Accounting Practices, Financial Literacy And Financial Performance Of Micro, Small And Medium Enterprises

Owino Thadeus Onyango*  
Gabriel Simiyu  
Mwengei Ombaba  

1,2,3 School of Business, Economics and Management Sciences, University of Eldoret, Eldoret, Kenya.

ARTICLE INFO

ISSN: 2723-1097

Keywords: Financial Performance, Accounting Practices, Financial Literacy

ABSTRACT

This study examines how financial literacy moderates accounting practices and financial performance of MSMEs in the Republic of Kenya. Micro, Small and Medium Enterprises (MSMEs) are significant in developing many economies by creating employment, alleviating poverty and food insecurity, and contributing to the Gross Domestic Product. Despite their significance, MSMEs face multiple challenges that affect their capacity to achieve desired economic outcomes. An explanatory research design and simple random sampling were used to select a representative sample. Data was collected from 398 managers/owners of MSMEs using a self-administered questionnaire. The hierarchical regression model was used to test the study hypothesis in SPSS vs.23. Accounting practices and financial literacy were found to have a positive and significant influence on MSMEs’ financial performance. Results further show that financial literacy moderates the relationship between accounting practices and financial performance. The study underlines the importance of accounting approaches and financial literacy in improving MSMEs’ financial performance in developed and emerging nations. Given the scarcity of research in this context, it is critical to employ financial literacy as a moderating variable. The interaction results contribute to the body of knowledge and serve as a catalyst for improving the association between accounting practices and financial performance.

Introduction

Financial performance is vital in every enterprise’s growth and survival, as finance serves as the enterprise’s operating blood (Ahinful, Boakye, & Osei Bempah, 2023) and must be properly managed and controlled since it leads to business sustainability (Matsoso & Benedict, 2016). Although MSMEs contribute significantly to the economy, most of them face many challenges that affect their financial performance and collapse within a few months of their operations due to financial distress affecting their operating power and growth capabilities (Ahinful et al., 2023; Oluoch, 2016). In addition, inadequate finance, poor management, level of education, lack of planning, lack of inventory control, insufficient skills in cash management practices, infrastructure problems, marketing problems, technological issues, inadequate training, unfavorable government policies, corruption problems, and poor accounting practices have been highlighted as the primary causes that affect financial

Journal of Business and Management Review Vol. 4 No. 9 2023 Page 700-719
DOI: 10.47153/jbmr49.7942023

*Corresponding Author
Email address: onyangothadeus0@gmail.com
performance MSMEs resulting to closure (Abdullahi, Jakada, & Kabir, 2016; Diabate, Allate, Wei, & Yu, 2019; Hamza, Mutala, & Antwi, 2015; Sibanda & Manda, 2016; Wach & Tarus, 2021). Hence, if the above-mentioned issues are not addressed, MSMEs cannot contribute much to the economic development and expectations of commitment policies such as Sustainable Development Goals by the UN, Africa Agenda 2063, and Vision 2030. Therefore, these necessitated the need to study the moderating role of financial literacy on the relationship between accounting practices and the financial performance of MSMEs in Eldoret Town, Kenya.

Financial performance is expressed as a measure of the results of business operations and policies in terms of money (Kivaya, 2022). Further, it is viewed as a business’s financial condition over time, including the collection and use of funds (Fatihudin, 2018). Financial performance is the result obtained from the various business activities conducted within the available financial resources (Daud et al., 2022; Ichsan, Suparmin, Yusuf, Ismal, & Sitompul, 2021). It aids the investors, financial institutions, and other lenders in understanding and rating the enterprise’s position on the ongoing concern. In addition, financial performance helps enterprises measure the extent to which resources are utilized to generate revenue, as well as their financial weaknesses and strengths (Chelogoi, 2020; Ndirangu, 2017). Financial performance defines a firm’s financial health and the business’ performance (Matar & Eneizan, 2018). It is a vital aspect of the enterprise’s performance and significantly affects business operations management (Bartolacci, Caputo, & Soverchia, 2020). Hence, effective financial performance in enterprises facilitates resources for promoting business activities, such as improving production rates and research development.

Moreover, financial performance dimensions such as profits, growth, and liquidity are the main objectives any firm desires to achieve to maximize shareholders’ wealth (Bărbuță-Misu, Madaleno, & Ilie, 2019). Therefore, MSMEs’ existence, survival, and financial stability depend on their financial performance (Ibrahim & Ibrahim, 2015). MSMEs play significant roles in the economies of both third-world countries as well as developed countries. The sector represents over 90% of manufacturing enterprises in the world. Furthermore, it depends on the financial performance of MSMEs in contributing to job creation, revenue creation, technological advancement, and other social issues (Peter et al., 2018; Wijewardena, Nanayakkara, & De Zoysa, 2008).

Many scholars have focused on the direct relationship between accounting practices and financial performance, with findings confirming a positive relationship (Nyathi, Nyoni, Nyoni, & Bonga, 2018; Tambadini & Bemani, 2021; Wach & Tarus, 2021). On the other hand, Chepngetich (2016); Tuffour, Amoako, and Amartey (2022) focused their research on the impacts of financial literacy on SMEs’ performance. Minjo (2018) investigated how the owner’s competencies in accounting practice affect the financial performance of small and medium businesses in Kasarani, Kenya, and recommended that future studies be conducted in other counties to identify other issues that impact the financial performance of similar enterprises. Wach and Tarus (2021) explored the effects of accounting practices on the financial performance of
SMEs in the Musanze District, Rwanda. They suggested that future research can launch similar studies in other areas but adopt different research designs to acquire in-depth findings.

Despite the prodigious and increasing interest in research on various dimensions concerning financial performance, limited empirical evidence has examined financial literacy involvement in conceptualizing how accounting practices relate to the financial performance of MSMEs in undeveloped countries like Kenya. Thus, this study aims to fill the existing gap by introducing financial literacy as a moderator in the relationship between accounting practices and financial performance and will form the basis for further academic studies.

Literature Review
The theories guiding the study.

The study utilized the Decision Usefulness Theory and Human Capital Theory.

Decision Usefulness Theory

George Staubus developed the decision usefulness theory in 1958. It provides directions for financial reporting and accounting choices. Under this theory, accounting is portrayed as a collection of procedures providing reliable information to help decision-makers make informed decisions during uncertainties. The theory stipulates that the prime goal of financial reporting is to offer managers and owners critical information that can be used as input when making investment decisions. Notably, the theory assumes the decision-maker's rationality determines their capacity to choose the action that yields the maximum utility. Therefore, this model highlights well-structured procedures by which decision-makers can make the best decision from their subjective probability. However, shortcomings in conventional economic understanding and human decision-making limit the definition of decision usefulness theory in a manner allowing its application in macro or micro level policy making decisions (Ravenscroft, 2011).

Decision Usefulness Theory has been broadly used in literature. For instance, Puspitaningtyas (2010) researched the decision usefulness approach of accounting and concluded that the concept of this theory plays a crucial role in helping the users of financial reports to identify relevant problems and access meaningful information to make informed decisions. This is further echoed by Sovinka, Fagbavimu, Adegoroye, and Ogumola (2017), who assert that financial information must be understandable, comparable, reliable, timely, and verifiable for effective decision-making in the business. Dandago and Hassan (2013) applied the concept of decision usefulness theory in determining if the financial reporting of companies in Malaysia offers useful information to the Inland Revenue Board to determine income tax. The current study requires recording business transactions intending to help MSMEs make viable decisions relating to improving their financial performance. Thus, the decision usefulness theory is relevant to this research and informs its first objective (accounting practices and financial performance) within the context of MSMEs.
Human Capital Theory

The human capital theory developed by Becker in 1962 posits that individuals have skills or abilities that can be improved through training and education. This theory claims that education enhances business owners' and managers' efficiency and productivity. Moreover, the human capital theory argues that training or education equips the workforce with valuable information and skills, which, in turn, can improve the business's performance. This theory mainly concerns experiences and knowledge of individuals owning small-scale businesses. The theory assumes the instrumentality of education and its ability to enrich the population’s productive capacity. Therefore, increasing access to formal education is an investment seeking to build human capital (Almendarez, 2011).

One of the theory’s weaknesses is that it fails to explain how education results in productivity, the role of status, and the rising inequalities in remunerations (Marginson, 2019). Rauch and Rijndijk (2013) argued that specific human capital does not relate to business growth. Existing literature indicates that human capital theory has been widely used in research. For instance, Sunu, Kwema, Muda, and Azaa (2020) used this theory to explore the association between financial literacy and financial performance of SMEs. Rahman and Akhter (2021) used the concept of human capital theory to investigate how human capital investment impacts banks’ performance. Engström and McKelvie (2017) used human capital theory in studying the relationship between micro-enterprise performance, role models and financial literacy. Hence, the capacity of the human capital theory in explaining the need for knowledge and skills, that is, financial literacy, and how it influences the financial performance of the business approves its relevance in this study.

Accounting Practices and Financial Performance

Accounting practices are any computation used to prepare financial statements (Abd Allah, 2009). It is further seen as practices used to identify, record, analyze, and communicate financial information. It is also considered as the typical practical application of auditing and accounting policies (Ratemo, 2018). Accounting is an essential unit of any organization since it helps firms keep track of their financial performance. Alvarez, Sensini, Bello, and Vazquez (2021) argue that the users of accounting tools perform better than non-users in hotel industries in Argentina. Accounting practices are essential since several accounting functions, such as bookkeeping, are tied to legislative obligations (Loikkanen, 2018). However, MSMEs’ accounting systems lack the required standards, leading to improper performance assessment, creating loopholes for mismanagement, and eventually collapsing within a few years of their operations (Obot & Enidiok, 2021).

A study done in Nigeria by Chukwuma and Egbuhuzor (2017) revealed that SMEs should put effort into adopting and maintaining proper and adequate accounting systems that cover all aspects of the business. Sound accounting practices improve SMEs’ effectiveness and efficiency, resulting in good financial performance. Accounting policies significantly affect financial performance, and businesses should adopt necessary accounting practices to improve or enhance the comparability of
accounting information (Nsoke, Okolo, & Ofoegbu, 2021; Obot & Enidiok, 2021; Odo & Isamade, 2021). This is further supported by Chimy and Forzeh (2021), who argued that applying mild accrual accounting practices marked better financial performance.

Lukumay and Wako (2018) studied the association between financial performance and accounting practices of SMEs in Ilala District, Tanzania. They found that best accounting practices positively influence SMEs' financial performance. A similar argument is also presented by Alili (2018); Wach and Tarus (2021), who established that accounting best practices are related to financial performance. Lack of adequate accounting practices in the firm results in misrepresentation of financial information, inappropriate financial statements, and distortion of information, which results in poor decision-making that affects financial performance (Masanja, 2019). According to Abdul-Rahamon and Adejare (2014), accounting record-keeping is crucial to decision-making, which has a widespread impact on performance. Therefore, enterprises must embrace the best accounting recording practices to achieve desired financial outcomes.

This argument is further supported by Omar (2015), who examined the impact of financial statements, internal audits, and bookkeeping on the remittance companies' financial performance in Somalia. Results from this study showed a positive relationship between variables. Manei and Omagwa (2019) studied the relationship between financial performance and accounting practices and confirmed a significant positive relationship between these variables. It has been further noted in the work of Nanjala, Manini, and Kamau (2018) that accounting control practices significantly influence SMEs performance in Kenya. Thus, enterprises that do not engage in accounting practices make unviable financial decisions that result in poor performance (Abdi, 2015). Owners/Managers with greater knowledge of accounting practices can seize the opportunities that result in the effective financial performance of SMEs. Lack of accounting practices threatens the survival as well as restrains the growth, development, and sustainability of enterprise (Kipsang & Mwangi, 2016; Minjo, 2018). Hence, we propose:

H1: Accounting practices significantly and positively influence financial performance.

Moderating Role of Financial Literacy and Financial Performance.

Financial literacy concerns understanding of financial principles, concepts, skills, and the capacity to apply such knowledge to formulate informed decisions (Esiebugie, Richard, & Emmanuel, 2018). Financial literacy drives the individual's capability to make informed decisions concerning financial resource management and utilization (Tuffour, Amoako, & Amartey, 2020). MSMEs are the cornerstone of many economies across the world. Therefore, poor financial literacy among founders of SMEs negatively influences the operation and performance of their operations. Financial literacy is a required entrepreneurial skill that enables enterprises to perform well financially and survive in a dynamic business environment (Tuffour et al., 2020).

Hendrawaty, Widiyanti, and Sadila (2020) examined the influence of chief executive officers’ financial literacy on the financial performance of SMEs in
Indonesia, with sources of investment decisions as a mediator. The direct effects results indicated that financial literacy positively and significantly affects financial performance. Hence, financial literacy is critical to business owners and can precipitate enterprise growth and effective financial performance. (Susan, 2020). Irurian, Fauzi, Wulandari, and Lutfi (2018) observed that high financial literacy levels of MSMEs managers enhance business performance. This qualifies the need to design effective training programs to improve financial literacy levels.

Tuffour et al. (2020) explored the link between performance (non-financial and financial) and managers' financial literacy in Ghana. Their study found that financial literacy has a significant impact on SMEs' performance. Tuffour et al. (2022) contended that SMEs' failure or success greatly depends on financial literacy. This is further noted in the work of Agyapong and Atiram (2019). The lack of knowledge by owner-managers hinders financial performance.

Zirabamuzale (2021) examined the effects of financial literacy on the financial performance of MSMEs in Uganda. Financial literacy was found to be significantly influencing financial performance. The findings were backed by the result of Arinda (2019) that financial performance has a significant relationship with financial literacy. In addition, Asanansi (2022)'s research shows that financial literacy is a prime competency needed for managing and growing SMEs' financial performance. This is further echoed by several other scholars (Chamwada, 2015; Mukundi, 2021; Otieno, 2016) Chamwada (2015); Mukundi (2021), who argued that financial literacy influences financial performance. Moreover, Asakania (2016) states that the key factor in promoting effective performance is the financial literacy levels of the individuals who manage or own SMEs.

Financial literacy has been used as a moderator in this study based on the literature review of other scholars. For instance, Kalaipriya (2018); Okello Candiva Bongomin, Mpeera Ntayi, Munene, and Akol Malinga (2017) used financial literacy as a moderator in determining the relationship between SMEs' growth and access to finance. Furthermore, Owusu, Ismail, and Osman (2019) also used aforementioned moderator to link the availability of financial resources and SME growth in Ghana. On the other hand, Yang, Ishtiaq, and Anwar (2018) examined the practices in managing risks and firm performance, the mediating role of competitive advantages, and the moderating role of financial literacy. This study introduced financial literacy as a moderator in examining the influence of accounting practices on financial performance of MSMEs to contribute to the body of knowledge. Thus, we pose:


Covariates

The researcher controlled two variables (firm age and size) to get the net effect of accounting practices, financial literacy, and financial performance of MSMEs. These variables were used in previous studies and were found to significantly influence
enterprise's financial performance (Blackburn, Hart, & Wainwright, 2013; Chelogoi, 2020; Pervan, Pervan, & Curak, 2017; C. Yang, Singh, & Wang, 2020), hence should be controlled.

![Conceptual Framework](image)

**Figure 1: Conceptual Framework**

**Methodology**

**Research Design and Sampling Techniques**

The research adopted an explanatory research design and simple random sampling techniques. It utilized a questionnaire to gather data from a target population of 72,557 with a sample size of 398 owners/managers of MSMEs within Eldoret town, Kenya. An explanatory research design and simple random sampling techniques were employed in the research. Three hundred and ninety-eight (398) questionnaires were administered to the respondents, of which three hundred and twenty (320) were collected from the field. After screening the data gathered, only 304 questionnaires were well-filled, representing 76% of the total questionnaires administered. However, 16 were not completely filled and hence were dropped from the study, representing about 4% of the questionnaires issued.

**Measurement of Variables**

Several measuring items used in this study were adapted from the work of other scholars with minor modifications to suit the current study. The study utilized profitability, growth in sales and liquidity as indicators of financial performance, which had nineteen measuring items adapted from Arinda (2019); Chepngetich (2016); Eton, Gilbert, Fabian, Benard, and Dennis (2019); Kirwa and Ngeno (2020). Record keeping, banking practices and computerized accounting were employed in this study as indicators of accounting practices, which resulted in fifteen (15) measuring items adapted from Ibrahim (2017); Lumumba and Aila (2022); Minjo (2018); Mungal (2015), and lastly, the study used financial behavior, financial knowledge and financial attitude as indicators financial literacy which resulted in twenty-four (24) measuring items adapted from Garg and Singh (2018); Ibrahim.
In addition, the study adopted a 7 Likert scale based on the suggestion of various scholars who argued that it provides a variety of options, which leads to an increase in the probability of meeting the objective reality of the respondents (Al-Mandil, 2016; Altuna & müge Arslan, 2016; Chelogoi, 2020; Joshi, Kale, Chandel, & Pal, 2015). Finally, firm age was categorized into four age brackets of operation, while firm size was measured depending on the number of employees categorized into three groups, as shown in Table 1.

**Results**

**Demographic Information of Respondents**

Results in Table 1 reveal that 67.4% of research participants were male and 32.6% were female; 37.5% of respondents were between the age bracket of 26-30; 39.1% had a degree, and at least 12.5% had other qualifications. The results further revealed that most of the enterprises, 45.1%, have been in operation for less than five years, with the least 5.9% being in existence for more than 15 years. Firm size indicates that the majority, 66.8%, were micro-enterprises, followed by small enterprises 26.6%, and the least were medium enterprises 6.6% based on the number of employees.

<table>
<thead>
<tr>
<th>Demographic Factor</th>
<th>Frequency</th>
<th>Percentage %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>205</td>
<td>67.4</td>
</tr>
<tr>
<td>Female</td>
<td>99</td>
<td>32.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>304</td>
<td>100</td>
</tr>
<tr>
<td>Age</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below 20 years</td>
<td>6</td>
<td>2.0</td>
</tr>
<tr>
<td>21-25 years</td>
<td>83</td>
<td>27.3</td>
</tr>
<tr>
<td>26-30 years</td>
<td>114</td>
<td>37.5</td>
</tr>
<tr>
<td>31-35 years</td>
<td>63</td>
<td>20.7</td>
</tr>
<tr>
<td>Above 35 years</td>
<td>38</td>
<td>12.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>304</td>
<td>100</td>
</tr>
<tr>
<td>Level of Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Certificate</td>
<td>49</td>
<td>16.1</td>
</tr>
<tr>
<td>Diploma</td>
<td>98</td>
<td>32.2</td>
</tr>
<tr>
<td>Degree</td>
<td>119</td>
<td>39.1</td>
</tr>
<tr>
<td>Other qualification</td>
<td>38</td>
<td>12.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>304</td>
<td>100</td>
</tr>
<tr>
<td>Firm age</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below 5 Years</td>
<td>137</td>
<td>45.1</td>
</tr>
<tr>
<td>5-10 Years</td>
<td>119</td>
<td>39.1</td>
</tr>
<tr>
<td>10-15 years</td>
<td>30</td>
<td>9.9</td>
</tr>
<tr>
<td>Above 15 years</td>
<td>18</td>
<td>5.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>304</td>
<td>100</td>
</tr>
<tr>
<td>Firm size</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Below 10 Employees</td>
<td>203</td>
<td>66.8</td>
</tr>
<tr>
<td>10-49 Employees</td>
<td>81</td>
<td>26.6</td>
</tr>
<tr>
<td>50-99 Employees</td>
<td>20</td>
<td>6.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>304</td>
<td>100</td>
</tr>
</tbody>
</table>

**Descriptive Statistics**

Article's contents are provided on a Attribution-Non Commercial 4.0 Creative commons license. To see the complete license contents, please visit [http://creativecommons.org/licenses/by-nc/4.0/](http://creativecommons.org/licenses/by-nc/4.0/)
Table 2 shows the results of the descriptives, reliability, and correlation analysis. The Table reveals that financial literacy had a leading mean score of 4.8790 with a standard deviation =1.14422. This was closely followed by accounting practices, with a mean =4.6830 and a standard deviation of 1.24650, whereas financial performance had the lowest mean of 4.6228 and a standard deviation of 0.97171. Reliability results of the research instrument show that all variables had a Cronbach’s Alpha value above 0.7, as suggested by Kennedy (2022); Süüctü and Maslakçı (2020), with financial literacy having the highest α = .946, accounting practices α =.928, and financial performance having the least α =.903. The findings in table further show the correlation analysis, which reveals that accounting practices had a strong and positive relationship with financial performance (r =.627, p < .01), which was followed by financial literacy having a positive relationship with financial performance (r = .468, p < .01), while accounting practices had the least positive relationship with financial literacy (r =.450 p < .01). These findings show no multicollinearity since the correlations among variables are below 0.8 (Hickey, Kontopantelis, Takkenberg, & Beyersdorf, 2019).

### Table 2: Descriptive Statistics, Reliability Test, and Correlation Analysis

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>SD</th>
<th>α</th>
<th>Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>4.6228</td>
<td>.97171</td>
<td>.903</td>
<td>1</td>
</tr>
<tr>
<td>Accounting Practices</td>
<td>4.6830</td>
<td>1.24650</td>
<td>.928</td>
<td>.627**</td>
</tr>
<tr>
<td>Financial Literacy</td>
<td>4.8790</td>
<td>1.14422</td>
<td>.946</td>
<td>.468**</td>
</tr>
</tbody>
</table>

NOTE: SD - Standard deviation, **. Correlation is significant at the 0.01 level (2-tailed).

**Hypotheses Testing**

A hierarchical regression model was employed to test the study hypotheses. Findings in relation to the control variables in Table 3, Model 1 indicate that firm age (β=.241, p =.006) significantly affects financial performance. However, in this context, firm size (β=.090, P=.467) was found to be insignificant. Findings further showed that control variables had R² of 0.061, and the model was significant at p = .001, F= 9.730. This implies that control variables explain a 6.1% variation in financial performance. Therefore, if covariates are not controlled, it may result in making wrong inferences. Table 3, Model 2 shows the inclusion of independent variable in the statistical analysis. This was meant to test the direct influence of accounting practices on financial performance, as indicated by H1, while holding covariates (firm age and size) constant. Results in this Model reveal a significant model fit of F=169.365, p = .001. In addition, all the variables in this model explain 40% of the variance in financial performance, as shown by a coefficient of determination R²= 0.401 with ΔR² = 0.340. The R-Square change of 0.340 shows that holding covariates constant, accounting practices explain approximately 34% of the variations in financial performance. The findings show that accounting practices (β =.606, p =.000) significantly and positively influence financial performance. Based on these findings, Hypotheses H1 is supported by the study.
In Model 3 of the same Table, the study tested the effect of the moderating variable (financial literacy) on financial performance by holding constant the covariates and the predictor variable. Results of this test indicate a model fit of F-statistics = 21.995, which was significant at \( p = 0.001 \). The study’s findings also reveal that the link between financial performance and financial literacy had a coefficient of determination \( R^2 = 0.443 \), implying that all variables in this Model account for 44.3% of the variance in financial performance. This model further shows \( \Delta R^2 = 0.041 \), indicating that holding other factors in the model constant financial literacy explains approximately 4.1% of the variance in MSMEs’ financial performance. Results further indicate that financial literacy has positively influences financial performance as indicated by \( \beta = 0.229, p = 0.000 \). Based on these results, Hypothesis H2 is also accepted by the study.

Model 4 of the same Table 3 shows the findings of the interaction of financial literacy as depicted in Hypothesis H3 while holding constants controls, predictor variable, and the moderator. Results in Model 4 indicate an increased \( R^2 = 0.472 \), implying that all the variables in this model explain about 47.2% of the variance in financial performance. This model also shows \( \Delta R^2 = 0.030 \), revealing that the interaction term contributes 3% of the variance in financial performance. Additionally, the F-statistics of this model was F = 16.731, with a significant \( p = 0.001 \). The interaction process also shows a positive and significant effect of financial literacy on the link between accounting practices and financial performance, as shown by \( \beta = 0.070, p = 0.000 \). Thus, Hypothesis H3 is supported by the study.

These findings are further illustrated by Figure 2, which reveals that at low levels of accounting practices, financial performance is at the same level in both enterprises (scenarios) with low and high financial literacy. However, as accounting practices increase, financial performance increases in both enterprises, but the increase is higher with enterprises embracing and investing resources in financial literacy than with those with low financial literacy. Thus, financial performance increases with higher financial literacy and vice-versa.
Figure 2: Graphical presentation of the Moderating Effect of Financial Literacy on Accounting Practices and Financial Performance

Table 3: Hierarchal Regression Results

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>β</td>
<td>p-β</td>
<td>B</td>
<td>p-β</td>
</tr>
<tr>
<td>Firm Age</td>
<td>.241</td>
<td>.006</td>
<td>.038</td>
<td>.597</td>
</tr>
<tr>
<td>Firm Size</td>
<td>.090</td>
<td>.467</td>
<td>.113</td>
<td>.251</td>
</tr>
<tr>
<td>Accounting</td>
<td>.606</td>
<td>.000</td>
<td>.510</td>
<td>.000</td>
</tr>
<tr>
<td>Financial Literacy</td>
<td>.229</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountpra*FinLit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td>.061</td>
<td>.401</td>
<td>.443</td>
<td>.472</td>
</tr>
<tr>
<td>ΔR²</td>
<td>.061</td>
<td>.340</td>
<td>.041</td>
<td>.030</td>
</tr>
</tbody>
</table>

NOTE: Accountpra = Accounting Practices, FinLit = Financial Literacy

Discussion

Accounting Practices and Financial Performance

The results of this research reveal that accounting practices positively and significantly influence MSMEs’ financial performance. The findings agreed with previous studies done by other scholars (Lukumay & Wako, 2018; Manei & Omgwa, 2019; Wach & Tarus, 2021). Okafor and Daferighe (2019) also found that accounting practices influence performance; thus, for the MSMEs to thrive, there is a need to implement efficacious accounting practices.

The current results are backed up by the idea of Nyathi et al. (2018) that accounting practices can be used for decision-making that positively influences the performance of SMEs. Additionally, the results are similar to those of Somathilake and Ranathunga (2021), who found that accounting record-keeping practices positively enhance financial performance. This is also supported by Nsoke et al. (2021), who advocated that applying accounting practices results in business growth. Accounting practices are essential for the well-being of SMEs (Okafor & Daferighe, 2019). As a result, the increase in the use of accounting practices aids in reducing the mortality rate of MSMEs (Nyathi et al., 2018) since the success or failure of the enterprises depends on keeping precise records and providing timely accounting information that gives a clear outlook the business’s well-being (Zotorvie, 2017). However, these findings contradict the study conducted by Chimy and Forzeh (2021), which revealed an insignificant but positive relationship between accrual accounting practices and financial performance.

Financial Literacy on Financial Performance

The current study examined whether financial literacy has a direct influence on financial performance of MSMEs in the Republic of Kenya. The result of Hypothesis H2 revealed that financial literacy has a significant and positive influence on financial performance. Literature has shown that a high level of financial literacy enables enterprises to run efficiently, resulting in better financial performance for any business.
enterprise. Moreover, financial literacy allows owners/ managers to make viable decisions on monetary matters, resulting in healthy business (Jemal, 2019). Thus, these results agree with Jemal (2019), who points out that financial literacy positively and significantly influences the financial performance of medium and small enterprises.

The current study's findings also concur with the arguments of Otieno (2016), whose study on the relationship between financial literacy and financial performance of SMEs in Kenya, the results showed a significant influence on the relationship between the variables. This is further supported by Zirabamuzale (2021), who points out that financial literacy among enterprises' owners and managers enhances the business's financial performance. Yakob, Yakob, Bam, and Ahmad (2021) further argued that managers and owners of any business with financial Knowledge have a better apprehension of business-related parameters such as investment, savings, and debt management, which results in good financial performance. The C.E.O.’s financial literacy of big corporations has also been found to influence the financial performance of those corporations positively and significantly. The results also support the work of Zulkiefimansyah et al., (2020), who advocated that financial literacy acts as a catalyst for developing and enhancing SMEs’ financial performance. Thus, there is a need for firms to invest enough resources in the financial literacy of their human capital to gain a competitive advantage.

**Moderating Influence of Financial Literacy on the Relationship between Accounting Practices and Financial Performance**

Hypothesis H3 postulated that financial literacy significantly moderates the link between accounting practices and the financial performance of MSMEs. The outcome of the current study revealed that financial literacy has a conditional effect on the relationship between accounting practice and financial performance with $\beta=0.070$, $p=0.000$. These results show that managers and owners with adequate financial skills handle accounting issues prudently, resulting in good financial performance of their businesses. On the other hand, managers and owners who do not have the requisite financial knowledge about their enterprise’s finances may lack the skills to direct the business's financial affairs. Consequently, the business may collapse due to poor financial management skills (Tuffour et al., 2022). Thus, the higher the financial literacy, the higher the financial performance, and vice-versa, as depicted in Figure 2. Due to scanty studies done in this context using variables in the current study, these findings provide new knowledge in the body of literature.

**Conclusion**

The current study provides valuable insight to managers or owners of MSMEs on the need to embrace financial literacy and accounting practices to enhance the financial performance of their businesses. Based on these results, accounting practices and financial literacy significantly influence financial performance. The findings indicated that financial literacy moderates the link between accounting practices and financial performance.
Implications of the Study

Theoretical Implications

The study supports the theories used and contributes additional knowledge to the existing literature. The current research concurs with what has already been established by various scholars: that accounting practices and financial literacy positively influence financial performance of MSMEs. In addition, the study adds new findings or knowledge to the literature that financial literacy moderates the relationship between accounting practices and financial performance. Furthermore, the findings support the Decision Usefulness Theory, which claims that financial transactions are needed to make viable decisions relating to enriching financial performance. Finally, the results concur with the Human Capital Theory that financial cognitive managers or owners can help their enterprises achieve the goal of financial performance by making prudent decisions based on financial knowledge and understanding, as these affect firm financial success.

Managerial Implications

The research outcomes may help managers and policymakers at the county and national levels in policy and strategic formulation and implementation to reduce the mortality rate of MSMEs. The study's findings reveal that financial literacy influences the financial performance of MSMEs. Therefore, for MSMEs to thrive, owners or managers require knowledge of finance relating to the access and management of funds (Susan, 2020). Thus, management and policymakers should develop training programs to equip owners and managers of various business enterprises with accounting practices that may reduce the business's mortality rate. Furthermore, the government and other stakeholders providing financial literacy training in Kenya and other countries should include technological skill modules. Acquiring these technological skills by owners and managers of MSMEs will help them market their products online and embrace the use of accounting packages, enriching their financial performance and accounting practices, which will effectively reduce the chances of business closure.

Limitations and Future Studies

The current study has several limitations. First, the study was conducted on MSMEs in Eldoret town, Kenya, with a sample size of 398 respondents. Thus, due to the limited geographical scope, future research can replicate the current study with a broader scope in different areas with a large sample size since it may reveal different results. In addition, data collection from the selected sample was done using a structured questionnaire. Future scholars could use secondary and primary data, which could help improve the study's findings. Furthermore, the current research focuses on MSMEs only; however, financial performance is significant for all firms. Therefore, the study suggests that future studies should focus on large firms. Finally, since the current research explores the moderating effect of financial literacy on the relationship between accounting practices and financial performance, future research should use this variable as a mediator or introduce other moderator variables to provide more insights.
References


