

## THE SMALL & MEDIUM ENTERPRISES ACT AS CATALYST FOR ECONOMIC GROWTH & DEVELOPMENT IN PAKISTAN: ECONOMIC GROWTH AND DEVELOPMENT PERSPECTIVE

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### Abstract

This paper explores the value of small and medium enterprises for the economic growth and development especially in Pakistan. Moreover, it assesses the usage of information technology in SMEs sector of Pakistan. According to the recent Census of Establishments conducted by the Federal Bureau of Statistics (FBS) there are about 3.2 million economic establishments in Pakistan. Out of these Small & Medium sized enterprises (SMEs) (with employment base up to 99) constitute 90% of all private enterprises employing approximately 78% of non-agriculture labor force<sup>1</sup>. SMEs contributed over 30% to GDP, 25% in export earnings besides sharing 35% in manufacturing value addition<sup>2</sup>. The paper suggests that SMEs act as a catalyst to economical growth and development where IT embedded in their operations, planning and decisions like Hong Kong, Denmark and USA. Many other societies also place great value on the small and medium enterprises and encourage their activity. In fact, wealth and a high majority of jobs are created by small & medium businesses in the world. As a result, many experienced business people, political leaders, economists, and educators believe that fostering a robust small and medium business culture will maximize individual and collective economic and social success on a local, national, and global scale. It is recommended that SMEs may be offered access to inexpensive capital, tax exemptions and management advice & experiences and IT infrastructure which further leads toward the economical growth & development. The economical growth and development in a country can bring happiness and prosperity to its nation.

**Keywords:** small business, entrepreneurship, catalyst, economy, growth, development

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<sup>1</sup> Census of Establishments – 2005

<sup>2</sup> Economic Survey of Pakistan 2003-04

## 1. Introduction

Small and medium enterprises or SMEs, also called small and medium-sized enterprises or small and medium-sized businesses are companies whose headcount or turnover falls below certain limits. European Union Member States traditionally had their own definition of what constitutes an SME, for example the traditional definition in Germany had a limit of 500 employees, while, for example, in Belgium it could have been 100. But now the EU has started to standardize the concept. Its current definition categorizes companies with fewer than 50 employees as "small", and those with fewer than 250 as "medium". By contrast, in the United States, when small business is defined by the number of employees, it often refers to those with less than 100 employees, while medium-sized business often refers to those with less than 500 employees. However, the most widely used American definition of micro-business by the number of employees is the same as that of European Union i.e. less than 10 employees.

According to Small and Medium Enterprises Development Authority (SMEDA), Lahore Pakistan, SME is defined as an enterprise having up to 250 employment size with paid up capital up to Rs. 25 million having annual sales of Rs. 250 million.

Many societies place great value on the entrepreneurs to encourage their activity; they may be offered access to inexpensive capital, tax exemptions and management advice. An entrepreneur has the greatest chance of success by focusing on a market niche either too small or too new to have been noticed by established businesses. To help new technologies come to market, good universities like M.A.J.U<sup>1</sup>, NUST<sup>2</sup>, LUMS<sup>3</sup> and IBA<sup>4</sup> established business incubator and entrepreneurship center for individuals hoping to turn leading edge research into marketable products and to start their own employment. There is need for utilization of information technology in SMEs to boost their performance. The owners of SMEs should focus on deploying IT that can help in managing of business processes, maintaining of product/service quality and sustaining the competitive edge.

The research has two main objectives. They are to promote small and medium enterprise in the country and to assess the use of information technology in the SMEs.

Small and medium enterprises are considered as a solid pillar to the economy of a country. Wealth and a high majority of jobs are created by small businesses started by entrepreneurially minded individuals. People exposed to small business frequently express that they have more opportunity to exercise creative freedom, higher self esteem, and an overall greater sense of control over their lives. As a result, many experienced business people political leaders, economists, and educators believe that fostering a robust entrepreneurial culture will maximize individual and collective economic and social success on a local, national, and global scale.

Moreover, the adaption of information technology in such culture can extremely multiply its performance. On one hand, IT will enable SMEs to act as catalyst for

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economic growth and development while on the other it provides opportunities for SMEs to participate and compete in the global business world. So the area of research has high level of significance. The Industrial Information Network (IIN) is a joint project of UNIDO, COMSATS, SMEDA and SME Bank. The project entails establishment of a sustainable web-based industrial information network designed to become the largest source of information generation, its exchange and dissemination, towards providing value-added support and services to SMEs in Pakistan

## **2. Literature Review**

Small and medium enterprises also mean the available jobs are engaging and rewarding in more than economic ways. It means the availability of work recruit the minds of the jobholders, offering challenges in problem solving, leading them to discover some of their talents and causing them to expand their abilities. But in Pakistan, SMEs are not performing well due to non availability of infrastructure, lack of resources and skilled peoples. According to (Ishrat Hussain<sup>5</sup> 2004) most SMEs in Pakistan are still stuck in the technology and product mix of 1960s and 1970s. Lack of access to capital has not allowed them to modernize their production techniques, hire skilled human resources, upgrade the quality of management and invest in new equipment.

The Prime Minister of Pakistan (Shaukat Aziz, 2006) said that SMEs sector has tremendous potential and SMEDA<sup>7</sup> should focus on improving bench marking with developing countries. They should create more awareness about their programmes among various stakeholders and deepen their footprint. The PM identified dairy and agro processing, marble and granite, gems and jewelry, furniture, surgical instruments, sports goods, leather, hunting and sporting and fisheries as the priority areas where the government's intervention can lead to maximum jobs creation.

To promote SMEs in Pakistan (LEAD<sup>6</sup> 2003) signed a Memorandum of Understanding (MoU) with SMEDA in 2003 to jointly conduct training for small and medium enterprises (SMEs) to enhance their capacity to manage profitable businesses without endangering the environment. This partnership is expected to have a significant positive impact on SMEs in the country.

According to (Jehangir Khan Tareen 2003) Pakistan and America are working as equal partners to spur economy of Pakistan. Therefore, the US\$ 10 million grant to be offered by USAID for setting up the competitiveness support fund (CSF) for SMEs sector would be matched by the government of Pakistan with an equal amount of fund that will increase the volume of CSF to \$ 20 million.

The Chief Executive Officer, SMEDA, (Shahab Khawaja 2006) said there are 3.17 million SMEs in the country. The contribution of the SMEs to GDP is 30%, its share

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<sup>5</sup> X-Governor, State Bank of Pakistan

<sup>8</sup> Minister for Industries Production and Special Initiatives

<sup>6</sup> Leadership for environment & development

in manufactured exports is 25% and the contribution of the SMEs to industrial employment is 80%.

There is consistent evidence that employment growth is conversely related to firm size i.e. small firms are more likely to grow than large ones (Heshmati 2001). Firm industry has been acknowledged as a central determinant of employment growth (Davisson et al, 2002). Small business is ‘at the heart of national advantage (Porter, 1990, p. 125). Concerning the role of entrepreneurship in stimulating economic growth, many links have been discussed. Explanations for economic growth have generally been restricted to the realm of macroeconomics (Romer, 1990, Krugman, 1991). The concept of economic growth is relevant at levels of firms, regions, industries and nations. Hence, small business management to economic growth means linking the individual level to aggregate levels. Small business management is the manifest ability and willingness of individuals, on their own, in teams, within and outside existing organizations to perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new product-market combinations) and to introduce new ideas in the market, in the face of uncertainty and other obstacles, by making decisions on location form and the use of resources and institutions (Wennekers and Thurik, 1999). So the attention has been given to the role of SMEs in economic development, i.e., for the functioning of markets. Many economists and politicians now have an intuition that there is a positive impact of SMEs on the growth of GDP and employment. On the one hand, one strand in the literature has found that unemployment stimulates entrepreneurial activity, which has been termed as a “refugee effect”. On the other, a very different strand in the literature has identified that higher levels of SMEs development reduce unemployment. Taken together, these two relationships result in considerable relationship between unemployment and SMEs (Audretsch, Carree and Thurik, 2001). There are several well-documented reasons for the revival of small business and self-employment in richest countries of the world.

The last 25 years of the 20th century may be seen as a period of creative destruction. (Piore and Sabel 1984) use the term “Industrial Divide”, (Jensen 1993) prefers the term “Third Industrial Revolution” and (Freeman and Perez 1988) interpret it as the transition from the fourth to the fifth Kondratiev wave. The most obvious evidence is the emergence of new industries like the software and biotechnology industries. Small firms play an important role in these new industries. Moreover, the new technologies have reduced the importance of scale economies in many sectors. Small technology-based firms started to challenge large companies that still had every confidence in mass production techniques (Meredith, 1987), (Carlson, 1989). In many Western countries there have been strong tendencies to deregulate and privatize (OECD 1995, p. 39-49). (Phillips 1985) reports that small firms have been dominant in the creation of new businesses and new jobs in deregulated industry sectors in the U.S. in the early 1980s. In addition, governments acknowledge and promote the role of small (start-up) firms in establishing economic growth and development (OECD 1998). Presently, self-employment is more highly valued as an occupational choice than before. Roughly one out of four young U.S. workers pursues self-employment starting small business according to (Schiller and Crewson 1997). (Kirchhoff 1996) argues that running a small size business is not characterized anymore as underemployment but as a way to achieve a variety of personal goals. (Oxenfeldt 1943) pointed out that

individuals confront with unemployment and low prospects for wage employment turn to run their own business as a viable alternative.

It is suggested by (Lucas 1978) and (Jovanovich 1982) that high unemployment is associated with a low degree of small business start up activities in the country. A low rate of entrepreneurship may also be a consequence of the low economic growth levels which also reflect higher levels of unemployment (Audretsch, 1995). In advocating a greater role for public policy to promote small business management in Europe, the President of the European Commission, (Romano Prodi 2002), recently asserted that “increases in small business activity tend to result in higher subsequent growth rates and a reduction of unemployment. (Audretsch and Thurik 2000) show that an increase in the number of business owners reduces the level of unemployment.

According to Youth Business International, there are an estimated 300 million young people between 18 and 30 years old around the world who are unemployed. Around 20% of these young people have the potential to run their own business and yet less than 5% do. This is an unacceptable waste of talent and presents the business world with both a challenge and an opportunity. There is requirement of time to attract, guide and articulate entrepreneurial minds individual to come in the filed of small business management. There is also essential need of awareness, guidance and mentoring to the owners of SMEs so that they can utilize IT in their business for optimum return of investment, loyalty of customer and to attract foreign direct investment in the country. It is the information age where economy is transforming into knowledge economy and no business without the weapon of knowledge can survive in the market. The role of Government 's start here because SMEs can not run and flourish without the proper guidance and training of the individual who want to bring prosperity in the country i.e. small & medium enterprise's owner. The government should exempt tax on SMEs for initial 3-5 years, to provide loan from 0.5 million to 5.0 million without interest, space for plants, offices in addition to personal training to attract the young generation toward this dynamic pillar of economy.

That knowledge plays an important role in the economy is not a new idea or finding. Every economy is based on knowledge of farming, mining, and construction (Mokyr 2002). Knowledge, embodied in people and technology has always been central to economic development. But only over recent decades has its importance received so much emphasis (Harris 2001). Policy makers are counting on entrepreneurial initiative to address contemporary economic problems associated with structural change, including unemployment. Several studies have found that new firms have a positive effect on economic growth in advanced capitalist economies and to a marked extent in transition economies (Van Stel et al. 2005; Wong et al. 2005; Acs and Mueller 2006; Stam et al. 2007; Bosma et al. 2006). In knowledge economy, SMEs has become catalyst to economic growth and development for any nation. The utilization of technology in SMEs not only increased the efficiency of business operations like supply chain management, Just in Time inventory, efficient customer relationship management but also have positive affects over the strategic decisions of the firms which further direct the economic dimension of country toward prosperity.

### **3. Methodology & Analysis**

The research based on the survey conducted on small and medium enterprises located in Islamabad and Rawalpindi region and registered in Islamabad Chamber of

Commerce and Industries, Islamabad (ICCII). The population for this research study is comprised of 1855 small and medium size firms with in twin cities i.e. Islamabad and Rawalpindi.

**Table 1. Region wise SMEs**

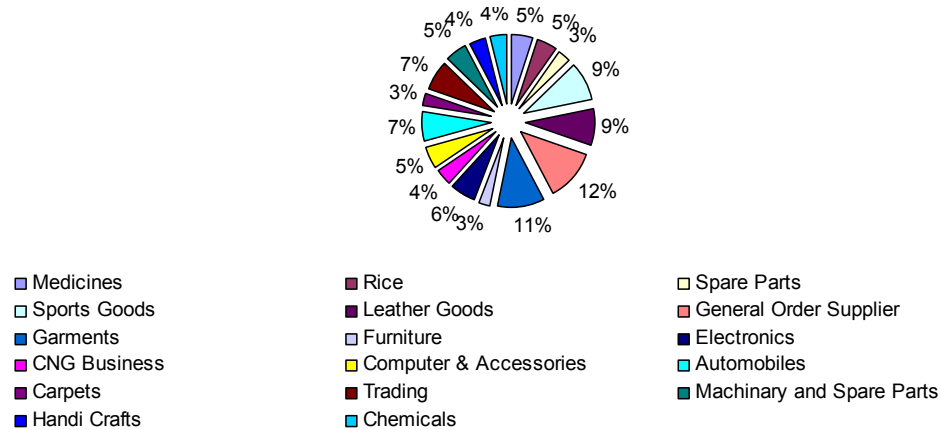
Region	Population
Islamabad	255
Rawalpindi	1600
Total	1855

Respondents were full time business man running their own small and medium size business. To participate in this study, respondents must have more then 1 year as registered firm in ICCII. The registration with Ministry of Chamber and Commerce was an optional Characteristic. Moreover, there were no educational constraints, legal constraints on the respondents. The sampling size used in this research was comprised of the both cities i.e. Islamabad and Rawalpindi i.e. 203 SMEs. The sample included 148 registered firms with Islamabad Chamber of Commerce and Industries, Islamabad while 55 were independent business with no registration running by independently in the twin cities.

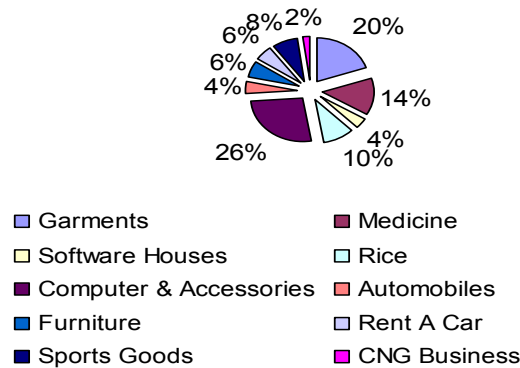
**Table 2. Sample Size of SMEs**

Region	Sample
Islamabad	101
Rawalpindi	102
Total	203

The survey includes the size of the firms based on the no. of employee i.e.  $25 < \text{SMEs} \leq 250$ . Stratification process is used for the grouping members of the population into relatively homogeneous subgroups before sampling. The mutually exclusive strata were used. Every element in the population was assigned to only one stratum. During this process it was kept in mind that the strata should also be collectively exhaustive. Then random sampling technique applied within each stratum. In this research study, the following strata were used from the Rawalpindi and Islamabad region:



**Figure 1. Sample from Rawalpindi Firms**



**Figure 2. Sample from Islamabad Firms**

In this survey, instrument was distributed to the individual and filled questionnaire collected back. The choice of method is difficult job if some one doesn't know what to assess. By comparing research objectives with the strengths and weaknesses of each method, it becomes easy to choose the methods that were best suited to our research work. So we used different data collection methods because it was not appropriate for selecting only one method in our opinion. No doubt, this mixed methodology increased the time and cost to us but it provides reliable data which is the core requirement of research. In the case of personal interviewing, we used audio, visual aids for the proper recording of the interview. The telephonic interviewing helps us by reducing cost, fastest completion time, and better access to hard-to-reach respondents through repeated callbacks. But we have to face problems like limited interview time, many phone numbers were out of order, not responding, people don't want to give information etc. The technique of personal observations is also used data collection methods which verify the validity of instrument results. Data is organized and entered into the Microsoft Excel Sheet for the editing and analysis. Average ratio methodology is applied.

The finding of the survey signals very alarming situation in Pakistan. It is because 25-30% of registered SMEs are close down due to shortage of finance. It shows that people involved in SMEs are not so happy due to non profitability. The 75% respondents from sample SMEs agreed that they are deficit in finance and don't have capital to run their business while others have different reasons. In many cases the SMEs rely on personal savings, including financial help of family and friends in Pakistan. In response to management skills, 25% responds that they have very good business management skills, 20% responds that they have good skills and 55% agree that they don't have good skills. In the technological perspective, the 85% respondents agree that they are working with old technology in their business while 10% respondents are in the state of transformation (from old to new) and remaining 5% have not responded. Technically speaking, typical Pakistani small firm used indigenous machines of old-vintage and relies on traditional productions methods for survival. They end up producing low-quality, low-priced products and sell it accordingly. It shows that SMEs in Pakistan are not aware with technology which affects negatively over the performance of their firms. Associated with this is a

general absence of information on opportunities for technological upgradation. This drawback acts as a major barrier on road to knowledge-based modern economy.

In case of skilled employees, the more than 60% SMEs have skill deficiencies and are unable to compete with larger firms' better-qualified manpower while 40% responded that they hire people but they turn out to larger firms or migrate to Middle East and other countries after short period of time. In particular, SME managers are found deficient in bookkeeping, marketing, cost accounting, stock management, production scheduling and quality control. The managers are unaware of the importance of assets valuation and in some cases even adopt personalized management style, all resulting in low economic efficiencies.

From business export point of view, 20% respondents export their products to international market, 25% market the upper segments at the domestic level, 45% targets the lower level and 15% serve to larger firms. One of major reason found in research is that Pak SMEs fail to enter in export market or even upper segments of the domestic market because they are unable to match products with the new trends in demand. There are many reasons found faced by owners of small & medium enterprises at their starting point. They are recovery of credit given to customers, access to markets, inadequate demand, Taxes, Transport, communication facilities, and Government regulations.

In the growth phase the SMEs faced challenges like educational level of entrepreneur, family background, personal qualities, access to institutional finance, new product design, modern technology, raw materials, advanced skills, and availability of modern infrastructure. SME policy 2007 will have to design programmes to overcome these constraints and to spell out specific supporting measures for SMEs.

#### **4. Discussion**

SMEs are considered the engine of economic growth in both developed and developing countries, as they provide low cost employment since the unit cost of persons employed is lower for SMEs than for large-size units. The common belief is that economical developed nations have natural resources like Russia, Nigeria, Brazil, and South Africa. Russia has large oil reserves, expansive farmlands and other minerals; Nigeria and South Africa has the world's largest diamond reserves and lots of farmland and wild life. Brazil is also blessed with lots of cattle and farmland and other resources. Yet they are not necessarily considered overall prosperous. As a matter of fact they find themselves in a constant struggle to maintain national stability. On the other hand countries like Finland, Singapore, Switzerland and Austria enjoy tremendous stability and prosperity having lack of natural resources. The developed countries preferred quality education for their nations and the result shows in the productivity of their people. According to the Bahamas government as much as 24 per cent of the National Budget is allocated to education. Despite this fact, the quality of education has decreased over the past decade and the results toward an educated citizenry are deficient. So contributing education budget is not the track toward development or reduction in unemployment. The quality education means that training and development of nations so they can identify the right track that goes towards the economical development, unemployment reduction and prosperity at micro as well as macro level.



SMEs assist in regional and local development since SMEs accelerate rural industrialization by linking it with the more organized urban sector. Moreover, they achieve fair and equitable distribution of wealth by regional dispersion of economic activities. SMEs contribute significantly to export revenues because of the low-cost labour intensive nature of its products. Therefore, SMEs have a positive effect on the trade balance. Moreover, SMEs assist in fostering a self-help and entrepreneurial culture by bringing together skills and capital through various lending and skill enhancement schemes. We can see that the SMEs growth & development can be a crucial and dynamic step towards the achievement of economical growth and employment in the country. But in the digital world, the flow of right information at right time to the right people for the right decision has become the key to success. It is shocking situation that SMEs in any country going to disappear from the market because if the solid pillar of economy will loose its strength then it will become difficult to sustain the economy as a whole. The decreasing economy will boost the unemployment in the country which leads toward poverty, corruption in the society. There are two important points to think about why SMEs are going to closing down and how we can give exposure, training of information technology to SMEs so that they utilized IT infrastructure. It is very much important to understand that government institutions should develop IT Policy in the alignment of SMEs policy.

The people who don't want to implement IT policy should guide and provide them opportunity to attend the training session offered by incubation center or center for entrepreneurship at different universities or academic institutions providing facility to society. The IT development sector should master SMEs in country at lower rate training on awareness, utilization and benefits to SMEs. There is special need to accumulate knowledge and expertise so that economy can be directed toward the knowledge or digital economy.

## **5. Conclusion**

SMEs play a very important role in the economic and social development of the Pakistan's economy. The SME sector act as catalyst in overcoming social tension brought about by the globalization tendencies connected with the rapid transfer of certain industrial programmes to countries with lower wage costs and with a high intensity of global competition. The SMEs in Pakistan are 3.17 million. The contribution of the SMEs to GDP is 30%, its share in manufactured exports is 25% and the contribution of the SMEs to industrial employment is 80%. SMEs are of particular significance for the development of the national economy, for job creation, and for the development of individual municipalities and regions. They help to create a healthy business environment and increase market dynamism. The SMEs development is generally considered to be a principal factor of economic development, irrespective of how economically advanced a country is.

The SMEs development is directly influenced by the quality of the business environment. The government, financial institutions, courts and universities can make a particular contribution to the creation of the business environment in the country. In addition, many commercial banks have the mandate to provide credit to SMEs. Nonetheless, SMEs are generally found to be short of institutional credit. The financial institutions in Pakistan should have diversified portfolio across sectors by lending to SMEs. This action will create a win-win situation for banks, SMEs and national economy. There is special need to develop the strength of skill people so that

migration of skilled employees to larger firms or other countries have least affect over the SMEs. The IT infrastructure to support SMEs must be developed in the country so that national SMEs can participate in international business activities.

## **6. Recommendations**

Financial institution should lend to SMEs which will facilitate them also their product mix to meet the demands of domestic and export markets so that they may acquire new technology and improve the quality of their products to meet the needs of future.

All the chartered universities or academic institutions should establish incubators or center of entrepreneurship to support practical implementation of small business ventures.

Ecommerce infrastructure by Government to facilitate SMEs sector of Pakistan can boost their performance in digital world.

The sector of SMEs should promote and facilitate by providing facilities like exemption of tax, no registration fee, interest free loans, training & guidance availability and good IT infrastructure. These all kinds of assistance to SMEs will promote this sector, attract young part of nation toward venturing which further strategically improve the growth of SMEs, economy to country and pleasure to society.

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