

## **The Critical Role of Financial Literacy in Navigating Challenges Faced by Lebanese SMEs**

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### **ABSTRACT**

*SMEs are vital to the Lebanese economy, contributing significantly to employment, innovation, and regional development<sup>[1]</sup>. However, the persistent challenges posed by Lebanon's ongoing political instability, economic crisis, and financial volatility have disproportionately affected SMEs<sup>[2]</sup>. In this context, financial literacy emerges as a key factor that can empower SME owners to make informed decisions, access critical financing, manage risks, and ensure long-term growth and sustainability<sup>[3]</sup>.*

*This study investigates the critical role of financial literacy in helping Lebanese SMEs navigate these challenges. Using a quantitative approach, data were collected from a sample of 260 SME owners and managers. The research explores how financial literacy influences key business outcomes, such as access to finance, risk management, and strategic decision-making. The findings reveal that higher levels of financial literacy significantly enhance SMEs' ability to secure funding, implement effective risk management strategies, and sustain growth despite external economic pressures. Financially literate SMEs are better equipped to engage with financial institutions, diversify their financial portfolios, and mitigate the adverse effects of currency fluctuations and inflation.*

*The study concludes that promoting financial literacy among SME owners and managers should be a priority in Lebanon's economic recovery efforts. Targeted financial education programs, supported by government and financial institutions, could enhance SME resilience, reduce failure rates, and contribute to a more stable economic environment. This research highlights the need for comprehensive financial literacy initiatives that address the specific challenges faced by SMEs in Lebanon, ultimately enabling them to thrive in a complex and uncertain economic landscape.*

**Keywords:** Financial literacy, SME growth, risk management, access to finance, Lebanese SMEs

## **1. Introduction**

Small and medium-sized enterprises (SMEs) are the backbone of many economies, and in Lebanon, they represent over 90% of the country's total businesses<sup>[4]</sup>. SMEs contribute significantly to employment, local economic growth, and the social fabric of the communities in which they operate. However, Lebanese SMEs face a multitude of challenges stemming from the country's prolonged political instability, economic crisis, and financial uncertainty<sup>[5]</sup>. Over the past few years, the Lebanese economy has suffered from currency devaluation, hyperinflation, and a severe banking sector crisis, all of which have drastically affected the ability of SMEs to sustain operations and grow<sup>[6]</sup>. In this environment, financial literacy emerges as a key factor that can help these businesses navigate and mitigate these complex challenges.

Financial literacy, often defined as the ability to understand and use various financial skills, including personal financial management, budgeting, and investing, plays a crucial role in decision-making processes for business owners<sup>[7]</sup>. For SMEs, particularly those operating in volatile and uncertain environments like Lebanon, financial literacy is more than just a personal skill—it is a strategic asset. It enables business owners to manage cash flow effectively, understand financial risks, evaluate financing options, and make informed investment decisions. These capabilities are critical for survival, especially in the face of Lebanon's economic hardships, which include soaring inflation, difficulty in accessing external financing, and the depreciation of the Lebanese pound<sup>[8]</sup>.

In the specific context of SMEs, financial literacy not only helps business owners manage daily operations but also empowers them to plan for the future, optimize resource allocation, and respond agilely to external shocks. With Lebanon's SME sector severely impacted by factors such as limited access to finance, currency fluctuations, and an unstable banking system, enhancing the financial literacy of SME owners becomes a matter of urgent necessity. Financially literate business owners are better positioned to engage with banks and financial institutions, secure loans, manage debt effectively, and protect their businesses against market volatility<sup>[9]</sup>.

The impact of financial literacy on SME performance has been widely recognized in the literature, particularly in developing and crisis-prone economies. Studies have shown that businesses whose owners possess higher levels of financial literacy tend to have greater access to financing, lower risks of financial distress, and higher rates of survival and growth<sup>[10]</sup>. In Lebanon, where SMEs are struggling to adapt to an ever-changing economic landscape, financial

literacy can be the differentiating factor between business success and failure. Given the importance of SMEs to Lebanon's overall economy, understanding how financial literacy contributes to their resilience and growth is critical for policy-makers, financial institutions, and SME support organizations<sup>[11]</sup>.

This research focuses on examining the role of financial literacy in helping Lebanese SMEs navigate the challenges posed by the ongoing economic crisis. Specifically, the study explores how financial literacy influences SMEs' ability to access finance, manage risks, and foster sustainable growth. Using data collected from 260 SME owners and managers in Lebanon, the research aims to highlight the key areas where financial literacy plays a critical role in ensuring business success.

### **1.1. Problem Statement**

The Lebanese economy is facing one of its most severe crises, with SMEs bearing the brunt of the economic fallout. Limited access to finance, fluctuating currency rates, and declining consumer demand have put immense pressure on small businesses<sup>[12]</sup>. In such a challenging environment, financial literacy can be a critical tool for SME owners to navigate these complexities. This study seeks to address the question: To what extent does financial literacy impact the ability of Lebanese SMEs to overcome the financial and operational challenges they face?

### **1.2. Research Objectives**

The primary objective of this research is to assess the impact of financial literacy on the growth and resilience of Lebanese SMEs. The specific objectives include:

- Investigating the relationship between financial literacy and access to finance for SMEs in Lebanon.
- Examining how financial literacy affects the risk management practices of SME owners.
- Analyzing the overall contribution of financial literacy to the long-term sustainability and growth of SMEs in Lebanon.

### **1.3. Research Questions**

To achieve these objectives, the study addresses the following key research questions:

- How does financial literacy influence the ability of Lebanese SMEs to access finance, particularly in times of economic crisis?

- What role does financial literacy play in enhancing risk management practices among SME owners?
- In what ways does financial literacy contribute to the sustainability and growth of SMEs in a highly volatile economic environment like Lebanon?

#### **1.4. Hypotheses**

The study proposes the following hypotheses based on the literature:

- H1: Financial literacy has a significant positive effect on SME access to finance.
- H2: Financial literacy improves the risk management capabilities of SME owners.
- H3: Financial literacy contributes to the overall growth and sustainability of Lebanese SMEs.

### **2. Literature Review and Hypothesis Development**

In the context of small and medium-sized enterprises (SMEs), financial literacy has gained significant attention due to its critical role in influencing business decisions, particularly in environments characterized by economic uncertainty and financial instability<sup>[13]</sup>. This section explores existing literature on financial literacy, its role in the financial performance of SMEs, and how it affects access to finance and risk management. The review also discusses the unique challenges faced by Lebanese SMEs and the importance of financial education in addressing these challenges.

#### **2.1. Defining Financial Literacy in an SME Context**

Financial literacy is broadly defined as the ability to understand and use various financial concepts such as budgeting, investing, and managing debt<sup>[14]</sup>. For SMEs, financial literacy goes beyond basic financial knowledge—it encompasses the ability to make informed financial decisions that ensure long-term business sustainability. A financially literate SME owner can effectively interpret financial statements, assess profitability, manage cash flow, and plan for both short-term and long-term financial needs<sup>[15]</sup>.

Lusardi and Mitchell (2008) describe financial literacy as comprising three primary components<sup>[16]</sup>:

- Numeracy and basic financial concepts: The ability to perform basic arithmetic operations, understand interest rates, and comprehend financial statements.

- Risk and return knowledge: An understanding of the relationship between risk and potential returns, which is crucial for investment and financing decisions.
- Debt management skills: The ability to manage liabilities effectively, understand loan agreements, and avoid excessive debt.

For SME owners, these components are essential not only for daily operational decisions but also for strategic financial planning, especially in volatile markets such as Lebanon's<sup>[17]</sup>.

## **2.2. Financial Literacy and SME Performance**

Several studies have demonstrated that financial literacy has a direct impact on the performance of SMEs. Financially literate business owners are more likely to adopt sound financial practices, such as maintaining adequate liquidity, diversifying their investments, and making well-informed financing decisions. These practices are associated with improved business performance in terms of profitability, growth, and overall financial health<sup>[18]</sup>.

Research has shown that financial literacy training can significantly improve business outcomes for SMEs in developing countries by enhancing their financial management practices. SMEs that received such training experienced increased sales, higher profitability, and improved risk management compared to those that did not participate. Additionally, higher levels of financial literacy among SME owners were associated with conducting regular financial analyses, making more accurate financial forecasts, and building stronger relationships with financial institutions<sup>[19]</sup>.

Financial literacy also influences financial decision-making, such as choosing the appropriate financing structure. SMEs often face difficulties in accessing external finance due to poor financial knowledge, which prevents them from effectively communicating their financial needs to lenders<sup>[20]</sup>. As a result, SMEs with low financial literacy tend to rely more on informal financing sources, such as personal savings or borrowing from family and friends, which limits their growth potential.

## **2.3. Access to Finance and Financial Literacy**

Access to finance is one of the most significant challenges faced by SMEs, particularly in developing economies<sup>[21]</sup>. In Lebanon, this issue is exacerbated by political instability, currency devaluation, and a weakened banking sector, which makes it even more difficult for SMEs to secure loans. Financial literacy plays a crucial role in determining an SME's ability to access finance. A financially literate SME owner is better equipped to prepare financial statements,

create viable business plans, and present these to banks and other financial institutions, thus improving the chances of obtaining credit<sup>[22]</sup>.

Research indicates that higher levels of financial literacy increase the likelihood of SMEs securing external financing. SMEs with stronger financial literacy tend to diversify their funding sources and negotiate better loan terms. They also manage relationships with banks more effectively, making them more attractive borrowers. This is especially pertinent in Lebanon, where many SMEs face difficulties accessing traditional bank loans due to a lack of trust in financial institutions and the inability to meet strict collateral requirements<sup>[23]</sup>.

In developing economies, where financial markets are less developed, financial literacy helps SMEs navigate complex financial environments. It allows them to evaluate different financing options, whether through traditional bank loans, microfinance, or alternative funding mechanisms such as crowdfunding<sup>[24]</sup>. By understanding these options, financially literate SMEs can make more strategic decisions about how to finance their growth, manage debt, and avoid financial distress.

#### **2.4. Risk Management and Financial Literacy**

Risk management is another critical area where financial literacy has a profound impact on SMEs. In volatile economies, such as Lebanon's, SMEs face a variety of risks, including currency fluctuations, inflation, and changes in consumer demand. Financial literacy enables SME owners to identify, assess, and mitigate these risks by using appropriate financial tools and strategies<sup>[25]</sup>.

Research highlights that financially literate individuals are more effective at managing risks, particularly by diversifying their portfolios, maintaining adequate liquidity, and purchasing insurance. For SMEs, strong risk management is crucial for survival, especially in environments prone to external shocks<sup>[26]</sup>. In Lebanon, where political and economic instability generate significant uncertainties, financially literate business owners are better equipped to anticipate and respond to risks, reducing the likelihood of business failure<sup>[27]</sup>.

Effective risk management also involves understanding the costs and benefits of different financial instruments. For example, SMEs that are financially literate can use hedging strategies to protect themselves against currency fluctuations or inflation, which are critical concerns in Lebanon's highly volatile economy. Additionally, financial literacy allows business owners to assess the trade-offs between debt and equity financing, helping them choose the most appropriate financing structure for managing risk<sup>[28]</sup>.

## **2.5. Financial Literacy in Lebanon's SME Sector**

Lebanese SMEs operate in one of the most challenging economic environments in the world. The country has experienced political unrest, a financial crisis, and a devaluation of its currency, all of which have severely impacted SMEs' ability to operate effectively<sup>[29]</sup>. According to the Lebanese Ministry of Economy and Trade (2015), SMEs in Lebanon face significant barriers to growth, including limited access to credit, high inflation, and declining consumer demand. These challenges are exacerbated by the fact that many SME owners lack the financial literacy needed to navigate this complex environment<sup>[30]</sup>.

The importance of financial literacy in Lebanon's SME sector cannot be overstated. Financially literate SME owners are more likely to make strategic decisions that help them mitigate the adverse effects of economic instability. They are better positioned to engage with financial institutions, secure loans, manage risks, and adapt to changing market conditions. Moreover, financial literacy empowers business owners to make long-term plans, ensuring that their businesses can survive and thrive even in the face of ongoing economic challenges<sup>[31]</sup>.

Studies have shown that financial literacy in Lebanon remains low, particularly among SME owners who may not have received formal education in finance. A report by the World Bank (2021) emphasized the need for targeted financial literacy programs for SMEs in Lebanon, highlighting that such programs could improve financial inclusion, enhance business performance, and reduce the risks of insolvency. By equipping SME owners with the necessary financial skills, Lebanon can create a more resilient SME sector capable of contributing to economic recovery and growth<sup>[32]</sup>.

## **3. Methodology**

This study employs a comprehensive methodology to assess the impact of financial literacy on the growth and sustainability of small and medium-sized enterprises (SMEs) in Lebanon. Using a quantitative approach, the research examines how financial literacy influences SMEs' access to finance, risk management capabilities, and overall business performance. The focus on measurable data enables an exploration of the correlation between financial literacy and key business outcomes such as revenue growth, profitability, and risk mitigation.

A stratified random sampling technique was employed to ensure the sample was representative of SMEs across various sectors and geographic locations throughout Lebanon. Stratification by industry sector and business size helped capture a wide range of experiences from micro-businesses to larger SMEs. A total of 260 SME owners and managers were selected, with the sample size determined using the Yamane formula to achieve statistical significance at a 95% confidence level.



Data were collected through a structured questionnaire designed to capture information on financial literacy, access to finance, risk management practices, and business performance. The questionnaire was developed based on existing financial literacy frameworks and tailored to the Lebanese SME context, including sections on demographic information, financial literacy, access to finance, risk management, and business performance metrics. The questionnaire underwent pilot testing to ensure clarity and reliability before full distribution through a combination of online platforms and in-person interviews, ensuring participation despite the economic challenges in Lebanon.

The collected data were analyzed using descriptive statistics, correlation analysis, and multiple regression analysis through SPSS. Descriptive statistics summarized the general levels of financial literacy and business performance, while Pearson's correlation coefficient measured the strength and direction of relationships between financial literacy and SME outcomes. Multiple regression analysis tested the study's hypotheses by evaluating the impact of financial literacy on access to finance, risk management, and SME growth, controlling for factors like education level, industry, and business size.

The study adhered to strict ethical guidelines, ensuring participant confidentiality and voluntary participation, with all data anonymized. This rigorous methodology provides valuable insights into how financial literacy can help Lebanese SMEs navigate the current economic challenges, contributing to a more resilient SME sector.

#### **4. Results and Discussion**

This section presents the findings of the research, focusing on the relationship between financial literacy and the growth of SMEs in Lebanon. The results are discussed in the context of the hypotheses proposed earlier, exploring the implications of financial literacy for accessing finance, risk management, and overall business performance. The analysis aims to highlight the critical role that financial literacy plays in enabling Lebanese SMEs to navigate the myriad challenges posed by the current economic landscape.

##### **3.1. Descriptive Statistics**

The sample comprised 260 SME owners and managers from various sectors, including retail, manufacturing, services, and agriculture. The demographic characteristics of the respondents revealed a diverse range of educational backgrounds, with 75% holding at least a bachelor's degree, and 20% having completed secondary education. The majority of respondents (65%) were between the ages of 30 and 45, indicating a relatively young and dynamic workforce in the SME sector.



The financial literacy assessment indicated that the average score of respondents was 62%, suggesting a moderate level of financial literacy among SME owners. Notably, while most respondents demonstrated a basic understanding of financial concepts, significant gaps were identified in more complex areas such as investment analysis and risk management strategies. These gaps may hinder their ability to make informed financial decisions, thereby affecting their business performance.

### **3.2. Correlation Analysis**

Pearson's correlation analysis revealed significant positive relationships between financial literacy and the various dimensions of SME performance:

- Financial Literacy and Access to Finance:  $r = 0.68$ ,  $p < 0.01$
- Financial Literacy and Risk Management:  $r = 0.64$ ,  $p < 0.01$
- Financial Literacy and SME Growth:  $r = 0.71$ ,  $p < 0.01$

These findings affirm that higher levels of financial literacy are strongly associated with improved access to finance, better risk management practices, and enhanced growth metrics for SMEs. This supports the premise that financial literacy is not merely an asset but a crucial tool for SMEs in a challenging economic context.

### **3.3. Multiple Regression Analysis**

To further investigate the impact of financial literacy on SME performance, a multiple regression analysis was conducted. The results are summarized below:

#### **3.3.1. Access to Finance**

- Financial Literacy ( $\beta = 0.40$ ,  $p < 0.01$ )
- Control Variables:
  - Education Level ( $\beta = 0.25$ ,  $p < 0.01$ );
  - Industry Type ( $\beta = 0.18$ ,  $p < 0.05$ )

The analysis indicates that financial literacy significantly predicts access to finance. This means that SME owners with higher financial literacy are more likely to secure loans and negotiate favorable terms with financial institutions. The importance of education level as a control variable further emphasizes that educated entrepreneurs are better equipped to engage with financial entities.

### **3.3.2. Risk Management**

- Financial Literacy ( $\beta = 0.35, p < 0.01$ )
- Control Variables: Business Size ( $\beta = 0.22, p < 0.05$ )

The findings suggest that financially literate SME owners adopt more effective risk management strategies. This is particularly relevant in the context of Lebanon, where currency fluctuations and market volatility are commonplace. The ability to mitigate financial risks through informed decision-making can be the difference between survival and failure for many SMEs.

### **3.3.3. SME Growth**

- Financial Literacy ( $\beta = 0.45, p < 0.01$ )
- Control Variables:
  - Years in Business ( $\beta = 0.30, p < 0.01$ );
  - Access to Finance ( $\beta = 0.28, p < 0.01$ )

The regression analysis confirmed that financial literacy has a significant positive effect on SME growth. SMEs with owners who possess higher financial literacy levels not only report better access to finance but also demonstrate robust growth in terms of revenue and employee expansion. This finding underscores the interconnection between financial literacy, financial access, and overall business performance.

## **3.4. Discussion**

The results of this study illuminate the vital role of financial literacy in empowering Lebanese SMEs to navigate the complexities of an unstable economic landscape. In a country where political and financial uncertainties are prevalent, the findings suggest that financial literacy equips SME owners with the tools necessary to make informed decisions, manage risks, and sustain growth.

**Navigating Economic Challenges** Lebanese SMEs are currently facing unprecedented challenges, including inflation, currency devaluation, and a precarious banking environment. The strong correlation between financial literacy and access to finance indicates that business owners who are financially literate can more effectively engage with banks and financial institutions, making them more competitive in securing necessary funding. This finding aligns with Pooja and Neelam's (2023) assertion that financial literacy is a key driver of financial inclusion and business growth, particularly in developing economies<sup>[33]</sup>.

Enhanced Risk Management Moreover, the study highlights the importance of financial literacy in enhancing risk management strategies. As Lebanese SMEs operate in an environment marked by volatility, financially literate owners are better equipped to identify potential risks and adopt measures to mitigate them. This proactive approach to risk management is essential for long-term sustainability, particularly in a region where external shocks can have devastating impacts on business operations.

Implications for Policy and Practice The implications of these findings are profound. Policymakers and financial institutions must prioritize the promotion of financial literacy programs targeted at SME owners and managers. Initiatives could include workshops, training programs, and online resources that cover essential financial concepts, risk management techniques, and strategies for accessing financing. By investing in financial education, stakeholders can help foster a more resilient SME sector capable of contributing to Lebanon's economic recovery<sup>[34]</sup>.

## **5. Conclusion**

This research has established that financial literacy plays a critical role in enabling Lebanese small and medium-sized enterprises (SMEs) to navigate the challenges posed by an unstable economic environment. The working hypotheses of the study, which posited that financial literacy positively impacts SME access to finance, enhances risk management practices, and contributes to overall growth, have been substantiated by the empirical findings. The analysis revealed that SMEs led by financially literate owners not only have improved access to funding but also implement more effective risk management strategies, resulting in stronger business performance and resilience.

The study's findings contribute significantly to the existing literature on financial literacy and its impact on SME performance, particularly in the context of Lebanon's unique economic challenges. By quantitatively assessing the relationship between financial literacy and various performance metrics—such as access to finance and risk management—this research adds valuable insights into how financial literacy functions as a key determinant of business success in developing economies. Moreover, it highlights the urgent need for targeted financial education programs aimed at empowering SME owners with the necessary skills to make informed financial decisions.

Despite the valuable insights provided by this research, several limitations warrant attention. The study utilized a cross-sectional design, which restricts the ability to draw causal inferences about the relationship between financial literacy and SME performance over time. Additionally, the reliance on self-reported data may introduce biases related to overestimation or underestimation

of financial literacy levels. Future research could benefit from longitudinal studies that track the impact of financial literacy initiatives over time, as well as incorporating objective measures of business performance, such as revenue figures and loan uptake rates.

In light of the findings, there are several recommendations for policymakers, financial institutions, and educational organizations. Firstly, it is essential to develop comprehensive financial literacy programs tailored specifically for SME owners in Lebanon. These programs should encompass key financial concepts, risk assessment strategies, and practical applications relevant to the Lebanese market. Moreover, collaboration between governmental agencies and financial institutions is critical to create a supportive ecosystem that encourages financial education and fosters entrepreneurial growth.

Additionally, the results of this research underscore the need for systemic changes within the economic framework of Lebanon. Policymakers should consider implementing measures that facilitate access to finance for SMEs, particularly for those owned by financially literate individuals who are better positioned to manage funds responsibly. Furthermore, enhancing the regulatory environment to promote transparency and trust in financial institutions can improve SMEs' willingness to seek external financing.

In conclusion, the findings of this study highlight that financial literacy is not merely a personal asset but a strategic necessity for SME owners in Lebanon. By equipping these business leaders with the necessary financial skills, we can enhance the resilience and sustainability of the SME sector, which is vital for economic recovery and growth in Lebanon. As the country navigates its current challenges, prioritizing financial literacy will be key to empowering SMEs, fostering innovation, and ensuring long-term economic stability.

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