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Performance Study of Micro, Small and Medium Enterprises (MSMEs): Case Study of Economic Value Added Method and Financial Decision

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A B S T R A C T

This research provides empirical evidence for developing the concept of measuring financial performance with EVA proxies in the MSME sector. This study uses a quantitative research design based on the positivism paradigm. The sample size used in this study was the Slovin formula. The calculation results show that the number of samples was 211.76 or rounded to 212 samples. The results of this study also found financial decisions have a positive and significant effect on financial performance. MSMEs can use the financial component of the EVA, which is available directly from their accounting information, coupled with the activities of the organization affecting it, to identify areas where it can create value.

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INTRODUCTION

MSMEs in Bali Province, dominated by souvenir crafts and various Balinese food and clothing such as endek, batik, and kebaya, are spread in all city districts in Bali. The contribution of MSME's growth should directly impact regional gross domestic product. Based on the data from BPS Bali Province, Bali's economy in the fourth quarter of 2023, measured based on Gross Regional Domestic Product (GRDP) based on current prices (ADHB), was recorded at Rp72.28 trillion or if calculated based on constant prices (ADHK 2010=100), Bali's GDP was recorded at Rp41.67 trillion. Badan Pusat Statistik (BPS) or The Central Statistics Agency noted that Bali's economy during the third quarter of 2023 grew by 0.30 percent compared to the achievements of the second quarter of 2023 (q-to-q). On the other hand, compared to the same period in the previous year (y-on-y), Bali's economy in the third quarter of 2023 grew by 5.35 percent, which growth was supported by the contribution of MSMEs.

The quality of MSMEs is largely determined by competitive advantage, achieved by utilizing resources that focus on developing or acquiring valuable resources and capabilities. The combination of elements between real assets, such as financial resources, and intangible assets, especially knowledge and experience, can be integrated into achieving the desired goals, known as the resource-based view concept (Barney, 1991, 2012). The integration process between financial resources and knowledge and experience will determine the quality of financial decision-making in the MSME sector. The purpose of financial decision-making in companies is to maximize the value of the company and shareholders (Damodaran, 2000). Corporate value creation can be achieved by building better investment decisions, using the right financing structure, or implementing optimal investment policies. A firm must generate additional economic value to attract investors and avoid risking the firm's insecurity.

Economic Value Added (EVA) is a statistic that aims to measure the value generated by a company, which is described as net operating profit minus the cost of all capital used to generate revenue. EVA concept for the first time introduced by Stewart (1980), EVA/NITAMI is a financial management method for measuring economic profit in an enterprise that states that well-being can only be created when the company is able to fulfil All operating expenses and capital expenses. EVA is more suitable for use in established companies because the calculation of EVA depends on financial statements based on accounting principles, as well as companies that are sensitive to capital components. After all, it concerns the interests of shareholders. Many previous studies have calculated value creation through the EVA concept in established companies or those going public.

The difference between the current study and previous research is in terms of the utilization of EVA calculation in the MSME sector through the Hudson, et al (2001) concept approach. MSMEs can use the financial component of the EVA, which is available directly from the financial statements, combined with the organization's activities that influence the effort to identify areas where it can create value.

Ortega and Villegas (2004) studied the characteristics of MSMEs in Mexico to assess how these companies create value. In SMEs, EVA cannot be measured directly. However, it can be related to the drivers, such as investment, financing, and operating decisions, with strategies that directly generate value for the company (Amat, 2000). Based on the reference above, in this study, the EVA model was used to determine whether the strategies used by small and medium-sized enterprises are oriented toward generating economic value. The study of financial performance is done by measuring the ability to create additional value by calculating Economic Value Added (EVA) as an indicator of MSME financial performance. The use of the EVA ratio has advantages, including maximizing the value of the rate of return and minimizing the level of capital costs, so that the company's value can be maximized. The greater the value of EVA indicates the greater capital structure and cost of capital, so the company's values and profits will tend to increase, as well as profit distribution. The use of EVA in the MSME sector is a differentiator in this study because EVA's previous research was only tested on companies that went public.

THEORETICAL REVIEW

Economic Value Added (EVA) in MSMEs

Economic Value Added (EVA) can function well in the MSME sector, Garengo et al., (2005) propose that it should enable managers to identify possible actions to improve firm performances and eliminate inefficiencies. Causality should be established between outcomes and determinant factors, especially to assess past decisions and actions, but also to identify potential improvements in the company's business practices or the utilization of resources. SMEs can use the financial component of the EVA, which is available directly from accounting information, coupled with the activities of the influencing organization, which can support the identification of areas where it can create value. These activities are called business practices, defined as "A series of observable tangible operations performed by employees of a company" (Boselie et al., 2005). Details of EVA and its connection with various business practices are shown in Figure 1. It illustrates how a Performance Measurement and Management System (PMMS) considers both quantitative and qualitative aspects of performance, as Hudson, et al (2001) recommended. These include sales management practices related to the "sales" of EVA components, manufacturing management processes related to the "operating costs" component, financial management practices related to the "finance costs" component, production equipment management practices related to "net capital assets", and working capital management practices related to the "current assets" component

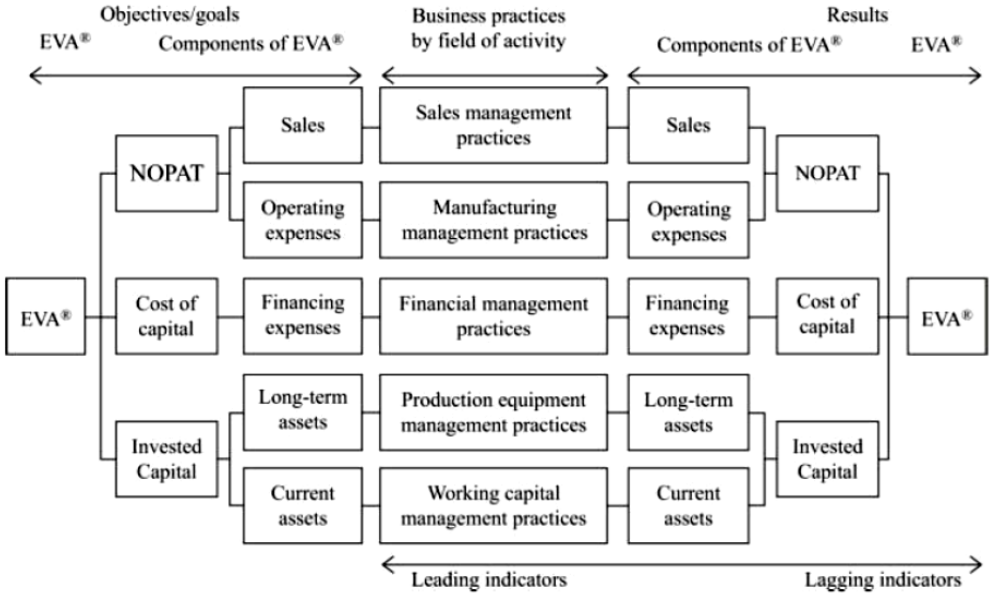

Figure 1. EVA Management Performance Measurement Tool (Hudson et al., 2001)

The concept in Figure 1 is aimed at SME performance measurement and is a tool for managers who act as key decision-makers. To improve the decision-making process, it is recommended that other employees with useful information in planning should also be involved, to show how managers can use tools to improve value creation in the company. In the second phase of the process, explore the various options available to achieve EVA objectives by considering the various factors and limitations that affect the company (human and financial resources, market conditions, and other factors). Depending on the chosen option, the manager then sets the amount or percentage of increase needed in different EVA components (e.g. 15 percent growth in sales, 4 percent reduction in operating costs,). In the third stage, they should identify business practices (driving values) and possible related actions to help achieve the objectives for each component of the EVA. In this stage, they should apply judgment and experience, and examine industry practices to identify their relevance to the company.

The EVA system is similar to the Balanced Scorecard, as it needs to be adapted to the concept of the company that uses it (Kaplan and Norton, 2003). Business practice is considered the main indicator, and it can be measured in terms of its existence and scope or frequency of use once a year when financial statements are produced. To make this system useful and valid, the company must produce a balance sheet and income statement at least once a year and collect data on the company's business practices.

Financial Decision in MSMEs

The decision-making process in MSMEs usually involves more complex strategic behaviour than usual, and the management is often analyzed from qualitative aspects that emphasize the use of creativity and intuition (Reboud and Mazzarol, 2008). In small and medium-sized firms, the process that takes place to evaluate, select and allocate resources lies with the owner or manager (Hoffman, 1972 cited by Landström, 1995). Experience, prejudice, or personal preference are elements that influence financial decisions. Byers and Snack (2001) state that entrepreneurial ability or managers are elements that become important in decision-making. Decision-making is an important process in this type of business (Spivey and McMillian 1999). A good business creates economic value and results from good financial decisions (investments, financing, and operations). However, poor financial decisions undermine value, as they threaten the viability of SMEs for decision quality, rather than external factors (Ross et al., 2002).

Selection of financial structure, which concerns funding sources derived from own capital and debt to be used by business actors. Business actors are profit-oriented and calculate the company's risk level. The company's risk level can be reflected in the comparison between the use of total debt and the company's total assets, so in this study, the Debt to Asset Ratio (DAR) is used. Debt policy includes the company's externally sourced funding policy (Hanafi, 2004); the DAR ratio is debt used to measure the ratio between total debt and total assets (Kasmir, 2012). Research from Mahendra (2015) uses DAR to measure funding decisions in manufacturing companies on the Indonesia Stock Exchange. This ratio measures how much of the company's assets are financed by creditors. The greater the use of debt, the higher the level of risk owned by the company. The safe point for companies to make loans is a maximum of 40% of the total value of assets (Farm Financial Standards Council, 2021)

The selection of investment structure involves determining how much the allocation for each asset component, both current assets and fixed assets, is decided by business actors. This dimension measurement will use the asset structure ratio indicator, which compares the number of fixed assets with total assets. If the asset structure ratio is above 50%, the company's fixed assets are greater than working capital, and large fixed assets can be used as collateral for debt to creditors. It has the potential to increase the company's risk. An asset structure that is below average by 50% means that the company invests more into working capital than fixed assets. This value shows the effectiveness of the company in managing working capital, resulting in good sales and affecting the company's profits. This condition gives the company larger internal funds so that the company will reduce dependence on external funds in the form of debt to finance company needs (Prasetya and Asandimitra, 2014).

Determining dividend policy by business actors concerns the portion of profits that will be distributed to business owners and retained as part of capital reserves. This dimension measurement will use the indicator of the ratio of capital reserves to net income (retention ratio). If companies have a retention ratio greater than 50%, larger companies allocate net profit for capital reserves as additional internal company capital, and vice versa. If the retention ratio is smaller than 50%, the larger company distributes profits in the form of dividends to the owners. For companies that are still MSMEs, capital growth obtained from net profit becomes a priority, if you make a profit, at least 50-60 percent is allocated as capital reserves so that internal capital is strong and can be reused as working capital (Rusyamsi, 1999).

METHODOLOGY

This study uses a quantitative research design based on the positivism paradigm. Positivism is an approach that departs from the belief that the legitimacy of science and research comes from using precisely measurable data, obtained through surveys/questionnaires and documentation studies on financial statements. The sampling technique in this study is the Proportionate Stratified Random Sampling method. This technique is generally used in heterogeneous populations (Solimun et al., 2018). Samples are taken from each stratum based on the type of business and then proportionally taken to obtain samples for research. Sampling is carried out through two stages. First, the selected respondents were from real-sector MSMEs. The second stage is that the selected respondents are already registered as taxpayers. The sample size used in this study applies the Slovin formula. The calculation results show that the number of samples is 211.76 or rounded to 212 samples.

RESULTS

Results of EVA Calculation on MSMEs

The calculation results will classify MSMEs as good if the EVA value is positive because they can create economic value. Conversely, if the EVA value is negative, the company's performance is not good because it cannot create economic value. Based on the results of EVA calculation shown in Table 2 below.

Table 2. Number of MSMEs Based on Financial Performance (EVA Ratio)

Information	Skala Nilai EVA	
	Positive EVA	Negative EVA
Number of MSMEs	71	141
Average EVA Value	-Rp. 32.815.499.-	

Source: Primary Data, processed (2023)

Based on Table 2, it can be seen that 71 MSMEs are able to create economic value added (EVA). In comparison, the remaining 141 MSMEs are unable to produce economic value added (EVA), with an overall average EVA value of minus Rp. 32,815,499, which means that, in general, MSMEs in Bali Province have not been able to create economic value in their business activities.

The calculation results also found information that there is a tendency from respondents who produce positive EVA to have a sales volume turnover above 10 percent of the total assets owned with an average net profit allowance of 12 percent a year for capital reserves used to expand production volume capacity to achieve sales volume targeted by the MSME players concerned. The same trend was also shown by other respondents who had negative EVA, showing that the turnover of sales volume per total asset was below 10 percent.

This research found that the tendency of sales volume growth has an important role in the creation of EVA. MSMEs with an average sales volume turnover above 10 times total assets are likely to create economic added value, and conversely, MSMEs with sales volume turnover below 10 times total assets are most likely unable to create economic added value. Slater and Narver (1990) suggest that performance should use multiple dimensions, namely not only using financial dimensions but also looking at the growth of company customers because there is a thesis that sales volume will depend on how many customers have known average consumption levels that are fixed. Therefore, the greater the number of customers, even with a fixed average consumption rate, the larger the sales volume.

Results of Financial Decision Calculation on MSMEs

Financial Decision is the skill and knowledge of MSMEs in making strategic decisions about funding sources, investment structure, and dividend policy. In this study, the financial decisions of MSMEs will be calculated using a three-ratio approach, namely Funding Decisions with Debt to Asset Ratio (DAR), Investment Decisions with Asset Structure Ratio (RSA), and Dividend Decisions with Retention Ratio (RR). The preparation of the components of financial statements needed in this study is complemented by interview techniques with respondents. The following are the results of the calculation of the three ratios of 212 respondents in this study in Table 3 below:

Table 3. Percentage Rate of MSME Financial Decision Ratio

Financial Decision Ratio (percentage)	Jumlah	Persentase
Debt to Asset Ratio (DAR)		
> 40	76	36
< 40	136	64
Average value DAR	34	
Asset Structure Ratio (ASR)		
> 50	86	41
< 50	126	59
Average value ASR	47	
Retention Ratio (*RR*)		
>50	0	0
<50	212	100
Average value RR	10	

Source: Primary Data, processed (2023)

Based on Table 3 above, it can be seen that from 212 MSME respondents, the average Debt to Asset Ratio (DAR) value is 34 percent, which means that the average respondent has a debt structure in financing total assets of 34 percent. In more detail, as many as 136 MSMEs have DAR above 40 percent, which means more than 40 percent of total assets are financed from debt. The remaining 76 MSMEs have DAR below 40 percent, which means that the total income is funded by less than 40 percent debt. The greater the use of debt will cause the level of risk owned by the company to increase. The safe point for companies to make loans is a maximum of 40 percent of the total asset value (Farm Financial Standards Council, 2021). So, in this study, most MSME respondents have a low risk of debt. Based on the results of interviews with respondents, information was obtained that MSMEs that have sources of debt financing are sourced from close relatives and families recorded as loans or debts, and others are sourced from financing non-bank microfinance institutions such as Cooperatives and Village Credit Institutions (LPD).

The second ratio is the asset structure ratio, which compares the number of fixed assets with total assets. Table 3 shows that the average value of the fixed asset structure ratio is 47 percent, which means that in general, MSME respondents have a fixed asset structure to total assets of 47 percent or below 50 percent. In more detail, as many as 86 MSMEs have an asset structure ratio above 50 percent, which means that most of the assets owned by MSMEs consist of fixed assets, while as many as 126 MSMEs have an asset structure ratio below 50 percent, which means that most of the assets owned by MSMEs consist of current assets. Based on information obtained from interviews, MSMEs with fixed assets above 50 percent of their total business assets are processing and agricultural businesses, where most of the capital is used to buy equipment and machinery. In contrast, trading and service businesses have a low fixed asset percentage because most of the capital is used for merchandise and raw material inventories.

The third ratio is the retention ratio, which is the portion of profits that will be distributed to business owners and will be retained as part of capital reserves. This dimension measurement will use the indicator of the ratio of capital reserves to net income (retention ratio). Based on Table 3, respondents' average overall retention ratio value is 10 percent, meaning that MSME respondents set aside an average of 10 percent of net profit as capital reserves. Specifically, it can be interpreted that if the company's retention ratio is more than 50 percent, so the larger company allocates net profit for capital reserves as an additional internal capital of the company, and vice versa. If the retention ratio is smaller than 50 percent, the larger company distributes profits as dividends to the owner. Based on the calculation results of Table 3, it can be assumed that all respondents, as many as 212 MSMEs, have a rent-ratio below 50 percent. For companies that are still MSMEs, capital growth obtained from net profit is a priority, if you make a profit, at least 50-60 percent is allocated as capital reserves so that internal capital is strong and can be reused as working capital.

Impact of Financial Decisions to EVA on MSMEs

The hypothesis is tested with a t-test. If the test obtained a p-value of 0.05 (α = 5%), then the test is significant. An overview of parameter estimation values and critical ratio values from structural models is presented in Table 4.

Table 4. Estimation of Structural Model Parameters

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Financial Decision (X) -> EVA (Y)	0.384	0.370	0.100	3.826	0.000

The results of the estimated parameters of the structure model show the estimated value of financial decisions on the financial performance of 0.384; with a p-value of 0.000; Based on the original sample coefficient that measures the effect of financial decisions on the company's financial performance is a positive and significant, it can be concluded that hypothesis is accepted.

DISCUSSION

The research results show that the estimated value of the effect of financial decisions on financial performance is positive and significant. These results show that financial decisions formulated by MSME players in Bali have affected the financial performance of their businesses. This finding is relevant to the evaluation-select-allocate paradigm, an element that influences financial decisions in small firms as expressed by Landström (1995). Limited sources of capital and uncertainty in the external environment, such as markets and business competition, make the financial decision-making process in the MSME sector a critical process.

MSMEs carefully evaluate, select, and allocate their resources. They also plan to determine the company's sales budget and operating expenses for additional capital reserves from the profits obtained. The allowance for profits obtained is based on sales targets to be achieved in the future by increasing capital to increase the inventory of goods or increasing production volume through the purchase of machinery that is removed from these profits. The characteristics of MSMEs managed and owned by the owner also minimize the retention ratio because most of the benefits are enjoyed by the manager and those who act as owners. The findings in this study outline that MSMEs have experienced a shift from financial management to strategic financial management, and this has proven to have a positive impact on improving MSME performance. The results of this study support the results of research from Ortega and Villegas (2004) that investment, financing, and operating decisions with strategies that directly generate value for the company. The results of this study prove the theory of Garengo, et al (2005) and Hudson (2001) that the EVA model can function well in the MSME sector and can be used to determine the strategies used by small and medium enterprises that are oriented to generate economic value.

CONCLUSIONS AND RECOMMENDATIONS

This research provides empirical evidence on the development of the concept of measuring financial performance with EVA proxies in the MSME sector. This study uses EVA calculations in the MSME sector through the Hudson, et al (2001) concept approach. The results of this study also found financial decisions have a positive and significant effect on financial performance, meaning that an increase in MSME financial decisions as measured by the ratio of debt to assets, capital structure ratio and retention ratio can improve financial performance as measured by Economic Value Added (EVA). MSMEs can use the financial component of the EVA, which is available directly from their accounting information, coupled with the activities of the organization affecting it, to identify areas where it can create value**.**

FURTHER STUDY

Further research can add other contingent variables such as psychological factors such as personality, attitude, and defence mechanisms.

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