

# **Importance and Challenges of SMEs: A Case of Pakistani SMEs**

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## **Abstract**

This paper attempt to highlight the importance and challenges that SMEs facing now a days. The small and medium-sized enterprises (SMEs) regarded as a key contributor in progression of an economy and main pillar of GDP of any country. SMEs are the major source in generating employment. Generally, the large firms are often thought as the larger contributors towards the economic development and foreign exchange earnings but now this point of view has been changed because countries like Korea, Taiwan, and Japan have developed and boosted their economies through the Small and Medium Enterprises businesses.

## **1. The Importance of SMEs**

SMEs promote sufficient economic growth and development and are the source of wealth, dynamism, knowledge, improved livelihood, and competitiveness. Compared to multinational corporations, on a social level, SMEs have a direct impact on poverty alleviation. In an economy where SMEs are successful and integrated into the formal economy, there is a better use of human and material resources (Leo, 2011).

All over the world, SMEs are regarded as the most substantial proportion of business establishments. According to Organization for Economic Cooperation and Development (OECD), SMEs contribute tremendously in employment opportunities, market creation,

and development; delivering a better living standard, along with contributing hugely in the gross domestic products (GDPs) in a vast majority of countries (OECD, 2002).

Strategically, SMEs' roles are crucial in many developing countries, mostly which are located in the Asian region. In Japan, SMEs signify 99.7% of businesses, provide 71 % of employment and accumulate 55.3 % in GDP (OECD, 2017); In Malaysia, SMEs characterize for 97% businesses, hold 65% of employment and contribute 36% in its GDP (The World Bank, 2016). In Indonesia, the conforming figures are 99.8%, 99.7%, and 57% respectively (International Council for Small Business, 2015). In the case of China, 99% of the total business establishments hold by SME's, signify 70% of employment and contribute 60% in GDP (Deborah & Oluwaseun, 2015).

In Pakistan there are about 3.2 million SMEs operating in Pakistan which holds about 90% of the total firms, contributing over 40% of GDP, sharing 35% in manufacturing goods and accounting for 30% in exports of manufactured goods (Khalique, Shaari, et al., 2011). Hence, in Pakistan SMEs are the main source of sustainable economic development of the country and need further research investigation for the problems desolation.

## **2. SMEs in Pakistan**

SMEs are perceived as the backbone of the Pakistani economy. In the industrial sector, they employ up to 90% of all private enterprises and almost 78% of the labor force from the non-agriculture sector. Besides giving out 36% value addition in the manufacturing products, their contribution is around 40% in GDP, and they contribute 30% share in the exports of manufactured products. Table 2.2 shows the Pakistani SMEs distribution.

Table 1

*SMEs division province wise in Pakistan*

Province	SME units
Punjab	65.26 %
Sindh	17.82 %
Khyber Pakhtunkhwa	14.21 %
Baloshistan	2.71%

Source: SMEDA (2016)

For this reason, the Ministry of Economy had established the National Entrepreneur Institute (INADEM), aimed at developing a competitive entrepreneurial environment. These plans strove to not only give financial assistance, but also to build entrepreneurs and employees' capacities in terms of marketing, training, organizational structure, and technology to fortify SMEs and promote regional development.

Likewise, two main factors make SME more favorable to innovate than large firms. Firstly, SMEs are flexible enough to make rapid adjustment in their business operations and planning in a short time span and secondly, this requires less financial resources for growth as the SMEs' organizational structure are less complicated as compared to large firms making them more flexible and possess less bureaucratic regulations and red tapes in the decision-making process.

Another point is the government has given a significant emphasis on the SME sector and prioritized it as an important strategic sector (SMEDA, 2016). To illustrate, the national strategy for the SMEs indicates that, undoubtedly, highly performing SME sector can play an active role in encountering the challenges of the low productivity and the other issues such as the regional development, the income generation, the unemployment, and the poverty eradication. This relevant as the Pakistani SME sector consists of a vast array of business areas including manufacturing, services, agriculture, tourism, construction, fisheries, and mining.

This is further supported by Jasra et al. (2012), who highlighted that SMEs are contributing quite effectively in industrial employment and export of different manufacturing goods. They added that dynamic and flexible SMEs are playing their part in reducing unemployment levels, earning foreign exchange, upgrading the knowledge

profile of the workforce, and diffusing technological learning all over Pakistan. Also, SMEs are constructively and productively mobilizing the domestic resources, which otherwise could have lain idle and unemployed (Akhtar, Raees & Salaria, 2011).

### **3. Importance of SMEs in Pakistan**

In fact, a few studies revealed that it has been on record that SMEs contribute significantly towards the promotion of Pakistan's industrial sector. Many researchers have studied this fact and documented in the SME literature. According to SMEDA (2016), SME plays the following roles in the Pakistani economy, which includes among others,

**Employment generation:** SMEs assists the government in the provision of employment opportunities as to many people in the country as possible, thereby reducing unemployment in the society. These enterprises operate in urban, semi-urban, and rural areas, and by this, they can provide means of livelihood to the inhabitants of such areas byways of employment.

**Use of local resources:** Small and Medium enterprise sector is geared towards the production of simple consumer goods that use local raw- materials as compared to modern large-scale manufacturing formations. Industries like textiles, food and beverages, and many more depend mainly on local resources.

**Entrepreneurship development:** The growth of SMEs has brought about the development of entrepreneurial activities in the sense that entrepreneurs have access to local raw materials and with little capital and initiative they can engage in small and medium scale activities.

**Conservation of foreign exchange:** One of the significant contributions of SMEs is the conservation of foreign exchange through import substitution because the total production of SME sector has been inadequate to meet the demand of the local consumption, the question of export hardly arises. However, the product from the sector serve as the substitutes for those: which might have been imported with a considerable

amount of foreign exchange. With the rapid development of SMEs, import of certain items is gradually reducing while the local production of such items is encouraged.

**Equitable distribution of income and wealth:** SMEs development does not concentrate on one particular area of the economy or state. Instead they exist in every part of the country, and each part have several types of such enterprises. This makes it possible for them to share almost equally all facilities and incentives made available to them by the government. For instance, the creation of Small Scale Industrial Centers in every state of the federation arid from which the sector benefited. Thus, SME growth potentials are bound to ensure equitable distribution of income and wealth to many people.

**Capital formation:** SMEs contribute to capital formation, and they are significant sources of private savings for productive purposes. SMEs are also known to acquire relatively little infrastructural investment, and to utilize locally available raw materials instead of relying on exports. Furthermore, SMEs can look inwards and identify/develop products for domestic consumption and the export market as a means of earning foreign exchange for their country.

It can be concluded that SMEs of Pakistan plays a vital role in the growth of the economy of the country and enhances GDP. In developing countries like Pakistan, SMEs contributes to the development of the economy and also a significant source of the employment generation. Despite the facts, the performance of Pakistan still lacking behind; therefore, the performance of SMEs has to be enhanced to get the maximum output.

#### **4. Challenges Faced by SMEs in Pakistan**

According to Ali et al., (2011) the main problems hindering performance of SMEs in Pakistan include insufficient sources of getting external knowledge, lack of innovation activities, unfavorable government policies, , high threats due to uncertainty, lack of intellectual resources, insufficient institutional support, lack of suitable business strategies adoption , and as well as the unfavorable business environment.

Also, another constraint faced by the SME sector is the low level of technology and the absence of technical and managerial skills. The low level of technology has directly reduced the innovation activities and operational efficiency of the SMEs. The insufficiency in intellectual skills decreases the ability to compete against the rivals. Unfortunately, the government supportive organizations and other organizations such as universities have not taken the responsibility of improving the technical and professional knowledge in this sector.

What is more, many SMEs in Pakistan do not have the intellectual skills and relevant educational background to manage their businesses. These affect their ability to do effective control and planning. Some SME owners use the loans obtained for the business for personal use (Khalique et al., 2015). This is evident when the large numbers of SMEs ended up their operation between 1 to 5 years, while some vanished within 6 to 10 years of existence and the small scale enterprises in Pakistan that continue to grow to maturity are less than 5% to 10% (Khalique, Isa, et al., 2011). Hence, this indicates that SMEs in Pakistan has low growth and high mortality rate. Consequently, SMEs performance of Pakistan is below the expectation level as compared to the others from the middle-income level countries (Bilal et al., 2016).

For any firm, Intellectual capital is one of the key success factor In the knowledge-based economy (Khalique, Shaari, et al. 2011; Arshad & Arshad, 2018).In Pakistan, lack of experienced and skilled workers are the main hurdle in declining the performance of SMEs. SMEs need to establish the concept and practical implication of intellectual capital, to attain the market-based competitive edge.

Other than that, innovation is considered a major issue in SMEs in Pakistan. In the Global Innovation Index report, Pakistan is positioned at 108th out of 128th countries. There are more than 3.2 million business enterprises in Pakistan; 99% of those businesses are SMEs (Bilal et al., 2016). However, the non-competitive SMEs sector has suffered loss of market share both in local as well as foreign markets, ultimately resulting in overall declining in SMEs performance. Bilal et al. (2016) further expanded that Pakistani SMEs are not actively and extensively involved in the innovation activity or building innovation capability, this is due to lack of financial and expertise capabilities, hence becoming barriers for SMEs to perform well and create value (Arshad & Arshad, 2019)

Another reason for the underperformance of SMEs in Pakistan is environmental turbulence. In Pakistan, turbulent environment is the main hurdle that hinders the performance of the firms and prevent them from taking advantage of opportunities (Harram & Fozia, 2015). That is the reasons behind the low growth rate of the textile industry which lags behind the other Asian counterparts such as China, India, and Bangladesh. In just few years, Pakistani manufacturer sector is facing competition from regional players and the textile share in global market keeps decreasing from 2.2% to 1.6%.

According to the Bureau of Statistics of Pakistan, the country's exports of the merchandise have decreased to \$10.322 billion from \$12.058 billion during the first seven months of the current year. Percentagewise, the decline is recorded at 14.40%. The leading causes of the declining exports such as the outdated technology, lack of intellectual capital, and absorptive capacity cited as some of the reasons contributing to the lower exports of the textile product of Pakistan (Pakistan Ports and Custom, 2015).

## **5. Conclusion and Recommendation**

SMEs are regarded as one of crucial pillar in progression of any economy. The importance of SMEs are acknowledged in each economy either they are developed, developing or under-developed. In Pakistan, SMEs are also playing vital role in economic development of the country. This paper tries to summarize the importance and challenges faced by SMEs of Pakistan. Current paper highlighted some factors which creating hurdle in smooth functionality of Pakistani's SMEs. Future researchers should focused on these key factors while conducting the researches.

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