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EXPLORINF THE INFLUENCE OF FINANCIAL LITERACY ON LOAN REPAYMENT AMONG SMALL AND MEDIUM ENTERPRISES (SMEs) IN DOWA; MALAWI

***Lucius Kabudulawatentha, E. Magalasi**

Bachelor of Commerce in Accounting and Finance.

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***Corresponding Author: Lucius Kabudulawatentha**

Bachelor of Commerce in Accounting and Finance.

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ABSTRACT

Small and Medium Enterprises (SMEs) play a significant role in economic development, employment creation, and poverty reduction in developing economies. Despite their contribution to economic growth, many SMEs face challenges in accessing and repaying loans obtained from microfinance institutions and commercial lenders. Loan default remains a major concern among financial institutions in Malawi, limiting access to credit and reducing the effectiveness of financial inclusion initiatives. This study examined the influence of financial literacy on microloan repayment among SMEs in Malawi, using evidence from SMEs operating in Dowa District. Specifically, the study assessed the relationship between financial literacy and loan repayment behavior among SME operators.

A quantitative research design was employed, and primary data were collected from 60 SME operators through structured questionnaires. Descriptive statistics and Pearson correlation analysis were used to analyse the data. The findings revealed that financial literacy positively influences repayment behaviour through improved budgeting, record keeping, financial planning, and communication with lenders. Budgeting knowledge demonstrated a significant positive relationship with communication with lenders ($r = 0.57$), suggesting that financially literate entrepreneurs are more proactive in managing repayment obligations. However, external factors such as inflation, high interest rates, and multiple borrowing continue to constrain repayment performance.

The study concludes that financial literacy is a critical determinant of loan repayment among SMEs and recommends strengthening financial literacy training programmes, integrating borrower education into lending practices, and promoting supportive policy interventions.

The findings contribute to the growing literature on SME finance and provide practical implications for financial institutions, policymakers, and development practitioners.

KEYWORDS: Financial literacy, microloan repayment, SMEs, financial behaviour, budgeting, Malawi.

INTRODUCTION

Small and Medium Enterprises (SMEs) are widely recognised as engines of economic growth, innovation, employment creation, and poverty reduction across both developed and developing economies. In many African countries, SMEs contribute substantially to gross domestic product (GDP), generate employment opportunities, and support local economic development. In Malawi, SMEs constitute approximately 90% of business establishments and employ a significant proportion of the labour force. Their contribution to economic activity makes them an essential component of national development strategies aimed at reducing poverty and promoting inclusive economic growth.

Despite their importance, SMEs often experience limited access to finance. Financial institutions frequently identify SMEs as high-risk borrowers due to inadequate collateral, poor financial records, and uncertainty regarding business performance. Consequently, microfinance institutions, commercial banks, cooperatives, and government-supported lending programmes have emerged as important sources of finance for SMEs. These institutions provide credit facilities intended to support business expansion, improve productivity, and enhance household welfare.

However, loan repayment remains a major challenge in the SME sector. High levels of loan delinquency and default have been reported across many developing countries, including Malawi. Loan repayment difficulties negatively affect the sustainability of lending institutions, increase operational costs, and reduce the availability of future credit to entrepreneurs.

One factor increasingly identified as influencing repayment performance is financial literacy. Financial literacy refers to the knowledge, skills, attitudes, and behaviours necessary for making informed financial decisions. It encompasses budgeting, record keeping, understanding loan conditions, managing cash flows, evaluating financial risks, and planning for future financial obligations. Financial literacy enables entrepreneurs to allocate resources efficiently, avoid excessive borrowing, and manage business finances more effectively.

In Malawi, although financial inclusion initiatives have expanded access to credit, relatively limited empirical evidence exists regarding the extent to which financial literacy influences repayment behaviour among SMEs. Most existing studies focus on access to finance, entrepreneurship development, or financial inclusion without adequately examining how financial literacy affects repayment outcomes. This knowledge gap limits the ability of policymakers and financial institutions to design effective interventions aimed at improving repayment performance.

The study is guided by the objective of examining the relationship between financial literacy and loan repayment behaviour among SMEs. Specifically, the article focuses on how budgeting knowledge, financial management skills, and communication with lenders influence repayment outcomes. The findings provide insights that are relevant not only to SMEs operating in Dowa District but also to financial institutions, policymakers, and development practitioners seeking to improve credit sustainability and financial inclusion across Malawi.

Objectives

1. To identify constraints Small and Medium Enterprises (SMEs) face when repaying microloans in Dowa district
2. To determine the factors that influence financial literacy among Small and Medium Enterprises (SMEs) in Dowa district
3. To determine roles of Financial literacy on Small and Medium Enterprises in Dowa district
4. To understand the relationship between Financial literacy and microloan repayment in Dowa district

3.0. LITERATURE REVIEW

3.1 Conceptual Review

3.1.2. Financial Literacy

Financial literacy has become a central concept in contemporary financial management and entrepreneurship literature. Ferri (2010) defines financial literacy as the knowledge and ability to understand financial concepts, manage resources effectively, and make strategic financial decisions. Similarly, the Financial Services Authority of Indonesia emphasises that financial literacy extends beyond awareness of financial products to include financial planning, budgeting, saving, borrowing, and investment decision-making.

Financial literacy consists of several dimensions, including budgeting skills, bookkeeping, cash-flow management, credit management, interest-rate comprehension, and financial planning. These competencies enable entrepreneurs to evaluate financial opportunities and risks while ensuring sustainable business operations.

3.1.3. Loan Repayment Behaviour

Loan repayment behaviour refers to the extent to which borrowers fulfil their financial obligations according to agreed contractual terms. Effective repayment behaviour includes timely instalment payments, compliance with loan conditions, maintenance of communication with lenders, and responsible utilisation of borrowed funds.

3.1.4. Small and Medium Enterprises

The Malawi MSME Policy classifies enterprises according to employment size. Micro enterprises employ between one and four individuals, small enterprises employ between five and nineteen employees, while medium enterprises employ between twenty and ninety-nine employees.

3.2 Theoretical Review

3.2.1 Dual-Process Theory

This study is anchored in the Dual-Process Theory developed by Lusardi and Mitchell (2011). The theory proposes that financial decisions are influenced by two cognitive systems. System 1 involves intuitive, automatic, and emotion-driven decision-making, while System 2 involves analytical, deliberate, and rational processing of information.

According to the theory, individuals with higher levels of financial literacy are more likely to utilise System 2 thinking when making financial decisions. Such individuals evaluate risks, analyse alternatives, and consider long-term consequences before acting. In contrast, financially illiterate individuals tend to rely on intuition, increasing their vulnerability to poor financial decisions.

3.3. Empirical Review

Several studies have been conducted internationally and locally on issues related to financial literacy and its impact on SME loan repayment. For instance, Claig (2009) examined the impact of financial literacy and its impact on loan repayment by SMEs with reference to industries have been benefited from Equity Group Foundation (EGF) literacy program within Ngara, Nairobi Country. Hence, they have used Equity Bank's record for capturing the population and it is about 300 SMEs, and they have used random stratified sampling method to select 10% of the respondents from the target population because of that their sample size is 30 no of SMEs. And they used a self-administered questionnaire, and the questions were structured and adjusted to the Likert range from 1 to 10.

4.0. METHODOLOGY

4.1. Research Design

This study employed a quantitative research design to examine the influence of financial literacy on microloan repayment among Small and Medium Enterprises (SMEs) in Malawi. Quantitative research was considered appropriate because it allows for the systematic collection and analysis of numerical data, enabling the researcher to identify relationships between variables and draw objective conclusions. The design was particularly suitable for assessing the association between financial literacy indicators and loan repayment behaviour among SME operators.

The study focused on the relationship between financial literacy and repayment performance rather than exploring all objectives contained in the original dissertation. This approach aligns with journal publication guidelines, which recommend concentrating on a single objective to enhance analytical depth and theoretical contribution. The research setting comprised SMEs operating in Dowa District, which served as the empirical context for understanding broader patterns affecting SME loan repayment in Malawi.

4.2 Study Area and Population

The study was conducted among SMEs operating within Dowa District in Malawi. Dowa District was selected because it hosts a substantial number of SMEs involved in agriculture, retail trade, agro-processing, and service provision. Furthermore, the district has significant participation in microfinance programmes offered by commercial banks, cooperatives, government-supported lending institutions, and microfinance organisations.

The target population consisted of SME operators who had previously obtained or were currently servicing microloans. These entrepreneurs represented a suitable population because they possessed direct experience with borrowing, loan management, and repayment obligations. Their experiences provided valuable insights into the role financial literacy plays in influencing repayment behaviour.

4.3 Sampling Procedure and Sample Size

The study utilised convenience sampling to identify SME operators who were willing and available to participate in the research. This technique was considered appropriate because SME operators are often reluctant to disclose financial information, making probability-based sampling difficult to implement. Convenience sampling facilitated access to respondents who possessed relevant experience concerning microloan utilisation and repayment.

A sample size of 60 SME operators was selected. The sample size was determined using Cochran's formula for populations n = $Z^2P(1\text{-}P)\ e^{2\ (}$ where the exact population size was unknow) The sample provided sufficient observations to conduct descriptive and correlational analyses while remaining manageable within the available research resources.

4.4 Data Collection Instrument

Primary data were collected using a structured questionnaire comprising closed-ended questions. The questionnaire was designed to measure key dimensions of financial literacy, including:

Budgeting knowledge; Record-keeping practices; Understanding of loan conditions and interest rates; Financial planning abilities; Communication with lenders.

The instrument also captured information relating to repayment behaviour and challenges experienced by SME operators when servicing loans.

The questionnaire was organised into several sections. The first section collected demographic information, while subsequent sections focused on financial literacy indicators and repayment-related behaviours. The structured nature of the questionnaire ensured consistency in responses and facilitated quantitative analysis.

4.5 Data Analysis

Data were analysed using descriptive and inferential statistical techniques. Descriptive statistics, including frequencies, percentages, means, and standard deviations, were used to summarise respondent characteristics and key study variables.

Pearson correlation analysis was employed to examine relationships between financial literacy indicators and repayment behaviour. Correlation analysis was particularly useful in determining whether improvements in financial literacy were associated with better repayment outcomes among SME operators.

The findings were presented using tables and explanatory narratives to facilitate interpretation.

4.6 Ethical Considerations

Ethical principles were strictly observed throughout the research process. Participation was voluntary, and respondents were informed about the purpose of the study before data collection commenced. Confidentiality and anonymity were maintained by ensuring that individual responses could not be linked to specific participants.

Respondents were assured that information provided would be used solely for academic purposes and would not be disclosed to third parties. Informed consent was obtained before administering questionnaires, and participants retained the right to withdraw from the study at any stage.

5.0. RESULTS AND FINDINGS

The study demonstrates a clear relationship between financial literacy-related factors and SME loan repayment behavior, as supported by both literature and theoretical frameworks. The empirical findings align with Claig (2009), Stiglitz (1981), and Behavioral Finance Theory, confirming that budgeting skills, credit discipline, and communication with lenders improve repayment performance.

Furthermore, the Dual-Process Theory provides a strong explanation for the observed behavior, showing that SMEs often rely on intuitive decision-making, which contributes to over-borrowing and poor financial planning.

Therefore, the study concludes that while financial literacy plays a significant role in improving repayment performance, behavioral tendencies and borrowing patterns especially multiple loan acquisition remain the most influential constraints affecting SME microloan repayment.

5.2 Financial Literacy and Repayment Challenges

Descriptive statistics – Repayment challenges.

Table 1: Repayment Challenges.

Variable	Mean	Std. Deviation	Interpretation
High Interest Rates	3.70	1.10	Agree (High Impact)
Multiple Loans	4.15	0.79	Strongly Agree
Communication with Lenders	3.80	0.93	Agree
Budget Challenges	3.60	0.97	Agree

The study examined the major challenges experienced by SMEs when repaying microloans. Descriptive analysis revealed that multiple borrowing emerged as the most significant challenge, recording the highest mean score ($M = 4.15$). This finding indicates that many SME operators obtained loans from multiple sources without adequate repayment planning, resulting in increased repayment pressure.

Communication with lenders was identified as another important factor affecting repayment performance ($M = 3.80$). Respondents indicated that maintaining regular contact with lenders facilitated repayment negotiations and improved understanding of repayment obligations.

High interest rates also posed substantial challenges (M = 3.70). Many respondents reported that interest-related costs increased repayment burdens and reduced available business capital. Budgeting difficulties recorded a mean score of 3.60, suggesting that inadequate financial planning contributed to repayment problems among some SME operators.

These findings suggest that both behavioural and structural factors influence loan repayment performance. While financial literacy contributes to better financial management, macroeconomic conditions such as inflation and lending costs remain important determinants of repayment outcomes.

5.3 Education and Financial Literacy

Table 2: Determining factors influencing financial literacy. (Mean)

Education Level	Budget Skills (Mean)	Record keeping (Mean)	Interest Understanding (Mean)
Primary Education	0	0	0
Secondary Education	2.5	2.2	2.7
Tertiary/College	2.3	2.8	2.5
University	3.4	3.2	3.2
No Formal	0	0	0

The study investigated the influence of education on financial literacy. Results indicated a positive relationship between educational attainment and financial literacy levels.

Respondents with university education recorded the highest scores in budgeting skills, record keeping, and understanding of loan interest mechanisms. In contrast, respondents with limited formal education demonstrated considerably lower levels of financial literacy.

The findings suggest that education enhances entrepreneurs' ability to understand financial concepts and apply them in business operations. Financially educated SME operators appear better equipped to manage cash flows, maintain financial records, and plan for loan repayment obligations.

The results further imply that investments in education and financial training programmes can contribute significantly to strengthening financial literacy among SMEs.

5.5 Relationship between Financial Literacy and Repayment Behaviour.

Table 3: Relationship between financial literacy and repayment.

Variables	Budgeting Knowledge	Interest Rate Difficulty	Communication with Lender
Budgeting Knowledge	1.000	0.09	0.57
Interest Rate Difficulty	0.09	1.000	0.18
Communication with Lender	0.57	0.18	1.000

Note: Correlation is significant at the 0.01 level (2-tailed)

Pearson correlation analysis was conducted to examine the relationship between financial literacy and repayment behaviour.

The results revealed a significant positive relationship between budgeting knowledge and communication with lenders ($r = 0.57$). This finding suggests that SME operators with stronger budgeting skills are more likely to engage proactively with lenders regarding repayment issues.

The analysis further indicates that financially literate entrepreneurs are better able to anticipate repayment challenges, communicate difficulties early, and negotiate repayment arrangements when necessary.

Conversely, the relationship between budgeting knowledge and perceived interest-rate difficulties was relatively weak ($r = 0.09$). This result suggests that external economic conditions, such as interest rates, operate independently of individual financial literacy levels.

Overall, the findings support the argument that financial literacy improves repayment behaviour through enhanced planning, monitoring, and communication mechanisms.

5.6. Summary of findings

The communication-budgeting link ($r = 0.57$) is especially significant for Malawi SMEs, where lenders like Vision Fund and NEEF often operate through group lending models. SMEs who budget well are better positioned to flag group repayment issues early, protecting the collective loan.

The interest rate independence finding is a policy signal for Dowa District Council and the Malawi government, financial literacy training alone cannot offset Malawi's high real interest rates structural lending reform must accompany SME literacy programs.

The majority female sample (56.6%) adds nuance-women SME operators in Dowa who demonstrate stronger budgeting skills are likely managing household and business budgets simultaneously, the literacy-communication link may be even more important for them, as they face greater social barriers to renegotiating loans.

The study assessed several dimensions of financial literacy, including interest understanding, record keeping, budgeting ability, and loan knowledge.

Overall, the findings indicate that financial literacy contributes positively to improved financial discipline, business management, and repayment behaviour among SMEs.

6.0. DISCUSSION, CONCLUSION AND IMPLICATIONS

6.1 Discussion

The findings demonstrate that financial literacy plays an important role in shaping repayment behaviour among SME operators. The positive relationship observed between budgeting knowledge and communication with lenders supports existing literature suggesting that financially literate entrepreneurs are more capable of managing debt obligations effectively.

The results are consistent with Dual-Process Theory, which argues that individuals with stronger cognitive capabilities make more rational financial decisions. Entrepreneurs possessing budgeting and record-keeping skills are more likely to evaluate financial risks, monitor cash flows, and develop repayment plans.

The findings also corroborate previous studies that identified bookkeeping, budgeting, and credit-management skills as important predictors of loan repayment performance. Financial literacy appears to improve entrepreneurs' ability to allocate resources efficiently and avoid excessive borrowing.

However, the study also highlights the continued influence of external factors such as inflation, high interest rates, and multiple borrowing. These factors can undermine repayment performance even among financially literate borrowers, suggesting that financial literacy alone cannot eliminate repayment challenges.

6.2 CONCLUSION

This study examined the influence of financial literacy on microloan repayment among SMEs in Malawi using evidence from Dowa District. The findings indicate that financial literacy positively influences repayment behaviour through improved budgeting, record keeping, financial planning, and communication with lenders.

The study established that education contributes significantly to financial literacy, while budgeting knowledge is positively associated with behaviours that facilitate loan repayment. Nevertheless, repayment outcomes remain affected by broader economic conditions, including inflation, interest rates, and multiple borrowing.

The study concludes that financial literacy is a significant determinant of repayment performance and should be viewed as an essential component of SME development and financial inclusion strategies.

6.3 Practical Implications

Implications for Financial Institutions

Financial institutions should integrate financial literacy training into lending programmes. Pre-loan education focusing on budgeting, cash-flow management, and debt management can strengthen repayment capacity among borrowers.

Implications for Policymakers

Policymakers should promote financial education initiatives aimed at SME operators. National financial inclusion strategies should incorporate financial literacy as a key pillar supporting entrepreneurship and economic development.

Implications for SME Operators

SME owners should prioritise continuous financial learning and adopt disciplined financial management practices, including budgeting, record keeping, and responsible borrowing.

6.4 Recommendations for Future Research

Future studies should examine the influence of digital financial literacy on repayment behaviour, particularly as mobile banking and digital lending services expand across Malawi. Comparative studies involving urban and rural SMEs may also provide deeper insights into contextual differences affecting repayment performance.

6.5 Conclusion of the Article

The evidence presented in this study demonstrates that strengthening financial literacy can improve repayment behaviour among SMEs and contribute to the sustainability of lending institutions. While financial literacy cannot eliminate all repayment challenges, it remains a critical mechanism for promoting responsible borrowing, enhancing business performance, and supporting inclusive economic growth in Malawi.

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