Keeping Pace with Trade Developments

Country Update Note 1: "Barriers for SMEs to export at regional and international level"

Setting the scene

SMEs in Pakistan are widely reported to represent 30 percent of national GDP, 25 percent of exports of manufactured goods, and 35 percent of manufacturing value added[1]. Other estimates put the number of SMEs contribution to exports at 70 percent[2]. The reality is that these estimates are outdated and unreliable, based on an economic census conducted thirteen years ago, a time frame during which Pakistan's economy has changed significantly.

Regardless of whether they contribute 25, 30 or 70 percent to exports, however, all randomly selected respondents of our survey reported a variety of internal and external barriers to exports. The respondents of our survey were mostly from the textile sector (27%). The rest reported exporting surgical and medical goods (9%); sports goods (9%); chemicals such as soaps, detergents and salts (14%); jewellery and handicrafts (18%); and the rest can be clubbed as 'miscellaneous' with one respondent each reporting beverages, carpets, furniture, grass and cutlery.

To the extent of textile, this follows the sector-wise share of SMEs in Pakistan, where textile is estimated to hold a share of 22 percent[3]. However, other major SME sectors such as carpets (24% share in total SMEs) do not enjoy similar share in exports with carpet exports halved in the decade ending FY14[4].

Majority of the exports by our respondents are shipped to North American and European markets (41%) of total. This is less than the trend in total Pakistani exports (of which more than 50% is for these markets) but suffice to say that Pakistan's SME and non-SMEs, both are mostly dependent on North America and Europe markets. About 14 percent each of the respondents said they were exporting to the Middle East and South Asia, including India. This echoes earlier findings that Pakistan-India trade is mostly led by SMEs rather than big corporates[5].

However, not surprisingly, majority of the respondents (68%) said "they were not aware of the WTO agreements". Those responded "yes" (32%) could not provide details despite probing. The most common answer among those who responded "yes" was to the affect of "we know about GATT, which aims to liberalise trade by reducing taxes & quotas". This mirrors findings from previous study when we found that "there is hardly any awareness amongst exporters of the WTO Agreement on Technical Barriers to Trade (TBT) or any knowledge of the working of the WTO TBT Committee[6]".

While all respondents flagged a host of barriers to exports (details of which in the ensuing section), 84 percent of the respondents said they have never raised an issue related to export

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1 SMEDA 2007;ADB 2009; SBP 2012; World Bank 2015
2Planning Commission 2014
3 Jasra et al 2011
4 Dawn 2016
5 Interview with stakeholders who wish to remain anonymous
6 CUTS International 2016a

barriers to the government because of their likely lack of response. The respondent from Mohsin Surgical Industries put it more categorically. He said, "we have never raised any issue regarding export barriers to the government because we know that they will not do anything about it".

Analysis of challenges faced by exporters

This section explores the barriers to exports faced by SMEs in Pakistan. These barriers, according to the consensus view of our respondents, are mostly external in nature as against internal to the firm. They are also recurring or ongoing problems as against those faced at the time of initiation of exports. The impact of these barriers varies: some result in cancellation of orders, others lead to production delays. Invariably, all of it boils down to an impact on sales or profits. Most respondents think that these are SMEs-specific with some expressing perceptions of discrimination.

Main barriers

Our respondents have identified a variety of internal and external barriers to exports. Internal barriers are those that originate from organizational resources – i.e. barriers that are informational, functional or marketing related. They are differentiated from external barriers that a firm faces during the process of exports – i.e. procedural, governmental or environmental. Examples of the former include shortage of or high prices of production inputs and organisational capabilities. The latter includes government policies, nature of competition, banking, and other factors that affect the environment[7].

Scholars also distinguish between initiating problems and on-going problems[8]. The former are those that are associated with initiation of business with an overseas buyer, such as recognising an opportunity or financing requirements. The latter are recurring features during the process of exports such as payment issues or port delays.

Based on our survey, it can be safely said that both categories of barriers problems are found common across a wide range of sectors. However, external barriers that pose ongoing problems are most frequent *(See table: Summary of Responses)*, whereas it is interesting to note that electricity crisis and political instability are not the most cited barriers to SME exporters.

Of these, the most frequently cited barrier is 'complicated and time-consuming export policies and procedures', although in some cases these are one-time problems such as at the time of initial foray into export markets. For instance, one furniture exporters reported that the biggest issue they faced was "lack of proper guidance from the authorities at the dry ports". "They did not guide us properly from the very beginning".

Documentation issues are followed by logistics problems as well as high or unstable raw material prices that are often the result of high import duties imposed on the price of raw material.

[7] *Khattak et al 2011*
[8] *Ibid*

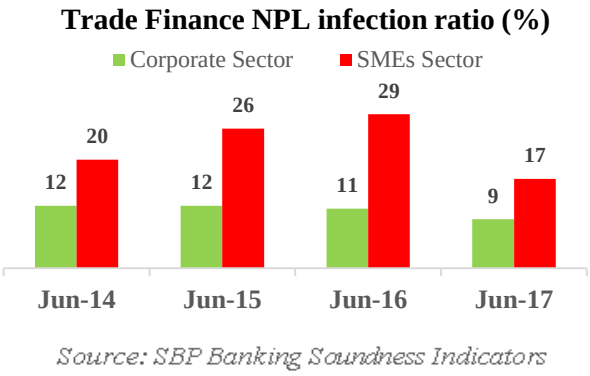
SUMMARY OF RESPONSES TO THE QUESTION OF MAIN BARRIERS TO EXPORTS		
	ONGOING	**EXPORT INITIATION STAGE**
EXTERNAL BARRIERS	* Export policies & procedures are complicated, and time consuming [7] * Transportation/logistics cost are high and marked by delays or mis-shipments [4] * Electricity crisis & civic/political unrest [2] * High taxes & high or unstable raw material prices [4] * Banking system weak & refunds/rebates not given in time [1] * Late payment from foreign clients [3]	* No proper guidance from port authorities [1] * Problems in getting licenses, permits & certifications [2]
INTERNAL BARRIERS	* Communication problems with foreign customers [1] * Lack of finance for international marketing [1]	* Lack of skills and know-how for marketing [2]
** Multiple answers possible*		

Problems in getting licenses, permits and certifications also present as external barriers to initiating overseas sales, whereas lack of capital, know-how and communication skills needed for overseas marketing – especially at the initiation phase - are the key internal barriers to exports.

Late payment by foreign clients, often the result of trade barriers within Pakistan, is another major issue, whereas a weak banking system with little availability of trade finance is also responsible for slow or stagnant export growth.

At the one end, the non-performing loans are higher in the case of SMEs which makes bankers shy of offering finance to this sector. Yet at the other end, SME exporters argue that getting trade finance is challenging because banks demand a guarantee even when LC is available. In many cases, the LC is not opened. Instead, an open contract is made based on mutual trust. That trust, however, often backfires especially when there are delays in delivery of goods.

Impact of barriers to trade



Most respondents gave the obvious answer that the various barriers to trade negatively affect their sales and profitability. Upon probing, however, some respondents gave various reasons how exactly the barriers affect their sales and profitability – implying that a single problem affects different SMEs differently. For instance, among those respondents that reported documentation issues as the biggest barrier, one said that documentation issues keep the firm "engaged in unproductive work rather than productive work like production planning etc".

Another said that "complicated procedures discourage us from exporting greater quantities" whereas one said the delays in export procedures "results in cancellation of further orders from foreign buyers". One responded from Karachi (Panacea International) also said that shipment delays due to cumbersome customs' procedures reduces their profit margins because their client demand discounts due to delays.

Cancellation of existing orders or the promise of future orders is reported to be the most commonly faced affect of the barriers to trade. Aside from the time-consuming export procedures, lack of direction by dry port authorities, shipment delays due to an inefficient logistics sector, and delays in certification, license and permits – that are usually one time or periodic concerns – also cause cancellation of export orders.

Problems in getting certification, license and permits are also the key reason why the respondents are unable to tap new markets for exports. Whereas high or unstable input prices impair the SMEs ability to be internationally competitive and keep their market share, communication barrier and payment delays are the main reason why respondents said their production gets delayed.

IMPACT OF BARRIERS - SUMMARY OF RESPONSES	
Sales & profits adversely affected	9
Leads to cancellation of orders	5
Exports not growing as per potential	4
Unproductive work consumes productive hours	3
Payment delays leading to production delays	3
Delivery issues/fewer orders	2
Not internationally competitive	2
** Multiple answers possible*	

“Because the payments we receive from the exports are the major source of making payments to our labor. When that payment gets delayed then the workers are also reluctant to work which hinders our production process,” the respondent from Kolumbus International, a sports goods maker from Sialkot told our interviewer.

Expressing his concern over language barrier, the respondent from XPO Field, another sports good maker from Sialkot said that “the language barrier makes it difficult for us to communicate with the foreign clients which makes it problematic to collect the payments from them. Consequently, the payments are often delayed which disrupts the production schedule since the business needs those payments for further production of goods”.

Is it a SME-specific problem?

The majority view (60%) of our respondents is that the problems they face are specific to SMEs. This view is held against most of the barriers highlighted in the previous sub-sections. There is, however, a key difference in responses.

Some respondents opine that it is the small and medium nature of their business that makes it a SME specific problem. For instance, one respondent who requested anonymity said “we often find problems in documentation and managing transactions. This is because the procedures are in English rather than our national language and most of our staff is not fluent in English”. Another said that they often face issues in expanding their customer base abroad and “those issues are usually because of lack of information about the foreign markets and inadequate funds for product promotion”.

Other respondents flag a sense of discrimination by a variety of stakeholders. One respondent said “being a small-scale business less priority is given to us as compared to well-known companies”. Another reported that clearing and forwarding agent “shows laziness” in handling their business because being a SME they don’t offer big revenues to the agent.

Bankers are also reported to have “non-serious” attitude towards SMEs. “The banking sector does not cooperate with us. Our receipts are often delayed from their side,” a Lahore-based company said on the condition of anonymity. Some respondents also said they felt government only listens to the big corporates while making laws, policies and procedures.

Seeking solution

Corresponding to the nature of barriers flagged in the preceding section, recommendations to fix export-related documentation and procedures tops the list, where the two most cited demands are to allow documentation in the national language (Urdu) and to improve online systems.

SUMMARY OF PROPOSED SOLUTIONS FOR DIFFERENT TYPES OF BARRIERS		
	ONGOING	**INITIATING STAGE**
EXTERNAL BARRIERS	* Documentation and procedures should be simplified and less time consuming [8] * Government should subsidise of control raw material prices [3] * Government should give tax relief to SME exporters[3] * Logistics cost need to be reduced [2] * Government should work on meeting and maintaining international standards for export markets [2] * Government should hold consultative dialogues to discuss ongoing problems and solutions [1]	* Licenses, permits & certifications requirements and processing should be made simpler [2]
INTERNAL BARRIERS	* Government should ensure transparency in export processing [4] * Awareness platforms and seminars for export procedures [2] * Government should set aside funds to subsidise SMEs' overseas marketing [2]	* Need to have a platform for information about new markets and new products [1]
** Multiple answers possible*		

Another set of recommendation surrounds improvements in communication strategies. Some demand the government to hold consultative dialogues to inform SMEs of their plans and to seek solutions to SMEs problems. Others want a platform using which SMEs can find out about new markets and products, whereas some demand the government to hold awareness seminars for changes in export procedures. On a related note, SMEs also demand transparency in export processing.

They argue that there is an "information asymmetry" between SMEs and big corporations, which echoes recent evidence that benefits of duty exemptions for raw material imports are skewed towards the large firms. "Top 100 firms in Pakistan accounted for roughly three quarters of duty-exempted value, and only five firms accounted for about a third of that total"[9]. Moreover, some respondents also claim that big corporations often bribe the authorities to fast track their exports pushing SMEs orders further down the queue.

While the subject of standardisation was not raised by respondents when we inquired about the barriers to exports, it did appear in their proposed solutions. One suggested that the government "should provide lab facilities where the products could be monitored to see if they meet the international standards or not". Another proposed that the government should establish a system to monitor the quality of goods exported "because often the exports do not meet international standards, which ruins the reputation of other Pakistani exporters in international market".

[9] *World Bank 2017*

These responses should be seen in the context that for most SMEs standardisation is an "insurmountable problem"[10], which emanates from lack of capital and lax enforcement of standards. In other studies, exporters have opined that technical regulation and standards are becoming more rigid, that requires "extensive upfront financial resources, which are beyond their means".[11] Therefore, those who do meet the standards, such as our respondents, complain of being undercut by those do not, or otherwise engage in shady practises.

It is, however, interesting to note that none of the SMEs suggested a solution related to banking, even though payment delays and its consequent impact on production is one of the main problems faced by SME exporters. To conclude, however, if Pakistan is to kick off its weakening exports, then supporting the SME sector has to be one of the key steps in the direction.

[10] *Afraz N et al 2013*
[11] *CUTS International 2016b*

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