

**SUBMISSION FORM
FULL PAPER**

Title	Measuring the Impact of Financial Management Practices on the Performance of Micro and Small Enterprises in Medan City
Conference's topic	Financial Accounting
Corresponding Author	Name: Heny Triastuti Kurnia Ningsih Email: henytriastuti@students.usu.ac.id Institution: universitas sumatera utara* Faculty: Faculty of Economics and Business Status: Students (S3)/ Lecturer <i>*Do not translate the name of University/ Institution in English</i>
Contact	Email: henytriastuti@students.usu.ac.id Mobile Phone/ WA: 081396192508

Other authors

Name	University	Email	Mobile Phone
Heny Triastuti Kurnia Ningsih	Universitas Sumatera Utara	henytriastuti@students.usu.ac.id	081396192508
Erlina	Universitas Sumatera Utara	erlina@usu.ac.id	
Khaira Amalia Fachruddin	Universitas Sumatera Utara	khaira@usu.ac.id	
Rina Br Bukit	Universitas Sumatera Utara	rina.bukit@gmail.com	

MEASURING THE IMPACT OF FINANCIAL MANAGEMENT PRACTICES ON THE PERFORMANCE OF MICRO AND SMALL ENTERPRISES IN MEDAN CITY

Heny Triastuti Kurnia Ningsih ^{*a}, Erlina ^b, Khaira Amalia Fachruddin ^c, Rina Br Bukit ^d

^{a,b,c,d}Universitas Sumatera Utara, Indonesia

Correspondent henytriastuti@students.usu.ac.id

ABSTRACT

This study aims to measure how much the influence of working capital management, maintaining accounting records, and financing on the performance of MSMEs in the city of Medan. The sample size was taken based on the number of dimensions/subvariables, namely 200 respondents of MSMEs in the Medan City Culinary sector, because in measuring the influence between exogenous and endogenous dimensions/subvariables in this study, using *partial least squares* (PLS). The results of the study show that working capital management, maintaining accounting records, has a positive (low) but insignificant (meaningless) effect on the performance of MSMEs in Medan City. Financing has a positive (high) and significant effect on the performance of MSMEs in the city of Medan; however, based on the R Square value of handling complaints, consisting of working capital management, maintaining accounting records, it is quite capable of explaining, or can also be a variable determining the performance of MSMEs. should be avoided, but if essential, they must be defined at their first mention in the abstract itself.

Keywords: working capital management, maintaining accounting records, financing, performance

INTRODUCTION

Governments around the world are aware of the important role of MSMEs in fostering and strengthening the economy. In developed and developing countries, MSMEs are considered the backbone of the economy (Madani, 2018); (Sataic, 2021). The role of MSMEs is very large for Indonesia's economic growth, with the number reaching 99% of all business units. In 2023, MSME business actors will reach around 66 million. The contribution of MSMEs reaches 61% of Indonesia's Gross Domestic Product (GDP), equivalent to Rp9,580 trillion. MSMEs absorb around 117 million workers (97%) of the total workforce.

The food and beverage industry sector is the largest contributor to the formation of the contribution of non-oil and gas processing industry sector, which is the backbone of the Indonesian economy. Until the first quarter of 2024, the GDP structure of the non-oil and gas processing industry is dominated by the food and beverage industry, which plays a role in 39.91%, or 6.47% of the total national GDP. This figure is added to the export value of the food and beverage industry in April 2024, which reached 2.71 billion USD or 19.4% of the exports of the non-oil and gas processing industry, and is the second largest export after the base metal industry sector. Of this value, part of it is the contribution of food and beverage SMEs, which amount to around 1.7 million business units by absorbing around 3.6 million workers, making it a labour-intensive industry.

Several studies argue that financial management practices are one of the dimensions in improving organisational performance by influencing efficiency and performance success (Hunjra et al., 2012); (Zada et al., 2021) In addition, research (Okyere et al., 2018); (Turyahebwa et al., 2013) showed that MSMEs that implement financial management practices have excellent performance in terms of record-keeping, resource allocation, fund management, and business performance while addressing poverty alleviation and solving employment challenges.

However, although there is evidence to show a positive relationship between financial management practices and organisational outcomes, the mechanisms used by financial management practices to influence performance are still underrepresented (Akpan et al., 2022) (Boisjoly et al., 2020); (Musah, et al, 2018). Most of the research on financial management practices in SMEs focuses on developed countries such as the United Kingdom (McMahon, 2001) Italy (Sensini, 2020); and Spain (Chalmers et al., 2020). The literature underscores the importance of the role of financial management practices in organisational competitiveness and performance (Adegboye & Iweriebor, 2018); (Ntuli & Nzuzza, 2022). Financial management strategies are a source of competitive advantage and valuable resources (Okyere et al., 2018); (Mwashi & Miroga, 2018).

Various empirical studies also reveal challenges that hinder the performance of MSMEs, these challenges include but are not limited to access to finance and low financial inclusion, fierce competition, lack of capacity to face technology, lack of databases, lack of interest in entrepreneurship, and inadequate business management skills, as well as lack of effective financial management (Kiyabo & Isaga, 2019).

Based on these, this study seeks to fill this gap by proposing a model to explore the relationship between financial management practices and organizational performance. This study makes a dual contribution to the literature on strategic financial management. First, this research theoretically supports the relationship between financial management practices and organizational performance. Second, this study provides empirical evidence on the relationship between financial management practices and organizational performance using financial and non-financial performance measures. Previous research has analyzed this relationship using non-financial or financial perception measures (Muneer et al., 2017) (Turyahebwa et al., 2013).

These findings contribute to the literature by providing a theoretical argument that justifies that financial management practices have a positive effect on financial and non-financial performance. To establish the basis for this research, the theoretical foundations of financial management practices and organizational performance are described. A conceptual model that links financial management practices to organizational performance is then used to construct a hypothesis. Structural equation modeling was used to assess the efficacy of the conceptual model and the proposed hypothesis, and the results were then compared with previous studies that yielded similar conclusions. Research limitations, implications, and suggestions for future investigations are provided.

Literature review

In the business world, especially in the micro and small enterprises (MSEs) sector, effective financial management has a very important role in achieving optimal performance. The resource-based theory (RBV) was developed by (Barney, 1991) serves as a theoretical foundation for identifying the relationship between financial management practices and organizational performance. According to RBV, companies gain a competitive advantage by utilising valuable and irreplaceable resources, which allows them to achieve better results in the long run. In the context of MSEs, the use of limited resources in the form of finance, human resources, and operational capacity is a very decisive factor in the sustainability and growth of the business.

Research (Khan et al., 2020) suggests that the success of an organisation does not only depend on external factors, such as the market and competition, but also on its internal capabilities. These capabilities include the management of existing resources, which in this case relates to financial management practices. Good financial management practices enable MSEs to manage cash flow, investment, and cost control efficiently, which in turn improves long-term performance.

In addition, the RBV theory also emphasises the importance of the quality and diversity of resources owned by the organisation. Resources that are valuable, unique, and difficult for competitors to replicate can provide a sustainable competitive advantage. In the context of MSEs, this is reflected in the appropriate use of information technology, the ability to access financial resources, and the quality of financial management that contributes to more strategic and informed decision-making. The resources owned by MSEs, both physical and intellectual, can play an important role in increasing operational efficiency and business competitiveness (Schmidt, 2009)

Referring to the RBV theory, the competitive advantage achieved by Indonesian MSEs through effective financial management practices can result in better performance and encourage sustainable business growth. This shows the importance of a resource-based approach in understanding the dynamics that occur in the MSE sector. By efficiently managing financial resources, MSEs can not only survive in fierce competition but also expand their capacity to grow even further.

MSME Performance

Organisational performance is the extent to which an organisation succeeds in achieving its goals (Nitzl et al., 2019). Some authors agree with the above view when they argue that an organisation's performance is a function of its ability to develop strategies that align it with the complexity and dynamic nature of the changing environment (Abubakar et al., 2019); (Rehman et al., 2019)

Similarly, many experts explain that organisational performance is a key measure to achieve the organisation's goals and objectives (Schwens & Wagner, 2019); (Laaksonen & Peltoniemi, 2018). Organisational performance can be measured subjectively by using non-financial indicators or objectively by using financial performance indicators to establish the achievement of organisational goals and objectives (Mazlan & Leng, 2018); (Singh et al., 2016)

Financial management practices

Financial resource management is known as financial management (Nkundabanyanga et al., 2017); it operates the practice of financial management as a process that includes planning and control, accounting, cash flow management, budgeting or capital valuation, and working capital management. According to (Sa'eed et al., 2020) Financial management practices are defined as standard operating procedures designed to appropriately improve the implementation of financial accounting, reporting, budgeting, and other related tasks to improve the efficiency of the company's engineering. Financial management practices are a set of standard procedures developed to handle financial reporting, budgeting, and other operations involving a company's funds (Ahmed & Mwangi, 2022). Financial management practices are an integral part of financial resource management and financial decision-making (Dwangu & Mahlangu, 2021); (L. Sooriyakumaran et al., 2022).

Working capital management, capital budget management, and asset management are outlined as components of financial management practices (Alles et al., 2021). Working capital management is essential for the fiscal viability of an organisation and is a determinant of its profitability and success (Kiymaz et al., 2024); (Louw et al., 2022). Working capital management is a procedure that allows a business to fulfil its daily operations while remaining liquid (Tadesse, 2016) Financial management practices ensure financial stability and the organisational profitability position (Farooq et al., 2023)

(Orobia et al., 2020) Effective financial management practices ensure adequate cash flow (Salazar et al., 2012)

METHOD, DATA, AND ANALYSIS

Research Design

This article uses cross-sectional surveys, a survey method that collects information at a time from representatives of different groups or sectors. These surveys simultaneously collect data from various individuals or groups to get an overview of a population or phenomenon. This study uses a quantitative research design to analyze the impact of financial management on MSME activities. The quantitative approach allows for the collection of statistically analyzable numerical data, identifying relationships between variables.

Sampel

This research uses the Directory of the Cooperative and Small Business Office of Medan City as a source of information about MSMEs. The size of the research sample was determined to meet the practical rules for the use of SEM PLS modeling from the target population of 1,240 MSMEs (MSMEs registered with the Cooperatives and MSMEs Office of North Sumatra Province). The sampling technique used is *proportional random sampling*. *Proportional sampling* or balanced sampling is that in determining the sample the researcher takes representatives from each group in the population, whose number is adjusted to the number of subject members in each group. While *random sampling* refers to the method of selecting a sample from a population where each element in the population has an equal chance of being selected, this technique is also called objective, so that all elements of the population have the opportunity to become a research sample. The sample of this study is 200 MSME actors who use financial management in their business transactions. Participant selection criteria include:

1. Type of Business: Participants must be engaged in the MSME sector, namely micro, small, and medium enterprises, as described by local regulations.
2. Use of Financial Statements: Only MSME owners who have actively used financial statements either manually or digitally in their operations are included in the sample.

Data Measurement

The measurement was carried out using the Likert scale, with a score of 1 ("strongly disagree") and a score of 5 ("strongly agree"). The estimation criteria for construct standards proposed by Hair et al. (2022); Henseler (2021) were applied. Construct statements that are less than the ideal threshold of 0.60 or higher will be deleted (Mehmetoglu and Venturini, 2021; Rhemtulla et al., 2020). The scale of financial management practices, working capital management (Mazlan and Choong, 2018), capital budget management (Balarabe, 2020), and asset management (Kelly and Hardy, 2018) are adopted in measuring financial management practices. An example item includes "Strong working capital system". The reliability of each of the three dimensions of the financial management dimension was 0.89, 0.86, and 0.82, respectively. The reliability score for all 14 items was 0.82. The correlation between dimensions that range between 0.56 and 0.77 is high.

Data Analysis Technique

In this study, the analysis used is *Partial Least Squares* (PLS), where two measurements must be made in *the Partial Least Squares* (PLS) analysis, namely the Outer Model and the Inner Model. The model's outer *measurement model* is used to test the construct validity and reliability of the instrument. The validity test was carried out to determine the ability of the research instrument to measure what should be

measured (Cooper and Schindler, 2003). Meanwhile, the reliability test is used to measure the consistency of the measuring tool in measuring a concept, or it can also be used to measure the consistency of respondents in answering statement items in questionnaires or research instruments. In *this Outer Model*, the measurement results are seen through *outer loadings*, *Cronbach's Alpha*, *Composite Reliability (CR)*, and *Average Variance Extracted (AVE)* with an indicator value of >0.5 each. In *the Inner Model*, structural models are carried out to test the relationship between latent constructs (Vincenzo, 2010). There are several tests for structural models, namely: *R Square* on endogenous constructs. The *value of R Square* is the coefficient of determination on endogenous constructs. The *R-squared* values are 0.67 (strong), 0.33 (moderate), and 0.19 (weak) (Chin, 1998).

The relationship was assessed using a p-value, with a threshold of < 0.05 , indicating a significant relationship. Using this methodology, the purpose of this study is to provide strong information about management practices in improving MSME activities.

RESULT AND DISCUSSION

The author needs to report the results in sufficient detail so that the reader can see which statistical analysis was conducted and why, and later to justify their conclusions. This part highlights the rationale behind the result, answering the question “why is the result so?” It shows the theories and the evidence from the results.

In this section, the profile of the respondents will be described based on questionnaire data obtained from an online questionnaire of 200 random respondents spread across the city of Medan and its surroundings.

Statistics Descriptive

Table 1.1. Demographic Characteristics of Respondents

Characteristics	Frequency	Percentage (%)
Gender		
Man	200	50.0
Woman	200	50.0
Age		
18-25	60	25.0
26-35	90	37.5
36-45	60	25.0
46 and above	30	12.5
Business Type		
Retailers	100	41.7
Service	80	33.3
Other	60	25.0

Source: Data processed, 2025

Based on Table 2 above, it can be seen that the dominant percentage is dominated by the female gender (50%),

Reliability and Validity Testing

Outer Model

The initial discussion of *the outer model* analysis is to test the value of *outer loadings*, *Cronbach's Alpha*, *Composite Reliability* (CR) and *Average Variance Extracted* (AVE) with each indicator value >0.5 (Vinzi, et al, 2010), if the indicator value < 0.50 then the indicator will be dropped and not included in the calculation of the research model, the initial stage of calculation can be seen in the following Table 2.1:

Table 2.1.Outer Model Calculation Results

Constructs/Item	Outer Loadings	Cronbach's alpha	CR	AVE
Working Capital Management				
WCM1	0.889			
WCM2	0.872	0.711	0.874	0.776
Maintaining Accounting Records				
MA3	0.928			
MA4	0.902	0.807	0.911	0.837
Financing				
F5	0.857			
F6	0.923	0.861	0.916	0.783
F7	0.874			
Business Performance				
K8	0.863			
K9	0.874	0.815	0.889	0.727
K10	0.880			

Source: Data process, 2025

Based on Table 4.it can be seen that the *outer* model test in the form of a validity and reliability test of the construct, it can be seen that based on the results obtained the value of *outer loadings*, *Cronbach's Alpha*, *Composite Reliability* (CR) and *Average Variance Extracted* (AVE) obtained a value of > 0.5 , it can be concluded that the construct of Working Capital Management and Maintaining Accounting Record, financing and MSME performance is valid and reliable and can be carried out next test to test *the Inner Model* and Hypothesis Test.

Inner Model

The Inner Model *measurement* was calculated through *bootstrapping* on SmartPLS to see the influence of working capital management, improving accounting records, financing on the performance of MSMEs, both significant and insignificant, which was indicated by a P value of < 0.05 and at the same time as a test tool for the hypothesis of this study whether H1, H2 and H3 were accepted or rejected. *The Inner Model* also looks at how much the MSME Performance variable can be explained/determined (determination) (*R Square*) by each variable of working capital management, improving accounting records, and financing. The following shows the path *coefficients* as well as the results of the hypothesis test on the influence of working capital management, maintaining accounting records, and financing on the performance of MSMEs. Financing has a high positive effect (0.645) and is significant on performance (*P Values* < 0.05). This indicates that financing has a significant influence on performance, showing that the financing method for MSMEs focuses on obtaining a return on their capital and does not survival in business.

Overall *R Square Customer Satisfaction* 0.462 is in the moderate (adequate) category, which indicates that the performance provided is quite determinable/explainable as well. The following is a framework of

research results on the influence of working capital management, improving accounting records, and financing on performance in the City of Medan, as follows:

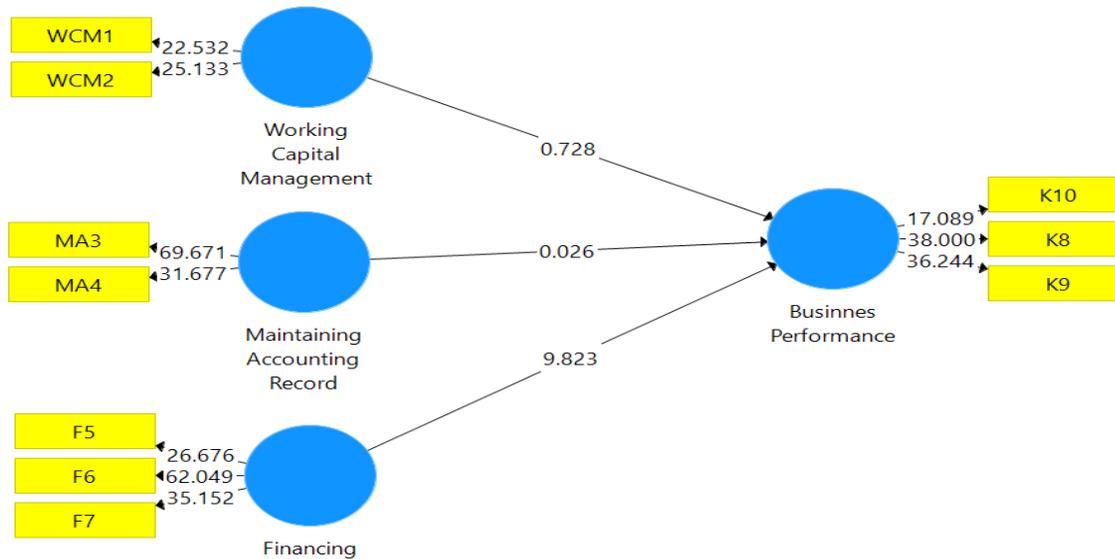


Figure 1.1. Research Results Framework Working capital management, maintaining accounting records, and financing affect the performance of MSMEs

Table 3.1. Hypothesis Test Results

Influence between Variables			Koefisien	P-Values	Hipotesis
Working Capital Management	>>	Businnes Performance (H1)	0.062	0,467	Rejected
Maintaining Accounting Record	>>	Businnes Performance (H2)	0.003	0.979	Rejected
Financing	>>	Businnes Performance (H3)	0.645	0.000	Accepted

Source : Data diolah, 2024

Based on the calculation results in Table 4, it can be seen that the Working Capital Management and Maintaining Accounting Record hypothesis is rejected, that Working Capital Management and Maintaining Accounting Record have a positive effect (low) (0.062 and 0.003) but not significant on Performance ($P\text{ Values} > 0.05$) or these two variables do not have a significant influence on performance, they should focus on their own capital participation and debt capital in their financing. This will help improve the viability of the entity. SMEs must reevaluate their working capital strategy with a fully automated receivables management system and accurate maintenance of debt records. This is because MSME financial management has not carried out a recording process. MSMEs only rely on memory, then have not separated functions between family and business finance. The results of this research support ((Komala Ardini, Syafnita, 2021); (Wulansari & Anwar, 2022) That Working Capital Management and

Maintaining Accounting Records do not affect performance. And the results of the financing hypothesis affect business performance; this result is in line with the research (D. L. Sooriyakumaran, 2024).

CONCLUSION

The Working Capital Management and Maintaining Accounting Records hypothesis is rejected, and the financing hypothesis affects business performance. The results of this study must be considered, considering its limitations. The possibility that these results are the result of inverse causality or causal relationships cannot be completely ruled out due to the cross-sectional nature of the study (Saunders et al., 2019). Longitudinal studies are needed in the future (Carroll, 2019). The study only considered the subjective opinions of employees (Otoo, 2022). Objective measurements are recommended in subsequent studies (Minbashian et al., 2019). General method bias will be less likely when objective measures are used (Delpechitre et al., 2018). Current research uses a variety of financial management practices to assess their impact on organizational performance. However, to conduct an in-depth and focused investigation, further theoretical and practical work is needed to gain a comprehensive understanding of the relationship between financial management practices and organizational performance. The ability to generalize these findings will be hampered because this study focuses on SMEs. Applying this model to different fields or sectors may be beneficial.

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