

# **DOES PERFORMANCE IMPROVE SUSTAINABILITY? EMPIRICAL RESEARCH ON INDONESIAN MSMEs**

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## **ABSTRACT**

Micro, Small, and Medium Enterprises (MSMEs) are business sectors known to play an essential role in the economic growth of a country, especially in Indonesia. In this context, the creative industry is one of the fastest-growing business sectors and the promotion of sustainable economic development is evident in the government's active support for improving the growth of MSMEs. Therefore, this study analyzes the impact of financial literacy and market orientation on the MSMEs performance and sustainability. The sample includes 95 respondents occupying the roles of owners or managers in the creative industry of Yogyakarta Province. The results show that financial literacy and market orientation positively impact performance and sustainability. The performance of MSMEs influences business sustainability but financial literacy has no significant impact. Therefore, the implications show the indispensable need for governmental assistance in improving the knowledge base of MSMEs owners concerning financial literacy and market orientation.

**Keywords:** Financial literacy; market orientation; performance; sustainability; MSMEs

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*Submission: 17<sup>th</sup> March 2020*

*Accepted: 18<sup>th</sup> Oct 2023*

<https://doi.org/10.33736/ijbs.6422.2023>

## **1. INTRODUCTION**

Micro, Small, and Medium Enterprises (MSMEs) are known to play a crucial role in developing a country (Audretsch et al., 2009). MSMEs in Indonesia contribute to poverty alleviation by creating new employment to absorb labor, as a contributor to the Gross Domestic Product (Budiarto et al., 2017). Central Statistics Agency (2019) stated that there was an increase in employment until February 2019, reaching 94.99% and the contribution of MSMEs to GDP was 65%. MSMEs are struggling to compete with large industries even with their significant role in creating employment. Some of the problems faced are (Human Resources) HR capacity, technology, business, ownership, marketing, financing, and other business management issues (Gebremariam,

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2017; Budiarto, Sari, Sudaryana, & Prabowo, 2018). A creative economy is a sustainable development approach aimed at leveraging unlimited resources of ideas, talents, and creativity to support MSME. Indonesia has 16 sub-sectors of creative industries such as applications and games, architecture, interior design, visual communication design, product design, fashion, film, animation and video, photography, crafts, culinary, music, publishing, performing arts, fine arts, television, radio (Ministry of Tourism and Creative Economy, 2019). Currently, the Indonesian government is driving growth with creative economic programs to reduce unemployment since the creative industry has the most significant potential to achieve sustainable development (Mardiana, Warsiki, & Heriningsih, 2020; Dahles, Prabawa, & Koning, 2020). This industry has an essential role in ensuring the continuity of creativity (Indriartiningtias et al., 2019).

The creative MSMEs in business decision-making use short-term orientation to prevent the increase in long-term performance (Cicea et al., 2019). Therefore, owners must understand financial management to develop and manage their business (Karadag, 2015). This is crucial for entrepreneurs to improve business performance (Dahmen & Rodríguez, 2014). Financial literacy helps companies access financial resources to increase company growth (Adomako et al., 2016). In addition, MSMEs owners must have a market orientation to improve business performance and sustainability. The entrepreneur is always required to find out the activities conducted in the market. Furthermore, it is important to comprehend the consumer's inclination to uphold business continuity. In this context, the comprehension of the significance of innovation and market orientation must be enhanced. This significantly improves the performance of MSMEs, exerting a profound impact on business competitiveness and improvement (Tham et al., 2017). Innovation is the key to the sustainability of businesses since the company is different from competitors (Klewitz & Hansen, 2014).

Even though there have been many studies on MSMEs, this research is interesting because 1. Sustainability of MSMEs in the creative industries sector always involves innovation and market orientation (Kraus et al., 2017). 2. The existence of research inconsistencies states that financial literacy and market orientation can improve business performance and sustainability (Dahmen & Rodríguez, 2014; Fatoki, 2014; Wise, 2013; Adomako et al., 2016; Eresia-Eke & Raath, 2013; Ozkaya, Droge, Hult, Calantone, & Ozkaya, 2015). 3. There is limited literature that combines financial literacy and market orientation on performance and sustainability, hence it is an empirical question.

This study provides two implications, first, MSMEs improve their marketing orientation by expanding market share, especially with e-commerce. Second, a local brand image is needed to remember the business name. These two implications encourage the maintenance of business sustainability in the future so that they are not easily affected by environmental changes.

## **2. THEORETICAL REVIEW AND HYPOTHESIS**

### **2.1. MSMEs (*Micro, Small and Medium Enterprises*)**

MSMEs are productive business activities that can realize development success, mainly in developing countries (Eniola, 2014) and play an essential role in creating jobs to increase income. According to (Law of the Republic of Indonesia Number 20 the Year 2008), MSMEs are grouped

into Micro, small, and medium-sized businesses. These three categories are differentiated based on net assets, annual sales income, and employees' numbers. Microbusiness has net assets <IDR 50,000,000.00, IDR 50,000,000.00-500,000,000.00 for small business and> IDR 500,000,000.00 for Medium-size with annual sales of <IDR 300,000,000.00, IDR 300,000,000.00-2,500,000,000.00 and> IDR 2,500,000,000.00. According to the Central Statistics Agency, the number of net assets excluding land and buildings is categorized based on the number of employees, which is <4, 5-19, and 20-300 for micro, small, and medium-sized businesses.

## **2.2. Financial Literacy**

The lack of financial literacy levels of MSMEs entrepreneurs has an impact on business performance. This skill is required in managing and using the money owned to increase future living standards (Eniola & Entebang, 2017). According to (Financial Services Authority, 2014), financial literacy is knowledge, skills, and beliefs that influence attitudes and behavior to improve the quality of decision-making and business management to prosper.

Eresia-Eke & Raath (2013) state there are several financial literacy perspectives, namely consumers, commercial service providers, government, and individuals or families. A consumer point of view explains that functional financial literacy can create purchase decisions for goods and services to prioritize quality. The perspective of commercial service providers suggests that proper financial literacy management produces adequate information on the product sold in terms of understanding risk and cost efficiency. The government perspective explains that the government obtains maximum tax revenue to develop infrastructure and public service facilities. From the perspective of individuals or families, the right level of financial literacy can improve one's ability to have long-term savings or investments.

## **2.3. Market Orientation, Business Performance & Sustainability**

MSMEs are one of the most popular business types for entrepreneurs. To maintain their business, the market must be crossed to survive among competitors. Market orientation is a strategy used to achieve a sustainable competitive advantage based on the generation, the information in organizations, and markets' selection (Ali et al., 2017). Companies must understand the needs, desires, and market demands to improve business performance (Octavia et al., 2020). According to Azam, Ferdous S, Haque, Abdullah, & Anwar (2014); Tham et al. (2017); Udriyah, Tham, & Ferdous Azam (2019), market orientation becomes three dimensions, namely customer orientation, competitor orientation, and coordination inter-functional.

Business performance is a concept to achieve success in market competition (Mahmoud et al., 2016). The MSME's performance is an achievement from an individual's effort in the company for a certain period (Mutegei et al., 2015). According to (Budiarto et al., 2017), the measurement uses self-measures to quantify financial and non-financial performance.

Business sustainability is a consistent business condition in achieving growth and development. This variable is influenced by several unique factors, such as capital resources, business culture, management strategy, owner's capabilities (Jonsson et al., 2017). Continuity is shown as the ability to innovate and sustain the business in the long term. The ability to innovate is proof that the business has guidance for building and reading the future chance (Kaswuri, 2016). Innovation is

the key to the sustainability of MSMEs differentiating companies from competitors (Khurana et al., 2018).

#### **2.4. Hypotheses Development**

Financial literacy is knowledge of managing finances to achieve prosperity in the current time and future (Karadag, 2015). This is needed by business owners in making strategic decisions to achieve company goals in improving business performance and sustainability (Drexler et al., 2014). Sound financial knowledge can also improve business sustainability (Fatoki, 2014).

MSMEs are a type of productive business owned by individuals and communities to reach economic development success. Financial literacy and market orientation are needed to improve performance and business sustainability (Udriyah et al., 2019). To maintain sustainability, companies are expected to improve performance (Wise, 2013; Dahmen & Rodríguez, 2014). Adomako et al. (2016) stated that there was a mutually influential relationship between the variables. Businesses with good functional financial literacy anticipate environmental changes in terms of trade, economy, and finance to improve performance and sustainability. The results contradict the findings of Eresia-Eke & Raath (2013), where there is no influence on financial literacy and business performance. According to (Adomako et al., 2016), company can survive during economic crises with proper financial literacy to increase business performance with long-term sustainability. Based on some findings above, the following hypotheses are proposed:

*H<sub>1a</sub>: Financial literacy positively impacts the performance of MSMEs.*

*H<sub>1b</sub>: Financial literacy positively impacts the sustainability of MSMEs.*

Market orientation increases competitiveness and directly influences company performance (Udriyah et al., 2019). This variation is essential because business owners can collect and manage information to understand market needs. Understanding market needs drives the innovation process in the company. In this context, sustainability must be increased by innovating and improving employee and customer satisfaction (Bumberová & Milichovský, 2019). Research conducted by Dubihlela & Sandada (2014); Šályová, Tábořeká-Petrovičová, Nedelová, & Ďaďo (2015); Lee, Kim, Seo & Hight (2015); Kaswuri (2016) states that market orientation has a significant effect on performance and innovation (Mahmoud et al., 2016). Based on the theoretical study, the following hypotheses are proposed:

*H<sub>2a</sub>: Market orientation positively impacts the performance of MSMEs.*

*H<sub>2b</sub>: Market orientation positively impacts the sustainability of MSMEs.*

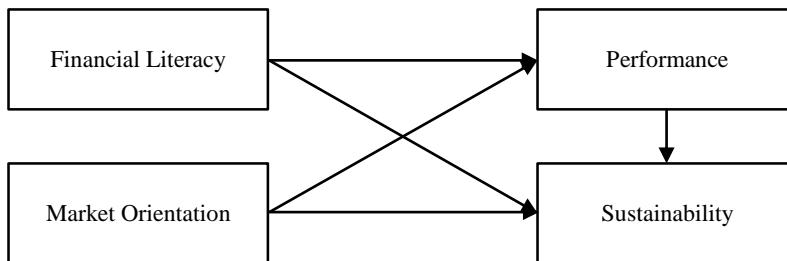
MSMEs plays a significant role in creating employment and generating economic development. In this context, improved performance increases business competition. The ability to create innovation is in line with performance because a lack of creativity is detrimental to business continuity (Barroso, 2017). According to Evans et al. (2017), innovation should be conducted to create long-term sustainability. Other study states that performance positively impacts business sustainability (Park et al., 2019). Based on the findings, the following hypothesis is proposed:

*H<sub>3</sub>: Performance positively impacts the sustainability of MSMEs.*

## **2.5. Research Model**

As a consensus, MSMEs has an essential role in the economic growth of developed countries (Alzougool, 2019). Even with a strategic position, competition with large companies is impossible (Adomako et al., 2016). Therefore, a particular strategy is needed to maintain growth performance. In line with these problems, inappropriate measurement is a primary problem (Maduekwe & Kamala, 2016). Different strategies can be used to improve performance, such as marketing strategies or increasing their ability (Indriartiningtias et al., 2019; Virtanen, Björk, & Sjöström, 2017). Financial literacy is the skills of MSMEs owners in various economic contexts useful for decision-making. This ability shows various problems in improving the financial well-being of small businesses (Mutegi et al., 2015). Market orientation is a strategy that makes consumers a vital factor affecting organizational activities. This variable is associated with MSMEs' progress because organizations easily learn about market developments and adapt quickly to changes (Octavia et al., 2020). Based on some of these perceptions, a research model is proposed, as shown in Figure 1.

**Figure 1: Research Model**



## **3. RESEARCH METHODOLOGY**

This research was conducted in 1 Yogyakarta city, and four regencies, namely Sleman, Kulon Progo, Bantul, and Gunungkidul. In Indonesia, Yogyakarta Province is known as the city of education, culture, and tourism so that creative business experiences growth (Sugandini et al., 2019). Previous research on MSMEs area was conducted in Bantul Regencies (Muafi, 2015), Sleman Regencies (Mardiana et al., 2020; Rachmawati, Hapsari, & Cita, 2018), Yogyakarta City (Dahles et al., 2020), and Gunungkidul Regencies (Probosari et al., 2020). Meanwhile, this research expands the object for easy generalization (Alharbi & Drew, 2014).

This study's population is the creative owners of micro, small, and medium enterprises (MSMEs) in the creative, culinary, fashion, TV, and radio sectors in the Special Region of Yogyakarta. Furthermore, purposive sampling was used since the number of SMEs was not available. The criteria employed for evaluation included 1. Continued operational status of the business. 2. Employment of at least one individual within the organization. The number of samples taken was 95 respondents, who were owners and managers of businesses. This sample size followed the rule

of thumb, where the sample size was between 30 and 500 appropriate for most research (Sekaran & Bougie, 2016).

This study used a local language questionnaire because the research location was in Yogyakarta Province. The questions were adopted and developed from previous research. Before online and offline distribution, a pre-test was conducted on research students and MSMEs owners to ensure easy understanding. Subsequently, several questions were modified to suit the real conditions of the organization. The financial literacy variable was measured with five questions modified from (Morgan & Trinh, 2019), such as identifying the company, potential savings, calculating credit interest, and the effect of inflation. Market orientation variables were measured by three indicators developed into four questions. Competitor orientation developed into two questions, and inter-function coordination becomes one question (Udriyah et al., 2019). In this context, performance variables were measured with four questions, namely the existence of planned work, the ability to anticipate products with increased demand, guarantee the timeliness to customers, and the suitability of products with specifications offered (Octavia et al., 2020).

Sustainability variables were measured with eight questions modified from previous research, such as willingness to try new ideas, introducing more new products, increasing product design capacity, modifications of the products, improving work practices, employee training, developing management, technological updates (Klewitz & Hansen, 2011). The measurement scale used was 1 to 5, representing Strongly Disagree, Disagree, Neutral, Agree, and Strongly Agree. Testing instruments in this study used validity and reliability tests. Bootstrapping techniques are used to analyze the impact of independent variables on the dependent.

#### 4. RESULT AND DISCUSSION

Data were collected for three months from mid-October to December 2019, by distributing 120 questionnaires. Based on the distribution, only 100 and 95 questionnaires were returned and analyzed, while 5 could not be included because of incomplete, as shown in Table 1.

**Table 1:** Respondent's Characteristic

		Sleman	Yogyakarta	Bantul	Kulon Progo	Gunung kidul	Total
Size	Micro	18	7	12	5	39	81
	Small	3	-	1	2	4	10
	Medium	2	-	2	-	-	4
Role	Owner	20	6	12	7	29	74
	Manager	3	1	3	-	14	21
Gender	Male	6	7	7	4	39	63
	Female	17	-	8	3	4	32
Education	Non-bachelor	16	7	12	7	41	83
	Bachelor	7	-	-	-	2	12
Business's Age	< 3 years	4	-	-	1	2	7
	3 - 5 years	2	-	2	-	3	7
	6 - 10 years	5	1	2	2	16	26
	> 10 years	12	6	11	4	22	55
1-10		18	7	12	5	41	83

Number of Employees	11-20	2	-	1	2	2	7
	21-30	3	-	1	-	-	4
	>30	-	-	1	-	-	1
Type of Business	Craft	11	7	8	2	42	70
	Culinary	8	-	2	2	-	12
	Fashion	4	-	5	2	-	11
	Multimedia	-	-	-	1	1	2

The measurement of model quality is a test that uses convergent validity and reliability tests. An indicator will meet convergent validity with an outer loading value > 0.5. Tables 2 and 3 show the results of convergent validity and reliability test results. The test of the structural model was shown using the coefficient of determination. Table 4 shows that the results of R square for the performance and sustainability variables. The low R square indicates that the variation in performance and sustainability can be explained by small market orientation and financial literacy. The low value of R square in social research is not a problem because the concept is used to test the theory, not to predict (Moksony, 1999). Furthermore, there are many other factors related to the growth of MSMEs, such as access to finance and capital (Adomako et al., 2016), organizational creativity (Indriartiningtias et al., 2019), social media (Konstantopoulou et al., 2019), and environment (ByoungHo Jin, 2017) which is an opportunity for further research (Hutahayan, 2019).

**Table 2: Cross Loading Value**

Variable	Question	Cross Loading
Financial Literacy	1. Identification of the company at the time of opening an account	0.655
	2. Understanding of potential savings yields in one year	0.765
	3. Understanding of potential savings yields in multi-years	0.755
	4. Understanding of calculating credit interest per year	0.713
	5. Knowledge of the effect of inflation on company growth	0.701
Market Orientation	1. Have a strong focus on understanding customer needs.	0.751
	2. Always provide value-added products for customer satisfaction.	0.698
	3. Pay attention to the after-sales service of our products.	0.740
	4. Always try to give the best quality products to our customers.	0.820
	5. Quick to respond to changes in prices or strategies made by competitors	0.624
	6. Competitive price comparison	0.648
	7. Encourage staff to bring in new ideas	0.694
Performance	1. The existence of planned work	0.720
	2. The ability to anticipate products when demand increases	0.747
	3. Guarantee timeliness to customers	0.733
	4. The suitability of products with specifications offered	0.724
Sustainability	1. Willingness to try new ideas	0.792
	2. Introducing more new products than competitors	0.679
	3. Increasing product design capacity	0.737
	4. Introducing modifications to existing products	0.741
	5. Continually improving work practices	0.738
	6. Employee training	0.740
	7. Developing management involvement	0.686
	8. Technological updates for service quality	0.575

**Table 3: Construct Reliability and Validity**

	<b>Cronbach's Alpha</b>	<b>Rho_A</b>	<b>Composite Reliability</b>	<b>Average Variance Extracted (AVE)</b>
Financial Literacy (FIN)	0.769	0.772	0.842	0.517
Market Orientation (MAR)	0.838	0.884	0.878	0.509
Performance (PER)	0.711	0.712	0.821	0.535
Sustainability (SUS)	0.861	0.865	0.892	0.509

**Table 4: R Square Value**

	<b>R Square</b>	<b>Adj. R Square</b>
Performance	0.396	0.383
Sustainability	0.407	0.387

The Hypothesis testing used smart PLS, affecting financial literacy on performance and sustainability through bootstrapping techniques. Table 5 shows the results of hypothesis testing using bootstrapping techniques.

**Table 5: Path Coefficients**

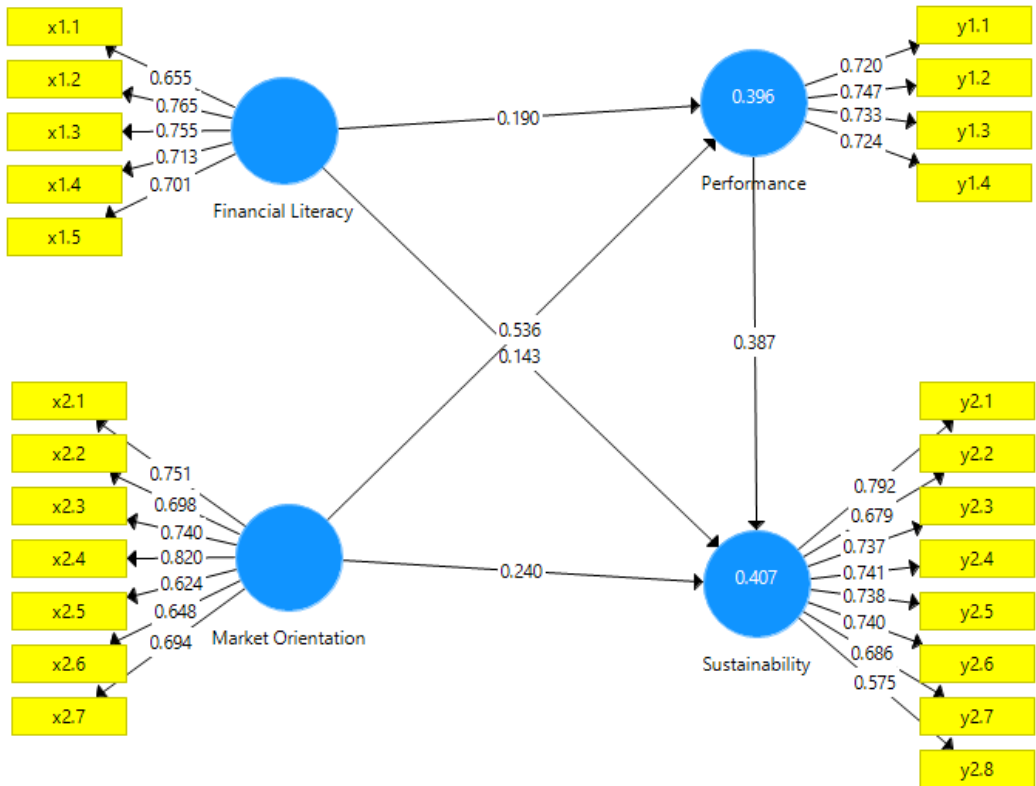
	<b>Beta</b>	<b>Mean</b>	<b>SD</b>	<b>T Statistics</b>	<b>P Value</b>	<b>Result</b>
FIN → PER	0.190	0.194	0.103	1.844	0.066*	H <sub>1a</sub> : Accepted
FIN → SUS	0.143	0.157	0.115	1.245	0.214	H <sub>1b</sub> : Rejected
MAR → PER	0.536	0.555	0.086	6.215	0.000***	H <sub>2a</sub> : Accepted
MAR → SUS	0.240	0.254	0.104	2.319	0.021**	H <sub>2b</sub> : Accepted
PER → SUS	0.387	0.371	0.112	3.464	0.001**	H <sub>3</sub> : Accepted

*Notes:* \*Sig < 10%, \*\* sig < 5%, \*\*\* sig < 1%

The hypothesis testing using the bootstrapping technique shows that financial literacy positively impacts MSMEs' performance. Financial literacy plays an essential role in helping business actors make decisions to maintain performance (Adomako et al., 2016). MSMEs has unique characteristics so that in running their business, they should be cooperation to complement the limitations of competing in running a business.



Figure 2: Hypotheses Testing



However, research cannot prove the significant effect of financial literacy on business sustainability because one of MSMEs' problems is a lack of financial knowledge (Adomako et al., 2016) These results are in line with Eresia-Eke & Raath (2013), where financial literacy does not affect MSMEs performance and growth. According to Fatoki (2014), the financial literacy of MSMEs owners is at a weak level. This study was conducted because many respondents did not understand the concept due to low levels of education. The majority level of education is non-bachelor (80%), while a few people only pursue Bachelor degree in education. Previous finding state that SMEs' development is experiencing a limitation due to low managerial ability (Gebremariam, 2017). The correlation between financial literacy on sustainability is the indirect impact through the performance. The coefficient test shows a significant influence between financial literacy and performance, as well as between performance and sustainability. This result is a challenge for further research to analyze the relationship between financial literacy and sustainability through performance mediation.

The result of hypothesis testing show that the level of education affects the understanding of financial literacy. MSMEs owners with higher education levels have a deeper understanding of financial literacy to influence the orientation of long-term efforts in making business decisions (Dahmen & Rodríguez, 2014). External expertise can be used when experiencing problems in

understanding financial literacy to continue to run. Individuals with business management knowledge can reduce the impact of financial mismanagement (Eniola & Entebang, 2017).

The result of hypothesis testing show that market orientation has a positive impact on the performance of MSMEs. Companies with this orientation improve performance to establish good relationships with suppliers. This helps to maintain performance by having appropriate and adequate material availability (Udriyah et al., 2019). Companies with a market orientation focusing on customers and observing competitors will make it easier to create products needed by the market (Mahmoud et al., 2016). The success in innovating to develop opportunities can describe sustainable businesses (Bumberová & Milichovský, 2019).

In this context, local brands should believe in the quality of the products produced. The right products can increase customer loyalty and make purchases (Wibowo et al., 2020). The problems of MSMEs are related to the costs of promotion in a conventional way (Alzougool, 2019). Therefore, social media is expected to be an efficient means of opening product marketing channels with relatively low cost, fast response, and wider reach, popularly known as e-commerce (Rachmawati et al., 2018). This online media is beneficial since the concept significantly influences consumer behavior (Kim & Ko, 2012).

To test the mediation effect, a coefficient test is carried out on financial literacy, performance, and sustainability. The direct impact between market orientation and sustainability is 0.240. This is more significant than the indirect effect through the mediation of performance 0.207 ( $0.536 * 0.387$ ). Therefore performance is not a mediating variable between market orientation and sustainability. Finally, the findings suggest that performance has a positive impact on business continuity. The performance of SMEs can be seen from the innovations to maintain business long-term. Innovation of the company can improve product quality, as well as increase sales and profitability. Therefore, improving performance can create sustainability to guarantee business (Park et al., 2019).

## **5. CONCLUSION AND RECOMMENDATION**

In conclusion, market orientation was reported to positively impact the performance and sustainability of MSMEs. Subsequently, performance had a positive impact on business sustainability. Financial literacy significantly impacted performance, unlike MSMEs sustainability. The results showed that the knowledge of MSMEs owners was essential for business continuity to drive long-term growth. This research had limitations since the samples used were only obtained from 4 creative industries with 16 subsectors. The subsequent examination was expected to expand the sampling to obtain better results (Alharbi & Drew, 2014). Further research was also suggested to add financial decision-making variables due to several benefits (Eniola & Entebang, 2017).

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