The Influence of Financial Ratios Analysis on the Financial Performance of Micro Small Medium Enterprises in Indonesia

Review of Integrative Business & Economics Research

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ABSTRACT

Under the current paradigm in small business finance research, Micro, small, and medium enterprises play a significant role in the economy of a country. With a large number of MSMEs in Indonesia today, MSMEs help open employment, contribute to state income in the form of taxes and also contribute a significant contribution to GDP. MSMEs in Indonesia have a fundamental problem, namely a lack of knowledge or insight into managing a business, especially in the field of financial management, so that this makes the development of MSMEs in Indonesia unsustainable. In this light, this paper will investigate the importance and influence of tools of financial performance measurement that is financial ratios analysis towards the condition of the financial performance of MSMEs in Indonesia. This research will further demonstrate the importance and influence of the financial ratios analysis on the financial performance of the MSMEs in Indonesia. The paper will also provide advice in using financial ratios analysis for the owner of MSMEs.

Keywords: Financial ratios analysis, financial performance, MSMEs, Indonesia.

1. INTRODUCTION

Based on Indonesian Law Number 20 of 2008 concerning Micro, Small, and Medium Enterprises, MSMEs stands for Micro, Small, and Medium Enterprises. The existence of MSMEs in Indonesia is undeniably very supportive of the country's economy. The number of MSMEs growth in Indonesia is not very fast, but a large number of MSMEs in Indonesia in 2018 is registered by more than 55 million units (Suci, 2017). Recorded on July 6, 2018, the MSMEs sector contributed 60% to national economic growth (Suci, 2017).
With a large number of MSMEs in Indonesia, the Indonesian Government continues to target a significant growth of MSMEs in the number of 5% by 2019. So it can be said that the Indonesian Government is serious in helping the community to develop industries in the MSMEs sector (Suci, 2017).

With the continued growth in the number of MSMEs in Indonesia, MSMEs business must improve their capabilities and insights to improve all limitations and compete optimally (Rahadi, 2016), one of the ways that MSMEs business can do to improve

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competitiveness is by learning about financial management, such as insight of financial ratio analysis (Wild, 2005).

According to Ward (2007), financial ratio analysis presents the relationship between the financial statements on a specific period. According to Aksoy & Ugurlu (2006), financial ratios indicate a company's financial performance so if the ratio of a company's performance is above the average industry performance of a company then either (outperformed) and vice versa (underperformed). Of the two statements above contained the sense that the actual financial ratios illustrate the direct relationship between the accounts that exist on the financial statements (Ahmad, 2013).

This study, as part of thesis research, will try to define the influence of financial ratios analysis to the financial performance of MSMEs in Indonesia by analyzing problems that arise that can be seen from the results of the financial ratio analysis. In this paper, a model is constructed to measure the usability of the financial ratios analysis on MSME's financial performance.

2. LITERATURE REVIEW

Researchers have suggested several theories that show the importance of financial ratio analysis to financial performances of micro, small, and Medium Enterprises.

Researchers have learned studies in financial ratios analysis and MSMEs in recent years. Examples of studies include studies from Shahbaz et al. (2014) about performance measurement of small and medium enterprises; Ndou (2014) about assessment of access to financial management services by small, medium, and micro enterprises; Mendoza (2015) about financial performance of micro, small, and medium enterprises; Mendoza (2014) about accountancy service requirements of micro, small, and medium enterprises; Chong (2008) about measuring performance of small-and-medium sized enterprises; Dalrymple (2004) about measuring performance of small and medium enterprises; Baltar et al. (2014) about innovative entrepreneur and strategic decisions; Lin et al. (2011) about financial ratio selection for business crisis prediction; Ohlson (1980) about using financial ratios analysis as a tool to predict bankruptcy; Lewellen (2002) about using financial ratios analysis as a tool to predict returns; Saikia (2012) about measuring financial performance of small scale industries; Naidu & Chand (2013) about Financial problems faced by micro, small and medium enterprises in the small island states; and Lohrey (2018) about the importance of financial ratio analysis in financial planning.

Other previous study shows that a company including MSMEs in determining its plans and evaluating its shortcomings, desperately needs a facility in the form of financial performance measurement, because financial performance as an indicator can provide very measurable considerations. Measurement in financial performance can also help a company in studying conditions in the past in order to avoid the same mistakes and also in order to maintain what is right (Chmielewska & Matuszyk, 2017).

Financial ratios are one of the tools in financial performances that used as an analytical tool to assess financial performance and to evaluate the overall financial

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condition of a corporation or other organization. So financial ratios are significant to pinpoint strengths and weaknesses from which strategies and initiatives can be formed (Theogene et al., 2017).

Financial ratio analysis has some of the essential components to be discussed, namely liquidity measurement ratios, debt ratios, profitability indicator ratios, cash flow indicator ratios, and operating performance ratios (Hayes, 2017).

2.1 Liquidity Measurement Ratios

Liquidity measurement ratios are the ratios that measure the capacity of a company to meet its temporary obligation commitments. These ratios measure the capacity of a company to satisfy its temporary liabilities when they fall due. The liquidity ratios are an aftereffect of partitioning money and other fluid resources by the temporary borrowings and current liabilities (Costea & Hostiuc, 2009).

Liquidity measurement ratios include some other ratio analyzes in order to take measurements comprehensively, the analysis of the ratio includes a quick ratio, current ratio, cash ratio, and cash conversion cycle (Wohlenr, 2017).

2.2 Debt Ratios

Debt ratios measure the ability of a company to meet its financial obligations when they fall due. Debt ratios indicate the ability of a company to repay the principal amount of its debts, pay interest on its borrowings, and to meet its other financial obligations. Debt ratios usually compare the debts of a company to its assets (Falk & Steiger, 2018).

The typical examples of financial leverage ratios include debt ratio, interest coverage ratio, capitalization ratio, debt-to-equity ratio, and fixed assets to net worth ratio (Kenton, 2019).

2.3 Profitability Indicator Ratios

Profitability Indicator Ratio measures a company's capacity to create income concerning deals, assets, and value. These ratios evaluate the capacity of a company to create income, benefits, and money streams in respect to concerning some measurement, frequently the measure of cash contributed. They feature how adequately the benefit of a company is being overseen (Tulsian, 2014).

Regular instances of profitability ratios incorporate net profit margin, return on investment (ROI), return on equity (ROE), earning per share (EPS). These proportions show how well a company is performing at creating benefits (Kenton, 2018).

2.4 Cash Flow Indicator Ratios

Operating performance ratios are tools, which measure the function of certain core operations for an organization or business. Mainly, these ratios reveal information about how efficiently that organization is using resources to generate sales and cash.

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A company with stable performance ratios can utilize a minimum resource pool to generate high levels of sales, as well as a significant cash inflow (Jooste, 2007).

2.5 Operating Performance Ratios

Operating performance ratios are instruments, which measure the capacity of certain primary operations for a business institution. Mainly, these ratios uncover data about how effectively that business is utilizing assets to produce deals and money (Heron & Lie, 2002).

3. SUMMARY OF ANALYSIS

With the significant role of MSMEs in economic growth in Indonesia, the condition of MSMEs in Indonesia is still not optimal, and there are still many MSMEs in Indonesia that do not yet have transparent work systems and other weaknesses such as the absence of standards for products produced and the limited types produced.

The weaknesses above can be overcome by applying measurements to the financial performance by using financial ratios analysis, one of the methods is to do financial analysis ratios. By knowing how well financial performance in MSMEs, of course, the owners of MSMEs can know and evaluate financial problems that have taken place as a whole so that MSMEs in Indonesia can develop without financial problems that are already commonplace.

4. DISCUSSIONS AND CONCLUSION

Based on the literature studies above, there are several syntheses that the authors can discover involving optimizing financial performance in MSMEs industry in Indonesia using financial ratio analysis. There are five main components involved in the maximization of financial performance using financial ratios analysis: liquidity measurement ratios, debt ratios, profitability indicator ratios, cash flow indicator ratios, and operating performance ratios.

For this preliminary study, the authors have concluded to make a conceptual framework, which will be applied through future studies.

By referring to Figure 1, a conceptual framework is made to illustrate the factors that will affect optimizing financial performance in MSMEs industry in Indonesia. In this study focuses on the five main independent variables namely liquidity measurement ratios, debt ratios, profitability indicator ratios, cash flow indicator ratios, and operating performance ratios toward the dependent variable which is maximized MSMEs financial Performance.

From the conceptual framework used, the hypotheses have been developed for this study as follow:

H1: Good liquidity measurement ratios had a significant impact on maximized MSMEs financial performance.

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H2: Good debt ratios had a significant impact on maximized MSMEs financial performance.

H3: Good profitability indicator ratios had a significant impact on maximized MSMEs financial performance.

H4: Good cash flow indicator ratios had a significant impact on maximized MSMEs financial performance.

H5: Good operating performance ratios had a significant impact on maximized MSMEs financial performance.

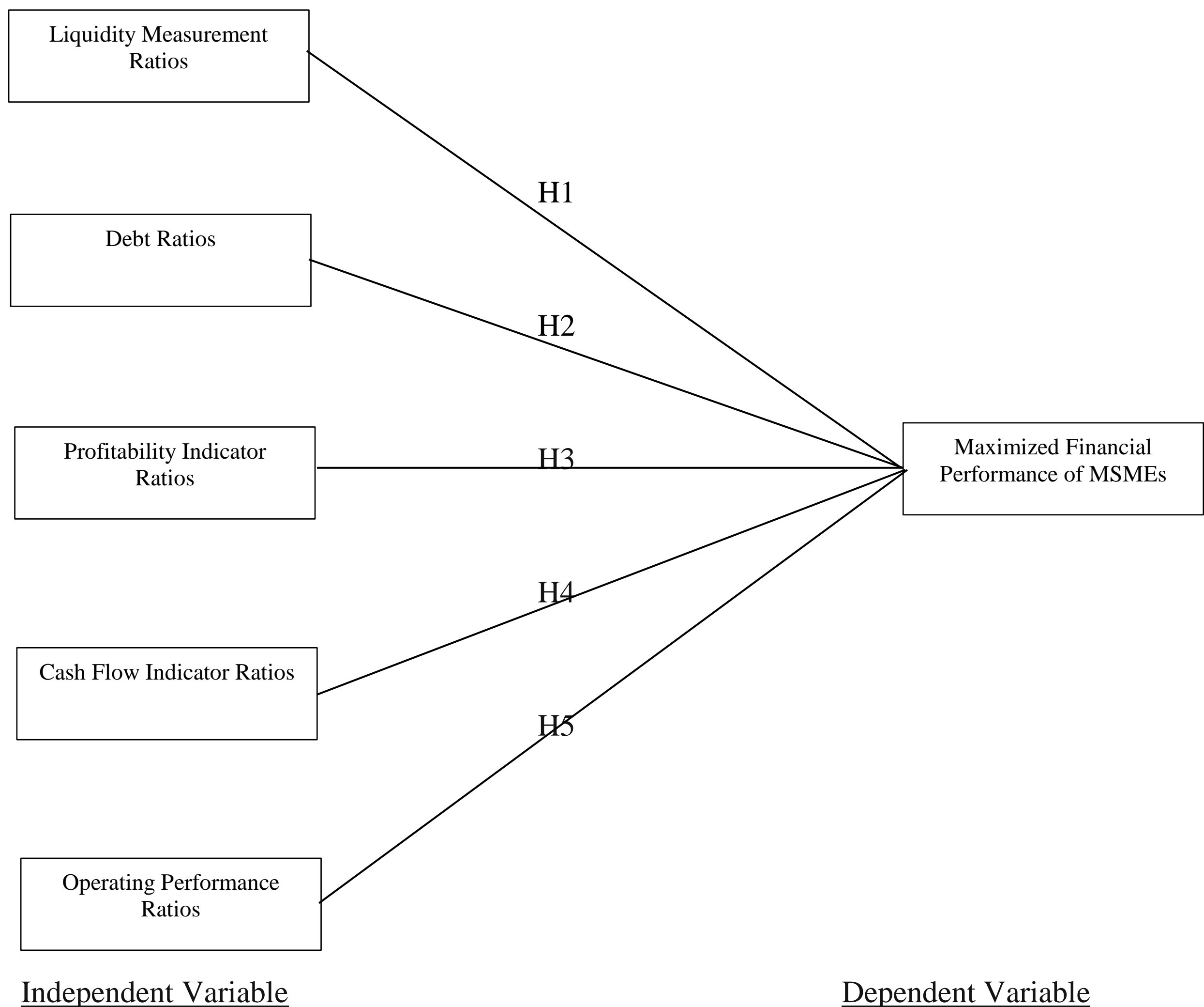

Figure 1: Conceptual framework (Author's Interpretation)

5. FUTURE RESEARCH

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This research is an ongoing and repeated process. This study aims to build a theoretical framework to understand the importance and influence of financial ratio analysis on the financial performance of MSMEs in Indonesia. This research was also made as a reference for future researchers with the same scope of research. Many previous studies have focused on the importance of financial performance to MSMEs business unit, but this study more intensely focused on tools of financial performance measurement of MSMEs that is financial ratio analysis.

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