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CHALLENGES FACED BY SME'S IN GETTING CREDIT IN SINDH: A CASE STUDY OF SINDH LARKANA

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ABSTRACT:

Small and Medium Sized enterprises (SMEs) are widely regarded as the nurseries of innovation, local development, employment and inclusive growth in developing countries. Yet in Pakistan, the SMEs show little to no access to formal credit market. The article aims to investigate the challenges faced by SMEs in getting credit in Sindh, with special focus on Larkana – an agri-industrial district of Sindh. Larkana is famous for producing rice, guava, horticulture and oil milling. The study synthesizes demand side, supply side and institutional constraints. With Larkana's underdeveloped economic structure, the SMEs are seasonal and hold light asset value to put up as collateral and access the credit market. The national figure shows SMEs penetration to credit markets as low as 5-6%. This article aims to present policy implications and proposes recommendations to encourage more SMEs penetration into credit markets, enabling them to grow and bring about employment, local development and inclusive growth.

INTRODUCTION

SMEs are considered as engines of growth in developing countries, unleashing innovation, regional development and local employment. This indirectly improves income, health, education, and life standards of local populations. Additionally, it also reduces crime, social evils and encourages social harmony in society.

In Pakistan, SMEs contribute to about 40% of GDP, claiming a share of 25% in Pakistan's overall exports. With respect to employment, it is the second largest source of employment generation in Pakistan after agriculture. Most of employment in SMEs is part of informal and shadowy economy. Given the economic importance, the SMEs are still systematically deprived to the access to credit markets. A report by SMEDA shows that the SMEs share to credit markets is just 6% of private sector credit markets (SMEDA, 2021).

These national patterns take a unique pattern in case of Larkana, a city in upper part of the province. Larkana has an agri-industrial economy, largely dependent on irrigation and wheat and rice crop. Additionally, it is home to guava production and hold stakes in oil and flour milling. In such a setting, credit demand is often working capital intensive or seasonal, with many businesses operating outside formal economy and bookkeeping practices. This adds more to problem than abating it, declining overall share of SMEs in private credit markets.

Therefore, this article aims to investigate challenges faced by SMEs in getting credit in Sindh, with special focus on Larkana. The article discusses the problems and proposes recommendations that help navigate the challenges faced by businesses in getting credit.

Credit Constraints Faced by SMEs

Despite numerous reforms by the State Bank of Pakistan (SBP), and introduction of risk-coverage schemes including SME Asaan Finance (SAAF) and Islamic SAAF, the SMEs penetration in credit markets remain thin.

Banks cite following reasons for constraints:

- Opaque information: Information is not well documented.

- Weak collateral: Small sized firms can not offer bank the collateral it demands.
- High delivery costs.

On the other hand, the SMEs cite following reasons for constraints to credit:

- Complex procedures: Banks operations include complex procedure which businesses struggle to meet.
- Hight interest rates historically, reaching 22% in recent years.
- Heavy colletral demands, which small business can not meet.
- Unfavourable loan size and maturity of loan.
- Absence of Shariah Compliant credit instruments.

In Larkana, these factors create friction with variety of other variables including the limited documentation of business and highly informal practices being used my rice mill and agro-industrial businesses. This creates chances of both adverse selection and hazardous policy options, creating a deterrence for banks to lend to SMEs.

Significance of Case Study

Much of the academic literature contributes to a broader, macro understanding of the issues at national level. This study focuses on district Larkana as micro unit, and seeks to understand the nuances involved at much micro level of SMEs eco system. Practically, Larkana's rice mill and agro-trade centers are strategically important for provincial value addition and employment and improved credit access can reduce breakage ratios in milling and support cold storage and pulp processing for guava and tomato crop. It will also improve formalisation of businesses and widen the tax base.

For policy makers, the study reveals geographical rebalancing of SME credit, which SMEDA (2024) shows is highly concentrated in Punjab, in both volume and borrower count.

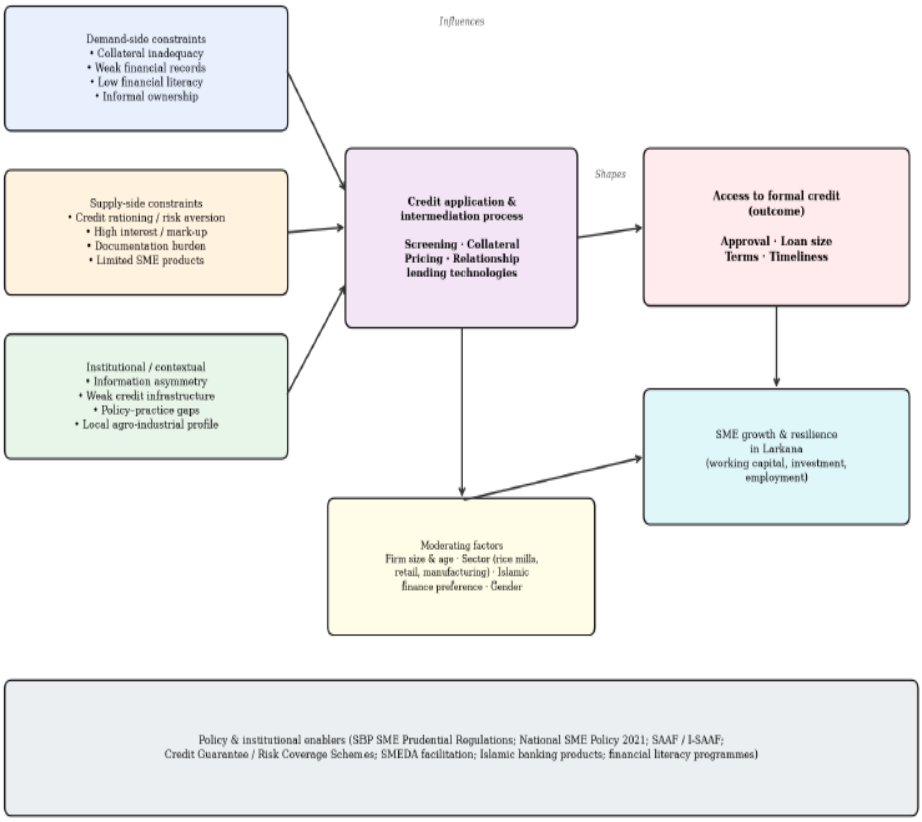
SMEs and Economic Development

A great deal of empirical literature confirms the role of SMEs in fostering employment and poverty reduction (Beck et al., 2005). In Pakistan, SMEs are the second largest source of employment after agriculture, but it largely operates with little equity buffers, uneven managerial skills, and outdated technology (Sherazi et al., 2013; SMEDA, 2021). A historic overview of the literature reveals that SMEs foster economic development in the following ways:

- Helps increase employment
- Reduce poverty
- Fosters inclusive growth
- Helps leverage demographic dividend
- Increase exports
- Fosters innovation
- Improves living standards
- Improves literacy
- Improves infrastructure
- Reduce crime
- Helps eliminate social ills
- Fosters an inclusive society

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Figure 1. Conceptual Framework: Challenges Faced by SMEs in Accessing Credit in Larkana-Sindh



Methodology

This section discusses the research data collection, analytical methods, data collection process, the levels of data analysis, data limitations, and the population range and the sample size that suffices the study and get the desired and statistically significant results.

Research Method

This study investigates and maps the unique challenges faced by the SMEs in getting loan and credit access, in situations in which they work. The study is limited to geographical unit of Larkana, Sindh with its objective business realities taken into account. The study uses the quantitative method, which is empirically more trusted method for studies similar to one under discussion. For the purposes of study and quantifiying the challenges faced by SMEs to receive the credit from banks and other financial institutions, the relevant "Terms and Conditions" of the banks formally registered with State Bank of Pakistan, are taken into account. Since, there is uniform policy, it is assumed that the "Terms and Conditions" in banks operating in Larkana will be same as in other parts of the country. Keeping this in mind, the study has been continued with Larkana as unit of investigation.

Data Collection Technique

Primary and secondary data sources collections were used for this study. For this study, the questionnaire was the main data base source. The questionnaire was split into three parts, with each designed to help identify the problems that SMEs face in getting credit while operating in Larkan's business eco system. The questionnaires were handed to SMEs operators and owners, and the

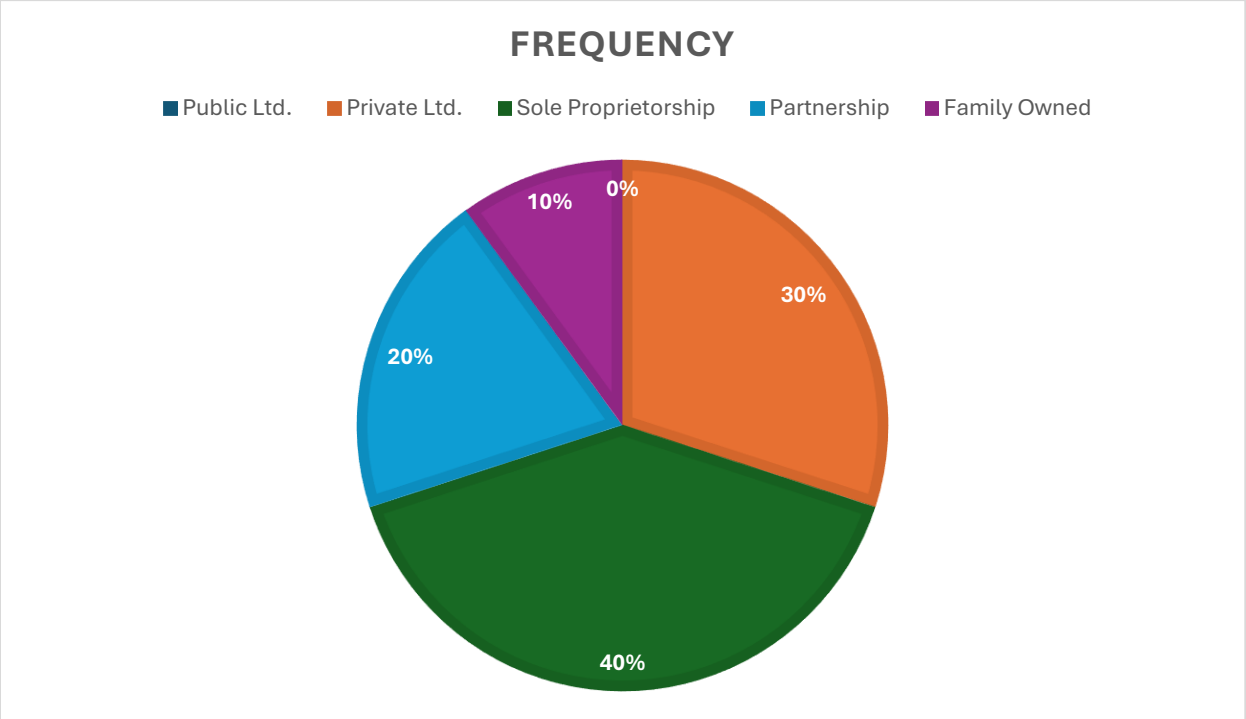
queries were designed to get answers helpful for the purposes of objectives of this study. The questions inquired the issues being faced by the SMEs, the cost of credit, the ease of getting credit secured as well as the future of SMEs in Pakistan and its prospects of expansion in other parts of the country.

For the secondary data, the literature review and Pakistan's policy papers were reviewed to better understand and identify the financial bottlenecks that the SMEs face.

Results and Discussions

Table 1 – Frequency Distribution on Nature of Ownership of Participant SMEs

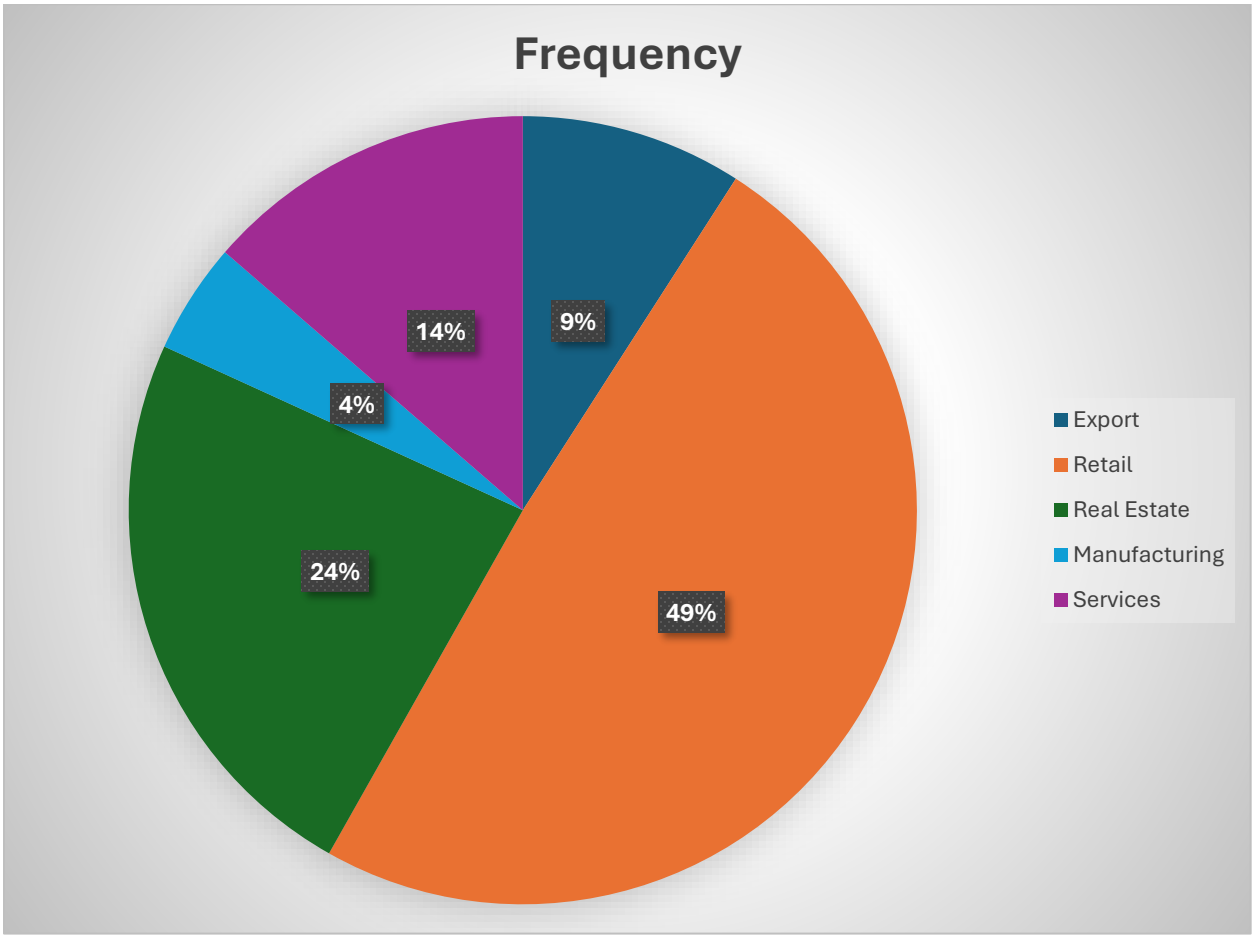
Ownership Form	Frequency	Percentage	Cumulative
Public Ltd.	0	0%	0%
Private Ltd.	30	30%	30%
Sole Proprietorship	40	40%	70%
Partnership	20	20%	90%
Family Owned	10	10%	100%
Others	0	0%	100%



The results above highlight that a major portion of SMEs running in Larkana are sole proprietorship, followed by private ltd. And partnership. The data also reveals the complete absence of any Public Sector SMEs. The data shows the scattered ownership spread across Larkana – the geographical unit of this study.

Table II: Frequency Distribution of Nature/Kind of Participant SME

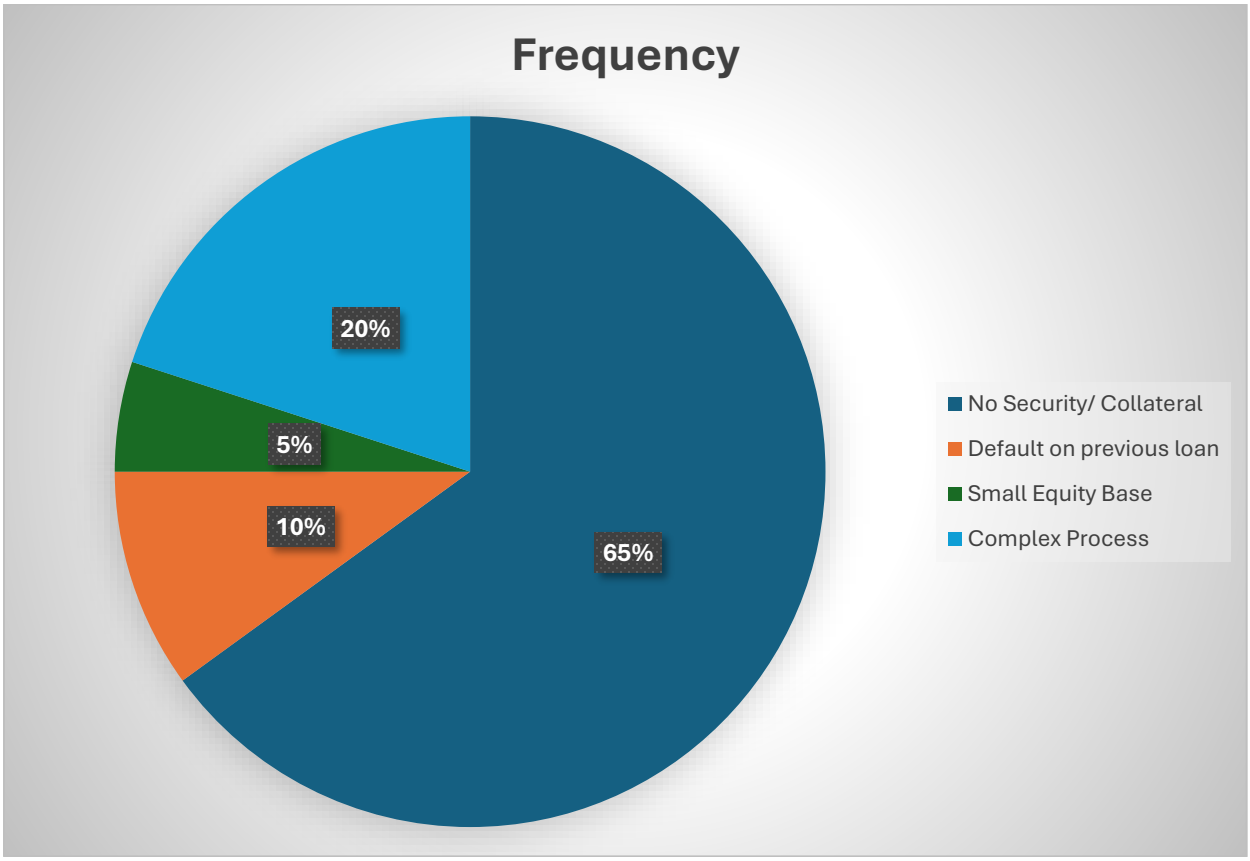
Nature	Frequency	Percentage	Cumulative
Export	10	10%	10%
Retail	54	54%	64%
Real Estate	26	26%	80%
Manufacturing	5	5%	85%
Services	15	15%	100%



The table above shows the impact of SMEs in broader provincial value chain. Although the export oriented SMEs are limited, a huge chunk of those SMEs operate as retailer, mostly in informal and undocumented economy. This reinforces the vicious cycle of SMEs being pulled out of credit market coverage. It is also observed that SMEs related to services are limited also. The SMEs are considered of strategic importance for export and services and Pakistan does possess prospects of growth, provided that the SMEs are offered healthy eco system with easy access to credit.

Table III – Factors that are barriers to credit access

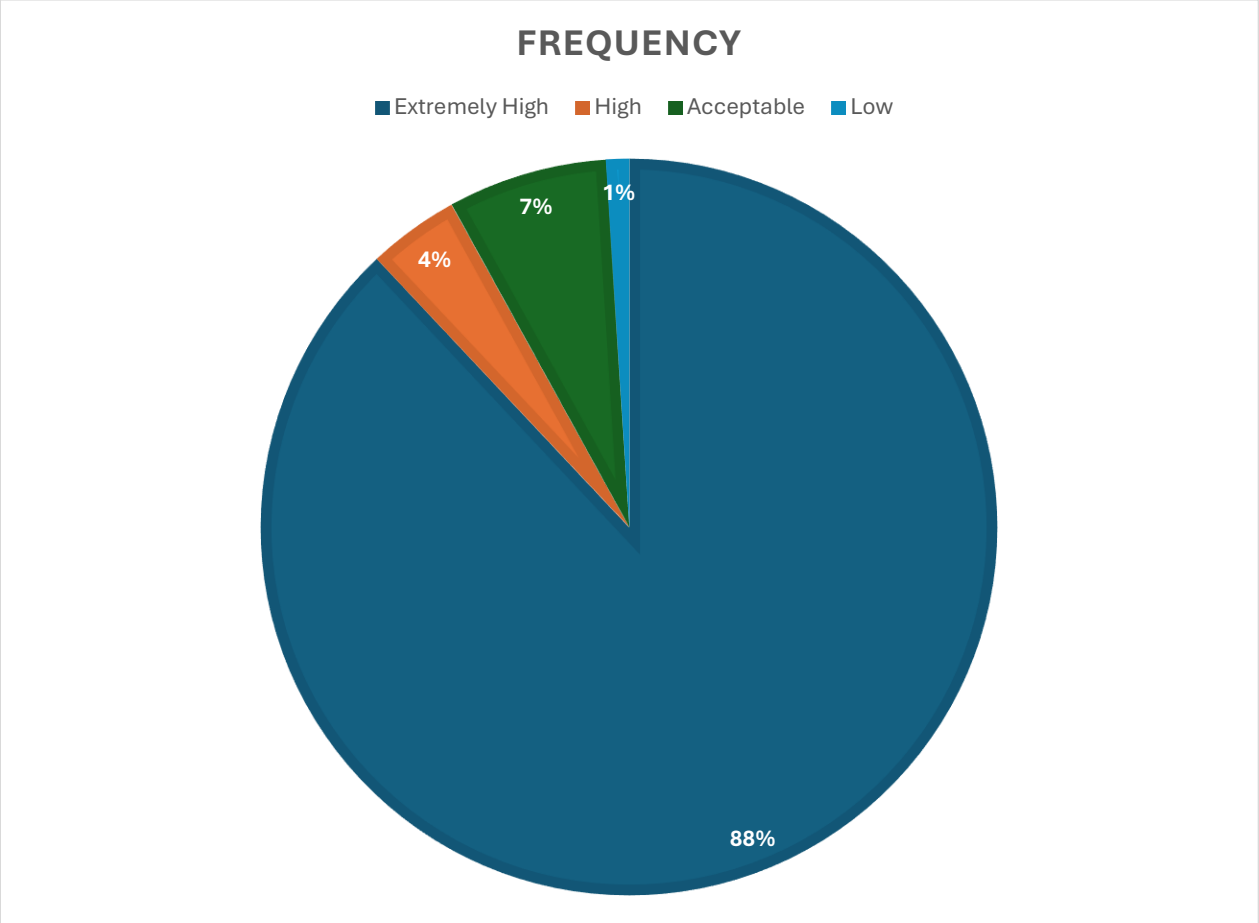
Factors	Frequency	Cumulative	Ranking
No Security/ Collateral	65	65%	1
Default on previous loan	10	75%	3
Small Equity Base	5	80%	4
Complex Process	20	100%	2



The survey reveals that the absence of security/collateral which is major requirement by banks across Pakistan makes the major and most critical reason because of which the SMEs fail to secure credit. Apart from it, the lack of banking literacy also add to the misery. From the 100 respondents surveyed, 20% reported to have issues with complex processes for securing loan, including banking technicalities, jargons and inability to access credit policy in local languages. Few respondents also reported to have defaulted on pervious loans, majorly for deteriorating economic conditions of the country and rising interest rates, which kept fluctuating across years, rendering their operations ineffective, and leading to default. Some respondents also pointed to their humble equity base for not getting credit they desire. Overall, the result notes that the SMEs operating in Larkana eco system with agro-industrial business nature, fail to secure loans from formal credit markets.

Table IV – Interest Rates as Constraint to Securing Credit

Measure	Frequency	Percentages	Cumulative
Extremely High	88	88%	88%
High	4	4%	92%
Acceptable	7	7%	99%
Low	1	1%	100%



The table above shows the role interest rates have played in deterring the credit access for the SMEs. A huge chunk of the survey respondents reported that the interest rates were exceptionally higher. This can be attributed to historic high interest rates in recent years, soaring as high as 22%. A minority of respondents report to have been satisfied with the interest rates i.e. 7% viewed interest rates acceptable while 1% reported that the interest rates were low.

This result also offers a distinctive perspective. Even if all the institutional bottleneck are removed, the credit access will still remain hampered if the macroeconomy of the country suffers. Because even if the banks are ready to lend, and the SMEs are willing to borrow, an interest rate as high as 22% will naturally deter any potential SMEs seeking credit. This also explains how micro level business eco system is affected by larger macro level policy instruments.

Conclusion

The article investigates in detail the constraints and challenges that the SMEs are facing in securing credit in Larkana. Through a well designed survey, it reveals the structure of SMEs, their types, potential constraints as well as macroeconomic factors – all of which contributing to SMEs inability to penetrate in credit markets.

Also, it should be noted that the issues faced by SMEs are structural in nature. Official estimates show that the financing share of SMEs in Pakistan is close to 6%, with gradual decrease in market share in recent years.

Apart from that the unique agro-industrial eco system of Larkana also create particular friction which deters banks from lending the credit. Factors such as seasonal working capital, absence of collateral, lack of documentation, literacy gaps, and potential faith sensitive presference for the Islamic banking – all contribute to Larkana being systematically underserved in formal credit market.

Last but not the least, the policy instruments such as National SME Policy 2021, SAAF/ISAAF, risk coverage schemes, and SMEDA facilitation need implementation at district level.

Recommendations

For Banks

- Establish the dedicated SME desks in Larkana with sector specific specialization in rice mills, retail, agricultural products and light manufacturing.
- Lending technologies that are suitable for the opacity should be deployed by the banks.
- State Bank of Pakistan's risk coverage schemes should be used to reduce first time borrowers exclusion to encourage inclusive financial inclusion.
- Product sheets for SAAF and ISAAF schemes should be printed in Sindhi/Urdu to overcome language barriers.

For SMEs owners in Larkana

- Invest in proper book keeping and accounting to reduce information opacity.
- Enter in documented economy to easily enter and access the credit markets.

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