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### SMALL AND MEDIUM ENTERPRISES AND HUMAN RESOURCE PRACTICES IN PAKISTAN

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#### ABSTRACT

*This paper presented the overview of the human resource practices in small and medium enterprises. The nature and importance of small and medium sized enterprises (SMEs) sector in Pakistan's economy is unparalleled. Hence this paper discussed the general views of the SMEs operating in Pakistan, the current employment sector and the HR practices in SMEs. The arguments developed in the paper supports the contention that SMEs in Pakistan have great potential for greater economic and social development. Some key issues pertaining to Pakistan's SMEs are also identified.*

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**Keywords:** SME, HRP, Employment, Entrepreneurial engagements, Human capital, Firm outcomes

#### INTRODUCTION

Small and medium sized enterprises represent a large, diverse and important sector worldwide and considered as the most significant segment which contributes in the development of a country. In recent years the small and medium sized enterprises (SME) have come under public policy limelight (Schlogl, 2004) and gets attention of the policy makers of developed and developing countries. According to the figures and facts provided by the UNIDO, 90 percent businesses worldwide are fall into the category of SME sector and provides approximately 60 percent employments around the world. While analyzing the significance of SME sector worldwide and its importance into the country's economy it can be inferred that SME sector plays a vital role in developing the Pakistan's economy. Islamic Republic of Pakistan got independence in 1947 from British India. Pakistan follows the Federal Republic Government system. It has four provinces

which include Sindh, Punjab, Balochistan and Khyber Pakhtunkhwa, and one territory Federally Administered Tribal Areas (FATA) and one capital territory Islamabad. Pakistan follows common law system with Islamic law influence. It has joint electorates and reserved parliamentary seats for women and non-Muslims. President of the country holds the position of Chief of the State and Prime Minister is the Head of the Government. The Cabinet appointed by the President of Pakistan upon the advice of the Prime Minister of the country. The President elected through an Electoral College comprising the members of the Senate, National Assembly, and Provincial Assemblies for a five-year term. Majlis-e-Shoora consists of the Senate and the National Assembly.

Pakistan is situated in the Southern Asian region bordering with India on the east and Iran and Afghanistan on the west and China in the north. The total area of the country is 796,095 sq km, it has four seasons, and mostly the weather is hot and dry. Pakistan has extensive natural gas reserves. Pakistan is basically an agriculture country with the irrigated land field of 198,700 sq km.

Pakistan is a 6<sup>th</sup> most populated country in the world with the population of 190.29 million. Muslims are in majority with the ratio of 95 percent and rest of the population includes Christian and Hindu. Urdu is the national languages of the country and English is the official language of Pakistan, moreover, more than eleven languages are widely spoken in the different areas of the country. The literacy rate of the country is 49.9 percent with educational expenditure of 2.7 percent of total GDP.

Pakistan is a developing country and mostly the economy based on agricultural activities. Though, from past few decades the country substantially shifted to the industrial activities. Albeit the economic development is still facing the mismanagement of resources and it can be controlled through a visionary and capable political leadership in Pakistan (Taha, 2012). Textiles industry is one of the most prominent sectors in the country and account for most of Pakistan's export earnings. The total labor force in Pakistan is 58.41 million with the unemployment rate of 5.6 percent. Agriculture sector engaged the majority of workforce with the proportion of 45 percent; moreover, industry and service sector employed 20.1 percent and 34.9 percent respectively with per capita income of USD 2800. The major agricultural products include cotton, wheat, rice, sugarcane, fruits, vegetables; milk, beef, mutton and eggs. Moreover, the industrial sector of Pakistan comprises of textiles and apparel, food processing, pharmaceuticals, construction materials, paper products and fertilizer.

### **Small and Medium Scale Firms in Pakistan**

The small and medium enterprises (SMEs) are playing vital role in the economies around the world in irrespective of the countries development stage (Mustafa and Khan, 2005; Dasanayaka, 2008). SMEs are now considered as the foremost source of economic growth. However, due to dynamic environment and globalization, SMEs are struggling for their smooth survival. In Pakistan there are about 90 percent of enterprises falls under the category of SME (SMEDA., 2006) therefore

Pakistan's economy can be considered as a SME driven economy. According to the Federal Bureau of Statistic data 65 percent enterprises are located in Punjab, 18 percent in Sindh, 14 percent in KPK and other 3 percent in Baluchistan and Islamabad. Further, 53 percent are wholesale, retail, restaurants and hotels, 22 percent community, social and personal services and 20 percent are in manufacturing. A noticeable thing is that more than 90 percent of SMEs are less than 20 years old (Federal Bureau of Statistics., 2004; SMEDA., 2006).

The significant contribution of SME sector in economic development brings it into the government limelight. Private sector entrepreneurs and investors also focus on small and medium scale firms by noticing the swift growth in this sector in recent years (Mazumdar, 2001; Schlogl, 2004; Bhutta *et al.*, 2008; Ghani, 2010). Moreover, the easiness in startup with less investment cost by an entrepreneur who have a market opportunity (Reynolds *et al.*, 2001; Gelderen *et al.*, 2006; Giacomini *et al.*, 2007) family business background (Wiklund *et al.*, 2003; Giacomini *et al.*, 2007; Verheul *et al.*, 2010), previous experience in particular industry (Bell, 2001; Ardichvili *et al.*, 2003; De Carolis and Saporito, 2006; Alsaaty, 2007; Wiklund *et al.*, 2009) and risk taking ability (Palich and Bagby, 1995; Miner and Raju, 2004; Stewart and Roth, 2004; Briggs, 2009), are considered as the influential determinants to establish a SME. Studies have been undertaken to identify the constraints small and medium scale firms face in startup and during its operations (Taylor, 1999; Bosma *et al.*, 2004; Grilo and Thurik, 2008; Hessels *et al.*, 2008).

By identifying the potential in this sector, an autonomous institution, Small and Medium Enterprise Development Authority (SMEDA) was developed in 1998 with the aim to support and develop SME sector in the country. Further developments have been noticed in banking industry when banks, specifically deals in small and medium sized business, were established in Pakistan (Rana *et al.*, 2003). Consistent with the developments Government of Pakistan (GoP) announced SME policy in 2005 and later announced a revised version of the policy for SMEs in 2007. Hence due to the policy implementation and potential in this sector, commercial banks are now enhancing their lending to SMEs. This development validates the significance of this sector in the country progression.

Academic and research advancements has also been noticed in the early 2000. Lahore Universities of Management Science (LUMS) had analyzed the importance of this sector in 1990s and opened a Small and Medium Enterprise Centre (SMEC) to undergone the academic research and later offering programs in Entrepreneurship and SME Management (LUMS., 2011). This advance motivates other universities and researcher as well. Currently, Institute of Business administration (IBA), one of the prominent business studies institute in Pakistan, is in a process of establishing an entrepreneurship research centre with collaboration of Babson College funded by USAID from 2007 and sequentially launched its degree program in entrepreneurship in Fall 2011. In addition majority of universities in Pakistan have included "entrepreneurship" and "small and medium enterprise management" in their degree program.

Small and Medium Enterprise Development Authority (SMEDA), is the official managerial authority for small business management in Pakistan (Rauf *et al.*, 2008). SME is referred to as firm upto 250 employees or paid up capital upto 25 Million or annual sales upto 250 Million. The government statistics show that Pakistan's SMEs sector recorded an impressive growth of 14.7 percent during 1988 – 1997 when the estimated value of its output increased from PKR 19,683 million (USD 1058 million)<sup>1</sup> to PKR 67,541 million (USD 1662 million)<sup>2</sup> with the exchange rate of 1PKR in 1988 and 1997 to USD 18.60 and 40.62 respectively. Meanwhile, the number of Small and Household Manufacturing Industries recorded growth of 5.8 percent in that period. *The shift in SME growth have been prolific in Pakistan hence* almost all major international donor agencies which includes ADB, World Bank, ILO, UNDP took initiatives in the SME sector within the last five years (Bhutta *et al.*, 2008).

According to the Economic Survey of Pakistan (2008) 3.2 million establishments are working in Pakistan out of which 93 percent entities falls in the category of SMEs. In addition, SME sector caters for 25 percent of manufacturing exports in Pakistan, while its share in value addition is 28 percent (Kureshi *et al.*, 2009). Furthermore, SMEs jointly contribute approximately 30 percent to GDP; employ 80 percent of the non-agricultural labour force, 25 percent to total exports and 35 percent to manufacturing value addition (Economic Survey of Pakistan., 2010). Small Scale Manufacturing, which accounts for 4.9 percent of total GDP. SME Bank was established to provide financial assistance and business support to small and medium enterprises. Up to 31st December, 2009 SME Bank has financed 8,299 SMEs, disbursed loans amounting to Rs. 9,510 million to 40,891 beneficiaries in the country (Economic Survey of Pakistan., 2010).

### **SME Categories as per Various Institutions in Pakistan**

Consistent with the discussion above the SMEs category approved by the Government of Pakistan mentioned in SME policy 2007 is widely accepted throughout the country. However various institutions have categorized SMEs according to their own policy and discretion. State bank of Pakistan, SME Bank, Federal Bureau of Statistics and other institutes define small and medium enterprises as a separate entity. Likewise, SME bank set the definition as per total assets for small and medium enterprises separately. Federal Bureau of Statistics set the definition as per number of employees. State bank of Pakistan has introduced "SME Prudential Regulations" which is based upon three clauses. The summary of all institutions SME definition is presented in the table below:

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<sup>1</sup> USD 1 = 18.60 PKR (FY 1988)

<sup>2</sup> USD 1 = 40.62 PKR (FY 1997)

**Table-2.1.** SMEs categories as per various institutions in Pakistan

<b>Institution</b>	<b>Small</b>	<b>Medium</b>
SME Bank	Total Assets of PKR 20 million	Total Assets of PKR 100 million
Federal Bureau of Statistics	Less than 10 employees	N/A
Punjab Small Industries Corporation	Fixed investment. up to Rs. 20 million excluding land and building	N/A
Punjab Industries Department	Fixed assets with Rs. 10 million excluding cost of land	N/A
Sindh Industries Department	Entity engaged in handicrafts or manufacturing of consumer or producer goods with fixed capital investment up to Rs.10 million including land & building	
State Bank of Pakistan	An entity , ideally not being a public limited company, which does not employ more than 250 persons ( manufacturing) and 50 persons (trade / services) and also fulfils one of the following criteria: (i) A trade / services concern with total assets at cost excluding land and buildings up to Rs 50 million. (ii) A manufacturing concern with total assets at cost excluding land and building up to Rs 100 million. (iii) Any concern (trade, services or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.	

**Source:** Small and Medium Enterprises Development Authority (2007).

### **Employment Sector of Pakistan**

Over the years, Pakistan has substantially moved from agriculture economy to manufacturing economy (Henneberry *et al.*, 2000; Khan, 2011a). Service sector contribution in economic cycle is also significantly high (Khan, 2011a) and continue to grow with an average growth rate of over 8 percent per annum since 2000 (SMEDA., 2009). Moreover according to the Pakistan Ministry of Commerce report, service sector contributes 53.8 percent to Pakistan's GDP. Economically active size of citizens is the largest in the total population of the country. According to the economic survey of Pakistan 2009-10 unemployment rate of the country is 15.4 percent. Human capital is enriched with diverse skills from unskilled labour to high-skilled critical mass. Pakistan's urban growth rate is highest in South Asia. Estimated in 1980s, urban population growth rate was 4.5 percent per annum and projected to 60 percent by the turn of the century. That proved true. Big cities urban economy e.g. Karachi, Hyderabad, Lahore, Sialkot, Islamabad, Faisalabad, Quetta and Peshawar and its employment pool is the glaring example of this. Its formal and informal sectors provide greater employment potential and are in a position to use human capital efficiently (Khan, 2011b).

As elsewhere in the world, Pakistani SMEs too are affected by the recent global economic meltdown. Low economic growth has substantially reduced employment pool in Pakistan. This process has been accelerated not only because global economic meltdown but also due to misdirected economic policies and bad governance despite highly productive demographic dividends. Employees in Pakistan are less paid and their natural needs like health care and family insurance are seldom offered, annual bonuses are not covered. Annual bonuses are not regular in

our SME sector. It is therefore observed that retention is one of the major problems (Barney and Wright, 1998; Davies, 2001; Parker and Wright, 2001; Taplin and Winterton, 2007; Chew and Chan, 2008) in small and medium size industries of Pakistan hence, it should become a strategic priority (Perrin, 2003) to decrease the level of turnover of employees and increase the retention within organization (Hom and Griffeth, 1995; Davies, 2001; Chew and Chan, 2008). Consistent with the discussion slightly better emoluments (Accenture., 2001; Parker and Wright, 2001; Lepak and Snell, 2002), working conditions (Wood *et al.*, 1986; Purani and Sahadev, 2008)), satisfaction with supervisor (Wood *et al.*, 1986; Johnson and Johnson, 2000; Kalliath and Beck, 2001), low organizational commitment (Huselid, 1995; Walker, 2001; Chew and Chan, 2008) effective organizational leadership (Ali, 2012) and job stress (Sagar, 1994; Rambur *et al.*, 2003; Zurn *et al.*, 2005) provide good reasons to an employee to switch over from one organization to another organization. Growth in salary in SME sector is far behind the growth in inflation which is a source of depression and made them less productive at their workplace. This situation has precipitated negative impact on the overall economy of Pakistan. However, economically active size is the largest in the total population of the country.

Pakistan's human capital is enriched with diverse skills from unskilled labour to high-skilled critical mass. Lack of will, vision and bad economic decisions have blurred the hope of any development that eventually resulted in utter disappointment among educated youth and labour class in Pakistan.

Globally, employment sector is directly related to economic growth in the country. Likewise, employment rate in Pakistan was depend upon the business activities, opportunities in investments, foreign direct investments, government subsidizations, relaxation in trades and tariffs, low interest rates, availability of basic infrastructure and production of skilled employees' which satisfied the demand of employment sector. However, Pakistan's economic growth remained uneven during military and civil rules in its sixty two years' history. Insurgency, political instability, religious extremism, terrorism, fragile legal system and delicate economic structure of the country negatively affect the stability and economical uplift. However, latest military regime led by General Pervez Musharraf, ex-president of Pakistan (2001-2008), brings apparent growth and prosperity. However majority of stakeholders considered it temporary and artificial due to the foreign aid by US, as a compensation to become an ally in the war against terrorism. Indeed economic conditions were dramatically affects after 9/11, when Pakistan took part in the war against terrorism. However it became worst after 2008 due to the political instability and lack of trust of investors, on governmental policies. Albeit a short-term inclined was noticed in the overall economy of Pakistan during 2004-07 due to the FDI's, foreign aid and reforms in financial sector.

Pakistan's overall growth strategy could not patronize the inclusive development in Pakistan (Amjad, 1982). In the decade of 1990s, government of Pakistan's 9th plan-1996 though attempted to extend the growth frontiers, ignored the aspect of productive employment generation.

Employment policy document has never been produced that synergizes supply and demand in employment market (Ghayur, 1996).

Rural and Urban employment have gone through unique experiences in this country. In the absence of innovative agricultural farming, land reforms and exclusive development zones, urban employment has come under strain. Pakistan's urban growth rate is highest in South Asia. Estimated in 1980s, urban population growth rate was 4.5 percent per annum and projected to 60 percent by the turn of the century. That proved true. Karachi's urban economy and its employment pool is the glaring example of this. Its formal and informal sectors provide greater employment potential and are in a position to use human capital efficiently. However, this study, on the basis of extensive study of hiring procedure in Pakistan, reveals a gap between employers and employees. Both are unaware about each other and are unaware of employers' requirements and employees' expectations. Government institutions, in this regard, hardly provide guideline and technological support to reduce this gap.

At present, SMEs are recognised as the backbone of the country's economy and representing nearly 90 percent of all the enterprises in Pakistan and providing 80 percent employment of the non-agricultural labour force. SMEs form a significant employment portion of the manufacturing and services sector. According to the Lahore Chamber of Commerce and Industry's report the labour force today is divided in agriculture 43 percent, manufacturing 13 percent, construction 7 percent, transport 6 percent, and services 14 percent and the other head carrying the rest of the burden. The total workforce in Pakistan is 102.7 million; out of which 50.79 million people are employed in 2010; this labour force will increase to 154.4 million by 2030 with the growth rate of 2.05 (Khan, 2011b).

### **Human Resource Management and Pakistani Small and Medium Scale Firms**

Pakistan, being a developing country, is facing many challenges to manage its human resource in various aspects. Small and medium scale firms or entrepreneurial engagements have an immense potential where available human resources may be utilized effectively to get dramatic boost in the economic development (Khan *et al.*, 2013). Small and medium scale business constitutes major part in any economy which can play key role in developing country's economy like Pakistan. Due to the importance of managing human resource in firm, policy measures have also been taken at national level. In SME Policy 2007 measure for firm development in various areas, which includes finance, technology, human resource management and development and marketing, have been outlined for the SMEs (Ahmed *et al.*, 2011).

As mentioned earlier that there are very few studies which show the impact of HRM practices on firm's performance. In consistent with discussion Arif *et al.* (2005) depict that the majority of the SMEs in Pakistan lack formal training and performance appraisal practices. Further the findings of this study depict a positive relationship (correlation) between HRM practices and firm performance

in Pakistan. These results show that SMEs' managers and owners do realize the positive impact of HRM practices; however it's hard for them to decide what kind of formal HR policies and practices to pursue. Additionally, there is no framework available to choose from in this specific contextual, institutional and cultural setting (Rauf *et al.*, 2010). Hence the lack of human resource practices is not allowing the SME sector to achieve its maximum outcomes in Pakistan (Rohra *et al.*, 2009; Khan and Khan, 2012).

## CONCLUSION

This paper validates the contention that SMEs in Pakistan have great potential for greater economic and social developments. SME sector can play a pivotal role in developing the viable economic structure of the country. The figures and facts presented earlier indicated the potential and further growth in this sector. However, SMEs are not utilizing their human resource strategically and coherently and management ignores organization's most valued assets, that is, the workforce. Incompetency in implementing human resource practices due to the scarcity of HR practitioners is one of the major obstacles, facing by the SMEs, to maximize their outcomes. Hence considerable steps should be taken to improve the sources of organizational efficiencies to achieve the SME performance.

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