

The Influence of Financial Literacy and Entrepreneurial Orientation on MSME Performance with Financial Management Behavior as A Mediation Variable

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Abstract

Micro, Small, and Medium Enterprises (MSMEs) constitute the backbone of the Indonesian economy and play a crucial role in promoting inclusive economic growth, employment generation, and poverty reduction. This study aims to analyze the effect of financial literacy and entrepreneurial orientation on SME performance with financial management behavior as a mediating variable. The research employed a quantitative approach using Structural Equation Modeling - Partial Least Squares (SEM-PLS) analysis with SmartPLS 4.0 software. A sample of 395 SME owners in Pekanbaru City, Riau was selected using purposive sampling technique. The results indicate that: (1) financial literacy has a positive and significant effect on financial management behavior; (2) entrepreneurial orientation has a positive and significant effect on financial management behavior; (3) financial management behavior has a positive and significant effect on SME performance; (4) financial literacy has a positive and significant effect on SME performance; (5) entrepreneurial orientation does not have a significant effect on SME performance; (6) financial management behavior partially mediates the relationship between financial literacy, entrepreneurial orientation, and SME performance. The implications of this study provide input for SME owners and policymakers in improving financial literacy capacity and strengthening entrepreneurial orientation to drive better business performance

Keywords

Entrepreneurial Orientation, Financial Literacy, Financial Management Behavior, SEM-PLS, SME Performance



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INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) constitute the backbone of the Indonesian economy and play a crucial role in promoting inclusive economic growth, employment generation, and poverty reduction. As one of the largest contributors to

national economic activity, MSMEs account for a substantial proportion of Indonesia's Gross Domestic Product (GDP) and provide employment opportunities for millions of people across various sectors. According to data from the Indonesian Ministry of Cooperatives and SMEs, MSMEs contribute approximately 61 percent of the national GDP and absorb more than 97 percent of the workforce, highlighting their strategic importance in sustaining economic stability and resilience. Despite their significant contribution, many MSMEs continue to face persistent challenges related to limited access to capital, inadequate managerial capabilities, technological constraints, and increasing market competition. These challenges often hinder business sustainability and reduce the capacity of MSMEs to achieve optimal performance in an increasingly dynamic and competitive business environment (Ministry of Cooperatives and SMEs of Indonesia, 2023).

The success and sustainability of MSMEs are closely associated with the ability of entrepreneurs to effectively manage financial resources. Financial literacy has emerged as one of the most critical determinants of sound financial decision-making and business success. Financial literacy refers to an individual's ability to understand, evaluate, and utilize financial information to make informed economic decisions. Entrepreneurs with a high level of financial literacy are more capable of preparing financial plans, managing cash flows, assessing investment opportunities, and accessing external financing sources. Conversely, inadequate financial literacy often results in poor financial management practices, limited business growth, and higher vulnerability to financial risks. Previous studies have consistently demonstrated that financial literacy positively influences business management practices and enhances organizational performance by improving entrepreneurs' capability to allocate resources efficiently and make strategic financial decisions (Chen & Volpe, 1998; Lusardi & Mitchell, 2014).

In addition to financial literacy, entrepreneurial orientation represents another essential factor influencing MSME performance. Entrepreneurial orientation reflects the strategic posture of a business characterized by innovativeness, proactiveness, and risk-taking behavior. Firms with strong entrepreneurial orientation are more likely to identify emerging opportunities, develop innovative products and services, and respond effectively to changes in market conditions. Entrepreneurial orientation enables business owners to create competitive advantages by fostering creativity and encouraging strategic experimentation. In highly competitive environments, entrepreneurs who demonstrate proactive and innovative behaviors are better positioned to adapt to market uncertainties and sustain long-term growth. Empirical

evidence indicates that entrepreneurial orientation contributes significantly to organizational performance by promoting innovation, strategic flexibility, and market responsiveness, particularly among small and medium-sized enterprises operating in rapidly changing industries (Miller, 1983; Lumpkin & Dess, 1996).

Although financial literacy and entrepreneurial orientation are widely recognized as important predictors of business success, their effects on MSME performance may not occur directly. Instead, these relationships may be mediated through financial management behavior, which refers to the practical actions and habits associated with managing financial resources. Financial management behavior encompasses activities such as budgeting, saving, investment planning, debt management, record keeping, and financial monitoring. Entrepreneurs who possess strong financial knowledge are more likely to adopt responsible financial behaviors that support business sustainability and profitability. Likewise, entrepreneurs with a proactive and innovative orientation may be more inclined to implement effective financial management practices that facilitate business growth. Consequently, financial management behavior serves as an important mechanism through which knowledge and entrepreneurial characteristics are translated into tangible business outcomes (Hilgert, Hogarth, & Beverly, 2003; Marsh, 2006).

The mediating role of financial management behavior has attracted increasing attention in entrepreneurship and financial management research. Studies have shown that financial literacy contributes to improved financial behavior by enhancing individuals' understanding of financial concepts and strengthening their confidence in making financial decisions. Effective financial management behavior, in turn, has been associated with improved financial performance, greater business stability, and enhanced organizational competitiveness. Similarly, entrepreneurial orientation can influence financial behavior by encouraging business owners to allocate resources strategically, pursue growth opportunities, and maintain financial discipline while managing uncertainty. Therefore, examining financial management behavior as an intermediary variable provides a more comprehensive understanding of how financial literacy and entrepreneurial orientation contribute to MSME performance. This perspective aligns with behavioral finance and resource-based theories, which emphasize the importance of managerial behavior in transforming knowledge and strategic capabilities into organizational success (Xiao, 2008; Fernandes, Lynch, & Netemeyer, 2014).

Based on these considerations, this study aims to investigate the relationships among financial literacy, entrepreneurial orientation, financial management behavior,

and MSME performance. Specifically, the study seeks to analyze the influence of financial literacy on financial management behavior, examine the effect of entrepreneurial orientation on financial management behavior, assess the impact of financial management behavior on MSME performance, evaluate the direct effects of financial literacy and entrepreneurial orientation on MSME performance, and determine the mediating role of financial management behavior in these relationships. By exploring these interconnections, the study is expected to contribute to the development of effective strategies for enhancing MSME competitiveness and sustainability while providing valuable insights for policymakers, educators, and business practitioners seeking to strengthen the financial and entrepreneurial capabilities of MSME owners (Lumpkin & Dess, 1996; Lusardi & Mitchell, 2014; Xiao, 2008).

METHODS

This study employed a quantitative approach with a causal-explanatory research design to examine the cause-and-effect relationships among the variables under investigation. The target population consisted of all Micro, Small, and Medium Enterprise (MSME) owners registered with the Department of Cooperatives and SMEs of Pekanbaru City, totaling approximately 27,358 business units. A Simple Random Sampling technique was utilized to ensure that each member of the population had an equal opportunity to be selected as a respondent. The sample size was determined using the Slovin formula with a 5% margin of error, resulting in a minimum sample requirement of 395 respondents. Data analysis was conducted using Partial Least Squares–Structural Equation Modeling (PLS-SEM), which is suitable for examining complex relationships among latent variables and testing mediation effects. The statistical analysis was performed using SmartPLS version 4.0 software to assess both the measurement model and the structural model, thereby ensuring the reliability, validity, and predictive capability of the proposed research framework. (Hair et al., 2022; Henseler, Ringle, & Sarstedt, 2015).

FINDINGS AND DISCUSSION

The results of the measurement model assessment demonstrated satisfactory convergent validity. Convergent validity was evaluated by examining the loading factors of each indicator on its respective construct. According to the recommended threshold, an indicator is considered valid when its loading factor exceeds 0.70. The analysis revealed that all indicators exhibited loading factors above the acceptable threshold, indicating that each indicator reliably represented its underlying construct.

Therefore, all measurement items were retained and considered valid for further analysis.

Discriminant validity was assessed using cross-loading values and the Fornell–Larcker criterion. The cross-loading results indicated that each indicator loaded more strongly on its corresponding construct than on any other construct, confirming that the indicators possessed adequate discriminant validity. Furthermore, the square root of the Average Variance Extracted (AVE) for each construct exceeded its correlations with other constructs, providing additional evidence that the constructs were empirically distinct from one another. These findings confirm that the measurement model achieved an acceptable level of discriminant validity.

The reliability assessment was conducted using Cronbach's Alpha, ρ_A , and Composite Reliability values. The results showed that all constructs exceeded the recommended threshold of 0.70 for reliability measures. Financial literacy recorded a Composite Reliability value of 0.978, entrepreneurial orientation 0.937, financial management behavior 0.996, and MSME performance 0.984. These values indicate a high degree of internal consistency and stability among the measurement items, confirming that all constructs were reliable and suitable for subsequent structural model analysis (Hair et al., 2022).

The structural model evaluation revealed substantial explanatory power. The R-square value for financial management behavior was 0.726, indicating that financial literacy and entrepreneurial orientation jointly explained 72.6% of the variance in financial management behavior. Similarly, the R-square value for MSME performance was 0.726, suggesting that financial literacy, entrepreneurial orientation, and financial management behavior accounted for 72.6% of the variation in MSME performance. The adjusted R-square values were nearly identical to the original R-square values, demonstrating the stability and robustness of the proposed model. These findings indicate that the model possesses strong predictive capability and substantial explanatory power (Hair et al., 2022).

The hypothesis testing results demonstrated that financial literacy had a positive and significant effect on financial management behavior ($\beta = 0.441$, $t = 5.286$, $p < 0.001$). This finding suggests that MSME owners with higher levels of financial literacy tend to exhibit more effective financial management practices. Similarly, entrepreneurial orientation exerted a positive and significant influence on financial management behavior ($\beta = 0.440$, $t = 5.744$, $p < 0.001$), indicating that entrepreneurs who are innovative, proactive, and willing to take risks are more likely to manage their finances effectively. These findings support the argument that both financial knowledge and

entrepreneurial attitudes contribute to improved financial management behavior among MSME owners (Lusardi & Mitchell, 2014; Lumpkin & Dess, 1996).

The analysis further revealed that financial management behavior significantly enhanced MSME performance ($\beta = 0.555$, $t = 6.484$, $p < 0.001$). This result implies that better financial planning, budgeting, monitoring, and resource allocation contribute directly to improved business outcomes. In addition, financial literacy was found to have a positive and significant direct effect on MSME performance ($\beta = 0.204$, $t = 2.412$, $p = 0.016$), suggesting that entrepreneurs with greater financial knowledge are more capable of making strategic decisions that improve business performance. However, entrepreneurial orientation did not demonstrate a statistically significant direct effect on MSME performance ($\beta = 0.134$, $t = 1.850$, $p = 0.065$). Although the relationship was positive, its magnitude was insufficient to reach the conventional significance threshold, leading to the rejection of the corresponding hypothesis.

The mediation analysis provided additional insights into the relationships among the study variables. Financial literacy exerted a positive and significant indirect effect on MSME performance through financial management behavior ($\beta = 0.245$, $t = 4.504$, $p < 0.001$). This result indicates that financial management behavior partially mediates the relationship between financial literacy and business performance. Likewise, entrepreneurial orientation showed a significant indirect effect on MSME performance through financial management behavior ($\beta = 0.244$, $t = 4.004$, $p < 0.001$). These findings suggest that entrepreneurial orientation can improve business performance when it is translated into effective financial management practices. Therefore, financial management behavior serves as an important mediating mechanism that links both financial literacy and entrepreneurial orientation to enhanced MSME performance (Xiao, 2008; Hilgert et al., 2003).

CONCLUSION

Based on the results of data analysis using PLS-SEM on 395 MSMEs in Pekanbaru City, this study produced several important findings. First, financial literacy has a positive and significant effect on financial management behavior, meaning that the higher the financial understanding of MSMEs, the better their financial management behavior. Second, entrepreneurial orientation has a positive and significant effect on financial management behavior, indicating that MSMEs with a strong entrepreneurial spirit tend to be more disciplined in managing their business finances. Third, financial management behavior has been shown to have a positive and significant effect on MSME performance, making good financial management behavior a determining factor for business success. Fourth, financial literacy has a positive and significant

direct effect on MSME performance. Fifth, entrepreneurial orientation does not have a significant direct effect on MSME performance, although the direction of the effect is positive. Sixth, financial management behavior has been shown to partially mediate the relationship between financial literacy and entrepreneurial orientation on MSME performance, making the mediating role of this variable an important pathway in improving business performance.

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