The Determinants of Micro, Small and Medium Enterprises (MSMEs) Financial Performance: A Literature Review

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ABSTRACT

Financial performance of Micro, Small and Medium Enterprises (MSMEs) is the focus for MSMEs to grow and develop as business entities that become the mainstay of the nation’s economy. The purpose of this study is to evaluate the effect of MSMEs determinant factors namely financial literacy, financial inclusion, internal locus of control and risk perception on its financial performance. The Systematic Literature Review (SLR) method is used in this research by reviewing some relevant journals which discuss related research topics. The results indicate that financial literacy, financial inclusion, internal locus of control and risk perception were become determinants that has a major effect on the financial performance of MSMEs.

Keywords: performance, financial literacy, financial inclusion, internal locus of control, risk perception

1. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) plays a significant role on nations economic development, and also it is believed to be able to contribute to poverty alleviation by creating jobs for those who needed (Audretsch, et al, 2009). Likewise Micro, Small and Medium Enterprises (MSMEs) in Indonesia, play an important role for the pace to accelerate regional development.

In accordance with Law No. 20 of 2008 concerning MSMEs, MSMEs are one of the sectors that have quite an important role in employment. In addition, MSMEs also have high resilience to economic turmoil. Based on Central Statistics Agency (BPS) data, the number of MSMEs has been increasing until today since the financial crisis occurred in Indonesia in 1998. In 2012 MSMEs contributed 56% of Indonesia's total GDP which was conducted a survey by the Financial Services Authority (OJK) which stated the contribution of the MSME sector in Indonesia proved to be very significant for the national economy by contributing 60% of Gross Domestic Product and absorbing 97% of the national workforce (OJK Press Release: SP38 / DKNS / OJK / 5/2016).

For the continuity of its business activities, MSMEs must think of the right way or steps for the success of the business undertaken. Business success will certainly be achieved if SMEs are able to achieve good performance.

Performance is a general term used for some or all actions or activities of a company in a certain period. Performance in particular is the determination of certain measures that can measure the success of a business in generating profits (Kusumadewi, 2017). The performance of a company is a formal effort made by a company...
to evaluate effectively and efficiently from each of the company’s activities that have been carried out within a certain time period. One of them in terms of finance. The company’s financial performance can be analyzed with various financial analysis tools, to determine the company’s financial condition in a certain period (Bogomin et al, 2016). MSME business performance evaluation cannot be only rely on financial statement data, as the character of the information provide in financial statements is historical (Kotane et al, 2016). So, it is infeasible to just depend on financial indicators to accurately prefigure the company financial stability.

There are various factors that affect the performance of MSMEs. According to Aribawa (2016) one factor that has an influence on MSMEs performance and sustainability is financial literacy. Furthermore, he also said there was a big challenge for creative SMEs to have more knowledge about financial literacy. Lusardi and Mitchell (2013) suggested financial literacy is a person’s ability to manage information about the economy, make plans in finance, and make better decisions about the accumulation of wealth, pensioners and debt they have. This definition reflects that one must have the ability to gather relevant and important information, while also distinguishing between diverse financial choices, discussing monetary and financial issues, planning and being able to determine decisions in the use of finance. Financial literacy is related to habits, behaviors and influences from external (external) factors.

Financial inclusion is one way that is believed to be able to reduce poverty levels and reduce economic disparities in society, where the community has an access to get a variety of quality formal financial services. Financial inclusion is a part of the financial literacy program, where through financial inclusion every MSMEs should have the opportunity to get financial services from financial institutions (Alvianolita, 2019). The higher of the increasing MSMEs financial inclusion, it will increase the national financial stability. Financial inclusion is a change in people’s mindset to understand how to view profit and money, an also can be simply interpreted as ease in obtaining financial services in economic activities. This become important because optimizing funding sources in the regions means that it helps MSMEs be more productive and developing.

The MSMEs performance can be driven by applying the financial management function. Research conducted by Bogomin et al (2017) shows that financial inclusion has a significant effect on MSME performance. The study states that on a large scale, financial literacy has not been reached optimally if there are still problems with asymmetric information on financial services so that it can hamper the success of MSMEs to compete. With financial literacy and good financial inclusion, business actors are able to use financial capabilities in making various decisions. MSMEs with good financial literacy will be able to implement strategic plans to identify opportunities and threats, have adequate financial access, and respond to changes in the unstable business climate, so that decisions made will provide innovative and targeted solutions to improve MSME performance. Quartey et al (2017) revealed that only respondents from the banking sector have high financial literacy compared to other sectors, so MSMEs that are one of the backbone of the economy must get high financial literacy and better financial inclusion. Nurjanah (2017) and Aribawa (2016) mention that there is significant influence between financial inclusion and MSMEs performance. In line with Chauvet and Jacolin (2017), they states that financial inclusion has a positive influence on the growth of MSMEs. They also said that financial inclusion policies positively and significantly impacted the operation of MSMEs. For this reason, financial inclusion was needed to improve financial literacy. Financial inclusion is all kinds of ways to facilitate the public in obtaining financial services. Financial inclusion aims to eliminate all forms of barriers to public access in making use of financial services supported by existing infrastructure (Nurjanah, 2017).
In a business such as MSME, financial decision making is certainly done by the manager or the owner of the business itself. Decision making must be carried out with the right considerations, the owner must have a fairly good financial literacy, and also be driven by various aspects in determining it, one of which is the influence within the business actor both internal and external influences or commonly referred to as locus of control. Locus of control is one of the factors that will affect one's financial behavior.

Locus of control will be good if someone is able to control their finances well, and vice versa will also have a bad impact if someone is not able to control their finances properly. Therefore, an SME actor, especially in the city of Padang must be required to have the ability to plan finances in their business properly, make decisions effectively and efficiently so that the business they have produces maximum profit.

2. METHODS

There are several previous research related to the financial performance of Micro, Small and Medium Enterprises (MSMEs). Some researchers have examined what are the determinants of MSME financial performance, namely financial literacy, financial inclusion, internal locus of control and risk perception. The purpose of this study is to answer the research question "what is the most influential determinant of MSME financial performance?"

This research used Systematic Literature Review (SLR) method. The first stage in SLR method is collected some previous research article from various journals which related to the determinants of MSME financial performance. Thus, those article will be used to formulate research results. The source of literature used in this study prevail from following data base, such as emerald insight on the link (www.emeraldinsight.com), science direct on the link (www.sciencedirect.com), and some others sources.

To get relevant literature, researchers use the appropriate keywords in the form of determinant used. Based on these keywords obtained some literature which is then selected again. Literature that meets the criteria based on keywords, will then be evaluated based on abstracts. Each literary abstract is read to ensure that the literature meets the criteria and can be used as a source of literature in this study. Selected literature based on abstracts will be read, analyzed and evaluated for quality as a reference source for formulating research results.

3. RESULT AND DISCUSSION

Chaves et al (2014) conducted research and examined the effect of locus of control towards organizational success on 58 MSMEs owners and 52 MSMEs managers. According to Gibb and Scot (1985), Phares (1976) and Chaves et al (2014) state that locus of control has a relationship with professional behavior. Individual who has a good internal locus of control will be challenged to have more difficult goals, have better motivation and have more commitment to their work. Meanwhile, individual who has an external locus of control will has a challenge to get a better job, one of the indicator is a better salary. Furthermore, Lamers et al (2010) examining the effect of risk as measured by risk perception on the financial performance of SMEs in Nigeria by as measured by profitability. In this study, Lamers et al proved that risk perception had a positive and significant effect on profitability. This is in line with Knight (1921) which states that risk and uncertainty play an important role in entrepreneurship.

Meanwhile, research conducted by Chilliya et al (2015) examined the effect of risk on the financial performance of MSMEs in South Africa, where risk was measured by risk awareness and the use of risk of management technique in several emerging industries. The results of this study indicate that the level of risk awareness and use of risk management techniques in developing industries is still low. The majority of respondents provide funding for training and seminars on risk management and introduce courses and programs related to risk management in schools,
colleges and universities to increase promotion about increasing risk awareness and use of risk management techniques.

Another study that examines the effect of risk management on the financial performance of 100 MSMEs in Kenya by using a desk research design (Wambazu et al., 2015). The results reveal that the implementation of risk management affects the financial performance of SMEs and it is recommended that MSMEs should adopt appropriate risk management to manage risk in the organization. Meanwhile, Chauvet and Jacolin (2015) conducted research on 55,596 MSMEs in 79 countries. This study examines the effect of financial inclusion on company performance and the results conclude that financial inclusion consisting of the distribution of financial services has a positive effect on the performance of MSMEs as measured by company growth. The same study in Ghana also prove that financial inclusion also has a positive effect on the performance of MSMEs and financial literacy has a positive effect on the performance of SMEs, Candiya et al. (2017).

4. CONCLUSION

Financial performance is one focus of attention that must be achieved by MSMEs in order to grow and develop into a company. Based on the discussion above, it is concluded that there are several determinants of MSMEs financial performance including financial literacy, financial inclusion, locus of control and risk. All previous researchers agreed that all of these determinants affect the financial performance of MSMEs.

REFERENCES


