

The Effect of Financial Literacy on Growth and Sustainability of SMEs (Small and Medium Enterprises) in the Handicraft Sector in Padang City

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Abstract — This study aims to empirically examine the effect of financial literacy on growth and the effect of financial literacy on the sustainability of SMEs (Small and Medium Enterprises) in the handicraft sector in Padang City. The object of this research is the handicraft sector in Padang City. Respondents in this study amounted to 150 people selected based on purposive sampling method. Hypothesis testing is carried out using Structural Equation Modeling (SEM) analysis with STATA program version 12.0. The results of this study indicate that financial literacy has a significant effect on growth in SMEs in the handicraft sector in Padang City and financial literacy does not affect the sustainability of SMEs in the handicraft sector in Padang City.

Keywords — Financial Literacy, Growth, Sustainability.

I. INTRODUCTION

Growth and economic development are very important in a country, especially in increasing economic income and improving the welfare of its people (Hapsari et al., 2014). Indonesia has enjoyed a period of high economic growth over a long period of time until it experienced a substantial monetary crisis in 1998. When the crisis occurred, the sectors that remained viable were the Small and Medium Enterprises (SMEs) sector while others fell due to the crisis (Ministry of Finance of the Republic of Indonesia, 2016). The resilience of SMEs to crisis makes SMEs an important asset for the sustainability of the country's economy both in the crisis years and at the moment (Tejasari, 2008).

According to UU No. 20 of 2008, SMEs (Small and

Medium Enterprises) constitute a stand-alone productive economic business carried out by individuals or business entities that are not subsidiaries or not branches of companies owned or part of either directly or indirectly from a medium or business large that has criteria of assets of fifty million Rupiahs up to ten billion Rupiahs. With a turnover of three hundred million Rupiahs up to fifty billion Rupiahs per year. The survey conducted by the Financial Services Authority (FSA) which stated that the contribution of the SME sector in Indonesia proved very significant for the national economy by contributing 60% of Gross Domestic Product and absorbing 97% of the national workforce (Indonesia FSA Press Release: SP-38 / DKNS / OJK / 5/2016).

The importance of the role of SMEs in supporting economic growth requires strengthening the capacity of SMEs. One form of strengthening is by increasing the ability to manage finances and expand financial access for SMEs. In addition, SMEs often experience delays in their development. This is due to various conventional problems that have not been resolved completely, such as the problem of human resource capacity, ownership, financing, marketing and various other issues related to business management, so that SMEs have difficulty competing with large companies (Abor and Quartey, 2010).

This SME development makes one of the activities carried out by the government in improving the economy of a society. The development of SMEs is essentially a shared responsibility between government and society. One of the efforts to achieve SME development is through the development of SMEs which in its implementation refers to the 2004 *ASEAN Blue Print Policy for SMEs (Small Medium Enterprises) Development* (APBSD) until 2014. In the APBSD program, SME development is carried out through five programs, namely: entrepreneurship development, increased marketing capabilities, financial access, access to technology and conducive policies. However, practice in the field is still found to be a problem, especially SMEs do not have transparent and organized financial information that causes credit providers to find difficulties in obtaining information about the financial and business conditions of SMEs (Bank Indonesia, 2012).

In research conducted by Manurung and Barlian (2012), SMEs tend to have a short-term orientation in making two decisions in their business. This can be seen from the absence of the concept of sustainable innovation and inconsistent core business activities. In the end, the development of SME's long-term performance tends not to be well directed. Therefore, strategic efforts are needed to

improve the performance and sustainability of SMEs. Performance is an achievement achieved by a company in a certain period that reflects the company's health level, and the size of the most widely used ROI (*Return on Investment*), besides other qualitative and quantitative measures (Glueck et al., 1999). One part of the performance is growth. If a business growth shows an increase, it can be said that the country's economy is better than the previous year.

Sustainability in SMEs is seen from the company's success in innovating, managing employees and customers and returning to their initial capital. In which this shows that the company has an orientation to develop and see opportunities for continuous innovation (Hudson et al., 2001). One way that can be done is to enrich the knowledge of SME performers regarding financial literacy, so that their management and accountability can be accounted for better as is the case with large companies. Previous research conducted by Njoroge (2013) stated that SME owners or managers in Nairobi County have a high level of financial literacy and so is research from Aribawa (2016) which stated that there is an influence between financial literacy on business performance and sustainability on creative SMEs in Central Java.

Individuals with good financial literacy skills tend to make better financial decisions with fewer management errors than their counterparts who do not understand financial literacy (Njoroge, 2013; Fatoki, 2014). SME growth depends on how well the owner is equipped with good information to make the right financial decisions in a business (Lusimbo, 2016).

Padang City is the capital of West Sumatra Province, where basically in a fairly large city like Padang, it is a business center for people in West Sumatra. The number of SMEs in Padang City is the most compared to other SMEs in West Sumatra with a total of around 77,013 SMEs in the city

of Padang. It can be seen that the growth of SMEs in Padang City is quite rapid from year to year.

Financial literacy can simply be interpreted as knowledge or ability to manage personal finances (Chen and Volpe, 1998). According to the Financial Services Authority (FSA) literacy or financial planning is a way of living today in accordance with financial capabilities (simply) and designing a more prosperous future life. Financial literacy is a combination of consumer or investor understanding of financial products and concepts, and their ability and trust to value financial risks and opportunities, to make informed choices, to know where to seek help and take other effective actions to improve their financial well-being (Siekai *et al.*, 2013). According to Fatoki (2014) citing the United States Agency for International Development (USAID, 2013) defines MSME owners or managers who know about financial literacy as "Someone who knows the financial management choices that are most suitable for the business at various stages of growth, knows where to get the most suitable products and services". Therefore, financial literacy is a person's ability to use knowledge and skills to manage financial resources effectively.

West Sumatra is a province that has a variety of cultures from each region. People who love the homeland are obliged to preserve their own culture. Like using original handicraft products from the area. Original handicrafts from West Sumatra have different characteristics from each region, that is what makes handicrafts from West Sumatra much loved by its citizens, even in other areas. Padang City, which is the capital city of West Sumatra Province itself, also has a variety of typical and unique handicrafts, such as embroidery, plaits and so on which are also known by the public. Handicraft business can have high economic value with raw materials such as cloth, rattan, bamboo, yarn and others that can be used as souvenirs, clothing, and items used

daily. The handicraft industry is the dominant sub-sector in making economic contributions.

Researchers are interested in examining this financial literacy because there are still some inconsistencies in research results regarding the financial literacy. As well as referring to the research conducted by Lusimbo (2016) which examined the financial literacy of growth in SMEs in Kenya, researchers became interested in applying what if the research were also applied in Indonesia, especially in the city of Padang, given the different countries, communities and economies. Then the researchers also added sustainability as the dependent variable, because the research was also still rarely done. As for the SME sector, the researchers chose the SMEs in the handicraft sector in Padang City, considering the Padang City people are creative in making a work or craft to improve the family's economy as well as for the country's economic development.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

1. Financial Literacy

A business person must have the ability to plan, implement and supervise the implementation of financial management in his/her business. To make financial decisions effectively and efficiently, a business person must have good knowledge about financial management, this ability is known as financial literacy. Dahmen and Rodriguez (2014) also stated how importance of business owners understanding financial literacy in order to have better performance, thus enabling SMEs to experience business growth. Chen and Volpe (1998) defined financial literacy as the ability to manage finances so that life can prosper in the future. Financial literacy can affect how people save, borrow, invest and manage finances. Financial literacy in this case emphasizes the ability to understand the basic concepts of economics in terms of finance, to how to apply it

appropriately and correctly. According to Rohrke & Robinson (2000), financial literacy is a good way to teach consumers about the benefits of having relationships with financial institutions. Among them are funding and credit, the ability to build positive finance.

The Association of Chartered Certified Accountants (2014) formulated that the concept of financial literacy includes knowledge of financial concepts, the ability to understand communication about financial concepts, the ability to manage personal/ corporate finances and the ability to make financial decisions in certain situations.

According to FSA the level of financial literacy of the Indonesian population is divided into four parts, namely:

1. *Well literate*, have knowledge and confidence about financial service institutions and financial services products, including features, benefits and risks, rights and obligations related to financial products and services, as well as having skills in using financial products and services.
2. *Sufficient literate*, have knowledge and confidence about financial services institutions and financial products and services, including features, benefits and risks, rights and obligations related to financial products and services.
3. *Less literate*, only have knowledge about financial services institutions, financial products and services.
4. *Not literate*, lack of knowledge and confidence in financial service institutions and financial products and services, and lack of skills in using financial products and services.

2. Stages of Growth Theory

This theory was developed by Greiner (1972) who suggested that a company moves through five stages of growth. The stages of this growth consist of:

1. *Creativity phase*: company established, product development and services offered, long working hours and sufficient salary.
2. *Direction phase*, characterized by sustainable growth and good management.
3. *Delegation phase*, organization decentralized, organizational structure applied. Most responsibilities are assigned to line managers and employees.
4. *Coordination phase*, implementing a formal system with a clear flow of authority and head office established to better coordinate activities.
5. *Collaboration stage*, a stage of growth characterized by strong interpersonal relationships and teamwork. Most of the investment in the company is related to capacity building through conferences and training.

3. Sustainability

Sustainability (business continuity) indicates how a business is able to survive and continue to grow amid increasing business competition that continues to occur. Business sustainability is an important aspect of ensuring long-term business success by contributing to economic and social development, a healthy environment and a stable society, with three process elements related to accountability, transparency and engagement with stakeholders.

Leigh *et al.* (1990) in Aribawa (2016) suggests several factors that influence the sustainability of Small and Medium Enterprises (SMEs) are:

1. A successful product strategy, return on capital has been achieved.
2. The ability of managers to create and exploit existing market opportunities and overcome emerging difficulties.

Focused business differentiation, not too competitive in price, but that does not mean that the company ignores the price factor, but rather emphasizes that price is not a factor in which the company makes it an advantage in the market.

4. SMEs (Small and Medium Enterprises)

Understanding Small and Medium Enterprises is explained in the Small and Medium Enterprises UU (SMEs) No. 20 of 2008 is as follows:

- a. Small Enterprise is a productive economic enterprise that is independent, carried out by an individual or business entity that is not a subsidiary or not a branch of a company that is owned, controlled, or becomes a direct or indirect part of a medium or large business that meets the Small Enterprise criteria as referred to in this law.
- b. Medium Enterprise is an economic business that is established by itself, carried out by an individual or business entity that is not a subsidiary of a company or branch that is owned, controlled, or a part that is either directly or indirectly with a Small Enterprise or Large Enterprise with a net amount of wealth or daily sales results in this law.

5. Hypothesis Development

5.1 Relationship of Financial Literacy with Growth

Corporate growth theory and financial literacy refers to the fact that entrepreneur skills and knowledge are very important in achieving company growth so that the financial management skills of owner managers are important determinants of SME growth. Siekei *et al.* (2013) use competencies in bookkeeping, credit management, budgeting skills and financial control to measure financial literacy. Research from Eke *et al.* (2013) showed that most MSMEs show a relationship between financial literacy and growth. Fatoki (2014) used analysis and control of financial planning, bookkeeping, understanding funding sources, business terminology, use of technology and risk

management (insurance) to measure the financial literacy of new micro entrepreneurs. Then the research from Lusimbo (2016) showed that there is a positive relationship between company growth and financial literacy. A more successful IMM is run by owners or managers who have financial literacy and understand the main financial concepts which include: debt management, interest rates, budgeting and control, knowledge of the use of efficient banking and bookkeeping services. Based on the explanation above, the formulated hypothesis is:

H1: Financial literacy has a significant effect on growth.

5.2 Relations of Financial Literacy with Sustainability

Sustainability in SMEs is seen from the ability of the level of return on initial capital used to establish businesses, complaints from consumers and the sustainability of income with performance and an increase in the number of customers. Where this shows that the company has an orientation to develop and see opportunities for continuous innovation. Business continuity is a form of consistency of business conditions, where sustainability is a process of ongoing business and business development where all this leads to the sustainability and existence of businesses.

Business sustainability indicates how a business is able to survive and continue to grow amid increasing business competition that continues to occur. The business owner or manager is closely related to complex and strategic financial decision making related to the success of achieving business goals and sustainability (Aribawa, 2016). With increasing financial literacy, owners and or managers of SMEs are able to make better management decisions and financial management with accountability that can be better accounted for in the future for SMEs. Based on the explanation above, the formulated hypothesis is:

H2: Financial literacy has a significant effect on sustainability.

III. RESEARCH METHOD

1. Research Design

This study used an associative quantitative approach which was used to analyze how one variable or more influences other variables and causal relationships between variables are explained by the hypothesis.

2. Population and Sample

2.1 Population

Population refers to the whole group of people, events, or things of interest that researchers want to investigate (Sekaran, 2009). The population in this study was the Small and Medium Enterprises (SMEs) in the handicraft sector in Padang City.

2.2 Sample

According to Sekaran (2009), the sample consists of a number of members selected from the population, which data on SMEs in Padang were obtained from the Padang Cooperatives and SMEs Office.

The number of samples in this study were 150 respondents.

2.3 Sampling Technique

The sampling technique that used in this study was a purposive sampling technique, which is a technique to determine a sample of research with certain considerations that aim so that the data obtained can later be more representative (Sugiyono, 2008).

3. Data Types and Data Sources

4.1 Data Types

The type of data used in this study was primary data. Data was obtained directly from the owner or manager of the SMEs in the handicraft sector in Padang City.

4.2 Data Source

The source of data used in this study was through data obtained from books, journals and the internet and through distributing questionnaires directly to owners or managers of SMEs which were selected based on purposive sampling in Padang City.

4. Data Collection Technique

In this study, data collection was carried out directly with field research methods in the form of questionnaires to the owner or manager of the SMEs in the handicraft sector in Padang City. Besides that, documentation method was also carried out.

5. Data Analysis Technique

The data analysis technique used in this study was Structural Equation Modeling (SEM) analysis with the STATA version 12.0 program.

IV. RESULTS AND DISCUSSION

1. SEM Assumption Testing

1.1 Validity Test

Validity test is used to measure whether it is valid or not an indicator statement contained in the questionnaire. Calculation of instrument validity was done by looking at the *corrected item-total correlation* value, which is the *r* count from the calculation of the validity of the research instrument. An instrument is stated to be valid if *r* count is greater than *r* table which is a standard or reference ($r \text{ count} > r \text{ table}$). The *r* table value in this study was 0.1603. Following are the results of the validity of each research indicator using STATA version 12.0:

Item	Item-rest Corr	Alpha	Keterangan
Financial Literacy			
FL 1	0,3766	0,7060	Valid
FL 2	0,4250	0,7009	Valid
FL 3	0,2192	0,7166	Valid
FL 4	0,3987	0,7032	Valid
FL 5	0,3086	0,7094	Valid
FL 6	0,2584	0,7138	Valid
FL 7	0,3604	0,7054	Valid
FL 8	0,2455	0,7152	Valid
FL 9	0,2010	0,7185	Valid
FL 10	0,3369	0,7088	Valid
FL 11	0,3114	0,7097	Valid
FL 12	0,2287	0,7157	Valid
FL 13	0,3133	0,7091	Valid
FL 14	0,2610	0,7134	Valid
FL 15	0,2431	0,7154	Valid
FL 17	0,2637	0,7150	Valid
FL 19	0,2978	0,7126	Valid
FL 20	0,3391	0,7074	Valid
FL 21	0,4342	0,7013	Valid
FL 22	0,3059	0,7099	Valid
Growth			
GROW 1	0,4023	0,6637	Valid
GROW 2	0,6645	0,5456	Valid
GROW 3	0,3321	0,7089	Valid
GROW 4	0,6122	0,5649	Valid
GROW 5	0,2882	0,7022	Valid
Sustainability			
SUSTA 1	0,5334	0,5646	Valid
SUSTA 2	0,5958	0,5168	Valid
SUSTA 3	0,5133	0,5796	Valid
SUSTA 4	0,2208	0,7409	Valid

Source: Output STATA ver. 12.0

Based on the validity test above, all indicators have been declared valid, because all the *ir_corr* values from the existing indicators have shown a number greater than the value of the *r* table.

1.2 Reliability Test

It can be seen from the *Construct Reliability* and *Variance Extracted*, manual calculations are needed to calculate *construct reliability* and *variance extracted*. With the construct reliability equation = (standard loading number) ² / ((standard number of loading) ² + (measurement error)) and variance extracted = ((standard loading number) ²) / (((number (standard loading)) ²) + (measurement error)). With measurement error = 1 - ((standard loading) ²). The expected value for construct reliability was above 0.60. If the resulting value is > 0.60, the data can be stated to be reliable, or it can be accepted to be processed.

No.	Variabel	Cronbach's Alpha
1	<i>Financial Literacy</i>	0,7218
2	<i>Growth</i>	0,6929
3	<i>Sustainability</i>	0,6800

Source: Output STATA ver. 12.0

Based on the reliability test of all variables using STATA 12.0, the data can be said to be reliable and can be processed, because the value of Cronbach's Alpha > 0.60.

1.3 Normality Test

Normality test aims to test whether in the dependent variable and independent variables both are normally distributed or not. In this study, if the test of normality table using Kolmogorov-Smirnov sig value > 0.05 then the data is normally distributed. The following is the normality test of the research data using STATA version 12.0:

Smaller group	D	P-Value	Corrected
Res :	0,0576	0,370	
Cumulative	-	0,578	
Combined	0,0576	0,702	0,665
K-S			

Source: Output STATA ver. 12.0

Based on the Kolmogorov Smirnov test results show that the residual data obtained follows normal assumptions, based on the output shows the Kolmogorov-Smirnov value is significant at 0.665 > 0.05 thus, the residual data is normally distributed and the model has fulfilled the normality assumption.

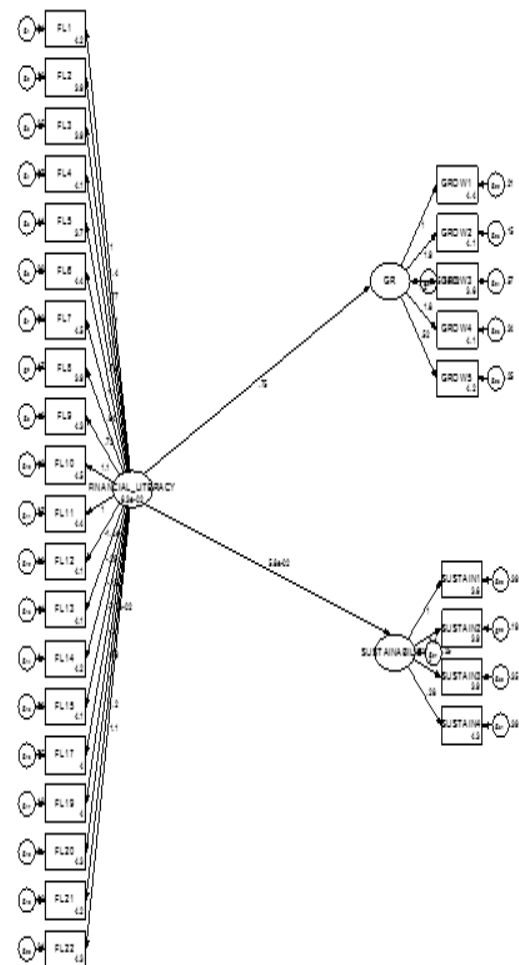
1.4 Structural Model Test

R-Square analysis was based on data processing using STATA version 12.0, the coefficient of determination was generated (R-square) which the variance of financial literacy variables could be explained by 83% and the remaining 17% was explained by other variables not used in this research model. Thus, financial literacy variables could be explained in the growth variable of 82% and the remaining 18% was

explained by other variables not used in this research model. Whereas the variance of financial literacy variables could be explained in the sustainability variable by 80% and the remaining 20% was explained by other variables not used in this research model.

2.Hypothesis Testing

Analysis of the results of data processing in the Full Model SEM stage is carried out by conducting conformity tests and statistical tests. Data processing results for full SEM model analysis are shown in Figure below. To test statistics on the relationship between variables in Figure below, it would be used as a basis for answering the research hypothesis that has been proposed. Statistical test results of processing with Full SEM was done by looking at the level of significance of the relationship between variables revealed through the probability value (p) in each relationship between variables.



Source: Output STATA ver. 12.0

The results of full SEM statistics testing can be seen in the table below:

	Coef.	OIM Std. Err	P > z	Std Coef.
<i>Financial Literacy</i> ←				
<i>Growth</i>	0,6391185	0,077503	0,000	0,7910215
<i>Sustainability</i>	0,0295346	0,106239	0,782	0,2377592

Source: Output STATA ver. 12.0

Based on the table, the results of testing the hypothesis in this study can be explained as follows:

2.1 Hypothesis 1 Testing: Financial Literacy has a significant effect on Growth

The estimated parameter of the relationship between

financial literacy and growth showed the standardized value of 0.791. Probability value = 0,000 <0,05. Significant value less than 0.05 indicates that financial literacy has a significant effect on growth. This statistical result successfully showed that the proposed **hypothesis 1 is accepted**.

2.2 Hypothesis 2 Testing: Financial Literacy has a significant effect on Sustainability

The estimated parameter of the relationship between financial literacy and sustainability showed the standardized value of 0.238. Probability value = 0.782 > 0.05. Significance value greater than 0.05 indicates that financial literacy has no effect on sustainability. The results of this statistic successfully show that the proposed **hypothesis 2 is not accepted**.

3. Discussion

3.1 Financial Literacy on Growth

The results of this study indicate that financial literacy has a significant effect on growth, meaning that the higher the financial literacy of an owner or manager of an SME, then the business growth will also increase. The skills and knowledge of the owner or manager is very important in achieving SME growth so that the financial management skills of the owners are important determinants for the growth of SMEs.

This research is in line with research from Lusimbo (2016) which showed that there is a significant relationship between company growth and financial literacy. As well as research from Turyahebwa *et al.*, (2013) stated that sound financial management is very important for growth and survival of a business.

Another study that supports the results of this study is the research conducted by Wekesa (2018) that the results of the study relatively show that credit approval practices, credit

worthiness practices, credit administration practices, and billing policy activities have a significant and positive influence on growth of business.

3.2 Financial Literacy for Sustainability

The results of this study indicate that financial literacy does not affect sustainability, meaning that even though the average financial literacy level of SME owners is moderate, it does not affect the sustainability of SMEs. This is due to the low rate of return on initial capital used in establishing a business that is equal to 3.61. This indicates that the length of the return on initial capital causes a weak or low sustainability of SMEs.

As we know there are three elements of financial literacy, namely: knowledge, confidence and skills. Based on the results of data processing, it was found that most of the owners or managers of SMEs only had knowledge and confidence, but did not have the skills in managing their finances.

The cause of financial literacy does not affect sustainability in SMEs in the handicraft sector in Padang City is because of the existence of other factors that influence it. This can be seen from SMEs tend to have a short-term orientation in making two decisions in their business. It can be seen from the absence of the concept of sustainable innovation and inconsistent core business activities. In the end, the development of SME's long-term performance tends not to be well directed. Therefore, strategic efforts are needed to improve sustainability.

This is not in line with research conducted by Acharya (2015) which his research focused on encouraging sustainability through literacy in managing money. Financial literacy is expected to be able to encourage countries to achieve sustainability with steps to instill the ability to transform ordinary individuals into financial service users

who have good information and are financially intelligent. As well as research conducted by Aribawa (2016) whose research results showed that financial literacy has a positive effect on the sustainability of MSMEs.

As we know, business sustainability indicates how a business is able to survive and continue to grow amid increasing business competition. With the increasing financial literacy, owners and or managers of SMEs are able to make better management decisions and financial management with accountability that can be better accounted for in the future of SMEs.

V. CONCLUSION AND SUGGESTION

1. Conclusion

From the results of the research that has been done, some conclusions can be drawn, as follow:

- a. The average level of financial literacy (*financial literacy*) of respondents in the handicraft sector in Padang City is classified as moderate, with an average of 3.82.
- b. Financial literacy has a significant effect on growth in the handicraft sector SMEs in Padang City which is affected by growth of 63.9% and the rest is influenced by other factors not discussed in this study.
- c. Financial literacy does not affect sustainability, this is due to the long rate of return on initial capital used in establishing businesses in the handicraft sector SMEs in Padang City.

2. Suggestion

Based on the discussion and conclusions above, the researchers suggests that:

- a. It is expected that the owners or managers of SMEs in the handicraft sector in Padang City should further improve their performance by increasing product

innovation and improving management style in order to be able to manage finances properly and appropriately in making business decisions that lead to increased sustainability in SMEs in the handicraft sector in the City Padang.

- b. It is expected that the formulation strategy in measuring variables towards more detailed and accurate research samples can explain and formulate better results.
- c. It is expected that the next researchers will add the number of other variables and the addition of the research sample, because this study only has a sample of 150 respondents in the handicraft sector in Padang City.

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