



A Pilot Study On The Impact of Financial Literacy On The Performance Of Small And Medium Enterprises In Afghanistan

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Abstract

This research aims to examine the impact of financial literacy on the performance of SMEs in Afghanistan, particularly focusing on financial behavior (record-keeping and saving) and financial knowledge (inflation and diversification) as key factors affecting SME success. For this study, a quantitative methodology was used, and data from 20 SME owners in Kabul, Afghanistan, were gathered. Using Google Forms, a structured questionnaire was created and sent by WhatsApp to small business owners. Excel was used for data analysis, with an emphasis on descriptive statistics to determine the connection between SME performance and financial literacy. The survey found that Afghan SME owners had a high degree of financial literacy, particularly about inflation, diversification, and financial behavior, particularly regarding record-keeping and saving. SME owners, although knowledgeable in financial literacy, expressed discontent with profitability and noted flat sales. According to this study, financial services consulting is necessary to meet the unique requirements of SMEs in Afghanistan. This emphasizes how crucial it is to offer specialized financial services to aid in the expansion and development of SMEs in Afghanistan.

Key words: Financial literacy, Afghanistan, SMEs, financial services.

Introduction

There has been plenty of research on the impact of business knowledge on entrepreneurship performance in developed as well as developing countries (Iramani et al., 2018; Enioal and Entebang, 2016; Meressa, 2023; Pandey and Gupta, 2018; & Usama and Yusof, 2018). Among the business knowledge specially, financial literacy has a positive significant impact on Small and Medium Enterprises' (SMEs) success. Research shows that entrepreneurs with good knowledge of risk and debt management, record keeping, and budgeting abilities are more successful than business owners with poor financial knowledge (Cherugong, 2015).

Usama et al. (2019) found that having a solid understanding of finance helps entrepreneurs prevent business failures brought on by making poor financial decisions. This research further

bolsters the idea that financial literacy should be cultivated as an integral component of corporate operations since it is a major driver of business success. Consequently, entrepreneurs need to understand and oversee the finance management education process.

Menike (2019) study shows that entrepreneurs who are financially educated and comprehend important financial concepts, such as debt management, record keeping, and budgetary abilities, are in charge of SMEs that have more success. The owners' financial literacy in terms of planning and budgeting abilities helps SMEs function more profitably while lowering operating expenses, which allows them to make appropriate loan repayment plans.

According to the report by the Ministry of Commerce and Industry (MoCI) (2010), Afghan SMEs owners have low financial literacy. Moreover, the report of the Da Afghanistan Bank (2024) study indicates that inadequate documentation and record-keeping, a poor level of financial literacy, a lack of capacity building, and government interference are among the issues faced by micro, small, and medium-sized enterprises (MSMEs). which makes it evident that owners of SMEs lack advanced financial literacy in Afghanistan. Therefore, I selected to examine the effect of basic financial literacy, such as record keeping, saving, inflation, and diversification, on the performance of SMEs.

However, several NGOs including USAID, World Bank, DFID, GIZ and other international organization have been actively working to empower Afghan SMEs owners by offering funds to equip their business with technology and training them about the business operations (MoCI) (2010). In particular Danish Refugee Council (DRC) attempted to train business owners about financial management based on Start and Improve Your Business (SIYB) training program. Through enhanced workplace procedures, DRC wanted to help SMEs establish standardized procedures for purchasing, inventory control, record keeping, costing, financial forecasting, marketing, and productivity enhancements (DRC, 2023).

Despite of these efforts, Afghan SME owners have poor financial literacy knowledge that has impeded their growth and performance. The main aim of this research is to investigate how financial literacy affects the performance of SMEs in Afghanistan. The study particularly measures whether financial behavior and financial knowledge affect SME's performances in Afghanistan. By financial behavior, this study means record keeping, and saving, and by financial knowledge, this study means diversification, and inflation.

A quantitative approach is being used in this study to collect data from owners of various SMEs in Kabul Quantitative approaches are useful in many fields, including scientific research, business analysis, and the social sciences, since they provide precise measurements, statistical analysis, and objective insights. Researchers and analysts can efficiently quantify events, recognize patterns, and test hypotheses with rigor and precision by utilizing quantitative approaches including statistical modeling, regression analysis, and mathematical computations. Using empirical evidence as a basis for decision-making instead of depending just on gut feeling or subjective assessment is made possible by these strategies. Google Forms has been used to create a structured questionnaire with closed-ended questions. WhatsApp will be used to send the questionnaire link to SMEs owners and managers in these various sectors, giving them an easy-to-use platform to complete it.

The study's findings will be very important for offering training programs and financial services to help SMEs develop financial behavior such as record keeping and saving and financial knowledge such as inflation and diversification. The study can help financial institutions, policymakers, and other stakeholders better understand how to customize their services to assist the growth and development of SMEs by uncovering critical insights and trends relating to the

financial demands and issues faced by SMEs in Afghanistan. This could entail creating customized financial products, expanding credit availability, offering focused financial education and training initiatives, or putting supportive laws and rules into place.

It is important to note that SMEs in emerging and undeveloped nations, such as Afghanistan, can be extremely important to employment and the nation's overall economic growth. In 2021, SMEs in Afghanistan contributed 20% towards Afghanistan's Gross Domestic Products (GDP) and provided 20% of the workforce in the nation (Mussawy, 2021).

Literature Review

Financial literacy affects the success of the business enterprise and helps entrepreneurs prevent business failures brought on by bad financial decisions. For entrepreneurs to succeed in business in today's world, financial literacy is therefore essential. Accordingly, entrepreneurs who are not sufficiently financially literate are more prone to make financial decisions that will negatively impact their company (Usama & Yousaf, 2019).

Better financial literacy can help supervisors, owners, and businesspeople comprehend financial concepts that are relevant to their organization, including debt, investments, savings, and financial management, among other things. SMEs can benefit from accurate financial decisions in a number of ways, including decreased operating expenses, cost-benefit evaluations, employee turnover, beneficial investment plans, and fewer internal conflicts. In these kinds of circumstances, logical decisions will be made using the financial data that has been gathered. SMEs can therefore increase sales and earnings, which will improve performance. Financial knowledge is unquestionably crucial for SMEs managers and owners (Yakob, et al., 2021).

According to Atkinson and Messy (2012), “financial literacy is a combination of awareness, knowledge, skill, attitude, and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing” (P. 13). Thus, demonstrating the broad range of financial literacy. In this study, we examine financial behavior and financial knowledge.

Financial Behavior

Major components of the financial behavior pillar include spending habits, record-keeping, the use of savings, managing money in a crisis, financial services used, income and expense planning, comparing prices, learning about competitors' offerings, and using additional income (Menike, 2019).

Kimunduu et al. (2016), demonstrated the importance of personal saving abilities in raising SMEs' profitability and concluded that business owners who possess sufficient personal saving knowledge tend to generate more profits than those who do not. This is because their abilities enable them to concentrate on saving for themselves, which raises the amount of money available for business expansion and reinvestment, ultimately resulting in higher earnings. Also, according to their findings, having good bookkeeping abilities aids in an organization's resource budgeting. Thus, the study concludes that having strong bookkeeping abilities is essential for a business since it prevents the owner from establishing unrealistic expectations for their meager funding. This study also shows that an entrepreneur with the right kind of entrepreneurial abilities can be profitable and competitive in a market where there are a lot of sellers. These abilities support both bringing in new business and preserving the current clientele.

All three of the financial literacy predictors financial record keeping abilities, financial planning skills, and knowledge of financial access had a statistically significant impact on the SMEs in the Nyarugenge district that were assessed in terms of their financial performance. By

highlighting the need for specialized training and assistance in financial planning, record keeping, and understanding financial access, the research advances our understanding of how financial literacy influences SME performance. Policymakers, financial institutions, and business support organizations working to improve SME success can benefit from these insights (Edward et al., 2024).

Weak savings cultures that postpone the maturity of loan services as an agreement between Microfinance Bank and SMEs' owners are the only services that have the potential to affect the growth of their client SME. Any customer for whom making a little deposit into the savings account would be difficult due to their limited access to loans (Kio et al., 2021). Therefore, an inability to put savings ahead of quick loan availability is indicative of a short-term financial behavior that could impede SMEs' ability to grow and maintain long-term financial stability. This kind of conduct can put SMEs in a vicious cycle of debt dependency, making it more difficult for them to save money and make investments in long-term growth plans.

The financial behavior of SME owners had a positive impact on the performance of their companies. This indicates that when making trading decisions, they frequently compare their actual operating performance to their aims, pay close attention to competitors' prices, and are motivated to learn about financial literacy. More informed owners tend to plan and execute regular savings and investments and spend wisely (Menike, 2019).

Financial Knowledge

Major components of financial knowledge include source of finance, time value of money and diversification (Rahim & Balan, 2020). Also, Menike (2019) measured financial knowledge by asking questions about numeracy, inflation, compound interest, time value of money, money illusion, financial statements, share market, banking, insurance, loans.

According to this study, producing financial statements more frequently was correlated with advances in financial literacy. Without financial literacy, it is difficult to compile financial accounts; also, a lack of comfort with financial topics such as financial literacy would equate to discounting its usage. It has been discovered that young entrepreneurs who possess greater financial literacy have a higher likelihood of repaying their loans when starting new businesses. This is consistent with the work's theoretical foundations. It is conceivable that a rookie entrepreneur would need greater assistance with business acumen than, say, a serial entrepreneur. By definition, young entrepreneurs are likely to be inexperienced and have low levels of financial literacy and business acumen. Mentors provide aspiring business owners with the knowledge and resources they need to make wise financial decisions by emphasizing the importance of financial literacy. According to this study, business owners that generated more financial statements had lower loan default rates and were less likely to shut down their operations without permission (Wise, 2013).

Small business owners have a fair awareness of risk diversification, inflation, and interest compounding, but they have a poor grasp of financial statement matters, which is a problem that can only be resolved via education (Fernandes, 2015).

In a context of inflation, companies will be less willing to provide long-term financing for capital creation and development. Continuous inflation is detrimental to long-term growth and the financial system as a whole. Economic factors (fiscal and monetary policies, inflation, interest rates, and foreign exchange rates) have a direct impact on the potential attractiveness of various strategies and consumption patterns in the economy (Ajagbe, 2012).

In conclusion, the assessment of the literature reveals that several research have been conducted on the impacts of financial literacy on the performance of SMEs and the majority of these studies have concluded that financial literacy has a major impact on SMEs. This study is informed by the literature review, which emphasizes the importance of financial literacy and other critical aspects such as record keeping, saving practices, managing inflation, and diversification strategies in the success of SMEs. It also directs the choice of methods and aids in a concentrated investigation of Kabul, Afghanistan's financial processes.

Methodology

Research Design

The research aims to investigate the impact of financial literacy on the performance of small and medium-sized enterprises (SMEs) in Afghanistan. Specifically, the study focuses on two aspects of financial literacy: financial knowledge, including understanding of diversification and inflation, and financial behavior, with an emphasis on saving and record-keeping practices. Using quantitative methods, data will be collected from a sample of 20 SME owners with diverse operations in Afghanistan. A structured questionnaire has been designed to gather relevant information for the study. The findings of this research are expected to contribute to the understanding of how financial literacy, particularly in terms of knowledge and behavior, influences the performance of SMEs in Afghanistan, and may provide insights for enhancing financial literacy programs for SME owners in the country.

Variables

Independent Variables

- Financial Behavior (Saving and Record Keeping)
- Financial Knowledge (Diversification and Inflation)

Dependent Variable

- SMEs Performance

Population Sample

The business owners of several SMEs operating in Kabul, Afghanistan, represent the population sample for this research study. To facilitate data collection, a sample of twenty (20) SMEs was selected. These SMEs operate in a variety of industries, such as online bookstores, food products, travel agencies, handicrafts, and medical services.

Afghan girls are denied access to education and as a result, the author of this research is unable to obtain data from SMEs' owners who are officially registered with the ministry of commerce and industry since doing so would put me in danger. Instead, the researcher of this study found a different way. The researcher of this study used personal contacts within their network to get around security issues. These relationships included friends who own their own companies and companies the researcher had previously bought items from, such scarves and books. This tactic made it possible to locate and enlist SMEs owners who were open to taking part in the research.

Participants were also urged to submit the contact details of other SMEs owners they stay in touch with, to increase the sample size and guarantee variety in the dataset. By making it easier

to include more individuals, this snowball sampling strategy improved the study's sample's representativeness. Notwithstanding the inherent security constraints of the setting, the researcher's and participants' cooperative efforts made it possible to gather insightful data from a diverse group of SMEs owners operating in Kabul, Afghanistan.

Sampling Method

Given the practical constraints and the use of Google Forms and WhatsApp for data collection, a convenience Google form sampling method appropriate for this study. Convenience sampling involves selecting participants based on their availability and willingness to participate. However, efforts are made to ensure that the sample is representative of the overall population of SMEs in Kabul by reaching out to a diverse range of businesses across different sectors.

Data Collection

Data will be collected using the structured questionnaire created on Google Forms. The questionnaire link will be shared with SME owners via WhatsApp, providing them with an easy-to-use platform to complete the survey. Reminders can be sent to encourage participation and ensure a sufficient response rate. The questionnaire was structured into three parts: General information, financial behavior (record keeping and saving), and financial knowledge (inflation and diversification).

Data Analysis

After completing data collection, the responses will be analyzed using Excel to derive meaningful conclusions. Excel is chosen for its widespread use and professionalism in quantitative data analysis. The collected data, which were cleaned and recoded, will be subjected to descriptive methods to determine the percentage of each variable and its effects on the study's objectives. Additionally, some variables will be visually represented through graphs and tables to enhance the presentation of findings. It's noteworthy that to provide insightful information, the sample consists of educated SME owners, ensuring a level of understanding and engagement conducive to meaningful analysis and interpretation. This approach is expected to yield valuable insights into the relationship between financial literacy, SME performance, and the specific aspects of financial knowledge and behavior under investigation in Afghanistan.

Research Limitations

The research aimed to assess the level of financial literacy among SMEs in Afghanistan. Due to security concerns, accessing official records from the Ministry of Commerce and Industry to obtain contact information for formally registered SMEs was not feasible. Moreover, cultural barriers, particularly for a female researcher like the author of this study, made it difficult to conduct traditional door-to-door surveys, as SME owners may be hesitant to share their data or could potentially perceive the survey as intrusive. To address these challenges, I utilized my personal network and targeted educated individuals who are more likely to be involved in SMEs. By leveraging these connections, I could reach a wider audience of SMEs owners and gather

valuable insights into their financial literacy without compromising security or encountering resistance.

This approach allowed to gather meaningful data that contributes to understanding the financial literacy landscape among SMEs in Afghanistan, despite the challenging circumstances.

Findings and Discussion

Demographic Respondents

In this study, the demographic profile of respondents was analyzed to gain insights into the characteristics of the target group shown in Table 1. The gender distribution revealed that 80% of respondents were male, with females comprising the remaining 20% of the sample. Regarding the age of businesses represented in the survey, 45% had less than three years of experience, while 30% had been operating for three to five years. Additionally, 10% had over 10 years of experience, and 15% had been in operation for six to ten years, indicating a predominance of newer businesses in the sample. In terms of education level, 80% of respondents held a bachelor's degree, while 20% had attained a master's degree. Regarding age distribution, respondents aged 30–40 years old accounted for 55% of the sample, while those aged 18–30 years old comprised the remaining 45%. Lastly, in terms of position, 60% of respondents were owners of their respective companies, while 40% were category managers responsible for business operations. This comprehensive demographic overview provides valuable insights into the characteristics of the survey respondents.

Table 1
Demographic Details of the Respondents

Demographic	Number	Percentage
Gender		
Male	16	80
Female	4	20
Age Group		
18 - 30	9	45
30 – 40	11	55
Greater than 40	0	0
Level of Education		
School	0	0
Bachelor degree	16	80
Postgraduate (MBA or PhD)	4	20
Professional Certificate	0	0

Position		
Owner	12	60
Manager	8	40
Age of Business		
Less than 3 years	9	45
3 -5 years	6	30
6 -10 years	3	15
10 Years and above	2	10

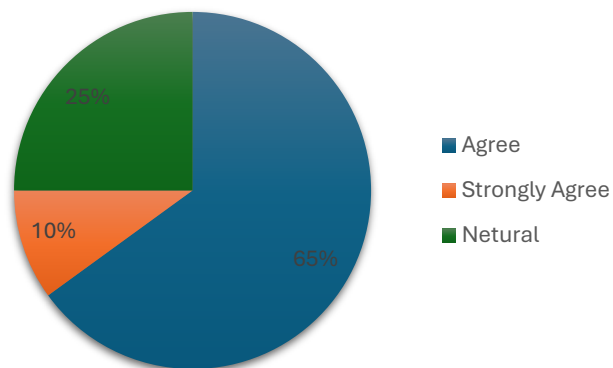
Notes: This table presents the demographic respondent percentage.

Financial Knowledge

Diversification

The data indicates that a majority of respondents (75%) understand how to diversify their investments to reduce risk, with 65% expressing agreement, and an additional 10% strongly agreeing. Only 25% remained neutral on this matter. As shown in Figure 1, respondents possess a high level of awareness about diversification. By spreading their investments over a variety of assets, markets, and industries, SME owners can reduce the total risk to their business and reduce the impact of any one investment performing poorly.

Figure 1
Diversification



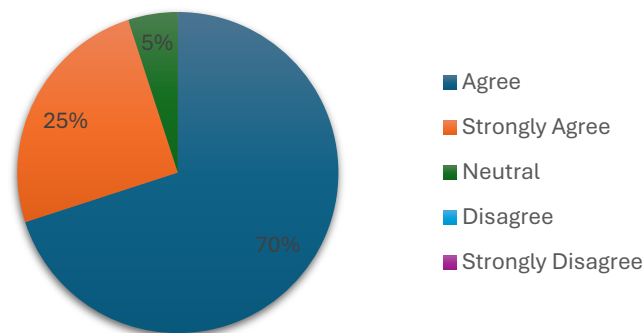
Notes: This chart shows participants' knowledge about investment diversification.

Inflation

The questionnaire included two inquiries aimed at assessing participants' understanding of inflation. The first question, "I know how inflation affects my investment," garnered responses indicating a solid grasp of the concept. Specifically, 70% of respondents agreed that inflation impacts their investments, with an additional 25% expressing strong agreement. Only 5% remained neutral on this matter. The survey data shows that respondents have a good awareness of how inflation affects their investments.

The second question aimed to gauge participants' understanding of estimating inflation, specifically regarding the relationship between high inflation and the increasing cost of living. Results indicated a generally strong comprehension, with 60% of respondents agreeing that high inflation corresponds to a rapid rise in living expenses. An additional 25% strongly agreed with this statement, while 15% remained neutral. As shown in Figure 2, the data implies that respondents had a good awareness of the connection between rising inflation and rising living costs.

Figure 2
Inflation



Notes: This chart shows participants' knowledge about the impact of inflation.

Financial Behavior

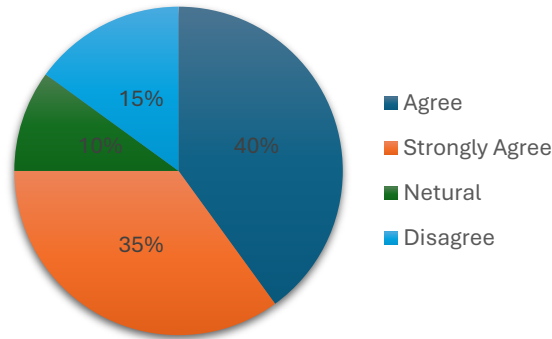
Saving

The questionnaire included three inquiries aimed at assessing respondents' understanding and practice of saving. Regarding the first question, which inquired about having a separate savings account for business and personal use, the data revealed that 35% of respondents strongly agreed and maintained separate accounts, while 30% agreed but were unsure, and 25% remained neutral. This data indicates a varied level of commitment to maintaining separate savings accounts among the respondents.

The second question aimed to gauge respondents' habits regarding saving funds for emergency situations. Results indicated that 35% of respondents disagreed with the notion of saving money for a six-month emergency fund, while 25% expressed neutrality, and 10% strongly agreed with the importance of this practice. This data shows a significant portion of respondents may not prioritize building an emergency fund, which could potentially impact their financial resilience.

Lastly, the third question asked whether respondents planned to use their savings for future business needs. As shown in Figure 3, The data revealed that the majority, 40%, of the respondents agreed to this statement, 35% strongly agreed, 10% were neutral and 15% disagreed. This data indicates a significant readiness among SME owners to utilize their savings for future business requirements.

Figure 3
Saving



Notes: This chart shows participants' knowledge about saving.

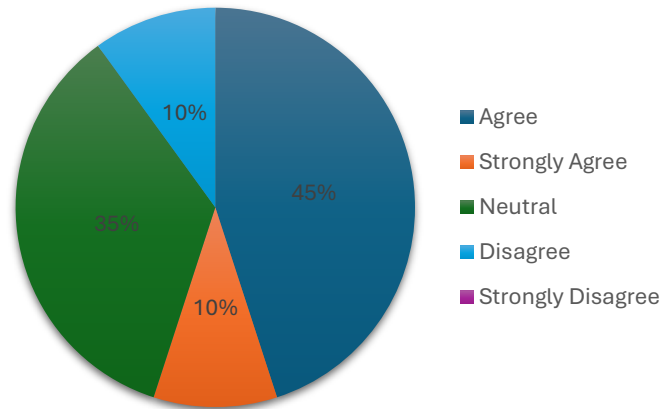
Record Keeping

Three questions were included in the questionnaire to assess respondents' understanding of the concept of record-keeping. The first question asked was, "Do you know how to maintain your business ledger accounts?" According to the data, 35% of respondents agreed they understood the process of keeping up business ledger records. 35% were neutral, 25% strongly agreed, and 5% disagreed. According to the data, a sizable percentage of respondents understand how to maintain business ledger accounts.

The second question aimed to determine if respondents were actively involved in record-keeping: "Do you prepare your business financial statements on your own?" The data revealed that the majority, 50%, of the respondents agreed that they prepared financial statements on their own; 20% strongly agreed, 15% disagreed, and 15% were neutral. According to the data, a sizable majority of respondents actively participate in the process of creating their company's financial statements.

Lastly, as shown in Figure 4, respondents were asked whether their business decisions were highly influenced by information from financial statements. The majority, 45%, agreed that business decisions are highly influenced by information from financial statements, 35% were neutral, 10% strongly agreed, and 10% disagreed. According to the data, a significant number of SME owners agree that financial statements have an impact on their choices regarding how to run their businesses.

Figure 4
Record-Keeping

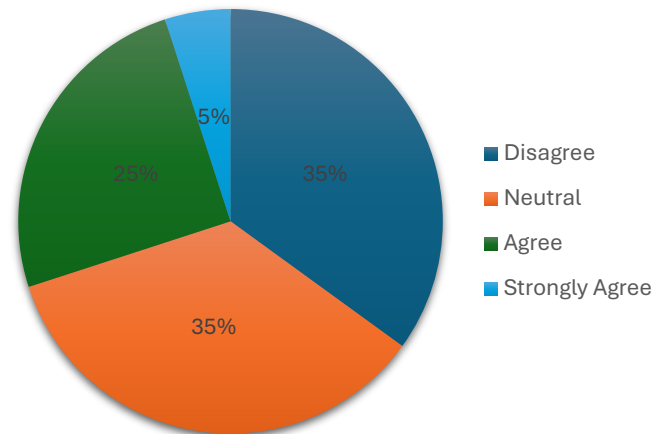


Notes: This chart shows participants' knowledge about record-keeping.

Performance of SMEs

Two questions were structured in the questionnaire to understand SMEs' performance. The first question asked was, "Are you satisfied with your profitability?" As shown in Figure 5, 35% of respondents expressed dissatisfaction with their profitability, while another 35% were neutral, On the other hand, 25% agreed with their profitability, and 5% strongly agreed. These respondents reveal that a significant portion expressed dissatisfaction about their profitability.

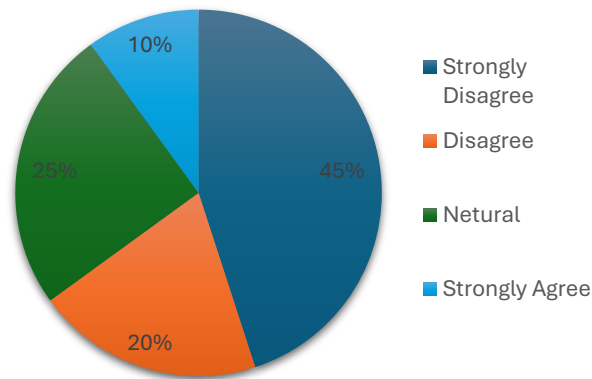
Figure 5
Profitability



Notes: This chart shows participants' satisfaction with profitability.

The second question aimed to assess whether respondents' businesses were experiencing continuous sales expansion. As shown in Figure 6, 45% of the respondents strongly disagree that their sales were expanding continuously. Meanwhile, 25% were neutral, 20% disagreed with the idea of expansion, and 10% strongly agreed. According to these respondents, SME sales are not increasing consistently.

Figure 6
Sales



Notes: This chart shows participants' sales expanding.

Conclusion

The research aimed to determine whether SME owners possess financial literacy and how their financial literacy impacts SME performance. Data was collected from 20 SME owners across various sectors in Afghanistan through a structured questionnaire created in Google Forms. The findings indicated a high level of financial knowledge among SME owners, particularly in key concepts like inflation and diversification, which aligns with Ibrahim's (2017) research, which stated SME owners possess a solid understanding of fundamental concepts like inflation, diversification, and the time value of money. The study also highlighted strong financial behavior among SME owners, especially in aspects such as record-keeping and saving, which aligns with Sakhizada's (2019) research, which also stated that SME owners have a high level of education in financial behavior, particularly in record-keeping and saving. However, despite their financial acumen, SME owners expressed dissatisfaction with profitability and observed stagnant sales. Consequently, the study concluded that while SME owners exhibit proficiency in financial basics, their financial knowledge and financial behavior might not significantly impact SME performance, leading to the suggestion that consultancy services may be necessary. According to the Ogar et al. 2019 study, there is a connection between management consulting services and the growth and development of SMEs. Additionally, a study by Idris et al. (2023) found a statistically significant and favorable relationship between SMEs' perceived actual and desired performance and on-the-job and off-the-job staff training, or training for employees and/or owner-managers. Since our findings and the results of other studies indicate that SMEs require financial and consulting

services, we have decided to establish a consulting firm to assist SMEs in managing their operations and achieving their desired outcomes.

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