Policy Brief 007

FINANCIAL LITERACY AS A TOOL OF BUSINESS TRANSFORMATION FOR SMALL AND MEDIUM ENTERPRISES IN UGANDA

Authors:

Kibira Vicent

Kiberu Jonah

Twinamasiko Emmanuel

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Majority of the businesses in developing countries, Uganda inclusive fall under Small and Medium Enterprises.

This brief presents what limits the performance of SMEs and recommends the possible policy measures that can be adopted to transform SMEs in Uganda citing financial literacy as the key general strategy to SME transformation.

Executive Statement

Majority of the businesses in developing countries, Uganda inclusive fall under Small and Medium Enterprises. They employ the largest part of the population and contribute to livelihood improvement and sustainability. SMEs thus play a significant role in economic growth and development of the economy.

This brief presents what limits the performance of SMEs and recommends the possible policy measures that can be adopted to transform SMEs in Uganda citing financial literacy as the key general strategy to SME transformation. The limitations to SME growth highlighted include shortage of capital and credit facilities, limited skilled labour, inadequate raw materials, poor infrastructure, inefficient management skills, and the contained use of new, emerging, and constantly changing technologies.

The brief recommends training of SME owners in budgeting and expenditure management, creation of periodical awareness on debt management for SMEs, establishing policies that would encourage and promote a positive saving and investment culture, preparing and distributing Bookkeeping user guiding manuals customized in local languages such that SME owners can use them to learn effective and efficient book keeping for their records, periodically scheduling trainings for SME owners particularly to understand their legal financial obligations such as taxes and organizing massive campaigns for SME awareness on earnings maximization and business sustainability

Key words: *Financial Literacy, Small and Medium Enterprises, Business transformation, financial management*

Background and Introduction

Small and Medium Enterprises (SMEs) are the main driving forces of economic growth, development, employment creation and poverty reduction, not only in developed countries but also in developing and emerging economies (Zafar & Mustafa, 2017). SMEs in most economies have barriers to access to finance, difficulties in exploiting the technology, insufficient capabilities, low productivity, and regulatory burdens in their business environment.

Regardless of the setbacks hindering SMEs, they have been instrumental in facilitating economic growth through creation of new jobs, widening the tax base, and spearheading innovation. SMEs promote competition and entrepreneurship hence has external benefits on the economy wide efficiency, innovation and aggregate productivity, (Wanjohi 2018). They are the primary vehicles by which new entrepreneurs provide the economy with a continuous supply of ideas, skills, and innovations. Ngui (2014) argued that the concentration of SMEs has a close relationship with the dominant economic activities.

A well-developed SME sector is essential to the steadiness of industrial development

Small and medium-sized enterprises (SMEs) play a significant role in the economic development of the country and their contribution has been well documented in a series of the literature. A well-developed SME sector is essential to the steadiness of industrial development, thereby contributing to consistence and steady economic growth in the economy.

What's wrong with SMEs?

Despite the contribution of SMEs in economic development, it is clear that the performance of SMEs is still low in developing economies, preventing them from contributing their quota effectively in the development of the economy. In general, shortage of capital and credit facilities, limited skilled labour, inadequate raw materials, poor infrastructure, inefficient management skills, and the contained use of new, emerging, and constantly changing technologies are some of the major barriers to SME growth. Therefore, there is a pressing need for exploring factors and mechanisms that can contribute to facilitating SME performance, especially in emerging markets like Uganda.

In Uganda, SMEs are considered the major form of businesses in the economy, as it accounts for more than 92% of the total number of enterprises, provides 80% of employment and contributes 35% of the Gross Domestic Production (GDP).

SMEs in Uganda face challenges that hinder them from attaining economies of scale largely due to insufficient skills and training which limit their capacity to manage the business resources effectively.

Such SMEs include carpentry, hawking, market vendors, transport sector, agricultural sector, building and construction, roadside traders especially women and youth. Small and Medium Enterprises facilitate broad-based equitable development and provide more opportunities especially for women and youth participation in the economic development of the country. Therefore, such SMEs have a high potential not only in semi-urban settings but also for rural sector development. However, SMEs in Uganda face challenges that hinder them from attaining economies of scale largely due to insufficient skills and training which limit their capacity to manage the business resources effectively.

Financial literacy therefore is regarded as one of the strategies which can be employed to improve SMEs' performance in Uganda.

Financial literacy enables quick decision-making processes such as efficient debt management which improves the credit worthiness position of potential borrowers to support their livelihood, timely bill payment, economic growth, reliable and sound financial systems and a reduction in poverty levels.

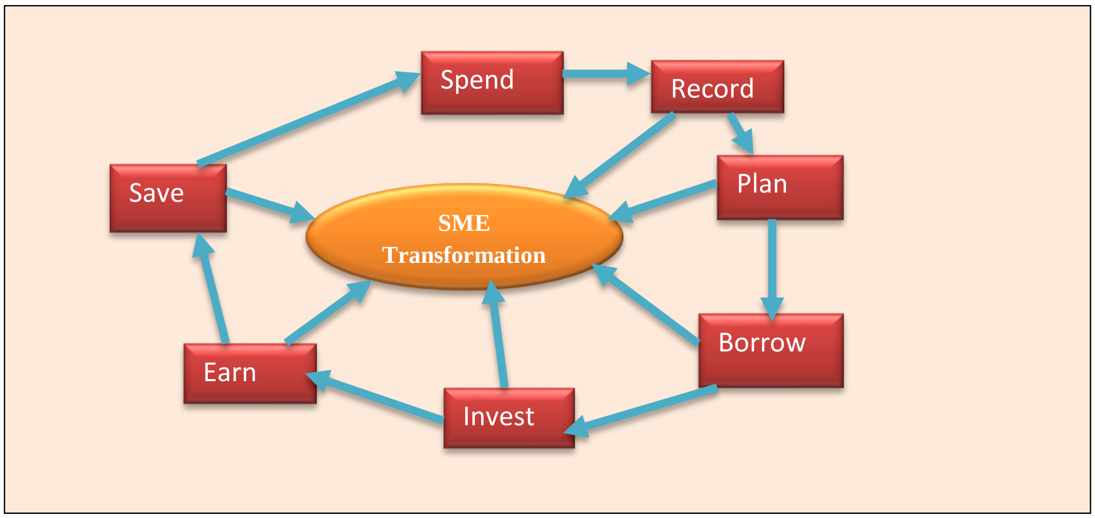
Financial literacy also provides more effective use of financial products and services, enhances greater control of one's financial future and reduced vulnerability to fanatic retailers. It is of no doubt that many developing economies Uganda inclusive have continued to rely on small businesses to cause impact on the economic growth and inequitable progress which is a major role played by the SMEs in keeping and maintaining currency circulation.

Financial literacy provides knowledge and understanding of financial concepts, business skills, credit worthiness, motivation and confidence to make effective decisions across a range of financial contexts and to improve the financial health and sustainability of SMEs.

Financial literacy is a driver of change for inclusive economic growth, regional development, employment generation, and poverty reduction. Financial literacy has been identified as a vital knowledge resource for efficient financial decision making, however little or insufficient attention has been given to SMEs on how financial literacy affects their sustainability and transformation.

Having a strong SME sector is crucial to establishing a solid industrial sector in an economy and therefore, well-functioning SMEs are essential to steady and continuous economic growth. Many SME owners regard financial literacy as a waste of time and resort to rudimentary business management approaches. To transform SMEs into self-sustaining businesses, intensive financial literacy would be a pivotal inevitable tool.

Considerations for financial literacy



Key Policy recommendations to use financial literacy to transform SMEs in Uganda

i) Train SME owners in budgeting and expenditure management. This would enhance identification budgetary variances and their causes. SMEs would be able to fight any form of extravagancy as they follow clear budget lines.

ii) Create periodical awareness on debt management for SMEs. SME owners acquire suppliers credit and other forms of debts and therefore, they awareness on how to manage such debts and considering going concern for their businesses as well as continuity with their suppliers.

iii) Establish policies that would encourage and promote a positive saving and investment culture such as increasing interest rates on savings, lowering interest on loans and constantly remind SME owners to save part of their income. Also train SME owners on how to set up emergency funds to cater for unforeseen eventualities to prevent them from encroaching on the business capital during such crises.

iv) Prepare Bookkeeping user guiding manuals customized in local languages such that SME owners can use them to learn effective and efficient bookkeeping for their records. These can as well be used to increase access to finance especially through credit.

v) Periodically schedule trainings for SME owners particularly to understand their legal financial obligations such as taxes.

vi) Organize massive campaigns for SME awareness on earnings maximization and business sustainability.

Conclusion

Financial literacy has been widely recognized as a key strategy to transform businesses regardless of their sizes. SMEs can transform into large businesses where their owners or proprietors have strong management skills and capacity to formulate and implement proper sustainability approaches especially in aspects of financial management. Thus, government and local authorities should redirect their efforts towards financial literacy to encourage business growth, adherence to legal financial obligations and promoting livelihood improvement.

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