

# Analysis of the Impact of Financial Illiteracy on Small and Medium Enterprises' (SMEs) Growth in Lusaka's Central Business District, Zambia.

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## Abstract

The purpose of the study was to analyse the impact of financial illiteracy on SMEs' business success in Lusaka's Central Business District. The study used a quantitative paradigm with a self-administered questionnaire being the main data collection instrument in which a cross section of SMEs, namely: Hardware Hair Dressing / barbershops; Computer Service/Business Centre; Supermarkets; Restaurants/Bars; Photo Studios; Health Service; Boutique/Fashion Stores; Electronic/Electrical Stores; and Butcheries, constituted the target population. The non-probabilistic and probabilistic sampling techniques were used particularly; purposive and random sampling criteria respectively. Out of the 500 target population (N) of SMEs in the subject matter area under review as per record of the local authority, the study sampled 10% which is 50 as sample size selected systemically. Purposive sampling was also used in this research to select business owners to be interviewed, while random sampling was used to select interviewees from various firms. Stratified sampling technique was used at various stages of the study because the study involved a heterogeneous population. Data were analyzed using computer based statistical data analysis package, SPSS (version 16.0). The study revealed, among others, that record keeping skills had a positive and significant effect on growth of SMEs studied. It was also revealed that people with more debt management literacy skills were able to generate more wealth through management of the resources more optimally with less financial cost and hence, the need for a more deliberate debt management literacy among SMEs. The study also found that poor budgeting skills were a major cause of failure for the SMEs. Therefore, it was concluded that financial literacy has a positive impact on SMEs success in Lusaka; and that SME owners with less financial literacy have less profitability than those with a higher financial literacy.

**Key words:** *Analysis, Impact, Financial Illiteracy, SMEs, Lusaka.*

## 1. Introduction

Zambia is known to be an entrepreneurial country in which small enterprises which are usually run by individuals constitute the main component of the Zambian economy by supporting the employment sector and contributing to the GDP (Zambia Bureau Authority, 2016). According to Maseko and Manyani (2011), the Micro and Small Enterprises are businesses in both formal and informal sectors, in which they employ 30 percent of 4.9 million strong labour-force out of which 58 percent are entrepreneurs (self-employed) thus forming a seed bed for entrepreneurship growth essential for sustainable national economic growth (Ministry of commerce, trade, and industry, 2003-2004). According to the 2003 - 2007 Economic Recovery Strategy, the Small Scale Enterprises are acknowledged in Zambia as significant contributors to the economic growth. They also contribute income to more than 25 percent of the approximately two million households in Zambia thereby contributing to poverty reduction and promoting the much needed social cohesion and stability (ERS, 2007). Like the rest of the world, Zambian entrepreneurs are faced with numerous challenges in running their small businesses. It is estimated that majority of SMES do not survive the first five years since establishment and three out of five new businesses fail within the first few months of operation (Zambia Bureau Authority, 2007). Lack of planning, improper financing and poor management skills have been posited as main causes of failure of small enterprises (Longenecker, *et al.*, 2006).

Furthermore, inadequate credit assistance has also been identified as one of the most serious constraints facing SMEs and hindrance to their development according to, Small enterprise development Board (SEDB, 2011). Financial literacy has attracted increasing attention in both the developed and developing world due to its role in business financial decision. It encompasses the knowledge and skills required by individuals to function effectively in the money economy and make informed judgments in respect to their own business and family circumstances. It is for this reason that many countries have created task forces to study and evaluate the

level of financial literacy of their citizens (Alessie, Van & Lusardi, 2011). It is also believed that the global economy is heavily dependent on the success of Small to Medium enterprises (SMEs) which create employment, alleviate poverty and balanced development which bring about economic growth in rural and urban setups. Financial literacy has become an increasingly valuable skill for anyone making decision in today's economy, as many small-business owners fail because they are unable to understand basic financial concepts. Hence, the impact of financial illiteracy on SMEs' success is a topic of great interest as it helps us to understand the pattern of operation and also how financial literacy affects the growth of SMEs. This paper will discuss in detail the impacts of financial illiteracy on the growth of SMEs in the Central Business District of Lusaka Province in Zambia.

## 1.1. Problem Statement

SMEs are the main driving force of economic growth and job creation in Zambia as evidenced from the background of this study. However, due to high levels of financial debt, poor investment choices and lack of adherence to set budgets, this has caused massive failures in the operations of most SMEs and hinders their growth thereby affecting the economy as a whole. According to Longenecker et al., (2006), these problems being faced by SMEs indicate the lack of financial knowledge and awareness. Wanjohi (2011) refers to lack of adequate business skills as a major challenge in the development and growth of SMEs globally. This is mainly attributed to low levels of education, lack of adequate information and business records (ibid: 2011). Therefore, the challenges highlighted hereinabove, though largely global, are an epitome of what seems to be the experiences of Zambian SMEs in Lusaka's CBD. This study, therefore, aims to analyse the impact of financial illiteracy on SMEs business growth as no empirical studies seem to have been undertaken to provide a foundational basis for policy decision direction in the context under review.

## 1.2 Study Objectives

- To analyse the level of financial knowledge of SME owners.
- To determine the effect of budgeting skills on the success of SMEs in the Central Business District of Lusaka.
- To establish the effect of debt management literacy on SMEs success.

## 2.0 Theoretical Review of Literature

### 2.1 Definition of Major Terms

**Financial Literacy:** This can be defined as the ability to understand and interpret various financial concepts as well as risks in order to be motivated and confident to apply the knowledge in making effective financial decisions (OECD, 2010). **SME:** An SME can be defined as an enterprise that is usually owned and (or) operated by an entrepreneur. According to a report of 2013 from the World Bank Group, SMEs play a major role in the economies of developing countries mostly taking away the burden of employment from the government with SMEs employing over 65% of the workforce in the world (World Bank, 2013). **Success:** In general, success relates to the achievement of goals and objectives in whatever sector of life. In the corporate entity, the concept of success is often used to refer to a firm's financial performance, in the sense of profit and losses. To a greater extent there is no universally accepted definition of success, and business success has been interpreted in many ways (Foley & Green 1989).

## 2.2. Review of Related Studies

### 2.2.1 Measuring Financial Literacy Level

Measuring financial literacy according to Mandell (2007) included measuring one's attitude, financial behavior and knowledge. Emphasis is drawn on these three elements, while Chen and Volpe, (1998) defined financial attitude as personal inclination toward financial matters. Financial behavior, however, is defined as how an individual financially conducts themselves in a given way, their manner or conduct towards financial issues that is how one spends, budgets, saves, borrows or invests (Lusardi, 2008b). Mohammed et al, (2013) measured financial behaviour in a five point scale about how important investing, saving, budgeting and debt management was. The OECD also measured individual's attitudes and behaviors using questions that focused on their spending, savings and investment, all these leading to different attitudes about financial knowledge. Similarly, The ANZ (2013) looks at goal setting and planning as well as spending compared to earning of individuals in New Zealand. Yoong *et al* (2009) measured financial behaviors using respondents' savings and investment culture. He also used debt management as a way to measure their debt behaviors. Santos and Abreu (2014) also came up with a study of measuring financial behaviors and he mentioned that financial knowledge is tied to financial behaviors like planning and saving for retirement. He, therefore, used planning and saving as core concepts to determine the respondents' financial behavior. The Australian Financial Attitude and Behavior Tracker, (2014) also came up with way of measuring financial attitudes and behaviors. They based their study on how the respondents kept track of their finances, planned, chose financial products and how they did financial control. The Social Research Centre, (ANZ, 2011). Lin, (2012), The Financial Services Authority, (FSA, 2005) and The Inceptia National Financial Aptitude Analysis, (2013), question individuals' knowledge about finance. Most of the findings from these surveys indicated financial illiteracies among respondents. Lastly, studies done by the OECD (2008), Banco de Portugal, (2010); Atkinson and Messy, (2012); Karadag (2015); Bachmann and Hens (2015); Schrader and Lawless (2004) conclude that for one to be fully financially literate, they have to have the right attitude, basic knowledge and understanding; skills and experience; personality and behavior and all this will aid an entrepreneur to make wise, informed and profitable decisions that will lead to a high firm performance.

### 2.2.2 Budgeting Skills and SMEs Success

Joshi *et al.*, (2013) scrutinized budgeting financial literacy by an analysis of 54 both medium and large businesses in Bahrain aiming at budgeting processes which are inclusive of the participation, planning, controlling and its overall performance the researchers identified that the expansion of a firm is linked to its growth. Chidi and Shad (2011) studied the challenges tackling human resource improvement in SMEs in Nigeria and found that budgeting was the greatest challenge among SMEs. Among others included lack of accountability and a lot of deficiencies in budgeting plans. Mahmood (2008) studied the relationship between budgeting process and SMEs performance and found that the formalization of the budget will depend on how clearly the relationship of the business and the owners is defined. Joshi *et al.*, (2003) who studied budgeting process and performance of companies found out that large companies have a susceptibility to perform an in-depth budget procedure and be in a position to present it excellently. Wijewardena and DeZoysa (2011) studied contributions to SMEs towards the budget process and identified that the proper budget is compromised by the two significant aspects of the expected budget process which are the budget planning and the budget control. Siekei *et al.*, (2013) assessed the possessions of budgeting skills on performance of SMEs and found that better presentation of SMEs in terms of sales increase and profitability is linked with proficiency on budgeting skills and business growth which is attained through finance education which enables the individuals to forecast sales and set achievable targets. Nonetheless, Fatoki (2014) identified that small enterprises operates informally in terms of expected income and expenditure lacking financial planning and measures as well. This is confirmed by Abanis, Sunday, Burani and Eliabu (2013) who found that most small businesses do not engage in formal financial planning and control and budgeting. Warue and Wanjira (2013) researched on hiccups of the businesses in Kenya and established that poor budgeting skills among Kenyans as a major contributor to the business failure in Kenya. Fin Access survey (FSD, 2009) exposed the fact that most people above 50% are not financially independent and lack control of the same in spite of them having an idea about budgeting. The above studies disclose a positive correlation between finance education and the individual performance such as the business portfolio, healthy debt administration, accumulated wealth and the business going concern strategies. On the other hand, escalating data shows there is a low level of financial literacy among grown-up across countries worldwide. This illiteracy is also higher amongst women than men which negatively impacts on their businesses.

### 2.2.3 Debt Management Literacy and SMEs Success

Lusardi and Mitchell (2011) studied the impact of literacy levels on entrepreneurs performance revealed that persons of limited financial literacy are more prone to exploitations when it comes to debt management, savings and credit, and are not able to administer their resources competitively. FSD (2009) and Master card (2011) sought to resolve the impact of financial literacy on any personal economic running practice among employees of commercial banks in Kenya using a sample of 100 respondents, the study revealed that, individuals who are highly skilled have an affirmative relationship with higher levels of domestic wealth and good financial decisions while poor numeracy were coupled with redundant expenses. Similarly, Pisa (2013) and Siekei *et al.*, (2013) revealed that financial knowledge helped in debt management as it looked at issues pertaining to individual's knowledge on government policies and regulation, financial decisions, self financing e.t.c

Lusardi and Tufano (2009) study to determine debt literacy, financial occurrences, and over indebtedness among Americans. The study established that the three quarter of the target population could not understand the conception of interest compounding to their daily business operations or be in a position to embrace effectiveness of a credit card. In addition they acknowledged that women, marginalized, elderly and single parents are the most affected due to their constrained resources and poor financial supervision. Obago (2014) studied the impact of financial literacy on running of personal finances established that most employed individuals suffer from pressure as a result of monetary problem behaviors which include: extravagance, credit mismanagement, over-indebtedness, meager cash management and scarce income. The above challenges make it hard for the staff to make ends meet which impacts negatively on their productivity at work. Problems emanating from deficiency of financial literacy have propelled many companies in the united States to introduce financial education at work places to empower their employees with self-administration skills.

The Financial capability Report of 2009 reveals that a significant population of Kenyans i.e 25% has credit difficulties and tends to borrow loans to repay loans and admit that they are not in control of their finances. Therefore, acquisition of financial literacy skills would have a positive impact on an individual's behaviors in terms of increased savings, wealth accumulation and avoidance of unnecessary expenses. This would make MSE managers better customers for the banks, prudent managers of the limited financial resources in their businesses and better able to select the most suitable products for their businesses.

### 2.2.4 Record keeping Literacy

Frank wood (2010) studied the benefits of record keeping on SMEs performance and found out that computation of the income statement is highly dependent on the proper record keeping which also enable the business to be able to collect their debts timely and also pay on time for their obligations. Additionally studies conducted by Ezejiofor, Ezenyirimba and Olise (2014), Wise (2013) indicate that proper record keeping literacy result in Quality accounting information, measure accurately the performance of businesses and leads to production of proper financial report. Fatoki (2014); Agyei (2011); Maseko and Manyani (2011) studied the methods of accounting used by SMEs and found that most SMEs operates on manual systems which fail to capture all data relevant for accounting purposes and this results to inefficiency of accounting information. The G20 Seoul Summit (2010) also reports that low levels of financial literacy particularly record keeping skills worldwide and Mills and McCarthy (2014), all advocate for entrepreneurs to acquire basic skills of Record keeping which increases the transparency of his business and improves one's credit standing.

### 2.3 Theoretical framework

This study was guided by two theoretical models namely: the financial literacy theory and the stages of growth theory. Financial literacy theory argues that the behavior of people with a high level of financial literacy might depend on the prevalence of the two thinking styles according to dual-process theories: intuition and cognition. Dual-process theories (Evans 2008) embrace the idea that decisions can be driven by both intuitive and cognitive processes. Dual-process theories have been studied and applied to many different fields, e.g., reasoning and social cognition (Evans 2008). Financial literacy remains an interesting issue in both developed and developing economies and has elicited much interest in the recent past with the rapid change in the finance landscape. On the other hand, Stages of growth theory was built up by Larry Greiner (1972) who posits that for an enterprise to progress, it has to do so via five discernible stages of growth. Each stage will undergo a quiet period of evolution and is concluded by an administration revolution (Gupta et al., 2013; Mckaskill, 2010). These stages of growth comprise of creativity, direction, delegation, coordination, and collaboration. The birth of an enterprise occurs at the creativity stage where production of goods and services are done. The staff work for long and salaries are modest too as they work extra hard to penetrate in the market. The next stage is direction which is marked by persistent development and good administration (Audretsch, 2006). At delegation stage, the organization is decentralized; composition of the organization is established. Line managers and employees are tasked the most. The third stage is Coordination stage, formalization stage which expresses authority order and headquarters is established for better harmonization of activities. Collaboration is the fourth stage which marks the climax and it entails sturdy inter-personal rapport and teamwork. The enterprise basically empowers in capacity building through workshops, conferences and training (Fatoki, 2014). Greiner (1972) disagree that growth (evolution) advanced until a calamity (revolution) happened. Each calamity requires a different management style. Communication is affected as the business matures, and communication channels lengthen. According to Mckaskill (2010), the five phases of evolution cannot be achieved without improving the literacy level of entrepreneurs. This theory is applicable to the study since SMEs go through various evolutionary stages before they become successful.

The conceptual model for this study connected the relationship between financial literacy and SMEs success. As shown in figure 1 below, it indicates that SME success can be achieved if business owners are well educated and financially literate;

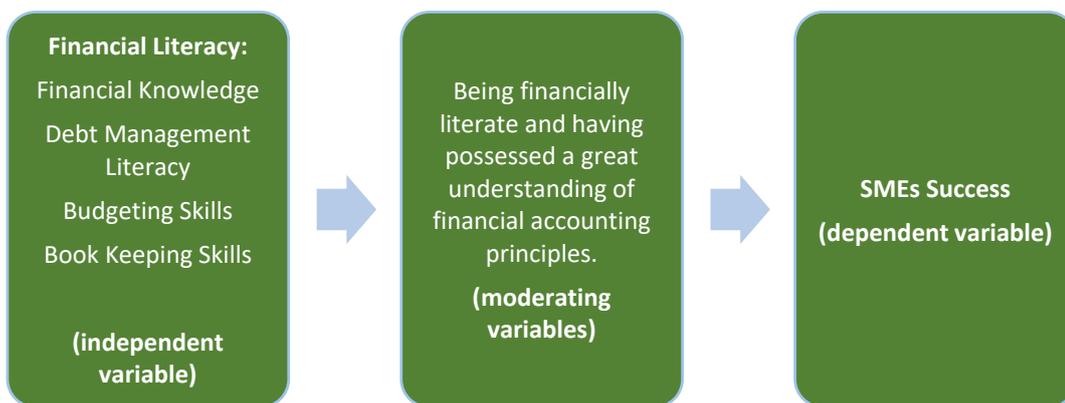


Figure 1: Source: Researcher's Development (2020)

### 2.4. Research Gaps

The analysis of the above literature reviewed, reveals that most of the studies were done in Nigeria, Tanzania and other developing countries of Africa (Chidi and Shad, 2011; Ezejiolor et al., 2014, Fatoki, 2014; Agyei, 2011; Diamond & Khemani, 2006; Abdallah, 2011; Erulkar and Bello, 2007). This is to say that there were very few studies undertaken in Zambia related to this study in spite of its importance. Furthermore, this study seeks to answer the following questions which were not answered in any of the previous studies reviewed: How financially literate are SME owners in Lusaka? How does budgeting skills affect the success of SMEs in the Central Business District of Lusaka? What is the effect of debt management literacy on SMEs success in Lusaka?

### 3.0. Research Methodology

The study used a quantitative paradigm with a self-administered questionnaire being the main data collection instrument. The non-probability and probability sampling techniques were used in particular purposive and random sampling respectively. The sample size used was 50 SME owners from the target population of over 500. Purposive sampling was used in this research to select the managers to be interviewed, and stratified sampling was used to select equal number of gender from various firms. The stratified sampling technique was chosen because the study involved heterogeneous population. The sample, therefore, was grouped into ten strata in such a way that each stratum is as homogenous as possible. After stratification, the sample for each group was chosen randomly. This method reduces the possibility of one-sidedness as each of the sub-groups must be represented. For the purpose of the study, small-medium scale enterprises operating within the Central Business District (CBD) of Lusaka were categorized into 10 strata: Hardware Businessmen; Hair Dressing/Hair Cut Saloon; Computer Service/Business Centre; Trading/Supermarkets; Restaurants/Bars; Photo Studios; Health Service; Boutique/Fashion Stores; Electronic/Electrical Stores; and Butcheries with the sample size being shared equally among them. In order to gather information and data about the research problem and achieve the research objectives, the Lusaka Central Business District (CBD) of Zambia was used as a case study. Data was collected using

both primary and secondary sources. Primary data was collected using questionnaires distributed to the registered small and medium enterprises operating within the Central Business District (CBD) of Lusaka. Secondary data was obtained through review of literature. Data were analyzed using computer based statistical data analysis package, SPSS (version 16.0).

#### 4.0. Discussion of Findings

##### 4.1 Level of Financial Literacy

Most respondents had positive financial behaviors even if they had low levels of financial knowledge. This means that respondents lack the skill of numeracy but know the fundamentals of finance and also the implications of certain financial behaviors. Financial literacy was a significant variable as it had a P-value of less than 0.05 and a positive coefficient. This proves that financial literacy has a positive impact on SMEs success; and that SME owners with less financial literacy have less profitability than those with a higher financial literacy. This is consistent with other researcher’s results like Nunoo and Andoh (2012).

##### 4.2 Effects of Budgeting Skills on SMEs success

The findings revealed that the majority of the respondents (52%) alluded to the fact that their level of knowledge on budget preparation was moderate. This finding of the study reaffirm the earlier study by Warue and Wanjira (2013) who researched on hiccups of the businesses in Kenya and established that poor budgeting skills among Kenyans as a major contributor to the business failure in Kenya. In addition, they also noted that there is a low level of financial literacy among SMEs across countries worldwide which negatively impact on their businesses. The finding of the study further supports Chidi and Shadare (2011) who studied the challenge of tackling human resource improvement in SMEs in Nigeria and found that budgeting was the greatest challenge among SMEs. The table below shows the effects of budgeting skills on the success of SMEs with 10% of Managers having acquired the knowledge regarding the preparations of annual budgets and sales forecasting experience and knowledge. Whereas 60% of the SMEs are very careful on spending and emphasize on reduction of cost, only 20% of the budget set is effectively implemented.

**Table 1: The effects of budgeting skills on the success of SMEs**

Budgeting Skills	Frequency	percentage
Managers have acquired the knowledge regarding the preparations of annual budgets.	5	10
Manager/s of the SMEs has the sales forecasting experience and knowledge.	5	10
We are very careful on our spending and we emphasize on reduction of cost.	30	60
The set budget is effectively implemented.	10	20
Total	50	100

Source: Field Data (2020)

##### 4.3 Debt Management Literacy

The findings from descriptive statistics revealed that majority of the respondents (58%) alluded to the fact that their level of knowledge on debt management literacy was moderate. This implies that SMEs know very little about debt management hence, a deliberate effort is required to equip SMEs with adequate debt management skills to enable them borrow and repay wisely. The finding of this study is in line with Obago (2014) who studied the impact of financial literacy on running of personal finances. He established that most employed individuals suffer from pressure as a result of monetary problem behaviour which include: extravagance, credit mismanagement, over-indebtedness, meager cash management and scarce income.

##### 4.4 Record keeping Skills

The findings further revealed that 34% of the respondents rated their level of knowledge on record keeping to be low; 26% rated their level as moderate while 40% rated their level to be high. This implies that SMEs level of knowledge on record keeping is wanting and they need to be trained to enable them prepare the books of account to enable management make informed decision based on financial performance. The finding further revealed that record keeping knowledge was not sufficient enough to enable SMEs to file the tax returns without engaging consultants. The finding of the study that there is low level of knowledge on record keeping literacy is in line with the G20 Seoul Summit (2010) whose report indicated that low levels of financial literacy, particularly record keeping skills, was a major contributor to lost opportunities for a large number of SMEs. Ezeji for et al., (2014) sought to establish the relevance of accounting records in small business performance in Nigeria and found that SMEs that kept proper books of account were able to measure accurately the performance of their businesses. They also assert that business decisions with regard to expansion, maintaining a competitive edge, prevention of business failure and filling tax returns require documentation with reliable and relevant information, easy to understand and readily available.

#### 5.0 Conclusion

Based on the objectives of the study and its findings, it can be concluded that there are high levels of financial illiteracy among SMEs which affect their successful growth. Financial knowledge is necessary as it enables SMEs to understand how banks operate to avoid being surcharged and penalized for failure to comply with terms and conditions associated with services provided.

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Moreover, it was also discovered that managers of SMEs normally conduct a survey about various bank products but very few monitor the savings and loan balances regularly. Moreover, the study further revealed that although some personnel operating SMEs have general knowledge on accounting for the business transaction, such knowledge could not enable them prepare financial statements independently. The study further concludes that most of the SMEs lack budgeting skills and debt management knowledge which are significant pillars for their growth. Financial literacy needs to be prioritised by these SMEs if they are to reach desirable levels of growth which can place them in a position of competitiveness and comparative advantage with other international and local players. There is need for government through the Ministry of Commerce, Trade and Industry to facilitate financial literacy capacity building trainings for these SMEs as a way of empowering them to be reliable contributors to the growth and development of the nation socio economically.

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