Determinants of Financial Inclusion in Small and Medium Enterprises: Empirical Evidence from Afghanistan

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Abstract

This study examines the determinant factors that influence financial inclusion among small and medium enterprises (SMEs) in Afghanistan. The study uses quantitative methodology with primary sources of data. More specifically, the study adopts a multiple linear regression model. The finding of the study reveals that; supply-side factors, demand-side factors, market opportunity, institutional framework factors, costs of borrowing, and collateral requirements have a positive effect on the firm's access to finance. This study suggests concerned bodies sustain rapid and inclusive economic growth and hence eradicate extreme poverty and hunger, the policymakers must build an efficient, strong, and well-functioning financial market system that provides affordable and sustainable financial services to SMEs.

Keywords: *Access to finance; collateral requirements; cost of borrowing; SMEs; financial inclusion; Afghanistan.*

Introduction

While financial risk has been reduced in developed and developing nations alike in recent decades due to the requirement of a better regulatory framework but developing countries still have to contend with a lack of equitable access to finance (Sahara, 2018). Financial inclusion is still a major policy issue for many countries, and there is much that can be done on the part of governments to make this a reality. In recent decades, a growing body of literature around the world has emphasized the importance of financial inclusion for inclusive economic growth and poverty reduction. It is important to note that policymakers have focused on the role that financial inclusion plays in establishing an environment that encourages small businesses to get into the financial sector as well as to develop as a result of the absence of collateral requirements (Kalunda, 2012). Abada (2015) believes that small and medium-sized businesses' growth is largely influenced by their ability to access financing, which is one of the key components of financial inclusion. Although Afghanistan has been lagging behind in the availability of financial inclusion for small and medium-sized businesses, however, the case is different in other South-central Asian countries. Less people in Afghanistan have access to a bank account. When it comes to financial services, however, more people will have access to them. This will lead to more savings, more capital for investment in businesses, and more entrepreneurs. To ensure economic growth, financial inclusion is essential, and it refers to all initiatives that make formal financial services accessible, and affordable to all segments of the population (Peria, 2007).

Vojislav et.al (2008) also found that financial inclusion is an important engine of economic development because it provides substantial benefits to the poor and marginalized. Afghanistan's small and medium-sized enterprises (SMEs) confront several obstacles, one of which is a dearth of funding options. It is worthwhile to investigate, evaluate, and

analyze the gap between the need, demand, and available options for financial inclusion in small and medium-sized enterprises (SMEs) in Afghanistan. On the other hand, more than half of the country's population lives below the national poverty line, and for small and medium-sized businesses, obtaining financing is one of the most significant challenges they face. Small and medium companies (SMEs) have been left behind in Afghanistan's financial inclusion because the government does not care about them. Despite the National, Financial Inclusion Strategy put forth by Da Afghanistan Bank in among Afghans and small and medium-sized enterprises (SMEs) into the country's financial system, there have been no discernible changes in Afghanistan's financial and economic conditions that could lead to an increase in GDP and/or financial inclusion. As a result, during the first eight years after the US invasion, Afghanistan lacked a coherent SME policy. Some studies have hinted that small and medium enterprises play an important role in the livelihood of people. While financial accessibility has always been a significant matter for such enterprises. This research is undertaken to study the determinants of financial inclusion in small and medium enterprises in Afghanistan to investigate financial accessibility and find determinants of financial inclusion in the context.

2. Literature review

The World Bank (2019) defines financial inclusion (FI) as the process by which all households and businesses regardless of income level have access to and can effectively use the appropriate financial services they need to improve their lives. Corporate Finance Institute (2020) also defines financial inclusion as a state at which individuals access a full suite of financial services at affordable prices, in a convenient manner, and with respect and dignity. Such services have to be availed responsibly and more safely to consumers and sustainably provided in an appropriately regulated environment (Jalil, 2022). Global and national level policymakers are taking up financial inclusion as an important development agenda and the priority it deserves. For example, the G20 included financial inclusion as the main pillar at the 2009 Pittsburg Summit (Melecky, 2016). At a macro level, financial inclusion can result in a diversified base of deposits creating a resilient financial system and increased stability (Susanne, 2021).

Claessens (2006) revealed that within a country's level, financial inclusion is affected by the limitations arising from numerous macroeconomic outcomes which include stability, equality, and economic growth. Information and communication technology have greatly improved digital financing. The delivery of financial services through digital means of service provision has been increasingly emphasized by governments, development partners, and service providers themselves as a good step towards financial inclusiveness (Fowowe, 2017). Till recently, studies on financial inclusion were mostly based on supply-side data on financial inclusion indicators (number of bank accounts, bank branches, loan accounts, etc.). Using supply-side data, scholars have documented that country-specific characteristics, such as levels of poverty, inequality, urbanization, physical and electronic connectivity, information availability, literacy rate, etc., play an important role in determining the extent of financial inclusion (Ayo-Oyebiyi, et.al, 2015). The provision of services like mobile banking has provided easy ways for electronic transfer payments to financially excluded people, and this method can help reduce theft and financial crimes which are related to cash transactions and reduce the risk of loss. Digital financing appears to be a better solution for those financially and socially excluded (Swamy, 2010). The attempt to support financial inclusiveness will address the challenges of access to finance that may likely hinder the growth of SMEs. A study

conducted by Hall (1992) suggests two primary causes for the failure of small and medium business enterprises in the world. These failures are classified as a lack of appropriate management skills and inadequate capital (both at start-up and continuously). Onaolapo (2015) believes that the most important internal factors that determine SME's stainability is risk-related factor and marketing, opportunities within the market, and financial, and political-legal factors are major external factors affecting SMEs' sustainability. However Institutional factors have attracted the attention of many authors in recent years (See for instance; Dienillah, 2018; Fang et.al, 2014; Han and Melecky, 2013). Most studies showed the influence of institutions on financial inclusion in both its overall and individual aspects. Morgan (2014) emphasized that regulations related to law, institutions, and political stability are factors that promote better financial inclusion, which is also confirmed by Neaime et.al (2018) in their study in Uganda as well. On the other hand, the high increase in financial inclusion can be associated with increased investment level, employment opportunity, higher income level, and lower poverty level, and economic growth can only be sustained if a good number of people have access to formal financial services (Melecky, 2013). To increase financial inclusiveness to the majority of the population, financial service providers should lower down the costs of operating accounts, particularly citizens from rural areas (Okpara, 2011; Steven, 2012; Izabela, et al., 2014). There are high transaction costs in lowly populated areas coupled with rigid and complex methods of assessing the risk profile of clients in rural areas, and these have been a challenge for formal financial institutions with a business model to sustainably offer adequate and effective financial services to rural populations (Kumar, 2109).

Addressing the challenges like information and communication technology, especially how cash transfer, cost of capital, usage, and access to finance will definitely play a key role in the growth of SMEs. Razak Alhassan (2019) pospositsat SMEs are described as the nucleus of economic growth and development and are major sources of employment. Studies also note that SMEs are major players in economic growth and development since it provides employment opportunities to citizens, and this increases their household income (Nega 2016; Morgan, 2014; Abel et.al, 2018). Okpara (2011) demonstrates that networking among SMEs, in addition to increasing competitiveness, allows sharing of employee training costs and cuts costs on consultancy and research and development, production, export, and human resource, and financial support. While Ali (2018) does not find causal links between networking of resource combinations, information sharing, and international performance, their research supports a positive relationship between a firm's human capital network and international performance.

Most SMEs operating in Sub-Saharan Africa and in Uganda in particular are faced with many challenges, which affect their operations and long-term survival. Fitane (2020) observes most African SMEs are operating in highly hostile and difficult conditions compared to their counterparts in more developed economies of the world. Levine et.al (2005) establish that SMEs in Africa find various obstacles in doing business due to unfavorable business conditions arising from unrealistic requirements like higher taxes, higher inflation rates, fluctuation, and unstable exchange rates thus making it very difficult for their operation. It is noted that the business failure rates are alarming with very few businesses surviving for a year of their operation. Hilario (2016) opines that governments should support SMEs by ensuring that they play their roles in helping them improve their economies. The study conducted by Ene (2015) also established that some of the challenges hampering the growth of SMEs were stiff competition, lack of markets,

unfair treatment exhibited by local authorities and lack of government support, and inadequate information and communication technology and training, which have greatly affected most of our SMEs.

As a result of the empirical review this paper develops the following schematic representation of the conceptual framework in the context of Afghanistan, as can be seen in Figure 1.

Figure 1: Research Framework
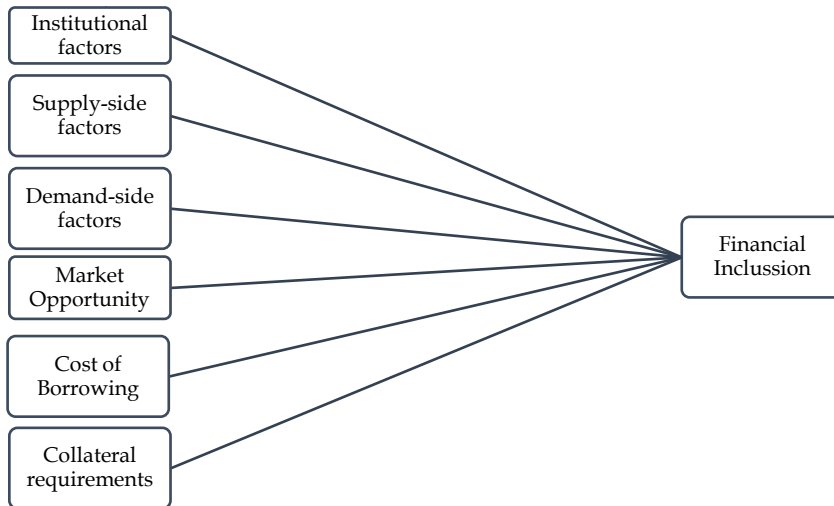
Source: Author's compilation

Thus, the paper formulates the following hypothesis for testing.

Hypothesis 1 (H1): Institutional framework factors have a negative and significant effect on financial inclusion.

Hypothesis 2 (H2): Supply-side factors have a positive and significant effect on financial inclusion.

Hypothesis 3 (H3): Demand-side factors have a positive and significant effect on financial inclusion.

Hypothesis 4 (H4): Market opportunity has a positive and significant effect on financial inclusion.

Hypothesis 5 (H5): The cost of borrowing has a negative and significant effect on financial inclusion.

Hypothesis 6 (H6): Collateral requirement has a negative and significant effect on financial inclusion.

3. Research Methodology

There are three methodologies that are used to direct research. They are quantitative, qualitative, & mixed techniques, where in this study we use quantitative data for the measurement of dependent and independent variables. Babbie (2010) contends that quantitative methods focus on target estimations, and investigation of mathematical, numerical, or factual information that is gathered by methods for reviews, surveys, & questionnaires, or through the control of prior measurable information by methods for computational procedures. For this study, a quantitative methodology with a survey approach is used where a structured questionnaire of 5- or 7-point Likert Scaling is designed & disseminated to 160 SME's owners of Kabul city. All variables used in this study are quantitative. The survey scale examines the research variables. The survey scale gives respondents a variety of alternatives on a topic and includes some open-ended questions. The questions include a 5- or 7-point Likert Scaling. There were two

components to this research questionnaire. The first part of the questionnaire is for personal information such as age, gender, education, and years of work experience, while the second part is for measuring variables such as Institutional framework factors, Supply-side factors, Demand-side factors, Market opportunity, and Cost of borrowing as independent variables, and financial inclusion as a dependent variable

3.1 Demographic, gender and level of education information of the respondents

Table 1. Respondents Information

Age	Frequency	Percentage
Less than 25 years	15	9.80
25-35 years	113	70.70
36-45 years	32	19.50
Gender		
Male	11	7
Female	149	93
Level of education		
Diploma	5	3
Bachelor	35	22
Master	120	75

Source: Data output from SPSS

3.2 Reliability Test

Cronbach's alpha is a reliability coefficient that determines how easily individual items in a collection may be singled out for verification. When assessing reliability, it is more important to take into consideration the dependability of the overall mean of the items than it is to consider the dependability of a single thing. This coefficient has a value that may be anywhere from 0 to 1, inclusive. A value of aftereffect that is more than or equal to 0.7 is diagnostic of a high degree of internal consistency. The table that follows presents the findings of the reliability test that was performed on the questionnaire.

Table 2. Reliability Test

Construct	Items	Cronbach's Alpha
Total Items	31	.950
Institutional factors	4	.950
Supply and demand-side factors	6	.953
Market opportunity	6	.952
Cost of borrowing	5	.948
Collateral requirements	5	.952
Access to Finance	5	.951

Source: Data output from SPSS

Thus, this paper's instrument seems to be reliable and authentic, with a typical Cronbach's alpha score of 0.950. This is despite the uncommon and one-of-a-kind limitations that are normally connected with this kind of study.

3.3 Normality Test

Table 3. Normality Test

Indicators	Kolmogorov-Smirnovb			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Institutional factors	0.245	160	0.145	0.124	160	0.087
Supply and demand factors	0.324	160	0.077	0.345	160	0.236
Market Opportunity	0.431	160	0.078	0.335	160	0.123
Cost of borrowing	0.325	160	0.054	0.863	160	0.272

Collateral requirement	0.324	160	0.065	0.346	160	0.256
Access to Finance	0.248	160	0.074	0.365	160	0.245

Data outpout from SPSS

The current study uses of the normality of the data determined by the Kolmogorov-Smirnov (KS) and Shapiro-Wilk (SW) values. The Kolmogorov-Smirnov (KS) and Shapiro-Wilk (SW) values were significant (P>0.05) for institutional factors, supply and demand factors, market opportunity, cost of borrowing, collateral requirement, and access to finance indicating that all variables were normally distributed.

3.4 Regression analysis

Regression analysis shows the statistical dependence & relationship of one variable to other variables. The regression analysis is used to show what proportion of variance between variables is due to the dependent variable, and what proportion is due to the independent variables. The relation between the independent variable & dependent variable can be showed graphically, or more usually using an equation. This paper adopts a regression analysis guided by the following model.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Where Y means access to finance, X_1 institutional factors, X_2 supply and demand side factors, X_3 Market opportunity, X_4 cost of borrowing, X_5 collateral requirements, β_0 & β_1 are constants, e is the error term.

Table 4. Descriptive Statistics

	Mean	Std. Deviation	N
Access to Finance	4.2700	.98344	160
Institutional framework	4.3609	.88344	160
Demand and Supply side	4.2437	1.05324	160
Opportunity to Market	3.7302	1.18219	160
Cost of borrowing	4.6397	.74205	160
Collateral Requirements	4.2859	1.20840	160

Source: Data output from SPSS

Descriptive statistics explain the basic descriptive statistics for both the dependent variable (access to finance) & independent variable (institutional framework, demand and supply side, opportunity to market, cost of borrowing, and collateral requirements). Column N whose value is 160 represent the number of respondents from whom the data has been collected and minimum value available for the respondent is 3.7302.00 and the maximum value is 4.6397. The majority of the respondents are in all independent variables and means and standard deviation is different for different variables.

Table 5. Anova

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	151.896	5	30.379	2488.945	.000[b]
Residual	1.880	154	.012		
Total	153.776	159			

Source: Data output from SPSS
a. Dependent Variable: Accesses to Finance
b. Predictors: (Constant), Collateral Requirements, Cost of borrowing, Opportunity to market, Institutional framework, Demand, and Supply side

The ANOVA table is used in the ordinary least square method of regression where our major focus is on checking the significance level of the overall model. As in the ANOVA table in the model column in the regression row, the value of F is more than 4 and the significance is .000 which is less than 5 so it shows that the regression model used in this study is an appropriate model.

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.994ª	0.988	0.987	0.11048	0.988	2488.945	5	154	0

Source: Data outpot from SPS
a. Predictors: (Constant), Collateral Requirements, Cost of borrowing, Opportunity to Market, Institutional framework, Demand, and Supply side
b. Dependent Variable: Accesses to Finance

A multiple regression model determines the model's fitness. R^2 can be used to assess the model's fitness. This study finds that R is 99.4% and R^2 is 98.8%. The R^2 value indicates that the independent variables such as collateral requirements, cost of borrowing, market opportunity, institutional framework, Demand and Supply-side explain that 98.8% of the changes in access to finance is due to these independent variables, while the remaining 2% of the change in access to finance is explained by variables not chosen in this study.

Table 7: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.135	.069		1.969	.041
Institutional factors	.101	.050	.091	2.033	.044
Demand and Supply side	.370	.071	.396	5.193	.000
Opportunity to Market	.266	.034	.320	7.927	.000
Cost of borrowing	.195	.040	.147	4.859	.000
Collateral Requirements	.053	.036	.065	1.478	.041
a. Dependent Variable: Access to Finance					

Source: Data outpot from SPSS

The beta value of institutional factors is 0.091. This implies that a one-unit change in Institutional factors results in a 0.091-unit increase in the dependent variable, access to finance. Because the significant level for institutional factors is less than 0.05, it can be concluded that institutional factors have a positive and significant impact on access to finance. The beta value of demand and supply side factors is 0.396. This implies that a one-unit change in demand and supply side factors results in a 0.396-unit increase in the dependent variable, access to finance. Because the significance level for demand and supply side factors is less than 0.05, it can be concluded that demand and supply side factors have a positive and significant impact on access to finance. The beta value of the market opportunity is 0.320. This implies that a one-unit change in market opportunity results in a 0.320-unit increase in the dependent variable, access to finance. Because the significant level for market opportunity is less than 0.05, it can be concluded that market opportunity has a positive and significant impact on access to finance. Borrowing costs have a beta value of 0.147. This implies that a one-unit change in borrowing costs will result in a 0.147-unit increase in the dependent variable, access to finance. Because the significance level for the Cost of borrowing is less than 0.05, it can be concluded that the Cost of borrowing has a positive and significant impact on access to finance.The beta value of collateral requirements is 0.065. This implies that a one-unit increase in collateral

requirements results in a 0.065-unit increase in the dependent variable, access to finance. Because the significant level for collateral requirements is less than 0.05, it can be concluded that collateral requirements have a positive and significant impact on access to finance.

Table 8. Correlations

	Institution al framework	Demand -Supply side	Opportunity to Market	Cost of borrowing	Collateral Requirements	Access to Finance
Institutional framework	1					
Demand and Supply side	.960**	1				
Opportunity to Market	.934**	.966**	1			
Cost of borrowing	.943**	.906**	.841**	1		
Collateral Requirements	.923**	.975**	.923**	.886**	1	
Accesses to Finance	.969**	.989**	.971**	.918**	.961**	1

n=160, *P < 0.05; **p < 0.01; ***p < 0.001

Source: Data outpot from SPSS

4. Conclusion

Aduda (2012) believes that small and medium-sized businesses' growth is largely influenced by their ability to access financing, which is one of the key components of financial inclusion. Although Afghanistan has been lagging behind other continents in the availability of financial inclusion for small and medium-sized businesses, the case is different in the context of South-central Asia. Less people in Afghanistan have access to a bank account. Financial inclusion is an issue for small and medium-sized businesses. As a result of SMEs, competition, innovation, and the development of human capital, as well as the creation of a financial system have all been bolstered (Nega and Hussein 2016). As a result of which this paper investigated the determinants of financial inclusion in small and medium enterprises in Afghanistan, of which the conclusions are as follows; The variable supply-side and demand-side factors (which are measured by strategic business planning, clear mission and vision, raw material availability, motivation, tolerance to work hard, business partner selection, management skill, availability of funds from banks, expansion plan, willingness of banks, customer handling system, availability working capital, availability of appropriate machinery and equipment, and selection of proper new technology) have a positive impact. The regression analysis results indicate that a one-unit increase in supply-side factors causes firms' access to finance to increase by 0.396 units and is statistically significant at a 5% significance level. The positive relationship between variables implies that whenever financial institutions increase the availability of credit to SMEs, the firm's access to finance may also increase. This variable's discovery is consistent with the findings of the study established by (Arnold, 2012).

Furthermore, the variable market opportunity (which is measured by the availability of market information, awareness about the product/promotion, connection with successful and other businesses, adaption to changing environment, and skills to handle new technology) has a statistically significant positive relationship with the firm's access to finance. The regression out result implies that a one-unit increase in the firm's (SMEs) market opportunity results in a 0.320-unit increase in the firm's access to finance, which

is statistically significant at a 5% significance level. The positive relationship between firm access to finance and market opportunity implies that if SMEs have more market opportunity to perform their business activities in the market, financial institutions are more likely to facilitate credit access to SMEs than in normal circumstances.

On the other hand, the variable cost of borrowing (which is measured by profit challenges in accessing credit, credit expensiveness, business performance, and growth magnificent, and bank service charges) has a negative and statistically significant relationship with firms' access to finance. The coefficient on the regression analysis of this variable indicates that a unit increase in cost borrowing causes a 0.147-unit decrease in firm access to finance, which is statistically significant at a 5% significance level. This means that when financial institutions raise the cost of borrowing by one unit, firms' (SMEs') access to finance increases automatically. Furthermore, the relationship between collateral requirements and access to finance is positive and statistically significant (as measured by; if collateral affects access to finance, problems in accessing loans than large firms, and mandatory requirement of collateral). The regression output implies that increasing the collateral requirement by one unit increases the firm's access to finance by 0.065 units, which is statistically significant at a 5% significance level. The implication is that if a firm's (SMEs') ability to provide collateral improves, so will the firm's access to finance.

The relationship between collateral requirements and access to finance, on the other hand, can be interpreted as follows: when the firm's (SMEs) collateral requirement decreases, the firm's access to finance also decreases because the two variables move in the same direction. The primary goal of this paper is to investigate the determinant factors that influence financial inclusion among Afghan SMEs, and the results of regression analysis show that supply-side, demand, and collateral requirement factors have a positive effect on access to finance and are statistically significant at a 5% significance level. Similarly, market opportunity factors have a positive effect on firms' access to finance and are statistically significant at the 5% level. The institutional framework and borrowing costs, on the other hand, have a positive effect on access to finance and are statistically significant at a 5% significance level. As a result of the study's findings, it is possible to conclude that factors such as collateral requirements, market opportunity, cost of borrowing, institutional framework, demand-side factors, and supply-side factors all have a significant impact on a firm's access to finance.

4.1 Future scope

As much as our knowledge of financial inclusion advances, this study nevertheless has significant limitations and provides only a quick look at the current state and relevance of small businesses. The empirical study is based on results from Kabul city because it primarily examines the factors influencing financial inclusion in this city. But the validity of conclusions does not need to be limited to Kabul city only. Other researchers can do the research in other provinces of Afghanistan and check and see the results.

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