



A New Framework for Amplifying Business Performance of SMEs in Riau Province through Digital Finance and Financial Literacy

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Abstract. The development of Small and Medium Enterprises (SMEs) plays a pivotal role in the Indonesian economy, particularly within Riau Province. These SMEs not only serve as significant sources of employment but also act as drivers for substantial economic expansion. Nonetheless, despite their substantial potential, several critical challenges impede the progress of SMEs in this region. Firstly, SMEs in Riau Province have encountered a concerning decline in profitability, compelling many entrepreneurs to seek survival strategies amid intensifying competition. Adapting their business strategies to enhance performance and viability becomes imperative. Secondly, the adoption of digital finance within SMEs faces obstacles, as numerous businesses are in the early stages of comprehending and integrating computer and internet technologies into their operations. A proactive approach is required to facilitate SMEs in understanding and embracing digital solutions. Thirdly, there is a pressing need to enhance financial literacy, especially concerning microfinance institutions and Financial Technology (FinTech) in Riau Province. A better grasp of financial principles, access to innovative financial services, and prudent financial management are fundamental to bolstering sustainable SME growth. This research endeavors to construct an integrated framework to address these challenges comprehensively. It explores the potential impact of digital finance adoption and improved financial literacy on enhancing SMEs performance in Riau Province. The method used in this research is descriptive-qualitative based on relevant literature. Through analysis, it can provide valuable insights for governments, financial institutions, and SMEs, thereby encouraging sustainable economic growth in the region.

Keywords: Business Performance, Digital Finance, Financial Literacy, Framework, SMEs.

1 INTRODUCTION

Small and Medium Enterprises (SMEs) provide employment opportunities and play a role in improving community welfare and encouraging economic growth [1]. The existence of SMEs in Indonesia has proven to be able to survive during economic crises;

for example, in 1998, when almost every sector collapsed, only the SMEs sector survived and grew. SMEs have five main roles, namely driving the people's economy, providing employment opportunities, developing and empowering local communities, creating new markets and innovation, and contributing to the balance of payments [2].

The success of SMEs in contributing to the economy in Riau Province has experienced a decline, especially during the COVID-19 pandemic, due to a decrease in people's purchasing power, which then affect the sustainability of SMEs in Riau Province [3]. Internally, as a business, SMEs must be able to continue to improve their performance when facing external problems such as the COVID-19 pandemic. In [4] an organization's business performance is the capability of the organization's home resources, which are measured in terms of profitability, efficiency, productivity, and quality of service to consumers.

SMEs in Riau Province must continue to improve their business performance in order to survive in business competition. Meanwhile, the problems of SMEs in Riau Province after the COVID-19 pandemic are related to a decline in business performance, including threats to consistency of production and sales, innovation problems, and the inability to compete with competitors [5]. The deteriorating performance of SME businesses in Riau Province is also marked by a drastic decline in market demand, a decrease in sales turnover, and difficulties in the production process and raw materials [6]. Based on Central Statistics Agency (BPS) MSEs data in Riau Province, it is known that MSME business performance, seen from the profit aspect, has decreased by 36.69% in all business fields from the previous year. Only 21.31% of SMEs have improved profit conditions. This shows that the financial performance of SME businesses has decreased.

Business performance can be measured based on perception (primary data source) and objectively through secondary data. Primary data comes from questionnaires, while secondary data can be measured from an accounting perspective, such as financial performance by calculating the percentage of sales for each product, profit, capital, ROA, ROI, ROE, EPS, and net income after tax, or through marketing performance, such as market share [7]. A phenomenon often found among SMEs actors is that most SMEs actors cannot explain the profit or profitability of their business and can only explain the tangible assets they can achieve, such as vehicles, houses, land, or operational equipment that they have purchased after having a business. This actually indicates that the majority of SMEs do not clearly know the financial performance of their businesses [8].

Based on BPS data (2021), the financial side of business performance for SMEs in Riau Province shows that there were 509,252 SMEs in Riau Province, and the expenditure-to-income ratio was 0.58, which shows that the average profit ratio obtained by MSMEs is not twice that. Apart from that, the data also shows that the districts and cities with the highest ratios were Kuantan Singingi, Indragiri Hulu, Rokan Hilir, Pelalawan, Rokan Hulu, and Indragiri Hilir districts. Meanwhile, Pekanbaru City, which had the highest percentage of SMEs, did not have a large income ratio. Furthermore, the report on the potential development of SMEs published by BPS Riau Province also shows that 36.69% of SMEs profits have decreased.

Another factor that influences SMEs business performance is financial literacy [9–11]. The Organization for Economic Cooperation and Development, or OECD (2013), conceptualizes financial literacy as financial knowledge, understanding of that knowledge, skills acquired and use of knowledge, and turning financial knowledge and skills into effective decision-making. Someone who has good financial literacy is categorized as financially literate. In addition, the Financial Services Authority (OJK) defines financial literacy as knowledge, skills, and beliefs that can influence a person's financial attitudes and behavior in order to improve the quality of financial decisions and management. This research has significant novelty and relevance in the context of SMEs development in Riau Province. By elucidating the relationships between digital finance, financial literacy, and the business performance of SMEs, this study can better understand the factors that can influence and enhance the business performance of SMEs in the digital era.

2 METHODS

This research uses a descriptive-qualitative method that aims to describe a phenomenon or situation in depth and comprehensively. Research sources refer to journals (article year 2002-2023) in Science Direct, Scopus, and Google Scholar, with the keywords used being business performance, digital finance, financial literacy, and SMEs. Table 1 shows the development of the proposed framework based on hypotheses and previous research, and Table 2 shows the operational variables used.

Table 1. Proposed Framework Based on Hypotheses and Previous Research.

Framework	Hypotheses	Previous Research
DF → BF	Digital finance has a significantly positive influence on business performance	[12-15]
FL → BF	Financial literacy has a significantly positive influence on business performance	[16-17]

Table 2. Proposed Framework Based on Hypotheses and Previous Research.

Variables	Dimension	Indicators	Scale
Digital finance	Digital payment	<ul style="list-style-type: none"> • Electronic money payments • Bank transfer service • Transactions with QR • Debit using a card 	Ordinal
	Peer-to-peer lending	<ul style="list-style-type: none"> • Payment with a later service • Loan services 	
Financial literacy	Financial knowledge	<ul style="list-style-type: none"> • Financial knowledge related to expense management • Knowledge about investment • Knowledge of debt • Knowledge of financial recording • Knowledge of financial risk management 	Ordinal
	Financial attitude	<ul style="list-style-type: none"> • Attitude in controlling expenses • Attitude in building expenditure targets • Attitude towards saving 	
	Financial behavior	<ul style="list-style-type: none"> • Behavior in financial management • Behavior in shopping • Behavior in paying burden costs • Behavior in investing and saving; • Behavior in establishing financial plans 	Ordinal

3 RESULTS AND DISCUSSION

In this research, digital finance and financial literacy have a significant positive effect on business performance. MSME business performance is influenced by digital technology innovation factors carried out by business actors [12-15]. Digital technology related to finance is digital finance, which includes all electronic products and services from the financial sector such as credit cards, digital wallets, electronic exchange systems, banking payments, Automated Teller Machines (ATMs), and other mobile services related to finance [12].

Financial literacy regarding financial products, services, and activities plays an important role in helping a person choose financial products that suit their needs [18–20]. Financial literacy has a strong connection with the development of each country's financial system; besides that, it also has an impact on personal financial decision-making [21–23] and economic development by increasing economic security and reducing unemployment [24-25].

In [17] it was proofed that individuals with high levels of financial literacy were more likely to have the capacity to handle financial shocks, were more likely to regularly save for the long term, and were less likely to be in debt. Next, in [26] it was revealed that higher financial literacy led to better financial decision-making. Financial decisions relate to how people spend, save, and invest money. If someone has higher financial literacy, they can increase their financial satisfaction by helping them develop savings goals, save money, control finances, and plan assets [5]. On the other hand, low financial literacy can lead to poorly planned financial decisions, difficulty in investing, and inappropriate spending of money [27]. Lack of financial literacy influences financial decisions that can disrupt financial stability [28].

4 CONCLUSIONS

The findings revealed that financial literacy and digital finance had a significant positive influence on business performance. Digital finance makes business work functions easier because of the benefits of digital finance, which utilizes data, social networks, and P2P technology. Apart from that, digital finance also includes ease of digital investment, access to digital money, digital payments, digital security, and even the provision of financial facilities. Meanwhile, financial literacy enables management to make better financial decisions, including decisions to utilize digital finance.

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