

Small and Medium Enterprises in Pakistan

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Traditionally an SME, (a small and/ or medium enterprise) is defined as an enterprise and is considered to be any entity engaged in an **economic activity**, irrespective of its legal form. This includes in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity. However, when we talk about the exact composition of an SME it tends to differ from one province to another. In Punjab an industry is categorized as an SME if its fixed investment consists up to Rs 20 million excluding its land and building. However, in the province of Sindh, an SME is defined as any entity engaged in producing handicrafts or in the manufacturing industry with a fixed capital not more than Rs 10 million including its fixed investments.

In Pakistan, cottage or household industries hold an important position in rural set-up. Most villages are self-sufficient in the basic necessities of life. They have their own carpenters, blacksmiths, potters, craftsmen and cotton weavers. Many families depend on cottage industries for income. The industry has immense potential in terms of its input in the total GDP growth of the country. However due to the lack of financial opportunities and other hindrances the small scale businesses are unable to work in its full potential and therefore only makes up to 5% of the total GDP growth. Special measures need to be taken for the improvement in the promotion of such industries in the economy since such industries in particular have created large scale employment opportunities. Since the industry is labor intensive in nature 25% of the Pakistani labor force is currently employed in the different SMEs especially in the different parts of

Punjab like Sialkot, Faisalabad and Gujranwala. Areas of Sindh include Hyderabad and Karachi in particular. Apart from these major city centers, there exist many different small scale enterprises in the remote areas of KPK and Kashmir.

Due to the low financial investments available to the entrepreneurs of the SMEs, there are a large number of problems and barriers for the proper functioning of such industries. Some of the major problems are:

1. The revenues generated tend to have a very small monetary value due to which the individual profits generated is so less that most of it is spent on the daily expenditures. Extra capital is not available for expansion purposes.
2. Economies of scale are not available so production cost is higher. Goods produced in small-scale industries cannot compete in open market if the same goods are manufactured on a large scale.
3. There is a lack of standardization and quality control. In some cases they do not meet the standards of foreign markets. A lack of coordination between different industries also creates differences in prices.
4. Due to the low literacy rate of the investors, the production methods and technology used is outdated
5. The wholesaler, who takes most of the profits, exploits the owners of the small-scale industry. In some cases goods are sold to wholesalers at cost price, which discourages the owners and they reduce the quality and quantity the produced.
6. In rural areas, where the electricity is not provided, small-scale industries are difficult to set up. Even the great fluctuation in voltage and power break-downs cause damage to

the electric motors. The commercial rates of electricity have also increased significantly which hinders the growth.

7. The craftsman and artisans learn their skills and production methods from their elders. The provision of technical advice and further training is limited.
8. Due to the lack of trade barriers and the promotion of free trade, the markets are flooded with internationally produced goods which over shadow the domestically produced output

In order to utilize the full potential of the SMEs in Pakistan there are special measures that are needed to be taken by the government which would secure and promote the existence of such industries. Currently one of the major problems faced by these producers are the lack of finances available due to which many producers and entrepreneurs are unable to fulfill their basic production requirements which has prevented them from any further enhancement of production and also acted as a huge barrier in the final products from reaching the market. In our current banking and economic system for the acceptance of any major long term loans, to reduce the chances of defaults, banks require security deposits or collaterals from the borrowers. However the majority of the owners of such SMEs are unable to fulfill the collateral requirements due to which they are deprived of such financial backups. In order to minimize such problems the government of Pakistan needs to introduce the concept of micro financing and collateral free loans which would provide such producers with startup investments and financial foundations and help in the basic cash cycle management. The concepts introduced by Grameen Bank of Bangladesh should particularly be promoted and adopted to cater to the needs to such small scale producers. Similarly to provoke private individuals to increase investments in the sector; tax breaks should be provided on the wealth returns from such investments. This would lead to an increase in private investments and help support the financially deprived producers with startup capitals.

Apart from financial hindrances SME producers also face the problems regarding small scale production. The output produced across the country in total may be huge in number, however due to the lack of proper channels; the producers individually are unable to take the large scale production advantage of economies of scale and hence face much higher cost as compared to the bulk producing masses, thereby making them less competitive. It is very important for the government to provide a strong proper channel which would help unionize such small scale producers which would basically help them increase their production capacity and also create large scale production benefits such as economies of scale and economies of scope. This would not only help them in increasing their productivity and economic efficiency but would also make them more competitive in the open market.

Also the output produced by the SMEs lack standardization and may not be partially or completely satisfying the international quality standards which in turn again reduces their competitiveness especially in the international market. This further leads to lower sales and smaller revenues generated. The main reason for the existence of such a problem is because of the lack of appropriate level of training. Many individuals especially women in the handicraft industries learn the skills of production domestically by their parents or elders which have been taught from generations as a family heritage. However these skills which may have proven successful 10 or 15 years earlier due to the low levels of competition and may have been able to produce successful products; they however; cannot cope up with the current situation. Also these skills differ from family to family therefore the final products even though perhaps meant to be similar lack uniformity in terms of standardization. Therefore it is necessary for the government to provide appropriate level of training to all such producers which improve the quality standards of the final processed goods. Training centers should be established especially in the rural areas for the local residents where special skills are to be taught

taking into consideration the current domestic and international competition so that the products are standardized and fulfill the basic quality control criterion.

Pakistan is currently suffering from very low rates of literacy due to which there exist barely any innovation in the technology and production machinery. The majority of the equipment used is outdated and are in a dire need to urgent replacement. Due to such technological backwardness the productivity and the efficiency of production is greatly reduced and also tends to increase per unit cost of production which in turn has adverse effects upon the profits. Therefore the government needs to provide convenient financing and mortgage schemes to such individuals where updated technology and machinery is readily available on low financial investments to improve the productivity and reduce wastage. Similarly SME economic zones need to be established where it the responsibility of the government for the promotion of such industries; at least basic infrastructural facilities are provided such as proper road links and telephone lines. Such economic zones should also be provided with tax breaks and exemptions to incentivize private investments in this sector.

Most of the SMEs are established in the rural areas of the country where work is done in households by women and children not for the sake of profit maximization but for the fulfillment of basic survival needs. Since the producers themselves have no direct access to the market there exist different middlemen who provide a channel and link between the rural producers and the urban consumers. However even though the purpose to such middlemen is to promote and support the rural producers; they on the other hand tend to adversely affect the total profits received by the producers. The rural producer unaware of the true value of his or her product sells the output to the middlemen at a very low cost. Whereas the middlemen; fully aware of the market situation makes abnormal profits by selling the output at a much higher price. Therefore in order to support the original producer the government needs to establish market centers closer to or even within the rural

areas so that the exploitations of the middlemen can be reduced and so the producers can take avail the maximum profits.

In the current competitive economy Pakistan is suffering from a severe trade deficit and in order to improve the persistent economic slump it is very important for the country to improve its balance of trade. One solution to the problem is to promote the domestically produced goods especially the output of the SMEs since they also cater to the problem prevailing unemployment. For that to happen it is important for the government and individuals to substitute the imported goods with the domestic production. Not only in the local market but also internationally government is required to promote the output of the SMEs. This can be done through the establishment and participation in different global trade fairs where the local producers would be provided access to the international market.

The small and medium enterprises of Pakistan play a very important role in the economic development of the country. In fact some of the products produced by this sector of the economy not only caters to the GDP growth rate but also forms the cultural identity of Pakistan. Hence the preservation, protection and promotion of the sector should be the top most priority of the government and it should take strong and immediate action in help in the development of such industries since these are the basic milestones to the road to economic success.
