

Microfinance and SMEs Growth: An Empirical Study from Afghanistan

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Abstract

This study examines the impact of microfinance on the growth of small and medium enterprises (SMEs) in Afghanistan. SMEs form a major part of the country's economy, yet many face persistent challenges in securing credit from formal financial institutions. This significantly hampers the growth of SMEs and calls for empirical studies to unveil the influence of microfinance on SMEs growth. Accordingly, this study is an attempt to understand how specific microfinance services influence SMEs growth. The study focuses on four key microfinance related factors i.e. loan availability, loan size, loan conditions, and loan usage. A quantitative research design was used to collect the data through a structured questionnaire from 255 SMEs owners and managers who had received microfinance services. Descriptive statistics, correlation analysis, and multiple linear regression were applied to determine the effect of each loan-related variable on SMEs growth. The results show that all four variables positively and significantly influence SME performance, with loan usage emerging as the strongest predictor. SMEs that used their loans for productive purposes recorded higher levels of growth. Theoretically, this study helps to understand the role of microfinance towards SMEs growth in a relatively complex and vulnerable context given the country's circumstances (political instability, war-like situation etc.). Practically, the findings suggest that microfinance institutions should improve loan accessibility, ensure appropriate loan sizes, and provide flexible terms to support SMEs growth. The strong influence of loan usage highlights the need for financial management support to help SMEs owners utilize borrowed funds effectively.

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Overall, the study offers insights that can guide policymakers and microfinance providers in promoting SMEs in Afghanistan.

Keywords: *Microfinance, SMEs growth, loan availability, loan conditions, loan usage, Afghanistan.*

Introduction

Small and medium enterprises (SMEs) form a major part of Afghanistan's private sector and remain essential to job creation, income generation, and local economic stability (World Bank, 2018; UNDP, 2020). In a fragile and evolving economic environment like Afghanistan, SMEs often play a role similar to that performed by large industries in more developed economies (OECD, 2017). They provide employment to thousands of people and support small-scale production, service delivery, and entrepreneurship across the country (International Labour Organization [ILO], 2019). Because of their widespread presence and ability to operate even in uncertain markets, SMEs are often seen as an engine for economic recovery and community resilience (Asian Development Bank [ADB], 2021). This aligns with prior research emphasizing how service-related improvements significantly influence performance outcomes in business environments (Zaheer, Sadiq, & Safi, 2025). Their growth, however, depends heavily on access to finance, which remains one of their most persistent and critical challenges in Afghanistan (World Bank, 2020; IFC, 2019).

Access to microfinance in Afghanistan has historically been limited due to the narrow reach of the formal banking sector, particularly outside major urban centers (World Bank, 2017). Strict collateral requirements imposed by commercial banks make it difficult for SMEs to secure loans, while lengthy approval procedures often discourage small business owners from applying for formal credit (Da Afghanistan Bank, 2018; IFC, 2019). As a result, many businesses are unable to meet traditional banking criteria, contributing to the emergence of microfinance institutions (MFIs) as an alternative source of financing (UNDP, 2020). MFIs were established to bridge this financing gap by providing smaller loan amounts with simplified procedures, thereby improving access to credit for SMEs excluded from conventional banking systems (Asian Development Bank [ADB], 2019). Over the past two decades, the role of MFIs has become increasingly significant as microfinance has evolved into one of the most practical financial tools for supporting small business operations in Afghanistan (World Bank, 2021; Microfinance Investment Support Facility for Afghanistan [MISFA], 2020).

The context of Afghanistan highlights why microfinance is considered critical. According to the Afghanistan Microfinance Association (AMA, 2021), over 314,000 borrowers were active in the microfinance sector, and loan disbursements continue to grow each year. Institutions such as First Micro

et al., 2011; Al-Maamari, 2025). Prior research also confirms that improvements in internal systems and resource utilization significantly enhance employee productivity and organizational performance (Zaheer & Sadiq, 2024). Many studies also use employment growth, improved capital investment, and operational efficiency as measures of growth (Beck et al., 2008; Hemat & Rahman, 2024). Previous evidence from Afghanistan also suggests that organizational and human factors, including leadership style, emotional intelligence, and employee motivation, contribute significantly to productivity and overall organizational performance, indicating that internal capabilities are important drivers of sustainable growth (Zaheer & Barakzai, 2026). In the context of microfinance research, SME growth is often viewed as a firm's ability to strengthen its financial position, expand its operations, and sustain long-term stability (Beck, Demirgüç-Kunt, & Levine, 2005; Storey, 1994). In this study, SME growth is defined through increases in financial performance, productivity, and business expansion resulting from improved access to credit (Roodman & Morduch, 2014; World Bank, 2020).

1. Loan Availability and SME Growth

Loan availability refers to the ease with which SMEs can access credit from microfinance institutions. Existing research consistently shows that easier access to loans allows small firms to address capital shortages, invest in operations, and expand their activities. Studies from Kenya, Bangladesh, and Afghanistan demonstrate that loan availability supports business development, improves production, and enables job creation (Raihan & Mahmud, 2017; Moussa, 2020; Hemat & Rahman, 2024). When SMEs can obtain loans without excessive barriers, they are better positioned to maintain working capital, purchase inventory, and manage cash flow. However, research from Pakistan and Nigeria highlights that limited loan availability or costly loan processes may restrict SME growth despite the presence of microfinance programs (Mahmood & Bakhsh, 2020;). In Afghanistan, microfinance remains the most reliable source of credit for SMEs due to the limited reach of banks, making loan availability particularly significant.

Hypothesis 1:

Loan availability has a positive and significant effect on SME growth.

2. Loan Size and SME Growth

Loan size represents the actual amount of credit provided to SMEs. Adequate loan amounts allow businesses to expand operations, upgrade equipment, purchase inventory, and invest in growth-oriented activities (Nicholaus et al., 2025; Moussa, 2020). Evidence from Tanzania, Lebanon, and Nigeria shows that sufficiently large loans improve profitability and operational efficiency (Onyeiwu et al., 2021). When loan sizes match business needs, SMEs are more capable of scaling their operations and competing in the market. Conversely, excessively small loans may not provide enough capital to support meaningful business expansion, while excessively large loans may create repayment challenges if business capacity

Conceptual Framework Diagram

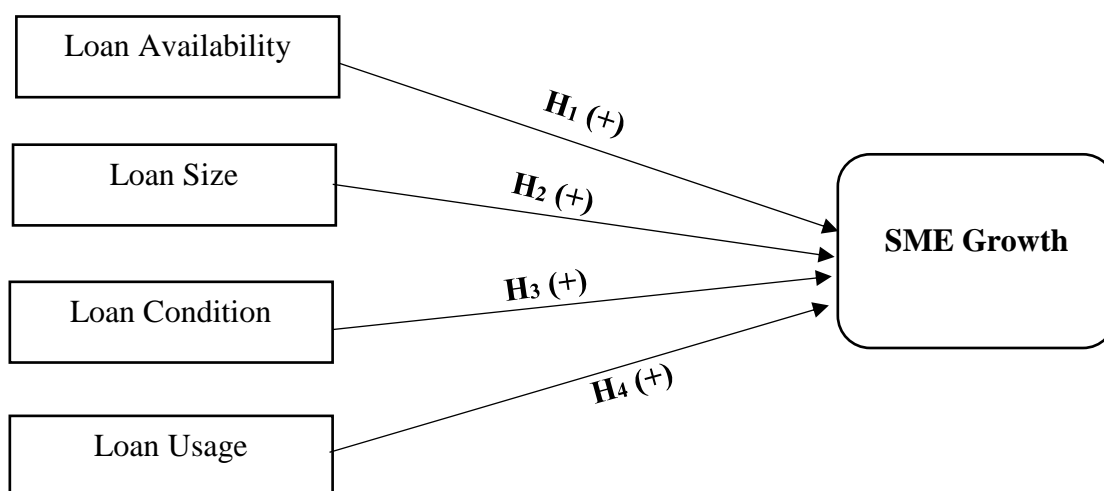


Figure 1. *Conceptual Model of the Impact of Microfinance on SME Growth in Kabul.*

Research Methodology

This study uses quantitative research design with a cross-sectional survey. A quantitative approach is appropriate because it allows the researcher to work with numerical data, test hypotheses, and understand how strongly each variable influences SME performance. The structured questionnaire ensures consistency across responses, while regression analysis helps isolate the effect of each predictor.

Population, Sampling Procedure, and Sample Size

Population

The target population consists of small and medium enterprise owners and managers in Kabul, Afghanistan who have received microfinance services. SMEs from trade, services, manufacturing, and agro-related sectors were included.

Sampling Procedure

A sampling frame was created from MFI client lists, local business associations, and field mapping of SME clusters. Convenience sampling was adopted due to accessibility and security constraints in Kabul. However, this non-probability sampling technique may limit the representativeness of the sample and the generalizability of the findings. When multiple respondents were available in one firm, the owner or senior manager was selected.

Sample Size

A total of 255 participated. This sample size is suitable for multiple regression and is consistent with recommendations in business research.

Table 1. Demographic Profile of Respondents

Characteristic	Category	Frequency	Percent
Gender	Male	235	92.2%
	Female	20	7.8%
Age	< 25 years	28	11.0
	25–34 years	96	37.6
	35–44 years	78	30.6
	45+ years	53	20.8
Education	Primary or less	12	4.7
	Secondary	50	19.6
	Diploma / vocational	70	27.5
	Bachelor	95	37.3
	Master+	28	11.0
Business sector	Trade / retail	86	33.7
	Services	72	28.2
	Manufacturing	48	18.8
	Agriculture / agro-processing	49	19.3
Years in business	<2 years	30	11.8
	2–5 years	78	30.6
	6–10 years	84	32.9
	>10 years	63	24.7

Instrument Development, Adaptation, and Pre-Testing

The questionnaire was adapted from established studies on microfinance and SME growth (Beck et al., 2005; Roodman & Morduch, 2014). Items measuring loan availability, loan size, loan conditions, and loan usage were drawn from international microfinance research and subsequently modified to ensure local relevance and contextual suitability (Armendáriz & Morduch, 2010; Cull, Demirgüç-Kunt, & Morduch, 2009). SME growth items were adapted from prior studies that assess financial improvement, productivity, and business expansion (Storey, 1994; Wiklund & Shepherd, 2005).

Afghanistan's political, economic, and security conditions may influence SMEs' access to microfinance and business performance over time. Data were collected through both in-person visits and online questionnaires. Enumerators visited business premises across Kabul, Afghanistan and provided digital access for respondents who preferred remote participation.

The data collection steps were:

- **Enumerator Training:** A team of trained data collectors received instruction on the questionnaire, ethical protocols, and interview procedures.
- **Field Visits:** Enumerators approached SME owners/managers during business hours and explained the purpose of the study.
- **Informed Consent:** Respondents were briefed on confidentiality and voluntary participation before starting the survey.
- **Quality Checks:** Completed questionnaires were checked daily for completeness and consistency.
- **Final Dataset:** Out of 260 responses collected, 255 were useable after cleaning.

Findings

Regression Model

A multiple linear regression model was used in this study to evaluate how loan-related factors affected the expansion of small and medium-sized businesses (SMEs). SME Growth (SMEG), which reflects the growth and performance of SMEs, is the model's dependent variable. Loan Availability (LA), Loan Size (LS), Loan Conditions (LC), and Loan Usage (LU) are the independent variables.

The regression model is expressed as:

$$SMEG = \beta_0 + \beta_1(LA) + \beta_2(LS) + \beta_3(LC) + \beta_4(LU) + \epsilon$$

This model assumes a linear relationship between SME growth and the selected loan variables. The coefficients (β_1 – β_4) measure the magnitude and direction of influence that each factor exerts on SMEG.

For example:

- A positive and significant β_1 would indicate that improved *Loan Availability* enhances SME growth.
- A positive β_2 would suggest that larger *Loan Size* contributes to SME expansion.
- A negative β_3 would imply that stringent or unfavorable *Loan Conditions* hinder SME growth.
- A positive β_4 would mean that proper *Loan Usage* enhances business performance.

The error term (ϵ) captures all other factors not included in the model but which may influence SME growth.

moderately strong intercorrelations: loan usage correlates positively with loan conditions ($r = 0.664$) and loan size ($r = 0.656$), while loan conditions correlate strongly with loan size ($r = 0.756$). Loan availability also shows moderate to strong correlations with loan size ($r = 0.709$), loan conditions ($r = 0.653$), and loan usage ($r = 0.576$). Overall, the correlation coefficients are positive and below the critical value of 0.80, suggesting that while the variables are related, as expected in financial behavior research, there is no indication of multicollinearity severe enough to threaten the validity of subsequent regression analysis. These results support the appropriateness of including all predictors in the regression model.

Multicollinearity Test

Table 6. Variance inflation factor

	VIF	1/VIF
LS	3.045	.328
LC	2.743	.365
LA	2.188	.457
LU	2.022	.495
Mean VIF	2.5	.

Table 6 indicates the Variance Inflation Factor (VIF) for variables influencing SME growth (SMEG), which is used to detect multicollinearity, when independent variables are too closely related. VIF values show how much a variable is correlated with the others. A VIF of 1 indicates no correlation, values between 1 and 5 are acceptable, and values above 10 suggest serious multicollinearity. In this table, Loan Size (LS) has the highest VIF at 3.045, while Loan Usage (LU) has the lowest at 2.022. Loan Condition (LC) and Loan Availability (LA) have VIFs of 2.743 and 2.188, respectively, and the mean VIF is 2.5, which is within the acceptable range. This indicates that multicollinearity is not a concern in this model, meaning that each variable, Loan Size, Loan Condition, Loan Availability, and Loan Usage, contributes unique information to explain SME growth. Overall, the regression results are reliable and can be interpreted confidently.

Regression Output

Table 7. Linear regression

SMEG	Coef.	St.Err.	t-value	p-value	[95% Conf Interval]	Sig
LU	.402	.063	6.38	0	.278 .526	***
LC	.194	.062	3.15	.002	.073 .316	***

Discussion

The findings of this study indicate that loan availability, loan size, loan conditions, and loan usage all have positive and statistically significant effects on the growth of SMEs in Kabul. Since all variables were coded in the same direction, higher scores represent higher levels of each construct. Therefore, the positive correlation and regression coefficients indicate that increases in loan availability, loan size, favorable loan conditions, and productive loan usage are associated with higher levels of SME growth. By comparing these findings with previous studies, valuable insights can be derived. These findings also provide empirical support for the Resource-Based View, which suggests that SMEs achieve superior performance when they acquire valuable financial resources and utilize them effectively. The significant effects of loan availability, loan size, loan conditions, and particularly loan usage indicate that both access to financial resources and their efficient deployment contribute to SME growth.

Firstly, loan availability was discovered to positively impact the growth of SMEs. This fits closely with the findings from Kenya, Bangladesh, and Afghan research, which found that loan availability has been instrumental in encouraging business growth and production as well as job creation (Kiplimo et al., 2015; Raihan & Mahmud, 2017; Hemat & Rahman, 2024). Like the previous examples, Afghan SMEs also found loan availability instrumental in helping them address the shortage of capital. However, the findings from research in Pakistan and Nigeria paint a different picture. In those states, loan availability does not readily contribute to growth because the loaned money becomes expensive to repay (Mahmood & Bakhsh, 2020; Open Journal of Social Sciences, 2025). In contrast to the previous findings, Kabul's SMEs can be said to be in a better position regarding loan Availability due to microfinance institutions being the only trustworthy option when it comes to acquiring business capital.

Second, the findings also revealed that the loan size positively affects the dependent variable. However, the effect was found to be of moderate intensity. This agrees with previous research in Tanzania, Lebanon, and Nigeria that revealed suitable loan sizes enabled businesses to grow and maximize their efficiency (Nicholaus et al., 2025; Moussa, 2020; Onyeiwu et al., 2021). This research also confirms that microloans containing smaller amounts will undermine growth because large loans will lead to increased financial problems. On the contrary, research in Pakistan showed that due to the minute size of the loans along with the interest level being high, microfinancing had little role in steering the businesses toward growth (Mahmood & Bakhsh, 2020). In the context of Afghan SMEs, the size of the loans can be said to be satisfactory enough to optimize performance.

Thirdly, loan conditions, the interest rate, collateral value, and repayment terms, also had a positive impact on the growth of the micro enterprises. This study's results bear similarity to Kamara (2023) who claimed that favorable and flexible loan terms encourage micro enterprises to access financial services. In

addition, Enoch et al. (2021) found that micro enterprises perform better when the loan terms are favorable. However, the result contradicts the findings of Sendyona & Kituyi (2025) who found that stringent collateral terms and high interest rates mitigated against the growth of micro enterprises in Pakistan. In addition, the study also disagrees with the findings of Mahmood & Bakhsh (2020) who found the same in Uganda. The seemingly improved results from Kabul imply that loan conditions at micro finance institutions in Afghanistan might be less stringent than those of other micro finance institutions from neighboring regions and Africa.

Loan usage was the variable that showed the strongest impact on the growth of the SMEs. This also came out strongly in the studies from Bangladesh, Ethiopia, and Tanzania, where the researchers found that productive loan usage, be it inventory, machinery, and/or technology, has a direct impact on the profitability and sustainability of the business (Islam, 2022; Endris, 2022; Costantino & Mbamba, 2025). Similar findings have been reported in service-sector studies where effective resource utilization significantly enhances performance outcomes (Zaheer, Sadiq, & Safi, 2025). However, when the loan usage was found to be non-business related, such as usage in the form of home expenses, the impact turned out to be negative. The study verifies this theory because it found that the growth of the SMEs who used the loan properly was highest. This defied the findings from the Nigerian study where poor financial literacy resulted in poor performance of loan usage and ultimately affected the performance of the business negatively (Open Journal of Social Sciences, 2025). In contrast to the above study, the Afghan businesses appear to be using their loans in a proper and directly productive manner because loan usage showed the strongest predictive power.

The findings should also be interpreted within Afghanistan's unique political, economic, and security environment. Afghan SMEs operate under conditions characterized by political uncertainty, limited access to formal banking services, economic instability, and persistent security challenges. These contextual factors increase businesses' dependence on microfinance institutions as one of the few accessible sources of external financing. Consequently, the positive effects of loan availability, loan size, favorable loan conditions, and productive loan usage observed in this study may be particularly important in supporting SME resilience and growth within such a challenging business environment. In general, when comparing the findings of the research done in the context of Afghanistan to those of various regions around the world, the findings support the global research findings that microfinancing promotes entrepreneurship and the performance of sme's (Raihan & Mahmud, 2017; Denen, 2025). Contrary to the impact of high interest rates and the amounts involved in microfinancing in various nations where their impact has been minimal, the Afghan sme's in the study seem to be relatively satisfied. The reason for this might be linked

stability among Afghan SMEs. Loan availability was identified as an important factor due to the limited access to formal banking institutions. SMEs in Kabul rely on microfinance alone because of underdeveloped banking services. Access to credit provides SMEs the opportunity to resolve capital shortages, maintain cash flow, and pursue opportunities to diversify and expand their business. Access to larger loan sizes also positively impacted SME growth and performance, supporting the growing need for financing to meet operational needs. Loan sizes that match an SMEs operational needs help entrepreneurs leverage their capital for investments in technology, inventory, and market development; higher productivity and business competitiveness were achieved.

The evidence regarding loan conditions also had an optimistic impact on SMEs, indicating that Afghan microfinance institutions are adopting loan conditions that are generally manageable for borrowers. Fair interest rates, flexible repayment schedules, and reasonable collateral conditions encourage SMEs to apply for loans and use them appropriately. However, the strongest driver of SME growth was the use of the loans, which demonstrate that the effectiveness of microfinance is directly related to the borrower being able to spend the loans appropriately on supporting growth for their business. When entrepreneurs utilize funds from loans in a productive manner, expanding their business, upgrading equipment, or purchasing raw materials, the loan provides demonstrable impact and benefit to their business growth and sustainability. These results indicate that microfinance is a powerful driver of SME growth in Afghanistan when used with consideration and within conditions that are supportive of sustainable use of the loans.

In summary, this study further contributes of credible evidence that microfinance continues to be a perceived crucial element of Afghanistan economic development especially since there are many businesses that otherwise have no access to traditional financial institutions. The findings also gave support to the notion that both MFIs and SMEs have responsibilities; MFIs to deliver loans that are fairly available, and SMEs to utilize them productively. This dynamic then creates an enabling environment for entrepreneurship, workplace, and ultimately for the business's sustained stability.

Limitations and Future Research Directions

Like any research, this study has several limitations that provide opportunities for future investigation. First, the data were collected only from SMEs in Kabul, which limits the generalizability of the findings to other provinces. Business conditions, access to finance, and the strength of local microfinance institutions vary across regions in Afghanistan. Future studies should expand the sample to multiple provinces or conduct a national-level comparison. Second, this study employed convenience sampling due to accessibility and security constraints, which may introduce selection bias and limit the representativeness and generalizability of the findings. Future research is encouraged to employ probability sampling techniques, such as simple random sampling or stratified random sampling, to obtain a more

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