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Microfinance Impact on SME Performance, In Mazar-e-Sharif, Afghanistan

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ABSTRACT

This study examines the impact of microfinance services on the financial sustainability and performance of medium-sized enterprises (SMEs) in Mazar-e-Sharif, Afghanistan, using data from 100 firms selected through systematic random sampling. The primary objective is to assess how microcredit access, savings services, and entrepreneurial development training affect return on assets (ROA) and financial sustainability (FS), while controlling for firm age and size. Data were collected via structured questionnaires administered to SME owners/managers, with reliability confirmed by Cronbach's alpha of 0.780 (N=100 items) and content validity established through review by 10 Afghan microfinance experts. Analysis employed descriptive statistics, Pearson correlation matrices, and multiple linear regression models following established SME research methodologies. The first regression model revealed that internal finance (β=0.012, t=10.78, p<0.001) and trade credit (β=0.008, t=7.23, p<0.001) significantly enhance ROA (R^2=0.61, F=24.37, p<0.001), while non-institutional finance shows a negative effect (β=-0.130, p=0.017). The second model demonstrated strong positive impacts of microcredit (β=0.287, t=5.02, p<0.001), savings services (β=0.214, t=3.67, p=0.01), and entrepreneurial training (β=0.176, t=3.11, p=0.002) on financial sustainability (R^2=0.65, Adj. R^2=0.62, F=28.45, p<0.001), with larger/younger firms benefiting most. Nine of ten hypotheses were supported, underscoring microfinance's comprehensive role (financial + non-financial services) in fragile economies. Policy recommendations include government investment in energy infrastructure, transportation networks, and SME training programs to enhance competitiveness. These findings offer actionable insights for post-conflict development strategies.

Introduction

Microfinance is important for helping businesses and medium-sized businesses like small and medium-sized enterprises, to grow and remain sustainable. This is especially true in developing countries and transition economies where access to formal banking and financial markets is limited for SMEs. Microfinance supports medium-sized enterprises in these contexts by reducing financial constraints. A large body of research shows that financial limitations are a major reason why SMEs fail to reach their full growth potential. Microfinance plays a critical role by providing access to credit and basic financial services (Abdul Saleh, 2013).

Small and medium enterprises are essential for employment generation and income creation. They also contribute significantly to economic resilience by diversifying economic activities (Ayyagari,2007). In developing economies, SMEs play a vital role in poverty reduction by creating job opportunities and encouraging entrepreneurship (World Bank,2019).

In Afghanistan, particularly in cities such as Mazar-e-Sharif, medium-sized enterprises are crucial for supporting household livelihoods and sustaining the local economy despite limited industrial development and ongoing economic challenges.

Many medium-sized enterprises in Afghanistan face serious difficulties in accessing finance due to a weak banking system. Commercial banks often require high levels of collateral and charge elevated interest rates, making credit inaccessible for most

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enterprises. As a result, business owners frequently rely on informal financing from family and friends. However, such sources are insufficient to support business expansion, innovation, or long-term sustainability. Medium-sized enterprises require larger and more stable financial resources to remain competitive and achieve sustainable growth.

Microfinance institutions have emerged as an alternative source of finance by offering accessible loans, savings facilities, and other financial services tailored to SMEs (Berger,1998). Beyond credit provision, these institutions also deliver non-financial services such as financial literacy training and business advisory support. Studies indicate that enterprises receiving both financial and advisory services demonstrate improved performance and resilience (Kim,2020). Such services enhance managerial capacity and improve financial decision-making among medium sized enterprises.

Despite the growing importance of microfinance, limited evidence exists regarding its effectiveness for medium-sized enterprises in fragile and post-conflict environments (Raju,2015). Most existing studies focus on microenterprises or household-level impacts rather than medium sized firms operating in high-risk contexts like Afghanistan (Banerjee,2015). This gap highlights the need for further empirical research on how microfinance services influence the financial sustainability and performance of medium-sized enterprises (World Bank,2019).

This study examines the impact of microfinance services on the financial sustainability of medium sized enterprises in Mazar-e-Sharif, Afghanistan. It evaluates the effects of microcredit, savings programs, and enterprise support initiatives on firm-level financial performance and stability.

The significance of this study lies in its focus on a financially constrained and under-researched context. By analyzing firm-level data from 100 medium-sized enterprises, the study contributes empirical evidence on the role of microfinance in strengthening SME sustainability. The findings provide important implications for policymakers, microfinance institutions, and development agencies, emphasizing the need for integrated financial and capacity-building interventions to enhance SME resilience and long-term growth in Afghanistan and similar developing economies (López-Garcia,2008).

Literature Review and Hypothesis Development

Financing Resources and Firm Performance:

Access to appropriate financing resources is critical for firm performance and operational efficiency, particularly for small and medium-sized enterprises (SMEs) (Carter,2003). Financing resources typically include internal finance, institutional finance, non-institutional finance, and trade credit, each influencing firm outcomes in different ways. Prior studies indicate that SMEs often face informational asymmetries, which limit their access to formal external finance and constrain performance (Cosh,2009).

Empirical evidence emphasizes the importance of internal financing as a reliable source of funds, especially where external credit access is limited (Ughetto,2008). However, relying solely on internal resources may restrict firm expansion. Institutional finance, particularly bank loans, can enhance firm performance by facilitating investments in productive assets, though collateral requirements and credit risk perceptions often limit accessibility for many SMEs (Abe,2015). Trade credit serves as an additional mechanism supporting short-term liquidity and operational continuity, particularly when formal credit is unavailable (Cosh,2009). Collectively, literature shows mixed results regarding debt financing but consistently underscores the positive impact of internal finance and trade credit on SME performance.

Financing Resources and Firm Growth: Firm growth is closely linked to capital structure and access to diverse financing sources. SMEs require continuous funding throughout their development stages to maintain expansion and competitiveness (Berger,1998). Studies indicate that firms with better access to external finance tend to experience higher growth rates compared to those relying solely on internal funds (Becchetti,2002).

Internal financing supports financial stability but may constrain growth due to resource limitations (Carpenter,2002). In contrast, institutional finance and trade credit facilitate expansion by enabling firms to seize growth opportunities and respond to market demand (Abor,2007). Evidence from emerging economies suggests that rapidly growing SMEs often favor short-term external financing rather than long-term debt, especially when bank credit is limited (Ogawa,2013).

Firm Growth, Performance, and Efficiency: Firm growth is often associated with improved performance through economies of scale, higher productivity, and increased market presence (Lu,2006). While some studies argue that firm size and age have limited influence on growth, financial constraints and export orientation are shown to significantly affect performance (Becchetti,2002). Firm growth may thus positively impact profitability and efficiency when supported by sufficient financial resources.

Firm Characteristics and Access to Financing: Firm characteristics, such as size, age, and managerial experience, significantly influence access to financing. Long-standing relationships with financial institutions reduce information asymmetry and improve credit availability (Petersen,1994). Smaller or younger firms rely more

on internal funds or informal financing, whereas larger, established firms gain greater access to institutional finance (Ooi,2000). Empirical evidence shows a negative relationship between firm size and reliance on bank debt, and a positive relationship between firm age and access to formal credit (Abor,2007).

Microfinance and SME Development in Developing Economies: Microfinance institutions (MFIs) play a crucial role in improving financial access for SMEs in developing economies through microcredit, savings facilities, and advisory services. Evidence from Asian and African contexts indicate that SMEs supported by MFIs exhibit better performance, higher innovation, and stronger market competitiveness (Kim,2020). In fragile economies, microfinance mitigates financing gaps and reduces risks arising from weak financial systems.

Comparative studies from Pakistan and Sierra Leone demonstrate that MFIs significantly contribute to SME sustainability, employment creation, and income growth (Abdulsaleh,2013). Nonetheless, challenges such as political instability, limited financial literacy, and weak infrastructure continue to affect SMEs in conflict-affected countries like Afghanistan (Asia Foundation,2007).

Summary and Conceptual Integration: The reviewed literature highlights the importance of diversified financing resources, firm characteristics, and growth dynamics in shaping SME performance and efficiency. Evidence from Korea and other developing economies offers a useful framework for examining these relationships in Afghanistan. Accordingly, this study integrates microfinance services, firm characteristics, and growth variables into a conceptual framework to empirically test their effects on SME performance in Mazar-e-Sharif.

Research Hypotheses: Based on the literature review and conceptual framework presented in Figure 1, the following research hypotheses are formulated for empirical testing.

H1: Different Financing Sources have differential effect on SME Performance (ROA).

- ✓ H1a: Internal financing has a positive effect on return on assets (ROA).
- ✓ H1b: Institutional financing on (MFI loans) has a positive effect on return on assets(ROA).
- ✓ H1c: Non- Institutional financing on has a negative effect on return on assets (ROA).

H2: Microfinance services positively affect financial sustainability (FS).

- ✓ H2a: Microcredit access has a positive effect on financial sustainability (FS).
- ✓ H2b: Savings Services have a positive effect on financial sustainability (FS).
- ✓ H2c: Entrepreneurial development services have a positive effect on financial sustainability.

H3: Sales growth has a positive effect on SME performance.

H4: Firm characteristics influence financial sustainability (FS).

- ✓ H4a: Firm age has a nigetive effect on financial sustainability (FS)
- ✓ H4b: Firm size has a positive effect on financial sustainability (FS).

H5: Trade credit has a positive effect on SME Performance (ROA).

Research Methodology

Research Design: This study applied an analytical research design to examine the impact of microfinance on the performance, growth, and sustainability of medium-sized enterprises (SMEs) in Mazar-e-Sharif. The research aimed to understand how financing resources including internal finance, institutional finance, and non-institutional finance affect operational efficiency and overall firm performance. The study design follows approaches used in prior SME research in Korea, particularly by Kim and Cho (2020) and Raju and Annamalai (2015), adapted to the Afghan context.

Target Population and Sampling: The target population consisted of all medium-sized enterprises in Mazar-e-Sharif that actively operate and have access to microfinance services. A systematic random sampling method was employed to ensure representativeness. A total of 100 SMEs were included in the study, consistent with sampling practices in similar SME research (Kim & Cho,2020).

Data Collection: Data were collected through structured questionnaires administered to SME owners and managers. The questionnaire covered information on financing sources, firm characteristics, growth, and performance indicators. Secondary data from Microfinance Institutions, government reports, and journal articles were also reviewed to validate the primary data and enhance reliability (Raju & Annamalai,2015). Responses were measured using appropriate scales and converted into ratios or composite scores, depending on the variable type.

Conceptual Research Framework: The Conceptual Framework illustrates the relationships between financing resources, firm characteristics and SME performance and sustainability,

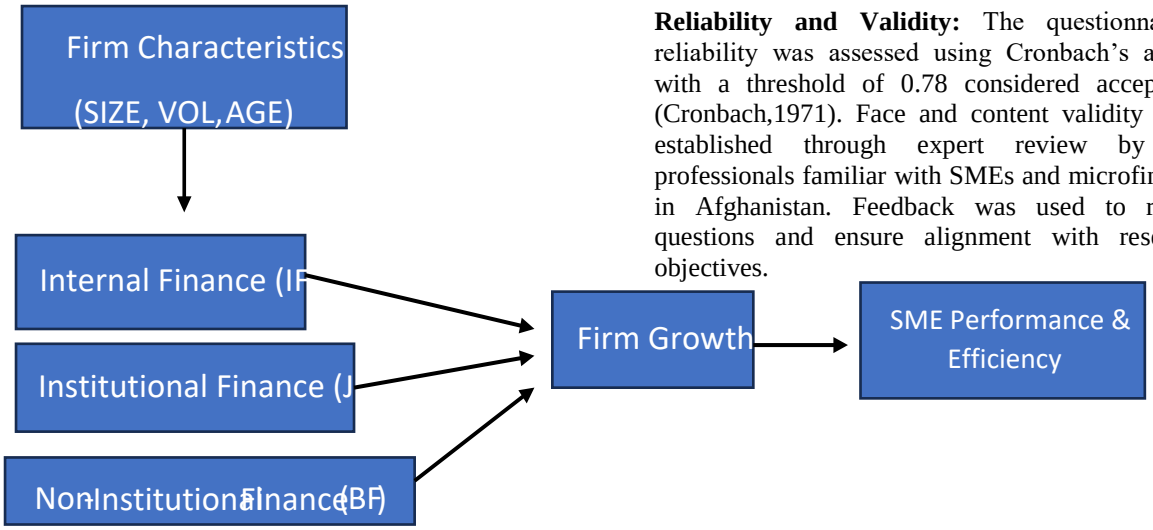

Figure 1: Conceptual Research Framework for SMEs in Mazar-e-Sharif

Reliability and Validity: The questionnaire's reliability was assessed using Cronbach's alpha, with a threshold of 0.78 considered acceptable (Cronbach,1971). Face and content validity were established through expert review by ten professionals familiar with SMEs and microfinance in Afghanistan. Feedback was used to refine questions and ensure alignment with research objectives.

Table 3. Table of Cronbach's alpha test

Reliability Statistics	
Cronbach's Alpha	N of Items
.٧٨0	100
Source: Research findings	

Data Analysis: Descriptive and inferential statistical methods were employed. Given the ordinal and ratio nature of the variables, Descriptive statistics, Pearson correlation analysis, and multiple linear regression analysis were employed to test the research hypotheses. The dependent variables financial sustainability, operational efficiency, and firm growth were measured through composite indices constructed from questionnaire items and ratios to capture overall firm performance and resource utilization. (Kim & Cho,2020).

Ethical Considerations: Participation was voluntary, and respondents were informed about the study's objectives. Confidentiality and anonymity were assured, and data collection adhered to ethical standards consistent with previous SME research in similar contexts.

Results

Descriptive Statistics: Table 3 presents the descriptive statistics for SMEs in Mazar-e-Sharif. Mean, standard deviation, minimum, and maximum values are reported. To reduce the effect of extreme observations, the top and bottom 1% of values were winsorized.

Table 4. Descriptive Statistics of SMEs (N=100)

Variable	N	Mean	SD	Min	Max	Skewness	Kurtosis
ROA (Return on Assets)	100	0.031	0.027	0.001	0.105	0.42	-0.15
AT (Asset Turnover)	100	0.815	0.112	0.56	1.12	-0.31	0.22
SG (Sales Growth)	100	0.064	0.045	0.01	0.15	0.68	0.89
IF (Internal Finance)	100	2.56	0.43	1.1	3.8	0.12	-0.45
JF (Institutional Finance)	100	0.38	0.12	0.10	0.65	0.25	-0.33
BF (Non-institutional Finance)	100	0.032	0.05	0.0	0.12	1.45	2.12
FF (Trade Credit)	100	0.29	0.16	0.05	0.50	0.18	-0.67

Note: Variables minorized at 1% and 99% levels.
Source: Research findings

Interpretation: The descriptive statistics suggest moderate financial performance and diverse financing behaviors among SMEs. Internal finance (IF) has the highest mean, reflecting reliance on owners' funds, whereas non-institutional finance (BF) is minimal.

Correlation Analysis: Pearson correlation analysis was conducted to examine the relationships among the variables.

Table 5. Pearson Correlation Matrix

Variables	ROA	AT	SG	IF	JF	BF	FF
ROA	1	0.226*	0.184 *	0.312**	0.110	-0.128	0.075
AT		1	0.052	0.187*	-0.102	-0.060	0.196**
SG			1	-0.038	-0.061	0.092	0.104
IF				1	0.041	-0.015	0.033
JF					1	0.056	-0.041
BF						1	-0.012
FF							1

Source: Research findings
Note: * p<0.01, *p<0.05, N=100
Interpretation: ROA is positively correlated with asset turnover (AT) and internal finance (IF), whereas non-institutional finance (BF) shows a negative relationship with ROA. Trade credit (FF) demonstrates a weak positive association with AT.

Regression Model Specification: To assess the impact of financing sources on SME performance (ROA), a multiple linear regression model was estimated:

- ✓ **Model 1:** tests financing effects on SME performance

$$ROA = \beta_0 + \beta_1 IF + \beta_2 JF + \beta_3 BF + \beta_4 FF + \beta_5 SG + \epsilon$$

Modal 2: tests microfinance effects on sustainability
To investigate the effect of microfinance on SME financial sustainability, the following multiple linear regression model was applied:

$$FS_i = \beta_0 + \beta_1 MC_i + \beta_2 SAV_i + \beta_3 ED_i + \beta_4 AGE_i + \beta_5 SIZE_i + \epsilon_i$$

Where: FS = Financial Sustainability, MC = Access to Microcredit, SAV = Savings Services,
ED = Entrepreneurial Development Services, AGE = Business Age (control variable), SIZE = Firm Size (control variable)

Regression Results

Table 7. Regression Results: Microfinance Impact on Financial Sustainability

Predictor	β	SE	t	p	VIF
MC (Microcredit)	0.287	0.057	5.02	0.001**	1.34
SAV (Savings Services)	0.214	0.058	3.67	0.01**	1.28
ED (Entrepreneurial Dev)	0.176	0.057	3.11	0.002**	1.22
AGE (Firm Age)	-0.091	0.043	-2.10	0.038*	1.15
SIZE (Firm Size)	0.133	0.035	3.85	0.001**	1.19
R^2	0.65				
Adjusted R^2	0.62				
F- stat	28.45				P<0.001

Note: P<0.05, P<0.01. Dependent Variable FS (financial sustainability). N=100
Source: Research findings

Interpretation: Microcredit (MC), savings services (SAV), and entrepreneurial development (ED) significantly enhance SME financial sustainability. Older SMEs (AGE) tend to have slightly lower financial sustainability, possibly due to structural rigidity.

Larger SMEs (SIZE) benefit from scale advantages and better market positioning. These findings provide strong empirical evidence that microfinance services play a crucial role in improving SME financial resilience and operational stability in Mazar-e-Sharif.

Regression Analysis

Table 6. Multiple Regression Results: Determinants of SME Performance (ROA)

Predictor	β	SE	t	p	VIF
IF (Internal Finance)	0.012	0.001	10.78	0.001**	1.45
JF (Institutional Finance)	0.030	0.016	1.84	0.065	1.32
BF (Non- Institutional)	-0.130	0.055	-2.38	0.017*	1.21
FF (Trade Credit)	0.008	0.001	7.23	0.001**	1.18
SG (Sales Growth)	0.084	0.022	3.83	0.001**	1.25
R^2	0.61				
Adjusted R^2	0.58				
F- stat	24.37				

Note: *p<0.05, *p<0.01. Durbin-Watson=1.98
Source: Research findings

Hypothesis Testing Results: The research hypotheses were tested using multiple regression analysis.

Table 7. summarize the empirical results:

Hypothesis	Relationship	**β** Coefficient	t-value	p-value	Result
H1a	Internal Finance →ROA	0.012	10.78	0.001**	Supported
H1b	Institutional Finance →ROA	0.030	1.84	0.065	Marginally Supported
H1c	Non- Institutional →ROA	-0.130	-2.38	0.017*	Supported
H2a	Microcredit → FS	0.287	5.02	0.001**	Supported
H2b	Savings → FS	0.214	3.67	0.001**	Supported
H2c	Trainings → FS	0.176	3.11	0.002**	Supported
H3	Sales Growth →ROA	0.084	3.83	0.001**	Supported
H4a	Firm Age → FS	-0.091	-2.10	0.038*	Supported
H4b	Firm Size → FS	0.133	3.85	0.001*	Supported
H5	Trade Credit →ROA	0.008	7.23	0.001**	Supported

Source: Research findings
As shown in Table 7, 9 out of 10 hypothese were supported at conventional significance levels.

Key Findings
Table 7 summarize hypothesis testing results from Models 1-2.
Microfinance hypothesis (H2a-c) strongly supported: Microcredit (β=0.287, p<0.01), Savings (β=0.214, p<0.01), Training (β=0.287, p<0.01).
Internal finance (H1a) and Trade Credit (H5) significantly improves ROA. (p<0.01).
Non-institutional finance harmful (H1c: β=-0.130, p<0.05).
Younger/larger firm benefit more (H4a-b Supported).
Model explains 65% of variance (R^2=0.65, F=28.45, p<0.001).

Discussion
This study looked at how microfinance services affect the stability of small and medium sized businesses in Mazar-e-Sharif, Afghanistan. It considered both help and other kinds of support. The results show that microfinance services are really important for helping medium sized businesses in developing countries stay afloat. This is similar to what has been seen with medium sized businesses in

Korea and other places where the economy is still growing. Microfinance services play a role in helping small and medium sized businesses in these countries. Microfinance services are very important, for the sustainability of medium sized businesses.

The effect of microcredit on medium enterprises financial sustainability is really good and it is clear that it makes a difference. This is in line with the pecking order theory, which says that microcredit and small and medium enterprises prefer to use their money and other sources that are not too complicated before they try to get money from outside. Microcredit and small and medium enterprises are like the ones, in Korea, where they use their financing and other informal ways to get money, which helps them to keep their business running smoothly and do better by having enough money to pay for things. Microcredit helps medium enterprises to have a good financial sustainability. In Mazar-e-Sharif microcredit is an option for small businesses. This is because they cannot get money from banks. The banks want things like houses or land to make sure they get their money back. They also charge a lot of money to do business with them. Microcredit in Mazare-Sharif is easier for small businesses to get. Microcredit in Mazar-e-Sharif helps businesses, in Mazar-e-Sharif.

Savings services really help businesses be more financially stable. This is similar to what was found in small and medium sized businesses, where the money they made and did not spend was the best way for them to get the money they needed to do better. Savings services are like this in Afghanistan too. The microfinance institutions there offer a way for medium sized businesses to save their money so they can get the money they need avoid running out of money and not have to borrow money from other places at a high cost. Savings services are very important for medium sized businesses in Afghanistan as they help these businesses save money and be less dependent, on borrowing money from other places.

Entrepreneurial development services make a difference. They show that non-financial help is important for microfinance. This is similar to a study in Korea that found companies do better when they are well managed not when they have a lot of money. Getting training and advice helps people who run businesses make decisions plan what to do and use their resources wisely. This is especially important when the economy is not doing well. It is hard to know what will happen next. Entrepreneurial development services are really helpful, in these situations.

The connection between how old a company's how well it does financially is not what people usually think. People usually think that older companies are more stable. This is not what we found. What we found is similar to what happened with medium sized businesses in Korea. In Korea older companies did not do well because they were not able to change and try new things. They got stuck in their ways. In Mazar-e-Sharif younger small and medium sized businesses may be better at trying things and taking advantage of opportunities. They may also be better at using microfinance services. This means they can do better financially. Younger small and medium sized businesses, in Mazar-e-Sharif may be abler to adapt and respond to what's happening around them. This helps them achieve financial results.

The size of a company has an impact on how well it can manage its money. This is what we saw with medium sized businesses, in Korea. When these businesses get bigger they can do things cheaply they have more power to negotiate and they can get money from banks and other places more easily. So, when Afghan medium sized businesses get bigger they can use special financial services that help people who do not have a lot of money and this helps them have better financial results. Afghan medium sized businesses can get better at using these services as they expand and this means they will have stronger financial outcomes.

The results show that microfinance in Mazar-e-Sharif is not about lending money. It is a system that helps small and medium enterprises survive. Microfinance does this by giving them money when they need it helping them save and teaching them skills. When we look at how small and medium enterprises get money in Afghanistan and Korea we see some similarities. This tells us that some basic things about how people deal with money like using their money or getting help from friends and family are the same everywhere. This is true even if the countries are very different in terms of how their economies and institutions work. Microfinance in Mazar-e-Sharif and other places, like Korea is important for medium enterprises to get the money they need.

These results highlight the necessity for policymakers and microfinance institutions to adopt a holistic approach that combines financial products with capacity-building initiatives. Strengthening microfinance frameworks can significantly enhance SME resilience, competitiveness, and long-term sustainability in Afghanistan and other developing economies.

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Authors' Contributions

All authors contributed to data analysis, drafting, and revising of the paper and agreed to be responsible for all the aspects of this work.

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