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Editor's Corner

Dear Readers,

The economic scene in Pakistan has substantially improved from that a decade ago. In the last few years the many sectoral reforms introduced, the consistency in policies, have put the economy on the road to growth and brought overall stability.

GDP growth averaged 7.6 percent in the last 3 years, fiscal deficit declined from an average of 7 percent of the GDP in the 1990s to an average of 3.5 percent during the last 6 years. The associated public debt burden fell sharply from over 100 percent of GDP to 56 percent in FY06. The banking sector witnessed phenomenal growth, the stock market performed well and compared to other markets in the region, the Karachi Stock market became attractive for both foreign and local investors. Market capitalisation as percent of GDP rose in all the three stock exchanges of the country. Foreign investment picked up, inflow of remittances increased and Pakistan received upgrades in credit ratings for foreign currency, local currency and short term sovereign ratings from Standard & Poor's last year.

Sustaining the growth achieved would however, require attending to the challenges and the structural issues facing the economy. The widening trade deficit and the resultant large current account deficits, low investment to GDP ratio, social sector development, concentration of export earnings on selected items and markets, traditional industries accounting for the major share of total manufacturing value added and emerging power and gas shortages are risks to the economy's medium term economic prospects and need government attention. It is reassuring that the policy makers are cognizant of these issues and have developed strategies accordingly.

In addition, the country also faces the economic challenge of achieving competitive advantage of entering/expanding into new markets. Competitiveness is driven not only by the macro economic environment in which businesses operate, but also by the quality of microeconomic business environment (includes, corporate governance, management & staff training, enforcement of contracts, access to skilled labour, delegation & authority etc) and by the quality of business strategy and operations.

While ranking Pakistan in terms of the Global Competitiveness Index (91st) and the Business Competitiveness Index (67th), the Competitiveness Support Fund has shown that in analysing each index in terms of key areas which constitute the index, Pakistan has ranked well on some indicators, but needs to focus on the health and primary education pillar, and on higher education and training if it is to dramatically improve its overall ranking, while also improving its technological readiness ranking.

As the pace of globalisation gathers momentum, and markets integrate, competition pressures are likely to intensify. Developing countries, once at the periphery of the global economy, are now moving to centre stage and are becoming serious competitors in the markets of high income countries and in each other's markets. Pakistan is no exception.

Among other areas, countries are now focusing upon the regulations that enhance business activity and those that constrain it. In Pakistan, the State Bank of Pakistan, the Securities and Exchange Commission, the Central Board of Revenue, the local courts, and other federal/provincial institutions are increasingly focusing upon building a conducive business environment which fosters growth and development of the economy. Implementing good practices of doing business would attract investors, business firms would have the opportunity to thrive, which would lower unemployment and consequently help in the reduction of poverty.

In a World Bank report, ‘Doing Business in South Asia 2007’, Pakistan ranks relatively well on some indicators of Doing Business regionally and among the countries globally. For instance, starting a business now takes lesser time than the South Asian average, registering property is a relatively simple process, though experiences of other countries provide simple ways to cut procedures, time and costs. It earns high scores for protecting investors in terms of disclosure, director’s liability and ease of shareholders’ suits. While recent reforms have reduced the time it takes to export and import, introduced corporate governance, brought reforms in the credit information system, among others, it still needs to modernize the outdated municipal bylaws and the process for issuing permits, particularly in the large industrial areas, reform tax policy to widen the tax base and reduce the average tax rate, reduce the number of steps and the cost of starting a business, undertake extensive reforms of the labour code, strengthen creditor rights and further reduce the steps, time and cost necessary to develop a site, so to improve the business environment.

Despite these challenges, the medium term outlook for the economy is positive according to the ADB. Pursuing pro growth policies, increase in public sector development programme, the projected rise in investment, the boom in banking and telecoms due the favourable policy environment for these sectors and with the governments’ commitment to strengthen the economic reforms of recent years, the economic prospects of the economy look promising.

Ayesha Mahmood

Small and Medium Enterprise Sector in Pakistan

Significance of SMEs

Small and Medium Enterprises (SMEs) play a central role in creating market oriented economic growth, employing the growing workforce in developing countries so helping in income generation and in reducing poverty. The abundance of labour and the shortages of capital which are characteristics of developing countries are compatible with the SMEs labour intensive character.

In the industrialized countries, statistics show that SMEs are major contributors to private sector employment. Empirical studies have shown that SMEs contribute to over 55 percent of GDP and over 65 percent of total employment in high income countries. SMEs and informal enterprises, account for over 60 percent of GDP and over 70 percent of total employment in low income countries, while they contribute over 95 percent of total employment and about 70 percent of GDP in middle income countries.

Many of the big companies today, began as an SME. Microsoft began as a couple of people in a small garage in North America; Hewlett Packard started in a little wood shack; Google was begun by a couple of young kids who thought they had a good idea, even Volkswagen at one point was just a little car maker in Germany. There are such success stories in Pakistan also.

Defining SMEs

Definition of SMEs varies across countries, and is usually based on the number of employees, and value of sales and/or value of assets. The most commonly used variable is the number of employees. The EU and a large number of OECD, transition and developing countries set the upper limit of number of employees in the SMEs between 200-250, with a few exceptions such as Japan (300 employees) and the US (500 employees).

The IFC definition

	Micro	Small	Medium
Employees	<10	10-50	50-300
Total Assets	<$100,000	$100,000-$3 Mn	$3 Mn-$15 Mn
Annual Sales	<$100,000	$100,000-$3 Mn	$3 Mn-$5 Mn

Source: World Bank Institute

In Pakistan, there is no single definition for SMEs. State Bank of Pakistan (SBP), Small and Medium Enterprise Development Authority (SMEDA), Federal Bureau of Statistics (FBS), SME Bank have been using their own definitions. The State Bank of Pakistan has defined SMEs in the Prudential Regulations for SME financing as an entity, ideally not a public limited company which does not employ more than 250 persons (if it is manufacturing/service concern) and 50 persons (if it is trading concern) and also fulfills the following criteria of either ‘a’ and ‘c’ or ‘b’ and ‘c’ as relevant:

a A trading/service concern with total assets at cost excluding land and building upto Rs50 million.

b A manufacturing concern with total assets at cost excluding land and building upto Rs100 million.

c Any concern (trading, service or manufacturing) with net sales not exceeding Rs300 million as per latest financial statements.

An individual, if he or she meets the above criteria, can also be categorized as an SME.

The SME Policy 2006 has recommended for a single SME definition, and has given the various organizations a two year time frame to align their current SME definition in line with the SME definition proposed in the policy (see Box).

SMEs receiving increasing focus

In the last few decades there has been growing recognition/commitment for enhancing the development of SMEs both in the developing and developed countries. For instance, in

China, where SMEs account for 99 percent of the total number of firms, 60 percent of GDP, 40 percent of fiscal revenue, 84 percent of total employment, account for 71 percent of total sales and 60 percent of exports, the Government provides support to the sector. China has set up technological innovation service centres, scientific and technological parks, universities, all lending support for SMEs technological innovation. The government has also promulgated a series of laws and regulations to protect and promote the development of SMEs; and has helped them to exploit international markets.

In the newly industrialized economies of Asia, such as Korea, Hong Kong, Taiwan, there is evidence to support that the SME sector has in many cases been the driving force, supported by clear government policy. *Experience of SMEs in South and Southeast Asia*, a paper by the South Asia Enterprise Development Facility shows the comparative experiences of the newly industrialized economies. In some cases, the SME sector was the driving force, whilst in other cases it followed developments such as the growth of export oriented large enterprises.

South and South-east Asian exper-iences

For example, in Taiwan, centre firms have supported SMEs by providing equipment or collateral for subcontractors, while subcontracting between SMEs has encouraged business linkages that have enhanced sector efficiency and productivity. There is evidence in the newly industrialized economies, of a well-developed understanding of the appropriate role for the SME sector as a component of overall policy, and the pursuit of measures that helped SMEs fulfil the sector's specifically required role.

Governments created an environment where entrepreneurship could flourish. For example, from the 1980s onwards, the Taiwanese government developed industrial parks, and encouraged the creation of geographic and sectoral clusters of SMEs, by targeting specific industries.

In all cases where the SME sector experienced significant growth, and despite the undoubted importance of financial services, non-financial instruments emerge as the primary stimulants. A range of approaches was evident, including well-targeted technology transfer, and the fostering of forwards and backwards linkages. Financing mechanisms were developed to support this growth.

The rapidly growing SME sectors in the newly industrialised economies generally focused on labour intensive activities that employed more lower-skilled workers than did large enterprises. Consequently SMEs were a major source of employment creation (in China, Japan, Taiwan, Thailand and Vietnam where SMEs account for over 70 percent of total employment) and so, seemingly, played a major role in poverty reduction.

Public sector role

Public sector has a major role to play in the development of SMEs, as the later are constrained by certain inherent weaknesses and need support. Due to their small size they do not have the same capacity to influence the environment in their favour as larger firms, regulations impose disproportional costs on SMEs, they are limited in capability, for because of their small size, SMEs usually lack management capacity, cannot afford costly support services (eg financial, human resources, legal, training) and ability to access and analyze information is particularly weak for SMEs.

Favour-able environ-ment for SMEs essential

SMEs basically need a national SME policy framework and a favourable policy environment to operate. This implies providing them with the opportunities and incentives, so they could invest productively, create jobs and expand. When entrepreneurs and firms have a positive perception of the overall investment climate (the macroeconomic conditions, legal and regulatory framework and infrastructure) know the risks and returns involved can they take meaningful decisions. Investment climate is important as it impacts firm level productivity, opportunities and employment, is crucial for private sector led growth and poverty reduction.

Many countries have implemented explicit SME development policies and strategies.

Pakistan has announced an SME Policy 2006. In East and South Asia, economies such as Hong Kong, India, Korea have formulated special policies to protect SMEs from imports and have provided incentives to improve productivity during their early development.

Impact of SMEs in India, Bangladesh and Sri Lanka

Many government in South Asia seem to have recognized the key impact that the SME sector could have on economic growth and poverty reduction. In India, development of the SME sector has been a consistent element of industrial and employment policy since the 1970s, with the objective of creating jobs, and reducing economic imbalance, notably in rural and less developed areas. Today small scale industry accounts for some 95 percent of all industrial units, 40 percent of industrial output and 35 percent of national exports.

SME play an important role in the economy of Bangladesh in terms of output, employment and private sector activities. They are quite predominant in the industrial structure of Bangladesh, comprising over 90 percent of all industrial units. Together, the various categories of SMEs are reported to contribute between 80-85 percent of industrial employment. In Sri Lanka, SME sector comprises largely well established businesses. Most countries of South Asia and the Newly Industrialised Economies of Asia have adopted policies/programmes to support SMEs, which are aimed at making them more globally competitive.

SMEs in Pakistan

SMEs are receiving increasing focus in Pakistan because of their significance to the economy; contributing 30 percent to GDP, with a share of 25 percent in manufactured exports, employing 78 percent of the industrial labour force, and contributing 35 percent towards value addition in manufacturing. An estimated 3.2 million SMEs operate in the country, where more than half are in trade, wholesale, retail, restaurants, where the bulk employs less than 5 persons. Punjab houses more than 65 percent of the small and medium sized business, followed by Sindh, NWFP and Balochistan with a share of 18 percent, 14 percent and 2 percent respectively.

Impediments SMEs face

Given the significance of the SME sector, recent years have witnessed increasing government/private sector focus. Studies have been undertaken to identify the constraints the SMEs face, an SME Policy has been announced, commercial banks are now enhancing their lending to SMEs, some Universities are offering programmes in Entrepreneurship and SME Management. In its endeavours, Pakistan like some of the other developing countries has received support from the Asian Development Bank.

ADB support to SMEs

ADB strongly supports a number of member countries in their SME development undertakings. The Bank sees assistance to SMEs as an important means of addressing its strategic objectives, particularly the objectives related to poverty reduction, sustainable economic growth and human development.

To date the bank has provided over $900 million in direct loans for SME development. Besides, it has also supported SME development indirectly through loans and grants encouraging policy reforms and through institutional reforms and capacity building. In its private sector operations, the Bank has provided loans and equity funds worth more than $1.1 billion to development finance institutions, which in turn, directly or indirectly supports SME development.

Recently it has also been recongnized that it is not enough just to ensure availability of funds to SMEs through DFIs, but that an enabling policy environment is critical to the growth of SMEs. Accordingly governments are improving their overall policy framework by removing discriminatory elements from sector policies and programmes.

ADB study

With the support of the ADB, a study to analyze the impediments to growth of SMEs in Pakistan was undertaken. The Paper "*SME Development in Pakistan: Analyzing the Constraints to Growth*" Faisal Bari, Ali Cheema, Ehsan ul Haque have analyzed the concerns about the small and medium scale industry, which inspite of the government's liberalization and

Box

SME Policy-2006

To formulate a basic framework for the growth and development of SMEs, the Government of Pakistan constituted a Task Force for SME Policy Development in January 2004. It was set up with the following objectives:-

§ Identify key areas for reforms concerning laws, regulations and achieve a policy for SMEs.

§ Develop SME Policy.

§ Define principles of SME support and set priorities.

§ Institutionalize SME support.

§ Propose detailed processes and time bound action and resource requirement for SME sector development.

§ Propose a National Level Authority to coordinate activities for SME development.

We give below excerpts from SME Policy 2006.

The SME Policy formulation was a participatory process through which private sector bodies, chambers of commerce and industries, trade associations, public sector organizations and more than 1000 SMEs were consulted across the country.

The SME Policy Task Force thus recommends that private sector led economic growth strategy should be primarily based on SME development. To achieve this objective a coherent policy framework is presented in this SME Policy document.

While developing the Policy framework the Task Force reviewed the past initiatives in this area. The various levels of the Government in Pakistan have, in the past, formulated and to an extent implemented small-scale business promotion policies. However, these policies were limited in their scope, to begin with, and are not in line with the dynamics of present time.

Various Schemes, The Youth Investment, Yellow Cabs and Self-employment promotion initiatives of the 80s and 90s followed the small-scale industrial promotion policy of the 60s and 70s. These schemes were limited in scope and designed as such that they did not address the core issues of enterprise development and employment growth and suffered from political manipulation accruing to bad loan portfolios of the banks and loss of public funds. These schemes contributed little in economic growth and employment creation. In some ways these initiatives created the mindset of the banking community, that is to date, responsible for a cautious stance towards SME financing in Pakistan.

In the recent past SMEDA stands out as a significant step towards GoP commitment to SME development. Created as an autonomous institution with private sector led governance structure, SMEDA promises to become an important institution spearheading Government's SME development efforts. However, in absence of a coherent SME development Policy framework it is unrealistic to expect a single organization such as SMEDA, to be able to implement aggressive SME development initiatives.

Objective

The objective of SME Policy is to provide a short and a medium to long-term policy framework with an implementation mechanism for achieving higher economic growth based on SME led private sector development.

The SME Policy suggests specific policy measures in all areas of SME development.

A single SME definition is recommended.

SME Definition

Problem Statement

Pakistan does not have a single definition of Small and Medium Enterprises. Various Government Agencies, e.g., State Bank of Pakistan (SBP), Federal Bureau of Statistics (FBS), Provincial Labour Departments, etc. use their own definition. Absence of a single SME definition makes it difficult to identify target firms, align development programs, collect data and monitor progress.

Policy Recommendation

GoP may adopt a single SME Definition that is accepted by all public and private agencies. However, various organizations may be allowed a two-year time frame to align their current SME definition in line with the SME Definition proposed in this Policy.

It is recommended that the following SME Definition may be adopted for the purpose of classifying Small and Medium Enterprises fulfilling the criteria either as "a and b" or "a and c".

Size	Sector	Employment (a)	Total Assets (Excluding Land & Building) (Rs. Mn) (b)	Annual Sales (Rs. Mn) (c)
Small	Manufacturing	≤50	Up to 30	≤100
	Service	≤50	Up to 20	≤100
	Trade	≤20	Up to 20	≤100
Medium	Manufacturing	51-250	30 to 100	100 to 300
	Service	51-250	20 to 50	100 to 300
	Trade	21-50	20 to 50	100 to 300

Expected Impact

Single SME Definition is expected to create focus in Government policies (targeted towards SME development) and uniformity in compilation and reporting of SME related data.

Business Environment

Problem Statement

The fiscal, labour and enterprise regulations of the Federal and Provincial Governments in Pakistan do not provide for a focus on SMEs that is in line with their specific needs. Generally the fiscal regulations divide enterprises by income levels and labour related regulations realize only two forms of enterprises small and large, thus, not providing laws and implementation mechanisms that are sensitive to SME needs.

Policy Recommendations

- § The Task force recommends promulgation of an SME Act that (in addition to addressing other issues related to SMEs) provides for identification of fiscal, registration, labour and inspection laws that may not apply to Small and/or Medium Enterprises and simplification of those that are required to be complied with.
- § A business entity may be certified as an SME by a simple process to be exercised by SMEDA in partnership with other government agencies, chambers of commerce and industries, trade associations and other private sector representative organizations.
- § The Federal Government may encourage periodic review of all fiscal laws in force with a view to facilitate and improve growth of the small & medium enterprises.
- § Periodic review of Labour Legislation.
- § SME Desks may be established at the Federal, Provincial, Banking and Tax Ombudsman Offices for handling and addressing SME grievances.
- § A minimum quota is proposed to be established for SMEs for allocation of land in the Industrial estates and Export Processing Zones (EPZs). SMEs may be charged a concessional rate of land (at no profit no loss basis) as compared to the cost offered to large-scale enterprises.
- § GoP may consider to support establishment of an SME Promotion Council (including its local chapters) and SME specific Trade Associations for organizing SMEs and providing them with a platform to lobby for favourable government policies.
- § Government to ensure adequate provision of physical infrastructure (roads, utilities etc.) in existing SME clusters.

Expected Impact

Implementation of the recommendations for creating conducive ‘Business Environment’ for SMEs will result in reducing the number and simplifying the compliance process of SME regulations. This is expected to trigger fast paced creation and growth of enterprises resulting in economic development and job creation.

Access to Finance & Related Services

Access to finance has been identified by the SMEs, as the single most important impediment to growth.

Policy Recommendations

- § Incorporation of SME financing in the Annual Credit Plan of the SBP and monitoring to cater for underserved segment of the SMEs.
- § Review of Prudential Regulations, periodically, in line with the SME credit demand and supply data.
- § Establishment of Credit Guarantee and Credit Insurance agencies, operating inline with sound international practices, to provide incentives and risk cover for banks, so as to provide them the relevant comfort in financing SMEs.
- § Support to FIs in designing and launching industry based program-lending schemes.
- § Capacity building of the CIB to report positive and negative data & sharing of SME financing data by the SBP.
- § Improvement in the regulatory procedures and fiscal incentives for Venture Capital companies.
- § Introduction of Bankruptcy Laws with dedicated and effective judicial process.
- § Expansion in the role of Banking Ombudsman to include redressal process for SME complaints.
- § Awareness and promotion of options for formal financing and good accounting practices amongst SMEs.
- § Promotion of Islamic mode of financing for SMEs.

Expected Impact

It is expected that improvement in the regulatory framework, provision of specialized credit lines and risk sharing schemes for FIs will result in creating an environment where banks will aggressively pursue the opportunities offered by the SME financing market in Pakistan. Improvement in the regulatory and fiscal environment and provision of matching contribution will result in establishment of new venture capital companies. Both these measures will improve accessibility of startups and existing SMEs to formal sources of financing, removing a major barrier to their growth and development.

Supporting Human Resource Development Technology Up-gradation and Marketing

Problem Statement

The poor national performance on the Human Development Index of the UN has its consequences for SMEs in Pakistan. These include inadequate and generic education and insufficient, poorly focused and under-serving training infrastructure. SMEs mostly draw their human resource (including the owners) from either the higher education institutions or the technical training infrastructure, both of which are not attuned to the SME needs nor are they equipped to address them.

This situation limits the capacity and capability of SMEs to innovate, add value, upgrade technology and devise new marketing strategies. Adding to these woes are the limited options available to SMEs to invest in HRD, technology and exploration of new markets. As a result, the SME sector in Pakistan is usually engaged in low value added manufacturing using inefficient labour, outdated technology and operating in limited and traditional markets.

Policy Recommendations

Human Resource Development

- Need Assessment Survey to identify major SME needs in HRD, technology up-gradation and marketing.
- Establishment of Institutes of Small and Medium Enterprise & Entrepreneurship Development in select business schools.
- Capacity building and up-gradation.
- Encouraging use of the technical training infrastructure by the private sector.
- Induction of genuine SME representatives in private sector boards of the technical training institutes.

Technology Up-gradation

- Introduction of SME specific research projects.
- Establishment of Technology Innovation Centers.
- Launching of pilot technology up-gradation projects for major SME clusters on cost sharing basis.
- Incentives for Investment in new Emerging Sectors and Skills upgrade in the form of reduced taxes and subsidized training for enterprises which sign up for up-gradation of business products, processes, quality accreditation, through a Business Improvement Program.

Marketing

- Encourage establishment of SME sector specific export marketing companies by providing matching grants in conducting international marketing research, developing marketing strategies, developing marketing material, packaging, branding, participating and conducting trade fairs and undertaking promotional and marketing activities.
- Matching grants for developing 'world-class' trade and product directories for major SME clusters.
- Establishment of SME quota in trade delegations supported by EPB.
- Compilation and dissemination of data on local markets using manufacturers, distributors and retailers data.
- Provision of support to SME associations in exploiting local market opportunities by holding domestic product exhibitions.
- Establishment of Annual SME Awards for recognizing outstanding performance in domestic and international markets, technology innovation, HRD practices etc.

Expected Impact

It is expected that effective implementation of Policy recommendations in supporting HRD, technology up-gradation and marketing will create a human resource pool and necessary infrastructure for adding value to SME businesses by technology up-gradation and innovative marketing.

Entrepreneurship Development

Problem Statement

The education and social system does not encourage entrepreneurship as a preferred career option amongst the youth. Entrepreneurship is usually undertaken by those belonging to the existing business families.

The past Government programs to encourage entrepreneurship such as Self Employment Scheme, Youth Investment Promotion Society and Yellow Cab Scheme were limited and not too comprehensively designed and thus achieved little in promoting entrepreneurship amongst the educated Pakistani youth.

Policy Recommendations

- Revision in primary and higher education curricula for promoting entrepreneurship amongst the educated youth.
- Inclusion of 'Entrepreneurship' courses in (all professional degree awarding) higher education, technical and vocational training institutions in Pakistan.
- Entrepreneurship Competitions at university level.
- Establishment of technology and business incubators in selected universities in Pakistan.
- Identification of investment opportunities offered by backward and forward linkages of successful services/products.

Expected Impact

Implementation of the recommendations on supporting entrepreneurship amongst the Pakistani youth will result in larger segments of the educated population taking interest in establishing their own businesses and some will eventually implement their ideas. As a result, a fast increase may be witnessed in enterprise creation thus adding jobs to the economy and improving income distributions.

SME Policy – Implementation and Resource Allocation

SME Policy – Ownership and Implementation

A large number of government Ministries and organizations (in addition to the private sector) will have to play their role in removing impediments and providing support for SME growth. Therefore, it is imperative that the SME Policy is approved by the Prime Minister and endorsed by all Provincial Governments.

SME Policy – Investment and Expected Impact

The SME Policy also presents the estimates of public and private sector investments for implementation of the policy recommendations and envisages benefits in terms of enterprise growth, job creation and poverty reduction.

Monitoring, Evaluation, and Continuous Improvement of Policy

Monitoring and Evaluation

In order to increase the quality and quantity of information available on the development of enterprises in Pakistan identical standards have to be used for classifying enterprises.

structural adjustment policies has not made recovery, like the recovery shown by the large scale manufacturing sector during the last couple of years. The study places special emphasis on removing the constraints on SME growth and investment.

The main aim of the study is to identify the binding constraints [binding constraints were defined as those constraints that were accorded an average score of 3.5 or above by the 'pooled' sample of respondents, and which over 30% (nearly one third) of the respondents ranked as an above-average constraint, according them a score of 3.5)] on firm level growth and investment in Pakistan, with particular emphasis on SMEs. A section in the Report has reviewed literature on the role the SMEs have played in the transformation of economies from low to middle income levels, and it has been stated in the Report that, 'the exercise is particularly relevant to Pakistan as a country at the threshold of achieving middle income status'.

The section reviewing the literature on Constraints on SME Growth in Pakistan have identified the following factors; excerpts from the Report are given below:-

Excerpts from the Report

The literature identifies the state-led models of industrialization followed during the 1960s, 1970s, and 1980s as a major factor constraining the growth of SMEs. There are several ways in which industrialization discriminated against SMEs during the time.

First, trade was regulated in a way that allowed large firms to obtain import licenses, official exchange rates for imports, and tariff rebates more easily than small firms. The anti-export bias induced by import substitution strategies also discriminated against the labor-intensive SMEs. Moreover, small firms were denied access to most investment incentives because of high rent-seeking costs.

Second, financial sector interventions also discriminated against SMEs. Selective credit controls in conjunction with controlled interest rates prevented banks from compensating for the higher cost of small loans by charging more. As a result, smaller clients were allocated limited credit, allowing large firms to grow at the expense of small firms.

Third, the problems of dealing with government regulations and tax authorities weighed more heavily on smaller firms in the shape of higher compliance costs, i.e., the fixed costs of complying with import/export and tax regulations, labor market regulations, and licensing and price controls.

Fourth, Pakistan's underdeveloped physical and social infrastructure creates a binding constraint on SME growth. SMEs rely heavily on inefficiently provided state infrastructure, and cannot afford the fixed cost of developing any alternatives. Similarly, inadequate investment in human capital hampers SME growth because of the scarcity of skilled workers, managers, and entrepreneurs.

Lastly, the market failure inherent in adopting technology in developing countries arguably constrains SMEs from moving onto a more dynamic growth path.

The Report has analysed the binding constraints by using the data collected during the study. Financial constraints, both, lack of access to credit and also the high cost of finance act as binding constraints on growth of SME.

Infra-structure problems

Then the SMEs are faced with infrastructure related problems. The main constraints faced by the manufacturing and export sector include;

- the high cost, poor service quality and unreliable supply of power;
- an inefficient transport network that is unreliable and costly to use;
- corrupt utilities

The Report states, "the country's power transmission and distribution losses (including power theft) are extremely high by developing country standards and are the highest in South Asia".

Small firms are faced with lack of trained middle management, low levels of skills, education and vocational training among workers.

Fiscal and Regulatory constraints impose binding constraints on firm level growth. These include, taxation, trade policy and procedure and law and order.

New areas of constraints

The study has also identified some new areas of constraints that hamper SME growth. These include high market transaction costs and inefficient contract repudiation: constraints on the growth of SMEs and their ability to take risks, which apply to the retail and manufacturing sectors. This is an important insight because it suggests that the right regulatory framework for executing and enforcing contracts is as important for SME growth as the traditional emphasis on reducing state-control and regulation.

Removing these constraints should be an essential goal of government policy, which already has the stated objective of stimulating growth in the SME sector. Apart from these variables, an inefficient power and transport infrastructure and poor-quality human capital constrain the growth of SMEs and large firms. Eliminating these binding constraints would propel the growth potential of the SME sector in Pakistan.

Such constraints are not specific to Pakistan only. In the paper "*Taking Stock and Charting a Path for SMEs in Bangladesh*", prepared by the Bangladesh Enterprise Institute, some common constraints to SME growth identified include:

Common constraints

- lack of modern technology
- lack of adequate investments
- irregular/inadequate supply of power
- high rate of interest on bank loans
- inadequate availability of raw materials
- absence of clear cut government policies
- lack of skilled technicians and workers

In addition, lack of institutional credit, non availability of working capital, low levels of technology, low productivity, and lack of marketing facilities and market access are major bottlenecks to SME growth in Bangladesh.

Recomm-endations for overcom-ing constra-ints

The ADB Report on SMEs in Pakistan after identifying the constraints has then given recommendations to overcome each of them. It has however, not given any recomm-endations to overcome the macro and law and order constraints, as it is beyond its scope.

We see that SMEs are not in a position to offer immovable property as collateral to secure loans from banks, and the movable property which they can offer as collateral presents risks because of weak judicial enforcement. The reforms suggested involves shifting the bulk of the work of repossessing and selling collateral out of the courts, so reduce the risks and costs. Also the initiation of measures that simplify documentation, processing requirements, and credit disbursement procedures will lower the costs of accessing credit for SMEs.

Poorly executed court cases continue to be a problem. The decision process takes months and the enforcement of foreclosure decress still takes very long, creating considerable costs for banks and weakening creditor rights.

The Report states, 'although information disclosure has improved with the SBP's decision to approve a panel of auditing firms for FIs, the integrity of the information in audited financial statements is still a cause for concern. Nonetheless, the SBP's decision is a positive step and should now be more widely adopted across Pakistan. It should also be supplemented by a broader rating system for auditor firms, based on quantitative and qualitative criteria such as the number of qualified personnel and professional support staff, and firms' experience.

There is also a need to improve the existing credit – reporting system and the regulations should be strengthened to extend reporting coverage to small and medium sized borrowers.

The Report has further suggested measures for reducing credit costs, and consolidating and rationalizing taxes on financial institutions, strengthening dispute resolution systems through initiatives which strengthen judicial reforms, and tax administration, tariff measures which would lower the costs of fiscal and regulatory constraints for SMEs and building human resource through sector specific vocational training, and creating sector – specific 'incubators' which provides the SMEs with credit, access to technology, vocational and management training and extensive consulting facilities. This would be very useful for SME industrial clusters in Sialkot, Gujrat, and Gujranwala.

Cluster development

The significance of cluster development, has been realized by SMEDA for which it has taken several initiatives. Clusters are important for SMES because they provide cost effective opportunities to deliver targeted technical assistance for upgrading technology, management and marketing. The clustering leads, to greater efficiency and flexibility not attainable by individual firms operating in isolation. Cluster development has proved its contribution in employment generations exports and poverty reduction worldwide.

SMEDA has started Cluster Development Programme for SMEs in Punjab, with the collaboration of Punjab Small Industries Corporation and UNIDO. Initially four clusters were selected:

Sports wear, Sialkot
Marble/granite, Rawalpindi/Islamabad
PVC and plastic products, Lahore
Autoparts, Lahore

Non availability of finances has been recognized as one of the major impediments to SME development. One of the major objectives of financial sector reforms in Pakistan, was enabling banks to direct funds to under served sectors of the economy, which have a significance for the economy but had not received adequate funds. Small and medium enterprises was one such area.

Financing by SME Bank

To meet the financing needs of the SME sector, there is the SME Bank formed by the merger of Regional Development Finance Corporation and Small Business Finance Corporation in 2002, with loans being extended for working capital and medium to long term financing, programme lending and leasing through its subsidiary, SME leasing. The SME Bank has lent to areas like CNG station, health development, surgical instruments, fan manufacturers, power looms, carpet manufacturers, gems & jewellery etc.

Sector-Wise Disbursements

(Rs.Bn)

Sector	FY02	FY03	FY04
Auto	10.77	6.60	8.10
Beacon House School	3.20	3.90	-
Carpet Industry	0.15	2.35	0.3.5
CNG Kit	0.73	0.06	3.60
Communication	0.50	1.59	-
Chemical & Pharmaceuticals	-	10.81	17.70
Dates	-	-	-
Education	28.67	34.72	17.68
Electric Industry	-	5.93	-
Electrical Machinery, Appliances & Fittings	-	2.50	3.49
Fertilizer	-	1.00	-
Fisheries	0.50	2.30	-
Food	35.26	63.55	28.45
Garments	32.19	12.00	12.15
Gems & Jewelleries	6.88	23.75	3.40
Hand/Power Looms	-	3.13	12.96
Health	6.30	23.67	1.50
Hotels & Services	44.29	80.32	27.05
Information Technology	6.65	7.14	0.50
Leather	7.30	6.33	0.80
Light Engineering	6.67	10.97	9.32
Machinery other than Electrical	-	0.08	-
Manufacturing (Glass)	4.00	1.30	-
Manufacturing (Others)	92.32	67.07	26.97
Manufacturing (Plastic)	2.68	8.43	5.55
Manufacturing (Sports Goods)	-	1.10	2.30
Manufacturing (Steel)	11.80	12.09	10.55
Manufacturing (Wood)	3.25	13.29	9.55
Motor cycle Rikshaw Loader	-	-	0.94
Oil & Gas	23.07	50.58	34.51
Other Non-Metalic Minerals	-	1.20	0.70
Power	-	0.30	-
Textile	23.28	52.69	23.19
Tobacco	-	0.25	-
Trading	91.85	397.59	123.06
Transport Industry	-	0.30	3.54
Total	442.31	908.86	387.90

Source: SME Bank

As SME bank alone cannot meet the entire needs of the SME sector in Pakistan, commercial banks are also playing an active role in this sector. By virtue of their wider outreach they can reach far flung areas.

NBP role in SME development

Recognizing the significant contribution of SMEs to the development of the economy, National Bank of Pakistan established a SME Division in Lahore last year, working under the Commercial & Retail Banking Group. Specific branches have been designated in SME concentrated regions and designated SME desks have been formed equipped with technically trained staff to look after the financing needs of the SMEs. The field staff also visits business concern of prospective borrowers to get relevant information. The field staff also assists the untapped segment of SMEs who are unable to approach a financial institution.

NBP performing loans to small and medium enterprises stood at Rs24.610 billion as on December 31, '04. Within the next two years, the loans rose by Rs 7.367 billion and by end December '06 the bank managed to finance a huge sum of Rs31.977 billion to these enterprises. The figures given below speak of the importance given by NBP to SMEs.

(Rs.Bn)

	31.12.2004	31.12.2005	31.12.2006
Performing SME	24.610	30.196	31.977
SME NPL	3.706	3.209	4.321
Total	28.316	33.405	36.298

The SME Division is aggressively pursuing a policy of product development for the following main sectors; milk suppliers, small & medium auto vendors and assemblers, power looms, cutlery sector. It also working towards developing a more proactive approach by concentrating on SME clusters in areas like Gujranwala, Sialkot, Faisalabad, Daska, Wazirabad, Khairpur, Multan etc.

For the year 2007, the Bank plans to increase the number of branches dealing with SMEs, identify untapped SMEs and specific market segments that require further support, initiate capacity building measures, and broaden the base of SME customers by tapping new/ potential customers and introduce some new products specifically for the SMEs.

LUMS research

The Entrepreneurship and Small and Medium Enterprise Centre at the Lahore University of Management Sciences (LUMS) conducted research on small and medium enterprises to inquire about their health. Subsequently a Report, "*SME Pulse*" was published, containing the results of the survey of 650 firms in ten districts of the country (these districts were home to 50 percent of the manufacturing SMEs in the country). The survey results in the Report have been divided into demographics, human resource, marketing, production, finance and governance. We would like to share with our readers, some of the major findings of this survey by LUMS.

Demographics

- Decision making was centralized at most of the SMEs. Company owners were reluctant to delegate authority to their employees not only regarding strategic decisions but also for routine decision making both at the organization level and the department level.
- The breakup of SMEs in terms of the type of product they produced, 22.1 percent of the firms were into textile manufacturing followed by food, fabricated metal products manufacturing.
- Firms with 7-10 employees were 50.2 percent of the total.
- The average number of employees in an SME in Pakistan was about 16.

Human Resources

- Almost all the employees in the SME sector (manufacturing) were in the production department.
- Education level of the employees was quite low.
- Very few get proper training.
- Human resource systems in most SMEs lack a formal appraisal system. There is a high degree of informality in the way these organizations work.

Market/Contracts

- Over the period of last three years, only 21 percent of the firms indicated an increase in sales as compared to almost 50 percent indicating a decrease in sales.

- SMEs do not seen to be too optimistic about their future.
- A very low percentage of SMEs were into exports.
- A direct relationship was observed between the size of a firm and the percentage of firms into exports.
- Most of the SMEs were not competiting with foreign firms.

Productivity and Technology

- Machinery used was imported, since the local machine producing industry was not well developed.
- As a percentage of sales, SMEs invested very little in machinery.
- There was lack of formal quality control procedures in SMEs in the country.
- The average labour productivity of the SMEs was Rs39,431/employee.

Finance/Trade Credit

- SMEs do not avail credit from banks. About 73 percent of the long term financing needs of the SMEs was contributed by investment through personal and family sources, while commercial banks contributed only 16 percent of the total requirement.
- About 60 percent of total working capital needs of the firms was provided by personal investment or investment through other family sources.
- 49.3 percent of the SMEs have a bank account and only 43 percent of the payments are in the firm of cheques.
- About 56 percent of the SMEs were not interested in making new investments. Approximately 13 percent cited expensive utilities as the foremost reason for this.

Governance

- Only 30 percent of the firms surveyed knew about the SME Bank and SMEDA.
- About 89 percent of the respondents were never contacted by any of the organizations established by the government to boost the SME sector.
- 29 percent of the firms wanted a reduction in electricity/utility charges and 13 perecent said that taxes should be reduced.

Conclusion

As SMEs encounter many obstacles in developing countries relating to access to finance, skills, technology and markets, it poses a challenge for policy makers. The business environment in which they operate is changing rapidly as a result of market oriented reforms and technological change.

The governments have to provide a supportive friendly environment which is not restrictive, and which facilitates SME operations. Generally areas requiring government attention are laws on taxation, compliance with labour and environmental requirements, infra-structure, training, access to finance among others.

Interest Rate Outlook

CPI declines

Inflation proved to be a very welcoming number this time around as CPI came in at an 8-month low of 6.64 percent in January on a y-o-y basis; taking the period average to 8.14 percent. It seems that government has taken State Bank of Pakistan's comments, that inflation may remain above the 6.50 percent target solely on account of burgeoning food inflation and may dilute the effects of monetary tightening, to heart; which has resulted in food inflation falling to 8.70 percent after remaining in double digits for the past five months. One thing that Central Bank really takes pride in (Rightly so) is core inflation. The core numbers are at 5.30 percent in January, whereas for July-January, core inflation was 5.80 percent. Inflation is likely to remain on a downward footing in February, largely due to the high base effect which will carve its way in inflation numbers till April.

Monetary assets – in control

Government borrowings for budgetary support are well within the full year target of Rs120 billion at Rs59.48 billion. Government is also reducing its reliance on SBP borrowings and has issued PIBs in every quarter of the running fiscal. Private sector credit is also within the yearly target at Rs227 billion. Reserve Money (currency in circulation + cash in T-Bills + Deposits with SBP), over which the SBP has expressed concern in its MP-2H-FY07, is a little higher at 17 percent after falling to 14 percent in the previous week. However, growth in Monetary Assets is at 7.09 percent against a full year target of 13.50 percent.

External Sector

Strong inflows in the shape of Foreign Direct Investment ($2.1 billion) and Portfolio Investment ($697 million) have contributed to the build up the country's foreign exchange reserves at $13.28 billion and have also resulted in Net Foreign Assets of the banking system at Rs14 billion. The rupee dollar parity has also come down to around 60.64/66 level which is the level attained since November '06. Twin Deficits continue to be a reason for disquiet as trade gap is increasing with a steady pace of $1 billion each month reaching $7.59 billion during July-January. During the 1H-FY07 current account deficit stood at $4.2 billion with Balance of Payments at negative $23 million.

Bond Auction

State Bank has announced a PIB auction for the last quarter of the fiscal year on March '05 with settlement on March 06, 2007. The details of the auction are as follows:

Tenor	*Issue Date*	*Coupon (%)*	*Target (R. Mn)*	*Last Cut-off (%)*
3-Years	19-May-06	9.10	3000	9.7393
5-Years	19-May-06	9.30	3000	10.0017
10-Years	19-May-06	9.60	3000	10.5270
15-Years	31-Oct-06	10.00	2000	11.1005
20-Years	31-Oct-06	10.50	2000	11.4203
30-Years	22-Dec-06	11.00	2000	11.7006
			15000	

Future Outlook

Regular PIB auctions are likely to bode well for the market as well as help reduce the government reliance on SBP borrowings which are inflationary in nature. The key indicator which is most closely watched for determining the future direction of interest rates remains our very own CPI; as for now we reiterate our stance of a downward trend in interest rates going forward, however for the time being interest rates are portraying a stable trend.

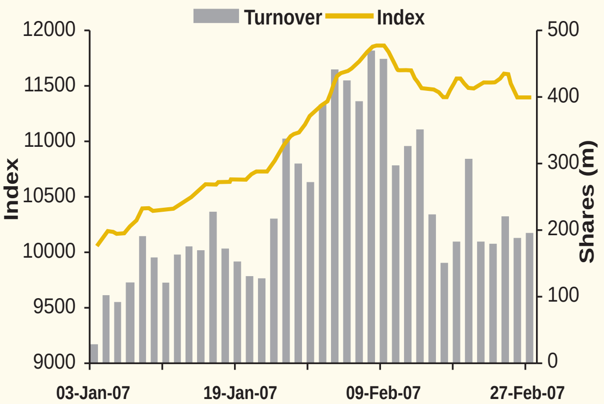
(Contributed by: NBP, Treasury Management Group)

Market Analysis

KSE Index gains

The market has started the new year on a positive note with the KSE-100 Index gaining 1,140 points or 11.3% during January – February 2007 to close at 11,180 points while average daily turnover during the period under review was 225.4m.

KSE-100 Index (January-February 2007)



Investor confidence was slightly restored with the announcement by the Prime Minister on January 8 to extend the capital gains tax exemption for another year till June 2008 and the deferment of stamp duty (0.01% of face value) for 2 years by the Sindh Government on the transfer of shares. Despite the overall declining trend of international oil prices, the market continued to rise gradually throughout the month of January because of the following factors:

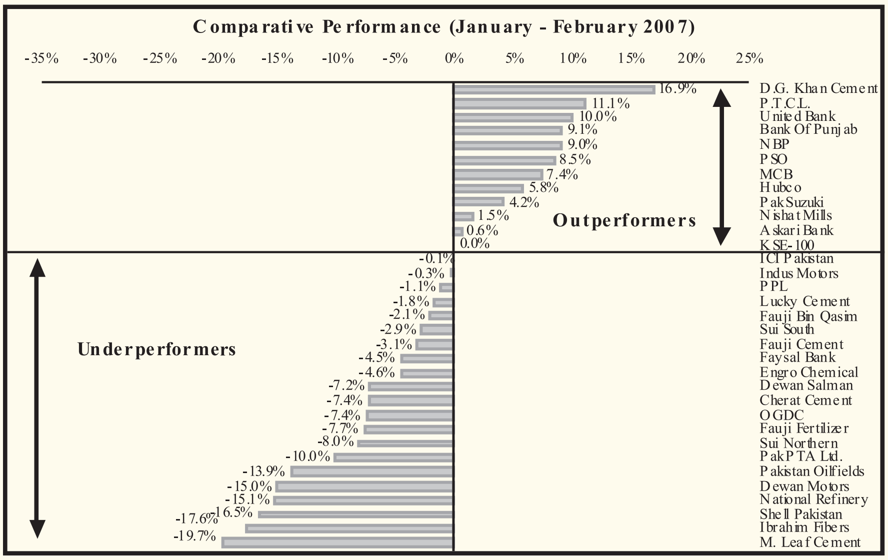
- Moody's rating agency expressed a stable outlook for Pakistani banking system and continued M&A developments in the sector such as Shaukat Tarin acquiring 52% equity stake in Mybank at PKRs35 per share (PKR 5.5bn) led to further accumulation in banking stocks.
- HYFY07 cement sales depicted 26% YoY to around 11m tons helped rejuvenate limited buying activity in the sector especially DG Khan.
- Despite declining sales volume and downward price revision on Motor Spirit (-6.9%) and high speed diesel (-2.6%), PSO's share price jumped by PKR 45.90 (+16%) because of privatization developments such as the public disclosure of 12 parties submitting SoQs (statement of qualifications).
- Foreign fund inflow in the equity market continued to influence local sentiments as January 2007 saw a net inflow of US$ 103.6m and the year-to-date net inflow of US$ 381.6m. Besides portfolio investments, growing confidence of foreign investors was also evident in the two important deals between a) PMI and Lakson Group and b) Paktel & China Mobile.
- The Monetary Policy Statement for 2HFY07 held no major surprises as the SBP reiterated that the tight money policy would continue as inflationary pressure still exists in the economy and that the FY07 inflation target of 6.5% would be higher (7.5%) while the GDP growth rate will likely be in-line with the target or slightly exceed it.

The market experienced a moderate surge in the last few trading days of the month because of local institutional activity which may be indicative of improved sentiments among major participants. The last 4 trading sessions of the month witnessed an average daily turnover of 279m shares as compared to 140m shares during the first 15 sessions of the month.

The KSE-100 Index declined by 92 points or 0.82% during February 2007 to close at 11,180 while the KSE-30 Index shed 150 points or 1.1% to 14,049. The average daily turnover during February was 289.4m shares compared to 168.9m shares during January 2007. At the start of the month, the market continued its bullish march that began last month because of foreign fund buying in major large cap stocks such as OGDC, MCB Bank and NBP. Also, with cement prices shooting up to PKR 300 per bag from below PKR 200 per bag in the north zone led to a buying spree in cement stocks helped support the rally. During the first 9 days of February, the average daily turnover was robust at about 427m shares perhaps indicating some restoration of investor confidence in the equity market. However, the rally ran out of fuel after the KSE-100 Index crossed the 12,000-plateau on February 9 but could not close at this level and so leading to a declining trend and eventually shifting into a consolidation phase for the remainder of the month. The main factors for the correction are as follows:

- The market was in the overbought region for a while and so a technical correction was expected at any time.
- With MCB, the announcement by the bank's management on February 9 that albeit they are receiving purchase offers from foreign institutions, they are not considering any transaction to sell at this moment led to selling pressure by weak holders as most of the run-up in share price before this announcement was due to M&A rumors.
- The quarterly/annual results also dampened investor enthusiasm as some results were disappointing while others were in line or slightly exceeded expectations.
- News reports of President Bush deciding to officially warn President Musharraf that the U.S. Congress could cut aid to Pakistan if it fails to step up its hunt for Taliban militants led to more pressure on the market.
- Measure approved by the Chinese government to curb excess speculation that they believed had driven stock prices to record highs. The preceding move was complimented by a decline of 9% in the Shanghai Composite Index; its heaviest fall since 1997. Moreover, it also had a catastrophic spill over effect on regional markets.

During the last 3 weeks of February, the average daily turnover has decreased from 427m in the first 9 days to around 186m shares in the last 7 days, indicating the lack of enthusiasm among investors. In addition to declining volumes, it appears that there was selling activity from foreign funds as evident from the decline in SCRAs during this period. In the first 2 weeks of the month there was a net inflow of over US$ 150m in the SCRAs while in the last 2 weeks, there has been a net outflow of around US$ 26m till February 23.



Corporate Results

Overall, recent corporate results have been disappointed as most major sectors are depicting decelerating or negative growth. The commercial banking sector is one of the ew positives when it comes to financial performance with large banks posting robust earnings growth. As expected, the cement sector with a few exceptions recorded decline in earnings because of dramatic fall in cement prices due to thebreakdown in the marketing arrangement, however, we feel that 2HFY07 would be better financially as we expect the marketing arrangement to be re-established. The OMCs and refinery sectors also saw a slump in profitability because of lower prices, margins and inventory losses. The E&P sector experienced decelerating profit growth because of lower crude oil price during 2QFY07 and lower production.

(Contributed by Taurus Securities a subsidiary of National Bank of Pakistan)

Pakistan Economy – An Update

The economy is expected to grow by around 7 percent in FY07, as agriculture and manufacturing performance improved in the first half of FY07 and services appear to be growing robustly. Last year, real GDP growth was supported by a substantial rise in the growth of the services sector (primarily finance & insurance) for the commodity producing sectors particularly agriculture had showed weakness.

Agricul-ture growth prospects improve

Agriculture had shown a sluggish growth of 2.5 percent, because of the lackluster performance of the major crops, inspite of improved water availability, continued access to credit and easing of the price of fertilizer. In FY07, production of major summer crops have shown an improvement. Higher offtake of fertilizers and an increase in production loans for agriculture, as well as greater availability of water all augur well for winter crops. Strong performance by the livestock sub-sector offer hopes of a recovery. Agriculture is projected to grow by 4.0 percent in FY07.

LSM expected to grow

The manufacturing sector is targeted to grow by 11 percent in FY07, with large scale manufacturing expected to grow by 8.6 percent. The first quarterly report for the year 2006-07 of the State Bank of Pakistan, shows that the growth achieved in the first quarter of FY07 was primarily because of improvements in textiles, electronics, chemicals and metal industries. Limited information available suggests that large-scale manufacturing growth is slightly higher during the first half of 2007 compared with the corresponding period of FY06.

Financial sector performs well

In services, rising foreign investment and privatization of Pakistan Telecommunication Company will help sustain the growth. The financial sector has shown good performance. Profitability of the banks has risen substantially and the capital base has been strengthened. There has been a significant expansion in business volume of the banking system. Consumer finance segment continued to contribute towards credit growth and credit to the agriculture and SME sector maintained the rising trend. Net NPLs of all banks and DFIs stood at Rs43.86 billion as on September 30, 2006 or 2.0% of net loans against Rs48.31 billion or 2.2% three months earlier.

FDI increases

Total inflow of foreign investment nearly doubled in the first eight months of FY07 against the comparable period last year. Figures show that the inflow rose to $3952 million (including privatization proceeds) against $1992.5 million. During July-February 2006-07 foreign direct investment constituting three fourths ($2970.8 million) of the total, was concentrated in communication, financial business, oil & gas exploration, trade, power, construction and petroleum refining.

Deficit widens

On the external front, the current account deficit widened to $4.8 billion during July-January FY07. "Moreover, in the short-run, the financing of the large current account deficit has eased somewhat given strong foreign investment and financing flows. Indeed, it is likely that despite the expected large fiscal and current account deficits the country's debt profile will continue to improve in FY07, with a continuing fall in the debt to GDP ratio", states the SBP Second Quarterly Report for the year 2006-07 on the State of Pakistan's Economy.

Trade figures for July-February 2006-07 reveal a trade deficit of $8.9 billion as exports rose to $10.91 billion ($10.50 billion in July-February 2005-06) and imports stood at $19.80 billion ($18.00 billion in July-February 2005-06). The sluggish growth in exports (3.86%), was because of decline in exports of items like rice, raw cotton, cotton cloth, bedwear, carpets & rugs, sports goods, leather and leather manufactures, footwear, surgical goods & medical instruments, chemicals & pharmaceuticals among others. Slowdown in exports needs to be carefully examined, for the importance of sustaining a strong export growth cannot be overstated. Meanwhile, the government has revised trade deficit projections to $13.4 billion against the original target of $9.4 billion set for the year.

Meanwhile remittances from workers abroad showed an increase of 21.82 percent to $3416.5 million during July-February 2006-07 against $2804.65 million in the comparable period a year earlier. This was attributable to higher inflows from Saudi Arabia, UAE, the US, Kuwait, Qatar and Oman.

Inflation-ary pressures ease

The inflationary pressures in the economy continued to ease in FY07, driven by the tight monetary posture of the central bank. The SBP continued to focus on moderating the excess demand pressures in the economy. Headline CPI inflation declined to 7.4 percent in February 2007 YoY basis from 8.0 percent registered in the same month of last year. However, while food inflation rose to 10.0 percent from 7.5 percent in the same period, non-food inflation declined to 5.6 percent from 8.4 percent a year earlier. Core inflation (non-food non energy) also declined to 5.7 percent in February 07 from 7.0 percent a year earlier. Food inflation has been in double digits since August 2006, except for January 07. Containing inflation continues to be a major challenge for the State Bank of Pakistan. Monetary policy tightening measures taken earlier and the downward revision in petroleum prices by the government wef January 16, 2007 would have a further dampening effect on non-food inflation and the double digit food inflation is anticipated to ease off due to improving supply condition of key food items.

Text revenues grow

On the fiscal side, the growth in tax revenues is quite encouraging. While direct tax collections have risen, indirect tax receipts of the CBR have declined. However, revenue targets for FY07 are likely to be achieved. Expenditures have risen with a substantial growth in current expenditures, essentially caused by a rise in domestic interest payments and an increase in other general public service spending. The strong receipts are expected to push up the tax GDP ratio, but Pakistan's performance continues to lag behind other regional benchmarks.

Commercial Banks' Advances to Private Sector Classified by Borrowers

(Rs. Mn)

Major Industrial/Business Enterprises	End-June											
	2001	% Share in Total Advances	2002	% Share in Total Advances	2003	% Share in Total Advances	2004	% Share in Total Advances	2005	% Share in Total Advances	2006	% Share in Total Advances
Agriculture, Forestry & Fishing												
Public Sector Commercial Banks	12079	1.62	14547	1.91	19307	2.29	12748	1.11	19723	1.24	24765	1.25
Domestic Private Banks							26926	2.35	31313	1.96	40052	2.02
Foreign Banks	99	0.01	106	0.01	183	0.02	510	0.04	224	0.01	75	0.00
Sub-Total	12178	1.63	14653	1.92	19490	2.31	40184	3.50	51260	3.22	64892	3.27
Food Beverages & Tobacco												
Public Sector Commercial Banks	28206	3.78	38936	5.11	58895	6.99	18624	1.62	26924	1.69	31867	1.61
Domestic Private Banks							73129	6.38	84372	5.29	100574	5.07
Foreign Banks	8889	1.19	8384	1.10	6446	0.77	8059	0.70	7092	0.44	7935	0.40
Sub-Total	37095	4.97	47320	6.21	65341	7.76	99812	8.70	118388	7.43	140376	7.07
Textiles												
Public Sector Commercial Banks	132729	17.78	94366	12.39	129958	15.43	47765	4.17	58101	3.65	70430	3.55
Domestic Private Banks							204878	17.87	277800	17.43	315335	15.88
Foreign Banks	26819	3.59	22376	2.94	22224	2.64	25561	2.23	27954	1.75	28043	1.41
Sub-Total	159548	21.37	116742	15.33	152182	18.07	278204	24.26	363855	22.83	413808	20.84
Readymade Garments & Leather Manufacturers												
Public Sector Commercial Banks	18178	2.44	46155	6.06	52010	6.18	2352	0.21	6599	0.41	3901	0.20
Domestic Private Banks							39067	3.41	31679	1.99	34152	1.72
Foreign Banks	6878	0.92	7436	0.98	8159	0.97	4518	0.39	6396	0.40	7765	0.39
Sub-Total	25056	3.36	53591	7.04	60169	7.15	45937	4.01	44674	2.80	45818	2.31
Chemicals, Medicinal & Pharma Products												
Public Sector Commercial Banks	17903	2.40	24947	3.28	22947	2.72	7749	0.68	6826	0.43	8252	0.42
Domestic Private Banks							25309	2.21	34910	2.19	46814	2.36
Foreign Banks	12570	1.68	13576	1.78	10993	1.31	9517	0.83	9349	0.59	9535	0.48
Sub-Total	30473	4.08	38523	5.06	33940	4.03	42575	3.71	51085	3.20	64901	3.27
Non Metalic Material, Basic Metal & Fabricated Metal Products												
Public Sector Commercial Banks	17802	2.39	14402	1.89	24640	2.93	7551	0.66	9372	0.59	17903	0.90
Domestic Private Banks							24855	2.17	38017	2.39	63335	3.19
Foreign Banks	3897	0.52	4748	0.62	4917	0.58	5132	0.45	7566	0.47	10140	0.51
Sub-Total	21699	2.91	19150	2.51	29557	3.51	37538	3.27	54955	3.45	91378	4.60
Electrical/Non-Electrical Machinery												
Public Sector Commercial Banks	8954	1.20	11945	1.57	12585	1.49	3638	0.32	5079	0.32	5828	0.29
Domestic Private Banks							11174	0.97	15277	0.96	17571	0.89
Foreign Banks	2147	0.29	2729	0.36	2502	0.30	1510	0.13	2614	0.16	2292	0.12
Sub-Total	11101	1.49	14674	1.93	15087	1.79	16322	1.42	22970	1.44	25691	1.29

Motor Vehicles & Transport Equipment												
Public Sector Commercial Banks	1569	0.21	7596	1.00	3898	0.46	1741	0.15	2953	0.19	4078	0.21
Domestic Private Banks							4825	0.42	9131	0.57	12286	0.62
Foreign Banks	1337	0.18	678	0.09	766	0.09	405	0.04	1391	0.09	5141	0.26
Sub-Total	2906	0.39	8274	1.09	4664	0.55	6971	0.61	13475	0.85	21505	1.09
Construction & Real Estate Business												
Public Sector Commercial Banks	6880	0.92	5181	0.68	7141	0.85	4710	0.41	7836	0.49	10651	0.54
Domestic Private Banks							13796	1.20	26766	1.68	35918	1.81
Foreign Banks	1894	0.25	511	0.07	576	0.07	2059	0.18	3764	0.24	1166	0.06
Sub-Total	8774	1.18	5692	0.75	7717	0.92	20565	1.79	38366	2.41	47735	2.41
Commerce & Trade												
Public Sector Commercial Banks	64263	8.61	51131	6.71	57796	6.87	9620	0.84	11942	0.75	21429	1.08
Domestic Private Banks							82193	7.17	107686	6.76	149823	7.55
Foreign Banks	7205	0.96	3810	0.50	3817	0.45	5645	0.49	5004	0.31	7957	0.40
Sub-Total	71468	9.57	54941	7.21	61613	7.32	97458	8.50	124632	7.82	179209	9.03
Transport & Communication												
Public Sector Commercial Banks	8390	1.12	9903	1.30	10654	1.27	934	0.08	9016	0.57	6474	0.33
Domestic Private Banks							19996	1.74	36027		45793	
Foreign Banks	2248	0.30	3421	0.45	3381	0.40	3395	0.30	6651	0.42	10271	0.52
Sub-Total	10638	1.42	13324	1.75	14035	1.67	24325	2.12	51694	3.24	62538	3.15
Other Private Business & Activity												
Public Sector Commercial Banks	85860	11.50	91892	11.98	107882	12.81	17391	1.52	25382	1.59	28708	1.45
Domestic Private Banks							75555	6.59	127327	7.99	157594	7.94
Foreign Banks	21474	2.88	16168	2.12	14568	1.73	13589	1.19	16827	1.06	18797	0.95
Sub-Total	107334	14.38	108070	14.19	122450	14.54	106535	9.29	169446	10.63	205099	10.33
Commercial Banks' Advance To Private Sector Business (Total)												
Public Sector Commercial Banks	402813	53.95	411001	53.79	507713	60.30	134823	11.76	189753	11.90	234286	11.80
Domestic Private Banks							601703	52.47	820215	51.46	1019247	51.34
Foreign Banks	95457	12.78	83943	11.02	78532	9.33	79900	6.97	94832	5.95	109417	5.51
Sub-Total	498270	66.73	494954	64.99	586245	69.63	816246	71.18	1104800	69.31	1362950	68.66
Commercial Banks' Advances (Grand Total)*	**746640**		**761550**		**841996**		**1146677**		**1593920**		**1985200**	

** Includes public sector business loans and consumer financing.*

Note: Classification of advances by borrowers was revised in December 2003, break-up of Advances by public/private banks was not available.

Commerical Banks' Advances And Weighted Average Interest Rate

	Dec-03	Growth	Jun-04	Growth	Dec-04	Growth	Jun-05	Growth	Dec-05	Growth	Jun-06	Growth
Public Sector Banks												
Amount (Rs. Bn)	462.8	9.38	320.0	-30.9	371.6	16.1	405.30	9.1	444.5	9.7	464.70	4.5
% Share in Total	42.24	-3.16	25.76	-39.0	24.19	-6.1	23.92	-1.1	22.97	-4.0	22.44	-2.3
Interest Rate (% per annum)	9.10	-19.04	9.21	1.21	8.31	-9.8	9.25	11.3	10.25	10.8	10.45	2.0
Domestic Private Banks												
Amount (Rs. Bn)	521.2	24.01	791.30	51.82	1011.4	27.81	1135.22	12.24	1327.40	16.93	1424.90	7.35
% Share in Total	47.57	9.79	63.69	33.90	65.85	3.39	67.01	1.75	68.60	2.37	68.80	0.29
Interest Rate (% per annum)	6.80	-15.42	6.63	-2.50	6.42	-3.17	8.46	31.78	9.91	17.14	10.36	4.54
Foreign Banks												
Amount (Rs. Bn)	111.7	-11.7	131.10	17.37	152.9	16.63	153.60	0.46	163.2	6.25	181.60	11.27
% Share in Total	10.19	13.04	10.55	3.51	9.96	-5.66	9.07	-8.93	8.43	-6.98	8.77	3.96
Interest Rate (% per annum)	6.72	-13.51	6.51	-3.13	7.56	16.13	10.24	35.45	12.02	17.38	13.04	8.49
All Banks												
Amount (Rs. Bn)	1095.7	12.97	1242.40	13.39	1535.9	23.62	1694.20	10.31	1935.1	14.22	2071.20	7.03
% Share in Total	100	-	100	-	100	-	100	-	100	-	100	-
Interest Rate (% per annum)	7.76	-17.45	7.28	-6.19	6.99	-3.98	8.81	26.04	10.17	15.44	10.61	4.33

Consumer Financing By Commercial Banks in Pakistan Classified by Borrowers

(Rs Mn)

Banks/Type of Finance	End-Dec		End-June					
	2003	% Share in Total Advances	2004	% Share in Total Advances	2005	% Share in Total Advances	2006	% Share in Total Advances
House Building Finance								
Public Sector Commercial Banks	307	0.02	499	0.04	2043	0.13	3417	0.17
Domestic Private Banks	12906	0.90	6520	0.57	22025	1.38	31375	1.58
Foreign Banks	4018	0.28	2679	0.23	4930	0.31	7000	0.35
Sub-Total	17231	1.20	9698	0.85	28998	1.82	41792	2.11
Auto Finance								
Public Sector Commercial Banks	2056	0.14	432	0.04	699	0.04	227	0.01
Domestic Private Banks	42769	2.98	25241	2.20	58546	3.67	88699	4.47
Foreign Banks	6174	0.43	5874	0.51	6892	0.43	8351	0.42
Sub-Total	50999	3.55	31547	2.75	66137	4.15	97277	4.90
Credit Cards Financing								
Public Sector Commercial Banks	0	0	11	0	55	0	0	0
Domestic Private Banks	6331	0.44	5473	0.48	10803	0.68	18115	0.91
Foreign Banks	6769	0.47	6892	0.60	8687	0.55	15408	0.78
Sub-Total	13100	0.91	12376	1.08	19545	1.23	33523	1.69
Consumer Durables Loans								
Public Sector Commercial Banks	766	0.05	1340	0.12	440	0.03	510	0.03
Domestic Private Banks	926	0.06	551	0.05	1857	0.12	1007	0.05
Foreign Banks	..	..	..	..	..	..	..	..
Sub-Total	1692	0.12	1891	0.16	2297	0.14	1517	0.08
Personal Loans								
Public Sector Commercial Banks	14709	1.02	13640	1.19	35796	2.25	43179	2.18
Domestic Private Banks	26751	1.86	18204	1.59	43708	2.74	56492	2.85
Foreign Banks	12020	0.84	16237	1.42	12344	0.77	20751	1.05
Sub-Total	53480	3.72	48081	4.19	91848	5.76	120422	6.07
Consumer Finance (Total)								
Public Sector Commercial Banks	17838	1.24	15922	1.39	39033	2.45	47333	2.38
Domestic Private Banks	89683	6.24	55989	4.88	136939	8.59	195688	9.86
Foreign Banks	28981	2.02	31682	2.76	32853	2.06	51510	2.59
Sub-Total	136502	9.50	103593	9.03	208825	13.10	294531	14.84
Commercial Banks' Advances (Grand Total)*	**1436680**	**..**	**1146677**	**..**	**1593920**	**..**	**1985200**	**..**

** includes public/private sector business loans and consumer financing.*

Note: Classification of advances by borrowers was revised in December 2003. Prior to December 2003, break-up of advances by public/private banks was not available. 2003 figures are for end-December and are not comparable with the following three years.

Book Reviews

The State of Pakistan's Competitiveness 2007
Competitiveness Support Fund

The Competitiveness Support Fund is a joint initiative of the Ministry of Finance, Government of Pakistan and the USAID, established to support Pakistan's goal of shaping a more competitive economy by providing input into policy decisions, working to improve regulatory and administrative frameworks and working to enhance public — private partnership within the country.

It is the first annual report on the State of Pakistan's Competitiveness; as earlier there had never been an indepth analysis of Pakistan's competitiveness. With the publication of the Report, Pakistan has joined the league of economies like the US, European Union, Singapore, some Islamic countries who annually publish a competitiveness report, revealing strengths and weaknesses of their economies. It thus provides a framework for evaluation.

The objective of this Report is to present the global competitiveness rankings for Pakistan, explain these results and to focus attention on potential areas of priority for improving competitiveness over the short to medium term. There is now a way to measure Pakistan's competitiveness and benchmark the progress from year to year. For benchmarking purposes, five countries Bangladesh, China, Indonesia, Malaysia and Sri Lanka have been selected.

Pakistan ranked 67th on the Business Competitiveness Index out of 121 total countries in 2006 (it was 77th in 2004) and 91st (94th in 2005) on the Global Competitiveness Index. The gap between Pakistan's performance in these two rankings is partly explained by the country's low scores in health and education, which are included in the GCI but not the BCI.

Pakistan's competitiveness rankings and impressive growth reflect increased macroeconomic stability. Reforms initiated in the last few years have brought positive results. Pakistan ranks relatively high, especially among low income countries, with relatively high marks given to both, the GoP for the national business environment and to Pakistan's relatively competitive private sector for the quality of its operations and strategy. Pakistan ranks quite well in various areas related to government promotion of innovation and infrastructure.

While there has been much emphasis on government reforms in Pakistan in recent years, it appears that the private sector also needs some reforming as well, especially in the area of corporate governance and modern approaches to the workforce. The weak points in the private sector are related to corporate governance and modern management and motivation of the workforce. The private sector needs to improve its use of human resources.

The Report mentions Pakistan's position with regard to the components of the Global Competitiveness Index and the conclusions drawn. This Index has nine components, which are, institutions, infrastructure, macroeconomy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication and innovation. The economy has done well in recent years because of the reforms introduced, however, the government is conscious that more needs to be done in areas that are weak like, infrastructure, business environment and is embarking on a set of second generation reforms.

Management Concepts & Cases 2007
Prof. Dr. Khawaja Amjad Saeed

Management: Concept & Cases consists of three sections; Concepts — spreading over 21 chapters, selected current articles; written by the author and 12 cases from South Asian Region. The first section — Concepts covers topics such as, Management as a Discipline, Tools of Management Thought, Managers Role and Impact of External Environment, Corporate Planning, Organizing, Decentralisation & Delegation Staffing, Motivation, Leadership, Controlling, MIS, among others.

Section II contains some articles related to the title of the book, written by the author earlier and presented in various conferences. These include Human Resource Management & Development, Knowledge Management, Sharing Productivity Gains: A Survey of Incentive Plans Globally Practiced, Motivation, The Rise of Reengineering and Promoting Corporate Social Responsibility.

The Third section are Cases for Analysis, where 12 real life cases are given, in the areas of decision making, entrepreneurship, personnel management, industrial relations, managing change.

It's a good book on Management for students, and others interested to read Management literature.

Denizens of Alien Worlds
A study of Education, Inequality and Polarization in Pakistan
Dr. Tariq Rahman

The book describes the three major streams of school education in Pakistan: madrassas, Urdu medium schools and elitist English medium schools. Each caters to the different socio-economic classes in the country and the students of these institutions hold divergent views about tolerance, war and gender equality.

The book provides new material and suggestions for the improvement of all educational institutions, including higher education, so as to create a society that values knowledge, justice and harmony.

In the introductory chapter, the author quotes some of the books and official reports on education in Pakistan. It states the objectives of the present book, which are: to give a historical overview of the development of educational institutions in British India; to describe how schools and universities are situated in contemporary Pakistan; and to understand how Pakistani society is polarized along socio-economic lives.

The second chapter discusses the education policies pursued. The next three chapters are devoted each to the Urdu medium schools, the English medium schools and the Madrassas.

The Urdu medium schools are the largest in number. The teachers receive low salaries and the quality of instruction in most schools catering to the common people is very low. Dropout is more compared to the other type of schools. The teachers, at least, in the boy's schools, often carry canes and punishment is allowed. This in fact, is a major reason why children tend to drop out of school.

There is a demand for English medium schools, as English is considered the key to a good future. The children of such schools, states the author, 'are alienated from Pakistan, especially from its indigenous languages and cultures. This makes some of them look down upon most things indigenous'.

Not much has been written upon the Madrassas. Credible information on the unregistered madrassas is very little. There is a chapter on higher education and recommendation follow. The later is based on the assumption that the state plans to reform the system of education so that it becomes equitable at the school level and college level and of high academic standard at the university level.

The concluding chapter tells the readers, that the study on which this book is based, the results have shown that state's resources are spent much more freely on the education of the elite than the masses. The very poor and those that live away from urban areas, often go without any formal education at all.