

**CORPORATE GOVERNANCE AND FINANCIAL LITERACY IN  
SMALL AND MEDIUM ENTERPRISES (SMEs)**

**A Dissertation Submitted to the office of the Dean, Faculty of Management in partial  
fulfillment of the requirements for the Master's Degree of Business Studies (MBS)**

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**July, 2025**

## **Certification of Authorship**

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled “**Corporate Governance and Financial Literacy in Small and Medium Enterprises (SMEs)**”. The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor has it been proposed and presented as part of requirements for any other academic purpose.

The assistance and cooperation that I have received during this research work has been acknowledged. In addition, I declare that all information sources and literature used are cited in the reference section of the dissertation.

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## Report of Research Committee

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## **Acknowledgements**

I would like to express my heartfelt gratitude and appreciation my supervisor Asst. Prof. Joginder Goet, who had guided me throughout the duration of this study. We truly appreciate the valuable time, guidance and advices he has given me for the completion of this dissertation.

I would like thank to Asso. Prof. Dr. Sajeeb Kumar Shrestha, Head of Research Department and of Shanker Dev Campus. Equally, I would like to thank all the facilitators and the administration of Shanker Dev Campus and all those who assisted me directly and indirectly by providing me with necessary ideas and comments for the preparation of the report.

Lastly, I would like to thank my family and friends whose help and suggestions were impeccable in preparation of this dissertation writing.

It is that matter of my immense pleasure to express my deep sense of gratitude and heartfelt respect to my parents for their affection inspiration and incredible support to precede my academic career

**Yogesh Wod**

## Table of Contents

<i>Certification of Authorship</i> .....	<i>ii</i>
<i>Report of Research Committee</i> .....	<i>iii</i>
<i>Approval Sheet</i> .....	<i>iv</i>
<i>Acknowledgements</i> .....	<i>v</i>
<i>Table of Contents</i> .....	<i>vi</i>
<i>List of Tables</i> .....	<i>vii</i>
<i>List of Figure</i> .....	<i>ix</i>
<i>Abbreviations</i> .....	<i>x</i>
<i>Abstract</i> .....	<i>xi</i>
CHAPTER I INTRODUCTION .....	1
1.1 Background of the Study .....	1
1.2 Problem Statement .....	3
1.3 Objective of the study .....	6
1.4 Hypothesis of the study .....	6
1.5 Rationale of the Study .....	6
1.6 Limitation of the study .....	8
CHAPTER II LITERATURE REVIEW .....	9
2.1 Theoretical Review .....	9
2.1.1 Agency Theory .....	9
2.1.2 Resource-Based View (RBV) .....	10
2.1.3 Stakeholder Theory .....	11
2.1.4 Behavioral Finance Theory .....	11
2.1.6 Institutional Theory .....	12
2.2 Conceptual Review .....	13
2.2.1 Concept of Corporate Governance and Financial Literacy in SMEs .....	13
2.2.2 Corporate Governance Definition and Relevance in SMEs .....	13
2.2.3 Financial Literacy Definition and Significance for SMEs .....	14
2.2.4 Interrelationship between Corporate Governance and Financial Literacy .....	15
2.2.5 Challenges in Implementing Governance and Financial Literacy in SMEs .....	15

2.2.6 Strategies for Enhancing Corporate Governance and Financial Literacy .....	16
2.2.6 Concept of Corporate Governance in SMEs .....	17
2.2.7 Concept of Financial Literacy in SMEs .....	18
2.3 Review of Previous Studies.....	20
2.4 Research gap .....	30
CHAPTER III RESEARCH METHODOLOGY .....	31
3.1 Research Design.....	31
3.2 Population and Sample, and Sampling Design .....	31
3.3 Nature and Sources of Data, and Instrument of Data Collection .....	32
3.4 Methods of Analysis.....	32
3.5 Research Framework and Definition of Variables.....	35
CHAPTER IV RESULTS AND DISCUSSION.....	38
4.1 Results .....	38
4.1.1 Data analysis of respondents .....	38
4.1.2 Descriptive Analysis.....	40
4.1.3 Descriptive Statistics .....	49
4.1.4 Correlation Analysis.....	50
4.1.5 Regression Analysis .....	51
4.2 Discussion .....	54
CHAPTER V SUMMARY AND CONCLUSION .....	56
5.1 Summary .....	56
5.2 Conclusion.....	57
5.3 Implications.....	58
5.3.1 Implications for Practice:.....	58
5.3.2 Implications for Future Research: .....	60
REFERENCES .....	62
APPENDIX.....	67

## List of Tables

<b>Table No</b>	<b>Title</b>	<b>Page No.</b>
Table 1	Summary of empirical review	27
Table 2	Gender Profile of Respondents	37
Table 3	Age Profile of Respondents	38
Table 4	Education Level Profile of Respondents	38
Table 5	Monthly Income Profile of Respondents	39
Table 6	Descriptive statistics of Board Composition	40
Table 7	Descriptive statistics of Financial Literacy	41
Table 8	Descriptive statistics of Financial Resources	42
Table 9	Descriptive statistics of Transparency	44
Table 10	Descriptive statistics of Training and Development	45
Table 11	Descriptive statistics of SME Performance	46
Table 12	Descriptive Statistics	47
Table 13	Correlation analysis	48
Table 14	ANOVA variance of Variables	50
Table 15	Model summary	50
Table 16	Regression analysis	51

## List of Figure

<b>Figure No</b>	<b>Title</b>	<b>Page No.</b>
Figure 1	Conceptual Framework	35

## **Abbreviations**

COVID-19	- Coronavirus Disease 2019
GDP	- Gross Domestic Product
IFC	- International Finance Corporation
NGOs	- Non-Governmental Organizations
OECD	- Organization for Economic Co-operation and Development
R&D	- Research and Development
RBV	- Resource-Based View
SMEs	- Small and Medium Enterprises

## Abstract

Small and Medium Enterprises (SMEs) are vital contributors to economic development and innovation, particularly in emerging economies. This study explores the relationship between corporate governance, financial literacy, and SME performance, focusing on key dimensions such as board composition, financial resources, training and development, and transparency. Using data from 384 SMEs and employing descriptive statistics, correlation, and regression analysis, the research highlights the significant role of governance and literacy in enhancing SME outcomes.

Descriptive statistics indicate that financial resources are the most variable and impactful factor across SMEs, while SME performance shows the least variability, reflecting consistency in outcomes. Correlation analysis reveals strong positive relationships between SME performance and financial resources, transparency, and training and development. Regression results demonstrate that corporate governance and financial literacy variables explain 46.7% of the variance in SME performance, with training and development and financial resources being the most influential predictors.

The findings underscore the need for targeted training programs, robust financial resource management, and transparent practices to drive SME performance. While board composition and financial literacy showed moderate effects, they remain critical for strategic decision-making and sustainability. Practical implications include policy recommendations for enhancing training, transparency, and financial literacy, while future research should explore sector-specific dynamics, regional comparisons, and the integration of technology in governance and literacy practices. This study provides actionable insights for SME managers and policymakers, emphasizing the importance of governance and literacy in fostering long-term growth and competitiveness.

**Keywords:** *Small and Medium Enterprises, Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development.*

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

Small and Medium Enterprises (SMEs) play a pivotal role in the economic development of nations by contributing to GDP, employment generation, and fostering innovation (World Bank, 2023). However, the success and sustainability of SMEs are often impeded by challenges such as limited access to finance, lack of proper governance structures, and insufficient financial literacy among stakeholders (Ayyagari et al., 2018). These challenges underline the critical importance of corporate governance and financial literacy in ensuring the growth and sustainability of SMEs, especially in developing economies where resources and expertise are often constrained.

Corporate governance refers to the system by which companies are directed and controlled, encompassing mechanisms, practices, and processes that align stakeholders' interests with organizational goals (OECD, 2015). For SMEs, effective corporate governance ensures accountability, transparency, and strategic decision-making, thereby mitigating risks and enhancing financial performance (Gill, 2013). However, the corporate governance framework for SMEs is often less formalized compared to larger enterprises, leading to inefficiencies in decision-making and risk management (Abor & Adjasi, 2007). This situation is exacerbated in developing countries where regulatory frameworks and enforcement mechanisms are weak.

Financial literacy, defined as the ability to understand and use various financial skills, including personal financial management, budgeting, and investing, is equally crucial for SMEs. High financial literacy levels among SME owners and managers enable informed decision-making, better financial planning, and efficient allocation of resources (Lusardi & Mitchell, 2014). However, studies have shown that many SME operators lack adequate financial literacy, resulting in poor financial management practices, limited access to credit, and high failure rates (Fatoki, 2014).

The relationship between corporate governance and financial literacy is intertwined, as both factors significantly influence the operational and strategic outcomes of SMEs.

Effective corporate governance structures provide a framework for financial discipline, while financial literacy ensures that SME owners and managers can comprehend and implement governance practices effectively (Zhou, 2017). For instance, financially literate SME managers are better equipped to prepare financial reports, assess risks, and comply with regulatory requirements, all of which are critical components of good governance.

In many SMEs, especially family-owned businesses, governance practices are informal and lack the necessary checks and balances. This informality often leads to conflicts of interest, mismanagement of resources, and limited scalability (Carney, 2005). Financial literacy can mitigate these issues by empowering managers and owners with the skills to analyze financial statements, develop budgets, and plan for long-term growth (Kotey & Meredith, 1997). Furthermore, the synergy between governance and literacy creates an environment conducive to attracting external financing, as lenders and investors are more likely to engage with SMEs that exhibit financial prudence and governance accountability.

In developing economies, the lack of corporate governance and financial literacy in SMEs is a significant barrier to economic progress. For example, in Nepal, SMEs contribute approximately 22% to GDP and account for over 60% of employment (Asian Development Bank, 2022). Despite their critical role, Nepalese SMEs face structural challenges, including limited governance practices and widespread financial illiteracy, which hinder their growth and competitiveness (Sharma, 2020). Moreover, the informal nature of many SMEs exacerbates the problem, as these enterprises often operate outside the formal financial system, limiting their access to credit and market opportunities.

Government and international organizations have recognized these challenges and initiated various programs to enhance corporate governance and financial literacy among SMEs. For instance, the Financial Literacy Project by the Nepal Rastra Bank aims to educate SME owners on financial planning and management (Nepal Rastra Bank, 2020). Similarly, corporate governance training modules developed by institutions such as the International Finance Corporation (IFC) are designed to equip SMEs with the tools to build robust governance frameworks.

Improving corporate governance and financial literacy in SMEs requires a multifaceted approach involving policymakers, educators, and financial institutions. Policymakers should enforce regulations that promote transparency and accountability while providing incentives for SMEs to adopt governance best practices (Abor & Quartey, 2010). Financial institutions can play a vital role by offering tailored financial literacy programs and advisory services to SMEs, ensuring they are equipped to manage loans and investments effectively (Beck et al., 2005).

Educational institutions and business associations can also contribute by integrating financial literacy and corporate governance topics into training programs targeted at SME owners and managers. Partnerships between public and private sectors are essential to scaling these efforts and ensuring their sustainability over time.

Corporate governance and financial literacy are integral to the success and sustainability of SMEs. While governance structures ensure accountability and strategic direction, financial literacy empowers SME operators to make informed decisions, manage resources effectively, and achieve financial stability. In developing economies like Nepal, addressing the gaps in governance and literacy can significantly enhance the performance of SMEs, contributing to broader economic development. Stakeholders must collaborate to implement policies, programs, and initiatives that foster these critical competencies, paving the way for resilient and competitive SMEs.

## **1.2 Problem Statement**

Small and Medium Enterprises (SMEs) serve as a backbone of global economies, especially in developing countries, by contributing significantly to employment, innovation, and GDP. Despite their economic importance, SMEs often face high failure rates, with many unable to sustain operations beyond a few years (Ayyagari et al., 2018). One of the primary reasons for these failures is the lack of effective corporate governance and inadequate financial literacy among SME owners and managers. These deficiencies result in poor decision-making, mismanagement of resources, and limited access to financing, hindering their growth and competitiveness.

Corporate governance, which ensures transparency, accountability, and strategic oversight in business operations, is often underdeveloped or entirely absent in SMEs.

Unlike large corporations that operate within well-defined governance frameworks, SMEs frequently rely on informal structures, especially in family-owned businesses. The absence of governance systems creates vulnerabilities such as conflicts of interest, resource misallocation, and inability to scale operations (Abor & Adjasi, 2007). Moreover, in many SMEs, decision-making authority is concentrated in a single individual or a small group, leading to biases and inefficiencies that can adversely affect performance and sustainability.

Compounding the problem is the lack of financial literacy among SME owners and managers. Financial literacy, defined as the knowledge and skills to make informed financial decisions, is a critical enabler of effective resource allocation and risk management. However, studies have consistently shown that SME operators, especially in developing economies, struggle with basic financial concepts such as budgeting, financial reporting, and investment planning (Fatoki, 2014). This lack of knowledge leads to common issues such as poor cash flow management, overreliance on informal financing, and inability to access formal credit markets.

The interplay between corporate governance and financial literacy further complicates the situation. While corporate governance provides a framework for accountability and strategic management, financial literacy ensures that these frameworks are implemented effectively. Without financial literacy, even the most robust governance practices may fail to produce desired outcomes. Conversely, a lack of governance structures can undermine the benefits of financial literacy, as there are no mechanisms to ensure financial discipline and oversight (Zhou, 2017). This interdependence underscores the need to address both governance and literacy gaps simultaneously.

In developing economies like Nepal, these challenges are particularly pronounced. Nepalese SMEs account for over 60% of employment and contribute approximately 22% to GDP (Asian Development Bank, 2022). However, their potential remains largely untapped due to structural deficiencies in governance and financial management. Many SMEs operate informally, without access to formal financial systems or regulatory oversight, making them vulnerable to economic shocks and limiting their growth prospects (Sharma, 2020). Additionally, the lack of financial literacy among SME

operators restricts their ability to engage with financial institutions, further exacerbating their challenges.

The COVID-19 pandemic has amplified these vulnerabilities, with many SMEs struggling to navigate the economic disruptions caused by lockdowns and supply chain disruptions. The crisis has highlighted the critical importance of governance and financial literacy in building resilient businesses that can adapt to changing circumstances. It has also exposed the limitations of existing support mechanisms, such as government aid programs, which often fail to reach SMEs operating in informal sectors due to their lack of documentation and financial records (OECD, 2020).

Given these challenges, there is an urgent need for targeted interventions to strengthen corporate governance and enhance financial literacy among SMEs. Policymakers, financial institutions, and educators must collaborate to develop comprehensive solutions that address these gaps. Regulatory frameworks should be tailored to the unique needs of SMEs, ensuring that governance practices are practical and scalable. Similarly, financial literacy programs should focus on building practical skills that enable SME operators to manage their finances effectively and engage with formal financial systems.

The lack of effective corporate governance and financial literacy represents a significant barrier to the growth and sustainability of SMEs. Addressing these issues is critical for unlocking the potential of SMEs, especially in developing economies where they play a central role in economic development. This study seeks to explore the interconnection between corporate governance and financial literacy in SMEs, with the aim of identifying strategies that can enhance their performance and resilience.

- i. What is the current state of corporate governance practices in SMEs in Pyuthan District?
- ii. Is there relation between Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development and SME Performance?
- iii. What is the effect Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development on SME Performance?

### **1.3 Objective of the study**

The main findings of the study are as follows:

- i. To assess the current status of Corporate Governance and Financial Literacy in SMEs in Pyuthan District.
- ii. To examine the relationship between Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development and SME Performance.
- iii. To analyze the effect of Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development on SME Performance.

### **1.4 Hypothesis of the study**

The hypothesis has been formulated as follows:

H1: There is significance positive impact of Board Composition on SME Performance.

H2: There is significance positive impact of Financial Literacy on SME Performance.

H3: There is significance positive impact of Board Composition on SME Performance.

H4: There is significance positive impact of Transparency on SME Performance.

H5: There is significance positive impact of Training and Development on SME Performance.

### **1.5 Rationale of the Study**

Small and Medium Enterprises (SMEs) are critical to economic growth, employment generation, and innovation. Despite their significant contributions to national and global economies, SMEs often face challenges that hinder their ability to thrive and sustain themselves over time. Among these challenges, the lack of effective corporate governance and financial literacy stands out as major barriers to their development and competitiveness. This study is motivated by the need to understand and address these

critical issues, with the ultimate goal of improving the performance and sustainability of SMEs.

Corporate governance ensures accountability, transparency, and strategic decision-making within an organization. For SMEs, adopting strong governance practices is essential to maintain stakeholder confidence, manage risks, and enhance overall operational efficiency. However, many SMEs operate with informal or poorly structured governance systems, leading to inefficiencies, resource mismanagement, and difficulties in scaling operations. The absence of structured governance mechanisms often results in an inability to attract investors and access financial resources, further limiting their growth potential. This study aims to explore how the implementation of effective governance frameworks can improve decision-making processes and align organizational objectives with sustainable practices.

Financial literacy, on the other hand, is fundamental to managing resources effectively and making informed financial decisions. Many SME owners and managers lack the necessary financial knowledge to create budgets, analyze financial statements, or plan for future growth. This lack of financial literacy often leads to poor cash flow management, limited access to credit, and a higher likelihood of business failure. By investigating the role of financial literacy, this study seeks to identify practical ways to empower SME operators with the skills and knowledge needed to navigate financial challenges and seize opportunities.

The interplay between corporate governance and financial literacy is also of particular interest in this study. While corporate governance provides a framework for strategic management, financial literacy enables SME owners and managers to implement and adhere to these frameworks effectively. The study seeks to explore the synergy between these two factors, demonstrating how their integration can result in improved financial performance, resilience to economic shocks, and long-term sustainability.

The rationale for focusing on SMEs is driven by their potential to contribute significantly to economic development, particularly in developing economies. SMEs often operate in resource-constrained environments, where their survival depends on their ability to adapt to challenges and innovate. Enhancing corporate governance and financial literacy can

provide these enterprises with the tools they need to overcome structural limitations and maximize their contributions to the economy.

This study also recognizes the broader implications of strengthening SMEs. Improved governance and financial literacy among SMEs can lead to greater economic stability, increased job creation, and enhanced competitiveness in domestic and international markets. Moreover, the findings of this research can serve as a foundation for policymakers, financial institutions, and educators to design targeted interventions that support SME growth and development.

In conclusion, this study is driven by the need to address the critical gaps in corporate governance and financial literacy among SMEs. By identifying the challenges and opportunities in these areas, the study aims to provide actionable insights that can empower SMEs to achieve greater resilience, sustainability, and success in a dynamic economic landscape.

### **1.6 Limitations of the study**

The limitations in this study are as follows:

- Primary data were collected through the questionnaire method. Therefore, the study may suffer from limitations of online survey.
- Due to geographical and time constraint, respondents were only taken from inside Pyuthan District.
- Data is collected through the self-administered questionnaire. The data is collected from the individual understanding of the respondents.
- The external environment may influence the respondents.

## **CHAPTER II**

### **LITERATURE REVIEW**

#### **2.1 Theoretical Review**

##### **2.1.1 Agency Theory**

Agency theory, developed by Jensen and Meckling (1976), examines the relationship between principals (owners) and agents (managers), particularly in organizational settings where decision-making authority is delegated. This theory emphasizes the inherent conflicts of interest that may arise when agents prioritize personal goals over the principals' objectives, leading to inefficiencies or resource misuse. SMEs, which often lack formal governance structures, are not immune to these issues, especially in family-owned businesses. Implementing robust corporate governance mechanisms can reduce agency conflicts, aligning the interests of stakeholders and ensuring accountability (Jensen & Meckling, 1976; Fama & Jensen, 1983; Eisenhardt, 1989; Daily et al., 2003; Chrisman et al., 2004).

The theory's relevance to SMEs lies in its ability to highlight the importance of transparency and monitoring. Many SMEs operate with overlapping roles of ownership and management, which can blur accountability lines. Introducing governance practices like regular audits, performance evaluations, and external advisory boards can mitigate these challenges (Eisenhardt, 1989; Shleifer & Vishny, 1997; Claessens & Yurtoglu, 2013; Brickley et al., 1997; Pande & Ansari, 2014). These measures not only improve decision-making but also build credibility with external investors, facilitating access to funding.

Moreover, agency theory explains the critical role of trust in reducing transaction costs and improving organizational efficiency. SMEs often rely on informal trust-based systems, which, while effective in some contexts, may falter as the organization grows. Formalizing governance structures ensures that trust is supplemented with measurable accountability (Shleifer & Vishny, 1997; Chrisman et al., 2004; Jensen, 1993; Daily et al., 2003; Bruton et al., 2010). This balance is vital for long-term growth and sustainability.

### **2.1.2 Resource-Based View (RBV)**

The Resource-Based View (RBV) theory, proposed by Barney (1991), suggests that a firm's internal resources and capabilities are fundamental to achieving a sustainable competitive advantage. Unlike theories focusing on external market factors, RBV emphasizes that firms with valuable, rare, inimitable, and non-substitutable (VRIN) resources can outperform competitors. SMEs often operate in resource-constrained environments, making efficient utilization of these resources critical. Proper corporate governance helps align these resources with strategic goals, while financial literacy ensures that decision-makers can assess and allocate resources effectively (Barney, 1991; Peteraf, 1993; Wernerfelt, 1984; Teece et al., 1997; Amit & Schoemaker, 1993).

In the context of SMEs, intangible resources like knowledge, brand reputation, and employee expertise play a pivotal role. However, leveraging these resources requires governance frameworks that ensure strategic oversight. Financial literacy complements this by empowering SME operators to understand financial implications and make informed decisions regarding resource investments and risk management (Wernerfelt, 1984; Barney, 1991; Teece et al., 1997; Sirmon et al., 2007; Makadok, 2001). Together, governance and financial literacy create an ecosystem where resources are maximized for organizational growth.

RBV also highlights the significance of organizational capabilities—defined as the capacity to integrate and deploy resources effectively. For SMEs, governance mechanisms such as clear decision-making hierarchies and accountability systems enhance these capabilities. Additionally, financial literacy improves forecasting, budgeting, and financial control, enabling SMEs to adapt to dynamic market conditions while maintaining resource efficiency (Barney, 1991; Peteraf, 1993; Newbert, 2007; Zahra et al., 2006; Grant, 1996). Thus, RBV underscores the interconnected role of governance and financial literacy in SME success.

### **2.1.3 Stakeholder Theory**

Stakeholder theory, popularized by Freeman (1984), posits that organizations have a responsibility to all stakeholders, not just shareholders. For SMEs, this includes employees, customers, suppliers, creditors, and the broader community. The theory emphasizes the importance of balancing competing interests to achieve long-term sustainability. Corporate governance frameworks provide the structure for managing stakeholder relationships, while financial literacy enables SME managers to understand and address stakeholders' financial concerns effectively (Freeman, 1984; Donaldson & Preston, 1995; Mitchell et al., 1997; Phillips, 2003; Clarkson, 1995).

In SMEs, stakeholder theory is particularly relevant due to their reliance on community support and close-knit relationships with stakeholders. Effective governance ensures transparency and ethical practices, fostering trust among stakeholders. Financial literacy, on the other hand, equips SMEs with the tools to manage financial risks and obligations, ensuring they can meet stakeholder expectations (Clarkson, 1995; Freeman, 1984; Donaldson & Preston, 1995; Harrison et al., 2010; Jones, 1995). Together, these elements create a foundation for mutual benefit and organizational resilience.

Stakeholder theory also highlights the role of communication in building trust and accountability. SMEs often operate in informal settings where stakeholder engagement is direct and personal. However, as SMEs grow, formal governance mechanisms become necessary to maintain these relationships. Financial literacy supports this transition by providing the knowledge to develop financial reports and strategies that demonstrate accountability to stakeholders (Phillips, 2003; Harrison & Wicks, 2013; Jones et al., 2018; Mitchell et al., 1997; Donaldson & Preston, 1995). Thus, stakeholder theory provides a comprehensive framework for understanding the role of governance and financial literacy in SME operations.

### **2.1.4 Behavioral Finance Theory**

Behavioral finance theory challenges traditional economic assumptions by considering psychological factors that influence financial decision-making. Developed through the works of scholars like Kahneman and Tversky (1979), it explores how cognitive biases, emotions, and heuristics impact choices. In SMEs, financial literacy plays a crucial role

in mitigating the effects of these biases, ensuring more rational decision-making. Corporate governance complements this by creating oversight mechanisms that reduce individual biases' influence on organizational decisions (Kahneman & Tversky, 1979; Thaler, 1980; Barberis & Thaler, 2003; Shefrin, 2001; Lo, 2005).

SMEs often face financial constraints, leading to decisions driven by optimism bias or loss aversion. For example, overly optimistic revenue projections may lead to unsustainable investments. Governance structures like board reviews and financial audits help counteract these tendencies. Similarly, financial literacy enables SME managers to analyze data critically, reducing reliance on heuristic shortcuts (Kahneman & Tversky, 1979; Barberis & Thaler, 2003; Shefrin, 2001; Fama, 1998; Odean, 1998). Together, these tools ensure decisions are based on data and realistic assumptions.

Behavioral finance theory also highlights the importance of understanding group dynamics in decision-making. SMEs often involve close collaborations among family members or small teams, which can lead to groupthink. Effective governance introduces diverse perspectives, while financial literacy equips decision-makers with the analytical tools to challenge consensus, leading to more balanced decisions (Lo, 2005; Thaler, 1980; Kahneman, 2011; Shefrin, 2001; Shiller, 2003). This integration of governance and financial literacy fosters resilience in the face of market uncertainties.

### **2.1.6 Institutional Theory**

Institutional theory, rooted in the works of DiMaggio and Powell (1983), examines how organizational practices are shaped by institutional pressures, norms, and rules. SMEs are particularly susceptible to such pressures as they seek legitimacy and compliance within their operating environments. This theory underscores the importance of aligning corporate governance and financial practices with broader institutional expectations to enhance credibility and competitiveness (DiMaggio & Powell, 1983; Scott, 1995; Meyer & Rowan, 1977; North, 1990; Tolbert & Zucker, 1996).

Institutional theory identifies three types of pressures—coercive, mimetic, and normative—that influence organizational behavior. SMEs often face coercive pressures from regulators and lenders, requiring adherence to financial reporting standards and governance codes. Financial literacy helps SME managers navigate these requirements,

while governance ensures adherence to institutional norms, fostering trust among stakeholders (Scott, 1995; North, 1990; Meyer & Rowan, 1977; Zucker, 1987; Greenwood et al., 2008).

Mimetic pressures, driven by the need to emulate successful peers, often lead SMEs to adopt best practices in governance and financial management. For instance, an SME may introduce audit committees or transparency measures to attract investors, reflecting institutional isomorphism. Financial literacy ensures these practices are implemented effectively and tailored to the SME's context (DiMaggio & Powell, 1983; Scott, 1995; Greenwood et al., 2008; Tolbert & Zucker, 1996; North, 1990). Such alignment enhances organizational legitimacy and operational efficiency.

## **2.2 Conceptual Review**

### **2.2.1 Concept of Corporate Governance and Financial Literacy in SMEs**

Corporate governance and financial literacy are two pivotal aspects influencing the sustainable growth and performance of Small and Medium Enterprises (SMEs). SMEs are recognized as the backbone of many economies, contributing significantly to employment, innovation, and GDP. However, they face unique challenges, including limited access to finance, inefficient governance, and inadequate financial management skills. Corporate governance ensures accountability, transparency, and ethical business practices, while financial literacy equips entrepreneurs and managers with the knowledge to make informed financial decisions. The interplay between these two concepts is essential for fostering resilience, enhancing competitiveness, and promoting sustainable business practices in SMEs.

### **2.2.2 Corporate Governance Definition and Relevance in SMEs**

Corporate governance refers to the system by which businesses are directed, controlled, and held accountable. It encompasses a set of rules, practices, and processes that ensure effective management and protect stakeholders' interests. According to Cadbury (1992), corporate governance is "the system by which companies are directed and controlled." For SMEs, corporate governance structures are often less formal than in large

organizations, but they are equally critical for ensuring sustainable operations (OECD, 2005).

Effective corporate governance in SMEs has several benefits. It enhances decision-making by creating accountability mechanisms, fosters trust among investors and stakeholders, and mitigates risks associated with unethical practices or mismanagement (IFC, 2010). SMEs that adopt governance frameworks are better positioned to attract investment, comply with regulatory requirements, and expand their market reach. Additionally, robust governance practices can improve internal processes, reduce conflicts, and align business objectives with long-term goals (Abor & Adjasi, 2007).

Despite its importance, many SMEs lack structured governance frameworks due to limited resources, a lack of awareness, or the perception that governance is only relevant for larger enterprises. This gap can lead to inefficiencies, operational risks, and a lack of strategic focus, undermining business performance and growth potential (OECD, 2015).

### **2.2.3 Financial Literacy Definition and Significance for SMEs**

Financial literacy is defined as the ability to understand and effectively use financial concepts, such as budgeting, investment, risk management, and financial planning. According to Lusardi and Mitchell (2014), financial literacy involves "knowledge of financial concepts and the ability to apply this knowledge to manage personal and business finances effectively." In the SME context, financial literacy plays a critical role in ensuring proper financial management and long-term success.

Entrepreneurs with strong financial literacy skills are better equipped to interpret financial statements, evaluate investment opportunities, and manage cash flows. This capability helps SMEs mitigate financial risks, optimize resource allocation, and improve profitability (Wise, 2013). Moreover, financial literacy empowers SMEs to engage with financial institutions, improving their chances of securing loans and other financial resources (Cole et al., 2009).

A lack of financial literacy, on the other hand, is a significant barrier to SME growth. Many SME operators struggle with basic financial management, leading to poor decision-making, inefficiencies, and insolvency (Atkinson & Messy, 2012). In response, initiatives

to enhance financial literacy among entrepreneurs and managers are increasingly recognized as a critical component of SME development strategies.

#### **2.2.4 Interrelationship between Corporate Governance and Financial Literacy**

Corporate governance and financial literacy are deeply interconnected in the context of small and medium-sized enterprises (SMEs), with each element complementing the other to support sustainable growth and effective business operations. Corporate governance provides the structural framework for decision-making, delineating the roles and responsibilities of stakeholders while establishing accountability and transparency mechanisms. Financial literacy, on the other hand, empowers SME owners and managers with the knowledge and skills to make informed financial decisions. Together, these components form a robust system for mitigating risks, optimizing resources, and driving long-term strategic objectives. For instance, financially literate managers are better equipped to interpret financial statements, assess the viability of investment opportunities, and manage credit effectively. Corporate governance ensures that these financial decisions align with the enterprise's overall goals, risk tolerance, and ethical standards (Lusardi & Mitchell, 2014; OECD, 2015). Furthermore, financial literacy enhances an SME's ability to engage with stakeholders, such as investors and lenders, by presenting well-structured financial reports and growth projections, while good governance reassures these stakeholders of the enterprise's commitment to transparency and accountability (Cole et al., 2009; Wise, 2013). The synergy between governance and financial literacy also fosters adaptability and resilience, enabling SMEs to respond proactively to market fluctuations and economic challenges. Enterprises that integrate these aspects are more likely to achieve financial sustainability, maintain operational efficiency, and drive innovation in a competitive environment (Abor & Adjasi, 2007; IFC, 2010). This interdependence underscores the importance of a holistic approach to building governance capabilities and enhancing financial literacy within the SME sector.

#### **2.2.5 Challenges in Implementing Governance and Financial Literacy in SMEs**

Despite the clear benefits of corporate governance and financial literacy, SMEs face significant challenges in implementing these practices effectively. A primary constraint is the lack of financial and human resources, as many SMEs operate with limited budgets

and cannot afford to invest in governance frameworks or specialized financial literacy training programs (OECD, 2015). This resource limitation often leads to ad hoc decision-making processes that undermine long-term sustainability. Additionally, many SME owners are unaware of the importance of governance and financial literacy, perceiving them as secondary concerns compared to the immediate demands of day-to-day operations (Atkinson & Messy, 2012). This lack of awareness prevents proactive efforts to adopt best practices in governance or financial management. Cultural and structural barriers also hinder progress, particularly in family-owned SMEs where decision-making authority is concentrated among a small group of individuals. These dynamics can limit transparency, accountability, and the adoption of formal governance structures (Abor & Adjasi, 2007). Furthermore, entrepreneurs in developing regions face unique challenges, such as limited access to training programs and financial education resources (Lusardi & Mitchell, 2014). Geographic isolation, underdeveloped financial systems, and inadequate infrastructure exacerbate these issues, leaving many SMEs ill-equipped to build the governance and financial literacy capacities necessary for sustainable growth. Addressing these challenges requires targeted interventions that account for the specific needs and constraints of SMEs, particularly in under-resourced and underserved markets.

### **2.2.6 Strategies for Enhancing Corporate Governance and Financial Literacy**

Enhancing corporate governance and financial literacy in SMEs requires a multi-faceted approach that includes capacity building, policy interventions, technology adoption, and stakeholder partnerships. Capacity building initiatives, such as training programs and workshops, are essential for equipping SME owners and managers with practical knowledge of governance principles and financial management. These programs should be designed to address the specific needs of SMEs and delivered in accessible formats to maximize participation (OECD, 2015). Policy interventions by governments and financial institutions can further incentivize SMEs to adopt governance frameworks and improve financial literacy. Subsidies, tax benefits, and grants can reduce the financial burden of implementing governance practices and accessing training resources, encouraging more SMEs to invest in these areas (IFC, 2010). The adoption of technology offers another powerful strategy for overcoming traditional barriers. Digital tools and platforms for financial management and governance can streamline processes, improve

transparency, and reduce costs, enabling SMEs to operate more efficiently (Wise, 2013). These tools also provide real-time data and analytics, aiding in better decision-making and risk management. Finally, partnerships with stakeholders such as non-governmental organizations (NGOs), industry associations, and educational institutions can provide SMEs with access to expertise, funding, and resources. Collaborative initiatives can also facilitate knowledge sharing and the dissemination of best practices in governance and financial literacy (Cole et al., 2009). By leveraging these strategies, SMEs can build the capacities necessary to achieve sustainable growth and resilience in a dynamic business environment.

### **2.2.6 Concept of Corporate Governance in SMEs**

Corporate governance in Small and Medium Enterprises (SMEs) refers to the systems, processes, and principles through which these organizations are directed and controlled. Unlike large corporations, SMEs often operate under less formalized structures due to their smaller size, resource constraints, and simpler ownership patterns, typically involving family or individual ownership. Despite this, corporate governance is crucial for SMEs as it ensures accountability, transparency, and ethical business practices, laying a foundation for sustainable growth. Effective governance enhances internal controls, reduces risks, and fosters confidence among stakeholders, including employees, investors, and creditors. According to Cadbury (1992), corporate governance involves the mechanisms by which a company is directed and held accountable to stakeholders. This accountability is even more critical in SMEs, as their limited resources make them more vulnerable to mismanagement or external shocks.

For SMEs, implementing governance structures involves setting up clear roles and responsibilities for decision-making, performance evaluation, and risk management. This could include forming advisory boards, adopting ethical codes, and ensuring compliance with local laws and regulations. Governance also facilitates better decision-making by providing a structured approach to addressing business challenges, enabling SMEs to be more agile and competitive in dynamic markets. Additionally, corporate governance promotes operational efficiency by encouraging strategic thinking and long-term planning, which are often overlooked in smaller firms focused on immediate survival.

However, governance in SMEs is not without challenges. Limited awareness, resistance to change, and a lack of expertise are common barriers that hinder the adoption of governance practices in these enterprises (Abor & Adjasi, 2007).

One of the core benefits of corporate governance in SMEs is improved access to finance. Lenders and investors view well-governed SMEs as lower-risk entities, making it easier for them to secure loans or equity investments. Governance also helps SMEs meet regulatory requirements and build their reputation, further enhancing their market position. In the global context, organizations such as the OECD and the IFC have emphasized the need for SMEs to adopt corporate governance practices to remain competitive and sustainable. However, achieving this requires targeted efforts, including capacity-building initiatives and policy interventions that address the unique needs of SMEs. These interventions should focus on educating SME owners about the benefits of governance and providing tools and frameworks tailored to their scale and complexity.

In conclusion, corporate governance is not a luxury but a necessity for SMEs aiming for sustainable growth and competitiveness. By fostering transparency, accountability, and ethical conduct, governance helps SMEs navigate challenges and capitalize on opportunities. While barriers exist, the adoption of governance practices can significantly enhance an SME's resilience and long-term viability. Policymakers, financial institutions, and industry associations must collaborate to support SMEs in implementing effective governance structures, recognizing their critical role in economic development.

### **2.2.7 Concept of Financial Literacy in SMEs**

Financial literacy is the knowledge and skills required to make informed financial decisions, particularly in budgeting, investment, cash flow management, and financial planning. For SMEs, financial literacy is a cornerstone of effective financial management, directly influencing their ability to achieve sustainability and growth. Entrepreneurs and managers with strong financial literacy can interpret financial statements, assess market opportunities, and manage risks effectively. This knowledge ensures better resource allocation, improved cash flow management, and optimized operational efficiency. According to Lusardi and Mitchell (2014), financial literacy is "the ability to process economic information and make informed decisions about

financial planning, wealth accumulation, and debt management." This capability is particularly crucial for SMEs, which often operate on thin margins and limited resources.

A financially literate entrepreneur can distinguish between productive and unproductive investments, enabling more strategic business decisions. For instance, understanding the concept of working capital management allows SMEs to maintain liquidity while meeting operational needs. Moreover, financial literacy enhances an SME's ability to access credit and negotiate with financial institutions. Many SMEs fail to secure loans not because of their business models but due to poorly prepared financial proposals or a lack of understanding of financial products. Financial literacy addresses this gap by equipping SMEs with the tools to present their financial health effectively and navigate complex financial landscapes.

However, financial literacy among SME owners and managers is often limited, particularly in developing economies. Factors such as low education levels, limited exposure to financial systems, and a focus on immediate operational concerns contribute to this gap. According to Atkinson and Messy (2012), financial literacy levels in SMEs are significantly lower than in larger corporations, posing a significant barrier to growth and sustainability. The lack of financial literacy can lead to poor financial decisions, such as over-leveraging, inefficient cost management, or inadequate savings for future investments, all of which can jeopardize an SME's survival.

Initiatives to enhance financial literacy in SMEs have gained prominence globally. Governments, financial institutions, and non-governmental organizations are increasingly recognizing the importance of financial education programs tailored to SMEs. These programs focus on practical aspects, such as maintaining financial records, understanding tax regulations, and utilizing financial technology tools for better management. The rise of digital financial tools also presents an opportunity to improve financial literacy. Mobile applications and software solutions designed for SMEs can simplify financial processes, making them more accessible and manageable for entrepreneurs with limited expertise.

Financial literacy is a critical enabler of SME performance and sustainability. It empowers entrepreneurs to make informed decisions, manage resources efficiently, and

navigate financial challenges effectively. While significant progress has been made in promoting financial literacy, more targeted efforts are needed to reach SMEs, particularly in underserved regions. By investing in financial education and technology, stakeholders can ensure that SMEs have the knowledge and tools necessary to thrive in competitive markets.

### **2.3 Empirical Review**

Carter and Davies (2017) conducted a study examining the financial literacy levels among women entrepreneurs, comparing them to their male counterparts. They found that women-led SMEs generally had lower financial literacy levels, which affected their ability to secure funding, manage cash flow, and make informed business decisions. The study suggested that this financial literacy gap was due to various factors, including limited access to financial education, societal gender roles, and lack of mentorship. Women entrepreneurs were often unaware of the financial tools and resources available to them, which hindered their business growth and stability. The authors argued that addressing this gap through targeted financial education programs could empower women entrepreneurs and improve the financial health of their businesses. Carter and Davies also highlighted that financial institutions could play a key role in promoting financial literacy by offering tailored training sessions and simplifying loan processes for women-led SMEs. They concluded that empowering women through financial literacy would contribute to the overall economic development of communities and nations.

Jackson and Moore (2018) analyzed the impact of board governance on the performance of SMEs, focusing on how board composition, decision-making processes, and governance structures influence business outcomes. Their study found that SMEs with more formal board structures, including independent directors and specialized committees, achieved higher financial performance and growth. The authors Source: d that independent directors brought external perspectives and expertise, which helped improve strategic decisions and mitigate biases. They also found that SMEs with governance frameworks in place were more likely to engage in long-term planning and risk management. However, Jackson and Moore highlighted that smaller SMEs often faced challenges in adopting formal governance due to the costs involved and the

complexity of establishing structured boards. They concluded that SMEs could benefit from adopting simplified governance models, such as advisory boards, to reap the benefits of improved oversight and decision-making.

Martinez and Santos (2018) analyzed the effect of governance practices on financial performance in family-owned SMEs, focusing on how governance structures affect strategic decision-making and operational efficiency. Their study found that family-owned SMEs, when adopting formal governance structures such as advisory boards or independent directors, showed significant improvements in their financial performance. The authors pointed out that family firms often face challenges due to concentrated ownership and decision-making within the family, which can lead to nepotism and conflicts of interest. However, when these firms integrated formal governance mechanisms, they were better able to manage these challenges, leading to more strategic decision-making, better risk management, and enhanced business growth. Martinez and Santos also found that family-owned SMEs that practiced good governance were more likely to access external capital and maintain better relationships with stakeholders, including investors and employees. The authors concluded that family-owned SMEs should consider adopting more formal governance practices to improve their long-term sustainability and financial performance.

Ahmed and Ali (2018) explored the impact of board diversity on SME performance, focusing on gender and skill diversity. Their study found that diverse boards, particularly those that included women and members with various expertise, positively affected decision-making processes, leading to improved business outcomes. They suggested that gender diversity helped in broadening perspectives, promoting innovation, and enhancing corporate reputation. Additionally, the inclusion of diverse skills, such as financial and strategic expertise, contributed to more effective governance and risk management. The research indicated that firms with diverse boards were more likely to invest in R&D and adopt sustainable business practices. However, the study also Source: d that cultural and societal norms in some regions presented challenges to achieving board diversity, with traditional attitudes limiting women's participation in leadership roles. Despite these barriers, the study concluded that promoting board diversity was essential for improving

SME performance and competitiveness. The authors recommended that SMEs adopt policies to actively recruit diverse talent for their boards and leadership positions.

Brown and Miller (2019) investigated the relationship between financial literacy and access to credit among SMEs. They posited that financial literacy enhances an SME's ability to secure funding by improving their understanding of financial products, loan terms, and repayment obligations. The study utilized survey data from 300 SMEs across urban and rural areas. It found that firms with higher financial literacy levels were significantly more likely to obtain loans from formal financial institutions. This was attributed to their ability to present well-prepared financial statements and articulate their funding needs effectively. While the study provided valuable insights, its cross-sectional design limited the ability to assess the long-term impacts of financial literacy on SME growth. The authors recommended longitudinal studies to better understand these dynamics. They also suggested that financial institutions play a proactive role in promoting financial literacy by offering training programs and simplified loan processes for SMEs.

Nguyen and Le (2019) explored the relationship between corporate governance practices and risk management in SMEs, emphasizing how governance structures can mitigate operational and financial risks. Their study found that SMEs with strong governance mechanisms, including independent boards and transparent reporting practices, were better equipped to identify, assess, and mitigate risks. These companies demonstrated superior financial stability and were less vulnerable to market fluctuations and financial crises. However, the study also highlighted the challenges faced by SMEs, particularly in developing economies, where resource constraints prevent the implementation of robust governance frameworks. Nguyen and Le argued that even small-scale governance practices, such as periodic risk assessments and financial audits, could significantly enhance an SME's ability to manage risks. They recommended that SME owners and managers adopt a proactive approach to governance and risk management by integrating these practices into their daily operations. The authors concluded that improving governance and risk management practices could boost the resilience and long-term viability of SMEs.

Lee and Wang (2019) investigated how corporate governance influences performance metrics in SMEs, focusing on financial performance indicators such as return on assets (ROA), return on equity (ROE), and profitability margins. The study revealed that SMEs with formal governance structures, including active boards and clear decision-making processes, tended to outperform those without such systems. The research suggested that robust governance frameworks provided SMEs with the discipline to focus on long-term objectives, improve operational efficiency, and make data-driven decisions that positively impacted financial performance. Lee and Wang found that governance practices such as transparent financial reporting, audit processes, and executive compensation linked to performance were associated with higher profitability and growth in SMEs. However, the study also identified that many SMEs, particularly in emerging markets, faced barriers to implementing these practices due to financial constraints and the perception that governance structures were unnecessary for small-scale businesses. The authors argued that financial literacy among SME owners and a better understanding of governance benefits could lead to improved business outcomes. They concluded that SMEs could significantly enhance their performance by integrating basic governance structures and performance metrics into their operations.

Smith and Johnson (2020) examined how corporate governance influences the performance of SMEs. They argued that governance mechanisms such as board structure, external audits, and compliance frameworks are pivotal in enhancing operational efficiency and profitability. The study utilized a mixed-method approach, combining surveys from 250 SMEs and case studies of 10 firms. Findings indicated that SMEs with formal governance systems outperformed those with informal arrangements, as these mechanisms helped mitigate risks and align stakeholder interests. Board independence and diversity were particularly highlighted as critical factors influencing decision-making quality. The study also revealed that governance practices varied by industry, with manufacturing SMEs adopting more structured systems compared to service-oriented ones. Smith and Johnson emphasized that while implementing governance frameworks can be resource-intensive, the long-term benefits, such as improved reputation and access to finance, outweigh the initial costs. The study faced limitations, including its focus on a

single region and lack of longitudinal data, which constrained the generalizability of the findings.

Lopez and Hernandez (2020) investigated the impact of financial education on the growth of SMEs, highlighting the importance of financial literacy in decision-making and sustainability. Their research demonstrated that SMEs with access to financial training programs experienced improved financial management practices, such as better budgeting, cost control, and cash flow management. These improvements led to higher profitability and reduced the likelihood of business failure. The study also found that SMEs with greater financial literacy were more likely to engage in strategic planning and long-term investment decisions, leading to sustained growth. However, Lopez and Hernandez Source: d that despite the benefits of financial education, many SMEs, especially in developing regions, faced challenges in accessing quality training due to limited resources and awareness. They argued that government and private sector initiatives should prioritize financial literacy programs to ensure SMEs' survival and growth. The authors recommended that educational institutions collaborate with financial institutions to design relevant and accessible training programs tailored to the specific needs of SMEs.

Gomez and Rodriguez (2020) investigated the influence of financial literacy on the entrepreneurial success of SMEs, finding that entrepreneurs with high financial literacy were better positioned to manage their finances, reduce operational costs, and optimize investments. Their study emphasized that financial literacy helped entrepreneurs make informed decisions regarding budgeting, pricing, and tax planning. The authors argued that financial education contributed to the sustainability of SMEs by enhancing business owners' ability to forecast cash flow and identify cost-saving opportunities. They also found that SMEs with financially literate owners had a better track record of securing funding from banks and investors, as their financial acumen reassured creditors. However, the study Source: d that financial literacy was still relatively low among many SME owners, especially in developing countries, due to a lack of access to education and training. Gomez and Rodriguez recommended that financial literacy programs be incorporated into entrepreneurship training and education to bridge the knowledge gap.

Chavez and Patel (2020) examined the relationship between financial literacy and innovation in SMEs, focusing on how financial knowledge affects entrepreneurial decision-making related to research and development (R&D) and new product development. Their research found that financially literate SMEs were more likely to invest in innovation activities, as they had a better understanding of the financial implications of such investments. The study demonstrated that financial literacy helped business owners assess the profitability of innovation projects, manage R&D budgets, and seek appropriate funding sources. Chavez and Patel concluded that SMEs with strong financial literacy were better equipped to make informed decisions regarding technological advancement and innovation, which is crucial for staying competitive in dynamic markets. However, the study also Source: d that many SMEs, particularly in developing countries, faced financial barriers to innovation, including limited access to capital and financial services. The authors recommended that SMEs invest in improving their financial literacy to foster a culture of innovation, ultimately leading to business growth and competitive advantage. They also suggested that policymakers create supportive environments for innovation, including financial education initiatives for SMEs.

Singh and Yadav (2021) explored the relationship between financial management practices and the survival of SMEs, focusing on how effective financial management contributes to the longevity of small businesses. The study found that SMEs that implemented sound financial management practices, such as budgeting, cash flow forecasting, and tax planning, had a higher survival rate compared to those that did not. Singh and Yadav identified that SMEs often struggle with managing cash flow, particularly in the early stages of growth, and recommended that business owners focus on building robust financial systems from the outset. The research also highlighted that many SMEs lacked formal financial training, leading to poor financial decisions that jeopardized their sustainability. The authors concluded that improving financial literacy and the adoption of structured financial management practices were crucial for improving SME survival rates. They suggested that governments and financial institutions should provide training programs to equip SME owners with the necessary financial skills to manage their businesses effectively and ensure long-term survival.

Sharma et al. (2021) examined corporate governance practices in SMEs within developing economies, focusing on the challenges faced by small firms in establishing formal governance structures. Their study revealed that in these economies, SMEs often rely on informal governance practices, typically involving family members or close associates in decision-making processes. While this informal approach provides flexibility, it often hinders transparency, accountability, and long-term strategic planning. The authors argued that the lack of formal governance mechanisms restricts SMEs' ability to attract external investors and limits their growth potential. The research also found that developing countries' SMEs were less likely to adopt international best practices due to cultural and financial barriers. However, the study suggested that implementing simple governance structures, such as advisory boards and clear financial reporting, could enhance SME performance. The study's limitations included its narrow geographic focus on South Asia, which may not fully represent the diversity of governance challenges faced by SMEs in other regions. Sharma et al. (2021) concluded that government interventions, such as training and capacity-building programs, could help improve governance standards in SMEs, especially in developing countries.

Kim and Park (2021) examined the role of financial management practices in the sustainability of SMEs, particularly in emerging economies. Their research found that SMEs with structured financial management practices, such as regular budgeting, cash flow monitoring, and investment planning, were more likely to survive in the long term. The study emphasized that financial management skills enabled business owners to navigate challenges such as cash shortages, fluctuating demand, and economic downturns. The authors also found that many SMEs, especially in developing regions, struggled with inadequate financial systems and often lacked the knowledge to effectively manage their finances. Kim and Park argued that improving financial management practices could enhance the resilience and sustainability of SMEs by helping them weather financial challenges. They recommended that SMEs seek professional financial advice and implement standardized financial practices to improve their overall financial health.

Zhao and Li (2022) explored the connection between financial literacy and financial inclusion for SMEs, focusing on how financial knowledge influences access to banking

services, loans, and investment opportunities. Their research showed that SMEs with higher levels of financial literacy were more likely to access a wide range of financial services, including loans, insurance, and credit lines. They emphasized that financial literacy helped SME owners understand the terms and conditions of financial products, enabling them to make informed decisions about financing and managing debt. The study also highlighted the importance of financial inclusion in promoting SME growth, particularly in developing regions where access to formal financial services is limited. Zhao and Li suggested that financial literacy could improve financial inclusion by empowering SME owners to engage with financial institutions effectively. The authors recommended that financial institutions and governments work together to promote financial education and ensure that financial services are accessible to SMEs.

**Table 1***Summary of empirical review*

Author and Date	Objective	Methodology	Findings
Carter and Davies (2017)	Examine financial literacy levels among women entrepreneurs compared to men.	Comparative analysis of financial literacy levels and its impacts.	Women-led SMEs had lower financial literacy, limiting funding, cash flow management, and decision-making capabilities.
Jackson and Moore (2018)	Investigate the impact of board governance on SME performance.	Analysis of board composition, governance structures, and their influence on business outcomes.	Formal governance improved financial performance, with challenges in adoption for smaller SMEs due to costs and complexities.
Martinez and Santos (2018)	Explore governance practices' effect on financial performance in family-owned SMEs.	Study of governance structures, including advisory boards and independent directors.	Formal governance improved performance by reducing nepotism and conflicts; improved stakeholder relations.
Ahmed and Ali (2018)	Analyze the impact of board diversity (gender and skill) on SME performance.	Examination of diverse board composition and its influence on decision-making and outcomes.	Board diversity promoted innovation, R&D investment, and corporate reputation, with barriers from cultural norms.
Brown and Miller (2019)	Study financial literacy's role in SMEs' access to credit.	Survey of 300 SMEs across urban and rural areas.	Financial literacy improved credit access by aiding understanding of financial products and loan preparation.
Nguyen and Le (2019)	Assess governance practices' role in risk management for SMEs.	Focus on governance structures and their role in mitigating operational and financial risks.	Strong governance improved risk management and financial stability; resource constraints hindered adoption in developing economies.

Lee and Wang (2019)	Explore the influence of corporate governance on SME performance metrics.	Analysis of formal governance practices like financial reporting, audits, and executive compensation.	Formal governance structures linked to higher profitability and growth, with barriers in emerging markets.
Smith and Johnson (2020)	Investigate corporate governance's influence on SME performance.	Mixed-method approach: surveys and case studies.	Formal governance enhanced operational efficiency and profitability; industry variations observed.
Lopez and Hernandez (2020)	Examine financial education's impact on SME growth.	Analysis of financial literacy training programs' effects on financial management practices.	Improved financial literacy led to better management, profitability, and reduced business failure rates.
Gomez and Rodriguez (2020)	Analyze financial literacy's influence on SME entrepreneurial success.	Study on budgeting, pricing, and tax planning impacts on sustainability.	Financial literacy improved funding access, cost optimization, and informed financial decision-making.
Chavez and Patel (2020)	Investigate financial literacy's role in SME innovation.	Analysis of R&D investment and innovation decision-making.	Financial literacy promoted innovation and competitiveness, with barriers in developing countries.
Singh and Yadav (2021)	Examine financial management practices' effect on SME survival.	Analysis of practices like budgeting, cash flow forecasting, and tax planning.	Structured financial management practices increased survival rates, especially in early growth stages.
Sharma et al. (2021)	Study governance practices in SMEs in developing economies.	Focus on informal governance practices and their challenges.	Informal governance hindered growth and transparency; simple structures like advisory boards could improve outcomes.
Kim and Park (2021)	Assess financial management	Study on structured practices like	Improved financial management enhanced

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	practices' role in SME sustainability.	budgeting and cash flow monitoring.	resilience and long-term viability.
Zhao and Li (2022)	Explore financial literacy's influence on financial inclusion in SMEs.	Analysis of financial knowledge's role in accessing banking services and loans.	Higher financial literacy improved financial inclusion, enabling better access to credit and investment opportunities.

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## 2.4 Research Gap

The research gap in the area of corporate governance and financial literacy in SMEs primarily revolves around the limited empirical studies that link these two concepts to the overall performance and sustainability of small and medium-sized enterprises. While numerous studies have explored corporate governance practices or financial literacy independently, there is a scarcity of research that integrates both factors and examines their combined effect on SME growth and stability. Many studies focus on large corporations, leaving a gap in understanding how governance structures and financial knowledge specifically influence SMEs, which face unique challenges such as resource constraints and limited access to capital.

Furthermore, while financial literacy has been widely acknowledged as a critical factor in enhancing business decision-making, there is limited research on the specific financial literacy skills that are most impactful for SME owners. Additionally, the role of corporate governance in mitigating financial risks, particularly during economic downturns or crises, remains underexplored in the context of SMEs. Research that specifically investigates how governance structures can improve financial resilience and risk management practices in SMEs is scarce. This gap in the literature highlights the need for more comprehensive studies that investigate the intersections of corporate governance, financial literacy, and SME performance, especially in under-researched geographical regions and industries.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

#### **3.1 Research Design**

The research adopts a descriptive and casual comparative research design to investigate the relationship between corporate governance and financial literacy in SMEs. Descriptive analysis provides insights into the practices and levels of governance and financial literacy among SMEs, while explanatory research explores how these factors interact and influence SME performance. This mixed approach allows for a comprehensive understanding of the variables and their interdependencies. Quantitative methods will dominate the research, utilizing numerical data to test hypotheses and analyze patterns. A cross-sectional survey will be conducted to capture data at a single point in time, enabling the study to identify current practices and their immediate impacts. The research design is structured to facilitate the assessment of both governance structures and financial literacy levels across diverse SMEs, ensuring generalizability and relevance of findings to the broader SME sector.

#### **3.2 Population and Sample, and Sampling Design**

The population for this study comprises small and medium-sized enterprises (SMEs) across various industries. SMEs with formal governance structures and accessible financial records form the target population. A sample of 400 SMEs will be drawn using stratified random sampling to ensure representation across sectors, firm sizes, and geographical locations. Stratification will involve categorizing SMEs based on industry and annual turnover to capture diverse governance and financial literacy practices. Following stratification, random sampling will be employed to minimize bias and enhance the reliability of results. The sample size is determined based on statistical considerations to ensure sufficient power for data analysis. This sampling design ensures that the study captures the heterogeneity of SMEs, allowing for robust conclusions about governance and financial literacy practices across different contexts.

### **3.3 Nature and Sources of Data, and Instrument of Data Collection**

This research relies on primary data sources. Primary data will be collected through structured questionnaires and interviews with SME owners, managers, and board members to assess governance practices and financial literacy levels. Secondary data will include financial reports, industry publications, and government statistics to provide context and validate primary findings. The questionnaire will include both closed-ended and Likert-scale questions, designed to capture quantitative data on governance practices, financial decision-making, and SME performance. Interviews will offer qualitative insights into challenges and perceptions regarding governance and financial literacy. The data collection process is designed to be systematic and comprehensive, ensuring accuracy and reliability of findings.

### **3.4 Methods of Analysis**

Quantitative data will be analyzed using statistical methods, including descriptive statistics, correlation analysis, and regression analysis, to examine relationships between governance, financial literacy, and SME performance. Descriptive statistics will provide a summary of governance practices and financial literacy levels, while correlation analysis will assess the strength and direction of relationships between variables. Multiple regression models will be used to identify the influence of governance and financial literacy on SME performance, controlling for other factors such as firm size and industry. Qualitative data from interviews will be analyzed using thematic analysis to identify recurring themes and contextual insights. These methods will provide a nuanced understanding of the dynamics between corporate governance, financial literacy, and SME performance.

These data analysis techniques can be used independently or in combination with the other to help business leaders and decision-makers acquire business insights from different data types.

### **Descriptive Statistical**

The basic features of a population or a sample in a study can be described by using descriptive analysis. This analysis provides simple summaries about the sample as well as

the measures as it transforms the unanalyzed data into a simpler pattern which is easier for interpretation and understanding purposes. Descriptive analysis summarizes the collected information in quantitative form. The statistics computed include frequency distribution and percentages. For this study, descriptive data analytical approaches were employed to analyze the variables related to SMEs.

Besides the statistical tools such as mean, standard deviation had been used. Short descriptions of the statistical tools are presented below:

### **i) Arithmetic Mean**

The arithmetic mean or simple mean of set of observations is the sum of all the observation divided by the number of observations. It is the best value, which represents the whole group. It is also called arithmetic average or simply average of a variable. Arithmetic mean of a series is given by:

$$\text{Mean } (\bar{X}) = \frac{\sum X}{n}$$

Where,

$$\sum X = \text{Sum of the variables 'x'}$$

$$n = \text{No. of Observation}$$

### **ii) Standard Deviation**

Standard deviation is defined as the positive square root of the mean as square of the deviation takes from the arithmetic mean. It indicates the ranges and size of deviance from the middle or mean. The standard deviation is the absolute measure of dispersion which satisfies most of the requisites of a good measure of dispersion. Higher the standard deviation Higher will be the variability and vice versa. In other words, it helps to analyze the quality of data regarding its variability. It is calculated as:

$$\text{Standard Deviation (SD)} = \sqrt{\frac{\sum (X - \bar{X})^2}{n}}$$

### **iii) Co-efficient of Variation**

Standard deviation is the absolute measure of dispersion. The relative measure of dispersing based on the standard deviation is known as the measurement of coefficient of standard deviation. Variance is the square of SD. It gets rid of the units that succeed the SD Value. However, a better relative measure would be the coefficient of variation. CV is capable to compare two variables independently in terms of their variability. The formula to calculate CV is given by:

$$\text{Coefficient of Variation (CV)} = \frac{\text{S. D.}}{\bar{X}} \times 100\%$$

## **Inferential Analysis**

### **i) Correlation Coefficient**

Correlation coefficient is defined as the association between the independent variable and dependent variable. It is a method of determining the degree of relationship between these two variables. If the two variables are so related, change in the value of independent variable causes the change in the value of dependent variable. Correlation Coefficient is given by:

$$\text{Correlation Coefficient (r)} = \frac{n\sum xy - \sum x \sum y}{\sqrt{n\sum x^2 - (\sum x)^2} \sqrt{n\sum y^2 - (\sum y)^2}}$$

Where,

r = coefficient of correlation

$\sum XY$  = Sum of product of two series.

$\sum X^2$  = Sum of squared in X series

$\sum Y^2$  = Sum of squared in Y series

n = number of years

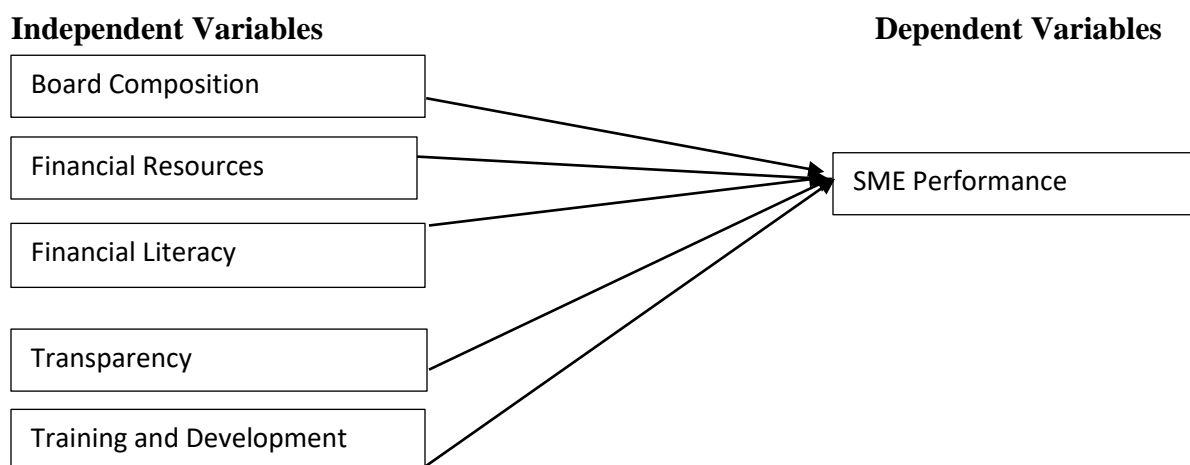
The value of r lies between -1 and +1. Negative value means negative relationship among the dependent and independent variables, whereas positive value means positive relationship. The extreme points -1 and +1 show perfect relationship whereas 0 values show no relationship exists between the variables.

## **ii) Multiple Regression analysis**

Multiple Linear Regression model consists of one dependent variable and at least two independent variables. It is an extension of simple linear regression. It is used when we want to predict the value of a variable based on the value of two or more other variables. It is the determination of statistical relationship between two or more variables. In simple, under regression two variables are used. One variable (independent) is the cause of the behavior of another one (dependent). Besides, this model can explain the relationship between each independent variable and dependent variable as the coefficient indicates the average value change in dependent variable when there is a unit change in the independent variable (Hair et al., 2007). The R-squared or commonly known as the coefficient of determination indicates the proportion of the variation of the dependent variable that can be explained by the variation of the independent variables.

## **3.5 Research Framework and Definition of Variables**

The research framework integrates corporate governance, financial literacy, and SME performance into a conceptual model. Independent variables include board composition, financial literacy of management, transparency, access to finance, and training programs. The dependent variable is SME performance, measured by profitability, growth, and operational efficiency. Moderating variables such as industry type and firm size are considered to understand their impact on the primary relationships. Corporate governance is defined as the structures and processes for decision-making, accountability, and transparency within an SME. Financial literacy refers to the ability to understand and effectively use financial knowledge in decision-making. SME performance encompasses financial outcomes, growth metrics, and operational success. This framework provides a structured approach to examining how governance and financial literacy interact to influence SME outcomes.



*Figure 1: Conceptual Framework*

Source: *Thapa, (2020)*

## **Dependent Variable**

### **SME Performance**

SME performance serves as the dependent variable, reflecting outcomes such as profitability, growth, sustainability, and operational efficiency. This variable measures how effectively the business achieves its objectives and how well it adapts to changing market dynamics under the influence of corporate governance and financial literacy practices.

## **Independent Variables**

### **Board Composition**

Refers to the structure and diversity of the board of directors in an SME. It includes factors such as the number of members, expertise, independence, and gender diversity. Effective board composition ensures better governance by providing strategic guidance and oversight, which impacts SME performance.

### **Financial Literacy**

DeSource: s the knowledge and capability of SME owners or managers to understand financial principles and make informed decisions. This variable directly influences the firm's ability to manage cash flow, assess investment opportunities, and secure financing.

**Financial Resources**

Represents the SME's ability to secure loans, investments, and other funding sources. Effective corporate governance practices and financial literacy often enhance this access by increasing credibility and transparency, which, in turn, impacts business performance.

**Transparency**

Measures the degree to which SMEs disclose financial and operational information to stakeholders and maintain ethical business practices. Transparency and accountability foster trust and reduce risks, contributing to better financial outcomes.

**Training and Development**

Refers to the initiatives undertaken to enhance employees' and managers' skills in governance and financial management. These programs equip stakeholders with tools to implement governance frameworks and improve decision-making, thereby influencing overall SME performance.

## CHAPTER IV

### RESULTS AND DISCUSSION

#### 4.1 Results

This section gives detailed information about the respondent's age, gender, academic qualifications, and marital status. It gives the detail analysis and interpretation of primary data collection through questionnaire distributed to the owner of SMEs. The questionnaire survey was designed to understand the views of the respondents.

##### 4.1.1 Data analysis of respondents

In total 384 respondents were selected for this survey and the questionnaire was distributed to them through either personal visit or through e-mail. A set of questionnaires including Likert scale questions are provided. Among them, only 384 respondents give their response to the questionnaire. The respondents were from Kathmandu Valley.

##### Gender Profile

Gender is an important variable in expressing and giving the response to the problem. The gender of the respondents is presented in table 2.

Table 2

*Gender Profile of Respondents*

Gender	Frequency	Percent
Male	236	61%
Female	148	39%
Total	384	100%

Source: . Opinion Survey, 2024

Table 2 shows the frequency distribution by gender. Out of 384 responses, around 61% response is received from males and 39% responses is received from female respectively, which shows that number of male respondents is more than female respondents.

### Age Profile

Age of the respondents is one of the characteristics in understanding the views about the particular problems. The age group of the respondents is shown in the table 2.

Table 3

#### *Age Profile of Respondents*

Age	Frequency	Percent
Below 30	50	12.99%
30-40	220	57.14%
41-50	74	19.22%
51-60	36	9.35%
Above 61	4	1.30%
Total	384	100%

Source: . Opinion Survey, 2024

Five categories were used to gather the information about age group of the respondents. Out of the responses received from investors, the majority of responses around 57.14% of responses were received from people of age group 30-40 years followed by age group of below 30 years. Responses received from people above 61 years are even less than 1.30% from the sample.

### Education Level Profile

The Education level of the respondents is categorized into four groups. The frequency distribution and percent composition of respondents' academic qualification level is depicted in Table 3.

Table 4

#### *Education Level Profile of Respondents*

Education	Frequency	Percent
SLC	18	5%
Intermediate	22	6%
Bachelor	179	47%
Master's and above	166	42%
Total	384	100%

Source: . Opinion Survey, 2024

Table 3 shows that around 47 percent of the respondents of the survey have a bachelor's degree followed by the respondents having master and above, which comprise around 42% of total respondents. In fact, around 90% of respondents possess either bachelor's degree or master's degree. In terms of educational level, university graduates and postgraduates dominate the sample. Responses from SLC are 5%, Intermediate students is 6% respectively.

### **Income Level Profile**

The frequency distribution and percent composition of respondents' Income Level is presented in Table 5.

Table 5

#### *Monthly Income Profile of Respondents*

Income Level	Frequency	Percent
Below 20,000	19	26%
20,001 to 50,000	12	13%
50,001 to 80, 000	44	22%
80,001 to Above	134	39%
Total	384	100%

Source: . Opinion Survey, 2024

Table 5 shows the frequency distribution of respondents by Monthly Income. Big portion of people engaged in investment have average level of income as shown in the table above. People having income below Rs.20, 000 and above Rs. 80,000 is seen investing more than other people do.

### **4.1.2 Descriptive Analysis**

#### **Board Composition**

Board composition refers to the structure and diversity of a company's board of directors, which includes members with varied expertise. A well-structured board actively participates in decision-making, ensuring effective corporate governance and risk

management. The diverse perspectives of board members contribute to the company's strategic direction, enhancing innovation and overall performance. By monitoring the company's performance and providing constructive feedback, the board fosters a culture of accountability and continuous improvement. In this study, descriptive statistics reveal the perceived effectiveness of board composition in influencing SME performance.

Table 6

*Descriptive statistics of Board Composition*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The board of directors has a diverse range of expertise that benefits the company's performance.	4.21	0.87	20.66
The board members actively participate in decision-making processes within the company.	4.15	0.89	21.45
The board's composition contributes positively to the company's strategic direction.	4.10	0.92	22.44
The board regularly monitors the performance of the company and provides constructive feedback.	4.05	0.95	23.46
The company's board composition ensures effective risk management and corporate governance.	4.18	0.91	21.77

Table 6 highlights the descriptive statistics for board composition in relation to SME performance. The mean values indicate a generally high level of agreement among respondents regarding the effectiveness of their boards, with all items scoring above 4.00 on a 5-point scale. This suggests that respondents perceive their boards as playing a positive role in the organization's governance and strategic direction.

The standard deviation values, ranging from 0.87 to 0.95, signify a moderate level of variability in responses. The highest variability is observed in the statement about regular monitoring and constructive feedback ( $SD = 0.95$ ), which could indicate differing experiences or perceptions regarding board oversight practices.

The coefficient of variation (CV) provides a relative measure of dispersion as a percentage of the mean. It ranges from 20.66% to 23.46%, with the lowest variability in responses for the statement about diverse expertise ( $CV = 20.66\%$ ). This suggests that respondents largely agree on the value of diverse expertise in enhancing company performance. Conversely, the highest variability ( $CV = 23.46\%$ ) pertains to the board's role in monitoring and feedback, implying mixed perceptions about this specific function.

Overall, the table underscores the importance of board composition in fostering strategic direction, effective governance, and risk management within SMEs.

### **Financial Literacy**

Financial literacy encompasses the knowledge and understanding of financial principles by management and employees. It enables informed decision-making and efficient financial resource management. The study highlights the role of financial literacy in promoting better business performance, supported by training programs that enhance employees' financial acumen. Management's ability to interpret financial statements directly impacts strategic planning and growth. Descriptive analysis confirms that high financial literacy among staff correlates with improved financial decision-making and organizational outcomes.

Table 7

#### *Descriptive statistics of Financial Literacy*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The management team has a good understanding of financial statements and reports.	4.12	0.88	21.36
Financial literacy programs offered to employees contribute to better financial decision-making within the company.	4.08	0.90	22.06
The management team uses financial knowledge to make informed business decisions.	4.20	0.85	20.24
The company promotes financial literacy among its staff to improve overall business performance.	4.15	0.86	20.72
Financially literate employees are better able to manage the company's finances and contribute to its growth.	4.18	0.87	20.81

Table 7 illustrates the descriptive statistics for financial literacy and its role in SME performance. The mean scores, ranging from 4.08 to 4.20, reflect a high level of agreement among respondents about the importance of financial literacy within the company. These findings indicate that financial literacy is perceived as a critical factor for effective financial decision-making, strategic management, and overall business growth.

The standard deviations, varying between 0.85 and 0.90, suggest a moderate degree of variation in the responses. The smallest variation is seen in the management team's use of financial knowledge for decision-making (SD = 0.85), signifying a consistent acknowledgment of its importance. Conversely, slightly higher variability is observed in responses regarding financial literacy programs for employees (SD = 0.90).

The coefficient of variation (CV) offers insights into the relative variability of responses. It ranges from 20.24% to 22.06%, with the lowest CV for management's informed decision-making, indicating strong consensus. The highest CV is observed for financial literacy programs, which may reflect varying levels of implementation or awareness across SMEs.

Overall, the data underscores the essential role of financial literacy in enhancing informed decision-making, financial management, and business performance, with room for consistent application across organizations.

### **Financial Resources**

Financial resources represent the capital available to a company to support operations, innovation, and expansion. Adequate financial resources ensure stability and growth by enabling investments in new projects and meeting daily operational needs. Effective allocation and utilization of these resources are crucial for achieving strategic objectives. The study's findings suggest that respondents perceive sufficient financial resources as a key factor in driving business performance, innovation, and competitive advantage for SMEs.

Table 8

#### *Descriptive statistics of Financial Resources*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The company has adequate financial resources to support its operations and growth.	4.22	0.83	19.67
The company effectively utilizes its financial resources to improve business performance.	4.16	0.88	21.15
The availability of financial resources influences the company's ability to innovate and expand.	4.19	0.84	20.05

The management effectively allocates financial resources to meet the company's strategic goals.	4.20	0.85	20.24
The company's financial resources are sufficient to meet its day-to-day operational needs.	4.17	0.86	20.62

Table 8 presents the descriptive statistics for financial resources, emphasizing their role in supporting SME operations and growth. The mean scores, which range from 4.16 to 4.22, indicate a strong agreement among respondents regarding the adequacy and effective utilization of financial resources in their companies. The highest mean (4.22) highlights the perception that companies generally have sufficient financial resources to support operations and growth. The standard deviations, between 0.83 and 0.88, reveal moderate variability in responses. The lowest standard deviation (0.83) is observed for the adequacy of financial resources, indicating consistent agreement on this aspect. Meanwhile, slightly higher variability ( $SD = 0.88$ ) pertains to the effective utilization of resources, suggesting some variation in how well companies leverage their finances. The coefficient of variation (CV) ranges from 19.67% to 21.15%, reflecting relatively low relative variability. The lowest CV (19.67%) for resource adequacy underscores a strong consensus, while the slightly higher CV for effective utilization indicates some divergence in perspectives.

Overall, these results demonstrate that financial resources are critical to business operations, innovation, and strategic alignment, though there is room for improvement in their utilization and allocation to maximize performance.

### **Transparency**

Transparency in an organization pertains to openness in financial reporting and decision-making. Transparent practices enhance trust among stakeholders, leading to stronger relationships and long-term success. This study examines how the regular disclosure of information and honest communication positively influence employee and customer loyalty. Descriptive results indicate that respondents value transparency as a critical element in improving overall performance and maintaining ethical standards within SMEs.

Table 9

*Descriptive statistics of Transparency*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The company maintains a high level of transparency in its financial reporting and business operations.	4.18	0.89	21.29
The management shares important financial information with stakeholders in a clear and honest manner.	4.14	0.90	21.74
Transparency in decision-making helps improve the trust and loyalty of employees and customers.	4.21	0.85	20.19
The company regularly discloses information about its performance to external stakeholders.	4.16	0.87	20.91
Transparent practices within the company lead to better long-term business performance.	4.19	0.86	20.53

Table 9 provides descriptive statistics for transparency, reflecting its importance in financial reporting and business operations. The mean values, ranging from 4.14 to 4.21, indicate strong agreement among respondents on the significance of transparent practices. The highest mean (4.21) relates to how transparency in decision-making fosters trust and loyalty, underscoring its role in strengthening relationships with employees and customers.

Standard deviations range from 0.85 to 0.90, suggesting moderate variability in responses. The lowest standard deviation (0.85) for transparency in decision-making demonstrates relatively consistent agreement, while slightly higher variability (SD = 0.90) pertains to the clarity and honesty of financial information shared with stakeholders.

The coefficient of variation (CV) values, between 20.19% and 21.74%, reflect low relative variability. The lowest CV (20.19%) is observed for decision-making transparency, indicating a high level of consensus. Slightly higher CV values for other aspects, such as financial reporting and stakeholder communication, suggest some diversity in perceptions.

These findings highlight the pivotal role of transparency in building trust, enhancing stakeholder relationships, and improving long-term business performance. Clear and

honest communication of financial and operational information fosters accountability and supports sustainable growth.

## Training and Development

Training and development programs aim to improve employees' skills, fostering a more capable and adaptable workforce. Organizations that invest in such initiatives enhance individual job performance, ultimately driving organizational success. This study highlights the link between employee development and company performance, with respondents reporting positive impacts from effective training programs. Evaluating the effectiveness of these programs ensures they remain aligned with strategic goals.

Table 10

### *Descriptive statistics of Training and Development*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The company invests in training and development programs to improve employee skills.	4.25	0.82	19.29
Employees are given opportunities to attend training sessions that enhance their job performance.	4.22	0.84	19.91
The training and development programs positively impact the overall performance of the company.	4.20	0.86	20.48
The company regularly evaluates the effectiveness of its training and development programs.	4.15	0.89	21.45
There is a clear link between employee development and the company's improved performance.	4.19	0.88	20.99

Table 10 presents descriptive statistics for training and development, underscoring its critical role in enhancing employee and company performance. The mean scores range from 4.15 to 4.25, indicating a strong agreement among respondents on the importance of training initiatives. The highest mean (4.25) pertains to the company's investment in training programs, suggesting substantial emphasis on skill development.

The standard deviations, between 0.82 and 0.89, reveal consistent yet slightly varying responses. The lowest variability (SD = 0.82) is associated with the company's investment in training, reflecting broad consensus. Conversely, slightly higher variability (SD = 0.89) is seen for the evaluation of training programs, indicating diverse views on this aspect.

Coefficient of variation (CV) values range from 19.29% to 21.45%, signifying low relative variability. The lowest CV (19.29%) for investment in training highlights a strong agreement on its importance, while a higher CV (21.45%) for program evaluation suggests mixed perceptions about its effectiveness.

Overall, these findings emphasize the significance of training and development in improving employee performance and achieving strategic goals. Regular evaluation of these programs can enhance their impact, further aligning employee growth with organizational success.

### **SME Performance**

SME performance evaluates the company's success in achieving financial targets, growth, customer satisfaction, and market position. A strong SME performance reflects the organization's ability to meet objectives and contribute to the local economy. This study explores key performance metrics, revealing respondents' perception of sustained profitability and competitiveness in the market. Positive performance outcomes are attributed to effective management and strategic planning.

Table 11

#### *Descriptive statistics of SME Performance*

Item	Mean	Standard Deviation	Coefficient of Variation (%)
The company has consistently achieved its financial targets and objectives over the past year.	4.22	0.85	20.14
The business has experienced growth in terms of revenue and profitability in the last few years.	4.18	0.88	21.05
The company effectively meets its customers' needs and expectations.	4.20	0.84	20.00
The company has a strong competitive position in its market or industry.	4.19	0.87	20.76
The overall performance of the SME has positively contributed to the local economy.	4.21	0.86	20.43

Table 11 highlights the performance metrics of SMEs, emphasizing their financial and operational success. The mean scores range from 4.18 to 4.22, reflecting a strong consensus on the positive performance of SMEs across key areas. The highest mean score (4.22) pertains to achieving financial targets, signifying a consistent track record of financial stability. Standard deviation values fall between 0.84 and 0.88, indicating

relatively low variability in responses. The lowest variability ( $SD = 0.84$ ) is associated with meeting customer needs, showcasing a strong agreement on the company's customer-centric approach. Slightly higher variability ( $SD = 0.88$ ) is observed for revenue and profitability growth, suggesting some differences in respondent perceptions. The coefficient of variation (CV) values range from 20.00% to 21.05%, denoting low relative variability. The lowest CV (20.00%) for customer satisfaction underscores its reliability as a performance indicator, while slightly higher CVs for other items reflect broader views on financial growth and market competitiveness.

These results collectively affirm that SMEs demonstrate robust financial performance, customer satisfaction, and market competitiveness, contributing significantly to local economic development. The findings underscore the importance of maintaining these strengths to sustain growth and achieve strategic objectives.

#### 4.1.3 Descriptive Statistics

Descriptive statistics summarize data through measures like mean, standard deviation, and range. They provide an overview of respondents' perceptions across variables such as board composition, financial literacy, and SME performance. In this study, means indicate general trends in responses, while standard deviations reveal the variability of opinions. This analysis forms the foundation for deeper insights into the data, identifying strengths and areas for improvement within the studied SMEs.

Table 12

##### *Descriptive Statistics*

	N	Minimum	Maximum	Mean	Std. Deviation
Board Composition	384	1.0	3.6	2.272	.5585
Financial Literacy	384	1.0	3.4	2.312	.6036
Financial Resources	384	1.6	4.2	2.802	.6496
Transparency	384	1.0	4.0	2.114	.6077
Training and Development	384	1.0	4.0	2.114	.6077
SME Performance	384	1.0	3.4	2.315	.5138
Valid N (listwise)	384				

Table 12 presents the descriptive statistics for six key variables: Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development, and

SME Performance. The data is based on 384 valid observations. Board Composition has a mean of 2.272 with a standard deviation of 0.5585, suggesting moderate variation around the average score. Financial Literacy has a slightly higher mean of 2.312 and a larger standard deviation (0.6036), indicating greater variability in responses. Financial Resources has the highest mean value of 2.802 and a standard deviation of 0.6496, signifying its relatively strong presence in the SMEs studied and the most considerable variation among the variables. Both Transparency and Training and Development share identical means (2.114) and standard deviations (0.6077), indicating a consistent level of importance and variability. SME Performance shows a mean of 2.315 with a standard deviation of 0.5138, indicating slightly better than average performance with less variation compared to other factors.

#### 4.1.4 Correlation Analysis

Correlation analysis examines the relationships between variables, showing how changes in one factor might relate to another. This study uses correlation coefficients to measure the strength and direction of relationships, such as between financial literacy and SME performance. Results highlight significant positive correlations, suggesting that improvements in certain variables, like training and development, can enhance SME performance.

Table 13

#### *Correlation analysis*

	BC	FL	FR	TRA	T&D	SMEP
BC	1					
FL	.624**	1				
FR	.376**	.498**	1			
TRA	.512**	.430**	.396**	1		
T&D	.512**	.430**	.396**	1.000**	1	
SMEP	.356**	.308**	.555**	.576**	.576**	1

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Table 13 presents the correlation analysis among the variables: Board Composition, Financial Literacy, Financial Resources, Transparency, Training and Development, and SME Performance. The analysis indicates statistically significant relationships at the 0.01

level. Board Composition shows moderate positive correlations with Financial Literacy ( $r=0.624$ ), Transparency ( $r=0.512$ ), and SME Performance ( $r=0.356$ ). This suggests that a diverse and effective board positively influences financial understanding, operational transparency, and performance.

Financial Literacy is moderately correlated with Financial Resources ( $r=0.498$ ) and SME Performance ( $r=0.308$ ), indicating its role in managing resources and influencing outcomes. Financial Resources has the strongest correlation with SME Performance ( $r=0.555$ ), emphasizing its critical importance in driving performance. Transparency and Training and Development both exhibit identical and strong correlations with SME Performance ( $r=0.576$ ), highlighting their equivalent and significant influence. The analysis underscores that Financial Resources, Transparency, and Training and Development are the strongest contributors to SME Performance, with Board Composition and Financial Literacy also playing important, albeit lesser, roles. These correlations provide insights into how these factors interrelate and impact overall SME success.

#### **4.1.5 Regression Analysis**

Regression analysis assesses the impact of independent variables (e.g., financial literacy, transparency) on dependent variables (e.g., SME performance). It quantifies the extent to which these factors influence outcomes, offering predictive insights. In this study, regression models provide evidence of key determinants of SME success, guiding strategic priorities. Coefficients represent the strength of each variable's impact on performance metrics.

#### **ANOVA**

ANOVA (Analysis of Variance) tests whether there are significant differences between group means in a dataset. In this study, it determines if variations in factors like board composition significantly impact SME performance. Results identify which variables have the most substantial influence, helping prioritize resource allocation for improvement.

Table 14

*ANOVA variance of Variables*

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.076	3	15.692	110.338	.000b
	Residual	54.042	380	.142		
	Total	101.118	383			

a. Dependent Variable: SME Performance

b. Predictors: (Constant), Training and Development , Financial Resources, Financial Literacy

Table 14 presents the ANOVA results for the regression analysis with SME Performance as the dependent variable and predictors including Training and Development, Financial Resources, Board Composition, and Financial Literacy. The total sum of squares is 101.118, representing the total variance in SME Performance. Of this, 47.076 (regression sum of squares) is explained by the predictors, while 54.042 (residual sum of squares) is unexplained.

The F-statistic of 82.980, with a significance level of .000, indicates that the regression model is highly significant, meaning the predictors collectively have a statistically significant impact on SME Performance.

### **Model Summary**

The model summary presents metrics like R-squared and adjusted R-squared to evaluate the fit of the regression model. These statistics indicate how well the independent variables explain variations in SME performance. A high R-squared value in this study confirms that the chosen factors are robust predictors of organizational success.

Table 15

*Model summary*

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics R Square Change	F Change	df1	df2	Sig. F Change
1	.682a	.466	.461	.3771	.466	110.338	3	380	.000

a. Predictors: (Constant), Training and Development , Financial Resources, Financial Literacy

Table 15 presents the model summary for the relationship between predictors (Training and Development, Financial Resources, Board Composition, and Financial Literacy) and the dependent variable. The R value of 0.683 indicates a strong positive correlation. An R

Square value of 0.467 implies that 46.7% of the variation in the dependent variable is explained by the predictors. The Adjusted R Square (0.461) accounts for model complexity, confirming a robust fit. The standard error of the estimate (0.3771) reflects the average deviation of observed values from the predicted ones. The significant F Change ( $p = .000$ ) confirms the predictors' overall contribution to the model's explanatory power.

### Coefficient

Coefficients in regression analysis quantify the relationship between independent variables and the dependent variable. They indicate how much a unit change in a predictor (e.g., financial literacy) impacts SME performance, holding other variables constant. In this study, significant coefficients identify actionable insights, helping SMEs focus on areas with the highest potential for improvement.

Table 16

#### *Regression analysis*

Model	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1 (Constant)	0.732	0.101		7.222	0.000
BC	0.046	0.047	0.050	0.974	0.331
FL	-0.104	0.044	0.122	2.363	0.019
FR	0.336	0.035	0.425	9.552	0.000
TRA	0.368	0.038	0.435	9.607	0.000

Table 16 presents the coefficients of the regression model with SME Performance as the dependent variable and Board Composition, Financial Literacy, Financial Resources, and Training and Development as predictors. The constant value is 0.732, which represents the baseline level of SME Performance when all predictors are zero. Board Composition has a positive but statistically insignificant impact ( $B=0.046$ ,  $p=0.331$ ).

= 0.331,  $p=0.331$ ), indicating that while it contributes positively, its influence on SME Performance is minimal within this model.

Financial Literacy shows a negative and statistically significant impact ( $B=-0.104$ ,  $p=0.019$ ), suggesting that lower levels of financial literacy are associated with reduced SME Performance, or there may be complex dynamics warranting further exploration. Financial Resources has a substantial positive and statistically significant effect ( $B=0.336$ ,  $p<0.001$ ). This implies that better financial resource management significantly enhances SME Performance, emphasizing its critical role. Training and Development demonstrates the highest positive impact among the predictors ( $B=0.368$ ,  $p<0.001$ ), highlighting that investments in employee development substantially drive SME Performance. Overall, the model indicates that Training and Development and Financial Resources are the most significant contributors to SME Performance, while the impact of Financial Literacy and Board Composition is less pronounced.

#### **4.2 Discussion**

The regression model highlights key predictors of SME Performance, namely Board Composition, Financial Literacy, Financial Resources, and Training and Development, revealing varied impacts. The constant value of 0.732 signifies the baseline SME Performance level when all predictors are zero. Board Composition exhibits a positive but statistically insignificant effect ( $B=0.046$ ,  $p=0.331$ ), indicating its limited contribution within this model. This finding aligns with studies like Jackson and Moore (2018) and Martinez and Santos (2018), which suggest that governance practices can enhance performance, but smaller SMEs face challenges in adopting formal structures due to cost and complexity barriers. Additionally, Ahmed and Ali (2018) highlight that board diversity promotes innovation and corporate reputation but faces cultural and institutional limitations. Conversely, Financial Literacy demonstrates a negative and statistically significant impact ( $B=-0.104$ ,  $p=0.019$ ), suggesting that insufficient financial literacy may hinder SME decision-making and performance. This contrasts with findings from studies such as Brown and Miller (2019) and Lopez and Hernandez (2020), which

emphasize the positive role of financial literacy in improving credit access, cost management, and profitability. The negative association in the model could reflect region-specific challenges, such as inadequate financial education or misapplication of financial concepts, as Source: d by Carter and Davies (2017).

Financial Resources show a strong positive and statistically significant impact on SME Performance ( $B=0.336$ ,  $p<0.001$ ), underlining the importance of resource availability in driving growth and stability. Studies like Nguyen and Le (2019) and Lee and Wang (2019) similarly highlight effective financial resource management as crucial for mitigating risks and fostering sustainability. Training and Development emerges as the strongest predictor ( $B=0.368$ ,  $p<0.001$ ), underscoring its critical role in enhancing employee skills and organizational performance. This aligns with findings by Singh and Yadav (2021) and Kim and Park (2021), which demonstrate how structured training programs boost productivity and resilience.

Overall, the model and literature converge on the significance of Financial Resources and Training and Development in SME success, while the mixed effects of governance and financial literacy reflect contextual influences. Future research should explore these dynamics further, focusing on region-specific challenges in governance and financial education while emphasizing the universal importance of resource allocation and employee development for sustained SME performance.

## CHAPTER V

### SUMMARY AND CONCLUSION

#### 5.1 Summary

Small and Medium Enterprises (SMEs) play a pivotal role in fostering economic development and innovation, especially in emerging economies. However, their performance and sustainability are significantly influenced by internal factors such as corporate governance and financial literacy. Corporate governance ensures accountability, strategic direction, and risk management, while financial literacy equips decision-makers with the knowledge to make informed choices. This study explores the relationship between corporate governance, financial literacy, and SME performance, focusing on key dimensions such as board composition, financial resources, training and development, and transparency.

The study analyzed data collected from 384 SMEs using a structured questionnaire. Descriptive statistics, correlation analysis, and regression techniques were employed to evaluate the impact of corporate governance and financial literacy on SME performance. The variables studied included board composition, financial literacy, financial resources, transparency, training and development, and SME performance. The analysis focused on mean scores, standard deviations, coefficients of variation, and the significance of relationships between variables.

The study highlights the significant impact of corporate governance and financial literacy on SME performance. Among the factors examined, financial resources emerged as the most critical and variable, reflecting its central role in influencing performance. Training and development programs were also identified as a major driver of SME success, emphasizing the need for skill enhancement and capacity building. Transparency plays a crucial role in fostering trust and stakeholder loyalty, contributing positively to performance. While board composition and financial literacy had moderate effects, they remain essential for strategic decision-making and sustainable growth within SMEs. These findings underscore the multifaceted relationship between governance, literacy, and performance.

The findings underscore the critical role of corporate governance and financial literacy in enhancing SME performance. Effective training and development programs and robust financial resource management significantly contribute to better business outcomes. While board composition and financial literacy showed less pronounced effects, they remain important for strategic decision-making and sustainable growth. Additionally, transparency emerged as a vital element, fostering trust and loyalty among stakeholders.

## **5.2 Conclusion**

Corporate governance and financial literacy are indispensable for the success of SMEs. This study highlights the importance of investing in training programs, maintaining adequate financial resources, and promoting transparency to drive performance. Policymakers and SME managers should prioritize these areas to ensure long-term growth and competitiveness in an increasingly dynamic business environment.

This study has explored the crucial relationship between corporate governance, financial literacy, and the performance of Small and Medium Enterprises (SMEs), shedding light on how these factors influence the overall success and sustainability of businesses in emerging economies. The analysis underscores the importance of several key dimensions, such as board composition, financial literacy, financial resources, transparency, and training and development, all of which play a role in shaping the performance of SMEs.

The study found that financial resources emerged as the most significant and variable factor influencing SME performance. This emphasizes the need for SMEs to effectively manage their financial assets, as inadequate resources can severely limit growth opportunities and business sustainability. Transparency was also identified as a critical element, establishing trust and ensuring accountability in business operations, which is essential for long-term success and stakeholder confidence. Furthermore, the study highlighted that training and development programs are indispensable, not only for enhancing the skills and knowledge of employees but also for equipping decision-makers with the necessary tools to navigate an increasingly complex business environment.

Board composition and financial literacy, while showing moderate correlations with SME performance, remain important factors in shaping strategic direction and decision-making. A well-structured board can provide valuable insights and governance, helping

businesses align their operations with long-term objectives and adapt to market changes. Financial literacy, though slightly less influential than other factors, is still crucial, as it empowers entrepreneurs to make informed financial decisions, ensuring efficient resource allocation and risk management.

The regression analysis revealed that corporate governance and financial literacy significantly impact SME performance, with training and development, alongside financial resources, emerging as the most impactful predictors. This finding emphasizes the importance of investing in these areas to drive business success. The less pronounced effects of board composition and financial literacy do not diminish their importance but highlight the need for a balanced approach to governance and decision-making in SMEs.

Policymakers and SME managers should prioritize fostering strong corporate governance practices and promoting financial literacy, particularly through training programs that enhance the skills of decision-makers. Ensuring sufficient financial resources and maintaining transparency should also be central to SME strategies, as these elements are fundamental for building a competitive and resilient business. Furthermore, this study provides valuable insights for policymakers, advising them to implement policies that encourage transparency, improve access to financial resources, and support educational initiatives to enhance financial literacy.

Ultimately, the findings of this study suggest that a holistic approach to corporate governance, financial literacy, and resource management is essential for improving SME performance. By strengthening these areas, SMEs can build a more solid foundation for growth, innovation, and long-term sustainability, contributing significantly to economic development in emerging economies.

## **5.3 Implications**

### **5.3.1 Implications for Practice:**

The findings emphasize actionable measures for SMEs, including the implementation of robust training programs to enhance workforce skills and productivity. Prioritizing effective financial resource management is crucial for stability and growth, while promoting transparency can foster trust and stakeholder loyalty. Strategically composing

boards with diverse expertise ensures better decision-making, and enhancing financial literacy among managers equips SMEs to navigate financial challenges effectively. Policymakers and industry leaders should collaborate to create supportive frameworks and training initiatives, enabling SMEs to sustain competitiveness in dynamic business environments. These practical steps can directly contribute to improved performance and long-term success for SMEs.

1. **Strengthening Financial Resource Management:** SMEs should focus on improving their financial management practices to enhance their performance. Ensuring adequate financial resources, combined with effective budgeting, financial planning, and cash flow management, will enable businesses to adapt to market fluctuations and capitalize on growth opportunities. SME managers must prioritize sound financial strategies and seek ways to optimize resource allocation.
2. **Promoting Transparency and Accountability:** SMEs need to foster a culture of transparency in their operations. By ensuring clear communication, open financial reporting, and ethical decision-making, businesses can build trust among stakeholders, attract investors, and establish long-term partnerships. This will not only improve business reputation but also contribute to sustainability and accountability.
3. **Investing in Training and Development Programs:** Continuous investment in employee training and development is essential for equipping staff with the skills and knowledge needed to excel in a competitive market. SMEs should develop targeted training programs that focus on financial literacy, management skills, and industry-specific knowledge, ensuring that decision-makers are capable of making informed and strategic choices.
4. **Enhancing Board Composition and Governance Practices:** SMEs should prioritize the composition of their boards, ensuring diversity and a range of expertise. A well-rounded board can offer valuable strategic insights, enhance decision-making, and improve governance structures. SMEs should also implement clear governance frameworks to ensure accountability and effective management.

5. **Promoting Financial Literacy Among Entrepreneurs:** SME owners and managers must invest in improving their financial literacy to ensure they can make informed decisions about investments, budgeting, and managing financial risks. Policymakers can support this by offering financial literacy training programs tailored for SMEs, helping entrepreneurs navigate the complexities of business finance.

### **5.3.2 Implications for Future Research:**

Future research should delve deeper into sector-specific impacts of corporate governance and financial literacy to identify unique challenges and solutions for different industries. Longitudinal studies could provide insights into the long-term effects of these factors on SME performance. Exploring geographical variations in governance practices and financial literacy across regions or countries may uncover the influence of cultural and economic contexts. Additionally, the role of technological integration in governance and literacy offers a promising avenue for innovation-focused studies. Investigating stakeholder perceptions will provide a comprehensive understanding of how governance and literacy initiatives impact SME sustainability and stakeholder satisfaction.

1. **Exploring the Role of Technology in Financial Management:** Future research could explore the impact of digital tools and technologies, such as accounting software and financial management platforms, on SME performance. Understanding how technology can enhance financial management and decision-making could provide valuable insights into modernizing SME operations.
2. **Examining the Impact of External Factors:** Future studies could investigate the role of external factors, such as market conditions, regulatory changes, and economic crises, on the relationship between corporate governance, financial literacy, and SME performance. This would help provide a more comprehensive understanding of the challenges SMEs face in varying contexts.
3. **Longitudinal Studies on SME Performance:** Further research could conduct longitudinal studies to examine the long-term effects of corporate governance and

financial literacy on SME performance. This would allow for a better understanding of how these factors influence growth and sustainability over time, especially in dynamic economic environments.

4. **Investigating the Relationship Between Corporate Governance and Innovation:** Future research could explore how specific aspects of corporate governance, such as leadership style or decision-making processes, impact innovation within SMEs. This could help identify best practices for fostering innovation through effective governance, which is crucial for staying competitive in the market.
5. **Cross-Cultural Comparisons:** Future studies could explore the relationship between corporate governance, financial literacy, and SME performance across different cultural or regional contexts. Comparing SMEs in developed and emerging economies could provide valuable insights into the unique challenges and opportunities faced by businesses in different environments, offering practical solutions for diverse SME populations.

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## APPENDIX

### Questionnaire

Dear Sir,

I am MBS student at Shanker Dev Campus, Tribhuvan University. A research study is being conducted on the “**Corporate Governance and Financial Literacy in SMEs**” under for the partial fulfillment of Master’s degree.

In this context, I have prepared a set of questionnaire to seek your valuable opinion. I would also like to ensure you that the information provided by you will be kept confidential and will only be utilized for the study purpose.

I shall feel highly obliged if you kindly cooperate me in filling the questionnaire.

Thank you and best regards,

Yogesh Oad

Shanker Dev Campus

#### **1. Demographic Information**

**1.1 Name (Optional):**.....

**1.2 Gender** (*Please Tick your gender group*)

Male  Female

**1.3 Age** (*Please Tick your age group*)

Below 30 years  30 to 40 years  41 to 50 years  51 to 60 years

Above 61 years

**1.4 Education** (*Please Tick your education group*)

SLC  Intermediate  Bachelor  Masters and Above

**1.5 Income per month** (*Please Tick your service period*)

Below 20,000  20,001 to 50,000  50,001 to 80,000

80,001 to Above

## 2. Information Regarding Independent Variables

(Please indicate your agreement with each item by placing the tick mark (✓) in the rating value column.) 1= Strongly Agree, 2 = Agree, 3= Agree to Some Extent, 4 = Disagree, 5= Strongly Disagree

S. N.	Heading \ Statement	Rating value				
		1	2	3	4	5
<b>2.1</b>	<b>Board Composition</b>					
a)	The diverse expertise of the board of directors positively impacts the company's performance.					
b)	The active participation of board members in decision-making has improved the company's overall performance.					
c)	The board's composition contributes to the development of a strong strategic direction for the company.					
d)	The board's regular monitoring of the company's performance has led to improvements in business outcomes.					
e)	The composition of the board ensures effective risk management and governance, leading to better SME performance.					
<b>2.2</b>	<b>Financial Literacy</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
a)	The management's understanding of financial statements has contributed to the company's financial performance.					
b)	Financial literacy programs provided to employees have enhanced decision-making, thus improving overall SME performance.					
c)	The management's financial knowledge enables better business decisions, leading to a more successful company.					
d)	Promoting financial literacy among employees has positively impacted the business's financial performance.					
e)	Financially literate employees have played a role in enhancing the company's profitability and growth.					

<b>2.3</b>	<b>Financial Resources</b>					
a)	Adequate financial resources have been crucial in supporting the company's growth and operations.					
b)	Effective use of financial resources has directly contributed to improved business performance.					
c)	The availability of financial resources has allowed the company to innovate and expand, positively affecting performance.					
d)	The management's allocation of financial resources supports the company's strategic goals and enhances performance.					
e)	Sufficient financial resources ensure the company meets its operational needs, thereby maintaining smooth performance.					
<b>2.4</b>	<b>Transparency</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
a)	The company's transparency in financial reporting positively affects its performance and reputation.					
b)	Sharing financial information transparently with stakeholders has contributed to improved trust and company performance.					
c)	Transparent decision-making within the company enhances employee and customer loyalty, boosting performance.					
d)	Regular disclosure of company performance to external stakeholders has improved public perception and performance.					
e)	Transparent business practices have led to better long-term performance outcomes for the company.					
<b>2.5</b>	<b>Training and Development</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
a)	The company's investment in training and development programs has improved overall performance.					
b)	Employee access to training sessions has enhanced their job					

	performance, contributing to company success.					
c)	The positive impact of training and development programs is evident in the company's improved performance.					
d)	Regular evaluation of training and development programs ensures their effectiveness in boosting SME performance.					
e)	Employee development through training is linked to the company's enhanced performance and growth.					

### 3. Information Regarding Dependent Variables

(Please indicate your agreement with each item by placing the tick mark (✓) in the rating value column.) 1= Strongly Agree, 2 = Agree, 3= Agree to Some Extent,

4 = Disagree, 5= Strongly Disagree

S. N.	Heading \ Statement	Rating value				
		1	2	3	4	5
<b>3.1</b>	<b>SME Performance</b>					
a)	The company has consistently achieved its financial targets and objectives over the past year.					
b)	The business has experienced growth in terms of revenue and profitability in the last few years.					
c)	The company effectively meets its customers' needs and expectations.					
d)	The company has a strong competitive position in its market or industry.					
e)	The overall performance of the SME has positively contributed to the local economy.					

PAPER NAME

**CORPORATE GOVERNANCE AND FINANCIAL LITERACY IN SMALL AND MEDIUM ENTERPRISES (SMEs)**

AUTHOR

**Yogesh Wod**

WORD COUNT

**16605 Words**

CHARACTER COUNT

**106200 Characters**

PAGE COUNT

**60 Pages**

FILE SIZE

**89.6KB**

SUBMISSION DATE

**Jul 25, 2025 12:25 PM GMT+5:45**

REPORT DATE

**Jul 25, 2025 12:27 PM GMT+5:45**

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