The Influence of Financial Literacy on the Performance of Small and Medium-Scale Enterprises

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The Small and Medium-Scale Enterprises (SMEs) sector has been recognized worldwide for its role in economic advancement through various ways like wealth generation, employment creation and poverty reduction. Accounting techniques serve as a critical tool for recording, analyzing, monitoring and evaluating the financial condition of organizations, preparation of documents necessary for tax purposes, and providing information support to many other organizational functions. In the context of SMEs, accounting techniques are important as it can help the firms manage their short-term problems in critical areas like costing, cash flow and budgeting by providing information to support monitoring and control. The present paper examines the impact of financial literacy of entrepreneurs on the performance of SMEs. An inquiry into their level of adoption of financial literacy is also studied. A review of related literature is carried out to examine the extent of work done in this field. A structured questionnaire is used to collect data on the level of adoption of financial literacy. The results show that the level of adoption of financial literacy by entrepreneurs of SMEs is low and that the utilization of accounting records does not influence their performance and success rate.

Introduction

The Small and Medium-Scale Enterprises (SMEs) sector has been recognized worldwide for its role in economic advancement through various ways like wealth generation, employment creation, and poverty reduction (Kithae *et al*., 2012). SMEs are a fundamental part of the economic fabric in most developing countries, and they play a very important role in furthering growth, innovation and prosperity. Although small in size, they are the most important enterprises in the economy due to the fact that when all the individual effects are aggregated, they surpass that of the larger companies. The social and economic advantages of SMEs cannot be overstated.

SMEs are defined as non-subsidiary, independent firms which employ less than a given number of employees; this number varies across national systems. Parameters other than number of employees are used in categorizing businesses as SMEs.

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In the new millennium, SMEs accounted for 95% of firms and 60-70% of employment creation in a majority of countries across the world (OECD, 2000). SMEs are mostly found in the service sector of various economies, which in most countries account for two-thirds of employment level. Being highly innovative, they lead to the utilization of natural resources, which in turn increases the country's wealth through higher productivity. SMEs have undoubtedly improved the standard of living of so many people, especially those in the rural areas (Ariyo, 2005).

Accounting techniques serve as a critical tool for recording, analyzing, monitoring and evaluating the financial condition of organizations, preparation of documents necessary for tax purposes, and providing information support to many other organizational functions (Amidu, 2011). In the context of SMEs, accounting techniques are important as it can help the firms manage their short-term problems in critical areas like costing, expenditure and cash flow by providing information to support monitoring and control.

Many small business owners are daunted by the mere idea of accounting techniques and bookkeeping. But in reality, both are pretty simple. It has to be kept in mind that bookkeeping and accounting techniques share two basic goals: to keep track of income and expenses, which improves chances of making a profit, and to collect the financial information necessary for filing various tax returns. There is no requirement that records be kept in any particular way, as long as records accurately reflect the businesses' income and expenses. There is a requirement, however, as some businesses use a certain technique of crediting their accounts: the cash method or accrual method. Depending on the size of the business and the amount of sales, one can create own ledgers and reports, or rely on accounting (Williams *et al.*, 1999). Elements of financial position, including property, money received, or money spent, are assigned to one of the primary groups, i.e., assets, liabilities and equity. Within these primary groups, each distinctive asset, liability, income and expense is represented by the respective 'account'. An account is simply a record of financial inflows and outflows in relation to the respective asset, liability, income or expense. Income and expense accounts are considered temporary accounts since they represent only the inflows and outflows absorbed in the financial position elements on completion of the time period.

Furthermore, nurturing of the SMEs is being hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development. This nurturing has resulted in increased entrepreneurial activities in the SME sector in developing countries (OECD, 2000). SMEs play a key role in transition in developing countries. These firms constitute a major source of employment and generate significant domestic and export earnings. Thus, SME development emerges as a key instrument in poverty reduction efforts and their advancement is key to sustained economic growth.

However, the mortality rate of these small firms is very high. According to the Small and Medium Scale Enterprises Development Agency of Nigeria (SMEDAN), 80% of SMEs close before their fifth anniversary, another smaller percentage goes into extinction between the sixth and tenth year; thus only about 5-10% of SMEs survive, thrive and grow to maturity. This implies that the survival rate of SMEs in Nigeria is less than 5% in the first five years of existence. This also suggests that SMEs in Nigeria have not been able to contribute to development. Among the factors responsible for these untimely closedowns are poor accounting techniques, lack of concrete record keeping, inadequate accounting information and procedures, lack of finance, weak institutional capacity, lack of managerial skills and training of SMEs, and tax-related issues.

Maintenance of proper accounting records and techniques is a pre-requisite for the success of every business or enterprise. This involves documenting all transactions of business entities including assets, liabilities, and capital (liquidity). In order to solve limitations such as lack of finance, weak institutional capacity, and lack of managerial skills and training of SMEs, there is a need for relevant business and management expertise to manage properly the finance, purchasing, selling, production, and human resources aspect of the business. According to Jones *et al*. (2014), accounting is important as it allows businesses or organizations to understand their financial perspective, and more so in order to develop the small business enterprises properly. Thus, there is a need for SMEs to adopt proper accounting techniques.

SMEs also require adequate and sophisticated accounting techniques and systems to better manage scarce resources, enhance customer and owner/manager values, assist them in controlling costs and measuring and improving productivity, and thus ensure the achievement of the business goals. Against this backdrop, the present paper aims to examine the effect of financial literacy of entrepreneurs on small-scale business performance.

Literature Review

Most of the existing research on accounting in Nigerian SMEs are biased toward the use of financial accounting techniques and methods by small business owners, information technology adoption as well as research in credit accessibility for SMEs. Only remote areas are away from the adoption of modern accounting techniques by SMEs in Nigeria.

Nandan (2010) argued that like larger firms, SMEs also require adequate and sophisticated accounting techniques and systems to better manage scarce resources and enhance the firm's values. Although SMEs may have some constraints in utilizing accounting techniques/ practices fully due to their relatively small size and limited resources, like larger firms, SMEs also face similar forms of complexities and uncertainties and are more prone to failures.

A number of SMEs have not given much attention to accounting techniques in relation to their business transaction, despite its importance to the success of businesses. This could be due to the lack of sound knowledge in accounting practices by owners or managers. Also, there was difficulty in ascertaining whether comprehensive accounting methods that satisfied the laws under which it was incorporated had been kept. It was hard to determine the extent of adherence to laid-down accounting procedure that constituted the wheel of implementation of the good accounting system. Difficulties exist in ascertaining, applying and recognising accounting techniques and are found to be barriers to success of small-scale business. Low educational background of owners and employment of unskilled accounting staff had led to unreliable accounting/financial statements.

In addition, the pace of adoption of modern accounting techniques by many organizations, mostly small business enterprises, has been slow. This has led to the diminishing relevance of major accounting techniques and methods as a vital aid to managerial decision making. This gap is commonly referred to as 'relevance lost' where organization's accountants have not entirely abandoned concepts of conventional management accounting despite advancements in the business environment, thereby leading to lack of managerial accounting skills for decision making and lack of technical skills as obstacles to developing a small business as is the inability to access credit, which in turn diminishes the rate of performances for mostly growing SMEs.

According to Goltz (2011), poor accounting techniques are one of the top 10 reasons why small-scale businesses fail, i.e., you cannot be in control of a business if you do not know what is going on. With bad numbers or no numbers, a firm is flying blind, and if it happens all the time, this affects the operations and performance of SMEs in Nigeria, especially this issue of lack of adoption of good accounting techniques/method which like a worm eats deeply a large chunk of revenues generated by these SMEs for their growth and survival. These have led to increase in closing down of SMEs.

Objective

The paper aims to evaluate the knowledge levels of small business entrepreneurs regarding the accounting techniques and how this affects the enterprises' performance.

Based on the objective, the following hypotheses have been formulated:

H_1: *Financial literacy has no significant influence on performance and success of SMEs.*

H_2: *There is no significant relationship between accounting training program and performance and success of SMEs.*

H_3: *There is no significant relationship between computer literacy and performance and success of SMEs.*

Data and Methodology

Variables

Financial literacy measured by three factors: academic knowledge of accounts and finance, accounting training program and computer awareness is considered as the independent variable, while performance and success of SMEs measured by profitability of the firms is taken as the dependent variable.

Research Techniques

ANOVA was used to determine the statistical relationship between dependent and independent variables. Statistical Program for Social Sciences (SPSS) Version 16.0 was used for data analysis.

Data Collection

For the purpose of the study, data was collected from 70 SMEs. From a sample size of 100, 70 samples provided data useful for this study. 15 were discarded for having no useful information, while 15 respondents refused to respond. The total rate of response was 70% which is a reasonable rate.

A questionnaire was framed to measure success and financial literacy. Questions 1-3 were asked to judge the success of the firm and Questions 4-8 were asked to measure financial literacy. If more than 50% opted for option (b) in both the criteria, i.e., measuring success and measuring financial literacy, firms were rated positively on that measurement (see Appendix).

Results and Discussion

The main objective of this study is to establish the relationship between financial literacy and success of SMEs. Impact of financial literacy, accounting training program and computer literacy on the success of an organization is found by using ANOVA model.

Tables 1 to 5 show the composition of entrepreneurs of small-scale industries in the sample by their success rate, education, financial background, training and computer literacy.

Table 1: Composition of Entrepreneurs by Success of SMEs

Particulars	No. of Firms
Success	59
Fail	11
Total	**70**

Table 2: Composition of Entrepreneurs by Education

Education	No. of Entrepreneurs
Accounting PG	15
Accounting UG	7
MBA Finance	10
CA	20
No Financial Background	18
Total	**70**

Table 3: Composition of Entrepreneurs by Background	
Background	**No. of Entrepreneurs**
Accounting and financial background	52
No accounting and financial background	18
Total	**70**

Table 4: Composition of Entrepreneurs by Training	
Particulars	**No. of Entrepreneurs**
Trained	40
Untrained	30
Total	**70**

Table 5: Composition of Entrepreneurs by Computer Literacy	
Particulars	**No. of Entrepreneurs**
Computer knowledge	30
No computer knowledge	40
Total	**70**

Table 6 indicates that the *F*-ratio supports the null hypothesis. As the *p*-value 0.540 > 0.05, the results reveal that at 95% level, the null hypothesis cannot be rejected and is hence accepted. It means that financial literacy has no significant influence on performance and success of SMEs. Thus, it is concluded that financial literacy does not play a role in the success of the small and medium-sized business.

Table 6: ANOVA Results – Financial Literacy					
	Sum of Squares	**df**	**Mean Square**	***F***	**Sig.**
Between Groups	0.051	1	0.051	0.379	0.540
Within Groups	9.220	68	0.136		
Total	**9.271**	**69**			

Table 7 indicates that the *F*-ratio supports the null hypothesis. As the *p*-value 0.262 > 0.05, the results reveal that at 95% level, the null hypothesis cannot be rejected and is hence accepted. It means that accounting training has no significant influence on SMEs' performance and success. Thus, it is concluded that accounting training does not play a role in the success of the small and medium-sized business.

Table 7: ANOVA Results – Accounting Training Program					
	Sum of Squares	**df**	**Mean Square**	***F***	**Sig.**
Between Groups	0.171	1	0.171	1.281	0.262
Within Groups	9.100	68	0.134		
Total	**9.271**	**69**			

Table 8 indicates that the *F*-ratio supports the null hypothesis. As the *p*-value 0.164 > 0.05, the results reveal that at 95% level, the null hypothesis cannot be rejected and is hence accepted. This implies that computer literacy has no significant influence on SMEs' performance and success. Thus, it is concluded that computer literacy does not play a role in the success of the small and medium-sized business.

Table 8: ANOVA Results – Computer Literacy					
	Sum of Squares	**df**	**Mean Square**	***F***	**Sig.**
Between Groups	0.262	1	0.262	1.980	0.164
Within Groups	9.009	68	0.132		
Total	**9.271**	**69**			

Table 9 shows that the correlation coefficient between financial literacy and SMEs' success is –0.74. This implies that financial literacy and SMEs' success are negatively and weakly correlated to each other. Further, the correlation between accounting education and SME's success is –0.136, which shows that they are negatively and weakly correlated. The correlation between computer literacy and SME's success is also negative and weak (–0.168). As the respective significance values, i.e., 0.540, 0.262 and 0.164, are greater than 0.05, it can be concluded that there is no statistically significant correlation between financial literacy, accounting education, computer literacy and SMEs' success.

Table 9: Pearson Correlation Coefficients				
	Financial Literacy	**Accounting Education**	**Computer Literacy**	**SMEs' Success**
Financial Literacy	1	0.019 (0.877)	0.064 (0.599)	–0.074 (0.540)
Accounting Education	0.019 (0.877)	1	0.714** (0.000)	–0.136 (0.262)
Computer Literacy	0.064 (0.599)	0.714** 0.000	1	–0.168 (0.164)
SMEs' Success	–0.074 (0.540)	–0.136 (0.262)	–0.168 (0.164)	1
Note: ** Correlation is significant at 0.01 level (2-tailed); *N* = 70; Sig. (2-tailed) values are given in parentheses.				

Conclusion

The results show that the level of adoption of financial literacy, accounting techniques and computer literacy by SMEs is still low. Financial literacy among entrepreneurs does not affect the success of SMEs and the utilization of accounting techniques does not significantly influence the performance and success of SMEs. Thus, the study concludes that there is no higher chance for financially literate entrepreneurs to be more successful than those with a low level of financial knowledge. ■

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Appendix

Questionnaire

For Measuring Success

Questions 1-3 are asked to judge the success of the firm. Performance and success is measured by profitability of the firms. If the firm opts for option (b) in two out of three questions, then the firm is considered as successful. Success is the net result of training, experience, computer knowledge, software knowledge and education.

For Measuring Financial Literacy

Questions 4-8 are asked to measure the financial literacy of the firm. Financial literacy includes three factors—Academic Knowledge of Accounts and finance, accounting training program and computer awareness. Questions 5 and 6 are for measuring financial knowledge, Question 7 is for measuring training and Questions 4 and 8 are for measuring computer literacy. If a firm opts for option (b) in three out of five questions, the firm is considered as financially literate. Financial literate is the net result of tenure of business, employability and growing (profitability) capacity.

Measuring Success

1. How long have you been in business?
   a. 5 years
   b. 5-10 years
   c. Over 10 years
2. State the growth of your firm?
   a. Less than 5%
   b. 5-7%
   c. 7-10%
3. How many permanent employees do you have?
   a. 1-3
   b. 4-5
   c. Over 5

Measuring Financial Literacy

4. Are you comfortable working with computers?
   a. No
   b. Yes

Appendix (Cont.)

5. What is your academic qualification relating to finance and accounting stream?
   a. No Financial background
   b. Accounting PG 5 years
   c. Accounting UG 5-10 years
   d. MBA Finance
   e. CA
6. Do you have any experience in accounting?
   a. No
   b. Yes
7. Have you taken any training in finance?
   a. No
   b. Yes
8. Have you taken any training in software like Tally?
   a. No
   b. Yes

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