The Interactions between Financial Inclusion with Microentrepreneurs Firm Performance in Malaysia

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**ABSTRACT**

This study is to examine the relationships between financial inclusion with microentrepreneur's firm performance in Malaysia. Cross-sectional data from the questionnaire were collected from 373 micro-entrepreneurs operating under the micro-financing scheme. Hence, the present study aimed to revisit the financial inclusions towards micro-entrepreneur firm performance using the approach in PLS-SEM. The Financial inclusion and micro-entrepreneur firm performance were constructed as a reflective measurement model. The survey findings further revealed that financial inclusion is significantly associated with micro-entrepreneur firm performance. This research's outcomes can benefit decision-makers such as Malaysian governments, microfinance organizations, and the decision-makers regarding distributing funding and promoting successful micro-entrepreneur performance in the long-run.

**Keywords**: Microentrepreneur, financial inclusion, firm, performance, Covid19

**INTRODUCTION**

Microentrepreneurs are microenterprise owners with an annual sales turnover of less than RM 300,000 or less than five employees (SME Corp Malaysia, 2016). However, according to a report by Small Medium Corporation Malaysia (SME Corp Malaysia), at least 75 percent of businesses failed during their first year of operation. Even though these micro-enterprises are small, they are responsive and capable of taking advantage of positions that larger enterprises cannot embark on successfully (Banks Negara Report, 2010). Development Finance Institutions (DFIs), Cooperatives, and Microfinance Institutions (MFIs) also have an essential role in serving niche groups of customers due to their vital contributions to Malaysia's economy. Due to the unexpected Covid-19 pandemic, MCO's implements, which effectively shut down all business operations and cause unemployment (WHO, 2020; Bails, 2020). This pandemic change life routines and social distancing to block the spreading of the virus. The Agriculture and Services sectors were founded to have recorded higher percentages of job losses than other sectors, 21.9 percent, and 15.0 percent, respectively (Department of Statistics Malaysia, 2020). Most of this industry player was microentrepreneurs with small scale business effected. The deficiency of financial and human resources will cause the firm to be unable to compete with other competitors (Hewitt-Dundas, 2006). Fatoki (2014) has reported the failure percentage of newly developed micro-enterprises as critical. Financial inclusion plays a vital role in providing loans to micro-entrepreneurs. Through financial inclusion, the microentrepreneurs can access the financial product and services at a reasonable rate, save cost, more options to choose from, and contribute to the business growth. Lack of capital and poverty in rural areas are more prevalent among micro-entrepreneurs due to limited inclusion to formal financial institutions (Beck & Demirguc-Kunt, 2006; Del Mel, 2008 & Chiba 2009). Firm Performance is a crucial measurement of whether the micro entrepreneur's business is booming. It can be measure by both financial and non-financial indicators (Murphy, Trailer & Hill, 1996; Dimitratos, Lioukas & Carter, 2004; Muhammad, 2009). Therefore, measuring performance is vital for the business to survive. The low level of risk- preparedness resulted in zero cash inflows, zero revenues, and unsold fresh agriculture products due to MCO Covid-19 implementation were among problems that need be solved. Hence, this has led to the need for an in-depth study of financial inclusion duringMCO Covid-19 on microentrepreneurs' firm performancein Malaysia.

**LITERATURE REVIEW**

Financial inclusion is a crucial determinant of microenterprises' performance as it provides all working capital, encourages greater and stronger innovation, and increased dynamism. It also magnifies entrepreneurship, produces more efficient reasonable point allocation, and enhances the firm's ability to take advantage of growth potentials (Beck et al. 2006). Demirguc-Kunt (2006), financial systems can assist business transactions, for instance, in savings, loan, repayment, and in the transferring, gathering, and processing of information about investors and investment projects. The major challenge for micro-entrepreneurs in developing their business is the lack of financial inclusion in the capital. This is because micro-entrepreneurs have come from low-income families, and they cannot provide any collateral for their loan application. Cohen and Klepper (1996) have also noted that small firms have smaller capital bases to secure loans to finance their business compared to the larger firms. Recently, researchers have shown an increasing interest in financial inclusion as a factor that contributes to performance. It has been claimed that credit history, inadequate collateral provided, and high transaction costs the main reason for young, owned entrepreneur's in Ethiopia do not obtain any loan from the commercial bank (Woldehanna, 2017). Degrees or phases of inclusion to the fund could be estimated through elective degrees. Three vital ones considered are as follows: (i) the institutional; (ii) the useful; and (iii) the item level. Inclusion through option innovative stages is a reasonable fourth degree or phase. Crucial financial service capacities are recognized as (i) exchanges or costs services; (ii) reserve funds (store) services; (iii) finance or credit services; and (iv) and protection (Kumar, 2005).

In the Malaysian context, the Credit Guarantee Cooperation (CGC) guarantees commercial banks' microcredit loans. The CGC is a government agency that guarantees the loan to small and medium ventures with no record of achievement or security to obtain credit enhancements from the financial institutions (Bank Negara Malaysia, 2010). Teoh and Chong (2008) found a diverse situation from the micro-entrepreneurs in Malaysia, where they have limited financial inclusion from financial institutions and social networks. Never less, not having enough capital and collateral, micro-entrepreneurs barely get loans from formal financial institutions (Van Eeden et al. 2004, p. 10; Togoe et al. 2005, p. 323; OECD, 2006, p. 46). Micro-entrepreneurs' challenge with financial inclusion is capital, collateral, technology, necessary financial skills, financial service provision, and gender discrimination. It was found that discrimination by gender in which female micro entrepreneur's in Africa faced challenges in financial inclusion where the financial system shows women account only for 46 % of ownership and 22 % of participation while only 18 % of businesses owned by women (Beck & Demirguc-Kunt, 2005; Honohan & Beck, 2007). Similar to Munoz (2010) and Abubakar (2015) have revealed several factors contributing to financial inclusion among micro-entrepreneurs in Africa, showing gender, ages, disparities between urban zones and rustic territories, ethnicity, and business status a direct negative impact on the overall economy.

It's proved that the awareness of primary financial products and services differ among nations. For the most part, the level of financial inclusion knowledge is still low, showing micro-entrepreneurs in Mozambique and Ghana have never known about saving accounts. Still, they merely have some awareness of financial products and services providers (Thara & Ali, 2014). In Africa, it has been affirmed that the use of financial services by Ghanaian SMEs among the financially literate entrepreneurs who have received and used such financial services would enhance the business's performance (Nunoo & Andoh, 2012). Additionally, Kebede, Kaur, Jit & Kuar (2015) have noted that financial literacy impacts financial inclusion, which would eventually affect the performance of small enterprises in Kenya. Another factor contributing to financial inclusion includes natural disasters such as earthquakes and floods. It has been evident that credit demand would significantly be on the rise after volcanic eruptions when the micro-entrepreneurs need funds to recover their losses after the tragedy. Banking institutions restrict loan applications due to uncertain circumstances. The results in capital constraints among micro-entrepreneurs sustain their business and lead to defaults in payment (Berg & Scrhrader, 2012). Therefore, based on the discussion on financial inclusion and microentrepreneur’s firm performance, the following proposition would be hypothesized:

***H1****: Entrepreneur financial inclusion has a significant influence on microfinance performance*

**METHODOLOGY**

The study is mainly a primary data-based descriptive-analytical research. The sample of the research is the micro-entrepreneurs in Sarawak, Malaysia. Before determined the sample sizes, a priori power analysis was conducted based on the proposed conceptual framework and encounter the minimum power of more than 0.95 with an effect size of 0.15 (Hager, 2006). The results were derived from G\* Power 3.1 (Faul et al. 2007; 2009) software was used as statistical tests commonly used in social and behavioral research. The minimum sample size requirements of 129, following Hair et al.'s (2009) approach, 375 was targeted as the sample size for the study. The authors distribute a total of 400 questionnaires all over Sarawak, Malaysia. The questionnaire adapted from Kumar (2005) toolkits for measuring financial inclusion and micro-entrepreneur performance consists of financial and non-financial measures that seem to be necessary to entrepreneurial and small microfinance (Muhammad, 2009). This study utilized a few standard statistical tools to analyze the data. SPSS Version 23 was used for this purpose. In the initial stage, factor analysis was performed on all the measurement items. The results indicated that the largest variance explained by the first factor was 33.774% of the total variance. In the present study, Common Method Variance (CMV) was performed using Harman’s Single Factor method (Podsakoff & Organ, 1986; Jarvis, Curran, Kitching & Lightfoot, 2003; Podsakoff, Mackenzie, Lee, & Podsakoff, 2003). CMV refers to “variance that is attributable to the measurement method rather than to the construct the measures represent” (Lee *et al.* 2003, p. 879). CMV is a subset of method bias, which arises in quantitative research and could cause the measured relationships between two constructs to inflate their actual value (Brown & William 1994, p. 2). Data were then keyed-in into the Statistical Package for Social Science (SPSS) for subsequent analyses using SmartPLS 3.0 (Ringle, Wende and Becker, 2015). A two-stage approach in PLS-SEM was used to predict the model; both financial inclusions and micro-entrepreneur performance use reflective measurement.

**ANALYSIS AND FINDINGS**

Table 1 shows the demographic details of 373 micro-entrepreneur sampled from all over Sarawak. Given the number of questionnaire copies distributed and collected, a response rate of 74% suggests appropriate administration of the data collection process in a month and that non-response error is not a significant issue  [(Richardson](https://www.researchgate.net/publication/42792418_Instruments_for_obtaining_feedback_A_review_of_literature?el=1_x_8&enrichId=rgreq-aa356c91-2b40-4c43-b83e-b72440ddd858&enrichSource=Y292ZXJQYWdlOzI5OTUwOTY5NDtBUzozNDYwNDg4ODgzNjA5NjFAMTQ1OTUxNTg5MjUxNA==),  [2005;](https://www.researchgate.net/publication/42792418_Instruments_for_obtaining_feedback_A_review_of_literature?el=1_x_8&enrichId=rgreq-aa356c91-2b40-4c43-b83e-b72440ddd858&enrichSource=Y292ZXJQYWdlOzI5OTUwOTY5NDtBUzozNDYwNDg4ODgzNjA5NjFAMTQ1OTUxNTg5MjUxNA==) Nulty, 2008).

**Table 1**: Profile of Respondent

|  |  |  |  |
| --- | --- | --- | --- |
| *Variable* |  | *Frequency* | *Percent* |
| Gender | Male | 124 | 33.2 |
|  | Female | 249 | 66.8 |
| Age | 15-24 | 40 | 44.7 |
|  | 25-34 | 73 | 19.2 |
|  | 35-44 | 120 | 33.0 |
|  | 45 and above | 180 | 47.8 |
| Status | Married | 307 | 82.3 |
| Single | 56 | 15.0 |
| Others | 10 | 2.7 |
| Race | Malay | 120 | 32.0 |
| Chinese | 14 | 3.0 |
| Native Sarawak | 235 | 63.0 |
| India | 4 | 2.0 |
| Religion | Muslim | 279 | 74.8 |
| Christian | 84 | 22.5 |
| Hindu | 4 | 1.1 |
| Buddha | 5 | 1.3 |
| Other | 1 | 0.3 |
| Education | PhD | 1 | 0.3 |
| Master’s degree | 1 | 0.3 |
| Degree | 9 | 2.4 |
| Diploma/STPM | 59 | 15.8 |
| MCE/SPM/SPMV | 145 | 38.9 |
| LCE/SRP/PMR | 108 | 29.0 |
| Others | 50 | 13.4 |
| Microfinancing Organization | AIM | 116 | 31.1 |
| Tekun | 220 | 59 |
| SEDC | 37 | 9.9 |

**Assessment of Measurement Model**

Table 2 depicts the assessment of the construct reliability and convergent validity of the constructs in this study. As illustrated, the composite reliability (CR) values of 0.926 (FI)) and the micro-entrepreneur MP (0.943) indicate that these constructs possess internal consistency. Similarly, these constructs also demonstrate adequate convergent validity after removing items with low loadings. Hence, they achieve the minimum threshold value of 0.5 for average variance extracted (AVE), which indicates that the items loaded to the respective constructs explain more than 50% of the constructs "variances (Hair, et al., 2014).

**Table 2:** Internal Consistency and Convergent Validity

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Construct** | **Item** | **Loading** | **Cronbach's Alpha** | **CR** | **AVE** | **Convergent Validity (Ave > 0.5)** |
| Financial Inclusion | FI1 | 0.706 | 0.91 | 0.926 | 0.561 | Yes |
| FI10 | 0.782 |
| FI11 | 0.774 |
| FI12 | 0.819 |
| FI13 | 0.816 |
| FI15 | 0.552 |
| FI2 | 0.712 |
| FI6 | 0.604 |
| FI7 | 0.866 |
| FI8 | 0.799 |
| Microentrepreneur Performance | MIC1 | 0.826 | 0.943 | 0.951 | 0.622 | Yes |
| MIC10 | 0.578 |
| MIC11 | 0.706 |
| MIC12 | 0.819 |
| MIC 2 | 0.821 |
| MIC 3 | 0.753 |
| MIC 4 | 0.801 |
| MIC 5 | 0.612 |
| MIC 6 | 0.888 |
| MIC 7 | 0.868 |
| MIC 8 | 0.871 |
| MIC 9 | 0.854 |

Table 3 illustrates the assessment of discriminant validity. To date, discriminant analysis is assessed using Henseler’s Heterotrait-Monotrait (HTMT) (2015) criterion. This denotes that the constructs are distinctively different from criterion, one that imposes more stringent assessment than the earlier criterion, suggests that all constructs are distinctively different at HTMT0.90 threshold  [(Henseler, et al.,](https://www.researchgate.net/publication/264934704_A_new_criterion_for_assessing_discriminant_validity_in_variance-based_structural_equation_modeling?el=1_x_8&enrichId=rgreq-aa356c91-2b40-4c43-b83e-b72440ddd858&enrichSource=Y292ZXJQYWdlOzI5OTUwOTY5NDtBUzozNDYwNDg4ODgzNjA5NjFAMTQ1OTUxNTg5MjUxNA==) 2015)

**Table 3:** HTMT Criterion

|  |  |  |  |
| --- | --- | --- | --- |
|  | Financial Inclusion | Mic Performance | |
| Financial Inclusion |  |  | |
| Mic Performance | 0.568 |  | |
| *Criteria: Discriminant validity is established at HTMT0.90* | | |

**Assessment of Structural Model**

Table 5 illustrates the results of path co-efficient assessment using a bootstrapping procedure for the hypothesized relationships. The relationships are significant (Fin Inclusion→ Mic Performance, ß = 0.219, p < 0.01; Hence, it is supported.

**Table 5:** Path Co-efficient Assessment

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Beta | S.E. | t-value | p-value |
| Direct Effect |  |  |  |  |
| Financial Inclusion -> Mic Performance | 0.219 | 0.077 | 2.855 | \*\*0.004 |

Table 6 presents the assessment of the coefficient of determination (R2), the effect size (f 2) as well as the predictive relevance (Q 2) of exogenous variables on an endogenous variable in this study. The value for the coefficient of determination (R2) for Financial Inclusion -> Mic Performance is 0.436.

**Table 6:** Determination of Co-efficient (R2), Effect size (*f*2) and Predictive Relevance (Q2)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | f2 | R2 | VIF | Q2 |
| Direct Effect |  |  |  |  |
| Financial Inclusion -> Mic Performance | 0.029 | 0.436 | 2.963 | 0.245 |
| *Lateral Collinearity: VIF 3.3 or higher (Diamantopoulos & Sigouw 2006)* | | | | |
| *R2 ≥ 0.26 consider Substantial (Cohen, 1989)* | | | |  |
| *F2 ≥ 0.26 consider Substantial (Cohen, 1989)* | | | |  |
| *Q2 > 0.00 consider large (Hair, 2017)* | | |  |  |

**CONCLUSION AND RECOMMENDATIONS**

The present study shows that micro-enterprises represent the largest component of SMEs in Malaysia. They face financial and non-financial difficulties challenges striving for their business objective were to establish the relationship between financial inclusion with the micro entrepreneur's firm performance. These findings from this paper show the importance of financial inclusion towards the micro entrepreneur’s firm performance. These results support findings from Del Mel (2018), which demonstrated that financial inclusion would have a significant impact on the micro entrepreneur's firm performance. Lack of awareness and information with government and microfinancing institutions' credit access is also one of the major challenges faced by micro-entrepreneurs in Malaysia, which contributed to their business's failure (Hashim, 1999; Salleh & Ndubsi, 2006; Soon, 2011). In Malaysia, government agencies such as Malaysian Technology Development Corporation (MTDC), Malaysia Venture Capital Management Berhad, Malaysia Debt Ventures Berhad, and Multimedia Development Corporation (MDeC) are among providers' financial alternatives to Bumiputera SMEs for their development and growth process. These organizations assist in the development and build-up of SMEs. The fund offered based on specific criteria include the business plan, business type, allocation, collateral, business license, and other criteria.

Despite the extent of the present study from theoretical, methodological, and empirical standpoints, it has a few boundaries which underscore the need for additional investigation. Firstly, this study is limited to looking only at financial access as exogenous compared to other factors such as knowledge, attitude. Secondly, purposive sampling and the selection of micro-entrepreneur in Sarawak in the study could potentially reduce the generalization of the findings to the population. Hence, future studies should cover respondents all over Malaysia include Peninsular and Sabah.

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