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Financial Performance and Business Sustainability Through Financial Literacy and Inclusion Among East Java MSME Actors

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ABSTRACT

Indonesia's MSME sector remained resilient during the crisis, boosting post-crisis GDP and employment. This study focuses on MSMEs in Malang, Jember, and Surabaya, addressing the limited financial literacy and financial inclusion that hinder MSME actors from utilizing financial services effectively. Using purposive sampling, data were collected from 290 respondents and analyzed using Partial Least Squares (PLS). The results show that financial literacy significantly affects financial performance (β = 0.367, p = 0.034) and business sustainability (β = 0.242, p = 0.039). Financial inclusion also has a significant impact on financial performance (β = 0.324, p = 0.036) and business sustainability (β = 0.214, p = 0.018). Financial performance strongly influences business sustainability (β = 0.661, p = 0.000). Indirectly, financial literacy influences business sustainability through financial performance (β = 0.214, p = 0.034), as does financial inclusion (β = 0.242, p = 0.018). These findings confirm that improving financial literacy and inclusion enhances financial performance, which in turn ensures the long-term continuity of MSMEs. Interventions such as targeted financial education and improved access to financial services are vital to strengthening MSME sustainability.

Keywords: Financial Inclusion; Financial Literacy; Financial Performance; MSMEs; Sustainability

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INTRODUCTION

The direction of a country's economic growth is influenced by various sectors. One sector that influences economic growth in various countries, including Indonesia, is the micro, small, and medium enterprises (MSMEs) sector. When the economic crisis began to hit the world, Indonesia's economic conditions worsened, and only the MSME sector was able to survive. The Indonesian Central Bureau of Statistics reported that after the economic crisis, the number of MSMEs in Indonesia did not decrease, but instead increased, absorbing 85 million to 107 million workers in 2020. In 2020, the number of entrepreneurs in Indonesia reached 85 million to 107 million workers, with a total of 56,539,560. Of these, 56,534,592 units, or almost 99.99%, were MSMEs, while only around 0.01%, or 4,968, were large businesses. This phenomenon demonstrates that MSMEs are highly productive businesses that need to be continuously developed to support macro- and microeconomic development in Indonesia (Mahanani et al., 2024). The business sector in MSMEs is a source of livelihood for many people and is able to provide employment for those with low education and skills, and is able to alleviates poverty. So far, MSMEs have shown several strategic positions in supporting economic growth, namely (1) their position as supporters of economic activities in various sectors, (2) as the largest provider of employment, (3) able to become actors in regional development, economic activities and community empowerment, and (4) as creators of new markets and sources of innovation.

The growth of MSMEs in Indonesia can be said to be very rapid, but currently, MSMEs are still in the small business zone and struggle to become large enterprises. However, the development of MSMEs is still hampered by several problems, both internal and external. Internal factors include weak capital, financial planning, and access to financial services, including banking, insurance, investment, and digital financial services. Meanwhile, external factors include problems arising from MSME developers and supervisors. MSMEs in the industry tend to be short-term in their business decisions. This is evident in the lack of a concept of sustainable innovation and inconsistent core business activities. Ultimately, the long-term performance of MSMEs operating in this industry tends to be stagnant and unfocused. MSMEs play an important role in the economic development of regions (Goenadhi et al., 2023), including East Java. The challenge facing MSMEs lies in the fact that most MSMEs have business ideas for developing their businesses. However, on the other hand, MSMEs still lack a strong understanding of financial literacy and financial inclusion, leading to underutilization of the services and products offered by financial institutions. This presents difficulties in long-term planning, particularly for working capital needs. Furthermore, limited knowledge of banking access hinders easy access to capital. Looking back, many MSMEs struggle to obtain additional capital from financial institutions due to numerous unmet requirements. As many as 74% of MSMEs in Indonesia lack access to financing. Therefore, MSMEs are required to continually improve their work efficiency to achieve their desired goals, namely increased performance, which in turn impacts business sustainability.

This study attempts to analyze the impact of financial literacy, financial inclusion, performance, and business sustainability on MSMEs in East Java, a sector that has not been widely studied separately. This study focuses on MSMEs, which are a key sector in the economy but often face barriers in terms of financial access and business management. This research has a specific geographic context and provides findings relevant to local conditions. This research can combine approaches from various disciplines, such as economics, finance, and management, to provide a more comprehensive understanding.

The specific objectives of this research are: first, to determine the impact of financial literacy on the performance and sustainability of MSMEs; second, to examine the influence of financial inclusion on MSME performance and sustainability; third, to analyze the interaction between financial literacy and financial inclusion in enhancing the performance and sustainability of MSMEs; fourth, to identify key factors that can drive improvements in MSME performance and sustainability through enhanced financial literacy and inclusion; and fifth, to formulate policy recommendations that support MSME development by strengthening financial literacy and financial inclusion.

Theoretically, this research contributes to the development of a more comprehensive conceptual framework that captures the relationship between financial literacy, financial inclusion, financial performance, and the sustainability of MSMEs. In addition, the findings offer practical implications for key stakeholders, including government bodies, financial institutions, and MSME actors, by providing evidence-based insights to guide efforts aimed at improving the performance and long-term viability of MSMEs.

LITERATURE REVIEW

Financial Literacy

Knowledge of financial literacy or financial literacy can be both an individual need and a necessity for company interests. The benefit of having financial knowledge is the ability to manage good financial planning to avoid financial problems. Individual financial literacy needs to be improved as a foundation for making adequate financial decisions and for managing personal finances as effectively as possible (Hilmawati & Kusumaningtias, 2021; Satoto & Putra, 2021). There are many expert opinions regarding the meaning of financial literacy, and in this study, several expert definitions are presented. Financial literacy enables individuals to make decisions regarding financial resources based on the knowledge and skills they possess, effectively and efficiently (Marija et al., 2021). Hilmawati and Kusumaningtias (2021) also stated that financial literacy includes knowledge and skills in financial management and their development within the business sector to achieve targets and success, ultimately leading to a prosperous life. Financial literacy is an educational program initiated by financial services managers to provide a set of knowledge that can improve the skills of service users in making effective financial decisions through the utilization of available information sources (Kuchciak & Wiktorowicz, 2021). Financial literacy has become part of the marketing strategy of financial institutions, providing various information and technology-based financial knowledge to the public (Moro-Visconti et al., 2020).

The MSME sector, as a business sector, still lacks adequate access to financial services (Mention, 2021). However, a structured financial literacy program can certainly improve financial knowledge for MSMEs (Erlianta et al., 2021). Financial literacy programs are not only intended to educate the public about financial knowledge but are also utilized by financial institution managers to offer financial services (Al Syahrani et al., 2022).

The main objective of financial literacy, according to the Financial Services Authority (OJK), is to provide financial education to the Indonesian public with the goal of enabling people to manage their finances well in business. It also helps those with weak financial management skills to find solutions, enhances people’s capability in financial decision-making, and protects them from being easily deceived by fraudulent investment schemes that promise high profits instantly without a proper understanding of the associated risks. Financial literacy is a combination of knowledge, belief, and skills, which together shape attitudes and behaviors to improve the way financial decisions are made, with the ultimate goal of enhancing societal welfare. In line with this, financial literacy is also defined as encompassing knowledge of basic financial principles, skills in managing finances both personally and corporately, and the courage and precision required to make financial decisions in various situations.

Financial literacy is a fundamental factor contributing to both economic growth and financial stability. In the context of learning and decision-making, financial literacy plays a vital role in promoting quality-driven choices by empowering consumers with the necessary knowledge and skills. Furthermore, in an environment of open competition and continuous innovation, financial literacy supports the creation and selection of high-quality products and services for consumers.

Financial literacy comprises two key dimensions. First, the knowledge domain refers to the comprehension of financial concepts and the application of that knowledge in real-life financial decision-making. This understanding may stem from formal education or personal experience and encompasses a broad range of financial topics. Second, the application domain, as described by Chang and Cheng (2019), involves the confidence and capability of individuals to apply their financial knowledge effectively when using financial products and services in practical situations.

From these perspectives, financial literacy can be understood as the capacity of individuals to manage their finances—whether personal or organizational—through informed and responsible financial decision-making. This ability not only contributes to individual and household well-being but also supports sound financial policy-making within organizations, ultimately enhancing broader life success and financial resilience.

The financial literacy classification in Ningrum's (2018) research divides community financial understanding into four categories. At the highest level is the well-literate group, which consists of individuals who possess both strong knowledge and confidence in financial institutions. They understand the features, benefits, and risks of financial services and are proficient in applying these services in daily life. The next level includes individuals with moderate or sufficient understanding. These individuals demonstrate a reasonable level of awareness and confidence about financial service providers, including the various products and services offered, their uses, potential consequences, and the related rights and responsibilities. The third category refers to those with poor understanding—people who only have limited knowledge of financial institutions, the types of services available, and the outcomes these services may produce. Lastly, the lowest level is comprised of individuals who lack understanding. These individuals have only basic knowledge and minimal trust in financial services and lack the necessary skills to use financial products effectively. This categorization emphasizes the varied levels of financial awareness within society and the need to improve financial education across all segments of the population.

Research on financial literacy incorporates various parameters that are closely linked to an individual's financial competencies. One of the primary components is basic knowledge of financial management, which encompasses the general financial understanding possessed by individuals. This includes personal-level competencies such as the ability to maintain bookkeeping or manage accounting records effectively. Another important aspect is credit management. In both personal and business-related economic activities, the ability to manage loans or credit is essential. This financial skill is particularly important for managing transactions related to personal consumption or business investments. Additionally, financial literacy includes investment and savings management. Given the unpredictability of economic conditions, it is crucial for individuals to comprehend the importance of saving and investing. Sound financial planning helps people prepare for unexpected expenses and emergency needs.

Individuals are therefore encouraged to establish savings accounts—whether in sharia-compliant or conventional banks—as a means of building financial security. In the context of MSMEs, investment refers to the allocation of capital that allows these businesses to grow while also providing returns to investors. Such investments can be tailored to medium- and long-term objectives. Finally, risk management forms a vital part of financial literacy. Risk involves the likelihood of adverse events that may lead to financial loss and often occur without warning. Managing these risks requires a systematic and structured process that includes identifying, measuring, mapping, designing strategies, monitoring, and controlling potential threats to financial stability.

Financial Performance

Performance is the work output produced by an individual, aligned with their role and responsibilities in the company within a certain period, and measured against agreed-upon values or benchmarks. According to Marija et al. (2021), MSME performance is the output generated by MSME entrepreneurs, beginning from the business's establishment to the achievement of predetermined targets based on company assessment standards that have been previously set. The determination of MSME performance levels often uses simple parameters to make it easier to identify the real condition of MSMEs. The parameters commonly used in research include company growth, total company sales, total number of orders, and the company's cash position.

There is a need for a performance measurement approach that does not impose a cost burden, in order to assess MSME performance in both the financial and non-financial sectors. Using the perception measurement method can help reveal the actual situation within MSMEs. It is concluded that it is essential to socialize how to measure company performance using simple parameters, which include company growth, total profits, number of orders achieved, and the company's cash flow at a given time (Dasman & Maulani, 2021). MSMEs are enterprises that engage in productive activities in the economic sector, either by individuals or business entities, and operate within the criteria of MSMEs. MSMEs are also the driving force of the largest informal business sector, absorbing large numbers of workers and playing a crucial role in Indonesia's economy.

One of the quickest ways to stimulate economic growth in emerging markets is to focus on developing MSMEs in the informal sector, as they contribute significantly to increasing income among the middle class. The financial management measurement in this study refers to a collaborative project as part of the Support for Economic Analysis Development in Indonesia (SEADI), implemented by Definit in cooperation with the OJK. Companies are expected to compete in the global era by providing added value through higher-quality products and services than those offered by competitors in both domestic and international markets. However, implementing product and service excellence remains difficult for MSMEs due to limited management skills and minimal business capital

Although MSMEs operate with low capital, they demonstrate strong resilience during economic crises and maintain stable development in Indonesia's business environment (Febriyantoro & Arisandi, 2018). The growth and development of MSMEs in Indonesia are relatively strong; they serve as a form of economic reinforcement aimed at enabling business actors to sustain and continue their operations. Therefore, improving financial literacy skills is critical for MSMEs to manage their finances effectively. Small business actors must implement a comprehensive financial management system that covers cash flow, income, expenses, building rent, and all transaction-related aspects of the business. The main factors that hinder MSMEs from sustaining their operations include poor financial management, limited capital, and the absence of structured and accountable bookkeeping, which is essential for informed decision-making in today's competitive business landscape.

Company performance is a reflection of the company's ability to create value, both from financial and non-financial perspectives. The financial perspective refers to the company's capacity to enhance shareholder welfare through the profits it generates, while the non-financial perspective refers to its ability to create positive impacts, such as environmental performance and social responsibility. Thus, a company is said to have excellent performance if both financial and non-financial aspects show favorable outcomes, starting with the financial side, without neglecting the non-financial dimension.

Meanwhile, sustainability refers to a company's ability to continue its business operations over time. MSMEs that demonstrate business sustainability are those that consistently experience growth. This means that if MSMEs show signs of stagnation, it could indicate an inability to sustain their operations in the long run. MSME performance can be measured based on several assumptions. These include performance assessments that consider financial and workforce understanding, the use of financial indicators to reflect the actual condition of MSMEs, and the evaluation of performance through the management conditions of MSMEs.

Therefore, based on the non-cost performance measurement approach used in this study, MSME performance is assessed from both financial and non-financial perspectives. Easy-to-use perception-based indicators are expected to accurately reflect the actual condition of MSMEs. Moreover, it is essential to provide education on how to measure company performance using simple indicators, such as company growth, total company revenue (sales), total number of orders, and the company's current cash position.

Several studies identify various tools for measuring MSME performance. Many of these studies emphasize the importance of innovation—whether in products, processes, or management systems—as well as the survival and competitiveness of MSMEs as critical indicators of performance. Financial literacy is increasingly being utilized to convey information related to marketing strategies (Lusardi, 2019). The success of financial education for the public is determined by the quality of the literacy programs implemented by financial service providers (Kou et al., 2021). It was further emphasized that three essential components in evaluating MSME performance: the ability of the business to survive, grow, and remain profitable; the alignment with the company's philosophy and values; and the maintenance of a strong public image. Improvements in MSME performance can be reflected more broadly in the economy through increased industrial income, expanded job opportunities, growth in exports, and higher productivity levels.

H1: Financial literacy has an effect on the financial performance of MSMEs in East Java.
H5: Financial performance has a direct, positive, and significant effect on business continuity.

Business Sustainability

Many businesses strive to maintain their sustainability, but a significant number also close due to poor management and the inability to preserve their existence, one contributing factor being the lack of financial literacy skills. Business growth and how it is measured typically involve certain standards or parameters, such as relative and absolute growth, changes in sales, asset conditions, performance, productivity, and profit levels. The growth and success of MSMEs are considered vital in every development policy. Business sustainability is often assessed through aspects such as innovation, employee and customer management, and the financial planning strategies implemented by the company. Panggabean et al. (2018) emphasized that business sustainability is influenced by the company's success in innovation as well as the management of employees and customers.

In addition to these, sustainability is also affected by several other factors, including the development of business plans, competitor analysis, ease of doing business, and knowledge of risk assessment in business. To ensure business sustainability, MSME actors must work hard to become more adaptable to changing conditions, while also being required to enhance their competitive advantage to survive and thrive amid tight competition (Panggabean et al., 2018).

Creating excellence allows a company not only to survive but also to grow in a more advanced direction. With this excellence, the business can maintain its sustainability and move toward a more prosperous future. Superior competitive ability is a key component in helping the company reach its ultimate goal: sustainability with profit orientation. Sustainable competitiveness is the pathway to achieving improved company sustainability. A company's precision in delivering the right products, meeting consumer needs, and achieving market dominance reflects the outcome of sustainable competition. Competitive ability can also be demonstrated by the capacity to anticipate new competitors, suppliers, products, distribution methods, and competition from existing businesses

Financially literate companies are more likely to implement sound financial management practices, which in turn improve their overall performance and sustainability. Therefore, financial literacy is considered to have a positive impact on the sustainability of MSMEs.

H2: Financial literacy has an impact on the sustainability of MSME businesses in East Java.

Financial Inclusion

Access to banking services is an essential component of economic growth. Easily accessible banking services can encourage MSMEs to engage with banking institutions, such as by taking out loans or saving funds. The ease of access to banking is expected to help MSMEs in building assets and supporting their operational activities. Financial inclusion is also expected to enhance the overall standard of living in the community (Klapper et al., 2019). Improvements in community welfare can be achieved when MSME performance aligns with the programs implemented by business actors so that the expected profits can be realized in accordance with the established business plans.

The objectives of financial inclusion are centered on enhancing public access and engagement with the financial system. These goals include increasing access to financial institutions, products, and services across all segments of society; expanding the availability of financial products and services that are suited to the varying capacities of different communities; encouraging the effective use of these financial products and services in accordance with people's specific needs and capabilities; and ultimately improving the quality of financial product utilization so that it aligns with the public's actual needs and financial abilities.

The level of financial literacy possessed by individuals, along with access to various financial products, significantly influences the management of both personal and corporate finances. Decisions made by individuals and business actors are closely tied to future investment activities. Business actors strive to improve their financial condition by making investments and expanding their business operations. Those who are capable of effectively managing MSMEs are in a better position to enhance their business, which includes both business expansion and improvements in financial conditions.

H3: Financial inclusion has an effect on the financial performance of MSMEs in East Java.

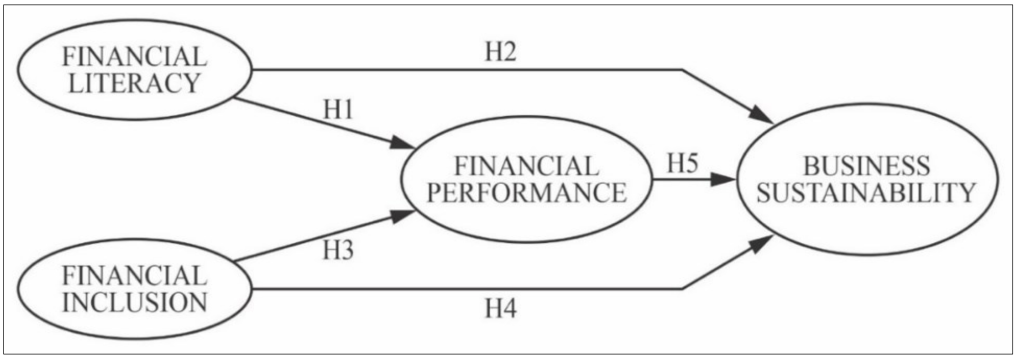
Financial inclusion is defined as the ease with which individuals and business units can access useful and affordable financial products that meet their needs in a responsible manner. A proper understanding of financial concepts helps MSMEs to manage and access financial products more efficiently. Financial inclusion is considered a process that facilitates access to, availability of, and benefits from the formal financial system for all economic actors. According to a regulation issued by the OJK, financial inclusion is defined as the availability of access to financial institutions, products, and services that align with the needs and abilities of the community to improve their welfare.

The availability of financial services that meet key inclusion criteria plays a vital role in helping MSMEs address capital adequacy challenges, one of the most significant obstacles they face. Limited access to capital often hampers MSMEs' ability to sustain and grow their operations. Therefore, accessible and inclusive financial services are essential to support their business continuity. Financial inclusion should be guided by four fundamental principles. First, it must be measurable, meaning efforts should account for accessibility in terms of location, cost, time, technological systems, and risk mitigation in every financial transaction. Second, it must be affordable, ensuring that financial services are easily obtainable by all segments of society. Third, financial inclusion should be right on target, aligning with the specific needs of communities and the intended target groups. Lastly, sustainability is crucial to guarantee the continuity and long-term viability of businesses operated by MSMEs and the broader population.

H4: Financial inclusion has an impact on the sustainability of MSME businesses in East Java.

Research Framework Model
Figure 1. Research Framework Model

As illustrated in Figure 1, financial literacy is positioned as the first independent variable (X1), while financial inclusion serves as the second independent variable (X2). Financial performance functions as the intervening variable (Y1), mediating the relationship between the independent variables and the outcome. Business continuity is identified as



the dependent variable (Y2), reflecting the ultimate impact of financial literacy, financial inclusion, and financial performance within the research model.

RESEARCH METHOD

The research method used is explanatory, meaning it tests hypotheses to explain how the research variables influence each other. There is a correlation between these variables, which results in a cause-and-effect relationship or causality. The research uses quantitative data to test the theory by examining how the variables influence each other

The data collection method used in this study is a survey method. The survey method is a research method that uses samples from the population and utilizes questionnaires as a tool to collect primary data. The questionnaire is used to obtain reliable, relevant, and objective data, and can serve as a basis for the analysis process. The questionnaire will be distributed directly to respondents to obtain information related to financial literacy and financial inclusion, financial performance, and sustainability of MSME businesses, so that analysis can be carried out on the development of financial performance models and the sustainability of MSME businesses. The questionnaire instrument is a means for data collection, which is meant as a series of questions that must be answered by MSME actors as respondents and meet the criteria as members of the population. The questionnaire as a research instrument must meet the requirements of validity and reliability. Validity in this study uses the loading factor formula, and reliability uses Cronbach's alpha. The instrument is declared valid if the loading factor is >0.70 and AVE >0.5, and the instrument is declared reliable if the Cronbach's alpha value is greater than 0.6. Referring to data from the Central Statistics Agency (BPS) of East Java, based on the largest number of MSMEs, namely Malang, Jember, and Surabaya City, and this is the population of the study.

The sample in this study was 290 MSMEs. The sampling technique used was purposive sampling, with the characteristics of those active until the end of December 2024. MSMEs are defined as managers, owners, or managers and owners who have been active for at least one year. The MSME sector in this study includes food and beverage businesses, handicrafts, clothing, and others (in addition to the three already mentioned).

This study used an interval scale. This measurement scale is used in research because it aims to determine the characteristics of a variable based on specific measurements, so that it can be ranked based on the characteristics of each variable. This study used a Likert scale. The Likert scale helps determine the extent to which subjects agree or disagree with the statements presented in the questionnaire (5 = strongly agree; 4 = agree; 3 = somewhat agree; 2 = disagree; 1 = strongly disagree).

The data analysis in this study employed statistical methods using a variance-based approach through Smart Partial Least Squares (PLS), which is designed to test the model structure and the relationships between latent variables. According to Yamin and Kurniawan (2009), the SEM-PLS analysis procedure involves several key steps. First, the inner model (structural model) is designed to illustrate the relationships between latent variables or constructs. Second, the outer model (measurement model) is developed to describe how observed indicators represent the latent variables. Third, data collection and selection are carried out, ensuring that the quantitative data used in SEM-PLS are complete and free from missing values and outliers that could affect the analysis.

The fourth step involves constructing a path diagram, which visually represents the inner and outer models and can be translated into equations that yield parameter estimates. These estimates include weight values used to create latent variable scores, path coefficients between latent variables, and loading values between latent variables and their indicators. Parameter estimation is performed iteratively until a convergence condition is achieved. Lastly, a goodness of fit evaluation is conducted, which is divided

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into two parts: evaluation of the outer model and the inner model. The outer model evaluation focuses on assessing the validity and reliability of the constructs, while the inner model evaluation determines the model's ability to explain the relationships among the constructs and the extent to which it reflects real-world phenomena.

Operational Definition of Variables

Financial literacy is the ability to understand and effectively use various financial skills, such as personal financial management, budgeting, and investing. Financial literacy is fundamental to a person's relationship with money and is a lifelong skill. Financial literacy indicators are (1) financial planning, (2) knowledge of investments, (3) knowledge of economic conditions, (4) spending based on needs, and (5) financial preparation for retirement.

According to the regulation issued by OJK No. 76/POJK.07/2016, financial inclusion is the availability of access to various formal financial institutions, products, and services according to the needs and capabilities of the community in order to improve community welfare. This increase in access is also supported by increasing public understanding of financial systems, products, and services, as well as the availability of formal financial services. Access to financial products, systems, and services according to community needs requires considering several factors: affordable costs, effectiveness and efficiency, and quality. The indicators put forward are (1) access to financial institutions, (2) understanding of financial institution products, (3) understanding of barriers to financial institution services, and (4) understanding of choosing financial institution products that improve welfare

Financial performance is based on the financial statements of the company/business entity concerned and is reflected in information obtained from the balance sheet, income statement, and cash flow statement, as well as other matters that strengthen financial performance (Kuchciak & Wiktorowicz, 2021). The indicators are (1) increased profits, (2) Increased assets, (3) increased capital, and (4) savings.

Business sustainability is a stable business condition, where sustainability is a business continuity system that includes: additions, continuation, and approaches to protect business continuity and business expansion (Chang & Cheng, 2019). The indicators are (1) business development, (2) income covers costs, (3) business growth, (4) serving requests quickly, and (5) repurchases.

RESULTS

Validity and Reliability

Table 1. Results of Validity and Reliability Tests

	Variable	Loading Factor	AVE	Cronbach Alpha	Information
1	Financial Literacy	0.718-0.849	0.628	0.804	Valid & Reliable
2	Financial Inclusion	0.786-0.836	0.593	0.777	
3	Financial Performance	0.754-0.828	0.642	0.801	
4	Business Continuity	0.777-0.877	0.552	0.732	

The results of data processing presented in Table 1 show that the loading factor for the financial literacy variable statement items ranges from 0.718 to 0.849, with an Average Variance Extracted (AVE) value for the financial literacy variable of 0.628. The loading factor for the financial inclusion variable statement items ranges from 0.786 to 0.836, with an AVE value for the financial inclusion variable of 0.593. The loading factor for the financial performance variable statement items ranges from 0.754 to 0.828, with an AVE value for the financial performance variable of 0.642. The loading factor for the business sustainability variable statement items ranges from 0.777 to 0.877, with an AVE value for the business sustainability variable of 0.552.

The results of data processing in Table 1 confirmed that the loading factor for all variables ranges between 0.718 and 0.877, which indicates a positive value greater than 0.70. The AVE values for all variables ranged between 0.552 and 0.642, exceeding the threshold of 0.50. Furthermore, the Cronbach's Alpha values for all variables ranged between 0.732 and 0.804, exceeding the minimum acceptable value of 0.60. These results confirm that the factor loading, AVE, and Cronbach's Alpha values indicate that the research instrument used to collect respondent data is valid and reliable.

Model Fit Test

The model fit test can be assessed using several indicators; however, in this study, it is evaluated using two key indicators. First, the Standardized Root Mean Square Residual (SRMR), which measures the difference between the observed and predicted correlations. A model is considered to have met the model fit criteria if the SRMR value is less than 0.1, while a value below 0.08 indicates a perfect model fit. Second, the Normal Fit Index (NFI), which ranges from 0 to 1, is used to assess the overall model fit, with values closer to 1 indicating a better-fitting model.

Table 2. Fit Model Test Results

	Saturated model	Estimation model
SRMR	0.098	0.096
d_ULS	3.380	3.316
dG	0.676	0.694
Chi-square	1137.060	1119.369
NFI	0.705	0.711

Source: SmartPLS Output

The calculation results in Table 2 show that the SRMR value is 0.098, which is less than 0.1, and the NFI value is 0.705, which is relatively close to 1. Therefore, it can be concluded that the model fits the data well.

Coefficient of Determination

Table 3. R-Square and F-Square

	Variables	R-square	F-square
1	Financial performance	0.405	
2	Business Sustainability	0.436	
3	Financial Performance-Business Sustainability		0.774

Source: SmartPLS output

The effect of the predictor variable at the structural level can be assessed using the F Square value, which indicates whether the influence is weak, moderate, or strong. The recommended thresholds for F Square are 0.02 (small), 0.15 (moderate), and 0.35 (large). The calculation results in Table 3 show an F Square value of 0.774, indicating that the predictor variable has a large influence.

Meanwhile, the magnitude of the coefficient of determination is indicated by the R Square value. The model evaluation begins by observing the R Square to determine the explanatory power of each dependent latent variable. An R Square value of 0.75 is considered strong, 0.50 is moderate, and 0.25 is weak. The results in Table 3 show R Square values of 0.405 and 0.436, which fall within the moderate category, suggesting that the predictor variable explains a moderate portion of the variance in the dependent variables.

Hypothesis Testing

Table 4. The Summary of Regression

Independent Variable	Dependent Variable	Standardized Coefficient	Sig (0.05)
Financial Literacy	Financial performance	0.367	0.034
Financial Literacy	Business Sustainability	0.242	0.039
Financial Inclusion	Financial performance	0.324	0.036
Financial Inclusion	Business Sustainability	0.214	0.018
Financial Performance	Business Sustainability	0.661	0.000

Source: Processed Data

Based on Table 4, financial literacy has a positive and significant effect on financial performance, with a standardized coefficient of 0.367 and a significance level of 0.034, which is below the 0.05 threshold. This result confirms H1, indicating that MSME actors with higher financial literacy tend to achieve better financial outcomes. Financial literacy also has a direct and significant effect on business sustainability, with a coefficient of 0.242 and a significance level of 0.039, supporting H2. This suggests that financial literacy not only enhances how MSMEs manage finances but also strengthens their long-term business resilience.

In the case of financial inclusion, the results also show a positive and significant influence on financial performance, with a coefficient of 0.324 and a p-value of 0.036, validating H3. Additionally, financial inclusion has a significant direct effect on business sustainability (coefficient = 0.214, sig. = 0.018), thereby confirming H4. These findings demonstrate that access to financial services contributes both directly and indirectly to the sustainability of MSMEs.

Furthermore, the data strongly support H5, which posits that financial performance significantly affects business sustainability. This is reflected in the highest standardized coefficient among all tested relationships, at 0.661, with a significance value of 0.000. This implies that financial performance is a critical factor in ensuring MSME continuity.

Table 5. Indirect Effect Path Coefficient

Independent Variable	Intervening Variable	Dependent Variable	Standardized Coefficient
Financial Literacy	Financial Performance	Business Continuity	0.214 (sig. α = 0.034)
Financial Inclusion	Financial Performance	Business Continuity	0.242 (sig. α = 0.018)

Source: Processed Data

Table 5 illustrates the indirect effects. Financial literacy influences business continuity through financial performance with a coefficient of 0.214 (sig. = 0.034), and financial inclusion has an indirect effect on business continuity through financial performance with a coefficient of 0.242 (sig. = 0.018). These results reinforce the mediating role of financial performance, suggesting that both financial literacy and inclusion contribute indirectly to business sustainability via their impact on financial outcomes.

In summary, all five hypotheses (H1–H5) are supported by the data, demonstrating the significant roles of financial literacy and inclusion in shaping financial performance, which in turn drives the sustainability of MSMEs in East Java.

DISCUSSION

The Influence of Financial Literacy on Financial Performance

Financial literacy has a weak direct effect on financial performance; however, the effect is statistically significant (coefficient = 0.367, sig. = 0.034). The results of this study indicate that financial literacy has a positive and significant impact on business performance. The better the financial literacy possessed by MSME owners or actors, the better they can manage their businesses, which in turn improves business performance (Aprila et al., 2022). This finding aligns with the research conducted by Butar-Butar (2021), which also showed a positive and significant relationship between financial literacy and MSME performance. Similarly, a study by Alamsyah (2020) supports the conclusion that financial literacy significantly influences financial performance. However, differing results were presented by Wahyudi et al. (2020), who found no significant relationship between financial literacy and financial performance. Despite these discrepancies, financial knowledge remains an essential component of financial performance, highlighting the importance of promoting financial education, especially for MSME actors. By improving financial literacy and implementing well-planned strategies for planning, budgeting, monitoring, and securing finances, they can achieve better financial results and long-term stability (Lestari et al., 2025).

Business owners who understand finance are able to improve business performance, and MSMEs experience business sustainability. This research has limitations, so it is hoped that future researchers can develop research models for MSME development through business sustainability and improved business performance, using other variables that influence MSME development. Testing on a wider area is necessary to understand the condition of MSMEs, given that Indonesia is divided into several regions, making it highly likely that different variables influence the condition of business sustainability and financial performance of MSMEs. Greater financial knowledge will facilitate financial decision-making.

The more financial knowledge individuals possess, the more effectively they can make informed financial decisions. According to Haupt (2021), financial literacy refers to the ability to apply knowledge and skills to manage financial resources effectively to enhance financial performance. It is strongly associated with financial performance, as financial knowledge and skills are crucial for daily financial management. However, the factors influencing individuals' financial attitudes, behaviors, and knowledge—and ultimately their financial performance—are not uniform. People from diverse backgrounds manage their finances differently, and even those with high incomes may experience financial difficulties due to poor financial management, impulsive spending, or a short-term mindset. Individuals who demonstrate sound financial behavior and knowledge tend to be more financially independent and capable of planning for their short-term, medium-term, and long-term needs. Sound financial knowledge helps MSME actors avoid repeating past mistakes and improves their decision-making. Business actors will also be more cautious in utilizing financing products, ensuring that such actions are taken only when their businesses are not in high-risk conditions. This study is consistent with the findings of Septiani and Wuryani (2020), who studied MSMEs in Sidoarjo, and Wulandari (2019), who conducted research in the DKI Jakarta Province, both of which concluded that financial literacy positively affects MSME performance.

In summary, this study found that: (1) financial literacy has a positive and significant effect on financial performance; and (2) financial literacy also has a positive and significant indirect effect on business sustainability through financial performance.

The Influence of Financial Literacy on Business Sustainability
Financial literacy has a weak direct effect on business sustainability; however, the effect is statistically significant (coefficient = 0.242, sig. = 0.039). The findings indicate that the higher the level of financial literacy possessed by MSME owners or actors, the better their business management, which in turn strengthens the sustainability of their businesses (Ambarwati et al., 2020). This finding is supported by research from Butar-Butar (2021), which shows a positive and significant relationship between financial literacy and MSME business sustainability. Similarly, the study by Rumini and Martadiani (2020) explains that improved financial literacy—as reflected in ownership of business accounts under the company's name—can enhance the sustainability of MSMEs in Badung Regency. In contrast, however, the research conducted by Imaniar (2022) found that financial literacy does not significantly affect MSME business sustainability. Inflation triggered by limited availability of goods and services can hinder MSME actors from making investment decisions to secure long-term financial stability. Poorly timed investments, particularly during the COVID-19 pandemic, could carry high risks, affecting both financial performance and business continuity. Many MSME actors tend to delay high-risk decisions, especially regarding future investments, until the economic environment stabilizes. As a result, in certain contexts, financial literacy alone may not sufficiently support business sustainability, especially when MSME actors face external challenges such as government-imposed activity restrictions that are not directly linked to financial knowledge. Financial literacy has a very strong relationship with decision making (Djou & Lukiastuti, 2021)

The results of this study conclude that: (1) financial literacy has a direct, positive, and significant influence on business sustainability; and (2) financial literacy also exerts an indirect, positive, and significant influence on business sustainability through its impact on financial performance.

The Impact of Financial Inclusion on Financial Performance
Financial inclusion has a direct but weak effect on financial performance, although the effect is statistically significant (coefficient = 0.324, sig. = 0.036). Financial inclusion reflects an individual's ability to resist short-term temptations in order to achieve long-term goals. Individuals with strong determination are more likely to have good self-control. A high level of financial inclusion among MSME actors enables them to manage their finances more effectively. With a solid understanding of financial systems, MSME actors are better equipped to run their businesses according to structured plans. Effective financial management, including controlling and minimizing costs, leads to improved performance and business growth. Furthermore, well-prepared business programs tailored to customer needs can drive demand and enhance performance. The findings of this study are consistent with the research by Septiani and Wuryani (2020), which found that financial inclusion significantly affects the performance of MSMEs in the Sidoarjo area.

This study also confirms a positive and significant indirect effect of financial inclusion on business sustainability, mediated through financial performance.

The Impact of Financial Inclusion on Business Sustainability
Financial inclusion has a weak direct effect on business sustainability; however, the effect remains statistically significant (coefficient = 0.214, sig. = 0.018). During the pandemic until 2022, restrictions on public activities led to a decline in MSME sales and income. Although operations gradually resumed post-2022, they remained in a trial phase, continuing to affect MSME performance. A good level of financial inclusion among MSME actors contributes to more efficient financial decision-making. The adoption of online-based sales strategies has helped MSMEs maintain income levels above the

Break Even Point (BEP). Additionally, MSME actors with limited capital have taken various initiatives to sustain their businesses, such as seeking financial assistance from family or friends and pursuing loan restructuring with banks. These efforts have enabled many MSMEs to continue their business operations. The findings of this study align with previous research on Muslim MSMEs, which showed that financial inclusion positively affects business sustainability (Nurohman et al., 2021).

This study found that: (1) financial inclusion has a direct, positive, and significant effect on business continuity; and (2) financial inclusion also has an indirect, positive, and significant effect on business continuity through financial performance.

The Influence of Financial Performance on Business Sustainability
Financial performance has a strong and significant direct effect on business sustainability (coefficient = 0.661; sig. = 0.00). This indicates that higher financial performance leads to a greater impact on the sustainability of MSME business actors. The success of business performance relies on sound economic performance, effective strategies employed by business actors, and the support of employees who are capable of working collaboratively and in a coordinated manner to achieve business goals. These findings are consistent with the results of Mwirigi et al. (2018), which demonstrate that financial performance has a significant and positive influence on business sustainability.

The findings of this study indicate that financial performance has a direct, positive, and significant influence on business continuity.

CONCLUSION

This research has successfully achieved its objectives: first, to examine how financial literacy affects the performance and sustainability of MSMEs; second, to analyze the influence of financial inclusion on MSME performance and sustainability; third, to investigate the interaction between financial literacy and financial inclusion in improving MSME outcomes; fourth, to identify key factors that contribute to business sustainability through financial performance; and fifth, to recommend policy directions that support MSME development by strengthening financial literacy and inclusion.

Theoretically, this research contributes to the development of a more comprehensive conceptual framework that explores the relationship between financial literacy, financial inclusion, financial performance, and MSME sustainability. It also offers practical insights for stakeholders, including government institutions, financial service providers, and MSMEs themselves, by illustrating how improved literacy and inclusion can enhance MSME performance and longevity. On a practical level, this study encourages the government and relevant stakeholders to focus on three key areas: increasing financial literacy education, expanding access to financial services, and reinforcing collaboration between the government, financial institutions, and MSMEs.

The study finds that financial literacy has a direct, positive, and significant impact on financial performance, supporting the first hypothesis. This underscores the need for broad-based financial literacy campaigns targeting diverse groups such as students, youth, and especially MSME operators, as stronger financial literacy leads to better financial management and outcomes.

Financial literacy also shows a direct, positive, and significant influence on business continuity, confirming the second hypothesis. This indicates that literacy programs should be customized to the specific contexts and needs of MSMEs to effectively support their long-term survival and stability.

In addition, financial inclusion has a direct, positive, and significant effect on financial performance, validating the third hypothesis. This implies that greater access to inclusive financial services enables MSMEs to make informed and strategic decisions, improving their financial outcomes. Consequently, inclusive finance programs must be actively promoted and expanded, particularly within MSME communities.

Likewise, financial inclusion significantly and positively affects business continuity, supporting the fourth hypothesis. This suggests that inclusive financial systems can strengthen the resilience of MSMEs, enabling them to withstand financial pressures and operational uncertainties.

Financial performance itself is shown to significantly and positively influence business continuity, affirming the fifth hypothesis. Among the three key variables studied—financial literacy, financial inclusion, and financial performance—financial performance exerts the strongest influence on MSME sustainability. Therefore, policies and interventions that directly improve financial performance should be prioritized to secure long-term MSME growth and resilience.

In summary, this study aimed to explore how financial literacy and inclusion contribute to improved financial performance and sustainability among MSMEs in East Java. The results clearly indicate that both factors play significant roles in enhancing performance, which in turn supports business continuity. Business actors with a solid grasp of financial concepts are better equipped to manage their resources efficiently and maintain operational stability. Nevertheless, this study has certain limitations. Future research should aim to refine the existing model and extend the investigation to other regions across Indonesia. Considering the country's vast geographic diversity, regional studies may uncover additional factors that influence the financial performance and sustainability of MSMEs.

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DECLARATION OF CONFLICTING INTERESTS

No potential conflict of interest was reported by the authors.

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