

THE EFFECT OF ENTREPRENEURIAL FINANCING CHOICE MEDIATION: FINANCIAL LITERACY ON SUSTAINABILITY OF SMES

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Abstract:

Background: Small and Medium Enterprises have great potential but face difficulties in achieving sustainability due to limited financial literacy and entrepreneurial financing choices.

Purpose: This research aims to investigate the influence of financial literacy on the sustainability of SMEs in West Sumatra and explore the mediating effect of entrepreneurial financing choice.

Design/methodology/approach: This type of research is quantitative research using a survey approach. This research involved 247 SMEs and data collection was carried out through questionnaires. This hypothesis testing was carried out by structural equation modeling (SEM) using SmartPLS 4.1.3

Finding/Results: These findings indicate that financial literacy significantly positively increases the sustainability of SMEs. However, financial literacy on entrepreneurial financing choices has a significant negative impact, as well as entrepreneurial financing choices on sustainability has a significant negative impact. Apart from that, the mediating effect of entrepreneurial financing choice in influencing financial literacy on sustainability has a significant positive impact.

Conclusion: This research shows that financial literacy positively influences sustainability in SMEs. Although entrepreneurial financing choice has a negative relationship with financial literacy and sustainability. However, the mediation role has a positive relationship.

Originality/value (state of art): Entrepreneurial financing choice is a choice made by SMEs in seeking and obtaining funding sources, both internal and external, but SMEs have obstacles in accessing external funding.

Keywords: entrepreneurial financing choice, financial literacy, SMEs, sustainability

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INTRODUCTION

Small and Medium Enterprises (SMEs) have an important role in the Indonesian economy, contributing significantly to the national Gross Domestic Product (GDP) of 60.5% as well as in employment. However, the sustainability of SMEs in Indonesia still faces various challenges, including financial literacy which is the key to empowerment SMEs so that it can be sustainable. Financial literacy involves a deep understanding of basic financial concepts including budget planning, cash management, investing and understanding risk (Kasenda, 2019). This research specifically examines SMEs in the creative economy sector in West Sumatra because they have great potential in developing SMEs in the Creative Economy Sector (Ekraf) which consists of crafts, culinary, fashion and performing arts, which not only play an important role in preserving local culture, but also has the potential to encourage regional economic growth and create jobs.

However, data shows low levels of financial literacy and limited access to financing, threatening the sustainability of SMEs in this sector. This creative economy sector has characteristics such as high innovation and creativity, but often has difficulty accessing conventional financing due to a lack of physical assets as collateral. According to Kurniawan et al. (2016) show that the creative industries in Indonesia, including West Sumatra, are dominated by SMEs and are an important source of new entrepreneurship. However, SMEs in the creative economy sector in West Sumatra still face various challenges in achieving sustainability.

According to (Mas et al. 2015) that Sustainability involves aspects of growth, evolution, strategies to maintain business continuity and development with the ultimate goal of achieving business resilience. Efforts to maintain, develop and protect resources can come from personal experience, collaboration with other people, and are based on ongoing economic conditions in the business world. It is important for business actors to continue to survive amidst the challenges they face, where successful businesses are those that can continue to develop and survive in various conditions (Ardhi, 2011). Most SMEs assume that their business operations run smoothly and normally. However, many SMEs experience no progress in business growth. This is because SMEs have limitations in financial literacy and funding choices which have an impact on business sustainability.

Lack of financial literacy can limit SMEs' opportunities to achieve sustainability. Financial literacy plays an important role in the sustainability of small and medium businesses in the creative economy sector in West Sumatra Province. Entrepreneurs with higher levels of financial literacy are more likely to make informed financial decisions and manage their resources effectively, leading to increased sustainability. In addition, financial literacy can also impact access to financial resources, because SMEs with better financial literacy tend to have better access to credit and other financial services (Li & Qian, 2020)(Akanke et al. 2023).

However, currently, financial literacy in West Sumatra Province is at a level of 40.7%, which is below the national financial literacy rate of 49.68%. (Asmaayi, 2023). This is due to the still low level of financial knowledge among SMEs. According to Rahayu and Musdholifah (2017), financial literacy affects the sustainability of SMEs. Then, according to Ye and Kulathunga (2019), financial literacy is a means to achieve business sustainability. However, before SMEs can achieve business sustainability, there is a supporting factor, namely entrepreneurial financing choice as a mediator.

Higher financial literacy is more likely to make strategic and informed financing choices, such as seeking external financing options from banks or investors, which can further contribute to the sustainability of their businesses. The relationship between financial literacy and entrepreneurial financing choices is very important for the sustainability of SMEs in West Sumatra Province. Entrepreneurial financing choice as mediation will open up opportunities for SMEs to meet operational needs that will streamline their business activities so that the desired goals are achieved.

However, there are problems faced by SMEs in accessing capital and financial institutions to provide capital. Not only does the credit value need to be increased in terms of quantity, which is currently still far from the target, but also in terms of quality it is necessary to pay attention. Of all the banks that distribute credit, not all of them have adequate experience and competence regarding SMEs. SMEs are still limited as objects that receive capital by financial institutions, but efforts to strengthen their businesses are still relatively limited (Suhendi et al. 2023). According to (Buchdadi et al. 2020) Increasing financial literacy

is considered capable of increasing access to external finance so that it has an impact on business sustainability for SMEs. The aim of this research is to examine the role of entrepreneurial financing choice in looking at the influence of financial literacy on sustainability. Apart from that, entrepreneurial financing choice as mediation is a new relationship.

METHODS

This research uses a quantitative research design with a comparative causal method, to test the impact of one variable on other variables. Data collection was carried out through distributing questionnaires. The data obtained was then analyzed using the Structural Equation Modeling-Partial Least Square (SEM-PLS) method. Determining the minimum sample size in this study was considered by the number of question indicators in the questionnaire (Hair et al. 2019). So the number of respondents for this research was 247 SME owners.

Financial literacy is knowledge and understanding of financial concepts and risks, skills, motivation and confidence to apply this knowledge and understanding to make decisions. Financial literacy can be seen from 8 measurements (Noor et al. 2020). Sustainability is the respondent's perception of a business condition in which there are ways to maintain, develop and protect resources, as well as meet existing needs in the business. Sustainability can be seen from 8 measurements (Imran et al. 2019; Zulpicha & Slamet, 2019) Entrepreneurial financing choice is a funding option for the need to procure certain goods, assets or services for entrepreneurial groups. Entrepreneurial financing choice is seen from 5 measurements (Pham & Talavera, 2018). This research was measured using a 1-5 Likert scale (1 = strongly disagree, 5 = strongly agree) to assess the extent to which the level of agreement or disagreement with the statement on a five-point scale (Sekaran & Bougie, 2016) and operational indicators for each variable can be seen in Table 1. The hypothesis applied in this research is as follows:

H1: Financial literacy has a significant positive effect on sustainability

The higher the level of financial literacy of SMEs, the more likely they are to continue running their business sustainably. This is because financial literacy provides a

better understanding of financial management, business planning and strategic decision making. SMEs with high financial literacy tend to be better able to identify and exploit opportunities, manage risks and access the resources and financing needed for business growth and sustainability.

H2: Financial literacy has a significant negative effect on entrepreneurial financing choice

Financial literacy has a significant influence on entrepreneurial financing choice taken by SMEs in West Sumatra. A good understanding of financial concepts, financial products and financing strategies enables SMEs to make more informed and strategic decisions in selecting funding sources that suit their needs and business risk profile. According to Ćumurović & Hyll (2019) show that financial literacy has a positive correlation with an individual's probability of becoming an entrepreneur, indicating that good financial understanding encourages individuals to be more confident in taking risks and seeking funding sources to start a business.

H3: Entrepreneurial financing choice has a significant negative effect on sustainability

SMEs that focus on short-term loan repayment may have limitations in allocating resources to social and environmental activities. Short-term loans, while they can help meet working capital needs, often create pressure to turn a profit quickly to meet repayment obligations. This can cause SMEs to prioritize profit-oriented operational activities and put aside social and environmental initiatives that may require Short-term loans, although they can help meet working capital needs, often put pressure on them to generate profits quickly to meet repayment obligations.

H4: Entrepreneurial financing choice has a significant positive effect in mediating the effect of financial literacy on sustainability

SMEs whose owners have a good understanding of financial products, "know about loans", tend to be wiser in choosing funding sources to support sustainability. SMEs may prefer loans with appropriate terms to finance initiatives. This is in line with the findings of (Li & Qian, 2020) which states that financial literacy contributes positively to entrepreneurial performance and participation, including in the sustainability aspect.

This research examines the impact of financial literacy on sustainability by considering the mediating role of entrepreneurial financing choice. The background is the importance of financial literacy for SMEs in facing economic challenges and business competition. Adequate financial literacy enables SMEs to manage finances effectively, access appropriate financing and make investment decisions. This will ultimately have an impact on the sustainability of SMEs. Entrepreneurial Financing choice plays a mediating role because high financial literacy is expected to increase the ability of SMEs to choose funding sources that suit the needs and characteristics of the business. Research model in Figure 1.

RESULTS

This research data was collected from SMEs in West Sumatra. The number of respondents obtained in this research was 247 SMEs in West Sumatra. The majority of respondents from 247 SMEs were 65.99% female and 34.01% male. SME owners have an age range that is dominated by 31-40 years as many as 94 people or 38.06% and have the highest level of education, which is predominantly high school graduates/equivalent. Respondents in this study were generally dominated by SMEs who were married, totaling 231 people or 93.52%. The results of the respondent characteristics are shown in Table 2. The first measurement model carried out was a reliability and validity test as shown in Table 3.

Tabel 1. Operational indicators for each variable

Variable	Dimension	Indicator symbol	Indicator	Reference
Sustainability	Sustainability	SU1	My business is involved in advancing the community/world in a non-business setting	Imran et al.(2019) & Zulpicha & Salamet (2019)
		SU2	I agree that sustainability is important to my business	
		SU3	We have created a sustainability plan for our business	
		SU4	Have a manager/office sustainability for our company is important	
		SU5	Our company treats our employees fairly (such as involvement, appreciation, respect, participation in recruitment result)	Noor et al. (2020)
		SU6	My business has capital circulation that runs smoothly	
		SU7	Maintain and maintain facilities and infrastructure as well as the quality of goods/services	
		SU8	Carry out ongoing promotions	
Financial Literacy	Financial Literacy	FL1	I know about savings	Noor et al. (2020)
		FL2	I know about the loan	
		FL3	I know about remittances	
		FL4	I know the current bank account	
		FL5	I know about savings accounts	
		FL6	I know about ATMs	
		FL7	I know how to create an account	
		FL8	I know how to withdraw or deposit cash in the account.	
Entrepreneurial Financing Choice	Formal Loans	EFC1	My business needs additional funds from a loan	Pham & Talavera, (2018)
		EFC2	My business gets a formal loan (from the bank)	
		EFC3	The formal loan term is less than one year	
	Informal Loans	EFC4	My business gets an informal loan (from friends/family)	
		EFC5	The informal loan term is more than one year	

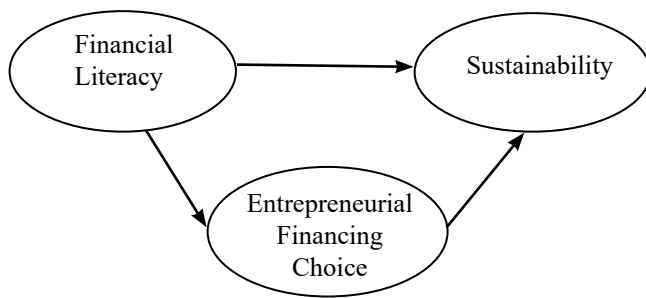


Figure 1. Research model

Table 2. Characteristics of Respondents

Category	Characteristic	Frequency	Percentage (%)
Gender	Woman	163	65.99
	Man	84	34.01
Age	<20	1	0.40
	20-30	27	10.93
	31-40	94	38.06
	41-50	93	37.65
	>50	32	12.96
Level of education	SD	7	2.83
	Junior High School	5	2.02
	SMA	154	62.35
	Diploma	12	4.86
	Masters	62	25.10
Status	Postgraduate	7	2.83
	Not married yet	16	6.48
	Marry	231	93.52

Based on the SmartPLS output in Table 3, to see the Average Variance Extracted (AVE) value, the acceptable AVE value is greater than 0.5. Apart from that, a discriminant validity test was carried out by looking at the cross loading values of each indicator. A model is said to be able to predict its own indicators well if the cross loading value of each latent variable is at the construct higher in comparison construct other. In this validity test, all variables in the outer loading are declared valid because they have a value of more than 0.6. To measure reliability, it is done by looking at the composite reliability and Cronbach's alpha values. The reliability test tested on each variable was declared reliable because it had a Cronbach's alpha >0.7. and composite reliability (CR) value > 0.7 (Hair et al. 2019).

Table 4 shows that financial literacy in entrepreneurial financing choice gives an R Square value of 0.117, which means that financial literacy is able to explain entrepreneurial financing choice by 11.7%.

Furthermore, the R Square value for financial literacy in sustainability is 0.171, which means that financial literacy is able to explain sustainability by 17.1%. After testing the external and internal models, the causal hypothesis testing for the research variables is then carried out, as shown in Table 5.

Table 5 shows that all hypotheses for direct influence are accepted. The results of the mediation test show that entrepreneurial financing choice mediates the effect of financial literacy on sustainability.

Financial literacy has a significant positive influence on sustainability. Financial literacy includes the ability to understand and use various financial services and products such as savings, loans, bank accounts and other banking transactions. When business actors have good financial literacy, they are able to manage business finances more effectively, make the right investment decisions, and utilize financial resources optimally. Good knowledge of various financial instruments also makes it possible to access and manage funds more efficiently, which supports the growth and sustainability of their business. Research conducted by Beck et al. (2015) show that good financial literacy increases entrepreneurs' ability to access and manage funds, which has a positive impact on business growth and sustainability. Research by Lusardi & Mitchell (2014) which casts financial knowledge as a form of investment in human capital. Endogenizing financial knowledge has important implications for welfare, as well as policies intended to enhance levels of financial knowledge in the larger population. Next, we draw on recent surveys to establish how much (or how little) shows that high financial literacy is closely related to better financial management practices, which in turn supports the long-term sustainability of SMEs.

Furthermore, financial literacy has a significant negative influence on entrepreneurial financial choices. High financial literacy is expected to support better decision making regarding entrepreneurial financing choices for SMEs in the creative economy sector. However, several studies show significant negative results because high financial literacy can cause business owners to be too confident or excessive in relying on external financing, such as formal loans from banks, even though the business's financial condition is not yet stable or has high risks. This decision can result in excessive financial stress and endanger business continuity. These findings are in line with (Portes, 2010) who found that business

owners with high financial literacy tend to apply for formal loans more often, but they are also more vulnerable to the risk of default if they do not have a mature financial plan and good risk management. According to (Imran et al. 2019) found that business owners may be more inclined to seek formal loans with short terms without considering the business's ability to repay the loan on time. This can cause liquidity problems and ultimately hinder business growth.

Research findings show that entrepreneurial financing choice has a significant negative influence on sustainability. This indicates that funding decisions taken by SMEs can endanger long-term business continuity. This can occur due to several factors related to the use of formal and informal loans. One of them is a mismatch between the financing period and

working capital requirements. Working capital needs are met within a short period of time, but SMEs due to difficulties in access or lack of financial literacy are trapped in short-term loans with high interest and tight payment schedules to finance long-term needs which ultimately have an impact on business sustainability. According to (Cosh et al. 2021) show that excessive dependence on formal financing can cause liquidity problems and increase the risk of bankruptcy if cash flow is not managed well. Other research that supports this finding is (Owusu et al. 2021) that SMEs that are too dependent on formal financing often face challenges in managing the debt load, which ultimately hinders long-term growth and sustainability. Pressure to repay loans in a short timeframe can shift management focus from innovation and market development strategies to sustainability.

Tabel 3. Validity and Reliability test

Variable	Items	Outer Loading	AVE	Cronbach Alpha	CR
Entrepreneurial Financing Choice	EFC1	0.827	0.612	0.845	0.887
	EFC2	0.694			
	EFC3	0.727			
	EFC4	0.840			
	EFC5	0.813			
Financial Literacy	FL1	0.847	0.761	0.955	0.962
	FL2	0.741			
	FL3	0.906			
	FL4	0.896			
	FL5	0.933			
	FL6	0.894			
	FL7	0.858			
	FL8	0.891			
Sustainability	SU2	0.664	0.536	0.711	0.821
	SU3	0.816			
	SU5	0.701			
	SU8	0.738			

Tabel 4. R Square (R²)

Variable	R Square (R ²)
Entrepreneurial Financial Choice	0.117
Sustainability	0.171

Tabel 5. Result of hypothesis testing direct and indirect effects

Hypothesis	Path	Effect Size	t-statistic	P-value	Decision
H1	Financial Literacy → Sustainability	0.299	4.516	0.000	Supported
H2	Financial Literacy → Entrepreneurial Financing Choice	-0.341	4.516	0.000	Supported
H3	Entrepreneurial Financing Choice → Sustainability	-0.20	2.895	0.004	Supported
H4	Entrepreneurial Financing Choice → Financial Literacy → Sustainability	0.069	2.335	0.020	Supported

Furthermore, research shows that entrepreneurial financing choice has a significant positive influence in mediating financial literacy on sustainability. SMEs that have high financial literacy tend to make smarter financing decisions, which in turn supports their sustainability strategies. Research by (Lusardi & Mitchell, 2014) which casts financial knowledge as a form of investment in human capital. Endogenizing financial knowledge has important implications for welfare, as well as policies intended to enhance levels of financial knowledge in the larger population. Next, we draw on recent surveys to establish how much (or how little) shows that good financial literacy allows entrepreneurs to be wiser in managing debt and cash flow, as well as taking advantage of investment opportunities that support long-term growth. SMEs that understand current savings, loans and bank accounts will be more likely to choose financing options that optimize financial stability and business sustainability. Previous research that supports these findings by (Li & Qian, 2020) shows that appropriate financing decisions, supported by good financial literacy, contribute to business sustainability.

Managerial Implications

Based on the research results, the managerial implications that can be made are improving financial literacy so that it can empower business owners to make informed decisions. Having financial programs tailored to the needs of SMEs can significantly increase the sustainability of SMEs. In addition, the negative impact of financial literacy on entrepreneurial financing choices shows the need for a balanced and diversified financing strategy. Managers should not only rely on traditional financing methods but also explore innovative options such as crowdfunding, investors and venture capital. SMEs can reduce risks and create more stable financial conditions, which is critical for their sustainability. To address the negative impact of entrepreneurial financing choices on sustainability, managers must develop systems that include access to financial advisory services, mentoring programs, and other resources. This support system can help SMEs with financing and sustainability options to thrive in a competitive market.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Research findings show important factors that influence the sustainability of SMEs in the creative economy sector in West Sumatra. Which shows that financial literacy has a significant positive effect on the sustainability of SMEs. This means that SMEs who are financially literate are better prepared to face challenges and make decisions that support business sustainability. However, high financial literacy also has a significant negative effect on entrepreneurial financing choices. This means that financially literate SMEs tend to avoid inappropriate financing options, such as short-term loans for long-term working capital or informal loans with high interest. Inappropriate entrepreneurial financing choices have been proven to have a significant negative effect on sustainability. Even though financial literacy reduces the tendency to choose risky financing, entrepreneurial financing choice as a mediation strengthens the positive influence of financial literacy on sustainability. This shows that financially literate SMEs not only experience poor choices but are also able to utilize the right financing options to improve business sustainability.

Recommendations

Based on the research results, it is recommended to examine the types of financing and their influence on the sustainability of SMEs by considering moderating factors such as type of industry and business scale so as to obtain more appropriate financing options. And SMEs are encouraged not to focus on entrepreneurial financing options that are easy or cheap in the short term but to consider entrepreneurial financing options that support SME sustainability.

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