

# Financial Literacy and MSME Performance: The Role Mediating of Financial Behaviour of MSMEs

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**Abstract:** Micro, Small and Medium Enterprises have a significant role in economic development and contribute to poverty alleviation efforts through job creation. The Covid-19 pandemic had a substantial impact on the development of MSMEs in the food and beverage sector in Malang City, which experienced a decline in turnover of around 70 per cent. Regarding the phenomenon of the impact of the Covid-19 pandemic on the survival of MSMEs, it is interesting to study the performance of MSMEs in Malang City. So that there is no purpose of this study to determine the effect of financial literacy on financial behaviour and performance of MSMEs and determine the role of financial behaviour in mediating the impact of financial literacy on MSME performance. The unit of analysis of this research is owners of food and beverage MSMEs in Malang, amounting to 132 MSMEs. Data analysis using *Structural Equation Modeling*. The results showed that financial literacy carried out by food and beverage SMEs in Malang City creates good financial management, thereby improving financial behaviour. Improving the performance of food and beverage SMEs in Malang City through financial performance requires greater emphasis on aspects of financial behaviour. Financial behaviour carried out by food and beverage MSME owners in Malang City can mediate the influence of financial literacy on MSME performance. To increase awareness of good financial behaviour in the MSME sector, it is necessary to conduct financial training and seminars by the government and the private sector that focus on the MSME sector because financial knowledge or literacy is needed as a basis for decision making in business activities.

**Keywords:** financial literacy, financial behaviour and performance of SMEs

**JEL Classification:** G4, G53, L26

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## 1. Introduction

Micro, Small and Medium Enterprises (MSMEs) have a significant role in economic development (Audretsch *et al.* 2009). Specifically, the existence of MSMEs is believed to contribute to poverty alleviation efforts through job creation (Adomoko *et al.*, 2014). The biggest problem MSMEs face in several developed

and developing countries is financing problems (Beck *et al.*, 2004). Some financial funds think that MSMEs in Indonesia are not bankable (Indonesian Banking Development Institute, 2015). Therefore, MSME owners try to find additional funds from family, friends or use their savings. MSMEs often experience delays in business development. This is due to various conventional problems, such as the problem of human resource capacity, ownership, financing, marketing and various other problems related to business management, making it difficult for MSMEs to compete with large companies (Abor and Quartey, 2010).

The Covid-19 pandemic has had a significant impact on the city's economy poor. Regional Original Income (PAD) experienced a 20.78 per cent decline due to the economy being stagnant until now in the middle of 2020 (merdeka.com). One of the sectors hardest hit by the COVID-19 pandemic is MSMEs. The Head of Business Development and Strengthening of the Malang City Industry and Trade Cooperatives Office (Diskopindag) explained, in Malang City, there were around eight thousand MSMEs. During the COVID-19 pandemic, 20 per cent of them or about 1,600 MSMEs experienced suspended animation and could not produce or produce. Run their business. This condition occurred from March to early September 2020. The most affected were textile and fashion SMEs, while the food and beverage persisted with their business during the covid-19 pandemic even though the turnover obtained decreased by around 70 per cent (jatimtimes.com).

Bank Indonesia's efforts to encourage MSMEs to rise during the Covid-19 pandemic by facilitating fostered MSMEs to identify potential and market taste related to various products produced through the distribution of MSME loans and loans disbursed by Bank Indonesia for MSMEs reached Rp40 trillion and 36 per cent or around Rp14. Trillion. Even though they have received a large amount of credit, MSMEs still face many obstacles, including the lack of competitiveness, because of their low ability to manage finances.

Regarding the phenomenon of the Covid-19 pandemic on the survival of MSMEs, it is interesting to study the performance of MSMEs in Malang City during the Covid-19 pandemic. Daft (2010) revealed that MSME performance is the level of success achieved both in quality and quantity from the group of achievement that has been targeted. The majority of MSMEs are not willing or objected to providing MSME performance data with data related to finance. Therefore, measuring the performance of SMEs using the owner's perception approach (Dess and Beard, 1984). Tsang *et al.* (1999) explained that it could measure financial performance, customer satisfaction, internal processes, learning and growth. Bittici *et al.* (2000) explain that the level of sales measures a business, cost of sales, assets owned, brand image and fixed assets owned by the company. In MSMEs, Taticchi (2010) explains that the MSME performance measurement scale uses financial performance, such as ROI and ROE.

Meanwhile, Hafeez *et al.* (2012), MSME performance indicators are seen from financial and market performance. Financial performance is measured by operating profit and Return On Investment per year. Meanwhile, market performance is seen from the sales and market share of SMEs for three years. Li *et al.* (2006) and Nybakk (2012) explain that performance indicators are measured by financial performance, market performance and competitiveness.

The performance produced by MSMEs comes from excellent resources, which is reflected in financial literacy. The causal relationship between financial literacy and business performance is motivated by the Resource-Based View (RBV) theory. RBV theory states that if companies can manage resources to become more valuable, rare, inimitable, and non-replaceable, they will achieve growth performance and gain sustainable competitive advantage (Barney, 1991). RBV theory explains competitive advantage, which

ultimately results in superior performance in the company (Clulow et al., 2007). With high financial literacy, companies will have the ability to access financial resources (as resources) and be managed optimally to create company performance (Adomako & Dans, 2014). According to Humaira & Sagoro (2018), Financial literacy is described as a reflection of how well an individual can deal with and use information related to personal finance. In addition, financial literacy includes the ability and belief of an individual to use his financial knowledge in making financial decisions (Huston, 2010). Cwynar (2020) shows a significant difference between the millennial generation and other generations in terms of financial literacy, where the millennial generation has less financial knowledge and financial behaviour than different generations. Financial literacy is viewed as an imperative instrument for the success of MSMEs because it helps to apprehend and consider the facts wished to make each day selections that have an economic effect on the everyday management of groups (Fernandes, 2015).

Chen and Volpe (1998) revealed that financial literacy could be measured using four indicators: basic knowledge of financial management, credit management, savings and investment management, and risk management. Van Rooij et al. (2011) uses financial management, debt, savings, insurance, and investment in measuring financial literacy. Mendari & Kewal (2013) revealed that financial literacy could be measured using indicators of basic knowledge of personal finance, savings and loans, insurance and investment.

Financial literacy has a close relationship with the performance of a business; financial information helps evaluate the success of previous decisions and is used to determine the current business position (Chepngetich, 2016). Dahmen and Rodriguez (2014) found that there was a relationship between financial literacy and business performance. Entrepreneurs who have good financial literacy skills are better able to review and review financial statements to influence decision-making related to their business and directly affect the company's overall success. Wise (2013) increasing financial literacy causes business or business actors to make financial reports more often. With frequent financial statements, entrepreneurs tend to be less likely to default when they have loans and have a slight chance of accidentally closing their business. Different results were found by Eniola & Entebang (2015) that financial literacy had no significant effect on firm performance. Sunday, U. Okanta (2018) concludes that the level of adoption of financial literacy has no impact on the performance of small-scale companies in the State of Abia, Nigeria.

The existence of conflicting results of empirical studies of the influence of financial literacy on the performance of MSMEs is interesting to be reviewed by examining financial behaviour as a mediating variable. The owners who run and manage the business will have behaviour in themselves, and this behaviour is reflected in the awareness of wanting to know about finances. Shefrin (2009) defines financial behaviour as a study that studies how psychological phenomena affect financial behaviour. Parotta (1998) states that behavioural finance is a process for managing financial resources to achieve financial success in money management, credit management, retirement planning and financial planning, implementation, and financial evaluation.

In their research, Hilgert and Hogart (2003) explain that healthy financial behaviour is indicated by good financial planning, management, and control activities. Parotta & Johnson (1998) revealed indicators of financial behaviour, namely (1) financial management, (2) credit management, (3) retirement plans, and (4) financial planning. Kempson et al. (2017) six warning signs in measuring monetary behaviour variables: spending restraint, energetic saving, now not borrowing for every day expenses, planning how you use your earnings (budgeting), keeping tune of money, and informed product preference. Selcuk (2015) has three

indicators of financial behaviour: being punctual in paying bills, paying several accounts such as electricity, postpaid credit, and rent according to the specified time. Create a personal budget prepare a budget systematically in the form of numbers for a certain period in the future. Have savings for the future, related to savings that can be used when there is an urgent need in the future.

*Financial literacy* provides essential knowledge and knowledge about a person's attitudes and behaviour in following individual financial decisions to plan future finances. Nofsinger (2011) defines behavioural finance as studying how humans behave in a financial decision, mainly how psychology affects financial decisions, companies and financial markets. Zemtsov & Osipova (2015) revealed that financial behaviour results from financial knowledge and literacy, financial attitudes, and financial management. Dwiastanti (2015), Grohmann (2018), Andarsari and Ningtyas (2019), Oliveira et al. (2019), Dai et al. (2021) concluded that financial literacy has a positive influence on financial behaviour. Continuing to pay attention to financial literacy can make financial behaviour more focused in the long term.

Efforts to improve the performance of MSMEs, greater emphasis on aspects of financial behaviour is needed because financial behaviour is significant to train MSME owners to be responsible for managing finances. Good financial behaviour can be described by having effective behaviour such as preparing financial records, documentation on cash flow, planning costs, paying bills, controlling the use of credit cards and savings plans (Zemtsov & Osipova 2015). Adomako & Danso (2014) prove that financial behaviour has a significant effect on firm performance.

Based on the phenomena and results of previous empirical studies that have not been consistent, this study examines financial behaviour as a mediator of the influence of financial literacy on the performance of MSMEs developed in one model.

## 2. Method

Following the main problem and research objectives, this study uses a quantitative approach, which is an approach that emphasizes testing theories or concepts through metric/numerical measurement of variables and performing data analysis procedures with statistical equipment and aims to test hypotheses. The type of research is explanatory research. The pattern of influence revealed in this study is the influence of financial literacy on financial behaviour and the performance of MSMEs. The unit of analysis in this study is the owners of food and beverage SMEs in Malang, which amount to 132 SMEs. Data collection techniques in this study were carried out using online questionnaires and face to face directly with respondents to obtain relevant information about facts in the form of opinions on assessments of financial literacy on financial behaviour and performance of SMEs. To measure the variables to be studied through respondents' responses, it will use the Likert scale. Respondent gave each answer to the questions in the questionnaire was given a measurement score of 5 (1=strongly disagree, 3=neutral, and 5=strongly agree). In general, the constructs and indicators used are presented in Table 1.

**Table 1. Operational Variables**

Variable	Indicator	Source
Financial literacy	Financial management	Chen and Volpe (1998) Van Rooij et al. (2011) Mendari & Kewal (2013)
	Credit management	
	Savings management	
	Investment management	
	Risk management	
Financial behaviour	Financial planning	Hilgert and Hogart (2003), Parrotta & Johnson (1998), Kempson et al. (2017) and Selcuk (2015)
	Budget planning	
	Expenditure control	
MSME Performance	Market performance	Tsang et al (1999), Bittici et al (2000), Taticchi (2010), Hafeez et al (2012), Li et al (2006), Ratnawati (2018) and Nybakk (2012)
	Financial performance	
	Growth	
	Production	
	Competitiveness	

The model used in this study is causal. To test the hypothesis proposed in this study, the analytical technique used is SEM (Structural Equation Modeling), operated through the AMOS version 20 program. The Sobel test will investigate financial behaviour as a mediator of the influence of financial literacy on SMEs' performance. With a level of significance  $\alpha = 5\%$ , if the probability is  $< 5\%$ , then financial literacy influences the financial behaviour and performance of MSMEs and financial behaviour as a mediator of the influence of financial literacy on the performance of MSMEs.

### 3. Findings and Discussions

#### Instrument Testing

The questionnaire as an instrument must meet the main requirements, namely valid and reliable. The results of testing the validity and reliability of the tool can be seen in Table 2 below:

**Table 2** Instrument Validity and Reliability Test Results

Variable	Items	Correlation		coefficient	
		r	status	alpha	status
Financial literacy	X1.1	0.606	Valid	0.704	Reliable
	X1.2	0.563	Valid		
	X1.3	0.695	Valid		
	X1.4	0.805	Valid		
	X1.5	0.714	Valid		
Financial behaviour	Y1.1	0.723	Valid	0.629	Reliable
	Y1.2	0.757	Valid		
	Y1.3	0.820	Valid		
MSME performance	Y2.1	0.911	Valid	0.794	Reliable
	Y2.2	0.827	Valid		
	Y2.3	0.797	Valid		
	Y2.4	0.485	Valid		
	Y2.5	0.691	Valid		

The validity and reliability tests outcomes show that all lookup instrument gadgets are stated to be valid and reliable due to the fact they have met the validity trying out criteria, namely the Pearson Product Moment Correlation Index (r) 0.3 and the reliability checking out criteria, specifically the Alpha value. Cronbach 0.6.

**Confirmatory Factor Analysis Results**

The results of measurements of the dimensions or indicators of variables that can form latent variables with CFA and the determination of indicators of research variables are based on the value of *factor loading*. The summary of the results of the CFA test on the hands that make up the research variables is shown in Table 3.

**Table 3 Factors Loading ( $\lambda$ ) Measuring Research Variables**

Indicators and Variables			FL
Financial management	<	Financial literacy	0.740
Credit management	<	Financial literacy	0.685
Savings management	<	Financial literacy	0.688
Investment management	<	Financial literacy	0.650
Risk management	<	Financial literacy	0.496
Financial planning	<	Financial behaviour	0.618
Budget planning	<	Financial behaviour	0.672
Expenditure control	<	Financial behaviour	0.800
Market performance	<	MSME performance	0.740
Financial performance	<	MSME performance	0.803
Growth	<	MSME performance	0.662
Production	<	MSME performance	0.683
Competitiveness	<	MSME performance	0.372

Based on Table 3, it can explain that the indicators that make up the financial literacy variable have a factor loading (FL) value above 0.5. Thus, all the indicators tested are essential indicators for forming financial literacy. Furthermore, when viewed from the loading factor value of each indicator, the indicator that is considered to have the most substantial contribution in developing the financial literacy variable is financial management, with a loading factor value of 0.740.

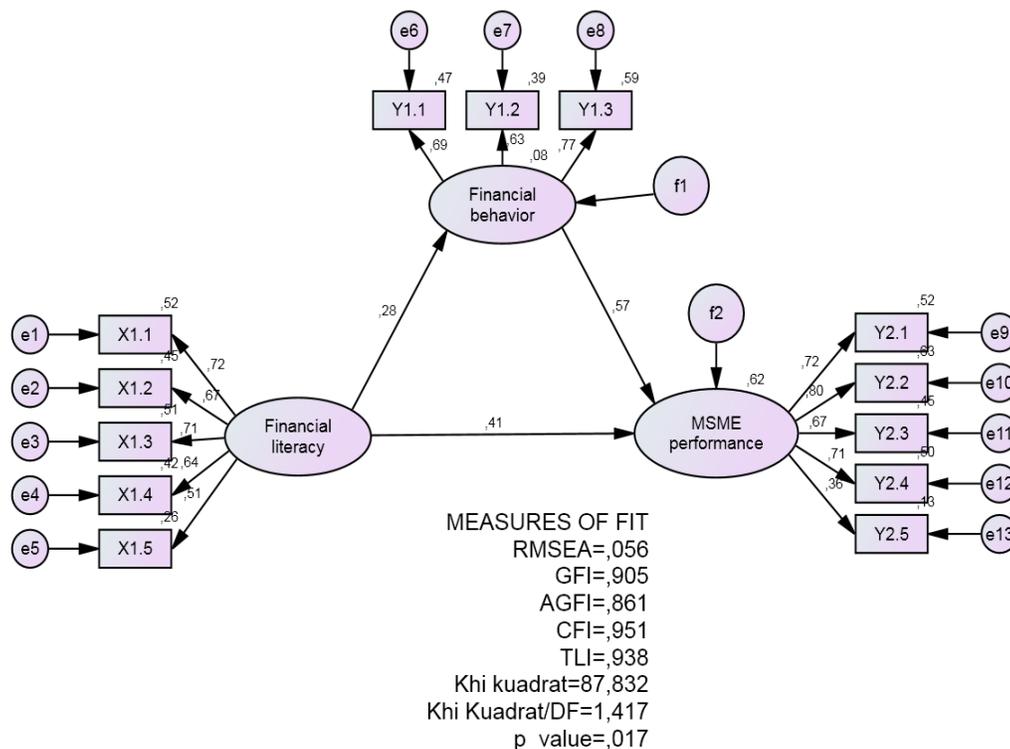
The indicators that make up the financial behaviour variable have a factor loading (FL) value above 0.5. Thus, all the indicators tested are essential indicators of forming financial behaviour. Furthermore, when viewed from the loading factor value of each indicator, the indicator that is considered to have the most substantial contribution to create the financial behaviour variable is expenditure control with a loading factor value of 0.800.

The indicators that make up the MSME performance variable have a factor loading (FL) value above 0.5. Thus, all the indicators tested are essential indicators for forming MSME performance. Furthermore, when viewed from the loading factor value of each indicator, the indicator that is considered to have the most significant contribution in developing the MSME performance variable is a financial performance with a loading factor value of 0.803.

**The goodness of Fit SEM Analysis Results**

The theoretical model in the study's conceptual framework is stated to be suit if supported by way of empirical data. The results of the goodness of in shape overall mannequin test, by the results of the SEM analysis, to decide whether empirical information guide the hypothetical model, are given in Figure 1.

Figure 1. The results of the goodness of fit overall model test



The Goodness of Fit Overall check results, based totally on Figure 1, explains that not all criteria point out a appropriate model. Referring to Arbuckle and Wothke (1999:617) opinion, the first-class criteria as an indication of the model's goodness are the CMIN/DF value, which is less than 2, and the RMSEA, which is beneath 0.08. In this study, the CMIN/DF and RMSEA values have met the reduce off value. Therefore the hypothetical mannequin is supported by using empirical facts so that it is appropriate and feasible to use.

**Hypothesis Testing Results**

Testing this hypothesis is used to show the impact of financial literacy on monetary behaviour and overall performance of MSMEs and economic behaviour as a mediator of the have an impact on of monetary literacy on MSME performance. The effects of hypothesis testing are presented in Table 4 below.

Table 4. Hypothesis Testing Results

Effect Between Variables				Cr.	p	
Financial literacy	→	Financial behaviour		2,164	0.030*	
Financial behaviour	→	MSME performance		4,903	0.000*	
Financial literacy	→	MSME performance		3,498	0.000*	
Financial literacy	→	Financial behaviour	→	MSME performance	1,980	0.047*

Note : \* p < 5%

The influence of financial literacy on financial behaviour produces a Critical ratio (Cr) value of 2.164 with a probability value (p) of 0.030, which is smaller than a significance of 5%. This result shows that the more potent financial literacy, the better the financial behaviour of MSME owners. The awareness of wanting to know about finances reflected in owners who run and manage businesses has internal behaviours such as financial planning, budget planning, and expenditure control. (Hilgert and Hogart, 2003, Parrotta & Johnson, 1998, Kempson et al. 2017 and Selcuk, 2015).

Based on the confirmatory factor analysis results, expenditure control is the most substantial contribution in shaping financial behaviour. The role of financial literacy carried out by food and beverage MSMEs in Malang City creates good financial management. Such as management in obtaining and using funds efficiently, contributing to the improvement of financial behaviour, which is shown through expenditure control that can do it with physician supervision, historical accounting, and financial literacy. Using budget control.

The results of this study are in line with the opinion of Nofsinger (2011) that financial behaviour studies how humans behave in a financial decision. Zemtsov & Osipova (2015) reveal that financial behaviour results from financial knowledge and literacy, financial attitudes, and financial management. Dwiastanti (2015), Grohmann (2018), Andarsari and Ningtyas (2019), Oliveira et al. (2019), Dai et al. (2021) concluded that financial literacy has a positive influence on financial behaviour. Continuing to pay attention to financial literacy can make financial behaviour more focused in the long term.

The influence of financial behaviour on the performance of MSMEs produces a Critical ratio (Cr) value of 4,903 with a probability value (p) of 0.000, which is smaller than a significance of 5%. This result shows that the better the financial behaviour of the MSME owners, the higher the performance of MSMEs. The study can explain the effects that the financial behaviour of food and beverage MSME owners in Malang City contributes to improving MSME performance such as market performance, financial performance, growth, production and competitiveness (Tsang et al., 1999, Bittici et al. 2000, Taticchi, et al. 2010, Hafeez et al. 2012, Albahusain, 2015, Li et al., 2006 and Nybakk, 2012). The results of the confirmatory factor analysis, the most significant or most potent contribution in shaping the performance of MSMEs is financial performance,

The results of this study are in line with the opinion of Zemtsov & Osipova (2015). Good financial behaviour can be described by having effective behaviour such as preparing financial records, documentation on cash flow, planning costs, paying bills, controlling credit cards, and saving plans. Adomako & Danso (2014) prove that financial behaviour has a significant effect on firm performance.

The influence of financial literacy on the performance of MSMEs produces a Critical ratio (Cr) value of 3,498 with a probability value (p) of 0.000, which is smaller than a significance of 5%. This result shows that the more vital financial literacy, the higher the performance of MSMEs. The study can explain that the version of food and beverage MSMEs in Malang City comes from superior resources, which are reflected in financial literacy through financial management, credit management, savings management, investment management and risk management (Chen and Volpe, 1998, Van Rooij, et al. 2011, and Mendari & Kewal 2013). The results of the confirmatory factor analysis, the most significant or most potent contribution in shaping financial literacy is financial management. It means that food and beverage MSME owners in Malang City who can manage finances well will impact improving MSME performance. The causal relationship between financial literacy and business performance is motivated by the Resource-Based View (RBV) theory. RBV theory states that if companies can manage resources to become more valuable,

rare, inimitable, and non-replaceable, they will achieve growth performance and gain sustainable competitive advantage (Barney, 1991). RBV theory explains competitive advantage, which ultimately results in superior performance in the company (Clulow et al., 2007). With high financial literacy, companies will have the ability to access financial resources (as resources) and be managed optimally to create company performance (Adomako & Dans, 2014). Financial literacy is seen as an essential instrument for the success of MSMEs (Fernandes, 2015). Dahmen and Rodriguez (2014) found that entrepreneurs who have good financial literacy skills are better able to review and review financial statements to influence decision-making related to their business and directly affect overall business success. Wise (2013) increasing financial literacy causes business or business actors to make financial reports more often,

The indirect effect of financial literacy on the performance of MSMEs through financial behaviour has a Critical ratio (Cr) value of 1,980 with a probability value (p) of 0.047, which is less than a significance of 5%. This result shows that financial behaviour can mediate the influence of financial literacy on MSME performance. These results can be explained by MSME owners who can manage finances well, such as financial planning, budgeting and expenditure control activities, improving financial behaviour. The creation of good financial behaviour impacts the performance of MSMEs, which is shown through improving financial performance.

#### **4. Conclusion**

Financial literacy carried out by food and beverage MSMEs in Malang City creates good financial management, such as management in obtaining funds and using funds efficiently to improve financial behaviour as indicated by financial planning, budgeting, and spending. Improving the performance of food and beverage MSMEs in Malang City requires greater emphasis on financial behaviour because financial behaviour is significant to train MSME owners to be responsible for managing finances.

Food and beverage MSME owners in Malang City who can manage finances well will impact improving MSME performance. With high financial literacy, the MSME sector will have the ability to access financial resources (as resources) and will be managed optimally to create MSME performance. Financial behaviour carried out by food and beverage MSME owners in Malang City can mediate the influence of financial literacy on MSME performance. It means that MSME owners who can manage finances by planning, budgeting, and controlling expenditures will improve MSME performance.

To increase awareness of good financial behaviour in the MSME sector, it is necessary to conduct financial training and seminars by the government and the private sector that focus on the MSME sector because financial knowledge or literacy is needed as a basis for decision making in business activities.

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