Journal of Business Management and Economic Research

2023, 7 (1): 1-10 DOI: 10.29226/TR1001.2023.321

Journal Homepage: https://www.jobmer.org

Nexus Between Debt Management Literacy and Digital Loan Repayment Performance Among Selected SMEs in Kenya

Thomas Kiptanui Tarus *
University of Kigali, Rwanda
*Corresponding Author: tarus9116@gmail.com

John Kipngetich Tarus
Moi University, Kenya

Abstract

The global economy is heavily dependent on the success of Small and Medium Enterprises (SMEs) which create employment, poverty alleviation, and balanced developments which bring about economic growth in rural and urban setups. Loan defaults continue to be a major challenge that confronts financial institutions in developing countries and this impedes their potential role in sustainable development. The main aim of the study was to establish the nexus between debt management literacy and digital loan repayment performance among selected SMEs in Kenya. The study was informed by financial literacy theory and it employed an explanatory research design. The study targeted owners/managers of 620 registered SMEs within Nairobi County. Systematic and simple random sampling was used to select 243 SMEs to constitute the sample. The main research instruments that were used in this study were questionnaires. Descriptive and inferential statistics were used to analyze data. The findings revealed that debt management literacy positively and significantly influences digital loan repayment performance. It is therefore paramount that SMEs owners need to be at the forefront in ensuring that they are trained on debt management strategies. In that way, the SMEs will benefit from the skills and knowledge of managing finances efficiently and how to ensure loans are paid on time.

Keywords: Digital loan repayment performance, Debt management literacy, Financial literacy theory, and SMEs

1. Introduction

Over the years Small and Medium Enterprises (SMEs) form a great percentage of all enterprises in the world. The global economy is heavily dependent on the success of SMEs which creates employment, poverty alleviation, and balanced developments which brings about economic growth in rural and urban setups. SMEs form more than 99% of all enterprises in the world (CMA, 2010). These business enterprises allow the marginalized and vulnerable groups to diversify their incomes, create new sources of economic growth and generate additional employment, especially in rural areas. The global economy depends on the success of the SME sector. The SMEs in Kenya play an important role in the economic development of the country and provide one of the most important reliable sources of employment creation, income generation, poverty reduction, and development of the industrial base.

The digitally delivered micro-credit has significantly increased access and utilization of credit to a large proportion of borrowers previously excluded from formal financial services in developing economies. Digitally delivered microcredit1 is easily and conveniently obtained particularly for the previously financially excluded; however, it is expensive and short-term relative to conventional credit (CGAP, 2017). However, the increase in digital credit uptake amid increasing default rates among borrowers has raised questions about the number of information consumers of digital credit to receive to inform their decisions to procure credit as well as the effect of digital credit on borrowers' indebtedness especially. These questions are more pertinent, especially for a majority of digital credit consumers, who may not make informed decisions due to limited financial literacy or disclosure of terms and conditions of the credit, thereby predisposing borrowers to welfare-reducing credit or over-indebtedness. There is no consensus in the literature on the effect of digital credit on borrowers' indebtedness and loan repayment performance.

The majority of SMEs lack corporate training and managerial skills, finding it challenging to manage funds received for corporate operations such as obtaining raw materials and components as well as investing in tools and machinery (Mutamimah et al., 2021). The necessity of financial literacy among small business management in ensuring the sustainability of their enterprises, particularly in resolving ongoing and prospective difficulties, has been frequently emphasized in the business community (Disse & Sommer, 2020). In the fiscal decision-making cycle, financial literacy alludes to a manager's ability to handle funds efficacious and efficient manner (Amadasun & Mutezo, 2022).

One way to tackle the loan repayment performance problem is to investigate the factors which affect the digital loan repayment performance of microfinance institutions (MFIs). The research of Gathergood et al., (2019), reported that low levels of debt management literacy among digital loan users are associated with high loan costs. In their research, Angaine & Waari, (2014) concluded that the key predictor for loan outcomes in financial behavior is determined by the level of debt financial literacy. Moreover, in their study Antoine (2015) reported that people with low financial literacy are found to be more likely to have debt problems. The findings of the research conducted by Huston, (2010) suggest that a consumer with a higher level of financial literacy is less likely to exhibit excessive borrowing behavior.

Debt financial literacy is one of the ways which may assist businessmen and women in minimizing the default rate. This would be done through seminars and training. Debt management literacy means the ability to make an informed judgment without fear (Bumcrot et al., 2011). However, the issue of the direction of causality between debt management literacy and loan repayment performance is far from being resolved. So far has not emerged a mainstream instrument that could be included in debt management literacy surveys around the world has. From the studies conducted, there is mixed evidence about the nexus between debt management literacy and loan repayment performance. Thus, the study main purpose of this study was to fill this significant gap by providing a systematic analysis of the relationship between debt management literacy and digital loan repayment performance.

2. Theoretical Review

The study was anchored on financial literacy theory. The theory argues that the behavior of people with a high level of financial literacy might depend on the prevalence of the two thinking styles according to dual-process theories: intuition and cognition. Dual-process theories (Evans, 2008) embrace the idea that decisions to have a high-performing enterprise can be driven by both intuitive and cognitive processes. Dual-process theories have been studied and applied to many different fields; reasoning and social cognition (Evans, 2008). 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 financial landscape.

According to this theory, Gallery, Newton, and Palm (2011) framework in financial knowledge is a form of investment in human capital like the necessary financial management skills, and many empirical surveys establish that people need to know much more to become informed. The authors show how financial literacy, and knowledge of financial management practices, shape economic outcomes derived from performing SMEs.

Atkinson and Messy (2005) define financial literacy as the combination of investors' understanding of financial products and concepts and their ability and confidence to appreciate financial risks and opportunities, to make informed choices, to know where to go for assistance, and to take other effective actions to improve their financial well-being. Financial literacy, which embeds financial management practices helps in empowering and educating investors and owners of businesses so that they are knowledgeable about financial management practices in a way that is relevant to their business and enables them to use this knowledge to evaluate products and make informed decisions that will lead to performing. It is widely expected that greater financial management practices and knowledge would help overcome recent difficulties in advanced credit markets that inhibit SMEs' performance (Fatoki, 2014).

3. Empirical Review

Various scholars have carried out studies on the relationship between debt management literacy and loan repayment. Agarwal et al (2011), carried out a study on the effect of a financial literacy program on loan repayment performance for urban female microfinance customers in India. They found out that microfinance groups that received debt management literacy training had higher repayment performance, confirming the positive effect of financial literacy and loan repayment performance. Nyamute and Maina (2011) examined the personal financial practices that encompass savings practices, expenditure practices, debt management, investment, cash management, retirement, and unexpected practices of employees who are financially educated versus those who are not. The results show that there is a significant difference between the personal financial management practices of the finance and the non-finance literate respondents. It can be concluded that entrepreneurs' financial literacy influences personal financial management practices. Moreover, Wanjiku and Muturi (2015) conducted a study on debt management literacy and loan repayment performance and they concluded that there is a negative relationship between debt management literacy and loan repayment performance of ECLOF Kenya clients.

Furthermore, Barua and Sane (2014) found no relationship between debt management literacy and loan repayment performance. Bay, Catasús, and Johed (2014) found no relationship between debt management literacy and loan repayment performance. They found that the people who received debt management training exhibited no difference from those who did not receive them. There is mixed evidence about the role of debt management literacy on loan repayment performance. Indeed, there is a need to conduct further studies on this. The study, therefore, hypothesized that;

H_0: There is no significant nexus between debt management literacy and digital loan repayment performance among selected SMEs in Kenya.

4. Methodology of the Study

The research employed explanatory research designs. From the target population of 620 SMEs licensed SMEs within the Central Business District in Nairobi. Taro Yamane's (1973) sample size formula was used to select a sample size of managers/owners of 243 SMEs. Systematic sampling was used to select SMEs to constitute the sample. The main research instrument that was used in this study was a questionnaire. Descriptive and inferential statistics were used to draw implications from the data.

5. Results

This section provides the empirical results of the research data analysis and the corresponding interpretations.

5.1. Descriptive Statistics- Debt Management Literacy

The results in Table 1, showed that reconciliation is normally done often (mean = 4.06, SD = 0.846). Besides, all the necessary accounts such as receipts and payments are up to date (mean = 4.02, SD = 0.815). Further, employees do have the necessary skills for preparing the various accounts (mean = 3.96, SD = 0.747). Also, enterprises keep proper books of account and account for the balances for every financial year (mean = 3.91, SD = 0.763). Overall, the findings on debt management literacy summed up to a mean of 3.99, a standard deviation of 0.7993, skewness -0.854, and kurtosis -0.505. The findings confirmed that SMEs owners possess debt management literacy. In line with Christopher (2010), they are less likely to delay the repayment of loans. Besides, debt management literacy assists them in making wise decisions which would, in turn, assist them in the repayment of loans.

Table 1. Debt management literacy

	Mean	Std. Dev	Skewness	Kurtosis
We keep proper books of account and account for the balances for every financial year	3.91	0.763	-0.803	0.836
Employees do have the necessary skills for preparing the various accounts	3.96	0.747	-0.589	0.444
All the necessary accounts i.e Receipts and payments are up to date	4.02	0.815	-0.438	-0.464
Reconciliation is normally done often	4.06	0.846	-0.614	-0.009
Average	**3.99**	**0.793**	**-0.854**	**0.505**

Source: Field Data (2022)

5.2. Descriptive Statistics - Digital Loan Repayment Performance

As shown in Table 2, the SME owners have never delayed in paying their loan (mean = 4.370, SD = 0.711). Also, they pay their loan on time (mean = 4.230, SD = 0.676). Besides, they receive text messages reminding them to pay their loan (mean = 4.130, SD = 0.766). As well, they fear the consequences of not paying their loan on time (mean = 4.120, SD = 0.739). Further, their businesses generate enough cash flows to repay their loans (mean = 3.810, SD = 1.065). Also, the mode of paying the loan is appropriate (mean = 3.790, SD = 1.071). Overall, the items on digital loan repayment performance summed up to a mean of 4.009, a standard deviation of 0.860, a skewness of -0.593, and a kurtosis of 0.063. The SME owners meet their financial obligation. There is a possibility that the SME owners' financial literacy could have contributed to the SME's digital loan repayment performance.

Table 2. Digital loan repayment performance

	Mean	Std. Deviation	Skewness	Kurtosis
We pay our loan on time	4.230	0.676	-0.804	1.333
We have never delayed paying our loan	4.370	0.711	-1.274	2.202
We have received a text reminding us to pay our loan	4.130	0.766	-0.638	0.107
We fear the consequences of not paying our loan on time	4.120	0.739	-0.644	0.401
I willingly pay my loans without any inducement	3.610	0.994	-0.083	-1.043
The process/mode of paying the loan is appropriate	3.790	1.071	-0.389	-1.106

My business generates enough cash flows to repay the loan we	3.810	1.065	-0.370	-1.139
Average	4.009	0.860	-0.593	0.063

Source: Field Data (2022)

5.3. Inferential Statistics and Hypothesis Testing

From the findings in Table 3, the strength of the relationship between debt management literacy and digital loan performance was found to be positive and significant ($r = 0.719$, $p<0.05$). The model summary of the simple linear regression model and the results showed that debt management literacy explained a 43.1 percent variation in digital loan performance (R2 = 0.431). The findings further revealed that the model was fit to predict digital loan performance using debt management literacy as evidenced in the F ratio of 4.377 with a $p<0.05$ level of significance.

The hypothesis stated that there is no significant relationship between debt management literacy and digital loan repayment performance among selected SMEs in Kenya. Nonetheless, the study findings showed that debt management literacy has a positive and significant effect on digital loan performance based on ($\beta= 0.405$, $p<0.05$) implying debt management literacy results in increased digital loan performance. The effect of debt management literacy was stated by the t-test value = 7.003 which implies that the standard error associated with the parameter is less than the effect of the parameter. Cognate of the findings, Agarwal et al., (2011) confirmed that microfinance groups that received debt management literacy training had higher repayment performance. In a similar vein, Nyamute and Maina (2011) confirmed that entrepreneurs' financial literacy influences personal financial management practices. The results are similar to the findings of Tuyisenge (2015) found a significant effect of debt management on loan repayment. However, Wanjiku and Muturi (2015) found a negative relationship between debt management literacy and loan repayment performance of ECLOF (Ecumenical Loan Fund) Kenyan clients. Further, Barua and Sane (2014) found no relationship between debt management literacy and loan repayment performance. In the same way, Bay et al., (2014) found no relationship between debt management literacy and loan repayment performance. Evidence from the extant literature confirms there is a mixed relationship between debt management literacy and digital loan repayment performance. Nevertheless, the study is in supports the notion that debt management literacy positively influences digital loan repayment performance.

Table 3. Regression and correlation results

	Unstandardized Coefficients		**Standardized Coefficients**			
	B	**Std. Error**	**Beta**	**T**	**Sig.**	**Correlation**
(Constant)	-0.525	0.122		-4.316	0.000	
Debt Management literacy	0.459	0.066	0.405	7.003	0.000	0.719
Model Summary						
R	0.656					
R Square	0.431					
Adjusted R Square	0.425					
F	4.377					
Sig.	0.000					

a Dependent Variable: Digital loan performance

6. Conclusion and Policy Implications

The purpose of this study was to examine the nexus between debt management literacy and digital loan repayment performance among selected SMEs in Kenya. This study discovered a direct and significant relationship between debt management literacy and digital loan repayment performance. According to academics and financial experts, having financial knowledge of debt management is key to financial stability. The results obtained from this study affirm that financial knowledge of debt management positively affects digital loan repayment performance among selected SMEs in Kenya implying that debt management literacy is key in facilitating SMEs' ability to repay their loans digitally. The implication is that, with debt management literacy, it is easier for SMEs to assess the interest rates that are charged on different loans and are at the same time aware of the implications of defaulting on loans. Besides, this knowledge enables SMEs owners to take caution and institute measures to ensure that they do not default in repaying the loans. Moreover, the relationship between debt management literacy and digital loan repayment performance is further facilitated by loan terms.

The study makes important contributions to knowledge and literature as far as loan default continues to remain a major challenge for financial institutions in Kenya and also the need to implement strategies and policies to improve loan repayment. The outcome of the study is therefore crucial for policy purposes, especially for Kenya. Given the positive relationship between financial literacy and successful loan repayment, the study recommends that policymakers, stakeholders, and all players in the financial industry should create awareness of debt management literacy. This is so because improving the debt management literacy of individuals will enable them to manage their financial resources efficiently and this is likely to equip them to repay loans received within the agreed loan period to avoid loan default. Ensuring a vibrant financial industry through the implementation of strategies and policies aimed at improving successful loan repayment will mean that financial institutions can survive and continue to play their role of funds mobilization and provision of loans to individuals with viable investment ambitions. This will then also mean that more employees will be created through job creation to facilitate economic growth and sustainable development of Kenya in the long run.

6.1. Recommendations and Suggestions for Future Studies

Debt management literacy enhances digital loan repayment performance; there is a need for employees in SMEs to have the necessary skills for preparing various accounts. Also, the enterprises should keep a proper book of accounts and account for the balances for every financial year. Specifically, SME owners need to be at the forefront in ensuring that they are trained on debt management strategies. In that way, the SMEs will benefit from the skills and knowledge of managing finances efficiently and how to ensure loans are paid on time.

Future studies should consider other factors that may influence digital loan repayment performance. Such factors could be political instability and inflation. Further, to make a comparative study on the findings, future research can be conducted on SMEs in other towns in Kenya. Finally, future scholars could assess the link between digital loan repayment performance using an intermediate variable to establish the consequences of loans on SME performance.

References

Agarwal, S., Amromin, G., Ben-David, I., Chomsisengphet, S., & Evanoff, D. D. (2011). Financial counseling, financial literacy, and household decision-making. *Financial literacy: Implications for retirement security and the financial marketplace*, 181.

Amadasun, D. O., & Mutezo, A. (2022). Effect of market-driven strategies on the competitive growth of SMEs in Lesotho. *Journal of Innovation and Entrepreneurship*, 11(1), 1-17.

Angaine, F., & Waari, D. N. (2014). Factors influencing loan repayment in micro-finance institutions in Kenya. *IOSR Journal of Business and Management (IOSR-JBM)*, 16(9), 66-72.

Antoine N. (2015). Effect of loan management on the financial performance of commercial bank: The case of Bank of Kigali (B. K). *East African Journal of Science and Technology*, 5(1), 46-59.

Atkinson, A., & Messy, F. A. (2011). Assessing financial literacy in 12 countries: an OECD/INFE international pilot exercise. *Journal of Pension Economics & Finance*, 10(4), 657-665.

Barua, R., & Sane, R. (2014). Repayment in microfinance: The role of financial literacy and caste. *Discussion papers in Economics*, 14(6), 1-25.

Bay, C., Catasús, B., & Johed, G. (2014). Situating financial literacy. *Critical Perspectives on Accounting*, 25(1), 36-45.

Bumcrot, C., Lin, J., & Lusardi, A. (2011). *The Geography of Financial Literacy (No. WR-893-SSA).* RAND Corporation.

Capital Markets Authority. (2010). *The development of micro-cap securities markets in Kenya.* Nairobi: Capital Markets Authority.

Christopher, I. F. (2010). *Impact of microfinance on small and medium-sized enterprises in Nigeria.* In International Conference on Innovation and management.

Consultative Group to Assist the Poor (CGAP), 2017. *What is financial inclusion and why is it important?* http://www.cgap.org/about/faq/what-financial-inclusion-and-why-it-important

Disse, S., & Sommer, C. (2020). *Digitalisation and its impact on SME finance in Sub-Saharan Africa: Reviewing the hype and actual developments (No. 4/2020).* Discussion Paper.

Evans, J. St. B. T. (2008). Dual-processing accounts of reasoning, judgment and social cognition. *Annual Review of Psychology*, 59, 255-278.

Fatoki, O. (2014). The financial literacy of micro-entrepreneurs in South Africa. *Journal of Social Sciences*, 40(2), 151-158.

Gallery, N., Newton, C., & Palm, C. (2011). Framework for assessing financial literacy and superannuation investment choice decisions. *Australasian Accounting, Business and Finance Journal*, 5(2), 3-22.

Gathergood, J., Mahoney, N., Stewart, N., & Weber, J. (2019). How do individuals repay their debt? The balance-matching heuristic. *American Economic Review*, 109(3), 844-75.

Huston, S. J. (2010). Measuring financial literacy. *Journal of Consumer Affairs*, 44(2), 296-316.

Mutamimah, M., Tholib, M., & Robiyanto, R. (2021). Corporate governance, credit risk, and financial literacy for Small Medium Enterprise in Indonesia. *Business: Theory and Practice*, 22(2), 406-413.

Nyamute, W., & Maina, J. M. (2011). Effect of financial literacy on personal financial management practices.

Tuyisenge, H. J., Mugambi, F., & Kemirembe, O. M. (2015). The role of financial literacy on loan repayment among small and medium entrepreneurs in Rwanda case study: Urwego opportunity bank. *International Journal of Small Business and Entrepreneurship Research*, 3(5), 33-66.

Wanjiku, K. J., & Muturi, W. (2015). Effect of financial literacy on loan repayment a case of ecumenical churches loan fund, Kenya. *International Journal of Social Science and Information*, 3(2), 1657-1675.

Yamane, T. (1973). *Statistics: An introduction analysis.* Harper & Row.