

**Financial Barriers and the Role of Financial Literacy in  
Microfinance for SMEs Growth: Evidence from Peshawar, Pakistan**

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**Abstract**

**Purpose:** This study focuses on the complex barriers faced by small and medium enterprises (SMEs) in Peshawar, Pakistan with a special focus on the moderating role of financial literacy in accessing, and make effective use of, microfinance services for business growth. **Methodology:** Employing quantitative (cross-sectional survey) design, primary sources of data were collected from 60 SME owners in retail and wholesale sectors from three major business zones (University Road, Kohat road and Saddar) in Peshawar. A structured questionnaire based on validated scales was used to measure the financial literacy level of respondents, their utilization pattern of microfinance, perceived growth barriers and business performance parameters. Descriptive and inferential statistical techniques, namely, correlation analysis and comparative assessments were used to investigate the relationship between financial literacy, access to microfinance and the growth outcomes of SMEs. **Findings:** Results show that SMEs in Peshawar are faced with systemic barriers such as poor financial access (according to 83% of respondents), political instability (according to 75%), corruption (according to 72%) and poor infrastructure (according to 68%). The State of Financial Literacy is also split with about 53% of SME owners showing good knowledge in financial concepts and 47% showing huge knowledge deficit. Financially literate owners attribute better business outcomes and more effective financial decision-making to financial literacy. Microfinance utilization is as high as 47% with

users mentioning benefits of working capital but procedural complexity and lack of post-loan support as a limitation. The findings of this study show that financial literacy and access to microfinance, although necessary, is not enough for the growth of SMEs without concomitant institutional and macroeconomic reforms. Practical implications: Findings highlight the need for integrated policy approaches that use multiple interventions (financial education, microfinance institutional reform, improvement of governance) to foster enabling environments for SME development in conflict-affected, emerging market contexts. Originality and value: This research adds to scarce empirical literature on SME finance in the Khyber Pakhtunkhwa province of Pakistan in terms of extending the theories of human capital and financial intermediation to investigate the nexus between literacy, finance and growth in a challenging institutional environment.

**Keywords:** Financial inclusion, financial literacy, microfinance, Pakistan, Peshawar, SM enterprises, SME growth

### 1.1 Background of Study

Small and medium-sized businesses (SMEs) dominate Asian nations economies. One of the primary causes of these nations slow growth is that, in spite of this, the SME sector is not as productive as that of the European Union. The function of SMEs is essential to long-term growth in transition economies. When the economy is doing well, SMEs can grow and improve their operations and performance. Given that the majority of transition nations now have high unemployment rates, the expansion of SMEs may lead to increased job possibilities. SMEs have several benefits, such as increasing industrial output, fostering an entrepreneurial culture, creating jobs, gradually improving workforce skills, and promoting the use of new technologies. This industry is therefore crucial to accelerating the conclusion of the Asian transition period. This would lead to greater development and higher living standards. SMEs contribute to economic development in transition countries, especially in the early phases of the transition, according to a number of studies in

the literature. The importance of SMEs in the development of the region has also been highlighted by international institutions such as the European Bank for Restriction and Development (EBRD), which has described them as a catalyst for innovation and growth.

The labor productivity (LP) of SMEs in those countries is still poor because of a lack of investments, restricted access to financing, political unpredictability, corruption, competition in the unorganized sector, and adverse business environments. Both the expansion of the SME sector and the general health of the economy are hampered by these obstacles. Scholars have investigated this topic and developed research models based on the stochastic models of small business growth. To better understand the elements influencing the expansion of SMEs, more study in transitional and emerging countries focuses on firm characteristics and the business environment.

Small and medium-sized enterprises (SMEs) contribute to economic development, especially in developing countries. Up to 45% of all jobs and 33% of national GDP in developing nations are held by SMEs, according to the World Bank (2015). However, SMEs' ability to contribute to economic advancement has been limited by their difficulty to access financial services, especially from formal financial institutions. The reason for this is the low level of financial literacy among SMEs' owners and management. Financially literate managers are better equipped to make strategic investment decisions and choices that will support the growth and success of their organizations. financial literacy significantly moderates the association between SMEs' expansion and funding availability in developing countries.

SMEs have not only strengthened their local competitiveness but also expanded internationally to compete on a global scale. The ability of SMEs to spot opportunities in foreign markets from the start is highlighted in the research on born global or early internationalizing enterprises. SMEs must become financially literate in order to comprehend and carry out a successful financing plan in order for this global strategy to be accomplished. In fact, SMEs with financially literate owners typically make better financial decisions and make fewer management errors than their financially illiterate counterparts. By helping people make wise financial decisions, financial literacy improves SMEs' access to and use of financial services. Furthermore, financial literacy helps small business owners evaluate financial products and, as a result, make informed decisions that promote proper debt management. SMEs may find it challenging to correctly assess and understand different financing options as well as to manage the complex loan application procedures if they lack financial literacy.

Previous studies have examined the impact of financing availability on the growth of SMEs in both developed and developing countries. However, the moderating role of financial literacy in the relationship between the expansion of SMEs in developing economies and their financing accessibility is not considered in these studies.

Microfinance, which has grown significantly over the last 30 years, is among the most well-known advancements in anti-poverty policy over the past 50 years. The potential of microfinance to foster long-term financial independence in these underdeveloped areas is its main benefit in India. Microfinance contributes to long-lasting effects by training consumers how to launch their own businesses and how to efficiently manage and grow their money. Microfinance's influence is rapidly growing in Pakistan, India and several other countries. Without a doubt, it has been successful in giving formal financial services to the poor. People believe it has provided funds to low-income households and has the potential to increase investments in education, health care, and women's empowerment. Due to their extensive social infrastructure, microfinance institutions (MFIs) are uniquely positioned to frequently reach millions of customers. From a funding channel, microfinance has developed into a potent distribution channel that provides a variety of credit products with long-term repayment terms. Solar lighting and fuel-efficient stoves are two examples. Many companies have begun manufacturing solar products and marketing them through MFI distribution networks throughout the last two years.

Therefore, the main objective of this study is to examine and understand what barriers does SMEs face and how financial literacy affects microfinance and the growth of SMEs engaged in developing countries, with a focus on Pakistan.

### **1.2. Aim of study**

This research aims to analyze the following

1. Identify the primary challenges facing Pakistan SMEs.
2. Investigate the impact of financial literacy on SMEs' growth in Peshawar.
3. Assess the ways in which financial literacy influences the region's utilization and effectiveness of microfinance.

### **1.3 Research Question**

1. What are the main obstacles preventing Pakistani SMEs from expanding and developing?
2. What impact does financial literacy have on Peshawar's SMEs' performance and growth?

3. How does the region's access to and use of microfinance services depend on financial literacy?

#### **1.4 Significance of the Study:**

This study is important because it looks at the main issues that small and medium-sized businesses (SMEs) in Pakistan, especially those in Peshawar, confront. It also looks at the connection between SMEs' ability to grow and obtain microloans and their level of financial literacy. The results will help development organizations, financial institutions, and governments create more efficient aid programs, encourage financial inclusion, and improve the sustainability and performance of SMEs in the area.

#### **1.5 Organization of the Study**

This study is organized into five main chapters.

- **Chapter 1 (Introduction)** provides an overview of the research background, objectives, significance, and organization of the study.
- **Chapter 2 (Literature Review)** discusses relevant theories, past research, and existing knowledge related to the topic, helping to identify research gaps.
- **Chapter 3 (Methodology)** explains the research design, data collection methods, instruments used, and procedures for data analysis.
- **Chapter 4 (Results and Discussion)** presents the findings of the study, analyzes the data, and interprets the results in light of the research questions and literature reviewed.
- **Chapter 5 (Conclusion and Recommendations)** Presents the conclusion of the study and also provide future recommendation regarding the topic.

## **Chapter 2**

## **LITERATURE REVIEW**

### **2.1 Introduction**

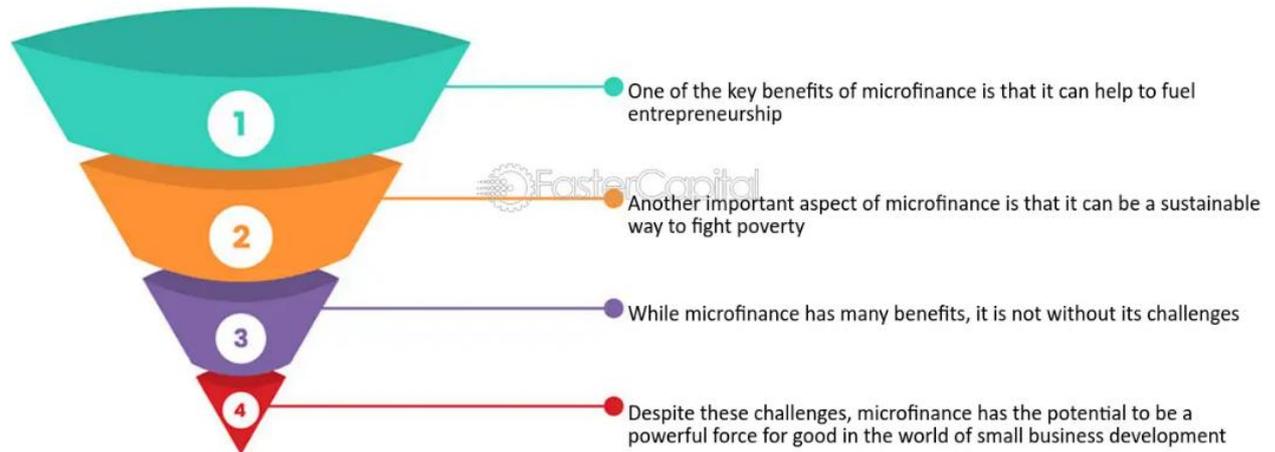
The performance and growth of SMEs have been a grave concern for many countries and voiced by governments, venture capital firms, financial institutions, entrepreneurs, development economists, and non-governmental organizations worldwide (Eniola & Entebang, 2014). In addition to a personnel management strategy that increases the likelihood of success within a mutually agreed-upon framework of predetermined goals, standards, and individual and group skill requirements, performance management comprises developing a shared understanding of what needs to be done but whether it will be done (Armstrong & Baron, 1998).

According to a review of the literature on SMEs, a variety of factors influence how SMEs are defined in different countries, including the number of employees, the value of fixed assets, production capacity, basic input characteristics, the level of technology used, capital employed, management characteristics, economic development, and the unique issues faced by SMEs (Eniola & Entebang, 2015b). According to IFC data, 90% of MSMEs in Africa are informal or micro, with the remaining 10% being formal SMEs (small, 8.6%, and medium, 1.4%, respectively) (IFC, 2010; Ketley et al., 2012).

### **2.2 Microfinance**

Micro finance can be described as the "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi urban or urban areas, for enabling them to raise their income levels and institutional initiatives of rural credit and to the improve living standards". Currently, credit alone accounts for a sizable portion of microfinance operations. The great majority of people who use savings and microcredit programs are women. The provision of savings accounts, loans, and other essential financial services to the underprivileged is known as microfinance (Kumar 2015). Since these financial services typically involve little sums of money—small savings, minor loans, etc.—the name "microfinance" serves to distinguish them from those offered by traditional banks. The poor hardly ever receive services from the traditional financial sector. To satisfy their needs for financial services, they turn to a variety of mostly unofficial financial partnerships.

## Understanding Microfinance



The environment in which the poor live is not static. By effectively adopting new farming methods, engaging in new business ventures, or finding new employment, millions of individuals escape poverty. At the same time, a lot of people experience financial setbacks, health issues, and other shocks that cause them to relapse into poverty. Effective savings, payment, credit, and insurance instruments can help households seize a chance to escape poverty or weather a catastrophe or emergency without sinking further into poverty if they are available at crucial times. The World Bank's Global Financial Inclusion Database estimates that 2.5 billion people worldwide lack a formal account at a financial institution. Because of this, the majority of impoverished households, especially in emerging nations, function virtually exclusively in the cash economy. This indicates that individuals meet their financial needs—from getting paid to saving for fertilizer—by using cash, tangible assets (like jewelry and animals), or unofficial suppliers (like money lenders and payment couriers). Nevertheless, these unofficial methods are frequently costly, difficult to use, and insecure. Additionally, they provide little options in the event of significant issues, such a family member's catastrophic illness.

### 2.3 Access to Finance and Financial Management

Access to funding and prudent financial management are the most important factors affecting the survival and growth of SMEs, according to numerous company surveys (IFC, 2010; OECD, 2006). SMEs in developing countries can make profitable investments to expand their businesses and acquire state-of-the-art technology by having access to financing, which ensures their competitiveness and fosters innovation, macroeconomic resilience, and GDP growth (Beckett &

Demirguc-Kunt, 2006). By promoting business capitalization, job creation, and long-term income growth, lending to microbusinesses also contributes to economic growth in the unorganized sector, claim Kevane & Wydick (2001). This is corroborated by Aghion & Bolton (1997), who contend that more credit promotes business creation, entrepreneurship, and economic expansion.

According to scholars like Tiwari et. al, (2013), poverty can be reduced and jobs can be created by giving low-income families access to low-cost loans and expanding their access to different funding sources for business expansion. According to a 2013 World Bank study, having access to financing enhanced business performance and expansion in poor nations by lowering risk, allowing market entry, and encouraging innovation and entrepreneurship.

### **2.3 Financial Literacy**

Financial literacy has many definitions, including a certain type of knowledge, the capacity to use that knowledge, perceived comprehension, prudent financial behavior, and even financial experiences (Hung, Parker, & Yoong, 2009). This is one of the most remarkable aspects of the literature. Personal financial management is based on financial literacy, which is described as having a sufficient awareness of personal financial facts (Garman & Fogue, 2002). Their study also examines the obstacles to financial literacy, such as a lack of personal finance knowledge, complex financial circumstances, a multitude of funding options, and time limits for personal finance education.

Financial literacy may have a major impact on lending access (Cole & Fernando, 2008). People with low financial literacy may be reluctant to buy more complicated financial products, such as insurance, because they may not fully comprehend the objective of the product. De Mel, McKenzie, and Woodruff (2008) claim that financial literacy—which can be obtained by mastering business skills—has a major impact on the expansion and productivity of SMEs. Financial literacy—the "ability to obtain, understand, and evaluate the relevant information necessary to make financial decisions and choices with an awareness of the likely financial consequences"—is crucial for SMEs in developing countries to have access to financial services.

Numerous scholars have defined financial literacy in numerous studies pertaining to personal finance; nevertheless, many fall short of providing a precise definition since it fails to account for managers and businesspeople. According to Gitman's (2003) overview of finance provision, financial services encompass the providing of

financial products to individuals. One of the most important managerial skills for SMEs' growth and development is financing literacy (Spinelli, Timmons, & Adams, 2011). According to the majority of academics, entrepreneurs of all ages regularly make decisions about the acquisition, distribution, and use of resources. Since these kinds of operations nearly always have financial repercussions, entrepreneurs need to be financially literate in order to be successful (Oseifuah, 2010).

Furthermore, according to Njoroge & Gathungu (2013), people who possess financial literacy abilities typically make better financial decisions and commit less management errors than their counterparts who lack this talent. Because financial literacy skills enable and educate SMEs' owners to evaluate financial products and make educated decisions, solid financial management is therefore essential to the survival and management of SMEs. Additionally, financial literacy helps SMEs' owners become more adept at managing risk. Through risk-reduction techniques including preserving money, diversifying assets, and avoiding excessive debt, financial literacy helps SMEs owners weather difficult financial times, according to Siekei et al. (2013).

Consequently, we may draw the conclusion that SMEs' owners and managers need to be financially literate in order for them to expand from small to medium-sized businesses.

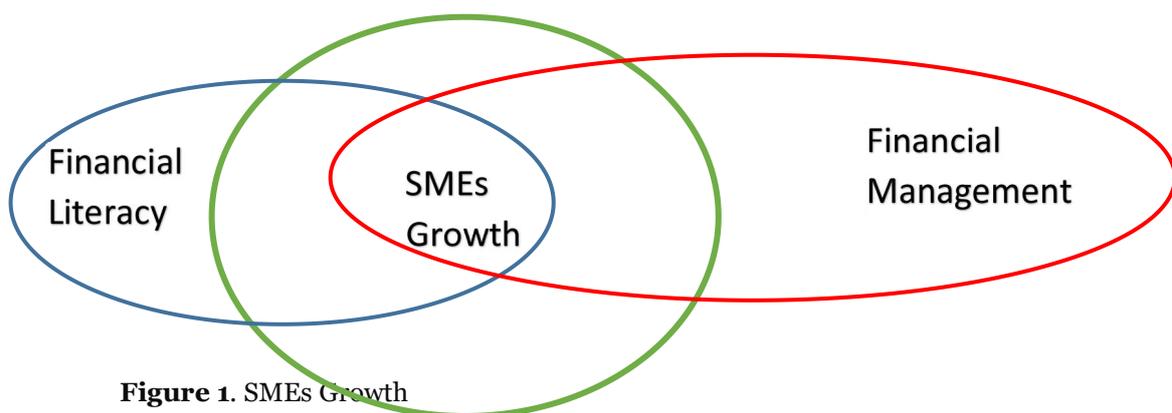


Figure 1. SMEs Growth

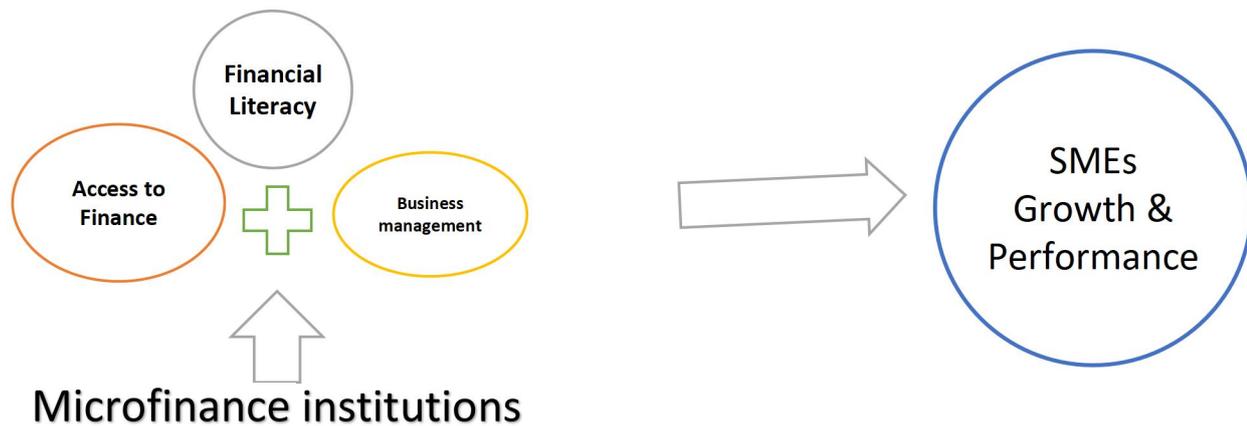
## 2.4 Lack of Business Management

The lack of Business management experience may make financial challenges for SMEs worse. SMEs may find it more difficult to correctly assess and understand different funding possibilities, as well as to navigate the complex loan application processes, if they lack financial literacy.

According to Bosma & Harding (2006), many SMEs in poor countries fail because of a lack of economic acuity and financial literacy, which deters entrepreneurship. In actuality, financial literacy is one of the most crucial managerial abilities for the expansion and functioning of SMEs, claim Spinelli, Timmons, and Adams (2011).

According to Oseifuah (2010), entrepreneurs of all ages habitually made decisions on the acquisition, distribution, and application of resources. Entrepreneurs need to be financially knowledgeable in order to be successful because such actions always have financial repercussions. Furthermore, researchers like Fidler & Webster (1996) contend that in order to increase the ability of SMEs managers to utilize the loans, it is essential to provide basic business skill training in conjunction with the microloan. Additionally, it offers information on how to use financial products and services more efficiently. This lessens their susceptibility to dishonest schemes and overzealous financial organizations.

Mutegi & Phelister (2015) provided support for this, revealing that financial literacy helps with decision-making processes like timely bill payment and effective debt management, which enhances SMEs' credit worthiness to support livelihoods, economic growth, sound financial systems, and poverty alleviation. According to Siekei (2013), SMEs' owners can manage their loan portfolios to decrease loan obligation and interest payments by using credit management skills acquired through financial literacy programs. According to Greenspan (2002), financial literacy aids small business owners in gaining the financial information and abilities required for business planning, savings plan implementation, and strategic investment decision-making.



**Figure 2:** SMEs Growth and Performance

## 2.5 Theoretical Framework

The theoretical framework driving this study is based on several interrelated concepts to comprehend the mechanisms impacting the expansion and performance of SMEs, especially in the context of emerging nations. These include Human Capital Theory (HCT), Financial Intermediation Theory, Pecking Order Theory (POT), and Resource-Based Theory (RBT). These concepts provide insight into how internal capabilities and external financial systems interact to impact SMEs' growth.

### 2.5.1 The Resource Based Theory (RBT)

A company's competitive advantage comes from its internal resources and competencies, according to Barney's (1991) Resource-Based Theory. These resources include physical, human, financial, and organizational assets that must be uncommon, valuable, one-of-a-kind, and non-replaceable. In the context of SMEs, strategic internal resources include things like sound financial management, financial literacy, and efficient company processes. Microlending and other funding sources are more likely to be successfully used by SMEs with greater resource capacities to grow.

#### **Application:**

The theory supports the premise that, in addition to financial access, effective internal resource management—including the owner's financial literacy and entrepreneurial abilities—is essential to the performance and survival of SMEs.

#### **2.5.2 Human Capital Theory (HCT)**

The Human Capital Theory (Becker, 1964) states that investing in training and education increases employee productivity, which in turn boosts company performance. For managers and owners of SMEs, financial literacy and business management training are crucial parts of human capital.

##### **Application:**

The theory backs up the notion that successfully obtaining and utilizing financial services requires the possession of business management and financial literacy skills. Entrepreneurs with sound financial judgment can make decisions that improve sustainability and business outcomes.

#### **2.5.3 The Pecking Order Theory (POT)**

The Pecking Order Theory, developed by Myers and Majluf in 1984, explains how businesses prioritize their funding sources. According to this theory, companies would rather finance themselves internally than take on debt, with equity being released as a last resort. This suggests that a lack of internal capital and difficulties obtaining traditional loans often drive SMEs toward microfinance institutions and unofficial lending channels.

##### **Application:**

Because SMEs lack collateral, financial records, or creditworthiness, this theory explains how they select financing options and why they are hesitant to approach formal financial institutions. Improved financial literacy and management can mitigate these problems.

#### **2.5.4 Financial Intermediation Theory**

This theory holds that financial intermediaries, including banks and microfinance institutions, aid in the economy's effective resource allocation by moving funds from savers to borrowers. It emphasizes how important institutional infrastructure is to SMEs' access to financial services, including loans.

##### **Application:**

In developing countries where SMEs usually do not have access to official banking services, microfinance firms play a crucial role as intermediaries. The idea highlights the importance of having inclusive financial institutions that can support small enterprises.

### **2.5.5 Conceptual Relationships**

When combined, these theories offer a conceptual framework wherein:

- When SMEs are financially literate, they are better able to make prudent financial decisions.
- Microfinance provides established banking institutions with a competitive alternative when it comes to fund access.
- Financial access enables innovation, technology adoption, and business expansion.
- Effective utilization of capital for long-term growth is ensured by company management expertise.

These factors work well together to improve the performance, sustainability, and scalability of SMEs.

### **2.6 Summary**

Chapter 2 offers a comprehensive review of the literature on the operations and growth of SMEs, paying special attention to crucial components such as microfinance, financial literacy, capital access, and company management skills. Microfinance services are essential for helping low-income entrepreneurs, particularly in developing countries, by offering savings, loans, and financial tools that are typically unavailable through standard banking institutions. The chapter emphasizes the importance of financial access in fostering SMEs' innovation, growth, and sustainability in addition to stressing financial literacy as a critical skill for risk management and educated financial decision-making. It also points out that effective resource use and loan administration are hampered by a lack of understanding of business and finance management. The theoretical framework that underpins this investigation incorporates the Resource-Based Theory, Human Capital Theory, Pecking Order Theory, and Financial Intermediation Theory. Together, these ideas explain how SMEs' performance is impacted by both internal and external financial resources. Collectively, these ideas support the idea that the growth and sustainability of SMEs depend on the financial and managerial skills of their owners as well as the accessibility of funding.

## CHAPTER 3: RESEARCH METHODOLOGY

### 3.1 Introduction

In this chapter, we explain the methodology we used in the research "**Barriers and the role of Financial Literacy and Microfinance on the Growth of SMEs in Peshawar, Pakistan**". The demographic, sample plan, data collection instruments, data analysis methods, and research design are all covered. Since this study employs a primary data strategy, a methodical questionnaire has been adopted and disseminated to collect responses from SME owners and managers in the region.

### 3.2 Research Design

The study used a quantitative, cross-sectional survey design. When examining the relationships among SME growth, barriers, financial literacy, and microfinance availability at a particular point in time, this approach performs admirably. Quantitative methods enable statistical analysis and results generalization to the target population.

### 3.3 Population

The research population consists of managers and owners of small and medium-sized enterprises (SMEs) in Peshawar (three regions i.e. University Road, Kohat Road and Saddar), Pakistan. This comprises businesses registered with the Small and Medium Enterprises Development Authority (SMEDA) and regional chambers of commerce, as well as unofficial SMEs engaged in production, trade, or services.

### 3.4 Sampling Technique

For sampling (Purposive sampling with non-probability) technique was used. This approach is suitable since it aims to reach respondents who have specific knowledge of financial processes and the application of microfinance in SMEs. The sample consists of SME owners and managers who are eligible for or presently use microfinance services and who have direct experience with financial decision-making.

### **3.4.1 Sample Size**

In order to ensure diversity in business types, ownership structures, and operating time, a total of 60 respondents were included. Taking time and logistical restrictions into account, this sample size is adequate to perform significant statistical analysis.

### **3.5 Data Collection Instrument**

A questionnaire was adopted to collect real time data from the SMEs, the questionnaire was adopted in line with the objectives and research questions of the study. Both closed-ended and Likert-scale items are included in the questionnaire, which is divided into the following sections:

1. Demographic Information: Age, size, kind of business, and participant profile.
2. Financial Literacy: Questions that help in understanding of financial terms (e.g., interest rates, budgeting, and credit products) (Adapted from Lusardi & Mitchell, 2007; OECD/INFE 2018 Toolkit).
3. Microfinance Access: Items assessing service satisfaction, barriers, and microfinance use in SMEs (Adapted from Ledgerwood, 1999; Churchill & Frankiewicz, 2006).
4. Business Growth Indicators: Metrics of performance such as revenue growth, employment creation, market expansion, and profitability (Adapted from OECD, 2004; Wang, 2008).
5. Barriers to SME Development: These encompass both external and internal barriers, such as capital, infrastructure, and regulatory issues. (Adapted from Beck et al., 2006; Ayyagari et al., 2011)

### **3.6 Data Collection**

Data was collected by in-person distribution. Participation was completely voluntary, and confidentiality was assured.

Follow-up visits were conducted and respondents were given enough time to complete the questionnaire in an effort to boost response rates. Ethical norms, such as informed consent and the freedom to withdraw at any moment, were strictly adhered to.

### **3.7 Data Analysis**

Descriptive statistics was used to analyze the collected data and the results were presented along with proper discussion. Descriptive statistics included frequency, Mean, Median and mode etc.

### **3.8 Ethical Considerations**

It was ensured that basic ethical guidelines were followed, the goals of the study were explained to the participants, along with the understanding that participation was entirely optional and that their responses would remain confidential. No identifying information was collected in order to preserve anonymity.

## Chapter 4: RESULTS AND DISCUSSIONS

This chapter presents the study's findings, which were derived from data collected from 60 SME owners in Peshawar. The findings are organized in accordance with the primary sections of the survey, which include demographic information, financial literacy, access to microfinance, barriers to SME growth, and SME performance. Each segment is supported by charts and a detailed explanation of the responses. The findings are then analyzed in the context of the study's objectives and existing research, highlighting significant patterns, challenges, and opportunities for the expansion of SMEs in the region.

### 4.1 Demographic Profile of Respondents

To understand the background of the small and medium-size enterprises surveyed, demographic data was collected. The male majority in Peshawar, Pakistan's business sector is demonstrated by the fact that all 60 responders were men. This is in line with more general national statistics that demonstrate how social norms generally prevent women from participating in official economic activity.

#### 4.1.1 Gender and Age Distribution

The age distribution of the respondents was dominated by working middle-aged groups. More than 36% (22) of the experienced business owners were in the 35–44 age range, and another 36% (22) were in the 45–54 age range.

**Table 1. Gender distribution**

Gender	Count
Male	60
Female	0
Other	0

A minority of respondents were either early-stage or late-career business owners, with 10% of respondents being between the ages of 25 and 34 and 16.6% being beyond the age of 55.

Table 2. Age Distribution

Age Group	Count
Below 25	2
25-34	10
35-44	20
45-54	18
55 and above	10

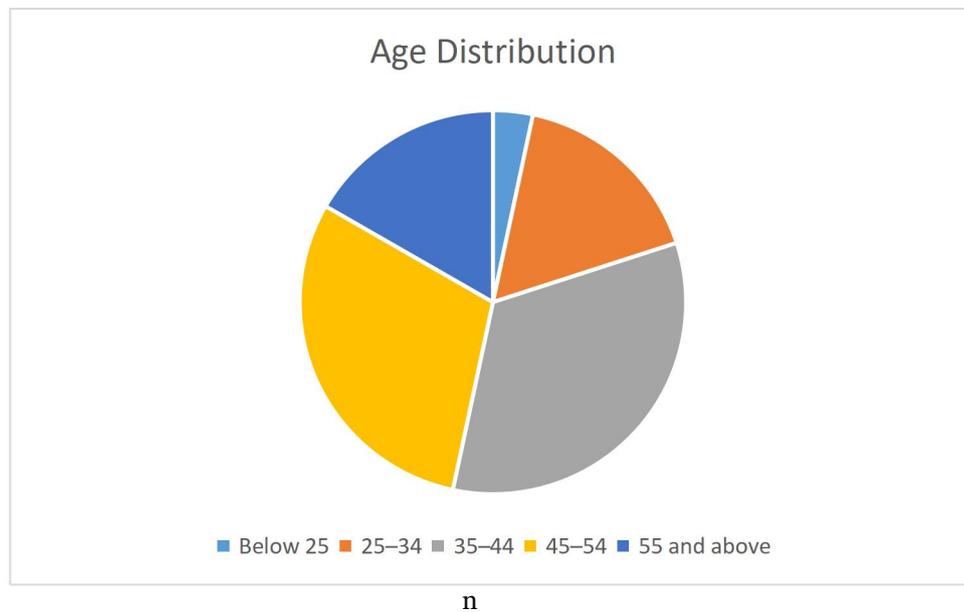


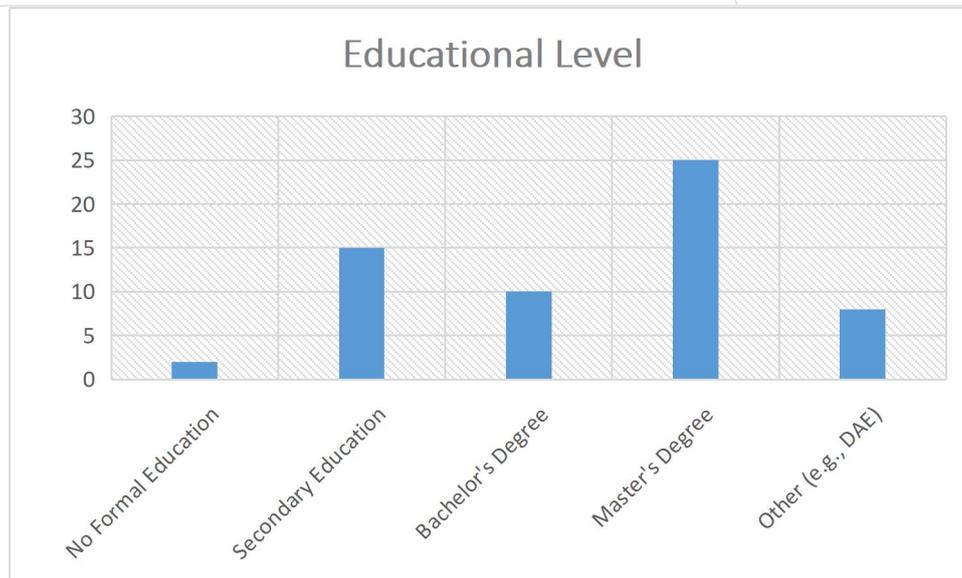
Figure 3. Age Distribution

#### 4.1.2 Educational Level

The majority had formal education, with 38.3% having completed secondary school, 38.3% having master's degrees, 13.3% having earned a bachelor's degree, and 10% holding technical diplomas such as DAE. One's educational experience may have an impact on their capacity to handle money, understand loan terms, or get over institutional obstacles.

**Table 3. Education Level**

Education Level	Count
No Formal Education	2
Secondary Education	15
Bachelor's Degree	10
Master's Degree	25
Other (e.g., DAE)	8



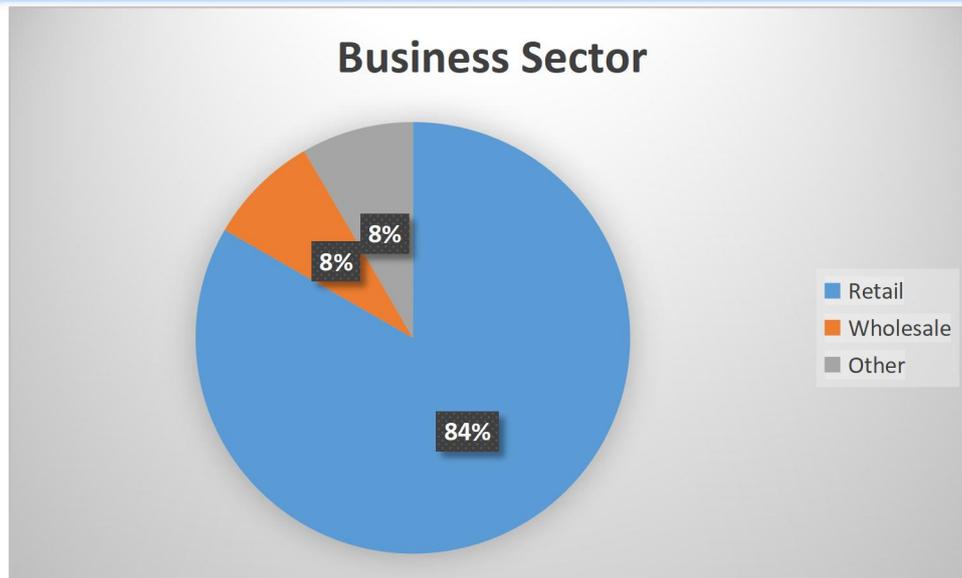
**Graph 1.** Representation of Educational Level

#### 4.1.3 Business Sector

The business sectors represented were mainly retail, with 87% of respondents operating retail businesses, and the rest in wholesale trade. These sectors are typical for urban SMEs in Pakistan due to their lower capital requirements and steady consumer demand.

**Table 4. Business Sector**

Business Sector	Count
Retail	50
Wholesale	5
Other	5



**Figure 4.** Representation of Business Sector

Finally, half of the businesses were micro-enterprises, with one to five employees across the board. The dominance of small enterprises in the SME scene is confirmed by the fact that just a small number (38.3%) employed more than 20 individuals, while a large share (38.3%) employed six to twenty persons.

#### **4.2 Barriers to SME Growth**

The respondents identified a number of structural and institutional barriers that hindered the expansion and success of their companies. A large number of participants considered the following challenges to be extremely important:

- Lack of financial access: Still the biggest barrier, over 80% of participants brought up this concern.
- Concerns about corruption and political instability were expressed by the more than 75% of respondents who rated political instability and corruption highly.
- Inadequate infrastructure and tax legislation were mentioned by over 65% of respondents as major obstacles that increase operational costs.
- Although less pronounced, limited market access and competition from the unorganized sector were also noted.

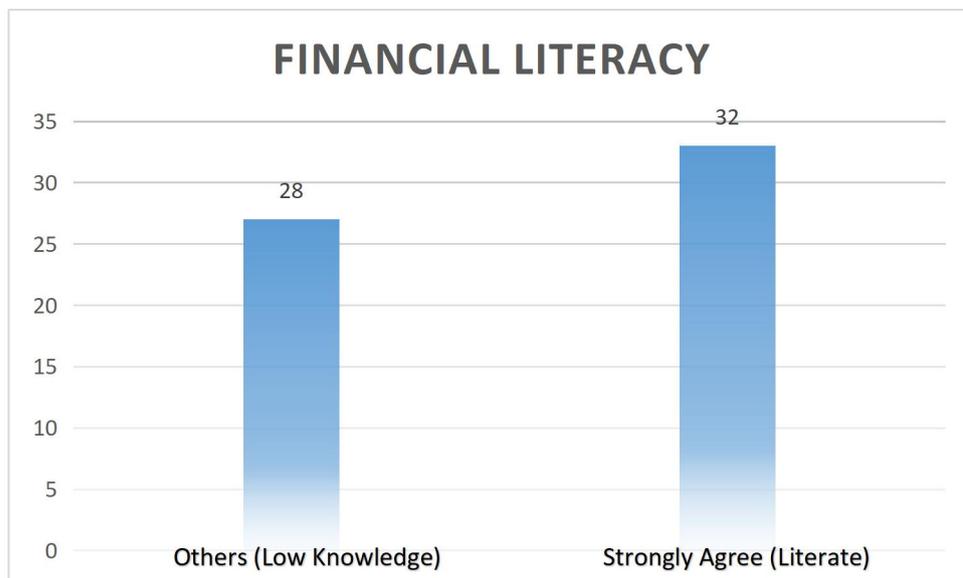
These findings suggest that issues with macro-level governance and a lack of institutional support are the primary barriers to the sustainability and growth of SMEs.

### 4.3 Financial Literacy

Financial literacy was assessed using five key variables. The findings are as follows:

**Table 5.** Financial Literacy

Level of Knowledge	Count
Strongly Agree (Literate)	32
Others (Low Knowledge)	28



**Graph 2.** Representation of Financial Literacy

- Thirty-two respondents claimed to understand basic concepts like interest and inflation,
- Thirty respondents claimed to be able to create and manage a business budget.
- About 24 to 28 showed an understanding of the consequences of borrowing and the ability to evaluate financial products.

Even with these relatively positive numbers, 40–50% of respondents showed ignorance or disinterest. This points to a serious lack of applied financial skills, which are necessary for risk management, loan utilization, and wise decision-making. Those that demonstrated financial literacy also reported stronger growth outcomes, suggesting a direct correlation between financial literacy and business performance.

#### 4.4 Microfinance Access and Use

When asked if they had used microfinance in any way,

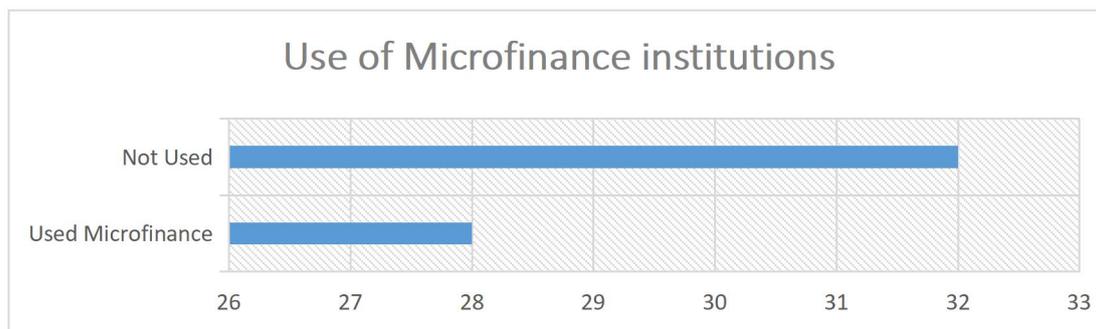
- 28 out of 60 respondents said they had been using microfinance institution;
- the institutions included Bank of Khyber, Meezan Bank, and Easypaisa/JazzCash; most of them had taken out loans;
- only a small portion had acquired insurance or training services.

These respondents generally acknowledged benefits such as:

- Increased business capital (28)
- Improved business skills from training (22)
- Confidence in repayment abilities (24)

**Table 6.** Microfinance Usage

Status	Count
Used Microfinance	28
Not Used	32



**Graph 3.** Representation of Usage of Microfinance institutions

However, only 18 respondents claimed that the application process was easy, showing that there are barriers to entry and procedural complexity. Despite its potential, these results show that microfinance has to be made more accessible and easier to use. Additionally, additional training ought to be provided, and financial products ought to more accurately represent the cash flow realities of SMEs.

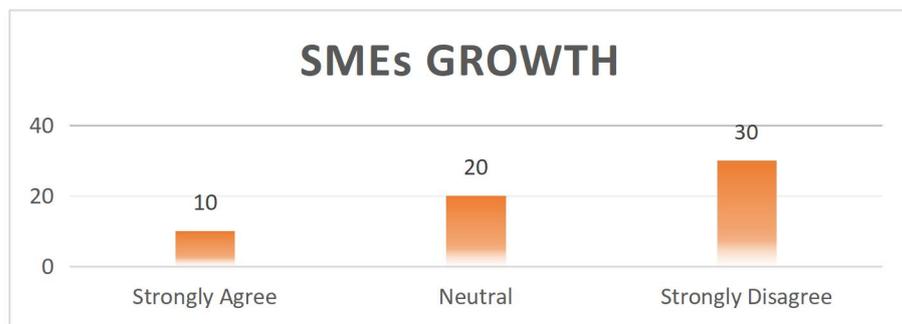
#### 4.5 SME Growth and Performance

The purpose of this part was to quantify real results pertaining to SME performance throughout the previous two years. Mixed results were obtained:

- Just 15% of those surveyed said their revenue had increased, and
- 10% said they had added products or entered new markets.
- Twelve said that new staff were employed.
- Twenty people concurred that having access to financing aided in growth, 1
- while twenty-two thought that having financial understanding enhanced decision-making.

**Table 6. SME Growth - Revenue Increase**

Response	Count
Strongly Agree	10
Neutral	20
Strongly Disagree	30



**Graph 4.**  
Representation of SME

Growth.

This indicates that most SMEs continue to develop slowly. Even in cases where financial tools are available, their influence may be limited because of inadequate financial planning or outside limitations (such as legislation or infrastructural problems). As a result, while some companies claim slight gains, the majority see no change in their revenue or market share. Growth is uneven and appears to be dependent on both internal and external resources.

#### **4.6 Open-Ended Questions**

High interest rates, demands for collateral, and difficult application processes were obstacles to financing. Because of informal activities or a lack of documentation, some were afraid of being rejected.

Some business owners attributed their improved budgeting, cash flow monitoring, and loan selection to their financial education. Others said they wanted training that was more practical and targeted.

The majority of participants said MFIs (Microfinance institutions) weren't helping SMEs enough. Low outreach in rural areas, ignorance of loan programs, and a lack of post-loan assistance or follow-up training were among the causes.

#### **4.7 Summary Discussion**

The results of the research show that Peshawar's SMEs deal with a complex network of interrelated issues that restrict their expansion and long-term viability. While having access to microfinance and being financially literate are crucial for entrepreneurship, they are not enough on their own. Many of the study's SME owners showed a lack of thorough financial understanding, which hampered their capacity to successfully manage budgets, assess credit possibilities, and make well-informed business decisions. External barriers including high interest rates, limited access to official credit, and a lack of training opportunities reduced the potential advantages of financial literacy and microfinance services, even for people with basic financial knowledge. Furthermore, the use and influence of microfinance mechanisms were further limited by uneven financial institution support and a lack of confidence in them.

The study found deeper, structural barriers rooted in the company environment in addition to these inequalities at the person level. Respondents repeatedly identified political instability, corruption, high taxation, and poor infrastructure as major obstacles to the expansion of SMEs. For entrepreneurs, these structural problems create an unpredictable and frequently hostile climate that makes it challenging to develop operations, draw in financing, or enter new markets. Therefore, tackling the growth of SMEs in Peshawar necessitates two separate strategies: one that incorporates government-led reforms aimed at simplifying regulations, guaranteeing transparency, and investing in supportive infrastructure, and another that concentrates on empowering entrepreneurs through targeted financial education and easier access to microfinance. This knowledge serves as the basis for the

following chapter, which offers specific findings and tactical suggestions based on the study's findings.

## Chapter 5: CONCLUSION AND RECOMMENDATIONS

### 5.1 Conclusion

The purpose of this study was to examine the barriers to SME growth in Peshawar and assess how financial literacy and microfinance can contribute to these issues. The majority of business owners are middle-aged men with varying levels of formal education who primarily operate in the retail sector, according to data gathered from 60 SME owners. They usually manage small businesses with limited staffing and operational resources. The most frequently cited barriers to expansion were a lack of capital, political instability, corruption, inadequate infrastructure, and excessive taxation; these issues are representative of more significant structural issues that SMEs in Pakistan face.

Although microfinance and financial literacy were found to be significant drivers of business growth, their influence was limited by the external environment. Better financial decisions and more steady performance resulted from the moderate to high level of financial knowledge exhibited by about half of the respondents. There is an urgent need for focused financial education, nevertheless, as the other half lacked even fundamental financial knowledge. Nearly 46% of participants used microfinance services, which were viewed as helpful for increasing capital but insufficient for long-term growth. Numerous customers complained about minimal institutional help and challenges with the application process. Ultimately, this study finds that although microfinance and financial literacy can have a positive impact, their efficacy is constrained in the absence of concurrent reforms to the structural and policy-related issues that predominate in Peshawar's SME scene.

### 5.2 Recommendations

The following suggestions are offered to encourage SME expansion in Peshawar in light of the findings:

#### 1. Financial Literacy Training Programs

- Government agencies and business chambers ought to provide free or significantly reduced training courses on budgeting, financial product evaluation, and debt management.
- MFIs and academic institutions can work together to offer specialized training to SME owners.

**2. Policy Reforms for Access to Finance**

- Simplify loan application processes for SMEs and lower collateral requirements.
- Motivate banks to develop lending solutions tailored to SMEs with adjustable payback plans.

**3. Political stability and Tax Support**

- Enhance commercial zones' energy, transportation, and internet infrastructure.
- Make local tax laws simpler, more clear, and more SME-friendly.
- A clear set of rules should be designed by the government which does not get affected by political instability.

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# Questionnaire

**Study Title: Barriers and the role of Financial Literacy and Microfinance on the Growth of SMEs in Peshawar, Pakistan**

**Introduction:** Assalam-U-Alaikum Sir, this questionnaire is designed to take data for research purpose only for Sarhard University of Science and Information Technology.

**Thanks for participating!**

## Section A: Demographic Information

1. Gender:

Male  Female  Other

2. Age:

Below 25  25-34  35-44  45-54  55 and above

3. Educational Qualification:

No formal education  Secondary education  Bachelor's degree  Master's degree  Other: \_\_\_\_\_

4. Business Sector:

Manufacturing  Retail  Services  Agriculture  Other:  
\_\_\_\_\_

5. Years in Operation:

Less than 1 year  1-3 years  4-6 years  Over 6 years

6. Number of Employees:

1-5  6-20  21-50  More than 50

## Section B: Barriers to SME Growth

Scale: 1 = Not a Barrier, 5 = Very Significant Barrier

Barrier	1	2	3	4	5
Lack of access to finance	<input type="checkbox"/>				
High cost of borrowing	<input type="checkbox"/>				
Political instability	<input type="checkbox"/>				

Corruption	<input type="checkbox"/>				
Taxation policies	<input type="checkbox"/>				
Lack of infrastructure	<input type="checkbox"/>				
Competition from informal sector	<input type="checkbox"/>				
Limited market access	<input type="checkbox"/>				

## Section C: Financial Literacy

Scale: 1 = Strongly Disagree, 5 = Strongly Agree

Statement	1	2	3	4	5
I understand basic financial concepts like interest, inflation, diversification	<input type="checkbox"/>				
I can create and manage a business budget	<input type="checkbox"/>				
I understand the differences between loan types and implications	<input type="checkbox"/>				
I regularly assess my business's financial performance	<input type="checkbox"/>				

I can evaluate financial products offered by banks or MFIs

## Section D: Microfinance Access and Use

1. Have you used microfinance services for your business?

Yes  No

2. Which institution(s) have you used? (Tick all that apply)

Allied Bank  Easypaisa/Jazzcash  Habib Bank  Other: \_\_\_\_\_

3. What type of service did you use?

Loan  Savings  Insurance  Business Training

Scale: 1 = Strongly Disagree, 5 = Strongly Agree

Statement	1	2	3	4	5
Microfinance improved my business capital	<input type="checkbox"/>				
It was easy to apply for and obtain microfinance loans	<input type="checkbox"/>				
Microfinance training improved my business skills	<input type="checkbox"/>				
I feel confident managing microfinance repayments	<input type="checkbox"/>				

## Section E: SME Growth and Performance

Scale: 1 = Strongly Disagree, 5 = Strongly Agree

Statement	1	2	3	4	5
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My revenue has increased in the past 2 years	<input type="checkbox"/>				
I have hired more employees recently	<input type="checkbox"/>				
My business has expanded to new markets or products	<input type="checkbox"/>				
Access to finance has helped my business grow	<input type="checkbox"/>				
Financial knowledge has helped improve my business decisions	<input type="checkbox"/>				

## Section F: Open-Ended Questions

1. What are the biggest challenges you face in accessing finance in Peshawar?

Ans: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

2. How has financial literacy helped (or could help) you run your business more effectively?

Ans: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

3. Are microfinance institutions supporting SMEs well in your region? Please explain.

Ans: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_