International Journal for Multidisciplinary Research (IJFMR)

E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

Financial Inclusion and Access to Finance for Small and Medium Enterprises (Smes) - A Literature Review

Kuldip Paliwal

Managing Director & CEO, First Alliance Bank, Zambia.

Abstract

Purpose: The aim of this paper is to review the interrelationships between financial inclusion, digital finance, and Small and Medium Enterprises (SMEs) performance in emerging economies, with a specific focus on Zambia.

Design/methodology/approach: The use of Google Scholar, Elsevier, research gate, and science direct generated the survey methodology. The suitable publications were selected from the papers published between the years 2000 and 2023. The terms applied for searching keywords include small and medium enterprises, financial services, SMEs in Zambia, financial performance of SME, SMEs in Africa, financial inclusion, economic growth, financial literacy, digital technology, and digital finance.

Findings: The dynamic interplay between digital finance, financial inclusion, and the inherent performance of SMEs has a profound impact on the broader economic landscape. Remarkably, SMEs' contribution to the nation's economic growth is significant. Within Africa, about 40% of economic contributions are attributable to SMEs. SME performance dramatically increased from 18% in 2010 to 40% in 2020.

Research limitations/implications: Common issues like bureaucratic documentation for financial services often impede Zambian SMEs from securing the financing they need. The role of SMEs in the economic growth of countries, particularly in emerging economies like Zambia, cannot be understated.

Originality/value: This study has addressed the impact of financial inclusion and digital finance on SMEs. Additionally this study provides a framework for the SME in Africa to improve their financial literacy which in turn equips SMEs to make informed and beneficial business decisions.

Keywords: Small and Medium Enterprises, Financial Inclusion, Economic Growth, Alleviating Poverty, Financial Infrastructure, Digitalization

1. Introduction

Employment is a pivotal mechanism for fostering economic growth and alleviating poverty. Several emerging nations, notably in Africa, have grappled with persistent poverty levels despite their economic advances over the years. Recent research predicts a 25% reduction in poverty rates for African nations by 2030, while other countries are expected to see a decrease of 3% (Beegle & Christiaensen, 2019). High unemployment rates in African countries have spurred individuals to venture into small businesses to secure their livelihoods, leading to the proliferation of SMEs across the continent. SMEs constitute approximately 91% of formal business entities in Africa, contributing to almost half of the continent's

GDP. Notably, they account for 60% of national employment. While SMEs confront various challenges, from training and technological adaptation to product quality and branding, financial access remains paramount. Despite decades of improvement, Africa's financial infrastructure remains underdeveloped; fewer than half of its nations boast a stock market, and among these, liquidity is often scant (zepari).

The accessibility of finance for SMEs emerges as a salient factor in addressing poverty. Recognized as primary economic growth and job creation engines in emerging economies, SMEs have been emphasized for their significance (Blancher et al., 2019; Ghassibe, Appendino, & Mahmoudi, 2019). The International Financial Corporation reports that around 40% of SMEs in developing nations struggle to access external financing (Obi et al., 2018). These SMEs, especially in budding economies, are instrumental in national developmental endeavors (Ndiaye, Razak, Nagayev, & Ng, 2018). They have been attributed to generating nearly 99% of all new jobs in some regions over the past five years, underpinning two-thirds of the private sector (Commission, 2022). Characterized by their adaptability, quick decision-making, and resilience to market fluctuations, SMEs require consistent and robust financial support to harness their potential (Pilar, Marta, & Antonio, 2018) (Dowling, O'gorman, Puncheva, & Vanwalleghem, 2019).

Policies that prioritize SMEs are indicative of a nation's forward-thinking economic strategies. The overarching intent of such policies is to bolster SME development, aligning with broader market and employment objectives. SMEs are frequently heralded as the nation's backbone (Yoshino & Taghizadeh-Hesary, 2019), credited with pivotal roles in poverty reduction, job creation, promotion of foreign trade, and technological innovation (Luo, Wang, & Yang, 2016) (Zakkariya & Nishanth, 2014). The growing consensus among policymakers suggests that financial inclusion is imperative for achieving comprehensive growth.

Furthermore, ensuring access to financial services can augment women's engagement in the workforce and elevate their educational prospects (Asongu, Nnanna, & Acha-Anyi, 2020; Asongu & Odhiambo, 2018). However, the relationship between financial constraints and employment growth among SMEs varies based on organizational makeup. In Africa, nascent enterprises often grapple with credit accessibility, hindered by inadequate financial auditing, tenuous property rights, and a scarcity of financial acumen among entrepreneurs. While small businesses tend to grow faster than their medium or large counterparts, they also face more pronounced financial constraints (Dao & Liu, 2017).

Existing literature has largely concentrated on emerging economies, exploring disparities in SME finance access and associated labor markets. This study sheds light on regions with underdeveloped financial systems, where labor markets offer limited job opportunities. Compounding these challenges, African nations frequently encounter collateral issues tied to property ownership and leasing, intensifying the financial exclusion of SMEs and pushing them towards informal financial avenues. This literature review is devoted to dissecting the nuances of financial inclusion and its implications for SMEs, as this remains a pivotal element for their business expansion and, by extension, national economic growth.

2. Overview of financial inclusion

Policymakers express growing concerns over bottom-of-the-pyramid economies, which often miss out on the benefits of growth and development evident in other emerging economies. Despite economic progress, many such countries still grapple with persistent poverty, inequality, and financial insecurity. The barriers to financial services and products further exacerbate these challenges (Selvarajan, 2019). Both researchers and policymakers highlight financial inclusion as a cornerstone of national growth. More than just an economic catalyst, financial inclusion also promotes health, education, and household consumption (Thomas & Hedrick-Wong, 2019). Financial inclusion ensures that individuals and businesses can effectively access and utilize the broader financial system (Ambarkhane, Singh, & Venkataramani, 2016). The World Bank has emphasized that many individuals are still excluded from these essential financial services and products. Leading financial institutions identify five pillars of financial inclusion:

- Universal services
- Enhanced client financial capability
- Quality-driven provision
- Comprehensive access
- A diverse and competitive marketplace.

Factors such as population size, legal frameworks, income, and demographics can impede financial inclusion. Nevertheless, there is a silver lining: African nations have steadily increased access to financial services (Demirgüç-Kunt & Klapper, 2012). Deepening financial service provisions, especially credit, have started reaching both institutions and individuals. Innovations like mobile money are expanding this access, encompassing payments, savings, and other financial products. Though many African countries remain relatively underdeveloped, their financial sectors have undergone significant transformations over recent decades. However, obstacles persist for African SMEs seeking financial inclusion (Dirir, 2022). The continent lags in foundational credit systems, with a startling 40% of its population unbanked (bank) and a vast majority (90%) of transactions being cash-based.

3. Impact of Digitalization on Financial Inclusion

The synergy between financial inclusion and digital finance has become increasingly crucial for economic progression. Digital finance refers to financial services delivered through digital channels, such as mobile devices, the Internet, and electronic cards, ensuring privacy and security (Gomber, Koch, & Siering, 2017). Embracing digital finance can address challenges businesses, individuals, and governments face. It can potentially elevate financial inclusion levels, offering benefits like cost reductions, GDP growth, and more streamlined services (Scott, Van Reenen, & Zachariadis, 2017).

Africa is witnessing a digital revolution in its financial infrastructure. While traditional banking remains inaccessible to many, mobile technology bridges this gap. Digital solutions present opportunities for cost savings in transactions (Mills & McCarthy, 2017), streamlining banking operations like loan disbursement and monitoring. Advanced data analytics foster efficient credit assessments, enabling banks to cater better to SMEs (Thakor, 2020). Digitalization does not only facilitate access; it also empowers financial institutions to minimize risks (Demertzis, Merler, & Wolff, 2018). The growth in digital finance adoption in Africa is evident: internet usage soared from 6.5% in 2010 to 16.8% in 2020 (Bongohive, 2023), and mobile phone adoption is predicted to reach 84% by 2025 (GSMA, 2019). This shift has catalyzed financial access for SMEs, enhancing affordability. Studies indicate that mobile financial services have positively changed 49 Sub-Saharan African countries, impacting GDP growth, poverty metrics, and wealth distribution (Nguena, 2019).

However, the digital transformation is not without its challenges. Balancing regulatory frameworks while ensuring market stability, data protection, privacy, and cybersecurity is crucial. Previous compromises often meant reduced risks but also reduced benefits. The surge in digital SME trading introduces risks, particularly as governments grapple with evolving digital finance regulatory challenges (Perez-Saiz & Sharma, 2019). SMEs also face internal challenges with digital applications, often stemming from their straightforward designs, which can limit managerial depth (Demertzis et al., 2018). Yet, digital finance offers SMEs a fresh perspective, especially when traditional banks deny them loans. Lastly, it seems implausible that digital finance providers, known for their targeted financing models, would pivot from SMEs to focus on sovereign lending.

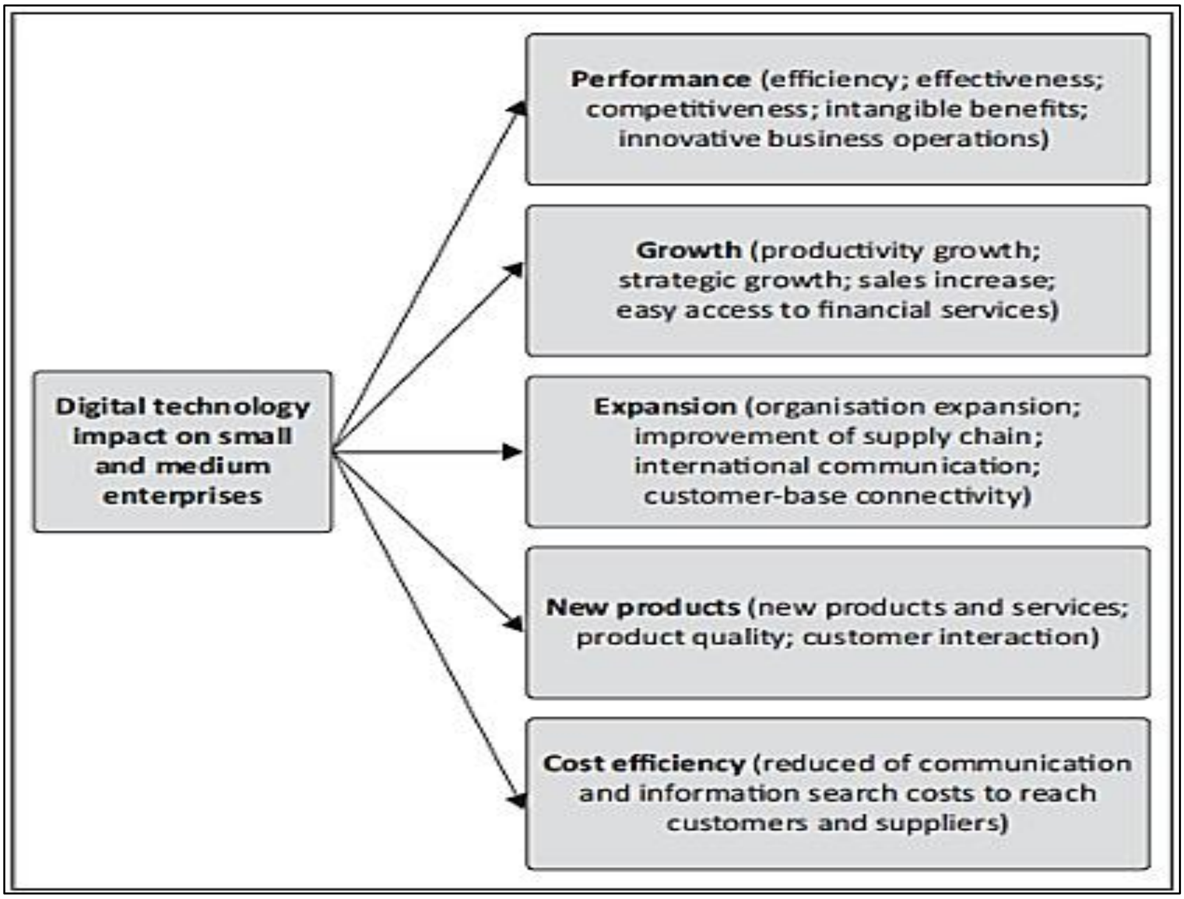

Figure 1. Digital technology on SME operations (digital, 2005)

Figure 1 illustrates the impacts of digital technology on SME business operations. The factors that have an impact on digital technology are shown. Digitalization is not only an advantage in finance operations in SMEs but also has benefits on the operational parameters.

4. Performance of SME

SME performance is essentially an appraisal of organizational achievements. Such evaluations are generally done at group or individual levels, primarily focusing on activities, roles, and tasks within the organization (Mutegi, Njeru, & Ongesa, 2015). Key determinants of SME business performance include the quality of innovation, human resource management, financial management, and customer relations (Fitriatia, Purwanab, & Buchdadic, 2020; Mukson, Hamidah, & Prabuwono, 2021). This underscores the idea that consistent innovation lies at the heart of SME growth. A specific study in Zambia aimed at understanding business performance in relation to access to finance showcased interesting results (Hassan, 2023). The study, which sourced data from the Zambia Informal Sector Business Survey by the World Bank Group, found that the educational level of business owners and the adoption of digital finance practices were instrumental in promoting SME growth. Interestingly, not just the ease of money transfer via mobile platforms drives this growth but also the resultant decrease in operational costs. Furthermore, the relationship between mobile money and business performance is framed around four key transactional activities:

- Payment to suppliers
- Savings
- Utility bill payments
- Payments received from customers

With these findings in perspective, it becomes clear that amplifying the growth of digital finance is pivotal to enhancing business performance. A potential strategy to achieve this might be promoting awareness and adoption of mobile money platforms within organizations. Despite its promise, the Zambian landscape is not without challenges for SMEs, especially concerning accessing finance. Although digitalization has alleviated some of these challenges, barriers remain. Common issues like bureaucratic documentation for financial services often impede Zambian SMEs from securing the financing they need. The country sees SME activity flourishing across both its traditional and modern sectors (Todaro, 2015). Remarkably, SMEs' contribution to the nation's economic growth is significant. Within Africa, about 40% of economic contributions are attributable to SMEs. SME performance dramatically increased from 18% in 2010 to 40% in 2020.

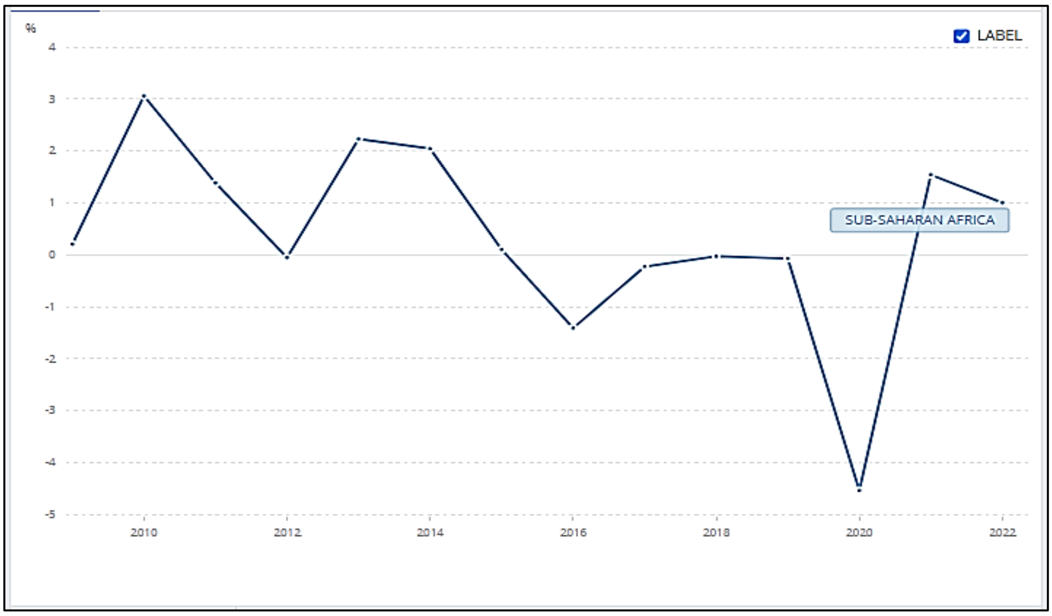

Figure 2. GDP per capita annual growth in Sub-Saharan Africa (w. bank, 2022)

Figure 2 illustrates the annual GDP growth in Africa, suggesting a correlation between the ascent of SME performance and the overall GDP growth.

5. Financial Literacy and Its Influence on SME Performance

Financial literacy is the foundational understanding of financial concepts crucial to every enterprise. More specifically, it encompasses knowledge, skills, and abilities related to financial aspects of business management (Lumbantobing, Tampubolon, Iskandar, Purnama, & Frederica, 2022). Beyond mere knowledge acquisition about financial products and services, financial literacy encompasses the following:

- A fundamental grasp of personal finance
- Insights into savings and investment mechanisms
- A comprehensive understanding of credit management
- Strategies for risk management

Several studies have examined how financial literacy impacts decision-making. Adequate financial knowledge can shape a more prosperous financial future (Lusardi & Mitchell, 2011). Sound financial literacy equips SMEs to make informed and beneficial business decisions. In contrast, a deficit in financial literacy could exacerbate issues, potentially hindering optimal business performance (Dahmen & Rodríguez, 2014).

6. Conclusion

The role of SMEs in the economic growth of countries, particularly in emerging economies like Zambia, cannot be understated. As illuminated in our discussion, the dynamic interplay between digital finance, financial inclusion, and the inherent performance of SMEs has a profound impact on the broader economic landscape. Digital finance, particularly in the form of mobile money, has emerged as a transformative tool, offering an alternative to conventional financial systems and addressing the prevalent financial access barriers faced by SMEs. This shift not only expedites financial transactions but also streamlines operational costs, lending a competitive edge to SMEs in the marketplace.

Furthermore, the essence of financial literacy is evident in shaping the trajectory of SMEs. A solid foundation in financial concepts enables businesses to make informed decisions, optimize resources, and navigate the often volatile economic terrains. The lack thereof can significantly impair a business's potential, limiting growth opportunities and compromising sustainability. The consistent surge of SMEs from 2010 to 2020, coupled with the increasing adoption of digital finance platforms, underscores a paradigm shift in Africa's economic narrative. As SMEs continue to anchor economic growth, concerted efforts must be geared towards enhancing financial literacy, promoting the benefits of digital finance, and addressing systemic challenges that might impede SME growth. In essence, the synergy of digital finance and robust financial literacy could potentially chart the course for the next phase of unparalleled growth for SMEs, propelling emerging economies into an era of increased prosperity and resilience.

Reference

1. Ambarkhane, D., Singh, A. S., & Venkataramani, B. (2016). Measuring financial inclusion of Indian states. *International Journal of Rural Management, 12*(1), 72-100.
2. Asongu, S. A., Nnanna, J., & Acha-Anyi, P. N. (2020). Inequality and gender economic inclusion: The moderating role of financial access in Sub-Saharan Africa. *Economic Analysis and Policy, 65*, 173-185.
3. Asongu, S. A., & Odhiambo, N. M. (2018). ICT, financial access and gender inclusion in the formal economic sector: evidence from Africa. *African Finance Journal*, *20*(2), 45-65.
4. bank. https://www.thebanker.com/Payments-innovation-the-key-to-financial-inclusion-in-Africa-1681890717#:~:text=The%20most%20attractive%20sector%20to,financial%20transactions%20are%20cash%2Dbased.

5. bank, w. (2022). https://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG?end=2022&locations=ZG&start=2009&view=chart.
6. Beegle, K., & Christiaensen, L. (2019). *Accelerating poverty reduction in Africa*: World Bank Publications.
7. Blancher, M. N. R., Appendino, M., Bibolov, A., Fouejieu, M. A., Li, M. J., Ndoye, A., . . . Sydorenko, T. (2019). *Financial inclusion of small and medium-sized enterprises in the Middle East and Central Asia*: International Monetary Fund.
8. Bongohive. (2023). https://bongohive.co.zm/implementing-digital-solutions-in-zambia/#:~:text=Zambia%20has%20made%20significant%20progress,International%20Telecommunication%20Union%20(ITU).
9. Commission, E. (2022). Entrepreneurship and Small and medium-sized enterprises (SMEs).
10. Dahmen, P., & Rodríguez, E. (2014). Financial literacy and the success of small businesses: An observation from a small business development center. *Numeracy, 7*(1), 3.
11. Dao, M. C., & Liu, L. Q. (2017). *Finance and employment in developing countries: The working capital channel*: International Monetary Fund.
12. Demertzis, M., Merler, S., & Wolff, G. B. (2018). Capital Markets Union and the fintech opportunity. *Journal of financial regulation, 4*(1), 157-165.
13. Demirgüç-Kunt, A., & Klapper, L. F. (2012). Financial inclusion in Africa: an overview. *World Bank policy research working paper*(6088).
14. digital. (2005). http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S2415-20052022000100027.
15. Dirir, S. A. (2022). Performing a quantile regression to explore the financial inclusion in emerging countries and lessons african countries can learn from them. *European Journal of Development Studies, 2*(5), 1-9.
16. Dowling, M., O'gorman, C., Puncheva, P., & Vanwalleghem, D. (2019). Trust and SME attitudes towards equity financing across Europe. *Journal of World Business, 54*(6), 101003.
17. Fitriatia, T. K., Purwanab, D., & Buchdadic, A. D. (2020). The role of innovation in improving small medium enterprise (SME) performance. *innovation, 11*(2), 232-250.
18. Ghassibe, M., Appendino, M., & Mahmoudi, S. E. (2019). *SME financial inclusion for sustained growth in the Middle East and Central Asia*: International Monetary Fund.
19. Gomber, P., Koch, J.-A., & Siering, M. (2017). Digital Finance and FinTech: current research and future research directions. *Journal of Business Economics, 87*, 537-580.
20. GSMA. (2019). https://www.gsma.com/subsaharanafrica/resources/the-mobile-economy-sub-saharan-africa-2019.
21. Hassan, R. (2023). Does Mobile Money Adoption Increase Informal Business Performance in Zambia? *Journal of the Knowledge Economy*. doi:10.1007/s13132-023-01205-z
22. Lumbantobing, R., Tampubolon, L. D., Iskandar, D., Purnama, E. D., & Frederica, D. (2022). Financial literacy and inclusion for millennial UMKM Owners in West Jakarta. *International Journal Of Community Service, 2*(3), 290-295.
23. Luo, P., Wang, H., & Yang, Z. (2016). Investment and financing for SMEs with a partial guarantee and jump risk. *European Journal of Operational Research, 249*(3), 1161-1168.

24. Lusardi, A., & Mitchell, O. S. (2011). Financial literacy around the world: an overview. *Journal of pension economics & finance, 10*(4), 497-508.
25. Mills, K., & McCarthy, B. (2017). How banks can compete against an army of fintech start-ups. *Harvard business review, 13*(20).
26. Mukson, M., Hamidah, H., & Prabuwono, A. (2021). Work environment and entrepreneurship orientation towards MSME performance through organizational commitment. *Management Science Letters, 11*(3), 871-878.
27. Mutegi, H. K., Njeru, P. W., & Ongesa, N. T. (2015). Financial literacy and its impact on loan repayment by small and medium entrepreneurs.
28. Ndiaye, N., Razak, L. A., Nagayev, R., & Ng, A. (2018). Demystifying small and medium enterprises'(SMEs) performance in emerging and developing economies. *Borsa Istanbul Review, 18*(4), 269-281.
29. Nguena, C. L. (2019). *Mobile financial and banking services development in Africa*: African Development Bank.
30. Obi, J., Ibidunni, A. S., Tolulope, A., Olokundun, M. A., Amaihian, A. B., Borishade, T. T., & Fred, P. (2018). Contribution of small and medium enterprises to economic development: Evidence from a transiting economy. *Data in brief, 18*, 835-839.
31. Perez-Saiz, H., & Sharma, P. (2019). FinTech in Sub-Saharan African Countries: A Game Changer. *International Monetary Fund: Washington, DC, USA.*
32. Pilar, P.-G., Marta, A.-P., & Antonio, A. (2018). Profit efficiency and its determinants in small and medium-sized enterprises in Spain. *BRQ Business Research Quarterly, 21*(4), 238-250.
33. Scott, S. V., Van Reenen, J., & Zachariadis, M. (2017). The long-term effect of digital innovation on bank performance: An empirical study of SWIFT adoption in financial services. *Research Policy, 46*(5), 984-1004.
34. Selvarajan, S. K. (2019). Financial inclusion: at the bottom of the pyramid. *Institutions and Economies*, 129-131.
35. Thakor, A. V. (2020). Fintech and banking: What do we know? *Journal of Financial Intermediation, 41*, 100833.
36. Thomas, H., & Hedrick-Wong, Y. (2019). *Inclusive growth: The global challenges of social inequality and financial inclusion*: Emerald Publishing Limited.
37. Todaro. (2015). https://oeclass.aua.gr/eclass/modules/document/file.php/AOA245/Economic%20Development%20-%20Todaro%20and%20Smith.pdf.
38. Yoshino, N., & Taghizadeh-Hesary, F. (2019). Optimal credit guarantee ratio for small and medium-sized enterprises' financing: Evidence from Asia. *Economic Analysis and Policy, 62*, 342-356.
39. Zakkariya, K., & Nishanth, P. (2014). Barriers faced by micro, small and medium enterprises in raising finance.
40. zepari. https://zepari.co.zw/sites/default/files/2018-03/EXPLORING%20THE%20ROLE%20OF%20SMALL%20AND%20MEDIUM%20%20ENTERPRISES%20IN%20%20ECONOMIC%20%20DEVELOPMENT.pdf.