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MSMEs FINANCIAL SUSTAINABILITY MODEL IN INDONESIA: POLICY, CAPITAL, LITERACY, STRUCTURE

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ABSTRACT

Purpose: This study looks into the intricate relationships that exist between capital structure, financial literacy, intellectual capital, social capital, and government policies in relation to the sustainability and financial performance of MSMEs in Indonesia.

Methodology/approach: This study used structural equation modeling (SEM-PLS) for quantitative analysis with a sample of 375 firms.

Findings: The findings support the significance of these elements and highlight complex connections that add to a comprehensive knowledge of MSMEs dynamics. Notably, the effects of government policies on sustainability financial and performance are varied.

Practical implications: For academics, practitioners, and policymakers seeking to support MSMEs growth and resilience in the particular Indonesian setting, these findings provide practical insights.

Originality/value: In doing so, the study aims to elucidate the complex interrelationships among these variables and their collective impact on the operational efficiency and long-term viability of MSMEs in Indonesia.

KEYWORDS: Capital MSME; Financial MSMEs; Government Policy; Sustainability Finansial.

ABSTRAK

Tujuan penelitian: Penelitian ini melihat hubungan yang rumit antara struktur modal, literasi keuangan, modal

intelektual, modal sosial, dan kebijakan pemerintah dalam kaitannya dengan keberlanjutan dan kinerja keuangan UMKM di Indonesia.

Metode/pendekatan: Penelitian ini menggunakan pemodelan persamaan struktural (SEM-PLS) untuk analisis kuantitatif dengan sampel 375 UMKM.

Hasil: Temuan-temuan ini mendukung pentingnya elemen-elemen ini dan menyoroti hubungan yang kompleks yang menambah pengetahuan yang komprehensif tentang dinamika UMKM. Khususnya, dampak kebijakan pemerintah terhadap keuangan dan kinerja keberlanjutan sangat bervariasi.

Implikasi praktik: Bagi para akademisi, praktisi, dan pembuat kebijakan yang ingin mendukung pertumbuhan dan ketahanan UMKM di Indonesia, temuan-temuan ini memberikan wawasan praktis.

Orisinalitas/kebaharuan: Dengan demikian, penelitian ini bertujuan untuk menjelaskan keterkaitan yang kompleks di antara variabel-variabel tersebut dan dampak kolektifnya terhadap efisiensi operasional dan keberlangsungan jangka panjang UMKM di Indonesia.

KATA KUNCI: Keberlanjutan Keuangan; Kebijakan Pemerintah, Keuangan UMKM; Permodalan UMKM.

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) face several financial constraints that hinder their growth and development. MSMEs often struggle with managing their working capital, which includes the day-to-day financial operations of the business ([Gupta et al., 2022](#); [Hamdana et al., 2021](#)). This can lead to cash flow problems, making it difficult for these businesses to meet their short-term obligations ([Nareswari et al., 2023](#)). MSMEs often face difficulties in accessing credit from financial institutions. This can be due to a variety of reasons, including stringent collateral requirements, lack of awareness of funding opportunities, and the structure of the financial sector ([Cruzado et al., 2023](#)). MSMEs often lack sufficient financial support from the government, which can limit their ability to grow and expand their operations ([Kurniawan et al., 2023](#); [Nareswari et al., 2023](#)). MSMEs often struggle with cost efficiency, which can impact their profitability and financial stability ([Hidayat et al., 2022](#); [Senjani, 2020](#)). The financial literacy of the owners of MSMEs can also be a constraint. A lack of financial management skills can limit their ability to effectively manage their business finances, which can impact their access to finance ([Tambunan, 2023](#)). While fintech can provide opportunities for MSMEs to overcome some of their financial constraints, there are barriers to its adoption. These include time constraints, lack of information and skills, security concerns, legal issues, market demand, transaction volume, and skepticism towards the technology ([Febrian et al., 2018](#); [Indriastuti & Kartika, 2022](#)). Many MSMEs face capital constraints, which can limit their ability to invest in their business

and hinder their growth ([Tambunan, 2023](#)). To overcome these financial constraints, MSMEs can explore various strategies such as improving their financial management skills, seeking financial support from the government, exploring alternative financing options such as fintech, and improving their awareness of funding opportunities ([Cruzado et al., 2023](#); [Nareswari et al., 2023](#); [Tambunan, 2023](#)).

This is particularly true in developing nations like Indonesia, where MSMEs account for a sizable share of the business environment and represent a variety of industries, from manufacturing to services ([Anatan & Nur, 2023](#)). Given the significant contribution MSMEs make to economic growth, it is critical to examine the nuances of the variables affecting their viability and performance ([Ramadhani et al., 2019](#); [Tambunan et al., 2021](#)). MSMEs in Indonesia operate in a dynamic and difficult business climate that is influenced by a number of internal and external factors ([Bawono et al., 2022](#)). A thorough investigation of the many facets of the influences, such as capital structure, financial literacy, social capital, intellectual capital, and government policies, is necessary to fully comprehend these intricacies ([Desai et al., 2021](#); [Edgar et al., 2022](#); [Febrian et al., 2018](#); [Sari & Kusumawati, 2022](#); [Suharto et al., 2021](#)).

Government policies play an important role in shaping the business environment for MSMEs in Indonesia. During the Covid-19 pandemic, the Indonesian government implemented various policies to support MSMEs ([Kurniawan et al., 2023](#)). These policies include social assistance, tax incentives, working capital expansion, and credit restructuring, which affect the development of MSMEs during the pandemic ([Lang et al., 2022](#)). Another policy is the credit relaxation program, which directly and indirectly affects the sustainability performance of MSMEs ([Ogujiuba et al., 2022](#)). However, the effectiveness of these policies may vary, and continuous improvement is required for their success ([Seda & Ismail, 2020](#)). Intellectual capital, which includes knowledge, application of experience, and professional skills, is an important factor in the competitiveness of MSMEs. The competitive advantage generated by MSMEs comes from superior resources, which are reflected in the firm's intellectual assets ([Barney, 1991](#)). The results show that the indicator that has the largest contribution in forming the intellectual capital variable is human capital ([PURNOMO et al., 2022](#); [Suharto et al., 2021](#)).

Social capital, which can be understood as the network of relationships among people living and working in a particular society ([Hausberg & Korreck, 2020](#)), also plays an important role in the sustainability of MSMEs ([Purwati et al., 2021](#)). Social media optimization is used to retain old buyers and attract new markets ([Jeong & Chung, 2023](#)). Financial literacy is another important factor that affects the performance and sustainability of MSMEs ([Farida et al., 2019](#); [Hamdana et al., 2021](#)). Financial literacy has been argued in several studies to be an important factor in the financial sustainability of MSMEs ([Desai et al., 2021](#); [Lestari et al., 2022](#)). The capital structure of MSMEs, which refers to the way firms finance their assets through a combination of equity, debt or hybrid securities, is another important factor ([Altaf & Shah, 2021](#); [Ramadhani et al., 2019](#)). Government policies such as the provision of social assistance, tax incentives, working capital expansion, and credit restructuring have affected the capital structure of MSMEs ([Desai et al., 2021](#); [Indra et al., 2021](#)).

Several studies have explored this relationship, highlighting various aspects that contribute to the performance and, consequently, the financial sustainability of MSMEs ([Alharbi et al., 2022](#); [GHOFAR et al., 2022](#); [Octavia et al., 2020](#)). MSME performance is a key factor for their financial sustainability. This performance is influenced by several factors, including financial literacy, government policies, intellectual capital, social capital, structural capital to

improve performance and sustainability ([Absah et al., 2018](#); [Farida et al., 2019](#); [Yaniar et al., 2021](#)). Therefore, improving those aspects can contribute to improving the performance and financial sustainability of MSMEs.

Understanding and resolving the issues Micro, Small, and Medium-Sized Enterprises face is more important than ever in the dynamic world of global economies ([Fernandes et al., 2022](#); [Metcalf et al., 2021](#)). The need for urgency arises from the critical role MSMEs - particularly in developing nations like Indonesia - play in maintaining economic vibrancy ([Tambunan et al., 2021](#)) MSMEs are major drivers of innovation, job creation, and community development; as such, their performance and resilience have a substantial impact on the state of the economy as a whole ([Aminullah et al., 2022](#)).

MSMEs' vulnerabilities have been made worse by modern issues, which have been made worse by worldwide occurrences like the continuing epidemic and the recent economic downturn. These difficulties include changes in customer behavior, supply chain interruptions, and regulatory uncertainty ([Onyeje et al., 2022](#); [Suariedewi et al., 2022](#)). Understanding the complex dynamics influencing MSMEs is especially important because their survival and expansion directly affect millions of people's lives as well as the stability of the economy as a whole. In the Indonesian setting, this urgency is very strong. The performance of the dynamic and diverse MSME sector in the country is closely associated with its economic trajectory ([Anatan & Nur, 2023](#); [Tambunan, 2023](#)). Technological developments, global trade dynamics, and rapid urbanization all contribute to the complexity of the difficulties encountered by MSMEs in Indonesia ([Kurniawan et al., 2023](#); [Ramadhani et al., 2019](#); [Tambunan et al., 2021](#)).

To avoid long-term financial losses and promote a robust MSME environment, it is essential to recognize and promptly address these difficulties. Despite the urgency, a critical information gap still exists. In the unique environment of Indonesia, the complex interactions between government policy, intellectual capital, social capital, financial literacy, and capital structure call for quick attention. To formulate efficacious policies, strategies, and interventions, a thorough comprehension of these elements and their combined influence on MSMEs is necessary. Although a large body of research has examined specific elements like financial literacy or government policies in the context of MSMEs, there is a significant vacuum in the literature concerning the combined effects of these factors on the Indonesian environment. By conducting a thorough mathematical analysis that takes into account the connections between financial literacy, intellectual capital, social capital, government policy, and capital structure, this study seeks to close this gap. In doing so, the study aims to elucidate the complex interrelationships among these variables and their collective impact on the operational efficiency and long-term viability of MSMEs in Indonesia.

This study is a reaction to the urgent demand for practical understanding. This study looks into the complex interactions between many factors that affect MSMEs to give scholars, business leaders, and policymakers up-to-date, pertinent information. The potential to spur well-informed decision-making and enable stakeholders to implement strategies and policies that can strengthen MSME resilience, improve performance, and guarantee financial sustainability is what makes the situation so urgent.

A conceptual framework that highlights the connections between government policy, intellectual capital, social capital, financial literacy, and capital structure is put forth to direct this investigation. This framework serves as the foundation for quantitative analysis, enabling a thorough investigation of how these factors interact to affect the financial sustainability

and overall performance of MSMEs in Indonesia (Figure 1. Conceptual Framework and Hypothesis.

Government Policies have a big impact on the business environment and how Micro, Small, and Medium-Sized Enterprises (MSMEs) function. Research (Anatan & Nur, 2023; Kurniawan et al., 2023; Sari & Kusumawati, 2022) has highlighted the benefits of policies that encourage MSME growth, such as tax breaks, streamlined regulations, and focused financial assistance initiatives. But it's important to recognize that policy environments are dynamic and that MSMEs must be able to adapt to new obstacles (Tri Wahyuningtihas et al., 2021). Government policies can have a significant positive effect on the performance of MSMEs (Kurniawan et al., 2023; Mojica et al., 2022). For instance, policies that promote gender equality, human capital development, and strategic business practices can enhance MSME performance (Gah et al., 2020).

Moreover, government policies can also influence the financial sustainability of MSMEs. For example, government regulations can have a positive and significant moderating effect on factors like infrastructure financing, utility efficiency, and subsidies, which can impact the financial sustainability of service providers (Ogujiuba et al., 2022). In the context of MSMEs, government policies can help promote an entrepreneurial environment, strengthen MSMEs in global markets, and enhance their capacity in the production of quality items (Amran et al., 2022). However, these policies need to be complemented with sufficient infrastructure and supportive measures to ensure their effectiveness (Amran et al., 2022).

During difficult times, such as the COVID-19 pandemic, government policies can play an important role in addressing the financial concerns of MSMEs, restarting supply chain management, and supporting new startups. This is the urgency of previous research (Anatan & Nur, 2023). Policies during this period may include tax relaxation, ease of regulation, capital assistance, improving the quality of human resources, technology assistance, and promotions (Kurniawan et al., 2023). Thus, we draw a common thread of hypothesis submission in this study to be tested:

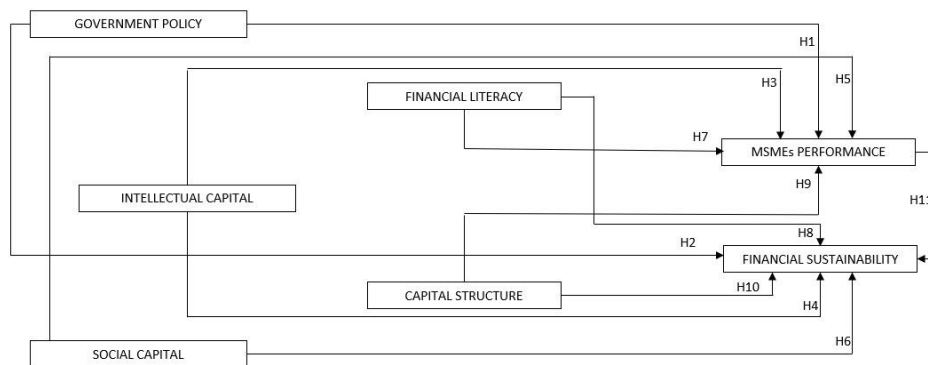


Figure 1. Conceptual and Hypothesis

H₁: Government Policy is suspected to be a positive and significant factor in MSMEs Performance

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H₂: Government Policy is suspected to be a positive and significant factor on MSMEs Financial Sustainability

Knowledge, skills, and intangible assets all make up intellectual capital, which has become a major factor in MSMEs' competitiveness ([Prakasa, 2019](#)). Studies indicate that a sustained competitive advantage, increased productivity, and innovation are all facilitated by the efficient use of intellectual capital ([Ginting, 2020](#); [Liu et al., 2022](#)). Leveraging intellectual capital becomes a crucial tactic for attaining long-term success because MSMEs frequently work in circumstances with limited resources. Intellectual capital also contributes to the financial sustainability of MSMEs ([Liu et al., 2022](#)). A study examining the effect of intellectual capital on the financial sustainability found that human capital efficiency and capital employed efficiency had a positive and significant effect on financial sustainability ([Purwati et al., 2021](#)). However, it's worth noting that structural capital efficiency had a significantly negative effect on financial sustainability in this context ([Altaf & Shah, 2021](#)).

Moreover, intellectual capital can also influence the financial strategy performance and financial sustainability of rural banks, as demonstrated in a study conducted ([Hidayat et al., 2022](#)). The study found that human capital and relational capital positively affected marketing performance, financial strategy performance, and financial sustainability ([Albertini & Berger-Remy, 2019](#)).

Previous research shows a consistent relationship, intellectual capital, which includes human, relational, and structural capital, plays an important role in improving the performance and financial sustainability of MSMEs. Intellectual capital serves as an important asset that can be leveraged to improve organisational performance, financial strategy and sustainability ([Liu et al., 2022](#)). However, the specific impact of different components of intellectual capital may vary across different contexts and types of organizations ([Rabiei et al., 2022](#)). Therefore, MSMEs should strategically manage their intellectual capital to optimize their performance and financial sustainability. Thus, we draw a common thread of hypothesis submission in this study to be tested:

H₃: Intellectual Capital is suspected to be a positive and significant factor in MSMEs Performance

H₄: Intellectual is suspected to be a positive and significant factor on MSMEs Financial Sustainability

Recent research has highlighted the significance of social capital for MSME performance ([Kanini et al., 2022](#)). The networks, connections, and social structures found both inside and outside of organizations are referred to as social capital. Social networks are a common source of resources, knowledge, and assistance for MSMEs ([Jeong & Chung, 2023](#)). Research demonstrates that enhanced business success is positively correlated with strong social capital, highlighting the necessity for MSMEs to cultivate and capitalize on social networks ([Kanini et al., 2022](#)).

Social capital plays a significant role in the performance and financial sustainability of MSMEs. It is defined as the collection of resources needed by individuals or groups to establish a more durable network of institutional relationships to recognize and respect each other ([Santoso, 2020](#)). This includes relationships with customers, partners, and policy makers, which can significantly influence the success of MSMEs ([Kadek et al., 2019](#)). In conclusion, social capital, along with financial management, plays a significant role in the

performance and financial sustainability of MSMEs ([Kanini et al., 2022](#); [Yao & Meng, 2022](#)). It helps in establishing strong relationships with various stakeholders, which can lead to better business strategies and improved performance ([Hausberg & Korreck, 2020](#)). However, challenges such as lack of financial resources and supply chain issues need to be addressed to ensure the sustainability of these enterprises ([Neumeyer et al., 2019](#)). Previous research underlines that social capital theory is an important concern for MSMEs in various countries, so we propose the following hypothesis:

H₅: Social Capital is suspected to be a positive and significant factor in MSMEs Performance

H₆: Social is suspected to be a positive and significant factor on MSMEs Financial Sustainability

According to ([Hamdana et al., 2021](#); [Suwarsi et al., 2022](#)) financial literacy among entrepreneurs has a significant impact on the financial management and general success of MSMEs. Entrepreneurs that possess sufficient financial literacy are better equipped to make well-informed decisions about risk management, budgeting, and investing ([Hamdana et al., 2021](#)). According to research, improving financial literacy can help MSMEs remain sustainable and expand, especially while facing difficult economic times ([Farida et al., 2019](#); [Sufyati et al., 2022](#)).

Financial literacy plays a significant role in the performance and financial sustainability of Micro, Small, and Medium Enterprises. It is a crucial factor that influences the ability of MSMEs to access finance, manage financial risks, and ensure business sustainability ([Alharbi et al., 2022](#)).

Financial literacy refers to the skills and knowledge that allow an individual to make informed and effective decisions with their financial resources ([Hutahayan, 2021](#)). It includes understanding and using various financial skills, including personal financial management, budgeting, investing, and understanding financial risks and opportunities ([Indriastuti & Kartika, 2022](#)). While financial literacy plays a significant role in the performance and sustainability of MSMEs, its impact can vary depending on various factors, including the type of financial literacy, the specific context of the MSMEs, and other factors such as access to finance and financial risk attitude ([Hidayat et al., 2022](#)). Therefore, it is very important for MSMEs to improve their financial literacy, so the hypothesis of this relationship is as follows:

H₇: Financial Literacy is suspected to be a positive and significant factor in MSMEs Performance

H₈: Financial Literacy is suspected to be a positive and significant factor on MSMEs Financial Sustainability

Because it affects both financial performance and sustainability, the capital structure of MSMEs—that is, the proportion of debt to equity—has drawn attention ([Altaf & Shah, 2021](#)). While the ideal capital structure varies depending on the industry and setting, research suggests that MSME growth and resilience can be enhanced by a carefully calibrated mix of debt and equity ([Desai et al., 2021](#); [Ramadhani et al., 2019](#)). The difficulty, however, is choosing the right capital structure to match the unique requirements and hazards that MSMEs in various industries must contend with ([Modigliani & Miller, 1958](#)).

Capital structure, which refers to the mix of debt and equity that a firm uses to finance its operations and growth, plays a crucial role in determining a firm's financial performance and sustainability ([Kochhar, 1997](#)). In conclusion, while capital structure can influence the

financial performance and sustainability of MSMEs, the specific impact can vary depending on a range of factors, including the firm's size, growth, operational efficiency, and liquidity (Altaf & Shah, 2021; Ramadhani et al., 2019). Therefore, it's crucial for firms to carefully consider these factors when making decisions about their capital structure.

H₉: Intellectual Capital is suspected to be a positive and significant factor in MSMEs Performance

H₁₀: Intellectual is suspected to be a positive and significant factor on MSMEs Financial Sustainability

Micro, Small, and Medium Enterprises (MSMEs) play a crucial role in the economy, contributing significantly to job creation and employment (Hidayat et al., 2022). Their performance and financial sustainability can be influenced by several factors, including government policy, intellectual capital, social capital, financial literacy, and structural capital. In conclusion, these factors can significantly influence the performance and financial sustainability of MSMEs (Albertini & Berger-Remy, 2019). Therefore, the government and relevant stakeholders must consider these factors when developing and implementing policies and programs aimed at supporting MSMEs.

H₁₁: MSMEs Performance is suspected to be a positive and significant factor on MSME's Financial Sustainability

METHODS

To collect data in this study and achieve its objectives, a self-reported online survey was used for both online and offline data collection. The Google platform was used to facilitate the online survey. In addition, to minimise the possibility of bias due to potential confusion among potential respondents, the author trained the enumerators to align their viewpoints towards the research objectives and the questionnaire. This enabled the author to assist with the implementation of the offline survey with the help of enumerators who were also her students. The sampling of this study followed Hair's suggestion in SEM-PLS to multiply the number of indicators between 5 and 10. The author chose to multiply by 10 and the indicators of this study were 23 meaning that the minimum sample size of this study was 230, but the author distributed 400 questionnaires and unfortunately 25 questionnaires were incomplete. A total of 375 data were collected during the preliminary procedure using a purposive sampling technique based on the specified criteria, which took place from 24 July 2023 to 20 August 2023, or about four weeks. The author and the enumerators put a lot of effort into this research.

The provinces of West Java, DKI Jakarta, and Banten were surveyed using the online survey method. If respondents from these provinces were discovered in the online poll, they were not included. Several social media platforms were used to acquire online surveys, such as Instagram, Facebook, and WhatsApp (WA). Both the author and the respondent have a confidentiality agreement in place that protects the respondent's full name and business name.

Participants in this study were chosen using a purposive strategy according to pertinent criteria, such as: (1) The legal owner or core management is the potential respondent. According to the MSME criterion found in the most recent Government Regulation Law of the Republic of Indonesia, No. 07 of 2021, the respondent's business employs a minimum

of one to five people. (3) Contains accounting records. (5) Researchers did not choose ultra-micro firms, like street vendors with little carts or tents, because it is doubtful that the items would be returned.

Determining and Measuring Variables

The study data was analyzed using partial least squares–structural equation modeling, or PLS-SEM. The PLS-SEM analysis approach was carried out using the SMARTPLS version 4 program. To make this study stronger, the Confirmatory Composite Analysis (CCA) method was applied. This strategy is built on a solid theoretical foundation that has been developed in prior research to guarantee the robustness of the model design and latent variable indicators employed in this study. An essential part of the two-stage analysis procedure mandated by the PLS-SEM approach is examining the outer and inner models. The outer model is made up of several statistical studies intended to evaluate the coherence and validity of the constructs that were utilized to develop the different indicators of the survey instrument. Instrument validity can be assessed using one of two distinct techniques: discriminant validity or convergent validity. The instrument's dependability is evaluated using the Composite dependability (CR) and Cronbach's Alpha (CA) metrics. When applying the CCA approach, any latent variable with CR and CA values more than 0.70 is regarded as dependable. Furthermore, the Average Variance Extracted (AVE) needs to be greater than 0.50 in order to be employed in evaluating the convergent validity of the CCA technique.

First, by using a Likert scale ranging from 1 to 5 to facilitate respondents' perceptions in answering the proposed statements to ascertain perceptions. The questionnaire underwent a pilot test stage before being approved and was first administered to scholars in management, accounting, and entrepreneurship who hold doctoral degrees and have published high-quality work in Scopus. Next, an initial sample of thirty people was selected, and the items were pilot-tested on them. With a total of 23 questions, this study aims to investigate the relationship between the exogenous variables of Government Policy (GPC) development ([Anatan & Nur, 2023](#); [Kurniawan et al., 2023](#); [Sari & Kusumawati, 2022](#)), Intellectual Capital (ICP) development by literature ([Albertini & Berger-Remy, 2019](#)), Social Capital (SCA) in development by ([Hausberg & Korreck, 2020](#)), Financial Literacy (FLC) in development by previous research ([Hamdana et al., 2021](#); [Suwarsi et al., 2022](#)), and Structural Capital (CSU) in this study development by literature ([Altaf & Shah, 2021](#)), and the endogenous variables MSME Performance (MSE) by ([Liu et al., 2022](#)) and Financial Sustainability (FSU) development by ([Edgar et al., 2022](#); [Sari & Kusumawati, 2022](#)). Detailed information on the survey items can be seen in Table 1 below.

	Variable & Indicators	Items	LF
267	Government Policy (GPC)	Cronbach's Alpha = 0.855, Composite Reliability = 0.915, AVE = 0.778.	
	Capacity Building (GPC.1)	1. We are very familiar with existing government programs that provide training and support for MSME entrepreneurs to improve their skills and adopt innovative techniques.	0.834
	Formalization (GPC.2)	2. We recognize the benefits that come with formalizing an MSME, such as increased access to financial resources and markets.	0.881
	Resilience (GPC.3)	3. We are aware of government policies or initiatives that have been implemented to help MSMEs increase the resilience of our business to unforeseen challenges.	0.866
	Intellectual Capital (ICP)	Cronbach's Alpha = 0.810, Composite Reliability = 0.876, AVE = 0.725.	
	Human Capital (ICP.1)	1. The successful operation of our company depends on the qualifications of our employees.	0.815
	Information Capital (ICP.2)	2. The information systems and databases used to support the company's operations are effective.	0.899
	Brand Awareness (ICP.3)	3. We often conduct surveys or market research to measure the level of our brand awareness.	0.880
	Social Capital (SCA)	Cronbach's Alpha = 0.884, Composite Reliability = 0.915, AVE = 0.631.	
	Trust (SCA.1)	1. In transactions with consumers, we always fully trust customers.	0.830
Networks (SCA.2)	2. We have strong connections with business associations or industry organizations related to our industry.	0.860	
Norm (SCA.3)	3. We believe that shared norms in our industry contribute to the formation of a positive image of our company in the eyes of society.	0.873	
Financial Literacy (FLC)	Cronbach's Alpha = 0.902, Composite Reliability = 0.938, AVE = 0.783.		
Financial Consciousness (FLC.1)	1. We are familiar with the concept of financial risk and its impact on the financial decisions we make.	0.900	
Financial Capabilities (FLC.2)	2. When choosing the best and most suitable option for our financial goals, we feel confident when analyzing different investment options.	0.984	
Financial Behaviors (FLC.3)	3. Our income is well planned and allocated so that business operations can continue.	0.842	
JRAK 14.1	Capital Structure (CSU)	Cronbach's Alpha = 0.848, Composite Reliability = 0.899, AVE = 0.684.	

Internal Funding (CSU.1)	1. Before seeking external funding, we tend to use internal funding such as retained earnings.	0.880
Debt Capacity (CSU.2)	2. We consider our debt capacity when making funding decisions.	0.908
Information Asymetry (CSU.3)	3. We have a specific strategy to overcome the challenge of disclosing personal information to external investors.	0.783
MSMEs Performance (MSE) Cronbach's Alpha = 0.833, Composite Reliability = 0.880, AVE = 0.652.		
Increased Sales (MSE.1)	1. Our business sales growth percentage in the last three years has been above 10%.	0.857
Net Profit (MSE.2)	2. We have reduced our operating expenses to increase our net profit during the period.	0.841
Sales Turnover (MSE.3)	3. Digital marketing strategy has helped increase sales turnover in the period.	0.815
Operational Efficiencies (MSE.4)	4. Our operating cost to operating income ratio in the last three years was below 30%.	0.844
Owner's Welfare (MSE.5)	5. Business performance will have an impact on the welfare of the owners.	0.748
Financial Sustainability (FSU) Cronbach's Alpha = 0.819, Composite Reliability = 0.877, AVE = 0.721.		
Sustainable Report (FSU.1)	1. Our business regularly prepares and issues financial statements that include information on revenue, expenses, profit/loss and cash flows.	0.811
Increased Capacity (FSU.2)	2. We involve employees in decision-making processes related to business planning and strategy.	0.854
Quality Enhancement (FSU.3)	3. We have a continuous improvement process that involves identifying defects or shortcomings in our products/services, followed by appropriate corrective actions.	0.811

Source: Results processing data by author's (2023)

Moreover, Table 1 makes evident that every indicator item analyzed in this research has a loading factor value greater than 0.70. The high loading factor values represent the fact that each indicator correctly depicts its respective structure. Table 2 further indicates that all latent variables that were looked at in this study have values of more than 0.70 for both composite reliability (CA) and comprehensive reliability (CR). Each of the latent variables in this investigation has an average variance extracted (AVE) value larger than 0.50. The instruments formed from latent variables and indicators in this study demonstrate validity and reliability, as demonstrated by these ratio values.

Table 1.
Validity and Reliability Test

Table 2.
Discriminant
Validity
Research

	GPC	ICP	SCA	FLC	CSU	MSE	FSU
GPC							
ICP	0.139						
SCA	0.147	0.247					
FLC	0.218	0.237	0.600				
CSU	0.335	0.498	0.421	0.732			
MSE	0.241	0.437	0.481	0.663	0.157		
FSU	0.342	0.611	0.582	0.443	0.348	0.432	

Source: Results processing data by author's (2023)

To assess the discriminant validity of the research instrument statistically, one technique that is employed is the Heterotrait-Monotrait Coefficient (HTMT). As evidenced by (Hair et al., 2019)R, it is crucial to remember that the HTMT ratio provides a more appropriate approach for evaluating discriminant validity in PLS-SEM analysis. To demonstrate the instrument's validity, the HTMT ratio needs to be maintained below 0.90. The validity of the study instrument for assessing the built-in model is demonstrated by Table 2, which displays the HTMT ratio value for each latent variable to be less than 0.90.

Determining the degree to which the conceptual model accurately predicts the variance of the independent variables is the aim of the internal assessment. This is accomplished through the use of four measurement analyses. Utilizing the R-square (R²) value, commonly referred to as the coefficient of determination, the combined impact of the exogenous and endogenous components was evaluated for significance. The bootstrap method was also applied to assess the statistical significance of the direct and indirect path coefficients using a subsample of 5000. This analysis requires a value of less than 0.1 for the t-statistic, also called the p-value, to demonstrate that there is a statistically significant link between latent variables. Here, the study's hypotheses were tested using the research methodology outlined. Next, a Goodness of Fit analysis was used to confirm the model's robustness and evaluate the structural model's overall efficacy and assessment. An analysis is conducted to determine the strength of the Chi-Square ratio, NFI, and SRMR values. This work also uses the blindfolding methodology, which is based on cross-validated redundancy and was thoroughly explained. This methodology is used in addition to the predictive relevance analysis that was previously stated. One major objective of this work is to examine and analyze partial least squares structural equation modeling (PLS-SEM) in connection to structural equation modeling.

RESULTS AND DISCUSSION

Diverse characteristics are displayed in the demographic profile, including age, income, education, company experience, scale, and geography. Respondents who owned small enterprises made up the majority of the sample. A cross-regional representation of respondents is seen in the participation in the online survey. Table 3 illustrates that the research sample is dominated by young people, with the majority of respondents being between the ages of 18 and 34 (32% for those between the ages of 18 and 24 and 24% for those between the ages of 25 and 34). Older respondents made up only 5% of the total, a decline in percentage as respondents' ages climbed. The largest category of business experience is 6–10 years, held by 28% of the respondents overall. With an increase in years of company experience, there is a trend for the percentage of responses to fall.

Individuals or individuals who operate their own businesses make up the majority of responders (58%). Small or micro-scale enterprises predominate, as seen by the lower percentage of respondents (33% and 9%, respectively) who had PTs and CVs. Degrees from elementary or junior high school came in second (31%), with a bachelor's degree accounting for the bulk of responses (48%). An indication of the range of educational backgrounds in the sample is the 21% of respondents who held master's and doctoral degrees.

Between 25,000,000 and 50,000,000 IDR is the gross income range for 39% of respondents. Thirty percent of respondents have incomes under 25,000,000 IDR, compared to eleven percent who earn more than 100,000,000 IDR. Whereas Banten (20%) and DKI Jakarta (24%), the majority of responders (30%) are based in West Java. An indication of the diversity of respondents from different regions is the fact that 26% of respondents took the poll online.

According to a warning issued to researchers doing SEM-PLS study (Hair et al., 2019), make sure no outlier data is missing from distributing questionnaires to research participants before doing a more in-depth analysis. After the authors and enumerators reviewed the data quality, they found that outliers were missing or that respondents had not proactively completed the questionnaires. Of the 500 questionnaires that were initially distributed, 375 were found to comply with the study's needs and objectives. Five to ten times more research must be conducted using the SEM-PLS approach than there are overall research indicators (Hair et al., 2019). Given that Table 1 lists 23 indicators for this study, at least 230 respondents must be included in the total multiplied by the indicator for this study to meet Hair's 2019 standards for 375 samples.

Moreover, the PLS-SEM test should be used to confirm that each variable that forms the construct does not assume multicollinearity. This test is considered passed if the VIF value is less than 3.00. The research was conducted without relying on the multicollinearity hypothesis, and the results are displayed in the table below.

Age (years)	n (sample)	%	Business Experience (years)	n (sample)	%
18-24	121	32%	1 to 5	87	23%
25-34	90	24%	6 to 10	106	28%
35-44	84	23%	11 to 15	93	25%
45-54	60	16%	16 to 20	51	14%
Above 55	20	5%	Above 20	38	10%
Business Scale	n (sample)	%	Education	n (sample)	%
Individu/Perorangan	217	58%	SD/SMP/SMA	118	31%
CV	121	33%	Bachelor's	182	48%
PT	37	9%	Master's and Doctoral	75	21%
Gross Income (IDR)	n (sample)	%	Geographical	n (sample)	%
< 25.000.000	110	30%	West Java	110	30%
25.000.000 - 50.000.000	144	39%	Banten	78	20%
51.000.000 - 100.000.000	73	20%	DKI Jakarta	89	24%
> 100.000.000	30	11%	Online Survey	104	26%

Source: Results processing data by author's (2023)

Table 3.
Demographic
al Participants

Table 4.
Multicollinearity
Test

Variable	MSMEs Performance	Sustainability Financial MSMEs
Government Policy	1.231	2.281
Intellectual Capital	2.342	1.482
Social Capital	1.322	2.121
Financial Literacy	2.029	2.312
Capital Structure	1.332	1.912
MSMEs Performance		2.123

Source: Results processing data by author's (2023)

This study's multicollinearity assumption criteria have complied with all applicable standards, as per as can be seen in Table 4 above, every structure that is produced has a VIF value of less than 3,000. Less than 3,000 is the VIF value of government policy variables, intellectual capital, social capital, financial literacy, and capital structure on MSME performance and sustainable finance, according to the VIF values of the network variables in these areas. This number suggests that the variables are appropriate. It was also discovered that values lower than three thousand were present for the constructs linked to the dependent variables.

In addition, the study model's GoF will be examined as a proposed criterion. The SMARTPLS website provides appropriate benchmarks for assessing model fit, in line with Hair et al. 2019. To guarantee that the external, internal, and structural models are all generally usable, model fit evaluation is crucial. The standardized root mean square (SRMR) and theta root mean square (RMS) should therefore be less than 0.02, 0.10, or 0.08. Furthermore, there should be at least 0.9 in the numerical fit index (NFI) value. The results of this study shows the computed model's SRMR value of 0.080, which is below the advised threshold of 0.10, and NFI value of 0.892, which indicates a strong degree of fit. The model meets the Goodness of Fit assumptions in light of the study's findings.

We can ascertain how much the dependent variable is influenced by other factors by using the coefficient of determination (R-square). As per, the dependent latent variable of the structural model demonstrates a positive influence from the influencing independent factors on the dependent variable under consideration, with an R2 value of 0.67 or above. There are two categories for the results: weak and moderate. Weakness is indicated if it falls within the range of 0.19 to 0.33 and 0.33-0.67. This study assessed the model using the Q2 redundancy measure while considering the reflection component of the metric, in addition to testing the coefficient of determination under suggestions from Hair. Hair's Q2 value shows how effectively the model predicts out-of-sample outcomes. A Q2 value larger than zero indicates the predictive utility of the route model for a particular dependent construct that represents an endogenous variable in a structural equation model. Table 8 displays the prediction ability of the model using the available data.

Table 5.
Coefficient and
Q2 Test

Variable	R ²	R ² adjusted	Q2 (=1- SSE/SSO)
MSMEs Performance	0.564	0.612	0.051
Financial Sustainability	0.602	0.642	0.064

Source: Results processing data by authors (2023)

In Table 5, it is explained that the MSMEs performance model has an R-squared of 0.564, which rises to 0.612 after adjustment, and a Q2 of 0.051. On the other hand, the financial sustainability model has an R-squared of 0.602 (which rises to 0.642 after adjustment) and a Q2 of 0.064, which also indicates ample accuracy in forecasting beyond the training sample.

The hypothesis is deemed significant when the 95% confidence level t-statistic value is higher than the t-statistic (>1.96). To obtain the results displayed here, SmartPLS bootstrap software was utilized. The construct hypothesis analysis is shown in Table 7, along with the beta values, means, standard deviations, t-values, and p-values. Consequently, decision-making was done using a p-value of 0.05.

Table 6's hypothesis analysis results demonstrate that Government Policy (GPC) has a substantial impact on Financial Sustainability (FSU) with a coefficient of -0.526 ($t = 5.261$, $p = 0.000$) and MSMEs Performance (MSE) with a coefficient of -0.485 ($t = 2.749$, $p = 0.003$). Financial Sustainability (FSU) has a coefficient of 0.192 ($t = 2.642$, $p = 0.000$) and MSMEs Performance (MSE) has a substantial positive correlation with Intellectual Capital (ICP) of 0.162 ($t = 2.581$, $p = 0.001$). MSMEs Performance (MSE) and Financial Sustainability (FSU) are significantly positively impacted by Social Capital (SCA), with MSE having a coefficient of 0.210 ($t = 3.213$, $p = 0.000$) and FSU having a value of 0.427 ($t = 4.778$, $p = 0.000$). Financial Sustainability (FSU) is positively impacted by Financial Literacy (FLC) with a coefficient of 0.643 ($t = 2.212$, $p = 0.004$) and MSME performance (MSE) with a coefficient of 0.763 ($t = 6.603$, $p = 0.000$). Financial Sustainability (FSU) (coefficient = 0.330 ; $t = 4.653$; $p = 0.002$) and MSMEs Performance (MSE) (coefficient = 0.536 ; $t = 5.690$; $p = 0.000$) also show a significant positive link. In the end, there is a statistically significant connection of 0.795 ($t = 7.653$, $p = 0.000$) between MSMEs Performance (MSE) and Financial Sustainability (FSU). These findings validate the proposed hypotheses (**H1 to H11 Approved**) and show that the variables of government policy, intellectual capital, social capital, financial literacy, capital structure, and MSMEs performance all significantly affect the performance and financial sustainability of MSMEs.

Hypothesis	O	M	STDEV	T-st	p-val	Statement
GPC -> MSE	-0.485	-0.546	0.176	2.749	0.003	Approved
GPC -> FSU	-0.526	0.616	0.100	5.261	0.000	Approved
ICP -> MSE	0.162	0.167	0.063	2.581	0.001	Approved
ICP -> FSU	0.192	0.192	0.073	2.642	0.000	Approved
SCA -> MSE	0.210	0.212	0.082	3.213	0.000	Approved
SCA -> FSU	0.427	0.437	0.089	4.778	0.000	Approved
FLC -> MSE	0.763	0.783	0.116	6.603	0.000	Approved
FLC -> FSU	0.643	0.673	0.192	2.212	0.004	Approved
CSU -> MSE	0.536	0.564	0.094	5.690	0.000	Approved
CSU -> FSU	0.33	0.453	0.084	4.653	0.002	Approved
MSE -> FSU	0.795	0.821	0.121	7.653	0.000	Approved

Notes: O = Original Sample, M = Sample Mean, STDEV = Standard Deviation.

Table 6.
Hypothesis
Test

The study's findings offer a sophisticated understanding of the connections between the financial sustainability and performance of Micro, Small, and Medium-Sized Enterprises (MSMEs) in Indonesia, as well as government policy, intellectual capital, social capital, financial literacy, and capital structure.

It is interesting to note that there is a negative correlation between government policies and MSMEs' financial sustainability and performance. According to the study's findings, certain regional developments, like improved roads, have a negative effect on MSMEs' performance. As a result, respondents expect government policies to take MSME businesses into consideration. The detrimental effect on performance is consistent with research showing that inflexible regulations and bureaucratic barriers might impede the agility and creativity of MSMEs ([Edgar et al., 2022](#); [Sari & Kusumawati, 2022](#)). The detrimental effect on long-term financial viability highlights how crucial it is to implement laws that support a supportive corporate environment. This is consistent with other research ([Gah et al., 2020](#); [Kurniawan et al., 2023](#)) that emphasizes the role of government action in building an ecosystem that is supportive to MSMEs.

The literature that highlights the significance of knowledge, skills, and innovation in the performance of small enterprises is consistent with the positive association between Intellectual Capital and MSMEs Performance and Financial Sustainability. The resource-based view (RBV) paradigm, which contends that valued and distinctive resources, such intellectual capital, can provide long-term competitive advantage, is consistent with this conclusion ([Barney, 1991](#)). In addition to the fact that MSMEs in Indonesia significantly contribute to the human capital indicator, MSME owners are well aware of their situation and how to respond to it in the face of intense global market rivalry.

The performance and financial sustainability of MSMEs are positively impacted by social capital, according to the social network perspective. Given that funding is one of the biggest problems MSMEs face, these MSMEs owners further attest to the value of social capital. With social capital, MSMEs owners can easily access conventional and informal financial institutions, which can help them raise money and accelerate their growth ([Santoso, 2020](#)). The communities that these owners have built in various provinces to construct their local business ecosystems also demonstrate how social capital contributes to their complexity. Studies on social capital have consistently demonstrated the significance of social capital for MSMEs with regard to information exchange, resource mobilization, and collective problem solving. This aligns with the notion that social networks are valuable assets that sustain an organization's ability to succeed.

According to earlier research [Farida et al., \(2019\)](#); [Hamdana et al., \(2021\)](#) financial literacy has a favorable impact on MSMEs' financial performance and sustainability. This is consistent with the importance of financial knowledge in decision-making and risk management for small business owners. According to the agency theory perspective, managers who possess sound knowledge and understanding of finance are better able to make decisions that are in line with the goals of the company. This finding bolsters that hypothesis. The MSMEs' owners indicated that one of the key components of their sustainability is financial literacy. Furthermore, the respondents' demographics indicate that these MSMEs are middle-to upper-scale MSMEs, as seen by the fact that they have college degrees and are hence more accustomed to financial literacy.

The beneficial effects of capital structure on the sustainability and financial performance of MSMEs demonstrate the importance of financial strategies in determining the course of small enterprises. This result is consistent with trade-off and pecking order theories, which

highlight the need of a balanced capital structure in accomplishing financial goals ([Modigliani & Miller, 1958](#)). It's interesting to note that, of the 375 research samples, over 70% have enough internal funding, while the remaining samples have formal financial institution debt. They are aware that structural capital, particularly financial capital, is necessary for innovation in their industry.

It is clear from the high positive correlation between MSME performance and financial sustainability that enhanced operational performance can have a major positive impact on MSMEs' long-term financial stability. This is consistent with the idea that one of the main factors influencing financial sustainability is successful business operations.

The present study's outcomes are consistent with prior research on MSMEs and go beyond its conclusions. Analogous research frequently highlights the beneficial effects of social capital, intellectual capital, and financial literacy on the performance and sustainability of small businesses ([Liu et al., 2022](#)). The study's distinctive contribution, though, is how it tested these variables in the particular context of Indonesia, providing information about how these relationships may be applied in various economic environments.

This study has important theoretical ramifications that should be noted. According to the resource-based view, social network theory, and agency theory, MSMEs benefit from the advantages of intellectual capital, social capital, and financial literacy. The results add to our theoretical understanding of how these theoretical views might be used in relation to Indonesian MSMEs. Furthermore, this study emphasizes the applicability of financial tactics, which is consistent with ideas like trade-off and pecking order theories. The combination of these theories provides a thorough framework for comprehending the complex relationships among the variables influencing MSMEs.

The study's practical implications provide policymakers, practitioners, and small business owners in Indonesia with useful information. The detrimental effects of bureaucratic roadblocks highlight the necessity of flexible and lean government regulations. The performance and sustainability of MSMEs can be enhanced through financial literacy initiatives in addition to investments in intellectual and social capital. Furthermore, in a difficult economic climate, strategic capital structure considerations can offer stability and resilience.

CONCLUSION

In summary, this research offers a thorough understanding of the various aspects that influence the development of MSMEs in Indonesia. By illustrating their influence on financial performance and sustainability, this study verifies the importance of capital structure, intellectual capital, social capital, government policies, and financial literacy. The findings advance our theoretical knowledge of MSME dynamics by confirming the predictions of existing theories including agency theory, social network theory, and resource-based approaches. The real-world consequences provide direction for practitioners in improving critical organisational components and policymakers in tailoring access to finance to support small businesses in a rapidly changing business environment.

This study has limitations despite providing in-depth information. The cross-sectional nature of the data makes it difficult to prove cause-and-effect relationships, and the conclusions may vary over time as the business environment changes. A longitudinal approach could be used in future studies to better capture the dynamic nature of MSMEs. In addition, examining sectoral differences and conducting comparative research among different regions could

provide a more comprehensive understanding of the contextual factors affecting MSMEs in Indonesia. Policies such as partnerships for MSMEs including capital loans are policies that must be harmonised by policymakers to create MSME sustainability.

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