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Influence of Financial Literacy on SME Performance in Gatundu South Constituency, Kiambu County, Kenya

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Influence of Financial Literacy on SME Performance in Gatundu South Constituency, Kiambu County, Kenya

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Abstract

The study sought to assess the influence of financial literacy on the performance of SMEs by examining budgeting and bookkeeping literacy in Gatundu South Constituency, Kiambu County, Kenya. The study utilized descriptive research design and assumed a random sampling technique to identify a sample of 130 SMEs. Purposive sampling was used to identify the respondents. A questionnaire was used as the primary data collection tool. The research utilized descriptive analysis and multiple regression model to analyze the relationship between financial literacy and financial performance. The findings indicated that there was consistency with prior empirical literature thus recommending that every business owner should strive at acquiring financial literacy skills to reap the benefits of better and improved financial performance. Persons of goodwill such as the government and financial institutions should aim at offering trainings to business owners since their success contributes to the greater good of the country and beyond.

Keywords: Financial Literacy, Financial Performance, Small and Medium Enterprises

1. Introduction

Financial literacy, among other factors is considered as a major factor influencing the performance of SMEs financially. This is because when key players such as the managers or business owners and employees have strong financial skills, they can make proper decisions about the finances of their entities, budget resources well, manage their cash flows and invest reasonably. This as a result enhances profitability and sustainability of the SMEs. Financial illiteracy is detrimental to the day today running of the organization because its leads to mismanagement of resources, debt accumulation and as an end result business failure (Graña-Alvarez et al., 2024).

According to Bayraktar and Algan, (2019) SMEs represent a large portion of businesses in a population which is approximately 90%. SMEs contribute between sixty to seventy percent of employment and fifty five percent of GDP in developed economies. This means their contribution to the global economy cannot be assumed and therefore ideas and support must go into their expansion and support. In Kenya, the SME sector is considered to contribute around 70% of the labor force thus contributing to job creation, poverty eradication and improved livelihood. Though

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the SME sector records such a high contribution, it is still the most elusive sector in terms of capturing its data since the SMEs have no obligation to have their financial records available to the public for consumption. SNDBX Chief Executive Joram Mwinamo, during the Big Baraza Conference in 2022 projected that the SME sector will contribute 50% of the country's GDP in the next three years (BigBaraza, 2022). This however has not come into fruition because of the high closure rate of these businesses especially during and post the COVID-nineteen pandemic. In manufacturing for example, the Purchasing Managers' Index of was 49.6%. The Purchasing Managers' index is an economic indicator showing the number of orders, employment changes, supplier deliveries and inventory levels. A PMI below 50% is a clear sign of a deteriorating economy. With SMEs forming the largest percentage of the private sector it means they are under very tough seasons. In December 2024, the World Bank noted huge declines in the decline of credit access from 13.9% to 1.4% (World Bank Group, 2025). This was a result of tightened borrowing by the financial institution because of the high default rates in repayment especially for small businesses. The GDP levels in our country have continued to decline from 5.7% in 2019 to 4.7% in 2024. The current GDP is at 4.5%.

This is a sign of a continuously weakening private sector where SMEs are the most in number and contribution. Kiambu county GCP declined to 5.6% in 2023 from 5.7% in 2019 linked to the decline in the performance of the local businesses (Sylvia, 2025). The national statistics reveal that approximately 44% to 47% of SMEs collapse within their first year of operation. In 2022, approximately 46.3% of SMEs did not live to see their first year. Additionally, 45% and 44% of SMEs were approximated to close within their first year in 2023 and 2024, respectively. With SMEs playing a vital role in the Kenyan economy, business owners have to continually remain creative for new and unique goods and services to serve their evolving customer needs (Felix, 2023).

1.2 Research Problem

SME sector has seen tremendous efforts from different stakeholders through the development and implementation of policies towards improving their performance. The SME sector is well aligned in the Vision 2030 that envisions long-term development of Kenya wholesomely by ensuring strategies that enable access to funds and financial literacy are in place. The Kiambu County for

example has been made available to the public the Enterprise Fund to provide credit to both youth and women owned enterprises. Bodies such as the MSME Authority, KNCCI have been entrusted in the implementation of policies laid down for the support of Small and Medium Enterprises. These outstanding efforts reflect an unwavering commitment to the growth and development of SMEs. Ranging from key policies framework to the access of finance and development of infrastructural ecosystems in support of SMEs, it is clear these efforts have not yielded results as expected.

Despite their prevalence, SMEs face immense challenges in their existence and sustainability. According to Maswin and Sudrajad, (2023), SMEs encounter challenges and one of them is the inability to manage their business financial resources well. Because of their low literacy levels, SME owners are challenged with how to plan for their financial resources at hand. In a survey conducted in Indonesia, the financial literacy index for MSME owners was reported to be about 38.32% in 2022 .In another study, World Bank, (2019) outlined that SMEs continue to encounter unmet financial needs amounting to approximately \$5.2 trillion every year. Access to finances for expansion and investment requires some level of financial literacy. Togun et al., (2023) recommends the need for financial literacy to bridge the gap between financial inclusion and the performance of SMEs. With financial literacy playing a key role in informing decisions relating to debt repayment and borrowing, proper bookkeeping, ability to make sound investment decisions and ability to prepare budgets and stick to them has a strong bearing towards the financial performance of SMEs.

Existing studies have examined the relationship between financial literacy and financial performance of SMEs. A research by Rahmajati and Kusuma, 2023 to investigate the impact of financial literacy on financial performance of SMEs revealed a strong positive effect on entrepreneurs who were well versed with the financial concepts that include budgeting skill, record keeping and debt management on the performance of their SMEs. In a study conducted by Yakob et al., (2021) in Malaysia, it was concluded that financial literacy has a positive influence on the financial performance of SMEs. Mah, 2020 conducted research on the effect of bookkeeping, literacy, budgeting literacy and financial inclusion of SME Financial Performance in Semarang, Indonesia. The study results showed there a positive influence of the above variables on the

financial performance of SMEs. This study however used accidental sampling as a sampling technique. Pascal et al., 2022 in his research to investigate the possible influence of budgeting, tax compliance and decision making to financial performance concluded that budgeting had no significant influence on financial performance recommending further research.

This research study intends to address the contextual, methodological, and conceptual gaps that exist from previous studies since they demonstrate limited empirical support on the impact of financial literacy on the financial performance of SMEs in Gatundu town. By assessing how financial literacy metrics influence the performance of SMEs in Gatundu town, this research seeks to provide practical recommendations that will help enhance the financial performance of SMEs in this locality.

1.3 Research Objectives

The study sough to determine the influence of financial literacy on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

Specifically, it sought to:

(a) Determine the influence of budgeting on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

(b) Determine the influence of bookkeeping on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

2. Literature Review

2.1 Theoretical Framework

This research study was anchored on three key theories namely: Human capital theory, financial literacy theory and financial social learning theory.

2.1.1 Human Capital Theory

Becker, (1993) advocated this theory that considers individual's skills, knowledge and experience as forms of capital that can be invested in on an individual to increase productivity and earnings of the business. The human capital contributes to the wellness of the entity by utilization of the skills gained. This theory proposes that investment in education and training enhances the workers'

productivity. The theory however ignored other factors such as poor infrastructure, lack of capital among others as possible influences on the performance of business. This limitation, however, did not water down the contribution of investing in one's own education to build one's financial skills. This theory is relevant to this study in showing how individual financial skills influence the performance of their businesses.

2.1.2   Financial Literacy Theory

This theory was advocated by Lusardi and Mitchell, (2013) and implies that financial literacy begins with one acquiring knowledge on financial principles and products that informs one's ability to save, keep records, budget and invest. Financial literacy equips individuals carrying out business activities with the necessary skills and insights for proper financial decisions to aid in the success of their entities and accomplishment of both personal and business strategic objectives. Kahneman and Tversky, (1979) highlights insights from behavioral finance stating that at times financial decisions such as loss aversion, overconfidence among others is influenced by psychological aspects of an individual. The theory assumed that financial literacy always translated to better decisions yet behavioral finance assumed people behave irrationally even when they know what to do. This however doesn't do away with the fact that individuals with better financial knowledge are aware of what needs to be done resulting to better decisions. This theory was relevant in this study in understanding how individuals make informed and sound judgments on finances and factors influencing such.

2.1.3   Financial Social Learning theory

Bandura, (1977) advocated the social learning theory that implies that individuals acquire knowledge through their day-to-day interactions with other individuals and this often influences their knowledge levels and in return influences their response on financial matters seen on behavior. This theory highlights that people learn behaviors through observing, imitating, mentorship and influence. As people interact with each other they get to observe and learn behaviors of different individuals and therefore apply those very concepts in their day-to-day operations. Beliefs about money, investment, savings, budgeting can easily be picked and copied as people interact and apply behaviors that add value to their businesses. This theory is limited in that people don't just learn and apply the knowledge in real life. This theory was useful in

understanding how interactions between business owners can be leveraged to influence financial behaviors positively for the achieving of business goals and success through improving the financial literacy of these business owners.

2.2 Empirical Review

2.2.1 Budgeting and Financial Performance of SMEs

Fortuna, (2021) examined 331 Small and Medium enterprises in Isabela. The objective was to examine the impact of budgeting practices on the profitability of the entities. This study focused on the manager's participation, organization strategy linkage to budget, allocation of resources, flexible consistent improvement and drop in the complexity of technology usage. The study discovered that a Small Medium enterprise profitability grows with the increase in the adoption of good and proper budgeting practices. He applied purposive sampling in studying the 331 SMEs. He also used three research methods: descriptive, causal comparative and correlational research. With a combination of both descriptive and explanatory research, Jemal, (2019) examined the financial performance of Medium scale enterprises giving a greater concentration on financial literacy influence on SMEs. He concluded that financially literate business owners on matters budget have better financial outcomes compared to those who don't. These conclusions were drawn from 276 medium scale enterprises whose study involved a mix of qualitative and quantitative research approaches.

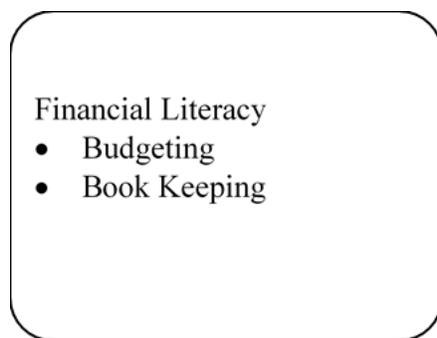### 2.2.2 Bookkeeping and Financial Performance of SMEs

In examining the financial determinants of SME performance, Benedict *et al*., (2021) drew conclusions from 300 respondents from the Kenya leather Industry. This study based their financial performance on cost minimization and product quality. This research utilized both questionnaires and interviews. Interviews were majorly conducted where the questionnaire could not suffice. Most firms sampled were not registered, making it difficult to access their financial information. With financial literacy, business owners can draw confidence from that for borrowing. Tuffour et al., (2022) examined both monetary and non-financial aspects when assessing how financial literacy among managers affects the performance of their Small-scale enterprises. The least squares method together with structural equation modelling was used to conclude the positive impact of financial literacy particularly bookkeeping on financial

performance. Financial literacy metrics included financial attitude, knowledge and awareness. A manager with proper financial knowledge has the ability to keep proper records which aid in growth.
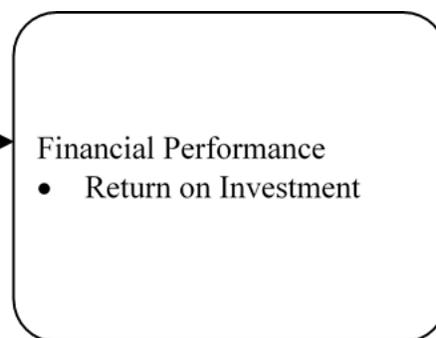
2.3 Conceptual Framework

This proposed study conceptualizes that financial performance of SMEs is influenced by the levels of financial literacy of the promoters.

Independent Variable   **Dependent Variable**

Financial Literacy
- Budgeting
- Book Keeping

Financial Performance
- Return on Investment

2.3.1   Research Hypothesis

H_{01}: Budgeting has no significant influence on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

H_{02}: Bookkeeping has no significant influence on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

3. Methodology

3.1 Research Design, Target Population and Sample Size

The researcher adopted a descriptive research design. This is because it gives the features of a population without manipulating any variables (Manjunatha, 2019). The researcher focused on 192 SMEs in Gatundu South Constituency, Kiambu County. The respondents were the SME owners or the managers in the absence of the owners. This comprises the SMEs across all sectors, which is in retail, service and manufacturing sectors. This study assumed a random sampling technique which identified 130 SMEs in Gatundu Constituency, Kiambu County, Kenya.

Purposive sampling was also adopted in identifying 130 respondents as the sample size which included the owners or managers of the respective SMEs per SME.

3.2 Data Collection, Analysis and Presentation

This research study adopted a questionnaire as the primary research tool. Since the research relied on primary data, the questionnaire offered standardized data due to its structured format (Dalitso, 2024). All responses from the respondents were tabulated and analyzed using descriptive and inferential statistics. Data presentation was through data visualization tools such as tables and histograms for easier understanding and display. Variables relationships were displayed by using a multiple linear regression model.

$$\gamma = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

γ = Financial Performance (ROI)

$X_1, X_2,$ = Budgeting, Bookkeeping respectively

β_0 = Intercept

β_1, β_2 = Regression Coefficient

ε = Error term

4. Research Findings and Discussions

From a sample size of 130 respondents, 102 respondents submitted their duly filled questionnaires. A Cronbach's Alpha of 0.968 confirmed the reliability coefficient scores were excellent and therefore the questionnaire was reliable for collecting data.

Table 1: Reliability Statistics

Cronbach's Alpha	N of Items
.968	12

Correlation analysis for the study was done to determine the relationship between budgeting and bookkeeping and Return on Investment from the sampled respondents by utilizing the spearman's rank order correlation. The correlation results showed strong positive correlation between the

variables meaning the variables were statistically significant. Financial performance was strongly related to budgeting practices with a coefficient P =.753 and Sig=<0.001. Bookkeeping with a P =.724 and Sig =<0.001 portraying a strong positive correlation to financial performance of SMEs. These results showed that with proper budgeting practices and excellent bookkeeping, the financial performance of an SME will improve.

Table 2: Correlation Tests

			Return on investment	Budgeting	Bookkeeping
Spearman's rho	Return on investment	Correlation Coefficient	1.000		
		Sig. (2-tailed)	.		
		N	102		
	Budgeting	Correlation Coefficient	.753**	1.000	
		Sig. (2-tailed)	.000	.	
		N	102	102	
	Bookkeeping	Correlation Coefficient	.724**	.616**	1.000
		Sig. (2-tailed)	.000	.000	.
		N	102	102	102

4.1 Descriptive Statistics

4.4.1   Influence of Budgeting on SME Financial Performance

The study examined the budgeting practices embraced by the SME owners / managers. From Table 3, the lowest standard deviation is 1.43433 while the highest mean is 2.86275. This means that the business owners did not possess proper budgeting practices which were essential in improving the performance of their businesses.

Table 3: Budgeting and Financial Performance

	Mean	Standard Deviation
I possess skills to prepare a budget on what the business intends to spend	2.70588	1.55804
I normally set aside any excess funds after all expenditure	2.64706	1.50015
I base the business's spending on the budget plan for the business	2.66667	1.54364
I possess skills on sales forecasting	2.86275	1.43533

4.4.2   Influence of Bookkeeping on SME Financial Performance

The study sought to examine the knowledge status of the respondents regarding bookkeeping. Most of the respondents had no knowledge of the bookkeeping metrics which translated to low return on investment. The highest mean was 2.97059 and lowest standard deviation was 1.38652, implying a gap in their financial knowledge regarding bookkeeping practices.

Table 4: Bookkeeping and Financial Performance

	Mean	Standard Deviation
Preparation of financial statements	2.92157	1.53949
Analysis and interpretation of financial statements	2.83333	1.38652
General ledger and cash book posting	2.90196	1.47259
Bank reconciliation	2.88235	1.48453
Filing returns	2.97059	1.81553

4.4.3   Financial Performance of SMEs in Gatundu South Constituency.

The study sought to establish the financial performance of the SMEs. From the field data, 28.4% indicated that their businesses were performing excellently, 2.9% indicated their businesses' performance was fair while 68.6 % of the SMEs' performance was poor.

Table 5: Financial Performance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Excellent	29	28.4	28.4	28.4
	Fair	3	2.9	2.9	31.4
	Poor	70	68.6	68.6	100.0
	Total	102	100.0	100.0	

4.2 Regression Analysis

To examine the overall influence of the predictor variables on the dependent variable, the model summary in Table 6 displays the output of their relationship. Statistic R of .883 show a very strong positive relationship between budgeting, bookkeeping and SME financial performance. The coefficient of determination (R^2) of .779 implied that 77.9% of the variation in Return on Investment is because of the two variables of financial literacy. Additionally, it means only 22.1% of the variation in Return on Investment was explained by other factors not considered in the research study. A Sig < 0.001 implies that the model is statistically significant and the variables positively influence Return on Investment.

Table 6: Model summary of Financial Literacy and Financial Performance

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | | Durbin-Watson |
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.883[a]	.779	.774	.0508073	.779	174.286	2	99	.000	1.797

a. Predictors: (Constant), Bookkeeping, Budgeting

b. Dependent Variable: Return on investment

The ANOVA Summary in Table 7 shows an F-Test of 174.286 meaning the regression model is greatly explained by the variables. A P value <0.005 means the model is statistically significant. The ANOVA summary showed a P value of .000.

Table 7: ANOVA of Financial literacy and financial performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.900	2	.450	174.286	.000[b]
	Residual	.256	99	.003		
	Total	1.155	101			

a. Dependent Variable: Return on investment

b. Predictors: (Constant), Bookkeeping, Budgeting

Table 8: Coefficients of Financial Literacy and financial performance

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	z	Sig.
1	(Constant)	-.164	.012		-14.006	.000
	Budgeting	.044	.006	.581	7.759	.000
	Bookkeeping	.026	.006	.352	4.694	.000
a. Dependent Variable: Return on investment						

Table 8 gives a summary of the regression coefficients of the model. The regression constant is -0.164 while budgeting regression coefficient is 0.044 and 0.026 for bookkeeping. The regression equation below implies that for every unit increase in budgeting resulted in a 0.044 increase in financial performance while a unit increase in bookkeeping resulted in a 0.026 increase in financial performance.

$$\gamma = -0.164 + 0.044X_1 + 0.026X_2$$

4.3 Discussion of Findings

4.3.1 Influence of Budgeting on the Financial Performance of SMEs in Gatundu South Constituency

The correlation coefficient for budgeting as analyzed was 0.753, showing a strong positive correlation between budgeting skills and financial performance of SMEs in Gatundu South Constituency. This implied that business owners or managers who possess and implement their budgeting skills in running their businesses results in a positive and improved Return on Investment. The results also indicated that budgeting skills are statistically significant since the regression analysis stated P= 0.000 which was below the alpha value of 0.05. This resulted in rejecting the null hypothesis and accepting the alternative hypothesis which stated that budgeting skills had a significant effect on the financial performance of SMEs. This study was consistent with the findings of (Fortuna, 2021) that concluded with the increase in the adoption of good and proper budgeting practices performance (profitability) is improved. This study built into this knowledge by looking at another aspect of financial performance which is return on investment

since his financial performance metric was profitability. The study was also consistent with the findings of (Mbogo et al., 2021) which considered budgeting as critical factor in enhancing a firm's performance. This study boosted the empirical findings of (Pascal et al., 2022) which had stated that budgeting does not affect SME performance. The study was also in agreement with the assumption of the financial literacy theory that indicated financial literacy always translates to better performance.

4.3.2   Influence of Bookkeeping on the Financial Performance of SMEs in Gatundu South Constituency

Bookkeeping revealed to have a correlation coefficient of 0.724 from the research findings. The research findings indicated a strong positive correlation between bookkeeping and financial performance of SMEs in Gatundu South Constituency. The research study also sought to establish the significance of bookkeeping in influencing financial performance. The regression analysis also stated a statistical significance P= 0.000 which was below the alpha value of 0.05 implying that bookkeeping is statistically significant. With this the null hypothesis was rejected since bookkeeping was concluded to significantly influence financial performance. This research study also build on the empirical findings by (Yakob et al., 2021) since he did not consider book keeping in assessing the financial literacy metrics that influence financial performance.

5.   Summary

The general objective of the study was to examine the influence of financial literacy on the financial performance of SMEs in Gatundu South Constituency. The researcher sought to assess how budgeting and bookkeeping influence financial performance in Gatundu South Constituency, Kiambu County. The research findings were explained using the two objectives mentioned. The research study employed descriptive, correlation and multiple regression analyses in analyzing their variables. The research findings established that 68.6% of the businesses were performing poorly with the businesses not embracing financial metric under financial literacy. Most of the business owners had their descriptive statistics with a mean of two, meaning they did not possess budgeting and bookkeeping skills. Further, the descriptive statistics established that most business owners did not consider the financial literacy metrics to be important for their businesses since they considered them not as important and time wasting. The business owners also indicated a lack

of knowledge of budgeting and bookkeeping which resulted in poor performance. The research sought to establish the relationship between budgeting and financial performance of SMEs in Gatundu South Constituency in Kiambu County. The results indicated that budgeting has a positive significant influence on financial performance. The research sought to establish the influence of bookkeeping on the financial performance of SMEs. The study findings established that bookkeeping significantly influences the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

6. Conclusions

The study sought to assess the influence of financial literacy on the financial performance of SMEs in Gatundu South constituency. The research findings therefore formed the basis of the conclusions. The research findings established that there was statistically significant influence of Budgeting and bookkeeping on the financial performance of SMEs in Gatundu South Constituency, Kiambu County.

From the field data, businesses that performed better on budgeting skills indicators had a higher return on investment compared to their counterparts. More than half of the respondents did not have skills in budget preparation or based their spending on a budget plan. Additionally, more than 50% did not set aside the excess funds after all the expenditure in their businesses. The managers and business owners did not also align their spending on a budget plan, and a considerable percentage did not possess sales forecasting skills, which resulted in a negative return on investment. 39% indicated that they considered budget preparation skills not an important skill in running their business. On the other hand, business owners who possessed budgeting skills had a positive return on investment. This is therefore to affirm that budgeting is a critical process in ensuring the success of any business. Possessing budgeting skills for a business owner ensures proper management of resources, thus ensuring proper cash flow management, better decision making and future preparedness for an improved financial performance.

The research findings established that bookkeeping significantly influenced the financial performance of SMEs in Gatundu South Constituency. With this, a section of business owners who had the ability to prepare, analyze and interpret financial statements combined with

establishing a general ledger, performing bank reconciliation and filing returns had a positive financial performance. Those who did not possess these skills had a negative return on investment, confirming the essence of bookkeeping in ensuring the firm's goals are established and financial performance is optimized.

7. Implications of the Study Results

The research aimed at assessing the influence of financial literacy on the financial performance of SMEs in Gatundu South Constituency, Kiambu County. It was established that all the two predictor variables (Budgeting and bookkeeping) have a statistically significant influence on financial performance. The study recommended that for the SME owners to enjoy greater and improved financial performance, they would need to embrace budgeting and bookkeeping fully. This means they should endeavor at gaining the skills either through training or interacting with other literate owners to enhance their financial literacy skills. This research also entails documentation of good financial literacy practices for the improved performance of businesses.

Other interested parties such as the county government department of trade and industrialization, Kenya National Chamber of Commerce and Industry Kiambu chapter, researchers, academicians and financial and microfinance institutions, could consider conducting trainings for business owners to enhance their financial literacy for improved financial performance. On employment of business managers, the business owners should ensure they are trained in budgeting and bookkeeping together with other workers.

8. Suggestions for further Research

This study findings showed that there was significant effect of financial literacy on the financial performance of SMEs in Gatundu South Constituency, Kiambu County. With 86.3% of the variability of financial performance being explained by the predictor variables which are budgeting and bookkeeping, it would be appropriate to study other financial factors that could influence the financial performance of SMEs such as the capital structure of businesses, cost control and operational efficiency, economic and market conditions among others. Additionally, further research studies could broaden the scope to include unregistered SMEs since this study only considered the registered SMEs. This is to recommend their registration so as to enjoy more benefits that registered SMEs get such as access to financing among others.

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