Financial Factors Determinant to MSME Performance Evident from City and Tegal Regency

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Abstract. This study aims to examine financial management factors that influence the performance of Micro, Small, and Medium Enterprises (MSMEs) in City and Tegal Regency. The factors tested include the use of accounting information system, the choice of capital structure, and adoption of capital budgeting methods. The research employs a quantitative approach with a population of 880 respondents and purposive sampling of 100 participants. Data were collected through surveys using a Likert-scale questionnaire and analyzed with Partial Least Squares (PLS) application. The findings reveal that in City and Tegal Regency, accounting information system and capital structure positively influence MSME performance, whereas capital budgeting has no significant effect. The implication of this study is that MSME in City and Tegal Regency should improve the usage of accounting information system and optimize capital structure selection to enhance performance. Findings provide MSME practitioners with insights into which financial factors could affect their business outcomes.

Keywords: accounting information system, capital structure, capital budgeting, msme performance

1 Introduction

Micro, Small, and Medium Enterprises (MSMEs) are recognized as a vital pillar of Indonesia's economic development and are acknowledged as a driving force of the national economy. As a major contributor to the economy, the government consistently supports MSME growth to absorb labor, enhance community welfare, and develop local enterprises. According to data from the Coordinating Ministry for Economic Affairs in 2023, MSMEs play a crucial role in Indonesia's economic trajectory. MSMEs contribute 61.07% to the national Gross Domestic Product (GDP) and provide employment for 117 million people, accounting for 97% of the total workforce. In addition, MSMEs attracted 92% of total investment in the first semester of 2023. The Ministry of Cooperatives and MSMEs recorded 65.5 million MSMEs, representing 96% of all business entities in Indonesia. This remarkable figure underscores the central role of MSMEs in the national economy. In terms of revenue, the MSME sector reached approximately IDR 8,573 trillion in 2023. Historically, MSMEs have also demonstrated resilience during economic crises, including the 2008 global financial crisis, and even earlier during the 1998 Asian financial crisis, where their performance exceeded that of large firms [1] [2].

Tegal City and Regency, historically known as port regions, have long hosted diverse industries, notably the metal industry and the culinary specialty of *tahu aci* (Banjaran tofu). Over time, various other industries have developed in the region, paralleling the growth of other Indonesian cities. According to the official Talang Village website, the Tegal metal industry

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dates back to the Dutch colonial era, established to supply equipment and spare parts for sugar mills, shipbuilding, railways, and textiles. Historical evidence includes the founding of NV Barat Metal Factory in 1918, which continues to operate until now as PT Barata. This early metal industry can be regarded as a precursor to the rise of MSMEs in Tegal. These industries remain active today, shaping the identity of both City and Tegal Regency, with the service sector as the most dominant. Alongside this, other sectors such as the renowned Tegal satay, sheep farmings, *kerupuk Antor* crackers, Bogares peanuts, and the Guci hot springs tourism center have fostered the development of MSME complementary businesses.

The essential role of MSMEs in improving welfare and supporting national development has positively influenced government policy. Regulations, such as Law No. 20 of 2008 on MSMEs, are aimed at promoting sectoral growth. However, as enterprises ranging from micro to medium scale, often established through modest initiatives and managed by owners with limited financial literacy, MSMEs face significant challenges in achieving growth potential. These include the adoption of accounting information systems (computer-based book-keeping and applications), financial management, and the utilization of digital technology.

The most recent study on MSME performance in Tegal City and Regency, to the author's knowledge, this study addressed financial literacy and management issues, but focused solely on the metal industry. This study, which covered eight key industrial sectors, is expected to better reflect the actual state of MSME financial management practices, particularly in the three factors examined: the use of computer accounting software, capital structure selection, and capital budgeting.

2 Literature Review and Hypotheses Development

2.1 Accounting Information Systems (AIS)

Automated data systems, commonly referred to as Accounting Information Systems (AIS), are computer-based tools that process financial information to support enhanced decision-making [5]. For businesses to generate reliable and useful information from these systems, a clear strategy for managing and applying information technology is essential. This facilitates the production of high-quality information that aids daily operations and guides executives in making sound business decisions [6]. Rapid, accurate, and reliable accounting systems - combined with strong corporate governance - significantly improve firm performance [7].

Business success largely depends on the effectiveness of AIS. Without robust AIS, organizations may struggle to monitor financial transactions with customers and suppliers, evaluate performance, or forecast future outcomes. [8] argue that AIS directly supports business success by providing a foundation for managerial decision-making and performance evaluation. Accounting and financial reports are vital across functional areas - marketing, operations, management, or IT - as they convey essential quantitative information. Empirical studies, including [9], confirm the positive influence of AIS on MSME performance.

Hypothesis 1: The implementation of Accounting Information Systems positively affects MSME performance.

2.2 Capital Structure

Capital structure plays a pivotal role in shaping a company's financial strategy and is a key responsibility of financial managers, as profitability is strongly influenced by financing decisions [10]. Prior research indicates that MSMEs often rely on short-term loans to sustain operations. Capital structure, defined as the mix of debt and equity used to finance business activities, is closely tied to growth potential [11].

Several studies [12] [13] found that capital structure has a positive and significant effect on financial performance. An optimal capital structure enhances business performance by balancing short and long-term debt relative to total assets, minimizing financing costs while maximizing asset utilization. [14] highlights that capital structure serves as an indicator of managerial efficiency, particularly in cost management. This is further supported by [15] and [16] who found direct links between capital structure and MSME performance.

Hypothesis 2: The choice of capital structure positively affects MSME performance.

2.3 Capital Budgeting

Research on capital budgeting practices among MSMEs has been conducted in both developed and developing countries. [17] notes that MSMEs in developed economies often prefer simpler methods, such as the Payback Period (PBP). In contrast, while capital budgeting has been extensively applied in large firms across developing nations, it remains underutilized among average MSMEs.

Capital budgeting is vital for long-term and sustainable planning [18]. Before launching a business, firms require clear strategies to guide investment decisions, which must be objective and well-informed [19]. These decisions help identify assets that generate future revenue streams. Capital budgeting tools assist in evaluating viable investment alternatives while mitigating financial missteps. Sound financial management enables business owners to track progress and assess performance effectively. Overall, capital budgeting is a complex decision-making process involving analysis, evaluation, and selection of investment options expected to yield long-term benefits [20] [21].

Several studies across different contexts have highlighted the link between capital budgeting and MSME financial performance. For instance, [22] and [23] both confirmed a significant positive correlation between capital budgeting practices and MSME performance. In general, better implementation of capital budgeting techniques enhances MSME financial outcomes.

Hypothesis 3: Capital budgeting positively affects MSME performance.

2.4 Financial Management Practices and Performance Measurement

Financial management encompasses the supervision and control of a firm's financial resources. Financial management practices as including planning, control, accounting, cash flow management, capital budgeting, and working capital management. Similarly, [24] describe it as a set of standardized procedures aimed at improving financial tasks such as accounting, reporting, and budgeting to enhance organizational efficiency. Accounting involves recording financial transactions and preparing reports to support business decisions, while capital structure focuses on balancing debt and equity financing. Capital budgeting concerns long-term asset management by planning investments and assessing returns. [4] regard financial management as activities related to fund allocation decisions, while [3] highlight four key components: working capital management, financial accounting and reporting, capital structure, and capital budgeting.

Performance measurement is critical for businesses to evaluate success and ensure long-term sustainability [25]. Corporate performance refers to outcomes achieved within a specific period based on established benchmarks, reflecting the empirical condition of a firm through agreed-upon indicators. Performance is defined as the extent to which a company aligns with market and financial goals.

MSME performance can be assessed quantitatively - through indicators such as efficiency, financial outcomes, production levels, customer base, market share, profitability, and liquidity [26][27] - or qualitatively, by evaluating goal achievement, leadership, employee behavior, customer satisfaction, and innovation [28]. [29] further identify 14 performance indicators for MSMEs, including reputation, profitability, productivity, product quality, and operational effectiveness.

2.5. Conceptual Framework

Based on the conceptual model below, this study identifies three independent variables and one dependent variable drawn from tenty indicators (five items per variable). These indicators include: accounting information systems, capital structure (financing), and capital budgeting practices [24] and MSME's performance it self. These practices are expected to be adopted and implemented by MSMEs in City and Tegal Regency to ensure efficient business operations and, ultimately, improved performance.

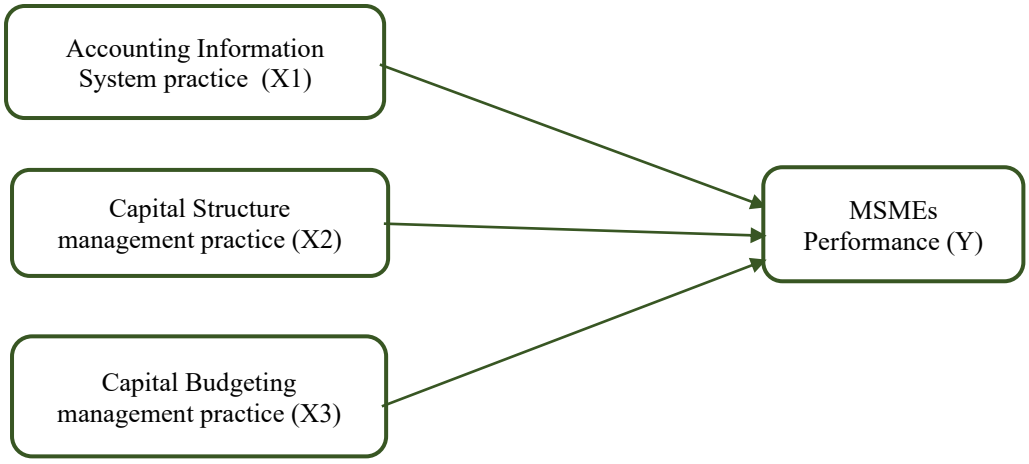

Fig 1. Conceptual Framework

3 Research Method

3.1. Type of Research

This study employs a quantitative research design, aiming to test relationships among variables by evaluating the proposed hypotheses. The objective is to generate findings that can be generalized to a broader population. The research is also classified as survey-based, as it objectively reports field realities that are observable and measurable. Primary data were

collected and subsequently analyzed to determine causal relationships among variables using quantitative parameters through cross-sectional and correlational approaches.

3.2. Sample Characteristics and Industry Sector Coverage

This study draws on data from eight industrial sectors that broadly represent the MSME of City and Tegal Regency landscape, they are: culinary, livestock, agriculture, crafts (metal and non-metal), fashion, services, tourism and trade. Microenterprises were predominantly represented by the culinary sector, where owners often operate the business themselves with occasional assistance from family members or a single employee. Medium-sized enterprises were more prominent in the service sector, typically employing more than five workers.

3.3. Data Collection

According to the 2024 records of the Tegal Regency Office of Cooperatives and MSMEs, there are 117,000 registered MSMEs and about 880 enterprises of selected most dominant sectors as mentioned previciously. The sample size was determined using Slovin's formula, with confidence level of 90% (margin error 0,1), resulting in 100 MSMEs as the unit of analysis. [30] noted that experts generally agree that a minimum of 100 respondents is sufficient for MSME studies.
Slovin formula :

$$n = \frac{N}{1 + Ne^2}$$

$$n = \frac{880}{1 + 880.(0,1)^2}$$

$$n = \frac{880}{1 + 880.0,01} = \frac{880}{9,8} = 89,8$$

Cluster sampling was applied, covering eight business sectors: food and beverages, metal and non-metal crafts, agriculture, livestock, fashion, tourism, trade/retail, and other service sectors. Data were collected through questionnaires based on a five-point Likert scale, ranging from "Strongly Disagree" to "Strongly Agree," with five items provided for each variable indicator.

Table 1. Construct and Indicator

Construct	Indicators
(X1) Accounting Information System	SIA1: Usefulness of AIS program/application
	SIA2: Easy of use of AIS program/application
	SIA3: Efficiency of AIS program/application
	SIA4: Information quality from AIS program/application
	SIA5: Reliability of AIS program/application
(X2) Capital Structure [38]	SM1: Source of fund of initial capital
	SM2: Source of fund for operational and business development
	SM3: Interest rate of outside loans

	SM4: Owned physical asset
	SM5: Ability to pay debts
(X3) **Capital Budgeting** [39]	AM1: The importance of capital budgeting/allocation
	AM2: Capital budgeting methods adoption
	AM3: Benefits of capital budgeting for business operations
	AM4: Benefits of capital budgeting from business planning
	AM5: Benefit of capital budgeting for revenue projections
(Y) **MSME's Performance**	KU1: Sales growth
	KU2: Capital growth
	KU3: Workforce growth
	KU4: Market growth
	KU5: Profit growth

3.3. Measurement

The study examines the extent to which three financial management factors - accounting information systems, capital structure, and capital budgeting - determine MSME performance improvement. For statistical analysis, hypotheses were tested using Structural Equation Modeling (PLS-SEM) with the SmartPLS 3.2.9 software.

According to [31], PLS is a robust analytical method as it does not rely on strict distributional assumptions. Within SmartPLS, two models are assessed: the outer model and the inner model. The outer model describes relationships between latent variables and their indicators, while the inner model (structural model) represents relationships among latent variables themselves. The outer model evaluates indicator validity and reliability, whereas the inner model measures relationships among variables through path coefficients and model fit indices such as R^2, f^2, SRMR, and NFI.

4. Results and Discussion

4.1. Measurement Model Evaluation

The quality of constructs was assessed through an evaluation of the measurement model (see Figure 2). The process began with assessing factor loadings, followed by an examination of construct validity and reliability. Factor loadings were evaluated against recommended thresholds: a minimum of 0.40, ensuring that each construct captured at least 50% of indicator variance. Cronbach's alpha, rho_A, and composite reliability values exceeding 0.70 further indicated strong internal consistency.

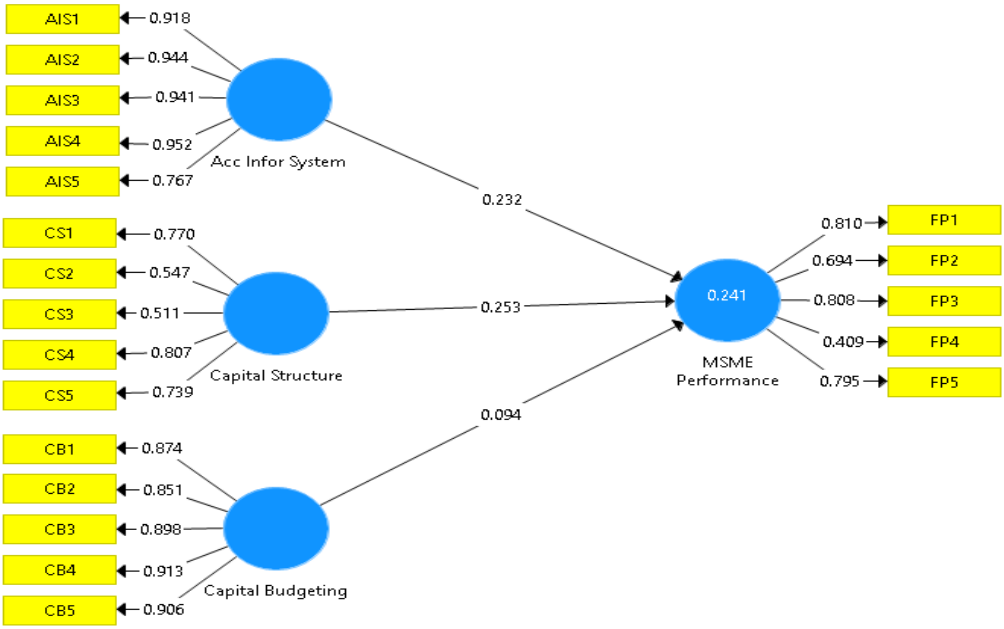

Fig 2. Outer Loading Score

4.2. Validity and Reliability Analysis

4.2.1 Convergent Validity

Most constructs reported Average Variance Extracted (AVE) values above 0.50, supporting convergent validity. However, the constructs of Capital Structure presented slightly lower AVE values, suggesting that some indicators did not fully capture the underlying latent variables.

4.2.2 Discriminant Validity

Discriminant validity is employed to demonstrate that respondents were not confused in answering questionnaire items across different latent variables. Discriminant validity is achieved when the Average Variance Extracted (AVE) value for a construct is greater than its correlations with other constructs. As shown in Table 2, discriminant validity was confirmed through the Fornell-Larcker criterion, where the square root of the AVE for each construct exceeded its correlations with other constructs. Additional support was provided by cross-loading analysis, in which all indicators exhibited higher loadings on their respective constructs than on others. This validity was further assessed using the Heterotrait-Monotrait (HTMT) ratio, with recommended threshold values below 0.90. This ensures that reflective constructs are most strongly associated with their own indicators rather than with those of different constructs. Collectively, these results confirm that the measurement model appropriately captures the intended constructs and does not, even inadvertently, measure unrelated concepts.

Table 2. Discriminant Validity – Fornell & Larcker Criterion

	Acc Infor System	Capital Budgeting	Capital Structure	SMEs Performance
Acc Infor System	**0,907**			
Capital Budgeting	0,676	**0,889**		
Capital Structure	0,507	0,530	**0,685**	
SMEs Performance	0,414	0,370	0,420	**0,725**

Discriminant validity was confirmed using the Fornell-Larcker criterion, as the square root of AVE for each construct exceeded its correlations with other constructs. Cross-loading analysis further supported this finding, with all indicators loading higher on their respective constructs than on others. The Heterotrait-Monotrait (HTMT) ratio values were below the recommended threshold of 0.90, ensuring that reflective constructs exhibited stronger associations with their own indicators than with those of other constructs.

Table 3. Validity and Reliability Analysis

Constructs	Indicators	Loading	Cronbach Alpha	Composite Reliability (rho_a)	Average Variance Extracted AVE)
AIS (Accounting Information System)	AIS_1	0,918	0,945	0,959	0,823
	AIS_2	0,944			
	AIS_3	0,941			
	AIS_4	0,952			
	AIS_5	0,767			
CS (Capital Structure)	CS_1	0,770	0,718	0,811	0,470
	CS_2	0,547			
	CS_3	0,511			
	CS_4	0,807			
	CS_5	0,739			
CB (Capital Budgeting	CB_1	0,874	0,934	0,950	0,790
	CB_2	0,851			
	CB_3	0,898			
	CB_4	0,913			
	CB_5	0,906			
SME_P (SMEs Performance)	SME_P_1	0,810	0,751	0,837	0,518
	SME_P_2	0,694			
	SME_P_3	0,808			
	SME_P_4	0,409			
	SME_P_5	0,795			

4.2.3 Cronbach Alpha Reliability

Cronbach's alpha is categorized as follows: 0.81–1.00 (highly reliable), 0.61–0.80 (reliable), 0.42–0.60 (moderately reliable), 0.21–0.41 (unreliable), and 0.00–0.20 (very unreliable). Based on this classification, all constructs demonstrated in Tabel 3 are acceptable reliability, with Cronbach's alpha values exceeding the recommended 0.70 threshold.

4.2.4 Composite Reliability

Table 3 shows that all constructs meet satisfactory internal reliability consistency with composite reliability values exceeding the recommended threshold of 0.7. Table 3 also indicates that all indicators have high internal consistency in their latent variables. Composite reliability values for all constructs also surpassed the 0.70 benchmark, confirming internal consistency across indicators within each latent variable.

4.3 Structural Model Evaluation (Inner Model)

Table 4. R-Square dan F-Square

Predictor Variable	SMEs Performance (F^2)	R Square	R Square Adjusted
Accounting Information System	**0.036**		
Capital Budgeting	**0.006**		
Capital Structure	**0.057**		
Total R^2 for SMEs Performance		**0.241**	**0.217**

4.3.1 R^2 (Coefficient of Determination)

The R^2 value for MSME Performance was 0.241, indicating that the independent variables explained 24.1% of variance in MSME performance, while the remainder was attributable to factors beyond the scope of this study. This represents a moderate level of explanatory power.

4.3.2 F^2 (Effect Size):

Criteria (0.02 = small, 0.15 = medium, 0.35 = large), the f^2 analysis revealed that only Accounting Information Systems and Capital Structure exerted positive effects. Capital Budgeting exhibited no significant or positive impact.

Tabel 5. Path Coefficient dan P Value

Path	Coeffi-cient	T-stat	p-value	Significance
Acc Info System → SME Performance	**0.198**	1.740	**0.082**	Significant
Capital Structure → SME Performance	**0.197**	1.683	**0.093**	Significant
Capital Budgeting → SME Performance	**0.037**	0.212	**0.832**	Not Significant

4.3.3 Path Coefficients:

The path coefficient results demonstrated that Accounting Information Systems (β = 0.198) and Capital Structure (β = 0.197) had positive and meaningful influences on MSME performance. Conversely, Capital Budgeting, Working Capital, and FinTech showed no statistically significant effects.

4.3.4 P-Values:

The p-values for Accounting Information Systems (p = 0.082) and Capital Structure (p = 0.093) were significant at the 0.10 level, supporting the corresponding hypotheses. However, the remaining three variables failed to achieve statistical significance.

4.4. Fit Model Analysis

This tests how well this model fits the data. The SmartPLS application uses these indicators as below:

a. SRMR (Standardized Root Mean Square Residual):
Acceptable SRMR is < 0.08 and some say < 0.10 is tolerable. The result for SRMR score are 0.110, slightly above threshold, indicates the model fit is marginal.

b. Chi-Square:
The Chi-Square score is 404, 739, shows a lower result represents a better comformity of the model to the data, even this cannot be used alone to judge fitness, because in PLS-SEM it is not the main indicator.

c. NFI (Normed Fit Index):
Acceptable NFI is ≥ 0.90 and good NFI is > 0.95. The NFI score is 0.760 indicate a poor fit, but also this result is not the main indicator in PLS-SEM.

Tabel 6. Summary of Model Fit

Indicator	Value	Interpretation
SRMR	0.110	Slightly above threshold (weak)
Chi Square	404,739	Slightly can explain 40,5% of data varians
NFI	0.760	Below standard (poor fit)

4.5. Discussion

The findings provide critical insights into the role of financial and technological factors in shaping MSME performance. Among the five variables examined, only Accounting Information Systems (AIS) and Capital Structure demonstrated significant positive effects.

1. *Hypothesis 1:* The positive impact of AIS highlights its essential role in providing timely and accurate financial data, thereby supporting managerial decision-making and strategic planning. This aligns with prior studies emphasizing the importance of reliable AIS for organizational performance [32] [33] [34].

2. *Hypothesis 2:* Capital Structure also had a modest yet significant positive effect, underscoring the importance of balancing equity and debt financing. An optimal capital mix reduces financing costs, enhances investment efficiency, and mitigates risks. These results corroborate findings from [35], [13], and [12].
3. *Hypothesis 3:* Capital Budgeting was not supported, as it showed no significant impact on MSME performance ($\beta = 0.037$, $t = 0.212$, $p = 0.832$). This aligns with [36], who also found no significant link. The weak influence may be attributed to informal or intuitive investment evaluations in MSMEs, where formal budgeting methods are seldom applied [37].

Overall, the results suggest that while AIS and Capital Structure are critical performance drivers, Capital Budgeting adoption may not directly influence MSME performance in this studied context.

5. Conclusion and Recommendations

5.1 Conclusion

This study concludes that among the various internal financial management factors examined in MSMEs, Accounting Information Systems (AIS) and Capital Structure emerge as the primary drivers of performance. The findings underscore the importance for MSMEs to invest in reliable digital financial reporting practices and to carefully manage financing strategies in order to sustain growth and competitiveness.

Although Capital Budgeting is recognized as an essential aspect of financial management, its influence on performance appears either indirect or context-dependent. Future research may explore moderating factors such as firm size, industry type, or technological readiness to gain a deeper understanding of this relationship.

5.2 Recommendations

1. *Prioritize the Implementation of Reliable Accounting Information Systems*
   MSMEs should invest in integrated accounting systems that are user-friendly and capable of producing timely and accurate financial reports. These systems enhance decision-making, increase transparency, and enable businesses to access funding opportunities more efficiently.
2. *Optimize Capital Structure for Long-Term Growth.*
   MSMEs should strive for a balanced mix of equity and debt financing. Overreliance on one financing source increases financial risk or underutilization of resources. Well-planned capital structures enhance financial flexibility and build investor confidence.
3. *Strengthen Awareness of Financial Management Practices in Business Operations*
   Although capital budgeting did not demonstrate a direct effect on performance, it remains an important managerial practice. MSMEs should be encouraged to adopt even the simplest capital budgeting techniques to improve business planning and investment decisions.
4. *Improve Financial Literacy and Strategic Planning*
   Enhancing financial literacy among MSME owners and practitioners is crucial. Stronger financial knowledge enables them to interpret financial data effectively, leading to more strategic decisions and improved overall performance.

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