

ANALYSIS OF FINANCIAL LITERACY AND FINANCIAL INCLUSION AS A STRATEGY TO IMPROVE THE COMPETITIVENESS OF SMALL-MEDIUM ENTERPRISES (SMEs)

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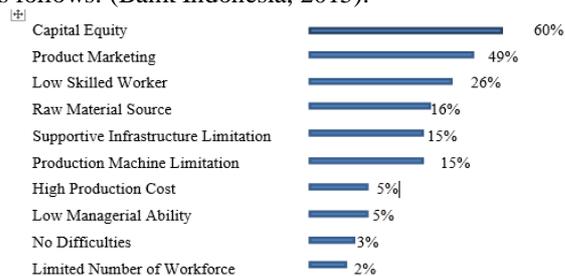
Abstract - The handicraft industry is one of top selling industries in West Sumatera. The industry also brings considerable contribution to the wealth of the community. In general, the main problem in the handicraft industry is on its capital and marketing. The objective of this study is to find the level of financial literacy and financial inclusion of the handicraft entrepreneurs, as well as to see the correlation between the level of financial literacy with the level of financial inclusion, and to identify the factors that hinder the development of financial inclusion. This research used field observations, interviews, and distribution of questionnaires as its primary data, and the secondary data were obtained from related agencies. To answer the research question, we used descriptive analysis method and structural equation modeling. The results show that the financial literacy has a positive and significant impact on the financial inclusion of the handicraft entrepreneurs, the level of financial literacy of the sample is categorized as sufficiently literate, and the financial inclusion of the handicraft entrepreneur is also categorized as sufficient. Therefore, it will be necessary to develop the financial inclusion by overcoming the obstacles faced by SMEs, especially in accessing banking services and other formal financial institutions in order to improve the competitiveness of SMEs.

Keywords - Financial Literacy, Financial Inclusion, handicraft SMEs.

I. INTRODUCTION

In order to create more equal, participatory, and inclusive economic growth, factual efforts are needed to encourage economically productive activities. One of productive economy sectors that needs to be developed is small and medium enterprises (SMEs). SMEs play a big role in stimulating the economic growth in various regions in Indonesia. The number of SMEs in Indonesia is higher than the number of large enterprises, reaching up to 99.99% of the market share (Kemenkop, 2013). SMEs are able to sustain and enliven the economy of a region and could highly contribute to the economic welfare for each family head in the neighborhood. However, the SMEs could not be separated from conditions that hinder their growth.

There are various types of SMEs in Indonesia; one of them is the handicraft SMEs. The conditions encountered by the SMEs are not entirely ideal. The result of a survey conducted by the World Bank team in 2014 shows the description of difficulties encountered by the handicraft SMEs in Indonesia in running their business. The difficulties are described as follows: (Bank Indonesia, 2015).



Source: Survey processed by World Bank Team (2014)

Based on the survey above, it is shown that in running their business, the biggest difficulties experienced by handicraft business player are the problem of capital, marketing, and human resource skills. Generally, the source of the capital for the handicraft business only comes from personal equity or from personal or family funds. This indicates the low level of financial inclusion of the SME handicraft managers. Therefore, a program or a model of financial inclusion is required to accelerate the access of SMEs to formal financial services in their regions. The West Sumatra economy is still supported by small and medium enterprises (SMEs). This could be seen from the composition of its business sector which is still dominated by 84% of micro business, followed by 14 % of small business sector, and only around 1.5% of medium business; it could be said that there is no large scale industry (Hap, 2017). Therefore, an effort in development of SME is needed to improve the wealth of community in West Sumatra.

Generally, the financial problems faced by the SMEs are due to the low financial ability or competency of the small business player (Rose, Kumar, & Yen, 2006). The low financial competencies is shown in the low financial literacy of small business player. Financial literacy is one of the principles that reflects conducive conditions which encourage access to financial institutions or financial inclusion (G20, 2012). Financial literacy will also affect the performance of small businesses (Dahmen & Rodríguez, 2014).

There are several obstacles faced by the SMEs in accessing the financial institutions. Based on the study results conducted by Bank Indonesia, it is

concluded that the SMEs have the obstacle to access and to obtain the funding resources from banks. This is due to the low knowledge on how to manage the business, especially on the financial aspects (Bank Indonesia, 2012). Various studies conducted in various countries also prove that financial problem is the most urgent problem faced by small business (Thevaruban, 2009; Suwastika & Anand, 2012)

One of the top selling products that become dominant in West Sumatra is the craft of embroidery, weaving, silver handicrafts, and furnitures. However, in its development, these business still encounter several obstacles. The main obstacle in developing the handicraft industry SMEs is in terms of capital and marketing (Rashid, 2016). To develop a business unit, capital is the main factor needed. In general, the source of capital in the craft business only comes from personal equity or from personal or family funds. Based on the research on 60 business players of embroidery in Padang, West Sumatera, the composition of funding resource of the craft business amounted to as much as 47% entrepreneurs used 100% personal capital which comes from personal savings of the entrepreneurs themselves, family and friends' support, 45% used a small amount of debt, and only 8% of entrepreneurs used bank loans in their capital composition (Rashid, 2016). This indicates that there is a lack of access to financial institutions among the handicraft businessmen in Padang.

Several things that become the obstacles for the community to access formal finance systems include: the lack of knowledge, high costs, non-price obstacles such as administrative issues and behavioral issues, such as community perceptions towards banks (Sachindra, 2013). Others argue that the factors that hinder the public access to the formal financial sectors can be grouped into two categories of the demand side and the supply side. Demand-side barriers are caused by the community's lack of knowledge and lack of awareness towards financial services, low incomes, and lack of financial and social security. The barriers from the supply-side are the distance of access from the people's residence to the bank, complicated procedures, incompatibility of the existing financial products with the entrepreneurs' needs, the use of less understood language toward customers, the bank employees' behavior, and inflexibility of the bank's operation time (Rakhmindyarto & Syaifullah, 2013). Meanwhile, according to the governor of Bank Indonesia, one of the factors that cause lack of access to financial institutions on the SMEs is the low level of financial literacy of the SMEs. In general, the SMEs knowledge is limited on banking service, and they tend to be less conscious of the financial products offered by other financial institutions, so that their funding only relies on the financing service of manual and conventional bank. This condition could decrease the development of SMEs, since the SMEs development will be in line with the level of financial

literacy and the proximity of SMEs to financial access (Soepardi, 2016)

The limited access of the handicrafts SMEs towards the formal financial sector are caused by several obstacles, which are generally grouped into two categories: demand barriers and supply barriers. This study is conducted to find the level of financial literacy and the implementation of financial inclusion of the handicraft's business player, as well as factors that hinder the handicraft SMEs' access to financial institutions. The objectives of this study is to determine the level of financial literacy of the handicraft SMEs and its correlation with the application of financial inclusion, and to find out the factors that hinder the access of crafts SMEs to financial institutions. In the future, the result of this study could help in finding the right model for the development of the financial inclusion as a strategy to increase the competitiveness of handicrafts SMEs in West Sumatra.

Financial literacy is the ability to manage finances in order to live more prosperously in the future (Chen & Volpe, 1998). Financial literacy includes concepts ranging from awareness and knowledge about financial products, financial institutions, and concepts about financial skills (Xu, Lisa, Zia, & Bilal, 2012). Financial literacy can also be defined as a measurement on how well a person can understand and use the financial information (Huston, 2010). Financial literacy not only requires the knowledge dimension, but also requires an additional dimension, i.e the application which requires a person's ability and his confidence to use his financial knowledge in financial decision-making.

Good financial literacy will enhance entrepreneurs' ability in financial management and in making the right decisions for their companies (Muraga & John, 2015). Financial literacy covers several aspects of finance: basic knowledge of personal finance, money management, credit and debt management, savings and investment, and risk management. Thus, financial literacy can be measured using four indicators: basic knowledge of financial management, credit management, savings and investment management, risk management (Chen & Volpe, 1998).

Based on the national strategy of Indonesian financial literacy, the public financial literacy is classified into 4 levels, namely: 1) Well Literate: having knowledge and belief on financial service institutions and financial products and services, including features, benefits and risks, rights and obligations related to financial products and services, and posses skills in using financial products and services. 2) Sufficiently Literate: possesses knowledge and belief about financial services institutions as well as the financial products and services, including features, benefits and risks, rights and obligations related to financial

products and services. 3) Less Literate: only possess knowledge of financial services institutions, financial products and services. 4) Not Literate: does not possess any knowledge and belief about financial services institutions and financial products and services, and does not have skills to use financial products and services (Sugiarto, 2013)

Financial inclusion is an effort to encourage the financial system to be accessible to any level of society. According to the Financial Services Authority, Financial Inclusion is efforts aimed at eliminating any obstacles, both price and non-price, for the public to access the use of financial services and to provide significant benefits to improve the living standards of society (Alamsyah, 2014). There are several factors that cause the need for inclusion, namely; (a) inability to access financial services that may result in the exclusion of financial entities to obtain capital, and (b) lack of access towards safe and formal savings that may reduce their motivation to save. The formal savings pose as security benefit and increase interest rates (Shankar, 2013).

Performance measurement is required to find out how far the development of financial inclusion activities is. Several indicators to measure the development of financial inclusion of a country are: 1) Availability / access, to measure the ability to use formal financial services, in terms of physical and price affordability, 2) Usage, to measure the ability of the actual use of financial products and services. 3) Quality, to measure whether the attributes of financial products and services have met the needs of customers, and 4) Welfare, to measure the impact of financial services on the level of users' life (Setiawan, 2015).

There are many researches who studied the factors that influence the public financial literacy. In general, the applied factors are the demographic factors. Demography is a description about a person's background that influences his financial literacy (Mandel, 2008). Demographic factors include age, sex, family status, migration status, education level, occupation, residence and regional area (Keown & Anne, 2011). They could also consist of parents' education level, allowance, education level and faculty, parent's income and insurance (Nidar & Bestari, 2012). Another demographic factors that affect financial literacy are age, sex, education level, number of children, marital status and work experience (Mahdzan, Shahnaz, Tabiani, & Saleh, 2013).

II. DETAILS EXPERIMENTAL

2.1 Operational Definition and Variable Measurement

Operational definition of the variables used in this study can be seen in the following table:

No	Variable	Indicator
1	Financial Literacy (Chen & Volpe, 1998)	<ol style="list-style-type: none"> 1. Basic Financial Finance 2. Money Management 3. Credit and Debt Management 4. Saving and Investment 5. Risk Management
2	Financial Inclusion (Setiawan, 2015)	<ol style="list-style-type: none"> 1. General Knowledge About Banking 2. Banking Services are often used 3. Difficulty in accessing Banking Service 4. Implementing Financial Inclusion

Tabel 1. Operational Definition and Variable Measurement

2.2 Conceptual Framework

This study highlights the level of financial literacy by measuring four indicators, namely: Basic Knowledge of Financial Management, Credit Management, Savings and Investment Management, Risk Management (Chen & Volpe, 1998). Financial inclusion is measured using four indicators, namely: availability / access, usage, quality, and welfare (Setiawan, 2015). This research finds out the correlation between financial literacy and financial inclusion, and then analyze the factors that hinders the development of financial inclusion. The conceptual framework and results can be seen in Figure 1 as follows:

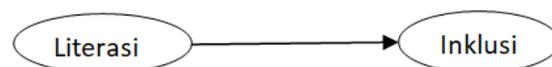


Figure 1: Research Framework

Based on the theory and identification of problems which have been presented previously, this study formulates four hypotheses as follows:

H1: Financial literacy has a positive effect on the financial inclusion of the handicraft SMEs in West Sumatra

2.3 Research methods

The population of this research is all of the hand and machine embroidery craft SMEs in West Sumatera. Samples were taken by purposive area sampling with the criteria of SMEs domiciled in Padang, Pariaman, and Bukittinggi, have a sustainable business, and are in the business for more than three years. The study was conducted on 100 SMEs of hand and machine embroidery crafts as the sample. Primary data were collected through questionnaire and face-to-face interview with respondents, and data collection technique was through indepth-interview and

questionnaire. The research results would be generalized better if the research uses a survey method (Kerlinger & Lee, 2000). The analysis technique used was qualitative descriptive and inductive analysis using PLS (Partial Least Square). PLS is a model of Structural Equation Modeling (SEM) which is based on the variance analysis. Total respondents achievement was measured with Likert scale (Jamieson, 2004). This technique is a powerful method because it is not based on assumptions (Abdillah & Yogyanto, 2015).

III. RESULTS AND DISCUSSION

3.1. Data Description

Financial Literacy

Based on money management, credit and debt, saving and investment, and risk management variables, the level of financial literacy of the handicraft SMEs could be identified from the value of respondents achievement (mean) of each research variable. The result is as follows:

No	Financial Literacy Variable	Mean	Percent	Description
1	Money Management	3,45	69,0	sufficient
2	Credit & Debt Management	3,13	62,6	sufficient
3	Saving and Investment	2,82	56,4	Less sufficient
4	Risk Management	3,01	60,0	sufficient
	Average	3,10	62,0	sufficient

Source : Primary Data Processing (2017)
Table 2. Data Recapitulation of Financial Literacy

From Table 2 above, it can be seen that the samples' ability to manage finance, loans, and risk management is categorized as sufficient, while the ability to manage savings and investments is categorized as less sufficient. Overall, the financial literacy of handicraft entrepreneurs is categorized as sufficiently literate with an average score of 3.10. This indicates that the handicraft entrepreneurs have sufficient knowledge and belief towards financial service institutions and financial products and services, including features, benefits and risks, rights and obligations related to financial products and services.

Financial Inclusion

The entrepreneurs's perception towards financial inclusion based on access, usage, quality, and welfare, could be identified based on the value of the respondent achievements (mean) of each research variable. The result is as follows:

No	Financial Inclusion Variables	Mean	Percent	Description
1	Access	3,18	63,6	sufficient
2	Usage	2,96	59,2	less sufficient
3	Quality	3,03	60,1	sufficient
4	Welfare	3,08	61,6	sufficient
5	Average	3,06	61,2	sufficient

Source : Primary Data Processing (2017)
Table 3. Data Recapitulation of Financial Inclusion

Table 3 above shows that the average respondents' perception on financial inclusion policy is categorized as sufficient, and the use of financial institutions belongs to the less sufficient category. There are several obstacles / barriers faced by SMEs in using banking services, as shown in table 4 below:

Obstacles in Accessing Banking Services(%)	
Too many procedures	56.7
No knowledge of banking services	48.04
A belief that interest is <i>riba</i> (usury)	62.06
Not able to use mobile phones to access the service	49.69
Technology illiteracy	51.55
Not having legal documents	49.9
Lack of experience	51.75
Not having financial reports	52.99
High cost of interest	66.39
Lack of knowledge about banking products	63.71

Source : Primary Data Processing (2017)
Table 4: Obstacles faced by handicraft SMEs in accessing banking services

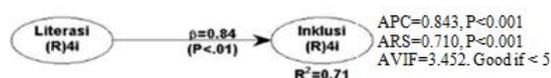


Figure 2: Research Result

3.2. Discussion

The financial literacy affects the financial inclusion of the handicraft SMEs in West Sumatra. From the study results, 71 percent of the increase in financial inclusion is influenced by the level of the financial literacy of the entrepreneur. This result is in line with the opinion expressed by (G20, 2012), who states that financial literacy can stimulate access towards financial institutions or financial inclusion. Therefore, in the framework for developing the financial inclusion, it will be necessary to increase the financial literacy by improving the knowledge about 1) financial management, including financing (budgeting / budget plan), implementation, and evaluation; 2) credit management, so that the credits are used effectively and efficiently as stated in the initial purpose of credit from before the credit is submitted until it is fully paid; 3) savings and

investment management, in order to have an easy access to liquidity, financial planning and security; and 4) risk management, a structured and systematic process of identifying, measuring, mapping, developing risk management alternatives, monitoring and controlling risk management, which aims to avoid or to minimize emerging risks. Furthermore, an increase in financial inclusion could happen by directing the handicraft SMEs to use the services of financial institutions.

CONCLUSION

The results show that the level of financial literacy is categorized as sufficiently literate and the SMEs perception towards the policy of financial inclusion is categorized as sufficiently good. Despite many SMEs still being unfamiliar with formal financial institutions, especially about the services, the factors that hinder the handicraft SMEs in accessing financial services are concluded as follows : 1) high cost of interest, 2) lack of knowledge about banking products, 3) a belief that interest is *riba* (usury), 4) too many procedures, 5) not having financial reports, 6) lack of experience, 7) technology illiteracy, 8) not having legal documents, 9) not able to use mobile phones to access the service, and 10) no knowledge of banking services.

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