


# Chapter 4

## Unlocking MSME Growth: The Role of Financial Literacy, Digital Finance, and Financial Inclusion in Driving Performance

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### **ABSTRACT**

*The financial literacy of the MSME actors has attracted much attention from researchers and practitioners. This study aims to explore how financial literacy affects MSME performance. Partial Least Squares Structural Equation Modeling (PLS-SEM) is used to analyze the responses from 100 MSME actors in Bandung City, including to test the moderated mediation hypothesis. This study reveals the role of financial literacy in improving MSME performance through financial inclusion. Besides, it further reveals the effect of financial inclusion on MSME performance*

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*when MSME actors use digital finance compared to those who do not use it. This study provides new theoretical insights into the literature on the mediating role of financial inclusion moderated by the use of digital finance by linking financial literacy with MSME performance. Our findings also guide MSME actors on how and when financial literacy will improve MSME performance in the industry 4.0 era.*

## **INTRODUCTION**

Micro, small, and medium enterprises (MSMEs) play a central role in the economic development of a country and contribute to economic growth (A D Buchdadi et al., 2020; Alharbi, Yahya and Kassim, 2021). Apart from the contribution of MSMEs to economic development, research shows that MSME performance is lower in developing countries (J Ye and Kulathunga, 2019; Omiunu, 2019). Generally, poor infrastructure; lack of skilled labor, especially in management; innovation; lack of capital and financing facilities; as well as the use of new and changing technologies; are observed as obstacles to MSME performance (Farida et al., 2019; Junoha, bin Hidhiir and Basheer, 2019; Kulathunga, J Ye, et al., 2020; Tuffour, Amoako and Amartey, 2020; Nuryakin et al., 2021). Therefore, exploring factors that can contribute to improving the performance of MSMEs, especially in emerging markets, is needed and this current chapter attempts to attain this objective. Specifically, this current chapter aims to investigate the impact of financial literacy on MSME performance by also including the roles of financial inclusion as the mediating variable and the use of digital finance as the moderating variable.

Theoretically, this current chapter is built on the Resource-Based View (RBV), especially knowledge resources, which are an important aspect that must exist in an organization. Integrating knowledge from individuals and companies into the services or products produced by the organization will gain a competitive advantage. Financial literacy is critical because it is one form of investment in human resources that will impact welfare. Financial literacy has a role in improving skills related to financial products, knowing the types of financial services available. It is a basic literacy in financial inclusion, so it is closely related to economic concepts that support decision-making, be it investments, loans, or savings. Financial inclusion is very much needed by organizations because it provides the broadest possible access and removes barriers to financial services (Lumenta and Worang, 2019). Financial inclusion can also increase the role of financial institutions and expand the reach of financial services that are greater and faster. Higher financial literacy and sound financial behavior and financial attitudes of a person will increase the use, utilization, and understanding of financial products and services, impacting organizational performance.

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