

# Financial Literacy and Entrepreneurship Development: A case of student entrepreneurship in Algeria

الثقافة المالية وتطوير المقاولاتية: حالة المقاولاتية عند طلبة الجامعة في الجزائر

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## Abstract:

The present study seeks to explain the existing relationship between financial literacy of new business owners/managers and entrepreneurship development, with a further analysis of Algerian case. Entrepreneurship is perceived as a catalyst for economic growth. Through encouraging individuals to launch their businesses, they will be able to create their own jobs, as well as providing job opportunities for others. Educating new business owners or generally known as 'financial literacy' is an important process to alleviate their performance, and to ensure the survival of these new fragile entities especially in underdeveloped environments.

**Keywords:** financial literacy, entrepreneurship, economic development, MSMEs/startups, Algeria

## ملخص:

تسعى الدراسة الحالية إلى توضيح العلاقة الموجودة بين الثقافة المالية لرواد الأعمال والمقاولين مع تطور المقاولاتية، بالتركيز على حالة الجزائر. تعتبر المقاولاتية محركا دافعا للنمو الاقتصادي، فمن خلال تشجيع الأفراد على إطلاق مؤسساتهم الخاصة، فإنهم سيكونون قادرين على خلق وظائفهم بأنفسهم، ناهيك عن توفير فرص عمل إضافية للغير. إن تكوين رواد الأعمال والمقاولين أو ما يعرف بـ "الثقافة المالية" هو خطوة أساسية لتحسين أدائهم، وضمان بقاء هذه المؤسسات التي غالبا ما توصف بكونها كيانات هشة خاصة في البيئات الأقل تطورا.

**الكلمات المفتاحية:** ثقافة مالية، مقاولاتية، نمو اقتصادي، مؤسسات مصغرة، صغيرة ومتوسطة/ ناشئة، الجزائر

**JEL code:** I25, D83, L26

## 1. Introduction:

Entrepreneurship is getting a huge attention in many developed and low-income countries. Through encouraging individuals to start their own businesses, whether in the form of new startups or MSMEs, additional job opportunities will be generated. These enterprises may contribute in creating new sources of income, and help to reduce poverty and increase social welfare. Additionally, they have the potential to help achieving a better wealth distribution in the economy, especially in emerging markets, where many remote areas and populations are still excluded from economic development.

In Algeria, entrepreneurship has been in the center of government's interest over the last years. The government is continuously working to promote entrepreneurship among the public. For this purpose, it has adopted a strategy aiming at educating university students the importance of having their own business ideas, and convert them into tangible projects. This strategy is implemented through the ministerial decree number -1275- that encourages students to prepare a graduation project in order to obtain a university degree along with a startup label. In this context, students can benefit from the guidance and the help of various institutions mainly universities' incubators and accelerators.

Being at the heart of this strategy, entrepreneurs (business owners/managers) need to have a significant level of financial knowledge and education to be able to start and conduct their own businesses successfully. They are confronted to various decisions on a daily basis, and are expected to handle firm's financial and accounting operations effectively. However, in reality studies assert that new owners/managers lack robust skills and they have poor financial knowledge (Shamim & Yanping, 2018) (Rapina, Meythi, Rahmatika, & Mardiana, 2023). This will negatively impact their management and overall performance, since they face great challenges to prepare, understand and establish financial statements, and to make accurate future estimations and forecasts.

The aim of this paper is to provide further insights on the relationship between financial literacy levels and entrepreneurial orientation, mainly among university students. The study focuses on explaining the concept of 'financial literacy' and its components, and tries to highlight its perceived impact on entrepreneurs' future performance.

In what follows, we present an overview of the relevant literature on financial literacy and entrepreneurship. Section 1 delves into various definitions of this concept, while its principal components are elaborated upon in Section 2. Section 3 elucidates the significance and importance of investigating this variable, along with its policy implications in the subsequent section. The following sections focus on entrepreneurship development in Algeria and the primary challenges encountered by new business owners, particularly those pertaining to education and knowledge.

## 2. Financial literacy: what is it?

Financial literacy is becoming a crucial skill in today's economic environment, marked by technological advances and rapid changes. This concept has gained great attention with various definitions attributed to it.

The Organization for Economic Cooperation and development (OECD) defines financial literacy as a mix of the following elements: "financial awareness, knowledge, skills, attitudes and behaviors necessary to make sound financial decision and ultimately achieve financial wellbeing" (OECD, 2023).

According to the OECD, financial literacy is a competency that has the ability to empower individuals to make informed financial decisions, to have more control over their personal financial matters, and avoiding all kinds of scams and misleading information. Moreover, this skill can equip individuals with necessary knowledge to take and manage, confidently, their own investment, saving and budgeting decisions to ultimately achieve both short- and long-term goals. (OECD, 2023)

In their study, (Lusardi & Mitchell, 2014) describe this concept simply as ‘peoples’ ability to process economic information and make informed decisions about financial planning, wealth accumulation, debt, and pensions’

Additionally, the World Bank (2012) provides in its report, the following definition: ‘financial literacy is the combination of consumers/ investors understanding of financial products, concepts and their ability and confidence to appreciate financial risks and opportunities to make informed choices, to know where to go for help and take other effective actions to improve their financial well-being. (Xu & Zia, 2012). It is worth noting that the same organization has used in its 2013 survey, the term ‘financial capability’ that has been defined as ‘the internal capacity to act in one’s best financial conditions. It encompasses the knowledge (literacy), attitudes, skills and behaviors of consumers with regard to managing their resources, and understanding, selecting, and making use of financial services that fit their needs’ (The World Bank, 2013). Thus, we observe that the study has employed the term ‘capability’, and considered literacy to be equivalent of knowledge.

Based on related literature, we conclude that despite its apparent simplicity, this concept still lacks an agreed upon, standard definition. Different studies have approached financial literacy from different perspectives. Some research focus on explaining this term to enhance financial knowledge and behavior of individuals and households, however, other studies aim to measure the level of literacy for political and economic purposes, and this measurement seems to be posing the greatest challenge.

In its survey aiming at assessing financial literacy levels across several countries, the OECD focuses on its primary components that are ‘financial awareness’, ‘knowledge’, ‘skills’, ‘attitudes’ and ‘behavior’. The organization tries to establish specific and targeted questions to indicate the extent of each component within the sample. Therefore, it is very important to understand these elements and how can be approached to determine the overall level of literacy.

### **3. Financial literacy fundamental components**

Based on reviewing related literature, financial literacy encompasses three main components: financial knowledge, financial behavior, and financial attitudes. While knowledge may be considered as equivalent to literacy, it actually represents only one dimension of it alongside the other two dimensions (Yahiaoui, 2022). In what follows, we try to explain thoroughly each of these three elements.

#### **3.1 First element: Financial knowledge**

This element refers to individuals’ capacity to understand and master fundamental financial knowledge. It includes what is called ‘mathematical literacy’, which is the ability to apply numerical skills appropriately (Oseifuah, 2010). Financial knowledge is ‘a particular type of capital acquired in life through learning the ability to manage income, expenditure and savings in a safe way’ (Grigion Potrich, Mendes Vieira, & Mendes-Da-Silva, 2016). This component requires a

basic comprehension of key financial concepts such as money, investment, saving, time value of money, main financial products/ instruments and associated risks, the relationship between risk and return and the importance of risk diversification. This knowledge enables individuals to have financial responsibility over their personal matters, to be aware of their rights and to know where to seek help and assistance if they face financial challenges. (OECD, 2023)

A more understanding of this element can be obtained through its assessment methods. For instance, in the OECD financial literacy survey, targeted questions were designed to determine the participants' knowledge about the following concepts: inflation, interest rate and its calculation (both simple and compound), time value of money, long term saving/ investing and risk diversification. (OECD, 2023)

### **3.2 Second element: Financial behavior**

This dimension focuses on examining how individuals' behaviors and actions affect their financial situation and overall well-being in both short- and long- term. Behaviors like delaying bill payments, neglecting to plan for future expenses, or selecting financial products without comparing the existing options, can have adverse effects, and will negatively affect individual's financial health and welfare.

To evaluate this second dimension, different aspects can be addressed like: (according to the OECD report) assessing how well individuals monitor and keep track of their financial inflows and outflows, determining the efficiency of individuals' saving and long-term plannings, and analyzing if they make thoughtful purchases.

### **3.3 Third element: Financial attitudes**

Financial literacy does not refer only to individuals having the knowledge and capability to act in a financially responsible manner, but it includes also their attitudes towards money. This latter has a significant impact on their decisions and behaviors. Related surveys usually focus on assessing people's attitudes through highlighting their relationship with money, their preferences related to saving or spending, and convictions towards future planning.

Despite the fact that these three components are the mostly referred to elements of financial literacy, other elements can be cited as well. For instance, in the World Bank (2013) survey, other concepts were used interchangeably with the previous elements, like skills, capability. Other studies have used other terms like ability, aptitudes, education, and competencies. (Zaibet & Cherbi, 2021) (Yahiaoui, 2022)

Based on the table presented in the World Bank (2013) survey, we try to sum up the main components of financial literacy.

**Table 1.** Components of financial literacy

Financial literacy components		
Knowledge	Behaviors	Attitudes
-Knowledge of basic financial concepts like: inflation, simple and compound calculation of interest rate, relationship of risk and return, diversification principle - Numeracy skills and mastery -Awareness of available financial products and services - know- how to make payments, manage their accounts etc.	-Money management -Ability of both short and long-term planning - ability of decision making -seeking financial help and assistance	-relationship with money: spending vs saving, -attitudes towards the future: planning for retirement vs immediate spending -confidence in own capacity to plan for the future

Source: The World Bank, 2013, p. 2

#### 4. Scope and significance of financial literacy

Financial literacy is increasingly becoming a public and political matter in both developed and emerging countries. For normal individuals and households, it is very important to acquire basic financial knowledge and skills to be more financially responsible. People are expected to take their own financial decisions and manage their own personal budgeting and planning. For policymakers, it is crucial to increase the level of financial literacy among communities and larger population, since studies have proved its direct impact on enhancing financial stability, financial inclusion, and achieving both economic growth and social welfare (Lusardi & Mitchell, 2014) (Khan, Siddiqui, & Imtiaz, 2022) (Mitchell & Lusardi, 2015) (Buccci, Calcagno, Marsiglio, & Sequeira, 2023).

In fact, people with a significant level of literacy are more likely to achieve their financial objectives and improve their economic circumstances. In their paper, (Lusardi & Mitchell, 2014) describes financial knowledge as ‘a form of investment in human capital’. Financial literacy can influence several aspects of people’s daily life and decision-making processes. Several areas that can be impacted and improved include:

1- Having a clear understanding of personal finances, including knowing how much money you earn, your assets and liabilities. It also means understanding whether your spending aligns with your financial goals.

2-Ability of setting financial goals, this means determining what you want your money to achieve, whether it's saving for a house payment or planning for early retirement. Once you've identified your objectives, you can create a plan to achieve them. (Tamplin, 2024)

3-Increasing saving and retirement planning, (Lusardi & Mitchell, 2014) have demonstrated in their study that people in the past didn’t have to think or worry about their retirement plans because all details were designed and implemented by governments. However, today the economic environment has changed with the emergence of multiple and complex alternatives, individuals have to follow and understand their options to optimize their wealth. (Lusardi & Mitchell, 2014)

4-Increasing financial efficiency, which means ‘the use of financial products and investing without waste and unnecessary cost’ (Capuano & Ramsay, 2011). This skill affects directly individuals’ capacity to select the right product or service among a variety of available options based on making necessary comparison.

5-Active debt management, also known as ‘debt literacy’, that refers to personal capacity to best avoid and manage debt. (Capuano & Ramsay, 2011) emphasize on individuals’ ability to select needed products, and avoiding unnecessary spending which increases costs. For (Tamplin, 2024), it is important to remember that not all debt is bad. If debt generates income, increases net worth, or has future value is considered a good debt. However, excessive debt can become a burden. It is essential to manage debt properly by creating a budget and a payment plan.

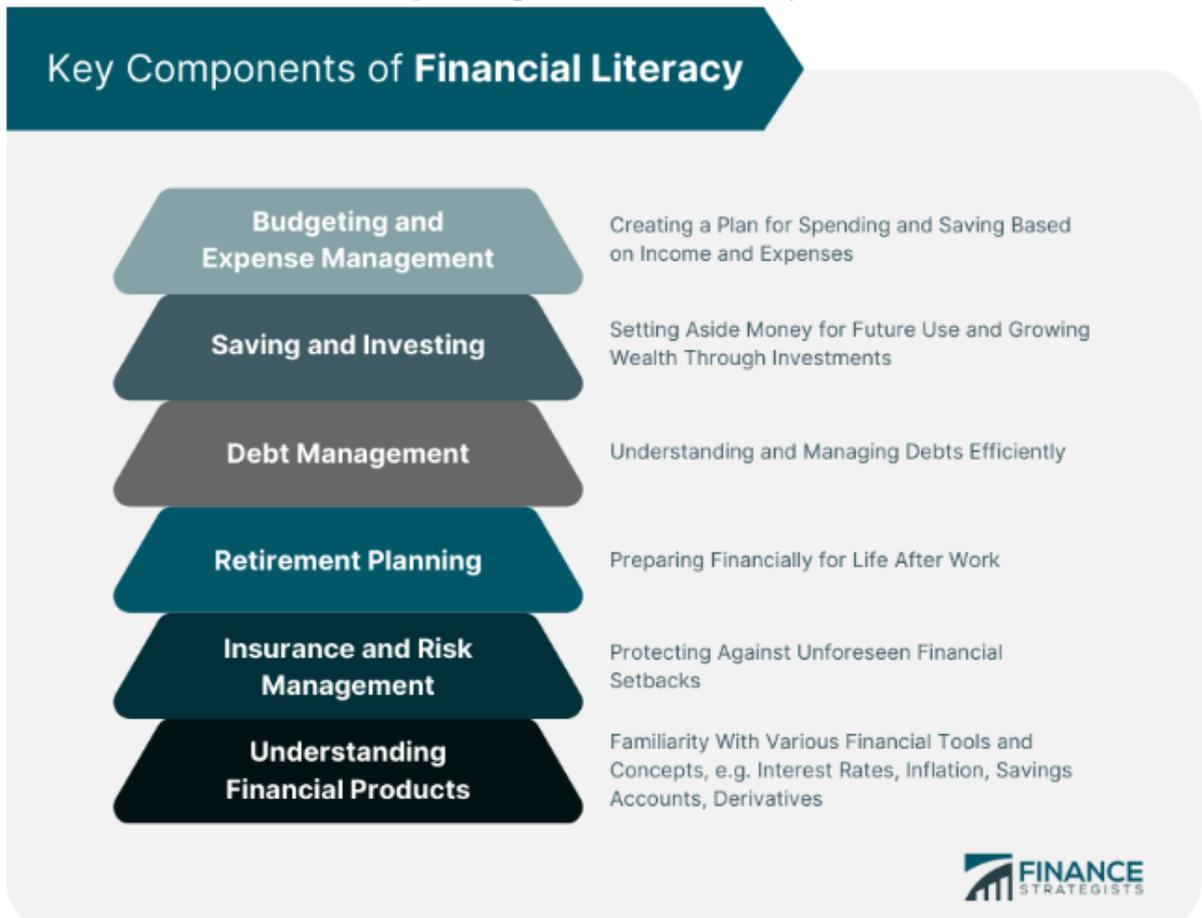
6-Rational investing and ability to choose the right financial product. This can’t be achieved without a proper knowledge about time value of money, associated risk and return. Investing helps grow your money especially if you learn how to take advantage of financial markets opportunities. In fact, limited financial market participation is often a consequence of low levels of financial literacy. (Capuano & Ramsay, 2011)

7-Increased awareness of consumer rights and protection. Literacy allows consumers to identify and avoid scams. Low chances of becoming a victim of fraudulent schemes leads to low regulatory intervention, since consumers are more vigilant and can take care of themselves.

8-High levels of competition, innovation and quality. Since financially literate individuals are constantly looking for better products, the whole financial industry will develop as a result of demand pressure.

The following figure provided by (Tamplin, 2024), shows the most important areas affected by financial literacy.

**Fig.1.** Scope of financial literacy



Source: Tamplin, 2024

## 5. Financial literacy and policy implications

The interest in enhancing individuals' financial literacy is becoming a major concern. It is addressed constantly in international organizations' global surveys (OECD, World Bank etc.) aiming at measuring the level of literacy across different countries and populations. Policymakers are working to develop comprehensive programs and strategies to increase the levels of financial literacy, because they are fully aware that a higher level of literacy leads to higher levels of economic wellbeing.

Recognizing the positive relationship between financial literacy and economic stability and growth is the starting point to build sound strategies. Various studies (Lusardi & Mitchell, 2014) (Mitchell & Lusardi, 2015) highlight this relationship and demonstrate how different areas can be improved through empowering individuals and increasing their literacy levels. The main implications include:

-Enhancing economic stability that is positively correlated with people's ability to make sound and informed financial decisions. Yet financial literacy is not a sufficient condition for financial stability, but it can reduce the occurrence of financial crises, and can mitigate their spread and impact if they happen, since literate individuals are more prepared to face and manage economic downturns (Buch, 2018).

-Enhancing financial inclusion through increasing the access to financial services. Providing financial education and knowledge can help underserved populations to understand and use available financial products. It can help them also to follow the latest innovations, especially with the pervasiveness of financial technology (FinTech), and to use them safely and effectively, which will ultimately reduce any form of exclusion (Khan, Siddiqui, & Imtiaz, 2022) (Cordie, 2022).

-Additional consumer protection, since literate individuals are more aware of possible risks and can make more informed choices. Moreover, working on increasing the overall literacy requires from governments to ensure more accountability and transparency, without neglecting the importance of communication. The synergy between all these factors can lead to a more protected environment.

-Financial literacy may contribute to enhance the overall financial well-being. Literate individuals, as explained earlier, are more able to plan for the future and make retirement savings. Furthermore, literacy may generate positive changes in the financial behavior of people, which may lead eventually to achieve financial security.

-A positive impact on economic growth, through multiple channels such as encouraging people to choose good investments with positive impact on the whole economy. Additionally, literate persons tend to make more savings, which provide the necessary capital to finance economic expansion and growth. Another important channel, that will be discussed later, is entrepreneurship development, that is encouraging people to start and manage their own businesses effectively. In other words, transforming people for consumers into wealth creators.

-Finally, working on developing literacy levels should be an integral part of policy and development strategies. Policymakers should design targeted interventions and tailored programs to address specific needs. In fact, this should be perceived as a complementary relationship, since the more literate individuals are, the easier this mission becomes, as they will have a better understanding of economic policies and reforms, leading to greater acceptance, trust, and implementation. (Lusardi & Mitchell, 2014) (Buch, 2018)

## 6. The effect of financial literacy on Entrepreneurship

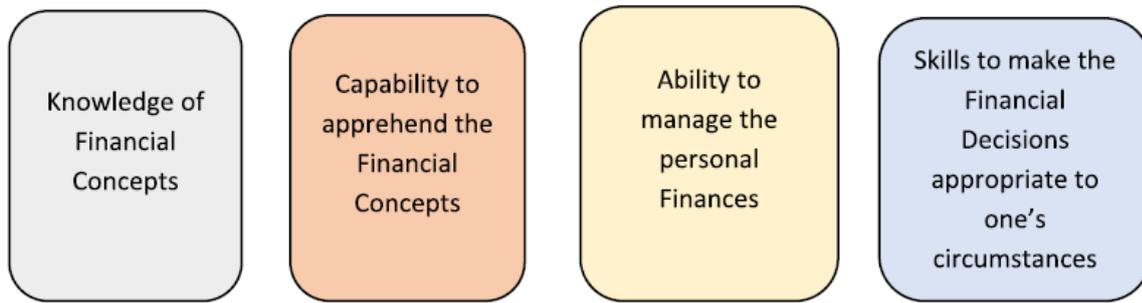
The interest in developing entrepreneurship is often justified by the capacity of micro, small and medium-sized enterprises, along with startups, to create an added economic value. Promoting entrepreneurship means encouraging individuals to become business owners by launching their own enterprises, and to take their own financial responsibility. As demonstrated by several studies (Beck & Demircuc-Kunt, 2004) (Beck & Demircuc-Kunt, 2006) (Beck, Demircuc-Kunt, & Levine, SMEs, 2005), the growth of this sector can significantly impact the whole economic system, along with socio-economic impacts (Damayanti, Sayed , Al-Shami, Bin, & Marwati, 2018). MSMEs/Startups are being considered to be a more active actor compared to large-scale companies, due to their specific features such as having a more dynamic structure. These small entities have to be more innovated to enter and survive in the market, so they need to provide competitive and good quality products.

The development of this sector may lead to various economic and social outcomes such as: job creation, poverty reduction, promoting exports and economic diversity, producing outputs and reducing imports etc. (Damayanti, Sayed , Al-Shami, Bin, & Marwati, 2018). These elements together contribute in reaching a sustained economic and social welfare. However, this sector faces many risks and challenges, especially in emerging markets. On the top of them is access to funds. Traditional banks often refuse to finance these projects for several reasons, mainly their risk profile, which limits their capacity to expand and innovate (Seddiki, 2023). Other challenges include a lack of support and adequate infrastructure that prevent MSMEs/startups to access the market and comply with regulations. Human capital can be considered among the main factors that limit the development and survival of MSMEs/startups. In fact, different studies have highlighted the relationship between the profile of owner/manager/entrepreneur and firm's performance (Shamim & Yanping, 2018) (Eniola & Entebang, 2017) (Rapina, Meythi, Rahmatika, & Mardiana, 2023). Entrepreneurs are expected to take various decisions in their everyday management routine. Decisions range from simple actions into strategic planning and forecasts. Therefore, business owners need to have a certain degree of financial education and knowledge. In fact, a large part of the previously mentioned challenges can be directly attributed to the owner's skills and competencies. On example in this context is the manager's ability to select suitable financial products and to apply for loans. Thus, it is very important to discuss entrepreneurs' financial literacy as an important determinant of the quality of decision- making and the performance of MSMEs/startups.

Financial literacy is defined – from entrepreneurial perspective- as ‘managers’ capacity to understand and analyze financial data so as to take financial decisions’ (Anshika, Singala, & Girijasankar, 2021). It refers to “the ability to evaluate the new and complex financial instruments and make informed judgments in both choices of instruments and extent of use that would be in their own best long-run interest” (Damayanti, Sayed , Al-Shami, Bin, & Marwati, 2018). As stated in (Eniola & Entebang, 2017), a financially literate SME owner/managers is ‘someone who knows what are the most suitable financing decisions for the business performance at the various growth stages of the business, knows where to obtain the most suitable products and services and interacts with confidence with the suppliers of these products and services.

Financial literacy of an entrepreneur can therefore be approached as a mixture of his knowledge of financial matters, competence to mitigate risks and to make optimal financial investments. Fig. 1 illustrates this definition.

**Fig.1.** Elements of Financial literacy



**Source:** Anshika, Singala, & Girijasankar, 2021, p. 2

These definitions reveal that financial literacy is essential for MSMEs/startups owners to make informed financial decisions, both personal and business-related. A literate entrepreneur has the capacity to manage the enterprise especially if operating in developing country, and to attain long-term objectives related to money management and funding. It is needed when the manager has to provide collaterals necessary for loan application, and when planning for future strategies.

(Anshika, Singala, & Girijasankar, 2021) state the following areas where entrepreneurs' financial literacy is mostly needed:

- to distinguish between personal and company's funds;
- to have comprehensive knowledge of the variety of financial products and services available;
- to accurately forecast the company's capital needs from various sources;
- to reduce risks;
- to enhance the firm's creditworthiness and readiness for investment;
- to manage taxes effectively;
- to practice effective financial management; (Anshika, Singala, & Girijasankar, 2021).

## 7. Financial literacy of young entrepreneurs in Algeria

Similar to other developed and developing countries, Algeria is giving a great interest to promote entrepreneurship. As the country is still relying on oil revenues (over 93 percent of products exports, and 38 percent of budget revenues between 2016 and 2021) (Worldbank, 2023), the government has started, several years ago, to focus on the creation of MSMEs and startups as a new developmental model aiming at providing job prospects for young people and women, and to reach sustainable growth. This strategy is implemented through the creation of multiple institutions and governmental bodies mainly a special ministerial department that is 'Ministry of knowledge economy and startups' to supervise and facilitate the creation of small enterprises, along with other agencies like 'National Consulting Council for SMEs' promotion' and the 'Agency for SMEs' development and innovation promotion' (Official Journal, Executive Decree No 17-194, 2017) (Official Journal, Executive Decree No. 18-170, 2018). This effort has led to the creation of over than 1 359 803 MSMEs in 2023 compared to 1 286 365 MSMEs in 2021 (Minsitry of Industry and pharmaceutical production, 2023). This segment provides only 28 MSMEs per 1000 inhabitants; which is very low if compared to global standards estimated to be 45 MSMEs per 1000 inhabitants (Seddiki, 2023). About 97 percent of Algerian MSMEs are micro enterprises, which reflect the fragility of this economic sector and its high exposure to failure.

This orientation is viewed also in higher education, where specific bodies like universities'

incubators and accelerators were installed to guide young entrepreneurs after their graduation. However, the most important step in this context is the 1275 ministerial decree stipulated by the Ministry of higher education and scientific research in 27 September 2022. This decision specifies the modalities and procedures for preparing a graduation project in order to obtain a university degree along with a startup label. (Badache, 2023) (Souiki, 2023)

The objective of this initiative is to create a new generation of students full of entrepreneurial spirit, holding their own innovative ideas, and willing to implement them in reality. Students will be guided into launching their own businesses, and they may benefit from different aids and supporting mechanisms set by the ministry. The ultimate goal of this strategy is encouraging students to create their own jobs instead of seeking them after graduation.

Obtaining a university degree as a startup requires completing a set of training programs in business plan preparation, e-marketing, finance and accounting, designed to support the students and equip them with necessary knowledge to convert their ideas into a startup.

Students enrolled in this program receive the support and guidance of different bodies, on the top of them is university incubator responsible of providing the assistance along the way of converting the innovative idea into a tangible project (Souiki, 2023).

This strategy actually reflects the interest given to education and knowledge. Instead of encouraging people to become entrepreneurs, a path that can be challenging and uncertain, it is more effective to educate them, and change their attitudes towards job prospection. As a result, the outcome will be a more knowledgeable and literate graduates, motivated to lead their financial lives independently, equipped with the necessary tools and skills. Starting financial education before graduation has a greater potential to foster an entrepreneurial spirit compared to waiting for individuals to navigate numerous choices and alternatives before deciding to become self-employed.

## **8. Conclusion**

This study focuses on analyzing the existing -and previously proven- relationship between financial literacy, that refers primarily to ‘peoples’ ability to process economic information and make informed decisions about financial planning, wealth accumulation, debt, and pensions’, and entrepreneurial orientation, with a special emphasis on entrepreneurship among university students in Algeria.

After providing an overview of related literature, it becomes more obvious that having a significant level of financial knowledge, behavior and attitudes, also known as ‘financial literacy’, is essential to new business’s owners/managers. Since they are expected to take various decisions and lead their enterprises in uncertain environments, entrepreneurs must have necessary competencies and skills. Otherwise, the overall performance and the survival of these businesses is jeopardized.

Algerian universities have taken this relationship into account, and they have tried to build a strategy aiming at financially educating students even before graduations. Through the law number 1275, students are encouraged to become entrepreneurs. They have the possibility to take advantage of many supporting programs and aids, to ultimately succeed in converting their innovative ideas into tangible business. Hence, instead of waiting for individuals to become entrepreneurs, this approach starts from educating them in becoming entrepreneurs themselves.

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