The Effects of Financial Literacy on the Financial Performance of Small-Scale Enterprise. (The Case of Makola Market)

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Abstract

This study sought to evaluate the Effects of Financial Literacy on the financial Performance of small-scale Enterprises. Financial. The findings of this study would benefit the government and other stakeholders in knowing whether the gains of the financial literacy training can outweigh the costs of undertaking the training. This study adopted a descriptive survey design. The target population for this study is all the small-scale enterprises at the makola market which was 6034 traders. The target sample was 100 and since this is a descriptive study, Simple random sampling is more appropriate as it gives all items in a population an equal chance of being selected. Primary data was gathered by use of structured questionnaires which was both open and close-ended questions. Data gathered from the questionnaires was analyzed quantitatively using statistical package for social sciences (SPSS) computer software. SPSS generated both descriptive and inferential statistics. Descriptive statistics including the mean and standard deviation was used to capture the characteristics of the variables under study. Inferential statistics was used to analyze the relationship of the independent variable and the dependent variables. The study established that there was positive correlation between the dependent variable (financial performance) and the Independent Variables (financial literacy). Financial literacy also affected the savings and behavior of small-scale enterprise owners at makola market while savings behavior and attitude do not have effect on financial performance which means that the performance of traders at makola market is not determined by their savings behavior.

Chapter one

Introduction

Background of the study

There is no universally agreed definition of a small-scale business. Sometimes called a small business, a small-scale enterprise is a business that employs a small number of workers and does not have a high volume of sales. Example includes sole proprietorship and partnership. The micro and small enterprises are business in both formal and informal sector, categorized into farm and non-farm employing 1-50 workers (GoK, 2005). According Abor and Quartey (2010), firms that employ less than ten (10) employees are classified as Small Scale Enterprises (SSEs). The National board for small scale enterprises observed that a firm with not more than nine (9) employees, has a plant and machinery (excluding land, building and vehicles not exceeding one thousand Ghana cedis (ghc 1,000.00) may be termed as small-scale enterprises. The important role of small-scale enterprises (SSEs) worldwide cannot be over-emphasize (OKonga, 2012). Financial literacy can be considered as a fundamental challenge. Remund (2010) defines financial literacy as the degree to which one understands key financial concepts and possesses the ability and confidence to manage personal finances through appropriate, short-term decision-making and sound, long-range financial planning. It implies that financial literacy may be defined as the ability to read, analyze, manage and write about financial conditions of firm.

The word performance is derived from the word “parfourment” which means to do; to carry out or tender’. It refers the performing; execution, accomplishment, fulfillment etc. In broader sense, performance refers to the accomplishment of a given task measured against present standards of accuracy, completeness, cost and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. In the words of Frich Kohlar, performance is a general term applied to time often with reference to past or projected cost efficiency, management

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responsibility or accountability. Thus, not just the presentation, but the quality of results achieve refers to the performance. Financial performance refers to the act of performing financial activity. In broader sense, financial performance refers to the degree to which financial objectives has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's policies and operations in monetary terms it is also used to measure firms overall financial health over a given period of time and can also be used to compare similar firms across the same industry. Specifically, the paper empirically identifies the channels through which financial knowledge translate into financial decision making.

Statement of the problem

Financial literacy is a problem to many small-scale enterprises which is evident in their inability to keep complete accounting reports. This has resulted in failure to improve financial performance. Lack of financial literacy in businesses can be portrayed in different ways, such as lack of awareness of financial risk and opportunities, reckless expenditure, use of business funds for personal transaction, limited access to bank credit facilities and insurance policies among others. There are successful small-scale enterprises with no basic financial education and there are unsuccessful small-scale enterprises with high financial education. It is interesting to find out whether financial literacy as we know has impact on financial performance of small-scale enterprises' success. Many studies have mainly dwelt on importance of financial literacy and its effects on household or personal financial behavior. This research work attempts to establish whether financial literacy has a positive effect on the financial performance of small-scale enterprise in makola market.

Research objectives

The objective of the study is to

1. To access the relationship of financial literacy on financial performance of small-scale enterprise in makola market.
2. To access whether financial literacy affects savings behavior and attitude of petty traders in makola market.
3. To analyze financial literacy importance to the small-scale enterprise at the makola market.

Chapter two

Literature review

Introduction

This chapter would be looking at existing theories and research work conducted on this study. The main objective of this section is to review these theories and literature in relation to this topic. This chapter therefore would be grouped into three main sections which are, theoretical literature review, conceptual framework and empirical literature review.

Theoretical literature review

The theoretical literature covers the various studies and theories on financial literacy and financial performance. The main objective of small-scale enterprise is to make profit, increase customer base and create employment opportunities. The theoretical framework supporting this proposed study would review the psychological theories that explain how financial literacy affect the financial performance of small-scale enterprises. The theories that are significant to the study are financial literacy theory and financial performance theory. The two main objectives of the research are to examine the relationship between financial literacy and financial performance of petty trading at makola market and to find out the importance of financial literacy on small scale enterprises.

Financial literacy theory

Al-Tamimi and Kalli (2009) suggest that financial literacy has gained the interest of various groups including governments, bankers, employers, community interest groups, financial markets and other organizations. Therefore, it is necessary for individuals or organizations to have a level of education in managing their finances.

This implies that in an organizational context, both the information system (matter) and the human behavior system (mind), can only become more than their individual parts if they are linked by an interface that can enhance the feed forward (prediction) and feedback action between them (Gouws & Shuttleworth, 2009). McDaniel, Martin and Maines (2002) describe financial literacy as the ability to read and understand basic financial statements. Nadler (2009) defines business financial literacy as the ability to

1. Read and understand a balance sheet, income statement and cash flow statement.
2. Seek feedback when financial statements are inaccurate or confusing.
3. Use the information to improve decision-making.
4. Understand the limits of financial information.

The significance of encouraging financial literacy have increased because of factors such as the development of new financial products and the complexity of financial markets, among others. Popular media and public in general, used to use various terms as synonymous to describe the concept of financial literacy, for example financial capability, financial culture, financial knowledge and financial education (Huston, 2010). Schagen and Lines (1996), defined financial literacy, as the ability to make informed judgments and to take effective decisions regarding the use and management of money. (Remund, 2010) OEDC, through the work developed by Atkinson and Messy (2012), provide, not only an embracing term that could include financial knowledge, financial ability, financial culture, etc., as Financial Literacy, but also a complete and widely accepted definition of financial literacy. The definition gathers three important concepts: knowledge, attitudes and behaviors, which are, nowadays, the three pillars.

Profitability theory

One of the most difficult attributes of a firm to conceptualize and measure its profitability (Ross, Wester field and Jaffe, 1999). Profitability means ability to make profit from all the business activities of an organization, company, firm, or an enterprise. It shows how efficiently the management can make profit by using all the resources available in the market. According to Harward & Upton (1991), "profitability is the 'the ability of a given investment to earn a return from its use."

Profitability ratios are viewed as other variables to identify and measure financial characteristics of SMEs. According to Jaggi and Considine (1990), profitability is a crucial indicator for determining the financial position of the firm. The firm is considered financially weak when its profitability is sliding or the profitability is weak compared to other firms in the industry. Burns (1985) and Meric et al. (1997) measured profitability by three ratios: return on total assets, return on net assets, and return on equity. According to Burns (1985) return on total assets is the best measure of a firm's efficient use of assets because it is independent of financing methods.

While return on equity is a measure of the profit return to shareholders. In summary, depending on the purpose of their study the researchers in the literature use different ratios to measure financial characteristics of a firm. However, the variables most popularly used by most previous researchers included. liquidity measured by current and/or quick ratios, financial leverage measured by debt (long-term and short-term) ratio, debt-to equity ratio, and/or equity-to-total asset ratio, activity measured by total asset turnover, receivables turnover, and/or inventory turnover, and profitability measured by return on sales, return on assets and/or return on equity.

Empirical review

The role of financial literacy on the profitability of women owned enterprises in Kitui town, Kitui county, Kenya.

The study adopted a descriptive survey design which was aimed at fact finding enquiries on the role of financial literacy on the profitability of women owned businesses in Kenya a focus on Kitui town. A sample of seventy-six business owned businesses was selected using stratified random sampling technique. The study population was stratified as hardware businesswomen, service businesses, clothes dealers, general traders and others. A self-administered structured questionnaire was used to collect primary data from the respondents. Descriptive statistics was applied to establish

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patterns, trends and relationships and to make it easier to understand and interpret the implications of the study. Data collected was then organized, coded, and entered in the computer for analysis using SPSS software. Measures of central tendency and dispersion were used to analyze the collected data and presented using tables and figures. The result revealed that majority of the women business owners are not financially literate (mean =3.07).

Nyabwanga (2011) in his study of the effect of working capital management practices on the financial performance of small-scale enterprises in Kisii south district

Using sample of 113 small scale enterprises and using a survey design established that majority of the small business owners or managers had just basic education and over 57% of these business operators hardly attend any business training programs despite the establishment that over 60% of them had little or no knowledge in business management hence were void of management skills vital in the running of their enterprises. The study also established that the performance of small-scale enterprises was on average low. The study recommended a study that will unravel the impact of training on the performance of businesses. The study established that; financial literacy made it is possible for entrepreneurs to make projections for Incomes and expenses thus the study concludes that debt management literacy had a positive effect on the performance of youth led enterprises. The study established that financial literacy provided entrepreneurs with the capability to budget for long term, medium- and short-term objectives, thus the study concludes that literacy budgeting literacy had a positive effect on the performance of youth led enterprises.

Conceptual framework

According to Kombo and Tromp (2009), a concept is an abstract or general idea inferred or derived from specific instances. Below is a representation of the variables explored by this study. The dependent variable in the study is profitability while the independent variable is financial literacy. The dependent variable in the study is profitability whilst the independent variable is financial literacy. Financial literacy entails knowledge and understanding, financial skills and confidence.

Knowledge and understanding

This refers to the wisdom and ideas one has to manage its finances small scale owners can maximize their profits. One’s acquaintances with principles, observation, investigation, familiar and experiences gives the petty trader an insight on the job, making him or her aware of factors that can increase his performance.

Financial skills

This is another major factor which affects the profitability of a firm. Having knowledge and training does not guarantee its performance, however the ability to manipulate data and apply financial principles practically. Example, preparing income statement to ascertain gross profit/loss and net profit/loss.

Confidence and attitudes

When the petty trader is a financial literate, there is more likelihood of him or her preparing accurate and reliable financial records or statement. This will boost one’s morale in making decisions to improve operations and increase profitability. One has more confidence in taking risks and again, more probability of acquiring bank loans since the petty trader can prove himself or herself worthy of repaying the loan, and ways of utilizing the finances to maximize profit.

Chapter three

Methodology

Introduction

According to Bryman (2004) ensuring the trustworthiness and reliability of a research result should be the prime aim of every researcher. This goes to suggest that the adoption of appropriate research methodology plays an important role in the research process.

The section therefore focuses on the research techniques that would be adopted for this study with the aim of achieving the research objectives and finding answers to the research questions posed. This section discusses the research design and provides details regarding the sample and sampling techniques as well as the research instruments used in collecting data for the study. It also discusses the reliability and validity of instruments to be used in the data collection process.

Research design

The research will be carried out at Makola market. The reason being that we will have access to more traders and we will get enough time to visit regularly at lower cost. Evaluation will be more convenient and effective. All outlined objectives can equally be achieved efficiently. We have the knowledge and experience in relation to the market, since we have been visiting there regularly. This will be achieved through designing questionnaires, thus, to help acquire our objective from the traders. Data collected will be bases on annual turnover, years of business, number of employees as well as answers to simple financial literacy questions. This research is basic/pure type of research.

The quantitative strategy to be used for the study is a survey design. A survey design provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample of that population and the survey will be cross-sectional/snapshot (with data collected from different people at one point in time).

Population of the study

The population under the study are small scale enterprises at makola market. An estimate of 6,036 traders will be the population size.

Sampling method or technique

The mode of collecting data will be by the use of simple random sampling. Simple random sampling is a sampling method in which each element of the population has an equal probability of being selected.

Sample size

The sample represent a set of observation drawn from the population. The sample will be drawn from petty trader at makola market. Currently, the makola market has a population of about 6,036 traders at 2015. If the population is not more than 10000 a smaller sample size can be used without affecting accuracy. This is called adjusted minimum sample

$n' = n / \{1 + (n/N)\}$

Where,

n' is the adjusted minimum sample size

n is the minimum sample size (as calculated)

N is the total population

$n' = 100 / \{1 + (100/6{,}036)\}$

$= 98.37$

Therefore, the sample which will be used for the study will be 100.

Data collection instrument

The data collection instrument to be used for this study will be in the form of questionnaires.

The questionnaires will constitute three parts

1. Demographics of respondents
2. Savings behavior and attitude
3. Awareness and perceptions of financial services
4. Performance
5. Perception of financial services and
6. Practices

The questionnaire design will be the adaptive method of questionnaire designing. Self – Administered type of questionnaire will be used for collecting primary data.

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Sources of data

The data to be used for this research is primary data and secondary data. According to Malhotra and Birks (2007), the researcher should locate and analyze secondary data before collecting primary data. They indicated that secondary data which are data collected purposely for another purpose other the problem at hand can help in sample designs and in the details of primary research methods. The primary data produced from the study will be generated from the questionnaires.

Data analysis techniques

The analysis tool which will be used in checking impact of financial literacy on the financial performance of petty traders at the makola market is the regression analysis. Regression is a statistical procedure of finding the relationship among variables. We define the characters as financial performance, financial literacy and savings behavior and attitude. Hypothesis one was tested by analyzing the data collected using Pearson product-moment correlation statistical tool in determining the relationship between the two variables. Hypothesis two was tested by analyzing the data collected using regression analysis. The linear regression equation is

$Y = a + b1X2 + e$
Where,
Y = FINANCIAL PERFORMANCE
a = constant
X1 = FINANCIAL LITERACY
e = Error

The co-efficient b from the equation represent the strength and direction of the relationship between the variables. Comments and remarks on the regression analysis equation would be made with a software package called the SPSS. The software will help summarize the results for easy understanding. Data will be analyzed and presented based on the quantitative data acquired.

Chapter four

Results and discussions.

Results

All analyses were done with the aid of Statistical Product and Service Solutions (SPSS).

Demographic characteristics

Table 1. Summary of demographic characteristics

Demographic Characteristics	N	Percentages %
Sex		
Male	44	44.0
Female	56	56.0
Age		
19 – 29 years	41	41.0
30 – 39 years	26	26.0
40 – 49 years	21	21.0
50 – 59 years	11	11.0
60 + years	1	1.0
Marital Status		
Single	47	47.0
Married	46	46.0
Widowed	6	6.0
Divorced	1	1.0
Educational Level		
Primary	5	5.0

JHS	25	25.0
Technical	39	39.0
SHS	19	19.0
University	12	12.0
Type of Trade		
Vegetable trade	15	15.0
Used clothes trade	8	8.0
Boutique owner	21	21.0
Phone trade	6	6.0
Shoe dealer	8	8.0
Hardware	3	3.0
Bookshop	3	3.0
Provision shop	15	15.0
Electrical	11	11.0
Spare parts	4	4.0
Food vendor	6	6.0

Source: Field data, March, 2019

Table 2. Where do you save?

Characteristics	N	Percentages %
Banks	68	68.0
Personal savings	16	16.0
Micro finance	15	15.0
Both 1.00 and 3.00	1	1.0

Source. field data, March, 2017 (n=100).

It can be observed that 68 (68.0%) of the traders prefer saving with the "banks" operated by personnel in the formal sector, 16 (16.0%) said they prefer personal savings, 15 (15.0%) said they prefer saving with micro finance and 1(1%) said they save with both banks and micro finance. Generally, the traders prefer saving with the banks.

Table 3. My understanding of financial statement helps make good decisions

Characteristics	N	Percentages %
Strongly agree	26	26.0
Agree	40	40.0
Neutral	22	22.0
Disagree	9	9.0
Strongly disagree	3	3.0

Source: field data, March 2019 (n=100).

Good decision is a factor in improving performance as it gives traders or managers an in- sight on the firm's activities and how to manage it. From the data above, market traders who agreed that financial statement can help them make good decision where 66 (66.0%), 22(22.0%) of them were neutral and 13(13.0%) of them disagreed. It takes a financial literate to understand financial statement therefore financial literacy can be considered to very important to small scale enterprise at makola market.

Table 7. Saving at the bank is more secured than saving at home.

Characteristics	N	Percentages %
Strongly agree	56	56.0
Agree	35	35.0
Neutral	3	3.0
Disagree	2	2.0
Strongly agree	4	4.0

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Source: field data, March, 2019 (n=100).

Savings behavior and attitude of traders are affected by being financially literate.91% of the traders agreed that saving at the bank is more secured than saving at home. A trader who is not financially literate would not be aware of the benefits of saving at the bank thereby saving at home exposes him/ her to the risk of the money being stolen.

Discussions of Findings

The main aim of this study was to find the effect of financial literacy on the financial performance of small-scale enterprise at makola market. From a sample size of 100, all the respondents successfully provided data useful for this study. Data collected for the analysis included the background of the respondents, awareness and perception of financial services, savings behavior and attitude and the numbers of years each small-scale enterprise has been in business. Data collected for financial literacy included answers to simple financial literacy questions that covered record keeping and budgeting skills. Absence of financial literacy can be said to hinder the capability of person to make well-informed financial decisions. Due to this, positive relationships that exist between financial knowledge and financial behavior have been acknowledged by Hilgert et al.., (2003).

A test was made to investigate how savings behavior and attitude affect financial performance of traders at makola market. Further, it showed that there was no significance between the two variables. Thus, it can be concluded that financial performance has no relationship with savings behavior and attitude of market traders. This means that, a market trader's savings behavior and attitude will not necessarily have an impact on his or her financial performance. In discussing the third objective, a number of factors which made some petty traders do not prefer the use of financial service are;

Small amount to save: it was realized that most of businesses of the market traders are of small scale in nature, nature, hence profit of the day to day activities are very small or little. Thus, market traders are not motivated to save since earnings from daily operations is very little to be taken to the bank. In conclusion, Base on the scale above, we can conclude that financial literacy is important to the small-scale enterprises at makola market

Chapter five

Limitations, conclusion and recommendations

Limitations of the study

As with any research, there are limitations that should be taken into consideration when planning to carry out the practical application. Getting access to information from the respondents was a challenge because not all the traders were willing to disclose all information.

Another challenge encountered was not being able to meet the actual owners to the shops and the care takers couldn't provide the relevant information.

The difference in language between the respondents and myself was another difficulty in getting the access to information as most traders couldn't understand what we were trying to gather.

Conclusion

The study was able to determine the role of financial literacy on the financial performance of small-scale enterprises at makola market. It was found out that financial literacy has a role to play in the performance of small scale enterprises at makola market.

Small scale enterprises that are more successful are operated by owners who are financial literates that is they understand key financial concepts and issues, good savings behavior and attitude and being equipped with financial skills.

Recommendation

Based on the conclusion, it is therefore important for small scale owners to enhance their training on financial skills such as knowing how to prepare budgets and simple calculations to ascertain profit or loss. Financial information is very useful in evaluating the success of past decisions and in determining the current position of the business.

The growth of accounts also needs to be analyzed and evaluated periodically. Most importantly, the government should include financial literacy in the curriculum of the primary and higher education levels of institutions. Additionally, workshops should be organized to educate business owners to create awareness on basic financial concepts and how it will impact on their business. Furthermore, financial institutions and other agencies should create financial products or services that are tailor to various individual needs. Again, there should be many outlets to reach market traders in their various locations.

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