

Financial literacy and firm performance: A case of Micro and Small Enterprises (MSEs) in North Central Province in Sri Lanka

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Introduction

Financial literacy has been defined in various ways; as the ability of skills to apply that knowledge, perceived knowledge, good financial behavior and financial experiences (Hung et al., 2009). According to the International Network on Financial Education, financial literacy is a combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decision and ultimately achieve individual financial wellbeing. Financial literacy has received a great concern in both the developed and developing countries due to its main role in financial decision making which implies its effectiveness on firm performance. Performance can be generally characterized as the firm's ability to create acceptable outcomes and actions. Further, financial literacy is now globally recognized as one of major factors of economic and financial stability and development of firm performance.

A compelling body of literature has shown a strong positive association between financial literacy and performance of Small and Medium Enterprises (SMEs) (Hilgert et al., 2003; Kidwell & Turrisi, 2004; Lusardi et al., 2010). In point of the view of the Department of Census and Statistics of Sri Lanka (2015), SMEs play a vital role in almost all the economies in the world, especially in the developing countries like Sri Lanka and it largely contributes to Gross Domestic Product and facilitates more employment opportunities. On the other hand SMEs serves as a nursery for large enterprises of the future, as most of the large enterprises right now originated as SMEs in the past.

As there have not been adequate researches to ascertain the relationship between financial literacy and Micro and Small Enterprises' (MSEs) performance especially in Sri Lanka, this article aims to fill the gap by way of an empirical study in Sri Lankan context. The main objective of this study is to determine the impact of financial literacy on performance of MSEs in Sri Lanka.

Methodology

A survey was conducted in Mihintale Divisional Secretariat Division in Anuradhapura District in North Central Province in Sri Lanka. There are 570

MSEs registered in Mihintale Divisional Secretariat Office during 2012 to 2016. Although it is difficult to obtain the population of MSEs in the study area, a sample was selected using convenience sampling method. Seventy (70) questionnaires were distributed among entrepreneurs and forty three questionnaire were returned. Therefore, forty three enterprises have been selected as the sample. Although there are different definitions of MSEs, this research used the definition used in Economic Census 2013/2014 of Department of Census and Statistics in Sri Lanka to define MSEs for this study. The empirical approach consists of data collection through the use of self-administered questionnaire in the survey to gather information from entrepreneurs who are the directly responsible persons to maintain businesses.

As there is no generally accepted definition for financial literacy, this study used four concepts to measure financial literacy after reviewing the literature (Huston, 2010; Cole & Fernando, 2008;. Zuhair et al., 2015; Remund, 2010). Budgeting and book keeping skills, Debt management skills, historical financial practices and future oriented financial practices are used to measure the financial literacy. The conceptual model in Figure 1 outlines the relationship between financial literacy and firm performance. Descriptive statistics, correction and regression analysis were used in data analysis.

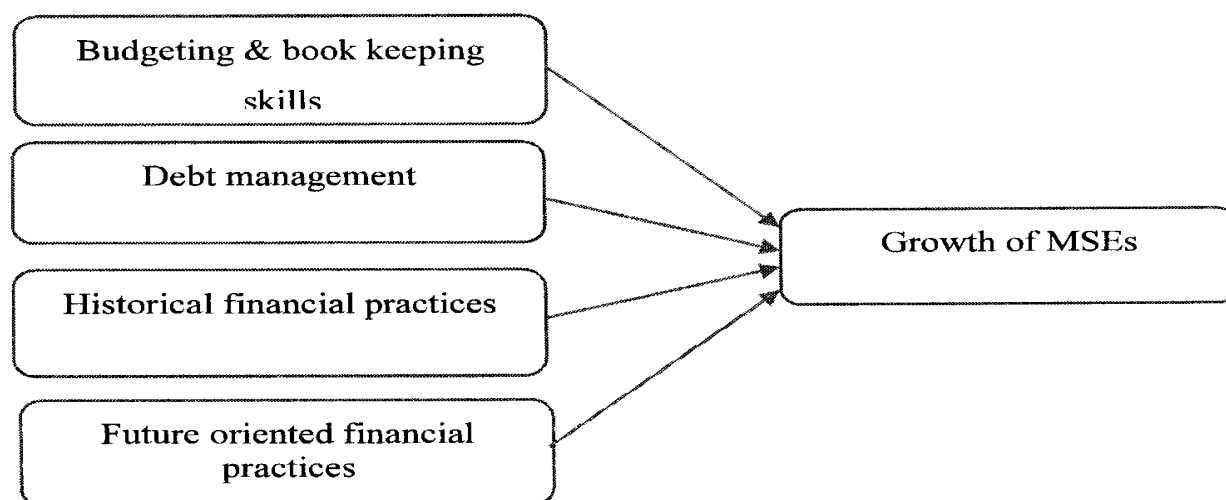


Figure 1 Conceptual framework

Results and discussion

The entrepreneurs were asked to indicate their demographic details and the results of them are outlined in Table 1. Cronbach's alpha value was used to determine the internal consistency of the variables to gauge their reliability. All coefficients are above 0.70 except the variable named future oriented financial practices (See Table 2).

Table 1 Sample profile

Demography		Percent	Demography		Percent
Gender	Male	74.4	Age	<25	2
	Female	25.6		26-35	21
M Status	Married	82	36-45	35	
	Unmarried	18	46-<	42	
Education	Primary	9.3			
	Secondary	32.5			
	Tertiary	58.1			

Table 2 Reliability statistics

Variable	No. of Items	Cronbach's Alpha
Budgeting & book keeping (BBK)	4	0.839
Debt management(DM)	4	0.743
Historical financial practices (HFP)	4	0.767
Future oriented financial practices (FOFP)	4	0.620

The correlation analysis is used to determine the extent to which different financial literacy factors are associated with changes in MSE performance. Its results are shown in Table 3.

The result of correlation indicates that all variables are the positively correlated with performance of MSEs. It means that, budgeting and bookkeeping (BBK), historical financial practices (HFP), Debt management (DM) are positively correlated with growth of MSEs (GMSE).

Table 3 Results of Correlation analysis

		G	BBK	HFP
Growth	Pearson Correlation	-		
	Sig. (2-tailed)			
BBK	Pearson Correlation	.896**	-	
	Sig. (2-tailed)	.000		
HFP	Pearson Correlation	.833**	.935**	-
	Sig. (2-tailed)	.000	.000	
DM	Pearson Correlation	.841**	.851**	.808**
	Sig. (2-tailed)	.000	.000	.000

Multiple regression analysis was used to examine the effect of BBK, HFP and DB on GMSE and its result is reproduced in Table 4. According the above result, all three predictor variables have a positive effect on growth of MSEs. In other words, budgeting and bookkeeping (BBK), historical financial practices (HFP), Debt management (DM) have positive effect on growth of micro and small enterprises in the region. Moreover R-Square value, 0.825, indicates that

budgeting and book keeping skills, debt management, and historical financial practices have good ability to promote the growth of micro and small enterprises in the North Central Province in Sri Lanka.

Table 4 Result of regression analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.383	.286		1.339	.188
BBK	.570	.111	.655	5.127	.000
DM	.367	.168	.288	2.192	.034
HFP	.014	.096	.011	.147	.048

Conclusion and recommendations

The main objective of the study was to investigate the impact of financial literacy on growth of MSEs. The result reveals that financial literacy has a positive and significant effect on growth of MSEs. In fact, budgeting and book keeping literacy ensures a sustainable growth in MSEs. Thus participation of employees in the budgeting and book keeping process is necessary for achieving better performance in the business firms. It is evident that some micro businesses are not practicing proper budgeting and book keeping activities. Therefore, such firm should keep accurate, meaningful, and timely information to make their decision appropriately. This is particularly true concerning financial information about a firm's operations. As a matter of policy, entrepreneur should keep the records on sales, purchase, accounts receivable, inventory, and stock on daily, weekly or monthly basis and should have an awareness on inflation and interest rate. But many entrepreneurs think that employing capable hands to keep adequate data of business operations is only required for the large businesses. This research sets an important benchmark for further research in this area.

Keywords: *Financial literacy, firm performance, micro and small enterprises.*

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