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REVIEW OF THE  
RURAL INFORMAL MICRO AND SMALL ENTERPRISES SECTOR:  
DEVELOPMENT OF AN ACTION-ORIENTED PROGRAMME

NC/PAK/92/039

PAKISTAN

Summary results and recommendations

Prepared for the Government of Pakistan  
under UNDP-financed TSS-1 facility

V.96-85246

This joint UNIDO/ILO report was co-ordinated (i) at UNIDO by the Asia and the Pacific Bureau, Country Programmes and Funds Mobilization Division, (ii) at ILO by the Small Enterprise Development Branch, Enterprise and Cooperatives Development Division. It is based on the work of Moïse Allal, Head, Micro Enterprise and Informal Sector Section of the above Branch, ILO, and Jürgen Reinhardt, Asia and the Pacific Bureau, Country Programmes and Funds Mobilization Division, UNIDO.

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## PREFACE

Formal and informal micro and small enterprises (MSEs) in both rural and urban areas play a very important role in the economy of Pakistan. The MSE sector's contribution to employment has increased over time, while employment in other sectors, particularly in agriculture, has remained stagnant or even declined. While available statistics tend to underestimate the MSEs' contribution, information at hand does bring out rising shares of this sector over the last decade, in terms of output, employment and value-added alike.

The MSE sector's importance becomes even greater if other contributions to socio-economic objectives are taken account of: MSEs are the main source of employment for a number of vulnerable groups, such as women, the youth or isolated populations. They are the main producers of basic consumer goods suited for the consumption habits and purchasing power of low-income groups. They also produce simple tools and implements for their own use as well as the agricultural sector. Taken together, these contributions as well as unresolved demographic and economic challenges make a clear case for a set of well designed and effective policies to promote small-scale industries in general and the segment of rural and informal micro and small enterprises in particular.

Against this background, UNIDO (as lead agency) and ILO have been commissioned by UNDP under the TSS-1 facility to jointly review past and present policies pursued in Pakistan with regard to MSE furtherance and promotion. The objective is to make recommendations for future supportive action pertaining to this field for use both by government and interested donors. The present summary report consolidates the major findings of the two main reports prepared by the Secretariats of UNIDO and ILO, respectively. The latter which are also made available as appendices<sup>1</sup> are mainly based (i) on synoptical reviews of earlier studies and other materials related to MSE development and promotion in Pakistan, and (ii) on the results of intensive discussions held with government officials, international donors, academics and private business representatives as well as on personal observations on site visits during field missions of UNIDO and ILO teams to Pakistan between November 1993 and January 1994.

At the request of UNDP, the present summary report also incorporates the results of and the feedback received at a workshop presentation of draft papers by UNIDO/ILO staff at Islamabad in December 1995<sup>2</sup> and - where deemed relevant - also takes account of updated information on relevant policy and other developments since the submission of the UNIDO/ILO draft reports in October 1994.

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<sup>1</sup> DP/ID/SER.D/27/Add.1 and DP/ID/SER.D/27/Add.2.

<sup>2</sup> A list of workshop participants is attached as annex to the present report.



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## **PART A: FINDINGS OF THE UNIDO/ILO STUDY**

### **I. INTRODUCTION**

Part A of the report first provides the UNIDO/ILO summary findings on the characteristics of the MSE sector in Pakistan. It then reviews the policy and regulatory framework and assesses the effects of the latter on the performance and competitiveness of the sector. Finally, it reviews the financial and non-financial services provided by public sector agencies, NGOs, private sector firms and organizations, workers' organizations, business associations and the donors' community. It should be stressed that the findings are based on the limited information the TSS-1 mission was able to collect over a relatively short period of time. Given the absence of reliable and comprehensive statistics on the MSE sector which would have allowed to draw more refined conclusions, some caution should be applied as to the interpretation of the results. This notwithstanding, the outcome summarized below most probably reflects the main characteristics, problems and constraints of the MSE sector in Pakistan.

### **II. SUMMARY FINDINGS ON THE CHARACTERISTICS OF THE MSE SECTOR**

#### **1. Definition of the MSE sector**

There are two main reasons for defining the MSE sector. First, avilment of incentive programmes as well as the application of policies and regulations, require that MSEs be officially defined. Second, assistance programmes must take into consideration the characteristics of enterprises. Therefore, the definition should reflect these characteristics on the basis of available information.

Each country uses different definitions for various sizes of enterprises. The Pakistani official definition of MSEs is based on both employment and asset size: units with 10 workers or less and assets (excluding land) of up to Rs 20 million are defined as small enterprises. However, this definition fails to differentiate between the modern small enterprise and the micro, often informal, enterprise. Since these two types of enterprises differ greatly in their characteristics, this report uses the following definitions for small and micro enterprises: 6 to 10 workers for the larger modern small enterprises and one to five workers for the micro enterprises.

#### **2. Size and characteristics of micro and small enterprises**

The mission was not able to obtain reliable statistics on small and micro enterprises. Available statistics are either incomplete or are based on different definitions of enterprises which do not allow meaningful comparisons. Therefore, a number of recommendations are made later in this report in order to remedy the situation. In particular, it is suggested to

explore whether the recent PAK-Netherlands data base could be used for a full survey of the small and micro enterprise sector.

It would also seem that there is currently no effective body for the regular collection of statistics and other information on the MSE sector. This probably explains the currently limited information available on this sector.

Using available published information as well as the findings of a small sample survey, the mission identified the following characteristics of MSE enterprises:

- Micro enterprises constitute by far the largest group in the sample, with an average of 1.5 to 2.5 workers per enterprise. Close to 50 per cent of manufacturing units are less than 5 years old which, probably, indicates both high mortality and birth rates.
- Only 47 per cent of rural units have access to water, and 70 per cent to electricity and paved roads. It is probable that these percentages are much lower for rural units nationwide.
- The majority of micro enterprises, particularly in rural areas, supply the local nearby market. Thus, their market potential is very limited.
- While their financial requirements are fairly low, most enterprises rely on relatives, family savings or money lenders for working capital or fixed investments. Very few attempt to seek assistance from formal financial institutions.
- The majority of entrepreneurs have been privately trained, mostly through on-the-job training. A minority of entrepreneurs have participated in a training course offered by a formal training institution.
- The productivity of small and micro enterprises is fairly low for the following reasons: use of labour-intensive techniques, low skill level, inadequate organization of production, etc. For example, the sample survey indicates that 81 per cent of the respondents used traditional modes of production and only 36 per cent had bought some kind of new equipment over the last three years.
- In spite of the infrastructural inadequacies, the lack of institutional credit, low skill level and low productivity, the number of rural enterprises continued to grow over the past years. However, the above constraints do affect the competitiveness and survival of these enterprises. Furthermore, the globalization of the world economy and trade liberalization should further weaken their position. Therefore, increasing efforts are needed in order to improve the competitiveness of micro and small enterprises and help them adjust to these new trends.

### **3. Behavioural characteristics of the entrepreneur**

The behavioural characteristics of the small and micro entrepreneur, as identified through the sample survey, are briefly summarized bellow.

**First**, the Pakistani entrepreneur exhibits considerable self-reliance and an enterprising spirit, which often leads to a fairly rapid growth of the enterprise.

**Second**, the MSE entrepreneur is typically very independent-minded and fiercely competitive. Although he/she may trade with other entrepreneurs commercially, he/she does not readily cooperate with them.

**Third**, the MSE entrepreneur is secretive and distrustful of outsiders, particularly those who may possibly be connected with government agencies. Indeed, he/she has an ambivalent attitude towards government officials: he/she expects "favours" from the government, while his/her perceptions of day to day experience with these officials and policies in practice is generally one of frustrations, bottlenecks and petty oppression. The survey clearly shows that few entrepreneurs perceive the government as an efficient and impartial partner and provider of services. While the respondents to the survey indicated a wide range of services that could be provided by the government, the large majority of entrepreneurs seem to think that the main assistance offered by the government is of a financial nature.

#### **4. Women entrepreneurs**

While available statistics are not reliable, information at hand clearly shows that the fraction of female-headed enterprises in the rural informal sector does not exceed 7 per cent to 8 per cent, with the manufacturing sector employing the largest number of women (17 per cent).

The findings and observations of the mission on the issue of women entrepreneurship development are briefly summarized below.

- The mission recognizes that cultural and other factors would have to be taken into consideration in any programme intended to promote women entrepreneurship. Experience shows that even comprehensive packages of directed support services to potential female MSE entrepreneurs have generally failed when such factors were not taken into consideration (e.g, male acceptance of women right to engage into a professional career).
- While recognition of this right by the total male population can only be a long-term objective, it should be possible to initiate immediately an education programme for male officials, in both the public and private sectors, directly involved in MSE development programmes (e.g, bank officials, extension agents, etc).
- The mission is of the opinion that female-targeted MSE development programmes are neither effective nor financially sustainable. While special measures will be required in order to deal with the special constraints faced by women, such measures should be implemented within main stream MSE development programmes. These measures should take into consideration the dual role of women as housewives and income generators (i.e., measures to facilitate this dual role, such as child care facilities); the need for building up confidence; the necessity to obtain the consent of the husband or male relatives; and the current legal restrictions on the ownership of assets, such as land.

- Currently, most women are engaged in traditional home-based activities with limited growth potential. Any future women-targeted MSE development programme should look into ways to induce women to engage into growth-oriented enterprises in sectors currently dominated by male entrepreneurs.
- The mission recognizes that, while the provision of services to MSEs should be, to the largest extent possible, financially sustainable, the special problems faced by women would probably require some level of subsidies.

## **5. Emergence of new flexible production networks**

The mission obtained good evidence that the strong growth of the MSE sector is partly the result of a trend for Pakistan to take on many of the flexible organizational practices prevalent in other countries. For example, sub-contracting arrangements are being increasingly practised by large textile and garment firms, using non-registered micro and small enterprises as sub-contractors. This practice allows the larger firms to reduce labour costs since the non-registered enterprises do not have to apply the prevailing labour legislation, such as laws on the minimum wage or those applying to working conditions. Large textile mills have also broken down their large weaving plant into smaller units (having no more than four looms) in order to benefit from various exemptions (e.g., social security, lower taxes).

While sub-contracting is on the rise, the mission also noted that other forms of flexible specialization or organization of production are currently absent. For example, there are very few industrial districts, common facility services or other forms of industrial clustering prevalent in other developing and industrialized countries. Yet, such structures could play a very important role in promoting competitive, growth-oriented small and micro enterprises. The mission suspects that this could be due to a reluctance of entrepreneurs to associate with others in the same business and/or to a lack of information on the benefits that could be derived from such association.

The mission also noted that, while sub-contracting should be encouraged, efforts should be made in order to eliminate, or at least, reduce abuses by the principals, such as unfair exploitation of the sub-contractor. The mission was not aware of any rule or regulation which would prevent such abuses.

## **6. Facing up to global competition**

Most countries, including Pakistan, are forced to open their borders to foreign goods and to compete in foreign markets against cheap labour countries. Currently, Pakistani enterprises suffer from two main weaknesses: low quality and low productivity. Most entrepreneurs interviewed by the mission indicated that they are deeply concerned about these new trends, and fear that they may not be able to remain competitive in foreign markets unless they succeed to improve productivity and quality. The same applies to entrepreneurs producing for the local market.

The need to adjust rapidly to world class standards is apparently widely accepted, and widespread training and general improvement in the level and spread of knowledge, including knowledge of the latest technical skills, design and research and development is now seen as essential.

This need does not apply to large enterprises only. It also applies to the MSE sector. In Pakistan, as in any other country, a strong and competitive industrial sector requires effective and strong linkages between both large and small enterprises. Such linkages have been instrumental to the growth and competitiveness of industrialized countries, such as Japan where large scale sub-contracting started as early as in the 1920s. The mission is of the opinion that this matter requires the greatest and urgent attention of all parties concerned, including the government, the sectoral organizations, R&D institutions, etc.

## **7. Problems and constraints faced by MSEs**

The mission collected a great deal of information on the performance of micro and small enterprises, their problems and constraints. It also obtained, through a large number of interviews, indications on the wishes and priorities of the entrepreneurs. The findings of the mission are briefly summarized below.

- The problems and constraints faced by enterprises vary between sectors and locations. They are generally more severe in rural areas and for units involved in the production of traditional goods (e.g, carpets). Enterprises in the urban informal sector and in manufacturing are, on the other hand, improving and paying greater attention to productivity and quality.
- However, productivity and quality is still generally low for the following reasons: limited mechanization, partly due to the difficulty of enterprises to secure loans for acquiring new equipment; lack of locally produced tools and equipment suitable for the scale of production of the smaller enterprises, combined with the high cost of imported equipment; lack of readily available information on improved production techniques; acceptance by non-discriminatory consumers of low quality goods; inappropriate organization of production; and low skills of the owner and the workers.
- Most entrepreneurs also complained about the lack of available credit. A large majority must depend on relatives, own savings, and money lenders. Very few entrepreneurs approach banks for loans because they do not expect a favourable answer. Even fewer entrepreneurs have benefitted from credit schemes operated by the government or NGOs (5 per cent to 10 per cent, at best, of the entrepreneurs did benefit from such schemes). It would seem that lengthy procedures and the lack of collateral are the main reasons for the problems faced by enterprises wishing to obtain a loan.
- Entrepreneurs also lack adequate technical and managerial skills. Training programmes operated by the government or NGOs are often not suitable for the following reasons: many entrepreneurs cannot afford to leave their business over extended periods for training purposes, even if training were offered free of charge; training courses are often seen as being too theoretical or do not take into consideration the training needs of the

entrepreneur; travel and accommodation costs for training courses offered at far away locations cannot be afforded by most entrepreneurs; the latter also find it difficult to retain skilled labour in view of the more attractive wages paid by larger firms. It should also be noted that training programmes operated by the government and NGOs are heavily subsidized and are not, therefore, financially sustainable. Furthermore, entrepreneurs enrolled in free or heavily subsidized training courses may be less concerned about the relevancy of the latter.

- Difficulties faced by MSEs in accessing appropriate work premises, well connected to electricity and water supplies, are also common. Inadequate premises also affect the productivity of the MSEs.
- The poor road infrastructure, particularly in rural areas, prevents MSEs from being properly serviced or from accessing distant markets.
- The supply of quality raw materials at fair prices is also inadequate, especially imported materials. Most MSEs cannot afford to purchase materials in large quantities and, therefore, benefit from lower discount prices. Furthermore, they are not in a position to take advantage of lower import duties easily accessible to the larger enterprises.
- Finally, MSEs are often subjected to various petty restrictions imposed by local officials who must be accommodated one way or another.

## **8. Application of labour laws and regulations**

Most micro enterprises are not registered and, therefore, pay little attention to labour laws and regulations. Minimum wage laws are not applied, child labour is prevalent in some sectors (e.g, carpet making), and working conditions are far below acceptable standards. This non-respect of labour standards and regulations may be explained by the following factors:

- The MSEs profit margin is generally fairly low. Entrepreneurs are, to some extent, forced to reduce costs to the largest extent possible. Therefore, they pay salaries acceptable to their workers, salaries which are usually lower than the official minimum wage. Child labour is used for the same purpose. They also feel that investing money for the purpose of improving working conditions is a luxury they cannot afford.
- The very large number of MSEs, and the fact that most of them are not registered does not facilitate inspection by the officials of the regulatory agencies, especially since the latter do not even have sufficient staff for inspecting the larger, registered firms.
- Few efforts have been made to induce entrepreneurs to pay greater attention to labour standards, either in the form of training or information. For example, entrepreneurs could have been advised that, in many cases, the benefits derived from improving working conditions or paying higher wages would be more than compensated by the higher productivity achieved.



The above findings and observations elicit the following comments. First, the non-respect of labour standards by MSEs cannot be rectified by forceful measures, even if the capacity of the regulatory agencies were to be increased. Many MSEs would be forced to close down if they were to comply with current regulations. Second, efforts should focus on those MSEs which are contemplating registration because they have reached a somewhat larger size or because registration is required for availing of benefits offered. Compliance with labour standards would be easier for this type of enterprises. Finally, regulatory agencies should make maximum efforts in eliminating the most obnoxious practices, and should not hesitate to fully prosecute those responsible for such practices (e.g, use of non-family child labour, very dangerous working conditions, production processes particularly harmful for the environment).

### **III. SUMMARY FINDINGS ON THE POLICY AND REGULATORY FRAMEWORK**

It is widely recognized that an enabling business and regulatory environment would go a long way in promoting the growth and competitiveness of micro and small enterprises. It is also recognized that, while such environment would be sufficient for many enterprises to achieve the above objectives, others would still require assistance in accessing effective services provided by public or private sector bodies. Any MSE sector development programme should, therefore, address these two issues concurrently for achieving the objectives of such a programme.

As already stated earlier, a large majority of micro enterprises are not registered. Thus, while these enterprises should still benefit from an enabling policy environment, they would not be in a position to avail of government incentive programmes which, usually, require that enterprises be registered. Furthermore, non-registered enterprises would pay little attention to current regulations since they are rarely visited by officials of the regulatory agencies. Therefore, in addition of promoting an enabling business and regulatory environment, special efforts are needed in order to induce small and micro enterprises to register and join the formal sector of the economy. This would require that policies and regulations be adjusted to the specific characteristics of these enterprises.

Although there is a general agreement on the importance of the MSE sector, it is the opinion of the mission that the current policy and regulatory framework is biased in favour of medium and large enterprises. While the official government policy strongly supports the MSE sector, such support has not been translated into effective policies and regulations which are, at the least, neutral towards all sizes and types of enterprises. While the limited duration of the mission did not allow a full assessment of the effects of the current policies and regulations on the MSE sector, the mission was able to identify a number of areas for improvement. A few such areas are discussed below.

## 1. Taxation policy

The effects of the current taxation policies on the MSE sector are not very clear. Furthermore, the application of such policies and tax collection procedures need serious improvement. A few illustrative examples are given below on this issue.

MSEs with less than 10 workers are exempt from general sales tax and excise duties. While this is a commendable policy intended to improve the competitive position of MSEs vis-a-vis the larger enterprises, it could also result in a number of adverse effects. First, enterprises with a potential to grow further, are induced to remain small in order to take advantage of the tax exemptions. Second, larger enterprises are also induced to break down into smaller units for the same purpose. This is particularly the case of the larger textile and garment firms.

Other policies supposed to benefit all enterprises (e.g, exemption of tariff duties or reduced tariffs on imported materials and equipment, tax holidays) mostly benefit the larger ones in view of the complicated procedures required or the fact that in actual terms such incentives are for the benefit of enterprises of a size usually exceeding that of MSEs.

The common perception that non-registered MSEs do not pay taxes is not either correct. Such MSEs do pay all kinds of taxes, including both official taxes (municipal taxes, motor taxes) as well as "informal" taxes they must pay to local officials in order to avoid problems. Indeed, the amount of taxes not collected from the larger firms for various reasons most probably exceeds that not collected from the smaller ones.

The above examples elicit the following comments. First, it is clear that the current taxation policy should be reviewed with a view to removing some of the most serious distortions which could affect the growth of MSEs. This would require the streamlining of taxation policies while ensuring that they would not be biased in favour of any particular size or type of enterprises. Second, the tax structure should be simplified and brought in line with international standards. Steps taken in recent years (broadening of the taxation base, elimination of exemptions, replacing the sales tax by a value-added type tax, etc.) are in the right direction and should be pursued. In addition it is urgently required to improve tax administration and collection.

## 2. Trade policies

The effects of trade policies on MSE sector growth are also far from being clear. A number of trade policy reforms have been recently adopted. They should remove various trade barriers which reduced the competitiveness of enterprises which depend heavily on imported inputs (e.g, tariff duties reductions, dismantling of exchange control, removal of quantitative restrictions). These measures have most probably benefitted MSEs. However, they still have to pay higher prices for the same inputs than larger firms because they rely on commercial importers who not only apply a mark-up on imported inputs, but are also subjected to higher commercial import tariffs. The larger firms, in turn, import directly the inputs they need at lower industrial import tariffs and, therefore, benefit from much lower prices. This puts MSEs at a disadvantage vis-a-vis the larger firms.

Another disadvantage vis-a-vis large firms is the wide range of duty exemptions and rebates granted for the import of raw materials and equipment under a number of promotional schemes (e.g, investments in backward areas, promotion of exports). Most MSEs do not qualify for such exemptions or rebates, or are not capable of handling the complicated procedures required for availing of these preferential schemes. Thus MSEs which must rely on imported inputs rarely benefit from such schemes.

It may, therefore, be concluded that the current improvement of trade policies is, at best, of marginal interest to MSEs, if at all. Individual MSEs are required to associate in one form or another in order to be able to take advantage of the above preferential schemes.

### **3. Money and finance**

While MSEs as the economy at large would benefit from a predictable monetary environment characterized by low and stable inflation rates resulting from conducive monetary policies on the one hand, at the operational level the existence of a well functioning financial sector is of utmost importance on the other hand. In spite of a number of reform measures taken by the government in recent years to improve the operating environment and performance of the country's financial sector, most observers share the view of the persistence of a largely inefficient financial services industry in general which also extends to the very limited supporting role played by the sector for MSEs in particular. The sector at large continues to be rated as overly bureaucratic and inert showing a limited exposure to innovative instruments of financial intermediation. Rather, the sector is frequently described as a vehicle for the transfer of public subsidies to borrowing clients from influential quarters, particularly among big businesses, with political favouritism playing an important role.

Against this background, mandatory credit targets prescribing the channelling of loans into the small-scale industry sector - as only one of several priority sectors - and subsidized credit provided through both commercial banks and development finance institutions have for a long time been the major policy instruments to link up the financial system with the small businesses. There is, however, ample evidence that the bulk of such subsidized credit has landed up in the larger small and medium-sized businesses while the loans arriving at the MSE segment have been rather minute. Moreover, in many instances funds earmarked for onlending small-industry credit have not even been fully used. Likewise, non-subsidized, i.e. market rate lending by commercial banks to MSEs has remained virtually non-existent. Low recovery rates frequently in the 50-80 per cent range add to the problems encountered with the past approach.

### **4. Public investment in education, training and infrastructure development**

MSEs require educated and skilled labour as well as an adequate infrastructure (good roads and transport facilities, access to adequate water and power supplies, access to a good telecommunication network, etc.) in order to prosper and grow. The mission findings clearly show these facilities are either inadequate or lacking, especially for MSEs located in rural areas. Available statistics fully support such findings. The adult literacy rate in Pakistan is relatively much lower than in other developing countries (approximately 35 per cent), and

is even much lower for women (23 per cent). The combined primary and secondary enrolment rate stands at approximately 35 per cent, while the number of scientists and technicians is as low as 1.5 per 10,000 people (this explains, to some extent, the low technological development of the country). While access to water in urban areas is somewhat satisfactory (84 per cent), it is very low in rural areas (35 per cent). Under these circumstances, MSEs face great difficulties in improving their productivity (e.g. in view of the limited power supply which prevent them from shifting to power equipment) or in accessing more profitable markets (e.g. in view of the lack of adequate roads or transport facilities). Furthermore, both urban and rural MSEs complain about the difficulties faced in renting or owning appropriate premises for their business. Thus, any MSE development programme should urgently address this issue if it were to have a reasonable chance to succeed.

## **5. Labour legislation and policies**

As stated earlier, many small enterprises and most micro enterprises are not registered and, therefore, pay little attention to labour laws and regulations. Furthermore, even those which are registered are officially exempt from applying most of the labour laws. In Pakistan, firms employing less than 10 workers - i.e. most of the small and micro enterprises - do not have to apply the minimum wage legislation, the social security provisions (i.e. contributions to the Workers Welfare Fund, Social Security, Workers' children education, etc.) or the hiring and firing regulations. It is not clear whether similar exemptions also apply to working conditions, protection of the environment or child labour. In any case, even if they are supposed to comply with regulations related to these latter issues, few would do so in view of the limited capacity of the regulatory agencies to enforce the regulations.

It is clear that the various exemptions offered to MSEs should help them to become more competitive vis-a-vis the larger enterprises and foreign imports. However, in practice, MSEs are not completely immune from some kind of payments to local inspectors (e.g. social security payments) made on an informal or formal basis. The whole issue of exemptions should also be assessed from the point of view of the distortions they could give rise to. As already discussed, such exemptions could induce MSEs to remain small in order to benefit from these exemptions, or for larger firms to break down into smaller units of 10 workers or less. Such a trend could have extremely negative effects on productivity and, therefore, the competitiveness of MSEs.

For both small and micro enterprises, compliance with the laws and regulations involves a cost which many such enterprises may not be able to afford. This is particularly the case of most micro enterprises in the informal sector. The dilemma faced by most governments may be summarised as follows: should the authorities apply forcefully the current labour legislation to these enterprises with the danger of having most of them close down, or should they refrain from doing so and let them continue to operate outside the law? The answer to this question is not an easy one. However, most specialists tend to agree that, rather than attempting to force micro enterprises to comply with the laws and regulations, one should induce them, through training and information campaigns, to gradually comply with those laws and regulations which would yield greater benefits than what they would cost. For example, low cost improvement in working conditions could yield larger benefits than the cost of such improvements.

In the long term, general compliance with the laws and regulations would only be achieved once small and micro enterprises become sufficiently competitive in order to withstand competition from the formal enterprises in the modern sector of the economy. In other words, programmes intended to improve the competitiveness of enterprises should also promote compliance by the latter with the labour laws and regulations.

#### **6. Concluding remarks on the policy and regulatory framework**

The findings of the mission clearly show that, to a large extent, the current policies and regulations related to small and micro enterprises have had a very limited impact on the growth and competitiveness of the latter. Very few enterprises have benefitted from the favourable policies and incentive programmes. Even fewer currently apply the most basic labour laws and regulations. The mission identified a number of reasons which could explain this limited impact of policies and incentive programmes. First, various inconsistencies have been identified among the policies specifically intended to promote enterprises. Second, insufficient attention was paid to the various obstacles that would be faced by MSEs wishing to take advantage of these policies and incentive programmes. In some cases, MSEs may not even qualify for availing of such programmes. Third, there is an important gap between the formulation and adoption of policies and their effective application, a fact recognized by the government officials involved in MSEs development. Fourth, the issue of non-registered micro enterprises in the informal sector, which may not qualify for availing of various incentive programmes and pay little attention to labour laws and regulations, has not been taken into consideration in the formulation and application of policies and the above programmes. Finally, and most importantly, information obtained by the mission clearly shows that such formulation and application were carried out in the absence of any effective participatory and consultative process which would have ensured that the views and wishes of all types and sizes of enterprises would be fully taken into consideration.

#### **IV. SUPPORT SERVICES FOR MSEs: SUMMARY AND ASSESSMENT**

The promotion of an enabling policy and regulatory environment would go a long way in helping enterprises to grow and improve their competitiveness. In addition, enterprises should be able to access quality non-financial and financial services which will help them improve their productivity, expand their markets and invest for business expansion. In Pakistan as in the large majority of countries, these services are mostly provided by the private sector in the context of commercial transactions. For example, a countrywide sample survey of 71 MSEs in Pakistan conducted in the context of this mission shows that only three received some form of assistance from government agencies, and two thirds of the enterprises indicated that they have never heard about any of the support institutions. The following sections summarize the findings of the mission on the role played by the government, NGOs and the private sector in the provision of various types of services provided to MSEs. An assessment will be made, in particular, of the scope and effectiveness of a number of support programmes initiated recently by the government and NGOs and of the extent to which the current linkages between MSEs and the larger firms do satisfy the needs of MSEs. This

section focuses on non-financial services while section V deals specifically with the financial services offered to MSEs.

## **1. Non-financial services offered by government agencies**

### **a) The institutional setting**

Direct assistance and support to MSEs (training, marketing assistance, consulting services, financing) are provided mostly by the Industry as well as the Planning and Development Departments of the four provincial governments and, in particular, by specific institutions that have been established at that level. In addition, a number of national organizations cater to the servicing needs of MSEs, and a number of specific government programmes for MSE development have been initiated by some of the above organizations.

#### **(i) The provincial Small Industries Corporations**

##### **▶ The Punjab Small Industries Corporation (PSIC)**

PSIC employs 2,800 staff members, with 100 located at its Headquarters in Lahore and the remaining staff distributed among its eight regional offices. Regional Directors are directly responsible for the full range of PSIC services. These include: **the operation of 13 common facility centres** mostly intended to upgrade the technology of MSEs through the renting of equipment and the provision of advisory services; **the operation of 60 handicraft-related centres**, including 31 carpet production centres, seven craft retail shops and 24 craft development centres and projects (six of the latter are exclusively for women); **49 training centres (welding, wood-working, carpentry and farm machinery)**; **management of 14 small industrial estates with a total of 4,200 factory plots**, with a foreseen addition of 25 estates at the district level; and investment promotion activities, including the provision of finance under several credit schemes administered either by PSIC itself or by specialized development finance institutions.

PSIC also runs a number of special programmes, such as the rural industrial programme and the self-employment scheme (see below).

##### **▶ The Sarhad Small Industries Development Board (SSIDB)**

SSIDB has its Headquarters in Peshawar, assuming responsibility for the North West Frontier Province. It has approximately 1,300 staff members employed in five corporate management and administrative Directorates and six separately managed promotional Directorates. The latter Directorates operate the following units: **31 cottage industries units** focussing exclusively on the production of carpets, embroidery/knitting and handicraft/textiles (SSIDB provides training, financial, design and marketing assistance); **nine industrial estates**, with a total of 1,473 plots (1,098 -75 per cent- have been allocated, and 40 per cent of the latter are reported as being operational); **11 Services Centres**, six of which in wood working, two in metal working and one each in leather, ceramics and electronic manufacture; and four

retail shops which are intended to provide marketing support to micro and small craft enterprises.

▶ **The Sindh Small Industries Corporation (SSIC)**

SSIC has its Headquarters in Karachi, and employs close to 1,000 staff members. It operates four regional offices with a staff of approximately 800. Its activities are similar to those of the other Corporations. It offers one year training courses covering a wide range of both traditional and non-traditional manufacturing and service activities through 79 training centres, with a combined capacity of 2,200 trainees per year. SSIC established seven artisan colonies which provide assistance in procurement of materials, advice in marketing and designs as well as assistance in accessing credit sources. It has also established 14 industrial estates with a total of 1,630 plots, 421 of which (26 per cent) being utilized at the time of the mission. It operates five craft retail shops as well as a soft term credit scheme for business star-ups. It has recently opened a quality control and marketing centre in Hyderabad and an entrepreneurship training institute in Larkana.

▶ **The Directorate of Industries in Baluchistan**

In Baluchistan, a Directorate of Industries was established in 1976, under the Department of Industries, Commerce and Minerals. It operates 63 training centres in various trades, one service centre, five sales and display shops and one small industrial estate. Two thirds of the training centres are devoted to carpet production, and the others cover tailoring, wood-working, marble work, etc.

▶ **The Azad Kashmir Small Industries Corporation**

This Corporation was established in 1990. The mission did not have the opportunity to review its activities.

**(ii) Major government programmes for MSE development**

A large number of programmes which attempt to address the target sector needs directly have been initiated by various government agencies over the years. The most important programmes are briefly described below.

▶ **Programmes intended for the development of rural industries**

A large number of programmes focusing on the promotion of rural industries have been implemented as early as the late fifties by different governments, starting with the Village Aid Programme. These programmes, which include various complementary components have yielded mixed results in terms of sustainable rural development. In 1990, the Federal Cabinet adopted a rural industrialization policy which provides a general package of fiscal and monetary incentives to new rural industrial units (e.g, preferential access to subsidized loans, eight years exemption from income tax).

**The National Rural Support Programme (NRSP)** was set up in 1991 as a public limited company with an initial government grant of Rs 500 million. The NRSP's declared objective is to replicate the very successful Aga Khan Rural Support Programme initiated in 1982 by the Aga Khan Foundation with the aim of establishing a network of grassroots organizations at local level able to plan and undertake their own development. By end-1993 NRSP had established 369 community organizations in eight districts with a total membership of 10,791. Other key features of NRSP include technical assistance and skill training, improving access to public sector programmes, and mobilization of local resources for economic and social development through a savings and credit programme to encourage peasant entrepreneurs and the development of micro enterprises.

**The Rural Industrialization Programme (RIP)** of PSIC has the following main objectives: the generation of rural employment through the promotion of rural industries; increasing non-farm incomes; promoting a sound industrial base in rural areas; slowing down rural to urban migration; and promoting rural entrepreneurship. This programme includes a credit scheme with a maximum of Rs 0.75 million and a preferred range of Rs 300-500 thousand (see below).

► **Nationwide, rural/urban programmes**

A number of programmes have been initiated for the purpose of promoting small and micro enterprises in both rural and urban areas. They include the following main programmes:<sup>3</sup>

- **The Self-Employment programme (SEP).** The main feature of this programme is the provision of loans not exceeding Rs 300,000 to unemployed persons wishing to establish a business in a wide range of manufacturing, handicraft and service sectors. Loans may be provided to groups of up to ten people.

- **The Self-Employment Scheme operated by PSIC.** This scheme is designed to encourage the self-employment of educated skilled and semi-skilled persons in both rural and urban areas by means of incentives for setting up modern small industries, particularly in the engineering, chemical and electronics fields. It provides loans under terms which are very similar to those of the RIP.

- **The Youth Investment Promotion Service (YIPS).** This programme is intended for unemployed youth between 18 and 30 years of age with a minimum formal education level corresponding to class 10. Established in 1987, YIPS offers business start-up credit to individuals and groups.

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<sup>3</sup> For details, also see IV... (b) below.



**(iii) National organizations involved in small and micro enterprise development**

A number of national organizations directly involved in enterprise development have been visited by the mission. The activities of the main one, the **Pakistan Industrial Technical Assistance Centre (PITAC)**, are described below.

PITAC was established as a technical arm of the Ministry of Industries, with the major objectives of developing the skills of industrial personnel in technical and managerial fields, assisting in the design and manufacture of jigs, fixtures, moulds, dies, tools, products, etc. PITAC also provides advisory services and disseminates modern technical know-how among the industries. It offers training courses in several fields on a regular basis as well as special courses on request. PITAC clientele is currently made up mostly of large companies, but it is also interested in addressing the smaller firms as well.

**b) Assessment**

The mission findings on the outreach, effectiveness, efficiency and relevance of non-financial services offered by government agencies and through special MSE support programmes are discussed below. Over-all, the mission identified a number of serious weaknesses in the provision of such services by most agencies, although some do perform better than others. In short, these weaknesses concern the limited outreach of these agencies, the relevance and usefulness of their support activities, the lack of responsiveness to the needs of MSEs, and the cost-effectiveness of the services provided. In addition, the mission has serious reservations on some quasi commercial activities currently carried out by government agencies, such as the operation of industrial estates and retail stores.

**(i) Programmes and activities of government agencies**

Most of the information collected by the mission clearly shows that the activities of the Provincial Industries Corporations (training, operation of the industrial estates, advisory services) are considered as insufficient, inadequate or outright failures. Shortages of qualified staff, time consuming bureaucratic procedures as well as a general lack of flexibility and responsiveness to changing demands have been characteristic features of these public support institutions. However, distinctions need to be made regarding the performance of the individual organizations.

In this connection, PSIC appears to be receiving the relatively best ratings. A recent evaluation ascribes some positive effects to the PSIC-run rural industrialization programme (RIP) which is acknowledged as having promoted industrial growth in rural areas (over 16,000 loans sanctioned at the time of the mission). PSIC seems also to make genuine, if imperfect, efforts to decentralize its operations, increase its rural outreach, and make its services more demand-led. On the other hand, various criticisms have been made in relation to some of the PSIC programmes. These include the dominance of agro-based enterprises vis-a-vis other manufacturing sectors in the PSIC's RIP credit scheme; limited involvement in enterprise management, marketing and product development; and the very limited performance of PSIC industrial estates. It also used overly complicated loan sanctioning and disbursement

procedures, and inefficient monitoring mechanisms. The above criticisms were voiced by respondents of a random sample survey involving 220 entrepreneurs participating in the RIP.

Criticisms against the Sarhad Small Industrial Development Board (SIDB) in NWFP are much harsher. These criticisms, included in a recent in-depth assessment of SIDB are briefly summarized below.

- Training provided within SIDB cottage industries units have been curtailed to a minimum in recent years, following complaints by the trainees that such training did not help them find a job. Furthermore, the above units are largely considered as pursuing quasi commercial operations under an ill-defined objective, without being able to compete effectively against the private sector (low quality goods, outmoded production techniques).
- Only 75 per cent of the plots of the SIDB industrial estates have been allocated, and out of these, only 40 per cent have been reported as being really operational. Unsuitable location and/or misjudgement of the potential for small businesses in the respective area are quoted as major causes for the limited success of these industrial estates.
- SIDB service centres are not either faring well. Two of the three bilaterally-funded centres have yielded very limited results, in view of the available resources. They mostly focus on training, and even in this area, progress has been rather limited with only 10 trainees for the financial year 1992/93, excluding training provided at the PAK-German centre.
- The craft shops were running losses in 1992/93, and do not seem to be able to compete against the private sector shops.
- SIDB assistance to MSEs in securing loans from financial institutions has been fairly limited and only a few entrepreneurs were able to benefit from such assistance after long delays.

In view of the above performance of SIDB, the investigators who assessed the latter recommended that SIDB be reduced to two directorates, that its staff be reduced from 1,300 to 400, and that it should establish local enterprise development agencies which will take over some of the Board's activities.

Similar weaknesses characterize the other provincial boards and corporations. Furthermore, the mission noted a number of shortcomings in some of the government support programmes for MSE development. For example, the YIPS programme failed to benefit the rural informal MSEs in view of the requirement that the beneficiaries must have undertaken formal schooling. Thus, talented people without formal education are prevented from taking advantage of this programme. Furthermore, women participation in this programme is very low, amounting to less than 10 per cent of the beneficiaries. The impact of YIPS has not been evaluated, and it is therefore difficult for management to adjust the programme on the basis of its potential shortcomings. Finally, it is the mission's opinion that the major problem faced by YIPS lies in the lack of coordination, and at times rivalry, between YIPS and SBFC which is supposed to disburse the loans after they have been approved by YIPS. Notwithstanding certain procedural changes introduced in 1995 which altered the division of work between the two institutions, the mission recommends that YIPS be operated under the full responsibility

of a single agency with a view to improving its effectiveness and the necessary coordination among the various phases of the credit scheme. SBFC could be the best placed to play this coordinating role.

**(ii) Main weaknesses and signs of improvement**

The mission identified five major weaknesses of government agencies involved in the provision of non-financial services to MSEs, but has also noticed that some of these agencies have initiated approaches which should help correct these weaknesses.

▶ **Lack of scale**

The mission findings, based on a large number of interviews and review of sample surveys of MSEs, clearly show that government agencies have reached a very small number of MSEs, particularly the larger small enterprises. Very few micro enterprises in the informal sector have benefitted from the services offered by these agencies. Furthermore, the sample surveys show that these agencies, and particularly their assistance programmes, are little known by the potential beneficiaries. This is indicative of the lack of efforts from these agencies to disseminate information on their support services, especially in rural areas. The large majority of MSEs has indicated that their main sources of services and information include their relatives and friends, suppliers and clients. Pertinent UNIDO and ILO studies confirm that this also the case for most MSEs in other countries. In Pakistan, as elsewhere, most government agencies have limited financial and human resources which would allow them to reach more than a tiny fraction of MSEs. Their role in this area should be at best a catalytic one, and they should rather focus on promoting linkages within the private sector (i.e, the main source of services for MSEs).

▶ **Antagonism between the heavy bureaucratic procedures and the need for flexibility required by businesses**

Government agencies involved in MSE development must apply various bureaucratic procedures which are at odds with the need for flexibility and a business approach required when dealing with MSEs. This is particularly the case when financial disbursements are needed in the context of the services provided. In general, sample surveys of MSEs clearly show that the government agencies are ill-adapted in serving the latter, particularly the micro-sized enterprises. Unfamiliarity with the business world, insufficiently qualified staff members, and the lack of sufficient financial and other resources (e.g, transport facilities) have considerably reduced the effectiveness of government agencies in providing relevant, useful and sustainable services to the large majority of MSEs. These deficiencies are most apparent in the case of training and finance (the latter issue is dealt with in the next section).

The mission visited a number of formal training centres and had extensive discussions with officials from these centres as well as with industrialists and training experts. Its findings show that the effectiveness of the training provided by these centres leaves much to be desired, especially in relation to the training needs of MSEs. First, the training programmes have been mostly designed in relation to the needs of the larger firms, with limited attention paid to those of MSEs. The main exception to this trend concerns the dehi mazdoor

programme. Almost the entire system of centre-based formal training (Vocational Training Centres, Technical Training Centres, Polytechnics, etc.) is geared to one- or two-year courses for young educated people (mostly male) without prior work experience, with a predominant expectation to find salaried employment in a large firm. Thus, neither the clientele of these centres, nor the length or the content of the training courses are suitable to the needs and characteristics of the micro and small entrepreneurs (they have little formal education and cannot afford to spend much time on long duration courses in formal training centres). Even the Apprenticeship Training Centres (ATCs) are intended to serve the larger firms with 50 workers or more and are, therefore, of no usefulness to MSEs.

In addition to being mostly focused on the larger firms' training needs, the existing centres suffer from a wide range of serious weaknesses, including: high unit cost per trainee; lack of coordination between federal and provincial centres; high unemployment rate among the graduates of these centres; and non-involvement of the larger firms in the design and implementation of the training courses. As stated earlier, the dehi mazdoor rural training centres for craft workers seem to be more relevant to the training needs of MSEs. However, even these centres - which are operated by PSIC - have not been efficient in disseminating information on their training programmes: only one of 377 entrepreneurs and workers who benefitted from PSIC loans did actually participate in a dehi mazdoor training course.

► **Inefficiency and ineffectiveness**

Information collected by the mission shows that there is a general agreement that public sector support institutions are not as effective and efficient as they ought to be. In addition to cumbersome bureaucratic procedures, the mission noted that decision-making is still somewhat centralized, a lack of closeness to the intended beneficiaries, too frequent a turnover of the officials of MSE development agencies, and the limited qualifications of the latter. These weaknesses concern both the financial and non-financial services provided by these agencies. In particular, these services are often offered on a heavily subsidized basis which is at odds with the promotion of a truly entrepreneurship spirit. Such subsidies, while necessary at times, are often supply rather than demand-led and, therefore, do not ensure that the services provided are relevant and useful to the intended beneficiaries.

The operation of industrial estates, retail shops and other quasi commercial ventures has also met with very limited success. Most, if not all, of the latter require continuous government subsidies since costs far exceed revenues. A large fraction of the plots located in industrial estates are still vacant, and those which are occupied are not performing well. This also applies to the retail shops which cannot compete against the private sector shops. It is the mission opinion that, in view of the government privatization policies, serious consideration should be given to the privatization of the industrial estates and the retail shops. Furthermore, the question as to whether government agencies should be involved in the provision of various services to MSEs is one which requires the utmost attention of the authorities in view of the past performance of these agencies.

► **Failure to be client-responsive**

Interviews carried out by the mission with a number of agencies, R&D institutes and entrepreneurs indicate that many government agencies and institution are either unaware or

not responsive to the needs of MSEs. For example, many R&D activities have been carried out without establishing first whether they are commercially viable or whether they correspond to needs expressed by the enterprises. The same applies to the content and modalities of training courses offered by a number of government-run training centres, and to the services available in various well-equipped testing centres (according to an authoritative estimate, the capacity utilization of the latter does not exceed 30 per cent). In general, most people agree that this lack of responsiveness of these organizations to their clients' needs is mainly the result of the little involvement, if any, of the potential beneficiaries in the formulation and implementation of the various support services.

► **Lack of coordination between government agencies**

The mission obtained concurrent information on a great deal of duplication of efforts among agencies involved in the provision of services to MSEs. Furthermore, it does not seem that these agencies have adopted a common approach to MSE development. Over 30 MSE development projects and programmes were under way at the time of the mission, with seemingly little coordination and sharing of information among the concerned agencies. The need for closer collaboration and, in some cases, integration of current MSE development efforts is seen by donors and MSE development specialists as an urgent area of intervention by the concerned authorities.

**Some signs in the right direction**

The above shortcomings in the provision of support services to MSEs by government agencies are, to a large extent, the result of a top-down approach characterized by too heavy a bureaucracy and centralized decision-making at both the federal and provincial levels. Local areas have their own peculiar development problems, and small firms are mainly affected by local conditions. In consequence, there is a growing consensus that a radically different decentralized bottom-up approach (including the transfer of decision-making to the local level, an increasing private sector involvement in the running of support institutions and networking amongst a range of interest groups and small firm support agencies) would be required for ensuring the provision of sustainable, cost-effective and relevant support services. Consistent with this consensus, a number of measures have been initiated recently which should foster this bottom-up approach. First, the 1990 National Manpower Commission report on human resources development strongly recommends the decentralization of development schemes down to the district level, the widespread establishment of Industrial and Business Support Centres, and the active involvement of trade unions, business associations and NGOs in the running of support institutions.

Second, the role of trade associations in fostering inter-firm cooperation in various areas, such as training, technology transfer, finance and marketing is a concept which is being gradually adopted by a number of such associations with the assistance of external agencies. For example, the Hosiery Manufacturers Association is acting as a medium for an outside agency to encourage groups of 20 to 30 small enterprises to cooperate together for the common purchasing of yarn. A few similar examples clearly show that, in the future, trade associations can be expected to play key roles in new development strategies such as the running of technical institutes or common facility centres.

Third, a few recent initiatives show that efforts are being made in order to make programmes and projects more sensitive and responsive to the clients' needs. For example, PIET designs its training programmes on the basis of a survey of the clients' requirements and follows up the graduates of these programmes with a view to ensuring that the training provided has been helpful to them in getting a job. Similarly, the PAK-SWISS Agricultural Light Engineering Project has initiated a participatory technology development approach that ensures that its newly developed tools and equipment are appropriate to the needs of its clients, particularly the farmers. The Pak-Holland Metal Project undertook extensive surveys of the MSE sector in the NWFP with a view to developing effective and relevant MSE development programmes, and has established a number of mobile training units in order to get closer to its clients. The Punjab Small Firm Investment Corporation is said to be fairly successful because it is established close to the industrial sectors it serves, and has established close collaboration with local trade organizations.

The above initiatives for improving the provision of quality support and services to MSEs, in addition to current attempts for agencies to coordinate their efforts in this area, are commendable and welcome. However, it is the mission's opinion that these measures would only marginally improve the situation. It is doubtful that government agencies, even those which initiated such measures, would be able to reach a significant fraction of MSEs and provide them with quality and sustainable services, taking into consideration the inherent weaknesses discussed earlier.

## **2. Financial services for MSEs**

In addition to non-financial services, MSEs require funds for capital investments and for working capital. In Pakistan, the large majority of MSEs use their own savings for this purpose or depend on loans provided by relatives and, to a lesser extent, by moneylenders. Very few MSEs benefit from loans provided by banks or through credit schemes operated by government agencies and NGOs. The constraints faced by MSEs in accessing effective and sustainable financial services are discussed below in relation to the current formal sources of finance available for MSEs.

### **a) Financial institutions**

Some of the country's development finance institutions are mandated to cater particularly for the financial needs of MSEs. The lending programmes of some of these institutions are assessed below.

#### **► The Industrial Development Bank of Pakistan (IDBP)**

IDBP provides finance for both the setting-up of new MSEs and for meeting the financial needs of existing ones wishing to expand or modernize their production units. The IDBP also operates the Equity Participation Fund which disburses credit to accelerate the growth of MSEs in the less developed areas of the country.

► **The Regional Development Finance Corporation (RDFC)**

RDFC provides loans to all sizes of enterprises on the condition that these are established in areas classified by the Federal Government as under-developed. Medium and long term credit, ranging from Rs 200,000 to 28 million, are made available for industrial, agricultural and service sectors projects. RDFC may take equity stakes up to 25 per cent in some projects. Pre-investment advisory services are also rendered to prospective entrepreneurs, including the preparation of feasibility studies at nominal cost.

► **The Small Business Finance Corporation (SBFC)**

In addition to its Headquarters in Islamabad, SBFC has six regional offices and some 60 branches country-wide. It operates credit programmes mostly intended for MSEs. Small scale industries with fixed costs of up to Rs 5 million and small businesses with a net asset not exceeding Rs 0.6 million are eligible for credit. The upper lending limits are RS 2 million for the former units and Rs 0.5 million for the latter ones. SBFC also operates a special credit programme for professionals, with a credit ceiling ranging between Rs 25,000 and 100,000. SBFC has been entrusted to extend funding for the SEP and YIPS programmes described earlier.

► **The Allied Bank**

In 1993, the Allied Bank initiated an Unorganized Sector Financing Scheme covering 15 of the bank branches, with plans to extend the scheme to other branches. During the first year, 260 loans were disbursed for a total of Rs 6.6 million, the maximum loan being limited to Rs 25,000. The recovery rate is reported to reach 100 per cent. This credit scheme seems, at this stage, to be fairly successful, and is well suited to the financial needs of micro enterprises.

► **The Bank of Khyber**

The Bank of Khyber, which covers NWFP, has recently adopted a more commercial approach in its lending policies. However, in relation to MSE lending, the Bank still uses the usual commercial banking practices in relation to collateral requirement, centralized loan approval procedures, and the length of loan terms. Furthermore, it tends to focus on large loans (an estimated average of Rs 5 million per loan to 50 per cent of its clients) which are far outside the requirements of MSEs.

► **The commercial banks**

Most commercial banks are reluctant to provide loans to MSEs. The main reasons offered to the missions are the usual ones: lack of collateral, small size of loans in comparison with the loan processing costs, etc. Some of the commercial banks are not sufficiently represented at the local level. Therefore, a large number of rural MSEs or those established in small towns have few contacts with these banks. Another reason is that small entrepreneurs do not maintain current or savings accounts in banks, and have not, therefore, established the necessary trust with officials of these banks. It is clear to the mission that, unless the mentality of both the small entrepreneurs and the bank officials change and that mutual trust is built up between these two groups, MSEs will continue to face great difficulties in securing

the funds they require for their business. The current development banks and special credit schemes for MSEs are not sufficient in number or in resources so as to reach the large majority of MSEs.

**b) Special credit schemes**

A number of credit schemes, specifically set up for the benefit of MSEs, are operated by various NGOs and government agencies, particularly the small industries development organizations. Some of these schemes have been assessed by the mission.

**The Pak-Holland Metal Project** operates a credit scheme for metal-working MSEs. It is the most successful credit scheme operated by a non-financial institution in Pakistan. The recovery rate is estimated at between 90 per cent and 95 per cent. The loans are mostly financed with The Netherlands financial assistance. However, even this seemingly successful credit scheme is not financially sustainable due to the persisting gap between the interest charged (8 per cent) and an inflation rate in the area of 20 per cent at the time of the mission. Thus, the real inflation-adjusted recovery rate is 85 per cent or less, taking into consideration the 2 to 4-year loan duration. Such a rate is obviously not financially sustainable and requires continuous subsidies from the donor.

**The Aga Khan Rural Support Programme (AKRSP)** operates a credit and savings programme for MSEs based on a system of collective savings and borrowing. This system is operated by a large number of Village Organizations (VOs) which grant collective loans based on the needs of their members. Two types of loans are made: short-term (six months) and medium-term (2-5 years). The default rates for both types of loans is lower than 2 per cent, which constitutes a fairly high recovery rate for a NGO.

**The Orangi Pilot Project** provides loans to 44 categories of micro enterprises. Since 1987, it has provided 284 loans to family enterprises and 74 loans to individual companies.

**The PSIC** provides financial assistance to MSEs under various credit schemes, such as the rural industrialization programme and the self-employment scheme. The rural industrialization programme provides loans for any industrial activity with a fixed investment of up to Rs 1.5 million established in rural areas, with the exception of some restricted industries determined by the government. The maximum loan is Rs 0.75 million, with the preferred range being Rs 300-500 thousand. Loans are provided with a 7 per cent mark-up rate, and repayment must be made within seven years after a one year grace period. Under the PSIC Self-employment Scheme, loans are made to encourage the self-employment of educated skilled and semi-skilled people in both rural and urban areas. The scheme is also targeted at experienced professionals of existing industrial units, young graduates of universities as well as qualified Pakistani returning from abroad. The terms and conditions of the loans are similar to those of the rural industrialization programme, except for an extended period of 10 years and a 1.5 years grace period.

**Under the self-employment programme**, loans in the range of Rs 10,000 to 300,000 are offered to unemployed people individually or in groups. No equity participation is required of the customer for credit below Rs 150,000 while higher amounts require a minimum 10 per



cent participation. The present mark-up rates range between 11 per cent and 16 per cent, depending on the repayment period. This scheme is jointly operated by SBFC and two publicly-owned commercial banks. By-end 1993, 37,800 loans were sanctioned for a total Rs 5.1 billion.

**Under the YIPS Programme**, loans for business start-ups not exceeding Rs 100,000 per person and Rs 400,000 per group of up to 10 people, are provided at a mark-up rate of 11 per cent in urban areas and 8 per cent in rural areas.

**The First Women Bank Limited of Pakistan** operates a subsidized credit scheme for women entrepreneurs, with the funds originating from the Ministry of Women Development. The maximum loan is Rs 25,000. Some 5 per cent of the Bank's total credit outlay are reported to be allocated to this credit scheme. Rural women with difficulties in providing collateral are encouraged to apply for loans in groups of four or more which guarantee the loans made to members.

### c) Assessment

The overall findings of the mission on this issue clearly show that the large majority of MSEs still face considerable problems in securing the funds they require either for capital investments or for working capital. The commendable efforts made lately by the government in order to improve the financial sector have benefitted mostly the larger enterprises and have had a marginal impact in solving the financial needs of MSEs. Most officials interviewed by the mission feel that the Pakistani financial sector is still overly bureaucratic and has failed to adopt innovative instruments of financial intermediation. In many cases, it is mostly viewed as a vehicle for the transfer of public subsidies to large clients. It has not yet established itself as a credible financial sector.

The government did initiate a number of measures in order to facilitate access to financial services by MSEs. One of the major policy instrument adopted by the government in this area is the establishment of mandatory credit targets for MSEs that should be, in principle, applied by all banks. In practice, the funds have been mostly used for loans to the larger enterprises because it was easier, less costly and supposedly less risky for banks to do so. Loans to MSEs make-up a very small fraction of all the loans offered by the banks. Furthermore, the mission has been informed that, in some cases, the available loanable funds have not been fully used.

The special credit schemes for MSEs have been generally characterized by a very low recovery rate, often not exceeding 50 to 60 per cent. These credit schemes have also reached a tiny fraction of MSEs, and even less of the latter in rural areas where the needs are the greatest. The mission was able to identify the following reasons for the limited outreach and performance of these credit schemes.

- In the case of credit schemes operated by formal banking institutions, the main reasons identified by the mission for the limited impact of these schemes are: reluctance of MSEs to approach the banks for loans in view of the cumbersome paper work and procedures, often complicated by the fact that the clients are not literate; high transaction costs in terms of foregone production and transport costs; limited number of bank branches in

some parts of the country; limited capacity of bank officials to appraise loan requests; and general reluctance of banks to deal with MSEs in view of the relatively high administrative costs and perceived greater risks.

- In the case of credit schemes operated by NGOs or special donors' funded projects, the main reasons for the limited performance of these schemes are: the highly subsidized rates which prevent the schemes from achieving financial sustainability; the false impression given to the loan-holders that the loans may be considered as gifts with no requirement for paying them back; the limited capacity of the staff to properly appraise the projects as well as the loan-holders; and the lack of linkages between the loans and the provision of non-financial services.

In view of the limited performance of MSE-targetted credit schemes, the mission is of the opinion that substantially different approaches are required in order to expand the outreach of financial services to MSEs and improve their effectiveness and financial sustainability. Specific recommendations are made later in this report for this purpose. They are briefly described below.

**First**, entrepreneurs should be induced to open deposit or saving accounts in local banks with a view to developing the necessary trust between MSEs and the banks.

**Second**, loans should not be subsidized unless this is fully justified in relation to the additional risks faced by enterprises which are induced to establish a business in a difficult area or sector. Interest rates should cover the full loan processing costs, inflation, losses and a normal profit margin. It is the mission opinion that such interest rates should still be attractive to MSEs in view of the much more higher rates applied by informal sources of finance.

**Third**, loans should be made available to all sectors rather than focusing mostly on the manufacturing sector, taking into consideration that the large majority of MSEs are involved in trade and services.

**Fourth**, there should be less emphasis on collateral or other security requirements for granting a loan and more focus on a progressively proven credit record of the borrower.

**Finally**, there should be more linkages between the financial sources of finance and local institutions, such as those providing support services on informal sources of finance (e.g, small rotating savings associations and moneylenders).

### **3. Non-Governmental Organizations (NGOs)**

While there are a large number of NGOs in Pakistan, few of them operate active and effective programmes for MSEs. They mostly focus on women and children, are very much donor-driven, and operate often as intermediary organizations between sources of funds and local bodies, such as community groups. Thus, most NGOs do not constitute "bottom-up" technical and organizational strength, and do not promote real local commitment. They do not have connections with small business associations, and have greatly benefitted from the

donors' reluctance to fund public sector bodies. Above all, very few of them have much expertise in MSE development. For example, out of 800 NGOs surveyed in NWFP with a view to finding out whether they could play the role of counterparts in a Swiss-funded MSE development project, only four of these NGOs qualified for this role. The only NGOs with substantive MSE development programmes identified by the mission are limited to four: Behbud Association, All Pakistan Women's Association, Aga Khan Rural Support Programme (AKRSP) and the Orangi Pilot Project (OPP-Karachi). Another organization, which is not strictly a NGO, but operates along similar principles, has also been surveyed by the mission: the Pakistan Institute for Entrepreneurship Training (PIET). The activities of AKRSP, OPP and PIET are briefly described below.

▶ **The AKRSP**

The AKRSP includes three main components: social development, economic development and cultural activities. The Industrial Promotion Services are provided under the economic development component, although there are no specific MSE development activities under this component. The distinguishing features of AKRSP are the institutional approach used and the method of implementation which is rooted in the full participation of local partners. AKRSP operates through Village Organizations (VOs) and Women's Organizations (WOs). These organizations are linked to AKRSP through the Social Organization Unit, which functions as a monitoring unit at the field and district level.

▶ **The Orangi Pilot Project (OPP)**

The OPP is an NGO that began operations in 1980 in the Orangi area of Pakistan. It is a community development project funded by various donors. OPP provides credit for 44 categories of micro enterprises under the economic programme initiated in 1987. Since 1987, 284 loans were made to family enterprises and 74 loans to individual enterprises, for a total of Rs 4.53 million. It is reported that these loans have helped establish a large number of viable and profitable enterprises.

▶ **The Pakistan Institute of Entrepreneurship Training (PIET)**

PIET was established in 1990 by its present Executive Director, a private Pakistani consultant. The first PIET office was established in Lahore, and subsequently other offices were set up in Karachi and Multan. It uses a small number of permanent staff as well as consultants and master craft workers. The main objectives of PIET are to advise people on business set-up and on how to improve productivity and to expand into new markets. A total fee of Rs 600 is requested from clients. This fee does not cover PIET overhead and permanent staff costs. The latter are covered by interest generated by an endowment fund laid down for the Institute by the Government of Pakistan. PIET clients include 50 per cent of established entrepreneurs and 50 per cent of potential ones. PIET advertises its training courses through various media. Both general courses and more technical courses are provided by the Institute. It handles approximately 60 clients per month in the three cities. PIET contacts the graduates six months after graduation with a view to finding out whether they have been successful in establishing a business. It also plans to conduct surveys among businesses in order to find out the types of courses most in demand by its clientele. One weakness of PIET is the lack of networking with other organizations which could offer extension services to clients.

#### **4. Private sector associations**

The mission surveyed some of the private sector associations in view of their potential importance to MSE development. These associations can act as an "advocate" of the MSE sector and could provide direct support services to their members. Data on associations of small enterprises is scarce. However, a comprehensive study on business associations on the informal sector exists. Findings from this study are summarized below.

65 per cent of the respondents think that a local or national association exists in manufacturing, services, trade or transport sector. Of these, only 3.5 per cent think that there is a national association. At the local level, knowledge of associations in the trade and transport sector is by far the highest. 41.3 per cent of the respondents indicated that they are a member of a local association, with most of them being members of associations in the manufacturing or services sector. Only 22 per cent are members of a national association.

Reasons for not being a member include the little usefulness of associations and the high membership fee. Many respondents are also not aware of the membership procedures. On the other hand, members provided a number of positive reasons for membership, including the solving of problems with government agencies, the role of associations as an advocate of the members vis-avis the authorities, the provision of training and information, the promotion of cooperation among the business community, etc. Similar reasons were given by those who are not members of associations. This survey clearly shows the need to promote associations through a better dissemination of information on the existing ones, strengthening of the latter and promotional activities to induce more entrepreneurs to join associations.

#### **5. Employers' organizations**

A large number of private sector organizations are active in Pakistan: 26 Chambers of Commerce federated to the Pakistan Chamber of Commerce, the Employers' Federation of Pakistan (EFP), etc. For example, the Karachi Chamber, with 13,000 individual firm members and another 50,000 affiliated through trade associations, is the biggest. Though not presently very active in providing services to MSEs, the EFP and the Chambers of Commerce have indicated interest in playing a more active role in the future.

EFP members must employ 20 or more workers, a restriction which prevents most small and micro enterprises to become members. While this restriction may be justified from a practical point of view, innovative approaches could be adopted in order to allow some degree of representation of MSEs in the EFP. For example, MSEs could be represented through their associations.

Membership of MSEs in the EFP would be very useful in view of the overall objectives of the latter, including the promotion of the interests of the employers at the national and international levels, good relations amongst the employers, and promotion of good relations between the employers and their employees. Besides its normal range of services, the EFP has initiated projects on occupational safety and health, advisory services to women, use of the ILO " Improve Your Business" training material and establishment of a Productivity Services Wing. It is clear that these projects could be of great interest to MSEs and should be made

available to the latter by EFP. In more general terms, EFP should play a major role in the strengthening of linkages between MSEs and the larger firms in the areas of technology transfer (improving the availability of more efficient tools and equipment), marketing (e.g. in the area of sub-contracting), training, etc.

## **6. Trade Unions**

The mission interviewed a number of trade union officials in order to obtain information on the unions' activities, and more specifically on those of particular interest to MSEs. It should be noted, however, that very few of the MSEs' employees, if any, are unionized, considering that only 24 per cent of the total labour force - mostly workers from the larger firms - are unionized. However, officers of the All Pakistan Federation of Trade Unions (APFTU) expressed support for a policy of up-grading small enterprises and labour conditions within the latter. A number of initiatives were suggested, including: to improve know-how, skills, technology and marketing; to extend labour legislation to the informal sector (e.g. regarding minimum wages and social security); to strengthen trade unions; and to convert, where possible, contract labour into permanent employment. Two specific initiatives have been adopted: the dissemination of information and know-how, to both workers and employers, about working conditions and on how to make MSEs more productive through better management and workers skills; and to organize seminars and workshops on themes and issues with direct relevance to both the employers and the employees. While the above initiatives are commendable, it is not yet clear how the unions' justified objectives could be easily adopted by the very large number of small, and particularly micro, enterprises which may find the cost of formalization - and, therefore, the full application of labour legislation - far exceeding the benefits to be possibly derived from the latter.

## **7. Role of the larger firms in the private sector**

Larger private sector firms can play a very important role as both suppliers of materials, tools and equipment to MSEs, as well as principals in sub-contracting arrangements. Such role is said to be a significant phenomenon, and possibly increasingly so. However, considering the mission findings on the various constraints faced by MSEs in accessing sustainable and quality services, it is clear that much more must be done in order to improve the current linkages between all sizes and types of firms for a mutually beneficial relationship.

It is apparent that some large firms are taking on the role of raising standards of their small firm suppliers. In fact, the branches of Japanese and German firms can be expected to develop a quality supplier network, and should be seen as an alternative strategy to one relying on home based support institutions for raising the standard of indigenous firms.

Achievement of the above objective by the local large firms would require a change in the mentality of the owners of the latter. They should consider their MSE suppliers as equal partners to be treated fairly, for a mutually beneficial relationship, rather than as a cheap source of labour to be exploited to the largest extent possible. The very rapid growth of the industrial sector in Japan earlier in this century was the result of a fair and supportive strategy of the larger firms in dealing with their smaller counterparts. A similar strategy should be

adopted by the large Pakistani firms. The mission findings clearly show that this is far from being the case in Pakistan. For example, large garments manufacturers tend to exploit their sub-contractors and mainly consider them as a cheap source of labour, especially since they do not contribute to various labour taxes and compensation schemes. For many large firms, sub-contractors are seen as an extension of these firms without the need to comply with the various labour laws and regulations. Very few large firms attempt to promote the growth and competitiveness of their suppliers through advice, training or other means.

It is the opinion of the mission that this is an area of serious concern necessitating the active and forceful involvement of both the authorities and employers' organizations for the establishment of positive and mutually beneficial relationships between the large firms and MSEs. In the long-term, such relationships would be beneficial to all enterprises, and would help the latter to face the stiff international competition resulting from the trade liberalization agreements.

## **8. Projects initiated by donors**

Donors in Pakistan are very active in the area of MSE development, particularly the governments of Switzerland, Germany and the Netherlands as well as the World Bank. Furthermore, the above and other donors have established a Donors Coordination Group on MSE Promotion in Islamabad in order to better coordinate their action in this area. While the above three countries have continuously supported programmes for small and micro enterprise development, the World Bank has only recently devoted substantial resources for this purpose. Some of the more interesting programmes initiated by the above donors are briefly described below.

In 1993, the World Bank initiated a US\$ 26 million micro enterprise development programme. These funds were loaned to the Pakistani government for on-lending to firms specialized in the leasing of equipment. At the time of the mission, the only leasing firm involved in this programme was the Orix Leasing Pakistan Ltd (OLP). Lease contracts for small and micro enterprises are financed through this loan, with MSEs paying the prevailing market rate without having to provide any collateral. At the time of the mission, 400 lease contracts were reported to have been concluded, mostly in urban areas, with a recovery rate of 99.75 per cent. Two other components of this programme are: a grant under which seed money is extended to four NGOs for their revolving credit schemes for MSEs; and a technical assistance component to these NGOs for the training of their staff, co-financed by the government of the Netherlands.

Many of the donors' MSE development programmes have focused on upgrading established enterprises (e.g. through skill training, technology transfer, extension services) rather than on promoting the creation of new ones. In most cases, the provincial Small Industries Corporations (SIDOs) have been selected as the counterpart or recipient organization for the implementation of the programme.

The Pak-Holland Metal Project (PHMP) was initiated in 1986 for a total duration of nine years. It focuses on the development of three sectors in the NWFP province: welding, automotive and engineering trades. The main activities include technical advice on design and

production technology; the development of local professional capabilities with regard to administration, marketing, engineering and technology; and familiarization of workers with precision machining, maintenance, and quality control and assurance. PHMP operates from seven decentralized Industrial Technology Centres within NWFP, as well as from three mobile training units which are supposed to reach all the province accessible areas.

The SIDB-implemented Pak-Swiss Agricultural Light Engineering Project (ALEP) started in 1984 and is due for completion in 1997, after a major re-orientation of the project in 1994. It is located in NWFP Mardan small industries estate. The objective of ALEP is to promote agricultural development and the production of agricultural equipment and implements by local MSEs. Due to the heavy concentration of the project on training activities, the project failed to establish close linkages with the end users/clients (i.e. the farmers) and, therefore, produced prototypes which were not appropriate to their needs. Consequently, the project has re-oriented its approach through the establishment of producer-farmer groups which will ensure that the equipment and implements needs of the farmers are properly taken into consideration at the time prototypes are being designed and test-piloted. Furthermore, it has been decided to start mobile and on-location training with a view to facilitating access to training by MSEs located far away from the training centres.

The Pak-German Wood-Working Centre in Peshawar has been in operation for over 10 years. It is run independently by SIDB. The centre combines promotional services with commercial activities. However, it has mainly focused on training activities. The centre's promotional activities (provision of common facility centres for kiln drying and band sawing, extension services and loans for the acquisition of machinery) have either become marginal or ceased altogether. The same applies to the commercial activities of the centre.

Finally, a Donors' Coordination Group has been established in Islamabad, the objective of which is currently to exchange views, experiences and information on MSE development programmes and approaches initiated by the members of the group. The latter is made up of all bilateral and multilateral donors with long-standing experience in the promotion of MSEs in Pakistan. The group meets frequently, and has so far developed an information data base on the group members' on-going and envisaged MSE development activities. The group intends to initiate joint activities whenever it is feasible to do so. It may be noted that the initiative to establish such a donors' group is in line with the policy of the international Donors' Committee on MSE Development in order to improve the coordination of these donors' activities in the project countries.

## **PART B: TOWARDS A NEW PROMOTIONAL STRATEGY FOR MSEs IN PAKISTAN: RECOMMENDATIONS FOR ACTION**

### **I. INTRODUCTION**

The foregoing presentation of major policy endeavours pertaining to the promotion and development of MSEs and their confrontation with actual achievements and continuous constraints allows to draw three main conclusions. **First**, there is a clear evidence of a far-reaching though not complete neglect in most of the past policies - both conceptually and in practice - of the lower end segment of the small-scale enterprise sector in general. **Second**, to the extent small enterprises have been addressed through policies and the set-up of institutional support mechanisms these efforts more often than not have lacked any meaningful geographical outreach, especially with regard to rural areas, have tended to remain top-down oriented and rather centralized and, hence, have proven to be relatively ineffective. And **third**, there appears to be ample scope for the creation of a more conducive policy and economic environment which helps a more viable MSE sector to emerge including in rural areas in order to better fight the growing unemployment and rural-urban migration problems.

These findings may be nothing but common knowledge among the relevant Pakistani community; yet, the very fact that they do not seem to have found a decisive and integrated policy response to date clearly justifies a repeated call for an early reconsideration and ensuing proactive action.<sup>4</sup> However, the rather limited success of previous promotional endeavours appears to be increasingly acknowledged by government officials at various levels alike. Even though rather isolated in nature, a number of recent initiatives and measures to improve MSE policies and/or operating conditions may reflect a growing readiness for a more fundamental change in the promotional approach. Pertinent activities include the launch of the National Rural Support Programme with its claim to focus on grassroot level participation of the target beneficiaries; the seemingly careful design and conduct of practically relevant training courses offered by the Pakistan Institute of Entrepreneurship Training; the recognition of the importance of decentralizing support activities to MSEs by expressing a desire to establish a series of industrial and business support centres in small towns considered as "growth nodes"; a readiness of public authorities to accept savage reviews of past and present MSE-related policies and the corresponding institutional set-up; as well as recent moves to actively involve the private sector in rehabilitating and running previously publicly managed technical support centres on a commercial basis, such as in the case of the Pakistan Cutlery Association which was to receive a Rs 20 million government contribution as seed money to take over the Wazirabad centre.

Taking a fresh look at the issues at stake with a view to seeking innovative solutions to foster the MSE sector requires to pursue a two-pronged approach, as is amply demonstrated in many developing countries. On the one hand, the **creation and maintaining of an enabling business environment** which allows the MSE sector to more fully tap its potential is called for as a sine qua non. This has to be complemented by efforts aimed at **facilitating access of MSEs to critically needed services and resources** on the grounds of efficiency and

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<sup>4</sup> In this connection, one of the co-authors of the 1987 Pakistan country study on rural small industrial enterprise support conducted by the Government of the Netherlands, ILO, UNDP and UNIDO recalled a government official questioning the then findings as allegedly well known. Why then, the analyst argued to the mission, has so little happened?



sustainability on the other hand. The suggested approach entails a clear need for a redefinition of the roles to be played by the social partners - government and private sector including non-governmental organizations (NGOs) - as to how best to nurture MSE growth in the years to come.

## **II. GUIDING PRINCIPLES OF MSE POLICY REFORM**

Future endeavours related to the promotion of MSEs, if successful, will have to be subjected to a number of guiding principles both with regard to the general policy as well as the regulatory framework and to the provision of services and assistance.

- ▶ **Seek participation/involvement of target beneficiaries/potential customers (demand-led approach).**

MSE support programmes and activities should to the maximum possible extent be based on the needs and requirements as actually expressed by the aimed-at target beneficiaries, i.e. actual and potential micro and small entrepreneurs, rather than on a supply-side approach which avails support with limited relevance to a vaguely defined target group. Only the participation of the addressees in designing the required support measures will ensure that both the type and the modalities of the assistance rendered is relevant in satisfying the perceived needs (development with, not for the people).

This general requirement in the first instance calls for the involvement of **grassroots or self-help organizations, including in the form of business associations**, to the maximum possible extent. By functioning as prime mechanisms through which to channel any assistance these target group bodies also **accept responsibilities and therefore provide certain guarantees for its effective and cost-efficient use**. In this context, notwithstanding the special circumstances that have made the Aga Khan Rural Support Programme in northern Pakistan a widely acknowledged success, the set-up of village or community organizations at local level is a promising approach which in principle lends itself to replication in other areas. By attempting this, the recent National Rural Support Programme conceptually points into the right direction. However, comments received on practical achievements following the UNIDO/ILO field investigations by end-1995 are less encouraging and, prior to a final conclusion, would thus necessitate a closer look at the present situation.

**Second**, a more demand-oriented MSE promotion approach requires to place increasing emphasis on the **decentralization (i) of decision-taking** down to and/or a higher degree of autonomy at the local level in general, and **(ii) of the actual MSE service delivery** in particular.

**Third**, in any demand-led approach due account should also be taken of the manifold evidence that MSEs are indeed willing to pay for support services which they deem to be of relevance and use. Hence, more often than not target group participation should entail **cost-sharing arrangements and/or (nominal) user fees**. The latter ensure that only those services will be in demand which are considered relevant/beneficial by their requestors. This in turn

will work as an incentive for the suppliers to keep their services in line with changing demand.

- ▶ **Restrict the role of government to being a catalyst/facilitator of MSE development.**

Advocating a clear preference for self-help and demand orientation of MSE support lends itself to a **redefinition of the government's role away from direct top-down intervention towards a concentration on catalytic and facilitating functions**. As a result, the overall emphasis for policymakers should be to encourage the initiative of and cooperation among local actors as well as to help in the creation of a conducive economic environment and institutional infrastructure. While this facilitating role should encompass the readiness to provide certain financial assistance for the promotion of MSEs, especially in the form of seed money, at the same time it should foresee to reduce the direct managerial or administrative involvement of public entities. This could be started by entering into joint management with the private sector and/or target group representatives (**public-private partnership concept**) and would entail a **gradual transfer of MSE servicing functions from existing public institutions to private and/or semi-private bodies**. As a general direction, government activity should be shifted from the provision of direct subsidized inputs to the removal of constraints which impede the MSE sector to grow and prosper.

- ▶ **Foster intensified private sector linkages.**

As a corollary to the above, in the long run the sustained growth, expansion and continuous upgrading of the MSE sector at large will be critically dependent on the capability of the private sector in general and of the micro and small entrepreneurs in particular to build up and maintain various kinds of business-driven linkages among and between each other through which needed services, assistance and resources would be obtained. Strengthening these linkages through the active involvement of the social partners, including the government and private sector organizations, will hence deserve paramount attention (for details, see IV.2. below).

### **III. PROMOTING AN ENABLING BUSINESS ENVIRONMENT**

#### **1. Adjusting policies and government incentives**

Besides the need to cater for a constant upgrading of the physical (rural) infrastructure (water and energy supply, telecommunications, feeder roads, etc.) the government is clearly called upon to concentrate on the **creation and maintenance of an enabling macro-economic environment** in general and the **removal of macro policy constraints**, especially in the form of anti-MSE biases in particular. In this connection, a number of policy adjustments would require prime attention:

In the area of **fiscal policies**, a major challenge lies in a bold reform of the tax system with a view to (i) broadening the tax base (in particular, by subjecting agricultural incomes to tax) and to (ii) rationalizing tax administration/collection including the system of incentives

and exemptions. Part of the additional tax revenue should be channelled into development expenditures including in the field of MSE promotion. Tax reform measures bearing a more direct relation with MSEs should entail to base taxation on turnover rather than on employment in order to avoid unintended artificial enterprise split-ups into small units. Also, a shift of sales tax collection from the producers to the point of sale would point into the right direction.

Apart from a continued strife against inflation, policies in the field of **money and finance** will need to be geared towards a more vigorous reform and modernization of the country's banking sector. More specifically, persisting gaps between interest rates charged from MSEs under the various concessionary lending schemes and the respective market rates - in spite of the formers' occasional upward adjustment - do not constitute much of an incentive for the banks to seek a higher exposure towards the target beneficiaries (also see IV.5. below).

With regard to **trade policy** a further reduction of import tariffs would help to broaden the procurement base (equipment, raw materials) for and to upgrade the technology base of certain - most likely more advanced - segments of the MSE sector. A removal of the distinction between commercial and industrial import tariffs should be pursued with priority in order to remedy the cost disadvantages MSEs are exposed to currently. Tariff distortions which have proven to be detrimental to MSEs should be abolished. The recent policy of opening bonded warehouses at locations closer to industrial/business agglomerations in other than the largest towns likewise tends to reduce trade-related costs to enterprises (regarding transport, commercial middlemen, customs formalities) and should therefore be continued.

In the area of **export promotion**, the Export Promotion Bureau under the Ministry of Commerce should explore ways, means and measures of enlarging the (direct or indirect) participation of MSEs in international trade. In the allocation of funds raised under the 1991 Export Development Fund scheme - by charging a levy of 0.25 per cent on fob export values -, due account should also be taken of the smallest businesses' needs. For instance, the already commenced establishment of some ten grading institutes, such as in cotton grading, might benefit from introducing special provisions to cater for MSEs. Should recent plans to establish a specialized export development bank materialize, serious efforts should be made to address the smallest businesses' needs as well, perhaps by means of devising specific programmes. Concerning **inward foreign direct investment** rules and regulations, a continued liberalization may contribute to the emergence of new and/or the technical and managerial upgrading of existing local MSE supplier networks through subcontracting.

## 2. Adjusting regulations

Access to incentives under various government schemes (mainly fiscal exemptions) while only of limited relevance to the bottom-end segment of the small-scale enterprise sector is usually restricted to formal sector, i.e. registered units only. Hence the fact that the vast majority of MSEs prefer to stay in the informal economy may be a direct reflection of their estimating the advantages of non-registration to surpass those of a formalized business, or, in economic terms that costs associated with registration are seen to exceed benefits. The same holds with regard to certain legal obligations such as under current labour laws which are only applicable for enterprises with more than ten staff.

If a gradual formalization of the informal MSE sector is considered a worthwhile undertaking, pertinent rules and regulations will have to be adjusted so as to constitute an incentive, not, however, a compulsory measure for MSEs to register. This may entail a simplification and streamlining of present registration procedures and requirements (e.g. one window operation instead of multiple registering); measures to alleviate arbitrary powers of government officials during inspections/ monitoring; and the immediate provision of clear benefits at the time of registration (e.g. information on and/or access to services/resources). The gradual introduction and enforcement of worker-related regulations over a longer period of time should be pursued with regard to minimum wages, working hours, health and safety standards, child labour or minimum social security benefits. Quick action in terms of stricter rules and early enforcement should, however, be sought in cases of particularly undesirable working conditions, such as with regard to child labour or grave environmental hazards. In parallel, appropriate ways should be found to demonstrate the productivity gains which can be expected from improved working conditions to micro and small entrepreneurs.

### **3. Ensuring policy coherence and an appropriate institutional set-up**

In view of the large number of government bodies which carry responsibilities for or whose actions have an impact on the MSE sector, **enhanced effective coordination among relevant government units** in the design and implementation of MSE policies and programmes, particularly in rural areas (provision of infrastructure, specific aids), has become a sine qua non for a better targeted and hence more successful promotion of MSEs in the future. This requirement extends to the central and provincial governments alike. It also holds true for vertical coordination between these two policy/administrative levels notwithstanding the continued desirability to maintain an intelligible division of responsibilities between central and provincial authorities to reap benefits commonly associated with decentralization.

Positive effects can also be expected from an **increased continuity of relevant policies and programmes** which ought to replace the ins and outs (e.g. overlappings, cancellation of ongoing programmes, etc.) of the past practice to launch ever new activities with the advent of a new government quite independently from a thorough review of preceding approaches. Also in this connection, the reported sluggishness of government departments concerning the translation into practice of MSE-related initiatives once incorporated into the five-year plans and adopted by the government should be done away with to underline that the expressed commitment has a sound basis.

Finally, policymakers should strive for **coherence of their overall policies with the narrower field of MSE promotion**, such as by avoiding and/or compensating for measures which - deliberately or not - work to the detriment of MSEs.

#### **► Short term: setting up Task Force for Micro and Small Enterprise Promotion**

Taken together, the aforementioned calls for a clear and innovative institutional response. Therefore, as a **short term measure**, the present study recommends the **setting up of a Task Force for Micro and Small Enterprise Promotion** as a means to express a clear commitment for serious MSE policy reform. The Task Force may be initiated either by the Planning Commission or the Ministry of Industry, either of which could then serve as a

Secretariat. It should be composed of representatives from all Ministries and other government bodies with direct or indirect responsibilities in the field of MSE promotion, such as the Prime Minister's Office and the Ministries of Industry; Labour, Manpower and Overseas Pakistanis; Agriculture; Commerce; Finance; the Federal Bureau of Statistics as well as representatives of major relevant provincial-level authorities and institutions. The private sector's participation should likewise be invited. The considerable expertise available with the donors coordination group on MSE promotion should also be fully tapped, preferably by coopting one or more representatives to the Task Force. Apart from these unpaid members two to three local consultants may be assigned to the Task Force as additional resource persons if and when required.<sup>5</sup>

The Task Force's general function would be to arrive at and maintain a common understanding of objectives, priorities and appropriate policies of how best to promote the country's MSE sector. Work should start with a detailed mutual briefing of each of the participating offices' related activities resulting in a thorough review of past and present policies and programmes, particularly those which seem to have never left the planning stage. Hence, ensuring implementation of once agreed policies and policy measures, a regular monitoring of progress made during implementation as well as finding agreement on corrective action if and when need arises will have to be ranking high on the Task Force's agenda. The suggested approach of consensus building, improved coordination and concerted action can be expected to contribute to the mobilization of synergies in the MSE promotion efforts.

► **Medium term: establishment of a National Council for MSE Development**

In the **medium to longer term**, the proposed Task Force could become the nucleus for the establishment of a **National Council for MSE Development** and a network of counterparts at the provincial levels. Such a body which has already been installed or is about to be installed in a number of developing countries would host representatives from government agencies, the private sector (with participants from all size brackets of enterprises as well as both formal and informal sectors), non-governmental organizations, financing institutions, the academia, and others. Raising public awareness of the importance attached to MSEs for overall development by its very existence, the Council would constitute a most important instrument to institutionalize the public-private dialogue on MSE issues, with a view to identifying and addressing related bottlenecks of policies, regulations and promotion measures. The Council would further establish close links between the legislative and executive bodies as well as review existing and upcoming rules and regulations which bear a potential for adverse effects on MSEs.

#### **4. Enhancing the knowledge and information base on MSEs**

A high rate of success of MSE policies in the longer term is critically dependent on the amount and quality of information available on the target sector as a basis for a meaningful

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<sup>5</sup> Complementarily, the set-up of the Task Force may be conceived of as a project with a full-time expert and a team of local professionals over a one year period.

policy formulation. The need for sound facts rather than educated guesses calls for the regular systematic collection of MSE-related data and information as an important prerequisite. There is ample scope to **increase the empirical knowledge about the type, numbers, size, location, assets, working conditions, gender situation, felt needs etc. of (particularly rural) informal micro and small enterprises (IMSEs) in Pakistan.** This has to be complemented by efforts to strengthen the capacity within government and other bodies to steer the collection and assessment of such data and information. Pending a more detailed enquiry, the Ministry of Industry might be best suited to assume the main responsibility for the key MSE collection unit, in close collaboration with the Federal Bureau of Statistics. At the operational level, the present report recommends therefore (i) to launch a series of IMSE surveys, with a focus on geographical areas bearing high development potential, and (ii) to follow-up closely recent efforts to compile informal sector-specific, especially enterprise data on a more regular and systematic basis, such as in the case of the PAK-Netherlands Data Base Project.

#### **IV. FACILITATING ACCESS OF MSES TO SERVICES AND RESOURCES**

Whereas the creation and nurturing of an enabling environment in overall terms will constitute the necessary condition for the MSE sector's accelerated development, availability of and access to adequate services and resources at enterprise level will remain key prerequisites for the micro entrepreneurs to actually make use of emerging opportunities (sufficient condition). As mentioned before, in most cases the provision of needed services by the private sector itself can be expected to be the best long-term solution. Hence, no more time should go by unused to embark on policies which enhance the private sector's involvement in the provision of such services. However, in the short- to medium-term, i.e. over a transitional period, government bodies will continue to play an important role albeit with a focus on measures and activities which facilitate the MSEs' access to services and resources.

##### **1. Reviewing the role of government**

Acceptance of the guiding principle of reform referred to above to limit the government's role to being a catalyst and/or facilitator of MSE development rather than a direct long-term provider of services would best be reflected in an early consideration of the following measures:

- ▶ **Question the previous funnel approach through small industry development organizations (SIDOs) as insufficient.**

As brought out by the present analysis, the large potential of rural MSEs has essentially remained untapped in spite of certain attempts in recent years by the Pakistani SIDOs to decentralize support activities into rural areas. Also, by and large the performance of the country's SIDOs has been rated rather negatively. Because of this, **the continued reliance on these government institutions as almost exclusive funnels for a whole range of support services should be seriously questioned.**

- ▶ **Continue critical assessment of past/present promotional approaches (policies, institutions) to adequately cover MSEs.**

It is therefore recommended that both central and provincial governments should be ready to critically review the established institutional set-up of MSE promotion with a special focus on the impact of the corresponding policy measures on the target group (with special emphasis on rural areas) and particularly the performance of SIDOs not yet brought under close scrutiny. It is hence suggested to launch in-depth investigations of the programmes and performances of the Sindh Small Industries Corporation, the Balochistan provincial government department for small industries promotion, and the Azad Kashmir Small Industries Corporation. Recommendations made in similar recent assessments, such as with respect to the urged restructuring of SIDB of NWFP, should be seriously analysed and acted upon.

While the suggested in-depth analyses would help to more clearly define the detailed requirements of a new and more promising MSE institutional support infrastructure, a reduction of SIDO functions to some core activity and the parallel establishment of a set of better targeted and probably more specialized institutions is likely to more effectively address the MSEs' needs. In this connection, the proposed review will have to pay sufficient attention to the question of how best to transfer the present related institutional set-up (e.g. SIDOs, industrial estates/districts, training institutions) into a new one better geared to meet the challenges ahead. Alternative solutions, ranging from restructuring to privatization/divestment and/or to outright dismantlement will hence have to be investigated in detail. There are various examples of diverse institutional solutions internationally of how such a more responsive support infrastructure may be shaped. What they share is a strong element of involving local initiative in general and the private sector in particular (for details, see section III.4. below).

The recommended critical assessment of past and present promotional approaches should also include relevant individual policy arrangements and measures. For instance, at federal level, persisting suggestions towards merging the Youth Investment Promotion Society (YIPS) with the Small Business Finance Corporation (SBFC) should be seriously examined, including in the light of procedural changes taking effect at YIPS in 1995 which altered the division of work between the two organizations. Ongoing rural development programmes, such as the National Rural Support Programme (NRSP), while conceptually pursuing a most relevant approach, requires an independent evaluation of achievements some five years after its inception. In case a continuation is deemed useful, the Programme should, however, seek to incorporate industrial/manufacturing activities and not remain limited to agriculture-related/agro-processing activities only.

## **2. Strengthening private sector linkages and involvement**

In international comparison, strong MSE growth and performance tend to be observable in an environment in which a large portion of the required services and inputs are being received from within the private sector itself. For instance, technological know-how is often embodied in tools and equipment procured from suppliers, learnt about in regularly obtained catalogues/journals or may be imparted through sales representatives of manufacturers,

through participation in fairs, etc. Most of the pertinent transactions are taking place on an essentially commercial basis and thus reflect the superiority assigned to interfirm cooperation or other collaborative action by private entrepreneurs over an individual approach. Given the weaknesses or outright lack of private sector involvement in the provision of services and other inputs to MSEs and, in consequence, of interfirm linkages in Pakistan, action is required to promote the use of mechanisms which enhance such link-ups.

► **Industrial sub-contracting/networking**

In view of the apparently huge yet untapped potential for increased sub-contracting relationships among MSEs as well as between MSEs and medium- and/or large enterprises a detailed investigation should be launched to determine the scope for and suitable ways of promoting like arrangements, with a focus on rural-rural and rural-urban link-ups. The investigation should be in the form of a study which - based on taking stock of current sub-contracting/sourcing policies and activities of larger companies in selected key manufacturing sub-sectors - would recommend policy measures on how to influence the make-or-buy decision of medium/large enterprises in favour of an increased farming-out of production, particularly into rural areas. The study may include a comparative analysis of approaches being taken in two geographically confined areas at different levels of industrial development, such as the artisan belt area (Gujranwala, Sialkot, Wazirabad) viz. the Saraiki region (lower Punjab, centered around Multan).

Since any decisive move towards a larger spread of sub-contracting arrangements will be contingent upon the capability of sub-contractors to deliver on time and, especially, at the agreed quality, a general policy requirement would be to enable the progressive upgrading of the MSE sector. This encompasses the creation of a "quality culture", i.e. an understanding on the part of small producers of the need to provide quality outputs as a basis for generating and maintaining business links over time. It also underlines the possible benefits to be derived from a further encouragement of foreign investment inflows of world class companies with a potential interest in local sourcing. A further general policy requirement relates to the proactive mobilization of the positive effects associated with industrial sub-contracting and partnership arrangements (transfer of technical/managerial know-how and technology; possibly, provision of finance/credit; enlarged sales markets; etc.) while at the same time trying to minimize potential adverse effects (exploitation by the main contractor; excessive use of child labour; cost-cutting poor safety and health standards; etc.). The appropriate answer are policies which assist MSEs to become sufficiently strong and independent in their relationship with larger business partners.

Pending the outcome of the stocktaking study suggested above, a policy package (action programme) aimed to facilitate subcontracting and partnership arrangements could be devised which may include as key components

- the installation of a conducive legal framework, the formulation of a code of conduct and establishment of arbitration councils for industrial sub-contracting;
- the set-up of (a national network of) sub-contracting and partnership centres as main mechanisms of sub-contracting-related information dissemination and promotion, to be best run by or with the major involvement of private sector associations; and



- a partnership promotion or vendor development programme with the aim to upgrade the skills and capabilities of suppliers and sub-contractors.

► **Marketing and franchising**

In order to overcome constraints related to the marketing of MSEs' products, efforts should be undertaken to enlarge and diversify available trade channels and market outlets. Complementing the experience made in recent years by Utility Store Ltd (US) with a growing procurement - primarily of a range of food items - from small producers outside urban areas, the scope and potential for enhanced link-ups between MSEs and department stores and/or retail chains should be explored, in particular with regard to franchise arrangements for MSEs at rural level.

For instance, Utility Store Ltd (US) indicated its willingness to provide one counter within a number of its retail outlets to specific groups of MSEs for selling their own produce. The arrangements could take the form of a contract between US and some intermediate organization/NGO (business association, community organization or cooperative) which would guarantee the quality and also organize the delivery of the agreed produce. Alternatively, there may also be a possibility for US to establish an outright subsidiary together with an NGO/self-help organization for the collection of products from rural producers and their subsequent transport to US outlets. Donors may consider to assist in launching such cooperation on a pilot basis first near middle towns with US stores in place.

Likewise, the prospects of replicating and expanding mini franchise projects along the lines of a recent example initiated with the assistance of a donor (ODA) in Punjab should be carefully examined: Coca Cola provides micro entrepreneurs with mobile trolleys on a long-term loan basis, meets all investment costs, and extends some initial group training to the operators. Stocks are provided on a credit basis. Operators must sell the company's drinks for which they get a commission, but are free to sell other refreshments. Efforts to enlarge MSE sales markets away from the immediate vicinity through partnerships between MSEs/village producers and department stores could further encompass a review - and possible adaption - of like activities in other countries known as "foster father programmes", such as in Indonesia.

► **Leasing**

Concerning the possible mobilization of new sources of finance for small enterprises, the applicability of instruments such as leasing at a larger scale for MSEs in general and an extension of their use into rural areas in particular should be explored. In this connection, the experiences being made presently by the World Bank project (Orix Leasing) should be carefully monitored. Access by rural MSEs in this and maybe in schemes to be created along similar lines may be facilitated (i) by also enabling the lease of second hand/used equipment rather than the present restriction to new one, (ii) by availing additional working capital loans through a link-up between the leasing company and commercial banks (see the trial Orix Leasing/Allied Bank link-up), and (iii) by more vigorously attempting to interest the foreign banks present in Pakistan in refinancing leasing companies for business with (rural) MSEs.

### 3. Promoting MSE associations and other NGOs

Pursuance of the demand-led promotion approach referred to above clearly calls for the involvement of suitable target group counterparts at local level to manage or to participate in designing, rendering and managing the extension of relevant support services to MSEs. In many countries, associations of microenterprises in particular have proven most relevant as sources of information, operators of common services centres, facilitators of access to finance, providers of some social protection and advocacy vis-à-vis government offices. It is therefore recommended to **identify existing self-help bodies/business associations of MSE target beneficiaries which might qualify for assuming responsibilities in the organization/channelling of required support services to the individual enterprise.**<sup>6</sup> An investigation should be launched as to the readiness and capability of selected Chambers of Commerce to manage - independently or in collaboration with public entities - existing or proposed (rural) industrial support, common services or other technical extension centres, e.g. with respect to providing investment advice, running training courses of various kinds or providing certain equipment and machinery for use by member MSEs. For instance, according to an estimate the mission received from the Gujranwala Chamber of Commerce and Industry, some 10 chambers country-wide would be both willing to and capable of rendering training programmes to small businesses.<sup>7</sup> As regards the actual establishment and/or growth of self-help bodies, a bottom-up approach while more time-consuming will be superior to a top-down imposition of such bodies (e.g. "political" associations) with little practical usefulness.

In view of the fact that the presently more active trade/business associations tend to be representing the relatively larger MSE segment only, a need would exist for special efforts to encourage the potential for collaborative activity of existing trade associations catering for the bottom-end MSE segment which so far have been limiting themselves to certain lobbying functions within narrow local limits only. The challenge of bringing MSEs together for joint action is even bigger where no such collaborative arrangements exist up to now. The same applies to the widely acknowledged absence of other types of self-help and/or non-governmental organizations sufficiently qualified for the provision of effective services and assistance to enterprises. Hence, the build-up from scratch of like counterparts to run support programmes at local level should be accorded high priority. Brokering services, i.e. the offering of assistance in the formation and/or upgrading of such business/self-help associations should be devised on an urgent basis. Prospects of success in this endeavour increase with the ability to clearly illustrate the advantages of joining forces to the individual, potentially participating micro and small entrepreneurs.

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<sup>6</sup> A good example in this connection in January 1994 was the imminent takeover of the Sialkot Leather Training Centre from the government, i.e. PSIC, by the Gloves Association.

<sup>7</sup> Since 1990, the Gujranwala Chamber has conducted a number of courses on export management (documentation requirements, etc.). As a result, the Gujranwala business community organizes its exports directly nowadays rather than by involving middlemen as before.

#### 4. Fostering area- and sector-based MSE development

International experience has brought about a number of promising institutional and organizational solutions which greatly improve access of MSEs to needed services and resources. They usually serve to promote MSEs along geographical and/or sectoral lines.

##### ► **Rural industrial and business support centres**

One such approach already recommended for implementation in Pakistan by the National Manpower Commission is the **encouragement, inter alia, of the private sector to participate in the establishment of a series of industrial and business support centres (IBSCs) at specified rural growth points** as a means to specifically promote small-scale agro and cottage industries. These centres' functions would encompass the provision of assistance in the areas of marketing (including the build-up of linkages with large-scale enterprises), monitoring/testing/quality control/gradation, skill/vocational training and product development, the provision of equipment for joint use, such as forging and heat treatment facilities, as well as a link-up to credit institutions.<sup>8</sup> However, for the reasons stated above, the fact that the concept up to now foresees the existing SIDOs to take the lead in the build-up of the IBSCs would deserve reconsideration and/or refinement with a view to enhancing the target beneficiaries' participation in designing and running these centres to a maximum. In this connection, preference might be given to a related suggestion inviting to set up a network of **rural development support centres, i.e. one each per 10 to 15 unit councils** which in turn represent some 200 villages. While the government would need to initiate the programme, the centres should be run by the private sector.

##### ► **Local enterprise development agencies**

Establishing a network of what in a number of industrialized countries (Western Europe, especially the United Kingdom, North America) has become known as **local enterprise development agencies (LEDAs)** is a **second** approach recently recommended to the Pakistani authorities.<sup>9</sup> Its merits should be carefully examined. In essence, LEDAs are designed to provide a wide range of support and enabling services needed for both start-ups and existing small enterprises over all stages of a project. This ranges from assistance in the preparation of business plans and proposals with a view to securing funding from banks and other financial institutions, through getting a project started and running, to overcoming obstacles and constraints during operation. Whereas the precise scope and delineation of the services rendered by LEDAs would have to be tailored according to the needs of the particular communities they are intended to serve, LEDAs would not only provide advice directly, but

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<sup>8</sup> See Government of Pakistan, Ministry of Labour, Manpower and Overseas Pakistanis, Report of the National Manpower Commission, Islamabad 1991, pp. 53 & 56-57, as well as S. Ghayur, H. Frey, K. Klennert, Action Plan for Employment and Manpower Development in Pakistan on the basis of Five Provincial Workshops on the Implementation of the National Manpower Commission Report, Friedrich-Ebert-Stiftung, Islamabad 1992, pp. 7f.

<sup>9</sup> For details see RES & Company Ltd, Reform of the Small Industries Development Board (SIDB) and Support Services for Small Scale Industry. Conclusions and Recommendations, Report submitted to GTZ, London, December 1993, pp. 18-22, VII-1 to 13.

also - by linking up with outside expertise beyond a core range of internal knowhow - work as facilitators of advice.<sup>10</sup>

Whereas the list of mainstream LEDA activities is normally expected not to require large amounts of money nor extensive internal resources nor any major commitment by external bodies to deliver, the three additional areas suggested for possible coverage by these LEDAs in the case of Pakistan would need some extended funding: (i) offering a loan support scheme; (ii) establishing managed workshops, understood as buildings which contain between 20 and 50 small units including common service facilities (on-site secretarial services, communications equipment, etc.) under one roof, each unit being separately lockable and offered for rent by small entrepreneurs; and (iii) assuming a matchmaker's role between users, suppliers and receivers in the area of technical training (identification of technical training skills in demand, assistance to the suppliers in the design and advertising of training programmes to the potential clients, assistance to the receivers in locating suitable training courses).

Set-up as non-governmental organizations, i.e. as autonomous self-determining entities, and as partnerships between the public and private sectors allowed to operate without the constraints of civil service regulations, LEDAs are reported to show the best results if provided on a fully decentralized basis, i.e. in each significant conurbation of a target area. They are usually staffed by small numbers of professionals (approx. 5) with mixed disciplines, with the manager being preferably drawn from the private sector.

#### ► **Valencia model**

A third approach if adapted to the specific conditions of Pakistan may also offer promising prospects for a more decentralized promotion especially of the small, probably less so of the micro enterprises. As elaborated upon more fully in the ILO contribution to the present exercise,<sup>11</sup> a strategy along the lines of what has been coined the **Valencia model** could help to replace the traditional cheap labour/low quality focus by a higher quality/higher value added- and hence more innovation-oriented approach as key determinant of achieving industrial competitiveness through a mobilization of small businesses. The model's basic idea is to set up a **decentralized network of semi-autonomous, technical support institutions located nearby sectoral agglomerations and coordinated by a central institute**. In Valencia, about a dozen technical institutes (i) either provide a range of services (e.g. training, technology transfer, quality testing) to specific sectors or (ii) offer highly specialized services for use by small firms from all sectors. The institutes render their services on a sales basis. Responsiveness to the clients' needs is ensured by the affiliated industry associations' majority presence on the individual boards.

The central institute (in the case of Valencia called the Institute for the Promotion of Small and Medium Sized Firms, IMPIVA) notwithstanding some reporting duties viz-à-viz government, particularly at the regional level, operates on a relatively autonomous basis.

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<sup>10</sup> For an illustrative listing of typical services rendered by LEDAs see the UNIDO background paper (DP/ID/SER.D/27/Add.1), Annex III, p. 68.

<sup>11</sup> See ILO background paper (DP/ID/SER.D/27/Add.2), Annex I, pp. 65ff.

Governed by a board of representatives from both the public and private sectors (relevant ministries, chambers of commerce, etc.), it aims at bringing the individual technical institutes in line with public policy via a bottom-up approach. Being represented in all the technical institutes' boards and subsidising part of their running costs (one third) on a permanent basis, IMPIVA is geared towards constantly identifying weaknesses and omissions within this "inner network" with a view to initiating relevant changes and adjustments whenever necessary. Additional inputs for service improvements can be obtained through an "outer network" composed of universities, training establishments, design schools, and other service institutions.

▶ **Common services/business incubation centres**

Finally, close collaboration between micro and small enterprises within a given location is also frequently institutionalized in their joint setting up of so-called **common services or business incubation centres**, designed in most cases for individual manufacturing sub-sectors. The range of services on offer varies, but may include the renting of expensive equipment not affordable for individual MSEs; the central production of intermediate inputs; skills and management training; the maintenance of stocks and materials, of tools and small equipment for sale to members; and/or some marketing assistance.

▶ **Identify promising locations for the establishment of (rural) MSE support centres and other locally oriented support institutions.**

As a first step towards the putting into place of a more effective MSE support network along the lines identified above, it is recommended that efforts be launched to **identify clusters**, i.e. critical masses of numbers of **certain industries** by sub-sectors in different parts of the country **which show sufficient development potential to qualify for the establishment of a limited number of locally oriented support institutions on a pilot basis**. For a start, preference may be given to a small number of **(rural) support institutions/centres**. The donor community may consider to extend funding to one or two such centres on a **pilot basis**, provided the target group's involvement is secured and the services rendered meet the actually felt needs. A similar approach may be taken with regard to **installing a small network of local enterprise development agencies (LEDAs)** which if successful will bode well for replication in other parts of the country.

## 5. Provision of finance and credit

Perceived high risks, lacking collateral and the high cost nature of entering into loan arrangements with MSEs have largely prevented the commercial banking sector from serving MSEs. At least two possible answers to overcoming the problem of lacking or insufficient access to finance for MSEs are to be distinguished. These are

- (i) the continued expansion of self-help informal banking mechanisms at grassroot level known in many developing countries, inter alia, as community banking or banking for the poor on the one hand; and

- (ii) increased efforts to link up formal financial sector institutions with the (rural informal) MSEs on the other hand.

As to the former, in the past decade considerable and varied experience has been accumulated internationally on the provision of credit to microenterprises. Whereas the greater part of a large number particularly of rural financial institutions (RFIs) in many developing countries has remained heavily dependent on subsidies, has shown lacking innovative management and hence has not fulfilled the initial expectations, a few and often cited examples have proved successful in the effective provision of creative financing to poor segments of the population. In essence, the principles applied in these success stories resemble - often deliberately - those that have emerged in the informal financial sector over many years. They are related to a close knowledge of the market, the trimming of administrative costs to a level commensurate with the small loan size, and the strong motivation of repayments by way of special techniques (group guarantee concept in particular).

In Pakistan, a community-oriented savings and credit programme has started operation under the NRSP at small scale. There is, however, a keen interest in many quarters (i) to study in more detail the terms and modalities of community banking schemes applied successfully in other countries, in particular the Grameen Bank in Bangladesh, and (ii) to assess the scope for replication - or, more accurately, transfer and adaption - of these schemes in Pakistan. **It is thus recommended to analyze the prerequisites for, to elaborate on possible forms of as well as to devise concrete steps for the accelerated introduction of community banking facilities into Pakistan with a special focus on rural MSEs.** In so doing, special emphasis should be placed on the example of the Grameen Bank in Bangladesh with a view to initiating a pilot programme of replication in Pakistan.

With regard to increasing the formal banking sector's involvement in the extension of finance to MSEs, steps should be taken to enhance both its indirect and direct exposure. In overall terms, measures should aim to reduce the risks perceived as well as to cut the high credit administration/surveillance costs associated with lending to MSEs. One promising approach of an indirect link-up may be for microenterprise (credit) programs run by NGOs (composed of target MSE beneficiaries and/or in the form of rural support centres) to finance parts of their lending by borrowing from commercial banks. NGOs may become involved in the screening and appraisal process of potential borrowers and their project proposals, in monitoring debt servicing and/or in operating mobile savings collection and credit extension units, possibly also by providing credit guarantees. [Concerning the latter, for an initial period there may also be good reason for foreign donors to step in as brokers between NGO-based programmes and the banks.]<sup>12</sup>

Any sizeable direct engagement of commercial banks in the field of MSE credit is likely to only materialize if banks are convinced that resource allocation to this bottom enterprise segment is not equivalent to sacrificing safety and hence income objectives. To achieve this, on the one hand banks need to be made familiar with applying the operating principles which characterize successful RFIs. On the other hand, a conducive macro-economic operating

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<sup>12</sup> Both formal sector banks and NGOs in Pakistan may be interested in entering into an agreement with the international, Swiss-based NGO RAFAD which offers guarantees to local banks for loans to MSEs (RAFAD Foundation; 1, rue Varembe, Geneva, Switzerland).

framework, inter alia, would entail to do without subsidized interest rates and/or interest rate ceilings. With regard to the soft loan schemes currently available to small enterprises under various programmes, the raising over time of upper credit limits has further contributed to a further concentration of credit extension at the larger enterprise segment. By the same token, many of the minimum ceilings or threshold levels applied preclude MSEs from the respective loan facility.

Against this background, the present report recommends to launch a study on appropriate measures, mechanisms and institutional requirements on how to foster the link-up, both directly and indirectly, between the commercial banking sector and MSEs, with a focus on the rural areas. This should be done in close collaboration with the commercial banking sector itself. At the macro level, subsidized credit in the form of interest rate ceilings should be dropped/phased out. The appropriateness of maintaining mandatory targets for the allocation of credits to small enterprises should be seriously questioned. However, the possible establishment of separate credit windows for rural enterprises, including in the form of mandatory crediting by geographical areas merits a careful examination. In doing this, emphasis should be placed on increasing both the banks' awareness/knowledge of and outreach to this clients group. The pros and cons of setting up a decentralized rural bank exclusively for credits up to Rs 50,000 only as suggested in the 1991 Manpower Commission's report should also be carefully examined.

Promising endeavours to broaden the access of MSEs to credit in Pakistan are likely to be those which pay due account, inter alia, of (i) a close supervision of loans as a general principle (see the pertaining positive experience of the PAK-Holland metal project), (ii) availing money including for badly needed working capital loans, and of (iii) making the viability of a project more important for a credit decision than the collateral issue. The latter may go hand in hand with raising credit limits extended without collateral requirements (e.g. up to Rs 50,000) or with accepting raw materials and/or machinery as collateral.

## 6. Training

In view of the limited relevance for industrial MSEs (i) of the great number of existing public vocational training institutions in general and (ii) of the weaknesses reported about training activities geared especially towards small enterprises in particular every effort has to be made to involve the target beneficiaries in the design of any future training services/activities to ensure that actual needs at workshop/shop-floor level are responded to. It is suggested to jointly identify practical training requirements by industrial/manufacturing sub-sectors, subjects and levels. While the new training policy recently set in force in Pakistan foresees the determination of pertinent curricula only upon consultation of entrepreneurs and/or their representation at the local level, the actual translation into practice deserves a thorough monitoring. As a general rule, instructions should be simple, relevant and easily accessible for the target groups. The imparting of technical skills has to be complemented by managerial/organizational know-how (basics of running a business, design, marketing, quality consciousness, etc.). The positive experiences made with mobile training units should be expanded.

The potential merits and feasibility of establishing privately-run trade-specific production-cum-training centres at local level may also be subjected to a careful examination. In so doing, the lessons to be drawn from earlier/ongoing donor-funded vocational/technical training centres and activities will have to be taken due account of. For instance, there may be a case for complementing training with the provision of certain tools and implements (in kind credit, probably in the range up to Rs 1,500 only) to enable poor trainees upon completion to apply their upgraded skills.

Overall, in the case of rural informal MSEs the installation of a "proper informal" education/training system in certain ways may be superior to a formal system. However, shortcomings commonly being associated with the traditional, well established Ustad-Shagird system (tendency towards exploitation by trainees of master-craftsmen; length of training period; limited inclination of Ustads towards upgrading of skills) will need to be avoided. Following a tripartite approach of apprenticeship training (selection of good craftsmen as masters to train apprentices at their workshop under the guidance/supervision of the programme management) such as under the PAK-German Technical Training Programme in NWFP may be a preferable alternative.

## 7. Support to women MSEs

**A special consultancy should be launched with the aim of establishing in detail the bottlenecks experienced as well as the needs felt by micro and small women entrepreneurs especially in rural areas in the set-up and/or expansion of their businesses.** This needs assessment study which should preferably be carried out by - or at least with the involvement of - female consultants would also review promotion measures currently in place (policies, individual programmes/measures, institutions, donor-funded projects) and develop recommendations for further action to strengthen the women's role in (rural) MSEs. Without preempting the outcome of the recommended investigation there may be good reason - except for some specific activities - to largely strive for an integrated male/female MSE promotion rather than advocating separate approaches for both genders. Building up group consciousness/identity, fostering empowerment and ensuring participation are likely to feature prominently in any promising endeavour to render support to women MSEs. In view of the small portion of women heading small enterprises in the more modern sector, special measures may also be required to tap the potential of educated women to set up such enterprises.

As a short term measure, the existing support institutions (the SIDOs, SBFC, etc.) should increase the share of female staff so as to ease the access by female customers. In the field of credit, given the recent positive rating of the First Women Bank's soft loan scheme for poor women entrepreneurs ways and means of its extension into the rural areas should be actively explored.<sup>13</sup>

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<sup>13</sup> For a summary evaluation of the First Women Bank's recent performance see A.R. Kemal, Constraints, Policy Approaches and Programmes for the Development of Micro Enterprises in Pakistan, Pakistan Institute of Development Economics, Islamabad, March 1994, pp. 31-35.



## 8. Local authorities

The potential of authorities at local level (small towns, villages) to act as MSE promoters should be fully mobilized. Possibilities may exist, inter alia, with regard to local regulatory powers (e.g. application of modest/reasonable fees for street vendors) as well as the contracting out of certain municipal/local services to MSE/informal sector associations, such as garbage collection or gardening.

## 9. Private consultancy services

The further development and expansion of indigenous consultancy services as would-be partners of the country's MSEs or MSE associations should be actively pursued. Appropriate mechanisms may include the set-up of a training and consultancy fund which could be approached by MSEs individually or, preferably, collectively for (non-subsidized) loans which would serve to buy needed training or other services in the local market. The economic responsibility stays with the entrepreneurs while the private consultancy business receives a stimulus for further advancement.

## 10. Role of donors

The commendable practice of both bi- and multilateral donors with years of experience in the promotion of MSEs in Pakistan to exchange views and expertise and to coordinate better their pertaining activities through their international donors' group should be maintained and expanded with a view to establishing joint activities. The usefulness of enhanced coordination cannot be overestimated.<sup>14</sup>

As long as the target beneficiaries lack adequate access to responsible decision-takers, the donors' coordination group should strengthen its role as a **lobbying mechanism for the (rural) MSEs viz-à-viz the government**. The key importance of an effective promotion of MSE businesses for income generation, employment and, hence, overall economic stability needs to be constantly communicated to the central government at the highest possible level, preferably at or in the vicinity of the Prime Minister's Office. The donors group's support in the proposed set-up and subsequent counselling of a Task Force for Micro and Small Enterprise Promotion and its possible later extension into a National Council for MSE Development should be actively invited.

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<sup>14</sup> Emphasized as a new priority, coordinated donor support for national strategies to strengthen the policy framework and institutional systems is also at the core of a recent report by the OECD on new directions in donor assistance to microenterprises. See OECD, *New Directions in Donor Assistance to Microenterprises*, Paris 1993, pp. 11-19.

## V. ROLE OF UNIDO/ILO

The primary objective of the present exercise is to identify action needs for early government attention in the field of MSE promotion as well as to suggest and outline response measures with a promising potential to help overcome existing constraints. It is thus for the government authorities to decide where to go from here, i.e. which recommendations to follow, and to take the necessary steps for their implementation so as to more effectively support the growth of a viable MSE sector.

Hence, at the request of UNDP, the formulation of possible UNDP/UNIDO/ILO support programmes and projects has not been accorded high importance. However, given their long-standing experience and accumulated know-how in the field of small enterprise promotion, both UNIDO and ILO stand ready to offer catalytic advisory services and technical assistance in the would-be implementation of most of the recommendations made above. Detailed programme/project concepts will be worked out upon request. Support can be rendered, *inter alia*, in the following areas:

- In-depth investigations of programmes and performance of existing small industries development organizations and other MSE support institutions;
- Establishment of Task Force for Micro and Small Enterprise promotion;
- Adjustments of the regulatory framework;
- Promotion of MSE self-help initiatives, especially business associations;
- Establishment of rural support centres and/or other locally oriented support institutions;
- Upgrading of small enterprises in selected subsectors;
- Promotion of industrial sub-contracting/networking and partnership for small enterprises;
- Promotion of women entrepreneurs for industrial growth;
- Organization of study tours for public and private sector officials/representatives, e.g. regarding the various institutional arrangements described above.

In order to determine external assistance requirements in more detail and to ensure that the responses offered are in line with needs as perceived by target beneficiaries, UNIDO/ILO suggest to conduct an Objective Oriented Project Planning (OOPP) Workshop on the future promotion of the MSE sector. Following a participatory approach OOPP reflects the principle of national capacity-building, recognizing that the establishment of priorities, the achievement of results and their sustainability are nationally owned. The workshop would be organized with the involvement of all stakeholders (including external supporters, i.e. bi-/multilateral donors and relevant NGOs, as well as business representatives), be guided by an independent "moderator" and encompass analysis and planning as main phases.

**Annex: List of participants at end-of-project workshop, held at the Ministry of Industries & Production, Islamabad, Pakistan, 3-4 December 1995**

Day 1:

Mr. Saghar Asad Hasan, Additional Secretary, Ministry of Industries & Production (MOIP), Chairman  
 Mr. Zaheer Ahmed, Joint Secretary, MOIP  
 Mr. M.S. Jamal, Central Labour Advisor, Ministry of Labour  
 Mr. Muhammad Asif Sheik, Deputy Chief, Economic Affairs Division, Ministry of Finance  
 Mr. Nayid Aziz, Member, Main Committee, Employers Federation of Pakistan  
 Mr. Jaramat Ali, Secretary, PILER, Karachi  
 Mr. Anwar Go  
 Ms. Suhela Asif, Director, Ministry of Women Development & Youth Affairs  
 Mr. Masood A. Tahir, Director, Operations, Youth Investment Promotion Society (YIPS)  
 Mr. Zahoor A. Malik, Director, Administration, Accounts & Coordination, YIPS  
 Deputy Managing Director, Small Business Finance Corporation  
 Mr. Raza Khan, Federation of Pakistan Chambers of Commerce and Industry (FPCCI)  
 Mr. Shuja-Ud-Din Siddiqui, Director General, Leather Industry Development Organization, MOIP  
 Mr. A. Mohammad  
 Mr. Khalid M. Mughal, Chief Research Officer, MOIP  
 Mr. S. Ali Shah, Additional Secretary, Ministry of Labour and Manpower, Punjab Province  
 Mr. Rueben W. Dudley, Director, ILO Office, Islamabad  
 Ms. Khin Khin Glauser, Deputy Director, ILO Office, Islamabad  
 Mr. Gerry Finnegan, Senior Specialist, ILO-SAAT, New Delhi  
 Mr. Moïse Allal, Head, Microenterprise & Informal Sector Section, ILO, Geneva  
 Mr. Abdel Rahim Marei, UNIDO Country Director, Islamabad  
 Mr. Andrea Sessa, JPO, UNIDO Office, Islamabad  
 Mr. Jürgen Reinhardt, Industrial Development Officer, UNIDO Vienna

Day 2:

Mr. Zaheer Ahmed, Joint Secretary, MOIP (Chairman)  
 Mr. Shaban Uppal, Joint Secretary, MOIP  
 Mr. Anwar Khan, Chief Research Officer, MOIP  
 Mr. Khalid M. Mughal, Chief Research Officer, MOIP  
 Mr. Nicholas Rosellini, Assistant Resident Representative, UNDP Islamabad  
 Mr. Farhan Sabih, Programme Officer, UNDP Islamabad  
 Mr. Sohail Ahmed, Programme Officer, Japan International Cooperation Agency  
 Mr. Farooq-I-Azan, Director, Overseas Pakistani Foundation  
 Mr. Fasih-Uz-Zaman, Manager Operations, Pak-Swiss Small-scale Enterprise Promotion Programme, Peshawar  
 Ms. Rukhsana Asghar, Small Enterprise Development Specialist, Faisalabad Area Upgrading Project  
 Ms. Karin Mittmann, Director, GTZ Project Administration Services, Islamabad  
 Mr. William Mellgren, CTA Pakistan Chapter, ILO Employment Promotion Project  
 Ms. Jeanette G. Hasan-Worp, Economist, Delegation of the European Commission to Pakistan  
 Mr. Rueben W. Dudley, Director, ILO Office, Islamabad  
 Ms. Khin Khin Glauser, Deputy Director, ILO Office, Islamabad  
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 Mr. Moïse Allal, Head, Microenterprise & Informal Sector Section, ILO, Geneva  
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REVIEW OF THE  
RURAL INFORMAL MICRO AND SMALL ENTERPRISES SECTOR:  
DEVELOPMENT OF AN ACTION-ORIENTED PROGRAMME

NC/PAK/92/039

PAKISTAN

Addendum 1: UNIDO Report

Prepared for the Government of Pakistan  
under UNDP-financed TSS-1 facility

Forming the UNIDO contribution to a joint UNIDO/ILO TSS-1 exercise, this report was co-ordinated by the Asia and the Pacific Bureau, Country Programmes and Funds Mobilization Division, based on the work of Jürgen Reinhardt, Asia and the Pacific Bureau, Christian Zimmermann, Investment Promotion Programme, and Seiichiro Hisakawa, Small and Medium Industries Branch. A background paper was provided by A.R. Kemal, Islamabad, as national expert.

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**REVIEW OF THE RURAL INFORMAL  
MICRO AND SMALL ENTERPRISES SECTOR:  
DEVELOPMENT OF AN ACTION-ORIENTED PROGRAMME**

**SUMMARY**

**IMPORTANCE OF (RURAL) INFORMAL MICRO AND SMALL ENTERPRISES IN PAKISTAN**

(1) In view of the varied definitional coverage of inputs reviewed and incorporated and the intended focus on practical policy discussions in this project report a somewhat flexible working definition is adopted. Informal micro and small enterprises (MSE) are understood to encompass, to the extent possible, largely unregistered independent units (i) of very small, i.e. micro enterprises, also frequently referred to as cottage or household industries, with 1-5 workers, as well as units (ii) at the lower end of the small-scale enterprise spectrum, employing up to say 10 people. Definite fixed asset ceilings are considered less relevant since the largest part of MSEs targeted here, particularly in rural areas, disposes of very low capital endowments in the range of a few thousand Rupees only. Informal MSEs are, however, typically characterised by the non-separation of ownership, management and "shop floor" operations.

(2) 85 million people or 70 per cent of the 121 million total population live in rural areas, being largely dependent on agriculture and small/cottage industries. Notwithstanding a far reaching absence of reliable up-to-date figures on rural MSEs an estimated nine million non-agricultural employed labour force highlights the sector's overall importance in already earning a living, frequently merely at subsistence level.

(3) However, unresolved demographic and economic challenges in their entirety make a clear case for a set of well designed and more effective policies to promote small- and medium-scale industries in general and rural informal MSEs in particular:

- the high population growth in connection with the deteriorating problem of rural-urban migration is estimated to raise the share of the urban population living in unserved localities to 55 per cent by the year 2,000 as compared to about a quarter in 1990;
- a corresponding rapid growth of the labour force by an estimated 1.2 million a year continues to be adding to the high unemployment, officially rated at 1.7 million at present; this is linked to;
- a stagnating absorption of labour to be observed in the formal sector in recent years as a result of which some 70 per cent of the urban labour force in its strive for subsistence is estimated to be active in the informal sector.

## **STRATEGIES, POLICIES AND PROGRAMMES DIRECTED AT THE MSE SECTOR**

(4) In turn, promotional efforts directed at the MSE sector in Pakistan have not yet been based on or resulted in the elaboration of a comprehensive and well-defined national strategy. On the one hand, the focus of past industrial policies particularly in the early phases was clearly put on the larger industrial enterprise segment. On the other hand, the small and medium-sized enterprise segment appears to have experienced a gradually increasing policy attention in the course of time, however, with the micro units at the bottom end witnessing a far-reaching though not complete neglect.

(5) While development plans and other general policy statements usually acknowledge the high importance of small businesses - including in rural areas - for the country's overall development, this generally favourable view at the operational level has essentially been translated into the establishment of a number of exclusively government-owned and -managed support institutions, known as small industry development organizations (SIDOs). Traditionally, these SIDOs have been designed so as to render a broader range of services to small enterprises, such as in the areas of finance, provision of premises within industrial estates, training/skills development, marketing, technological advice, etc. In addition, several development finance institutions have been set up to provide funding particularly for small businesses.

(6) The scope and details of a variety of government schemes and programmes to promote small - less so micro - businesses in general and their accelerated development in rural areas in particular frequently changed with the advent of a new government. This applies both to direct approaches, e.g. in the provision of credit, extension services, training/skills development, and to indirect approaches aimed at improving the general conditions for MSEs to operate, such as in the context of (integrated) rural development programmes. Recent efforts, inter alia, to strengthen the basis for rural MSEs include the Social Action Programme (1992/93), the National Rural Support Programme (1991), the Rural Industrialization Programme (1990) or the Self-Employment Programme.

### **KEY ISSUES AND CONSTRAINTS OF MSE PROMOTION AND DEVELOPMENT: AN ASSESSMENT**

(7) An assessment of the key problems and constraints which hinder the development of an economically healthy and dynamic MSE sector, including in rural areas, requires to distinguish between three, in many ways interrelated levels: (i) the macro-economic policy framework and conditions, (ii) the level of support institutions, and (iii) the enterprise or micro level.

(8) With regard to the macro policy framework, the linkage with the development of (rural) MSEs is rather indirect and general. Hence, the creation and maintenance of an enabling business environment through appropriate macro economic policies which helps economic activity to flourish at large can also be expected to foster MSEs by means of spread effects. However, the extent of any direct impact on (rural) MSEs to be reached through macro policies is open to debate, except for a few selected areas. For instance, as to present trade policies the often criticised distinction between the (higher) commercial viz-a-viz industrial import tariffs puts small enterprises which rely on commercial importers at a disadvantage when compared to the large enterprises which procure foreign inputs directly at the lower

industrial tariffs. Equally, in the area of taxation policies, the apparent prevalence not only in rural areas of arbitrary tax assessments by as well as informal arrangements with tax collectors are clearly inferior to a fair and transparent tax system which takes due account of MSEs in the context of the overall economy.

(9) The lack of continuity to be observed both in the overall policy direction and with regard to the MSE-oriented programmes as well as the preferential treatment in past industrial policies of big, especially urban industries, over small businesses have been further hindrances for the development of a viable MSE sector. Policy inconsistencies which turn out to be self-defeating point at least to a lack of coordination. A recent example is a technical assistance project on the promotion of metal workshops which includes the manufacture of agricultural implements. When the government subsequently granted a subsidy to selected large, high cost manufacturers of agricultural implements, the latter were able to outmanoeuvre the small promoted units through lower price sales, resulting in the entire support programme becoming obsolete.

(10) After more than 20 years of experience with the present set-up of SIDOs as main channels of assistance to MSEs in Pakistan there is a widely held view among local and foreign observers including some government offices and the international donor community that by and large little achievements are to be reported. The institutional setting has repeatedly been criticised for in fact favouring the large-scale over the small-scale manufacturing segment. Several empirical analyses have shown very clearly that direct public support programmes have largely failed to reach the small and ever more so the micro business target groups, particularly in rural areas. MSEs are either frequently unaware of the offered SIDO services or have reservations about the usefulness of the individual support scheme in the light of their specific needs. As a result, for instance, the portion of credit extended to the rural MSEs through the SIDOs over time has been almost negligible. Thus, the question to be raised here is whether and to what extent the existing institutions can and should be reoriented towards putting greater emphasis on the micro enterprise sector.

(11) Likewise, the results of the SIDO's vocational training activities, the provision of small industrial estates or the rendering of investment advisory services have repeatedly been described as highly inadequate or outright failures. Inadequate staff, time consuming bureaucratic procedures and a general lack of flexibility and responsiveness to changing demands have also been identified as characteristic features of these public support institutions, even though distinctions need to be made regarding the performance of the individual organizations. In this context, recent evaluations ascribe some positive effects to the rural industrialization programme of the Punjab Small Industry Corporation, whereas the activities of the Sarhad Small Industries Development Board of NWFP have been qualified as an almost complete failure.

(12) The volumes of special assistance to rural MSEs channelled through both development finance institutions and the commercial banking sector (costliness of extending small credit amounts; collateral problem) have been equally minute. In addition, repayment ratios as a rule have been far from satisfactory. Existing business associations with a few exceptions would not normally care about micro enterprises. Among the relatively high number of non-governmental organizations active in the country so far there appear to be only very few which address aspects of promoting (rural) MSEs.

(13) Problems encountered by actual or potential (rural) MSEs at the workshop, i.e. the micro level, encompass a series of well established constraints, both of an external and internal nature:

- The lacking access to finance continues to be of prime importance, although the degree of relevance is somewhat unclear from the available empirical results. Funding for the start-up phase seems to be less of a problem than overcoming working capital needs or finance for the expansion of a business. Also, given that rural credit is frequently obtained through informal channels (moneylenders, middlemen) at very high interest rates, the price charged for loans normally is much less relevant than its very availability.
- Shortcomings of the physical infrastructure (roads, means of transport, communications, reliable energy supplies, etc.) continue to be in the way of a more decentralized emergence of a sustainable MSE sector.
- The lack of education, technical knowhow, knowledge of markets as well as of managerial and organizational capabilities of running a business constitute further constraints - in varied composition - at enterprise level. In spite of quite substantial horizontal and vertical interlinkages between (including rural) MSEs and medium/large companies to be observed in selected areas, the present degree and scope of subcontracting arrangements overall leaves much to be desired.

(14) Summing up, while the presentation of previous policy endeavours and its confrontation with actual achievements and ongoing constraints pertaining to MSE promotion and development in the light of numerous studies may be nothing but common knowledge among the relevant community, the deep-rooted dissatisfaction with the past performance appears to have paved the way for a principle readiness in the recent past for fundamental change in the promotional approach.

## **ELEMENTS OF A NEW PROMOTIONAL STRATEGY FOR MSEs IN PAKISTAN: RECOMMENDATIONS FOR ACTION**

### General thrust:

(15) **Participation/involvement of target beneficiaries/potential customers (demand-led approach).** MSE support programmes and activities should to the maximum possible extent be based on the needs and requirements as actually expressed by the aimed-at target beneficiaries, i.e. actual and potential micro and small entrepreneurs, rather than on a supply-side approach which avails support with limited relevance to the target group. Only the participation of the addressees in designing the required support measures will ensure that both the type and the modalities of the assistance rendered is relevant in overcoming the perceived needs (development with, not for the people). This general requirement in the first instance calls for the **involvement of grassroots or self-help organizations, including in the form of business associations.** By functioning as prime mechanisms through which any assistance is being channelled these target group bodies also accept responsibilities for its effective and cost-efficient use. In this context, notwithstanding the special circumstances that have made the Aga Khan Rural Support Programme in northern Pakistan a widely acknowledged success, the set-up of village or community organizations at local level is a promising approach which in principle lends itself to replication in other areas. By attempting

this, the recent National Rural Support Programme points into the right direction and should thus qualify for enhanced support.

(16) Second, a more demand-oriented MSE promotion approach requires to place increasing emphasis on the decentralization (i) of decision-taking down to and/or a higher degree of autonomy at the local level in general, and (ii) of the actual MSE service delivery in particular. Third, in any demand-led approach due account should also be taken of the manifold evidence that MSEs are indeed willing to pay for support services which they deem to be of relevance and use. Hence, more often than not target group participation should entail cost-sharing arrangements/(some) user fees to ensure a continued interest in making best use of a service.

(17) Previous funnel approach through SIDOs to be questioned. The large potential of rural MSEs has essentially remained untapped in spite of certain attempts in recent years by the Pakistani SIDOs to decentralize support activities into rural areas. Also, by and large the performance of the country's SIDOs has been rated rather negatively. Because of this, the continued reliance on these government institutions as almost exclusive funnels for a whole range of support services should be seriously questioned.

(18) It is therefore recommended that both central and provincial governments should be ready to critically review the established institutional setup of MSE promotion with a special focus on the impact of the corresponding policy measures on the target group (with special emphasis on rural areas) and particularly the performance of SIDOs not yet brought under close scrutiny, i.e. the Sindh Small Industries Corporation, the Balochistan provincial government department for small industries promotion, and the Azad Kashmir Small Industries Corporation. Recommendations made in recent assessments, such as with respect to the urged restructuring of SIDB of NWFP should be seriously assessed.

(19) While the suggested in-depth analyses would help to more clearly define the detailed requirements of a new and more promising MSE institutional support infrastructure, a reduction of SIDO functions to some core activity and the parallel establishment of a set of better targeted and probably more specialized institutions is likely to more effectively address the MSEs' needs. There are various examples of diverse institutional solutions internationally of how such a more responsive support infrastructure may be shaped. What they share is a strong element of involving local initiative in general and the private sector in particular. One such approach already recommended for implementation in Pakistan by the National Manpower Commission is the encouragement, inter alia, of the private sector to participate in the establishment of a series of industrial and business support centres (IBSCs) at specified rural growth points as a means to specifically promote small-scale agro and cottage industries.

(20) Establishing a network of what in a number of industrialized countries (Western Europe, especially the United Kingdom, North America) has become known as local enterprise development agencies (LEDAs) is a second approach recently recommended to the Pakistani authorities. Its merits should be carefully examined. In essence, LEDAs are designed to provide a wide range of support and enabling services needed for both start-ups and existing small enterprises over all stages of a project. Whereas the precise scope and delineation of these services has to be tailored according to the needs of the particular communities they are intended to serve, LEDAs would not only provide advice directly, but also - by linking up with outside expertise beyond a core range of internal knowhow - work as facilitators of

advice. LEDAs perform best if set-up as non-governmental organizations and as partnerships between the public and private sectors allowed to operate without the constraints of civil service regulations.

(21) A third approach if adapted to the specific conditions of Pakistan may also offer promising prospects for a more decentralized promotion especially of the small, probably less so of the micro enterprises. As elaborated upon more fully in the ILO contribution to the present exercise, a strategy along the lines of what has been coined the **Valencia model** could help to replace the traditional cheap labour/low quality focus by a higher quality/higher value added- and hence more innovation-oriented approach as key determinant of achieving industrial competitiveness through a mobilization of small businesses. The model's basic idea is to set up a **decentralized network of semi-autonomous, technical support institutions located nearby sectoral agglomerations and coordinated by a central institute.**

(22) **Restriction of government role to catalyst/facilitator of MSE development.** The foregoing general recommendations lead themselves to **redefine the government's role away from direct top-down intervention towards a concentration on catalytic and facilitating functions.** The overall emphasis for policymakers should be to encourage cooperation among local actors and to help in the creation of a conducive institutional infrastructure. While this facilitating role should encompass the readiness to provide certain financial assistance for the promotion of MSEs, at the same time it should foresee to reduce the direct managerial or administrative involvement of public entities, at least by entering into joint management with the private sector and/or target group representatives (**public-private partnership concept**). Generally, government activity should be shifted from the provision of direct subsidized inputs to the removal of constraints which impede the MSE sector to grow and prosper.

(23) In the latter context, besides the need to cater for a constant upgrading of the physical (rural) infrastructure the government is clearly called upon to concentrate on the **creation and maintenance of an enabling macro-economic environment in general and the removal of macro policy constraints, especially in the form of anti-MSE biases in particular.** In the area of fiscal policies, a major challenge lies in a bold reform of the tax system with a view to (i) broadening the tax base (in particular, by subjecting agricultural incomes to tax) and to (ii) rationalizing tax administration/collection including the system of incentives and exemptions. Part of the additional tax revenue should be channelled into development expenditures including in the field of MSE promotion. Tax reform measures should entail to base taxation on turnover rather than on employment in order to avoid unintended artificial enterprise split-ups into small units. Also, a shift of sales tax collection from the producers to the point of sale would point into the right direction.

(24) With regard to trade policy a further reduction of import tariffs would help to broaden the procurement base (equipment, raw materials) for and to upgrade the technology base of certain - most likely more advanced - segments of the MSE sector. A removal of the distinction between commercial and industrial import tariffs should be pursued with priority in order to remedy the cost disadvantages MSEs are exposed to currently. Tariff distortions which have proven to be detrimental to MSEs should be abolished. The recent policy of opening bonded warehouses at locations closer to industrial/business agglomerations in other than the largest towns likewise tends to reduce trade-related costs to enterprises (regarding transport, commercial middlemen, customs formalities) and should therefore be continued.

(25) In the area of **export promotion**, the Export Promotion Bureau under the Ministry of Commerce should explore ways, means and measures of enlarging the (direct or indirect) participation of MSEs in international trade. In the allocation of funds raised under the 1991 Export Development Fund scheme, due account should also be taken of the smallest businesses' needs. For instance, the already commenced establishment of some ten grading institutes, such as in cotton grading, might benefit from introducing special provisions to cater for MSEs. Should recent plans to establish a specialized export development bank materialize, serious efforts should be made to address the smallest businesses' needs as well, perhaps by means of devising specific programmes.

(26) Concerning **inward foreign direct investment** rules and regulations, a continued liberalization may contribute to the emergence of new and/or the technical and managerial upgrading of existing local MSE supplier networks through subcontracting.

(27) In more general terms, **enhanced coordination among relevant government units** in the design and implementation of MSE policies and programmes, particularly in rural areas (provision of infrastructure, specific aids) would also help to enlarge the rate of success. The same can be expected from an **increased continuity of relevant policies and programmes** which ought to replace the ins and outs (e.g. overlappings, cancellation of ongoing programmes, etc.) of the past practice to launch ever new activities with the advent of a new government quite independently from a thorough review of preceding approaches. Finally, policymakers should strive for **coherence of their overall policies with the narrower field of MSE promotion**.

(28) **Assumption of MSE lobbying function by international donors' group.** The commendable practice of both bi- and multilateral donors with years of experience in the promotion of MSEs in Pakistan to exchange views and expertise and to coordinate better their pertaining activities through their international donors' group should be maintained and expanded with a view to **establishing joint activities**. The usefulness of **enhanced coordination** cannot be overestimated. The group should also explore ways and means to develop into a **lobbying mechanism for the (rural) MSEs viz-à-viz the government**. The key importance of an effective promotion of MSE businesses for income generation, employment and, hence, overall economic stability needs to be constantly communicated to the central government at the highest possible level, preferably at or in the vicinity of the Prime Minister's Office. If pursued jointly, a move by the donors towards a **higher degree of conditionality** in the sense of granting assistance only in line with a real, more visible and sustained commitment on the government's part to make progress as to the promotion of MSEs, might add to a faster reorientation of failed or only partly successful policies of the past.

#### Specific recommendations:

(29) **Enhance information base on rural informal MSEs.** There is ample scope to increase the empirical knowledge about the type, size, working conditions, felt needs etc. of (particularly rural) informal micro and small enterprises (RIMSEs) in Pakistan. It is therefore recommended (i) to launch a series of RIMSE surveys, with a focus on geographical areas bearing high development potential, and (ii) to follow-up closely recent efforts to compile informal sector-specific, especially enterprise data on a more regular and systematic basis (see PAK-Netherlands Data Base Project).

**(30) Continue critical assessment of past/present promotional approaches (policies, institutions) to adequately cover MSEs.** Recent efforts to identify shortcomings of MSE promotion at policy and institutional level both of central and provincial governments should be continued. It is therefore suggested to launch an in-depth investigation of the programmes and performance of (i) the Sindh Small Industries Corporation, (ii) the respective Balochistan government department, and (iii) the Azad Kashmir Small Industries Corporation similar to the one conducted for GTZ recently on NWFP's SIDB. At federal level, recent suggestions towards merging the Youth Investment Promotion Service (YIPS) with the Small Business Finance Corporation (SBFC) should be seriously examined. Ongoing rural development programmes, such as the National Rural Support Programme (NRSP) should seek to incorporate industrial/manufacturing activities and not be limited to agriculture-related/agro-processing activities.

**(31) Raise public awareness of MSE importance for overall development/institutionalize public-private dialogue.** A mechanism should be devised to bring together on a regular basis key policymakers, government officials and business representatives (i) to overcome the prevalent underestimation of the MSE sector, including in many segments of the larger industries sector, and (ii) to discuss ways and means of tapping the unexplored potential of MSEs through mutually beneficial cooperation. Awareness has to be raised of the sector's overriding importance for the badly needed generation of income and employment opportunities for a large number of people. For instance, the Federation of Pakistan Chambers of Commerce and Industry indicated an interest to participate in such a public-private dialogue.

**(32) Identify suitable target group counterparts at local level to manage or to participate in designing, rendering and managing the extension of relevant support services to MSEs.** Following the demand-led promotion approach outlined above, it is recommended on a sample basis to identify existing bodies/self-help associations of MSE target beneficiaries which might qualify for assuming responsibilities in the organization/channelling of support services to the grass-root level. An investigation should be launched as to the readiness and capability of selected Chambers of Commerce to manage - independently or in collaboration with public entities - existing or proposed (rural) industrial support centres, e.g. with respect to providing investment advice, running training courses of various kinds or providing certain equipment and machinery for use by member MSEs. The widely acknowledged absence of non-governmental organizations sufficiently qualified for stepping in here may also necessitate the build-up from scratch of like counterparts at local level.

**(33) Identify promising locations for the establishment of rural support centres.** In parallel with the aforementioned, efforts should be launched to identify clusters, i.e. critical masses of the number of certain industries by sectors in different parts of the country which show sufficient development potential to qualify for the establishment of a limited number of rural support institutions/centres along the lines suggested in the Manpower Commission's Report. The donor community may consider to extend funding to one or two such centres on a pilot basis, provided the target group's involvement is secured and the services rendered meet the actually felt needs. A similar approach may be taken with regard to installing a small network of local enterprise development agencies (LEDAs) which if successful will bode well for replication in other parts of the country.



(34) **Reorient training activities to real needs of clients.** Every effort has to be made to involve the target beneficiaries in the design of any future, possibly informal, training services/activities to ensure that actual needs at workshop/shop-floor level are responded to. It is suggested to jointly identify practical training requirements by industrial/manufacturing sub-sectors, subjects and levels. Instructions should be simple, relevant and easily accessible for the target groups. The positive experiences made with mobile training units should be expanded. While in the case of rural informal MSEs the installation of a "proper informal" education/training system in certain ways may be superior to a formal system and hence recommend to build pertaining efforts upon the traditional, well established Ustad-Shagir system, in a broader context increased attention should also be paid to a corresponding reorientation of the training provided by formal sector institutions.

(36) **Expand MSE access to credit through enhanced community banking and improved cooperation between MSEs and commercial banks.** Perceived high risks, lacking collateral and the high cost nature of entering into loan arrangements with MSEs have largely prevented the commercial banking sector from serving MSEs. At least two possible answers to overcoming the problem of lacking or insufficient access to finance for MSEs are to be distinguished. These are (i) the continued expansion of self-help informal banking mechanisms at grassroot level known in many developing countries, inter alia, as community banking or banking for the poor on the one hand, and (ii) increased efforts to link up formal financial sector institutions with the (rural informal) MSEs on the other hand.

(37) As to the former, in the past decade or so considerable and varied experience has been accumulated internationally on the provision of credit to microenterprises. Whereas the greater part of a large number particularly of rural financial institutions (RFIs) in many developing countries has remained heavily dependent on subsidies, has shown lacking innovative management and hence has not fulfilled the initial expectations, a few and often cited examples have proved successful in the effective provision of creative financing to poor segments of the population. In essence, the principles applied in these success stories resemble - often deliberately - those that have emerged in the informal financial sector over many years. They are related to a close knowledge of the market, the trimming of administrative costs to a level commensurate with the low loan size, and the strong motivation of repayments by way of special techniques.

(38) In Pakistan a community-oriented savings and credit programme has started operation under the NRSP at small scale. There is, however, a keen interest in many quarters (i) to study in more detail the terms and modalities of community banking schemes applied successfully in other countries, and (ii) to assess the scope for replication - or, more accurately, transfer and adaption - of these schemes in Pakistan. It is thus recommended to analyze the prerequisites for, to elaborate on possible forms of as well as to devise concrete steps for the accelerated introduction of community banking facilities into Pakistan at a larger scale with a special focus on rural MSEs.

(39) With regard to increasing the formal banking sector's involvement in the extension of finance to MSEs, steps should be taken to enhance both its indirect and direct exposure. In overall terms, measures should aim to reduce the risks perceived as well as to cut the high credit administration/surveillance costs associated with lending to MSEs. One promising approach of an indirect link-up may be for microenterprise (credit) programs run by NGOs (composed of target MSE beneficiaries and/or in the form of rural support centres) to finance parts of their lending by borrowing from commercial banks. NGOs may become involved in

the screening and appraisal process of potential loaners and their project proposals, in monitoring debt servicing and/or in operating mobile savings collection and credit extension units, possibly also by providing credit guarantees. Concerning the latter, for an initial period there may also be good reason for foreign donors to step in as brokers between NGO-based programmes and the banks. Any sizeable direct engagement of commercial banks in the field of MSE credit is likely to only materialize if banks are convinced that resource allocation to this bottom enterprise segment is not equivalent to sacrificing safety and hence income objectives. To achieve this, on the one hand banks need to be made familiar with applying the principles referred to in the characterization of successful RFIs above. On the other hand, a conducive macro-economic operating framework, inter alia, would entail to do without subsidized interest rates and/or interest rate ceilings.

**(40) Against this background, the present report recommends to launch a study on appropriate measures, mechanisms and institutional requirements on how to foster the link-up, both directly and indirectly, between the commercial banking sector and MSEs, with a focus on the rural areas. This should be done in close collaboration with the commercial banking sector itself. At the macro level, subsidized credit in the form of interest rate ceilings should be dropped/phased out. The appropriateness of maintaining mandatory targets for the allocation of credits to small enterprises should be seriously questioned. The possible establishment of separate credit windows for rural enterprises merit a careful examination. In doing this, emphasis should be placed on increasing both the banks' awareness/knowledge of and outreach to this clients group.**

**(41) Concerning the possible mobilization of new sources of finance for small enterprises, the applicability of instruments such as leasing at a larger scale for MSEs in general and an extension of their use into rural areas in particular should be explored. In this connection, the experiences being made presently by the World Bank project (Orix Leasing) should be carefully monitored. Access by rural MSEs in this and maybe in schemes to be created along similar lines may be facilitated (i) by also enabling the lease of second hand/used equipment rather than the present restriction to new one, (ii) by availing additional working capital loans through a link-up between the leasing company and commercial banks (see the trial Orix Leasing/Allied Bank link-up), and (iii) by more vigorously attempting to interest the foreign banks present in Pakistan in refinancing leasing companies for business with (rural) MSEs.**

**(42) Enlarge/diversify trade channels/market outlets for MSEs. The scope and potential for franchise arrangements of retail outlets for MSEs at rural level should be explored. Utility Store Ltd (US) indicated its willingness to provide one counter within a number of its retail outlets to specific groups of MSE producers. The arrangements could take the form of a contract between US and some intermediate organization/NGO which would guarantee the quality and also organize the delivery of the agreed produce. As to the possible promotion of MSE exports, models known from other countries, such as the export village approach applied in Sri Lanka, should be analyzed regarding their replicability in Pakistan.**

**(43) Determine needs and possible forms of support to women MSEs. A special consultancy should be launched with the aim of establishing in detail the bottlenecks experienced as well as the needs felt by micro and small women entrepreneurs in rural areas in the set-up and/or expansion of their businesses. This needs assessment study which should preferably be carried out by female consultants would also review promotion measures currently in place (policies, individual programmes/measures, institutions, donor-funded**

projects) and develop recommendations for strengthening the women's role in rural MSEs. As a short term measure, the existing support institutions (the SIDOs, SBFC, etc.) should increase the share of female staff so as to ease the access by female customers. In the field of credit, ways and means for the First Women Bank to extend its activities into the rural areas should be carefully explored.

**(44) Determine scope for and take measures to facilitate increased MSE participation in industrial subcontracting/networking activities.** In view of the untapped potential for increased subcontracting relationships among MSEs as well as between MSEs and medium-and/or large enterprises a detailed investigation should be launched to determine the scope for and suitable ways of promoting like arrangements, with a focus on rural-rural and rural-urban link-ups. The investigation should be in the form of a study which - based on taking stock of current subcontracting activities in selected key manufacturing sub-sectors - would recommend policy measures on how to influence the make-or-buy decision of medium/large enterprises in favour of an increased farming-out of production into rural areas.

## I. Introduction

In Pakistan, some 85 million people or 70 per cent of the 121 million total population live in rural areas, being largely dependent on agriculture and small/cottage industries. While reliable up-to-date figures on rural micro and small enterprises (MSEs) are lacking, an estimated nine million non-agricultural employed labour force is indicative of the sector's considerable overall importance in already earning a living for a large number of individuals, albeit frequently merely at subsistence level.

However, as in other developing countries, unresolved demographic and economic challenges in their entirety make a clear case for a set of well designed and effective policies to promote small- and medium-scale industries in general and the segment of rural informal MSEs in particular:

- The high population growth of some 3 per cent per annum in connection with the deteriorating problem of rural-urban migration is estimated to raise the share of the urban population living in unserved localities to 55 per cent by the year 2,000 as compared to about a quarter in 1990;
- A corresponding rapid growth of the labour force by an estimated 1.2 million a year continues to be adding to the high unemployment, officially rated at 1.7 million at present, and a much larger underemployment; this is linked to
- A stagnating absorption of labour to be observed in the formal sector in recent years caused, inter alia, by insufficient growth, a tendency towards a more capital-intensive production in both industry and agriculture as well as restrained job opportunities in the public sector. As a result some 70 per cent of the urban labour force in its strive for subsistence is estimated to have resorted to informal sector activities.

Against this background, UNIDO and ILO have been jointly approached by UNDP under the TSS-1 facility to review past and present policies pursued in Pakistan with regard to MSE furtherance and promotion. The objective is to make recommendations for future supportive action pertaining to this field for use both by government units and interested donors. The present report which constitutes the UNIDO input to this joint exercise is a response to this request. It is organized as follows:

After a short definitional remark **Chapter II** provides some summary information on the country's MSE sector (overall importance and basic structural patterns).

This is followed by a description in **Chapter III** of key strategies, policies and programmes directed at the MSE sector, covering the general orientation, the institutional setting as well as major government and donor-funded activities.

In **Chapter IV** a critical assessment is undertaken of past policy achievements and major constraints of MSE development observable at the level of the macro-economic policy and regulatory framework, the support institutions and the micro and small enterprises.

Based on the preceding confrontation of previous policy endeavours with the actual achievements and continued constraints, **Chapter V** identifies a number of general and more specific elements which are recommended for inclusion into a new and more promising promotional strategy for MSEs in Pakistan.

The report is mainly based (i) on a synoptical review of earlier studies and other materials related to MSE development and promotion in Pakistan, and (ii) on the results of intensive discussions held with government officials, international donors, academics and private business representatives as well as on personal observations on site visits during the UNIDO team's mission to Pakistan in January 1994.<sup>1</sup>

## **II. The (Rural) Informal Micro and Small Enterprises (MSE) Sector in Pakistan**

### **1. Definition**

Definitions of any of the target sector's components - micro/small, informal/formal, urban/rural - differ distinctly between the few pertaining surveys and investigations conducted so far in Pakistan. This fact, together with a far reaching absence of official data on this sector, renders the compilation of any quantitatively reliable picture about the size, growth and structural patterns of informal MSEs in the country a difficult if not impossible task. Most figures quoted in this report should thus be understood as indicative only, giving orders of magnitude rather than precise numbers.

The Pakistani official definition of small-scale enterprises is based on both employment and capital size. Units with less than 10 workers on the one hand and - alternatively - with fixed assets excluding the cost of land of up to Rs 20 million (until 1993 Rs 10 million) on the other hand are labelled as small in the official statistics. In turn, most analysts set much lower capital ceilings to more adequately determine this "bottom end" segment of the non-agricultural sector in general and to distinguish micro enterprises (1-5 workers, Rs 5,000-10,000 fixed assets) from small-scale enterprises (6-10/20 workers, Rs 10,000-500,000 fixed assets) in particular. The main criteria for classifying a business as informal, i.e. an activity outside the formal economy, is its non-registration with government authorities, for instance for taxation or labour law applicability purposes. In Pakistan, enterprises with less than 10 employees are exempt from registration under the Factories Act 1934 and from the payment of sales tax and excise duties.

In view of the varied definitional coverage of inputs reviewed and incorporated and the intended focus on practical policy discussions the present report adopts a somewhat flexible working definition. Informal micro and small enterprises (MSEs) are understood to encompass, to the extent possible, largely unregistered independent units (i) of very small, i.e. micro enterprises, also frequently referred to as cottage or household industries, with 1-5 workers, as well as units (ii) at the lower end of the small-scale enterprise spectrum, employing up to say 10 people. Definite fixed asset ceilings are considered less relevant since the largest part of MSEs targeted here, particularly in rural areas, disposes of very low capital

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<sup>1</sup> See Annex IV, p. 70, for the mission programme.

endowments not exceeding a few thousand Rupees only. Informal MSEs are, however, typically characterised by the non-separation of ownership, management and "shop floor" operations.

## 2. MSEs in the overall economy

National accounts statistics record a 5.8 per cent share of small-scale manufacturing in GDP for the fiscal year 1994/95 which compares with a 12.7 per cent share for large-scale manufacturing (Table II.1). Small-scale activities in other than manufacturing sectors, such as in services, are not separately given. Over the last decade, small-scale manufacturing clearly outperformed the large-scale business with average annual growth rates of 13.6 per cent and 8.4 per cent, respectively. As a result, small-scale business increased its share in total manufacturing from 25.8 per cent to 31.3 per cent in the period 1982-95.

**Table II.1: Structure and Growth Performance of the Pakistani Economy, 1982 - 1995**

Gross Domestic Product (constant prices of 1980/81)									
Sector	1982/83		1987/88		1992/93		1994/95		Average Growth p.a. 1982/3- 1994/5 (%)
	Rs Mil.	% share	Rs Mil.	% share	Rs Mil.	% share	Rs Mil.	% share	
Agriculture	83,532	29.3	99,108	25.7	118,795	24.2	128,228	24.0	4.5
Industry	65,091	22.9	96,925	25.1	131,129	26.7	144,341	27.0	10.1
- Mining and Quarrying	1,164	0.4	2,029	0.5	2,642	0.5	2,648	0.5	10.6
- Manufacturing	45,592	16.0	67,622	17.5	89,889	18.3	98,914	18.5	9.7
- Large scale	33,847	11.9	50,043	13.0	63,577	12.9	67,996	12.7	8.4
- Small scale	11,745	4.1	17,579	4.6	26,312	5.4	30,918	5.8	13.6
- Construction	11,910	4.2	16,563	4.3	20,701	4.2	21,788	4.1	6.9
- Utilities	6,425	2.3	10,711	2.8	17,897	3.6	20,991	3.9	18.9
Services	136,044	47.8	189,383	49.1	241,401	49.1	261,371	48.9	7.7
- Transport & Communication	27,971	9.8	39,293	10.2	50,333	10.2	54,389	10.2	7.9
- Wholesale & Retail Trade	44,397	15.6	63,932	16.6	81,061	16.5	86,003	16.1	7.8
- Finance & Insurance	7,498	2.6	9,452	2.5	110,650	2.3	12,389	2.3	5.4
- Ownership of Dwellings	14,125	5.0	20,828	5.4	26,939	5.5	29,858	5.6	9.3
- Public admin. & defense	21,490	7.5	27,666	7.2	33,295	6.8	34,803	6.5	5.2
- Other Services	20,563	7.2	28,212	7.3	38,708	7.9	43,929	8.2	9.5
Total GDP	284,667	100	385,416	100	491,325	100	533,940	100	7.3

Source: Government of Pakistan, Economic Adviser's Wing, Economic Survey 1992-1993, Statistical Supplement, Islamabad 1993, pp. 45-47; and Economic Survey 1994-95, Statistical Appendix, Islamabad 1995, pp. 29-31.

**Table II.2: Profile of the Small-scale Manufacturing Sector in Pakistan, 1983/84**

Sub-sectors	Units		Employment		Value added		Share of Small-scale Manufacturing in Pakistan Total		
	Nos	% of total	Nos	% of Total	Rs Mil.	% of Total	Units %	Employment %	Value-Added %
Textile	46,541	19.2	130,102	23.4	1,722.9	20.1	98.10	42.04	21.21
Wood & Furniture	35,167	14.5	76,278	13.7	822.5	9.6	99.78	95.28	83.77
Jewellery	30,381	12.6	47,154	8.5	752.8	8.8	100.00	100.00	100.00
Metal & Engineering	23,304	9.6	54,302	9.8	605.7	7.1	96.28	46.12	9.95
NMM Products <sup>1)</sup>	7,270	3.0	14,319	2.6	492.9	5.7	98.37	54.79	46.58
Footwear	22,171	9.2	45,287	8.2	485.1	5.6	99.92	97.92	93.55
Bakery Products	6,281	2.6	21,389	3.9	331.6	3.9	99.33	88.61	74.88
Rice Milling	3,290	1.4	13,736	2.5	307.3	3.6	95.05	87.86	67.71
Wheat Milling	8,896	3.7	18,683	3.4	291.9	3.4	98.03	80.36	55.88
Tobacco/Cigarettes	19,165	7.9	32,509	5.8	164.0	1.9	99.90	76.52	2.77
Ice	1,031	0.4	4,420	0.8	149.0	1.7	94.41	89.65	91.24
Other	38,399	15.9	97,318	17.5	2,463.6	28.7	96.07	32.89	8.61
Total	241,896	100.0	555,497	100.0	8,589.3	100.0	98.35	53.77	16.02

<sup>1)</sup> Non-metallic mineral products, excluding cement.

Source: Survey of Small and Household Manufacturing Industries 1983-84, Federal Bureau of Statistics, Government of Pakistan, Islamabad, reproduced from Friedrich-Ebert-Stiftung; Swiss Development Corporation (Eds.), Small and Micro Enterprises Promotion in Pakistan, Informal Sector Studies No. 1, Islamabad 1992, p. 7.

**Table II.3: Manufacturing Establishments by Employment Size and Registration Status 1988**

Employment Size	Number of Units Registered	Per cent	Number of Units Not Registered	Per cent
Total	7,656	100.00	282,417	100.00
Less than 10 persons	1,479	19.32	266,584	94.39
10 to 19 persons	2,694	35.19	11,947	4.23
20 to 49 persons	1,839	24.02	2,927	1.04
50 to 99 persons	658	8.59	588	0.21
100 & more persons	986	12.88	371	0.13

Source: Government of Pakistan, Federal Bureau of Statistics, Census of Establishments 1988, Islamabad 1991, pp. xv ff.

More detailed information gained from the 1983-84 Survey of Small and Household Manufacturing Industries<sup>2</sup> reveal a rather diversified small-scale manufacturing sector which accounted for the bulk of total manufacturing in terms of the number of units (98 per cent) and of employment (54 per cent) as well as for a 16 per cent share of value-added (Table II.2). Sub-sectors of particular importance are textiles, wood & furniture, jewellery, metal & engineering, non-metallic mineral products and footwear which jointly contribute some 57 and 66 per cent to the total small-scale manufacturing value-added and employment, respectively. Overall, MSEs assume a dominant role in the manufacture of wood & furniture, jewellery, footwear, bakery products, rice milling and ice where they account for between 68 (rice milling) and 100 (jewellery) per cent of the country-wide total manufacturing.

Only a tiny fraction of manufacturing MSEs is registered with government, i.e. not operating informally. According to the latest Census of Establishments 99.4 per cent of a total 268 thousand manufacturing units with less than 10 employees were not registered under the Factories Act 1934 in 1988. This corresponded to some 94 per cent of the unregistered units total (Table II.3). With as many as 72 per cent of the manufacturing units employing 10 persons and above not having registered the census also revealed a generally high degree of disregard of legal requirements.

### 3. MSEs in rural areas

According to the 1990-91 Labour Force Survey some 37 per cent of the rural labour force was engaged in non-agricultural activities, marking a distinct increase from 28 per cent in 1971/72.<sup>3</sup> With the likely exception of the finance and electricity, gas and water sub-sectors rural production can be assumed to largely take place in the informal sector. In 1990/91 roughly a quarter of the estimated nine million non-agricultural employed labour force in rural areas was working in the field of community and social services, followed by manufacturing (22 per cent), trade (21 per cent) and construction (18 per cent). Over time, while the employment share of trade declined since 1982/83, the other three sub-sectors increased their share with some variations (Table II.4).

With regard to the status of rural non-agricultural employment, self-employment together with the contribution of unpaid family members account for more than 60 per cent of the overall total which is significantly higher than the 50 per cent observed in the informal sector of urban areas (Table II.5). Self-employment is most pronounced in the trade sub-sector (73 per cent) and exceeds 50 per cent for construction, manufacturing and transport.

Female employment is reported to account for only 7 per cent of the total informal rural sector, with the largest share observed in manufacturing (17 per cent; Table II.6). The average weekly working time is given with 45 hours; 22 per cent of rural informal labourers work at least 56 hours whereas a third indicates to work 49 hours and more (Table II.7).

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<sup>2</sup> The results of the more recent 1988 survey had not been published by the time of report writing; full details were not to be obtained.

<sup>3</sup> These and the following figures, if not otherwise indicated, are taken from a background paper prepared for the present report by A.R. Kemal, *Informal Sector in Rural Pakistan*, Islamabad, December 1993, mimeo.



Rural manufacturing in Pakistan is very labour-intensive and generally displays a low productivity level of production. While it absorbs almost half of the total manufacturing labour force, its contribution to total manufacturing output is estimated with roughly 5 per cent. Amounting to Rs. 6,928 the cost of a job in rural manufacturing reaches about two third of the urban equivalent. However, a higher capital-output ratio (equalling a lower productivity of capital) and a lower labour productivity of rural vis-à-vis urban areas are indicative of a relative competitive disadvantage of the former (Table II.8). Both capital-output ratios and labour productivity vary significantly across the different manufacturing sub-sectors. Maximum capital-output ratios have been observed in food, textiles, printing and basic metals industries while wearing apparel, footwear, paper, electrical machinery and leather industries report rather low ratios.<sup>4</sup>

**Table II.4: Non-agricultural Rural Employment by Economic Sectors (Percentage Shares)**

Sector	1982-83	1986-87	1987-88	1990-91
Mining and Quarrying	0.0	0.6	0.6	0.4
Manufacturing	17.6	26.1	25.5	22.0
Electricity, Gas and Water	1.5	1.1	1.2	1.4
Construction	14.8	17.0	18.8	17.9
Trade	28.4	21.0	21.2	21.2
Transport	3.7	10.3	10.8	10.1
Finance	-	0.6	0.6	0.8
Community & Social Services	18.8	23.3	21.2	24.5
Others	15.2	0.3	0.3	0.3
Total	100.0	100.0	100.0	100.0

**Table II.5: Status of Rural Non-Agricultural Employment by Economic Sectors, 1988 (Percentage Shares)**

Sector	Employers	Self-Employed	Unpaid Family Helpers	Employees
Manufacturing	1.1	52.6	16.4	29.9
Construction	0.3	59.7	3.9	36.0
Trade	3.4	73.4	12.0	11.2
Transport	0.6	50.4	5.5	43.5
Community & Personal Services	0.1	30.7	5.6	63.5
Total	1.2	52.4	9.3	37.1

<sup>4</sup> For details, see Annex table I, p. 59.

**Table II.6: Informal Sector Employment in Rural Areas and Economic Sectors, 1987-88**

Activities	Males	Females
Mining and Quarrying	92.3	7.7
Manufacturing	83.0	17.0
Construction	98.4	1.6
Trade	97.0	3.0
Transport	100.0	0.0
Community & Social Services	92.5	7.5
Total	93.0	7.0

**Table II.7: Distribution of Working Hours by Economic Sectors, 1987-88**

Activities	Number of Hours Worked Per Week							Average
	10-14	15-24	25-34	35-41	42-48	49-55	56 & Above	
Manufacturing	1.7	5.2	6.2	21.3	34.1	11.0	20.4	44.0
Construction	1.0	2.3	3.3	20.2	49.7	9.0	14.6	43.6
Trade	1.3	1.3	2.2	17.7	29.3	15.9	32.1	47.2
Transport	0.6	0.9	1.4	14.5	35.7	10.1	37.1	48.3
Community & Social Services	1.2	2.9	3.9	25.3	44.1	8.5	14.0	43.6
Total	1.2	2.8	3.8	20.3	38.8	10.9	22.1	45.1

**Table II.8: Capital and Labour Productivity in Urban and Rural Informal Sector Manufacturing Enterprises in 1988**

	Capital-output Ratio	Capital-labour Ratio (Rs. per worker)	Productivity of Labour
Urban	0.54	9,910	18,358
Rural	0.66	6,928	10,566

Rural manufacturing is largely concentrated in food-processing (mostly wheat milling), textiles (mostly carpets), wood and mineral products which in 1988 together accounted for three quarters of rural manufacturing value-added (Table II.9). On average, rural manufacturing enterprises employ two persons. Contrary to urban areas where small enterprises tend to be larger than household units, according to census data the reverse is true in rural areas (Table II.10).

**Table II.9: Breakdown of Manufacturing Value Added in Rural Areas**

Industry	Percentage Shares	
	1983-84	1988
Food processing of which wheat milling	24.8 (17.5)	33.3 (27.8)
Beverages	-	0.9
Textiles of which cotton fabrics carpets	20.2 (1.7) (11.5)	29.6 (4.5) 19.4)
Wearing apparel	0.1	0.9
Leather products	-	0.2
Footwear	6.7	3.6
Cotton ginning	0.8	0.8
Wood and products	6.0	7.2
Furniture and fixture	3.7	5.1
Paper & products	0.1	0.1
Chemicals	1.0	0.7
Mineral products	22.7	6.2
Metal products	8.2	5.4
Non-electrical machinery	1.4	1.1
Electrical machinery	0.1	0.1
Transport equipment	2.0	0.2
Other manufacturing	1.6	5.5

**Table II.10: Average Firm Size of Rural Manufacturing Enterprises (Number of Workers, 1988)**

	Total	Household Unit	Small Enterprises
Pakistan	2.02	2.10	1.95
Punjab	1.99	2.07	1.91
Sindh	2.42	2.44	2.29
NWFP	2.34	2.20	1.88
Balochistan	1.87	1.60	2.09

### III. Strategies, Policies and Programmes Directed at the MSE Sector

#### 1. General direction

Promotional efforts directed at the MSE sector in Pakistan have not yet been based on or, for that matter, resulted in the elaboration of a comprehensive and well-defined national strategy. On the one hand, the focus of past industrialization moves particularly in the early phases was clearly put on the larger industrial enterprise segment which was the primary addressee of government incentives and support. On the other hand, the small and medium-sized enterprise segment appears to have experienced a gradually increasing policy attention in the course of time, with the micro units at the bottom end witnessing a far-reaching though not complete neglect.

Direct measures to aid the small-scale sector introduced in the 1970s included (i) the transfer of the decision-making power related to the sector from the centre to the provincial governments, (ii) tax exemptions for selected small-scale industries, (iii) tax concessions on imported capital goods for use in less developed areas of the country, and (iv) a liberalization of imports to ease certain raw material shortages. The government's decision in 1972 to nationalize large-scale firms favoured the small- and medium-sized ones more indirectly by redirecting investors towards the latter.<sup>5</sup>

The importance of small-scale businesses for the country's overall development continues to be acknowledged in the development plans and other general policy statements. For instance, the Seventh Plan (1988/89-1992/93), inter alia, emphasized industrialization in less-developed areas, foresaw increased outlays for small-scale industries and aimed at strengthening linkages between small engineering industries and large-scale industries through the encouragement of subcontracting arrangements. According to government officials small and medium enterprise issues have been equally emphasized in the current Eighth Plan (1993/94-1996/97).<sup>6</sup> This also seems to be in continuation of the new "Industrial Policy Package" announced in 1989 two of the four major objectives of which were related to the reduction of regional imbalances in industrial development and to assigning a pivotal role to small-scale industries. Industrial deregulation and privatization were earmarked as key features of this package which emerged as a direct result of a structural adjustment programme agreed upon with the IMF at end-1988.<sup>7</sup>

In line with a variety of developing countries worldwide this generally sympathetic view of MSEs at the operational level has essentially been translated into the establishment of a number of exclusively government-owned and -managed support institutions, known as small industry development organizations (SIDOs). Traditionally, these SIDOs have been designed so as to render a broader range of services to small enterprises, such as in the areas of

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<sup>5</sup> See K. Aftab; J. Keddie; H. Weijland, Thematic Evaluation of Technical Co-operation in Support of Rural Small Industrial Enterprises, Phase II Country Study: Pakistan, December 1987, mimeo, p. 22.

<sup>6</sup> Although the eighth plan period commenced in July 1993, the plan had not been published by the time of the UNIDO mission.

<sup>7</sup> For details, see UNIDO, Pakistan. Towards Industrial Liberalization and Revitalization, Industrial Development Review Series, Oxford/ Cambridge 1990, pp. 74-78.

finance, provision of premises within industrial estates, training/skills development, marketing, technological advice, etc. In addition, several development finance institutions have been set up to provide funding particularly for small businesses.

## 2. Institutional framework

### (a) Public sector

In general, the responsibility for the formulation of overall policies pertaining to the MSE sector rests with authorities at central government level, particularly the Planning Commission and the Ministry of Industries. In turn, the specifics of MSE support activities (range/extension of services, terms and conditions, investment projects) are elaborated and decided upon by the Industry as well as the Planning and Development Departments of the four provincial governments.

As mentioned above, three SIDOs - one each operating in the North Western Frontier Province (NWFP), the Punjab and Sindh - as well as an unincorporated department of the Balochistan provincial government presently constitute the major institutional mechanisms through which assistance to the MSE sector is being channelled. All set-up in 1972, these provincial boards by replacing the previous West Pakistan Small Industries Corporation reflected the then newly installed administrative structure of Federal Pakistan. In addition, 1990 saw the establishment of the Azad Kashmir Small Industries Corporation in the capital Muzaffarabd.

With the objectives being broadly similar to its counterparts in the other Provinces, the Punjab Small Industries Corporation (PSIC) aims to "provide the maximum possible facilities and services for the establishment of small industries and to standardise production, reduce financial difficulties and provide trained manpower". PSIC employs some 2,800 staff in total at present, approximately 100 of which are assigned to the Lahore head office, the remainder are distributed among eight regional offices.<sup>8</sup> Following a policy of decentralization and delegation of authority to the regions in recent years Regional Directors are now directly responsible for the full range of PSIC's services. These are related to:<sup>9</sup>

- 13 common facility centres whose major function is to impart technological know-how, to provide certain specialised machinery and equipment for use by the private sector against a user fee, and to offer technical training services;
- more than 60 handicraft-related centres established throughout Punjab Province under PSIC's Handicraft Development Programme, including 17 Handicraft Development Centres (6 of which exclusively for women), 31 carpet centres, 7 handicraft shops and 7 craft development projects in underdeveloped areas;

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<sup>8</sup> These are in Lahore, Rawalpindi, Gujranwala, Faisalabad, Multan, Sargodha, Bahawalpur and D.I. Khan.

<sup>9</sup> For the following summary see PSIC, What does it stand for?, Lahore, no date, pp. 5-10; RES & Company Ltd, Reform of the Small Industries Development Board (SIDB) and Support Services for Small Scale Industry. Conclusions and Recommendations, Report submitted to GTZ, London, December 1993, pp. II-13ff.

- skilled manpower development through 49 Dehi Mazdoor Training Centres, particularly in the areas of welding, wood-working, carpentry and farm machinery;
- a total of currently 14 small industrial estates offering nearly 4,200 fully developed factory plots, foreseen to be complemented by some 25 additional estates at district level. Plots are provided on a 99 year lease payable on an instalment basis (50 per cent on application, 25 per cent each at the start of construction and on the hand-over to the entrepreneur, respectively). A small maintenance charge is levied to cover running costs, such as street lighting and site maintenance;
- investment promotion activities in the small industries sector, including the provision of finance under several credit schemes, either administered by PSIC itself (e.g. rural industrialization programme, self-employment scheme; see section III.3 below) or by specialized development finance institutions.

The Sarhad Small Industries Development Board (SIDB) has its headquarters in Peshawar assuming responsibility for the NWFP. As of mid-1993, a total of some 1,300 staff were employed (i) at five corporate management and administrative directorates as well as (ii) at six separately managed promotional directorates, with those for cottage industries, service centres and industrial estates assuming the major importance. The latter directorates maintain and/or supervise around 60 outlying units throughout the province. These encompass

- 31 cottage industry units, exclusively in the areas of carpets, embroidery/ knitting and handicraft/textiles. SIDB is mandated to provide training and financial support and to render assistance to these units with regard to procurement and design as well as marketing and distribution;
- 9 operational industrial estates which so far form the basis of the Board's physical infrastructure development in the small business sector. By mid-1993, 1098 or 75 per cent of the total 1473 plots available had been allotted to 387 tenants, 40 per cent of which were recorded as being operational. Tenants erect their own buildings while the estates are serviced and supplied with water, electricity, gas and drainage facilities. Charges are levied for maintenance, water and ground rent. The plots are leased out for 99 years, with a down-payment of 20 per cent of the lease cost due at the beginning and the balance to be paid over a ten year period following a three year moratorium;
- 11 service centres, six of which in wood working, two in metal working, and one each in leather, ceramics and electronics manufacture. The provision of training, technical assistance, credit facilities, extension services and sub-contract work are earmarked as main functions of these centres. Three centres have enjoyed funding under bilateral aid agreements, i.e. the PAK-German wood working centre, the PAK-Holland metal project and the PAK-Swiss agricultural light engineering project;
- 4 retail shops under operation to provide marketing support to micro and small craft industries.

Located with its head office in the provincial capital Karachi, the Sindh Small Industries Corporation (SSIC) is embarking on activities similar to its above parallel institutions. Close to 1,000 staff are distributed among headquarters (about a fifth of the total) and four regional offices. According to the latest available Annual Report, one year training courses extending

over a wide variety of both traditional and non-traditional manufacturing and service activities are provided through a total of 79 training centres with a combined capacity of 2,200 trainees per year.<sup>10</sup> Seven so-called artisan colonies have been established for local craftsmen which are to be assisted by the SSIC in the procurement of credit and raw materials as well as in design and marketing. A total 1,630 plots had been made available for small businesses in 14 small industries estates (with an additional two under implementation) by mid-1992, 421 or 26 per cent of which being utilized at that time. A soft term credit scheme, jointly financed by the Sindh Provincial Government and SSIC, was on offer for business set-ups especially within the industrial estates. Other activities include some 50 training centres in the field of traditional crafts, with emphasis on carpet production, and five handicraft shops as marketing outlets for craftsmen. Further recent fields of action comprise a new quality control and marketing centre at Hyderabad and an institute for entrepreneurial training at Larkana and Sanghar.

Some of the country's development finance institutions are mandated to cater particularly for the small- (and medium-)scale business sector. The Industrial Development Bank of Pakistan (IDBP), founded in 1961) provides finance both for the setting-up of new capacities and for meeting balancing, modernization and replacement needs of existing industrial units. The IDBP also administers the Equity Participation Fund (since 1970) which disburses credit to accelerate the growth of SMEs in the private sector in the less developed areas of the country.

The Regional Development Finance Corporation (RDFC) established in 1985 is extending loans for investment independent of size in commercially viable projects only in areas classified by the Federal Government as underdeveloped. These include the whole of North West Frontier Province, the Northern Areas, Azad Jammu and Kashmir, Balochistan as well as a few selected areas of Punjab and Sindh. Medium and long term credit advancements may range from Rs 200,000 to 28 million with no sectoral limits, i.e. including industries, services and agricultural projects alike. RDFC may take equity stakes up to 25 per cent in certain projects. Pre-investment advisory services are also rendered to prospective entrepreneurs, including the preparation of feasibility studies at a nominal cost.

The Small Business Finance Corporation (SBFC) which apart from its Islamabad head office maintains a network of six regional offices and some 60 branches country-wide is running a series of basically credit programmes, all geared towards the smaller-scale segment of enterprises. Under a general loan scheme, cottage and small-scale industries with fixed costs up to Rs 5 million as well as small businessmen and traders with net assets not exceeding Rs 0.6 million are eligible for credit. The upper lending limits are fixed at Rs 2 million for the former and at Rs 0.5 million for the latter group, respectively. Credit ceilings of a special programme for professionals vary from Rs 25-100,000, depending on the type of profession. Moreover, the SBFC has been entrusted to extend funding under two more recent nationwide schemes, the Self-Employment Programme and the Youth Investment Promotion Society (see section II.3 below).

In the area of training, the Pakistan Institute of Entrepreneurship Training (PIET), since late 1990) in Lahore constitutes a recent effort in a special programme to address the lack of

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<sup>10</sup> For details on this and the following see Sindh Small Industries Corporation, Review of Activities 1991-92, no place (Karachi), no date, pp. 4ff.

entrepreneurial and managerial skills frequently observed in connection with the setting-up of small businesses. PIET's overheads are covered from the interest earned on an endowment fund laid down for the Institute by the Government of Pakistan, while the clients pay fees for the 2-6 day courses of both a general (e.g. enterprise establishment and registration, marketing, bank loans, management and accounting practices) and a specific/technical nature (e.g. textile printing and dyeing, leather, woodworking).

#### (b) Private sector

At the federal and provincial levels, the institutional setting which bears some relevance for MSE units in the private sector mainly consists of a limited number of business associations. According to the management of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) large and medium businesses make up for the bulk of membership of the 26 member chambers and the more than 100 business associations registered with the FPCCI, with the micro and small ones frequently not being represented at all. Hence, small units play a noticeable role only at a limited number of associations. Examples enjoying a rather good reputation include the Pakistan Gloves Manufacturers and Exporters Association, the Surgical Instrument Manufacturers Association of Pakistan (both at Sialkot) and the Wazirabad-based Pakistan Cutlery and Stainless Utensils Manufacturers and Exporters Association.

In addition, a considerable number of business associations is active at the local level only. According to a recent survey of some 1400 informal units exclusively in urban areas an average 41 per cent of respondents from various sectors were registered with a local association, with an 88 per cent share among the manufacturing units.<sup>11</sup>

Based on a recent survey on (other) non-governmental organizations (NGOs) more than three thousand of them are estimated to be operational countrywide, less than a third of which in rural areas. The majority of surveyed NGOs identified itself as "social welfare groups", another third as "community groups". The largest number reported the areas of womens' development (49 per cent of the sample) and medical care (44 per cent) as their main objectives. However, virtually none of the NGOs is directly oriented towards the MSE segment, while only very few have been said to exercise some influence on the provision of (small) industrial facilities.<sup>12</sup> For instance, mention has been made elsewhere of the Association of Women in Pakistan (AWPA) which runs industrial homes, subcontracts the production of handicrafts to rural women and then sells the latter's produce.<sup>13</sup> The Karachi-based Network for Enterprising Women (NEW) undertakes entrepreneurship development and

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<sup>11</sup> See A.R. Kemal; Z. Mehmood, Labour Absorption in the Informal Sector and Economic Growth in Pakistan, Informal Sector Studies No. 2, published by Friedrich-Ebert-Stiftung/Pakistan Institute of Development Economics, Islamabad 1993, pp. 158-164.

<sup>12</sup> For more details see UNDP, NGOs - Working for Others. A Contribution to Human Development, 3 vols., Islamabad 1991.

<sup>13</sup> See K. Aftab; J. Keddie; H. Weijland, *op. cit.*, p. 28.



management training programmes which, however, appear not to be linked to the rural or grassroot level.<sup>14</sup>

### 3. Major government programmes

As stated above, the aimed-at promotion of small - less so of micro - businesses in general and their accelerated development in rural areas in particular has been reflected in a variety of government schemes and programmes announced over time. However, the scope and details of such programmes under ever new names frequently changed with the advent of a new government which also entailed the interruption, modification or outright abandonment of individual activities. Two types of programmes are to be distinguished: those which address the target sector directly, for instance by providing direct assistance in the form of credit, extension services, training/skills development etc., and those which pursue an indirect approach, e.g. by attempting to improve the overall environment and general conditions for the emergence as well as strengthening of MSEs, such as in the context of (integrated) rural development programmes.

Government efforts date back to the so-called Village Aid Programme (VAP) launched along with the First Five-Year Plan (1955-1960) which aimed to develop the "rural community" by simultaneously striving for (i) the introduction of better farming methods, (ii) the expansion of cottage industries, and (iii) the multiplication of community services. Mainly due to the scant resources allocated to this scheme, there was hardly any impact on rural industries.<sup>15</sup> Subsequent schemes encompassed the integrated rural programme of Prime Minister Ali Bhutto in the early 1970s, the rural works programme initiated during the first term in office of Prime Minister Benazir Bhutto, or the model village programme which was to be executed by the provincial rural development departments from 1987/88 onwards with an emphasis on upgrading the physical infrastructure including farm-to-market roads and rural electrification. The Tameer-e-Watan Programme launched under Prime Minister Sharif in July 1991 has since been targeted at the removal of rural-urban disparities and is providing funds for works at local level, such as the construction and repair of rural roads, schools and dispensaries, the supply of drinking water, drainage systems and other sanitary measures as well as for village electrification.<sup>16</sup>

The regional dispersal of industrial production into rural areas has also been the declared objective of a rural industrialization policy framework announced by the Federal Cabinet in May 1990. Conceived as a dynamic concept open for change, the scheme provides, inter alia, a general package of fiscal and monetary incentives to new rural industrial units, such as preferential access to subsidized loans or an eight year exemption from income tax and

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<sup>14</sup> See F.u.D. Ahmad, Small and Micro Enterprises. A Survey of Support Organizations, Lahore, January 1994, mimeo, p. 19 (input from the ILO national expert).

<sup>15</sup> See SEBCON, An Evaluation of the Rural Industrialization Programme of Punjab Small Industries Corporation, Islamabad, 15 December 1993, p. 22.

<sup>16</sup> See Government of Pakistan, Finance Division, Economic Adviser's Wing, Economic Survey 1992-93, Islamabad, no date, pp. 146f.

promises the exemption of imported machinery used by rural industries from the payment of customs duties, sales tax and licence fees unless such equipment is available locally.<sup>17</sup>

The so-called Social Action Programme (SAP) launched in the fiscal year 1992/93 is the most recent effort to address existing imbalances essentially in the provision of basic social services, such as between rural and urban areas or between female and male access, in a coordinated and concerted manner. The SAP which is conceived as an operational framework for the progressive improvement of access to and the coverage and quality of basic social services spells out increased development and recurrent expenditures over the five year period to 1998 in the areas of basic education, primary health, nutrition, population as well as rural water supply and sanitation.<sup>18</sup>

Set up as a public limited company under the Companies Ordinance 1984 in November 1991 with an initial government grant of Rs 500 million, the National Rural Support Programme (NRSP) has been linked to the SAP in that it aims at the mobilization of local communities as partners in the implementation of SAP activities. First steps towards the eventual establishment of a countrywide network of grassroots organizations at local level which would be able to plan and undertake their own development have been initiated in eight districts since March 1993. 369 community organizations had been formed by end-1993 with a total membership of 10,791. The NRSP's declared objective is to replicate the widely acknowledged success of the Aga Khan Rural Support Programme (AKRSP) initiated in 1982 by the Aga Khan Foundation in the north of the country and since gradually extended with financial support from several bilateral donors and non-governmental organizations.<sup>19</sup> Consequently, participation of the target groups, i.e. their organization into multi-purpose broad based community organizations (COs) or sectoral organizations of special interest groups is considered the single most important element of any rural development endeavour. Other key features of NRSP include (i) technical assistance and skill enhancement activities in order to improve agricultural production and to foster the commercialization of the rural economy, (ii) improving access to and facilitating implementation of public sector programmes for rural areas, and (iii) the mobilization of local resources for economic and social development through a savings and credit programme to encourage peasant entrepreneurs and the development of micro enterprises.<sup>20</sup> It is particularly in the context of the latter that the rural informal MSE sector is directly addressed currently with first credit disbursements becoming effective in June 1993, so far to already operational enterprises only.

The provision of loans is also considered as the major mechanism to aid small businesses under various other schemes, both at federal and provincial government levels. Important

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<sup>17</sup> For details, see M.H. Sahibzada; R. Illahi, Rural Industries: Employment and Income Enhancement for the Working Poor. Pakistan Case Study, Centre on Integrated Rural Development for Asia and the Pacific, Dhaka, June 1991, pp. 43-49.

<sup>18</sup> See Government of Pakistan, Finance Division, Economic Adviser's Wing, Economic Survey 1992-93, op. cit., pp. 137ff.; for details, see also Government of Pakistan, Planning Commission, Social Action Programme, Report to the Donors Meeting, Islamabad, September 1993.

<sup>19</sup> For a recent detailed account of the AKRSP experience see Mahmood H. Khan; Shoaib S. Khan, Rural Change in the Third World, Pakistan and the Aga Khan Rural Support Program, New York 1992.

<sup>20</sup> See National Rural Support Programme, Briefing Notes, Islamabad, November 1993.

examples are the Prime Minister's Self-Employment Programme (SEP) of 1992, mainly managed by the Small Business Finance Corporation (SBFC) on a country-wide basis, as well as the Rural Industrialization Programme (RIP) and the Self-Employment Scheme (SES), both administered by the Punjab Small Industries Corporation (PSIC).

Under the Self-Employment Programme (SEP) loans in the range of Rs 10-300,000 are offered to unemployed persons wishing to earn their own living through small ventures in a large number of manufacturing, handicraft and services businesses. Mini feasibility studies have been prepared as project profiles for some 60 production items for reference by potential clients. Groups of up to ten people may apply for a maximum credit of Rs 300,000. No equity participation of the customer is required for credits below Rs 150,000 while higher amounts necessitate a minimum 10 per cent participation. Present mark-up rates stand at 11, 13.5 and 16 per cent for early, on time and late repayments, respectively. Loans not exceeding Rs 150,000 need to be repaid within five years, the remainder within seven years. The SEP is jointly operated by the SBFC and two public-owned commercial banks, the Habib Bank Ltd and National Bank of Pakistan.<sup>21</sup> In early 1994, the scheme within which some 37,800 loans totalling Rs 5.1 billion had been sanctioned by end-1993 was under revision for improvements.

The Rural Industrialization Programme of PSIC which emerged from the previous Rural Industries Loan Fund in 1986 and which witnessed an extension in 1991 has as its major objectives, inter alia,

- the generation of employment in rural areas through industrial activities;
- an increase of non-farm income;
- the provision of a sound industrial base in rural areas as a means to uplift the general rural economic conditions;
- an expansion of the rural entrepreneurial base; and
- the discouragement of rural-urban migration.<sup>22</sup>

Except for a category of restricted industries to be determined by the Pakistani Government any industrial activity (agro-based/related, manufacturing) involving fixed investments up to Rs 1.5 million in the Province's rural areas, i.e. outside the limits of municipal corporations/committees and town committees, may qualify for a maximum loan of Rs 0.75 million with a preferred range of between Rs 300-500 thousand. The debt-equity ratio is set at a 70:30 per cent ceiling. Loans are granted at a 7 per cent mark-up rate per annum. Repayment is to be made within seven years after a one year grace period.

Being operational since 1987 the PSIC's Self-Employment Scheme (SES) is designed to encourage the self-employment of educated skilled and semi-skilled persons in both urban and rural areas by means of incentives for setting up modern small industries, particularly in the

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<sup>21</sup> See Small Business Finance Corporation, Self-Employment Programme, no date, mimeo.

<sup>22</sup> See Punjab Small Industries Corporation, Rural Industrialization and Self-Employment Scheme, Lahore, no date, p. 1.

engineering, chemicals and electronics fields. The scheme is targeted likewise at experienced professionals of existing industrial units, young graduates of universities, polytechnics and other training institutions, as well as qualified Pakistani returnees from abroad. Terms and conditions of the available loans are almost identical with those under the RIP except for an extended repayment period of ten years with a 1.5 years grace period.<sup>23</sup>

The initiation of one's own business rather than the search for employment elsewhere is the prime objective of another countrywide soft loan programme: unemployed youth between 18 and 30 years of age with a minimum formal education level corresponding to class 10 are the target beneficiaries of the Youth Investment Promotion Society (YIPS). Established in 1987 under the Societies Act 1986 as a government-owned body (40 per cent of assets hold by the central government, the remainder distributed among the National Development Finance Corporation, the Small Business Finance Corporation, and the Federal Bank for Cooperatives), YIPS offers business start-up credits up to a maximum of currently Rs 100,000 per person or of Rs 400,000 for groups of up to ten people at a concessional mark-up rate of presently 11 per cent (urban areas) and 8 per cent (rural areas), respectively.

A subsidized credit scheme for micro businesses up to a Rs 25,000 maximum amount is on offer at a 11 per cent mark-up rate for women entrepreneurs at the First Women Bank Limited (FWBL). With the respective funds originating from the Ministry of Women Development FWBL was established as a public commercial bank by the government in 1989 as a contribution to raising the socio-economic status of women in the country on the grounds of their aimed-at increasing economic independence. Some five per cent of the Bank's total credit outlays are reported to come under such subsidized schemes at present. Rural women with difficulties in providing collaterals are encouraged to apply for loans in groups of four or more whose members receive loan advancements in subsequent stages only, to be jointly guaranteed by the other group members (group guarantee concept).

#### **4. Development cooperation activities of the international donor community**

A substantial portion of foreign financial and technical assistance rendered by both multilateral and bilateral donors over a longer period has been directed towards the small-scale enterprise sector, with the micro enterprise segment encountering increasing awareness and support in the recent past. Under bilateral arrangements, assistance, inter alia, from Switzerland, Germany and particularly the Netherlands has apparently shown a keen appreciation of MSEs including in rural areas. In turn, the considerable funds provided by the World Bank under its Small-Scale Industry loan programmes (SSI-I and II) until the late 1980s for onlending through commercial banks and development finance institutions to small-scale industries were not designed to cater for the micro businesses and also remained concentrated on the urban areas. Implementation of SSI-III which initially was to be implemented in the period 1987 until 1992 with a total amount of US\$ 66 million was still pending at the time of the mission.

In turn, following an innovative approach, the World Bank in its operational micro enterprise project (since 1993) over a several year period is availing a US\$ 26 million loan to the Pakistani Government for on-lending to certain leasing companies, currently only to the

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<sup>23</sup> See Punjab Small Industries Corporation, op.cit., p. 4f.

Karachi-based Orix Leasing Pakistan Ltd (OLP). Out of this, the latter finances equipment lease contracts for small and micro entrepreneurs at prevailing market rates without seeking any collaterals, so far, however, only in urban areas. By this the earlier bottleneck of the commercial banking sector's unwillingness to provide refinance to OLP (and leasing companies in general) for business with MSEs is being addressed. Some 80 per cent of the first wave of applications were rejected by OLP as not viable; yet some 400 lease contracts were reported to have been concluded during the first year. The recovery rate is given with 99.75 per cent. The project also entails (i) a grant component under which seed money is extended to four NGOs for their MSE-oriented revolving credit schemes, as well as (ii) a technical assistance component to, inter alia, assist these NGOs in staff training, both co-financed by the Netherlands.

Bilateral activities have frequently been targeted at upgrading existing small enterprises rather than creating new ones and, hence, been centred to a varied degree around training activities - e.g. the enhancement of technical skills -, transfer of technology support, the introduction and gradual expansion of extension services as well as, in some cases, the provision of funds for small business loans. In most cases, the provincial SIDOs, particularly of Punjab and NWFP, have been working as counterpart or recipient organizations through which implementation has been effected.

One prominent example is the Pak-Holland Metal Project (PHMP) in NWFP which after starting in 1986 has seen an extension in its current phase II (1992-95). Following a survey of metal-related MSEs in the province, the welding, automotives and engineering trades had been selected for support under this programme. At present, special emphasis, inter alia, is being placed on technical advice pertaining to design and production technology, the development of local professional capabilities with regard to administration, marketing, engineering and technology, as well as the familiarization of workers with precision machining, maintenance, quality assurance and control. PHMP is operating from a total of seven decentralized Industrial Technology Centres within NWFP. In addition, three self-contained truck-based mobile training units (MTUs), one each for the above target sectors (welding fabrication, automotive repair, light engineering) are designed to conduct training courses in all the province's accessible areas.<sup>24</sup> Other ongoing activities with Dutch assistance include funding support for the rural industrialization credit programme of PSIC and a common facility cum training centre for leather finishing in Kasur (Punjab). The modernization/ rehabilitation of the Institute of Leather Technology in Kasur/Gujranwala and of the Metal Industry Development Centre in Sialkot are projects under preparation.

The SIDB-implemented Pak-Swiss Agricultural Light Engineering Project (ALEP) after being operational for ten years was scheduled to be phased out by mid-1994. Installed at NWFP's Mardan small industries estate, ALEP had aimed at promoting both agricultural development and the production of improved agricultural equipment and implements by local MSEs. However, due to the heavy geographical concentration of training activities under this scheme the local outreach remained very limited. Missing adequate links with the target groups, i.e. the local would-be users/customers, resulted in the production of prototype implements which did not meet with actual demands. As a consequence, the last phase of

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<sup>24</sup> For details and a thorough review of past MSE-related Dutch assistance to Pakistan see Leon Tomesen; Henk Thomas, Small for Development. An Account of 10 Years Pakistan-Netherlands Industrial Development Cooperation, Islamabad: Netherlands Embassy, 1992, esp. pp. 53-66.

ALEP has seen a certain reorientation towards the establishment of producer-farmer groups linkages as well as some mobile or on-location training. Foreseen to constitute a new approach, a pilot programme is under preparation currently by the Swiss Development Corporation for the period 1994-97 which aims at the joint design and management of training courses together with target group manufacturing associations.

Likewise in NWFP, the Pak-German Wood-Working Centre in Peshawar is looking back on a ten year history. Independently run under the SIDB, the Centre combines promotional services with commercial activities. However, except for the training of stipends (various types of courses from 0.5-3.5 years duration) the Centre's promotional activities, i.e. the provision of common facilities in kiln drying and band sawing, extension services and loans for machinery have either become marginal or ceased altogether. Also, the commercial activities are reported to have declined below levels of competitiveness. A major recent activity under German funding exclusively in the area of training is the ongoing Pak-German Technical Training Programme in Peshawar.

With regard to pursuing a more coordinated approach among the international donor community the establishment in 1992 of a donors' coordination group in Islamabad specifically on micro and small enterprise issues constitutes a major new development. The group's regular meetings are attended by representatives and project management staff from both bi- and multilateral donors with long-standing experience in the promotion of MSEs in Pakistan in order to exchange views and expertise with the aim, inter alia, to devising joint activities. Much of the work so far has been devoted to building-up an information base, such as by introducing ongoing and envisaged activities of individual participants to each other.<sup>25</sup> The very fact of the group's existence also expresses varied degrees of (dis)satisfaction with past achievements while at the same time is understood to help in seeking innovative and more promising avenues for MSE-related technical and financial assistance in the future.

#### **IV. Key Issues and Constraints of MSE Development and Promotion in Pakistan: An Assessment**

##### **1. Macro-economic policy and regulatory framework**

Whereas the available evidence suggests that in practice MSEs including those in rural areas have been playing an increasing role in terms of both numbers and outreach for the Pakistani economy over time, there is also a widely shared view that the described policies and promotional efforts of the past leave much to be desired as to the development of an economically viable and dynamic MSE sector which is capable of generating the badly needed income and employment contributions on a sustainable basis. A whole range of problems and constraints continues to be in the way of the MSE sector's accelerated development in the years to come. The pertinent analysis requires the distinction of weaknesses at three, in many ways interrelated levels: (i) the macro-economic policy and regulatory framework, (ii) the level of support institutions (meso level), and (iii) the enterprise or micro level.

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<sup>25</sup> For reference, a list of 62 completed, ongoing and prepared MSE-related activities (programmes, projects, research results/ publications) as circulated at the group's January 1994 meeting is attached to this report as Annex II (pp. 60-67).

In Pakistan, MSEs have had to operate within a macro economic environment which has been frequently described as favouring the large-scale, capital-intensive and predominantly urban manufacturing sector, especially in and around Karachi and central Punjab. This is said to have been observable in spite of public policy announcements to the contrary, i.e. the recognized importance of small and medium - less so of micro - enterprises, and may indeed find proof in the key importance of large industrial businesses. However, while the general direction of the impact on MSEs of certain macro policy or regulatory measures, such as in the areas of fiscal, trade or labour policies may be clear for plausibility reasons, a detailed assessment of the extent, let alone quantification of such effects would appear to be a difficult task.

### Taxation policies

For instance, in the area of taxation on the one hand enterprises employing less than 10 people are exempt from paying general sales tax and excise duties. However, intended to improve the MSEs' competitive position viz-à-viz the larger units, MSE investments may also be induced into activities in which they are less efficient, such as when the potential for scale economies is significant. The exemptions have also had the distortive effect of formally breaking up larger manufacturing units into smaller ones so as to qualify for the incentive and thus evading tax payments.

Since, on the other hand, the country's tax system has for a long time been characterized by a plethora of tax exemptions/holidays, rebates and other fiscal incentives in general,<sup>26</sup> the relative advantage to be enjoyed by the MSEs over other sectors in the context of the above exemptions has tended to be rather limited. This notwithstanding, small businesses, including in the (urban) informal sector, are in fact paying taxes of various kinds, inter alia income tax, professional tax, municipal tax and motor tax. In requesting these, little distinction is reportedly made by tax collectors between registered and non-registered MSEs. However, according to a recent sample survey of some 1400 urban informal units, the combined tax payments were given as reaching an average 3 per cent of total incomes only.<sup>27</sup> In turn, rural MSEs appear to be subjected to tax to an even lower degree. This may likewise be attributable (i) to a certain reticence displayed by the authorities' tax collectors to visit rural/remote areas, and (ii) to efforts on the part of MSEs to keep a low profile viz-à-viz the tax offices, e.g. by downscaling the scope of their businesses. Collusion and outright bribery between (potential) taxpayers and tax inspectors with the result of rather arbitrary tax assessments are also reported as a relevant phenomenon countrywide relatively independent from the unit size. Large-scale tax evasion is a typical feature of the country's tax system overall.<sup>28</sup> Consequently, the prevailing lack of transparency of taxation rules and enforcement

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<sup>26</sup> A prominent example is the agricultural sector which was earmarked to become subjected to income and wealth taxation only under the 1993 caretaker government. At the time of the mission, under the present government a final decision was still pending.

<sup>27</sup> See A.R. Kemal; Zafar Mehmood, Labour Absorption in the Informal Sector and Economic Growth in Pakistan, op. cit., pp. 61ff.

<sup>28</sup> In this context, the mission was given the example of Lahore's Liberty Market where tax collection from the entirety of vendors corresponded to what one individual (a university professor, i.e. a fixed salary earner) had to pay.

modalities applied in practice continues to hinder the establishment of a level-playing field including for MSEs.

Distortions, such as exempting workshops with up to 4 handlooms from tax and/or social security contributions, resulted in artificial split-ups of larger businesses. Moreover, levying the sales tax at each step of the manufacturing/distribution chain as presently done may adversely affect MSEs indirectly by discouraging inter-firm cooperation and networking and encouraging independent in-house production.

In conclusion, while the influence on the MSEs of the available tax incentives and even the entire tax system so far may not have been dominant (and hence not constituted a major direct development constraint) at the working or shop-floor level, there is ample scope for a continued reform of the country's overly complicated tax system, characterized by a diverse range of federal, provincial and local taxes. Steps taken in recent years, inter alia, to broaden the taxation base (elimination of exemptions, replacement of the traditional sales tax with a new value-added type of general sales tax, conversion of specific to ad-valorem excise duties, etc.) and to improve tax administration deficiencies, if continued, should result in increasing tax revenue, a tax structure more in line with international standards, i.e. a more balanced relation between revenue from direct viz-à-viz indirect taxes (in 1992, indirect taxes accounted for some 80 per cent of the total),<sup>29</sup> and consequently - in addition to narrowing the fiscal deficit - should help to raise funds for development expenditures, including the promotion of MSEs. Sound fiscal policies overall would also help to redress the credit squeeze due to heavy government borrowing as a result of which only about a third of total bank deposits are available for private sector loans.

### Trade policies

In the area of trade policies, recent years have shown a gradual liberalization and the adoption of a more outward oriented stance as opposed to the previous inward-looking import substitution strategy approach. This reorientation has taken the form, inter alia, of customs tariff reductions, a certain rationalization of tariff structures, the dismantling of exchange controls and the removal of a number of quantitative restrictions and the ensuing trade licensing procedures. Again, while in a general sense positive spillover effects arising from a less regulated trading environment can be expected to also benefit MSEs through reduced price distortions and better access to quality goods, the immediate relevance for shop-floor operations of the reforms taken would appear to vary widely. For instance, the recent reductions of statutory/nominal import duties from a maximum 225 per cent in 1988 to 90 per cent in 1992 will only benefit MSEs which actually procure inputs from abroad. Since imports of raw materials, machinery and equipment so far appear to have had some importance only for a small portion of (rural informal) MSEs, any direct impact from lowered tariffs would be rather minute. In addition, anecdotal evidence suggests that the reduced tariffs are still well above the "mark-up" to be paid by importers for smuggled goods which may help to explain the generally limited effects of tariff cuts so far. To the extent MSEs do use imported inputs, the still existing distinction of tariff rates applied between industrial and commercial importers

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<sup>29</sup> For details, see World Bank, Pakistan: Country Economic Memorandum FY 1993 - Progress Under the Adjustment Program, Washington, 23 March 1993, pp. 11-16 and 43.



has frequently been identified as the major impediment in the area of trade barriers.<sup>30</sup> While medium and large firms easily qualify for the import of raw materials and other inputs at reduced/more favourable tariff rates as "industrial importers", MSEs have to rely on procurements from "commercial importers" liable to higher rates for identical items. This, together with a mark-up for the intermediaries' transaction costs and profit margins put the MSEs at a cost disadvantage when compared to larger firms.<sup>31</sup>

Persisting tariff distortions are also apt to work to the detriment of small local businesses. For instance, while customs duty is to be paid on paper imports, book imports are duty free. As a result, books even in Urdu language are printed abroad and imported with adverse effects on the domestic (generally small-scale) printing industry. Reverse examples, i.e. an escalating import tariff structure is also to be found. However, for instance, the extent to which the difference between the lower import tariffs for parts and components needed to produce a television set and the higher tariff levied on the final product is actually big enough to render the local assembly a profitable and competitive business is open to discussion, also with regard to potential - rather indirect - beneficial effects for MSEs.<sup>32</sup>

In turn, the wide range of duty exemptions and rebates granted for the import of raw materials, machinery and equipment under a number of promotional schemes, such as for investments in backward areas or industrial estates do not appear to be of any significant direct relevance for the bottom segment of manufacturing activities under review here. Given the by and large very low propensity to export of MSEs, the same applies in the case of certain export rebates granted to foster non-traditional exports. However, as far as those concessions and even more a continued gradual liberalization of the trade regime by means of an increasing competition help to improve the overall quality of domestic production, MSEs may indirectly benefit from better quality produce which they procure at home as inputs for their own manufacture.

### Money and finance

In spite of a number of reform measures taken by the government in recent years to improve the operating environment and performance of the country's financial sector, most observers share the view of the persistence of a largely inefficient financial services industry in general which also extends to the very limited supporting role played by the sector for MSEs in particular. While the privatization of two of the four main state-owned commercial banks, the licensing of about a dozen new private banks and other financial institutions as well as a certain tightening of prudential supervision constituted commendable moves of

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<sup>30</sup> See Swiss Development Corporation; Friedrich Ebert-Stiftung, Small and Micro Enterprises Promotion in Pakistan, Islamabad 1992, p. 17.

<sup>31</sup> No confirmation could be obtained by the mission of the removal of the distinction between industrial and commercial importers for tariff purposes announced as having become effective by the State Bank of Pakistan. See State Bank of Pakistan, Annual Report 1992-93, Karachi, December 1993, p. 175.

<sup>32</sup> See N. Hyder, The Employment Situation in Pakistan. An Assessment, Strategic Approaches toward Employment Promotion, Discussion Paper PAK/1, Islamabad: Ministry of Labour, Manpower and Overseas Pakistanis; ILO, February 1994, p. 56.

financial sector reform,<sup>33</sup> the sector at large continues to be rated as overly bureaucratic and inert showing a limited exposure to innovative instruments of financial intermediation. Rather, the sector is frequently described as a vehicle for the transfer of public subsidies to borrowing clients from influential quarters, particularly among big businesses, with political favouritism playing an important role. Consequently, the entire sector is enjoying little credibility with the general public which in recent years has been fuelled by a number of newly established private banks ceasing their operations under conditions of fraud and/or mismanagement after a short time period only.<sup>34</sup>

Against this background, mandatory credit targets prescribing the channelling of loans into the small-scale industry sector - as only one of several priority sectors - and subsidized credit provided through both commercial banks and development finance institutions have for a long time been the major policy instruments to link up the financial system with the small businesses.

There is, however, ample evidence that the bulk of such subsidized credit has landed up in the larger small and medium-sized businesses while the loans arriving at the MSE segment have been rather minute. Moreover, in many instances funds earmarked for onlending small-industry credit have not even been fully used. Likewise, non-subsidized, i.e. market rate lending by commercial banks to MSEs has remained virtually non-existent. Low recovery rates frequently in the 50-80 per cent range add to the problems encountered with the past approach.<sup>35</sup> A number of reasons help to explain the so far unsatisfactory results:

- MSEs have frequently been perceived by banks as high risk undertakings unable to meet the formal collateral requirements. This and the high cost nature of administering a multitude of small loans coupled with more favourable prospects of serving larger nearby clients has contributed to ignoring the MSE businesses, especially in rural areas which are anyway inadequately covered by the banks' network of branches. In this context, not much change is reportedly observable after making mandatory the opening of a rural branch for each one to be established in an urban area.
- Subsidized credit, i.e. the granting of loans at below-market interest rates add to cost pressures and thus render business with MSEs even less attractive for the banks. This holds particularly in a negative or low real interest environment due to inflation as has been witnessed in Pakistan for most of the past. Recent steps to raise interest rates of most of the concessionary lending schemes still leave a gap of more than 10 percentage points when compared with market rates and hence may not yet provide enough of an incentive. In effect, mandatory credit targets and subsidized credit schemes tend to result in distortions, such as when banks attempt to rid themselves of the corresponding obligations in the easiest way (e.g. lending to medium/large rather than small businesses, little care concerning project appraisal, etc.). Fraud and abuse of subsidized loans are likewise invited and, for instance, have been observed in the form of bigger enterprises or landlords

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<sup>33</sup> See World Bank, Pakistan..., op. cit., pp. 29-34.

<sup>34</sup> For a recent example, see Far Eastern Economic Review of 28 April and 12 May 1994, p. 20, on the near-collapse of Mehran Bank.

<sup>35</sup> This phenomenon, however, is by no means limited to the small-scale sector which became visible with the publication of a list of large-loan defaulters by the caretaker government in mid-1993.

who make eligible target beneficiaries under their control borrow such funds for their own use.

- The capabilities of financial sector staff with regard to a sound screening of investment proposals (investment project appraisal, feasibility analyses, etc.) in many instances appear to have been rather limited.
- On the demand side, the hesitance on the part of the MSEs to approach the commercial banks is caused (i) by one or several of a number of reasons which all result in high transaction costs, such as the geographical distance from bank units, a low literacy rate, the inability to provide collateral, cumbersome administrative procedures and paperwork as well as frequently delayed credit disbursements; (ii) a relatively easy access to informal credit markets/moneylenders including in rural areas; and (iii) the backing available in the form of family savings and credit for opening up a business.

### Labour rules

In Pakistan, firms employing less than 10 persons are exempt from labour laws which include minimum wage legislation, social security provisions (i.e. contributions at both federal and provincial levels to the Workers Welfare Fund, Social Security, Worker's children's education cession) and hiring and firing regulations. Given that the application of labour laws normally carries a cost to the firm, MSEs enjoy a relative advantage in this area because of which the present rules are said to discriminate in their favour.<sup>36</sup> However, similar to the collection of tax, in practice there appear to be grey areas, for example, in the collection of social security payments by the respective local inspectors, again leaving room for informal arrangements at the enterprise level.

At the same time, this regulatory setting apparently has also prevented small units from growing above the 10 staff mark in order to avoid being subjected to the labour laws. For the same reason, there is also evidence of larger units formally splitting up their manufacturing operations. In addition, in some instances the number of permanent staff has been reduced to below 10 with the remaining work slots being filled up through contract labour. While the aforementioned may be classified as (unintended) distortive or side effects, the very irrelevance of labour laws for most MSEs also tends to be conducive to certain socioeconomically questionable practices with regard to working conditions, such as the widespread use of child labour.

### Overall policy consistency

On several occasions during the mission government officials readily admitted the prevalence of a distinct discrepancy between what was described as "strong/good policy planning" on the one hand and "weak/bad implementation" on the other hand. While the observable gap may indeed be an indication of administrative/managerial difficulties at the level of implementing government bodies, unsatisfactory results may also be due to suboptimal, e.g. unrealistic planning. The lack of cohesiveness and continuity of government policies frequently criticised is a restraining factor also with regard to the promotion of MSEs

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<sup>36</sup> For this and the following see Swiss Development Corporation; Friedrich Ebert-Stiftung, op. cit., p. 19.

as has become visible in the multitude of programmes announced over time with the installation of every new government.<sup>37</sup> The preferential treatment in past industrial policies of big, especially urban industries, over small businesses have been further hindrances for the development of a viable MSE sector.

Moreover, policy inconsistencies which turn out to be self-defeating point at least to a lack of coordination within and among government entities. A recent example is a technical assistance project on the promotion of metal workshops which includes the manufacture of agricultural implements. When the government subsequently granted a subsidy to selected large, high cost manufacturers of agricultural implements, the latter were able to outmanoeuvre the small promoted units through lower price sales, resulting in the entire support programme becoming obsolete.

## **2. Policies/measures of support institutions**

Assessing the effectiveness of past MSE promotion policies necessarily implies a critical review (i) of the "funnel approach" which stands for the larger part of these policies, i.e. the primary channelling of assistance to MSEs through the individual provincial small industry development organizations (SIDOs) as well as (ii) of selected schemes and programmes impacting on the target sector. It has to be kept in mind, however, that the bottom end segment of small businesses under review here, i.e. the (rural informal) MSEs, with a few exceptions mainly in the most recent past have not really been in the centre of small-scale industry-related policy measures. One such exception is to be seen in the National Rural Support Programme (NRSP) described above which is exclusively geared towards the village level creation of self-help groups including in the area of micro businesses. Hence, general assessments such as with regard to condemning SIDOs as having achieved only modest results in the area of (rural informal) MSEs may be partly attributable to their very design, i.e. to a certain neglect of MSEs right from the outset, and their in-built focus on the larger small business units.

In view of the present set-up of rendering assistance to MSEs in Pakistan there seems to be a growing perception lately among local and foreign observers including some government offices and the international donor community that by and large only very limited achievements are to be reported. Criticism is likewise directed (i) at the failure to adequately address MSE issues in general and (ii) to the extent MSEs are being catered for at a by far insufficient scale/scope as well as at a deficient delivery of such assistance. A number of investigations have shown very clearly that direct public support programmes have largely failed to reach the small and ever more so the micro business target groups, particularly in rural areas.

This is also illustrated by the results of a sample survey covering 71 MSEs (45 in urban, 26 in rural areas) countrywide conducted for the present exercise: two thirds responded to have never heard about any of the support institutions, whereas only three had in fact received

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<sup>37</sup> See section III.3. above.

some assistance, one each from SSIC, RDFC and IDBP.<sup>38</sup> Next to this unawareness of available support many target beneficiaries are said to express reservations about the usefulness of the individual support schemes in the light of their specific needs. For instance, training courses conducted at distant locations and requiring the entrepreneur's presence over a period of months or even years, probably compounded by (partly) irrelevant curricula, will not raise the aimed-at interest on the part of the MSEs. On the contrary, it is brief specific courses of one or a few days duration which are likely to attract the small/micro producers. Similarly, the minimum credit limits prescribed in some of the offered loan schemes may reflect levels well above of what the smallest units may wish to take up. As a result, as one among a number of reasons, the portion of credit extended to the rural MSEs through the SIDOs over time has been rather negligible.

Likewise, the results of the SIDOs' vocational training activities, the provision of small industrial estates or the rendering of investment advisory services have repeatedly been described as insufficient, inadequate or outright failures. Shortages of trained staff, time consuming bureaucratic procedures as well as a general lack of flexibility and responsiveness to changing demands have also been identified as characteristic features of these public support institutions. In addition, the obsolescence of the machinery and equipment in some of the existing technical service centres has made the small private businesses refrain from their extensive use. However, distinctions need to be made regarding the performance of the individual organizations.

In this connection, the Punjab Small Industry Corporation (PSIC) appears to be receiving the relatively best ratings. A recent evaluation ascribes some positive effects to the PSIC-run rural industrialization programme (RIP).<sup>39</sup> The programme under which by mid-1993 some Rs 5.6 billion of concessional loans had been sanctioned for some 15,800 units is acknowledged as having promoted industrial growth in rural areas, particularly at the level of rural towns serving as a link between villages and urban areas. With farmers constituting the largest group of RIP beneficiaries, progress has been made in creating opportunities for off-farm income and employment. The scheme is also reported as having contributed to the promotion of a new class of rural entrepreneurs.

In turn, the two target groups of landless farmers and women have failed to emerge as self-employed entrepreneurs. Other criticisms are related, inter alia, to the dominance among the loaners of agro-based viz-à-viz manufacturing industries (65:35); the lack of critical support on the part of PSIC in the areas of enterprise management, marketing and product upgrading; an only "mildly successful" support for RIP originating from the established set of small industrial estates; as well as overly complicated loan sanctioning and disbursement procedures including inefficient loan monitoring/recovery mechanisms which is partly associated with an insufficient familiarity of PSIC staff with common methods of investment appraisal (feasibility analyses, etc.) and with a lack of transport facilities to outreach into the countryside. Again, it should be recalled that the quoted evaluation is based on a random sample survey of 220 entrepreneurs participating in the RIP whose total fixed investment averaged some Rs 1.1 million, i.e. far beyond margins normally relevant for MSEs.

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<sup>38</sup> See Maqbool A. Babri, Small and Micro Enterprises Opportunities and Difficulties. A Survey of Small and Micro Enterprises based on a Nation-wide Study of Seventy-One Enterprises, Lahore, January 1994, mimeo, p. 14 (input from the ILO national expert).

<sup>39</sup> Here and in the following see SEBCON, op. cit., pp. 123ff.

A recent in-depth assessment of past and present programmes and performance of the Sarhad Small Industries Development Board (SIDB) in NWFP resulted in the harsh conclusion that "the SIDB as it currently stands is almost wholly ineffective in the context of its responsibility to provide promotional services to the small scale industrial sector... The current situation reflects a legacy of ineffective management and direction which has persisted for many years."<sup>40</sup> The Board of Directors and the Provincial Government are said as to "have given little attention to performance control or accountability".<sup>41</sup> As to the particulars of main activities, the major criticisms can be summarised as follows:

- Cottage industry units: training activities have been curtailed to a minimum in recent years following the observation of previous trainees having had difficulties in finding subsequent employment outside. Existing units are largely considered as pursuing quasi commercial operations under an ill-defined objective, yet with little chance to compete successfully with the private sector, i.e. to achieve economic viability. For instance, the carpet units are criticized for following an outdated production process (single rather than double knots), using obsolete designs and colourways and, hence, supplying inferior quality goods only.
- Industrial estates: against the background of an average vacancy rate of 25 per cent only six of the nine estates record satisfactory letting levels. Unsuitable locations and/or misjudgment of the potential for small businesses in the respective area are quoted as major causes.
- Service centres: two of the three bilaterally funded centres are recognized as not achieving worthwhile results. Promotional services of the independently financed centres are seen as being largely confined to training alone. Excluding the reportedly only significant training establishment, i.e. the PAK-German centre, overall training turnout with merely ten stipendiaries in the 1992/93 financial year is rather limited. Finally, only insignificant trading surpluses and losses recorded for the centres' commercial activities indicate considerable inefficiencies.
- Craft shops: running losses in 1992/93 the majority of these units appears to be unable to compete effectively with private sector businesses.
- Credit to small-scale industries: contrary to its mandate, the SIDB's record to assist small businesses in linking with banks and other financial institutions is judged as extremely poor since the late 1980s. Only a handful of projects had been sponsored per year since the mid-1980s, whereas no disbursements have been effected after 1989/90.

In view of this, the radical recommendation given by the investigators entails (i) the reduction of SIDB to two directorates, one for cottage industries, marketing and the small service centres, one for the major service centres, (ii) an ensuing staff reduction from 1,300 to an estimated 400, both to be compensated for (iii) by a network of so-called local enterprise development agencies (LEDAs).

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<sup>40</sup> RES & Company Ltd., op. cit., p. 13.

<sup>41</sup> Ibid.

While no equally comprehensive evaluation of the Sindh Small Industries Corporation (SSIC) appears to have been conducted to date, it seems safe to assume a similar general picture.

Beyond the ambit of the SIDOs, shortcomings are also to be identified with regard to some of the other government schemes and programmes bearing MSE relevance mentioned above. For instance, the experience made with limiting the provision of business start-up credits exclusively to formally educated youth under the Youth Investment Promotion Service (YIPS) is seen as a hindrance to reach out into the (rural) informal MSEs in any meaningful way, including in the eyes of the management. Talented people both in manufacture (e.g. carpet weaving) and services (e.g. maintenance and repair) are frequently formally uneducated and thus do not qualify for participation under this programme. Other problems are seen in the low awareness of YIPS in rural areas with more than 70 per cent of applicants and loaners coming from urban localities; a low share of female participants with some 12 and 3 per cent in urban and rural areas, respectively; and occasional government interference with the selection of applicants on the grounds of personal recommendations. The impact YIPS has had since its inception in 1987 has not yet been assessed; hence, the management is unaware of the number of loaners remaining in business after credit repayment. Repayment ratios are given as "average" against the measure of considering an 80 per cent rate as "good".

However, the major operational problem of YIPS seems to lie in the agreed division of labour with the SBFC. YIPS' role is limited to receiving loan applications, verifying the credentials, assessing the project proposals and recommending the disbursement or not of a loan to a committee chaired by its chief executive. After approval, the application is passed on to the SBFC for the actual credit disbursement and all further handling, reckoned to account for more than 50 per cent of total work involved. YIPS is not engaged in any follow-up or monitoring activities. Yet, there are reports about some duplication of work, problems of coordination and rivalries/competition between SBFC and YIPS in the implementation because of which a merger, probably under the lead of SBFC may be more conducive to a more successful programme.

Views on the relevance and usefulness of the existing private sector institutional support for informal MSEs differ. However, most observers would agree that at the level of national business associations due to their low representation MSE issues have largely been enjoying only marginal attention. There are exceptions to this in a few localities, primarily in Punjab. For instance, 200 of the 350 members of the Surgical Instrument Manufacturers Association of Pakistan in Sialkot are said to employ between 3 and 50 workers. Similar proportions are reported for the Pakistan Gloves Manufacturers and Exporters Association, the Pakistan Sports Goods Manufacturers and Exporters Association, both also in Sialkot, and the Pakistan Cutlery and Stainless Utensils Manufacturers and Exporters Association in Wazirabad. The products represented by these associations are manufactured within a geographically concentrated network of independent producers and have been very successfully marketed abroad over the last 20 years already. Yet, it is only since recently that driven by dissatisfaction with the support received from the government these associations have begun to develop themselves from being mere lobbyists to form (technical) self-help groups. The readiness of the Gloves Association to run the previously government-managed leather training centre in Sialkot is a clear hint in this direction.

The almost complete lack of (other) non-governmental organizations (NGOs) playing an active role in or for the promotion of MSEs at the grassroot level is another major

development constraint. As mentioned in this report, the great number of operational NGOs is mainly working in areas unrelated to MSEs. A recent survey of 800 NGOs aimed at identifying potential local counterparts for a prospective small enterprise project in NWFP earmarked only four of these as meeting rather basic criteria (broad definition including private consultancy firms; exclusion of "one-man" shows; some networking/cooperative link-up in existence with other service institutions; some experience of servicing MSE business start-ups or extensions).<sup>42</sup> By and large, NGOs in Pakistan which have grown by number in parallel with the increasing attention received from international donors during the last decade do not seem to enjoy a good reputation among informed observers. Many of them are essentially "one-man" undertakings, set-up for the mere purpose of absorbing funds including from domestic authorities for a specific activity. Criticism is also raised towards what is called government operated NGOs (or GONGOs) which are frequently said to be run by relatives of influential decision-takers; there have repeatedly been cases of nepotism and outright fraud.<sup>43</sup>

### 3. Micro-level constraints

The available evidence of the distinct increase in numbers of MSEs throughout Pakistan during recent years should not mislead to assume a lack of obstacles at the operational level hindering the development of a more thriving and viable MSE sector beyond the level of subsistence. Problems encountered by actual or potential MSEs at the micro, i.e. the workshop or enterprise level, continue to entail a series of well established constraints, both of an external and internal nature. The major ones which naturally affect the individual units in a varied composition are summarised below.

#### Lacking access to finance

With regard to external constraints, the lacking access to finance remains to be of prime importance, although the degree of relevance is somewhat unclear from the available empirical findings. When being asked explicitly, many MS entrepreneurs - expectedly? - earmark the lack of funds as one of their major problems. However, by resorting to savings of their own, of relatives or friends funding seems to be less of a problem for the start-up phase of many businesses, i.e. for the procurement of tools, small machinery and other equipment. In turn, overcoming working capital needs or availing finance for the expansion of a business is a recognized bottleneck. In this connection, the price to be paid for a loan is normally much less relevant than its very availability. This is reflected in the MSEs' acceptance of often exorbitant interest rates for short-term loans obtained in informal credit markets (moneylenders, middlemen), particularly in rural areas. According to one estimate given to the mission, informal credit accounts for some 80 per cent of total loans in the countryside.

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<sup>42</sup> See ILO, Micro and Small Enterprise Sector Development in Pakistan: Institutional Issues, ILO contribution to present TSS-1 exercise, June 1994, p. 36.

<sup>43</sup> For instance, allegations of fraud have recently been raised in connection with the handover of a newly constructed and fully furnished 80-bed hostel for working women by the Ministry of Women Development to the Islamabad-based Business and Professional Woman Club (BPWC). BPWC which is chaired by a former staff member of the Ministry is demanding room charges of Rs 3,000 per month while it pays a nominal lease of Rs 1,000 for the entire building only. See "No law to check this fraud?", The Frontier Post, 21 January 1994, weekend supplement.



In a wider sense, this observation contributes to rendering the provision of credit at subsidized rates a questionable policy approach.

### Physical infrastructure bottlenecks

Shortcomings of the physical infrastructure also remain highly relevant for a more decentralized emergence of a sustainable MSE sector. This refers primarily (i) to a well designed road network enabling the timely procurement of needed inputs and the sale of outputs beyond the immediate local markets, (ii) to functioning communication links permitting a speedy exchange of market- and production-related information, as well as (iii) to reliable energy supplies the absence of which is recently causing increasing difficulties for the Pakistani economy overall. Several hours of power cuts a day throughout the country known as load-shedding are adversely affecting production particularly in smaller units which cannot afford the installation of generators.<sup>44</sup>

### Low productivity/technology level

The prevalent use of simple and unsophisticated technologies is at the root of the generally low productivity levels to be observed in most rural MSEs in Pakistan. While this may suffice for mere subsistence, it constitutes a hindrance for the growth of enterprises into economically efficient and sustainable production units. At least three reasons help to explain the low technology level: (i) rural micro and small entrepreneurs simply are not aware of available technologies or lack the knowledge of production techniques applied beyond their immediate working environs, (ii) they have no or only limited access to desired technologies, or (iii) the relevant technologies surpass the financial possibilities of individual units.

In turn, on the part of a few more advanced and mainly export-oriented larger small industries above the micro level the critical importance of appropriate and up-to-date technology as a means to master competitive challenges is increasingly being recognized. For example, with the emergence in international markets of new materials gaining importance in the production of surgical instruments or gloves (synthetic leather), the respective Pakistani business associations consider the strengthening of domestic R&D efforts including the establishment of local testing facilities for new materials an urgent requirement, if recent pressures in export markets are to be met successfully.

### Skills and managerial deficiencies

Resulting from an age-old industrial tradition in Pakistan the inter-generational transfer of manual skills is largely effected through the so-called system of Ustad-Shagird (master-trainee). Under this system the master receives cheap and hardworking labour in exchange for his teaching specific skills to the apprentice "on the job". While this informal training system explains the high degree of skilfulness observable with respect to many crafts, it also tends not to allow for any significant skills upgrading over time. Again, the latter's importance for improved productivity is not fully understood as a result of which most produce remain of a relatively poor or inferior quality. Difficulties to maintain a good quality output over a larger volume of production (bulk sales/orders) are a related problem pointing at serious weaknesses with regard to a testing and/or quality control consciousness (and the respective facilities).

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<sup>44</sup> See, for instance, Far Eastern Economic Review of 12 May 1994, p. 62.

The lack of managerial and/or organizational capabilities of rural entrepreneurs is even more pronounced. Apart from missing familiarity with the basics of running a business (small books of account; how to keep an inventory; etc.) there is also little knowledge as to the identification of (changing) market demands/business opportunities beyond the immediate local markets, e.g. regarding design or marketing, and the corresponding (re)orientation of production. Rural MSEs are usually reluctant to diversify into new products; enterprise growth, if occurring at all, is mostly taking place along the established lines of production. A lack of familiarity with the established procedures to benefit from government support, such as with filling in duty drawback form sheets, also explains a frequent underutilization of like incentives.

### Lack of demand

Shortfalls of demand for rural MSEs' produce constitute a further growth constraining factor. The increase of local demand which typically accounts for the bulk of these enterprises' sales is limited by the slow growth of rural incomes. Demand from urban areas depends critically on the provision of goods of a reasonably good quality as well as on a functioning transport infrastructure and sales channels. For the same reasons, direct international demand for rural MSEs' output is virtually non-existing. The indirect production for export markets could be enhanced by intensifying subcontracting relationships with export-oriented companies in urban areas which so far appear to be playing a modest role only.

### Low degree of subcontracting/networking

Contrary to urban areas where there are signs of an increasing networking among enterprises through subcontracting arrangements - both in terms of small-small and small-medium/large enterprise linkages and particularly with regard to the textile and metal subsectors -, rural MSEs so far remain to be largely oriented towards local markets, with little interfirm linkages. This focus on the immediate locality is observable on the input side (procurement of raw materials) as well as on the output side (sales).

In urban areas, according to a recent survey on some 1400 units almost two thirds of the total reported to be practising some form of subcontracting, albeit with a high degree of variation among the provinces, ranging from 14 per cent in NWFP to 94 per cent in Balochistan.<sup>45</sup> In turn, a similar analysis of 600 rural MSE units established a mere three per cent of the total maintaining some subcontracting linkages. Of these, two thirds were link-ups among small enterprises, arranged around activities such as metal stamping, electroplating, galvanizing and enamelling. Geographical proximity, a higher degree of technical, economic and managerial compatibility as well as psychological barriers are given as major determinants of the preference for small-small relationships. The remaining third acted as subcontractors for large firms in the areas of wood working and metal working, respectively.<sup>46</sup>

Where they exist, contractual relations between small and large enterprises tend to be of a long-term or permanent nature. Small firms procure raw materials from their large partner which may be complemented by some financial (e.g. advance payments, rebates) and/or

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<sup>45</sup> See A.R. Kemal; Z. Mehmood, op. cit., pp. 57-60.

<sup>46</sup> See K. Aftab, Rural Small Industries in Pakistan. A Survey Report, ILO/ARTEP, 1990, pp. 71-78.

technical assistance. In exchange, they deliver parts and components or ready products to the larger enterprise or take over certain processing stages of a larger production process. Problems may arise, however, in the case of too high a degree of dependence of MSEs on an individual large firm - or, for that matter, a single middleman, e.g. a merchant -, with the ensuing danger of exploitation by the dominating partner. This may be reflected in low prices paid to MSEs which in turn adversely affects their scope for and capability to upgrade and expand their business (acquisition of new equipment/technology, etc.). Given the general ease of replacing individual delivering units by others, dominating partners may not in all cases show a long-term interest in the MSEs' growth and survival.

In conclusion, given the widely accepted economic advantages of networking particularly for the small partners, e.g. in the form of intensified subcontracting relationships, such as the potential to reap scale economies, the transfer of knowhow, technology and finance to the small units and/or their link-up with otherwise unreachable markets, the seemingly minute exposure to subcontracting of rural MSEs in Pakistan must be viewed as a major development constraint. Any effort to change this would have to be based on raising the MSEs' attractiveness to potential large partners, i.e. their progressive upgrading in terms of quality, flexibility and responsiveness to change.

#### Special problems of women producers/entrepreneurs

Showing a considerable degree of variety, an estimated 20-30 per cent of the female population is believed to be economically active in the country's urban areas, whereas the available evidence suggests a female participation rate of above 50 per cent in the rural sector.<sup>47</sup> Female participation in formal sector activities is generally low - with a share in the urban formal labour force of around 5 per cent - while the bulk of the womens' contribution is located in the informal sector. Of this, some four fifths account for home-based work, largely in the form of piece work most of which in manufacturing (e.g. tailoring, packing medicines, stitching leather goods, processing of dried fruits and spices, making costume jewellery, rubber slippers or tin bases for gas lamps). As to outside work in urban areas women are active in the manufacturing, construction and service sub-sectors. A distinct dichotomy between the low-income women micro entrepreneurs - largely in manufacturing, but also in the trade/vendor business - at the lower end and a group of relatively affluent, educated middle/upper-class business women at the upper end of the socio-economic spectrum is another characteristic feature of the womens' participation in urban MSE activities.

In rural areas, total female participation rates are estimated to well exceed the 75 per cent mark established by census data for agricultural households alone, however primarily as unpaid family members. Women are the main contributors pertaining to crop production, livestock production and cottage industry alike. When asked, the major obstacles encountered in their manufacturing/craft businesses are similar to those generally observable, such as a lacking access to credit, marketing outlets and training, and a high degree or complete dependence on contractors/middlemen. There are, however, gender-specific social pressures. For instance, while the craft production within the confines of the home has traditionally been accepted socially, cultural limits still apply with respect to the external exposure of a business (e.g. in marketing). Male approval is usually needed for womens' economic activities, whether

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<sup>47</sup> For this and in the following see A. Hussain, Women in Participatory Development, CIDA Study, no place, May 1990, esp. pp. 1-17.

related to education/training, the search for/acceptance of paid employment, the establishment of an own business, etc.

#### 4. Conclusions

The foregoing presentation of major policy endeavours pertaining to the promotion and development of MSEs and their confrontation with actual achievements and continuous constraints allows to draw three main conclusions. First, there is a clear evidence of a far-reaching though not complete neglect in most of the past policies - both conceptually and in practice - of the lower end segment of the small-scale enterprise sector in general. Second, to the extent small enterprises have been addressed through policies and the set-up of institutional support mechanisms these efforts more often than not have lacked any meaningful rural outreach, have tended to remain top-down oriented and rather centralized and, hence, have proven to be relatively ineffective. And third, there appears to be ample scope for the creation of a more conducive policy and economic environment which helps a more viable MSE sector to emerge including in rural areas in order to better fight the growing unemployment and rural-urban migration problems.

These findings which are in line with similar earlier investigations may be nothing but common knowledge among the relevant Pakistani community; yet, the very fact that the bottlenecks and problems as identified already on previous occasions do not seem to have found a decisive and integrated policy response to date clearly justifies a repeated call for an early reconsideration and ensuing action.<sup>48</sup> However, the mission got the impression that the rather limited success of previous promotional endeavours is increasingly acknowledged by government officials at different levels. This changing attitude may also be reflected in a number of initiatives and measures recently taken to improve MSE policies and/or operating conditions. In this context, mention may be made of

- the impressive start of the National Rural Support Programme with its focus on grassroot level participation of the target beneficiaries even though the short running time does not yet allow a definite assessment;
- the seemingly careful design and conduct of practically relevant training courses (short-term nature; full fees basis; held in various locations, however, not yet in rural areas; demand-led design of contents) offered by the Pakistan Institute of Entrepreneurship Training;
- the recognition of the importance of decentralizing support activities to MSEs by establishing a series of what is called industrial and business support centres in small towns considered as "growth nodes", i.e. localities with a potential for enhanced rural

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<sup>48</sup> In this connection, one of the co-authors of the 1987 Pakistan country study on rural small industrial enterprise support conducted by the Government of the Netherlands, ILO, UNDP and UNIDO recalled a government official questioning the then findings as allegedly well known. Why then, the analyst argued to the mission, has so little happened?

industrialization, as suggested by the National Manpower Commission in 1991/92, so far, however, with no practical consequences;<sup>49</sup>

- an obvious readiness on the part of public authorities to accept savage reviews of past and present MSE-related policies and the corresponding institutional set-up, such as the recent in-depth investigation of SIDB's performance,<sup>50</sup> as well as of
- recent moves to actively involve the private sector in rehabilitating and running previously publicly managed technical support centres on a commercial basis; an example is the Pakistan Cutlery Association which was to receive a Rs 20 million government contribution as seed money for the purchase of land and some construction works for the Wazirabad centre; the running costs were to be borne by the Association, i.e. the users.

In conclusion, there appears to be a growing evidence that the dissatisfaction with the past results of MSE promotion and development has provoked an increasing readiness lately among relevant policymakers to take a fresh look at the issues at stake with a view to seeking more fundamental changes in the future promotional approach. Taking the form of both general as well as more specific recommendations the following chapter identifies key elements for such a new strategy of assisting rural informal MSEs in Pakistan.

## **V. Elements of a new promotional strategy for rural informal MSEs in Pakistan: Recommendations for Action**

### **1. General thrust**

#### **(1) Participation/involvement of target beneficiaries/potential customers (demand-led approach).**

As amply demonstrated by international experience, the major thrust of any strategy to more effectively promote the largely informal, lower-end segment of the MSE sector, especially in a country's rural areas, would lie in pursuing a demand-led approach, i.e. the participation/involvement of the target beneficiaries/potential customers. MSE support programmes and activities should to the maximum possible extent be based on the needs and requirements as actually expressed and defined by the aimed-at target beneficiaries, in this case actual and potential micro and small entrepreneurs. This has clearly proved to be superior to a supply-side approach which avails support turning out to be of a limited practical relevance to the target group. Only the participation of the addressees in designing and actually playing a role in the delivery of the required support measures will ensure that both the type and the modalities of the assistance rendered is relevant in overcoming the perceived needs (development with, not for the people).

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<sup>49</sup> See Government of Pakistan, Ministry of Labour, Manpower and Overseas Pakistanis, Report of the National Manpower Commission, Islamabad, 1991, pp. 53-54 & 56-57; as well as S. Ghayur, H. Frey, K. Klennert, Action Plan for Employment and Manpower Development in Pakistan on the basis of Five Provincial Workshops on the Implementation of the National Manpower Commission Report, Friedrich-Ebert-Stiftung, Islamabad, 1992, pp. 7f.

<sup>50</sup> See RES & Company Ltd., op. cit.

This general requirement has a number of important implications. First, it calls for the involvement of grassroots or self-help organizations, including in the form of business associations. By functioning as prime mechanisms through which the assistance is being channelled these target group bodies also accept responsibilities for its effective and cost-efficient use. Recalling the far-reaching absence of appropriate NGOs in Pakistan as stated in this report, the recommended approach might necessitate special support in first building up such relevant target/interest group organizations. In this context, notwithstanding the special circumstances that have made the Aga Khan Rural Support Programme in northern Pakistan a widely acknowledged success, the set-up therein of village or community organizations at local level is a promising approach which in principle should lend itself to replication in other areas. By attempting this, the recently launched National Rural Support Programme points into the right direction and - on the basis of a close monitoring - should thus qualify for enhanced support.

Second, a more demand-oriented MSE promotion approach requires to place increasing emphasis on the **decentralization (i) of decision-taking** down to and/or a higher degree of autonomy at the local level in general, and **(ii) of the actual MSE service delivery** in particular. As to the former, local actors can be expected to know best what their capacities, needs and maybe potential are. Whenever feasible and justifiable on the grounds of securing well-defined effectiveness and efficiency targets, a (close to) **doorstep delivery** of support services should be aimed at. Operating mobile units regularly at a larger scale (with regard to both geographical and substantive coverage, e.g. in the fields of general advice, provision of equipment, training and credit) in rural areas than hitherto should feature prominently in these endeavours.

Third, in any demand-led approach due account should also be taken of the manifold evidence that MSEs are indeed willing to pay for support services which they deem to be of relevance and use. Hence, more often than not target group participation should entail **cost-sharing arrangements/(some) user fees** in order (i) to ensure a continued interest in making best use of a service, and (ii) to induce adjustments of the services offered whenever indicated by a decreasing demand.

**(2) Questioning the previous funnel approach through small industry development organizations (SIDOs) as inappropriate.**

As pointed out above, the large potential of rural MSEs has essentially remained untapped in spite of certain attempts in recent years by the Pakistani SIDOs to decentralize support activities into rural areas. Also, by and large the performance of the country's SIDOs has been rated rather negatively. Because of this, **the continued reliance on these government institutions as almost exclusive funnels for a whole range of support services should be seriously questioned.**

It is therefore recommended that **both central and provincial governments should be ready to critically review the established institutional setup of MSE promotion with a special focus on the impact of the corresponding policy measures on the target group (with special emphasis on rural areas) and particularly the performance of SIDOs not yet brought under close scrutiny, i.e. the Sindh Small Industries Corporation, the Balochistan provincial government department for small industries promotion, and the Azad**

Kashmir Small Industries Corporation. Recommendations made in recent assessments, such as with respect to the urged restructuring of SIDB of NWFP should be seriously assessed.<sup>51</sup>

While thus the suggested in-depth analyses would help to more clearly define the detailed requirements of a new and more promising MSE institutional support infrastructure, a reduction of SIDO functions to some core activity and the parallel establishment of a set of better targeted and probably more specialized institutions is likely to more effectively address the MSEs' needs. There are various examples of diverse institutional solutions internationally of how such a more responsive support infrastructure may be shaped. What they share is a strong element of involving local initiative in general and the private sector in particular.

One such approach already recommended for implementation in Pakistan by the National Manpower Commission is the encouragement, *inter alia*, of the private sector to participate in the establishment of a series of industrial and business support centres (IBSCs) at specified rural growth points as a means to specifically promote small-scale agro and cottage industries. These centres' functions would encompass the provision of assistance in the areas of marketing (including the build-up of linkages with large-scale enterprises), monitoring/testing/quality control/gradation, skill/vocational training and product development, the provision of equipment for joint use, such as forging and heat treatment facilities, as well as a link-up to credit institutions.<sup>52</sup> However, for the reasons stated above, the fact that the concept up to now foresees the existing SIDOs to take the lead in the build-up of the IBSCs would deserve reconsideration and/or refinement with a view to enhancing the target beneficiaries' participation in designing and running these centres to a maximum.

Establishing a network of what in a number of industrialized countries (Western Europe, especially the United Kingdom, North America) has become known as local enterprise development agencies (LEDAs) is a second approach recently recommended to the Pakistani authorities.<sup>53</sup> Its merits should be carefully examined. In essence, LEDAs are designed to provide a wide range of support and enabling services needed for both start-ups and existing small enterprises over all stages of a project. This ranges from assistance in the preparation of business plans and proposals with a view to securing funding from banks and other financial institutions, through getting a project started and running, to overcoming obstacles and constraints during operation. Whereas the precise scope and delineation of the services rendered by LEDAs would have to be tailored according to the needs of the particular communities they are intended to serve, LEDAs would not only provide advice directly, but also - by linking up with outside expertise beyond a core range of internal knowhow - work as facilitators of advice.<sup>54</sup>

Whereas the list of mainstream LEDA activities is normally expected not to require large amounts of money nor extensive internal resources nor any major commitment by external

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<sup>51</sup> See RES & Company Ltd., *op. cit.*

<sup>52</sup> See Government of Pakistan, Ministry of Labour, Manpower and Overseas Pakistanis, Report of the National Manpower Commission, *op. cit.*, pp. 53 & 56-57, as well as S. Ghayur, H. Frey; K. Klennert, *op. cit.*, pp. 7f.

<sup>53</sup> For details see RES & Company Ltd, *op. cit.*, pp. 18-22, VII-1 to 13.

<sup>54</sup> For an illustrative listing of typical services rendered by LEDAs see Annex III, p. 72.

bodies to deliver, the three additional areas suggested for possible coverage by these LEDAs in the case of Pakistan would need some extended funding: (i) offering a loan support scheme; (ii) establishing managed workshops, understood as buildings which contain between 20 and 50 small units including common service facilities (on-site secretarial services, communications equipment, etc.) under one roof, each unit being separately lockable and offered for rent by small entrepreneurs; and (iii) assuming a matchmaker's role between users, suppliers and receivers in the area of technical training (identification of technical training skills in demand, assistance to the suppliers in the design and advertising of training programmes to the potential clients, assistance to the receivers in locating suitable training courses).

Set-up as non-governmental organizations, i.e. as autonomous self-determining entities, and as partnerships between the public and private sectors allowed to operate without the constraints of civil service regulations, LEDAs are reported to show the best results if provided on a fully decentralized basis, i.e. in each significant conurbation of a target area. They are usually staffed by small numbers of professionals (approx. 5) with mixed disciplines, with the manager being preferably drawn from the private sector.

A third approach if adapted to the specific conditions of Pakistan may also offer promising prospects for a more decentralized promotion especially of the small, probably less so of the micro enterprises. As elaborated upon more fully in the ILO contribution to the present exercise,<sup>55</sup> a strategy along the lines of what has been coined the **Valencia model** could help to replace the traditional cheap labour/low quality focus by a higher quality/higher value added- and hence more innovation-oriented approach as key determinant of achieving industrial competitiveness through a mobilization of small businesses. The model's basic idea is to set up a decentralized network of semi-autonomous, technical support institutions located nearby sectoral agglomerations and coordinated by a central institute. In Valencia, about a dozen technical institutes (i) either provide a range of services (e.g. training, technology transfer, quality testing) to specific sectors or (ii) offer highly specialized services for use by small firms from all sectors. The institutes render their services on a sales basis. Responsiveness to the clients' needs is ensured by the affiliated industry associations' majority presence on the individual boards.

The central institute (in the case of Valencia called the Institute for the Promotion of Small and Medium Sized Firms, IMPIVA) notwithstanding some reporting duties viz-à-viz government, particularly at the regional level, operates on a relatively autonomous basis. Governed by a board of representatives from both the public and private sectors (relevant ministries, chambers of commerce, etc.), it aims at bringing the individual technical institutes in line with public policy via a bottom-up approach. Being represented in all the technical institutes' boards and subsidising part of their running costs (one third) on a permanent basis, IMPIVA is geared towards constantly identifying weaknesses and omissions within this "inner network" with a view to initiating relevant changes and adjustments whenever necessary. Additional inputs for service improvements can be obtained through an "outer network" composed of universities, training establishments, design schools, and other service institutions.

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<sup>55</sup> See ILO, *op. cit.*, Annex 1.



**(3) Restricting the role of government to being a catalyst/facilitator of MSE development.**

In line with international experience, the foregoing general recommendations lead themselves to **redefine the government's role away from direct top-down intervention towards a concentration on catalytic and facilitating functions.** The overall emphasis for policymakers should be to encourage cooperation among local actors and to help in the creation of a conducive institutional infrastructure. While this facilitating role should encompass the readiness to provide certain financial assistance for the promotion of MSEs, at the same time it should foresee to reduce the direct managerial or administrative involvement of public entities, at least by entering into joint management with the private sector and/or target group representatives (**public-private partnership concept**). Generally, government activity should be shifted from the provision of direct subsidized inputs to the removal of constraints which impede the MSE sector to grow and prosper.

In the latter context, besides the need to cater for a constant upgrading of the physical (rural) infrastructure the government is clearly called upon to concentrate on the **creation and maintenance of an enabling macro-economic environment in general and the removal of macro policy constraints, especially in the form of anti-MSE biases in particular.**

In the area of **fiscal policies**, a major challenge lies in a bold reform of the tax system with a view to (i) broadening the tax base (in particular, by subjecting agricultural incomes to tax) and to (ii) rationalizing tax administration/collection including the system of incentives and exemptions. Part of the additional tax revenue should be channelled into development expenditures including in the field of MSE promotion. Tax reform measures bearing a more direct relation with MSEs should entail to base taxation on turnover rather than on employment in order to avoid unintended artificial enterprise split-ups into small units. Also, a shift of sales tax collection from the producers to the point of sale would point into the right direction.

With regard to **trade policy** a further reduction of import tariffs would help to broaden the procurement base (equipment, raw materials) for and to upgrade the technology base of certain - most likely more advanced - segments of the MSE sector. A removal of the distinction between commercial and industrial import tariffs should be pursued with priority in order to remedy the cost disadvantages MSEs are exposed to currently. Tariff distortions which have proven to be detrimental to MSEs should be abolished. The recent policy of opening bonded warehouses at locations closer to industrial/business agglomerations in other than the largest towns likewise tends to reduce trade-related costs to enterprises (regarding transport, commercial middlemen, customs formalities) and should therefore be continued.

In the area of **export promotion**, the Export Promotion Bureau under the Ministry of Commerce should explore ways, means and measures of enlarging the (direct or indirect) participation of MSEs in international trade. In the allocation of funds raised under the 1991 Export Development Fund scheme - by charging a levy of 0.25 per cent on fob export values -, due account should also be taken of the smallest businesses' needs. For instance, the already commenced establishment of some ten grading institutes, such as in cotton grading, might benefit from introducing special provisions to cater for MSEs. Should recent plans to establish a specialized export development bank materialize, serious efforts should be made to address the smallest businesses' needs as well, perhaps by means of devising specific programmes. Concerning **inward foreign direct investment** rules and regulations, a continued liberalization

may contribute to the emergence of new and/or the technical and managerial upgrading of existing local MSE supplier networks through subcontracting.

In more general terms, **enhanced coordination among relevant government units in the design and implementation of MSE policies and programmes, particularly in rural areas (provision of infrastructure, specific aids) would also help to enlarge the rate of success. The same can be expected from an increased continuity of relevant policies and programmes which ought to replace the ins and outs (e.g. overlappings, cancellation of ongoing programmes, etc.) of the past practice to launch ever new activities with the advent of a new government quite independently from a thorough review of preceding approaches. Finally, policymakers should strive for coherence of their overall policies with the narrower field of MSE promotion.**

#### **(4) Assumption of MSE lobbying function by international donors' group.**

The commendable practice of both bi- and multilateral donors with years of experience in the promotion of MSEs in Pakistan to exchange views and expertise and to coordinate better their pertaining activities through their international donors' group should be maintained and expanded with a view to establishing joint activities. The usefulness of **enhanced coordination** cannot be overestimated. Emphasized as a new priority, coordinated donor support for national strategies to strengthen the policy framework and institutional systems is also at the core of a recent report by the OECD on new directions in donor assistance to microenterprises.<sup>56</sup>

The donors' coordination group should also explore ways and means to develop into a **lobbying mechanism for the (rural) MSEs viz-à-viz the government.** The key importance of an effective promotion of MSE businesses for income generation, employment and, hence, overall economic stability needs to be constantly communicated to the central government at the highest possible level, preferably at or in the vicinity of the Prime Minister's Office. If pursued jointly, a move by the donors towards a **higher degree of conditionality** in the sense of granting assistance only in line with a real, more visible and sustained commitment on the government's part to make progress as to the promotion of MSEs, might add to a faster reorientation of failed or only partly successful policies of the past.

## **2. Specific recommendations**

### **(1) Enhance information base on rural informal MSEs.**

There is ample scope to **increase the empirical knowledge about the type, size, working conditions, felt needs etc. of (particularly rural) informal micro and small enterprises (RIMSEs) in Pakistan.** It is therefore recommended (i) to launch a series of RIMSE surveys, with a focus on geographical areas bearing high development potential, and (ii) to follow-up closely recent efforts to compile informal sector-specific, especially enterprise data on a more regular and systematic basis, such as in the case of the PAK-Netherlands Data Base Project.

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<sup>56</sup> See OECD, New Directions in Donor Assistance to Microenterprises, Paris 1993, pp. 11-19.

- (2) Continue critical assessment of past/present promotional approaches (policies, institutions) to adequately cover MSEs.**

Recent efforts to identify shortcomings of MSE promotion at policy and institutional level both of central and provincial governments should be continued. It is therefore suggested to launch an in-depth investigation of the programmes and performance of (i) the Sindh Small Industries Corporation, (ii) the respective Balochistan government department, and (iii) the Azad Kashmir Small Industries Corporation similar to the one conducted for GTZ recently on NWFP's SIDB.

At federal level, recent suggestions towards merging the Youth Investment Promotion Service (YIPS) with the Small Business Finance Corporation (SBFC) should be seriously examined. Ongoing rural development programmes, such as the National Rural Support Programme (NRSP) should seek to incorporate industrial/manufacturing activities and not be limited to agriculture-related/agro-processing activities.

- (3) Raise public awareness of MSE importance for overall development/ institutionalize public-private dialogue.**

A mechanism should be devised to bring together on a regular basis key policymakers, government officials and business representatives (i) to overcome the prevalent underestimation of the MSE sector, including in many segments of the larger industries sector, and (ii) to discuss ways and means of tapping the unexplored potential of MSEs through mutually beneficial cooperation. Awareness has to be raised of the sector's overriding importance for the badly needed generation of income and employment opportunities for a large number of people. For instance, the Federation of Pakistan Chambers of Commerce and Industry has indicated a keen interest to participate in such a public-private dialogue.

- (4) Identify suitable target group counterparts at local level to manage or to participate in designing, rendering and managing the extension of relevant support services to MSEs.**

Following the demand-led promotion approach outlined above, it is recommended on a sample basis to identify existing bodies/self-help associations of MSE target beneficiaries which might qualify for assuming responsibilities in the organization/channelling of support services to the grass-root level.<sup>57</sup> An investigation should be launched as to the readiness and capability of selected Chambers of Commerce to manage - independently or in collaboration with public entities - existing or proposed (rural) industrial support centres, e.g. with respect to providing investment advice, running training courses of various kinds or providing certain equipment and machinery for use by member MSEs. For instance, according to an estimate the mission received from the Gujranwala Chamber of Commerce and Industry, some 10 chambers country-wide would be both willing to and capable of rendering training

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<sup>57</sup> A good example in this connection in January 1994 was the imminent takeover of the Sialkot Leather Training Centre from the government, i.e. PSIC, by the Gloves Association.

programmes to small businesses.<sup>58</sup> However, the widely acknowledged absence of non-governmental organizations sufficiently qualified for stepping in here may also necessitate the build-up from scratch of like counterparts at local level.

**(5) Identify promising locations for the establishment of rural support centres and other locally oriented support institutions.**

In parallel with the aforementioned efforts should be launched to identify clusters, i.e. critical masses of the number of certain industries by sectors in different parts of the country which show sufficient development potential to qualify for the establishment of a limited number of rural support institutions/centres along the lines suggested in the Manpower Commission's Report. The donor community may consider to extend funding to one or two such centres on a pilot basis, provided the target group's involvement is secured and the services rendered meet the actually felt needs. A similar approach may be taken with regard to installing a small network of local enterprise development agencies (LEDAs) which if successful will bode well for replication in other parts of the country.

**(6) Reorient training activities to real needs of clients.**

In view of the limited relevance for industrial MSEs (i) of the great number of existing public vocational training institutions in general and (ii) of the weaknesses reported about training activities geared especially towards small enterprises in particular every effort has to be made to involve the target beneficiaries in the design of any future, possibly informal, training services/activities to ensure that actual needs at workshop/shop-floor level are responded to. It is suggested to jointly identify practical training requirements by industrial/manufacturing sub-sectors, subjects and levels. Instructions should be simple, relevant and easily accessible for the target groups. The positive experiences made with mobile training units should be expanded. While in the case of rural informal MSEs the installation of a "proper informal" education/training system in certain ways may be superior to a formal system and hence recommend to build pertaining efforts upon the traditional, well established Ustad-Shagir system, in a broader context increased attention should also be paid to a corresponding reorientation of the training provided by formal sector institutions.

**(7) Expand MSE access to credit through enhanced community banking and improved cooperation between MSEs and commercial banks.**

Perceived high risks, lacking collateral and the high cost nature of entering into loan arrangements with MSEs have largely prevented the commercial banking sector from serving MSEs. It is predominantly informal financial services, usually in the form of short term credit from moneylenders which MSEs, particularly in rural areas, rely upon. At least two possible answers to overcoming the problem of lacking or insufficient access to finance for MSEs are to be distinguished. These are (i) the continued expansion of self-help informal banking

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<sup>58</sup> Since 1990, the Gujranwala Chamber has conducted a number of courses on export management (documentation requirements, etc.). As a result, the Gujranwala business community organizes its exports directly nowadays rather than by involving middlemen as before.

**mechanisms at grassroot level known in many developing countries, inter alia, as community banking or banking for the poor on the one hand, and (ii) increased efforts to link up formal financial sector institutions with the (rural informal) MSEs on the other hand.**

As to the former, in the past decade or so considerable and varied experience has been accumulated internationally on the provision of credit to microenterprises. Whereas the greater part of a large number particularly of rural financial institutions (RFIs) in many developing countries has remained heavily dependent on subsidies, has shown lacking innovative management and hence has not fulfilled the initial expectations, a few and often cited examples have proved successful in the effective provision of creative financing to poor segments of the population. In Asia, four RFIs are frequently mentioned in this context: the Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand, the Grameen Bank in Bangladesh, the Badan Kredit Kecamatan as well as the Bank Rakyat Indonesia Unit Desa, both in Indonesia.<sup>59</sup> Without going into details here, the techniques applied in these and other success stories resemble - often deliberately - those that have emerged in the informal financial sector over many years. In essence, three credit principles which always require adaptation to the respective local conditions are at the core of the new techniques.<sup>60</sup>

- Close knowledge of the market. The major need of the poor who are willing to pay for access to credit and convenience of delivery is loans for liquidity and working capital, with loan periods usually of one year or less. Transaction costs for borrowers are kept low by locating banking outlets near the customer, offering simple application processes, and disbursing quickly. Interest rates are relatively high when compared to formal financial sector rates but low in comparison with the typical informal sector rates.
- Trimming administrative costs to a level commensurate with the low loan size. This entails the use of simple procedures, such as one page application forms, decentralized loan approvals based on readily verifiable eligibility criteria rather than on "classical" business appraisal procedures and the partial takeover of the loan processing burden by borrower groups. Close knowledge on the part of the local banking staff of the individual loan applicant including his/her social standing and reputation greatly facilitates a credit decision - known in some countries as "character loans" - and thus also reduces cost pressures.
- Motivating repayments through special techniques. These include the promise of repeat loans, in increasing amounts, savings requirements and - most importantly - group guarantees or pressure from social networks. Especially the latter feature, i.e. shared liability for any individual member's default by the entire group, has proven an extremely useful tool to ensure close to 100 per cent repayment ratios.

If striving for commercial viability of like banking operations is accepted as the only promising way to ensure their long-term sustainability - at least within a foreseeable time period - the above credit principles need to be complemented by similarly distinct principles

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<sup>59</sup> For a concise review of these widely acknowledged successful examples see J. Yaron, Successful Rural Finance Institutions, in: Finance and Development, vol. 31, no. 1, March 1994, pp. 32-35.

<sup>60</sup> For a more detailed elaboration of the following see E. Rhyne; M. Otero, Financial Services for Microenterprises: Principles and Institutions, in: World Development, vol. 20, 1992, pp. 1563-1565.

to attract savings as equally important as the provision of credits. This refers to, inter alia, offering safety, convenience, ready access to money, and a positive real rate of return. Also, the opportunity to save should not be limited to those who borrow. Observing this, lending to MSEs can to a significant extent be financed by savings from the same local communities. Overall, full-cost pricing policies need to be aimed at which includes a call for doing without the imposition of - usually below-market - interest rate ceilings.

As mentioned in this report, in Pakistan a community-oriented savings and credit programme has started operation under the NRSP at small scale. There is, however, a keen interest in many quarters (i) to study in more detail the terms and modalities of community banking schemes applied successfully in other countries, in particular the above mentioned Grameen Bank in Bangladesh, and (ii) to assess the scope for replication - or, more accurately, transfer and adaption - of this and related schemes in Pakistan.<sup>61</sup>

**It is thus recommended to analyze the prerequisites for, to elaborate on possible forms of as well as to devise concrete steps for the accelerated introduction of community banking facilities into Pakistan at a larger scale with a special focus on rural MSEs.**

With regard to increasing the formal banking sector's involvement in the extension of finance to MSEs, steps should be taken to enhance both its indirect and direct exposure. In overall terms, measures should aim to reduce the risks perceived as well as to cut the high credit administration/ surveillance costs associated with lending to MSEs. One promising approach of an indirect link-up may be for microenterprise (credit) programs run by NGOs (composed of target MSE beneficiaries and/or in the form of rural support centres) to finance parts of their lending by borrowing from commercial banks. For this to happen at least two stringent criteria would have to be met. First, these programmes/NGOs must be in a position to repay the borrowed funds at interest rates acceptable to the bank. And second, they must assure the refinancing banks of their creditworthiness. NGOs may become involved in the screening and appraisal process of potential loaners and their project proposals, in monitoring debt servicing and/or in operating mobile savings collection and credit extension units, possibly also by providing credit guarantees. Concerning the latter, for an initial period there may also be good reason for foreign donors to step in as brokers between NGO-based programmes and the banks. The donor's involvement may or may not include the provision of guarantees viz-a-viz the banks or even some soft funding support for blending with bank credit in order to meet the commercial banks' interest rate demands.

Any sizeable direct engagement of commercial banks in the field of MSE credit is likely to only materialize if banks are convinced that resource allocation to this bottom enterprise segment is not equivalent to sacrificing safety and hence income objectives. To achieve this, on the one hand banks need to be made familiar with applying the principles referred to in the summary description of successful RFIs above. On the other hand, a conducive macro-economic operating framework, inter alia, would entail to do without subsidized interest rates and/or interest rate ceilings.

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<sup>61</sup> An interesting illustration of the varying degrees of success encountered internationally with the attempted emulation of the Grameen Bank model is given in D. Hulme, Replicating finance programmes in Malawi and Malaysia, in: Small Enterprise Development, vol. 4, no. 4, December 1993, pp. 4-15.

Against this background, the present report recommends to launch a study on appropriate measures, mechanisms and institutional requirements on how to foster the link-up, both directly and indirectly, between the commercial banking sector and MSEs, with a focus on the rural areas. This should be done in close collaboration with the commercial banking sector itself. At the macro level, subsidized credit in the form of interest rate ceilings should be dropped/phased out. The appropriateness of maintaining mandatory targets for the allocation of credits to small enterprises should be seriously questioned. The possible establishment of separate credit windows for rural enterprises merits a careful examination. In doing this, emphasis should be placed on increasing both the banks' awareness/knowledge of and outreach to this clients group.

Promising endeavours to broaden the access of MSEs to credit in Pakistan are likely to be those which pay due account, inter alia, of (i) a close supervision of loans as a general principle (see the pertaining positive experience of the PAK-Holland metal project), (ii) availing money including for badly needed working capital loans, and of (iii) making the viability of a project more important for a credit decision than the collateral issue. The latter may go hand in hand with raising credit limits extended without collateral requirements (e.g. up to Rs 50,000) or with accepting raw materials and/or machinery as collateral.

Concerning the possible mobilization of new sources of finance for small enterprises, the applicability of instruments such as leasing at a larger scale for MSEs in general and an extension of their use into rural areas in particular should be explored. In this connection, the experiences being made presently by the World Bank project (Orix Leasing) should be carefully monitored. Access by rural MSEs in this and maybe in schemes to be created along similar lines may be facilitated (i) by also enabling the lease of second hand/used equipment rather than the present restriction to new one, (ii) by availing additional working capital loans through a link-up between the leasing company and commercial banks (see the trial Orix Leasing/Allied Bank link-up), and (iii) by more vigorously attempting to interest the foreign banks present in Pakistan in refinancing leasing companies for business with (rural) MSEs.

**(8) Enlarge/diversify trade channels/market outlets for MSEs.**

The scope and potential for enhanced link-ups between MSEs and department stores and/or retail chains should be explored, in particular with regard to franchise arrangements for MSEs at rural level. For instance, Utility Store Ltd (US) indicated its willingness to provide one counter within a number of its retail outlets to specific groups of MSEs for selling their own produce. The arrangements could take the form of a contract between US and some intermediate organization/NGO which would guarantee the quality and also organize the delivery of the agreed produce. Donors may consider to assist in launching such cooperation on a pilot basis. Efforts to enlarge MSE sales markets away from the immediate environs through partnerships between MSEs/ village producers and department stores could also encompass a review - and possible adaption - of like activities in other countries known as "foster father programmes", such as in Indonesia.

As to the possible promotion of MSE exports, the experience made with models introduced in other countries, such as the export village approach applied in Sri Lanka, should be analyzed in detail with a view to assessing their potential replicability in Pakistan.<sup>62</sup>

**(9) Determine needs and possible forms of support to women MSEs.**

A special consultancy should be launched with the aim of establishing in detail the bottlenecks experienced as well as the needs felt by micro and small women entrepreneurs in rural areas in the set-up and/or expansion of their businesses. This needs assessment study which should preferably be carried out by - or at least with the involvement of - female consultants would also review promotion measures currently in place (policies, individual programmes/measures, institutions, donor-funded projects) and develop recommendations for further action to strengthen the women's role in rural MSEs. Without preempting the outcome of the recommended investigation there may be good reason - except for some specific activities - to largely strive for an integrated male/female MSE promotion rather than advocating separate approaches for both genders. Building up group consciousness/identity, fostering empowerment and ensuring participation are likely to feature prominently in any promising endeavour to render support to women MSEs.

As a short term measure, the existing support institutions (the SIDOs, SBFC, etc.) should increase the share of female staff so as to ease the access by female customers. In the field of credit, ways and means for the First Women Bank to extend its activities into the rural areas should be carefully explored.

**(10) Determine scope for and take measures to facilitate increased MSE participation in industrial subcontracting/networking activities.**

In view of the apparently huge yet untapped potential for increased subcontracting relationships among MSEs as well as between MSEs and medium- and/or large enterprises a detailed investigation should be launched to determine the scope for and suitable ways of promoting like arrangements, with a focus on rural-rural and rural-urban link-ups. The investigation should be in the form of a study which - based on taking stock of current subcontracting activities in selected key manufacturing sub-sectors - would recommend policy measures on how to influence the make-or-buy decision of medium/large enterprises in favour of an increased farming-out of production into rural areas.

Any decisive move in the desired direction will be contingent upon a fair degree of trust in the commercial viability of these subcontracting arrangements on the part at least of the stronger participant. Also in this connection, recommendations pertaining to institutional arrangements meant to facilitate subcontracting/networking activities (e.g. matchmaking services, exchange of relevant market information) should always incorporate a strong element of private sector involvement, preferably even ascribe the lead role to the private sector (e.g. in the form of chambers). As in other countries, the successful build-up of the necessary confidence between the potential/ actual subcontracting partners, such as in terms of price,

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<sup>62</sup> See, for instance, International Trade Centre UNCTAD/GATT, Export Production Villages. A study of a Sri Lankan scheme for rural export development, Geneva 1992.



agreed quality, timely delivery and payments in early phases will be crucial for the spread of sustainable cooperation between and among the various size segments of industry in Pakistan.

### **3. UNIDO's possible role**

Given its long-standing experiences in the field of micro and small-scale enterprise promotion, UNIDO finds itself in a position to offer its assistance in the translation of the above action oriented recommendations to practice. Rural micro and small-scale enterprises create non-farm employment and income generating opportunities in the rural area. These enterprises contribute to stemming urban migration and to supplement other sources of income. They can find pockets of markets where domestic and foreign large scale suppliers are not yet able to serve. They could also serve the needs of customers with distinctively local preferences. UNIDO could support the efforts of the Government in the following areas:

1. Further review of fiscal policies, legal requirements, directives and administrative involvement of national and local authorities that relate to rural micro and small-scale enterprises in order to assist the government in improving the business environment for existing and new rural micro and small-scale enterprises.
2. Conduct in-depth review of the performance of selected existing institutions to provide advice on rural micro and small-scale enterprise development methods to provincial and central governments. This should be done within the framework of a market mechanism-oriented promotion programme for rural micro and small-scale enterprises. Possible options on institutional restructuring should be identified in order to improve efficiency, effectiveness and public accountability. The study should evaluate performance of existing institutional infrastructure particularly on the legal framework, mandated functions, organizational structure, administrative rules and procedures, quantity, qualifications and position of staff, availability of facilities and equipment. It should further analyze management systems, annual budgets and funding sources, record of expenditure, record of auditing, actual practice of the mechanism to reflect the concerns of beneficiaries to the management, type and quantity of actual services offered, record of actual impacts created among their beneficiaries and coordination mechanisms and the record of practice.
3. Establish an action oriented inter-disciplinary policy advisory board in order to implement the measures to improve the policy environment for the rural micro and small-scale enterprises and to restructure the institutional set-up. Technical assistance could be provided in terms of a team of medium-term advisors.
4. Assist and advise in establishing a network of associations of rural micro and small-scale enterprises which consists of sub-sector based groups and localities at provincial and national level in order to initiate self-help programmes through cooperation with other technical institutions. The goal of these groups is to participate together with the government in the mainstream policy making process for the development of the sector.
5. Establish an independent statistics and research facility especially focusing on the promotion and development of rural micro and small-scale enterprises. The facility would be a joint undertaking of selected academic institutions and the business community. It will conduct and regularly publish analyses of development trends of the sector and

findings from thematic researches into issues that are relevant to the business community. It will provide data to policy makers particularly targeting on participation in the law making process and on increasing awareness among the public on facts and issues on this sector.

6. Introduce an integrated programme to encourage closer cooperation and or mergers between rural small-scale enterprises to become larger enterprise units, consisting of simple legal procedures and administrative requirements, tax and infrastructural incentives, legal, technical and managerial advisory services, identification of prospective business opportunities etc. These measures aim at promoting the graduation of micro enterprises into the category of more modern small- and medium-scale enterprises. These measures should be designed to contradict other sets of measures geared to enabling the start-up of new micro enterprises.
7. Encourage sub-contracting arrangements between rural small-scale enterprises and medium-scale enterprises by assisting the formation of sub-contractors with incentive measures for the contracting medium scale enterprises, fair arbitration facilities for the contracting parties, technical and managerial advisory services etc.
8. Establish management and technical training programmes that are accessible, affordable and appropriate to the needs of rural micro and small-scale enterprises. This should be done in cooperation with existing training institutions, educational establishments and local authorities financially supported by the national and local authorities as well as by industrial associations.
9. Organise, on an ECDC/TCDC basis, training and study tours for staff and managers of rural/micro/small enterprise promotion institutions and associations. During these tours the trainees should be exposed to activities undertaken, services offered and methodologies applied by successful institutions working in a similar environment in different countries. Selected subjects could be e.g. rural banking, training practices and marketing methods.
10. Introduce simple industrial training programmes into primary and secondary schools that are located in relatively poorer regions in order to improve the human resource base for an entrepreneurship-led rural enterprise development and for the creation of competitive and flexible industrial workmanship.
11. Assist in the establishment of sub-sectoral institutions specialized in market research to monitor and analyze competitive conditions for various types of products to be manufactured by domestic micro and small-scale enterprises and to assist entrepreneurs in adjusting their business plans to emerging business opportunities. These institutions should be located at provincial level where there is a concentration of a certain magnitude of sub-sectors. They could be established within already existing institutions if appropriate. Social costs and benefits should be carefully evaluated in developing them.

## Annex I

**Capital Intensity and Labour Productivity of Rural Manufacturing Enterprises, 1988**

	Capital per Firm (Rs.)	Capital-labour Ratio (Rs.)	Capital-output Ratio	Productivity of Labour (Rs.)
Food manufacturing	28,959	17,472	1.31	13,288
Wheat milling	28,731	18,178	1.41	12,833
Beverages	17,666	9,217	1.13	8,174
Tobacco	7,585	2,180	0.20	10,924
Textiles	3,944	1,683	0.21	7,645
Cotton-weaving	41,163	12,618	1.39	18,337
Woolen carpets	1,831	735	0.10	7,024
Wearing apparel	1,055	568	0.12	4,718
Leather & products	9,745	3,111	0.19	16,300
Footwear	3,323	2,319	0.22	10,557
Ginning	9,527	7,960	1.08	7,360
Wood & products	23,171	6,662	0.97	12,001
Furniture	7,081	3,579	0.31	13,268
Paper	2,971	1,496	0.26	5,793
Printing	38,889	12,069	0.66	18,310
Chemicals	11,648	4,129	0.26	15,706
Mineral products	14,530	5,144	0.32	16,039
Basic metals	88,089	12,732	0.54	16,040
Metal products	7,087	4,013	0.28	14,094
Non-Elec. machinery	11,125	6,930	0.60	11,505
Electrical machinery	11,382	2,563	0.16	15,774
Transport equipment	12,933	6,261	0.33	18,991
Other	5,268	3,068	0.25	12,468
Total	13,964	6,928	0.66	10,566

Source: Census of Small and Household Manufacturing Industries 1988, reproduced from: A.R. Kemal, Informal Sector in Rural Pakistan, Islamabad, December 1993, p. 14.

## Small and Micro Enterprise Promotion

### Donor Agencies' Projects and Programmes in Pakistan

SNo.	Title	Area (National/ Province & District)	Amount ('000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
1.	Start your Business/Improve your Business courses in various sectors (Employers' federation of Pak/ILO)	National		Ongoing	E, T/ General		ILO	Mr. B. Ahmad ILO Area Office 853919/854804
2.	Vocational rehabilitation & Employment of disabled persons with community participation, PAK/88/010 (UNDP/ILO)	National		Ongoing	T, W/ Informal		UNDP/ILO	Ms. S. Hasan ILO Area Office 853919/854804
3.	Strategic Approaches towards Employment Promotion	National	500 per annum	Ongoing	E, TT/ Micro & Informal	Available on request	Govt. of Japan	Mr. W. Mellgren Manpower Division - ILO 813863
4.	Small-Scale Industry Project	National	50,000	Ongoing	Small	Restricted	Dept., Area Div 3/ ADB	A. Hashida/Private Sector (632) 632-6458
5.	IDBP XI	National	4,500	Ongoing	F/ Medium		German Government KFW	KFW
6.	PICIC XI	National	6,840	Ongoing	F/ Medium		German Government KFW	KFW
7.	SSI III (Co-financing World Bank)	National	14,000	Preparing	F, TT/ Micro & Small	Available on request	Netherlands Government and The World Bank	Mr.C.E.Kengen, Dutch Emb & Mr.P.Aklilu, The WB 819781 (WB) 214336 (Emb) (fx 822630)
8.	Micro Enterprise Project (Cofinancing The World Bank)	National	3,000	Ongoing	E, F/ Micro & Informal	Available on Request	Netherlands Government and The World Bank	Mr.C.E.Kengen, Dutch Emb & Mr.P.Aklilu, The WB 819781 (WB) 214336 (Emb) (fx 822630)

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SNo.	Title	Area (National/ Province & District)	Amount (000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
9.	Strengthening Punjab Economic Research Institute (PERI)	National	1,700	Preparing	RI/ Micro, Small & Sectoral	Available on request	Netherlands Government and PERI	Mr.C.E.Kengen, Dutch Emb & Mr. Tameel Khan 042-876144/873814 (Proj) 214336 (Emb) (fx 822630)
10.	Women's Development Support Network: Self Employment and Micro Enterprise Development for Women	National	Rs.968,983		E, T/ Micro, Small & Informal	Available on request		Shahnaz Kapadia ECI, Islamabad 213485
11.	Marketing Training and Credit support for women workshops	National	Rs.185,600	Ongoing	T, W		UNICEF	Shameim Kazmi National Association of Business Professional & Agricultural women, Karachi 440640
12.	Organisational & Management support, NWFP	NWFP	DM 500.000	Ongoing	TA		German Government/GTZ	Project Administration Services, 1-E, Blue Area, Islamabad
13.	Women's Development Support Network: Microenterprise Training Workshops for existing women entrepreneurs	Sindh, Punjab Federal	Rs.217,000+ Rs.213,000+ Rs.200,000					1.Tehmina Malik Abpaw Association of Business, Prof. & Agri Women, Rawalpindi 580124 2.Parvin Shaikh ECDI Entrepreneurship Carrer Dev. Institute, Karachi 438283 3.Shaheen Atiqur Rehman Pakistan Social Services Board 41 Shahra e Binbadis, Lahore
14.	Income Generation	Balochistan	Rs.1,695,000		B, T/ Micro, Informal	Available On request	UNICEF	Social Welfare Dept. GoBalochistan
15.	Women's Integrated field action: Income generation support for ICT women	ICT	Rs.200,000		E, T/	Available on request	Office of the Chief Commissioner, Islamabad Capital Territory	Mrs. Nargis Sethi, Dir (Admin) ICT 852902 - 6

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SNo.	Title	Area (National/ Province & District)	Amount (*000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
16.	Balochistan Rural Support Programme Component: Income Generating	Balochistan	overall amount 1,217	Ongoing	B, T/		German Government/GTZ	Dr. Bürk BRSP Quetta 081-42153
17.	Pak-German Technical Training Programme Peshawar	NWFP	9,300	Ongoing	T/		German Government/GTZ	Dr. Latte Pak-German TTP 0521/213865 or 60638
18.	Fuel Efficient Cooking Technology	NWFP	5,600	Ongoing	TT/ Small		German Government/GTZ	Thomas Neumaier FECT 0521/42511 or 45387
19.	Employment & Training for rural women in NWFP PAK/89/M01/NET (Netherlands/ILO Project)	NWFP	1,315	Ongoing	E, T, W/ Micro		Netherlands/ILO	Ms. S. Hasan ILO Area Office 853919/854804
20.	Agricultural Light Engineering Programme (ALEP)	NWFP - Mardan		Ongoing	E, TA, T/ Micro	Available on request	SDC	B. Girardin/ COOF - SDC, Islamabad/ 211059
21.	*Small & Micro Enterprise Promotion	NWFP		Preparation	B, E/ Micro & Small		SDC	B. Girardin/ COOF - SDC, Islamabad/ 211059
22.	Leather Goods Centre Bannu	NWFP - Dist. Bannu	909	Ongoing	T/		German Government/GTZ	GTZ
23.	Pak-Holland Metal Project 1992 - 95	NWFP	8,000	Ongoing	E, F, T, TT/ Micro, Small & Informal	Available on request	Netherlands Government	Mr. C.E. Kengen, Dutch Emb & Mr. M. Criete Pak-Holland Metal Project 0521-30670/71 (fx 75652)
24.	Components of National Vocational Training Project, PAK/86/017 (UNDP/ILO)	Punjab, Sindh, NWFP	Overall amount 3,587	Ongoing	E, T, W/ General		UNDP/ILO	Mr. B. Ahmad ILO Area Office 853919/854804

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SNo.	Title	Area (National/ Province & District)	Amount ( '000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
25.	Establishment of a National Supervisory Training Centre in PITAC - Lahore + Karachi. PAK/88/061 (UNDP/ILO)	Punjab	637		Ongoing Small - Medium	T/	UNDP/ILO	Ms. M. Tacoma ILO Area Office 853919/854804
26.	Rural Industrialisation Credit Program	Punjab	11,000	Ongoing	B, E, F/ Micro & Small	Available on request	Netherlands Government and Punjab Samll Industries Corporation/RICP	Mr.C.E.Kengen, Dutch Emb & Director, P&D Lahore 042-304148
27.	Women's integrated development field action: Women's Training for economic activities	Punjab - Lahore	Rs.175,000		E, TT, T/ Mincro, Small & Informal	Available on request	UNICEF	Kishwar Naheed Business & Professional women association, Lahore 260311
28.	Agri Implements Industry Service Centre Main Channu	Punjab - Multan	3,200	Ongoing	E, F, T, TT/ Small	Available on request	Netherlands Government and PSIC/FIISC	Mr.C.E.Kengen, Dutch Emb & Mr. R. Beeks 0448-2280 (Project) 214336(Emb) (fx 822630)
29.	Rehabilitation Institute of Leather Technology (1993 - 95)	Punjab Kasur & Gujranwala	2,000	Preparing	E, F, TT, T/ Micro & Small	Available on request	Netherlands Government and PSIC/ILT	Mr.C.E.Kengen, Dutch Emb & Mr. Anwar Yunus 0431-51850 (Proj) 214336 (Emb) (fx 822630)
30.	Facility cum training Centre for Leather Finishing in Kasur	Punjab - Kasur	730	Ongoing	TY, TT, T/ Small	Available on request	Netherlands Government and UNDP/UNIDO	Jon Holten/ UCD, Islamabad/ 211507
31.	Metal Industry Development Centre (1993 - 95)	Punjab - Sialkot	900	Preparing	E, F, TT, T/ Micro & Small	Available on request	Netherlands Government and M.I.D.C and The Royal Netherlands Emb	Mr.C.E.Kengen, Dutch Emb & Mr. Mirza 04320-87157 (Proj) 214336 (Emb) (fx 822630)
32.	Microenterprise Training of trainers Workshop for Women (Food Processing) 1990	Punjab (Taxila & Wah)	10,000	Completed	T, E, W	Report on the workshop available	USAID	Ahmed Jamil Office of ARD, USAID/Islamabad 824071 Ext. 390/387

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SNo.	Title	Area (National/ Province & District)	Amount (000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
33.	Microenterprise development training workshop for women	Punjab & Sindh	50	Ongoing, Study almost completed	E, T, W/ Micro & general		USAID/UNIDO	Nasim Sherin/Private Entreprise & Energy/ 824071 ext. 374/275
34.	Women's integrated development field action: strengthening of NGO credit activities	Rawalpindi/Islamabad	Rs.100,000		T/ Micro, Small & Informal	Available on request		Nighat Saeed Khan Behbud Association, Rawalpindi 552828
35.	Establishment of Hyderabad Leather Footwear Centre	Sindh	1,000	Completed	E, TA, TT, T/ General & Small	Available on request	UNDP/UNIDO	Jon Holten/ UCD, Islamabad/ 211507
36.	Enterprise Development A Component of Agha Khan Rural Support Programme	NWFP - Chitral	1.720 (£)	Ongoing	B, E, TA, W/ Micro & Small		ODA	J. Lingham / Asghar Ali/ British High Commission/ 822131
37.	Small Enterprise Development A component of Faisalabad area upgrading Project	Punjab - Faisalabad	300,000 (£)	Preparing	B, E, TA, T, W/ Small & Micro		ODA	J. Lingham / Asghar Ali/ British High Commission/ 822131

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## Small and Micro Enterprise Promotion

### Donor Agencies' Study/Research/Publication Activities in Pakistan

SNo.	Title	Area (National/ Province & District)	Amount ('000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
1.	Enabling People to Help Themselves. An Employment and Human Resource Development Strategy for Pakistan in the 1990', by John Cameron and Mohammad Irfan, ILO - ARTEP 1991.	National		Completed	R(B, E, I, T, W, O)/ General	Published	ILO (ARTEP)	ILO, Islamabad 853919/854804
2.	UNDP/ILO interagency mission on employment & human resources in Pakistan, particularly, focusing on rural employment and income generation, Jan 1993	National		Completed	R(E, F, T, W)/ General	Published	UNDP/ILO	
3.	Assessment of Employment situation in Pakistan, Dr. S.N. Hyder	National	6	Drafting	Macro	Available when completed	ILO/Japan	Mr. W. Mellgren Manpower Division - ILO 813863
4.	Directory & assessment of all special employment schemes of Govt. & NGOs Mr. Saleem Maqsood	National	8	Drafting	Micro to self-employment	Available when completed	ILO/Japan	Mr. W. Mellgren Manpower Division - ILO 813863
5.	List & assessment of all labour market information programmes, Mr. G.A. Qureshi	National	6	Drafting	Micro to self-employment	Available when completed	ILO/Japan	Mr. W. Mellgren Manpower Division - ILO 813863
6.	Capacity assessment of Labour Ministry & Directorate Mr. Rizwan Hussein	National	4	Drafting	Micro to self-employment	Available when completed	ILO/Japan	Mr. W. Mellgren Manpower Division - ILO 813863
7.	Urban Informal Sector - Labour absorption & economic growth by Dr. A.R. Kemal, Dr. Zafar Mehmood - 1992	National		Drafting	R(E, B, F, I, O)/ Micro & Informal	Available on request	FES	K.Klennert & Sabur Ghayur/ PIDE/ 852724, 254112

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SNo.	Title	Area (National/ Province & District)	Amount ('000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
8.	Skill generation & entrepreneurship development under "Ostad-Shagird" system in Pakistan by Abid Chaudhry, Parvez Azim, Abid Aman Burki - 1989	National		Completed	R(E, F, T)/ Micro & Infomal	Published, Available on request	FES	K.Klennert & Sabur Ghayur/ PIDE/ 852724, 254112
9.	The informal sector in Pakistan: Problems & Policies by Abid A. Burki, Sabur Ghayur - 1992	National		Completed	R(B, E, F, I, T)/ Micro and Infomal	Published, Available on request	FES	K.Klennert & Sabur Ghayur/ Economics Dept., Quaid-e-Azam Univ./ 852724, 254112
10.	Small & Micro Enterprise Promotion in Pakistan - Macro Economic Policy Framework & Implementation Issues	National		Completed	R(B, E, T)/ Micro & Small	Published	SDC	B.Girardin/ COOF - SDC, Islamabad/ 211059
11.	TSS-1 Study on Small Scale Industries in Pakistan	National	120	Planning	R(I, T)/ Micro & Small	No	UNDP/UNIDO + ILO	Jon Holten & R. Dudely 211507
12.	Traditional Crafts	National	10	Completed	R(E, TA, TT, T)/ Micro & Small	No	UNDP/UNIDO	Jon Holten/ 211507
13.	Electronic Cottage Industries	National	25	Data Analysis	R(E, TA, TT)/ Micro & Small	No	UNDP/UNIDO	Jon Holten/ 211507
14.	Pakistan Informal Sector Study by Development Research & Management Services (Pvt.) Ltd. March 1991	National	27,964	Completed	R(B, W)	Published, available on request	USAID	Nasim Sherin, O/PEN USAID 824071 Ext. 374
15.	Small Scale Industry in Pakistan with special reference to their Regulatory Framework. by ePru (Economic Policy Research Unit)	National		Completed	R(B, R)	Published, available on request	USAID	Nasim Sherin, O/PEN USAID 824071 Ext. 374
16.	Private Sector Investment Climate Assessment of Baluchistan by Stephan Silcox & Gilbert Lane of Louis Berger, Int. 1990	Balochistan		Completed	R, B	Published available request	USAID	Asif Bhattee O/ARD USAID/Islamabad 824071 Ext. 217

Subject: B = Business E = Entrepreneurship F = Finance I = Infrastructure TA = Technical Assistance R = Research  
RI = Research Industry TT = Technology Transfer T = Training EP = Export Promotion W = WID O = Others

SNo.	Title	Area (National/ Province & District)	Amount ('000 US\$)	Status	Subject/ Size	Documen- tation	Sponsor	Contact Person/ Department/ Telephone No.
17.	Preparatory Assistance for the Development of the Small Scale Industries in Poppy growing areas of NWFP	NWFP - Dir		Planning	R(E)/ Small	No	UNIDO	Jon Holten/ 211507
18.	Evaluation of Punjab small industries corporation's rural industrialisation programme, ILO-ARTEP 1987	Punjab		Completed	R(B, E, F, W)/ Small		ILO (ARTEP)	Mr. B. Ahmed ILO Area Office 853919/854804
19.	Evaluation of Punjab Small Industries Corporation's Rural Industrialisation Programme, 1992 - 93	Punjab		Data Analysis	R(B, E, F, W)/ Small		ILO (ARTEP)	Mr. B. Ahmed ILO Area Office 853919/854804
20.	Assistance to the Light Engineering industry in the region of Gujranwala and Wazirabad	Punjab - Gujranwala	34	Planning	R(TA, TT)/ Small & Medium	No	UNDP/UNIDO	Jon Holten/ 211507
21.	A socioeconomic profile of poor women in katchi abadies, report of a survey in Rawalpindi by Faiz Bilquees, Shahnaz Hamid - 1989	Punjab - Rawalpindi		Completed	R(B, W)/ Informal	Published (out of stock)	FES	PIDE/ 852724, 254112
22.	Socioeconomic Conditions of the self-employed by Hafeez-ur-Rehman Chaudhry, Salahuddin A. Khan - 1990	Punjab - Rawalpindi		Completed	R(B, E, F)/ Informal	Published, Available on request	FES	K.Klennert & Sabur Ghayur/ Ministry of Manpower and Overseas Pakistanis/ 852724, 254112
23.	Assistance to Fish Processing Units	Sindh	30	Planning	R(E, TT)/ Small & Medium	No	UNIDO	Jon Holten/ 211507
24.	Reproductive & Productive choices of Metropolitan Women. Report of a survey in Karachi by Zeba A. Sathar, Shahnaz Kazi - 1988	Sindh - Karachi		Study Completed	R(B, W)/ Informal	Published (out of stock)	FES	K.Klennert & Sabur Ghayur/ PIDE/ 852724, 254112
25.	Diversification of women's training and employment	National					FES & Quaid-e-Azam University	K.Klennert & Sabur Ghayur/ 852724, 254112

Subject: B = Business  
RI = Research Industry

E = Entrepreneurship  
TT = Technology Transfer

F = Finance  
T = Training

I = Infrastructure  
EP = Export Promotion

TA = Technical Assistance  
W = WID

R = Research  
O = Others

**ANNEX III****Range of Services typically offered by Local Enterprise Development Agencies (LEDAs)**

1. Helping entrepreneurs prepare professional business plans in support of loan application to banks and financial institutions;
2. Providing an information and advisory service on how to satisfy government and regulatory requirements and minimize the costs of establishing and running a business;
3. Providing advisory services on how to obtain grants and incentives available to small businesses under regional development or other policies;
4. Giving business training in management techniques and practices to small businessmen and entrepreneurs on an ad hoc basis or on arranged courses;
5. Providing professional support functions (accounting and legal) to start-ups or for growing businesses;
6. Giving technical advice or helping small businesses locate suitable advice in the technologies of their industry;
7. Giving advisory services to sick units;
8. Helping small businesses with locating and establishing premises;
9. Providing enabling services for cottage and home based industries in areas such as supply of raw materials, product design and merchandising;
10. Organizing local or regional trade fairs and exhibitions to promote the products and services from the SMI sector;
11. Taking initiatives to promote inward investment to the SMI sector in the region;
12. Developing programmes to promote inter-trading between small scale businesses and sub-contracting to large businesses;
13. Identifying and promoting new business opportunities through, for example, import substitution programmes;
14. Providing an information directory for small businesses on trade development issues, such as product specification regulations and lists of distributors or agents in an industrial sector;
15. Developing expert knowledge about the availability of physical infrastructure in the region and taking initiatives with government and private bodies to ensure adequate infrastructure exists;

16. Keeping close contact with and maintaining strong relationships with banks and other financial institutions;
17. Maintaining contact with other local organizations (eg. training foundations), or federal organizations (eg. Pakistan Textile Craft Development Organization), which can give assistance to small businesses;
18. Developing and maintaining a database on the small business community in their region, and lobbying for policy to help the SMI sector with government.

Source: RES & Company Ltd., *op. cit.*, pp. VII-2 & 3.

**ANNEX IV: UNIDO MISSION PROGRAMME**Wednesday, 5 January 1994Flight Vienna-IslamabadThursday, 6 January 1994

- Briefing at UNIDO Office
- Dr. A.R. Kemal, Joint Director, Pakistan Institute of Development Economics (national consultant of UNIDO team)

Sunday, 9 January 1994 (jointly with Mr. F. Pyke, ILO international consultant; Ms. Sherin R. Khan, Programme Officer/ILO Islamabad, Dr. Kemal)

- Mr. Shahrokh Mohammadi, Assistant Resident Representative, UNDP
- Mr. Saleem Maqsood, Joint Secretary, Ministry of Labour, Manpower Division
- Mr. William Mellgren, CTA Pakistan Chapter, ILO Employment Promotion Project
- Mr. Saghir Asad Hasan, Additional Secretary; Mr. Qureshi, Joint Secretary Development; Mr. Mansoor Zubair, Joint Secretary, Ministry of Industries

Monday, 10 January 1994

- Mr. Aftab Akhtar, Economic Adviser, Federation of Pakistan Chambers of Commerce and Industry
- Mr. Mohammad Malik, Joint Secretary, Ministry of Commerce
- Mr. A. Hassan Qureshi, Advisor for Industry and Finance, The World Bank Office

Tuesday, 11 January 1994

- Mr. Fasih Uddin, Chief Economist, Planning Commission
- Mr. Sajid Hassan, Joint Secretary, Exports, Ministry of Commerce
- Dr. A.R. Kemal, Joint Director, Pakistan Institute of Development Economics

Wednesday, 12 January 1994

- Mr. Jalil Khan, Managing Director, Small Business Finance Corporation
- Dr. Hans-Joachim Esderts, Resident Representative; Dr. Sabur Ghayur, Programme Coordinator, Friedrich-Ebert-Stiftung
- Drs. Wim Stoffers, Project Manager; Mr. Falak Sher, Project Director, PAK/Netherlands Project on Human Resources Development, Data Base Project

Thursday, 13 January 1994

- Federal Bureau of Statistics
- Mrs. Shafqat Sultana, Vice President, First Women Bank Ltd.
- Mr. Masood Tahir, Member, Central Board of Revenue
- Mr. Benoit Girardin, First Secretary (Development), Swiss Development Corporation

Saturday, 15 January 1994

- Mr. Ejaz Ahmed, Programme Manager, Rural Credit and Enterprise Development, National Rural Support Programme
- Mr. James V. Terry, Project Coordinator RAS/92/009 - Innovative Policy Approaches to Entrepreneurial Skill and Micro-enterprises Development
- Mr. Abdullah Yusuf, Managing Director, Utility Stores Corporation of Pakistan Ltd.

Sunday, 16 January 1994

- Ms. Barbara L. Brouwer, Head, Development Section; Drs. E.C. Kengen, First Secretary, Royal Netherlands Embassy
- Mr. M. Aleem Akhter, Regional Chief, Youth Investment Promotion Society

Flight Islamabad-Karachi PK 309

Monday, 17 January 1994

- Mr. Mohammed Ashraf Janjua, Deputy Governor, State Bank of Pakistan
- Mr. Humayun Murad, Managing Director; Mr. H.K. Bharvani, Manager Credit and Marketing, Orix Leasing Pakistan Ltd.

Tuesday, 18 January 1994

- Mr. S. Aziz-ud-Din, Chief Economist; Ms. Mussarat Jalal, Industry Secretary, Government of Sindh, Planning and Development Department
- Mr. Gul Mohammad Rind, Managing Director; Mr. Qadir Bukhsh Channa, Director Administration; Mr. Masood A. Siddiqui, Director Banking and Credit, Sindh Small Industries Corporation
- Mr. Ahmeduddin Hanjrah, Additional Secretary, Government of Sindh, Industry, Commerce and Mineral Development Department

Flight Karachi-Multan-Lahore PK 334

Wednesday, 19 January 1994

- Mr. Muhammad Zia ur Rehman, Member (Planning); Mr. Muhammad Nawaz Khan, Senior Chief, Government of the Punjab, Planning and Development Department; Mr. Sarfaraz Karim Qureshy, Director, Punjab Small Industries Corporation
- Prof. Dr. Khalid Aftab, Principal, Government College Lahore
- Dr. Akmal Hussain, Managing Director, Sayyed Engineers (Private) Ltd.

Thursday, 20 January 1994

## Round-trip Lahore-Gujranwala-Wazirabad-Sialkot-Lahore

- Mr. Raja Asmat Ullah, Secretary, Gujranwala Chamber of Commerce and Industry; Mr. Muhammad Aslan Shaikh, Senior Vice President, Habib Bank Ltd.
- All Pakistan Cutlery Manufacturers and Exporters Association Wazirabad:  
Mr. Sheikh Ihsan Ullah, Senior Vice President;  
Mr. Hameed A. Chadda, Chairman, Partner, New Stainless Industries;  
Mr. Mohammad Saleem, Vice Chairman, Chief Executive, M.A. Asar & Co. (Pvt.) Ltd.;  
Mr. Arshad Iqbal Mughal, Partner, Hofman Import and Export
- Factory visit M. A. Asar & Co. (Pvt.) Ltd.: Mr. Mohammad Saleem, Chief Executive
- The Surgical Instruments Manufacturers Association of Pakistan, Sialkot: Mr. Kifayat Ullah Sheikh, Chairman;  
Mr. Abdul Wahid Mirza;  
Mr. Khalid Aziz Mahmood, Chief Executive, Concorde (Pvt.) Ltd.;  
Mr. Anees Ahmed Malik, Zapaya General
- The Pakistan Gloves Manufacturers & Exporters Association:  
Mr. Mohammad Anwar Butt, Chairman, Managing Director, Spotlight (Pvt.) Ltd.; Mr. Javid Ahmed, Vice-Chairman;  
Mr. Salak-Ud-Din Mir, Former Chairman;  
Mr. Naseer A. Malik, Partner, Danish Trading Corporation;  
Mr. Ehsan Mirza Engr, Project Director, Metal Industries Development Centre, Government of Punjab

Friday, 21 January 1994

## Flight Lahore-Islamabad PK 388

Saturday, 22 January 1994

- Dr. A.R. Kemal, Joint Director, Pakistan Institute of Development Economics (wrap-up session)
- Mr. Olivier Bovet, JPO, UNIDO Islamabad



Sunday, 23 January 1994 (jointly with Ms. Sherin R. Khan, Programme Officer/ILO Islamabad; Mr. F. Pyke, ILO international consultant; Mr. O. Bovier, UNIDO Islamabad)

- Mr. P. Regan, Deputy Resident Representative, UNDP Islamabad
- Mr. Winston Rueben Dudley, Director, ILO Islamabad
- Donors' Coordination Committee Meeting:
  - Mr. Benoit Girardin, First Secretary (Devt) Swiss Development Corporation;
  - Ms. Nasim Sherin, Project Management Assistant, USAID;
  - Drs. E.C. Kengen, First Embassy Secretary, Royal Netherlands Embassy;
  - Mr. James V. Terry, Project Coordinator RAS/92/009 - Innovative Policy Approaches to Entrepreneurial Skills;
  - Dr. Hans-Joachim Esderts, RR, Friedrich-Ebert-Stiftung;
  - Mr. Sharokh Mohammadi, Ass. RR, UNDP;
  - Mr. A. Hassan Qureshi, Adviser for Industry and Finance, World Bank Office Islamabad;
  - Dr. Jarik R. Lette, Project Manager, Pak-German Technical Training Programme;
  - Mr. William Mellgren, CTA Pakistan Chapter, ILO Employment Promotion Project;

Monday, 24 January 1994

- Dr. Irene B. Wilson, CTA UNDDSAS;
- Debriefing UNIDO Office

Flight Islamabad-Vienna

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REVIEW OF THE  
RURAL INFORMAL MICRO AND SMALL ENTERPRISES SECTOR:  
DEVELOPMENT OF AN ACTION-ORIENTED PROGRAMME

NC/PAK/92/039

PAKISTAN

Addendum 2: ILO Report

Institutional Issues

Prepared for the Government of Pakistan  
under UNDP-financed TSS-1 facility

Forming the ILO contribution to a joint UNIDO/ILO TSS-1 exercise, this report was co-ordinated by the Small Enterprise Development Branch, Enterprise and Cooperatives Development Division, based on the work of Moïse Allal, Head, Micro Enterprise and Informal Sector Section of the above Branch, Farid ud Din Ahmad and Maqboal A. Babri as national experts, James Keddie and Frank Pyke as international consultants.

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## 1. EXECUTIVE SUMMARY

### General findings

1.1 Micro and small enterprises (MSEs) are a very important part of the Pakistani economy. Because of the limited absorptive capacity of the agricultural and large enterprise sectors, it is widely recognized that the MSE sector will have to be the main provider of jobs for the rapidly expanding labour force. Estimates indicate that the MSE sector account for some 85% of total manufacturing employment and that as many as nine million persons participate in the rural informal sector. The dominant sectors are food and beverages, textiles and leather, and metal. Despite the large number of MSEs, it is estimated that the sector contributes only ten per cent to total manufacturing output, a clear indication of the inefficiencies and low labour productivity which are major problems for MSEs in Pakistan.

1.2 MSEs are characterized by high turnover in terms of 'birth' and 'mortality' rates with around half being less than five years old, although around ten percent being more than 20 years old. Major constraint to the sectors development include lack of access to infrastructure such as water, power, telecommunications, roads and transport facilities. Thus most MSEs are serving highly localized markets which are characterized by low levels of competitiveness in terms of product quality. Other major constraints include a lack of access to credit, technology, technical and managerial skills training and market information. There are also reports of bureaucratic regulations and procedures as well as harassment by government authorities. Also the sector is characterized by low pay and poor working conditions and the incidence of child labour particularly in certain sectors such as textiles and leather. Despite these problems and constraints the MSE sector has been growing rapidly with some sources indicating annual growth rates of over eight per cent annually in recent years. Recent years have also seen encouraging developments in terms of subcontracting linkages with larger enterprises and the development of new forms of small enterprise networks.

1.3 The typical MSE entrepreneur is male, generally exhibits strong entrepreneurial characteristics but is hampered by low levels of education with around half having only attended elementary school, and by inadequate technical skills which are largely acquired on the job. Female entrepreneurs are subject to a number of particular social and cultural constraints which include relatively lower levels of education, dual family-business roles, a need for male acceptance of their economic role, and certain restrictions in terms of applying property rights for bank collateral.

1.4 Pakistan has a wide range of government institutions involved in the support (financially, technically etc.) of micro and small enterprises. These organizations are found to be of varying quality in terms of their ability to serve the sector. Generally, however they tend to have a very limited impact in terms of outreach and actual numbers served, they are most often not very responsive to the specific needs of the MSE sector, and tend to be bureaucratic and relatively inefficient. Efforts to support the MSE sector are furthermore constrained by a lack of coordination between the various service providers which leads to frequent duplication and gaps in services where they do exist.

1.5 The report also identifies a number of recent innovations in terms of programmes and institutions which could form the basis for development of future strategies for MSE support. These initiatives tend to be public-private partnerships or wholly privately based, such as the Pakistan Institute of Entrepreneurship Training (PIET), the Pak-Holland Metal Project, or the recently restructured Pak-Swiss Agricultural Light Engineering Project. The report also reviews other organizations with an existing or potential role in MSE support including NGOs and private sector organizations such as trade associations, employers organizations and larger enterprises. It is generally found that while many of these organizations exist they generally, this far, play a very limited role and that much could be done to capitalize on the potential which they represent. A couple of positive developments are highlighted, however, including government support for private sector initiatives to set up sectorial-oriented resource institutes and other collaborative ventures by groups of enterprises.

### Major Recommendations

1.6 A number of recommendations are made with regard to making government institutions more effective with regard to supporting the MSE sector. They include further encouraging recent initiatives to forge public-private partnerships including the establishment of private sector led structures which receive public sector financial and other support in such areas as technology, training and information. Such a strategy should draw on the full involvement of industry associations and other bodies representing the private sector's needs and interests. Institutions should be encouraged to acquire more of their income through sale of services though it is recognized that services aimed at MSEs are not likely to ever be fully financially viable. Furthermore, future strategies to support the sector should be based on a strategy of organizational decentralization and close involvement of local government authorities who are likely to be much better placed and more motivated to facilitate the planning and coordination of effective MSE support programmes which meet the local needs and constraints under which the target groups operate.

1.7 It is suggested that a reorientation of the government's role along the above lines will require the development of new attitudes and skills among government officials. A structured programme involving a tripartite national workshop to initiate a national discussion on the problems and issues facing Pakistan and to bring in relevant expertise from other countries which have successfully embarked on similar programmes for more locally based support structures for MSEs, including measures to facilitate enterprise network building and other strategies which have proven to lead to higher levels of small enterprise performance and competitiveness. If successful such a workshop would be followed up by overseas study trips to expose government officials and private sector representatives to good examples of government agencies acting out intermediary roles, and service institutions supporting, in particular, small enterprises. The report introduces several such international examples with particular emphasis on the Valencia Model from Spain in general and their applicability to Pakistan in particular.

1.8 If the above workshop and overseas exposure leads to a consensus that such strategies need to be explored further, the report suggests a number of specific initiatives which should be taken including implementation of provincial level investigations and pilot projects to draw up detailed plans for how specific programmes may be planned and launched with full involvement of all concerned local actors.

1.9 The report also points to the need for better coordination among individual programmes as well as between technical and institutional initiatives and broader aspects of the policy environment.

1.10 A number of suggestions are put forward with regard to encouraging the full involvement of private sector interest groups such as trade associations and trade unions, and facilitating firm level collaboration and networking, including the training of 'brokers' and facilitators as well as the introduction of subsidies and incentive structures.

1.11 Measures aimed at addressing the critical areas of small enterprise product quality and productivity are suggested including the fostering of a quality and productivity culture. It is suggested that such an effort may be effectively combined with strategies for fostering interfirm cooperation and improving occupational safety and health standards in the MSE sector.

1.12 Lastly it is recommended that specific studies be undertaken as a basis for formulating strategies for developing subcontracting arrangements between large and small enterprises.

## **2. PREFACE**

### **2.1 Objective of the TSS1**

The overall objective of the joint UNIDO/ILO mission is to assist the Government of Pakistan in reviewing current efforts to promote the rural and informal small and micro enterprise sector, and to make recommendations on future plans and programmes in this order.

UNIDO, designated as the lead agency for the TSS1 exercise, has covered the aspects related to the policy and regulatory environment in relation to promoting the rural and informal micro and small enterprises sector. Also, UNIDO has covered the mechanisms related to subcontracting and inter-sectoral linkages.

ILO has covered all aspects related to provision of institutional and related services (governmental, non-governmental and private sector firms and institutions) to the sector except those relating specifically to the promotion of subcontractual linkages. This includes measures to provide training, consultancy, market access, credit, technology and other services aiming at improving the performance and productivity of the sector.

Thus, this report deals with the issue of the effectiveness of the existing level of institutional support for small and micro-enterprises in Pakistan and describes some ways it might be improved.

## **2.2 Methodology applied**

The manpower resources involved in the ILO part of the TSS1 mission were two national consultants and two international consultants. One national consultant, Mr. Ahmadi,<sup>1</sup> carried out a survey of the institutional framework while another national consultant, Mr. Babri<sup>2</sup>, carried out a survey of micro and small enterprises in Pakistan.

Two international consultants, with broad based experience in micro and small enterprise development, were assigned for one month each to carry out the TSS1 mission.

An ILO headquarters preparatory mission was undertaken in October 1993 to brief the two national consultants on their respective assignments.

Due to initial problems in implementing the joint UNIDO/ILO TSS1 mission at the originally foreseen time, the ILO team was split into two separate missions. One international consultant, Mr. James Keddie, undertook a mission as originally planned in November - December 1994. However, in order to ensure overlap with the UNIDO mission, the other international consultant, Mr. Frank Pyke, postponed his mission until January 1994.

Thus, this report is built on the observations and findings from the two international consultants' mission to Pakistan in November/December 1993 and in January 1994 respectively.

Both consultants carried out extensive field visits. See Annex 3 and 4 for their programmes. In addition to the surveys undertaken specifically for this mission, the report also draws on other national surveys available and various published reports. See annex 5 for a full list of references.

## **3. THE MICRO AND SMALL ENTERPRISE SECTOR IN PAKISTAN: CHARACTERISTICS, THREATS AND CHALLENGES**

This chapter gives an overall description of the micro and small enterprise sector in Pakistan. Following an overall presentation of the conditions of Pakistan and the micro and small enterprises' contribution to the economic situation, a micro level description of the sector is given. In this part of the chapter, the report focuses on the characteristics and performance of the sector.

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<sup>1</sup> Farid ud Din Ahmad, *Small and Micro Enterprises: A survey of support organizations*, Lahore, 1994.

<sup>2</sup> Maqbool A. Babri. *Small and Micro Enterprises Opportunities and Difficulties: A survey of small and Micro Enterprises based on a nation-wide study of 71 enterprises*, Lahore 1994.

### 3.1 Introduction to Pakistan

Pakistan consists of the four provinces: Punjab; North West Frontier Province (NWFP); Sind; and Baluchistan, the Federal Administered Tribal Areas and the tribal areas along the border with Afghanistan) and the Federal Capital Area (FCA) of Islamabad.

A federal government sits in the capital Islamabad whilst each province has its own provincial government. The national legislature is bicameral. The National Assembly, the lower house, has 217 directly elected members who serve for five years. The Senate, the upper house, has 87 senators. Each of the four provinces elects 19 senators whereas the remaining 11 senators are elected from the FCA and the FATA.

Each of the provinces has a governor, a Council of Ministers headed by a chief minister appointed by the governor and a provincial assembly. It is said that the provinces enjoy considerable autonomy.

Pakistan is the ninth most populous country in the world. The estimated population figure for January 1993 is 124.45 million with an estimated growth rate of 3% which is well above the South Asian average of 2.4%. The population density for the whole county was recorded at 156/square km (1993). However, it should be noted that the population density varies considerably. e.g. in Baluchistan the density was recorded to be 12.5/square km while in Punjab it was 230.3/square km (according to the 1981 census). The majority of the population lives in the fertile Indus river plain in the Punjab and Sind.<sup>3</sup>

According to the official estimate in 1993 the urban population was 31.5% (39.20 million), a slight increase from 1981 where the urban population was 28.3% and the rural population was 68.5% (85.25 million). The population distribution by age and gender reflects the situation of a high ratio of dependants to adults. The estimated population age distribution according to the Pakistan Demographic Survey<sup>4</sup> shows that 46.3% of the males and 45.3 % of females are below 15 years. In the 15 - 64 years age group 49.8% are males and 51.4% females.

Pakistan differentiates herself from most other Asian countries by her extremely low government spending on education. According to official estimates for 1992/93 the literacy rate was 48.9% for men and 23.5% for women. In the urban areas the literacy rate was estimated to average 57% whereas the rural areas were estimated to average 27.5%.

The agricultural sector's contribution to the GDP has fallen from approximately 53% in 1950 to about 29% in 1973 and 23.9% for 1993/94.

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<sup>3</sup> Economic survey 1993/94, Government of Pakistan, Finance Division, Economic Advisor's Wing, Islamabad 1994.

<sup>4</sup> Pakistan Demographic Survey, 1990.

**Table 3.1: Economic Contribution to Gross Domestic Product<sup>5</sup>**

Sector	% contributions to GDP	YEARS		
		1991-1992	1992-1993	1993-1994
Agricultural sector		28.9	24.2	23.9
Manufacturing sector		16.0	18.3	18.6
Large-scale manufacturing sector		12.5	12.9	13.0
Small-scale manufacturing sector		3.5	5.4	5.6

Nevertheless, agriculture is still the largest single contributor to the GDP with manufacturing accounting for less than one-fifth of the GDP. However, it should be noted that the sectoral growth rates have been highest in mining, manufacturing, utilities and transport.<sup>6</sup>

The total size of the Pakistani labour force was in 1993/94 estimated at 34.98 million. Hereof, 10.25 million was urban and 24.73 million rural.<sup>7</sup> See Table 3.2.

**Table 3.2: Labour Force Statistics<sup>8</sup>**

	1990/91	1991/92	1992/93	1993/94
Total labour force (m)	31.83	32.97	33.97	34.98
Rural	22.37	23.30	24.00	24.73
Urban	9.46	9.67	9.97	10.25
Participation rate	27.97	28.11	28.11	28.11 <sup>9</sup>
Rural	28.70	28.99	28.99	28.99
Urban	26.37	26.08	26.08	26.08
Unemployment	6.28	5.85	5.85	5.85
Rural	5.48	5.40	5.40	5.40
Urban	8.19	6.97	6.97	6.97

<sup>5</sup> Pakistan Demographic Survey 1990.

<sup>6</sup> Economic survey 1993/94, Government of Pakistan, Finance Division, Economic Advisor's Wing, Islamabad 1994.

<sup>7</sup> Economic survey 1993/94, Government of Pakistan, Finance Division, Economic Advisor's Wing, Islamabad 1994.

<sup>8</sup> Labour Force Survey 1990/91 to 1993/94.

<sup>9</sup> 1993/94 participation rate figures are estimated on the basis of labour force survey 1990/91, 1992/93.

As reflected in the above table, the participation rate has been constant around 28% during the past years. The very low percentage of women in the labour force (according to Labour Force Survey 1991/92 about 9% of women aged over ten years) explains why this rate has been at this low level.

The official estimate of unemployment is 5.85%. However, this does not reflect the proportion of the labour force that is underemployed (i.e. working less than 35 hours a week). Also, only about a quarter of the employed labour force are wage earners. This indicates that family labour is extensively used in the rural areas and that casual and self-employed labour is preponderant in the urban areas. In 1990/91 in the rural areas the percentage of waged employees was 20.1% in comparison with 45.4% for the urban areas.

In 1990-91 36.2% of the rural labour force was engaged in the non-agricultural activities.<sup>10</sup>

**Table 3.3: Employment by sector<sup>11</sup>**

	1987/88		1992/93 <sup>12</sup>		1993/94 <sup>13</sup>
	Million	%	Million	%	Million
Agriculture	13.46	51.2	16.05	47.5	15.98
Manufacturing and mining	3.36	12.8	4.19	12.4	4.11
Construction	1.68	6.4	2.23	6.6	-
Utilities	0.15	0.6	0.27	0.8	-
Trade	3.13	11.9	4.46	13.2	4.32
Transport	1.29	4.9	1.76	5.2	-
Other Sectors	3.23	12.2	4.84	14.3	-
<b>Total</b>	<b>26.30</b>	<b>100.0</b>	<b>33.80</b>	<b>100.0</b>	<b>-</b>

The above Table 3.3, reflecting the employment pattern, indicates the structure of the economy and its changes. In 1992/93 the agricultural sector accounted for an estimated 47.5%

<sup>10</sup> A.R. Kemal; Informal Sector in Rural Pakistan. December 1993. Mr. Kemal was the national consultant assigned to the UNIDO TSSI team.

<sup>11</sup> The Economist Intelligence Unit Country Profile 1993/94, Pakistan.

<sup>12</sup> Estimates.

<sup>13</sup> Estimated on the basis of Labour Force Survey 1991/92.



of the labour force while it accounted for 60.5 % in the 1960s. For the same span of years the employment for the mining and manufacturing sectors has decreased from 13.6% to 12.4%. Increases in employment have been seen in trade, construction and transport.

In conclusion, greater unemployment is expected during the coming years. Main factors contributing to this trend are: increased female participation in the labour force; growing urbanization; a continuing shift to more capital-intensive production methods in both agriculture and industry; the diminishing capacity of the public sector to absorb labour and the net fall in migration.

**Table 3.4: Agricultural and manufacturing sector's economic contribution in 1993/94<sup>14</sup>**

Sector	Agriculture	Manufacturing
% Contribution		
Gross domestic product	23.9%	18.6%
Employment	48.27%	12.28%
Exports	11%	66.6%

The above table reflects the importance that the agricultural sector carries in terms of employment and economic output, accountable for almost half of the employment and one fourth of the gross domestic product in 1993/94. The manufacturing sector is a key sector in terms of exports where it was accountable for almost 67% in 1993/94.

It should be noted that the small enterprises's share of the manufacturing sector's contribution to the GDP accounts for about 6 of the 17%. In 1987/88 this share was 5%.

Looking at the forecast for the coming years, it is expected that these two sectors' contribution to the GDP will increase by an average of 5.5% per year for the manufacturing sector and an average of .5% for the agricultural sector.

It is clear that neither the agricultural sector nor the large companies in industry will be capable of absorbing the growth in the labour force. There are therefore high expectations for the small scale enterprise sector to provide future jobs.

This point was emphasized in a recent paper prepared by the Ministry of Local Government and Rural Development.<sup>15</sup> The paper points out that labour absorption in the agricultural sector seems to have declined with the passage of time. The paper emphasizes that the small scale industries while having the potential to create greater employment and

<sup>14</sup> The figures in this table are estimates.

<sup>15</sup> Country Paper for: ILO Sub-Regional Seminar on Employment Policies for the Rural Informal Sector in South Asia, New Delhi, India. 22-26 November 1993: "Employment in the Rural Informal Sector". Zaheer Ahmad, Joint Secretary, Ministry of Local Government and Rural Development.

better income distribution have not received adequate support. The paper concluded that greater emphasis on this issues is necessary.

### **3.2 Definition of MSEs**

Taking the Pakistani conditions into due account an enterprise cannot generally be regarded as small if it provides more than 25 full time jobs including those of the proprietor(s). This is therefore the working upper limit definition of a Pakistani small enterprise used in this report. In line with customary practice, the term micro and small enterprise has been taken to exclude small-holder farming enterprises.

The distinction between small and micro is also fluid. Internationally, an often accepted dividing line is that employment in a micro enterprise can be as high as 9 or 10 jobs. One of the criteria justifying this dividing line is that enterprises below it are generally "informal" in the sense of having no fixed or officially recognized premises, or being largely outside the normal attention and regulations of the authorities, whether national or local.

However, when applying this criterion in Pakistan the dividing line should be set much lower. Probably a micro enterprise would provide only 3 jobs or less. Beyond that size there would appear to be only small and gradual changes in operating modes (use of machinery, training and education of those employed, fixation and ownership of premises, access to loans etc) and regulatory environment (habitual exposure to government inspectors and tax officials) up to the working upper small scale employment limit of 25 jobs, and perhaps even beyond that.

Also, it may be that the dividing line varies with the sub-sector considered. In trade, the typical micro enterprise may provide 2 jobs or less, most micro enterprises larger than this having fixed premises and regular full time operations which tend to attract the attention of officials.

On the other hand, in "mobile" sub-sectors such as transport and construction which tend to be less visible, informality may indeed extend up to enterprises with 9 or 10 jobs.

Though the above provides a uniform and operational definition of micro and small enterprises it should be kept in mind that these business units vary considerably in terms of their economic activities, levels of employment, productivity and profitability.

### **3.3 MSEs' economic contribution**

Small and micro enterprises are clearly a very important part of the Pakistani economy. For example, in the Sind province, in Karachi, a city of 7 1/2 million in Sind small scale industry is very significant. In all the six largest sectors<sup>16</sup> except transport equipment, over

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<sup>16</sup> The six biggest formal sector industries, in order of size (numbers of employees): Textiles; Iron and Steel; Garments; Transport Equipment; Fabricated Metal Products; and Food - employ 64% of the total number of people employed in registered manufacturing establishments in Karachi. Textiles and garments alone employ a third.

80 per cent of registered establishments (employing 10 or more people), employed between 10 and 50 people at the end of 1991.<sup>17</sup>

When workshops employing less than 10 people are brought into the picture the quantitative importance of small enterprises becomes even more significant. A recent report on the informal sector reported a World Bank paper as estimating that the small scale sector, employing an average of 2.3 people, accounts for 85 per cent of total employment in manufacturing (Enterprise and Development Consulting, 1991).

Major activities in the urban informal sector include textiles, food processing and metal working (Enterprise and Development Consulting, 1991). The informal sector accounts for some 75 per cent of total employment in urban Sind and Punjab (Enterprise and Development Consultants, 1991). A rough estimate from sources inside Sind Regional Government Labour Department suggests that there may be as many as 130,000 workshops employing less than 10 people in Karachi alone.

As many as 9 million persons participated in the rural informal sector. Here the proportional significance of very small enterprises, with an average size of around two people, appears even greater.

**Table 3.5: Distribution of employed rural labour force<sup>18</sup>**

	<b>Employers</b>	<b>Self-employed</b>	<b>Unpaid family helpers</b>	<b>Employees</b>
Manufacturing	1.1	52.6	16.4	29.9
Construction	0.3	59.7	3.9	36.0
Trade	3.4	73.4	12.0	11.2
Transport	0.6	50.4	5.5	43.5
Community and Personal services	0.1	30.7	5.6	63.5
<b>Total</b>	<b>1.2</b>	<b>52.4</b>	<b>9.3</b>	<b>37.1</b>

Source: Based on labour force survey (1987/88)

<sup>17</sup> Calculated by the author from statistics in: The Directorate of Labour Year Book for Sind, 1991/2.

<sup>18</sup> A.R. Kemal, Pakistan Institute of Development Economics: Informal Sector in Rural Pakistan, December 1993.

Table 3.5. illustrates the percentage distribution of employed rural labour force in the non-agricultural activities. The vast majority, in general more than half of the total, are self-employed. This indicates that the business units are very small (less than 2 persons per unit).

When looking at the average size of the firms in the rural manufacturing industries at a provincial level, it is seen that the average size ranges from 1.87 persons in Baluchistan to 2.36 in Sind while Punjab and the NWFP have average sizes around 2 persons per unit.

Rural areas are said to have virtually no large scale industry but rural manufacturing still accounts for 48 per cent of Pakistan's manufacturing sector. Food processing and carpet weaving are particularly dominant.<sup>19</sup>

Due to the possible backwards and forwards linkages the manufacturing sector plays a central role in the income generation and in creating employment opportunities in the rural areas. Within the manufacturing sector three subsectors (food and beverages, textiles and leather, metal products) seem to dominate as it has been reflected in the following table 3.5..

**Table 3.6: Three manufacturing sub sectors' dominance**<sup>20</sup>

Three main manufacturing sectors	Food and beverages textile and leather metal
Present ages	
Number of companies in urban areas	69%
Fixed assets	75%
Employment	69%
Value adding	70%

The rural areas account for 48 % of the labour force employed in the manufacturing sector. However, the share of the small scale manufacturing output is only 10%. The lower share in output in comparison with the share of employment is a clear indication of the productivity of labour, which is relatively low.<sup>21</sup> This is due to a low total factor productivity and the fact that very labour intensive industries (e.g. wheat milling and carpet weaving) account for the main part of the output.

The composition of the manufacturing output in the rural areas has changed considerably during the past ten years. As indicated above, the majority of the output is generated from the above mentioned three subsectors (inclusive of carpet weaving and wheat milling) and the traditional goods industries.

<sup>19</sup> A.R. Kemal: Informal Sector in Rural Pakistan. December 1993

<sup>20</sup> World Bank: Islamic Republic of Pakistan - Micro Enterprise Project, March 1991.

<sup>21</sup> A.R.Kemal: Informal Sector in Rural Pakistan. December 1993

### 3.4 Micro and small enterprises: characteristics and performance

#### 3.4.1 Characteristics of the MSE sector

The rural entrepreneurs are, on an average, 42 years old. They are pursuing the profession of the father and have the same level of education as that of their workers. A vast majority (81%) used the traditional modes of production and as many as 60% did not buy any new tools and equipments. Only 36% had bought some kind of new equipment during the last three years.<sup>22</sup>

In general, the rural entrepreneurs do not have difficulties with access to raw material. The raw materials are obtained from two sources, i.e. either from the manufacturing sector or from the local area.

Many rural industries are young. Almost half of the manufacturing units are less than five years old which, probably, indicates both a high "mortality rate" and a high "birth rate". Nevertheless, about 11 % of the units were older than 20 years which indicates that a considerable portion of the units do survive in the long run.

The rural entrepreneurs have selected the location based on four main issues: 1) closeness to market; 2) closeness to their residential area; 3) availability of skills and 4) ancestral associations.

Adequate infrastructures and access to essential facilities (electricity, water, road etc.) play a pivotal role in the growth and overall performance of the rural industries. For rural Pakistan the infrastructures are not adequate. Only 47% had access to water. 79% had access to electricity and 76 % to paved roads. Industries located inside villages had even poorer facilities.<sup>23</sup>

The rural industries target the rural local markets or, at least, geographically near-by markets. The closeness to the market reduces the dependency on the transport system and lowers costs. It is through personal and intimate contacts with the customer that the demand is met.

The financial requirements are, due to the size of the industries, not high. In general, institutional credit is not available<sup>24</sup> and the majority of the entrepreneurs have relied on family savings and/or loans from relatives or friends. Another important source of credit is the suppliers' credit for both equipment and raw material.

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<sup>22</sup> A. R. Kemal: Informal Sector in Rural Pakistan. December 1993

<sup>23</sup> A. R. Kemal: Informal Sector in Rural Pakistan. December 1993

<sup>24</sup> In this connection it should be mentioned that the rural industries have a serious comparative disadvantage. Very few rural entrepreneurs have the competence to read and write English which is the official language for interaction with the banking system.

The majority of the entrepreneurs have been privately-trained. Relatively speaking, few seem to have received skills from any formal training course or exercise. This is indicated in the survey of small and micro enterprises<sup>25</sup>. Almost one fourth of the sample had no formal educational background. About 50% (inclusive of persons with no educational background) of the sample had not received training beyond elementary school. One fourth of the sample had received either vocational or college training.

When the sample entrepreneurs were asked about training, 70% responded that they had received some training. Of those, the majority had received the training on-the-job.

Furthermore, the micro and small scale entrepreneur regards the graduates of such courses as being typically (a) too theoretical to be useful (b) too expensive to hire or (c) liable to leave the enterprise for other employment, based on his training certificate.

Notwithstanding the entrepreneurs' limited formal training many exhibit considerable technical skill in practice. When the entrepreneurs were asked whether they had the skills required prior to starting their own businesses, a distinct majority said that they had the required skills to start the businesses. Naturally, this is merely a reflection of a subjective opinion. Nevertheless it does reflect that the entrepreneurs do not perceive a need to up-grade their own skills.

The opinion of local experts is that technology, skills and productivity in the small scale sector is generally inadequate and needs upgrading, especially in rural areas. Responses from respondents for small enterprise survey<sup>26</sup> suggest that entrepreneurs (in both rural and urban areas) might be aware of their technological weaknesses. For example, when asked what needed to be done to strengthen their enterprises 30 per cent (27) of the enterprises surveyed mentioned a need for machinery, and 27 per cent (19) said they would like to borrow money to buy more machinery. When asked about problems they perceived they were facing 20 per cent (14) mentioned inadequate technology.

In conclusion, in spite of the infrastructural inadequacies and inefficiencies, the lack of institutional credit, technology & skills and sophisticated markets, the micro and small manufacturing rural industries have grown. The focus on simple technology and labour intensivity has made the survival possible. However, this pattern sustain inefficiencies. This has been the experience of the Agricultural Light Engineering Programme (for further details see Section 5.2.3) which aimed at the promotion of enterprises in the production of agricultural machinery and equipment in the NWFP. The final report of the project<sup>27</sup> argues

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<sup>25</sup> Maqbool A. Babri: A Survey of Small and Micro Enterprises Based on a Nation Wide Study of Seventy-One Enterprises. National consultant assigned to the ILO TSSI team.

<sup>26</sup> Maqbool A. Babri: A survey of small and micro enterprises based on a nation wide study of seventy-one enterprises. January 1994.

<sup>27</sup> John Grierson, International expert in the Agricultural Light Engineering Programme: Final report 1990.

that, based on the experience of the project with this industry in Punjab and the NWFP, only the well-linked, specialized and efficient rural manufacturers will survive.

### 3.4.2 Behavioural characteristics of the entrepreneurs

Through several encounters with entrepreneurs and persons in close contact with entrepreneurs (e.g. the ILO and the UNIDO national consultants assigned to this TSSI exercise) the mission found that the following perceptions of MSE characteristics<sup>28</sup> should be added to the previous, more quantitative, description of the sector.

Though many of these characteristics are generally applicable it is found that they are worth a brief listing here. It may be noted that the perceptions are not mutually exclusive. To some extent, they overlap each other.

The Pakistani micro or small entrepreneur typically exhibits considerable self-reliance and enterprising spirit, which often leads to fairly rapid and substantial growth in assets and employment in the enterprise. Moreover, these characteristics are shared by a substantial proportion of their (male) workers. Frequently, these workers desire and do indeed achieve to set up their own enterprise either in the same, or a related, line of business.

An illustrative anecdote: A metal-working enterprise interviewed by the mission in Mingora, a medium-sized and rather remote town in NWFP, was set up some years ago by a Punjabi. He first came to Mingora from the Punjab as a textile-operative working in one of the town's medium-scale silk-weaving mills. He saw that these and other local factories needed a machine shop for parts and maintenance service. He went back to the Punjab, obtained employment in such a small private machine shop, and learnt the necessary skills. He then returned to Mingora, set up his shop with his own savings. It now employs six people and four working machine tools, at least one of which - a milling machine - was bought second-hand and inoperative, and was restored to working condition by the proprietor and his two sons.

Almost certainly, the above anecdote could not be told of a female micro or small scale entrepreneur of working-class origins, because of the different social conventions governing men and women in Pakistan. The mission should like to point out that this is a crucial distinction. There may be entrepreneurial opportunities open to and successes among educated middle-class Pakistani women. However, the vast majority of women in Pakistan are denied the opportunities open to working-class men for completely self-reliant and hard-driving entrepreneurial advancement from lowly beginnings. This point will elaborate on this under section 3.4.2. Women entrepreneurs.

The MSE entrepreneur is typically very independent-minded and fiercely competitive. Although, he may trade with other entrepreneurs commercially, he does not readily cooperate with them. Exceptions being "self defence" against an obvious common "adversary", e.g. the tax-collector.

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<sup>28</sup> The majority of the cases which form the basis for the description were from Punjab and NWFP.

The MSE entrepreneur is "on his own". Apart from representation from "self defence" associations, and the occasional bank which may receive his deposits but will very rarely grant him loans, he is not in receipt, and has never been in receipt, of any services from directed support service institutions. In this context the mission does not include private profit-oriented firms, which may sub-contract work to him to further their own commercial interests, into the definition of support service institutions.

The MSE entrepreneur is secretive and distrustful of outsiders, particularly those who may possibly be connected with government. Even officials of institutions rendering useful technical and credit services to MSEs in a continuous relationship which may stretch back several years - such as the Pak-Holland Metal Project (PHMP) in NWFP - confess that they do not believe statistics given them by their MSE clients. The clients fear the tax-collector may enter after the project<sup>29</sup>.

Analogously, partners in MSEs are typically close relatives: and MSE entrepreneurs are reluctant to put up non-family employees for upgrading training, for fear they may leave the enterprise afterwards.

The MSE entrepreneur has an ambivalent attitude towards the government though mostly adversarial. On the one hand, he may expect, and sometimes depend on, preferential policies from government, e.g. particularly the small - not micro - enterprises in certain industries such as cotton textiles. Or, he may hope for publicly-supported loans at subsidized rates he can "afford". Or he may be willing to contemplate accepting training services, if they are offered to him free. In other words, he hopes for "favours" from government.

On the other hand, his perception of day to day experience with government officials and policies in practice is generally one of frustrations, botherations, and petty oppressions<sup>30</sup>, without the receipt of any effective directed services. Thus government is, at one and the same time the hoped-for saviour of some MSEs, and the perceived tormentor or obstructor (more or less onerous, varying from enterprise to enterprise) of most of them. An episode from Mr. Babri's survey mentions that "one labour inspector demanded that a restaurant keep in the dining hall red painted buckets of water and sand as well as a fifteen feet long ladder. The roof of the restaurant is only 10 feet high. The restaurant owner had to pay gratification to get the official off his back".

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<sup>29</sup> For confirmation from another (in this case, published) source, see Sahibzada, M.H. and Illahi, R. (1991): *Rural Industries; Employment and Income Enhancement for the Working Poor* (Pakistani Case Study), CIRDAP, Dhaka, p. 109

<sup>30</sup> See, for example, Sahibzada, M.H. and Illahi, R. (1991): *Rural Industries; Employment and Income Enhancement for the Working Poor* (Pakistani Case Study), CIRDAP, Dhaka, p. 60, for comments on this point. It is worth noting that the authors of this study are themselves civil servants, in the Federal Ministry of Local Government and Rural Development: and that in the opinion of the ILO national consultants, rural MSEs are probably *less* exposed to harassment by officials than their urban counterparts.



Very rarely does the micro and small scale entrepreneurs perceive the government as an efficient and impartial provider of services or impartial "holder of the ring" in which they may be enabled to compete in a stable and well-ordered environment generally conducive to enterprise.

The entrepreneurs participating in the survey done by the ILO national consultant<sup>31</sup> were asked which actions they expected from the Government. Multiple answers were provided. However, the majority (42%) suggested that government should provide financial assistance; some suggested that taxes should be reduced and some requested improvement in the infrastructure. Other expectations were on marketing support, manpower training, technology.

The above perceptions are, primarily, based on discussions with, and about, male participants in MSEs<sup>32</sup>. Though supported by several survey, these perceptions are not the results of formal statistical surveys.

### 3.4.3 Women entrepreneurs

Naturally, the gender of MSE entrepreneurs does not affect the general principle that many of entrepreneurs, be they men or women, may benefit from various directed support services, e.g. skill and technology transfer, marketing or credit. However, the basic social position of women in Pakistan is so different from the position of the men, that the *design* of the services directed at women must differ from those directed at men.

Furthermore, the women may need complementary measures which are not needed to promote the male entrepreneurs, which at the present time constitute the majority of the business units in the MSE sector.

In this section the mission will present its observations concerning the general status of women and their attitudes. Such features will have an extensive influence on the design of the support services. Also, this latter issue will be touched upon.

If it is taken as a "given" that, whilst maintaining the basic Islamic moral principles to which most Pakistanis (of both sexes) subscribe, women should be brought into the

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<sup>31</sup> Maqbool A. Babri: A survey of small and micro enterprises based on a nation wide study of seventy-one enterprise. January 1994.

<sup>32</sup> It is believed that all the main Mission members - international and national - are male. It will therefore be difficult for the Mission to obtain direct perceptions of MSEs with heavy female participation, except by being kindly conducted - as was the Consultant- by institutions (NGOs, donor agencies and projects, etc.) to their women clients. This biases the female MSE 'sample' interviewed, and probably also biases the responses received, in the presence of sponsors, from the women interviewed. There is therefore a strong case for a national consultancy (conducted by a woman) on female MSE practices, based on MSEs where there is no prior knowledge whether they have received directed support services, and conducted without the introductions or presences of institutions providing them. The consultant should ideally not have any current, nor strong recent past, connection with such institutions. She should regard the assignment essentially as an impartial 'market research' exercise. It is not known whether these conditions can be fulfilled, particularly within the time-frame of the TSS1 Mission.

economic mainstream on increasingly equal terms with men, then a broad-based approach must be taken.

Since the majority of Pakistani women are dependent on male approval of their economic activities, mainstreaming can only be brought about by progressively winning male approval of the expansion and diversification of those activities. It cannot, therefore, be done in direct opposition to the wishes of the men.

In Pakistan it has been the experience that even comprehensive packages of directed support services to potential female MSE entrepreneurs (e.g. technical and business training, motivational support, marketing assistance, credit, etc.) have generally failed. When it came to the point, the male relatives of the women entrepreneurs did not fully accept the changed economic role these women would eventually enjoy. Given the Pakistani social conventions, these women could not resist such lack of male acceptance. Thus, the potential enterprises were mostly still-born<sup>33</sup>.

One component of the required broad-based approach has already been noted above. Formal training of increased numbers of women in modern technical skills is to be encouraged. With most women graduate-trainees entering formal-sector employment, they thereby gain increased economic experience, and economic interaction with men.

This will progressively strengthen both women's general economic competence/confidence as well as male acceptance of diversification of their economic role in society. In other words, it will contribute to a gradual and voluntary change in social values. From an MSE standpoint, some proportion of the skilled women working in the formal large-medium sector, may at a future date be expected to set up on their own as MSE entrepreneurs.

Other measures to change values progressively and voluntarily are also probably indicated. They include training of mainstream public officials (mostly now male) in many departments - and likewise of male bank officers - in recognition of the economic potential of female MSEs, and in ways of assisting, rather than resisting this potential.

For example, working with the Capital Development Authority, ECI has recently won the acceptance of the Authority to the principle of female-owned and -operated trading MSEs in the Islamabad public markets. The Authority has allocated lots for such enterprises in one of the main public markets. However, the capital to build the necessary MSE premises is now lacking.

Other approaches already being adopted include radio and television programmes favourably airing the concept of female-headed MSEs and their contribution to family and household livelihood. Such programmes may be especially effective if they partly focus on

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<sup>33</sup> Information provided by ECI (Entrepreneurship and Career Institute), a private consulting company located in Islamabad, and targeted at female MSE development. ECI grew out of an NGO. Its principals decided that it would be more efficient at its job, if it were privatized on a 'for profit' basis.

actual "success stories" of female MSE entrepreneurs, with due prominence given to the explicit approval of their husbands or other male relatives to their success.

It will be noted that all the above components stress the integration of male and female economic roles and/or attitudes, not a pattern of segregated development promoted only by separate women-only institutions, departments, banks, etc. For example, it may be that in preliminary community work, male social workers should work in teams with their female counterparts. In some circumstances, this might mean their jointly-addressing the same (mixed) audiences. In others, the work could proceed in a physically separate but parallel mode, the men talking to and following up with the men, the women with the women, but with a common and consistent message about the opportunities, and benefits to both sexes, of female-headed MSEs.

These complementary or preliminary measures will all have a profound impact on the design, potential, and limitations of more specific directed support services. In the following, a number of features about women's general status and attitudes, that needs to be taken into account<sup>34</sup>, is presented:

- **Confidence & Support:** Potential female MSE entrepreneurs need to be convinced that they will be allowed, by male social and economic nexuses, to set up and operate MSEs: that the prospect is feasible and potentially beneficial.
- **Dual roles:** Women must be able to reconcile their MSEs with what are perceived to be their essential familial responsibilities. It is unacceptable for a woman to pursue an economic activity that leaves her husband and children, or perhaps other relatives, uncared for from day to day<sup>35</sup>.
- **Safety & Moral:** Partly for the above, and partly from fears - however well-grounded or unfounded - about their safety and/or morality, frequent and unaccompanied long-distance travel by women MSE entrepreneurs is unacceptable. So, usually, is prolonged absence away from home for training in distant locations.
- **Male consent:** Although women fairly frequently hold title to land and/or houses, the consent of their male relatives must be obtained before such real property can be used as collateral for a loan.

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<sup>34</sup> As with practically all generalizations, exceptions may be found. It is taken as read, that the following statements should be qualified by 'normally' or 'in the vast majority of cases'.

<sup>35</sup> This does not mean that women MS entrepreneurs must usually be unmarried, childless, or separated from their husbands and children. Four women MS entrepreneurs were interviewed by the Consultant. The first two were unmarried; the third was separated from her husband, but lived with her two (non-adult) children; the fourth was married with eight children, and living with them and her husband. However, this last woman noted that both the other female MS entrepreneurs she knew of in her village, were also married and living with their husbands and children.

- **Independency:** There is no social restriction on women having independently-disposable savings-accounts; and the gold which some of them possess can sometimes be accepted by a bank as collateral.
- **'Down to business':** While there may be initial resistance from male traders or purchasing managers to face-to-face approaches by female MSE entrepreneurs exploring markets or selling their products, such resistance fades away into a normal trading relationship once the men are convinced of the women's seriousness, competence, and reliability as suppliers.

These features have several more or less obvious implications for directed support services.

First, it cannot be expected that women will, like men, spontaneously set up myriads of MSEs, which it is the basic task of support services merely to upgrade. Female MSE entrepreneurs must usually be encouraged and helped to set up their enterprises. This may include motivational and basic business training. It also involves accompanying them in their initial public contacts with male traders or buyers, whether for market research or, often, for obtaining their first orders.

Second, set-up training, of whatever type, must usually be free or heavily-subsidized. Most women have neither the means nor the initial entrepreneurial motivation to pay for such training at full-cost rates. Furthermore, the training must usually be conducted in ways which permits the trainees to return to their homes each evening.

Thirdly, female MSE entrepreneurs will face fairly severe comparative disadvantages - but no more than that - in trying to get loans even from mainstream banks. Specialist banks for women may have a role to play. However, they are by no means the only potential providers of savings or credit facilities for female entrepreneurs.

Fourthly, most female-headed MSEs will for the foreseeable future be operated out of the entrepreneurs' own or family residences, and/or the residences of other women producing on sub-contract to the female MSE entrepreneurs. This means that markets will mostly be local, but that is also true of most male MSEs.

However, the sectoral range of enterprises will be technically restricted. More important still, home-based production, even accompanied by the female MSE entrepreneur's venturing-out to purchase and sell, means that spontaneous imitation of success, new techniques or business strategies, etc. will be far less rapid and widespread than amongst male-headed MSEs, whose core operations are generally conducted in fixed public premises for all males to see<sup>36</sup>.

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<sup>36</sup> All the four interviewed female MS entrepreneurs' operating bases were their homes: and none could indicate any successful attempts to imitate their enterprises (either by neighbours' copying, or by employees' branching out on their own) by other women. Three of the enterprises designed, financed, and traded textile products (clothes, bed-linen, embroidery) with the bulk of the actual production being done other women in their own homes on sub-contract. The fourth, a food processing enterprise, based all of its production in the entrepreneurs' own residence.

Accordingly, the directed services to support women MSE development, relative to those targeted at male MSE entrepreneurs, will be:

- **More costly:** The cost of stimulating an enterprise will be higher as set up (not merely upgrading) support services are required, and indirect MSE-stimulation by imitation will be much more restricted;
- **Difficult to sustain financially:** The costs per enterprise directly served will probably be higher, while the capacity and the willingness to pay for such services will be lower. For example, it will be recalled that the Pakistan Institute of Entrepreneurship Training (PIET) is able to cover its course-operating costs by charging RS 600 per day per trainee to its (institutional, or male MSE) clients. In contrast, ECI charges its female MSE clients Rs 28 per day per trainee, and laughs ruefully at the very notion of covering its course-costs from these or higher fees.

These are not arguments against female-targeted MSE support services. On the contrary, one must start somewhere with an "infant industry". In the long run, as more and more women MSEs develop, some of them operating in public, cost-effectiveness of services will increase, and the need for subsidy will decline.

The financing of women's MSE directed support services is also a matter for concern. In Pakistan, the provision of such services by NGOs or private contractors such as ECI, is very largely donor-financed. Neither the public sector, nor the beneficiaries themselves advance much, if any, funds to these third-party service institutions. To base services on donor-funding is hardly a sustainable or "bottom-up" strategy.

Pakistani public money in this field, on the other hand, goes almost exclusively towards financing efforts by public-sector departments. These were not extensively observed by the Consultant in respect of women's MSE development. The departments concerned (the Department of Social Welfare, etc.) probably have a higher than average level of genuine development motivation, which is a good starting point.

Finally, with respect to financial services for female MSE entrepreneurs, it has been argued above that there may be roles for both "mainstream" and specialist women's banks in providing such services. However, the mission found that the one such specialist bank, the First Women Bank (FWB), gave rise to some questions about its suitability for this role. It is a public-sector nationwide institution. It was set up in the mid-1980s by a consortium of the big public-sector banks. Today it has twenty-four branches. Even if its parent-banks are privatized the FWB (being profitable) will be retained by the government in the public sector.

Some of its senior staff would like to see FWB privatized as well. They consider it bureaucratic and political. For example, its Small Loans' Scheme for (female) Micro-Businesses is government-funded and -inspired. The interest-rate is very much below-market, at 10% per annum. FWB is reportedly under intense government pressure to disburse loans under this scheme sometimes against its better judgement.

A glance at its figures reveals another motivation for government retention of FWB. Its deposits are nine times as great as its advances to borrowers. Much of the difference is

invested in Treasury Bills, Government Bonds, etc. Thus in effect FWB is functioning primarily as a savings banks, with most of the savings financing general government operations. Not surprisingly, it is profitable, and the public sector also owns its profits.

Moreover, according to the (few) female MS entrepreneurs interviewed, together with ECI, FWB is in practice almost as bureaucratic and conservative in its lending procedures as the mainstream banks. For example, when the NWFP rural women's training project approached the bank for loans for its potential female MSE entrepreneurs, the FWP agreed in principle to make up 50 small loans on pilot-basis. However, its real wish was for the project to provide its own credit funds which FWB would then administer. Thus it also wishes to perpetuate and extend the flawed principle of lending other agencies' money, rather than risking its own.

In conclusion, the mission should like to point to the report of an ILO mission on reviewing the Women in Development Programme in Pakistan.<sup>37</sup> The report analyses issues and challenges for women's employment and working conditions and gives recommendations on the creation of an enabling environment as well as the policy and programme framework.

#### **3.4.4 Emergence of new flexible production networks**

As pointed out earlier in this report, the small scale "informal" sector is large and growing rapidly. Messrs Kemal and Mahmood (1993) report that during the period 1970-1990 small scale manufacturing enterprises employing less than 10 people have grown at a rate of 8.4 per cent a year. Since then it is known that strong growth has continued. It is further well known that there are strong links between large parts of the informal small scale sector and the larger scale formal sector, especially, possibly, in urban areas.

Indeed, there is good evidence that the strong growth is linked to a trend for Pakistan to take on many of the flexible organizational practices prevalent in other countries. Three interviews carried out by this mission with businessmen from larger establishments in Karachi, in the province of Sind, suggested that in Pakistan, as in other countries, many large firms are breaking up their units, focusing on certain products or processes, and sub-contracting the rest of activities out to small suppliers. Specialization and organizational flexibility have become the watchwords. These men, all prominent in the eight Karachi Chamber of Commerce, stated that such practices are now common - at least in urban areas.

Unregulated establishments in the informal sector that are not subject to certain labour laws or trade union activity, and which offer special tax savings, appear to be favoured as suppliers.

Although all three respondents were from the textiles and garment industry all three confidently asserted that decentralized, flexible networks of specialized firms had become the norm in many industries in Pakistan.

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<sup>37</sup> International Labour Organization, regional Office for Asia and the Pacific, Bangkok 1993. "A review of the WID programme in Pakistan with particular focus on women's employment and working conditions". 20 - 29 September 1993.

Some support for this trend comes from a recent comprehensive report on the textiles industry which stated that many of the larger integrated spinning and weaving mills have specialized by withdrawing from weaving at the same time that there has been a growth in small scale weaving establishments, with "the ratio of very small mills (having no more than 4 looms) estimated to be considerably high" (JICA, 1992, p. II-20). This report confirms the generally held view that the growth of the very smallest establishments has been connected to exemptions from labour, social security, and tax regulations, but it also points out that producing through small establishments provide advantages of small lot flexibility. So significant have the many thousands<sup>38</sup> of "flexible" small and especially micro establishments become that they now produce 90 per cent of all Pakistan's cotton fabric production (JICA, 1992).

Further support for this view - of the existence of strong subcontracting, "putting out" and credit links between larger firms in the formal sector and smaller units in the informal sector - comes from Ahmad (1993); and also from Kemal and Mahmood (1993) who found, for example, that 90 per cent of the urban informal manufacturing sector in Sind is involved in sub-contracting, and 94 per cent of these very small enterprises are supplying the larger (or at least less small) firms in the formal sector. Other studies have found that about 60 per cent of informal manufacturing in textiles and metal products industries for Pakistan as a whole is being carried out for the formal sector (Enterprise and Development Consulting, 1991).

#### Growing Use of Sub-Contractors

"Firms in the regulated sector have made increasing use of the "putting out" system and labour sub-contracting in recent years, partly to save capital and labour, but also to avoid the high costs associated with labour regulations". (Enterprise and Development Consulting, 1993, p. 72.)

Thus it is likely that this practice - of specialization and decentralization of activities to small specialized suppliers - has contributed significantly to the growth of the small scale informal sector in Pakistan, especially in urban areas; and whilst the avoidance of labour and other regulations has undoubtedly played a part, perhaps more significant has been the attraction that small firms, and networks 10 of small firms, offer as flexible suppliers to an increasingly unstable and uncertain international demand. There is no reason to suppose that this trend will not continue in the same vein.

#### 3.4.5 Facing up to global competition

Pakistan tends to have an image as a low quality producer of goods competing on a basis of cheap labour. Textiles is clearly the biggest and most important sector, but this

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<sup>38</sup> The trade association representing the very small establishments with less than 9 looms alone has over 15,000 members.

sector is experiencing difficulties.<sup>39</sup> There is said to be a strong awareness in the industry of mounting international competition, particularly from countries in South East Asia. Countries like Bangladesh and Taiwan are perceived by some as outperforming Pakistan, whilst for the garment sector in particular China is seen as a great threat whilst countries like Malaysia, Cambodia and Vietnam are expected to cause serious problems in the future. In the carpet trade competition from Iran is giving rise for concern.

A need to improve rapidly to world class standards is apparently widely accepted, and widespread training and general improvement in the level and spread of knowledge, including knowledge of the latest technical skills, design and research and development is now seen as essential.

#### Catching up with the International Competition

"We are very much lacking in technical know how down line - in the stitching, finishing and packing .... At the moment the norms of output are very low - both quantity and quality - compared to Hong Kong, Sri Lanka, Bangladesh, Taiwan and South Korea. We have to come up to their 14 standards in producing the right quality of goods and the right output per person ..We have to compete in the international market." (From interview with a leading member of the All Pakistan Textiles Mills Association.)

The greater internationalization of markets has increased the tendency for purchasers to "shop around" for the best deal - in terms of price, quality and delivery - and increasingly, it seems, this could mean choosing from a range of competing flexible production systems. One leading manufacturer suggested that European purchasers can now choose from between 6 and 8 competing textiles producing regions in the world. In textiles, at least, the market is now very much perceived as a buyer's market, with world supply outstripping demand, and consequently, industry is being forced to try and keep up to date with changing consumer tastes and requirements - whether it be for improved quality, design, delivery, price or a capacity to be adaptable.

Some manufacturers feel a mounting sense of crisis as other countries threaten to leave Pakistan behind.

#### A mounting sense of crisis

"We are facing a crisis. Our exports are dropping. They've already dropped by about 16 per cent to 18 per cent during the last quarter of 1993; and this January is not as optimistic as last year. Everybody is worried..The problem is that there is more supply and less demand". (From interview with a leading member of the All Pakistan Ready Made Garments Association.)

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<sup>39</sup> According to a recent report in the Financial Times, the All Pakistan Textiles Manufacturers Association has recently said that over the past year manufacturers have been forced to take out of operation 1.2 million spindles out of a total of 6.5 million (Financial Times, 1994).



Many other industrial sectors, mainly oriented towards the domestic market, are said to be equally plagued by low quality. Again, to the extent that Pakistan is increasingly being forced to come to terms with world competition these other sectors will be required to raise their standards and learn how to produce and deliver for export markets. Engineering, an industry that when well established is often associated with strong economies, is generally underdeveloped in Pakistan and again in too many areas suffers from poor quality<sup>40</sup>. A danger is that as the textiles industry upgrades its own quality there will be an increased tendency to buy machinery from abroad as local machine manufacturers are found wanting for machines that can deliver the necessary accuracy. As a garment manufacturer put it to interviewers for this project:

"At the moment we (the garment manufacturers) are using all imported machinery - mostly Japanese. 90 per cent of the factories have Japanese machines. Only those people who are working at home with three or four machines have either bought second hand Japanese machinery or have possibly purchased local machinery. Local machines are good but now people demand speed and accuracy, and people don't want to take any chances and so they buy machines from Japan."

It is in this context of a need to raise productivity, quality and innovatory capacity to new levels if industry is to compete in the world market; where it is well recognized that whole industrial networks of interdependent suppliers and contractors have to raise their standards together; where it is realized that whilst existing industries such as textiles need to be revitalized and strengthened there is also a need to diversify and develop new sectors; and where there is a recognized renewed reliance on small enterprises to soak up unemployment, that the whole question of the adequacy of Pakistan's supporting institutional infrastructure for small enterprises has been raised.

### 3.4.6 MSE performance problems

Small enterprises in both rural and urban areas have many characteristics as well as weaknesses in common. In summary, they are rather small business units operating on unsophisticated technology, often on labour-intensive technology. They lack adequate skills and knowledge of technology and markets. The entrepreneurs face severe infrastructural inadequacies and inefficiencies and lack access to institutional credit. A most commonly mentioned issue by commentators is the lack of available credit (see, for example: Chaudhary, Azim and Burki, (1989)). Also, Mr. Babri's survey tends to bear this out. Better access to finance was a clearly perceived priority in many respondents' minds.

There is some evidence that there are sectoral variations with, for example, carpet weaving being more "backward" than other sectors. Moreover, one large scale survey of urban informal sector enterprises engaged in manufacturing and repair work found that

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<sup>40</sup> Kibria (1993) reports that there are around 20,000 engineering units in Pakistan's small scale informal sector, employing over 100,000 people. He says that they play an important service role but quality is generally low and there is a need to assist them to upgrade.

improvements are taking place and that small enterprises are gradually modernizing (Chaudhary, Azim and Burki, 1993).

As already indicated earlier, on top of low productivity another problem is that the quality of locally made goods is generally poor, in part reflecting inadequate technology and production techniques, but also reflecting a sophisticated markets and the lack of public demand in Pakistan for better made goods.

Low pay, long hours, poor working conditions, and inadequate protective labour legislation are often complaints made about the very smallest enterprises.

Low incomes are associated with inadequate productivity. Often also the poor conditions are blamed on an inferior power position experienced by small firms in relation to larger middlemen and large company contractors.

A tendency for officials not to enforce labour and health regulations is also blamed. A common view that over-regulation might seriously affect the informal sector's vitality might also partly be of some influence. An absence of trade unions might also have an effect.

#### Informal sector working conditions

"It has been observed during the survey that a good number of the informal sector enterprises operate more or less under relatively unattractive working conditions in terms of inadequate work space, improper lighting arrangements, inadequate devices for protection against accidents, dirty toilets, etc. Since the relevant government functionaries either do not visit many such enterprises, or do not press for improvement, the same conditions have continued to prevail in them." (From "Chaudhary, Azim and Burki, 1993, p. 84".)

Child labour is a particularly disturbing phenomenon. Messrs Kemal and Mahmood's survey of urban enterprises employing less than 10 people found that the full time employment of children under 10 years of age varied widely by sector; some of the worst sectors in manufacturing were textiles production and leather goods manufacture, with between 15 per cent and 20 per cent of the labour forces composed of young children; in the service sector cycle repairers and electricians had similarly high percentages (Kemal and Mahmood, 1993).

In rural areas household carpet manufacturers have been widely criticized for employing child labour - although in interviews for this project the National Association of Carpet Manufacturers and Exporters strenuously denied the claim.

Other weaknesses or disadvantages could be said to include: the fact that small enterprises have to pay more than do large firms for imported goods because of duty differentials in tariffs; sometimes difficulties to access raw materials; poor physical infrastructure, particularly in rural areas with major inadequacies in road systems, telecommunications, and power supplies; limited markets, in rural areas in particular (Kemal, 1993); and the need to cater for, i.e. bribe, corrupt government officials.

#### 4. SMALL ENTERPRISE SUPPORT MECHANISMS: OVERVIEW

There are an extremely large number of institutions involved in small enterprise support though the extent of their services are varied. An overall assessment would have been a major separate exercise beyond the resources of this mission. Nor are there presently available any overall evaluation report of these multi-functional institutions. Thus, selected main institutions within each category of the types of institutions will be presented in the following.

The types of agencies assisting or serving small enterprises, either exclusively or as part of a general mandate to serve industry, are wide and varied. The mission has found it feasible to focus on governmental agencies, non-governmental agencies, the private sector associations, the trade unions and the larger companies as these types of institutions have (or should have) a major concern for the promotion of the MSE sector.

##### 4.1 Government agencies

###### Provincial Government Small Industry Promotion:

Much responsibility for the promotion of small and micro enterprises rests on the provincial governments and in particular on specific development institutions that have been established at that level.

In the early 1970-ies the Pakistan Government created Small Industry Corporations in each of the country's provinces. They are relatively autonomous organizations with the goal of promoting small and micro enterprises and employment, especially through the instruments of industrial estates (offering basic facilities and business support services and tax advantages) and training centres.

Today, in Punjab, the Small Industries Corporation for the province operates 15 estates, and it has set up training centres for carpet weaving, ready made garments, hosiery and handicrafts as well as rural training centres providing skills in electrical, masonry, carpentry and mechanical trades.

Further, the Punjab Small Industries Corporation has set up a number of branch specific technology centres within towns noted for specific industrial activities. These include a ceramics institute and woodwork centre in Gujarat, the Light Engineering Services Centre and the Leather Research Centre in Gujranwala, a Cutlery and Small Tools Service Centre in Wazirabad, and the Metal Industries Development Centre in Sialkot. The functions of these centres are to introduce local entrepreneurs to new technology advances and production methods as well as providing specialized sub-contractual production and advisory services.

The Sind Small Industries Corporation operates 14 estates, 7 artisan workshop colonies, 2 institutes of entrepreneurship and training centres providing skills for over 3000 people.<sup>41</sup>

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<sup>41</sup> Nadvi 1993

The Small Industries Board of the North West Frontier Province (SIDB) concentrates most of its activities on managing industrial estates of which there are reported to be 8.

In Baluchistan, the West Pakistan Small Industries Corporation was dissolved in 1972 and the affairs of the small industries sub-sector were assigned to the Directorate of Industries of the Department of Industries, Commerce and Minerals. This is in contrast to institutional arrangements in other provinces where, as far as the mission has been informed, separate Small Industries Corporations, were created.

The Directorate of Small Industries was created after 1976 and operates some 63 training centres in various trades, one service centre, 5 sales and display shops and one small industries estate. Of the 63 training centres, about two thirds are carpet centres, seven are embroidery centres and the others cover areas like tailoring, woodwork, marble work, mazri and durree production.

The provincial Small Industries Corporations and their Baluchistan equivalent have come in for mixed criticisms. One criticism has been that the industrial estates can leave small enterprises isolated and that in practice these estates tend to house mainly larger enterprises.

Informally it was mentioned to the mission that for Baluchistan<sup>42</sup> there exists a serious lack of data in the province on the small and micro-enterprise sector and blamed the state of affairs largely on a lack of provincial government attention to the sector.

In respect of the Sind Small Industry Development Corporation, businessmen interviewed by the mission were not very enthusiastic about its effectiveness:

"The Sind Small Business Industrial Corporation is a government body that has set up industrial estates (in different towns) but they are not too effective at the moment. It is in the hands of the government and when it is in the hands of government there is not that much flourishing."<sup>43</sup>

The Small Industries Development Board (SIDB) has come in for more criticism. One recent report written for an international donor reported a general lack of confidence amongst donors in the institutions and said that its weaknesses "are well known". Another international donor is reported as desiring that either the Sarhad International Development Board decentralizes its operations and ways are found to make it more efficient, or an entirely new and autonomous body should be created. Interviews by this mission indicated that the Pak Holland Metal Project (PHMP) (see later) may be meeting bureaucratic obstacles from the NWFP Small Industries Development Board headquarters. Its Mingora Industrial Technology Centre, according to PHMP staff, has never once been visited by the Small Industries Development Boards headquarters's senior management.

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<sup>42</sup> An international report will be published. As the report only exists in the unofficial version it is not possible at this point to give the reference.

<sup>43</sup> From an interview with a leading Karachi business man.

The Punjab Small Industries Corporation seems to have had relatively better reviews. For example, interviewers for this mission thought that it seems to be making genuine, if imperfect, efforts to decentralize its operations, increase its rural outreach, and make its services more demand-led. It has organized itself into 7 regional offices which have authority to approve loans up to 500,000 rupees under its Rural Industrialization Programme. It has a Rural Industrialization Programme which has been perceived as a significant attempt to assist rural manufacturing and livestock farming small and micro enterprises. The Punjab Small Industries Corporation also claims that its rural craftsmen (dehi mazdoor) centres are shifted in location when the need for training in particular localities has been satisfied. Moreover, the fact that Common Service Facilities have been established in Sialkot and Kasur indicates a demand-led recognition that shared-production Common Service Facilities must be near their customers. Also, the Punjab Small Industries Corporation plans to re-locate the shoe making equipment at the Institute of Leather Technology at Gujanwala to Lahore, a major centre of private shoe manufacture.

However, comparing the agencies in the Punjab with the North West Frontier the point could be made that while the Punjab Small Industries Corporation appears to be the more dynamic of the two Small Firm Industrial Development Agencies, its small and micro enterprise directed support services are certainly not comprehensive.

#### Pakistan Institute of Entrepreneurship Training:

Pakistan Institute of Entrepreneurship Training (PIET) was established in Lahore in late 1990 by its present Executive Director (ED), and effectively started its training courses in July 1991. The ED, formerly a private Pakistani consultant with prior working experience in the UK, appears to be the driving force of the Institute. He has hired a few permanent staff, and employs consultants and master-craftsmen to staff the courses on a contract basis.

PIET's permanent headquarters office is quite small. It first started giving courses in Lahore. Then followed Karachi and Multan. Now, there are hopes to expand to other cities as demand builds up. The objective is to advise people on 1) business set-up and 2) improve productivity and expansion into new markets.

The clients pay fees for the courses, Rs 600 per day per client. This covers the course materials, the course staff (hired on contract), and the advertising of the courses. The fee does not cover PIET's permanent staff and other overhead. Such expenses are met by interest on an endowment fund laid down for the Institute by the Government of Pakistan. If PIET gives a lot of courses, its fee income from courses is considerably greater than its endowment income: and always at least equals the endowment income.

Though PIET, originally, thought of potential entrepreneurs as its main target group, the figures show that about 50% of the clients are potential entrepreneurs, another 50% are established entrepreneurs. PIET attracts its clients - essentially "all-comers" - by advertisements, in both English and Urdu language newspapers as radio is found to be too expensive. In some outlying areas, television is cheap enough.

Sometimes the courses are general. These cover enterprise establishment and registration, marketing, bank loans and how to obtain bank loans, management and

productivity, business plans, accounting, the mechanics of exporting, and legal topics. Normally, such a course will last 6 days.

Others are more technical and specific to particular industries, e.g. textile printing and dyeing, leather, woodworking, etc. These include visits to "good practice" factories, and vary in length between 2 and 6 days.

The PIET applies a limit of 20 participants to these classes. If more than 20 have applied for the course, additional classes will be offered. Course materials are in English, but the instruction is in Urdu or local languages. If courses are spread between 2 or 3 cities it is estimated that the PIET can handle 60 clients per month. The PIET writes to the course graduates, the potential entrepreneurs about 6 months after their courses, to find out whether they have set up in business. So far the record have shown that 30-40% have actually started their own business.

The training institute now plans to conduct surveys of businesses to find out what they want in the way of courses, thus courses will be designed accordingly.

Also, "after sales service" are offered (that is, follow-up advice) but the clients have to come back and visit PIET to get it. The Institute does not currently offer extension service.

PIET has also run courses for "training of trainers", for example for NEW (Network of Entrepreneurial Women) an NGO in Karachi, and for the Department of Social Welfare's female field workers to help them advise women on starting up in business.

Where PIET presently seems weakest is in "networking". It cannot offer extension services, and has not yet sought to cooperate with agencies such as PSIC, NGOs, and small business associations (SBAs), which do offer these services, or might start them in the future.

The Executive Director sees the marketing attitude of many MSEs as a problem. According to him the MSEs are not adventurous in trying to diversify products and markets or raise productivity.

"They all stick to the same thing, copying each other. A glut results, and then they go crying to government".

The same pattern is found with small business associations (the report will revert to small business associations in a later section). They do not try to develop themselves from being mere lobbyists to form marketing or technical self-help groups, although the ED has offered to find skilled specialists to help them and their members with particular topics: the SBAs, even the exporters' associations, have not been interested in this approach. He further states that:

"The shortage of good marketing advice is a problem. There are many technical specialists available, but few consultants who know about new markets and their requirements. And the attitude of the big buyers is often not exploratory or helpful: you must approach them with a developed product, and then they might buy it".

In conclusion, PIET combines a number of promising features. Its courses are short and (apparently) to the point. The courses are offered near the clients' own bases and not, as is often the case, in a large centrally placed facility. The MSE clients pay the full operating costs of the courses, and what they pay for at a reasonable rate, they must be presumed to value.

Government subsidy is limited to endowing the Institute with a sufficient investment income to cover its non-course overheads: a very reasonable initial approach to subsidy.

Further, PIET is making additional efforts, by surveying potential MSE clients' needs, to make its courses demand-led: its pricing-cum-subsidy policy makes it in its interests to do this. It serves both existing MSEs, and potential entrepreneurs. The latter, so far, have a very fair record of actually starting up.

At need, PIET offers either entrepreneurial or technical skill training. It also tries to offer marketing advice as well. Moreover, it seems well-positioned to become, inter alia, a competent "apex" training institute: that is, one that can pass on its expertise to more "local" training-and-advice bodies.

This may well be preferable to a policy of making an organization unwieldy by setting up many branches, a policy that PIET shows no present signs of adopting. Its small size is therefore not necessarily a disadvantage. Indeed, its policy of a small permanent staff combined with use of short-contract private consultants, instructors, and other specialists, seems a good way to avoid bureaucratic staff attitudes and over-manning.

Obviously, as a new institution, PIET has yet to establish a proven successful record of MSE development, and it may be heavily dependent on the talents and contacts of its founding ED. Moreover, it is probable that, so far, its clientele lies among the SEs and the potential SEs with a certain level of educational background.

However, so short are its courses that PIET - or other institutions that may be modelled, with appropriate adaptations, on its various promising features - could even become attractive to operating micro-entrepreneurs who cannot readily leave their businesses. Naturally, changes in course content and materials would be required. It would also remain to be seen whether such entrepreneurs could or would pay the fees on a full-operating-cost basis.

If the entrepreneurs will not (or cannot) pay the fees (this should be tested in reality) then government might well consider whether another subsidy element would be worthwhile and workable. It might, for example pay half the micro-entrepreneur's course fee, if the micro-entrepreneur himself paid the other half.

#### Pakistan Industrial Technical Assistance Centre:

Pakistan Industrial Technical Assistance Centre (PITAC) was established as a technical arm of the Ministry of Industries, with the major objectives of developing the skill of industrial personnel in technical and managerial fields, assisting in the design and manufacture of jigs, fixtures moulds, dies, tools and products etc. etc. Also, the PITAC extend advisory

services in the solution of in-plant problems and disseminating modern technical know-how among the industries.<sup>44</sup>

PITAC offers training courses in several fields (see above) on a regular basis. Also, special courses will be designed upon request suiting the sponsoring agency's programme of skill development. Technical assistance to the industry is offered through the Tool Development, Advisory & Consultancy Service.<sup>45</sup>

Presently, the services of PITAC are targeted the larger companies. However, the mission found that this government institution, providing industrial technical assistance, has an interest in addressing the smaller companies as well.

#### 4.2 Financial institutions

It is definite that many entrepreneurs would benefit from long-term access to credit facilities. For further details on this see the previous chapter, in particular 3.4. The entrepreneurs need the credit for upgrading of their technology, improving the capacity-utilization, or otherwise expand their operations, through more ample working capital.

It is possible, although less certain, that many of them would avail themselves of such facilities in all good commercial faith<sup>46</sup>, if they were offered them on terms viable both to the MSE-borrower and to the institution making the loans. Unfortunately, no such institution has yet been proved to exist, operating in either of the provinces covered.

If the principle of making a return on capital, whether it be termed interest or mark-up, is once admitted - and the general conduct of private business and savings in Pakistan shows that it is, in practice, admitted - then the provision of financial services (savings, credit, and related facilities) becomes an industry.

Like other industries, it should then be required to cover its costs fully, and make a return over and above them, under competitive conditions, in order to survive and grow. However, this corollary principle has yet to be applied in practice, probably in general<sup>47</sup>, and certainly in respect of financial services to MSEs.

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<sup>44</sup> Pakistan Investment Guide. Ministry of Industries 1992-93.

<sup>45</sup> Pakistan Industrial Technical Assistance Centre. Leaflet from the National Productivity Organization.

<sup>46</sup> in blunter terms, with the intention of honouring their debt obligations - principal and interest - fully and in timely fashion.

<sup>47</sup> See, for example, the stinging critical comments of the Governor of the Central Bank (State Bank of Pakistan) to the Peshawar Bankers' Club, reported in *The News*, 5 December 1993, page 13, e.g.: "inefficient management (of banks)"; "the world of banking had undergone profound changes leaving Pakistani banking way behind"; "the sooner we accepted realities the better it would be for all of us". Further, in *Dawn*, 9 December 1993, p. 13, it is reported that outstanding loans in default to the banks total Rs. 78 billions, that is, about one-quarter of all advances by the banking system.



Instead, such services have been envisaged and operated simply as mechanisms to deliver credit to MSEs, based on specially-provided public or donor funds, and at interest rates significantly below the non regulated market rates charged by the commercial banks on their fully-secured lending (currently about 20-22% per annum).

By any standards the recovery-rates on these MSE credit programmes have generally been low. For example, the 72% average recovery rate on PSIC loans to MSEs under its Rural Industrialization [Credit] Programme has been described as "relatively high" by ILO-ARTEP<sup>48</sup>.

The average current recovery rate on loans made by the Small Business Finance Corporation is 50%<sup>49</sup>. The mainstream commercial banks were not interviewed, except for small rural branch of one of the banks, in a village in Punjab. It only made loans to farmers, and any loans the bank might make in future to MSEs would be administered by the much bigger branch in Gujranwala. This is hardly a fair sampling of the commercial banks' MSE lending operations.

However, the mission was repeatedly informed, both by MSEs and by the staff of other MSE-related institutions, that those operations are characterized by extreme conservatism (the collateral, in real property, to be at least twice the size of the loan), tiresome bureaucracy, long delays, and frequent corruption. Recovery rates are also believed to be low, which indeed they must be if PSIC's 72% rate is considered relatively high<sup>50</sup>.

The only institution in the two provinces, which was found to maintain a plausibly "high" recovery rate on a substantial volume of MSE lending is Pak Holland Metal Project, whose recoveries of its loans to metal-working MSEs in NWFP are currently between 90 and 95%.

By present Pakistani standards, this is indeed a highly commendable performance. However, it does not amount to maintenance of real loanable capital, even before the probably very considerable operating costs of administering the credit are taken into account. A simple calculation will readily show this. PHMP loans - which are financed ultimately with Netherlands aid - bear the highly-subsidized interest rate of 8%. Thus, recovery of 92.5% of

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<sup>48</sup> ILO/UNDP Mission. (1992): Employment and Human Resource Development in Pakistan with Particular Reference to Rural Employment, ILO-ARTEP, New Delhi, p.28.

<sup>49</sup> SBFC internal communication to its branch offices, November 1993. Within this average, the recovery-rate on the small-loan Self-Employment Programme (SEP) is higher at 82%. However, the SEP is only 18 months old, so it is too early to judge success or failure: and it has received most of SBFC's attention since its inception. As with SBFC's other lending, the funds for SEP come from government, not from private savings deposits.

<sup>50</sup> This reported pattern tallies closely with the Mr Keddie's previous observations of the commercial banks' MSE lending during a mission in 1987. Evidently, further and more direct checking of it by the remainder of the joint TSSI Mission, would be desirable. A good starting point would be the local office of the World Bank, which has long been a major source of funding for the big Pakistani banks' MSE lending.

principal - the mid-point of the range stated by PHMP - plus (say) 97.5% of 8% interest on original capital<sup>51</sup>, yields a total repayment of just over 100% of original capital.

However, most observers consulted, reckon that current inflation rates approach 20% per annum. Thus even if this total repayment were to be made after only one year, the real (inflation-adjusted) value of the recoveries would have sunk to 85% or less of the original loans advanced<sup>52</sup>. In fact, PHMP loans have a 2-year to 4-year repayment term. Thus, with continuing inflation, the real value of recoveries is very significantly lower even than 85%. And this is even before deducting the annual costs of operating the system, which are very unlikely to be less than 10% of original loan capital.

In other words, even a "successful" MSE loan programme such as PHMP's, is operating at a massive real loss. The real value of loanable funds recovered for re-lending, after losses and expenses, is significantly decreasing each year. Even such a relatively high-performing programme is dependent for its maintenance on fresh infusions (essentially on interest-free terms) of donor or public funds. These funds are never likely to be made available on anything like the scale of the potentially beneficial use of credit by Pakistani MSEs.

Part of the problem no doubt lies in the high inflation rate, which needs to be reduced. But, more generally, the attempted promotion of MSEs by advancing them loans at below-market rates based on the infusion of free or "soft" donor/public funds to lending institutions, is a fundamentally flawed approach. It encourages irresponsibility on the part of borrowers and institutions alike.

Because these loans are (in theory) available cheaply, they make MSE borrowers regard market-rates as inequitable. Because they are usually unprofitable, they do not attract any enthusiasm on the part of bankers.<sup>53</sup> Because the funds are not really the banks "own" (i.e., not part of their normal deposit or capital base) they have sharply reduced incentives to lend them wisely. And because they are cheap and publicly-funded, they are liable to be seen by MSE borrowers as largely a "gift" from above, which does not have to be repaid in full or on time.

Furthermore, the outreach of such programmes is relatively very low. The vast majority of Pakistani MSEs seems never to have received a loan from any formal lending

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<sup>51</sup> In customary banking practice, loan (re)payments by the borrower are credited to interest before principal. Therefore, interest recovery rates are higher than principal recovery rates.

<sup>52</sup>  $85\% = 100\% / (1.176)$ , i.e. the assumption of a price-inflation rate of 17.6%.

<sup>53</sup> For example, the Netherlands Government, which is genuinely committed to Pakistani MSE development on many and varied fronts, has recently withdrawn from co-financing the World Bank sponsored programme of small-scale industry credit (SSI-III) channelled through the country's commercial banks, because of the low up-take by the banks of the funds available under the programme.

programme, whether at below-market interest rates or not<sup>54</sup>. Further details have been given in 3.4.

Thus it is probable that an entirely new, demand-led and business-like, approach to the problem is needed. This may be termed "financially-viable financial services to the small saver and the MSE entrepreneur". Some main components of this approach are:

- base MSE lending on funds raised by attracting local deposits at market-based interest rates;
- on-lending to small borrowers, including MSEs, at "high" rates, covering losses, deposit-rates, operating costs, and a profit element<sup>55</sup>;
- multi-sectoral lending to all-comers, rather than concentration on, and preferential interest rate to, "favoured" sectors such as manufacturing MSEs;
- primarily short-term lending, including overdraft facilities, consistent with the deposit base, and also with the principle of placing less emphasis on collateral security, and more on the progressively-proved credit-record of the borrower<sup>56</sup>, and
- linkage with localized institutions, whether these provide non-financial directed support services, or are themselves informal financial institutions, such as the local small rotating savings associations which are widely prevalent throughout almost all social groups in Pakistan under the name of "the committee system".

The only interviewed institution which responded warmly to this approach, or claimed to be adopting many components of it, was the Bank of Khyber (BK) in NWFP. However BK is new, and its professions have yet to be validated in long-standing practice.

Moreover, the very limited field enquiries which could be made by the mission about its actual MSE lending practices (at ALEP in Mardan), indicated that they varied little - in respect of, for example, collateral requirements, centralized loan approval procedure, or (medium) length of loan terms to MSE manufacturers - from the other commercial banks.

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<sup>54</sup> For example, only two of the 17 MSEs interviewed by the mission, without prior knowledge whether or they had received a formal loan, had in fact received such a loan. The first was a female MS entrepreneur who had received a very small loan from the First Women Bank. The second was a fully-secured overdraft facility at market rates from a commercial bank. The (male) MS entrepreneur in question was General Secretary of the local manufacturers' association, and was thus presumably well-connected. Sahibzada, M.H. and Illahi, R. (1991), pp. 80-2, found that only 1.5% of rural manufacturing MSEs they surveyed in the west of the Punjab, had ever received a formal loan. [No doubt, other surveys of MSEs, to be reviewed by the UNIDO side of the TSS1 Mission, will further confirm this pattern.]

<sup>55</sup> It is relevant that the lowest implicit interest rate on trade credit granted to, or by, the MSEs interviewed, was 2% per month. Duly compounded, this yields an equivalent rate of 27% per annum.

<sup>56</sup> And also, under inflationary conditions, with the willingness of borrowers to accept 'high' interest rates.

ALEP felt that its MSE clients were regarded by BK as "rather too small for the bank's liking".

This is borne out by statistics provided by BK itself. It has advanced Rs. 768 millions in 249 loans. Of these, 115 are "less than Rs. 1 million". No lower dividing line was provided. Rs. 1 million would be a very large loan indeed by the standards of most MSEs, beyond their wildest dreams and indeed far beyond the capacity of most of them to handle. Moreover if it is assumed that loans less than Rs. 1 million average (say) Rs. 500,000 in size, then BK is concentrating 93% of its advances on 134 (249 - 115) clients who are receiving, on average, a loan of Rs. 5.3 million (US\$ 177,000) definitely a loan-size indicating a medium- or larger-scale enterprise.

However, if "new" implies "unproven", it also hopefully implies "not yet firmly fixed in its ways". BK is saying most of the right things, and the State Bank of Pakistan, in collaboration with donors, might well consider providing it with technical assistance towards putting its money where its mouth is.

An encouraging approach is the one started by Allied Bank in April 1993 with its Unorganized Sector Financing Scheme. During the first year 260 loans were disbursed for an amount of RS 6.6 million. The recovery accedes 100% as some borrowers prefer to repay earlier whenever possible. The interest rate is 15% and the maximum loan amount per individual cannot exceed RS 25,000. No material security is needed, only the personal security provided by two citizens. This should make the scheme specially suitable for micro-enterprises. Started in only 15 branches of the Bank, the scheme will be expanded gradually to most of the 800 branches. Allied Bank is a former nationalized bank that was privatized in 1991 when its 7,500 employees purchased it under a Employers Stock Ownership Plan.

#### **4.3 Non-governmental organizations**

Although fairly numerous, NGOs are, generally, not well "grass-rooted" in Pakistan. Nor do more than a very small fraction of them operate active or effective directed support services for MSEs. Based on discussions with Pakistani and foreign experts active in, or frequently working with these organizations in Pakistan, the general characteristics of the NGOs are as follows:

- most of them are focused primarily on women (and children);
- they are mostly donor-funded and "donor-driven". They find out what various donors will support financially (e.g. drug control, environmental programmes, health, family planning, community education, children exploited by early employment at low wages, etc.), and tailor their activities accordingly;
- they are essentially intermediary organizations between sources of funds (generally donor funds) and highly-local grass-roots bodies such as community groups, which are essentially recipients and have little technical capacity. Thus, most NGOs do not constitute "bottom-up" technical and organizational strength, or of local commitment to building up such strength in fields chosen at the grass-roots;

- they have essentially been boosted by the increasing reluctance of donors to fund public-sector bodies, given these bodies perceived bureaucracy and inefficiency, and
- they do not have strong connections with small business associations (SBAs).

Above all, very few of them have much activity or expertise in MSE development. This is well-illustrated by a study commissioned by the Swiss Development Corporation from Sebcon, a Pakistani consulting firm. The study<sup>57</sup> surveyed nearly 800 NGOs in NWFP, to identify potential local counterpart-institutions to work with the proposed Swiss-funded Small Scale Enterprise Project (SSEP) in that province. It used four basic criteria:

- the definition of "NGO" was used deliberately broad, so as not to exclude potential candidates. For example, it included private consulting firms;
- candidate NGOs should not be merely "one-man" bands;
- candidate NGOs should have some networking or cooperative links with other service institutions, and
- they should have at least some practical experience of providing services to start-up or pre-existing MSEs.

These criteria are not particularly onerous. Yet, of almost 800 NGOs surveyed, only four were found to meet them!

A second study, also involving Sebcon, provides another illustration. The study was to formulate, if feasible, a women's MSE development project in the Punjab. It found that such a project might be mounted, but that no NGO possessed both the essential skill-fields: women in development, and entrepreneurship development.

Moreover, the entrepreneurship development oriented institutions had little contact with micro, as opposed to small, enterprises. Sebcon and its co-author, Shirkatgah (an NGO), recommended that an entirely new provincial NGO, recruiting both skill fields, be set up to run the project. Inter alia, the study recommended that this new NGO should be equipped with 4 wheel drive vehicles to allow its managers access to all parts of the province with ease and comfort<sup>58</sup>.

Apart from illustrating the paucity of NGOs with MSE development skills, this study also perfectly exemplifies the intermediary, as opposed to grass-roots "bottom-up", nature of most NGOs in the country. They are "demand led" not so much by grass-roots expressed local needs, as by donor funds!

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<sup>58</sup> Sebcon Consultants, and Sarkatgah [an NGO] (1991): Final Report on a Women's Small Enterprise Development Support Project in the Province of the Punjab, presented to the Royal Netherlands Embassy, Islamabad, pp. 149-50

Again, enquiries of those involved in MSE development (donors, Pakistani researchers and former NGO workers) revealed an almost identical common, and very short, list of NGOs with any serious involvement in the development of MSEs or even of income-generating activities among women or other disadvantaged groups. They were:

- Behbud Association;
- All Pakistan Women's Association, Lahore office;
- Aga Khan Rural Support Programme, Gilgit operation;
- Orangi Pilot Project, Karachi

plus a few private-for-profit consulting firms (not strictly NGOs), such as Sebcon, ECI, Entrepreneurial Development Advisory Services in Lahore, and Network for Entrepreneurial Women in Karachi.

The mission managed to collect detailed information on the Aga Khan Rural Support Programme and the Orangi Pilot Project. These NGOs will be briefly presented in the following.

#### Aga Khan Rural Support Programme:

The Aga Khan Rural Support Programme (AKRSP) is the best known example of a Rural Support Programme. Generally, the rural support programmes focus on cooperative infrastructural projects in small rural communities, e.g. water supply, erosion control, social forestry etc..

Overall, the Aga Khan Development Network has three main areas of activity. The social development, the economic development and cultural activities. The Rural Support Programme belongs to the social development component<sup>59</sup>.

Under the component for economic development the Aga Khan Development Network focuses on three issues: 1) Industrial Promotion Services; 2) Tourism Promotion Services and 3) Financial Institutions. However, there are no specific programmes for micro and small enterprises under the economic development component.

The AKRSP was established in December 1982 in the Northern Areas of Pakistan under the Companies Act, with the objective of increasing the integrated package of interventions that include: technical and financial support for small scale infrastructure; human resource development; a program of credit and savings; input supply and marketing assistance.

The operation of the Aga Khan RSP (AKRSP) in the Gilgit valley, does include some MSE development activity. The mission made attempt to visit this, but bad weather made it impossible. Gilgit is well-connected by road to Rawalpindi via the Karakoram Highway.

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<sup>59</sup> The Aga Khan Development Network. A leaflet distributed by the network.

Nevertheless, difficulties are encountered according to the British High Commission, one of AKRSP's co-founders.

The distinguishing features of the AKRSP are its institutional structure (Village Organizations (VO) and Women's Organizations (WO)) and the method of implementation which is rooted in the participation of local partners and the VOs. Most VO members are village residents who participate jointly with the AKRSP staff in identifying and addressing the needs of their area. These organizations and the AKRSP are connected through the Social Organization Unit, which function as a monitoring unit at the field and district level.<sup>60</sup>

The savings and credit programme is based on a system of collective savings and borrowings. Each member deposits his or her savings with the VO, which is responsible for combining them. The VO makes a collective loan according to the needs of its members and disburses individual loans. There are two types of loans: 1) short term (six months) loan which is given e.g. seed, fertilizer, marketing etc.; 2) medium-term (2-5 years) loan which is given as development loan for infrastructure projects. The group's formation and savings effectively replace the need for collateral to secure repayments. 87% of the short term loans were used for fertilizer and marketing operations where as 88% of the medium term loans were for land development and agricultural machinery. The default rate for both types of loan has been very low. 1.4% default rate for the short term and 1.97% default for the medium term loans.<sup>61</sup>

Efforts are reportedly concentrated on villages rather than towns, and moreover on community enterprises rather than those based on individuals or small groups. This probably limits the sectoral and MSE development scope. The one definite success is apricot drying. AKRSP dried apricots are a well-received quality brand in shops and bazaars in the main cities of Pakistan.

Furthermore, despite an apparent emphasis on members of a cohesive Islamic sect, local project development by AKRSP reportedly requires "considerable planning time and effort .... per [presumably small] community"<sup>62</sup>.

#### Orangi Pilot Project:

The Orangi Pilot Project (OPP) is a registered NGO that began its operation in 1980 in the Orangi area of Pakistan, which is the largest squatter settlement in Karachi (about 1 million). The OPP is a community development project which was originally funded by the Bank of Credit and Commerce International. Now, the OPP is receiving its funds from a variety of donors, inclusive of the Canadian and Swiss Governments<sup>63</sup>.

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<sup>60</sup> World Bank Staff Appraisal Report.

<sup>61</sup> World Bank Staff Appraisal Report 1991

<sup>62</sup> ILO/UNDP Mission (1992), p. 33

<sup>63</sup> World Bank Staff Appraisal Report 1991

The main objective of OPP is community organization and self-management which it promotes through programmes for physical infrastructure and economic development. OPP provides credit for 44 categories of micro-enterprises under the economic program that was initiated in 1987. However, Orangi has been in existence since 1965 thus demonstrating that low-income area residents are willing to pay for services they have closely been involved in designing, constructing and maintaining.

The economic program initiated in 1987 for the 44 categories of micro-enterprises has provided 284 loans for about Rs 3.03 million to family enterprises and another 74 loans for about Rs. 1.5 million to individual companies. OPP has identified a number of existing activities where the scale could be increased from both the demand and the supply perspectives. These same activities could e.g. be started by new entrepreneurs in the same area of operation. The OPP is currently lending to several micro-enterprises that have become viable and profitable. Furthermore, the OPP can, with very little increase in the operating costs, increase its loan portfolio.

#### **4.4 Private sector associations**

Internationally it is increasingly recognized that the private sector, in the form of representative association, has a crucial role to play in the promotion of the small enterprise sector.

As pointed out earlier, the micro and small enterprise sector in Pakistan faces several constraints to growth and increased efficiency. Private sector associations could play a pivotal role in eliminating many of these constraints through actions at two levels:

- (a) to act as an "advocate" of the interests of the small scale sector towards government in the formulation of the policy and regulatory framework to void biases against the sector;
- (b) to provide direct support services to the small scale sector.

The current status of private sector associations in general and MSE associations in particular will be reviewed fully below.

##### **4.4.1 Business associations**

Data on business associations for the small enterprises is scarce. However, a comprehensive study on business associations for the informal sector exists.<sup>64</sup> Although the average size of a micro enterprise comes to about 2 employees inclusive of the owner it is likely that the survey nevertheless gives a realistic picture of the degree of organization for the MSE sector as a whole.

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<sup>64</sup> A.R. Kemal and Z. Mehmood, Friedrich Ebert Stiftung: "Labour Absorption in the informal sector and economic growth in Pakistan." Islamabad 1993.



The following table shows that most of the associations are at the local level only. However, in the manufacturing and the services sectors, there are some associations at the national level as well.

**Table 4.1: Existence of local and national associations in the informal sector<sup>65</sup>**

Sector	Respondents who think there is an association at the		Respondents who are members of	
	Local level %	National level %	Local associations %	National associations %
Manufacturing	28.76	4.48	88.44	51.61
Services	28.98	9.54	76.83	37.04
Trade	95.96	0.00	0.00	0.00
Transport	94.52	0.00	0.00	0.00
Total	62.06	3.51	41.32	22.15

The table also shows that more than half of the entrepreneurs acknowledged the presence of associations at the local level. However, only a minor part of the entrepreneurs were aware of any national level associations. The acknowledgement of the local level associations is lowest for the manufacturing and services sectors.

The level of membership among the respondents appear quite low. However, wherever an association exists in the case of manufacturing and services sectors, the membership at local level is as high as 88% in the manufacturing sector and 77% in the service sector. Where a national association exists as many as 52% of the manufacturers and as many as 37% of services sector entrepreneurs hold membership to these associations.

When asked about reasons for not holding membership, the typical argument was that the association was useless because it did not provide the help needed. Some respondents complained that the membership fee was too high (on an average it was Rs 200 per annum). Interestingly enough, when the respondents were asked about the procedures for becoming a member of the associations, a considerable number of respondents were unaware of these. This might indicate that some respondents actually might find a membership useful but simply did not know how to apply for membership.

Further, the survey asked the respondents why they had become members of the association. The respondents justified their memberships as follows<sup>66</sup>:

<sup>65</sup> Kemal & Mehmood, Islamabad 1993.

<sup>66</sup> Kemal & Mehmood, Islamabad 1993

1. Associations solve the problems of the members be they business related or related to government agencies and departments;
2. Associations facilitate in effecting the desired changes in government policies;
3. Associations help in cartelization and fixation of product prices;
4. Associations set rules of the business;
5. Associations arrange training for workers and disseminate information of issues such as latest technology and production techniques, market situation nationally and internationally;
6. Associations promote cooperation among the business community.

Where associations were not available, the respondents were asked to point out possible benefits that might accrue to them if an association did exist. The following benefits were envisaged by the respondents:

1. Protection from big business;
2. Resolution of problems associated with government departments;
3. Fixation of wages of workers;
4. Fixation of prices of their products;
5. Resolution of business related problems in general.

When comparing these two set of responses, it is interesting to note that there is a considerable overlap between them which would indicate that the business associations do in many cases manage to provide services answering the specific needs and expectations of their members. It is also clear, however, that associations are uniquely placed to provide a more comprehensive range of cost-effective services such as information on markets and technology, training and consultancy, facilitation of inter-firm linkages and so on.

#### **4.4.2 Employers organization**

Within this category, there are numerous organizations such as the various Chambers of Commerce and the Federations of Employers. For example, Pakistan has 26 Chambers of Commerce federated to the Pakistan Chamber of Commerce. The Karachi Chamber, with 13,000 individual firm members and another 50,000 affiliated through trade associations, is the biggest. In the following the mission will focus on the Employers' Federation.

Though not presently very active in providing services to the micro and small enterprise sector, the EFP and the Chambers of Commerce, as the direct representatives of the private sector, has indicated interest in the area and could play a major role.

The Employers' Federation of Pakistan (EFP) was founded in 1950. The EFP is managed by a committee of 20 members who are elected biennially. The Managing Committee is as policy making body. It is assisted by specialized sub-committees. The various sub-committees guide and advise the managing committee on issues considered pertinent to the interest of employers and the working of the EFP. The sub-committees are 1) Public Relations; 2) Seminar, Courses and Training; 3) Research and Publication; 4) Planning and Development; 5) Membership and 6) Administration and Finance.<sup>67</sup>

The overall objectives of the EFP are:

- to promote the interests of the employers at both a national and an international level;
- to promote good relations amongst the employers;
- to promote co-operation between the employers and the employees;
- to "encourage and advance all reasonable and advisable scheme for the larger welfare and up-lift of labour and other employees"<sup>68</sup>.

Any company employing more than 20 employees can become member of the EFP. It has been estimated that the present number of memberships (direct and indirect) total around 12,000 employers.

Besides the normal range of services, the EFP is planning to implement projects on 1) Occupational Safety and Health; 2) Advisory Cell for Women; 3) Improve Your Business<sup>69</sup> and 4) Productivity Services Wing<sup>70</sup>. The latter three projects (where off one has been partially implemented) have been designed to target small enterprises as well as the members of the EFP.

#### 4.5 Trade unions

There are many trade unions with a general interest in improving working standards and skills. Small scale enterprises, however, are at present only weakly represented. Unfortunately, the mission found that the information about unions and the levels of organization is limited. However, an ongoing study sponsored by the Friedrich Ebert Foundation should clarify these matters later in 1994.

The number of unionized workers is known to be very low. One estimate put forward by one of the leading union federation is that only about 24% of Pakistan's labour force of

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<sup>67</sup> Employers' Federation of Pakistan. Leaflet.

<sup>68</sup> Employers' Federation of Pakistan. Leaflet.

<sup>69</sup> This ILO programme for small enterprises has been implemented.

<sup>70</sup> The Employers' Federation of Bangladesh has with ILO/UNDP support established a Productivity Services Wing which provides training and consultancy services to the small enterprises on a partly self-financing basis.

33,000,000 is unionized and these are concentrated in larger urban places of work. Trade union presence in small enterprises is very low and in rural areas almost non-existent. Most unions are single enterprise organizations and consequently small and numerous (estimated around 7,500). An exception is the public services union which, faced with one employer (the government) covers many power and water utilities and has about 137,000 members.

There are also said to be numerous federations. Two stand out in terms of numbers represented. The All Pakistan Federation of Trade Unions and the Pakistan Federation of Trade Unions. Behind these the third largest is the All Pakistan Federation of Labour.

The All Pakistan Federation of Trade Unions (APFTU) is the largest of the federations, and claims a membership of over 600,000 through its affiliated industrial, national and plant level trade unions, both in the public and private sectors. A broad range of sectors is covered.

It has four provincial headquarters located in Lahore (Punjab), in Karachi (Sind), in Quetta (Baluchistan) and Peshawar (NWFP). Within each province there are further offices in a total of 35 towns.

The Federation provides assistance and advice to affiliated trade unions in regards to collective bargaining and industrial disputes. It promotes training and educational activities, carries out research on labour issues; promotes welfare policies and represents workers in various national and regional forums such as the National Training Board. Also, the Federation is affiliated to the International Confederation of Free Trade Union.

To the mission, officers of the Federation has expressed support for a policy of parallel up-grading small enterprises and labour conditions. Five general initiatives were suggested:

1. Improve know-how, skill, technology, marketing and quality;
2. Extend labour legislation to the informal sector, e.g. legislation regarding minimum wages and social security;
3. Strengthen trade union rights;
4. Promote general unions;
5. Convert, where possible, contract labour into permanent employment.

Of specific initiatives two activities were suggested. First, to increase the dissemination of information and know-how, to both workers' and employers' organizations, about working conditions and how to make small enterprises productive with better management and better worker skills. Second, to organize seminars and workshops on themes and issues with direct relevance to both the employers and the employees.

#### 4.6 Larger companies

Larger companies supporting and promoting their small firm suppliers is said to be a significant phenomenon, and possibly increasingly so.

Even without the part to be played by publicly promoted institutions it is apparent that some large firms are themselves taking on the role of raising standards of their small firm suppliers. In fact, attracting in branches of Japanese or German multinational firms who can be expected to develop a quality supplier network is generally seen in many countries as an alternative strategy to one of relying simply on home based support institutions for raising standards of indigenous firms. On the other hand, multinational firms are all the more likely to be attracted to a new location if there already exists a quality supplier network with access to a strong system of supporting institutions.

#### Developing Quality Suppliers

"When Toyota came (to Pakistan) the President at the opening ceremony made a speech that Toyota wanted to encourage suppliers by sharing technical know how with them, to help them so that they could come up the standards of Toyota."<sup>71</sup>

In Pakistan's case, large indigenous textiles firms are also promoting their suppliers, with mixed results. On the one hand such "fostering" is said to have beneficial long term effects for the small firms' capabilities. On the other hand, the unequal balance of power between customer and supplier is said to lead to exploitation, forcing suppliers to cut profits and costs, including labour and social costs.

The following "extreme" case can be presented to illustrate the contradictory situation of a strong inequality of power.

A large textiles manufacturer interviewed for this project reported having a very high degree of control over many aspects of his 20 small firm suppliers' operations. He lends money for establishment start-up and for the purchase of machines. He provides the cloth (taking a price for it). He provides a guaranteed market (his own firm). He organizes quality control (with his own inspectors regularly visiting suppliers). He transfers knowledge from his own research department to the suppliers to make sure that they upgrade their machinery. Even, he interferes with the hiring and firing of labour. In other words, the whole network is treated as if it were all his own business which he invests in, promotes, and profits from.

The textiles manufacturer is quite clear why, out of self-interest, he does it. He obtains a very flexible cheap labour force (often including, indirectly, "extra" family helpers), an absence of "hindering" trade union and labour regulations, and a very flexible production system that can absorb market shocks without harm to his core 40 business.

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<sup>71</sup> From interviews with a leading members of Karachi Chamber of Commerce.

## Why decentralize production to small suppliers?

"The number one advantage is the labour. In small industries there are no labour problems; they are not covered by the labour laws; they are not covered by strike votes; and all that. Then when I get my work done by a small jobber that man is the owner and so he works around the clock - even on weekends. When he's sick his brother takes over. When his brother's not there his wife takes over - to get the job done. And I know how much the man is making; he's not cutting my throat. He is making a reasonable living for himself - and growing - which I want him to do."<sup>72</sup>

## 5. INSTITUTIONAL SUPPORT MECHANISMS: WEAKNESSES AND SIGNS IN THE RIGHT DIRECTION

This chapter will present the major weaknesses that the mission identified in the institutional support mechanisms. As such the chapter should be read together with Chapter 4.

During its work the mission have identified developments that indicate that there is increasing awareness of the various problems in supporting the development of the micro and small enterprises sector, and that a number of specific initiatives are being taken based on this awareness. These efforts, which could set directions for future work in support of the SE sector will be presented in the second part of the chapter.

### 5.1 Institutional weaknesses

#### 5.1.1 Lack of scale

There have been criticisms that the numbers and types of enterprises reached by most support programmes are too limited. In respect of the informal sector, government support policies are said to be "extremely low"<sup>73</sup>, and where there has been government intervention to promote the informal sector it has mostly been limited to only a small number of enterprises directly touched by small scale projects<sup>74</sup>.

Furthermore, Chaudhary, Azim and Burki (1993) report that amongst the small scale informal enterprises they surveyed, "a dismayingly small fraction" of shagirds (apprentices) were aware of agencies offering business start-up credit facilities (such as the Youth Investment Promotion Society and the People's Finance Corporation), and knowledge of how to take advantage of such facilities was equally poor. The authors concluded that the information about relevant agencies and their services is not disseminated in a manner comprehensible to the target group.

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<sup>72</sup> From an interview with a large textiles manufacturer, Karachi.

<sup>73</sup> Ghayur, 1993

<sup>74</sup> Kemal & Mahmood, Islamabad 1993

As pointed out earlier, in respect of financial institutions, the outreach of programmes to lend money to small and micro enterprises is relatively very low. The vast majority of micro and small enterprises seem never to have received a loan from a formal lending programme.

An indication of institutional effectiveness in respect of number and geographical spread of support for small and micro enterprises is provided in the survey by the national ILO consultant Mr. Babri. It is significant that 87 per cent of the 71 small scale enterprises in this survey did not report receiving any kind of assistance from an institution at any time in the past or currently.

Perhaps even more startling is that none of the 26 rural enterprises in the sample mentioned ever receiving any institutional support. Even amongst the urban small scale enterprises, 80 per cent (of 45) reported receiving no assistance from institutions.

Apart from formal institutions, family and friends could be another source of help and, as reflected in the survey, such people had been of assistance to 23 per cent (6) of the rural enterprises and 17 per cent (8) of the urban enterprises. Nevertheless, even if possible help from family and friends is included, it still leaves 66 per cent of the 71 firms reporting receiving no help from anyone.

### 5.1.2 Ill adapted to serving small and micro enterprises

It is generally agreed that government policies in Pakistan have not been favourable to small enterprises (see, for example, Aftab, 1993), and indeed in some people's views overtly biased against them (see, for example, Burki and Ghayur, 1993). The neglect appears to be even stronger for rural small enterprises (Kemal, 1993). In consequence, institutions tend to be ill adapted to assisting small units, and perhaps especially those located beyond urban areas. As pointed out in the previous chapter, this definitely is the present situation.

For example, Pakistan's **banking infrastructure** has been criticized as not being geared to helping small firms. The two major reasons normally forwarded for why commercial banks are reluctant, or unable, to lend to small enterprises are: 1) that it is more expensive in terms of transaction costs to lend to them; and 2) small entrepreneurs do not normally have the necessary collateral that commercial banks demand of them.

Some people, such as Chaudhary, Azim and Burki (1993) suggest that also significant, or maybe even more so, is that small scale entrepreneurs lack knowledge of what is available and are deterred by complicated procedures.

Consequently, family and relatives, and own savings are major sources of funds, whilst suppliers' and buyers' credit is also important. For starting their businesses 86 per cent of Babri's respondents said they had relied on their own resources or loans from relatives (28 per cent of all respondents); the rest had received help from a financial institution. Only 4 per cent said that they had obtained loans from commercial banks.

As mentioned in a previous chapter, the mission found that the commercial banks' micro and small enterprise lending operations can be characterized by extreme conservatism, tiresome bureaucracy, long delays and frequent corruption.

Also, in respect of **training**, the limited use of state sponsored formal training for the smallest enterprises has been noted, whereby the formal and informal sectors have been identified as having their own exclusive training systems (the informal sector using the Ustad-Shagird apprenticeship system), and that people trained in one sector are not generally employed in the other.

As reported earlier, throughout Pakistan training activities, which could be relevant to small and micro-enterprises, have concentrated upon formal technical and vocational training courses in fixed, usually purpose built, centres run by various public authorities. Unfortunately, it would appear that such training has achieved very little outreach to small and micro-enterprises in practice.

The mission visited three such centres, all of high technical reputation, in Lahore, Sialkot, and Gujanwala in the Punjab. From previous reports and, still more, from discussions with several relevant officials, experts, and industrialists - of the large remainder of this centre-based formal technical/vocational system in Pakistan generally a good account was obtained. The system has numerous problems, particularly from the viewpoint of small and micro-enterprises.

In the first place, though with some exceptions, such as the dehi mazdoor programme, it was never set up with small and micro-enterprises in mind. From the birth of the country onwards, non-agricultural state planning in Pakistan has focused on larger enterprises, which have been seen as the primary engines of development and growth. As large scale enterprises developed, government has come to see technical/vocational training as the joint responsibility of such enterprises and the public authorities.

The latest major initiative in the system - the National Vocational Training Programme focused on Vocational Training Centres - was made in response to mid-1980s manpower projections indicating rapid investment and employment growth in the large-medium formal sector, and a consequent perceived need for increased supplies of skilled manpower in that sector. In the event, such growth failed to materialize, but the National Vocational Training Programme is only lately beginning to try to readjust its priorities and programmes.

Almost the entire system of such centre-based formal training, in Vocational Training Centres, Technical Training Centres, Polytechnics, etc, is geared to one- or two-year courses which are mostly given to educated young people (up to the present, mostly male) without prior work experience. The predominant expectation of the trainees is subsequent paid employment in a large-medium formal employment unit, be it a public authority or an enterprise.

Thus, neither the expectations of the trainees, nor their educational pre-qualifications, nor indeed the length of the courses given, are suited to the needs of small and micro-enterprises, wherein most workers have limited formal general education and cannot afford



the time off to attend lengthy courses at a centre possibly a considerable distance from their place of work.

Even the system of Apprenticeship Training Centres (ATCs), which is designed to give sandwich courses to workers learning their trades in actual enterprises, serves only enterprises with 50 or more workers. Moreover it receives little emphasis from the authorities and is relatively inactive. Nationwide, only 10,000 apprentices are legally registered each year under the system, and of these, only 10% actually attend an Apprenticeship Training Centre.

Given this basic cast of the system, its many other problems - high unit cost per trainee; sometimes divorced federal\provincial responsibilities for endowment\design and actual operation of centres; frequent difficulties in keeping parts; prevalence at many centres of high unemployment rates of trainee-graduates; non-attendance of (large) enterprise representatives at joint public-private centre training advisory committees; reluctance of the officials to convert these committees into centre management committees with true budgetary and curricular-strategy powers - may seem almost irrelevant to small and micro enterprise development.

However, these common features of public bureaucracy do not augur well for current or future attempts to amend its operations, so that at least part of them is geared to meeting small and micro enterprise needs in a demand-led participative fashion.

The dehi mazdoor rural craftsmen training centres operated by the Punjab Small Industries Corporation (PSIC) do not suffer from all the above disadvantages. They are aimed specifically at the supposed needs of rural small and micro enterprises; and their locations are said by Punjab Small Industrial Corporation officials to be periodically shifted when the training needs of a particular locality are thought to have been met.

However, it is significant that only one respondent - out of 377 small and micro enterprise entrepreneurs and workers interviewed in a survey of 147 rural small and micro enterprises actually assisted with Punjab Small Industries Corporation loans under its Rural Industrialization (credit) programme - had received dehi mazdoor training.

Moreover, great care would have to be taken in such a programme, essentially imparting basic trade skills, that it does not merely duplicate the far more widespread intra-\inter-small and micro enterprise private training mechanism known in Pakistan as the "ustad-shagird" (master-apprenticeship) system.

In other areas also there is evidence that research and development institutes, employers organizations, trade unions, and other agencies have tended to focus on the larger establishments, to the neglect of the smallest, and particularly the very smallest enterprises.

### **5.1.3 Government in-efficiency and in-effectiveness**

There seems to be general agreement that many government organizations and support institutions in the public sector are not as efficient and effective as they could be. Bureaucracy; the propensity to refer matters upwards when information is readily available at local levels; a lack of closeness, both mentally and geographically, to the industry being

served; poor motivation; instability with a tendency for officials to be moved on to new positions at short notice; the tendency to appoint people for political reasons rather than entirely professional ones; and widespread corruption, are amongst the many charges made. Some public departments and provincial agencies are seen as being particularly weak.

The financial services sector is mostly publicly owned and it comes in for particularly strong and frequent criticism. The mission believe that the fact that the bulk of the industry is publicly-owned increases the natural tendency of the formal banks toward bureaucratic and centralized procedures, lessening their competitive pressures towards efficiency. It has also, by almost universal allegation, opened the doors wider to political favouritism and corruption amongst bank officials, particularly those approving or disbursing loans.

Whether from public ownership, or close public regulation and direction of the industry, the financial sector has become a large vehicle of public subsidy of its borrowing clients. Special, below-market, interest rate schemes - and special public funds to finance loans under such schemes - abound. It can be argued that the strong reliance on subsidy as a promotional instrument, together with the bureaucratic organization of its disbursement, is in danger of diverting policy makers from what are supposed to be the developmental objects of the exercise.

It has been observed in other countries that where there is a heavy reliance on subsidy to encourage industrial growth much entrepreneurial effort, and even expertise, can in fact be exercised in devising the best ways to obtain the subsidy rather than on the economic activities that the subsidy is supposed to be promoting. "Obtaining the subsidy" can in a sense become "the business", and people can be very good at this business; but from a developmental point of view it is not a desirable practice. Moreover, those best able to obtain such subsidies might not necessarily be the ones that subsidy policy is supposed to be helping. It is mentioned elsewhere in this report that micro and small enterprises receive very little financial support regardless of the availability of subsidized credit schemes.

This is not to argue that subsidized schemes are not appropriate in some circumstances. But it does suggest that in the financial area, as in others, there is a need to reduce bureaucratic governmental control and take the policies much closer to the real world of the enterprise, and to move the balance of resource allocation away from the giving of subsidies per se to the provision of concrete technical services; or at least the tying of financial help in with concrete technical assistance in an integrated package.

#### **5.1.4 Failure to be client-responsive**

Closely related to the criticisms of performance by government agencies has been the widespread belief that many institutions supposedly supporting industry are inadequately tuned in to the day to day needs of their clients. Recognition of this was voiced by staff of two government funded and run applied research and development agencies interviewed for this project. In one case it was pointed out that the "clients" were refusing to adopt the products of the research institute; whilst in the other case concern was expressed that subsequent to a government announcement that the agency must prepare itself for selfsufficiency (through product sales) it was unclear exactly who or where the clients were. In both cases a desire

was expressed for the institutionalization of affiliated industry associations with which close consultations could be carried out.

References to similar cases were made by local experts who had evaluated support institutions, including research and development centres.

#### An evaluation of an industry research and development centre

"We thought that the (Research and Development) Centre was very far away from the private sector - far from the demand. It was doing its own research, depending totally on government funds and not earning anything from clients; and maybe not even doing research in the right direction. There seemed to be absolutely no link between the industry and the Centre". (From an interview with a local expert.)

Of particular concern, perhaps, in the light of what was said earlier, is the low degree of utilization of some government run quality testing centres. Despite possessing modern equipment, one authoritative estimate put the capacity utilization of these agencies at only between 10 and 30 per cent.

As part of an attempt to get away from large bureaucratic structures and draw closer to the particular needs of local small enterprises there is a clear trend around the world towards the introduction of mechanisms to make institutions providing technical services more sensitive to their clients needs.

#### **5.1.5 Lack of coordination between the different agencies**

There are indications that there is much duplication amongst agencies providing industry, including small scale industry, with services (see, for example, Ghayur 1993). It was said in interviews with government officials under this mission that different ministries each have their particular "angles" on small firm promotion. In respect of the provision of training, for example, several different government ministries have their own programmes without any apparent attempt at coordination between them. There are also at least 30 different projects and programmes in Pakistan aimed at promoting small and micro enterprises, being sponsored by outside agencies, with a clear risk of duplication and wasted effort.<sup>75</sup>

Further, in the past there has been a tendency for services for small enterprises to be provided in isolation rather than in combination with other needed assistance.

#### Need for More Coordination

"There is need for a much closer cooperation (between the institutions of the Ministry of Labour and Manpower) with other government agencies, such as technical ministries and local government, as well as with NGOS, including employers and trade

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<sup>75</sup> For a complete overview of existing programmes for the support and development of micro and small enterprise sector see Annex xxx.

associations, in order to effectively promote employment generation." (Hussain and Mellgren, 1994, page 2.)

## **5.2 Some signs in the right direction**

### **5.2.1 Awareness for the need for greater decentralization of power and local involvement**

There is strong awareness amongst researchers and policy makers in Pakistan of the many shortcomings of the institutional and governmental framework of support for industry, and for small enterprises in particular. It is recognized that for small enterprises especially a single reliance on a top down policy approach initiated by federal politicians and implemented by bureaucrats with no local stake, and often located many miles away, is not effective. Local areas have their own peculiar developmental problems, and small firms are tied into local conditions. In consequence, there is a growing consensus that what is required is a radically different decentralized "bottom-up" approach, that transfers a degree of policy making power to the local level, increases private sector involvement in the running of support institutions, and which generally fosters involvement and networking amongst a range of interest groups and small firm support agencies.

Consistent with this thinking were the recommendations of the 1992 "Action Plan" for the implementation of the high powered 1990 National Manpower Commission report on human resource development in Pakistan. The Plan strongly recommended the decentralization of the planning and implementation of development schemes down to district level; called for, amongst other things, the widespread establishment of "Industrial and Business Support Centres" and locally based financial institutions to support small scale enterprises; and recommended that interest groups such as trade unions and business associations, and NGOs and other agencies be encouraged to become actively involved in development issues and the running of support institutions (Ghayer, Frey and Klennert, 1991).

More recently, a high level advisory commission, the Task Force for a New Social Contract, has also recommended a complete overhaul of the country's governance structures, again with a particular emphasis on decentralizing power to the local level, recommending that a new structure of district level government be promoted with the aim of empowering local people to become more involved in running their own affairs (International News, 1994).

### **5.2.2 Improving inter-firm cooperation**

An appropriate mix of interfirm cooperation and competition is now widely perceived as essential for small firm development. Small firms with their limited resources need cooperation just as they need a strong and effective service support system. Cooperation between firms can take the form of group organization of training; or marketing; or research and development; or joint resource utilization; or common purchasing; or the dissemination of information on best working practices and technology; or the joint guaranteeing of bank credit; or the collective representation of interests at government level; or the collective production of a common product or group of products.

Strategies to increase interfirm cooperation are growing, in Pakistan as elsewhere. In particular, Pakistan's advantage in having a rich number of trade associations has been seized

upon as providing an opportunity to be exploited. Trade associations, of which there are many in Pakistan (see Section 4.4), offer the possibility of increasing scale (i.e. reaching out to large numbers of entrepreneurs) by acting as a medium for spreading ideas and best practice "automatically" i.e. by cooperative action amongst entrepreneurs informally, albeit possibly subsequent to initial intervention by an external animating agency.

Trade associations, further, can act as organizers, whether as lobbying groups, or as providers of services for their members, and they can act as representative bodies on development agencies and service institutions that offer technical assistance. Involvement by entrepreneurs on the boards of centres, such as those offering training or collective use of equipment, can be expected to increase an institute's sensitivity to industry.

Already there are projects in existence to utilize trade associations, such as, for example, one where the Hosiery Manufacturers Association is acting as a medium for an outside agency to encourage groups of 20 to 30 small enterprises to cooperate together for common purchasing of yarn. In the future, trade associations can be expected to play key roles in new development strategies, such as in the running of technical institutes (see below).

### **5.2.3 Making institutions more client responsive**

As part of an attempt to get away from large bureaucratic structures and draw closer to the particular needs of local small enterprises there is a clear trend around the world towards the introduction of mechanisms to make institutions providing technical services more sensitive to their clients needs.

There are at least four ways in which such institutions can be induced to be more responsive:

- (a) the selling of at least some services on a market "for sale" basis; the propensity of entrepreneurs to buy offered services gives an indication of the value of the services to industry;
- (b) the affiliation to the service institution of an industrial association which elects from its members a majority of an institute's directorial board; this board would be expected to have a strong influence on the programme of the institute;
- (c) the carrying out of surveys, firm visits, and group discussions with entrepreneurs in order to keep in touch with their needs;
- (d) the linking of the institution into agencies promoting public policy, by, for example, financial and/or legal contractual links, especially between the institute director and a regional coordinating institute. The coordinating institute should be in a position to evaluate whether the service institution is achieving desired goals such as, say, the development of small scale industry.

A further assistance to effectiveness is physical closeness to the small firm clients. This might be achieved by either locating the service institution in the midst of a sectoral agglomeration (such as close to a group of small textiles firms); or by linking a central main institution, or headquarters, to a decentralized network of small branches or mobile small units, which can act as both providers of immediate services and as ports of entry to the services located at the main headquarters.

The above mechanisms help support institutions to break down mental distances between staff and clients and make them more aware and responsive to the latter's needs. It does not, however, imply an abrogation of leadership. Rather it means a new balance between being demand driven and leading, or between top down and bottom up approaches. Where, for example, leadership involves the carrying out of research and development, or the engaging in technology transfer, or, say, the introduction of training in the latest techniques, or the provision of information on fashion trends, the service institute must make itself aware of the latest standards and techniques, and thereby be "ahead" of its clients and be in a position to provide a service on demand. At the same time, however, sensitivity by the service institution to clients' needs must also be there in order to ensure the appropriateness of transferring certain kinds of technology, or researching into particular processes or products, or providing a certain training curriculum, or indeed engaging in research into fashion trends.

In Pakistan, it has tended to be this latter aspect which has been at fault: a **lack of sensitivity and responsiveness to clients' needs**, especially those of small enterprises. However, changes are afoot. The mission found that there were a few innovative approaches to training and technology transfer that followed some of the above approaches, and which were aiming to be more decentralized and responsive to micro and small scale clients. The Pakistan Institute of Entrepreneurship Training (PIET, see Section 4.1), for example, has achieved some sensitivity to client needs.

The Institute combines a number of promising features. Its courses are short and to the point, and are offered near the clients' own bases, not in a large Institute-owned centre. The micro and small scale clients pay the full operating costs of the courses, and what they pay for at a reasonable rate they must be presumed to value. Government subsidy is limited to endowing the Institute with a sufficient investment income to cover its non-course overheads. Further, the Institute is making additional efforts, by surveying potential small and micro enterprise clients' needs, to make its courses demand-led, which its pricing-cum-subsidy policy makes it in its interests to do so. It serves both existing micro and small enterprises, and would-be start-up micro and small scale entrepreneurs; and the latter, so far, are said to have a good record of actually starting up. Finally, it could be argued that its policy of a small permanent staff combined with use of short-contract private consultants, instructors and other specialists, might go some way to avoid bureaucratic staff attitudes and over-manning.

The PAK-SWISS Agricultural Light Engineering Project tries to assist local small and micro metal workers and equipment fabricators by promoting development and local production of improved agricultural equipment. Considered simply as a project or institution, the history of the project has not been a particularly happy one. Indeed the project is scheduled to be closed down in June 1994. It was established in 1984 with Swiss technical and financial assistance as a project of the North West Frontier Province Small Industries

Development Corporation, at a large and lavishly-equipped centre on the development board's Mardan small industries estate.

However, until phase III (1991-present) it suffered the fate of many "centre based" small and micro enterprise support service institutions. According to project staff interviewed, it was introverted, producing prototypes without demand-led consultation with farmer-customers or producers, for dissemination to local private fabricators.

Understandably, this approach was not very productive. Now, however, it has introduced farmer-groups where their perceived needs for equipment or equipment-improvements are discussed; and also maintains close liaison with its clients on the metal-working producer side, to ensure that production engineering and production issues are addressed. Thus, in cooperation with both consumers and producers, it has introduced a number of products - among them a powered hand guided rotovalor - that are in successful local use and for-profit micro and small enterprise production. As a project Keddie believes it is still burdened with a heavy overhead of relatively under-utilized equipment and staff which has led to the withdrawal of further Swiss support and the impending closure of the institution.

However, the principle it has now adopted - of demand-led linking of the consumers of new or improved products, via and with the technical support of the institution, is one that merits replication elsewhere in Pakistan.

Aftab (1993) described as "extremely effective" The Pak-Holland Metal Project (PHMP) in North West Frontier Province which aims to introduce training and new technology to small outlying enterprises by operating 3 mobile training and technology demonstration units which travel into remote areas.

The Pak Holland Metal Project (PHMP) is a project of the North West Frontier Province Industrial Development Board, with Netherlands technical and financial assistance. It operates from several widely-spread locations throughout North West Frontier Province. It was established in 1986 in demand-led fashion. An extensive prior survey of metal-related micro and small enterprises in the province identified three target groups amongst them: automotive repair shops, light engineering workshops, and welding fabricators.

These were determined by the field survey to be in need of technical upgrading; and to have the existing technical capability, and the potentially expandable markets, to benefit from directed support services to achieve such upgrading.

The Pak Holland Metal Project has other activities, including a micro and small enterprise credit programme. However, the focus of the present discussion is the linked system of mobile trading units and widely dispersed industrial technology centres, which the programme has operated since its inception.

As mentioned above, there are three mobile training units, one for each target sub-sector (light engineering, welding fabrication, and automotive repair). Each has its own range of equipment fully installed, together with electric power-generation capacity, on a medium-sized truck. When opened out - which can be done in five minutes - the truck based mobile

training unit can operate as a training workshop. The range of equipment in each mobile training unit has advanced with the needs and the times. For example, the automotive repair mobile training unit now covers servicing and repair of electronic gadgets. The mobile training units are intended for basic upgrading training in all accessible areas of the province. The term "accessible" is constructively applied. In Chitral, the Pak Holland Metal Project transferred some mobile training unit equipment to 4-wheeled drive vehicles to reach over the high approach pass to the district, and set it up there in local micro and small enterprise premises.

The local industrial technology centre professionals conduct the training when the mobile training units come their way, usually once a year per mobile training unit. The operation of this project appears to have been influential in the design of a current government programme to take training to the people, administered by the National Training Board, that will involve establishing 10 mobile training units spread over the four provinces.

Also, in Punjab the provincial government's Small Firm Investment Corporation has created the Metal Industry Development Centre in the town of Sialkot. This centre provides small firms with the use of its expensive equipment (at a price), advisory services, research and development, testing and standardization, and technical training courses. It is said to be more successful than other similar centres because it is located close to the industrial sectors it serves, in a town with many metal-working enterprises. It also liaises with a trade association representing many of the town's firms - the Surgical Instruments Manufacturers' Association - through committees.

On a larger scale, the federal government is now beginning to encourage trade associations to run their own, sectorally-specific, training institutes with the aim of making courses more industry relevant. With the assistance of money allocated to them by government, associations are establishing their own institutes specific to their industrial sectors, run by management committees drawn from the associations. Government is providing money for land, buildings and machinery; and the trade associations are expected to finance management, instructors and day to day running costs. Fees are likely to be charged for services provided and income will also be raised from subscriptions. So far, it is reported, six or seven associations in the textiles industry are considering plans for institutes: including, for example, associations serving ready made garments, knitwear and towelling.

Other industries are also said to be making plans. In each case the trade association will dominate the board of the institute. Although the initial requirement is seen as a need for better trained workers, it seems to be generally expected that these institutes will expand into other activities should the association members demand them.

#### **5.2.4 Movements towards more agency coordination and better integrated service provision**

Calls are being made for better coordination of policies and projects. Such is appearing in evaluation reports (see, for example, Hussain and Mellgren, 1994). Also, there has been established a broad based Pakistan Donors' Coordinating Group which aims to promote harmonization of approaches and which could be influential in the future.



For the effective provision of services it appears to be increasingly recognized that services should, if necessary, be supplied as integrated packages. Thus, for example, clients might not only need to be made aware of new technology, they might also need to have training provided in order to operate the new technology, and also they might need credit facilities in order to purchase the new technology. Such integrated packages might be supplied through the medium of one agency or, alternatively (or also), through the medium of a coordinated network of specialized agencies. See, for example, the experiences in Valencia, Spain, (Annex 1 General International Trends in Small Business Promotion and the Valencia Case).

A recent evaluation of Punjab Small Business Corporation's Rural Industrialization Programme found that small firms who had received credit from the Corporation on concessional terms welcomed this support but they also expressed a need for other services, including what were described as "technical support services", "marketing facilities" and "common service centres". The evaluation report thus recommends that in the future the Corporation supplements its useful credit provision roles with a package of other services, necessary, it says, if long term sustainability is to be achieved (SEBCON, 1993, p. 91).

Already there is a tendency for some service institutions to complement a basic service such as training, or research and development, with other services such as shared use of expensive machinery or the provision of credit facilities. For example, the Pak Holland project mentioned earlier not only provides a mobile training service it also allows firms to share equipment, provides a comprehensive information service, advises on how to establish enterprises, and provides a credit service.

Another training based project, this time in Baluchistan, the Pak German Training Technical Training Centre, also provides an integrated range of services for small scale enterprises, combining training of new techniques and new technology, and skills needed for running businesses, with the establishment of 17 "model" self-sufficient workshops in different towns, with the idea of providing ideal workshops for people to copy (UNDP/ILO, 1993).

### **5.2.5 Larger firms developing their suppliers**

As indicated in the earlier part of this report large firms are increasingly relying on smaller enterprises and workshops to supply them with goods and services that might in earlier times have been done in-house. There are, then, new, and it seems increasing, opportunities for small enterprises to act as sub-contractors.

Their ability to obtain orders are likely to depend on their abilities to meet the latest standards. Conversely, the more that the larger firm must face global competition then the more that success will depend on having access to quality, flexible suppliers, of the kind that has underpinned much Japanese competitiveness. Thus the general success of the Pakistani manufacturing economy, including both large and small firms, may increasingly depend on raising the standards of the small enterprise sector.

Clearly the potential for exploitation, for excessive use of child labour, and for operating under cost-cutting poor safety and health conditions exist in such networks. On the other hand, it can equally be reasonably argued that as far as the owner of the small firm or

workshop is concerned, he or she receives capital, a definite market at no risk, the benefits of his or her customer's research and development department, and he or she learns about quality and technology.

Thus in many ways, it might be claimed, some large firms in flexible production systems are carrying out the same functions of technical service provision and upgrading that government agencies, NGOS, and other institutions are providing for small enterprises elsewhere.

The challenge for public policy is to build on these positive features whilst minimizing the negative ones. One issue would be the extent to which the small firm suppliers have long term prospects of developing into independent firms, maybe even exporters, in their own right. In the case above the large firm textiles manufacturer stated that he would be quite happy for his suppliers to develop autonomy and supply other customers than himself. Other large firm customers might not be quite so well spirited.

In fact, the literature suggests that the more normal situation is one of dominance and suffocation, whether by large firm customers or by wholesalers and other middlemen. In such cases there is a role for public policy to help small firms, particularly through the medium of technical institutes and appropriate NGOs, utilizing trade associations and other interfirm cooperative arrangements, to become independent and strong, whilst still retaining the efficiency and flexibility to attract the large customers.

## **6. RECOMMENDATIONS FOR PAKISTAN**

### **6.1 Make government institutions more effective**

It is generally understood in Pakistan that whilst the Federal government might be good at making policies there are significant weaknesses in the actual delivery of those policies. Whilst it would be wrong on this evidence available to generalize to all government officials and institutions, nevertheless it is quite clear from our discussions with people from a range of backgrounds and perspectives that there is a considerable lack of confidence in most government run institutions.

There are, however, initiatives emanating from higher level government circles, and some provincial bodies, which at least indicate that there is some awareness of the problems, and it seems that some of these initiatives offer platforms on which to build. For example, it is clear that there is commitment to a new public-private mix, with the private sector being encouraged to take more active roles in initiatives such as the development of new technical institutes. It will be recalled that this report mentioned that trade associations are being offered the opportunity to govern their own training technical institutes. This is definitely a positive move and should be taken further. The findings of this mission have been that all too frequently there is too much intellectual, and often physical, distance between service institutions and the clients they are supposed to be serving, and the involvement of industry representatives on directorial boards can significantly help matters. This does not mean, however, that the Director responsible for the day to day running of the institute should

necessarily be from a trade association. Much more important is that the person appointed should have a professional orientation and be capable of linking or networking with a variety of other agencies in both the public and private sectors. It has often been the experience of other countries that the calibre of the Director can be key to the success or not of a service institute.

The encouragement of research and development agencies to acquire more of their income through the sale of services is another trend which can be considered further, although the precise likely effects should be well thought out. For example, whilst the discipline of earning income from the market might very well (and from the limited evidence we were able to accumulate we can say it actually does) tend to focus the institution's attention to identifying exactly who and where are the clients, it should be born in mind that the 'clients' produced by a pure reliance on market forces might not necessarily be the ones that a broader public industrial strategy might wish to see assisted.

Moreover, a pure reliance on market sales might not produce a demand for services which are seen by a public authority as necessary from a long term developmental point of view - services such as research into new production techniques or training for example -, especially when such services are not perceived by entrepreneurs as providing immediate private gains. Consequently, it can be concluded that policies aimed at making institutions more industry responsive can certainly include the encouragement of earning income from sales of services, but the developmental implications should be well thought out, and other policies should also be considered.

Another encouraging sign of high level government initiative has been the recommendations referred to earlier by the Task Force for a New Social Contract to encourage a much greater level of local government involvement in development activities. This again seems to be a very positive move, especially to the extent that it might be accompanied by the desire to introduce greater private sector involvement through a new public-private mix. It is recommended that the general tenor of the task force's aspirations be acted upon. Moreover, it should be pointed out that whilst Pakistan's current government run institutional administration is generally very poorly thought of, this does not mean that somehow all government involvement in development matters is automatically necessarily a bad thing. It seems highly likely, for example, that local government officials will be better motivated and effective because they are dealing with an area in which they have a personal connection and stake, than say officials that are part of a distant centralized government bureaucracy. Nevertheless, it is equally generally recognized that many developmental functions would be better pursued if there was strong influence from people actually involved in the work of making and selling things, and encouraging responses from both trade unions and employers' organizations interviewed for this project indicate a readiness to become involved in tripartite activities at the local level. It seems necessary, therefore, to start thinking about a new role for government, one which involves a more strategic stand-off approach, facilitating and coordinating, and providing back-up services, but leaving much actual implementation to the non-government sector.

One immediate problem with such a 'facilitating' role for government officials is that it calls for skills and attitudes for which they might not have been trained. For some, a major reorientation might be required. This might also be the case for the Directors and senior staff

of service institutes (R & D Institutes, Technical Institutes, Testing Centres, etc). We can suggest the following strategy:

A programme of exposure to new ideas is proposed whereby key staff will be brought into contact with practitioners from other countries

### **Programme of Exposure to New Ideas**

#### 1. Five Day Workshop in Pakistan

This can be particularly oriented to government officials and Directors and senior staff of service institutes, but representatives of other organizations such as employers' organizations, trade unions and universities could also be encouraged to participate.

The aim of the workshop will be to discuss the problems and issues besetting Pakistan government agencies and to make comparisons with experience in other countries. Under the auspices of the ILO's international network selected experts and practitioners from abroad would be invited to attend.

#### 2. Study Trips Abroad

The workshop should then be followed up by the organization of study visits abroad to good examples of government agencies acting out intermediary roles, and service institutes supporting, in particular, small enterprises. The precise locations can be decided later but possibilities are Newfoundland in Canada where a government agency the Economic Recovery Commission very much works by mobilizing and networking with private interest groups; or Emilia Romagna in Italy where the regional government is acting as mediator and supporter of interest groups that are searching for new strategies to upgrade industry, and where there is a network of agencies supporting small firms; or Valencia in Spain where a government agency mediates amongst and coordinates a range of relatively autonomous service institutions and interest groups. Annex I provides a general introduction to international trends in enterprise networking programmes in general and the case of the Valencia Model in particular.

3. Follow-up activities can include: i) the bringing over to Pakistan of foreign practitioners and experts to comment and advise, and engage in further seminar discussions with local people; ii) the carrying out of an in-depth investigation at provincial level of the potential for establishing a new decentralized institutional approach (see later).

As a general principle Pakistan might wish to recognize that many of the structural changes it is undergoing are also occurring in other places, and that there appears to be a growing global trend for areas undergoing change to learn new ideas by copying what they see as the best practices in other parts of the world. This seems a good strategy and it can be recommended that for Pakistan also either at the national or provincial levels collaboration with other countries and regions for the purposes of exchange of ideas be strengthened. In respect of the recommendations being discussed here it is important for government officials to become aware that an effective decentralized, coordinated system of institutional support for small enterprises in Pakistan is very much also the goal of people in other countries and that there is a lot that can be learnt from them. An international organization such as the

International Labour Organization would be able to play a significant networking role in bringing people from different countries together. Indeed, there is no reason why the technical assistance that the ILO can give to Pakistan in this respect cannot be coupled with requests for similar assistance to other countries. The possibility might be pursued of gradually developing a network of collaborating regions, initially coordinated from ILO Headquarters in Geneva.

4. Literature outlining international experiences should be made widely available to interested parties in Pakistan, and, if necessary, translated into appropriate languages.

## **6.2 A provincial project investigation of a new decentralized institutional approach**

It is recommended that a 6-month project be undertaken to explore the potential for a new provincial level institutional approach for supporting small enterprises in Pakistan. It is recommended that the project be specifically focused at provincial level. Such a programme should complement the Programme of Exposure to New Ideas suggested earlier. It should be initiated soon after the proposed 5-day workshop (see earlier).

Activities for such a project would include:

- the identification and detailed mapping of industry, service institutions, interest groups, political authorities, and administrative organization in a local area, at provincial level and smaller.
- the carrying out of interviews with representatives from the identified local actors to assess the prospect for a collaborative network approach, and to consider possible institutional arrangements. Should, for example, a new coordinating institute be established and, if so, where should it be located?
- the drawing on, and cooperation with, existing work and ongoing projects of a complementary kind. For example, a planned Swiss Development Corporation sponsored pilot project for small scale enterprise promotion in the North West Frontier Province has many features which could be complementary, particularly regarding the promotion of technical institutes near sectoral clusters, the promotion of trade associations, and the intention to try and establish collaborative networks. Other projects, geared, for example, to promoting small firm trade associations and encouraging interfirm cooperation, could also be complementary; a project being carried out by Mr. William Mellgren by the ILO/Japan Project Strategic Approaches Towards Employment Promotion sponsored by Japan is one example. Other projects being sponsored by the World Bank, by Dutch interests and by German organizations, such as the Friedrich Ebert Foundation, are also carrying out relevant work. It is recommended that the Donors' Committee be used as a valuable medium for exchanging ideas.
- meetings with local and national experts for reaction and discussion. Included could be one or more presentations at the Donors' Committee. Further seminars and discussions can be held with other interested parties, particularly within the provincial area being studied.

- a report on the prospects for a decentralized institutional approach can be written. This will cover the situation for a particular province (yet to be decided upon) and will draw on i) discussions and reports from the Exposure Programme, ii) Field Work from this specific project, iii) Reports emanating from and discussions with members of the Donors' Committee and other expert parties in both government and non-government organizations.

### 6.3 Need for better coordination

It was noted in the report that there is a plethora of institutional initiatives being promoted in a variety of governmental and non-governmental bodies. For maximum effectiveness it is essential that different programmes emanating from different authorities do not contradict one another, and, if possible, should positively mutually reinforce one another. As mentioned earlier, there are encouraging signs that this need has been recognized. In respect of government, for example, we pointed out that demands have been made for more coordination between different ministries and departments in respect of labour policies; whilst the existence of a Donors' Coordinating Committee reflects the concern with coordination, particularly amongst the large number of programmes being funded by international bodies.

We also pointed out that it is increasingly recognized that there is a need for coordination in the delivery of various facets of technical assistance, such as technology upgrading, managerial skills, and credit provision. Small scale enterprises often need a 'package' of assistance.

Further, there is also a need for coordination between technical and institutional initiatives and broader aspects of the policy environment. Clearly if the overall objective is to pursue a high productivity/high wage/high innovation set of aspirations, taking into account the specific needs of small and micro enterprises, then again there must be specifically tailored policies to positively encourage this track of development and they must complement institutional and technical assistance.

Finally, there must also be complementarity amongst different levels of political and administrative authority. In other words, in as far as is practically possible, at both local level and higher levels, government and non-government development institutions must all be moving in the same general direction. This is all the more important if the contention suggested in this report is accepted that a focus on development should not be so much on individual enterprises as on developing the capacities of whole industrial networks of enterprises. Such an approach calls for policies which emphasize achieving scale in terms of numbers of enterprises covered, and policy coordination and cohesion.

### 6.4 Strengthening interest groups and the capacity for collaborative activities

If the federal government's general policy of encouraging a greater public/private mix as an alternative to the dead weight of a generally inefficient state bureaucracy is to be made effective there needs to be a strengthening of the capacity of private interest groups to become active in the development process. Trade associations are already taking an interest in the running of technical institutes, and this is good; but there is a suggestion that the greater response might be coming from the associations that represent the relatively larger

establishments such as the All Pakistan Textiles Manufacturers Association. Small enterprises also need their representation and possibly their own technical institutes. Many trade associations for small and micro-enterprises already exist and although they tend to act mainly as lobbying organizations their potential for other kinds of collaborative activity is great. It is strongly recommended that this potential be encouraged.

Where there are no existing trade associations then clearly the organizational problems are much greater. Nevertheless, there is no good international experience in respect of how small and micro-enterprises might be brought together for common economic goals.

Basically, it would seem that in order to encourage enterprises to come together entrepreneurs must have the motivation and an issue around which collaboration can (initially) centre. Experience from other countries suggests a range of possible circumstances and issues that can motivate collaboration - ranging for example from the attractions of shared advertising to common purchasing to group product design and production - but perhaps particularly prominent have been:

**where enterprises are facing crisis and so are particularly willing to consider new solutions; where enterprises need new markets and are willing to consider collective solutions such as the common exhibiting of their products, or even collective exporting; where small enterprises need to raise their quality standards and will look for economically viable ways to do it; where enterprises need to raise financial loans and will welcome assistance in this direction; where enterprises feel a lacking in the latest skills and techniques and will become involved in seminars, discussion groups and common training programmes.**

A tentative suggestion might be that small enterprises could be encouraged to initially cooperate on the more popular issues and/or in the most propitious circumstances suggested above. Experience has been that once enterprises collaborate on one issue they are likely to later develop other areas of collaboration.

There appear to be at least three factors which are likely to help a government inspired programme to increase interfirm cooperation. One is the presence of a culture and business environment that motivates individual entrepreneurs to improve their enterprises (and in this regard see, for example, references to the promotion of a 'quality culture' discussed below). A second is the presence of organizers or brokers who intervene to encourage cooperation and to provide advice on possibilities and procedures. Such brokers can be located in a variety of institutions, including government departments, universities, technical institutes, and non-governmental organizations. A third is the provision of a subsidy, either in cash or in terms of concrete equipment and facilities. Such a subsidy should be provided only to groups of firms rather than on an individual basis. Exactly how much subsidy, and for how long, will differ according to circumstances.

By such means existing trade associations can be encouraged to broaden the character of their existing activities, and new cooperative groups can be formed from scratch. It is recommended that current plans to expand the numbers and roles of technical institutes include the possibility of using them as bases from which to 'broker' and organize cooperative activities beyond simply the provision of training. In the case of outlying enterprises

consideration can be given to adapting outreach programmes such as that exemplified by the Pak Holland project. Other agencies can also be encouraged to promote cooperative activities.

A possibility voiced by a trade union federation representative interviewed for this project would be for the very smallest micro unit entrepreneurs to be encouraged to join self-employed special sections affiliated to trade union federations. This idea, of trade unions organizing the self-employed, seems to be gathering ground in other countries, especially in contexts of increasing employment flexibility where there can be frequent changes in status between employer and employee.

Other interest groups must not be forgotten either. If a corollary of breaking down bureaucratic state inefficiency is greater decentralization and empowerment at the local level then clearly other recognized special interest groups with a stake in local development must be encouraged to make a contribution. There might be special women's groups or agricultural organizations for example.

It is recommended that the question of how best to promote interfirm cooperation be included in the five day workshop and the follow up activities already recommended earlier under the heading of a Programme of Exposure to New Ideas.

## **6.5 Improving quality**

The raising of quality standards is one of the most pressing issues facing Pakistan industry, including small and micro enterprises. In order to achieve this there must be both the motivation on the part of enterprises and the capability. Motivation can reflect an awareness of economic advantage or need; it can also possibly reflect a sense of cultural normality, in the sense of belonging to a quality culture. Certain standards are taken for granted. Part of the problem in Pakistan is that all too often it appears that the normal standards are low standards, and that because the expectation of such is so widespread there is no perception of an economic need to meet them. Customers in Pakistan are not demanding, possibly because not expecting, quality.

However, the more that Pakistan becomes integrated into the world market and the more that competition intensifies the greater that, in some sectors at least, the perception of the need for quality will rise. Already this appears to be happening in the textiles sector and maybe in other sectors also.

The ability to respond to a demand for increased quality is conditioned by a number of factors including appropriate skills and technology, not only inside an individual enterprise but also amongst other enterprises from which supplies can be obtained. This calls for a widespread introduction of quality and so the ensurance that programmes to raise standards have geographical and sectoral scale.

Introducing a quality culture into Pakistan is going to be a difficult, but very necessary task. The government should give it high priority. In this connection the government plans to establish a National Productivity Center (possibly under the Pakistan Industrial Technical Assistance Centre (PITAC) in Lahore).



Amongst the instruments that might be considered are: national propaganda campaigns and extensive training programmes; the introduction of an accreditation scheme to authenticate product quality, with technical institutes possibly being key institutes given the authority to carry out the necessary testing; schemes to allow small enterprises to share expensive measuring and testing equipment can be introduced; possibly manuals can be introduced that rate individual enterprises in a district for their quality and production capabilities; another approach is to institutionalize an annual award ceremony for enterprises that excel in different industrial sectors; also credit schemes could be tied to the meeting of quality standards.

Again to repeat what was said earlier, the aim should not be to do things piecemeal but in an integrated coordinated fashion. There is no point providing the facilities for upgrading quality if people are not of a mind to use them; neither is there advantage in persuading people they need to upgrade if they can then do nothing about it. In this respect a campaign to improve quality can be linked to a programme to increase interfirm cooperation as a means of raising standards on a broad scale.

#### **6.6 Large firm - small firm linkages**

A possible policy option for government is to increase and to upgrade small enterprises by encouraging inward movement of world class companies who will provide new markets for small indigenous firms whilst hopefully forcing up suppliers' standards. Evidence from respondents for this mission suggested that Pakistan's large firms, especially in the textiles sector, might increasingly be relying on the support of flexible networks of small and micro enterprises and that having access to such could be an important source of international competitive advantage. Thus large firms could have an increasing interest in ensuring the highest standards amongst small enterprises.

We recommend that a thorough study be carried out to look into the current subcontracting and sourcing policies of large firms in Pakistan. Which firms in which sectors have an interest in raising suppliers' standards? What are they doing about it? What are the perceptions of large Pakistani companies of the small enterprises sector? What, in brief, is the potential for a large firm led growth of the small scale sector? How might any beneficial tendencies be encouraged further? What is the potential for a development strategy that tries to attract specific targeted multinational companies calculated to be the most beneficial to small scale enterprise growth?

#### **6.7 Improving working conditions**

Working conditions in many small and micro-enterprises are inadequate. The proposals suggested here to raise the standards and productivity small and micro-enterprises go hand in hand with the raising of living and working conditions. Greater competitiveness demands higher skills, superior productivity, and a bigger capacity to generate income. Quality improvements will require cleaner and safer environments. A capacity for change and innovation, increasingly necessary for successful competition, benefit from a climate of consensus and trust, and a confidence in the economic system's capacity to provide improvements in living standards. Whether for moral reasons or out of perceptions of straightforward economic advantage to the country, the pursuit of improvements of living and working conditions in tandem with enterprise development is necessary.

**General international trends in small business promotion and the Valencia case**

Developments like intensifying international competition, global sourcing by multinational companies, and the weakening of trade barriers are exposing countries everywhere to new heights of competition on home markets from foreign producers, and equally severe pressure from foreign competitors on export markets. "Safe" markets, whether at home or abroad, are fast disappearing.

Along with the trends towards greater global economic integration, there have been significant political re-alignments, with the nation state tending to fade in significance in the context of the development of great trading blocs such as the North American Free Trade Area and the European Union, and, conversely, the rise to prominence as economic protagonists of provinces or regions within national boundaries. In many cases such regions are beginning to relate to one another as trading partners, over and above relations taking place at national level. Competition between regions seems to be a growing phenomenon; and increasingly this is taking the form of competition between onal systems of innovation.

In many countries of the world small firms are playing an important part in the process of change that is occurring. This is for a number of reasons, which may include the following:

- (a) large units, partly through technological change, are no longer providing sufficient jobs; consequently, small firms have taken on a new political importance as potential sources of employment;
- (b) flexibility and risk avoidance have become major objectives of large companies, resulting in an increased tendency for firms to specialize in what they do best and to outsource the rest;
- (c) new market conditions have put a premium on speed, flexibility, quality and innovatory capacity; it has been recognized that the capability of any individual firm depends on the standards of the suppliers from which it can source; hence a recognition of the need to make sure small firm suppliers are capable of meeting the necessary standards;
- (d) a recognition that for certain industries (such as garment manufacture, footwear, and engineering) small firms, when organized into appropriate contracting networks, with adequate institutional and regulatory support, can compete with large firms; hence countries or regions which are unable, or do not wish, to rely on large firms to lead their economies now perceive alternative possibilities based on small units.

Some people have suggested that many developing countries are at risk of becoming marginalized, or excluded, from a new world order based on new competitive conditions. Rich regions that already have a technological and knowledge advantage might draw further ahead as under the spur of competition amongst themselves they invest in the latest processes, techniques and knowledge.

This lagging is thought to be especially likely to be the case for developing countries that are unable to escape from a dependency on a competitive strategy that relies overwhelmingly on cheap labour. On the other hand, examples of rapid advances in certain countries, such as, in South East Asia, South Korea, and in relatively backward regions within otherwise rich countries, such as (was) Emilia Romagna in Italy, have given hope that a "catching up" process is not impossible.

The object of many regions has become to create the most appropriate regulatory and institutional environment for raising standards to world class levels and establishing a framework for permanent innovation and improvement. Small firms are seen as central elements in the new vision of innovatory economies, and regions or provinces are increasingly seen as the appropriate protagonists and foci of action. This focus on the region is itself partly a consequence of the rise to prominence of small firms with their particular local connections.

Many authorities are looking for ways to bring their small firms up to world class standards, especially those small firms which wish to supply international companies, or which wish to export, either alone or through consortia.

In the effort for regions to create an innovatory environment for small firms, two policy instruments stand out in respect of their growth in popularity:

- ◆ The provision of a supportive service infrastructure, providing, in particular, a range of direct technical services such as technology transfer, training, information services, applied research and development, quality testing and certification, and marketing.
- ◆ The encouragement of interfirm cooperation in order to increase economies of scale and scope, and rapid information spread.

In many countries of the world a search is in progress to identify the most appropriate means of organizing and delivering a new range of services for small firms at the local level. This focus on delivery mechanisms follows from the recognition that just as important as new policies is an appropriate governance and institutional structure that can not only be capable of delivering services, or carrying out promotional actions, in the most effective manner, but which is also inherently capable of adapting to an environment of constant change. In the search for the best approach regions are actively learning from one another. Amongst the more closely watched are the approaches of Japan, Emilia Romagna in Italy, Denmark, Oregon in the United States, four certain states in Germany, and Valencia in South East Spain.

In Japan, for example, the Kohsetsushi network of 170 technology centres has been identifying as playing a significant part in developing hundreds of thousands of small, flexible, technologically proficient manufacturers (Shapiro, 1993). Emilia Romagna is famous for its industrial districts of internationally competitive small firms supported by sectorally specific "real service" centres (Pyke, F., Becattini, G. and Sengenberger, W., 1990). Whilst the Valencia region of Spain has risen to prominence because of an innovative strategy to raise industrial standards and competitiveness through an approach that stresses cooperation, networking and the roles of technical institutes (Pyke, 1994).

This report focuses on the adequacies of the service infrastructure available to Pakistan's small and very small enterprises, looks at the prospects for improvement, and asks whether the country might learn from some of the foreign initiatives, particularly that of Valencia.

### The Valencia Model

In the region of Valencia in South East Spain a programme of institutional support for small firms has been initiated which could offer many lessons for Pakistan. This programme seeks to deal with many of the same weaknesses that are perceived to exist in Pakistan's institutions, with the object of leading Spanish industry away from a traditional reliance on cheap labour and low quality as sources of competitiveness towards a higher quality, higher value added innovation minded strategy. Much of the approach being taken resonates strongly with the kinds of progressive ideas and practices now developing in Pakistan, as presented in the last section above. The suggestion in this section is that possibly Pakistan could learn from Valencia's experience.

The essence of Valencia's strategy is to create a decentralized network of synergistic support institutions, coordinated by, but not dominated by, a central institute. This institute is known in Valencia as the Institute for the Promotion of Small and Medium Sized Firms (IMPIVA). It has its own budget of approximately \$70,000,000 a year, and it acts with a good deal of autonomy; it is ultimately, however, responsible to the regional government to which it must make yearly reports.

The institute is leading the upgrading industrial strategy of the region. The cornerstone of the strategy is a network of 11 semi autonomous technical institutes. Eight of these institutes serve specific small firm sectors (providing a range of services to, in turn, sectors specializing in footwear, textiles, ceramics, and others); and three cater for all sectors by supplying specialized services (e.g. microelectronics or packaging).

The particular services provided by the 8 sector specific institutes depend on the particular needs of each sector. Whilst the provision of training, technology transfer, quality testing and certification, and the provision of information feature strongly in nearly all technical institutes, other activities can include advice and actual help with marketing, research and development, shared use of machinery, the encouragement of interfirm cooperation, and other aspects.

The institutes are made responsive to their clients by virtue of the existence of affiliated industry associations which elect a majority of the boards of the institutes; further

responsiveness is assured by virtue of the fact that the institutes sell services and charge an affiliation fee; also, the sectoral institutes keep in close touch with their clients by being sited close to the industry - which in Valencia's case is often agglomerated; finally, the institutes effectiveness is monitored by IMPIVA.

IMPIVA has a representative on each institute board; its influence is further aided by the fact that the appointment of each institute director must be ratified by IMPIVA, and also by the fact that it channels to the institutes a permanent subsidy amounting to approximately 33% of costs. Thus each institute director must try to satisfy not only the demands of his affiliated entrepreneurial association, but also make sure his institute can sell services, and also meet the demands of IMPIVA - which has the responsibility of trying to coordinate the semi-autonomous institutes in line with public policy through a bottom-up approach. IMPIVA thus plays a crucial coordinating role. It has an overall view and is in a position to identify the total range of services available in the region - both within the network of technical institutes and beyond - and to identify weaknesses and omissions. It does not play this role alone however. Central to the approach has been to institutionalize a strategy of cooperative networking between the institutes, between the technical institutes and other supporting agencies, and between the agencies and IMPIVA.

This has been facilitated by ensuring the involvement of representatives of key local institutions, such as banks, chambers of commerce, and trade unions on the boards of various institutions, and on a consultative board for IMPIVA itself. Further, regular meetings of all the institute directors are held to discuss developments; it was after such meetings, for example, that it was decided, in turn, that there were needs for a packaging institute and a statistical institute on whose services the other institutes could call.

Two other significant elements in the IMPIVA networking strategy are the creation of three Business Incubation Centres (BICs) to aid the foundation of new enterprises, and the inauguration of a Science Park to which it is hoped to attract prestigious international companies. Each Business Incubation Centre has a board on which sits representatives of banks, trade unions, employers organizations and other significant actors. These boards are responsible for providing an integrated package of support which they are able to ensure by virtue of their personal links and through links with other institutions, such as the technical institutes, and through IMPIVA.

The 11 technical institutes, the three BICs and the Science Park (on which some technical institutes are located) constitute what IMPIVA calls its 'Inner Network'. Beyond this network IMPIVA then has further connections with an 'Outer Network' of universities, training establishments, design schools, and other service institutions.

### **The Valencia Model's Applicability to Pakistan**

The introduction to Pakistan of a version of the Valencia strategy is highly appealing. It appears to address many of the current weaknesses of the existing support institutions whilst strengthening the progressive developments mentioned in Section 5.2. The Valencian technical institutes, and indeed the whole network of institutions in the region, are made responsive to both the small firms which they are trying to promote and to the other stakeholders in the local economy.

IMPIVA seeks to act as a facilitator, as an intermediary amongst a network of institutions that act with considerable autonomy. If an affiliated trade association in the shoe industry, for example, informs its dedicated technical institute that there is a need for more training in a particular specialism then either the institute itself will provide the training or, if this is not possible, it will refer the matter to IMPIVA: IMPIVA then will use its broad knowledge of the training institutions existing in the region to find a suitable educator; should, for example, a university level course be required then IMPIVA will link up the university with the shoe technical institute and thereby with the industry.

IMPIVA also has the role of gathering information from its network of informants - such as the members of consultative committees and the regular meetings with the directors of the technical institutes - to identify unsatisfied needs of industry, and then act upon it. And by operating a range of institutions as a network IMPIVA can ensure that small enterprises can be offered a package of assistance, including, say, entrepreneurial training, credit assistance, help with marketing, and whatever else is needed. The ideal aim should be that all small enterprises have access to the whole network of assistance. Thus there is a coordinated approach to development which Pakistan also needs.

Further than this, an aim in Pakistan should also be to facilitate linkages between local supporting institutions, such as the technical institutes, with other institutions specialized in the advancement of knowledge. In order for technical institutes to play their leadership role and contribute towards the encouragement of innovation they must themselves be in a position to keep abreast of the latest ideas. Thus there should be linkages to universities, including a planned Pakistan textiles university being promoted by the textiles trade association APTMA, and other sources of knowledge. This knowledge could range from the latest technological advances to fashion trends to a better understanding of how small firm economies can be developed.

The IMPIVA system has the strong advantage of involving the major interest groups in regional development. It was pointed out at the beginning of this report that there is a general global trend to find a kind of decentralized governance structure that can facilitate adaptation to an era of constant change. Greater involvement of interest bodies, with government agencies acting as mediators or facilitators, is seen as a possible route. Financial institutions, employers associations, trade associations, and trade unions are all potentially important partners in the development process. In Pakistan's case, some organizations, such as associations for the self employed or trade associations for industries that have none might need to be positively encouraged to develop.

All the above bodies and more can help local development with their specialist expertise and resources, legitimize change by virtue of the numbers they represent, and spread new ideas and information quickly and widely through the medium of their organizations.

IMPIVA has the advantage that it is relatively autonomous from government. Should Pakistan wish to follow its example it is recommended that the director of a similar institute be appointed from outside government circles. A highly respected university academic or researcher with a strong practical interest in regional development would be a likely choice. Such a person would then be responsible for appointing a professional team, again with no

governmental connections. By this means a strong independent professional institution can be fostered.

Nevertheless, such an institute must ultimately be responsible to an elected political authority through a directorial board. However, in order to prevent the institute becoming tied to any particular ministry and thereby threatening to compromise its independence, it is recommended that the board be composed of representatives from a range of ministries, and possibly including representatives from outside institutions also - such as employers organizations and trade unions. In keeping with the need to decentralize operations and involve local people in development issues, such a coordinating institute, and its immediate network of connected institutions, should operate at a local level. Possibly in Pakistan's case the most practical approach might be to establish a coordinating institute for each province with the longer term possibility of considering further sub-institutes at more local district levels.

The creation of a coordinated network of support institutions can both tap into existing agencies and activities and initiate new ones where particular needs are identified. For example, in respect of the promotion of better credit facilities, the National Manpower Commission of 1990 recommended the establishment of new locally-based financial institutions. Such institutions, providing credit for small and micro enterprises, no doubt taking note of the need to simplify procedures, could certainly be installed within a network approach, with representatives sitting on boards of various other support institutions, such as technical institutes or business incubation centres. Moreover, the technical institutes would also be in an excellent position to encourage joint collateral credit clubs amongst the affiliated trade associations. Further, other ideas relevant to credit provision, such as a better understanding of the role of suppliers' and buyers' credit, and the role of trust, could be fed into the network system from outside (such as from university economics departments).

*An integrated service approach for establishing new enterprises in Valencia*

*Within IMPIVA's network of technical institutes there is one particular one which has the specific mission to create an entirely new industry. How it goes about this mission could be of relevance to Pakistan's efforts to promote small enterprises.*

*This Valencian institute locates itself in the midst of a network of activities and institutions necessary for developing an industry, and sets about coordinating them towards a common focus. To explain further, this institute aims to create an entirely new industry that produces high value added metal medical aids (such as artificial body parts or instruments for strengthening brittle bones). It goes about this by establishing close relations with all the main purchasers of medical equipment in Spain, especially the hospitals, in order to ascertain what are their needs. Having identified a need it researches, designs and then produces a prototype to fit the medical purchasers' specifications.*

*Concurrently with going about this activity, the institute also identifies small workshops, or even just individual entrepreneurs, located in Valencia, who would be capable of producing a new product. The new product is then designed to be produced in component parts, so that they can be distributed amongst 3 or 4 separate sub-contractors.*

*Having identified the eventual purchasers and the producers, the technical institute then links the producers with a bank with which it has close relations; the bank, seeing that there is a definite purchaser, a definite product, and a definite producer(s) is then prepared to lend money to establish production.*

*The workshops are then given the rights to make the product which is then sold to the medical purchasers at a high price because of its unique high value characteristics. Such a product might last the newly established workshops say five years during which time they are expected to find other business and expand. Often the technical institute itself is funded for the research and development of the product by the eventual medical purchasers.*

*On top of this interventionist role the technical institute also supplies services, such as quality testing services, on a market demand basis. It also advises the other technical institutes on matters for which it has a particular expertise.*

In Pakistan's case, as elsewhere, it can be expected that training and quality improvement (through testing and teaching new practices)<sup>1</sup> will feature strongly. Again the particular form in which they are promoted will need to take account of peculiar Pakistani conditions and existing institutions and regulations. For Pakistan's informal sector, for example, it seems to be generally agreed amongst experts that it will be necessary to build upon the existing Shagird-Ustad training system, possibly reducing apprenticeship lengths and introducing new techniques and appreciation of new technologies where necessary. Raising the level of entrepreneurial cooperation<sup>2</sup> is also likely to feature strongly: the sharing of research and development, the sharing of expensive machinery including quality testing technology, the formation of marketing and buying consortia, the establishment of experience exchange clubs to spread knowledge of latest techniques, and other joint activities, such as organizing credit clubs mentioned above, could be promoted - either through technical institutes or by other means.

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<sup>1</sup> In respect of encouraging technical institutes to introduce quality testing some means will have to be found to convince Pakistani entrepreneurs that they do in fact need to improve their quality. Simply providing institutes might not be enough. It might be worthwhile pointing out that techniques that have been used elsewhere have included: government campaigns to frighten small enterprises that they will not be able to survive in the future without improved quality; campaigns to change people's values and expectations through the establishment of high status, special awards, given in highly public ceremonies, to entrepreneurs demonstrating technical and quality improvements; and the introduction of national quality standard certification to be awarded by accredited technical institutes.

<sup>2</sup> A number of people pointed out for this project that entrepreneurs in Pakistan will not cooperate, and that trade associations will not go beyond what are generally very limited objectives of providing some information and acting as lobbying groups with government. However, it can be said that such claims have been commonly made in other countries, but yet given encouragement and shown clear advantages small enterprises have in fact collaborated on many aspects. The intervention of an independent 'honest broker' such as a technical institute or an NGO or a university has often been useful.



As in Valencia's case it would be expected that the semi-autonomous support institutions in Pakistan will evolve their services, their activities, and their means of delivery to suit their particular clientele. Where appropriate, for example, a technical institute could be located in the midst of a sectoral agglomeration, such as exist in the Punjab. In other cases a mobile unit approach reaching out to scattered clients might be more appropriate. Moreover, technical institutes or other agencies might be established to cater for specific industrial groups, such as particular size ranges of small enterprises.

More generally it can be stated that the improvement of the provision of institutional support should go hand in hand with the introduction of other appropriate policies to promote small scale enterprise, and in particular the creation of a high productivity, high wage, high innovatory environment. Moving Pakistan away from a dependency on a competitive strategy of low wage and low quality must be the first basic principle on which policies can be developed. The underlying ethos of what a new institutional networking strategy is trying to achieve should be well understood by the staff of the new coordinating institute, as well as by members of other agencies involved.

**Mission programme for Mr. J. Keddie**

**November 1993**

- 11 November Travel from Scotland to Geneva
- 12 November Briefing sessions with ILO headquarters officials:
- Mr. Henriques;
  - Mr. Allal;
  - Ms. Capt; and,
  - Ms. Vejs-Laursen.
- 13 November Travel from Geneva to Islamabad
- 14 November Briefing/planning session with Ms. Khan, programme officer, and Mr. Thresher, chief technical advisor for the vocational rehabilitation project PAK/88/010 (Islamabad)
- 15 November Meetings with:
- Mr. S. Mazsood, Joint Secretary of the Ministry of Labour and Manpower;
  - Messrs S.S.H. Shah, Joint Secretary, and R. Illahi, Deputy Secretary of the Ministry of Local Government and Rural Development
  - Mr. I. Ahmad, Director of the project PAK/89/M01/NET (Peshawar)
  - Ms. S.F. Lavador, chief technical advisor of project PAK/89/M01/NET for training and employment for rural women in NWFP
  - Messrs W. Mellgren, chief technical advisor, and S. Hussain, programme officer for the project RAS/92/MOI/JPN entitled Strategic Approaches Towards Employment Promotion (Islamabad)
- 16 November Meetings with:
- Mr. B. Girardin, First Secretary (development) of the Swiss Embassy
  - Mr. James Terry, Chief Technical Advisor for the project RAS/92/009
  - Mr. M.J. Khan, Managing Director of the Small Business Finance Corporation
- 17 November Meetings with:
- Ms. K. Mittmann, GTZ project administration services
  - Mr. J.L. Swift, Private Enterprise and Energy Office (USAID)
  - Ms. N. Shirin (USAID)
  - Ms. K. Fatima, (USAID) NGO coordinator (by telephone)
- 18 November Meetings with:
- Mr. R. Saghir, Managing Director (also represented Entrepreneurship & Career Institute (ECI)) - Systems Development and Resource Centre
  - Messrs J. Lingham, First Secretary (development), and A. Ali, programme officer of the British High Commission
    - Ms. S. Sultana, Vice President of the First Women's Bank Ltd.
    - Mr. E. Kengen, First Secretary (Industry) of the Royal Netherlands Embassy
- 20 November Travel to Lahore
- Meetings with:
- Mr. M. Babri, national TSSI consultant, The Konsultants
  - Dr. M.A. Mueez, Executive Director of the Pakistan Institute of Entrepreneurship

## Training

- 21 November Meetings with:
- Labour Department (Punjab Government)
- Mr. F.D. Ahmad, Additional Chief Secretary, national TSS1 consultant
  - Mr. G. A. Maken, Director manpower and training
  - Mr. A. Ahmad, Joint Director technical training
  - Mr. M. Shafi, Joint Director apprenticeship
- Medium and small enterprises (Gulberg main market, Lahore)
- Engineering firm
  - Electrical and auto parts trader
  - Contractor
- 22 November Meetings with:
- Mr. T. Hamid, President of the Employers Association of Lahore
  - Messrs G.A. Hafeez, Managing Director Industries corporation, and H.H. Malik, Regional Director of the Punjab Small Industries Corporation
  - Mr. M.B. Akhtar, Principal of Pak-German Technical
  - Professor K. Aftab, Principal of Government College (Lahore)
- 23 November Travel to Sialkot
- Meetings with:
- Mr. H.H. Malik, Regional Director of the Punjab Small Corporation (Gujranwala)
  - Furniture and tractor parts makers, medium and small enterprises
  - Manager of the United Bank
  - Mr. E. Haq Mirza, project director, Metal Industries Development Centre (Sialkot)
  - Mr. M. Farook, area director, Punjab Small Corporation (Sialkot)
  - Mr. N.R. Paul, manager of small business finance (Sialkot)
- 24 November Travel to Lahore
- Meetings with:
- Messrs Haq Mirza, Farook and Malik, PSIC
  - Mr. A.J. Sandal, Honorary General Secretary, Surgical Instrument Manufacturers' Association of Pakistan (Sialkot)
  - Manager, MIDC heat treatment satellite unit (Sialkot)
  - Surgical instrument sub-contractor and agricultural equipment manufacturer, MSE Daska
  - Mr. M.I. Mughal, General Secretary, engineering and industrial association (Daska)
  - Mr. A Yunus, project director, Institute of Technology (Gujranwala)
- 25 November Travel to Kasur and return to Lahore. Flight to Peshawar
- Meetings with:
- Messrs Aslam, MSE tanner, and S. Husain, Chairman of Kasur Tanners' Association, PSIC Leather Industries Centre (Kasur)
  - Mr. Shafiq, MSE fish restaurant (Mori Gate, Kasur)
  - MSEs in country towns on return journey to Lahore:
    - . metal fabricator
    - . building materials merchant
    - . machine shop, maintenance and parts
  - Professor J. Ghani, Lahore University of Management Sciences

- 27 November Peshawar
- Meetings with:
- Mr. T. Shahzad, Technical Manager, Pak-Holland metal project
  - Mr. N. Khan, Deputy Managing Director, NWFP small industries development board
  - Mr. K. M. Khan, Assistant Registrar Cooperative Societies, Government of NWFP, Chitral
  - Mr. B. Ahmad, Managing Director, The Bank of Khyber
  - Mr. A. A. Arbab, Executive Director (idem)
  - Dr. M.M. Khan, Director (Project Loans), idem
  - Mr. M.P.A. Qayyum, Managing Director, Rehman Aluminium Industries Ltd, SIDB industrial estate
- 28 November Travel to lower Dir (Temegara) and Mingora
- Meetings with:
- Ms. Luzot & Ms. Khan, ILO project members PAK/89/MOI/NET
  - Mr. S. Mahammad, social welfare officer
  - Dr. Rafiq, bee-keeping expert
  - Women bee-keeper trainees/beneficiaries
  - Mr. M. I. Niazi, Pakistani rural development consultant
- 29 November Travel to Mardan and Peshawar and flight to Islamabad
- Meetings with:
- Pak-Holland Metal Project Industrial Technology Centre, Mingora
  - Mr. F. Mahmood, light engineering instructor
  - MSEs in Mingora
    - . metal-working I: Razzaq Engineering
    - . metal-working II: Ishan Engineering
  - Pak-Swiss agricultural light engineering project, SIDB Estate, Mardan
  - Mr. J. Puddifoot, technical/extension adviser
  - Mr. I.I. Khan, agricultural engineer
- 30 November ILO Area Office for Pakistan, Islamabad
- Preparing further interviews, and reviewing previous studies
- 1 December Meetings with:
- Mr. G.M. Ward, Chief Technical Advisor CTA, national vocational training programme
  - Mr. R. Dudley, ILO Area Office Director
  - Dr. B. Ahmad, ILO Senior Programme Officer
  - Mrs. S. Khan, ILO programme officer
  - Mr. E. Kengen, First Secretary (Industry), Royal Netherlands Embassy
- 2 December Meetings with:
- Dr. A.R. Kemal, Joint Director, Pakistan Institute of Development Economics and UNIDO TSS1 National Consultant
  - Report writing
- 4 December Report writing
- 5 December Report writing

- 6 December Meetings with:
- Mr. R. Dudley, ILO Area Office Director
  - Mrs. S. Khan, ILO Programme Officer
  - Report writing
- 7 December Meetings with:
- Ms. S. Khan, ILO Programme Officer
  - ECI (Entrepreneurship & Career Institute)
  - Female-headed MSEs (Islamabad):
    - . clothing manufacture
    - . bed-linen manufacture
    - . frozen fast-foods manufacture
    - . embroidery manufacture, Kena (near Islamabad)
  - Report writing
- 8 December Meetings with:
- Mr. R. Dudley, ILO area director
  - Ms. S. Khan, ILO programme officer
  - Report writing
- 9 December Flight, Islamabad-Nairobi
- 10-11 December Report printing/copying

**Mission programme for Mr. F. Pyke**

- 7 January 1994 Arrival in Islamabad
- 8 January Meetings with:
- Messrs Zimmerman and Reinhardt, UNIDO researchers
  - Ms. Khan, ILO Programme Officer
- 9 January Meetings with:
- Mr. Shahrakh Mohammadi, UNDP
  - Mr. Maqsood, Ministry of Labour
  - Mr. Asad Hussain, Ministry of Industries
- 10 January Meeting with Ms. Khan
- 11 January Meetings with:
- Mr. Girardin (Swiss Development Corporation)
  - Mr. Dudley, Director ILO office
- Arrival at Lahore. Held meeting with Messrs Babri and Farid (ILO national consultants)
- 12 January Meetings with:
- Mr. Ahmed, General Secretary of All Pakistan Federation of Trade Unions
  - Mr. Malik, Assistant General-Secretary (idem)
  - Mr. Farouk, Head of Glass and Ceramics Centre Pakistan (Centre for Scientific and Industrial Research)
- 13 January Meetings with:
- Mr. Jabbar Khan, General Manager of Pakistan Industrial Technical Assistance Centre
  - Messrs Babri and Farid, ILO national consultants
- 15 January Arrival in Karachi. Meetings with:
- Ms. M. Leeks, ILO project secretary
  - staff of the ILO Occupational Safety and Health Centre
- 16 January Meetings with:
- Mr. M.M. Sharif, Secretary General of the Employers Federation of Pakistan
  - Director and staff members of the Leather Research Institute (Pakistan Centre for Scientific and Industrial Research)
  - Visit to Karachi Industrial Zone (including the leather district)
- 17 January Meetings with:
- Messrs Aziz and Memon, Karachi Chamber of Commerce
  - Ms. Kazmi, President, Women's Development Association
  - Mr. Hashmi, Chairman, and colleagues of the Pakistan Carpet Manufacturers and Export Association
- 18 January Meetings with:
- Mr. Ashraf W. Tabani, President of the Employers' Federation of Pakistan
  - Mr. Akhtar, Assistant Director of Labour - Labour Department, Government of Sindh
- 19 January Meeting with Mr. Habib, Association of Pakistan Textiles Manufacturers

- 20 January Meeting with Mr. Soorty, Pakistan Ready-Made Garments Manufacturers and Exporter's Association
- 21 January Arrival in Islamabad
- 22 January Report writing
- 23 January Meetings with:
- Mr. P. Regan, Deputy Resident Representative, UNDP Islamabad
  - Mr. Dudley
  - Donor members
  - Mr. S. Hussain Gardezi, Vice President of Rawalpindi All Pakistan Federation of Trade Unions
  - Mr. R. Hussain, Chairman of Refinery Employees Union, Rawalpindi
- 24 January Meetings with:
- Ms. Wilson, UNIDO
  - Mr. Mellgren, CTA of ILO/Japan Project Strategic Approaches Towards Employment Promotion
  - Mr. Esderts, Friedrich Ebert Foundation
  - Mr. Ward, CTA for National Vocational Training Programme
- 25 January Report writing
- 26 January Meetings with:
- Mr. B. Girardin, Swiss Development Corporation
  - Mr. Merdin, UNIDO
  - Visits to factories in Rawalpindi
- 27 January Return to Geneva

## List of abbreviations

AKRSP	Aga Khan Rural Support Programme
ALEP	PAK-Swiss Agricultural Light Engineering Project
APFTU	All Pakistan Federation of Trade Unions
ATC	Apprenticeship Training Centre
BK	Bank of Khyber
ECI	Entrepreneurship and Career Institute
ED	Executive Director
EFP	Employers' Federation of Pakistan
FATA	Federal Administered Tribal Areas
FCA	Federal Capital Area
FWB	First Women Bank
GDP	Gross Domestic Product
ILO	International Labour Organization
ILO-ARTEP	International Labour Organization - Asian Regional Team for Employment Promotion
JICA	Japan International Corporation Agency
MS	Micro and Small
MSE	Micro and Small Enterprises
NEW	Network of Entrepreneurial Women
NGO	Non-Governmental Organizations
NWFP	North West Frontier Province
OPP	Orangi Pilot Project
PHMP	PAK-Holland Metal Project (a Dutch-funded bi-lateral project in Pakistan)
PIET	Pakistan Institute of Entrepreneurship Training
PITAC	Pakistan Industrial Technical Assistance Centre
PSIC	Punjab Small Industries Corporation
SBFC	Small Business Finance Corporation
SEP	Self-Employment Programme
SIDB	Small Industries Development Board in NWFP
SSIC	Sindh Small Industries Corporation
SSPE	Small Scale Enterprise Project
TSSI	Technical Support Services
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees
UNIDO	United Nations Industrial Development Organization