

21. SME Development for Employment Generation

21.1. Introduction

A major global re-structuring is underway in the manufacturing as well as services sector. This has taken the form of re-location of manufacturing, design, and service activities to places where cost reduction can be affected without compromising reliability. Such activities are generally undertaken by small and medium enterprises (SMEs) which comprise the bulk of any nation's economic units and contribute significantly to employment. In some newly industrialised Asian countries, SMEs have evolved into major global players and conglomerates through this activity, offering complete end-to-end services in the supply chain, whether as manufacturers of piece parts and systems, or providers of electronic services.

Industrial economies of the 21st century have short product lifecycles; production is flexible and lean, with focus on the entire value chain and not just on internal processes. Key drivers of growth now are people, innovation and capabilities and not just capital. In the 1980s-90s, it was shown that manufacturing could be undertaken anywhere; now designing can also be done anywhere. These activities are ideally suited for SMEs if they can become partners in an internationally accepted supply chain. This is the peril, but this is also the promise of the present globalisation.

The contribution of small and medium industries (SMEs) to Pakistan's economy, employment absorption, and poverty alleviation, can be gauged from the fact that 90 % of all private sector manufacturing units employ less than 99 persons. Their impact is extremely high in the manufacturing sector, even when most of this may be employment generation at 'subsistence levels'. They contribute 7% to GDP, and generate 25 % of exported manufactures. However, low investments in technical and managerial skills, coupled with an unfavourable legal, regulatory, and taxation environment, prevents the SMEs from achieving their actual growth potential for employment, income generation, and poverty reduction.

The key ingredient needed to make SMEs competitive is enhanced technical skills and organisational capacity. Earlier attempts in this direction in Pakistan and elsewhere were not very successful, partly due to limited conceptualisation of technology and its role in development, and lack of practical experience in project implementation and delivery mechanisms. Choice of content and mechanism of delivery has always been critical to the success of such attempts in the world.

21.2. Objectives and Targets

It is planned to double the share of small and medium industries (SMEs) in the manufacturing sector by enhancing their productivity, capacity for innovation, and competitiveness. While traditional sectors engaged in manufacture and exports will be protected and enhanced, special attention will be given to emerging areas in light engineering, electro-medical equipment, transport equipment, machinery, industrial automation, electronics, information and communication technology, food processing, and biotechnology, so that they can exploit the potential of outsourcing through contract manufacturing, contract design, and electronic services.

It is planned to invest considerably in capacity building in the next five years, with most of the business investment in actual enterprises made by the private sector. Generous volumes and credit terms are envisaged to be available for the private sector through the

banking sector (a restructured SME Bank & greater role for commercial Banks), facilitated through the Small & Medium Enterprise Development Authority (SMEDA).

Legal and regulatory policies, including taxation and registration laws, which discourage SMEs from obtaining formal access to financial and technical assistance will be re-formulated and the availability of micro/mini-finance will be doubled from its present share of 7% of total credit.

The wider issue of Intellectual Property Rights (IPRs), or fast, efficient and transparent dispute resolution is perhaps most influential in determining the access of technology and foreign investment through strategic alliances, or sub-contracting from within or outside the country, and will be tackled on the highest priority to complete its conformance with international conventions.

Finally, special attention will be given to technical resources and infrastructure support needs of such enterprises for meeting quality standards and GMP (good manufacturing practices), so that they can be better integrated in the wider international supply chain, and also meet potential challenges due to globalisation and WTO requirements. The Cluster Development Programme will be closely monitored and reviewed in order to improve and enlarge the delivery mechanisms.

21.3. Issues

Several issues affect the SME sector in Pakistan. Some of these are institutional, as represented by absence of a focussed and supportive policy or framework or access to appropriate credit. Others are endemic to the manufacturing sector as a whole and are caused by problems of transformation from a low technology / low skill environment, and personalised / inefficient management and organisation structures out of tune with knowledge based economies of the 21st century. There is also an absence of institutional arrangements for change management, i.e. transmitting new skills (technical and non-technical) and monitoring their long term assimilation and internal sustainability. The major issues are identified as:

- i) Low levels of technical skills and information at the level of product, process, management, or marketing, all of which can affect quality and competitiveness.
- ii) Issues of verifiable quality and standards, or GMP (good manufacturing practices), which impinge upon market acceptability.
- iii) Complex and unfriendly set of labour, tax and industry legislation and implementation procedures, which can encourage official abuse, push up the cost of starting or running an enterprise, and discourage the SMEs from joining the formal economy.
- iv) Enforcement of Intellectual Property Rights (IPR) and judicial mechanisms to resolve disputes quickly and transparently.
- v) Low access, low availability of financial resources, and high transaction costs.
- vi) Industry / sector newsletters are missing which can disseminate market trends and demands quickly and reliably
- vii) Inadequate comprehension and slow pace of information for WTO requirements Sanitary/Phytosanitary compliance.
- viii) Higher commercial power tariffs for small SMEs as compared with other industry.

- ix) Absence of reliable and timely data /survey on assets, turnovers, employee numbers and employee skills in the country's SMEs

21.4 Policies and Strategies for Strengthening the Competitiveness of SMEs

Several initiatives and specific policies and measures will be adopted during MTFD 2005-10. These are geared towards reforming and strengthening the institutional structures so that access to technology, business skills and credit can be made available in larger amounts and in a more friendly manner. The stress will be on policies and strategies which speed up and ensure greater implementation, assimilation, up-gradation and finally monitoring which can be fed back into the system in order to increase internal and external efficiencies.

A uniform definition of an SME is suggested, as current definitions tend to favour the so-called 'medium' (or larger) units and discriminate against the smaller and younger operators for access to finance and resources by increasing their transaction costs. The basic definition as recommended by the Working Group (Annex I) will be adopted. This will help shift credit access and outreach from larger units to smaller ones.

Technology up-grade and Enhancement of Business Skills

In earlier studies on enterprise promotion, it was believed that larger firms were more efficient because of economies of scale, while the smaller units had high unit costs caused by inappropriate machinery. The consensus now is that the SME competitiveness is limited by lack of human skills, knowledge, and organisational ability, rather than the ability to *have* machines. This results in a serious inability to adapt and improve hardware and processes. The internal and external efficiencies of traditional small manufacturing units are ultimately limited by the skill set of the owner, resulting in a learning curve of workers which is limited or too slow in time, and works against innovation. Their managerial practices and technological levels are therefore at a totally different plane from those of large modern companies or even the modern SMEs in the Newly Industrialised Countries (NICs). Small- and micro-enterprises in Pakistan, as elsewhere, therefore, lack the capacity to carry out up-gradation of technology and products, or process innovation, on their own.

The mechanism whereby technology and business skills are delivered or embedded in an SME is of paramount importance. This *change management* (training, skill development, and adaptation of technology) must be institutionalised, since low-income, small- and micro-enterprises in developing countries always tend to under-invest in innovation relative to the social optimum.

Actions are being planned to :

Increase Competitiveness of SMEs: It is planned to deliver incremental, regular, and continuous up-gradation of competitiveness through provision of focussed short duration training modules to workers and their shop-floor managers. This may be subsidised by the government or other agencies, and is expected to cover groups of similar industries/processes and users through appropriate Common Facility Centres (CFCs) for key industrial clusters, where the following assistance will be made available:

- i) Training and education in general process dynamics for a particular industry which will include common machinery usage skills and quality matters
- ii) Imparting specific sets of training modules dealing with case studies in problem-solving in that industry

- iii) Upgrade of processes and adoption of modern tools, including ICTs (Information & Communication Technology) and international CAD/CAM standards and protocols.
- iv) Access to modern accounting and ERP techniques
- v) Technology forecasting as well as defining new training needs.

Offer Incentives for Investment in new Emerging Sectors and Skill Upgrades:

Incentives are planned to be offered in the form of reduced taxes and subsidised training for enterprises(Annex II) which sign up for up-gradation of business products, processes, and quality accreditation, through a Business Improvement Programmes (BIP) provided they:

- i) Join BIP for technology, products, processes and managerial skills, and are confirmed in this improvement by an approved agency
- ii) Invest in ventures on their own or with strategic foreign partners in designated high technology areas, or in export related manufacturing or electronic services as part of a larger supply chain
- iii) Join the Industry Links Programme (ILP) offered through various CFCs.

Improve Quality Standards by Preparing for a Globally Integrated Economy:

Creating awareness about quality standards and its incorporation in the SME culture, specially the micro and small SMEs is regarded as a public good and hence is planned to be freely available and accessible.

- i) Concerns regarding communications with appropriate agencies such as Pakistan Standard and Quality Control Authority (PSQCA) as well as prime contractors are expected to be addressed when the enterprises join the BIP, which requires quality accreditation. Further facilitation can take place through incorporating local engineering universities in the process, and greater use of Urdu and regional languages for preparing quality manuals and procedures.
- ii) An internal transfer of technology, (TOT), is envisaged in which the not-so-good are brought at the level of the good organisations within the country. This can take the form of special linkages (ILP) between industry groups, and universities and strategic organisations, since the latter are likely to be neutral and without conflicts of interest.

Rural Enterprises. Non-farm rural enterprises are an important source of employment to an important and vulnerable group of persons. It is planned to build on inherent skills for cottage and handicraft industries by adapting the One Village One Product (OVOP) programme successfully pioneered by Japan and now being adopted in Thailand as OTOP. This scheme will help promote products utilising traditional wisdom and skills unique to each community. Typical products are textiles and fabrics, gifts and decorative items. Handicrafts is already a useful enterprise across Pakistan, and better market access and financial returns can help alleviate rural poverty.

Improve Market Access and Product Information in the Global Context: It is planned to overcome this through an Industrial Information Network (IIN) between SMEs and the wider supply chain, an SME Network Group (SMENG) between the small and medium enterprises themselves. These measures are expected to provide information about market dynamics, timelines, niche markets and demands, or sources of better machinery, technologies, and solutions (e.g. access to university researchers or teachers who can help redesign fan blades to reduce noise levels). Free industry specific newsletters operated by

SMEDA in collaboration with Trade Associations and similar bodies, use of Urdu and regional languages, are possible vehicles of dissemination.

Export Orientation: Managers and owners need to be aware of the looming negative aspects of globalisation towards demand recognition and even demand creation. WTO stipulations about Sanitary and Phyto-Sanitary (SPS) compliance are likely to be another serious issue if not addressed through active awareness programmes. SMEDA can play a vital role in dissemination of such issues and their solutions, in concert with various Trade Associations & Bodies.

21.5. Re-structuring and Strengthening of Legal, Taxation, and Institutional Framework.

Legal and Regulatory Framework : Prudential regulations as well as entities & instruments are planned to be improved, so that they provide friendly lending policies as against current ones which favour bigger corporate clients. Issues of financial information, collaterals, and risk mitigation are very real for the borrower as well as the lender, but these are weighted against micro and small enterprises and drive them away from the formal sector. These reforms are expected to cover Credit Guarantee Agency, Credit Insurance, and Credit Information Bureaus along the lines recommended by SBP and the Working Group on SMEs.

Intellectual Property (IP) Rights: A major factor discouraging investment in emerging areas is inadequate protection for intellectual property in all its manifestations (patents, trademarks, designs etc) whether foreign or locally derived, because of slow and non-transparent dispute resolution. This results in difficulties in obtaining sub-contracting or investment in manufacturing as part of the internationally accepted supply chain. Hence IP laws will be suitably revised where necessary to bring them in conformance with international standards and provide adequate protection and relief to both local and foreign enterprises.

Improving Labour Laws: Re-drafting and implementation of less intrusive labour laws, and involvement of trade bodies in the inspection process is a persistent demand by the industrial sector in order to minimise harassment by inspectors. However, since the important element of social equity is involved, it is planned to couple less intrusive inspections with incentives related to reduced costs of credit, technical inputs, and tariffs, if owners voluntarily comply with EOABI (Employees Old Age Benefit Insurance) and ESSI (Employees Social Security Institution) requirements over a timeline of, say, 2-3 years.

Bankruptcy Laws: SMEs need appropriate bankruptcy laws and judicial infrastructure to protect them. The system needs to be fast, efficient and transparent and will need to be coupled with reformed property laws.

21.6. Access to Financial Resources and Services

SMEs are denied access or have very limited access to the credit market, mainly because the national financial structure is more suited to serve the formal medium /large enterprise rather than the smaller unit (securing guarantees and risk mitigation, cumbersome paperwork, high transaction costs). Asset evaluation is subjective or non-existent, specially when it comes to *non-physical* knowledge and skills. Access to financial and technical resources is generally missing outside the major urban / industrial areas and.

Share of Formal Credit: Share of total bank financing for SMEs is planned to be substantially raised, with improved weightage for skill levels, technology and export potential, and linkages with the prime contractor, in addition to the usual evaluations based only upon physical assets and turnover. Evaluators with modern technical and financial

skills are planned to be trained and inducted for dealing with applicants engaged in manufacturing, or ICT related design and electronic services.

Venture Capital / Business Start-ups: A dedicated amount of total credit for SMEs is planned to be available as venture capital for new start-ups, specially those engaged in export oriented contract-manufacturing and designing, or electronic services. Exciting new growth areas are emerging in electronics services (back-office operations, call centres etc), which has been encouraged by the low agency/seat costs in Pakistan compared with traditional supplier countries in Asia. Similarly contract manufacturing of precision mechanical parts, textile designing, digital archiving, and VLSI/chip designing for FOEs (Foreign Owned Enterprises) has quietly come into Pakistan spurred by the recent investments in skill development at the tertiary levels. These enterprises are small and efficient, and are led by highly competent technical personnel, and make ideal clients for venture capital.

Taxation Policies: Taxation and business registration laws and procedures vary from province to province and even within a province. They can also be oppressive and cumbersome in terms of paperwork, with at least 20 different levies or fees each at the Federal, Provincial and Local Council levels, scaring away most SMEs from seeking formal access to credits (as much as 59% of new investments and 68% of working capital is raised by the SMEs through retained earnings or informal credits). Incentives are being offered to encourage upgrades.

21.7. Delivery Mechanism for Business Development and Up-gradation

The key issue everywhere is the identification and development of an institutional delivery mechanism. Common Facility Centres (CFCs) can play the important role of conduit, since it may cost only once or very little to allow another producer to use a new technology or to make it generally available to others in the same sub-sector. This assumes that such Centres or service providers are neutral, and no conflict of interest is involved.

The initial feedback so far is disappointing with because of confusion and conflicts of interest regarding the lack of infrastructure, lack of political support, and lack of ownership of the project facilitator known as the Cluster Development Agent (CDA). Public-private ownership with public equipment and private management, and with the mandate to be financially self-sufficient is planned to be refined to meet the objectives:

Appointment of Industry Neutral Managers And Operators to manage the CFCs as change agents, coupled with tax and training incentives as proposed.

The Content Of Delivery is ultimately not that in the syllabus or what is delivered in the classroom, but what is actually absorbed by trainees. The formulation of the training programme is expected to be undertaken by an organisation(s) in the public or private sector with technical skills *and* managerial experience. Short focussed on-the-job training modules at SME premises, or at premises of the industrial partner will be most effective. Continuous mentoring will also be required.

However, the Government recognizes that direct government intervention is not an effective approach and that a market-based mechanism and private ownership will ultimately need to replace these change agents.

To enlarge the delivery mechanism, 100 CFCs will be set up in the country during MTFD 2005-10, through initiation of seven new Cluster Development Programmes in each province

21.8. Investment

In the SME sector the private investment is planned to increase from the present level of Rs 31.13 billion in the year 2004 -05 to Rs 53.88 billion in 2005-10 with an annual average growth rate 7.8%. The total public sector investment in SMEs is planned to the tune of Rs 6018 million, which will focus on a specific set of programmes for improving technical and management capacity, competitiveness, common facility centre and credit availability. It is anticipated that these programmes will qualitatively raise the ability of SMEs to become more efficient and competitive leading to employment generation and poverty reduction.

21.9. Conclusion

In a rapidly changing global economy, small and medium enterprises are increasingly a force for national economic growth. Since the 1970s, SMEs and the entrepreneurs who drive them have received serious attention by planners, multilateral agencies and governments the world over. Yet there is the need for the management of the environment at the macro level to facilitate the growth of the SMEs sector. There is a need for setting up and managing institutions and networks which support directly, indirectly, formally, informally, the growth business at the regional and national level. This also calls for the development of entrepreneurs and their team, development of the organisation and the business.

A lot of this institution building of management of the macro and micro environment of SMEs has to do with scattered institutions and agencies dealing with SMEs. New structures, policies and strategies are required that will help SMEs start, survive and grow. In this objective the SMEs must be helped and must be directed towards a one-window operation. The integrating concept is Small Enterprise Hub, industrial clusters and Technology/Business Incubators.

In developing countries the problems are more complex because of the lack of support infrastructure. The developed world caters for research, capacity building, training, skill development, accreditation of certifications, standardisation, and regulatory environment, fostering marriages of large and small enterprises.

SMEs development would mean industrial leverage, institutional tool for economic development, employment generation, technology acquisition, internationalisation of SMEs, boost to information technology and standing at par with international development. But all this needs a complete set of support institutions and the building of support institutions infrastructure for the development of SMEs and integrating them into a holistic idea leading to the goals of the overall economic development plan.

The very concept of SMEs is associated with industrial chaos, mushroom growth and clusters. To create an order out of this chaos there is a need to have support institutions: common facilities: self-help-organisations: business development services: business incubators: technology parks and technical assistance: management training, the financial support institutions, Partnership and strategic alliances. Other major areas of attention during MTDI improvement in quality and standards would include increase in competitiveness Good Management Practices (GMP), Business Improvement Programmes (BIP) and finally restructuring and strengthening of legal, taxation and institutional framework i.e. credit guarantee agency, credit insurance, credit information bureau improvement and enforcement of intellectual property right labour and inspection and bankruptcy laws.

#	Factor	Small Enterprise	Medium Enterprise
a.	No of Employees ¹	<ul style="list-style-type: none"> • Up to 50 for Manufacturing and Services • UP to 20 for Services 	<ul style="list-style-type: none"> • 36 - 99 for Manufacturing • 21 to 50 for Services
b.	Total Value of Assets ²	<ul style="list-style-type: none"> • Rs 2 - 20 m; for Manufacturing • Rs 2 - 10 m; for Services 	<ul style="list-style-type: none"> • Rs 21 - 100 m; for Manufacturing • Rs 11 - 50 m; for Services
c.	Gross Sales ³	<ul style="list-style-type: none"> • Rs 2 - 20 m; for Manufacturing • Rs 2 - 10 m; for Services 	<ul style="list-style-type: none"> • Rs 21 - 100 m; for Manufacturing • Rs 11 - 50 m; for Services

Table 1: Revised Definition of SMEs. Should be based on (a) + (b) or (c)

Notes:

¹ Full time employees with at least 6 months employment prior to evaluation

² As per latest evaluations, and includes buildings and technical non-physical capital

³ As per latest financial statements

#	Nature of Tax, Bills	Incentive for	
		Small SME	Medium SME
1	Registration	Zero ¹	Zero ¹
2	Business Improvement Programme (BIP) with subsidised training for managerial, quality & technology up-grades	Eligible up to (1 month x 1/5 of staff) every year for 3 years) ²	Eligible up to (1 month x 1/5 of workers) every year for 3 years) ³
3	Sales Tax	Zero ⁴	50 % ⁴
4	Electricity Tariffs	50% of Industrial rates ⁵	75% of Industrial rates ⁵
5	Statutory Income Tax/ Withholding Tax	Zero, if ⁶ or ⁷	Zero, if ⁶ or ⁷

Table 2: Incentives for Upgrading Skills, Quality, Exports

¹ No conditions

² Pays 25% of Training Costs in first year, then 10% for next two years, (this cost is refundable if unit is finally accredited by PSQCA or designated agency.

³ Pays 50% of Training Costs in 1st year, then @ 25% of Costs for next 2 years

⁴ Initially for 5 years, renewable for 5 years, if unit accredited by PSQCA or designated agency after training, HRD, and managerial up-gradation

⁵ Initially for 5 years, renewable for 5 years, if BIP successfully implemented + exports are ≥15% of turnover

⁶ Initially for 5 years, renewable for 5 year periods if exports are ≥15%, and grow @ 10% per annum, and there is compliance with EOABI and ESSI

⁷ Initially for 10 Years, if investment in designated high technology / pioneering areas, renewable for another 5 years

High Priority Activities to be Designated Pioneering Industries:

	Manufacturing	Design	Services
1	<ul style="list-style-type: none"> Industrial Materials based on local minerals Special alloys Carbon fibers 	<ul style="list-style-type: none"> Industrial Plants/Processes Textiles Graphics 	<ul style="list-style-type: none"> Food Preservation Certified Seeds Industrial Material Testing & Certification
2	<ul style="list-style-type: none"> Pharmaceutical Chemicals Dyes Pesticides 	<ul style="list-style-type: none"> VLSI/Chips 	<ul style="list-style-type: none"> Digital Archiving Call centres CAD services & digital conversions
3	<ul style="list-style-type: none"> Biotechnology 		
4	<ul style="list-style-type: none"> Light Engg Pressure Vessels Traction Equipment Machine Tools (NC, CNC) Industrial Automation Machinery 		
5	<ul style="list-style-type: none"> Electro-medical Devices PCs & Peripherals Automotive Electronics Electronics & Sensors Multilayer PCBs Communications (Fiber/ electronic interfaces, Cell phones, Modems,) 		