THE EFFECT OF FINANCIAL LITERACY ON THE PROFITABILITY OF SMALL AND MICRO INTERPRISE IN CASE OF JIMMA TOWN

A Research paper Submitted to the School of Graduate Studies of Jimma University in Partial Fulfillment of the Requirements for the Award of Master of Sciences Degree in Accounting and Finance

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As thesis advisors, we here by certify that we have read and evaluated the thesis prepared by KIDIST ALEMAYEHU under our guidance, which is entitled “*THE EFFECT OF FINANCIAL LITERACY ON THE PROFITABLITY OF SMALL AND MICRO ENTERPRISESIN CASE OF JIMMA TOWN”*, in its final format it is consistent and acceptable. Hence, we recommend that the thesis be accepted as it fulfills the university and department style requirements for the degree of Master of Science in Accounting and finance.

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DECLARATION

I the under signed declare that this study entitled "*THE EFFECT OF FINANCIAL LITERACY ON THE PROFITABLITY OF SMALL AND MICRO ENTERPRISESIN CASE OF JIMMA TOWN*"Is my original work and has not been presented for degree in other universities and that all sources of materials used for the study have been dually acknowledged.

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CERTIFICATE

This is to certify that this study, "*THE EFFECT OF FINANCIAL LITERACY ON THE PROFITABLITY OF SMALL AND MICRO ENTERPRISESIN CASE OF JIMMA TOWN*", undertaken by Kidist Alemayehu for the partial fulfillment of Master of Sciences Degree in Accounting and Finance at Jimma University, is an original work and not submitted earlier for any degree either at this University or any other University.

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ABSTRACT

The main objective of the study was to investigate the effect of financial literacy on the profitability of micro and small enterprises owners of Jimma town. The study aimed to measure and describes financial literacy and profitability of SME operators in Jimma town, examining the effect of financial knowledge, behavior and attitude on the profitability of SMEs. The study adopted a descriptive research design for analyzing the obtained primary data and to give clear understanding of the research objectives. To achieve the objectives, the primary data was gathered through issuing a set of structured questionnaires to a sample population of 384 owners/managers of SMEs that have their own businesses in Jimma town. probability sampling method were used by applying specifically stratified sampling techniques and randomly select respondents from each strata to collect data and to achieve the objective of the study. A descriptive statistics and inferential statistics were employed for analyzing the effect of financial literacy on profitability of MSE's. A Correlation analysis was used to find out the relationship between financial knowledge, financial behavior and financial attitude of SMEs operators and profitability. Multiple Linear Regression analyses of variable, frequency distribution were used to analyze the findings. These analyses were carried out using Statistical Package for the Social Sciences (IBM SPSS) statistical software version 24 and the report was presented using both frequency tables and graphs. The finding suggests that most of the financial literacy such that financial knowledge, financial attitude and financial behavior have positive and significant effect on profitability of SMEs owners in Jimma town. The study concludes that financial knowledge has a necessarily effect in translating into profits. It also concludes that good financial behavior contributes to profitability of MSE's. Also, positive attitude towards future and social influences for acquisition of skills translates into profits for micro and small enterprises. The study therefore, recommended that financial education and training programs should have to be given by the government along with other institutions, to encourage application of financial knowledge on activities of business owners. These programs should also be able to motivate and encourage positive attitude toward future orientation and growth of the businesses.

***Key word:* -** financial literacy, SMEs, Jimma

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Acronyms and Abbreviations

ANOVA	Analysis of Variance
FDRE	Federal Democratic Republic of Ethiopia
FMSEDA	Federal Micro and Small Enterprise Development Agency
GDP	Gross Domestic Product
IFC	International Finance Corporation
INFE	International Network of Financial Education
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
OECD	Organization of Economic Co-Operations and Development
SME	Small and Medium Enterprises
SPSS	Statistical Package for Social Sciences
USIU	United States International University

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The national economic plan considered, Ethiopia is developing country which has a vision to join medium developed economy. Micro and small enterprises (MSE's) as a facilitators of broad-based growth in through entrepreneurship which could offer economy-wide benefits such as innovation and aggregate productivity growth (Tarasi, et,al, 2011). For development to be achieved, small and medium enterprises are expected to play great role by creating employment opportunity and reducing undue dependency of the counters economy on the performance of agricultural sectors. The success of Small and Medium Enterprises (SMEs) thus is a vital issue for Ethiopian is rising from time to time by number as well as their contributions to economy. SMEs utilize local resources, satisfying vital needs of large segment of the population with their products and services, serve as spheres of technological, marketing and management capacity and skill gaining, amenable technological progress by adoption technologies. Therefore, the health of small business sector is very important for the overall economic growth potential and future strength of an economy since (FEMSEDA, 2004).

Many SMEs firms fail because of lack financial literacy, insufficient business acuity, as well as poor financial literacy, undermines entrepreneurial activity. This is supported by (Adomako and Danso (2014) that concludes a significant obstacles to performance and growth of sustainable in the developing world is a lack of knowledge, skills, attitude and awareness to cope and direct the finances of their organization in a hardy, transparent, and professional way. While the contributions of small businesses to development are generally known, SME entrepreneurs face many problems that limit their long term survival and development. (Kamunge, Njeru&Tirimba(2014) According to (Harding, 2006) financial literacy is the mastery of a set of knowledge, attitudes and behaviors as the ability of an individual to make informed judgment and take effective decisions regarding the use and management of money. They added that such person also possesses a facilitating attitude to the effective and responsible management of financial affairs.

That is the ability to read, analyses, manage and communicate personal financial conditions that affect well-being and the ability to distinguish financial choices, discuss money and financial issues without discomfort. It has assumed the role in allowing people to make responsible decisions as they strive to attain financial wellbeing Ani, C. G. P., Kelmara, M. V., & Wesley, M.-D.-S. , (2016)). Financial literacy has become essential in the running of businesses and operations of organizations in the complex and dynamic environment today the need to improve financial literacy is important. Atkinson, A., & Messy, F. , (2012), added that governments around the world are interested in finding effective approaches of improving financial literacy of their populations through developing strategies for financial education with the main aim of providing various learning opportunities. Financial education as defined by Ani et, al(2016), is a process of developing abilities of people to facilitate making decisions that are correct and to manage finances successfully financial education programs implement by different government and other stockholders expect to enhance financial literacy and financial management ability. Many countries have developed strategies for the implementation of financial education to improve financial literacy of their population as it is perceived as a life skill necessary for intelligent financial conduct in modern life and an important basis for the economic and financial stability of society and the state Tali, (2016). A literature on small-business development has shown that the rate of failure of MSEs in developing countries is higher than in the developed world Okpara&Wynn (2007). Additionally they concluded significant obstacle to performance growth of sustainable small and medium scale enterprises (SMEs) throughout the developing world is a lack of knowledge, skills, attitude and awareness to cope and direct the finances of their organization in a hardy, transparent, and professional way.

Many researchers have focus with great concern the skills addition to the profitability of SMEs and one of such skills not given due attention in our country is the financial literacy skills. Therefore, the current researcher is motivated to investigate how financial literacy measured by financial knowledge, financial skill, financial attitude, financial behavior personal saving skills affect the profitability of micro and small enterprises in Jimma town. This study will be an important addition to the existing repository of knowledge and hence will be of interest researchers who seek to explore or investigate the importance of financial literacy on the profitability of micro and small enterprise in Jimma town or any other town.

1.2 Problem Statement

The growing recognition of the importance of Micro and small enterprises (MSE's) in developing countries is not by choice but out of necessity in order to add value to the economies by creating jobs, enhancing income, strengthening purchasing power among others. The government of Ethiopia has recognized the importance of MSE's in employment generation and poverty eradication in the country (FDRE, 2002). This led to the development and promotion of policies that are there to support the growth of the sector like the Ethiopia Vision that further rejuvenated policy efforts targeted at growth of MSE's through skills development and access to financial services. The government has enacted an MSE legislation that among other interventions aims to promote growth of MSE's through enabling business environment, access to business development services, and establishment of an authority to formulate, review and monitor relevant policies (FDRE, 2002). It is therefore, an avenue for incubating enterprises, catalyzing innovation, and promoting industry, creating employment, and growing the economy. Despite successive policy interventions and financial education programs, MSE's sector in Ethiopia in addition to improved access to finance demonstrates limited growth and competitiveness Micro and Small Enterprises Authority, (2013). Studies have been conducted on the importance of financial literacy on performance in terms of profitability and growth of MSE's and have shown that lack of financial literacy level among people around the world has cause business failures and even considered as one of the factors that contributed to the worldwide economic crisis of 2008/9 Niwaha, M., Schmidt, O., & Tumuramye, P. ,(2016). It emphasized the importance of financial training in enhancing capabilities and day to day running of businesses. Another study by Lusimbo and Muturi(2016) that focused on the importance of financial literacy on small enterprises growth found that although MSE managers had fair knowledge of debt management literacy, majority do not understand the effect of inflation and interest rates on loans they borrow in terms of matching assets and liability. They added that the managers exhibit low book keeping literacy and in turn recorded minimal or no growth. Other researchers argued that the success of a small enterprise does not depend on financial literacy of the managers.

For example a study by Plakalovi, (2015) focused on financial literacy among SMEs managers and found that the interviewed managers have disappointingly low level of basic financial knowledge and only a few managers use the proper ratios and ratio analysis. He added that they are not aware of the intangible values of their companies and they manage liquidity of the firms on spontaneous way. Plakalovi concluded that financial knowledge is not a prerequisite for the success of SMEs. Many researchers conducted on financial literacy focused on personal finance and fail to relate it to business management. They tend to look at factors like book keeping literacy, banking services literacy and ratio analysis on personal and household finance. Different research done previously by focusing on a few components of financial behavior of managers, but there's no research done to in indicate various components of financial knowledge, financial skills, financial attitude and personal saving skills and how they affect the profitability of MSE'

This research sought to answer the following research questions;

- ✓ To what extent financial literacy established among owners of micro and small enterprise in Jimma town?
- ✓ What is the effect of financial knowledge on profitability of Micro and Small enterprises in Jimma town?
- ✓ What is the effect of financial behavior on profitability of Micro and Small enterprises in Jimma town?
- ✓ What is the effect of financial attitude on profitability of micro and small enterprises in Jimma town?

1.3. OBJECTIVES OF THE STUDY

1.3 .1General Objective

The general objective of this study was to examine the effect of financial literacy of owners/managers on the profitability of micro and small enterprise in Jimma town.

1.3.2 Specific Objectives

The specific objectives emanating from this study were to;

- To measure financial literacy and profitability of SME operators in Jimma town.
- To assess the effect of financial knowledge on the profitability of Micro and Small enterprises in Jimma town.
- To assess the effect of financial behavior on the profitability of Micro and Small enterprises in Jimma town.
- To assess the effect of financial attitude on the profitability of micro and small enterprises.

1.4 Significance of the study

The findings of this study are more important for the following entities:-

Researchers and Academicians

This study will be an important addition to the existing repository of knowledge and interest of both researchers and academicians, who seek to explore or investigate the importance of financial literacy, among other factors on the profitability of micro and small enterprises in Ethiopia or any other country.

The Government and Financial regulators

It is an objective of every government to promote innovations of all kinds in a country and Micro and Small enterprises being of economic benefits cannot be ignored. In addition to the perceived economic benefits, MSE development has long been viewed by policymakers to increase incomes of the poor. The results of this research will be provide information on possible ways the government can tackle the issue of financial illiteracy among business owners and possible ways of promoting financial education among the entrepreneurs and small business owners which will in turn promote the profitability of the MSE's.

Investors and Financial Institutions

This study will be useful to investors because it will highlight the benefits that will be derived by their firms from acquisition of financial literacy. These benefits will include proper financial management skills that will lead to profitability of their firms. Also, for investors who are assisted by others, emphasis the use of financial literacy in financial reports of the firm, how assets are allocated and how to derive further profits. For financial institutions, it will help them asses the credibility of an MSE by the financial knowledge of the owners.

1.5 Scope of the Study

As the main objective of this study is to analysis the effect of financial literacy on the profitability of micro and small enterprise, the study were limited in Jimma town aiming those different owners of micro and small enterprises exist in Jimma town.

1.6 Limitations of the study

The study to a limited extent was hindered by a number of challenges, like uncooperative respondents who feared exposing their literacy levels. However, the researcher assured the respondents that the study is for academic purposes only and that the information given by the respondents would be treated with utmost confidentiality. Further, the researcher obtained an introduction letter from the university indicating that the study was purely for academic purposes. Other respondents said they did not have adequate time to take part in the study as a result of their busy schedules. This posed a serious challenge, as entrepreneurs in SME sector were the key respondents to the study. Proper prior arrangements were therefore done with the respondents to avail themselves for the study. Also, the researcher administered the questionnaire through a drop and pick later method so that the respondents filled the questionnaires at their own time.

1.7 Organization of the paper

The thesis has five chapters. The first chapter provided an introduction of the research project giving the background as well as the statement of the problem. Thereafter, the chapter highlighted the purpose of the study, the research questions that will guide the study and the importance of the study to various institutions and bodies. Chapter two presented literature review where the research questions were explored. The literature review described recent studies that have been carried out in the area of research. Chapter three presented the research methodology in terms of how data was collected and analyzed in order to answer the research questions. Chapter four and five presented the results and findings of the research and discussion, conclusions and recommendations drawn from the findings respectively.

1.8 Operational definition of terms

Financial literacy

The OECD, (2011) defined financial literacy as a combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing. That is, it is the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being.

Micro and Small Enterprise:-

Micro and small enterprises have different meaning from country to country, or there is no commonly accepted definition. As cited in article of (Shantanu, &Londhe , 2014), Microenterprises can be defined differently, depending on country's stage of development, policy objectives, and administration. In the majority of countries, SMEs are defined as firms employing between 10 and 250 people. Firms with up to 10 employees are usually referred to as micro firms.

In Ethiopia the SMEs Development strategy defines MSEs according to the number of employees and capital (FEMSEDA, (2010). Micro Enterprise under the industry sector (manufacturing, construction and mining) is an enterprise operates with less than or equal to 5 people including the owner and/or their total asset is not exceeding Birr 100,000. Under service sector (retailer, transport, hotel and Tourism, Information Communication Technology (ICT) and maintenance service) Micro enterprise are an enterprise operating with less than or equal to 5 persons including the owner of the enterprise and/or the values of total asset is not exceeding Birr 50,000. Small Enterprises in the industrial sectors are an enterprise operating with 6-30 persons and/or with a paid up capital of total asset Birr 100,000 and not exceeding Birr 1.5 million. Similarly, in the service sector, small enterprises are an enterprise operating with 6-30 persons and/or with a paid up capital of total asset Birr 50,000 and not exceeding Birr 500,000 (FMSEDA 2010).

Table 1 the **enterprises sector, employees and capital in Ethiopia**

Enterprises	Sectors	Employees	Capital
Micro enterprises	Industry	$\leq$ 5	$\leq$ ETB 100,000
	Service	$\leq$ 5	$\leq$ ETB 50,000
Small enterprises	Industry	6-30	$\leq$ ETB 1,500,000
	Service	6-30	$\leq$ ETB 500,000

Source: FMSEDA (2010)

Profitability

The word profitability is composed of two words, namely, profit and ability Dr. Monica Tulsian (2014). The term profit is a measure of receipts less cost and the term ability indicates the power of a business entity to earn profits. The ability of a concern also denotes its earning power or operating performance. Therefore, profitability may be defined as the ability of a given investment to earn a return from its use.

Financial Knowledge: - Financial knowledge is wisdom acquired through learning the ability to manage income, expenditure and savings in safe way Annamaria Lusardi & Mitchell, (2008).Financial knowledge is associated with a number of "best practice" financial behaviors, including possessing an adequate emergency fund, monitoring credit reports, avoiding checking account overdrafts, avoiding revolving debt, owning a dedicate retirement account, and having insurance protection (Robb, 2014).

Financial Behavior:- Financial behavior as defined by (Zeynep, 2015), is the capability to capture of understanding overall impacts of financial decisions on one's circumstances and to make the right decisions related to the cash management, precautions and opportunities for budget planning.

Financial Attitude: - Financial attitude can be defined as the application of financial principles to create and maintain value through decision making and proper resource management Latif and Lumpur, (2011).

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Introduction

Financial literacy gives an individual or business owner the ability to make informed and effective decisions regarding management of money through understanding and application of financial concepts. Due to the importance of financial literacy on financial stability and profitability of individuals and businesses respectively, it has attracted increasing attention by various governments and researchers. The aim of this chapter therefore is to present a review of existing literature on the importance of financial literacy on the profitability of Micro and small enterprises. It will focus on the impacts of financial knowledge, financial behavior and financial attitude on the profitability of Micro and small enterprises.

2.1.1 Concept of financial literacy

There is no universally accepted definition of financial literacy (Huston, 2010). However, Lusardi and Mitchell (2007b) used the definition of OECD (2005) which defines financial literacy as the process by which financial consumers/investors improve their understanding of financial products and concepts and through information, instruction, and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities to make informed choices, to know where to go for help and to take other effective actions to improve their financial well-being".

Financial literacy is the ability to understand matters of financial nature, consisting in the set of skills and knowledge that allows an individual to make informed and effective decisions through their understanding of finances. It is associated with the set of attitudes that are relevant for the financial decision-making, behavior and knowledge. These decisions include when to save, when to spend, managing a budget, choosing the right financial products and willingness to address other events, such as financing children's education and planning for retirement.

The higher the financial literacy, the higher the benefit for people because it helps them making better financial decisions and gives them more control over their money. Consequently, it improves the economy performance. More financially literate contribute to broader economic growth and development (Kefela, 2010). However, (Braspenning, 2012) argue that consumers generally do not have a sufficient level of financial literacy in order to enable them to make informed and rational decisions, concluding that behavioral biases have a distorting influence on consumer decision-making.

According to Consumer and Financial Literacy Taskforce, (2004), the recent evolutions in financial markets, has become increasingly necessary for entrepreneurs and consumers to be more knowledgeable and competent in administering their finances. This is because changes in financial markets have resulted in the availability of a wider selection of financial products and services, making financial decisions multifaceted and more complicated. Easier access to credit facilities, deregulation of financial markets and technological improvements in the way financial services are distributed have undoubtedly left many entrepreneurs with a confusing array of investing opportunities and decisions to be made Financial literacy skills enable individuals to navigate the financial world, make informed decisions about their money and minimize their chances of being misled on financial matters(Beal &Delpachitra, 2003); CBF, 2004b; Raven,(2005).The literature suggests that there is a strong relationship between financial literacy and entrepreneurs' welfare.

Studies indicate that households with less financial knowledge or literacy, tend not to plan for their retirement (Lusardi, A., & Mitchell, O. S., 2007),receive lower asset levels and usually borrow at higher interest rates (Stango, Zinman, 2006). These results have convinced policy makers in both, developed and developing countries to increase efforts in advancing financial literacy. Financial literacy can be measured in diversified approaches, namely; personal savings skills, entrepreneurship skills, book keeping skills and access to banking services skills. Personal saving skills are defined as the strategy of setting aside part of disposable income which is not spent on consumption (Bime&Mbanasor, 2011).

According to (Virani, 2012) saving skills is any action undertaken by an individual resulting to scarifying the current consumption in order to increase the living standard and fulfilling the daily requirements in future. The amount saved by the entrepreneur could be used for investment to earn interest (profit) or be used to purchase assets such as buildings. Personal savings skills help in increasing savings base for an individual especially when the interest rate in banks and other financial institutions is high, hence possible to borrow using the savings as the collateral (anjanapon, 2004).Personal saving skills is an essential yard stick for capital accumulation and formation which further enhance economic growth and development through investing the saved fund.

3.1.2 The concept and nature of SMEs

The small and medium enterprises have a long history which stretches back to over 4000 years ago when the first piece of writing about the small and medium enterprises was done; this writing was about loaning from a bank for small and medium enterprises with terms and conditions. Since then small and medium enterprises have become the backbone of most economies providing products and services to the customers. When Adam Smith published "Wealth of Nations" in 1776, he was describing an economy in which local small and medium enterprises were virtually the only economic entities.

SMEs have been identified the world over as the stepping stones for industrialization. Robust economies like the United States of America and the United Kingdom trace their development from growth and development of their SMEs. Currently, it is estimated that the contribution to the GDP by this sector stands at over 25% (Economic Survey, (2012).

As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potentials in contributing towards economic growth, (SMEs management journal (2010).

SMEs operations cut across almost all sectors of the economy and sustain majority of households in Kenya, (Wanjohi, 2010). This was well recognized by the 14, 2003, national budget. David Mwiraria, the then minister for finance noted that "SME activities form a breeding ground for businesses and employees and provide one of the most prolific sources of employment.

Their operations are more labor intensive than the larger manufacturers." As such, policy provisions would mean boosting not only the operations of these enterprises but the country's economy as well.

Financial Knowledge

Financial knowledge is defined as the understanding of key financial terms and concepts needed to function daily (Huston, 2017).

It was defined by (Potrich, Kelmara, & Wesley, 2016) as a particular kind of capital acquired in life through the ability to manage income, expenditure and savings in a safe way. The Organization of Economic Co-Operation and Development (OECD), added that financial knowledge is an important determinant of whether the individual is financially literate, involving questions related to concepts such as simple and compound interest, risk and return and inflation (OECD INFE, 2011).

It is an important constituent in the making of financial decisions for individuals and businesses. It is a generally held argument that improved financial knowledge is said to result in more responsible financial behavior and hence effective financial decisions (Tang, Baker, & Peter, 2015).

Empirical evidence has shown that a higher level of knowledge is positively related to individuals engaging in a number of “best practice” financial behaviors, such as possessing an adequate emergency fund, monitoring credit reports, avoiding checking account overdrafts, avoiding revolving debt, owning a dedicated retirement account, and having insurance protection.(Robb, The Personal Financial Knowledge Conundrum, 2014).

A common solution to lack of financial knowledge is the prescription of financial education with the general assumption that improved knowledge will result in more effective financial decision-making (Robb, C. A., & Woodyard, A. S, 2011).

Policymakers, the financial service industry and educators have promoted numerous initiatives to combat low levels of financial knowledge through promoting financial education programs (Tang, N., & Peter, P. C., 2015).

Financial education is a process of improving comprehension regarding financial products and associated concepts and risks by individuals in such a way that the individuals can develop the abilities and the confidence necessary to make secure and fundamental decisions to improve their financial wellbeing (OECD, Advancing National Strategies for Financial Education, 2013)It is a preventive measure, as it allows the individual to understand financial problems and manage personal finances in a satisfactory way, thereby avoiding indebtedness (Potrich, A.et al, 2016). It is therefore important for MSE managers to develop these abilities that facilitate correct decisions and to manage their businesses' finances successfully.

2.1.3 Financial Knowledge and Profitability of MSE's

Risk and Return risk and return relationship is important in every financial or non-financial decisions that are made in an organization as it gives an investor or business manager ideas on how much an investment is going to make (returns) and the possibility of losing cash. Return was defined by (Tarasi, Bolton, Hutt, & Walker, 2011)

As the change in worth of an investment which includes capital appreciation plus the cash yield. They defined risk which is also known as uncertainty as the difference between actual the expected returns and actual returns of an investment.

(Eugene, F. B., & Michael, l C. E., 2016b)Defined return as the total gain or loss experienced on an investment over a given period and risk as the variability of returns associated with a given asset. The knowledge of uncertainties or risks associated with an investment is important because it helps to investor or business owner to make certain changes in behavior or activities of the business to prevent uncertainties (Maranjian, 2013).

However, it is commonly stated in finance that the more risk you take, the greater your possible returns (Sullivan, 2012). The more financially informed managers of MSE's are, the more rationally they will be able to asses risk and returns in their decision-making processes such that they are able to understand the effects of riskier projects on the firms net income and being able to evaluate and translate data from finance personnel into decisions that are profitable to their business.

Inflation

According to (Dutta, 2008) inflation arises when money supply is greater than available goods and services. Dutta argued that some businesses are affected by inflation positively considering businessmen raise prices of products when there is a certain level of inflation and in turn it leads to greater profits. The knowledge of inflation is important to MSE managers because it affects financial decisions of the business such as taking debts, opening savings account and bargaining over wage (Burke, M. A., & Manz, M. , 2014).

Empirical evidence by (Burke, M. A., & Manz, M., 2014), showed the relationship between financial literacy and inflation. They found that a measure of financial literacy is associated with heterogeneity in inflation expectations. Small businesses exercise less control over the markets and a rise in inflation and a small increase could affect their capital expenditure and increase their cost of production such that some MSE's may not even survive.

It affects their demand and input costs and rates at which credits are made available to them to mention a few. The knowledge of the effects of the risks of unanticipated changes in purchasing power of cash flows cannot be ignored by MSE managers (Andonov, A., Bardong, F., & Lehnert, T., 2010)

Financial knowledge is a very critical aspect of any decision making regardless of the subject matter, as it is argued to result in a more effective decision (Robb, The Personal Financial Knowledge Conundrum, 2014).

It impacts key outcomes including borrowing, savings, investment and even future plans in terms of retirement income (Lusardi, A., & Mitchell, O., 2014). In 2006, Lusardi and Michell proposed that financial literacy is needed to create a measure of financial competence in terms of participation in financial market and ability to manage financial matters. A few researchers have attempted to show the relationship between financial knowledge and growth in terms of profitability and size of businesses. Lusardi and Mitchell have conducted various surveys on financial literacy and have come up with set of questions that are commonly used to measure financial knowledge. They performed an examination on the impacts of financial literacy on economic decision making in the United States and elsewhere.

From their study, we can conclude that less financial savvy businesses incur high transaction costs and pay higher fee and financial knowledge is an investment in human capital that promotes wealth accumulation (Lusardi, A., & Mitchell, O. , 2014). Another research by (Clark, R., Lusardi, A., & Mitchell, O. S. , 2014) on investment performance and financial knowledge using a unique and new set of data found that financially knowledgeable employees have more volatile and diversified portfolios. They recommended that efforts to enhance financial knowledge should be exerted as it helps people invest more profitably.

(Guliman, 2015)Evaluated financial literacy of MSE owners with focus on financial knowledge and skills and found that most owners of these enterprises have low financial knowledge on taxation, time value of money and investing in securities.

(Lusardi, A., & Bassa, S. C, 2013)Found that lack of financial concepts affects performance level in a business, in their paper on financial literacy and high cost borrowing.

Financial knowledge, despite being important in the financial performance of both individuals and businesses is argued by various researchers to be insufficient in contributing to performance. (Tang et al, 2015)Researched other variables that could contribute to responsible financial behavior and they concluded that responsible financial behavior is not just attained from financial knowledge but also parental influence and self-discipline otherwise known as psychological characteristics.

(Monticone, 2010)Conduct the study on how much wealth matters on acquisition of financial knowledge. The result on the study showed that there is a positive but small relationship between wealth and financial knowledge.

2.1.4 Effects of financial behavior on Profitability of MSE's

Financial Behavior

Research has shown that financial literacy consistently predicts measures of financial behavior of individuals (Hung, A. A., Parker, A. M., & Yoong, J. K., 2017)). Some findings like that of (Potrich et al, 2016) who came up with various models that could be used to measure financial literacy indicated that financial knowledge and financial attitude have positive impacts on financial behavior.

(Sucuahi, 2013) highlighted that, SMEs owners that have a good financial behavior involves the ability to make financial decisions that increase profit and prevent uncertainties of businesses and individuals. These activities generate more financial assets, prevent over-indebtedness, finance retirement, and insure against major life contingencies. Good financial behavior is argued by (Grohmann, A., Menkhoff, L., & Storck, J. , 2015) to be the ability to diversify assets across multiple types of investment as different investment types are affected by its own specific risk profile.

Budgeting and planning a budget is an important aspect of business planning. It is defined as a master financial document that states the expected contribution from the activities of an organization in terms of expected cash or revenues and expenditures over a certain period of time (Heinle, M.S., Ross, N., & Saouma, R. E, 2014).

Organizations prepare budgets for the process of planning to allocate resources that are limited human, physical, and financial resources. Budgets often use historical data to be formulated and as the firm grows, the accuracy of its budget becomes almost perfect because of the many historical data to draw from (Jims, (2014). Although a budget may not be 100 percent accurate budgeting aid to better management of an enterprise and helps to achieve higher profits and minimize losses.

Budgeting is a contributing factor to the success of a business's operations; however, most small business owners focus more on cash flows instead (Sucuahi, Determinants of financial literacy of micro entrepreneurs in davao city, 2013). Sucuahi found that managers of Micro enterprises used budgeting for monitoring performance but they were not able to prepare these budgets on a regular basis. Most scholars argue that financial planning should not be integrated into the equation of financial literacy. Like (David, 2010), who pointed that financial literacy only involves understanding about investing and financial planning rather than the actual planning process. He added that an alternative view of incorporating planning in the financial literacy equation is by looking at it as a long-term financial management decision making process

Debt management

Debt management is the ability to perform activities of a business within a budget. A plan is usually created to help people manage their debts especially those with too much debt, often referred to as debt management plan (Bankrate.com, 2017).

(Sucuahi, 2013)Debt management skill is a necessary financial literacy measure that gives the ability to obtain capital at a minimum cost. Researchers have shown that most Micro and Small entrepreneurs are not financially literate when it comes to the aspect of obtaining finance for their business (Assibey, 2010). However, the findings of Suchuahi suggested that micro entrepreneurs are very much aware of the consequences and penalties that come with poor debt management.

One of the challenges of micro and small entrepreneurs encounter in debt management is the inability to perform accurate calculations and lack the level of numeracy skills especially for the elderly, female and less educated population (Plakalovi N. , 2015). He highlighted in his 2011 publication that the less financially literate are not able to properly estimate their debt burden and they borrow at inflated costs, therefore, they end up with excessive borrowing and many nonperforming loans. Acquiring debt management skills is henceforth very important for MSE mangers for greater performance.

Record keeping

Record keeping also known as book keeping is an important accounting process that involves recording of all business transactions for sustaining and expanding a business. These include the process of collecting, organizing, storing and analyzing the financial information of an entity to facilitate its day to day operations and preparations of statements, tax returns and internal reports.

Enterprises require records to be used by managers as guides for routine action, decision making, and formulation of policies and maintaining relationships with stakeholders (Lusimbo, E. N., & Muturi, W. , 2016).

(Sucuahi, 2013), Keeping a record is an important skill for business owners because it provides vital information for decision-making. He added that it is a measure of financial literacy because; all summaries of daily transactions cannot be recorded in the human memory. Sucuahi's research showed that most small business owners use notebooks to record transactions rather than journals and ledgers.

(Kalekye, P. N., & Memba, F. , 2015), found that most small business owners did not summarize records and they keep records in an informal manner. The findings of (Lusimbo, E. N., &

Muturi, W., 2016) revealed that most MSE managers are not practicing bookkeeping in their business because of lack of appropriate skills and knowledge of preparing record keeping.

Research has shown that most MSE owners recruit unskilled personnel for clerical and accounting management and in turn they are not able to keep reliable accounting records, hence inability to determine profits or loss of the firm (Everlyn, 2016).

2.1.5 Effects of Financial Attitude on Profitability of MSE's

Financial attitude is one of the factors that have significant impact on financial management practice. Attitude was defined by (Eagly, A., & Chaiken, S., 1993) as a "psychological tendency that is expressed by valuating a particular entity with some degree of favor or disfavor". It is a psychological predisposition when it comes to agreeing or disagreeing with certain financial management practices. (Latif et al, 2011), defined that financial attitude as the creation of value in decision making and resource management through application of financial principles. Financial attitude is improved through procurement of adequate information (Abiodun, 2016). Research has shown that financial literacy can be boosted through the attainment of the right financial attitude in terms of risk appetite, training and time orientation to mention a few. Aboidun observed that financial attitude of SMEs managers influence their access to finance and expansion of capital among other business activities. He added that successful people are financially literate such that they had long-term savings and investments that are future oriented.

Risk taking Risk and uncertainty play a role in almost every important economic decision in a business (Dohmen et al, 2011). Understanding individual attitudes towards risk are therefore, intimately linked to the goal of understanding and predicting economic behavior. The financial attitude of business people is related to how they commit resources to projects that are of elevated risk with the expectations of bigger returns. It has been argued that most successful entrepreneurs are risk-takers (Abiodun A. , 2016).

(Thompson & David, 2010), classified risk attitudes into four; pragmatists with a belief that the world is uncertain; conservators who take high risks; maximizes who see the world as self-correcting and managers who are moderately risky. Jing, Alhabeeb, Gong-Soog, & George (2001), did a study that examined the risk-taking behavior among family business owners. They found that risky decisions made by these businesses have significant impact on consumption of the families and other stakeholders of the business. Also, their findings suggested that family business owners are risk tolerant and age, race, net worth and number of employees affect risk-taking attitudes of managers.

Many researchers have tried to find the factors that determine the willingness or ability of individuals to make risky decisions. Like (Dohmen et al., 2011), who's finding suggest that the gender, height and parental background have an economic impact of the willingness to take risk.

Long term versus short term plan

Business owners develop plans to reach their objectives usually by separating them into different timeframes such as; short term planning which looks at the present situation of the company and develop strategies for improving them; and long term planning usually to solve problems permanently (Markgraf B. , n.d.).

Many business casualties are caused by companies being short term oriented, offering excellent short-term earnings growth with little or no growth in the long-term value (Shah, (2010). Financial illiteracy has been a motivation for the creation of financial education programs that aim at increasing financial literacy. This has motivated researchers to estimate the effectiveness of such programs on the financial attitude or behavior of individuals. It is arguable that financial education program has greater effect on long-term financial attitude of individuals rather than short-term. Findings suggest that orientation towards the future promotes financial decision making and performance of individuals and businesses (Elizabeth, H., Jermy, K., & Kemp, E., 2008).

If people prefer to priorities short-term wants over long-term security, they are unlikely to make emergency savings that will serve for their long-term financial plans and growth (Atkinson, A., & Messy, F., 2012). MSE managers should therefore, have positive attitude towards future security as well as present wants rather than focusing just on the short-term.

Financial attitude of business owners is improved through procurement of adequate information (Abiodun A. , Financial literacy and SME firm performance, 2016). Research has shown that financial literacy can be boosted through the attainment of the right financial attitude in terms of risk appetite, training and time orientation to mention a few. Aboidun observed that financial attitude of SMEs managers influences their access to finance and expansion of capital among other business activities. He added that successful people are financially literate such that they had long-term savings and investments that are future oriented.

Economists have become interested in studying financial literacy and the effects of financial attitudes.(Wagner, 2015) highlighted that better financial decisions are made when the decision maker is informed and hence a positive long-term effect in consumption and in profitability for consumers and managers respectively.

Financial attitude of business managers plays significant role in determining performance of the business. It is a combination of concepts, information and emotions about learning, which in turn results in readiness to react favorably and leads to more effective decisions that generate profits for business owners (Potrich, et al, 2016).

2.2Theoretical framework

The study applies the following theories, contingency theory, financial literacy and behavior theory, accounting theory and motivational theory.

Contingency theory

Contingency theory claims that there is no optimum method of systematizing a firm and the organization structure of the company (fielder, 1964). It argues that the most appropriate, structure for an organization is the one that best fits a given operating contingency, such as technology (Woodward 1968, Penon, 1970) or environment (Burns and Stalker, 1961; Lawrence and Lorsch, 1967). (Moorthy, 2012) postulated that contingency theory has been widely used in researches on measuring the performance and effectiveness of an organization. (Cacciolatti and McNeil , 2011) indicated that SMEs that make good use of their structural marketing information presented a higher probability of growth. This concurs with what would (Mahmoud, 2011) established on SME's in Ghana that the higher the level of market orientation the greater the level of performance. This shows that there is a positive relationship between information utilization and the firm performance as noted by (Keh and Nguyen , 2007)

Financial Literacy and Behavior theory

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. Further they 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.

Accounting theory

In terms of its theoretical framework, this study drawn on the Accounting theory and particularly the decision usefulness theory. This theory attempts to describe accounting as a process of providing the relevant information to the relevant decision makers. Since the theory set out a formal procedure whereby an individual can make the best decision given his or her subjective probabilities, it is then relevant in this research where the SMEs managers are expected not only to monitor their business transactions but also to make the most accurate decisions that would bring profit to their enterprises. (Clelland, 1961), explains how entrepreneurs succeed in their business. He contends that successful business operators consider profit to be a measure of success and competency. They set personal but attainable goal for their business and are concern in how well they are doing. In this sense, they are conscious of every transactions accruing from their business and hence they are in a better position to control loss. The decision usefulness accounting theory emphasizes the recording of business transaction for the purpose of effective decision making in business.

Motivational theory

Motivational theory suggests that measures of financial literacy should be related to financial behavior that is in the consumer's best interests, (Hilgert et al, 2003)formed a "Financial Practices Index" based upon (self-benefiting) behavior in cash-flow management, credit management, saving and investment practices. When they compared the results of this index with scores on a financial literacy quiz, they found a positive relation between financial literacy scores and Financial Practices Index scores. Their results suggest that financial knowledge is related to financial practices. Although financial behavior seems to be positively affected by financial literacy, the long-term effects of financial education on financial behavior are less certain; (Bemheim, Garrett and Maki , 2011)found that those who took a financial management course in high school tended in middle age to save a higher proportion of their incomes than others. On the other hand, (Mandell, 2006a) found little positive impact of a well-regarded high school personal finance course on post high school financial behavior from one to five years after taking such a course.

2.3 Empirical studies

There are several empirical studies that were undertaken by different scholars concerning SMEs, both in developed and emerging economies. This are discussed as follows;

(Lusimbo, E. N., & Muturi, W. , 2016), Investigated the relationship between financial literacy and the growth of MSEs in Kenya. Descriptive cross sectional survey design was used. 306 MSEs were selected using stratified random sampling from a population of 1300 MSEs registered in Kakamega Central Sub County as of (2015). A questionnaire was used to collect primary data while document analysis was used for secondary data. Data was analyzed using percentages and frequencies using SPSS. Findings reveal that; although MSE managers had a fair knowledge of debt management literacy majority do not understand the effect of inflation and interest rates on loans they borrow and were not comparing terms and conditions before purchasing financial products, most managers have low book keeping literacy. Managers with low financial literacy have recorded minimal or no growth.

(Mabhanda, 2016), explored the impact of financial illiteracy to SMEs in spite of various interventions to promote growth of SMEs. All the participants of this study were purposefully selected in line with qualitative research approach used in data analysis. The researcher employed a qualitative research approach where document analysis, focus group discussions, open-ended questionnaires and face to face interviews were used. The study revealed that several factors that include lack of financial education contributed further to poor management skills, poor budgeting skills, lack of business information, poor decision making and lack of non-business behavior. The study revealed a considerable low level of financial literacy among entrepreneurs and this has far reaching consequences to the management of their ventures. Such factors worsened the state of SMEs in Zimbabwe. The study therefore recommends that the government, stakeholders, banks, financial support institutions and individuals conduct financial literacy programmer to revive and strengthen the viability of SMEs.

Bowen *et al*. (2009) observed that over 50% of SMEs continue to have a deteriorating performance with 3 in every 5 SMEs failing within months of establishment. Only 2.5% respondents saying their businesses were very successful. They established 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 of the need for SMEs owners to get trained in an area that is relevant to the business carried.

(Mazzarol Reboud and Clark, 2015), examined the financial management practices in small to medium enterprises (SMEs) from a study of 289 small business owner managers across 30 industry sectors in Australia and Singapore. The data was collected using a case study survey by MBA students and analyzed via three stages: first was the examination of the quantitative survey data; second was the NVivo analysis of the interview data; and thirdly was the Leximancer analysis of the selected coded transcripts. The findings show that SMEs have largely informal and ad hoc financial management practices. Differences by size and financial literacy levels were found. As the firm grows in size and complexity the owner-manager is required to adopt more sophisticated and systematic approaches to financial management. SMEs with higher financial literacy have greater capacity to monitor and control the financial performance of their businesses.

Challenges for SMEs negotiating with more powerful players were also identified and approaches to address this issue briefly discussed. (Ngek, 2016), Sought to find out the impact of financial literacy on firm performance, as well as to examine the moderating effect of financial capital availability on the financial literacy – performance relationship, amongst SME in the Free State province of South Africa. The results showed that on average SME have low levels of financial literacy and financial capital availability. It was also observed that financial literacy positively influenced SME performance, and that the relationship is positively moderated by financial capital availability. It is, therefore, necessary for SME owners to develop financial literacy skills as an essential part of entrepreneurial activities. Likewise, since businesses rely on financial capital to invest, develop and grow, policy makers should put in place measures on how to bridge the access to finance gap, and, thus, ensure that entrepreneurs are relieved from financing constraints.

(Osindeet, 2013), observed that 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.(Longeneckeret et al, 1994), observed that personal savings and contribution of business partners constitutes an important source of funds, particularly in the formative stages of a firm. Significant financial commitments made by owners of a company tend to build a lot of confidence among potential investors.

(Kuriloffet al, 1993), these include borrowing using one's personal assets such as house and bonds as collateral. Loans and contributions from friends and relatives are common source of funds, especially for new business since the financial institutions are reluctant to providing funding for start-up business because of the risk involve. This source of funds, however, comes with one serious challenge whereby many friends and relatives find it very difficult to stay as creditors or investors without having to interfere with the business operations. They usually try to interfere with policy and operational issues of the business (Kuriloffet al, 1993).

As a remedy to this problem, (Kuriloffet al, 1993)Recommended the treatment of such loans like bank loans by putting in writing all the terms including interest rates and payment schedule. 20 Solomon & Winslow, (1988) indicated that business management training transforms one into an innovative person who creates something unique with value by devoting time and effort, assuming the financial, psychological and social risks in an action oriented perspective and receiving the resulting rewards [and punishments] of monetary and personal satisfaction" (Carland, et al, 1984)suggest the business management skills are critical factors in business as it gives entrepreneurial owners innovation, with entrepreneurial types showing more innovative combination of resources to achieve a profit and stability.

Katz & Green, (2006), postulates that businesses entrepreneurship skills are important for owners who are interested in control, financial independence and autonomy. Basic entrepreneurship skills augmented with networking and resource management are foremost in the minds of the business owner-manager. The high growth venture entrepreneurs are fascinated by the birth and growth of their ideas. They want to create wealth, are highly innovative and creative and seek to form, where feasible, strategic alliances. This is well facilitated by quality entrepreneurship skills.

Bruhn and Zia (2011) in their study on the impact of business and financial literacy for young SMEs 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.

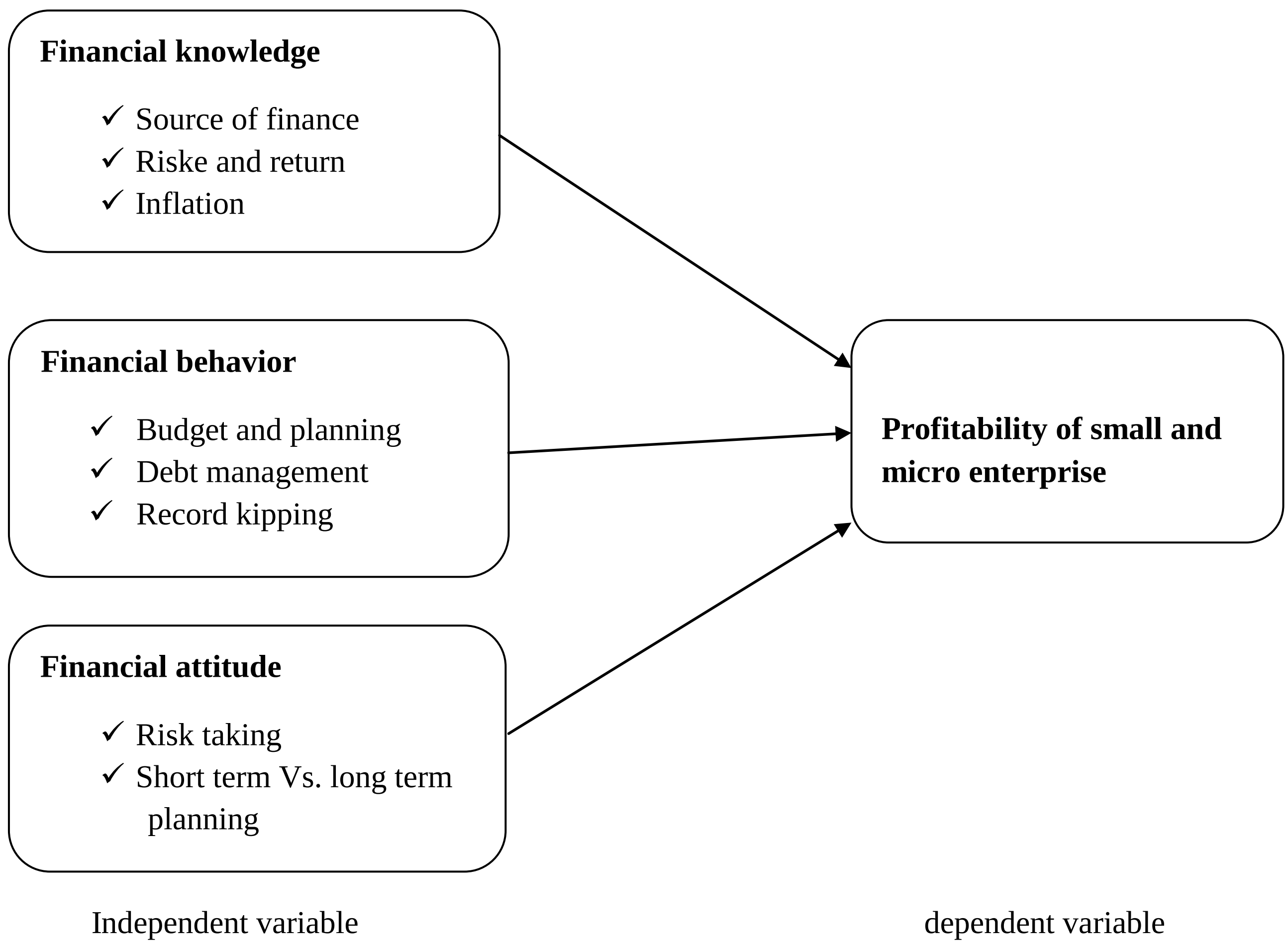
(Barte, 2012), on a study on financial literacy in SMEs, also found out that financial literacy was directly linked to performance. The study was conducted using descriptive research survey design. Data was analyzed using descriptive statics and simple regression analysis. The study found out that Entrepreneurs had low levels of financial literacy as demonstrated lack of financial records, lack of monitoring of profit and losses and lack of cash management practices. The vendors were also confined to high interest loan. The study however did not show the exact influence of financial literacy on these SMEs. Asquith *et al*, (2004) found that small and medium term enterprises (SMEs) comprise the largest proportion of businesses in most economies and frequently offer the greatest potential for job creation The government of Kenya has placed a lot of emphasis on the development of SMEs as a means of encouraging self-employment, poverty reduction and accelerating economic growth. This has seen SMEs contribute over 50% of the employment opportunities in Kenya and over 40% of the GDP. Despite their significance, recent studies show that 60% of the SMEs fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). It is hard for the SMEs to access finances from the financial institutions since they lack proper financial records as a requirement (William *et al* 2003).

(Dawuda, 2015) in his study an assessment of financial records keeping behavior of small scale businesses in Ghana found out that lack of education and high cost of hiring qualified staff made it very difficult for the owners to keep proper books of accounts. Some SMEs owners are ignorant of the value of keeping proper financial records and have perception that it is waste of time and resources to create finance and accounting department with qualified staff considering the scale of their operations. This may be true for businesses which are not generating much revenue. It could be argued from this evidence that, the volume and value of transactions can influence records keeping behavior of SMEs owners.

2.4Conceptual Framework

Various theories such as prospect, transaction, exchange related to financial literacy were developed by different authors. In addition, empirical studies were made to observe the effect of financial literacy on the financial profitability of SMEs. Based on theoretical and empirical studies the following diagrammatic framework is developed that shows the relationship between financial literacy variables and financial profitability

Conceptual Framework



Source: Reviewed literature

Conceptual framework is a diagrammatic representation of variable interrelations.

Financial literacy comprises of financial attitude, financial behavior, and financial knowledge and personal saving skills. These have been conceptualized as the independent variables in the diagram above. The study seeks to investigate the influence or effect of changes in these variables on the dependent variable which is financial profitability attempts to indicate the total influence arising from the influence of the independent variables

CHAPT THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter provides the detailed research methodology that will be applied in the study. It will address the research design, population and sampling design that will be used in this study. The chapter further discusses the data collection methods, research procedures and data analysis methods that were implemented

3.2 Design of the study

A research design as described by (Kothari, 2004), is the arrangement of conditions for collection and analysis of data in a manner that aims to give bearing and relevance to the research purpose with economy in procedure. It is a plan that provides the overall framework for the collection of data for a study. (Mafuwane, 2012) defined research design as a strategic framework for action that serves as a bridge between research questions and the execution, or implementation of the research strategy. The suitable research design for a study is one that minimizes bias, maximizes the reliability of data to be collected and in line with the purpose of the study.

The research design used in this study is descriptive and survey that is unrestricted. Descriptive type of research design is an attempt to explore and explain a topic in the dark while creating a fuller picture of the topic as defined by (Devin, 2015). That is, it seeks to answer questions such as who, what, where and how to any provided topic. The descriptive research design is select for this study becau.se it allows for obtaining numerical and structured description of the population and gives clear understanding of financial literacy and how it affects the profitability of MSEs in Jimma town. Also survey research design was used in this study to infer the characteristic of population in to the sample and to analyze the effects of variables within each other.

3.3 Research approach

The research problem tends to be descriptive which seeks to describe the relationship between financial literacy and profitability. Therefore, quantitative research approach is applied for this study to achieve the objectives of the study and to answer the research question used in this study because it was contain a quantitative component to examine effect of financial literacy on profitability of micro and small enterprise. The quantitative component was derived from the survey data collected from micro and small enterprise operator in Jimma town.

3.4 Target Populations

(Mugenda, 2003), define a study population as consisting of the total collections of elements about which the study wants to make some inferences. The target population of this study was all owners of SMEs in Jimma town.

3.5 Sample Frame

The sampling frame is the ordered list of individuals in a population Burt, Barber &Rigby, (2009). Mugenda, (2003), define a study population as consisting of the total collections of elements about which the study wants to make some inferences. The sampling frame used for this study was all registered micro and small enterprise operator's in SMEs development office of Jimma town and the total registered SMEs member are 22638.

3.6 Sampling technique and sample size

3.6.1. Sampling Technique

Sampling technique is a statistical method of selecting the sampling unit that would be representative of the population in study. It can be classified into probability and non-probability sampling (Krishnaswami&Satyaprasad, 2011).

In this study, probability sampling method was used by applying specifically stratified sampling techniques to achieve the objective of the study. The stratified sampling technique was used because of different sector were grouped under one small and micro enterprises in Jimma town. This indicates that the population is similar across and different within.

After grouping the respondents in to seven strata such as constriction, service, trade, agriculture, minerals and mining, livestock and manufacturing, random sampling techniques were used to select the individual respondents from each strata,

3.6.2. Sample size determination

Sample size is the actual number of respondents that would be representative of the population under research, and should bear some proportional relationship to the size of the population from which it is drawn (Cooper & Schindler, 2014). So the target population of this study was all sectors grouped under SMEs of Jimma town. According to SMEs development office of Jimma town the total registered SMEs member are 22638 under 7 different sectors in 2020.

According to Barttlet, (2001) to determine the sample size the following formula will be used when the population is greater than 10,000

$$n = \frac{z^2pq}{d^2}$$

Were n = the desired sample size when the population more than 10.000

z^2= standard normal deviate usually set at 1.96 (@95% confidence level)

p = the proportion of target population usually 50%

q = 1-p

d^2 = a absolute precision /accuracy normally set at 0.05

$$n = \frac{z^2pq}{d^2}$$

$$n = \frac{(1.96)^2(0.5)\,(0.05)}{(0.05)^2}$$

$$n = \frac{(3.8416)\,(0.25)}{0.0025}$$

$$n = \frac{0.9604}{0.0025}$$

n = <u>384</u>

From all sector (strata) the sample were selected proportionally as follow:-

Sector	Population	Calculated proportion	Sample
Constriction	2782	$\frac{2782 \times 384}{22638}$	**47**
Service	4436	$\frac{4436 \times 384}{22638}$	**75**
Trade	6739	$\frac{6739 \times 384}{22638}$	**114**
Agriculture	2820	$\frac{2820 \times 384}{22638}$	**48**
Mineral and mining	512	$\frac{512 \times 384}{22638}$	**9**
		$\frac{1013 \times 384}{22638}$	**18**
Manufacturing	4336	$\frac{4336 \times 384}{22638}$	**73**

Total	22638	384

Sources: - SME development of Jimma town.

Total sample size of SMEs owners will be =47+75+114+48+9+18+73

= 384

NB: 22638 is total population and 384 is total SMEs Owners sample size

3.7 Source of data

: -in this study both primary and secondary data has been used to achieve the objective of the study.

3.7.1Primary sources:

The primary sources of data were collected from the owners of the SMEs enterprises by using structured questionnaires prepared in the form of closed-ended.

3. 7 .2 Secondary sources of data:

The secondary sources of data in its side focus on the data get from written documents, files and compiled kinds of resources of the organization. So in this study different articles were used as a source of information on SMEs background in different countries.

3.8 Data collection tools

The method of data collection tools used in this study was:-

Questionnaire: questionnaire is the instrument that is used to collect the desired data from the respondents. The questionnaires that the researchers used in this study contain close ended kinds of the questions were distributed to the respondents of this study.

3.9Data collection procedure

In this study first the sectors are listed in to seven sectors such as construction service, trade, agriculture, minerals and mining, livestock and manufacturing .Then after questionnaires were distributed to the respondents by using random sampling method. The data was collected during working hours over four weeks.

3.10 Method of data analysis and interpretation

Cooper and Schindler (2014), defined data preparation or analysis as the processes that ensure the accuracy of data and their conversion from raw form into classified forms appropriate for analysis. After data collection, data analysis is carried out by completing the steps of questionnaire checking, editing, coding, transcribing, data cleaning, adjusting the data and selecting a data analysis strategy to gather sense or meaning from the data collected and the final information can be tabulated in the form of table. The data that were collected in this study was analyzed by using quantitative methods of analysis because of the nature of the data. The quantitative data will be analyzed by using descriptive statistics to provide description of the population through numerical calculation or graphs or tables and to make inference and prediction about population that will be based on sample of data taken from the population in question. Data analysis was done with the aid of the SPSS software version 24 to perform regression analysis on the collected data.

The regression model is shown below and thereafter the definition and measurement of the variables. The multiple linear regression models were used to determine the relative importance (sensitivity) of each independent variable in affecting the profitability of SMEs.

$Y = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \mathcal{E}$

Where; Y–profitability of the SMEs as measured by returns on asset, Net sale and net profit

FK–financial knowledge

FB–financial behavior

FA–financial attitude

$\beta 0$– Constant Value

$\beta 1$- Coefficient of financial knowledge, indicating that change in profitability of SMEs due to 1 unit increase in Personal saving skills.

$\beta 2$- Coefficient financial behavior, indicating that change in profitability due to 1 unit increase in financial behavior.

$\beta 3$- Coefficient of financial attitude, indicating that change in profitability due to 1 unit increase in financial attitude

Ɛ –The error or disturbance term

3.11Ethical Consideration

The purpose of the study was to explain the participants and the study would ask their consent to answer questions in the questionnaires. The study also informed the participants that the information they provided was only be used for the study purpose. Accordingly, the study would be used the information from his participants only for the study purpose. To ensure the safety, social and psychological well-being of respondents and others participant;

- The researcher was got an introduction letter from the Jimma University of Post Graduate Studies that introduces him to Jimma Town out his study.
- The researcher would have got permission from the SMEs development Office of Jimma town to carry out the study.
- The researcher seeks consent of the respondents.
- The researcher ensures that the information would be given was treated with confidentiality. The researcher also quotes all the authors used in the study.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter presents the findings obtained from the data analysis done. The chapter further gives findings based on the research objectives. The first part of the chapter covers the response rate of the study. The second part covers demographic and general information on the respondents. The third part presented results on financial knowledge questions. The fourth and fifth part presents findings on the financial behavior and financial attitude of respondents respectively a. A descriptive of the dependent variable was provided in the chapter. Also, the results of the regression analysis were presented.

4.2Response Rate

The study targeted a sample size of 384 respondents from which 282 filled in and returned the questionnaires making a response rate of 73.43 percent. This response rate was satisfactory to make conclusions for the study. The response rate was representative. According to Mugenda, (1999), a response rate of 50 percent is adequate for analysis and reporting; a rate of 73 percent is good and the response rate was considered to be good to make conclusion for the study.

4.3. Background of respondent

4.3.1 Age Category

Different age groups are perceived to hold different opinion on various issues, to ensure that study collected wide range of opinions from different age groups; respondents were requested to indicate their age category. Results are as shown in. table 4.1 below:-

Table 4.1 age of respondent

respondent age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	less than 18	5	1.8	1.8	1.8
	18-30	140	49.6	49.6	51.4
	30-48	122	43.3	43.3	94.7
	greater than 48	15	5.3	5.3	100.0
	Total	282	100.0	100.0	

Source;- survey result , 2020

Age category From the findings, most of the respondents as shown by 49.6% were aged between 18 and 30 years, 43.3% of the respondents were aged between 30 to 48 years, 5.3% of the respondents were aged Above 48 years, and 1.8% of the respondents were Below 18 years. These findings indicate that the majority of the respondents were at the age of youth.

4.3.2 Gender Category

The study sought to establish the gender category of the respondents. This was done in view of ensuring fair engagement of respondents in terms of their gender. Results are show in table 4.2

Table 2.2 Sex of respondent

respondent gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	185	65.6	65.6	65.6
	Female	97	34.4	34.4	100.0
	Total	282	100.0	100.0	

Source;- survey result, 2020

From the research results, the study noted that majority of the respondents as shown by 65.6% were males whereas 34.4% females. This shows SMEs industry was highly dominated by male gender in the study area.

4.3.3 Level of Education Attained

Individual level of education determines the personal uptake/understandability of different issues. Respondents' were requested to indicate their educational qualifications. Results are show in table 4.3

Table 4.3: Level of education attained

respondent qualification

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Secondary education and below	115	40.8	40.8	40.8
	College diploma	25	8.9	8.9	49.6
	Degree	107	37.9	37.9	87.6
	Masters and above	35	12.4	12.4	100.0
	Total	282	100.0	100.0	

Source own survey, 2020

The result of the study show that most of the respondents attained secondary level of education (40.8%) followed by degree (37.9%), masters and above (12.4%) and collage diploma (8.9%). This implies that most of the SME owners have low level of education statues.

4.4 Operational characteristics of a business

4.4. 1Age of Business

The study was also set to establish the ages of business run by the respondents and the findings revealed that most of the businesses were between 2 -5 and accounted for 42.9% of the total response rate. Those of 6-10 accounted for 32.6%, and those below 2 were 24.5%as shown in table 4.4.This implies that most of the respondents' business ages were between 2-5 years of existence.

Table 4.4 businesses age

business age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	less than 2 years	69	24.5	24.5	24.5
	2-5 years	121	42.9	42.9	67.4
	6-10 years	92	32.6	32.6	100.0
	Total	282	100.0	100.0	

Source own survey, 2020

4.4.2Position in Business

Regarding positions held, owners were the majority accounting for(57.1%) of the total followed by those who filled in for managers for 25.9%, chief accountant (7.1%), finance manager (6.4%) and others (3.5%) as shown in table 4.5.

Table 4.5 respondent position

respondent position on business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Owners	161	57.1	57.1	57.1
	Managers	73	25.9	25.9	83.0
	chief accountant	20	7.1	7.1	90.1
	finance manager	18	6.4	6.4	96.5
	Others	10	3.5	3.5	100.0
	Total	282	100.0	100.0	

Source own survey, 2020

4.4.3. Respondent Sources of capital for starting a business

Respondents were asked to identify the possible sources of capital for starting their business and the results show that a majority of the participants were use Micro finance institution to start their business(36.5%), followed by retained earnings (30.9%), From family and friend (24.1%), from bank(8.5%). This indicates that most of the respondents use micro finance institution to start their business. The results were indicated in the table 4.6 below:-

Table 4.6 respondent source of finance

respondent possible source of finance

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	retained earning	87	30.9	30.9	30.9
	loan from bank	24	8.5	8.5	39.4
	microfinance institution	103	36.5	36.5	75.9
	loan from family and friends	68	24.1	24.1	100.0
	Total	282	100.0	100.0	

Source own survey, 2020

4.5 Effects of financial knowledge on profitability of MSE's

The second objective of this study sought to establish the effects of financial knowledge on profitability of SME's. To measure the financial knowledge correct answer of the respondent, the researcher was assigned a one point to each correctly answered for all four financial knowledge questions and a zero point for each incorrectly answered for all four financial knowledge questions.

4.5.1 Descriptive of Variables of Financial knowledge

In this study, the respondents were asked to identify the financial option which gives the highest returns for them. The financial option that were given for the respondents as alternatives were: Account Boned, Stock, Treasury bill and saving in bank. The result indicates that (54.6%) of the respondents answered incorrectly and (45.4 %) of the respondents were answered the correct answer by choosing stock. Which indicate that most of MSEs have low knowledge on choosing the best source of finance for high rate of return. The respondents were also asked whether risk could be reduced through investing in wide range of assets or not, Majority accounting for(71.6%)got the answer right said it was true while (28.4) did not agree, and The researcher also sought to establish if the respondents were aware if the fact that there is a diminishing return as level of risk exceed a certain level and The findings revealed that (50.7%) were aware of the diminishing return as level of risk exceeds a certain level by answering the question correctly (49.3%)were not aware about the diminishing return as level of risk exceeds a certain level. This indicates that most of the respondent has more knowledge about risk and diversification. In addition to this the researcher also sought to establish if the respondents were aware that high inflation means that the cost of living is increasing rapidly. The findings revealed that(69.9%) were aware while 30.1% got the answer wrong as shown in table 4.7 below:-

Table 4.7 Descriptive Statistics of financial knowledge

Rate of Return for sources of finance			**Frequency**	**Percent**
A long time period (e.g. 10 years) which asset described below gives the highest rate of return?	Valid	Incorrect	154	54.6
		Correct	128	45.6
		Total	282	100.0
Risk Reduction and diversification	Valid	Incorrect	80	28.4
An investment with a high return is likely to be elevated risk.		Correct	202	71.6
		Total	282	100.0
There is diminishing return as level of risk exceeds a certain level.	Valid	Incorrect	139	49.3
		Correct	143	50.7
		Total	282	100.0
Inflation	Valid	Incorrect	85	30.1
High inflation means that the cost of living is increasing rapidly.		Correct	197	69.9
		Total	282	100.0

Source own survey, 2020

4.6Effects of financial behavior on profitability of MSE's

The third objective of this study sought to establish the effects of financial behavior on profitability of MSE's. The respondents were asked questions on budgeting and planning, Debt Management and Record keeping, with which they were to respond to base on a five point Likert scale where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree, 5= strongly agree. The questions were structured based on behavior regarding budgeting and planning, debt management and record keeping.

4.6.1 Descriptive Variables of Financial behavior

In Budgeting and Planning the findings revealed that most of the respondents have lower budgeting and planning habit. From the results most of the respondents does not prepare a written financial objectives to achieve in the business, following weekly or monthly plan for expenses and preparation of budgets to help in monitor performance. Similarly the respondents are uncertain whether their long-term financial influences management of their expenses. The results were shown in table 4.8below. This shows that, most of MSE's do not have an effective budgeting and planning mechanism and therefore there is a need to educate them on the benefits they can accrue from budgeting and planning. In debt management, the findings revealed that most of the respondents were disagreed about debt management skills enabled them to access various sources of finance for their business, knowing the effect of inflation and interest rates on the loans borrowed and accessing finance at a minimum cost. The respondents were uncertain on determining the total debt position of their business as mean value is 3.60 with standard deviation of 1.427. The results were shown in the table 4.8below:-The implication is that there is a need to educate the MSE's on the debt management and its benefits and in Record Keeping, The findings revealed that most of the respondents were disagreed in preparing financial statements of their businesses (income statement, balance sheet) and in performing financial Analysis on the business financial statements with the mean value of (3.22) and 3.08 respectively. Also the respondents has no enough knowledge for maintaining their balance ledger account and they do not use their financial statements information to make a decision with a mean value of 2.48 and 2.26 respectively. The results were indicated in the table 4.8 below:-

Table 4.8 Descriptive Statistics of financial behavior

Descriptive Statistics on budgeting and planning	N	Mean	SD
I prepare written financial objectives of what I want to achieve for my business	282	2.62	1.319
My long-term financial targets influence managing of my expenses	282	3.10	1.165
I follow a weekly or monthly plan for expenses	282	2.29	1.106
I prepare budgets to help me monitor my performance	282	2.29	.875
Valid N (list wise)	282		
Descriptive of Variables of Debt Management			
My debt management skills have enabled me to access various sources of finance for my business	282	2.83	1.221
I know the effect of inflation and interest rates on the loans I borrow for my business	282	2.94	1.301
I can determine accurately the total debt position of my business	282	3.60	1.427
I can access finance at a minimum cost	282	2.63	1.050
Valid N (list wise)	282		
Descriptive Statistics of record keeping			
I prepare financial statements for my business (income statement, balance sheet)	282	3.22	1.151
I can perform financial Analysis , business financial statements (gross profit margin, net profit margin, current ratio)	282	3.08	1.171
I have adequate knowledge on how to maintain and balance ledger accounts	282	2.48	1.030
My decisions are guided by information from my financial statements	282	2.26	.904
Valid N (list wise)	282		

Source own survey, 2020

4.7Effects of Financial Attitude on Profitability of MSE's

The fourth objective of this study sought to establish the effects of financial attitude on profitability of MSE's. The respondents were asked questions which they were to respond based on a five point Likert scale where 1= strongly disagree, 2= disagree, 3= neutral, 4= agree, 5= strongly agree. The questions were structured based on financial attitude.

4.7.1 Descriptive Variables of Financial Attitude

From the result, the respondents agreed controlling monthly expenses was important with the mean value of (4.00) and uncertain about importance of establishing financial targets for the future (3.52), the way managing money today affect my future (3.41), My parents have influenced my Money management skills (3.33) and about Preventing risk ensures security of their business with the mean value of (3.58). Many of the respondents also disagreed that making risky decisions will add value to their return (2.10), all their short-term decisions are influenced by their long-term financial goals(2.79), social environment has contributed so much to their financial skills (2.93) and have participating in training programs for financial skills with the mean value of (2.16) in addition to this the respondent also strongly disagreed about having knowledge for cost/benefits trade off from training programs with the mean value of(1.75), as shown in the table 4.9 below:-

Table 4.9 Descriptive Statistics of financial attitude

	N	Mean	SD
It is important to control monthly expenses	282	4.00	1.152
It is important to establish financial targets for the future	282	3.52	1.006
The way I manage my money today will affect my future	282	3.41	1.229
Making risky decisions will add value to my returns	282	2.10	1.507
Preventing risk ensures security of my business	282	3.58	1.382
All my short-term decisions are influenced by my long-term financial goals	282	2.79	.934
My social environment has contributed so much to my financial skills	282	2.93	1.086
My parents have influenced my Money management skills	282	3.33	1.293
I have participated in training programs for financial skills	282	2.16	.947
I have learnt cost/benefits trade off from training programs	282	1.75	.806
Valid N (list wise)	282		

Source own survey, 2020

4.8Descriptive variables of Profitability

The term profit is a measure of receipts less cost and the term ability indicates the power of a business entity to earn profits. In this study to measure the profitability of MSEs the researcher used total assets, total annual sale and total annual profit of their business. The respondents were asked questions which they were to respond to base on a five point Likert scale where 1= Very Low(less than 50,000), 2= Low (50,000-100,000), 3= Moderate (100,000-500,000), 4= High, (500,000-1000, 000), 5= Very High (1000, 000-1.5mill)

From the result of profitability of micro and small enterprise in Jimma town, the findings revealed that most of the respondent's total assets are categorized under the low level with the mean value of (2.07), their business annual sales (2.04) and their business net profit with the mean value of (2.41). This indicate that the SMEs total asset, annual sale and annual net profit is fall in between 50,000-100,000br as shown in table 4.10

Table4.10 Descriptive Statistics of profitability

	N	Minimum	Maximum	Mean	Std. Deviation
What is your business total asset?	282	1	4	2.07	.644
What is your business annual sale?	282	1	4	2.04	.559
What is your businesses annual net profit?	282	1	4	2.41	.561
Valid N (listwise)	282				

Source own survey, 2020

4.9Descriptive Statistics of Financial Literacy

The purpose of the current study was to empirically examine the relationships between financial literacy and profitability of MSE in case of Jimma town. Financial literacy in the current study was coined to incorporate three domains: basic Financial Knowledge, Financial Attitude and Financial Behavior. The financial literacy level of the respondents was measured using 27 survey questions. By combining positive responses to each survey question scores were constructed for each domain and for overall level of financial literacy.

Table 4.11 descriptive statistics of financial literacy

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
AFB score	282	1.58	4.08	2.7775	.66355
AFK score	282	.80	2.80	1.6482	.42912
AFA score	282	1.90	4.20	3.0167	.53060
AFL score	282	4.68	10.00	7.4424	1.09066
Valid N (listwise)	282				

Source own survey, 2020

The study has measured financial literacy level of the respondents under four dimensions, viz. financial knowledge, financial attitude, financial behavior and personal saving skills. The descriptive statistics summarized on table show the average score of respondents which were computed based on answers to questions designed to measure financial literacy with respect to each domains of financial literacy.

The first domain of financial literacy in the study is financial knowledge. The financial knowledge was measured using four objective questions and the aggregate financial score was constructed by aggregating a one point assigned to each correctly answered question. The descriptive statistics presented in table above indicated that about four questions (M =1.6, SD0.42) this shows that the respondents scored 34 % of the maximum financial knowledge score.

The second domain of financial literacy is financial behavior. The financial behavior was measured using 12 objective questions and the aggregate financial behavior scores were constructed from a set of five point Liker scale questions. The descriptive statistics presented in table above indicated that about 12 questions (M 2.77 =, SD0.66) this shows that the respondents scored 23.33 % of the maximum financial knowledge score.

The third domain of financial literacy is financial attitude. The financial attitude was measured using 10 objective questions and the aggregate financial attitude scores were constructed from a set of five point Liker scale questions. The descriptive statistics presented in table above indicated that about 10 questions (M 3.01=, SD0.530) this shows that the respondents scored (30.1 %) of the maximum financial knowledge score.

The overall financial literacy score of each respondent was constructed by aggregating the scores obtained in individual financial literacy domains. The result indicated that the mean score of the sample amounts about 30 percent of the maximum possible overall financial literacy score of 27 points.

4.10 Correlation Analysis

A correlation analysis was performed to determine if there were any relationships between financial literacy and profitability. There are standards for evaluating the magnitude of a correlation/strength of relationship between variables. According to, (Somekha and Lewin, 2005): if correlation coefficient result is between 0.01 -0.29, it implies weak relationship, when it is between 0.30-0.49; it implies medium relationship and if it is between 0.50-1.0, implies strong relationship. The result of correlation coefficient of this study for financial knowledge r=0.064, for financial attitude r=0.330 for financial behavior r= 0.433. This result shows that financial knowledge exhibited week relationship with profitability and financial attitude and financial behavior have a medium relationship with profitability.

Table4.12 Correlations

		Profitability	FA	FB	FK
Profitability	Pearson Correlation	1			
FA	Pearson Correlation	.330**	1		
FB	Pearson Correlation	.433**	.570**	1	
FK	Pearson Correlation	.064	-.208**	-.041	1

**. Correlation is significant at the 0.01 level (2-tailed).

Independent variables: Financial knowledge, financial attitude, Financial Behaviors

Dependent variable: Profitability

Source; Own survey, 2020

Before applying the multiple liner regression analysis to test the effect of financial literacy on the profitability of micro and small enterprise, some tests were conducted in order to ensure the appropriateness of data analysis as follows;

4.11Test for assumption used in the regression

Normality Test-

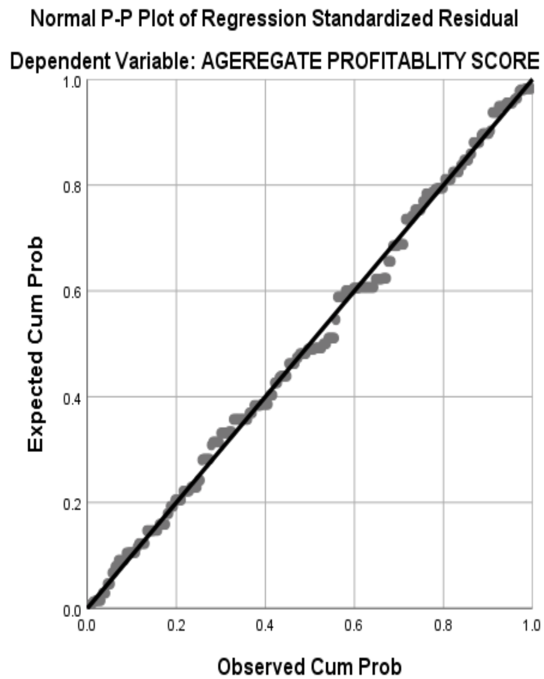
To test normality of the distribution, the residual value should be computed firs and the test should be conducted on the residual values. To perform normality test of the distribution, it is customary to use Shapiro –Wilk W and the significance value should have to be greater than 0.05. In this study the value of Shapiro- Wilk were greater than 0.05 which fulfills the assumption of normality. The results were shown in the table below:-

	Shapiro-Wilk			
	Statistic	Statistic	Df	Sig.
profitability of SMEs owners	.192	.906	282	.059

Linearity test:

Linearity refers to the degree to which the change in the independent variable in related to the change in the dependent variable. To determine whether the relationship between the independent variable and dependent variable is liner; plot of regression result trough SPSS software was used. In case of linearity, the residual should have a straight line with predicted dependent variable score and based on this study since the change in the independent variable is more related to the change in dependent variables. Therefore, there is no linearity problem on the data for this study and residuals follow at a straight line. This test result is depicted in the following figure.

Figure 1 test of linearity



Source; own survey, 2020

Hetroskedasticity test:

This is a very important assumption in parametric process as the ability of variance is of important implication in estimating the value essential for the study purpose. This study full fill linearity and normality issue there is no problem of Hetroskedasticity.

Multicollinearity test;

It can be checked by correlation matrix and Variance Inflation Factors (VIF). A correlation matrix is used to ensure the correlation among independent variables. On the other hand, Variance Inflation Factors (VIF) of the linear regression indicates the degree that the variance in regression estimates is increased due to multicollinearity.

As Hair, (2016) argued that correlation coefficient below 0.90 may not cause serious multicollinearity problem. In this study, the correlation coefficient (r) among the independent variable in table 4.26 is less than the stated value so there is no problem of multicollinearity. In addition to the above rule, the Tolerance and VIF of variables were used to test multicollinearity of the independent variables as indicated in the table 4.13 below:-

Table 4.13 coefficients for collinearity

Coefficients[a]

Model		Collinearity Statistics	
		Tolerance	VIF
1	Aggregate financial attitude	.640	1.561
	Aggregate financial behavior	.668	1.496
	Aggregate financial knowledge	.948	1.055

a. Dependent Variable: Profitability of SMEs owners/managers

Source: Own Survey, 2020

The Variance Inflation Factors (VIF) of the linear regression indicates the degree that the variances in the regression estimate are increased due to multicollinearity and VIF value higher than 10.0 shows as there is multicollinearity problem. As stated by(Pallant, 2007), tolerance is a statistical tool which indicates the variability of the specified independent variable from other independent variable in model and it has no multicollinearity problem if the tolerance is greater than 0.10 values. The result tolerance in table 4.13 suggests that multicollinearity is not suspected amongst the independent variables because the value of Variance Inflation Factors (VIF) is below 0.10 while the tolerance value is above 0.10 values.

From an examination of the information presented in the entire test, it can be concluded that there is no significant data problem that would lead to say the assumptions of multiple regression have been violated. Therefore conducting regression is sound worthy.

4.12Regression Analysis

Once the assumptions are checked, regression analyses were run to find the casual association between the independent variable and the dependent variable. Regression analysis is the statistical technique that identifies the relationship between two or more quantitative variables: a dependent variable, whose value is to be predicted, and an independent or explanatory variable (or variables), about which knowledge is available. The technique is used to find the equation that represents the relationship between the variables. Multiple regressions provide an equation that predicts one variable from two or more independent variables. Regression analysis is used to understand the statistical dependence of one variable on other variables. The technique can show what proportion of variance between variables is due to the dependent variable, and what proportion is due to the independent variables. The relation between the variables can be illustrated graphically, or more usually using an equation. The study adopted simple regression to determine the relationship between dependent variable (Profitability) against Financial Knowledge, Financial Behavior and Financial Attitude the Adjusted R Squared was 0.437 therefore 43.7% of the variations in Profitability is caused by the variations in Financial Knowledge, Financial Behavior and Financial Attitude as shown in table 4.14:-

Table 4.14 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.665[a]	.443	.437	.37546

a. Predictors: (Constant), Aggregate financial attitude score, aggregate financial knowledge score, aggregate financial behavior score

Source; own survey, 2020

The analyses of variance (ANOVA) and F- statistics, which reveals the value of F =73.599 is significant at p=0.000 level of significance. The value of F is large enough to conclude that the set of independent variable as a whole are contributing to the variance of profitability and this result indicate the relationship was highly significant in predicting how financial knowledge, financial behavior and financial attitude explain profitability as shown in table 4.15 Below;

Table 4.15 ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	31.125	3	10.375	73.599	.000[b]
	Residual	39.189	279	.141		
	Total	70.314	282			

a. Dependent Variable: Profitability of SMEs owners/managers
b. Predictors: (Constant), aggregate financial behavior , Aggregate financial attitude, aggregate financial knowledge

Source; own survey, 2020

As per Table 4.16, the equation (PR= β0+ β1FK+ β2FB+ β3FA+Ɛ) becomes:

Where PR is the dependent variable Profitability

FK – Financial Knowledge

FB–Financial Behavior

FA- Financial Attitude

Table 4.16 Model Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	-1.844	.307		-6.005	.000
	AFK	.003	.001	.131	2.784	.006
	AFB	.032	.003	.587	12.340	.000
	AFA	.008	.004	.099	2.157	.032

a. Dependent Variable: Profitability of SMEs owners/managers

Source; own survey, 2020

Based on The regression equation illustrated in Table 4.16 above has shown that taking all factors into account (Financial Knowledge, Financial Behavior and Financial Attitude) all other factors haled constant profitability changes by -1.844. The finding presented also showed that with all other variables held at zero, a unit change in Financial Attitude would lead to 0.008 unit changes in profitability, a unit change in Financial Behavior found to result in a 0.032units change in profitability of SMEs, And a unit change in financial knowledge led to 0.003 changes in profitability of micro and small enterprise in Jimma town. The result indicated that on the above table all the variables has a positive and a significant effect on profitability of SMEs owners, P- value is less than .05($p<0.05$).

4.13 Discussions of the result

Effects of financial knowledge on profitability of MSE's

The findings from the study that majority of the respondents have adequate financial knowledge as the higher percentage could answer the basic financial knowledge questions that were drawn from the financial literacy questionnaire correctly. However, there are some aspects that were not correctly answered as it will be discussed below for the different determinants of financial knowledge. According to empirical evidence of research by (Robb, 2014), financial knowledge influences positive financial behavior. In this study however, despite the majority being able to answer the financial knowledge questions correctly, this implies that the individuals have adequate financial knowledge but are not necessarily putting it in practice.

The findings revealed that the respondents with the percent value of (45.4%) would go for stocks as the source by giving the higher rate of return from other assets. This is in line with the study by (Keasey& Paul, 1990), which found that externally raised finance is associated with higher rate of return.

The benefit of having adequate knowledge on risk is that one can change and adopt an optimal behavior that takes risks that are sensible and worthwhile(Tarasi et al, 2011). Literatures by (Maranjian, 2013) highlighted that the knowledge of the relationship between risk and return is important for business owners in order to make certain change decisions or behavior decisions. The findings of this study revealed that a majority respondent answer correctly the question that an investment with a high return is likely to be elevated risk with the percent value of (71.6) and (50.7)of the respondents are aware about the diminishing return as level of risk exceed a certain level. This implies that the respondents have knowledge about the relationship between risk and returns, they are aware of the consequences of the risk involved in every decision they make on the returns they will expect from such decision.

The findings of (Burke &Manz, , 2014)suggested that knowledge of inflation is an important determinant of financial behavior such as taking debts, opening savings account to mention a few. From this research, (69.9%) of the respondents are aware of the term.

Robb (2014) stated that for effective decision makings, financial knowledge is very critical. Also, (Lusardi& Mitchell, 2014) concluded from their study on economic importance of financial literacy that financial knowledge is an investment in human capital that is important for wealth accumulation. Subsequent research by (Clark et al., 2014) using a different data set found that financially knowledgeable people have more profitable investments. The findings of this research however, in line with the above findings. It found that financial knowledge has a positive and a significant effect on the profitability of micro and small enterprises with a p-value

< 0.05 and a unit change in financial knowledge lead to 0.003 changes in profitability of micro and small enterprise in Jimma town.

Effects of financial behavior on profitability of MSE's

The results on the second objective revealed that although the majority of the respondents are disagreed in putting the knowledge into practice with mean response of (2.29 –2.62) on most of the financial behavior questions. The findings therefore, contradicts with the findings of (Potrich et al., 2016), which concluded that financial knowledge and financial attitude have positive impact on financial behavior. In this case, majority of the respondents scored high in financial knowledge however, their financial behavior opinions are negative.

The findings revealed that most of the respondents were not agreed with preparing written financial objectives, making weekly or monthly budgets and using them to monitors performance. This is supported by the findings of (Sucuahi, 2013) which insinuated that small business owners focus more on cash flows than budgeting, Also, (Kalekye&Memba, 2015) found that as much as budgeting and planning increases profits and minimizes losses, women with micro and small enterprises are not consistent with them hence supporting the findings of this research.

The findings of this research show that most micro and small entrepreneurs disagreed on debt management literacy. That is, they are not able to access various sources of finance, not knowledgeable on effects of inflation and interest rate and uncertain on making accurate calculations. These findings agree with the findings of (Assibey,2010) on inability of MSE managers to obtain finance for their business and the findings of(Plakalov, 2015)who found that most MSE managers are not able to perform accurate calculations and lack numeracy skills especially elderly, female and less educated population. The results of(Sucuahi, 2013)however, contradicts the findings of this study as he found that most micro and small entrepreneurs are very much aware of consequences of poor debt management when it comes to dealing with inflation and interest rate.

The findings revealed that most of the respondents are uncertain about preparing financial statements the business (income statement, balance sheet) (3.22) and they do not perform financial Analysis on the business financial statements (3.08). The study implies that, they keep their records in an informal manner. This is supported by the findings of (Kalakye&Memba, 2015) that reported that MSE managers record transactions in notebooks rather than journals or ledgers. This research also found that respondents do not have knowledge on how to maintain and balance ledger accounts with the mean value of (2.48) and they cannot make decisions from information from financial statements.

The study by (Grohmann et al, 2015) has shown that financial literacy is positively related to financial behaviors such as cash flow management, debt management, savings and investment practices that maximize benefits for micro and small enterprises. The studies above are in line with the findings of this study that reveals that financial behavior has a positive and a significant effect on profitability of MSE's ($p<0.05$) and a unit change in Financial Behavior would lead to 0.032change in profitability.

Effects of financial attitudes on profitability of MSE's

The findings of the study reveal that most of the respondents have neutral opinions about establishing financial targets for the future and the effect of managing money today on their future. So the finding of this study is contradict with the finding stated by (Abiodun, 2016) suggested that successful people are financially literate such that their investments are future oriented. In Addison to this the findings of the study reveal that most of the respondents have neutral opinions when it comes to taking risks. However, the respondents of this study are uncertain about the importance of risk prevention on ensuring security of their business. However, it revealed that the respondents do not realize the importance of directing shot-term decisions towards long-term financial objectives opposing the findings of (Atkinson & Messy, 2012) which found that prioritizing shot-term wants over long-term security makes people unable to make emergency savings that will serve their long-term financial plans and growth.

Researchers have attempted to find the relationship between the social environment of the business and how it affects the financial attitude of business owners. The findings of this research paper revealed that most of the respondents disagreed on the effects of their social environment on their financial skills. They are also uncertain on family influence on their money management skills. The results of the findings contradicts the findings that (Calamato, 2010), which revealed that the family influences individuals financial decisions including the ability to make financial choices, money management, understanding of financial issues and planning for the future.

The attitude of individuals towards financial training is an important determinant of financial literacy because it shows how willing the individual is to go extra miles to acquire financial knowledge and skills. Carlin and Robinson (2010) found that people that went through training were somewhat better at making current-cost and current-benefit tradeoff decisions as compared to those that did not. The results of the findings revealed that the respondents did not attend any training programs to attain financial skills. This is supported by the finding of(Everlyn, 2016), who conducted a study on micro and small enterprises in Kakamega county of Kenya found that a small percentage of MSE owners in that area attended training on financial literacy due to lack of awareness on training programs.

According to (Wagner, 2015) financial decisions are more effective when the decision maker has the right attitude and hence a positive long term effect in consumption and in profitability for consumers and managers respectively. The findings of this study suggest that financial attitude have a significant effect on the profitability of MSE's, with unit change in Financial Attitude would lead to 0.008 changes in profitability. The findings agree with the findings of (Abiodun, 2016) who studied the financial attitude of business managers and role they play in determining performance of the business. He found that financial attitude is linked to ability of business to obtain resources and capabilities, competitive strategic decisions, competitive advantage and performance outcomes. That is, firms with better financial attitude have more competitive advantage than those with poor attitudes.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1Introduction

In this chapter the Summery, conclusions and recommendations are discussed. Based on the findings of the study recommendations are made to operators of MSEs, suggestion for other researchers and responsibly bodies.

5.2Summary of the finding

The objective of the study was to investigate the effect of financial literacy on the profitability of micro and small enterprises in case of Jimma town. The study aimed to measure and describes financial literacy and profitability of SME operators in Jimma town, to examining the effect of financial knowledge, financial behavior and financial attitude on profitability of micro and small enterprises in case of Jimma town. The study adopted a descriptive research method and the study involved samples drawn from the total registered SMEs in Jimma town. To achieve the objectives, primary data was gathered through issuing of a set of structured questionnaires to a sample population of 384 of SMEs that have their own businesses in Jimma town. Probability sampling method was used by applying specifically stratified sampling techniques and randomly selects respondents from each stratum to collect data and to achieve the objective of the study. A descriptive statistics and inferential statistics were employed for analyzing the effect of financial literacy on profitability of MSE's. A Correlation analysis was used to find out the relationship between financial knowledge, financial behavior and financial attitude of SMEs operators and profitability. Linear Regression analysis of variance and frequency distribution was used to analyze the findings. These analyses were carried out using Statistical Package for the Social Sciences (IBM SPSS) statistical software and the report was presented using frequency tables. One of the objectives of this study was to determine the financial literacy level of the respondents. The descriptive statistics employed in the study showed that, the overall financial literacy score of small and micro enterprise were 30 percent .The study conclude that most participants of the study has low level of financial literacy in Jimma town .The study also examined how financial knowledge affects the profitability of micro and small enterprise in Jimma town. The finding suggests that most of the respondents are financially knowledgeable as the greater percentage of them answered the financial knowledge questions questionnaire on risk and return and inflation correctly except for rate of return for sources of Finance for startup businesses. However, the study reveals that financial knowledge has a positive and a significant effect on the profitability of micro and small enterprises operators in case of Jimma town.

The study assessed the effects of financial behavior on the profitability of micro and small enterprises and found that financial behavior affect the profitability of such businesses. The study also found that majority of the business owners are disagreed on budgeting and planning, debt management, savings and long term goals to expand the business and having alternative sources of income. Also, they recorded low on record keeping. However, the study reveals that financial behavior has a positive and a significant effect on the profitability of micro and small enterprises owners/managers in case of Jimma town. In addition to this the study observed the effect of financial attitude of owners of micro and small enterprises and how it affects their profitability. It found that most the respondents have positive attitude about importance of controlling monthly expenses. The study reveals that the business owners are neutral on important of establish financial targets for the future, The way of managing their money today effect on their future, about Preventing risk ensures security of their business and their parents money management influence on their money management skills. The study also found that majority of the business owners do not believe in Making risky decisions will add value to their returns, the influence of short-term decisions on their long-term financial goals, the contribution of social environment on their financial skills, participating in training programs for financial skills and learning about cost/benefits trade off from training programs. The study established that there is a meaningful relationship between profitability and financial attitude of micro and small enterprise owners.

5.3Conclusion

This section comprises of conclusions on the specific research objectives of the study based on the research results and findings in comparison to the literature review. The study aimed at examining the effect of financial literacy on the profitability of small and micro enterprise in Jimma town.

- ✓ One of the objectives of this study was to determine the financial literacy level of the respondents. The descriptive statistics employed in the study showed that, the overall financial literacy score of small and micro enterprise were 30 percent .The study conclude that most participants has low level of financial literacy in Jimma town .

- ✓ The study concludes that most MSE owners are knowledgeable about the basic financial concepts because a greater percentage of the respondents answered the financial knowledge questions correctly. The study also concludes that financial knowledge necessarily lead to profitability of MSE's owner in Jimma town. Financial knowledge is important but it requires application of the knowledge to turn into profits.

- ✓ The study concludes that financial behavior is significant predictor of profitability for micro and small enterprises in Jimma town. The respondents however, are not very conversant with the application of good financial behaviors in their businesses.
- ✓ The study notes that financial attitudes of MSE's have a significant effect on their profitability in Jimma town. However, most MSE managers and owners have poor attitudes towards their financial activities. This was evident by the low future orientations, inability to takes risks and lack of participation in training programs that can promote their financial skills despite the knowledge on the importance of directing short-term activities towards long-term goals of the firm.

5.4Recommendations

Since in general the study has established that financial literacy has effect on profitability of SMEs in Jimma town, the study recommended that:-

- ✓ More awareness should be created to the SME owners on the importance of participating in financial literacy training programs.
- ✓ The government should have to provide SMEs with permanent services, facilities, training and access to credit and markets.
- ✓ Government agencies along with micro finance institutions and banks should organize financial education programs that will create awareness on areas that are lacking such as more effective sources of funds for startup businesses. This will encourage MSE's to expand and grow in areas they are lacking. Financial education programs will not only improve the growth of the enterprises but also the entire economy as MSE's contributes so much to the economies where they exist.
- ✓ As reflected from the study, it is evident that financial behavior is an important contributor to profitability of MSE's. This therefore, reflects the need for training programs on Budgeting and planning, and debt management, which seek to promote financial literacy and practice.
- ✓ From the results, it is evident that the financial attitude of MSE owners and managers is significant in their profitability. Therefore, it is important for both public and private institutions, the schools, family and friends to put efforts in influencing the attitudes of MSE managers and owners positively. A Positive attitudes leads to positive behaviors and hence benefits both the MSE's and their stakeholders.

5.4.2Recommendation for further studies

The study focused on financial knowledge, financial behavior and financial attitude as variables of financial literacy. Further research can be done testing the effects of other cofounding variables that are not covered in this study to ensure more reliability and accuracy of the data as well as the results. This study was carried out only in Jimma town; this means that the results of this study are skewed to the beliefs and perceptions of the MSE owners in Jimma town. It is recommended that such a study be done in other town and institutions to increase the statistical relevance of the study and more reliable results.

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Appendix I Questioners

Jimma University

Business and economics collage

Department of accounting and finance

The purpose of this study is to assess the effect of financial literacy on the profitability of micro and small enterprise owners in Jimma town which help to enhance financial education intervention. The information you will provide in this questioner will be used only for the intended research and academic purpose. Your response to all questions will be used anonymously and will be confidential. Thus please be free to provide your genuine response

Thank you in advance for your cooperation!

Section A: General information

1. What is the form of business organization?
   - ☐ Sole proprietorship
   - ☐ corporative society
   - ☐ Partnership
   - ☐ joint venture
   - ☐ Private limited company
   - ☐ other
2. Age of business
   - ☐ Less than 2 year
   - ☐ 6-10 years
   - ☐ 2-5 years
   - ☐ greater than 10 years
3. What is your position in your business?
   - ☐ Owners
   - ☐ Finance manager
   - ☐ Managers
   - ☐ Other (specify)
   - ☐ Chief accountant
4. What is your HIGHEST educational qualification or nearest equivalent?
   - ☐ Bachelor degree
   - ☐ High degree
   - ☐ Masters degree
   - ☐ others (specify)

5. Gender

- Male
- Female

6. Age

- Less than 18
- 18-30
- 30 -48
- Above 48

7. What are your Sources of finance?

A, what are the possible sources of capital for starting business? (May circle more than one answer?

- Retained earning
- Loan from bank
- Microfinance institution
- Loan from family and friends
- Do not know

Section B; financial knowledge

Kindly indicate the option that best reflect your response by ticking or circling the box provided

1. Considering a long time period (e.g. 10 years) which asset described below gives the highest rate of return?

- Account bond
- Stocks
- Treasury bill
- Saving in bank
- Don't know

2. Risk and return

A, An investment with a high return is likely to be elevated risk.

[TRUE OR FALSE]

B, There is a diminishing return as level of risk exceeds a certain level.

[TRUE OR FALSE]

3. Inflation

A, High inflation means that the cost of living is increasing rapidly

[TRUE OR FALSE]

Section C; Financial behavior

Please indicate the most appropriate number that describe your business position on the scale; 1= strongly disagree, 2=disagree, 3= neutral, 4= agree, 5= strongly agree

Budgeting and planning	**1**	**2**	**3**	**4**	**5**
1. I prepare written financial objectives of What I want to achieve in a term for my Business	☐	☐	☐	☐	☐
	☐	☐	☐	☐	☐
2. My long-term financial targets influence The managing of my expenses					
3. I follow a weekly or monthly plan for expenses	☐	☐	☐	☐	☐
4. I prepare budgets to help me monitor my Performance	☐	☐	☐	☐	☐

Debt management	**1**	**2**	**3**	**4**	**5**
5. My debt management skills have enabled me to Access various sources of finance for my business	☐	☐	☐	☐	☐
6. I know the effect of inflation and interest rates on The loans I borrow for my business	☐	☐	☐	☐	☐
7. I can determine accurately the total debt position Of my business	☐	☐	☐	☐	☐
8. I can access finance at a minimum cost	☐	☐	☐	☐	☐

Record keeping **1** **2** **3** **4** **5**

9. I prepare financial statements for your business

(Income statement, balance sheet)

10. I can perform financial Analysis on your business

Financial statements (gross profit margin, net

Profit margin, current ratio)

11. I have adequate knowledge on how to maintain

And balance ledger accounts

12. My decisions are guided by information from my

Financial statements

SECTION D: FINANCIAL ATTITUDE

Kindly indicate to what extent you agree or disagree with the following statements with

Regards to financial attitude

1= strongly disagree, 2= disagree, 3= neutral, 4= agree, 5= strongly agree

1 **2** **3** **4** **5**

1. It is important to control monthly expenses
2. It is important to establish financial targets
   For the future
3. The way I manage my money today will
   Affect my future
4. Making risky decisions will add value to my returns
5. Preventing risk ensures security of my business
6. All my short-term decisions are influenced
   By my long-term financial goals
7. My social environment has contributed so
   Much to my financial skills
8. My parents have influenced my Money
   Management skills
9. I have participated in training programs for
   Financial skills
10. I have learnt cost/benefits trade off from training

Programs

SECTION E: PROFITABILITY

Kindly indicate the right answer by ticking or circling the option that applies to your business.

1. Which of the following ranges is the best indication of your business total assets?

Less than 50,0 00 –100,000

100,000 -500, 1, 000,000-1.5m

500, 000 – 1,

2. Which of the following ranges is the best indication of your business annual sales?

Less than 50, 000,-100,000

100,000- 500 1,000,000-1.5m

500, 000-1,00

3. Which of the following ranges is the best indication of your business annual net profits?

Less than 5 50, 000 –100,000

100,000–500, 000,000-1.5m

500, 000 –1,0 0

THANK YOU FOR YOUR TIME