

## The Influence of Financial Management on Financial Literacy of MSMEs

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### Abstract

*This study examines the effect of financial management on the financial literacy of Micro, Small, and Medium Enterprise (MSME) actors in Timor-Leste. MSMEs play a vital role in economic development; however, limited financial literacy and weak financial management practices continue to hinder business sustainability. This research employed a quantitative approach using a survey method, with data collected through structured questionnaires distributed to MSME actors selected through purposive sampling. Financial management was measured using indicators of financial planning, transaction recording, budgeting, cash flow management, and financial evaluation, while financial literacy was assessed based on financial knowledge, attitudes, and financial behavior. The collected data were analyzed using descriptive statistics and simple linear regression techniques. The results indicate that the level of financial management among MSME actors is moderate, with stronger performance in basic recording and cash flow management than in long-term financial planning and evaluation. Financial literacy was also found to be at a moderate level, particularly in terms of basic financial knowledge. Furthermore, regression analysis reveals that financial management has a positive and significant effect on financial literacy, suggesting that better financial management practices contribute to improved financial understanding and behavior. These findings highlight the importance of integrating financial management training with financial literacy programs to enhance MSME competitiveness and sustainability. The study contributes theoretically to the literature by emphasizing experiential learning in financial management and provides practical implications for policymakers and development institutions in designing effective MSME empowerment strategies in Timor-Leste*

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## 1. INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) play a strategic role in the national economy, particularly in job creation and income equality. The contribution of MSMEs to Gross Domestic Product (GDP) demonstrates their significant role in Indonesia's economic structure. However, various studies indicate that the sustainability of MSMEs still faces managerial challenges, particularly in financial management. Limited competence in financial recording, planning, and control often leads to business failure (Tambunan, 2019). This situation demonstrates that effective financial management is a crucial factor in supporting the sustainability and growth of MSMEs.

Financial literacy is understood as an individual's ability to understand financial concepts and risks, as well as the skills to make appropriate financial decisions to improve

well-being (OECD, 2018). In the context of MSMEs, financial literacy is the foundation for business planning, cash flow management, investment decision-making, and debt management. Low financial literacy among MSMEs often results in irrational decision-making that is not based on accurate financial data (Lusardi & Mitchell, 2014). Therefore, improving financial literacy is an urgent need to strengthen entrepreneurial capacity.

Financial management encompasses the activities of planning, recording, budgeting, controlling, and evaluating business finances. Systematic financial management practices enable MSMEs to obtain relevant information to support strategic decision-making (Brigham & Houston, 2019). Furthermore, implementing sound financial management can raise awareness of the importance of business transparency and accountability. From the perspective of behavioral finance theory, consistent financial management practices contribute to the formation of more rational financial mindsets and behaviors (Ajzen, 1991).

Several empirical studies have shown a positive relationship between financial management practices and the financial literacy levels of small business owners. Business owners who actively record and evaluate their finances tend to have a better understanding of basic financial concepts, such as risk management and investment planning (Atkinson & Messy, 2012). This indicates that practical experience in financial management can simultaneously improve financial knowledge and attitudes. Thus, financial management serves not only as an administrative tool but also as a means of financial learning.

Although extensive literature has discussed financial literacy and MSME performance, studies specifically analyzing the influence of financial management on financial literacy are still relatively limited, particularly in the context of MSMEs in developing regions (Lusardi & Mitchell, 2014; OECD, 2018). Most studies emphasize aspects of access to financing and business performance, while the relationship between financial management practices and the formation of financial literacy has not been studied in depth (Atkinson & Messy, 2012). However, practical experience in managing business finances is believed to play a crucial role in improving the financial understanding and behavior of MSME actors (Hilgert et al., 2003). Therefore, this study is important to fill this empirical gap by systematically testing the causal relationship between financial management and financial literacy. The results are expected to provide theoretical contributions to the development of financial literacy models and form the basis for formulating MSME empowerment policies based on strengthening financial managerial capacity (Tambunan, 2019).

### **Problem Formulation**

- a. What is the level of implementation of financial management among MSMEs in terms of planning, recording, budgeting, and controlling business finances?
- b. How is the level of financial literacy of MSME actors measured based on indicators of financial knowledge, attitudes, and behavior?
- c. Does financial management have a significant impact on the financial literacy of MSMEs?
- d. How big is the contribution of financial management in explaining variations in the financial literacy of MSME actors?
- e. What are the implications of the research results for developing policies to increase the managerial capacity and financial literacy of MSME actors?

### **Research purposes**

- 1) To analyze the level of implementation of financial management in MSMEs based on aspects of planning, recording, budgeting, and controlling business finances.
- 2) To identify and measure the level of financial literacy of MSME actors based on indicators of financial knowledge, attitudes, and behavior.

- 3) To empirically test and analyze the influence of financial management on the financial literacy of MSME actors.
- 4) To determine the extent of financial management's contribution to increasing financial literacy among MSMEs.
- 5) To provide policy recommendations and strategies for empowering MSMEs based on improving financial management and literacy.

## 2. METHOD

This research uses a quantitative approach with a survey method. This approach was chosen because the study aims to empirically test the relationship between financial management as an independent variable and financial literacy as a dependent variable through statistical analysis. The survey method was used to obtain data directly from respondents through the distribution of structured questionnaires. This approach allows researchers to obtain an objective picture of the financial management conditions and financial literacy levels of MSMEs in Timor-Leste systematically and measurably.

This research was conducted in Timor-Leste, a region with a concentration of MSMEs in the trade, services, and small-scale industries. The research location was chosen based on the consideration that MSMEs in Timor-Leste play a strategic role in the national economy, yet still face limitations in financial management. The research was conducted over a specific timeframe aligned with the field data collection schedule, from preparation and data collection to data processing and analysis.

The population in this study was all MSMEs actively running businesses in the research area in Timor-Leste. This population includes micro, small, and medium enterprises operating in various business sectors. Given time and resource constraints, this study employed a nonprobability sampling technique with a purposive sampling method. The sample was selected based on certain criteria: MSMEs who had been in business for at least two years, engaged in regular financial transactions, and were willing to participate as research respondents.

The data collection technique in this study used a questionnaire as the primary instrument. The questionnaire was structured as a closed-ended statement using a five-point Likert scale, ranging from strongly disagree to strongly agree. The research instrument was designed based on financial management indicators, including planning, recording, budgeting, and financial control, as well as financial literacy indicators, including financial knowledge, attitudes, and behavior. In addition to the questionnaire, supporting data were obtained through documentation studies and limited observations to strengthen the research findings.

The research variables consist of independent and dependent variables. The independent variable in this study is financial management, measured through indicators of financial planning, transaction recording, cash flow management, budgeting, and business financial evaluation. The dependent variable is financial literacy, measured through indicators of financial knowledge, attitudes toward financial management, and financial behavior in business decision-making. Each indicator is translated into several statements that can be measured quantitatively.

Instrument validity and reliability tests were conducted before primary data collection. Validity tests aimed to ensure that each statement item adequately measures the intended variable, while reliability tests measured the consistency of the research instrument. Validity tests were conducted using product-moment correlation, while reliability tests were conducted using Cronbach's alpha coefficient. An instrument is deemed suitable for use if it meets the validity and reliability criteria according to quantitative research standards.

The data analysis techniques in this study used descriptive and inferential statistical analysis. Descriptive analysis was used to describe the characteristics of respondents, the level of financial management, and the level of financial literacy of MSMEs. Inferential analysis was used to examine the effect of financial management on financial literacy through simple linear regression analysis. Before the regression analysis, the data were first tested using classical assumption tests, including normality, multicollinearity, and heteroscedasticity.

Hypothesis testing was conducted using a t-test to determine the partial effect of financial management variables on financial literacy. Furthermore, the coefficient of determination was used to determine the extent of financial management's contribution in explaining variations in MSME financial literacy. All data processing was performed using relevant statistical software to ensure more accurate and objective analysis results.

This study also considers ethical aspects of research. Each respondent was given an explanation of the research objectives and guaranteed confidentiality. Participation was voluntary and without coercion. The data obtained will be used solely for academic purposes and the development of knowledge, particularly in the field of MSME financial management in Timor-Leste.

## 1. RESULTS AND DISCUSSION

### Result

The research results were obtained from distributing questionnaires to MSMEs in Timor-Leste who met the sample criteria. Based on respondent characteristics, the majority of MSMEs operate in the trade and services sector and have been in business for more than two years. Most respondents have a secondary education and run their businesses independently without specialized administrative staff. This indicates that business financial management is largely carried out directly by the business owner, financial literacy significantly influences the quality of business decision-making.

The descriptive analysis results indicate that the level of financial management of MSMEs is moderate. The indicators for transaction recording and cash flow management have relatively higher average scores than the indicators for financial planning and evaluation. This indicates that MSMEs tend to maintain simple record-keeping but have not yet systematically developed long-term financial planning and evaluation. This situation indicates that financial management practices are still operational and not yet strategic.

Meanwhile, the analysis of financial literacy showed that respondents' financial knowledge was adequate, but their financial attitudes and behaviors varied. Some respondents understood basic concepts such as debt management and business savings, but had not fully implemented the principles of risk diversification and investment planning. This indicates that financial literacy has not been fully internalized in daily business management practices.

The results of a simple linear regression test indicate that financial management has a positive and significant effect on the financial literacy of MSMEs in Timor-Leste. The regression coefficient is positive, indicating that better financial management practices lead to higher levels of financial literacy among MSMEs. The t-test shows a significance value less than 0.05, thus accepting the research hypothesis. The coefficient of determination indicates that financial management makes a significant contribution to explaining variations in financial literacy.

### Discussion

The findings of this study indicate that financial management plays a crucial role in improving the financial literacy of MSMEs. The practice of recording transactions, controlling cash flow, and budgeting indirectly encourages entrepreneurs to gain a deeper

understanding of basic financial concepts. This aligns with experiential learning theory, which states that practical experience can enhance an individual's conceptual understanding and skills in a specific field.

The positive influence of financial management on financial literacy indicates that systematic managerial practices can shape more rational financial behavior. When MSMEs regularly conduct financial evaluations, they become more aware of business risks, capital requirements, and the importance of long-term planning. This awareness contributes to improved financial attitudes and behaviors that lead to more prudent business decision-making.

However, research also shows that some MSMEs still haven't implemented long-term financial planning optimally. This may be due to limited formal knowledge, access to training, and minimal managerial mentoring. Therefore, improving financial literacy depends not only on internal business practices but also requires external support in the form of training and empowerment policies.

In the context of Timor-Leste, the results of this study have important implications for the government and MSME development institutions. Training programs should focus not only on financial literacy theory but also on practical and simple financial management practices tailored to the capacities of business actors. Integrating financial management skills development with financial literacy education is believed to enhance the competitiveness and sustainability of MSMEs.

Overall, this study demonstrates that financial management is a significant determinant in improving the financial literacy of MSMEs in Timor-Leste. This finding reinforces the importance of a managerial practice-based approach as a strategy for enhancing entrepreneurial capacity. With improved financial management, MSMEs are expected to be able to make more rational, adaptive, and long-term sustainability-oriented business decisions.

#### 4. CONCLUSION

Based on the analysis and discussion, it can be concluded that the level of financial management of MSMEs in Timor-Leste is moderate, with aspects of transaction recording and simple cash flow management being dominant. However, long-term financial planning and evaluation have not yet been optimally implemented. This indicates that most MSMEs are still focused on short-term operations and have not fully implemented systematic financial management principles.

The research results also show that the financial literacy level of MSMEs is adequate, particularly in terms of basic financial knowledge. However, the application of rational financial attitudes and behaviors in business decision-making remains inconsistent. This indicates that conceptual understanding of finance has not been fully internalized in daily business practices.

This study empirically proves that financial management has a positive and significant impact on the financial literacy of MSMEs in Timor-Leste. The better the financial management practices implemented, the higher the level of financial literacy of the entrepreneurs. These findings confirm that practical experience in managing business finances serves as an effective financial learning tool.

Theoretically, the results of this study reinforce the view that financial literacy is influenced not only by formal education but also by managerial experience in running a business. Systematic financial management can shape more rational financial mindsets, attitudes, and behaviors that are oriented toward business sustainability. Therefore, this research contributes to the development of financial literacy studies in the MSME sector in developing countries.

Practically, this research emphasizes the importance of integrating financial literacy training and financial management mentoring for MSMEs. The government and supporting institutions in Timor-Leste are expected to design empowerment programs that emphasize simple yet applicable financial recording, planning, and evaluation practices. With these efforts, MSMEs are expected to improve the quality of their business decision-making and strengthen their competitiveness and long-term business sustainability.

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