

# Barriers to Growth of Small Firms in Pakistan

Case Study of Selected LE Industries



**IGC WORKING PAPER, 2013**  
**NAZISH AFRAZ (LUMS), TURAB**  
**HUSSAIN (LUMS) AND USMAN KHAN**  
**(LUMS)**

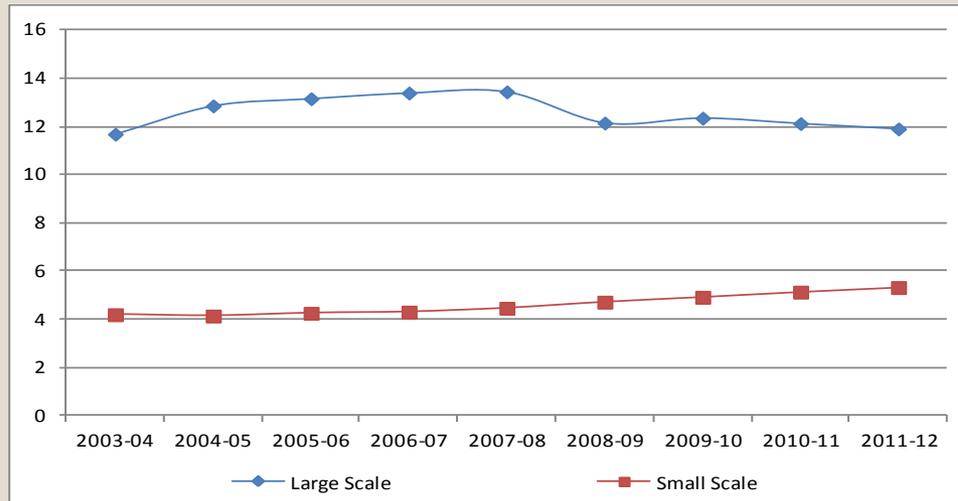
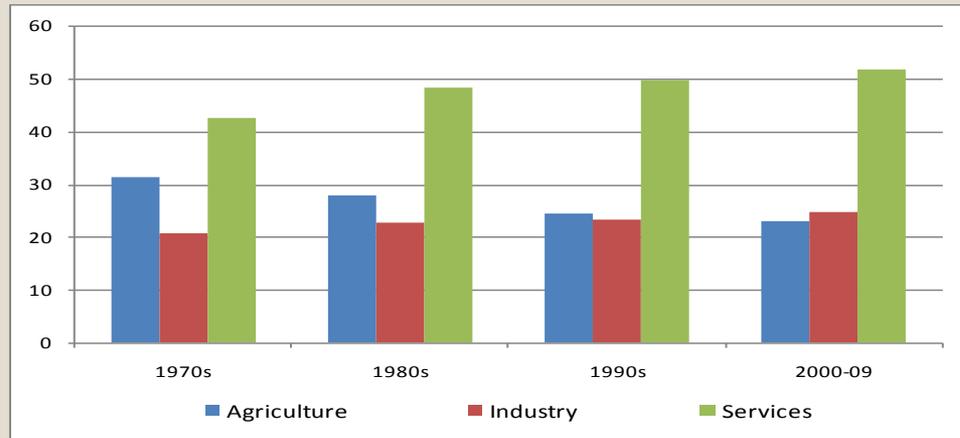
# Introduction



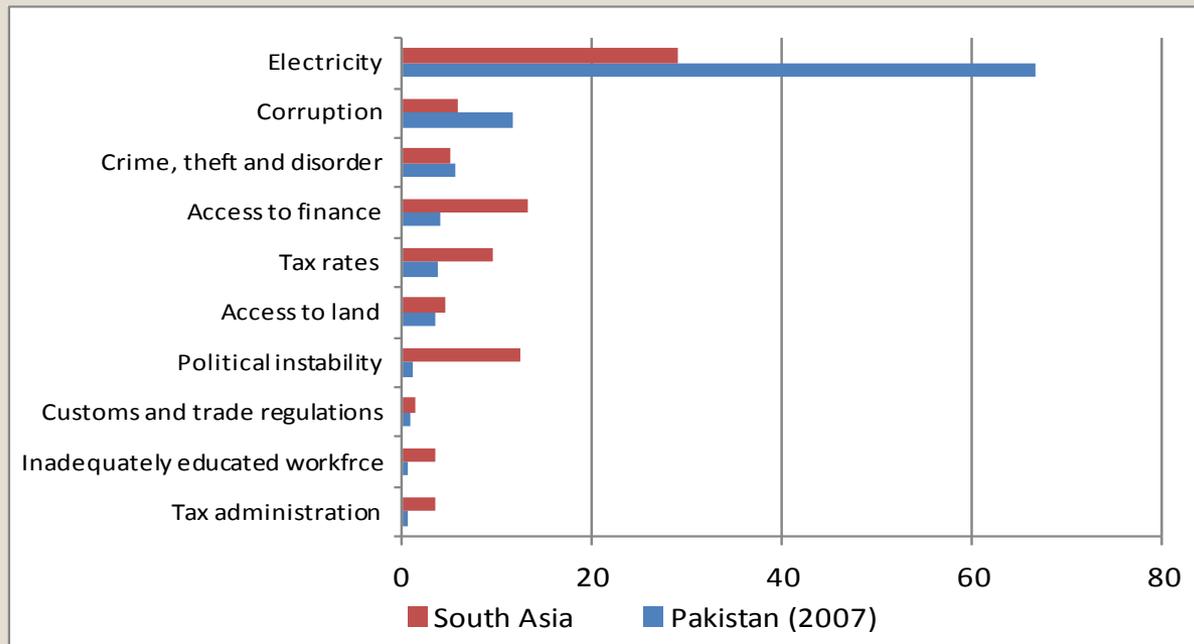
- **SMEs in Pakistan:** 90% of economic est., 78 per cent non-agri employment and 25% to exports.
- **Skewed structural change:** from Agri to Services in last 30yrs – manufacturing share almost stagnant!
- What explains lack of growth of SME?

**Literature:** WB Investment Climate Survey (2009); WB Enterprise Analysis (2007), (2010); Hussain et al (2012) etc.

# Changes in Sectoral Shares, LSM, SSM in GDP of Pakistan: Stagnancy!



# Barriers to Growth: Cross Sectional



Source: WB 2009

# Motivation



1. Cost of business surveys capture constraints/barriers at a point in time: **some constraints might be more endemic.**
2. Large Surveys have a list of constraints and firms rank these in terms of severity: **Breadth but might lack depth.**
3. Given these overall constraints: **we observe variations in firm and industry performance.**

# Methodology



Case study of two clusters:

Fans (Gujrat and Gujranwala)

Sports Good (Sialkot)

- Purposive selection of 12 firms in each sector from 125 firms in fan sector and 450 firms in sports goods.
- Equal split of success and failure based on growth in **employment, capital investment and export status/performance** since inception.
- Semi-structured detailed interviews of the firms.
- Information triangulated with cost of business survey results and a value chain analysis.

# A Tale of Two Clusters



## **Gujrat and Gujranwala – Fan sector:**

- Inward looking – exception a few bigger players (0.2% of Exports)
- 4/5 big players with a large domestic mkt share (approx. 70%), competition over residual mkt share between small firms selling a differentiated but low quality product
- Seasonal production (approx. 30,000 sector employment)
- Labourer to entrepreneur transition

## **Sialkot – Sports goods:**

- Outward oriented – all firms export (directly to brands or through buying houses) (3% of Exports)
- Recent stagnancy in exports.
- Firms more evenly distributed in terms of size. (approx. 350,000 sector employment)
- Trader to entrepreneur transition

# Fan Sector: Impediments to growth



- **Lack of standardization:** price competition leads to cost cutting, use of low quality material and low quality/value added products.
- **Limited access to Int'l mkt:** one off exports through traders, e.g., Iraq export, low quality standard (performance and safety) – lack of certification
- **Management and succession:** labourer to entrepreneur, no professional management practices, generational fragmentation and diseconomies.

# Fan Sector: Impediments to growth

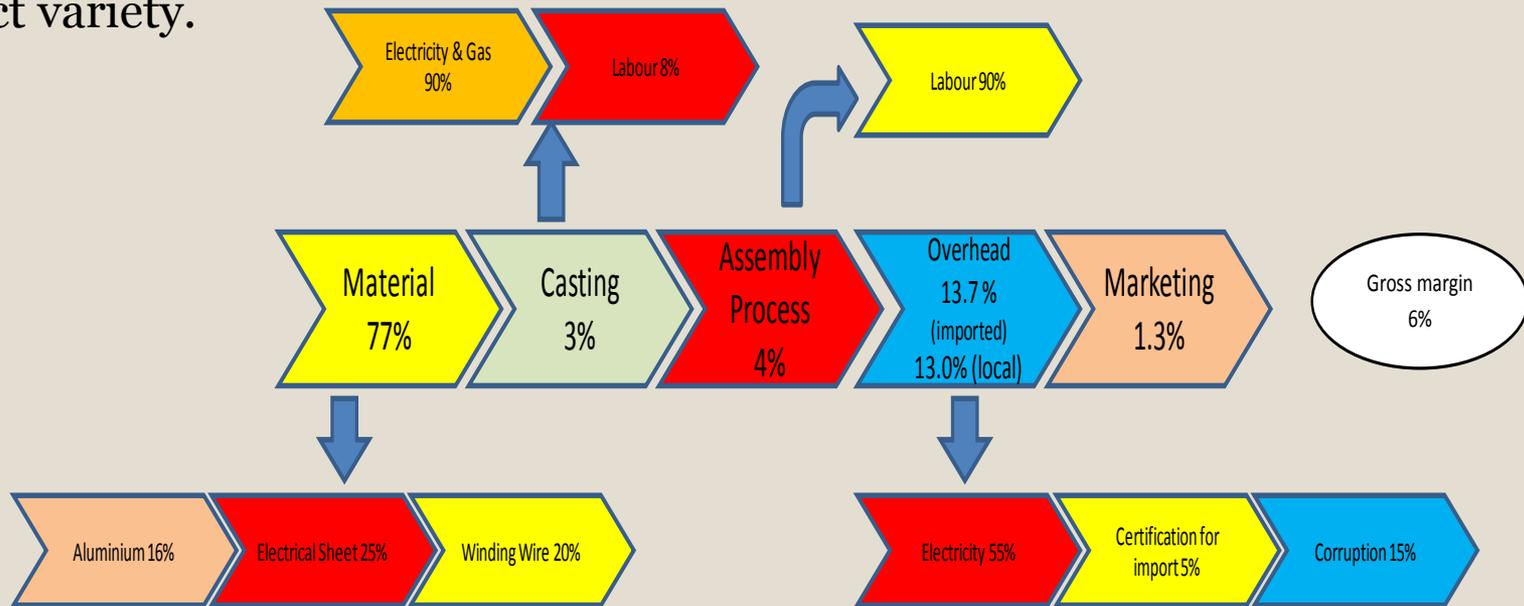


- **Credit rationed:** self financing and informal market credit - high default rate.
- **Labour and Capital:** Low quality dated machinery and inputs and low skill labour matching (seasonality issue).
- **Lack of institutional support:** courts & contract enforcement, PEFMA, FDI(Fan Dev. Inst) and govt dept (tax & labour) – perverse incentive to remain small and informal.

# Value Chain of a Ceiling Fan vertically integrated unit

**Benchmarking:** Compete in price but relatively poor input material; energy inefficient, low product quality; no proper testing/certification; limited product variety.

Average capacity 200-300 fans/day  
China: 45-50,000 Fans/day



# Sports goods: Impediments to growth



- **Credit market:** recourse to retained earnings, working capital and letters of credit, lack of long term capital financing.
- **Entrepreneurship, management and succession issues:** trader to entrepreneur, management practices and growth dependent on relationship to major int'l brands.
- **Labour skills:** low wages but low skill and productivity. Not an issue for direct suppliers but for firms exporting through buying houses.

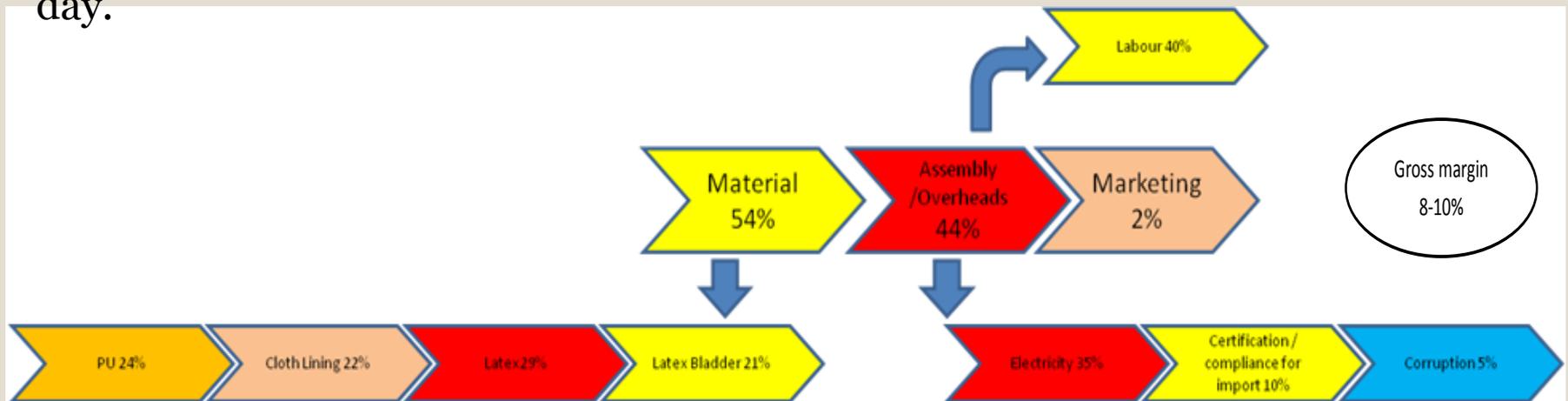
# Sports goods: impediments to growth



- **Raw material supply:** shift in the 80s to composite material - negative impact on the racket industry, composites imported as no domestic production, potential of cheap import from India. 70% imported raw material.
- **Innovation and product differentiation:** thermo bonded footballs, successful firms diversified into accessories and sporting apparel, JVs – forward looking!

# Value Chain of a Hand Stitched Soccer Ball

**Benchmarking:** 70% inputs imported thus relatively higher (unstable) cost and low value addition; low labour skills hence low productivity e.g., 4 balls/day – 50 balls/day.



# Policy Recommendations



## **Cross cutting:**

- Weak contract enforcement: Courts, ADRs and Police.
- Limited R&D: Improve Industry-University(Research Centers) linkages.
- Simplification of tax regime.
- Availability of credit: Simplification of procedures, product based lending.

# Policy Recommendations



## **Fan Industry**

- Quality standard enforcement in domestic mkt: PEFMA in conjunction with PSQCA.
- Management/labour skills and training on modern machinery. TEVTA – PEFMA, FDI.
- Access to int'l mkt: Information, marketing and common branding for export. PEFMA- TDAP

# Policy Recommendations



## **Sports goods**

- Innovation and product diversification: innovation and design centers (PPP) – operationalize Sports Industries Development Centre in Sialkot and link up with universities/research centers.
- Absence of ancillary – input industry: carbon, latex, chemical, dyes and adhesives.