"The Role of Business Development Agencies in Developing Economies for Improving the Business Environment for SMEs"

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Executive Summary

The present study explains regional priorities for business environment reforms while making specific reference to the experience of Small & Medium Enterprise Development Authority (SMEDA), Pakistan. The paper illustrates in depth the necessary conditions required to sustain business environment reform efforts in developing countries in general and Pakistan in particular. Business Environment reform efforts in the Marble & Granite sector are discussed as a case study.

The role of an SME agency in a developing country's setting is difficult to define and is contingent upon its own business environment. It is often stretched beyond its service capacity. The compulsion for such a stress emanates from socio-economic conditions that a government in any developing economy is confronted with. There are two major considerations in this regard; the growth in SME sector pledges to yield more job opportunities hence considered an important tool for combating poverty. Alternatively, with the enhanced productivity and competitiveness, SMEs have the potential to serve as a wider base for developing exports.

While most of the national level business environment studies do not give full account of micro or meso level issues or the issues related to institutional capacity to support reforms for improving business environment, sector level studies work best as proxy for providing necessary details. Operational strategy of an SME development agency that gives due consideration to issues related to sector development at sub national level and the speed of reforms at macro, meso and micro level while prioritizing activities aiming at competitiveness or productivity improvement of SME sector holds better chances for success.

For donors, it is important to note that results of future interventions in SME sector are linked to service capacity of SME promotion agencies in mobilizing resources of other public and private sector agencies and come

up with innovative institutional setups where meso level reforms are pivotal. Equally important is the role of positioning policy and regulatory issues in the public policy agenda and proposing micro level interventions to the government, donors' support to SME development agencies on this account can significantly increase their effectiveness.

The objective of the paper is to present a model that has been used to improve the business environment for SME sector in Pakistan. First, the rationale and purpose of sector development approach has been discussed briefly while discussing the case of Marble & Granite Sector in Pakistan. The case outlines the socio-economic conditions of Balochistan & NWFP region and the composition of a typical SME sub-sector. It is followed by a discussion on strategy being adopted by SMEDA; an SME development agency and the lessons learned from sector development at sub-national level. Third section of the paper explains the relationship of sector development approach in explaining the general business environment. It elaborates on key factors that shape the operational strategy of SME support institutions operating in developing economies. Finally, the paper concludes with the key lessons learned from this experience and presents recommendations.

Background

The role of an SME agency in a developing country's setting is difficult to define and is contingent upon its own business environment. It is often stretched beyond its service capacity. The compulsion for such a stress emanates from socio-economic conditions that government in any developing economy is confronted with. There are two particular reasons for this kind of behavior; first, SME sector is the largest employer in the economy and growth in this sector pledges to yield more job opportunities hence pro-SME policy is a politically correct policy. In relation to that, promotion of SME sector is considered as an important tool for combating poverty in these economies[2]. Second, the sheer number of enterprises in the sector which normally constitute more than 90% of the total enterprise population is considered as a good base for developing exports.

Pakistan suffered a low growth trap during 1990s and could not do much about its deteriorating economy. The continuously declining economy gave birth to the other socio-economic problems such as corruption, migration of talented professionals, dollarization of economy, flight of capital, disinvestment, higher unemployment and rising poverty leading to social unrest and law and order situation. The entire economic policy fabric in the country was re-laid after formally embarking on the IMF structural adjustment program. Throughout 1990s economic policy focus remained on opening up the economy, liberalizing trade, and instituting fiscal and monetary discipline besides completely restructuring the financial sector. In the given situation the policy choice of the Government of Pakistan was to first stabilize the macroeconomic indicators. It was hoped that high growth would follow though it did not happen during 1990s. The basic premise was that unless the economy achieves macro stability the Government would not be able to support or

[2] Please see Poverty Reduction Strategy Paper (PRSP)-2003, Medium Term Development Frame Work (MTDF) 2005-10, Pakistan Ten Years Perspective Plan 2001-11.

even sustain the entailing reforms targeting the larger socio-economic improvements in the country[3]. Nonetheless, in late 1990s, stagnant exports and rising poverty levels were identified as two inter-related factors fundamental to economic slow down. The new economic policy analytical framework emphasized that macroeconomic stability was not sufficient for development; the reforms should also focus on microeconomic policy and institutions. It was agreed that there was a need to take proactive measures for boosting exports and stimulating investment in labor intensive businesses for employment generation particularly in the Small & Medium Enterprises (SMEs) sector. Consequently, Small & Medium Enterprise Development Authority (SMEDA) was set up in October 1998, through an Executive Order issued by the Prime Minister's Secretariat.

In the given circumstances, as an SME development agency the mandate given to SMEDA was broad and encompassed poverty eradication by accelerated employment generation in the SME sector and export growth through productivity improvements. The other objectives behind the creation of SMEDA were policy making for small and medium enterprises, provision and facilitations in business support services, developing resource base for SMEs, and serving as a voice of small and medium business within the government. The ultimate objective was to kick start the economy through an aggressive launch of a Small and Medium Enterprise support program where private sector growth is led by SME development.

After its inception, the first challenge for SMEDA was to develop its own understanding about the SME sector in Pakistan. There was a lack of basic business statistics at that time and it was difficult to portray true picture of SME landscape. In the absence of replicable institutional history[4] in the country for the support and promotion of small and medium business it

[3] Interim Poverty Reduction & Strategy Paper -2002, Government of Pakistan; pp 7

[4] Earlier examples of small business support were through financial institutions, mostly operating at provincial (regional) levels.

was even difficult to estimate the basic numbers[5]. The second challenge was the political pressure forcing this nascent institution to deliver on ground in the shortest possible time. SMEDA hence structured itself into a sector based organization while focusing on nine priority sectors[6] of the economy where SME presence was perceived prominent and contribution to GDP was significant. A complete value chain analyses was undertaken to develop understanding of micro level business environment for each sector on four basic parameters; sector specific policy and regulatory environment, local and international market benchmarking, level of technology and composition of market competition. These analyses were followed by Integrated Sector Development Strategies (ISDS) for each sector supported by development and implementation plans. This phase uncovered the basic character of SMEs, their structure, cross-sector linkages and explained the interplay of various government regulations. This enhanced SMEDA's capacity; first, to explain the general business environment surrounding SMEs. Second, SMEDA was able to distinguish issues at the sector level according to their priority. Third, define issues at institutions level and finally recommend actions and develop services that could immediately affect their efficiency.

The Sector Development Approach

The basis for selection of sectors for SMEDA depended on the socio-economic importance of any sector. In our typical approach we conducted a complete value chain analysis[7] of a sector over a period of one to two years, followed by a sector development strategy and a plan. The template for value chain analysis followed by SMEDA is attached as *Annex 1* of this

[5] It was commonly believed that there were about 0.5 million SMEs in the country until 2004 when preliminary results of the Economic Census of Pakistan-2005 listed 3.3 million business enterprises in Pakistan and SMEs were estimated to be 99 percent.

[6] These nine sectors included Textiles, Leather, Marble & Granite, Fisheries, Transport, Dairy, Light Engineering, Information Technology, Gems & Jewelry

[7] Value Chain Analysis and Sector Analysis as terms have been used interchangeably for the purpose of this paper. SMEDA after selecting a sector at national or sub-national level conducts a value chain analysis. In some cases SMEDA conducts value chain analysis at sub-sector level in order to further disaggregate issues.

document. Though it represents the most commonly used value chain analysis approach, the methodology SMEDA followed is unique in following terms:

- All sector studies were led by a group of private sector entrepreneurs. These sector players were selected from all major types of enterprise classifications based on size and region. The Sector Working Group (SWOG) identified and prioritized issues to be investigated and steered the process.
- SMEDA being the public sector agency provided a formal platform for exchanging views including necessary technical, logistical, financial and human resources thereby fostering the model of public private partnership.
- The focus of the sector study was kept action oriented and issues were prioritized according to their weights. The binding constraints were separated from non-binding constraints
- The entire study culminated into a comprehensive sector development plan which recommended concrete solutions to improve the business environment including policy interventions surrounding the enterprises and proposed actions to improve productivity and competitiveness at enterprise level.

In order to better explain the context of our sector approach in shaping the role of SMEDA as an SME development agency; Marble & Granite Sector has been briefly discussed in this paper. This sector covers the entire spectrum of activities and services that SMEDA was entrusted to deliver ranging from policy inputs to the government and BDS to SMEs that better reflects business condition for SMEDA. This case study highlights many operational difficulties that were confronted during the course and how it helped SMEDA to shape its service methodology.

Socio Economic Background of NWFP & Balochistan Region

The provinces of Balochistan and NWFP are rich in mineral resources and are comparatively less developed regions in Pakistan. The incidence of poverty and extreme poverty is most prevalent in these regions and 38% of the population is living below the poverty line against the national average of 26.3%[8]. The share of the region in population is close to 19% and in GDP less than 10%[9]. Three major economic sectors include agriculture, retail trade, mining and mining related processing industry[10]. Since 1990 mining & quarrying has consistently contributed 0.5 percent to the Gross Domestic Product[11].

Balochistan and NWFP also have rich deposits of good quality dimensional stones with a great investment potential especially in Marble, Granite, and Onyx. The estimated combined reserves are over 2.5 billion tons of marble, 1.9 billion tons of granite & 15-20 million tons of Onyx[12]. Marble and Granite is the sixth largest mineral extracted among coal, rock salt, lime stone, china clay, dolomite, fire clay, gypsum, silica sand etc. Unlike other mining sectors, M&G has the largest proportion of micro, small and medium enterprises and thus has a direct role in wider employment generation. Regional concentration of most of the enterprises is in NWFP and Balochistan. Marble & Granite tile sector on the other hand also has the export growth potential. There are more than 250 operational mines of Marble, Granite, and Onyx in these provinces that feed to over 2,000 processing units nationwide. 95% of these units including mines are characterized as micro, small or medium enterprises while most of them are operating in the informal sector. This sector is pivotal to the livelihoods of the local population and currently provides employment to 123,000 people and has a potential to absorb another 357,000 in the next five years. In this socio-economic background SMEDA

[8] Figures are for 1997 source: Pakistan Household Income and Expenditure Survey 1999

[9] Economic Survey of Pakistan 2005-06

[10] Economic Census of Pakistan 2005 (the survey was conducted during 2000 to 2003 in different parts of Pakistan)

[11] SMEDA Marble & Granite Development Plan

[12] SMEDA Sector Brief and Department of Industries & Mineral Development Balochistan

after its inception in 1998 picked Marble & Granite sector as one of the priority sectors for intervention in the region.

The Case Study: Marble & Granite Sector in Pakistan

The sector at the time of SMEDA's intervention was suffering from slow growth or negative growth. According to estimates 1.37 million tons of marble and granite were produced in 1997[13]. Out of this 6,176 tons were exported in raw form, 3,976 tons in intermediary product (slabs) and 3,335 tons in finished form (tiles). Total worth of these exports in monetary terms was US $4.9 millions in addition to handicraft marble and onyx product worth $11.1 million. Domestic consumption remained at 1.37 million tons or 97% of the total volume. Marble & Granite extracted in Pakistan is of a premium quality. Even then the production in 1997 had declined by 5% compared to 1996 and 6.2% as compared to 1995. The major reasons for the negative growth of the sector were the overall economic slow down and sharp decline in the growth of construction sector. Fresh domestic or foreign investment in the sector was nonexistent. The M&G sector was generally lacking the equipment, skilled manpower and business environment that could unleash their potential for growth. The sector was also not in the immediate consideration of the Provincial or the Federal governments for development purposes.

Composition of Business Environment for M&G Sector

The exploitation of M&G potential involved a range of issues falling within the responsibility of the Federal, Provincial and District governments. From private sector's point of view technical, skill and market issues were of core importance and draw up the agenda for the government's intervention. SMEDA on the other hand approaches issues from productivity gap analysis while examining the skill level of labor,

[13] Federal Bureau of Statistics (FBS) reported production estimates at 433,482 tons which were grossly under estimated due to high degree of informality of enterprises in the sector

technology employed and prevailing capital structures of enterprises. The situation of the industry is then linked to the factors in the external environment including industry specific regulations, trade and investment policies, infrastructure, capital and financial market regulations, macro economic conditions etc. The assumption is that some of these factors in the external environment are forcing the enterprises to behave in a certain way and constrain their ability to attracting investment or finance due to poor operational performance.

SMEDA discovered that the productivity in the sector is half of its potential due to low skilled human resource and age old technology being used for the extraction and processing of stones. The firm level survey of M&G sector conducted for the purpose of productivity gap analysis revealed that 85% of the labor employed in the sector has not received any formal education at any stage. Their poor employability in other sectors results in wage rate equilibrium which was normally below the government stipulated minimum wage rate. Remaining human resource had not received any formal training in any of the areas of quarrying, extraction or processing of dimensional stones. Their capital base was also lean and nearly 100 percent of all reported business investment (with the exception of few), excluding land and business, remains less than a million rupee[14]. Sales data for the firms revealed that 84 percent of enterprises had sales below 0.5 million rupee and 93 percent report sales below 1 million rupees. These characteristics of firms suggested that most of the businesses were undercapitalized and fresh investment in the sector was nonexistent. The prevailing capital structures had forced enterprises into a low growth trap while using crude technology from extraction to processing[15]. Finally, they were unable to climb-up the technology ladder due to poor operational performance. Most of the enterprises often became

[14] One US Dollar ≈ 60 Pakistani Rupees

[15] The sector uses indiscriminate blasting technique for extracting stones. This technique results in two major faults; hair line cracks in the stone and irregular shaped boulders resulting in significantly high wastage rate (74-85%).

vulnerable to various external shocks and disappeared in the low productivity spiral. Our investigation linked the barriers to higher productivity and investment of M&G sector in Pakistan to the external factors and discovered as under:

Regulatory Environment

The single most important barrier in the development of this sector was the laws regulating Mining rights. The mining rights were granted to investors by the respective Provincial Governments under Mining Concession Rules. The normal mining rights were granted through a lease for a tenor extending from ten to thirty years. At the same time, mining concession rules allowed discretionary powers to the officials to revoke lease rights at any time.

The entire lease mining rights regime was regulated through four types of licenses, which were issued by the Directorate General Mines & Minerals in Balochistan and the Directorate of Industries and Mineral Development in NWFP. Reconnaissance licenses were issued for the general search of minerals. Exploration Licenses allow operations in connection with exploration, including any assessing, extraction and incidental winning of any mineral for the purpose of mineralogical examination, assaying, test work, or marketability surveys[16]. Traditionally, these two types of licenses are monopolized by multinational corporations for the exploration of base metals, oil and gas reserves. Prospecting License allows leaseholders the erection or construction of ancillary works for future mining operations and Mining Lease finally granted rights for an initial tenor of 10-30 years and may be renewed for next 30 years on each occasion.

The regulations allowed excessive powers to the regulators for the grant and renewal of licenses peculiarity of thee discretionary powers resulted in the insecurity of mining tenure implied at various places within the rules. The other issue was related to the inadequacy of the rules to

[16] Balochistan Mineral Concession Rules and National Mineral Policy 1995

accommodate joint ventures or subcontracting of mining work. Assignment of part of the license to second party is often in the best interests of the country (by attracting foreign investment). This all summed up to a lack of security of lease tenure for investors. Leaseholders of dimensional stones in particular shied away from investing in new technology for extraction of Marble & Granite. As a result indiscriminate uncontrolled blasting was *(still is)* continued to be used for stone extraction causing environmental hazards, high rate of waste and unsafe working conditions for labor.

Technology - Trade & Investment Policy

Unlike other mineral sectors M&G sector did not get the attention of local or foreign investors. Our study confirmed that even within the existing regulations with modern technologies the returns could be significantly higher with possibility of direct exports to USA & EU. The reasons for this low interest were explored and link was traced in the prevailing Trade and Investment policies of the Pakistan. After the liberalization of trade import tariff were classified in into four classes of tariffs i.e. 5%, 10%, 15% and 25%. The first class of 5 percent is generally applicable to the import of plant, machinery, equipment, spares and raw materials feeding to local manufacturing industry and classified as category "A" [17] sectors. The Trade Policy recognizes potential sectors for investment on the recommendations of the Board of Investment which is entrusted with Investment Policy of the country. The Investment Policy classified M&G sector as category "C" hence attracted duty of 15% on the import of plant, machinery and equipments. The other tax incentives such as initial depreciation allowance was also not available besides charging income tax at 37% and sales tax at 15% rendering the entire investment in the formal sector an unviable proposition.

[17] According to Investment Policy of Pakistan; the sector categorized as "A" can attract import duty between 0-5 percent. Other fiscal incentives include initial depreciation allowance of 50 percent on initial investment and the full repatriation of capital, capital gains, dividends in addition to payments of royalties and technical services.

The Trade Policy also regulates the Export Development Fund (EDF). This Fund is collected as surcharge on exports and utilized for the export development activities or projects. A good deal of fund is allocated every year for export promotional activities and financing infrastructure related facilities considered important for export growth. M&G sector was never considered for EDF funding.

The overall policy and regulatory environment explained the high degree of informality and small size of business enterprises in the sector together with the disinterest of investors. As an extension of this policy and regulatory regime the reasons for low technology could also be explained.

Access to Finance & other Business Services

Traditionally financial regulations in Pakistan only allowed financing secured against tangible assets[18]. For the manufacturing sector, assets like land, building, plant and machinery were the most desired securities. Our experience with the sector suggested that the financial sector did not address the financing needs of the quarrying industry, the major reason for their reluctance was insecurity attached to mining leases and inability of banks to secure a charge in order to minimize or mitigate risks. The M&G processing industry was also facing difficulty in getting access to finance. With the exception of few projects located in Lahore, Karachi or Islamabad there was hardly any unit being financed by the banks. In the prevailing regulatory regime leasing could have been a promising mode of financing but financial institutions were equally reluctant to extend leases due to difficulties in repossession of assets and little knowledge about the sector and its ability to yield sufficient cash flow to pay off debts.

There was an ample potential and need for business services as well in the areas of marketing, financial and legal services, and most important of all was guidance on latest technologies. Throughout the value chain there

[18] The Prudential Regulations of Central Bank of Pakistan (State bank of Pakistan) did not allow financing unless secured against tangible assets until 2004.

had been hardly any change in the conditions of enterprises for past two decades in terms of their access to markets, technology being employed and skill level of the workers. Some public sector training institutes existed for training workers to make handicrafts using marble waste. The overall size of the market for such products was less than 2% hence did not promise any big future prospects. The business associations of the sector were not really fully functional nor were considered as an appropriate platform to discuss industry or sector wide issues. In the prevailing business conditions SMEDA's assessment was that there should be functional network of enterprises serving as the common platform and for the purpose All Pakistan Miners Owners Association (APMOA) and All Pakistan Marble Industry Association (APMIA) needed to be strengthened. There was also a need for business services in the areas of financial management, marketing, technology and contract drafting, though there would be little capacity among enterprises to pay for such services initially.

Approach for improving Business Environment for the Sector

SMEDA; an SME development agency, developed a sector strategy in 2001. A table of initiatives under the plan has been placed at *Annex-II*. The strategy formulation process while taking the note of micro level issues recommended many initiatives. These initiatives gave due weights to the factors of business environment and firm features therefore, actions, programs and projects suggested had an ability to improve the firm level working conditions. The common feature of most of these initiatives was that they either proposed reforms at meso-level institutions or demanded business services at micro level. In the same vein, the binding constraint however, was the prevailing regulatory environment and more specifically, the Mining Concession Rules of 1976. These rules were revised in 2001 in the case of NWFP however; any major breakthrough in Balochistan is yet to be recorded.

The most important element in the process of strategy formulation was the formalization of public-private dialogue, aiming at improving the business environment and redefining public and private governance mechanisms. The formalization of this process and institutional support as provided by SMEDA resulted in fostering enterprise networking and the accumulation of knowledge on business environment and micro conditions at firm level. This synergy was used to develop a sector development plan. One important element of this plan was the identification of areas where microeconomic policy and public governance needed to be improved. The role and responsibilities of various institutions were also proposed to accommodate the reforms in the microeconomic policy for improving the business environment. The process also suggested the proportionate priority of reforms at the policy and intermediary institution level. The implementation and execution of the plan sought wider participation from other federal, provincial and districts governments and relied on their institutional capacities.

These efforts grossly failed even to bring any change in the policy or regulatory front let the provision of BDS and infrastructure for SMEs aside. The failure could be largely attributed to SMEDA's incapacity to give necessary institutional solution to sector development. SMEDA, as an SME promotion agency understood that the regulatory and institutional reforms had taken a long time to realize. The need and importance for micro level interventions could not be undermined especially with reference to various BDS and provision of sector specific infrastructure. The proposed initiatives were needed to be collectively owned by a number of federal and provincial public sector business development agencies. Those initiatives were well understood at the industry level but public sector funding was not committed due to diffused ownership of initiatives at institutional level. It was also considered that current level of focus on the sector development could not be maintained by SMEDA especially on the provision of BDS for a fairly long period of time. These facts cited SMEDA to reviewing its approach in two areas; the possible institutional arrangement for leading the sector development and mobilization of initial investment to fund the pilot projects. The solution finally considered was the development of a separate institution; a sector development company that had sole responsibility of sector development. Any such institution should distill collective services for the development of businesses and aim at the provision of those. It was in this context that the USAID agreed to fund Pakistan Initiative for Strategic Development and Competitiveness (PISDAC) in 2004. Its objective was to support self-selected Pakistani industries in developing and implementing strategies for growth, and instituting a sustainable mechanism for effective sector development. Initially three sectors Marble & Granite, Dairy, and Gems & Jewelry were selected for support under the project. The USAID support added more depth to the study using Porter analysis and stimulated necessary policy and regulatory debate. The sector development process became more formal with a separate team and initial endowment to fund activities. The major achievement in this regard was the setting up of Pakistan Stone Development Company (PSDC) which drew its management from the public and private sector (relevant trade and industrial associations). Initial resources of Rs.300 million (US$5 million) were provided by the government as an endowment with the purpose of execution and implementation of sector strategy. The other achievements of the project are as under:

- The investment and trade policy upgraded the M&G sector status to category "A"; M&G sector is now entitled to customs duty concessions and other fiscal incentives.
- Central Bank of Pakistan revised commercial banking regulations and new regulations allowed collateral free financing up to Rs. 3 million to banks. Additionally, long term export development financing to the sector through all the commercial banks was now possible.

- The regulatory procedures under Mining Concession Rules 1976 were reviewed removing uncertainty attached to mining rights. In NWFP these were revised in 2001 and implemented. This was possible with the support of World Bank.
- Under the above rules a provision for community participation was introduced and regulations were enforced with private-public partnership while composition of *Mining Committee* ensured membership from relevant trade and industry associations.
- The Government recently, earmarked Rs.1.5 billion (US$25 million) through the Pakistan Stone Development Company (PSDC) for i) Master planning of M&G bearing areas, ii) Establishment of Rock Mining Training Institutes & Model Quarries with the support from Italian Development Agency iii) Creation of machinery pools and support for technological up gradation as collective service for undercapitalized enterprises iv) Marketing and product development support up to 50 percent of costs from Export Development Fund
- The Government of Balochistan established a stone processing industrial state in Gadani City, Balochistan in 2004. All the necessary infrastructure and related business support services were made available.

M&G sector registered an average annual growth rate of 7.3% in the past couple of years. Over 100 units are under major BMR, 50 new enterprises emerged and three joint ventures with Italian counterparts are currently being negotiated. The overall investment in the sector in five years is roughly Rs 2 billion (US$33 million) and 3,000 new jobs have been created.

SMEDA's experience in other Sectors and SME Development

SMEDA over the years specialized in conducting value chain and sector analysis. In the beginning it was the compulsion to develop an understanding of SME sector while keeping the scope of SMEDA activities manageable. By 2001 SMEDA was able to complete sector analysis of more than nine sectors for dealing with business environment and SME competitiveness issues. The common pool of knowledge that emerged out of these sector studies suggested that firm level conditions greatly vary from sector to sector. Their interface with regulatory and policy environment also cited to custom made solutions. At best in all cases the urgency for immediate reforms points to intermediary meso-level institutions and access to BDS at firm level. Resultant heterogeneity of business conditions at firm level posed service challenges to any SME agency in a developing country. One option could be to distance itself from any micro level interventions even in the provision of BDS. By saying this the purpose is not to undermine the importance of BDS for improving business conditions for SMEs at firm level but is to proportionately reprioritize intervention strategy at the operation level and finally focus on the provision of collective goods or services at the agency level. Other major byproducts of sector level activities were the understanding of the nature of various BDS being demanded. The vertical and horizontal linkages of firms were better understood – giving a fair insight into the possible BDSP market development for private sector investment.

The large size of the SME sector[19] was the major constraint for the Government and business support agencies to *achieve complete coverage by support programs* at any sub-national level. This fact made policy and regulatory reforms of tremendous importance for SME promotion. It was understood that much more could be achieved only by appropriate policy tools and regulations than with support programs. Likewise, SME development was hampered more by inappropriate regulations than compensated by means of appropriate support programs. For the purpose it was important to develop a common topology of issues through national

[19] The Economic Census of Pakistan – 2005 lists 3.2 million SMEs in the country.

level studies in order to contextualize operational strategy of SMEDA. Some of the significant national level studies are discussed here.

World Bank (2001) identified the severity of constraints based on firm perceptions. Their two-tiered approach first identified the top ten problems experienced by firms in their efforts to grow, and then further investigates seven of these constraints i.e. government and regulations related issues, access to finance, infrastructure, human resources, raw material, technology barrier, law and order, and marketing. ILO-SMEDA (2002) surveyed firms to understand the regulatory burden on firms by assessing necessary legislation and administrative steps for compliance. The study identified important issues related to labor and taxation laws and clarified the complications faced by SMEs in complying with these laws. The study suggested an overall focus of future policies on three broad areas; labor laws, access to finance, and taxation. Bari et al. (2002) noted the need to focus on microeconomic problems as well as the macro-economy. The binding constraints observed included issues related to financing, infrastructure, government regulation, human resources, market regulations, and macroeconomic uncertainty. SMEDA-World Bank (2003) concluded that Pakistan needs to focus on microeconomic reforms to reduce business costs by providing better services in the areas of "power, telecom, tax administration, access to finance, and law and order" (p. iv).

These studies reiterated that many micro and meso level policies despite being well intended remain major barriers in the growth of SMEs and qualify to be brought on the public policy agenda. At the same time, when economic policy of government is more focused on macro issues such as macro-stability, law and order, privatization, trade liberalization, education, infrastructure etc. the micro policy issues critical for the development of SMEs remain out of focus from public policy debate. The role of articulation of issues and explaining their links to macro policy issues become critical for improving business environment for SMEs. The policy advocacy thus becomes a major role for an SME development agency. The effectiveness of this role remains largely compromised in most developing economies like Pakistan. SME development in particular and debate on micro policy reforms in general is relatively a recent phenomenon. SMEs are mentioned in socio-economic development strategies and policies, but measures are never appropriately specified, contextualized, or prioritized to speak of any concrete SME development efforts. The possibility of becoming more concrete, specific and thereby more effective could only be through sector development approach. Donor interventions that could support SME agencies' efforts for sector studies, policy advocacy including the capacity building in explaining cross linkages with macro economic issues could be of pivotal importance.

The other important aspect of our sector related experience was that an assimilation of sector level issues helped to portray general picture of business environment for the SME sector (Fundes, 2005). This approach was used as a shortcut (with caution) to explain major policy and regulatory issues *(see Annex-III)* at national level though intra-sector and intra-regional issues did not get adequate coverage. In the absence of capacity to undertake national level economy wide studies, it served as a useful tool though not pleaded as replacement for comprehensive national level study (Vincent Palmade, 2005).

Operational Strategy for SME Agency

There should be two major considerations while defining the operational strategy for an SME agency in developing countries. First consideration must be the speed of reforms and *real* change at policy, regulatory and institutional levels. In our experience, the speed of change is fairly acceptable at the policy level. The major problem is the slow progress of reforms at meso level or at the intermediary institutional level[20] whereas,

[20] The M&G sector as discussed above also support this conclusion and instead of following up on reforms in the existing institutional structures, new institutional designs

micro level environment remains dynamic and adjusts quickly with the changes in factor markets especially in case of liberalized economies like Pakistan. The other important consideration is the competitiveness and productivity of SME sector as the sum of sub-national economic sectors. The activities that can improve the competitiveness or productivity of SMEs at sector level thus qualified for SMEDA's interventions.

The operational strategy of SMEDA reflects our sector development understanding and experience and follows a four step approach to define our service paradigm where each step is building on the other. First step addresses cost competitiveness of firms. The discussion above on firm level constraints entails that SMEs need a business environment that rationalize regulatory burden, provide adequate infrastructure and business support services at an affordable cost, give access to long-term funding, foster firm level linkages. This ultimately results in significant reduction in the cost of doing business. This approach is suited for all those SME sectors that are at the initial phase of development. By the same token in Pakistani context retail, dairy, Marble and Granite sector etc. qualify for such interventions.

Second step targets quality competitiveness. SMEs typically suffer from weak entrepreneurial skills as well as deficiencies in accounting, production management, technical know how and business planning. As SMEs grow, they increasingly need connectivity to export markets and capacities to match contemporary quality standards. The weak affordability of SMEs to buy such services due to lean capital base and low turnover pose a service challenge to SME development agency. The programs thus envisaged should cater for supporting SMEs through resource provision in terms of short to long term funding arrangement along with service provision. If and where required, investment in public goods that improves SME competitiveness including infrastructure i.e.

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had to be considered. In either case, it slowed down the pace of change or development.

common facility centres should be the focus. Quality training for human resource development and infrastructural support through common facility centres allowing SMEs access to quality improvement and technology acquisition facilities would be important. The surgical and gems & jewellery sectors in Pakistan qualify for this treatment.

Equally important for the rapid growth of SMEs is the technology competitiveness. It is understood as the third step of the strategy and feeds to the fourth step of ultimately achieving business competitiveness. The basis for these two has to be built by investing into science and technology, related research and development initiatives both at the higher educational institutions and industry levels and constitute macro economic policy agenda. However, there is no shortcut for achieving that and it would at least require continuous support from the government and private sector for fairly long period of time to yield results.

SMEDA's entire spectrum of activities and services if now reviewed in the context of above discussion can be classified in four priority areas; i) Policy related interventions aiming the improvement in the macro business environment ii) Business support services with priority to develop market for their provision in the private sector, iii) Support for sector and cluster development programs and, iv) Enterprise development initiatives.

Conclusion

SMEDA's experience with sector development at sub-national level suggests that while setting the priority of reforms for improving business environment, sector development approach on the basis of value chain analysis should be considered. It is important that issues related to public private dialogue and governance, market for business support services, product market competition, and regulatory environment are addressed concurrently. The formalization of the process and providing it institutional outfit is a precondition for success. Donor support for providing initial resource endowment can significantly increase the chances of success. The major role of an SME agency in developing economies is the articulation of microeconomic issues and explaining their relationship to macro policy issues. In the absence of required capacity, effectiveness of this role is proportionate to donor support for policy advocacy to initiate national level debate.

In our experience an SME development agency operating in a developing economy would be required to work on a multiple service paradigm. The experience suggests that such agencies can be more effective if they design their operational strategy while targeting productivity and competitiveness improvements at sector level within SME sector. This will entail institutionalizing the consultative process with stakeholders, advocating and negotiating regulatory concession with government and delivering critical business services to SMEs directly where no such markets exist. Only sector level initiatives can yield necessary conditions to deliver effectively on these accounts. Donors support will again be pivotal in developing organizational capacities in terms of process development, resource mobilization and creating political pressures for bringing about change.

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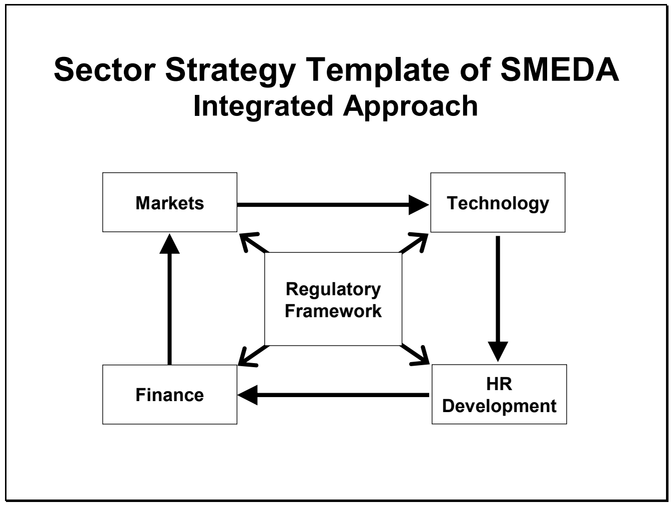
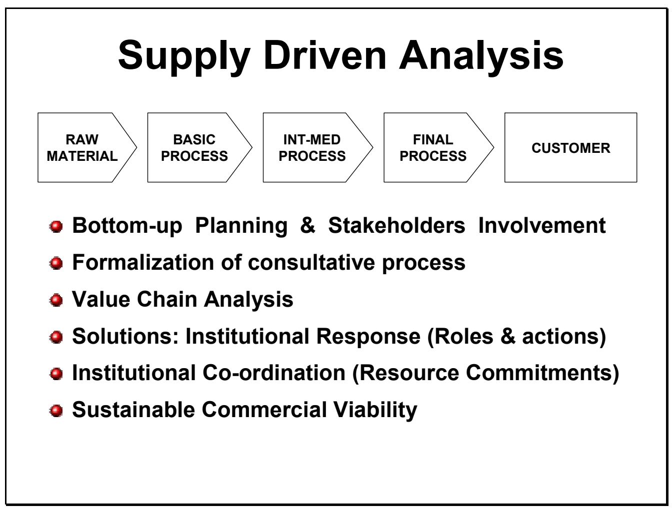
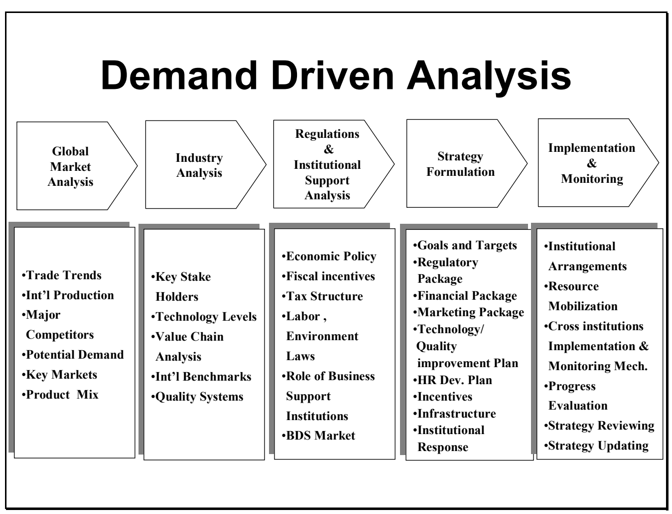
Annex – I: Sector Development Strategy Template







Annex – II: Synopsis of M&G Sector Strategy

	Situation Analysis	**Strategic Initiatives**
Quarrying	• Mining Technology • Indiscriminate Blasting • Low Skill Level • Lack of training	• Model Quarries • Expert services with innovative & diverse tool-kits • Technical assistance based on-the-Job training program for Quarrying • Phase-in Quarrying & Environment Standards
Processing	• Low Capacity utilization in processing • Limited value addition	• Common Facilities – Model Processing & Training Centers • Introduce new technology and facilitate JVs • Focus on Cut-to-size Jobs, Higher value addition, Crafts Training • Diversification of Processing
Market Orientation	• Competition with low price, higher quality imports • Non-Collateralization of Lease • Investment Category "C" Industry	• Cluster Development - Highly integrated with sophisticated demand • Testing facilities & Product Information • Laws & Regulations: incentives for land owner for profitable use of quarries • World-Class Valuation (Prospecting & Planning) of Quarries • Investment & Trade Policy Reforms - Industry category, rationalizing tax structures and fiscal incentives
Quality	• Poor Quality of Products • No Environmental Concerns	• Phase-in minimum Quality Standards • Management: Introduction of quality controls at all stages
Management	• Industry Structure cannot provide efficient or effective allocation of resources	• Pakistan Stone Development Co. (PSDC) – An Industry Services Company focusing on Training, Technology, Quality, R&D, Info Access, Marketing, Policy reforms & Environmental Controls

Annex – III: Common topology of issues from selected sector studies

	Textile	Dairy	Gems & Jewelry	Marble & Granite	Surgical
Finance	High interest rates for working capital/ inadequate long term credit facilities to support BMR	Inadequate financing support from banks for Farm Equipment, Cooling Tanks and Transport Vehicles	Non availability of working capital and trade finance facilities – existing regulation non-facilitating	Non-availability of working capital and trade finance facilities	Very high Interest rates Long term financing absent
Infrastructure	No accredited product testing and certification labs Customs Clearance and capacity at the ports	Lack of storage, transport infrastructure (Only 25% of milk produced reaches markets), Milk testing Facilities	Testing and assaying facilities not available Lack of training institutes for cutting, polishing and jewelry making	Inadequate infrastructure for primary industry, transport and infrastructure	Metallurgical Testing facilities Gamma Radiation facilities
Macroeconomic Policy Issues	Issues like anti-dumping and countervailing duties, trade related non tariff barriers, PTAs, RTAs	Inadequate Food Quality Standards and Laws Investment Policy – Fiscal & Trade incentives	Economic instability Sector Highly vulnerable to overall economic stability	Investment & Trade Policy: Industry Category “C”;	Trade policy issues Tariffs on raw material
Other Regulatory Issues	Import/ Export Quota Industry capacity for compliance to Int’l environmental and social standards	Inadequate hygiene standards and regulations	Import entitlements on jewellery or gemstones sales/imports and exports (Gold Jewellery and Gemstones Order 2001)	Lack of security of lease tenure for investors Sector licenses (Four types of licenses) Surface Rent regulations	Trade policy issues on R&D
Labor & Tax Issues	Multiple Labor levies and numerous inspections; Fiscal Incentives	Not as such	Discriminatory tax treatment	High tax rates (income tax 37% and sales tax 15%)	High tax rates Withdrawal of fiscal incentives on exports
Domestic Market	Highly competitive market and low quality domestic production	Large amounts of powdered milk is imported	Highly competitive and threat from imported items	Highly Competitive – imported good quality substitutes	Non-availability of requisite raw material
International Trade	WTO – Threat from India and China and Bangladesh Perception as low quality producer – High volume non branded exports	Not a possibility due to Poor Hygiene and quality standards	Non-conformity of local products to int’l standards of quality and purity Hallmarking and Assaying facilities	Non-conformity of local products to international standards	Low quality products and diversification
Human Recourse	Lack of qualified HR to facilitate sector R&D	Shortage of technical manpower in the areas of processing, storage, breeding etc.	Lack of trained product designer, craftsman and marketers	Lack of technical manpower in quarrying, cutting, polishing, marketing	Shortage of skilled/ technical manpower
Technology & Innovation	Obsolete textile technology Low investment in technology Lack of proper equipment for essential quality controls	Lack of equipment and technology, Technical know how of entrepreneurs	Lack of technical know how and equipments esp. in designing and fabrication Lack of standardization to ensure quality	Low level of Technology being employed in the industry	Absence of R&D in non-steel products Lack of technical knowledge on Electro-medical devices
Environmental and Social Issues	Lack of CSR – Buyers demand for compliance to social and environmental Stds.	Under-developed dairy processing industry; Low awareness on issues	N/ A	Uncontrolled blasting Tribal Setting; Royalty, Law & Order issues	Hazardous waste – environmental pollution