

Effect of Financial Capability on the Financial Decisions of Small and Medium Enterprises (SMEs) in Ondo State

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Although the challenges confronting SMEs are in exhaustive, however, the emphasis on the inability to access capital by researchers may be overemphasized. While there is an increasing study on the need to scale up finance for SMEs in order to alleviate the funding gap in entrepreneurial finance, very little or no attention has been given to its financial capability. The study examines the effect of financial capability in terms of these core elements; financial attitude, financial behaviour, financial literacy, and financial skills on the financial decisions of SMEs. Survey research design was employed. Using a structured questionnaire, simple random sampling technique was used to proportionately select the sample for data collection. Judging by the average mean value of 4.45, findings also reveal that financial capability has a high effect on financial decisions of SMEs. Generally, findings reveal that financial capability has a significant effect on the financial decisions of SMEs with $p\text{-value } 0.043 < 0.05$. The policy implication thereof is that the government, educational institutions and industry should align their policies to introduce initiatives where SMEs can learn and develop their understanding of financial capability components that are needed in financial decision making. The study recommends financial education, with a plethora of programs, seminar, workshops and similar windows for SMEs in order to enhance its financial capability and strengthen its sound financial decisions making ability which has the propensity to enhance its financial soundness and creditworthiness.

Background to the Study

Nearly all Small and medium enterprises (SMEs) in the world and in particular, developing countries are facing financial capability problems. To this effect, financial capability has become a topical issue in recent time around the globe (World Bank Group, 2018; Kamini, Shikha and Miklesh 2019). Enterprises must recognise the intricacies and complexities of their finances, the challenge of taking the appropriate financial decisions and other financial goals prudently in order to provide a better understanding and usage of financial services, reinforce their financial decisions capacity as well as their ability to manage risks. To do so, SMEs must be well harnessed with the requisite financial knowledge, attitude, behaviour with the essential skills which have the propensity to enhance prudent financial decisions making, gain access to financial prospects and improve performance (Victoria, Leon and Mark 2014; IFC, 2020).

It is readily noted that financial literacy/knowledge is a widely used concept (Bongini, Iannello, Rinaldi, Zenga, and Antonietti, 2018; Hensley, 2015), but recently, financial capability, as a new phenomenon is gaining prominence. Financial capability goes beyond the knowledge of financial concepts to include a combination of behaviors, skills, and attitudes that enable effective and responsible financial decision making (Holzmann, 2013; World Bank Group, 2018). According to World Bank (2013), financial capability can be measured by assessing enterprises' financial knowledge, skills attitudes, and behaviours. Based on these measurements, meaningful indicators can be developed to effectively inform policy objectives. Financial capability is very important for the entrepreneur to make the right decisions, leading to more valuable opportunities. Firms lacking financial capability may be at the risk of serious consequences whereby they have cash flow management problems, limited basic accounting and budgeting skills, lack of skill required to access financial risks, lack of understanding of the suitability of financial products and services, lack of skills required to take financial and investment decisions and above all, getting into high profile debts.

While there is growing research on the need to scale up finance for SMEs, there is paucity of studies on how financial capability shapes financial decision of SMEs. Ojeka and Mukoro (2011), noted that though SMEs have been known to contribute tremendously to employment generation, creating a better standard of living, as well as contributing to the gross domestic products (GDP), however, the dearth of financial capability has lowered the rate of SMEs performance to the Nigeria economy. Addressing this gap is crucial to enhancing SMEs' ability to manage its financial resources, take informed financial decisions and use financial services in a way that best fits enterprises' needs. The need to bridge this intellectual gap informs this study. The overall objective of this study is to examine the effect of financial capability on financial decisions of SMEs in the study area.

Review of Literature

Conceptual Literature

Small and Medium Enterprises (SMEs)

The definition of SMEs varies from sector to sector and country to country. In Nigeria,

based on nuanced assessment of existing national perspectives, micro, small and medium enterprises are defined based on three classifications such as Micro enterprises with staff employment less than 10 and assets value (excluding land and building) less than N5 million. Small enterprises with staff employment between 10 and 49, while assets value (excluding land and building) ranges between N5 million and N50 million. The third classification is medium enterprises with staff employment ranging between 50 and 199 with assets value (excluding land and building) ranging between N50 and N500 million (SMEDAN, 2015).

Financial Capability

Financial capability refers to the application of financial knowledge underpinned by desirable financial behaviours to attain financial well-being (Potocki and Cierpia-Wolan, 2019; Xiao, Chen and Chen, 2014). Financial Capability goes beyond the knowledge of financial concepts to include a combination of behaviors, skills, and attitudes that enable effective and responsible financial decision making (Holzmann, 2013; World Bank Group, 2018). Financial capability refers to people's ability to manage and take control of their finances (Taylor, 2011). It is firm's ability to manage financial resources and use financial services in a way that is most appropriate to enterprises' needs.

Financial Decisions

Financial decisions involve decision making in a way that indicates the capability and ability of the entrepreneur or manager on elements that influence sound decisions taking on financial matters involving investment decision, financing decisions, and dividend/profit decisions (Hoffman, 1972 quoted by Sandstorm, 1995; Spivey & McMillan, 1999). It is the process by which SMEs evaluate, select and allocate financial resources to meet desired goals. Put differently, financial decision is the thought process of allocating financial resources of a firm in a way that will maximize the objectives of the firm.

Financial Capability Components

Financial capability can be measured by evaluating enterprises' financial behaviours, knowledge, attitudes, and skills. Based on these measurements, meaningful indicators can be developed to effectively inform policy objectives (World Bank, 2013).

Financial Attitude

Attitude expresses implicit beliefs that can affect behavioural intents (Ajzen 1991). Financial attitude can be defined as the application of financial principles to enhance financial decisions (Rajna, Latif, Junid, and Moshiri, 2011). Attitude is about confidence to take suitable financial decisions, and it influences an individual's financial capability (Shim, Xiao, Barber, and Lyons, 2013). Improved attitudes boost financial capability (Batty, Collins, and Odders-White, 2015).

Financial Behaviour

Financial behaviour has to do with how humans actually behave in financial determination (financial setting) to influence financial decisions. It is the capability to

make the right decisions related to the cash flow management, precautions and opportunities for budgeting and planning (Nofsinger, 2005). Financial behaviour is an important factor that shapes financial capability (Potocki and Cierrpial- Wolan, 2019; Xiao, Chen and Chen, 2014). Higher financial capability is associated with favourable and less risky financial behaviours.

Financial Literacy

Financial literacy is the combination of investors understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for assistance, and to take other effective actions to improve their financial well-being (Lusardi, 2008). Financial literacy (learning financial concepts) is associated with improved attitudes and behaviours, and if they persist, it may result in enhanced financial capability (Batty, Collins, and Odders-White, 2015). In other words, increasing financial knowledge is the base for improving financial capability.

Financial Skills

Financial capability has an action component – the skills to put financial knowledge to use (Atkinson, 2007). It is the ability to make simple calculation, demonstrate numerical and literacy skills that are essential to taking financial decisions. Evaluating manager's financial/cognitive skill such as basic numeracy and literacy skills, can also support the measurement of financial capability which sheds light to the proper use of financial products and services (World Bank, 2013). Considering the above, the literature however reveals the association of financial behaviour, financial attitude, financial literacy and skills towards financial capability.

Theoretical Background

The study has its theoretical underpinning supported from three perspectives: Sen's (1993) capability theory, Bandura's (1977) self-efficacy theory, and Ajzen (2001) theory of planned behaviour (TPB). The capability approach according to Sen (1993) contains functioning and capabilities at the individual level. Functioning is about what individuals do (e.g. making prudent financial decisions) and what they are (e.g. are they financially literate?). Individual's financial literacy is grounded in this functioning. The capability is a derivative concept and reflects the various functioning an individual might achieve and it involves the individual's choice. So, capabilities are about the set of choices an individual makes to achieve a set goal to be a financially capable individual (Clark, 2005). The focus of the current study advocates financial capability for SMEs in order to enhance their ability to take informed decisions to protect enterprises from current and future financial dilemma and improve their financial decision making. Bandura's (1997) self-efficacy theory refers to individual's assessment of their capacity to attain the designed financial behaviour and to achieve financial capability through financial knowledge, financial attitude and financial inclusion (Danes and Haberman, 2007). This study will also relate to Ajzen (2001) theory of planned behaviour (TPB). Ajzen is the proponent of the planned behaviour theory. Ajzen (2001) in this theory, proposes that

behavioural intentions are formed by individual's attitude. In other words, financial attitudes play a significant role in shaping a person's financial behaviour. The justification for adopting capability theory, self-efficacy theory and theory of planned behaviour (TPB) is that individuals' financial literacy/knowledge capability has the propensity to shape attitude and consequently behaviour towards financial matters, and ultimately, the entrepreneurs' financial capability- ability to take informed financial decisions which best suits the enterprise goals.

Empirical Studies

Kidwell and Turrisi (2004), in a study found that firms with better financial knowledge keep detailed firm financial records and have a more competitive advantage in assessing external funding than their counterparts who keep not. Shelby (2013) investigated the impact of financial literacy on high school students' financial decisions. The result showed that there was no significant impact. Anne, Alex, and Nyang'aya (2017), examined the effects of financial literacy on personal financial decisions among Egerton University employees, Nakuru County, Kenya. Findings revealed that financial knowledge and financial skills were significant in determining personal financial decisions while financial attitudes did not influence significantly personal financial decisions. Overall, the effect of financial literacy was found to have a positive statistically significant relationship with personal financial decisions.

Similarly, Atkinson, McKay, Collard and Kempson (2007), using the financial capability survey, found that the least financially capable were younger, with children who were struggling on low incomes and were disorganized. Muhammad (2020) examined the relationship between financial literacy, rational financing decision, and financial performance. The results showed that financial literacy significantly affects rational financing decision and financial capital. Rational financing decision significantly affects financial capital. Furthermore, financial literacy and capital significantly affects performance. Tatik, Iramani, and Lindiawati (2017) investigated financial capability of SMEs in Indonesia and the solutions by using financial application. It was found that lack of financial capability made them found it difficult to manage their finances, prepare financial record, loss and profit report, as well as cash and assets reports. Prasand and Nataraj (2017) examined the impact of financial literacy on financial decision making- a study with reference to retail investors. The Pearson's correlation showed that, there was a direct positive relationship between, financial literacy and financial decision making of investors.

Methodology

The study was descriptive in nature, using field survey research design for data collection. The survey instrument employed to collect data from the respondents was a structured questionnaire. The questionnaire was administered directly to respondents and responses were collected immediately, except where the respondents asked for more time. Research assistants were engaged where necessary. The questionnaire was organized in two sections. Section I captures demographic information and educational

background of respondents while section two investigated the relationship between financial capability and financial decisions of SMEs. The questionnaire was in the form of YES/NO. Also, a five-point Likert Scale ranging from Very High (5) to Undecided (1) as well as a five-point Likert Scale ranging from Strongly Agreed (5) to Strongly Disagreed (1) were used to address the objectives of the study. The Cronbach Alpha reliability test yielded 0.725. The study employed both descriptive and inferential statistics to analyse data. The descriptive statistical analysis was conducted using the statistical package for Social Sciences (SPSS) software. Data were analysed using descriptive statistics (frequency distribution, percentages and mean). The inferential analysis employed was regression.

Population, Sample Size and Sampling Technique

The population from which the sample size was drawn consists of 600 registered SMEs in the manufacturing and service sectors in Akure metropolis (Ministry of Commerce and Trade, Akure, Ondo State, 2016). Taro Yamane (1968) formula was used to derive the sample size for a total population of 600 SMEs.

The Yamane formula is of the form:

$$n = \frac{N}{1 + N(e)^2}$$

Where; n = Sample size

e = the significance level

N= total population size

$$n = \frac{600}{1 + 600(0.05)^2}$$

$$n = 240$$

The sample size for the study therefore was 240. Simple random sampling technique was used to distribute the questionnaire among SMEs. Out of 240 sets of questionnaire distributed, 177 were retrieved, representing 74% response rate.

Operationalisation of the Variables

$$Y = f(x)$$

Where:

Y = Financial decisions (FD) = {SMEs Performance}

x= Financial capability (FC)

x= x_1, x_2, x_3, x_4

Where:

x_1 = Financial behaviour (FB)

x_2 = Financial attitude (FA)

x_3 = Financial literacy (FL)

x_4 = Financial skills (FS)

Expressing the above equation in an econometric model gives the following:
 $FD = \alpha_0 + \beta_1 FB + \beta_2 FA + \beta_3 FL + \beta_4 FS + e_i$ (i)

Results and Discussion

Reliability Test

Table 1: Reliability Test

Cronbach's Alpha	N of items
.725	30

Source: Researcher's Field Survey, 2021

Table 1 explains the reliability and excellent correlation in the data used in the study. Cronbach Alpha Coefficient result is greater than the threshold of 0.7. and therefore, the questionnaire was considered reliable

Table 2: Educational Level of Respondents

Educational Level	Freq.	%
Elementary/Secondary	28	16
NCE/OND	32	18
HND/B.Sc./B. A	111	63
MBA/M.Sc./Ph. D	6	3
Total	177	100

Source: Researcher's Field Survey, 2021

Table 2 shows the educational level of respondents. The survey shows that more than 80% of the respondents had access to tertiary education while 16% had completed elementary or higher schools. This is a good one for the study. Ibrahim and Alqaydi (2013) concluded that education can improve personal financial attitude, thereby reducing dependence on credit cards.

Table 3: Likert Scale Distribution of the Effect of Financial Capability on Financial Decisions of SMEs.

Items	SA		A		UN		D		SD		Mean
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%	
Financial capability is needed for record keeping, basic accounting and budgeting skills	85	48	74	41.8	14	7.9	4	2.3	0	0	4.4
Financial capability helps to mitigate cash flow management problems.	116	65.5	54	30.5	5	2.8	2	1.1	0	0	4.6
Financial capability is needed to evaluate financial options.	115	65	56	31.6	4	2.3	2	1.1	0	0	4.6
Financial capability enhances credit worthiness towards external funding.	92	52	71	40.1	14	7.9	0	0	0	0	4.44
Financial capability is needed for profit decisions	70	39.5	82	46.3	23	13	0	0	2	1.1	4.23

Source: Researcher's Field Survey, 2021

Table 3 shows data from respondents on the effect of financial capability on financial decisions of SMEs. Judging by the means score of 4.4, the survey reveals that respondents strongly agree that financial capability is needed for record keeping, basic accounting and budgeting skills. This is supported by Tatik, Iramani, and Lindiawati (2017); Atkinson, (2007) which found that lack of financial capability made SMEs found it difficult to make simple calculation, demonstrate numerical and literacy skills, prepare loss and profit statements and other financial records that are essential to taking financial decisions.

With the mean value of 4.6, respondents also strongly agreed that financial capability helps to mitigate cash flow management problems. The result further reveals that respondents strongly agreed that financial capability is needed to evaluate financial options, judging by the mean score of 4.6. This position was further emphasized by Anne, Alex and Nyang'aya (2017), that with an array of products and services, entrepreneurs are required to be equipped with the financial capability to evaluate options and identify those that best suits their needs and circumstances. Again, with the mean value of 4.6, respondents also strongly agreed that financial capability is needed to evaluate financial options. In addition, with the mean value of 4.44, the survey shows that respondents were strongly of the opinion that financial capability of entrepreneurs will all things being equal enhance credit worthiness and ability to assess external funding. This is corroborated by Sherraden (2010); Watson (2010); and Siaw (2014), which emphasized that one of the factors associated with the inability to manage finances and attract additional finances is the low financial capability. Similarly, with the mean value of 4.23, the result shows that respondents strongly agree that financial capability is needed by SMEs for profit decisions, that is, decision on the percentage of profit that should be shared or retained in the business. The result emphasized the position of Tatik,

Iramani and Lindiawati (2017) that financial capability of SMEs will affect its ability to manage profits or take decisions on allocation of profits. Judging by the average mean score of 4.45, respondents generally agree that financial capability has effect on the financial decisions of SMEs.

Table 4: Regression Analysis Result: Effect of Financial Capability on Financial Decisions of SMEs

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig.
	.451	.378	.318	.35153	.043

Predictors: (constant), financial behaviour, financial attitude, financial literacy, and financial skills

Dependent variable: Financial decisions

The model summary shows the result of regression analysis of the effects of financial capability on financial decisions of SMEs. The regression shows that R² is 37.8% while and when adjusted, gives 32% approximately. This shows that 32% of the variation in the dependent variable (financial decisions of SMEs) is explained by the predictors used in the model. The model is significant with p value 0.043<0.05. The result indicates that financial capability proxy by financial behaviour, financial attitude, financial literacy and financial skills have positive and significant effect on financial decisions of SMEs. Put differently, the result reveals that as SMEs ability to manage financial resources and use financial services in a way that best suits enterprises' needs increases, the chances are that it will enhance their ability to make sound and informed financial decisions capable of enhancing their credit worthiness and performance. This resulted is corroborated by previous by Tatik, Iramani, and Lindiawati (2017), who investigated financial capability of SMEs in Indonesia. It was found that lack of financial capability made them found it difficult to manage their finances, prepare financial record, loss and profit report, as well as cash and assets reports. Similarly, the result is consistent with the empirical work of Prasand and Nataraj (2017), who examined the impact of financial literacy on financial decision making- a study with reference to retail investors. The Pearson's correlation shows that, there is a direct positive relationship between, financial literacy and financial decision making of investors. In addition, the finding emphasizes the work of Anne, Alex, and Nyang'aya (2017) in their study of the effects of financial literacy on personal financial decisions and found that financial literacy has a positive statistically significant relationship with personal financial decisions.

Table 5: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1(Constant)	5.129	.469		10.946	.000
Financial Behaviour	.308	.287	.080	1.076	.283
Financial Attitude	-.985	.411	-.176	-2.395	.018
Financial Literacy	.273	.190	.104	1.435	.153
Financial Skills	.298	.197	-.110	-1.514	.132

Dependent Variable: Financial Decision

Note: $p < 0.05$, indicates the item is significant at 5% significant level

Table 5 reveals that financial behaviour, financial literacy and financial skills are important financial capability variables affecting SMEs' financial decisions. The most influencing financial capability variable is financial behaviour with coefficient/estimator of 0.308. This is followed by financial skills and financial literacy with coefficient of 0.298 and 0.273 respectively. However, judging by their p values, they are insignificant. Regression result also shows that financial behaviour has positive relationship with financial decisions. This shows that financial behaviour increases with the positive effect on financial decision of SMEs. The result equally shows that there is a positive relationship between financial literacy and financial decisions. This means that financial literacy or knowledge increases with the positive effect on financial decision of SMEs. This is consistent with the work of Prasand and Nataraj (2017), who found that there is a direct positive relationship between, financial literacy and financial decision making of investors. Similarly, Muhammad (2020) examined the relationship between financial literacy, rational financing decision, and financial performance. The results showed that financial literacy significantly affects rational financing decision and financial capital. The result from the study further reveals that financial skills have a positive relationship with financial decisions; meaning that financial skills increase with the positive effect on financial decision of SMEs. This finding is consistent with the work of Drexler Fischer and Schoar (2014) which lends credence to the positive relationship between financial skills and financial decisions and financial practices. On the other hand, financial attitude has a significant negative relationship with financial decisions; meaning that financial attitude decreases with negative effect on financial decision of SMEs. Previous studies found that negative attitude will weaken financial-decision making power (Shim, Xiao, Barber & Lyons, 2009; Sohn, Joo, Grable, Lee and Kim, 2012; Anne, Alex, and Nyang'aya, 2017).

Conclusion

This research article examines the effect of financial capability on financial decisions of small and medium enterprises (SMEs) in Akure metropolis, Ondo State, Nigeria. The study examines financial capability in terms of financial attitude, financial behaviour, financial literacy and financial skills and its relationship with financial decisions. The outcome of descriptive finding shows that with the average mean value of 4.45, the result reveals that financial capability has a high effect on financial decisions of SMEs.

On the other hand, empirical validations generally reveal that financial capability has a positive significant effect on the financial decisions of SMEs. Findings further reveal that financial behaviour, financial literacy and financial skills have positive effect on financial decisions whereas, financial attitude were found to negatively influence financial decisions of SMEs. The finding also reveals that the level of financial attitude is high but negative. Meaning that higher level of financial attitude does not translate into appropriate financial decision among SMEs. More so, negative financial attitude has the tendency to weaken financial-decision making ability of enterprises. The findings complement accumulated knowledge in the subject matter and shed further light on the relationship between financial capability components and financial decisions. This study provides useful insights for policymakers by having a clear idea on how they can design policies capable of enhancing the financial capability of SMEs. In this way, the government, educational institutions and industry can align their policies to introduce initiatives where SMEs can learn and develop their understanding of financial capability components that are needed in financial decision making. No doubt, sound financial decision-making ability of SMEs has the propensity to enhance their creditworthiness and access to external funding. The study concludes that financial capability is an important consideration in SMEs' ability to manage its finances effectively and take informed financial decisions.

Recommendations

Based on the findings that financial capability has a positive effect on the financial decisions of SMEs, the study therefore recommends that policymakers should design policies capable of enhancing the financial capability of SMEs. In this way, the government, educational institutions and industry can align their policies to introduce initiatives where SMEs can learn and develop their understanding of financial capability components (financial knowledge, literacy, behaviour and skills) that are needed for sound financial decision making.

1. It is evident from the study findings that financial attitude does not influence the financial decisions of SMEs. This further calls for concerted efforts to ensure entrepreneurs inculcate appropriate attitude capable of translating acquired financial literacy and skills into practice and in a way that will enhance informed financial decisions.
2. The study further recommends financial education, with a plethora of programs, seminar, workshops and similar windows on SMEs' ability to access financial risk, prepare firms' budget, evaluate different financial products available, as well as the skill to put financial knowledge to use.

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