MGT601 – SME Management

Lesson 1

HISTORY, DEFINITION AND REGIONAL CONCEPTS Of SMEs

This lecture will give a clear concept of history, definition and regional concepts of SMEs. A student should be able to understand the concept of small business, its characteristics, definitions, kinds and an overall view of its comparison with large business.

The History

Recent years have seen a major resurgence of small business throughout the developed world. The countries like divided Russia and Eastern Europe are prizing such skills very high. The first piece of writing about the small business discovered was of about more than 4000 years ago. This writing is about loaning from a Bank for a small business with terms and conditions. Since then, the small business people have been the backbone of most economies providing products and services to the consumers.

Small business flourished in almost all ancient cultures. The Egyptians, Arabs, Babylonians, Jews, Greeks and Romans contained a substantial population of small business. Their products and services, however, were often of poor qualities. Consumers were cheated and degraded. The result was that small business became object of contempt. To protect the customers from such unscrupulous traders, HAMMURABI, the king of Babylon introduced the first business laws.

Despite many successes the Greek and Roman historians virtually ignored the role of small business and talked more about the other things. Yet it was largely through small business that the traders by doing business in other countries spread law, religions, and philosophy and basic sciences. In the centuries that followed the small business, the religions held small business people in low esteem. Although now held in the higher esteem than ever before, small business remains overshadowed by professions such as medicine and law. When, he was describing an economy in which local small business was virtually being the only economic entities. Indeed, the era of local economy was the heyday of small business.

In the undivided subcontinent if we look at beginnings of the known history of small business, the cottage industries thrived through the period when society was organized more or less into self sufficient and self-contained units. The sub-Continent industry, whether small or large scale, suffered a serious set back Page during British rule. Indian industries including small and cottage did not receive any patronage during the period before Second World War. It was, however, since independence that a positive policy for the industrial development could be formulated and implemented. The best model of small industries in our region is considered to be of India. This model is defined the SMES development through the development of infrastructure. In the year 1938 national planning committee "NPC" was set up and its general secretary Mr. K.T. Shah made the definitions of cottage, village and small-scale industries. The various definitions since then are in practice having different variables as manpower, capital, assets value etc. The definitions are as under

Definitions

Cottage Industry:

The cottage industry or small scale industry may be defined to be an enterprise or series of operations carried out only by a workman skilled in the craft on his own responsibility, the finished products of which he markets himself. He works in his own home with his own tools and materials and provides his own labor. These workers are mostly hand labors and having personal skills with little or no aid from modern technology and machinery they work in accordance with the traditional technique. In the year 1940 another Indian definition came which had a more pragmatic approach where it was divided small industry into following categories.

1. **No mechanical power and no hired labor.**
2. **No mechanical power and hired labor fewer than 10 persons.**
3. **No mechanical power but hired labor of over 10 persons.**
4. **Mechanical power under 10bhp but no hired labor.**
5. **3 and 4 are treated here as small industries.**
6. **Mechanical power under 10bhp and hired labor**

7. **Mechanical power over 10bhp and hired labor.**
   Here 6 and 5 were considered as the medium size industries

Different countries defined these categories in their own way. In USA the small industry was defined as "a business qualifies a small if does not dominates its industry and less than 100 employees". In the United Kingdom small firms were defined in 1969 as "entities having less than 200 employees. It should be run by its owner and should have a relatively small share of its market". In France, it was defined as " a company with less than 10 employees, representing over 90 percent of all businesses and employing one sixth of the total work force and they categorized it as follows:

I. **Less than 10 employees (very small enterprise)**
II. **10 to 40 employees (small enterprises)**
III. **50 to 500 employees (medium enterprises).**
IV. **Over 500 employees (large enterprises)**

In Denmark, a small business is one with fewer than 49 employees; a medium one has 50 to 199 employees and large business employees over 200 people. In Japan which is considered to be a landmark in the history of SME's the term small industry is used in a much wider context. The term "smaller enterprises refers to such companies with a capital of not more than five million yen, companies with not more than two hundred personnel regularly employed. In the West Germany, Australia and Norway the definitions were made for the legal purposes and different deciding factors were kept as landmarks.

Nowadays, a generalized definition is in practice and it says an SME entity is defined as a business with an investment in productive assets (not including land and building) ranging between rupees 2 to 40 million and employing among 10 to 99 workers.

Small: Among10 to 35 employees and productive assets ranging 2 to 20 million,
Medium: Among 36 to 99 employees and productive assets range of rupees 20 to 40 million.

Concept of Small Business
Clifford Baum back regards small business as one that is:

- Actively managed by its owner
- Highly personalized
- Largely local in its area of operation
- Relatively small in size within the industry and
- Largely dependent on the internal resources of capital to finance its growth

According to the **"Committee on Economic Development"** a business is small if it meets two or more of the following criteria.

1. Management of firm is independent in the sense that owners themselves are managers.
2. Capital is supplied by ownership and is held by an individual or a small group.
3. Area of operation is local.
4. The size of the firm in the industry is small as compared to the highest unit in its field.

Characteristics of Small Business

1. Privately held small business is again subdivided into two categories.
   - Very small where chief worker is the owner like jewelry shops, shoe stores and grocery shops etc.
   - The Large Small business where the proprietor mainly directs the work of its employees.
2. No or few management layers
3. Style of management is personalized the owner has first hand knowledge of every move in the business at all levels he is the main decision maker.
4. Limited resources: a small business is unlikely to have sufficient resources to dominate the market.

5. Independence: the owner has ultimate authority and effective control
6. Scope of operations: small enterprises serve a limited segment of local or regional market.
7. Scale of operation: they occupy a limited share of given market.
8. Labor: they are low in capital and high in labor, as they cannot afford capital-intensive machinery.
9. Technological innovation if available small business does well
10. Specialized skills: The small enterprises normally have specialized skills for certain specific clients.
11. The small business does well in small, isolated, overlooked and imperfect market.
12. Small business does well in developing markets as it can easily absorb the changes
13. Small business survives well in a bad business condition due to having quick and clever capability of bringing changes in cost and labor.

Typical Small Business

1. **Retailing**: It's a traditional business where normally the owner is the boss and owner
2. **Services**: such as legal and accounting, courier services and beauty parlors etc.
3. **Construction** activity
4. **Whole sale** business
5. **Financing**, insurance and real estate
6. **Transportation** communication and public utilities
7. **Manufacturing**

Large vs. Small Business

1. They foster changes differently: small business fosters changes through a cycle of birth and death whereas the large business cycle changes through expansion and contraction
2. The risk, reward and investment decisions are assessed differently in case of small business it is personal while in the cases of large business it is made by the employee managers without livelihood stake
3. Their economic power is different: the small business is in no position to influence its immediate economic involvement but big business does.
4. They utilize different resources in the economy small business may use secondary resources but the big business use most of the primary resources
5. They serve different markets in the economy: small business serves markets which big business does not wish or cannot serve.

Key Terms:

1. **Merchandising**: Buying, Selling and Promoting Goods.
2. **Enterprise:** A company or business project or the courage and willingness to undertake business projects or a business activity
3. **Retailing**: The sale of goods to the general public.
4. **Wholesale**: Buying and selling the goods in large quality from manufacturers.

Books Recommended

1- Entrepreneurship and small industries by C.L. BANSAL
2- Small industries and the developing economy in India by RV RAO
3- What is an SME (UNIDO)

Lesson 2

THE REGIONAL CONCEPT Of SMEs

This lecture will throw light on the relationship between small and big business ,concept of SME's in our region i.e. South East Asia and in Pakistan. It should give a student a clear idea about its definitions in these areas and will help him in differentiating the variable factors of labor, investment and production volume of our region in comparison with developed countries of Europe and USA.

The Relationship between Small and Big Business

Small businesses powerfully effected by developments within the big business sector this relationship serves the interest of general economic disequilibria. Small business is less affected by economic disruptions and is more or less self-adjusting. It tends to act as cushion for economy .The nature of interlink age between small and medium business is as under

1. **Job subcontracting** i.e. the large business provides materials and components to small units who process the same into finished goods
2. **purchase subcontracting** i.e. in this case the material is procured by small unit who manufactures a specific part or component needed by a particular large unit
3. **Complementary:** in this case the product manufactured by small company is purchased by a big unit as accessory like plastic dust covers for video recorders, electronic passive components, packaging etc.
4. **Merchandising or commercial trading**: in this case the small units manufacture the goods and big units on the strength of their financial power market it with their own brands like fans, washing machines, refrigerators etc.
5. **Maintenance and repair services:** many large enterprises give the operation and maintenance contract to the small companies due to being more economical and helpful
6. **Social benefits:** employment generation, decentralization of industrial benefits etc.

The regional Concept of SME'S

The countries generally try to identify their SME sector in order to target it for special assistance. Yet, the definition of an SME depends to a greater extent on local conditions. An enterprise considered an SME in one country might well be bigger than many large countries in another. In some cases, the SME sector is further broke down in to two separate groups

A generic definition is not easy to find, any definition of classification of SME can thus be considered specific to the country in question. Countries have widely different definitions of SME's for example, in India; the criteria for determining SME status are based on investment while in South Africa SME eligibility depends on the number of employees and turn over. There are nevertheless three parameters that are generally accepted, either signally or in combination, in defining SME's in most countries, these are:

- Number of workers employed which is the most widely used criteria
- The level of capital investments or assets
- The volume of production or business turnover.

In many countries, medium scale industry is not defined and is understood to include those that fall between small and large industries:

Criteria Used to Define SME's in South East Asian Countries			
	Employees (Number)	Capital (US $ '000)	Turnover (US $ '000)
Brunei Darussalam	Small 1-10 Medium- sized 11-100		
Indonesia	SME's <100	SME's <84 (Total assets)	SME's < 1,000 (sales)
Lao PDR	Small < 10 Medium- sized 10-29	Depends on the number of establishments in sector	
Malaysia	SME's < 76	Small < 198 Medium-sized 198-939	
Myanmar	Small <50 Medium-sized 50-100	Small <167 Medium-sized 167- 835	Small 417 Medium- sized 17-1,670 (production)
Philippines	Small 10-99 Medium-sized 100-199	Small <570 Medium 570-2,282	
Singapore	Services sector SME's <100	Manufacturing sector SME's < 8570	
Thailand	Labor-intensive industries: Small <50 Medium-sized 50-200	Capital intensive Industries- fixed assets: Small 781 Medium-sized 781-3,905	
Viet Nam	Small < 50 Medium-sized 50-100	Small <4 Medium-sized 4-18	

Source (United Nations, Small industry bulletin for Asia and Pacific (No, 30 page 44)

The SME'S in Pakistan

Pakistan's economy is an economy of SME's. Policies in the past have given a general perspective, direction and defining broad parameters of activity within the macro economic framework, but efforts have focused on the large enterprises, neglecting SMEs which are at the heart of our economy while SME's are being mentioned in some of our socio-economic strategies and policy documents, measures are not sufficiently specified and prioritized for us to be able to speak of any coherent SME policy or approach. SME promotion is an important issue for many government departments and central offices. However, there is an existing lack of coordination and regular information exchange mechanism among institutions that constrains their collective ability to deliver in the SME development process.

The Government's Effort towards SME Development

The government of Pakistan keeping in view the importance of SME's has adopted multi pronged approaches at the regional, sub regional and national levels. Initiatives at the national and sub regional levels include efforts to strengthen economic integration and cooperation. At the national level, structural adjustment programs have been inauguration along with attempts at re structuring and diversifying the production base, integration the informal sector into the economic mainstream and stimulating increased participation at the enterprise level. The development process was initiated in the 60's and the concept of development derived its origin from within, "Indian model" of small enterprise development. The basic idea behind this model is to develop infrastructure facilities such as industrial estates, common facility centers and vocational training institutes which would to a great extent the problems faced by SME's. Based on this model numerous provincial level organizations were setup mostly with the help of foreign assistance in the shape of grants and soft loans. The definitions thus depend upon the criteria set out by such provincial or federal institutions.

Definitions by Provincial Level Institutions

a) Punjab Small Industries Corporation (PSIC):
b) Sindh Small Industry Corporation (SSIC):
c) Small Industries Development Board (SIDB)

d) Directorate of Industries Balochistan (DIB)

These organizations defined the small industries as under:
An industrial undertaking with fixed investments up to 20 million excluding the cost of land and no limit of people employed.

Definition by Small Business Finance Corporation (SBFC)

Small:
- No limit of people employed.
- Productive assets limit of 20 million

Medium:
- No limit of people employed.
- Productive assets limit of rupees 100 million.

Youth Investment Promotion Scheme (YIPS)
According to the concept paper on SME's in Pakistan, developed by YIPS, small-scale industry was defined as industrial enterprise with fixed assets of up to rupees 10 million (Excluding the cost of land and building). It is pertinent to note that majority of the definitions have been formulated either by the national institutions themselves or with the objective of meeting the financial requirements

The State Bank of Pakistan
MICRO:
The State Bank's federal credit scheme (small loan scheme) for micro and small scale enterprises, defined their target group in year 1972 –1973 as enterprise with assets of less than rupees one million (excluding the cost of land and building). This limit was redefined in the year 1992 and increased to rupees 20 million.
SMALL:
Assets up to rupees 20 million (excluding the cost of land and building)

Small & Medium Enterprise Development Authority (SMEDA)
The government to promote the cause of SME development in the country has recently established SMEDA. Given the mandate of SMEDA, it was not possible to work in the absence of definition for the target segment. At a broader level SMEDA's objective is not only limited to catering to the financial requirements of the SME's whereas its mandate encompasses all other aspects such as marketing, human resource development etc. SMEDA went one step ahead and used two variables to define SME's in Pakistan. Following are the definitions of the SME's:

Micro:
- Less than 10 people employed
- Productive assets limit of 2 million rupees.

Small:
- Between 10-35 people employed.
- Productive assets limit of 20 million.

Medium:
- Between 36-99 people employed
- Productive assets limit of 40 million.

Definitions of SMEs in Pakistan
The definitions of "small" and "medium" sized enterprises differ from one country to another. Each country has adopted different criteria for defining SMEs, such as the number of workers employed the, volume of output or sales, the value of assets, etc. As far as the case of Pakistan is concerned no concentrated efforts are observed at a macro level to define SME's. Numerous efforts have been made to formulate basic policy guidelines limited to the small-scale industry while ignoring a vital component, the medium sized enterprises.

As a result, inconsistent policies have been formed from time to time without taking into considerations the overall importance of SME sector. The need for a uniform definition is crucial for the successful development of this sector. Various organizations follow different definitions of SME's according to their needs. Mainly these definitions are based on one variable, the fixed assets; key motive is to cater the credit requirements of the small-scale sector.

References

1. Pakistan Small industries entrepreneurs Gallup/BRB World Bank survey
2. Research cells LCCI (Lahore chamber of commerce and industry)
3. SMEDA (research Cell)
4. Small Enterprises in developing Countries By Dr. Asghar S. Nasir
5. State Banks circular for Micro credits

Recommended Book

Small Enterprises in developing Countries by Dr. Asghar S. Nasir

Key Terms

1. Multi pronged (with many tips, branches)
2. Generic (Belonging to a class or group)
3. Soft Loan (A loan with very low interest)
4. Grant (A non returnable helping money or commodity)

Lesson 3

THE ROLE OF ENTREPRENEURSHIPS IN SMEs

This lecture will define the modern concepts of enterprise, entrepreneurship and will establish the relationship between an enterprise and an entrepreneur. It will also relate the SMEs advancement with entrepreneurship.

The modern civilization is the industrial system and the directing force that animates this framework is the business enterprise. In the current economic theory "the businessman" is called entrepreneur.

History

A French baker Cantilon identified the first definition of entrepreneur function in the mid-18th century to mean, a person who is "uncertainty bearer" the same term appeared in Adam Smith's writings but not very clearly. J.B Say regarded entrepreneur to be an organizer who combines various factors of production to produce a viable project. The famous economist Joseph Schumpeter defined the theory of entrepreneurship with a new perspective and regarded the entrepreneur as an innovator who has the potential of doing things in a new way. He subdivided this innovation process into following five forms.

1. Introduction of new goods
2. Introduction of new methods of production
3. Finding of new product
4. Discovery of new sources of supply of raw materials.
5. The organization of industry in a new way.

But, the concept of innovation has been criticized by the developing countries who need "**imitating entrepreneurs**" capable of implementing innovation made in the developed countries. According to Peter Kilby, an entrepreneur in an underdeveloped country performs a wide range of activities including perception of market opportunities, combining and managing factors of production, introduction of production techniques and products etc. This conflict was solved by defining innovation entrepreneur as "independent entrepreneur" and the person who carried out new combinations in order to meet perceived opportunity "corporate entrepreneur".

The concept of entrepreneur was referred to a generic type of operator who bought at fixed prices in order to sell at prices, which were uncertain at the time of purchasing. Entrepreneurship was defined by Cole (1959), "a purposeful activity (including an integrated sequence of decisions) of an individual or group of associated individuals who undertake to initiate, or organize a profit oriented business unit for the production or distribution of economic goods or services". In the year 1959 her Bison and Meyers replaced the terms with "management" and "organization" for entrepreneurship.

The entrepreneurship played a very vital role in the small and medium sized industries. The new innovations, courage to face the risk of uncertainties and qualities of entrepreneur to act as a leader gave rise to more than seventy percent of new innovations and new combination of skills like Microsoft, Yahoo, and Linux etc. The major developments in the computer industry, bio- informatics, medicine, electronics, telecommunications and hundreds of other things are the result of such entrepreneurships in the medium and small industrial sector.

Entrepreneurship

By Reggie Aggarwal and Mark Esposito:

Entrepreneurship is a way of life. It is a driving force that compels you to do more, move faster, and go farther than anyone else, even in the face of high risk and uncertain outcomes. Unmistakably, the rewards of entrepreneurship, especially in the technology arena can be great. But it is not an easy road to travel. Consider the following five facts:

1. Only 1 in 6,000,000 high-technology business ideas wind-up in an IPO;
2. Less than one percent of business plans received by venture capitalists get funded;
3. Founder CEOs typically own less than 4 percent of their high tech companies after an IPO;

4. 60 percent of high tech companies that are funded by VCs go bankrupt.
5. Most high tech companies that succeed in having an IPO take between three and five years to get there.

Clearly, it is not easy to be a technology entrepreneur. Many successful entrepreneurs have failed at one point or another. And most have experienced a healthy dose of frustration, burnout, and sorrow along the way. So why become an entrepreneur? For the true entrepreneur, that is a rhetorical question. For the **emerging entrepreneur**, there are at least three major reasons.

First: Objective of creating something novel and useful. "To be on the cutting edge" is a necessary mantra. A technology entrepreneur generally seeks to solve a problem that exists in the market. Whether that means developing a better communications resource tool, a better optical switching device, or a better bioinformatics system, a void is always identified and then attempted to be filled.

Too many people confuse this process with the process of identifying hot technology companies in the market and building new companies that mimic them. The hot technology companies are hot because they seek to solve a problem. Those that mimic them neither identified a problem nor created a solution; they simply found a new trend that they wish to follow. The ability to maintain a sustainable competitive advantage over others is what brings rewards to the entrepreneur. The reason for taking risks fundamentally is tied to this concept. That is why being on the cutting edge is so critical to the entrepreneur.

Reggie Aggarwal is the CEO of Cvent, Inc., a premier online registration, e marketing, and data analysis company dedicated to maximizing the return on meetings and events. He also is the co-founder of the Indian CEO High Tech Council, the largest and most influential CEO organization on the east coast. Mark Esposito is the Vice President of Global Sales and Business Development for the NASDAQ Stock Market, the most influential stock exchange in the technology world

Second: A second objective of the technology entrepreneur is to build long-term value. Sustainability is crucial. The would-be entrepreneur often confuses this concept with building "valuation." Those who build companies for the primary purpose of attracting investment dollars at high premiums are opportunists, not entrepreneurs. The entrepreneur always is focused on creating something of lasting utility. This does not mean that the entrepreneur is not concerned with attracting investment dollars or creating wealth. Rather, the entrepreneur's strategy is to create long-term value and thereby ensure wealth. The trick is to not put the proverbial cart before the horse. Concentrating on long-term value can create wealth; concentrating on wealth typically creates neither value nor wealth.

Third: A third objective of the entrepreneur is to have freedom. Being your own boss has definite appeal. Glass ceilings cease to exist and achievement is limited only by imagination. Entrepreneurs are motivated by having control over their work and the flexibility to pursue their dreams. But freedom always has a price. With greater personal freedom, comes greater uncertainty about the future, particularly in relation to finances. Greater personal freedom also means a less structured environment, in which greater self-discipline is required in order to thrive. Entrepreneurs are willing to accept these risks, though, because of their absolute conviction that they have what it takes to overcome any odds.

If achieving these three objectives is not of basic interest, then the very thought of becoming an entrepreneur should be extinguished. If a big personal cash payout seems to be glaringly missing from the list of major objectives, it is because it is not a primary motivating factor. These three major goals are not objectives to be self-evident should embrace entrepreneurship. But what makes an entrepreneur special, besides believing in major common objectives?

There are **several characteristics** that define the entrepreneur. For example, Entrepreneurs always have passion. Entrepreneurs live and breathe their business enterprises. They are zealots about their business models and are evangelical about their products or services. They have to be. If they weren't, the stress and financial pressures of running a fledgling business would completely wipe them out. The sheer magnitude of the odds that are stacked against entrepreneurs requires a special kind of irrational exuberance to overcome.

Entrepreneurs have unshakable confidence in and enthusiasm for their business ventures that contagiously spreads to their business team. Laser focus is another feature of entrepreneurs. There are many people that are creative, but lack discipline. Entrepreneurs, on the other hand, have both qualities. An entrepreneur identifies a path towards a solution and follows that path, notwithstanding the frequent temptation to take side roads leading to seemingly newer, more exciting destinations. The entrepreneur knows that most of the journey down the chosen path is checkered with drudgery, yet continues down the path unswervingly, confident that there will be a reward at the end. The entrepreneur also knows that the side roads encountered along the way may appear appealing at their start, but will quickly become as checkered with drudgery as the originally chosen path and likely lead to a dead end.

Focus and Perseverance Guide the Entrepreneur

Courage is a defining trait of entrepreneurs. To understand the odds against success and still forgeahead, knowing that many battles will be lost along the way, requires a certain amount of fearlessness. Entrepreneurs are purposeful in their tactics and can think on their feet. Yet they regularly face daunting challenges whose failure to overcome will spell certain disaster for their business ventures. Their ability to face these challenges without fear enables entrepreneurs to succeed where others cannot.

Entrepreneurs also are leaders. Contrary to the popular belief those entrepreneurs are Mavericks who prefer to be lone wolves, entrepreneurs are visionaries that can inspire and lead their colleagues. There are few things more compelling than people who are Passionate about their work, have the discipline to achieve success, and are fearless in their outlook. An entrepreneur builds teams and instills confidence in others. Finally, an entrepreneur always is thinking ahead, perpetually in motion towards well-defined goals. In the end, entrepreneurs can best be described as ocean waves, existing only so long as they move forward.

Characteristics of Entrepreneurs

Studies have established the existence of some common personal characteristics amongst entrepreneur like high level of energy, desire to pursue innovation goals, desire for achievement, a deep involvement in work, optimistic believe in work etc.

Let's discuss the resume some of the important studies relating to characteristics profile of entrepreneur by David Mecleaaland:

1. **Need for achievement**
   It is the prime psychological derive that motivates the entrepreneur it brings behavior motivation towards accomplishment, i.e. in achieving a goal that possesses reasonable challenge to an individuals competence such an entrepreneur is energetic but not a gambler. His motivation is the product of a scientific assessment of his energies and the challenge.
2. **Desire for Responsibility**
   Entrepreneur prefers to use his own resources and to be personally responsible for the results. He can perform well in groups particularly when he can influence the results in some specific way.
3. **Preference for Moderate Risk**
   Always seeking high level of performance consistent with the possibility of achievement.
4. **Perception for the Probability of Success**
   This consists in collecting and analyzing facts and thereafter falling upon his own self-confidence for accomplishing the task.
5. **Future Oriented:**
   He plans and thinks in the future. He anticipates possibilities that lie beyond the present.
6. **Stimulated by Feedback**
   Irrespective whether the signals about his performance are good or bad, he draws his inspiration from the feedback.
7. **Energetic Activity**
   He exhibits a high level of energy than an finding out novel ways of getting task done.
8. **Skill in Organizing**
   Entrepreneurs have remarkable skill in organizing work and people. They make objective selection of individuals in conformity with their skill in solving a specific problem.
9. **Attitude Towards Money**

His attitude towards money is cavalier, i.e. money is not a principal obsession. He values money but not for itself. Money acts as a measure of his accomplishment, a token of his achievement rather than a commodity to be hoarded.

Qualities of an Entrepreneur

1. **Mental Ability:** it consists of :(a) overall intelligence, (b) creative thinking, i.e. the ability to adapt to various situations, (c) analytical ability, i.e. ability to systematically analyze the business problems.
2. **Human Relation Ability:** it is demonstrated by emotional stability, skill in interpersonal relations, sociability, tactfulness, empathy (to put oneself to another's place).
3. **Communication Ability:** it is the skill in conveying information to others so that understanding is created.
4. **Technical Knowledge:** the expertise in such areas as personal selling techniques, operating a complex piece of equipment, analysis and interpretation of financial records etc.
5. **Decision Making Ability:** the skill in selecting satisfactory course of action from among various alternatives.
6. **Conceptual Ability:** the ability to comprehend the organizational structure and how each units fits into the whole. It enables him to recognize opportunities.

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3. Entrepreneurship and small business management by C L BANSAL
   (This is also the recommended book.)

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Key Terms

¾ Bio-informatics (The branch of electronics dealing with life or biology)
¾ IPO (A public issue of shares on stock exchanges)
¾ Venture Capital (VC) Money invested in a business or firm but with high risk factor
¾ NASDAQ (National association of dealers in securities automated quotations)
¾ Mavericks (individualists)

Lesson 4

KINDS OF ENTREPRENEURS
THEIR ROLE AND FUNCTIONS IN AN ENTERPRISE

The lecture is about the kinds of entrepreneurs, their role and functions in an enterprise. It also explains the hurdles they encounter. The overall general profile of Pakistani entrepreneurs and their importance in enhancement of progress.

Kinds of Entrepreneurs

Innovating entrepreneurs
He is the one who introduces something new into the economy or employs a new technique of production.

Imitating Entrepreneur
They lap up innovations originated by the innovative entrepreneurs. They are suited to developing countries which are not able to take up expensive research.

Fabian Entrepreneurs
They are very cautious and skeptical in adopting and implementing any change. They are lazy and shy and lack the will to adopt new methods. They follow the old traditions and avoid risk taking.

Drone Entrepreneurs
Inert and traditional, they are hurdles in economic development. They struggle to exist, not to grow.

Role of Entrepreneurship or Entrepreneur

It may be noted that an entrepreneur is a combination of two skills vise, "an idea person" and "a manager", He is either the originator of the new business venture or a manager who tries to improve organizational effectiveness by initiating productive changes. His role consists of the ability to take up the factors of production and employ them in the production of new goods ad services. He perceives opportunities, which others does not see or do not care about. As rightly pronounced by Jule Buckman, "Basically an entrepreneur sees a need and then brings together the manpower, materials and capital required to meet that need." Akio Morita [the Founder of Sony], for instance, adopted the company's production to create Walkman personal-stereo. Gulshan Kumar of T-series skimmed the audiocassette vast Indian market.

Introduction of Change

An entrepreneur's role lies in introducing the following five broad types of changes:

a) Initial launching, i.e., original production of goods.
b) Subsequent expansions i.e. increase in quantity.
c) Factor innovation, i.e., increase in the supply or the productivity of the factors mentioned below:
    - ¾ Financial (procuring capital from a new source or in a new form)
    - ¾ Labor (upgrading existing labor)
    - ¾ Material (procuring old material from new source or use of new material)
d) Production innovation i.e., hinges in the production process.
e) Market innovation comprising changes in the size or composition of the market, e.g., production of new goods, change in the quality or cost of existing goods, discovery of new markets etc.
   Essentially, the entrepreneur always searches for change, responds to it and exploits it as an opportunity.

Increasing Productivity

Entrepreneurship has a role in increasing productivity. The keys to higher productivity are : (a) Research and development, (b) investment in plant and machinery and human resources, (c) resource allocation from areas of average to above average rate of remuneration of capital and labor, and (d) realization of internal and external economies of scale.

Innovation

Entrepreneurship plays an important role in promoting innovative technologies, products and services. Invention of zipper, titanium, operation of spinning jenny from foot to steam engine, invention of power loom etc., owe to the spirit of entrepreneurship.

Functions of Entrepreneurs

1. Determination of the objectives of the enterprise.
2. Development of the organization.
3. Securing adequate financial resources.
4. Requisition of technological; equipment and its revision consonant with the technical change.
5. Development of market and devising new products to meet anticipated consumer demand.
6. Maintenance of good relations with public authorities and society at large.
7. Management of human relations.
8. Financial management.
9. Production management.

Barriers in the Path of Entrepreneurship

Vesper has listed 12 common barriers in the path of entrepreneurship. These are:

1. Lack of viable concept
2. Lack of market knowledge
3. Lack of technical skills
4. Lack of seed capital
5. Lack of business know-how
6. Complacency (lack of motivation)
7. Social stigma attached to certain vocations
8. Job " Lockins", "Golden Handcuffs" or attachment with the job
9. Time Pressures, Distracter
10. Legal constraints
11. Monopoly- Protectionism
12. Inhibitions Relating to Patents

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Book Recommended

Entrepreneurship and Small business Management by Dr C L Bansal

Key terms:

1. Titanium (an element use to make non corrosion alloys)
2. Stigma (Disgrace) a sign of.
3. Monopoly (Exclusive control of trade, business, etc)
4. Protectionism (A system of controls set up by government to protect country's` agriculture or industry from foreign competition)
5. Patent (An official document that gives the holder right to protect his product from others copying it)

Lesson 5

SMALL ENTREPRENEUR IN PAKISTAN AND ROLE OF SME IN GLOBAL AND REGIONAL LEVEL

This lecture will introduce the small entrepreneur in Pakistan the activities of SMEs in global and regional level. It will also reveal the role of SMEs in a developing economy.

Salient Features of Small Entrepreneurs in Pakistan

1. **Single Owner Entrepreneur**
   He works with his own hands, combines the entrepreneur function of initiating the business making investments, taking decisions and performing managerial functions.
2. **Age Pattern**
   The mean age of entrepreneur was found to be 42 years and of their enterprises 12 years. It is comparable to the Korean age pattern (46).
3. **Educational Level**
   Differing from industry to industry 60% have school education and 30% have college or better education only 10% have professional or graduation level.
4. **Social Background**
   Caste played an important role in certain industries and on the other hand heritage is dominant. But overall it is much diversified.
5. **Sizes and Investment**
   Majority started in a small way with less than 10 workers and 1/2 to 2/3 of the firms started with less than 50,000 investments.
6. **Growth**
   The growth was fast in case of small firms than in large firms.
7. **Profitability**
   Rate of profit is higher in case of small industries in comparison with the large industries.

Role of SMEs in a Developing Economy

Unemployment and under employment are the prevailing economic diseases in most of the Asian countries and they are result of a fundamentally disproportionate relationship between population and the use of available land resources. Rapid and continuing increase of population, in the last half century have led to a situation in which there are far too many people engaged in agriculture this situation is further aggravated by an antiquated system of land tenures, by poor standards of health and malnutrition by the use of primitive and inefficient techniques on small un-Economical holdings and by an uncertain climate for rains, weather changes etc. among the classical remedies suggested for tackling the problem of poverty and underemployment, large scale industrialization is perhaps the most important. This has no doubt, resulted in a phenomenal increase in the production of useful goods and have brought movement in living standards as well as in lowering the rate of population growth. But in many Asian countries large-scale industrialization has been slow particularly for the shortage of supply of capital.

Under the circumstances, the problem of unemployment and underemployment can be tackled by the expansion and modernization of the existing small-scale cottage industry and the introduction of new industries capable of raising the level of production and improving the present depressed standard of living. The large-scale industry has been slow to develop and has succeeded to a very limited extent in absorbing the surplus population of the countryside. SMEs are still the most extensive tools for controlling unemployment.

In Ceylon (Sri Lanka) as early as in 1949 nearly 286,000 persons were engaged in small industries, in China in 1949 approximately 10 million workers were responsible for 80% of the total industrial output by working in SMEs. In India more than twenty five million people are engaged in cottage and small industry. In countries like Germany, Switzerland and France there exists today a large group of industrial workshops and units side by side with the large factories. Japan furnishes the most striking example of the survival and growth of small-scale industries. This phenomenal development is due to careful planning, the integration of industries with agriculture and not the least important.

Cottage and small industries have a very important role in the national economy, offering as they do, scope for individual, village or cooperative enterprises and means for the rehabilitation of the displaced persons.

National Approaches
South Africa
In South Africa there are about 800,000 small medium sized and micro enterprises in addition to the two to three million persons carrying different self-employment activities.

Country	Index	Share
United States	Less than 100 employees	34% employment and 32% sales
Japan	Less than 300	99% of all employees' establishments. 71.9% of all employees. 55% of all value added. 51.8% of all shipments.
Federal Republic of Germany	Less than 10 employees	85%% of all companies.
France	Less than 9 employees	99.9% of all firms.
Chile	Less than 9 employees	99% of all firms. 39% value addition.
Republic of Korea	Small industry	38.4% value addition.
Brazil	Small- scale sector	43.6% employment. 29.6% production share.
Philippines	Small scale manufacturing	99% of all establishments. 50% of employment. About 33% value addition.

Pakistan
SMEs are considered as engines of economic growth in both developed and developing countries. They provide low cost employment since the unit cost of persons employed is lower for SMEs than for large-size units.

- Assist in regional and local development since SMEs accelerate rural industrialization by linking it with some organized urban sector.
- Help achieve fair and equitable distribution of wealth by regional dispersion of economic activities.
- Contribute significantly to export revenues because of the low cost labor-intensive nature of its products.
- Have a positive effect on trade balance since SMEs generally use indigenous raw materials.
- Assist in fostering a self-help and entrepreneurial culture by bringing together skills and capital through various lending and skill enhancements schemes.
- Impart the resilience to withstand economic upheavals and maintain a reasonable growth rate since being indigenous is the key to sustainability and self-sufficiency.

Although no accurate data is yet available, it is estimated that there are approximately 220,000 SMEs in Pakistan, which:

- Provide employment to over 80% of the labor force since artisans, workshops, household units, craft industries, vendors and agro based businesses that cluster around the townships and population centers have a tremendous capacity to provide employment.
- Contribute more than 50% to GDP by manufacturing products to meet the demands of local and regional markets.
- Contribute more than 50% towards export earnings through both, direct and indirect exports. Have a default rate that is far less than that of large-scale enterprises.
- 15% for SMEs, as against 65% for LSEs. Avail credit to the tune of only 12% from the formal financial sector, which indicates the wide gap between the lenders and SMEs.

- The SME sector also provides both rural and urban women to utilize their vocational skills while staying within residential premises. In urban areas, many female entrepreneurs have introduced product lines uniqueness has created a strong demand in the market.
- Today, the SME sector is the lifeline of the big industrial establishments due to its direct contribution and support towards value addition and exports. For the past three decades, the fastest growing export industries have been dominated by SMEs. Of all, cotton weaving and textile rank between the top two exporting sectors. Others include sports goods, surgical instruments, carpets and footwear etc. SME exports dominate low value added sectors and rely on traditional technologies.

Saudi Arabia

	LARGE FIRMS	**SMALL FIRMS**
Sales per employee	SAR 48,600	SAR 158,000
Gross Margin to Sales %	14.2	4.4
Return on Assets %	18.7	5.4
Saudization*	14.3	8.5
Jobs created per million SAR invested	1.0	28.3

** Saudis as a share of total employees.*

The erroneous view of SMEs all-scale industry, which is persisting in many developing countries, is that they constitute only a transitional phase in development and that small industry development is a temporary expedient or a "second best" alternative. This seems to base on the assumption that as a country moves from a traditional to a modern economy, it will have no more need or place for small-scale industries. But experience of some of the most industrially advanced countries clearly shows that while some industries start as small and grow into large establishment in terms of capital, output and employment, small scale industries as such continue to constitute a fairly large and important sector of their industrial structure. In the United States, Germany, the United Kingdom, the Netherlands and Japan industrial enterprises employing less than 100 persons account for the overwhelming majority of small- scale industrial enterprises. Employing less than 100 persons need not necessarily be small. Because in capital-intensive industries in advanced countries generally small number of workers may be evidence of automation rather than smallness in size. However, in a majority of cases, enterprises employing less than 100 persons may be taken as relatively small in the scale of operation as well. The contribution to total output in manufacturing ranges from about one quarter to one third, and to total employment in manufacturing from about one quarter to one half in some industries.

Small establishments have a predominant position, in the United States for example, they contribute more than 75% of total value added in certain branches of foodstuffs and clothing industries. Small industries can coexist successfully with large industries because of certain inherent advantage of small-scale production or of small industries which functions complementarily with large industries as producers of components and supplies for them. Experience in advanced countries has established the fact that in certain circumstances, in manufacturing certain products by small industries cannot only coexist with large industries, but also even out compete them. Similarly, experience in developed countries has proved that the subcontracting system by which a large numbers of small firms supply components and parts of large industries have not only stabilized and strengthened the small firms, but also contributed substantially to the efficiency and economies of the big industries. One of the major tasks of the small industries promotion should be to identify the industries where production on small-scale basis offers the maximum advantages and give direction and lead to potential entrepreneurs into such fields. In fact, we would consider this as the first and most important step in small industry promotion. It is true that some small industries require some more measures of protection. This incidentally is true also of many large-scale industries as well. If care is taken to promote sustained capacity, it will be possible to build up a truly balanced industry structure where small and large industries will coexist to their mutual advantage. Given adequate encouragement, this sector has greater potential of growth with spin of benefits. An investment in small enterprises is alone synonymous with investment in human resource.

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Book recommended

Small Entrepreneurs in Developing Countries by Dr Asghar Nasir

Key terms

1. Antiquate
2. GDP (gross domestic product) the annual total value of the goods produced and services provided by a country)
3. Default rate (The rate of failure to pay back the loans/credits)
4. Value added (The worth placed on a product by a particular stage in the production process)

Lesson 6

THE DEVELOPMENT OF SMES IN PAKISTAN

This lecture is about the history of industrial growth in Pakistan and its related factors; the factors for adopting an SME based industrial system, the institutional support of government in the shape of long term and short-term policies.

The Development of SMEs in Pakistan

The Industrial History of Pakistan

Pakistan's industrial history has been dominated by a single-minded emphasis on industry and that too of large-scale enterprises. The fall out of that development strategy was formally adopted in the 60's as conscious policy step in the start of second policy plan period (1960-1965) has been large scale industrial holdings, accounting for much of the country's assets and capital. The feeling among the masses is that a few families control 70 to 80 percent of the country's assets, led to political rebellion. That rebellion also culminated in the dismemberment of the eastern part of the country. The primary causes for that tragedy, were basically economic in nature. The upheaval also generated a parallel economic thought, exclusive to the peculiarities of Pakistan's economy. That economic thought advocated across the board nationalization of economic assets as a vehicle for ensuring social justice in the society.

The fall out of that strategy was two pronged:

- Inefficient labor
- Shaken Business Confidence.

The reaction to that policy mix in the early 1980's was reverting to the Ayubian model of economic development. The model was characterized by**:**

1. Promotion of large-scale units.
2. Expansion of large-scale enterprises.
3. Banking sector turned to cater to large loans.

The IMF conditions and poor recovery rate of huge borrowings played a major role in creating a negative point for the progress curve. These constraints further pushed the economy towards recession, industry towards sickness and individual units towards default. All these factors precipitated the rethinking of a strategy to revive the growth of economy. It was due to dis-involvement that medium scale and small-scale enterprises has got the attention of the stakeholders i.e. the economic managers and the private sector. The development of SMEs suits the current situation on account of the following factors.

1. Low overhead cost, low level of financing
2. Lesser pressure on the banking system
3. Employment generation
4. Entrepreneurial development
5. Vendor based development
6. Development of large-scale industry on firm basis
7. A more just distribution of resources and profits

The pre-requisites for the development of SME sector rest heavily on an infrastructure tuned to support such development that includes:

¾ A banking system customized for SME development
¾ One window operation

Currently, our banking system continues to be the large sector banker. Despite talk of SME development under the auspices of SMEDA and development of SME Bank and Khushali Bank, the financial sector's general response has been influenced by the security issue, i.e. against which asset the bank would be advancing loans to the small and medium scale business entity. In the absence of a customized banking

setup, the development in the SME sector so far has been evolutionary and not the result of any conscious activity.
The turning up of the system for development of the SME also includes an enabling environment. Though the need for an enabling environment is not exclusive to the SMEs and is a pre-requisite for all types of economic activity. That includes a one-window operation culture, where the investor does not have to go from pillar to post to get his task done. A conscious effort by the state to reform the banking setup and the attitude of the government functionary and the bureaucracy will set into motion the mechanics of change in the development strategy priorities of our economy.

The development of SME hold within its mechanics of expansion the growth of economy coupled with a more just distribution of wealth. The social justice aspect of it ensures that the development will not compromise the distribution of wealth issues. To begin with, the SME development does not depends upon the expansion of the family enterprises; rather, it is the outcome of the initiative of the single individual or asset of individual. Unlike the development of family concerns, where the emphasis on the particular group's interests, the SME never seeks to totally control the market, rather, it only identifies its place in the market and sustains it. The modus operandi of most of the vendors in the auto sector is like this. They do not control a major chunk of the market. What they are doing is to maintain their share as a sustainable vendor. Thus the market is not blocked for the new entrant unless there is saturation point already experienced by the industry.

The small overheads involved in fixed and running cost structure of a SME unit means that each unit does not need excessive financing. As a result a large section of society benefits from the available resources. There is no accumulation of wealth in few hands and the money circulates in a fashion, where people are able to derive the needed benefit.

The availability of resources for the SME unit means that the opportunity to develop are not confined to a restricted section of society, rather anyone with a idea and plan can create a place for himself. The success of venture capital in the United States and the likes of **Yahoo and Hotmail** are indicative of the development of SME as a vehicle for equal opportunity, besides technological development. The other success stories like **Microsoft, Linux** owe their development to the practical implementation of the idea, which was presented by individuals or a set of individuals with not so privileged backgrounds. Yet they made it big. Bill Gates was not a Kennedy scion, but the opportunity to develop from a SME allowed him enough room. Even today, developers jointly own Microsoft. In the process the above-mentioned advantage of technological development as also been realized.

A more just distribution of wealth and prospects of technological development set the pace for the growth of economy. New technologies generate economic activity on industrial scale. That is not exclusive to developed countries. We have experienced in the context of the Information Technology that it did generate economic activity in the affiliated sectors and provided employment opportunities to many hardware engineers and software developers. The development of IT sector had a more egalitarian character to its credit allowing professionals to prosper, without having to be a large enterprise or scions of big families.

The recipe of SME development infects does two things. On one hand the processes are developed at a grass root level. Vendors are identified and the production process takes off. As small-scale vendors characterize most of the development, the profits are naturally divided according to the contribution to the process. There are no new big families appearing in the process, rather, it is the matter of fact stages of production line, which are identified. The Japanese and Italian economies are increasingly modeled on the basis of SME development. These societies are characterized by the dignity of work, not for the huge amount of sweat, the worker sheds, but for the rewards, which are ensured in this setup. The vendor knows the respect he earns and the rewards he is insured. For that very cause, peace and almost no records of militant trends have characterized the developed societies like Japan.

The debate in the support of the SME can be unending. The prescriptions for the societies and economies like Pakistan in the context of the best possible economic solution are simple. There is a need to retune the priorities of the state, if the results are to be realized, in the absence of which our efforts would remain devoid of any tangible results.

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Recommended Book

50 years of Pakistan's economy (traditional topics and Contemporary Concerns by Shahrukh Rafi Khan (Oxford Press)

Key terms

1. Modus operandi (the way in which something is done)
2. Overheads (a regular cost of running a business i.e. rent, wages, gas, electric bill etc)
3. One window operation (provision of all facilities at one place)

Lesson 7

GOVERNMENT'S EFFORT TOWARDS SME DEVELOPMENT

This lecture will throw light on the efforts of government towards SME development and the role of institutions in public sector.

The government of Pakistan keeping in view the importance of SMEs has adopted multi -pronged approaches at the regional, sub regional and national levels. Initiatives at the regional and sub-regional levels include efforts to strengthen economic integration and cooperation. At the national level, structural adjustment programs have been in operation along with attempts at restructuring and diversifying the production base, integrating the informal sector into the economic mainstream and stimulating the increased participation at the enterprise level.

Over the years the government has developed a wide network of numerous support institutions for the development of small-scale enterprise in the country. The development process was initiated in the sixties and the concept of development derived its origin from the "Indian Model" of small enterprise development. The basic idea behind the model is to develop infrastructure facilities such as industrial estates, common facility centers and vocational training institutes, which would, to a great extent the problems faced by the SMEs. Based on this model numerous provincial level organizations were set-up mostly with the help of foreign assistance in the shape of grants and soft loans.

Financial sector organizations also are of great importance to the SME development in the country. The government has also established some institutions, which cater to the financing needs of the small firms. Some of these institutions are meant exclusively for the small sector. Besides the efforts of the Government the non-governmental organizations have also been actively participating in the micro and small enterprise development. The role of these organizations is also discussed here. Some of these NGO's design programs to address social needs on a community basis which have a positive impact on employment generation at a micro level, the functions of NGO's have been discussed very briefly.

Provincial Level Institutions

1. **Punjab Small Industries Corporation (PSIC)**
   In the province pf Punjab PSIC was established in 1972 as an autonomous body for the promotion and development of the small-scale industries in the province. The PSIC covers the critical areas of investment promotion and provision of credits for setting up new industries and modernization of the existing ones. It also promotes the common facility center, technology transfer, guidance, handicrafts development and design facilities.

   (a) **Financing and Loans:**
   PSIC is providing two types of loans to its clients, working capital and capital investment loans. The maximum limit of loan is RS. 7.5 Lac. There are district officers appointed for monitoring the loan recovery and in the case of unrecoverable loans, they are transferred to the revenue authorities. PSIC has managed to recover 81.6% of all loans given out. Disbursing Rs. 1768.537 million to 6339 units through its 8 regional offices (till 31-02-2001). The debt equity ration for loan up to Rs. 7.5 Lac is 70:30.

   (b) **Industrial Estates**

   PSIC has developed 14 industrial estates in various areas of the Punjab. The costs of land within these industrial states have been subsidized to allow the development of the small-scale sector.

   (c) **Services and Programs:**

   PSIC has also launched "Rural Industrialization Program" to control unemployment and strengthen the marginal household income through stimulation of industrial growth in the urban and rural areas of the Punjab.

PSIC has established various types of service centers e.g. metal industries development center, Sialkot, Engineering service centers. Gujranwala, institute of pottery development, Shahdara etc

2. **Sindh Small Industries Corporation (SSIC):**
SSIC was established in 1972 having motives to indulge into promotional activities of small-scale industries in Sindh. The objectives of SSIC include financial assistance, education of craftsman, census and survey of cottage and small industries, procurement and distribution of raw materials to artisans and craftsman. SSIC was also involved in the Prime Minister's self-employment scheme for the dispersal of the micro credits.

   (a) **Industrial Estates and Colonies:**
   The SSIC has established 17 industrial estates in Sindh. Total number of plots developed there are 1938 and there are 302 units working utilizing 571 plots. There are six different craftsman colonies established having 92 shops.

   (b) **Financing Schemes:**
   The SSIC also launched a credit scheme in 88,89. The rate of markup was 7% for industrial estates and 11% for factories outside the industrial estates. The scheme was discontinued in 1993 due to shortage of funds although SSIC has created already 526 jobs and disbursed 20.6 million rupees. In October 1992, a self-employment scheme was started for locally manufactured machinery (LMM). The loan ceiling is 1 million with the markup rate of 14%. The total amount disbursed to 171 units is rupees 98 million. The recovery rate is 47%.

3. **Small Industries Development Board (SIDB) NWFP**
The SIDP was established in 1972. It is playing a promotional role to support and assist the development of small and cottage industry in the province. The SIDB is an autonomous body, focusing on manpower training, model projects and industrial infrastructure. It has 14 regional offices in the different cities of NWFP.

   (a) **Training Centers**
   SIDB has established carpet centers in five cities of NWFP and has trained 1327 number of trainees. The SIDB has established "Patti" training centers, textile training and "gabba" training centers which has trained 151 trainees.

   (b) **Development Programs and Model Projects**
   SIDB has also launched various women development programs, which has trained 2062 women trainees in a number of fields of work. The SIDB is also involved in establishing other various kinds of model projects for wood working, leather goods, wool spinning, ceramic device etc. The total number of trainees trained is about 8000.

   (c) **Industrial Estates**
   SIDB has established 9 industrial estates. There are a total of 1620 plots and the total jobs created are 4405.

   (d) **Financial Assistance**
   SIDB is also managing different credit schemes for small industries. To date, a total number of 198 million rupees have been disbursed to 452 enterprises. SIDB is also disbursing credit under the self-employment scheme.

4. **Directorate of Industries (Balochistan)**
The directorate of industries was formed in 1976 and it looks after all the promotional schemes for SMEs. Further more, the directorate is also involved in providing various kinds of advisory and consultancy services.

   (a) **Training Centers:**
   The directorate operates sixty-three training centers in various trades, one service center, 5 sales and display shops and one small-industries estate. Of the 63 training centers, about third are carpet centers, seven are embroidery centers and the others cover areas like tailoring, wood work, marble work, mazri and durree production.

5. **Financial Institutions**

In order to meet this financing requirement, a number of institutions have been formed. These are:

I. Small Business Finance Corporation (SBFC)
II. Youth Investment Promotion Scheme (YIPS)
III. Regional Development Finance Corporation (RDFC)
IV. Industrial Development Bank of Pakistan (IDBP)

A few commercial banks such as Allied Bank Limited and First Women Bank Limited have also started schemes to provide loans to low-income clients who are generally not able to access the formal source of financing.

1. **Small Business Finance Corporation (SBFC)**

It was established in 1972 as a federal entity. The main aim was at the time of establishment, to assist small entrepreneurs for self-employment and setting up cottage industry. The mark up was kept lower; the majority lending was towards self-employment leaving only 2% for small industries.

Restructuring SBFC

The management took over in year 2000 and restructured the entire corporation. The restructuring was based on the facts that SBFC has deviated from its main aim resulting in a weak balance sheet. 70% of its credit portfolio was infected by non-performing loans. Usage of information technology was non-existing and the management was ineffective. There were 1400 employees at 96 branches. The internal control and management was highly ineffective with poor quality of human resources, poor work ethics, poor infrastructure and non-existence of training and development culture.

Restructured SBFC

The total number of branches has been reduced to 63 around 270 people opted for golden handshake. Separate human resource department has been setup, a separate information technology department was established to spread IT knowledge among SBFC employees, and a treasurer division has been setup in Karachi, which is responsible for management of cash and surplus funds.

Financing Programs

SBFC is financing various types of projects such as Gem Stones, cotton ginning, textile apparel, and marble processing etc. currently SBFC can disburse up to rupees 1.5 million for a project having total cost of five million and lend up-to 50% of the total project cost of small businesses but for that total project cost should not exceed 50 million. It can also share up to 30% of total projected cost for a medium sized industry where the total project cost does not exceed rupees 100 million.

2. **Regional Development Finance Corporation**

The Regional Development Finance Corporation was established in 1985 having paid up capital of Rs. 172,500 million and with the specific objective of promoting the industrialization of the less developed areas of the country. RDFC is a multi-product financial institution. It participates in money market, capital market and micro credit delivery. The head office of RDFC is located at Islamabad and a network of 14 branches carries out its operations across the country. Besides financing of medium to large sized industrial concerns RDFC has been involved in disbursing micro and small sized loans. However, over the last few years the organization has restrained from forwarding long-term project loans and currently is in the process of recovering loans from the borrowers.

3. **Youth Investment Promotion Scheme (YIPS)**

Various schemes have been initiated with credit lines from local as well as foreign sources. It has also started a micro credit scheme called the Credit for Rural Women (ICRW) under which small loans ranging from Rs. 25000 to Rs. 200,000 are disbursed to women entrepreneurs on subsidized interest rates of 10%. The total disbursements under the scheme stand at Rs. 2.5 million. RDFC was allocated a credit line of Rs. 167 million for the self-employment schemes out of which a total of Rs. 80 million was disbursed.

4. **Industrial Development Bank of Pakistan**

   IDBP is Pakistan's one of the oldest development financing institution created with the primary objective of extending term finance for investment in the manufacturing sectors in the economy. Over the years however, the bank has emerged as an institution fostering the growth and development of SME sector stimulating industrial progress in the rural or less developed regions of the country. As a part of its services the bank offers business development assistance through providing information on potential small-scale investment projects. In this regard numerous pre-feasibility studies have been developed for identification of viable sub sectors.

Key Terms

1. Muti-pronged (Having different branches)
2. Revenue authorities (The provincial authorities normally act through TEHSILDAR under the Punjab revenue act for the recovery of Punjab revenue taxes like malya, abyana, takavee etc)
3. Gabba (Usually the terms is used for a thick traditional carpet knit with local spun and dyed wool)

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Lesson 8

The ROLE Of NGOs

The NGOs are working on socio-economic sector in the development of SMEs. They are privately owned organization registered under the social welfare act. They normally work through grants, aids or donation based finances. They are having a very constructive role in the SME development. The special property of this sector is gender development. They at some places tried to replicate Grameen banks model.

NGO Non-governmental Organization, a non-for-profit agency not affiliated with any government or private sector entity, devoted to managing resources and implementing projects with the goal of addressing social problems. May receive some public funding. NGO is a community based organization with its own management structure. The organization may receive some or all of its operating funds through a government department known as the funder, however it is accountable or answerable to its stakeholders - the people who stand to benefit or lose by its actions. The funder is one of those stakeholders. NGOs play a vital role in development of SME. NGOs helps to reduce poverty, NGOs create awareness in women of rural areas to develop small business in their own premises.

The NGO Business

Non-governmental Organizations (NGOs) have become involved in international trade in recent years in two different ways. The first is to establish fair trade cooperatives to facilitate the export of goods from developing to industrialized countries directly from the producers. Their underlying operating principle is to ensure that more of the profits from the sales of diverse products go to the producer and less to middlemen. Often these products are slightly more expensive than similar goods in the market and these businesses rely on the social conscience of its customers to ensure a steady market for their products.

Another less well-known NGO business strategy is for the NGO itself to take on the role of designer, marketer and distributor of specific products and to work with particularly disadvantaged groups, primarily women, as sub-contractors who are taught to produce the goods that the NGO sells. Thus the NGO, in effect becomes a private sector actor. How they differ from standard private sector producers is in their selection of subcontractors and the fact that all profits are invested back into the organization to ensure organizational sustainability and to expand their base of sub-contractors. Their subcontracting role also serves to empower their sub-contractors as opposed to setting up an exploitative piecework arrangement. It provides a viable means of poor women to set up their own home-based enterprises. The key to the success of this particular strategy is the fact that the NGO takes on the responsibility for the development of the international market for the product produced.

SMEDA (Small and Medium enterprises Development Authority)

Introduction

Premier institution of the Govt. of Pakistan under Ministry of Industries, Production & Special initiative, SMEDA was established in October 1998 to take on the challenge of developing Small & Medium Enterprises (SMEs) in Pakistan. With a futuristic approach and professional management structure it has focus on providing an enabling environment and business development services to small and medium enterprises. SMEDA is not only an SME policy-advisory body for the government of Pakistan but also facilitates other stakeholders in addressing their SME development agendas. Growth of globally competitive SME sector through a conducive and facilitating environment and support services as an engine of growth and sustainability to national economy.

Mission Statement

To function as the promoter & facilitator of SME sector in Pakistan by creating a conducive and facilitating environment as well as providing and facilitating service delivery to SMEs for enhancing their capacities and competitiveness.

SMEDA Objectives

1. Policy formulate to encourage the growth of SMEs in the country and to advise the Government on fiscal and monetary issues related to SMEs.
2. Facilitation of Business Development Services to SMEs.
3. Facilitate the development and strengthening of SME representative bodies associations/chambers.
4. Set up and manage a service provider's database including machinery and supplier for SMEs.
5. Conducting sector studies and analysis for sector development strategies.
6. Facilitation of SMEs in securing financing.
7. Strengthening of SMEs by conducting and facilitating seminars, workshops and training programs.
8. Donor assistances for SME development of SMEs through programs and projects.
9. Assist SMEs in getting international certifications (such as UL, CE, DIN, JIS, ASME, KS, etc.) for their products and processes.
10. Identification of service opportunities based on supply/demand gap.

References

1. Research cells SMEDA/LCCI
2. Small industries and the developing economy in India by R.V.RAO
3. The essence of small business by ADRIAN BUCKLEY

Book recommended

Small industries and the developing economy in India by R.V.RAO

Key terms

1. NGOs (Non Governmental organizations)
2. Autonomous (Self governing)
3. Debt equity ratio (The ratio of money participation by the borrower and lender)
4. Subsidize (Helping money given by government to the producers)
5. Portfolio (A group of different investments held by a private investor)

Lesson 9

ISSUES AND POLICY DEVELOPMENT FOR SME – I

This lecture is concerned with the different issue and other obstacles faced by the policy makers while forming an SME policy for Pakistan. This includes both long term and short term issues.

Issues and Policy Development

Pakistan's economy is an economy of SME. Policies in the past have given a general perspective, direction and defining broad parameters of activity within the macro environment framework, but efforts have focused on large enterprises, neglecting SME, which are at the heart of our economy. Our SME suffers from variety of weaknesses, which have constrained their ability to adjust to the economic liberalization measures introduced and to take full advantage of the rapidly expanding markets of the world. But SME importance and contribution in the economic activity suggests that there is a significant potential to enhance their growth through appropriate regulations and promotion.

While SME are mentioned in some of our socio-economic strategies and policy documents, measures are not specified and prioritized for us to be able to speak of any coherent SME policy or approach. The SME Sector Development Program seeks to improve the situation by inviting all concerned stakeholders to draft Pakistan's future SME policy.

SME promotion is an important issue for many government departments and central offices. However, there is an existing lack of coordination and regular information exchange mechanism among institutions which constraints their ability to deliver in the SME development process. The responsibility for facilitating the SME policy development lies with SMEDA, attached to the Ministry of Industry and Production. One of the major reasons for the lack of coordination is that SMEDA has not been provided with a mechanism to initiate, coordinate, monitor and evaluate initiatives of SME development outside of its own scope of activities. Therefore, cross departmental and stakeholder consultations, resulting in the preparation of our national SME policy are our key to success. A network of institutions stimulating the growth of SME is also being proposed. The issues highlighted in this lecture give a retrospective view of things while giving a current picture of the SME business environment in Pakistan. There are issues we may only solve in the long term and which therefore are beyond our current scope. And there are issues we may solve in the short to medium term. These issues should become the focus of our SME policy. Short to medium term issues revolve around three major topics:

Business Environment

Creating a favorable business environment for SME in Pakistan's economy and eliminating unnecessary obstacles, which obstruct their development. This concerns the relationship between Government and SME as well as specifically taxation and labor.

Delivery of Assistance and Access to Resources

Improving the delivery mechanism for assistance and the access to the resources for SME in Pakistan, *inter alia finance*, business development services, qualified human resources and technology, so as to improve their productivity and capacity for employment generation. Market driven support programs are important to attain substantiality, maximize the potential for cooperation with the private sector, and minimize the distortions in the economy. Yet the structures for such a system still need to be mutually agreed and implemented in Pakistan.

Monitoring Developments

Harmonizing enterprise size categories for Pakistan of what are to be considered micro, small, medium and large enterprises. Furthermore, the establishment of a sound mechanism by which their development of the SME sector and the effectiveness of the assistance provided the SME can be monitored. What is at stake is that we forego the benefits of learning from one another in order to continuously improve our support structures to meet the needs of the target groups, SME. There is also ample scope to make use of SME promotion channels to achieve major aims related to equitable and sustainable socio-economic

development which we have not only yet exploited. Cases in point are gender development and environmental issues.
Implementing change requires the formulation of a policy for SME development and assigning specific responsibilities for its implementation and continuous improvement. A fair number of countries have opted for legislation on SME promotion. The appropriate format of the SME policy for Pakistan is to be decided by the Task Force.

Background of Basic Situation of SME and Their Support Structures

Current Status of SME
It is fair to say that our economy is an economy of SME. The significant role of SME is clearly indicated by research and statistics. Enterprises employing up to 99 persons constitute about 90%[1] of all private enterprises in the industrial sector and SME employ some 78% of non-agriculture labor force[2]. They contribute over 30% to GDP, PKR 140 billion to exports, and 25% of manufacturing export earnings besides sharing 35% in manufacturing value added[3].

Stability of policy is a necessary condition for achieving and sustaining high levels of economic development. A desirable mix of various other policies can insure the stability in the economy. In Pakistan, policies in the past have given a general perspective, direction and defining broad parameters of activity within the macro environment framework. However, efforts have remained limited focusing on the large enterprises, neglecting SME, which are at the heart of our economy. For example, institutions established to facilitate business activity, like Board of Investment (BOI), Export Promotion Bureau (EPB), Central Board of Revenue (CBR), to name a few have been concentrating their efforts on large scale industry.

The adverse influences of legal affect all economic agents. The evidence suggests small firms are discriminated against relatively large firms[4] and while large enterprises and established holding structures possess the necessary economic and human resource potential to cope with and overcome these difficulties, SME, due to their size and due to their resulting peculiarities, are far less capable of adjusting and carrying on successful business[5]. While spared direct statutory or administrative discrimination, SME remain subject to unequal treatment, which distorts the competitive environment for business. The economic significance of this bias is apparent. Such an environment does not cater well to innovative activities which come from newly founded, small firms, and the new job creation potential of the economy is thus constrained while the informal sector tends to grow[6]. Our SME suffer from a variety of weaknesses, which have constrained their ability to adjust to the economic liberalization measures introduced by the Government of Pakistan and to take full advantage of rapidly expanding markets of the world. But SME importance and significant potential to enhance their growth through appropriate regulations and promotion.

More recently, the importance of SME has been realized, with the Government's efforts focusing on the hitherto neglected informal sector. The reason behind the increased stress on the SME sector is that SME promote entrepreneurial culture, create a wider base for employment generation and are a primary vehicle for poverty eradication.

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[1] Pakistan Country Association Strategy, World Bank Report, Annex 2, page 3
[2] Census of Establishments-1998
[3] Economic Survey of Pakistan 2002-03
[4] SME policy Note, the World Bank; ILO SMEDA Study 2001 on MSME, LUMS study on SME Constraints
[5] LUMS in its study on "Barriers to SME Growth in Pakistan: An Analysis of Constraints" compared the growth rates of Large VS Small scale manufacturing and established that during 1970's both were growing at a comparable rate of over 4% whereas in 1990's during the period of economic downturn small scale manufacturing growth dropped to 2.6% against large scale growth rate of 3.6%
[6] Non-Linear Model to estimate underground economy in Pakistan, SBP Research Department

Government's Socio-economic Strategies and SME

SME are a distinct pillar of the economy that needs to be given due attention. It requires specific policy and regulatory space to turn SME into an effective tool for driving the economy and increasingly contribute to economic growth and employment. The Government of Pakistan has developed a number of strategies for socio-economic development.

- Poverty Reduction Strategy Paper (PRSP)[7]
- Micro Finance Sector Development Program
- SME Sector Development Program
- Education Sector Reforms 2001-05
- Reform of Financial Sector
- Reforms in Tax Administration

While SME are being mentioned in some of these important socio-economic strategies and policy documents, including even very specific measures for their promotion, these measures are not sufficiently specified and prioritized for us to be able to speak of any coherent SME policy or approach. The SME Sector Development Program seeks to improve this situation by inviting all concerned stakeholders to draft Pakistan's future SME policy. Although SME policy is a sector specific policy, it should be noted that the task of formulation is not a simple exercise. SME are a cornerstone of our economy. Many changes in the existing legislation may have direct or indirect effects on SME, e.g. in labor law, financial law, export regulations, banking system regulations, tax regulation etc. SME promotion therefore comes close to a crosscutting issue. Furthermore, the environment for SME is constantly changing, in particular with an increased exposure to world markets due to the opening up of the economy. Therefore, SME policy within a socio- economic development strategy cannot be a one-off exercise. Only a process of regular review linked with predictable behavior by all stakeholders will ensure successful outcomes in the long run.

Coordination and Institutional Support

The role of government as a facilitator of business and its interaction with business support institutions is imperative for the establishment of a mutually beneficial relationship for the growth of the sector. SME promotion is an important issue for many government departments and central offices. For example, the Ministry of Labor plays an important role in shaping the labor market policy of the state. Similarly, in order to gather information on the health of the SME population the role of Federal Bureau of Statistics, the Ministry of Finance, and planning division is pivotal. Other ministries and divisions such as Ministry of Local Government and Rural Development, and the Ministry of Science & Technology also influence the situation of our SME. Provincial and local governments also take their share in responsibility.

However, there is an existing lack of coordination and regular information exchange mechanism among institutions, which constrains their collective ability to deliver in the SME development process. As a result of the Government's recent efforts, two institutions Small and Medium Enterprise Development Authority (SMEDA) and SME Bank were created. The responsibility for facilitating SME policy development now lies with SMEDA, which is attached to the Ministry of Industry and Production (MOPI). SMEDA is responsible for creation and coordination of Government policy for the SME sector. Parliament, naturally, is responsible for monitoring policy and its implementation.

One of the major reasons for the lack of coordination is that SMEDA has not been provided with a formal mechanism to initiate, coordinate, monitor and evaluate initiatives undertaken for SME development, which fall outside of its own scope of activities. Therefore, cross-departmental and stakeholder consultations, resulting in the preparation of our national SME policy are our key to success. Regular information exchange mechanism and networking needs to be developed amongst our public and private sector institutions. There is a strong need to devise such an information exchange mechanism and redefine the role

[7] Under PRSP government is following a five point strategy which includes 1) Macro-economic stability and fast growth. 2) Investment in Human Resources 3) Government's involvement in particular sectors (including SME). 4) Expansion in social security system and 5) Good Governance

of institutions, specifying their functions in order to avoid duplication of efforts and allowing the best possible usage of resources.

Under the SME Sector Development Program it is expected that SMEDA:

- Prepares Government documents on policy regarding SME.
- Drafts relevant laws and regulations.

To form a collective view of all stakeholders, the SME task force has been established at the MOIP, SMEDA will serve as the secretariat. A network of institutions stimulating the growth of SME is being proposed. The institutions in this network cover all stakeholders involved in SME promotion; Regional Development Agencies, Business Support Centers, Chambers of Commerce as well as other organizations, which are established as an initiative of local communities.

Reference

The research cell SMEDA/LCCI
50 years of Pakistan's economy by Shahrukh Rafi khan (Oxford Press)
UNIDO unit 2 studies on SMEs

Book recommended

Small entrepreneurs in developing countries by Dr Asghar S. Nasir

Key terms

Retrospective (having effect in past)
MOIP (ministry of industries and planning)

Lesson 10

ISSUES AND POLICY DEVELOPMENT FOR SME – II

This lecture deals with the policy-making issues on short and medium term basis. The importance of these issues is self evident in this lecture. This lecture reflects issues where we feel we may achieve strong impacts in the short and medium-term, i.e. until 2011. They should therefore become major topics of our deliberation and shape the formulation of our SME policy.

Issues in Policy Development (Short and Medium-Term Issues)

Business Environment

The large size of the SME sector limits the ability of the Government and business support institutions to achieve competitive coverage by support programs. This is a fundamental reality in most countries of the world and it is why policy framework and regulatory measures are of tremendous importance when SME promotion is concerned. It is agreed that only appropriate policy tools and regulations than with support programs can achieve much more. Likewise, SME development is hampered more by inappropriate regulations than compensated by means of appropriate support programs.

Most of the developed nations therefore have mechanisms in place to revert the biases against small firms. For instance, the United Kingdom introduced the "Think Small First" initiative, which requires all Government organizations to assess the impact of their actions on small business prior to implementation. Furthermore, participation of small business in government procurement is being facilitated as a matter of routine.

The result of such policies is that (unfortunate) surprises to small firms are less frequent. It is made sure that businesses potentially affected are consulted and informed of any forthcoming policy shifts so as to avoid negative impacts. They are also allowed an adequate grace period for the adjustment of economic activity and there is no retroactivity of new regulations. Besides this, special attention is paid to minimizing the room for bureaucratic discretion while developing policy rules or procedures. All such mechanisms are missing in present policy or legal environment in Pakistan. The absence of a specialized, uniform legal framework for the development of SME hampers SME operations[8].

Relationships between Government and SME

The relationship between government and SME seems to be fundamentally flawed. In many cases this extends also to other large organizations and their interaction with smaller clients as SME. Our compulsion of centralized control stems from the fear of the regulator to be misled by the opportunistic profit-seeking entrepreneur. And our administration practice is characterized by rent-seeking bureaucrats, who given the low level of their pay, take advantage of low literate entrepreneur. Of course, we all know there are many dedicated and honest professionals on both sides. But the fact of the matter remains that there are severe attitude problems in the relationship between the two sides. The only way to break this discouraging situation is to face the problem squarely and seek solutions in a positive spirit and entertain systematic dialogue between the two sides. The present divide is, among others, reflected in a language gap. Part of the concern for local business people is the inadequate business facilitation process in the local language, which includes laws, regulations and business support material available in the English language only.

As a starting point, we propose to consider the increased usage of Urdu in our written documentation, in our official deliberations and communications.

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[8] To this point, the Ten Year Perspective Development Plan 2001-2011 notes that there is a large range of zoning and other regulations imposed by the federal, provincial and local governments and public sector utilities which affect the functioning of SME hence, legislation similar to the US Small Business Regulatory Enforcement Act of 1996, which includes Regional Small Business Ombudsmen, would be considered to ensure fair and effective functioning of SME. Whatever the mechanism to enforce it, a "level playing field" is one of the cardinal conditions for SME development.

A second point is how we may increase the share of SME participating in the provisions of goods and services to public sector, as it is common practice in many countries. A typical SME in Pakistan caters to the domestic private sector. It is noted that fewer than 4%[9] are supplying to the government sector. Some of the issues are related to tough bargaining price (36%) and supplies on credit (34%) and other are related to absence of rules on how to the public sector should increase its procurement for SME. Further points may possibly emerge from the dialogue between Government, stakeholders and their SME clients.

Taxation Issues

High tax rates are one of the major reasons for firms to drift into the informal economy. This holds for the countries all over the world, including developed countries. These effects are compounded by high compliance costs for small firms to deal with tax laws and other forms of government regulation. This is a specific size-related disadvantage compared to large-scale firms, which have not only the necessary accountants, but also frequently, also in-house tax and legal advisors. Compliance costs have monitory implications (such as paying tax advisor fees or salary payments to personnel dealing with tax issues); time cost implications (in the form of time spent by a taxpayer to handle tax issues), and physiological cost (in terms of anxiety, stress and apprehensions related to possible mistake or a possible audit by the tax authorities).

Firms in Pakistan's SME sector, encounter an increasingly complex legal, tax and administrative environment, both in starting up and developing their business. According to research, 67% of enterprises termed tax regulations as most problematic. 56%[10] of businesses report a crunch of taxes, while 28% of businesses felt that the taxes in the country are too high. From SME point of view, the present tax structure and administration generally distort incentives and discriminate against small firms who are harassed by the tax authorities. Smaller firms found tax related issues more restrictive than larger firms, 69% of firms, whose size of assets was less than Rs.1million faced the greatest of tax related problems. Many small firms claim it is not possible for them to maintain books[11]. As per law or hire a professional due to cost constraints.

The prevailing system is non-standardized and offers excessive discretion to the tax authorities. There is no consolidation or rationale in current provincial or local tax structure either. Hence, there has been a constant confrontation between tax authorities and the business communities resulting in very slow expansion in tax base[12]. Two sectors; retailers and small to medium sized manufacturers have already propounded the idea of fixed taxation as remedy to this continuous ailment. Cognizant of the change required to cater to the SME sector in its policies, there have been reforms in the advance stage of implementation of Pakistan's tax regime. But these reforms are focused on tax administration and management, instead of addressing the aspects that directly affect SME. No incentives are being offered to SME to enter the formal economy[13]. There has been no consideration as such reviewing tax law form an ordinary SME or even micro enterprise perspective.

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[9] World Bank SME Policy Note 2001, the results of SMEDA-World Bank Investment Climate Survey 2003 also conform to the findings.

[10] The 56% figure is an addition of the three tax related responses: High Taxes 28%, High sales tax 16% and high income Tax Rate 12%

[11] In Japan, after the war in 1949, old taxation system was replaced by new system to resolve the problem of incomplete bookkeeping and fear of over taxation of SME. The new system allowed certain tax merits if a tax return is made with a "certain formula of quick bookkeeping." This system resulted in not only the improvement of financial accounting but also the strengthening of financing systems for SME.

[12] There are 1.05million active tax filers in Pakistan. In 1999-2000 the number of salaried taxpayers was 440,000 and those filed under old self-assessment scheme were 275,000. Lowering tax rates may well lead to substantial expansion of the tax base in compensation and be neutral for the government income. However, without more profound improvements in the relationship between government and the enterprises, hopes should not be raised high for tax rate changes to bring immediate tax base expansion

[13] A taskforce on the reform of tax administration, chaired by Mr. Shahid Hussain, was constituted by government, which gave detailed recommendations in its report published in May 2001. Based on this

Reference

1- As quoted above
2- SME sector By SMEDA
3- Developing SME policy in Pakistan By Policy planning and strategy department (SMEDA)
4- Small entrepreneurs in developing countries by Dr Asghar S. Nasir

Book Recommended

Small entrepreneurs in developing countries by Dr Asghar S. Nasir

Key terms

1- Arbitrary (dependent on will or pleasure)
2- Bilateralism (consist of both parties)
3- Inter alia (among other things)

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document and comments from the IMF and the World Bank a restructuring plan was drawn up by the CBR. This restructuring plan is now being made operational with the World Bank support.

Lesson 11

SHORT AND MEDIUM TERM ISSUES FOR SME POLICY FORMULATION – I

We are dealing with the short and medium term issues for SME policy formulation. In fact this whole issue is inter-related in lessons No 10,11,12,13 and14.

Labor Issues

Likewise, the intensity of the regulations is the second most important reason for firms to drift into the informal economy all over the world. Labour Laws and regulations in Pakistan[14] are considered to be one of the most complicated areas with which any business enterprise deals. The present set of the labor laws was the result of checkered initiative of various governments to create a healthy business environment for the labor. Consequently, enterprises have to deal with fifty six (56) labor laws with some of them being industry specific. The existing plethora of labor laws has made compliance impossible for the enterprises due to their inherent inconsistencies. Numerous labor inspections under these laws are yet another impediment that retards the growth of SME.

The labor market dynamics have changed considerably over the years, a higher degree of adaptability and flexibility along with Labor market security, including protection against arbitrary loss of employment, reductions in income and healthy work practices are essential requirements of new environment. Besides, the condition for compliance for international labor standards under the global economic system is another issue.

Taking into account the need of labor market and employers, the Ministry of Labor and Manpower introduced an employment security regime. The new labor policy initiatives is aimed at creating a favorable environment for facilitating industrial promotion and revival along with legislative and structural changes to bring in an environment to devoid of restrictive labor practices, but protecting the rights and interest of the workers.

It was proposed that existing labor legislation be simplified and rationalized into six basic laws. In addition, for promoting bilateralism among government employer and employees, government established a forum Workers Employers Bilateral Council of Pakistan (WEBCOP). The government is also working in the development of Labor Inspection Policy under the SME Sector Development Program to reduce the interface of government officials with businesses without compromising on the unhealthy work practices. The only issue highlighted thus far through direct interaction with SME is that of co-ordination. The business and labor community at large has been supporting the reforms.

Delivery of Assistance and Access to Resources

Competitive advantage is determined by the productivity with which a country, region or cluster uses its human, capital and natural resources. Pakistan's international competitiveness markedly declined over past few years[15]. Part of the blame is shared by lower productivity of the workers. The evidence reveals that median labor productivity, as measured by annual value added per worker, is 25 percent lower in Pakistan than in India and 35 percent lower than in china[16].

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[14] A committee on Reforms in Regulatory Legal and Policy Environment was established in the Ministry of Industries and Production in 2000 with the purpose to co- ordinate, review, identify issues of concern and formulate recommendations on several laws affecting businesses. Some of their efforts have resulted in the consolidation of the labor laws as announced in the Labor Policy 2002 and proposed amendments in the Factories Act 1934, Drug Act 1976, Boiler Act 1923, and Explosive Act 1884, and as such reviewed 101 commercial and labor laws that affect the industrial sector.

[15] World Bank, Development Policy Review 2002, reveals that the annual manufacture exports of Pakistan are barely 12 percent of those of Malaysia. 18 percent of Thailand's and less than a third of Philippines---- countries whose combined manufacturing exports were lees than Pakistan's in the mid 1960's.

[16] Investment Climate Survey of Pakistan- 2003

Trade liberalization at the global and regional levels and the new information and communication technologies have entwined to create rich opportunities as well as formidable challenges to all independent countries and enterprises. Competition has become increasingly fierce among the global and regional economies and enterprises. The structure of markets and their demand[17] is increasingly complex.

Despite operating locally, Pakistan's SME need to be increasingly aware of the world market. They cannot escape it even in their local economy. To meet this challenge, there is growing need for information on global technology trends, rules and compliance cost including facilitation services regarding global issues.
An integrated program for improving competitiveness, promoting trade, and developing workforce can help[18]. Training, research and development, labor productivity enhancement, technology transfer and up-gradation and support to business startup through business incubation and various other business support services, including finance, are issues that need to be addressed separately by the SME policy. What is important is that access to resources and services necessary to compete in this global environment are being provided to SME because their size poses an effective limit on their capacity to assess world market conditions and tap appropriate resources. Old policy tools of protection now require replacement with promotional and facilitation functions. The roles of business development services, hence, become imperative.

The capacity to deliver such services by the public or private sector led institution is a major topic for debate but also relates to the specifics of the service in question. However, market-driven support programs are a cornerstone in any SME support system which strives for sustainability. This also maximizes the potential for cooperation with private sector organizations and minimizes the distortions in the market economy. Yet the structures for such a system still need to be mutually agreed and implemented in Pakistan. Below we flag the important issues.

Finance
Access to equity and formal debt financing has repeatedly been identified as recurring constraint to SME growth and development. Commercial banks apply conservative policies in lending to SME. More, importantly the existing structure of financial sector was developed to serve medium to large enterprises which are organized as a formal business. Most banks prefer to hold risk free-income generating assets and lending to SME is unattractive due to a range of objective and subjective factors. These include high transaction cost, inability to do away with tangible collateral requirement, no linkage of financial products with sector needs and the inability to structure/ offer and manage risk-prone SME specific medium to long term financing options.

It has been observed that 57% of new investment for small and Medium Enterprises and 67% of working capital finance come from internal finance or retained earnings; only about 7% of funds for investment or working capital come from banks or other financial institutions. Even suppliers' credit rivals the contribution of the banks as a source of working capital (4.5%)[19]. Another survey[20] concludes that SME are indeed being rationed out of the credit market, rather than merely exhibiting a lower demand for credit.[21]

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[17] Consumer preferences and market standards have become more sophisticated and exacting. Competitive advantage is now determined by several non-price parameters such as quality, health and safety, social equity in employment and production and ecological compatibility of products and processes

[18] The Ministry of Science and Technology is preparing a National Quality Policy and Plan and another initiative of the government is working on the development of National Productivity Policy

[19] SMEDA- World Bank Investment Climate Assessment Survey was conducted between May and November 2002 by using SMEDA in collaboration with the World Bank covering a random selection of 965 mainly manufacturing businesses (90% being SME), drawn from 12 largest cities of Pakistan. To date it represents the most comprehensive data set.

[20] Faisal Bari, Ali Cheema, & Ehsan-ul-Haque; Barriers to SME growth in Pakistan: An analysis of constraints, June 2003

[21] This finding is corroborated by the World Bank (2001) survey, which finds that over 50% of their sample SME who had ever approached a bank reported difficulties in obtaining credit. SMEDA-ILO Study 2001 also reports a similar finding.

However, financing SME is one of the key pre-requisites for the future development of the national economy and the achievement of economic growth. The government of Pakistan had originally responded to the growing needs of the sector by introducing a Self Employment Scheme through Small Business Finance Corporation (SBFC) in 1992. SBFC continued to grant loans to small business and disbursed 12 million by June 1998, catering to the needs of 157,162 unemployed persons. Other schemes for SME development or employment generation included the Youth Investment Promotion Society, and Yellow Cab scheme. But all of these efforts lacked coherence across institutions, and, in the absence of any national policy, resulted in disjointed efforts and even corruption

Previous efforts have therefore had limited results and were highly inefficient because the financial sector accumulated a huge portfolio of non-recoverable loans under these schemes. The SME Bank will need to undergo restructuring for next three years. Furthermore, severe damage has been done because the financial sector has developed disinterest for any such initiatives in future, and we need to basically start from a scratch. The banking industry in general is also not venturing into the areas where new processes and procedures with a view to improve SME's access to credit are required. It is likely that market-led mechanisms will take some time to improve the access of smaller firms to formal credit. In particular, outreach shall remain to be a problem for the due to the limited presence especially in the rural SME market.

The government is seeking to facilitate the participation of commercial banks in SME leading by training with the assistance of the ADB. The sooner commercial banks obtain the know-how how to successfully engage in cash-flow based lending to small business enterprises, the better. Finally, new prudential regulations increase the likelihood of viability and sustainability in the financial sector. However, the broad definition of SME also bears a risk of upward filtering of the loan portfolio towards the higher-end medium enterprises unless targeted programs for micro and small enterprises exist. The creation of SME credit endowment fund may be one way of mitigating the effect.

References

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2. Policy issues papers by SMEDA
3. 3-50 years of Pakistan's economy by Shahrukh Rafi Khan
4. Research cell LCCI

Book Recommended

Small entrepreneurs in developing countries by DR Asghar S. Nasir

Key Terms

1. Productivity (The rate amount produced by a worker)
2. Tangible asset (An asset that has physical existence and value at least equal to liability)

Lesson 12

SHORT AND MEDIUM TERM ISSUES FOR SME POLICY FORMULATION – II

This lecture is a continuation of the lectures No 9&10 and 11 dealing with the short term, medium term and long term issues. These issues are pre-requisites for forming a comprehensive SME policy.

Human Resource Development

One of the major challenges that SME have to face is the emergence of the knowledge-based economy. People must continue to innovate, change and upgrade. There is a need to nurture the entrepreneurial spirit and skill development for adopting innovative technologies. The low-literacy level of our population poses an immense challenge to our competitiveness. Yet, it is a fact of life, which we will not overcome, in the short run. It is therefore imperative that we seek intelligent short and medium-term solutions to bridge the literacy gap.

One aspect of the Government's strategy is to strengthen non-formal skills and entrepreneurship development, to better prepare workers for employment and to improve population's general capacity of self-employment. But are there other ways by which we can enhance the skills of our workforce in such a way that we need not despair when facing external competition?

The government has established a number of institutions that impart training and skill development. These institutions, Pakistan Institute of Management Science (PIMS), Provincial Vocational Training Councils Authority, Technical Training and Vocational Authority (TEVTA) Government Universities and various other support institutions have however remained rather passive regarding the shaping of human resource development for SME.

A frequent complaint is the mismatch of the output of our human resource development institutions with the demand of SME. There are also only limited options for the training of the middle management. Low skills of workforce, inadequate vocational training facilities yet remain out of the scope of the reforms agenda. Are there any mechanisms by which we may achieve effective consultation between supply and demand sides of our vocational training system so as to attain a maximum benefit for our economy?

Entrepreneurship does not breed in a vacuum. For a healthy, growing business environment, it is necessary to foster entrepreneurial culture in Pakistan, which goes beyond the inclination to trade in goods. Entrepreneurial skill development programs can boost this.

Technology Transfer and Up-Gradation

Developing SME based on local skills/resources has now been rightly recognized as a means of promoting economic growth and a very effective tool for providing productive employment in a country. But up to date technology also plays a vital role in the vertical integration of the firms, moving them up the ladder in terms of firm productivity enhancement.

In our country, growth oriented export firms still have problems sourcing quality inputs due to the lack of a network of reliable suppliers. This adds to their transaction costs. Likewise, the SME are not large enough to furnish sufficient demand to be an incentive for a big high quality input supplier.

The government in its efforts to facilitate technology transfer for indigenous SME initiated a program with the United Nations Development Program (UNDP) to promote Technical Cooperation between Developing Countries (TCDC)[22]. The scope of Phase 1 remained narrow and focused on capacity building of various public sector organizations through training programs. The intended final beneficiary, SME, has not yet been able to benefit from the program.

[22] A few countries (mainly China, Singapore, Indonesia, Sri Lanka) also shared their experiences and expertise with Pakistan.

In its other efforts, the government used to offer cash grants[23] for ISO certification to those enterprises that choose to be growth oriented internationalized SME. The government also set up a National Productivity Organization as a resource center and a research institute to enhance industrial and labor productivity in Pakistan.

Similarly, other organizations like Pakistan Council for Scientific Industrial Research (PCSIR), Pakistan Industrial Technical Assistance Center (PITAC), Ministry of Science and Technology (MOST) etc. established to facilitate industrial growth still need to adopt an active approach to provide their services to SME in an effective manner.

Major technology up-gradation obstacles include:
- ¾ Inability to acquire sophisticated testing equipment and R&D facilities. (SME see it as a financial problem).
- ¾ Lack of skills/experience to operate high-tech machinery.
- ¾ Insufficient information on technological cooperation opportunities.
- ¾ Lack information on target market quality requirements and lack of knowledge on how to achieve these quality levels.
- ¾ Absence of appropriate metrology and testing equipment and related infrastructure as common facility centers.

References

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2. World Bank survey (Gallop)
3. Financial issues &SMEs (paper read by Dr Ishrat Hussain)
4. Small Entrepreneurs in developing countries By Dr Asghar S. Nasir

Book Recommended
Small Entrepreneurs in developing countries By Dr Asghar S. Nasir

Key Terms
1. ISO certification (International Standards organization certification like ISO 9000 Quality certification)
2. R&D (Research and Development)
3. SBP (State Bank of Pakistan)

[23] Discontinued since June 2003.

Lesson 13

SHORT AND MEDIUM TERM ISSUES FOR SME POLICY FORMULATION – III

This lecture is continuation of defining the issues for making a SME policy; this lecture deals with the short and medium term issues. The vital issues of gender development and environmental protection are also discussed in detail

Market and Industry Information

Access to market and industry information is one of the keys to develop successful business strategies. Frequently, business and trade associations are able to provide their members with such services. By associating with like institutions in foreign countries, they are also able to establish links and obtain information on foreign markets.

Over half of our SME belong to business and industry association. Their perceived role is limited to lobbing and negotiation with the government. Yet very few SME (12%) perceive their associations to be a source of information on new developments in their fields of business operation. How to increase the service provisions by all types of stakeholders will become a fundamental issue when SME support programs will be looking for deliver channels.

Monitoring Developments

Harmonizing Enterprise size Categories

Pakistan has no across the board legal definition of SME. This makes is extremely difficult to monitor the development of our SME economy and to establish benchmarks against other countries in order to devise areas of intervention and support.

Various government departments and public-sector agencies have adopted their own definitions. There are, of course, various reasons for them to define SME, and there may even be discussion on just how a strict and reasonable size standard could be defined. A number of current definitions are based on capital standards since this influences the pattern of fund raising in the formal and informal market by SME. Many stakeholders consider enterprises with 100 or more employees as large, and enterprises with less than 5 employees as micro. Yet our statistical system classifies enterprises with more than 10 employees as large, and the State Bank of Pakistan considers those with more than 250 employees as large.

The reference to international practice also suggests differentiation among industrial, wholesale, and retail[24] and services related enterprises. This view also gets credence from various studies on the issue for Pakistan[25]. Again, this consideration is only visible in the SBP definition and missing in all others. There are also rationales beyond the particular organizational motivations for defining specific size classes, and it will therefore be useful for all stakeholders to review definitions on technical grounds.

For a national policy, it is extremely important to have a harmonized definition for, as it is also important for the government to focus assistance as reasonably as possible for maximum efficiency. It is also imperative to adopt a definition to foster the coherence of vision in the SME policy development and for the better implementation of related support programs across institutions.

Measuring Our Success

Public sector resources are as scarce as private sector resources, and we need to ensure that they are being used in a most efficient way so as to be able to create and maintain sustainable support structures for SME,

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[24] The Census for Establishments 1998 reveals that retail constitute 42.5% of total non-agriculture establishments and employs 20% of the labor force.

[25] The survey of SME for ADB study on SME Constraints report observed differences for retails sector. It suggests that the sector is dominated by micro enterprises and there has been considerable organizational, management and technological differences between enterprises employing 10-49 workers and those employing 50 or more workers.

which are able to perform in the long run. At the same time, we, of course, seek a maximum effectiveness of our support programs[26].

As things stand, we have no mechanism in place for measuring our success. In fact, we do not even have a criteria established by which we are able to determine our success as a nation in fostering SME development. And we are not able to correctly state what the Government is spending on SME support annually.

Our present "system" of support is incoherent. While division of labor with diverse stakeholders is necessary condition for obtaining a maximum reach, it is also a perfect ground for the duplication of activities and wastage of resources. There is no current overview of activities, and the various stakeholders compel us to commission specific research if we seek information on the diverse contributions. What is at stake is that we forego the benefits of learning from one another in order to continuously improve our support structure to meet the needs of the target group, SME.

SME as a Medium-Term Channel for Other Objectives

It is common practice in many countries to make use of SME in order to further specific development objectives as, for example, sustainable or equitable development. After all, SME constitute the overwhelming part of the economy. Currently, we are not making use of this channel for promoting the development of our country. Two issues, which also relate to our competitiveness, are flagged in the section below.

Gender Development

Each of the two genders of any society constitutes roughly half of the population, and Pakistan is no exception. People of both genders embody not only labor force, but also knowledge and creativity, which may be mobilized, to achieve economic ends. Discarding either of the genders, therefore, implies foregoing the potential benefits, which arise from mobilizing the respective human resources for development.

Pakistani women have been engaged in the production process for ages. Their participation in the economic activities in the modern society has also progressed beyond agriculture into the local market economy. Women are increasingly migrating to urban areas for employment in a range of cottage industries, such as carpet weaving, textiles and handicrafts. In search for wage employment, women are moving into small business and self-employment ventures thereby creating many formal and informal opportunities for work.

Women entrepreneurship in the formalized sense, however, remains a new concept. Our current strategies also tend to focus on increasing women's participation in the labor force. The business environment for women in Pakistan reflects a complex interplay of many factors made up of social, cultural, traditional and religious elements. These have taken shape over many centuries; are anchored in patriarchal system and are clearly manifested in the lower status of women. The form of constitutional structures, policy documents, regulatory arrangements and institutional mechanisms is contemporary rather than traditional, so it is cosmetically impartial.

Yet the gender bias is rigid and deep-rooted as it draws legitimacy from the perpetuation of a traditional mind-set, established rituals and a firm belief system. It has conclusively been shown that women business owners encounter more obstacles, and face more risks, financially, socially, economically, culturally and legally than male business owners face.

The Government of Pakistan is well aware of the potential of the women in our society and the contribution they can make towards economic development. Women are continuously being encouraged to enter the business stream of the country and are being provided incentives. However, there still is a strong dearth of focused initiatives that need to be taken by existing business facilitation institutions.

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[26] Reminder: "Efficiency" measures inputs vs. outputs whereas "effectiveness" measures outputs vs. objectives. Programs may be very effective and at the same time inefficient. The goal must be to seek both effectiveness and efficiency at the same time.

Environmental Issues
Environmental issues are most frequently a result of the interaction between human activities of production and the environment. Under fierce competitive pressure in the market economy and as part of the coping strategy when faced with difficulties to cover basic needs, enterprises and individuals are creating environmental issues.

While certainly one of the economic root causes for environmental damages are externalities, which require appropriate government intervention, it is frequently overlooked that there are many economic gains, which may be achieved from producing in an environmentally friendly manner. Reducing material waste can be one way of reducing cost. Saving resources such as water and energy does not only generate benefits at the national level but may translate into competitiveness and thus economic gain at the enterprise level.

There is also a direct link between the effectiveness of the technology transfer and the stabilization of the global climate change and natural resources depletion. Major constraints to effectiveness lie in the high transaction costs associated with the development of the capacities and capabilities to manage and generate technological change. Developing countries enterprises thus tend to ineffectively exploit available technology options, as well as to inefficiently utilize the transferred technologies.

Many OECD countries make use of channel of SME promotions in order to achieve improvements for the environment. For example, special credit lines may be provided in order to encourage the adoption of environmentally friendly technologies. Specific training courses are being offered to SME on waste reduction. ISO 14000 is actively being promoted in the European Union as one way of combining environmental concerns with quality and thus competitiveness. How may we best use our current and future SME support structures in order to achieve positive effects?

Reference:
1. Gender inequalities and development in Pakistan By SHAHNAZ KAZI
2. Environment: Some key Controversies By Shaheen Rafi Khan and Shahrukh Rafi Khan
3. Policy issues Paper (SMEDA)

Book recommended
50 years of Pakistan's' Economy edited by Shahrukh Rafi Khan (Oxford Press)

Key terms
1. Gender (classification based on male, female, neuter)
2. Externalities (A term used in environmental studies, like a drain having polluted water from one factory may be used by some other industry and suffer the bad effects of pollution)

Lesson 14

LONG TERM ISSUES FOR SME POLICY

This lecture is still the continuation of the policy forming issues for SMEs. But in this section instead of short and medium term issues, we are dealing with long-term issues.

Long Term Issues

There are issues, which are beyond the scope of our current interventions. They are partially rooted in the multiple cultural structures of our society, frequently exacerbated by our geo-political situation. We, nevertheless, recognize their importance and therefore point them out here. However, it is not recommended to attempt to solve these questions by ways of an SME policy Initiative.

Literacy

The evidence reveals that SME find it extremely difficult to grow because of their inability to delegate to soundly trained staff. The day the small businessman feels comfortable to delegate, SME start progressing. The low literacy level also determines the potential of our labor force. Higher literacy rates are essential to enhance the quality of production can be enhanced by multiple factors which is what we need to be able to effectively compete in the international economy which is being extended to our local markets by the effects of opening up and WTO accession.

Law and Order

Law and order situation in Pakistan has always been regarded as worrisome. One survey reports that one in five respondents report that the business was the target of at least one crime during 2002. Another assessment suggests that the businesses in NWFP spend 4.5%, Sindh and Punjab 1-2% of their revenue on security. One in four SME consider law and order to be a severe problem.
Law and order problems weaken property rights and as a result weaken investor's decision to invest. These problems are clearly linked to the manner in which the law enforcement and criminal justice system functions. The high time cost involved in seeking legal resource together with lack of access to both effective informal and formal enforcement mechanisms, increase the costs associated with contract enforcement.

Intellectual Property Rights

Intellectual Property Rights (IPR) is a vital issue that needs to be looked into**.** It has been observed that many developing countries with the help of a change in their IP systems and laws are able to attract Foreign Direct Investment (FDI) in the Research and Development(R&D) especially in the industrial and the scientific field. Therefore, promotion and protection of the intellectual property spurs economic growth, creates new jobs and industries, enhancing the quality and enjoyment of life.

Another benefit for Pakistan in properly adopting IPR culture is that it will protect the indigenous products such as rice, Kinno, traditional knowledge, pottery etc. the owners of the IPRs has the most valuable assets which can be utilized in commercial transactions, whether IP licenses, joint ventures, manufacturing, purchase or distribution agreements, or mergers and acquisitions. Licenses to use patents, trademarks and copyrights are often combined with transfer of know how in the form of training and are increasingly an important term in such transactions.

Infrastructure

Basic physical infrastructure is a prerequisite to growth and development. Power outages and access to the connections are considered an irritant, which significantly affects the productivity of firms in Pakistan. It is estimated that a typical business in Pakistan loses 5.6% in annual sales revenue due to just this single factor. Differences associated with firm size recognize that smaller firms are relatively hard hit in comparison with the larger ones because of inability to arrange alternate power source such as private power generators. High rates of power, the poor quality of delivery and its reliability are the serious concerns for SME in Pakistan.

Similarly, access to the telecommunication facilities and transport also serve as a detriment to smooth growth and transition of smaller firms to larger ones. The chief problem in the provision of the telephone services is the shortage of new fixed line connections, which currently stand at a mere 0.5-0.6 million a year for the whole country. Pakistan could also save up to 16.5% of the value of exports by improving its trade and transport logistics systems. Inefficiency in transport alone is estimated to cost the economy RS.320 Billion a year. The concentration of power, telecommunications and transport services, except for road transport, in the public sector has been regarded as a major concern. Evidence suggests that Pakistan's state-controlled and concentrated structure of infrastructure delivery is highly inefficient.

References

1. Small Entrepreneurs in developing countries by Dr Asghar S. Nasir
2. Task force issues paper for new SME policy (SMEDA)
3. Pakistan Small Entrepreneurs Summary and Statistical Tables, January 2001,GALLUP/BRB (A world Bank survey)

Book Recommended

50 Years of Pakistan's' Economy (traditional topics and contemporary concerns) EDITED by Shahrukh Rafi Khan Published by Oxford press Pakistan.

Key Terms

1. WTO (World Trade Organization)
2. IPR (Right to protect an idea, piece of writing, design from copying)
3. Merger (combination of two or more organization)

Lesson 15

THE START UP PROCESS OF A SMALL

This lecture Deals with the start up process for obtaining a Bank loan, identification of projects and its sources.

The Start up Process of a Small Enterprise

The challenges of starting a new enterprise from the stage of its conception till functioning are indeed stupendous or multidimensional as indeed its contribution to the society in various forms such as employment, economic growth, balanced development, equitable distribution of wealth etc. Success is a slave to those who only correctly perceive the nature and intensity of problems that they are likely to encounter but also plan appropriate remedial actions. This lecture is devoted to studying the following:

1. The Identification of New Venture Opportunities and
2. The Field Problems of Starting a new Enterprise.

Identification of New Venture Opportunities

In the search for new ventures, entrepreneurs explore both (a) external and (b) internal resources. The external resources include:-

I. Newspapers, trade journals, professional journals etc. which tell about trends in fashions, customs and other social areas.
II. Professional magazines catering to particular interests such as electronics, computers, oils and banaspati etc.
III. Trade fairs and exhibitions displaying new products and services.
IV. Government agencies.
V. Ideas put forth by others.

Internal resources basically consist of storehouse of knowledge build up by an individual over the years. An entrepreneur draws upon it and undertakes the following exercise:

I. Analysis of concepts in the light of existing problems and their capacity to solve them.
II. Search of memories to find similarities and elements related to the concept and its problems.
III. Recombining the elements found in new and useful ways.

Steps in Innovative Process

1. Comprehension of a need: Innovation follows from clear perception of a need that should be fulfilled. A number of products or services have been developed from such a perception. These range from xerographic copying machine, credit card, instant photography etc.
2. Collection of data and definition of concept.
3. Outlining the problem.
4. Searching memory for similarities that seem related to the concept and its problem.
5. Evaluating the possibility to combine similarities and related ideas.
6. Reaching tentative solution.
7. Critical scrutiny of solution.
8. Practical implementation.

Sources of Ideas for New Products

1. **Necessity**
   It involves the identification of potential customer needs and then tailoring the product and services to meet them.
2. **Hobbies/ Personal Interest**
   For example, an aircraft designer working for a large company developed a catamaran for his own pleasure. Later he was asked to build a similar catamaran for a friend. Gradually, it took the shape of a successful business.

3. **Watching Trends in Fashions and Customs**
   Alert observers of the fashion scene can capitalize the opportunity thrown by the change of fashion. Demand for handcrafted jewelry, fast foods etc. have made many professionals in these fields.
4. **Observing Other's Deficiencies**
   It helps improve performance or add desirable features, for instance, development of a key that would identify the person and open the door only to him. It would sound an alarm if the door is forced open or in case an improperly coded key is used.
5. **Gap Filling**
   Business opportunities may be found to exist in reply to the question, why is not there a gadget for doing this? Several products have been developed to fill up a felt gap. For instance, the difficulty of cleaning an old paint brush has led to the discovery of a disposable paint brush with plastic handle into which a polyurethane tapered brush can be inserted and later an discarded after finishing painting.
6. **Novel Use of Known Products**
   With ingenuity, it is possible to think of new uses of existing products e.g. Use of fly ash- a common effluent in thermal plants, to make bricks and light-weight concrete etc. Similarly, rice husk (a common product in rice sheller) could be used for making hardboards.
7. **Ancillarisation**
   An entrepreneurially oriented brain can conceive new ideas or think of improvements in products with which they are familiar: As a consequence, a unit ancillary of an existing industry could be started.

Pitfalls in Selecting New Venture Opportunities

1. **Lack of objectivity**
   Some entrepreneurs get so obsessed with their idea that they overlook the need to scrutinize its feasibility. No wonder such projects end up as failures.
2. **Market Myopia**
   A shortsighted approach of concentrating on production rather than on marketability could lead to avoidable disaster. An entrepreneur may fail to properly assess the market acceptability of his product. He may not appreciate that no product can become instantaneously profitable or could have an endurable success. Selection of the right time for introducing the product is important for its success. If actions are taken too soon or too late, it will result in failure.
3. **Inadequate Understanding of Technical Aspects**
   Technical difficulties involved in the production of a product are a time consuming and thorough job. Inexperience in this area can prove quite costly and swamp a budding enterprise.
4. **Improper Estimation of Financial Requirements**
   Sometimes in their enthusiasm to initiate an enterprise or due to pre occupation with other details, entrepreneurs overlook the financial details. Later it could be the cause of either over capitalization or under capitalization.
5. **Lack of Product Differentiation**
   To capture the market, the product should have distinctive characteristics in terms of design, utility and other features. Assured superior performance over the products is essential to provide it a competitive edge. Pricing is no problem in the case of such products. Product differentiation is essential so that the potential customer could recognize the product merely by looking at it.
6. **Overlooking Legal Issues**
   A shrewd entrepreneur should be alive to meeting the various legal requirements. For instance, workers should be provided with legitimate legal dues, consumers are provided with reliable and safe products, copyright, trade mark etc. should be observed.

Books References

1. Entrepreneurship and small business By C L Bansal
2. How to approach Banks By ITC (UNO) & SMEDA

Book Recommended

How to approach Banks by ITC (UNO) & SMEDA

Key Term

1. Myopia: Short sightedness of vision

Lesson 16

TECHNICAL AND MARKETING FEASIBILITY OF THE IDENTIFIED PROJECT

Evaluation of New Venture Opportunities

A crucial task in starting a new business enterprise is the systematic analysis and evaluation of its feasibility and long term profitability. Since a number of variables enter the calculations, the exercise is quite a cumbersome one, a US study relating to the reasons for failure of new ventures has found that most of the factors underlying the failure lie within the control of entrepreneur. Following have been listed as the reasons for failure of new ventures:

I. Inadequate market knowledge regarding demand potential, the present and future size of market, the market share, appropriate methods of distribution
II. Faulty product performance due to hastily taken shortcuts in production, development, quality control etc
III. Ineffective marketing and sales efforts
IV. Inadequate awareness of competitor's reactions e.g. price cuts, special discounts.
V. Rapid product obsolescence due to rapid technological advances in case of certain industries
VI. Poor timing of starting a new venture e.g. introducing the product before the market has successfully matured
VII. Undercapitalization, unforeseen operating expenses, excessive investments and related financial difficulties.

Hence, there is the need to undertake a comprehensive feasibility study in the following five areas. Dealing with the technical and marketing feasibility of the identified project

1. Technical Feasibility

It covers the following:

a) Identification of critical technical specifications comprising

a. The functional design of the product.
b. Adaptability to the new customer demand.
c. Durability
d. Reliability of performance.
e. Safety
f. Reasonable utility (i.e. acceptable level of obsolescence)
g. Standardization (i.e. elimination of unnecessary variety)

b) Examination of product Quality-Cost Relationship

In making this investigation, the entrepreneur must understand that there are trade offs between technical excellence and associated cost i.e. a positive relationship exists between technical quality and costs. It is possible through an increase in the technical excellence of a product to that level at which marginal product quality equals marginal cost. This level is reached where slope of product quality and product cost curves are equal. Quality enhancement should not be carried beyond a particular point because it would cause cost increase and lead to decrease in total market demand (except where the product has a snob value). Thus entrepreneur should avoid unnecessary gold plating when market situation does not justifies it.

c) Product testing, which includes?

a. Engineering studies relating to machines, tools, instruments work flow etc.
b. Product development through blueprint, models, prototypes.
c. Product testing through laboratory testing and field-testing.

2. Market Feasibility

The following process may be adopted to assure the market opportunities of a product.

a) Identifying the Market Potential

It involves an estimation of both the current demand of the product and projection of future market trends. The prospective entrepreneur will do well to identify

i. Specific end users,
ii. Major market segments, and
iii. Potential volume of purchases within each market segment. Some statistical yardstick may be of quite help in accomplishing this work. To illustrate, a potential manufacturer of helmets may find out the annual production of two wheelers, percentage of helmet users and proportion of demand already met.

b) Estimating Cost-volume Relationship to ascertain how various price levels may affect total sales volume

The price must reflect the value of the product. The entrepreneur may not adopt a uniform price structure to take care of the sensitivity of the buyer to price changes. The cost-volume analysis would also facilitate the determination of appropriate economies of scales i.e. optimum size of enterprise, which has lowest average per unit cost of production and distribution.

c) Sources of Market Information

Relevant data for market analysis can be gathered from two main sources vise

i. Primary sources such as interviews, mailed questionnaire, survey etc and
ii. Secondary sources like government agencies, trade unions, chambers of commerce etc. Whereas the former is costly, the latter may not meet the requirements of the entrepreneur.

The following kind of data matrix may be quite helpful:

a) Data relating to general economic trends as revealed by various indicators such as new orders, house activity, inventories consumer spending.
b) Market data relating to demand pattern, seasonal variation etc
c) Pricing data i.e. range of prices for same, complementary and substitute products; base price; discount structure etc.
d) Channels of distribution both wholesale and retail
e) Data relating to competitors (To obtain this data, the entrepreneur may either conduct his own survey or approach a consultant).

d) Market Testing

It is an important method of establishing the overall feasibility of a new venture, significant market-testing methods include:

a) Displaying the product at trade fairs,
b) Test marketing to analyze the receptivity of the product, and
c) A market test can provide following information.
d) Likely sales volume and profitability
e) Sales volume at different price levels
f) Soundness of chosen market strategy
g) Unknown weakness that need attention

The drawbacks of this technique are:

a) Delay in implementation
b) Premature exposure to competitors and
c) Expensiveness

Books References

1. Entrepreneurship and small business management by Hans and Kuriloff and Arthur H.
2. New product decision an analytical approach by Pessemeir, Edgah A

Book recommended

Entrepreneurship and small business BY C L Bansal

Lesson 17

FINANCIAL FEASIBILITY OF SMES

This lecture deals with the financial feasibility, flow sheets, short term and long term loans, cash flow analysis and financial cost.

Financial Feasibility
It covers the following:

Determination of total financial requirements
It can be done by preparing a financial statement in the following way:

Financial Requirement Statement:

Initial Expense	**Period 1**	**Period 2**
Expense in product development	-------	-------
Legal expense	-------	-------
Product testing expenditure	-------	-------
Marketing and technical feasibility Expenditure	-------	-------
Miscellaneous expense	-------	-------
Sub Total(1)		
Fixed investments		
Building	-------	-------
Equipment and machinery	-------	-------
Patents	-------	-------
Other equipments	-------	-------
Sub Total(2)		
Operational expenditure		
Material	-------	-------
Wages	-------	-------
Sales promotion, distribution	-------	-------
Rent, interest, insurance, taxes	-------	-------
Contingency	-------	-------
Sub Total(3)		
Total	1+2+3	1+2+3

In making the above estimation, provision must be made for cost escalation that is inevitable due to price changes. Besides, appropriate sales forecasts should also be made to have a clear picture of expenditure. The projection could be weekly or monthly.

Financial resources and other costs
Financial resources could be categorized on the basis of periodicity into:

Short term resources:
(those payable in a year). Trade credit supplies, short term loans from backs or other lending institutions, sales of account receivable etc. belong to this category.

Term Loans:
Intermediate term loans are those available for one to three (sometimes five) years. It includes terms loans from banks, lease finance, financial assistance from institutions etc.

Long-term loans
Long-term loans are those from banks, equity capital and investments of earnings.

While considering different sources, it is better to consider specific costs as well as advantages and disadvantages of each. It would be appropriate to compute weighted average cost of funds as illustrated below:

1) Method of finance	**2)Proportion (Assumed)**	**3) Cost (Assumed)**	**4)Weighted Cost [2X3]**
Short term debt	20	7%	1.40
Intermediate dept	10	8%	0.80
Long term debt	20	9%	1.80
Equity	20	10%	5.00
Weighted Average Cost of Capital			9.00

On the basis of average cost of capital, it is possible to ascertain whether there is positive net present value when anticipated cash flow are discounted at average rate of cost of capital.

Key Terms

Feasibility study a detailed study about judging the future of a commercial project/product

Lesson 18

PROBLEMS FACED BY NEWLY ESTABLISHED COMPANY

This lecture will continue with the previous lecture problem and then chapter deals with the teething problem that a newly established company faces.

Cash Flow Analysis

If the projected sales associated financial requirements and available financial resources are known, the anticipated cash flow can easily be determined.

Cash Flow (Projected)

Cash Flow and Financial Transactions	**Period 1**	**Period 2**
1) Cash flow		
Initial expense		
Fixed investment		
Operating expense		
Total cash outflow		
2) Cash inflow		
Cash sales		
Account receivables		
Total operating inflow		
3) Net cash flow (2-1)		
4) Desired minimum cash balance		
5) Total amount of funds required [3 (if negative + 4)]		

Source of Funds

Fund Type	Amount
Short term Net trade credit Commercial loans	
Intermediate loans	
Long term loans	
Equity	
Total Financing	

Anticipated return on investment

Financial feasibility is adjudged on the basis of satisfactory yield on investment. It can be calculated by relating the average earnings expected over a given period to either the total amount of investment or net worth of organization (Return on equity). Both are compared with potential yield from alternative investment opportunities to ascertain the acceptability or otherwise of a new venture.

Assessment of Personal Requirements and Organizational Capabilities

Human beings provide the motive force to an enterprise. For this purpose, it is necessary to consider the available talent and skills consonants with the organization structure. An inventory must be made of the skills needed for effective implementation of new venture. The steps in undertaking the exercise relating to determination of personal requirements and designing the initial organizational structure are described below:

a) Ascertaining the anticipated workflow and the various activities (called activity analysis). At this stage, the total range of activities and level of skills are identified.
b) Grouping the activities into set of tasks that individuals can handle effectively.

c) Categorization of various tasks to form the basis of structure of organization.
d) Determination of interrelationship between different positions and designing of organizational hierarchy.

Analysis of Competition

In order to ensure the survival and growth of enterprise, it is essential to make competition analysis. Generally, every organization to face two types of competition:

a) Direct competition from similar products.
b) Indirect competition from substitutes.

Competition analysis must seek to identify potential competitors, the strategies adopted by them and their impact on proposed enterprise, specific advantages enjoyed by the purpose venture and formalization of strategy in consonance with these advantages. The entrepreneur must guard against being content with neutralization competitors strategic advantages. The aim should be to have superior strategies at least during the initial stages.

Field Problems of Starting a New Enterprise

Identification of a venture after a thorough analysis of the five major aspects described earlier should not be regarded as the end of all problems. Rather the real problems have been summarized in the following paragraphs.

1. **Pre-Operator Problems**
    a. Problem of selecting an appropriate form of business organization.
    b. Problems related with the acquisition of basic facilities such as sources of raw materials, power, transport etc.

2. **Problems during the construction phase**
    These would be connected with:
    I. Acquisition of land;
    II. Construction of building and other aspect of civil works;
    III. Acquisition of machinery and its installation;
    IV. Preliminary work about the sources of supply of raw materials , labor and managerial inputs;
    V. Prospecting about marketing;
    VI. Preliminary work regarding sources of working capital;
    VII. Coordination problem connected with the acquisition of different kinds of assets or completion of jobs;

Reference

Corporate Collapse; the causes and symptoms by John Wiley

Book Recommended

Entrepreneurship and small business by C L Banasal

Lesson 19

POST AND FIELD PROBLEMS FACED BY A NEW ENTERPRISE

Chapter deals with post and field this problems faced by a new concern.

1. Acquisition of land;
2. Construction of building and other aspect of civil works;
3. Acquisition of machinery and its installation;
4. Preliminary work about the sources of supply of raw materials , labor and managerial inputs;
5. Prospecting about marketing;
6. Preliminary work regarding sources of working capital;
7. Coordination problem connected with the acquisition of different kinds of assets or completion of jobs;

Unless care is taken to ensure proper sequencing of different activities, the project would have cost over-run and/or time over run. Here in some kind of PERT analysis could be quite helpful.

Post Operative Problems of a New Enterprise

Several problems can create hurdle to start any enterprise-whether small or large. They need not always arise but an awareness regarding them could enable their timely avoidance or prevention. Below are given some of the post-operative problems.

- **Lack or absence of profits.**
- **Experience factor:**
  - Unfamiliarity or lack of experience in product or services line.
  - Lack of experience in management. There is a vast difference between being a machinist and being able to manage a machine shop.
  - Over-concentration of experience e.g. focusing only on the area of interest say, sales, finance, production etc and neglecting others.
  - Incompetence of management.
- **Sale Causes:**
  - Weak competitive position;
  - Lack of proper inventory control
  - Low sales volume;
  - Poor location
  - Decline in demand due to recessionary trends in the particular industry;
  - Inappropriate marketing strategy;
  - High production costs and consequent high pricing;
- **Expense Causes**
  - Fails to control operating expenses that reduce profits and pose a threat to survival of the firm. For instance, borrowing too heavily may force business to close if debts cannot be timely paid;
- **Neglect Causes**
  - Common cases of neglect are: poor health, laziness, and family or marriage problems. Entrepreneurs need to establish priorities for themselves relative to their involvement in the firm. They must concentrate on the objectives of the firm.
- **Capital Causes**
  - Low or over estimation of capital needs;
  - Fund management;
  - Cash losses;
  - Poor debt collection or unfavorable credit terms.
- **Customer Causes:** i.e. extension of credit on liberal terms.
- **Personal Causes**
  - High rate of absenteeism &/or labour turnover;

  - Unhealthy industrial relations;
  - Frequent strikes and lockouts;
  - Low productivity;
  - Militant trade unions.
- **Natural calamities such as burglaries, earthquakes, fire etc.**
- **Government Regulations**
  - Difficulty of compliance due to excessive cost burden;
  - Interference and dilatory tactics adopted by government authorities
- **Unmindful expansion so that sufficient business is not generated to sustain expanded capacity.**
- **Environmental Causes:**
  - Changes in government policy;
  - Changes in social or political conditions;
  - Inflationary pressures leading to increases in the input cost.
- **Production Causes**
  - Technological obsolescence;
  - Low capacity utilization;
  - Inability of labour to correctly understand technology;
  - Non-availability of spares and replacements;
  - Poor machinery maintenance;

Book recommended

Entrepreneurship and Small business By C L Bansal

Lesson 20

GUIDE LINES FOR APPROACHING LENDERS – I

This lecture is dealing with the approach guide lines for approaching lenders. The lecture also explains the expectations of a lending institute from borrower.

How to Approach Lenders

You have explored all means to you to improve your liquidity. You believe you now need a short term credit from a bank to finance your trading activities. Your next step is to decide whom to approach. You should take this decision on the basis of financing sources available in Pakistan, how you rate their effectiveness and your own experience and affinities with these institutions. If cannot obtain the credit you need through them, because of the lack of resources or the weakness of the financial sector, it may be possible to you to reach overseas institutions. There are also private institutions that provide trade finance. Talk to your banker or a financial advisor before you start negotiating with your customers or suppliers. Remember the working capital serves to pay for goods and services. The type or terms of credit you obtain from a bank should be closely linked to the method of payment you use to settle your creditor's invoices, or that your customers or buyers use to pay you.

Your bank's motivations will not be the same as yours. As a lender, it is interested in obtaining a good return on money lent, and it does not want to run the risk of not being paid. It will not went to spend time and effort discussing your needs, evaluating your company, assessing your transactions and advising you without an adequate fee for such services.

Your aim is to get the best possible advice on payment mechanisms and on the most appropriate related facilities; to obtain credit on firms you afford and to ensure that you are covered for all associated risks. You will want to look at all options. Your bank on the other hand, may want to solve your problem quickly, using techniques that are well known to its staff and that involve least effort and risk. You will want the bank to consider your trade transactions on merit, be your partner and share the risks with you. The bank may prefer to avoid losing time and may simply ask for changes on your fixed and current assets as security. On the other hand, your bank is in competition with other institutions. It will want to retain you as a customer if it considers you creditworthy and a good person or company to deal with, and if you offer good growth potential.

The following sections in this lecture will examine three aspects and show how the expectations of both the borrower and the lender can be reconciled.

Bank's Lending Criteria

There are no standard criteria for short-term credit. Banks tend to set their own internal rules. Nevertheless, they are bound by general regulations and guidelines established by the state bank of Pakistan. There is usually a lending limit per customer. Banks are required to report any extra exposure to a customer or a group of related customer beyond 30% of its unimpaired capital. As per prudential regulations, the bank has to make sure also that the total accommodation availed by the borrower is not more than 10 times of the total capital and reserves (free f looses).

Another requirement set forth in the prudential regulations is that the debt equity ratio of the borrower may not exceed 60:40 and the ratio between current liabilities and current assets should not be less than 1:1. As per prudential regulations, the bank, as a matter of rule, should obtain copy of accounts of borrower related to the business, for analysis and record purpose. The requirement of the account is related to the amount of financing required.

Banks may sometimes invoke their lending criteria or statutory regulations as a pretext for not granting a facility to a borrower. There is nothing much you can do about this and in any case, it is unwise to insist on borrowing from an unwilling lender.

Your request for a short-term credit will have greater chances of success if you can satisfy the short-term lending criteria set out below.

1. **Good Cash Flow**
   As a borrower, you must show that your performance is positive and that operations are not only profitable but also generate enough cash to cover all your commitments.
2. **Adequate Shareholder's Funds**
   In other words, you must not be already over committed to other lenders, but have a reasonable proportion of your own capital in the business.
3. **Adequate Security**
   You will not obtain credit from a bank if all of your assets are pledged to other lenders.
4. **Expertise in Trading**
   Most institutions like to know that you have a good record of successful trading. It is difficult to convince a banker to lend you money if you are a complete beginner, or if you're a starting a completely different and new trading activity with untried products and unknown customers or suppliers in countries you have never dealt before.
5. **Good Reputation and Standing**
   Your references and credentials must be acceptable to the lenders. They would no doubt find it difficult to convince their loan committee or board to approve an advance to a bankrupt company or a known crook! But, even assuming that your past is without blemish, it is helpful to have a backing of a reputable sponsor. This could be a well-known person in the business, your trade association or even your customer or supplier.
6. **Specific Purpose**
   Although some lenders will be prepared to grant overdraft facilities on the basis of the security you offer, most institutions prefer to see their loans linked to specific transactions. In these cases, the transaction must be explained in full detail and shown to be profitable and self liquidating (the money borrowed will be repaid from the proceeds of the transactions to be financed).

Presenting Your Request for a Short-Term Loan

The way you approach a bank or other lending institution is all-important. Here are a few tips. Most are simply common sense ideas, and should always be guided by the elementary rules of the courtesy openness.

1. **Know whom you are dealing with**
   Unless you are already institutions customers and know it well, find out all you can about the institution beforehand. Ask those who know it about their experience with the institution. Seek advice from your trade association, chamber of commerce, or association of industry. Try to obtain a copy of the institutions annual report and see what its affiliations are, and who its shareholders and directors are. Brochures and annual reports, are normally freely available in the banks and other institutions, tell you a great deal about their structure, organization and services. Banks should also indicate their lending rates and should give you their schedule of their charge and fees for services.
2. **Give prior notice of your intentions**
   Always call up beforehand for an appointment or sometimes better still write a letter or a fax setting out briefly who you are and what you do (if the lender doesn't know you well), how much need to borrow and why. Although you can conduct your transactions by correspondence, it is usually preferable to meet the person in charge of short-term commercial lending or trade finance. If the institution is far away or abroad, this will obviously be not possible, in which case you should be particularly careful about how to introduce yourself and what information you provide.
3. **Be Well Prepared**
   Your banker is a busy person and you should come quickly to the point. State who you are, what you do, how much money you need and what you need it for. Be prepared to handover a copy of your annual report or your financial statements (balance sheet, profit and loss account, budget etc.) as well as a brochure on your company's activities or products. Always make a point of stating clearly of what you intend to do with the funds you want to borrow. If your intention is to finance the purchase of goods or services essential for manufacturing products for export, tell your banker the whole story; whom your are buying from, whom you are selling to, how you intend to pay and

get paid. It is always wise to speak to our bank about these matters before you sign contracts or agreements with your suppliers or customers or make payment arrangements.

4. **Seek Advice:**
   Experienced bankers can guide you and advise you on the risks and dangers of various payment methods, on the most suitable way to finance your transactions and on the security you should provide as a guarantee for your borrowings. You should also remember to ask about hedging possibilities to cover or reduce risks of currency and price fluctuations.
5. **But Be Cautious:**
   Resist borrowing more than you need, or for too long, or at a too high interest rate. Banks sometimes propose kinds of credits or payment methods that they are most familiar with, or that are the most to themselves or that present the least risk to them. Ask about the costs. Remember there are costs, fees, and charges in addition to the interest rate. What about front-end fees? (These are payments deduced from the loan at disbursement to cover the lender's cost of evaluating your request, assessing the risk or opening the loan account). What are the back-office fees? On each disbursement, for instance? If the bank to purchase foreign exchange or to open a documentary credit applies the advance, how much will it cost?

   Most institutions have standard or sliding scale rates for their services. Never hesitate to ask for a copy and seek guidance on how these rates will effect your transactions. If there are to be legal costs, such as lawyer's fees for drafting a loan contract or registering a charge on assets or a debenture, you should obtain clarification on these matters before committing yourself to any obligation.
6. **While Avoiding "shopping around"**
   Bankers will not like the idea of your shopping around for the best deal, visiting several institutions and making comparisons between them. If you tell them that you have found a better deal elsewhere after they have spent hours with you, drawn up documentation and obtained clearance from their loan committee, senior management or board, they will feel that you have wasted their time.

There is in fact nothing wrong in trying to get to know the banking sector and wanting the best deal. But you should avoid giving the impression that you are also talking to others after negotiations have reached the stage where the agreement is virtually finalized and awaiting management or board approval. The success of a good borrower-lender is built largely on trust. Trust is developed over time and is a result of a positive experience. The banker will often prefer to try out a prospective customer by offering small, well secured loans on a very short-term basis to see how it works. S transactions are successfully repeated, the customer's standing rises and his or her credit improves. When you approach an institution for the first time, bear this in mind. The cheapest lender may not in the long run, rove the best.

Book Recommended

How to approach Banks By ITC/SMEDA

Lesson 21

GUIDE LINES FOR APPROACHING LENDERS – II

What a Bank Needs to Know About You

This section discusses the information lenders may need to have before they can assess your request for finance. As stated earlier, it is good to policy to be as open and transparent with your bankers or financial advisers as you can. This will enable them to grasp the full situation and to give you appropriate advice. To withhold important information, such as your possible liabilities with other lenders or the fact that you have already pledged your assets, may cause difficulties at a later stage.

General Credentials

If the leader you have approached does not already know you well enough, it is best to have some general background information ready. This may include the following:

1. **Letters of introduction**
   If you are relatively new in business and not yet known in your business community, you may find it worthwhile to seek the sponsorship of someone respected by other business people who is sufficiently acquainted with you to be able to give you a reference. A short letter, setting out your achievements and testifying to your good character and integrity, is a traditional method of introduction. Its effect will be positive if the referee is a person well regarded in the business community.
2. **Your Profile**
   This is a resume or curriculum vitae, setting out your educational achievements, professional training, qualifications and experience, and your employment record and achievements. It is a helpful introduction to you and need not be longer than a page or two. If you are a newcomer to the business community, your profile will help your bank to assess your capacity for conducting trade, producing goods and services for export, and managing people. You may also want to attach to your profile any certificate or reference from former employers if you feel this will help to show up your experience and capacities, especially if the employer is known and respected, and has written favorably about you.
3. **Brochure on your business**
   Do not hesitate to hand out your company brochure. This should state what business you are in, what your products are and how long you have been trading. A list of clients or customers will be very helpful. If the list is confidential, you should say so when you give it to your banker. If you are in partnership or have directors in your company, state who they are and draw up a very brief resume on each, particularly if they have a good reputation in the business community.
4. **Bank and other references**
   If you are approaching an institution that is not your current bank, it is important for you to provide bank references that will enable the person you are discussing with to check your credentials, particularly with regard to regularity of payments, past borrowing record and general standing. You may also give the names of your accountants and lawyers if this is helpful.
5. **Proof of company ownership or registration**
   You may be asked to provide evidence that the company in whose name you want to borrow belongs to you or has been duly registered. You may also be required to provide a sworn list of assets and liabilities in the absence of audited or approved accounts. Always try to find out beforehand whether there are any particularly eligibility criteria for which you need to produce documents or statements.

Checklist for a Career Profile or Curriculum Vitae

Keep the profile or CV short – one to two pages at the most. Focus on significant information. Avoid too much detail. Your professional experience is most important part of the profile. Present your profile in the order suggested below.

Name: Your given and family names.

Personal Details: Address, telephone and fax numbers; marital status; date of birth; nationality, or residence or work-permit status if you are an expatriate; state whether you are a home-owner; list your other significant assets (property, land, interest in other companies, etc.)
Education and qualifications: Start with your most recent qualifications, stating where obtained and in what year. Include relevant courses and seminars. There is no need to go back to your primary schooling. If you do not have valid qualifications or little educational background, leave this section out altogether. Your professional experience will be your best qualification. **Professional experience:** This is the most important part of your presentation. Start with your most recent experience. For each firm you worked with, state the starting and ending dates (year or month and year), its name (if the firm is your own, says so), your job title and your main area of responsibility. Very briefly, state your principal achievements in each job held. Examples of this would be: “exported US$ 450,000 worth of cotton garments yearly to Australia over a period of four years;” “managed the firm’s assembly plant which employed 20 skilled workers and produced 850 components a month for export.”
References: You should give the names of persons who can vouch for your professional capabilities as well as your integrity in business matters. Avoid naming senior government or civil service officials.

Financial Situation
A lender will most probably expect you to produce up-to-date financial information on your business. The standard financial reports you should have ready are:

Balance Sheet, Profit-and-Loss account, and Cash-Flow Statements:
According to the prudential regulations if the loan amount is less than Rs. 2 million financial accounts of the business, signed by the borrower are required. The borrower and internal auditor of the bank, or a charted accountant must sign the accounts where the loan amount exceeds Rs. 2 million, accounts signed by a practicing Chartered Accountant, or by a practicing Cost and Management Accountant in case of a borrower other than public limited company, which is a subsidiary of a public company.

The size of your balance sheet and the amount of equity in your business are significant, but by no means has the determining factored in your banker’s decision to grant you short-term credit. Your banker may be far more concerned with the transactions that the facility will finance, as shall be explained later.

If your audited accounts are more than, say, three months old (that is, if the closing date of the accounts goes back three months or more), you should also have with you a recent operating statement and cash flow statement.

Budget for the Current and Coming Year
This document should show your projected sales and revenues for the current period or the coming year, as well as your operating costs and overheads. You should also have a separate paper showing your planned capital expenditure, if any. Your budgeted (or estimated) revenue should be sufficiently detailed to be creditable. In other words, the figures must not be simply wishful thinking but based on firm and tentative orders to which you may add orders anticipated on the basis of past performance.

Book recommended

How to approach Banks by ITC/SMEDA

Lesson 22

GUIDE LINES FOR APPROACHING LENDERS – III

The prerequisites for approaching a lender which every small and medium scale industry owner should know are discussed in this lecture.

Commercial Information

Details of orders booked: If you are requesting credit to enable you to fulfill a large or profitable new contract, it is advisable to have all the documents, correspondence, quotations from suppliers, draft contracts with buyers and suppliers, and your own costing, and calculations ready for discussion. This is all the more important if your order is for export. The credit facility you obtain from your bank will almost certainly need to tie in with the payment methods that you use with your suppliers or that are stipulated by your overseas buyers.

You are strongly advised not to sign any firm contract with suppliers or customers before you have discussed credit and payment methods with your bank. The reason is simple. Most import-export business arrangements or contracts stipulate the form of payment and the credit (delayed payment) terms the buyer or the seller offer or require. Once the contract is singed it may be too late to alter the terms and this may seriously limit the scope of the facilities your banker may be able to offer you.

Business Plan: If you have an up-to-date business plan for your company, showing intended capital investments and forecast revenue and expenditure for the coming three to five years, this is an excellent document to produce during discussions with your banker or financial adviser.

If, on the other hand, you do not have such a plan, you may find it useful to draw one up. It will be of great value to you personally, apart from anything else. It will also add to your credibility when you discuss your credit request with lenders. You should be able to prepare such a plan yourself, with the assistance of your qualified status is necessary. You may also ask an outside accountant or consultant to prepare the plan for you. The outline of a short, simple but effective business plan is shown in Box 7.

An outline of a Business Plan for a Working Capital Facility

The business

- Presentation of the sponsors, shareholders;
- Background and history of the company, business;
- Performance to date (key figures) LECTURE NO 15;
- Brief outline of the firm's objectives, strategy, and policies.

Review of past turnover and future trading prospect

- Analysis of past year's turnover by country, customer highlighting credit terms offered, payment performance and bad debts;
- Analysis of firm orders received, prospects for further orders, customer creditworthiness and payment risks.

The Market

- Survey of the market for the traded products, commodities: demand, supply, pricing, distribution, margins and profits, competition, trends.

Production or procurement

- Summary of production techniques or procurement procedures (if trading).

Inputs

- Raw materials required;
- Sources, suppliers, costs.

Organization and Management

- Internal management structure
- Ordering, invoicing, back-office procedures.

Financial data, projected results, economic justification

- Planned capital and working capital expenditure;

- Requirements for short-term credit facility and payment methods to be used;
- Cash flow of operations, transactions;
- Projected profit-and-loss, and balance sheets;
- Economic benefits of the project net foreign currency earnings.

Feasibility Study

Feasibility studies are usually carried out in connection with medium- or long-term projects and are consequently prepared, among other reasons, as an aid to raising medium- to long-term project loan finance. You may find yourself ready to start a new project or to expand an existing activity, and you need more capital to finance the additional capital goods required (e.g. machinery, tooling, spares and raw material). It will be necessary for you to produce a feasibility study for such projects for presentation to your banker during your discussions. You will also need to give your banker copies of draft or actual loan agreements with other lending institutions. These are important because the loan agreements may stipulate that you cannot borrow from another leader unless the loan is subordinated to them. This may mean that you cannot pledge fixed or current assets if the first lenders have fixed and floating charges on such assets. You may be limited to providing your bank with a second charge or some other, less secure, form of guarantee.

In many respects, the feasibility study is not dissimilar in its presentation to the business plan.

Checklist for Feasibility Study

The Business:

- Presentation of the sponsors, shareholders;
- Background and history of the company, business;
- Performance to date;
- Brief outline of the firm's objectives, strategy, and policies.

The export programme and equipment required:

- Detailed description of the proposed programme stating: buyer, goods, quantities, quality, shipment schedule, prices, shipping terms, packing conditions, inspection procedures, other formalities;
- Details of equipment required, sources and costs.

The Market

- Summary of production techniques or procurement procedures (if trading).

Production or procurement

- Summary of the market for the traded products, commodities: demand, supply, pricing, distribution, margins and profits, competition, trends.

Inputs

- Raw Material required;
- Sources, suppliers, cost.

Organization and management

- Internal management structure;
- Ordering, invoicing, back-office procedures.

Eligibility for export incentives, promotional schemes

- Benefits the business is entitled to, export premiums, concessionary loans.

Financial data, projected results, economic justification

- Planned capital and working capital expenditure (equipment and raw materials);
- Finance required to purchase equipment; credit and payment methods;
- Cash flow of operations, transactions;
- Projected profit-and-loss and balance sheets;
- Economic benefits of the project, net foreign currency earnings.

Book recommended

How to approach banks by ITC/SMEDA

Lesson 23

TYPES OF COLLATERALS/GUARANTEES / ASSETS AND PLEDGE TECHNIQUES FOR SECURITY

This lecture deals with the types of collaterals /guarantees/assets and pledge techniques for security.

Guarantees or Collateral You Can Offer

Not many lenders will consider granting you, or anyone else for that matter, a loan without security. The question will come up early in the discussion. What guarantees or collateral can you offer? The terms collateral and security really mean the same thing. They are guarantees you give to lenders by pledging assets, which they can seize and sell off, if you do not payback the loan. . There are other forms of guarantees that can secure a loan, such as an insurance policy to the benefit of the lender, or an understanding by a third party to repay the loan, should default. The point is that, whichever way you turn, you will obtain a satisfaction from a lender only if you have something to offer should you default in your repayment obligations. The most common form of security is a charge (a pledge) on fixed assets, particularly land and property. Most lenders feel that land and property are readily marketable if this means selling them off at a price below their market value. Moreover, land and property are evidenced by the title deeds and, in many countries, the authority's register these titles and any encumbrance would also be noted when an asset is encumbered, it means another party has a valid claim on it. When an asset is pledged to a lender, it is encumbered and it cannot be pledged a second time to another party unless the two parties agree to share the security.

Other fixed assets can also serve as a security: machinery, equipment, vehicles and suchlike. But it is often impractical for a lender to consider these as security because their market value is often difficult to determine, especially if they are not new. Instruments are sometimes acceptable to the lenders as collateral, particularly if they can be easily realized (sold). These are evidenced by share certificates of the companies listed on the stock exchange, bonds, debentures, treasury bills etc.

You can pledge current assets: stocks of raw materials, finished goods, and commodities for exports, even receivables. The easiest net asset to pledge is cash. This is called cash collateral. Your loan is secured by money! In practice, borrowers resort to this form of security when they have liquidity in another bank, which they do not want to touch. (It may be in another currency or tied up in investments. It may be funds owned by a third party or even by the borrower, but not part of his or her business).

When you approach an institution for short-term credit, it is useful to have a list of assets that you are prepared to pledge as a security for the loan. If these are fixed assets for which you have the land or other property titles, bring copies with you to show the bank. If you have marketable stocks of raw materials or finished products or, better still, internationally quoted stocks of commodities that are not yet sold, bring warehouse receipts or inventory lists with you. If you do not have warehouse receipts, delivered by a third party and attesting to the quantities or values of the commodities stored, you can usually obtain a certificate from an inspection company evidencing the quantity and quality, sometimes even the price or value, of the goods stocked. Your list of receivables is also useful, because your bank may say that it would be willing to discount some of them, purely and simply, rather than lend you money.

Financial institutions rarely lend the full value of the security taken. The reason is plain enough: should they need to sell the security because of default in the payment, the price they obtain may be less than the value of the loan. The amount of cover needed for loans varies from country to country and asset to asset. In some cases you may to pledge assets worth two or more times the amount of the loan.

Typical Collateral

- **Land and buildings**: first, second mortgages, debentures on property;
- **Other fixed assets:** charges, debentures on machinery, equipment, vehicles;
- **Share certificates** in the borrowing company;
- **Guarantees** from banks, other institutions, export credit guarantee and insurance schemes, third parties;

¾ **Cash; Receivables:** invoices, bills, promissory notes;
¾ **Stocks or inventories of finished goods**, commodities, warehouse receipts;
¾ **Raw materials;**
¾ **Investments,** marketable securities.

Negotiating Short Term Credit

Negotiating with a lender (who should be ready in principle to grant you a short-term facility) relies more on how well you are prepared than on any particular bargaining skill. A good knowledge of your business and a sound grasp of all the facts and figures on your results, current situation and prospects are the most convincing arguments you can put forward. As already stated, lenders aim to get a good rate of interest on their money at a little risk. They will probably prefer the types of facilities and payment methods that their staffs are most familiar with, and which do not present too much back office effort or time. As their time is precious, lenders will try to obtain fees for services rendered.

Negotiations should benefit both the parties and each must come away feeling satisfied with the outcome. The relationship will perhaps develop into a long-term one, with the bank growing to appreciate and trust you as transactions develop and your business expands. Bankers are also keen to keep good customers. Banks work in a competitive environment and will vie with one another to get business. If your bank likes to deal with you, because it is pleased with they way the transactions are conducted and there is a feeling of mutual satisfaction and loyalty, your negotiation position will be strengthened and concessions will be granted in your favorite in due course. But building up such relationship will take some time. In the beginning you may have to bear higher charges and pay more fees, because you are new to the financing sector and must first demonstrate your worth.

Obtaining the Most Favorable Terms

There are many ways of arranging a credit package, especially as a far as the trade finance is concerned. Always inquire into the cost of the facility offered and compare this cost with those of the alternatives. If you are able to show the bank that it would be cheaper for you to obtain the same result using another method, point this out tactfully but firmly. But know your facts. If, for some instance, the bank's interest rate is higher than the bank rate your supplier is prepared to accept for trade credit, state it clearly and be prepared to show a letter to that effect.

In foreign trading, it is virtually impossible to avoid the banking system if you are an exporter or an importer. Most payment methods require a third party to hold money or documents in trust until an obligation is satisfied. The credit you obtain from your bank may be used by the bank itself to pay your supplier (e.g. by opening a documentary credit) or to give you an advance until payment is made by the foreign buyer, with the bank reimbursing itself from the proceeds of the export transaction.

Seek the bank's advice on the different methods of payments and credit facilities available. Don't stop at the list given in the bank's brochure or leaflet. Explore all the possibilities, but remember that your banker will be more knowledgeable than you are about the risks, advantages and drawbacks of each system if you are new to the business. Tact and diplomacy are useful; avoid marring relationships that could prove invaluable later on. It is also worth remembering that the financial sector is a close-knit community despite the competition among its members. A banker will ask for and will easily obtain references on a customer from another bank. Getting the most favorable terms is not only the matter of obtaining the lowest interest rate.

> **Note***:* fees, commissions and charges vary from bank to bank but the difference is quite significant. In the case of a documentary credit, for instance, the fees are quite high-the issuing bank charges around 0.4% on issuing the documents, around 0.25% is charged by your bank on arrival of the documents, and for each service rendered, the bank will charge a fee importers are strongly advised not to accept payment terms before being sure of the amount of the fees, charges or commission that may prove to be very expensive in the country from which they are buying. You may in this case ask your bank to enquire about the level of such costs in the country from which you are importing. The best terms for yourself must also include what is most convenient for you. Avoid for instance, tying up fixed assets if you know you are going to

need them as a security for a medium-to longer term loan in a few months to finance the purchase of the capital goods such as vehicles or machinery.

Checklist for Commission Fees and Charges

- **Appraisal Fee (Or Front-End Fee):** Percentage of total facility paid up front, often as a deduction from principal disbursed. Amount varies from one institution to another.
- **Commitment Fee, Interest Rate Per annum on Un-Disbursed Portion of Facility**. This is often waived. Rate usually varies from ½% and 1%.
- **Interest on Outstanding Principal, Overdrafts Expressed as a Per Annum Rate**. Rate may reflect lender's assessment of risk. Low rates may be available through incentive schemes for exporters or for development components considered for special economic benefit to the country. (The method of calculation varies from one institution to another. You should make sure this method is thoroughly explained to you. Fro instance, interest may be calculated on day-to-day balances, or on monthly overdraft ceilings, on a 360-day year and so on)
- **Legal Costs and Charges**. Expenses incurred in preparing the legal documentation and drawing up charges, debentures. Mortgage fee 1% of the mortgage value, insurance@ 1 % of the sum ensured, stamp duty @ 1% of the value, registration fee 2% of the mortgage value.
- **Revenue Office Fee:** Disbursement fees. Amount charged by the lender as a flat fee at each disbursement if there is more than one.
- **Charges for Payment Facilities, Services**. Fees and commission charged for opening and confirming L/Cs, collection and other sundry services rendered by the banks.
- **Discount Rates**. Percentage taken by the bank for discounting receivables

Finally, always keep in mind the purpose of borrowing. To survive in the business, you have to be competitive, which means in minimizing costs and overheads. If you borrow, it must always be the better alternative to not borrowing, and this can only be so if the terms and conditions are right. If the financial charges and related costs of borrowing are not to your advantage, and risk putting you into a situation where you are no longer competitive as a manufacturer or trader, make this clear to your banker and turn down his offer to credit unless he is prepared to revise his conditions. The banks must always be your partner in competitiveness.

Improving Your Negotiating Position

Obtaining short-term credit from your bank is hardly likely to be a one-off affair. The chances are that, after the success of your initial transactions, your business will grow and you will become a regular customer for credit facilities. How can you then improve your negotiating position?

"Be a good player" is the first and foremost rule. Build up your reputation as someone who always pays on the dot. Be particularly careful to honor interest payments on time. Interest payments are the bank's revenue and affect its operating results. Banks have to apply stringent credit risk management rules, usually enforced by regulatory bodies for the banking system. If interest is paid late, banks may have to constitute provisions for risky debts and this affects their balance sheets. Late payment will give you a bad mark and you may become branded as a poor payer and a risky debtor, making it harder or more expensive for you to borrow in the future. Being punctual with your interest payments does not mean that you can be late with the payment of the installments on the principal.

They are also important but, because loans to customers are assets on a bank's balance sheet, they lose their value (through the constitution of provisions) only if the amount due is outstanding for more than two or three months after the schedule repayment date. This means that a bank will not be too worried if you are a week or so late with your payment of the installment on principal. But the golden rule is to let the bank know beforehand. Do not wait until you receive a reminder or a curt telephone call. Explain as early as you can that there may be a delay, owing to late payment, for instance, by a customer. Provide the bank with supporting evidence of the fact that you will be getting the funds in due course (for instance, a written undertaking from your customer or an accepted bill or a promissory note). Your bank may even be able to assist you by discounting receivables to improve your liquidity or advancing your money against warehouse receipts

Book recommended
Entrepreneurship and Small business Management by CL Bansal

Lesson 24

ASPECTS OF FINANCIAL MANAGEMENT

All businesses need sound financial management and small firms are no exception to that rule. Proper management of account s with Performa cash flows, profit and loss accounts and balance sheets are essential if a firm is to survive and prosper, as is variance analysis comparing what was planned and with what actually occurred.

Aspects of Financial Management

- ¾ Winning the Cash Flow War.
- ¾ Understanding the Nature of Profit.
- ¾ Breaking Even.
- ¾ Working Capital Management.

Winning the Cash Flow War

Most of the business founders think their problems are over once customer starts to roll in. Unfortunately they may have only just begun. One of the common characteristic that new and small businesses have in common is a tendency to change their size and shape quickly. In early weeks and months customers are few and each customer mean a large percentage increase in sales.

A large increase in sales in turn means an increase in raw material and perhaps more wages and other expenses. Generally these expenses are to be met before your customer pays up. But until the money comes in, the business has to find cash to meet its bills. If it cannot find the cash to meet these day to day bills the business very often goes bankrupt. Bankers have a name for it. They call it over trading. It means taking on more business than you have the cash to finance. Sales growth is a natural to successful new business as physical growth is to baby. And just as baby runs out of clothes, new businesses run out of cash. The following measure will help you to minimize the need for extra cash to finance the sales growth.

1. **Send Bills Out Promptly**
   Have a list of debtors, who owe money must be chased up for payment. It is good idea to list the debtors by age of debt as this shows who owes how much and for how long. Take non-nonsense approach with them and stop suppliers to people who take too long to pay or threaten to sue.
2. **Check Credit Ratings**
   Before taking on a new or big customer have them checked out. If they are blue-chip you may be able to factor the debt and get up 80% of the cash owed immediately. Alternatively, offer discount for cash and charge interest on over due amount.
3. **Keep Stock Levels Down**
   The chances are that the opening stock will be out of line with customer demand. After all, before the start companies have to guess what will sell. Once a pattern develops to emerge, order accordingly. Too many new ventures spend all their cash on opening stock.
4. **Take Credit**
   As rule of thumb successful business men and women try to take as much credit as they are giving. So if their customers take a month to pay, they aim to take a month's credit from their suppliers.

Understanding the Nature of Profit

A significant number of small business firms operate largely on a cash basis. That is, most of their transactions and income come in either as cheques or in folding notes. While it is certainly very pleasant to; be able to conduct your business affairs in this way. Cash can often give rise to misleading signals. The whole problem arises from the difference between accounting definition of Profit and common-sense definition of cash. Cash and profits are not same thing, even in cash business, and a business need both cash and profits to survive. To make matters even more confusing, there are at least three sorts of profit to keep track of. The fundamental difference between cash and profits can best be explained under the following heading.

a. **The Realization Concept**
A particularly prudent sales manager once said that an order was not an order until the customer cheque had been cleared, had consumed the product, had not died as a result and finally, had shown every indication of wanting to buy again. In accounting, income is usually recognized as having been earned when the goods (or services) are dispatched and the invoice sent out, not when an order is receive, or on assumption of firm order, or expectation of prompt payment.
If it is possible that some of the products dispatched may be returned at some later date. This means that income and consequently profit can be achieved in one period. And have to be removed later on. Obviously, if return can be estimated accurately, then an adjustment can be made to income at the time.

b. **Cost of Sale**
Obviously the goods which have not yet been dispatched must still be held in stock. A vital calculation is that of how much stock has been used up over the period. This is calculated by adding the opening stock to any purchase you have made and taking away the stock that is left to get it right.

Stock used over a period = Opening stock + purchases – Ending Stock.

The materials used in business are usually a major element of expense and as such are separated from the rest of expenses. For a manufacturing company materials are easy to define. For service business the sum is less obvious, but still necessary.

c. **Matching Expenses**.
Expense is a general name given to the cost incurred in selling marketing, administrating, distributing and advertising a company's products or services. Some of these expenses may be for items not yet paid for. The profit and loss account sets out to "match" income and expenditure to the period in which they were incurred.

Breaking Even

While a business has difficulty in raising start-up capital paradoxically one of the main reasons small businesses fail in the early stages is that too much start-up capital used in buying fixed assets. While some equipment is clearly essential at the start, other purchase can be postponed. This may mean "desirable" and labour saving devices have to be borrowed or hired for specific period. This is not as nice as having them to handle all the time. But if the photocopiers, minicomputers, typewriters and even delivery vans are purchased into business they may become the part of fixed cost. The higher the fixed cost the longer it usually takes to reach breakeven and then profitability. But small business has to become profitable relatively quickly or it will simply run out of money and die. Difficulties usually begin when people become confused by different characteristics of cost.

¾ **Fixed cost** is a cost which remains fix in total but varies per unit of sales, e.g. rent of the shop or salaries of employees.
¾ **Variable cost** is a cost varies in total but remains fixed per unit of sales, e.g. direct material, direct labour. Here is an example; if rent is \$10,000.The angled line running from the top of the fixed costs line is the variable cost. In this example we plan to buy at \$3 per unit. so every unit we sell adds that much to our assets. Only one element is needed to be calculated is breakeven point. We plan to sell it out at \$5 per unit. So this line is calculated by multiplying the units sold by that price.

The breakeven point is the stage when a business starts to make a profit, when sales revenue begins to exceed both fixed and variable cost.

Breakeven Point formula

Fixed Costs	=	Selling Price–Unit Variable Cost
Breakeven Point	=	Fixed Costs / (Selling Price–Unit Variable Cost)
Breakeven Point	=	10,000 / (5-3)
	=	5,000 units

Profitable Pricing

To complete the breakeven picture we need to add one further dimension-profit.

It is a mistake to think that profit is an accident of arithmetic calculated at the end of year. It is specific and quantifiable target that you need at the outset.

$$\text{Breakeven Profit Point Formula} = \frac{\text{Fixed Costs} + \text{Profit Objective}}{\text{Selling Price} \quad \text{Unit Variable Cost}}$$

Let's go back to our previous example. If you expect a return of say $4,000 then:

$$\text{Breakeven Profit Point Formula} = \frac{10000 + 4000}{5 - 3}$$

Breakeven Profit Point Formula = 7,000units

WORKING CAPITAL

Working capital management or current asset management is one of the most important aspects of overall financial management in an enterprise. It is basically concerned with the management of current assets and current liabilities and inter relationship between them.

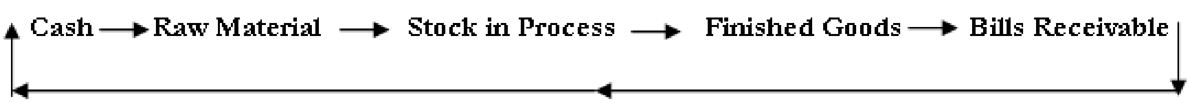
Meaning of Working Capital

Working capital is the amount of funds needed by an enterprise to finance its day to day operation. It is the part of capital employed in short-term operation such as raw materials, semi finished products, sundry debtors. Because of its variable nature, the working capital is also referred to as circulating capital. It may be pointed out that the total working capital is composed of two parts.

1) Regular Capital
2) Variable Capital

Regular Working capital is required for permanent investment in any business for holing certain minimum quantity of raw material, finished product or cash. Such investment is irreducible minimum and remains permanently sunk into business.

The remaining portion of working capital is variable. The variable portion first gets tied up into raw materials which are then converted into finished goods. On the sale of goods it gets converted into account receivables or cash and circle is then completed. It is depicted in following figure.



Working Capital Cycle

Different Senses of "Working Capital"

The term working capital is usually used in two different senses namely.

1) Gross Working Capital
2) Net Working Capital

Gross Working Capital

It represents total value of current assets. In other words, it is the sum total of net working capital and current liabilities. It is a quantities concept showing the total amount available for financing the current assets. It cannot reveal the true position of the company. For instance, every increase in borrowings will increase the gross working capital but net working capital will remain the same.

Net Working Capital

It represents excess of current assets over current liabilities. Current assets include cash, debtors, stock, and bills receivable, Current liabilities include bills payable, accounts payable, expenses payable. It indicates the liquidity position of an enterprise i.e. the soundness or otherwise of the current financial position. The ratio of 2:1 between current assets and current liabilities is considered sound. The concept of net working capital is quantitative concept indicating firm's capacity to meet operating expenses and current liabilities. Net working capital is increased only when there is an increase in current assets without corresponding increase in current liabilities.

Net Working Capital = Current assets – Current liabilities.

Significance of Working Capital

- Conversion of cash into inventory.
- Conversion of inventory into receivable.

- Conversion of receivable into cash.

These events constitute operating cycle of business. If all these events could happen simultaneously, there would not arise any need for working capital. Since cash inflows and cash outflows do not match, an organization need necessary cash and liquidity to be able to meet its obligations. Thus adequate capital is required for smooth operation of any business concern.

Sound working capital management results in maximization of productivity and Profits. It requires the maintenance of proper balance between working and fixed capital, so as to maintain both profitability and solvency. Proper management synchronizes cash receipts and cash outlays.

For small concerns, efficient working capital management is still more essential to ensure purchase of inputs at competitive prices and timely payment to factors of production. It may be noted that shorter the gap between spending of money on production of goods and the recovery of money through rapid sales turnover, the better shall be the quality of working capital management.

Factors Affecting Working Capital Requirements
In case of a small enterprise, the various factors affecting its working capital requirements.

1. **Size of Business**
   What are the size of unit and the volume of business?
2. **Nature of Process**
   Nature of production process i.e. lengthier the duration of production, higher shall be the working capital needs and vice-versa.
3. **Proportion of Raw Materials and Total Cost**
   Proportion of raw material to total cost must be decided.
4. **Terms of Sale & Purchase**
   Terms of sale and purchase e.g. sales are on cash terms, lesser working capital will be sufficient.
5. **Turnover of Inventories**
   If inventories are large and their turnover is slow, larger working capital would be needed.
6. **Labour Vs. Capital Intensive**
   Labour vs. capital intensive, the former requiring higher amounts of working capital.
7. **Cash Requirements**
   Cash requirements will have direct impact on working capital quantum.
8. **Banking Facilities**
   Availability of goods and dependable banking facilities reduces working capital needed.
9. **Seasonal Requirements**
   Seasonal requirements may push up the amount of working capital needed.
10. **Contingencies**
    If the demand and prices for small concerns products are subject to wide fluctuation, contingency provision will have to be made for arranging higher amounts of working capital.

Determination of Working Capital Needs
Working capital requirements of a small enterprise vary from unit to unit and in accordance with the difference on the nature of the enterprise. Broadly speaking, working capital should be adequate to meet operating expenses like raw materials, labour, factory and other overheads etc. Operating expenses can be ascertained from the final accounts of the firm. But the working capital requirements needs not be equal to the level of expenses. Operating cycle is of primary significance in every case.

$$\text{Working Capital Requirement Formula} = \frac{\text{Operating Exp in Previous Year}}{\text{Number of operating Cycles in Year}}$$

Ingredients of Working Capital Management in Small Enterprise

1. **Budget the Material Requirements**
   Budget the material requirements and devising a proper system of control.

2. **Production Goes on Uninterrupted**
   Ensure that production goes on uninterrupted so that there id minimum blockage of working capital in the production process.
3. **Realize Cash Fast**
   Expeditious dispatch the finished goods to realize cash fast.
4. **Follow the Bills**
   Follow the bills for early realization of cash.
5. **Identify Surplus Cash**
   In the field of cash management, clearly identify the quantum of really surplus cash which could be utilized to meet financial obligations.
6. **Working Capital Sources**
   Ensure proper management of working capital sources so that there is no costly fund rising. There must be a judicious blending of different resources so that sufficient funds are raised at the cheapest cost.

Lesson 26

RECRUITMENT, SELECTION AND TRAINING – I

Talented employees are the key assets of the company. The problem with small business entrepreneur is that it cannot afford the luxury of a full time specialist in personnel area. The entrepreneur himself is generally a novice and tends to look after this aspect rather haphazardly. Either the owner personally takes care of the personnel function or delegates it to an employee who performs it along with his main job. The general tendency is to hire the first person who comes the way and accepts the lowest salary. Their basic thrust is on marketing, regarded as primary to existence.

Defining Job Requirement

The pre-requisite to efficient selection is the systematic defining of requirements of each task. The identification process has three phases;

- Conducting job analysis,
- Developing job descriptions, and
- Preparing job specifications.

Job Analysis

It is the process of investigation and collection of pertinent information about each task in terms of skill, abilities, duties and responsibilities. It covers;

a) Job title,
b) Department to which it relates,
c) Line of supervision,
d) Description of job including major and minor duties
e) Relationship with other jobs i.e. promotional avenues. Transfer, possibilities, experience required etc.
f) Unique job characteristics (location, physical setting),
g) Type of material and equipment used,
h) Educational qualifications,
i) Experience,
j) Mental and manual dexterity,
k) Physical requirements,
l) Working conditions.

Job Description

It consists of a written statement of the major and minor duties involved in each task along with a description of responsibilities, work conditions and task requirements e.g. hazards, time involvement etc. The job description, therefore, focuses on what, why, when and how tasks are to be performed.

Job Specification

It describes the salient features of the person expected to fit in the job. It enumerates qualities, knowledge, skills and abilities an individual should possess to perform satisfactorily along with such other characteristics as planning, leadership and decision-making abilities, experience, education etc. It provides a standard against which to measure how well an applicant matches the job.

Recruitment- Engaging the Employee

It is the translation of job specifications into actual recruitment of the employee by exploring main sources of supply. The major sources of supply could be;

1. **Current employees or references** i.e. asking friends and acquaintances to provide a good person.
2. **Newspaper advertisement** specifying the requirements of the position to attract individual with appropriate qualification.

3. **Drop-in applicants** i.e. individuals who occasionally drop in to inquire if any job is available. It is better to take down sorn e information relating to them.
4. **Unsolicited application** i.e. those who may have applied in anticipation of vacancy. Maintenance of record of them could be advantageous.
5. **Technical journals** to look up to candidates with specific technical qualifications and backgrormd.
6. **Universities, colleges and technical institutes.**
7. **Employment agencies-** public and private.
8. **Former employees** who may have voluntarily quit.

Lesson 27

RECRUITMENT, SELECTION AND TRAINING – II

It involves a number of activities which may be performed either by the owner-manager himself or with the assistance of specialists. Following is the process of selection.

¾ **Application Blank**
It contains a written record of candidates qualifications, name, experience, references etc. from a perusal of the record, a broad idea can be formed about the applicant' potential.

¾ **Personal Interview**
The purpose of this interview is to ascertain technical competence of the candidate and his capacity to meet the requirements of the position. The fundamental mistakes committed in interviewing are;

1) Not spending enough time analyzing the requirements of the job to be filled.
2) Failing to ask right questions to test strengths and weaknesses of the candidate,
3) Relying too much on gut reaction instead of making an objective analysis.

¾ **Checking References**
References listed by the applicant should be cross – checked through telephone and preferably through a written letter.

¾ **Employment Tests**
Though not a sole criterion of selection, these tests are making the employee selection more efficient. These are;-

1) Aptitude test to measure mechanical, electrical, manual dexterity and other potential talent.
2) Achievement test to measure performance (skill proficiency)
3) Intelligence test to measure general mental abilities e.g. verbal ability, reasoning, comprehension etc.
4) Personality test to select managers.

¾ **Final Interview**
It is designed to final impression based on earlier assessments and particularly to ascertain interpersonal competence (capability to go along well with others), whether he has autocratic/democratic disposition, cooperativeness, rigidity flexibility. The interviewer should do well to adopt a balanced approach. He should guard against "Halo effect" i.e. forming rational judgment on the basis of first impression. What happens is that the interviewer forms a favorable or unfavorable impression of the applicant very early and searches for confirmation. To guard against it, the interviewer should withhold judgement until after the interview.

¾ **Physical Examination**
Physical examination to determine whether the prospect meets health standards demanded by the job.

¾ **Orientation**
The new employee should be provided thorough orientation regarding company policies and specific nature of the job. It markedly reduces apprehension during the first few days of the employee. He should be introduced to colleagues, explained as to how the job fits into overall goals of the company, the operations and conditions of employment. Some employers have" Employee Handbooks" containing written information about salient aspects of company e.g. company's expectations of employees, pay-policies, working conditions, fringe benefits etc.

¾ **Wage and Salary Administration**
Principal object of a compensation plan is to motivate employees to achieve higher levels of performance. Following are the elements of wage and salary administration.

1. Wage & Salary Level.
2. Wage & Salary Structure.
3. Individual Wage Determination.
4. Method of Payment.
5. Individual Compensation or fringe benefits.
6. Management Control.

Wage & Salary Levels and Structure
The wages should be established by reference to the following:-

1. Prevalent Wage Levels in Industry.
2. Compliance with Minimum Wages Laws and other enactments governing compensation.
3. Standards and Values of the entrepreneur.
4. Consent of Trade Union.

By adhering to the above, a small firm can hire and retain productive work force.

Wage Determinations and Method of Payment
Determination of compensation for each position is the second step in salary administration. More responsibilities and more difficult a job, higher should be the pay-packet. Also establish a range of compensation for each position. The wage structure must be such that the staff has the motivation to work for vertical movement. The incentives and fringe benefits associated with each position should also be settled. To attract qualified, hardworking and loyal staff, small firms may introduce special awards. Benefits to be offered to managers pose special problem. The popular forms of benefits given to them include:

1. Stock Option.
2. Profit Sharing.
3. Use of Company Vehicle.
4. Club Membership.

Small firm should use its limited resources carefully and devise a productive salary administration. Broad objectives of a good salary program include; maintenance of competitiveness, capacity to attract managers of superior caliber, rewarding superior performance and motivating staff to achieve higher production levels. Two more ingredients of efficient compensation plan are:-

1. It should link reward and performance,
2. It should ensure payment of reward as soon as after achievement.

Compensation plans suitable for small businesses are:-

1. Straight salary.
2. Hourly wage-to reward employees whose work is difficult to measure or where employer has no control over output.
3. Piece rate.
4. Commission based on sales.
5. Combination of salary and commission.

Lesson 28

TRAINING AND DEVELOPMENT

Objectives of Training

1. To improve job performance.
2. To develop employees for new responsibilities.
3. To prepare employees for promotion.
4. To reduce accidents and wastage.
5. To instruct in the operation of new equipment.
6. To ensure management succession.

Effective management succession requires prior planning. Seemingly simple matter has special problems in the case of small business particularly when it comes to its practical implementation. The entrepreneur is moulded in thinking in a groovy fashion. Moreover, training is not a one time job. It is a rather continuous process. Training seeks to upgrade an employee's knowledge to keep abreast of changes in competitive business environment and prepare for advancement to challenging opportunities.

Before initiating a training Programme, the owner/manager should ascertain as to what training would induct change. Change herein implies the attainment of improved ability. The change should benefit both individual and organization. The change should occur in the following five areas:-

1. **Knowledge**
   It refers to the storage of information by an individual for use in problem-solving and decision-making. Greater the amount of knowledge, better equipped shall be a person to accomplish a job.
2. **Attitude**
   It is a state of mind which creates an urge to work for personal and organizational growth.
3. **Ability**
   It is the proficiency in performance of a given task.
4. **Job Performance**
   It measures how well the individual meets the requirements of a position.
5. **Operational Results**
   These indicate how well the organization has been able to achieve its objectives and goals.

Conditions Facilitating Training and Development in Small Company

1. Existence of a board that insist on management succession program and its follow up.
2. Steady growth of company which stimulates the need to prepare staff for foreseeable change.
3. Recognition of need for training by the entrepreneur who devotes his time and energy towards it.
4. Freedom given by entrepreneur to young executive to new experiment with new ideas and accept risk connected with it.
5. Degree of delegation of responsibilities.

Methods of Training

1. **On-the-Job Training**
   It is the most practical and most often used technique in small business. Depending on the complexity of task and experience level of the employee, the training may vary from few hours to several days. Training of this kind is given in three phases.
   a. **Demonstration**
      The job is demonstrated and each stage is explained. It is done slowly so that trainee can ask questions as well as provide feedback on his understanding of work procedure.
   b. **Performance**
      Performance i.e. the employee applies what he has learned in the preceding.
   c. **Inspection of work**
      Inspection of work of employee is to provide immediate reinforcement of correct method of performance.

2. **Apprenticeship Training**
   Apprenticeship training is the from of training that combines both formal classroom learning and on-the-job training experience particularly in technical cadres.
3. **Job Rotation**
   It is particularly beneficial in the case of small companies wherein each employee has through understanding of different functions. Employees are moved from job to job for few days. It helps employees combat the problem of monotony and boredom because of varied work experience.
   Group Training Through Conference Method.
   Major advantage of this technique is that participant has opportunity to express their viewpoint and share their experiences through a discussion of a common problem.
4. **Heir Apparent Technique**
   In it, entrepreneur identifies the person to be trained for management succession. He is encouraged to learn every facet of company's functioning. He is rotated trough various positions of the company and is gradually given increasing responsibility.
5. **Off the Company Premises Training.**
   It includes:
   a. University & Technical College.
   b. Correspondence Course.
   c. Training Films.

Evaluating Training Needs in Small Business

The evaluation of training needs in a small business can be done by asking the following.

1. What are the objectives of training?
2. What do employees need to learn?
3. How much will the program cost?
4. What will be the method of instruction?
5. What kind of physical facilities would be needed?
6. What shall be the duration of training?
7. Who will conduct training?
8. How will effectiveness of program be measured?

Lesson 29

LEARNING IN AN ORGANIZATION

Conditions that Stimulate Learning

¾ **Behavior of Boss**
Boss is the key figure in an organization. Others tend to emulate him. Every meeting between boss and subordinate presents a teaching learning situation. If the boss favors training and development, the subordinates tend to become positively inclined to learn. Therefore, the boss should exhibit a tendency towards learning and training.

¾ **Behavior of Informal Group.**
Informal groups set the behavior norms for its individual members. It may either support or resist the introduction of any change. If the informal groups support training, measure would find a motivated group inclined towards obtaining it.

¾ **Influence of Formal Organization.**
The organizational structure, policies, procedures, objectives etc. reflect and reinforce the behavior which the formal organization prizes. For instance, if the company keeps the top management within the family or has rigid control, would little opportunity for growth. Learning is stimulated when there is openness, lack of constraints and climate of exploring new ideas and the objectives of the organization support training and development.

¾ **Economical &Technological Influence.**
A rapidly growing company in an expanding field offers more opportunities through training.

¾ **Performance Appraisal**
It is a form of counseling and coaching. It is used for defecting and correcting errors. It is the process by which owner gathers information about each employee's performance, effectiveness and communicates the same to employee. It includes

a Establishment of Standards.
b Recording of Performance.
c Reviewing of Performance in accordance with Standards.
d Taking Corrective Action.

¾ **Purpose of Performance Appraisal**

a To evaluate performance over a specific time.
b To motivate employees through performance feedback.
c To evaluate individual employee's potential for growth and development.
d To collect information for decision making.
e To evaluate effectiveness of training program.

Limitations of Performance Appraisal

1. **Limitation of Job Description**
People are unique. The same job may be performed differently by different people. The same is true of conditions within the organization. While framing position description, the managers attempt to find some congruence between the job description and their knowledge of requirements. No wonder, the position description may not be totally correct.
2. **Inadequacy of Appraisal and Problem of Reliability**
Many of the items that are included in appraisal such as initiative, quality of work, cooperation, adaptability etc. are subject to personal standards of the appraiser. Bias and prejudice are common failings of every individual. Therefore no appraisal can be considered as absolute. Due to these defects, ratings tend to vary widely and raise doubts about their reliability.
3. **Impediments in Communication**
Managers insist on fair criticism, based on performance appraisal. The employees, however, regard it as censure and tend to adopt a defensive mechanism against it. Therefore, there arise conflicts which make the goal of appraisal self-defeating.
4. **Failure to Motivate**
Appraisal procedures are not designed to provide motivation impact. The urge to change must come from within the individual. There is too long a gap between the act and its consequence and hence its failure to play any significant role in motivating the employee.

Employee Morale

Morale is the attitude of the employee towards factors in the work environment such as job, pay, superiors etc. Since it is an attitude, it can not be measured as the profits. Therefore indirect techniques are used to measure the morale.

Indirect Techniques to Measure the Morale

One such technique is" survey" in it employees are asked to check how they feel in a particular factors in a company. Another method of collecting morale data is" descriptive" survey wherein employees are asked to provide descriptive answer to question.

1) Indicators of employee morale:
2) High employee turnover ratio.
3) Higher number of accidents.
4) Lower productivity.
5) Increased number of defective output.

Discipline

Disciplinary problems arise due to lack of knowledge, Lack of interest and Carelessness. The following acts call for disciplinary action:

a) Disorderly conduct: reporting for work under the influence of liquor.
b) Dishonesty
c) Obtaining employment by using false or misleading information
d) Violation of safety procedure
e) Gambling
f) Excessive Tardiness
g) Insubordination.

Types of Discipline

Progressive Discipline

It consists of minimum disciplinary action for first offence. The degree of punishment increases for subsequent violations. It may be in the form of oral warning, reprimand, written warning stating consequences of future violation, disciplinary lay off, demotion, discharge etc.

It should have following ingredients:

a) A forewarning
b) Immediate action
c) Consistent
d) Impersonal administration

Positive Discipline

1) It is the most effective type of discipline since it corrects and strengthens an individual. Guidelines in this behalf are:
2) Disciplining should be done in private and never in front of fellow employees.
3) Concentrate on mistakes than on individual.
4) Listen to the employees so as to get complete facts and clarify misunderstanding.
5) Explain not only that something is being done incorrectly but also on as to why employee should be doing it the other way.
6) There must be no favorites and privileged.
7) Provide for appeal against decision considered unfair.

Lesson 30

QUALITY CONTROL – I

Breadth of Scope

- Raw Materials and Piece Parts Inspection.
- Vender Relation.
- Process Control.
- Motivation of Employees.
- Reliability

What is Quality?

Quality is Conformance to Given Requirement or Specifications on a Product or Service.
The term quality by itself does not necessarily mean high quality. It means uniformity, consistency and conformity to what user wants.

Two Aspects of Quality.

- Design Quality.
- Manufactured Quality.

Design Quality

- Design Quality Covers (materials, form, appearance, functions)
- When Reference is made to "high cost of quality" such Reference is Almost Associated with Design Quality.

Manufactured Quality

Manufacturing is the transformation of raw materials into finished goods for sale, or intermediate processes involving the production or finishing of semi-manufactures. It is a large branch of industry and of secondary production. Some industries, like semiconductor and steel manufacturers use the term fabrication.

- After Designing Product has been placed to Manufacture. Defects in Material, Parts, and Subassemblies May Arise.
- Poor Quality is the Result of Poorly Controlled Manufacturing Process.

What is Quality Control?

In engineering and manufacturing, quality control or quality engineering is a set of measures taken to ensure that defective products or services are not produced, and that the design meets performance requirements.
Quality Control Principles and Methods have been developed and have Proved Effective in Bringing about Cost Reduction & Improved Quality.

- Quality Control has Many Aspects.
- Its Techniques are Statistical.
- Its Motivation is Responsibility of Top Management.

Statistical Quality Control

Process of Application of Statistical Principles and Techniques in Stages of Design, production, maintenance and Service. Statistical Process Control or SPC is a method for achieving quality control in manufacturing processes. SPC relies on measuring variation in manufacturing output and setting control limits based on observations of variations arising solely from common causes. A process that is "in control" is expected to generate output that is within the control limits. If the process produces an "out of control" point, one would not necessarily assume the process had moved to an "out of control" state but would try to locate the special cause(s) for this condition. Only if special causes could not be found would an assumption be made that there might be new common causes to be identified. One aspect of process quality improvement is achieved as these common causes are found and corrected - special causes have no bearing on the overall quality improvement process.

Two Important Aspects of Quality Control

- ¾ Control of Quality.
- ¾ Improvement in Quality.

Control of Quality Can Be Achieved.

- ¾ Control of Manufacturing Information.
- ¾ Control of Purchases & Storage of Raw Materials.
- ¾ Control of Manufacturing Process.
- ¾ Control of Finished Products.
- ¾ Control of Measuring Instruments and Test Equipments.
- ¾ Control of Corrective Action.

If Pakistani Manufacturers are to capture Greater market share, they will have to shift their Emphasis to quality control.

Lesson 31

QUALITY CONTROL – II

This lecture is dealing with the quality standardization under WTO.

Quality Control Programs in Developing Countries

- Establish Strong National Leadership & Q.C Society.
- Create Govt. & Commercial Compulsion for Reasonable levels of Quality.
- Establish a Media For Exchange.
- Establish an Extensive Program for Training.
- National Standardization Efforts.
- Public Awareness.

International Quality Standards

If each country had its own set of standards, companies in selling in international markets would have difficulty in quality documentation standards in the countries where they did business.

ISO 9000

It is set of standard governing documentation quality program. Proving to a qualified external examiner that they have completed with the entire requirement certifies companies. Once certified, companies are listed in a directory so that potential customers can see which companies have been certified and to what level. Compliance with ISO 9000 standards says nothing about the actual quality of a product. Rather, it indicates to customers that companies can provide documentation to support whatever claims they make about quality.

Five Documents of ISO 9000

ISO 9000 actually consists of five documents;

1. ISO 9000
2. ISO 9001
3. ISO 9002
4. ISO 9003
5. ISO 9004

1. **ISO 9000**
   ISO 9000 is an overview Document, Which Provide Guideline for use and selection of other standards.
2. **ISO 9001**
   ISO 9001 is a Standard that focuses on various aspects of design, produce, install and service products. It also includes management responsibility, quality System, purchasing, product design, and inspection, training & Corrective action.
3. **ISO 9002**
   ISO 9002 covers same area as 9001 for companies that produce to customer's design or have their design and service activities.
4. **ISO 9003**
   ISO 9003 is most limited in scope and addresses only production process.
5. **ISO 9004**
   ISO 9004 contains Guidelines interpreting other standard.

ISO 14000

ISO 14000 requires participating companies to keep track of their raw material use and their generation, treatment and disposal hazardous wastes. ISO 14000 is a series of five standards that cover a number of areas, including the following.

¾ **Environment Management System.** Requires a plan to improve performance in resource use and pollutant output.

- ¾ **Environment Evaluation Program.** Specifies guidelines for the certification of companies.
- ¾ **Environment Labeling.** Defines terms such as recyclable, energy efficient, and safe for the ozone layer.
- ¾ **Life Cycle Assessment.** Evaluates the lifetime environmental impact from the manufacture, use, and disposal of a product.

To maintain their certification, companies must be inspected by outside, private auditors on a regular basis.

ISO 17025

The main area under WTO comes under quality control in laboratory standards and the standard that deals with it is ISO 17025. The laboratory for testing under this standard for quality control is not available in Pakistan. The need is to have a new one or up gradation of existing labs so that we can meet the requirements of WTO.

Marketing

Role of Marketing

Improved marketing is central to a small firm's industrial strategy. Unfortunately, many small firms assume that the only requirement for success is to open and wait for customers. Perhaps, it is due to severe limits on their resources. It is seldom recognized that marketing is a complex process affected by internal external factors. Internal variable includes firm's financial position, management capability personnel resources, products offered. External variable includes general economic conditions, characteristics of population, social and cultural factors, competition, government regulations etc. Small firms success depends on the ability to plan organize staff and control marketing activity in relation to internal and external environment. Marketing is the performance of business activities that direct the flow of goods and services from the producer to consumer.

Small firm's Advantage

Advantages enjoyed by small firm in the field of, marketing include realistic marketing planning, shorter lines of communication, flexibility, and ability to act quickly.

Lesson 32

ROLE OF MARKETING IN SME – I

Concept of Marketing

Marketing is the process of integrating and coordinating the following.

¾ Identifying and measuring the needs of customers for the type of products or services that the firm is equipped to provide.
¾ Translating the perceived needs into products or services development.
¾ Developing and activating a plan for availability of product or service available.
¾ Informing perspective customers about availability of the product/service and stimulating their demand at a price that generates satisfactory profits for the firm.

Marketing Function

The functions that must be performed in the marketing process are as follows:

1. **Buying And Selling**
   Exchange process involves buying in anticipation of customer demand and searching for materials that will satisfy those needs. Selling function includes determination of potential customers and using a combination of sales techniques to stimulate demand for those goods or services.
2. **Transportation And Storage**
   It involves the movement and handling of goods. Not all goods are sold at the same time they are manufactured. Storage is done so that goods are available at the time and place they are needed.
3. **Risk-Taking, Standardization And Grading**
   Stored goods are subject to several types of risks. They may undergo spoilage, obsolescence, destruction. Consumer preferences may change leaving the business owner with a large quantity of unsold goods. Some of the risks can be shifted through insurance coverage. But the most effective means of dealing with risks is the adoption of good management practices. Standardization and grading enable consumers to make a comparison of the products. Standardization establishes uniformity of specifications in the matter of color, weight, composition etc. grading is done in the case of products that cannot be produced uniformly e.g. fruit, egg.

Marketing Process - Steps

1. **Identification of Potential Changes in Firm's Market**
   Identification of potential changes taking place in firm's market that could materially affect the firm's business.
2. **Identification of Customer Needs**
   The first step in marketing should be to identify the needs of customers the firm intends to sere. Many firms simply focus an introducing technical perfection in the product with out assessing customer reactions. The small firm is advised to proceed only on the basis of definite information collected with the help of a following exercise.
   a. **Sources of information about markets and customer:**
      There are two broad sources of market intelligence viz,
      i. **Primary sources** which the company develops for us own specific requirements
      ii. **Secondary sources** i.e. the published reports of trade association, government agencies, and other. These are not geared to the requirement of an individual firm.

      Primary Sources
      From a marketing perspective, the three primary sources of information are:-
      ¾ **Internal Records of the Firm:** These consist of invoices, inventory audit, reports of salesmen etc.
      ¾ **Mail Surveys:** Telephone interviews and personal interviews of actual or prospective customers.
      ¾ **Direct Observations:** information derived from direct observation of customers and competitors.

Secondary Sources

A number of publications provide overwhelming useful marketing information industry. Specific data are published by trade and professional associations.

b. Pinpointing the real customers

The potential customers must not only be recognized but placed into proper categories as follows:

i. **Users. (**who consume the product/service**);**
ii. **Buyers. (**who actually purchase**);**
iii. **Deciders. (**who decided what should be purchased**);**
iv. **Influencer. (**who has some influence on the purchase process**);**
v. **Informer. (**who controls the flow of information to the decision groups**);**

A typical customer may play several of these roles. Costlier the item to be purchased, more actors playing different roles will get into the process. To illustrate, suppose the family decides to buy a TV set. All the family members would be the users. But the actual buyer could be the husband. Deciders could have been the husband and wife both. The children could be the influencers on the decision-makers. Any member could act ad informer by providing or withholding information from decision making group. Generally the role of buyer and decider could have been performed by the same individual. But in case of organizational purchases. For successful marketing, the entrepreneur will endeavor to identify the roles played by different members in the decision process.

3. Market Segmentation

It is the grouping of customers into segments so that each segment has similar needs, characteristics and requirements. It helps a firm to relate its products to those requirements of the target group. A small firm may focus on a segment that may not be found attractive by a large firm. Segmentation could be on demographics (i.e. age, sex, religion), geographic, psychographic or social basis. Good segmentation must meet the following criteria:

a) Needs of customs must be both identifiable and measurable.
b) Firm must have the capacity to develop products that will satisfy the customer's choice in the particular segment.
c) The segment must be economically worthwhile.

Procedure for market segmentation is described below:

I). Ascertain firm's Capabilities.

It must know what wet of needs it can satisfy. For instance, the small firm may be willing to sell its products to foreign buyers. But it must ascertain whether it has the necessary financial, promotional or distributive capabilities.

II). Ascertain the Competition.

Identify the characteristics and extent of competition in the various segments. All other conditions being equal, it should focus on the segment which has the least competition or the segment which are too small for large firms.

III). Focus on the Segment Chosen.

For a small firm, the segment chosen on the criteria of customer characteristics such as geographical region, demography has been found to be more suitable.

Lesson 33

ROLE OF MARKETING IN SME – II

Marketing Decision Variables

1. **Marketing Controllable Variable**
   - a) **Target Market Segment**
     - ¾ Location
     - ¾ Target customers
     - ¾ Timing
   - b) **b) Products offered**
     - ¾ Type of product
     - ¾ Range of product
     - ¾ Design features
     - ¾ Quality
   - c) **c) Price**
     - ¾ Price level
     - ¾ Price variables (discount)
     - ¾ Maintenance
   - d) **d) Advertisement & Promotion**
     - ¾ Advertising level
     - ¾ Advertising media
     - ¾ Sales promotion
   - e) **e) Distribution.**
     - ¾ Channels
     - ¾ Number of sales outlets
     - ¾ Warehousing facility
   - f) **Servicing**
2. **Marketing Uncontrollable**
   - a) **a) Resource Availability.**
     - ¾ Availability of required materials
     - ¾ Cost and quality of required material
     - ¾ Material
   - b) **b) Competition – Direct & Indirect.**
   - c) **c) Economic Conditions** – total market size, economic trends, income situation.
   - d) **d) Socio- Cultural Conditions** – societal values, life style, fashion consciousness.
   - e) **e) Political & Legal Conditions.**
     - ¾ Political risk situation
     - ¾ Legal regulation
   - f) **f) Technological Situation** – state of technology, rate of technological change.

Decision about Product

Product decisions have quite important because the length of time for which a Product remains profitable has considerably shortened. Frequent technological innovation and entry of new products have contributed to the shortening of life of a product. Such factors pose a problem beyond the financial capabilities of a Firm. The product features amenable to manipulation by a small firm are;

a) Performance and functional features i.e. firm's ability to perform, durability, reliability and precision.
b) Use characteristics i.e. ease in handling and serviceability.
c) Aesthetic qualities e.g. style, design, color etc.
d) Extrinsic features e.g. uniqueness of product, status value etc.

Product Life Cycle

Product Life Cycle is equally helpful in deciding about appropriate marketing strategy to be adopted.

- ¾ Product Development
- ¾ Introduction

- ¾ Late Growth
- ¾ Maturity
- ¾ Decline

Marketing Mix

It is the integration of the four elements noted below to service the needs of target market.

a) Product Mix: Correct combination of product and service. It will cover product depth (i.e. model, size, style, and color) and product breadth (i.e. number of product lines carried).
b) Promotional Strategy: Promotional Strategy to inform customer about firm, products/.service etc. through personal selling, sales promotion etc.
c) Physical Distribution: Physical Distribution i.e. the chair of distribution to be adopted. It forms the subject matter of a separate chapter.
d) Pricing.

Lesson 34

ROLE OF MARKETING IN SME – III

Product Mix
It refers to number of products offered by a company. It is not uncommon to find small firms selling ultiple products. Product mix is done to optimize profits.

Advantages of product mix
1. It enables the firm to serve different segments of the market.
2. It gives steady sales & profits to the firm.
3. The firm can keep all its bases covered.

Demerits of Product Mix
1. It makes greater demand on firm's resources in the form of increased investment in production facilities and inventory.
2. Marketing Problems.

The firm should weigh the pros and cons of a wider versus narrow product mix. The ultimate decision would rest on such considerations as the available resources, existing and future market opportunities and strategies of competitors. Phillips kotler has suggested the following indicators of firm's sub optional product mix;

1. Disproportionately high percentage of total profits from a few products;
2. Insufficient product breadth to exploit sales force;
3. Excessive productive capacity on a chronic or seasonal basis;
4. Steadily declining sales or profits.

Development of New Product
Small firms should consider the frequent introduction of new or improved product as part of their market strategy. The procedure for generating new product ideas and implementing them is described below:

1. Making creative Search for new product ideas
2. Scrutiny of ideas for their worthwhile ness
3. Evaluating whether the idea is compatible with firm's objectives
4. Establishing technical and market feasibility
5. Reviewing internal resources and capabilities
6. Product development and product testing
7. Test Marketing
8. Commercial sales

State Assistance in Marketing
- ¾ Export Promotion Bureau.
- ¾ Export Promotion Zone Authority.
- ¾ Small & Medium Enterprise Development Authority.

Export Promotion Bureau
Exhibitions

Export Promotion Zone Authority
Small & Medium Enterprise Development Authority (Marketing Services Division)
- ¾ Internal Support
- ¾ External Support
- ¾ Marketing Support to SME
- ¾ Packaging Support
- ¾ Advertisement & Media Support

SMEDA (Marketing Services Division)

- Internal support
- External support
- Marketing support to SME
- Packaging support
- Advertisement and media support

Marketing Facts (A World Bank Survey)

- Most small enterprise work for domestic center.
- Only 8% work in export sector
- 4% work for govt. sector
- Tough bargaining on price 36%
- Credit customer 34%
- 28%are optimistic to grow in the next 2 years while the real number is 30%

Lesson 35

ROLE OF TECHNOLOGY – I

The application of industrial technology, as indeed of all technologies, is a means to an end, the end being the development goals of each country. An appropriate technology path has therefore to be derived from the development goals adopted. Industrial development is a centre piece of the development process. It cannot be viewed only as the means of producing a large variety of goods and services by modern processes and techniques; it must result in adequate employment opportunities, greater income generation and distribution to poorer sections and improvement in the conditions of life for the larger community in developing countries.

Technology is in fact not applied in isolation

Technology is in fact not applied in isolation but as part of the performance of one economic activity or another which contributes to development. in such activity, say industrial development, technology is again applied, not alone, but matching with investment, skills, resources and other related factors, in other words, the application of industrial technology cannot be divorced from the total context of industrial development. When considering industrial technology, and for that matter any technology a balance has therefore to be struck between considering it is the abstract and treating it as totally indistinguishable from the economic activity itself. To strike such a balance between these two trends, either of which by itself is likely to be misleading. There is a close interrelationship between industry & technology in general. Perhaps no other single branch of economic activity influences or gets influenced by technology more than industry.

Within this over-all framework, attention will be focused on certain major elements for purposes of national and international action. The linkage of technology to industrial development and industrial development to over all development goals will be successful only in the context of the formulation of relevant policy measure by national government. Technology policy and planning therefore becomes an important element. The second major element is the development of technological capabilities in each country which is a prerequisite for the selection, acquisition, adaptation, absorption or development of technology. This will involve among other things the building up of institutions and the training manpower.

The Development & Transfer of Technology

The Development & Transfer of Technology has several aspects – policy aspects, institutional aspects, enterprise level considerations, skills, training, investment, feasibility studies etc. Sometime activities relating to the development and transfer of technology can be carried out as distinct and separate activities e.g. assisting in the establishment of a research institute or a national office for transfer of technology.

Training programmes

Training programmes especially *aimed* at providing capability to acquire, evaluate and manage industrial technology.

Publications

Publication on ways and means to promote technological and industrial co-operation among developed and developing countries, identification of projects that can be implemented with the technical resources of those countries. The intensification of courses on technological and industrial management, including industrial technological information in accordance with needs of each country.

Lesson 36

ROLE OF TECHNOLOGY – I

Measures to Implement

Measures to implement the Programme of Action include the organization of international meetings in the field of appropriate industrial technology, the establishment of a consultative group on appropriate industrial technology and the monitoring and analysis and follow up for appropriate choice of technology presupposes the existence of alternative technologies for production and knowledge and information about them. One of the first tasks is to enlarge the flow of available information. With this in view the evaluation and comparison of alternative industrial technologies will be merged for selection. This information made available should be fed into the Industrial And Technological Information Bank.

Available Information

Available information on technologies could also be enlarged through the systematic identification of technologies including the traditional ones available in developing countries themselves. With this input projects can be initiated through national research institutes, systematic survey of indigenous technologies in selected branches. The surveys are expected to bring out material on the basis of which some of the existing technologies could be upgraded and some others could be transferred for adoption by other countries. It will also provide it methodology for systematic action by the research institutes in the elaboration of their research programs.

Methods of Integrating Science & Technology in Economic & Social Development

The rapid and fruitful application of industrial technology to industrial development could be achieved only if the attempts to promote appropriate industrial technology are part of the main stream of industrial development and not apart from it. To reach this goal by stimulating policy and decision makers, enterprises and research institutes for promoting the application of appropriate industrial technology; stimulating suppliers of technology and equipment in industrialized countries to undertake the necessary adaptation and redesign to suit the needs of developing countries; stimulating government and donor agencies in industrialized countries and in developing countries with sufficient financial resources at their disposal to allocate more funds to co-operative programs on appropriate technology; mobilizing existing research capacity in research organizations, universities, private enterprises and particularly small companies and individual investors so as to promote the adaptation of available technologies and the development of new technologies where necessary.

The appropriate technology path has to be derived from the industrial development strategy and consequently from the over-all development strategy itself. It is only by this integration nor only conceptually but in practical action that the application of industrial technology can have the most fruitful results through national institution for projects services can provide a set of specialized services to all industries in the areas such as testing, meteorology, product development and general advisory and information services.

Measure to Undertake for Promoting Framework.

1. Evaluation & Comparison of Alternative Industrial Technologies
2. Promotion of Technological Research
3. Collection & Dissemination of Practical Experience
4. Application of Technology to Rural Development
5. Technology for Alternative Sources of Energy
6. National & International Policies Related to Appropriate Industrial Technology
7. Institutional Infrastructure for Appropriate Technology

The important point, apart from implementing specific programs, is the consolidation of efforts in this field and the mobilization of interest on a world-wide scale. This step will bring about a fuller use of existing resources and also place the concept of appropriate industrial technology in the main stream of existing activities and not apart from it. this goal can be achieved by stimulating policy and decision-makers, enterprises and research institutes to promote the application of appropriate industrial technology;

stimulating suppliers of technology and equipment in industrialized countries to undertake the necessary adaptation and redesign to suit the needs of developing countries; stimulating governments and donor agencies in industrialized countries and in developing countries with sufficient financial resources at their disposal to allocate more funds to co-operative programs on appropriate technology; mobilizing existing research capacity in research organizations, universities, private enterprises and particularly small companies and individual investors so as to promote the adaptation of available technologies and the development of new technologies where necessary.

Industrial & Technological Information Bank

Since in its design and operation the industrial and technological information bank will rely heavily on its effective links with the suppliers and users of technological information, its operation could well mark the beginning of a new phase of international co-operation in the exchange of technological information. This will be particularly so, since the INTIB is not expected to physically store all available technological information.

One component of the INTIB which involves international co-operation in a significant manner is the system of exchange of information among the national registries of transfer of technology on the terms and conditions of technology contract. This will provide, through international co-operation, access to information not hitherto available, but of great value to developing countries in the acquisition technology.

Role of ICT

ICT means information and communication technology. ICT plays a vital role in small and medium enterprises.

EXPORT POTENTIAL OF SME IN DEVELOPING COUNTRIES – I

Definition and Role in Economy

The small and medium-sized sector is a varied one and plays a predominant role in the economies of most developing countries. It comprises factories, workshops, traders and other service facilities. It ranges from the most modern and up-to-date to the simple and traditional, from independent enterprises to ancillaries and subcontractors, and from units mainly catering to the domestic market to exporters.

Small and medium-sized enterprises (SMEs) are a key component in economic life, not only because of their number and variety but because of their involvement in every aspect of the economy, their contribution to regional development, the complementary role they play in support of the large sector, and their role as proving ground for innovations and adaptations. They can be seen as a kind of industrial breeding ground, a source of constant renewal of industry and commerce, and a wellspring of competition and dynamism.

There is no universally accepted definition of an SME. One study has identified more than 50 definitions in 75 countries. Frequently, criteria defining as SME in a country may be based on the purpose for which the identification is required.

Again it is possible notionally to group manufacturing SMEs in three broad categories:

¾ Cottage or Artisan Units.(less than 10 employees)
¾ Small Scale Units.(up to 50 employees)
¾ Medium Sized Industries.(Between 50 and 200)

These would not be watertight compartments and such a grouping would be arbitrary. SMEs play a significant role in the economies of most countries, industrialized as well as developing. Organized small and medium-scale industries in many African countries are relatively smaller in number and their contribution to GNP more limited.

Public Policy Approaches to the SME Sector

Small and medium-sized enterprises play a predominant role in the economies of most developing countries. For valid socio-economic reasons relating to employment creation, income distribution, dispersion of industries etc. many govt. and specialized SME development agencies have long been engaged in providing assistance for the establishment of SMEs and for their growth and development. The range of assistance has included training and entrepreneurial development activities, pre-investment feasibility surveys, finance arrangements, facilities for raw materials and other inputs, infrastructural facilities, product and design advice, domestic marketing assistance, etc. However, few SME development programmes have incorporated and export dimension into the assistance package until recently.

SME support programs have been in place in many developing countries for a number of years. Framework legislation and articulated government policies also exist in many countries. Observers have generally concluded that even when there is no policy bias in favor of large units, the operational systems and the well-known difficulties of SMEs in gaining access to support institutions for their inputs-finance, raw materials, approvals, etc.—render the policy framework biased in favor of large units. SMEs have an inherent handicap in dealing with institutions because of their smallness. thus, even in industrialized countries the need for special intervention in favor of SMEs has been acknowledged. Even proponents of laissez-faire policies concede these needs.

Public policy in developing economies typically includes recognition of the importance of the sector and measures to stimulate the establishment and to encourage the growth of this sector.

Commonly Seen Assistance Programme

Some commonly seen assistance programs, implemented with widely varying degrees of efficiency and success, relate to establishment of;

- ¾ Institutional Support Infrastructure (Like Small Industry Boards or Small Industry Corporation).
- ¾ Physical Infrastructure Facilities(Like Industrial Estates, Common facility centers)
- ¾ Initiative in Field of Financing (Creation of Small Industry Finance Programme, Credit guarantee Scheme, Preferential financing Rates).
- ¾ Entrepreneurship development Programme and so on.

However, in SME promotion programme of most of the countries potential markets are assumed to exist and thus a marketing dimension is not taken into consideration. However, growth of SME sector is possible only when the SMEs are assisted in entering existing markets or in new market creation. In certain situations an individual SME or a production sector can create new markets.

New market creation is generally not in the hands of the individual SME or groups of SMEs.

A Favorable Climate is Required, Which Depends on.

- ¾ A variety of Macro-Economic Factors
- ¾ International Factors
- ¾ Government Policy

Conscious government policy approaches are required to assist SMEs to create markets. For this, SME groups have to organize into powerful lobbies to be in a position to create the ground swell required to influence national public policy. *i*f new markets do not exist or cannot created nationally, encouraging the establishment of SMEs may be counterproductive.

Levels of Exports from SMEs in Developing Countries

The products of SMEs find their way to export markets through three different channels:

- ¾ Direct Export
- ¾ Indirect Export through agencies acting as middlemen such as merchant export and trading houses.
- ¾ Physical Incorporation of SME produced components/ subassemblies in exports by larger manufacturers.

A series of workshops conducted recently by the International trade centre UNCTAD/GATT (ITC) in seven developing countries concluded.

- ¾ Only a very small proportion of their manufacturing SMEs participate in the export trade.
- ¾ It was estimated that in India not more than 5% of all registered small units participate in export trade directly or indirectly regularly or sporadically.

Information compiled by ITC on the shares of SMEs in exports of some developing countries is given for a sample of countries:

- ¾ In Pakistan over 30% exports of manufacturers are by small manufacturing units (World Bank Studies, 1982) (Figure does not include contribution of medium scale units).
- ¾ In Thailand, Sri Lanka small locally-owned traders and manufacturers account for approximately 35% of total national exports.
- ¾ In India number of registered small units 526,035 (1981) (only a very small proportion of these is participating in exports).and 46% of total national exports were accounted for by organized small-scale units and by the cottage industry sector.
- ¾ In **Republic of Korea** the share of small units in total exports is39% in 1983.
- ¾ In **Singapore** between 1973 and 1981, the average annual increase of direct exports from small firms was 48.5% as against 25% for large firms during the same period.

On the above information some general observations can be made:

- ¾ Statistical data on the role of SMEs in the economics of developing countries are generally available in many cases, and relate to numbers, production, employment etc.
- ¾ Available information suggests that only a small percentage of SMEs engage in export, but their contribution to total exports is considerable.
- ¾ Appreciation of the inpo9rtance of domestic marketing mechanisms in channeling SME production to export markets is generally inadequate.
- ¾ It would appear that there is a correlation between the successful exporting by developing countries/ areas and the role played by SMEs in their economies.
- ¾ There appears to be a need for systematic research to establish the role played by SMEs in exports from developing countries and to facilitate formulation of public policy.

As a general conclusion, it can be stated that the contribution of the SME sector to the export trade in developing countries is substantial, despite the fact that only a small minority of SME units participate in export activities. The experience of successful SMEs in some developing countries demonstrates that there is considerable untapped potential for greater participation of SMEs in export activities.

Lesson 38

EXPORT POTENTIAL OF SME IN DEVELOPING COUNTRIES – II

Relationship between SMEs and Export Development

While in certain circumstances SMEs enjoys some advantages of flexibility, in general they suffer from structural handicaps in their operations arising from small size, particularly where exports are concerned. Even SMEs that are highly successful domestically, for a variety of reasons, do not find it easy to upgrade production to production for exports.

Problems faced by SMEs in developing countries typically include:

- Scarcity of capital.
- Limited and unequal access to institutional credit markets.
- Irregular access to domestic and imported inputs coupled with higher cost.
- Inadequate infrastructure facilities.
- Weak managerial and technical skills.

A large number of SMEs have successfully overcome these formidable difficulties, established a sound base in the domestic market, and may be potentially capable of breaking into export markets. However they may be hampered by a variety of circumstances:

- Lack of information on possible export market.
- Absence of guidance on export regulations and procedures.
- Inability to identify sources of assistance for product development and product upgrading for export.
- Lack of information on export credit and insurance facilities as well as for export requirements.
- Lack of information on operation of indirect marketing channels like merchant export houses.
- Absence of guidance on basic management issues relevant exporting firms.
- Absence of sound steps that need to be taken to enter in export field.

SMEs are often uninterested and unprepared to enter export field owing to: Lack of market information, Lack of incentives, Lack of credit, Lack of staff and organization and Difficulties in obtaining export licenses, export guarantees and foreign exchange. Thus, while in many developing countries SMEs are now receiving greater attention and aid from both the public and the private sector in many developing countries, little attention has so far been focused on the specific help needed to increase exports from SMEs. Developing the export capabilities of SMEs is difficult because of their special problems. Yet it is often assumed that the needs of SMEs are adequately net by 'traditional sources' of assistance, which are usually geared to the needs of larger firms. While most developing countries have well-established SME support programmes with agencies. Yet it can be argued that many of the techniques used to stimulate and support small business growth in general can be extended to support the export activity of SMEs.

This argument is based on the fact that the development of export capability in small firms is just one more aspect of their business development. In the essence exporting means moving to improve basic organizational capabilities: such as management control, financing, costing and pricing, design and marketing management. General support structure for SME development to be linked with export support. This structure demonstrates the linkage between the general support infrastructure for SMEs and the specific export support infrastructure and their different goals.

The former has as its objective the development of capability of SMEs for survival and growth, the latter the development of specific capability for export. Whereas in the context of the firm the development of general organizational capability and that of specific organizational capability for export are obviously closely linked, casual observation indicates that there is often no close linkage between the general support infrastructure for SMEs and the export support infrastructure.

SMEs assistance institutions can be considered in terms of a number of characteristics including: Whether they are public, private or mixed. Whether they are local, regional or national. And their degree of coverage. Whether they provide integrated forms of assistance, meeting a variety of different kinds of needs; whether they are general or concentrated upon particular industry sectors or sectors of the population; whether they are strong in terms of resources and capability; and finally whether they are long established traditional sources of small business support with a good track record.

Strategy for Development of Exports from SMEs

Today, export promotion in general by most of the developing countries and particularly by SMEs is not easy. This is true for a variety of reasons. Some of which are listed below.

1. **First,** the products available in most developing countries are generally known in international markets and discovery new product capabilities is not likely to be as regular and frequent as before.
2. **Second**, international marketing techniques are well disseminated in most developing countries, though they are not equally well known in the interior of the countries.
3. **Third**, as more developing countries penetrate in world markets, path to other developing countries will be that much harder and competition correspondingly greater.
4. **Finally**, international markets are tending to become less open to manufactured products from developing countries.

Common Difficulties at Various Levels

A summary of some of these problems is given below.

At the national level

¾ It is often observed that a well-planned strategy to develop exports from SMEs does not exist. The objectives are frequently not well defined and the available policy instruments for industry and trade are frequently not aimed at developing the SME sector and its exports.

¾ Where support for SMEs is a stated objective, there is often inadequate follow-up in terms of specific measures and mechanisms. In many instances, the institutional infrastructure is sub-optimal with a lack of coordination among trade service institutions.

¾ The environment is often not conducive to the creation and growth of marketing channels for SME exports such as merchant export houses, export development companies, joint marketing arrangements, export consortia, etc.

At the level of trade organization (TPOs) and industry export institutions

¾ There is often an inadequate focus on issues of concern and relevance to SMEs and a lack of appreciation of the special features and difficulties of SMEs in their export efforts.

¾ Many service institutions do not have well-defined programmes with clear objectives for assisting SMEs in export development.

¾ The channels of communication between service institutions and SMEs are frequently inadequate.

At the level of Enterprise

¾ In many situations, special difficulties are encountered, leading to inadequate and more costly access to factor markets.

¾ Individual SMEs are often not in a position to identify sources of assistance for product development and product upgrading for export.

¾ SMEs generally have difficulty in obtaining information and guidance on export markets and are unable to undertake direct export marketing.

¾ Absence of indirect export marketing channels like merchant export houses, export development companies, etc. in many situations inhibit export market access for SMEs.

¾ Training facilities in export management are often not readily available.

Involving SME Development agencies

The trade organizations and export service agencies in many developing countries interface only with exporting SMEs, though the majority of the SMEs are usually linked with national level with SME development agencies and institution. Many governments have established a network of SME institutions which are in close touch with SMEs. There is a need to deliver an export orientation programme to a new target audience, that is, established SMEs in the region who are currently not participating in exports. It is important to create awareness in SME development institutions and through them among the enterprises themselves of export potential for export. To achieve this, it will be necessary to strengthen SME development institutions capacities to provide export development services.

Lesson 39

WORLD TRADE ORGANIZATION (WTO)

Introduction

The emergence of World Trade Organization (WTO) in 1995, as a result of Uruguay Round of negotiations of GATT, marks a watershed in the history of international trade. GATT, the predecessor of WTO, was established by 23 countries in 1948, which liberalized the trade and created an environment that enabled the evolution of WTO is much wider as compared to GATT. It encompasses areas like textile, agriculture, services and intellectual property etc. that were excluded in the GATT.

The main guiding principles of WTO are: non-discrimination among the members in stipulation of favours regarding market access and tariff reductions provision of national treatment to foreign investors, imported goods and services stability and predictability of international trade patterns to promote confidence of investors and businesses by bounding the tariffs and market access for services; and promotion of economic development by encouraging reforms in the less developed and transition economies.

To ensure that trade is as fair as possible and as free as practical WTO has a large number of agreements that are the result of negotiations among member states. The current sets of agreements are the outcome of 1986-94 Uruguay Round negotiations. Through these agreements WTO members operate a non-discriminatory trading system that spells out their rights and obligations. Important agreements are of goods, agriculture, textile and clothing, subsidies and countervailing measures, antidumping, safeguard measures, TRIMs, customs valuation, dispute settlement, technical barriers to trade, sanitary and phytosanitary measures, GATS and TRIPs.

These agreements resulted in considerable reduction in tariffs in member countries and increased market access for developing and developed countries.

WTO Agreements: Salient Features

1. **Trade in Services**
   Trade in Services is regulated by the GATS, which concerns with some basic obligations that apply to all members. its second part deals with nations schedules of commitments that contain specific assurances that will be the subject matter of ongoing process of liberalization and the third part deals with the annexes addressing the special situations of individual services sectors that are not binding on all members.
2. **Agreement on Textile and Clothing**
   The Agreement of Textile and Clothing stipulates that the Multifibre Arrangement will be phased out and that the textiles and clothing sector will be integrated into WTO in four stages over 10years. The major portion i.e., 49% will be assimilated in the stage four (ending January 1, 2005).
3. **Agreement on Subsides and Countervailing Measures**
   Agreement on Subsides and Countervailing Measures lays down rules on the subsidies for industrial products and on countervailing duties to counteract the effects of subsidies. Subsidies are divided into three categories; prohibited subsidies, actionable subsidies and non-actionable subsidies. Export subsidies and those contingents on the use of domestic as opposed to imported products are categorized as prohibited subsidies.
4. **Agreement on Anti-dumping**
   Agreement on Anti-dumping provides the right to the contracting parties to apply anti-dumping measures, i.e. measures against imports of a product at an export price below its "normal value" if such dumped imports caused injury to a domestic industry.
5. **Agreement on Safeguards**
   Agreement on Safeguard provides remedies for domestic producers injured by fairly traded imports. It allows the use of temporary protective measures but sets rules to guard against the abuse of such measures.

6. **TRIMs Agreement**
   The TRIMs agreement identifies trade related investment measures that are against the provisions of the GATT and prohibits the use of such measures. TRIMs consist of investment incentives, such as subsidies, investment grants and allowances, priority access to credit, tax relief and exemption, tariff protection and other forms of fiscal, financial and commercial inducements for investment and performance requirements, such as local content, trade-balancing and export requirements.
7. **The Agreement on Custom Valuation**
   The agreement on Customs Valuation intends to provide greater uniformity and certainty in the application of customs valuation rules and procedures. It provides for a fair, uniform and neutral system for the valuation of goods for customs purposes and precludes the use of arbitrary or fictitious customs values. Transaction value is the principal basis and method of value.
8. **The TBT & SPS Agreements**
   The TBT and SPS Agreements do not question the right of governments to use technical regulation, standards and sanitary and phytosanitary measures for health and safety reasons. The SPS Agreement also requires that SPS measures be based on scientific justification.
9. **Agreement on TRIPs**
   The Agreement on TRIPs provides for adequate intellectual property rights for copyrights, trademarks, industrial designs, layout designs of integrated circuits, patents etc. and the provision of effective enforcement measures for those rights, multilateral dispute settlement and transitional arrangements. Adequate arrangements are also proposed for the protection of Geographical Indications.
10. **General Agreement on Trade in Services**
    General Agreement on Trade in Services establishes rules of conduct for governments to follow in their laws and regulations relating to services. It provides for specific commitments by member countries to open up certain sectors of services to import competition.
11. **The Dispute Settlement Mechanism**
    The Dispute Settlement Mechanism is a keystone of multilateral trade order that encourages the members to solve mutual disputes by consultation but also have a legal framework for solving the matter if concerned parties fail to reach a consensus.
12. **Trade Policy Review Body**
    Trade Policy Review Body encourages greater transparency in national trade policies by conduction mid term trade policy reviews.

Lesson 40

WTO MINISTERIAL CONFERENCES

The apex body of WTO, the Ministerial conferences has a mandate to meet at least once every two years in order to strengthen the political guidance of WTO and enhance the prominence and credibility of its rules. Four ministerial conferences have been held till now and fifth one is scheduled for September 10-14 this year.

¾ **First Ministerial,** held in Singapore 1996 declared the information technology as tariff free till the year 200. It emphasized the importance of regional trade agreements and talked about further liberalization of services. It was unable to resolve the controversies on issues like link between trade and labour standards. .

¾ **Second Ministerial,** held in Geneva on implementation issues, discussed the US and EU demand of making E-Commerce tariff free.

¾ **Third Ministerial,** held in Seattle was disrupted by violent protests by anti-globalization organizations and conference failed to follow its proposed agenda.

¾ **Fourth Ministerial,** convened at Doha in 2001 agreed to launch a new round of talks under the 'Doha Development Agenda' to take into account the areas of interest of developing countries.

¾ **Fifth Ministerial,** held in Cancún, Mexico from 10 to 14 September 2003. The main task was to take stock of progress in negotiations and other work under the Doha Development Agenda.

¾ **Sixth Ministerial Conference** was held in Hong Kong, China, 13–18 December 2005. In general, ministerial conferences are the WTO's highest decision-making body, meeting at least once every two years and providing political direction for the organization

Doha Development Agenda

Doha Round of negotiations include critical issues such as production subsidies to Agriculture, TRIPs/Geographical Indications, access to generic medicines in case of public health crisis, requests/offers for services sector, antidumping agreement, revision and dispute settlement negotiations, market access to nonagricultural products. Special and Differential treatment of developing countries.

Though deadlines for reaching agreement on modalities for negotiations on most of the issues have been missed but still hopes are alive and these matters would be taken up at the forthcoming Ministerial in Cancun, Mexico.

Pakistan and WTO

Pakistan being the founding member of GATT, the predecessor of WTO, accepted all the Uruguay Round agreements and is in the process of implementing them. It is modifying its domestic legal and administrative rules so as to make them consistent with WTO rules. Under these agreements Pakistan has to open up its market for full blown foreign competition, must have stringent enforcement of Intellectual property laws and maintain international quality standards.

Pakistan committed to bind 33% of its tariff lines. Approximately 81% of agricultural import tariffs are bound, most at the ceiling rate of 100%. Tariffs on Tea, wheat, maize and sugar are bound at ceiling rate of 150%. For the Industrial products are bound at 25% of its tariff, most at ceiling rate of 40-50%. For these products, tariff reductions were to take place in five equal installments beginning in July 1995. For a number of products like leather items, travel goods, wood products, some textiles and certain equipment, tariffs will be bound at ceiling rates of 22 to 30 percent. Tariff reduction on textiles and clothing are scheduled in 10 equal installments.

The textile sector, which contributes 67 percent to our total exports, would in 2005 face severest competition from other major suppliers like China, Hong Kong, Thailand, India and Bangladesh. We have made some progress in facing post quota era to take the production of textile goods upwards in the value chain. It is apprehended that the MFA phase out will start another era of non-tariff barriers (including social standards, child labour, environment and other, quality standards, anti-dumping duties etc.). With the phasing out of quotas, textile manufacturers in industrialized and some quota free countries may decide to relocate; Government should notify policies providing incentives to ensure that they relocate in Pakistan.

The country urgently needs to build a strong network of Anti-dumping and countervailing duties to protect the local industry against the onslaught of unfair foreign competition. It is heartening to note the trade Policy 2003-04 envisages enhancement of capabilities of National Tariff Commission. It is recommended that NTC should be restructured and converted into an autonomous body employing private sector professionals and its chairman should be from the judiciary.

To enhance the credibility of our products we need to adopt international quality standards. Pakistan still has a long way to go in obtaining certifications of ISO- 9000, ISO-14000 and other standards. We need to set up accredited testing laboratories for conformity assessment. Pakistan is committed to fulfilling TRIPs obligations, for which five laws have been promulgated. The Government had announced, in Trade Policy 200-03, establishment of umbrella organization PIPRO for improving the administration and enforcement scenario, but necessary legislation for PIPRO to start functioning, is still pending.

Pakistan has done well by undertaking liberalization measures relating to communication and financial sectors under GATS. Pakistan in collaboration with other LDCs is pressing for further progress on the issue of movement of natural persons, which is an unfinished agenda of GATS. While Pakistan till now has paid a great deal of attention to export its own services. This needs to be rectified. We still do not possess the institutional and technical capabilities to develop, advocate and formulate the standards and legislations to meet the WTO requirements. While WTO, in principle, offers technical assistance to developing countries to develop the capabilities to implement obligations and to benefit from its membership rights, Pakistan has not tapped into these opportunities well. It is time that we take full advantage of technical assistance and capacity building programs of WTO and other multilateral agencies.

Lastly, in this era of globalization, regionalism has assumed great importance. It is high time that we make SAARC and ECO more proactive to spur up intraregional trade toward off the risk of being marginalized.

General Agreement on Trade in Services (GATS)

Pakistan has participated in GATS negotiations, but did not undertake extensive commitments. Pakistan signed the second protocol to the GATS that pertains to financial services, which apply to insurance, banking and other financial services. Pakistan also provided offers in the negotiations on Basic Telecommunication which were completed on February 15, 1997.

Pakistan's schedule of specific commitments consists of both;

¾ Sector-specific commitments
¾ Horizontal commitments.

Sector- Specific Commitments

The Sector- Specific Commitments cover 47 activities within the business, communications, construction/engineering, health, financial and tourism/travel services. The GATS agreement recognizes 12 main sectors for the purpose of classification of services are as follows.

1. Communication.
2. Financial.
3. Construction/Engineering.
4. Health.
5. Tourism/travel.
6. Distribution.
7. Education.
8. Environment.
9. Recreation/culture.
10. Sporting.
11. Transport.
12. Others.

Pakistan has so far made commitments in only first six of above mentioned twelve sectors which are business services, financial services, communication services, health and related services, construction and related engineering services and tourism and travel related services.

Pakistan also submitted two lists of MFN Exemptions, One relating to telecommunications on April 11, 1997 and the Second relating to banking and other financial services on February 26 1998.Under Article II of GATS, Pakistan maintains MFN exemptions for four financial services/activities with a view to presenting reciprocal requirements, for four financial services/activities with a view to presenting reciprocal requirements. Islamic financing transactions and join ventures among ECO countries.

Pakistan also maintains exemptions in two identical communication services in favours of countries/operators signatories of bilateral agreements on rtes with the PTCL. It may be mentioned that the maintenance of Article II exemption is not unusual: 79 member countries have maintained 390 MFN exemptions. However, such exemptions should not exceed a period of ten years (beginning from1995). In any event, they shall be subject to negotiation in subsequent trade liberalization.

The activity or **Industry-Specific Commitments** have been made under;

¾ Article XVI (Market Access).
¾ Article XVII (National Treatment).

Of the GATS, MFN exemptions on the other hand originate from Article II of the GATS.

Horizontal Commitments of Pakistan

The Horizontal Commitments of Pakistan, that is, commitments that apply to all sectors, relate to "commercial presence" or "presence of natural person". Pakistan's commitments regarding "commercial presence" are subject to incorporation in Pakistan with maximum foreign equity of 51% unless different percentage is inscribed against a particular sector or sub-sector. All expenses of representative offices have to meet by foreign remittances. A Foreign undertaking is allowed to hire up to 50% of its total executive and specialist from abroad.

Acquisition of real estate by non-Pakistani entities and/or persons is subject to authorization on a case by case basis taking into consideration the purposes and location of the undertaking.

A study on Trade in Services commissioned by Ministry of Commerce, Government of Pakistan (March 2003) brought forth following important points;

¾ Pakistan like a large majority of countries was rather cautious in its approach to GATS commitments. This was only natural. But what was unique to Pakistan was that while it had paid a great deal of attention to inward flow of foreign investment and technology it did not view the GATS as a mean of expanding export of its services. The central lesson of this Study is that Pakistan should increase the range of its objectives from inward investment and importation of foreign technology to the expansion of its exports. In future its objective should be attraction of foreign investment, increase in importation of modern technology, and promotion of exports of services.
¾ Pakistan has already liberalized substantially at least 16 of its major services.
¾ Pakistan should also extend its interest to all the four modes of supply instead of focusing on politically difficult on or two modes such as mode 4, the movement of natural persons.
¾ The GOP institutions concerned with the 12sub-sectors of the Services should make arrangements for preparing strategies aimed at the promotion of their exports.
¾ Pakistan should notify to the WTO Secretariat its own Enquiry and Contact point.
¾ The Ministry of education, in collaboration with the engineering Council, needs to create a specialized institution to deal with issues relating to "mutual recognition" and pursue in particular the right conferred on member countries by Article 7 of the GATS.

¾ This study recommends that Pakistan may undertake partial or full commitment, at least in respect of those liberalization policies that have remained in force for five to seven years after proper evaluation of their impact.

It is a matter of great concern the exports in services sectors has grown marginally in Pakistan, while it has grown four fold in India and fie fold in China during decade of 1990s. In fact, share of export and import of services in total exports and import of Pakistan fell during the decade. Pakistan has done well by undertaking autonomous liberalization measures relating to communications and financial sector, well over and beyond its commitments under the GATS. Policies regarding telecommunication and banking are the other two examples of 'autonomous liberalization'. This has brought technology and investment in these sectors.

Pakistan did not upgrade its commitments to the level of its higher actual liberalization partly because it was too early for it to bind its hands, partly because of lack of time-tested regularly framework for services, but mainly because the industrialized countries did not offer sufficiently attractive export opportunities for its service sector. These measures taken for liberalization have not been translated into internationally binding commitments. The binding will provide an assured and relatively stable environment for investment for foreigners and overseas Pakistanis/ the Government can offer to commit these policies as bargaining chips and seek credit for these. Attempts are made to obtain commercial quid pro quo.

Report, Pakistan has received offer from 20 countries for talks for concluding most favored nation (MFN) treaties. It has not made any request for concessions because it has adopted a wait and sees posture to see what concessions are announced at Cancum for the developing countries.

Lesson 41

WORLD TRADE ORGANIZATION (WTO)
PAKISTAN & WTO – I

Trade Related aspects of Intellectual Property Rights (TRIPS)
As a member of the WTO, Pakistan is committed to fulfilling TRIPs obligations. Copyrights piracy is considered very high, affecting imported computer software, videos, films and textile designs. Pakistan like developing countries was given deadline of January1, 2000 (i.e. five year period) to bring into conformity with the WTO commitment. List copyrights laws etc. Pakistan is not yet fully ready to implement its commitment.

In Pakistan, five laws/amendments have been promulgated, to provide intellectual property protection under WTO standards.

1. Patents Ordinance, 2002
2. Trademarks Ordinance, 2001
3. Copyrights Amendments Ordinance, 2000.
4. Industrial Designs Ordinance, 2000.
5. Registration of Layout Designs of Integrated Circuits Ordinance, 2000.

In Industrial economies, intellectual property laws are regulated under a single umbrella organization to reduce the regulatory impediments that discouraged entrepreneurs from compliance with regulations. In Pakistan, all three areas (Copyrights, trademarks and patents) are managed separately by different federal ministries, i.e. Ministry of Education (copyrights), Ministry of commerce (trademarks) and Ministry of Industries & Production (Patents). There is urgency for enforcement of the laws promulgated regarding infringement of IPRs for which necessary rules should be farmed and notified a priority basis.

General enforcement obligations under TRIPS
Pakistan IPR legislation follows the TRIPs standards by providing for civil and criminal remedies and also for broader measures for enforcement of IPRs. For all forms of intellectual property, civil remedies are available against infringement .All decisions of lower courts i.e. the district courts are appeal able in the High Court. Due process such as the timely service of notice, right of being heard. Production of evidences etc. is available in IPR cases as in any other legal action in Pakistan. In any suit for infringement of IPR in addition to provisional and border measures the courts may order remedies that act as effective deterrents to infringements of intellectual property.

Enforcement of IPRS
The enforcement of IPRs is weak area in Pakistan and this state of affairs makes us vulnerable not only to criticism but potentially also to trade retaliatory measures from our trading partners. Our manufacturer needs to be very careful about infringement of IPRs to avoid possible trade sanctions against us. American Business Council has suggested setting up of an IPR task force.

WTO and Pakistan Intellectual Property Rights Organization (PIPRO)
To improve the administrative and enforcement scenario, the government of Pakistan has approved establishment of an umbrella organization called "Pakistan Intellectual Property Rights Organization" and, as per Trade Policy 2003-04, "necessary legislation will come soon so that PIPRO can start functioning". This organization is intended to fill the much-needed gaps in the areas of IPR policy articulation, legal and enforcement issues, research and development, up gradation of outdated systems and procedures, coordination, human resource development, etc. Reportedly, United States, has offered technical assistance for the establishment of PIPRO. The importance of IPRs is further underscored by the fact that these are directly linked with signing of FTA between USA and Pakistan.

International Treaties
Among the WIPO Conventions, Pakistan has joined the Universal Copyright Convention and is in the final stage of acceding to Paris Convention for the protection of Industrial Property.

Pakistan's Viewpoint

¾ All provisions of the TRIPs agreements must strike a balance private rights and public policy objectives.
¾ Technical assistance for development and transfer of technology.
¾ In Geographical indication, additional protection should be extended to products like Wine & Spirit.
¾ TRIPs Agreement to be made compatible with the Convention on biodiversity. There is a need to incorporate a provision that patents inconsistent with the convention must be granted.
¾ Harmonization of the Convention on Bio-diversity and TRIPS Agreement on protection of traditional knowledge, Folklore and Plant Breeders Rights.
¾ Maximum flexibility to adopt measures for pubic health and access to medicines.
¾ The Agreement should be reviewed to ensure how developmental objectives can be taken into account.

Trade Related Investment Measures (TRIMs)

Under the TRIMs Agreement, WTO members agreed not to apply any TRIMs inconsistent with GATT national treatment and quantitative restriction subject to the exemptions permitted under GATT 1994.

Pakistan is committed to phase out the "Deletion Programme" for automobiles, electronics, electrical products and engineering items, which were to be phased out within five years of the entry into force of the agreement. However, transition period could be extended, on the request of individual developing/LDCs if there are difficulties in elimination them. Pakistan along with six other developing countries received extension of the transition period through the end of 2001 and in November 2001 further extensions were granted for period up to end-2003. Thus, instead of the extension of seven years demanded by Pakistan, WTO Council of Trade and Goods (CTG) has granted only a two year extension up to December 2003 for the implementation of the deletion program. Reportedly consideration of one further request for extension on the transition period is pending.

Textile and Clothing (ATC)

One of the principle objectives of Pakistan in UR was not only to achieve elimination of multi-fibre agreement (MFA) but full integration of textile and clothing into the GATT in order to secure greater access to international markets.

However, the results of UR Agreement on textile and clothing were disappointing is for Pakistan. Almost half (49 %) of the products of textile and clothing are left to be integrated in final year of 10 years integration period. this "back loading" suggests that meaning full integration will take place in the final stage and at that time developed countries may either impose new restrictions or impose Antidumping or other Safeguard measures to restrict market access.

In mid 1996, Pakistan presented to the WTO Goods Council a paper on behalf of WTO members arguing that developed importing countries were not living up to the liberalizing spirit of the Agreement. The exporters raised a number of concerns including the fact that most of the commercially meaningful items are being left until last stage of integration.

Developed countries were using transitional safeguard measures to protect their industries on the plea that surges of imports of specific products were causing serious damage to their industries. In the first year of ATC, two transitional Safeguard actions were taken by USA to restrict textile imports from Pakistan. The US government adopted delaying tactics for fulfillment of 3-year quota restrictions imposed in October 1999 on imports of combed cotton yarn from Pakistan.

Although Textile Monitoring Body (TMB) gave its decision in favours of Pakistan, the US government did not pay any attention. The GOP initiated proceedings with the DSB and received favorable decision, whereupon US filed an appeal with the DSB for review. Finally, Pakistan received decision in its favours but the damage was already done.

Our exports in 2005 would face severest competition from major suppliers like China, Hong Kong, Thailand and Bangladesh. Potential growth of Pakistani exports depends on ability of producers to improve the quality of their exports, and improvements in productivity and restructuring of the domestic industry.

The textile sector, which contributes 67 percent to our total exports, has made some headway in facing the post quota era after January, 2005. Under Textile Vision 2005, industry planned to invest 6 billion dollar in a phased program to take the production of textile goods upwards in the value chain. In the last four years, textile sector has invested US$ 2 billion for BMR to ring their production at par with the world quality. There has been quantum jump in the exports of value added textiles during the year 2002-03: three more value added items namely knitwear, bed wear and ready-made garments have joined the fabrics in the elite club of billion dollars in export of textile goods.

However, the pressure is mounting on textile industry from foreign buyers for compliance with social, labour, health, hygienic and environment standards. This needs to be addressed on top priority basis.

It is apprehended that the implementation of WTO and the MFA phase out will start another era of non-tariff barriers by developed countries. The non-tariff barriers consist of a long list of social standards and social issues, including child labour, environment and other quality standards.

Lesson 42

WORLD TRADE ORGANIZATION (WTO)
PAKISTAN & WTO – II

Anti-Dumping
In economics, **"dumping"** can refer to any kind of predatory pricing. However, the word is now generally used only in the context of international trade law, where dumping is defined as the act of a manufacturer in one country exporting a product to another country at an unfairly low price.

Antidumping Duty
A penalty charge on imports to protect domestic industry against disruptive pricing practices by foreign firms (see dumping). An antidumping duty is supposed to be set equal to the margin of dumping, defined as the difference between fair value and the actual sales price. GATT Article 6 permits members to levy antidumping duties, while the GATT Antidumping Code attempts to standardize and discipline importing governments' activities in this area. See also circumvention and injury test.

During recent years, Pakistan's exports especially of textile and clothing have been subjected to anti-dumping and safeguard measures in Japan, EU and USA. EU is presently investigating a dumping case against Pakistan bed-linen exporters.

There is prima facie evidence that cases of imposition of ANTI Dumping Duties (ADDs) against different sub-sectors of the textile industry have been registered in orde4r to protect jobs of textile industries of developed countries. This is seriously impacting on Pakistan's economy. Even in cases where investigations do not lead to eventual imposition of definitive ADDs, trade is disrupted in the interim period and valuable customers are lost.

Given the backdrop of increasing anti-dumping measures against our exports, we need to implement anti dumping measures to protect domestic industry against the onslaught of unfair competition. In this context, following ordinances have been promulgated in Pakistan;

- Anti dumping law 2000
- Countervailing Duties Ordinance 2001
- Safeguard ordinance 2002.

National Tariff Commission (NTC), with the assistance of CBR, has been assigned the task to implement these ordinances in Pakistan. Since the promulgation of Anti-dumping law, NTC has levied 27.33 % anti-dumping duty for a period of 54 years on Tinplates of thickness of less than 70.5 mm and width of 600mm or more imported from South Africa. It has also imposed provisional anti-dumping duty at the rate of 96.50 % on Roquette Freres of France and 91.12 % on P.T.Sornini Corporation of Indonesia, for allegedly dumping Sorbiol 70% Solution, a sweetener of pharmaceuticals etc.

Pakistan has resorted to Anti-dumping measures only twice in the eight years of WTO regime, as against on 100 occasions by India. The country urgently needs to build a strong network of ADDs and CDs to protect the local industry. In this context, it is heartening to not that the Trade Policy 2003-04, envisages enhancement of capability of National Tariff Commission in the sphere of Anti-dumping and Countervailing duties and Safeguards measures as well assisting stakeholders in filling their applications with NTC.

Dispute Settlement Body
The developing countries including Pakistan are facing problems of hiring law firms to advise and represent them in WTO related cases. Exorbitant fees of these law firms ranging from US$ 200 to US$ 600 an hour restrict the developing countries from seeking relief. This underscores the need to train local lawyers with WTO expertise.

Customs Valuation

After availing the grace period of 5 years, the finance Act 1999 -2000 amended the Section 25 of the Customs Act 1969 to accommodate the necessary changes for adoption of GATT code of valuation based on transaction value.

There is, however, a general complaint that rules and regulations are not being observed by customs officials with respect to custom valuation. Instead of observing the transactional value system, they apply various procedures including the fixation of ITP on the basis of weak evidences, loading of the declared value with or without any evidence or any other method devised by the assessing officer on case-to-case basis.

Agriculture

It is expected that under UR Agreement, market forces would result in domestic prices rising to world prices, which would stimulate domestic production. Tariffs in developed countries were reduced by 36% on fruits and vegetables, and 48% for such non-traditional products as flower, providing Pakistan improved export opportunities.

The result on rice and wheat could have mixed effects. The agreement to reduce subsidies on rice and wheat maintained by developed countries could result in increased market access. The reduction on subsidies and resulting price increase would mean that total expenses of Pakistan for wheat imports, in wheat deficit years, will rise. Pakistan is not fully availing of investment subsidies generally available to agriculture and other input subsidies admissible under AoA. besides provision on S&DO treatment permit developing countries to use subsidies to reduce cost of making exports of agricultural products including upgrading and other processing costs and the cost of internal and external transport and freight. But GOP is not extending such subsidies to the warranted level on the pretext of budgetary constraints.

It is ironic that while developed countries are slow in phasing out subsides under WTO regime, most of the reductions in farm subsidies in Pakistan so far have been made under the commitments to IMF, ADB and other international financial institutions.

According to Pakistan's WTO Representative, substantial reduction in tariffs and farm subsidies would mean greater market access to Pakistani agricultural products. Pakistan's cotton would fetch better prices for our farmers.

Lesson 43

WORLD TRADE ORGANIZATION (WTO)
PAKISTAN & WTO – III

WTO Agreements on TBT and SPS

To meet the requirements of WTO Agreements on Technical Barriers of Trade (TBT) and Sanitary and Phytosanitary Standards (SPS), Pakistan has taken a number of key initiatives aimed at strengthening technical institutions capabilities in standard setting, compliance.

In Pakistan, ISO9000 – and ISO14000 certification is rising and reportedly now well over 3,000 companies are ISO 9000 certified. as for ISO 14000 certifications, out of a total of 103 countries, Pakistan ranks 56th with only ten ISO 14001 certified firms while India is 19th. All these companies are certified by foreign based bodies. The problem with foreign certification bodies is that notwithstanding the fact that they are accredited by reputable accreditation bodies, very few have been listed for surveillance audits in Pakistan. This greatly reflects on the performance of these certification bodies.

Against this backdrop, Pakistan National Accreditation Council (PNAC) was set up in 1998 in Ministry of Science & Technology and in 1999, under ADB-assisted Trade Export Promotion & Industry Program (TEPI). Project, it launched the accreditation services for ISO 9000/ISO 14000 certification bodies and ISO-17025 laboratory certification.

According to Pakistan Country Report on Trade and Sustainable Development, prepared by Sustainable Development Policy Institutes (SDPI), in October 2002, the TBT and SPS agreements present both an opportunity and constraints. The two agreements seek to increase market access for the exports of its member countries. However, the prerequisite is that they abide by the strict rules the WTO has formulated for the development of mandatory technical regulations, voluntary standards and conformity assessment procedures. This is where developing countries like Pakistan come up short. They do not possess the institutional and technical capacity to develop, advocate and formalize such standards in WTO for a, nor the conformity assessment and accreditation bodies to certify that domestic industries are complying with international standards. While the WTO, in principle, offers technical assistance to developing countries to develop these capabilities, the concern expressed by various stakeholders suggest that Pakistan has not tapped into these opportunities.

Role of Exporters in tackling Non Tariff Barriers

Some of non-tariff barriers can be tackled by the exporters themselves by ensuring that they adhere to quality and standards requirements of the importing countries. For this purpose they need to plan production and packaging methods especially for the export markets.

- The manufacturing techniques must be carefully selected so as to insure that the resultant products do not cause any harm to human, animal or plant life or health.
- The exporters need to carefully study the laws and regulations of the importing countries and their likely impact on the exports. similarly they should also carefully examine the notices or notification made by the importing countries under the Agreement on Application of Sanitary and Phytosanitary measures and the Agreement on Technical Barriers to Trade.
- The exporters should maintain an effective interaction with their counterpart associations etc. in the importing countries. Any difficulties due to technological or economical limitations must be adequately brought forward to the notice of the Government. Most of the WTO Agreements envisage special and preferential treatment to developing countries. Specific problems being faced and the favours required should therefore, be identified. This may help the Government to have effective bilateral consultations with the concerned countries and to seek specific dispensation.

Since any dispute in the WTO can be raised by the Governments only, the exporters will do well to fully cooperate with their Government and to provide it with all the necessary information through their associations.

Impact of Reduction of Tariff and NTBs by Developed Countries

Developed countries committed to a 40 percent reduction in the average tariff on industrial products from 6.2 percent to 3.8 percent. While these cuts will improve access, their impact has been small because tariffs on manufactures in industrial countries were already low (except apparel). Pakistan's exports to OECD will face average rates of 6.9 percent. However, textile and clothing products, which account for 57 percent of our exports to OECD received below average tariff reduction of 22 percent, meaning that developed countries will reduce tariffs from 14.6 percent to 11.3 percent. Exports of leather products and travel goods are also important to Pakistan but this again received below average 18 percent tariff reduction.

After the complete phase out of quota restriction is feared that developed countries would resort to use of NON-Tariff Barriers like imposing requirement of environment and labour standards and use of child labour etc. to protect their own interests.

Lesson 44

WORLD TRADE ORGANIZATION (WTO)
CONCLUSIONS AND RECOMMENDATIONS

WTO is a reality, which has come to stay. We have to face the emerging challenges and grasp the opportunities. As the Governor, SBP stated that we need to develop strategy to get maximum benefit from globalization.

Foremost areas of concerns

- The textile sector, which contributes 67% of our total exports, would in 2005 face severest competition from other major suppliers like china, Hong Kong, Thailand and Bangladesh. We have made some progress in facing post quota era under Textile Vision 2005 to take the production of textile good, upwards in the value chain. it is apprehended that the MFA phase out will start another era of non-tariff barriers. With the phasing out of quotas, textile manufacturers in industrialized and some quota free countries may decide to relocate. Government should provide incentive to ensure that they relocate in Pakistan.
- The country urgently needs to build a strong network of anti-dumping and countervailing duties to protect the local industry against the onslaught of unfair foreign competition. It is heartening to note that Trade policy 2003-04 envisages enhancement of capabilities of NTC and it is recommended that NTC should be restructured and converted into an autonomous body employing private sector professionals.
- The developing countries face problems in hiring law firms to advice on WTO related issues, which is a constraining factor in seeking relief from Dispute Settlement Body. There is a need to train local lawyers with WTO expertise.
- Our survival lies in enhancing credibility through adoption of international quality standards, but Pakistan has a long way to go in obtaining certifications of ISO9000, ISO14000 and other standards. We need to set up PNAC accreditation testing laboratories for conformity assessment.

GoP must collect data in respect of standards of manufacturing, food and other agricultural produce in the countries where we are targeting out exports. GoP may amend the policies for manufacturing of engineering goods so that it offsets the effects on their performance due to termination of grace period of TRIMs by end 2003. We should take up our concern at wto for a regarding replacement of tariff barriers by some countries with SPS and TBT- which is evident from increased emphasis being placed on inspection of imported food and agricultural products. As a member of WTO, Pakistan is committed to fulfilling trip's obligations, for which five law amendments have been promulgated. There is urgency for enforcement of laws regarding infringement of IPRS, a sine qua non for attracting foreign investment, for which necessary rules should be framed and notified on a priority basis. The Government had announced, in Trade Policy 2002-03, establishment of umbrella organization PIPRO for improving the administration and enforcement scenario, but necessary legislation for PIPRO to start functioning is still pending.

Pakistan has done well by undertaking liberalization measures relating to communication and financial sectors well over and beyond its commitments under GATS. But the measures have not been translated into internationally binding commitments. We should undertake partial or full commitments, where feasible, which will provide an assured and relatively stable environment for investment for foreigners and overseas Pakistanis. Attempts may be made to obtain commercial quid pro quo from other countries. Pakistan in collaboration with other LDC's needs to stress for further progress on the issue of movement of natural persons, which is an unfinished agenda of GATS.

According to recent study, the major flaw in Pakistan's approach that while it paid a great deal of attention to inward flow of foreign investment and technology it did not view gats as a means of export of its services. This needs to be rectified but the Developing countries are still in a low level of economic equilibrium, which was the raison d'etre of grant of grace period. there was, however, one exception relating applicability of WTO norms on "prohibited subsidies", contingent upon export performance admissible to

20 countries including Pakistan until they attain per capita GNP of US $ 1000. We suggest that other concessions of grace period should like wise be linked with attainment of specific level of economic progress and institutional capabilities.

Besides, most of the provisions of WTO agreements regarding S&D treatment are declaratory. In the absence of implementation modalities, these provisions have not been of any particular use to developing countries. Pakistan should evolve joint strategy with other developing states and press hard at Cancun ministerial for finalization of necessary modalities, as envisaged in Doha development agenda.

In this era of globalization, regionalism has assumed great importance. It is high time that we make SAARC and ECO more proactive to spur up intra-regional trade to ward off the risk of being marginalized. The core WTO related issues are discussed and debated in the technical committees, where our participation is not effective, as it is not backed by background research for submission of technical papers.

This underscores the need for meaningful coordination of efforts at government level and industry level under the aegis of SAARC to ensure effective participation in the meetings. We still do not posses the institutional and technical capabilities to develop, advocate and formulate the standards and legislations to meet the WTO requirements, while WTO, in principle, offers technical assistance to developing countries to develop the capabilities to implement obligations and to benefit from its membership rights; Pakistan has not tapped into these opportunities well.

It is time that we take full advantage of technical assistance and capacity building programs of WTO and other multilateral agencies. There is urgent need for capacity building of private sector institutions for dissemination of information on WTO and provide research feedback to government for policy formulation and for their on going negotiations with WTO under Doha round.

1. Due to the enlargement of European Union from 15 to 20 countries.
2. Due to bilateral agreements in which countries of our interest are also GoP should take up studies to ascertain the impact on trade of Pakistan involved. accession of china to WTO.

Lesson 45

SUMMARY & CONCLUSIONS

The role of government as a facilitator of business and its interaction with business support institutions is imperative for the establishment of a mutually beneficial relationship for the growth of the sector. SME promotion is an important issue for many government departments and central offices. For example, the Ministry of Labour plays an important role in shaping the labour market policy of the state. Similarly, in order to gather information on the health of the SME population the role of Federal Bureau of Statistics, the Ministry of Finance, and planning division is pivotal. Other ministries and divisions such as Ministry of Local Government and Rural Development, and the Ministry of Science & Technology also influence the situation of our SME. Provincial and local governments also take their share in responsibility.

However, there is an existing lack of coordination and regular information exchange mechanism among institutions, which constrains their collective ability to deliver in the SME development process. As a result of the Government's recent efforts, two institutions Small and Medium Enterprise Development Authority (SMEDA) and SME Bank were created.

The responsibility for facilitating SME policy development now lies with SMEDA, which is attached to the Ministry of Industry and Production (MOPI). SMEDA is responsible for creation and coordination of Government policy for the SME sector. Parliament, naturally, is responsible for monitoring policy and its implementation.

One of the major reasons for the lack of coordination is that SMEDA has not been provided with a formal mechanism to initiate, coordinate, monitor and evaluate initiatives undertaken for SME development, which fall outside of its own scope of activities.

Therefore, cross-departmental and stakeholder consultations, resulting in the preparation of our national SME policy are our key to success. Regular information exchange mechanism and networking needs to be developed amongst our public and private sector institutions. There is a strong need to devise such an information exchange mechanism and redefine the role of institutions, specifying their functions in order to avoid duplication of efforts and allowing the best possible usage of resources.

Under the SME Sector Development Program it is expected that SMEDA

- Prepares Government documents on policy regarding SME.
- Drafts relevant laws and regulations.

To form a collective view of all stakeholders, the SME task force has been established at the MOIP, SMEDA will serve as the secretariat.

A network of institutions stimulating the growth of SME is being proposed. The institutions in this network cover all stakeholders involved in SME promotion; Regional Development Agencies, Business Support Centres, Chambers of Commerce as well as other organizations, which are established as an initiative of local communities.

Pakistan has no across the board legal definition of SME. This makes it extremely difficult to monitor the development of our SME economy and to establish benchmarks against other countries in order to devise areas of intervention and support.

Various government departments and public-sector agencies have adopted their own definitions. There are, of course, various reasons for them to define SME, and there may even be discussion on just how a strict and reasonable size standard could be defined.

A number of current definitions are based on capital standards since this influences the pattern of fund raising in the formal and informal market by SME.

Many stakeholders consider enterprises with 100 or more employees as large, and enterprises with less than 5 employees as micro. Yet our statistical system classifies enterprises with more than 10 employees as large, and the State Bank of Pakistan considers those with more than 250 employees as large.

The reference to international practice also suggests differentiation among industrial, wholesale, and retail10 and services related enterprises. This view also gets credence from various studies on the issue for pakistan11. Again, this consideration is only visible in the SBP definition and missing in all others. There are also rationales beyond the particular organizational motivations for defining specific size classes, and it will therefore be useful for all stakeholders to review definitions on technical grounds.

For a national policy, it is extremely important to have a harmonized definition for, as it is also important for the government to focus assistance as reasonably as possible for maximum efficiency. It is also imperative to adopt a definition to foster the coherence of vision in the SME policy development and for the better implementation of related support programs across institutions.

Financing Tool
There should be a security tool devised be SBP to handle the security problem of SME LENDING.

Think Small First
The small industries should be given priority in purchasing from private sector and priority should be given to small industries like UK.

Approach On Site
The small industries should be approached at the it site as due to scattered locations of the small industries.

Technical and language barriers.
The training of manpower should be in line with the requirements of the industries and the main policies and plans should be published in Urdu to make it understandable for every body.

Soft Tax System
There should be customized system for the small industries as that lack documentation and can not afford costly book keeping.

Simple Labour & Other Laws
The labour and other laws should be made very simple as there are 56 laws in labour only. To make them simple should be adopted
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Book Recommended
Small Entrepreneurs in developing countries By **Dr Asher S. Nair**

THE END