

# Portrait of MSMEs' Islamic Financial Literacy and The Impact on Business Development

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## **ABSTRACT**

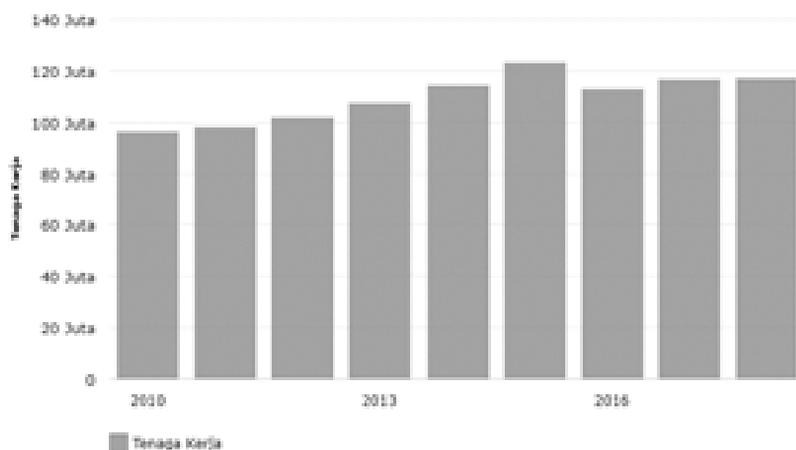
MSMEs are part of the supporting aspects of the country's economy. However, the competitiveness of MSMEs in Indonesia towards the global economy still tends to be low when compared to other ASEAN countries. This is caused by low levels of education and expertise, difficulties in obtaining licensing for MSMEs, lack of access to capital, and lack of infrastructure support. One aspect that should not be missed from the field of education and expertise is the level of public financial literacy. The purpose of this study is not only to analyze and classify the level of financial literacy of MSMEs but also to examine the impact of literacy levels on the development of MSMEs. This research approach is descriptive quantitative with a sample size of 1392, obtained by using cluster random sampling technique in Special Region of Yogyakarta (DIY). The results of the study show that the financial literacy of MSMEs in DIY is Less Literate. The effect on the business developing had a positive and significant influence amounted to 36.1%. With this finding, it is expected to be an input for regulators in the framework of planning and implementing policies related to Islamic financial literacy.

Keywords: Business Development; Islamic Financial Literacy; Micro, Small, And Medium Enterprises; Financial Literacy Index, Yogyakarta

## INTRODUCTION

The discussion on Micro, Small, and Medium Enterprises (MSMEs) is one of the new issues to be appointed in the achievement of an economic growth in Indonesia.<sup>1</sup> This is not excessive considering that MSMEs are part of the economic support aspect, and their existence is believed to be able to contribute to poverty alleviation efforts through job creation.<sup>2</sup> Based on data from the Ministry of Cooperatives, Small and Medium Enterprises, employment from MSMEs during 2010-2018 tends to increase every year and experiencing rapid increase in 2015.<sup>3</sup>

Figure 1. Employment from MSMEs during 2010-2018



Sumber: Ministry of Cooperatives, Small and Medium Enterprises

However, the potential of MSMEs in Indonesia has not been optimally pursued.<sup>4</sup> Of the five selected countries, the involvement of the Indonesian MSME sector in the global value chain is the lowest. Only 6.3 percent of the total MSMEs in Indonesia are able to be involved in the trade chain in the Southeast Asia region.<sup>5</sup> The low competitiveness of MSMEs in Indonesia is partly due to low levels of education and expertise, difficulties in obtaining licensing for MSMEs, lack of access to capital, and lack of infrastructure support.<sup>6</sup> Therefore, to sustain economic growth,

one aspect unnoticed in education and skills is the level of financial literacy whose activity cannot be separated from financial institutions.<sup>7</sup> MSMEs that are well literate (financial literacy) are easier to understand and understand about the ins and outs of the financial services sector which in the end will utilize financial products and services optimally to improve welfare and can protect themselves from potential losses due to financial sector crime.<sup>8</sup>

To create a policy strategy that is right on target, effective and efficient, data on current conditions of public financial literacy are needed.<sup>9</sup> One of these efforts was carried out by the OJK by conducting a national scale survey called the National Survey of Financial Literacy 2016 and the 2019 National Financial Literacy and Inclusion Survey to determine the current conditions of public financial literacy and inclusion. The survey showed that the financial literacy index reached 38.03%. This figure is an increase compared to the results of the 2016 OJK survey, where the financial literacy index of 29.7%.<sup>10</sup>

The survey then underlies researchers to conduct more specific research on the level of Islamic financial literacy of MSMEs in Yogyakarta. As a student city, the high level of consumers is a driving force for the development of MSMEs. This is evidenced by the large number of ID card number data and the development of MSMEs in DIY.<sup>11</sup>

Figure 2. Total ID card number in DIY



Source: Ministry of Cooperatives, Small and Medium Enterprises DIY

Figure 3. Development of DIY MSMEs



Source: Ministry of Cooperatives, Small and Medium Enterprises DIY

Previously, several studies that discuss MSMEs are.<sup>12</sup> Apart from that, some previous studies that discussed the financial literacy of MSMEs were.<sup>13</sup> These several journals, all of them discussed financial literacy, although they also studied MSMEs, none of them had deepened Islamic financial literacy, especially for MSMEs. This research is expected to be used as material for evaluating the effectiveness and efficiency of the financial literacy program that was previously made by OJK. Based on the gap from previous research, this study contributes to classifying MSME financial literacy standards according to the Financial Literacy Index (FLI) from the OJK. In addition, this study also focuses on assessing the impact of literacy levels on the development of MSMEs. This is an effort to complement OJK in reviewing Islamic financial literacy data, especially in the special region of Yogyakarta.

## Literature Review

### Financial Literacy

Financial literacy by the Financial Services Authority (FSA) is a series of activities or processes to further enhance the knowledge (knowledge), confidence (competence), and skills (skills) or consumer society so that they can manage their finances better. Literacy finance occurs when a person has the ability and expertise that makes a person able to manage finances to achieve something he wants.<sup>14</sup>

Financial literacy is a measure of financial concepts understanding and financial management capabilities in making short-term and long-term decisions according to the dynamics of economic needs and conditions.<sup>15</sup> Financial literacy is the ability to use knowledge and expertise to achieve

good financial behavior. Knowledge, expertise and behavior are interrelated entities in the concept of financial literacy.<sup>16</sup>

### **Islamic Finance Literacy**

Financial literacy itself can be interpreted as financial literacy. Financial literacy refers to knowing Islamic financial services and products as well as being able to distinguish between Islamic banks and conventional banks in order to choose the economy following sharia. The goal (maqhasid) of Islamic financial literacy is so that consumers and the wider community can determine Islamic financial products and services that suit their business needs, and properly understand the benefits and risks, know the rights and obligations of each of their chosen financial products and services so that it can improve the health of their business based on Islamic principles that are lawful and profitable.<sup>17</sup>

### **Financial Literacy Index**

The financial literacy index is built through several stages, namely<sup>18</sup> : 1) The group financial literacy variables into basic financial literacy; 2) Give a score of each variable that is 1 for knowing and very knowledgeable answers and 0 for other answers, do not know, very ignorant, and refuse to answer; 3) Calculating the weight of each variable using a simple weight; 4) Calculate the financial literacy index in each observation in each group of variables and then calculate the number of scores and weights. The overall score is calculated by the arithmetic to mean both for basic financial literacy.

The determination of the financial literacy index category divided into three categories, namely<sup>19</sup> : 1) Financial literacy index lower than or equal to 60 categorized as a low literacy index ( $0 \leq \text{FLI} \leq 60$ ); 2) The financial literacy index is higher than 60, and less than or equal to 80 said as a moderate or moderate financial literacy index ( $60 < \text{FLI} \leq 80$ ); 3) The financial literacy index higher than 80 categorized as a high financial literacy index ( $\text{FLI} > 80$ ).

### **Financial Literacy Classification**

Financial literacy is a measure or understanding of financial concepts and the ability of a person in proper financial management in making long-term and short-term decisions by economic conditions. The Financial Services Authority classifies financial literacy into four levels as a benchmark for reference<sup>20</sup>: 1) Well Literate: have confidence and understanding regarding financial service institutions including products and financial services as well as knowing the risks, benefits, rights, and obligations related to financial services used. And in this category, someone has the skills to utilize the financial products and services they use; 2) Sufficient Literate: have confidence and understanding regarding financial institutions, including financial products and services and knowing the risks, benefits, rights, and obligations related to financial services used; 3) Less Literate: only has an understanding about financial services institutions, including financial products and services; 4) Not Literate: do not have confidence and understanding regarding financial institutions, including financial products and services.

### **Development of MSMEs**

Development of MSMEs (Micro, Small and Medium Enterprises) is the ability possessed by an entrepreneur to socialize himself to market needs to improve the standard of living they have.<sup>21</sup> The development of MSMEs can be measured using several indicators, namely<sup>22</sup>: 1) The number of sales increases is a situation where the sale of goods/services can cover all capital and generate profits. Whichever is meant by the number of sales increases, namely the existence of financing and products of Islamic financial institutions make business sales in DIY increase; 2) Innovating is a person's knowledge to make product changes with new ideas. What is meant by innovation is that with the financing and products of Islamic financial institutions, MSME players in DIY can innovate with the products they make; 3) The extent of the market that controlled is a situation where a person can assess sales owned by others. What is meant by the breadth of the market being controlled is by the existence of financing and products of Islamic financial institutions of business people in DIY can

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### **Previous Studies**

Several previous studies that also discussed financial literacy were<sup>23</sup> financial literacy is very low around the world, irrespective of the level of financial market development and the type of pension provision.

Accordingly, changes in markets have apparently not wrought enhancements in financial knowledge, suggesting that people's gain in knowledge might be limited to what they learn from their own financial experiences. Most workers, including older ones, have not planned or even thought much about retirement. This is important because retirement planning is a good proxy for retirement wealth; those who have calculated how much they need to save for their own retirement reach retirement age with as much as three times the wealth of those who did no such calculations. We also show that retirement planning can be traced back to financial literacy; those who can undertake simple calculations, who have an understanding of inflation, and who grasp the concept of risk diversification are more likely to plan for their retirement.

<sup>24</sup>also found that the demographic factors of gender, age, and education; the socio-economic factors of income and occupation; and the psychological factor of perceptions about the future significantly affect financial literacy. Among the factors found to be related to financial literacy, occupation, and future orientation are of particular interest because the other factors are somewhat related to the attainment of education in general. Having an occupation in the field of finance and insurance is helpful for attaining financial literacy because of the knowledge gained through working with financial matters. Future orientation is also a financial literacy specific factor because people tend to want to make better financial decisions when they place more importance on the future. We checked the robustness of the results using a different measure of financial literacy, which also confirmed our findings. The results emphasize the need for a formal financial education and social contact to boost financial literacy levels in Japan.

Current academic research suggests that financial literacy may be more important than income level and professional qualifications, as the decisive factor in the future will not be the amount of financial resources available to a person but the ability to manage them effectively and achieve their goals. The research results proved the impact and interconnection of main financial inclusion aspects such as account ownership, use of the Internet, availability of ATMs, and bank offices on

financial literacy level. The main factor influencing the demand side of financial services is numeracy knowledge; a strong correlation has been found between PISA mathematics average scores for countries and their literacy level. The analyzed savings factor (voluntary savings for pension, life insurance, and investments in mutual funds) showed a heterogeneous situation – the ranks of countries differed from the financial literacy levels. It draws the attention of government policy-makers to attract citizens to these long-term investment and social security products by strengthening the supply side of the financial services.<sup>25</sup>

Another research that explores the impact of microfinance on multidimensional constructs of empowerment and the catalysts thereof is research by<sup>26</sup>. The reference point for analysis in this research is the women microfinance borrowers' self perception about their life transmutation as well as that of household power configuration. Unlike other recent research papers on the topic that focus on women's economic empowerment, this paper focuses on both economic and socio-cultural empowerment. This research argues that microfinance can be a useful empowerment tool that can transmute women's economic position and power relationships, but only when combined with financial literacy. It concludes that financial literacy is more important than access to credit and should be the focus of all future microfinance.

### **Hypothesis**

H1: MSMEs actors financial literacy is less literate

H2: Islamic Financial Literacy for MSMEs has a positive and significant effect on business development

### **Research Method**

The type of research in this study is field research, with a quantitative descriptive method approach, because the data in this study obtained from the results of direct observation which described systematically and factually. The object in this study was MSMEs in DIY. The types of data used are primary data and secondary data. In this study, the primary data obtained from MSMEs actors in DIY. The data is in the form of

information from the answers to questions, direct interviews, and research observations. Secondary data in this study were taken from journals, which is related to this research such as research from).<sup>27,28</sup>

The population in this study is the MSMEs in the province of Special Region Yogyakarta some 238.619 MSMEs. The sampling technique used in this study was the cluster random sampling technique. The number of samples consisted of 1392 samples from Sleman; Gunung Kidul; Bantul; Kulon Progo, and the City of Yogyakarta. Data collection techniques in this study used a questionnaire. Data analysis techniques are carried out in two stages, including (1) analyzing the financial literacy index; (2) analyze using multiple linear regression analysis. The questionnaire assessment technique in this study used a Likert scale. The range of values used in this study is 1-4, with an SS measuring scale worth 4, S worth 3, TS worth 2, STS worth 1.

### **Financial Literacy Index**

The financial literacy index can be known through several stages, there are: Grouping basic financial literacy variables; Give a score for each variable, namely 1 for agreeing answers and strongly agree. While the answers disagree, strongly disagree, and refuse to answer given a score of 0; Calculate the weight of each variable by using simple weight based as follows (Bumcrot):

$$\text{Simple basic } W_i = 1/N$$

Explanation:

Simple basic  $W_i$  = the weight for each variable using simple weight

$N$  = number of variables

Calculate the financial literacy index in each observation by calculating the number of scores and weights. The overall score is calculated by the arithmetic to mean for basic financial literacy.

### **Multiple Linear Regression Analysis**

The method used to analyze the influence of financial literacy variables (knowledge, beliefs, and skills) on the development of MSMEs in DIY is Ordinary Least Square (OLS). Multiple linear regression method is a data

analysis technique that discusses the relationship between dependent variables with independent variables. Multiple linear regression is a regression in which the dependent variable  $Y$  in this case is the development of MSMEs in DIY connected with more than one independent variable. The independent variables used our knowledge, beliefs, and skills. The estimation equation uses the OLS model<sup>29</sup>:

$$Y_t = a + \beta_1 \text{Ln}x_1 + \beta_2 \text{Ln}x_2 + \beta_3 \text{Ln}x_3 + e$$

explanation:

$Y$  = Development of MSMEs in DIY

$a$  = Constant

$\beta$  = Independent variable regression coefficient

$x_1$  = knowledge

$x_2$  = confidence

$x_3$  = skill

### Discussion

The results of Table 1 show that the sample in this study was 1392 samples. The minimum value for Development of MSMEs ( $y$ ) is 0 and the maximum value is 24, and the average value is 9.63. Meanwhile, the minimum value of knowledge, confidence and skill is 6, 0 and 3, while the maximum value is 24, 37, and 12. Then the average of each variable of knowledge, confidence and skill is 14.11, 6.70 and 7.03. Previously, this research had passed the classical assumption test with the results of multicollinearity tests of each variable is more than 0.1 and VIF values in the three variables are less than 10. This research is free from heteroscedasticity because the significance value ( $p$ -value) of each variable is more than 0.05. Besides that, the variable development of MSMEs has Kolmogorov-Smirnov value of 0.057 with a significance of 0.200, which is more significant than 0.05. It shows that the independent and dependent variables have a normal distribution.

Table 1. Descriptive statistical test results

	N	Minimum	Maximum	Sum	Mean	Std.Deviation
Knowledge	1392	6	24	19646	14.11	4.224
Confidence	1392	0	37	9332	6.70	3.202
Skill	1392	3	12	9788	7.03	2.080
Development of MSMEs	1392	0	24	13402	9.63	7.451
Valid N (listwise)	1392					

The validity test in this study used the Confirmatory Factor Analysis (CFA) method with the help of SPSS 25. The criteria before carrying out factor analysis were the KMO (Keizer-Meyer-Olkin) test, the MSA (Measures of Sampling) test, and Bartlett's test. If the results of  $KMO \geq 0.5$ , then the analysis of items in a dimension is declared valid and feasible to do.<sup>30</sup>

Table 2. KMO, MSA and Bartlett's Test

Test equipment	Test results
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	0.936
Bartlett's Test of Sphericity	Approx. Chi-Square
	Df
	Sig.
	23561,717
	153
	0,000

Source: Data Test Result

Table 3. Indicator Validity Test

Variable	Value of Loading Factor	Information
Know1	0.672	Valid
Know 2	0.706	Valid
Know 3	0.831	Valid
Know 4	0.858	Valid
Know 5	0.765	Valid
Know 6	0.756	Valid
Confidence1	0.882	Valid
Confidence 2	0.918	Valid
Confidence 3	0.869	Valid
Skill1	0.721	Valid
Skill 2	0.844	Valid

Skill 3	0.830	Valid
Development 1	0.958	Valid
Development 2	0.947	Valid
Development 3	0.969	Valid
Development 4	0.950	Valid
Development 5	0.973	Valid
Development 6	0.945	Valid

Source: Data Test Results

In table 3, it can be seen that all statement indicators can be extracted correctly and validly because each indicator has a loading value greater than 0.5 so that it is suitable to be used for the subsequent analysis.

### Reliability Test

If the reliability in this research uses the Cronbach's Alpha test, a research instrument can be said to be reliable if it has a value of  $\geq 0.60$ . If the value of Cronbach's Alpha is getting closer to number 1, the better the measurement of the instrument.<sup>31</sup>

Table 4. Reliability Test Results

Variable	Cronbach's Alpha	Information
Knowledge	0,792	Reliable
Confidence	0.858	Reliable
Skills	0,825	Reliable
Development of MSMEs	0.822	Reliable

Source: Data Results

Based on table 4 the value of Cronbach's Alpha  $> 0.60$  and close to 1, it can be said that all variables have good reliability.

### Hypothesis Testing

#### T-test

Table 5. Test Results t

Free variable	B	t count	Sign t	Information
Constant	-5,056	-7,925	0,000	Significant
Knowledge	0.401	7,844	0,000	Significant
Confidence	0.759	11,920	0,000	Significant
Skills	0.559	6.052	0,000	Significant

Dependent variable: Development of MSMEs  
Source: Primary data processed (2019)

Based on table 5 the significant value of knowledge and belief variables is smaller than 0.05 ( $0,000 < 0.05$ ) which indicates that the knowledge and beliefs of MSME players regarding Islamic financial institutions have a significant effect on the development of their MSMEs. Similar to the skill variable, which has a significant value smaller than 0.05, which means that the skills in managing finance have a significant effect on the development of MSMEs.

### Determination Coefficient (R square)

Table 7. Coefficient of Determination

Model	F	Sign F	Information
Regression	261,592	0,000	Significant

Dependent variable: Development of MSMEs Predictors: (Constant), Skills, Confidence, Knowledge Source: Primary data processed (2019)

Based on table 7, the R square value is 0.361. This means that the independent variables simultaneously have an influence of 36.1% on the development of MSMEs. While other variables outside the research model explain the remaining 63.9%, it can be concluded that the knowledge and beliefs of the community regarding sharia financial institutions as well as skills in managing finances affect the development of MSMEs by 36.1%. Based on the results of the data above, the regression equation is as follows:

$$PU = -5,056 + 0.401 P + 0.759 KEY + 0.559 KET + e$$

Based on the regression equation above, it can interpret as follows: the regression coefficient for knowledge is positive 0.401. It shows in case increasing one unit on the knowledge of the development of SMEs will increase by 0.401. The regression coefficient for confidence is positive at 0.759. This shows that if there is an increase in one unit in the belief, the development of MSMEs will increase by 0.759. The regression coefficient for skills is positive at 0.559. This shows that if there is an increase in one unit in the belief, the development of MSMEs will increase by 0.559.

**First Hypothesis: MSMEs Actors' Financial Literacy Is Less Literate.**  
**The Level of MSMEs Financial Literacy and The Classification of Literacy Using The Financial Literacy Index**

Financial literacy is a measure of understanding financial concepts. Financial literacy is seen from one's ability in financial management to make long-term and short-term decisions. Alternatively, in other words, financial literacy can be interpreted as the ability to effectively evaluate and manage finances in achieving good finance.<sup>32</sup> Conceptually financial literacy has two dimensions, namely understanding financial knowledge in theory and using financial knowledge that is owned by the application.

According to the Financial Services Authority, Islamic financial literacy is classified into four types. First, Well Literate: have trust and understanding of the risks, benefits, rights and obligations and have the skills to utilize the financial products and services they use. Second, Sufficient Literate: do not yet have the skills to utilize the financial products and services they use but already have the trust and understanding of the financial institutions' risks, benefits, rights and obligations. Third, Less Literate: only have an understanding of financial institution products and services. Fourth, Not Literate: do not have the trust and understanding of financial institutions.<sup>33</sup>

In this study, the researchers used the financial literacy index (FLI) by the OJK to determine the classification of the level of Islamic financial literacy of MSMEs in DIY. This study focuses on the basic financial literacy considering the object of this research is micro-scale entrepreneurs. The researcher measures FLI with simple weight method where each variable is given the same weight as the formula.

$$\text{Simple\_basic\_w1} = 1/N$$
 (The number of basic financial literacy variables)

$$\text{Simple\_basic\_w1} = 1/12 = 0,0833$$

Next, calculate the financial literacy index in each variable and then calculate the number of scores and weights. The overall score is calculated by the arithmetic mean for basic financial literacy. As for the basic literacy level, the researchers chose 12 indicators in the table below as follows:

Table 8. Indicators of Community Islamic Financial Literacy Rate Assessment

No	Indicator	Basic Financial Literacy	Weight	% Agree & strongly agree
1	Knowledge	Knowing the existence of Islamic financial institutions in Yogyakarta	0.083333	6.458.333
2		Can recommend someone to use the products and services of sharia financial institutions in Yogyakarta	0.083333	3.175.287
3		Use products and services provided by Islamic financial institutions in Yogyakarta	0.083333	4.454.023
4		Can choose Islamic financial institutions in Yogyakarta according to my needs	0.083333	433.908
5		Can distinguish Islamic financial institutions from conventional financial institutions	0.083333	4.051.724
6		Islamic financial institutions do not use interest systems but are in accordance with sharia	0.083333	3.637.671
7	Confidence	Believe in the performance of Islamic financial institutions in Yogyakarta	0.083333	476.259
8		Believe in the quality and service of Islamic financial institutions in Yogyakarta because they are in accordance with what is offered	0.083333	4.382.184
9		Believe in continuing to use the services and products of sharia financial institutions in Yogyakarta because they meet my expectations	0.083333	3.527.299
10	Skills	Have the ability to manage money well	0.083333	5.366.379
11		Have financial planning for the future of my business through financing and products of Islamic financial institutions	0.083333	4.037.356
12		Have the right way to solve financial problems by financing in Islamic financial institutions (additional capital)	0.8333	3.393.242
Financial Literacy Index				4.298.764

Source: Data processed

The determination of the financial literacy index category is divided into three categories, namely<sup>34</sup>: 1) Financial literacy index lower than or equal to 60 is categorized as a low financial literacy index ( $0 \leq \text{FLI} \leq 60$ ); 2) The financial literacy index is higher than 60 and less than or equal to 80 said to be a moderate or moderate financial literacy index ( $60 < \text{FLI} \leq 80$ ); 3) Financial literacy index higher than 80 is categorized as a high financial literacy index ( $\text{FLI} > 80$ ). So based on the results of FLI calculations, the level of MSME financial literacy in DIY with the basic

financial literacy classification is at the index of 42.99 which means it is in a low category.

The level of FLI above also illustrates that the ability to use knowledge, beliefs, and skills to achieve good financial behavior on average has not even touched the figure of 50%. This is where the level of Islamic financial literacy by MSMEs is still limited to understanding the existence of Islamic financial institutions without being accompanied by a significant contribution to the use of LKS products and services to develop their business. In terms of variations in the use of MSME products and services, they are also not diversified and have not used products and services provided by Islamic financial institutions precisely such as the use of Islamic bank savings and deposit products as well as Islamic non-bank financial institutions (NBFi) products.

Based on the magnitude of the basic financial literacy index of the MSMEs in Yogyakarta, it is still limited to having an understanding of financial institutions. Understanding is still limited to knowledge of financial products and services but has not been accompanied by risks, benefits, rights, and obligations related to financial services used. Besides that, MSMEs in DIY is still less skilled in utilizing the financial products and services they use to improve their businesses. The low level of financial literacy is proven by low business development, which only reached an average of 30%.

Table 9. Assessment of MSMEs Business Development

No	Indicator	Basic Financial Literacy	% agree & strongly agree
1	Development of MSMEs	The amount of my business sales has increased	30.96264
2		Can innovate in making silver products	25.6455
3		Can expand my product sales more broadly.	30.55356
4		My business products are able to compete with other business products	26.14943
5		My business income is increasing	30.74713
6		Can do financing (additional capital) in Islamic financial institutions in Yogyakarta	29.5977
Average			28,94

Source: Data processed

In a survey conducted by the Financial Services Authority (OJK) in 2019, it was explained that only 38,03 percent of the Indonesian people were financially literate. While for DIY region touches the figure of 58.53 percent of the well literate people. This number has also seen an increase in public financial understanding (literacy) by 8.33 percent during 2016-2019. However, the level of Islamic financial literacy is only 8.93 percent, in other words only 9 out of 100 Indonesian adults are familiar with Islamic financial products. This literacy level is much lower than the national average financial literacy level of 38 percent.<sup>35</sup> The cause of low financial literacy is actually not only a matter of financial knowledge and skills, but also the ability to apply them.<sup>36</sup>

Based on several literature reviews, the key aspect related to financial literacy among MSMEs is the relationship between the actors' personal socio-cultural backgrounds, including gender<sup>37</sup> and place of origin.<sup>38</sup> Apart from personal factors, other factors that also affect the level of financial literacy are family factors. This is because families who are from the upper middle class will have more financial support in studying financial problems formally and informally.<sup>39</sup>

So that financial literacy needs to be pursued and improved. Low financial literacy can have an impact on an uncomfortable retirement. Efforts that need to be made to improve financial literacy, especially Islamic financial literacy among MSMEs are educational programs. Educational programs are useful for increasing financial understanding where the impact can help increase awareness of saving and making financial decisions. It is hoped that MSME financial activities will be more effective in the future.<sup>40</sup>

## **Second Hypothesis: Islamic financial literacy of MSMEs has a positive and significant effect on business development.**

### **Effects Of Islamic Financial Literacy on Business Development**

Islamic finance literacy for MSMEs influences business development. Based on table 6, literacy has a significance value of 0,000 which is smaller than 0.05 ( $0,000 < 0,05$ ). This indicates that literacy consisting of knowledge, beliefs, and skills together (simultaneously) has a significant

effect on business development. Literacy rates have a positive and significant influence on business development. This can be interpreted that the higher the level of Islamic financial literacy of MSMEs, the greater the development of their business. In general, the research states that if MSME actors have adequate sharia financial literacy, the business and financial decisions taken will improve over time. MSME actors are also able to have the skills to overcome financial problems. So, MSME actors will be able to make the business grow and be sustainable in the long term.

Functional financial literacy enables entrepreneurs (MSME players) to be able to use financial capabilities in making the right decisions for the businesses they run (Muraga and John, 2015). Business managers are closely related to strategic financial decision making related to the success of achieving business goals and sustainability.<sup>41</sup> The results of this study are in line with the research conducted by.<sup>42</sup> There is a meaningful relationship between financial literacy and company performance. This relationship indicates that companies that have functional financial literacy will be able to identify and respond to changes in the business, economic, and financial climate. The results of the study also support previous research conducted by Aribawa which states that there is a significant effect of financial literacy on the performance and sustainability of MSMEs. Thus, decisions made by capable entrepreneurs create the best and innovative solutions for improving business performance and sustainability.<sup>43</sup> Based on table 5, it can be seen that the knowledge of MSME actors has a positive and significant influence on business development. The knowledge variable has a coefficient marked positive with a value of 0.401. The significance value of the knowledge variable is 0,000, which is smaller than 0.05. Thus, the knowledge of MSME actors has a positive and significant influence on business development.

Knowledge has a positive and significant effect on the development of MSMEs. The higher the knowledge of MSMEs, the more the development of their businesses will increase. Knowledge here includes six indicators. Mostly, as much as 64.83%, MSMEs players already knew about the existence of Islamic financial institutions in the Special Region

of Yogyakarta. Not only knowing, but MSME players have also used products and services offered by Islamic financial institutions. MSME players can choose financial institutions that suit their needs. Some MSMEs players can provide recommendations to others to use Islamic financial institutions products and services. MSME players can distinguish between Islamic financial institutions and conventional financial institutions. The MSME players can ensure that Islamic financial institutions do not use the interest system but use the sharia system. Good knowledge of Islamic finance, business, and financial decisions created by MSMEs will lead to business development that improves overtime. MSMEs players can share knowledge about Islamic financial institutions to be able to develop their business.

Based on table 5, it can be seen that the beliefs of MSMEs actors have a positive and significant influence on business development. Confidence variables have coefficients marked positive with a value of 0.759. The significance value of the knowledge variable is 0,000, which is smaller than 0.05. Thus, the confidence of MSMEs actors has a positive and significant influence on business development. Confidence in MSMEs has a positive and significant effect on business development. The higher the confidence of MSMEs actors, the more the development of their business will increase. Beliefs here include indicators of product trust, quality suitability, and confidence in service. MSMEs actors have a sense of trust in the performance of Islamic financial institutions. MSMEs players also have a sense of trust in the quality of products and services offered by Islamic financial institutions. MSMEs actors have confidence in the services of products and services of Islamic financial institutions because they are under what is expected by MSMEs actors.

Based on table 5, it can be seen that the skills of MSMEs actors have a positive and significant influence on business development. The skill variable has a positive coefficient with a value of 0.559. The significance value of the knowledge variable is 0,000, which is smaller than 0.05. Thus, the skills of MSMEs actors have a positive and significant influence on business development. Skills have a positive and significant effect on business development. The higher the level of skills of MSMEs, the more

the development of their business will also increase. Confidence or competence here includes several indicators as follows: financial management ability, financial planning ability, and ability to solve financial problems. Entrepreneurs who can manage finances well will have bookkeeping for every financial transaction carried out. The ability to manage finances can be seen from the ability to budget, record cash inflows (income), and cash outflows (expenses). MSMEs who can manage finances well can separate them from business finance with their household finances. However, documentation of receipts has not been done well. The ability to manage finances owned by MSMEs players will be able to develop their business.

MSMEs actors have the ability to plan finances well for the continuity of their business. The MSMEs actors need to plan the budget for their business. Business actors can use the budget as a material for business evaluation. In terms of financial planning, proper documentation is also needed, including revenue and expenditure. Proper also needed, including revenue and expenditure. Proper documentation can be taken into consideration when MSMEs players will develop their business through financing in Islamic financial institutions. Functional literacy includes financial planning skills. MSMEs players can plan business development through financing products in Islamic financial institutions.

MSMEs managers can solve problems, find the right solution to overcome the financial problems of their business. To overcome financial problems, for example, by applying for financing (additional capital) in Islamic institutions. The ability to solve problems is needed so that business people have innovative and well-directed solutions to improve business performance and sustainability. Excellent management skills will make MSMEs players able to make the right decisions and strategies to develop their business.

## **CONCLUSION**

MSMEs are one part of supporting a country's economy. The existence of MSMEs can contribute to efforts to alleviate poverty through job creation. One aspect that must not escape the attention in the field of

education and expertise is the level of public financial literacy whose activities are inseparable from financial institutions.

Success in developing MSME business actors is supported by various factors, including business financial management. The results showed that the literacy rate of DIY MSMEs was in the less literate category. Islamic financial literacy for MSME players has a positive and significant influence on business development. The effect on business development is positive and significant, with an effect of 36.1. Seeing the importance of the influence of financial literacy on the development of MSMEs businesses, efforts are needed to encourage MSMEs actors who are still less literate to be well literate. Increasing financial literacy will help MSMEs in making appropriate management and financial decisions to develop their businesses.

## ENDNOTES

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