

ANALYZING FINANCIAL LITERACY OF INDIAN ENTREPRENEURS – A STUDY OF MSMEs

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Abstract

Entrepreneurs are constantly involved in decision making activities where the substantial decisions are financial in nature. So, increasing the financial literacy levels of entrepreneurs can play an effective role in efficient management of business finance and handling of financial risks and opportunities. This paper is an attempt to examine the financial literacy of MSME entrepreneurs along four dimensions- preparation and use of accounting statements; savings, investments and insurance; financial budgeting; and management of debt. The study is descriptive in nature. Since the majority of medium firms exhibited a higher level of financial literacy as compared to small and micro firms, so the policy makers, practitioners and other stakeholders should focus more upon the enhanced financial education needs of micro and small firms.

Keywords: *Financial literacy, entrepreneur, MSME, accounting statements, financial budgeting, debt management*

I. Introduction

The holistic development of an entrepreneurial ecosystem is essential to transform India's socioeconomic landscape and to boost its growth (Mittal & Raghuvaran, 2021). The Indian MSMEs have a significant role in expansion of entrepreneurial endeavours in the country. The contribution of MSMEs in India's GDP is 30% which is crucial to achieve and sustain its growth

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momentum. The share of MSMEs in country's export has reached to 48% in 2018-19 and this sector has been creating 11.10 crore jobs in the rural and the urban areas across the country. This discussion clearly exhibits the important role played by MSMEs in promoting sustainable and inclusive development of the nation.

In the context of Indian MSMEs, the government launched many schemes to provide financial assistance to this sector. But, accessibility to finance is still a major challenge for MSMEs, reflecting the fact that such benefits have not percolated down to the MSME entrepreneurs due to demand side barriers. This challenge can be countered to great extent if the entrepreneurs possess financial literacy, which includes the awareness and confidence to access the business finance and efficient management of financial risks and opportunities (Mittal et. al., 2021).

A recent report of OECD working group of experts on financial education of MSMEs and future entrepreneurs (OECD, 2017) cited that in most of the Asian countries including India, challenges currently faced by MSMEs included lack of financial literacy, financial exclusion and a lack of awareness of financing options. This study thus aims to assess the financial literacy of MSME entrepreneurs, which can enhance their financial management practices and help scale up their business (OECD, 2015).

The OECD (2018) defined financial literacy of entrepreneur as "the combination of awareness, knowledge, skills, attitudes and behaviour that a potential entrepreneur or an owner or manager of a micro, small or medium sized enterprise should have in order to make effective financial decisions to start a business, run a business, and ultimately ensure its sustainability and growth. "The United States Agency for International Development (USAID, 2009) further elaborated that a financially literate entrepreneur possesses information about different sources of funds, loan products, how to access financial institutions for different financial products and services, options for business savings, using credit/debit cards for transactions,

buying business insurance, decision regarding business ownership/ legal structure, knowledge of taxes and digital literacy (Mittal, 2020).

The Netherlands Chamber of Commerce listed fifteen areas of financial knowledge which an entrepreneur should have in order to be successful (Lentz, Smetsers, Vergeer & Grotenhuis, 2016). It includes preparation and interpretation of financial statements, management of debtors and creditors, forecasting profits and liquidity, knowledge of financing options and the ways to apply for the same, taxation and VAT, understanding performance measures, analysis of interim statements and investments.

2. Literature Review

Financial literacy has been a priority for policymakers around the world, particularly in the wake of global financial crises. The literature reviewed recognised the growing necessity for entrepreneurs to acquire basic financial literacy, in order to visualise the potential effects of their financial decisions.

Oseifuah (2010) investigated the determinants of financial literacy as financial knowledge, attitude and behaviour as well as literacy in maths and computers. Barte (2012) evaluated the financial skills of fish vendors in Philippines and observed lack of record keeping, profit analysis and cash management skills among them. Informal loans and high interest were adversely impacting their income and business growth. Sucuahi (2013) concluded that book keeping; savings; budgeting and financing skills of micro entrepreneurs of Davao city were low and education was a significant determinant of entrepreneur financial literacy.

Dahmen and Rodríguez (2014) found that the entrepreneurs of small business in Florida did not use financial statements and financial ratios for decision making, so majority of them faced financial issues related to cash flows and debt management. Andoh, Nunoo and Darfor (2015) noticed that utilisation of financial services was directly correlated with financial literacy

of SMEs in Ghana. Bruhn and Zia (2011) concluded that financial literacy training did not considerably impact the business survival but improved sales, profits, investments, business practices and better terms for business loan.

Bijli (2012) stated that provision of micro finance was not sufficient to alleviate poverty among women SHG members in Karnataka. Good financial practices like credit management, knowledge of interest rates, keeping records and savings literacy could play an important role in their venture success. Rao (2013) focussed on adoption of sound accounting practices to improve the profits of MSMEs in Visakhapatnam. Levi D'Ancona (2014) observed that the root cause of financial exclusion was lack of financial literacy among women entrepreneurs of Rajasthan.

On the basis of literature reviewed, it was observed that very limited research has been conducted so far in the context of financial literacy of MSME entrepreneurs in India. India doesn't currently measure financial literacy levels of MSMEs. The paper aims to assess the level of financial literacy of MSME entrepreneurs, an essential requirement for entrepreneurship development and its sustainability, and thus contribute to renewed interest of policy makers and the government towards the same.

3. Research Methodology

Data Source: This research work is based on primary data collected through structured questionnaire.

Sampling Frame: The sampling frame comprised of MSME clusters located in NCT of Delhi. Total 93 clusters were identified, divided into five districts as North Delhi, South Delhi, East Delhi, West Delhi and Walled City (Report of National Capital Region Planning Board, 2015). Five manufacturing activities (Packaging Material, Chemicals, Furniture, Steel Utensils and Hosiery) were chosen, covering majority clusters. Service activities (Tour

operators, Printing, Dry Cleaning, Advertising consultancy and Tailoring) were chosen from the illustrative list of service enterprises by MSMED Act, 2006.

Sampling Technique: Non-probability purposive sampling technique was used to collect information from specific target groups. The distribution of responses is provided in Table 1.

Research Method: Descriptive statistics was used to summarize the responses to the questionnaire using SPSS version 19.0. Frequency distribution and cross tabulation was done for analysis.

Table 1: Distribution of Responses

Type of Business	Frequency	Percentage
Micro	149	33.3
Small	150	33.5
Medium	149	33.3
Total	448	100

Source: 'The Author'

3.1 Dimensions of Entrepreneur Financial Literacy

Based on literature review, the following dimensions of financial literacy of MSME entrepreneurs were chosen.

Preparation and Use of accounting statements: Every business owner must possess the ability to read and understand the financial statements in order to make informed decisions and to manage the funds efficiently. It is a tool of planning and helps the entrepreneur in numerous other ways like evaluating projects, profitability analysis, tax management, managing loan repayment etc.

Savings, Investments and Insurance: Entrepreneurs' saving habits are a significant financial tool for understanding differences in their reinvestment decisions, overcoming credit limits, and dealing with emergency situations.

They can control risks by employing several tactics such as establishing financial reserves, diversifying their investment portfolio, and purchasing insurance for their business.

Financial Budgeting: By estimating the income and cost figures in advance, a financial budget functions as a tool of planning and control. Problem areas can be discovered and off-target performances can be easily controlled by comparing actual performance to budgeted estimates. The preparation of financial plans aids in the identification of a company's strengths and weaknesses, allowing funding to be diverted to areas with higher returns.

Management of debt: Financial literacy in debt management makes it easier to obtain credit and manage loan portfolios, lowering loan liabilities and interest costs. It improves the ability to comprehend the benefits and hazards of various sources of external financing. It also facilitates the understanding of the requirements and procedures for acquiring finance from various financial institutions.

4. Result Findings

4.1 Business Characteristics

Table 2: Business Characteristics

Legal Ownership	Frequency	Percentage (%)
Sole Proprietor	247	55.1
Partnership	108	24.1
Limited Liability Partnership	15	3.3
Private Limited Company	78	17.4
Total	448	100
Nature of Business		
Manufacturing	237	52.9
Services/ Consulting	211	47.1
Total	448	100

Source: 'The Author'

4.2 Demographics (Table 3)

Table 3: Demographics

Gender	Frequency	Percentage (%)
Male	423	94.4
Female	25	5.6
Total	448	100
Age of Entrepreneur		
Less than 25 years	18	4.0
25-35 years	163	36.4
35-45 years	162	36.2
Above 45 years	105	23.4
Total	448	100
Highest Level of Education		
Below Class X	12	2.7
Class X	46	10.3
Class XII	150	33.5
Graduate	211	47.1
Post Graduate	18	4.0
Professional Degree	11	2.5
Total	448	100

Source: 'The Author'

4.3 Preparation and use of accounting statements

(i) Maintenance of accounting records: (Table 4) reported that majority entrepreneurs (66.5%) were maintaining accounting records through accountants, 11.8% through accounting consultants, 1.8% on their own using accounting software and 19.9% on their own manually. Cross tabulation of results revealed that more micro firms were maintaining records manually, small firms were mostly using accountants whereas medium firm entrepreneurs majorly used accountants and consultants.

Table 4: Maintenance of Accounting Records

Preparation of accounting records		Micro	Small	Medium	Total
Self (Manual)	Count (%)	76 (17)	13 (2.9)	00 (0)	89 (19.9)
Self (Using Software)	Count (%)	01 (0.2)	06 (1.4)	01 (0.2)	08 (1.8)
Accountant	Count (%)	72 (16)	129(28.8)	97(21.7)	298(66.5)
Consultant Services	Count (%)	00 (0)	02 (0.4)	51(11.4)	53 (11.8)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448 (100)

Source: 'The Author'

- (i) Use of accounting records: (Table 5) reported that 83.9% entrepreneurs were using accounting information for managing debtors and creditors, 76.8% for taxes, 71.7% to examine business performance, 28.3% to control expenses, 23.4% for availing credit and very limited use for business planning, decision making and distribution of income. There were considerable differences in the use of accounting records by micro, small and medium firm owners.

Table 5: Use of Accounting Records

Use of Accounting Records		Micro	Small	Medium	Total
Determining financial performance	Count (%)	42 (9.4)	136 (30.4)	143 (31.9)	321 (71.7)
Accessing credit facilities	Count (%)	00 (0.0)	29 (6.5)	76 (17.0)	105 (23.4)
Tax compliance	Count (%)	70 (15.6)	131 (29.2)	143 (31.9)	344 (76.8)
Planning purpose	Count (%)	01 (0.2)	13 (2.9)	78 (17.4)	92 (20.5)
Managing creditors and debtors	Count (%)	102 (22.8)	139 (31.0)	135 (30.1)	376 (83.9)

Income distribution purpose	Count (%)	8 (1.8)	15 (3.3)	53 (11.8)	76 (17.0)
Control over expenses	Count (%)	0 (0.0)	37 (8.3)	90 (20.1)	127 (28.3)

Source: 'The Author'

4.4 Savings, Investments and Insurance

- (i) Diversification of funds: (Table 6) reported that 22.1% entrepreneurs viewed diversification of investments as 'very important', 23.2% as 'important', 45.8% as 'somewhat important' and 8.9% as 'not at all important' for them. All medium and small firms gave importance to diversification in varying degrees but all firms giving no importance to diversification belonged to micro firm category.

Table 6: Diversification of Funds

Diversification of funds		Micro	Small	Medium	Total
Very important	Count (%)	01(0.2)	31(6.9)	67(15.0)	99(22.1)
Important	Count (%)	18(4.0)	52(11.6)	34(7.6)	104(23.2)
Somewhat Important	Count (%)	90(20.1)	67(15.0)	48(10.7)	205(45.8)
Not at all important	Count (%)	40(8.9)	00(0)	00(0)	40(8.9)
Unsure	Count (%)	0(0)	0(0)	0(0)	0(0)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448(100%)

Source: 'The Author'

- (ii) Understanding investment guidelines and associated risks: (Table 7) reported that 42% entrepreneurs had complete awareness and rest 58% had partial awareness of guidelines and the risk associated with their investments. Majority of medium firm owners had full awareness of their investments, as compared to micro and small firms.

Table 7: Understanding Investment Guidelines and Associated Risks

Awareness of investment guidelines & risks		Micro	Small	Medium	Total
Fully	Count (%)	34(7.6)	45(10.0)	109(24.3)	188(42.0)
Partially	Count (%)	115(25.7)	105(23.4)	40(8.9)	260(58.0)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448(100)

Source: 'The Author'

- (iii) Purchase of business insurance: (Table 8) reported 30.8% entrepreneurs had not purchased any business insurance whereas some insurance was taken up by 69.2% entrepreneurs. Medium firms pioneered in purchasing insurance while micro firms mostly lagged in such behaviour.

Table 8: Purchase of Business Insurance

Purchase of formal insurance for business		Micro	Small	Medium	Total
Yes	Count (%)	71(15.8)	98(21.9)	141(31.5)	310(69.2)
No	Count (%)	78(17.4)	52(11.6)	08(1.8)	138(30.8)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448(100)

Source: 'The Author'

4.5 Financial Budgeting

- (i) Preparation of financial budget: (Table 9) reported that 75.4% respondents prepared a financial budget for their business whereas 24.6% did not feel the need of preparing it. Majority of medium and

small firm entrepreneurs prepared a budget for their business as against micro firms, where majority did not require any budget.

Table 9: Preparing Financial Budget

Preparing Financial Budget		Micro	Small	Medium	Total
Yes	Count (%)	149(33.2)	132(29.5)	149(33.3)	338(75.4)
No	Count (%)	92(20.5)	18(4.0)	00(0)	110(24.6)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448(100)

Source: 'The Author'

- (i) Benefits derived from financial budget: (Table 10) reported that 75.4% entrepreneurs used the budget for planning and allocation of resources, 47.3% for timely loan repayment, 43.5% to control their expenses, 24.3% for identifying financial needs in advance and 19.9% to compare the actual and budgeted cost figures.

Table 10: Benefits of Financial Budget

Benefits of financial budget		Micro	Small	Medium	Total
Resource allocation	Count (%)	57 (12.7)	132 (29.5)	149 (33.3)	338 (75.4)
Timely loan repayment	Count (%)	5 (1.1)	65 (14.5)	142 (31.7)	212 (47.3)
Tracking actual and budgeted cost	Count (%)	1 (0.2)	23 (5.1)	65 (14.5)	89 (19.9)
Control the expenses	Count (%)	10 (2.2)	73 (16.3)	112 (25.0)	195 (43.5)
Identify the financial needs	Count (%)	0 (0.0)	30 (6.7)	79 (17.6)	109 (24.3)

Source: 'The Author'

4.6 Management of debt

- (i) Business having debt: (Table 11) reported that 63.4% respondents had taken loan for business, whereas 36.6% had no debt. The loan availing firms were majorly medium firms (30.4%), followed by small (22.5%) and micro (10.5%) firms.

Table 11: Business having debt

Business having loan or borrowings		Micro	Small	Medium	Total
Yes	Count (%)	47(10.5)	101(22.5)	136(30.4)	284(63.4)
No	Count (%)	102(22.8)	49(10.9)	13(2.9)	164(36.6)
Total	Count (%)	149(33.3)	150(33.5)	149(33.3)	448(100)

Source: 'The Author'

- (ii) Managing debt: (Table 12) reported that 63.2% entrepreneurs borrowed from formal sources, 60.7% respondents compared interest rates and other charges before taking loan, 59.4% understood terms and conditions of loans, 57.6% split long term and short term debts to facilitate better management and 53.1% respondents knew the process of taking loans from different financial institutions.

Table 12: Managing debt

Debt Management		Micro	Small	Medium	Total
I prefer to borrow from formal sources.	Count (%)	66 (14.7)	91 (20.3)	126 (28.1)	283 (63.2)
I always compare interest rates before taking loan.	Count (%)	67 (15.0)	89 (19.9)	116 (25.9)	272 (60.7)
I split long-term and short-term debt to manage them.	Count (%)	56 (12.5)	87 (19.4)	115 (25.7)	258 (57.6)
I understand the terms and conditions of loans.	Count (%)	58 (12.9)	93 (20.8)	115 (25.7)	266 (59.4)
I understand the process of fund acquisition.	Count (%)	12 (2.7)	91 (20.3)	135 (30.1)	238 (53.1)

Source: 'The Author'

Conclusion

The study is an attempt to examine the financial literacy of entrepreneurs of MSME sector in India on four dimensions of accounting practices; savings, investments and insurance literacy; budgeting; and debt management. Some micro businesses were keeping manual records, showing a lack of understanding or necessity for computerised accounting. More medium firms were using accounting consultants who provide for financial analysis of accounting statements. A considerable number of medium and small businesses successfully used financial records, although most micro businesses' accounting needs seem to be driven more by regulation such as tax compliance (Halabi, Barrett & Dyt, 2010).

Medium and small firms provided relatively more importance to diversification of funds than micro firms. Diversification benefits may be undervalued or ignored entirely by entrepreneurs with insufficient financial literacy (Guiso & Jappelli, 2009). Medium firm entrepreneurs were fully aware of risk and returns associated with their investments, as compared to micro and small firm entrepreneurs. Medium firms were leading in purchasing insurance for their business. High financial literacy contributing to creation of financial reserves, diversifying investment portfolios, and purchasing insurance, indicates a more sophisticated approach to balancing of risk and return (Widdowson & Hailwood, 2007).

Medium and small firms engaged more in financial budgeting and deriving its benefits as compared to micro firms. Budget planning helps businesses predict and improve their financial performance (Foster, 2017). Because of their financial illiteracy, micro-entrepreneurs were less likely to seek external financing, and this makes them interest agnostic, focusing on cheap and quick access to credit rather than the cost of borrowing (Osei-Assibey, 2010). Medium firms were efficiently managing their debts, as compared to small and micro firms.

Research Implications

Policymakers can seek to improve the financial abilities that are mostly lacking among MSME entrepreneurs by gathering evidence on their levels of financial literacy through regular surveys. It would also assist in identifying gaps in existing measures to support MSMEs' financial education needs.

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