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The Influence of Financial Literacy, Financial Inclusion and Financial Management on MSME Performance in The East Canal Flood Area (BKT)

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ABSTRACT

Micro, Small and Medium Enterprises (MSMEs) play a crucial role in the Indonesian economy, but they face challenges in improving their performance, particularly related to financial literacy and financial inclusion. This study aims to investigate the relationship between financial literacy, financial inclusion, and financial management with the performance of MSMEs. Recent studies show that higher financial literacy and financial inclusion have a positive impact on the performance of MSMEs. Moreover, effective financial management also significantly affects the ability of MSMEs to access financing and improve profitability. This research concludes that improving financial literacy, financial inclusion, and effective financial management are key factors in supporting the performance and sustainability of MSMEs in Indonesia.

Keyword : MSMEs, financial literacy, financial inclusion, financial management, business performance

1. INTRODUCTION

MSMEs (micro, small and medium enterprises) have a primary function in the Indonesian economy. Based on data from the Ministry of Cooperatives and Small and Medium Enterprises in 2021, there were 64.2 million MSMEs that absorbed 97% of the total workforce in the country (Ministry of Cooperatives and Small and Medium Enterprises, 2021). The contribution of MSMEs to national GDP is 61.1%, and non-oil and gas exports are 16.7% (Bank Indonesia, 2021). Although Indonesian MSMEs have made significant contributions, they still face challenges in improving their performance. An example of this challenge is the low level of financial literacy regarding the relationship between financial literacy and MSME performance.

A study by Curak et al. (2022) found that MSMEs with higher levels of financial literacy have more optimal work performance in terms of profitability, productivity, sales growth, and others. Adomako & Danso (2022) also found that good financial literacy helps MSME managers make better financial choices, manage cash flow more efficiently, and access external finance, indicating that it helps improve performance, which ultimately

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contributes to improving business performance.

Based on the 2019 OJK survey, the level of financial literacy of MSME actors only reached 29.7%, far below the national level of adult financial literacy of 38.03% (Financial Services Authority, 2019). Low financial literacy has an impact on weak financial and accounting regulations for MSMEs (Susilowati & Budiarto, 2020). Furthermore, the level of financial inclusion is related to the relationship between financial inclusion and MSME performance. Recent studies have shown that financial inclusion has a positive impact on MSME performance. A study by Nwachukwu & Hieu (2022) found that increasing access to financial services in the form of credit and savings allows MSMEs to increase investment, increase productivity, and ultimately improve performance.

Micro, Small and Medium Enterprises (MSMEs) have a primary function in the Indonesian economy, but still face various challenges, especially in terms of financial management. According to data from the Ministry of Cooperatives and SMEs (2022), around 60% of MSMEs in Indonesia still have difficulty in managing their business finances properly. This has a significant impact on the performance and sustainability of their businesses. Poor financial management is often the root of the problem for MSMEs. Research conducted by Nurwani & Safitri (2021) shows that more than 70% of MSMEs do not have regular bookkeeping without distinguishing between personal and business finances. As a result, many MSMEs have difficulty managing cash flow, controlling expenses, and planning investments for business development.

Regarding the relationship between financial management and MSE performance, recent studies have shown a significant positive correlation. Research conducted by Pratiwi & Hermawan (2023) found that MSEs with good financial management have a 30% higher profitability level compared to MSEs with poor financial management. Furthermore, Suryani et al. (2022) in their research concluded that MSEs with a regular and transparent financial recording system have a 40% higher chance of obtaining financing from the conventional financial sector.

Effective financial management also affects the ability of MSEs to make strategic decisions. According to a study conducted by Firdaus & Rahman (2023), MSEs with good financial management tend to be better able to identify investment opportunities, manage risks, and respond to market changes more quickly and accurately. This ultimately has a positive impact on business growth and MSE competitiveness in the market.

However, there are still many MSEs that do not have sufficient understanding and creativity for financial management. A survey conducted by the Financial Services Authority (OJK) in 2023 indicated that only 35% of MSME owners had ever attended financial management training. Limited access to financial education and training has an impact on low financial literacy among MSME actors (Wibowo et al., 2022).

Financial management is a crucial factor that affects MSME performance. If the financial management practices implemented are good, then the ability of MSMEs to increase profitability is also high, gain access to financing, and make the right strategic decisions. Therefore, efforts to increase financial management capacity for MSME actors need to be a priority in the MSME development program in Indonesia.

Thus, the study carried out has something to be achieved, namely to be able to analyze the influence of financial literacy, financial inclusion, and financial management on the work performance of MSMEs in Indonesia. Good financial literacy and inclusion, as well as appropriate financial management, are expected to improve financial literacy, access to finance, and professionalism in running MSMEs. In this way, the performance and competitiveness of Indonesian MSMEs can be improved, especially MSMEs in the East Flood Canal (BKT) Area.

2. THEORETICAL BASIS

2.1 Financial Literacy

a. Financial Literacy Concept

In today's modern world, especially for working professionals, literacy skills are essential to solving complex challenges in everyday life. Low financial literacy makes it difficult for someone to assess finances, manage money, and make financial plans. In addition to low income, poor household financial management such as carelessly taking loans can also cause household financial problems. Lack of financial literacy affects daily decision-making and can lead to financial mismanagement, inefficiency, financial difficulties and vulnerability to crime. Poor financial literacy affects daily decision-making and can lead to financial mismanagement, inefficiency, and vulnerability to financial difficulties and crimes. One way to overcome low financial literacy is through financial education, although Indonesia is still lacking in distributing financial education, unlike developed countries that have implemented it to obtain healthy financial literacy for their people.

b. Definition of Financial Literacy

Financial literacy is not only about knowing, using, and trusting financial institutions, products, and services, but also about changing individual financial actions and behaviors to become financial leaders to live a richer life. Because, the design of a financial literacy system based on an understanding approach alone will not be able to change behavior if individuals do not have the right actions and motivations. Actions, on the other hand, are the implementation of an attitude. Financial attitudes and behaviors support individuals in determining what they want to achieve from finances, implementing financial plans, determining financial choices, and managing finances appropriately to achieve wealth.

The ability to meet current and future financial obligations, plan for future financial needs, and make decisions to enjoy life are indicators of financial well-being. Financial knowledge is an important component in

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shaping financial well-being and is an important component in shaping financial well-being. The concept is driven by a subjective perspective that encourages everyone to understand their financial behavior. In this way, we move from pure financial literacy to achieving broader and more sustainable financial well-being.

2.2 Financial Inclusion

a. Understanding Financial Inclusion

Financial inclusion emphasizes the availability and equality of access to financial services for individuals and businesses. This includes a range of financial products and services including banking, loans, investments, and insurance that are affordable and timely. Financial inclusion efforts generally target the unbanked and underbanked. Having an inclusive financial system is associated with stronger and more sustainable economic growth and development, making it a priority for many countries.

Financial inclusion aims to help inclusive growth by reducing economic deprivation, increasing development, equalizing financial distribution, and balancing the financial system. Financial inclusion is an effort to eliminate all things that hinder access to financial services, both price and non-price barriers, so that every individual can improve their standard of living. Financial inclusion parameters include savings account ownership rights, coverage, payment services, and installments from non-formal financial institutions.

A study by Sarma (2012) formulated a financial inclusion index based on banking indicators, namely the use of accounts in the community, banking penetration (how many people have bank accounts), and accessibility of financial services to reach the community. The indicator interprets people's behavior when managing finances with banking products. The target of financial inclusion planning is a group of individuals who have not used financial services, including low-income economic groups who have little income, are unemployed and unproductive, will be poor, and across groups including migrant workers, women, and residents in remote areas. The most important financial services for the community include saving funds, installments, payment methods, guarantees, and pension funds.

b. Financial Inclusion Model in Indonesia

The development of global financial inclusion is driven by the acceleration and innovation of technology, especially through the use of mobile phones that facilitate access and make it more inclusive. Mobile communication media is an option to offer access to financial services to people in various regions. One of the obstacles in the development of financial inclusion is the difference in geographical areas that make it difficult to access financial services. The implementation of financial inclusion, especially banking financial institutions, through a number of obstacles both from the community and the financial institutions themselves. From the community side, the obstacles include the absence of banks around the place of residence or the long distance to reach the nearest branch office, and the level of knowledge in managing finances is considered inadequate. Meanwhile, from the financial institution side, the obstacle is the limited scope of the region in expanding connections within the institution. To open an office in a remote area, financial institutions face the problem of a high development budget.

2.3 Financial Management

a. Definition of Financial Management

According to Kasmir (2017), financial management refers to all activities related to income, financing, and asset management that contain a number of things that are to be achieved as a whole. Based on the statements of Hartati (2018) and Supriadi (2022), in addition to business value being maximized through efficient use and allocation of funds, the entire process of minimizing costs and increasing business income is carried out to produce. In recent years, financial management practices have attracted great attention from various organizations including governments, financial institutions, and universities (Mien Nguyen Thi Ngoc, 2019). A number of studies define financial management as a series of actions related to planning, implementing, and evaluating cash, credit, investment, insurance and pension benefits, as well as estate planning matters. Financial management can also be interpreted as several things related to cash flow, installments, savings, and stock investment management (Dew & Xiao, 2011)

b. Financial Management and Development of MSME Businesses

Financial management and developing a business are very necessary in the implementation by parties who have MSME businesses. Based on Ediraras' statement (2015) MSMEs whose finances are managed and conveyed openly and appropriately can have a positive impact on the MSME business unit. If this can be implemented by all who have a business, there is a great opportunity to advance a business that was initially small, crawling to medium to large businesses. The stages that need to be implied by MSME owners so that their businesses can grow and progress are not to include a person's characteristics, feelings and tendencies towards something to determine decisions, because it can cause them to determine the wrong attitude, this can be known as behavior management or management behavior (Ricciardi & Simon, 2010). Giltman (2020) said that personal financial management is knowledge in managing financial resources from individual businesses. Thus, personal financial management contains two aspects covering an understanding of finance and creativity to carry out management because the activity of managing requires perseverance and determining priorities that come from self-control. The role of parties who have MSMEs is very dominant in carrying out their business. The party that owns the MSME bears full responsibility for the business that it carries out. Some of the right decisions in its business management, therefore, find the right attitude

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of financial management and business development (Supriadi, 2022).

c. Financial Management Behavior

According to research by Ida & Dwinta (2010), financial management is related to personal financial obligations, including daily planning, budgeting, and financial management. Based on the statement of Dew & Xiao (2011) financial management behavior is a person's expertise in making a strategy for making a budget, managing, controlling, tracking and saving financial funds every day. Financial management behavior is related to individual financial obligations related to financial management methods.

The tasks related to finance are the stages of financial management and the stages of mastering the use of financial capital or other capital productively. Based on the statement of Laily (2013) it is revealed that personal financial management is an application of the idea of individual-level financial management. Financial management includes activities to formulate strategies, manage and control finances in order to achieve financial prosperity. Financial management is an individual's expertise in managing, namely organizing a plan, managing, controlling, finding, and saving a daily financial budget (Al Kholilah & Iramani, 2013).

The high desire of a person to meet the needs of life based on the level of per capita income is the cause of the presence of financial management behavior. According to Zahro (2014), personal financial management behavior is the most basic ability needed by every individual today, because customer options over time affect financial protection and individual living conditions. Based on Mien & Thao (2015) "optimal financial management must improve positive financial well-being and failure to manage personal finances can result in serious long-term problems in the form of crime and social concepts. Financial behavior is a financial theory that ignores the role of individuals (humans) in the real world in making decisions and making a difference". Factors that can influence financial management behavior based on the statement of Rizkiawati & Asandimitra (2018:94) "there are seven factors that influence a person's financial management behavior including income, gender, age, financial knowledge, attitudes towards finance (financial attitudes), locus of control, and financial self-efficacy".

2.4 MSME Performance

Ali in Aribawa (2016) stated that measuring the performance of MSMEs is often not easy to be carried out quantitatively due to limited resources such as financial knowledge and workers. In measuring the performance of work that is commonly used, which has complete financial elements, it does not fully describe the actual condition of the business. In addition, the performance measurement that is often used is more suitable for a large and well-structured business unit in relation to the business arrangement. Thus, a non-cost performance measures approach is used, namely a measurement method through a point of view, in order to measure the level of performance

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of MSMEs, which is financial or non-financial (Kaplan, 2005). Samir & Larso (2011) stated that company performance is the expertise possessed by the party managing the business to determine attitudes that have consequences that can be borne.

Aribawa (2016) "said that in analyzing MSME performance, all approaches are needed that are based on a number of assumptions, namely: (1) limited resources make performance measurement difficult to implement quantitatively; (2) complex financial indicators in measuring performance, have an impact on the lack of effectiveness of the actual state of the company; (3) performance measurement is generally less suitable when implemented in companies other than large companies with structured management". However, in contrast to these perceptions, the opinion outlined by Rapih (2015), "measurement of MSME performance can be carried out with a number of indicators, namely: (1) growth in profits in nominal money that is increasing; (2) the number of consumers who buy products is increasing; (3) the number of product sales is increasing; (4) the number of company assets, both fixed and non-fixed assets, is increasing". Widiyanti (2016) in her study showed findings that financial literacy variables can influence MSME performance.

2.4 Hypothesis

H1: Financial Literacy Has a Significant Influence on MSME Performance

H2: Financial Inclusion Has a Significant Influence on MSME Performance

H3: Financial Management Has a Significant Influence on MSME Performance.

3. RESEARCH METHODS

3.1 Population and research sample

The population of this study is MSME actors in the BKT (East Flood Canal) area with a total of approximately 780 MSME actors. The sample of this study is part of the MSME stakeholders in the BKT (East Flood Canal) area as many as 90 samples.

3.2 Data collection

The data collected are primary and secondary data. Data collection was carried out by observation in the East Flood Canal (BKT) Area. Then distributing questionnaires to respondents who are logically related to the performance of MSMEs in the East Flood Canal (BKT) Area. Data collected

3.3 Data Analysis

This study uses the Partial Least Squares (PLS) method to analyze the effect of Financial Literacy (X1), Financial Inclusion (X2), and Education Level (X3) on MSME Performance (Y). The PLS-SEM model consists of three elements/measurement models (outer model), structural model (inner model) and hypothesis testing.

4. DISCUSSION

4.1 Evaluation of Measurement Model (outer model)

a. Convergent Validity

Convergent validity is used to test variable indicators against factor loading values. This value is accepted if the load factor value is greater than 0.7. However, load factor values between 0.4 and 0.7

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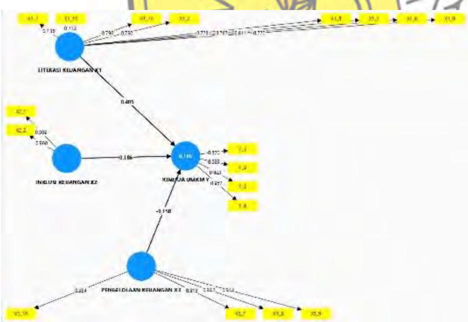
will be completely eliminated if the AVE value can be increased (the value must be greater than 0.5). It can be observed that a number of indicators have loading factors below 0.7 which will be immediately removed to increase the AVE owned by the research model.

Indicators whose values are invalid or below 0.7 need to be eliminated from the model, so for the red indicator model, it needs to be eliminated and then the PLS algorithm is re-run and the results can be seen in figure 1 which shows all indicators are more than 0.7.

Figure 1 Final Loading Factor



Source: data processed with SmartPLS 4 (2024)

The final check of convergent validity is by observing the AVE value. Indicators are assumed to have good convergent validity, namely if they have an AVE value of more than 0.5.

b. Discriminant Validity

- Crossloading

The discriminant validity test is conducted by examining the value of the cross-loading indicator. Discriminant validity is considered good if the indicator correlates more strongly with the variable compared to other variables.

- Fornell-Larcker

All variables have a higher AVE square root value than their correlation with other variables, indicating that discriminant validity is met for all constructs. This means that each latent variable shares more variance with its own indicators than with other latent variables in the model. Good discriminant validity indicates that the constructs in the model are conceptually and empirically different from each other.

In the Financial Literacy Variable (X1) (AVE square root value: 0.773). Higher than its correlation with other variables, indicating good discriminant validity. In the Financial Inclusion Variable (X2) (AVE square root value: 0.905). Has the highest value compared to its correlation with other variables, indicating good discriminant validity. In the Financial Management Variable (X3) (AVE square root value: 0.937). Has the highest value, indicating very good discriminant validity. In the MSME Performance Variable (Y) (AVE square root value: 0.918). Higher than its correlation with other variables, indicating good discriminant validity.

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- Heterotrait-monotrait ratio (HTMT)

A lower HTMT value indicates better discriminant validity. Generally, an HTMT value below 0.90 is considered to indicate good discriminant validity. All HTMT values in this matrix are below 0.90, indicating good discriminant validity between all pairs of constructs.

The highest HTMT value (0.876) is between Financial Management (X3) and Financial Literacy (X1), indicating that these two constructs have some similarities, but are still within acceptable limits. The lowest HTMT value (0.268) is between Financial Management (X3) and MSME Performance (Y), indicating that these two constructs are very different from each other.

Based on the HTMT criteria, this model shows good discriminant validity for all constructs. This means that each construct in the model is empirically unique and captures events that are not represented by other constructs in the model. These results support the validity of the measurements used in this study.

4.2 Evaluation of Structural Model (inner model)

a. R-square

R-square: The R-square value is 0.186 or 18.6%. This shows that the independent variables in the model can interpret 18.6% of the variation in MSME performance (Y). The rest (81.4%) is interpreted by other factors outside the model.

R-square adjusted: The R-square adjusted value is 0.157 or 15.7%. The adjusted R-square takes into account the number of predictor variables in the model and provides a more conservative estimate of how well the model explains the dependent variable. This value is slightly lower than the usual R-square, which is common.

Table 1 R-square

	R-square	R-square adjusted
MSME performance (Y)	0,186	0,157

Source: data processed with SmartPLS 4 (2024)

This model has relatively low explanatory power, because it only explains around 15-18% of the variation in MSME performance (Y). This shows that there may be other important factors that influence MSME performance (Y) that have not been included in the model. Nevertheless, this model still provides some insight into the factors that influence the performance of MSME (Y), although its influence is limited.

b. F-square

The f-square value measures the magnitude of the influence of the independent variable on the dependent variable. General instructions for interpreting f-square: 0.02 = small effect 0.15 = medium effect 0.35 = large effect All independent variables (X1, X2, X3) have a relatively small effect on MSME Performance (Y). Financial Literacy (X1) has the largest effect, followed by Financial Inclusion (X2), and finally Financial Management (X3). Although there are differences in the magnitude of the effect, all variables are still in the small effect category.

Table 2 F-square

	Financial Inclusion (X2)	MSME Performance (Y)	Financial Literacy (X1)	Financial Management (X3)
Financial Inclusion (X2)		0,028		
MSME Performance (Y)				
Financial Literacy (X1)		0,063		
Financial Management (X3)		0,010		

Source: data processed with SmartPLS 4 (2024)

Financial Inclusion X2 on MSME Performance Y (f-square value: 0.028). This means the influence is small. Financial inclusion has a relatively small effect on MSME performance. Financial Literacy X1 on MSME Performance Y (f-square value: 0.063). Small to medium effect. Financial literacy has a greater influence than financial inclusion, but is still in the small effect category. Financial Management X3 on MSME Performance Y (f-square value: 0.010). Very small effect. Financial management has the smallest influence among the three variables on MSME performance.

c. GOF Test

The Goodness of Fit (GoF) Index is a single measure used to test the combined performance of measurement and structural models

5. CONCLUSION

Based on the results of the analysis and discussion of research on the influence of financial literacy, financial inclusion, and financial management on MSME performance, it can be concluded that Financial Literacy has a significant positive influence on MSME Performance. This is indicated by the path coefficient of 0.405 with a p-value of 0.028 (<0.05). Financial Inclusion also does not have a significant influence on MSME Performance. Although the path coefficient shows a positive direction (0.186), the p-value of 0.137 (> 0.05) indicates that the influence is not statistically significant. Furthermore, Financial Management does not have a significant influence on MSME Performance. The path coefficient shows a negative direction (-0.150) with a p-value of 0.364 (> 0.05). Of the three variables studied, Financial Literacy has the largest and only significant influence on MSME Performance.

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