

## Between Expectation and Reality: Factors Determining Financing Sources Preferred and Used by MSMEs

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### Abstract

**Keywords:**  
MSMEs; Capital Structure;  
Financing Gap;  
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MSMEs have a vital role in Indonesian economy and capital is a central issue for them. However, there are still many MSMEs that struggle to grow despite various programs that are instigated to assist this sector. This study aims to provide evidence of mismatch between capital needs/preferences and use for MSMEs. We call that mismatch financing gap. The financing gap was identified through analyses of various MSMEs and owner's characteristics that affecting preference and use of financing sources by MSMEs. Questionnaires were distributed to MSMEs owners in Magelang City and 121 samples were collected. One-way Anova and Independent t-test were utilized to determine financing sources preferred by MSMEs across different owners and MSMEs characteristics. The output showed that MSMEs at different levels of growth and owners who have different levels of education and experience had different preferences toward bank debt. Furthermore, preference to government assistance and informal sources of financing were driven by MSMEs' sales and owner's motivation to start business, respectively. Multiple regression analysis was employed to determine the drivers of MSMEs' use of financing sources. The results of this study were ownership status, gender, acquisition mode, and education influenced the use of bank loans. Assistance from the government was affected by MSMEs' type of activity, sales, and experience of the MSMEs' owners. The use of informal financing sources was affected by motivation and experience of MSMEs' owners.

### Abstrak

**Kata kunci:**  
UMKM; Struktur Modal;  
Kesenjangan Pembiayaan;  
Karakteristik Organisasi

UMKM memiliki peran yang penting dalam perekonomian Indonesia dan modal merupakan salah satu faktor penting bagi mereka. Akan tetapi, masih banyak UMKM yang kesulitan untuk berkembang. Walaupun berbagai program pembiayaan digulirkan untuk membantu sektor tersebut. Penelitian ini bertujuan untuk memberikan bukti adanya ketidakcocokan/celah antara kebutuhan modal (preferensi) dan penggunaan sumber pembiayaan untuk UMKM (financing gap). Financing gap tersebut diidentifikasi dengan menganalisis berbagai karakteristik usaha dan pemilik UMKM yang berpengaruh terhadap preferensi dan penggunaan sumber pembiayaan. Pengumpulan data dari penelitian ini melalui kuesioner yang dibagikan kepada pemilik UMKM di Kota Magelang dan diperoleh 121 responden. Pengujian terhadap karakteristik UMKM dan pemilik yang berpengaruh terhadap preferensi sumber pembiayaan menggunakan One-way Anova dan independent t-test. Hasil penelitian ini menunjukkan bahwa tingkat pertumbuhan UMKM yang berbeda dan tingkat pendidikan dan pengalaman pemilik menentukan preferensi terhadap sumber pembiayaan dari pinjaman bank. Selain itu, preferensi terhadap sumber pembiayaan bantuan dari pemerintah dan informal masing-masing dipengaruhi oleh penjualan UMKM dan motivasi pemilik untuk memulai usaha. Analisis regresi berganda juga digunakan untuk menentukan karakteristik UMKM dan pemilik yang berpengaruh terhadap penggunaan sumber pembiayaan. Hasil dari penelitian ini adalah status kepemilikan, gender pemilik, cara akuisisi/memulai bisnis, dan pendidikan berpengaruh terhadap sumber pembiayaan hutang bank. Bantuan dari pemerintah dipengaruhi oleh faktor jenis aktivitas UMKM, penjualan, dan pengalaman pemilik. Sumber pembiayaan informal dipengaruhi oleh karakteristik motivasi dan pengalaman pemilik UMKM.

## 1. Introduction

Micro, small and medium enterprises (MSMEs) have several distinguishing characteristics from large companies. MSMEs are very dependent on human factors, namely the owner or manager, and capital. It is a common fact for the owner to be a manager of the MSME. Moreover, the capital owned by the owner is the only source of financing for MSMEs. The aspiration of MSMEs to grow is constrained by the availability and ability of MSMEs to access funding sources (Mulyani & Mulyadi, 2019).

Various government programs have been launched to promote the growth of MSMEs. Easy and inexpensive loan mechanisms are provided to MSMEs through micro financing institutions, for example KUR. However, MSMEs still experience difficulties in accessing these sources of funding, thereby inhibiting MSME growth as they expected (Ramdhansyah & Silalahi, 2013).

The current research stream on the field of MSMEs' financing focuses more either on the accessibility of financing sources by MSMEs (the demand side) or availability of capital by financial institutions (the supply side). On the demand side, Narsa et al. (2012) and Rahmawati & Puspasari (2017) examine the relationship between MSMEs reporting quality and access to capital. In addition, Bhagas & Handayani (2016) and Saragih (2015) provide evidence of the relationship between organizational factors and the financial performance of MSMEs. On the supply side, Ismanto & Diman (2014) and Susilo (2010) study the provision of loans and Koperasi to MSMEs.

Therefore, research on the match between financing preferences and needs (the demand side) and the availability of financing sources that can be used by MSMEs (the supply side) is of paramount. A mismatch between preferences and the use of financing sources will indicate a financing gap that exists in MSMEs financing sources.

Specifically, the research questions are what factors determine the preferences of financing sources desired by MSMEs and what factors determine the use of MSMEs financing sources. Identifying financing gap faced by MSMEs could help the policymakers to better understand the financing needs sought after by MSMEs. Therefore, they could provide more encouraging ecosystem for MSMEs to grow.

## 2. Literature Review

There are various theories that could explain the choice of a company's capital structure. Pecking Order Theory explains that, in general, companies choose to exhaust internal sources of capital. If the internal source has been used, a new external source of capital will be chosen (Nuswandari, 2013). Another theory to explain the choice of capital structure is Trade-Off Theory which rationalises that companies should use debt to take full advantage of tax deductions (Serrasqueiro & Caetano, 2015). In addition, Managerial Theory states that the owners of MSMEs as the main decision makers will have essential role in determining the capital structure (Kent Baker et al., 2017).

Based on Managerial Theory, various characteristics of owners and organizations can influence preferences and use of financing sources. The owner is a vital factor in MSMEs thus they determine the funding decisions. The ability of MSMEs to meet the terms and

conditions of fund providers depends on the availability of resources. It is ultimately determined by the characteristics of the company (Mac an Bhaird et al., 2016). Therefore, analysis of the effect of owners and MSMEs characteristics differences on preferences and use of sources of financing is essential. MSMEs characteristics used in this study are legal status, ownership status, business level, business activities, and sales. Whereas owners characteristics used are entrepreneurial motivation, business acquisition mode, gender, experience, age, and education.

In general, Medium Enterprises have more resources than Micro and Small Enterprises. These resources can be used as business capital or financing collateral (Mac an Bhaird et al., 2016). MSMEs affiliated with group companies also rely more on bank loans and inter-company loans. Meanwhile, MSMEs owned by individuals use less bank debt (Kumar & Rao, 2016). The type of business activity also affects the choice of financing. MSMEs engaged in manufacturing and construction require more capital than service businesses. Therefore, they are dealing more with banks. Likewise, MSMEs at development and expansion stages require large capital to meet their growth goals (Kumar & Rao, 2016; Wu et al., 2008).

Experienced owners could help MSMEs to obtain loans, especially those who have good relationship and good reputation with the bank. Owners who have had previous experience also tend to apply for loans again (Kumar & Rao, 2016; Mac an Bhaird et al., 2016). Owner's age also affects the financing patterns chosen and used by MSMEs. Younger owners tend to face more difficulty to access bank loans due to inadequate experience (Forte et al., 2013; Kumar & Rao, 2016; Nguyen & Luu, 2013; Serrasqueiro & Nunes, 2012). Owners with lower level of education experience a higher level of difficulty than owners with higher level of education (Belas et al., 2015). Meanwhile, men and women have different appetite toward risk. Thus, gender has different influence on capital structure decisions (Belas et al., 2015; Nainggolan & Nainggolan, 2016).

Based on previous studies, two hypotheses can be formulated, namely (1) MSMEs and owners characteristics affect the preferences of MSME financing sources, and (2) MSMEs and owners characteristics affect the decision to use financing sources.

### 3. Method

The objectives of this study are to determine the factors that influence the preferences and use of financing sources by MSMEs. The population of this research is MSMEs in Magelang City. Magelang City has considerable economic potential that it is one of the mainstay economic regions in Central Java. Magelang has better GRDP rate than other cities/districts in the Kedu Residency Area (Nuraini & Setiartiti, 2017). In addition, Magelang has strategic location. It is located in intersection between Semarang, Yogyakarta, Solo, Purworejo, Wonosobo, and Temanggung. The sample selection method is using purposive sampling technique from MSMEs data obtained from Disperindagkop Magelang City.

Questionnaire is used to collect data by visiting respondents directly. The questionnaire used was an instrument developed by Kent Baker et al. (2017). Before the

questionnaire was distributed, a pilot study was conducted involving practitioners. In addition, a review is also carried out by academics to ensure the validity and reliability of the questionnaire.

The instrument consists of 3 parts. The first part contains questions about the characteristics of MSMEs and business owners. The second part consists of questions regarding financing sources preferred by MSMEs. Whereas in the third part, the actual source of financing used by MSMEs are revealed. The financing sources are internal sources (INT), bank loans (DBT), government assistance (GVM), and informal loans (INFRM). Financing source preferences are measured using a Likert scale of 1 to 5, namely scale 1: very low preferences, scale 2: low preferences, scale 3: neutral, scale 4: high preferences, and scale 5: very high preferences. The use of financing sources is also measured using a Likert scale of 1 to 5, namely scale 1: not used at all, scale 2: rarely used, scale 3: neutral, scale 4: used frequently, and scale 5: used very frequently.

The analysis technique used to determine financing source preferences is One-way Anova (Equation 1) and independent t-test (Equation 2):

$$PRF = \mu + EXPRC + OWRSP + ACTVT + SALE + LEVEL + MTVS + \varepsilon \quad (1)$$

$$PRF = \mu + GNDR + AGE + EDCTN + LGL\_STS + MDS\_ACQ + \varepsilon \quad (2)$$

PRF is preferences of financial source, EXPRC is experience, OWRSP is ownership status, ACTVT is business activity, SALE is sales turnover, LEVEL is business level, MTVS is business motivation, GNDR is gender, AGE is age, EDCTN is education, LGL\_STS is legal status, and MDS\_ACQ is a business acquisition mode.

Multiple regression analysis is used to determine the factors that influence the selection of financing sources as shown in Equation 3.

$$\begin{aligned} PRTC = a + b1GNDR + b2AGE + b3EXPRC + b4EDCTN + b5LGL\_STS \\ + b6OWRSP + b7ACTVT + b8SALE + b9LEVEL + \\ b10MDS\_ACQ + b11MTVS + \varepsilon \end{aligned} \quad (3)$$

PRTC is the actual use of MSMEs financing sources.

#### 4. Result and Discussion

Data collection is carried out for 2 weeks at the end of 2019 and obtained 121 respondents. Table 1 shows the characteristics of the samples.

It can be concluded that 71 MSMEs have not yet registered their business. In line with this, some 90 MSMEs are micro businesses with monthly sales turnover of less than Rp. 300 million and the remaining 31 respondents are small businesses that have a sales turnover of no more than Rp. 2.5 billion. Nevertheless, as many as 33 MSMEs claimed to be in the expansion phase. In addition, 10 MSME respondents started the business with motivation to expand. This means that the business they own is not their first business.

Table 1. MSMEs and Owner Characteristics

A. MSMEs Characteristics (respondent numbers)					
Legal status	Registered	50	Activity	General trading	37
	Not yet registered	71		Manufacture	54
Ownership status	Private	102	Sales per month	Service and culinary	29
	Joint venture	2		Other	1
	Family business	17		< Rp300 million	90
Business level	Incubation	10	Rp300 million – Rp1 billion	26	
	Coaching	7	Rp1 billion – Rp2,5 billion	5	
	Development	71	Motivation	Have skills	69
Acquisition mode	Expansion	33	Work termination	1	
	Inherit	14	Expansion	10	
	Bought	1	No other work	41	
	Start from beginning	106			
B. Owner characteristics (respondent numbers)					
Gender	Male	70	Age	< 35 years	16
	Female	51		>35 years	105
Experience	< 3 years	18	Education	Highschool	108
	3 - 5 years	30		University	13
	6 – 10 years	19			
	>10 years	54			

Judging from the characteristics of the business owner, 18 respondents have less than 3 years of experience. In accordance with the data, 16 respondents aged less than 35 years and 17 MSMEs are at the level of incubation and coaching. It can be concluded that 73 MSMEs have more than 5 years of experience and 71 MSMEs are still at the growth stage. However, the MSMEs still cannot improve its business. This can be seen from the sales turnover of all MSMEs samples that are still classified as micro and small businesses.

Validity and reliability testing are done before analyzing hypotheses. Pearson correlation product moment is used to test the validity of the data. The results of the validity test showed that all variables used had a significance value of less than 0.10 except the preference and use of internal financing source. The variable has a significance value greater than 0.10 and the calculated  $r$  value is smaller than the value of  $r$  table or negative value. Therefore, preferences and use of internal financing source are invalid and are not included in the subsequent analysis test. The analysis in this study will then use 3 sources of financing, namely bank loans, government assistance, and informal loans. Cronbach's alpha value is equal to 0.6 so that it can be concluded that the instrument used is reliable.

The first objective of this study is to determine the drivers of MSMEs financing source preferences. Differences in financing source preferences are analyzed for each MSMEs and owner characteristics. Table 2 is the result of the one-way Anova and independent t-test.

Table 2. One-way Anova and Independent t-test Results

Financing source preferences			DBT	GVM	INFRM
Legal status	Registered		2,10	4,44	1,12
	Not yet registered	Average	2,14	4,49	1,13
	Independent t-test	t value	0,20	0,24	0,07
		Sign.	0,85	0,81	0,95
Ownership status	Private		2,19	4,46	1,12
	Joint venture	Average	1,50	5,00	1,00
	Family business		1,82	4,47	1,18
	One-way Anova	f value	1,08	0,20	0,15
		Sign.	0,34	0,82	0,87
Business level	Incubation		2,40	4,70	1,40
	Coaching	Average	3,43	5,00	1,14
	Development		2,08	4,42	1,10
	Expansion		1,85	4,39	1,09
	One-way Anova	f value	4,39	0,68	1,02
		Sign.	0,01	0,57	0,39
Activity	General trading		2,22	4,32	1,08
	Manufacture	Average	2,14	4,79	1,10
	Services and culinary		2,07	4,39	1,17
	One-way Anova	f value	0,17	1,51	0,32
		Sign.	0,84	0,23	0,73
Sales	< Rp300 mln		2,03	4,46	1,17
	Rp300 mln-Rp1 bln	Average	2,31	4,73	1,00
	Rp1 bln-Rp2,5 bln		2,80	3,40	1,00
	One-way Anova	f value	1,56	2,79	1,16
		Sign.	0,21	0,06	0,32
Motivation	Have skills		2,09	4,52	1,04
	Expansion	Average	2,20	4,70	1,40
	No other work		2,15	4,41	1,20
	One-way Anova	f value	0,06	0,28	2,61
		Sign.	0,94	0,76	0,07
Acquisition mode	Inherit		1,93	4,43	1,07
	Start from beginning	Average	2,14	4,48	1,12
	Independent t-test	t value	0,67	0,16	0,34
		Sign.	0,51	0,88	0,73
Gender	Male		2,11	4,46	1,10
	Female	Average	2,14	4,49	1,16
	Independent t-test	t value	0,11	0,15	0,59
		Sign.	0,91	0,88	0,56
Experience	< 3 years		2,50	4,33	1,28
	3-5 years	Average	2,40	4,37	1,07
	6-10 years		1,84	4,47	1,16
	>10 years		1,94	4,57	1,09
	One-way Anova	f value	2,20	0,29	0,72
		Sign.	0,09	0,83	0,54
Age	<35 years		2,19	4,38	1,19
	>35 years	Average	2,11	4,49	1,11
	Independent t-test	Nilai t	0,24	0,35	0,52
		Sign.	0,81	0,73	0,61
Education	Highschool		2,05	4,51	1,12
	University	Average	2,77	4,15	1,15
	Independent t-test	t value	2,23	1,03	0,22
		Sign.	0,03	0,31	0,83

MSMEs that are at different levels of growth have significantly different preferences for bank loans (DBT). MSMEs that are at the growth level have a higher preference than MSMEs that are at the incubation level, coaching or expansion. MSMEs in growth level need more capital to buy assets. In addition, MSMEs at the expansion level generally show the lowest preference for these funding sources (Abdullah et al., 2011; Ismanto & Diman, 2014).

Significant differences also appear in the government assistance preference (GVM) in MSMEs based on sales. MSMEs with sales of between Rp. 300 million to Rp1 billion have slightly higher preference to MSMEs with sales of less than Rp. 300 million. This can be due to the obstacles for MSMEs to access assistance from the government. However, assistance from the government in general has the highest average preference compared to other sources of financing.

In addition, there are significant differences in the preferences of informal financing sources based on motivation to start a business. MSMEs with motivation to expand their businesses have higher preference for informal sources of financing. MSMEs that wish to expand require large capital. If they cannot access funding sources from banks or other formal institutions, then informal sources are an option (Masiak et al., 2019).

The experience of MSME owner also significantly determines the preference for bank debt financing (DBT). The less experience of the owner, the higher the preference for bank debt. The preference for bank debt is also significantly different between high school/vocational and university graduates. University graduates prefer to obtain funds from bank loans compared to respondents with a high school/vocational education. This result is in accordance with the research conducted by Borgia & Newman (2012). They found that there is a positive relationship between the level of education of MSME owners with the leverage of debt.

The second objective of this research is to determine the factors that influence the use of financing sources by MSMEs. Table 3 shows the results of the regression to the use of bank debt financing sources.

In the MSMEs sector, most businesses are owned individually. Nevertheless, ownership status significantly influences the use of bank loans. In terms of lenders, banks consider the ownership status of an MSME in providing loans. MSMEs that are professionally managed and have a good system have easier access to sources of loans (Rahmawati & Puspasari, 2017). In addition, MSMEs affiliated with a group or joint ventures use more bank loans to finance their businesses (Kumar & Rao, 2016). Credibility and insider information help the business to get debt more easily. The gender of MSME owners influences the use of bank loans. Men and women have different perceptions and preferences about business and financial risks. Women in general have a higher risk perception compared to men (Belas et al., 2015). However, men generally have a higher risk preference than women (Sunarjanto & Roida, 2013). These perception and preference for risk will determine the source of capital to be used.

The business inception also significantly influences the use of bank loans. Businesses managed to achieve growth and expansion will require greater capital. The level of education

of the owner significantly influences the use of bank debt. Owners with higher education are considered to have better knowledge on financial markets (Kumar & Rao, 2016), higher quality and professional business management (Rahmawati & Puspasari, 2017), and assurance to achieve high profitability (Ismanto & Diman, 2014).

Table 3. Factors Affecting the Use of Bank Debt

Variables	Value	t value	Sign.
Constanta	-0,02		
Legal status	0,07	0,47	0,64
Ownership status	0,29	2,71	0,01
Level	0,03	0,30	0,77
Activity	-0,12	-1,24	0,22
Sales	-0,10	-0,75	0,45
Motivation	-0,06	-1,12	0,27
Acquisition mode	0,31	2,58	0,01
Gender	-0,28	-1,92	0,05
Experience	0,01	0,15	0,88
Age	-0,02	-0,11	0,91
Education	0,63	2,74	0,01
F value	2,37		0,01
R square	0,20		

Table 4 shows the analysis results of the use of government assistance within MSMEs and owner characteristics. Independence is essential for MSMEs. If MSMEs use bank loans as a source of capital, at some level banks can interfere in MSMEs operational activities, for example determining the minimum profitability and liquidity levels of MSMEs (Mulyani & Mulyadi, 2019). Assistance from the government is one solution for MSMEs to maintain independence and continue to get capital sourcing. The experience of the owner has a significant influence on the access MSMEs have to government assistance. The experience and knowledge of the owner can make it easier to obtain information and the process of getting government assistance. The business activities of MSMEs have a significant influence on the use of assistance from the government. Sales have a negative relationship with the use of government funding assistance. Assistance from the government is given to MSMEs with low sales or micro businesses. Microenterprises generally operate with traditional systems and tools, and use limited capital. Therefore, microenterprises are very vulnerable and need help from the government. The provision of financial assistance from the government is done selectively by considering the urgency of MSMEs funding needs. The government will provide assistance to MSMEs that really need it by considering the sustainability impact of the business.

Table 5 shows the results of factors affecting the use of informal financing sources. MSMEs require greater capital when entering growth and expansion stage, compared to MSMEs in incubation stage. MSME owners who have the motivation to expand need more funds (Masiak et al., 2019). In this study it can be seen that the motivation of the MSME owners has a significant impact on the use of informal funding. This means that funding sources originating from banks or government assistance cannot be accessed by MSMEs. MSME owners must switch to using informal sources to meet their operational needs and achieve their goals as a last resort. This motivation is then supported by the experience of



MSME owners to be able to access and pay off the informal loans. These results are in line with research conducted by [Mulyani & Mulyadi \(2019\)](#). They found that currently informal sources of financing are still very widely used by MSMEs.

Table 4. Factors Affecting the Use of Government Assistance

Variables	Value	t value	Sign.
Constanta	1,27		
Legal status	-0,16	-0,97	0,34
Ownership status	-0,13	-1,09	0,28
Level	-0,13	-1,09	0,28
Activity	0,31	2,98	0,00
Sales	-0,37	-2,62	0,01
Motivation	0,01	0,19	0,85
Acquisition mode	-0,09	-0,71	0,48
Gender	-0,21	-1,28	0,20
Experience	0,15	1,70	0,09
Age	0,33	1,41	0,16
Education	0,14	0,57	0,57
F value	2,29		0,02
R square	0,20		

Table 5. Factors Affecting the Use of Informal Financing Sources

Variables	Value	t value	Sign.
Constanta	0,10		
Legal status	0,14	0,98	0,33
Ownership status	0,01	0,09	0,93
Level	-0,09	-0,87	0,38
Activity	0,08	0,93	0,35
Sales	-0,13	-1,12	0,27
Motivation	0,12	2,59	0,01
Acquisition mode	0,08	0,76	0,45
Gender	0,15	1,14	0,26
Experience	0,16	2,16	0,03
Age	-0,04	-0,22	0,83
Education	0,03	0,13	0,90
F value	1,63		0,10
R square	0,14		

## 5. Conclusion

The objective of this research is to analyze the financing gap exists in financing sources available and expected to be used by MSMEs. This financing gap exists in the mismatch of the financing sources preferred and used in various owner's and MSMEs' characteristics. Bank loans are more preferred by business owners who have better knowledge and more experience. However, this type of financing is majorly being used by businesses that have been registered or have legal status and owners who have higher risk tolerance. Government assistance is more preferred by micro and small businesses. In fact, beside qualification of business, assistance from government is distributed based on MSMEs' type of activities and owners' past experience in dealing with government agencies ([Ardiani & Putra, 2018](#)). Informal source of financing is more preferred by owners who are motivated to expand their businesses. In reality, owners must have excellent money management experience to access this type of financing source ([Woldie & Ubrurhe, 2018](#)).

This study's results show that financing gap does exist in the preference and practice of financing sources in MSMEs, especially in Magelang City. Based on Managerial Theory, business owners and MSMEs' characteristics are the key factors in determining the type of financing sources that will be used. This study shows that for different type of financing sources require different type of qualification that the business owners' and MSMEs must have. When the business owners started their business for the first time, the majority of them would have some plans of how they would fund their operation. However, they would find that in order to access certain financing sources they would have to meet certain requirements. This could potentially be an obstacle for MSMEs to flourish.

The results of this research could help the policymakers in making a more friendly and favourable policies for the development of MSMEs. Additionally, further research could use better and more robust methods that can explain the relationship between organizational factors and performance of MSMEs.

Some of the findings of this research are noteworthy. There are significant differences in bank loans preference based on MSMEs business level, experience, and education of MSMEs owners. Whereas the use of debt financing is significantly influenced by the MSMEs ownership status, acquisition mode, gender, and owner's education level. MSMEs with different level of sales also have different preferences for assistance from the government. This study shows that MSMEs with sales of less than Rp1 billion have more preference to obtain government assistance than MSMEs with sales of more than Rp1 billion. This means that micro and small businesses are more leaning toward assistance from government than larger businesses. This might be due to government's policy to only distribute fund to micro and small businesses (Natasya & Hardiningsih, 2021). On the other hand, the use of government funding assistance is influenced by the characteristics of business activities, sales, and experience of the owner. The preference of informal financing source is influenced by owner's motivation. Whereas the actual use of informal financing is influenced by the motivation and experience of the owner.

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