

ENTREPRENEURSHIP IN PAKISTAN

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ENTREPRENEURSHIP IN PAKISTAN

INTRODUCTION: (Reasons for policy failure)

THE CONCEPT: Innovation and Risk Bearing

ENTREPRENEURSHIP AS RENT SEEKING

HOW DID IT DEVELOP IN PAKISTAN?

UNDERSTANDING BUSINESS IN PAKISTAN

(Factors responsible for a poor business environment)

CONCLUSION & RECCOMENDATIONS

INTRODUCTION

- ❑ Economic development as a conscious mechanism in Pakistan is a recent post colonial phenomenon.
- ❑ International agencies were founded with the objective of achieving economic development and eradicating poverty.
- ❑ 60 years later poverty still persists and many countries like Pakistan is in a poverty trap.

Reasons for Policy, Aid and Donor Failure

1. Economic growth requires institutional prerequisites:

Democratic Institutions
Sound legal Framework
Market developing Regulation
Free and Open media

- Without these the environment remains very uncertain and full of risk which impairs entrepreneurship and investment. [‘Primacy of Institution’ argument. [(Landes (1998)).]

Reasons for Policy, Aid and Donor Failure

2. Growth is a result of knowledge accumulation and entrepreneurship (Dejardin (2004&2005)). Innovation and ideas drive growth and not just infrastructure development and investment promotion. (Romer (1994) and Grossman and Helpman (1994)).
3. Growth happens when policy and management at every level in the economy turns entrepreneurial. Easterly (2003 and 2005)
4. Entrepreneurship need not always be wealth-creating and growth-inducing. Tullock (1989), Krueger (1974) have shown that entrepreneurship can be directed towards the accumulation of wealth through unproductive enterprise.

Research Objectives:

- How policy and the environment can be adjusted to allow entrepreneurship play a greater role in the economy
- Provide a general understanding of entrepreneurship

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Understanding Entrepreneurship

- An entrepreneur is a person who is willing to put his/her career and financial security on the line and take **risks** in the name of an **idea**, spending **time** as well as **capital** on an **uncertain** venture.
- Entrepreneurship is thus being taken as a process of **discovering**, **evaluating** and **exploiting** opportunities.

ENTREPRENEURSHIP- “defined”

1. Transformation of demand into supply for profits.	(Smith 1776)
2. Bringing together factors of production	(Say, 1803)
3. Founding a private enterprise	(Mill 1848)
4. Creation of organizations	(Gartner,1988)
5. Ownership	(Hawley,1892)

ENTREPRENEURSHIP- “defined”

6. Responsible decision making	(Knight,1921)
7. Carrying out new combinations: later on termed innovation through the process of <u>‘creative destruction’</u> i.e. old being washed away by the new.	(Schumpeter, 1934)
8. Bearing Uncertainty	Knight,1921 Cantillon 1755

ENTREPRENEURSHIP- “defined”

9. Exploration of opportunities- being an arbitrageur and an equilibrating agent

(Kirzner, 1973),

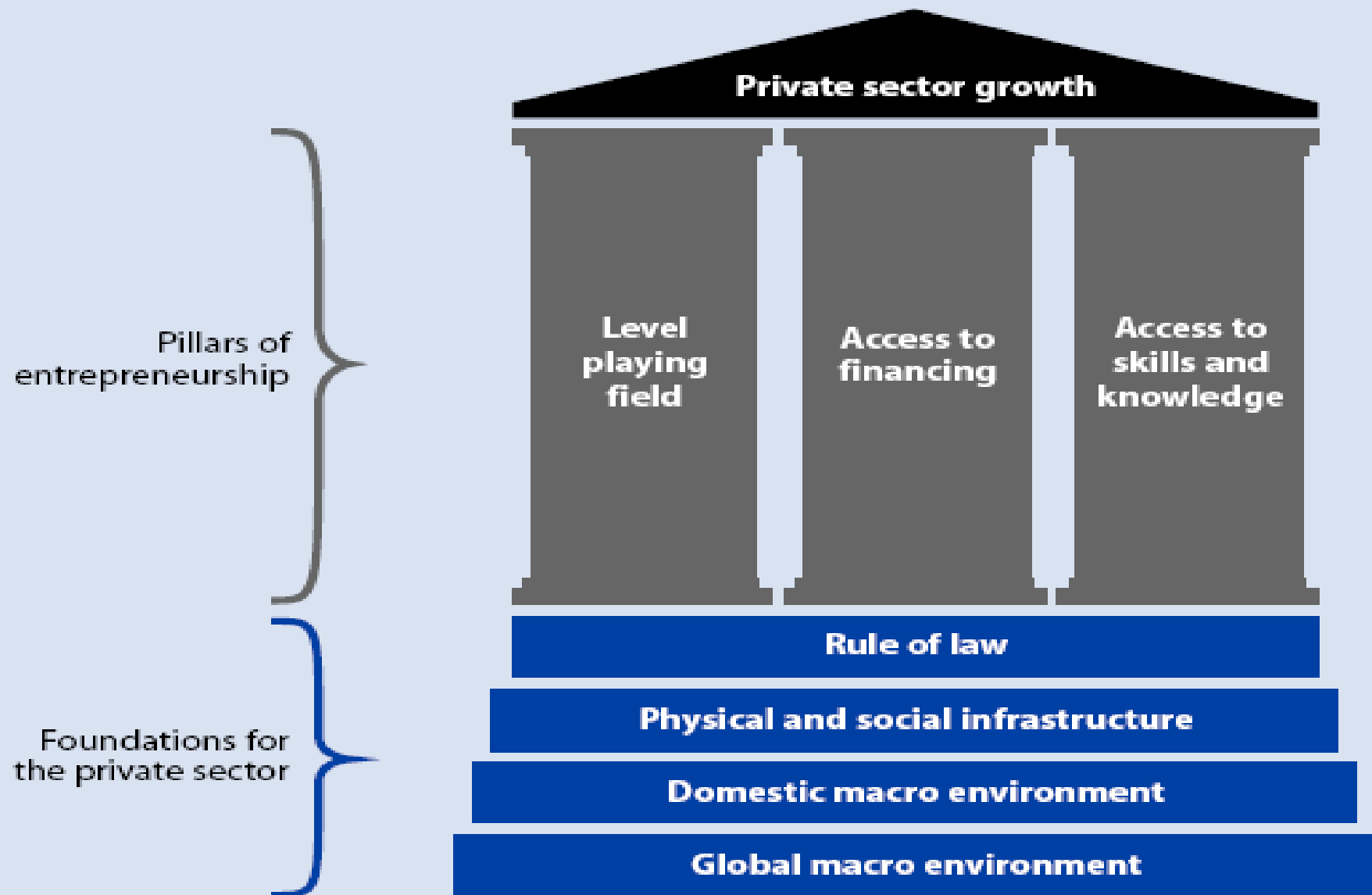
Exploiting the opportunities that changes in technology, consumer preferences, social norms, etc., create.

Undertaking innovation and bearing risk

WHAT MAKES AN ENTREPRENEURIAL ECONOMY?

1. Competitive environment with a level playing field
2. Free and flexible markets that will enable the closing down of business that have run their course and be replaced by more efficient firms
3. Rule of Law: Protection of property rights & Contract enforcement.
4. Availability of a financial system that provides the entrepreneurs with an easy access to capital
5. A quality educational system

FIGURE 2.3 FOUNDATIONS FOR THE PRIVATE SECTOR AND PILLARS OF ENTREPRENEURSHIP



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Entrepreneurship as 'Rent seeking'

- Rent seeking is defined as a situation in which an individual or firm makes money by manipulating economic environment rather than by profit making through trade and production of wealth
- When wealth transfers can be achieved through government provided wealth transfers, Economic agents will expend efforts toward attempting to influence government actions in their favor in order to accumulate wealth.

Examples

1. Conferring of a monopoly through a license
2. Obtaining resources at below the market prices (e.g. publicly provided land at cheaper rates than market to influential groups)
3. Protection from competition (e.g., restriction of number of players in a market)
4. Manipulation of government subsidies, tariff and tax policies

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Development of Entrepreneurship in Pakistan

- a) The Big Push for industry**
- b) The Neglect of the “Small”**
- c) Agriculture and the Elite bias**
- d) Subsidies for Export**

a) The Big Push for Industry

- ❑ 'Enterprise' for the government was synonymous to large industry only
- ❑ Policy measures gave rise to rent seekers instead of entrepreneurs
- ❑ Government policy was never neutral and favored industrialization through out (Stephen 1969 & Hussain 1999)

Historical Overview:

1947-58	Era of emerging exchange rate and trade policies and import substitution industrialization.
1953-64	Virtually all imports into Pakistan were regulated by some form of quantitative controls
1950-55	Large scale sector experienced phenomenal growth rates of over 20%
1950's	Introduction and active functioning of "Import Licensing System"

Historical Overview:

1958-68	The “decade of development”, industry experienced a relatively higher growth rate
1958-70	65% of total loans disbursed by PICIC, went to 37 monopoly houses, with the largest 13 of these accounting for about 70% of the loans
1972-77	Bhutto’s regime characterized by Nationalization. Caused some dent in elite power.
	Still however banks continued to lend on the basis of political and governmental influence.

Historical Overview:

- This resulted in losses on bad loans for banks to the extent that, for example, governments had to inject equity of **RS.20 billion** and **RS.7 billion** into **United Bank Limited (UBL)** and **Habib Bank limited (HBL)** respectively to make these viable for privatization that took place in recent past.

1977-88: Zia years of encouragement of private sector, preference still given to large scale sector.

b) Neglect of the 'Small'

- ❑ Small scale manufacturing sector developed in the context of a difficult / biased industrialization process
- ❑ Reality: Informal and Small scale sector dominate our lives.
- ❑ Today almost **40%** of business takes place in the informal sector
- ❑ Small scale sector is the breeding ground for innovation but continues to attract little research

Small Scale Sector– ‘Neglected’

1950-62	Consistent trend of only 2.35% growth
1962-69	Stagnant growth rate of 2.95% !
1977 onwards	Consistent trend of 8.4% growth
From 1990s...	Growth rate fell to a stagnant 5.3%
NOTE:	Informal sector & small scale sector employment has always exceeded large scale sector's.

Small Scale Sector– ‘Neglected’

- ❑ A recent study by SMEDA showed that a person could be employed in a small-scale industry at **1/80th investment** of what it takes him to be employed in a large-scale industry!
- ❑ The location problems of the SME's are far less than those of the large-scale industries.
- ❑ In the context of an institutional framework, one or the other government institutions established solely for the facilitation of the small scale industry and enterprise have always been there.

Institutions for the promotion of SMEs

Sarhad Small Industries Development Board (SSIDB)	1972
Sindh Small Industries Corporation (SSIC)	1972
Small Business Finance Corporation (SBFC)	1972
Punjab Small Industries Corporation (PISC)	1972
Small Business Finance Corporation	1985
Regional Development Finance Corporation (RDFC)	1985

Institutions for the promotion of SMEs

Directorate of Industries in Balouchistan	1998
Small and Medium Enterprise Development Authority (SMEDA)	1998
RDFC and SBFC amalgamated to form SME Bank	2002
National SME Development Council	2004

Institution	Small	Medium
Small and Medium Enterprise Development Authority (SMEDA)	10-35 Employees or Productive assets of Rs 2-20 million	36-99 Employees or Productive assets of Rs. 20-40 million
SME Bank	Total Assets of Rs. 20 million	Total Assets of Rs. 100 million
Federal Bureau of Statistics	Less than 10 employees	N/A
State Bank of Pakistan (SME Prudential Regulations)	<p>An entity , ideally not being a public limited company, which does not employ more than 250 persons (manufacturing) and 50 persons (trade / services)³² and also fulfills one of the following criteria:</p> <p>(i) A trade / services concern with total assets at cost excluding land and buildings up to Rs 50 million.</p> <p>(ii) A manufacturing concern with total assets at cost excluding land and building up to Rs 100 million.</p> <p>Any concern (trade, services or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.</p>	
Sindh Industries Department	Entity engaged in handicrafts or manufacturing of consumer or producer goods with fixed capital investment up to Rs.10 million including land & building	
Punjab Industries Department	Fixed assets with Rs. 10 million excluding cost of land	
Punjab Small Industries Corporation	Fixed investment. up to Rs. 20 million excluding land and building	N/A

No unanimity over the definition of SMES.

c) Agriculture & the Elite bias

- ❑ Impressive agricultural 1960 and 1970 (green revolution)
- ❑ The main elements of the green revolution were: **tube wells**, **tractorization** and **High Yield varieties (HYV)** - all the three elements have been a source of rent seeking
- ❑ ADB, followed a liberal credit policy and made numerous loans to farmers (cheap availability of credit)
- ❑ Overvalued exchange rate made tractors available in Pakistan at below world market prices
- ❑ HYV of food grains were provided to farmers at subsidized prices

c) Agriculture & the Elite bias

- ❑ HYV required plenty of water and therefore mainly the farmers owning tube wells were able to benefit from HYV
- ❑ Thus seventy percent of the tube wells were put in by farmers owning 25 acres or more
- ❑ Hence, the beneficial effect of green revolution, that has been the case of incentives from the government, remained restricted to rich farmers only
- ❑ Akmal Hussain, “The new technology made it possible to accelerate agricultural growth substantially through an elite-farmer strategy” which concentrated on the new inputs on large farms only.

d) Subsidies for Exports

- ❑ In 1960s , the dual exchange rate system was used to subsidize machinery imports and penalize consumer imports while offering a large subsidy to exporters.
- ❑ This policy again favored large scale industrialist and exporters at the expense of small scale producers
- ❑ Businesses have grown on the back of various protective measure that had a tilt towards rent-seeking rather than welfare improvement.
- ❑ Protections available to businessmen reduced their risks

Consequences:
Intended or Unintended?

CONSEQUENCES-Intended or Unintended?

a. Inequality and Bank Defaults

b. Crippled Innovation

c. Rent-seeking and Land Development

d. Non-commercial Cities

a) Inequality and Bank Defaults:

Gustav Papanek	<ul style="list-style-type: none">- In 1950 there were 3000 individual firms- Only 7, individual, families or foreign corporations constituted 25 percent of all industrial assets in united Pakistan- Only 24 units constituted nearly 50 percent of all industrial assets.
Dr. Mahbub ul Haq	<p>In Ayubs' regime, 22 families controlled :</p> <ul style="list-style-type: none">-66 percent of the industrial assets-70 percent of the insurance-80 percent of banking assets

a) Inequality and Bank Defaults:

<p>Akbar Zaidi (2005)</p>	<p>Between 1958-70:</p> <ul style="list-style-type: none">-7 of the 17 Pakistani banks were under the direct control of monopoly houses accounting for 60 percent of total deposits and 50 percent of loans and advances-Public sector financial institutions like PICIC and PIFCO were structured to provide loans only to larger and more established firms that had adequate security and high profit rates
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a) Inequality and Bank Defaults:

Ishrat
Hussain
(1999)

- Public sector financial institutions have faced huge loan defaults during '90s
- Institutions were used to accord political patronage - to reward loyal followers and to win over adversaries
- The cost of the project was almost always shown to be greater than the actual cost so that the loan for the project (60-70 percent of the total project cost) would be enough to finance the equity portion of the project as well

b) Crippled Innovation

- ❑ The planning model developed in the country encourages government interventions on the assumption that markets fail.
- ❑ Recent privatization stories are evidence to the fact that governments can fail as well
- ❑ Innovation on the other hand, requires entrepreneurs to be able take risks fearlessly
- ❑ As such innovation thus is only possible in the private sector

b) Crippled Innovation

- ❑ The nationalization period in Pakistan affected it quite adversely
- ❑ In the years to come very little of it could take place, since the private sector was again adjusting it self after the policy was abandoned in the Zia regime
- ❑ The entire essence and the spirit of innovation were strangled

b) Crippled Innovation

<p>“Enterprise Surveys” (By The World Bank) 2002</p>	<ul style="list-style-type: none">-Only 17.01% of the 965 firms surveyed have ISO certification ownership- Out of the sales of these firms only a depressing 0.57% is spent on research and development
<p>Global Competitiveness Report (2004-05)</p>	<ul style="list-style-type: none">-Pakistan’s innovation index is 91/125- Indicating despite the government efforts of industrialization promotion throughout out , Pakistan still falls in the lowest band of innovation

c) Rent-Seeking and Land Development

- ❑ Land development and allotment
- ❑ Pursued by: People in power positions- civil servants, judiciary, army etc
- ❑ State provision of subsidized land to those with power has existed since colonial times
- ❑ The process evolved to the point where more and more urban land was developed to satisfy this demand for subsidy by the army and the bureaucracy
- ❑ The process evolved through the development of Islamabad and later the Defense Housing Authority schemes

c) Rent-Seeking and Land Development

- ❑ Profits from land game $>$ profits from business
- ❑ Interest & Money \rightarrow from business \rightarrow trading in land \rightarrow artificial increase in real estate prices
- ❑ Land game adversely influenced entrepreneurship by:
 - ❑ increasing the cost of doing business
 - ❑ shifting the interest of businessmen away from entrepreneurial activities
 - ❑ locking in funds that could have been available for entrepreneurial activity

Land Related Regulations

1924	Cantonments Act
1960	Capital Development Authority Ordinance
1999	Defense Housing Authority Lahore Ordinance
1999	Commercial Policy of Punjab
2002	Cantonments Ordinance
2004	The Punjab Local Government (Commercialization) rules

Legal Impediments

Transfer of Property Act (1882)	Does not envision that the state will guarantee title to property Even after the registrar enters the transaction in official records, it does not give any assurance of title to the transferor of property
Rule 135 of the Registration Rules (1929)	It is not the registrar's concern to establish any validity of the document

Legal Impediments

The Registration Act (1908)	Envisages the registration of documents and not the registration of titles itself. Thus, Land titling is not secure.
Cooperatives Society Act (1925)	<p>Made for promoting the wellbeing of poor farmers</p> <p>Now being used for the development of rich city housing projects for the influential groups</p> <p>Cooperatives formed by powerful groupings then use the land acquisition act in their favor. Those who lose are the poor.</p>

Misuse of Land Acquisition Act (1894)

- ❑ Sub section (1) of Section 4 :
- ❑ Allows for occupation of private lands by the government in 'public interest'.
- ❑ In practice this act is used against the poor. Compensation is always inadequate especially when land is to be rezoned
- ❑ A re-examination of zoning laws and regulations needs to take place to benefit the poor.

d) Non-Commercial Cities

- ❑ Rent seeking through cooperatives and the use of the Land Acquisition Act distorted the urban land market and the development of cities.
- ❑ Its is important for entrepreneurship to establish in cities because cities allow space for everyone and all activities
- ❑ The bulk of the output in any country is produced in the cities and it is noted that the difference between poor and rich countries often lies in the productivity of their cities

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FOCUS GROUP DISCUSSIONS

□ Held with businessmen at

- Lahore

- Sargodha

- Sialkot

- Gujranwala

□ Two interesting themes emerged from the discussions:

1. Absence of 'Innovation'

- ❑ Most of the businessmen seem to be involved in inherited business.
- ❑ The few entrepreneurs that we met had stumbled upon their business, did so as a result of some information advantage
- ❑ Most of the businesses were 'imitation.' Investment fashions appear to dictate entrepreneurship

2. Business is not Dynamic

- ❑ **Businesses** seem to grow to be large conglomerates and multinationals
- ❑ Small businesses seldom seem to even develop across cities let alone grow into international conglomerates
- ❑ **WHY?**
- ❑ Innovative entrepreneurship and dynamic markets which allow businesses to grow are a prerequisite
- ❑ Our respondents identified the following factors that were responsible for the poor business environment:

**ATTRACTION
OF RENTS**

**COSTS
OF
CORRUPTION**

**CONSTRAINTS
ON
FINANCING**

**Factors Responsible
for
Poor Business
Environment**

**LACK OF
RESEARCH &
EXPERT SKILLS**

**LACK OF
TRUST &
SOCIAL
CAPITAL**

**POOR
LEGAL
FRAMEWORK**

**UNFREINDLY
CITY
ADMINISTRATIONS**

a) Attraction of rents:

Businessmen expect the government to provide incentives

Example: businessman in smaller towns of Sargodha and Gujranwala demanded government protection against Chinese goods.

Given the established rent-seeking culture, businessmen, rather than focusing upon innovation expect government help

Most were always seeking a tariff or a subsidy advantage. Consequently, they were not comfortable with free trade in all products. Another example was the demand for cheap credit regardless of the cost to the tax payer

b. The Costs of Corruption

- ❑ Businessmen involved in manufacturing of various products, told that numerous government departments (**numbering around 15-20**) 'visit' enterprises with various threats to extort small sums.
- ❑ They collect anywhere from 0.2% of annual sales to about 5%. (tax incidence is higher on smaller firms)
- ❑ Businesses dedicate from 1 to 3 employees for dealing with this extortion!

c. Lack of Research, Expertise Skills and Knowledge

Business in Pakistan remains largely owner-operated and resistant to developing professional management

Business growth has traditionally depended on policy favors rather than on professional management

Clear mistrust of professional managers given that the legal and judicial systems may not prevent fraud, theft and outright misuse of business information

In all cities, there is no expertise for providing advice on key areas such as assisting project feasibility, operating a business, establishing brand names, and marketing

d. City Administrations Unfriendly to Small and Trading Businesses

- ❑ All the smaller retailers complained of a lack of quality space
- ❑ Poorer retailers who could not afford structured shops had to remain mostly in the informal market
- ❑ Urban administrations would not allow them into better parts of town
- ❑ The presence of cantonments within the city hinders commercial activity

d. City Administrations Unfriendly to Small and Trading Businesses

- ❑ Example: Sargodha cannot have high-rise towers due to location of PAF base within city limits → increased cost of doing business.
- ❑ Example: Commercialization rate is very high in Sialkot, higher than the one prevailing in Lahore.
- ❑ This prevents all sorts of construction needed by business from happening (the city of exporters has no proper hotel to date)

e. Poor Legal Framework

- All interviewees complained about the lack of rule of law
- There is no faith in the legal system to enforce even the basics of business—property rights and contracts

EXAMPLES

1. Businessmen prefer to use owning rather than renting premises because of poor state of contract enforcement
2. Participants of the focus group discussion held at Sialkot complained that the labor trained by one employer, either moves to another employer or opens up his own firm
3. Suppliers do not meet commitments in terms of delivery schedule and at times quality as well

f. Lack of Trust and Social Capital

Sialkot especially noted how the lack of governance and a quality legal and justice system was impairing business conditions

They pointed to an extreme lack of trust among their business community. In their attempt to hide business information they maintain mailing address and bank in other cities !!!

an important reason that businesses remain owner operated and do not grow is that professional employees cannot be trusted

Cluster Developments

- ❑ Sialkot, (surgical and sports goods industry)
 - ❑ Gujrat and Wazirabad (light consumer engineering)
 - ❑ Sargodha (agribusiness and light electric)
 - ❑ Faisalabad (textiles)
-

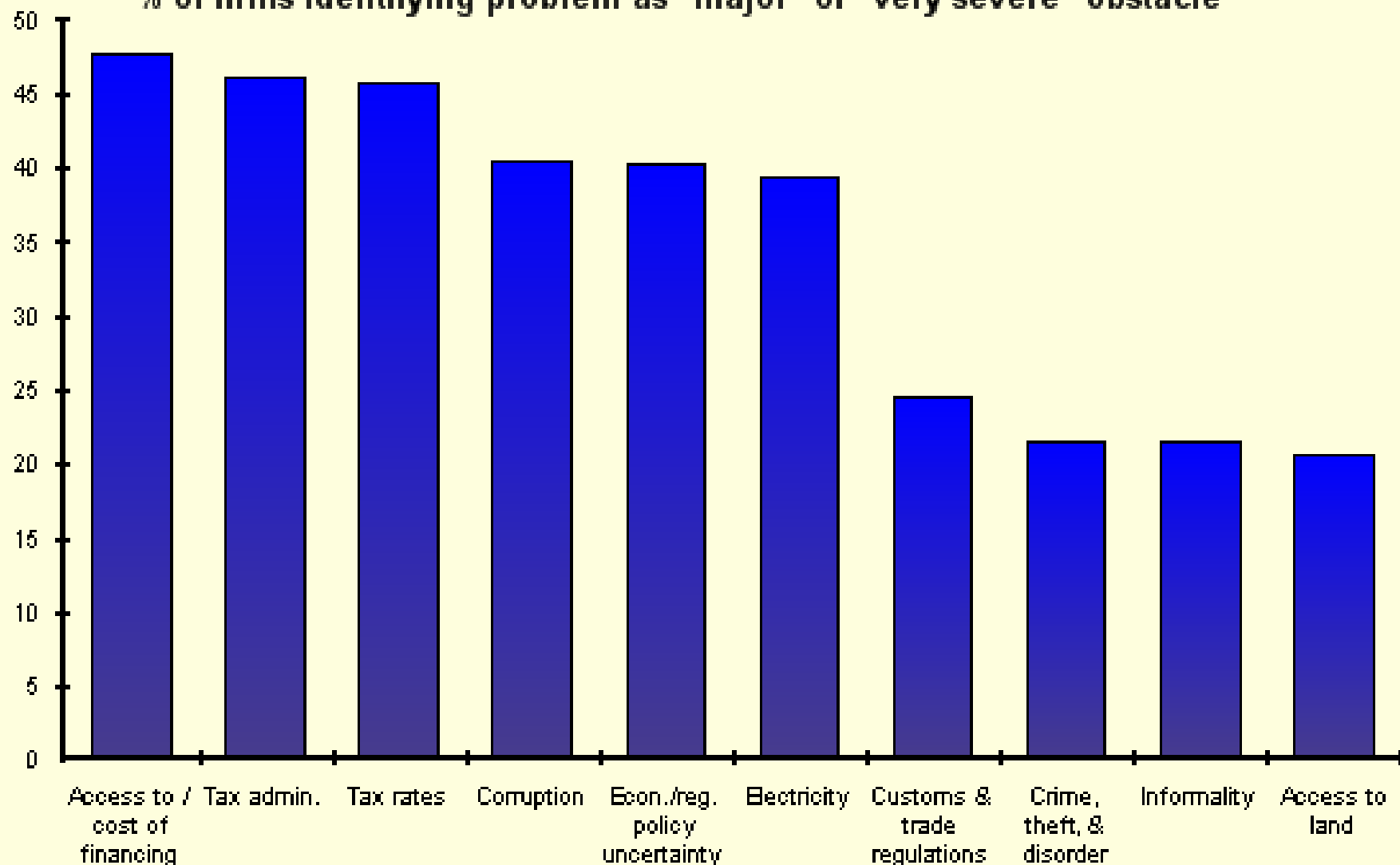
- ❑ However, this clustering has not led to any real development of ancillary activities that will facilitate business growth.
- ❑ Examples of such ancillary activities would be such as institutionalized skill development and knowledge development and sharing

g. The Constraint of Financing

- ❑ Small businessmen have little recourse to bank financing
- ❑ Only one person from Sialkot out of the approximately 50 people we interviewed in all, had had raised funds through the stock market.
- ❑ Most interviewees agreed that they did not know enough about financing through the stock market.
- ❑ Raising funds from the stock market is also not preferred to avoid sharing important business information with competitors and tax authorities.

Top 10 Constraints to Firm Investment in Pakistan (2002)

% of firms identifying problem as "major" or "very severe" obstacle



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Conclusion

Current Scenario:

Entrepreneurship is stifled because of rent seeking.

If entrepreneurship is to develop, deep government reform is needed which limits rent seeking, encourages innovation and fosters enterprise

The following is recommended:

RECOMMENDATIONS

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graph LR; R1[Reinventing the Role of Government] --- V[ ]; R2[Removing Instruments of Rent Seeking] --- V; R3[A New Growth Strategy] --- V; R4[Building Growth Cities] --- V; R5[Identifying 'Lemons'] --- V; R6[Releasing the energy of the domestic sector] --- V; V --- B[Brand Development & Management]; V --- G[Guarantees & Warranties]; R5 --> B; R5 --> G;
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Reinventing the Role of Government

Removing Instruments of Rent Seeking

A New Growth Strategy

Building Growth Cities

Identifying 'Lemons'

Releasing the energy of the domestic sector

**Brand Development
& Management**

**Guarantees &
Warranties**

a. Reinventing the Role of Government and Ensuring Rule of Law

- ❑ No society can progress without developing rule of law
- ❑ Once rule of law is strictly in place, the state has no favorites and rent seeking efforts dissipate
- ❑ Market competition does not take place on the basis of product development and consumer preferences but on unfair practices (influencing the government)
- ❑ Returning the government to take seriously its magisterial function has to be an important first step

b. Removing the Instruments of Rent Seeking

- ❑ There is a need to stop the policy of ‘sector-picking’
- ❑ A need for civil service reforms to eradicate corruption and rent seeking
- ❑ Government must get out of the business of land development
- ❑ The cooperative housing society act should be re examined before use
- ❑ Land acquisition law should be tightened

c. A New Growth Strategy

- ❑ Pakistan's growth strategy should be the subject of some debate.
- ❑ There may be a case for moving away from the current focus on government planning, production to a more market- and commerce-based approach
- ❑ The new approach would be more aligned with globalization, creativity, and innovation

d. Building Growth Cities

- ❑ Policy, research and thinking need to accept the role of cities as engines of growth
- ❑ Decentralization needs to be strengthened to allow cities adequate ownership of their land and resources
- ❑ City management should be professional, consultative and accountable
- ❑ Commercialization policy should be reviewed to remove the bias towards engaging in business

e. Identifying 'Lemons'

i) Brand development and brand management:

- Pakistan can boast of very few brands. We feel that to give a significant boost to entrepreneurship, Pakistani businessmen need to invest in brand development and brand management

ii) Guarantees, Warrantees/Returns

- Very few sellers, in Pakistan, issue guarantees in the first place. The ones who do offer guarantees quite often fail to honor the same in letter and spirit.

f) Releasing the energy of the domestic sector

- ❑ Pakistan has a very large market of over 160 million people waiting to be exploited.
- ❑ Administrations should review their zoning and commercialization rules and regulations to facilitate and promote commercial development
- ❑ Commercial activities may be treated at par with industry in terms of taxation and other government policies.

f) Releasing the energy of the domestic sector

- ❑ Domestic commerce should be made pro-poor by allowing the poor some space for entrepreneurship in all Pakistani cities as well as in all the best areas in Pakistani cities.
- ❑ Currently, none of the fancy markets, have any space for poor entrepreneurs.
- ❑ Q: ‘How and why have Bangkok and Singapore found space for *khokhas* and small stalls (while we in Pakistan officially prohibit it)?’

Final Words...

- A broad based reform agenda that arises out of a political economy analysis of the economy of Pakistan.
- More academic research and debate on fresh approaches to growth through entrepreneurship

THANK YOU

“

Entrepreneurs are risk takers, willing to roll the dice with their money or reputation on the line in support of an idea.

They willingly assume responsibility for the success or failure of a venture.”

“Innovation is specific instrument of entrepreneurship...the act that endows resources with the capacity to create wealth.”

(Peter Drucker – Founder of Modern Management)