

## **Public Private Partnership and SMEs Development; The Case of AJ&K Pakistan**

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*This study examines the current developments of SMEs in AJ&K and the effectiveness of Public and Private sectors SME-development programs. Some important facts are presented. A comprehensive international literature study was undertaken. A questionnaire was developed for small and medium sized enterprises owners and top managers to access the status of their enterprises and also to examine SMEs developmental strategies adopted by them. Chi square test was employed for analysis of the data. The study find that SMEs are of overwhelming importance to AJ&K because they account for more than 90 percent of all firms outside the agricultural sector. Second, the main constraints faced by small entrepreneurs are cumbersome and onerous business regulations and restrictions, lack of finance, and low human resource and technological capabilities. Finally, the government has been the most important supporting agency for SMEs in AJ&K. However, evidence of the effectiveness of government and private programs to support SME development is mixed and not so encouraging. After analyzing the current SMEs' developmental strategies (adopted by both public and private sectors) the study suggested public private partnership (PPP) as future strategy for SMEs' development in AJ&K Pakistan.*

**Field of Research:** SMEs Management

### **1. Introduction**

Small and medium enterprises (SMEs) development is a key factor in economic development of Azad Jammu and Kashmir (AJ&K) Pakistan. It is self reflective that lack of entrepreneurship has been the main cause for AJ&K's as well as Pakistan's slow economic development compared with other Asian countries such as Malaysia, Thailand, China, South Korea, and Singapore. Thus, supporting small and medium enterprises in AJ&K needs to be adopted as a strategy to develop entrepreneurship in the state. In AJ&K, at the present time, SMEs represent perhaps the best alternative for economic growth. Given the difficult economic and social situation existent in the state, more attention

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requires to SMEs start, growth and survival. Specially, to SMEs be able to mobilize help from sources of outside assistance is an issue of utmost importance at the present time. Small and medium-sized enterprises are a very heterogeneous group of businesses usually operating in the service, trade, agri-business, and manufacturing sectors. They include a wide variety of firms such as village handicraft makers, small machine shops, and computer software firms that possess a wide range of sophistication and skills. Some are dynamic, innovative, and growth-oriented while others are satisfied to remain small and perhaps family owned. SMEs usually operate in the formal sector of the economy and employ mainly wage-earning workers. The aim of this study is to analyze current developments of SMEs in the country. The AJ&K's literacy rate is quite high compared to many asian states but the government is facing challenges in job creation. The SMEs sector is the best alternative for job creation, but it is also underdeveloped. The development of SME sector is necessary for economic development of AJ&K.

This study is conducted for this specific purpose how SMEs can be developed in AJ&K Pakistan. Specifically, this study addresses, how important are SMEs in the AJ&K's economy? What role public and private actors are playing in the development of SMEs' in AJ&K? And how effective are Public and Private-sponsored programs in supporting the development of SMEs? What should be the future strategy for SMEs development in AJ&K? Despite some limitations, these questions will be addressed by analyzing primary data. There is no prior study in this area in AJ&K Pakistan, so literature provided is international. The study contains five sections. Section 1 provides the detailed introduction of the study. Section 2 provides the relevant literature about the study. Section 3 deals with methodology applied in the study. Section 4 and 5 deals with results and conclusion respectively.

## **2. Literature Review**

The development of SMEs and changes over time in their structure (for example employment and output shares, output composition, market orientation, and location) are usually thought to be related to many factors, including the level of economic development, changes in real income per capita, population growth, and progress in technology. "Classical" literature on SME development suggests that SMEs will become less important in the course of economic development, as income per capita increases. The World Bank (2002, 2004), however, gives three core arguments in supporting the view that SMEs can function as the engine of growth in developing countries. First, SMEs enhance competition and entrepreneurship and hence have external benefits for economy-wide efficiency, innovation, and aggregate productivity growth. Second, SMEs are generally more productive than large enterprises (LEs). Third, SME expansion boosts employment more than LE

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growth because SMEs are more labor intensive. In other words, the World Bank believes that SMEs can boost economic growth and development.

SMEs create benefits that spillover in the entire economy. The spillover benefits of SMEs are chronicled by several studies: Audretsch, Carree and Thurik (2001), Baumol (1993), Carree and Thurik (1998) and Shumpeter (1912). McDowell (2004) estimates that the direct and indirect effects of small business formation accounts for more than half of gross domestic product and approximately sixty to eighty percent of the new jobs created. Robbins and Kirchhoff (1994) and Loveman, G. and W. Sengenberger (1991) note that high rates of gross state product and productivity growth are directly related to the size and extent of business formations. Many argue that being less reliant on formal markets and formal credit, SME are able to respond more quickly and flexibly than LEs to sudden shocks (Berry et al. 2001). Besser and Miller (2004), in a study of 715 small business owners and managers in communities across the United States, posit that communities promote and support business development, asserting that when businesses prosper, the quality of life in the community will be better. A majority of these small businesses indicated that strengthening the community was important or very important to their business success.

Tambunan and Tulus (2007) stated that in the classical paradigm, the development of an economy was dependent on two main factors (as explicitly included in a general Cobb Douglas production function), namely labor and capital (with advanced technology embodied). In the 1980s, after looking at the development miracle in the so-called newly industrialized Asian countries (NICs), such as Chinese Taipei (Taiwan), Hong Kong-China, and South Korea, (1960s and 1970s) and the widening gap between developed/industrialized nations and less developed countries (LDCs), new thinking emerged on the nature of economic development and factors determining it. In this new paradigm, it is stated that along with the above two classical production factors, there is also another crucial factor: entrepreneurship formation (SMEs start-up). Presently, the development of entrepreneurship together with human skills improvement have become two crucial factors for sustainable economic and social development.

In AJ&K, the SME has historically not been the effective player in domestic economic activities, as it's a relatively less established sector of the economy, but still it's the second largest source of employment after agriculture sector. Thus it is a primary or secondary source of income for many households. For low income group in rural areas, SMEs non-farm activities are especially important. These enterprises have also been an important engine for the development of local economies and communities. The positive relationship between SMEs formation and economic growth is chronicled by a number

studies: Audretsch and Thurik (2000), Carree and Thurik (1998), Carree, van Stel, Thurik and Wennekers (2001), Audretsch, Carree and Thurik (2001). However, compared with many other more developed economies, AJ&K's SMEs are not contributing significant value added to the national economy. Instead, they have been more important as the locus of most employment. SMEs in AJ&K account for more than 90 percent of all firms outside the agricultural sector, and thus they are the second largest source of employment. The majority of SMEs, are scattered widely throughout the rural area and therefore they may play an important role as a starting point for development of villagers' talents as entrepreneurs, especially women. Small enterprises are dominated by self-employment enterprises without hired paid workers. They are the most traditional enterprises, generally with low levels of productivity, poor quality products, and serving small, localized markets. There is little or no technological dynamism in this group. The majority of these enterprises are working at subsistence level. Some of them are economically viable over the long-term, but a large portion is not. However, the existence or growth of this type of enterprise can be seen as an early phase of SMEs' development.

### **3. Methodology**

The methodology included structured interviews with owners and managers, and document reviews.

#### **3.1 Hypothesis**

Ho. Small and medium enterprise sector can be developed in AJ&K Pakistan only/individually through public/government sector's efforts or only/individually through private sector's efforts

H1. Small and medium enterprise sector can not be developed in AJ&K Pakistan only/individually through public/government sector's efforts or only/individually through private sector's efforts; instead SMEs in AJ&K can be developed through PPP.

#### **3.2 Data Collection**

Exploratory research data were collected at 50 SMEs using three different methods: 100 structured interviews and document reviews. An initial convenience sample of 70 prospective SMEs was drawn from Mirpur AJ&K Pakistan's utilizing the following criteria:

Each prospective SME was a company with 10 to 99 employees. Such companies are large enough to require internal systems and policies, yet small enough to require direct contact with customer requirements at all levels of the firm (including managers and owners). The 70 SMEs were contacted to

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arrange screening interviews with senior managers or owners. The interviews were used to determine if the owners and managers had significant experience in judging the essentiality of PPP for SMEs development in AJ&K and to explain the research purpose and methods. After the initial interviews, 150 managers and owners that met the criteria were asked to make a substantial time commitment to participate in the research. One hundred owners and managers decided to participate. The firms manufacture diverse types of products and serve different types of consumer and industrial markets.

Data collection instrument was pretested. Structured interview were held at the SMEs to clarify important points. Specific questions began with the following topics: (1) Basic company information (2) identifying the support and resources provided by public/government sector for SMEs' growth and development in AJ&K (3) identifying the support and resources provided by private sector for SMEs' growth and development in AJ&K (4) identifying positive and negative experiences that each firm had regarding public and private sectors' role and support for SMEs growth and development in AJ&K (5) Identify the need for PPP for SMEs' growth and development in AJ&K.

Document reviewed identified evidence on the use of PPP strategy for SMEs growth and development. Examples include SMEDA's annual reports, AJ&K chamber of commerce reports and Azad Jammu and Kashmir planning and development department reports. To ensure confidentiality, respondents were asked to return the questionnaires directly to the researcher. After analysis of the information obtained, some proposals regarding ways to improve the delivery and obtaining of assistance are presented. The firms or small and medium enterprises working in AJK were the population of the study. The sample was selected randomly and the numbers of respondent interviewed were 100.

### **3.3 The Model**

SMEs Development = (Public sector's role + Private sector's role)

Public Sector's Role = (CELF + EDTI + EACEG + FABAS + IPI + SAT + PRI + TESM + CBIS + PSU)

Where

CELF is Creating Enabling Legal Framework, EDTI is Establishing Differential Taxation and other Incentives, EACEG is Easing Access to Credit, Equity and Guarantees, FABAS is Facilitating Access to Business Advisory Services, IPI is Improving the Physical Infrastructure, SAT is Supporting Access to

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Technology, PRI is Promoting Rural Industrialization, TESM is Training in Entrepreneurship, Skills and Management, CBIS is Capacity Building and Industrial Strengthening and PSU is Promoting Support from Universities (PSU), Adopting Quality Standards (AQS), Advancing Opportunities for Women and Youth (AOWY) and Fostering Linkage with Large Industries (FLLIs).

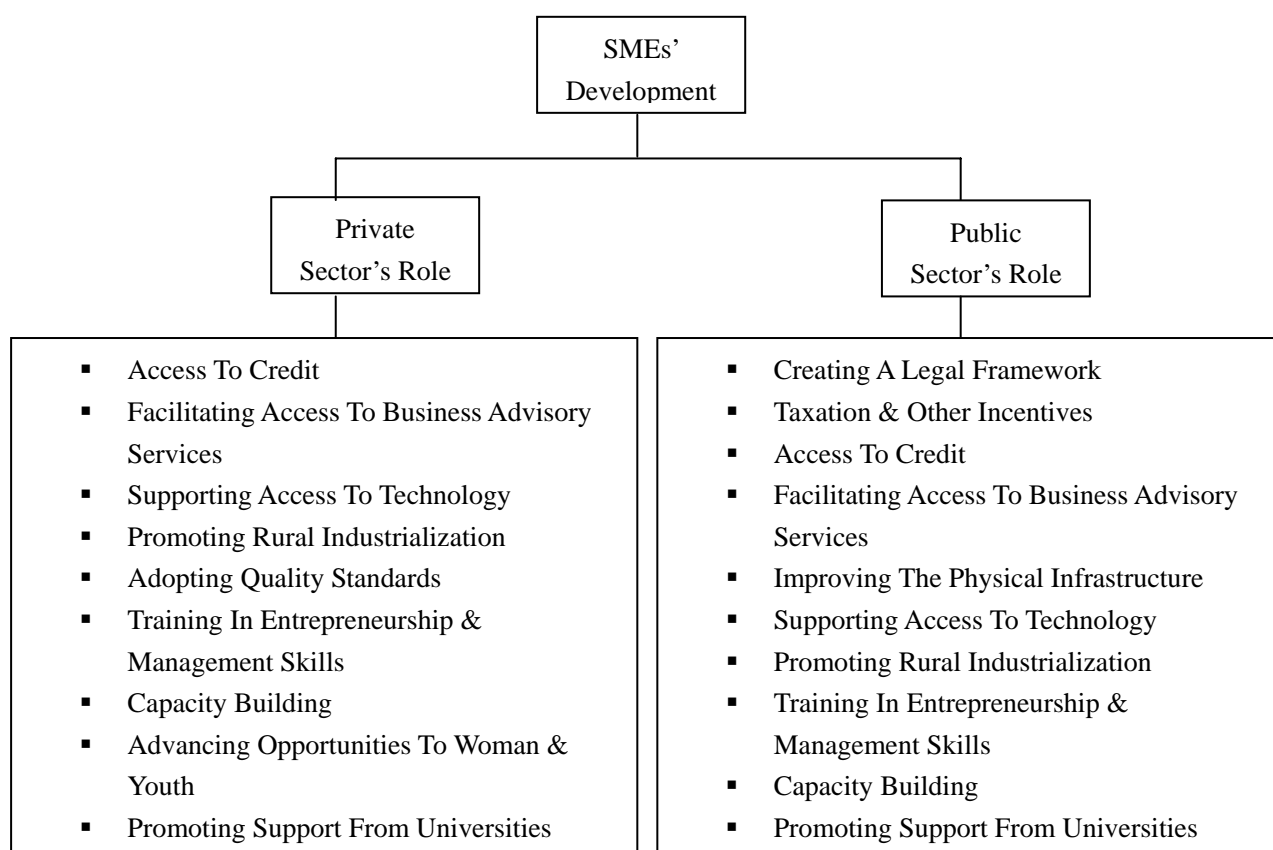
Private Sector's Role = (EACEG + FABAS + SAT + PRI + TESM + CBIS + PSU + QS + AOWY + FLLIs)

Where

EACEG is Easing Access to Credit, Equity and Guarantees, FABAS is Facilitating Access to Business Advisory Services, SAT is Supporting Access to Technology, PRI is Promoting Rural Industrialization, TESM is Training in Entrepreneurship, Skills and Management, CBIS is Capacity Building and Industrial Strengthening and PSU is Promoting Support from Universities, AQS is Adopting Quality Standards, AOWY is Advancing Opportunities for Women and Youth and FLLIs is Fostering Linkage with Large Industries. Because of the nature of the data, chi-square test is employed. The chi-square test is essentially concerned with the differences between frequencies that are obtained from the sample survey and those that could be expected to be obtained if there were no true differences among the categories of variables. In other words, the chi-square test intends to identify whether the perceived findings are real or result of sampling error. The equation looks like the following.

$$\chi^2 = \sum (f_o - f_e) / f_e$$

**The Figure 1 Indicates Variables under Consideration in the Study**



#### 4. Results And Discussions

The test ran public sector first then private sector next. The statistics are coming from several contingency tables. Two summarizing tables are listed as following.

**Table 1**

Variable	Pearson Chi-square	Likelihood Ratio	Significance
CELF	.785	.803	.941
EDTI	7.855	8.207	.249
EACEG	13.228	13.766	.010*
FABAS	32.506	32.760	.000*
IPI	1.531	1.463	.216
SAT	16.166	16.064	.003*
PRI	30.462	28.469	.000*
TESM	15.174	16.834	.175
CBIS	15.174	16.345	.154
PSU	5.560	5.388	.234

\*Hypothesis rejected at < .05 level

**Table 2**

Variable	Pearson Chi-square	Likelihood Ratio	Significance
CELF	9.989	9.069	.041*
EDTI	13.228	13.766	.010*
EACEG	4.134	3.754	.388
FABAS	8.280	9.727	.218
IPI	30.561	28.615	.000*
SAT	1.504	1.098	.220
PRI	3.422	3.306	.490
TESM	30.131	28.524	.000*
CBIS	14.156	15.621	.164
PSU	14.224	13.614	.011*

\*Hypothesis rejected at < .05 level

The statistics results in table 1 indicate that in case of some of the variables leading to SMEs development in AJ&K the public sector's efforts has shown significant impact' on the other hand in case of some other variables the impact is insignificant or vice versa. Whereas the statistics results in table 2 indicate that in case of some of the variables leading to SMEs development in AJ&K the private sector's efforts has shown significant impact' on the other hand in case of some other variables the impact is insignificant or vice versa. Overall the results indicate that both public and private sector have a significant role in SMEs' development in AJ&K in some cases but in some other cases this is not true. Thus the alternative hypothesis that "Small and medium enterprise sector can not be developed in AJ&K Pakistan only/individually through public/government sector's efforts or only/individually through private sector's efforts; instead SMEs in AJ&K can be developed through PPP." . Thus results for the first hypothesis tested reveals that in the majority of the cases the null hypothesis could not be rejected. This study finds that contrary to some studies that showed that only private sector is the sole source of SMEs' development or only public sector is the sole source of SMEs' development. A composite model of both public and private sector can be a more effective source of SMEs' development in AJ&K.

## **5. Summary And Conclusions**

The study results reveal that SMEs have received disproportionately smaller support from the government in terms of policy or fiscal incentives. SMEs, as a group, are weak in echoing their needs and demands. There have been improvements in the sanctioning and other administrative procedures affecting SMEs; further simplification, transparency, and accountability are necessary to promote SME development. A wide array of constraints are faced by SMEs in AJ&K. The above mentioned areas Creating Enabling Legal Framework, Establishing Differential Taxation and other Incentives, Easing Access to Credit, Equity and Guarantees, Facilitating Access to Business Advisory Services, Improving the Physical Infrastructure, Supporting Access to Technology, Promoting Rural Industrialization, Training in Entrepreneurship, Skills and Management, Capacity Building and Industrial Strengthening and Promoting Support from Universities, Adopting Quality Standards, Advancing Opportunities for Women and Youth and Fostering Linkage with Large Industries, are factors that have adverse affect on SME development. As results indicates in order to cope with these problems for SMEs development in AJ&K as individual neither the government/public nor the private sector's efforts are successful. Therefore to achieve the desired results of SMEs development the study suggested the PPP approach. Where public/government sector, business community, NGOs and others are



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collectively needed to bring about improvements. The notion of public private partnerships (PPPs) is often associated largely, if not exclusively, with large-scale national-level infrastructure undertakings such as utilities, national roads and highways, airports and dry ports the growing trend toward decentralization of service delivery introduces numerous PPP opportunities in non-traditional areas such as health, education and other social services.

To further clarify this approach PPP, understood as a system in which a government service is funded and operated through a partnership of government and one or more private sector companies and where the aim is to stimulate economic growth. The key feature of PPP is that private-sector partners (industry employers from the private sector) take over responsibilities which traditionally have been held more or less exclusively by public sector or civic sector institutions. This new point of view is built on the idea that the private sectors can complement, supplement and extend services provided by the public sector by increasing the available resources and at the same time develop their CSR strategy with these kinds of initiatives. Corporate Social Responsibility (CSR) is a concept that implies that organizations have an obligation to consider the interests of customers, employees, shareholder and the community in all aspects of their operations. CSR is closely linked with the principles of Sustainable Development, which argues that enterprises should make decisions based not only on financial factors such as profits or dividends, but also based on the immediate and long-term social consequences of their activities. Thus PPP is a kind of approach that can ensure long term sustainable development of SMEs in AJ&K Pakistan.

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