RELATIONSHIP BETWEEN FINANCIAL LITERACY AND ENTREPRENEURIAL SUCCESS IN NAIROBI COUNTY KENYA

BY

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DECLARATION

I declare that this research paper is my original work and has not been exhibited or published in any way and has never been presented for any awards in any institution. Where other sources of information have been used they have been acknowledged.

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DEDICATION

I dedicate this paper to my wife Mary Mutegi and our son Henry R. Muhia Jr. To, my wife for unwavering support in every step of the way and to my son for inspiring me.

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LIST OF ABBREVIATIONS

CBD	:	Central Business District
EGF	:	Equity Group Foundation
ERS	:	Economic Recovery Strategy
GDP	:	Gross Domestic Product
GOK	:	Government of Kenya
K REP	:	Kenya Rural Enterprises Programme
KCB	:	Kenya Commercial Bank
MBA	:	Master of Business Administration
MFI	:	Micro Finance Institutions
PACFL	:	Presidents Advisory Council on Financial Literacy
R&D	:	Research and Development
SACCO	:	Saving and Credit Co-operative
SMEs	:	Small Medium Enterprises
SPSS	:	Statistical Program Social Sciences
SSE	:	Small Scale Enterprises
UN	:	United Nations

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ABSTRACT

Kenya is an entrepreneurial country and the SME sector is one of the key drivers of Kenyan economy. Majority of Kenyans whether educated or not want to be entrepreneurs by engaging in various business activities ranging from farming to offering professional services such as lawyers and doctors. However, not all entrepreneurs succeed in growing their small enterprises to successful business. In fact most of new businesses end up as a failure within the first five years after the commencement.

The objective of this paper is to find out whether there is a relationship between entrepreneurial success and SMEs success by interviewing a sample of seventy nine entrepreneurs who are registered and operates in Nairobi County. The samples were randomly picked from a population of 27,485 SMEs where questions in both financial literacy and SMEs success are asked.

The data collected was then analyzed to establish relationship between financial literacy and SMEs success. From the research findings, all the SMEs interviewed were found to have some level of financial literacy and on average most entrepreneurs scored well above average in financial literacy. Highly successful entrepreneurs scored highly in financial literacy and demonstrated high understanding of finance. In contrast, less successful entrepreneurs exhibited stagnant growth, and low level of financial literacy majority of whom were found to be in informal sector.

This study concludes that there is a positive relationship between financial literacy and entrepreneurial success in Nairobi County. It further suggests that financial literacy plays a key role in SMEs success both in formal and informal sectors.

CHAPTER ONE

INTRODUCTION

1.1Background of the Study

Kenya is an entrepreneur country and the small enterprises that are usually run by individuals are one of the key drivers of the Kenyan economy. The Micro and Small Enterprises are businesses in both formal and informal sectors, classified into farm and non-farm categories employing 1-50 workers (GoK, 2005). The Small Scale Enterprises are acknowledged in Kenya as significant contributors to the economic growth and are estimated to contribute 20% and 72% to the GDP and employment respectively (The 2003–2007 Economic Recovery Strategy (ERS). They also provide fertile ground for grooming medium sized and large enterprises that are vital for economic development.

Like the rest of the world Kenyan entrepreneurs are faced with numerous challenges in running their small businesses. It is estimated that majority of SMES do not survive the first five years since establishment and three out of five new businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007).Lack of planning, improper financing and poor management have been posited as the main causes of failure of small enterprises (Longenecker, *et al.*, 2006). Lack of credit has also been identified as one of the most serious constraints facing SMEs and hindering their development (Oketch, 2000; Tomecko & Dondo, 1992; Kiiru, 1991).The modern business environment have not given SMEs a chance. Efficient management has been lacking due to external factors that are beyond the owner-manager’s control (Oketch, 2000). There is increase in competitiveness and the market has become quite dynamic due to advancement in technology and globalization. Consumers are more aware than ever before, only enterprises with high competitive edge can survive.

Despite high rate of failure, a good number of entrepreneurs have succeeded to grow their business from small enterprises to strong medium sized and large companies. Perhaps this being motivation, many Kenyans in formal and informal sectors are in one way or the other engaged in entrepreneurship.

1.1.1 Financial Literacy

Financial literacy is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being (PACFL, 2008). It entails the knowledge of properly making decisions pertaining to certain personal finance areas like real estate, insurance, investing saving tax planning and retirement .It also involves intimate knowledge of concepts like interest rates financial planning, time value for money, borrowings and savings profit and loss assets and liabilities etc. In the world all over, financial literacy has been given a lot of attention and is believed to be a key ingredient to personal finance success and entrepreneurship; it's relevant to anyone who makes decision about money. Several countries in the world are promoting financial education as a tool of fighting poverty (UN 2003), some of the countries involved are Egypt, Uganda, Ghana, South Africa, Tanzania, Kenya (African Development Bank, 2007).

In Kenya, key efforts have been made by the government through Financial Sector Deepening (FSD), which educates people to enhance financial freedom. Financial literacy enables one to make informed decisions as far as money matters are concerned thus one can borrow, save and invest wisely. The central bank has direct interest in financial education and ensures that commercial banks show the public their charges so as to enable persons to compare and make decisions. Commercial banks involvement has been mainly relying on their marketing activities e.g. market activations. Further financial institutions like Equity Bank and KCB has made deliberate effort to educate Kenyans on finance. Equity Group Foundation (EGF) in has partnered with The Master Card Foundation while KCB has partnered with Visa International to provide finance literacy programs that are aimed to giving Kenyans opportunity to learn how to effectively manage their finances.

A past study by Consumer Insight showed that young people in Kenya spend more than nine billion shillings a year, which is mostly spent on snacks, beverages, educational materials and mobile phone airtime. In America, according to an American Consumers for Education and Competition report, nearly 90 percent of high school students graduate without knowledge of basic financial literacy.

1.1.2 Entrepreneurial Success

Firm performance refers to the firm’s success in the market, which may have different outcomes. Firm performance is a focal phenomenon in business studies. However, it is also a complex and multidimensional phenomenon. Performance can be characterized as the firm’s ability to create acceptable outcomes and actions. Success, in general, relates to the achievement of goals and objectives in whatever sector of human life. In business life, success is a key term in the field of management, although it is not always explicitly stated. Success and failure can be interpreted as measures of good or indifferent management. In business studies, the concept of success is often used to refer to a firm’s financial performance. However, there is no universally accepted definition of success, and business success has been interpreted in many ways (Foley & Green 1989). There are at least two important dimensions of success: 1) financial vs. other success; and 2) short- vs. long-term success. Hence, success can have different forms, e.g. survival, profit; return on investment, sales growth, number of employed, happiness, reputation, and so on. In other words, success can be seen to have different meanings by different people. In spite of these differences, people generally seem to have a similar idea of the phenomenon, i.e. of what kind of business is successful.

1.1.3 Effects of Financial Literacy on Entrepreneurial Success

Financial literacy has attracted increasing attention in both the developed and developing world due to its role in financial decision. For example, in January 2008, the United States government set up a President’s Advisory Council on Financial Literacy tasked to improve financial education at all levels of the economy. Developing world have also not been left behind, countries like Indonesia and Ghana have set up programs that are aimed at increasing financial literacy. The critical question that needs to be answered is what is the effect of financial literacy on entrepreneurs’ success?

A compelling body of evidence demonstrates a strong association between financial literacy and entrepreneurs’ success. Survey after survey shows SMEs that are run by financial literate entrepreneurs have a higher chance of being more successful than their illiterate counterparts. Financial literacy encompasses the knowledge and skill required by individual to function effectively in the money economy and make informed judgments in respect to their own and their family circumstances. There is evidence of a correlation between financial literacy and positive financial behavior although the direction of causality is unclear (Hilgert,Hogarth and Beverly 2003).Financial illiteracy can lead to self-exclusion from the formal financial system. Those who are financially literate are not likely to be intimidated by the complexity of the financial system and therefore can result in people making inappropriate decisions

Hartog et al. (2010) used the U.S. National Longitudinal Study of Youth to examine the effects of various personal characteristics among entrepreneurs and employees. They found that verbal abilities appear to be more important for employees, while mathematical, technical and social abilities are more important for entrepreneurs. They also argued that general ability and balance across the various kinds of ability generate higher incomes for entrepreneurs. Caliendo et al. (2010) found that entrepreneurs with intermediate levels of risk tolerance survive longer than entrepreneurs with very high or very low levels of tolerance for risk. Fairlie and Holleran (2011) found that more risk tolerant individuals and those with a preference for autonomy benefit more from business training.

Nunoo et al (2012) in a study to examine how financial literacy influences SMEs in Ghana found that financial literacy is crucial in stimulating the SME sectors. Financial literate SMEs may save more, and better manage risk, by purchasing insurance contracts. The results of the study proved that financial literacy has a positive effect on SMEs performance. Basic education enhances the overall quality of the entrepreneur by providing the basic numeric and financial literacy skills, that increases the chance of survival Carter and Jones-Evans, 2000.Some studies state that the fact that a manager has a higher education degree or even a postgraduate degree seems to stimulate the growth of the firm, thus having an impact on both survival and growth (Hall, 2000; Barkham et al., 1996).

Majority of studies have proved that financial literacy has a positive effect on entrepreneurship success. However, there are also cases of illiterate persons running successful enterprises. In Kenya where vast majority of SMEs are in informal sector, many Jua Kali and farming entrepreneurs are financially illiterate and yet they run very successful SMEs. More research is needed to find out whether the financial illiterate entrepreneurs would be better if they had financial literacy.

1.1.4 Entrepreneurialism in Kenya

Common entrepreneurships include farming, hawking, public transport service, professional services such as lawyers and doctor, hospitality etc. Most SMEs operates in urban areas but majority of farming takes place in rural areas. Entrepreneurship cuts across all the demographics in Kenya. Men and women, young and old, educated and uneducated are all involved in entrepreneurship. Most small enterprises are family owned and are run by two or more employees who are mostly immediate family members. SMEs starting capital is usually small and is mainly raised from personal savings, inheritance, and borrowings. The main lenders to small enterprises are microfinance lending institutions, commercial banks, SACCOs and government sponsored funds such as Youth Funds and Women Fund. Contribution by members of investment groups popularly known as "chamas" is another common means of raising capital.

The government of Kenya has recognized the importance of SMEs in creating employment and eradicating poverty in the country. It has provided initiatives that are aimed to spur growth in the sector. The youth fund and women fund are just examples of government efforts in supporting small enterprises. Policy recommendations of the government of Kenya as contained in its 7th National Development Plan on Divestiture and subsequently in Sessional paper No. 2 of 2005, advocates for the government to take leading role by providing an enabling environment for SME's market operations. This will require the establishment of infrastructure for access to markets, provision of work site structures, dissemination of market information through networks and innovation amongst other well-known strategies. The 2003–2007 Economic Recovery Strategy (ERS) for Wealth and Employment Creation provides the road map for economic recovery. The paper estimated that SSEs contribute 20 and 72% to the GDP and employment respectively. Hence, when the ERS anticipated creating 500,000 jobs annually, 88% of the targeted jobs were to be created in SSEs with the aim of reducing poverty rates from 56.7 to 51.8% (Ministry of Planning and National Development, 2003).

In 2013-14 budgets the government continues to provide an enabling environment for SMEs growth. Some of the key strategic interventions are to amend procurement law to reduce the turnaround time to complete a public procurement tender process within 30 days. Special provision was increased from 10% to 30 days for youth, persons with disabilities and exclusive preference for local suppliers in priority area e.g. construction materials, furniture, motor vehicles food stuff. In expanding economic participation and opportunities for the youth woman and persons with disability the government proposes to reform business regulatory framework to make it easy and faster to register business. In Vision 2030 the government recognizes the role of SMEs in manufacturing and the regional market and in its flagship projects in manufacturing plans to develop and create at least five SMEs industrial parks (Vision 2030)

1.2 Research Problem

The relevance of financial skills to successful entrepreneurship remains subject for discussion. In a dynamic and uncertain business environment entrepreneurs are faced with many challenges that can be overcome by acquiring financial knowledge. As the adage goes "knowledge is power "and so financial literacy is power. Ideally business education would give an entrepreneur an upper hand in making financial or investment decisions when compared to a counterpart with no basic financial education.

In Kenya, entrepreneurs are drawn from all walks of life and from both extremes that is those who are financially educated and on the other hand, those with no financial knowledge. In fact majority of SMEs in informal sector are financially illiterate and with little or no basic education. Many entrepreneur keeps no books of accounts or any record at all and do not know the difference between income and profit. There are many stories of very successful entrepreneurs who did not have basic financial knowledge and ended up running an empire business. In his book Beyond Expectations, the late Ngenga Karume talks about his entrepreneurship success without any form of education. There are successful entrepreneurs with no basic financial education and there are unsuccessful entrepreneurs with MBA in finance. It is therefore interesting to find out whether financial literacy as we know it has impact on SMEs success.

Many studies have mainly dwelt on importance of financial literacy and its effects on household or personal financial behavior with little or no theoretical and empirical study on financial literacy and entrepreneurial success. In Kenya, Nyabwanga (2011) studied the effects of working capital management practices on financial performance of small scale enterprises in Kisii South district. In his study, he established that majority of business operators did not have business management knowledge and further suggested a study to unravel the impact of training on performance of business. Simeyo et al (2011) and Osinde et al (2013) in their study on effects of working capital management and business development services on SMESs established a positive relationship between business training and performance. Entrepreneurs with training on business skills were found to perform better than their counterparts with no business management knowledge. In this paper we deep further in an attempt to establish whether financial literacy has a positive effect on entrepreneurship success. Does it matter whether one has basic business education or not? Does a MBA in finance graduate stand a better chance in entrepreneurship than an illiterate person? What makes illiterate people succeed even when they don't understand simple math?

1.3 Objective of the Study

To establish relationship between financial literacy and entrepreneurial success in Nairobi County, Kenya.

1.4 Value of the Study

Considering that the vast majority of SMEs are in the informal sectors where entrepreneurs has no or only basic education, the government policy makers will find out whether the basic financial education taught in school has any bearing to SMEs success. The study will further establish whether there is need for financial literacy programs amongst SMEs in a bid to stimulate growth in the sector.

The study will help training institutions in understanding the significance of business education to success in business. It will also help academicians in establishing the relevance of curriculum taught in business schools to the actual business world.

Financial institutions such as commercial banks will understand risk profile of financially literate entrepreneurs as compared to their illiterate counterparts. Micro finance institutions and NGOs will establish whether there is need to build financial literacy capacity in an effort to reduce poverty through entrepreneurship.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents studies conducted in an attempt to understand the relationship between financial literacy and entrepreneurship success. We also dig deeper in understanding the concept of entrepreneurship and what it entails.

2.2 Theoretical Review

Entrepreneurship has long been perceived little more than an applied trade as opposed to an academic area of study. For a long time there was no research to be accomplished because it was thought that those who could not attend college would simply practice the concept of new business start-up (Kuratko 2009). Due to SMEs critical role in economic growth, many research studies have now been carried out to deepen understanding of entrepreneurship. In this study we review some of the concepts that are relevant to our proposal.

2.2.1 The Knowledge Spillover Theory

In this theory the creation of new knowledge expands the set of technological opportunity. Entrepreneurial activity does not involve simply the arbitrage of opportunities, but also the exploitation of intra-temporal knowledge spillovers not appropriated by incumbent firms. The theory focuses on individual agents with endowments of new economic knowledge as the unit of analysis in a model of economic growth, rather than exogenously assumed firms. Agents with new knowledge endogenously pursue the exploitation of knowledge. This suggests that knowledge spillovers come from the stock of knowledge, and there is a strong relationship between such spillovers and entrepreneurial activity. If incumbent firms appropriated all the rents of R&D, there would be no intra-temporal knowledge spillovers (Zoltan et al 2008).This theory will help in determining whether the knowledge spillover affects entrepreneurs' success in Kenya. It will also help us understand the distinction between financial literacy and economic knowledge.

2.2.2 Theory of Behavior and Personal Finance Education

Braunstein and Welch (2002) pointed out nearly a decade ago that while acquiring additional information can lead to improved financial behavior, it cannot be counted on to do so automatically. Research has shown that individuals and households do not always act in ways consistent with their best financial interests even when they have accurate financial information. Although there are a few notable examples of programs with a behavioral component (e.g.,Lusardi et al. 2009; Sherraden et al. 2009), financial education has most frequently been focused on enhancing knowledge (or knowledge, attitudes, and skills) related to specific personal finance topic areas, such as money management, banking, credit, saving, investment, insurance, and taxes rather than behavior per se (Coussens 2006; McCormick 2009; Vitt et al. 2005).When the importance of behavior is acknowledged, financial behavior is often presumed to follow from improved understanding of financial concepts. Definitions for the field reflect the importance of action, but also commonly reflect an implied link between knowledge and action. This theory will help in understanding the effect of financial literacy on entrepreneur's behavior and its implication to their business performance.

2.2.3 Financial Literacy and Behavior

Several studies showed that financial literacy is positively related to self-beneficial financial behavior. Hilgert,Hogarth, and Beverly (2003) added financial behavior and financial literacy questions to the nationwide Survey of Consumer Finances. They formed a Financial Practices Index based upon behavior in four variables: cash-flow management, credit management, savings, and investment practices. Comparing the results of this index with scores on the financial literacy quiz, they found that those who were more financially literate had higher Financial Practices Index scores, indicating that financial knowledge is related to financial behavior. In a study of Dutch adults, Van Rooij, Lusardi, and Alessie (2007) found that those with low financial literacy are more likely than others to base their behavior on financial advice from friends and are less likely to invest in stocks. Mandell (2006) found that high school seniors with higher financial literacy scores were less likely than others to bounce a check and more likely to balance their checkbooks.

2.3 Motivation of Entrepreneurship

Entrepreneurs are motivated by different things depending on the type of entrepreneurship involved. An artist can be motivated by need to express talent while a farmer may be motivated by desire to generate income. Entrepreneurship basic motivation is desire and willingness to become entrepreneur. Individual personality also acts as motivation to business, and those people who are willing to proceed despite odds might be more optimistic or higher in self-efficacy than people deterred by these odds.

2.3.1 Need for Achievement

Within the research domain of personality traits and entrepreneurship, the concept of need for achievement (nAch) has received much attention. McClelland (1961) argued that individuals who are high in nAch are more likely than those who are low in nAch to engage in activities or tasks that have a high degree of individual responsibility for outcomes, require individual skill and effort, have a moderate degree of risk, and include clear feedback on performance. Further, McClelland argued that entrepreneurial roles are characterized as having a greater degree of this task attributes than other careers; thus, it is likely that people high in nAch will be more likely to pursue entrepreneurial jobs than other types of roles.

2.3.2 Risk Taking

Risk-taking propensity is another motivation of interest, which emerged from McClelland’s (1961) original research on entrepreneurs. McClelland claimed that individuals with high achievement needs would have moderate propensities to take risk. This claim by McClelland is especially interesting for entrepreneurship research because the entrepreneurial process involves acting in the face of uncertainty. Liles (1974) argued that entrepreneurs often must accept uncertainty with respect to financial well-being, psychic well-being, career security, and family relations. Moreover, several theories of entrepreneurship view the entrepreneur as bearing residual uncertainty (Venkataraman, 1997).

2.3.3 Tolerance for Ambiguity

Schere (1982) argued that tolerance for ambiguity is an important trait for entrepreneurs because the challenges and potential for success associated with business start-ups are by nature unpredictable. Budner (1982) defined tolerance for ambiguity as the propensity to view situations without clear outcomes as attractive rather than threatening. Because entrepreneurs continually face more uncertainty in their everyday environment than do managers of established organizations, entrepreneurs who remain in their jobs are likely to score high on tests for this trait than would managers.

2.3.4 Locus of Control

Another motivational trait that has received attention is locus of control—the belief in the extent to which individuals believe that their actions or personal characteristics affect outcomes. Individuals who have an external locus of control believe that the outcome of an extent is out of their control, whereas individuals with an internal locus of control believe that their personal actions directly affect the outcome of an event (Rotter, 1966). As McClelland (1961) discussed earlier, individuals who are high in nAch prefer situations in which they feel that they have direct control over outcomes or in which they feel that they can directly see how their effort affects outcomes of a given event. This point was extended by Rotter (1966) who argued that individuals with an internal locus of control would be likely to seek entrepreneurial roles because they desire positions in which their actions have a direct impact on results.

2.3.5 Self-Efficacy

Self-efficacy is the belief in one's ability to muster and implement the necessary personal resources, skills, and competencies to attain a certain level of achievement on a given task (Bandura, 1997). In other words, self-efficacy can be seen as task-specific self-confidence. Self-efficacy for a specific task has been shown to be a robust predictor of an individual's Performance in that task and helps to explain why people of equal ability can perform differently. An individual with high self-efficacy for a given task will exert more effort for a greater length of time, persist through setbacks, set and accept higher goals, and develop better plans and strategies for the task.

A person with high self-efficacy will also take negative feedback in a more positive manner and use that feedback to improve their performance. These attributes of self-efficacy may be important to the entrepreneurial process because these situations are often ambiguous ones in which effort, persistence, and planning is important.

2.3.6 Goal Setting

Tracy, Locke, and Renard (1998) conducted a study of the owners of small printing firms. Both concurrent and longitudinal measures of four aspects of performance were obtained: financial performance, growth, and innovation. The quantitative goals the entrepreneurs had for each outcome were significantly related to their corresponding outcomes, both concurrently and longitudinally (nAch in this study was unrelated to performance). Baum, Locke,and Smith (2001) also found that growth goals were significantly related to the subsequent growth of architectural woodworking firms. Although there have been other studies of entrepreneurial goals, to our knowledge, only these two have related quantitative measures of goal difficulty to performance.

Entrepreneurialism is a very important component in economic growth as it's one of the main factors of production besides land, capital and labour. It involves identification of four striking functions namely coordination, arbitrage, innovation and risk management. Factors that affect entrepreneurs are need for achievement, risk taking ability, tolerance for ambiguity, locus of control, goal setting etc. There is a correlation between financial literacy and entrepreneurs' behavior. Entrepreneurs with financial education are better placed to make better financial decisions in investment, risk management.

2.4 Aspects of Entrepreneurship

There are different aspects to entrepreneurship that includes, entrepreneurship as a process, as a behavior, as and as outcomes.

2.4.1 Entrepreneurship as a Process

Entrepreneurship is a process of creating something new of values by devoting the necessary time and effort assuming the accompanying financial psychic and social risks and receiving resulting rewards of monetary and personal satisfaction and independence (Hisrich and Peters 2002).It is also a process by which individuals either on their own or inside organizations pursue opportunities without regard to the resources they currently control (Stevenson and Jarillo 1990).

2.4.2 Entrepreneurship as Behaviors

Entrepreneurship is the manifest and willingness of individuals on their own in teams within and outside existing organizations to perceive and create new economic opportunities and to introduce their ideas in the market in the face of uncertainty and other obstacles by making decisions on location form and use of resources and institutions (Wennekers and Thurik 1999). Entrepreneurship is a way of thinking, reasoning and acting that is opportunity based, holistic in approach and leadership balanced(Timmons and Spinelli 2004). Entrepreneurs are specialists who use judgment to deal with novel and complex problems (Casson 1982) .Entrepreneurship consists of the competitive behaviors that drive the market process (Kirzner 1982). While entrepreneurs carry out new combinations by such things as introducing new products or processes, identifying new export market or resources of supply or creating new types of organizations (Shcumpeter 1934).

2.4.3 Entrepreneurship as Outcomes

In this concept entrepreneurship is viewed as outcome of process or set of behaviors. Outcomes are usually in terms of new products and services innovation, new ventures and creation of value for society. In this concept entrepreneurship is the introduction of new economic activity that leads to change in the market place.(Simon in Sarasvathy). Entrepreneurship is the creation of new organizations (Gratener 1988),it is also results in the creation, enhancement, realization and renewal of value not just for the owners but for all participants and stakeholders (Timmons and Spinelli 2004).

2.5 Empirical Review

Fidler and Webster (1996) advocate that in many cases, basic business skill training should accompany the provision of micro loans to improve the capacity of the poor to use funds. Micro enterprise investment training mainly addresses capital investment decisions, general business management and risk management. Capital investment decisions include allocation of the microenterprise limited capital funds most effectively in order to ensure the best return possible. Therefore, a wrong decision can have long lasting effect not only on the profits but on very survival of the enterprise.

Bowen et al. (2009) researched on Management of business challenges among small and micro enterprises in Nairobi Kenya. The findings of the research indicated that over 50% of SSEs continue to have a deteriorating performance with 3 in every 5 SSEs failing within months of establishment. Only 2.5% respondents saying their businesses were very successful. The results also showed that 49.5% of those who had received training in their areas of business reported that their businesses were doing well hence the conclusion that relevant training or education is positively related to business success and recommendation that of the need for SSEs owners to get trained in an area that is relevant to the business carried.

Nyabwanga (2011) in his study of the effect of working capital management practices on the financial performance of small scale enterprises in Kisii South district using a sample of 113 small scale enterprises and using a survey design established that majority of the small business owners or managers had just basic education and over 57% of these business operators hardly attend any business training programmes despite the establishment that over 60% of them had little or no knowledge in business management hence were void of management skills vital in the running of their enterprises. The study also established that the performance of small scale enterprises was on average low. The study recommended a study that will unravel the impact of training on the performance of businesses.

Simeyo et al (2011) in their study of the effect of provision of micro finance on the performance of youth micro enterprises under Kenya Rural Enterprise Program (K-REP) in Kisii County using a sample of 86 youth micro enterprises established that training in micro enterprise investment had a significant positive impact on the performance of the microenterprises with a standardized beta coefficient of 0.281 which indicated that a unit increase in the provision of training to SSEs resulted to a 28.1% increase in performance. The study further established that majority of the respondents were very satisfied with the provision of capital investment and basic business skills training in micro enterprise investment. This suggests that the business skill training accompanying the provision of micro loans most likely improves the capacity of the entrepreneurs to use funds and hence impacts on business performance. In terms of business risk management, the results showed that respondents were moderately satisfied in terms of achievement of business risk management skills. With the implication that the youth micro entrepreneurs were inadequately equipped with knowledge and skills of business risk management hence are unable to adequately deal with business risks and therefore in the event that such risks occur, their micro enterprises are significantly affected.

In a study to investigate the effect of business development services on the performance of Small Scale enterprises in Kisii Town Osinde et al (2013) found out that the entrepreneurs who received business development services recorded an improvement in the growth of sales and growth in market shares on the various businesses they were operating. The study further established that those who attended the training services recorded an improvement in their businesses in terms of growth in sales and profits with 83.3% of the respondents who always attended training reporting to have good growth in profits as opposed to only 41.2% of those who never attended training.

Bruhn and Zia (2011) in their study on the Impact of Business and Financial Literacy for Young Entrepreneurs in Bosnia and Herzegovina found that business outcomes and practices is the difference in effects of the training on individuals with below and above median financial literacy at baseline. They also found that both entrepreneurs with below and above median financial literacy changed some of their business practices, such as separating personal accounts from business, and making investments in their business; however, only entrepreneurs with above median financial literacy at baseline reported increases in sales and profits as a result of the training. These findings suggest that baseline knowledge and information conveyed in the financial training act as complements in increasing the productivity and sales of a business. They also found that entrepreneurs with relatively high ex-ante financial literacy exhibit improvements in sales due to the training program.

While business training does not impact the extensive margin, it has significant effects on existing entrepreneurs, and on specific aspects of their businesses. Teaching entrepreneurs the value of capital investment indeed encourages them to change business practices that allow for greater innovation, for instance by implementing new production processes and making personal investments in the business. Since the study findings have shown that business development services have an influence on business performance the study recommends that the Kenyan government through the Ministry of Trade should provide training programs for the owner-managers and managers of SSEs so as to help polish their knowledge in financial management and other managerial skills. Field officers should be recruited to coordinate and monitor the provision of training, advice, counsel and provide other non-financial services to these small business operators.

2.6 Summary of Literature Review

Entrepreneurship theory responds to the functions entrepreneurs have to perform in order to make sure that they survive or be successful in competition. Many studies have been carried out and considerable varieties of entrepreneurial functions are under discussion. It’s also evident that financial literacy has a positive effect on entrepreneurship success .Many studies have concentrated on SMESs success factors as well as the causes of high rate of SMEs failures. However considerable number researches have studied the effect of business knowledge on entrepreneurship but no direct study on financials literacy and SMEs success. There are also no specific theories that talks about financial literacy and entrepreneurship. Many scholars have only concentrated on entrepreneurism as a concept. No studies have been directly carried out to establish the effects of financial literacy entrepreneurs’ success. In this paper we will try to establish the relationship of the two variables by asking the question: Does financial literacy translates to entrepreneurship success?

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter focuses on research design and methodology that was applied in carrying out the study. It deals with research design, variables and location of study, targeted population sampling techniques and sample size, research instruments, validity and reliability of research instruments, data collection and data analysis techniques.

3.2 Research Design

The methodology used was of quantitative in nature and was aimed at depicting the manner in which financial literacy affects SMEs success. (White 2002). Aspects of qualitative research were also used through observation. The study made use of entrepreneur's financial literacy scores against the level of SME success as per questionnaire. Financial literacy was measured by scoring simple financial literacy questions, while SMEs success was be measured by scoring SMEs years of operation, number of permanent employees as well as revenue annual growth.

3.3 Population

The target population for this study was 27,485 SMEs licensed by Nairobi City County in 2012.

3.4 Sample

A sample of one hundred entrepreneurs was randomly selected from all regions of Nairobi City County but only seventy nine respondents provided useful data. Stratified sampling technique was also used and in each stratum, simple random sampling technique was used.

Stratified sampling ensures that specific groups are represented, even proportionally, in the sample(s) (e.g., by gender), by selecting individuals from strata list. The criterion used was to select samples from entrepreneurs running small enterprises with salaried employees and with a turnover of at least KShs.5m.

3.5 Data Collection

Primary data was collected from seventy nine samples randomly picked in Nairobi county and included both formal and informal sectors. Simple questionnaires were distributed amongst the respondents and face to face interview conducted. Drop and pick method was also used in the administration of questionnaire. Telephone interviews were also used especially where there was geographical and time constraints. Data collected was annual turnover, years of business, number of employees as well as answers to seven simple financial literacy questions.

3.6 Data Analysis

The analysis was done using descriptive statistics where mean mode standard deviation and variance were used. Simple regression analysis was done to determine statistical relationship between dependent and independent variables. SPSS (Statistical Program for Social Sciences) Version 20.0 was be used to obtain coefficients and regression analysis.

Successful SMEs were determined by analyzing answers to three questions in the attached questionnaire. Each answer had a score of 1 to 10, SMEs with higher score were deemed to be more successful and vice versa. Financial literacy was also determined by scoring answers against seven questions that were also provided in the questionnaire. Each answer had a score of 1 to 10, entrepreneurs with the highest score were deemed to be more financially literate and vise versa.

3.6.1Analytical Model

The study involved the use of linear regression analysis. The regression equation was;

$$Y_1 = a + b_1 \times X_1 + \epsilon$$

Where; **Y_1 -** SME success (measured by years in business, number of employees and rate of growth)

X_1 - financial literacy (measured by scoring financial literacy questions)

a - constant (or intercept)

b_1 - slope of the regression

ϵ - error

Regression analysis was done using SPSS version 20.0. The b coefficient from the equation above represented the strength and direction of the relationship between the variables. Assuming that the error term ϵ in the linear regression model was independent of x, and normally distributed, with zero mean and constant variance, it was decided whether there is any significant relationship between x and y at 0.05 significance level by testing the null hypothesis that $\beta = 0$. If the p-value is much less than 0.05, we reject the null hypothesis that $\beta = 0$. Hence there will be no significant relationship between the variables in the linear regression model. Due to large numbers of samples we used Z test to test significance level.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

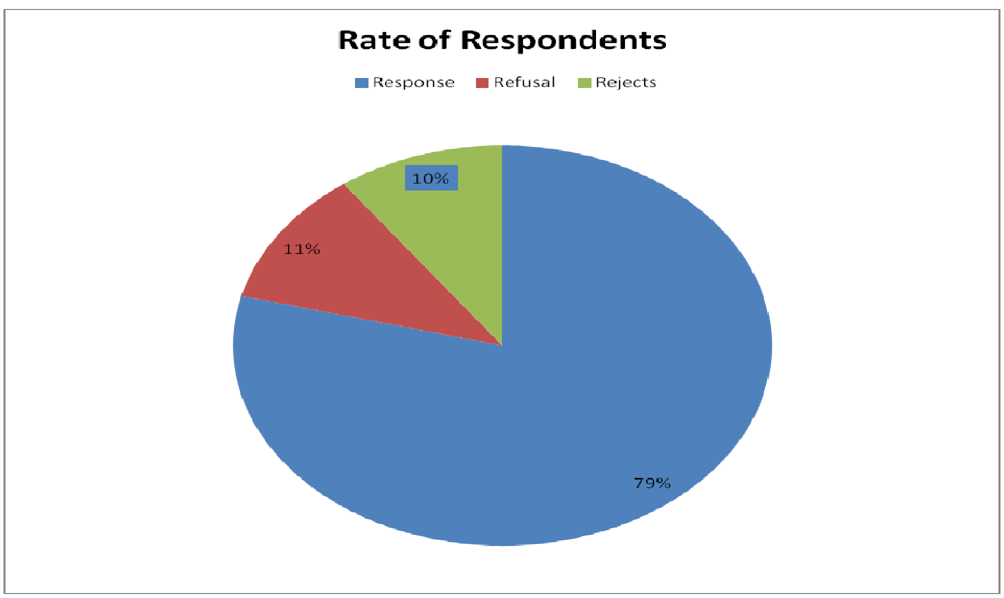
4.1 Introduction

In this chapter we analyze data collected by from seventy nine SMEs licensed by Nairobi City County. Financial success is measured by scoring the answers to three questions that are aimed to determine the level of success. Each answer to each question is scored between 0, 3, 7 and 10 points and then total percentage score is given. Financial literacy data is provided by scoring answers to simple financial literacy questions that tests knowledge in financial market. Each correct answer is scored 10 points and incorrect answer zero point and percentage aggregate score is then given for all the questions.

4.2 Rate of Respondents

From a sample size of 100 samples, 79 samples were collected while 10 samples were discarded for having no useful information, 11 respondents refused to respond. The total rate of response was 79% and therefore considered successful.

Figure 4.1 Rates of Respondents



Source: Research Findings

4.3 Descriptive Analysis

In this analysis we describe the basic features of the data in a study by simple summaries about the sample and the measures.

Table 4.1 Descriptive Statistics

		Statistic	Std. Error	Bootstrap[a]			
				Bias	Std. Error	95% Confidence Interval	
						Lower	Upper
Sucess Score	N	79		0	0	79	79
	Range	87					
	Minimum	13					
	Maximum	100					
	Mean	65.97	3.148	0.13	3.17	58.53	71.82
	Std. Deviation	27.979		-0.258	1.234	25.405	30.653
	Variance	782.846		-12.843	68.69	645.429	939.589
	Skewness	-0.45	0.271	-0.022	0.201	-0.912	0.046
Financial Literacy Score	N	79		0	0	79	79
	Range	87					
	Minimum	13					
	Maximum	100					
	Mean	68	2.853	0.08	2.84	61.87	73.15
	Std. Deviation	25.355		-0.177	1.314	22.78	27.688
	Variance	642.897		-7.229	66.38	518.908	766.612
	Skewness	-0.459	0.271	-0.011	0.194	-0.898	-0.067
Valid N (listwise)	N	79		0	0	79	79

Source: Research Findings

The total numbers of samples were 79 with a minimum score for both success score and financial literacy being 13% and financial literacy 100%. Average mean score for success was 65.97% and 68% for financial literacy. Standard deviation was 27.979% and 25.355% for success and financial literacy respectively.

4.4 Correlation Analysis

In this analysis we determine the extent to which changes in SMEs success is associated with changes in financial literacy.

Table 4.2 Correlations

				Sucess Score	Financial Literacy Score
Sucess Score	Pearson Correlation			1	.923**
	Sig. (2-tailed)				0
	N			79	79
	Bootstrap[b]	Bias		0	0.001
		Std. Error		0	0.016
		95% Confidence Interval	Lower	1	0.885
			Upper	1	0.947
Financial Literacy Score	Pearson Correlation			.923**	1
	Sig. (2-tailed)			0	
	N			79	79
	Bootstrap[b]	Bias		0.001	0
		Std. Error		0.016	0
		95% Confidence Interval	Lower	0.885	1
			Upper	0.947	1
**. Correlation is significant at the 0.01 level (2-tailed).					
b. Unless otherwise noted, bootstrap results are based on 79 bootstrap samples					

Source: Research Findings

In this finding the correlation between success rate and financial literacy is significant at 0.01 levels (2-tailed). This implies that change in success score is attributable to financial literacy.

4.5 Regression Analysis

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.923[a]	.852	.850	10.845

a. Predictors: (Constant), Financial Literacy Score

Source: Research Findings

Table 4.3 provides R and R^2.The R value is 0.93 which represents the simple correlation. It indicates a higher degree of correlation. The R^2 value how much of the dependent variable "success" can be explained by the independent variable "financial literacy". In this findings 85.2% can be explained which is very large.

Table 4.4 ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	52004.915	1	52004.915	442.129	.000[b]
	Residual	9057.034	77	117.624		
	Total	61061.949	78			

a. Dependent Variable: Success Score

b. Predictors: (Constant), Financial Literacy Score

Source: Research Findings

Table 4.4 indicates that the regression model predicts the outcome variable significantly well. The "Regression" row and go to the Sig**.** column indicates the statistical significance of the regression model that was applied. Here, $p < 0.0005$, which is less than 0.05, and indicates that, overall, the model applied can statistically significantly predict the outcome variable.

Table 4.5 Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-3.274	3.512		-.932	.354
	Financial Literacy Score	1.018	.048	.923	21.027	.000

a. Dependent Variable: Success Score

Source: Research Findings

Table 4.5, Coefficients, provides information on each predictor variable. This gives us the information we need to predict success from financial literacy. We can see that both the constant and financial literacy contribute significantly to the model (by looking at the Sig. column). By looking at the B column under the Unstandardized Coefficients column, we can present the regression equation as: Success = -3.274 + 1.018(financial literacy)

4.6 Interpretations of the Findings

From a sample size of 100 samples, 79 samples successfully provided data that is useful for this study. The main objective of this study was to establish relationship between financial literacy and entrepreneurial success in Nairobi County. Data collected for SME success included the numbers of years each SME have been in business, number of permanent employees for each business, and the rate of revenue growth in the first five years of business. Data collected for financial literacy included answers to simple financial literacy questions that covered interest rates, inflation, and time value for money, money illusion, understanding risk, diversification and knowledge in financial market.

The minimum score for financial literacy was 13% with a maximum score of 100%, while on average the financial literacy score was 68%. With such a high average score, it means that on average most SMEs in Nairobi County are financially literate and understands the basic financial concepts. This is further explained by the fact that there was also a significant number of SMEs with 100% score in financial literacy, especially the ones in formal sector. On the other hand, the lowest score for SMEs success was 13%, maximum score was 100% while average score was 65.97%. This means that on average, most SMEs in Nairobi County are successful and have been in business for more than five years, have experienced growth in the first five years, and have at least 3 permanent employees.

As shown in table 4.4 above, correlations between financial literacy and SMEs success R at 0.93 and R^2 at 85.2%, this means that significant amount of SMEs success can be explained by financial literacy. In table 4.5, the results indicate that there is a linear relationship between SMEs success and financial literacy. It further suggests that the model applied can statistically significantly predict the outcome of the outcome variable. Further, Table 4.6, shows that both constant and financial literacy contribute significantly to the model and that SMEs success can be predicted by using a linear equation :SMSs Success = -3.274 + 1.018(financial literacy).In general the findings suggests a strong positive relationship between financial literacy and SMEs success in Nairobi County..

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter looks at summary of findings and recommendations. Section 5.2 outlines the summary of key findings, 5.3 is the conclusion, section 5.4 presents the limitations of the study, section 5.5 is the recommendation for policy and finally section 5.6 presents the recommendation for further research**.**

5.2 Summary

The main objective of this study was to establish whether there is a relationship between an entrepreneur's success and level of financial literacy. From the research findings, it's evident that a positive relationship between entrepreneurs' success and the level of financial literacy exists. The finding shows that more successful SMEs employs more than three permanent employees, have been in business for more than five years, has an annual revenue growth of more than 5% and are basically financial literate. Majority of these SMEs are in formal sector and are run by well educated businessmen that understands financial concepts such as inflation, interest rates diversification, stock market etc. On the other hand, the SMEs whose business success score was low also scored low in financial literacy. These SMEs are mostly small enterprises run by one or two family members in the informal sector and runs small shops such as hardware shops, filling stations, spare part shops etc, and have recorded minimal or no growth over the years.

5.3 Conclusion

This study concludes that there is positive relationship between entrepreneur's success and financial literacy. SMEs that are more successful are run by entrepreneurs who are financial literate and understand key financial concepts that include, risk management, interest rates, time value for money and financial market. Financial literacy exposes entrepreneurs to better decision making skills that lead to borrowings, risk taking, diversifications, and investments. The study also concludes that there is a higher a chance for financially literate entrepreneurs to be more successful than those with low level of financial knowledge. Nevertheless, the findings suggest that, all Nairobi County entrepreneurs have some level of financial literacy and majority especially in formal sector are highly financially literate. Financial literacy also seems to go hand in hand with formal education; entrepreneurs that scored high in financial literacy seemed to be well educated, while in contrast, entrepreneurs with low level of financial literacy demonstrated low level of formal education. This further implies that the business education taught in schools has bearing to ones success in business.

5.4 Policy Recommendations

Considering the fact that majority of SMEs are in informal sector scored poorly in success and financial literacy, the Government needs to ensure that all SMEs have the basic financial literacy. This is very important owing to the fact that, SMEs plays a paramount role in Kenyan economy and growth in this sector means growth in economy.

Financial literate entrepreneurs demonstrated high level of formal education which emphasis the importance of business education taught in our learning institutions. However, there is need for more capacity building in areas of diversification, raising capital and investments in order to stimulate growth.

The study further recommends financial institutions such as MFIs to educate SMEs in informal sector the basic financial concepts in order to boost their risk profile and enable them to access credit. Financial institutions can play a very important role in financial literacy due their frequent interactions with SMEs in financial matters.

5.5 Limitations of the Study

This study was limited by some respondents not willing to disclose their financial information in terms or revenue.

Some entrepreneurs were not available for interview and were represented by their employees who would have different financial literacy level than the owners of business.

The study was also limited by some entrepreneurs' inability to read and interpret the questions asked due lack of familiarity in English language.

5.6 Recommendation for Further Research

This study recommends training of small SMEs that are in informal sector and run by few family members. Most of these business survives for many years but with minimal or no growth at all, perhaps due to lack of financial knowledge. If trained, SMEs in this sector would embrace more risk ventures, diversify investments and raise capital to grow and transform into more solid enterprises.

Since this study covers only Nairobi County, there is need for further study that will cover other urban areas in the country and indeed the entire country. It's also recommendable conduct the same study in informal sector alone.

Since this study only covers basic financial literacy, it's also recommendable to further study relationship between advanced financial literacy and entrepreneurial success.

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APPENDICES

Appendix I: Questionnaire

This questionnaire is designed to assist in collecting data to determine the relationship between financial literacy and entrepreneurship success.

Please note that the findings of this research are solely meant for academic purposes and all the responses will be treated with utmost confidentiality.

Section A:General Information

Name of SME---

Sector (tick where appropriate)

Formal ☐ Informal ☐

Business location ---------------------------

Designation (optional)----------------------

Section B:Measuring SMEs Success

How long have you been in business?

0- 5yrs ☐

5- 10yrs ☐

Over 10 years ☐

How many permanent employees do you have?

1-3 ☐

4-5 ☐

Over 5 ☐

State your revenue in the first five years since inception (KShs million)

Year 1	
Year 2	
Year 3	
Year 4	
Year 4	

Section C: Basic Financial Literacy Questions

1) Interest compounding

Suppose you had KShs100, 000.00 in a savings account and the interest rate is 20% per year and you never withdraw money or interest payments. After one year, how much would you have on this account in total?

A. More than KShs 200;
B. Exactly KShs 200;
C. Less than KSh 200;
D. Do not know;
E. Refusal.

2) Inflation

If you have KShs 100,000.00 in your bank and inflation is 10% per year, how much would you be able to buy after one year?

A. More than today;
B. Exactly the same;
C. Less than today;
D. Do not know;
E. Refusal.

3) Time value of money

Assume a John inherits KShs 100,000.00 today and his Tom inherits KShs 100,000.00 3 years from now. Who is richer because of the inheritance?

A. John

B. Tom;

C. They are equally rich;

D. Do not know;

E. Refusal.

4) Money illusion

Suppose that in the year 2013, your income has doubled and prices of all goods have doubled too. In 2013, how much will you be able to buy with your income?

A. More than today;

B. The same;

C. Less than today;

D. Do not know;

E. Refusal.

5) *Understanding risk*

If someone offers you the chance to make a lot of money there is a chance that you will lose a lot of money?

A. True

B. False

C. don't know

D. Refusal

6) Diversification

Is it possible to reduce the risk of investing in the stock market by buying a wide range of stocks and shares

A. True
B. False
C. Don't know
D. Refusal

7) Understanding financial market

In the past 12 months have you been [personally] saving money in any of the following ways?

A. Saving cash at home
B. Building up a balance in bank account
C. Buying financial investment product

9) Do you keep books of accounts?’

A. Yes
B. No
C. Refusal

Name-----------------------------------

Contact--------------------------------

Signature-------------------------------

Appendix II: Score Sheet

	SME Success	
Questions	Number of Years in Business	Score
1	0-5 Yrs	3
	5-10 yrs	7
	Over 10 yrs	10
2	Number of permanent employees	
	1-3 employees	3
	4-5 employees	7
	Over 5 yrs	10
3'	Revenie growth	
	No growth	0
	1-5%	3
	5-10%	7
	Over 10%	10
	Financial Literacy	
Question	Answer	Score
1	A	10
2	C	10
3	A	10
4	B	10
5	A	10
6	A	10
7	C	10
8	A	10
	Total Scores	80

Appendix III: Collected Data

	NAME	Success Score	Financial Literacy Score
1	4x4 Adventures	80	87
2	Afrocentric Health Services	100	100
3	Akim Electrical & Hardware	90	75
4	Akuria A Kangari Investments	90	100
5	Alexander Forbes Financial Services	100	100
6	Alexander Forbes Risk & Insurance Brokers'	100	100
7	All Sevens Company Ltd	76	40
8	Assia Phrmaceuticals Ltd	100	100
9	Bhavin Motors	43	38
10	Blues Restaurants	56	75
11	BMKIB Electricals	30	43
12	Botana Kenya Ltd	56	25
13	Bridge Electricals	30	25
14	Bridge Side Properties	43	75
15	Circuit Field Electrical	67	87
16	Corporate &Pension Trust Services	100	100
17	Dave Electrical Services	43	50
18	Demker Electricals	20	13
19	Desset Rose Resort	76	63
20	Dry Associates Ltd	100	100
21	Dunstone Construction	100	38
22	Entrust Advisories	67	90
23	ESRI Eastern Africa	90	100
24	Express Advertising	80	87
25	Fair Price Auto & Gas	13	37
26	Fifth Element Ltd	30	63
27	Firstline Rentals Ltd	30	38
28	Four by Four Adventures	57	87
29	Freeway Service Station Ltd	100	63
30	Gallant Worldwide Investments	50	80
31	Herdag Consult K Ltd	90	75
32	Insile Africa Support Ltd	86	87
33	Intent Stationers	80	87
34	Interlinks Investment Ltd	90	75
35	Iqplus	67	75
36	Jimarack Investment Ltd	30	30
37	Joyce M. Mutegi Advocates	30	75
38	Kalolwanga Engineering Services Limited	30	40
39	KBN Rover Garage	33	38
40	Khali & Company Ltd	70	78
41	Kingsway Tires Limited	100	90

42	KMA Enterprises	20	25
43	Kroner Construction	67	73
44	Lucral Stalls	33	37
45	Mara Bush Camp Ltd	100	88
46	Maxland Restaurant	100	50
47	Meta Meta Connections	20	25
48	Minari Transporters	80	87
49	Mister Seed Holdings	67	90
50	Misukar Electrical Agency	30	50
51	New Plymer Enterprises	53	75
52	Njema Africa Tours Limited	35	88
53	Nothern Press Ltd	20	38
54	Parsons Brinckerhoff	70	63
55	Planet Stationary Ltd	80	75
56	Pony Cabs	80	50
57	Prime Tech Aagencies	33	50
58	Professor Albert Mumma & Co Advocates	90	87
59	Ramagon Construction	87	78
60	Raymak Movies	36	25
61	RCO Ltd	20	87
62	Rhapta Terraces Management Co. Ltd	80	100
63	Ridge Side Enterprises	90	63
64	Riki Motors	33	38
65	Samaha Company Ltd	33	38
66	Sanasan Bar & Reustarants	87	50
67	Sannex Electricals	30	25
68	Sunworld Safaris	90	88
69	Tassew Mehrete and Family	56	25
70	Tecbytes Computer Solution	13	37
71	Techedge Limited	30	75
72	Techno Drill	20	40
73	True Colour Arts	20	25
74	Tupelo Restaurant	56	75
75	Urban Haul Movers	90	87
76	Vibo Valencia Ltd	70	100
77	Vicky Enterprises	20	25
78	Weensllyn Ventures Ltd	43	50
79	Zahur Enterprises	100	87