

## Rural Small and Micro-Enterprises in Pakistan: Issues and Options

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### *Abstract*

*The paper discusses the role of rural small and micro enterprises in Pakistan in terms of employment generation, poverty alleviation and creation of linkages to accelerate the process of rural development. Considering the importance of the sector, the government has created several channels of finance and other support organizations. Besides, the Investment Policy 1997 allows for foreign investment in agriculture and includes agro-based industries as priority manufacturing activities. The paper highlights the constraints and suggests policy options for promotion of rural small and micro-enterprises in Pakistan. In this context, the need of reorientation in four key areas e.g. skill, credit, marketing and government policies are emphasized.*

### 1.0 Introduction

In Pakistan, issues of rural small industry and micro-enterprises, particularly their role in employment generation, poverty alleviation, arresting rural brain drain, creating forward and backward linkages and promoting economic development have been widely discussed. The persistence of rural poverty and concomitant unemployment have been the major concerns of the policy makers. More than one million unemployed youth enter the labour market annually and about one-fourth of the new entrants are educated/trained. The women are also increasingly participating in the labour market but their concerns are not adequately integrated into the micro-enterprises. On the supply side of the labour market, employment in the public sector and out-migration of labour have been on the decline. In addition, employment in large-scale industry has not been expanding.<sup>1</sup>

In view of the emerging employment prospects, the importance of rural small and micro-enterprises has increased manifold. It is also encouraging that the policy makers

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<sup>1</sup> See, Hijazi, 1997.

have realized the importance of small and micro-enterprises. The Eighth Five Year Plan, for instance, focuses on the sector for generating a significant proportion of additional employment opportunities. Similarly, some supporting measures have been taken like the establishment of SBFC, YIPS, SICs, ADBP, IDBP, Rural Support Organizations and Poverty Alleviation Fund. Furthermore, the fixation of mandatory targets by the State Bank of Pakistan for the commercial banks and DFIs to advance credit to such enterprises under self-employment schemes, expansion and diversification of vocational training programmes and incentive package under rural industrialization (1991) are several measures which may be mentioned. The new investment policy 1997 allows foreign investment in agriculture including agro-based industries in priority manufacturing sectors.<sup>2</sup>

Nevertheless, the programmes aiming at rural industrialization have been hampered due to a lack of a holistic and integrated approach. The micro-enterprises, both in farm and non farm sector of the rural economy, could not grow due to a lack of entrepreneurial, managerial and technical skills, limited access to credit, and inadequate facilities of marketing. Besides, the industrial policies since the independence remained biased towards large-scale urban enterprises except during 1972-77 (Hijazi, 1997). The deficiency in quality control and standardization, lack of infrastructure, training and organization also put heavy restraint on rural industrialization. The paper highlights a few policy options and emphasizes the need of research on rural small and micro-enterprises.

## **2.0 Small and Micro-Enterprises in Pakistan**

The definition of small business/industry varies from country to country. However, a country specific and a clear definition is essential. In the context of developing countries, micro and small enterprises are defined in terms of workers and fixed assets. In Pakistan, micro-enterprises comprise of 1-5 employees and Rs.5,000-10,000 in fixed assets. Whereas, small enterprises consist of 5-10/20 employees and Rs.10,000-500,000 in fixed assets. Moreover, a firm having Rs.2 million, in fixed assets and below is classified as a small scale manufacturing firm. (Economic Survey 1997-98).

The characteristic features of the small industry in Pakistan may be summarized as follows:

- Investment in small-scale manufacturing sector over 1971-72 to 1986-87 accounted for only 11.8 percent of the total investment in the manufacturing sector and their

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<sup>2</sup> See Economic Survey, 1997-98, P.35.

contribution to output was 30.5 percent. Despite their relatively low share in total manufacturing investment, small scale manufacturing sector contributes more than 80 percent in total manufacturing employment.<sup>3</sup>

- The investment cost (in 1985-86 prices) to create an additional job on the average during 1969-70 to 1980-81 period was Rs.2,327 in small scale manufacturing industries and Rs.185,223 in large-scale manufacturing industries i.e. eighty times higher.<sup>4</sup>
- Its share in GDP is 4.7 percent, and in manufacturing sector export is 30 percent while contribution to the industrial sector is 27 percent.<sup>5</sup>
- The consumers increasingly look for goods that are crafted to reflect individuality, tastes, preferences and meet specific needs. The trend is visible both in the international and domestic markets for clothes, garments, furnishings, food based commodities, household sanitary items, electronic goods and hardware products. The small-scale industries are well suited to meet such demands.

### **3.0 Major Issues in Small Scale Industry Development**

In Pakistan, four core issues e.g. skill, credit, marketing and policies, are essential to be re-oriented for the promotion of small scale industry.

#### **Skill development**

According to the Human Development Report 1977, Pakistan ranks 119th in the list of 175 countries. It occupies 139th position on the basis of Human Development Index (HDI). While it is well known that the human factor is critical in economic and social development, human resources development indicators in the rural areas, are very dismal in Pakistan. The rural literacy rate stands at 28 percent, access to rural water supply and sanitation is 59 percent and 26 percent respectively. The specific issues that could be highlighted are:

- Inflexible, rigid, regimental and bureaucratic rules that govern vocational and academic institutes while autonomy, freedom of opinion and expression, dialectic and polemic environment is a sine quo non for creative activities.
- Rather than vocational and skill orientedness, a general education system is followed. Only 2.5 percent of the GDP is spent on education/training.

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<sup>3</sup> See. Ghayur, 1993.

<sup>4</sup> See Ghayur, 1993.

<sup>5</sup> Economic Survey, 1996 -97.

- Skilled manpower is hardly available due to brain drain from rural to urban areas. The annual urbanization rate is 4.6 percent compared to a population growth rate of 2.6 percent.
- Sites of training centres are chosen in in-appropriately distant places from the rural areas.
- Skill imparted in formal training centres is hardly suited to the rural labour market since the training programmes are generally urban oriented.
- Absence of management and organizational aspects e.g. marketing, book-keeping and leadership skills in training programmes
- Business counselling regarding location, investment requirement, cost analysis, projected profits, source of machinery, credit availability and entrepreneurial competencies do not seem to form parts of skill oriented programmes.
- Women form a sizeable part of the cottage industry. In spite of their substantial contributions, women specific trainings are not emphasized.
- Traditional rural skills and craftsmanships are vanishing due to migration of rural auxiliary skilled class and reluctance on the part of parents to let their children adopt their professions primarily for reasons of social status.
- Ustad-Shagird System though not as prevalent as in urban areas, takes long time in skill transfer.
- Due to scarcity of repair workshops in rural areas, the rural producers face a great deal of hardships in the proper maintenance of machinery.
- Conditions in training institutes in terms of motivating working environment, incentives, budgetary allocation, staff, and paraphernalia are pitiable.

### **Micro-credit**

Rural financial market has been widely defined as consisting of inter-linkages between the buyers and the sellers of financial assets in the rural economy. One of the major problems faced by the small industry is the lack of credit. Many factors constrain the access to credit. Several interventions by the government, international agencies and voluntary groups have been designed and implemented to advance credit to the small producers. A number of impediments, however, can be identified which limit the access of the rural small-scale producers to credit.

- The physical distance, cultural gap, and the transport costs constrain the micro-entrepreneurs from approaching formal financial institutions.

- Small industrialists in remote rural areas find the formal institutions with restricted banking hours and days in urban environment not easily accessible to make their financial transactions. As a result, units located in the urban sector appropriate a larger share of the bank credit.
- Information relating to various credit schemes, formalities, obligations etc., do not reach the small rural producers, particularly when they are illiterate.
- Some small producers dislike to obtain credit on interest basis and consider taking a loan from the bank against their pride and social status.
- A majority of the poor women feel/believe that their income generating activities are bad omen for their family welfare. Consequently they are reluctant in approaching the banks.
- High loan administration cost, high sense of safety on the part of the bank because of unstable incomes, irregular savings and borrowing of the small producers compromise the bank ability and creditworthiness of the small producers.
- Inflexible repayment schedule and complex procedures discourage the small producers to approach the banks.
- Being dispossessed, the poor cannot fulfil physical collateral stipulations and the prospective borrower is hardly identified. What happens, is that malafide borrowers in connivance with the credit institutions siphon off the loans.
- Formal banking institutions perceive the rural poor as unbankable and bad credit risks. The NGOs which are working in the field of micro credit are not adequately encouraged. The credit line from the donors are not properly linked to such grassroots initiatives.
- The informal institutions provide credit which, taken as a whole, is inadequate for the industry needs.
- The micro credit taken by women often ends up being controlled by men in the family. Such findings have led to the argument that micro financing may be increasing women's workload and responsibility without enhancing their control over income and expenditure.<sup>6</sup>
- Restricted interest rates make it impossible to mobilise rural saving in substantial quantities and induce the lenders to concentrate cheap loans in the hand of wealthy and influential persons. This reduces the prospects of developing viable rural financial markets.

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<sup>6</sup> Kamal, 1997.

## **Marketing**

The business activities that directs the flow of goods and services from the producers to the consumers so as to get them at the time, place and in the form they are prepared to pay is marketing. Marketing continues to remain one of the vital areas where the small industry requires the maximum assistance. There are a number of imperfections in the rural market.

- The rural economy is not fully monetized. A substantial part of the transactions do not take place on cash payment. Particularly, services are paid in commodities rather than in cash. The village shopkeepers, arthis and money lenders advance credit on high interests in anticipation of buying the produce at harvesting time at reduced prices.
- The supply of inputs in the rural economy is characterized by exorbitant prices, adulteration and non availability on time.
- The terms of trade are biased in favour of the urban economy. As a result, resources are transferred to the cities and the urban centres are thriving at the cost of the rural economy.
- Support price systems do not cover all rural products. The role of small industry corporation/board is limited in promotion of handicrafts and cottage industry in term of marketing and credit.
- Government policies like overvalued exchange rate, food controls and subsidised food import have negative impact on farm prices.
- There exist only 117 marketing cooperative societies under the Cooperative Act in the country. The societies could not take roots due to vested interest of traders, village elites, factionalism in the rural society and prescriptive approach.
- Malpractices like commission charges above the prescribed rates, deduction, absence of open auction, misinterpretation of current market prices and others are wide spread in rural marketing. The long chain of intermediaries appropriates margins of about 35 percent of non-perishable goods and 50 to 75 percent of perishable goods.
- Due to weak financial position, the small producers cannot withhold their produce for better prices.
- The role of 131 regulated markets established in Punjab under the Marketing Act 1939 is insignificant. In the market committees, the farmers are in a minority. Above all, nominated administrators continually occupy the positions of chairmen rather than elected members. These committees also lack financial discipline. Functions relating to grading of products are not performed.

- Rural marketing research is almost non-existent particularly to ascertain the cost of production and pricing of rural products.
- Infrastructures e.g. transport and communication, storage facilities and village electrification are inadequate. Only 16 percent of the villages are connected with all weather roads and 30 percent have all weather connections. Against a minimum requirement of 0.64 km of road per sq. km, there is 0.12 km per sq. km.
- In terms of gender, women's participation in marketing activities, in general, in the rural economy is insignificant.

### **Industrial and investment policies**

The small-scale manufacturing sector provides increased employment, but the government policies are generally biased against the sector. The government generally encouraged large-scale investment projects during the past decades. The small-scale sector exhibited varying trends. It declined during the 1960s and somewhat recovered in the 1970s.

During the 1970s, the government made credit increasingly available to the small scale sector. As a result, the small-scale sector's share in exports increased from 15 percent to 24 percent between 1971-72 and 1975-76. The investment in the small scale sector also increased at an annual rate of 22 percent. The growth rate of the small-scale sector remained close to 20 percent per annum. It is estimated that an investment of Rs.150 thousand in the small industry creates one job as against Rs.35 million in large-scale industry. The past focus on capital intensive large-scale industry, therefore, did not help much in poverty alleviation and employment generation. The capital intensive nature of investment is also reflected in a decline in the share of wages and salaries in value-added from 26.9 percent in 1976 to 20.3 percent in 1986.

#### **4.0 Policy Options for Developing Rural Small and Micro-Enterprises**

In order to remove the constraints that impede the growth of small-scale rural industry and micro-enterprises, appropriate strategies are required:

- The Union Councils as growth centres should be provided with necessary social and physical infrastructure. Five growth centres may be federated as an integrated centre - a source for information, skill, credit, inputs, market and storage. The integrated centres may be federated at the district level. A rural support organization (e.g. NGO) may be assigned the task of institutional capacity building for cooperative marketing and mobilization of rural resources.

- Mobile training programmes and decentralized production-cum training centres at rural growth/focal points need to be established after assessing training needs of the local area.
- Rural financial markets based on realistic fixation of maximum limit of a loan, period of repayment, well-defined locations, trade specific loaning procedures, simplified collateral requirements, viable interest rates, saving mobilization and group lending to ensure sustainability in the financial operations need to be established. One-man branch of rural industries bank with flexible working hours needs to be established, keeping in view the rural working culture.
- Women's access to credit needs to be improved through a variety of measures including special windows for lending to women at all banks and networking with NGOs to identify female borrowers.
- Tax holidays, exemption from custom duty on imported machinery, reduction of debt equity ratio and export refinancing schemes are needed to promote rural industry.
- Rationalization of fiscal, credit, industrial and investment policies and integration of rural small industry into rural development efforts may go a long way in the promotion of small industry.
- Establishment of associations and chambers of agriculture and rural small industry is likely to support rural cottage industry.
- Research needs to be undertaken to study the replication prospects of micro-credit efforts e.g. (AKRSP and Idara Kissan experiments) in the fields of micro-enterprises and marketing of rural products.
- Marketing research (opportunity and effort research) are needed on a regular basis to explore new business avenues, markets, strengthen business counselling and provide feed back to training, marketing and financial institutions.
- Measures should be taken at improving productivity, enhancing quality and standards through training and establishing grading centres as envisaged in the Marketing Act 1939. Upgradation, particularly of food technology and modernization of industrial processes, is to be taken-up to improve the competitiveness of rural products in the face of trade liberalization.
- Provision of infrastructure and transport facilities for setting up small scale industrial estates in backward rural areas based on local raw materials and manpower to remove rural urban disparity needs to be given priority.



- Rural and agriculture development strategy and Social Action Programme have to be geared toward poverty alleviation and gainful employment generation to create demand for rural products and bring about structural changes in the rural economy.

## 5.0 Conclusions

The small-scale industry can play a leading role in economic development of a country like Pakistan. The countries in South East Asia owe much of their economic miracles to cottage and small-scale industries. The small and medium enterprises can play a significant role in the promotion of several modern industries e.g. electronics. Pakistan can also achieve economic miracles by promoting small-scale and micro-enterprises through adoption of a comprehensive, realistic and holistic strategy focusing on skill development, establishment of efficient marketing network, effective market information system, standardisation of rural products, availability of micro-credit based on group lending, marketing research, development of appropriate technology, export orientendness and improvement of social and physical infrastructure. Moreover, research should be encouraged on working condition, labour absorptive capacity, growth potential, nature and scope of training, availability of credit, marketing issues, employment and income generating, opportunities, linkages between rural small industry and urban small and large scale industry, women working conditions, and identification of a set of feasible policy alternatives.

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