

MACRO POLICY AND REGULATION CHANGE CAN BETTER NOURISH PAKISTAN

Creating an enabling environment for small- and medium-sized food businesses

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KEY MESSAGES

- Pakistan's many small- and medium-sized enterprises (SMEs)⁵, including the very large number involved in food supply, face major constraints from the country's existing policy and regulatory environment, resulting in limited opportunities for expansion or investment in production /promotion of safe and nutritious food.
- Building on the context of the national SME policy 2021 and based on recent research with SMEs in Pakistan, policy advancements could be made in:
 - 1) clarifying the definitions and distinguishing characteristics of SMEs, microenterprises and startups for better targeting;
 - 2) simplifying regulatory and taxation regimes,
 - 3) developing a dedicated legislation with respect to Micro, Small and Medium Enterprises,
 - 4) improving infrastructure, such as special economic zones and internet,
 - 5) boosting gender equality and inclusion, for example through earmarking extra resources to boost women's inclusion and agency, and
 - 6) implementing special measures for food-related SMEs such as preferential public procurement, education, and public awareness campaigns to drive demand, or support to relevant research and development.



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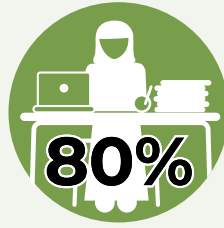
⁵ According to SMEDA, a small enterprise has an annual turnover of up to Rs. 150 million, while a medium enterprise has an annual turnover of up to Rs. 800 million

INTRODUCTION

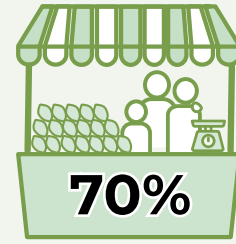
Small- or medium-sized enterprises (SMEs) are a dominant feature of Pakistan's business landscape.



Most Pakistani businesses – **90%**, or more than **5.2 million** – are classified as SMEs.



They employ some **80%** of the non-agricultural labor force, contribute **40%** to the country's GDP, and **30%** to total exports.



About **70%** are estimated to be operating in the informal sector and most are modest in terms of sales turnover (annual turnover figures for **98%** of these SMEs fall below PKR 150 million; SMEDA, 2022).

About this brief

In the context of the latest national SME policy “2021 SME Policy Pakistan”, this brief, focusing on the external macro policy and regulatory environment affecting SMEs, and its two related briefs have been prepared using the most up-to-date research (conducted over the last 5 years) on ongoing issues faced by Pakistani SMEs, particularly food-related SMEs, to develop policy recommendations.



6 "Addressing market constraints facing small and medium-sized food enterprises for a better nourished Pakistan", and "Improving access to finance for small and medium-sized food enterprises for a better-nourished Pakistan".

SMEs in the food sector

The food sector is considered Pakistan's largest industry, accounting for 27% of national value-added production, and 16% of total employment in the manufacturing sector. Much of this food manufacturing and processing is small- or even micro-sized, and many of these businesses are in rural areas, depending heavily on agricultural raw materials and poorly skilled non-farm labor (SMEDA, 2021).

Unfortunately, not enough of the food that is available, affordable, and desirable from SMEs and other sources is nutritious, safe, and sustainable. SMEs face many barriers, including that good practices are not well incentivized in policy. In many cases, SMEs require more support and appropriate incentives if they are to forge towards, demand for, advocate for and be involved in a value chain consistent with more nourishing, sustainable, equitable and resilient food systems (GAIN, 2021).

A recent online survey (GAIN, 2022) of SMEs in 12 countries, including Pakistan, identified key issues faced by food-related SMEs, including: non-availability and high and volatile prices of inputs; difficulty accessing finances; limited financial reserves; declining sales; volatile output prices; difficulty accessing equipment; difficulty hiring; increased taxes/levies; and restrictive regulations.

Evidence suggests SMEs, including those in the food sector, are constrained by the macro policy and regulatory environment, supply and demand side issues common across different sectors (See Policy Brief-2 "Addressing market constraints faced by small and medium-sized food enterprises for a better-nourished Pakistan"), as well as low access to financing (See Policy Brief-3 "Improving access to finance for small and medium-sized food enterprises for a better-nourished Pakistan") (CDPR, 2023).

A recent study of Pakistan's food processing sector found that most businesses were in the informal and unregulated economy, facing difficulties in accessing essential raw materials and other resources, especially finance, skills, knowledge, and management. They also experienced erratic inputs, including supply of utilities. Moreover, they received poor financial support, with commercial banks often failing to understand that their businesses depend on the natural environment and required credit for only short periods of time (SMEDA, 2021).



POLICY ISSUES AND RECOMMENDATIONS

This section describes some of the main issues for food SMEs in Pakistan posed by inappropriate regulation, including for instance through taxation, public procurement rules, immigration and visa policies, intellectual property rights enforcement, bankruptcy laws, regulations for new business models, etc. Key shortcomings in the institutional framework are also discussed – such as the lack of coordination among important government and private sector stakeholders (CDPR, 2018).

The corresponding recommendations respond to the identified issues. Firstly, they aim to reduce the cost of doing business by improving and rationalizing both the regulatory environment and the interface of firms with the government. Secondly, they address coordination problems between public investments and private sector growth. Thirdly, emphasis is given to interventions that are cost effective and leverage private sector resources and services wherever state capacity is weak or non-existent. Fourthly, while the suggested policy interventions aim to lower the disproportionately high costs faced by small firms, they are also designed to create a supportive environment to encourage the creation and success rate of fast growing and innovative enterprises. Finally, the proposals are inclusive in terms of both geographical coverage and gender. They include special concessions for women-led businesses in order to tackle existing gender imbalances (CDPR, 2018).



The recent survey of SMEs in 12 countries (GAIN, 2022) also called for similar recommendations and other measures, including for instance better public procurement, non-subsidy financial support, price subsidies, import facilitation, and measures to boost access to key food products (inputs) such as grains, edible oils, and other key inputs. These recommendations and measures are included in the recommendations given in this brief and its two related briefs.

The key policy issues and related policy recommendations for food SMEs in Pakistan related to the external macro policy and regulatory environment are summarized in **Table 1**.

Table 1: Policy issues and corresponding policy recommendations for food SMEs in Pakistan

Topic/area	Policy Issues	Policy Recommendations
Definition of SMEs, Startups, and Microenterprises	<ul style="list-style-type: none"> The needs and requirements of Small Enterprises (SEs) and Medium Enterprises (MEs) are significantly different. The National SME Policy, 2021 includes start-ups but excludes microenterprises from the definition of SME. Startups differ in their overall composition and financing channels, speed and growth, and risk profile compared to SEs and MEs. 	<ul style="list-style-type: none"> Separate categories should be developed to address the different needs and requirements of micro-enterprises, startups, small enterprises (SEs) and medium enterprises (MEs).
Complex regulatory regime	<ul style="list-style-type: none"> Ensuring compliance with various regulations and guidelines related to food safety, labeling, and health claims can be complex and time-consuming, especially for small businesses. 	<ul style="list-style-type: none"> Develop one-stop portals for issuing licenses, permits, and registration to reduce SMEs' transactions costs. Implement the Regulatory Guillotine as given in the 2021 National SME Policy. Adopt a one-in-one-out system to keep the regulatory burden in check and force government to evaluate costs to business of proposed regulations. Exempt small non-incorporated firms and new firms from regulations such as reporting and accounting requirements (regulatory tiering). Adopt measures for easing the process of inspections and compliance checking, such as offering support and training, self-inspection, and a system of clear communication of compliance requirements to SMEs.
Complex taxation regime	<ul style="list-style-type: none"> The high frequency of tax payments, as well as double taxation (levying of tax by two or more jurisdictions on the same income asset or financial transaction) add to the cost of compliance for SMEs. Food sector SMEs are forced to pass on the additional costs to the end consumers, resulting in higher food prices. For instance, small firms cannot afford accountants or tax lawyers to respond to frequently issued tax notices. 	<ul style="list-style-type: none"> The process of filing tax returns should be simplified and made more transparent to improve compliance and reduce burdensome administration on payers of tax. Simple tax filing procedures and information/forms in the Urdu language should be developed with SMEs in mind. The tax base should be broadened, while the frequency of tax payments needs reduction. Set up an SME facilitation center at the Federal Board of Revenue (FBR) for direct, personalized, and timely guidance to taxpayers on compliance. Discriminatory Regulatory duties and custom duties should be reviewed by the Federal Board of Revenue. SMEs should be supported to become vendors to multinationals, by making existing tax breaks for multinationals (for example under Special Economic Zones (SEZ)) conditional on sourcing products, services and labor locally. Expenses incurred in developing the capacity of SMEs (e.g. through licensing, labor training, technology upgradation) should be made tax deductible. Corporate investors that channel funds to incubators, accelerators, and other venture capital and business angel activity should get tax relief.

7 The guillotine is an orderly, systematic, transparent, rapid and low-cost means of counting and then rapidly reviewing a large number of regulations against clear scientific criteria for good regulation, and eliminating those that are no longer needed.

Topic/area	Policy Issues	Policy Recommendations
Dedicated legislation for MSMEs	<ul style="list-style-type: none"> • Unlike other Asian countries, the MSME or SME sector in Pakistan does not have legislation or country-wide plans in place for SMEs. 	<ul style="list-style-type: none"> • An MSME Act should be created to provide for the vision and direction of the MSME sector, help to enforce rights, support the growth and development of MSMEs. This will encourage fair competition and leading to improved efficiency, innovation, and entrepreneurship. • The legislation should have a targeted approach to MSMEs in the food sector, as they may have uniquely different needs to MSMEs in other sectors. • Under such a law, funds could be allocated for developing and promoting SMEs, improving their registration process, their statutory purchase preference, credit support, help penalize delayed payments, and help implement the regulatory guillotine at the federal and provincial level.
Infrastructure	<ul style="list-style-type: none"> • The infrastructure provision (industrial estates, roads, electricity, high-speed internet, etc.) for SMEs, especially those in the food manufacturing sector, is insufficient. • There exist major intra-provincial and inter-provincial disparities. • Most SMEs in urban areas are located in congested residential spaces without suitable infrastructure. This is not only a binding constraint for enterprises to grow, but poses a serious environmental hazard for residents. • Only 1% of the Pakistani female population are entrepreneurs and only 12% of registered firms have female owners. However, 38% of women and 42% of men run informal enterprises. • There is a lack of gender sensitivity in the performance indicators set to be achieved by 2025 in the 2021 National SME Policy. • The National Coordination Committee on SME Development, as outlined in the 2021 National SME Policy, involves multiple government agencies but does not sufficiently represent women at federal or provincial levels. 	<ul style="list-style-type: none"> • The industrial sector could be offered a block tariff regime, while off-grid rural SMEs could be provided with clean energy from alternate sources such as solar or wind energy. • They also need to be provided access to reliable and affordable internet connectivity, devices, and software tools. • SMEs in the manufacturing sector, including food manufacturers, should be incentivized to locate in a cluster through creation of industrial estates or Special Economic Zones (SEZs) and industrial parks developed by the federal/provincial governments. Small chambers are engaged on the board of SEZs to promote the interests of SMEs. • Land, space, and area may be allocated explicitly for SMEs in the SEZs, or specialized SEZs dedicated for SMEs, including food manufacturers, may be created at the provincial and federal level, and land made available to SMEs at affordable rates. • The National Commission on the Status of Women, provincial women departments, and women-led SMEs for instance should be represented in the National Coordination Committee on SME development, to propose and recommend further measures in policy and legislation inclusive of women and/or sensitive to women's needs. • Make the SME Policy performance indicators (increasing the economic contribution of SMEs, making SMEs more competitive and productive, enhancing formalization and increasing the number of SMEs, improving networking of SMEs, and increasing start-up enterprises) more gender sensitive.

CONCLUSION

In conclusion, it is evident that macro policy and regulatory changes hold the key to fostering a more nourishing environment for Pakistan. The small- and medium-sized enterprises (SMEs), particularly those in the food sector, face numerous hurdles stemming from the existing policy and regulatory landscape. These challenges hinder their growth potential and inhibit their ability to contribute effectively to the nation's economy. However, with concerted efforts towards creating an enabling environment, Pakistan can unlock the full potential of its SMEs and enhance its competitiveness regionally and globally.

The recommendations put forth in this policy brief highlight the need for comprehensive reforms across various aspects of governance. From refining the definitions of SMEs and startups to streamlining regulatory and taxation regimes, each recommendation aims to address specific challenges faced by SMEs. Furthermore, the proposal for dedicated legislation for micro, small, and medium-sized enterprises (MSMEs) offer a structured framework for supporting and promoting the growth of these vital economic players.

Infrastructure development, gender inclusion, and support for food-related SMEs are also critical components of the proposed policy interventions. By prioritizing these areas, Pakistan can create a conducive environment for SMEs to thrive and contribute significantly to the nation's economic growth and development. In essence, the success of Pakistan's SME sector hinges on the implementation of forward-thinking policies and regulations that prioritize inclusivity, innovation, and sustainability.



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