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Financial Access, Financial Literacy and Entrepreneurial Firm Performance: A Review of Literature

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Abstract

In the past two decades, scholars and policy makers in both developed and developing countries have recognized the access to finance and financial literacy levels among entrepreneurial firmsas being critical to the performance of firms. This motivated empirical research focusing on the relationship between financial literacy and financial access, and their impact on the firm performance. This review is an attempt to critically examine these variables in the context of entrepreneurial firms and study the relationship between them.

Introduction

Economies across the globe have identified firms as the key drivers of job creation, inovation and economic development leading to an increased attention focused on firm performance. Firm performance is defined as the ability of firm to achieve planned objectives measured by financial and non-financial indicators. Financial measures include profit, revenue, return on investment (ROI), return on equity (ROE), earnings per share (EPS) whereas non-financial measures can be represented by market share, number of employees, customer satisfaction, employees' satisfaction, social and environmental performance. The outcome of activities of a firm is, however, not limited to revenue generation and employment, but extends toward the development of a vibrant small- and medium-sized business sector, which is considered as the center of development, particularly for emerging economies. In order to undertake developmental activities in an economy, it is of paramount importance to foster the creation and development of firms thus empowering youth to attain their socioeconomic potential and become self-reliant, thereby leading to sustainable economic development.

The role of finance in the performance of firm has been well documented in the literature and the firm-financing gap has become common terminology which indicates the insufficient access to finance faced by firms (OECD, 2006). Access to finance is broadly defined as the ability of households and firms to use financial services if they choose to do so, which can contribute significantly to economic welfare (Suarez & Gonzales, 2010). Despite the presence of robust financial institutions worldwide, young entrepreneurial firms find it difficult to secure funding for their enterprises. One of the main concerns that financial institutions have about financing the young firms is the lack of business experience and skills since creditworthiness is usually assessed on the basis of track record and business expertise. Building an effective financial ecosystem is a key challenge for countries to broaden the firm's access to finance while promoting a sound credit culture.

Lack of financial literacy is another challenge faced by entrepreneurial firms. Financial literacy is defined as follows: 'A combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing'(Atkinson & Messy, 2012). Given the importance of financial literacy in today's complex financial landscape, governments across the globe are working towards improvement of financial literacy levels amongst their population. Financial literacy is one of the key factors affecting the performance of firms globally. Financially literate entrepreneurs are well aware of the most suitable financing options given the different stages of business and use the financial resources as well as information in a much prudent manner, thereby improving the profitability of their enterprises (Berman *et al*, 2008). Financial literacy, thus, exerts a significant influence on the overall access and utilization of various financial services.

There is a growing national and international interest in overcoming the challenges to development of entrepreneurial firms due to its significant implications on individual well being and economic development. The Government of India has launched a number of schemes and programs like Startup India and Atal Innovation Mission to foster entrepreneurship in the country.

Review of Literature

Finance plays a significant role in the survival and growth of businesses, the lack of finance is considered to be the major reason for business failures (Chan & Lin, 2013). Financing is thus a highly essential part of entrepreneurship. According to a study conducted by National Bureau of Economic Research, financing constraints are one of the biggest concerns impacting potential entrepreneurs globally (Kerr & Nanda, 2009). Fanta, Mutsonziwa, Berkowitz, & Maposa (2017) recognize lack of financial access as the primary obstacle in start-up and growth of entrepreneurial firms. The ability to source funds for an entrepreneurial venture is one of the most difficult impediments in the translation of an entrepreneurial idea into a business opportunity (Mikic, Novoselec, & Primorac, 2016). Access to finance is a key determinant of the performance of microenterprises, enhancing their ability to exploit growth opportunities thereby promoting innovation and dynamism (Beck & Demirguc-Kunt, 2006). A positive relationship has been found between access to finance and performance of Small and Medium Enterprises (Harelimana, 2017). Extending proper finance to deserving enterprises can help them overcome the challenge of financial access, moreover it has significant implications for the economic growth of nations.

Lack of financial literacy is another challenge faced by entrepreneurial firms which can have a significant influence on their performance. It is well known that firms are involved in decision-making on a regular basis with respect to their day to day business activities. Such activities have financial implications and in order to ensure smooth functioning of business, entrepreneurs need to be financially literate. Financially illiterate person may face issues like inability to budget properly to meet the expenses, inability to make informed choice of financial products or services, lack of proper understanding about seeking and evaluating financial advice, and

lastly, may fall victim to exploitative scams (ASIC, 2003). The practitioners in financial sector view financial education as an effective way of addressing the problem of financial exclusion for both households and firms. Financial literacy affects businesses by enabling entrepreneurs to differentiate between personal and business finances, enabling them to be competent buyers of financial products and use financial management concepts to optimize business performance (ACCA, 2014). A study conducted in South Africa reveals that the level of financial literacy among young entrepreneurial firms is above average and contributes to their entrepreneurial skills in a significant manner (Oseifuah, 2010). The impact of financial literacy programmes is found to be significant in enhancing the performance of firms. A study conducted in Kenya investigated the financial literacy skills imparted to small businesses, and their impact on the performance of such enterprises. The findings suggest that financial literacy programmes aimed at improving credit management and budgeting skills resulted in growth in sales and profits, ensuring smooth functioning of business (Siekei, Wagoki, & Kalio, 2013). Musie (2015) investigated the relationship between the use of financial literacy concepts and the economic success of small and medium enterprises and found a positive relationship between the two. Furthermore, it was found that entrepreneurs are not informed about the other sources of finance like venture capital and funding schemes run by government agencies.

Studies reveal that financial literacy has an impact on financial access which in turn influences the performance of firm. There are many factors contributing to limited access to financial services in developing countries, lack of financial literacy has been identified as one such factor (Lewis & Messy, 2012). Nunoo & Andoh (2012) argued that entrepreneurs with high levels of financial literacy were more likely to utilize financial services where the most commonly used financial service was operating a bank account. Kaigama, Talib, & Ashari (2016) investigated the impact of utilization of financial services on the performance of firms. The findings suggested that these services can only improve the performance of such businesses which are exposed to financial literacy. This implies the potential of financial literacy in influencing the profitability of firms by improving the utilization of financial services. Abubakar (2015) argues that financial access affects the potentiality of firms to operate successfully in Africa where the majority of people fail to understand how financial products work, thus making it tough for them to acquire seed capital or funds for expansion of business.

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