

**FINANCIAL LITERACY AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MOMBASA COUNTY, KENYA.**

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## DECLARATION

This Research task is my unique work and has not been presented in any other university for any other award.

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## **DEDICATION**

This study is dedicated to my dear wife Lucy Ruguru, my daughter Zawadi Wairimu and my son Baraka Murimi who have morally supported me through the entire process. The sacrifices and the unconditional support they accorded me were critical to my successful completion, and for that, I dedicate my successful completion of this project to them.

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## **ABBREVIATIONS AND ACRONYMS**

<b>ANOVA</b>	Analysis of Variance
<b>BEP</b>	Break Even Point
<b>CMA</b>	Capital Markets Authority
<b>EPS</b>	Earnings Per Share
<b>FSD</b>	Financial Sector Deepening
<b>GDP</b>	Gross Domestic Product
<b>KBA</b>	Kenya Bankers Association
<b>KIPPRA</b>	Kenya Institute for Public Policy Research and Analysis
<b>KITI</b>	Kenya Industrial Training Institute
<b>KNBS</b>	Kenya National Bureau of Statistics
<b>MSEA</b>	Micro and Small Enterprises Authority
<b>MSMEs</b>	Micro, small and medium Enterprises
<b>NACOSTI</b>	National Commission for Science, Technology, and Innovation.
<b>NPM</b>	Net Profit Margin
<b>NSE</b>	Nairobi Stock Exchange
<b>ROA</b>	Return on Assets
<b>ROE</b>	Return on Equity
<b>ROI</b>	Return on Investments

<b>SMEs</b>	Small, and medium Enterprises
<b>SPSS</b>	Statistical Package for Social Sciences
<b>UNGA</b>	United Nations General Assembly
<b>USAID</b>	United States Agency for International Development
<b>VAT</b>	Value Added Tax
<b>VIF</b>	Variance Inflation Factor

## OPERATIONAL DEFINITION OF TERMS

- Bookkeeping Skills:** These are specific competencies that enables a proprietor to effectively record business financial transaction into organized accounts on a daily basis. Measured using a 5-point Likert scale evaluating accuracy in record-keeping, budgeting, financial statement preparation, and sales forecasting.
- Capital Structure:** This is combination of equity and debt used by a business for financing. An optimal capital structure aims at maximizing the value of the business while minimizing its cost of capital.
- Cashflow management:** This is the tracking and controlling of cash that comes into and out of a business enterprise to ensure optimal and sustainable cash levels. This is through effective monitoring of operating, investing, and financing cashflows. Measured using a 5-point Likert scale assessing ability in cash flow forecasting, receivables and payables management, and maintaining liquidity .
- Cost of Capital:** This is the minimum rate of return an enterprise should make before generating value. It is calculated using the weighted average cost of capital formula that considers both the cost of equity and debt.

<b>Debt Management:</b>	This is a strategy to control debt levels while enjoying tax shield on interest repayments and maintaining an optimal capital structure mix to ensure a sustainable cost of capital. Measured using a 5-point Likert scale assessing proficiency in managing loans, debt restructuring, interest rate management, and negotiation of credit terms.
<b>Financial Leverage:</b>	The use of borrowed funds to buy and invest in assets with an expectation of a return that exceeds the cost of borrowing.
<b>Financial Literacy:</b>	This is the possession of financial skills that enable one to understand and effectively undertake basic tasks of budgeting, borrowing, taxation. It also includes personal financial management.
<b>Financial Planning:</b>	The process of assessing current financial situation of a business to guide in forecasting future financial goals and drafting a strategy on how to achieve them.
<b>Profit Maximization:</b>	This is the process of identifying the best price levels, output and input with the aim of maximizing returns. Prices, production cost and output levels are adjusted accordingly to realize profit goals.
<b>Profitability Ratios:</b>	These are financial metrics put in place to evaluate the ability of a business to generate earnings in correspondence with its assets, costs, revenues and shareholders' equity using financial data generated for a specific period of time.

**Small and Medium Enterprises:** These are businesses maintaining assets, revenues or employees below a certain threshold. with limited employees, turnover, and capital investment within set thresholds.

**Tax Management:** This is the process of administering taxes in compliance with legal requirements in a business jurisdiction. It entails taking advantage of exemptions, exclusions, deductions, rebates, and permissible allowances to minimize tax liability. Measured using a 5-point Likert scale covering competence in tax computation, VAT planning, tax compliance, and awareness of tax regulations

## ABSTRACT

Small and Medium-sized Enterprises (SMEs) play a vital role in Kenya's economic development by providing employment and fostering innovation. However, despite their significance, many SMEs in Mombasa County experience low profitability and short lifespans, with most collapsing within five years of establishment. This challenge has been attributed to limited financial literacy among proprietors, particularly in the areas of debt management, bookkeeping, tax administration, and cash flow management. The present study sought to examine the effects of financial literacy on the financial performance of SMEs in Mombasa County, Kenya. Specifically, the study aimed to: determine the effect of debt management skills, bookkeeping skills, tax management skills, and cash flow management skills on SME financial performance. The study adopted a descriptive research design and utilized primary data collected through structured questionnaires. A sample size of 132 SMEs was drawn from a population of 52,245 registered enterprises using stratified random sampling to ensure sectoral representation. Data analysis was conducted using Statistical Package for Social Sciences (SPSS version 29), employing both descriptive and inferential statistics. The hypotheses were tested at a 0.05 significance level. Findings revealed that debt management skills, bookkeeping skills, and tax management skills had a statistically significant positive effect on the financial performance of SMEs, while cash flow management skills showed no significant effect. Interestingly, SMEs that regularly updated financial records and practiced structured debt management reported higher net profit margins and better liquidity positions than those that did not. The results confirmed that financial literacy is a critical determinant of SME profitability and sustainability.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background Information

Globally, small and medium-sized enterprises (SMEs) have emerged as the backbone of economic development, contributing over 90 percent of businesses and more than half of total employment worldwide (World Bank, 2023). Despite their importance, limited financial literacy continues to hinder their sustainability and competitiveness. International organizations such as the OECD and World Bank have implemented financial education initiatives aimed at improving entrepreneurs' decision-making and access to finance. In developed economies, evidence shows that SMEs led by financially literate owners experience higher survival rates, profitability, and access to credit.

Regionally, across sub-Saharan Africa, SMEs account for nearly 80 percent of employment yet face structural challenges including poor bookkeeping, low savings culture, and overreliance on informal borrowing. Financial literacy programs such as those by FSD Africa and AFI Alliance have sought to enhance entrepreneurial capacity, but adoption remains uneven. In Kenya, financial education has been integrated into national strategies through institutions such as the Central Bank and Financial Sector Deepening (FSD) Kenya to promote prudent borrowing, taxation, and cash management among SMEs.

The financial performance of SMEs has attracted significant global attention in recent times emerging as a crucial subject for economists and policymakers involved in the advancement of financial and economic growth. They are the principal sources of employment, increased competition and innovation, and can have a significant effect on income distribution and poverty reduction (Eniola & Entebang, 2017). The importance of financial literacy has been exhibited by

its application to improve business performance both in the developed and developing economies. Lusardi (2019) points out that while there are many causes of SMEs closures, financial literacy remains among the most important initiatives that a small business can take to build resilience to navigate complex and dynamic business uncertainties. Importantly to note is that 27<sup>th</sup> June has been designated by the United Nations General Assembly (UNGA) as the MSMEs day to raise global awareness on the significant contribution small businesses make in the global economy.

As per a 2019 report by the World Bank, the role of financial literacy in influencing the performance of SMEs has attracted immeasurable attention recently. This interest has been driven mainly by the recognition that the ability to adequately manage personal and business finances is paramount in minimizing poverty reduction both at national and global levels. In practice, sound financial literacy empowers individuals and groups to plan for long-term financial goals that include resilient physical, mental, and emotional well-being. The massive contribution made by SMEs to the GDP and overall employment has made most developed countries to adopt different approaches in finding ways to improve financial literacy to business proprietors and relevant stakeholders of SMEs (North & Varvakis,2016). This in turn has brought significant performance through effective management of liquidity and debt to enhance stable SMEs in the developed world significantly impacting on business profitability through informed decision-making process.

Japan and Malaysia stand out as countries that have successfully developed their economies on the back of SMEs with friendly policies aimed at creating a conducive and enabling environment through an effective institutional framework. Capacity development geared towards entrepreneurs through improved business management skills have led to the growth of the two economies through industrialization and export-led enterprises. The success of Japan and Malaysia, in

particular, to the extent it has been replicated with significant positive results in the Asian region and beyond provides best practices to developing countries (Hussain, Salia & Karim,2018).

Developing nations such as the ones in Southern Asia and Africa have a larger share of SMEs which are mainly responsible for fostering competition and innovation in numerous economic sectors with a relatively smaller portion of them being formal, the rest, which make up the majority, are in the informal economy. This poses a greater challenge for policy makers, financial institutions, governmental and non-governmental organizations in conducting financial education. Muriithi (2017) indicates that the impact of small businesses in Africa is poorly understood due to fragmentation of data, but the world bank estimates that SMEs provide 80% of jobs in Africa, thus, a significant economic driver of poverty reduction and economic growth. Without the required capacity development through finance literacy, SMEs are unable to make proper investments decisions needed for growth leading to stagnation.

Business leaders and stakeholders in sub-Saharan Africa are actively seeking sustainable solutions to help lift the region out of economic vulnerability. Of the various development paths suggested, the continued growth of SMEs features prominently (Brownhilder Ngek, 2016). One reason for this is the urgent need to alleviate poverty and shrinking job opportunities in the region. In Kenya, where an estimated 1.5 million new employment opportunities are required annually, the majority of jobs that have been created have come from micro, small, and medium scale enterprises (MSMEs). At the end of 2014, the sector accounted for 80% of all newly created employment, and in 2015 agricultural MSMEs allowed roughly 750,000 small-holder farmers to earn more income (Chepsang et al., 2018).

Competitive strategies are thought to play a crucial role in bringing about better financing for MSMEs in the form of trade credit, debt, and other financing instruments. In sub-Saharan Africa,

financing from the formal sector has been the leading form of business capital, outstripping traditional forms of collateral such as gold or inheritance. Without access to capital from the formal sector, MSMEs find it difficult to seize investments, employ new employees, acquire raw materials in large quantities, and give cash discounts to customers. It has also been suggested that financial capital enhances enterprises' bargaining power, so that, for instance, MSMEs can withhold or threaten to withhold orders if they suspect possible contractual breaches by clients (Chepsang et al., 2018). Hence, it is expected that the availability of financial capital, assuming everything else to be constant, will have a positive effect on a firm's performance in terms of profitability and overall turnover.

According to Osano (2019), in the wake of numerous failures experienced by SMEs, it has increasingly become apparent that the problems bedeviling the SMEs are far much more complex than hitherto assumed. For instance, there is a realization that the weaknesses often observed in the demand and supply sides credit markets alone cannot explain some of the rather prevalent challenges being experienced by the SMEs. The sector provides numerous employment opportunities to women, youth and person living with disabilities. The USAID report (2023) estimates that Kenya has 7.4 million SMEs out of which 1.5 million are registered and over 5 million are informal SMEs collectively generating 40 percent of the GDP and providing non-agricultural employment. The Kenyan administration has done substantial strides through the financial sector deepening (FSD) an independent trust dedicated to disseminating financial knowledge to women and SMEs (Aduol & Mwangi, 2018). The central bank is concerned about finance literacy through its supervisory role to commercial banks by ensuring adequate disclosures in advancement of business loans to enterprises, this helps in debt and cashflow management through sustainable debt levels. Microfinance institutions and commercial banks have made

concerted efforts to educate Kenyans on both personal and business financial skills for proper decision making.

It is now widely recognized that SMEs have become the principal engines of economic growth and employment generation, particularly in emerging countries. The part of finance in influencing the growth and survival of SMEs has likewise attracted considerable attention, and a variety of formal financial institutions and informal financing mechanisms have been promoted to enhance their financial performance. Various studies have been carried out to investigate the role of financial literacy on the behaviour of entrepreneurs, and that it has been considered as a catalyst for the provision of finance. Entrepreneurial finance is perceived as a self-disclosure mechanism rather than an understanding of financial information; however, studies have proven that the knowledge of finance is important (Maduekwe and Kamala, 2016).

Further, financial knowledge, which also means financial literacy, plays an important role in enabling the entrepreneur to enhance perception, improvisation of judgment, and releasing the effect of entrepreneurs' finance on the economy. Thus, it becomes essential to provide entrepreneurs with financial knowledge that they can use effectively in problem solving and in making financial decisions for running their enterprises. Furthermore, given the potential benefits of adequate financial literacy — including making SMEs more competitive and potentially faster-growing and stimulating a greater degree of formal finance usage — efforts to improve the financial literacy of SMEs are viewed as particularly promising for reducing poverty and promoting economic growth and development (Okanta, 2018). Although improving financial literacy programs for SMEs are being rolled out, empirical evidence on their impact is limited. An understanding of how financial literacy training affects financial literacy — and how these changes

feed through to changes in the workings and financial performances of firms — is crucial for the design of effective programs (Fridson and Alvarez, 2022).

This study focuses on four dimensions of financial literacy, debt management, bookkeeping, tax management, and cashflow management, identified in literature (Eniola & Entebang, 2017; Ochola, 2017; Momanyi et al., 2017) as key competencies directly linked to SME profitability and liquidity. These variables capture the operational and strategic decisions that determine financial outcomes for small enterprises. Other aspects such as savings behaviour, investment analysis, or budgeting were excluded because they are largely personal-finance oriented, less measurable within enterprise operations, and beyond the control of most SMEs. The selected variables therefore represent the most practical and business-relevant measures of financial literacy influencing firm performance.

### **1.1.1 Financial Performance**

Financial performance refers to the extent to which an enterprise utilizes its assets and resources to generate revenue and profit over a given period. Conceptually, it represents the outcome of managerial efficiency in deploying capital and managing operations to achieve financial sustainability (Husain & Sunardi, 2020). Empirically, various scholars have measured financial performance using quantitative indicators such as Return on Assets (ROA), Return on Equity (ROE), Return on Investment (ROI), Gross Profit Margin (GPM), and Net Profit Margin (NPM) (Maduekwe & Kamala, 2016; Restianti & Agustina, 2018). For instance, Kasozi (2017) used ROA to capture managerial efficiency in Ugandan SMEs, while Husain and Sunardi (2020) employed ROE to measure shareholders' returns in Indonesian firms. In Kenya, studies by Minjo (2018) and Ombongi and Long (2018) applied NPM as a profitability indicator due to data limitations among SMEs that do not publish full balance sheets.

Fridson and Alvarez (2022) indicates that, the three elements of measuring financial performance of an enterprise are the cashflow and income statements, and balance sheet. The three statements are informative tools that business stakeholders use to analyse an enterprise financial strength and assess the value of a company. The income statement reveals the results of a company's business operations for a particular period in a given time.

Onyiengo (2019) argues that the primary reason why an enterprise should measure its financial performance is to show external investors and lenders why the company is a viable investment. It is an indicator of capability to repay loan obligations once they are due and to generate good returns to shareholders. Internal analysis of financial statements helps better understand business strengths and weaknesses through comparing current and past financial performance metrics to those of the industry and competitors. Evaluation of financial statements helps simplify financial information into ratios that can easily be understood by stakeholders (Husain & Sunardi, 2020). Liquidity ratios help monitor when an enterprise is running low on available funds and is monitored through the current and quick ratios. Current ratio is determined by dividing current assets which are either receivables, inventory or cash with current liabilities. A quick ratio measures the ability of an entity to access cash quickly to support immediate trade obligations. This ratio excludes inventory in its current assets. Both the current and quick ratio should be maintained above the ratio of 1:0 but optimal levels should not be exceeded to prevent opportunity cost from underutilized capital (Restianti & Agustina, 2018).

Fridson and Alvarez (2022) further asserts that, financial performance through net profit is an important method of analysing a company and evaluating its ability to pay taxes, generate resources, and pay expenses and short-term liabilities. It oscillates in an economic downside of the company. The financial ratio method is a conventional method used to measure financial

performance in company-based studies. A higher gross profit margin indicates a higher efficiency meaning that a company can still cover its operating expenses and still provide net earnings to the business. A low profit margin is an indication of higher cost of goods sold attributable to wrong purchasing policies, low selling prices and probably stiff market competition. The net profit margin is the bottom-line measure which analyses a company net income after interest and taxes in comparison to sales. Kasozi (2017) points out that a business having a higher net profit margin than its competitors will attract a huge pool of investors who will view it as more efficient, flexible, and strategic in taking up new business opportunities in the market.

In analysing the financial success of a firm, ROA is an important ratio to an investor as it serves as a reflection of how well management uses real investment resources to generate profits. Hussain and Sunardi (2020) assert that ROA should range from 10% to 12% and that an increased ROA is better for investors since it means more money on invested capital is being earned. For asset-intensive companies requiring huge investments in plant and machinery ROA may be lower compared to less asset-intensive companies such software companies. To effectively measure company's efficiency, ROI and ROE should be taken into consideration. A higher ROE translates into higher earnings per share (EPS) indicating a profitable venture.

Recent statistics reveal a worrying trend in the financial performance of Kenyan SMEs. According to the Kenya National Bureau of Statistics (KNBS MSME Survey, 2022), over 60 percent of SMEs operate below break-even levels, with average annual net profit margins of only 6–8 percent, barely matching the average inflation rate of 6 percent. The Kenya Bankers Association (2023) further reports that the proportion of profitable SMEs declined from 58 percent in 2018 to 45 percent in 2022, indicating a shrinking profitability trend. Regionally, FSD Africa (2023) observed that sub-Saharan African SMEs experienced a 12 percent drop in average returns on assets between

2019 and 2023 due to cash-flow constraints and poor financial management. In Mombasa County, county licensing records (2023) show that more than 40 percent of registered SMEs reported declining sales and liquidity levels over the past three years, signaling weak financial performance.

The declining profitability trend among SMEs demonstrates a pressing need for enhanced financial management competencies. Weak bookkeeping, ineffective debt control, and inadequate tax and cashflow management continue to undermine financial performance in Mombasa County. By focusing on these constructs, this study seeks to establish how different aspects of financial literacy influence the observed decline in SME profitability.

The current study adopted Net Profit Margin (NPM) as the primary indicator of financial performance. Unlike ROA or ROE, which require detailed balance sheet data often unavailable in SMEs, NPM relies on income statement information, sales and profit, which are commonly recorded even by informal businesses. Prior research (Ombongi & Long, 2018; Chepkemai & Njoroge, 2017) confirms that NPM provides a reliable proxy for profitability where asset and equity data are limited. Furthermore, SMEs in Mombasa rarely maintain audited accounts, making ratios such as ROA and ROE impractical to compute. Consequently, NPM offers the most consistent, comparable, and valid measure of financial performance for this context

### **1.1.2 Financial Literacy**

Financial literacy, according to Kodongo (2018) is the ability to understand finance related concepts in a business process. More importantly, it is considered knowledge and skills that enable a company or an individual to make effective and informed decisions with all of their financial resources (Kodongo, 2018). Applying this definition in the business field, it is defined as the ability to use the necessary skills and knowledge necessary to make good and informed economic

judgments and decisions (Tuffour, Amoako & Amartey, 2022). While there are many aspects of financial literacy, the most fundamental skills for a business set up entails bookkeeping for proper financial accounts, debt management, tax management and cashflow management. These four skills are vital to a business proprietor in ensuring legal compliance and finance sustainability. Joseph and Moses (2019) argue that dissemination of financial knowledge is a key aspect in nurturing small businesses in Kenya. The Inuka training program by the Kenyan bankers association is one of the best initiatives that has greatly improved financial literacy among most SMEs in Kenya with content focusing on enhancing business ability to access finance from banks (Mwangi,2020)

In the competitive landscape of small businesses, financial literacy is the cornerstone of sustainable business success (Fanta & Mutsonzwa,2021). Knowledge in bookkeeping and accounting enables traders to systematically record financial transactions, interpret financial information through well guided projections that provides valuable insights into a business financial health. Maintaining of accurate financial records helps in tracking incomes, expenses, and profit levels. A study by Chepkemoi and Njoroge (2017) found that a financially literate entrepreneur can identify potential risks and opportunities while ensuring the overall stability of the business. Implementing organized bookkeeping practices is fundamental for every business irrespective of the size. Utilizing digital tool and computerized financial software for accurate record keeping helps an enterprise to regularly update records, monitor cashflows, track expenses and prepare for tax obligations. Financial literacy is necessary for any business that wants to succeed in the long term. This is the knowledge behind dealing with debts, understanding how credit works, and how to evaluate the different proposals in the financial market, for example. Financial literacy can be considered a competitive advantage for many entrepreneurs and managers (Kodongo,2018).

A business should estimate its sales revenue on a periodic basis through identifying sales cycles. According to Hussain et al (2018), writing a small business financial plan entails a four-step process. The process begins with creating a strategic plan covering business goals and objectives. The next step is to create financial projections which are dependent on anticipated sales and expenses. Step three entails planning for contingencies while the final step is that of monitoring financial goals through comparing actual results to projections. Budgeting is a key activity of financial planning and guides in setting business targets. Lusardi (2019) asserts that, a financial plan requires an effective tax management strategy to minimize tax liabilities through taking advantage of various laws and regulations. Business and capital expenditure in plant and machinery should be prioritized to take advantage of tax allowable expenses. A financial plan should neither underestimate expenses nor overestimate revenues.

Proper debt management is essential for financial sustainability of an entity through maximizing on available business opportunities. An enterprise should neither be over geared nor under geared but should maintain optimal and sustainable debt levels (Eniola & Entebang,2017). Debt financing has a tax advantage on interest paid and prevents opportunity cost that arises from using company limited resources to finance business activities. High levels of unmanaged debt may increase financial risk through bankruptcy. When interest rates are hiked, market demand shrinks making loan repayments costly hence the importance of effective debt management practices. Ernest (2018) reasoned that, in dealing with customers, a business should have a good credit management policy with clearly defined terms. Credit terms should be realistic and properly stipulated in the invoices issued to customers to enable a clear debt collection process for effective cash flow management.

Cashflow management involves tracking and controlling money coming in and out of a business to accurately forecast cashflow needs. It entails the monitoring, analysis, and optimization of net amount of cash receipts minus cash expenses (Momanyi, Bichanga & Nyangau,2017). A business should prioritize on profit maximization since this is what generates cash injections into the bank account. The debt ratio should be kept low as an efficiency measure while current ratio should be maintained above 1.5 by ensuring current assets exceeds current liabilities in the balance sheet. Automating payment and invoicing makes it easy in ensuring stable cashflows. Negotiating favourable payment terms with suppliers helps avoid cash shortages.

Minjo (2018), was of the view that effective bookkeeping practices makes tax management easy through proper monitoring of an enterprise profits. Corporate taxes are computed on operating profits which is revenue generated less business-related expenses. Value added tax (VAT) is computed from sales and purchases with the resulting balance payable to the tax authorities. Preparation of accurate quarterly management accounts guides an enterprise in estimating correct instalment taxes on periodic basis in a financial year (Ochola,2017). Tax planning ensures that the financial burden of tax compliance is spread within the year to adequately manage liquidity crisis of an enterprise. Failure to ensure tax compliance can lead to business collapse through litigation, hefty penalties and poor business image which leads to dwindled revenues and lost business opportunities.

### **1.1.3 Small and Medium Enterprises (SMEs)**

Both the European union and United States of America have three broad parameters that define SMEs. Small enterprises comprise of up to 50 employees while medium sized ones have up to 250 employees. In the U.S., the limit is 500 employees for the classification of a medium-sized enterprise. In Asia specifically India SMEs are defined based on investment size, nature of

activities and turnover. Most African countries SMEs are classified differently as focus is on the level of capital invested, number of staff and asset base. For instance, South Africa classifies micro enterprises as very small businesses employing 6 to 20 employees while small businesses are classified as those that employs between 21 to 50 employees. The medium sized business classification is for those enterprises that employs up to 200 employees. According to a 2021 survey by the World Bank, approximately 90% of businesses are SMEs and more than 50% of the global population is employed under SMEs.

The key attributes considered in defining SMEs include turnover, level of capitalization and the number of employees. They are universally referred to as businesses whose personnel and revenue fall below certain limits (Nagaraj & Vaibhav, 2020). According to the world bank group report (2021), SMEs are an important economic and social tool given the sectors role in reducing inequalities and boosting employment levels. Due to their sizes decision making is mainly anchored to the chief executive officer (CEO) who happens to be the founder, owner, and manager of the enterprise. However, despite the role they play, most SMEs are frequently confronted with market imperfections, have difficulties making proper financial decisions especially on affordable credit, market access and business growth plan hampering economic transformation into large-scale business.

In Kenya, SMEs are explained under the Micro and small enterprise Act of 2012. The MSEA Act classifies SMEs by the total number of employees engaged, annual turnover, or by total financial investment (Milgo, 2017). These businesses play an integral role in the economic development. SMEs are major sources of employment and income to Kenyan residents, thus, playing a relevance role in fostering economic development. Typically, most SMEs in Kenya are engaged in trade, services, and manufacturing, especially food manufacturing, textiles and products, and metals

works. Muriithi (2017) posits that, the Kenyan government has made significant efforts through the ministry of co-operatives and SMEs development to create favourable economic policies aimed at facilitating adequate flow of credit from financial institution. Administration of “Uwezo Fund” and “Hustler Fund” are initiatives for enhancing competitiveness of SMEs through access to domestic and export markets.

The SME survey of 2021 by Kenya bankers’ association (KBA) revealed that close to two-thirds of enterprise owners had a prior experience of more than 3 years in employment before venturing into business. The KBA (2021) also revealed that 60% of SMEs are concentrated in the urban areas with a huge chunk in Nairobi, Mombasa and Kisumu city. Most are start-ups with little experience in market dynamics hence low survival. Data from the local integrated financial operations management system and county licensing records (2023), indicates that Mombasa County has 54,245 registered SMEs. A huge chunk of these enterprises are non-registered businesses commonly known as Jua Kali organizations and employing a substantial population in the county. SMEs functioning within Mombasa County feature all sectors of business including transport, hospitality, catering, entertainment, wholesale and retail sector, pharmaceuticals and health services, technology, real estate, clearing & forwarding amongst others (KIPPRA,2019). A study by Mohammed and Rugami (2019) found out that despite the conducive business environment and proximity to the port of Mombasa which gives SMEs in Mombasa County a comparative advantage to access supplies cheaply, the survival rate remained low due to poor financial performance resulting from ineffective business management hence dire need for financial literacy.

## **1.2 Problem Statement**

Small and Medium-sized Enterprises (SMEs) remain the backbone of Kenya's economy, contributing approximately 40 percent of GDP and employing over 80 percent of the working population (KNBS, 2022). Despite this critical role, their financial performance, measured through net profit margin (NPM), has persistently declined. According to the Kenya Bankers Association (2023), average NPM among SMEs dropped from 11.4 percent in 2018 to 7.2 percent in 2022, while data from the Micro and Small Enterprises Authority (MSEA, 2023) shows that nearly 46 percent of SMEs operate below break-even levels. In Mombasa County, county licensing records (2023) indicate that more than 40 percent of SMEs reported a consistent decline in profitability between 2020 and 2023, with most recording profit margins barely above the inflation rate of 6 percent. This trend reflects a worrying deterioration in financial performance and signals inefficiencies in managing key financial functions.

Financial performance, conceptualized in this study as net profit margin, captures the ability of SMEs to control costs, optimize revenues, and sustain operational efficiency. Previous empirical evidence has associated financial literacy with improved financial performance, but the link remains inconsistent and underexplored in local contexts. Eniola and Entebang (2017) found that financial literacy significantly enhances SME profitability in Malaysia through better debt and cashflow management. However, their study focused on formalized enterprises with structured accounting systems, unlike many Kenyan SMEs that operate informally. Ochola (2017) in Migori County established that poor tax management leads to liquidity crises and profit decline, yet the study emphasized tax compliance rather than overall financial performance. Similarly, Momanyi et al. (2017) demonstrated that weak cashflow management among Kenyan SMEs negatively affects profitability but did not examine the combined effect of multiple financial literacy dimensions. These studies largely focus on sales revenue or liquidity, leaving a gap on how specific

financial literacy constructs, debt management, bookkeeping, tax management, and cashflow management, collectively influence profit margins over time.

SMEs in Mombasa face unique financial challenges linked to these constructs. Many proprietors lack formal bookkeeping systems, leading to inaccurate cost and revenue tracking. Others struggle with debt repayment scheduling, inefficient tax planning, and poor cashflow forecasting, resulting in reduced liquidity and shrinking profits. The observed decline in profitability suggests that these financial management shortcomings directly erode NPM levels, yet few empirical studies in Kenya have quantitatively measured this relationship over time.

This study therefore seeks to fill these gaps by examining how specific aspects of financial literacy—debt management, bookkeeping, tax management, and cashflow management skills—affect the financial performance of SMEs in Mombasa County, measured by net profit margin between 2020 and 2023. Unlike prior studies that focused narrowly on single constructs or sales revenue trends, this research integrates multiple financial literacy dimensions into one analytical framework. The study is expected to generate new empirical evidence on how SME profitability trends can be explained by variations in financial literacy skills, thereby guiding policymakers and practitioners on targeted financial training interventions for sustainable SME growth.

### **1.3 General Objective**

The study' investigated the effects of financial literacy on financial performance of SMEs in Mombasa County.

#### **1.3.1 Specific Objectives**

- i. To examine the effects of debt management skills on the financial performance of SMEs in Mombasa County.
- ii. To evaluate the effects of bookkeeping skills on financial performance of SMEs in Mombasa County.
- iii. To evaluate the effects of tax management skills on financial performance of SMEs in Mombasa County.
- iv. To investigate the effects of cash flow management skills on the financial performance of SMEs in Mombasa County.

#### **1.4 Research Hypothesis**

The following hypotheses were tested:

**H<sub>01</sub>:** Debt management skills have no significant effects on financial performance of SMEs in Mombasa County.

**H<sub>02</sub>:** Bookkeeping skills have no significant effects on the financial performance of SMEs in Mombasa County.

**H<sub>03</sub>:** Tax management skills have no significant effects on the financial performance of SMEs in Mombasa County.

**H<sub>04</sub>:** Cashflow management skills have no significant effects on financial performance of SMEs in Mombasa County.

#### **1.5 Significance of the study**

This study is significant to several stakeholders in the SME ecosystem. SME owners and managers will benefit by gaining practical insights into how financial literacy, specifically debt management, bookkeeping, tax management, and cashflow management, can improve profitability and business sustainability.

Financial institutions such as banks and microfinance organizations will use the findings to design targeted financial training and credit programs aligned with SME capabilities.

Policymakers and government agencies, including the Ministry of Co-operatives and Micro and Small Enterprises Authority (MSEA), will benefit from empirical evidence to guide formulation of capacity-building and financial inclusion strategies tailored for SMEs.

Academic researchers and scholars will find the study valuable for expanding the literature on financial literacy and firm performance, providing a basis for future comparative studies across regions.

Lastly, development partners and training institutions will draw on the results to refine entrepreneurship and financial education programs that enhance SME competitiveness. Collectively, the study contributes to improved decision-making, profitability, and long-term growth of Kenya's SME sector.

## **1.6 Scope of the study**

This study focused on examining the relationship between financial literacy and financial performance of Small and Medium-sized Enterprises (SMEs) in Mombasa County, Kenya. The contextual scope was limited to Mombasa because, despite its strategic economic position and proximity to the port, SMEs in the county continue to record low profitability and short survival

rates. The area therefore provides an ideal setting for assessing how financial literacy influences SME profitability and sustainability.

The conceptual scope covered four dimensions of financial literacy—debt management, bookkeeping, tax management, and cashflow management—as the key independent variables, while financial performance was measured through net profit margin (NPM). These constructs were selected because they directly reflect the financial decision-making capacity of SME owners and are quantifiable within the operational framework of small enterprises.

The periodical scope covered the financial years 2020 to 2023, representing a post-pandemic recovery period when many SMEs faced liquidity challenges and profitability fluctuations. This timeframe allows an accurate assessment of financial literacy practices during an economically volatile phase.

The methodological scope employed a descriptive research design using quantitative data collected through structured questionnaires. This design was appropriate for establishing measurable relationships between financial literacy constructs and SME financial performance.

By addressing these scopes, the study fills existing contextual gaps (limited regional evidence from Mombasa), conceptual gaps (limited integration of multiple financial literacy dimensions), and methodological gaps (scarcity of quantitative, multi-variable studies in Kenyan SMEs).

## **1.7 Study Organization**

This research is organized into five chapters. The first chapter is the introduction. The research background, the purpose of the study, and relevant hypotheses and objectives of the study are

featured in this chapter. Additionally, the scope, its significance and limitations of the study are also included.

The second chapter is the literature review that captures the theories underpinning the study, an empirical review of previous researchers' works and the conceptual framework. The section concludes by outlining the gaps evident in the literature.

The third chapter entail the research design and sample size are detailed. Research instruments as well as the validity of the instruments are also covered. Data collection procedures are explained, and the data analysis strategy detailed. The section winds up by outlining the ethical considerations.

The fourth chapter focuses on data analysis, where both descriptive and inferential analysis is carried out. This chapter also tests hypotheses to facilitate answering of the overarching research question.

The final chapter is the fifth chapter, which centred on the discussions, conclusions, and implications of the research findings. This chapter also focuses on recommendations and limitations.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1. Introduction

This section contains a theoretical framework and an empirical review of studies discussing the study's variables. A summary of research gaps identified from prior empirical works is also taken. The conceptual framework of the study is also presented outlining independent and dependent variables.

#### 2.2 Theoretical Framework

The investigation is anchored on various finance theories and hypotheses. These include double entry accounting theory, trade off theory, decision usefulness theory and the transaction cost theory.

##### 2.2.1 Double Entry Accounting Theory

The theory of double entry accounting was developed by an Italian mathematician Luca Pacioli in 1494 who saw the need to improve the single-entry bookkeeping system, and which was limited to incoming and outgoing cash only. Double entry bookkeeping captures all aspects of a financial transaction where an entry is recorded in at least two accounts as a debit or a credit. According to Sangster (2016), every economic financial transaction has two effects exactly opposite to each other hence at the end of an accounting period total debits should tally to total credits. Andreica (2016) argues that unlike the single-entry bookkeeping system where incomes are only registered in a cash register only, the double entry system starts by documenting daily entries in a journal where transactions are recorded sequentially and in a chronological order. Items booked in the

daybook are then recorded in ledgers which are also books of final entries. The ledgers are then balanced at the end of a certain accounting period to generate the general ledger which is a consolidation of ledgers maintained by an entity.

Double-entry accounting is based on the concepts of duality of transactions, debit and credit, and cause and effect. The principles of double-entry accounting are rooted in the concept of duality of transactions because for every transaction, there should be either a receiver or a giver. It is one of the simplest yet powerful principles, according to which each business transaction has a dual effect. Therefore, for every action, there is an equal and opposite reaction (Wyson, 2022). When a business concern receives something, it must be giving something in return to someone else, such as assets and liabilities, income and expenditure. Unlike single-entry accounting, double-entry accounting (debit and credit) has universal principles such as the dual effect principle, the concept of 'Debit' and 'Credit', and the principle of cause and effect, all of which apply regardless of the nature or category of business (Basu & Waymire, 2021).

It is important for enterprises to note that, for each “Debit (DR) there must be a corresponding Credit (CR) and for each CR there must be a corresponding DR” as per the double-entry bookkeeping rule (Andreica, 2016). The prime drive of double-entry bookkeeping is to provide a clear status of the firm's financial performance and position. In double-entry bookkeeping, all transactions are recorded in two names of accounts; they are personal account and impersonal accounts. In this context, the personal account includes all trading debtors, owners, and creditors. Chepkemoi and Njoroge (2017) notes that business owners neglect to apply double-entry bookkeeping so that they may save on accountancy related costs and the need to hire accountants who are the bookkeeping professionals. As a result, most suffer losses unknowingly while unable

to properly forecast business patterns. Proper bookkeeping helps in forecasting future business trends through analysis of past financial performance and current trends.

The trial balances summarize and maintains the arithmetic accuracy of the general ledger transactions into a one bookkeeping worksheet indicating the debit and credit balances which should tally. From the trial balance an entity is able to generate summary level reports commonly known as financial statements. These statements include the income statements which indicate losses and profits made by the company. It is an important report for income tax assessment and guides lenders in evaluating business performance (Iyehen & Sabit, 2023). The balance sheet is also generated from the trial balance and helps monitor the financial position of an enterprise at a given period of time. An analysis of the balance sheet and the income statement guides an entity to come up with a cashflow statement which is an important tool that monitors both cash inflows and outflows and tallies them to the available cash and cash equivalents.

This theory is well suited to this study as it acknowledges the importance of bookkeeping knowledge in the success of an enterprise. It is from an effective bookkeeping system that accurate financial statements can be prepared to guide business decision making.

### **2.2.2 Trade off Theory**

This theory was introduced by August Myers in 1984. It emerged from the debate about Modigliani and Miller theorem of capital structure where both equity and debt were considered significantly important source of capital. The theory argues that companies should determine the optimal capital mix of equity and debt financing to balance the benefits and cost of each source of finance. Business proprietors should remain vigilant on market information that relates to financing and cost of capital when coming up with a financing model. They need to consider factors such as

expected cashflows, company risk profile and tax implication for each source of financing. Hirdinis (2019) asserts that small and medium enterprises should not shy off from using debt capital to minimize on the opportunity cost that comes from using own sources of capital. A business should not lose on a profitable venture which rate of return is above the borrowing rate, but level of finance leverage should be anchored on company's growth and investment plans.

An optimal capital structure is when the value of a business is maximized and while the WACC is minimized. According to Brusov and Filatova (2023), successful businesses must consider debt financing's primary benefit by computing interest tax shield (Brusov & Filatova, 2023). Decision to depend on leverage from debt causes the risk of financial distress due to the contractual commitments with fixed costs and a higher debt can limit future borrowing hence accelerating opportunity cost on lost investment opportunities. The theory underpins this study as it informs business proprietors on the importance of optimal mix between debt and equity capital in business financing. It also guides on proper debt management skills so as to maximize on tax shield from interest payments.

The Trade-Off Theory is variously applied in the finance literature, and it clarifies that investment and financial policy choices are confronted with advantages and disadvantages, and investors and managers have to trade one against the other. Overall, trade-offs are just worth making to the degree they generate the biggest profit (Grass et al., 2020). This theory suggests that a trade-off is supposed to happen in firms. Complicating the capital structure may need profits that arise from bankruptcy or distress costs, while releasing debt may need profits that derive from a lower tax advantage from interest loans. Nevertheless, these two aspects are competitors because an increased possibility of bankruptcy or restriction will reduce the tax advantage of borrowing (Khoa & Thai, 2021).

Accordingly, Jayanagara and Hartanto (2022) contend that it is rational to expect a trade-off theory to watch a gradual firmness leash weeks or years due to the expense of financial distress. Specifically, managers track events closely and options of the signs of fiscal difficulties. Moreover, detailed labels for the materializing of financial distress recommend one through signs of the likelihood of distress being obvious. All of these combines to suggest that leverage structure would be primarily influenced by the costs of a decline that affect the costs over time, either by the extent of difficulty and/or when hardship occurs.

### **2.2.3 Decision Usefulness Theory**

This theory was postulated by George J. Staubus in 1958 from an accounting concept of revenue. The fundamental objective of bookkeeping practices is to come up with financial reports that can guide decision making of an organization. According to Wachter and Kahana (2024) decision usefulness is defined in terms of reliability, relevance, consistency, comparability, and understandability to satisfy user of accounts namely, investors, creditors, tax authorities and other relevant stakeholders. To monitor business performance an entity should prepare income statement which is an equivalent of profit and loss account that shows revenue and business expenses. The profit before taxes should be well indicated while tax computation should consider tax allowable expenses to prevent over taxation. Failure to keep proper books of accounts is punishable by most jurisdictions and is normally interpreted as a tax evasion scheme which is criminal.

According to Keasey and Watson (2019) financial projection is an essential business strategy tool that guides future decision making. A business uses the current financial statements to forecast future trends. The balance sheet of an enterprise is an important statement especially to financial institutions when advancing collateralized loans. The statement of cashflows should clearly

indicate the outflows and inflows from business operations, financing activities and investing activities by the entity. Financial statements need to be prepared on periodic basis as they are an important metric in business performance.

This theory underpins this study as its application is relevant with respect to developing economies. In reality, SMEs operate in an environment which faces very asymmetric information problems. They are typically controlled by their owners who are also their managers. In such a situation, they also possess financial reports, which are supposed to provide decision usefulness to both the providers of the records and the users. It may be deduced that SMEs owners in developing nations, Kenya included, might not possess financial literacy as assumed by existing theories. They require information that could help them make informed decisions on the financial matters affecting their enterprises which in effect can be reverted to their own personal financial matters.

The decision usefulness theory in accounting is a normative, deductive theory because it portrays a desired consequence orientation. Direction is largely from the economics decision-making process, through information to efficiency in resource allocation because the users demand that their needed information be related to states of the world which are decision relevant for their best alternative action. Wachter and Kahana (2024), further puts it that information is power hence every business should be properly equipped through proper financial knowledge to guide appropriate decision making.

#### **2.2.4 Transaction Cost Theory**

It was authored by Williamson in 1981, suggests that rational economic agents will search for ways to economize on transaction costs, and in so doing will structure their transactions to minimize these costs. These costs include the cost to actually purchase or secure the loan, the cost

of monitoring the way the money is used, regular communication, technological and reporting requirements, and costs of enforcing the loan agreement. Akbar and Tracogna (2018) argue that through transaction cost, businesses are able to measure the efficiency of their business operations, thus, for a firm to effectively manage its transaction costs, business proprietors and managers need to acquire financial management skills.

Low financial skills or lack thereof in cashflow management may cause increased transaction costs which in turn affects financial performance of an enterprise. Rindfleisch (2020) points out that businesses should get acquainted with this theory to avoid activities that do not yield results and to keep proper books of accounts to ascertain accurate business analysis. This theory will underpin the study given that it is vital to maintain proper records on business transactions to secure an organization past performance, present review and for accurate forecasting of future financial position. Most SMEs are operated by business owners who may not have adequate knowledge in maintaining proper books of accounts but are required to get these services to run successful and sustainable business enterprises. Small businesses should also invest in information systems which are capable of integrating various business modules to enable follow up and monitoring.

### **2.2.5 Theoretical Critique and Link to Financial Performance**

The study was anchored on four theories that explain how financial literacy influences the financial performance of SMEs. Each theory provides distinct insights into the relationship between financial knowledge and profitability, while also presenting certain assumptions and limitations. The table below summarizes how each theory underpins the dependent variable (financial performance).

#### **Table 2.1 Theoretical Critique Summary**

<b>Theory</b>	<b>Key Propositions</b>	<b>Link to Financial Performance (Dependent Variable)</b>	<b>Assumptions</b>	<b>Critique / Limitations</b>
<b>Double Entry Accounting Theory</b> (Luca Pacioli, 1494)	Every business transaction affects at least two accounts, ensuring balanced and accurate records.	Accurate bookkeeping and record-keeping enhance financial transparency, enabling SMEs to track profitability and make informed financial decisions.	Assumes SMEs maintain structured bookkeeping systems and possess basic accounting knowledge.	Many SMEs lack formal accounting systems or professional expertise to apply double-entry bookkeeping effectively.
<b>Trade-Off Theory</b> (Myers, 1984)	Firms aim to balance the tax benefits of debt with bankruptcy risks to achieve an optimal capital structure.	Proper debt management minimizes financing costs, improving profit margins and overall financial performance.	Assumes SMEs can access credit markets and rationally determine sustainable debt levels.	Ignores contextual constraints such as limited access to credit, fluctuating interest rates, and managerial inexperience in debt management.
<b>Decision Usefulness Theory</b> (Staubus, 1958)	Financial information is valuable if it aids users in making rational economic decisions.	Quality and timely financial information help SME owners make profit-oriented decisions such as cost control, pricing, and investment planning.	Assumes that financial reports are available, reliable, and that SME owners can interpret them correctly.	Many SMEs lack formal reporting systems, making the usefulness of financial data dependent on owners' literacy levels rather than system accuracy.
<b>Transaction Cost Theory</b> (Williamson, 1981)	Firms seek to minimize costs associated with economic	Efficient financial management, including cashflow control	Assumes that SMEs act rationally and have efficient	Overlooks differences in firm capacity, literacy, and

Theory	Key Propositions	Link to Financial Performance (Dependent Variable)	Assumptions	Critique / Limitations
	exchanges such as monitoring, negotiation, and enforcement.	and cost monitoring, reduces transaction costs and enhances profitability.	systems to monitor and control transaction costs.	resource availability that limit cost minimization efforts.

Collectively, these theories establish the conceptual foundation linking financial literacy to SME financial performance. Double Entry Accounting and Decision Usefulness theories explain the role of bookkeeping and financial reporting; Trade-Off Theory supports debt management decisions; and Transaction Cost Theory underpins cashflow and cost efficiency. The combined theoretical framework assumes that financially literate SME owners are better positioned to manage financial resources effectively, resulting in improved net profit margins, the measure of financial performance in this study.

**2.3 Empirical Review**

Several studies that have been carried out on financial literacy and the performance of SMEs. There are studies that were also carried out on the specific cases where the quality of financial service delivery and the role of business-related financial management or financial literacy were studied to ascertain the bearing on the performance of SMEs in the country. The direct linkage of financial management in the form of financial literacy on SME financial success, if investigated, could significantly increase the understanding of financial literacy in the new conceptualized environment by lack of access to finance.

**2.3.1 Debt management and financial performance**

Debt management and its effect on financial performance have been extensively studied in numerous fields, including finance and management, due to its crucial importance. Researchers such as Odo and Udodi (2022) and Tuffour, Amoako and Amartey (2022) from diverse backgrounds, have delved into this topic, exploring the intricate relationship between debt capacity, capital structure, and operational profits. Through their investigations, they have shed light on various aspects of this subject, providing a wealth of insights. According to Tuffour, Amoako and Amartey (2022), capital structure decisions should be undertaken with a lot of consideration to maximize on available and new business opportunities. An enterprise resources are often limited and thus owners' equity cannot be adequate to undertake market opportunities thus the need for debt capital. While both debt and equity play a big role in establishing the cost of capital an optimal mix is necessary so that a firm is not overgeared through debts or is losing on business opportunities from lack of investment resources. An overgeared company phenomenon adds complexity to debt management, leading to higher costs and potential risks on financial distress. One significant consequence, as Sokol (2021) and Tung (2021) add, is the potential market risk where expected returns may go below the cost of capital further disrupting the overall debt structure and posing challenges to a firm's financial stability and eventually leading to business collapsing. Consequently, managers must be mindful of the debt proportion and the stage of growth of an enterprise to ensure financial capacity which eventually prevents debt defaults.

Obuya (2017) conducted a critical literature review on the options of financing, and specifically debt financing and impact it has on the MSMEs' financial performance. Trade credit and short- and long-term loans operationalized debt financing while current ratio, ROA and gross profit margins operationalized financial performance. The review used both the theoretical and empirical

methods from studies where quantitative, associative, descriptive, and predictive analysis were applied. The literature review established that debt financing was an important branch of the capital structure financial performance depended on the type of investment decision undertaken by the enterprises. The review encountered conflicting findings and recommended for a further study to establish the power balance between business financiers and proprietors especially on the interest given in the advancement of credit and the rate of return on investment from borrowed funds. This review was skewed to debt financing and did not focus on how debt management affects the bottom line of financial performance, which is the net profitability of SMEs.

Ngungu (2020) conducted a study on the effects debt management has on the performance of listed NSE firms. Focus was on 54 firms and inferential and descriptive statistics were used in analysing data attributes. Findings revealed that firm size and debt proportion positively correlate with financial performance. The current and solvency ratios negatively correlate with financial performance both in the short and long run operations of a company hence the need for proper debt management. This study focused on the listed companies which by classification are large enterprises.

Ndemi and Mungai (2018) discovered that there are a number of factors that enable organizations to manage their debt well and improve their financial performance. The most significant of them is understanding the sources of debt. This is particularly important for that period when funds are needed to finance a project, firm's operations, or acquisition of an existing business. Also, important when debt is applied to finance project expansion and small to buy assets that can be sold readily and for which a ready market exists. The reason for adopting this approach is that the price of the assets can be disposed can be easily determined as these assets do not require technical needs. Some of these established organizations include micro-finance institutions and banks, Sacco

credit societies, etc. The others are through a loan by the government to enhance training and YEP among other sources of debt.

Jan et al. (2021) and Hamed (2023) reiterated that managing debt in financial institutions is an essential function in maintaining sustainable performance. A proper investment strategy and effective debt management would improve a firm's soundness and performance. Debt management in financial institutions reduces the probability of negative impacts from a financial crisis and its ability to keep the firm's safe profits level (Valášková et al., 2021). According to Lenarduzzi et al. (2021) and Hamed (2023), the future objective debt management would be important to consider regarding important firm parameters. Improving the firm's capital structure might require heavy changes in the business decision-making process. A sufficient cash reserve might slow down the firm's productivity and its growth opportunity. Still, a good market position, trustworthiness, and familiarity with the external agencies would create potential future capital markets possibilities at lower interest rates (Zhang et al., 2023). These problems consider the firm's basic financial statements, acknowledgment of business and portfolio investment decisions, and external factors that may cause financial difficulties and long-term engagement in the market.

Studies such as Biondi (2023) and Mariam et al. (2023) posit that the impact debt management has on financial performance is a multifaceted and intricate matter. It necessitates thorough evaluation and analysis to comprehend the intricate relationships between debt capacity, capital structure, and operational profits. By delving into this subject, researchers have contributed significantly to our understanding of how debt management decisions can shape a firm's financial performance and overall well-being.

It has also been realized that many entrepreneurs start businesses without financial literacy skills due to the misconceptions that businesses start with physical assets rather than how money moves within assets and liabilities. Attaining financial literacy helps entrepreneurs to take managed financial risks, hence being able to seek for higher returns from investment ventures

(Nyamboga et al., 2014). One of the successful strategies of achieving desired level of financial growth and sound governance for every state is through aiding individuals to develop their financial literacy skills. Ensuring the financial system is well structured and transparent and ensuring large firms do not get away anymore in making the worth of not risky; it was crucial for the agencies to follow the law accountability ( Ngek, 2016).

Internal financial literacy enhances the ability of SMEs to optimise the best use of scarce resources through efficient and effective building of financial management systems ( Hussain et al., 2018).

An entrepreneur with knowledge of finance is seen to effectively mitigate the consequences of restrictions on capital or cash flow, making it the key variable in firms' financial management. Furthermore, the incidence of illiteracy negatively influences the performance of entrepreneurs due to the inability to provide and evaluate the consistency and completeness of information regarding the use of borrowed capital (Ngek, 2016). Consequently, credit decisions by financial institutions are influenced more by luck, statutory considerations and implied collateral rather than the economic and investment rationality of the project. This can therefore result in easier loan rejection and eliminate innovation incentives to invest the credit received. Due to financial limitations, the entrepreneur's association concluded that financial difficulties are the main reason why potential entrepreneurs do not seek institutional credit. Unless otherwise indicated, current regulatory schemes do not enable entrepreneurs to access organizational credit based solely on their self-made guarantees or the alternative collateral they own. The analysis below confirms the

validity of these theoretical findings and considers how financial literacy can influence the financial performance of entrepreneurs from SMES.

Of the various financial management dimensions of the firm, debt management is one of the most important and, despite the firm's own business, the choice of the exact amount, timing and proportion of debt is mostly related to the outside financial market. Due to the information asymmetry between managers and banks, successful debt policy is more complex for small or medium-sized renowned companies. Considering that most SMEs are unable to enter the stock market, the execution of the internal debt by these companies should be more well prepared considering the bank borrowing cost is significantly affected by the SME credit risk. Due to information asymmetry, banks bear higher agency costs, so they lend only to the most transparent companies, which further enhances the importance of credit risk considerations in the terms of the credit agreement.

The strategies that Small Medium Enterprises (SMEs) use to manage their debt can influence their financial performance. In particular, debt maturity, debt intensity, and leverage affect financial stability, financial risk, and profitability. Debt instruments can help improve performance if they are managed correctly (Ngek, 2016). Access to finance is an important factor that affects the performance of SMEs. The literature thus far has shown that bank debt has an optimistic bearing on business performance, because banks are the main sources of SME finance in Poland. Working capital loans, cash credits, investment loans, leasing, and overdrafts are widely used by SMEs to ensure liquidity. This also shows that short and medium-term loans affect performance in the construction and housing industry, food processing, as well as the hotel and restaurant sectors. Other types of debt financing such as factoring and trade credit had a negative impact on SMEs in the research sample. Businesses can increase their effectiveness through internal resources.

Ploughing back profits and maintaining an optimal level of liquidity positively affect the company's financial performance.

### **2.3.2 Bookkeeping Skills and financial performance**

Earnst (2018) carried out a survey in Kumba Municipality, Cameroon attempting to establish the effects bookkeeping has on the survival of small businesses. Data, from 150 respondents was gathered through questionnaires and descriptive and inferential statistics was utilized to assess data. Outcomes exposed that proper bookkeeping had a substantial bearing on the survival of the businesses as it enabled effective financial planning and actual projections through timely monitoring of gross profit margins and break-even points. The study also discovered that proper bookkeeping helps monitor business fixed and variable costs while keeping the business operating at optimal levels to meet sustainable revenue targets. The research was confined to the economic landscape of Cameroon particularly Kumba municipality and was skewed to business survival rather than financial performance, highlighting a contextual gap.

Minjo (2018) conducted a study on the effects owner accounting practice competencies have on the performance of SMEs in Nairobi, Kenya. Reliability and validity tests were carried out prior to administration and descriptive and inferential statistics employed in the analysis. Findings revealed that competencies in owner accounting practice significantly influence financial performance. The study's major focus was on accounting practice competencies which requires an aspect of professional competency unlike the current study which focusses on bookkeeping which is more simplified skill of financial tracking of daily business financial transactions. Traders can easily be trained on bookkeeping practices as compared to accounting practices.

Aladejebi and Oladimeji (2019) examined the bearing of record keeping on the performance of selected SMEs in Lagos Metropolis. Data was gathered through a questionnaire issued to 197 respondents out of the 200 questionnaires given out to owners/managers. Findings revealed that proper record keeping has a substantial effect on the performance of SMEs as it guides proper decision making hence reducing management inefficiencies. The research was majorly centered on record keeping and did not focus on bookkeeping which the current study seeks to fill this gap.

Bookkeeping is a measure of financial literacy that involves the preparation and evaluation of financial statements so as to calculate some ratios. The performance of the SMEs in Mombasa County, Kenya could be attributed to financial literacy training on credit management skills, book keeping skills, budgeting skills and investment skills on the enhancement of credit facilities, the maintenance of debtors and creditors ledger, the estimation of weekly profit and losses or costing, the maintenance of the clearing goods or container service, the improvement of advert placement and the maintenance of a budget committee, has enhanced the performance of the SMEs. Credit management skills have been increased because of loan repayment issues after financial literacy training. The credit management skills would cause SMEs to be disbanded. Book keeping skills are financial literacy concerning the maintenance of debtors and creditors ledgers, which has made it easy to maintain normal business records, and this will affect the ability of the control of cash inflows, cash outflows, or the cost of goods sold, that is, operational expenses, so as to reduce the loss of control of goods or merchandise after credit transactions. However, this trading would have a good chance of expansion, for example, leather selling instead of the genuine leather bag. Among the book keeping skills was the ability to do a self-internal audit, so after the financial literacy training, the enhancement would have made it easy to detect each resource leakages, injudicious

and unnecessary output, diversion of raw materials, comparison too, which could have been made, and that it is easy to comply with the intended way of loan repayment (Biondi, 2023).

Financial literacy is key in running a successful small and medium enterprise (SME). It has been noticed that most entrepreneurs and managers lack understanding of basic financial concepts. This include record keeping, financial statement analysis, credit management, variance between profit and cash, financial ratio, and taxes. A significant number of entrepreneurs do not keep any record of transactions at all, while record keeping by those who do so is limited to a record of cash transactions ( Nyamboga et al., 2014).

Bookkeeping is associated with financial literacy. An entrepreneur or manager who keeps good records is more knowledgeable about financial matters than someone who does not. Financial literacy is associated with business performance. The study suggest that entrepreneurs and managers who keep good records may have businesses that are up to 30% more profitable than those who do not. More generally, bookkeeping generates the information required for all of the concepts described above because it is possible to assess a business's financial bank statement, credit assessment, and business planning (Ngek, 2016).

One of the key aspects of successful ownership and management of a SME's is the management of their financial resources. This particularly concerns their ability to not only have the financial resources available to them but to also effectively manage and allocate those resources to ensure the continued and sustainable growth of the enterprise. An often talked about, but less studied aspect of financial literacy, particularly in the evolving and increasingly complex SMEs is the ability of the owner/managers to keep and successfully maintain financial records to track the financial health of the business. Preparing and keeping financial records is an important measure of financial literacy (Brownhilder Ngek, 2016). Ease of use makes it a preferable measure of

financial literacy for testing smaller business owners/managers. Bookkeeping skills can be seen as simple and procedural form of maintaining financial records. Yet, a small number of businesses in both developing and advanced economies managed to keep their books for a variety of reasons. SME literature discusses the difficulties of keeping these records. While bookkeeping ability can be seen as a measure of financial literacy, relatively few studies investigate the impact of bookkeeping confidence and training on business owner/manager financial performance. Furthermore, past research largely concentrates on specific industries and agriculture-focused SMEs. Lastly, few studies investigate bookkeeping thresholds, identifying at what point bookkeeping confidence increases its impact on financial performance (Nyamboga et al., 2014).

### **2.3.3 Tax management and financial performance**

Ochola (2017) discovered that tax compliance and incentives contribute to an aspect of financial performance, or it is a key antecedent, or it is seen to be directed towards maintaining or improving financial performance through ensuring positive business image and long-term viability. His study was based in Migori county and featured a sample of 104 SMEs. The research findings further revealed that, while tax may seem like an expense to the organization, it cannot be avoided, and non-compliance leads to business closure and litigations which puts business survival at risk. It also noted that Income tax is only paid from profits made and hence a relief to loss making enterprises. Tax management needs to be planned and executed to its fullest capacity to ensure compliance and business sustainability in the long run. The research's focus was on tax compliance in general but failed to factor the aspect of tax management skills which entails tax planning and having a proactive stance on settling tax obligations through instalments and prepayments especially when the business cycles are favourable, and profits are high. Tax planning ensures an

enterprise pays a huge chunk of its taxes during peak season to compensate for low season during a financial year.

Otwani, Simiyu and Makokha (2017) aimed to establish the effects corporate income tax has on the financial performance of NSE firms. Source data was acquired through interviews and a questionnaire to a purposive sample of 59 CEOs, CFOs and the Finance Managers. The study concluded that corporate income tax significantly influences financial performance. This study was skewed to listed companies in Kenya which comprises of large enterprises. The aspect of tax management has not been factored and especially on how it affects SMEs financial performance.

Kabajulizi (2019) examined whether taxation policies affected the financial performance of SMEs in Hoima district, Uganda, particularly Hoima municipality (Mparo division). Descriptive survey design was adopted for a population of 360 SMEs in the district. Data gathered was analysed using descriptive statistics and inferential statistics. The findings indicated that tax administration greatly improves taxpayers' convenience in tax assessment and that favourable tax policies significantly influence financial performance. The study discovered tax to be a fiscal tool adopted by the government to either positively or negatively influence a business depending on the nature of business activities. Nevertheless, the research was confined to Hoima district in Uganda leaving room for research in different geographical areas and jurisdictions. From this study, the issue of tax management and how it impacts the financial performance of SMEs remains an open question which the current study seeks to answer.

Financial literacy, as the literature review has so far demonstrated, is an essential factor for the financial welfare of any business and the personal wellbeing of an individual. SMEs dominate the total business sector in most countries and this is also the case in Kenya where they have their own

unique challenges that affect their growth. Some of the challenges facing SMEs are the inability to equip entrepreneurs with the appropriate tax management skills due to inadequate training for controlling the tax liabilities of their businesses. SMEs serve a critical role in the development of a nation through providing job opportunities and boosting the country economy (Mariam et al., 2023).

Tax management skills are crucial for financial performance. The skills that the entrepreneur acquires on tax laws of the countries concerned, customs procedures, nature of advances, and provisions of the filing of grant and subsidies applications are important determinants of financial performance (Ngek, 2016). The right knowledge enhances tax planning through selecting the appropriate tax instrument for investment achievement for improvements in financial performance. Good financial performance can be derived from a comprehensive understanding of the refund procedure and from minimizing the costs in compliance with the tax authorities. Otherwise, the risks increased by failing to satisfy various tax obligations, and this could lead to a deterioration in financial performance.

The performance of SMEs is determined by a correlation with the financial capital availability variables. The ownership of appropriate tax management skills is triggered by the financial literacy explorative variable to moderate the linkage between the financial literacy index and the performance index of the SMEs (Nyamboga et al., 2014). Access to finance has consistently been regarded as a critical issue among small and medium enterprises (SMEs), presenting a matter that has attracted significant attention from policymakers everywhere (Brownhilder Ngek, 2016). Financial literacy is fundamental in the capacity of SMEs to gain access to finance, begin operations, and become successful. The numerical part of the tabulated data may change

periodically depending with a variety of reasons mostly statistical and other GIS phenomenon, thus the results and discussions.

Such data seeks to quantitatively measure the shadow economy in a country in relation to the country's real GDP. In general, there is deterioration from every three-year period against immediate previous period in the percentage of both the total SMEs and the largest SMEs. In 2012 alone, a steep drop was noticed in the percentage of the largest SMEs, while the total SMEs declined drastically in 2013. It is believed this change of government has an influence on this, where since president Jokowi came to power, he took numerous measures to address tax compliance by both corporate taxpayers, and individuals, including strict measures to address tax evasion. Meanwhile, reflecting on yearly government taxpayer compliance through the standardized fees paid to De Jure's tax authority, quite a different scenario can be observed from the EIC tax rate profile of EIS.

One example is the substantial excellent improvement until the end of 2011 with cessations the very next year. Similar patterns can be observed for all four financial years. Further exploration indicated that in general, companies in a particular previously more jangling to avoid their compliance by engaging in bribery practice search study before the years of transition have greater likelihood survive the subsequent years of government changes compared to the companies that first became the subject of a particular research study during the years of transition itself, particularly related to the EIA analysis.

#### **2.3.4 Cashflow management and financial performance**

Effective cash flow management is critical for the financial sustainability and operational efficiency of firms, predominantly SMEs. Various studies have explored the relationship between cash flow management and financial performance, revealing key insights into the importance of cash flow practices for business success.

Kinyanjui, Kiragu, and Riro (2017) examined cash management practices and their bearing on the performance of SMEs in Nyeri, Kenya. The research adopted a descriptive research approach and distributed 62 questionnaires to collect data. The findings indicated that cash holding practices significantly influenced the financial success of SMEs. However, the research did not comprehensively address the broader impact of cash flow management on financial performance, highlighting a gap in the literature that requires further investigation.

Similarly, Momanyi et al. (2017) investigated the effects of cash flow on the financial performance of firms listed on the NSE, Kenya. This research utilized a descriptive research design and relied on secondary data analyzed using SPSS software. The results demonstrated a statistically significant relationship between cash flow management and financial success. However, as the study focused on large publicly listed firms, it did not consider SMEs, which operate under different financial constraints and management structures. Addressing this gap, the current study seeks to evaluate how cash flow management affects SME financial performance.

Momanyi et al. (2017) further argued that poor cash flow management has severe consequences for businesses, including an inability to pay key suppliers, leading to stock shortages of essential items. Additionally, firms struggling with cash flow issues may be unable to cover daily operating expenses, resulting in difficulties in converting inventory into sales. Marketing efforts may also be curtailed due to reduced liquidity, ultimately leading to lower revenue and profitability. For

investors, a company's margin of safety—ensuring that sufficient cash reserves or profits act as a financial buffer against external uncertainties—is crucial in determining the security of their investments. Thus, maintaining positive cash flow is essential for sustaining business operations and covering expenses promptly.

Turgut (2022) researched the effects of cash management practices on SMEs' financial sustainability in Kericho, Kenya. The study adopted a descriptive research design with a sample of 81 SMEs, collecting data through questionnaires analyzed using descriptive and inferential statistics. The findings revealed that many SME operators struggle with accurate cash flow projections, making it difficult to improve their financial position. This deficiency significantly impacts their overall performance and long-term sustainability. Furthermore, the study did not thoroughly examine the monitoring of cash inflows and outflows, an essential aspect of cash flow management that the current research aims to explore in detail.

SME's require specific management skills in order to manage relevant financial functions optimally so as to ensure the long-term success and sustainability of their enterprises. When it comes to financial literacy, most local SMES lack money management skills that lead to good cash flow management; this is because most SMEs are started without a solid capital base and the improvement of their cash flow management in financial literacy is a panacea to their performance ( Ngek, 2016). In South Africa, most studies pointed out that lack of proper financial planning among SMES as well as lack of access to startup and development financial capital sources form much of an impediment that is inhibiting their performance. The result suggests that financial literacy together with multi-facet and sound business practices among SME's are an important cog in the wheel in enhancing their financial performance incentives. In narrower and most important

focus, the results offer some important strategic intervention pointers especially subsequent to the adoption of the new BEE regulations in South Africa. Cash flow management is a specific operation nature of business enterprises. The cash flow management skills in financial literacy are an important guide for financial planning in an enterprise (Nyamboga et al., 2014). The research investigated the impact of financial literacy on the cash flow management skills with a view to lay the theoretical basis for enhancing the financial performance of SMEs. The results showed that financial literacy has a significant positive impact on cash flow management skills; also interact and jointly affect the financial performance of SMEs.

Cashflow management is essentially the lifeblood of business, allowing the business owner to maintain a healthy and successful venture. It encompasses both control and projection of income and expenses, facilitating a better understanding of the flow of money in and out of the business. Conversely, poor cashflow management may lead to business failure, regardless of the remuneration for the provision of goods and services or any other practices adopted by the business. Many small business owners assume that surplus cash is a signal of a successful business. That is not always true. Even if there is not enough cash on hand, it is still possible to convince a financier that the business is worth supporting, and funds will be infused accordingly. On the other hand, research from Mungal & Lall Garbharran (2014) find that a surplus of cash allows a business to maintain its competitive edge, by taking opportunities as they emerge and protecting itself against unexpected problems. Use of surplus cash for purposes like development, product improvement, or the development of competitive pricing strategies can be seen as a competitive weapon.

In any business, and more so in SMEs, the ability to manage liquidity and cash flow is essential. Cash flow shortages, particularly during the first years of operation, are a principal reason for the failure of many SMEs. In business, cash is always needed to pay bills and employees (Afrifa & Tingbani, 2017). Cash flow management is the process of monitoring, analyzing, and optimizing the net amount of cash receipts (inflows minus outflows). It allows a company to better manage the demands of its employees, suppliers, and lenders, and also to take advantage of opportunities related to growth and expansion. It is essential for SMEs to be proactive about cash flow management on a regular basis as it is crucial to success and business sustainability. Cash inflow mainly results from operations, financing, and investment. Inflow of cash over time is a basis for sufficient cash availability that can be accessed for business operation (Afrifa & Tingbani, 2017).

The inflow of cash is essential for payments and reinvestment. Furthermore, it is essential to invest cash resources to generate a return within companies that do not have an immediate need. Consequently, firms' cash availability is essential for working capital management (Afrifa & Tingbani, 2018). Cash flow strategies that companies use depend on whether the cash inflows are large initially and later decrease, are slow at first, but steadily increase, or are large and relatively level. Due to the lack of financial resources of SMEs and limited access to capital markets, SMEs need efficient cash flow management to ensure adequate cash is maintained in the flow. By effectively monitoring and managing cash flows, SMEs or individual business owners can ensure that revitalization or performance is maintained. Any aspect of money inflow and outflow can make a significant contribution to success or failure due to a fluctuating economy or market sales. Essentially, employees and expenses must be controlled, making cash flow management all the more important for both successful and unsuccessful businesses.

Previous studies have demonstrated the critical role of cash flow management in determining financial performance. However, gaps remain in understanding how SMEs specifically navigate cash flow challenges. Addressing these gaps can provide valuable insights for improving SME financial sustainability and strategic decision-making.

### 2.3.5 Summary of Literature review and Gaps

Previous studies have emphasized isolated aspects of financial literacy, mainly in developed or large-enterprise contexts, focusing on indicators such as sales revenue or liquidity rather than profitability (NPM). The present study addresses contextual, conceptual, and methodological gaps by analysing how four core financial literacy components, debt management, bookkeeping, tax management, and cashflow management, affect the financial performance (NPM) of SMEs in Mombasa County, Kenya, over the period 2020–2023 using a quantitative approach.

Table 2.2 summarizes the empirical review and highlights the gaps noted in the work of previous researchers and how the current study seeks to fill these gaps.

**Table 2.2 Summary of Literature review and Gaps**

<b>Author &amp; Year</b>	<b>Topic and Context (Where Conducted)</b>	<b>Methodology of Study</b>	<b>Findings of the Study</b>	<b>Research Gap Identified</b>	<b>Gap Filled by Current Study</b>
<b>Eniola &amp; Entebang (2017)</b>	Financial literacy and performance of SMEs in Malaysia	Quantitative survey design using structured questionnaires on 180 SMEs	Financial literacy significantly improved profitability and sustainability of SMEs	Study conducted in a developed Asian economy with formalized accounting	Current study examines financial literacy effects in an emerging African context (Mombasa)

<b>Author &amp; Year</b>	<b>Topic and Context (Where Conducted)</b>	<b>Methodology of Study</b>	<b>Findings of the Study</b>	<b>Research Gap Identified</b>	<b>Gap Filled by Current Study</b>
			through enhanced debt and cashflow management .	systems, limiting applicability to informal African SMEs.	County, Kenya) with a largely informal SME sector.
<b>Ochola (2017)</b>	Tax management and business sustainability among SMEs in Migori County, Kenya	Descriptive research design using primary data from 104 SMEs	Poor tax management led to liquidity challenges and business closures.	Focused solely on tax compliance and did not assess its combined effect with other financial literacy constructs on overall profitability.	Current study integrates tax management with other literacy constructs (debt, bookkeeping, and cashflow) to explain overall financial performance.
<b>Momanyi, Bichanga &amp; Nyangau (2017)</b>	Effect of cashflow management on financial performance of firms listed at the NSE, Kenya	Descriptive correlational design using secondary data	Cashflow management had a significant positive effect on firm profitability.	Focused on large listed firms, ignoring unique financial constraints of SMEs.	Current study focuses on SMEs in Mombasa County, where cashflow challenges are more acute and underexplored.
<b>Minjo (2018)</b>	Owner accounting competencies and performance of SMEs in Nairobi	Quantitative research using descriptive and inferential analysis	Accounting competencies significantly influenced SME performance.	Focused on professional accounting skills rather than practical bookkeeping	Current study isolates bookkeeping as a measurable financial literacy

<b>Author &amp; Year</b>	<b>Topic and Context (Where Conducted)</b>	<b>Methodology of Study</b>	<b>Findings of the Study</b>	<b>Research Gap Identified</b>	<b>Gap Filled by Current Study</b>
	County, Kenya			skills applicable to small businesses.	dimension accessible to non-professional SME owners.
<b>Aladejebi &amp; Oladimeji (2019)</b>	Record keeping and performance of SMEs in Lagos Metropolis, Nigeria	Cross-sectional survey with 197 SME owners/managers	Proper record keeping improved decision-making and overall business performance.	Study concentrated on record keeping only and excluded other financial literacy aspects such as debt and tax management .	Current study expands the scope to include multiple financial literacy variables and their joint effect on SME profitability.
<b>Ngungu (2020)</b>	Debt management and financial performance of firms listed at NSE, Kenya	Correlational research using financial ratio analysis	Found a positive relationship between firm size, debt proportion, and performance.	Studied large listed firms; results may not reflect the realities of smaller, informal SMEs.	Current study contextualizes debt management practices within SMEs in Mombasa County to test applicability across firm sizes.
<b>Fanta &amp; Mutsonzwa (2021)</b>	Financial literacy and SME sustainability in Zimbabwe	Mixed-method approach using survey and interviews	Financial literacy positively influenced SMEs' growth and	Did not specify which financial literacy components	Current study isolates four key literacy constructs—debt, bookkeeping,

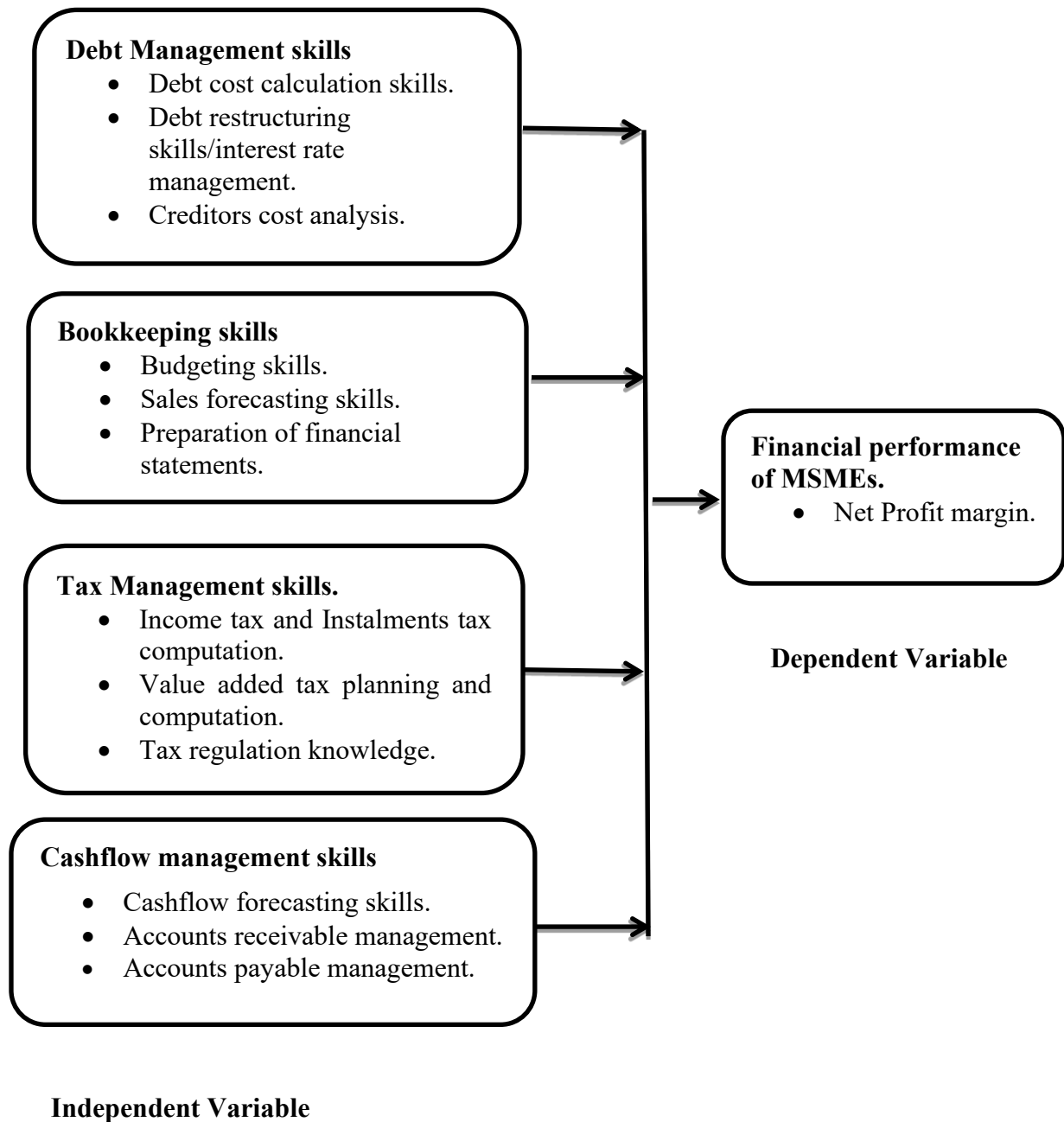
<b>Author &amp; Year</b>	<b>Topic and Context (Where Conducted)</b>	<b>Methodology of Study</b>	<b>Findings of the Study</b>	<b>Research Gap Identified</b>	<b>Gap Filled by Current Study</b>
			access to credit.	contributed most to performance outcomes.	tax, and cashflow management—to determine their specific effects.
<b>Hamed (2023)</b>	Debt management and profitability of financial institutions in Egypt	Quantitative design using regression analysis of secondary data	Efficient debt management enhanced profitability and reduced financial distress.	Focused on financial institutions rather than SMEs, limiting relevance to small enterprise operations.	Current study extends debt management analysis to non-financial SMEs to test generalizability across sectors.

**Source Author (2024)**

## **2.4 Conceptual Framework**

As stated by Tamene (2016), an informative conceptual framework helps explain the supposed link between the variables of a study. The elements of finance literacy which are believed to influence financial performance of SMEs are: debt management skills, bookkeeping skills, tax management skills and cashflow management skills. The dependent variable is financial performance and was operationalized through NPM. This study examined four independent variables of financial literacy, debt management, bookkeeping, tax management, and cashflow management, and one dependent variable, financial performance. Debt management relates to prudent borrowing and repayment decisions that sustain profitability. Bookkeeping involves

maintaining accurate financial records for informed decision-making. Tax management focuses on efficient tax planning and compliance to minimize liabilities, while cashflow management entails monitoring and controlling cash movements to maintain liquidity. Financial performance, the dependent variable, was measured using Net Profit Margin (NPM), reflecting the efficiency of SMEs in generating profits from sales. Together, these variables capture the influence of key financial literacy dimensions on SME profitability in Mombasa County between 2020 and 2023.



**Figure 2.1 Conceptual Framework**

**Source Author (2024)**

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Introduction

This chapter detailed the research design, target audience, sample size, and instruments and procedures of data collection instruments. The validity and reliability of the research instrument were detailed and so were the data analysis procedure. Ethical considerations were also be detailed.

#### 3.2 Research Design

Descriptive research design was applied to address the linkages between financial performance and financial literacy. According to Kothari (2013), this type of research design utilizes different quantitative and qualitative data to make accurate predictions on the either the objectives or hypotheses. It is particularly appropriate in cases where data is being collected from numerous participants. Its suitability for this study is in its ability to obtain fact through surveying or simply inquiries. The study adopted a descriptive research design to systematically examine the relationship between financial literacy and SME financial performance. This design was appropriate because it allows for quantitative measurement of variables, captures perceptions and practices from a large sample, and facilitates analysis of existing conditions without manipulating the study environment.

#### 3.3 Target Population

Kothari (2011) referred to target population as a complete group from which certain information needs to be obtained, and whose members possess at least one noteworthy characteristic. The study targeted 54,245 registered SMEs in Mombasa County (Mombasa County Licensing Records,

2023). Proprietors and supervisors of the SMEs were the main focus as they are expected to have first-hand information about the enterprises. The total population was, therefore, 54,245 SMEs in Mombasa County and the research was done in the six sub-counties which are: Changanwe, Likoni, Kisauni, Nyali, Mvita, and Jomvu.

**Table 3.1 Target Population**

<b>Category of MSMEs</b>	<b>Target Population</b>	<b>Percentage</b>
Wholesale and Retail Business	23,600	44%
Transport and Logistics	6,986	13%
Tourism and Hospitality	6,754	12%
Manufacturing	4,632	9%
Professional and Technical Services	7,342	14%
Information Technology	4,931	9%
<b>TOTAL</b>	<b>54,245</b>	<b>100%</b>

**Source: Mombasa county licensing department (2023).**

### **3.4 Sampling Design**

The study adopted stratified random sampling technique. Stratified random sampling design was used to enhance the disaggregation of the sample to pinpoint the variation of the population. This is important for ensuring that all the important sub-groups within the population that are likely to be different and carry unique information are represented. Furthermore, the use of stratified design is one of the standard ways to deal with representative bias. The study adopted a formula by Wang (2015) to calculate the target population.

$$n_0 = (Z^2 * p * (1 - p)) / E^2$$

where:

$n$  = sample size

$Z$  = Z-score corresponding to the confidence level

$p$  = estimated proportion of the population

$E$  = margin of error

Given:

Population size ( $N$ ) = 54,245

Confidence level = 95% (Z-score = 1.96 for 95% confidence level)

Margin of error ( $E$ ) = 0.05

Estimated proportion ( $p$ ) = 0.5 (for maximum variability)

$$n = (1.96^2 * 0.5 * (1 - 0.5)) / 0.05^2$$

$$n = (1.3225 * 0.5 * 0.5) / 0.0025$$

$$n = 0.330625 / 0.0025$$

$$n = 132.25$$

$$n = n / (1 + (n_0 - 1) / N)$$

where:

$$- n = 132.25$$

$$- N = 54,245$$

$$n = 132.25 / (1 + (132.25 - 1) / 54,245)$$

$$n = 132.25 / (1 + 131.25 / 54,245)$$

$$n = 132.25 / (1 + 0.002419)$$

$$n = 132.25 / 1.002419$$

$$n = 131.99$$

A sample size of 132 SMEs was considered. The sample size was split among the six categories of SMEs operating in Mombasa County.

**Table 3.2 Sampling Frame**

Category of SMEs	Target Population	Sample Size	Formula
Wholesale and Retail Business	23,600	57	$(23,600/54,245)*132$
Transport and Logistics	6,986	17	$(6986/54,245)*132$
Tourism and Hospitality	6,754	16	$(6754/54,245)*132$
Manufacturing	4,632	11	$(4632/54,245)*132$
Professional and Technical Services	7,342	18	$(7342/54,245)*132$
Information Technology	4,931	12	$(4931/54,245)*132$
<b>Total</b>	<b>54,245</b>	<b>132</b>	

Source: (Researcher. 2024)

### 3.5 Data Collection Instruments

A structured questionnaire was utilized to gather source research. The first draft questionnaire measures various demographic and interacted variables including financial concepts, exact economic facts, and formed useful aggregate indices. Numeric scores were assigned to correct answers in order to capture the statistical and economic significance of the answers. The purpose of the questionnaire test was to ensure that the questions posed precisely measure the researched concepts.

### **3.6 Pilot Study**

Pilot study was done prior the initial study to guarantee that the designated tool is strong and unambiguous (Dawson, 2019). A pilot study ensured consistency is achieved and revised accordingly based on the results. As an outcome, the tool was pretested on a sample of 30 respondents from Kilifi County and was not included in the actual study. Any vagueness in the questions were amended prior the real data collection.

The pilot study was conducted in Kilifi County, selected for its socio-economic and business similarities to Mombasa County, ensuring comparable SME characteristics without overlapping the main study area. Validity was ensured through expert review of the questionnaire, achieving a content validity index (CVI) above 0.8, indicating acceptable instrument accuracy. Reliability was tested using Cronbach's Alpha, with all constructs recording coefficients above 0.7, confirming internal consistency and stability of the research instrument.

#### **3.6.1 Validity of research instruments**

According to Cooper and Schindler (2014) validity is validating the research measurement tool to ensure that the questionnaire, as administered, results in the collection of quality information from the respondent. The validation tests the degree to which the survey is able to measure its intended

behaviour accurately. Additionally, the research tests whether the variable's definitions match the concept of the research. The five components of validity, which are known as content validity, are considered as essential criteria of validity for a research instrument. Other tests of validity usually include external (postscript) validity that ask the question of whether the instrument's measure correlates with outside criteria. Also, there is internal or structural validity to determine if the independent variables are in fact independent of one another, and other measures that may be modified internally.

An extensive literature review was carried out to determine validity. Books, websites, journals, articles, and other published materials were thoroughly studied. Each question was checked for accuracy, fitness, and validity. Researchers also used their own moral judgment to ascertain the accuracy and relevance of their intended measure. After selecting the dimensions of financial literacy, researchers tried to make each question as representative of that dimension as possible.

### **3.6.2 Reliability of research instruments**

Allan and Skinner (2020) aver that reliability refers to the uniformity of a measure of a variable, which implies that the measurement is free from errors. It is also essential that a study's results should be tested for stability over time by repeating the study using the same or suitable sampling frame, especially in similar or nearby counties or localities. This may be achieved by repeating the study in the near foreseeable future. The instruments, once the reliability is determined and found to be reliable, may then be used in future similar study. The study used a pilot study and observations to ensure reliability. A Cronbach's Alpha Coefficients with the help of the SPSS was used to test the reliability of the questionnaire (Allan & Skinner, 2020).

### **3.6.3 Data Collection Procedure**

Once the research proposal was approved by the supervisor, the researcher sought an introductory letter from the university to obtain research consent from NACOSTI. This helped get information easily from the respondents. With the aid of a research assistant, the respondents were given questionnaires by hand. Using good rapport, the researcher convinced the respondents to fill in the questionnaires assisting them where necessary. The filled questionnaires were collected from the respondents after two weeks.

### **3.7 Data analysis and presentation**

In inferential statistics, sample data is put into the context of a larger population and draw inferences about how this larger population behaves, with respect to the sample data that is collected. Inferential statistics can yield estimates of population parameters, test hypotheses about the population parameters, and identify relationships among parameters (Kothari, 2013).

The simplest way to deal with data is to describe them using mean and standard deviation. This measure enables a person to build up a picture of the data and to understand the way that it behaves.

In this research, the data that was subjected to inference or descriptive statistical testing was financial performance and financial literacy among small and medium entrepreneurs operating in Mombasa County and was tested using such statistical tools as correlation analysis. Relationships between financial literacy and the two aspects that make up financial performance - growth and profit are established, and conclusions are made with the aim of achieving the most desirable characteristics of financial performance and therefore experiencing growth in business activity.

Multiple linear regression analysis was also applied to test for correlation between the study's variable. The regression model is as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

$Y$  =Financial Performance of SMEs

$\beta_0$  = Constant

$\beta_1- \beta_3$  = Co-efficient

$X_1$  = Debt management skills

$X_2$ = Bookkeeping skills

$X_3$  = Tax management skills

$X_4$  = Cashflow management skills

$\varepsilon$  = Error term

Significant variables were determined at  $p < 0.05$ .

### **3.8 Diagnostic Tests**

Diagnostics are imperative in carrying out a thorough examination to ascertain the accuracy and appropriateness of the tools utilized for data collection (Verbeek, 2017). Additionally, it is crucial to determine the efficacy and efficiency of the process of resolving any issues encountered during the data collection phase. The diagnostic tests for this study encompassed a comprehensive evaluation of various aspects, including the normality test, tests for multi-linearity, assessments for autocorrelation, and examinations for heteroscedasticity.

#### **3.8.1 Normality Test**

This study conducted a normality test which is a statistical concept that evaluates the distribution of data and is conducted through the utilization of the Shapiro-Wilk and Kolmogorov-Smirnov screening tests (Dawson, 2019). These tests specifically focus on assessing the properties of

kurtosis and skewness, which are measures of the shape and symmetry of the distribution. The purpose of this analysis is to determine whether collected data follows a normal distribution. To establish a benchmark for standard univariate distributions, the criteria set forth by Kothari (2011) state that values between -2 and +2 for both asymmetry and kurtosis are deemed appropriate

### **3.8.2 Multicollinearity Tests**

To gauge this correlation, the analysis to be conducted in this study incorporated the use of the VIF. The VIF value is calculated using the formula  $VIF = 1 / (1 - R^2)$ , where  $R^2$  represents the Decision Coefficient. It is important to note that a general guideline suggests that if all the VIFs surpass a value of 10, it indicates a significantly high level of multicollinearity, thus indicating a poor measurement. Consequently, the vector associated with this high VIF value is subsequently removed from the model. On the other hand, if the VIF value falls between the range of 5 and 10, it suggests that the degree of multicollinearity is relatively mild. Lastly, if the VIF value is below 5, it indicates that the presence of multicollinearity is trivial

### **3.8.3 Autocorrelation Test**

Autocorrelation tests, such as Durbin-Watson, Ljung-Box, Q-statistic, and Portmanteau, are statistical tests used to determine if regression residuals are autocorrelated (Sekaran, 2016). To validate the presence of autocorrelation, the examination employed the Durbin Watson test, a statistical method utilized to assess the possibility of autocorrelation within a given dataset. Notably, the Durbin Watson statistic, which ranges from 0 to 4, serves as a critical indicator in this analysis. It is crucial to note that when the Durbin Watson value equals 2, the occurrence of autocorrelation is negated, thereby negating any concerns pertaining to this phenomenon.

However, when the Durbin Watson value is less than 2, it signifies the presence of positive or permanent autocorrelation, which implies that this correlation persists over time.

#### **3.8.4 ANOVA Test**

In this study, ANOVA analysis was conducted to investigate the relationship between the variables across different enterprise types. Hypotheses tested for significant differences in financial performance among SMEs based on their levels of financial literacy. Data collection involved gathering information on financial literacy and performance from a diverse sample of enterprises in Mombasa County. ANOVA tests were performed with a significance level of 0.05 to determine if there are significant variations in financial performance across enterprise types and financial literacy levels.

#### **3.8.5 Kurtosis Test**

A kurtosis test was carried out to assess whether financial literacy scores deviate significantly from a normal distribution. The null hypothesis posits conformity to a normal distribution, while the alternative hypothesis suggests otherwise. Data collection from SMEs in Mombasa County preceded the computation of kurtosis. A significance level of 0.05 was used. A one-sample t-test compared the computed kurtosis to an expected normal distribution. Findings informed interventions to enhance financial literacy among SMEs.

### **3.9 Operationalization and Measurements of Variables**

Operationalization of variable is the process of discovering a valid index and measurable quantifiable for the study variables for their accurate measurement. According to Kothari (2013), this is of relevance for abstract or effort dependent, or subjective factors as they are not measured easily, this is detailed in the table 3.3.

**Table 3.3 Measurement of Variables**

<b>Variable</b>	<b>Nature</b>	<b>Operationalization</b>	<b>Indicators</b>	<b>Measurement Scale</b>
Financial Performance	Dependent Variable	Ability to determine if the enterprise is making a profit or a (loss) and to relatively measure net profit against assets and total revenue.	<ul style="list-style-type: none"> <li>• Net Profit Margin in Percentage (NPM)</li> </ul>	Rating 5-1 Ordinal
Debt Management Skills	Independent Variable	Ability to manage business debts through sustainable financial leverage levels to prevent bankruptcy and financial distress.	<ul style="list-style-type: none"> <li>• Debt cost calculation skills</li> <li>• Debt consolidation skills/interest rate management.</li> <li>• Debt ratio management</li> </ul>	Rating 5-1 Ordinal
Bookkeeping Skills	Independent Variable	Bookkeeping skills and financial presentation to guide in business processes while tracking business incomes, expenses, and asset levels.	<ul style="list-style-type: none"> <li>• Budgeting skills</li> <li>• Sales forecasting skills</li> <li>• Preparation of financial statements.</li> </ul>	Rating 5-1 Ordinal

<b>Variable</b>	<b>Nature</b>	<b>Operationalization</b>	<b>Indicators</b>	<b>Measurement Scale</b>
Tax Management Skills	Independent Variable	Tax planning approaches to minimize tax liabilities while still remaining compliant to relevant authorities. Timely payment of tax liabilities to prevent hefty penalties and interests that are detrimental to financial performance.	<ul style="list-style-type: none"> <li>• Income tax/Instalment tax computation</li> <li>• Tax planning skills</li> <li>• Tax regulations knowledge</li> </ul>	Rating 5-1 Ordinal
Cashflow Management Skills	Independent Variable	Ability to maintain optimum cashflow levels through proper management of operating, investing, and financing cashflow activities.	<ul style="list-style-type: none"> <li>• Cashflow forecasting skills.</li> <li>• Accounts receivable management</li> <li>• Accounts Payable management</li> </ul>	Rating 5-1 Ordinal

Source: (Researcher. 2024)

### **3.10 Ethical Considerations**

In cases where respondents voluntarily participate in study, a researcher upheld the concept of voluntary consent. Information on the study's objective, the researcher's identity, and any potential advantages should be the basis for informed consent. Ethical principles dictate that research subjects have the freedom to opt out of the study at any moment without facing any repercussions. Participation in the study was optional. Before the study began, the researcher informed the participants of this. The researcher made sure that every responder thoroughly comprehends all the information relating to the study through the trained assistant. No respondent was coerced into participating in the study; all participation were voluntary.

## CHAPTER FOUR

### RESULTS AND ANALYSIS

#### 4.1 Introduction

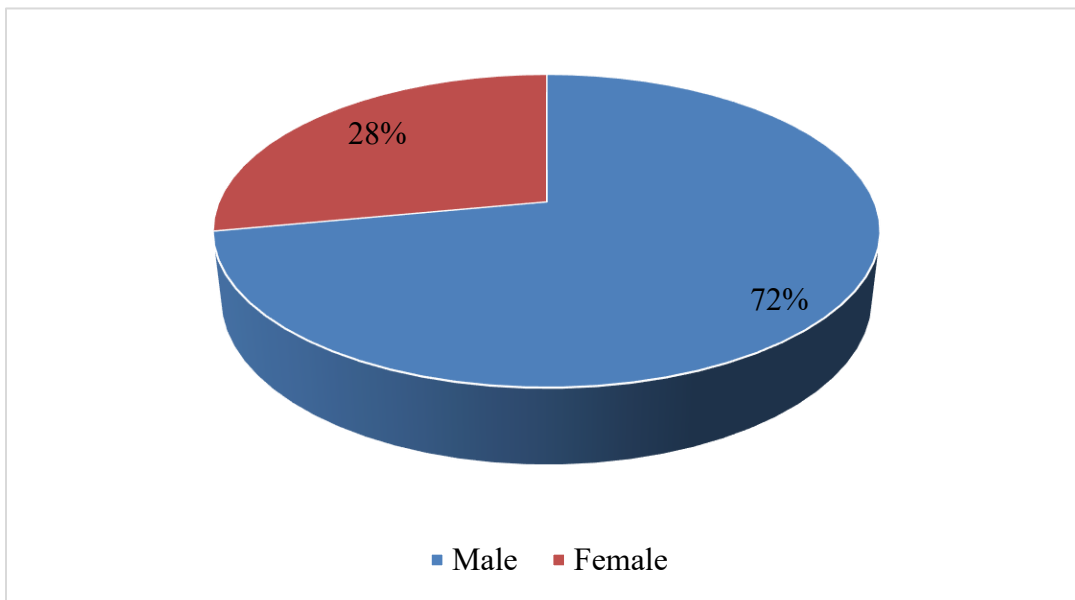
This chapter presents the data collected and analysed to answer the main research questions, and most importantly, to test hypotheses.

#### 4.2 Response Rate

163 questionnaires were sent, 132 were fully completed and returned in time, with all participants meeting the inclusion criteria. This represents an 80% response rate.

#### 4.3 Bio Data

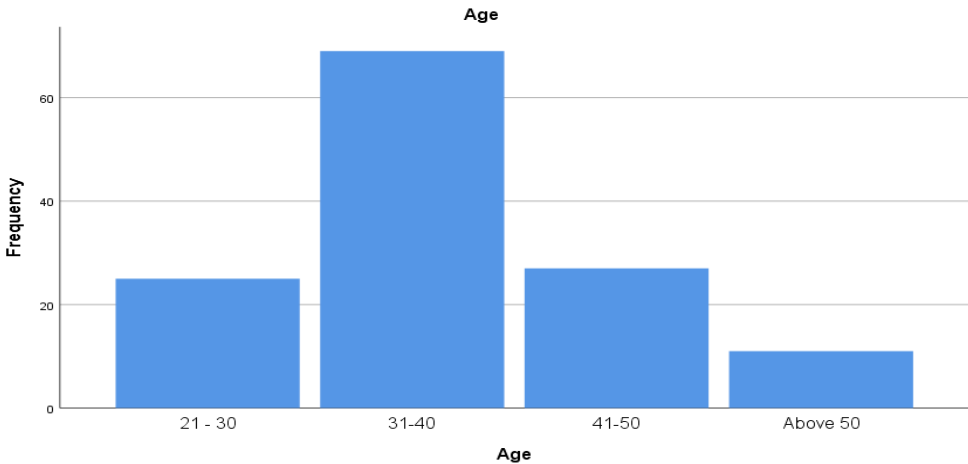
The study collected response from a total of 132 participants across six SME categories in Mombasa County. Of these, 37 respondents were female and 95 were male. This is shown in the Figure 4.1



**Figure 4.1: Gender**

**Source Author (2024)**

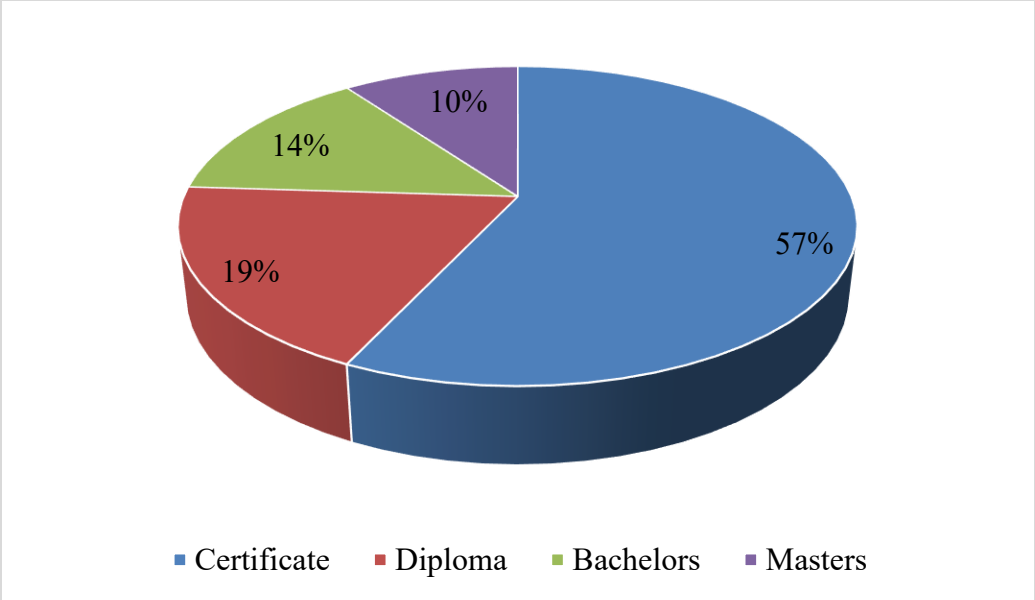
The age distribution, were between 31-40 years, indicating that most entrepreneurs were in the early-to-mid of their careers. The 41-50 years age group comprised 27 respondents (20.5%), while the 51 and above category had 11 respondents (8.3%). This distribution reflects a diverse age range of entrepreneurs, with a concentration in the 31-40 age group, highlighting the active engagement of mid-career individuals in entrepreneurship within Mombasa County.



**Figure 4.2: Age**

**Source: Author (2024)**

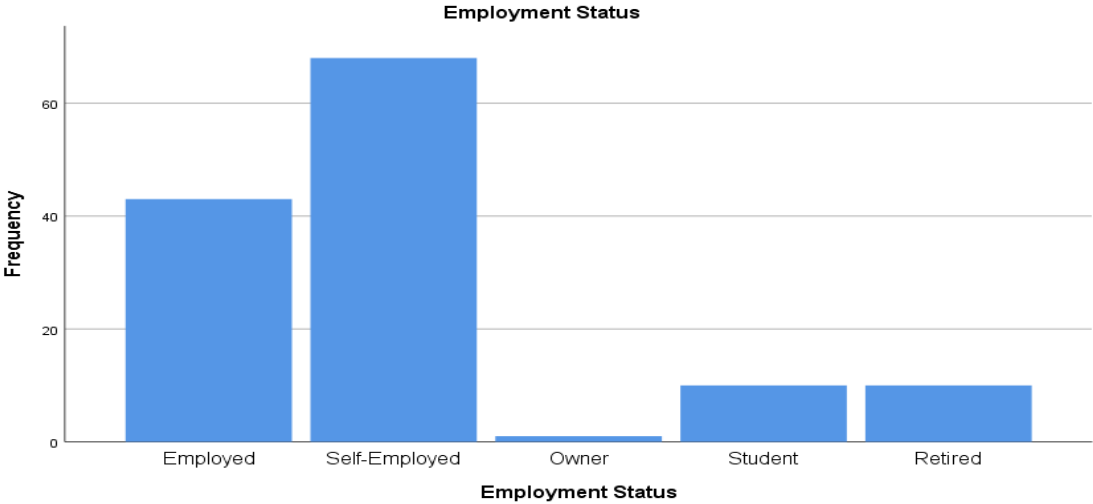
The educational background of the 132 respondents was distributed as follows: 75 respondents (57%) had obtained a Certificate level of education, while 25 respondents (19%), held a Diploma. 18 respondents (14%) reported having an Undergraduate degree. Finally, about 10% of the respondents (14) had postgraduate education. This data indicates that most entrepreneurs in Mombasa County have either a Diploma or certificate, with a smaller percentage having pursued higher education at the Postgraduate or master’s Level.



**Figure 4.3: Highest Education Level**

**Source: Author**

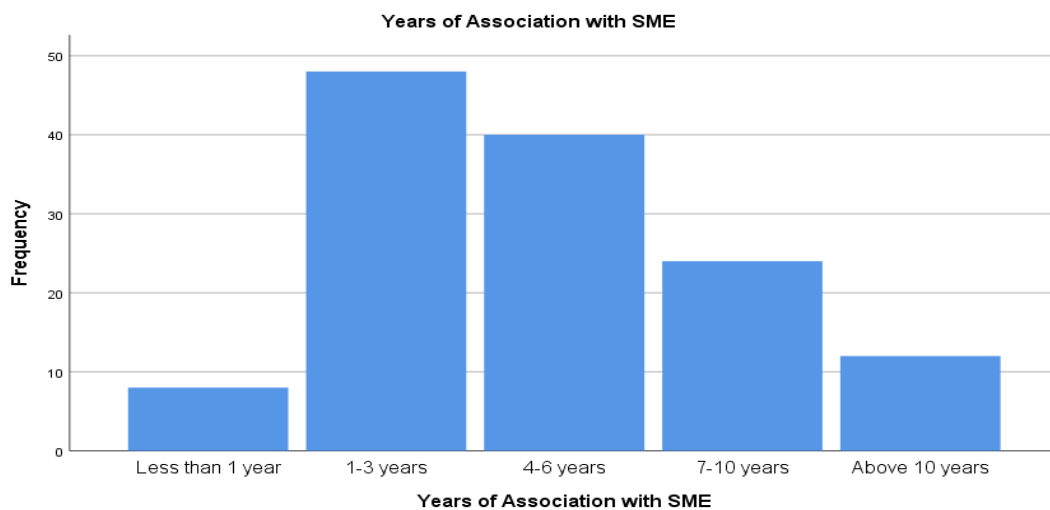
A majority of the respondents indicated that they were self-employed, followed by those who were employed as shown in the figure below. There were participants who were retired and others who were students, but the least number of participants were owners of the business.



**Figure 4.4: Employment Status**

**Source: Author (2024)**

The respondents' years of association with their respective SMEs were distributed as follows: 8 respondents (6.1%) had been associated with their SME for less than 1 year, indicating a fresh involvement in entrepreneurial activities. The largest group, 48 respondents (36.4%), had been with their SME for 1-3 years, reflecting early to mid-stage business experience. 40 respondents (30.3%) had between 4-6 years of involvement, and 24 respondents (18.2%) had worked with their SME for 7-10 years. Finally, 12 respondents (9.1%) had over 10 years of experience. This distribution showcases a range of experience levels, from newcomers to seasoned entrepreneurs in Mombasa County's SME sector.

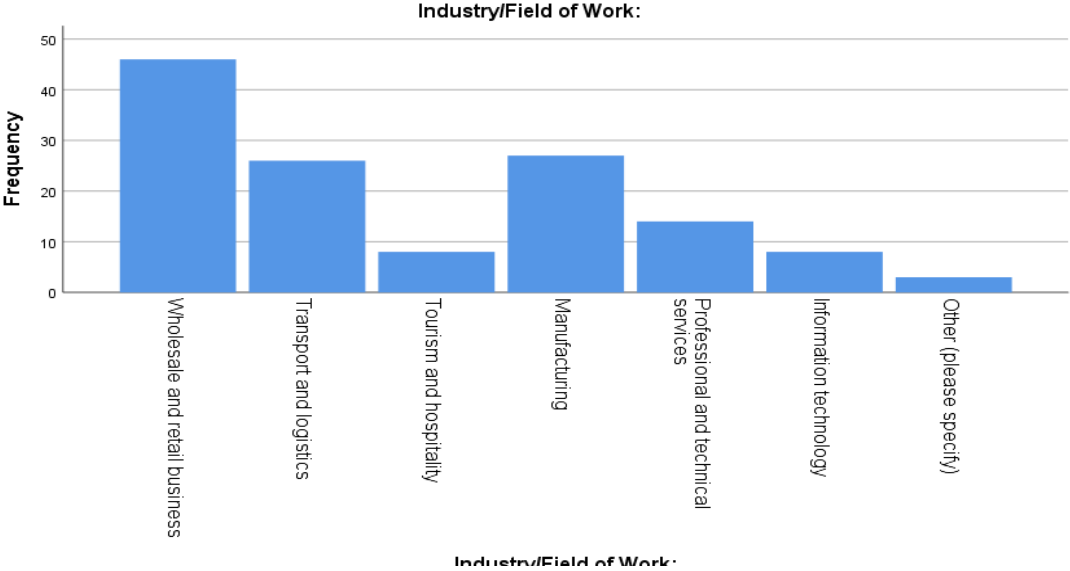


**Figure 4.5: Years of association**

**Source: Author (2024)**

The completed questionnaires were distributed across six SME categories in Mombasa County as follows: Wholesale and Retail Business received 46 responses, accounting for a significant portion of the total sample. Transport and Logistics followed with 26 responses, while Tourism and

Hospitality 9, Manufacturing 28 respondents. The Professional and Technical Services sector saw 15 responses, and the Information Technology category attracted 8 responses. This distribution reflects a balanced representation of SMEs across diverse sectors, with notable participation in Information Technology and Professional and Technical Services, providing key insights into the entrepreneurial activities in Mombasa County. Studies such as KBA (2021) indicated that close to two-thirds of enterprise owners had a prior experience of more than 3 years in employment before venturing into business, and that 60% of SMEs are concentrated in the urban areas. According to KIPPRA (2019), SMEs operating within Mombasa County feature all sectors of businesses.



**Figure 4.6: Industry of work**

*Source: Author (2024)*

The respondents’ bio-data, including gender, age, education level, business experience, and ownership type, were analyzed to contextualize their influence on financial literacy and SME performance. Gender may affect access to financial training and credit; age reflects experience and risk tolerance in financial decisions; education enhances understanding of financial concepts; and

business experience influences record-keeping and cashflow management. These attributes collectively shape entrepreneurs' financial literacy and, consequently, their firms' profitability.

#### **4.4 Descriptive Analysis**

All the items representing each of the variables in the questionnaire have been averaged to create an index that explains the overall score on the Likert scale. The questionnaire used a 5-point Likert scale, where 1-strongly disagree, 2-disagree, 3-neutral, 4-agree, and 5-strongly agree. Therefore, any scores less than 3 suggest that most participants generally did not agree with the statement, and any score above 3 suggests that most of the participants agreed with the statement. For debt management skills, mean of 3.982 suggests that most of the participants agreed with most of the items of debt management. A relatively small standard deviation suggests small variability in the responses on this variable. For bookkeeping skills, mean of 4.088 suggests that most of the participants agreed with most of the items of bookkeeping skills. A relatively small standard deviation suggests small variability in the responses on this variable. For tax management skills, mean of 4.003 suggests that most of the participants agreed with most of the items of tax management skills. A relatively small standard deviation suggests small variability in the responses on this variable. For cash flow management skills, mean of 3.985 suggests that most of the participants agreed with most of the items of cash flow management skills. A relatively small standard deviation suggests small variability in the responses on this variable. This trend was the same for net profit margin where the mean was 3.989 and a small standard deviation of 0.6254.

#### **Table 4.1 Descriptive Statistics**

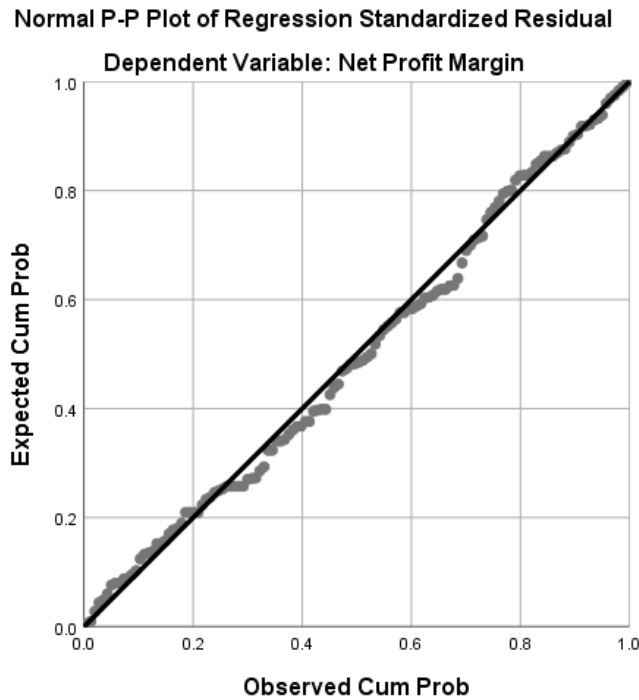
	N	Minimum	Maximum	Mean	Std. Deviation
Debt Management Skills	132	2.0	5.0	3.982	.6093
Bookkeeping Skills	132	2.0	5.0	4.088	.6385
Tax Management Skills	132	2.0	5.0	4.003	.6525
Cash Flow Management Skills	132	2.3	5.0	3.985	.6646
Net Profit Margin	132	2.0	5.0	3.989	.6254

#### 4.5 Diagnostic Tests: Testing Regression Assumptions

This section tests the various assumptions of regression (whether or not the data meets the assumptions of regression).

##### 4.5.1. Normality

Assumptions of normally distributed residuals and characteristics are central assumptions in multiple regression. When these assumptions are violated, data transformation techniques may be warranted. Normality rarely occurs when one or more of the independent or dependent variables equates to zero or near zero (Weisburd et al., 2022). To test for normality in this study, the researcher used a P-P plot, and the decision rule for the P-P plot is as follows: if the cumulative probability roughly conforms to the diagonal line of normality, then the data is normally distributed, otherwise, it is not. From the figure below, it is clear that this assumption is satisfied.

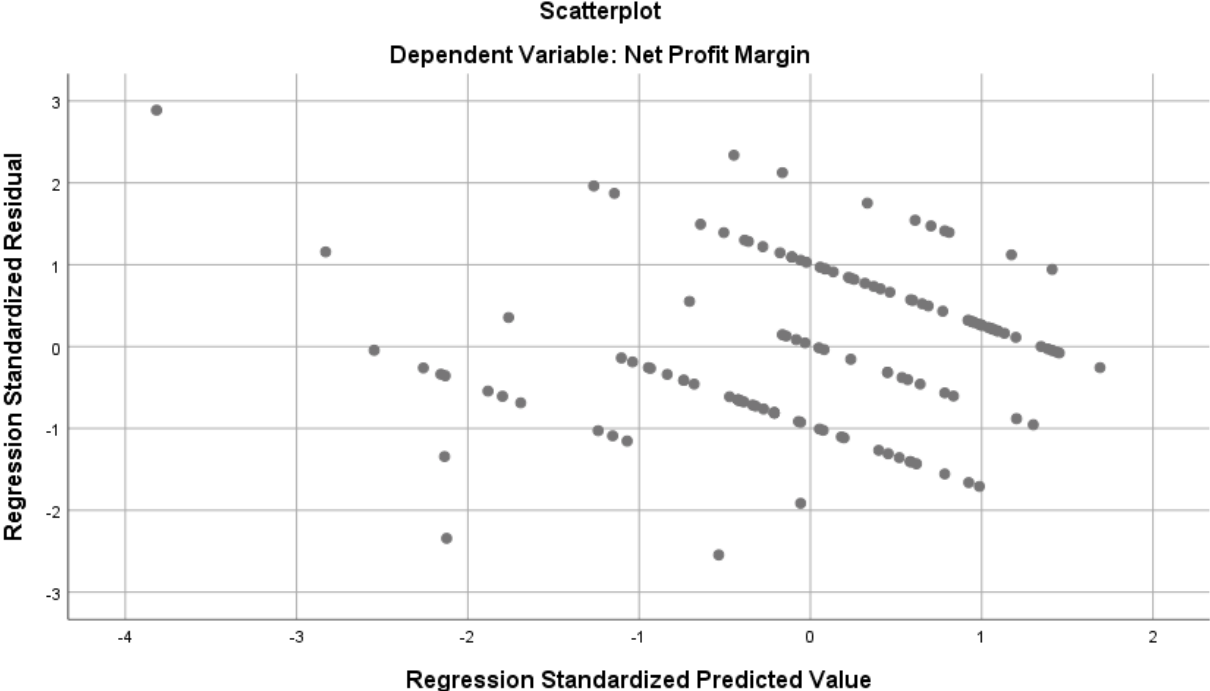


**Figure 4.7: Normality test**

#### 4.5.2 Homoscedasticity

It is important for regression assumptions that residuals have constant variance across all levels of the independent variable(s). If this assumption is violated, estimated coefficient standard errors will be biased and hypothesis tests will be affected. Heteroscedasticity can lead to inefficient estimates and biased inference. To check for equal variance of error terms, we can use graphical methods and tests. If residuals and their squared terms significantly explain the residuals, it indicates heteroscedasticity. Testing the assumption for all independent variables is recommended. If there is strong evidence against the null hypothesis, indicating significant differences from zero, heteroscedasticity is present. Another approach is to use residuals with squared terms and product of residuals to test for homoscedasticity. Using a scatterplot, the data appears to form some pattern,

which suggests heteroscedasticity. As such, data was transformed into natural logarithms to address the heteroscedasticity problem (Knaub Jr, 2021).



**Figure 4.8: Homoscedasticity**

To confirm this test, an additional test was performed; the Breusch-Pagan-Godfrey test, where, the decision rule is that is the probability values are significant or are less than 0.05, then there is evidence of heteroscedasticity, and as such, the null hypothesis is rejected. Otherwise, the null hypothesis is not rejected. In this case, the null hypothesis is not rejected, since the probability values are > 0.05, which means that the data is homoscedastic.

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

$$\text{chi2}(1) = 9.4$$

$$\text{Prob} > \text{chi2} = 0.6109$$

Table 4.8.1: Breusch-Pagan-Godfrey test for heteroscedasticity

Prob. F (4, 128)	0.6109
Prob. Chi square (4)	0.400

### 4.5.3 Autocorrelation

Autocorrelation is the interdependence of residuals in time series data, which can affect the validity of ordinary least squares (OLS) coefficients and test statistics. The Durbin-Watson (DW) test is used to check for autocorrelation, with a value of 2 indicating no positive or negative autocorrelation. Negative correlation is when DW statistic is  $>2$ , while positive autocorrelation is when the DW statistic is  $<2$ . The acceptable DW statistic range is 1.5- 2.5 (Turner, 2020). One can visually inspect the plot of residuals for autocorrelation. The presence of autocorrelation can be accounted for by incorporating lagged variables in the model. Differencing the variables can also help remove autocorrelation and convert highly persistent data to non-persistent. In table 4.3 below,  $DW = 1.662$ , which means it is within the acceptable range, and thus, the assumption is satisfied.

**Table 4.2 Autocorrelation**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.606 <sup>a</sup>	.368	.348	.5051	1.662

Since the DW statistic is at 1.662, it means that there is very little to mild positive autocorrelation in the residuals. This means that previous errors may slightly influence future errors, but the correlation is not strong enough to be a major concern.

#### 4.5.4 Multicollinearity

Multicollinearity is the correlation between independent variables in regression. It affects estimation and interpretation of coefficients and can result in inflated standard errors. To test for multicollinearity, we can calculate the Variance Inflation Factor. Diagnostic resources include correlation matrices, inspection of the correlation matrix, and reduced form of the affected equation. It is best to diagnose and address multicollinearity early. Approaches to lower multicollinearity include detecting signs, endogeneity, variable selection, and principal component analysis. The decision rule is as follows: If  $VIF < 1$  or  $> 10$ , then there is multicollinearity, otherwise, there is no multicollinearity. From table 4.4, all the variables pass this assumption, and as such, there is no multicollinearity.

**Table 4.3 Multicollinearity**

	Collinearity Statistics	
	Tolerance	VIF
Debt Management Skills	2.151	1.215
Bookkeeping skills	1.443	1.259
Tax Management Skills	2.146	4.216
Cash flow management skills	0.407	2.259

#### 4.6 Correlation Analysis

All the variables showed positive, and statistically significant correlation with net profit margin. Debt management skills ( $r= 0.473$ ,  $p$  value  $<0.05$ ), bookkeeping skills ( $r =0.459$ ,  $p <0.05$ ), tax management skills ( $r=0.509$ ,  $p <0.05$ ) and Cash flow management skills ( $r =0.422$ ,  $p <0.05$ ).

**Table 4.4 Correlations**

		Debt Manageme nt Skills	Bookkeepi ng Skills	Tax Manageme nt Skills	Cash Flow Manageme nt Skills	Net Profit Margin
Debt Management Skills	Pearson Correlation	1	.584**	.526**	.607**	.473**
	Sig. (2-tailed)		.000	.000	.000	.000
	N	132	132	132	132	132
Bookkeeping Skills	Pearson Correlation	.584**	1	.312**	.457**	.459**
	Sig. (2-tailed)	.000		.000	.000	.000
	N	132	132	132	132	132
Tax Management Skills	Pearson Correlation	.526**	.312**	1	.579**	.509**
	Sig. (2-tailed)	.000	.000		.000	.000
	N	132	132	132	132	132
Cash Flow Management Skills	Pearson Correlation	.607**	.457**	.579**	1	.422**
	Sig. (2-tailed)	.000	.000	.000		.000
	N	132	132	132	132	132
Net Profit Margin	Pearson Correlation	.473**	.459**	.509**	.422**	1
	Sig. (2-tailed)	.000	.000	.000	.000	

N	132	132	132	132	132
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\*\* . Correlation is significant at the 0.01 level (2-tailed).

The results indicate that higher or better debt management skills are associated with higher profit margins, and that advanced bookkeeping skills are also an indication of higher profit margins. These results were also the same for tax management skills and cash flow management skills.

#### 4.7. Test of Hypotheses: Inferential Analysis

This section uses regression analysis to test the hypotheses, where the analysis will determine whether or not different variables can predict financial performance.

##### 4.7.1. Test for Direct Relationship Hypothesis

The test for a direct relationship between the variables was done using multiple regression. The general multiple regression formula is as shown in equation 4.1 below.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \dots \dots \dots \text{EQ 4.1}$$

Y = Financial Performance of SMEs

$\beta_0$  = Constant

$\beta_1 - \beta_3$  = Co-efficients

$X_1$  = Debt management skills

$X_2$  = Bookkeeping skills

$X_3$  = Tax management skills

$X_4$  = Cashflow management skills

$\varepsilon$  = Error term

The results of multiple regression are shown in table 4.6, 4.7, and 4.8 below. In Table 4.6 below, R squared = 0.368, and this means that the independent variables account for 36.8% of net profit margin.

**Table 4.5: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.606 <sup>a</sup>	.368	.348	.5051

a. Predictors: (Constant), Cash Flow Management Skills, Bookkeeping Skills, Tax Management Skills, Debt Management Skills

b. Dependent Variable: Net Profit Margin

In table 4.7 below,  $F(4, 131) = 18.458$ , p value  $< 0.05$ , indicating that the model can significantly predict the outcome.

**Table 4.6: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	18.835	4	4.709	18.458	.000 <sup>b</sup>
	Residual	32.398	127	.255		
	Total	51.233	131			

a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Cash Flow Management Skills, Bookkeeping Skills, Tax Management Skills, Debt Management Skills

The decision rule for the hypothesis is as follows: since all the hypotheses were stated as null hypothesis, p values that are  $<0.05$  (statistically significant) indicate that the null hypothesis is rejected. P values that are  $>0.05$  infer that the null hypothesis is accepted. Using this decision rule,  $H_{01}$  is rejected, (p value  $<0.05$ ), and the conclusion made is that debt management skills have a significant effect on financial performance of SMEs in Mombasa County.  $H_{02}$  is rejected (p value  $<0.05$ ), bookkeeping skills have a significant effect on the financial performance of SMEs in Mombasa County.  $H_{03}$  was also rejected (p value  $<0.05$ ), indicating that tax management skills have a significant effect on the financial performance of SMEs in Mombasa County. Finally,  $H_{04}$  was accepted (p value  $>0.05$ ), and the conclusion made is that cashflow management skills have no significant effects on financial performance of SMEs in Mombasa County.

**Table 4.7: Coefficients**

Model	Unstandardized Coefficients	Standardized Coefficients	t	Sig.
-------	-----------------------------	---------------------------	---	------

		B	Std. Error	Beta		
1	(Constant)	.506	.417		1.214	.227
	Debt Management Skills	.121	.107	.115	2.126	.042
	Bookkeeping Skills	.288	.094	.271	3.078	.003
	Tax Management Skills	.414	.107	.349	3.879	.000
	Cash Flow Management Skills	.029	.112	.025	.260	.795

a. Dependent Variable: Net Profit Margin

The regression equation to predict net profit margin, therefore is as follows:

Net Profit Margin =  $\beta_0$  + 0.121 (debt management skills) + 0.288 (book-keeping skills) + 0.414 (tax management skills) + error.

#### 4.7.2. Testing Hypothesis 1

In Table 4.9 below, R squared = 0.047, and this means that debt management skills account for only 4.7% of net profit margin.

**Table 4.8: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.217 <sup>a</sup>	.047	.040	.6129

a. Predictors: (Constant), Debt Management Skills

In table 4.10 below,  $F(1, 131) = 6.394$ ,  $p$  value  $< 0.05$ , indicating that the model can significantly predict the outcome. The outcome in this case in the dependent variable (net profit margin).

**Table 4.9: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.402	1	2.402	6.394	.013 <sup>b</sup>
	Residual	48.831	130	.376		
	Total	51.233	131			

a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Debt Management Skills

The same decision rule is applied as follows: since all the hypotheses were stated as null hypothesis,  $p$  values that are  $< 0.05$  (statistically significant) indicate that the null hypothesis is rejected.  $P$  values that are  $> 0.05$  infer that the null hypothesis is accepted. Using this decision rule, hypothesis 1 is rejected, ( $p$  value  $< 0.05$ ).

**Table 4.10: Coefficients**

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	3.104	.354		8.766	.000
	Debt Management Skills	.121	.088	.217	2.529	.013

a. Dependent Variable: Net Profit Margin

The regression equation is therefore as follows:

$$\text{Net Profit Margin} = 3.104 + 0.121 (\text{Debt Management skills}) + \text{error}$$

A one-unit increase in debt management (better borrowing and repayment practices) leads to an increase of  $\beta_1$  units in financial performance, meaning SMEs become more profitable as debt is managed efficiently.

#### 4.7.3. Testing Hypothesis 2

In Table 4.12 below, R squared = 0.079, and this means that bookkeeping skills account for only 7.9% of net profit margin.

**Table 4.11: Model Summary**

Model	R	Adjusted R		Std. Error of the Estimate
		R Square	Square	
1	.281 <sup>a</sup>	.079	.072	.6024

a. Predictors: (Constant), Bookkeeping Skills

In table 4.13 below,  $F(1, 131) = 11.172$ ,  $p$  value  $< 0.05$ , indicating that the model can significantly predict the outcome. The outcome in this case is the dependent variable (net profit margin).

**Table 4.12: ANOVA**

Model		Sum of		Mean Square	F	Sig.
		Squares	df			
1	Regression	4.054	1	4.054	11.172	.001 <sup>b</sup>
	Residual	47.179	130	.363		
	Total	51.233	131			

a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Bookkeeping Skills

Since this hypothesis was stated as null hypothesis, the same decision rule still applies,  $p$  values that are  $< 0.05$  (statistically significant) indicate that the null hypothesis is rejected.  $P$  values that are  $> 0.05$  indicate that the null hypothesis is accepted. Using this decision rule, hypothesis 2 is rejected, ( $p$  value  $< 0.05$ ), as shown in table 4.15.

**Table 4.13: Coefficients**

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	2.862	.341		8.392	.000
	Bookkeeping Skills	.288	.082	.281	3.342	.001

a. Dependent Variable: Net Profit Margin

The regression equation is therefore as follows:

$$\text{Net Profit Margin} = 2.862 + 0.288 (\text{Bookkeeping skills}) + \text{error}$$

A one-unit improvement in bookkeeping skills increases financial performance by  $\beta_2$  units, indicating that accurate financial records enhance decision-making and profitability.

#### 4.7.4. Testing Hypothesis 3

In Table 4.16 below, R squared = 0.262, and this means that tax management skills account for 26.2% of net profit margin

**Table 4.14: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.511 <sup>a</sup>	.262	.256	.5395

a. Predictors: (Constant), Tax Management Skills

In table 4.17 below,  $F(1, 131) = 46.037$ ,  $p$  value  $< 0.05$ , indicating that the model can significantly predict the outcome. The outcome in this case is the dependent variable (net profit margin).

**Table 4.15: ANOVA**

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Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	13.398	1	13.398	46.037	.000 <sup>b</sup>
	Residual	37.835	130	.291		
	Total	51.233	131			

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a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Tax Management Skills

Since this hypothesis was stated as a null hypothesis, the same decision rule still applies, where  $p$  values that are  $< 0.05$  (statistically significant) indicate that the null hypothesis is rejected.  $P$  values that are  $> 0.05$  indicate that the null hypothesis is accepted. Using this decision rule, hypothesis 3 is rejected, ( $p$  value  $< 0.05$ ), as shown in table 4.18.

**Table 4.16: Coefficients**

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	2.027	.293		6.920	.000
	Tax Management Skills	.414	.072	.511	6.785	.000

a. Dependent Variable: Net Profit Margin

The regression equation is therefore as follows:

$$\text{Net Profit Margin} = 2.027 + 0.414 (\text{Tax management skills}) + \text{error}$$

A one-unit increase in tax management competence leads to a  $\beta_3$ -unit rise in financial performance, showing that efficient tax planning and compliance improve profitability by reducing unnecessary penalties and costs.

#### 4.7.5. Testing Hypothesis 4

In Table 4.19 below, R squared = 0.103, and this means that cashflow skills account for 10.3% of net profit margin.

**Table 4.17: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.321 <sup>a</sup>	.103	.096	.5945

a. Predictors: (Constant), Cash Flow Management Skills

In table 4.13 below,  $F(1, 131) = 14.935$ ,  $p$  value  $< 0.05$ , indicating that the model can significantly predict the outcome. The outcome in this case in the dependent variable (net profit margin).

**Table 4.18: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.279	1	5.279	14.935	.000 <sup>b</sup>
	Residual	45.954	130	.353		
	Total	51.233	131			

a. Dependent Variable: Net Profit Margin

b. Predictors: (Constant), Cash Flow Management Skills

Using the same decision rule, hypothesis 4 is supported, since  $p$  values were  $> 0.05$  indicating that the null hypothesis is accepted. This is shown in table 4.21. since the analysis shows no statistical significance, no regression equation is developed.

**Table 4.19: Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.785	.316		8.820	.000
	Cash Flow Management Skills	.029	.078	.321	.260	.795

a. Dependent Variable: Net Profit Margin

Holding other factors constant, a one-unit increase in any financial literacy dimension ( $X_1$ – $X_4$ ) leads to a positive change ( $\beta_1$ – $\beta_4$ ) in financial performance, demonstrating that improvements in financial literacy collectively enhance SME profitability.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter grants a summary of findings, conclusions, policy recommendations, limitations of the study, and suggestions for further studies. The chapter has thus summarized the findings of the study from the main introduction of the research project. The chapter has thus carried out a precise summary of the main findings and highlighted major insights gained from the findings.

#### 5.2 Summary of Findings and Discussions

The study set out to examine the effect of financial literacy on the financial performance of SMEs in Mombasa County. It was guided by four specific objectives: to determine the effect of debt management skills, to evaluate the effect of bookkeeping skills, to assess the effect of tax management skills, and to determine the effect of cash flow management skills on financial performance. The findings revealed that debt management skills had a statistically significant positive influence on the financial performance of SMEs. Enterprises that effectively managed their debts by borrowing prudently, negotiating favourable repayment terms, and maintaining sustainable debt levels recorded improved profitability and liquidity positions. This implies that entrepreneurs who are knowledgeable about debt sources, interest rates, and repayment scheduling are better positioned to enhance their firms' financial stability.

In regard to bookkeeping skills, the study established that proper record-keeping and financial documentation significantly influence SME profitability. Businesses that maintained accurate records, prepared budgets, and monitored their expenses were able to make informed decisions

that improved performance. The findings further indicated that poor bookkeeping practices contributed to mismanagement, poor decision-making, and limited access to credit facilities, all of which undermine growth and profitability.

The study also found that tax management skills had a significant positive relationship with financial performance. SMEs that demonstrated proper tax planning, compliance, and understanding of tax laws minimized tax-related risks and penalties, improved liquidity, and enhanced business sustainability. In contrast, inadequate tax knowledge exposed enterprises to unnecessary costs, legal challenges, and disruptions in cash flow.

Lastly, the results indicated that cash flow management skills did not have a statistically significant relationship with financial performance. Although cash flow management is theoretically important for sustaining liquidity, most SME owners lacked structured systems for forecasting and monitoring cash movements. This finding suggests that poor cash flow planning continues to hinder SMEs from achieving consistent profitability in Mombasa County.

### **5.2.1 Debt Management Skills**

Debt management skills are closely related to prudent borrowing and the proper use and servicing of available credit facilities. It involves proper handling of what, when, why, and how much to borrow. It requires an understanding of the source, form, and cost of available credit, as well as the implications of default and sole reliance on debt financing. It is also understood as the appropriate assessment of credit capability and planning for credit use. Debt management refers to an individual's knowledge and decision-making abilities when taking on and managing debt (Odo & Udodi, 2022). The significance of the results could indicate that more SME owners tend to be financially literate, and they are more likely to use credit services. Therefore, enhancing

financial literacy is important for SME development because financially literate individuals and businesses are more likely to manage credit services effectively and to ask for a loan.

### **5.2.2 Bookkeeping Skills**

Bookkeeping is a prevalent factor that greatly influences the financial performance of SMEs. Bookkeeping skills and financial literacy are closely intertwined as they help in the establishment of financial soundness. Bookkeeping is an effective basic factor utilized by business owners as a tool to induce the planning and control factors of effective business management. The question of how valuable it is to improve one's bookkeeping skills is a significant, and one that was explored in this study in detail, as well as in previous research. Some experts in the SME sector raised concerns that the non-availability of business records was the primary reason for the lack of debt finance from financial intermediaries (Aladejebi & Oladimeji, 2019).

Shocks or surprises that arise from bad debts, creditors not settling their bills, errors in supplier invoices, or overhead control issues can be reduced in a cash or revenue-run business by having answers and ruling out some issues properly by keeping business records, as evidenced in the literature review. A business owner may recognize early that the business is trading on negative margins and quickly downgrade costs or raise prices. By mistake, the business owner might not be losing money, and by removing potential errors in their records, they could uncover this state of affairs. In this way, the anticipation or knowledge of these situations' places business owners in a better position and gives them a greater ability to act, pulling them further toward a position of financial success by being financially literate and having an incentive to enhance their bookkeeping skills by using accounting software and other methods of keeping updated information.

The information that we receive from the loan repayment participants on what they know keeps financial records is one only them think that special skills only required in Kenya Shillings 104: juggling of loan repayment schedules. But, according to expert views, when clients borrow multiple loans from multiple sources, juggling repayment schedules add a level of complexity that can be very challenging to manage. An important finding are those who have never attended the basic bookkeeping training that only 7.7% of entrepreneurs indicated the practice of setting up controls system to protect cash against loss.

Keeping with forward looking financial strategies are necessary, and these required specific knowledge, skills middle and attitudes about financial management. The approach is expanded of financial education program of financial literacy being one end to only measures relating to own business' finance, using a wider range of financial literacy measures. On loan management issue, prioritizes with the lender is the strategy most commonly implement by client in response to loan default. There is significant less training in bookkeeping. Effort is needed to improve ability to read and understand the basic accounting information provided in financial statement.

### **5.2.3 Tax Management Skills**

SMEs are exposed to both direct and indirect taxes. The effective management of these taxes impacts the success of the SMEs. Successful management requires tax planning, good internal control systems, and knowledgeable and skilled staff regarding taxes. Nonetheless, SMEs are said to have capacity problems in dealing with tax matters, which they consider more demanding than those for larger companies. Tax management mainly involves determining the taxes an organization is liable to pay to the government and generating revenues to allow smooth implementation of government policies, ensuring an improved standard of living for the Kenyan

people through equitable utilization of taxpayers' money. According to the findings, local SMEs might not be paying the right amount of taxes as required by tax laws, thus lowering the government's revenue collection. This is because SME management lacks the tax capabilities to guide the firm in meeting their tax obligations correctly (Otwani, Simiyu & Makokha, 2017). Small businesses bear a significant tax burden, so tax issues should be carefully analysed. Small businesses are of particular concern due to the weight of their contribution to the economy, given that they are hit directly by taxes. Hence, the strength of the enterprises cannot be separated from their tax problems, as tax issues amplify existing problems or contribute to new ones.

#### **5.2.4 Cashflow Management Skills**

The excessive mismanagement of cash flow is associated with many failures of small businesses. These failures arise from a lack of knowledge and poor management skills by owners and/or managers. Many business owners do not have the skills to manage the business well, especially in the field of finance and accounting. A company that has strong cash flow management will have a strong foundation and a greater capacity to finance growth. Enterprises with poor cash flow management can quickly find themselves in liquidity problems, and increasing sales levels only increase the financial problems associated with uncollected accounts receivable.

The effective management of cash flows is one of the most critical areas in business success. Many business failures in recent years have resulted from the inability to properly manage cash. On the other hand, adequate cash management leads to better debt collection, smarter borrowing, and better negotiation with creditors, which translates into a better bottom line. Effective cash flow management can have a meaningful and positive impact on the net income of a company. At the end of the day, cash continues to be king, especially in tough economic times. Based on this logic,

success in cash management is considered by many to be the number one metric associated with long-term business success, as evidenced by Momanyi et al. (2017).

### **5.3 Conclusions**

The study concludes that financial literacy plays a vital role in enhancing the financial performance of SMEs. Specifically, debt management, bookkeeping, and tax management skills significantly contribute to profitability and business sustainability. Proper debt management enables SMEs to maintain optimal capital structures and avoid financial distress, while sound bookkeeping practices improve accountability, transparency, and informed financial decision-making. Similarly, effective tax management ensures compliance, reduces unnecessary tax burdens, and enhances resource utilization. However, the insignificant relationship between cash flow management skills and financial performance suggests that SMEs have not yet adopted effective cash flow monitoring systems to fully realize its potential benefits. Overall, the study concludes that improving financial literacy among SME owners is critical for achieving profitability and long-term survival.

#### **5.3.1 Objective 1: Effects of debt management skills on financial performance**

This research defined debt management skills as prudent borrowing and the proper use and servicing of available credit facilities, as well as proper handling of what, when, why, and how much to borrow. The research finds a significant positive association between debt management skills and performance. The significance of the results could indicate that more SME owners tend to be financially literate, and they are more likely to use credit services, and as such, enhancing financial literacy is important for SME development.

#### **5.3.2 Objective 2: Effects of bookkeeping skills on financial performance**

The study finds a significant positive association between bookkeeping skills and performance. The question of how valuable bookkeeping is to improve firm performance is explored in detail in this study as well as in previous research. A business owner may recognize early that the business is trading on negative margins and quickly downgrade costs or raise prices. The anticipation or knowledge of the situations where the business could be losing money places business owners in a better position and gives them a greater ability to act, pulling them further toward a position of financial success by being financially literate and having an incentive to enhance their bookkeeping skills by using accounting software and other methods of keeping updated information.

### **5.3.3 Objective 3: Effects of tax management skills on financial performance**

The study also finds a significant positive association between tax management skills and performance. Successful management requires tax planning, good internal control systems, and knowledgeable and skilled staff regarding taxes. Nonetheless, SMEs are said to have capacity problems in dealing with tax matters, which they consider more demanding than those for larger companies. Tax management mainly involves determining the taxes an organization is liable to pay to the government and generating revenues to allow smooth implementation of government policies, ensuring an improved standard of living for the Kenyan people through equitable utilization of taxpayers' money.

### **5.3.4 Objective 4: Effects of cashflow management skills on financial performance**

However, the current study did not find any association between cash flow management skills and performance. The excessive mismanagement of cash flow is associated with many failures of small businesses according to previous research. These failures arise from a lack of knowledge and poor management skills by owners and/or managers, and this could lead to poor performance. These findings were, however, not generalizable to the context of Mombasa County.

#### **5.4 Recommendations of the study**

Based on these conclusions, the study recommends that SME owners and managers undergo regular training on debt management to enhance their understanding of borrowing, credit terms, and repayment planning. Financial institutions and government agencies should collaborate to provide affordable financial literacy programs tailored to SME needs. Additionally, bookkeeping training should be emphasized to ensure that entrepreneurs can maintain accurate financial records, prepare financial statements, and make data-driven decisions. Tax authorities such as the Kenya Revenue Authority (KRA) should simplify tax education and offer advisory support to SMEs to enhance compliance and reduce tax-related penalties. Furthermore, SME support organizations and the County Government of Mombasa should promote the adoption of digital cash management systems that assist entrepreneurs in tracking inflows and outflows, forecasting cash requirements, and maintaining adequate liquidity. Such interventions would collectively strengthen financial literacy and enhance SME profitability and sustainability.

#### **5.5 Contributions of the study**

This study contributes to both theory and practice by empirically demonstrating how financial literacy influences SME financial performance in a developing economy context. It provides

evidence that debt management, bookkeeping, and tax management skills are critical components of financial literacy that significantly improve profitability. The findings offer valuable insights to policymakers, financial institutions, and SME development agencies in designing targeted financial training programs and policies aimed at enhancing SME competitiveness. Academically, the study enriches the existing literature by integrating multiple financial literacy dimensions within one analytical framework focused on SMEs in Mombasa County.

### **5.6 Suggestion for future research**

Future researchers should consider expanding the scope to include other counties or sectors to allow for comparative analysis and enhance generalizability of findings. Studies can also explore the moderating effect of factors such as technology adoption, financial regulation, and access to credit on the relationship between financial literacy and financial performance. In addition, qualitative research approaches could be adopted to gain deeper insights into how SME owners acquire and apply financial literacy skills in their day-to-day business operations.

### **5.7 Limitations of the study**

The study was limited to SMEs in Mombasa County, which may restrict the generalizability of its findings to other regions in Kenya. The research relied on self-reported data, which may have introduced some response bias. Time and resource constraints also limited the study to four dimensions of financial literacy, excluding other possible determinants of financial performance such as investment planning and savings behaviour. Nonetheless, the study's findings provide credible and valuable insights into the influence of financial literacy on SME performance.

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## **Appendix 1: Introduction Letter**

**Michael Gathara Kariuki**

**Cell: 0727702986**

**Email: mgkariuki@gmail.com**

Greetings

### **QUESTIONNAIRE FILLING**

I am an MBA student at Kenyatta University carrying out a study titled “Financial Literacy and Financial Performance of SMEs in Mombasa County, Kenya”.

I kindly request you to finish the attached questionnaire. Provided data will be used strictly for academic purposes only. Your participation is highly appreciated.

Thank you.

**Yours Sincerely.**

**Michael G. Kariuki**

## **Appendix II: Questionnaire**

### **SECTION A: DEMOGRAPHIC INFORMATION**

#### **Gender**

Male [ ]

Female [ ]

#### **Age**

21-30[ ]

31-40[ ]

41-50[ ]

51 and above [ ]

#### **Highest Education Level**

Certificate [ ]

Diploma [ ]

Undergraduate [ ]

Postgraduate [ ]

Masters [ ]

PhD. [ ]

#### **Industrial/Field of Work**

Wholesale and retail [ ]

Transport and logistics [ ]

Tourism and hospitality [ ]

Manufacturing [ ]

Professional and technical services [ ]

Information Technology [ ]

Other (please specify)

#### **SECTION B: DEBT MANAGEMENT SKILLS**

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
B1	How proficient are you in managing debts and loans optimally to maximize financial resources for your business?					
B2	To what extent do you possess the competence to calculate the costs associated with debt to make informed financial decisions?					
B3	How advanced are your skills in debt restructuring and interest rate management for optimal debt management strategies?					
B4	How thoroughly do you analyse creditors' costs and negotiate favourable terms to maximize profits for your business?					

## SECTION C: BOOKKEEPING SKILLS

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
C1	How well do you maintain meticulous and accurate financial records, providing a solid foundation for informed decision making?					
C2	To what extent do your expertise in budgeting enable effective resource allocation and achievement of financial goals?					
C3	How advanced are your sales forecasting skills for anticipating market trends and adapting business strategies accordingly?					
C4	How proficient are you in preparation of comprehensive financial statements providing clear insights into the financial health of your business?					

## SECTION D: TAX MANAGEMENT

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
D1	How proficient are you in computing income tax and instalment tax to ensure compliance with tax regulations and optimize tax liabilities?					

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
D2	To what extent do your expertise in value-added-tax (VAT) planning and computation minimize tax burdens and maximizes cash flows efficiency?					
D3	How updated are you with tax regulations and possess in-depth knowledge to navigate complex tax environments, safeguarding your business from potential risks?					

**SECTION E: CASH FLOW MANAGEMENT SKILLS**

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
E1	How advanced are your skills in cash flow forecasting enabling proactive management of liquidity and financial stability?					
E2	How effective do you manage accounts receivables to ensure timely collections and maintain health cash flows to support operations?					
E3	How efficient are you in managing accounts payable to optimize payment schedules and preserve cash reserves for strategic investments?					

**SECTION F: FINANCIAL PERFORMANCE OF SMES**

	<b>Statement</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
F1	How consistent is your achievement of outstanding net profit margins reflecting efficient cost management and revenue generation strategies?					
F2	To what extent do you possess a deep understanding of your business's return on investment (ROI) metrics enabling evaluation of performance and identification of improvement areas?					
F3	How often does your business outperform industry benchmarks in term of financial performance demonstrating resilience and competitiveness in the market					

**Thank You**

## Appendix III: KU approval letter



**KENYATTA UNIVERSITY  
GRADUATE SCHOOL**

E-mail: [dean-graduate@ku.ac.ke](mailto:dean-graduate@ku.ac.ke)

Website: [www.ku.ac.ke](http://www.ku.ac.ke)

**P.O. Box 43844, 00100  
NAIROBI, KENYA  
Tel. 810901 Ext. 4150**

**Internal Memo**

**FROM:** Executive Dean, Graduate School

**DATE:** 21<sup>st</sup> November, 2024

**TO:** Michael Gathara Kariuki  
C/o Accounting and Finance Dept.

**REF:** D53/OL/MSA/20123/2021

**SUBJECT: APPROVAL OF RESEARCH PROJECT PROPOSAL**

This is to inform you that Graduate School Board at its meeting of 15<sup>th</sup> November, 2024 approved your Research Project Proposal for the M.B.A Degree Entitled, **“Financial Literacy and Financial Performance of Small and Medium Enterprises in Mombasa County, Kenya.”**

You may now proceed with your Data Collection, Subject to Clearance with Director General, National Commission for Science, Technology and Innovation.

As you embark on your data collection, please note that you will be required to submit to Graduate School completed Supervision Tracking and progress report Forms per semester. The Forms are available at the University’s Website under Graduate School webpage downloads.

Also, please ensure that you publish article(s) from your project before submitting it to Graduate School for examination as per the Commission for University Education and Kenyatta University guidelines.

Thank you.

**ANNBELL MWANIKI  
FOR: EXECUTIVE DEAN, GRADUATE SCHOOL**

c.c. Chairman, Accounting and Finance.

Supervisors:

1. **Dr. Peter Ng’ang’a**  
C/o Department of Accounting and Finance  
Kenyatta University

AM/c





**Appendix V: MAP of Mombasa County**

