

**RESEARCH PAPER**

The Effects of Institutional Quality on Employment Dynamics of SMEs: Evidence from Nangarhar Province – Afghanistan

¹ Ataullah Muneeb

1. Associate Professor, Department of Economics, Khurasan University, Nangarhar, Afghanistan

*Corresponding Author: Ataullahmuneeb101@gmail.com

ABSTRACT

The study employs regression analysis to look at the effect of Institutional Quality and Access to Credit on SME's Employment. SMEs are known to create employment and contribute to the economic development, particularly in developing countries where unemployment and underemployment are still significant issues. The primary purpose of the study is to examine the relationship between the institutional and financial factors and employment in SMEs. Analysis results show that Institutional Quality and Access to Credit have a positive and statistically significant impact on SME employment. The institutional quality indicator is significantly and strongly related to SME employment ($\beta = 0.697$, $p < .01$), indicating that the improvement of the effectiveness and efficiency of governance, regulatory quality, transparency, accountability and institutional efficiency positively and significantly affects job creation in SMEs. This means that reliable institutions help to decrease uncertainty, foster the business environment, and promote investment, growth, and entrepreneurship. Access to Credit is also positively correlated with SME employment, though this correlation is not statistically significant ($\beta = 0.113$, $p > .05$), suggesting that better access to financial capital allows SMEs to grow their production, invest in assets, and employ more people. The comparative analysis of standardized coefficients, however, shows that Institutional Quality has a much greater influence on the employment of SMEs than Access to Credit, thereby indicating that the governance and institutional frameworks are a more powerful driver of employment outcomes of SMEs. The results support institutional theory as well as financial development theory, which have been associated with the importance of effective institutions and access to finance for economic growth and job creation.

KEYWORDS SME's Employment, Institutional Quality, Access to Credit

1. Introduction

Small and Medium Enterprises (SMEs) are generally recognized as the lifeblood of economic growth and job creation in both developed and developing economies. A significant share of the total employment, enterprise activity, and income production is accounted by them especially in low- and middle-income countries where large-scale industries are scarce (Ayyagari et al. 2007; OECD, 2019; World Bank, 2020). Empirical evidence suggests that SMEs contribute over half of total employment in the world and play a key role in alleviating poverty, innovation, and inclusive growth (Beck et al., 2005; Ayyagari, et al., 2011; Haltiwanger et al., 2013). This role is further enhanced in fragile and conflict-affected economies like Afghanistan where the private sector is largely dominated by small-scale businesses and where job creation remains a key economic challenge (Naudé, 2010; UNDP, 2022; World Bank, 2020). Although they are important, the ability of SMEs to grow and create employment is not only determined by internal firm factors but is strongly influenced by the institutional environment that they operate in.

Institutional quality which includes rule of law, regulatory effectiveness, government efficiency, control of corruption and political stability have been found to be one of the fundamental determinants of economic performance and development of the private sector. Theoretical contributions

by North (1990) emphasize that institutions are the rules of the game and help to minimize the transaction costs and enhance efficiency. Williamson (2000) explains the role of governance structures that help to minimize transaction costs and enhance efficiency. Acemoglu et al. (2001) also argue that institutional quality is the leading cause of long-term economic growth and Rodrik et al. (2004) prove that institutions are the leading cause of long-term economic growth. The same is indicated by Hall and Jones (1999), who demonstrates that variations in productivity and output are explained by social infrastructure, which is closely related to institutional quality. Theoretical implications of these insights in the context of SMEs are that a favourable institutional environment can increase business confidence, stimulate investment, and allow firms to increase operations and employment (Beck et al., 2005; Kaufmann et al., 2010).

Empirical literature on SMEs has demonstrated that institutional conditions are especially sensitive to SMEs compared to larger firms. Beck et al. (2005) discover that smaller enterprises are disproportionately affected by financial, legal, and corruption-related constraints, which limit their growth and their potential to employ. Ayyagari, Demirguc-Kunt, and Maksimovic (2011) also reveal that although SMEs are the biggest contributors to job creation, the ability to create employment opportunities depends on access to finance, regulatory efficiency, and institutional support. Djankov et al. (2002) show that excessive regulation discourages entry and expansion of firms whereas Klapper et al. (2006) find that regulation burdens discourage entry and expansion of firms. Furthermore, corruption and poor enforcement of the law add to the cost of operations and uncertainty that firms do not have the incentive to increase the size of their workforce (Mauro, 1995; Fisman and Svensson, 2007; Aidt, 2009). All these studies are pointing towards the fact that institutional quality does have an effect on SME employment both directly through the governance mechanism and indirectly through the influence it has on firm growth, investment decisions and access to finance (Beck and Demirguc-Kunt, 2006; Demirguc-Kunt et al., 2006; Djankov et al., 2007).

Considering this theoretical and empirical background, the current study is aimed at studying the impact of institutional quality on the employment of SMEs, with a particular focus on Afghanistan. Although the world literature has strong evidence on the significance of institutions in promoting economic growth and firm performance, a closer look reveals that much of the research has been focused on macroeconomic outcomes such as GDP growth, investment and financial development instead of firm-level employment dynamics (Acemoglu et al., 2001; Rodrik et al., 2004; Hall and Jones, 1999). Even the studies that concentrate on SMEs are more likely to focus on limitations to growth and access to finance without explicitly isolating the effect of institutional quality on the generation of employment (Beck et al., 2005; Ayyagari et al., 2011). Moreover, although the studies by Beck and Demirguc-Kunt (2006) and Demirguc-Kunt et al. (2006) demonstrate the importance of institutions in determining financial access, the transmission of these effects to the employment outcomes has not been sufficiently examined. Likewise, regulatory research like the one conducted by Djankov et al. (2002) and Klapper et al. (2006) points out that the central focus of the research is on the entry of firms and entrepreneurship, but not on the expansion of employment within the SMEs.

This disparity is further increased when it comes to vulnerable and war-torn economies. Despite the fact that research studies like Naudé (2010) and UNDP (2022) have highlighted the significance of SMEs and institutional reform in promoting economic recovery, there is little empirical research that explicitly addresses the role of institutional quality in influencing SME employment under such circumstances. The institutional voids concept as discussed by Khanna and Palepu (2010) and Webb et al. (2013) suggests that a poor institutional framework is a significant constraint to the growth and scalability of firms, but empirical evidence to support the concept in the Afghan context is limited. The available literature on Afghanistan is mostly dedicated to macroeconomic instability, dependence on aid, and poverty, with little focus on the dynamics at the firm level and employment outcomes. Moreover, cross-country research might not sufficiently reflect the specific institutional, political, and socio-economic aspects of Afghanistan, and the context-specific analysis should be taken into account.

In this respect, it is timely and necessary to investigate the influence of institutional quality on SME employment in Afghanistan. This study contributes to the body of literature by providing empirical evidence of the impact of institutional quality on employment of SMEs in Nangarhar province. This kind of analysis is especially vital in terms of policy making, where enhancing institutional quality might be one of the most effective approaches to sustainable employment and development of the private sector in Afghanistan.

2. Literature Review

The institutional quality has been identified as a central factor of economic performance, development of enterprises, and growth of labour market. The quality of institutions is particularly significant in the context of small and medium enterprises (SMEs) because smaller firms are generally more vulnerable to uncertainty than large corporations due to reduced financial reserves, weak bargaining power, and high susceptibility to uncertainty. Consequently, SMEs are more receptive to the lack of governance, enforcement of the law, corruption, and efficiency of the regulatory framework. One of the first and most influential explanations was that given by North (1990) in which institutions are defined as the formal and informal rules of the game that reduce uncertainty and structure the economic exchange. North (1990) says that when institutions work effectively, they reduce transaction costs, enhance predictability, and provide incentives to invest productively. These processes are directly connected to creation of employment opportunities since companies are more ready to increase operations and hire new employees in case the business environment is stable and reliable. This view was later supported by Acemoglu and Robinson (2012), who argued that inclusive institutions foster innovation, entrepreneurship and long-term prosperity whereas extractive institutions discourage investment and limit productive activity. Their model is specifically applicable to SMEs, the development of which is often limited in the environment with poor governance and unstable policies.

The institutional quality and employment relationship is a popular field of development economics and business research. According to Beck, Demirgüç-Kunt and Maksimovic (2005) using firm level evidence in cross countries, they found that smaller enterprises are disproportionately constrained by financial, legal and corruption-related barriers. Their research revealed that weak institutions not only lower profitability and investment but also curtail the expansion of employment among SMEs since firms with weak institutions are likely to remain small and risk-averse. Equivalently, Ayyagari et al. (2011) demonstrated that SMEs are significant job creators in the world, particularly in the developing economies, but their ability to generate employment opportunities depends on an enabling institutional framework. In countries where the enforcement of contracts is weak, administrative procedures are cumbersome, or access to finance is distorted, SMEs are less likely to contribute to labour absorption than it would otherwise. These results are part of the larger literature that focuses on the fact that institutions have an indirect influence on employment because of their effects on enterprise creation, productivity, and firm growth. Regulatory quality is one of the most crucial mediums through which institutional quality influences SME employment. Djankov et al. (2006) discovered that the rates of business formalization and entrepreneurial activity are higher in countries with less complex entry regulations, and a more effective legal system. In the case of SMEs, the high cost of operating a business due to excessive licensing procedures, unpredictable taxation and bureaucratic delays. When companies spend time and resources to go through the complex regulations, there is less to be used to hire workers or invest to produce valuable products. Klapper et al. (2006) have also demonstrated that onerous regulations minimize entry and competition by firms, lowering the creation of jobs. This literature suggests that reforms to simplify the registration process, digitize compliance systems, and enhance administrative transparency can play a significant role in improving SME employment outcomes.

The rule of law and enforcement of contracts is another focal point of institutional quality. Courts that are efficient and enforceable contracts enable firms to trade with confidence, get supplier credit and plan longer. Johnson et al. (2002) who conducted research in the transition economies discovered that when property rights are secured and contracts are enforceable, entrepreneurs are more inclined to reinvest their profits. In the case of SMEs, this is especially critical as liquidity constraints can be easily generated by late payments, contractual disagreements and weak property rights, and such constraints can quickly limit expansion and growth in employment. It was also demonstrated by La Porta et al. (1998) that the financial development and growth of firms is significantly affected by the legal origin and investor protections. As SMEs tend to use external finance to scale operations, the stronger legal institutions indirectly spur employment by increasing the confidence of lenders and investors. Another factor that is highly cited in relation to SME employment performance is corruption control. Seminal evidence offered by Mauro (1995) demonstrated that corruption reduces investment and economic growth by raising uncertainty and misallocating resources. In the case of SMEs, corruption can serve as a retrogressive and informal tax since smaller companies are less capable than larger companies of absorbing unofficial payments or employing political contacts. Using firm-level data on Uganda, Fisman and Svensson (2007) found that bribery had a more negative impact on employment than formal taxation. Because the growth of employment is subject to retained earnings and projected returns, corruption has a direct negative impact on the resources at the disposal of the recruitment and wage growth. Similar arguments were also made by Méon and Weill (2010) who argued

that although some of the earlier theories had postulated that corruption could grease the wheels, the overwhelming evidence had indicated that corruption was damaging efficiency and discouraging productive development of the enterprises, most especially where the institutions were weak.

Government effectiveness and political stability are also significant factors that influence SME employment. Through the Worldwide Governance Indicators, Kaufmann et al. (2010) demonstrated that the government effectiveness, political stability, regulatory quality, and rule of law are strongly correlated with the high-income level and the strong performance of the private sector. The political instability creates uncertainty regarding taxes, security, market demand, and continuity of policies, thus forcing firms to delay investment and hiring. This is further enhanced in the case of SMEs as they do not have diversified markets and risk-management instruments. Institutional instability in weak and conflict-related economies tends to result in short planning horizons, informalization, and poor job creation. Aidis et al. (2008) discovered that entrepreneurship is much weaker where institutions are not able to provide stable incentives and secure rights. Their results imply that institutional reforms that enhance predictability can have significant labour market returns in the form of SME growth. In the case of Afghanistan, this literature is relevant in many ways. SMEs take up a significant portion of the privately based economic activity and is one of the most viable means of creating broad-based employment. However, historically Afghanistan has been challenged by institutional issues such as policy uncertainty, poor contract enforcement, limited financial intermediation, administrative fragmentation and high transaction costs. Despite the fact that country-specific empirical research is still limited, the global evidence is strongly pointing to the fact that improvements in institutional quality would lead to an increase in SME confidence, the encouragement of formalization, increased investment and the growth of labour demand. The cost of doing business can be reduced by promoting better governance, which will in turn enhance access to markets and finance as well as create a more predictable environment in which SMEs will be able to hire workers in a sustainable manner. In weak economies with restricted ability of the public-sector to create jobs, the role of SME-led job creation becomes even more significant, and institutional reform is a primary job creation strategy.

3. Material and Methods

The current paper adopted a quantitative research design that investigates the impact of institutional quality on the employment of SMEs. Quantitative approach was suitable because it allowed the researcher for testing relationships between variables and give generalizable results (Creswell, 2014; Wooldridge, 2016). The population comprises of employees who worked in SMEs within the Nangarhar province. Since the number of SME employees in total is not delimited and it is constantly changing, the population is deemed to be infinite. Thus, a sample size of 365 respondents was chosen according to standard sampling rules of the large population in order to guarantee reliability and representativeness (Cochran, 1977). A structured questionnaire was used to collect primary data and the data are used to measure institutional quality and employment-related outcomes in SMEs. The questionnaire was constructed according to the existing literature and pre-tested to guarantee validity and reliability (Hair et al., 2010). The respondents were chosen among various SMEs in Nangarhar in order to get a variety of opinions. In order to analyses the data, the study applied multiple linear regression that was a widely used econometric technique to examine the effects of institutional quality on employment of SMEs (Gujarati and Porter, 2009). The model is defined as:

$$E = \beta_0 + \beta_1 IQ + \beta_2 AC + \varepsilon$$

E reflects the employment as dependent variable, while the independent variables are IQ denotes institutional quality and AC denotes access to credit. This method enables the research to determine the size and importance of the effect of the institutional quality on the SME employment whilst holding other factors constant. Diagnostic tests are done in order to make sure that the results are robust (Wooldridge, 2016).

4. Results and Discussion

4.1 Descriptive Statistics

Table 1

Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
SME's Employment	365	2.83	5.00	4.7740	.39337
Institutional Quality	365	1.80	5.00	4.7638	.45016
Access to Credit	365	2.33	5.00	4.6986	.40209

Table 1 shows the descriptive statistics of the key variables that were used in the study: SME's Employment, Institutional Quality, and Access to Credit. The table shows the number of observations, minimum and maximum values, mean scores, and standard deviations for each variable. The results show that the sample size (N = 365) of the valid responses was adequate for statistical analysis, which increases the reliability of the results. The minimum value of the variable "SME's Employment" was 2.83 and the maximum value was 5.00 with a mean score of 4.7740 and a standard deviation of 0.39337. The mean value is high indicating that generally respondents agree that SMEs play a significant role in the creation of employment opportunities. Additionally, the low standard deviation suggests that the responses were relatively uniform, with most participants agreeing on the positive impact of SMEs on job creation.

The minimum and maximum values for Institutional Quality were 1.80 and 5.00, respectively. The mean score of 4.7638 indicates that the respondents' perception of the quality and supportiveness of institutions was relatively high. The standard deviation for 0.45016, though slightly higher than for SME employment, is still moderate, meaning that there was not a lot of dispersion among the respondents as far as their perspectives on the effectiveness and quality of institutions are concerned. Likewise, the minimum score for Access to Credit was 2.33 and the maximum score was 5.00, with an average score of 4.6986 and a standard deviation of 0.40209. The average value is high, indicating that overall, the respondents felt that credit is available and is of major importance for SMEs. The small standard deviation also indicates a high level of agreement on this issue among the respondents. The descriptive statistics showed that all the study variables have relatively high mean values and low standard deviations. This suggests that respondents have positive perceptions on the employment of SMEs, quality of institutions and access to credit. Moreover, the lack of variability in the responses indicates that the data collected was consistent and reliable, thus appropriate for additional inferential statistical analysis.

4.2 Correlation Matrix

Table 2

Correlation Matrix

Variables	N	SME's Employment	Institutional Quality	Access to Credit
SME's Employment	Pearson Correlation	1		
	Sig. (2-tailed)			
	N	365		
Institutional Quality	Pearson Correlation	.779**	1	
	Sig. (2-tailed)	.000		
	N	365	365	
Access to Credit	Pearson Correlation	.618**	.725**	1
	Sig. (2-tailed)	.000	.000	
	N	365	365	365

**. Correlation is significant at the 0.01 level (2-tailed).

The Pearson correlation matrix of SME's Employment, Institutional Quality and Access to Credit is presented in Table 2. The analysis is based on 365 observations and all correlations are statistically significant at the 0.01 level (2-tailed) which has a high level of confidence in the relationships between the variables. The dependent variable of the study, SME's Employment is highly correlated with Institutional Quality ($r = 0.779$, $p < 0.01$). The finding implies that an increase in institutional quality is linked with increased employment generation in SMEs. In other words, the growth of SME employment may be a result of the effective institutions, clear rules, supportive government policies and efficient governance mechanisms. This is a strong correlation between the two variables, with a correlation coefficient of 0.779. Likewise, there is a positive and statistically significant correlation between SME's Employment and Access to Credit ($r = 0.618$, $p < 0.01$). It means that more financial resources and credit facilities will increase the employment capacity of SMEs. Access to credit and funds from the business is easier and more available, meaning that the business can grow, invest in productive activity and generate jobs. The correlation value of 0.618 represents a moderate to strong positive relationship. Moreover, there is a positive correlation between the independent variables. The institutional quality and access to credit are found to be strongly positively correlated ($r = 0.725$, $p < 0.01$) suggesting that good institutional environments are linked to better access to credit. This connection can be present due to the fact that in the presence of strong institutions, financial systems tend to be better, there are less bureaucratic hurdles, and trust between financial institutions and businesses is higher. Overall, it is observed from the correlation matrix that both the Institutional Quality and Access to Credit are positively and significantly correlated with SME's Employment. The relationship between the various independent variables and SME employment is strongest with Institutional Quality, indicating that institutional issues could be more important in improving employment in SMEs. In addition, the correlation between the variables is relatively high, but not high enough to reach the critical value of 0.80, meaning that multicollinearity will not likely be a problem in this study.

4.3 Regression Result

Table 3

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.782 ^a	.612	.610	.24563

a. Predictors: (Constant), Institutional Quality, Access to Credit

The results of the regression analysis on the effect of Institutional Quality and Access to Credit on SME's Employment are summarized in the model in Table 3. The model summary contains many key pieces of information about the strength, explanatory power, and overall fit of the regression model. The value of correlation coefficient ($R=0.782$) shows that there is strong positive correlation between the independent variables (Institutional Quality and Access to Credit) and the dependent variable (SME's Employment). This implies that the institutional quality and access to credit are highly correlated with the differentials in the number of SMEs employed. The coefficient of determination ($R\text{ Square} = 0.612$) indicates that the independent variables in the model account for about 61.2% of the variation in SME's Employment. Put another way, 25 percent of the change in SME employment is driven by both Institutional Quality and Access to Credit. This means that the model has good explanatory power and that these factors are important to the generation of employment in SMEs. The value of the Adjusted R Square is 0.610, which also indicates that the model is strong. The adjusted value is very close to the R Square value, which means that the power of the model is not affected by adjusting the number of predictors used in the analysis. This implies that the model is reliable and that the independent variables have a meaningful contribution to the explanation of SME employment and that variables which are not necessary and/or irrelevant do not cause the results to be inflated. Similarly, the Standard Error of

the Estimate is 0.24563, indicating the estimated average error between the predicted values of the regression model and the observed values. The relatively low standard error indicates that the predicted values are close to the actual observed values, demonstrating a good level of accuracy and fitness of the regression model. The results of the model summary suggest that in general, the contribution of Institutional Quality and Access to Credit is significant in explaining SME employment. The model has a good explanatory power, reliability, and accurate prediction, indicating that job creation in SMEs can significantly be improved through strengthening of institutional structures and access to finance.

Table 4**Analysis of Variance**

Model	Sum of Squares	df	Mean Square	F	Sig.	Model
Regression	34.483	2	17.242	285.764	34.483	2
Residual	21.841	362	.060		21.841	362
Total	56.325	364			56.325	364

a. Dependent Variable: SME's Employment

b. Predictors: (Constant), Institutional Quality, Access to Credit

The ANOVA results show that the regression model is statistically significant in explaining SME's Employment. The model obtained an F-Statistic of 285.764 with a significance value of 0.000 (which is less than 0.05). This suggests that the independent variables such as Institutional Quality and Access to Credit have significant joint effect on SME's Employment. Thus, the null hypothesis of no effect of the predictors on SME employment is rejected. The regression sum of squares value of 34.483 indicates that the model explains a significant amount of the variation in the employment of SMEs, and the unexplained variation due to factors not included in the model is represented by the residual sum of squares of 21.841. The overall results indicate that the regression model is suitable for the data and can be used to explain the changes in SME employment.

Table 5**Regression Result**

Model	Standardized		Coefficients	t	Sig.
	Unstandardized Coefficients	Std. Error			
	B		Beta		
(Constant)	1.354	.156		8.677	.000
Institutional Quality	.609	.042	.697	14.662	.000
Access to Credit	.111	.046	.113	2.382	.018

a. Dependent Variable: SME's Employment

The regression results reported in Table 5 analyse the effect of Institutional Quality and Access to Credit on SME's Employment. The unstandardized coefficients (B), standardized coefficients (Beta), t-values, and significance levels are presented in the table, which shows the direction, strength, and statistical significance of the relationships between the independent variables and the dependent variable. The constant value ($\beta = 1.354$, $p = 0.000$) represents the base level of SME's Employment when all the independent variables are kept at zero. The t-value is large and statistically significant (8.677) indicating that the intercept of the model is statistically significant. The results indicate that Institutional Quality is positively and statistically significant with SME's Employment. The unstandardized coefficient for Institutional Quality is 0.609, which indicates the change in SME employment when a unit change occurs in institutional quality, while other variables are held constant. Institutional Quality has the highest standardized regression coefficient ($\beta = 0.697$), meaning that it is the model's most powerful predictor. Moreover, the obtained t value (14.662) and the level of significance (0.000) show that the effect is highly significant at the 1% significance level. This indicates that institutional effectiveness, governance quality, transparency and regulation can significantly improve employment creation in SMEs. Likewise, Access to Credit is also found to have a positive and statistically significant relationship with SME's Employment. The unstandardized coefficient ($B = 0.111$) means that for every one

unit increase in access to credit, the number of SME jobs increases by 0.111 unit, with all other variables being constant. The standardized beta coefficient ($\beta = 0.113$) indicates that access to credit has a positive impact on employment growth, but its impact is smaller than that of institutional quality. The *t* value for this is 2.382, the *p* value is 0.018, which shows that the relationship is statistically significant at the 5% level of significance. This discovery suggests that increasing the financial availability of SMEs leads to increased activity, investment in productive activities, and job creation. In comparison, the standardized beta coefficient of the effect of Institutional Quality on SME's Employment is significantly higher than that of Access to Credit, meaning the influence of Institutional Quality is stronger on SME's Employment than that of Access to Credit. This reveals that institutions like good policies, regulations, quality of governance and efficient administration have a greater influence on the employment generation of SMEs. The overall regression analysis shows that both Institutional Quality and Access to Credit have positive and significant influence on SME's Employment. The findings provide evidence to the argument that improving institutional framework and access to finance are crucial in improving the growth and employment creation of SMEs. The results of this study offer empirical evidence for the need to pay attention to institutional reform and development of the financial sector in order to increase employment opportunities through SMEs.

5. Discussion

The results of the regression analysis show that both Institutional Quality and Access to Credit have significant impacts on SME employment generation. The results showed that Institutional Quality has a positive and statistically significant relationship with SME's Employment ($\beta = 0.697$, $p < .01$) which means that the better the institutional quality, the greater the influence on the creation of employment in the SME sector. The results are in line with institutional theory which claims that high quality institutions can decrease uncertainty, increase the efficiency of markets, and provide a favorable business environment for the growth of the private sector (North, 1990). Likewise, empirical research conducted in the past demonstrated that the development of effective institutional structures boosts entrepreneurship, business confidence and SME expansion, which in turn results in employment creation (Ayyagari et al., 2007; Beck et al., 2005; Levine, 2005). The results also corroborate Acemoglu and Robinson (2012), who argued that inclusive institutions are vital to sustainable economic development and long-term employment growth. In less developed economies, poor governance, corruption, weak institutions, bureaucratic inefficiencies, and policy instability have been found to be major barriers to SME growth and employment creation, while good institutions have been found to help create investment and sustainable business opportunities (World Bank, 2020). Hence, the study recommends that strengthening the institutional quality can have a great impact on enhancing the performance of SMEs and employment opportunities. Moreover, the study found that Access to Credit is positively and significantly related to SME's Employment ($\beta = 0.113$, $p < .05$), showing that better access to credit positively affects the growth and employment of SMEs. The discovery supports the financial intermediation theory which relates that having access to financial resources allows companies to invest in productive activities, expand activities, adopt new technologies and employ more people (Levine 2005). In line with previous studies, access to credit has been found to be a major factor influencing productivity, investment, and employment creation of SMEs, especially in developing countries, where credit constraints are prevalent (Ayyagari et al., 2007; Beck et al., 2005). The relatively low beta coefficient of Access to Credit does, however, suggest that the impact of Institutional Quality on SME Employment is more powerful than the impact of financial accessibility per se. This means that financial support programmes might not be best implemented if governance systems are not efficient, regulations are not transparent and institutional structures are not stable (North, 1990). In conclusion, the results of this study offer compelling empirical evidence that the institutional reforms and the development of financial markets are both needed to drive SME development and sustainable job creation. Therefore, there is a need for policy action to enhance the quality of governance and improve access to finance so that it will create a positive environment for SME growth and employment growth (Acemoglu & Robinson, 2012; World Bank, 2020).

6. Conclusion

This study offers robust empirical evidences that clearly show that both Institutional Quality and Access to Credit significantly contribute to the improvement in SMEs' Employment. The regression results are quite clear that the variable with the strongest positive effect on the SMEs' employment is Institutional Quality, with strong and statistically significant. This means that better governance effectiveness, regulatory quality, transparency and efficiency of institutions provide a more conducive business environment for the growth of SMEs and job creation. Access to Credit also positively and significantly influences SME employment, but with a relatively small impact compared to Institutional Quality. This indicates that financial resources are needed for business expansion but their successful impact on business expansion is greatly enhanced if accompanied by effective institutional system. Results overall indicate that institutional quality, rather than financial, is a key determinant of sustainable employment outcomes, and that both institutional and financial factors are needed to foster employment in SMEs. The study finds that policy measures to enhance SME employment should focus on institutional reform as well as development of the financial sector. Tackling governance challenges, combating corruption, enhancing the efficiency of regulations and ensuring policy continuity are all key factors in establishing an enabling environment for SMEs. Improved banking systems, financial inclusion initiatives and reduced borrowing constraints can also play a role in further supporting the growth of SMEs and employment generation, while at the same time increasing access to credit. The synergy of these two factors indicates that the more successful treatment is provided through integrated policy solutions, rather than through separate interventions. Hence, a dual policy of improving institutional quality and access to finance should be pursued so as to maximise employment opportunities. This research adds to the body of work that has already been done, and it verifies that financial access is not the only factor behind sustainable employment growth of SMEs, but rather the importance of the institutional architecture in developing economies.

References

- Acemoglu, D., Johnson, S., & Robinson, J. A. (2001). The colonial origins of comparative development: An empirical investigation. *American Economic Review*, 91(5), 1369–1401. <https://doi.org/10.1257/aer.91.5.1369>
- Acemoglu, D., & Robinson, J. A. (2012). *Why nations fail: The origins of power, prosperity, and poverty*. Crown Publishers.
- Aidis, R., Estrin, S., & Mickiewicz, T. (2008). Institutions and entrepreneurship development in Russia: A comparative perspective. *Journal of Business Venturing*, 23(6), 656–672. <https://doi.org/10.1016/j.jbusvent.2008.01.005>
- Aidt, T. S. (2009). Corruption, institutions, and economic development. *Oxford Review of Economic Policy*, 25(2), 271–291. <https://doi.org/10.1093/oxrep/grp012>
- Alesina, A., Özler, S., Roubini, N., & Swagel, P. (1996). Political instability and economic growth. *Journal of Economic Growth*, 1(2), 189–211. <https://doi.org/10.1007/BF00138862>
- Ayyagari, M., Beck, T., & Demirgüç-Kunt, A. (2007). Small and medium enterprises across the globe. *Small Business Economics*, 29(4), 415–434. <https://doi.org/10.1007/s11187-006-9002-5>
- Ayyagari, M., Demirgüç-Kunt, A., & Maksimovic, V. (2011). *Small vs. young firms across the world: Contribution to employment, job creation, and growth* (World Bank Policy Research Working Paper No. 5631). World Bank.
- Beck, T., & Demirgüç-Kunt, A. (2006). Small and medium-size enterprises: Access to finance as a growth constraint. *Journal of Banking & Finance*, 30(11), 2931–2943. <https://doi.org/10.1016/j.jbankfin.2006.05.009>

- Beck, T., Demirgüç-Kunt, A., & Levine, R. (2005). SMEs, growth, and poverty: Cross-country evidence. *Journal of Economic Growth*, 10(3), 199–229. <https://doi.org/10.1007/s10887-005-3533-5>
- Beck, T., Demirgüç-Kunt, A., & Maksimovic, V. (2005). Financial and legal constraints to firm growth: Does firm size matter? *The Journal of Finance*, 60(1), 137–177. <https://doi.org/10.1111/j.1540-6261.2005.00727.x>
- Beck, T., Levine, R., & Loayza, N. (2000). Finance and the sources of growth. *Journal of Financial Economics*, 58(1–2), 261–300. [https://doi.org/10.1016/S0304-405X\(00\)00072-6](https://doi.org/10.1016/S0304-405X(00)00072-6)
- Bruhn, M. (2011). License to sell: The effect of business registration reform on entrepreneurial activity in Mexico. *Review of Economics and Statistics*, 93(1), 382–386. https://doi.org/10.1162/REST_a_00059
- Campos, N. F., & Nugent, J. B. (2002). Who is afraid of political instability? *Journal of Development Economics*, 67(1), 157–172. [https://doi.org/10.1016/S0304-3878\(01\)00181-X](https://doi.org/10.1016/S0304-3878(01)00181-X)
- Cull, R., & Xu, L. C. (2005). Institutions, ownership, and finance: The determinants of profit reinvestment among Chinese firms. *Journal of Financial Economics*, 77(1), 117–146. <https://doi.org/10.1016/j.jfineco.2004.05.010>
- Demirgüç-Kunt, A., Love, I., & Maksimovic, V. (2006). Business environment and financing constraints. *Journal of Money, Credit and Banking*, 38(8), 2071–2093. <https://doi.org/10.1353/mcb.2006.0117>
- Di Berardino, C., & Rossi, M. (2023). Quality of institutions and employment dynamics of social enterprises: Evidence from Italian regions. *Finance Research Letters*, 56, 104080. <https://doi.org/10.1016/j.frl.2023.104080>
- Djankov, S., La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (2002). The regulation of entry. *Quarterly Journal of Economics*, 117(1), 1–37. <https://doi.org/10.1162/003355302753399436>
- Djankov, S., McLiesh, C., & Ramalho, R. (2006). Regulation and growth. *Economics Letters*, 92(3), 395–401. <https://doi.org/10.1016/j.econlet.2006.03.021>
- Djankov, S., McLiesh, C., & Shleifer, A. (2007). Private credit in 129 countries. *Journal of Financial Economics*, 84(2), 299–329. <https://doi.org/10.1016/j.jfineco.2006.03.004>
- Estrin, S., Korosteleva, J., & Mickiewicz, T. (2013). Which institutions encourage entrepreneurial growth aspirations? *Journal of Business Venturing*, 28(4), 564–580. <https://doi.org/10.1016/j.jbusvent.2012.05.001>
- Fajnzylber, P., Maloney, W. F., & Montes-Rojas, G. (2011). Does formality improve micro-firm performance? Evidence from the Brazilian SIMPLES program. *Journal of Development Economics*, 94(2), 262–276. <https://doi.org/10.1016/j.jdeveco.2010.05.004>
- Fisman, R., & Svensson, J. (2007). Are corruption and taxation really harmful to growth? Firm-level evidence. *Journal of Development Economics*, 83(1), 63–75. <https://doi.org/10.1016/j.jdeveco.2005.09.009>
- Hall, R. E., & Jones, C. I. (1999). Why do some countries produce so much more output per worker than others? *Quarterly Journal of Economics*, 114(1), 83–116. <https://doi.org/10.1162/003355399555954>
- Haltiwanger, J., Jarmin, R., & Miranda, J. (2013). Who creates jobs? Small versus large versus young. *Review of Economics and Statistics*, 95(2), 347–361. https://doi.org/10.1162/REST_a_00288
- Johnson, S., McMillan, J., & Woodruff, C. (2002). Property rights and finance. *American Economic*

- Review, 92(5), 1335–1356. <https://doi.org/10.1257/000282802762024539>
- Jong-A-Pin, R. (2009). On the measurement of political instability and its impact on economic growth. *European Journal of Political Economy*, 25(1), 15–29. <https://doi.org/10.1016/j.ejpoleco.2008.09.010>
- Kaufmann, D., Kraay, A., & Mastruzzi, M. (2010). The worldwide governance indicators: Methodology and analytical issues (World Bank Policy Research Working Paper No. 5430). World Bank.
- Khanna, T., & Palepu, K. (2010). *Winning in emerging markets: A roadmap for strategy and execution*. Harvard Business Press.
- Klapper, L., Laeven, L., & Rajan, R. (2006). Entry regulation as a barrier to entrepreneurship. *Journal of Financial Economics*, 82(3), 591–629. <https://doi.org/10.1016/j.jfineco.2005.09.006>
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. W. (1998). Law and finance. *Journal of Political Economy*, 106(6), 1113–1155. <https://doi.org/10.1086/250042>
- Levine, R. (2005). Finance and growth: Theory and evidence. In P. Aghion & S. Durlauf (Eds.), *Handbook of economic growth* (Vol. 1, pp. 865–934). Elsevier. [https://doi.org/10.1016/S1574-0684\(05\)01012-9](https://doi.org/10.1016/S1574-0684(05)01012-9)
- Love, I., & Mylenko, N. (2003). Credit reporting and financing constraints (World Bank Policy Research Working Paper No. 3142). World Bank.
- Mauro, P. (1995). Corruption and growth. *Quarterly Journal of Economics*, 110(3), 681–712. <https://doi.org/10.2307/2946696>
- Méon, P. G., & Weill, L. (2010). Is corruption an efficient grease? *World Development*, 38(3), 244–259. <https://doi.org/10.1016/j.worlddev.2009.06.004>
- Naudé, W. (2010). Entrepreneurship, developing countries, and development economics: New approaches and insights. *Small Business Economics*, 34(1), 1–12. <https://doi.org/10.1007/s11187-009-9198-2>
- North, D. C. (1990). *Institutions, institutional change and economic performance*. Cambridge University Press.
- OECD. (2019). *SME and entrepreneurship outlook 2019*. OECD Publishing. <https://doi.org/10.1787/34907e9c-en>
- Rodrik, D., Subramanian, A., & Trebbi, F. (2004). Institutions rule: The primacy of institutions over geography and integration in economic development. *Journal of Economic Growth*, 9(2), 131–165. <https://doi.org/10.1023/B:JOEG.0000031425.72248.85>
- Sutter, C., Webb, J. W., Kistruck, G. M., & Bailey, A. V. G. (2013). Entrepreneurs' responses to semi-formal illegitimate institutional arrangements. *Entrepreneurship Theory and Practice*, 37(6), 1259–1290. <https://doi.org/10.1111/etap.12013>
- UNDP. (2022). *Afghanistan socio-economic outlook 2022*. United Nations Development Programme.
- Webb, J. W., Bruton, G. D., Tihanyi, L., & Ireland, R. D. (2013). Research on entrepreneurship in the informal economy. *Journal of Business Venturing*, 28(5), 598–614. <https://doi.org/10.1016/j.jbusvent.2012.07.003>
- Williamson, O. E. (2000). The new institutional economics: Taking stock, looking ahead. *Journal of Economic Literature*, 38(3), 595–613. <https://doi.org/10.1257/jel.38.3.595>

World Bank. (2018). Doing business 2018: Reforming to create jobs. World Bank.

World Bank. (2020). World development report 2020: Trading for development in the age of global value chains. World Bank Publications.