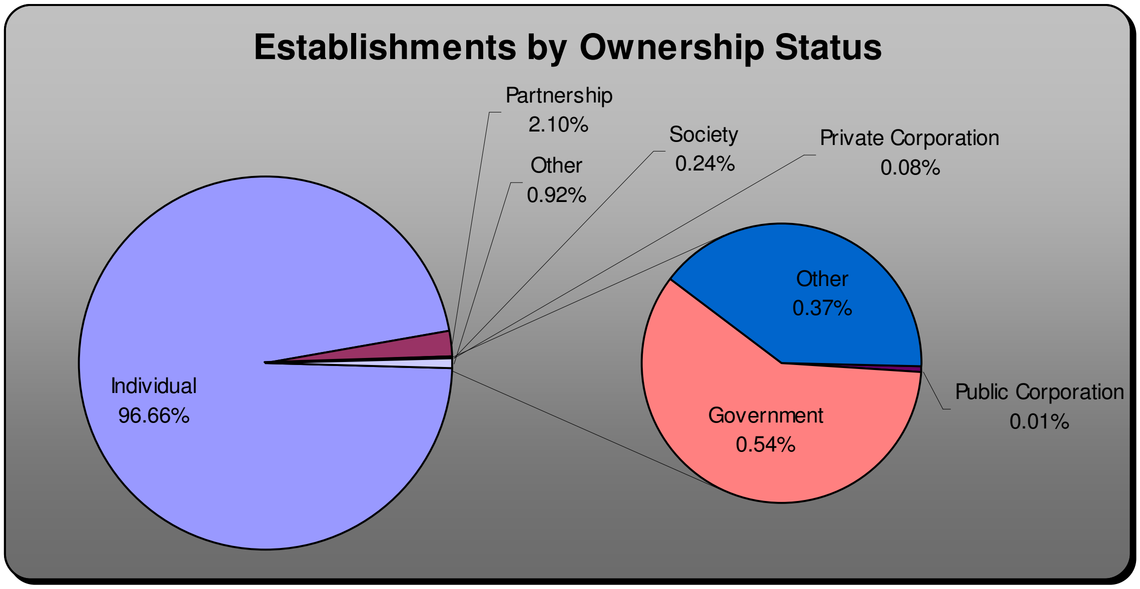


Source: Economic Census 2005, Federal Bureau of Statistics

iv. Mode of Business and the Pre-dominance of Informality among SMEs

Corporate status and mode of business determines in many ways the approach, mindset, style and strategies of that business. In Pakistan, around 96.66% of economic establishments fall in the category of sole proprietorships while only 2.10% are partnerships and 0.08% private corporations. This again alludes to the fact that while there is an entrepreneurial consciousness in the country, its manifestation so far has been mostly in the form of subsistence businesses. Hence there is a need to exploit the untapped potential in order to promote greater entrepreneurship among educated youth.

Graph 2.9



Source: Economic Census 2005, Federal Bureau of Statistics

Concentration of bulk of SMEs in the owner managed category is also indicative of the extent of informality in the economy. Given the self limiting constraints of the informal sector, one can easily fathom why our industrial sector has lagged behind compared to other developing countries over the years. Encouraging documentation through voluntary/incentivised schemes needs to be considered seriously by the policy makers, so as to encourage graduation of SMEs from informal to formal.

Sizing up the Sector

The picture evident through statistics above gels well with the philosophy discussed in the earlier part of this chapter. SMEs need to be supported as a "proposition" towards attaining a "perspective" of graduating to a higher level needs to be driven home and supported through appropriate interventions

The predominant impression coming forth through statistics is about the overtly informal nature of the sector signifying the “survivalist/subsistence” aspect of entrepreneurship, concentrated mostly in the retail business, followed by small scale manufacturing, run under sole proprietorship mode of business, scattered in urban and peri-urban areas. An inference that comes across strongly is that strategies for economic development must be targeted towards catalyzing growth of these establishments, providing the necessary support structures for their transformation from micro to small & subsequently medium sized businesses.

This would not only provide the necessary impetus for growth of the economy, but also generate greater employment opportunities for an ever growing population

Chapter III

Blind Spots

Issues and ills besetting SMEs are numerous. However, their intensity varies from sector to sector and across regions. Some of the sectors have evolved over the years with more integrated value chains, better technology, trained human resource and a long term vision. Automobile sector is a case in point. Others are still struggling to dig in their heels in the corporate soil. Regional disparities also reflect in the character of SMEs in a particular area. Availability of skilled labour, proximity to sources of raw materials and markets, exposure to modern methods of business, higher level of awareness and the general cosmopolitan culture of big cities imbues SMEs with a progressive outlook compared to businesses operating in remote regions. Even so, the fundamental factors, hindering growth of small and medium businesses are, more or less common across sectors and regions. What follows is an overview of issues and constraints hindering SMEs progress.

I. Access to Finance

SMEs operate on a narrow capital base. Those who have the urge to expand in terms of assets or sales turnover or aspire to augment quality, have limited options for financing e.g. retained profits and borrowing from informal sources i.e. friends/relatives etc. SMEs' access to formal credit, from commercial banks and leasing companies over the years, has been insignificant. In 2006, out of the total credit off take of Rs. 2400.8 billion for private sector, SMEs' share was Rs. 408.3 billion or just 17% of the total amount. Following table gives the trend of credit disbursement to SMEs in the past few years:

Year	Amount (Rs. Billion)	Percentage
2004	284.0	17.5
2005	361.4	17.7
2006	408.3	17.0
2007	437.4	16.2

Source: State Bank of Pakistan

As evident from above, SMEs' share has been hovering around a meager 16-17% with a declining trend in the recent years. This is despite prodding from the State Bank through liberal provisions in prudential regulations and general persuasion with the banking sector to expand services to SMEs. This situation has resulted in slow growth in Gross Fixed Capital Formation, low scores on Total Factor Productivity and weak performance on the competitiveness front in the SME sector. Interestingly, the share of agriculture credit in the total credit off take in the same period has risen from 18 to 20%.

Analysis of the situation shows that there are issues on both the demand and supply sides. Imagine the mindset of a small vendor operating in rented premises, somewhere downtown, with a couple of machines, needing immediate replacement. He neither has collateral, credit history, nor even a certified set of financial statements to produce before a bank[11]. The usual inhibition felt by a semi literate person in approaching a bank and the documentation involved, is a further dampener. Coming to the supply side, notwithstanding usual rhetoric about desirability of lending to SME sector, inwardly very few credit managers, till date, feel comfortable dealing with small & medium businesses. SMEs, to them, are difficult customers shrouded in informality. One could lose touch with them anytime during the credit repayment trail, with no further clue where

[11] 77% of respondents mentioned lack of financial resources as the main obstacle to their business – SMEDA SME Baseline Survey Results.

to locate them. Bridging this mismatch of mindsets is the first step towards increasing credit flows to the sector[12]. It is a formidable challenge; none has been able to meet adequately so far.

Reviewing the essence of discussions on the subject embodied in various research studies one can identify a few key factors responsible for the situation:

a. Excessive reliance on collateral as a security & unaffordable rates of interest
b. Absence of suitable banking products aligned to SME needs
c. Lack of awareness among SMEs and inadequacy of documentation
d. Absence of Credit Enhancement Mechanisms and other alternatives

a. The Collateral Issue

Perhaps the single most important hindrance is the collateral issue that comes to fore while analyzing SMEs access to finance[13]. In the absence of documentation, collateral becomes the mainstay of lender's confidence. There are no intermediation mechanisms for risk mitigation either. Neither is there a credit rating agency for SMEs nor a dedicated Credit Information Bureau or any credit guarantee or insurance mechanisms to underwrite a loan. One form of collateral is a personal guarantee. Such being the case, collateral is unanimously stressed as the sole anchor of banker's confidence.

[12] Only 14% of all SMEs approach Banks for credit. Reasons quoted by the rest include high interest rate 36%, difficult application procedure 11%, lack of collateral 7% etc.

[13] 25% of all refusals of loans to SMEs by banks were on the basis of lack of collateral – SMEDA SME Baseline Survey

In their study, *SME Development in Pakistan: Analyzing the Constraints to Growth, Bari, Cheema, Haq 2005, Asian Development Bank,* highlights the problem as follows:

"*A number of respondent SMEs said that they were required to provide fixed property as collateral because banks refused to accept moveable and immoveable assets other than land as collateral. In their case, the SMEs withdrew from the formal sector credit market altogether. Other applicants were forced to spend a lot of time negotiating with banks and following up the process. In some cases, even after providing the necessary collateral, feasibility studies, and financial statements, the process of loan approval took well over six months---*'.

The Study was conducted in 2005. Since then, things have changed to an extent, but there are still large gaps[14] . Here it may not be impertinent to mention World Banks' Doing Business 2008 Report, which rates Pakistan 4th on an ascending scale of 1-10 on the Strength of Legal Rights Index. Higher the index for a country, better are its collateral and bankruptcy laws, designed to expand access to credit as a benchmark.

The collateral issue has psychological dimensions as well. Usually fixed assets at the disposal of an SME are residential houses etc. Mortgaging them, with a bank and living under the constant threat of being thrown on the street in case of a bankruptcy, is a spectacle a small entrepreneur dreads. It makes him desperate in business decisions and strips him of whatever little potential for innovation and risk taking could be there. Secondly in addition to the primary collateral, there is a tendency on part of banks to demand additional securities including liquid assets as a

[14] *Why are Pakistan's SMEs Bank-Shy, NPO 2005*

further guarantee against default. Intangible assets like ISO certification, licenses, brand names etc. are not entertained as collaterals, which particularly hurts the service sector. After repayment of loan, release of collateral also involves cumbersome procedures and repeated visits to the bank.

b. *Absence of suitable banking products aligned to SME needs*

SMEs generally complain of the incompatibility of financial products offered by Banks and Leasing companies. This is, however, perhaps a subtly guised protest on the absence of concessionary credit flows for them. Banking instruments designed on the eternal principle of balancing the risk-return equation, carrying market based interest rates on floating or fixed terms and other compelling provisions to secure credit, of course do not bemuse SMEs too much. There are few products designed to suit needs of a particular sector, nor do cluster based and programme lending schemes have much appeal with the banking industry. Loans for new start-ups and Islamic financing instruments are almost unavailable. Categorization of loans as SME credit by commercial banks is also less nuanced. Mostly, all loans falling in the no man's land between corporate loans (above Rs. 300 million) and consumer financing are termed as SME credit. Sectoral analysis of the credit disbursement over the past few years further indicates skewed pattern of distribution. The sectors getting lion's share are textiles, communication, transport etc. while other SME sectors with huge growth potential and export capacity do not get a significant slice of the cake[15].

c. *Lack of Awareness and Access for SMEs*

[15] ibid

Though World Bank Doing Business 2008 Report accredits Pakistan 4 points on Depth of Credit Information Index at a scale of 0-6, reflecting relatively easy availability of credit, information, to an extent lack of awareness, is also a factor hindering their access to credit. Credit instruments launched by banks remain concealed for ordinary SMEs, particularly the smaller segment because of the general gulf between the two, in terms of communication. Pre-occupied with their day to day existence, SMEs seldom get time to obtain and study marketing materials and product brochures produced by banks. Moreover, there is a greater concentration of banking operations in big business centers like Lahore, Karachi, Islamabad, and Faisalabad than in the areas of SME concentration such as Gujranwala, Sialkot and Gujrat. The location wise split of credit off take also shows a bias towards big locations[16]. This combined with the general inhibition SMEs feel towards banks explain hindered access, due to less proximity.

d. ***Absence of Credit Enhancement Mechanisms and other Alternatives***

World-over, countries have developed alternative models to boost the fortunes of their SMEs through enhanced access to credit resources. There are risk mitigating mechanisms like dedicated agencies for SME credit rating, credit information bureaus, credit registries, credit insurance and credit guarantee schemes etc. Some of them aim at increasing transparency and bringing objectivity in the assessment criteria for loaning, others involve intermediary institutions to share the risk. Countries like Japan, Malaysia and Thailand have been using these mechanisms gainfully to lift and sustain their SMEs.

[16] Out of the total SMEs who never applied for a bank loan, 3% mentioned banks' location too far as reason for not applying – *SMEDA SME Baseline Survey*

In a nutshell, SMEs get a very small share of credit available for the private sector and that too at market rates which are prohibitive these days[17]. Obtaining finance at a high cost necessitates earning higher profit margins to cover the interest cost, which inevitably increases product prices, making SME products less competitive. The situation is further exacerbated when we take into account SMEs' lack of access to equity markets and weak 'trust' networks[18]. Past experiences have also made "directional lending" an anathema for the banking industry. Hence, there have been no special concessional windows available for small investors. Small Industries Corporation do however extend credit for medium to long term investments in fixed assets, the proportion of which is very small when compared with the size and needs of the SME sector. Dedicated Banks like First Women Bank and SME Bank etc. have also come up with specific products for their target segments, only at market rates and tied with security requirements in the form of collateral and/or personal guarantees.

In recent years, Government of Pakistan constituted two donor supported funds namely Business Support Fund and Competitiveness Support Fund. Former gives matching grants for soft initiatives like, HR development, standardization, market linkages etc. and the latter offers partial grants for initiatives to increase competitiveness. Both are pilot initiatives with limited coverage. In the past, SMEDA designed a few Programme Lending Schemes in collaboration with Banks for Power Loom, Auto and Trucking sectors, which met reasonable success. All such initiatives have their merits but compared to the size of the sector they are just symbolic.

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[17] 36% of all SMEs who never applied for a loan mentioned high interest rate as a reason for not applying – *SMEDA SME Baseline Survey*.
[18] Bari, Cheema, Haq Op.cit.

II. The Regulatory Bind

Government of Pakistan embarked upon a programme of deregulating and liberalization of the economy in the 1990s. Reforms aimed at reducing Government's interference in business were introduced in phases in the fiscal realm as well as in labour laws etc. The result of course, has been alleviation in regulatory burden to an extent. Businesses feel at a relative ease and are relieved to an extent from the constant and intrusive glare of numerous overseeing agencies. In the process, some of the factors causing hindrance in business through imposition of undue compliance requirements resulting in excessive paper work and interface with government agencies have abated. However, it is too early to assume that all hassles in the way of business have been removed. Following is a brief description of problems in this regard.

a. Taxation

There have been reforms in tax administration to encourage documentation and expand tax base besides redressing imbalances between direct and indirect taxes etc. Introduction of self assessment scheme, flat rate of taxation in the form of turn-over tax on small businesses, establishment of large & medium tax payer units, lowering of tariff barriers, reduction in the number of various taxes, computerization, fiscal incentives for small companies and for exporting businesses etc. are all steps in the right direction.

Apart from exemption from the requirement of Sales Tax registration for businesses with a turn over below Rs. 5 million, there is no special consideration for SMEs in the Sales Tax regime. Current rate of sales tax @16% is perceived as high by small and medium enterprises. There is a multiplicity of District Provincial and Federal levies entailing unwarranted exposure to tax administration. Concessional Income Tax regime for small companies with a sales turn over of less than Rs. 500 million and paid up capital of Rs. 25 million, hasn't been able to lure a significant number of SMEs towards registration, because the resulting obligations for documentation and reporting outweigh the benefits like easy access to bank credit etc. in the absence of a firm tradition of upholding the sanctity of the principle of limited liability[19]. In addition to these specific problems, often regulatory measures aimed at improving transparency and tax collection assume punitive dimensions for SMEs because of the peculiar governance culture in our society. Following are a few examples:

- According to Sales Tax Act, 1990, local supplies of manufacturers having annual turnover up to Rs. 5 million are exempt from Sales Tax. In other words they are not required to register with the Sales Tax Department. But the Government still charges Sales Tax on their Electricity Bills which can not be reclaimed or adjusted, resulting in increase in their cost of production. There are other examples, where apparently well meaning steps contain veiled consequences for SMEs. Following are a few:
    - Businesses with working capital up to PKR 500,000 are currently obliged to file an affidavit with the Income Tax Return that they are maintaining books of accounts like cash book, ledger, and sales and purchase vouchers. Bulk of small retailers fall in this category and the requirement of filing an affidavit is not only an added hassle for them but also exposes them to black mail by tax officials
    - Section 76 of Income Tax Ordinance binds businesses to make payments beyond PKR 10,000/- through cross cheque.

[19] Usama, Simplification and Promotion of Laws and Procedures for Corporatization of SMEs, 2005

This provision is applicable to purchases as well. Small retailers and manufacturing vendors buying inputs from miscellaneous sources cannot fulfill this requirement. This makes them liable to additional Income Tax because tax officials treat only those purchases as valid which are made through cross cheques.

- A small vendor /retailer selling to a limited company has to pay 3.5% Withholding Income Tax. At the same time he becomes liable for registration for Sales Tax, as he is now treated as a wholesaler. Resultantly, small suppliers are reluctant to sell to limited companies which hinder formation of linkages between SEs and MEs.

As evident from the above examples, at times measures introduced to promote documentation and transparency result in unintended ominous consequences for SMEs. Following excerpt from Bari et al paraphrases the same point:

"*the problems of dealing with government regulations and tax authorities weigh more heavily on small rather than large firms. This is because SMEs face higher compliance costs and because of the fixed-cost entailed in complying with government regulations. Import/export regulations, tax regulations, labour-market regulations, licensing and price controls are argued to be the main areas of constraints hampering SME growth*".

Federal Board of Revenue (FBR) authorities, however, have a different story to tell. In a presentation on "Management of Tax Debt Collection" in ITD Global Conference on October 19th 2007, made by Chairman FBR, it has been highlighted that businesses with less than Rs. 5 million turnover though comprising 68% of the total businesses in Pakistan contribute just

9% in terms of sales tax and 18% in Income Tax *(According to SME Baseline Survey findings, 25% SMEs mentioned that typically only 0-50% of sales figure is reported for tax purposes)*. Compared to this, 3% of large tax payers pay 83% of sales tax and 0.2% of large tax payers pay 72% of Income Tax, thus implying that SMEs evade taxes.

Summing it up, the relationship between SMEs and tax administration is still tenuous, to say the least. For tax authorities, the large amorphous mass of SMEs mostly located in the informal sector contribute far less than their avowed contribution to GDP etc. SMEs therefore, are more of a challenge than an opportunity. SMEs, however, relate their side of the story in a more nuanced and pensive way. There are no easy and piecemeal solutions to these subtle problems. The answer to SME woes lies in giving them a greater consideration in framing tax policies, keeping in view their overall significance in the national economy and Government of Pakistan's vision to promote them.

b. Labour Laws

Availability of a skilled and productive workforce at efficient prices, along with a supportive regulatory framework covering hiring, firing, inspections and protection of labour as well as employer's rights, is crucial for any economy. Government of Pakistan embarked upon a scheme of reforming Labour Laws of the country. A Labour Protection Policy (LPP) and Labour Inspection Policy (LIP) have been put in place. The former deals with the issues related to Social Security and Labour Rights, Working Environment and Capacity Building of Public and Private sector agencies for Compliance Monitoring of policy objectives, while the latter deals with a realistic and supporting Inspection Regime with an emphasis on self inspection[20]. In addition, Ministry of Labour is working on a project to reduce the former 52 labour regulations into 32, eliminating unnecessary, duplicating and obsolete labour provisions[21].

Despite that, Doing Business 2008 suggests that availability of skilled human resource in Pakistan is scarce that is why the Rigidity of Employment Index stands at 43 points (improved nevertheless from 46 points during 2005). This index has three inherent characteristics i.e. Difficulty of Hiring Index - 78 points (remains unchanged as it was in 2006), Rigidity of Hours Index - 20 points (as there is an 8 hour working time limitation) and Difficulty of Firing Index at 30 points. Rigidity of employment regulations, according to the Report, leads to restricted mobility of workforce and curtailed ability of a worker to find a job of his choice in a productive sector. Furthermore, businesses tend to hire informal workers, paying them lower wages that are unaccompanied with any social security benefits.

III. Absence of Linkages

Emergence of SMEs in any society is to a large part a spontaneous process triggered by economic conditions and the compulsions of livelihood, notwithstanding what the Government is offering by way of incentives. The landscape of SME sector is, therefore, seldom planned and organized, at least in the initial phase. Effort, however, has to be made both by the Government and SMEs themselves to develop linkages with larger enterprises on one hand and educational institutions on the other, besides entwining SMEs with each other through a network of associations. Building of SME specific industrial estates, providing technology support through creation of Common Facility Centres and

[20] On an average, an SME was inspected twice in one year by the Labour Department – *SME Baseline Survey*
[21] 35% SMEs mentioned that Labour Regulations have a great effect on doing business – *SME Baseline Survey*

linking SMEs with networks of market based Business Service Providers are still more dimensions of the same phenomenon. SME sectors in Japan, Korea, Thailand and Malaysia have progressed and consolidated on these lines and are now serving as the backbones of those economies.

SME sector in Pakistan, however, is still behind on this count. Most SMEs in the country still operate on the fringes of the corporate map, in isolation, without taking benefit of synergies and the potential leverage of horizontal cooperation. Famous maxim *"Everyone for himself and God for all, and devil takes the hindmost"* fits the dynamics of most of the SME clusters. Apart from the very basic requirements of existing together there is no manifest urge to cooperate and build consortia for R&D, international trade etc. thus pooling resources to attain higher business profits and operate at larger scales, beyond the reach of individual SMEs. Nor there is an effort to tap the knowledge and expertise of educational institutions for R&D purposes. Links with business promotion organizations are also minimal and half hearted[22].

According to Census of Economic Establishments 2005, Small Enterprises in the industrial Sector mostly consist of units comprising 5 or less workers. These are industrial vendors manufacturing machine accessories and components. They operate on flexible basis in accordance with demand and are as such not part of value chain of any specific industry. This simplistic business process hinders specialization and makes them dependent on middlemen for getting orders and selling their produce. Middlemen as usual, gobble up the bigger part of profit while the manufacturer receives the residual, which is barely enough to keep the business afloat. Any prospects of improvement in quality and developing

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[22] Only 32% SMEs are members of any trade association, industrial or professional association or of any chamber of commerce and industry

competitiveness are lost. In order to strengthen the foundation of our industry we have to buttress this bottom tier of our vendors through various means including knitting them in the value chain through forging linkages with the downstream industry. Similarly there is a need to create backward linkages with educational institutions to provide R&D support to industry particularly its small segment.

Developing linkages and giving the SME sector a more organized look ultimately helps in reducing informality in an economy. Greater the number of SMEs entwined in various networks, more are the prospects of their graduation from informal to formal. Becoming part of any of the networks, is in fact, the first station towards joining the world of documented economy. According to World Bank's estimates, the size of informal economy in Pakistan is 36.8% of income that represents a fairly large share. Channelizing this segment into formal economy will need a massive awareness campaign. Out of 3.2 million economic establishments in Pakistan only 50,000 are so far registered with SECP and among these just 1500 are paying taxes. Most of them (about 99%) are in the informal sector. This hinders their access to resources. However, despite this, there isn't much tendency towards registration.

IV. Lack of Trained HR and Weak Management Skills

Men, money, materials and machines are vital inputs for any business. SMEs need them to turn the wheel of business as much as anybody else. Difficulties involved in obtaining finance for SMEs have already been explained. Here we explore other factors, mainly skilled labour, infrastructure, and technology that impede SME growth & development.

a. Skilled Labour

Let's first have a look on the availability of skilled labour. Connected to this is the quality of human resource. Causal analysis in these issues of course leads one to probe the quality of training infrastructure available in the country, including curricula, quality of trainers and on job training facilities etc.. Allied to this, is the question about the structural imbalance between production of engineers, technicians, skilled workers and managers. Then there is the issue of lack of sectoral focus in trainings, as most institutes provide skills training in main technologies including Electrical, Mechanical and Chemical. Training institutions for catering to the needs of many up and coming sectors of our economy including Gems and Jewellery, Marble and Granite, Hunting and Sporting Arms, Dairy, Sports, Plastics and others have yet to be created. Last but not the least, there is an overt technology bias in our training planning and the managerial and entrepreneurial dimension is relatively pronounced.

Government of Pakistan has taken a number of initiatives in the past two decades to address this problem. Creation of institutions like Technical Education & Vocational Training Authority (TEVTAs), National Vocational and Technical Education Commission (NAVTEC), Technology Upgradation & Skill Development Company (TUSDEC) are steps in the right direction. However, despite all this, the problem persists.

From the perspective of SMEs, their austere business ethic and down to earth business paradigm, labour is a cost not an investment. There is a need to undertake detailed skills mapping in the country to identify skill gaps. A comprehensive training strategy then has to be developed to address the problem.

V. Raw Material

SMEs' access to raw material is constrained. They cannot afford to buy in bulk, nor do they have the business acumen or financial depth to explore advantages of forward transactions and futures trading for hedging against global price fluctuations. Practices like allowing export of raw material which is of use in local industry, have also continued till recent past. Neither the Government, nor the private sector follow any tradition of maintaining strategic reserves in industrial raw materials, otherwise to be imported at short notice. Hence SMEs are exposed to price fluctuations as well as shortages in the global input markets[23]. Add to this, reluctance of foreign suppliers to ship materials falling in the list of sensitive items and the list of SMEs woes is completed[24].

VI. Infrastructure

SME clusters are usually located either on the fringes of the city or in dense areas in downtown, where access through road, rail and other means of transportation/communication is restricted. Lately Government has worked on the idea of developing dedicated industrial estates and industrial parks to provide state of the art infrastructure and facilities at one place. Sunder Industrial Estate in Lahore is a good example. However, here too, the size of plots and prices are generally beyond the reach of ordinary SMEs.

VII. Issues Related to Services Sector

Unlike manufacturing sector, Services sector is that part of the industry or business, which deals with the marketing and selling of intangible products rather than physical goods. The analysis developed in the following

[23] Majority of SMEs believe that prices of raw material are stable only up to one month – *SME Baseline Survey*
[24] 22% SMEs mentioned restrictions on prohibited materials as great difficulty in procurement of raw materials – *SME Baseline Survey*

sections has a more living tone hemming the chaotic dynamism of service markets and the culture and environment that shapes it, particularly in developing societies. Following is a very brief coverage of a few issues peculiar to the services sector.

a. Lack of Standardization

Services are not standardized. Legislation protecting consumers is still at an early stage and there are no strong traditions to support customers, seek recompense or damages from the service provider. International quality certifications are system based, requiring a lot of documentation, besides being expensive. There is a need for some simple but effective mechanism on the level of Associations to certify quality of services and thereby ensure adherence to a set of quality standards.

b. Deficiency of Trained HR[25]

Apart from a few organized sub-sectors like banking, medicine and engineering, there are no credible training institutions imparting courses in the skills required for Service sector. Resultantly, most artisans in the trades like electricians, mechanics, drivers, tailors, barbers, cooks, masons etc. are those trained on the job. The level and quality of skill acquired by them is inconsistent and dependant upon the source and environment of learning.

c. Informational Asymmetry

In the absence of professional and quality certification, customers do not have adequate information about the pricing structures for various grades of services, nor are they fully aware about their availability.

[25] SMEDA, ITC, Hand book on Trade in Services 2007

d. Lack of Intellectual Property Protection

Services markets, being informal and open are not conducive to Intellectual Property Protection. This phenomenon is more pronounced in the developing world where protections through Copyrights, Patents, Trade Marks are not yet in vogue. This has multiple consequences such as:

- Hindrance in brand development
- Discourage innovation
- Frequent copying and plagiarism discourages competition, progress and availability of services to people at lower cost

e. Free Entry and Unemployment

With rising unemployment, service businesses requiring a minimum level of skill, small capital and virtually no registration requirement are an easy options for investment to earn livelihood. With scores of people entering into the lower end of the market, competition is high and the range of pricing limited. One, therefore, has to squeeze livelihood from the thin margin left after meeting all costs and overheads. Expecting such a market to be quality conscious is an illusion.

Chapter IV

Pitching at the Right Spot

SME Policy 2007

The canvas of SME support activities is so broad that at the end of the day, every second initiative in the socio economic realm can be dubbed as an SME promotion measure, be it an incubation centre, a hostel for female entrepreneurs, a model dairy farm, an effluent treatment plant, a skill development initiative, a series of workshops on IP issues, a quality certification lab, a trade fair or exhibition, a study in competitiveness or productivity, construction of an industrial park, building a CFC, a programme lending scheme, upgrading educational syllabi from entrepreneurship angle, and even a study to introduce tax reforms; all have relevance for SMEs. Accordingly, the entire set of Government's socio economic policies relating to health, environment, labour, energy, education, IT, science and technology, trade, finance, women development, tourism and youth etc. makes part of the SME policy universe. Pakistan's SME Policy 2007 was an effort to bring these diverse initiatives from different policy platforms under one, all encompassing framework. The idea was to lay down a roadmap for development of SME sector in consultation with all prominent players and pursuing a coordinated strategy for implementation. Unlike the usual policy making pattern in the public sector, SME Policy 2007 was a product of intense and organized consultation with public and private sector stakeholders. Following is a gist of the policy making process, principles and recommendations made in the document:

SME Policy Development Process

Given the cross cutting nature of the subject, Government of Pakistan constituted an inter-ministerial Task Force in January 2004. SMEDA was designated as the Secretariat of the Task Force and steered the process of Policy formulation. The Task Force consisted of members, both from the public and private sectors.

As a first step, an SME Issues Paper was developed by SMEDA that identified obstacles to SME growth and development to serve as a starting point for debate. The Task Force in its first meeting established four Working Committees to look into four key thematic areas impeding SME growth i.e. i) Business Environment , ii) Access to Finance and Related Services, iii) Access to Resources & Services (Human Resource Development, Technology and Marketing & Industry Information) and iv) SME Definition, Feedback, Monitoring & Evaluation Mechanism.

The approach adopted for undertaking the exercise of Policy formulation relied significantly upon the expertise available in the private sector. While Working Committees were led by private sector, relevant stakeholders and experts from public & private sectors were included as members, to deliberate upon identified issues and develop proposals. Recommendations thus developed were shared with SMEs and related stakeholders through consultative workshops across 13 cities of Pakistan. For greater participation and soliciting feedback, a dedicated website was also launched *(www.smepolicy.net.pk)*. The participatory process assisted in bridging the gap between the government and private sector.

Year 2006-07 saw culmination of the process of SME Policy development spanning a period of over 2 years. *SME Policy 2007 was approved by the Federal Cabinet on January 17, 2007*. The Policy Statement summed up a medium to long term vision for SME sector:

"To create globally competitive SMEs by creating a hassle free business environment, ensuring provision of modern infrastructure & institutional support structures for access to resources & services. The Government shall take measures for promotion of women entrepreneurship, cluster development and also focus on neglected/untapped sectors of the economy. Strengthening Industry-Academia linkages shall also be a key feature of the Policy."

SME Policy – Pillars

- Distinct recognition of SMEs as the backbone of our economy
- Practical, clear & well conceived, initiatives to implement key aspects of the Policy comprising business environment and access to finance, resources and services inclusive of human resource development, technology, marketing and industry information
- Effective monitoring mechanism for implementation of SME development initiatives at various levels. In-built corrective measures for Policy implementation in-line with SME Vision

Recommendations

Aligned with the thematic areas identified by the SME Task Force and ensuing debate thereon, specific Recommendations, along with Programmes/projects were developed as part of the roadmap to achieve Policy objectives.

i. Business Environment

SME Policy therefore recommends the following:

- Provision of infrastructure

- Adjustments in statutory & non-statutory regulations hampering SME growth & development
- Review of Labour Legislation to facilitate SME growth
- Desks for SMEs at Ombudsperson's Organizations
- Promulgation of Small & Medium Enterprise (SME) Act 2007

ii. Access to Finance & Related Services

- Establishment of Credit Guarantee & Insurance mechanisms
- Capacity building of Financial Institutions & SMEs
- Industry based SME financing programmes
- SME Support Funds

iii. Access to Resources & Services

a. Human Resource Development

- Women Enterprise Development
- Institutes of Small & Medium Enterprise & Entrepreneurship Development
- Establishment of Business Incubation Centres
- Facilitation and support for private sector Business Development Service Providers
- Capacity building and strengthening of Chambers of Commerce and Trade Associations
- Strengthening Industry – Academia linkages

b. Technology Up-gradation

- Incentives for SMEs to upgrade / acquire new technology
- Establishment of Technology Innovation Centers offering common facility, technology up-gradation, R&D and design related services to SMEs.
- Protection through Intellectual Property Rights
- Incentives for Investment in new Emerging Sectors and Skills upgrade.

c. Marketing

- Generate market intelligence
- Mechanisms to link SMEs globally
- Participation in National & International fairs and exhibitions
- Instituting Annual SME Awards for recognizing outstanding performance in domestic and international markets, technology innovation, HRD practices, etc.

Implementation and Monitoring, Evaluation & Feedback Mechanism

Government policies at times remain shelved and are not implemented. To obviate this, an implementation mechanism of policy initiatives was laid down in the SME Policy, both at the National & Provincial levels, also comprising a set of Committees to monitor programme/project implementation[26]. The National Committee on SMEs at the political decision making level has been entrusted to develop strategic plans for SME development, providing policy guidelines in line with Government's vision, while also providing a platform for advocacy of SME issues and monitoring & suggesting improvements and corrective measures in implementation to keep it harmonized with the macro economic framework of the Government. The Provincial Committees on SMEs on the other hand, better represent the concerns and demands of SMEs and therefore have been constituted to develop and articulate recommendations and projects for the benefit and promotion of SMEs, for integration in the annual development and budgetary planning process of Government and for coordination amongst various agencies & departments in the respective Provinces. This two tiered process was thus devised to work within a holistic framework so as to enable policy makers

[26] Key Projects of SME Policy Implementation Plan – Annex I

to be right at the heart of the problem and also to be constantly in touch with SMEs, rather than having to develop policy interventions behind closed doors. While the mechanism may have been spelt out in SME Policy, its actual implication rests on the fact that such a mechanism is highly dependent upon the political will and importance government assigns towards the sector within the macro economic sphere. With little or no support at the top level, monitoring effectiveness of measures undertaken for development remains a distant dream.

SME Support Architecture – Allied Policy and Strategy Work

Government of Pakistan has taken a number of steps through setting up of dedicated institutions and organizations and development of infrastructure having relevance for SMEs. Some of them predate the SME Policy, others have been parallel developments. Following matrix provides a picture of the SME support architecture in Pakistan:

Area	Organization	Objective
Compliance with Intellectual Property/ WTO rules	Intellectual Property Office (IPO) Pakistan	Enabling SMEs to get integrated in the global value chains
Export Development	Trade Development Authority (TDAP)	Discovering new markets and developing linkages with foreign buyers
Infrastructure Development	National Industrial Parks (NIPS)	Developing industrial estates and providing SMEs a hassle free business environment
Quality Certification & Testing	Pakistan Standards & Quality Control Authority (PSQCA), Pakistan Council for Scientific & Industrial Research (PCSIR), Pakistan National Accreditation Council (PNAC)	Enabling SMEs fulfill quality standards
Skill Development	National Vocational Training & Technical Education Council (N AVTEC)	Providing quality HR to SMEs
Engineering Support	Engineering Development Board (EDB)	Putting SMEs in a higher technological orbit
Technology Upgradation and Skill Development	Technology Upgradation & Skill Development Company	Common Facility Centres (CFCs) and Demonstration Projects

	(TUSDEC)	
Productivity	National Productivity Organization (NPO)	Enhancing productivity of industry through arranging foreign trainings and bringing in foreign expertise
Competitiveness	Competitiveness Support Fund (CSF)	Boosting competitiveness of local industrial output through benchmarking with international standards
Business Development Services	Business Support Fund (BSF), Agribusiness Support Fund (ASF)	Providing access to business development services like HR development, marketing, technology etc.
Sectoral Development	Pakistan Dairy Development Company (PDDC), Pakistan Gems & Jewellery Development Company (PGJDC), Pakistan Stone Development Company (PSDC), Furniture Pak. Etc.	Value chain analysis, identification of gaps and design and implementation of interventions for sectoral development

As the above picture indicates we now have institutions in place for most of the essential compliance/regulatory requirements and business development. Allied to this institutional set up, a development framework in the form of MTDF has also been put in place, and a number of initiatives under the auspices of the above mentioned organizations are on the anvil for the benefit of SMEs. Following matrix enumerates projects being implemented in vital areas, and their linkage with MTDF.

With the institutional framework in place and a development programme for implementing interventions tied with it, the needful apparently has been done. And yet there are a few major lapses, concealed from common opinion on the subject, which if not covered will keep our policy thinking actually vague despite apparent illusions of soundness.

MTDF	Development Initiatives
Increase in Competitiveness of SMEs: • Training and Education • -Up gradation of processes and adoption of Modern tools • -Access to Modern accounting and ERP techniques • -Technology forecasting	• Up gradation of Automotive Testing and Training Centre Limited, Karachi • Up gradation of Plastic Technology Centre, Karachi • Modernization and Up gradation of Pakistan Industrial Technical Assistance Centre (PITAC), Lahore • Gujranwala Business Centre, Gujranwala**. Rs. 98.78 million** • Women Business Incubation Centre, **Rs. 31.22 million** • Agro-food processing facilities, Multan **Rs 135.19 million** • Gujranwala Tools, Dies and Moulds Centre, **Rs. 878.04 million** • Ceramic Development and Training Centre Gujranwala, **Rs. 314.7 million** • Development of Marble and Granite Sector, Rs.**1976 million** • Product Development Centre for Composite materials, Sialkot **Rs. 382.22 million** • Foundry Service Centre Lahore, **Rs. 179.4 million** • Glass Products Design and Manufacturing Centre, **Rs. 37.08 million** • Chromite Beneficiation Plant, **Rs. 8.38 million** • Revival of Hyderabad Leather Footwear Center, **Rs. 35.01 million** • Revival of Cutlery Institute of Pakistan, **Rs. 39.84 million** • Women Business Development Centre (WBDC), **Rs.28.41 million** • Sialkot Business & Commerce Center (SBCC), **Rs.341.67 million**
Incentives for Investment in New Emerging Sector and Skill Upgrades: Up gradation of business products, processes and quality accreditation through business Improvement Programs (BIP)	• Sports Industries Development Centre Sialkot, **Rs. 272.61 million**
Improve Quality Standards by Preparing for Globally Integrated Economy: Creating Awareness about quality standards and its incorporation in the SME.	• Creation of PSQCA and PNAC

Improve Market Access and product Information: • Industrial Information Network • SME Networking Groups (SMENG)	• Creation of TDAP, Sector Development Companies
Export Orientation Awareness Programs regarding International Trade Standards	• TDAP, IPO and Sector Development Companies
Re-structuring and Strengthening of Legal, Taxation and Institutional Framework • Design SME friendly lending schemes • Promoting awareness regarding IP related issuesImproving labor laws and Bankruptcy Law	• Apart from a number of institutional reforms over the past five years, a World Bank sponsored project of reform in taxation policies is currently on-going.
Access to Financial Resources and Services • Increase share of SMEs in formal credit • Venture Capital for New startups • Simplification of Taxation and Business registration and procedure Laws	• Business Support Fund • Agribusiness Support Fund • Competitiveness Support Fund
Delivery Mechanism for Business development and Up gradation: • Appointment of Industry Neutral Managers and Operators • Improving the content of delivery	• Common Facilitation Centres • Washing and Pressing Plant, **Rs. 5.38 million** • SME Subcontracting Exchange, **Rs. 26.09 million**

Chapter V

Testing the Conviction

Formulation of a policy based on a realistic appraisal of current realities as seen through bipartisan opinion linked with a vision of the future, is important. Implementation of the policy through well designed initiatives geared to benefit end user is even more important. But the crucial part perhaps is to sustain the policy approach and refine the policy priorities in a continuous manner, factoring in the lessons learnt. SME Policy 2007 marked the advent of a new approach towards SME development in this country. However, new approaches need momentum to sustain and there has to be a holistic mindset and a coordinated perspective to tackle the problems faced through a consultative and collective strategy, when dealing with a cross cutting policy theme like SMEs. How far that seems to be materializing? Following analysis specifically probes Government's earnestness in strengthening a policy approach towards SME development on two basic criteria:

The Missing Identity at Policy Level

Two independent but related concepts have come to fore as a result of the discussion in Chapters 2 and 5.

- The origin of the term SME was more as a perspective than a definition per se, to approach and study an area which is broad, dense, unorganized and elusive. The perspective subsumed an approach which was positive rather than normative. Using the term SME for a sector obligated the policy planners to take steps to catalyze Small to become Medium and the efficacy of a policy should be measured on that.

- Policy making with the above objective in view ordains a pluralistic approach. SMEs should not be treated as a truism, in policy formulations. As the top priority area for the Policy Makers, it should find explicit space in every policy of the Government due to their cross cutting nature, just like a mention is made for minorities, women and physically disadvantaged. In fact going a step further every policy and rule should be simulated before finalization with respect to its impact on SMEs' business operations.

- SME Policy 2007 is not a basic but a coordinating policy which aims at bringing a kind of coherence about the SME related aspects of different policies. It provides a coordinating mechanism at the policy level. It should not be considered an exclusive parking yard for SME issues and the Government should not consider itself having been discharged of the obligation to take any further policy steps for SMEs, considering the diverse and cross cutting nature of their issues and constraints. SME issues in their related context should figure up in every policy with SME Policy providing a platform for coordination, monitoring and further policy making.

The above precepts apparently have not gained much of a foothold in our policy thinking. Policy making in the social and economic realm generally does not recognize the SME perspective as a key driver. Instead development is pursued under the generic banner of economic development rather than SME development. True, that SMEs being the main part of economy stand to gain a major benefit from all these programmes, still there is a difference between launching something avowedly in the name of SME, reflecting Government's priority for this sector and a general prescription from which anyone can benefit.

SMEDA undertook an analysis of a few key policies dealing with vital socio-economic sectors namely Education, Environment, Trade, Labour etc. Most of them are self contained documents spelling out parameters clearly. However, seldom anyone of them mentions SMEs as a specific reference nor there are any dedicated initiatives proposed with reference to them. For example, the Environment Policy of the Government of Pakistan spells out promotion of low cost water treatment plants, metering of water consumption, effective enforcement of NEQs etc. however, it stops short of mentioning any specific measures/proposals as to how these intended goals will take shape in the context of SME production methods. Following matrix juxtaposes the stated policy objectives of Environmental policy and the suggested Policy space that could have been assigned to SMEs, in order to honour the general conviction about their backbone support to economy.

Environmental Policy	
Stated Policy Objective	**Suggested Policy Space for SMEs**
Ensure effective enforcement of the National Environmental Quality Standards and Self Monitoring Rules. Promote low-cost water treatment technologies at the community and household levels.	At the moment SMEs do not have sufficient knowledge of NEQs. Educate SMEs about low-cost water treatment technologies, encourage industry to develop low-cost water treatment plants.
Promote metering of water consumption to discourage the indiscriminate use of water for industrial and municipal purposes.	Initiate projects and disseminate best practices in industries that consume large quantities of water e.g. Leather, paper industry etc.
Introduce discharge licensing system for industry.	A regulatory system to be put in place ensuring that licensing does not affect SMEs adversely and they are given ample time to adapt to this mechanism.

An apologist might say that polices enumerate broad goals and it is for project planners to envisage specific interventions in the light of these objectives, however the point remains that SMEs being avowedly the backbone of economy, deserve a dedicated space as a major policy theme, rather than left to be dealt with at the a lower level through random schemes.

Similarly, SMEs remain an elusive sector for budget makers, particularly those operating from the fiscal side of the equation. They are a sector which is informal, undocumented, difficult to catch and challenging to bring within the tax net. They try to avoid taxation and yet have an unlimited appetite for more and more concessions. Their contribution to the exchequer is not commensurate with their hypothetical turnover. Whatever the merit in these arguments the point remains that we are talking about a sector, which provides 78% non agriculture employment in the country. A tax concession of one rupee, perhaps contributes to greater job creation compared to any other sector of economy, notwithstanding the allied benefits. This is the premise on which SMEs' argument for tax concessions exists. There was hope that Government will come up with a comprehensive package for an incentivized tax regime for SMEs, in the wake of SME Policy 2007. However, the same has not materialized as yet. Such a far sighted measure will not only provide relief to the SMEs but will also promote documentation of the sector, ultimately contributing to the overall goal of graduation from informal to formal realm of economy.

The Data Gap

Just as SMEs fail to gain a permanent presence on the Government's policy radar and ironically remain parked in the enclave of SME Policy, similarly, there are no dedicated data sources for this sector to provide a firm anchor to the process of research and policy development on the subject. In the absence of credible benchmarks it is not possible to gauge progress on ground in the pre and post policy implementation period, which not only results in increasing the gap between public expectations and new policy making but also stagnates the prospects of refinements in the current policies. Different agencies of Government collect industry statistics including Federal Bureau of Statistics, State Bank of Pakistan, Finance Division, Provincial Industries and Labour Departments etc. Federal Bureau of Statistics is Pakistan's main statistical agency responsible for collecting and compiling federal and provincial statistics[27]. It issues as many as 18 publications including periodicals, census, surveys and statistical reports on monthly, quarterly and annual basis related to the demographic, social and economic condition of the country. Out of these, seven publications report data on manufacturing sector i.e. Economic Census 2005, Census of Manufacturing Industries, Census of Mining & Quarrying Industries, Census of Electricity Establishments, Monthly Statistical Bulletin and Pakistan statistical year book. Among the Industry statistics collected and accumulated by FBS, there is no dedicated SME related publication. The data included in these sources is industry wide; however there is a segregation of small and large. Small scale enterprises are defined as manufacturing units having less than 10 employees and anything above the threshold is treated as large. This traditional division of industry into Small and Large dates back to the first five year plan written for this country in which Small Scale Industry was mentioned as a separate category.

[27] http://www.statpak.gov.pk/depts/index.html

Chapter VI

And a Word on Donors

By virtue of their location at the cross roads of most of the donor promoted themes like competitiveness, productivity, poverty alleviation, gender empowerment, environmental safety, IP etc. SMEs should qualify as a priority area for donor assistance. Following sections give a critical analysis of donors' aid portfolio for SME sector with a view to constitute a comment on its ultimate effectiveness. It covers aid portfolios of four major donors including World Bank, Asian Development Bank, European Union and USAID 2001-2008. While sifting SME related assistance from the rest of the portfolio of a particular IFI, flexible criteria has been used counting all assistance meant for industry, business and entrepreneurship development as SME assistance. Specific assumptions used for the purpose are given as follows:

- Except for EU, composition of SME funding has been presented as per the donor agencies' classification
- Type of assistance is classified according to the objective and nature of the projects. It does not represent donor's own classification.
- In case of multi dimensional projects, the SME component has been segregated for the purpose of analysis
- Technical Assistance special fund has been assumed as a grant.

Over view of Donor Portfolio[28]

Following table gives the overall assistance packages earmarked by the five donors for Pakistan in the period under view:

[28] Research conducted by Maryam Riaz

Table: 6.1

SME Funding Status by Donor Agencies (2001-08)

Value in million US$

	ADB	W.B	USAID	EU	Grand Total
Total Portfolio	12057.15	5010.39	706.99	520.36	18294.9
Share of SMEs	241.90	257.6	53.18	77.94	630.6
% Share of SMEs	2.01%	5.14%	7.52%	14.98%	3.4%

Aggregate figure of combined donor assistance amounts to $ 18294.9 million, out of which SME share was $630.4 million, which is around 3.4% of the total amount. If we take a donor wise split in absolute terms, World Bank has earmarked maximum funds of $ 257 million followed by ADB's allocation of $242 million, EU's $78 million and USAID's $53 million. As percentage of the total amount EU's share stands at the highest at 14.98% followed by USAID's 7.25% and World Bank 5.14%.

Structural Analysis of SME Component

Focusing on the available assistance we have analyzed three aspects; nature, composition and type of assistance of funding. Table 6. 2 gives the composition of SME funding by donor agencies. Coming to the nature and composition77.98% of the total amount comprises loan, while the remaining 14.70% is a grant. Highest share of grant is that of US AID.

Table: 6. 2

Composition of SME Funding by Donor Agencies

Value in million US$

	ADB	W.B	USAID	EU	Grand Total
Total Portfolio	12057.15	5010.39	705.41	520.36	18293.3
Loan	468 (86.28%)	257 (99.77%)	0	0	725.0 (77.98%)
Technical Assistance	2.45 (0.45%)	0.6 (0.23%)	0	0	3.05 (0.33%)
Grant	7 (1.29%)	0	51.68 (100%)	77.94 (100%)	136.6 (14.70%)
Private Sector	65 (11.98%)	0	0	0	65 (6.99%)

**EU funds composition is not available*

Coming to the type of assistance, as shown in table 6. 3, most of the funding almost 75% goes to soft initiatives such as institutional reforms, policy formulation and capacity building. Programs for SME sector reforms such as AHAN and PISDAC contains 1.75% of total funding. Programmes for infrastructure development for SMEs and direct assistance materializing in SME asset creation are hardly 23% and that too mainly attributable to the micro credit schemes sponsored by World Bank and rural infrastructure development programs by ADB.

Table: 6. 3

Activity wise Fund Allocation

Value in Million US$

	ADB	W.B	USAID	EU	Grand Total	% of Total
Inst Reforms	152.50	257.00	0	0	409.5	44.08%
Policy Formulation & Capacity Building	178.55	0	35.48	77.94	291.97	31.43%
Sector Reforms	5.00	0	11.3	0	16.3	1.75%
Infrastructure & Asset Creation	205.8	0.6	4.9	0	211.3	22.74%
Total	541.85	257.60	51.68	77.94	929.07	100.00%

Most of the funding for infrastructure development and asset creation is made by ADB. Other donor organizations such as USAID and EU have allocated bulk of funding for capacity building and just a nominal percentage goes to direct asset creation and infrastructure development.

Prominent Donor Sponsored Interventions:

Following matrix gives brief information on a few prominent initiatives sponsored by donors over the past six years.

Project	Donor Agency	Total Cost	Objectives
SME Sector Development (Project Loan) SME Sector Development (Program Loan)	ABD	153.1	**Improve SME Policy Environment** • Develop SME Policy. • Establish Effective Labor Protection and Labor Inspection Policies. **Enhance SMEDA's Effectiveness and Outreach to SMEs** • Improve Market-Based SME Access to Business Development Services. • Enhance SME Competitiveness Through Private Sector Services. **Improve Market-Based Access to and Delivery of SME Finance** • Improve Regulatory and Credit Information Infrastructure and Build Private FI Capacity. • Restructure and Privatize SME Bank.
Rural Enterprise Modernization Project (loan) AHAN	ADB	5.0	• Establishment of Rural Development Company known as AHAN. • Pilot project implementation for the development of rural small enterprises. • Baseline studies and initiation of sub sector and cluster development plans.
Trade-related Technical Assistance[29]	EU	6.65	• To assist Pakistan in fostering its integration into the world economy and, ultimately, contribute to poverty alleviation through the achievement of trade-related conditions for sustained and stable economic growth.
Pakistan Initiative for Strategic Development and Competitiveness (PISDAC)	USAID	11.3	• Upgrading production, improving marketing, and understanding and meeting consumer demand. • Activities include benchmarking against the global market, identifying pertinent policy reforms, enlisting the support of the public sector to improve the regulatory and legal framework. • Developing linkages with major local and international research institutions.
FSD Kashf Foundation	World	0.6	• Provide financial services to SME sector.

[29] List of Studies carried out under TRTA annexed

Pakistan	Bank		

Inventory of Outputs

- ***Research Studies/Publications***
    - Census of Economic Establishments 2005
    - SME Baseline Survey
    - Studies published under TRTA Programme

- ***Policies and Strategies formulated***
    - National SME Policy 2007
    - Labour Inspection Policy
    - Labour Protection Policy
    - Sector Strategies for Dairy, Marble and Granite, Gems and Jewellery and Furniture Sectors,

- ***Reform of Institutions***
    - Privatization of SME Bank
- ***New Institutions Created***
    - Competitiveness Support Fund[30]
    - Business Support Fund

Critical Issues for Analysis and Follow up

i. Out of the total portfolio of $18294 of four main donors, SME share amounts to $631 million, which is 3.4% of the total amount. Poverty alleviation through income enhancement and economic empowerment at grass root level being donor's cherished objective; one wonders why SMEs shouldn't qualify for a larger slice of the donor cake. Is it a question of donor priorities or inability of SME development institutions to solicit funds through designing of viable projects?

[30] List of Research work carried out by CSF annexed

ii. Bulk of the SME assistance (78%) has gone into soft initiatives like Institutional Reform (45%) and Policy Formulation and Capacity Building 31%. The share of funds allocated to Infrastructure building and direct disbursement to SMEs has been just 23%. How far this approach has delivered in the medium term? Have the agencies and institutions working for SME development been able to come up with better ideas, more coherent polices and effective strategies yielding results on ground? Are the policies formulated in the process being implemented and their progress regularly monitored?

iii. What should be our future strategy in addressing the imbalance between soft initiatives and building infrastructure and direct asset creation in the SME sector? Can a better coordination between donors, SME support institutions, EAD and SMEDA result in a greater understanding and consequently soliciting and channelizing foreign assistance into more productive channels for SMEs. How far SMEDA can play the role of a sheet anchor in the process?

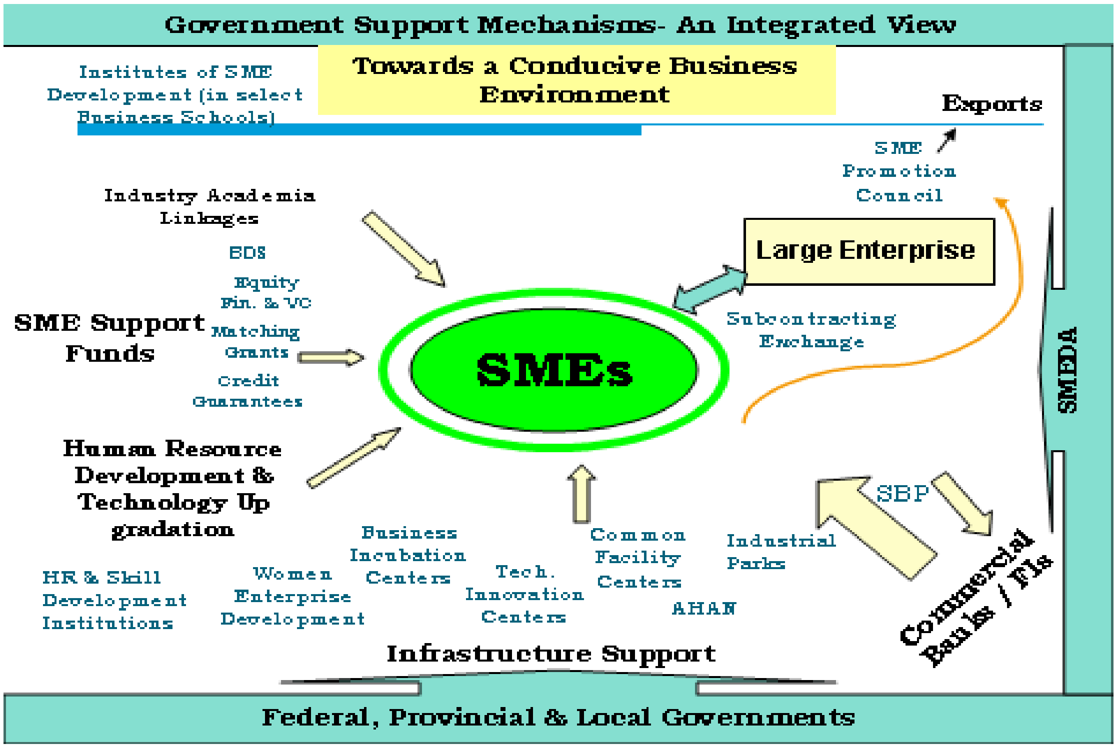
iv. The loan component of assistance for SMEs comprises 85% of the total amount. What is the state of disbursement of this amount? What are the lessons learnt in the process?

v. What are the lessons learnt from the prominent SME Development Initiatives launched in the past five years including SME SDP (ADB), AHAN (ADB), TRTA (EU), PISDAC (US AID) and FSD through Kashaf foundation by World Bank?

Epilogue

Brooding over all the technically correct noises raised about SMEs over the past six decades in the policy corridors and watching very little impact on ground, one feels at a loss, how to phrase a set of recommendations which are genuine and implementable. One thing is certain, the cause of SMEs cannot be served through scattered remedies like random tax concessions and administrative reprieves. The need can be served only by adopting a conscious new perspective embodying SME world view, like the "think small first" philosophy prevalent in UK. If we believe SMEs are the foundation of a sound economic structure, the formulation of policies for SME uplift should not be swayed by short term cost benefit analysis. We must pursue the aim single mindedly over a medium to long term horizon across the policy spectrum, so that there are no hiccups due to conflicts, inconsistencies and incompatibilities.

Apart from a correction of priorities at the policy level, there is a need to develop a sympathetic constituency among the SMEs for Government's development work. The development planners need to design a set of second generation initiatives, with an integrated approach knitting together all aspects of SME development with a holistic emphasis. Lessons learnt in the course of work over the past few years allude towards the need for accurate insight into genuine requirements of ordinary SMEs. Unless an ordinary SME perceives benefit in Government sponsored measures and shows readiness to come forth, engage and cooperate in the endeavors for reform, most of the efforts remain supply side initiatives. Following schematic diagram depicts the type and intensity of inter-linkage required to be built in the SME support mechanisms.


Government Support Mechanisms- An Integrated View
Towards a Conducive Business Environment
Institutes of SME Development (in select Business Schools)
Exports
SME Promotion Council
Industry Academia Linkages
BDS
Equity Fin. & VC
Matching Grants
Credit Guarantees
SME Support Funds
Large Enterprise
Subcontracting Exchange
SMEs
SMEDA
Human Resource Development & Technology Up gradation
SBP
Business Incubation Centers
Common Facility Centers
Industrial Parks
HR & Skill Development Institutions
Women Enterprise Development
Tech. Innovation Centers
AHAN
Commercial Banks / FIs
Infrastructure Support
Federal, Provincial & Local Governments

Annexure

Annex I

SME Policy Implementation Plan – Key Projects

1. SME Subcontracting Exchange

Whereas the Policy emphasizes a multi pronged approach to tackle SME problems, a significant part of the initiatives proposed in the SME Policy relates to increasing networking facilities among SMEs, resulting in forward linkages with Large Industry and International Markets and backward linkage with educational and vocational training institutions to provide the R&D support and HR back up. In addition SMEs need to enhance horizontal linkages to pool resources, other wise impossible for individual SMEs. Different SME development approaches like cluster development, sectoral development, SME Trade consortia and R&D consortia building are basically anchored with this side.

The objective of the Exchange is to make SMEs competitive through developing inter-firm linkages, promoting large scale manufacturing to procure/subcontract from smaller firms in clusters facilitating Small Enterprise creation & growth. SME Subcontracting Exchange shall facilitate the process of industrialization; create inter-linkages between enterprises through specialization in the functions of production system. These linkages will contribute to coherent, integrated development, effective allocation and use of resources. Developed & other competing economies have similar systems in place. In order to compete globally, manufacturing industry in Pakistan needs to upgrade itself by way of adopting such systems. The Subcontracting Exchange will initially target 2 - 3 sectors of the vending industry feeding the light engineering manufacturing sector, such as home appliances manufacturing, fabricated metal products, metal forging & fabrication, auto parts, surgical instruments, textile machinery and others.

In the light engineering fan cluster alone (Gujranwala/Gujrat), 89% assembling units operate as small sized units, 8% assembling units are medium sized while only 3% are large sized quality fan core makers and recognized brand assembly units (4 to 7). Small units comprise 47% of total electrical fan assembly, followed by assembling volume of medium sized assemblers (25%) and large sized assembling units (28%). Similarly, in the surgical sector, there are between 2000 – 3000 vendors employing more than 50,000 people, offering immense opportunity for subcontracting.

Like wise, in the auto parts segment alone, there are about 1600 units, of which only 400 are within the organized sector and are SMEs. The estimated capacity of auto parts manufacturing industry is to produce parts amounting to $705 million per annum. Of the total capacity, only an estimated 40% of the capacity is being utilized. The main reasons for this low capacity utilization are low production at the end of the assemblers and less demand in the replacement market.

SMEs often do not have timely information on target market quality requirements and applicable technical regulations. Additionally, many suffer from the absence of appropriate testing and other quality control or measuring equipment and the corresponding calibration and repair services. In other cases they may lack the appropriate processing equipment and/or raw materials which are needed to achieve the required quality to comply with the stipulated requirements. More often they lack the necessary knowledge, skills and expertise needed to plan, organize, co-ordinate and execute the quality activities as required to achieve the necessary quality. This adds up to the list of requirements that SMEs have to comply with in order to survive the highly competitive global markets.

The Subcontracting Exchange shall serve as a conduit for technology transfer and raising technology levels prevalent in the industry at present. It shall induce large enterprises & TNCs to invest in small vending industry to meet their own requirements. Common Facilities shall be made available to SMEs for R&D, testing and quality standardization through other public sector funded initiatives.

Following are the objectives of the project:

- Strengthening backward & forward linkages
- Developing inter-firm linkages
- Business Matchmaking
- Induce competition among vendors:
    - To promote efficiency and competitiveness
    - Harness idle capacity
- Small enterprise growth through graduation to higher levels of technology & integration with global supply chains
- Technical database detailing capacities of SMEs
    - Data storage for specifications, quality and output
    - Data storage for idle capacities available on particular processes/machines
- Promoting inter-organizational cooperation for subcontracting locally and internationally through targeted marketing and advocacy campaign, highlighting the benefits of subcontracting in the long term

- Development of a database as per buyers' requirements for product/components/sub assemblies /services
- Business Matchmaking
- Provision of information on international market demands - disseminating information to SMEs regarding WTO and Subcontracting compliance
- Contract facilitation between large firms and SMEs

2. SME Promotion Council

To date, SME Associations in Pakistan are a few and far between. The structure of Associations in Pakistan is such that they generally serve as interest articulation groups with a protectionist, reactive, short sighted approach, not particularly inclined to change. On the other hand, chambers of commerce & industry are prone to politicking and lobbying for stronger & larger sized member interests. Given below is an overview of the number of SMEs in some of the cities and membership of chambers/associations:

City	No. of SME Establishments	Chamber of Commerce	No. of Chamber Members	% Assisted by Chambers
Lahore	204310	Lahore Chamber of Commerce & Industry	3200	7.59%
Quetta	21497	Chamber of Commerce, Quetta	2000	9.30%
Peshawar	77245	Sarhad Chamber of Commerce	2812	3.64%
Hyderabad	58104	Hyderabad Chamber of Commerce	1053	1.81%

In Lahore alone there are 204,310 SMEs out of which only 3200 SMEs (7.59%) are being facilitated by Lahore Chamber of Commerce & Industry.

Furthermore, there is no SME specific Chamber of Commerce & Industry. This alone highlights the demand side gap of SMEs. This is exacerbated by a lack of opportunity for SMEs in existing chambers of commerce & industry to advocate their point of view due to lack of resources & political clout. In order for them to emerge as a strong lobbying force they need to reorganize/assemble themselves under one umbrella; establishing a new distinct identity as SMEs for themselves.

Organized Business Membership Organizations housed under the umbrella of an SME Promotion Council are more focused, enjoy greater membership participation and improve their public recognition and acceptance. They are able to fulfill their responsibilities for the whole – small and large – business community and can therefore be regarded as genuine representatives of the private sector. The rationale for establishing and supporting SME Promotion Council rests on the catalytic role private sector led organizations can play in development. This role is based on their (i) network, (ii) self-regulative, and (iii) intermediary character, which makes them interesting/viable for SMEs and donors alike in terms of benefiting from them. SME Promotion Council shall be a distinct body to serve and advocate interests of SMEs, looking beyond the upper superficial crust of dominant Medium Enterprises to try to take into its fold the smaller enterprises.

SME Promotion Council shall provide a common platform for advocating SME issues and lobbying for incentives with the government. It shall promote, develop and further the economic well-being of members by providing:

- Certification to SMEs in order to enable them to avail any specific incentives announced by the Federal Government from time to time
- Collective voice in SME advocacy to Government to represent and protect members' interests
- Quality business development services to help members enhance their competitiveness and succeed in their businesses
- SME facilitation and arbitration
- Proactively organize association of associations and members orchestrating interests of SMEs
- Incentives for smaller businesses to graduate to medium size
- Encourage informal businesses to formalize
- Certification of SMEs
- Market selection and market research, customer identification and evaluation
- Commercial and technical negotiations, product packaging, adaptation and technology up gradation
- Links with sub-contracting exchange.

3. Credit Guarantee & Insurance Agencies

Facilitating SMEs access to formal finance has been a unanimous demand of stakeholders across the SME spectrum. It came to fore vociferously during the consultative process carried out in the course of developing SME Policy. Whereas there has been a consensus on the diagnosis, the remedies administered so far have not been effective enough. The share of SMEs in the total credit off take has been insignificant. The initiatives taken by various banks and the range of products offered by them for SMEs are not appealing enough to cause or bring a major break through in the process. SMEs generally find themselves on the wrong side of the collateral based lending approach pursued by most banks. Given their limited financial depth and volatile nature of business, SMEs are considered a high risk borrowing segment, to which banks expose themselves only reluctantly. The key to solve SMEs' access to credit problem is to mitigate the risk of the Banker on the one hand through creation of SME Credit Guarantee Agency/Fund and through making the SMEs bankable by bringing transparency in their accounting systems and promoting best practices. In addition a sizable amount of funds need to be made available through venture capital windows, for encouraging new start-ups in innovative businesses. The envisaged project adopts an integrated approach towards the solution of the problem of inadequate access for SMEs to the available formal credit in the country.

The purpose of a Credit Guarantee Scheme (CGS) is to assist with providing access to finance. For an SME, the additional cost of the CGS fee is the price of obtaining access to finance that it would not otherwise have. All too often, SME borrowers do not have the level of acceptable collateral that the bank requires and lack of security blocks the SMEs' access to finance. CGS will bridge the gap in collateral with its guarantee.

The Credit Guarantee Scheme will be backed by a Credit Insurance Mechanism for risk mitigation.

4. **Institute of Small & Medium Enterprises Development (INSMED)**

Existing universities offer entrepreneurship development and business plan development services on a very limited scale. The existing organizations in the public and the private sector offer very little entrepreneurship development programmes, diplomas, promotional events and new business creation opportunities among the entrepreneurs. INSMED will help to fill this existing gap by providing subsidized services in a systematic manner.

Most enterprises in Pakistan are either of small or medium size having limited resources and investments for the training of their management and staffs to upgrade their skills. Moreover the available private sector Training Service Providers (TSPs) and business plan development experts charge heavily for the customized business management services and thus are not affordable by most of the private sector small organizations both in the manufacturing and services sectors. Due to limited resources and infrastructure, it becomes difficult for public sector organizations to cater to all training and business development needs across all sectors of the economy.

Institutes of Small & Medium Enterprise & Entrepreneurship Development (INSMED) shall be established to bridge the gap between Human Capital demand and supply, while also focusing on promoting entrepreneurial culture in the country. INSMED shall be a training facility for people interested and connected to SMEs. In addition to SME managers, administrators, and those planning to start a new venture, INSMED shall also provide a high-level of practical training to those who assist SMEs. The training would consist of not only formal lectures, but also focus on practical training, exercises, and group debates, with the overall purpose of improving participants' problem solving ability.

INSMED would launch educational and training programs and offer business development services to promote entrepreneurial culture among the existing and new SMEs. Given below are objectives of the project:

- To carryout research on local SMEs for need identification, developing curriculum and case studies in line with the requirements of SMEs.
- To produce quality Managers and Entrepreneurs in line with the needs of SMEs.
- To impart education and training on;
  - Management, Marketing and Finance
  - Compliance, quality and productivity
  - Latest changes in business requirements, technology and management practices
- To help entrepreneurs organize, setup, and manage a business of their own choice.
- To promote the entrepreneurial culture and spirit
- To become a resource base for SMEs of the Region

5. Business Incubation Centres

According to Federal Bureau of Statistics (FBS), there are 3.2 million enterprises in Pakistan and almost 99% of them fall under the category of small & medium enterprises. This shows that the development of this sector is crucial for the uplift of our economy. It is important that government should focus on young educated individuals and encourage them to start their business.

There are currently a total of 49 universities in the country, enrolled with a total of 423,236 students (2003-04 statistics from Higher Education Commission-HEC). Unfortunately only a few of them having the available financial resources are able to pursue self-employment. Commercial banks currently do not provide unsecured loans to new startups which is a major barrier for their development. This highlights the need to provide basic facilities such as business incubation centres that will assist entrepreneurs to set up their own businesses. Business Incubation Centre can help reduce the initial cost for new startups and increase the probability of success rate. They can play an important role in nurturing the development of entrepreneurial companies, helping them to survive and grow during the start-up period when they are most vulnerable. The most common goal of incubation program is to create jobs in a community, enhance a community's entrepreneurial climate, retain businesses in a community, build or accelerate growth in a local industry and diversify local economies.

The goal of this project is to help promising young entrepreneurs to develop their business skills that will enable them to compete effectively in today's marketplace. Objectives of the project are mentioned as under:

- To provide an office platform for Young Entrepreneurs.
- Explore new business opportunities.
- Exposure to new ideas of marketing and business expansion.
- Provide entrepreneurs business support services.
- Provide entrepreneurs confidence for graduating to establish independent facility after operation at Incubation Centre.
- Increase the probability of new startup success rate.

The Business Incubation Centre (BIC) will provide 'hands-on support' to aspiring new business persons. BIC staff will provide information in key areas such as business planning, raising finance, enterprise development, marketing, product development, team-building and also specialist areas (e.g. sector knowledge). Business Development Services provided by BIC would include:

- Direct, one-to-one advice
- Contacts with Business Service Providers & Business Membership Organizations
- Professional services (e.g. accountants, lawyers, product developers, etc.)
- Seminars, Workshops and Training Programs
- Training & Meeting Room Facility
- Other Services

The Centres will provide shared secretarial services such as, reception, telephone answering, and postal mail management along with telecommunication and internet facilities.

Annex II

Trade Related Technical Assistance (TRTA) Publications

1. Compliance issues affecting enterprise clusters in Punjab province of Pakistan (2007)
2. Guidelines for the operation of WTO Reference Centres in Pakistan (2007)
3. Pakistan: Establishing Confidence in Competence (2007)
4. Pakistan's agro-based exports and SPS compliance
5. Resource guide for the use by the WTO reference centres in Pakistan (2007)
6. Strengthening the public-private trade policy consultation mechanism (2007)
7. The automotive parts sector in Pakistan (2007)
8. The footwear sector in Pakistan (2007)
9. The furniture sector in Pakistan (2007)
10. The pharmaceutical sector in Pakistan (2007)
11. The sports goods sector in Pakistan (2007)
12. The statistical system of Pakistan for reporting on international trade in services (2006)
13. Trade related challenges facing exporters in Pakistan
14. WTO NAMA negotiations (2007)

Annex III

Competitiveness Support Fund (CSF) Publications

1. Balochistan Fisheries Development Study: Options for Balochistan Coastal Fisheries & Aquaculture
2. Karachi Fish Harbour: Roadmap for Restructuring Harbour Management and Operations
3. Action Plan for Fish Quality and Value Adding at Karachi Fisheries Harbour
4. Strategic Study for Competitiveness in Pakistan's Telecom Sector
5. One Product One Village (AHAN): A Business Plan For Empowering Village Enterprise Networks (EVEN)
6. Competitiveness Support Fund Annual Progress Report 2007
7. Competitiveness Support Fund Annual Progress Report 2008
8. Expanding Women's Access to Financial Services: Need for Commitment and Scale(Pakistan)
9. Horticulture Action Plan
10. Matching Grants Brochure
11. Policy Analysis on the Competitive Advantage of the Food Processing Industry
12. Policy Analysis on the Competitive Advantage of the Motorcycle Industry in Pakistan; Problems and Prospects
13. Policy Study into the Economic Empowerment of Women in Pakistan and its Linkages with Competitiveness and Economic Growth
14. Special Economic Zone Benchmarking and Policy Action Plan
15. The State of Pakistan's Competitiveness Report 2007
16. The State of Pakistan's Competitiveness Report 2008

Annex IV

SME Development Funds

Competitiveness Support Fund (CSF)

The Competitiveness Support Fund is based on international best practices (India, Thailand, Turkey, Ireland, Finland etc.) to strengthen and make the private sector more competitive and to improve the policy framework needed for innovation-based competitiveness. The Competitiveness Support Fund is supporting Pakistan's goal of a more competitive economy by providing input into policy decisions, working to improve regulatory and administrative frameworks and enhancing public-private partnerships within the country. The CSF is also providing technical assistance and co-financing for initiatives related to entrepreneurship, business incubators and private-sector led initiatives with research institutes and universities that contribute to creating a knowledge-driven economy. CSF activities are helping all producers along the value chain that contribute to ultimate product quality. By obtaining better value and better prices for quality products, and improving cooperation throughout the Pakistani economy, the CSF is contributing to poverty alleviation by providing more income for producers and better employment prospects for employees.

The CSF has been benchmarked against similar funds that are operating in the countries mentioned above and has been tailored to the current Pakistani economic environment.

Through the operations of the CSF, the private sector, the Government of Pakistan, research institutions and international donors is supporting enterprise development, new start-ups and sectors that have potential to grow by enabling them to compete more effectively and thus:

- Improve the performance of the Pakistan's economy and help expand gross domestic product.
- Develop small and medium-sized subcontractors and link them to large manufacturers.
- Extend the use of research and development results, patents and know-how in enterprises, ventures and promote the establishment of business incubator programmes.
- Enhance the quality of industrial services to increase their impact on production, creation of better jobs and overall development of manufacturing businesses in Pakistan.
- Promote venture capital and encourage business incubation programmes.
- Support the creation of an improved policy framework needed for a viable competitive business environment.

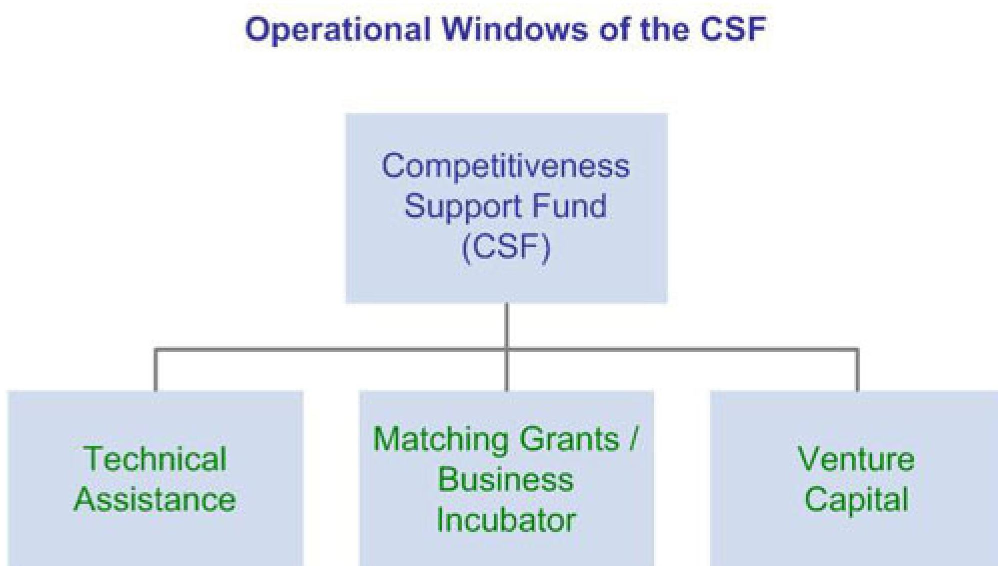
The Fund has become one of the key instruments in Pakistan to support the development of innovation systems;

i. upgradation of enterprises' competitiveness;
ii. start-ups that have completed the business incubation process;
iii. commercialization of the results of research;
iv. pilot projects that demonstrate the impact of better strategy;
v. competitive enterprises that have potential for increasing a sector's
vi. domestic market and export; and
vii. close cooperation with Stanford University for journalists training to increase public focus on innovation and competitiveness through news and improving communication within and across the sector.

In this way, the Fund is contributing to promoting and speeding up the process of bridging existing competitiveness gaps and catching-up to successful developing economies and more advanced countries in the region.

CSF Operational Window

The CSF has the following three operational windows to promote a knowledge-based economy to improve Pakistan's competitiveness at the global economic scene:



CSF operates with a highly qualified, internationally competitive and efficient team in accordance with internationally acceptable standards. To ensure the independence and effectiveness of CSF and its operations, the Fund has been incorporated as an independent company under the Companies Ordinance and has its own private-sector led Board of Directors. The CEO of the CSF reports to the Board.

The small, flexible and efficient team source out some of its work to the local and international experts as well as it works and coordinates its operations with the other relevant institutions in and outside of Pakistan. However, due to the needs of the CSF's operations, its CEO, in consultation with its Board might extend the proposed team of the CSF, if needed.

Business Support Fund (BSF)

SME Business Support Fund (BSF) is a company owned by the Ministry of Finance and funded by the Asian development Bank. BSF is a non profit organization created to assist both the SMEs and the Business development services Providers (BDSP's). The objectives of the BSF are to assist in the improvement of the competitiveness of SMEs and to enhance the revenue-generating capacity and profitability of emerging businesses. The BSF provides matching grants to SME's to stimulate the use of business support services.

Target Groups

The target group comprises of tax paying SMEs (employing up to 50 staff and having turnover lesser than Rs 50 million) and BDSP's. BSF can support individual enterprises or a group of enterprises.

Eligible Activities For Support

Only new engagements of business services can qualify for funding. BSF can support activities such as:

- Short-term consultancies for production process improvement, product development and adaptation, packaging, quality improvement, moulds & dies and installation of equipment.
- Market and Consumer research, marketing, designing or promotional material, stall designing for trade fairs, benchmarking, Funds are not available for capital expenditure or working capital

Annex V

Sector Development Companies

I. Pakistan Dairy Development Company (PDDC)

Pakistan Dairy Development Company (PDDC or, as it is commonly known, "Dairy Pakistan") has been established to drive the development of the Pakistan dairy sector. Dairy Pakistan is a Public-Private sector joint initiative to bring about structural long term change in the dairy industry in Pakistan. With a vision to turn Pakistan into one of the top five dairy manufacturing countries in the world, Dairy Pakistan is embarking on a phased plan targeting all the key players in the dairy sector. Dairy Pakistan is chartered to coordinate, manage and facilitate initiatives leading to the development of the dairy sector in the country.

Dairy Pakistan is a company established under Section 42 of the Companies Ordinance, 1984 and was incorporated as Pakistan Dairy Development Company on the 9th September 2005. The establishment of Dairy Pakistan was a result of recommendations made by the Dairy SWOG (Strategic Working Group). SWOG is a body representing the major players and stakeholders in the dairy chain, including farmers, processors, marketers and the government. The Company is being funded primarily by the Government of Pakistan and partly by the private sector. Dairy Pakistan has been established under the guidance of the Ministry of Industries & Production.

The Board of Directors of Pakistan Dairy Development Company is made up of representatives of both the private and public sectors, with one representative of an agricultural University. A majority of Directors are from the private sector, and according to the Articles of Association of the Company, the Chairman must always be from the private sector.

Strategic Initiatives & Timeframes

Through its "White Paper" – "The White Revolution", Dairy Pakistan has identified many programmes to drive sector development. These programmes will be pursued under the following strategic timeframes:

Horizon One: Programmes already under action

Programmes presently underway are Model Farm and Cooling Tank Programmes.

Horizon Two: Programmes for implementation in the near future

Bulk Vending of Pasteurized Milk: Under this concept, which is practiced in India, most notably by Mother Dairy in Delhi, pasteurized milk is transported in bulk rather than packaged form, to outlets equipped with liquid storage and vending facilities. Liquid milk is dispensed into containers brought to the shop by the consumer. In this manner, high quality milk is made available at reasonable price. This programme is open to existing processors, operating from manufacturing facilities already in place. In addition, it is likely that some installations will be made as part of Milk Pocket Development Programme.

Community Farms: Community farms are intended to group poorer farmers in manner which allows them to receive technical and financial assistance to introduce improved farm management practices. Grouping of these poorer farmers will allow technical and financial assistance to be provided in an economic manner, an important consideration given that the vast majority of dairy farmers in Pakistan have only two or three animals.

Vocational Training: Dairy Pakistan is investigating with possible partners how vocational training can best be provided. There is a desperate need for vocational training for both farmers and industry process workers, and our plans are to address both these needs. The first step towards a comprehensive training programme is to upgrade farms so that modern farm management practices can be demonstrated. The first such upgrade is underway.

Milk Pocket Development: There are areas in Pakistan where milk production occurs in reasonable volume, or production could be enhanced with appropriate support, but where milk processing companies are not active. This programme will identify such areas and provide a link to regional markets for the farmers through appropriate processing facilities. In this manner, opportunity for economic growth for the district and the farmers in the region will be improved, while meeting the needs of consumers for better quality milk. Integration with Dairy Pakistan efforts in the farm production field will occur. Private sector participation will be sought.

Creation of Rural Entrepreneurs: In low cost dairying countries, major items of farm equipment tend to be owned and operated by a "rural contractor" rather than each farmer owning expensive equipment which may be used only seasonally. Given Dairy Pakistan's determination to introduce low cost practices into the dairy sector of Pakistan, it is intended to support the introduction of rural contractors to Pakistan. Private equity will be sought from prospective rural contractors. The following contains more background to this programme.

Livestock Housing: Dairy Pakistan will contract international experts familiar with dairying in tropical and other hot climates, to design sheds for animal housing. With summer temperatures well in excess of 40°C, the main requirement in Pakistan is temperature mitigation.

Link to Finance: Dairy Pakistan intends to work with processors and financial institutions in order to utilize their cash flow generation properties of milk production, with a view to introducing formal credit to the sector, and to lower levels within the sector, than occurs to day.

Horizon Three: Programmes for implementation in the 3-5 year timeframe

Farm Management and Dairying Research Institute. Such an Institute is intended to focus very much on enhancing farming practices in the Pakistani environment.

Biogas: Dairy Pakistan intends to introduce economical production of biogas. Electricity is not always available through rural Pakistan, so this initiative will provide alternative and renewable energy for rural communities, while reducing environmental impacts and improving fertilizer values.

Mobile Milk Collection Units: It is intended to broaden links between the market and farmers by enhancing milk collection through assisting investment in small milk collection units, of the scale of motorcycles and auto-rickshaws. Access to many farms in rural Pakistan is difficult, so such a scheme will enable more milk to be collected and taken to cooling stations.

Farm Input Stores: It is proposed to establish farm input stores across rural Pakistan. These stores will provide to farmers good quality animal feeds and other farm necessities at fair prices. Farm input stores will be focal points for the dissemination of information relating to farm management and market developments.

Review of Support Services Technical Training: It is intended to review the effectiveness of the training course provided to people involved in supporting the dairy sector. In the medium term it is important that the lessons from the Model Farm Programme are built into the education of people who will work in the dairy sector.

Protection of Indigenous Breeds: It is vital that breeds indigenous to Pakistan are protected. Not only is this a matter of principle, but this breeds also offer traits such as resistance to tropical pests and diseases and the ability to cope with high temperatures. It is important that these traits be protected and indeed built upon.

II. Pakistan Stone Development Company (PASDEC)

Pakistan Stone Development Company has been established with SECP as a not-for-profit company. under section 42 of Companies Ordinance 1984 by Ministry of Industries, Production & Special Initiatives, Government of Pakistan as a subsidiary of Pakistan Industrial Development Corporation. PASDEC was incorporated in June, 2006. The Board of Directors consists of 13 Members (7 from Private sector and 6 from Government Sector) and was constituted by Gazette Notification from the Prime Minister's Secretariat.

Objectives

The objectives of the project are:

- Support Dimensional Stone Industry.
- Increasing production of squared blocks and in-turn producing better quality products to compete in international market.
- Increase the mining productivity and efficiency
- Minimize the wastage of valuable natural resources and help reduce environmental degradation.
- Reduce the mining cost.
- To enhance and facilitate value addition in quarrying

III. Pakistan Gems & Jewellery Development Company (PGJDC)

Pakistan is a country with a population of more than 150 million. Labour force is available at relatively cheap rates hence offers a competitive edge. In this part of the world women love to wear gold jewellery. On occasions of marriage and other ceremonies a lot of jewellery is bought and worn. Secondly, gold is also bought for investment purposes, and considered a security as well. Historically Pakistan has a rich tradition of jewellery designs and craftsmanship, being handed down from Ghandhara civilization, Alexanderian period and various other dynasties which ruled the subcontinent and finally the Mughal era. We find a mark from all these periods. Today contemporary period is a fusion of tradition and modern.

In addition, Pakistan is blessed with vast natural reserves of precious and semi precious coloured gemstones, including ruby, emerald, tourmaline, garnet , topaz, peridot, aquamarine, spinel, pargasite, diopside, moonstone, serpentine jade, epidote, pink beryl (morganite), purple beryl, sphene, zoisite, lapis lazuli, turquoise, kunzite and almost all known varieties of quartz. Considering these two factors Pakistan is ideally placed for the industry to flourish and grow to meet the international challenges, if channelized in the right direction. PGJDC, which has the support and backing of the Government of Pakistan through Ministry of Industries and Production, has been allocated Rs. 1.4 billion for its developmental projects and Rs. 150 million for its operational expenses. The success of two years of consultative exercise led to the formation of PGJDC. This consultative process of value chain analysis, gap identification and pilot project identification was led by private sector stakeholders representing all the four provinces and federally administered territories. The result was the first ever mine-to-market strategy based on first hand information.

The main strategic initiatives of the Gems & Jewellery Strategy cover the following areas:

a. Geological Survey for Gemstones Resources. (Location: Northern Areas, NWFP, Balochistan)

At present, there is no scientific quantification of existing and potential deposits in Balochistan. The geological survey for gem deposits in NWFP and Northern Areas was conducted approximately 20 years ago. Furthermore, the recent earthquake may have altered the geological composition of these regions. The Gems and Jewelry SWOG has identified the need to conduct a geological survey of all three areas as one of its main strategic initiatives to quantify existing deposits and identify potential mining locations. This is a crucial requirement if Pakistan is to develop and sustain competitiveness in the long-run. Determining the size and nature of a deposit is a pre-requisite for effective allocation of resources:

- If the deposit is small and high-grade than demand will encourage a small industry with low to medium machinery and premium margin strategy;
- Where the deposits are large, low-value yet in great demand, investment should focus on efficient, automated, engineering driven mining and processing since time-to-market and cost will determine market success;
- Innovation, a key component of branding and sustainable development, will be generated as the discovery and branding of new types of stones provides opportunities to strengthen Pakistan's positioning as a unique source, and help to improve margins along the value chain. Tanzanite is a prime example of how sourcing and distribution benefited from controlling supply to position this stones as a premium branded offering.

The strategy implementing body will lobby with the Pakistan Geological Survey and possibly external resources to conduct the survey. Once GSP decides to undertake the survey, the implementing body will work closely with GSP to define specifically what is required form the survey. It has been identified that each mine's deposit potential needs to be verified along with information on how much has been depleted. The implementing body will also work with GSP to assist them in project funding and technical support. The Geological Survey will lead to greater exploration and exploitation of Pakistan's gemstone resources by assisting the mining industry in identifying potential investment opportunities. It will also assist in attracting more investment in mining leading to an increase in employment opportunities and up-gradation of mining technology and processes.

b. Boutique Mining.

With its abundant resources in precious and semi-precious gemstones, Pakistan can have a significant competitive advantage in the gem and jewelry market. However, mining technology and processes are rudimentary and unscientific resulting in significant wastage at the extraction stage. Indiscriminate blasting damages the gemstone crystals and mineral specimen thus drastically reducing their value. In majority of the mines basic machinery and equipment like compressors and drill sets are not available. A large number of mines are currently inactive due to lack of equipment. The SWOG has highlighted a need for establishing Common Training and Facility Centers to upgrade mining practices in Pakistan. The CFTMC will perform two major functions:

- Training in mining techniques to reduce wastage and extract better quality gems;

- Provision of machines for use of local miners. The CFTMC will have a common pool of machines which will be leased out to miners on a need basis.

The overall objective of the CFTMC is to modernize mining practices, reduce wastage, improve the quality of extracted gems, and thereby increasing the income of miners. Training will improve the skills of those already in the mining industry and train new entrants, leading to an increase in the overall productivity of workers and hence better quality output. Provision of machines will have an immediate impact in terms of rehabilitation of inactive mines and improved production of ones already functioning. The SWOG has highlighted the need for mining CFTMCs in Balochistan, NWFP, Northern Areas and Tribal Areas.

c. Gems / Jewellery Exchange Centers.

There is currently an absence of any formal trading infrastructure due to which miners and dealers resort to temporary locations to conduct their transactions. There are several informal trading centers in Pakistan. Namak Mandi in Peshawar is one the main trading hubs in the country. The second market place is Quetta in Balochistan. Formal gem exchange centers are needed in various locations in Pakistan (Quetta, Peshawar, and Karachi). These exchanges will be open to retailers as well as wholesalers. The objectives of establishing exchanges are as follows:

- Facilitate access to market;
- Provide competitive sourcing to buyers;
- Provide visibility to suppliers without marketing expenditures;
- Improve cooperation between suppliers;
- Enhance profitability by lowering transaction costs of suppliers;
- Discourage informal trade.

It has been recommended that gems CFTMCs, gem labs and gem exchange centers be established under common infrastructure where possible. This integrated approach of providing all the services under one roof will reduce costs and increase cooperation amongst the different participants of the value chain.

d. Gems Identification/ Certification Centers. Location: Gilgit, Peshawar, Karachi, Quetta

Due to lack of adequate gem identification facilities, there is limited understanding of gemstones and their properties often leading to underselling of precious stones as well as lack of buyer confidence. To improve upon the quality of the industry, introduction of standards in the form certification of gems is essential. Currently, there are four gem identification labs in Pakistan: GGIP located in Peshawar, NWFP, two in Karachi and one in Islamabad. GGIP and the one in Islamabad do not issue certificates. According to industry sources these labs have limited identification capacity. The strategy calls for setting up gem identification and certification labs to provide international scientific standards of gem testing and identification. The labs will perform the following functions:

- Identification of new colored gemstones and provide examination reports;
- Testing and certification;
- Grading reports for diamonds (possibly to be implemented at a later stage as the need is created).

The SWOG has also highlighted the need for gems identification and certification labs in Karachi, Peshawar, Quetta, and Northern Areas.
Gem identification and certification labs will stimulate local sales and exports as well as improve profit margins as a greater number of people

will have confidence in product quality. Stone studded Pakistani jewelry will get better prices internationally. The industry as a whole will benefit and move to a higher level of efficiency as parties will have access to impartial professional information about the nature and value of their sales transactions. The standards within the trade will improve as more and more gemstones are correctly identified and described. Quality assurance will reduce transaction costs along the value chain and allow manufacturers and retailers to improve their profits by using certification and grading information to develop consumers' perception about color stones as a worthwhile investment. This will upgrade Pakistan's reputation in the international market as a source of quality gems. The establishment of a laboratory will demonstrate national intent to improve quality standards. It will also provide an institutional mechanism for consumer protection as the consumer will be able to independently verify his/her purchases. The gemologists employed in the laboratory will further stimulate gemological awareness within the trade which will help in increasing the knowledge of the entire sector.

e. Assaying and Hallmarking Centers

Setting up of model Assaying Office (Lahore, Karachi)

For hallmarking in Pakistan, PGJDC constituted a Hallmarking Committee consisting of experts from trade. PGJDC sought London Assay Office's co-operation to work on the feasibility of establishing hallmarking centers.

Hallmarking Act to be framed and Approved:

Hallmarking Act is to be enacted to give assaying/hallmarking a complete legal backing by the Parliament. PGJDC is in the process of selecting a legal firm which will draft the Hallmarking Act, and will also lobby for the promulgation of the Hallmarking Act.

f. Common Facility Training and Manufacturing Centers (CFTMCs).

Common Facility Training and Manufacturing Centers (CFTMCs) - Gilgit, Peshawar, Karachi, Quetta, Lahore

The objective of the Common Facility Training and Manufacturing Center is to provide common training and manufacturing facilities for each of the three primary activities within the industry: mining, gems processing and jewelry manufacturing.

(i) Mining: With its abundant resources in precious and semi-precious gemstones, Pakistan can have a significant competitive advantage in the gem and jewelry market. However, mining technology and processes are rudimentary and unscientific resulting in significant wastage at the extraction stage. Indiscriminate blasting damages the gemstone crystals and mineral specimen thus drastically reducing their value. In majority of the mines basic machinery and equipment like compressors and drill sets are not available. A large number of mines are currently inactive due to lack of equipment. The SWOG has highlighted a need for establishing Common Training and Facility Centers to upgrade mining practices in Pakistan. The CFTMC will perform two major functions:

- Training in mining techniques to reduce wastage and extract better quality gems;
- Provision of machines for use of local miners. The CFTMC will have a common pool of machines which will be leased out to miners on a need basis.

The overall objective of the CFTMC is to modernize mining practices, reduce wastage, improve the quality of extracted gems, and thereby increasing the income of miners. Training will improve the skills of those already in the mining industry and train new entrants, leading to an increase in the overall productivity of workers and hence better quality output. Provision of machines will have an immediate impact in terms of rehabilitation of inactive mines and improved production of ones already functioning. The SWOG has highlighted the need for mining CFTMCs in Balochistan, NWFP, Northern Areas and Tribal Areas.

(ii) Gem Processing: Due to lack of adequate processing infrastructure and skills, approximately 75 percent of Pakistan's exports are in unworked stones, representing a significant loss in value added (total value of exports in 2003 was USD 3.7 million). Gems cutting and processing in Pakistan suffers from obsolete technology, limited skills, and lack of precision. Presently, there are more than 30,000 people involved with the industry and there are around 500 units involved in cutting and polishing of gemstones. Most of the gemstone processors are clustered in Karachi and Peshawar (Namak Mandi), with smaller clusters in Lahore, Quetta and Islamabad. Little value is gained by processing stones as cutting exists on a very limited scale in small one to three person workshops. The prevailing technique is cutting for yield to maximize weight, not value. The industry lacks expertise in precision and calibrated cutting and is not up to date with the latest treatments. The skill level of the craftsmen engaged in gems processing depends entirely on their experience and on what they have learned from their families, mainly migrants from Jaipur, India. These local craftsmen are unaware of latest technologies and international quality standards. Most of the stones are recut, once they reach international markets. While the value addition which can be accrued through processing of these stones (cutting and polishing) starts from 10 times and goes up to as high as 100 times. This reduces the potential price a dealer is willing to pay to the Pakistani seller. Lapidary training is being offered at the Gems and Gemological Institute of Pakistan at Peshawar. Experienced dealers have voiced concerns over the institute's limited resources and training capacity. The objective of the Gemstones CFTMC is to provide state of the art training in cutting, polishing and treating gemstones as well as common processing facilities in order to enhance the value of gemstones sold into the local and international markets. The CFTMC will train a new generation of lapidarists in the latest processes thereby upgrading their skills and earning potential. Training of cutters will be focused on international standards of calibration and new enhancement techniques. The CFTMC will also provide a common processing facility that can be used by gemstone dealers and exporters. The SWOG has highlighted the need for lapidary training and common processing facilities in Quetta, Karachi, Peshawar, Northern Areas and Tribal Areas.

The CFTMC would offer long-term training and short-term certificate courses. Long-term courses would be for people who want to learn in-depth the different sort of cuts, faceting and polishing. Short-term courses would be for experienced artisans to learn the latest techniques of cutting and polishing. The CFTMC would also offer tailored courses and workshops in response to specific industry, firm or group demand. As a result of better processing facilities and skills, buyers will be able to place larger orders as calibrated stones are preferred internationally. A common model lapidary facility will encourage the emergence of other private modern workshops leading to an overall up-gradation in the quality of stones and consequently have a direct impact on Pakistan's export earnings. Significant value addition can be accrued by precision cutting and good polishing, which can be captured by gems exporters rather than foreign buyers. By enhancing the income levels of those directly involved in mining and trading, it will have spin-off effects for the entire region.

Better technology and processes throughout the value chain can increase the price of stones by ten times, and in some cases even more.

(iii) Jewellery Manufacturing: Jewellery manufacturing in Pakistan is done on 21kt and 22 kt gold, predominantly with traditional tools and techniques. Although Pakistan's craftsmen are considerably skilled in 22kt manufacturing of stone studded gold jewelry, they lack access to modern technology and techniques. In absence of proper training facilities, the age old ustaad-shagird (master-apprentice) method of teaching is most popular. A few leading shops have their own little training workshops where they teach students, who are later employed by the same shop owners, but these training sessions are more on job training rather than formal teaching. In such workshops, development is constrained due to lack of resources that a private owner can spend to update himself and his workers on latest trends and techniques. The current working conditions do not conform to international safety standards. There is lack of adequate mechanism for exhaust of toxic vapors produced by the chemicals used in manufacturing. The industry uses cadmium based solder which has been proven to be harmful to health.

The industry's current manufacturing capabilities cannot cater to the technology-driven 14 to 18kt market in the US and Europe or other contemporary design oriented markets. Hence, Pakistan's current export potential is limited by its inability to produce high technology jewelry at scale. Few exporters producing chain and bangles in large quantities invest in modern production techniques and provide competitive pricing and good quality finishing. Even domestically, the jewelry market is increasingly being driven by the latest international fashion trends and new market segments. This requires the industry to upgrade its manufacturing capacity in line with international demand as well as changing domestic preferences.

A common training and manufacturing center will equip the industry with the latest techniques and processes. It will provide artisans with the skills needed to upgrade current manufacturing processes as well as train them to use modern technology for production of 14 and 18kt jewelry. The CFTMC will train workers to use alternatives to cadmium based solders as well as how to incorporate safety and health measures in their work practices. The common manufacturing facility will provide an opportunity for existing manufacturers to diversify their product offerings. It will also provide incubation support for new entrepreneurs, who would not have the capital to invest in manufacturing infrastructure, thereby encouraging SME growth and employment generation. It is expected that training in the latest production techniques will allow manufacturers to become internationally competitive and eventually lead to an increase in exports. The overall impact would be to upgrade the industry's skill level and facilitate its transition into high technology production. The CFTMC will also serve as a catalyst to encourage private businesses to invest in modern manufacturing facilities.

Marketing / Branding through:

a) Participation in International Shows.

b) Local Trade Shows.

c) Market Studies and Surveys.

d) Advertising and Promotion.

The government is providing adequate support and funding to achieve these objectives and to develop the required infrastructure. In this respect, the company is coordinating with the Pakistan Council for Scientific and

Industrial Research (PCSIR) and the Geological Survey of Pakistan (GSP). An MoU has been signed with the Geological Survey of Pakistan (GSP) to explore and identify gemstone reserves. The Company is facilitating development of a Gems and Jewellery Manufacturing cluster in the first ever National Industrial Park (NIP) of Pakistan in Karachi. The idea is to have various processes of manufacturing and commercial activities under one roof. Pakistan has been participating in international fairs and exhibitions under the brand; GEMS & JEWELLERY PAKISTAN The trade has already participated in the following shows/exhibitions either as country pavilion or as delegates:

- Indian International Jewellery Show – Bombay (30 August - 3 September 2007)
- Bangkok Gems and Jewellery Fair (18 – 22 September 2007)
- Women's Gold @ Gems Exhibition (2 – 4 November 2007)
- Jewellery Collections Dubai (11 – 15 December 2007)
- The Tucson International Gem Show (6 – 11 February 2008)
- Indian International Jewellery Show – Goa (29 February – 3 March 2008)

The Company will continue these efforts and undertake initiatives to develop ties with international and regional agencies and institutions. In addition, Pakistan Gems and Jewellery Development Company is planning to organize an International Gems and Jewellery Exhibition Pakistan.

a) Participation in International Shows.

b) Local Trade Shows.

c) Market Studies and Surveys.

d) Advertising and Promotion.

Annex VI

SME Support Architecture

In 2006-07 SMEDA started a rather ambitious programme of project implementation in different SME clusters. The projects have been conceived in consultation with prominent cluster players. The aim is to catalyze induction of new technologies through demonstration, training, provision of common facilities and ancillary services. Initially three projects were picked in Gujranwala, Sialkot and Multan besides a small Business Incubation Centre in Lahore. Later in 2007-08 more projects were added. All in all SMEDA now has sixteen projects under implementation worth Rupees 1.68 billion. Following is brief glimpse of each one of them.

Sr. No.	Name of Project	Objective	Project Cost (Pak Rupees)
01.	Agro Food Processing, Multan	Common facility center for pulp extraction of various fruits in Multan to help growers / exporters in processing and value addition of their products by introducing vegetable and fruit processing techniques	135.19 Million
02.	Foundry Service Center, Lahore	First institutional set up to support foundry cluster, Product Dev. Support i.e. Light Eng. Sectors, Casting process optimization, Compliance with Int'l quality standards and new technology integration, Training, Consultancy & Advisory for SMEs	150.04 Million
03.	Glass Products Design, Development & Training Center, Hyderabad	To diversify bangles manufacturing cluster into manufacturing other glass products such as decorated ware, tableware, automobile headlight lenses, glass bulbs, shells, consumer products such as bowls and ashtrays etc.	37.08 Million
04.	Gujranwala Business Center	Establishment of a shared display, meeting and incubation facility for Gujranwala based industry. It will serve as one stop shop for Int'l buyers. Provision of round the year exhibition, in-house business development services for SME exporters	98.78 Million
05.	Product Development Center for Composite Materials, Sialkot	o Facilitate export of composite based sports goods o A CFC to provide skilled workforce for this emerging sector, develop necessary machinery through reverse engineering, provide consultancy services in setting up new industrial units	382.22 Million
06.	Sports Industries Development Center, Sialkot	Common Facility Center for introducing mechanized ball technology in soccer ball industry Sialkot - facing threat of new technology	272.61 Million

07.	Women Business Incubation Center, Lahore	To provide one window office facility to encourage Women to participate in Economic development and achieve economic empowerment.	31.22 Million
08.	Revival of Cutlery Institute of Pakistan (CIP) - Wazirabad	To train about 500 fresh and retrain 500 semi skilled craftsmen for the cutlery cluster every year. Training to include documentation, E-Business, B2B, packaging and branding	Rs. 39 Million
09.	Sialkot Business & Commerce Center, Sialkot	o Provision of business infrastructure facility for exporters especially SMEs o Establishment of a shared display facility o Promote and export of Products from Sialkot o One Stop Shop for International Buyers o Round the year Exhibition	341.67 Million
10.	SME Subcontracting Exchange	Developing inter-firm linkages, promoting large manufacturing to procure/subcontract from small firms	26.09 Million
11.	Policy & Projects Implementation, Evaluation and Monitoring Unit	Unit for PSDP Project Implementation Execution & monitoring of PSDP projects require specialized staff – trained in project management with diverse skill set. With the current pace of new initiatives need for a separate unit is imperative. This unit will lend support to ROs/ divisions in proposal development, ensure timely completion and compliance with all procedural requirements.	25.82 Million
12.	Chromite Beneficiation Plant	A Common Facility Centre to remove impurities from mined chromite to reduce transportation costs	Rs8.38
13.	Women Business Development Center (WBDC)	Provision of business infrastructure for women entrepreneurs in a commercial area -- giving this marginalized cluster of entrepreneurs to come in the business main stream	Rs. 34.03 Million
14.	Revival of Hyderabad Leather Footwear Center (HLFC	Revive Hyderabad Leather Footwear Center (HLFC) and train workers from footwear cluster in modern machine made shoe making. The Center will also provide business development and incubation services to the footwear cluster in Hyderabad	Rs. 35.01 Million
15.	Women Business Development Centre (WBDC) - Peshawar	Provision of business infrastructure for women entrepreneurs in a commercial area -- giving this marginalized cluster of entrepreneurs to come in the business main stream	Rs. 28.41 Million
16.	Washing & Pressing Plant (CFC)	Washing/Dry Cleaning & Pressing Common facility for the weaving cluster, to improve the finishing of cloths produced in the cluster by providing professional services	Rs. 5.38 Million

Acronyms

BIC	Business Incubation Centre
CGS	Credit Guarantee Scheme
FBR	Federal Board of Revenue
FBS	Federal Bureau of Statistics
GDP	Gross Domestic Product
GNP	Gross National Product
GoP	Government of Pakistan
Govt.	Government
HR	Human Resource
HRD	Human Resource Development
INSMED	Institutes of Small & Medium Enterprise & Entrepreneurship Development
ISO	International Standard Organization
LIP	Labour Inspection Policy
LPP	Labour Protection Policy
ME	Medium Enterprise
NAVTEC	National Vocational and Technical Education Commission
NWFP	North West Frontier Province
PKR	Pakistan Rupee
R&D	Research & Development
SE	Small Enterprise
SECP	Securities & Exchange Commission of Pakistan
SME	Small & Medium Enterprise
SMEDA	Small & Medium Enterprises Development Authority
TEVTA	Technical Education & Vocational Training Authority

TSPs	Training Service Providers
TUSDEC	Technology Upgradation & Skill Development Company
WAPDA	Water & Power Development Authority
WTO	World Trade Organization

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