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**The Investment Climate and Enterprise Performance in Rural Pakistan:
Implications for Rural Non-farm Employment Generation and Poverty Reduction**

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The Investment Climate and Enterprise Performance in Rural Pakistan: Implications for Rural Non-farm Employment Generation and Poverty Reduction

Agricultural growth remains an important pathway out of poverty in rural Pakistan, but given that 60 percent of the country's rural poor are landless, and primarily reliant on non-agricultural activities as their main source of income and employment, it is increasingly recognized that a well developed and well-functioning rural non-farm sector is essential for generating employment, ensuring income diversification and reducing poverty (World Bank, 2004). Between 1984-1985 and 1990-1991, real agricultural growth rates averaged 3.9 percent per year in Pakistan. During this period, rural poverty declined steadily from 49.3 percent to 36.9 percent. But, despite even higher growth in the 1990s (averaging 4.6 percent per year), rural poverty remained essentially unchanged, from 36.9 percent in 1990-1991 to 35.9 percent in 1998-1999. According to the 2001-02 Household Income and Expenditure Survey data from Pakistan, 45 percent of the rural poor are non-agricultural households, highlighting the importance of non-farm sector growth for increasing incomes and welfare and thereby reducing poverty in rural areas.

Although the large contribution of the non-farm sector to rural incomes in Pakistan has been recognized, there is limited understanding of factors that determine the performance and growth of non-farm enterprises and the policies and investments that would spur the development of this sector. This gap in knowledge is in large part due to inadequate data on rural enterprises. Much of the information that does exist on the performance of enterprises in Pakistan is primarily based on surveys of formal urban manufacturing firms or from household surveys which did not specifically collect data on various aspects of the investment climate facing rural firms. Given the nature and scale of rural enterprises, it is likely that the challenges they face differ considerably from those of their urban counterparts.

Drawing on a recently completed survey of rural enterprises in Pakistan, this paper addresses some of the existing knowledge gaps. The paper sets out to address two main

questions: What are the main investment climate constraints and business obstacles faced by rural non-farm enterprises in Pakistan? How does the investment climate in rural areas of Pakistan affect the performance of non-farm enterprises?

This paper is structured as follows: Section two provides a description of Pakistan's rural enterprise landscape. Section three discusses the investment climate constraints facing rural firms and is followed by an analysis of the impact of the investment climate on firm performance in section four. Section five concludes.

Data

This paper draws on a Rural Investment Climate Survey conducted in Pakistan between May and December, 2005.¹ The survey covered three provinces of Pakistan including Punjab, Sindh and North West Frontier Province (NWFP). The sample includes 1069 non-farm enterprises in Punjab, 300 non-farm enterprises in Sindh and 282 non-farm enterprises in NWFP. For the purposes of this study, non-farm enterprises were identified as firms engaged in any activities excluding primary agricultural production (crops, livestock and fisheries). In each province roughly half the enterprise sample is drawn from small towns defined as Town Committees and Municipal Committees with populations under 100,000. The remaining enterprises were selected from rural villages. In total the sample includes 50 small towns and 50 villages in Punjab covering 10 districts (Attock, Faisalabad, Bahawalpur, Vehari, Khanewal, Jhelum, Kasur, Pakpattan, Sargodha, and Sialkot); 15 small towns and 15 villages in Sindh (from Khairpur, Mirpur Khas, Jacobabad, Nawabshah, and Badin districts) and 12 small towns and 16 villages in NWFP (covering D I Khan, Laki Marwat, Swat, Lower Dir, Haripur, Swabi, and Peshawar districts). In the rest of this paper non-farm enterprises located in rural villages are referred to as “village enterprises” and those located in small towns are referred to as “small town enterprises.”

The Rural Enterprise Sector in Pakistan

As in other South Asian countries, the non-farm sector in Pakistan's rural villages and small towns primarily consists of micro-enterprises. The average small town enterprise had slightly more than 2 workers, and village enterprises employed about 1.74 workers including paid and unpaid family workers and hired workers. Only 3 percent of non-farm enterprises in small towns and 1 percent in villages had more than 5 workers. The vast majority of labor in small town and village enterprises in Pakistan consists of family workers. About 24 percent of small town enterprises report hiring workers, as compared to only 12 percent of village enterprises. Enterprises in small towns and villages are fairly young, 50 percent have been in operation for less than 5 years, reflecting high birth and closure rates of micro enterprises. As has been observed in other surveys of rural non-farm enterprises, enterprises involved in manufacturing/production activities tend to be older than the average services and trading enterprise. The average age of a production enterprise in this sample is around 16 years for firms located in small towns and 12 years for firms in villages while the average age of both village and small town trading and services enterprises is about 8 years.

Trading enterprises dominate in Pakistan's villages and small towns. Close to 60 percent of small town and village enterprises are engaged in wholesale or retail trade, followed by around 35 percent in services and the remaining in production/manufacturing (Table 1). The very thin manufacturing base in small towns and villages stands out particularly when compared to the rural non-farm sector in other South Asian countries. In Sri Lanka, production oriented firms account for 40 percent of rural enterprises while in Bangladesh manufacturing and construction

¹ This survey was conducted by Innovative Development Solutions, Pakistan and the World Bank with support from DFID and FAO.

together account for about 27 percent of non-farm enterprises (ADB and World Bank, 2005, World Bank, 2005).²

Table 1: Profile of Enterprises

	Punjab		Sindh		NWFP		All	
	Small Town	Rural	Small Town	Rural	Small Town	Rural	Small Town	Rural
Employment								
Average number of workers	1.82	1.52	2.32	1.93	1.87	1.51	2.03	1.74
Size distribution								
<i>2 of fewer workers</i>	84%	96%	74%	81%	88%	94%	80%	87%
<i>2-5 workers</i>	14%	3%	22%	18%	10%	6%	16%	12%
<i>More than 5 workers</i>	2%	1%	4%	1%	3%	0%	3%	1%
Firms hiring workers	19%	7%	26%	17%	31%	5%	24%	12%
Age								
Average age of firm	9.92	8.22	7.34	9.04	6.82	6.38	8.39	8.27
Age Distribution								
<i>2 years or less</i>	15%	27%	16%	8%	15%	34%	15%	18%
<i>2-5 years</i>	26%	29%	39%	32%	29%	24%	31%	30%
<i>5-10 years</i>	24%	17%	20%	20%	30%	12%	23%	18%
<i>More than 10 years</i>	36%	26%	26%	40%	27%	30%	31%	35%
Manager's profile								
Manager is male	98%	99%	100%	100%	93%	100%	98%	100%
Years of experience	3.12	1.92	2.95	2.98	5.12	2.71	3.38	2.67
Level of Education								
<i>None</i>	13%	37%	8%	11%	24%	21%	13%	19%
<i>Completed Secondary</i>	27%	13%	29%	26%	33%	20%	29%	22%
<i>F.A./FSc</i>	11%	7%	18%	13%	14%	27%	14%	15%
<i>Professional Degree</i>	1%	1%	1%	3%	0%	1%	1%	2%
<i>University Degree</i>	5%	3%	14%	3%	6%	6%	9%	3%
Sectoral Distribution								
Production	12%	8%	4%	11%	3%	12%	7%	11%
Services	42%	34%	29%	35%	25%	31%	34%	34%
Trade	47%	58%	67%	54%	72%	57%	59%	56%
Registration & Taxes								
Registered firms	31%	21%	9%	5%	12%	12%	19%	10%
Time to obtain registration (days)								
Pay income taxes (*)	17%	5%	13%	5%	4%	0%	13%	4%
Sole-proprietorships	91%	94%	92%	96%	93%	88%	92%	94%

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

The majority of non-farm enterprises in small towns and villages of Pakistan are owned and operated by men. This is not surprising as female labor force participation in Pakistan for

² The sectoral distribution of enterprises in Pakistan is similar to that recently observed in Nicaragua where manufacturing accounted for about 7 percent of rural non-farm enterprises, 42 percent were engaged in the service sector and the remaining in trade.

activities outside the home is the lowest in South Asia (11 percent in 1999-00) (World Bank, 2004). The managers of non-farm enterprises appear to be relatively inexperienced with an average of 3 years of experience.³ In contrast managers of rural enterprises in Sri Lanka had about 9 years of experience in operating a business. About a third of managers of enterprises in small towns have completed secondary education, compared to 20 percent in villages. Close to 20 percent of managers of village enterprises had no schooling.

As is typical in most countries, non-farm enterprises primarily operate as sole proprietorships. Most of these enterprises can be considered to be informal businesses, not only do they have less than 10 workers, but very few are registered or pay taxes. Although registration is generally low, enterprises located in Punjab appear to have a higher probability of being registered as compared to those located in Sindh or NWFP. Only 9 percent of small town enterprises and 5 percent of village enterprises in Sindh are registered as compared to 30 percent of small town enterprises and 21 percent of village enterprises in Punjab that report being registered.

Sales revenues ranged from a median value of \$1,700 for village enterprises to just over \$3,000 for small town enterprises (Table 2).⁴ The median value of fixed assets was around \$200 although the mean was considerably higher (about \$2,840 for enterprises in small towns and \$730 for village enterprises). As a comparison, the average value of fixed assets of rural enterprises in Sri Lanka was about \$6,000. The median value-added per worker was \$300 for village enterprises and around \$441 for small town enterprises. These estimates are very close to those computed for rural non-farm enterprises in Bangladesh (\$480) and Sri Lanka (\$940). Significant differences in productivity exist within firm size categories both in small towns and villages. With competitive and efficient markets these differences are expected to disappear as inefficient firms will be

³ Considering that the average enterprise is around 9 years old, this figure seems to indicate that a significant number of non-farm enterprises in Pakistan are not owner-managed.

forced out of the market, however the large variation in labor productivity observed may be indicative of high entry and exit barriers or constraints with acquiring adequate technology of services to improve productivity (World Bank, 2005).

Table 2: Enterprise Sales and Assets ('000 Rs)

	Punjab		Sindh		NWFP		All	
	Small Town	Rural	Small Town	Rural	Small Town	Rural	Small Town	Rural
Mean sales revenues	725	237	553	265	549	260	629	246
Median sales revenues	156	96	295	180	180	72	183	100
Value of assets	104	42	281	51	76	30	170	41
Assets/worker	7	12	23	13	10	7	12	11
Mean value added per worker	277	52	96	29	(61)	134	153	65
Median value added per worker	29	20	30	18	6	10	26	18

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

The Rural Investment Climate

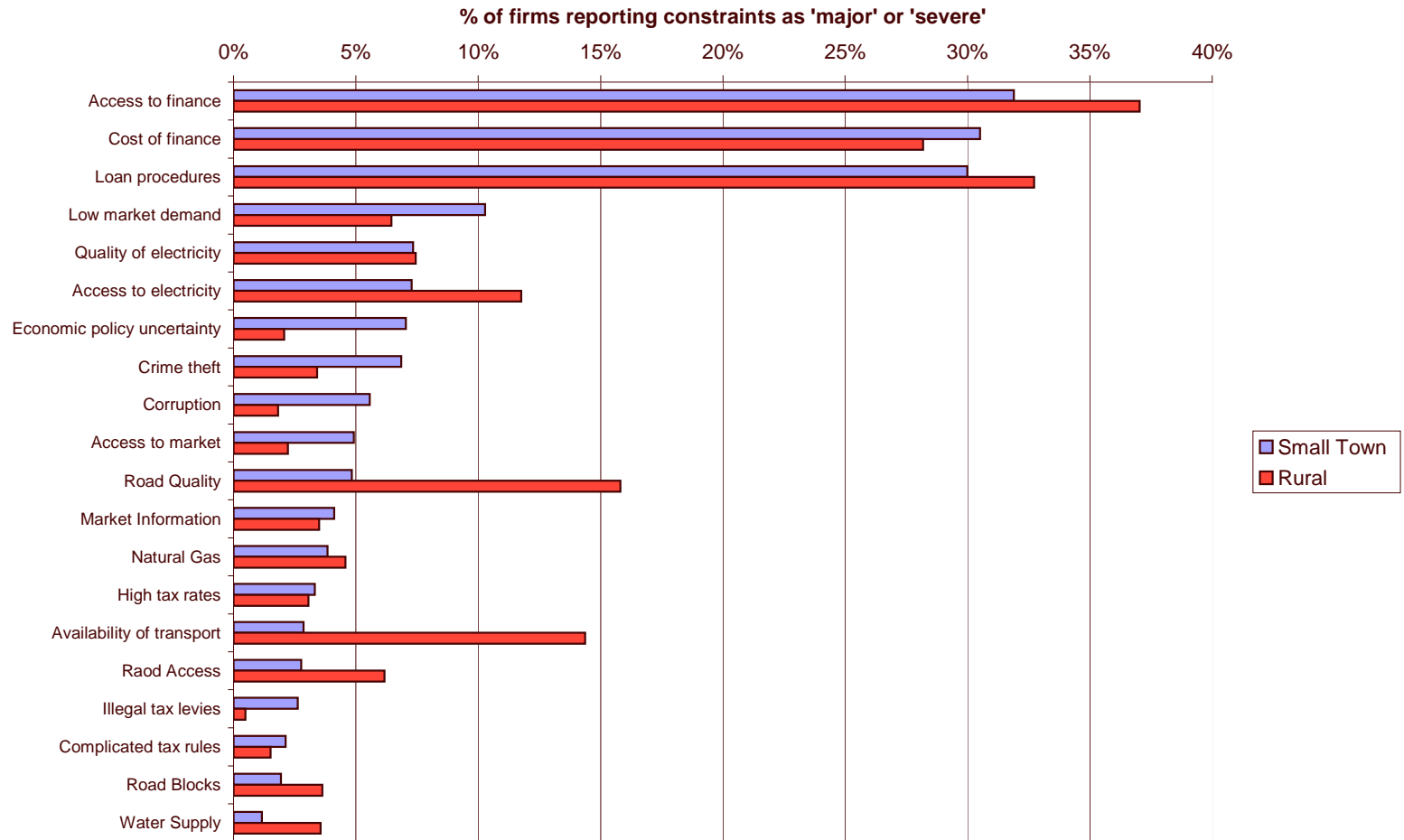
As part of the Rural Investment Climate Survey, non-farm enterprises in were asked to identify the major obstacles to their operation and growth. The top constraints identified by entrepreneurs in rural villages and small towns across the three provinces were access to formal finance, the cost of finance and cumbersome loan procedures (Figure 1). With the exception of small towns in Sindh, more than a third of entrepreneurs in villages and small towns complained about access to finance as being a serious obstacle for operating their business (Annex Table 2).

Poor infrastructure also ranks as a serious constraint for businesses in villages and small towns. Access to electricity, the quality of electricity, road quality, and availability of transport are among the main infrastructure constraints that are identified. The differences in perceptions of village enterprises as compared to small town enterprises with regards to these infrastructure constraints is quite striking, with a larger share of village enterprises reporting infrastructure constraints as a major obstacle to business. Significant numbers of businesses in Punjab also

⁴ An exchange rate of US\$1= 60 PKRs is used.

report access to natural gas as being a constraint, although this seems to be less of a problem in other provinces.

Figure 1: Investment Climate Constraints



Low market demand also ranks fairly high among the various constraints faced by firms. This is essentially entrepreneurs indicating that they do not reach a large enough consumer base. The perception of problems related to market demand appear to be more acute in Punjab. While infrastructure bottlenecks pose more of a challenge for village enterprises, enterprises in small towns perceive factors such as economic policy uncertainty, crime and corruption as being relatively more serious than their village counterparts. In small towns in Sindh, about 10 percent of entrepreneurs identify corruption, crime and theft as being major or severe constraints. These numbers stand out as very few enterprises in other areas identify corruption as a business obstacle.

Access to Finance

Access to formal credit is identified as the single largest business constraint by entrepreneurs in villages and small towns in Pakistan. In the sample about 30 percent of entrepreneurs responded that they had wanted to apply for formal loans in the five years preceding the survey. Only about 14 percent of those wanting a loan in villages and 20 percent in small towns actually applied for a loan (Annex Table 3). Of those wanting a loan, but that did not apply for one, 40 percent stated that loan procedures were too complicated, 27 percent felt that the interest rate would be too high, 16 percent felt that they had insufficient collateral and 8 percent stated that the duration of the loan would be too short. Overall only 4 percent of non-farm enterprises in villages and 7 percent in small towns had applied for a formal loan to finance investment or working capital in the five years preceding the survey. The proportion of enterprises applying for loans was highest in Sindh where 8 percent of village enterprise and 14 percent of small town enterprises applied for loans. In contrast, only 1 percent of small town enterprises and 3 percent of village enterprises in Punjab and NWFP applied for loans.

The fact that only a small fraction of enterprises that want to apply for loans are actually able to apply for one is consistent with the observation that the formal sector banking in Pakistan

is largely urban based and that advances to the rural sector are only a small fraction of advances to the urban sector (3.5 percent). Commercial banks seem to face higher costs and risks in lending to small businesses, while the latter often do not know what is needed to qualify for bank financing and lack critical market information. Small businesses are geographically dispersed, and lenders usually face greater costs in identifying potential borrowers, conducting due diligence, and maintaining contact with the borrower after a loan has been made. Small entrepreneurs are generally less knowledgeable than their larger counterparts regarding what is required to qualify for financing, which imposes a greater burden on financial institutions during the loan application process. They often lack formal financial records and have much more limited track records. Only about 5 percent of village enterprises and 11 percent of small town enterprises in Pakistan prepare financial statements.

Overall very few firms appear to deal with the formal banking sector. At most 10 to 12 percent of enterprises have savings accounts and less than 10 percent have checking accounts. A very tiny fraction of village (2 percent) and small town enterprises (6 percent) have access to an overdraft facility to finance investment or working capital needs. There is a strong association between access to banking services and the degree to which firms complain about finance being a major constraint. In small towns of Sindh only 14 percent of enterprises complained about access to finances being a major or severe constraint. As indicated in Annex Table 3, 40 percent of firms in small towns in Sindh that wanted a loan actually applied for one, 22 percent of these firms prepared financial statements.

The primary sources of start-up capital for village and small town non-farm enterprises are funds borrowed from family and friends, household savings and earnings from the sales of assets. The share of start-up capital from bank loans is negligible (1 percent for small town enterprises and less than 1 percent for village enterprises). Similarly the major source of investment finance comes from savings and funds from family and friends. About 43 percent of

village enterprises and 58 percent of small town enterprises made new investments in the year preceding the survey. Among firms making new investments, the median investment was \$133 for village enterprises and \$142 for small town enterprises. Close to 90 percent of all new investments were made using savings. The average investments which ranged between \$340 to \$365 were less than half the size of the average investment observed among similar types of enterprises in Sri Lanka.

While access to long terms financing and formal credit for working capital and investment is limited, approximately 46 percent of village enterprises and about 54 percent of enterprises in small towns purchase inputs/goods on supplier credit. Once again enterprises in small towns of Sindh appear to have better access to supplier credit. This type of credit is generally only extended on a very short term basis with most enterprises required to make repayments within two weeks. Across the various sectors, traders are significantly more likely to have access to supplier credit than manufacturing or service enterprises.

Infrastructure

Infrastructure-related problems rank relatively high among the various investment climate obstacles identified by village and small town enterprises. In rural Sindh, road quality and access to public transport were identified as major problems by about 20 percent of village entrepreneurs. Data on road quality (the type of internal roads in the community), the availability of public transport and connectivity reveal that villages in Sindh are considerably disadvantaged compared to enterprises located elsewhere. For instance, 93 percent of enterprises in rural Sindh are located in communities where dirt roads are the most common type of internal road surface (Annex Table 4). In comparison only about 54 percent of village enterprises in NWFP and 26 percent in Punjab report being located in a community with dirt roads. Twenty-eight percent of village enterprises in Sindh are located in communities with access to public transportation. The comparable figure for Punjab and NWFP are 85 percent and 47 percent, respectively. Fewer

small town entrepreneurs complain about road quality and availability of public transport as compared to village entrepreneurs and not surprisingly small town enterprises have better roads and access to public transport.

The last urban investment climate assessment in Pakistan found that the typical business loses 5.6 percent of annual output due to power outages, much higher than in China (1.99 percent) and Bangladesh (2.35 percent) (SMEDA Report). Access to electricity remains a major challenge in many rural villages and small towns, and even among enterprises with access, reliability of supply is uncertain. Eighty-three percent of village enterprises and 96 percent of small town enterprises reported having access to electricity.⁵ Almost all enterprises with access to the grid report experiencing power outages. In villages and small towns of Sindh as well as villages in NWFP, entrepreneurs report almost daily outages. The median number of days with power outages in a typical month was reported as being 20 days in villages and 15 days in small towns. Frequent outages increase production costs and firms have to tie up significant resources to produce their own power, resources that could be productively engaged in their core business. About 5 percent of villages enterprises and around 7 percent of small town enterprises reported owning or sharing a generator.

Access to and use of telecommunications among enterprises is surprisingly limited, particularly considering that close to 60 percent of the enterprises are traders. About 28 percent of entrepreneurs in small towns owned fixed line phones and 9 percent own cellular phones. The comparable figure for village entrepreneurs is 7 percent for fixed-line phones and 4 percent for cellular phones. Use of faxes and email is extremely rare. On the whole, entrepreneurs in NWFP appear to have slightly better connectivity than their counterparts in Punjab and Sindh. The last urban investment climate assessment found that only 30 percent of urban businesses in Pakistan normally communicate with their customers or suppliers using Internet—far fewer than the 71

percent of firms that do so in China or the 45 percent that do so in India. Internet connectivity among rural and small town firms is extremely limited and only about 1 percent of firms in small towns reported using email.

Market Demand

Lack of market information and isolation from supply chains also constitute important barriers to the success of small rural firms. About 6 percent of village enterprises and 10 percent of small town enterprises complained about low market demand being a major or severe constraint and 3 to 4 percent complained about lack of adequate market information. Inadequate market information can cause businesses to sell into local markets where prices may not be optimal or to miss opportunities in markets where growth prospects are greater.

Examining where enterprises sell their goods and services and whom they trade with provides some indication of the markets they have access to (Annex Table 5). Some interesting trends emerge from the data. Most of the sales of production-related firms in Punjab and Sindh occur locally within the same Thesil (administrative division). In contrast, 70 percent of sales of both village and small town production enterprises in NWFP are to buyers in other provinces. The exact reasons for these differences are not readily apparent.

In all three provinces most services are sold locally either within the same village, or to a different village within the same Union Council. On the other hand, traders appear to be considerably more dependent on customers located further away in different districts and provinces. Close to 30 percent of sales by traders in small towns in NWFP are to buyers in other countries (mostly likely in Afghanistan). Most sales are made directly to households or other small firms with very few firms reporting sales to larger domestic or multinational firms.

⁵ Connectivity to the grid appears relatively high compared to rural Sri Lanka where slightly less than 70 percent of enterprises reporting being using electricity from the national grid.

Crime and Corruption

Crime and Corruption rank among the top ten business obstacles faced by enterprises in small towns, although relatively few firms raised these issues. The Pakistan urban ICA reported that one in three managers was concerned about extortion or intimidation of the company's employees, a somewhat higher percentage was concerned about arson and more than three quarters feared theft. One in five respondents reports that its business was the target of at least one crime during the survey year. NWFP fared particularly poorly and businesses in NWFP reported spending 4.5 percent of their revenue on security, with firms in Sindh and Punjab spending 1-2 percent. Although the problems with crime and corruption appear less pronounced in the rural areas of Punjab more than 90 percent of enterprises are located in communities where it is reported that unofficial fees are required in order to get services such as an electricity connection. About 4 percent of village enterprises and 6 percent of small town enterprises report losses due to theft. The largest proportion of firms reporting incidents of theft are small town enterprises in NWFP (8 percent) and Punjab (7 percent).

The Investment Climate and Firm Performance

To estimate the impact of the investment climate on village and small town enterprise performance, we estimate the impact of various indicators of the investment climate on enterprise productivity as measured by value-added per worker. A Cobb-Douglas production function can be expressed as :

$$\ln Y_k = \gamma_0 + \gamma_1 (\ln L_k) + \gamma_2 (\ln K_k) + \gamma_3 (IC_k) + \gamma_4 (E_k) + \gamma_5 (D_k) + \mu_k \quad (1)$$

where Y_k is value added, L_k is the number of workers and K_k the value of fixed assets, IC_k is a vector of investment climate characteristics (access to banks, road quality, availability of public transportation, availability of electricity, fixed-line and cellular phone services), E_k a vector of enterprise characteristics such as type and age, manager's experience and education and D_k is a set of provincial dummies. To avoid potential problems with endogeneity, we use community

level variables to capture various dimensions of the investment climate. We use a dummy variable reflecting the presence of a bank in the community (the variable equals 1 if a community has a ZTBP bank, a commercial bank or a cooperative bank) to capture access to finance. Access to electricity is proxied by the share of households in a community with access to electricity. Similarly access to telecommunications is measured by the share of households in a community with fixed and cellular phone services. The road surface of internal village/small town roads is used as a measure of road quality. Value added is constructed by subtracting expenses from material inputs, charges to utilities, transportation cost and other variable costs from the total sales in the same year. Equation 1 is estimated separately for village and small town enterprises.

Table 3 presents the results of OLS regressions of value added per worker. These initial results suggest that the major investment climate obstacles identified by small town and village entrepreneurs do in fact affected a firm's performance. Both access to finance and electricity have a positive and significant effect on the productivity of village non-farm enterprises. For small town enterprises the only investment climate variable that is significant is access to public transportation. The manager's education levels, experience and gender all have a significant impact on enterprises productivity and the signs of the coefficients are as expected. While experience is not significant in the village enterprise regression, village enterprises with more educated managers (i.e. those with education beyond secondary school) also appear to perform better. There also appear to be significant differences in firm performance across the different types of enterprises with trade-related enterprises performing significantly better as compared to production and service sector enterprises in small towns. Trading establishments also appear to perform better in rural villages. Finally, there are some significant regional differences, with small town enterprises in Punjab performing significantly better than comparable firms in Sindh and NWFP.

Table 3: The Impact of the Investment Climate on Firm Performance

	(1) <i>Small town</i>	(2) <i>Village</i>
	Ln(Value Added per worker)	Ln(Value Added per worker)
Bank in community	0.091 (0.20)	0.287 (3.39)***
Internal road: dirt road	0.231 (0.84)	-0.234 (1.41)
Public transport available	0.637 (3.22)***	0.081 (0.69)
Share of households with electricity	-0.002 (0.76)	0.005 (1.83)*
Share of households with fixed-line phones	-0.003 (0.66)	-0.002 (0.66)
Share of households with cell phones	-0.003 (1.00)	-0.002 (0.75)
Ln(Fixed assets)	0.033 (1.59)	0.037 (1.30)
Ln(Number of workers)	-0.405 (3.88)***	-0.763 (2.92)***
Age of firm	0.018 (1.64)	0.012 (1.95)*
Manager's experience (years)	0.028 (1.94)*	-0.013 (0.87)
Manager's gender	1.433 (1.97)*	0.028 (0.06)
Manager's education (none)	-0.778 (2.14)**	-0.636 (1.73)*
Manager's education (up to secondary)	-0.485 (2.96)***	-0.403 (2.51)**
Production enterprise	-0.495 (3.22)***	-0.211 (0.76)
Service enterprise	-0.323 (1.95)*	-0.344 (1.87)*
Punjab	0.498 (2.83)***	0.106 (0.63)
Sindh	0.256 (1.07)	0.349 (1.50)
Constant	8.650 (7.95)***	9.981 (14.83)***
Observations	636	519
R-squared	0.20	0.18

Robust t-statistics in parentheses

* significant at 10% level, **significant at 5% level; *** significant at 1% level

Conclusion

This paper has provided a descriptive analysis of the profile of village and small town enterprises in Pakistan drawing on a recently completed survey of enterprises. Notwithstanding their small size, non-farm enterprises and the employment they generate have been an important source of income in rural areas and small urban centers in Pakistan. Although the enterprise sector does not appear to be particularly dynamic, data indicate that there has been employment growth in this

sector. The average annual compound employment growth has been about 1% in village enterprises and 3 % for small town enterprises.⁶

At present, access to formal finance, the cost of finance and cumbersome loan procedures pose major challenges for rural entrepreneurs in Pakistan, particularly in terms of availing of long-term financing for investment purposes. Access and quality of electricity supply, marketing difficulties and transportation-related problems also pose major obstacles. These obstacles have a negative impact on enterprise productivity, the level of investments made by existing firms and discourage the start-up of new enterprises.

Addressing the constraints faced by non-farm business in villages and small towns is needed to promote private investments, generate employment and reduce poverty. Investment climate improvements that drive growth are conducive to poverty reduction in a number of ways. Fostering a vibrant private sector by lowering the cost of doing business (including less red tape and corruption), lowering risks (through more secure property rights and less policy uncertainty) and lowering entry barriers will likely generate more employment and result in higher wages thereby having a positive impact on poverty (World Bank, 2005). Investment climate improvements could also benefit the poor by reducing the costs of producing and distributing goods and services.

⁶ Employment growth rates are calculated for the subset of firms that reported data for both 2001 and 2004.

Table 1: Composition of Small town and Village Enterprises

Industry Type	Small towns	Villages
Manufacture of food, beverages and tobacco	1.75%	4.35%
Textile, wearing apparel and leather in	0.71%	0.69%
Manufacture of wood and wood products	1.63%	0.61%
Manufacture of paper and paper products	0.01%	
Manufacture of chemicals and related pr	0.13%	0.19%
Manufacture of non-metallic mineral pro	0.27%	0.89%
Basic metal industries	0.61%	0.64%
Manufacture of fabricated metal product	1.04%	0.46%
Other manufacturing industries	0.45%	0.61%
Electricity, gas and water	0.63%	0.06%
Construction	0.02%	
Wholesale trade	1.23%	0.79%
Retail trade	58.43%	56.47%
Restaurants and Hotels	5.58%	3.64%
Transport and storage	1.13%	0.43%
Communication	1.75%	0.11%
Insurance	0.04%	
Real estate and business	1.84%	2.60%
Sanitary and similar services	0.07%	
Social and related community services	1.17%	3.13%
Recreational and cultural services	0.76%	0.26%
Personal and household services	20.66%	23.29%
Other	0%	0.77%

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

Annex Table 2: Major & Severe Investment Climate Constraints Identified by Enterprises

	Punjab		Sindh		NWFP		All	
	Small Town	Rural	Small Town	Rural	Small Town	Rural	Small Town	Rural
Access to finance	43%	49%	14%	32%	46%	36%	32%	37%
Cost of finance	29%	26%	26%	25%	46%	38%	31%	28%
Loan procedures	17%	19%	40%	37%	40%	37%	30%	33%
Low market demand	19%	14%	5%	6%	1%	1%	10%	6%
Quality of electricity	10%	10%	6%	8%	4%	2%	7%	7%
Access to electricity	6%	8%	8%	14%	8%	9%	7%	12%
Economic policy uncertainty	15%	8%	1%	0%	0%	0%	7%	2%
Crime theft	5%	5%	12%	4%	0%	0%	7%	3%
Corruption	1%	1%	12%	3%	0%	0%	6%	2%
Access to market	9%	6%	3%	1%	0%	1%	5%	2%
Road Quality	5%	9%	6%	24%	0%	3%	5%	16%
Market Information	5%	1%	4%	6%	0%	0%	4%	3%
Natural Gas	8%	12%	0%	3%	1%	1%	4%	5%
High tax rates	1%	0%	7%	5%	0%	0%	3%	3%
Availability of transport	2%	6%	5%	21%	0%	6%	3%	14%
Road Access	5%	7%	1%	8%	0%	2%	3%	6%
Illegal tax levies	3%	1%	3%	0%	2%	0%	3%	0%
Complicated tax rules	0%	0%	5%	3%	0%	0%	2%	2%
Road Blocks	2%	1%	2%	6%	0%	1%	2%	4%
Water Supply	1%	1%	2%	2%	0%	9%	1%	4%
Telecommunications	1%	2%	0%	3%	2%	1%	1%	2%
Postal Service	1%	1%	0%	3%	0%	0%	0%	2%

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

Annex Table 3: Access to Finance

	Punjab		Sindh		NWFP		All	
	Small Town	Rural	Small Town	Rural	Small Town	Rural	Small Town	Rural
Firm wanted to apply for a loan in past 5 years	41%	36%	38%	24%	7%	7%	34%	28%
Firms that applied for loans (of those wanting a loan)	3%	8%	38%	34%	17%	39%	20%	14%
Firms that applied for a loan (among all firms)	1%	3%	14%	8%	1%	3%	7%	4%
Firms with a PLS account	10%	12%	12%	18%	5%	9%	10%	12%
Firm has current account	3%	2%	13%	17%	4%	6%	8%	6%
Firm has overdraft facility	1%	2%	10%	4%	4%	2%	6%	2%
Firm has access to supplier credit	53%	43%	59%	48%	45%	51%	54%	46%
Repayment period supplier credit (median days)	10	15	15	15	10	15	15	15
Share of goods/inputs purchased on credit	50%	50%	50%	50%	50%	50%	50%	50%
Prepares a financial statement	2%	1%	22%	13%	6%	10%	11%	5%
Made new investment	39%	31%	80%	87%	57%	44%	58%	43%
Mean value of new investment (Rs.)	26,570	22,554	21,479	13,973	14,561	25,868	21,889	20,452
Median value of new investment (Rs.)	10,000	5,000	10,000	8,000	4,000	10,000	8,500	8,000
Share of investment from own savings	95%	94%	88%	90%	89%	67%	90%	87%
Share of investments from formal loans	0%	0%	2%	0%	0%	0%	1%	0%
Share of investment from relatives/friends	4%	5%	5%	8%	10%	33%	5%	12%
Share of investments from private lenders	0%	1%	5%	1%	1%	0%	3%	1%
Source of start-up capital								
<i>Family or friends</i>	53%	38%	43%	28%	32%	50%	46%	39%
<i>Income from agriculture</i>	6%	17%	3%	20%	7%	14%	5%	17%
<i>Income from non-farm activities</i>	36%	39%	19%	35%	36%	25%	29%	36%
<i>Remittance</i>	0%	3%	2%	0%	8%	3%	2%	2%
<i>Sale of assets</i>	7%	6%	19%	13%	9%	0%	12%	6%
<i>Bank loan</i>	0%	1%	2%	1%	0%	0%	1%	0%
<i>Private money lenders</i>	2%	1%	1%	1%	0%	0%	1%	1%
<i>Other</i>	5%	8%	20%	9%	11%	14%	11%	9%
Share of start-up capital from:								
<i>Family or friends</i>	49%	33%	41%	25%	29%	48%	42%	35%
<i>Income from agriculture</i>	5%	16%	2%	18%	7%	13%	4%	16%
<i>Income from non-farm activities</i>	31%	37%	15%	34%	35%	24%	25%	34%
<i>Remittance</i>	0%	2%	2%	0%	9%	3%	2%	2%
<i>Sale of assets</i>	6%	5%	19%	13%	9%	0%	12%	5%
<i>Bank loan</i>	0%	0%	2%	1%	0%	0%	1%	0%
<i>Private money lenders</i>	2%	1%	1%	1%	0%	0%	1%	1%
<i>Other</i>	5%	6%	18%	8%	11%	11%	11%	7%

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

Annex Table 4: Quality of and Access to Infrastructure

	Punjab		Sindh		NWFP		All	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Roads & Transport								
Internal roads are dirt roads	1%	26%	37%	93%	0%	54%	15%	42%
Public transport available to nearest main city	98%	85%	85%	28%	92%	47%	92%	68%
Main road connects community to nearest city	91%	97%	93%	82%	100%	98%	93%	95%
Electricity								
Enterprises with access to electricity	97%	79%	94%	81%	98%	96%	96%	83%
Enterprises connected to the grid reporting power outages	98%	99%	100%	100%	100%	100%	99%	100%
Median days/month when outages occur	10	10	30	30	20	30	15	20
Own or share a generator	4%	7%	12%	4%	5%	0%	7%	5%
Median days to get new electricity connection	40	45	20	30	30	20	30	30
Unofficial fees needed for a new connection	81%	90%	100%	100%	97%	100%	91%	94%
Telecommunications								
Owns fixed line phone	28%	9%	24%	4%	39%	6%	28%	7%
Owns cellular phone	10%	3%	3%	3%	19%	6%	9%	4%
Use fax	0%	0%	1%	0%	3%	0%	1%	0%
Uses email	1%	0%	0%	0%	2%	0%	1%	0%

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005

Annex Table 5: Market Linkages: Geographic Location of Sales and Trading Partners

Village Production Enterprises	Production			Services			Trade		
	Punjab	Sindh	NWFP	Punjab	Sindh	NWFP	Punjab	Sindh	NWFP
Sells to buyer in:									
Same village	45	94	25	76	73	56	1	5	3
Same UC, different village	21	2	2	22	23	39	3	5	1
Same Tehsil, different UC	7	0	0	1	2	0	13	8	17
Same district, different Tehsil	10	0	0	1	0	5	24	12	6
Same Province, different district	6	4	2	0	2	0	50	41	43
Other Provinces	10	0	71	0	0	0	7	27	23
Other countries	0	0	0	0	0	0	2	2	8
Small town Production Enterprises									
Sells to buyer in:									
Same town	47	74	21	55	74	60	2	4	4
Same UC, different town	14	20	11	25	16	33	1	3	4
Same Tehsil, different UC	30	0	0	16	6	4	3	4	1
Same district, different Tehsil	2	1	0	4	4	1	11	11	8
Same Province, different district	2	4	0	1	0	0	55	58	13
Other Provinces	5	0	68	0	0	1	21	15	43
Other countries	0	0	0	0	0	0	8	5	28
Village Production Enterprises									
Sells to buyer in:									
Government	3	0	0	0	0	5	0	0	0
Traders	15	1	0						
Multinationals located in your country	0	0	0	2	0	0	0	0	0
Your parent company or affiliated subsidiaries	2	0	0	1	9	0	0	0	0
Large domestic firms	3	0	0	0	0	0	0	1	0
Agricultural producers and ag. Cooperatives	4	17	71	2	0	0	3	0	9
Households	60	75	27	86	80	92	92	77	88
Other (sales to small firms, etc)	13	7	2	10	11	3	5	22	3
Small town Production Enterprises									
Sells to buyer in:									
Government	0	0	0	0	0	1	0	0	0
Traders	5	0	0						
Multinationals located in your country	0	0	0	0	0	2	0	2	0
Your parent company or affiliated subsidiaries	0	0	0	0	0	0	0	0	0
Large domestic firms	1	0	0	0	1	0	1	0	0
Agricultural producers and ag. Cooperatives	2	1	0	4	0	0	1	1	1
Households	75	76	29	77	75	84	84	83	82
Other (sales to small firms, etc)	17	23	71	19	24	14	14	14	17

Source: Authors' calculations based on the Pakistan Rural Investment Climate Survey, 2005