

Financial Inclusion and SMEs Performances in Sri Lanka: From Financial Literacy and Digital Finance Perspective

Thathsarani U.S.^{1*}, and Jianguo W.²

¹*Department of Economics and Statistics, Faculty of Social Sciences and Languages,
Sabaragamuwa University of Sri Lanka, Sri Lanka*

²*School of Economics, Wuhan University of Technology, China*
**thathsarani@ssl.ac.lk*

Financial inclusion has been given priority on numerous policy agendas in Sri Lanka. SMEs face significant growth obstacles due to financing difficulties, including poor financial literacy, market knowledge, transparency, and risks associated with modern technologies. The central research question of this study is whether financial inclusion impacts SMEs' financial and non-financial performances in Sri Lanka. Mediating factors in the relationship between financial inclusion and SME performance and constructing the Digital Financial Inclusion Index for SMEs were other aims of the study. Firms in the Western and Sabaragamuwa provinces were sampled with the size of 366 usable questionnaires. Stratified random sampling procedures were initially employed to distribute samples throughout the districts, and the final sample was chosen with a convenient sampling method. Multiple Factor Analysis for Mixed Data (FAMD) available in the FactoMineR package in R software and Structural Equation Modeling (SEM) with Partial Least Squares (SEM-PLS) in SmartPLS-3.0 were applied. The results show that the three crucial external factors of financial availability, utilization, and quality were positively correlated with SME financial performance. Financial inclusion and performance in SMEs were found to be mediated by financial literacy. Digital finance did not act as a mediating factor in the association between financial inclusion and SME success. The type of SME has a moderating effect on the association between financial inclusion and SME performance. Usage of digital financial services was the most critical determinant of the overall inclusion index, followed by access and risk of using the services. Establishing the infrastructure that supports financial trades, such as the rules and regulations, and strengthening agencies for implementing collateral, insolvency regimes, and credit reporting systems are some approaches to minimizing SME funding barriers. The mobile device used for digital financial services also significantly lowers transaction costs.

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