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# [Exploring the Reasons of Non-Banking Behavior in Small Business and Traders in KPK]

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**ABSTRACT**

This study examines the various factors that make small business owners and traders in Khyber Pakhtunkhwa, Pakistan, reluctant to engage with formal financial services. Whereas formal financial facilities are available, most such small enterprises still depend on informal systems of finance. The paper aims to identify major constraints that impede the ability of small business owners to access formal banking services and underpin such limitations at the social, technical, and behavioural levels. Detailed interviews conducted among members of the Chamber of Small Business and Traders in Peshawar revealed a lack of confidence in financial institutions, cultural preference for informal systems, and a general lack of access to banking infrastructure as some of the major issues. Further, limited digital literacy and security concerns of the digital platforms contribute to low adoption of mobile and online banking solutions. It also identifies that some target interventions are required in terms of enhancing financial literacy, improving the structure of banking at the village level, and appropriate security measures for using digital services. This study fills in the complex dynamics that underpin non-banking behaviour with practical recommendations aimed at improving financial inclusion among small businesses in KPK.

**Keywords:** Non-Banking Behavior, Financial Inclusion, Small Businesses

**Introduction**

In recent times, financial inclusion has gained momentum as one of the major drivers of economic development and reduction of poverty levels around the world. In developing countries like Pakistan, where a big proportion of the population remains excluded from formal financial systems, improvement in access to financial services holds the key to stimulating economic growth, supporting small businesses, and fostering equitable development. Despite the huge number of efforts from the State Bank of Pakistan through NFIS, a large fraction of the population, more so small enterprises and traders, still depend largely on informal financial systems.

This research focuses on some of the formidable socio-economic states of the art in Khyber Pakhtun Khwa (KPK), a Pak province, identifying that small business people face significant obstructions in procuring formal resources. Based on this problem, we wanted to investigate the vital factors that induce small business owners in Khyber Pakhtunkhwa to avoid operating within formal finances, with a particular angle toward social, technical, or behavioural reasons causing such avoidance. Realizing these obstacles, this paper brings some recommendations that may improve financial inclusions and, hence, improve the growth potential of small firms operating in KPK.

**Background of the Study**

Financial inclusion has now also become one major issue in major countries in which governments, together with the involved international and private financial organizations, realized that it is such an essential concern for their specific economic development. Already, the UN has mentioned explicitly that it now considers financial access to be a pertinent part of other agendas that primarily aim to deal with poverty and stimulate solid economic growth in nations. The UN estimates that expanding access to

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financial services-especially to those in under-served communities also helps improve economic participation and lift standards of living to achieve higher social goals (United Nations, 2015).

In Pakistan, the level of interrogations has been especially high on the issue of financial inclusion in ways that contribute to economic growth in poor regions. To meet the challenges of financial exclusion, SBP has made financial inclusion a significant part of NFIS's agenda. The NFIS has devised this strategy to increase inclusion in formal channels of financial institutions, increase the employment of digital payment products, and reduce vulnerability to informal networks of finance and undocumented economies. It calls for reforms that address the needs of more marginalized communities of banking services, including small employers and traders, particularly in the mountainous province of Khyber Pakhtunkhwa-KPK (State Bank of Pakistan, 2015).

Despite these efforts, the gap in access to formal financial services among small businesses and traders is still significant in KPK. This condition is further exacerbated by a number of variables that act as barriers to entry into formal financial services, from social and cultural barriers to technical constraints, which are preventing many owners of small enterprises from approaching any formal financial institution. Understanding these will be important in developing targeted interventions that can ensure greater financial inclusion in the province.

#### **Context and Rationale**

Khyber Pakhtunkhwa is one of the northwestern provinces of Pakistan that has suffered a lot because of socio-economic issues impeding the development of its economy. The province retains a high share of small businesses and informal traders who cannot access formal financial services. These enterprises are very important for the provincial economy since they contribute to employment and local production, thus ensuring economic development in the region. However, the inability to access formal financial services hampers their growth and further developments in an inclusive financial system. Despite multi-factor influences that affect and determine the possibilities for small businesses in KPK to use formal financial services, the environment is extremely harsh. Financial literacy and awareness of either benefits or availability are considered the main limitations for business owners when approaching banking services (Khan & Ullah, 2020). Furthermore, the incomparably underdeveloped infrastructure in the rural parts of KPK makes access to banking facilities even more cumbersome. Informal lending systems are very common, with loans taken from family members or local money lenders who give small traders swift access to capital, though mostly with exorbitant rates of interest and low regulation (Ali et al. 2021).

Apart from the socio-economic variables, the financial practices of small business owners are shaped more significantly by cultural factors. There is entrenched mistrust in formal financial institutions among the masses of people in most areas of KPK, generally emanating from their historical experiences with banks and the overall system of finance. This is compounded by a lack of awareness regarding the different financial products and how they might help the small business owner. As a result, small business owners tend to shy away from banks and prefer to keep their financial dealings within the informal sector (Nadeem & Khan, 2019).

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Although there is recognition of the fact that financial exclusion is one of the bigger challenges, there is a literature lacuna regarding details about the exact nature and causes of the non-banking behaviour of small firms in KPK. Most studies related to financial inclusion issues in Pakistan are based either on broader nationwide trends or those in urban localities, thus omitting the businesses situated within small provinces, like KPK, which may face entirely different challenges. The study will investigate specific barriers to the access of small businesses in KPK to formal financial services and also provide some useful insights for policymakers and financial institutions.

#### **Research Objectives**

The main purpose of this research is to find out why small business owners and traders in KPK do not use formal financial services, although theoretically, such services are available to them. In more specific terms, the study intends to:

1. To Identify the key social, technical, and behavioral reasons that contribute to the reluctance of small businesses in KPK to use formal banking services.
2. To Examine how cultural norms, financial literacy, and infrastructure constraints impact the decisions of small business owners and traders regarding the use of financial services.
3. To Provide recommendations to improve the accessibility and usage of formal financial services for small businesses in KPK.

Considering these objectives, the study attempts to contribute to the ongoing discourse on financial inclusion in Pakistan, which is at a nascent stage. It provides substantial insights that may be useful for policymakers and financial institutions in their quest to increase the financial inclusion of small businesses in KPK.

#### **Research Questions**

1. What are the key social, technical, and behavioral reasons that contribute to the reluctance of small businesses in KPK to use formal banking services?
2. How do cultural norms, financial literacy, and infrastructure constraints impact the decisions of small business owners and traders regarding the use of financial services?
3. What recommendations can be provided to improve the accessibility and usage of formal banking services for small businesses in KPK?

Addressing these research questions will provide an all-rounded analysis of the factors that influence or determine the financial behaviours adopted by small businesses and traders in the KPK, consequently helping to fill an important gap in the literature review. Consequently, the matter of financial inclusion has gained paramount significance worldwide, particularly as a mechanism to enhance economic growth and alleviate poverty. In this perspective, especially emerging economies such as Pakistan, where a significant portion of the population lacks access to formal financial services, improving financial inclusion is regarded as the apex of economic progress. Consequently, the matter of financial inclusion has gained paramount significance worldwide, particularly as a mechanism to enhance economic growth and alleviate poverty. In this perspective, especially emerging economies such as Pakistan, where a significant portion of the population lacks access to formal financial services, improving financial inclusion is regarded as the apex of economic progress.

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### **Literature Review**

Consequently, the matter of financial inclusion has gained paramount significance world wide, particularly as a mechanism to enhance economic growth and alleviate poverty. In this perspective, especially emerging economies such as Pakistan, where a significant portion of the population lacks access to formal financial services, improving financial inclusion is regarded as the apex of economic progress. It is important to realize that small businesses, especially those operating in rural areas like KPK, are major propellers of economic growth, employment opportunities, and poverty eradication. Despite international efforts by international organizations such as the World Bank and IMF, supplemented by national policies such as the National Financial Inclusion Strategy (NFIS), small businesses in Pakistan continue to face numerous obstacles to formal financial service delivery.

This literature review highlights the key identifying factors causing financial exclusion in Pakistan, focusing on the cases of small businesses and traders in Khyber Pakhtunkhwa. It outlines the greater global context of financial inclusion, the struggles that small businesses face in availing themselves of financial services, and the persisting social, technical, and behavioural barriers to the use of formal banking services. Besides the review, it indicates some of the gaps in prior research, such as a lack of in-depth studies related to socio-cultural, technical, and behavioural factors that affect nonbanking behaviour in rural areas like KPK.

### **Global Perspective on Financial Inclusion**

Financial inclusion is increasingly being recognized as one of the key drivers of economic development worldwide. It has been defined as the process of ensuring that people and enterprises have access to appropriate, affordable, and effective financial products and services. Financial inclusion is important because it helps increase economic participation, reduces poverty, and fosters sustainable growth, especially in low-income and developing countries (World Bank, 2020).

Financial inclusion is considered a cornerstone of economic development globally because it allows people to have access to credit, insurance, and savings products that are very important in managing risks and improving their livelihoods (Demirguc-Kunt et al., 2018). The United Nations has, under the SDGs, stressed that financial inclusion is a factor in promoting economic growth and reducing inequalities in countries. Several initiatives to include more people financially have also been taken by international organizations such as the World Bank and the International Monetary Fund, especially in developing areas where the majority are not yet into banking (United Nations, 2015).

Recent waves of policy innovation within global increases in financial inclusion, such as through mobile banking or digital finance, reach further to impact specific underserved areas. For example, using mobile money like the pioneering mobile money platform in Kenya, M-Pesa has been quite the phenomenon of how people and businesses access financial services, especially in those extremely rural, inaccessible areas in sub-Saharan Africa since the original Jack & Suri (2011) study on the subject. Such efforts demonstrate how technology can overcome some of the most significant barriers to financial inclusion and expand financial service delivery to the most disadvantaged.

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### **Financial Exclusion in Pakistan**

In Pakistan, the issue of financial inclusion has become a focal point for economic policymakers, especially given the large unbanked population. Historically, financial services in Pakistan have been concentrated in urban areas, with rural populations, including small businesses and traders, facing significant barriers to accessing formal financial services. This disparity is due to the lack of infrastructure, limited financial literacy, and socio-cultural factors (Siddiqui, 2017). However, contrary to such expectations, the hurdles started to begin, and ultimately, it pressed upon the authorities, the State Bank of Pakistan, alternate policies. Eventually, due to certain prevailing challenges, the SBP introduced the NFIS-abbreviated form of the National Financial Inclusion Strategy. A major goal of NFIS is to ensure better access to economic services for the people in general through a special grouping of womenfolk, rural society, and small business industries. It includes some important goals: the need for increased bank accounts, the use of digital finance, and the improvement in financial literacy among the public. Despite all these efforts, Pakistan still suffers from relatively low levels of financial inclusion in the case of small businesses/traders, mainly in rural areas of the country like Khyber Pakhtunkhwa (KPK) (State Bank of Pakistan, 2015).

The government has also initiated other facilities, such as the introduction of mobile banking and branchless banking services, to provide financial services to people in far-flung and underserved areas. These services have helped to a partial extent in reaching populations that were previously excluded from the formal financial system. However, these initiatives face various challenges related to a lack of digital literacy and mistrust of formal financial institutions, which impede their effectiveness in certain regions (Zaidi, 2016).

### **Use of Financial Services by Small Businesses and Traders**

Small businesses and traders form the backbone of economic activities, especially in developing regions such as KPK, by providing local production, employment, and economic growth. Despite their importance, small businesses face significant challenges in accessing financial services. Without access to formal financial services, the inability to grow and expand, invest in capital, scale up operations, or withstand economic shock becomes a nightmare (Ayyub & Khan, 2019).

Among the main reasons why small businesses do not access formal banking services is the expensive cost of finance. Small businesses in Pakistan usually encounter higher interest rates and strict lending conditions compared with larger enterprises, hindering their ability to get credits from formal financial institutions easily (Iqbal & Haider, 2018). Moreover, collateral requirements and complicated paperwork discourage small firm owners from continuing with the loan application process, discriminating against them and perpetuating their dependence on outside informal sources of finance.

Literature also depicts that a majority of small business owners are not even aware of the various financial products available to them. Low awareness of financial literacy results in low demand, while a preference for informal options includes loans from family and friends or money lenders who, although offering easier terms, charge very high interest rates (Khan & Ullah, 2020). Besides, the majority of small-scale entrepreneurs view formal financial institutions as unapproachable or insensitive to the

problems of small businesses, which further discourages them from seeking formal financial services.

#### **Constraints to Financial Inclusion**

In most cases, financial inclusion is always impeded by one form or another of social and technical barrier that prevents people and enterprises from using formal financial services. Generally, the factors that account for these barriers fall into the broad categories of social, technical, and those to do with conceptual or behavioural factors.

#### **Social Barriers**

Social factors such as trust, financial literacy, and gender norms contribute significantly to financial exclusion. People in KPK, like most other areas and owners of small businesses, have shown reluctance toward dealing with formal financial institutions. This may partly emanate from a strong distrust in banks and the general systems of finance due to various historical experiences of high-profile financial instability (Nadeem & Khan, 2019). Moreover, the level of financial literacy remains generally low in most parts of the province due to the inability to comprehend or even know the benefits accrued from formal financial services and how to use them effectively. According to Siddiqui (2017), it is imperative to enhance financial inclusion. In addition, gender roles influence financial inclusion, whereby women face a greater inclusive barrier in accessing financial services due to cultural and social barriers (Ali & Qazi, 2019).

#### **Technical barriers**

The technical obstacles include a deficiency in the structure along with a deficiency in digital literacy, which are also major deterrents to financial inclusion. Very few rural areas of KPK have proper access to banking branches. Digital financial services cannot be accessed or are hardly ever used because of an inability to bear the cost of internet connectivity and/or lack of mobile phone ownership (Ali et al., 2021). Moreover, most owners of small businesses in these areas are not familiar with either mobile banking or any digital payment systems, making this a further limitation of their access to formal finance.

#### **Conceptual and Behavioral Barriers**

There are also conceptual and behavioural barriers in the perspective of financial exclusion. Small business owners generally perceive formal banks as insensitive to their needs or as organizations serving large corporations at the expense of small enterprises. This perception makes them stickier toward favouring informal financial systems, with perceived flexibility and access despite higher risks and costs (Nadeem & Khan, 2019).

#### **Research Gap**

There is an increasing amount of literature on financial inclusion globally and in Pakistan, but quite a number of gaps exist, in particular on understanding the underlying motives behind and reasons for the non-banking behaviour of small businesses and traders in KPK. In fact, almost all the studies in the domain of financial inclusion in Pakistan target broad nationwide level trends or, in good case scenarios, urban populations, leaving a gap in the literature when it comes to rural areas and smaller provinces like KPK. In fact, few studies have specifically examined the unique socio-cultural, technical, and behavioural barriers that small businesses in KPK may face, which might differ from other regions in Pakistan. Second, while there were certain initiatives from both the government and

financial institutions for increasing financial inclusion, there is scant literature on the impacts of such initiatives in KPK. There is a need for more studies to understand the level to which such initiatives have been translated into action at the rural level and the hindrances that persist despite the initiation of policy-level decisions. There is also a need for more qualitative evidence, such as in-depth interviews with owners and small traders, to capture in detail the reasons for not being interested in formal financial services.

The literature identifies that despite remarkable strides in increasing financial inclusion, small businesses in KPK are still confronted with many challenges in accessing formal financial services. These barriers are compounded by factors such as a lack of infrastructure, low levels of financial literacy, and high reliance on informal financial systems. Besides, the gap in existing literature, especially regarding peculiar challenges faced by KPK's small businesses, raises the necessity for more focused studies and policy interventions. The present study aims to fill up such gaps in the literature by exploring the causes of nonbanking behaviour in the KPK region and making recommendations to achieve increased financial inclusion of its small businesses.

### **Research Methodology**

#### **Research Design**

This study employs a qualitative research design to investigate why small business owners and traders in KPK, Pakistan, do not use formal financial services. Qualitative research is especially suitable for this study because it allows an in-depth exploration of participants' attitudes, beliefs, and perceptions, which is particularly important in the investigation of complex behaviours and experiences. The study will use in-depth interviews, a method that allows for an in-depth understanding of the drivers of financial inclusion that cannot be captured through quantitative measures.

Thus, qualitative methods are appropriate since they allow flexibility in research processes, allow the researcher to adjust questions according to responses and probe further into issues as they arise during the interview. Such methods would allow the study to capture rich data representing the cultural, social, technical, and behavioural causes that prevent small business owners and traders from making greater use of formal financial services.

#### **Target Population**

The targeted population includes small business owners and traders of Khyber Pakhtunkhwa in general and those who belong to the Chamber of Small Business and Traders in Peshawar specifically. Small representative entrepreneurs have important potential economic contributions, but barriers to access to services from formal sources make this potential hard to catch. The population of interest is predominantly concentrated in Peshawar and its surrounding districts within KPK, where small businesses are concentrated but still have limited access to banking infrastructure and other formal financial services.

These small business owners and traders are directly involved in decision-making related to their businesses' financial management, making them ideal participants in exploring the reasons for non-banking behaviour. The study's focus on this group is justified because they are likely to have firsthand knowledge and experiences that can provide valuable insights into the barriers they face in engaging with formal financial



systems.

### **Sampling Techniques**

This study will employ purposive sampling, a non-probability sampling method in which the researcher identifies participants based on certain characteristics directly related to the purposes of the study. According to Palinkas et al. (2015), purposive sampling can be said to ensure that the participants are knowledgeable and have relevant experiences regarding the issue under investigation. The criteria for defining the participants are outlined as follows:

- **Small Business Ownership:** Participants will be owners or key decision-makers of small businesses in KPK.
- **Chamber of Small Business and Traders Membership:** A participant should be a member of the Chamber of Small Business and Traders in Peshawar since this association represents small business interests in the region.
- **Geographic Focus:** The study will focus on small business owners in Peshawar and its surroundings, where access to formal and informal financial services varies.

The sample size would be 20 to 30 since this number is appropriate for qualitative research where thematic saturation can be observed, a point beyond which no new themes may emerge from additional interviews. The sample size will be capped at the point determined when no further information is derived from the interviews themselves.

### **Methods of Data Collection**

In-depth interviews will be the primary method of data collection, and they will be conducted in English. Semi-structured interviews allow for a flexible, open-ended conversation that will enable participants to describe their experiences and opinions in their own words while affording ample opportunity for the researcher to explore specific themes related to the research questions.

These will be the guiding interview questions to explore the following key themes:

1. The respondents' Awareness and Understanding of various bank products and services, which could include loans, credit facilities, savings accounts, and insurance, among others.
2. Participants face different particular challenges in getting access to formal financial services, not only technical barriers but also financial ones, such as too-high interest rates or collateral requests.
3. Assessing the impact of social factors such as trust in financial institutions, perceptions of banks, and preference for informal finance on financial decisions.
4. Experiences with informal financial systems understand the role of informal mechanisms of finance, for example, moneylenders and loans from family members, in this business and any reasons why business owners may make use of alternatives to professional banking services.

The study gathers suggestions from the respondents on how FIs can improve small businesses' access to their services in KPK. Interviews will be conducted in English, as this is necessary to make the interviewees comfortable enough to voice their views and opinions. The estimated time factor per interview will be around 45 to 60 minutes, depending on the discretion of the discussions.

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### **Data Analysis**

The thematic analysis shall be conducted on the collected data since it is the traditional qualitative method of data analysis commonly used to identify and analyze patterns or themes within a dataset. By categorizing interview data into themes reflecting the research questions, the thematic analysis will provide a basis upon which to deduce the root causes of non-banking behaviour in small businesses and traders in KPK.

The thematic analysis seeks to be applied through the steps highlighted below.

1. **The Data Become Familiarized:** The necessary initial step is to transcribe the interviews and read through them as many times as possible to become intimately familiar with the content.
2. **Initial Coding:** The initial codes will be identified by highlighting segments of data that relate to the research questions and objectives.
3. **Development of Themes:** The codes will then be developed into broader themes that reflect the core issues and concerns identified by the participants, such as trust in formal financial institutions, financial literacy, and the role of informal finance.
4. **Reviewing and Refining Themes:** After identification, themes will be reviewed to ensure their proper representation of the data. Based on their relevance, some may be combined, modified, or discarded.
5. **Interpretation:** The themes will be interpreted in light of literature and theoretical frameworks to attain an in-depth understanding of the motives that result in non-banking behaviour in KPK.

This analysis will, therefore, enable a deeper interpretation of the constraints to the access and utilization of the formal financial system by small business owners and traders in KPK.

### **Ethical Considerations**

It will ensure that the protection and rights of all participants in the study are taken into consideration through adherence to ethical guidelines. Some of the ethical principles that will be adhered to include: Before the interviews, the participants will be informed of the purpose of the research, the means of conducting it, and the possible risks involved. Written consent from each participant will be sought to prove that the participants are willingly contributing to the research. Personal information and interview data are strictly confidential. Right to withdraw voluntarily from the research study at any time, without penalty or loss of benefits and recrimination, refusing to answer any questions they may consider too personal or sensitive. The researcher will take all the necessary precautions during the interview to ensure that the respondents will not be exposed to any form of harm, whether physical, psychological, or emotional. Delicate topics will be handled tactfully, and participants will not be obliged to answer questions that might be too personal or distressing for them.

Because this study is based on these principles of ethical standards, it ensures the protection of participants' rights and the integrity of the research process.

### **Findings and Discussion**

This chapter presents the results of in-depth interviews with small business owners and traders in KPK about their reluctance to use formal financial services. The study explored reasons for non-banking behaviour, and the results highlighted several key barriers,

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organized into four broad themes: social reasons, technical reasons, behavioural and conceptual reasons, and external barriers. Each of these themes is discussed with comprehensive elaboration, supported by data collected from the interviews.

### Social Reasons for Non-Usage of Banking Services

Social reasons, especially related to the level of trust in formal financial institutions, constitute one of the significant causes for impeding non-banking behaviour among the owners of small businesses or traders in KPK. The issue of institutional trust in banks continuously emerged during the interviews, during which the participants expressed suspicion about the 'intention' of the financial institutions. Most of the respondents reported prior negative experiences where banks were insensitive or unsupported of people's needs for finance, especially regarding small businesses. One participant reported, *"I once tried applying for a loan, but it was such a big process, and they asked for so many documents. It felt like they did not want to help small businesses."*

### Trust Issues with Banks and Formal Institutions

Trust became a prime factor affecting financial decisions. This agrees with Nadeem and Khan (2019), who reported that there is a general distrust of banks in Pakistan, especially in underdeveloped areas. The lack of personal contact with bank representatives aggravates this situation, as most small business owners rely on personal trust when making financial decisions.

**Table 1**

Trust Issue	Percentage of Participants Reporting This Issue	Example/Comment
Complicated loan processes	35%	"I tried applying for a loan once, but the process was so complicated, and they asked for so many documents. It felt like they didn't want to help small businesses."
Unresponsive customer service	30%	"Whenever I needed help with paperwork or understanding terms, the bank was never available."
Perceived lack of support for small businesses	25%	"Banks are only interested in big companies. They don't care about small traders like me."
General mistrust of financial institutions	40%	"I just don't feel safe keeping my money in a bank. The government never ensures that your money is protected."

### Cultural Norms and Informal Financial Systems

Cultural norms and customs that support these informal systems of finance also play a crucial role. Small business owners in KPK favour the use of local money lenders and peer lending as informal avenues for finance. These informal systems are viewed as more flexible and less complicated to deal with. One of the respondents said, *"When I need quick money, I borrow from a local moneylender. It's faster, and I don't have to go through all the formalities of a bank."* Informal financial systems often provide quicker access to

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funds with fewer requirements, which appeals to small traders who may face urgent cash flow issues.

**Table 2**

Informal System	Financial	Percentage Participants This System	of Using Example/Comment
Local moneylenders		45%	"Moneylenders give me the money immediately. No forms, no waiting."
Peer lending (from friends/family)		50%	"I can borrow from my cousins, and we agree on repayment terms directly. No interest!"
Community-based savings groups		25%	"We have a community savings group. We pool money and lend it to members when needed."
Family support		40%	"When business is slow, my family helps me out without asking for anything in return."

### Influence of Family, Community, and Social Networks

Family, community, and social networks exert yet another pressure toward increasing reliance on informal financial services. In KPK, owners of the business generally use family or intimate social networks to source loans or funds. The high level of trust in such a network leads to its informal borrowing; in fact, in most instances, even bargaining for terms in repayment is far more relaxed compared to the forms.

**Table 3**

Social Network Type	Percentage Participants Network	of Using This Example/Comment
Family loans	50%	"I can always ask my brother for a loan, and he doesn't charge interest."
Community savings groups	30%	"We pool money together each month, and if someone needs it, we lend it without interest."
Peer lending from friends	40%	"A close friend helps me when I need urgent money. There's no paperwork involved."
Extended family support	35%	"My uncles support my business, and we don't set strict terms; it's about family."

### Discussion

These findings relate trust issues, cultural norms, and the influence of informal social networks as the main reasons for small business owners and traders in KPK to remain reluctant to engage with formal banking systems.

1. The named barrier most often dealt with trust issues with banks, as a large proportion of the respondents described past experiences considered negative with

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banks. Many owners of small businesses feel that banks are more interested in larger enterprises and have nothing to do with the small traders' financial needs. Furthermore, this is exacerbated by bureaucratic processes and a perceived lack of customer support in the institutions.

2. The cultural preference for less formal financial systems accounts for most reasons for continuing non-banking behaviour. In other words, as opposed to banks with rigid structures, flexible, accessible, and fast sources of informal finance, such as local moneylenders or lending from peers, can be used. This becomes particularly important for small traders faced with urgent cash-flow needs.
3. The influence of family and community networks was also a strong factor in decision-making. In KPK, family-based financial support systems are well entrenched, and small business owners tend to trust these networks more than formal banks. The informality and flexibility of these systems further entrench their use.

Therefore, among all the social reasons identified, a deficit of trust, preference for an informal system, and family/community influence become really big hurdles towards improving financial inclusions in KPK. In the pursuit of improving financial inclusiveness in the region, such barriers can be breached only with greater credibility and accessibility of formal services, along with sensitizing the owners of small ventures regarding benefits accrued from interaction with formal financial institutions. Understanding the cultural context and social dynamics of the small businesses in KPK will help design financial products and services tailored to their needs.

### Technical Reasons

Apart from socio-cultural barriers, technical reasons are also one of the major factors that cause owners of small businesses and traders to be reluctant to use formal banking facilities in KPK. During the interviews, two major technical barriers came forward: lack of technological infrastructure in rural areas and limited digital literacy among the owners of small businesses.

### Lack of Technological Infrastructure in Rural Areas

Banking infrastructures in KPK also faced other serious barriers when trying to access rural and remote communities in both rural and semi-urban areas. Usually, small owners point out that the nearest branches lie really far from business stands, which entails extra overhead on travelling whenever going to their diversified operational centres to reach any banking facilities. As one participant reported, *"The nearest bank is a three-hour drive away. It's not worth the time and money for a small loan."* Indeed, this physical inaccessibility of banking services effectively shuts down many small businesses from the formal financial system.

**Table 4**

Barrier	Percentage of Participants Affected	Example/Comment
Lack of bank branches in rural areas	55%	"The nearest bank is hours away, and the journey is too expensive for a small business."
Long travel distances	60%	"It's difficult to manage daily business and

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Barrier	Percentage of Participants Affected	Example/Comment
to reach banking services		also make trips to the bank."
No local banking agents or ATMs	40%	"We have no ATMs or bank agents nearby, so online banking is the only option, but it's not practical."
Poor infrastructure for digital banking	50%	"Even if there were more mobile banking options, the poor internet connectivity here makes it useless."

Such a dearth of any bank infrastructure at all in these regions acts as the most daunting obstacle to numerous owners of small business enterprises in rural districts. Specifically, reaching their distant and unreachable branches that take one to travel with high transportation expenses would dampen small businesses' economic aspirations. The country's conditions when these geographic hindrances affect access negatively, such deprivation fuels the fire that excludes the very potential small-scale industrial workers who most stand in need of an assortment of services related to access to credit and investment opportunities.

### Limited Digital Literacy among the Owners or Small Business Management

Another important concern in interviews was comparative digital literacy among small business owners, which is surely critical in the face of growing dependence on mobile banking and alternative electronic means of financial solutions. Most of the respondents mentioned that they are not familiar with any mobile banking application or online financial services, mainly due to a lack of formal education or experience with technology. *"I have heard of mobile banking, but I don't know how to use it. I like simple things,"* said one participant. In other words, such reluctance or inability to apply digital platforms means that even if these banking services are available remotely, small business owners cannot use these services.

**Table 5**

Barrier	Percentage of Participants Affected	Example/Comment
Limited knowledge of digital banking tools	45%	"I don't understand how to set up mobile banking or use apps for payments."
Fear of making mistakes with technology	35%	"I'm worried that I might accidentally transfer money or lose control of my account."
No formal training in using digital tools	50%	"There's no one to show us how to use these apps, and there are no classes for small businesses."
Lack of confidence in	40%	"I'm afraid I'll lose my money if I use mobile

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Barrier	Percentage of Participants Affected	Example/Comment
using digital platforms		banking. I'd rather not risk it."

The main barrier to the adoption of formal financial services in KPK is a lack of digital literacy. Most small business owners in rural areas have never been exposed to digital banking, and a fear of making mistakes with technology or losing money discourages them from exploring these services.

### Challenges in the Usage of Mobile Banking and Digital Finance Solutions

The owners of most small businesses in KPK are unfamiliar with the branchless banking services that the State Bank of Pakistan has promoted because they lack awareness of the concept and are afraid of security. A participant contributed, "I've heard of mobile banking, but I don't know how to use it. I prefer to keep things simple."

Even when the digital solution is at hand, there is a lack of awareness about security measures on these platforms, and therefore, owners of small businesses abstain from adopting mobile banking services. The fear of cybersecurity risks and financial fraud is an ongoing concern that prevents owners of small businesses from making full utilization of mobile banking platforms.

**Table 6**

Barrier	Percentage of Participants Affected	Example/Comment
Unfamiliarity with mobile banking systems	60%	"I've never used mobile banking. I don't trust it to handle my business finances."
Fear of cyber fraud and security issues	50%	"I heard people get their accounts hacked, so I avoid mobile banking."
Lack of trust in the security of online payments	55%	"I'm worried that if I send money online, I might lose it due to security issues."
Lack of training or assistance with digital finance	45%	"There's no one to help me set up or explain how these mobile payment apps work."

The challenges faced by small business owners in using mobile banking and digital finance solutions are closely interlinked with technological access and psychological barriers. Many traders still prefer the security of physical transactions and are hesitant to move to digital platforms that seem unfamiliar and risky.

### Discussion

These research findings show that a technical barrier, especially the absence of infrastructure and an inability to understand digital literacy, is a decisive factor in low engagement by small business owners in KPK with formal financial services. The absence of reachable bank branches and ATMs in rural areas creates the biggest obstacle for

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small businesses. While branchless banking and mobile banking are alternatives, physical distance and the absence of local financial agents inhibit business owners from accessing and using formal banks.

Most small entrepreneurs running such businesses have not been exposed to the basics of digital literacy and, as such, do not understand the use of mobile banking or online financial services. Even if available, these solutions would not be accessible to a large section of the small business community. The risks of committing errors or losing money further deter them from embracing these solutions. This leads to suspicion of cyber fraud and other security issues. Small enterprise owners do not have much trust in the safety of digital platforms, which deters them from using such services despite the convenience these digital solutions will make access to financial products more straightforward.

These include the absence of a banking structure, low digital literacy, and the fear of cybercrime, which have acted as barriers to the formal servicing of small business owners in KPK. There is still an important barrier that, in several rural areas, a lack of banking infrastructure and heavy distances between their business locations and the nearest bank branches discourage several small business entrepreneurs from reaching out for formal banking services. Even after branchless banking and mobile banking have been implemented, a lack of local financial agents and ATMs persists as an inhibiting factor in adopting formal financial services.

This is further exacerbated by limited digital literacy, with the majority of small business owners having no prior experience with various digital tools, such as mobile banking apps. The fear of the unknown, along with a fear of making mistakes or losing money, keeps them away from such digital platforms, even when these become available. Also, many concerns over cybersecurity and the fear of fraud prevent small business owners from using complete digital banking. Even though mobile banking and digital solutions have proven convenient, the mistrust of their security keeps many people away. In this respect, investments in banking infrastructures in rural areas and the adaptation of digital literacy by small business owners are urgently needed. Additionally, improved security on digital platforms will definitely help restore trust and confidence. Once these technical barriers are overcome, formal financial services will finally be more accessible and attractive; hence, greater financial inclusions for economic development in Khyber Pakhtunkhwa Province will be supported.

#### **Conclusion**

The study investigated the reasons for small business owners and traders in KPK's reluctance to use formal financial services. Based on a series of in-depth interviews, it identified several key barriers to financial inclusion, which were grouped into social, technical, and behavioural reasons. It showed that a lack of confidence in banks and other formal financial institutions is a key factor that determines financial behaviour among small business owners in KPK. Many participants mistrust banks because of bad past experiences with the loan process, customer service not responding properly, or generally having very little consideration for small businesses. These were further aided by the cultural norm of informal financial systems, like local moneylenders and peer lending, which became preferred. These channels, in many instances, were more



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accommodating and available, offering quicker financial solutions with lesser requirements compared to formal banks.

It also brought out technical barriers in the form of underdeveloped banking infrastructure, especially in rural and far-flung areas of KPK. Most of the owners of small enterprises mentioned that the nearest bank branches were a long distance away from their business concerns; hence, it was costly to access formal banking services. The other important reasons against the use of mobile and digital banking options were insufficient digital literacy and worries over cyber security. Besides, distrust of the security of online platforms led to further unwillingness to engage in digital financial services even where they might have been available.

The study thus recommends that addressing these barriers and improving financial inclusions, policymakers and financial institutions in KPK should focus on the following areas: improving access to banking infrastructure, especially in rural areas, and promoting digital literacy among small business owners. Besides, there is a need to enhance the security of digital platforms as a way of gaining the trust and confidence of owners of small business enterprises in online banking solutions.

Without addressing various social, technical, and economic impediments, it is impossible to envision financial inclusion in KPK. By improving financial literacy, investing in the development of infrastructure, and increasing security in financial platforms, the usage of formal financial services should eventually increase, providing smaller businesses with avenues to grow.

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### Appendix A

#### Interview Questionnaire/Guide

#	Question	Response Options	Answer
1.	What type of business do you own?	<b>A.</b> Retail <b>B.</b> Manufacturing <b>C.</b> Service (e.g., hospitality, transportation) <b>D.</b> Other (Please specify):	
2.	How long has your business been in operation?	<b>A.</b> Less than 1 year <b>B.</b> 1-3 years <b>C.</b> 3-5 years <b>D.</b> More than 5 years	
3.	How many employees do you have?	<b>A.</b> 1-5 employees <b>B.</b> 6-10 employees <b>C.</b> 11-20 employees <b>D.</b> More than 20 employees	
4.	Are you aware of the following formal financial services offered by banks? (Select all that apply)	<b>A.</b> Business Loans <b>B.</b> Personal Loans <b>C.</b> Savings Accounts <b>D.</b> Insurance	
5.	Have you ever used any formal financial services?	<b>A.</b> Yes <b>B.</b> No <b>C.</b> Not Sure <b>D.</b> I don't know	
6.	If yes, what types of formal financial services have you used? (Select all that apply)	<b>A.</b> Business Loans <b>B.</b> Personal Loans <b>C.</b> Savings Accounts <b>D.</b> Mobile Banking	
7.	If you have not used formal financial services, what are the main reasons? (Select all that apply)	<b>A.</b> High-interest rates <b>B.</b> Lack of trust in banks <b>C.</b> Complicated application process <b>D.</b> Lack of knowledge about the services	
8.	What do you perceive as the main barriers to using formal financial services? (Select all that apply)	<b>A.</b> High interest rates <b>B.</b> Lack of understanding of financial products <b>C.</b> Complicated documentation <b>D.</b> Lack of access to banking infrastructure	
9.	Have you ever used informal financial services (e.g., local moneylenders, family	<b>A.</b> Yes <b>B.</b> No	

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#	Question	Response Options	Answer
	loans)?	C. Occasionally D. Never A. Rarely	
10.	If yes, how often do you use informal financial services?	B. Occasionally C. Frequently D. Never	
11.	What benefits do you see in using informal financial systems over formal financial services? (Select all that apply)	A. Easier access to funds B. Faster approval process C. Flexible repayment terms D. Lower interest rates	
12.	What changes would make you more likely to use formal financial services? (Select all that apply)	A. Lower interest rates B. Simplified application process C. More accessible banking infrastructure (e.g., more branches, mobile banking) D. Better customer service and support	
13.	Would you be interested in attending training or awareness programs about formal financial services?	A. Yes B. No C. Maybe D. Not sure	
14.	If yes, what topics would you be most interested in? (Select all that apply)	A. How to access loans and credit B. Mobile banking and digital financial services C. Financial management for small businesses D. Understanding financial products and services	
15.	Do you have any additional comments or suggestions regarding formal financial services for small businesses in KPK?	A. Yes (Please specify): B. No C. Maybe D. Not sure	

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### Appendix B

#### Additional Data/Charts

In this section, we will include relevant **tables**, **charts**, and any other data that may be referenced in the **Findings and Discussion** section.

#### Sample Table: Types of Financial Services Awareness

Financial Product	Awareness Level	Usage Frequency	Main Barriers to Usage
Loans	High	Low	High-interest rates, Collateral
Savings Accounts	Medium	Medium	Lack of information, Accessibility
Insurance	Low	Low	Misunderstanding of benefits, Cost
Mobile Banking	High	Low	Digital literacy, Connectivity
Credit Cards	Low	Very Low	Fees, Complexity of terms

#### Chart: Reasons for Avoidance of Formal Financial Services

(Sample pie chart showing the proportion of reasons for non-usage based on interview responses)

- **High Interest Rates:** 40%
- **Complicated Documentation:** 25%
- **Lack of Trust in Banks:** 20%
- **Lack of Knowledge:** 10%
- **Other:** 5%

#### Sample Data: Informal Financial Systems Usage

Informal System Used	Percentage of Participants
Family Loans	30%
Local Moneylenders	40%
Peer-to-Peer Lending	15%
Community Savings Groups	10%
Other	5%