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Financial literacy and Financial Performance of Micro and Small Enterprises (MSEs) in Mbarara city, Uganda

Christone Arinda

Department of Accounting and Finance, School of Management and Entrepreneurship, Kyambogo University

Corresponding author email: arindachris@gmail.com

Abstract

The financial performance of MSEs is a major concern for Uganda with high solvency rate. To address this, Financial literacy has been acknowledged as a key concept required for the survival of these enterprises. However, the extent to which it affects financial performance of MSEs hasn't been fully explained by existing literature thus the need for further investigation. Basing on gist of Resource Based Theory, the study sought to examine how financial literacy affects financial performance drawing an empirical investigation on MSEs in Mbarara city in Uganda. A cross sectional survey design was deployed where 285 registered MSEs were sampled from a population of 1100 registered MSEs. Financial literacy variables considered were book keeping, debt management and Budgeting and financial performance was measured by revenue growth, market growth and profit growth. Data was collected using a questionnaire and some extracted from reports and financial statements from these enterprises. Data corrected was statistically analysed and correlation and multiple regression were run to establish the effect and the relationship between the study variables. With the models developed, the study established that financial literacy significantly affects financial performance of MSEs. The study further concluded that financially literate MSEs perform better than financially illiterate ones and recommended that government and development partners should extend financial literacy training programs through workshops to MSEs aiming at instituting skills and knowledge for improved financial performance.

Keywords: Micro and Small Enterprises (MSEs), Financial Performance, Financial Literacy

Introduction

Background of the study

The evolution of market economies has dramatically broadened the opportunities of consumers, workers, investors, and firms to get engaged in multiple business (ACCA, 2017). Business environment has become increasingly complex generating from one single enterprise to industrial and multinational firms as it is stretched way back from the industrial revolution era. This also led to the emergence of Micro, Small and Medium Sized Enterprises as well as large corporations operating across the borders and overseas (Turyahikayo, 2015) depending on each firm's financial and managerial capabilities. Still most of these enterprise's performance was viewed along the full proportions of financial, strategic and structural development. Development partners and governments have of recent made financial services become free and accessible, however, they must understand their investment choices and decisions and likely repercussions of each alternative choices.

Uganda has been cited among developing countries which are populated with Micro, Small and Medium Enterprises (World Bank Group, 2018). These enterprises contribute 70% of Uganda's private sector and their contribution per sector stands at 49% in service sector, 33% in commerce and trade, 10% in manufacturing and a small portion of these enterprises at 8% in others. These MSEs are a key driver in strengthening and fostering wealth creation, innovation as well as job creation for the increasing young population. Substantial financial support from both government and other development partners for example an African Guarantee fund worth US$ 30 million have been granted to African MSME sector as well as fund support extended by the government through presidential initiatives to support Micro, Small and Medium Enterprises (MoFPED/UNPF, 2019). In addition, there has been also emergency of financial institutions for instance commercial banks and micro finance institutions in almost all parts of Africa in general and Uganda in particular and this has also led to easy accessibility of funds by these enterprises (BOU, 2013). However, PSFU Annual Report (2018) explained that majority of these MSEs fail to perform financially as evidenced by the high solvency rate and most of them fail to celebrate their second birthday due to misappropriation and mismanagement of their financial resources and all this is a true indicator of limited knowledge on how to manage their financial matters.

Financial literacy is one of the key competences entrepreneurs need to make decisions in a competitive environment and sustain growth. And therefore, poor financial performance of these enterprises may be due low levels of financial literacy where majority of these enterprises in Uganda do not understand how to draw up and operate within a given financial budget, the importance of maintaining and keeping proper records, when and from where to borrow responsibly so as to avoid becoming over-indebted, to make informed choices between different financial products and services as well as understanding the importance of investing back part of the profits into their business (BOU Annual Report, 2012).

Al-Tamimi and Kalli (2009) abridged all definitions from many scholars and debated that financial literacy can be defined in a summary as “the ability to make informed judgments and to take effective decisions regarding the use and management of money.” Emergency of globalized economy and global financial markets has influenced financial literacy to attract the interest of many groups including government agencies, bankers, employers, community, financial markets and other organizations.

In the study done by DeThomas and Fredenberger (2005) aimed at establishing the financial information accessibility levels among small enterprises found out that over sixty-one percent of the respondents acknowledged the fact that the financial statements are source of information managers need for effective decision making and planning with 11 percent providing that they had partially based on the information provided to make decisions.

Theoretical underpinnings

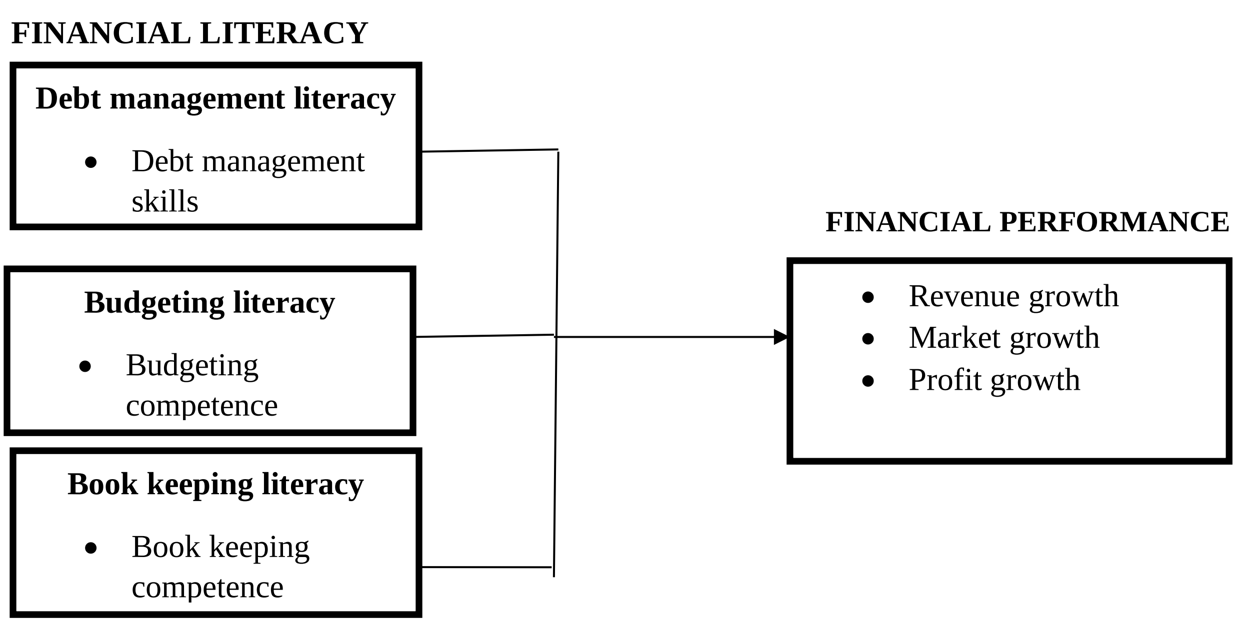
This study was guided by Resource Based Theory (RBT) (Barney, 2001). This theory holds that organizations are a mixture of valuable, rare, inimitable and non-substitutable resources that an enterprise must possess and utilize so as to attain a competitive advantage and growth (Karimi, 2012; Barney, 1991). Within the logic of the theory, financial literacy in form of skills, competence and knowledge is viewed as resource alongside other organizational resources like non-financial and financial assets, organizational processes, and technology among others that create difference between making and breaking enterprises (Adamako & Danso, 2014). In this study therefore, financial literacy is a competence, a unique resource a business owners need to make appropriate financial and business decisions in order to achieve competitive advantage and growth in a competitive business environment (Barney, 1991).

Statement of the problem

The financial performance of Micro and Small sized enterprises continues to be a growing concern for Uganda (PSFU, 2018). Despite the increasing focus on these MSEs by the government of Uganda and other development partners, recent reports continue to show limited progress among these enterprises in terms of increased sales and achieving necessary profitability hence threatening their survival (BOU Report, 2018; PSFU Annual Report, 2018; UIA Report, 2017). For instance, the recent data shows that out of 10 startups in Uganda, only three survive to their second year in operation. Amidst low revenue growth, profit growth as well as market growth challenges among these enterprises, there is limited understanding on how these enterprises can enhance their financial performance especially by building their financial literacy levels and yet from the previous studies (Eniola & Entabang, 2014; Chepkemoi *et al*, 2017; Derbyshire, 2016), this has been considered as an important strategic area enterprises can concentrate on in order to enhance their financial performance. This study therefore sought to examine how financial literacy affects financial performance of Micro and Small Sized Enterprises in Mbarara City in Uganda.

Conceptual framework

Figure 1. 1: Conceptual frame work showing financial literacy and the financial Performance of MSEs



Source: *Adopted from Eniola and Entabang (2014) and Chepkemoi, Patrick, and Njoroge (2017) as modified by the researcher*.

From the model in figure 1.1, Financial literacy is comprehended as a multi-dimension construct that affects firms performance (Eniola & Entabang, 2014). It is conceptualized by three dimensions of debt Management literacy looking at debt management skills, book keeping literacy mainly focusing on record keeping competence and budgeting literacy looking at possession of budgeting skills and knowledge. With explanation from RBT, the researcher intends to extract an explanation on how possession of such skills affect financial performance which was conceptualized into accounting based measures such as profit growth and revenue growth and market based measures such as market growth.

Purpose of the study

The purpose of the study was to examine the effect financial literacy on financial performance of MSEs in Mbarara city in Uganda. Explicitly, the study sought to: 1) analyse the effect of debt management literacy on financial performance of MSEs, 2) examine the effect of book keeping literacy on financial performance of MSEs, and 3) investigate the effect of budgeting literacy on financial performance of MSEs in Mbarara City, Uganda.

Materials and Methods

Research design

A cross sectional survey design was adopted in this study where data on all the variables under the study was to be collected at a point in time. This design has been widely accepted and applied by many scholars (Sugioko, 2010; Onduso, 2013) and found it appropriate as it is effective when collecting data across different enterprises at a given point at a time. Furthermore, the study also deployed quantitative and qualitative methods that were explanatory in nature were used in generating numerical data through descriptive statistics that was later statistically manipulated to explain the effect of financial literacy on financial performance of MSEs.

Study population

The population for this study comprised of Micro and Small sized enterprises which are registered under Mbarara City Council Authority. This area of research was selected because Mbarara district was named among the districts that have struggling enterprises (PSFU Annual Report, 2018). These MSEs are engaging majorly in activities of commerce, manufacturing and services and. Basing on the information provided by URA, Mbarara District, there are 2000 registered Micro and Small sized enterprises that are operating in sectors of service, trade and commerce, retail as well as manufacturing which are widely spread and operate within the district. However, most of these enterprises are sparsely located and therefore the researcher considered Mbarara City as the area target area under the study. And therefore, the target population constituted 1100 enterprises which operate from the city and these included 316 MSEs engaged in service-based business, 260 enterprises engaged in trade and commerce, 427 MSEs in retail business and 97 enterprises engaged in manufacturing. The units of inquiry were composed of employees, managers and owners of MSEs whereas unit of analysis were MSEs in the City.

Sampling design and sample size

A stratified random sampling technique was adopted where stratum with similar characteristics and business line in which an enterprise is engaged in, were formed. Therefore, all MSEs in trade and commerce were put in the same strata, as well as those in service and manufacturing respectively. After, enterprises in a given strata were selected using simple random sampling to constitute sample respondent enterprises to participate in the study. Basing on Krejcie and Morgan (1970) sample size determination model. A sample size of 285 respondents was selected from a population of 1100 registered MSEs in Mbarara city basing on the statistics from the City Authority.

Data sources and methods of data collection

In the study, both primary data and secondary data were collected from relevant sources where primary data was mainly obtained from interviews conducted and secondary data mainly obtained from financial statements and reports. Survey data collection method was used in the study to collect quantitative data. Specifically, a structured self-administered questionnaire method was deployed in carrying out a survey as it was used as an instrument. Many researchers (Pimpong & Laryea, 2016) deployed this particular method in related studies. The questions which were scaled on a 5 point Likert with answers varying between one to five: strongly disagree (1); disagree (2); normal (3); agree (4) and strongly agree (5) where the lowest scale represent strongly disagree and the highest scale represent strongly agree were mainly close ended as an intention to reduce and limit irrelevant and unnecessary responses from the respondents.

Data Analysis

In this study, descriptive and inferential statistical analysis were employed. Descriptive analysis involved use of means and standard deviations, while inferential analysis involved use of correlation and multiple linear regression analysis. Correlation analysis enabled the researcher to establish the relationship between the study variables while regression analysis enabled the researcher to establish the relationship between dependent variable and one or more independent variables under the study.

Results and Discussions

Tests of Normality

Shapiro-Wilk test

For a researcher to determine the appropriate statistical test, a test of normality of the data was conducted. A Shapiro- Wilk test was used to test normality of data. The null hypothesis stated for this test is that the distribution of the residual is not normal if p-value established is less than 0.05.

Table 1. Shapiro-Wilk W test for normal data

Variable	**Obs**	**W**	**V**	**Z**	**Prob > z**
Residual	215	0.84311	1.429	1.167	0.11904

Source: *Primary data, 2020*

From the table 1 above, the p- value for the model established is greater than 0.05. So, null hypothesis is rejected in favor of an alternative hypothesis and therefore the residual has normal distribution pattern.

Multi Collinearity Test

Multi collinearity refers to a circumstance in which more than one explanatory variable in a multiple regression model are highly linearly related. If the variance inflation factor appears to be less than 10, then multi collinearity be would presumed not be a problem.

Table 2. Degree of Multi collinearity for variables

Variable	**VIF**	**1/VIF**
BKL	1.63	**0.6135**
DML	1.91	**0.5236**
BL	1.02	**0.9804**
FP	1.48	**0.6757**
Mean	**1.51**	

Source: *Primary data, 2020*

From the table 2 above, all variables extracted a variance inflation factor (VIF) which is significantly less than 10 and therefore multi collinearity may not be a problem to data analysis using this model

Correlation Coefficients

This analysis explains the direction and the strength of relationship that exists between the study variables. The correlation coefficient ranges from -1 to +1.0 and the closer it is to 1, the stronger the relationship and closer it is to -1, the weaker the relationship between the variables (Kubiszy & Borich, 2013). For the researcher to establish the strength and direction of relationship between the variables, Karl Pearson's coefficient of correlation was run to establish the degree of association between the study variables.

Table 3: Correlation between the study variables

	1	2	3	4
Book keeping literacy (1)	1			
Budgeting Literacy (2)	0.325**	1		
Debt Management (3)	0.140	0.225**	1	
Financial Performance (4)	0.416*	0.138	0.138**	1

N=285, **P<0.01, *P<0.05

Source: *Primary data, 2020.*

From the table 3 above, it is evident that there is a positive and significant relationship between book keeping literacy and financial performance ($r = .416$ $p<0.05$). Furthermore, budgeting literacy is positively related to financial performance (0.138) although their relationship is insignificant with P-value > 0.05. It is also noted that a significant relationship exists between debt management literacy and financial performance indicated by a Pearson's correlation coefficient of 0.138 significant at $p<0.01$. Basing on the above findings, the independent variables relate with the dependent variable and therefore further regression analysis can be done to examine the effect of financial literacy on financial performance.

Regression analysis results

To address the purpose of the study aiming at examining the effect of financial literacy on financial performance of Micro and small sized enterprises in Mbarara city, a multiple regression analysis between three dimensions of an independent variable that included Debt management literacy, Book keeping literacy and Budgeting literacy and financial performance as a dependent variable was conducted and the results from analysis are presented in the table below.

Table 4: Multiple regression results for the research model

Model		Unstandardized Coefficients		Standardized Coefficients	Sig.
		B	Std. Error	Beta	
1	(Constant)	3.011	.470		.000
	Budgeting Literacy	.229	.105	.036	.001
	Book Keeping Literacy	.205	.096	.305	.022
	Debt Management Literacy	.172	.096	.095	.016

R-Square = 0.285, Adjusted R-Squared= 0.241, P-value = 0.025< 0.05 significance level.

Source: primary data, 2020

The study was guided the following the multiple regression model: FP=$\beta 0+ \beta_1$BL+ β_2BKL+ β_3BML+ε where FP is financial performance, BKL is book keeping literacy, DML is debt management literacy, BL is budgeting literacy, β_0 is Co-efficient of the model and ε is an error term. Therefore, from the findings presented on the table 3, the predictive model developed by the study is FP=3.011+0.229BL+0.205BKL+0.172BML.

From the tables 3 showing the model summary statistics above, a p-value = 0.025 that is less 5% level of significance indicates that budgeting literacy, book keeping literacy and debt management literacy among MSEs positively predict and affect their financial performance and their effect is significant at p-value < 0.05 level of significance. An adjusted R^2 of 0.241 from the findings implies that an extra effort in strengthening financial literacy in terms of possessing book keeping knowledge, budgeting competences as well as debt management knowledge and strategies among these MSEs explains 24.1% variations in their financial performance. Basing on such findings, the researcher therefore concluded that financial literacy significantly affects MSEs financial performance.

Discussion

In previous sections, the evidence regarding the effect of book keeping literacy, budgeting literacy and debt management literacy levels as well as financial performance levels was reported. Therefore, in this chapter, the discussion of these findings is given.

From the study findings, a low level of debt management was revealed to be exiting among these MSEs with a lower mean score of 2.52. This implied that most these enterprises in Mbarara City don't have required knowledge, skills and competence in managing debts and the extent at which debt management is emphasized in many of these enterprises is moderately low irrespective of its significant effect on financial performance. This is in line with Addaney *et al.,* (2016) who explains that improper debt management has the capacity to cause poor performance of small scale enterprises. Individuals who are financially illiterate tend to borrow unknowledgeable end up opting to more expensive sources leading to increase cost of dent and this hinders performance in the loan run. However, OECD (2016) urged that sometimes MSEs with less debt management skills, knowledge and competence tend to avoid debts and borrow less and this limits their capital structure expansion causing a negative effect on their financial performance. Debt management is a necessary competency that each enterprise requires to ensure its survival not to become over indebted. It is true that most of them operate on borrowed funds and therefore require knowledge on how to manage external and internal debts and avoid struggling during debt payment paybacks.

A moderate high level of budgeting literacy among the MSEs with a mean score of 3.55 established implies that these enterprises in Mbarara city tend to give attention to how budgeting should be done especially when purchasing what's is budgeted for, preparing budgets for activities to be engaged in. However, with low scores by the respondents, most of their budgets don't run for a complete year and they don't normally budget for all their sales to be made in a period and they rarely budget for what they spend on every day. Therefore, their low performance is attributed to the poor budgeting process and budgetary controls as evidenced from the findings. Effective budgeting, budgetary process and controls enhance performance inform of reduced unnecessary expenditures and this streamlines revenue and expenditure lines. This in return helps an enterprise in production cost reduction and increased surplus revenues or net profits made. Presence of such controls enhances more formal budget planning which in turn escalates higher growth in sales and profit. This is in agreement with Sugioko (2010) who explained that budgeting in any business affects positively its performance especially sales in that effective budgeting process results into increased sales revenues as well as budgetary performance.

A study further revealed a moderate level of book keeping literacy with a mean score of 3.56 established implying that most of these enterprises have skills, knowledge and competence in maintaining proper book keeping as evidenced in ensuring proper recording of assets. However, some of MSEs proved to be lacking such skills as they don't separate petty cash book from the main cashbook, don't do even collect bank statements for bank reconciliation purposes to establish the cause for the disagreements between the two separate accounts and some enterprises don't even record essential transactions leading to low accountably of what they spend on and this results not low sales made and low profits at the end of the period hence threatening their survival. The study findings are in line with Chepkemoi, Patrick, and Njoroge (2017) in that Small and medium Enterprise that ensure prosper record keeping are in position to determine their performance accurately in terms of profit growth as well as sales growth . conclusively, MSEs what fail to keep proper records of their transactions, fail to plan and budget effectively and this hinders effectively decision making due to lack of proper records as a basis for making decisions as Fatoki (2014) explains that such conditions limits their financial performance hence stunted growth and expansion.

Book keeping simplifies business processes such as filing of tax returns, bench marking its performance with other similar or related enterprises and provide a basis for instituting relevant financial controls to prevent early business failures, most enterprises have failed to keep properly their records due to lack accounting knowledge and this has caused their performance to remain low and their growth to be stunted.

Conclusion

Basing on the findings, the study concludes that financial literacy significantly and positively affect financial performance of MSEs. Financial literacy is a key to enhancement of financial performance. It provides knowledge and understanding of how business operations can be made and streamlined, what alternatives to be considered for investment decisions and ensuing effective accountability. Therefore, Possession of financial management skills, knowledge and competence as a resource puts an enterprise at a competitive advantage over other enterprises. Drawing from the study variables, Enterprise' literacy in book keeping significantly affects its financial performance. Any business success in making proper and well informed financial and managerial decisions depends on how well and proper they maintain their books or records. This helps in tracking the past performance so as to provide and the plan for an improved future performance. Debt management literacy significantly and positively predicts financial performance and therefore concludes that possession of such skill, knowledge and competence streamline proper debt assessment and evaluation leading to increased financial performance of MSEs in Mbarara city. Furthermore, budgeting literacy has a positive and significant influence on enterprise' financial performance and therefore any enterprise must invest in equipping its workforce with skills and knowledge or employing people with competence in budgeting. This streamlines an enterprise' operations like how much to spend on what items and how much income is expected and this in return improves performance of these enterprises.

Recommendations

This study is a justification that MSE owners and managers with enough financial literacy knowledge skills and competence to carry out businesses will enjoy more financial returns than those with less skill and knowledge. Therefore development agencies and government bodies need to sensitize these MSEs about how, where and when to borrow money for their investments. Most of these enterprises are indented with their debt to equity ratio being high. Therefore, they need to understand the disadvantage of using borrowed capital for status especially after looking at prevailing economic conditions. In spite of the increasing focus on distributing money for startup business by the government, Government of Uganda should invest in instilling financial literacy knowledge to MSE owners across the country. This can be done through holding workshops and programs like skilling Uganda at district levels, sub county levels as well as municipality levels and educating mangers, business owners on matters of financial management especially money management matters and proper book and record keeping so to trace their actual operations and as a result increase their financial returns as well as boost their growth.

In Most of these small sized enterprises, there is need to follow separate business concept of accounting. This concept explains that business and owners are two separate entities and therefore business activities should be separated from individual or owner's activities. This has killed most of these MSEs and majority of them are remaining small because they are being run on family and owner basis. Resources are withdrawn from the business now and then. Therefore, owners should separate themselves from the business and employ people with skills, knowledge and competences to run these enterprises if they are to increase their financial performance. It is evident from interviews that most of these enterprises get knowledge and skills from their fellow family friends and less in schools and books when most of the owners, employees and managers have attained formal education. Therefore, Government agencies financial literacy trainings should be introduced in formal schools so that most people can get a chance of studying different financial management disciplines. It is indeed true that everyone needs to be financially discipline to go through daily challenges.

Therefore, MSEs should put much emphasis on acquiring and maintaining skills, knowledge and competences in ensuring that there is effective record keeping, budgeting for operational activities is done promptly as well as ensuring proper management of external and internal debts so as to enhance their performance and win a competitive edge over other competing entities in an industry.

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