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*Original Article*

# Influence of Financial Knowledge on Investment Decisions among Small and Medium Enterprises in Dodoma

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**Abstract**

*This study investigated the influence of financial knowledge on investment decisions among small and medium enterprises (SMEs) in Dodoma, Tanzania. Grounded in the Theory of Planned Behaviors (TPB), the research explores how financial knowledge shapes entrepreneurs' confidence and decision-making processes. Using ordinal logistic regression analysis on survey data collected from SMEs, the findings reveal that financial knowledge significantly affects investment decisions, explaining approximately 20% of the variance. While the model shows moderate predictive power, results highlight financial knowledge as a critical factor in guiding investment choices, though other factors also play important roles. Based on findings, it is concluded that financial knowledge is critical in investment choices. Thus, it is recommended that the government should enhance financial education policies and practical training programs to improve SMEs' financial literacy, ultimately supporting better investment outcomes and business growth.*

**Keywords**

*Financial Knowledge, Investment Decisions, Small and Medium Enterprises (SMEs), Theory of Planned Behaviors.*

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## 1. Introduction

Investment decision-making is a critical component in the sustainability and growth of Small and Medium-Sized Enterprises (SMEs), particularly in developing economies such as Tanzania. SMEs often play a pivotal role in national development by contributing to employment creation, poverty reduction, and GDP growth. However, despite their economic significance, many SMEs struggle to make sound investment decisions, leading to business failures and missed growth opportunities. In Dodoma, the political capital of Tanzania, rapid urbanization and the influx of business opportunities have not been matched with adequate capacity among SMEs to make informed investment choices (URT, 2020). This situation raises concerns about the factors influencing how SME owners and managers make financial decisions, particularly the role of financial knowledge.

Financial knowledge refers to the understanding of essential financial concepts, including interest rates, inflation, risk diversification, budgeting, and investment options. Research consistently shows that financial knowledge is a foundational determinant of sound financial behaviors and decision-making (Lusardi & Mitchell, 2014; Darwish, 2025; González-Prida, 2025). SME owners equipped with adequate financial knowledge are more likely to evaluate investment opportunities critically, understand risk-return trade-offs, and allocate resources efficiently. Conversely, limited financial knowledge may lead to poor investment decisions, increased vulnerability to financial shocks, and business instability. In Tanzania, financial literacy rates remain relatively low among micro and small business operators, partly explaining the high rate of business failure among new enterprises (Bank of Tanzania, 2021; Muliana, 2025).

The urgency to enhance SMEs' financial capacity has increased amid global economic transformations and financial market complexities. As digital financial products and services expand, understanding how to evaluate and engage with various investment options becomes essential for business growth. Empirical evidence from multiple contexts, including Sub-Saharan Africa, indicates a positive correlation between financial knowledge and investment decision-making (Atkinson & Messy, 2012; Potrich, Vieira, & Kirch, 2015; IS et al., 2024; Abdallah, Ragab, & Hassan, 2024). Studies specific to SMEs further show that financial literacy—particularly in areas such as savings, budgeting, and risk assessment—positively influences investment decisions (IJAAS, 2024; Donggon, 2024; Muhongerwa, 2025). However, much of the prior research focuses either on individual financial behaviors or large enterprises, leaving a gap in understanding SME-specific dynamics. In Tanzania, limited empirical evidence explores how financial knowledge shapes SME investment decisions in rapidly urbanizing areas like Dodoma (González-Prida, 2025; Muliana, 2025).

As financial markets and investment products evolve, SMEs must navigate increasingly complex environments that demand not only intuition and experience but also structured financial understanding. Financial literacy empowers entrepreneurs to assess investment risks, manage capital more effectively, and build sustainable business models. Lusardi (2019) emphasizes that access to capital or credit alone is insufficient for success, as poor investment decisions can nullify potential benefits. Recent empirical studies reinforce this, demonstrating that higher financial literacy among SME owners leads to more informed and effective investment choices while mitigating overconfidence and other biases (Darwish, 2025; Muhongerwa, 2025; Abdallah et al., 2024).

Given this context, the present study investigates the influence of financial knowledge on investment decisions among SMEs in Dodoma. By examining key financial concepts and their role in shaping investment behaviour, this research contributes to the discourse on SME development and financial literacy. It also offers practical insights for policymakers, financial institutions, and education providers aiming to strengthen SME financial capacity and decision-making. This investigation is timely, aligning with ongoing efforts by the Tanzanian government and development partners to improve the SME business environment and enhance financial inclusion (FSDT, 2022). Through empirical analysis, the study seeks to bridge theory and practice and provide evidence-based recommendations for improving SME resilience and growth through enhanced financial knowledge (González-Prida, 2025; Donggon, 2024; Muliana, 2025).

## 2. Literature Review

The relationship between financial knowledge and investment decisions is well supported by the Theory of Planned behavior (TPB), developed by Ajzen (1991). TPB posits that behaviors is driven by behavioral intention, which is influenced by three components: attitude toward the behaviors, subjective norms, and perceived behavioral control. Financial knowledge is closely associated with these components, particularly attitudes and perceived behavioral control. Individuals with higher financial knowledge are more likely to evaluate investment behaviors positively and feel confident in their ability to make sound financial choices. In this way, financial knowledge strengthens both the motivation to invest and the perceived capacity to do so, making it a central driver of investment decisions (Lusardi & Mitchell, 2014; González-Prida, 2025).

Empirical evidence consistently supports this theoretical connection. Hassan Al-Tamimi and Bin Kalli (2009) investigated the impact of financial knowledge on investment behaviors among 200 individual investors in the United Arab Emirates and found that financial knowledge, alongside risk perception, significantly influenced investment decisions. Limited financial literacy was linked to irrational investment practices, highlighting the importance of national financial education programs. Similarly, Kumari (2020) examined 384 undergraduate students in Sri Lanka and found that financial knowledge and behaviour significantly influenced investment decisions, although attitude had minimal effect. The study suggested that financial knowledge equips individuals with practical skills and cognitive frameworks necessary for effective investment planning. Aggarwal (2019) further indicated that financial knowledge had the most significant impact, surpassing both attitudes and behaviors, underscoring the importance of delivering actionable financial knowledge to enhance decision-making. Baihaqqy et al. (2020) found that financial knowledge and attitude positively influenced investment behaviour, with financial behaviour serving as a mediating variable, suggesting that technical knowledge combined with motivational support is crucial to translate understanding into action.

Recent studies focusing on SMEs reinforce these findings. For instance, González-Prida (2025) demonstrated that financial knowledge significantly improves decision-making among microenterprises, particularly in sustainable investment and saving behaviour, although gaps remain in risk management and formal investment appraisal.

Darwish (2025) found that higher financial literacy among SME owners leads to more informed investment choices and helps mitigate the negative effects of overconfidence. Similarly, studies in Indonesia (Muliana, 2025), Rwanda (Muhongerwa, 2025), and the Philippines (Donggon, 2024) show that SME owners with stronger financial knowledge make more effective investment decisions, particularly when financial planning, budgeting, and risk assessment are emphasized. Abdallah, Ragab, and Hassan (2024) further corroborated that higher financial literacy correlates with improved financial outcomes and decision quality among SME owner–managers, suggesting that targeted training and access to financial advice can enhance investment effectiveness.

Both theory and empirical evidence highlight the centrality of financial knowledge in shaping investment decisions. According to TPB, knowledge informs attitudes and perceived control, guiding behavioural intentions and actions. Across diverse socio-economic contexts, financial knowledge consistently emerges as a primary driver of sound investment behaviour. For SMEs in Tanzania, strengthening financial knowledge can empower business owners to make rational investment decisions, manage risks effectively, and contribute to sustainable enterprise development (González-Prida, 2025; Darwish, 2025; Muliana, 2025; Muhongerwa, 2025; Abdallah et al., 2024; Donggon, 2024).

## 3. Methodology

This study employed a quantitative research methodology grounded in a positivist philosophy, which assumes that reality is objective and can be measured through empirical observation. A cross-sectional research design was used to collect data at a single point in time, allowing the researcher to assess the influence of financial knowledge on investment decisions among small and medium investors in Dodoma. The study population comprised 400 investors from two major markets (Majengo and Machinga Complex), with a sample size of 200 determined using Yamane's (1967) formula. Simple random sampling was employed to ensure every investor had an equal chance of selection, thereby enhancing the representativeness of the sample. Data were collected using structured questionnaires consisting of closed-ended and Likert-scale items, which were pre-tested for validity and reliability. The collected data were analyzed using descriptive statistics and ordinal logistic regression, appropriate for examining the relationship between ordered levels of investment decisions and the financial literacy variables. This methodology ensured objectivity, replicability, and generalizability of the findings within the Tanzanian context.

## 4. Results

**Table 1: Descriptive statistics**

| Description | Mean | Std. Deviation | Kurtosis | |
|---|---|---|---|---|
| | Statistic | Statistic | Statistic | Std. Error |
| Understanding basic financial concepts such as interest rates and inflation. | 3.6127 | .96645 | .395 | .404 |
| Awareness of different investment options available in the market. | 3.5986 | 1.09842 | .055 | .404 |
| How to calculate risks and potential returns on investments. | 3.6056 | 1.07820 | -.105 | .404 |
| Understanding the importance of diversifying investment portfolios. | 3.8099 | .84159 | 2.229 | .404 |
| Keeping updated with financial news and information. | 3.6479 | .95425 | 1.129 | .404 |
| Frequently making decisions to invest in new financial products. | 4.3380 | .51760 | -.945 | .404 |
| Diversifying investments across different asset classes. | 4.4014 | .51995 | -1.304 | .404 |
| Investing based on careful analysis of available information. | 3.8521 | .95239 | 1.058 | .404 |
| Amount invested depends on my current financial knowledge and confidence. | 3.7324 | .95216 | .546 | .404 |
| Updating investment choices when new financial information becomes available. | 3.8873 | .73512 | .291 | .404 |

### *A. Descriptive Statistics for Financial Knowledge*

The first item under financial knowledge, "I understand basic financial concepts such as interest rates and inflation," recorded a mean score of 3.6127 (SD = 0.9643), suggesting that most respondents have a moderate understanding of foundational financial concepts. This level of awareness reflects the basic financial education acquired either formally or through experience. The second item, "I know how to calculate risks and potential returns on investments," had a similar mean score of 3.6056 (SD = 0.9745), indicating that while respondents may be aware of risk-return dynamics, there may be some variability in their ability to apply this knowledge consistently. The third item, "I understand the importance of diversifying my investment portfolio," scored slightly higher with a mean of 3.8099 (SD = 0.9156), implying that many respondents recognize diversification as a key principle in managing investment risk.

### *B. Descriptive Statistics for Investment Decision*

Regarding investment decision-making, the statement, "I feel confident in making my own financial decisions," recorded a mean of 4.0423 (SD = 0.84108), indicating a strong sense of financial self-efficacy among respondents. This confidence likely stems from their positive attitudes and moderate-to-high levels of knowledge and behavior. The second item, "I make investment decisions based on adequate information," scored 3.9201 (SD = 0.8842), suggesting that most respondents consider research and data before committing funds. Lastly, the item, "My past investment decisions have led to positive outcomes," had a mean of 3.8450 (SD = 0.9316), which reflects a relatively positive self-assessment of previous financial actions.

The results suggest that respondents demonstrate a generally high level of financial literacy across knowledge, behavior, and attitude, which appears to positively influence their investment decisions. However, variations in standard deviation across items indicate that not all respondents share the same strength in each area. These findings underscore the need for targeted financial education programs to bridge specific gaps especially in areas like consistent investment behavior and practical risk calculation while reinforcing the positive attitudes and motivations that are already present among SME investors in Dodoma.

### *C. Influence of Financial Knowledge on Investment Decisions*

The ordinal logistic regression model assessing the influence of financial knowledge on investment decisions showed a good overall fit, with the final model significantly improving over the intercept-only model (Chi-square = 32.056, df = 18, p = 0.022). The goodness-of-fit tests produced mixed results: the Pearson test indicated poor fit (p = 0.000), while the deviance test suggested an adequate fit (p = 0.993). The model explained approximately 20% of the variance in investment decisions, as shown by Cox and Snell (0.202) and Nagelkerke (0.205) pseudo-R-squared values.

**Table 2: Model Fitting Information**

| Model | -2 Log Likelihood | Chi-Square | df | Sig. |
|---|---|---|---|---|
| Intercept Only | 284.463 | | | |
| Final | 252.407 | 32.056 | 18 | .022 |

*Link function: Logit.*

Results in Table 2 presents the model fitting information for the ordinal logistic regression examining financial knowledge's influence on investment decisions. The final model shows a significant improvement over the intercept-only model, with a chi-square value of 32.056 (df = 18, p = 0.022). This indicates that the predictors included in the model explain a significant portion of the variance in investment decision outcomes, confirming the model's overall fit and relevance for further analysis.

**Table 3: Goodness-of-Fit**

| Description | Chi-Square | df | Sig. |
|---|---|---|---|
| Pearson | 750.667 | 180 | .000 |
| Deviance | 136.394 | 180 | .993 |

*Link function: Logit.*

Observations in Table 3 displays the goodness-of-fit statistics for the ordinal logistic regression model assessing the impact of financial knowledge on investment decisions. The Pearson chi-square test yielded a value of 750.667 with 180 degrees of freedom and a significance level of 0.000, indicating a poor fit according to this test. In contrast, the deviance chi-square test produced a value of 136.394 with the same degrees of freedom but a significance level of 0.993, suggesting an excellent fit of the model to the data. The contrasting results between these two tests can occur due to differences in sensitivity to sparse data or model assumptions, with the deviance test often considered more reliable in such contexts. Overall, the deviance test supports the adequacy of the model, implying that the specified predictors appropriately capture the variability in investment decisions related to financial knowledge.

**Table 4: Pseudo R-Square**

| Pseudo R-Square Measure | Value |
|---|---|
| Cox and Snell | .202 |
| Nagelkerke | .205 |
| McFadden | .052 |

*Link function: Logit.*

The pseudo-R-square values presented in Table 4 provide an indication of the explanatory power of the ordinal logistic regression model assessing the influence of financial knowledge on investment decisions. The Cox and Snell R-square value of 0.202 suggests that approximately 20.2% of the variability in investment decisions is accounted for by the model. Although this statistic is not directly comparable to the R-square in linear regression due to differences in calculation, it still provides a useful benchmark for evaluating model performance within the context of logistic regression.

The Nagelkerke R-squared, an adjusted version of the Cox and Snell statistic that scales the value to a maximum of 1, was reported at 0.205. This value confirms a modest improvement in the explanatory power of the model and reinforces the interpretation that financial knowledge contributes meaningfully, though not overwhelmingly, to predicting investment decisions among small and medium enterprises in Dodoma. It highlights the importance of financial knowledge as one of several key factors, while acknowledging that additional variables may further enhance the model's predictive strength.

The McFadden R-squared was reported at 0.052, which may appear low by traditional regression standards. However, in logistic regression, McFadden values between 0.02 and 0.10 are typically considered indicative of acceptable model fit, especially in studies involving behavioral or social phenomena. This suggests that while the model explains only a modest proportion of the variance, it still offers meaningful insights into how financial knowledge shapes investment decisions. Taken together, these pseudo-R-squared values demonstrate that financial knowledge has a statistically significant, though moderate, influence on investment decision-making in the study area.

## 5. Discussion Of Results

The findings from this study demonstrate that financial knowledge significantly influences investment decisions among SMEs in Dodoma, aligning with existing literature that underscores the pivotal role of financial literacy in shaping investment behaviour. The ordinal logistic regression results indicated that financial knowledge accounted for approximately 20 percent of the variance in investment decision outcomes, reflecting a moderate yet meaningful impact. This suggests that SME investors with better understanding of fundamental financial concepts such as budgeting, interest rates, and risk assessment are more likely to make informed and prudent investment choices. These findings echo those of Hassan Al Tamimi and Anood Bin Kalli (2009), whose study of UAE investors found that higher financial knowledge improved investment behaviour through enhanced risk perception and decision accuracy, emphasizing the necessity for comprehensive financial education in developing effective investment strategies.

Further reinforcing the significance of financial knowledge, the present results resonate with Kumari's (2020) research, which identified financial literacy as a key determinant in investment decision-making among undergraduates. Kumari's findings revealed that financial knowledge and behaviour strongly predicted investment choices, while attitude played a less prominent role. This is consistent with the present observations, suggest that the cognitive dimension of financial literacy, what investors know, is crucial in enabling SMEs to navigate complex financial environments, especially in emerging economies where access to formal financial advisory services may be limited. The implies that building foundational financial understanding is a priority in efforts to empower SMEs, as knowledge forms the groundwork upon which effective behaviour and positive attitudes can be developed.

Aggarwal's (2019) investigation among professionals similarly highlighted the dominant influence of financial knowledge over other literacy components such as behaviour and attitude. Reported findings suggest that practical knowledge about financial products, market dynamics and investment instruments equips individuals with the confidence and skills to make strategic investment decisions. This insight is particularly relevant for SMEs in Dodoma, where entrepreneurial success often hinges on the ability to optimize scarce resources through sound investment. The alignment of Aggarwal's results with the current study supports targeted financial education interventions that emphasize not only theoretical knowledge but also the practical application of financial concepts tailored to the SME context.

Moreover, observations from Baihaqqy et al. (2020) offer a nuanced perspective as an interplay between financial knowledge, attitude, and behaviour in shaping investment decisions among Indonesian entrepreneurs. Their identification of behaviour as a mediating factor suggests that while knowledge is foundational, the translation of this knowledge into consistent financial practices determines the ultimate impact on investment outcomes. The present study's moderate explanatory power for financial knowledge implies that complementary factors such as behaviour and attitude have a likelihood to influence investment decisions among SMEs in Dodoma. Hence, policy approaches should integrate knowledge enhancement with behavioural skills training and attitude transformation to foster a holistic improvement in investment decision-making capacity.

Finally, this study contributes to the broader discourse on financial literacy in developing countries by confirming that improving financial knowledge is a critical but not solitary component of enhancing SME investment decisions. The findings support calls from empirical research for comprehensive financial literacy programs that are contextually adapted to the socio-economic realities of SMEs in emerging markets. Such programs encompass technical knowledge, behavioural guidance and attitudinal shifts to address the multifaceted challenges faced by SMEs. Doing so, these interventions can promote sustainable investment behaviours that contribute to business growth, economic resilience, and poverty reduction, fulfilling both individual and broader developmental goals.

## 6. Conclusion And Recommendations

The ordinal logistic regression analysis confirms that financial knowledge significantly influences investment decisions among SMEs. While the model explains a moderate proportion of the variance, it highlights that having a solid understanding of financial concepts plays an important role in shaping investment behavior. However, the mixed goodness-of-fit results suggest that other factors beyond financial knowledge contribute to investment choices. Therefore, enhancing financial knowledge alone may improve investment decisions complemented by addressing additional social, psychological and contextual influences to foster better financial outcomes for small and medium enterprises.

Based on the conclusion that financial knowledge influences investment decisions therefore it is recommended that policymakers should prioritize the development and implementation of comprehensive financial education programs targeting SMEs. Also, programs should focus on improving financial knowledge, equipping entrepreneurs with practical skills for investment decision-making. Furthermore, policies should encourage collaboration between government agencies, financial institutions and educational bodies to create accessible and ongoing financial literacy initiatives that address the specific needs of small and medium enterprises.

On practical side, it is recommended that SMEs should actively seek financial training and resources to enhance their understanding of investment principles and risk management. Moreover, business support organizations and financial advisors can play a key role by providing tailored workshops, mentorship and easy-to-understand tools that build confidence and financial competence among entrepreneurs. Thus, integrating financial literacy into local business development services is inevitable to make more informed investment decisions, contributing to their growth and sustainability.

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