

EVALUATION OF THE LEVEL OF FINANCIAL LITERACY OF ENTREPRENEURS OF MSMEs – CASE OF RURAL AREAS IN ALBANIA

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Abstract

Micro-Small and medium-sized enterprises (MSMEs) make up the majority of enterprises in Albania. International studies argue that the low level of financial literacy is a major obstacle to seeking financial products and services for MSMEs, since their entrepreneurs are unfamiliar with such products and services and consequently do not ask to access them. The main purpose of this research is to assess the impact of the financial literacy components in promoting financial inclusion for MSMEs entrepreneurs in rural areas in Albania. Based on the data collected through the survey, it was also analyzed, the relationship between entrepreneurs financial literacy, demographic and socio-economic factors. From the results of this study it was concluded that skills, knowledge and financial attitude are necessary to enable the financial inclusion of entrepreneurs. Also, significant differences have been noted in the level of financial literacy according to the socio-demographic characteristics of MSMEs entrepreneurs. The findings of this study are important for government authorities, educational institutions and financial system actors. Understanding the level of financial literacy of entrepreneurs can contribute not only in clarifying their financial decision making process but also their business performance.

Key words: financial literacy, entrepreneurs, financial inclusion, Albania.

Introduction

Financial literacy has been and continues to be a matter of great interest worldwide. Its lack of influence affects the financial decision-making of entrepreneurs, since without realizing it they can give up the benefits of using the financial products they need, can make ineffective financial decisions, or on the other hand may fall prey to frauds, which

could potentially result in bad credit, bankruptcy or exclusion.

The majority of enterprises in Albania, which provide employment and contribute considerably to the national income, are Micro-Small and medium-sized enterprises (MSMEs). The main sectors in which the MSMEs operate in rural areas of Albania are those of services, agriculture and tourism. Many of the MSMEs encounter a number of problems such as poor access to financing, informality and corruption and bureaucratic regulations. These challenges are a serious obstacle for the investments and growth of their business. This situation implies that financial education is indispensable for MSMEs and the potential entrepreneurs to obtain increase of outputs, employment generation, profitability, efficiency, exports, productivity and return on assets (Beck et al. 2008). In Albania, while there are a limited number of researches related to financial literacy, there has been not any specific one focused on entrepreneurs of MSMEs in rural areas in order to measure the impact of the components of financial literacy on the level of their financial involvement. Initially this paper examines the existing literature on the impact of financial literacy on financial inclusion, followed by a description of the methodology used and the main achieved outcomes. This paper concludes by linking the findings with the studies of the previous international literature and finally presenting the relevant recommendations.

Benefits of financial literacy

In developing countries as suggested by the scholars Abor and Quartey (2010), the MSMEs contribute considerably to the economic development. In Albania two thirds of value added and 81.6% of employment are generated by SMEs as compared to the EU value added average of 56.8 % and employment average of two thirds (INSTAT, 2016). Micro-firms provide 40% of employment thus comprising the backbone of the Albanian economy. De Mel et al. (2012) argue that financial literacy acquired through business skills acquisition is an important driver of SMEs' growth and a key determinant of productivity.

Financial literacy is a key element that affects the access to the financial system by creating incentives which stimulate savings (Lusardi & Mitchell, 2011), budgeting (Perry & Morris, 2005), investment (Mouna & Anis, 2017) or even smart credit utilization (Lusardi & Tufano, 2009), well-informed financial decision making (De Mel et al., 2012), the behaviors that favor MSMEs growth. If entrepreneurs are financially capable, they will use a prudent approach to their investment strategies by taking well-informed financial decisions or positioning to maximize the regulated rate of return on risk (Siekei et al., 2013). Consequently, the resources will be distributed more productively, resulting in a higher growth rate of the company but also of the domestic economy (Widdowson & Hailwood, 2007). Scholars like Lusardi and Tufano (2009) observe that financial literacy helps managers of SMEs in developing economies to acquire knowledge, skills and ability to financially strategize their financial decisions and choices. Meanwhile, Atkinson & Messy (2012) note that the main cause of financial exclusion in rural areas is attributed to the lack of information about the different types of financial products and /or the low level of trust and behavior which hinder the use of formal financial products. At global level, about 31% of the population is financially excluded, while in Albania only 40% of the population has an account at a financial institution (Kunt et al., 2017). According to Marku (2016), the penetration of banking services in rural areas in Albania is at a very low level and banking services are generally under-utilized. The low level of demand for financial products as a result of the lack of financial literacy has an impact on the non-expansion of the financial activity of banking institutions in rural areas (Widdowson & Hailwood, 2007). A financially capable public is expected to manage finances more carefully and to make prudent choices of investments and financial products. As a result, the risk of borrowing can be reduced on the one hand as entrepreneurs become more aware of the risk-return ratio and on the other hand the financial institutions will respond to the demands of entrepreneurs with more innovative products, making the financial system more cunning and with a stronger market discipline

(Widdowson & Hailwood, 2007). Without developing their capacities in order to identify financial opportunities in the national and international market, the MSMEs cannot be competitive. Therefore, in order to be capable to execute effective plans to access finances, the entrepreneurs and managers of MSMEs need financial literacy. The lack of understanding of the economy and finances is an obstacle for entrepreneurs to participate in the stock market (Mouna & Anis, 2017).

Methodology

The main purpose of this quantitative research was to assess the impact of the components of financial literacy (skills, knowledge, attitudes, behavior as defined by the OECD, 2005) in promoting the financial involvement of MSMEs in rural areas in Albania. To enable this, based on the data collected from the 399 questionnaires, an analysis was conducted through the Eviews 10 statistical program and it was constructed a multiple regression model that determines the correlation between the variables taken from the study through Tobit regression. MSMEs were the unit of analyses, while MSMEs owners and managers were the unit of inquiry. The questions on the basis of which the research has been conducted were: *What is the impact of literacy components on the level of financial involvement of entrepreneurs / managers of MSMEs in rural areas in Albania?*

Referring to INSTAT (2016), the MSMEs number in Albania was about 87,500. Using the simplified formula for sample calculation (Yamane, 1973), a sample of 399 businesses was obtained. Where: n is the size of the sample; N is the size of the population; e is the allowed level of error.

$$n = \frac{N}{1 + N(e^2)}$$

In Albania the definition of Small Business refers to a business that has less than 50 employees and a total turnover and /or annual balance sheet that does not exceed 50 million ALL. Whereas a Micro enterprise

is the one which has less than 10 employees and a total turnover and /or annual balance sheet which does not exceed 10 million ALL.

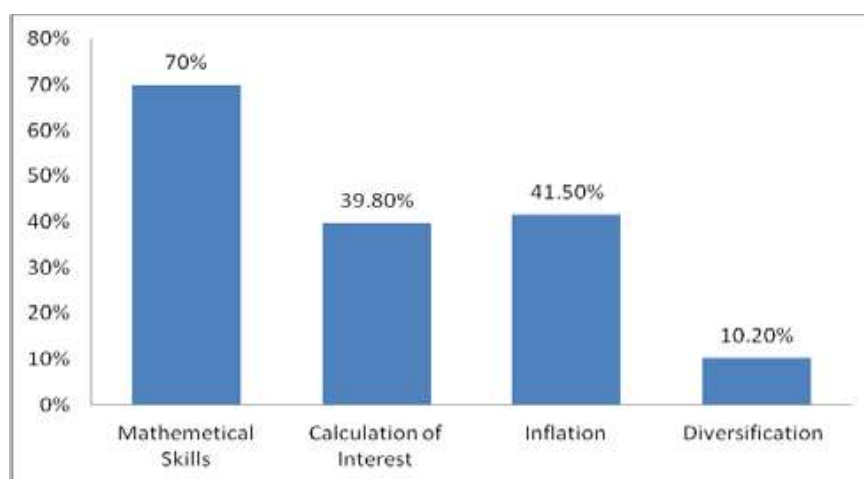
The questions of the interviews were adopted from past studies (Lusardi & Mitchell, 2011), as they were considered reliable and valid. In order to measure the financial literacy, were observed the level of knowledge, skills, attitude and behaviour as adopted from Atkison and Messy (2012) and Lusardi and Mitchell (2011) which comprise independent variables. While for the dependent variable of the financial involvement were used the level of accessibility, usage, quality (relevance) and the purpose of usage of financial services (Bongomin et. al, 2017). The questionnaire consisted of three sections. The first section provided demographic data on the gender, age, level of education and civil status of entrepreneurs and demographic data on the company as the number of employees, the annual turnover. The second section of the questions related to the assessment of the level of the financial literacy of the entrepreneurs and the third section collected data on the level of financial involvement of the company. The questions of the interviews used to measure the independent variables, were put on a five-point Likert scale with 1 - strongly disagree, 2 - disagree, 3 - not sure, 4 - agree and 5 - strongly agree. In section II where financial literacy was measured, were also included questions aiming at measuring the level of financial knowledge of entrepreneurs such as calculation of interest; inflation; and risk diversification (Lusardi & Mitchell, 2011) as well as questions about insurance or borrowing policies. In Section III of the questionnaire, it was estimated the level of financial inclusion with its constituent elements.

Results and discussion

The analysis of data led to the conclusion that only 11.8% of entrepreneurs who run their businesses in rural areas have a high level of financial literacy. Referring to the answers to the questions related to the financial knowledge that individuals should possess in order to make

effective financial decisions, it is noted in Graph 1 that respondents have a low level of ability to calculate the interest earned from a deposit / bank loans. As for basic knowledge on the concept of inflation and diversification, only 41.5% of individuals responded correctly to the question on the inflation and 10.2% of them to the question of diversification. Concerning mathematical calculator skills, the results were good as 70 percent of the average respondents answered the question correctly.

Two important elements of financial literacy are financial attitude and financial behavior. Some data about these two elements presented in Table 1 show that individuals feel safe on average in managing money.



Graph 1: Accurate Answers in Percentage, Level of Knowledge.

They said they were not very interested in receiving financial information, and they did not want to have any relationship with the banks. Regarding the questions related to measuring financial behavior, responses prove that entrepreneurs generally invest in compliance with their budget; they invest not on a regular basis; and it often happens to them to take informal debt to make investments. Regarding the data gathered on financial inclusion, entrepreneurs, whose businesses operated in rural areas, had limited access to banking products / services. This result is mainly due to the distance (by an average of 2.5) and the non-presence of banks in these areas (with an average of 2.3) as well as

the perception of the existence of high costs for banking services (average rating 3.3).

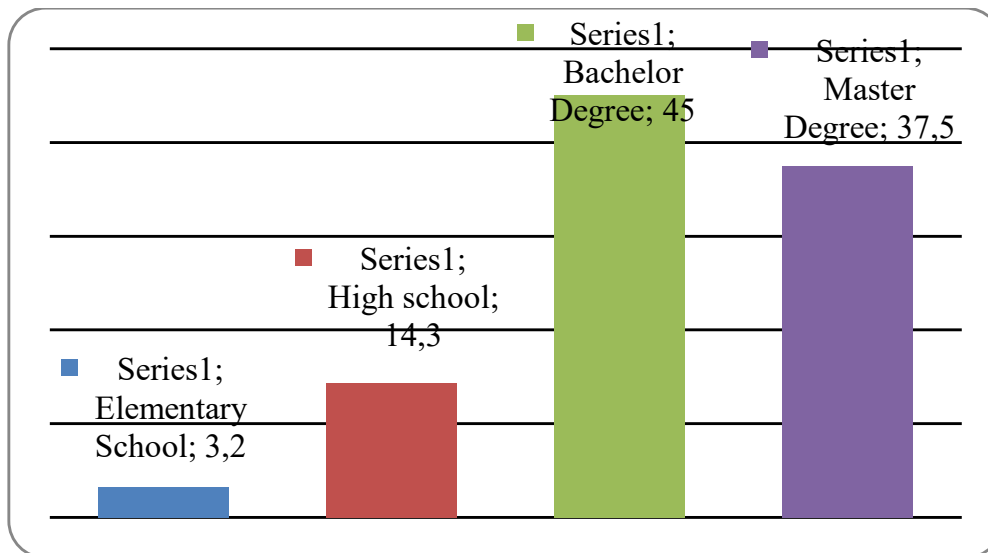
Table 1

Average Evaluation on the expression of financial attitudes and behaviors

| Financial Attitude | Average estimation | Financial Behavior | Average estimation |
|--|---------------------------|---|---------------------------|
| I am always interested in getting information on financial issues. | 2.8 | We always spend in compliance with the budget of the company. | 3.9 |
| I feel confident in managing money. | 3.3 | I always invest on regular basis. | 3.2 |
| I am interested in establishing relationships with banks. | 2.2 | It often happens to me to get informal loans to make investments. | 4.4 |

Regarding the level of use of banking products, data show that 47.5% of MSMEs have ongoing relationships with the banking system and 60% of them have received at least one informal loan. Also, entrepreneurs have provided a rating under the average related to the quality of banking products as deposit / bonds / treasury bills and loans, respectively with 2.8 and 2.6. This was justified by entrepreneurs with the fact that the savings / investment products are unsafe and inappropriate for their needs and credit products are not affordable and do not match their needs.

There were 284 male entrepreneurs and 115 female entrepreneurs, participants in the study. The analysis showed that 15.8% of men surveyed have high financial literacy, compared to 11.6% of women. Men have demonstrated better results in reference to the questions on skills and financial literacy compared to women. On the other hand, women have more positive financial attitude and behavior than men. This conclusion is also consistent with the results (Nano, 2014).



Graph 2: Percentage of individuals with high financial literacy according to the level of education

According to the data generated from questionnaire 47% of the interviewees had attended 9- year school and 40% had graduated from high school. The results of the study reinforce the conclusions drawn from multiple studies according to which individuals with higher levels of education have better financial skills than the poor and the less educated (Atkinson & Messy, 2012; Klapper, Lusardi, & Oudheusden, 2015). The trend in the use of financial products increases according to the level of education up to the University level, followed by a decrease at the Master level.

The overall model estimated in this study of financial inclusion is:

$$\text{INCL} = 1.4237 + 0.1769\text{SKI} + 0.1313\text{KNOW} + 0.0968 \text{AT}$$

$$\text{INCL} = f(\text{SKI}, \text{KNOW}, \text{AT}, \text{BEH})^5$$

All coefficients of the model are statistically significant and the model as a whole is statistically significant. Referring to the regression equation there is a right correlation between the dependent variable and the independent variable. Since we are not dealing with a linear regression model, the parameters of the Tobit model cannot be

⁵ INCL –Financial inclusion, dependent variable, SKI– Financial Skills, independent variable (explanatory) ; KNOW – Financial Knowledge independent variable (explanatory); AT – Financial Attitude, independent variable (explanatory); BEH – Financial Behaviour independent variable (explanatory);

interpreted as the change in the dependent variables derives from the change in the independent variable. In this case the interpretation of the coefficients of the model is done through elasticity. Overall for the entire model, the change with a unit in the level of financial education will affect the level of financial inclusion with a probability of 87.6%. This result goes hand in hand with the conclusions drawn by other scholars who underline that financial literacy enables individuals to evaluate complicated financial products and services in order to make well informed financial decisions and choices (Lusardi, 2008; Cole, Sampson, & Zia, 2009; Grohmann, Klühs & Menkhoff, 2017; Bongomin et al., 2017).

Referring to the impact of financial skills it is noticed that the change of one unit in the level of financial ability affects the increase of financial inclusion with a probability of 54%. Indeed, financial skills for entrepreneurs exercising their activity in rural areas help them evaluate the financial products provided by financial institutions to make smart choices in the multitude of financial products and services available in the financial market (Lusardi & Mitchell, 2011). Mastering of accounting skills helps individuals compare financial products such as deposits or loans not only to make the most convenient choice for their interests but also to avoid becoming prey to manipulation or misguidance. According to Lusardi & Scheresberg, (2013), individuals who fail to understand the concept of calculation of interest spend more on transaction costs, end up in higher debts and become subject to higher interest rates on loans. All of them affect the reduction of financial involvement of individuals as they are disappointed or become parties of unaffordable financial contracts for them.

Referring to the influence of knowledge on financial inclusion as it resulted from the model; the change with a unit referring to the level of financial knowledge was reflected in a change in the level of financial involvement, with a probability of 53%. Indeed, if people understand better basic financial concepts such as interest rates, inflation, timely value of money, they will use their financial resources better and save a

larger part of their income (Gaisina & Kaidarova, 2017). Knowledge acquired about financial products and the financial system helps individuals maximize their well-being and minimize the risks they face, as they will know where to invest the money saved to maximize it and better manage risk through insurance products. All of them affect the increase in demand for financial products and services.

Concerning the impact of financial attitude on financial inclusion it was shown by the model that the change with a unit in the level of financial attitude was reflected in a change in the level of financial inclusion, with a probability of 52%. In the Bongomin et al. (2017) study, focusing on the rural population, also it resulted that attitude as an element of financial literacy explains significantly and positively the financial involvement of these individuals. The more interested individuals are to establish relationships with financial institutions, to get information on financial issues, the more secure they feel about money management, the more likely they will be to use financial products and services. According to this study financial behavior did not result to be an important predictor of individual's financial inclusion in rural areas. This result contradicts the argument of Atkinson & Messy, (2012) according to which bad financial behaviors hinder the use of formal financial products by rural households, affecting their financial exclusion.

Conclusion and recommendations

The findings of this study demonstrate a low level of financial literacy among entrepreneurs operating in rural areas in Albania. They have financial knowledge at basic levels, while the financial concepts such as compound interest, diversification, rate-of-return ratio adjusted to inflation rate or insurance concepts were missing. Furthermore the significant effect that financial literacy has on access to finance of MSMEs in Albania has been revealed by the regression results. According to them this fact is justified by the distance or absence of

financial institutions. So as a result they obtain funding sources through informal routes outside the banking system. Developing adequate financial infrastructure is just one of the prerequisites for financial inclusion. Financial literacy should be developed simultaneously with improvement of access to markets and financial services. As financial literacy skills are necessary for the empowerment and education of the owners and managers of MSMEs to evaluate the financial products and make informed decisions. Without financial management the MSMEs cannot ensure their survival and general management. Consequently attending financial literacy training is indispensable for the managers of MSMEs in developing economies. Only in this way they will be able to gain the knowledge and skills to make more effective financial decisions while managing their businesses.

Another recommendation would be to consider the financial education as a long-term process. Institution of higher education should consider the option of including financial education in curricula in all branches of university or pre-university studies.

The final recommendation is related to the problem of access to financial products and services. The penetration of banking products and services in rural areas is at a very low level and banking services are generally under-utilized. As a result, banking and microfinance institutions should expand their network in rural areas to respond to the unfulfilled demand for loans.

Limitations and further research

The data collected in this study refer only to one country. Similar challenges may be encountered by other developing countries in the Balkan region still they may occur in different institutional and cultural environment. One of the limitations of this study is related to the error distribution, from JB statistic testing it resulted that the model does not have normal distribution (with a JB statistic value of 15.3 and $p = 0$). This suggests that in order for the model to be used for long-term

estimation, it may be recreated again after a certain period of time.

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