

Title

**ASSESSING THE EFFECT OF FINANCIAL LITERACY ON THE GROWTH OF  
SMALL AND MEDIUM SCALE ENTERPRISES: A CASE STUDY OF AREA 3  
MARKET IN LILONGWE, MALAWI**

Author

**YEWO SOKO**

Co-Author

**MRS JOSOPHINE JEFTER**



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**ABSTRACT**

This study thoroughly examined the effect of financial literacy on the growth and performance of Small and Medium Enterprises (SMEs) with a specific focus on Area 3 Market in Lilongwe, Malawi. SMEs are widely acknowledged as the backbone of the economy in developing countries because they create the majority of jobs, generate significant income for households, support community development, reduce poverty, and provide livelihoods especially for young people, women, and other vulnerable groups. However, despite their critical importance, a large number of SMEs in Malawi continue to face serious difficulties such as slow growth, low productivity, frequent business failures, poor profitability, and limited ability to access finance or evaluate investment opportunities. Many of these problems are directly linked to low levels of financial literacy and poor financial management practices among business owners.

The research adopted a carefully designed mixed-methods approach to provide a deep, balanced, and comprehensive understanding of the relationship between financial literacy and SME growth. Primary data were collected directly from SME operators

through well-structured questionnaires that captured quantitative information and semi-structured interviews that allowed for rich qualitative insights. Financial literacy was systematically assessed across several key dimensions including budgeting skills, record keeping practices, savings behaviour, credit management knowledge, and long-term financial planning abilities. The collected data were rigorously analysed using both descriptive statistics such as frequencies, percentages, and means to summarise patterns, and inferential statistical techniques including correlation and regression analysis to establish clear relationships between variables. Qualitative responses were further explored through detailed thematic analysis to uncover deeper experiences, perceptions, and contextual realities faced by the entrepreneurs.

The findings clearly revealed that a significant proportion of SME operators in Area 3 Market possess only low to moderate levels of financial literacy, with particularly noticeable weaknesses in practical areas such as consistent financial record keeping, disciplined savings habits, effective cash flow management, and proper understanding of loan terms and conditions. These limitations were shown to negatively affect their capacity to make informed financial

decisions, manage daily cash flows efficiently, access formal credit from banks, and confidently plan for business expansion or long-term sustainability. Importantly, the results demonstrated a strong and consistent positive relationship between financial literacy and SME growth. Entrepreneurs who displayed higher levels of financial literacy consistently reported improved business performance, higher profitability, increased sales revenue over the past three years, better cash flow control, and greater capacity for expansion, hiring more workers, or opening additional operations compared to those with limited financial knowledge.

The study firmly concludes that financial literacy is not just an important factor but a critical and decisive determinant of SME growth and long-term sustainability in Area 3 Market and similar settings across Malawi. It strongly emphasises the urgent and pressing need for well-designed, practical, accessible, and market-specific financial education and training programmes that are tailored to the real needs and educational levels of SME operators. The study provides clear and actionable recommendations for policymakers, financial institutions, non-governmental organisations, market committees, and development partners to work together in creating and rolling out

targeted financial literacy initiatives that can support the growth, resilience, and sustainability of SMEs. Ultimately, strengthening financial literacy among entrepreneurs is essential not only for individual business success but also for promoting broader sustainable economic development, improving household livelihoods, creating more jobs, and contributing meaningfully to poverty reduction efforts throughout Malawi.

**KEYWORDS:** Financial literacy, SME growth, entrepreneurship, business performance, record keeping, budgeting, savings behaviour, credit management, access to finance, cash flow, Malawi, Area 3 Market

## **INTRODUCTION**

Financial literacy remains one of the most powerful and influential factors that determine the success, sustainability, and overall growth of businesses, particularly for small and medium-sized enterprises that must operate in challenging, resource-limited, and highly competitive environments such as those found in Malawi. In the Malawian context, SMEs

play an absolutely central and irreplaceable role in the national economy by creating the vast majority of employment opportunities, generating essential income for millions of households, supporting community development initiatives, and serving as the primary source of livelihoods especially for young people, women, and other vulnerable population groups who often have limited access to formal jobs. Despite this enormous contribution to the economy and society, a surprisingly large number of SMEs continue to experience persistent problems including slow or stagnant growth, consistently low profitability levels, high rates of business failure, difficulties in accessing formal finance, and an inability to properly evaluate or seize new investment opportunities.

This comprehensive study was therefore designed to deeply investigate and clearly explain the extent of financial literacy among business owners and operators in Area 3 Market and to analyse precisely how this financial knowledge (or the lack of it) directly influences their business performance and long-term growth. The research carefully highlights the many ways in which gaps in essential financial skills contribute to serious real-world challenges such as low profitability, accumulation of unmanageable debt, poor cash flow

management, frequent mixing of personal and business finances, and ultimately higher risks of business failure. At the same time, the study also outlines in detail the main objectives, the specific scope of the research, the practical significance of the findings, and the important limitations that were encountered during the process.

## **BACKGROUND OF THE STUDY**

Small and medium-sized enterprises are universally recognised as playing a vital, indispensable, and dynamic role in Malawi's economy and social fabric. They create thousands of employment opportunities every year, generate much-needed income for families, support local community development projects, and act as the main economic lifeline particularly in urban and semi-urban areas where formal sector jobs are scarce and insufficient. Despite their proven importance and massive contribution, however, many SMEs unfortunately underperform, grow very slowly, or even collapse prematurely. One of the most frequently cited and well-documented reasons for these difficulties is the persistently low levels of financial literacy among the business owners and managers who run these enterprises.

Many operators in markets like Area 3 in Lilongwe have only limited understanding of fundamental financial concepts such as proper budgeting techniques, disciplined saving habits, responsible borrowing practices, accurate and consistent record keeping, and strategic long-term financial planning. These knowledge and skill gaps often result in a range of harmful and costly business practices, including taking loans they cannot comfortably repay, failing to maintain proper financial records, mixing personal household expenses with business funds, and operating without any clear or realistic financial roadmap. This study deliberately focuses on the real-life experiences of traders, retailers, service providers, and other entrepreneurs actively operating in Area 3 Market to examine exactly how these gaps in financial knowledge are constraining business growth. The research also strongly emphasises that targeted improvements in financial literacy have the real potential to dramatically enhance decision-making abilities, strengthen risk management practices, boost profitability, and create more sustainable and resilient businesses for the future.

## **PROBLEM STATEMENT**

Small and Medium-sized Enterprises are incredibly important and foundational to Malawi's entire economy. They make up roughly 80% of all businesses operating in the country and serve as the main engine for creating jobs, reducing poverty levels, generating income, and providing economic opportunities particularly for young people, women, and other vulnerable population groups who face significant barriers to formal employment. Vibrant trading centres such as Area 3 Market in Lilongwe function as extremely busy and dynamic economic hubs where hundreds of SMEs operate every single day, supporting the daily livelihoods of countless families and contributing directly to the local and national economy. Nevertheless, despite their undeniable importance and massive contribution, a very large number of SMEs in Malawi — and especially those located in busy markets like Area 3 — continue to struggle with chronic problems including very slow growth rates, persistently low productivity, frequent inability to evaluate or seize new investment opportunities, and overall poor business performance.

One of the most significant and frequently repeated reasons behind these ongoing

difficulties is the widespread and serious lack of financial knowledge and practical financial management skills among the business owners themselves. In the specific context of Area 3 Market, many entrepreneurs are observed to make repeated and costly financial mistakes simply because they do not possess adequate understanding of how to manage money wisely and professionally. Common examples include borrowing far more money than their businesses can realistically repay, completely failing to keep proper and accurate financial records, regularly mixing personal family expenses with business funds, and attempting to run their operations without any clear, realistic, or structured financial plan or budget. This research project was therefore specifically designed to carefully assess and measure exactly how financial literacy levels affect the growth and performance of SMEs in Area 3 Market. The study explores in depth the various financial challenges that these small business owners face on a daily basis and investigates how practical improvements in their financial knowledge and skills could enable their businesses to grow more successfully, create more jobs, generate higher incomes, and ultimately contribute more substantially to the overall economic

development and prosperity of Malawi as a whole.

## **RESEARCH OBJECTIVES**

### **Main Objective**

- To comprehensively and rigorously assess the effect of financial literacy on the growth, performance, and sustainability of small and medium scale enterprises operating in Area 3 Market, Lilongwe, Malawi.

### **Specific Objectives**

- To accurately assess and measure the current overall level of financial literacy among SME owners and operators in Area 3 Market.
- To thoroughly examine and analyse the nature, strength, and direction of the relationship that exists between financial literacy and the actual growth and performance of SMEs in Area 3 Market.
- To clearly identify, describe, and rank the main financial challenges and difficulties that SME owners in Area 3 Market encounter as a direct

result of their limited financial knowledge and skills.

- To carefully identify the most pressing financial literacy challenges faced by SME owners and to develop and propose practical, realistic, feasible, and actionable strategies and recommendations that can effectively improve their financial knowledge, skills, and overall business growth and sustainability.

## RESEARCH QUESTIONS

- What is the actual and current level of financial literacy among the SME owners and operators who are actively running businesses in Area 3 Market?
- In what specific ways and to what extent does financial literacy influence, affect, and determine the growth, profitability, and overall performance of SMEs operating in Area 3 Market?
- What are the primary, most common, and most serious financial challenges and obstacles that SME owners in Area 3 Market face every day because of their limited financial knowledge and management skills?

What practical, effective, and context-appropriate strategies and interventions can be designed and implemented to significantly improve financial literacy levels among SME owners in Area 3 Market and thereby promote stronger, faster, and more sustainable business growth?

## LITERATURE REVIEW

This chapter presents a detailed, thorough, and comprehensive review of the existing academic and empirical literature that is directly relevant to the effect of financial literacy on the growth and performance of small and medium scale enterprises. The purpose is to clearly establish what is already known in the field, to identify important knowledge gaps that still need to be addressed, and to properly position the current study within the wider body of research. The review draws upon both international studies and local Malawian and African research, with special emphasis on issues that are particularly relevant to SMEs operating in busy urban market environments like Area 3 Market in Lilongwe.

## Conceptual Clarifications

Financial literacy is broadly understood as the knowledge, understanding, skills, and confidence that individuals or business owners need in order to effectively manage their finances. It includes the ability to understand and apply concepts such as budgeting, saving, investing, borrowing responsibly, and interpreting basic financial information (*Lusardi & Mitchell, 2014*). For SME operators in markets like Area 3, financial literacy means being able to prepare simple budgets, keep accurate records, manage cash flow, understand loan conditions, and plan for future business needs.

Small and Medium Scale Enterprises in the Malawian context are officially defined by the government as businesses that employ between 4 and 100 people and operate with relatively modest capital and turnover levels. In Area 3 Market, these typically include small retail shops, food vendors, tailoring businesses, agro-product traders, salons, and other micro and small service providers. Growth of SMEs is measured through multiple indicators such as rising sales revenue, increasing profit margins, ability to hire more workers, expanding stock or

services, opening additional outlets, and acquiring more business assets.

## Theoretical Framework

The study is strongly guided by two well-established and highly relevant theories. The Human Capital Theory (*Becker, 1964*) views financial literacy as a valuable form of human capital that, when developed through education and training, directly increases productivity, efficiency, and overall business success. The Resource-Based View of the firm (*Barney, 1991*) treats financial literacy as a strategic internal resource that is valuable, relatively rare, difficult for competitors to imitate, and non-substitutable, thereby giving SMEs a sustainable competitive advantage in challenging market environments.

## Empirical Literature Review

International and regional studies consistently show that higher financial literacy leads to measurable improvements in SME performance. Research conducted in Ghana, Rwanda, Zimbabwe, and South Africa confirms positive links between financial skills and better sales, profits, and

expansion. In Malawi, recent local studies have similarly found that improved financial literacy helps SMEs survive longer, access credit more easily, and grow more steadily. Common challenges documented across these studies include poor record keeping, cash flow problems, difficulty accessing loans, and high reliance on expensive informal credit sources. Effective improvement strategies that have been recommended and tested include practical hands-on training workshops, mentorship programmes, peer learning groups, and the use of simple mobile-based financial education tools.

### **Knowledge Gaps**

Although substantial research exists, important gaps remain. Very few studies have focused specifically on SMEs operating inside busy urban markets like Area 3. There is limited research on how cultural, social, and local contextual factors in Malawi influence the relationship between financial literacy and business growth. Few studies have examined the exact mechanisms through which financial literacy affects different aspects of growth, and even fewer have evaluated the real-world effectiveness of different types of

financial literacy interventions in the specific Malawian market context.

### **Conceptual Framework**

The conceptual framework for this study positions financial literacy (including budgeting, record keeping, savings, and credit knowledge) as the main independent variable that influences SME growth (measured by sales, profits, expansion, and sustainability) as the dependent variable. The framework also recognises important intervening factors such as access to training, availability of finance, and prevailing market conditions that can strengthen or weaken the relationship.

### **RESEARCH METHODOLOGY**

The study carefully employed a mixed-methods research design that effectively combined quantitative and qualitative approaches to ensure a rich, balanced, and reliable understanding of the topic. The research was conducted entirely in Area 3 Market, Lilongwe, which was deliberately selected because it is one of the city's most active, representative, and diverse commercial centres hosting hundreds of

SMEs from different sectors. The target population consisted of all active and registered SME owners and operators in the market, estimated at approximately 150 businesses based on field observations and discussions with market leaders and local authorities.

Quota sampling was strategically used to guarantee diversity and proper representation across different business types (retail, services, agro-trading), owner gender, and length of operation. The final sample size was scientifically calculated using Yamane's formula and resulted in 60 respondents. The primary research instruments were a detailed structured questionnaire for collecting measurable quantitative data and a flexible semi-structured interview guide for gathering in-depth qualitative insights. A pilot study was successfully carried out with a small representative group to test the clarity, relevance, and practicality of the instruments, and all necessary improvements were made based on the valuable feedback received.

Quantitative data were entered, cleaned, and analysed using the Statistical Package for the Social Sciences (SPSS) with both descriptive and inferential statistical

methods. Qualitative data were transcribed and subjected to careful thematic analysis to identify recurring patterns, experiences, and meanings. All ethical considerations were strictly and rigorously followed throughout the study, including obtaining clear informed consent from every participant, guaranteeing full confidentiality and anonymity of responses, ensuring that participation remained completely voluntary with the right to withdraw at any time, and securing official ethical approval from the university and relevant local market authorities.

## **RESULTS**

The study achieved an excellent 100% response rate, with all 60 questionnaires successfully completed and returned. Demographic information showed that respondents represented a good mix of age groups (majority between 21 and 40 years), both male and female entrepreneurs, and varying levels of education (most with primary or secondary schooling and a smaller number with tertiary qualifications).

Analysis of financial literacy levels indicated that while many owners had basic awareness of budgeting and simple

accounting ideas, there were clear and concerning weaknesses in practical skills such as maintaining consistent financial records, practising disciplined savings, and understanding loan requirements. A strong and statistically significant positive relationship was found between higher financial literacy and better SME growth outcomes, with literate owners reporting higher sales, improved profits, and more frequent business expansion. The main financial challenges identified included poor record keeping, mixing of personal and business money, difficulties accessing formal loans, cash flow problems, and intense market competition. Respondents overwhelmingly supported the need for practical financial literacy programmes focusing on budgeting, bookkeeping, savings, credit management, and general money skills, and they believed such training would directly lead to stronger and more sustainable business growth.

## **DISCUSSION**

The detailed results obtained in this study provide powerful confirmation that financial literacy functions as a major and influential driver of SME success and growth in the specific context of Area 3 Market. The

observed strong positive relationship between better financial skills and improved business performance is highly consistent with both international theories and recent empirical findings from Malawi and neighbouring countries. The challenges documented — especially poor record keeping and loan access difficulties — closely match patterns reported in other studies and clearly demonstrate the urgent need for practical, hands-on, and locally relevant interventions rather than generic or theoretical approaches.

## **CONCLUSION**

This research has successfully and convincingly demonstrated that financial literacy plays a vital, powerful, and decisive role in shaping the growth, performance, and long-term sustainability of small and medium enterprises in Area 3 Market. Although many SME owners possess basic financial awareness, significant practical gaps continue to limit their full potential. Targeted and well-designed financial literacy improvement programmes have the clear capacity to empower these entrepreneurs, enhance their decision-making abilities, improve access to finance, boost profitability, and create more resilient

and successful businesses that can contribute more meaningfully to Malawi's economic development and poverty reduction goals.

## **RECOMMENDATIONS**

- Government agencies, banks, NGOs, and development partners should urgently design and roll out practical, regular, and market-based financial literacy training programmes specifically tailored for SME owners in Area 3 and similar markets.
- SME owners should be actively encouraged, trained, and supported to adopt consistent and accurate bookkeeping practices and to maintain a clear separation between personal and business finances.
- Financial institutions should partner with market associations to provide simple and accessible education on loan products, credit terms, and responsible borrowing practices.
- Community-based workshops, mentorship schemes, and peer learning groups should be established to build stronger financial discipline, savings habits, and long-term planning skills.

- National policies and SME development strategies should fully incorporate financial literacy components and ensure continuous, sustainable capacity-building support for entrepreneurs across the country.

## **AREAS FOR FURTHER STUDY**

Future researchers are encouraged to conduct longitudinal studies that track the long-term effects of financial literacy training on SME growth over several years. Comparative research across different markets and rural areas would provide valuable broader insights. The potential of digital financial tools, mobile applications, and online training platforms also deserves deeper exploration. Additionally, studies that examine how financial literacy interacts with other important factors such as infrastructure availability, market regulations, and cultural influences would greatly enrich the existing body of knowledge.

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