

# THE ROLE OF SMALL AND MEDIUM ENTERPRISES ON POVERTY REDUCTION IN DEVELOPING COUNTRY: A CASE OF PAKISTAN

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## Abstract

*This study has been conducted to examine the size of impact of Small and Medium enterprises to eradicate poverty in Pakistan over the period of 2001-2017. Study investigates relationship between Small and Medium enterprises and poverty reduction by using secondary data from World development indicator by estimating simple linear regression model. Results indicate that small medium enterprises have negative and significant association with poverty. SMEs generate employment opportunities which contribute to the poverty alleviation in the economy of Pakistan whereas this study will helps policy makers by suggesting exact size of impact of small and medium enterprises on poverty alleviation. Moreover, human capital significantly reduces poverty in Pakistan. As human capital increase, it causes to lower poverty growth rate. Similarly trade and inflation also has significant association with poverty, however, inflation and poverty has positive association while trade has negative association with poverty growth rate in Pakistan. The value of R square (0.756) indicate that model is good fit and F-ratio states the overall significance of the model. Therefore, results suggest that government should adopt the policies that promote SMEs growth rate, trade openness, human capital, GDP and lower inflation rate to control poverty in Pakistan.*

**Keywords:** SMEs, Poverty Reduction, Government Expenditure, Inflation, Trade Openness.

**JEL Classification:** L000

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## Introduction

Poverty is a stipulation where individuals are unable to meet basic economic standards of life. Poverty is not only a curse for individuals but it brings dynamic impacts on developing economies as nowadays Pakistan is facing this challenge in broader way because of its political instability (Theng & Boon, 1996). This fact has been realized after comparison with current and past situations, where earlier all graduates and specialized got job with hundred percent guarantees after having their degrees. They were having different opportunities and offers peculiar to their qualifications. This is the time when economics of Pakistan should realize their significance role by taking sensible verdict to improve their industrial sector for upcoming generation to play their role actively (Ali, 2013a). Government opportunities are not enough our small medium enterprises can play a vital role for generating employment levels as in this industry more human capital is required. This fact is associated with the increasing population of Pakistan where labor supply is increasing with high pace.

Policymakers should give serious attention to raise economic and social level of Pakistan by generating employment level, which can be achieved by giving special importance to the industrial rising problem of unemployment started around 1990's in Pakistan where graph of unemployment ascend from 3% to 8%. That causes disequilibrium in the labor market by increasing unemployment in the industrial sector. Poverty becomes a burning issue to resolve at its earliest possibility with the assistance of establishment of Small and Medium enterprises in the Pakistani economy (Turker, 2015). This is the time to realize that labor market is entirely different from the commodity market as they need complete attention, motivation and remuneration to work at their full capacity. To remove poverty from the economy, it is needed to work on human capital and their needs at social and personal level. The role of SMEs is clear in every economy, but the point of ambiguity arises in Pakistani context that weather they help to alleviate poverty from the economy of Pakistan? As most of the time sectors play their individual role and contributed socially but they might not help to improve economic issues; the reason of this is advancement of technology and awareness. So the need arises to investigate the role of SMEs particularly in Pakistan to remove poverty (Ali, 2013a).

The theory of development indicates that it grows by the development of the SMEs especially the third world countries (Herman, 2012; Islam, Khan, Obaidullah, & Alam, 2011; Oba & Onuoha, 2013). SMEs have positive effects in the national development of an economy not only operationally but nominally as well. The Small and Medium enterprises increase the capacities of the nation by providing the entrepreneurial training opportunities associated with investment for the labor related operations which is a strategy on the part of the economy to decrease the poverty among people. Almost throughout the world SMEs have dominant role in the economic growth of the nation to reduce poverty. In emphasizing the importance of Small and Medium enterprises Agwu and Emeti (2014) stated that: they enhance capacity and abilities of the people executing the entrepreneurial training avenues; which in return create more employment opportunities through investments in these

entrepreneurial activities. In addition economy is working on more labor intensive products as it add value in products. On the other hand small medium enterprises are playing vital role to boost economic activities which are industry related goods.

### **Literature Review**

The SMEs bring actions which ultimately become major traders of transitional goods and raw material for small and large-scale industries. Similarly SMEs also playing important role as mediators for the distribution of finished products of large scale enterprises and provide chances for the growth of domestic services and technology attainment through adaptation which ultimately helps to reduce the poverty from the economy. As Ali (2013b) discussed that an effective and fully funded policy needs to be designed for the development and betterment of SMEs. SMEs are supposed to generate employ chances for economic growth, and struggle to empower the poor and deprived people of Pakistan. Moreover SMEs are focusing in labor intensive techniques while production process so they focus more on rural areas where more labor is easily accessible. In addition Eneh (2007) shed more light on causes of poverty, when unemployment increases because of less resources and promoting culture of capital oriented goods that labor intensive goods which ultimately cause to increase hunger, malnutrition, bad health and less access to education like issues arises .On the other hand, in West Virginia, it has been observed that indices of poverty and development of small scale business are strongly and negatively correlated. (Gebremariam, Gebremedhin, & Jackson, 2004). But at the same time few studies indicate that development usually starts in metropolitan cities than country side so SMEs are neither playing important role in rural areas and nor help in reduction of poverty.

In case of Pakistan SMEs are not effective as compared to other developed and developing nations because of financial constraints and stubborn policies of the Government (Ali, 2013b).Moreover a study also reveals many models proposed for the reduction of poverty from rural areas other than specifically work on the progress of SMEs (Bowale & Akinlo, 2012). Where the National Directorate of Employment, defines small scale industry as a formation where capital investment can be more than 5,00,000 and having labor less than four people (Oba & Onuoha, 2013). According to Agwu and Emeti (2014) “90% SMEs did not perform efficiently because of lack of experience and incompetence”. Similarly, MBUYISA and LEONARD (2015) added inefficiency in overall business management and poor record keeping is another hurdle in the development of SMEs. Moreover, other problems may associate with progress of SMEs as lack of competency, expertise maintenance issues, wrong marketing strategies drives unrealistic targets and misallocation of funds which may cause obstacles in the growth of SMEs which ultimately mislead them to perform their due role as poverty reduction from rural and urban areas. On the other hand, the National Association of SME also revealed that SMEs are playing an important role to improve economic progress of the country and helping in poverty alleviation.

Nowadays the role of SMEs for developing different sectors is the burning issue of literature other than only economic growth. The special area is still to explore the role of SMEs for the development of unskilled labor for reducing poverty and removing the problem of income inequality from less developing nations (Beck, Demircuc-Kunt & Levine, 2005). Moreover poverty is a state which can get influence from different sectors but usually it is considered that poverty arrives when people have less access towards economic opportunities. Therefore SMEs help to achieve socioeconomic objectives to alleviate poverty through developing employment opportunities at gross level (Oba & Onuoha, 2013). Moreover poverty may arrive because of other reasons such as: natural disasters, environmental issues, wars or any structural changes by the policy makers of reducing employment level, it may cause transitory poverty. The adoption of labor intensive industries can help to enhance economic growth of the country which ultimately help to reduce the gap between rich and poor economies (Ali, 2013b; Mazumdar, 2003). Large scale business are capital intensive industries whereas SMEs are more labor intensive industries so they can play an effective role to reduce poverty from the economy (Hallberg, 2000).

Moreover, low income countries for example in African economies SMEs are playing important role for reduction of poverty at massive level. The supporters of pro manufacturing SMEs are of the disagreement that SMEs establish environment of entrepreneurial and innovativeness which help to improve growth of the economy and reduce the poverty levels in developing economies (Beck et al., 2005). "The development of SMEs helps the economies to grow in the long run because these enterprises enhance domestic market efficiency and uses the limited resource productively" (Abor & Quartey, 2010). However, insufficient Infrastructure, lack of favorable atmosphere for the development of SMEs, the problem of organizations, shortage of water supply, inadequate transport systems, lack of energy, and improper solid waste management causes to lower the standard of living, enhance poverty. Lower the resources of individuals are less satisfactory to provide an informally satisfactory condition of living because of poverty. Agwu and Emeti (2014) stated that one problem of SMEs is absence of scheduled planning. As specifically in Nigeria it is observed that less developed countries are weak in physical and social infrastructure so they can get boost by the growth of SMEs. SMEs perform poor because of low capital and they are depending upon Government support or SMEs friendly policies from different financial institutes (Mukras, 2003). SMEs are unable to reduce poverty from rural areas as compared to urban areas which help to reduce income inequality from selected regions of the country. If labor intensive industry is more highlighted as compared to capital intensive then economy may start a drive towards poverty reduction. The role of micro firms like SMEs for poverty alleviation but at the same time study does not confirm the poverty alleviating impact of SMEs in an illustration of selected countries (Agyapong, 2010). SMEs can only be effective when there issues are resolved through proper system and strategies to encourage business environment (Ali, 2013b).

*Hypothesis:*

Does a Small and Medium enterprise play any role to reduce poverty in Pakistan?

**Methodology**

Simple linear regression model is used to examine the role of Small and Medium enterprises and poverty reduction in Pakistan. A simple regression model is employed to evaluate the size of impact on dependent variable because of independent variable. Moreover it explains the significance of results which ultimately helps policy makers to take decision accurately (Bates, 1988). This study used a data set for analysis contains one dependent variable that is poverty and independent variable which is small and medium enterprises and along with that five variables: GDP, Trade, CPI, Government expenditure, and income inequality are taken as control variable.

*Econometric Model*

$$Y_t = \alpha + \beta X_t + \epsilon_t$$

*Unit Root Test (Augmented Dickey- Fuller Test)*

Prior to statistical analysis, non-stationary and Co integration are tested for unit roots and co integration. Stationarity of data implies that means and variances of data are constant over the time. To check the null hypothesis of non stationarity, Levin and Lin Test (1992), and Im-Pesran test is utilized. Results are reported in table 1.1. Results indicate that data is stationary at level. If the data is stationary at level then in the next step we will check correlation among variables. Results are reported in table 1.2, 1.3, 1.4 which shows size of impact of small and medium enterprises on poverty reduction.

Table 1.1  
(Unit Root Test)

Series	Coefficient
GDP	-6.43034*
Trade	-2.80276*
CPI	-17.0376*
Govt. Exp	-14.3736*
Inflation	-8.03394*
GINI	-4.41630*
HRATIO1	-24.5667*

\*Means significant at level

Unit root test applied with individual intercept at level. The outcome of applying the unit root tests is presented in Table 1.1 and results shows that all variables are stationary at level at individual intercept. None of the above variable is stationary at first difference. So, we find that simple regression is more appropriate technique for assessment in present circumstances. So we can apply multiple regression to evaluate the relationship among trade openness, Consumer price index, government expenditure, inflation, income inequality and economic growth.

### *Descriptive Statistic*

Table 1.2 shows the synopsis information of the variables used in the model to estimate SMEs and Poverty Reduction in Pakistan. Descriptive statistic table shows statistics of all modeled variables from 2001-2017. These statistics include mean, median, minimum, maximum and standard deviation of all variables. Summary of all variables are given below.

Table 1.2  
*Descriptive Statistic*

	<b>Mean</b>	<b>Median</b>	<b>Maximum</b>	<b>Minimum</b>	<b>Std. Dev.</b>	<b>Obs.</b>
<b>HRATIO1</b>	16.50	15.64	28.6	6.07	7.76	16
<b>SME</b>	3.57	4.28	5.60	1.20	1.97	16
<b>TRADE</b>	32.6	32.8	35.6	28.1	2.05	16
<b>GOVT</b>	6.43	4.24	48.3	-6.9	12.7	16
<b>CPI</b>	8.32	7.64	20.2	2.91	4.74	16
<b>GINI1</b>	31.4	31.2	33.1	29.8	0.94	16
<b>GDP</b>	1.76	1.29	5.49	-0.49	1.87	16

There are considerable variations in minimum and maximum values of different variables. The minimum value of growth domestic production is -0.49 while maximum value is 5.49, minimum value of GINI coefficient is 29.8 and maximum value is 33.1, consumer price index is 2.91 while maximum value is 20.2. The minimum value of government expenditures on development on small and medium industries, trade, SMEs and poverty are -6.9, 28.1, 1.20 and 6.07 respectively. The maximum value of government expenditures on development on small and medium industries, trade, SMEs and poverty are 48.3, 35.6, 5.60 and 28.6 respectively.

### Correlation

The correlation was computed for small and medium enterprises and poverty reduction data series, below results indicate a strong positive correlation between the variables; this means that there is a significant relationship between SMEs and Poverty reduction in Pakistan.

Table 1.3  
*Regression Analysis*

	<b>HRATIO1</b>	<b>SME</b>	<b>TRADE</b>	<b>GOVT</b>	<b>CPI</b>	<b>GINI1</b>	<b>GDP</b>
<b>HRATIO1</b>	1						
<b>SME</b>	0.501	1					
<b>TRADE</b>	-0.497	-0.28	1				
<b>GOVT</b>	-0.108	0.237	0.272	1			
<b>CPI</b>	-0.725	-0.719	0.508	-0.068	1		
<b>GINI1</b>	0.369	0.504	0.278	0.158	-0.313	1	
<b>GDP</b>	0.022	0.463	0.099	0.309	-0.278	0.405	1

The table of regression analysis shows the relationship between exogenous variables and endogenous variable.

Table 1.4  
*Dependent Variable: HRATIO1-povert*

<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
SME	-2.976	0.553	5.378	0.0004
TRADE	-0.965	0.473	-2.042	0.072
GOVT	-0.076	0.059	-1.294	0.228
CPI	-0.146	0.227	-0.643	0.536
GINI	2.929	1.076	2.722	0.024

(Table Continued...)

GDP	-2.091	0.462	-4.525	0.001
C	-49.341	28.084	-1.757	0.113
R-square	0.937	Mean dep var.		16.501
Adj R-square	0.895	S.D. dep var.		7.766
S.E. of reg	2.511	AIC		4.979
Sum squresid.	56.764	Schwarz criterion		5.317
Log liklyhood	-32.834	H-Q c		4.997
F-stat	22.404	D-W		1.929
Prob (F-statistic)	0.000			

Here in this table we can estimate the nature of relationship between poverty and independent variables in case of Pakistan. In this regression analysis the probability value indicate that small & medium enterprises, trade, GINI coefficient that indicate that income inequality and GDP significantly related to poverty. Whereas government expenditure or investment on small and medium enterprises and consumer price index are not significantly related with poverty. The strength or nature of relationship we can measure the coefficient values. Above table indicate that SMEs has negative relationship with HRATIO1 (poverty). It means that if small and medium enterprises increase in Pakistan then results indicate that poverty decreases. If one percent increment in SMEs then poverty reduces 2.976 percent. In other words we can present the results in different way if one percent decreases in SMEs then poverty increases 2.976 percent. The main reason is that about 87% of industrialized sector of Pakistan consists of small and medium enterprises and contribute 35% of GDP share and employing 78% of population. This sector has helpful to provide and sufficient opportunities for employment, technological advancements, income, tax revenue, efficiently utilization of resources of country and improvement in economy so our results get more strengths from (Subhan, Mahmood & Sattar, 2014).

Trade is most important factor for the development of an economy. In this regression analysis we have results regarding results and results describes that trade and poverty have negative relationship. If one percent increment in trade then poverty reduces 0.965 percent. We can understand this phenomenon by understating trade procedure. In a country increase production and start to trade



to other countries then it's understandable that the total income of a country increase and per capita income also increases and it cause to reduce poverty in country. Another study that illustrate the same results (Cicowiez & Conconi, 2008) and support our study results.

### **Discussion & Conclusion**

The objective of this study was to investigate the role of SMEs that how they can contribute to reduce poverty of Pakistan. The results indicates that in the context of Pakistan if we promote to start new businesses by appreciating new investors and creating new policies to relax on rate of interest for giving loans to people for startups. Study also represents that human capital has negative relation with poverty reduction. So it is also suggest policy makers to more invest on human capital that will reduce poverty in the context of Pakistan. Moreover, inflation and poverty reduction have positive relationship with each other, as inflation increases in Pakistan then poverty increases on the same ratio. It is proved through above results that in Pakistan SMEs are playing a major role to alleviate poverty and to upgrade the living standard. Similarly Radam, Abu, and Abdullah (2008) argued that SMEs use local scarce resource or wastes of large scale industries more efficiently and play important role to lower poverty growth rate by improving employment opportunities in local economies. Moreover, it also has been observed that SMEs are able to substitute capital intensive technique with labor intensive techniques and adjust negative economic shock at lower cost than large scale enterprises (Biggs & Shah, 2006). Moreover, results indicate that increase in small and medium enterprises will help to lower poverty in Pakistan.

#### *Implications of the Study*

The hypothesized model provides a deeper understanding of the relationship between small and medium enterprises and poverty reduction in Pakistan. The findings of this study can be of immense help in promoting the SMEs. This study identifies five other important factors which help to reduce poverty for example GDP, trade openness and Consumer price index has negative relation with poverty reduction, whereas inflation has positive and significant relation with poverty reduction in Pakistan.

#### *Recommendations*

Based on the findings of this study, the following recommendations are made:

- Government should arrange training and workshop programs for general public to motivate them to start Small and Medium enterprises and help to reduce poverty from Pakistan.
- Government should allocate a certain part of budget to invest to develop human capital which ultimately helps to reduce poverty of Pakistan.

- Government should control the rate of inflation with full concentration to reduce poverty.

### *Limitation and Future Research Direction*

The findings of this study have only scope in Pakistan however; the data obtained from other countries may have different implications. Future studies can use the proposed model in other sectors of the economy and in other countries. Moreover, this study used only five variables like human capital, trade openness, GDP and inflation to develop a framework of reduction in poverty. Future studies can incorporate more variables to improve the results.

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