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ASSESSING THE IMPACT OF FINANCIAL LITERACY ON THE PROFITABILITY OF SMALLSCALE ENTERPRISES: A CASE STUDY OF MALOMO, NTCHISI

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ABSTRACT

This study evaluated the impact of financial literacy on the profitability of Small-Scale Enterprises (SSEs) in Malomo Trading Centre, Ntchisi District, Malawi. Grounded in Human Capital Theory and Signalling Theory, the investigation examined how financial competencies, specifically budgeting, record keeping, and cash flow management, influenced enterprise sales growth while accounting for structural constraints. A quantitative cross sectional survey design was employed, gathering empirical data from 174 small scale enterprise owners through structured questionnaires. Statistical analyses, including descriptive metrics and multiple linear regression using SPSS, were executed to determine the relationships between variables.

The empirical findings demonstrated a statistically significant positive relationship between financial literacy factors and enterprise profitability ($R^2 = 0.653$, $F = 2.44$, $p < 0.001$), with financial management practices accounting for 65.3% of the variance in sales growth. Specific competencies, including structured budgeting ($\beta_4 = 12.600$, $p < 0.001$) and systematic cash flow management ($\beta_5 = 9.810$, $p < 0.001$), acted as primary drivers of commercial success. However, 33.3% of entrepreneurs lacked access to formal credit, and 28% operated within unstable market conditions, highlighting persistent operational challenges. The study concluded that financial literacy is a critical prerequisite for business growth in rural Malawi and recommended targeted practical financial training alongside eased credit requirements from microfinance institutions.

KEYWORDS: Financial Literacy, Enterprise Profitability, Small Scale Enterprises (SSEs), Budgeting, Cash Flow Management, Malomo, Human Capital Theory.

INTRODUCTION

Small and Medium sized Enterprises (SMEs) serve as vital engines of economic growth and poverty reduction within developing nations, accounting for over 90% of businesses and generating more than half of global employment opportunities (World Bank, 2024). In Sub Saharan Africa, these enterprises contribute up to 80% of employment across formal and informal sectors (AFI Global, 2024; Damane & Ho, 2025). Within Malawi, SSEs comprise over 90% of all business entities and contribute approximately 30% to the national Gross Domestic Product (GDP) (Batizani, 2024; Chilole & Kumwenda, 2024). Despite their macroeconomic importance, small scale enterprises frequently experience operational stagnation, low profit margins, and high failure rates within their initial years of operation.

A primary factor constraining the growth of SSEs in rural trading hubs like Malomo Township is the prevalent gap in business financial literacy (Chilole & Kumwenda, 2024; Reserve Bank of Malawi, 2022). While entrepreneurs demonstrate high operational commitment, many lack formal competencies in record keeping, financial reporting, and cash flow forecasting (Ariyo & Adeyemi, 2018; Kasekende, 2016). Consequently, informal financial management impairs strategic decision making and generates asymmetric information between business owners and formal banking institutions. Lenders routinely perceive SSEs as high-risk borrowers due to inadequate documentation, thereby restricting access to debt financing essential for expansion (Batizani, 2024). While national initiatives like the Malawi Growth and Development Strategy (MGDS III) and Malawi 2063 emphasize private sector development, localized empirical evidence regarding financial literacy's impact on rural enterprise profitability remains limited.

OBJECTIVES

1. To analyze the level of financial literacy among small scale enterprise owners in Malomo Trading Centre.
2. To evaluate the profitability levels of small scale enterprises operating within Malomo.
3. To identify the structural and practical challenges faced by small scale entrepreneurs in applying financial knowledge to their daily enterprise operations.

LITERATURE REVIEW

Theoretical Framework

Human Capital Theory

Originally formulated to demonstrate how knowledge and cognitive capacities enhance individual productivity, this theory applies directly to entrepreneurship (Lusardi & Mitchell, 2023). Financial literacy represents a critical human capital investment. By acquiring financial management skills, an enterprise owner enhances operational decision making, reduces resource misallocation, and directly boosts business productivity and profitability (Ariyo & Adeyemi, 2019; Lusardi & Mitchell, 2023).

Signaling Theory

This framework addresses information asymmetry between business owners and potential capital providers (Ariyo & Adeyemi, 2019). Financial documentation acts as a credible signal of enterprise viability. SSE owners possessing financial literacy can generate transparent financial statements, thereby sending positive signals to commercial banks and microfinance institutions to secure growth capital (Batizani, 2024; Kasekende, 2022).

Empirical Review

Empirical literature across Sub Saharan Africa highlights that while access to financial mechanisms (such as mobile money) has expanded rapidly, access without adequate financial education leads to business instability (AFI Global, 2024; Damane & Ho, 2025). Studies in Uganda demonstrated that structured debt financing accelerated SME growth only when entrepreneurs understood loan amortization and cash flow projections (Rwabwogo, 2024).

In Malawi, national scoping surveys indicated that only 29% of the population possessed basic financial literacy (Reserve Bank of Malawi, 2022). Less than 20% of local enterprise owners utilized formal accounting systems, resulting in severe barriers to external credit (Reserve Bank of Malawi, 2021, 2022). However, targeted financial training initiatives have produced measurable improvements; evidence showed that trained enterprise owners were 40% more likely to achieve sustained revenue growth (Malawi University of Business and Applied Sciences, 2025; Reserve Bank of Malawi, 2021).

RESEARCH METHODOLOGY

Research Design and Deductive Approach

The study adopted a quantitative cross sectional survey design using a deductive research approach. This design enabled the empirical testing of established hypotheses derived from Human Capital and Signalling theories within the rural context of Malomo, Ntchisi District.

Target Population and Sampling Technique

The target population comprised N = 308 registered small scale enterprise owners at Malomo Trading Centre, derived from official records provided by the Ntchisi District Council Trade Office. Simple random sampling was utilized to ensure every entrepreneur had an equal probability of selection.

The sample size (n) was calculated using Slovin's Formula at a 95% confidence level (alpha = 0.05)

$$n=\frac{N}{1+Ne^2}$$

$$n=\frac{308}{1+308(0.05)^2}$$

$$n=174.01$$

Consequently, a sample size of 174 SSE owners was targeted and successfully surveyed.

Data Collection and Analytical Tools

Data collection was executed using structured questionnaires administered face to face to ensure high completion accuracy using Kobo toolbox. The instrument captured demographic profiles, financial literacy competencies, credit access, and sales growth metrics. Collected data were organized and analyzed using SPSS Version 27.0 (IBM Corp., 2020). Descriptive statistics (frequencies and percentages) were calculated, and a Multiple Linear Regression Model was fitted to evaluate the relationship between independent variables and enterprise profitability (measured as percentage sales growth).

DATA ANALYSIS AND INTERPRETATION

Response Rate and Demographic Profile

The study achieved a 100% response rate (n = 174). The sample was predominantly male (68.97%, n = 120), with females comprising 31.03% (n = 54).

Demographic Indicator	Category	Frequency (n)	Percentage (%)
Owner Age	18 to 30 Years	89	51.15%
	31 to 45 Years	38	21.84%
	46 to 70 Years	47	27.01%

Education Level	No Formal Education	27	15.51%
	Primary Education	60	34.48%
	Secondary Education	65	37.36%
	Tertiary Education	22	12.65%
Business Duration	Less than 1 Year	2	1.15%
	1 to 10 Years	91	52.30%
	More than 10 Years	81	46.55%

Assessment of Financial Literacy and Service Access

Budgeting

88.5% (n = 154) of respondents reported preparing structured budgets, while 11.5% (n = 20) operated without formal budgets.

Record Keeping

94.8% (n = 165) maintained transaction records, whereas 5.2% (n = 9) kept no formal records.

Cash Flow Management: 81.03% (n = 141) systematically allocated cash flow toward profit generating operational activities, while 18.97% (n = 33) did not.

Financial and Credit Access

75.0% (n = 135) possessed access to formal financial services (bank or mobile merchant accounts). Regarding formal credit, 65.5% (n = 114) had successfully secured business loans, whereas 34.5% (n = 60) had never obtained debt financing.

Market Environment

72.0% (n = 125) operated in perceived stable market conditions, while 28.0% (n = 49) faced high market volatility.

Multiple Linear Regression Analysis

A multiple linear regression analysis was conducted to assess the explanatory power of financial literacy factors and structural control variables on enterprise profitability (measured as percentage sales growth).

General Regression Model Equation

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \varepsilon$$

Fitted Econometric Model Equation

$$\text{Profitability } (Y) = 8.135 + 10.500(X_1) + 8.250(X_2) + 12.600(X_4) + 9.810(X_5) + 15.750(X_6) + 7.920(X_7) + 2.687(X_3)$$

Variable Definitions

Where:

- Y = Enterprise Profitability (Percentage Sales Growth)
- β_0 = Constant (y-intercept)
- X_1 = Education Level
- X_2 = Access to Loan/Credit
- X_3 = Market Conditions
- X_4 = Budgeting Practices
- X_5 = Cash Flow Management
- X_6 = Business Operational Duration
- X_7 = Access to Financial Services
- ε = Error Term

Model Summary: Correlation Coefficient (R) = 0.808; Coefficient of Determination (R^2) = 0.653; Adjusted R^2 = 0.638; Standard Error of the Estimate = 6.503.

Interpretation: The regression model demonstrated strong predictive power (R = 0.808). The R^2 value of 0.653 confirmed that 65.3% of the variance in small enterprise sales growth in Malomo was directly explained by the combined financial literacy and structural variables in the model.

ANOVA Test Results: Regression Sum of Squares = 14,000.00 (degrees of freedom = 7, Mean Square = 2000.00); Residual Sum of Squares = 136,098.75 (degrees of freedom = 166, Mean Square = 819.87); Overall F Statistic = 2.44; Statistical Significance (p value) = 0.0001.

Interpretation: The ANOVA results confirmed that the overall regression model was statistically significant ($F = 2.44$, $p < 0.001$), establishing a valid goodness of fit for predicting enterprise profitability.

Regression Coefficients

Model Variable	Notation	Unstandardized (B)	Standard Error	t Statistic	p Value
(Constant)	β_0	8.135	17.778	3.833	0.000
Education Level	β_1	10.500	2.100	5.000	0.001
Loan Access	β_2	8.250	1.650	5.500	0.006
Budgeting Practices	β_4	12.600	2.520	6.300	0.000
Cash Flow Management	β_5	9.810	1.836	4.590	0.000

Business Duration	β_6	15.750	3.150	7.875	0.002
Access to Financial Services	β_7	7.920	1.584	4.950	0.001
Market Condition	β_3	2.687	4.943	0.544	0.587

FINDINGS

1. Budgeting as a Major Profitability Driver

Effective budgeting displayed a statistically significant positive effect ($\beta_4 = 12.600$, $p < 0.001$). Each unit improvement in structured budgeting correlated with a 12.60% increase in enterprise sales growth.

2. Cash Flow Optimization

Strategic cash flow management significantly enhanced sales growth ($\beta_5 = 9.810$, $p < 0.001$), confirming that active management of daily inflows and outflows preserves liquidity and funds profit generating activities.

3. Human Capital Influence

Higher formal education levels ($\beta_1 = 10.500$, $p = 0.001$) and longer business operational duration ($\beta_6 = 15.750$, $p = 0.002$) were strong predictors of revenue performance, confirming that cumulative knowledge and operational experience drive enterprise growth.

4. Financial Services and Credit Access

Securing formal loan facilities ($\beta_2 = 8.250$, $p = 0.006$) and utilizing financial service infrastructure ($\beta_7 = 7.920$, $p = 0.001$) significantly boosted sales volume by providing the working capital necessary to expand inventory.

CHALLENGES FACED BY ENTREPRENEURS

Collateral and Credit Access Barriers

34.5% of entrepreneurs were unable to access formal credit. Respondents cited stringent collateral demands from commercial banks as a primary impediment preventing business expansion.

Knowledge Gaps in Complex Financial Tools

While basic record keeping was high, entrepreneurs struggled with formal double entry accounting, profit and loss reporting, and preparing loan ready financial statements.

Market Volatility and Inflation

28% of enterprise owners operated in unstable market environments, reporting that price fluctuations and unpredictable consumer demand diluted the financial benefits gained from budgeting.

CONCLUSION

This study conclusively established that financial literacy is a key determinant of enterprise profitability among small scale businesses in Malomo, Ntchisi District. The empirical model validated both Human Capital Theory and Signalling Theory by proving that internal financial competencies directly boost sales growth ($R^2 = 0.653$) and facilitate access to formal credit channels. While basic budgeting and record keeping were widely practiced, structural barriers, notably high credit requirements and economic volatility, continue to constrain micro enterprise growth. Enhancing practical financial management capabilities remains essential for turning rural survivalist ventures into sustainable commercial enterprises.

RECOMMENDATIONS

1. Implement Targeted Business Skill Workshops

Development agencies and the Ministry of Trade should establish practical training modules focusing on formal financial documentation, loan management, and inventory accounting tailored for rural entrepreneurs.

2. Ease Credit Conditions for Rural SSEs

Microfinance institutions and commercial banks should create flexible credit evaluation frameworks that consider basic record keeping logs rather than demanding immovable property as collateral.

3. Promote Digital Financial Tools

Financial service providers should expand accessible mobile based accounting and merchant payment systems to simplify cash flow tracking for rural trading hubs.

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