

Growth for Rural Advancement and Sustainable Progress

Domestic commerce for rural
MSMEs in Balochistan and Sindh

Acknowledgements

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The report was developed during the inception phase of the GRASP project to inform internal discussions at ITC to develop and finalize the project's activities related to the domestic commerce regulatory and institutional frameworks in Pakistan in general, and in Balochistan and Sindh in particular.

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CHAPTER 1 INTRODUCTION

Growth for Rural Advancement and Sustainable Progress (GRASP) is a 66 month project designed to support poverty reduction and sustainable, inclusive economic growth in Pakistan by strengthening small-scale agribusinesses in two provinces: Balochistan and Sindh. GRASP is implemented by the International Trade Centre – a joint, specialized agency of the United Nations and the World Trade Organization – and funded by the Delegation of the European Union to Pakistan.

To achieve this objective, the programme will help MSMEs and agribusinesses in the horticulture and livestock sectors become more competitive by making improvements at all levels of the value chain – including in primary production, service provision and value addition in and around selected clusters of production".

GRASP is composed of the following, three, main result areas (Intermediary Outcomes):

1. Regulatory and institutional frameworks improved at federal and provincial levels for rural value chain and MSME development.
2. Productivity, quality, and sustainability of selected value chains in horticulture and livestock improved.
3. MSME commercialization within selected value chains improved.

Across all three components, GRASP will focus on empowering women by bringing them into the conversation, creating jobs and strengthening women's organizations.

Under Intermediate Outcome 1, GRASP will seek to improve the regulatory and institutional frameworks governing domestic commerce by designing policy reforms and deploying technical assistance and capacity building activities to enhance the competitiveness of MSMEs in rural Balochistan and Sindh. These include conducting regulatory impact analysis of laws, regulations and acts related to various areas of domestic commerce, enhancing business registration and simplifying compliance procedures for rural MSMEs, building the capacity of institutions and businesses and business associations on policy advocacy, formulation and implementation and facilitating public-private dialogue.

This report has been commissioned during the inception period of the project to assess the state of domestic commerce for rural MSMEs in Sindh and Balochistan, including those related to the selected value chains. These include: (i) the identification of the most important pillars (or recommended areas of intervention) of domestic commerce for rural MSMEs using various internationally-recognized methodologies and local knowledge; (ii) mapping of laws, regulations, compliance procedures at federal and provincial levels; (iii) public and private stakeholders along with their roles, responsibilities and capacities; and (iv) challenges faced by rural MSMEs. Finally, recommendations will also be made for potential GRASP interventions which will feed into the finalization of the inception report which will be submitted to the EU and project beneficiaries before formal implementation of the project.

CHAPTER 2 IDENTIFICATION OF PILLARS OF DOMESTIC COMMERCE FOR RURAL MSMEs

The following were identified as most important pillars of domestic commerce for rural MSMEs, divided into four levels: firm, sector, provincial and federal. Although the list could be long, these were identified as priority. The most important are the pillars at firm level. Without these being improved, any intervention done at sector, provincial or federal levels would not create any meaningful impact. All the levels should be dealt, simultaneously, as they are interconnected. Any one level lagging behind may create a drag to dampen the impact of others.

Firm Level:

- a) Managerial Capacity Building
- b) Availability of Skilled Manpower/ Labor Market
- c) Credit and Banking
- d) Legal and Tax Compliances (Sector specific and General Legal Framework)
- e) Business Dynamism (Absence of Business Models and Growth Vision)
- f) Productivity of manpower, energy, machines and processes (Total Factor Productivity)

Sector Level:

- a) Value Chain Up-gradation/ Value Added
- b) Research and Development
- c) Common Facilities as Services
- d) Information Services

Provincial Level:

- a) Logistic Infrastructure ensuring access to markets and Inputs
- b) Facilitation Framework, instead of Regulatory Framework
- c) Cluster Development/ Small Industrial Estates
- d) Vocational Training/ TEVTAs/ SMEDA
- e) Environment and Sustainability

Federal Level:

- a) Banking Laws
- b) Federal Taxes and Compliance Costs
- c) Import/ Export Procedures
- d) Logistics (Ports, Airports)

The list was compiled after reviewing the pillars and methodologies used by internationally-recognized studies (listed below) as well as the consultant's knowledge of the business environment in Pakistan, particularly in rural Sindh and Balochistan.

- i. World Bank's "Doing Business 2020" Report
- ii. WEF's "Global Competitiveness Report"
- iii. ITC's "National Trade Policy for Export Success Framework"
- iv. ITC's "SME Competitiveness Outlook"
- v. Others. Reliance was placed on the actual working of the consultant with MSMEs in the past.

The above reports were studied/reviewed with the objective of understanding and listing the methods used in compilation of these reports so that the scope and limitations of this study could be outlined.

The following points were kept in mind while reviewing above-mentioned reports:

- i. The objectives of above-mentioned studies were different from this specific study for which these were being reviewed.
- ii. It was considered that the above-mentioned studies were of general nature and global in coverage.
- iii. These were made under stated assumptions and were not specific to any geographical area.
- iv. The reviewed reports did not address any specific business sector.
- v. These methodologies have never been tested in the business theater of rural Balochistan and Sindh.

CHAPTER 3 ANALYSIS OF DOMESTIC COMMERCE REGIME

Development of domestic commerce is mandated to the Domestic Commerce Wing at the Ministry of Commerce at the federal level and to the Department of Industries and Commerce at the provincial level. However, both of these are yet to develop its capacity to deal with this critical aspect as the Ministry of Commerce is focussed towards international trade and the provincial departments are more engaged towards industries. As a result, development of rural MSMEs that are agriculture linked has never been the priority for either of them.

Similarly, Small and Medium Enterprise Development Authority (SMEDA) has the mandate to develop small and medium enterprises in Pakistan. Traditionally, it has remained focused on development of urban manufacturing SMEs. Rural agriculture linked MSMEs have never been in its operations.

Despite the above neglect, it is important to understand the existing market mechanisms, regulatory framework, and facilitation structures, as these exist today. Without developing an understanding of evolution of existing market setup, any analysis of existing markets and role of stakeholders would not be worthwhile.

A perfectly imperfect market

If one looks at the existing market from the viewpoint of western economic theoretician, the existing market structures can at best be described as “perfectly imperfect”. Understanding its evolutionary process and development into what it has become would require a study in economic behavior, economic history and the prevalent economic-legal infrastructure. Although outdated in character, the market has not remained in total isolation of the modern influences. It did accept these influences and absorbed some of these. However, the old governance structure (the informal one) of the market has remained in tact to a large extent.

Efforts have been made to reform the agricultural produce markets, but with limited success. What makes this market unique is the overbearing presence of a middleman (“Arthi”) that plays multiple roles. This middleman is also the exploitative beneficiary of market imperfections. He controls the supply chain as supplier of seeds, insecticides/ pesticides, fertilizers, etc. He acts like a traditional banker by extending loans/ advances, mostly even without a collateral. He is the preferred buyer as he makes supplies on credit and extends loans. He is the warehouse keeper. He has the necessary connections in other markets and trade channels and is able to sell to the larger markets. He controls the information, regulates the market and is the enabler. Without him not much can happen. There have been efforts to do away with this middleman but without any success.

There are two simple reasons for the success and continuity of the middleman system. Firstly, he is well entrenched in the economy and controls cash flows. Secondly, without him the small-scale farmer cannot survive, being totally dependent on him for all, whatever is needed. A few, those tried to escape him, were not successful as they lacked access to finances and more importantly information. So, the exploitation continues.

The solution to this exploitation problem is the conversion of existing market to a near perfect market wherein the supply chain, trade channels, enablers and regulators are independent of each other. Unless, the concentration of multiple roles in one stakeholder is done away with, the market development to match international standards is not possible.

Evolution of existing legal framework

At federal as well as provincial levels, Pakistan follows the Anglo Saxon legal tradition. It would not be wrong if one assumes that most of the current laws at federal and provincial levels were actually enacted during British colonial period. In the post-colonial period, some of these laws were re-done or new legislations were enacted. But the old tradition continued. The following facts need attention:

- a) The British Indian Government was a colonial government. For them colony was a business. So all the trade and commerce laws enacted by it were meant to maximize the profits of the colony. The civil service that administered these laws had the same objective. So these were exploitative by nature and orientation. These also had a coercive element added to it.
- b) The post-colonial governments that replaced the British Indian government inherited the same legal framework and civil service. This continuity of approach and orientation has not changed until now.
- c) Most of the revenue of British India was coming from the rich provinces. Sindh and Balochistan were never in the lime light in colonial period being the peripheral territories largely ruled by local nobility. Therefore, the efforts were never made to develop market structures in these provinces. Implementation of legal framework was always ignored, with few exceptions. This has continued in the postcolonial period, even without rule by local nobility.
- d) Due to the coercive and exploitative nature of these colonial enactments, the people never developed the liking for these laws. This dislike has not ended with the post-colonial change. On top of it, there were and are compliance costs that need to be born by the MSMEs. So, an aversion to legal compliance is still there.
- e) The official language of Pakistan and all the provinces is English. All the laws, rules, procedures and even the forms are in English language. This creates a huge communication gap for understanding the legal framework. It needs to be kept in mind that least literate provinces are being dealt here. Therefore, for compliance MSMEs need an intermediary that entails costs. The fear of the unknown also plays a role here, for the unwillingness to comply.
- f) There is a clear communication gap and a level of mistrust exists between government functionaries and the general public. The civil service, other departments and personal have a specific mindset. They consider themselves to be rulers and authorities having the backing of law. The common man is considered to be subservient and a subject. This again is a colonial hangover that has persisted. This mindset needs to change. The government functionaries need to understand that their success does not depend on maximization of revenue but it depends on the success of their clients (in the current case, the farmer and MSME). Unless this changes, the mistrust and communication gap would not vanish.

Enabling infrastructure

There exists an enabling infrastructure in Pakistan and the provinces, both in government and private sectors. The little that is available is generally believed to be inefficient and ineffective. In the province of Balochistan, it is perceived to be least functioning.

Supply-side infrastructure

- a) **Seeds:** There are a number of businesses supplying locally developed and imported seed stock. These businesses are usually medium to large scale and supply seeds through their distribution and sales network. The appointed local distributors (mostly the traditional middleman) are controlled by the parent companies that determine packaging, labeling, price etc. The local distributors/ sale outlets work on fixed profit basis. A number of such local MSMEs are present in all the relevant markets in Sindh. However, in the province of Balochistan, availability of good quality seed is a problem. This represents a possible area of intervention by promoting certified good quality seeds.

Otherwise “seed” is a regulated business and is administered through the Seed Act, 1976 and the rules made thereunder. This legislation was primarily done to ensure supply of quality seeds to the farmers. All seeds, whether locally produced or imported need to be registered with Federal Seed Certification and Registration Department of the Federal Ministry of Food Security and Research.

Currently more than seven hundred companies are registered with the Federal Seed Certification and Registration Department. A few of these are transnational companies. These companies are responsible for documentary controls, quality assurance, labeling of seeds, etc. before these are placed in the market for use by farmers for sowing. The compliance procedures are time consuming

and tedious for the small-scale seed companies. The cost of compliance is also high for these seed producing and marketing MSMEs. The distribution network of rural MSMEs that actually interfaces with farmers acts as a supply/ sale conduit, only.

- b) **Fertilizers:** The fertilizer business in Pakistan is essentially large scale. The large-scale companies locally produce as well import fertilizers. They have their regional marketing and sales networks. However, the interface with the farmers is provided by local MSMEs that act as distributors of fertilizers (mostly the traditional middleman). Such MSMEs are local market based and are controlled by the large-scale fertilizer companies. The price, packaging and labeling is controlled by parent companies and the local distributor acts only as a stock conduit on fixed commission basis.

The province of Sindh has enacted The Sindh Fertilizer (Control) Act, 1994 and has notified Rules, thereunder. The Controller of Fertilizers is responsible for ensuring that good quality fertilizers are made available in required quantities and on the prescribed rates. This office also has the mandate to check adulteration in fertilizers and other malpractices. The Act requires all businesses dealing with fertilizers to be registered with the Government. The local MSMEs that act as distributors of fertilizers are also registered with the Government agency for the purpose of monitoring.

No such law could be found for the province of Balochistan.

- c) **Insecticide/ Pesticides:** There are both local and transnational companies in the business of insecticides and pesticides. The company size is medium to large scale. These large-scale companies determine the packaging, labeling and price. The customer interface is provided by local MSMEs who act as distributors and sale points for insecticides and pesticides. Usually, insecticide/ pesticide companies use the local distribution set up dealing with fertilizer, simultaneously.
- d) **Feed, Medicine and Equipment for Livestock:** Livestock includes all types of living animals considered as economic assets. For farming livestock and to maximize gains, the farmers need prepared feed, medicines, vaccines, machinery and equipment. With the exception of poultry, the supply chain of all the required inputs is quite weak. The outreach of Livestock, Fisheries and other allied Departments of the Governments of Sindh and Balochistan is considered limited. There are a very limited number of service providers in private sector and that too not for all types of livestock.
- e) **Farm Machinery and Equipment:** This is probably the most important but weakest area of supply side infrastructure, especially in the province of Balochistan. This is on account of multiple reasons. Firstly, the financial capacity to procure this equipment is not there. Even if, it becomes available, there is no training and capability to put it to the optimum use. Since, land holdings are small, the pursuant idle time renders the investment on such equipment, financially unfeasible. There are no private sector service providers working in a business model for short term leasing of such equipment to the farmers or even to deliver the assignment as service. This is a highly neglected area.

The Agricultural Engineering Departments of the provinces are supposed to provide these services. However, they leave a lot to be desired and practically nothing much has happened on ground. There are a few MSMEs in the province of Sindh that provide farm support services, but none in the province of Balochistan. In comparison, a number of MSMEs in the province of Punjab are working to provide services with machinery and equipment. Such services include land leveling, soil preparation, water management, environment-controlled farms, harvesting, grading, packing, etc. The gap left open by the Agricultural Engineering Department of Punjab has been filled up by private sector MSMEs to some extent. Probably, for the provinces of Sindh and Balochistan, MSMEs need to be encouraged to enter this business area.

Demand-side infrastructure

- a) **Farm-to-table trading channels:** All of the agricultural produce is perishable in nature. Some of it has to be consumed within days, unless processed. The remaining needs to be stored under specified conditions for consumption later. Even this one has a storage life and it needs to be consumed before it becomes unfit for consumption. It is in this perspective that MSMEs dealing with perishable produce has to operate. With no modern storage and logistic facilities (e.g. cool chain)

available, and without any information about markets, the farmer has to sell his produce to the local middleman (Arthi). Even this middleman runs the risk in case of fast perishing produce. A lot of quick perishing produce is wasted during transportation and never reaches the table of ultimate consumer. The case of storable produce may be a little different. However, no one is immune to logistic and market risks. Reaching from farm to the consumption table is an uphill task for every body. The best example here is the famous case study of “Banana Split” wherein the farmer gets the least and the end retailer is the main risk taker and beneficiary of this journey.

- b) Industrial demand/pull:** In Pakistan and elsewhere, experience has proven that the growth in rural agricultural sectors has been achieved if an industrial demand for agricultural produce was created. The cases of cotton (fiber to fabric and apparel), sugar cane (white sugar), maize (edible oil, starches and sugar), tobacco (cigarettes), sunflower (edible oil), etc. can be seen in this regard. This industrial demand-pull has given rise to many successful MSME businesses directly and indirectly. It is in this context that policy instruments for creation of industrial demand-pull have to be prepared along with implementation/ delivery mechanism.
- c) Exports:** Some of the horticulture produce of Pakistan is already being exported. The cases in point are those of citrus, mango, dates and dried fruits. Otherwise, rice and few vegetables remain the main stay of agricultural exports. Barring the example of very few large-scale farmers, all such exporters are urban medium to large size companies who consolidate economically feasible quantities from rural MSMEs. If the rural MSMEs were to be plugged into international markets, these would need to be up-graded, substantially. Under the current circumstances, there appear to be hardly any rural MSME from provinces of Sindh and Balochistan that has the capacity to internationalize.

The Trade Development Authority of Pakistan (TDAP) and Pakistan Horticulture Export Development Company (both working under the Federal Ministry of Commerce) has the necessary mandate to promote exports of agricultural produce. However, their performance has been lackluster. Until now, these agencies have been trying to promote exports without realizing that exporters need a special skillset to be able to export. Without this skillset, it would not be possible for them to export. What is required here is an “Exporter Development Plan” that prepares the MSMEs by giving them necessary skills to integrate into the international value chains.

Services infrastructure for MSMEs

- a) Information Services:** Information about market (demand, supply, prices, trends, trade channels), or the lack of it, is vital for development of rural commerce and trade. All the economic, financial and logistic decisions depend on availability of this vital factor. Imperfect information would only lead to bad decision-making. Unfortunately, there is no existing mechanism that makes available any information to farmers, traders, middlemen, service providers and MSMEs whose business revolve around agriculture. And all this is despite the resounding digital information revolution. Looking around for an example of international best practices, one does not need to go far. In India, they have already started providing all the real time information through smartphones. It could very well be a service provided to all those who need it against a marginal fee.
- b) Logistic services:** Logistics has come out to be a very vast field. It is an essential component of economic infrastructure of any country. From temporary storage at the farm to cool chain operation to warehousing to long distance shipments, it includes almost every thing. It is logistics that saves perishables. Logistics not only saves value, it also adds value to the agricultural produce. Without perfect logistic arrangements, the rural agriculture based MSME's risk factor compounds many times. This is also probably one of the weakest links in rural value chains in the province of Sindh and more so in case of Balochistan. The existing logistic businesses are MSMEs that operate in archaic conditions. Unless the logistic businesses are improved/ upgraded, rest of the links in rural agricultural value chain would remain vulnerable.
- c) Farm support services:** Small-scale farmers need farm support services in order to maximize utilization of inputs to enhance yields. These services include land leveling, tillage, waterways management, harvesting, grading, pest control, warehousing, animal husbandry, etc. Currently, there are hardly any such MSMEs providing farm support services in the province of Sindh and

practically none in the province of Balochistan. The intervention of Agricultural Engineering Departments for providing bulldozers for land leveling is too narrow in scope and too little in coverage. It is ineffective and inefficient. On the livestock side, the position is no better with the exception of poultry where private sector MSMEs have filled the gap to a large extent. In fact, all this needs to be done in a business model commercially. The provincial governments may only promote and subsidize such activity.

- d) **Business Support Organizations (BSOs):** Trade bodies, clusters, cooperatives, associations and chambers of commerce play an important role as Business Support Organizations. These provide forums for exchange of views, experience sharing, collective decision-making and advocacy. Some BSOs also manage a service portfolio for its stakeholders and work in a business model. There appears to be a total absence of such forums in the market. As a result, the farmers as well as rural agriculture based MSMEs have gone voiceless.
- e) **Capacity building:** The rural agriculture linked MSMEs are usually owned and managed by local entrepreneurs. They learn by experience (trial and error). No structured training in commercial and activity based skills has ever been offered or imparted by any agency. As a result they lack vision for growth and are handicapped in delivery. The existing training infrastructure of Small and Medium Enterprise Development Agency (SMEDA), Skill Development Council, National Training Bureau and NAVTEC at federal level and the TEVTAs at provincial level are essentially geared towards factory worker skill sets. The Higher Education Commission's initiative for entrepreneurship development focuses university graduates for innovative ideas. As a result, the capacity building needs of rural agriculture related MSMEs are totally neglected. There is a clear gap for building managerial, commercial and technical capacities of rural MSMEs.

Financial Support Infrastructure:

- a) **Banks:** Commercial banking services are available in almost all regions barring few in Balochistan. However, rural economies are cash based with few inter-city transactions made through Banks. The rise of smart phone based banking services, although limited in scope, have filled the gap to some extent. There is a need to promote use of bank transfers to replace the existing practices of cash handling.

Banking Companies are not interested in rural businesses as they consider this as low profit yielding and high risk. There have been reports that some banks have closed some of their rural bank branches and are concentrating on urban consumer finance.

- b) **Insurance companies:** Insurance provides the necessary risk coverage to businesses. Such services could mean a lot to rural MSMEs, especially dealing with agricultural perishable produce. There is a total absence of such services from crop insurance till end of the value chains. There is no denying the fact that even the owner managers of MSMEs are unaware of the usefulness of insurance services. Any resort to risk coverage in rural MSMEs is unheard of.

The federal Ministry of Commerce administers laws relating to insurance in Pakistan. Also, there are state owned insurance companies. Probably, a government intervention is needed to introduce risk insurance coverage to agricultural linked MSMEs through state owned insurance companies.

- c) **Credit availability:** The Government of Pakistan established the Agriculture Development Bank of Pakistan as a specialist bank dealing with credit needs of agriculture sector and businesses related to it. However, its geographical and activity-based coverage has remained limited. Simultaneously, the State Bank of Pakistan has a number of schemes/ policies to support credit needs of agriculture related businesses, through commercial banks. However, the credits extended has been very little and that too to a select group. These schemes cannot be termed as a success.

There are many reasons for it. Firstly, commercial banks consider such credits as "high risk". Therefore, there is little appetite in the commercial banks to extend credit facility on this account. Secondly, there is a cultural aversion in the rural MSMEs for obtaining such loans. Thirdly, the collateral and documentation requirements of commercial banks are cumbersome. On top of all these, the current financial cost of credit is prohibitive. The owner-managers of rural MSMEs have

been arranging financial credits through informal sources, a channel that has its limitations. Therefore, it can be assumed that formal credit availability (especially project finance) to rural MSMEs is almost negligible.

- d) **Leas purchase of machinery and equipment:** Leas purchase of machinery and equipment is an important source of financing for MSMEs. While using this facility, the lessee pays as he earns. On payment of full amount, the leased assets become free of encumbrances. There are leasing companies in operation but this facility is usually made available to industrial sector. However, such a facility is not available to rural agriculture related MSMEs.

CHAPTER 4 DOMESTIC COMMERCE REGULATORY FRAMEWORK

Agriculture, with all its sub-sectors is within the provincial domain of governance. There are very few issues that are dealt at federal level relating to food security, international trade, plant protection, research and development, standardization, etc. However, the agriculture related commercial MSMEs are not considered purely agriculture and are dealt functionally both by the federal and provincial governments.

Compliance with federal and provincial laws and procedures is the responsibility of every person, including the legal persons (Business Individuals, Firms, Companies, etc.). It is another story that every business wants to operate under the radar and don't want to be detected by any government agency. Without going into the reasons for this tendency, this is important to note at the very outset that businesses would want to avoid any kind of paper work with the Government Departments (federal and provincial, alike) unless it becomes unavoidable. Even after getting registered, there is a tendency to under report. On the other hand, even the government departments exhibit a lack luster attitude. They have failed to alleviate the fear of MSMEs by explaining the advantages of getting engaged and sharing full information. As a result, there is no meaningful communication between government functionaries and MSMEs.

A number of federal and provincial laws exist today along with the agencies to administer the regulatory and facilitation mechanisms. These are described below:

Starting a business for MSMEs

Any MSME can start a business as a limited liability company (including a single member company), a partnership firm (association of persons), or as business individual (sole proprietorship). To do so, one needs to be registered with the relevant agency/ authority. There are legal instruments and structures available for all the options. The available legal structures are as follow:

- The Companies Act, 2017
- The Companies Rules, 2017
- The Limited Liability Partnership Act, 2017
- The Partnership Act, 1932
- Sole Proprietorship under Income Tax Ordinance, 2001

Registering a company

A limited liability company can be registered under the Companies Act and Rules in ten steps. These steps are described below:

- a) Choose a company name.
- b) Reserve a company name.
- c) Procurement of clearance certificates for directors and shareholders.
- d) Preparation of documents, memorandum and articles of company.
- e) Have an address to be a registered address for correspondence.
- f) Application to be filed with regional office of SECP.
- g) Reply to any questions asked by SECP.
- h) Issuance of certificate of incorporation.
- i) Issue shares.
- j) Register for taxes and other professional statutes.

The incorporated company is ready to operate and conduct business. However, the real trouble starts, soon thereafter. The company needs to appoint a Company Secretary, Legal Advisor and an audit firm to operate. The periodic statutory returns need to be filed with SECP. There are fifty plus different kinds of forms and returns to be filed with SECP. On top of all this, the corporate governance norms are to be observed.

All this is not possible for the rural MSMEs to achieve by themselves. Any lapse or late filing entails punitive actions. They need intermediaries (usually not available in rural regions) to prepare documents, fill in forms and to file statutory returns, periodically. The annual compliance cost of the legal requirements may run into millions of rupees. It appears that registering a limited liability company under Companies Act is out of question for a rural MSME in Sindh and Balochistan.

Registering a Firm

The other option is registering a partnership firm under the Partnership Act. For firm registration, an application is required to be filed with the Registrar of the Firms on Form 1 along with certain documents that are mentioned as under:

In order to register business as partnership firm minimum two persons are required and following information is required:

- a) For each partner – full name, father or husband name, residential address and occupation.
- b) Copy of the National Identity Cards (NICs) of all the partners.
- c) Partnership deed on stamp paper.
- d) Proof of the address of the partnership business, usually electricity bill.
- e) If the address of the partnership business is rented then rent deed is required.
- f) Copy of the original receipt of partnership fee deposited in the National Bank of Pakistan.
- g) Signatures of all the partners in partnership firm/ business in the presence of registrar or an authorized officer.

Additionally the following records are required to be kept:

- a) National Tax Number from Federal Board of Revenue.
- b) Bank account in the name of business.
- c) Accounting records of partnership business properly maintained profit and loss account and balance sheet.
- d) Advance payment of income tax as required under the provisions of the Income Tax Ordinance, 2001
- e) Registration from any other authority if required under any law of the business to be undertaken.
- f) NTN registration in Inland Revenue local office.

Most of the rural MSMEs would find even this difficult and a barrier for starting a business. However, locally available low-level intermediaries can help cross this barrier. The compliance cost is also low.

Business Individual / Sole Proprietorship

The third option is to start the business as sole proprietorship. This is probably the simplest and easiest way of starting a business. It is not a legal entity but only refers to a person who owns the business and he is responsible for and beneficiary of business transactions.

In order to register a basic sole proprietorship, all one needs to do is as follow:

- a) Think of a name for business.
- b) Make a letterhead and business card with business name, logo, phone number and physical office address on it.
- c) Take CNIC, letterhead/ business card, and a stamp with business name to any bank of choice.
- d) The bank will open a bank account in the name of business and give confirmation with account details (account maintenance / welcome letter).
- e) The applicant can then take this letter along with other documents to FBR local office for issuance of NTN and/ or GST registration (if it does not exist already in sponsor's personal name). Alternatively this can be done online on FBR website and requires scanned copies of all documents. Please note that a valid cell phone number, email address, rent agreement of your office and electricity bill are required.
- f) Note that there is no official certificate issued by any authority in case of a sole proprietorship. The business will receive only NTN certificate with sponsor's name & details on it.

Most of the current MSME businesses are operating as sole proprietorship basis. But it has its limiting impact on growth of individual businesses.

Federal income tax

Income tax is a federal levy administered by the Federal Board of Revenue. Income tax is payable by all businesses, whether an incorporated as limited liability company, a registered firm or a business individual. All businesses are to register and obtain a National Tax Number (NTN), keep records of business transactions, file an income tax return annually and pay income tax. In some cases, the withholding or advance income tax is payable for each transaction. Such withheld tax is adjustable against final liability at the time of filing of annual income tax return.

Under normal circumstances, the businesses are willing to share their tax responsibility. However, problem is with the tax compliance costs. The businesses (MSMEs) need to devote time, incur costs on hiring an accountant, maintain accounts, hiring an intermediary to file income tax returns and to face audits by tax authorities. This may not be a problem for a large or medium scale business. But for the small and micro scale business, this may become a major cost by itself. In some cases, the compliance costs may exceed the tax costs.

The Federal Board of Revenue under the Ministry of Finance may look into this aspect of compliance costs and revise exemption limits.

Agricultural produce market regulations

The provinces of Sindh and Balochistan have done legislation to replace the old legal framework under The Agricultural Produce Markets Act, 1939. There is little uniformity in market governance prescriptions in both the Acts, as the province of Sindh opted for corporate structures while the province of Balochistan had stayed with the old government department structure. However, both were enacted with the objective of regulating the markets to achieve fair practices and for protection of rights. The laws are listed below:

- a. Sindh Wholesale Agricultural Produce Markets (Development and Regulation) Act, 2010
- b. Balochistan Agricultural Produce Markets Act, 1991

The agricultural produce has been defined to “include all agricultural or horticultural produce, livestock or poultry, fish or seafood, and products and by-products thereof, all of which are capable of human consumption, for sale or purchase in whole sale market, within a boundary”. This is practically an all-inclusive definition. More so, the legal framework does not exclude the possibility of establishment of specialized markets, private markets and transactions done outside the designated markets. As provided therein, the market administration is to be the responsibility of board of directors/ market committees constituted under the law.

This place (wholesale agricultural produce market) is important for the purpose of this study because this is where the pure farming (agriculture) converts into commercial domain and the role of agriculture linked rural commercial MSME starts. Most of the agricultural produce pass through this channel before it enters food, industrial or export value chains. Despite the progress, the market place remains imperfect for farmers, MSMEs, as well as the ultimate consumers.

The relevant legislations and implementation mechanisms need to be looked in to expand the role of market management mechanisms. These could very well be converted into trade development mechanisms by building a promotional service portfolio for MSMEs. Common Facility Centers (facility for warehousing, sorting, grading, packaging, etc.) and for logistics can be built and managed in tandem. The clients that cannot afford their own facility can very well be upgraded in this manner.

CHAPTER 5 RECOMMENDATIONS

- i. **Translation of laws:** There is a clear communication gap and a level of mistrust among MSMEs towards understanding the legal requirements and complying with these. The lack of understanding of the usefulness of compliance with laws is another barrier in this respect. There is a need to translate related laws and rules in the national and regional languages so that these can be understood by manager-cum-owners of MSMEs. There is also a need to print and distribute made easy compliance guides in national and local languages.
- ii. **Moving from control to facilitative mindset:** The very outlook of existing laws in all fields is regulatory and coercive. This needs to be changed to a facilitative outlook. There is a clear need to change it. The Government departments need to be repositioned as facilitative infrastructure rather than regulatory and coercive.
- iii. **Trade Development Authority of Pakistan (TDAP):** This organization is primarily geared towards promotion of export of manufactured goods from Pakistan. The domestic commerce development activities are lukewarm generally and non-existent in case of rural MSMEs that are agriculture linked. The organization would need support and capacity building for an enhanced level of activities.
- iv. **Small and Medium Enterprise Development Authority (SMEDA):** The SMEDA is mandated for development of small and medium enterprise development in Pakistan. However, its focus has remained to be manufacturing related SMEs in urban centers. This organization has no capacity to work on rural based agriculture linked MSMEs. SMEDA would need support and capacity building to focus on hitherto neglected part of its mandate.
- v. **Agricultural produce market regulations:** Both in the provinces of Sindh and Balochistan the regulations exist for regulation of agricultural produce Marketing. However, these need to be reframed to serve the current day needs.

The Sindh Agricultural Produce Markets (Development and Regulation) Act, 2010 and Balochistan Agricultural Produce Markets Act, 1991 as these exist today, cannot serve the needs of farmers and agriculture linked commercial MSMEs. The “market committees” need to be established as independent companies working in a financially sustainable business model in a self-regulating system. The Government controls would need to be minimized for market based functioning of these companies. These may be designed for serving its stakeholders as service providers. The market committees (companies) may provide information services, capacity building, shared warehousing services (logistics), shared processing services (sorting, grading, packaging, etc.), shared cold chain services, etc.

There is also a need for **commodity specific specialized markets in agricultural produce clusters**. Some of these already exist like palm date market in Khairpur (Sindh). The market committees (proposed companies) can develop their service portfolio to suit the needs/ requirements of its specific agricultural produce.

- vi. **Banking services:** The Agricultural Development Bank of Pakistan already exists. Its mandate and scope of services needs to be reviewed and expanded to cover facility for rural MSMEs that are agriculture linked. The out-reach of Agriculture Development Bank also need to be extended to remote parts of Sindh and Balochistan.

The Government of Pakistan needs to realize that commercial banks can never serve the development needs of this sector and only a specialized bank can fill the existing gaps.

- vii. **Compliance costs of Income Tax:** All commercial activity done by rural agriculture linked MSMEs are subject to Income Tax laws. Unfortunately, The Federal Board of Revenue has never looked at the compliance costs associated with it. MSMEs usually complain that at times, the compliance costs are more than the tax costs. It is therefore proposed that a separate study be commissioned to assess the problems associated with compliances.

- viii. **Fertilizer control laws:** No Fertilizer regulation exists in the province of Balochistan. This business needs to be regulated on the lines of the province of Sindh. The Balochistan Government may do legislation in this regard.

APPENDICES

Appendix I Mapping of domestic commerce regulatory framework

Pillar/ Function	Law, Regulation or Act	Stakeholders	Status
Business Registration	The Companies Act, 2017 (Federal Government)	Securities and Exchange Commission of Pakistan	
	The Partnership Act (Provincial Government)	Provincial Governments	Needs Revision
	Income Tax Act (Federal Government)	Federal Board of Revenue, Government of Pakistan	Compliance Costs Simplification
Seeds	The Seeds Act, 1976	Federal Seed Certification and Registration Department Ministry of Food Security and Research	Need up gradation
Fertilizer	The Sindh Fertilizer (Control) Act, 1994	Government of Sindh No such law exists in Balochistan	Law need to be enacted for Balochistan.
Insecticide/ Pesticide	The Agricultural Pesticides (Control) Ordinance, 1971	Ministry of Food Security and Research (Federal) Plant Protection Department Provincial Governments	Laws/ Regulations at Federal and Provincial levels need to be reviewed.
Agricultural Produce Marketing	Sindh Wholesale Agricultural Produce Markets (Development and Regulation) Act, 2010 Balochistan Agricultural Produce Markets Act, 1991	Government of Sindh Government of Balochistan	The legal framework needs to be revised.
Banking		Agriculture Development Bank of Pakistan Federal Government	Extension of banking/ credit services to MSMEs