EXPLORING FINANCIAL CAPABILITY OF SMES AND IMPROVING FINANCIAL MANAGEMENT PERFORMANCE USING FINANCIAL APPLICATION

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Abstract- Lack of Financial capability of small-medium enterprises SMEs) potentially lead to problems disturbing performance and growth of SME in Indonesia. This lack also triggers the loss of their competitive advantage. This problem arises from the less of financial literacy and capability for managing finance. Consequently, they get difficulty to access financial institutions to get funding, and cannot develop their business well. The objective of this research is to identify financial capability within SME's and design application tools to facilitate their financial management. Using qualitative methods, this research interviewed 60 entrepreneurs in Eat Java producing local prominent products. Questionnaires were used to measure SME business performance and financial capability such as financing decision, investment decision and profit management. Triangulation was used by confirming the interview data, quantitative data and FGD data. Statistic descriptive was used to analyze the data resulting that 80% of SME has good business performance. Their current sales grew more than 10%. This growth rate can be increased if they have eagerness to take a risk by investing more for increasing their production to penetrate markets. In more detailed way, it was identified the lack of SME knowledge and management on preparing financial record, loss-profit report, cash report, and assets. One of the research's outputs is a financial software compatible with PC, laptop, and mobile phone. This software is use full for SME owners to manage theirs financial business.

Key words- financial literacy, financial capability, financial system

I. INTRODUCTION

Small and Medium Enterprises (SMEs) were already proven in many countries to show an important role to boost one country economic growth. Study in Malaysia showed that SMEs were able to apply 38.9% of Malaysians workforce1.. Furthermore, Narethstated that SMEs are the driving economic growth of a country.2 In addition, 97.3% of Indonesian's Labor force are working in the SMEs sector.3

The potential of SMEs can be improved if the performance itself is upgraded. One of the main problems of SMEs in Indonesia is financial management. As a result of poor financial management, SMEs in Indonesia face difficulties in accessing the funding and focusing on growth or business development.

One of the factors associated with the inability to manage finances is the low financial capability. Financial capability is very important for the entrepreneur to the make the right decisions, leading to more valuable opportunities. In the wider context, improving financial capability can be seen as one of the ways to create Reviews These risk-taking entrepreneurs and facilitating for managing finance properly.4,5,6 Financial capability to describe people's financial knowledge and their confidence and motivation to manage personal finances.7,8 In the context of SME's, the entrepreneur's financial capabilities will affect behavior in business and financial management capability in the financial management of the business.

In a broader concept, Financial capability includes not only people's knowledge and skills to manage finance, but also their own understanding of the company owns financial circumstances, along with the motivation to take action. Financial capability enables SME plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market.9

Other than the inability to manage the SME's finances, the SME's also faced with the lack of information technology (IT) to support and manage finances. IT, in particular the applicative software needed to record and documented the requirements needed to create a financial statement. With a limited understanding of financial concepts, technology is necessary to support because when the business grows the company must find a funding from the financial institution. Financial institution itself requires company to provide them with financial statements. In addition, IT software also helps the company to create the tax reports and use the data from the software to make a strategic decision which require the company financial data. Considering the number of SMEs in Indonesia, as well as the lack of studies focusing on the SME's financial capabilities, the study aims to assess the financial capability and its influence on the company's financial capability and develop application systems can be used easily and practical for SMEs in Indonesia.

II. THEORITICAL REVIEW

2.1 Small and Medium Enterprises in Indonesia

The Limitation of SMEs can vary from one country to another country. Even in Indonesia, the term of

SMEs might also vary depending on the institution who defines them. Referring to the regulations in Indonesia, a scale businesses are grouped into micro, small, medium and large.

According to the 2008 Indonesia Government Law No. 20, Small enterprise is a business entity which has a net worth of more than Rp. 50,000,000.00 (fifty million rupiah) up to more than Rp 500,000,000.00 (five hundred million rupiah) not including land and buildings, has an annual sales turnover of more than Rp. 300,000,000.00 (three hundred million rupiah) up to a maximum of Rp 2,500,000,000.00 (two billion five hundred million rupiah). While Medium Enterprises is a business entity which has this following criteria: a net worth of more than Rp. 500,000,000.00 (five hundred million rupiah) up to a maximum of Rp 10,000,000,000.00 (ten billion rupiahs), excluding land and buildings and have annual sales revenue of more than Rp2.500.000.000,00 (two billion five hundred million rupiah) up to a maximum of Rp 50,000,000,000.00 (fifty billion rupiah).

One of the important issues faced by SMEs in Indonesia is the inability to access funding from financial institutions, particularly banks. Past studiesshowed the lack of financial competence from business owners will translate in to their financial management capability, creating difficulties for them when applying for a loan. Their financial administration is poorly managed, causing them unable to complete the SME credit terms. From a business standpoint, SMEs also have difficulty determining investment for business development.

2.2 Financial Capability and Financial Management Performance

The concept of financial capability is a broad concept because it involves a financial literacy in it. Financial capability enables people to have a proper financial behavior. People who has financial capability has the knowledge, skills and confidence to the make financial decisions.7,11, 12. In another study stated that financial capability is the knowledge, skills of a person to understand the financial condition and motivation to take action in accordance with his understanding of finance9. Johnson &Sherradenstates that financial capability is the ability to understand, assess, and act on financial awareness. Individuals who have high financial capability will seek opportunities to gain access and take advantage of financial products and services.10

Financial capability of SME managers or owners will affect their behavior in managing business finances. In financial management, there are three important activities that is related to the financial aspect, profits, and investment, three activities is an important policy in the management of the company.

Funding policy is an important policy for the company, because it involves the acquisition of resources for the company's operations. This policy will affect the capital structure and leverage factor for the company, both operating and financial leverage. Financial leverage occurs when companies use the resources which have fixed costs. It is used to provide an additional benefit that is greater than its fixed costs to improve the profit for the stakeholders. If the company determines the policy to use the resources of the debt, meaning the company's financial leverage increased, and the company will bear the fixed costs in the form of interest.13

There are several sources of funds which can be used by entrepreneurs. To fund its short-term financial needs, the company can lend from the banks, while for their long term and large quantities funding can be obtained from a capital market. Seeking funding from a capital market is greater for long term growth because there are many investors in the capital market, and there is no specific limit in which the company should lend. Other than that, the company can also seek internal funding sources. Source of internal funds derived from profits that are not shared or retained profits within the company (retained earnings).

Financial capability SMEs will affect its ability to manage profits. Whether the profits earned will be held for business development, or used for other purposes is a strategic decision which is important in financial management. This decision will have an impact on business development. In financial management, profit is the increase in capital (net assets) from the side transaction or transactions that rare of an enterprise, and of all transactions or other events that have a business entity during a period, except those arising from the income (revenue) or the owner's investment.14 In general, profit is the difference of revenue over the costs in the period (a period of) specific. Profit is frequently used as a basis for taxation, dividend policy, investment guidelines and decision making and predictive element.

Profit sharing involves the decisions to allocatethe profit of a business. Profit can be used for the personal benefit of SME owners, improving facilities and infrastructure of SMEs, or to transfer it into other assets. Each allocation has a purpose and goal of its own. SME owners can use them for personal use when it is needed and should not affect negatively on their SMEs. SME’s owner can also change their profits in to a funding by growing their profits and investing them into other profitable assets.

Another decision, which also plays an important role in business development is an investment decision. Investment decisions have a strategic long-term affect which should be carefully considered. Investment

decisions are often called as a capital budgeting which is a whole process of planning and decision-making regarding the expenditure of funds in a period which the return exceeds one year. According to Sutrisnothe planning of the investment decision is very important because two key things; firstly, the funds is very large sum; secondly, the fundscannot be recouped in the short term or obtained at once.16 The funds released will be bound in the long term, so the company had to wait for a period long enough to obtain these funds. Investment decisions regarding expectations for profits in the future. Errors in forecasting would conduct may result in over or under investment, which will ultimately hurt the company. Term investment decisions, long-term, so the error in the decision will have consequences long and heavy, as well as errors in this decision cannot be repaired without any great loss.

Investment decision is usually based on three motives. Firstly, it aims to get a better life in the future. Secondly, it reduces inflationary pressures. And thirdly, it saves the company from taxes.Good financial management can improve business performance. Business performance is a feat achieved by the company in a given period which reflects the condition of the company.17 Business performance can be measured from various perspectives such as financial perspective, internal business processes, learning and growth, as well as the marketing perspective. In this research, business performanceperformance will be viewed from the aspect of marketing and financial performance. 3.

III. RESEARCH METHODOLOGY

This study used qualitative approach involving 60 SMEs in Indonesia. Data were collected using questionnaires which includes in-depth interviews. Interviews were conducted to the owners of SMEs who produce superior local area products. Interviews were focused on knowledge of SME owners in 1) the financial base, 2) savings / deposits, 3) insurance and 4) the risk management and investment and skills in understanding about the funding policy, profit sharing policy and investment policy. The question is based on the measurement instrument and the financial capabilities of the important aspects which are fundamental to the company's financial management.

Besides interviews, Focus Group Discussion(FGD) were also conducted to identify SME requirements in financial management as an input to develop the financial management software. FGD were conducted with 10 financial managers of the SMEs. The results of these discussions will also be used to develop the financial management system software. The software will be developed and trial tested by the SME's financial managers, by doing this the software can be reevaluated and it will create more robust software .

IV. RESULTS AND DISCUSSION

The results showed that SMEs realize the importance of financial management and financial planning. However, they lack the basic understanding of it.

In terms savings, insurance and risk management understanding, the SMEs show a sufficient level of knowledge. The savings understanding is better than the insurance. Insurance related to workers and staffs, is still not well understood, even much less attention. Insurance is seen as an obligation to comply with government regulations, especially for employees. In fact, not many SMEs in Indonesia applied forother kind of insurance such as business protection.

The financial capability of the SMEs affects its ability to manage the company finances. In terms of funding, SMEs funding decisions mostly came from its own funds (49%), 51% comes from the financial institutions such as banks, pawnshops, and a personal loan. This shows that the use of funding from the financial institution has not been an important part in funding decisions. .

There are many barriers which cause difficulties for SMEs on utilizing financial institution. The main barriers are the lack of knowledge about banking (31%), owner perception on high rate of banking interest (28%), did not understand banking technology (26%), and lastly did not have prior experience on interacting with the banks (18%).

SMEs do not have a clear basis, risks assessment, and a set of long term goals in determining how much the amount of funds required to achieve targets on their business. Because there are no guidelines on this, they do not have proper plan on how much funds they needed to grow their business in the future.

In terms of profit policy, the profits were mostly used to develop the business (60%). This is reasonable, because most SMEs use their own funding, so most of their profits will go either to the business (developing the business) or to pay their loan. These results supported the ongoing research by Sriyana which showed that most profit obtained by SMEs were used for business development initiatives.15

Most SMEs investigated do not have optimal investment decisions. The analysis showed that through various financial products offered by financial instituions, only savings were chosen by the SMEs. Other products were not widely used by the SMEs, including Reksana and Deposito. The lack of managerial investment decisions to manage their finance, caused their funds being idle and not fully optimised.
This financial capabilities contribute to the business performance achieved by SMEs. The growth in sales

and profit growth was positively correlated with financial capability. Thus, the financial capability will support the business performance of SMEs. SMEs who are able to have a good financial capability, will likely able to manage their finances well, thus improving their business performance Problems faced by SMEs are their inability to manage finances, as well as having lack technology support to enable managing their financial records. Based on the survey with SMEs in four areas in East Java, it was found that all SMEs did not make proper records on their finance such as sales, supplies, account receivable, account payable. Since they are not well supported by proper records, they even hardly have forecast of sales. Things referring to purchasing have been done by common sense which in the long run this condition will not be of giving them development stand. That's why, by this research, an application system to help SMEs get used to recording such financial inputs must be developed and introduced to them. The application is designed as simply as their early level of learning so it is hoped that they can be in a good acceptance.

The application is developed based on the concept of accounting cycle, especially for small business, which begins with activities that run from a transaction takes place and ends with the reports are needed to check (closing the book). The process of recording consists of some steps simplifying several accounting concepts which are collecting data from transactions and events, putting entry of transactions into the general journal supported by each account, posting entries to the general ledger, organizing the accounts into the financial statements, closing the book. For SME owners or staff, the only one they do is putting entry of the nominal of transaction into each account of the journal. After posting all financial transactions to the accounting journals and the owners or staff are able to check the record in the general ledger, the balance sheet, income statement, capital records, and cash flow.

This financial application is a web-based application, so it can be applied using mobile phone and users can do the entry of the transaction anywhere. The benefits for SMEs are that 1) they have good financial record that ends automatically in several important financial statement that are basically used by businesses namely balance sheet, income statement, capital statement, and cash flow, 2) SMEs can be easily to make financial-based decision since they have financial references that is reliable, 3) SMEs can provide themselves with funds from banks since banks are more sure with SMEs performance by the financial statements. Besides, to support the day-to-day operation of SMEs, Financial management is important to SMEs is to increase the value of their business is (1 Recording income and expenditure of each month, (2) Recording of the use of debt and savings, (3) Inventories cash operating needs, (4) Inventories cash as a precaution, (5) The recording period of accounts payable and receivable, (6) management of the funds until the end of the month, (7) financial Planning, (8) The use / allocation of income each period end.

CONCLUSION

Financial capability plays an important role which is needed for the owners and the finance managers of SMEs. The financial capability enables SMEs to understand most financial issues and act accordingly with the data and framework for financial management. Business opportunities can also be improved if SMEs have good financial capabilities.
Financial capability also contributes heavily toward financial management. Business decisions, especially regarding funding, profits, and investments can be optimized if these aspects are supported by sufficient financial capabilities. This finding is support the previously research which was conducted by Johnson &Sherraden10.In the increasingly fierce business competition and the development of enterprises, SMEs cannot solely rely on the company's internal funding sources. Therefore, financial capabilities of SME owners are needed to manage and take the right decision in funding. The r ight investment decisions that yield optimal results are needed for the SMEs survival by making the right investment. Sufficient financial capability allows SMEs owners to make appropriate alternative profitable and secure investment, allowing them to raise the funds to support the business development. The profits are also important to be well-managed. Whether the profits will be shared or used for business development is a decision that requires sufficient financial knowledge. If SME owners have sufficient financial capability, they will be able to take appropriate decisions.
Financial management will be easier in SMEs if it is supported by a simple and practical financial application systems. As long as the system could supply with necessary information, it will help the managers to create the reports required by the management, as well as stakeholders. This application facilitates SMEs to record all of their business transactions, and access the reports required for businesses, governments and financial institutions, tax offices and other institutions. Good financial administration as a result from implementing the financial application system will also facilitate SMEs in seeking funding from financial institutions.

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