

The Role of Small and Medium Enterprises in Perspective of Labour Abundant Economy of Pakistan

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Abstract

The small and medium enterprise sector has played a significant role in the income and employment generation in the developed and developing economies. The current study is conducted to find out the potential of the SMEs to achieve the economic and social objectives. The survey data of 300 SMEs indicates the wider gap between the demands for SME financing and the supply-side. The test result $p < 0.05$ indicates that the lack of access to capital investment, finance, and support from the public sector institutions to upgrade the technology and commutation means are the major obstacles for the SME's to scale-up their performance in the current market reforms. While the result of the regression model ($r = 0.992$) indicates a strong correlation between the variables. In fact, those SME's had overcome the issues of technology, communication, dearth of functional barriers because they had the access to the formal sources of financing. Therefore, to attain the target of 10 million jobs and reduce unemployment in the country, the policymakers have to make necessary arrangements to establish new financial sources and facilitate the existing financial firms to expand their network for the advancement and modernization of SMEs operating in the formal and informal fold of the economy.

Keywords: Micro; Small and Medium Enterprises; Finance; Technology & Innovation; Income.

1. Introduction

Small and Medium Enterprises (SMEs) have played a remarkable role to attain social and economic objectives including employment generation; improvement in export earnings; level of productivity, saving, investment, health, education, and gender inequality of the prosperous economies of the world. SMEs are involved in more than 90% of business and provide more than 50% of employment opportunities globally. While the formal SMEs share more than 40% of the Gross Domestic Product of emerging economies of the world (Ayyagari, Demirguc-Kunt, & Maksimovic, 2017). Japan attained again its prewar economic status of the second-largest economy of the world in a decade by advancing its SME sector (Japan Small Business Research Institute, 2010).

Internationally, there is not a single definition to define SME. It is defined by countries as per their regulations and the size of the domestic

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economy. SME defined on the parameters by the different institutions in a country based on the number of the labor force employed by the entity, fixed capital investment of the firm, the volume of production, sales turn over during a specific period, type of business and son on (Cunningham & Rowley, 2008); whereas from the accounting perspective the contribution of SMEs in the economy during a period, is counted upon the size of the labor force. A micro-entity should have 1 to 9 labors, a small entity with 10 to 49 labor, and a medium-size firm with 50 to 249 workforces (OECD, 2017). Similarly, in Pakistan no standard definition of SME. The sector is differently defined by the Central Bank of Pakistan, Small Medium Enterprises Development Authority, and other development institutions. Table no.1 indicating the various definitions used for SMEs.

Table 1: Definitions Used For SME in Pakistan by the Various Organizations

Organization	Definition
SME Bank Limited	In the case of a small enterprise total value of assets is not less than Rs.20 million and Rs.100 million for a medium-sized enterprise
Pakistan Bureau of Statistics	The organization has less than 10 labor forces to be considered as a small size enterprise.
Punjab Small Industries Corporation	The value of capital investment of any business enterprise excluding land and building is not more than Rs.20 million refer to as a small enterprise.
Punjab Industries Department	The value of fixed assets of any business enterprise excluding the cost of land is not more than Rs.20 million refers to as a small enterprise.
Sindh Industries Department	The value of capital investment of consumer or producer goods manufacturing units and handicrafts business including the value of land and building is not more than Rs.10 million refer to as small enterprise.
State Bank of Pakistan (SME Prudential Regulations-Updated by SBP, December 2017)	A business entity having 50 employees including contract labor force and annual sales turn over not more than 150 million categorized as a small enterprise. While the private business entity, not a public limited entity engaged in the business of manufacturing and service with the number of employees from 51 to 250 and annual sales turnover from 151 million to 800 million considered as a medium enterprise. The trading business entity that does not employ more than 51 to 100 labor force will be considered as a medium enterprise.

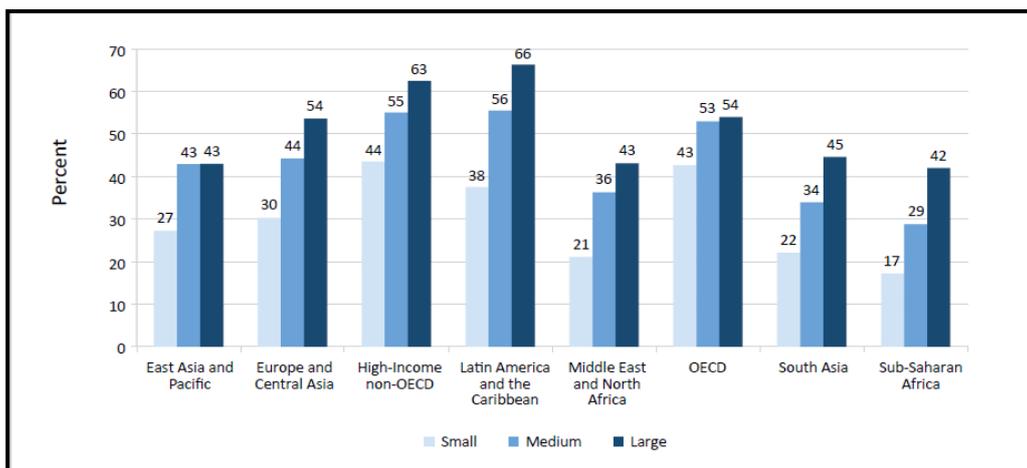
Source: Small and Medium Enterprises Authority, 2015.

1.1 The Share of Small and Medium Enterprises in Economy of Pakistan

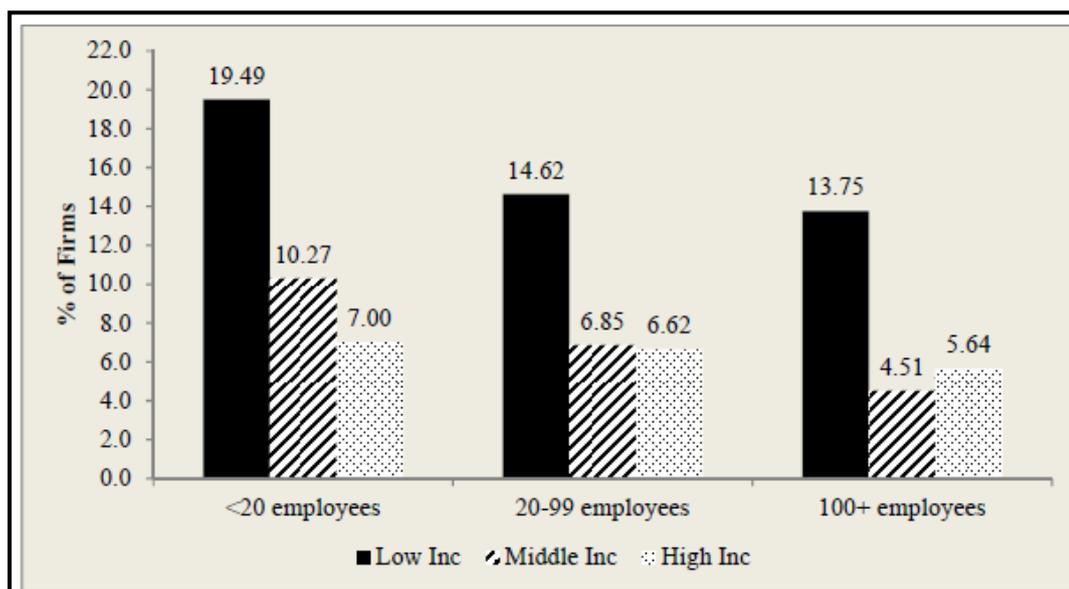
However, 95% of 3.2 million business enterprises are SMEs and absorb 78% non-agricultural labor force of Pakistan (SAMEDA, 2017). SMEs add the value in the business of wholesale, retail trade, restaurant, hotel, manufacturing, and services in Punjab, Sindh, Khyber Pakhtunkhwa, and Baluchistan provinces of Pakistan respectively likewise 65, 18, 14, and 2 percent out of total SMEs (Pakistan Federal Bureau of Statistics, 2017). They contribute more than 30% to the gross domestic product, share 25 percent in exports of manufacturing products, and add Rs.140 billion in the export revenue and also share 35 percent in the manufacturing sector (Government of Pakistan, 2019).

Despite the contributions of SMEs to the economic competitiveness of developed and developing economies. They have limited access to financing in comparison to the large-scale industry to grow particularly in developing countries. The obstacles that refrain the SMEs to access financing in developing countries are financial regulations, the dearth of the managerial skills and accounting skills to account for business activities, nature, and type of the SMEs, high rate of interest, macroeconomic indicators of the country, etc (World Bank, 2017). Figure no.1 & 2 indicates that access to financing in developing and underdeveloped countries. Mostly the SMEs rely on saving, borrowing from friends, relatives, and from the market to maintain, run, and upgrade the existing business operations (Hussain, 2017).

Figure 1: SME's access to the formal sources of financing



Source: Facundo & Sergio, 2017.

Figure 2: Access to finance as a Serious Problem by the size of the firm

Source: World Bank, 2017, SME Financing, Policy Research Paper # 8241
retrieved from [http:// worldbank.org](http://worldbank.org)

Most SMEs in Pakistan are operating in the private sectors and facing the various challenges to adopt new business patterns and models, and discover new markets internally and internationally. While the agriculture sector and its allied fields are the major contributors to the economy of Pakistan. The sector accounts for 21% of the GDP and absorbs 45% labor force and provides livelihood to 60% rural population, but the performance of a large number of small and medium-size agro-based industries is very low (Government of Pakistan, 2019). Though the advanced SME sectors in the world have lessened the economic inequalities between the rural and urban areas and ensure long-term social-economic prosperity in the country (UNCTAD, 1998). The SME sector of the world's second-largest economy Japan absorbs 70 percent of the total workforce of the country (World Bank, 2003).

The developed economies to achieve socioeconomic sustainability increased the capital expenditure for the advancement of micro small and medium enterprises, and provide the flexible access for capital development to attain the objective of economic and social development. Table no.02, presents the gross fixed capital formation by the south Asian countries during the last five years from 2014 to 2019 in the south.

Table 2: Gross fixed Capital Formation- South Asian Countries

	2000	2014	2015	2016	2017	2018	2019
% of Annual Growth							
India	-1.8	2.6	6.5	8.5	7.2	9.8	-2.8
Pakistan	5.0	2.5	15.8	7.5	10.3	11.2	-12.8
Bangladesh	7.1	9.9	7.1	8.9	10.1	10.5	8.4
Maldives	17.8	2.8	7.5	29.1	-2.7
Sri Lanka	10.0	-1.7	0.1	9.1	5.1	-0.5	6.0
Bhutan	..	29.9	12.9	10.2	-0.8	-6.3	-16.8
Nepal	..	11.4	19.6	-12.3	44.3	18.1	5.0
% of Gross Domestic Product							
India	26.02	30.08	28.73	28.19	28.07	28.96	26.90
Pakistan	15.98	13.04	14.11	14.09	14.55	15.74	14.01
Bangladesh	23.81	28.58	28.89	29.65	30.51	31.23	31.57
Maldives	..	26.73	33.04	39.25	40.15	46.50	40.60
Sri Lanka	28.04	27.74	25.70	26.76	26.39	25.56	27.10
Bhutan	52.20	54.99	55.73	56.40	52.09	47.19	37.52
Nepal	19.32	23.52	27.97	28.73	31.43	34.55	33.68

Source: World Bank National account data, 2020, retrieved from the <https://data.worldbank.org/indicator/>

1.2 Effects of Small and Medium Enterprises on Economic and Social Sustainability

The advancement of the SME sector is considered the most important factor to the growing economy of a country and the largest source to generate income and employment opportunities in rural and urban areas in order to reduce poverty. It is extensively recognized that the SME sector supplies talents generate job opportunities by supporting and spurring the development of the agriculture, manufacturing, service sectors industry. The SME sector is perceived as an area of undertaking to achieve financial development, to lessen joblessness, and reduce destitution in the industrialized and agricultural nations of the world. Therefore, these economies underscored the advancement of SMEs as the bloodline of their economy and increased investment volume to modernize the SME sector. Because it provides the youth of the society to share in the development of the economy and diminish the provincial metropolitan relocation.

The qualitative and quantitative studies on the subject indicate that the economic growth in a country is associated with the advancement of the SME Sector in low, middle, and high-income countries. The advancement of the SME sector and economic development has positive relation because the SME sector is the major source of income and employment generation in developed

and developing countries (Beck et al., 2005); two-third of the labor force is employed by the SME sector in the Organization of Economic Co-Operation and Development (OECD) countries (OECD, 2017).

Although, small and medium firms are critical for the economic development of developing economies and, however; SMEs predominantly is the major source for creating employment and value-added segment. In the current serious and dynamic worldwide climate, SMEs undertake an imperative job for the financial advancement of developing economies. Besides, it is stated that SMEs are known deliberately significant in Asian area nations. For instance, in Japan, the share of SMEs is about 99.7% of total business enterprises, generate 71% employment opportunities, and share 55.3% of gross domestic product. In China, 99% of business enterprises are SMEs, that absorb 75% of the workforce of the labor force of the country, and 56% contribution to GDP; In Indonesia, SMEs portrayal to business entities is about 99.7%, which create 99.6% employment opportunities and contribute 57% to GDP. In Malaysia, SMEs ' huge portrayal is about 90% of business ventures, employed 56% of the total workforce, and contribute 32% to GDP. Additionally, in Malaysia, SMEs add 19 percent to the export earnings of the country (Raza et al., 2018).

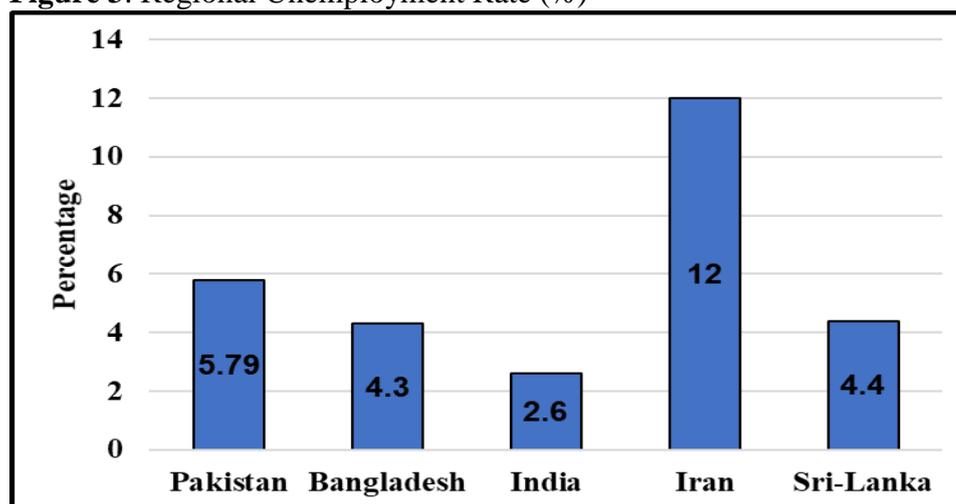
1.3 The Perspective of Labor Abundant Economy in Pakistan

The creation of income and employment opportunities is a challenge for low-income countries. Keeping in view, the predominant financial circumstance in Pakistan policymakers have targeted that 10 million job opportunities can be generated during the five years so as to reduce the unemployment rate by 5.79 percent by strengthening the labor-intensive sectors such as the construction industry and the Small and Medium Enterprise Sector. Small and medium enterprises are playing a vital role to create income, and employment opportunities and attaining economic development in the south region. Moreover, the income and employment situation in India, Bangladesh, and Sri-Lanka is better than in Pakistan. The statistics illustrated the unemployment rate in India, Bangladesh, and Sri-Lanka found as 2.6, 4.3, and 4.4 percent respectively, as shown in figure no.03. The same can be envisaged from table no.3 that the female participation in the Pakistan labor market has consecutively decreased during the fiscal years 2014-15 to 2017-18, from 15.8 percent to 14.5 percent. While the highest unemployment rate of 15.17, percent of females belong to the age group 20 to 24 years in comparison to the 10.5 percent of the male of the same age group (Pakistan Bureau of Statistics, 2017-18). According to the report of a multilateral agency had ranked Pakistan 133 at the position in the gender inequality index in 2017, (UNDP, 2018). The SMEs can play a vital role in the to empower women and reducing the impact of gender inequality in Pakistan alike the SMEs have a substantial role in the South Asia region to attain socio-economic objectives.

Table 3. Labor Force (in million)

	2013-14	2014-15	2017-18
Labor Force	60.1	61.04	65.5
Male	45.65	46.38	50.74
Female	14.45	14.66	14.76
Employed Labor Force	56.52	57.42	61.71
Male	43.33	44.07	48.17
Female	13.19	13.35	13.54
Unemployed	3.58	3.62	3.79
Male	2.32	2.31	2.57
Female	1.26	1.31	1.22
Crude Participation Rate (%)	32.3	32.3	31.7
Male	48.0	48.1	48.3
Female	15.8	15.8	14.5
Unemployment rate	6.00	5.9	5.8
Male	5.1	5.00	5.1
Female	8.7	9.00	8.3

Source: Pakistan Bureau of Statistics 2017-18

Figure 3. Regional Unemployment Rate (%)

Source: Government of Pakistan, Economic and Advisory Wing, 2019

2. Literature Review

Dar, Ahmed, and Raziq (2017) critically examined different definitions as applied by public institutions and other private organizations. It indicates that the significance of SME has not been recognized by Pakistani economic planners, and as they have perceived ideas from the developed countries' socioeconomic development that is due to the advancement of the SME.

Shah (2018) despite SMEs, appreciated the contribution to the economy of Pakistan particularly in this era of a competitive market, and providing a platform for innovation. The challenges such as financial constrain, complicated regulatory frameworks, up-gradation of technology; lack of human resources development facilities ;Market limitations; deficiency of the resources to find out new international markets for their products, and so forth that have suppressed them to participate more in the economic activity of the country.

World Bank (2015) stated that in the developing economies, the major portion of the generation of employment sources are SMEs. The formal SMEs share 33 percent of national income and 45 percent of the total employment. The share in GDP will increase, upon the inclusion of informal SME's contribution. Despite that, around 0.6 billion jobs would be needed worldwide up to 2030, SME facing the problem of capital development.

Vijaykumar (2013) believes that it is the fact of the highest human development index and poverty alleviation in Sri Lanka among south Asian countries and based on the result of consistency in economic policy to enhance the participation of the private sector and support the SMEs. Sri Lankan being an agricultural country paid to focus on the promotion of SME.

Zafar and Mustafa, (2017) write that competency of SMEs in the economic growth of developed economies is the remarkable. Further, Japan, Korea, Taiwan, and other emerging economies had attained economic prosperity and social development due to the developed SME network in these countries. The contribution of SMEs to the gross domestic product of these developed and emerging economies accounted for 60, 57.3, 55.3, 50, and 47.3 percent respectively in China, Germany, Japan, Korea, and Malaysia. While in developing countries like Pakistan, Sri Lanka, and Kenya the role of SMEs is contradictory.

Ali, Rashid, and Khan, (2014) indicates SME growth harms poverty alleviation. The reason behind it is the output that is not up to the mark of a competitive market and size of firms due to the lack of capital investment. Therefore, it is essential to strengthen SMEs by remedying a lack of capital investment and financing for SMEs to grow according to the demand of the market.

Qureshi and Herani (2011) study emphasis removing the unnecessary problems to the advancement of small and medium enterprises. Such as over regulations, high cost of funds; and easy access to the governmental and financial institutions support to grow SMEs. Even study also indicates that a large number of SMEs possess the potential to grow. Though, there is no problem of liquidity with the banks operating in Karachi and Pakistan.

Smallbone and Welter's (2001) research study discovers that the role of governmental institutional reforms of the advanced economies is the main feature in the advancement of SMEs at the various stages of market reform. The developed economies facilitate SMEs in essential structural changes, product development, to initiate the new business models and approaches.

Furthermore, the field survey of the SMEs of Moldova, Belarus, and Ukraine depicts that the business entities were initiated by an individual's efforts because of difficulty to access governmental or other external facilities to mobilize resources to set up a new business. In this situation, the advancement to develop was only for a short period otherwise their size remained smaller. Therefore, their contribution to the economy is limited.

According to Qureshi, Ghani, & Kazi (1990), large scale and small and medium scale industries are situated in the urban and rural areas respectively. SMEs located in rural areas are a great (Qureshi et al., 1990) source of income and employment generation for the rural population. SME sector of Pakistan comprises of the agriculture and its allied fields, agro-based industry, manufacturing industry; slaughtering, wholesale and retail trades, services, and so forth. Further a dire need great attention aimed to redress the internal and external challenges faced by the SME to grow in this respect.

The studies indicate that the developed SME sector is the main provider of employment opportunities, training grounds, and utilization of local resources. SME is a track through which social and economic development can be achieved by the advancement of SMEs in the country, and also eradicates poverty. Because the production structure, conduct, and performance of SMEs can be modified in a short time and at low cost. According to the changing business environment as compared to the large-scale industry. Therefore, the external support (i.e. access to finance, support to overcome the firm's functional and internal problems, safety and security, etc.) can easily manage to change SME from the low scale to high scale performing business entity. In Pakistan, the importance of the sector is continuously ignored despite its vital role to develop the economy. SMEs are facing the problem of capital development. Thus, they are not capable to generate quality employment.

3. Objectives of the Study

- To find out the potential of the SMEs to achieve the economic and social objectives
- To ascertain the effects of financing on the SMEs growth

4. Hypotheses of the Study

H₀ There is no relationship between the obstacles and institutional reforms by the government to SME advancement of the SMEs.

H_a There is a relationship between the obstacles and institutional reforms by the government to SME advancement of the SMEs

H₀ There is no relationship between the growth of Small and Medium Enterprise employment generation and poverty alleviation

H_a There is a relationship between the growth of Small and Medium Enterprise employment generation and poverty alleviation

5. Research Methodology

The random sampling method was adopted to select the sample. Primary data was collected through a questionnaire-based survey from 300 SMEs, including formal and informal enterprises having an employment size from 5 to 100. Table number like 4 and 5 present the breakup of the sample size, study area, and description of entities. The primary data analyzed through the Pearson correlation to find out the correlation between the dependent variable (i.e. SME Growth without having access to financing) and independent variables (i.e. financial obstacles, SMEs functional barriers, institutional reforms by the government). While the regression model is used to find out the relation between the dependent variable (for instance, SME Growth having access to financing SME and independent variable (such as Growth improvement in employment, revenue, production cost, and process).

Table 4. Breakup of Sample Size and Study Area

Sampling Method	Sample Size (formal & Informal enterprises)	Area of Study	Nature of Work of Respondents	Economic Sector
Random Sampling Method	150	Hala and Matiari	Woodwork (Jhandi), Handmade Pottery, (Kassi), Khaddi and Ajrak, Cotton ginning factories, Oil Mills, Flour Mill	Agro-Based Industry Cottage Industries Handicrafts
	150	Hyderabad and Kotri	Furniture, Plastic Works, Glass Bangles Industries, Daal Mills, Oil Mills Foundry, and Steel Re-Rolling	Mineral Industries, Wholesale, Retail trade and Service

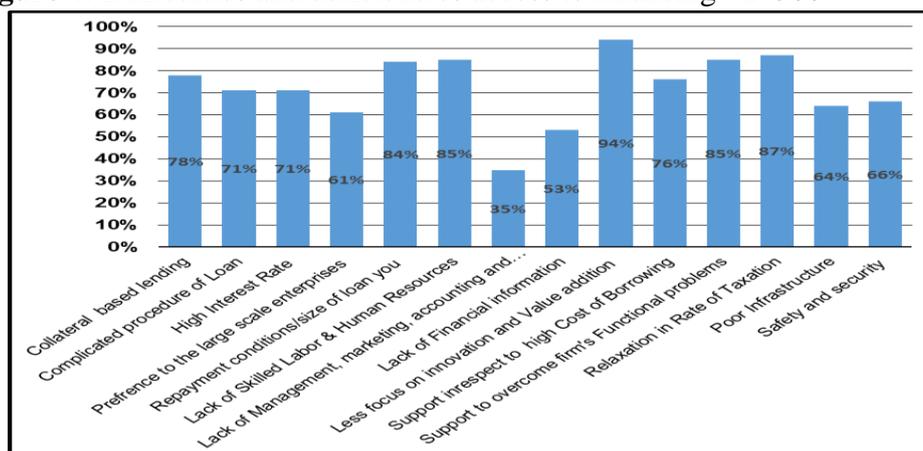
Source: Produced by the author

Table 5. Description of Sampled Entities

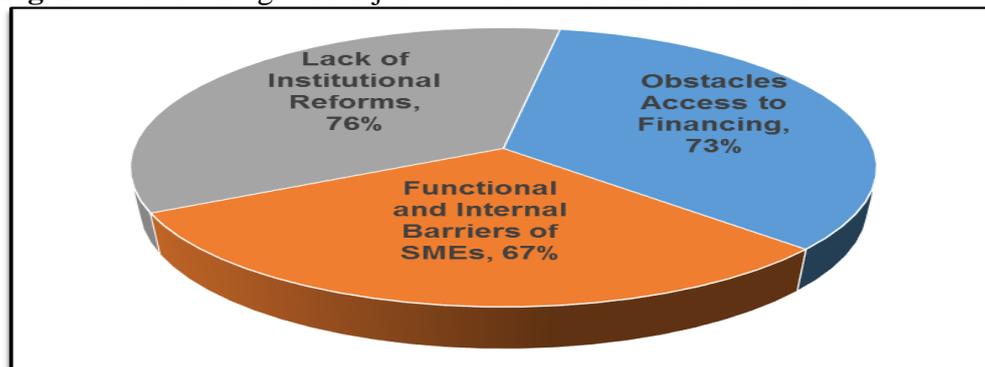
Cottage Industries including handicrafts, Woodwork (Jhandi), Handmade Pottery (Kassi), Cloth (Khaddi and Ajrak)	55	18%
Agro-Based Industries including Cotton Ginning Factories, Flour Mills, Oil Grinding Mills, Dall Mills	60	20%
Glass Bangles Industries	50	17%
Furniture Manufacturers (Wood and Iron)	30	10%
Plastic Works (Polyethylene bags, Plastic utensils)	20	7%
Marble processing units	20	7%
Textile (Loom)	10	3%
Confectionary and Bakers (Biscuits and toffees)	10	3%
Wholesale and retail trading and service	45	15%
	300	100%

6. Result and Discussion

Hence, 65% of respondents were operating a small type of business from 5 to 50 employees and monthly income is not more than rupees 50,000 to 200,000 only. The survey data indicates the wider gap between the demands for SME financing and the supply-side. The 38% of respondents were financed by commercial banks, microfinance institutions, and other financial institutions. While 62% were not given credit by the commercial banks for the startup due to lack of the security, financial strength to repay the loan amount, and size of the firm. Figure no four and five highlight the frequency of obstacles to SME progress. As based on the average percentage of the reason for SME growth is classified into three different groups (1) financial limitations to SME growth (73%). (2) Internal Weakness of SME to scale-up performance (67%). (3) Lack of institutional reforms by the government to SME advancement (76%). The result of these observations is alike to the research study of (Qureshi & Herani, 2011).

Figure 4. Difficulties and deficiencies access to financing n=300

Source: Field Survey, 2019.

Figure 05. Percentage of Major Obstacles to SME Growth n=300

Source: Field Survey, 2019

Table 6. Correlation Statistics between the Dependent and Independent Variables of SMEs have not accessed to Formal Financing Sources.

		Financial Obstacles	Internal Weakness of SME to scale-up performance	Institutional reforms by the government to SME advancement	SME Growth
SME Growth (not have access to finance)	Pearson Correlation	.995**	.930**	.902**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	186	186	186	186

** . Correlation is significant at the 0.01 level (2-tailed).

Table 06. the Pearson correlation test result highlights the strong correlation between dependent variable SME Growth and independent variables government incentives and support, Internal Weakness of SME to scale-up performance, financial obstacles. The $P < 0.05$, therefore we accept our alternative hypotheses, “There is a relationship between the obstacles and SME growth”.

Table 7. Regression Statistics of SMEs have access to Formal Financing Sources.

Multiple R	0.992
R Square	0.984
Adjusted R Square	0.984
Standard Error	1.347
Sig.	0.000
Observations	114

- a. Dependent Variable: SME Financing
- b. Predictors: (Constant), Improvement in the employment, Improvement in the Revenue, Improvement in Cost Production and Process

In table 7, the regression statistics method is adopted to find out the relationship between the dependent variable and independent variable. The test result shows that the multiple correlation coefficient $r = 0.992$ indicates a strong level of prediction or a strong correlation between the variables. While the adjusted $r^2 = 0.984$ indicates that our independent variables explain more variability of the dependent variable. The p-value is less than 0.05. So, there is enough evidence to narrate that there is a relationship between SME's access to formal sources of financing and dependent variable and independent variable.

The test outcome discloses that the multiple correlation coefficient $r = 0.992$ demonstrates a solid degree of expectation or a solid connection between the dependent variable (such as SME Financing) and independent variables (likewise Improvement in employment, Improvement in Revenue, Improvement in Cost Production and Process). While the adjusted $r^2 = 0.984$ features that our independent variables clarify greater changeability of the dependent variable. The p-value is less than 0.05. Thus, there is sufficient proof to state that there is a strong connection between the SME's access to formal sources of financing and SME's Growth (for instance, improvement in the employment, Revenue, Production cost, and process). Furthermore, SMEs Growth is considered, to transmit the SME from low to high scale performing industry. For example, development from the production process to the distribution of production, innovation, enhancement in employment, investment in socio-economic development. The employment generation rate is correlated with access to financing (Dinh, Mavridis, & Nguyen, 2010) and it also supports our hypotheses 2, "there is a significant relationship between the growth of SME employment generation and poverty alleviation. Therefore, we accept our alternative hypotheses.

7. Conclusion

The present study and empirical test result $P < 0.05$ (Table no.6) indicate that the lack of access to capital investment, access to finance, and support from the public sector institutions to upgrade the technology and commutation means are the major obstacles for the SME's to scale-up their performance in the current market reforms. Thus, it is difficult for SMEs to adopt new business models and methods to improve the productivity level according to the modern business environment and globally changing market reforms. On the other hand, test of multiple correlation coefficient $r = 0.992$ (Table 7.) indicating that those SME's had overcome the issues of technology, communication, dearth of functional barriers because they had the access to the formal sources of financing. These findings result out the potential of the SMEs to achieve the economic and social objects so as reduce unemployment

pressure, to earn foreign exchange ; production at economical cost ; skill development, saving, investment, health, education, and gender inequality. Hence, it is proved that economic prosperity is centered on SME's advancement. The industrialized as well as the agricultural nations have achieved economic development due to micro, small and medium enterprises and have continued capital investment in that sector.

To accomplish the perspective of the labor abundant economy in Pakistan by developing the agriculture, industrial, and service sectors. Therefore, the economic managers and policy-makers of the country have to make the necessary arrangements to encourage the large number of small and medium-sized firms operating in the informal fold of the economy in the country providing the access to the formal sources of finance with the flexible terms and conditions to these SMEs for the up-gradation of technology, communication, and skill development to run their business according to the changing market reforms globally. Access to finance the youth of the country to start up new business and so forth. The statistics illustrating that the agriculture sector is a major contributor to the GDP and absorbs a large number of the workforce. Thus, the many agro-based micro, small and medium enterprises in the urban, semi-urban, and rural areas of the country are associated with the agriculture sector. It is a fact that high-income jobs can't be generated in the agriculture sector. The access to the capital enables agro-based firms to adopt new business models and methods. Thus, the policy-makers have to mobilize and activate other additional financial sources for the SME's capital development like the services of the non-banking financial institutions and microfinance institutions to asset-based financing and to scale up the business potentiality of SMEs. While conventional banks do not do finance to the SMEs without collateral and charge a high markup rate. Thus, MSMEs abstain to acquire loan facilities from large conventional banks. The statement supports the discussion to promote SME in perspective of Labour Abundant economy in Pakistan. "Access to the credit facility for SMEs is an important factor for socio-economic development in developing countries. Financial support for a startup a new business and from production to the distribution will help to create new job activities" (IFC, 2013).

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