

*Original Article*

# The Effect of Financial Literature on the Growth of Msmes in Financial Inclusion Mediation

<sup>1</sup>**Ratnawati**

<sup>1</sup>*Master of Management, Postgraduate University of Wisnuwardhana Malang Indonesia.*

Received Date: 06 January 2023

Revised Date: 16 February 2023

Accepted Date: 26 February 2023

**Abstract:** *In this study, we'll look at the connections between financial literacy and inclusion in the financial system, financial inclusion and business growth, and financial literacy and inclusion-mediated company growth. The owner of MSME Batik in Malang City is the subject of this study, which employed the path analysis technique (path analysis). The census method, also known as complete enumeration, in which every member of the community is sampled, was the sampling technique used in this research. According to the test findings, financial literacy affects financial inclusion, financial inclusion affects the growth of MSME, and MSME growth affects financial literacy. Financial inclusion can reduce the effect of financial literacy on SMEs.*

**Keywords:** *Financial Literacy, Financial Inclusion, MSME Growth.*

## I. INTRODUCTION

The Micro, Small and Medium Business (MSMEs) sector is one of Indonesia's key economic players. This is so because small- and medium-sized company owners begin with a home industry that is run by people and organizations with a vested interest in the economy (Rakhmawati, 2018). The Covid-19 pandemic is currently causing economic instability throughout the world, including in Indonesia, and a recession. The prosperity of Malang City has been significantly impacted by the Covid-19 pandemic. MSMEs are among those impacted by the Covid-19 pandemic; in Malang City, about 20% of MSMEs are suffering suspended animation as a result of the pandemic. This is what slows down MSMEs' expansion in Malang City. In addressing the issues SMEs and cooperatives confront.

The fact that Malang City is a tourist destination presents a chance for MSME actors to grow their businesses, with students and university students as their primary market (Wahyuni, 2014). The expansion of MSMEs in Malang City must still be taken into account, and batik MSMEs are one that must be constantly taken into account. In fact, every October 2 is recognized as National Batik Day by UNESCO, which declared Indonesian batik a part of the world's cultural legacy that must be preserved (Dwipasari & Subianto, 2017). One of the Indonesian people's original crafts, batik is well known for its exquisite patterns with a variety of philosophical values (Triatmanto et al, 2019). The standard Malang City batik is typically

The issue that many Batik MSMEs face is business growth. Many Batik MSMEs are no longer able to carry out their operations as a result of a number of issues, including challenges with marketing and high prices because the production process is time-consuming and complex, the ability to draw is still very limited and relatively easy, and the lack of orders also lowers the enthusiasm of craftsmen (Dwipasari & Subianto, 2017). Additionally, a lot of Batik MSME owners have not maintained organized bookkeeping, cash flow is still ambiguous, and there is still no connection between household consumption spending and company spending (Herawati et al., 2017). Increased financial management skills and knowledge are necessary for MSMEs to thrive. This is because maintaining a company requires a strong grasp of financial literacy. According to Wise (2013), improving financial literacy leads to better financial reports, higher profitability from loan repayments, and better company continuity. According to earlier studies by Aribawa (2016), Fitria et al. (2018), Mwanki (2018), and Eniola (2017), financial literacy and MSME development have a strong, positive connection. Based on current events and important findings from earlier studies, it is intriguing to reevaluate the effect of financial literacy on the expansion of MSMEs via the lens of financial inclusion.

Financial inclusion is a coordinated endeavor with the goal of removing obstacles to inclusion and utilizing readily available financial services for the general public without incurring significant costs (Nasution, LN: Dwita, 2016). (2011) Saputra & Dewi's Financial Action Task Forces (2017) Financial inclusion refers to the accessibility of inclusion in adequate financial institutions that are safe, comfortable, and affordable for their financial services for disadvantaged vulnerable groups and others, including those with low incomes, those who reside in rural areas, and those without a legal status who have been shut out of the official economy with the aim of promoting personal wellbeing.

Previous research conducted by Yakubu et al. (2017), Mindra & Moya (2017), Bongomin et al. (2016), Saputra & Dewi (2017), Hutabarat (2018), and Pulungan & Ndruru (2019) found a positive and substantial relationship between financial literacy and financial inclusion. Financial technology and financial literacy, according to Simanjuntak (2019), have a significant impact on how financially included students are in North Sumatra. Financial literacy among MSMEs in South Tangerang City has little effect on financial inclusion, according to Natalia's (2019) findings from a different study.

MSMEs' quality of living is significantly improved by economic growth, but economic growth cannot take place without MSMEs' economic activity. The financial industry is the one that primarily propels the MSME economy (Adriani & Wiskuana, 2020). Financial institution growth in Indonesia is presently quite significant. According to Aqida and Fitria, MSMEs grow at a faster rate when business actors are more adept at using banking services, such as when they have adequate understanding of managing loans, savings, and other financial products (2019). According to earlier studies by Adriani & Wiksuana (2018), Setiawan (2020), and Choirunnisa (2018), financial inclusion significantly boosts the expansion of SMEs.

## II. LITERATURE REVIEW

### A. Financial Literacy

Financial literacy, as defined by Lusardi & Mitchell (2014), is the capacity to apply financial information in daily life. Financial literacy was defined by Huston (2010) as the ability to understand, analyse, manage, and communicate about one's personal financial situation. A person's decision-making skills, willingness to save money, and credit score can all be improved through financial literacy, which will also boost their access to credit and use of financial products (Bongomin et al. 2016).

### B. Financial Inclusion

Financial inclusion, according to Durai and Stella (2019), is the process of ensuring that everyone has affordable access to sufficient financial and credit services. Financial inclusion is the capacity to satisfy requirements for dependable and sustainable transactions, payments, savings, credit, insurance, and valuable formal goods and services (World Bank, 2014).

### C. MSME Growth

Business development is management growth and the company's economic competitiveness (Ayodeji et al., 2015). This level of competition will benefit the business. Companies will get more income so they can survive and even compete with other companies.

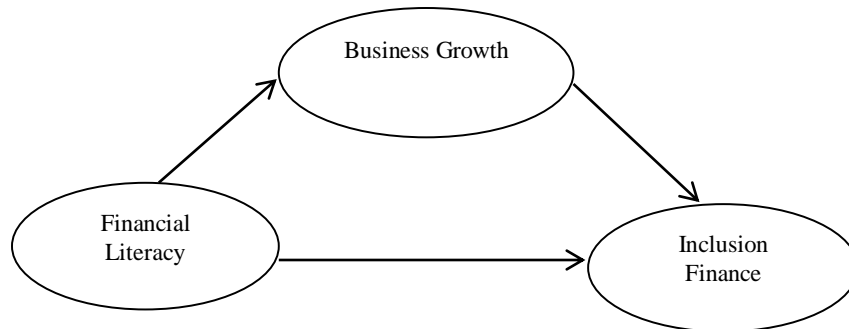


Figure1. Research Concept Framework

## III. MATERIAL AND METHOD

This study is an example of an explanatory study (Explanatory Re-search). By putting the proposed hypotheses to the test, it will be possible to explain the position of the variables under study and the relationship between one variable and another. The population in this study were 30 Batik MSME owners in Malang, Indonesia. The selection of this population is based on the area where the MSME runs its business. Sampling was carried out using the census or complete enumeration method, that is, if all members of the population become samples or respondents in this study at 30 Batik SMEs in Malang City.

The impact of intervening variables is evaluated using route analysis (path analysis). Path analysis uses regression analysis to calculate the causal relationship between variables (casual model), which has already been established based on theory (Ghazali, 2016). To determine whether or not a hypothesis can affect how the independent variable affects the dependent variable, the partial test (t test) is utilised (Ghozali, 2018). If the independent variable has a significant value of  $<0.05$ , it can be regarded to be important. The Sobel test is carried out by testing the strength of the indirect effect of the independent variable (X) on the dependent variable (Z) through the intervening variable (Y), where in this study the influence of financial inclusion mediation on the effect of financial literacy on MSME growth.

## IV. RESULTS AND DISCUSSION

### A. RESULTS

It is possible to understand testing the direct effect between variables as follows:

**Table1. Direct Influence Between Variables**

Influence Between Variables	Path Coefficient	t-statistics	Sig. t
Financial Literacy → Financial Inclusion	0.828	7,817	0.000
Financial Literacy → MSME Growth	0.755	7,701	0.000
Financial Inclusion → MSME Growth	0.232	2,400	0.024

#### Hypothesis 1. Effect of financial literacy on financial inclusion

It can be concluded that the hypothesis of financial literacy on financial inclusion is acceptable based on the statistical t value of 7,817 with a significance level of 0,000, which is less than the error rate ( $\alpha$ ) of 5%, the results of testing the hypothesis about the impact of financial literacy on MSME growth. This indicates that, with an increase value of 0.828, the level of financial inclusion increases as financial literacy increases.

#### Hypothesis 2. Effect of financial literacy on MSME growth

It may be inferred that the financial literacy hypothesis on MSME growth is acceptable given the statistical t value of 7,701 and significance level of 0,000 obtained from testing the hypothesis regarding the impact of financial literacy on MSME growth, which is less than the error rate ( $\alpha$ ) of 5%. This indicates that, with an increase value of 0.755, the growth rate of MSMEs is inversely correlated with financial literacy.

#### Hypothesis 3. The effect of MSME growth on financial inclusion

The MSME growth hypothesis on financial inclusion can be considered to be valid given that the results of testing the hypothesis about the impact of financial literacy on MSME growth generate a statistical t value of 2.400 with a significance level of 0.024, which is less than the error rate ( $\alpha$ ) of 5%. This indicates that, with an increase value of 0.232, the level of financial inclusion increases in direct proportion to the growth of MSMEs.

Evaluation of the impact of financial inclusion on the growth of MSME's using the Sobel test. Whether or whether the effect of mediation is significant is determined using the Sobel test. The Sobel test results are shown in Figure 1.

**Figure 1. Sobel test**

Input:		Test statistic:	Std. Error:	p-value:
a	0.677	Sobel test: 2.29660184	0.07723324	0.02164149
b	0.262	Aroian test: 2.27948349	0.07781324	0.02263834
s <sub>a</sub>	0.087	Goodman test: 2.31411173	0.07664885	0.02066159
s <sub>b</sub>	0.109	Reset all	Calculate	

#### Hypothesis 4. Effect of Financial Literacy on MSME Growth through Financial Inclusion

Based on the findings in Figure 1, it is known that the indirect impact of financial literacy on MSME growth through financial inclusion has a statistical T value of 2.297 and a value with a significance level of 0.022, which is less than the error rate ( $\alpha$ ) of 5%. As a result, the financial inclusion variable is able to mediate the indirect impact of financial literacy for MSME growth.

### B. DISCUSSION

#### a) Financial Literacy Directly Has a Significant Effect On Financial Inclusion

According to the analysis's findings, the financial literacy variable significantly affects the financial inclusion of Batik MSMEs in Malang City. Based on the results of the analysis, it can be explained that the owner of MSME Batik in Malang City who has knowledge of financial literacy is indicated by the owner of MSME having knowledge of basic accounting, so that the financial management carried out by the owner of Batik MSME runs effectively which is indicated by the owner being able to plan, budget, inspection, management, financial control up to keeping cash in and out every day. That way MSME owners have a financial attitude with the courage to take risks in decision making, and set strategies to minimize the risks that occur.

These findings are consistent with The Association of Chartered Certified Accountants' (2014) definition of financial literacy, which includes knowledge of financial concepts, the capacity to comprehend communication about those concepts, the capacity to manage one's own and one's company's finances, and the capacity to make sound financial decisions in specific circumstances. This demonstrates that financial inclusion will expand as financial literacy levels rise. The ability to use financial products and services in accordance with needs and the capacity to carry out financial planning more effectively are two benefits of financial literacy for society. More people will use financial products and services as financial literacy among the general population rises.

Previous studies that found a positive and significant correlation between financial literacy and financial inclusion, including those by Yakubu et al. (2017), Mindra & Moya (2017), Bongomin et al. (2016), Saputra & Dewi (2017), Hutabarat (2018), and Pulungan & Ndruru (2019), provide support for the findings of this study. According to Simanjuntak (2019), financial technology and financial literacy have a big impact on how financially included students are in North Sumatra. The findings of this study also conflict with those of Natalia's (2019) study, which found that financial inclusion in MSMEs in South Tangerang City is unaffected by financial literacy.

**b) *Financial Literacy Directly Has a Significant Effect on The Growth of MSMEs***

The financial literacy variable has a substantial impact on the growth of MSMEs in the batik MSMEs in Malang City, as can be shown from the analytical results in this study. Based on the results of the analysis, it can be explained that the efforts of MSME owners to develop MSME growth are shown by providing innovation for the latest products, introducing products to a wider market, providing training to increase labor productivity, increasing the productive business of members and groups by strengthening group capital, so that can increase the product produced / sold.

In increasing the growth of MSME knowledge, behavior and financial attitudes that must be implemented with the owner must have basic accounting knowledge, for effective financial management, so that the owner can carry out planning, budgeting, auditing, managing, financial control up to making cash bookkeeping in and out every day. That way the owner is brave/able to take risks in making decisions, and rearranges strategies to minimize the risks that occur.

These results are supported by Grohmann et al (2017) in his research which concluded that increasing financial literacy in a population will increase account ownership, and have a major impact in several countries with low financial understanding. So that the more financial information obtained, the higher the financial knowledge possessed and can be used as a basis for decision making. Yushita, (2017) having insights related to finance will be very helpful in being able to make arrangements for financial plans, thereby optimizing profits will be higher so as to be able to increase living welfare.

The findings of this study are consistent with those of Wise's (2013) study, which found that improving financial literacy leads to better financial reports, higher loan repayment profitability, and greater business continuity. According to studies by Aribawa (2016), Fitria et al. (2018), Mwanki (2018), and Eniola (2017), there is a strong correlation between financial literacy and MSME growth. The findings of this study contradict those of studies by Eke, E. Dan Raath (2013), Kusumadewi (2017), and Olawale and Garwe (2010), which found no connection between financial literacy and the expansion of MSMEs.

**c) *Financial Inclusion Directly has a Significant Effect on The Growth of MSMEs***

According to the analysis's findings, the financial inclusion variable significantly influences the expansion of MSMEs in the batik sector in Malang City. Based on the results of the analysis, it can be explained that access to financial institutions is indicated by the owner knowing the financial services owned by the bank, so that he can use financial institution facilities to meet needs and manage finances, save money from sales using a special business-owned account, use financial services to improve income, and use loans from financial institutions, to develop the business.

These findings are in line with the Financial Services Authority's (2016) regulation, which defines financial inclusion as the accessibility of different financial institutions, products, and services based on the requirements and capacities of the community in order to enhance social welfare. Financial inclusion is the ability of an individual or group to access practical formal goods and services and to satisfy needs for reliable and sustainable transactions, payments, savings, credit, and insurance (World Bank, 2014).

From these findings, it can be deduced that MSMEs will expand more rapidly the more adept business actors are at utilising banking services, such as by having appropriate knowledge of handling loans, deposits, and other financial products (Aqida and Fitria 2019). The growth of MSMEs is inversely correlated with financial inclusion. The findings of this study support earlier findings by Adriani & Wiksuana (2018), Setiawan (2020), and Choirunnisa (2018) that financial

inclusion significantly boosts the expansion of MSME. The findings of this study, however, do not support research by Ibor et al. (2017) that found no connection between financial inclusion and MSME growth.

**d) Financial Inclusion Mediates the Effect of Financial Literacy on MSME Growth**

According to the study's findings, financial inclusion has the capacity to mitigate the impact of financial literacy on the expansion of MSMEs in the batik sector in Malang City. The better MSME growth, in other words, has been made possible by the values developed in financial literacy, where the literacy values of MSME owners are having knowledge of basic accounting and understanding how to manage finances effectively, so they can carry out planning, budgeting, checking, managing, controlling finances to keep cash in and out every day, so the owner can set a strategy and dare to take risks when making decisions.

The high level of financial literacy of a business will have an impact on business financial inclusion, where access to financial institutions is indicated by the owner knowing the financial services owned by the bank, so that they can use financial institution facilities to meet their needs and manage finances, saving money from sales using a special account owned by businesses, using financial services to increase revenue, and using loans from financial institutions, to develop businesses.

According to the intended goals, it will improve MSMEs' growth through promoting business financial inclusion and literacy. The efforts of MSME owners to develop MSME growth are shown by providing innovation for the latest products, introducing products to a wider market, providing training to increase labor productivity, increasing the productive business of members and groups by strengthening group capital, so as to increase the products produced/sold.

Previous studies that found a positive and significant correlation between financial literacy and financial inclusion, including those by Yakubu et al. (2017), Mindra & Moya (2017), Bongomin et al. (2016), Saputra & Dewi (2017), Hutabarat (2018), and Pulungan & Ndruru (2019), provide support for the findings of this study. According to Simanjuntak (2019), financial technology and financial literacy have a big impact on how financially included students are in North Sumatra. According to studies by Aribawa (2016), Fitria et al. (2018), Mwanki (2018), and Eniola (2017), there is a strong correlation between financial literacy and MSME growth. Financial inclusion, according to Adriani & Wiksuana (2018), Setiawan (2020), and Choirunnisa (2018), significantly boosts MSME growth.

## V. CONCLUSION

The findings of this study suggest that financial literacy has an impact on MSMEs' expansion. So, it may be argued that MSMEs expand more rapidly the more financially literate people are, and vice versa, that MSMEs grow less rapidly the less financially literate people are. Financial inclusion is influenced by financial literacy. So, it may be argued that MSMEs are more financially included the higher their financial literacy, and vice versa, that MSMEs are less financially included the lower their financial literacy.

Growth of MSME's is impacted by financial inclusion. So, it may be argued that MSMEs expand more rapidly the more financially included they are, and vice versa, that MSMEs grow less rapidly the less financially included they are. The ability of financial inclusion to moderate the impact of financial literacy on MSME growth demonstrates the indirect effect.

## VI. ACKNOWLEDGEMENTS

The author would like to thank the Wisnuwardhana University of Malang and the Malang-Indonesia batik MSME Association and related agencies.

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