

## **THE EFFECT OF TAX LAWS ON SMALL INDUSTRIES IN MULTAN, PAKISTAN**

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### **ABSTRACT:**

The objective of this research paper is to analyze the impact of tax laws, government policies and tax structure on small and medium enterprises operating in Multan, Pakistan. The study is aimed at filling the research gap existing in the contemporary literature about the effects of tax laws on small industries. To measure this impact a questionnaire was structured under 5-points Likert scale and data was collected from 209 small entrepreneurs and managers of small and medium firms. Different statistical techniques such as descriptive statistics, correlation matrix, regression analysis and normality test were used to analyze the data. The study found that different tax laws, government policies and tax structure have substantial impact on small and medium enterprises and it is one of the major factors of their failure in Pakistan.

**Keywords:** Tax laws; Government policies; Tax structure; SMEs Performance.

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### **1. Background of study:**

Small-medium enterprises play a significant role in the financial development and contribute significantly to Gross domestic product in both advanced and developing nations. A few studies such as Porto, Lederman, and Brambilla, (2012) and Roper and Love, (2015) have noted the significant role of SEMEs in financial development all over the world. For example, SEMEs provide employment to 100 million people and in this way, they are playing a vital role in reducing unemployment from the member countries of European Union. (Bruno and Villa, (2013). As per Matt and Ohlhausin (2011), findings, SMEs are the driving force of the economic development of European Union and their participation in promoting business activities and employment is vital in every member of European union.

Pakistan is an emerging economy, so the role of SMEs in Pakistan is not dissimilar to that of other emerging economies (Khan et al., (2020). Pakistan is one of the countries that places a high value on SMEs to compete for growth and success with other countries. This sector has significant potential and capability to transform Pakistan into a regional financial hub. It provides more investment chances in the private sector. The most common forms of taxation used by governments around the world are tax laws that are imposed both directly and indirectly on SMEs. Direct taxes are the categories that include a general explanation of how these taxes are administered and are, thus, known as income tax and corporate tax. In contrast, indirect taxes are typically imposed on goods and services produced. Moreover, government policies, education, and entrepreneurial capacity have also been cited as impediments to research. Henceforth, the second variable in this study is government policy, which includes factors such as support, tax, public procurement, permits,

licensing, and other necessary regulations. Government regulations and policies are inconsistent due to lack of financial support to entrepreneurs, and low educational and training opportunities for SMEs development and growth. Accordingly, if tax laws, government policies, and the tax structure are not properly designed, their effects may hamper to the development of SMEs. The effects of public tax laws are born by consumers who mostly pay indirect taxes. In short, tax laws, public policies and tax structure have negative impact not only on SMEs but also on consumers.

The main problem of this research study is that small medium enterprises are facing multi-dimensional problems in present changing business environment and these are serious challenges for shareholders, senior managers and planners of SMEs. (Ebrahimi,etal (2018) ; Yan, Makinde, and Maladzhi, (2012). In Pakistan most of the studies conducted on the contributing factors that enhance the performance of small medium enterprises. (Hafeez et al., (2013); Qureshi, (2012). The number of SMEs is 3.3 million and according to World Bank Report (2021) the pace of GDP growth in Pakistan is low as compared to other countries of Asia and South Asia and Pakistan ranked 108 out of 189 countries of the world. Moreover, Pakistan ranked 110<sup>th</sup> out of 144<sup>th</sup> countries in the Global competitive index and it is very low position. (Sherani, (2020). According to Arshad and Arshad (2019) and Zulfiqar and Batool (2011), there is a lot of potential for research on small medium enterprises to improve their performance if we study difficulties confronting by them due to harsh taxation, rigid tax structure and ever-changing public policies. Major causes noted are low efficiency, slow growth, poor R&D and low profitability. These factors inhibit the growth of small medium enterprises in Pakistan. The unavailability of skilled labor and

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imperfect labour market and non-availability of finance are some other factors that slow the growth of SMEs (Khawaja, (2006); Tanveer, Rizvi, and Riaz, (2012). Furthermore, the government policies, regulations, tax laws, and tax structure that govern the system are inefficient, resulting in the inability of enterprises to sustain themselves in uncertain environment (Tuakuila et al., (2012). In this scenario, there is tremendous scope of research on the performance of SMEs in the context of tax laws, tax structure and Government policies in order to propose solution for improving their performance. Thus, main objectives of this study are to examine relationship between tax laws, tax structure and Government policies and the performance of small medium enterprises operating in Multan, which is the main industrial city of Southern Punjab, Pakistan.

This study has the potential to contribute into existing body of literature in number of ways. Previously tax laws, government policies and tax structure have been investigated separately to determine their individual effects on the performance of small medium enterprises. This study will fill the gap existing in the literature by conducting combined research on these three variables on the performance of small medium enterprises. This will not only highlight the collective impact of these variables on SMEs' performance but also reflect individual impact of each variable. The findings of this study will give benefit to entrepreneurs in general, especially those operating within the purview of micro and small businesses, as an owner-managers which is the focus of this study. This will enable them to break the yoke of failure, by given them the foresight to look beyond the problems of government policies, tax laws, tax structure, capital inequalities, social and institutional barriers, as being the major constraints leading to their lower performance. This will make them to rejuvenate themselves to stay in business by focusing on these factors and

develop their own individual capabilities and competencies, which serves as the key determinant of business success at the micro or small level of business operation. Although the scope of this study is confined to SMEs working in Multan and their business is related to embroidery, stitching clothes, baking, beauty salons, handicrafts yet its results will be more valuable for small entrepreneurs. The key variables of this study, their definitions and sources are given in [Table 1](#).

Table 1.1: Description of variables and their sources.

<b>Variables</b>	<b>Definitions</b>	<b>Sources</b>
SMEs performance	Performance is the “firm’s ability to achieve and accomplish its objectives by using the firm’s resources in an efficient and effective manner”	(Daft, 2000).
Tax laws	“Tax law, often known as revenue law, is a branch of study in which public authorities employ a set of rules and procedures to assess and collect taxes in a legal setting”. “Pakistan current taxation system is defined by tax ordinance 2001 (for direct tax) and sales tax act 1996 (for indirect taxes) and administrated by Federal Board of revenue (FBR)”.	(Bird & de Jantscher, 1992).
Government policies	“Policies are an institutionalized proposal to solve relevant and real-world problems, driven by a vision and implemented through	(Eniola & Entebang, 2015).

	programs as a course of action devised or legislated, generally by a government, in response to societal challenges”.	
Tax structure	“The tax structure of an economy is determined by the tax rate and how it varies”. “The tax rate refers to the proportion of the tax base that reflects potential of taxes”.	(Esteller-Moré & Solé-Ollé, 2002).

## **2. Review of literature and hypotheses development:**

Savlovschi & Robu (2011) stated that the term "small and medium enterprise" (SME) is defined differently in different nations and contexts. Based on the intended role of SMEs in that country, each country has its own peculiar meanings. As a result, while classifying SMEs, several countries consider their level of economic potential and industrial development. The meaning of a private company in the European European depends on yearly turnover and the number of employees. A private company has over 50 workers and a yearly turnover equivalent to 10 million Euro. The strength of employees in small-medium enterprise is equivalent to or under 250, and annual turnover is around 43 million. Euro. According to SMEDA (2018), small- medium enterprises (SMEs) are regarded as the backbone of the Pakistan's economy. Pakistan has roughly 3.3 million SMEs. They utilize more than 78% of non-farming workforce. Beside accomplishing 36% worth expansion in assembling items, their contribution to Gross domestic product is more than 40% and they produce 25% of finished products. SMEs in Pakistan are located in different areas. In Punjab Province SMEs ratio is 65.26 percent, in Sindh provinces their ratio is 17.82 percent, in Khyber

Pakhtunkhwa is 14.21 and in Baluchistan provinces is 2.7 percent. These SMEs are controlled by Small Medium Enterprises Development Authority (SMEDA.).

### ***2.1 Impact of Tax Laws on SMEs' Performance:***

Taxes laws are often interpreted as compulsory government payments to allow it to function. A duty is a monetary charge or other toll forced by a state on an individual or lawful element. Tax collection is a crucial strategy proportion of government and consequently straightforwardly affects the functioning of SMEs. The core objective of taxation is to raise revenues to finance public expenditure. It is also used to influence the economy, for example by giving production, investment and savings ~~in~~ This study incorporates four tax laws namely, income tax, value added tax, corporate tax, and presumptive tax into this study. These are the direct and indirect taxes, which government required to meet tax obligations exacerbated the problem by encouraging non-compliance among small and medium-sized businesses.

**Hypothesis 1:** Tax laws have a positive and significant impact on SMEs' performance.

### ***2.2 Impact of Government Policy on SMEs' Performance:***

The government policies are external policies that are beyond the direct control of entrepreneurs. It is assumed that the government policies and regulations have a significant impact on SMEs' performance in Pakistan (Qureshi at et. (2009). This study focuses on public policies that are directly related to entrepreneurs or small medium enterprises. Some policies have positive while other policies have negative impact on the performance of SMEs.

**Hypothesis 2:** Government policies have a positive and significant impact on

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SMEs performance.

### **2.3 Impact of Tax Structure on SMEs' Performance:**

Tax structure has been found to affect private firms. According to Fischer et al. (1992a), the expense rate, the probability of identification, and the punishment structure, are drivers of the money related cost of tax assessment. The tax structure has a significant positive link with performance of business firms (Stoilova, 2017). Furthermore, a high tax rate may result in the closure of some businesses (Murphy & Nagel, (2002). One of the main reasons for businesses to migrate to the informal economy is high tax rates. This is true for all countries, including developed ones, across the world. These consequences are exacerbated by small businesses' high compliance costs in dealing with tax rules and other regulations (SMEDA, 2010b).

**Hypothesis 3:** Tax structure has a positive and significant impact on SMEs performance.

### **3. Theoretical foundation:**

Adam Smith (1776) in his book "The *Wealth of Nations* states:

"It is reasonable that the population as a whole should contribute to the tax costs. It is also reasonable to demand certain other things of a tax system – for example, that the amounts of tax individuals pay should bear some relationship to their abilities to pay... Good taxes meet four major criteria. They are (1) proportionate to incomes or abilities to pay (2) certain rather than arbitrary (3) payable at times and in ways convenient to the taxpayers and (4) cheap to administer and collect."

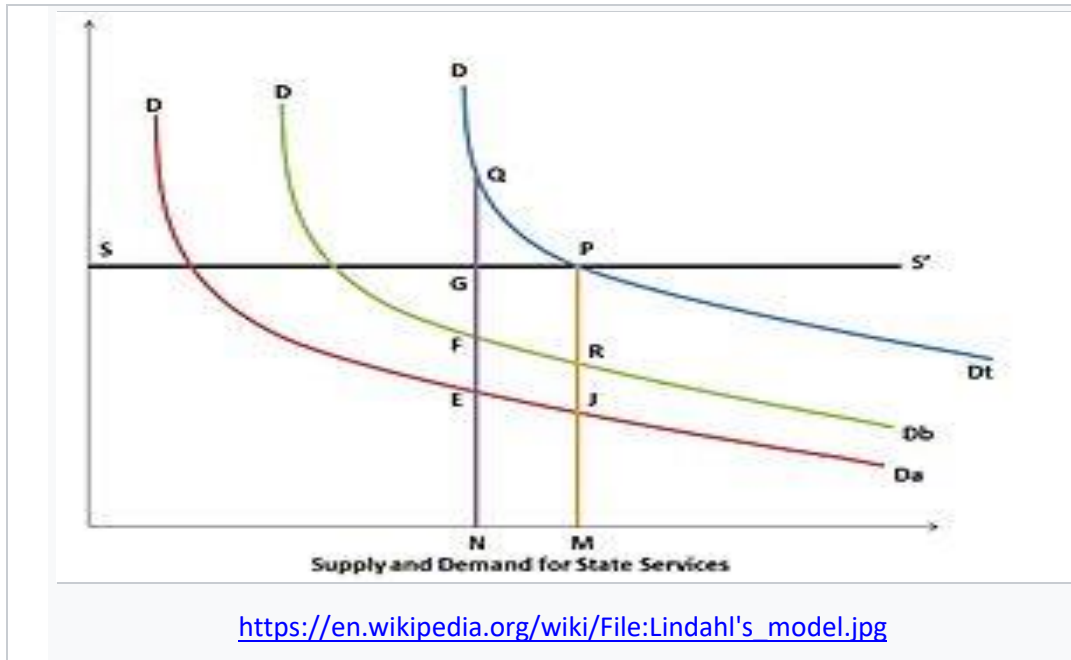
In modern world there are two major issues "who can pay and who can benefit." Pigou (1920) in his book "The Economics of welfare" presented "Ability to pay theory." The ability to pay theory postulates that tax may be levied keeping in view the ability or capacity of tax payers so that he can pay



it conveniently. This theory treats government revenue and expenditures separately. Taxes are based on taxpayers' ability to pay and there is no discrimination. Taxes paid are assumed as a sacrifice by taxpayers. Pigou argues that total loss of utility as a result of taxation should be equal for all taxpayers, which means the rich will be taxed more heavily than the poor. This, he called, equal sacrifice. He also pleads that the proportional loss of utility as a result of taxation should be equal for all tax payers and he terms it "Equal proportional sacrifice."

Lindah (1960) developed "Benefit theory. which is also known as "Voluntary exchange" theory states that taxpayers pay taxes in proportion to they receive benefits from the government. It means that the individuals who get most benefit from public services pay the most taxes. Lindah explained his theory through [Fig 1](#).

Fig 3.1: Lindahl's tax levy model



The Figure 3.1 shows, if  $SS'$  is the supply curve of state services it is assumed that production of social goods is linear and homogeneous.  $DDa$  is the demand curve of taxpayer A, and  $DDb$  is the demand curve of taxpayer B. The Horizontal summation of the two demand curves results in the community's total demand schedule for state services. A and B pay different proportions of the cost of the services which is vertically measured. When  $ON$  ( $O =$  graph origin, at axes intersection) is the amount of state services produced, A contributes  $NE$  and B contributes  $NF$ ; the cost of supply is  $NG$ . Since the state is non-profit, it increases its supply to  $OM$ . At this level, A contributes  $MJ$  and B contributes  $MR$  (total cost of supply). Equilibrium is reached at point  $P$  on a voluntary-exchange basis. The Lindahl equilibrium proposes that individuals

pay for the provision of a public good according to their marginal benefits in order to determine the efficient level of provision for public goods. In the equilibrium state, all individuals consume the same quantity of public goods but may face different prices because some people may value a particular good more than others. The Lindahl equilibrium price is the final amount paid by an individual for his or her share of the public goods. In the light of above theories, we have developed the following conceptual model to determined the effect of tax laws, government policies and tax structure on the performance of small medium enterprises. The model is shown in Fig 3.2.

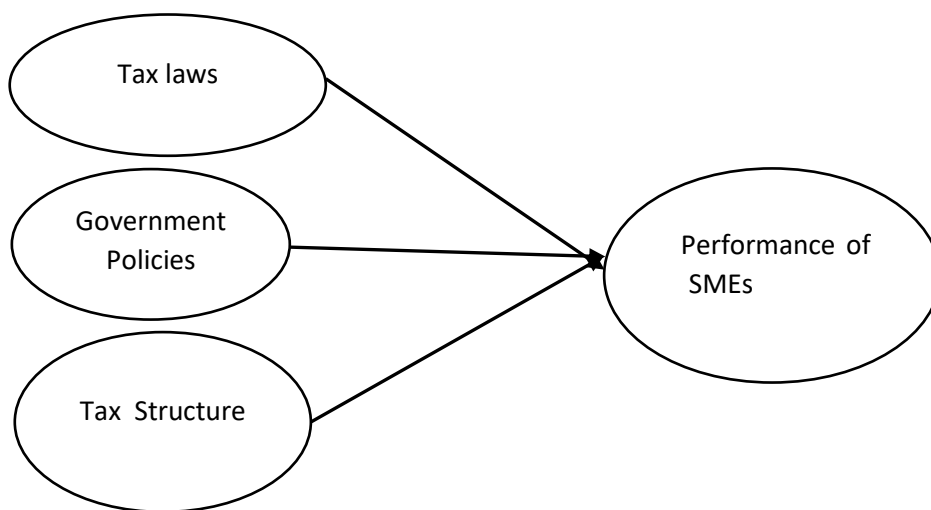


Figure 3.2: Conceptual model

#### **4.Data and Methodology:**

This is quantitative study in which primary data has been used. The data was collected through a structured questionnaire. The performance of small medium enterprises was dependent variable while Government policies, tax laws and tax structure were independent variables. Total 300 questionnaire

were distributed among selected respondents out of which 209 were received and found fit for analysis. These respondents were working in small industries such as Ginning, Cotton textile mills, Rice mills, Flour mills, Paper and board mills, Cold storage, agriculture products factories, soap and detergents, Tanneries, and pharmaceutical located in Multan district. The respondents were selected through convenience sampling technique. The data was analysed through different techniques such as descriptive statistics, Cronbach Alpha, correlation matrix, regression analysis and normality test. Different scales for different variables were adopted from three different studies. For example, the SMEs' performance scale was adopted from Daft (2000) it includes 15 items. It has six dimensions like new product development, market size, profit volume, capital investment, sale volume, and number of employees. The value of Cronbach alpha for this study was 0.84 (Demo, Neiva, Nunes, and Rosset, (2012). These items were gauged on a 5-points Liker scale ranging from 1 to 5, with 1 being strongly disagree while 5 being strongly agree. Table 4.1 contains the functional definition and scale things.

Table 4.1: Definition of variables and items relating to SMEs' performance.

Variable	Functional Definition	Number of items
SMEs performance	Performance is defined as "firm's ability to achieve and accomplish its objectives by using all the firm's resources in an efficient and effective manner".	<ol style="list-style-type: none"> <li>1. Our company launches new products to survive in the market.</li> <li>2. Our company extends numbers of product lines.</li> <li>3. For marketing of new products, our company explores new markets.</li> <li>4. Our company launches customized products according to market demands.</li> <li>5. Our company adopts advanced process and real-time control</li> </ol>

	<p>technology.</p> <p>6.Our company imports advanced automatic quality restriction equipment/software.</p> <p>7.Our company imports advanced programmable equipment.</p> <p>8.Our company adopts innovative reward systems.</p> <p>9.Our company adopts innovative work designs.</p> <p>10.Our company adopts innovative administration aiming at new product development.</p> <p>11.Our company engages in organizational reconstruction for pursuing operational efficiency.</p> <p>12.Our company engages in business process re-engineering.</p> <p>13.Our company use innovative methods of distribution to reduce cost.</p> <p>14.Our company use innovative marketing strategies to enhance sale.</p> <p>15.Our company continually exploit the potential of market demand”.</p>
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Source: Daft (2000).

The tax laws scale was adopted from the study [Bachuza \(2020\)](#) that consists of seven (7) items. It has four dimensions: value added taxes, corporate tax, income tax and presumptive tax. The value of Cronbach alpha for this scale was 0.84 ([Demo et al., \(2012\)](#)). These items were also assessed on a 5-point

Liker scale. [Table 4.2](#) contains variables, their definitions and relevant item relating to tax laws...

Table 4.2: Variable, their definition and items relating to Tax laws

<b>Variable</b>	<b>Functional Definition</b>	<b>Number of items</b>
Tax laws	“Tax law, often known as revenue law, is a branch of study in which public or sanctioned authorities, including as the federal, state, and local governments, employ a set of rules and processes to assess and collect taxes in a legal setting”.	<ol style="list-style-type: none"> <li>1. The value added taxes registration threshold is expensive for most SMEs.</li> <li>2. Value added taxes charges are always perceived to be a major problem for both young and old SMEs.</li> <li>3. The high corporate taxation rates in the Pakistan have greatly reduced the profit obtained by SMEs.</li> <li>4. SMEs remain non-compliance to presumptive tax requirements due to unbearable charges.</li> <li>5. The presumptive income tax system is deemed by many SMEs as inequitable.</li> <li>6. Income tax rates are normally computed with lack of assessment of the actual revenue of SMEs.</li> <li>7. Presence of income tax overcharge and penalties are high due to lack of taxation knowledge”.</li> </ol>

Source: Bachuza (2020).

The scale to measure the impact of government policies in this study was adopted from (Ahmad & Xavier, (2012) and it consists of seven (7) items. It has six dimensions: support, public procurement, permission, licensing, taxes,

and other government regulations. The value of Cronbach alpha was 0.84 (Demo et al. (2012). These seven items were analyzed through 5-points Likert type scale. Table 4.3 contains the functional definition and items relating to Government policies.

Table 4.3: Variable, definition and items relating to Government policies

Variable	Operational Definition	Number of items
Government Policies	<p>“Government policies are defined as an institutionalized proposal to solve relevant and real-world problems, driven by a vision, and implemented through programs as a course of action devised or legislated, generally by a government, in response to societal challenges”.</p>	<p>“1. In my country, government policies (e.g., public procurement) consistently favor new firms.                  2. In my country, the support for new and growing firms is a high priority for policy at the national government level.                  3. In my country, the support for new and growing firms is a high priority for policy at the local government level.                  4. In my country, new firms can get most of the required permits and licenses in about a week.                  5. In my country, the amount of taxes is not a burden for new and growing firms.                  6. In my country, taxes and other government regulations are applied to new and growing firms in a predictable and consistent way.</p>

		7. In my country, coping with government bureaucracy, regulations, and licensing requirements it is not unduly difficult for new and growing firms”.
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Source: Ahmad and Xavier (2012)

Tax structure has four dimensions: charge framework intricacy, likelihood of discovery and assessment rate punishment. The value of Cronbach alpha was 0.84 (Demo et al., 2012). These items were scored at 5-points Likert scale ranging from 1 to 5, with 1 being strongly disagree and 5 being strongly agree. Table 4.5 contains the functional definition of variable and items relating to tax structure.

Table 4.5: Definition of variable and items relating to tax structure.

<b>Variable</b>	<b>Functional Definition</b>	<b>Number of items</b>
Tax Structure	“The tax structure of an economy is determined by the tax rate and how it varies. The tax rate refers to the proportion of the tax base that must be paid in taxes”.	<ol style="list-style-type: none"> <li>1. If there is a discrepancy in the annual tax return, how likely would that be audited?</li> <li>2. If your company is chosen for a compulsory audit, how likely would a discrepancy be identified?</li> <li>3. If discrepancies are discovered during an audit, how severe are the penalties?</li> <li>4. If there is a discrepancy that led to a penalty, it can place criminal charges on the management of the company.</li> <li>5. Detection of an act of bribery of tax officials can attract the attention of the</li> </ol>



		<p>Economic and Financial Crimes Commission.</p> <p>6. Is Preparation of the company income tax return is difficult?</p> <p>7. Company income tax computation is full of ambiguity.</p> <p>8. Complexity in tax law are existing and companies are suffering due to it.</p> <p>9. Corporate income tax law is relatively simple to understand.</p> <p>10. Tax offices should provide enough guidelines and procedure for clarity purpose.</p> <p>11. A 'fair' tax rate should be the same for every company regardless of their size.</p> <p>12. A fair tax rate should be made proportional to the level of business performance.</p> <p>13. It is fair that high-profit companies should pay a higher tax than low-profit companies.</p> <p>14. The company income tax rate is higher as compared to SME profit earnings potentials and activities.</p> <p>15. The current tax rate paid by SME can hamper the sector's growth".</p>
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**Source:** Christensen & Hite, (1997; Christensen et al., (1994); Fischer et al., (1992b); Sapiei et al., (2014).

A questionnaire was developed keeping in view the variables. Total forty items were included into the questionnaire. The detail of questionnaire and its structure is shown in [Table 4. 6](#).

Table 4.6: Questionnaire Structure, Variables, and their Relevant items

<b>Variables</b>	<b>Number of items</b>
SMEs performance	15
Tax laws	07
Government policies	07
Tax structure	11
Questionnaire Structure	Description
Section A	Demographic profile
Section B	Research questions
Type of scale	Likert scale

## **5. Uni-variate analysis**

### **5.1 Response Rate**

According to Biemer and Lyberg (2003), the response rates are usually considered to be one of the most extensively compared statistic for evaluating the quality of surveys in the field of social science research. Thus, the response rate should be maximized to become genuine representative of the population to generalize the findings of study. In accordance with procedure of data collection, 300 questionnaires were distributed among respondents working in SMEs in Multan, Pakistan. The Researchers personally visited all the respective SMEs and met with their owners/managers to distribute the questionnaire and adopted the follow-up techniques using phone calls, reminders, SMS, emails and personal visits. Finally, 221 questionnaires were returned, out of those 209 (69.67 percent)

were found valid whereas other 12 were incomplete and were not included into analysis. The data was collected from January to February, 2022. The sample size was appropriate as per view of Hair, Babine, Black, and Anderson (2011) Table 5.1 illustrates the summary of Response Rate of the questionnaires.

Table 5.1: *Response Rate of respondents*

<b>Responses</b>	<b>Frequency/Rate</b>
Questionnaires distributed	300
Returned questionnaires	221
Valid questionnaires returned & usable	209
Questionnaires returned & excluded	12
Not returned questionnaires	79
Total responses rate	73.67
Valid responses rate	69.67

### ***5.2 Demographic characteristics of respondents***

This section contains statistics about the gender, marital status, age, qualification, job status, type of ownership, work experience, number of employees, sale turnover, years of operation. This detail is given in Table 5.2..

Table 5.2: Demographic statistics of respondents.

<b>Description</b>	<b>Frequency</b>	<b>Percentage</b>
<b>Gender</b>		
Male	168	85.28
Female	40	14.72
<b>Marital Status</b>		
Married	154	78.17
Unmarried	55	28.83
<b>Age</b>		
Less than 25 years	17	6.60
25-35 years	119	59.35
36-45 years	61	30.96
Above 45 years	12	6.09
<b>Qualification</b>		
Matriculation	24	12.18
Intermediate	30	15.22
Bachelor	100	50.76
Master	31	15.73
Diploma holders	24	9.09
<b>Job Position</b>		
CEO (Chief executive officer)	108	54.82
Senior manager	89	45.18
<b>Type of Ownership</b>		
Sole proprietorship	143	72.59
Joint-venture	16	8.12
Partnership	50	20.29

<b>Work Experience</b>		
Less than 3 years	35	17.77
Between 4-6 years	88	44.67
Between 7-9 years	40	20.30
Between 10-12 years	12	6.09
Between 13-15 years	14	7.11
Above 15 years	20	8.06
<b>Number of employees</b>		
51-100 employees	176	89.34
101-200 employees	19	9.63
201-300 employees	14	1.00
Above 300 employees	0	0
<b>Sales Turn Over (In Million rupees)</b>		
Less than 50 million	172	87.31
51-100 million	25	9.64
101-150 million	12	3.05
Above 150 million	0	0
<b>Years of Operation</b>		
Less than 1 year	21	10.66
1-5 years	119	60.41
6-10 years	15	4.57
11-15 years	20	7.11
16-20 years	22	11.17
Above 20 years	12	6.09

According to Table 5.2, most of the respondents 168 (85.28 percent) were male respondents, while 29 (14.72 percent) were female respondents working

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in different manufacturing SMEs of Multan, Pakistan. In terms of marital status, most of the respondents 154 (78.17 percent) were married, while 43 (21.83 percent) were unmarried. Regarding the age group of respondents, the majority 111 (56.35 percent) belonged to the age group of 25-35 years, while the least 12 (6.09 percent) belong to the age group of above 45 years. In addition, Table 4.6 showed most participants 100 (50.76 percent) had a bachelor's degree, whereas the least 12 (6.09 percent) had a diploma. Likewise, this research collected study data from SMEs operating in Multan, Punjab, Pakistan. In this survey, most respondents 108 (54.82 percent) had a job position as Chief Executive Officer (CEO), while 89 (45.18 percent) worked as senior managers. Regarding the type of ownership, most of the respondents 143 (72.59 percent) had Sole proprietorship, while only 16 (8.12 percent) had joint-venture. Regarding work experience, most of the respondents 88 (44.67 percent) had work experience between 4-6 years, while only 08 (4.06 percent) had work experience above 15 years. Furthermore, considering the number of employees working in SMEs, most of the SMEs 176 (89.34 percent) had number of employees between 51-100 and only 2 (1.02 percent) SMEs had number of employees between 201-300 employees. Accordingly, considering the SMEs sales turnover, 172 (87.31 percent) SMEs had sale turnover of less than 50 million rupees, whereas only 06 (3.05 percent) SMEs had sale turnover of between 101 and 150 million rupees. Finally, considering the SMEs years of operation, 119 (60.41 percent) SMEs had 1-5 years of operation, while only 12 (6.09 percent) SMEs had above 20 years of operation.

**6. Multi-variate analysis:**

**6.1. Cronbach Alpha Test:**

To check the dependability of items in one dimension or group for a certain variable, the Cronbach alpha is used to verify the similar outcomes in a specific group or dimension. The Cronbach alpha value 0.7 is acceptable. Its results are shown in [Table 6.3](#).

Table 5.6: Results of Cronbach’s Alpha

Constructs	Cronbach Alpha	No. of Units
Firm's Performance	0.789	15
Tax Laws	0.829	07
Government Polices	0.814	07
Tax Structure	0.793	15

Note: SPSS output

**6.2 Correlation analysis:**

Correlation matrix shows degree of relationship between variables. The correlation coefficient value ranges between “- 1” to “+1”. While ‘- 1’ means a negative relationship, ‘0’ signifies no relationship, and ‘+1’ indicates a positive correlation between variables. The correlation may be positive or negative, indicating that two variables move in the same direction or opposite direction. If the value of correlation is more than 90 then it is assumed to be multi-collinearity problem between variables due to intangible effect of independent variables. This is check through connection grid and difference expansion factor (VIF) and resistance esteem evaluation (Peng and Lai, (2012). The two procedures were used to check whether there is any multi-collinearity among independent variables in the model. (Hair et al., (2021) Table 9 shows that

none of the value is more than 0.90 proposing that there is no multi-collinearity among independent variables. The assessment of VIF and tolerance level are performed to recognize multi-collinearity. Likewise, the value of tolerance  $> 0.20$  and the VIF value  $< 5.0$  show that there is no multi-collinearity among explanatory variables as suggested by Hair, Ringle, and Sarstedt (2011). In Table 8 the VIF most extreme value is 1.731 which is lower than 5.0 and the low value of tolerance is 0.506 which is higher than 0.20. Thus, it was proved that there is no multi-collinearity issue among independent variables. The results are exhibited in Table 6. 2..

Table 6.2: Results of Correlation Matrix, Tolerance and VIF Index of independent variables

Constructs	TL	GP	TSS	Tolerance	VIF
Tax laws	1			.608	1.384
Government policies	.413	1		.575	1.597
Tax structure	.487	.529	1	.506	1.731

Note: \* $p < 0.01$  (Two-tailed); TL = Tax Laws, GP = Government Policies, and TSS = Tax System Structure.

### **6.3 Multiple Regression Analysis:**

By utilizing SPSS software, the author conducted multiple regression analysis for the testing of hypotheses. Multiple regression is adopted to test the effect of independent variables on dependent variables (Sekaran & Bougie, (2019) This implies that if change occurs in independent variables the dependent variable is likely to be change proportionately. Similarly, t-statistics is used to if the hypotheses are accepted or rejected. The t-value for a two-tail test should be greater than 1.96 for this purpose. These values were higher than 1.96 in the coefficient table of the model, which suggests all



hypotheses of the theoretical model are accepted. The results are shown in the Table 6.3. that depicts that there are significant positive relationships between tax laws, government policies and tax structure with firm’s performance.

Table 6.3: Results of Regression analysis

Hypo	Relationship	$\beta$ -value	Std. Error	t-value	Decision
H1	Tax law -> firm’s performance	0.189	0.062	2.808	Accepted
H2	Government policies -> firm’s performance	0.342	0.064	6.101	Accepted
H3	Tax system structure -> firm’s performance	0.205	0.065	3.218	Accepted
<b>R square (R<sup>2</sup>)</b>		0.364			
<b>F stat (Prob)</b>		63.028 (0.000)			

Results from regression analysis suggest that tax law has a significant and positive influence on firm’s performance as beta value is ( $\beta = 0.189$ ,  $t = 2.808$ ,  $p < 0.05$ ) that supports first hypothesis. The second variable is government policies. Results from Table 6.3 suggested that the government policies have a positive and significant influence on firm’s performance as its beta value is ( $\beta = 0.342$ ,  $t = 6.101$ ,  $p < 0.05$ ), which supports second hypothesis. Lastly, the third independent variable is tax structure. The Results in Table 9 suggests that tax structure has a positive and significant impact on firm’s performance because its beta value is ( $\beta = 0.205$ ,  $t = 3.218$ ,  $p < 0.05$ ), which also supports

third hypothesis. Thus, Hypotheses 1, 2, and 3 are accepted. The results further reveals that the value of R square ( $R^2$ ) is 0.364, which imply that tax law, government policies, and tax structure can jointly predict 36.4 percent variation in firm's performance, whereas the probability value of F-statistics show overall model is goodness of fit.

### 6.4 Normality test

Dabchick et al. (2007) utilized a graphical method way to assess distribution of residual. Mostly histograms are utilized and a typical likelihood plot, as recommended by Field (2017). The results of normality test are shown in Fig 6.1 and 2.

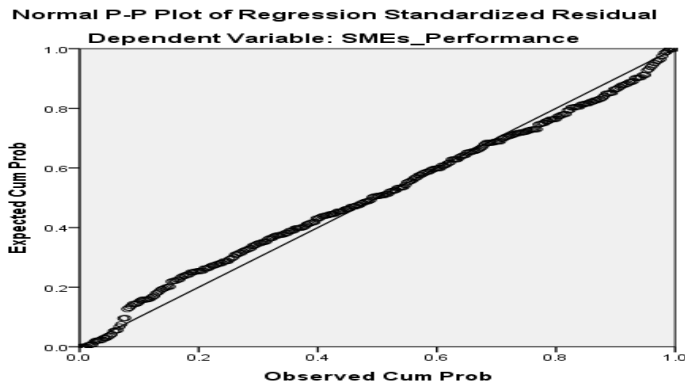
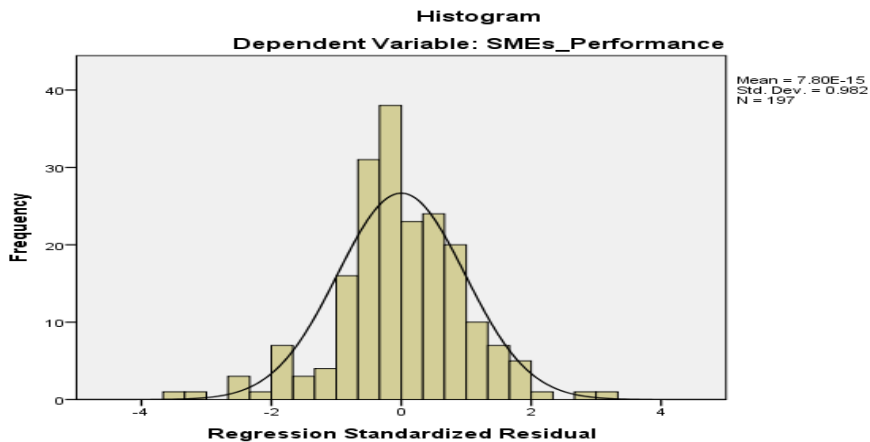


Figure 6.1 Histogram for Normality of Data

Figure 6.2 Normal P-P Plot

Figure 6.1 shows the ordinariness plot, which shows that every one of the information bars are either near or inside the typical bend. In like manner, Figure 6.2 portrays a p plot to assess the typical guess of the information dispersion, demonstrating that the information is near the middle mean line of ordinariness (Wilk and Znanieckian, (1968).

## **7 Findings of study:**

### ***7.1. Tax laws and SMEs Performance:***

The association between tax laws and firm's performance was determined to be statistically significant at the  $p = 0.05$  level that supports hypothesis 1. This outcome is in line with findings of (Nyame, 2017; Saad, 2014), who found that tax laws had a considerable impact on the performance of firms. They also found that tax laws had strong impact on firms' performance, confirming the idea that tax rules can both improve and degrade a company's performance. Many researchers such as (Dess & Lumpkin, (2005); Zahra & Covin, (1995) have also supported the findings of this study by emphasizing on the importance of tax regulations in boosting the performance of large corporations and small firms. In another research like, Dhami and Al-Nowaihi (2007) found that, both small and large businesses in developing nations are subjected to high value added taxes which are always very expensive. Increased taxation restricts profit opportunities (incentive effect), discouraging productive entrepreneurship and, as a result, growth (Balioune-Lutz & Garelo, (2014).

### ***7.2 Government policies and SMEs Performance:***

The association between government policies and firm's performance was found significant at the  $p = 0.05$  level. As a result, hypothesis 2 was accepted. This study is in line with earlier research findings of (Aziz & Yassin, 2010;

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Kirca, Jayachandran, & Bearden, (2005), who found that government policies had a considerable impact on firm's performance. The high rate of corporate taxes, according to, Kamba-Kibatshi (2016), interferes in the financial affairs of SMEs, perhaps results in business failure. Thus, it can be argued that government regressive policies have played significant role in SMEs' poor performance in Pakistan (Kureshi et al. (2009). Furthermore, it was also noted that with ever-increasing competition and a shorter life cycle, SMEs managers must stay connected to customers and competitors in order to strategically position their businesses.

### **7.3 Tax System Structure and SMEs Performance:**

The association between tax structure and firm's performance was found significant at the  $p = 0.05$  level. Thus, hypothesis 3 is accepted, This finding is in line with prior study of (Stoilova, 2017), who found that tax structure had a substantial positive link with firm's performance. Correspondingly, a research by Murphy and Nagel (2002) found that excessive taxation and unfair penalties demotivate potential entrepreneurs in many cases, leading to the closure of some businesses or a failure. It was noted that the high failure rates of SMEs have also been linked to high taxation rates. The study of Deshpande (2012), demonstrated that SMEs' growth is constantly challenged by high taxation policies that ignore the financial position of SMEs. In the case of SMEs, taxation must be enforced in a way that considers the income level and survival need of the business.

## **8. Conclusions and practical implications**

Tax laws, government policies, and tax structure are widely acknowledged as critical issues for small medium enterprises. It seems no advisable to frame tax laws, public policies and tax structure without keeping their financial impact on SMEs. Thus, it is imperative to frame laws, public policies and tax

structure to expedite the productivity and performance of small medium enterprises. Another point is that small medium enterprises encourage to use their existing capital efficiently not only for enhancing their productivity but also for economies of scale. The cumulative growth process, as well as the associated expectation of increasing earnings, spurs the development of new capital or the transfer of existing capital, resulting in increased economic opportunities. The SMEs provide industrial experience and serve as a training Centre for many managers who will be able to make significant contributions to the region's next phase of industrialization. As small businesses have a low import intensity in their capital structure, they have less demand for foreign capital or currency as such they do not create balance of payment problem for country. Thus, their role in economic development is vital. However, the rate of SMEs failure in developing countries like Pakistan is higher than in industrialized countries. because the SME sector does not receive adequate attention and priority, they do not have access to financial services. Aside from that, most of government policies are geared toward the growth of large corporations. As a result, SMEs are stuck in a low-growth cycle, selling obsolete goods and so unable to opt advance technologies.

This study provides policymakers and practitioners with a road map for developing policies that give benefits to SMEs. According to the findings, SMEs need to collaborate closely with marketing and government departments to improve customer satisfaction and performance. Because the external environment is continuously changing, and competitors and customers must face uncertainty. Tax regulations, government policies, and the structure of the tax are all important variables for SMEs management to consider when analyzing their performance. This study provides a valuable insight to the

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management of SMEs to closely work tax authorities to save themselves unexpected shocks. Small Medium Authority, which is a controlling authority of SMEs to formulate its strategy of improving the performance of SMEs in the light of the findings of this study.

### ***9. Limitations of Study:***

Even though this study provides useful information and made numerous practical and theoretical contributions, it had some limitations. For example, the data in this study was collected from real life by owners/Managers, as the strategic head of the company, were asked to explain the current condition of tax laws, government policies, and tax structure, as well as their company's performance. The authenticity of a single informant technique is debatable, as it could lead to discrepancies in data. The use of 5-points Likert scale in which respondents rate their level of agreement or disagreement with statements about tax laws, government policies, tax structure, and SMEs' performance was the second main limitation. Respondents were seen to automatically measure their impressions of the questions without paying close attention or comprehension to statements. However, it is impossible to believe that all the questions were fully comprehended, and the data was of excellent quality. To further validate the results, future study could use mixed methods approaches that combine qualitative and quantitative approaches. Because the variables tax laws, government policies, and tax structure are dynamic and vary over time, assessing their relationship with performance of a firm in a static manner based on data obtained at a single point will not likely to be accurate. Long-term studies should be conducted to re-examine the effectiveness of these strategies. Finally, because this study's sample only included Manufacturing SMEs in Multan, Punjab, and as such it does not represent the entire SMEs sector of Pakistan, so its results cannot be generalized to other parts of the

country. Therefore, a study in other parts of the country may be conducted to gain a better understanding of the effect of tax laws, government policies, and tax structure on SMEs' performance.

### ***10. Suggestion for future research:***

This research offers valuable insight about the relationship between Pakistani tax laws, government policies, tax structure, and SMEs' performance. This research implies that more research is needed to overcome the study's weaknesses. Because this study used a cross-sectional approach, more work on longitudinal research is required. It is suggested that future researchers should be conduct longitudinal studies based on interviews to re-examine the dynamic nature of the effect of tax laws, government policies, and tax structure on the performance of SMEs in the long run. As the current study used a quantitative research approach, the information acquired on the variable is limited to the responses to the questionnaire. Future research may combine qualitative and quantitative methods to further validate the findings and gain a better understanding of the problem

### **Data Statement:**

The data that supports the findings of this study will be available on request by corresponding author.

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The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper or conflict of interest with any person or organization relating to this research study

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