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Effect of Financial Literacy of Owner-Managers on Financial Risk Management among Small and Medium Enterprises in Nakuru County, Kenya

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Abstract

This study examined the effect of financial skills, as a dimension of financial literacy, on financial risk management among SMEs in Nakuru County, Kenya. Drawing on the principles of Human Capital Theory and Financial Capability Theory, the research employed a survey-based design guided by a predictive correlational approach. The Nassiuma (2000) formula was used to obtain a sample of 100 SMEs, selected from a target population of 336,661 SMEs across the county's eleven sub-counties, as per the county's enterprise register as at December 2025. Data were collected using structured questionnaires, and 85 valid responses were analysed using descriptive statistics, Pearson correlation and multiple linear regression. The findings revealed that respondents applied financial skills to a small to moderate extent ($M = 2.59$, $SD = 1.18$), with weaknesses in financial statement interpretation, contingency planning and cash flow analysis. Financial skills demonstrated a strong, positive and statistically significant relationship with financial risk management ($r = 0.784$, $p < 0.01$) and a significant positive predictive effect ($B = 0.485$, $\beta = 0.452$, $p < 0.001$), controlling for financial awareness and financial attitudes. The regression model explained 70.9 per cent of the variation in financial risk management ($R^2 = 0.709$). Financial skills made the largest relative contribution among the three financial literacy dimensions examined. The study concludes that practical financial skills are important predictors of financial risk management among SMEs in Nakuru County. It recommends targeted, practice-oriented financial education focused on budgeting, cash flow analysis, financial statement interpretation, credit assessment, and contingency planning to strengthen SMEs' capacity to identify, assess, and manage financial risks.

Key terms: Financial literacy, financial risk management, financial skills, Nakuru County, Kenya, small and medium-sized enterprises.

INTRODUCTION

Shortages of this kind are what budgeting, cash flow analysis and contingency planning are meant to prevent. Financial risk management, the systematic identification, assessment, response to and monitoring of financial risks (Alrawad et al., 2023; Mthiyane et al., 2022), therefore sits at the centre of SME survival. Because only a minority of SMEs can obtain bank finance (Kimani, 2026), owner-managers must largely absorb shocks themselves, and how well they do so depend on what they can do with financial information.

The problem matters in Nakuru County, which contributes about 5.2 per cent of Kenya's gross value added (KNBS, 2025). Given that MSMEs represent nearly 98 per cent of enterprises in Kenya and contribute approximately 80 per cent of total employment (KNBS, 2016), their sustainability is vital to the local economy. Therefore, business closures and declining performance among county-based SMEs can undermine employment opportunities and reduce the income available to households.

Owner-managers' capability is commonly described as financial literacy, comprising financial awareness, financial skills, and financial attitudes (Lusardi & Messy, 2023; OECD, 2022). Financial skills are the most directly applied of the three: the practical ability to prepare budgets, analyse cash flows, interpret financial statements, compare financing options, assess customer creditworthiness and plan for contingencies (Hassan & Sofoluwe, 2022). Knowing that a contingency fund is different from being able to build one, so skills are the dimension most likely to show up in observable risk management practice. This study therefore treats financial skills as the focal predictor and includes awareness and attitudes as covariates.

Evidence from Nakuru County is thin and points elsewhere. Onyando (2018) found that many Nakuru SMEs did not run formal cash management practices and that cash management was strongly associated with financial performance ($r = .859$). Still, the study measured cash management practices and financial performance rather than skills and risk management. Bett (2025) studied 301 women-owned SMEs in the country and reported that financial literacy, among other factors, shaped borrowing capacity, which concerns access to credit rather than risk management. Elsewhere in Kenya, studies link skills such as bookkeeping, budgeting and debt management to SME performance or growth (Kariuki, 2025; Nyaga & Kariuki, 2025; Ochola & Kimutai, 2025). Kenyan studies that address financial risk examine risk attitudes among Nairobi SMEs (Nyongesa et al., 2024) or risk management practices in private hospitals (Ogutu et al., 2021); neither tests the financial skills of SME owner-managers. Performance, growth, and credit access are not the same as risk management, because an enterprise can look profitable while facing liquidity shortfalls or unplanned obligations. What remains unresolved is whether specific financial skills are associated with risk management practice among SMEs in Nakuru County.

This study aims to determine the effect of financial skills on financial risk management among SMEs in Nakuru County, Kenya.

Hypothesis (H_0). Financial skills have no statistically significant effect on financial risk management among SMEs in Nakuru County, Kenya.

LITERATURE REVIEW

Theoretical Underpinnings

Human Capital Theory.

Becker (1964) treats knowledge and skills as capital: stocks built through education, training and experience that raise productivity and the quality of decisions. For an SME, the financial skills of the owner-manager are human capital applied to financial decisions. Budgeting, cash flow analysis and statement interpretation are the abilities needed to notice a shortfall early (risk identification), estimate its size (risk assessment) and respond before it becomes a crisis. Customer credit assessment is the matching ability for limiting default losses, and contingency planning is for holding reserves. The theory therefore predicts a positive relationship between financial skills and financial risk management practice. It also sets a limit: skills improve outcomes only when they can be used, and finance, institutions, and regulation can restrict their use.

Financial Capability Theory.

According to Sherraden (2013), financial capability encompasses both an individual's capacity to make informed financial decisions, shaped by knowledge, skills, confidence and motivation, and the availability of appropriate financial products and services that enable effective financial action. Two implications follow for this study. First, skills are one component of ability alongside awareness and attitudes, so those two are kept in the model as covariates and the skills coefficient is read net of them. Second, ability alone does not guarantee behaviour: owner-managers without access to credit, insurance or reliable record-keeping tools may be unable to act on their skills. Access is not measured here, so any link between skills and risk management is expected to be positive but incomplete.

Together, the theories imply that SMEs whose owner-managers' report stronger financial skills will report stronger financial risk management, after accounting for awareness and attitudes, and that skills will carry more weight for applied practice than awareness or attitudes. H_0 in Section 4 tests the first expectation; the standardised coefficients test the second.

Empirical Literature

The table below summarises the literature review and research gaps.

Table 1: Kenyan Studies on Financial Literacy, Financial Skills and SME Outcomes

Study	Setting and sample	Skills or literacy measured	Outcome	Main finding	Limitation for the present study
Onyando (2018)	SMEs, Nakuru County	Cash management practices, including cash planning and credit management	Financial performance	Cash management strongly correlated with performance (r = .859); many SMEs lacked formal cash management	Practices, not skills; performance, not risk management
Bett (2025)	301 women-owned SMEs, Nakuru County	Financial inclusion dimensions, including financial literacy	Access to credit	Financial literacy, service availability and digital platforms significantly increased credit access	Credit access outcome; women-owned firms only
Kariuki (2025)	132 SMEs, Mombasa County	Debt management, bookkeeping, tax management, cash flow management skills	Financial performance	First three skills positive and significant; cash flow skills not significant	Performance outcome; different county
Nyaga & Kariuki (2025)	126 small and micro enterprises, Embu Town	Budgeting, financial planning, debt management	Financial growth	All three positive and significant	Growth outcome; single town
Ochola & Kimutai (2025)	112 medium enterprises, Kisumu	Investment literacy, working capital management	Enterprise growth	Working capital, accounting and analysis skills	Growth outcome; medium

	County	literacy, accounting knowledge, financial analysis skills		significant (60.3% of variance); investment literacy not	enterprises only
Abdi et al. (2025)	73 SMEs, Kiambu County	Financial literacy (budgeting, saving, investing, diversification)	Profitability	Strong correlation ($r = .812$; $R^2 = .659$)	Aggregated literacy; small sample; risk mitigation inferred, not measured
Ogonji (2024)	SMEs, Kajiado County	Financial literacy	Financial performance	Strong positive association; weak bookkeeping and debt management hurt performance	Performance outcome; aggregated literacy
Odunga (2024)	Women-owned SMEs, Garissa County	Financial literacy	Performance	Literacy linked to performance	Performance outcome; women-owned firms only
Nyongesa et al. (2024)	383 SME owners, Nairobi CBD	Financial risk attitude	Financial sustainability	Positive and significant effect	Attitude, not skills
Ogutu et al. (2021)	68 private hospitals, Nairobi County	Financial risk management practices	Business sustainability	Positive and significant; 23.6% of variation	Hospitals, not SMEs; no literacy measure

METHODOLOGY

The study adopted a survey research design with a predictive correlational approach, suited to examining how an independent variable (financial skills) predicts a dependent variable (financial risk management) across many SMEs.

The population comprised owner-managers of the 336,661 SMEs registered across Nakuru County's eleven sub-counties as of December 2025. Using the Nassiuma (2000) formula, $n = NC^2 / (C^2 + (N - 1)\, e^2)$, with a coefficient of variation of 0.5 and a standard error of 0.05, the sample size was approximately 100. Proportionate stratified random sampling allocated the sample across sub-counties in line with each sub-county's share of SMEs. As illustrated in Table 2.

Table 2: Registered SMEs and Sample Allocation by Sub-County

Sub-county	Registered SMEs	Share of SMEs (%)	Calculated allocation	Sample allocated
Gilgil	28,797	8.55	8.55	9
Kuresoi North	27,242	8.09	8.09	8
Kuresoi South	24,154	7.17	7.17	7
Molo	24,422	7.25	7.25	7
Naivasha	55,362	16.44	16.44	16
Nakuru East	30,293	9.00	9.00	9
Nakuru North	33,922	10.08	10.08	10
Nakuru West	30,945	9.19	9.19	9
Njoro	37,157	11.04	11.04	11
Rongai	31,105	9.24	9.24	9
Subukia	13,262	3.94	3.94	5
Total	336,661	100.00	100.00	100

Owner-managers completed a structured drop-off questionnaire adapted from the OECD (2022) toolkit and Brustbauer (2016). Financial skills, awareness, attitudes and financial risk management were each measured by six items rated from 1 (no extent) to 5 (very large extent); composite scores were item means. Means were read as no extent (1.00–1.80), small (1.81–2.60), moderate (2.61–3.40), large (3.41–4.20) or very large extent (4.21–5.00). A pilot of 10 owner-managers was excluded. Cronbach's alpha was .845 for skills, .812 for awareness, .791 for attitudes and .873 for risk management. Of 100 questionnaires, 85 were usable. Analysis in SPSS comprised descriptive statistics, Pearson correlation and multiple regression (risk management = $\beta_0 + \beta_1$ skills + β_2 awareness + β_3 attitudes + ε), with awareness and attitudes as covariates, at $\alpha = .05$. Regression assumptions were tested. The study followed Kabarak University Research Ethics Committee and NACOSTI guidelines, with informed consent and confidentiality.

A pilot study of 10 SME owners-managers was conducted and excluded from the main sample. Content validity was assessed by five experts. Internal consistency was satisfactory: Cronbach's alpha was 0.845 for financial skills and 0.873 for financial risk management, against a 0.70 threshold.

The collected data were processed and examined in SPSS through descriptive statistical analysis, Pearson's correlation analysis, and multiple regression modelling ($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon$), where Y is financial risk management, X_1 is financial awareness, X_2 is financial skills, and X_3 is financial attitudes. Financial awareness and financial attitudes were retained as controls so that the effect of financial skills could be isolated. Normality (Shapiro–Wilk), multicollinearity (tolerance and VIF), heteroscedasticity (Breusch–Pagan) and autocorrelation (Durbin–Watson) were tested. Hypotheses were tested at the 5 per cent significance level. The study followed the ethical guidelines of the

Kabarak University Research Ethics Committee and NACOSTI, including informed consent and confidentiality.

RESULTS AND DISCUSSION

Response Rate and Respondent Profile

Of 100 questionnaires distributed, 85 were returned fully completed, a response rate of 85 per cent. Most respondents were owners (n = 73, 85.9%) rather than managers (n = 12, 14.1%), so most were directly involved in financial decisions. Wholesale trade (37.6%), service provision (25.9%) and retail trade (24.7%) were the most common activities, and 54.1 per cent of the businesses had operated for at least four years. Secondary education was the most common qualification (31.8%), and 9.4 per cent of respondents had no formal education.

Descriptive Statistics for Financial Skills

Table 3 shows how owner-managers rated their financial skills and their risk management practice

Table 3: Descriptive Statistics for Financial Skills and Financial Risk Management Items (N = 85)

Item	M	SD	Extent	No or small extent (%)
Financial skills				
Interpreting financial statements to assess profitability and stability	2.27	1.19	Small	64.7
Developing financial contingency plans	2.35	1.21	Small	62.3
Analysing cash flow records to identify liquidity shortages	2.51	1.22	Small	55.3
Preparing a realistic business budget	2.58	1.16	Small	50.6
Assessing customers' payment histories and creditworthiness	2.72	1.15	Moderate	42.3
Comparing financing options by interest rates and repayment terms	3.11	1.13	Moderate	29.4
Financial skills overall	2.59	1.18	Small	
Financial risk management				
Minimising losses from customer payment defaults and overdue receivables	3.87	1.07	Large	9.4
Regularly identifying potential financial risks	3.82	1.04	Large	10.6
Assessing likelihood and consequences of risks before major commitments	3.64	1.12	Large	16.5
Maintaining contingency funds or alternative financing	3.48	1.11	Large	17.7
Monitoring cash inflows and outflows	3.42	1.15	Large	20.0
Regularly reviewing and adjusting risk management measures	3.39	1.22	Moderate	22.3
Financial risk management overall	3.60	1.12	Large	

Items rated from 1 (no extent) to 5 (very large extent). Overall rows give the mean of the six item means and the average of the six item standard deviations. Extent bands: small = 1.81–2.60, moderate = 2.61–3.40, large = 3.41–4.20. The last column adds the "no extent" and "small extent" response percentages.

Financial skills were applied to a small extent overall (M = 2.59), just below the moderate band. Only comparing financing options and assessing customer creditworthiness reached a moderate extent. The weakest skills were interpreting financial statements (M = 2.27), contingency planning (M = 2.35) and cash flow analysis (M = 2.51); more than half of respondents rated their ability at no or small extent on each of these and on budgeting. Overall, respondents practised financial risk management to a large extent (M =3.60). Minimising losses from customer defaults (M = 3.87) and identifying risks (M = 3.82) scored highest, and reviewing and adjusting risk measures (M = 3.39) scored lowest.

Correlation Analysis

Table 4 reports the relationships among the four study variables.

Table 4: Means, Average Item Standard Deviations and Pearson Correlations Among Study Variables (N = 85)

Variable	M	Avg. item SD	1	2	3
1. Financial risk management	3.60	1.12	—		
2. Financial skills	2.59	1.18	.784**	—	
3. Financial awareness	3.66	1.11	.652**	.421**	—
4. Financial attitudes	3.47	1.06	.541**	.312**	.388**

Financial skills showed the strongest positive correlation with financial risk management (r = 0.784, p < 0.01), ahead of financial awareness (r = 0.652) and financial attitudes (r = 0.541). Financial skills were only moderately correlated with financial awareness (r = 0.421) and weakly with financial attitudes (r = 0.312), indicating that the dimensions are related but distinct.

Diagnostic Tests

The diagnostics supported using multiple regression. Residuals did not depart significantly from normality (Shapiro–Wilk = 0.982, p = 0.274). Multicollinearity was not a concern: for financial skills, tolerance was 0.797, and VIF was 1.255, with all VIF values below 5. The Breusch–Pagan test showed no significant heteroscedasticity (χ^2 = 2.184, p = 0.535), and the Durbin–Watson statistic (1.874) indicated no substantial autocorrelation.

Regression Results

The model was statistically significant, F (3, 81) = 65.839, p < 0.001, with R = 0.842, R^2 = 0.709 and adjusted R^2 = 0.698. Financial awareness, financial skills and financial attitudes therefore jointly explained about 70.9 Per cent of the variation in financial risk management. Table 4.3 reports the coefficients.

Table 5: Multiple Regression Predicting Financial Risk Management (N = 85)

Predictor	B	SE B	β	t	p
Constant	0.412	0.150		2.747	.007
Financial skills	0.485	0.072	.452	6.736	< .001
Financial awareness	0.325	0.065	.310	5.000	< .001
Financial attitudes	0.211	0.058	.198	3.638	.001

Dependent variable: financial risk management. R = .842, R^2 = .709, adjusted R^2 = .698, F (3, 81) = 65.839, p < .001. B = unstandardized coefficient; SE B = standard error of B; β = standardised coefficient.

Holding awareness and attitudes constant, SMEs whose owner-managers rated their financial skills one point higher on the five-point scale reported financial risk management about 0.49 points higher (B = 0.485, SE = 0.072, p < .001). In standardised terms, financial skills (β = .452) carried more weight than awareness (β = .310) or attitudes (β = .198). The R^2 of .709 describes the three predictors together. Skills alone explain about 61.5 per cent of the variance in risk management (R^2 = $.784^2$ = .615, calculated from Table 3), so awareness and attitudes add about 9.4 percentage points (.709 – .615).

Hypothesis Test

Because the p-value for financial skills (p < 0.001) was below 0.05, the null hypothesis H_{02} was rejected. Financial skills have a positive and statistically significant effect on financial risk management among SMEs in Nakuru County, Kenya

Discussion

The central finding is that financial skills strongly and significantly predict financial risk management, and that they do so more powerfully than financial awareness or financial attitudes. This is consistent with Human Capital Theory, which treats applied competence as a productive asset: owner-managers who can budget, read cash-flow records and plan for contingencies are better placed to identify, assess and respond to financial threats. It also fits Financial Capability Theory, which stresses that ability to act, rather than knowledge alone, drives financial behaviour.

The result aligns with earlier work that connects financial competence to better SME outcomes (Graña-Alvarez et al., 2022; Molosiwa & Holland, 2025; Panigrahi, 2023; Kopmut et al., 2025). It extends the Kenyan evidence from Ochola and Kimutai (2025), Ogonji (2024) and Odunga (2024), who found literacy and specific analytical skills to matter for growth and performance, by showing that the same applied skills matter for financial risk management as a distinct outcome. It also supports treating financial literacy as separate dimensions rather than a single construct, since skills, awareness, and attitudes differed in both level and effect.

A notable pattern is the gap between capability and practice. Respondents reported only small to moderate financial skills (M = 2.59) yet moderate to large risk management practice (M = 3.60). This suggests that many SMEs rely on simpler, intuitive practices, such as chasing overdue customer payments, which scored highest. More technical practices, including contingency planning, cash-flow analysis, and regular review of risk measures, are where skills were weakest and risk management scores lowest. Because financial skills carry the strongest effect, closing these specific skill gaps is likely to yield the largest improvements in how SMEs manage risk.

The findings should be read with several cautions. The study is cross-sectional and relies on self-reported ratings, which may overstate or understate actual ability; the regression shows association and

predictive effect, not proof of causation. The sample of 85 usable responses, while adequate for the analysis, is small relative to a population of over 336,000 SMEs. The model also leaves 29.1 per cent of the variation unexplained, so factors such as access to credit, business experience and institutional support likely play a role.

CONCLUSION AND RECOMMENDATIONS

Conclusion: Financial skills significantly predict financial risk management among SMEs in Nakuru County, and they make the strongest relative contribution among the three dimensions of financial literacy examined. At the same time, SME owners-managers show notable weaknesses in the skills that matter most, particularly interpreting financial statements, developing contingency plans, analysing cash flow, and preparing realistic budgets. Strengthening practical financial skills is therefore central to improving SME resilience.

Recommendations: There is a need for SME development institutions, particularly the Micro and Small Enterprises Authority (MSEA), alongside financial sector regulators and policymakers, to strengthen the provision of practical and easily accessible financial literacy programmes for SME owner-managers. Such initiatives should equip them with essential competencies in budgeting, cash-flow management, interpretation of financial statements, credit evaluation, and risk preparedness.

To enhance financial management practices, SME owners-managers need to strengthen their practical competencies through targeted training, leverage digital technologies for efficient and accurate financial record-keeping, and engage financial experts to guide them through challenging financing decisions. Financial institutions and business support organisations can reinforce this by pairing credit products with practical financial skills coaching.

Future studies should use larger, multi-county samples; examine moderating and mediating factors such as access to credit, digital financial literacy, and institutional support; compare sectors; and apply longitudinal designs to track how improvements in financial skills translate into risk management over time.

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