

## Executive Summary

### Introduction

The domestic commerce sector is the vital link through which production of goods and services as well as the gains from international trade reach the consumer.

Despite contributing roughly one third to national GDP and 10% of aggregate employment, domestic commerce has not been the subject of research and explicit policy planning. The Domestic Commerce Survey, commissioned by the Federal Ministry of Commerce, seeks to reduce this research gap.

The report is divided in five sections. Section 1 gives details of sample representativeness and the methodology of data collection in each sector. Section 2 looks at firm level characteristics for the sample as a whole and for each sector. Section 3 then delves into the structure of the markets that prevail, i.e. the level of competition in the sectors and the entry barriers they face. It also makes some preliminary forays into levels of profitability and value addition as well as into the infrastructure side of 'cost of doing business'. In section 4, we delve into governance issues of contract enforcement, the regulatory environment, issues of law and order and the nature of collective action. Section 5 concludes.

### 1. Sample Size, Data Collection Methodology and Sector Characteristics

#### *1.1: Survey*

The Domestic Commerce Survey was conducted across four sectors: retail and wholesale markets, storage and warehousing, transport and real estate. The survey was carried out in a selected number of cities (including large, medium and small cities). In all, the sample comprised 2000 establishments.

#### *1.2: Areas of Inquiry*

Within the sectors the main areas of inquiry were regarding competitiveness, protection, subsidies and incentive schemes and regulation.

#### *1.3: Sampling Technique by Sector*

The sample sizes for the different sectors were determined thus that a population proportion could be estimated by the sample proportion within about eight percent with probability of 0.90. Tables A and B give the sample size in each sector and the cities in which the survey was conducted.

**Table A: Sample Size (Number of establishments)**

Sector	Sample
Retail	1000
Wholesale	500
Real Estate	200
Storage and warehouses	200
Transport	100

**Table B: Number of enterprises survey in each city (sector-wise)**

City	Retail	Wholesale	RealEstate	Storage	Transport
Faisalabad	90	45	15	15	10
Gujranwala	60	30	10	15	5
Lahore	140	70	30	25	15
Rawalpindi	60	70	10	10	5
Multan	60	30	10	15	5
Okara	40	20	10	15	5
Hyderabad	60	30	10	15	5
Nawabshah	40	20	10	5	5
Karachi	180	90	40	35	20
Sukkar	50	25	10	10	5
Peshawar	60	30	10	10	5
Abbotabad	40	20	10	5	5
Quetta	60	30	10	15	5
Islamabad	60	30	15	10	5

## 2. Firm Level Characteristics

Firm level characteristics provide the micro view of the structure of the market for domestic commerce in Pakistan. Capital invested in the firm at the time of its initiation and owner's experience in the business (in owner driven businesses) are important indicators of firm size and human capital developments. In this section we also look at the level of access to other business services for the sectors that were surveyed.

### *Firm Size*

The level of start up capital appears generally low for all sectors. Once we discount the possibility of underreporting, this data indicates that the size of firms across all sectors is small. Smallness of firm size is further corroborated by low levels of full time employment also.

We further disaggregated firms according to their age to check if there is a pattern over time with regard to the size of firms and the only sector where firm size appeared to have increased over time is storage.

### *Registration Status*

Registration is a proxy for the 'formal' nature of the enterprise. Roughly half of the establishments surveyed across the sectors were registered. Registration, it appears, is closely correlated to firm size (smaller sized firms tending to not be registered). The lowest level of registration is found amongst retail outlets while the highest level is in the storage sector, possibly due to the high share of capital intensive nature of activities. Given a higher proportion of smaller firms in the wholesale and transport sector, the level of formalization through registration is low in these sectors.

### *Employment Patterns*

Mean full time employment levels across all sectors is 3. Given the overall smallness in the size of firms, in no sector is the level of mean employment higher than 9. As expected, the mean level of full time employment is 3 times higher in the transport and storage sector compared to that in wholesale and retail. Part time employment, contrary to expectations, appears fairly low across all sectors.

The data indicates that the sectors surveyed have overall low employment generation capacity. However, given the relatively labour intensive nature of this segment of the economy, it is a potential employment generator at the lower end of the skill segment of the population.

### *Human Capital*

Information on human capital endowments is available, albeit partially, for both owners as well as workers. Detailed information on education and training for owners is available for the storage and transport sectors. Bulk of the owners in both sectors had gone through on the job training, working as employees elsewhere while the remaining, more than half of the owners said they had learnt their vocation either from friends and relatives or were self taught and a small group had been to a technical college. Information for educational attainment of employees was obtained for the retail, wholesale and storage sectors. The low level of education is likely to pose an impediment for firm growth.

### *Access to Financial Services*

Data collected on this important area of concern was on sources of finance used for starting the business and subsequently those who sought access to financing in the last five years for purposes of either initiating a business, further investment or working capital. We also explore data for reasons that entrepreneurs could not access the financial sector.

The predominant form of startup capital has been family savings and sale of assets. Across different sectors also, resort to formal sector credit for business startup was low across all sectors. Loans from the informal money markets are also miniscule.

From the data, we can tentatively conclude that in an overall context of low levels of borrowing, access to the formal financial sector was not uncommon while there is extremely low level of access to the informal financial market. We further checked if firms that are larger in size tend to access the formal financial sector compared to smaller firms. Using start up capital as a proxy for firm size, we see that firms with higher startup capital have a greater propensity to borrow from banks than smaller firms, but the difference is minimal.

Procedural problems of acquiring loans also kept away some 27 firms from acquiring loans from the formal financial sector. One of the most prevalent reasons for credit denied from the banks was the lack of collateral.

Data on the purpose for which loans were acquired demonstrates that the bulk of the borrowing took place for expansion of businesses rather than for working capital requirements.

### *Use of Other market Services*

An important indicator of a robust domestic commerce environment will be the use of support services. Engineering services will be most relevant for the transport and storage sectors, with the use of trucks and lorries; consequently the demand for engineering services was highest amongst these sectors. However, given the engineering 'intensive' nature of these sectors the level of demand is low.

Demand for management consultants was low across all sectors. The demand for marketing services, on the other hand, is much more prevalent amongst all sectors. Demand for accounting services is significant only for storage, necessitated by requirements for inventory management. The use of legal services was most prevalent in the transport sector. The demand for insurance services is again low, considering that it is an important service for all four sectors, both in terms of their fixed assets as well as inventory. The use of information technology, as expected, is minimal. The only sector which expresses demand for it is storage, though usage in this sector is also fairly low.

## **3. Competitiveness and Efficiency of the Domestic Commerce Sector**

Efficient use of resources in domestic commerce is an important prerequisite for sustained growth in the sector. Based on conventional economic wisdom, a competitive environment is an important condition for efficiency. Discussed in the following sections are important measures of the level of efficiency and competition including barriers to entry, levels of profitability and value addition and cost of and access to infrastructure.

### *3.1. Market Competition*

The survey measured competition on the basis of similar enterprises with a certain radius of the firm that was surveyed. According to survey results, market competition was intense in the retail sector. Wholesale markets are generally clustered by nature of goods, so market competition was fairly intense. Market competition was also fairly intense in the storage and trucking sectors.

### *3.2. Barriers to Entry*

In the retail, wholesale and storage sectors, capital requirements (or the need for finance) were cited as the most important barrier while the need to have personal contacts in the proposed business, government regulations and tariffs were also important barriers to entry. In road transport, although barriers to entry are minimal in absolute terms, minor irritants include large capital requirements while corruption and government tariffs are the major ones.

### *3.3. Value Addition and Profitability*

Due to unavailability of comprehensive data across time on prices as well as operating revenues and expenditures, our analysis of value addition has been restricted to retail, wholesale and transport sectors only.

### *Transport*

Within the transport sector, it has been difficult to obtain data on prices, operating revenues and expenditures. However, output indices for the sector (excluding aviation, due to lack of the above mentioned data) have been calculated while weights for value added index have been calculated for the road sector only.

A steadily growing transport index is observed, where the total, passenger and freight indices follow extremely similar trajectories. A relationship may be discerned between the transport output index and the national GDP growth rate; the relation is inverse suggests an average 3-5 year lag period between the movement in the transport index and GDP growth. Forecasts for the transport output index up till 2009-10 suggest a significant upturn in the sector, given the high GDP growth rates since 2002-03 and the presence of a 3-5 year lag. Secondly, passenger services are likely to grow at a higher rate than freight as confirmed by survey results.

Relative weights for a value added index for the road sub-sector reveal passenger services to be marginally higher than freight. Due to unavailability of data, weights could not be calculated for the rail sub-sector. A cursory examination of the rail sub-sector reveals that freight services cross-subsidize passenger services while the core commercial network cross-subsidizes the non-commercial network. As far as rail's prospects go, the bulk of its operations constitute passenger traffic. Although it is the most cost-effective in terms of containerized cargo clients appear to prefer paying higher prices for more efficient container transport.

### *Retail*

Value added in this sector is calculated through use of the data on revenues, expenditures and profits obtained from the survey. Due to the likelihood of misreporting of profits, estimates of value added must be considered with caution. Average monthly value added was estimated at almost Rs.95, 000; however, the distribution was significantly skewed and reflected provincial disparities in commercial activity.

### *Wholesale*

Value added in this sector is calculated through use of the data on revenues, expenditures and profits gained from the survey. Due to likelihood of misreporting of profits, estimates of value added must be considered with caution. Average monthly value added was estimated at almost Rs.54, 000; however, the provincial disparity was again observed.

The only conclusion that can be drawn for the wholesale and retail sectors on survey information is that profitability, on average, is low. If growth in this sector is to be promoted it will require firms to increase their size rather than merely smaller firms

entering the fray to meet existing demand. This is where linkages with efficient and accessible infrastructure and other market services will be critical.

### *3.4. Infrastructure: Bottlenecks*

One important component of the cost of doing business is the cost at which infrastructure is provided to the commercial sector. According to survey results the cost of electricity dominates among the three infrastructure items, except of the wholesale sector where the cost of telephony is somewhat higher.

The cost of electricity in Pakistan, especially for commercial enterprises costs, is much higher than that in the region; if growth in the commercial and industrial sectors is a priority then the government will have to find a rational approach to cross-subsidization.

Infrastructure related losses due to the state of the road network are most constraining for the road transport sector. Given the priority that is being given to road construction and road works in the last few years, it is hoped that the situation on this front will improve.

### *3.5 Constraints to Growth*

Chief among constraints to growth is limited access to finance across all sectors. Small establishments are left out of the loop of formal credit markets due to the absence of collateral and unavailability of credit history. Furthermore even in the informal credit market, the need for personal contacts or the lack of collateral disadvantages small establishments.

Taxation and regulation are also oft-cited primary constraints to growth. A tough tariff regime and the sales tax are impediments to growth in the retail sector. Quality of public services (including condition of roads) is cited in many cases as a primary or secondary constraint to growth.

In the retail, wholesale and storage sectors there was no additional space on which to expand. The storage sector faces costs in terms of conversion fees given the lack of specified storage space while the transport sector faces problems with respect to the maintenance of the highways and roads in general.

Corruption and law and order are cited as significant constraints to growth. Lack of confidence in the formal justice system is betrayed by the fact that a majority of both serious criminal and business disputes are resolved through negotiation in all sectors. Furthermore corruption leads to bribery costs, in particular for the transport sector. Regulation on property rights ownership is the least frequently cited constraint to growth in all four sectors.

## **4. Governance**

Governance is now acknowledged as the critical ingredient in sustained growth and productivity improvements. Governance issues on which the survey concentrated were: contract enforcement, law and order, taxation, regulation and collective action.

#### *4.1. Contract Enforcement*

Details on the nature of the contract were only available for the transport and storage sectors. The results suggest that the majority of contracts are of a simple nature (often statements written on a plain paper and signed by both parties) while in a small minority of cases electronic receipts or more formal contracts were used. In the few cases where contracts are not used at all, either the two parties enjoy an established professional relationship or the transaction is certified by a system of honour or by a payment in advance. In the retail and wholesale sectors, the only detail on contract forms is regarding the receipt that is given to customers in 50 and 72 percent of the cases respectively.

Data on contract enforcement, however, provides conflicting results: around 90% of the retail, wholesale, storage and transport sectors agreed upon having to rely on the reputation of those they enter into contracts with while more than 80% of the respondents agreed that a contract would protect them from being cheated. This depicts a contradiction in that if the contract provides protection than the reputation of those entered into contracts with should be immaterial. Furthermore the survey results suggest a lack of trust in people from different communities or cities for a substantial portion of the sample, belying the data suggesting high incidence of faith in the legal system and contracts. Also, across the four sectors a very low incidence of seeking police intervention in disputes is observed.

#### *4.2. Corruption and Law & Order*

In all four sectors, corruption and law and order have been strongly cited as third ranked constraints to growth.

In rail transport, there is a high incidence of pilferage and switching of items such as live animals. While there is a formal system of compensation if the loss can be proven, the complaint that rigid rules make it difficult to obtain compensation is common.

In the storage and wholesale sectors the large majority of disputes appear to be over late payments. Most of the disputes were resolved through negotiation in both sectors and formal justice was not sought. The incidence of serious crimes was low in these two sectors. Within the wholesale sector, another common contravention of the law is illegal encroachments which are ignored by corrupt officials in Market Committees. In the retail sector, the incidence of serious crimes was higher. However, only a few of the cases were reported to the police and dispute resolution was achieved largely through negotiation.

#### *4.3. Regulation*

All five sectors cite regulation systems as one of the top ranked constraint to growth. Though the lack of clear regulation on property rights is not seen as an impediment to

growth among the majority of the sample, zoning regulations are the most frequently cited constraint across sectors. Regulation regarding access to finance is unfriendly towards small enterprises in all sectors. Another important aspect of regulation is a tough import tariff regime, which has resulted underdevelopment in all four sectors. Lastly registration is an aspect of regulation that is not adhered to in a large number of enterprises in the sample. Below we discuss regulation issues pertinent to the different sectors.

### *Retail*

A tough import tariff regime has negatively impacted retail in both directions of the link in the supply chain. Formal and informal credit facilities are usually denied to retail establishments owing to their small size. Government initiated financing schemes are one possible source for these establishments but stringent requirements for classification as a Small and Medium Enterprise (SME) has meant that several retail establishments have been left out of the loop even when financing options are made available for small enterprises. Lastly, urban zoning is particularly unfriendly to small retailers, lacking capital to enter expensive market places.

### *Wholesale*

Wholesale markets are ill planned in Pakistan, whether they be privately owned or under the administrative control of Market Committees. Typically these markets are congested, lack well designed entry and exit points and other infrastructural facilities (such as roads, storage, etc).

### *Storage*

Storage is in many cases a highly seasonal business yet majority of those who reported seasonality did not convert their facility to any other use during the 'off season'. 15 percent of these cited regulations as not permitting use of storage facility for any other purpose.

Zoning regulations do not specify land for warehousing purposes but industrial plots may be used for warehousing (in the case of Karachi and Islamabad, on the payment of a conversion fees). Considerable delay can occur in acquiring utility connections.

### *Transport*

Given the low rate of mobility of women in Pakistan, regulation has a pivotal role to play in the transport sector. Regulation to eliminate any gender bias is essential for greater contribution of women as clients of the transport sector, as well as to the overall economy.

Contravention of regulation is regularly observed in the road transport sub-sector, particularly with respect to road safety protocols. In 1992, Pakistan's road fatality rate

stood at 18.62 fatalities per 1,000 vehicles, reflecting the highest rate in Asia while economic losses due to lack of safety measures are estimated at over 2 percent of GDP. The transport industry, too, is equally guilty of not participating in a process to redress the institutional bottlenecks as the industry perceives lax implementation of laws to be in its favor.

Zoning has resulted in travel routes being restricted for transporters both within urban towns and on inter-city routes, amounting to both monetary and time losses.

Lastly the tough tariff regime has resulted in an aging truck fleet. Replacement and maintenance of the fleet is severely restricted due to this aspect of regulation.

#### *4.4. Taxation*

Taxation is considered one of the key constraints to growth by 16-25 percent of respondents in the aggregate sample. Within the retail sector, sales tax (GST) is considered to be a disincentive to growth as small retailers can easily evade taxes while more visible supermarkets are under regulatory scrutiny.

#### *4.5. Associations and Collective Action*

Collective action through industry associations in the transport sector is the highest with 75.5 percent of the sample being members of transport associations. While 45.8 percent of real estate establishments are members of associations, 47.3 percent of storage establishments are members of market based associations 58.7 percent of retail and wholesale establishments are members of market based associations.

Trade union data is available only for the transport sector. Transport unions, while active, are not effective. Union action often results in temporary compromises, but at an immense cost to the economy in terms of stalled economic activity. The strikes however are not of an extended duration.

Prevalent opinion is that the country's trade associations have failed to develop successful institutional relations with the government.

### **5. Conclusion and Areas of Policy Focus**

This survey, the first of its kind, has brought forth a number of preliminary conclusions from which we can draw on a number of areas where the Ministry of Commerce can take policy initiatives.

The *retailing and wholesaling* business is the front end of commerce. The most important result we draw from the survey with regard to this sector is the small size of enterprises. Enterprise level growth is primarily a function of the levels of income in that particular area and the economy in general. The conventional hypothesis that the growth of the retail and wholesale sectors is endogenous to the size of the market appears to be borne out by the survey.

This is not to say that policy does not have a role to play. Access to formal sector credit is a constraint. The newly introduced SME and micro credit banks that do practice unconventional banking should be encouraged to reach out to this segment of entrepreneurship also.

Urban land use policy and high land prices (in the recent past) also create a serious disincentive for growth. A rational land use policy, coupled with appropriate zoning laws that are enforced will go a long way in the planned growth of all areas of domestic commerce also.

Contract enforcement and dispute resolution also requires that the capacity of small claims courts and business tribunals is enhanced, while the creation of consumer courts is important for protection of consumer rights.

The development of the *storage and warehousing sector* is endogenous to the wholesale, retail and international trade development. As such, much of its development will take place once the other two chains develop. However, the development of the sector is critically dependant on issues of urban zoning and planned linkages with the transport infrastructure. Another area that is important for this sector (as well as transport) is that of insurance services. Predictable and affordable insurance of goods and assets will increase demand for these services and reduce risk and uncertainty for the entrepreneur also.

For the *transport industry* as a whole, a supply chain management approach with an inter-modal transport system attaining optimal productivity should be adopted. The new road transport legislation seeks to address many of the bottlenecks highlighted in the preceding discussion. Implementation and dissemination of the legislation need to be focused on. Moreover, measured steps should be undertaken to integrate trucking into the formal economy. A revision of the current restrictive industrial and import policies for vehicles and auto parts is in order. The import policy needs to be relaxed and the domestic truck assembly plants also need to be modernized.

One way of bringing the industry into the formal economy is by mandating a carrier registration policy. Through this process, the road sub-sector's services could be standardized with relative ease. This said, realistically, a registration drive would have to provide sufficient incentives to the transport entities to register themselves.

The change in the structure of the industry from a large number of small-scale enterprises to well organized large entities competing against one another requires attention to 'soft' management issues such as automation, marketing, and availability of a well trained labor force. Transport firms could also be provided incentives to automate services, perhaps by subsidizing their transition.