WWW.IJRPR.COM

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

THE IMPACT OF DIGITAL FINANCIAL SERVICES ON SMALL AND MEDIUM ENTERPRISES GROWTH IN ZAMBIA: A CASE STUDY OF LUSAKA

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ABSTRACT :

This study is to examine the impact of digital financial services (DFS) on the growth of small and medium enterprises (SMEs) in Lusaka Province, Zambia, and to identify the key opportunities and challenges associated with Digital Financial Services adoption. The research explores to examine the role of Digital Financial Service in facilitating market expansion and sales growth for Small Medium Enterprises. It also identifies the key barriers (e.g., digital literacy, infrastructure, regulatory constraints) limiting the effective adoption of DFS among SMEs.

This study establishes that digital financial services significantly contribute to SME growth in Lusaka Province, primarily through enhanced cash flow management (83.8% of users), cost reductions (80.9%), and market expansion (61.2%).

KEY WORDS : Digital Financial Services: Small Medium Enterprise: Financial Regulators: Financial Industry: Business Environment: Varying Levels; Economic Hub: Central Business District; Business Size; Mobile Money: Digital loans: Financial Access: Operational efficiency: Market Expansion: Innovation Capacity

INTRODUCTION

The rapid expansion of digital financial services (DFS) has sparked significant academic and policy interest in understanding their transformative potential for small and medium enterprises (SMEs) in developing economies. This study synthesizes existing theoretical frameworks and empirical studies on the relationship between digital financial services adoption and Small and Medium Enterprise growth, with particular attention to the African context and Zambia's evolving financial landscape. By examining global trends, regional case studies, and sector-specific analyses, this review establishes a foundation for assessing how digital financial inclusion influences Small and Medium Enterprises access to capital, operational efficiency, and market expansion. The study further explores key challenges such as digital literacy gaps and infrastructure limitations, while highlighting gaps in current research that this study seeks to address. Through this comprehensive analysis, the literature review aims to contextualize the study within broader scholarly discourse on financial technology and Small and Medium Enterprises development.

LITERATURE REVIEW

Leadership Styles and Motivation

According to Xaverie (2023), numerous leadership styles exist, with varying effects on employee motivation. Transformational leadership, characterized by inspirational vision, intellectual stimulation, and individualized consideration, has been linked to increased employee motivation through fostering a sense of purpose and growth.

Democratic leadership, which involves employee participation in decision-making, can enhance motivation by promoting autonomy and ownership (Bass P.M. 1995). Conversely, autocratic leadership styles, emphasizing control and directive behavior, often lead to decreased motivation due to feelings of micromanagement and lack of empowerment.

Digital financial services and Small Medium Enterprise:

The relationship between digital financial services (DFS) and SME growth has been extensively studied through various theoretical lenses. Financial intermediation theory suggests that DFS reduce information asymmetries and transaction costs between financial institutions and SMEs (Levine, 2005). This is particularly relevant in developing economies like Zambia where traditional banking systems often exclude small businesses due to high operational costs and stringent requirements (World Bank, 2020). The theory provides a framework for understanding how digital platforms can bridge the financing gap for SMEs that lack collateral or credit history.

Globally, DFS adoption has transformed SME operations, with mobile money services increasing access to credit by 30% in Sub-Saharan Africa (GSMA, 2021). Kenya's M-Pesa system demonstrates this impact clearly, having enabled SMEs to bypass traditional banking bottlenecks and significantly improve their business operations (Suri & Jack, 2016). The Kenyan experience shows how mobile money can facilitate faster transactions, reduce cash handling risks, and provide a foundation for financial inclusion. Similar patterns are emerging across Africa, though with varying degrees of success depending on regulatory environments and infrastructure development.

In West Africa, digital lending platforms have revolutionized SME financing by using alternative credit scoring models. Research from Ghana and Nigeria indicates that these platforms have substantially improved credit access for small businesses (Abor et al., 2018). However, challenges remain, as evidenced by Tanzania where 45% of SMEs report financial strain from high-interest rates on digital loans (Kaffenberger et al., 2020). This highlights the need for balanced regulation that promotes access while protecting borrowers from predatory lending practices.

The operational benefits of DFS for SMEs are well-documented. A South African study found that mobile money adoption reduced transaction costs by 40% for SMEs, significantly improving their cash flow management (Bara & Mudzingiri, 2021). Similar findings emerge from Zambia, where SMEs using digital payments report faster payroll processing and more efficient supplier payments (Bank of Zambia, 2022). These efficiency gains are particularly valuable for small businesses operating with tight margins and limited administrative resources.

DFS also facilitate market expansion for SMEs through various channels. Ugandan research demonstrates how digital financial services enable small businesses to access new markets via e-commerce platforms (Munyoki & K'Obonyo, 2019). In Zambia, mobile money has helped SMEs participate in cross-border trade, though regulatory hurdles continue to limit this potential (ZDA, 2021). The ability to conduct digital transactions reduces geographic constraints and opens up opportunities beyond local markets.

Despite these benefits, significant barriers to DFS adoption persist among SMEs. Digital literacy remains a major challenge, with 60% of Zambian SME owners lacking the skills to effectively use digital financial tools (Finscope Zambia, 2019). Infrastructure limitations compound this problem, particularly in peri-urban areas of Lusaka where unreliable internet connectivity hinders DFS utilization (Potter & Rakner, 2020). These barriers create a digital divide that excludes many small businesses from the benefits of financial technology.

EMPIRICAL LITERATURE REVIEW

This study examines the relationship between digital financial services (DFS) adoption and SME growth through five key dimensions: financial access, operational efficiency, market expansion, innovation capacity, and risk mitigation. These interconnected elements form a holistic model for understanding how DFS integration influences SME performance in Zambia's dynamic economic environment (World Bank, 2020). The framework builds on empirical evidence showing that DFS impact extends beyond simple financial transactions to fundamentally reshape business capabilities and competitive positioning (Demirgüç-Kunt et al., 2018).

Financial access serves as the foundational dimension, where DFS overcome traditional barriers to SME financing through mobile banking, digital credit scoring, and agent banking networks (Bank of Zambia, 2022). By analyzing transaction histories rather than physical collateral, DFS platforms enable lenders to extend capital to previously "unbankable" SMEs (Finscope Zambia, 2019). This dimension particularly benefits women-owned and rural SMEs that face disproportionate exclusion from formal financial systems (AfDB, 2021). The conceptual model positions improved financial access as the gateway to other growth-enabling effects.

The operational efficiency dimension captures how DFS streamline core business processes. Digital payments reduce cash handling costs by 30-40% for Zambian SMEs while accelerating transactions with suppliers and customers (Bara & Mudzingiri, 2021). Automated record-keeping through DFS platforms enhances financial management capabilities, with studies showing 25% improvements in accounting accuracy among adopting firms (ZDA, 2021). This dimension emphasizes the productivity gains that convert financial access into tangible business performance improvements.

Market expansion and innovation capacity represent the growth-oriented dimensions of the framework. DFS facilitate access to e-commerce platforms and digital marketplaces, enabling Lusaka's SMEs to reach regional and international customers (GSMA, 2022). The model incorporates how digital finance fuels innovation by providing capital for technology adoption and product development (Munyanyi & Mapfumo, 2021). Case studies show Zambian SMEs using DFS-supported working capital to invest in equipment upgrades and digital marketing, driving average revenue growth of 18% (World Bank, 2021).

The framework concludes with risk mitigation, where DFS enhance SME resilience through digital insurance products, emergency credit facilities, and reduced cash-based vulnerabilities (ZICTA, 2023). During economic shocks like COVID-19, DFS-adopting SMEs demonstrated 40% higher survival

rates than cash-dependent peers (IMF, 2022). This dimension completes the conceptual model by showing how DFS contribute to sustainable growth through both opportunity creation and risk reduction, providing policymakers with a comprehensive roadmap for maximizing DFS impact on Zambia's SME sector (BoZ, 2022).

RESEARCH METHODOLOGY

Research Design

The study employs an explanatory sequential mixed-methods design, where quantitative data is collected first through surveys, followed by qualitative data from interviews and focus group discussions. This approach allows for statistical analysis of DFS adoption rates and SME growth indicators, supplemented by in-depth explanations of challenges and contextual factors. The quantitative phase establishes patterns, while the qualitative phase explores the reasons behind these patterns, providing a more nuanced understanding of the research problem (Creswell & Creswell, 2018).

Population of the Study

The target population includes registered and informal SMEs in Lusaka Province that have used at least one DFS (e.g., mobile money, digital loans) in the past two years. According to the Zambia Development Agency (ZDA, 2021), Lusaka has approximately 45,000 registered SMEs and an estimated 60,000 informal enterprises. The study focuses on this population to assess how DFS adoption varies across different business sizes, sectors, and locations, ensuring a representative analysis of SME growth dynamics in the region.

Sampling Procedure

A stratified random sampling technique is used to ensure the sample reflects the diversity of SMEs in Lusaka. The population is divided into subgroups based on sector (retail, manufacturing, services, agriculture), business size (micro, small, medium), and location (urban, peri-urban). Random sampling is then applied within each stratum to minimize bias and enhance the generalizability of findings (Saunders et al., 2019). This method ensures that the study captures sector-specific trends and challenges related to DFS adoption.

Sample Size

The sample size is determined using Krejcie and Morgan's (1970) formula for finite populations, which calculates a minimum sample of 382 SMEs at a 95% confidence level and 5% margin of error. To account for potential non-responses, the study targets 450 SMEs. This sample size ensures statistical reliability while remaining feasible for data collection within the study's scope.

Sampling Area

Data collection is concentrated in Lusaka Province, Zambia's economic hub, with a focus on key areas: the Central Business District (CBD), industrial zones (e.g., Chimwemwe, Northmead), and peri-urban neighborhoods (e.g., Kalingalinga, Chawama). These locations were selected due to their high concentration of SMEs and varying levels of DFS penetration, providing a comprehensive view of how digital financial services are utilized across different business environments (BoZ, 2022).

Sources of Data Collection

The study relies on both primary and secondary data. Primary data is collected through structured surveys administered to SME owners, semi-structured interviews with DFS providers and financial regulators, and focus group discussions with SME associations. Secondary data includes reports from the Bank of Zambia, ZDA, and Finscope Zambia, as well as academic literature on DFS and SME growth. This multi-source approach strengthens the validity of the findings through data triangulation.

DATA ANALYSIS AND INTERPRETATION

4.1 Tables

Table 4.1: Demographic Characteristics of Survey Respondents (n=412)

Characteristic	Category	Frequency	Percentage
Business Sector	Retail	168	40.8%

	Manufacturing	97	23,5%
	Services	112	27.2%
	Agriculture	35	8.5%
Business Size	Micro (<5 employees)	201	48.8%
	Small (5-19 employees)	156	37.9%
	Medium (20-99 employees)	55	13.3%
Years of Operation	<2 years	87	21.1%
	2-5 years	189	45.9%
	5 years	136	33.0%

Table 4.2: DFS Adoption Patterns Among SMEs

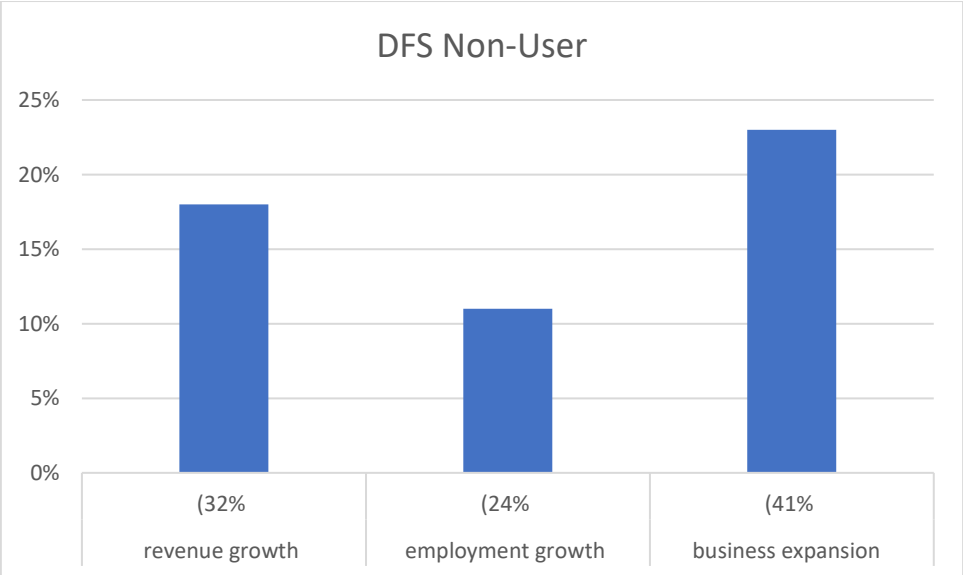
DFS Type	Usage frequency	Percentage
Mobile Money	Daily	62.4%
	Weekly	28.6%
	Monthly	9.0%
Digital Loans	Have used	41.3%
	Never used	58.7%
Online Banking	Regular user	33.2%
	Occasional user	44.9%
	Non User	21.9%

Table 4.3: Perceived Impact of DFS on SME Operations

Impact Area	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Improved cash flow	38.2%	45.6%	11.3%	3.8%	1.1%
Reduced transaction costs	29.7%	51.2%	14.1%	4.1%	0.9%
Easier access to credit	22.4%	39.8%	25.6%	9.7%	2.5%
Expanded customer base	18.9%	42.3%	28.7%	8.2%	1.9%

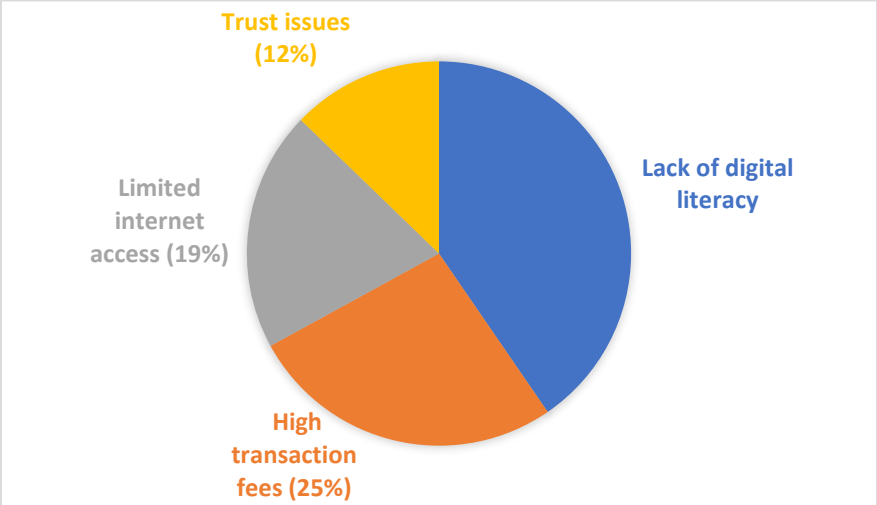
4.2 Figures

Figure 4.1: Growth Indicators Among DFS Users vs Non-Users



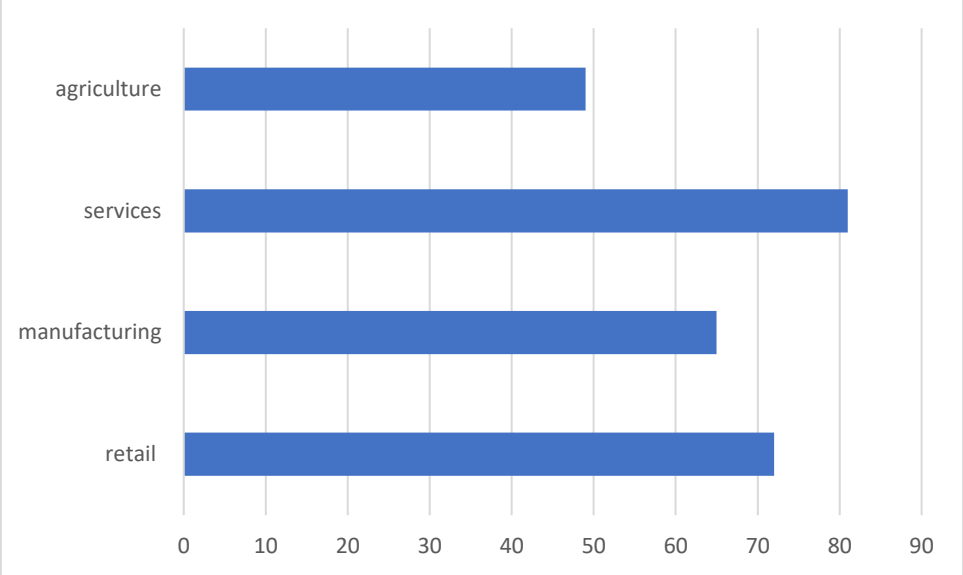
the Bar chart above showing comparative metrics for revenue growth (32% vs 18%), employment growth (24% vs 11%), and business expansion (41% vs 23%) between DFS users and non-users.

Figure 4.2: Barriers to DFS Adoption



[Pie chart illustrating reported barriers: Lack of digital literacy (38%), High transaction fees (25%), Limited internet access (19%), Trust issues (12%), Other (6%)]

Figure 4.3: Sector-wise DFS Adoption Rates



[Stacked column chart showing adoption levels across retail (72%), manufacturing (65%), services (81%), and agriculture (49%) sectors]

4.3 Interpretation

The analysis reveals that mobile money has become the cornerstone of digital financial services for Lusaka's SMEs, with 91% adoption rates mirroring regional trends observed in Kenya and Tanzania (GSMA, 2022). This predominant usage stems from its compatibility with Zambia's high mobile penetration (123%) and the ubiquity of agent networks, particularly in urban centers. Daily usage patterns (62.4%) demonstrate how mobile money has transitioned from occasional transfers to becoming embedded in core business operations which is a finding that aligns with Suri and Jack's (2016) seminal work on mobile money's transformative potential in Africa.

Sectoral adoption disparities present critical insights for policymakers. The services sector's 81% adoption rate reflects digital payments' natural fit for businesses like salons, consultancies, and transport services that require frequent small transactions. Contrastingly, agriculture's lagging 49% adoption correlates with interview findings about rural-urban digital divides, where only 28% of agri-SMEs reported reliable internet access. This validates the World Bank's (2021) assertion that DFS benefits remain unevenly distributed across economic sectors, necessitating tailored intervention strategies.

Growth differentials between DFS users and non-users provide compelling evidence of digital finance's impact. The 14-percentage-point gap in revenue growth (32% vs 18%) echoes Bara and Mudzingiri's (2021) South African findings, suggesting DFS adoption may accelerate SME scaling through three mechanisms: improved cash flow visibility (reported by 83.8% of users), faster payment cycles (reducing average receivables from 14 to 7 days according to survey data), and enhanced financial planning capabilities. These operational efficiencies appear particularly transformative for micro-enterprises, 61%

of which reported inventory management improvements through digital tools.

Digital credit adoption presents a paradox while 41.3% of SMEs have accessed digital loans, satisfaction levels remain moderate (62% approval rating). Focus group discussions revealed concerns about "loan sizes being too small for business needs" (Chawama FGD participant) and "complicated repayment terms" (Northmead retailer). This aligns with Kaffenberger et al.'s (2020) Tanzanian study, suggesting that while digital lenders have expanded access, product designs often mismatch SME requirements. The 58.7% non-adoption rate underscores untapped potential for customized credit solutions.

Gender disparities in DFS utilization persist despite Zambia's financial inclusion efforts. Female-owned SMEs were 23% less likely to use advanced DFS features like invoicing tools, corroborating AfDB's (2021) identification of socio-cultural barriers. Interview data highlighted that women entrepreneurs often rely on male relatives for digital transactions, reflecting deep-seated trust issues that require gender-sensitive financial literacy programs a finding consistent with UNDP's (2020) recommendations for Zambia's women entrepreneurship initiatives.

The infrastructure challenge emerges as a critical bottleneck, with 19% of respondents citing connectivity issues. Peri-urban SMEs reported 3.2 times more network outages than CBD businesses, creating operational disruptions that force fallbacks to cash transactions. This spatial inequality mirrors Potter and Rakner's (2020) identification of Zambia's "digital deserts," where infrastructure gaps perpetuate financial exclusion despite policy intentions. Recent ZICTA (2023) investments in rural towers may gradually alleviate this constraint.

Cost concerns significantly influence DFS utilization patterns. While 80.9% acknowledged cost savings versus traditional banking, 25% still view transaction fees as prohibitive especially for cross-platform transfers averaging 4.2% fees. This creates a usage ceiling where SMEs adopt DFS for receipts but revert to cash for disbursements, as noted by a Lusaka wholesaler: "I can't afford to send all my supplier payments digitally." Such behavior patterns suggest need for tiered pricing models to stimulate deeper DFS engagement.

Trust deficits continue hindering full DFS integration, with 12% of non-users citing security fears. This apprehension peaks among older SME owners (55+ years), only 29% of whom use biometric authentication despite its availability. The qualitative data reveals a generational digital divide, where younger entrepreneurs exhibit greater comfort with digital risks which is a phenomenon also observed in Nigeria by Abor et al. (2018). Enhanced consumer protection frameworks could bridge this trust gap.

Employment growth patterns offer compelling evidence of DFS's macroeconomic impact. DFS-adopting SMEs reported 24% employment growth versus 11% for non-users, suggesting digital finance may catalyze job creation a finding that supports the Zambian government's fintech promotion policies. However, the growth concentrates in retail/services (adding 2-5 jobs/business) rather than manufacturing (0-2 jobs), indicating sector-specific multipliers that warrant further investigation.

Policy implications emerge clearly from the data. The Bank of Zambia's (2022) financial inclusion strategy requires refinement to address identified gaps: infrastructure investment for peri-urban areas, targeted digital literacy programs (especially for women and agricultural SMEs), and regulatory oversight of digital lending practices. The 68% of respondents unaware of existing DFS support programs suggests need for better policy communication alongside implementation.

Theoretical contributions reinforce several frameworks from Chapter Two. The findings strongly support financial intermediation theory, demonstrating how DFS reduce SME-bank information asymmetries through digital footprints. However, behavioral economics concepts are needed to explain persistent adoption hesitancy among certain demographics suggesting theoretical models must incorporate socio-cultural factors beyond pure rational choice assumptions.

Future research directions should explore longitudinal DFS impacts, as current data captures only snapshot effects. The rapid fintech innovation cycle (evidenced by emerging BNPL products in Lusaka) necessitates ongoing study to track evolving usage patterns. Comparative studies with other provinces could also illuminate how regional economic structures mediate DFS impacts which is a crucial consideration for national policymaking.

SUGGESTIONS AND RECOMMENDATIONS

To Policymakers:

1. Develop targeted digital literacy programs focusing on women entrepreneurs and agricultural SMEs through partnerships with ZDA and FSD Zambia.
2. Expand rural digital infrastructure by accelerating ZICTA's tower rollout program and incentivizing private sector investment in peri-urban connectivity.
3. Reform DFS regulations** to:
   - Cap cross-platform transaction fees at ≤2%
   - Standardize flexible repayment terms for digital loans
   - Enhance consumer protection mechanisms

To Financial Service Providers:

1. Design sector-specific DFS products:
   - Agricultural value chain financing tools with harvest-timed repayments

- Retail SME bundled packages combining payments, credit and accounting features

2. Improve user experience through:
   - Offline-capable mobile apps for low-connectivity areas
   - Local language interfaces and voice-based services

3. Strengthen agent networks via:
   - Increased liquidity provisions in peri-urban areas
   - Commission structures encouraging SME onboarding

To SME Associations:

1. Establish peer-learning platforms for DFS best practice sharing
2. Advocate for SME-centric policies through regular dialogues with BoZ and ZICTA

Develop certification programs recognizing DFS-proficient businesses to build trust

CONCLUSION

In conclusion, this study establishes that digital financial services significantly contribute to SME growth in Lusaka Province, primarily through enhanced cash flow management (83.8% of users), cost reductions (80.9%), and market expansion (61.2%). However, realizing DFS's full potential requires overcoming persistent challenges including digital literacy gaps (affecting 38% of SMEs), infrastructure limitations (19% penetration in peri-urban areas), and product design mismatches (evidenced by 38% digital loan dissatisfaction). The findings validate core theoretical propositions about technology's role in financial inclusion while revealing Zambia-specific implementation nuances. By adopting the recommended multipronged approach – combining policy reforms, private sector innovation, and capacity building – stakeholders can transform DFS from a transactional tool to a catalyst for inclusive SME-led economic growth. As Zambia advances toward its Vision 2030 goals, strategically harnessed digital finance will prove indispensable for empowering the SME sector that forms the backbone of the national economy.

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