

Bridging the Gap: Financial Literacy, Business Experience, and Performance of Small and Medium Enterprises in Sri Lanka

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Abstract

This study investigates the impact of financial literacy and business experience on the performance of Small and Medium Enterprises (SMEs). Globalization and interconnectedness create a more complex financial landscape. Financial literacy becomes even more crucial for navigating this complexity and making informed decisions about a wider range of financial products and services. Financial literacy is hypothesized to directly influence firm performance, with business experience acting as a mediator in this relationship. To capture the diversity of SMEs in Sri Lanka, this study employed a stratified random sample of 677 businesses across all nine provinces and 25 districts in Sri Lanka. The survey instrument was designed to measure financial literacy, business experience, and firm performance. The study utilizes SmartPLS software to analyze data collected from SMEs. Partial Least Squares (PLS) is a structural equation modeling (SEM) technique well-suited for analyzing complex relationships of this nature. Findings reveal a significant positive influence of financial literacy on both firm performance and business experience. Furthermore, business experience was found to partially mediate the relationship between financial literacy and firm performance. These findings highlight the critical role of financial literacy for SMEs, especially in the cosmopolitan era, where a complex financial landscape and globalized markets demand strong financial decision-making capabilities. The importance of fostering business experience is further emphasized, as it allows SMEs to leverage their financial literacy for enhanced performance in this dynamic environment.

Keywords: Financial Literacy, Firm Performance, Business Experience, SMEs, Sri Lanka

Introduction

The rise of the cosmopolitan era, characterized by increasing globalization and economic interconnectedness, presents both challenges and opportunities for Small and Medium Enterprises (SMEs). In this dynamic environment, financial literacy emerges as a crucial factor for SME success (Adomako & Danso, 2014; Barte, 2012; Fatoki, 2014; Huston, 2010; Lusardi, & Mitchell, 2014). SMEs have the potential to bring socio-economic development and quality of life (Erdin & Ozkaya, 2020). Financial literacy equips entrepreneurs with the knowledge and skills necessary to make informed financial decisions, manage resources effectively, and navigate the complexities of modern business (Eniola & Entebang, 2015; Okello et al. 2017; Kulathunga et al., 2019). Menike (2018) potentially related to Sri Lanka, likely supports the notion that SMEs with higher financial literacy are more likely to make informed financial decisions. This, in turn, contributes to improved firm performance and sustainability of business (Adomako & Danso, 2014). SMEs are key to making globalization and economic growth more inclusive (Pucci, Nosi & Zanni, 2017). By giving them better access to international markets and information networks, we can unlock their full potential and contribution. However, the Organization of Economic Cooperation and Development stated that trade barriers and limitations on investment make it harder for SMEs to compete globally (OECD, 2017). OECD International Network on Financial Education (INFE) has identified key areas where SMEs worldwide face fundamental barriers to deviating from their core growth and development. One such barrier is the poor financial literacy level of the owners (OECD/INFE, 2018).

More than 97% of Sri Lanka's businesses are classified as small and medium-sized enterprises (SMEs) making them a crucial segment of the country's economy. This industry is responsible for 45% of all jobs in the nation. Micro, Small, and Medium-Sized Enterprises (MSMEs) are part of the SME sector, which has about a million businesses and employs 2.25 million people nationwide (MIC, 2016). Small businesses have a significant economic and social impact in both developed and developing nations (Halabi, Barrett, & Dyt, 2010). The Government of Sri Lanka has designated the SME sector as a key strategic sector in its overall policy objectives (GOSL). It is a change agent for equitable economic development, local growth, job creation, and

poverty eradication. The SME sector is expected to turn struggling regions into emerging, prosperous regions (MIC, 2015).

SMEs have inherent diverse problems which prevent or curtail their rapid growth and development. The main underlying issue that curtails the growth and development of SMEs is the inappropriate financial management decisions taken by the owners (Abeyesuriya, 2019; Barte, 2012; Kulathunga et al., 2019; Menike, 2018; Heenkenda, 2014; Cole & Fernando, 2008; Lusardi & Mitchel, 2014). The problems start with the fundamental design errors of the business model at the initial stage. Subsequently, the problem will further extend to the operational and strategic level leading to the business's bankruptcy at the early stage of the lifecycle. Business decisions are broadly categorized into financial and non-financial. However, all the decisions taken by SME owners have financial implications. Therefore, even business-related decisions like recruitment of potential new employees, access to modern technology, access to relevant information, reach to business development services, developing business relationships, hiring or getting infrastructure, adopting the legal and regulatory framework, industrial relations, entrepreneurial and management skills developments, feasibility studies and environmental issues, etc. are directly and indirectly brings financial consequences. That means their outcomes can be numerically measured through rupees or dollars. Where favorable decisions get profits or cash inflows into the business, adverse decisions bring losses or negative cash outflows the knowledge and skills of how financial know-how is recognized as the financial literacy level of SME owners. Financial literacy is a fundamental prerequisite for SME owners since it deals with how cash inflows and outflows exist within the business due to owners' decisions. It is vital to identify that an SME owner is an economic agent. His level of financial literacy drives the company and navigates its direction. This research explores the relationship between financial literacy and firm performance in SMEs, with a specific focus on the mediating role of business experience. Building on prior research, it is proposed that financial literacy directly impacts firm performance and that business experience strengthens this relationship.

The cosmopolitan era presents unique challenges for SMEs. Increased competition from international players demands greater efficiency and innovation. Complexities of global supply chains require debt management and risk mitigation strategies. Navigating fluctuating currency exchange rates

and international regulations further complicates financial decision-making. However, this era also offers exciting opportunities for SMEs. Access to a wider customer base through online platforms fosters growth potential. The ability to source materials and services globally allows for cost optimization. Entrepreneurs with strong financial literacy are better positioned to seize these opportunities and navigate the challenges of the cosmopolitan era.

Recognizing the critical role of financial literacy for SME success, policymakers and educators can implement various initiatives. Developing curriculum and training programs specifically tailored to the needs of entrepreneurs equips them with the necessary financial knowledge and skills (Atkinson & Messy, 2012). Promoting financial literacy workshops and online resources empowers SMEs to make sound financial decisions, manage cash flow effectively, and access funding opportunities (Basu, 2005). By fostering a culture of financial literacy within the SME sector, policymakers and educators can contribute significantly to the growth and competitiveness of SMEs in the cosmopolitan era.

While research suggests a positive correlation between financial literacy and firm performance in SMEs (Atkinson & Messy, 2012; Basu, 2005), a gap exists in understanding the potential mediating role of business experience. Previous studies highlight the importance of both financial literacy (knowledge and skills) and business experience (applications) for SME success (Lusch & Laczniak, 1989; Chironga et al., 2011).

This research aims to address this gap by investigating how financial literacy directly influences firm performance and whether business experience plays a mediating role in this relationship.

Research Objectives

To understand the complex relationship between financial literacy and firm performance in SMEs, this study establishes two key research objectives. The first objective is to directly examine the impact of financial literacy on firm performance. This aligns with existing research suggesting a positive correlation. Second, it aims to investigate whether business experience acts as a mediator in this relationship. Since financial literacy provides knowledge and skills, exploring how business experience influences the utilization of that knowledge for improved performance becomes crucial. By addressing these objectives, this study seeks to provide a more comprehensive understanding of the factors influencing SME success.

The article's literature analysis continues with a part that examines financial literacy in the context of SMEs. It starts by going over pertinent research on the subject and explores how financial literacy and SME are related, as well as the relationship between financial literacy and business experience and the mediating role of business experience. The research techniques, sample, and population, as well as how data were gathered, are then described in the methodology part. The study's conclusions and their interpretation are then presented in the analysis and results section. The paper ends by outlining the main conclusions, pointing out its shortcomings, talking about its practical implications, and recommending more research topics.

Literature Review and Hypotheses Development

Financial Literacy and SMEs

Financial literacy plays a vital role in the success of SMEs. Entrepreneurs with strong financial literacy are better equipped to manage cash flow, secure funding, and make sound investment decisions (Atkinson & Messy, 2012). Studies have shown a positive correlation between financial literacy and various aspects of firm performance, including profitability, growth, and survival rates (Adomako & Danso, 2014; Barte, 2012; Basu, 2005). The positive impact of financial literacy extends beyond firm performance. Entrepreneurs with strong financial literacy are better positioned to manage personal finances effectively. This translates to benefits such as improved financial well-being, increased savings, and a stronger ability to weather unexpected financial hardships (Clark et al., 2022; Lusardi & Mitchell, 2014). Furthermore, financially literate entrepreneurs can make informed decisions regarding personal investments and retirement planning, leading to greater financial security over the long term. Empowering entrepreneurs through financial literacy initiatives fosters a robust business environment, ultimately propelling Sri Lanka's economic well-being.

Business Experience and Firm Performance

Business experience is another critical factor influencing firm performance. Experienced entrepreneurs possess valuable knowledge and skills that enable them to navigate market dynamics, build strong relationships with stakeholders, and make strategic decisions (Lusch & Laczniak, 1989). Research suggests that experience fosters better financial management

practices and contributes to improved firm performance (Chironga et al., 2011).

Entrepreneurs gain business experience through various avenues. Formal education programs in business administration or entrepreneurship can equip individuals with the foundational knowledge and skills necessary for success. However, practical experience gained through working in established businesses or launching and managing their ventures plays a crucial role in developing essential competencies. Over time, entrepreneurs encounter various challenges and overcome obstacles, fostering problem-solving abilities, adaptability, and a deeper understanding of the intricacies of running a business (Cooper & Dunkelberg, 2014). These acquired skills contribute significantly to improved firm performance.

The benefits of business experience extend beyond the individual entrepreneur. Experienced teams, where multiple members possess diverse skills and knowledge gained from prior ventures, can significantly enhance a firm's performance (Hambrick & Mason, 1988). A team with a balance of experience in areas such as finance, marketing, and operations allows for a more comprehensive approach to decision-making, risk mitigation, and seizing new opportunities. By fostering a culture of continuous learning and knowledge sharing within the team, businesses can leverage the collective experience of their workforce to achieve superior performance.

The Mediating Role of Business Experience

We posit that business experience acts as a mediator in the relationship between financial literacy and firm performance. Financial literacy equips entrepreneurs with the foundational knowledge, but experience allows them to translate this knowledge into practical skills and effective decision-making, ultimately leading to improved performance.

Financial literacy provides entrepreneurs with a valuable foundation for the knowledge and understanding of financial concepts, tools, and strategies. However, translating this knowledge into effective action requires practical experience. Business experience allows entrepreneurs to improve their financial skills, apply their knowledge to real-world scenarios, and make sound financial decisions under pressure (Haynes & Hewstone, 2017). Experienced entrepreneurs can develop a more in-depth understanding of financial risks and opportunities, analyze complex financial data effectively, and implement strategies that optimize resource allocation, leading to

improved firm performance. The specific type of business experience plays a crucial role in its effectiveness as a mediator. Entrepreneurs with experience in a similar industry or market are better equipped to leverage their knowledge and skills to navigate the specific challenges and opportunities within that domain. For example, an entrepreneur with prior experience running a retail store would possess valuable insights into customer behaviour, inventory management, and marketing strategies relevant to the success of another retail venture. Anwar et al. (2020) state that experience is worthy in achieving the SME's performance as experienced managers can make rational decisions. This context-specific experience strengthens the mediating effect, allowing entrepreneurs to translate their financial literacy into actions that demonstrably improve firm performance within their chosen industry.

The Conceptual Framework and Hypotheses

This study examines the relationship between financial literacy and firm performance, with business experience acting as a mediating factor. Financial literacy equips entrepreneurs with the knowledge to understand financial concepts and tools. However, translating this knowledge into effective action requires practical experience. Business experience allows entrepreneurs to enhance their financial skills, make sound decisions, and navigate industry-specific challenges. Ultimately, both financial literacy and business experience contribute to improved firm performance. Drawing on the key insights from the above discussion, this conceptual framework provides a structured approach to oversee the relationships and develop the hypotheses mentioned below.

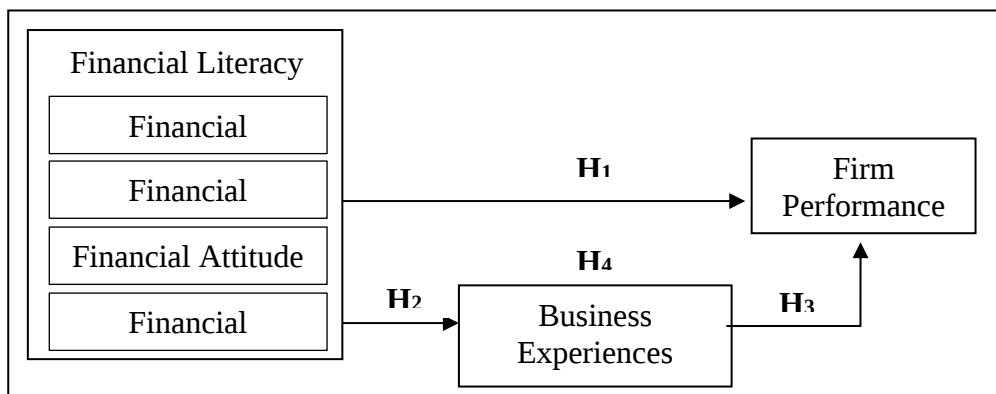


Fig. 1: Conceptual Framework

Financial Literacy and SMEs Firm Performance

This hypothesis suggests that entrepreneurs with a stronger understanding of financial concepts and tools will be better equipped to manage their businesses effectively. This can lead to improved financial outcomes such as increased profitability, better resource allocation, reduced risk and enhanced wealth of the business. Imagine an entrepreneur who can analyze financial statements and identify areas where costs can be cut. This financial literacy allows them to improve their profit margins by streamlining operations or negotiating better deals with suppliers. Additionally, they can utilize tools like budgeting and forecasting to allocate resources more efficiently. This might involve investing in marketing campaigns during peak seasons or strategically purchasing materials based on projected sales. Furthermore, a financially literate entrepreneur can recognize and mitigate risks. For example, understanding cash flow allows them to avoid situations where they can't pay their bills due to a temporary dip in sales. By proactively managing these risks, they can ensure the long-term sustainability of their business. Ultimately, these combined factors can lead to an enhanced wealth of the business, which can be reinvested for growth or distributed to the entrepreneur as increased personal wealth. Therefore, we hypothesized that;

Hypothesis 1: Financial literacy significantly influences SMEs firm performance.

Financial Literacy and Business Experience

While financial literacy is important, business experience also plays a significant role. Experience allows entrepreneurs to develop a deeper understanding of the market, their customers, and their competitors. When the owner is financially literate with the experiences he has, the owner will be stronger and his level of efficiency will be increased. Experience in the business indicates knowledge of the market, exports and imports, operations, and other topics (Ying, Hassan & Ahmad, 2019). Business experiences are developed with daily routines and some notable incidents over time. Experiences enhance decision-makers confidence, as they know the possible outcomes. Therefore, experienced SME owners dare to make related financial decisions without hesitation. Thus, our second hypothesis;

Hypothesis 2: Financial literacy significantly influences business experience.
Business Experience and SMEs Firm Performance

The next hypothesis is suggested that, even though financial literacy is important, it's not enough on its own. Business experience allows entrepreneurs to translate their financial knowledge into practical skills and make informed decisions. Therefore, the positive effect of financial literacy on firm performance is likely strengthened by the experience of the entrepreneur. In simpler terms, experience helps bridge the gap between financial knowledge and its practical application, ultimately leading to better firm performance. Therefore, the third hypothesis is suggested to empirically verify the following relationship.

Hypothesis 3: Business experience significantly influences firm performance.
The Links Between Financial Literacy, Business Experience, and
SMEs Firm Performance

While financial literacy provides valuable knowledge, applying it effectively in the real world of business requires experience (Covin & Slevin, 1990). Business experience allows entrepreneurs to develop a deeper understanding of their industry, customer base, and competitive landscape. This experience can help them drive his business to increase the wealth of his business. Bandura (1979) stated the most reliable indicator of whether someone can succeed at something is their own experience of the action or concept. Further, Bandura (1979) pointed out that people can get experiential information from watching others, influencing their confidence in their talents. Bandura (1979) tested and said a person's ability to visualize future success may be improved by visualization or imaginary experiences, which might help them believe that success is achievable. Thus, the fourth hypothesis is developed as follows.

Hypothesis 4: Business experience mediates the relationship between financial literacy and firm performance.

Methodology

Sample Design and Data Collection

The population for this study comprised SMEs in Sri Lanka. After considering the number of definitions of SMEs we selected the sample based on the definition provided by the Ministry and Industries and Commerce (MIC) in Sri Lanka. According to (MIC,2016), there are two main criteria for SMEs. Those are annual turnover and the number of employees attached to the business. When annual turnover is less than Rs. 15 million and employees are less than 10, such an enterprise is recognized as a micro entity. Annual turnover between Rs. 16 to 250 million and employees in the range of 11 to 50 are the criteria of a small entity. A medium-sized entity is recognized when its annual turnover is between Rs. 251 to 750 million and the number of employees is between 51 to 300. However, this criterion slightly changed in the service sector, where the number of employees should be between 51 - 200. To capture the diversity of SMEs in Sri Lanka, this study employed a stratified random sample of 677 businesses across all nine provinces and covering 25 districts. This sample size exceeded the minimum of 384 recommended by Krejcie and Morgan (1970) and ensured a proportionate representation of SMEs according to the definition established by the Ministry of Industry and Commerce's National Policy Framework for Small Medium Enterprises. According to Hair et al. (2010), a sample size of 100 or more should be considered suitable for statistical analysis. A survey instrument was developed to measure financial literacy, business experience and firm performance. To ensure data quality, the structured questionnaire was pre-tested with a small sample of SMEs owners to identify and address any ambiguities or confusing questions. The questionnaire was based on questions used in previous studies conducted in different contexts. The survey link was then disseminated through various channels to the SMEs owners attached to the Small Enterprise Development Division (SEDD) and National Enterprise Development Authority (NEDA) in Sri Lanka.

The sample profile of the study is summarized in the following table.

Criteria		Frequency	Percentage
Age	a) Years 20 - 30	117	17.3%
	b) Years 31 - 40	235	34.7%
	c) Years 41 - 50	287	42.4%
	d) Years 51 Over	38	5.6%
		677	100%

Gender	a) Male	279	41.2%
	b) Female	398	58.8%
		677	100%
Business Registration	a) Sole proprietorship	603	89.1%
	b) Partnership	18	2.7%
	c) Private Limited Liability	29	4.3%
	d) Other	27	4.0%
		677	100%
Annual Income Financial year	a) Between Rs.01-15 Mn	358	52.9%
	b) Between Rs. 16 -250 Mn	299	44.2%
	c) Between Rs.251-750 Mn	20	3.0%
	d) Between Rs.751-1000 Mn	0	0%
		677	100%
Number of Employees	a) No Employees [Owner only]	140	20.7%
	b) Between 01-10	457	67.5%
	c) Between 11-50	70	10.3%
	d) Between 51-200	10	1.5%
		677	100%

Table 1. Profile of the sample

The surveyed population's age distribution reveals a diverse range, with a significant portion falling between 31 to 50 years old, comprising about 77.1% of the total respondents. This indicates that the study encompasses a broad demographic, with a focus on individuals in their prime working years. However, there is also representation from younger and older age groups, 20 - 30, 17.3% and over 51 age group 5.6% respondents, suggesting a balanced sample across different age brackets. Gender representation in the survey shows a slight majority of female respondents, making up approximately 59% of the total, compared to around 41% of male respondents. This distribution highlights a relatively equitable participation of both genders in the study. The data on business registration types indicates that the majority of respondents (89.1%) are operating as sole proprietors, showcasing the prevalence of this form of business ownership within the surveyed population. Additionally, a small percentage of respondents are engaged in partnerships (2.7%) or private limited liability companies (4.3%), with a further 4% falling into other categories. This breakdown offers insights into the varying legal structures adopted by businesses represented in the study.

Analysis of respondents' annual incomes reveals a diverse distribution, with a majority (over 97%) falling within the range of Rs. 01 - 250 Mn. Specifically, around 53% of respondents report incomes between Rs. 01 - 15 Mn, while 44% fall in the range of Rs. 16 - 250 Mn. A smaller proportion of respondents (3%) report higher incomes, ranging from Rs. 251 Mn to 750 Mn, indicating the presence of larger enterprises within the surveyed population. Examination of the number of employees within surveyed businesses illustrates a varied landscape, with a substantial portion being owner-operated ventures (20.7%) with no additional staff. The majority of businesses (67.5%) employ between 1 to 10 individuals, indicating a prevalence of small-scale enterprises. However, there are also representations from businesses with larger workforces, with 10.3% employing between 11 to 50 employees, and a smaller fraction (1.5%) having staff sizes ranging from 51 to 200, underscoring the diversity in business sizes within the study sample.

Measurement of Variables

Due to the variables' abstract character, it is more challenging to measure more abstract and subjective aspects (Sekaran and Bougies, 2012). Abstract ideas like satisfaction or trust cannot be measured straightforwardly. However, we can quantify what we have come to refer to as contentment or confidence, for instance, in a name, a product, or a business. One method uses indicators that act as proxy variables to measure the images indirectly when measuring complex concepts (Hair, Hult, Ringle, and Sarstedt, 2014). All the indicators of the main concepts or constructs were measured through a Likert scale questionnaire in this study. When it is put on the Likert Scale following scale is used in the study. 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree. The Likert-scale questionnaire is one form of instrument that may be used to obtain quantitative data that is representative and generalizable (Ledesma & Izquierdo, 2023). All the main variables are described via indicators in the table mentioned below.

Financial Literacy; Financial literacy encompasses a range of qualities essential for making informed financial decisions and securing personal financial well-being, as defined by the Organization for Economic Cooperation and Development (OECD) and its International Network on Financial Education (INFE) in (OECD INFE, 2020). These qualities include awareness, knowledge, skills, attitudes, and behaviours. To assess financial

literacy, 32 indicators have been identified across four main dimensions: financial education (measured by 12 indicators), financial awareness (measured by 6 indicators), financial attitude (measured by 8 indicators), and financial behaviour (measured by 6 indicators).

Firm Performance; Firm performance is a multidimensional construct that plays a pivotal role in the evaluation and assessment of a company's overall success. It encompasses a range of financial and non-financial indicators, highlighting the firm's ability to generate value, achieve strategic objectives, and adapt to changing market dynamics. Financial metrics such as return on assets (ROA) and net profit margin are often utilized to gauge the financial health of a company (Dellis, 2018). Additionally, market-based measures like market share and brand reputation can provide insights into a firm's competitiveness and its ability to capture market opportunities (Smith & Johnson, 2019). These measures collectively contribute to the understanding of how well a firm is performing in terms of its financial stability and competitive positioning (Santos & Brito, 2012).

Business Experience; Business experience is the amount of learning and familiarity with business management functions in running the business operation. Bandura (1983) states that one's behaviour is determined mainly by experience. Individuals get more experience engaging in many business activities (Kiyosaki, 2014). The general sense is that; experiences lead to effective decision-making. For the identification of new prospects and the performance of SMEs, it is essential to have both financial literacy and business/trade/operational experience. (Anwar, Shuangjie, and Ullah, 2020). Therefore, financial literacy and business experiences are antecedents of the firm performance of SMEs. The route between intellectual capital and resource acquisition is strengthened by business expertise, which significantly speeds up resource acquisition (Ying, Hassan & Ahmad, 2019). Kang et al. (2019) noted that experienced managers benefit from improved performance and market position. Therefore, this study's researcher is interested in empirically verifying the association between financial literacy and business experiences.

Smart PLS software was employed to analyze the collected data. Partial Least Squares (PLS) is a structural equation modeling (SEM) technique well-suited for analyzing complex relationships with smaller sample sizes (Hair et al., 2017). The analysis focused on assessing the direct effect of

financial literacy on firm performance and the mediating role of business experience.

Analysis and Results

Assessment of Validity and Reliability

Tables 1 and 2 provided below demonstrate efforts to ensure both validity and reliability in this research. Validity refers to whether the measures accurately capture the intended constructs. Here, the Fornell-Larcker Criterion examines the correlation between each construct and its corresponding measures. As the values in the diagonal line are greater than the squares of inter-constructed correlations, we concluded that the construct had satisfactory discriminant validity. AVE values in Table 2 are greater than the cut-off value of 0.5 evidence of convergent validity of the constructs (Hair et al., 2017).

Reliability reflects the consistency of the measures. Cronbach's Alpha, rho_A, and Composite Reliability coefficients are all above 0.7 for most constructs, exceeding the recommended threshold. This suggests the measures produce consistent results when applied repeatedly, demonstrating good internal consistency and reliability. Overall, the evidence presented suggests the measures used in this study are both valid and reliable, strengthening the confidence in the research findings.

	BE	FA	FA	FB	FE	FP
Business Experience	0.708					
Financial Attitude	0.600	0.768				
Financial Awareness	0.629	0.708	0.772			
Financial Behaviour	0.604	0.674	0.658	0.782		
Financial Education	0.597	0.673	0.756	0.630	0.775	
Firm Performance	0.545	0.546	0.489	0.491	0.522	0.716

Table 2: Validity Criterion (Fornell-Larcker Criterion)

	Cronbach's Alpha	rho_A	Composite Reliability	AVE
Business Experience	0.799	0.801	0.857	0.501
Financial Attitude	0.768	0.768	0.852	0.589
Financial Awareness	0.831	0.831	0.881	0.597
Financial Behaviour	0.683	0.684	0.825	0.612

Financial Education	0.778	0.782	0.857	0.600
Firm Performance	0.841	0.846	0.880	0.513

Table 3: Reliability Criterion

Constructs	Items	Reflective Latent Measures	CFL
Financial Education	FE1	I am competent in using simple interest methods for the calculation	Dropped
	FE2	I am capable of doing multiple interest rate calculations correctly.	Dropped
	FE3	I have a sense of the current inflation rate in Sri Lanka and particularly feel at the time of purchases.	Dropped
	FE4	I have properly diversified the assets of my firm.	0.750
	FE5	I have the required skills to ascertain financial risk before spending.	0.768
	FE6	In my business, I have a well-established main operational income.	Dropped
	FE7	I have created a few passive income methods in my business.	Dropped
	FE8	I have a practice of getting three quotations before buying an asset.	Dropped
	FE9	My firm operates a savings account, and a specific amount is saved monthly.	Dropped
	FE10	I know the costs of borrowing a loan from the bank.	0.775
	FE11	I consciously assess the return on investment that appears in the financial statement of the business.	0.805
	FE12	I have safeguarded business assets from the insurance policies.	Dropped
Financial Awareness	FA1	I am reasonably aware value of products and services offered by sellers before purchasing.	Dropped
	FA2	I am capable of calculating the loan repayment schedule of my business loan.	0.773
	FA3	I can prepare and analyze bank reconciliation statements monthly.	0.795
	FA4	I try to get maximum cash inflows from existing assets of the business before buying new assets.	0.763

	FA5	I am aware that financial planning for unexpected expenses helps me to successfully cope with the shortage of funds.	0.765
	FA6	I can compute and compare the return on savings from investments under the given rate of interest in a period.	0.766
Financial Attitude	FAt1	I regularly maintain a formal budget for the successful financial management of my business.	0.767
	FAt2	I plan diversified investment in assets which in return bring positive cash flows to my business.	0.766
	FAt3	I am careful to pay due bills on time without delay.	Dropped
	FAt4	I am prioritizing expenditures before setting them off.	Dropped
	FAt5	I regularly bargain on the price of almost everything purchased for the business.	Dropped
	FAt6	I regularly analyze the value of the net wealth of my business by reducing liabilities from assets.	0.789
	FAt7	I try to maintain the consistency of the quality of the products.	Dropped
	FAt8	I have a positive attitude toward updating the financial statements of the business.	0.748
Financial Behaviour	FB1	I maintain formal ledger accounts for revenue recognition and expenditure recording for my business.	0.757
	FB2	I am concerned about prices and utility before purchasing assets for my business.	0.790
	FB3	I always issue cheques for payment to suppliers and prepare monthly bank reconciliations.	Dropped
	FB4	I follow regular saving and investment strategies in my business	0.799
	FB5	I am free from overindulgence of liquor and gambling	Dropped
	FB6	I have taken formal insurance protection for my business and all its assets.	Dropped

Firm Performance	FP1	The gross profit margin of my business is greater than the expected return rate.	0.747
	FP2	The net profit of my business is greater than the cost of capital and increased the net wealth annually.	0.745
	FP3	The net sales value of my business has increased greater than last year's sales.	0.707
	FP4	My business's cash flow statement shows a sufficient positive cash balance.	0.754
	FP5	I get maximum utilization of all my business assets.	Dropped
	FP6	The present market value of my business is a few times greater than the initial investment.	Dropped
	FP7	I feel that My firm's employees are delighted with organizational policies and strategic performances.	Dropped
	FP8	My firm's number of employees has gradually improved over the last few years.	Dropped
	FP9	My firm's customers are delighted with my firm's sales methods and after-sales policies.	Dropped
	FP10	My firm's customer number has gradually improved over the last few years.	Dropped
	FP11	I have trained and skilled employees in my business.	0.634
	FP12	I have established a formal management system in my business, and organizational hierarchy is in practice.	0.709
	FP13	I have established machine and process controllers in my firm.	0.710
	FP14	I have established cyber security technologies to safeguard my firm's Management Information System (MIS).	Dropped
Business Experience	BEx1	I have sufficient experience in main business operations and the functions of my business.	0.709
	BEx2	I have adequate experience in setting the price for each product and service	0.780

	BEx3	I have a sense of identification of domestic market demand for products and services of our business.	0.709
	BEx4	I have a fair knowledge of the export process of products and countries who buy our products.	0.675
	BEx5	I have a fair knowledge of the import process of products and countries that can supply us with products.	0.638
	BEx6	I have experience in online business operations.	Dropped
	BEx7	I try to update my ICT knowledge regularly	Dropped
	BEx8	I have experience in using marketing strategies to attract customers	0.727

Table 4: Confirmatory Factor Loading

In our confirmatory factor analysis (CFA), we evaluated the strength of the relationships between 54 observed variables and their underlying latent constructs. We refined the model by removing indicators with low factor loadings (below 0.7), resulting in a final set of 29 strong indicators for further analysis.

It is important to consider quality criteria before running bootstrapping to estimate the significant relationships mentioned in the conceptual model. Following are a few such quality criteria derived from the PLS algorithm.

Variables	R Square	R Square Adjusted
Firm Performance	0.378	0.376
Business Experience	0.486	0.482
	Saturated Model	Estimated Model
SRMR	0.091	0.091
d_ ULS	8.524	8.571

Table 5: Quality Criteria

The analysis examined the factors influencing business experience and firm performance. The results indicate that nearly half (48.2%) of the variation in business experience can be explained by the factors included in the model.

For firm performance, the model explains a slightly lower proportion of the variance, at 37.8%. The SRMR value of 0.091 suggests a good fit for both the saturated and the estimated model. Values less than 0.1 generally indicate a good fit. The d_ULS values for both models are very high (greater than 8.5) which would normally indicate a poor model fit. However, d_ULS is not recommended for PLS path models, so we can ignore this value.

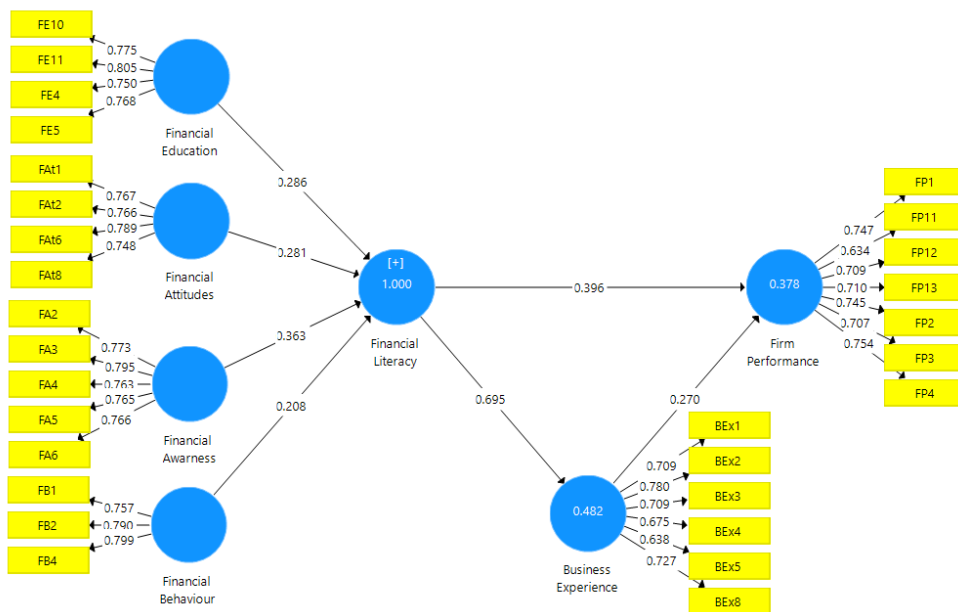


Fig.2: Smart PLS output

Variables	Estimate (P Values)	Decision Accept/ Reject
Business Experience -> Firm Performance	0.000	Accept
Financial Attitude -> Financial Literacy	0.000	Accept
Financial Awareness -> Financial Literacy	0.000	Accept
Financial Behaviour -> Financial Literacy	0.000	Accept
Financial Education -> Financial Literacy	0.000	Accept
Financial Literacy -> Business Experience	0.000	Accept
Financial Literacy -> Firm Performance	0.000	Accept
Financial Literacy -> Business Experience -> Firm Performance	0.000	Partially Accepted

Table 6: Path Coefficients and Bootstrapping results with direct/indirect effects

Direct Effect of Financial Literacy

The analysis confirmed a significant positive relationship between financial literacy and firm performance, financial literacy and business experience, and business experience with firm performance, aligning with our initial hypotheses. This implies that SMEs with stronger financial literacy tend to achieve better performance outcomes. The study further revealed a cascade effect by leveraging business experience with financial literacy. Financial literacy has a significant positive relationship with business experience, suggesting that financially literate entrepreneurs are more likely to gain valuable experience through informed decision-making and effective financial management. This experience, in turn, has a significant positive relationship with firm performance. This finding highlights the potential for financial literacy to empower entrepreneurs and contribute to improved business outcomes, not just directly, but also indirectly by fostering valuable business experience.

Mediating Effect of Business Experience

The analysis not only confirmed a positive relationship between financial literacy and firm performance but also revealed a significant mediating role played by business experience. This finding shed light on the underlying process through which financial literacy translates into better firm performance. Imagine financial literacy as the knowledge and tools needed to navigate the financial aspects of running a business. While this knowledge is undoubtedly valuable, it takes experience to effectively put it into action.

Summary and conclusion

The findings of this study contribute to the growing body of research on the importance of financial literacy for SMEs. The significant positive effect of financial literacy on firm performance underscores the need for initiatives that enhance financial literacy among entrepreneurs. The mediating role of business experience highlights the synergistic effect of knowledge and experience. While financial literacy provides the foundation, business

experience allows entrepreneurs to leverage this knowledge for better decision-making and improved performance.

Financial literacy equips entrepreneurs with the knowledge to understand financial statements, make sound investment decisions, and manage resources effectively.

Business experience allows them to translate this knowledge into practical skills. Through real-world application, entrepreneurs enhance their financial acumen, learn to adapt to industry-specific challenges, and develop a deeper understanding of the financial implications of their decisions.

This experience then strengthens the positive influence of financial literacy on firm performance. With the ability to implement their financial knowledge effectively, entrepreneurs can make better financial decisions, optimize resource allocation, and ultimately achieve superior business outcomes.

Therefore, business experience acts as a bridge, taking entrepreneurs beyond just possessing financial knowledge and enabling them to leverage it for greater success. This highlights the importance of not only financial literacy training but also opportunities for entrepreneurs to gain practical experience to truly maximize the positive impact on their firms.

Implications, limitations, and Future Research Directions

This study investigated the impact of financial literacy on firm performance in SMEs, with a particular focus on the mediating role of business experience. The findings provide compelling evidence supporting the crucial role of both financial literacy and business experience for SME success in the cosmopolitan era.

The analysis confirmed a significant positive direct effect of financial literacy on firm performance. This aligns with our initial hypothesis, suggesting that SMEs with stronger financial literacy achieve better performance outcomes. More interestingly, the study revealed a significant mediating effect played by business experience. Financial literacy empowers entrepreneurs with the knowledge to make informed financial decisions, but it's business experience that allows them to translate this knowledge into practical skills and navigate the complexities of the financial landscape. This highlights the importance of a dual approach, fostering financial literacy among entrepreneurs while also providing opportunities for them to gain practical experience. By equipping entrepreneurs with both the knowledge and

the ability to apply it effectively, policymakers and educators can significantly contribute to enhancing the performance and competitiveness of SMEs in the dynamic and challenging cosmopolitan era.

Theoretical Implications

This research study's conceptual framework draws upon various behavioural finance and economics theories. Several of these theories align with the core idea of financial literacy and the self-efficacy theory is connected to business experience. Self-efficacy theory is about how confident people feel when handling financial matters. This research study found that having more business experience makes SMEs owners better understand money matters. This confirms the theory. But here are some interesting things found. The self-efficacy theory is directly supported by the relationship between business experience and financial literacy because the findings explicitly state a significant relationship; further, business experience did mediate the relationship between financial literacy and firm performance. Accordingly, it can be confirmed that aligned with the theory, SME owners or managers with greater financial literacy may have higher self-efficacy beliefs in financial matters, potentially influencing their business decisions.

Managerial Implications

The findings highlight the value of having both business expertise and financial literacy. Entrepreneurs with business expertise can put their financial literacy into practice, while financially literate individuals are better equipped to make wise financial decisions. SMEs should give building both skill sets top priority. Therefore, the following implications would be recommended. Programmes for Education and Training; conduct seminars or training sessions to improve entrepreneurs' financial literacy. Financial Literacy enhancement initiatives; Give entrepreneurs access to tools and information that make financial concepts and decision-making easier. Mentorship Programmes; Assist young business owners by matching them with seasoned mentors who can offer helpful advice on handling complex financial situations. On-the-Job Training; This research underlines the value of "learning by doing" alongside continuous improvement achieved through dedicating a small portion of each day to micro-learning activities. This

commitment to ongoing learning and development, even in small daily doses, fosters steady and sustainable growth in the long term.

Limitations

The study concentrated on all 25 districts in Sri Lanka as the geographic area, encompassing various industries and SMEs of varying sizes, thereby potentially introducing deviation in measuring financial literacy. This limits the generalizability of the findings to a broader population of SMEs. Future research could explore the impact of financial literacy and business experience across diverse SME contexts with a larger sample size. Measurement of Business Experience: The study likely relied on a specific method to measure business experience (e.g., not years in operation but Likert scale measurements). This method might not capture the sense of experience, such as the variety of financial situations encountered or the depth of financial knowledge gained through past challenges. Future research could explore alternative or multi-faceted ways to measure business experience.

Future Research Directions

Future research should focus on unveiling the complex connections within the realm of financial literacy and small and medium-sized enterprises (SMEs) by investigating the intersectionality of demographic factors, including gender, age, education level, and cultural background. This exploration aims to identify disparities and dynamics, laying the groundwork for targeted strategies to enhance financial literacy and improve overall SME firm performance across diverse demographic groups. Additionally, a comprehensive study of the impact of government policies on SME financial literacy and performance is reasonable. Such research should assess the effectiveness of governmental initiatives in fostering financial literacy, business experience, and resource diversification skills among SMEs. Understanding the direct and indirect consequences of these policies can provide valuable insights into areas where interventions can be optimized to create an environment conducive to sustained SME success. Furthermore, an examination of the transformative role of technology, particularly digital financial tools and platforms, is crucial in elevating SME owners' financial literacy. Research in this area should analyze how technological interventions contribute to enhanced financial literacy and, consequently, influence SME firm performance. By focusing on the evolving landscape of digital solutions,

future research will pinpoint ways in which technology can empower and equip SMEs for success in an increasingly digitized business environment.

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