

# Approaches to SME Development: Lessons for Pakistan

Ammar Naveed

**Acknowledgement:** I am grateful to Mr. Zulfiqar Thaver, President Union of Small and Medium Enterprises, for his valuable input. However, Mr. Thaver bears no responsibility for the conclusions drawn.



## **Abstract**

*This paper looks at various approaches to SME development in Asia and the lessons Pakistan can learn from the experiences of other Asian countries. It also sheds light on the extent to which the governments of major Asian economies have been involved in industrial and economic policy, especially with regard to export oriented SME development. Moreover, the amount of resources governments across Asia spend on the SME development institutions has also been discussed.*

## **I - Introduction**

The economic scenario of every country is directly affected by the prevailing concept of market globalization. Approbation of liberal ideologies including trade liberalization and free markets in World Trade Organization's agenda along with rapid advancement in technologies like communication, transportation and infrastructure in general has endorsed numerous new competitions in national and local markets worldwide including in developing countries. Study of economics needs to integrate these aspects in its analysis in order to aptly formulate models and suggest approaches tailored according to the individual needs of countries at different stages of economic development. The initial six decades of the last century saw the predominance of booming Fordist companies "based upon productive structures that guaranteed important scale economies and the related cost reduction". However, by the 1960s and 70s SMEs came into the picture and were thriving tremendously especially within industrial clusters which could develop their production and export capacity<sup>1</sup> (Piore and Sabel, 1984), as the Fordist companies were troubled due to their own directorial and productive rigidities resulting in considerable losses in market shares in several sectors. By late 1980s however, the social-economic development of the SMEs was endangered as most large-scale firms reorganized bringing in technological advancements thereby becoming capable or pressurizing the SMEs in global markets.

Despite the aforementioned issues, SMEs continue to play a significant role in any country's economy across the globe; in Latin America<sup>2</sup>, Asia (CFR, 1998) and Europe (European Observatory for SMEs, 2003) they represent more than 90 percent of the total number of firms, 40–70 percent of employment and 30–60 percent of GDP<sup>3</sup> (Bianchi et al., 2006). Moreover, it is not only the economy of a state to which the SMEs are pertinent, rather they hold relevance with respect to political as well as social development of a nation. One of the major reasons being that economies having an aggressive SME participation tend to stimulate domestic development through collective action in formulation of networks by helping individuals to configure efficient associations within and among firms and

---

<sup>1</sup> Michael Piore and Charles Sabel, *The Second Industrial Divide*, (New York: Basic Books, 1984).

<sup>2</sup> W. Peres and Giovanni Stumpo, "Small and Medium-sized Industrial Enterprises in Latin America and the Caribbean under the New Economic Model", *World Development*, vol. 28, No. 9 (2000).

<sup>3</sup> P. Bianchi and S. Labory, ed., *Handbook of Industrial Policy* (Cheltenham: Edward Elgar, 2006).

other institutional entities<sup>4</sup>. Secondly, such activities as taken up by SMEs involve greater number of people who when personally involved, take up economic responsibility and value their own competencies more. This sort of arrangement is a vital aspect of an efficient and effective society<sup>5</sup>.

Nevertheless, as long as the competitive role and potential effect of SMEs in a society are elucidated, these possibilities continue to be merely theoretical constructs especially in the developing world. Lagging in technological development and faced with a competitive gap with respect to international firms and prosperous ventures in the economically liberalized world, the importance of the need for such a clarification is highlighted in developing countries.

It remains ever so pertinent to encourage the growth of SMEs in today's competitive business environment. As a result, entrepreneurship development, productivity increase in traditional enterprises and strong networks form part of a strategic approach to achieve such an aim (Bianchi et al., 2000; Bianchi and Parrilli, 2002; Parrilli, 2004b).

## **II - The Importance of SMEs**

As has been witnessed during the course of economic development in many Newly Industrialized Countries (NICs) in Asia, SMEs have a crucial role to play in terms of employment creation, egalitarian distribution of economic resources leading to poverty reduction, growth of exports, and development of entrepreneurship in both urban and rural areas. Their importance is evident from the following factors:

Their number is huge and they are scattered widely throughout the country in urban as well as rural areas; in Pakistan there are 3.2 million economic establishments out of which 99% are SMEs<sup>6</sup>.

Most of these economic establishments consist of firms that have significant potential for employment growth and generation. Awareness of this fact also explains the growing emphasis on the role of these enterprises in rural development in developing countries across Asia. SMEs use technologies that take into account the endowment of factors of production particular to the area in which they function. They use technologies "that are in a general sense more "appropriate" than modern technologies used by large enterprises (LEs) to factor proportions and local conditions in developing countries".

Given that the majority of Pakistan's population lives in the rural areas and that by 2030 Pakistan's urban population will be equal to the rural population, SMEs

---

<sup>4</sup> K. Cowling, and R. Sugden, "The Wealth of Localities", *New Political Economy*, Vol. 4(3) (1999).

<sup>5</sup> P. Cooke, and D. Wills, "Small Firms, Social Capital and the Enhancement of Business Performance through Innovation Programmes", *Small Business Economics*, Vol. 13, (September 1999).

<sup>6</sup> P. Bianchi, and M.D. Parrilli, "Small and Medium-sized Enterprises: A Comparative Approach to Latin America and the European Union", *Dept. of Economics, Ferrara University, Discussion Paper no.26* (2002).

provide a good starting point for the mobilization of both rural populations' talents as entrepreneurs and their capital; while, at the same time, rural SMEs can function as an important sector providing an avenue for testing and developing entrepreneurial ability. Moreover, a majority of SMEs finance their business from their personal savings or through informal credit channels. These enterprises can, therefore, also act as a means to allocate rural savings that otherwise would be used for unproductive purposes; rural or farm households might keep or save any surplus money for zero interest inside their homes because in most rural areas there is no banking system.

In Pakistan, as elsewhere, SMEs are largely involved in the production of consumer goods such as clothing, handicrafts, furniture, leatherwear, sports goods, household, and simple tools, equipment, and machines to meet the demands of farmers and producers in the industrial, trade, construction, and transport sectors. Although many of the goods produced by SMEs are bought by consumers from the middle and high income groups, these goods also cater to the needs of local low-income consumers and hence SMEs are important for securing the basic necessities for this segment of the population by providing low priced products available in areas which are otherwise not well connected to big cities.

SMEs are generally more flexible than their larger competitors; such enterprises are especially important in industries or economies that face rapidly changing market conditions, such as the sharp macroeconomic downturns that have bedeviled many developing countries over the past few years, including Pakistan.

### **III - Role of the State in SME Development**

Issues pertaining to the development of viable and efficient SMEs are numerous; varying from region to region, between rural and urban areas, between sectors, and even between individual enterprises within a sector. However, certain constraints are common to all SMEs, including the "lack of capital, human resources, technology, and information; difficulties in procuring raw materials, marketing, and distribution; high transportation costs; problems caused by cumbersome and costly bureaucratic procedures, especially in obtaining the necessary licenses; and policies and regulations that generate market distortions."<sup>7</sup> In the course of the economic development of the Newly Industrialized Countries (NICs) of Asia, there is no example of a country following a completely laissez-faire policy with regard to economic and industrial development.<sup>8</sup> While the nature and extent of the involvement of state varied across countries, with each country having its particular recipe/formula, industrialization did not take place through the unregulated workings of the market in any of these cases. The success of the Asian Tigers has been on the

---

<sup>7</sup> T. Tambuna, "The Impacts of Trade Liberalization on Indonesian Small and Medium-sized Enterprises", *TKN Policy Paper* (2011).

<sup>8</sup> T. Hussain, "Industrial Policy: Irrelevant or Essential?", *Social Science and Policy Bulletin*, Vol. 2, No.2 (2010).

back of active government involvement in industrial and economic policy, especially with regard to export oriented SME development. The extent of state intervention in these economies ranged from input subsidies, tax exemptions, and tariff protection to direct public sector investments, while the outward-oriented industrial policy of the East Asian countries provided opportunities for domestic firms to target regional and international markets, allowing for economies of scale and efficient production. Moreover, for some theorists, effective local development requires appropriate national and international institutions, policies and strategies. Otherwise, efforts to expand face a series of bottlenecks linked to the existence of ‘regressive coalitions’ and ‘transnational powers’ that tend to marginalize SMEs and their local business associations.

#### IV - SME Development Institutions in Asia

Given the fact that the government has a very pertinent role to play in SME development, it is worth noting the amount of resources governments across Asia spend on the SME development institutions. Table 1 shows organizations which are mandated to promote the SME sector in the various Asian countries including Japan (SMRJ), Korea (SMBA), Malaysia (SME Corp), Thailand (OSMEP), India (SIDO/DCMSME) and Pakistan (SMEDA). Looking at Pakistan, we note that “SMEDA grossly falls short of almost all its international comparators in almost every dimension, including services offered, outreach, human resources and financial resources”, while on the other hand, most of the other countries have allocated considerable resources towards their respective SME development organizations which has resulted in greater advocacy and policy making for the SME sector and business support provision to SMEs in these countries. Figure 1 shows the Per Capita Budget of SMEDA- Equivalent bodies, with Pakistan at the bottom of the list with an inadequate \$0.01 per capita.

Table 1<sup>9</sup>

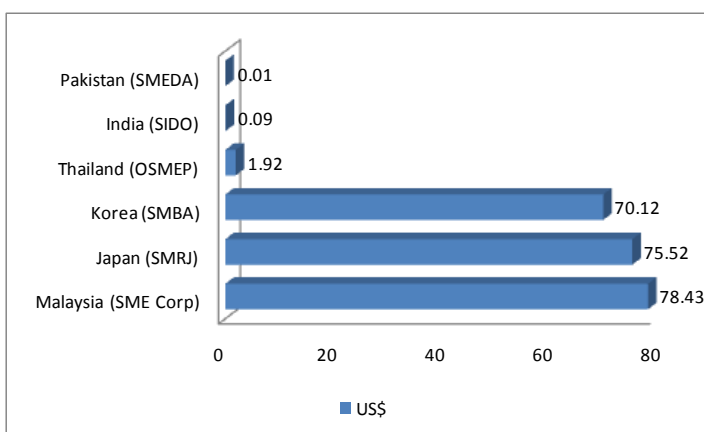
Country	Org.	Outreach (Offices)	Budget	Total Staff
India	SIDO	30 Regional Offices called SISIs (Small Industries Service institute) 28 Branch SISIs 4 RTCs (Regional Testing Centers) 7 FTSS (MSME Testing Stations)	\$109 Million	2500
Japan	SMRJ	Headquarter 10 Branches/Office 9 SME Universities	\$10 Billion	811

Continued ....

<sup>9</sup> “Independent Organizational Evaluation of SMEDA”, Ministry of Industries, <http://www.moip.gov.pk> (accessed on 16 November, 2011).

Country	Org.	Outreach (Offices)	Budget	Total Staff
Korea	SMBA	Headquarter 11 Regional Offices	\$3.49 Billion	2794
Malaysia	SME Corp	Headquarter and 11 regional Offices	\$2.22 Billion	289
Thailand	OSMEP	Headquarter and 19 regional Offices 90 Service Centers	\$122 Million	-
Pakistan	SMEDA	A headquarter and 4 provincial offices 18 Regional Business Centers	\$1.74 Million	125

**Figure 1**<sup>10</sup>



Lower budget as compared to similar SME development organizations in other countries has seriously constrained SMEDA's ability to actively engage the SME sector. Despite its efforts to address the issues pertaining to SMEs, its lack of resources hinders it from uplifting the SME sector in terms of outreach and policy development. The following is an excerpt from a report titled 'Independent Organizational Evaluation of Small and Medium Enterprise Development Authority (SMEDA)' on the resource deficiency faced by SMEDA which leads to lack of national outreach highlights this issue:

*“The country, which is the closest to Pakistan in terms of population, level of development and demographics is Brazil. Their organization, SEBRAE, is getting a funding of \$7.24 per capita (with a dedicated revenue base of .3% of payroll taxes), which is an immense amount when compared to Pakistan. Brazil like Pakistan is an emerging economy and its SME agency employs 4500 direct workers and has over 9000 external*

<sup>10</sup> ibid.

*consultants helping the SMEs. In contrast, SMEDA employs only 125 workers and handful of consultants. SEBRAE runs 788 service centers, has presence in 2000 municipalities supports 200 clusters and runs 377 incubators. In contrast, SMEDA has 4 provincial offices and 18 regional offices...If SMEDA were to acquire enough funding, with a proper organizational structure and good management in place, Pakistan would take the first step towards energizing the SME sector for industrial development of Pakistan.”<sup>11</sup>*

## **V - Pakistan’s Expanding Workforce: Access to Finance and New Start-ups in Pakistan**

By 2050 Pakistan is projected to have a population of over 351 million out of which 263 million will be in the working age group<sup>12</sup> - this can be either an impending disaster or an opportunity to earn the ‘Demographic dividend’. With such an influx of labor force, unless and until mechanisms for employment are developed, poverty and frustration among the ‘young’ generation is likely to swell leading to increased crime, drug use and extremism. In Asia, *“high unemployment rates coupled with limited economic growth triggered policy makers into giving greater importance to entrepreneurship and self-employment as ways to foster economic progress and reduce unemployment.”*<sup>13</sup> However, while studies of the relationship between new firm formation and job creation have found very diverse results, an important analysis is provided by the Global Entrepreneurship Monitor which analyzed the relationship across 21 countries between ‘Total Entrepreneurial Activity’ and per cent growth in GDP finding that “amongst nations with similar economic structure, the correlation between entrepreneurship and economic growth is high and very significant”.<sup>14</sup> Therefore, it is important for policy makers in Pakistan to provide a conducive business environment in which entrepreneurship flourishes and new ventures are created.

However, as is pointed out in SME Policy 2007 and as has been experienced in SME sectors in Asia and elsewhere, access to finance is a major obstacle hindering SME growth and development.<sup>15</sup> In the SME Baseline Survey 2009 (Pakistan), 84% of the total respondents had not applied for a bank loan during the last 2 years, while out of the 16% who did apply for a loan only 10% did so to start a business, i.e. only 1.6% of the total respondents applied for a loan to start a new venture in the last 2 years. Out of the 84% respondents who did not apply

---

<sup>11</sup> *ibid.*

<sup>12</sup> Framework for Economic Growth Pakistan, 2011 (Islamabad: Printing Corporation of Pakistan Press, 2011).

<sup>13</sup> R. Baptista, R., and A.R. Thuric. “The Relationship between Entrepreneurship and Unemployment: Is Portugal an Outlier?”, *Technological Forecasting & Social Change* 74, (2007).

<sup>14</sup> “GEM 2000 Global Report”, Global Entrepreneurship Monitor, <http://www.gemconsortium.org/docs/254/gem-2000-global-report> (accessed 12 November, 2011).

<sup>15</sup> “SME’s inaccessibility to Finance: The Bottom Line”, SMEDA Research Journal Vol. 1, Issue 1 (December 2010): 24-39.



for a loan, 37.5% stated that they did not apply for a loan due to high interest rates<sup>16</sup>.

SMEs' access to formal credit, from commercial banks and leasing companies over the years, has been low. "At the end of March 2011, SME sector's outstanding credit stood at Rs. 303.4 billion constituting about 8.6 percent of total outstanding banking portfolio (corporate, SME, agriculture, consumer, commodity and others). This was 9.3% lower from the previous quarter and 6.3% from the corresponding period in 2010"<sup>17</sup>. It is believed that banks' perceptions regarding the high credit risk associated with the sector and subsequent surge in Non-Performing Loans should they default, is the reason that SMEs receive such little share in their total credit portfolio.

In light of the increasing workforce and shirking credit to SMEs it is highly improbable that the demographic dividend can be earned. In countries that developed a comprehensive and holistic program to fortify the SME sector in their respective countries did so by providing SME support funds such as Business Development Support Equity, Credit Guarantee Schemes, Venture Capital Funds, and Matching Grants.<sup>18</sup> Such support funds not only played a great role in providing the much needed capital to enhance competitiveness of existing firms but more importantly gave impetus to entrepreneurs to start new ventures and turn their ideas into profitable realities.

## **VI - Conclusion**

NICs of Asia have been growing at an impressive rate during the last decade and a half. While the formulas and parameters of growth may have differed in these countries, one definitive feature that has been witnessed in these countries is the proactive role played by governments to provide a conducive environment for local and international businesses. In doing so, these governments have allocated resources for the development and uplift of the Small and Medium enterprises - providing them with incentives to start and expand their ventures, and providing them with financial resources and business development services. Given the fact that SMEs play a vital role in Pakistan's economy, GoP needs to actively support SME development organizations which are currently operating under strict financial constraints: these organizations are critical to analyze the ails of this sector and provide solutions to uplift it. Lastly Pakistan's population is expanding and with such an influx of labor force, unless and until mechanisms for employment are developed, poverty and frustration among the 'young' generation is likely to swell leading to increased crime, drug use and extremism. This indicates the high priority the GoP should set for entrepreneurship and SME development to impede an looming economic and social disaster.

---

<sup>16</sup> Small & Medium Enterprises Development Authority, SME Baseline Survey 2009 (Lahore: SMEDA, 2010): 30-44.

<sup>17</sup> Development Finance Quarterly Review, March 2011 (Karachi: State Bank of Pakistan, 2011): 4

<sup>18</sup> Small & Medium Enterprises Development Authority, SME Sector: Genesis, Challenges and Prospects (Lahore: SMEDA, 2009).

## References

- Baptista, R., & A.R. Thuric. "The Relationship between Entrepreneurship and Unemployment: Is Portugal an Outlier?". *Technological Forecasting & Social Change* 74, (2007).
- Bianchi, P., and M.D. Parrilli. "Small and Medium-sized Enterprises: A Comparative Approach to Latin America and the European Union". *Dept. of Economics, Ferrara University, Discussion Paper* no.26 (2002).
- Bianchi, P., and S. Labory, ed., *Handbook of Industrial Policy*. (Cheltenham: Edward Elgar, 2006).
- Cooke, P., and D. Wills. "Small Firms, Social Capital and the Enhancement of Business Performance through Innovation Programmes". *Small Business Economics*, Vol. 13, (September 1999).
- Cowling, K., and R. Sugden. "The Wealth of Localities". *New Political Economy*, Vol. 4(3) (1999).
- "GEM 2000 Global Report". Global Entrepreneurship Monitor. <http://www.gemconsortium.org/docs/254/gem-2000-global-report> (accessed 12 November, 2011).
- Government of Pakistan. Planning Commission. *Framework for Economic Growth Pakistan*. Islamabad: Printing Corporation of Pakistan Press, 2011.
- Government of Pakistan. Small & Medium Enterprises Development Authority. *SME Baseline Survey 2009*. Lahore: SMEDA, 2010.
- Government of Pakistan. Small & Medium Enterprises Development Authority. *SME Sector: Genesis, Challenges and Prospects*. Lahore: SMEDA, 2009.
- Hussain, T. "Industrial Policy: Irrelevant or Essential?". *Social Science and Policy Bulletin*, Vol. 2, No.2 (2010).
- Peres, W., and Giovanni Stumpo. "Small and Medium-sized Industrial Enterprises in Latin America and the Caribbean under the New Economic Model". *World Development*, vol. 28, No. 9 (2000).
- Piore, Michael, and Charles Sabel. *The Second Industrial Divide*. New York: Basic Books, 1984.
- "SME's inaccessibility to Finance: The Bottom Line". *SMEDA Research Journal* Vol. 1, Issue 1 (December 2010): 24-39.
- State Bank of Pakistan. Infrastructure, Housing & SME Finance Department. *Development Finance Quarterly Review*. Karachi: State Bank of Pakistan, 2011.
- Tambuna, T. "The Impacts of Trade Liberalization on Indonesian Small and Medium-sized Enterprises". *TKN Policy Paper* (2011).
- "Independent Organizational Evaluation of SMEDA". Ministry of Industries. <http://www.moip.gov.pk/> (accessed on 16 November, 2011).