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THE EFFECT OF REMITTANCES ON NEW BUSINESS CREATION IN PAKISTAN: THE ROLE OF FINANCIAL DEVELOPMENT

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Abstract
This study examines the contributions of remittance inflows and financial development to encourage new business in Pakistan and specifically the small and medium-sized businesses (SMEs). This paper employs the micro-level empirical research approach that uses firm level evidence of the World Bank Enterprise Surveys with country-level financial indicators to determine the ways in which remittances and financial development impact the likelihood of new business creation. The findings indicate that remittance inflows positively and significantly influence the probability of starting a new business, which implies that remittances alleviate liquidity and financing pressures experienced by new business investors. The research has added to the existing literature on entrepreneurship and financial development literature by offering firm-level evidence in Pakistan about the independent contribution of remittances and financial development to the establishment of new business.
JEL Classification: *F24, G32, G29*

1. Introduction

New business creation has also been identified as a central force behind the economic development because numerous countries promote the entrepreneurial activity to stimulate economic growth and create new jobs (Alhassan, 2023; Bettin et al., 2024; Lee, 2019; Piras, 2023). Simultaneously, a significant amount of research identifies limited access to finance as one of the most serious challenges business creation and growth (Aung, 2025; Ogunjobi et al., 2025; Okello Candiya Bongomin et al., 2017).

Financial institutions in developing economies tend to mitigate risk through high collateral requirements to which most of the small firms fails to provide. Nevertheless, growth and investment theories note that financial development is crucial in facilitating investment among new and emerging companies (Kropelnytska et al., 2025; Toor et al., 2025). However, the availability of external finance is still extremely limited to new businesses in most developing economies. According to the existing studies, these financing constraints are not only caused by the firm-specific characteristics, but also due to the financial structure of the markets (Jongwe et al., 2025; Manjo, 2025).

The lack of development of the financial sector in most developing economies also limits access to credit by SMEs. Moreover, the local financial institutions may be instrumental in aggregating the SME investment opportunities into such financial products that foreign investors would find appealing, facilitating external investment into the SME sector. These initiatives might include new financing methods such as debt-to-equity conversion and utilizing alternative sources of finance. Remittances are one of the significant non-traditional sources of finance, which can be described as the component of migrant earnings sent to their home countries in the form of cash or in kind to finance the household members. The possibility of remittance inflows as the means that can help to finance the development in the home country has been studied by many scholars (Kakhkharov & Rohde, 2020). This has seen their remittances being the primary source of foreign incomes to the majority of the

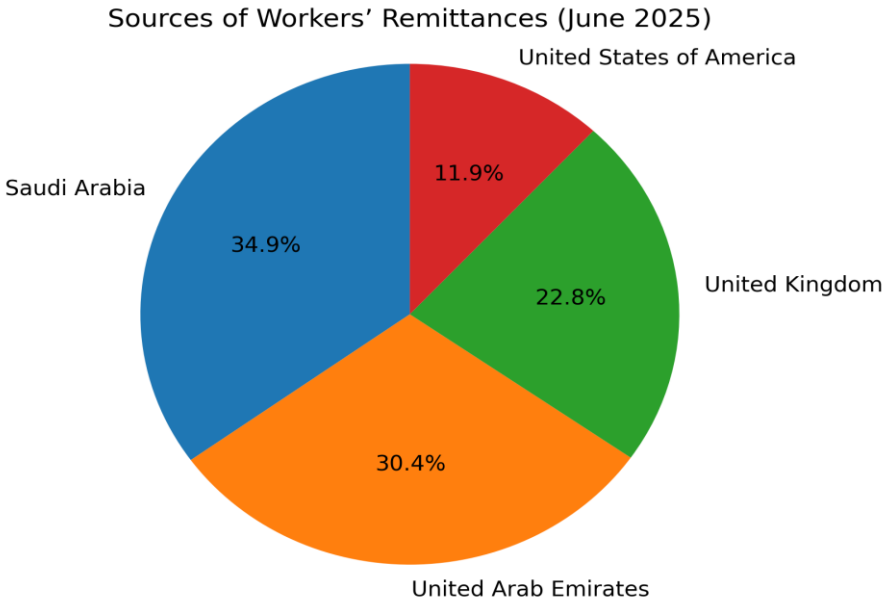
developing economies as their rate of growth has been so intense in the past few years. In these countries, they are a bigger geo-economic stabilizer, economic growth, and overall GDP. The net amount of remittance flows, however, cannot be well measured due to the high percentage of remittance flowing on informally. Yet, officially registered remittances to developing economies amounted to more than USD 85 billion in 2024 and currently take an even higher percentage of GDP in most economies (World Bank, 2024).

Table 1: Current Status of Remittances Inflows and Major Source Countries in FY25

Inflows		Source	
Indicator	**Amount (Billion USD)**	**Country**	**Amount (Million USD)**
Workers' remittances (June 2025)	3.4	Saudi Arabia	823.2
Year-on-year growth (June 2025)	7.9%	United Arab Emirates	717.2
Total remittances (FY25)	38.3	United Kingdom	537.6
Growth in remittances (FY25 vs FY24)	26.6%	United States of America	26.6%

Source: Press Release of Workers' Remittance, State Bank of Pakistan (June, 2025)

Figure 1: Distribution of Workers' Remittances by Major Source Countries



Source: Press Release of Workers' Remittance, State Bank of Pakistan (June, 2025)

Despite the rapid rate of growth of remittance inflows in recent years, empirical data regarding its effects on access to finance by SMEs in developing economies is limited. Remittances can contribute to the capacity of SMEs to access external funds. Laeven et al.(2015) notes that the presence of a good financial development, backed by good financial systems, increases the level of capital accumulation and an overall improvement in the distribution of financial resources, which in turn increases the accessibility of credit to entrepreneurs. In this regard, an increase in capital accumulation due to inflows in the form of remittances can reinforce the lending power of financial institutions (Nyasha & Odhiambo, 2020). Regardless of this, the joint impact of remittances and financial development on the new business creation in Pakistan has not been

fully determined. This paper aims to fill this literature gap. This research has the main objective of investigating the relationship among remittance inflows and financial development on new business creation in Pakistan.

This research contributes to the body of literature in two aspects. This paper uses a micro level approach by examining the impact of remittances on new business creation. It is based on the firm-level data on small and medium-sized enterprises which was obtained on the basis of the World Bank Enterprise Surveys of Pakistan. Second, the paper identifies the need to broaden the financing systems of SMEs as one of the ways to promote economic activity, enhance the quality of life, and decrease poverty in the Pakistan. The rest of the paper is organized in the following way. Section 2 provides a review of the literature. The section 3 records the data, model and empirical methodology. The empirical results are presented and discussed in Section 4 and the policy implications and recommendations are given in the conclusion in Section 5.

2. Literature Review

Ngea (2024) used two channel to show the impact of remittances. Remittance inflows may also provide liquidity to the recipient entrepreneur, allowing them to fund investments through internal sources. Banerjee et al (2019) show that extra income boosts entrepreneurial action and borrowing power by relieving liquidity and collateral constraints. Investment choices become very reliant on income changes caused by remittance inflows when formal credit is scarce and virtually permits remittances to replace bank credit. Here, migrants take an intermediate position by directly investing in entrepreneurship in their mother countries which results in the new business creation (Cao & Kang, 2020).

The second mechanism is a debt or financial inclusion channel, which presupposes that the receipt of remittances encourages financial literacy and access to formal financial institutions. Remittances exposure to financial services may make recipients more familiar with financial products and may motivate them to use the formal financial system (Xia et al., 2022). One example is Orozco et al (2005) who claim that remittances will create a demand of further banking services, whereas other researchers claim that remittance transfer services are a way to bring previously unbanked households into the financial system.

The wider literature also highlights the impact of financial development in enabling capital build-up and enhancing access to credit by entrepreneurs. Financial development increases access to finance in several ways such as better capital allocation, efficient mobilization of savings, improved risk management, lower transaction costs, and improved governance mechanisms. This model suggests that lending by financial institutions can be enhanced by the accumulation of capital induced by remittance inflows. In addition, developed technological financial system can better mobilize and allocate remittances, decrease information asymmetry, lower transaction costs, and alleviate risk, thus enhancing access to finance among entrepreneurs which results in new business creation (Ramcharran, 2020).

Fromentin (2017) investigated the short and long run impact of remittances on financial development in developing countries. The study use time series analysis to quantify the impact of remittances. The study come up with facts that remittances increase liquidity, reduces credit constraints only in long run, but the effect of remittances on financial development shows weak effects. This might be due to the fact that remittances required time to pass through it effect on financial activity. The study also concluded that remittances only raise monetary aggregate, while it has little impact on private credit.

Piras (2023) found heterogeneous evidences regarding the impact of remittance on new business creation. The results show that remittances spur investment and establishment of new firm in less develop countries while due to the complex economic system of developed economies, remittances are less likely to facilitate new business.

Bedi et al. (2023) points out that remittances are a major source of foreign inflows, and shows the positive relationship between remittances and entrepreneurship in early stages of business.

Bettin et al. (2024) used panel data from 143 countries and concluded that remittances have positively correlated with the decision to create new firms. They also found how migrants' home countries is going through a structural transformation due to financial remittances in new business formation.

3. Methodology and Variables of the Study

In order to investigate the association between remittances, financial development and new business creation, this paper will utilize a combination of firm level data of the world bank enterprise surveys and country level data of the world development indicators of Pakistan. The study utilized the most recent available Enterprise Survey wave. Table 1 describes the variables that were used in the analysis.

3.1 Operational Definition of Variables

NBC is measured as a binary (dummy) variable, where a value of 1 indicates firms established within the last 5 years, representing new business entry, and 0 otherwise. REM is operationalized as personal remittance inflows expressed in monetary value received by firms/regions, capturing transfers from migrant workers including personal transfers and employee compensation. FD is defined as the level of financial sector depth and access, proxied by an index/score reflecting financial infrastructure, credit availability, and financial services usage at the firm or regional level. Interaction Term (REM × FD) captures the moderating effect of financial development on remittances, computed by multiplying REM and FD to assess their combined influence on new business creation and firm performance. Control Variables Firm Age measured as the number of years since firm establishment. Firm Size categorized based on the number of full-time employees, reflecting small, medium, or large firm status. Firm Type operationalized as a categorical/dummy variable identifying industry classification. Ownership defined as a dummy variable, where 1 = foreign ownership stake exists, 0 = otherwise. Ownership Structure measured as private, public, or joint ownership category using dummy variables.

3.2 Model Specification

In order to fulfill the objective of the paper, the following functional form will be estimated.

$$\boldsymbol{NBC = \beta_0 + \beta_1 REM + \beta_2 FD + \beta_3 (REM * FD) + \beta_4 X_i + e_i}$$

Where

NBC= New Business Creation

REM= Remittances as independent variable.

FD= Financial Development

(REM*FD) = Interaction term of remittances and financial development.

X_i = Matrix of firm level variables (Firm Age, Firm Size, Firm Type, Ownership)

e_i = the error term.

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4. Results and Discussion

Table 1: Summary Statistics of Core Variables

	NBC	REM	FED
Mean	0.380435	19304.77	12.22115
Median	0.000000	20000.00	12.00000
Maximum	1.000000	30000.00	18.00000
Minimum	0.000000	500.0000	0.000000
Std. Dev.	0.485697	9083.511	3.275847
Skewness	0.492551	-0.201271	-0.538992
Kurtosis	1.242607	1.780349	4.255757
Jarque-Bera	202.2664	82.20446	136.4923
Probability	0.000000	0.000000	0.000000
Sum	455.0000	23088500	14616.50
Sum Sq. Dev.	281.9022	9.862310	12823.75
Observations	1196	1196	1196

Source: Author's Calculations

Table 2 shows the summary statistics of NBC, REM, and FED, using 1,196 observations, which shows that the sample used is robust to conduct an empirical analysis. The central tendency of NBC (0.38) indicates that the sample is binary in nature (38% are new businesses). The average inflow in terms of REM is around 19305 with median 20,000 implying that most companies get remittances around the sample center though the standard deviation of 9,083 and wide range (500-30,000) imply a lot of variation. FED has a high central tendency as the mean (12.22) corresponds to the median (12.00), and negative skew (-0.54) indicates that the distribution consists of more

firms at the higher stages of development. Jarque-Bra statistic (p = 0.000) rejects the hypothesis of normality of all variables (which is standard of NBC) and indicates non-Gaussian behavior of both of the variables in the subsequent econometric analysis, meaning that the robust or non-linear estimation methods can be quite useful in subsequent econometric analysis. On the whole, the variables are varied enough to enable the use of regression-based analysis of remittances and financial development in explaining the new business creation and firm performance.

Table 2: Correlation Matrix of Core Variables

	NBC	REM	FED
NBC	1	0.0160	0.0939
REM	0.0160	1	0.3648
FED	0.0939	0.3648	1

Source: Author's Calculations

Table 3 presents the pairwise correlations between the core variables. REM and NBC are correlated at 0.016, which is a weak positive correlation, indicating that inflows of remittance are not strongly related to the creation of new businesses. The correlation between the FED and NBC is low positive (0.094), meaning that increased financial development has a slight positive relationship with probability of new business entry. The highest correlation in the matrix is between REM and FED (0.365) the correlation between the two indicates a moderate positive relationship, such that firms with higher remittances are likely to operate in comparatively more financially developed.

Table 3: Logistic Regression Analysis

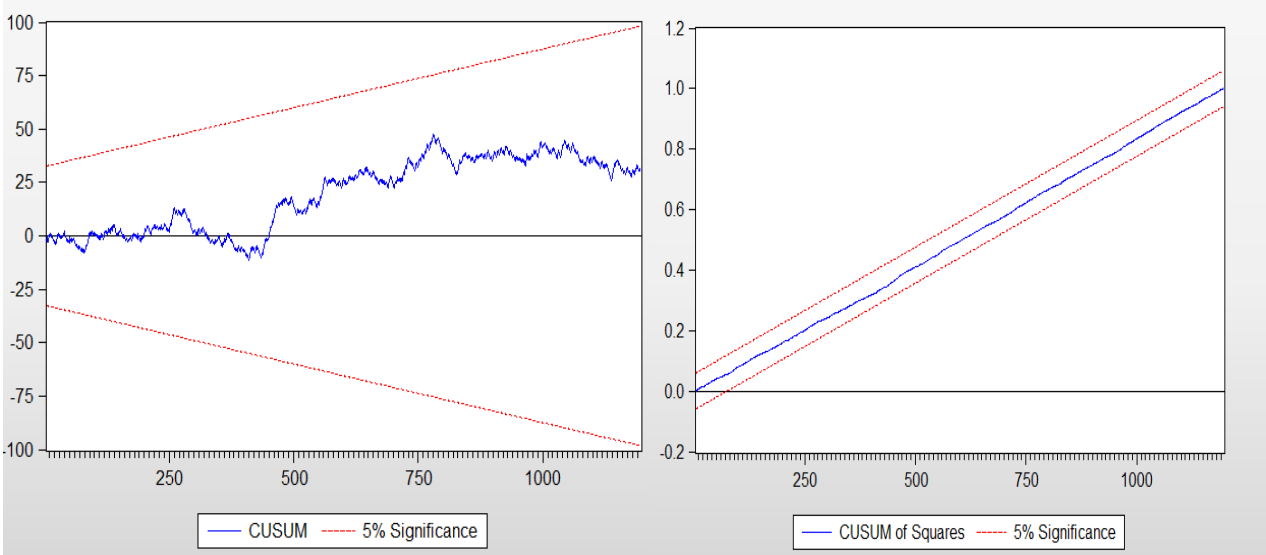
Variable	Coefficient	Std. Error	t-Statistic	Prob.
NBC	0.020712	0.009071	2.283452	0.0226
REM	0.015066	0.004589	3.282956	0.0011
FED	0.542867	0.055268	9.822535	0.0000
REM*FED	0.017922	0.028997	0.618047	0.5367
Firm Age	0.127136	0.106378	1.195139	0.2323
Firm Size	0.000219	0.004594	0.047644	0.9620
Firm Type	2.05E-06	4.50E-07	4.560050	0.0000
Firm Ownership	0.029819	0.029025	1.027366	0.3045
Constant	0.000927	0.055300	0.016754	0.9866

Source: Author's Calculations

Table 3 reports the logistic regression estimates examining the effect of remittances and financial development on new business creation while controlling for firm characteristics. REM shows a positive and statistically significant coefficient (0.015, p = 0.001), indicating that higher remittance inflows increase the likelihood of new business creation. FED has the strongest positive impact (0.543, p = 0.000), suggesting that firms operating in financially developed environments have a substantially higher probability of entering as new businesses. Firm Type is also positive and significant (2.05E-06, p = 0.000), implying that industry classification plays a meaningful role in shaping new firm entry. In contrast, the interaction term REM×FED is statistically insignificant (0.018, p = 0.537), indicating that financial development does not moderate the effect of remittances in a conditional sense. Among control variables, Firm Age (0.127, p = 0.232), Firm Size (0.0002, p = 0.962), and Firm Ownership (0.030, p = 0.305) do not show

statistically meaningful effects, suggesting that these firm-specific attributes do not significantly influence the probability of new business creation in this model. The constant term is also insignificant, reflecting no baseline effect when predictors are held at zero. Overall, the results highlight that remittances and financial development independently support new business creation, but their combined interactive effect is not empirically validated.

Figure 2: Stability Diagnostics Test-CUSUM Test



The CUSUM test evaluates the stability of model coefficients over time. Since the plot in Figure 2 remains within the 5% significance bounds, it provides strong evidence of parameter stability, indicating that the model is well-specified, reliable, and structurally consistent, which reinforces confidence in the regression results and overall empirical findings.

5. Conclusion and Policy Recommendation

This main objective of the study was to test the impact of remittance on new business creation in Pakistan with how remittance and financial development jointly impact on the dependent variable. This paper employs the micro-level empirical research approach that uses firm level evidence of the World Bank Enterprise Surveys with country-level financial indicators to determine the ways in which remittances and financial development impact the likelihood of new business creation. The findings indicate that remittance inflows positively and significantly influence the probability of starting a new business. The research has added to the existing literature on entrepreneurship and financial development literature by offering firm-level evidence in Pakistan about the independent contribution of remittances and financial development to the establishment of new business. On the basis of the findings of the study it is recommended that government should strengthen the financial system so that remittance can be easily transformed from consumption to investment channel.

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