INTERNATIONAL JOURNAL OF SOCIAL Sciences and Information Technology
ISSN 2412-0294 www.ijssit.com
http:// www.ijssit.com

EFFECT OF KNOWLEDGE OF CASH BUDGETING ON FINANCIAL PERFORMANCE OF SMALL-SCALE BUSINESSES IN KISII, KENYA

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Abstract: The financial sector in the developing world and especially in Kenya has been developing rapidly in the recent years. The expanded credit options have increased the temptation of small business owners to borrow more loans, which have risen to unprecedented levels resulting in up to 70% of these businesses collapsing under the burden of unserviced loans. Statistics indicate that loans taken by small businesses in Kisii form 60% of the non-performing loans portfolio among the banks and SACCOs operating in the town indicating poor financial performance. The present research sought to analyse the effect of financial literacy on financial performance of small-scale business owners in Kisii town with a specific objective to assess the effect of knowledge of cash budgeting on financial performance of small-scale businesses in Kisii town. A sample of 301 small scale businesses owners were selected through stratified random sampling technique. Interviews and structured questionnaires were used to collect primary data. Tables and figures were used to present the results. Results showed that knowledge of cash budgeting has a positive significant effect on financial performance ($\beta = 0.296$, $p = 0.010$), implying that when all factors are held constant, a unit increase in knowledge of cash budgeting leads to a 29.6% significant increase in financial performance in the small scale businesses. Findings from the study may benefit the small business owners in understanding the need to be more financially literate and to the management of loan-providing financial institutions so that they increase their efforts in capacity building their credit customers in financial management that may in the end lead to reduced loan default levels.

Keywords: Financial Literacy, Financial Institutions, Small Scale Business

Introduction

Financial literacy remains an interesting issue in both developed and developing economies, and has elicited much interest in the recent past with the rapid change in the finance landscape (Gitari, 2012). The idea of financial literacy has for a long time interested scholars since it is seen as the combination of consumers and investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities. It also involves making informed choices, knowing where to go for help, and to take other effective actions to improve their financial well-being (Miller *et al*., 2009).

Different scholars have defined financial literacy in different ways. For instance, Worthington (2005) defines it as the as ability to make informed judgments and to make effective decisions regarding the use and management of money. According to Agnew, *et al.* (2007), financial literacy is that knowledge that enables businesses to build their financial skills and gives them confidence to undertake financial decisions for their pension schemes. Knowledge on borrowing, savings and plans to save is critical for effective long term financial decision making that is relevant to small businesses (Gitari, 2012).

Atieno (2014) conducted a research on assessment of financial education and its implication on individual investment in Kenya. Results indicated that cash budgeting has no relationship with investment by the respondents. The variable was also found to have no direct relationship with financial performance of the respondents.

The review of literature indicates that the effect of knowledge of cash budgeting and financial performance of businesses is also contentious since scholars have not agreed upon the relationship with some indicating a positive significant relationship (Raghumandan *et al*., 2012; Qi, 2010) and others indicating that there is no relationship between the variables (Atieno (2014). Of the reviewed studies, none has attempted to establish the relationship between knowledge of cash budgeting and financial performance of small-scale business owners in Kisii town.

In a study on small-scale businesses in Kisii County, Ombachi (2014) noted that the greatest challenge facing these small-scale businesses was repayment of loans advanced to them. The study noted that concerns with providing accessible and appropriate credit systems for small-scale businesses in developing countries have been growing for many decades. This is because appropriate credit systems could cater for the financing needs of the small-scale enterprises in the rural areas. Nyabwanga *et al*., (2011) in his study of the effect of working capital management practices on the financial performance of small scale enterprises in Kisii district using a sample of 113 small scale enterprises and using a survey design established that majority of the small business owners or managers had just basic education and over 57% of these business operators hardly attend any business training programmes despite the establishment that over 60% of them had little or no knowledge in business management hence were void of management skills vital in the running of their enterprises. The study also established that the performance of small-scale enterprises was on average low.

In another study by Oyier (2012) on determinants of non-performing loans among financial institutions operating in Kisii town, it was revealed that loans to small-scale businesses formed the greatest portfolio of non-performing loans especially for Saccos. Findings from the study indicated that up to 60% of small-scale businesses in Kisii town who borrowed loans from the commercial banks and Saccos operating in Kisii town were not able to service the loans that they had borrowed leading to non-performing loans making up to 70% of them to fail within the first five years of their start-up. The research however did not link the borrowers' financial literacy and the financial performance of their businesses. The present study therefore sought to fill this gap by analysing the effect of financial literacy on financial performance among small business owners in Kisii town.

Knowledge of Cash Budgeting and Financial performance

The relationship between knowledge of cash budgeting and financial performance of businesses is also contentious since scholars have not agreed upon the relationship with some indicating a positive significant relationship and others indicating that there is no relationship between the variables. Raghumandan *et al*., (2012) examined the behavioural aspects of budgeting with particular emphasis on public sector in India. The main objective of the study was to establish whether knowledge of cash budgeting has an effect on the psychology of entrepreneurs in respect to their financial performance. The study was descriptive in nature and it focused on the crucial role of the behavioural aspects of budgeting by studying a selected sample of 340 entrepreneurs in India. The data was collected using telephone interview and results showed that knowledge of cash budgeting has an important significant bearing on the financial performance on the entrepreneurs in India.

In a study by Qi (2010), it was established that by cash budgeting has a positive significant effect on a number of financial behaviour of entrepreneurs including their financial performance. The main objective for this empirical study was whether the cash budgeting process significantly and positively impacts the performance of Chinese SMEs with reference to their financial performance. The study used a sample of 124 entrepreneurs. A correlational research design was used to establish the relationship between the variables. Firstly, it is found that more formalized cash budgeting planning leads to higher sales revenues. Secondly, budget goal characteristics strongly affect the budgetary performance of Chinese SMEs. Specifically, this conclusion tells us that clear budget goals lead to higher goal achievement starting from financial performance. Furthermore, results also reveal that the more formalized budgetary control tends to lead to a higher growth of profit of a firm. The underlying reason can be that due to management control, the total expense of a firm will be at most minimized, which thus results into the growth of profit of the firm.

Kytonen (2004) carried out a study on cash management behaviour of firms and its structural change in an emerging money market in Finland. The main purpose of this study was to examine if evidence of a structural change can be detected from the decision-making practices of cash management and from the financial statement data. Through survey evidence an attempt was made to identify the best practices followed by Finnish listed manufacturing and service companies and their developments during the research period. The factors assumed to change were the organizational and technological arrangements in cash budgeting and how these were influencing their borrowing decisions. In addition, the behavioral changes in cash management were examined by testing both static and dynamic cash management models and their potential structural change before and after the deregulation years of the money market. The results of the survey part of the study revealed that cash management practices changed significantly during the research period. Findings indicate that cash budgeting has no relationship with financial performance of the companies.

Atieno (2014) conducted a research on assessment of financial education and its implication on individual investment in Kenya. The specific objectives of the study were to determine the effect of cash budgeting on individual investment of employees in Kisii University, to access the effect of savings on individual investment of employees in Kisii University, to evaluate the effect of debt management on individual investment of employees in Kisii University and to find out the effect of retirement planning on individual investment on employees in Kisii University. The study adopted descriptive research design. The study was carried out at Kisii University in Kisii County. The target population for this study was the academic and non-academic staff in Kisii University, which is 829 members. A sample of 106 employees was selected using stratified random sampling. Both qualitative and quantitative data was collected using a questionnaire that consisted of both open ended and close-ended questions. Data were analyzed using descriptive statistics and inferential statistics. The findings of the study revealed that the desire to be financially dependent was perceived to be the major influence in budgeting. This indicated that the employees have better budgetary controls of their resources and ensure that they utilize their resources optimally. The saving culture for the respondents was low due to lack of enough money to enable them save. Generally, results indicated that cash budgeting has no relationship with investment by the respondents. The variable was also found to have no relationship with financial performance of the respondents.

Statement of the Problem

Statistics have indicated that up to 60% of small-scale businesses in Kisii town who borrowed loans from the commercial banks and Saccos operating in Kisii town were not able to service the loans that they had borrowed leading to non-performing loans which leads to about 70% of them to fail during the first five years of their start up. While a number of studies have been carried on the possible causes of these failures, studies on the relationship between financial literacy and financial performance of the businesses are missing.

Studies on the relationship between financial literacy and financial performance have demonstrated that there is no agreement on the relationship between the variables with some studies finding a significant positive relationship between knowledge of key money concepts and various measures of financial success and others finding no significant relationship between knowledge of key money concepts and various financial performance measures. Empirical literature review has shown that there is no study that has investigated the effect of cash budgeting on financial performance of small-scale businesses Kisii town. A relevant issue for empirical investigation was therefore that of establishing the effect of financial literacy on financial performance of the small-scale businesses in Kisii town.

Objectives of the Study

The main objective of the study was to analyse the effect of financial literacy on financial performance of small businesses in Kisii town; a survey of businesses and the specific objective was to assess the Effect Of Knowledge Of Cash Budgeting On Financial Performance Of Small-Scale Businesses In Kisii town.

Scope of the Study

This study was carried out among small-scale businesses in Kisii town. The town was chosen since small-scale businesses in it face the same problems that other small-scale businesses in other parts of the country face in repaying their loans. It was also chosen because of the researcher's knowledge of the town, which helped make the research more comprehensive since data collection was easier. The research was conducted between the months of November and December, 2019.

Research Methodology

The Theory of Reasoned Action (TRA) anchored the study. The research adopted the correlational research design. The population of the study was the 1220 small businesses owners in Kisii town. The population was stratified into three strata; retail, manufacturing and service. A sample of 301 small scale businesses owners were selected through stratified random sampling technique. Interviews and structured questionnaires were used to collect primary data. Content Validity Index and Test-retest methods were used to check validity and reliability of the research questionnaires respectively. Multiple regression analysis was used to establish the effect of financial literacy on financial performance of the small-scale businesses.

Results And Discussion

Reliability and Validity of the Research Instrument

Test-retest based on the pilot study was used to test reliability using Cronbach's Alpha yielded a ratio of 0.81, which showed that the questionnaire was reliable. Content Validity Index (CVI) was used to check validity of the questionnaires. For the present study, a CVI of 0.76 was achieved. The instrument was therefore found to be valid.

Period of Operation in Kisii town

The respondents were asked to indicate the number of years that they had businesses in general in Kisii town. The information is presented in Figure 1 below.

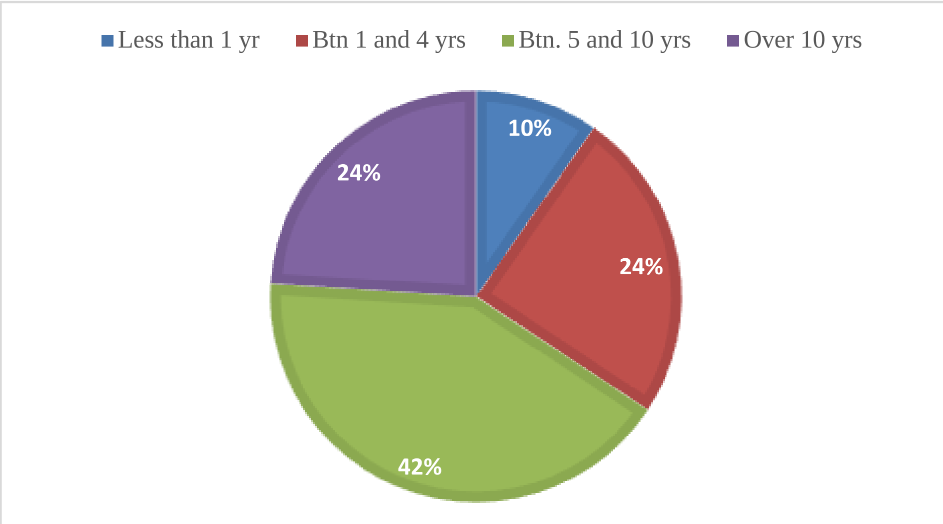

Figure 1: Period of Operation in Kisii Town

The information presented in Figure 1 above shows that most of the respondents (42%) had operated businesses in Kisii town for a period of between five and ten years. This was followed by those who had operated their small-scale businesses for between one and four years (24%) and those who had operated for over 10 years (24%). The least number of respondents were those who had operated their businesses in Kisii for a period of less than one year. Generally, information in the Figure 1 indicates that most of the respondents had operated their businesses in Kisii town for a relatively long period of time that makes them understand the financial issues and challenges that are unique to the small-scale traders operating in Kisii town.

Descriptive Statistics on Knowledge of Cash Budgets

The study sought to establish how knowledge of cash budgets affects performance of small-scale businesses in Kisii town. The descriptive statistics on the status of knowledge of cash budgets are shown in Table 1.

Table 1: Descriptive Statistics of Cash Budgets

Statements	5	4	3	2	1	Mean	Std. Dev.	Std. Error
Knowledge of how to prepare cash budgets	23	14	56	78	4	2.85	1.67	0.71
Knowledge of how to read cash budgets	14	62	56	34	9	3.22	1.34	1.39
Knowledge of items in the cash budget	10	12	19	60	74	1.99	1.67	2.01
Knowledge of following cash budgets when prepared	9	6	18	78	64	1.53	2.02	2.61
Knowledge of connecting cash budgets with other types of budgets	5	13	34	114	9	2.38	2.21	2.10
Grand Mean						**2.39**	**2.38**	**1.76**

Results in Table 1 above indicate that the respondents generally have low knowledge of cash budgets among the small-scale business owners in Kisii town. This is shown by the weighted mean of 2.39, which is closer to two. In the Likert scale, two represents “I know a little”. The relatively large standard deviation value of 2.39 shows that the responses were widely distributed from each other. This finding can generally be interpreted to mean that cash knowledge of cash budgeting is low among the small-scale business owners. Out of the five measures of cash budgets, knowledge of connecting cash budgets with other types of budgets was known the most (M=2.38), while knowledge of following cash budgets when prepared was known the least (M=1.53).

Inferential Statistics of Study Variables

Correlation Analysis

To establish whether there was a relationship between the variables, a correlation analysis was conducted. The correlation analysis shows the direction, strength, and significance of the relationships among the variables of the study (Sekaran and Bougie, 2010). A positive correlation indicates that as one variable increases, the other variables will also increase. On the other hand, a negative correlation indicates that as one variable increases the other variable decreases (Sekaran, 2003). The research model that was used in the study was:

$$FP = \beta_0 + \beta_1 CB_i + \varepsilon \quad \text{(i)}$$

Where:

FP is financial performance that was measured in terms of number of loans borrowed and repaid or being repaid without defaulting and ROE

β_0 is the constant term

β_1 is the coefficient for Knowledge of Cash Budgeting (***CB***) for Small-scale business *i.*

ε is the error term which was assumed to be normally distributed with zero mean and constant variance.

Results of the correlation are shown in Table 2.

Table 2: Correlation between Study Variables

	FP	KM	FI	CB	DV
BUADHE	1				
CB	.272***	.124	.056	1	

Note: * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

From the results in Table 2, several conclusions can be drawn. First, all correlation coefficients are less than 0.80 in general and therefore there is no issue of multicollinearity between the independent variables. According to Gujarati and Porter (2009), multicollinearity exists in a set of data is the correlation coefficient is above 0.80 beyond which the variables will yield spurious results. Knowledge of cash budgeting is also shown to be significantly and positively correlated with financial performance with a significant correlation coefficient of 0.272 ($p < 0.01$), which that implies a unit increase in knowledge of cash budgeting results to an increase of 0.272 in financial performance in the small-scale businesses.

Generally, the correlation findings presented in Table 2 indicate that the relationship between the identified factors and financial performance is positive and significant. These results confirm the findings Bruhn and Zia (2011) and Njoroge (2013) who reported a significant positive relationship between knowledge of key money concepts and various measures of financial success. These findings are however in contradiction with those of Mandel and Klein (2009), and Mwangi and Kihiu (2012) who found no significant relationship between knowledge of key money concepts and various financial performance measures. These findings are also in line with those of Miles (2004), Olima (2013) and Kempson *et al*., (2008) who found a significant positive relationship between knowledge of financial institutions and financial performance and in contradiction with studies by Moore (2003) and Onyango who found that knowledge of financial institutions does influence borrowing behavior.

A regression was run to determine the effect of financial literacy among the small scale business owners on financial performance of their businesses. The output of the regression is shown in Table 3.

Table 3: Regression Coefficients for Financial Literacy

		Unstandardized Coefficients		**Standardized Coefficients**		
Model		**Beta**	**Std. Error**	**Beta**	**t-stat**	**Sig.**
1	(Constant)	0.376	0.286		1.315	.002
	CB	0.296	0.106	0.207	2.792	.010

Dependent Variable: **Financial Performance**

From Table 3 above, several inferences can be derived. The constant term in the regression equation of 0.376 indicates the level of financial performance that is in existence in the small-scale businesses.

Regression results based on assessing the effect of knowledge of cash budgeting on financial performance of small-scale businesses in Kisii town show that knowledge of cash budgeting has a positive significant effect on financial performance ($\beta = 0.296$, $p = 0.010$). This implies that when all factors are held constant, a unit increase in knowledge of cash budgeting leads to a 29.6% significant increase in financial performance in the small-scale businesses. These results are in agreement with those of Mathenge and Muturi (2017) whose study found that annual budget adherence has significant effect on financial performance among public organizations in Kenya. Findings by Raghumandan *et al*., (2012); Qi (2010) contradict these findings since they found that knowledge of cash budgets influences borrowing behaviour.

Summary of Findings

Regression results based on the third objective showed that knowledge of cash budgeting has a positive significant effect on financial performance ($\beta = 0.296$, $p = 0.010$). This implies that when all factors are held constant, a unit increase in knowledge of cash budgeting leads to a 29.6% significant increase in financial performance in the small-scale businesses.

Regression results based on the third objective show that knowledge of cash budgeting has a positive significant effect on financial performance in the small-scale businesses implying that when all factors are held constant, an increase in knowledge of cash budgeting leads to a significant increase in financial performance in the small-scale businesses. It is therefore concluded that knowledge of cash budgeting is significantly important in enhancing financial performance in the small-scale businesses.

It is therefore recommended that the budget teams in the lending institutions train the small scale business owners on how to budget their cash tare trained more in order to enhance their knowledge of cash budgeting which will at the end enhance financial performance in the small scale businesses.

ISSN 2412-0294
Vol VII Issue X, October 2021

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