

Impact of Financial Literacy on the Financial Performance of Selected MSMEs of Purba Medinipur District, West Bengal: An Empirical Study

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Abstract:

Financial literacy is the capacity of entrepreneurs to handle the financial planning, organizing, and controlling of the business. The paper aims to assess how entrepreneurs' financial literacy affects the financial performance of their businesses. Financial literacy is an independent variable, while financial performance (Profit) is a dependent variable. The research variables are collected via primary data and Likert scales. Regression is employed to analyse the data, and the results indicate that financial literacy has a considerable impact on the MSME's financial performance in Purba Medinipur.

Keywords: MSME, Financial Performance, Financial Literacy, Purba Medinipur.

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Introduction

Micro, small, and medium-sized businesses (MSMEs) are important to the national economy during times of the Covid-19 economic crisis. It would be more competitive in both domestic and international markets if they were strengthened and developed with financial resources. It was emphasized by their role in providing jobs and contributing to the national income (Suci, 2017). MSMEs are important for both the distribution of development outcomes and labor absorption. Additionally, positive is the MSMEs' contribution to the GDP. MSMEs often experience delays in development. Human resource capacity issues are among the many unresolved conventional difficulties (closed-loop issues) that are to blame for this. Because of issues with ownership, funding, marketing, and other aspects of managing a huge firm, MSMEs find it difficult to compete with larger companies. In MSMEs, one of the issues is financial literacy. Financial literacy is the set of ideas, knowledge, and abilities that can affect attitudes and behaviour to help MSME actors manage their money and make wise decisions that will lead to wealth. The capacity of managers to create budgets, handle debt, and record financial statements. The MSME management must be able to document business operations, revenue and expenses, profitability, and other performance-related subjects to record financial statements. Most commercial banks are reluctant to offer capital credit to MSMEs because they cannot frequently produce their financial reports. For MSMEs, financial reporting is essential to assessing the success of their company. Awareness of financial literacy is required to avoid financial issues and problems, according to Akmal & Saputra (2016). In addition to low income, poor money management practices, including credit abuse, poor planning, and a lack of savings, can also lead to financial issues. Financial decision-making and management in business are influenced by financial literacy, which also affects how individuals see financial circumstances. According to Kasendah and Wijayangka (2019), company owners' financial management skills are critical to the success and longevity of their companies.

Literature Review:

Knowledge of finance is the capacity to comprehend the fundamentals of finance, including financial instruments and how they are used in business, including investing, insurance, savings and loans, and financial management. Higher financial literacy will boost the firm's financial performance (Gunawan, Pulungan, & Koto, 2019; Pulungan, 2017). Kasumaningrum asserts that financial inclusion, which facilitates MSME participants' access to additional capital, is one element that might enhance financial literacy. According to Chepngetich, P., the

achievement or failure of small and medium-sized businesses is decided by their financial viability. Chepngetich, P., found that "a high level of financial literacy significantly contributed to the operation and financial performance of the firms," which is consistent with theory. Financial literacy improves MSME performance, according to Setiawan, B., Panduwangi, M., & Sumintono, B. Martínez-Ferrero and Herath, S., & Albarqi, N. Ahmedmed et al., Lusimbo and Pusung discuss the role of financial knowledge on business performance; they conclude that this knowledge positively impacts business performance. Therefore, the study's hypothesis states that financial literacy improves performance.

Research Gap

Prior research has examined how entrepreneurs' financial literacy affects their company's financial performance in various states and nations. No research has been done on how the financial literacy of entrepreneurs in the Purba Medinipur area affects MSME financial performance. The research gap is therefore selected as the study's goal.

Objective of the Study

The goal of the current study is stated below, which was determined by reviewing the literature and identifying the study gap.

1. To understand how financial literacy affects the financial performance of MSME.

Hypothesis:

H1: The performance of MSMEs in the Purba Medinipur District is positively impacted by financial literacy.

Materials and Methods

A questionnaire survey was used as the major data source for this investigation. Only MSME actors in the Purba Medinipur district are eligible. The districts of Contai, Tamluk, Haldia, Mahisadal, Digha, Kolaghat, and Panskura are chosen for data collection based on the District Industrial Center's (DIC) database. A five-point Likert scale was utilized to measure each variable, and 188 sample data were collected through the purposive sampling technique. The primary survey was carried out between October 1st and October 25th, 2024.

The target respondents are those who operate enterprises in the following industries: food processing, bus body manufacturing, garment manufacturing, human hire processing, salt manufacturing, steel fabrication, and conch products. Regression analysis is used to conclude the study hypothesis. First, validity and reliability tests were carried out as a conventional assumption test before regression. The data test is carried out using SPSS.

Selection of the variables

For the study, we used financial performance (Profit) as the dependent variable and the entrepreneurs' financial literacy (F_L) as the independent variable. The following subtitles of financial literacy are used to represent the respondents' financial literacy: cost of capital management (X1), profit and loss management (X2), capital structure management (X3), saving, investment, and insurance management (X4), inventory management (X5), and debt management (X6).

Results and Findings

Table 1: R-Square

| Variable | R2 |
|--------------------------------|-------|
| Financial Performance (Profit) | 0.297 |

Source: Analysis by Author

R-squared is an important parameter to assess the quality of the model (Juliandi, 2018). The value is greater than 0.75; it means the model is strong, 0.50 is moderate, and the value of 0.25 indicates a poor model representation. Table 1 shows that the MSMEs' financial performance (Profit) has only 29.7% (R-squared .297) change due to financial literacy.

Table 2: Regression Analysis

| Variables | Beta | C.R (t) | P |
|----------------|-------|---------|------|
| Profit --- X1 | -.057 | -.395 | .693 |
| Profit --- X2 | 1.022 | 8.820 | .000 |
| Profit --- X3 | -.330 | -2.731 | .006 |
| Profit --- X4 | .440 | 3.254 | .001 |
| Profit --- X5 | .741 | 6.077 | .000 |
| Profit --- X6 | .254 | 1.973 | .048 |
| Profit --- F_L | .545 | 8.858 | .001 |

Source: Analysis by Author

According to Table 2, the study's primary hypothesis—that entrepreneurs' financial literacy has a positively and significantly impact on their financial performance (Profit) at the 5% level of significant (0.001)—is supported. The remaining six subcategories of financial literacy reflect the entrepreneurs' overall financial literacy. The financial performance of the MSME is not significantly (0.693) impacted by literacy of cost of capital management (X1), but other financial literacy parameter of the entrepreneur like profit and loss management (X2), capital structure management (X3), saving, investing, and insurance management (X4), inventory management (X5), and debt management (X5) have significant role on the financial performance of MSME.

Table 3: Validity Test

| Variable | Statement Items | r-count | r-table | p-value | Result |
|--------------------|-----------------|---------|---------|---------|--------|
| Financial Literacy | X1 | 0.778 | 0.1475 | 0.001 | Valid |
| | X2 | 0.845 | 0.1475 | 0.001 | Valid |
| | X3 | 0.807 | 0.1475 | 0.001 | Valid |
| | X4 | 0.769 | 0.1475 | 0.001 | Valid |
| | X5 | 0.776 | 0.1475 | 0.001 | Valid |
| | X6 | 0.778 | 0.1475 | 0.001 | Valid |

Source: Analysis by Author

A validity test in research refers to the process of evaluating whether a study accurately measures what it intends to measure. It ensures that the research findings are credible, reliable, and applicable to real-world situations. In this study, where: The Degree of Freedom is 186, according to the r table. Considering Degree of Freedom (df) the value is 0.1475. Table 3, The calculated r-count value of all variables is more than the r-table (0.1475) value, and the p-values (0.001) of the all variables also are less than the 5% level of significance; it is confirmed that all the variables of financial literacy are valid.

Table 4: Reliable Test

| Variable | Alpha Cronbach's | Result |
|----------------------------------|------------------|----------|
| X1 | .863 | Reliable |
| X2 | .842 | Reliable |
| X3 | .851 | Reliable |
| X4 | .857 | Reliable |
| X5 | .858 | Reliable |
| X6 | .856 | Reliable |
| Overall Financial Literacy (F L) | .876 | Reliable |

Source: Analysis by Author

Generally, if the Cronbach alpha value is near 0.9 to 1.0, it is considered very good. Table 4, which presents the reliability of the data, shows that the main variable (F_L) and its sub-variables (X1 to X6) are both legitimate, with Cronbach's Alpha values over near to 0.9. Therefore, the all variables used in this study are deemed trustworthy and appropriate.

Discussion

We know that the financial literacy is the part of planning, organizing, and controlling the finances in business. MSME managers must document business operations, revenue and expenses, profitability, and other performance-related subjects to prepare financial statements. Most commercial banks won't give capital credit to MSMEs if they can't produce their financial reports. The provision of financial reports is essential for MSMEs to gauge the success of their enterprises.

In this study results show that the financial literacy of the entrepreneurs is an important parameter that significantly impact on the financial performance of the business, if the business owners do proper accounting records and maintain, it helps to access the business health conditions, even if it allows to get finance from different financial institutions. According to study results, capital structure is having positive role on the financial performance of the businesses. Capital structure management plays a fundamental role in determining the financial stability and profitability of MSMEs. The Poor capital structure decisions, on the other hand, may lead to excessive debt burdens, increasing interest costs and lowering profitability. On the other hand, Effective inventory management is another key factor influencing MSME financial performance. The study highlights that businesses with efficient inventory control systems are better positioned to minimize holding costs, avoid stockouts, and enhance operational efficiency. Proper inventory management ensures a smooth production cycle and helps in maintaining cash flow stability, which is crucial for small and medium enterprises that often struggle with liquidity constraints. Similarly, literacy on debt management is significant role on the financial performance of the MSME business, the Debt management also emerged as a crucial determinant of financial performance. The findings suggest that MSMEs that effectively manage their debt obligations tend to have stronger financial health. Excessive debt, particularly when mismanaged, can lead to high financial costs and increase the risk of default, ultimately impairing business profitability. Additionally, saving, investing, and insurance management significantly influences financial outcomes for MSMEs.

Businesses that prioritize strategic savings and investment decisions are more resilient to financial shocks and economic downturns. Investments in productive assets and revenue-generating opportunities contribute to long-term growth, while adequate insurance coverage helps mitigate business risks, safeguarding financial stability. Overall, the results underscore the interconnected nature of financial management practices and their collective impact on MSME financial performance. Effective financial management strategies contribute not only to short-term profitability but also to long-term sustainability. These insights suggest that MSMEs should adopt a holistic approach to financial decision-making, ensuring that profit and loss management, capital structure, debt, inventory, and investment decisions are aligned with their growth objectives.

Conclusion

The findings indicate that financial literacy is important in improving financial performance of the MSME business. We can say that illiterate entrepreneurs cannot manage the financial and non-financial programs properly that help their business growth today and in the future; even if they do not maintain accounting records due to lack of financial literacy, it does directly affect access to finance; they cannot get finance from banks and non-banking institutions. It is concluded that financial literacy helps business success especially in financial performance; the entrepreneurs can easily handle accounting records, sources of finance, cost of capital, manage budgeting and inventories, and maintain business losses.

Implication

The study highlights the crucial role of financial literacy in enhancing the financial performance of MSMEs in Purba Medinipur. Specifically, literacy in capital structure, profit and loss management, inventory management, saving and investment, and debt management significantly contributes to business growth. However, awareness of the cost of capital does not show a significant impact, suggesting that MSMEs may prioritize operational financial skills over financing costs. Policymakers and financial institutions should focus on targeted financial education programs to strengthen key financial competencies, ensuring sustainable business growth and resilience in the MSME sector.

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Appendix

Impact of Financial Literacy on the Financial Performance of Selected MSMEs of Purba Medinipur District, West Bengal: An Empirical Study

: QUESTIONNAIRE:

A. Personal Data of Entrepreneurs/Respondents:

1. Entrepreneurs Name(optional):
2. Gender:
 - A. Male () B. Female () C. Transgender ()
3. Age:
 - A. Below 25 year () B. 25-35 year () C. 36-50 year () D. above 50 year ()
4. Education:
 - A. Up to M.P () B. H.S pass () C. Graduate pass () D. Post graduate () E. Other ()
5. Marital Status.
 - A. Married () B. Unmarried () C. Divorce ()
6. Caste
 - A. General () B. OBC () C. SC () D. ST ()
7. Income of entrepreneur (Annual): Rs.

B. Details of MSMEs:

1. Types of Firm:
 - A. Micro () B. Small () C. Medium ()
2. Nature of Firm:
 - A. Manufacture () B. Trade () C. Service ()
3. The firm Belong in:
 - A. Rural area () B. Urban area () C. Semi-urban area ()
4. Loan taken: A. Yes () B. No ().
5. Types of loan: A. Collateral () B. without collateral ().

C. Measure of financial literacy of entrepreneurs and financial performance of the firm on the basis of Likert scale (Strongly Disagree-1; Disagree-2; Neutral-3; Agree-4; Strongly Agree-5).

| Sl no. | Variable name | 1 | 2 | 3 | 4 | 5 |
|-----------|--|---|---|---|---|---|
| 1. | <u>Financial Literacy</u> Literacy on profit and loss management. | | | | | |
| A. | Do you Have Basic idea about on Profit and Loss Calculation? | | | | | |
| B. | Do you Have idea of management on Break-even Analysis? | | | | | |
| C. | Do you Have idea of manage on profit margin? | | | | | |
| D. | Do you have idea about the profit and loss statement that help in making business decisions? | | | | | |
| 2. | Literacy on cost of capital management | | | | | |
| A. | Do you Have idea about how to calculate cost of capital? | | | | | |
| B. | Can you manage which source of capital is suitable based on cost of capital decision? | | | | | |
| 3. | Literacy on capital structure management? | | | | | |
| A. | Do you Have idea about different sources of capital for business? | | | | | |
| B. | Can you manage the which capital structure ratio is best that support to business growth? | | | | | |
| 4. | Literacy on saving, investment and insurance management | | | | | |

| | | | | | | |
|-----------|--|--|--|--|--|--|
| A. | Do you Have idea about saving, current, fixed deposit knowledge? | | | | | |
| B. | Do you Have idea on mutual fund, stock market and business investment? | | | | | |
| C. | Do you Have idea about the insurance management for business? | | | | | |
| 5. | Literacy on inventory management. | | | | | |
| A. | Are you familiar with different inventory management systems? (e.g., FIFO, LIFO, JIT)? | | | | | |
| B. | Can you track and control inventory of business? | | | | | |
| C. | Can you manage the inventory optimal level and Economic Order Quantity (EOQ)? | | | | | |
| 6. | Literacy on debt management. | | | | | |
| A. | Do you know how to calculate the interest rate of loan and borrowing cost? | | | | | |
| B. | Can you manage the credit or CIBIL score? | | | | | |
| C. | Are you able to manage the creditors and debtors? | | | | | |

A. Quantitative data of MSMEs (Performance basis):

- 1. Profit of the Business (Last Three Years):**