THE EFFECT OF FINANCIAL LITERACY ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN TRANS NZOIA COUNTY

BY:

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DECLARATION

I declare that this research project is my original work and has not been exhibited or published in any way and has never been presented for any awards in any institution. Where other sources of information have been used they have been acknowledged.

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D61/64777/2013

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This research project has been submitted for examination with my approval as the University of Nairobi Lecturer.

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DEDICATION

To

My beloved wife Nancy Cherugong for your unfailing encouragement and love.

And

My dear mother Alice Koech, without your caring support and motivation, it would not have been possible.

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LIST OF ABBREVIATIONS

CBD	:	Central Business District
CMA	:	Capital Market Authority
BPO	:	Business Process Outsourcing
ERS	:	Economic Recovery Strategy
GDP	:	Gross Domestic Product
GOK	:	Government of Kenya
MBA	:	Master of Business Administration
MFI	:	Micro Finance Institutions
PACFL	:	Presidents Advisory Council on Financial Literacy
R&D	:	Research and Development
SACCO	:	Saving and Credit Co-operative
SMEs	:	Small and Medium Enterprises
SPSS	:	Statistical Program Social Sciences
SSE	:	Small Scale Enterprises
UN	:	United Nations

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ABSTRACT

The study was carried out to examine the aspect of the present day financial literacy of small and medium scale enterprises in Trans Nzoia County on business performance. More specifically, the study addressed the effect of financial literacy on performance of small and medium enterprises in Trans Nzoia County. The researcher used a descriptive research design. A sample of 85 SMEs was selected using stratified random sampling technique. The study population was stratified as hardware businessmen, clothes dealers, general retail traders and others. The study employed questionnaires to collect data from the field. Data was typeset using a computer to ease preparation of the report. Data was then tabulated and presented using descriptive statistics. The results of the research indicate that more performing SMEs employs more than three permanent employees, have been in business for more than five years, has an annual revenue growth of more than 10% and are basically financial literate. Secondly the researcher establishes that there is a positive strong effect of financial literacy on SMEs performance exists. Finally the researcher report urges the providers of various financial literacy programs to consider implementing a program which fits the culture and traditions of the context targeted and avoid one size fits all because different SMEs have different experiences. County of Trans Nzoia should focus more on the secondary education where technical and vocational training should be done to develop artisans, entrepreneurs and managers for the informal sector in both rural and urban centers.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Small and Medium Enterprises (SMEs) are the main driving forces of economic growth & job creation that have a special importance, not only in developed countries but also in developing and emerging economies (Lockea,2012). SMEs in most countries have barriers to access to finance, difficulties in exploiting the technology, insufficient managerial capabilities, low productivity and regulatory burdens in their business environment.

According to Capital Market Authority (2010) Small and Medium enterprises form more than 99% of all enterprises in the world. Small and medium scale enterprises (SMEs) play an important role in the Kenyan Economy such as creating jobs, but face serious challenges such as finance setbacks, discrimination, problems associated with government regulation, tax and government levies, poor access to justice, and lack of education, among others. The economic pillar of vision 2030 initiative aims to improve the prosperity of all Kenyans through an economic development program, covering all the regions of Kenya, and aiming to achieve an average Gross Domestic Product (GDP) growth rate of 10% per annum beginning in 2010. It focuses on moving the economy up the value chain, addresses tourism, Agriculture, wholesale and retail trade, manufacturing, business process outsourcing (BPO), and financial services. SMEs in Kenya face challenges that hinder them from attaining economies of scale. They lack training and management capacity to manage the business resources effectively. Financial literacy therefore is regarded as one of the strategies used by bankers to provide knowledge and skills needed to change attitude and attract more potential users of agent banking.

Despite all these challenges SMEs have ability to fuel economic growth because they create new jobs, expands the tax base, and is drivers of innovation. According to Wanjohi (2011) SMEs enhance competition and entrepreneurship hence has external benefits on economy wide efficiency, innovation and aggregate productivity. They are the primary vehicles by which new entrepreneurs provide the economy with a continuous supply of ideas, skills, and innovations According to Normah (2007) the concentration of SMEs has a close relationship with the dominant economic activities. SMEs dominate the world economies in terms of employment and number of companies, yet their full potential remains remarkably untapped (Atsede et al, 2008).

1.1.1 Financial Literacy

Financial literacy refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. Making the right financial choices is very important decision in the life of individuals with long-term financial consequences. Management of financial of a firm is not an easy task; SMEs need to make a choice out of a large menu of financial needs of which many have complicated features. The SME Act (2011) was enacted to guide the provision of credit, capacity development for micro, small and medium enterprises in the country going forward to attaining vision 2030 (Republic of Kenya, 2012).Financial literacy provides knowledge and understanding of financial concepts and the skills, motivation and confidence to apply such knowledge and understanding in order to make effective decisions across a range of financial contexts and to improve the financial well-being of SMEs (Hogarth, 2002).

Mutegi et al (2015) affirms that financial literacy facilitates the decision making processes such as payment of bills on time, proper debt management which improves the credit worthiness of potential borrowers to support livelihoods, economic growth, sound financial systems, and poverty reduction. It also provides greater control of one's financial future, more effective use of financial products and services, and reduced vulnerability to overzealous retailers or fraudulent schemes.

According to Miller et al (2009), Facing an educated lot, financial regulators are forced to improve the efficiency and quality of financial services. This is because financially literate investors create competitive pressures on financial institutions to offer more appropriately priced and transparent services, by comparing options, asking the right questions, and negotiating more effectively. Investors on their part are able to evaluate and compare financial products, such as bank accounts, saving products, credit and loan options, payment instruments, investments, insurance coverage, so as to make optimal decisions.

1.1.2 Performance of Small and Medium Enterprises

SMEs are the backbone of the economy, providing a prime source of new jobs, playing a crucial role in income generation, reducing poverty by helping boost employment in rural areas and recognized as an engine of economic growth and development. Common SMEs include farming, hawking, public transport service, professional services such as lawyers and doctor, hospitality etc. Most SMEs operates in urban areas but majority of farming takes place in rural areas. Entrepreneurship cuts across all the demographics in Kenya. Men and women, young and old, educated and uneducated are all involved in entrepreneurship. Most small enterprises are family owned and are run by two or more employees who are mostly immediate family members.

The government of Kenya has recognized the importance of SMEs in creating employment and eradicating poverty in the country. It has provided initiatives that are aimed to spur growth in the sector. The youth fund and women fund are just examples of government efforts in supporting small enterprises. Policy recommendations of the government of Kenya as contained in its 7th National Development Plan on Divestiture and subsequently in Session paper No. 2 of 2005, advocates for the government to take leading role by providing an enabling environment for SME's market operations. This will require the establishment of infrastructure for access to markets, provision of work site structures, dissemination of market information through networks and innovation amongst other well-known strategies. The 2003–2007 Economic Recovery Strategy (ERS) for Wealth and Employment Creation provides the road map for economic recovery. The paper estimated that SSEs contribute 20 and 72% to the GDP and employment respectively. Hence, when the ERS anticipated creating 500,000 jobs annually, 88% of the targeted jobs were to be created in SSEs with the aim of reducing poverty rates from 56.7 to 51.8% (Ministry)

Performance is commonly used as an indicator of a firm's financial health over a given period of time. The performance of a firm can be defined or measured in various different ways. Each of these different measures captures a slightly different aspect of performance. Some, such as profitability, gauge return; others, like sales growth and market share growth, gauge the growth of a firm. Some measure profitability (return on investment, return on equity), some liquidity(quick ratio, current ratio), and still others solvency (gearing). Some measures are indicators of commercial success (growth, market share) while others are indicators of financial success (profitability).

Some writers believe that the performance of SMEs is measured by many factors such as internal and external to the SMEs themselves. They cited sales turnover, caliber of management and ability to meet daily obligations of the business. However, there are few studies on performance measurement of the SMEs and there is only small number of researches in developing countries (Muthoni, 2015).

Therefore, they also agreed that management control must take account of non-financial factors and be broadened to include strategic information, which will indicate whether or not the business will continue to be competitive. Mohinder & Anastasia (2007) also qualify multiple organizational financial performances like profit, cash flow and assets. Furthermore, Fabbri and Klapper (2008) added that profitability has been most widely used measure of financial performance of SMEs. Profitability is the excess revenue over expenses, which can be seen by the ratios like gross profit margin and pre-tax profit margin. They further argued that profits have got a lot of shortcomings as a measure of performance.

According to Wanjohi (2011), Most SMEs lack training and management capacity, so they have trouble managing funds secured for their business activities such as procuring raw materials and products, and investing in plant and equipment. SMEs are regarded as insecure and costly businesses to deal with because they lack financial management and have the capacity to absorb only small amount of funds from financial institutions. So they are rationed out in their access to credit because of lack of financial records, including the cost of monitoring and enforcement of loan contracts. A number of initiatives have also been advanced by the government, NGOs, and the private sector aiming at increasing access to affordable credit, and financial management to enable SMEs efficiently manage finances in their businesses. However, it is not clear whether these initiatives on financial literacy education have translated to better management of finances among SMEs,

1.1.3 Relationship between Financing Literacy and Performance of Small and Medium Enterprises

The government of Kenya has recognized the importance of SMEs in creating employment and eradicating poverty in the country. It has provided initiatives that are aimed to spur growth in the sector. The Uwezo fund, youth fund and women fund are just examples of government efforts in supporting small enterprises. These funds mainly provide mentorship opportunities to enable the beneficiaries take advantage of the 30% government procurement preference through its Capacity Building Programme. It is therefore, an avenue for incubating enterprises, catalyzing innovation, and promoting industry, creating employment, and growing the economy (Daily Nation, 2014). Many studies have mainly dwelt on importance of financial literacy and its effects on household or personal financial behavior with little or no theoretical and empirical study on financial literacy and entrepreneurial success.

According to Siekei (2013) credit management skills obtained through financial literacy programme enhance performance through acquisition of credit financing and management of loan portfolios to ensure that loan liability is minimized and interest expenses minimized. Budgeting skills are very significant in growing sales, profits and ensuring smooth running of the business. Financial literacy argues that the behavior of people with a high level of financial literacy might depend on the prevalence of the dual process theories which are; intuition and cognitive theories (Evans, 2008).

1.1.4 Small and medium enterprises in Trans-Nzoia County

SMEs in this area include farming, hawking, professional services such as lawyers and doctor, hospitality and public transport services commonly known as bodaboda. Most SMEs operates in urban areas but majority of farming takes place in rural areas. SMEs cut across all the demographics in Trans Nzoia County. Men and women, young and old, educated and uneducated are all involved in SMEs. Most small scale enterprises in this area are family owned and run by two or more employees who are mostly immediate family members. The financial training bodies are microfinance lending institutions such as Faulu, KWFT and SMEP (Small and Micro-Enterprise Programme), commercial banks such as Barclays Bank, Diamond Trust Bank, Cooperative Bank, Standard Chartered Bank, Kenya Commercial Bank (K.C.B), National Bank of Kenya and Equity Bank, SACCOs and county government.

The county government of Trans-Nzoia has recognized the importance of training SMEs in order to create employment and eradicating poverty in the country by training and funding them. It has provided initiatives that are aimed to spur growth in the sector. The youth fund and women fund are just examples of county government efforts in supporting small enterprises. A number of initiatives have also been advanced by the government, NGOs, and the private sector aiming at increasing access to affordable credit, and financial management to enable SMEs efficiently manage finances in their businesses. The county government of Trans-Nzoia has a growing recognition in the microfinance community that to develop successfully low income people need a wider range of integrated financial and non-financial services. A combination of expanded financial and non-financial services can help an entrepreneur succeed by: building their self-confidence; increasing their income, productivity, and employment; and ultimately facilitating the personal growth of the entrepreneur.

1.2 Research Problem

Despite the role played by SMEs, it’s been characterized by a number of challenges one of them been lack of financial information and business records. Wanjohi (2011) cites lack of adequate business skills as a major challenge in the development and growth of SMEs. This is mainly attributed to low levels of education basically lack of adequate information and business records. The CMA (2010) has also identified that SMEs in Kenya suffer from constraints that lower their resilience to risk and prevent them from growing and attaining economies of scale. Challenges associated with access to financial information are constrained by both internal and external factors. Therefore, this makes it difficult for them to achieve their performance in term of liquidity, long term solvency and profitability hence leading to lost business opportunities, and failure to grow in terms of size and financial resources (Badagawa, 2008).

However, empirical studies on the impact of financial literacy on performance of SMEs in Kenya are limited. Mutegi et al (2015) Banks like Equity and micro finance like Faulu, SMEP and KWFT have established separate units to be more responsive to the needs of their SME clients, in recognition of the inherent differences between SMEs, consumer and corporate clients. Obstacles to SMEs performance include lack of adequate information and business records, the most important deterrent to banks' involvement with the SME segment. Such is the perceived extent of the problem that banks and micro finance institutions have allocated internal budgetary resources to assist SMEs through the extension of training services (Equity Bank, 2012).Most banks and micro finance institutions have allocated resources to provide training to their SMEs clients to improve their book keeping and financial management skills (Rocha, 2011).

A comparison of the situation of SMEs financial literacy in developing countries and developed countries shows a mixed picture. Liedholm and Mead (2005) in the review of national surveys conducted in several African countries estimate that between 17% - 27% of the working population was employed in SMEs is financial literate, being nearly twice the employment of large scale enterprises and public sector. The United States Agency for International Development (USAID) considers that SMEs employ a third or more of the labour force in low income countries (USAID, 2010). In Kenya, Nasirembe (2007) indicated that the MSE sector employs around 2.3 million people and generates around 14% of the country’s Gross Domestic Product (GDP).

Although, a considerable number of research reports have mentioned lack of information and business records as the major problems in SMEs, a survey of literature dealing with this area indicates there is a significant gap in knowledge of the effects of financial literacy on performance of SMEs. The question that begged for answers therefore is what are the effects of financial literacy on performance of SMEs in Kenya?

1.3 Objective of the study

To examine the effect of financial literacy on performance of Small and Medium Enterprises in Trans-Nzoia county

1.4 Value of the study

The study will help training institutions in understanding the significance of financial literacy to performance of SMEs. It will also help academicians in establishing the relevance of curriculum taught in business schools to the actual business world.

Considering that the vast majorities of SMEs are in the informal sectors where SMEs has no or only have basic education, the government policy makers will find out whether the basic financial education taught in school has any bearing to SMEs performance. The study will further establish whether there is need for financial literacy programs amongst SMEs in a bid to stimulate growth in the sector.

Nevertheless, the research add to the existing literature and provide background information to research organizations and scholars who will need to carry out further study on SMEs financial performance as a key area of development. For instance, a research on SWOT analysis should be conducted on the SMEs finance situation in the country, using lenders (financial institutions) and borrowers (SMEs) to ascertain how financial literacy in the country is characterized by problems associated with risk, information, fund availability and government's policies.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents studies conducted in an attempt to understand the effects of financial literacy on performance of SMEs. We also dig deeper in understanding the concept of SMEs and what it entails.

2.2 Theoretical Review

SMEs have long been perceived little more than an applied trade as opposed to an academic area of study. For a long time there was no research to be accomplished because it was thought that those who could not attend college would simply practice the concept of new business start-up (Kuratko 2009). Due to SMEs critical role in economic growth, many research studies have now been carried out to deepen understanding of SMEs. In this study we review some of the concepts that are relevant to our proposal.

2.2.1 The Agency Theory

Jensen and Meckling (1976) identified two types of agency conflicts. The first focuses on the conflict between shareholders and managers and the second on the conflicts between equity-holders and debt holders. Conflicts between shareholders and managers arise because managers do not hold total claims thus they cannot capture the entire gain from their value maximizing activities. The second type of conflict arises between debt holders and equity holders because debt holders give equity holders an incentive to invest sub optimally. The debt contracts results in asymmetric distribution of the gains, that is if an investment is profitable above the face value of debt, most of the gains is captured by equity holders, while if the investment fails, debt holders bear all the consequences because the limited liability of the equity holders. Thus, equity holder may benefit from investing in very risky projects, even if they are value-decreasing. Such investment results in a decrease of the value of debt, while the loss in the value of equity due to poor investment is more than offset by the gains in equity value transferred from debt holders.

Agency problems such as asymmetric information and moral hazards can impact negatively on the financial performance of SMEs (Stiglits and Weiss, 1981). In general, agency theory is related to the problem that occurs when cooperating parties have different goals and a division of labor. Specifically, the agency theory focuses on the relationship in which one or more persons (the principal) engage another person (the agent) to perform some work on their behalf. The basic premise of agency theory is that both principals and agents are assumed to be rational economic-maximizing individuals.

Therefore, the separation of ownership and control will result in decisions by the agent which are not always in the principal's best interest and there will arise costs (agency costs) of bringing the agent's behavior into line. For example, costs arise which are incurred by the principals when monitoring and controlling the behavior of the agent (so-called monitoring costs), and costs incurred by the agent in demonstrating compliance with the wishes of the principal (so-called bonding costs).

The agency theory has its roots in information economics, and the theory has developed along two lines; positivist and principal-agent research. The two approaches share a common unit of analysis and use the same agency cost minimizing tautology, but differ in their mathematical strictness. Positivist research is less mathematical and more empirically oriented than principal-agent research. The positivist researchers have focused mainly on the principal-agent relationship between owners and managers of large corporations whereas principal-agent researchers are concerned with a general theory of the principal-agent relationship. According to Jensen and Meckling (1976), the relationship between the owners and the management involves the delegation of some decision-making authority to the agent by the principal. One critique of the agency approach is that the analytical focus on how to resolve financial literacy problem is too narrow and the shareholders are not the only ones who make financial decisions in the company therefore financial literacy will be affected by the relationships among the various stakeholders in the firm.

One of the core issues in the agency theory concerns the principals' possibilities to monitor the agent's behavior. Monitoring refers to the principals' ability to determine whether the agents have lived up to the provisions of the contract and to prevent the agent's misuse of assets dueto conflicts of interest. In monitoring refers to more than just measuring or observing the behavior of the agent. It also includes efforts to "control" the behavior of the agent through budget restrictions, operating rules, In the case were the principal does not have complete information about the agent's behavior, as in the case of external investors, two options exist; to put the agent's behavior under surveillance (e.g., through reporting procedures, and board of directors), or to reward the agent based on outcomes(e.g., profitability).

Following such reasoning Ouchi (2002) suggests two underlying monitoring strategies. The strategy can be either behavior or outcome based. The behavior-based strategy refers to an agreement between the principal and the agent which concerns a certain behavior that in some way will be rewarded, whereas outcome-based strategy refers to the principal's measurement of certain outcomes and the reward will be based on this measurement. According to Ouchi (2002), the choice between the strategies depends on two dimensions; knowledge of transformation process and availability of output measures. To use a behavior-based strategy, that is, to continuously observe the agent's behavior, the principal requires a causal knowledge of what is required to attain a desired outcome. When the principal uses outcome-based strategy, for example, to measure the agent's attained results, the transformation process need not be known at all, buta reliable and valid measure of the desired outputs must be available.

2.2.2 Goal Setting Theory

More recently, expectancy theory has been integrated with goal setting theory (Hollenbeck, 1987). Goal setting theory is grounded in the belief that conscious goals and intentions drive results. Based on the goal setting theory of motivation, Locke (1986) and Locke and Latham (1990) find that individual goals are likely to determine how well they perform to related tasks. Specifically, clearly defined and more challenging goals yield higher performance than vague, easy or do-your -best goals. To be effective, goal setting theory assumes that individuals must be committed to the goal, must get feedback and must have the ability to perform the task. This means that financial literacy programs should be more effective when they are motivated by perceptions and concerns about financial well-being later in life.

Motivational theory suggests that measures of financial literacy should be related to financial behavior that is in the consumers" best interests. Hilgert, Hogarth and Beverly (2003) formed a *Financial Practices Index* based upon (self-benefiting) behavior in cash flow management, credit management, saving and investment practices. When they compared the results of this index with scores on financial literacy quiz, they found a positive correlation between financial literacy scores and Financial Practices Index Scores. Their results suggest that financial knowledge is related to financial practices.

2.2.3 The Expectancy Theory of Motivation

Motivation has long been recognized as a key driver of individual behavior. Starting as early as Tolman (1932) and Lewin (1938), expectancy theory ties perception to behavior. Since then, extensive academic research has been focused on developing the understanding of motivation. Further work by Vroom (1964) on the force model and Samuelson (1967) on the utility model provides a theoretical grounding for explaining the motivational influences underlying human behavior as a function of expectancy, instrumentality and valence or utility.

Expectancy relates to the expectation or likelihood that specific actions or states of nature will yield a certain outcome, meaning that performance is based on effort. Instrumentality relates to the relation between performance and reward, meaning that outcome is based on performance. Valence and/or utility relates to the value of importance the individual places on the perceived outcome. Based on these theories, individuals are motivated by things that can successfully lead to valued outcomes (Mandel & Klein, 2007).

Financial literacy imparts individuals with the skills and knowledge to help them make key decisions that affect their lives. According to this theory therefore, the impact of financial literacy programs depend on the expectations individuals have on the program and the expected reward of the outcome (Mandel et al, 2007). This means that if individuals perceive financial literacy to enhance the quality of their decisions, they would be motivated to partake of them and this improves on their long term perceived outcome (financial freedom).

This study will be anchored on the expectancy theory since the targeted respondents exhibit reasonable levels of financial literacy hence would be expected to employ their expertise in the management of their personal finances i.e. expenditure and investment planning resulting into high financial freedom. The high financial freedom would result into a more motivated workforce hence high productivity among employees of Equity Banks in Kenya and beyond.

2.2.4 The Knowledge Spillover Theory

In this theory the creation of new knowledge expands the set of technological opportunity. Performance of SMEs activity does not involve simply the arbitrage of opportunities, but also the exploitation of intra-temporal knowledge spillovers not appropriated by incumbent firms. The theory focuses on individual agents with endowments of new economic knowledge as the unit of analysis in a model of economic growth, rather than exogenously assumed firms. Agents with new knowledge endogenously pursue the exploitation of knowledge. This suggests that knowledge spillovers come from the stock of knowledge, and there is a strong relationship between such spillovers and performance of SMEs. If incumbent firms appropriated all the rents of R&D, there would be no intra-temporal knowledge spillovers (Zoltan et al 2008).This theory will help in determining whether the knowledge spillover affects performance of SMEs in Trans Nzoia County. It will also help us understand the distinction between financial literacy and economic knowledge.

2.3 Determinant of performance in SMEs

SMEs are motivated by different things depending on the type of entrepreneurship involved. An artist can be motivated by need to express talent while a farmer may be motivated by desire to generate income. SMEs basic determinant is desire and willingness to become entrepreneur. Individual personality also acts as motivation to business, and those people who are willing to precede despite odds might be more optimistic or higher in self-efficacy than people deterred by these odds.

2.3.1 Budgeting Skills

Studies done indicate that SMEs beneficiaries tend to acquire budgeting skills related to business planning for profit, financing and cash flow. The moderately low level of budgeting skills imply that, although the skills are emphasized during the training, the content may not be sufficient in handling the planning aspects in SMEs, orthe focus was more on personal budgeting rather than business. Budgeting skills play a key role in enhancing the performance of SMEs. The budgeting skills acquired assist the entrepreneurs to increase their sales, and business profitability by providing a basis of establishing performance targets. Furthermore the budgeting skills contribute towards ensuring smooth running of the business (Siekei, et al, 2013).

2.3.2 Record Keeping

All over the world, Kenya not being exempted, many new business owners are daunted by the mere idea of record keeping and accounting. But in reality, both are pretty simple. Record keeping and accounting share two basic goals: to keep track of income and expenses, this 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 they accurately reflect the business's income and expenses. There is a requirement, however, that some businesses use a certain method of crediting their accounts: the cash method or accrual method. Based on the size of the business and amount of sales, one can create own ledgers and reports, or rely on accounting (Williams et al., 1993).

An accounting system records, retains and reproduces financial information relating to financial transaction flows and financial position. Financial transaction flows encompass primarily inflows on account of incomes and outflows on account of expenses. Elements of financial position, including property, money received, or money spent, are assigned to one of the primary groups that is assets, liabilities, and equity. Within these primary groups each distinctive asset, liability, income and expense is represented by 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 (Williams et al., 2008). There are account types that include real accounts which represent physically tangible things in the real world and certain intangible things not having any physical existence.

SMEs are a large contributor to both the Kenyan and the global economies and their importance is noted in every country. SMEs make a substantial contribution to the economy in terms of job creation, GDP, investment and social welfare (Nieman, 2006). According to the African Development Bank (2005), SMEs contribute more than 55% of total employment and 22% of the Gross Domestic Product in Kenya. Since they are so important to the economy, their creation is very important as it a positive move towards economic growth. However there is a need to keep these SMEs in operation and avoid failure. Lack of skills has been a major challenge to the SMEs (Smith and Perks, 2006) and skills acquisition through training can provide a long lasting solution to the survival battle of the SMEs. Due to various reasons, some SMEs end up closing down business at an early stage. This could result from the view that the entrepreneur miscalculated the opportunity, and unforeseen threats that are too big for the business to overturn, lack of essential information on running the business and lack of proper funding of the business.

A look at the Kenyan context shows that there are a lot of other issues that may appear insignificant when the business is starting which can bring down the business at the end. Seemingly there is a lot that needs to be done in all fields that may prevent the loss of jobs, revenue and increase of poverty in the communities by preventing failure in the SMEs. Apart from the financial problems that may affect the businesses, the input of the owner and the business skills (Smith and Perks, 2006) are very important in keeping the business afloat.

The purpose of this study was to examine the important financial analysis skills including financial risks management. The study would help new SMEs in the industry to be able to survive and keep growing finances, thus benefiting the province in development, employment and the country in revenues. These skills do not only promote business and manufacturing efficiency success but also efficiency and benefit the country at large. Therefore, it was, of great importance to assess and specify success factors that promote efficiency and survival of SMEs that could serve as benchmarks for emerging SMEs. It went further to assess whether training can play role in the acquisition of these skills by entrepreneurs.

2.3.3 Debt Management Strategies

Idowu (2010) claims, that a major barrier to rapid development of the small and medium enterprises sector is a shortage of both debt and equity financing. Accessing finance has been identified as a key element for small and medium enterprises to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing countries. Small business especially in Kenya and Africa as a whole can rarely meet the conditions set by financial institutions, which see small and medium enterprises as a risk because of poor guarantees and lack of information about their ability to repay loans Idowu (2010). Without finance, small and medium enterprises cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms Idowu (2010).

According to Cork and Nixon (2000), poor management and accounting practices hamper the ability of smaller enterprises to raise finance. This is coupled with the fact that small businesses are mostly owned by individuals whose personal lifestyle may have far reaching effects on the operations and sustainability of such businesses (Idowu, 2010).

Given the myriad of challenges faced by SMEs and the central role played by their managers, (who are often the owners of the business), having sound credit management skills cannot be over emphasized. A number of researchers such as García (2005) and Pansiri & Temtime (2008) have found that a lack of appropriate skills for SME owner managers is one of the main causes of failure for SMEs. Fatoki and Odeyemi (2010) define managerial competencies as sets of skills, attitudes, behaviors and knowledge that contribute to the effectiveness of an individual. According to these two authors, managerial skills play a key role in the success of small enterprises as they determine its growth. Likewise, (Fatoki and Asah, 2011) point out that lack of managerial skills, personal qualities and skills are major contributors to the failure of firms. Lack of managerial competence reduces the ability to develop sound plans and strategies for effective management of SMEs. Fatoki and Odeyemi (2010) explain that managerial skills influence business planning as well as the ability of the firm to obtain knowledge regarding sources of finance and means of obtaining it. As such, managerial skills do affect access by new small firms to financing.

2.4 Empirical Review

Fidler and Webster (1996) advocate that in many cases, basic business skill training should accompany the provision of micro loans to improve the capacity of the poor to use funds. Micro enterprise investment training mainly addresses capital investment decisions, general business management and risk management. Capital investment decisions include allocation of the microenterprise limited capital funds most effectively in order to ensure the best return possible. Therefore, a wrong decision can have long lasting effect not only on the profits but on very survival of the enterprise.

Bowen et al. (2009) researched on Management of business challenges among small and micro enterprises in Nairobi Kenya. The findings of the research indicated that over 50% of SSEs continue to have a deteriorating performance with 3 in every 5SSEs failing within months of establishment. Only 2.5% respondents saying their businesses were very successful. The results also showed that 49.5% of those who had received training in their areas of business reported that their businesses were doing well hence the conclusion that relevant training or education is positively related to business success and recommendation that of the need for SSEs owners to get trained in an area that is relevant to the business carried.

Simeyo et al (2011) in their study of the effect of provision of micro finance on the performance of youth micro enterprises under Kenya Rural Enterprise Program (KREP)in Kisii County using a sample of 86 youth micro enterprises established that training in micro enterprise investment had a significant positive impact on the performance of the microenterprises with a standardized beta coefficient of 0.281which indicated that a unit increase in the provision of training to SSEs resulted to a28.1% increase in performance. The study further established that majority of the respondents were very satisfied with the provision of capital investment and basic business skills training in micro enterprise investment. This suggests that the business skill training accompanying the provision of micro loans most likely improves the capacity of the entrepreneurs to use funds and hence impacts on business performance.

In terms of business risk management, the results showed that respondents were moderately satisfied in terms of achievement of business risk management skills. With the implication that the youth micro entrepreneurs were inadequately equipped with knowledge and skills of business risk management hence are unable to adequately deal with business risks and therefore in the event that such risks occur, their microenterprises are significantly affected.

In a study to investigate the effect of business development services on the performance of Small Scale enterprises in Kisii Town Osinde et al (2013) found out that the entrepreneurs who received business development services recorded an improvement in the growth of sales and growth in market shares on the various businesses they were operating. The study further established that those who attended the training services recorded an improvement in their businesses in terms of growth in sales and profits with 83.3% of the respondents who always attended training reporting to have good growth in profits as opposed to only 41.2% of those who never attended training.

Bruhn and Zia (2011) in their study on the Impact of Business and Financial Literacy for Young SMEs in Bosnia and Herzegovina found that business outcomes and practices is the difference in effects of the training on individuals with below and above median financial literacy at baseline. They also found that both entrepreneurs with below and above median financial literacy changed some of their business practices, such as separating personal accounts from business, and making investments in their business;

however, only entrepreneurs with above median financial literacy at baseline reported increases in sales and profits as a result of the training. These findings suggest that baseline knowledge and information conveyed in the financial training act as complements in increasing the productivity and sales of a business.

They also found out those SMEs with relatively high ex-ante financial literacy exhibit improvements in sales due to the training program. While business training does not impact the extensive margin, it has significant effects on existing entrepreneurs, and on specific aspects of their businesses. Teaching entrepreneurs the value of capital investment indeed encourages them to change business practices that allow for greater innovation, for instance by implementing new production processes and making personal investments in the business. Since the study findings have shown that business development services have an influence on business performance the study recommends that the Kenyan government through the Ministry of Trade should provide training programs for the owner-managers and managers of SSEs so as to help polish their knowledge in financial management and other managerial skills. Field officers should be recruited to coordinate and monitor the provision of training, advice, counsel and provide other non-financial services to these small business operators.

2.5 Summary of Literature Review

These theories respond to the financial functions of SMEs to be performed in order ensure that they survive or be competitive amongst each other. Many studies have been carried out and considerable varieties of SMEs financial functions are under discussion. Many studies have concentrated on SMEs success factors as well as the causes of high rate of SMEs failures. However considerable number researches have studied the effect of business knowledge on SMEs but no direct study on financials literacy and SMEs performance. There are also no specific theories that talks about financial literacy and SMEs performance. Many scholars have only concentrated on entrepreneurism as a concept. No studies have been directly carried out to establish the effects of financial literacy on performance of SMEs in Trans Nzoia County. In this paper we will try to establish the relationship of the two variables by asking the question: Does financial literacy translates to performance of SMEs in Trans Nzoia County?

Financial literacy programs target nearly every segment of society, and in particular, youth, employees, and underserved populations in the financial markets. Yet, research has not yet effectively demonstrated whether this diversity in programming is appropriate or effective. More research is needed to better identify which populations financial literacy providers should be targeting with financial literacy programs. Should the focus be on providing a certain level of general financial literacy to all individuals such as formal financial education in the schools? Should those who are most in need of financial education be given priority? What do these various target populations need to know? Also, very little research has investigated issues related to program participation. In particular, more research is needed to better understand why some programs are better at reaching certain target populations than others and how these “best practices” can be applied to improving participation and retention in other programs. What are the most effective ways to reach various target populations? Are current financial education efforts effectively reaching those who need financial education the most? Why or why not? Current research has not adequately addressed these issues.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter discusses the research strategy and design, survey population, sampling design, sample size, sampling procedure, data sources, data collection method and tools, data processing and analysis as well.

3.1 Research Design

The researcher used a cross-sectional study design. The purpose of this research was to analyze the effect of financial literacy on performance of SMEs in Trans Nzoia County. As a broad group, SMEs can be categorized into several distinct sub groups based on type of activity. Given these circumstances, a cross-sectional study design is the most appropriate. This however was combined with other design type.

The descriptive study design was applicable also since the study is aimed at providing a clearer picture of SMEs financial literacy. Similarly, element of an analytical study design was employed to establish the relationship between financial literacy and performance of SMEs.

3.2 Target population

This study will be carried out in Kitale town, Trans Nzoia County. The town center has Four(4) major markets comprising of a high concentration of all types of SMEs in major sub sectors like commerce/trade, service and manufacturing. The researcher chose the four centers for easy of making reliable conclusions. These centers are Soko mjinga, Nyayo market, Municipal market and Jua kali markets.. The researcher will employ stratify sampling which will be based on the SMEs. The sampling frame will comprise of 665 SMEs operating within Trans Nzoia County. A sample of 85 SMEs was selected using stratified random sampling technique. The study population was stratified as hardware businessmen, clothes dealers, general retail traders and others.

3.3 Sampling

To ensure representation of various strata in the population, a stratified random sampling technique was employed. The population was divided into four categories based on their principle commercial activities. These are hard ware dealers, clothes dealers, general retail traders and milk dealers.

3.4 Data collection

Primary data was collected from eighty five samples randomly picked in Trans Nzoia county and included both formal and informal sectors. Simple questionnaires were distributed amongst the respondents and face to face interview conducted. Drop and pick method was also used in the administration of questionnaire. Telephone interviews were also used especially where there was geographical and time constraints. Data collected was annual revenue turnover, years of business, number of employees as well as answers to seven simple financial literacy questions. Primary data source provided first hand data and much of the conclusion is be based on this source. Primary data is from questionnaires and interviews which were distributed to SMEs. Questionnaires were supplied to the respondents with an intention to capture their opinions on the effects of financial literacy on their performance. Interviews involved face to face interaction with the respondents. This was particularly important when talking to respondents who were financial illiterate. Interviews was also helpful in situations where the respondents had no enough time and also in cases where certain terms and language used in the questionnaires are not vividly enough. Secondary data source provided supplementary data to the primary source. The secondary data sources involved the use of internet, textbooks, newsletters, previous research on performance of SMEs and other relevant documented data on financial literacy.

3.5 Data processing, presentation and analysis

Raw data collected from the field was processed both manually and with the help of computer based programmes to ensure quality, completeness and accuracy. Manual processing involved collating and tabulating the information from the questionnaires. Responses were enumerated according to pre-coded categories, intervals or commonality of responses in the case of open-ended questions. For computer processing, a data logging sheet was manually prepared and the information entered on a spreadsheet on a micro-computer.

The analysis was done using descriptive statistics where mean mode standard deviation and variance were used. Simple regression analysis was done to determine statistical relationship between dependent and independent variables. SPSS (Statistical Program for Social Sciences) Version 16.0 was be used to obtain coefficients and regression analysis.. In most cases, these figures are also expressed as ratios or percentages of the total number of the respondents for ease of comparison. In a few cases, statistics of central tendency and variability will work out and presented.

To achieve this, both qualitative and quantitative techniques was used to analyze the data. It involve the use of statistical techniques and management science methods like MS Excel in obtaining frequency distribution tables which will be used to determine the most frequently employed method of financial literacy.

Performance of SMEs was determined by analyzing answers to five questions in the attached questionnaire. Each answer had a score of 1 to 20, SMEs with higher score was deemed to have a higher performance and vice versa. Financial literacy was also determined by scoring answers against ten questions that was provided in the questionnaire. Each answer have a score of 1 to 10, entrepreneurs with the highest score was deemed to be more financially literate and vice versa.

The Correlation analysis was employed so as to ascertain the accuracy of the data. The correlation statistics obtained was used to explain the degree of relationship between the dependent and independent variables. The regression equation of the form of

$$\mathbf{Y=\beta_0+ \beta_1X_1+ E}$$

where Y= Performance of SMEs (measured in number of Employees ,growth in market size and measured by years in business,)

X_1=Financial literacy (measured by scoring financial literacy questions)

β_1 = coefficient

β_0= is a constant term and

E=Error term in the equation

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

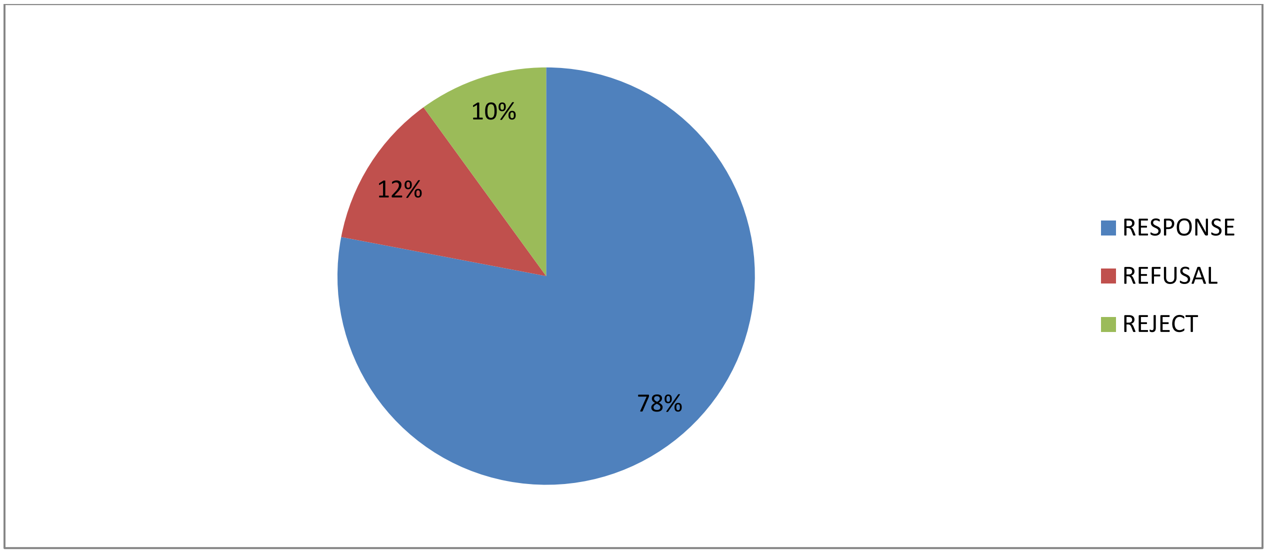
4.1 Introduction

In this chapter we analyze data collected by from sixty six SMEs licensed by Tranzoia County. Performance is measured by scoring the answers to five questions that are aimed to determine the level of firm's performance. The answer to two questions (question 19 and 20) is scored between 0, 5, 10 and 20 points, question 21 and 23 scores ranges from 5, 10 and 20 points, question 22 is based on revenue growth in percentage per 20 points and then total percentage score is given. Financial literacy data is provided by scoring answers to simple financial literacy questions that tests knowledge in financial market. Each correct answer is scored 10 points and incorrect answer zero point in question 9, 13, 14, 16, 17 and 18 while the remaining questions scores ranges from 0, 3, 5, 7 and 10 per question and then percentage aggregate score is then given for all the questions as shown in the score card (appendix),

4.2 Rate of Respondents

From a sample size of 85 samples, 66 samples were collected while 9 samples were discarded for having no useful information, 10 respondents refused to respond. The total rate of response was 78% and therefore considered successful.

Figure 4.1 Rate of respondents



Source: Research Findings

4.3 Descriptive Analysis

In this analysis we describe the basic features of the data in a study by simple summaries about the sample and the measures.

Table 4.1 Descriptive statistics

	N	Range	Minimum	Maximum	Sum	Mean		Std. Deviation	Variance	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error
Financial Literacy	66	68.00	32.00	100.00	4580.00	69.3939	2.02662	16.46430	271.073	-.071	.295
Performance	66	75.00	20.00	95.00	3943.00	59.7424	2.04817	16.63944	276.871	-.577	.295
Valid N (listwise)	66										

The total numbers of samples were 66 with a minimum score for financial literacy score and performance as 32 and 20 respectively while maximum score for financial literacy being 100% and performance 95%. Average mean score for performance was 75% and 68% for financial literacy. Standard deviation was 16.638% and 16.464% for performance and financial literacy respectively.

4.4 Correlation Analysis

In this analysis we determine the extent to which changes in SMEs performance is associated with changes in financial literacy. To quantify the strength of the relationship between the variables, the study used Karl Pearson's coefficient of correlation. The Pearson product-moment correlation coefficient (or Pearson correlation coefficient for short) is a measure of the strength of a linear association between two variables and is denoted by *r*. The Pearson correlation coefficient, *r*, can take a range of values from +1 to -1. A value of 0 indicates that there is no association between the two variables. A value greater than 0 indicates a positive association, that is, as the value of one variable increases so does the value of the other variable. A value less than 0 indicates a negative association, that is, as the value of one variable increases the value of the other variable decreases.

The Pearson's coefficient was used to verify the existence or non-existence of linear correlation between and among the variables. The findings are presented as follows;

Table 4.2 Correlations

		Financial literacy	Performance
Financial literacy	Pearson Correlation	1	.772**
	Sig. (2-tailed)		.000
	N	66	66
Performance	Pearson Correlation	.772**	1
	Sig. (2-tailed)	.000	
	N	66	66

**. Correlation is significant at the 0.01 level (2-tailed).

Results from table 4.2 above reveal that there is a significant positive relationship between annual number of house units build and annual housing loans allocated ($r = .772^{**}$, P-value < 0.01). In this finding the correlation between performance rate and financial literacy is significant at 0.01 levels (2-tailed). This implies that change in performance score is attributable to financial literacy. Further, since the r value is so small (less than 0.5) there is consequently no evidence of multi-co linearity and hence the following regression analysis.

4.2.2 Regression Analysis

Regression analysis is the statistical technique that identifies the relationship between two or more quantitative variables: a dependent variable, whose value is to be predicted, and an independent or explanatory variable (or variables), about which knowledge is available. The technique is used to find the equation that represents the relationship between the variables. Multiple regressions provide an equation that predicts one variable from two or more independent variables.

Regression analysis is used to understand the statistical dependence of one variable on other variables. The technique can show what proportion of variance between variables is due to the dependent variable, and what proportion is due to the independent variables. The relation between the variables can be illustrated graphically, or more usually using an equation. The study adopted simple regression guided by the following model:

$Y=\beta 0+ \beta 1X1+ E$ where Y= Performance of SMEs (measured in number of Employees ,growth in market size and measured by years in business,)

X1=Financial literacy (measured by scoring financial literacy questions)

$\beta 1$ = coefficient , $\beta 0$= is a constant term and E=Error term in the equation

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.772[a]	.597	.590	10.65122

a. Predictors: (Constant), Financial literacy

Table 4.3 provides R and R^2.The R value is 0.772 which represents the simple correlation. It indicates a higher degree of correlation. The R^2 value how much of the dependent variable (performance) can be explained by the independent variable (financial literacy). In this findings 59.7% can be explained which is large. The independent variables studied explain only (59.7%) of the effects of financial literacy on the performance of SMEs in Trans Nzoia County as represented by R^2. This means that the other variables not studied in this research contributed (40.3%) and thus further research should be conducted to investigate these other effects of financial literacy on the loan performance of SMEs in Trans Nzoia County.

Table 4.4 ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	10735.913	1	10735.913	94.632	.000[a]
	Residual	7260.708	64	113.449		
	Total	17996.621	65			

a. Predictors: (Constant), Financial literacy

b. Dependent Variable: Performance

Table 4.4 indicates that the regression model predicts the outcome variable significantly well. The "Regression" row and go to the Sig**.** column indicates the statistical significance of the regression model that was applied. Here, $p < 0.0005$, which is less than 0.05, In this case, it indicates that the model applied can statistically significantly predict the outcome variable.

Table 4.5 Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.575	5.721		.974	.333
	Financial literacy	.781	.080	.772	9.728	.000

a. Dependent Variable: Performance

Table 4.5 present results of the simple linear regression of effect of financial literacy on performance. We can see that both the constant and financial literacy contribute significantly to the model by looking at the Sig. column. We can derive a simple regression analysis equation from column B as $Y=5.575 + 0.781X$

4.6 Interpretations of the Findings

From a sample size of 85 samples, 66 samples successfully provided data that is useful for this study. The main objective of this study was to examine the effect of financial literacy on performance of Small and Medium Enterprises in Trans-Nzoia County. Data collected for SME performance included the market share, profitability, the numbers of years each SME have been in business, number of permanent employees for each business, and the rate of revenue growth in the first five years of business. Data collected for financial literacy included answers to simple financial literacy questions that covered debt management, record keeping and budgeting skills

The minimum score for financial literacy is 32% with a maximum score of 100%, while on average the financial literacy score was 69%. With such a high average score, it implies that on average most SMEs in Trans Nzoia County are financially literate and understands the basic financial concepts. This is further explained by the fact that there is also a significant number of SMEs with 100% score in financial literacy, especially the ones operating in formal sector. On the other hand, the lowest score for SMEs performance is 20%, maximum score was 95% while average score was 59.74%. This means that on average, most SMEs in Trans Nzoia County are highly performing and have been in business for more than five years, have experienced high revenue and market share growth in the first five years, and have at least 3 permanent employees.

As shown in table 4.4 above, correlations between financial literacy and SMEs performance R at 0.772 and R^2 at 59.7%, this means that significant amount of SMEs performance can be explained by financial literacy. In table 4.5, the results indicate that there is a linear relationship between SMEs performance and financial literacy. It further suggests that the model applied can statistically significantly predict the outcome of the outcome variable. Further, Table 4.6, shows that both constant and financial literacy contribute significantly to the model and that SMEs performance can be predicted by using a linear equation SMEs Y(Performance)= 5.575 + 0.781X(financial literacy). In general the finding shows that there is a strong positive relationship between financial literacy and performance of SMEs in Trans Nzoia County.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of data findings, conclusions based on the findings and recommendations there-to. The chapter also presents recommendations on further studies. The aim of the study was to examine the effect of financial literacy on performance of small and medium enterprises in Trans Nzoia County.

5.2 Summary of Findings and Interpretations

The main objective of this study was to examine the effect of financial literacy on performance of small and medium enterprises in Trans Nzoia County. From a sample size of 85 samples, 66 samples successfully provided data that is useful for this study. The main objective of this study was to examine the effect of financial literacy on performance of Small and Medium Enterprises in Trans-Nzoia County. Data collected for SME performance included the market share, profitability, the numbers of years each SME have been in business, number of permanent employees for each business, and the rate of revenue growth in the first five years of business. Data collected for financial literacy included answers to simple financial literacy questions that covered debt management, record keeping and budgeting skills

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In correlation analysis table, its shows that the correlation between performance rate and financial literacy is significant at 0.01 levels (2-tailed). This implies that change in performance score is attributable to financial literacy. Further, since the r value is so small (less than 0.5) there was consequently no evidence of multi-co linearity.

As shown in regression analysis, correlations between financial literacy and SMEs performance R at 0.772 and R^2 at 59.7%, this means that significant amount of SMEs performance can be explained by financial literacy and 40.3% is explained by other factors.

From coefficients analysis table, the results indicate that there is a linear relationship between SMEs performance and financial literacy. However taking the independent variable at zero, then a unit increase in financial literacy will lead to 0.781 increases in performance. It is in agreement with the study done by Simeyo (2011) his study came out with a significant positive impact on the performance of the microenterprises with a standardized beta coefficient of 0.281which indicated that a unit increase in the provision of training to SSEs resulted to a28.1% increase in performance. It further suggests that the model applied can statistically significantly predict the outcome of variable. Further, Table 4.6, shows that both constant and financial literacy contribute significantly to the model and that SMEs performance can be predicted by using a linear equation SMEs Y(Performance) = 5.575 + 0.781X(financial literacy).

In general from the research findings, it's evident that a positive strong effect of financial literacy on SMEs performance exists. The finding shows that more performing SMEs employs more than four permanent employees, have been in business for more than five years, has an annual revenue growth of more than 30% and are basically financial literate. Majority of these SMEs are in formal sector, able to get funds from formal borrowings and are run by well educated businessmen that understands financial concepts such as budgetary skills, record keeping skills and debt management. On the other hand, the SMEs whose performance score was low also scored low in financial literacy. These SMEs are mostly small enterprises run by one or two family members in the informal sector and runs small shops such as milk bar shops, boutiques, small shops etc, and have recorded minimal or no growth over the years and also have been in operation in less than five years.

The study further established that those who attended the training services recorded an improvement in their businesses in terms of growth in market share, profits and revenue. The findings of this study agree with those of Osinde (2013) who found out that 83.3% of the respondents who always attended training reporting to have good growth in profits as opposed to only 41.2% of those who never attended training.

5.3 Conclusion

This study concludes that there is a strong positive effect of financial literacy on performance of SMEs. SMEs that are more successful are run by entrepreneurs who are financial literate and understand key financial concepts that include, risk management, debt management, record keeping and budgetary skills. Financial literacy regarding the budgeting skills assist in reducing the SMEs running costs and ultimately enabled advance planning on loan repayment. In addition, financial literacy skills enhanced the ability to do a self internal audit that enabled beneficiaries to identify resource leakages and ensure proper channeling of resources towards credit management. This revelation appears to compliment Miller's (2009) argument that financial literacy helps in empowering and educating investors so that they are knowledgeable about finance in a way that is relevant to their business and enables them to use this knowledge to evaluate products and make informed decisions. It is widely expected that greater financial knowledge would help overcome recent difficulties in advanced credit markets. Financial literacy prepares investors for tough financial times, through strategies that mitigate risk such as accumulating savings, diversifying assets, and purchasing insurance. Financial literacy facilitates the decision making processes such as payment of bills on time, proper debt management which improves the credit worthiness of potential borrowers to support livelihoods, economic growth, sound financial systems, and poverty reduction. It also provides greater control of one's financial future, more effective use of financial products and services, and reduced vulnerability to overzealous retailers or fraudulent schemes.

Further findings indicated that the growth and expansion attracted qualified professionals and eliminated inefficient management through job descriptions and specification reviews, trainings, seminars and workshops. This is in line with Greenspan (2002) who argues that financial literacy helps to inculcate individuals with the financial knowledge necessary to create household budgets, initiate saving plans, and make strategic investment decisions. Financial literacy exposes entrepreneurs to better decision making skills that lead to borrowings, risk taking, diversifications, and investments. The study also concludes that there is a higher a chance for financially literate SMEs to be more successful than those with low level of financial knowledge. Financial literacy also seems to go hand in hand with formal education; entrepreneurs that scored high in financial literacy seemed to be well educated and have been attending financial education class or seminars, while in contrast, entrepreneurs with low level of financial literacy demonstrated low level of formal education or have never attended financial literacy classes.

5.4 Policy Recommendations

The study recommends that SMEs should consider enrolling in financial literacy program or any other related programs to enhance their capability. The study recommends the formation of mergers for those SMEs facing constraints in the market in order to remain competitive in the market. SMEs need physical access to markets and help with registration, assistance in finding staff and managing cash flow. Considering the fact that majority of SMEs in informal sector scored poorly in performance and financial literacy, both Trans Nzoia County government and national government needs to ensure that all SMEs have the basic financial literacy. This is very important owing to the fact that, SMEs plays a paramount role in economy and growth in this sector means growth in economy. The providers of various financial literacy programs should consider implementing a program which fits the culture and traditions of the context targeted and avoid one size fits all because different SMEs have different experiences. For financial literacy programs to achieve better results should be provided by neutral providers who may not have any other interest to derive from the program apart from benefiting the target beneficiaries. The providers of various financial literacy programs should consider implementing a program which fits the culture and traditions of the context targeted and avoid one size fits all because different SMEs have different experiences. The provision of technology based financial services must be preceded with the necessary infrastructures to make its implementation realistic like electricity, network connectivity, general improvement of local population literacy levels and identification of business opportunities and ways of exploitation for the entire population to be economically active and then can discern the relevance of financial literacy training and its influence in usage of technology based financial services and products. More should be done to improve on training and mentoring through designing of Youth Enterprise Development Fund pre financing programs to the beneficiaries. There should be more collaboration between the various association affecting different sectors. This will enable the SMEs achieve a better and bigger effort in their marketing of their products, improved competition and promotion of technological exchange and improved skills on individual members. There should be more focus on the secondary education where technical and vocational training should be done to develop artisans, entrepreneurs and managers for the informal sector in both rural and urban centers. Linkages between the SMEs should be developed especially within the associations to enable better operation, coordination and collective benefits.

5.5 Limitations of the Study

This study was limited by some respondents not willing to disclose their financial information in terms of revenue. Many firms especially those that have a no or decreasing revenue growth were unwilling to declare.

Some entrepreneurs were not available for interview and were represented by their staffs that would have different financial literacy level than the owners of business. The researcher targeted the Managing Director/CEOs/owners to fill the questionnaire. However, the Managing Directors/Owners delegated the filling of the questionnaire to the departmental managers such as Human Resources and Administration Manager, Customer Service Officer, Operations Manager, among others.

The response rate of the study was low due to reluctance of the targeted SMEs to participate in the study. Further, some respondents were of the opinion that some of the information sought was confidential and hence they did not fill the questionnaire. Some entrepreneurs were so busy serving clients hence delegating the marking of questionnaires to their employees.

The time period covered by the study and the resources available to the researcher were also limited. The resources available were not enough to cover the entire part of Trans Nzoia County. Also, there are many challenges affecting the ability of SMEs operating within Trans Nzoia County in acquiring financial literacy training programs. A detailed review of all the issues is beyond the scope of this study. This was mainly due to the constraints of time. Finally, the sample studied was restricted to the population of SMEs alone. Perhaps a broader pool of financial literacy providers would have given more insights into the financial literacy programs they provide to SMEs.

There was also a problem of language barrier where by some entrepreneurs' inability to read and interpret the questions asked due lack of familiarity in English language.

5.6 Recommendation for Further Research

This study recommends training of small SMEs that are in informal sector and run by few family members. Most of these businesses survive for many years but with minimal or no growth at all, perhaps due to lack of financial knowledge. If trained, SMEs in this sector would embrace more risk ventures, diversify investments and raise capital to grow and transform into more solid enterprises. Networking events for entrepreneurs should be established by the associations to enable them to share experiences and marketing information. The study recommends for structures and safe and secure market areas through which entrepreneurs of associations can be able to market their products and services, e.g. incubators, display venues, market stall and trade fairs. There is need for the government to work towards streamlining coordination of institutions implementing SMEs activities. This will promote institutional structures necessary for effective policy design, implementation and monitoring of MSE activities for the benefit of the associations and entrepreneurs as well. The same study should be carried out in other firms in different industries to find out if the same results would be obtained. The government of Kenya in conjunction with the county government of Trans Nzoia should improve security, infrastructure and efficiency in government bodies that deal with businesses to dead firmly with corrupt practices in tendering procurement procedure.

There is need to provide SMEs with permanent services, facilities, training and access to credit and markets. Planning and zoning should be done to ensure the space allocated for MSEs is accessible, with proper communication network, and with proper sheds. Further study should be carried to find out the challenges faced by financial literacy providers faced while undertaking the financial educations to SMEs and why many firms have not considered taking financial literacy classes despite the advantages got from engagement in the same. A further study should be carried to find out the challenges facing the formation of SMEs in Kenya. Further studies should also be done to establish other factors (40.3%) of financial literacy that could affect performance of SMEs since the study only covered 59.7% of the factors.

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APPENDICES

Appendix I: Questionnaire

This questionnaire is designed to assist in collecting data to determine the effect of financial literacy on performance of SMEs in Trans Nzoia County. Please note that the findings of this research are solely meant for academic purposes and all the responses will be treated with utmost confidentiality.

SECTION A: GENERAL INFORMATION

1. Name of the business ……………………………………………………………….
2. Year of establishment ……………………………………………………………….
3. Location of business…………………………………………………………………
4. Education level

   ☐ Primary ☐ Secondary ☐ Tertiary ☐ University

   Others (please specify)…………………………….........................
5. Form of business organization (please tick one)

   ☐ Sole proprietorship ☐ Partnership ☐ Private limited company

   ☐ Cooperative society ☐ Joint venture

   Others (please specify) ………………………………………………..
6. What is the source of financing of your business?

   ☐ Borrowing (formal)

   ☐ Savings

   ☐ Borrowing (informal)

   Others (please specify)…………………………………………………..

7. Have you ever attended management training programs related to financial management?

   Never..

   Rarely (from 1 to 2 attendances annually)..................................

   Sometimes (3 to 4 attendances annually)...................................

   Often (5 to 6 attendances annually)..

   Always (more than 6 attendances annually)..............................

8. Which of the following agencies provided the training programmes that you have attended before?

   KWFT..

   Equity Foundation Group…..

   Ministry of Trade..

   Other Microfinance Institutions..

   NGOs…………………………………………………………

SECTION B: FINANCIAL LITERACY

Records Keeping Perspective of Financial Literacy

9. I have improvement in record keeping as a result of financial literacy

YES (A)	NO (B)	Not sure (C)

10. The Knowledge on balancing of the ledger has improved my operations

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

11. There is a significant improvement in my financial reporting as a result of proper financial literacy

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

12. I now have ease in filling tax returns and cashbook maintenance.

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

Budgeting skills of Financial Literacy

13. Suppose that in the year 2014 your income was Ksh 100,000 and the prices of all goods was constant. In the year 2015 your income and prices of goods have doubled. Will you be able to buy the same amount of goods in 2015 with your income?

NO (A)	YES (B)	Not sure (C)

14. Suppose a short term sales forecast is been made for the month of October 2015 in your firm. For the past several years, sales in October have totaled 12.5% of annual sales. During the same period, August sales have averaged 10% of annual sales. Sales during previous August were Ksh. 160,000. Estimate annual sales and find out October projected sales

Annual sales	160,000	1,280,000	1,600,000	1,000,000
October sales	200,000	128,000	200,000	100,000
	A	B	C	D

Debt management of financial literacy

15. Through financial literacy I can now access credit easily from banks

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

16. Suppose you had KShs100, 000.00 in a savings account and the interest rate is 10% per year and you never withdrew money or interest payments. After one year, how much would you have on this account in total?

More than Ksh. 100 (A)	Exactly Ksh100 (B)	Not sure (C)	Less than Ksh 100 (D)

17. Assume that Leonard saved KShs 100,000.00 in the year 2010 and his wife Daisy saved the same amount (KShs 100,000.00) this year. Who is richer because of the savings?

Both (A)	Daisy (B)	Not sure (C)	Leonard (D)

18. Assume your company has Ksh 100,000 of bank lines of credit and Ksh. 500,000 mortgage on its property. The shareholders of the company have invested Ksh. 1,200,000. What would be the firm's debt ratio?

0.8 (A)	2 (B)	0.5 (C)	0.4 (D)

SECTION C: PERFORMANCE OF SMES

19. Financial literacy has led to increased profitability in my firm

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

20. Financial literacy has increased my enterprise market share

Strongly agree	Agree	Not sure	Disagree	Strongly disagree

21. How long have you been in business?

☐ Less than 5 year ☐ 5-10 ☐ 10 and above

22. State your revenue in the first five years since inception (KShs million)

Year 1	Year 2	Year 3	Year 4	Year 5

23. How many permanent employees do you have?

1-3 ☐ 4-5 ☐ Above 5 ☐

THANK YOU

Appendix II: Scorecard

	Performance of SMEs	**Scores**
Question 19 & 20	On profitability & market share	
	Strongly agree	20
	Agree	15
	Not sure	10
	Disagree	5
	Strongly disagree	0
Question 21	On number of years in business	
	0-5 years	5
	5-10 years	10
	Over 10 years	20
Question 23	On number of permanent employees	
	1-3	2
	4-5	10
	Over 5	20
	Financial literacy	
Question	Answer	Score
9	A	10
13	B	10
14	C	10
16	A	10

17	D	10
18	C	10
Question 10,11,12,15	Strongly agree	10
	Agree	7
	Not sure	5
	Disagree	3
	Strongly disagree	0

Question 22: on Revenue growth = $\frac{year2 - year1}{year1} x20$

SMEs	Financial literacy (%)	Performance of SMEs (%)
1. Easy shop	78	78
2. Botanic enterprises LTD	97	95
3. Nedys cooperation	61	71
4. Cherangani wholesalers	97	83
5. Matunda stores	68	72
6. Shilo Agro-stores	78	71
7. Umoja place	50	20
8. Amani corner place	77	63
9. Boaz shop	68	42
10. Mtaani Grand Regency	56	45
11. Hotel Imani	58	65
12. Soy trading	70	67
13. Malimali shop	48	40
14. R.W bookshop	48	40
15. New-Mpesa & shop	68	70
16. Corner cave	68	68
17. Cherang'any Hardware	71	70
18. H-Lands chemist	90	74
19. SibangaMkulimaAgrovet	100	83
20. Chechun Traders	87	70
21. Kamur agro-stores	100	66
22. Elite bookshop	90	61
23. Kachibora agro-stores	58	55
24. Espas	74	45
25. Arks stores	78	70
26. Kamurr agrovet	80	75
27. Winners	58	55
28. Kilate shop	45	36
29. Blue boutique	38	20
30. Mama Kiptoo shop	40	35
31. Huruma shop	54	45
32. Kilimo stores	67	80
33. Utalii traders	77	55
34. Shavan merchandise	85	70
35. Oshindi hardware	68	60
36. Sheum shop	88	66
37. Candy shop	88	76
38. Justus shop	48	56
39. Sam's Mpesa	77	77
40. Muketa enterprises LTD	48	54
41. Medal Platz agrovet	42	54
42. Kibagenge shop	100	85
43. Manase wholesalers	70	72

44. Muthoni M shop	68	57
45. Salama traders	76	59
46. Njemuboss chemist LTD	64	52
47. Amani chemist	80	74
48. Classic Move hotel	61	65
49. Classic restaurant	84	64
50. Speedcom computers	58	45
51. Jack & Sons	90	75
52. Joint shop	54	32
53. New Corna Mpesa	90	73
54. Summit beauty world	68	42
55. Heshima stores	88	63
56. Millenium Boutique	58	41
57. Paps Unique Collection	47	46
58. Asali shop	32	20
59. Toply cosmetics	71	68
60. Liza computers	60	50
61. Kihingo Auto spares	68	60
62. Mwana Auto spares	77	68
63. Ronak agrovet	70	57
64. Dan Town electronics	60	30
65. Neema electronics	77	67
66. Elgon View enterprise	68	80

Appendix III: Analyzed data

```
* Define Variable Properties.
*VAR00001.
VARIABLE LABELS  VAR00001 'Financial literacy'.
EXECUTE.
* Define Variable Properties.
*VAR00002.
VARIABLE LABELS  VAR00002 'Performance score'.
EXECUTE.
DESCRIPTIVES VARIABLES=VAR00001 VAR00002

  /STATISTICS=MEAN STDDEV VARIANCE RANGE MIN MAX SEMEAN SKEWNESS.
```

Descriptive Statistics

	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance	Skewness	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error
Financial literacy	66	68.00	32.00	100.00	69.3939	2.02662	16.46430	271.073	-.071	.295
Performance score	66	75.00	20.00	95.00	59.7424	2.04817	16.63944	276.871	-.577	.295
Valid N (listwise)	66									

```
CORRELATIONS
  /VARIABLES=VAR00001 VAR00002
  /PRINT=TWOTAIL NOSIG

  /MISSING=PAIRWISE.
```

Correlations

		Financial literacy	Performance score
Financial literacy	Pearson Correlation	1	.772**
	Sig. (2-tailed)		.000
	N	66	66
Performance score	Pearson Correlation	.772**	1
	Sig. (2-tailed)	.000	
	N	66	66

**. Correlation is significant at the 0.01 level (2-tailed).

```
REGRESSION
  /MISSING LISTWISE
  /STATISTICS COEFF OUTS R ANOVA
  /CRITERIA=PIN(.05) POUT(.10)
  /NOORIGIN
  /DEPENDENT VAR00002

  /METHOD=ENTER VAR00001.
```

Regression

Variables Entered/Removed[b]

Model	Variables Entered	Variables Removed	Method
1	Financial literacy[a]	.	Enter

a. All requested variables entered.

b. Dependent Variable: Performance score

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.772[a]	.597	.590	10.65122

a. Predictors: (Constant), Financial literacy

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10735.913	1	10735.913	94.632	.000[a]
	Residual	7260.708	64	113.449		
	Total	17996.621	65			

a. Predictors: (Constant), Financial literacy

b. Dependent Variable: Performance score

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.575	5.721		.974	.333
	Financial literacy	.781	.080	.772	9.728	.000

a. Dependent Variable: Performance score