

# Exploring The Financial Management Practices on The SMEs Business Performance

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## Abstract

The rapid change in the business environment emphasizes the company to adapt faster to advance toward sustainable development. Although SMEs significantly contribute to the Gross Domestic Product in Indonesia, in terms of managing the business, a previous study showed that many SMEs continue to use the traditional approach, especially in the financial management aspects, so they are prone to failure. This study tries to explore the presence of financial management practice at SMEs in Indonesia which data are taken from 216 SMEs owners or managers. The study was conducted with the qualitative method with the in-depth interview approach through an online platform from January to April 2022. Results showed that present SMEs in Indonesia have better financial management practices that can be seen from 1) most SMEs have already recorded their financial report, 3) Most SMEs have moderate to high levels of financial literacy, and 3) their overall performance somewhat increases rather than previous years.

## Keywords

Small Medium-Sized Enterprise, Financial Management Practices, Business Performance

## 1. Introduction

MSMEs are one of the economic supports in Indonesia, this can be seen from the contribution of the MSME sector which is quite high to GDP, which is 61.07% or worth 8,573.89 trillion rupiahs in 2020 (Ministry of Cooperatives and MSMEs). SMEs also play a strategic role in the Indonesian economy by being a major subject in economic activity across various sectors, creating large employment opportunities, developing local economic activities and empowering people, creating new markets and sources of innovation, and maintaining the balance of payments through export activities (LPPI & BI, 2015). In 2019, according to the Ministry of Cooperative and SMEs showed that the number of SMEs in Indonesia has reached above 90% compared to the large industries (Mahdi, 2022) and the distribution of these SMEs concentrated in Java Island, such as central java province, east java province, and west java province detailed about the distribution of SMEs can be seen in Figure 1.

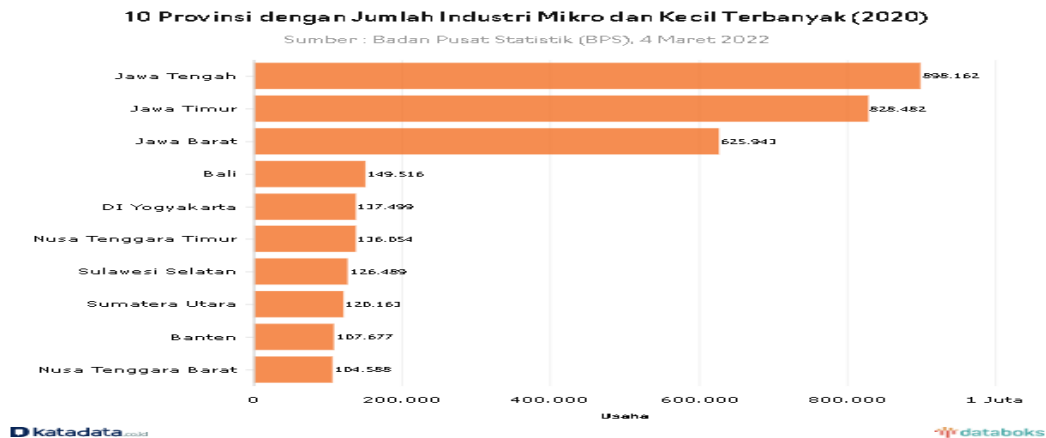


Figure 1. Distribution of SMEs in Indonesia (Source: Katadata.co.id and BPS)

While in West Java Province, the proportion of SMEs compared to medium and large enterprises is 98.84%, with the most extensive distribution in Bogor, Bandung, Sukabumi, Garut, Cirebon, Cianjur, Karawang, and Bekasi, details can be seen in Figure 2.

Kabupaten/Kota	Jumlah	Persentase (%)
Kab. Bogor	367.271	8,08
Kab. Bandung	347.573	7,65
Kota Bandung	330.314	7,27
Kab. Sukabumi	266.729	5,87
Kab. Garut	258.314	5,68
Kab. Cirebon	249.823	5,50
Kab. Cianjur	249.061	5,48
Kab. Karawang	229.031	5,04
Kab. Bekasi	227.110	5,00
Lainnya	2.020.648	44,45
Total	4.545.874	100,00

Sumber: BPS, SE2016-Lanjutan

Figure 2. Gambar 1. Distribution of SMEs of West Java Province in 2016 (BPS, 2018)

Despite having a significant contribution, it is unfortunate that the management of SMEs is still conventional in nature and even tends to be traditional, especially in the financial aspect where many of them still have not carried out a financial plan, records, and analysis consistently (Fatoki, 2012; Siswanto et al., 2022; Subroto et al., 2016) and of course this will have an impact on these SMEs concerning the calculation of the profits that they have earned (Musah et al., 2018; Zada et al., 2021) SMEs owner or manager also not create a financial report because they have a perspective that creating a financial report is complicated, takes a lot of time, and confusing (Lia, 2015). Managing the finances of the organization for SMEs is essential because SMEs are prone to bankruptcy, high default risk, and high failure rate organization (Ogawa & Tanaka, 2013; Zada et al., 2021). These findings are reinforced by the survey data conducted across of world, as represented in figure 3, which showed that the early stage of business has a high rate of failure(GEM (Global Entrepreneurship Monitoring), 2022). (Figure 3) In Indonesia, this condition also happens many of SMEs also prone to bankruptcy and have a high failure rate, from the study showed that almost 60% of new SMEs created in Indonesia failed in the first three years of business (Wirasmita, 2019), and one of the biggest failures are related to the financial aspects (Asri, 2013). The study also found that SMEs are more focused on short-term planning and internal operations that they own rather than long-term planning and external orientation (Ates et al., 2013).

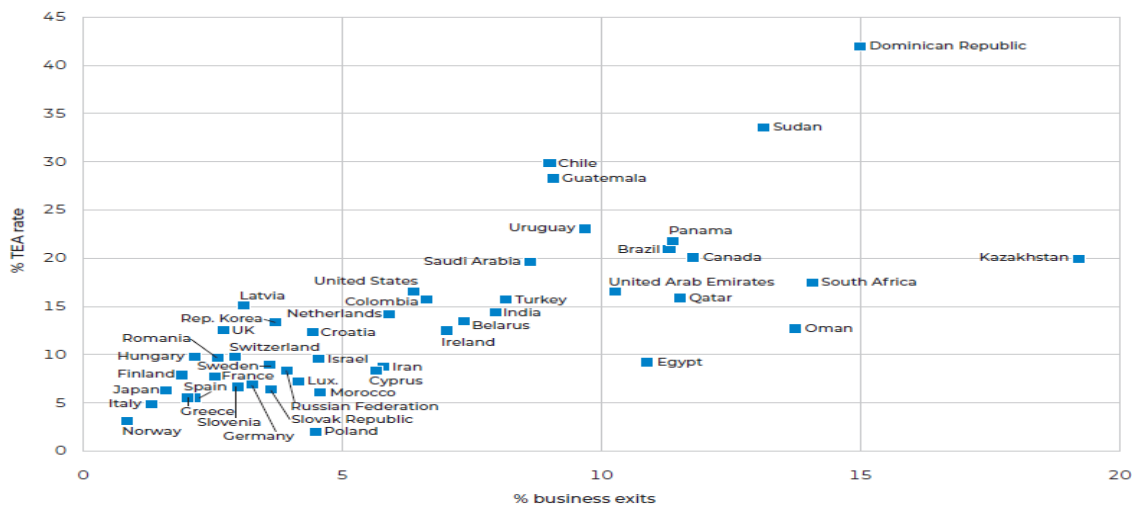


Figure 3. Scatter Plot of Business Exits and Total Early-Stage Activity Rate (Source: GEM Report, 2022)

Moreover, many research studies show that SMEs which apply financial management practices have a better financial performance (Butt et al., 2010; Bilal et al., 2017; Musah et al., 2018; Mukarromah & Astuti, 2020), increase their competitive advantage (Bilal et al., 2017; Nkundabanyanga et al., 2017), and SMEs growth (Fatoki, 2012; Musah et al., 2018; Zada et al., 2021). Even though SMEs have similar characteristics in many countries, the different business environments also can influence and affect the financial management practice of SMEs (Musah et al., 2018). As a result, it is interesting to investigate how SMEs implement financial management practices in their businesses and compare the finding with other researchers from other countries.

## **1.1 Objectives**

The research aims to explore the implementation of financial management practices in SMEs in Indonesia and its effect on their performance because the SMEs have a high failure rate and compare the finding with other researchers.

## **2. Literature Review**

### **2.1. Organization Goals**

In general, the goal of an organization in the short term is profit. However, in the long-term, the goals of an organization is not only for profit but also to sustain, maximize the shareholders value, and become an organization that can compete in the business environments and fit the market need (Firer et al., 2012; Ross et al., 2018).

In terms of SMEs perspective, the goals of SMEs can be measured in two terms: quantitative and qualitative. Quantitative means measured the financial aspects of organizations and qualitative means measured the non-financial aspects (Newby et al., 2012). Financial aspects include earning, financial security, and family future wealth; non-financial aspects include family security, time flexibility, employee and customer relationship, personal satisfaction, intrinsic award, autonomy, and the opportunity to hire the owner's family. Another researcher stated that the SMEs objectives are different from the large firm which include simply having a job, enjoying a specific lifestyle associated with becoming involved in a particular type of business, providing income to the owner-manager, and growing the business in terms of profits through sales (Fatoki, 2012).

### **2.2. Financial Management**

Financial management can be defined as the area of business management concerned with the careful utilization of capital and the careful selection of capital sources to enable an organization to progress toward its objectives (Gitman & Zutter, 2015). Financial management commonly consists of four critical constructs (Gabrielsson et al., 2004; Ross et al., 2018) such as:

1) Investment decision, the process of planning and managing a company's long-term investments, is known as investment decisions. Capital budgeting determines the organization's investment such as adding fixed assets (new plant, new machinery, and research & development project). There are two types of capital budgeting techniques: non-discounted cashflow techniques (accounting rate of return and payback period) and discounted cashflow techniques (net present value, profitability index, internal rate of return, and discounted payback period).

2) Working capital management, working capital management ensures that the organization has enough cash flow to meet short-term debt obligations as well as its operating expenses, which can include the management of the organization assets and short-term debt.

3) financing, decision, this part is related to the acquisition of funds from various types of sources depending on the management decision of the organization that determines the funding period, type of source of funds, cost of fund, and income generation that can be made by the organization. The capital structure in an organization shows how an organization funds its assets through some combination of debt, equity, or both.

4) dividend decision, this depends on the top management and also the owners of the organization decision which can be decided to share the organization profits or to hold them for reinvestment.

Financial management in SMEs is different from those found in the larger organization, because of the nature of their cycle of cash flow, their working capital management, and their difficulty in raising capital from external finance through debt or equity (Mazzarol et al., 2015; Muneer et al., 2017; Siswanto et al., 2022). Financial management plays a vital role for SMEs success in ensuring positive cashflow, it is also a central role for any kind of business (Oduware,

2011; Zada et al., 2021). Due to this significant contribution for the SMEs business continuity, so it is important for SMEs to focusing on financial improvement capabilities through creating an effective capital structure management and working capital management (Mukarromah & Astuti, 2020), analyzing the financial performance periodically, and forecast the future financial performance or conduct a proforma analysis (Carpenter & Petersen, 2002).

### **2.3. Financial Management Practice**

Financial management practices can be identified as a financial planning and control activities, financial performance analysis, determining the risk management, manage accounting information, management accounting that includes pricing and also costing activities, capital budgeting activities, and working capital management activities in the organization (Hunjra et al., 2011). According to the term, many of the research try to apply the approach and see the fitness to SMEs, the result showed that only three components of financial management practices could be categorized as a core component which are financial planning and control, financial accounting, and working capital management. Others can be categorized as supplementary components, which are financial analysis, management accounting, and capital budgeting (Agyei-Mensah, 2010; Mohd Amy Azhar et al., 2010). The study also revealed that many SMEs only conduct a few part of accounting activities, such as sales and expenses records only without conduct financial analysis (Agyei-Mensah, 2010; Fatoki, 2012) and those financial management practices activities are crucial to the performance of SMEs (Agyei-Mensah, 2010; Musah et al., 2018; Mukarromah & Astuti, 2020).

Furthermore, effective financial management is required to ensure business planning and strategic implementation. It is critical for users of financial reports that appropriate resource allocation and management decisions are made. Business decisions are based on the generation and application of relevant information (Zada et al., 2021). High-quality of accounting information must have four key attributes such as completeness, accuracy, timeliness, and consistency (Karadag, 2015).

In the SMEs perspective, the financial management practice aspects that are important to measure are working capital management, financial reporting including financial analysis, accounting information system, financing management, and investment capital budgeting decision (Suriyankietkaew & Avery, 2016; Zada et al., 2021). This measurement can be summarized into financial performance and financial management, then adding the financial literacy aspect to measure the financial management practices at SMEs (Mukarromah & Astuti, 2020; Siswanto et al., 2022).

## **3. Methods**

To explore the financial management practices in SMEs, we conduct this research through qualitative approach by use the in-depth interview. The framework of questions to ensure the quality of research guidance questions are follow (Mays & Pope, 2020):

1. Provide the guiding fundamentals, the guiding fundamentals should be 1) contribute to better knowledge or understanding of policy, practice, and theory; 2) research design should be defensible; 3) perform research in a systematic and transparent manner, begin from data collection, data processing include analysis, and interpretation of findings; and 4). Credible and consistent in presenting findings based on reasonable arguments and evidence.
2. Create suitable appraisal questions that address the research objective.
3. Ensure that appraisal questions that researchers provide to the respondents are aligned with the quality indicators such as consistency and free from researcher subjectivity.
4. Provide additional quality assessment criteria; for some specific reason, researchers can provide another assessment criteria such as conducting a more in-depth analysis for a better knowledge understanding and contribution.

From the guidance above, researchers create a criterion for the respondents, such as 1) SMEs owner or representative managers that understand the overall business process organization, 2) the business already run, 3) respondents are available and willing to participate in this research. The design of the questionnaire is semi-structured interview questions and the questions represent the objective of research that adopt from the previous research that including 1) financial performance, 2) financial management practices, and 3) financial literacy of SMEs (Mukarromah & Astuti, 2020; Siswanto et al., 2022).

Data were collected through online meeting platforms such as google meet or zoom. The collection period is from January to April 2022 and we collect 251 representative respondents that want to participate in this study. After screening and assessing the answer given during the interview session, we collect 216 respondents from Indonesia.

## 5. Results and Discussion

### 4.1 Respondent Profiles

Based on the results of the survey conducted by researchers, here are the profile of the respondents

Table 1. Profile of Respondent

Description	Information	Percentage	Description	Information	Percentage
Gender	Male	35%	Year of Business	Less than 3 Years	75%
	Female	65%		3 - 8 Years	20%
Age of Respondent	18-24	48%		9 - 15 Years	1%
	25-30	23%		More than 15 Years	3%
	31-35	13%	Form of Business	Sole Proprietorships	88%
	36-40	13%		Partnership	9%
	> 40	4%		Limited Liability	2%
Area of Business	Jakarta	20%	Type of Industries	Food and Beverages	25%
	West Java	32%		Retail	20%
	Bali	5%		Services	18%
	Central Java	10%		Online Business	16%
	East Java	13%		Fashion	12%
	Sumatera Island	10%		Finance	4%
	Borneo Island	4%		Farming	3%
	Others	7%		Others	2%

The result as represented in Table 1, showed that most of the respondents are female (65%). This study is similar to the previous study which also showed that most respondents are women (Mukarromah & Astuti, 2020; Siswanto et al., 2022). However, as represented in Figure 4, this finding is contrary to the survey conducted by GEM in 2022, which indicates most of the early stages of entrepreneurial activity are conducted by males rather than females. Other studies support the result of the GEM survey, for example, is in South Africa (Fatoki, 2012) and Pakistan (Zada et al., 2021) present that most of the respondent is male. This result could be because of the different characteristics and perspectives of SMEs in Indonesia, and most SMEs are run by women who create and sell their products directly to the customer this activity is an additional activity to fill their free time and help a little family finance.

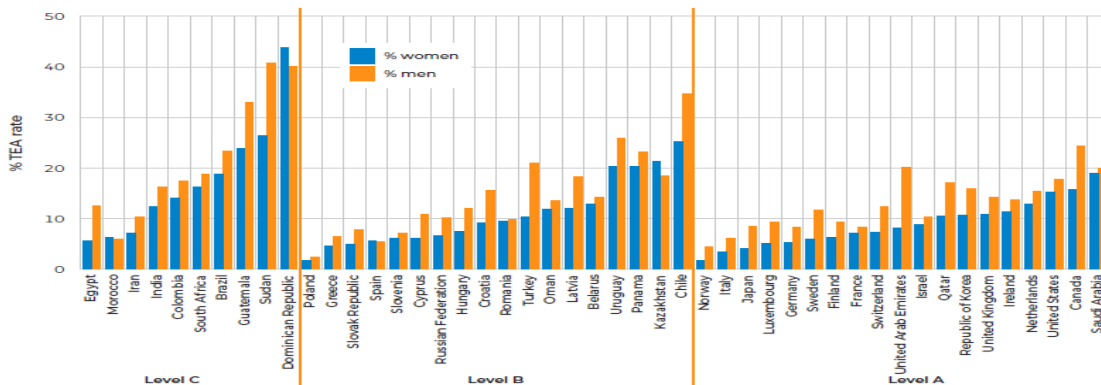


Figure 4. Total Early-Stage Entrepreneurial Activity (TEA) by Gender, (Source: GEM Report, 2022)

From the age sized, our findings similar with the other researcher that showed most of SMEs run from age 18-35 years old (Table 1). This means that nowadays, young people are interested in entrepreneurship and starting their own

business. This finding also aligns with the GEM report (Figure 5) and also Zada et al. (2022) that show that in many countries, there are a lot of young people with age 18-34 who run the business, especially an early-stage companies.

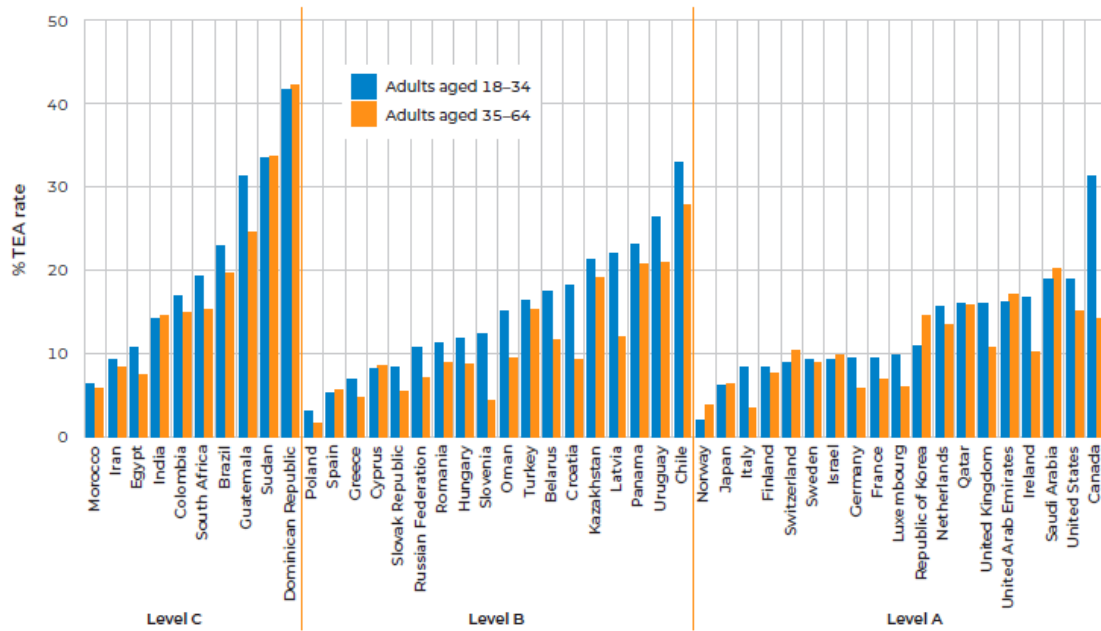
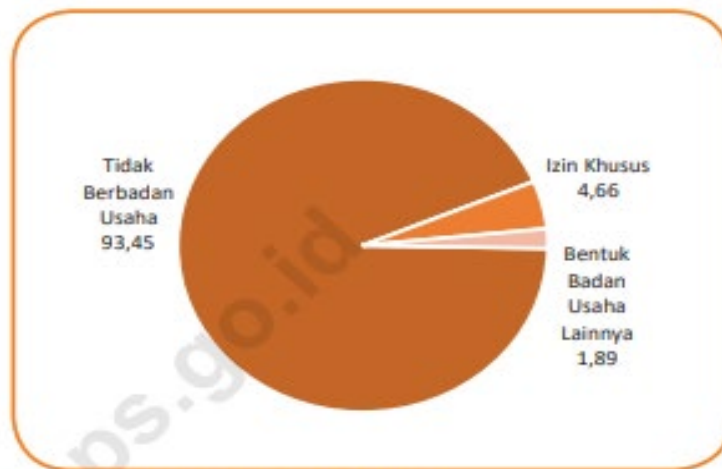


Figure 5. Total Early-Stage Entrepreneurial Activity (TEA) by Age Range (Source: GEM Report, 2022)

For the type of business, our result represents that most of the respondents have food and beverages firms (25%), retail firms (20%) and services firms (18%), this result has similarity to the data from National Statistics Bureau which show that SMEs dominate by retail sectors (46.40%) and food and beverages sectors (17.01%) (BPS, 2019).

As represented in Table 1, the form business of SMEs is mostly dominant with sole proprietorship (88%) compared to the limited liability company (2%). In Figure 6, we can see that our result also points out the same result as the data from the government which showed that most SMEs have sole proprietorship businesses (93.45%) rather than limited liability companies.



Sumber : BPS. SE2016-Laniutan

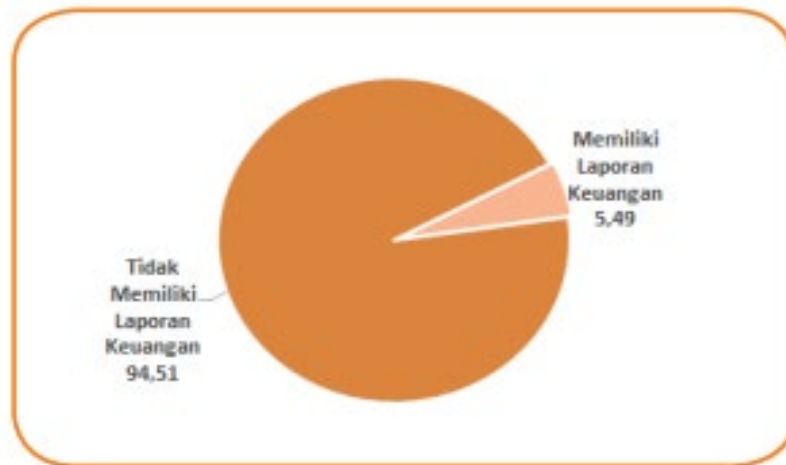
Figure 6. Form Business of SMEs Indonesia (Source: BPS, 2019)

#### 4.1. Financial Management Practice

Table 2. Financial Reporting of SMEs in Indonesia

Conduct Financial Report	Percentage
Yes	84%
No	16%
Type of Financial Report	Percentage
Income statement only	39%
Cashflow only	18%
Balance Sheet Only	5%
Full financial report	15%
Income statement & Cashflow	20%
Income statement & Balance sheet	3%

Table 2 represent that most SMEs conduct financial reports (84%). This result indicates different findings from the previous study which presents that most SMEs do not record their financial activities as present in Figure 7, around 94.51% (BPS, 2019), and prefer to save money for their neighbor (Mukarromah & Astuti, 2020).



Sumber : BPS, SE2016-Lanjutan

Figure 7. SMEs Financial Reporting (Source: BPS, 2019)

The report that are mostly conduct consistently by SMEs as represent in Table 2 are income statement (39%) and cashflow report 18%, this findings aligned with the previous study that also found many of SMEs conduct the sales record, which also can be represent the income of the firms, and also few of SMEs record their assets and inventory, which can be represent in the their balance sheet report (Siswanto et al., 2022).

#### 4.2. Financial literacy

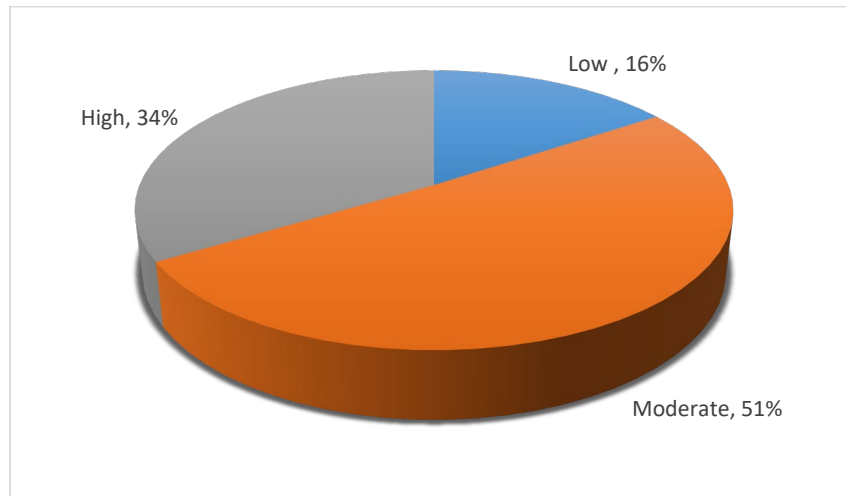


Figure 8. Financial Literacy of SMEs

According to our research finding present that most of SMEs already meet the financial literacy standards. As showed in Figure 8, it can be seen that most SMEs are already in a moderate level of financial literacy (51%) and high literacy (34%). If we look more detail into this result, our respondents mostly is young people which most of them have good digital literacy and also they live surrounding urban and sub-urban areas which support with technology. Based on the result, we support the previous study that also found that most of their respondents have a moderate financial literacy rate of 44.19% (Mukarromah & Astuti, 2020). (Figure 8)

#### 4.3. Impact of Covid 19 to The SMEs Performance

Our study revealed that the pandemic also does not impact the SMEs business performance. As represented in Figure 9, most SMEs feel that their business performance somewhat increases (69%). This finding is similar to the GEM Report (2022) in some countries such as Croatia, Sweden, and South Korea (Figure 10).

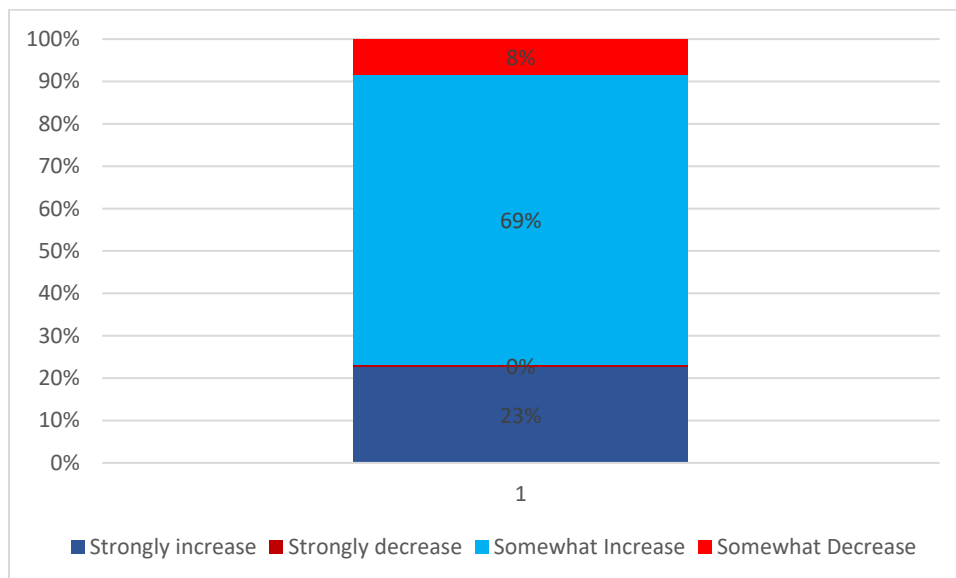


Figure 9. SMEs Overall Performance



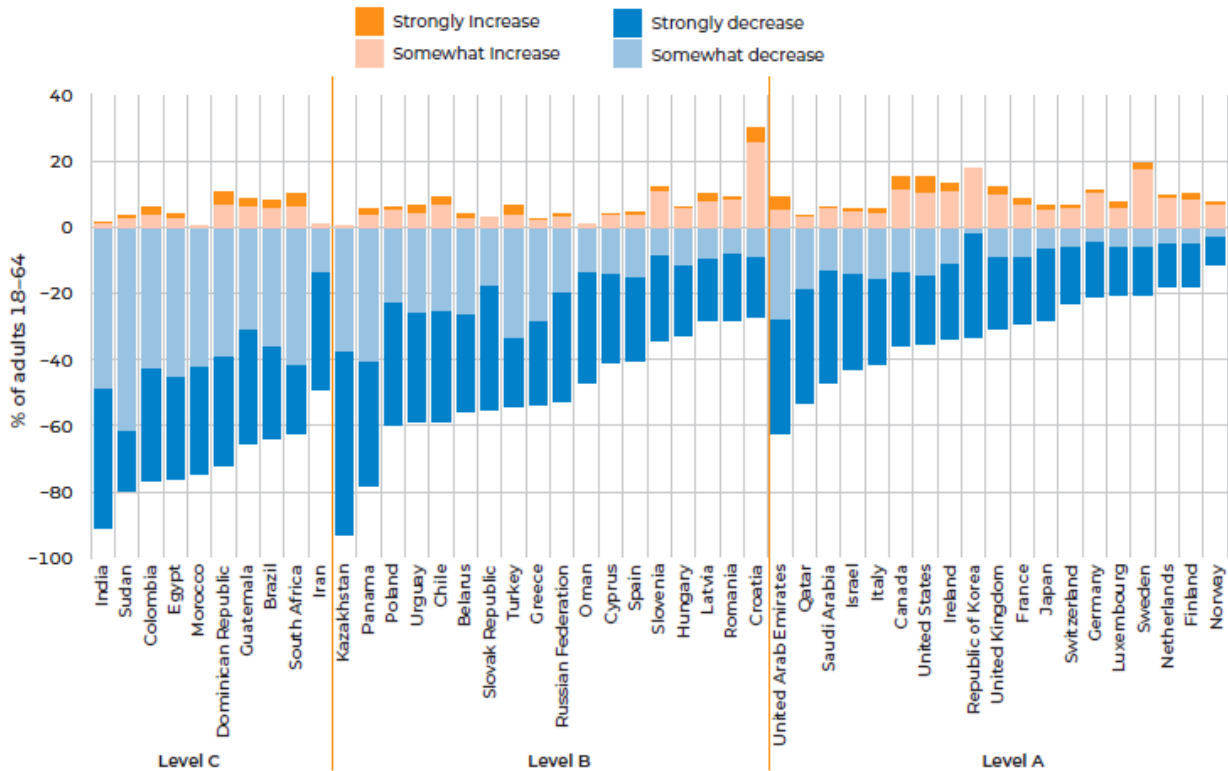


Figure 10. Perceived of SMEs Business Performance Due to Covid-19

## 5. Conclusion

From our study, it can be concluded that the financial management practice of SMEs in Indonesia has already gone to the next level. It can be shown from the implementation of financial management practices that 1) most SMEs have already recorded their financial report, even though most of them record the income statement report and cashflow report, 2) Most SMEs have moderate to high levels of financial literacy, and 3) their overall performance somewhat increases rather than previous years.

Despite this satisfactory result, future research suggests conducting a study that includes the rural area with the same portion of the urban area, which expected can represent a better population.

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