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Significance of Financial Literacy on Business Performance in Nigeria

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ABSTRACT

The absence of financial literacy is among the various factors responsible for the poor performance of most businesses, as several Small and Medium Scale Enterprises (SMEs) owners lack adequate knowledge of financial decision making, which often times, results in the failure of their businesses. The important function performed by small businesses in the socioeconomic sector of most developing countries is widely known. SMEs in particular, are catalysts for broad-based growth; they essentially contribute to employment as well as the revitalization of the global economy, including individual national economies. It is based on this, that this study reviewed the importance of financial literacy in the SME sector. Essentially, this paper illustrates the importance of financial literacy by reflecting on the dual theory; it further contributes to the information of financial literacy having examined the correlation between financial literacy and business performance. In the same vein, this paper will enhance the ability of policy makers to come up with notable blueprints that will improve financial literacy, particularly the ones that are directly tailored to the needs of small businesses.

Keywords: Business, Financial Literacy, Performance, Significance, Economy.

INTRODUCTION

In a business, decision-making needs to be rational and supported by available information. This means that it is necessary that business owners should possess a fair amount of knowledge related to the available information to make good decisions. [1] stated that financial literacy is the extent to which one understands essential financial concepts and possesses the ability and confidence to handle personal funds of appropriate, brief period decision-making and solid long-term financial forethought. A major obstacle to performance growth of small and medium scale enterprises (SMEs) in a country like Nigeria is a lack of knowledge, skills, attitude and awareness to cope and direct the finances of their organization in a robust, transparent, and professional way. [2] stated that the reasons why business people make inappropriate, inadequate and ineffective financial decisions are because of the lack of personal financial knowledge, lack of time to learn about personal financial management, complexities in financial transactions and the extensive variety of choices in financial products/services. Lack of business management skills can magnify financial barriers for SMEs. Low degree of financial literacy can prevent the performance level of SMEs from adequately assessing and understanding different financing provision, and for navigating complex loan application procedures. While some decisions can be made based on experience, age and other factors, other decisions are complex, requiring financial literacy: knowledge, awareness, skills and attitude towards proper financial management to achieve performance outcomes. There have been few in-depth analyses of how specific knowledge resources, such as financial literacy, influence the performance of SMEs, as such, this study, provides an analysis of financial literacy and looks at the process by which financial literacy can boost SMEs' performance.

Theoretical Framework

The dual-process theory was propounded by [3]. This theory posits that financial decisions are influenced by both intuitive and cognitive processes which imply that financial literacy may not always yield the best financial decisions. [4] contributed to this theory by describing the concept of financial literacy as the combination of individuals' understanding of financial products and services, and their ability to take financial opportunities and risk, which help them to make informed choices for a strong financial stability. [5] envisage that financial literacy and wealth will be strongly correlated. For example, [6] propose that financial literacy enables people to take advantage of increased financial market competition by applying their risk management knowledge and skills. Research indicates that financial literacy facilitates the ability of SME owners to meet the challenges of changes to the business and to financial markets and thus achieve optimal performance [7]. Others have analysed the link between financial knowledge, saving and investment behaviour [8].The dual process theory is regarded as appropriate for this study because it demonstrates that individuals with high cognitive abilities will search for information, and their decisions are more likely to be made based on relevant message; hence, their decision making skills can be enhanced by financial literacy training. In addition, use of intuition may be reduced by provision of relevant information to support decision-making through financial education since individuals tend to rely on intuition where relevant information is lacking.

Small and Medium Enterprises (SMEs)

In Nigeria, MSMEs are defined by various programmes such as SMEEIS, Nigeria Ministry of Commerce and Industry [9] "Operational Guidelines of Micro, Small and Medium Enterprises" and National Policy on MSMEs which adopted SMEDAN definition. This study however adopted the definition by SMEDAN, [10]. Micro enterprises are enterprises that have less than N5 million assets minus land and buildings and also employ less than ten (10) people. On the other hand small enterprises have at least N5 million but not up to N50 million assets minus land and building as well as employ between ten (10) and forty nine (49) people. Medium enterprises have at least N50 million but less than N500 million assets minus land and building as well as employ between fifty (50) and one hundred and ninety nine people. In case of conflict between assets and employment criteria, the employment criterion takes precedence.

Financial Literacy

Financial literary has been described as the knowledge and cognitive capabilities required to manage finances and make executive decisions on financial matters [11]. Financial literacy is the ability of an individual to make informed judgments and take effective decisions regarding the use and management of financial resources [12]. Accordingly, knowledge about finance is very crucial, not only for individuals but also for businesses as well. For this reason, financial literacy has been recognized as a necessary tool for growth, development of organizations and individual's financial stability [13]. SMEs need financial literacy in order to appraise their business's financial activities and make financial decisions. Financial literacy helps businesses to manage risks through strategies, such as maintaining financial reserves, diversifying their investment portfolio and buying insurance. Inadequate financial literacy has been identified as one of the main barriers to the quality performance of SMEs.

Empirical studies have shown that levels of financial literacy are low amongst business owners. [14] found a lack of financial literacy as a general problem in SMEs. Lack of financial literacy has an impact on business organizations in the starting up phase and subsequently. [15] concluded that lack of financial literacy was the major cause of failure of SMEs.

Elements of Financial Literacy

i. Financial Knowledge

Financial knowledge is defined as the understanding of key financial terms and concepts needed to function daily [16]. [17] describe it as a specific type of capital obtained through the ability to manage income, expenditure and savings in a safe way. Financial knowledge revolves around the intelligence, understanding or knowledge gained through learning the ability to manage income, expenditure and savings in a secured way [18]. Financial knowledge correlates with a number of "best practice" financial behaviors, including possessing an adequate emergency fund, monitoring credit reports, avoiding checking account overdrafts, avoiding revolving debt, owning a dedicated retirement account, and having insurance protection [19]. The Organization of Economic Co-operation and Development (OECD), added that financial knowledge is an important determinant of whether the individual is financially knowledgeable, involving questions related to concepts such as simple and compound interest, risk and return and inflation (OECD INFE, 2011).

ii. Financial Behaviour

Financial behavior according to [20] is the ability to comprehend the entire impacts of financial decisions on one's situations and to make the right decisions related to the cash management, precautions and opportunities for budget planning. Studies have shown that financial literacy always forecasts measures of financial behavior of individuals [21]. [22] draws attention to the fact that a good financial behavior involves the ability to make financial decisions that increase wealth and prevent uncertainties of businesses and individuals. These activities generate more financial assets, prevent over-indebtedness, finance retirement, and insure against major life contingencies.

iii. Financial Attitude

Financial attitude can be defined as the application of financial principles to build and sustain value through decision making and proper resource management [23]. Financial attitude is one of the factors that have significant impact on financial management practice. According to [24], financial attitude refers to a psychological propensity that is expressed by estimating a particular entity with some degree of favor or disfavor". That is, it a psychological predisposition when it comes to agreeing or disagreeing with certain financial management practices. [25] defined financial attitude as the creation of value in decision making and resource management through application of financial principles. Financial attitude is improved by acquiring of adequate information.

IV. Performance

Business performance is the ability of a business enterprise to come across or surpass its pre-set objectives or goals as agreed upon by its investors over a definite period which enables the business enterprise to realise unique or superfluous set goals relevant to a business progress in the market [26]. Also, [26] defined business performance as a consistent dimension of consequences and results, which produces reliable data on the success and effectiveness of a planned effort. [27] further portrays business performance as a central marvel in commercial philosophies and also a multifaceted phenomenon, nonetheless, performance generally deals with the attainment of aims and goals in any segment of human life prospects.

There is no consensus on measures of performance; however, the conventional standards of business performance comprise financial and non- financial indicators. Financial indicators include profitability indicators like return on asset, sales return, Investment return, return on equity, market share and operational efficiency [28] cited in [29]. Nonfinancial measures consist of career satisfaction, organizational commitment, employee turnover and entrepreneur satisfaction. In the context of small businesses, it is common knowledge that entrepreneurs frequently consider financial performance measures to be confidential and protect them from community scrutiny [30]. In addition, due to legal reasons small businesses tend to maneuver some data and control such manipulation over subjectively adjusting measures [31]. Thus, researchers can assess the business performance of small businesses using common subjective measures which can reflect more-specific objective measures [32]. The use of such measures to assess performance is acceptable, as it shows high positive connections with objective business performance measures.

Determinants of business performance are described as factors that influence business development and growth. Thus, according to [33] as cited in [34], business performance is presently the struggle around the world of business, which needs not only measurement but also calls for appraisal in trying to improve it. Besides, [35], mentioned that reviewing business performance is a better move towards finding out whether a business enterprise is growing through the use of indicators which permits an easy way to look into the enterprise situation such as the annual sale turnover rate, growth, number of employees, innovation, competition and resources availability. On the other hand, [36] noted that business owners will likely use their value orientation as a measure of business performance as opposed to the financial indicators. The most common measure of business performance in literature was profitability, growth, innovation and survival [37]. Importantly, [38] opined that researchers should focus on a holistic approach in measuring business performance by including both financial and non-financial markers. According to him, an index such as work-life balance and giving back to the community are some of the factors critical to business owners. However, [39], observed that such measures must include both business performance such as "economic growth" and other criteria that business owners themselves deemed to be successful [40]. Moreover, [12] hinted that only objective indicators of the business performance should be adopted, that is the business performance must be compared to the achievement of positive economic growth such as annual sales and growth in the employee's competency.

Financial Literacy and SMEs Performance

The resource-based view (RBV) posits that a firm's competitive advantage and performance are dependent on its tangible and intangible resources [2]. Tangible resources include financial capital (e.g., equity capital, debt capital, retained earnings) and physical capital (e.g., machinery & buildings). Intangible resources consist of entrepreneurial knowledge, skills, experiences, organizational procedures and reputation, among others [17]. According to [8], firm's resources include all assets, capabilities, organizational processes, knowledge, firm's feature, information, etc. controlled by a firm that enable the firm to conceive and devise strategies that improve its efficiency and effectiveness. Also, the relationship between firm's resources and competitive advantage is significantly enhanced by attributes and elements such as value, rareness, inimitable and non-substitutable, i.e., the VRIN factor. [12] further add that human capital resources include the training, knowledge, experience, judgment, intelligence, attitude, relationships, and insights of individual managers in a firm.

To preserve their competitive advantage, firms need a wide range of resources and a wide knowledge base. [9] explained that intellectual capital has a positive impact on organizations' performance. Financial literacy as an aspect of human capital shows that entrepreneur with higher general and specific human capital can be expected to show higher levels of performance than those with lower levels of general and specific human capital [4]. Thus, financial literacy plays a significant role in the value creation process of SMEs, which leads to maximum performance [14]. Financial literacy contributes to an organization's knowledge base, helping it to adapt to changes in the business environment and profit from opportunities presented by such changes [20]. Therefore, firms should understand the importance of financial literacy and their strategic roles in order to increase the knowledge capabilities of the firm. As observed by [27], there is a considerable body of research demonstrating that financial literacy is positively related to firm performance [2]. Also, financial resources are necessary for obtaining both tangible and intangible resources [31]; likewise, the concept of financial literacy as comprising three dimensions in knowledge [16]; attitude [14]; and awareness [12]. Knowledge is about understanding how business performance and business condition are measured using the mental model to facilitate, support, or enrich decision-making [8].

Financially literate firms have better insight into the financial aspects of strategic issues; hence, their performance is better. [5] showed that financial literacy was important to the survival of SMEs in both developed and developing countries. Low financial literacy caused poor financial management practices and led to frequent financial mistakes [23]. [11]

pointed out that financial literacy is needed to cope with rapid economic changes. Similarly, [17] concluded that people with strong financial knowledge were more likely to invest in complex assets and more likely to do so successfully. [32] also found an association between financial literacy and firm performance. Furthermore, financial literacy is known to be an important factor in wealth accumulation, as well as firm performance [39]. Accordingly, financial literacy has become one of the most important driving forces in organizational decision-making [33] and strategic, long-term financial planning [35].

CONCLUSION AND RECOMMENDATION

Financial literacy is a typical problem of small and medium enterprises (SMEs). Irrespective of the industry's ability to stimulate economic growth through high rates of job creation, the chances of going out of business largely remain owing to institutional and financial literacy problems. The contribution of financial literacy to performance growth, employment creation, and social progress is highly acknowledged and considered as a crucial factor for attaining economic growth in the small and medium enterprises (SMEs) sector. Thus, this paper supports the fact that financial literacy is a significant key driver of business performance and should be developed as an inbuilt part of the business activities. Business owners should be encouraged to take a more complex assessment of how and why financial knowledge, financial behaviour and financial attitude affect performance outcomes. Also, workshops, training and seminars to improve the financial literacy of SMEs should be organized and included in the annual training and development schedule of SMEs. The programmes should cover bookkeeping, financial statement analysis, cash flow analysis, business environment analysis, risk analysis, investment management and development of project proposals as these areas are germane to the financial literacy of any business.

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