

Financial Literacy in MSMEs: Challenges and Growth

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Abstract

Low financial literacy has been related to global economic crises and business failures, with MSME managers often lacking essential financial knowledge, skills, and attitudes. In West Bengal, MSMEs employ 1.35 crore individuals, yet financial literacy among their managers remains alarmingly low. This study identifies causes and potential remedies for this deficiency, employing life cycle theory and scores derived from traits such as attitude, behaviour, awareness, and skill. A survey of 400 MSME units across four districts—Howrah, Kolkata, 24 Parganas (N), and 24 Parganas (S) - revealed gaps in financial management practices, including a limited understanding of how interest rates and inflation affect loans. While managers demonstrated some knowledge of debt management, they struggled with matching assets and liabilities. The findings highlight a critical need for targeted financial literacy interventions to ensure MSMEs remain competitive, especially in the context of Industry 4.0, where digitalization and user-friendly cloud solutions are increasingly adopted.

Keywords: *Financial literacy, MSMEs, Industry 4.0, West Bengal*

1. Introduction

The capacity to handle personal or professional financial issues is known as financial literacy. Abiodun (2016) has labelled it the "new business reality". Even though there are several definitions for the notion, this study focused on three factors: the financial behaviour, attitude and knowledge of MSE managers. Micro, small, and medium-sized enterprises (MSME) play a big part in output and employment in both advanced and least-developed countries. Additionally, they are crucial to the revival of the national and international economies.

In numerous African countries, micro and small-scale enterprises (MSEs) employ almost twice as many people as all registered large-scale enterprises. This implies that for a sizable segment of the population, MSEs constitute a significant source of income. Consequently, MSEs are essential for initiating broad-based growth, growth driven by the private sector, and employment generation, especially in developing countries striving for sustainable growth.

The mastery of particular knowledge, attitudes, and behaviours is known as financial literacy. According to Nkundabanyanga & Kasozi (2014), an individual can exercise sound judgment and make informed choices regarding the use and management of their financial resources. It can hardly be denied that a person without Financial literacy will be able to manage businesses and organizational operations in the evolving environment of today. According to Atkinson and Messy (2012), governments worldwide are searching for effective methods to raise their citizens' financial literacy by developing financial education initiatives that place a high priority on providing a range of learning opportunities.

It is found from the S&P Global Fin Lit Survey that approximately 3.5 billion people globally - the bulk of whom reside in third-world countries - do not understand the foundations of finance. Klapper, Lusardi, and Peter (2015) on the other hand went on to state the highest rates of financial literacy are seen in the majority of first-world industrialized countries, where four out of five adults, or roughly 65% of the population, have a basic

understanding of finance. The number of people in developing nations that use financial services has gone up recently and they are also becoming more involved in the emerging financial markets. According to Lusardi and Mitchell (2007), financial literacy is widespread in developing countries. Furthermore, price bubbles and pyramid schemes are widespread in developing countries, according to Greenspan (2002), and they trick a lot of gullible customers into purchasing financial products. The Global Findex database for 2017 shows that 69% of people in the working age range are registered in formal financial institutions worldwide. It is supported by the fact by a decrease in a number of people without accounts from 2.9 billion in 2011 to 1.7 billion in 2017.

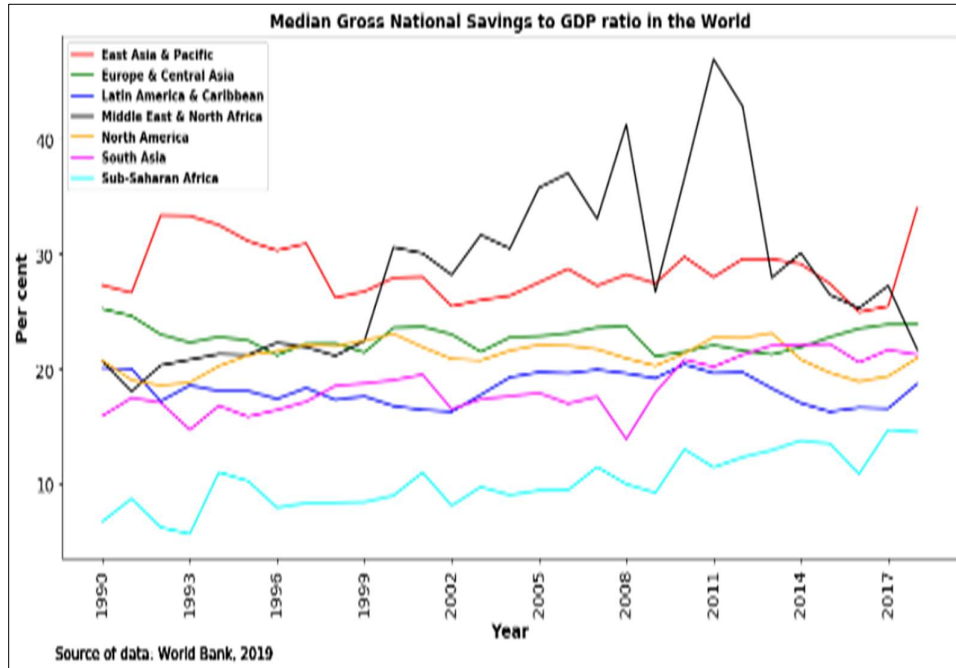


Figure 1. Position of Fin Literacy Worldwide (2019)

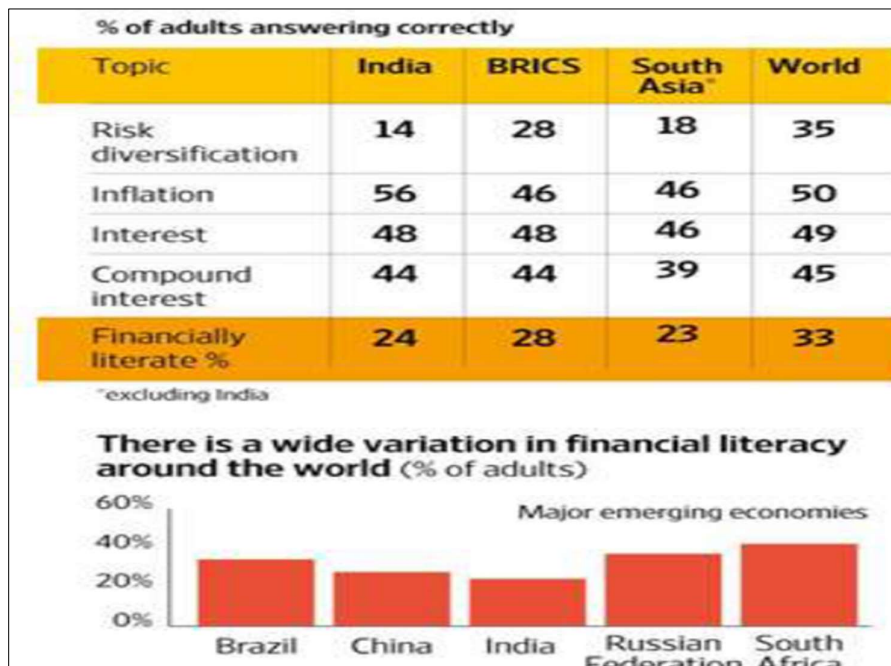


Figure 2. An overview of current Financial Literacy Efforts in India (Source: Economic Survey 2022)

2. Literature Review

Profitability consists of two key elements: ability and profit. Ability refers to a company's capacity to generate profit, while profit is calculated as the total revenue minus expenses. Thus, profitability can be evaluated by examining an investment's potential to deliver a return on investment.

Financial literacy is associated with several "best practice" financial behaviours, including monitoring credit reports, maintaining a sizable emergency fund, omitting inspection in connection with overdrafts, mitigating debt, initiating a supernatural plan account specifically for it, and obtaining insurance (Robb, 2014). According to Zeynep (2015), financial behaviour is the ability to comprehend how one's financial decisions impact the whole situation and to make informed decisions about budget planning, safety measures, and cash management. According to Latif, Razak, and Lumpur (2011) applying financial principles to prudent resource management is known as a financial attitude.

According to some experts, the success of small enterprises is unaffected by the financial literacy of managers. For instance, a 2015 Plakalovi study on financial matters amongst owners of small-scale industries confirmed that very few managers employed ratio analysis due to their managers' low level of basic financial knowledge. He went on to claim that they are blind to the intangible values of the organizations' operations and manage the funds of the organizations in an ad hoc manner. Plakalovi concluded that SMEs can thrive even in the absence of a strong financial background. Many research on financial literacy did not link personal finance to corporate management, instead concentrating on personal finances. Unlike prior research that focused on a limited number of variables of managers' financial conduct, this study examined the various facets of financial literacy and their impact on MSE profitability.

Low financial literacy levels have been linked to business failures worldwide and are even believed to have contributed to the global economic crisis of 2008–2009, according to research on the impact of financial literacy on MSE performance, profitability, and growth (Niwaha, Schmidt, & Tumuramye, 2016).

A study on the effect of financial literacy on women-owned enterprises in Kenya found that bookkeeping, management of cash, budgeting, and savings are important factors to the benefit of female-led enterprises (Kalekye & Memba, 2015). It made clear how important financial education is to enhancing capabilities and daily business operations. While most MSE managers had a reasonable understanding of debt management, a different study (Lusimbo & Muturi, 2016) examined the effect of financial education on the implementation of small businesses and projected that most of them were unaware of how interest rates and inflation affected the loans they took out in terms of matching assets and liabilities. They went on to explain that little to no development had been documented since the management lacked adequate bookkeeping literacy. The factors that contribute to the profitability of large and medium-sized enterprises have not been extensively studied by scholars. On the other hand, very few researchers have examined the factors that affect the profitability of MSE organisations. In small businesses, one key decision maker frequently owns and controls the capital, giving them significant control over how the company achieves its objectives. Because of their exceptional decision-making abilities, the owner can launch companies that have the potential to make a lot of money and succeed. As a result, in order to make decisions that will increase the company's profitability, the proprietor or manager of an MSE has to be financially literate. According to (Margaretha and Supartika, 2016) other variables that affect the profitability of micro and small businesses are the size of the company, sales growth, lagging earnings, productivity, asset turnover, and firm age.

3. Objectives

- To find out a scenario on financial management practices amongst owners of small-scale industries.
- To understand different components of financial literacy.
- To measure financial literacy by life cycle hypothesis.

4. Financial Management Practices in Bengal

One of the key elements of management that determine whether a business endeavour, particularly one involving micro and small firms, succeeds or fails is financial management. It comprises figuring out how much money is needed, selecting the best funding sources, raising the money when it's needed, skilfully assessing investment offers, successfully managing working capital, and maximizing earnings. The viability of micro and small businesses depends on effective financial management. Solomon claims that the effective use of capital funds, a crucial economic resource, is the focus of financial management. The primary goal of financial management is to

maximize wealth and profit for the company and its owners. The following are the components of financial management: Financial Choice, Investment Choice, Dividend Choice (Profit Management).

Financial management is one of the biggest issues that Bengal's micro and small companies face. Many of these companies' promoters/owners are not eligible to manage their finances efficiently or they have not selected competent and experienced people to be their financial managers. Despite their lack of experience and education in the newest techniques and instruments for financial management, the owner/managers are ultimately responsible for these companies' financial operations.

5. Methodology

The study on the financial management techniques of Bengal's micro and small companies was conducted in two phases. Initially, existing literature and data were collected and reviewed from published sources, including books, journals, websites, and publications from state and federal governments, the Industries Department, District Industries Centres, Ministry of MSME and the Industries Department. In the second stage, primary data were collected using a scheduled interview process, who are primarily engaged in the production of handicrafts, electronics, apparel, food processing, agro-processing, engineering, and other related industries provided the original data. Pilot research with 100 sample units was conducted before the final survey.

West Bengal has 88.67 lakh units of MSME after Uttar Pradesh citing National Sample Survey 73rd Round during 2015-16. The samples were selected at random from the four districts of West Bengal viz. Kolkata, Howrah, 24 Pgs(N) and 24 Pgs(S). These four districts have the major share of micro small and medium enterprises. From these four districts, a sample of 100 units each was selected at random. The list of the micro and small enterprises registered in these four districts was collected from the concerned District Industry Centers. From these two districts, a sample of 100 units each was selected at random. According to MSME Ministry's Annual Report West Bengal's MSME units employ 1.35 crore people including 91.95 lakh men and 43.51 lakh women.

6. Measurement Of Financial Literacy by Financial Knowledge, Behaviour, Attitude, Skill and Awareness

Five questions are used to assess an individual's awareness of financial literacy level: fundamental calculations; calculation of interest rate (time value of money) inter-relationship amongst price, inflation and return; and use of diversification as a strategy in risk reduction. A score of one is awarded for each right response. Five to four points indicate very good and good financial awareness, three points indicate moderate financial awareness, and the remaining respondents' scores indicate bad financial knowledge.

To assess the respondents' **financial behaviour**, questions about their daily money management are asked. To find out if respondents evaluate financial items, establish long-term goals, pay bills on time, manage finances related to business, check the affordability of goods and services, participate in long-term financial planning, and save and borrow money regularly thus a total of eight questions are utilized. If a response demonstrates suitable financial behaviour, it receives a score of one; if not, it receives a score of zero. Extremely Positive and positive financial conduct is defined as having 5-4 points; medium financial behaviour is defined as having three points; and independent financial behaviour is defined as having the remaining respondents' points.

One could contend that a person's borrowing, saving, and risk-taking behaviours are influenced by their outlook on money and finances. The degree of planning belief, the likelihood of saving, and the likelihood of consuming are the three metrics used to assess respondents' financial views. The MSME units' level of optimism over their financial status is indicated by a score ranging from 1 to 5. A positive financial attitude is defined as someone who scores four or higher on average across all three measures; an indifferent financial attitude is defined as someone who scores two or lower; and an average financial attitude is defined as the remaining respondents.

Likewise, financial **knowledge** consists of avenues of short-term and long-term funds from sources like retained profits, microfinance, venture capital and personal savings, track of financial records, strategy to cope with contingency and comparison of different sources of finance. A score of one to five indicates a different level of financial knowledge. MSME units who score three or higher on average are classified as having positive financial knowledge; those who score two or lower are classified as having an indifferent financial knowledge and the remaining respondents are classified as having an average financial knowledge. Similarly, financial **skill** consists of techniques for the preparation of cash and sales budgets, forecast of profitability and ability to adjust planning according to changes in economic factors.

7. Data Analysis

Table – 1: The effect of 5 variables on financial literacy

Variable	Most relevant	Relevant	Neutral	Less Relevant	Least Relevant
Awareness of the time value of money, inflation, risk & return	37	33	20	10	0
Behaviour towards daily money management	57	28	10	5	0
Attitude towards consumption, planning	25	45	13	12	5
Knowledge of short-term and long-term fund	35	40	10	8	7
Skill towards preparation of budget and profitability analysis in business	22	48	6	10	14

1. 37% of the total population are mostly aware of time value of money, and diversification followed by 33% who think it is relevant. While 20% are neutral and 10% think it is irrelevant.
2. 57% of SMEs surveyed think daily money management is most important followed by 28% who think it is equally important. Only 15% might take family assistance in maintaining proper management.
3. Risk is the major factor affecting attitude according to 25% of the total population and relevant factor to 45% of the total population.
4. Knowledge of short-term and long-term funds is most relevant to 35% of SMEs surveyed followed by 40% who think it is relevant.
5. 22% of SMEs surveyed have skills for the preparation of budget and profitability analysis followed by 48% who think it is equally relevant while the rest 30% take the help of experts.

Life Cycle Management in SMEs

SMEs: How well SMEs implement environmental management (including LCM) depends on a number of factors, including owner/manager influence, environmental culture, resource availability, future orientation, knowledge of environmental issues, market requirements, geographical separation of production and consumption, and awareness of one's own environmental impacts. Mortimer provides a sustainability organizational transformation model and associated adoption criteria. The model is composed of four categories: the individual, the organization, the organizational field (supply chain), and the broader environment (government, market). Accordingly, the characteristics and components identified in this study that could either promote or hinder the adoption of LCM can be condensed into four viewpoints. (Figure - 3) Numerous research on financial literacy concentrated mostly on personal finances, ignoring the link between personal and business finances.

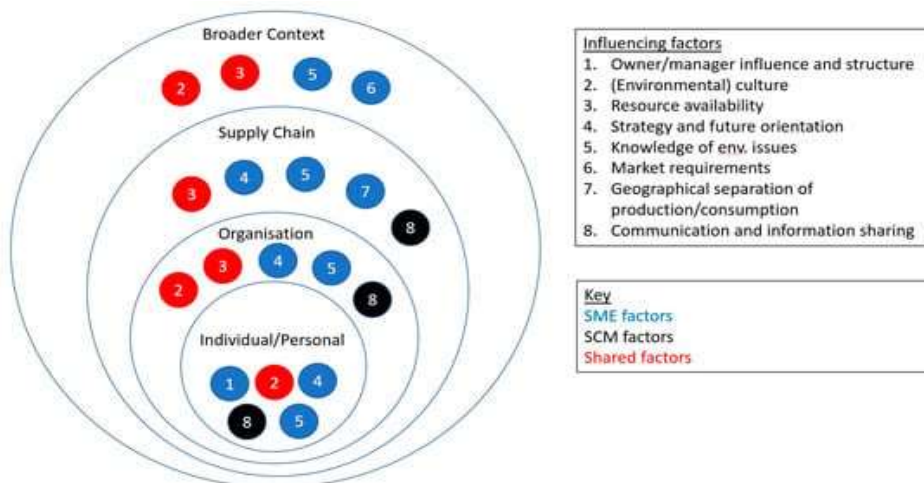


Figure 3. Enablers and barriers to successful life cycle management (LCM) uptake based on four views
 The many lenses that can be used based on the stakeholder's position and/or point of view are summarized in

Figure 1. While certain variables are unique to a given group, others are present in various perspectives. This method can serve as the foundation for comprehending and appropriately handling pertinent difficulties. While some enablers and obstacles, for instance, can be impacted at the individual or organizational level, other concerns may be more effectively and efficiently addressed at the industrial sector or larger context level.

8. Challenges in Accessing MSME Finance

Companies had to reveal problems they were having getting funds, including for phases other than this one. A scale of 1 to 5 was used, with 1 signifying relatively easy, 2 meaning somewhat challenging, and 3 meaning manageable. 4 challenging to control and 5 robust. The number of businesses evaluating a problem as tough overall and the number of businesses rating at least one issue as problematic at each stage were used to calculate the percentage numbers.

Start-Up: At this stage, companies determined that the main barriers to funding were the following: the availability of funds, the capacity to offer collateral or a guarantee, the processing time of a loan application, the lack of knowledge about current programs, and administrative complexity, in that order.

Survival Stage: Among the equally burdensome difficulties were long processing times, ignorance of available schemes, excessive service fees when processing loan requests, and trouble filling out the necessary documentation. By now, businesses often seek to expand within their industry and break even on their original investment. It would be difficult for small businesses to furnish collateral as doing so would cause them to be hindered by lengthy loan disbursement delays and onerous procedures. At this point, businesses asserted that their primary purposes for cooperative banks were operating capital, short-term loans, and collateral loans. It would be beneficial to look into the causes of its recurrence.

Growth Stage: At this point, businesses discovered a number of serious issues, such as a lack of awareness of relevant programs, high processing costs for loan applications, challenges supplying collateral or a guarantee, high interest rates, and challenges finishing the necessary paperwork.

Sustenance Stage: Businesses at this point frequently reported encountering difficulties obtaining funding, such as difficulties providing collateral or a guarantee, challenging procedures, ignorance of available schemes, protracted loan application processing periods, costly processing fees, and difficulties finishing necessary documentation.

Before Industry 4.0, a study determined that SMEs needed to invest heavily in their systems, processes, and technology to keep their competitive edge. In the era of Industry 4.0, SMEs still need to make these investments and continuous improvements in order to stay competitive. Specifically, in post digital era, cloud solutions have been shown to be widely adopted, partly because they are easier to use than other Industry 4.0 technologies and because doing so may have advantages. Moreover, they found that the relatively high cost of other Industry 4.0 technologies (autonomous robotics, cyber-physical systems, machine-to-machine communication, etc.) makes it impractical for SMEs to implement them.

Observations

The promoters of many of these businesses lack the necessary skills to handle their funds effectively, or they haven't chosen knowledgeable and capable individuals to serve as their financial managers. The owner-managers are ultimately in charge of these organizations' financial operations, despite their lack of training and experience in the newest methods and tools for financial management.

9. Conclusion

India has a number of natural advantages that affect the MSME sector, including a growing number of young, educated people, high domestic demand, increased use of social media and mobile devices, unexplored markets in underserved rural areas, and a rise in the number of women with the capacity to start their own businesses. These are new developments that will influence Indian entrepreneurship in the future. Therefore, the government's task is to create an environment that encourages new business ventures and entrepreneurs while also encouraging the right individuals to start their own businesses and improving the caliber of already-existing ones. This section outlines some of the factors to take into account while creating future interventions for the aforementioned trends and other nations' approaches.

Timely access to relevant information is of key importance for an enterprise's successful emergence, growth and survival. Entrepreneurs, both potential and existing, will be looking for information related to the government schemes, scope for new projects, incubation support, cluster information, infrastructure availability.

To promote a culture of entrepreneurship, the government has presently taken certain positive steps such as promoting entrepreneurship education in educational institutions, and introducing product design competitions, incubation centers, best entrepreneur awards, etc. In this direction, the government should also encourage the creation of an entrepreneurial network involving successful role models, industry associations, and social leaders to develop a pro-entrepreneurship culture.

Improvement in identifying the right candidates and providing mentoring support will definitely change the enterprise eco-system. In addition, the government has to identify the skills needed by MSMEs to better match labor supply and demand.

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