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## FINANCE | RESEARCH ARTICLE

## The Influence of Financial Literacy and Financial Digitalization on the Profitability: Study on Micro and Small Enterprises Business Incubator in Palu City, Indonesia

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**Abstract:** This study aims to analyze the effect of financial literacy and financial digitalization on the profitability of MSMEs registered with the Palu City Business Incubator (INBIS) in the 2023-2024 period. Given the crucial role of MSMEs in the local economy and the challenges related to financial literacy and digitalization adoption, this study seeks to provide empirical evidence. A quantitative approach with descriptive and causal methods was used, involving 30 MSMEs through a census to obtain comprehensive data. Data analysis was carried out using multiple linear regression. The results showed that financial literacy significantly affected MSME profitability, making a greater contribution than financial digitalization. Financial digitalization also had a positive impact, although its contribution was relatively smaller. Simultaneously, financial literacy and financial digitalization significantly affected MSME profitability. These findings emphasize the importance of a combination of good financial literacy and adoption of digital technology. The implication is that the government and INBIS need to design a sustainable integrated training program to improve MSME digital financial literacy. MSMEs are advised to actively utilize digital financial platforms and improve their understanding of financial management. Financial institutions are expected to develop products according to MSME needs and provide more effective financial education. This research provides insights for stakeholders in supporting the growth of MSMEs through increasing literacy and digital transformation, which ultimately contributes to regional economic stability.

**Keywords:** Financial Literacy, Financial Digitalization, Profitability, MSMEs.

**JEL Classification Code:** G53, D14, L26, O33, M21, C30.

### 1. INTRODUCTION

The influence that is considered quite significant has been given by Micro, Small and Medium Enterprises (MSMEs) to the economy, because this sector plays a crucial role in a country's economy and is also included in the largest group of economic actors for Indonesia in the economic sector (Arini et al., 2023; Rusyida, 2022). Therefore, MSMEs play an important role in recovering from the economic crisis (Ibrahim et al., 2024). The low resilience and flexibility of MSMEs in facing various challenges, including during the pandemic, is caused by the lack of digital literacy (Rusyida, 2022), and also the low level of financial literacy in Indonesian society is based on the results of an OJK survey conducted in 2022. The results show that the financial literacy index of Indonesian society is only 49.68% (OJK, 2022). Although it shows an increase compared to previous years, this figure is still relatively low compared to the average of several other ASEAN countries, such as Singapore,



Thailand, and Malaysia (Rahayu, 2022). In addition, there are still many people or MSMEs who do not have a good understanding of how to utilize this financial digitalization to develop their businesses (Yolanda et al., 2023a). This is a significant challenge for MSMEs in Indonesia in the era of financial digitalization.

MSMEs really need a deep understanding of financial literacy. Given the importance of financial literacy, MSMEs need a deeper understanding related to managing finances (Mukhtar et al., 2017). However, as is well known, the Indonesian people have a relatively low level of financial literacy (Parandy et al., 2024). A similar situation is also experienced by business actors in Palu City, including Small and Medium Industries (IKM) members of the Business Incubator. Most of these business actors have not recorded transactions routinely and have not utilized digital financial recording applications. This problem arises due to the lack of financial literacy, including digital financial literacy, among business actors in Palu City (Wijayanti et al., 2024a). This shows that the Palu community, who are also MSMEs, do not implement good financial management practices in their businesses (Rusyida, 2022).

Financial literacy plays a major role in individual welfare when managing financial matters. This affects the activities of financial institutions and has an impact on financial stability (Pahlawi et al., 2024). The rapid growth that has occurred in the digital economy has drawn attention to the important role of financial literacy in managing the financial performance of MSMEs (Kartini & Wijaya, 2024). Financial digitalization is also very important for MSME owners. Currently, various aspects of life, including the business world, are undergoing significant transformation due to the industrial era 4.0 (Darman, 2019).

Financial digitalization is part of the main point in the current era, which offers convenience for humans in all walks of life thanks to technological advances. Information and communication technology continues to develop digitally, allowing information management to be carried out in real time without involving human intervention through the sophistication of its automatic system (Rombe et al., 2021). Business actors responded quickly by trying to change their business models from conventional (offline) to digital (online) in order to face increasingly fierce competition (Darman, 2019). In recent years, digitalization has been utilized as a form of key strategy adopted by most companies (Bachri et al., 2023). The presence of internet technology with its various applications has made many aspects of life easier, eliminating old jobs that are no longer needed. Important online service providers must also continue to improve and develop the quality of the e-services they manage to meet the dynamics of customer needs (Muzakir et al., 2021). However, this digital transformation will not be optimal without being accompanied by adequate financial literacy. Financial literacy not only includes a basic understanding of financial management, but also the ability to utilize digital technology in making smarter and more efficient financial decisions.

There has been a lot of research related to financial literacy and digitalization, but studies that directly link these two variables to the profitability of MSMEs in the INBIS environment are still limited. Previous studies have shown that financial literacy has a major influence on the profitability of MSMEs, a person with a deeper understanding of finance, has a greater chance of success (Endarto & Tirtana, 2020a; Parandy et al., 2024). In addition, financial technology and Financial Literacy can bring enormous opportunities and potential and have an impact on the Sustainability of MSMEs (Trimustikapuri et al., 2024). However, several other studies provide evidence that financial literacy and financial digitalization do not always have a major impact on the profitability of MSMEs (Demu, 2023).

In the context of the ever-evolving digital, financial literacy skills are considered important for the success of MSMEs, especially related to the application of financial technology that can improve operational efficiency and increase profitability. Therefore, this article is intended to analyze the impact of financial literacy and financial digitalization on the profitability of MSMEs registered in the Palu City Business Incubator (INBIS) in 2023-2024. By highlighting the importance of literacy and adoption of financial technology, the research carried out is expected to provide insight for MSME actors so that their financial performance improves, as well as provide suggestions for the government and financial institutions regarding regulatory planning that supports MSME growth through increased literacy and digital transformation.

## 2. LITERATURE REVIEW

The purpose of the literature review in this study is to analyze the impact of financial literacy and financial digitalization on the profitability of Micro, Small, and Medium Enterprises (MSMEs) registered in the Palu City Business Incubator (INBIS) in 2023-2024.

### 2.1 Financial Literacy

The Financial Services Authority (OJK) defines financial literacy as the skills, knowledge, and beliefs that shape a person's actions and attitudes when making decisions in managing finances in order to achieve financial well-being. Competencies included in financial literacy include an individual's ability to plan and manage finances effectively to meet daily living needs (Trimustikapuri et al., 2024). Financial understanding enables entrepreneurs to make better financial decisions, especially in cash management and investment, which have a major impact on the stability and sustainability of MSMEs (Rahim & Balan, 2021). Financial literacy in MSMEs can be improved through optimal financial planning, including structured expenses and income, investments, savings, and facilitating access to credit (Hartina et al., 2023).

Financial literacy emphasizes three main aspects: skills, knowledge, and instincts related to finance. If a community has good financial literacy, it means that the community also has adequate financial knowledge, skills to manage finances based on that understanding, and trust in financial service institutions (Primandari et al., 2024). Awareness of financial literacy is a key factor in planning finances, determining financial goals, managing finances efficiently, and making investment decisions that are beneficial for the future (Kartini & Wijaya, 2024). There are four main indicators used to measure financial literacy, namely basic knowledge of credit management, financial management, investment management and savings, plus risk management (Chen & Volpe, 1998).

### 2.2 Digitalization of Finance

The implementation of digital finance is now considered to play an important role in optimizing business financial management (Wijayanti et al., 2024b). In the financial industry, it improves performance, increases effectiveness, and efficiency of the financial intermediation process, which in turn drives economic growth and also plays an important role in various aspects of economic activity (Ngong, 2024). Fintech includes various digital financial services and platforms that utilize technology to promote innovative and easily accessible financial services and products. And can help overcome challenges such as high costs, limited physical access, and low levels of financial literacy (Rahayu, 2022). The increasingly developing technology has significantly changed the way financial services are designed, developed, and used. Fintech combines technology with financial services (Bhatt et al., 2022) and can increase competitiveness in the market by encouraging MSMEs to innovate in their products and services (Putri & Kadang, 2024).

Digital finance in the digitalization era is related to individual understanding of financial services from offers provided by financial institutions, including banks or non-bank institutions (Widyastuti et al., 2024). Financial digitalization offers inherent advantages in terms of information collection and analysis. With the help of big data, artificial intelligence, and blockchain technology, digital finance can access and process information at very low costs (Lu et al., 2024). In financial digitalization, there are three main indices used as indicators, namely the Digital Financial Inclusion Index, the Digital Intelligence Index, and the World Bank Digital Adoption Index (Tok & Heng, 2022).

### 2.3 Profitability

In general, profitability refers to the results obtained by a company in the form of income that has been reduced by all costs paid within a certain period of time and is the company's ability to make a profit (Putra & Kadang, 2020; Zaki & Qoura, 2019). Profitability can also be interpreted as an increase in owner's equity resulting from success in running business operations (Rianisari et al., 2020). Profitability ratios are Return on Equity (ROE), Net Profit Margin (NPM), Return On Asset

(ROA) and are measuring tools used to assess a company's competence in generating profits. This ratio also provides a description of how far the effectiveness of the company's management is reflected in the profits generated through sales and investment income. In general, this ratio shows the level of company efficiency (Dewanto, 2017; Muhammad et al., 2016; Ramadhani et al., 2019).

Profitability should be a primary concern for all business actors because it can help assess the extent to which a company can survive. In general, profitability measures are used to estimate how financial conditions relate to the profits and losses obtained by business actors (Yusuf et al., 2022). Profitability is always calculated through the company's asset ownership and is the main indicator that reflects the company's competence in terms of obtaining profits from ongoing operational activities (Harahap et al., 2024; Totanan et al., 2021). The most commonly used profitability indicators include net profit margin, return on capital employed (ROCE), return on invested capital (ROI), return on equity, EBIT margin, and EBITDA margin (Perisa et al., 2017).

## 2.4 Hypothesis

Awareness of basic financial concepts is the core of financial literacy, so that financial insight has a major impact on profitability. A better understanding of finance can increase profitability, and there is a positive influence found on financial literacy with MSME profitability (Sohilauw et al., 2020). Completed research provides evidence that attitudes, behaviors, and financial knowledge have a significant effect on MSME profitability (Rahim & Balan, 2020). Financial literacy plays an essential role in company profitability (Yang & Liu, 2023). The higher the financial literacy, the lower the potential for fraud or failure when managing finances (Endarto & Tirtana, 2020b).

Technological advances have driven changes in various aspects, even almost all daily activities and businesses (Ismail et al., 2023). One of the most prominent technological advances in the digital era in Indonesia today is Financial Technology (FinTech) in financial services (Ferdinandus et al., 2022). Financial digitalization can speed up and simplify the transaction process, which in turn reduces costs and increases profitability for small and medium enterprises (Yolanda et al., 2023b). Research shows that the implementation of fintech or financial digitalization can result in better financial performance, including in terms of profitability (Djoewita et al., 2024).

The impact of financial literacy is increasing along with the increasing complexity of digital finance. A good understanding of finance is essential to recognize the risks and benefits of various digital financial services and products (Yang et al., 2023). Research shows a significant relationship between financial literacy and digital financial access (Frimpong et al., 2022). Based on linearity testing, it was found that business development is significantly influenced by digital financial literacy (Ardiansyah et al., 2023). Financial literacy and fintech do have a significant influence on MSME performance, including in terms of profitability. The profitability of MSMEs in Bantul has been shown to have a significant and positive influence from financial literacy and financial digitalization (Ardiansyah et al., 2023). Therefore, the following hypothesis is proposed:

H1: Financial Literacy Affects Profitability

H2: Financial Digitalization has an impact on Profitability

H3: Financial Literacy and Financial Digitalization simultaneously affect Profitability

## 3. RESEARCH METHOD AND MATERIALS

This study uses a quantitative approach with a descriptive and causal design to analyze the impact of financial literacy and financial digitalization on MSME profitability. The descriptive approach is used to provide an overview of the level of financial literacy, financial digitalization, and MSME profitability. Meanwhile, the causal approach is used to analyze the effect of financial literacy and financial digitalization on MSME profitability. This study involves two independent variables, namely financial literacy and financial digitalization, and one dependent variable, namely profitability. Population is a collection of subjects or objects that have specific criteria and qualities and are used by researchers as the focus of research to be studied, with the intention of drawing conclusions from the results of the analysis of samples that represent the entire group (Primandari et al., 2024). The population in this study were all MSMEs registered with the Palu City Business Incubator (INBIS)



in 2023-2024, totaling 30 MSMEs . A sample is defined as a part of the population that is specifically selected for observation or research purposes (Susanto et al., 2024 ). The sample of this study was the entire population, namely 30 MSMEs, which were selected using the census method. In this study, each MSME was represented by one respondent who was the owner or financial manager of the MSME. Given that the number of MSMEs sampled was 30, the number of respondents involved in this study was 30 respondents. The selection of respondents was carried out by ensuring that they had a good understanding of the operations and finances of the MSME in question.

Data collection was conducted by distributing questionnaires directly to 30 respondents who were the research sample. Respondents were given an explanation of the purpose of the research and instructions for filling out the questionnaire. The questionnaires were collected after the respondents had completed the questionnaires. The questionnaire was designed to collect primary data on financial literacy, financial digitalization, and MSME profitability. The questionnaire consisted of three main parts, each measuring these variables. The questions in the questionnaire were arranged based on indicators relevant to each variable, obtained from a literature review and previous studies. Before being used in the study, the questionnaire was pre-tested on a small group of MSME actors outside the research sample to ensure the validity of the content and clarity of the questions. The results of the trial were used to revise and improve the questionnaire before being distributed to respondents.

The data collected from the questionnaire were analyzed using multiple linear regression techniques. Before being analyzed, the data from the questionnaire were processed through coding stages and data entry into statistical software. Coding was done to change the respondents' answers into quantitative data that could be analyzed. After the data was entered, a check was carried out to ensure there were no errors in the data input. Multiple linear regression was used to test the effect of financial literacy and financial digitalization on the profitability of MSMEs

#### 4. RESULTS AND DISCUSSION

Validity testing is carried out to test the validity of the measuring instrument. A measuring instrument is said to be valid if it is able to measure what should be measured and is able to reveal the data studied accurately. The validity of the measuring instrument is known by comparing the calculated  $r$  value with the table  $r$ .

**Table 1. Validity Test**

Variables	R count	R Table	Information
X1.1	0.813	0.3494	Valid
X1.2	0.610	0.3494	Valid
X1.3	0.610	0.3494	Valid
X1.4	0.608	0.3494	Valid
X1.5	0.835	0.3494	Valid
X1.6	0.612	0.3494	Valid
X1.7	0.611	0.3494	Valid
X1.8	0.783	0.3494	Valid
X1.9	0.579	0.3494	Valid
X1.10	0.783	0.3494	Valid
X1.11	0.567	0.3494	Valid
X2.1	0.805	0.3494	Valid
X2.2	0.739	0.3494	Valid
X2.3	0.855	0.3494	Valid
X2.4	0.507	0.3494	Valid
X2.5	0.837	0.3494	Valid
X2.6	0.837	0.3494	Valid
X2.7	0.888	0.3494	Valid
X2.8	0.739	0.3494	Valid
Y1.1	0.603	0.3494	Valid
Y1.2	0.645	0.3494	Valid
Y1.3	0.761	0.3494	Valid
Y1.4	0.771	0.3494	Valid

Variables	R count	R Table	Information
Y1.5	0.827	0.3494	Valid
Y1.6	0.853	0.3494	Valid
Y1.7	0.679	0.3494	Valid
Y1.8	0.697	0.3494	Valid
Y1.9	0.639	0.3494	Valid

Based on the table 1, all items on the measuring instrument for all variables are declared valid because the calculated r value is greater than the r-table. Reliability testing is used to test the reliability of research instruments. A questionnaire is said to be reliable if the responses given by respondents to questions or statements are stable and consistent even though the time is different. The instrument is considered reliable when the Cronbach's Alpha value exceeds 0.6.

**Table 2. Reliability Test**

Variables	Cronbach's alpha	Information
X1	0.813	Reliable
X2	0.908	Reliable
Y	0.877	Reliable

The test results show that the Cronbach's Alpha value on variable X1 is 0.813, variable X2 is 0.908, and variable Y is 0.877. Because all variables have Cronbach's Alpha values that exceed 0.6, each variable is declared reliable.

**4.1. Normality Test**

**Table 3. Normality Test**

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		30
Normal Parameters a,b	Mean	1.2084704
	Std. Deviation	1.49517523
Most Extreme Differences	Absolute	.136
	Positive	.110
	Negative	-.136
Test Statistics		.136
Asymp. Sig. (2-tailed)		.162 c
a. Test distribution is Normal.		
b. Calculated from data.		
c. Lilliefors Significance Correction.		

The normality testing method using Kolmogorov-Smirnov shows an Asymp. Sig. (2-tailed) value of 0.162, which exceeds 0.05. This result indicates that the data is normally distributed.

**4.2. Multicollinearity Test**

**Table 3. Multicollinearity Test**

Coefficients a								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-3.054	4.279		-.714	.481		
	X1	.644	.114	.669	5,659	.000	.656	1,524
	X2	.331	.137	.286	2,420	.023	.656	1,524
a. Dependent Variable: Y								

The results of the multicollinearity test show that the tolerance value for variables X1 and X2 is 0.656, and the VIF value is 1.524 respectively. Since the tolerance value is greater than 0.01 and the VIF value is below 10, the regression model does not indicate multicollinearity.

### 4.3. Heteroscedasticity Test

**Table 4. Heteroscedasticity Test**

Coefficients a								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-3.486	4.214		-.827	.415		
	X1	.702	.108	.727	6,515	.088	.695	1,439
	X2	.265	.129	.230	2,056	.050	.695	1,439

a. Dependent Variable: Y

The results of the heteroscedasticity test show a significance value greater than 0.05, which indicates the absence of heteroscedasticity symptoms.

### 4.4. Auto Correlation Test

**Table 5. Auto Correlation Test**

Model Summary <sup>b</sup>										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.868 <sup>a</sup>	.753	.734	2.119	.753	41.112	2	27	.000	1,004

a. Predictors: (Constant), X2, X1  
b. Dependent Variable: Y

Autocorrelation testing was conducted to ensure that there were no deviations in correlation between sample members. The results showed a Durbin-Watson value of 1.004. This number is in the interval  $dU = 1.594$  with  $4-dU = 2.406$ , which means that the tested model is free from autocorrelation.

### 4.5. Regression Analysis Test

**Table 5. Regression Analysis Test**

Coefficients a								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-3.054	4.279		-.714	.481		
	X1	.644	.114	.669	5,659	.000	.656	1,524
	X2	.331	.137	.286	2,420	.023	.656	1,524

a. Dependent Variable: Y

Data processing using multiple linear regression techniques produces the following regression equation:

$$Y = -3.054 + 0.644X1 + 0.331X2$$

The constant of -3.054 indicates that when Financial Literacy (X1) and Financial Digitalization (X2) are zero, Profitability (Y) will have a negative value of 3.054. The regression coefficient of X1 of 0.644 indicates that every increase of one unit of financial literacy will increase profitability by 0.644 units, assuming other variables are constant. The regression coefficient of X2 of 0.331 indicates that every increase of one unit of financial digitalization will increase profitability by 0.331 units, assuming other variables are constant.

#### 4.6. T-test

**Table 6. T-Test**

Coefficients a								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-3.054	4.279		-.714	.481		
	X1	.644	.114	.669	5,659	.000	.656	1,524
	X2	.331	.137	.286	2,420	.023	.656	1,524

a. Dependent Variable: Y

- Hypothesis 1: Financial Literacy (X1) has a significance value of 0.000, which is less than 0.05. This result proves that Financial Literacy has a significant effect on Profitability.
- Hypothesis 2: Financial Digitalization (X2) has a significance value of 0.023, which is less than 0.05. This result proves that Financial Digitalization has a significant effect on Profitability.

#### 4.7. F-Test

**Table 7. F-Test**

ANOVA a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	369,375	2	184,688	41.112	.000 b
	Residual	121,291	27	4.492		
	Total	490,667	29			

a. Dependent Variable: Y  
b. Predictors: (Constant), X2, X1

Significance value The significance value in the F test is 0.000, which is less than 0.05. This proves that profitability is significantly influenced by financial literacy and financial digitalization simultaneously.

#### 4.8. R<sup>2</sup> Test

**Table 8. R<sup>2</sup> Test**

Model Summary b										
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				Durbin-Watson	
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.868 a	.753	.734	2.119	.753	41.112	2	27	.000	1,004

a. Predictors: (Constant), X2, X1  
b. Dependent Variable: Y

Based on the test results, the R Square value is 0.753, which means that 75.3% of the variation in profitability (Y) can be explained by financial literacy (X1) and financial digitalization (X2). The remaining 24.7% is influenced by other factors not included in this research model.

#### 4.9. Discussion

The results of this study indicate that financial literacy and financial digitalization have a positive and significant effect on the profitability of MSMEs in Palu City. Financial literacy has a greater influence than financial digitalization. This is in line with the theory that states that a good understanding of finance helps MSMEs in making more appropriate and effective financial decisions. Financial digitalization also has a positive effect, but its contribution is smaller than financial literacy. This may be due to the uneven level of technology adoption among MSMEs in Palu City.

Simultaneously, financial literacy and financial digitalization contribute significantly to the profitability of MSMEs. This indicates the importance of a combination of good financial literacy skills and the use of digital technology to improve the financial performance of MSMEs. The results of this study strengthen the theory of the importance of developing financial literacy training programs and access to digital technology for MSMEs.

## 5. CONCLUSION

Based on the results of the study, it can be concluded that financial literacy and financial digitalization have a positive and significant effect on the profitability of MSMEs in Palu City. Financial literacy has a greater influence than financial digitalization. Simultaneously, financial literacy and financial digitalization provide a significant contribution to the profitability of MSMEs.

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