



The Effect of Financial Literacy and Financial Inclusion on MSMEs Performance (Case Study in MSMEs Assisted by SME & IKM DPW North Sumatra Province)

Mangihut Parlindungan Aritonang^(✉), Isfenti Sadalia, and Chairul Muluk

University of North Sumatra, Medan, Indonesia
mangihut.arios1988@gmail.com

Abstract. The performance of Micro, Small, and Medium Enterprises (MSMEs) has a vital role in the economy in Indonesia. Reaching 99.9% of the total businesses in Indonesia, MSMEs contribute significantly to job creation and employment. However, they still face many problems, especially capital problems, which are indicated by the low level of financial literacy and financial inclusion of MSME actors in Indonesia. This study aims to examine the effect and relationship of financial literacy and financial inclusion either partially or simultaneously on the performance of MSMEs in Indonesia. The population in this study was 517 MSMEs that were assisted by SME & IKM DPW of North Sumatra Province spread over 33 Regencies & Cities in North Sumatra. This study type is quantitative research using an associative approach and using PLS (Partial Least Square) analysis tools. The impact show that financial literacy and financial inclusion partially and simultaneously significantly affect the performance of MSMEs. Furthermore, skills and knowledge are the two most significant financial literacy indicators. Meanwhile, connection and quality are financial inclusion indicators with the most significant effect. Thus, it can be concluded that MSMEs performance in Indonesia can continuously be improved by increasing financial literacy and financial inclusion efforts. The government and relevant stakeholders need to continue developing, adjusting, and ensuring that the current and future programs and policies can be implemented well to address various problems most MSMEs face.

Keywords: Financial Literacy · Financial Inclusion · MSMEs Performance

1 Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a vital role as one of the driving forces of the economy in Indonesia. This is because MSMEs contribute significantly to job creation, employment, Gross Domestic Product (GDP), exports, and fixed capital/investment. According to data from the Ministry of Cooperatives and Small and Medium Enterprises of the Republic of Indonesia, MSMEs accounted for 64,194,057 (99.9%) of Indonesia's total 64,199,607 enterprises in 2018. MSMEs could absorb 116,978,631 workers out of this total, accounting for 97.2% of Indonesia's workforce. MSMEs might contribute 61.07%, or Rp 8,573.89 trillion, to Indonesia's Gross Domestic

Product (GDP). MSMEs generated 14.37% of overall exports, or Rp. 293.84 trillion, in terms of revenue. The MSMEs sector generated 60.42% of total fixed capital/investment creation, or roughly IDR 2,564.54 trillion.

Recognizing the enormous contribution of MSMEs to the economy, efforts to improve MSME performance become important. This is also based on the bitter experience during the 1997 financial crisis, where MSMEs were able to survive and become a safety valve for the national economy during the crisis. This further reinforces the importance of MSME performance to strengthen the economy and the welfare of the Indonesian people.

According to Mutegi et al. [1], the performance of an MSMEs is the result of a person or group completing the company's job in the form of tasks and duties over a period of time while adhering to the company's standards. Meanwhile, according to Septiani & Wuryani [2], the MSMEs' performance is the company's ability, in this case, MSMEs, to achieve predetermined targets. The main requirement to develop MSMEs is a good performance in all divisions such as the financial, production, distribution, and marketing. In other words, It may be inferred that MSMEs' performance is influenced not only by MSME actors' capacity to run and build their businesses, but also by external factors such as capital, human resources, distribution channels, and other factors. MSMEs' performance will be evaluated in this study based on sales, capital, labor, market, and profit growth [3].

In fact, bookkeeping, small business margins, limited capital, limited managerial competence, small economic scale, marketing capabilities, and a lack of connection to financing continue to be challenges for MSME operators in Indonesia. As a result, efforts by the government and other important stakeholders to improve MSMEs' performance through various policies, programs, and empowerment activities are critical. Suryani [4] indicated that the majority of the issues stated above are caused by a lack of financial literacy. Dahmen & Rodriguez [5] revealed that financial literacy enrichment is one way to overcome the problems.

According to the Financial Services Authority's (OJK) National Survey on Indonesian Financial Literacy (SNLK), which is conducted every three years, the financial literacy level of Indonesian entrepreneurs dominated by MSMEs was 43.60% in 2019. This figure is lower than that of employees, professionals, and retirees, but higher than that of students, housewives, the jobless, and farmers/fisherman.

Based on previous research, it was found that there is a relationship between financial literacy and MSME performance. Rumini & Martadiani [6] found that financial literacy has a positive and significant impact on the performance of MSMEs. This is supported by Sanistasya et al. [7] research, which found that financial literacy and financial inclusion significantly affect the MSMEs performance in East Kalimantan. Akanno, Emejuru, & Khalid [8] also found that the financial literacy level has a significant effect on the MSMEs' profitability in Kenya. However, several studies found the opposite impact. Winarno and Wijijayanti [9], who conducted research on MSMEs in the Batu area, found that financial literacy has no effect on the overall performance of MSMEs. Eke, E. & Raath [10] also revealed that financial literacy has no effect on the growth of MSMEs. The inconsistency of research impact is interesting to be further investigated in this study.

In addition to the financial literacy factor, other problems faced in improving its performance are related to financial inclusion factors. The OJK Regulation No. 76/POJK.07/2016 [11] of the Financial Services Authority encourages consumers to use credit. Connection to a variety of financial institutions, products, and services tailored to the community's needs and abilities to improve people's welfare is defined as the availability of connection to a variety of financial institutions, products, and services tailored to the community's needs and abilities to improve people's welfare. The Financial Services Authority's National Survey of Indonesian Financial Literacy and Financial Inclusion is used by the government to assess financial inclusion in Indonesia (SNLKI). According to the 2019 survey, the financial inclusion level of entrepreneurs, who make up the majority of MSMEs in Indonesia, is relatively good, at 84.46%, although it is still lower than that of employees, professionals, and retirees.

Septiani & Wuryani [2] showed that financial inclusion influences the MSME performance. This is in line with Sisharini et al. [12], which found that an increase in financial literacy supported by financial inclusion can increase the MSMEs performance. In addition, this is in line with Odetayo et al. [13], who found that financial literacy and financial inclusion both partially and simultaneously have a significant effect on the MSMEs' performance in Nigeria. However, Awaluddin et al. [14] found that financial inclusion as one of the variables studied did not have a significant effect on the performance of MSMEs in Makassar. Research by Hilmawati and Kusumaningtias [15] postulated that financial inclusion has no effect on the performance and sustainability of the MSME sector. The inconsistency of research impact is interesting to be further studied in this study.

With financial inclusion, the financial system is encouraged to be connectionible to all levels of society, including MSMEs. Adiandari and Winata [16] found that financial inclusion accelerates the performance of MSMEs in Indonesia by providing MSME connection to credit/financing from banks connection to credit/financing by banks is essential because it is a source of business capital for MSMEs for business development [17]). However, many MSMEs still have difficulty connectioning credit/financing. Syamsulbahri [18] revealed that although most businesses in Indonesia are MSMEs, they still have difficulty connectioning capital, especially credit from banks, where MSMEs only get about one-sixth of the share of national credit. In fact, Indonesian MSMEs only obtained a 3% share of national credit in 2013, which shows that large-scale businesses still have connection to capital. Based on data from the Indonesian Financial System Statistics (SSKI) in 2022, the proportion of lending by banks to MSMEs is still low compared to the total loans disbursed, where commercial banks show stagnation below 20%, while rural banks (BPR) show a downward trend. This is also supported by the findings of Pricewaterhouse Coopers (PwC) in June 2019 that revealed 74% of MSMEs in Indonesia have no connection to capital from formal financial institutions.

Based on the above background, the authors are interested in conducting research titled "The Effect of Financial Literacy and Financial Inclusion on MSME Performance (Case Study on MSMEs Assisted by SME & IKM Nusantara DPW North Sumatra Province)". SME and IKM Nusantara were formed in 2017, had legal entities headquartered in Jakarta, spread nationwide, and chaired by Hj. Chandra Manggih. The Regional

Leadership Council (DPW) of North Sumatra Province is chaired by Binsar M Simatupang, SE. MM., with the number of MSMEs being fostered amounting to 517 MSMEs at the time of this research, which is spread across 33 regencies/cities in North Sumatra.

2 Research Methods

This study type is quantitative research using an associative approach. The population in this study was 517 MSMEs that was assisted by SME & IKM Nusantara DPW of North Sumatra Province. The Purposive Sampling approach was used to select the sample size, in which the researchers set certain criteria for identifying the research sample. The Partial Least Square (PLS) method was used to analyze the data, and SmartPLS version 3 was used. This study's analytical stage consists of multiple stages: (1) Testing the instrument's validity and reliability; (2) descriptive analysis of the level of questionnaire distribution; (3) descriptive analysis of respondents' characteristics; (4) descriptive analysis of the research variables; and (5) PLS-SEM analysis utilized to evaluate hypotheses in this study [20].

3 Results and Discussion

The results of this study include (a) validity and reliability of the instruments; (b) questionnaire; (c) descriptive analysis of respondents' characteristics; (d) descriptive analysis of research variables, and (e) path analysis as a reference for testing the hypotheses in this study.

3.1 The Result of the Validity and Reliability Test

The instrument trial phase was conducted with 100 respondents prior to the distribution of questionnaires to 180 respondents. The data from the questionnaire was then evaluated to see if the instruments were valid and reliable. The corrected item validity test – total correlation was employed in this study as the validity test. If the determined R-value $>$ R Table, the question item is judged valid in this test. R Table provides the R-value of the table, which is compared to the calculated R. Based on R Table, the calculated R-value obtained for the number of trial samples of 100 respondents at a significant level of 5% is 0.1966 (R table with $df = n - 2 = 100 - 2 = 98$, at a significance level of 5%). The test impact show that all 36 questions in this research instrument are valid, where the calculated R-value has exceeded the R Table value (0.1966). The Cronbach's Alpha reliability test was used to assess the study's reliability. If the Cronbach's alpha value is more than 0.7, the instrument is considered reliable in this test. All instruments in this study are reliable, according to the reliability test impact, as evidenced by the Cronbach's alpha value of all instruments that have exceeded the cut value (Cronbach's alpha $>$ 0.7).

3.2 The Result of Questionnaire Distribution

After the data collection stage was completed, the researcher calculated the return rate of the questionnaire (response rate). The rate of return of the questionnaire can indicate the level of the sample’s representativeness. According to Babbie [19], a 50% return on the questionnaire is considered a relatively good result, a 60% return rate is considered a good result, and a 70% return rate is considered a very good result. Based on the impact of the questionnaires distributed via Google Form, all 180 respondents returned and filled out the questionnaire (100%). Hence, the research data should be analyzed further until the objectives are achieved.

3.3 The Results of Descriptive Analysis of Respondents’ Characteristics

Descriptive analysis was conducted to find out and interpret the data regarding the demographics of the respondents. The demographic information of the respondents is shown in Table 1.

3.4 The Results of Descriptive Analysis of Research Variables

This study used a descriptive analysis of the research variables to see how the three variables were described.

Table 1. Respondents’ Characteristics

Item	Total	Item	Total
Gender		Educational Background	
Women	137	Primary School	1
Men	43	Senior High School	63
Age		Diploma & Bachelor	116
Under 30 years old	37	Business Age	
Between 31–40 years old	62	Less Than 2years	38
	56	Between 2–5 years	93
Above 50 years old	25	Above 5 years	49
Number Of Employees		Number Of Employees	
No Employee	71	No Employee	71
Between 1–5 Employees	105	Between 1–5 Employees	105
Between 6–10 Employees	4	Between 6–10 Employees	4
Business Ownership Status		Business Operational	
One’s own	158	Completely Offline	55
Family owned	16	Completely Online	8
Business Cooperation	6	Combined	117

In this study, descriptive analysis was performed by determining the mean and standard deviation before applying Sekaran's categorization technique to further categorize the data into low, middle, and high categories [21]. A 5-point Likert scale was employed in this investigation, with 1 being the lowest and 5 being the highest. The following are the impact of a descriptive analysis of each research variable based on the impact of filling out the questionnaire.

Table 2 shows the mean value of the overall answer score on the perceived financial literacy variables is 4.276, which is in the high category, indicating that most of the respondents have good financial literacy in terms of behavior, skills, knowledge, and attitudes, which are assumed to affect their business performance.

Table 3 shows the mean value of the overall answer score on the perceived financial inclusion variables is 4.023, which is in the high category, indicating that most of the respondents have good financial inclusion in terms of connection, usage, quality, and welfare, which are assumed to affect their business performance. In addition, other things are in the moderate category: the realization of lending/financing from formal financial service institutions and the addition of workers.

The mean value of the overall answer score on the perceived MSMEs performance variables is 3.846, which is in the high category, indicating that most of the respondents have good business performance in terms of connection, sales growth, capital growth, labor increase, market growth, and profit growth, as shown in Table 4.

3.5 Results of PLS Analysis

Hypothesis testing in this study was carried out using the Partial Least Square (PLS) analysis technique with the help of the SmartPLS program. The stages in this PLS analysis include the outer model and the inner model testing phases.

3.5.1 Outer Model Testing

Convergent validity, discriminant validity, and composite reliability are all part of the measurement model's outer testing phase. Each construct's loading factor is more than 0.7 for all indicators, according to the PLS model's estimate findings. The AVE value of all constructs has exceeded 0.5, according to the impact of the PLS analysis. These two suggest that each construct's indicators have all met the convergent validity criterion. The discriminant validity test findings reveal that all indicators and constructs in the PLS model meet the requisite discriminant validity standards; for example, the Financial Literacy variable (X_1) has a square root value of AVE, which is higher than X_1 's correlation with other constructs. The HTM value between constructs also shows discriminant validity. All constructs are declared to meet the discriminant validity requirement in this technique if the HTMT value between constructs does not exceed 0.9. The impact of the research show that there is no HTM value greater than 0.9 between constructs, indicating that the discriminant validity criteria were met. Discriminant validity is also revealed by the cross-loading value of each indication to the construct. All indicators have the highest indications in their constructions, indicating that they have met the discriminant validity standards, according to the impact of the discriminant validity test. For each construct, Cronbach's Alpha and Composite Reliability scores can be used to assess

Table 2. Frequency Distribution of Respondents' Answer Scores on Financial Literacy Variables

No. Items		SS	S	N	TS	STS	Mean	Category
Behavior Dimension								
1	Carry out book keeping/recording transactions (X1.1)	69	99	11	1	0	4,311	High
2	Prepare a business operational cost budget plan (X1.2)	72	96	11	1	0	4,327	High
3	Separating business finances from personal/household finances (X1.3)	72	93	14	1	0	4,311	High
Skills Dimension								
1	Able to compile simple bookkeeping/recording of business finance (X1.4)	48	119	12	1	0	4,188	High
2	Able to manage business finances to fit the budget plan and targets (X1.5)	57	111	12	0	0	4,249	High
3	Able to recognize market trends (X1.6)	51	113	16	0	0	4,194	High
Knowledge Dimensions								
1	Have basic knowledge of simple record keeping/bookkeeping (X1.7)	43	119	18	0	0	4,138	High
2	Understand how to manage my business finances well (X1.8)	41	128	11	0	0	4,166	High
3	Knowledge of Various financial products and services from financial services Institutions (Bank/Pegadaian/PNM/Dintech), which can be utilized for business development (X1.9)	29	126	21	3	1	3,994	High
Attitude Dimensions								
1	High spirit to continue to develop the business (X.10)	106	69	3	0	2	4,538	High
2	Dare to take risks and be responsible for business decisions (X1.11)	77	95	6	0	2	4,361	High
3	Top priority consumer/customer satisfaction (X1.12)	107	68	3	0	2	4,544	High
							4,276	High

Table 3. Frequency Distribution of Respondents' Answer Scores on Financial Inclusion Variables

No	Items	SS	S	N	TS	STS	Mean	Category
Access Dimension								
1	The location of the nearest financial services institution's office is not far from sop residence/business place (X2.1)	49	110	18	3	0	4,138	High
2	I have no trouble getting information about various financial products and services (X2.2)	43	105	31	1	0	4,055	High
3	The various financial products and services offered by Financial Services Institutions are easy to access for their requirements (X2.3)	29	109	39	3	0	3,911	High
Usage Dimension								
1	Using a variety of financial products and services (credit, savings and others) to support business operations (X2.4)	22	121	30	5	2	3,866	High
2	Using a variety of financial products and services (credit, savings and others) in accordance with the financial capabilities of the business (X2.5)	29	132	18	1	0	4,049	High
3	Using a variety of financial products and services (credit, savings and others) in almost all business activities (X2.6)	27	114	33	5	1	3,894	High
Quality Dimensions								
1	The available financial products and services are quite diverse according to the needs of MSME players (X2.7)	31	121	23	5	0	3,988	High
2	The procedure for using a variety of financial products and services is uncomplicated (X2.8)	18	126	33	2	1	3,877	High
3	The quality of services provided by Financial Services Institutions is quite good(X2.9)	22	119	36	3	0	3,888	High
Welfare Dimension								
1	Theme of financial products and services helps improve business progress and sustainability (X2.10)	59	107	14	0	0	4,249	High

(continued)

Table 3. (continued)

No	Items	SS	S	N	TS	STS	Mean	Category
2	Base of accessing financial products and services helps improve the welltstre of MSMEs (2.11)	48	119	13	0	0	4,194	High
3	A wider variety of financial products and services is very melitI to support business operations (X2.12)	48	116	16	0	0	4,177	High
							4,023	High

construct reliability. According to Cronbach’s alpha, the value of Cronbach’s alpha and the composite reliability of all constructs exceeded 0.7 to meet the required reliability.

3.5.2 Inner Model Testing

The inner model testing includes assessing the Goodness-of-fit structural model, the path coefficient, the significance of the partial effect of exogenous variables on endogenous variables, and the coefficient of determination.

Based on the analysis impact for the Goodness-of-fit structural model test, the R-squared value of the three variables studied was above 0.67, so the model was in the strong PLS model. Based on the impact of the Q-squared value, all endogenous constructs have exceeded 0.67, As a result, the PLS model can be concluded to have a high predictive relevance. To determine the importance of the direct effect, the partial effect of exogenous variables on endogenous variables was used. If P-value 0.05 and t-count > 1.96, exogenous factors have a substantial effect on endogenous variables, however if P-value > 0.05 and t-count > 1.96, Ho is not ruled out, implying that the exogenous variable has no bearing on endogenous variables. All paths are significant with a P-value less than 0.05, according to the estimation impact of the PLS model using the bootstrapping procedure.

Exogenous factors have an influence on endogenous variables, as seen by the coefficient of determination. The coefficient of determination in the PLS analysis is determined by the adjusted R-squared value, which ranges from 0 to 1. The greater the contribution of exogenous variables to endogenous variables, the higher the adjusted R-squared. The adjusted R-squared value for the endogenous variables analyzed is greater than 0.5, indicating that the exogenous variables are indeed influencing the endogenous variables researched, but other factors can still be investigated.

Based on the impact of the PLS analysis that has been carried out in this study, Because the path P-value is less than 0.05, the T-statistic is more than 1.65, and the path coefficient is positive, all study hypotheses are verified. The findings indicate that financial literacy has a favorable and significant impact on MSMEs’ performance. This means that the higher the financial literacy of MSME actors, the better MSME performance will be. This supports Hypothesis 1 in this study, signifying that Hypothesis 1 is

Table 4. Frequency Distribution of Respondents' Answer Scores on MSMEs Performance Variables

No.	Items	SS	S	N	TS	STS	Mean	Category
Sales Growth Dimension								
1	Sales/business turnover is relatively increasing every year	28	124	28	0	0	4	High
2	The number of production or the number of merchandise	17	137	25	1	0	3,944	High
3	The amount of demand for relative merchandise increases every year (Y3)	23	130	26	1	0	3,972	High
Capital growth dimensions								
1	Relatively increasing business assets every year (Y4)	20	122	37	1	0	3,894	High
2	The number of loans/financing provided by Financial Services Institutions increases every year (Y5)	7	99	62	12	0	3,561	Moderate
3	Merchandise inventory increases every year (Y6)	14	128	35	3	0	3,894	High
Labor Increase Dimension								
1	The number of employees/workers (permanent and freelance) increases every year (Y7)	9	87	77	7	0	3,544	Moderate
2	The number of people who want to work for my business is increasing every year (Y8)	12	96	71	1	0	3,661	Moderate
Market Growth Dimension								
1	The number of new consumers is relatively increasing every year (Y9)	29	120	31	0	0	3,988	High
2	The business marketing area expands every year (Y10)	27	124	29	0	0	3,988	High
Profit Growth Dimension								
1	Profit/business profit is relatively increasing every year (YI I)	18	131	18	0	0	3,927	High
2	Personal Wealth from business results increases every year (Y12)	14	116	48	2	0	3,788	High
							3,846	High

accepted. Furthermore, the impact show that financial inclusion has a positive and significant effect on the performance of MSMEs. This means that the higher the financial literacy of MSME actors, the better MSME performance will be. This supports Hypothesis 2 so that Hypothesis 2 is accepted. Simultaneously, based on the analysis impact, together, financial literacy and financial inclusion have a good and considerable impact on MSMEs' performance.

4 Conclusion

MSMEs' performance in Indonesia can continuously be improved through some efforts to increase financial literacy and financial inclusion. Several things must be followed up by the Government (central and regional), Regulators, Ministries/Agencies, Financial Services Institutions, and other relevant stakeholders. Conceptualized, measurable, and sustainable assistance and coaching programs that match the MSMEs' characteristics and needs must be carried out. The cognitive development of MSME actors who are oriented towards true entrepreneurship is also essential. Financial connection points, both in physical offices as well as agents of financial service institutions spread to the sub-district/village level, need to be expanded. Connection to information about financial service products and institutions, business managerial materials, financial management, market reviews, and other user-friendly applications or web-based information, and building MSMEs Incubation Centers are considered important. The government and relevant stakeholders need to continue developing, adjusting, and ensuring that the current and future programs and policies can be implemented well to address various problems most MSMEs face.

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