MSMEs Tax Reform for Financial Sustainability: Financial Literacy, Financial Capability and Capital Structure

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ABSTRACT

In light of tax sector reforms, this study explores the dynamics of Micro, Small, and Medium-Sized Enterprises (MSMEs), with a particular emphasis on the impact of capital structure, financial literacy, and financial aptitude on these businesses' long-term viability. Structural Equation Modelling with Partial Least Squares (SEM-PLS) analysis was performed on a sample of 231 MSMEs. The findings show a strong positive correlation between capital structure and financial sustainability, financial literacy and capability, and financial capability and capital structure. For educators, practitioners, and policymakers looking to improve MSMEs' financial resilience in the face of changing tax sector reforms, the study offers insightful information.

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1. INTRODUCTION

MSMEs, or micro, small, and medium-sized businesses, encounter several difficulties since tax laws are complicated. These difficulties may impede their development and growth [1]. Nonetheless, advantageous tax laws can have a good impact on MSMEs' business expansion and investment choices, which can produce advantageous economic results [2]. Tax laws should be created by policymakers to encourage investment and business expansion, and MSMEs should carefully use these laws to boost their competitiveness and growth [3]. MSMEs also have to contend with other difficulties like competitive markets, difficulty obtaining financing, burdensome regulatory compliance, and a lack of skilled labor [4]. On the other side, MSMEs can prosper and grow with the support of government policies, access to new markets, and digital transformation prospects [5]. It is advised that customized business plans, technology adoption, talent development programs, and legislative changes be made in order to increase MSME competitiveness.

The financial sustainability of MSMEs is impacted by a number of interrelated factors, including capital structure, financial literacy, and financial capacity. Because it empowers MSMEs to make knowledgeable decisions about the acquisition and management of financial resources, financial literacy has a favorable impact on the sustainability of businesses [1] [6]. Because financial technology adoption capability gives MSMEs access to alternate funding choices, it also contributes to increased business sustainability [7]. Favorable tax laws also have a positive impact on MSMEs' business expansion and investment choices, both of which support economic growth [8]. It is crucial that MSMEs strategically take use of these advantageous tax laws in order to promote expansion and competitiveness [9]. However, there is no discernible impact of financial risk mindset or access to capital on the viability of MSMEs. In general, policymakers can create interventions and improve tax laws that support MSMEs' financial sustainability by having a better knowledge of how these elements interact. In the context of tax sector reform, this study aims to investigate this intricate link in order to offer empirical insights that can guide policies intended to strengthen the financial structure of MSMEs.

The understanding of MSMEs' crucial role in the economic ecosystem and the pressing need to comprehend the variables influencing their financial resilience in a changing tax environment serve as the foundation for this study. This study aims to provide actionable insights for policymakers, practitioners, and academics by examining the relationship between financial literacy, financial capability, capital structure, and financial sustainability. It also fosters a more nuanced understanding of the opportunities and challenges that define the MSME sector in the context of tax reform.

To maintain the sector's resilience and avoid negative repercussions on employment, innovation, and general economic stability, it is imperative to comprehend how tax sector reform affects MSMEs' financial sustainability [1]. Given MSMEs' substantial contribution to GDP and employment, it is crucial to take into account how these reforms may effect them as governments throughout the world reevaluate their tax laws in an effort to address economic difficulties and spur growth [10]. The purpose of the study is to look into how tax laws, investment choices, company expansion, and economic growth in MSMEs are related to one another [11]. Policymakers may create tax policies that encourage investment and business growth by studying how tax laws affect investment decisions and business development. MSMEs can strategically take advantage of advantageous tax laws to boost growth and competitiveness [12]. Insights from this study will help the MSMEs sector grow and develop sustainably, which will have a positive economic impact [13].

Despite playing a crucial role, the MSMES sector has significant challenges when negotiating the intricate web of tax sector reforms. The potential mismatch between changing tax laws and MSMEs' capital structure, skills, and financial knowledge is a difficulty, [14], [15]. A lack of financial competence can impede good financial management, and inadequate financial literacy can result in less than ideal use of tax incentives [16],[17],[18] . Furthermore, there is still a dearth of study on how capital structure choices affect financial sustainability in the context of tax change [19],[10] It is imperative to address these issues since they have an impact on not just specific companies but also the resilience of the MSME sector as a whole. By analyzing and addressing these problems, this research aims to provide empirical data that will help stakeholders, policymakers, and practitioners working with MSME to create a strong and sustainable economic environment.

2. LITERATURE REVIEW

2.1 Financial Literacy in MSMEs

To maximize tax planning, take advantage of available incentives, and make wise financial decisions, MSMEs must possess financial literacy in order to comprehend and negotiate the complicated tax landscape [20], [21]. In an ever-changing tax environment, it not only strengthens MSMEs' financial resilience but also serves as a vehicle for individual empowerment [22]. The inability of SMEs to fully take advantage of tax benefits and make wise financial decisions can be attributed to a lack of financial literacy [23]. Consequently, raising MSMEs' level of financial literacy is essential to their development and success in the current tax climate [24].

2.2 Financial Capability of MSMEs

Beyond financial literacy, financial capacity encompasses the tools and resources needed for efficient money management. The significance of financial competence in determining the sustainability and financial health of MSMEs has been repeatedly recognized by numerous research [25] [26]. MSMEs must carefully plan, budget, and manage their financial resources in order to maintain compliance and maximize financial strategies that will increase sustainability, particularly in light of the recent tax change [27]. To better understand how MSMEs may manage the complicated tax environment and increase their financial sustainability, a thorough examination of financial capabilities is essential [28].

2.3 Capital Structure and Financial Sustainabilityz

The capital structure decisions made by MSMEs, which involve a combination of loan and equity, have a significant impact on their capacity to remain financially stable. Industry effects have a role in determining the capital structure of MSMEs, with varying industries exhibiting distinct correlations between loan ratios and capital structure determinants [29]. Small and medium-sized businesses in the healthcare industry sometimes experience financial difficulties as a result of debt market volatility and other issues, which makes it difficult for them to secure official funding [30]. Micro, industrial, and national variables all contribute to financing difficulties for SMEs. Enhancing operational capabilities, fortifying customer links, and establishing rules for digital transformation are some of the ways to address these issues [31]. Corporate tax, firm size, tangible assets, firm risk, profitability, non-debt tax protection, and liquidity are factors that affect SMEs' capital structure [32]. MSMEs' growth is positively impacted by the quantity of funding and the repayment duration, but growth is negatively impacted by the application process and frequency of borrowing [33]. It is essential to comprehend how MSMEs respond to tax reform by optimizing their capital structure in order to develop strategies that increase their long-term financial viability.

2.4 Gaps in Existing Literature

Comprehensive research on capital structure, financial literacy, and financial aptitude in the particular context of tax sector reforms impacting MSMEs is severely lacking. The majority of research tends to concentrate on one or two factors alone, ignoring regions where it is still unclear how these factors interact and how their combined effect affects financial sustainability [34], [35], [36] . The extant body of research offers significant insights into individual components; nevertheless, a thorough comprehension of their interdependencies is absent. In light of tax sector reforms impacting MSMEs, more study is required to examine the relationship between capital structure, financial literacy, and financial competence as well as how these elements all work together to promote financial sustainability [37], [38] . By offering a thorough quantitative analysis that takes into account the complex relationships between financial literacy, financial competence, capital structure, and financial sustainability of MSMEs, this study seeks to close the gap.

3. METHODS

3.1 Design and Sample

In order to methodically gather and examine data on the capital structure, financial sustainability, financial literacy, and financial aptitude of MSMEs, a quantitative study approach was used. With the use of statistical analysis and variable measurement, this design enables the development of empirical conclusions.

In order to guarantee representation across a range of MSMEs' industries, the sampling strategy employs a stratified random sample technique. Purposive sampling in this study refers to the usage of particular criteria, such as (1). There are financial reports for MSMEs (2). NPWPs (Taxpayer Identification Numbers) are owned by MSMEs. MSMEs that are registered and active in the designated geographic area make up the target population. Using statistical power analysis, the number of selected samples of 231 MSMEs was established from a distribution of 250 questionnaires in order to strike a compromise between feasibility and accuracy.

3.2 Data Collection

A standardized questionnaire is used to collect data on capital structure, financial sustainability, financial literacy, and financial capability. The validity and reliability of the questionnaire will be pre-tested. The chosen MSMEs are made more accessible and encouraged to participate through the use of both online and offline techniques. The financial sustainability of MSMEs is the dependent variable in this study, and the independent variables are capital structure, financial literacy, and financial capability.

3.3 Data Analysis

A statistical method called Structural Equation Modeling with Partial Least Squares (SEM-PLS) is employed to examine the gathered information. The selection of SEM-PLS was based on its capacity to manage intricate correlations among variables, particularly in scenarios involving reduced sample sizes. Model specification, indicator selection, measurement model evaluation, structural model assessment, bootstrapping, and model fit assessment are the steps in SEM-PLS analysis. The process of defining a theoretical model with postulated variable relationships is known as model specification. For every hidden variable, the right indications are chosen through indicator selection. The validity and reliability of the measurement model are assessed through measurement model assessment. The relationships between variables are examined in structural model assessment. The purpose of bootstrapping is to make the analysis more resilient. The model's overall fit is assessed using the model fit evaluation tool.

4. RESULTS AND DISCUSSION

4.1 Demographic Sample

Information on company size, industry type, duration of operation, regional dispersion, ownership structure, and educational background are among the demographic characteristics of the sample group in this study. Small businesses (36.8%), medium-sized businesses (47.6%), and large businesses (15.6%) make up the sample. The industries included in the sample are as follows: retail (18.2%), manufacturing (21.6%), services (39.8%), technology (11.7%), and other (8.7%). More than 30 years (8.7%) and less than 5 years (17.4%) make up the distribution of operating length. The sample is geographically composed of metropolitan areas (52.0%), suburban areas (28.2%), and rural areas (19.8%). The ownership structure is composed of the following entities: corporations (10.4%), limited liability companies (LLC) (39.8%), partnerships (17.4%), and sole proprietorships (32.5%). The sample comprises people with the following educational backgrounds: 13.0% have only completed high school, 47.8% have a bachelor's degree, 26.1%) have a master's degree, and 13.5% have a Ph.D. or equivalent. This demographic distribution is crucial for placing the study's findings in context and offers a thorough grasp of the traits of the sample population.

4.2 Measurement Model

Assessing the measurement model's validity and reliability was the first stage in the SEM-PLS analysis. For each latent variable, Table 2 shows the loadings, Cronbach's alpha (CA) values, composite reliability (CR), and Average Variance Extracted (AVE) in order to verify the measurement model's robustness for the variables Financial Sustainability (FSU), Capital Structure (CPS), Financial Capability (FCY), and Financial Literacy (FLI).

Table 1. Validity and Reliability

Variable	CA	CR	AVE
Financial Literacy	0.857	0.873	0.654
Financial Capability	0.874	0.899	0.723
Capital Structure	0.783	0.802	0.584
Financial Sustainability	0.754	0.783	0.616

Source: Results of data processed by the author (2023)

These metrics for the variables of capital structure, financial sustainability, financial literacy, and financial capability are shown in Table 1. The range of CA values, which show strong internal consistency, is 0.754 to 0.874. With CR values ranging from 0.783 to 0.899, good reliability was indicated. The range of AVE values, which show strong convergent validity, was 0.584 to 0.723. These findings show that the variables are genuine and dependable for more study, and the measurement model is robust.

Additionally, the study's validity was determined by calculating the HTMT value below the suggested threshold (<0.85), which validates the discriminant validity between the latent variables Financial Sustainability (FSU), Capital Structure (CPS), Financial Capability (FCY), and Financial Literacy (FLI)

Table 2. Discriminant Validity

	CPS	FCY	FLI	FSU
CPS				
FCY	0.735			
FLI	0.643	0.763		
FSU	0.584	0.674	0.722	

Source: Data results processed by the author (2023)

With HTMT values below the advised level (<0.85), discriminant validity among the latent variables Financial Literacy Variables (FLI), Financial Capability (FCY), Capital Structure (CPS), and Financial Sustainability (FSU) was validated. Additionally, the research questionnaire's factor loadings and multicollinearity show how strongly the indicators and their latent variables are related.

Table 3. Research Questionnaire

Variable	Items	Code	Loading Factor	Outer VIF
Financial Literacy	1. I understand basic financial concepts, such as income, expenses and savings.	FLI.1	0.770	1.657
	2. I understand financial terms, such as ROI (Return on Investment) and investment diversification.	FLI.2	0.865	2.626
	3. I am familiar with financial instruments, such as stocks, bonds and mutual funds.	FLI.3	0.864	2.638
	4. I can interpret financial information contained in a company's financial statements.	FLI.4	0.769	1.854
	5. I often seek new information on strategies for managing my personal or business finances.	FLI.5	0.858	2.487
Financial Capability	1. I plan and manage my monthly financial budget.	FCY.1	0.810	1.711
	2. I am able to conduct risk analysis related to financial decisions, such as investing or taking out a loan.	FCY.2	0.802	1.692
	3. I can manage your debt or financial obligations in a timely manner.	FCY.3	0.838	2.101
	4. I am always effective in making long-term financial decisions, such as retirement planning or long-term investments.	FCY.4	0.846	2.175
Capital Structure	1. I am careful in determining the capital mix (equity and debt) to support my company's finances.	CPS.1	0.960	1.918
	2. I consider financial risks when determining my company's capital structure.	CPS.2	0.840	2.382
	3. I understand tax policies that may affect my company's capital structure.	CPS.3	0.739	1.864
	4. My company's capital structure is flexible in response to changes in market or economic conditions.	CPS.4	0.866	2.675
	5. I evaluate my company's capital structure to ensure long-term financial sustainability.	CPS.5	0.908	2.672
Financial Sustainability	1. I have had consistent levels of profitability in my business over the past few years.	FSU.1	0.734	1.739
	2. My business can withstand difficult economic conditions.	FSU.2	0.858	2.797
	3. My business manages cash flow to ensure operational continuity.	FSU.3	0.832	2.406
	4. My business has reserve funds to cope with unexpected events or financial crises.	FSU.4	0.795	2.147
	5. My business can meet financial obligations on time, such as debt repayment and employee salaries.	FSU.5	0.838	2.346
	6. My business is adaptive to changes in financial and tax regulations that may affect financial sustainability.	FSU.6	0.739	1.637

Source: The results of the data processed by the author (2023)

The measurement model's evaluation reveals acceptable validity and reliability. The robustness of the measurement model is supported by good discriminant validity, convergent validity, and high internal consistency. Factor loadings show that the chosen indicators capture the intended latent components accurately. These findings provide the structural model analysis that follows with confidence, guaranteeing that the measurement model offers a strong foundation for comprehending the connection between MSMEs' financial sustainability, capital structure, financial literacy, and financial capability in the context of tax sector reform.

4.3 Model Fit Evaluation

An overall evaluation of how well the structural model fits the observed data is provided by a number of model fit indices, including the Root Mean Square Error of Approximation (RMSEA), Tucker-Lewis Index (TLI), and Comparative Fit Index (CFI). Model fit indices offer important information about how well the observed data and the structural model match. A good fit is indicated by the Comparative Fit Index (CFI) value of 0.94, which is higher than the suggested threshold of 0.90. This suggests that the relationship between financial sustainability, capital structure, financial literacy, and financial capability among MSMEs is well-represented by the suggested structural model. The model fit is further validated by the Tucker-Lewis Index (TLI) value of 0.92. Like the CFI, the TLI shows that the model is in line with the observed data when it is higher than the suggested threshold. Given that the value of 0.06 for the Root Mean Square Error of Approximation (RMSEA) is within the allowed range (≤ 0.08), it suggests a satisfactory match. A low RMSEA score denotes a good fit. This metric evaluates how well the model reproduces the observed covariance matrix.

According to the model fit evaluation, the suggested structural model does a fair job of fitting the observed data. In the context of tax sector reform, the CFI, TLI, and RMSEA values all show a good fit, giving confidence in the model's capacity to capture the linkages between financial sustainability, capital structure, financial literacy, and financial aptitude among MSMEs. The R2 value offers information on the percentage of variance in each endogenous latent variable that is explained by the exogenous latent variables, and these findings support the validity of the structural model and offer a meaningful interpretation of the relationships looked at in this study. The majority of the variation in Financial Sustainability (63%), Capital Structure (49%), and Financial Capability (57%), can be explained by the suggested model. A good match between the model and the observed data is shown by these moderate to high R^2 values. Additionally, the model's predictive significance is validated by the Q^2 values, which show that the model can predict financial sustainability, capital structure, and capability. Financial Sustainability: 0.61, Capital Structure: 0.46, and Financial Capability: 0.53 are large Q^2 values that show the model's strong predictive performance for these important endogenous variables. Together, these findings highlight how well the structural model explains and forecasts the relationship between capital structure, financial sustainability, financial literacy, and financial capability among MSMEs in the context of tax sector reform.

4.4 Hypothesis Testing

The path coefficients, standard errors, t-values, and p-values for every relationship that the structural model postulates are shown in Table 4. Experts used 5,000 sub-samples to determine the structural model estimations in order to guarantee data stability [1]. This exploratory study's significance level, which varied from 5% to 10%, corresponds to the degree of significance regularly seen in management and economics studies [2]

Table 4. Hypothesis Testing

Relationship	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T-statistic	p-Values
CPS -> FSU	0.300	0.309	0.097	3.094	0.002
FCY -> FLI	0.926	0.927	0.018	52.671	0.000
FCY -> FSU	0.689	0.699	0.099	6.941	0.000
FLI -> CPS	0.899	0.903	0.030	30.282	0.000
FLI -> FSU	0.372	0.392	0.087	4.326	0.000

Source: Results of data processed by the author (2023)

In the context of tax sector reform, we investigate the impact of capital structure, financial literacy, and financial capability on the financial sustainability of Micro, Small, and Medium-Sized Enterprises (MSMEs). A total of five hypotheses are put forth, and the statistical values demonstrate an acceptable level of confidence in Hair, 2019.

Capital Structure and Financial Sustainability were shown to be significantly correlated (T-statistic = 3.094, p-value = 0.002). The association is statistically significant because the T-statistic of 3.094 is more than the critical value. As a result, we accept the alternative hypothesis (H1) and reject the null hypothesis (H0), confirming the substantial relationship between capital structure and financial sustainability of MSMEs. Financial Literacy and Financial Capability have a highly significant association, according to the analysis (T-statistic = 52.671, p-value = 0.000). Strong statistical significance is indicated by the low p-value and extremely high T-statistic. Consequently, the alternative hypothesis (H1), which shows a substantial impact of financial capability on financial literacy in MSMEs, is supported and the null hypothesis (H0) is rejected.

According to this research, financial capability significantly affects financial sustainability (T-statistic = 6.941, p-value = 0.000). The results strongly reject the null hypothesis (H0) and support the alternative hypothesis (H1), with the T-statistic exceeding the crucial threshold. This demonstrates how financial capability has a significant impact on MSMEs' financial sustainability. Financial Literacy and Capital Structure have a highly significant link, according to the analysis (T-statistic = 30.282, p-value = 0.000). The alternative hypothesis (H1) was accepted and the null hypothesis (H0) was rejected as a result of the big T-statistic and low p-value. The claim that financial literacy has a major impact on MSMEs' decisions regarding capital structure is supported by this. Financial Sustainability and Financial Literacy were found to have a significant relationship (T-statistic = 4.326, p-value = 0.000). The alternative hypothesis (H1) is accepted and the null hypothesis (H0) is rejected when the T-statistic rises beyond the critical threshold. This demonstrates that the financial sustainability of MSMEs is significantly influenced by financial literacy.

The links suggested in this study are strongly supported by the results of the hypothesis testing. The intricate interplay between Capital Structure, Financial Capability, and Financial Literacy in shaping the financial resilience and success of MSMEs amidst meaningful tax sector reform is highlighted by the statistically significant impact of these factors on Financial Sustainability (H1 to H5).

DISCUSSION

The links suggested in this study are strongly supported by the findings of the hypothesis tests. The complicated interplay of Capital Structure, Financial Capability, and Financial Literacy in determining the financial resilience and performance of MSMEs amidst tax sector reforms is shown by the statistically significant impact these determinants have on Financial Sustainability. MSMEs who manage their capital structures well have greater degrees of financial sustainability. Increasing financial literacy will improve the practical abilities needed for MSMEs to handle their finances effectively. In order to help MSMEs develop practical financial abilities, education is crucial. A staff that is knowledgeable and financially savvy is better suited to handle difficult financial decisions. Strategic capital structure decisions are more likely to be made by MSMEs with stronger financial capabilities. It is crucial to fund initiatives that help MSME owners and managers become more financially capable. Sustaining SMEs' long-term sustainability is ensured by effective capital structure management. The financial stability and health of these companies are largely determined by decisions made about debt and equity [39],[40], [41],[42] .

Our results support and add to earlier research that highlights the significance of financial capability and literacy in the setting of MSMEs. Our results support and add to other studies that have highlighted the significance of financial capability and literacy in the setting of MSMEs. The literature that is currently available supports the beneficial association between financial literacy and capability by highlighting the importance of education in enhancing practical financial skills [43]. In a similar vein, research emphasizing the impact of managerial decision-making and financial intelligence on strategic financial choices is consistent with the observed positive link between financial capacity and capital structure [44]. These results add to the increasing amount of data that shows a connection between financial capability, financial literacy, and strategic financial decision-making. Furthermore, studies highlighting the need of managing the debt-to-equity ratio for the long-term viability of MSMEs are consistent with the substantial influence of capital structure on financial sustainability [45].

Implications

These insights can be used by practitioners and policy makers to create focused strategies.

a. Support Financial knowledge Initiatives: Increasing MSME owners' financial knowledge can have a domino effect on their ability to make and sustain financial decisions.
b. Encourage the Development of Financial Capabilities: MSMEs are better equipped to handle complexity and optimize capital structure through programs that enhance practical financial skills.
c. Promote Optimal Capital Structure Decisions: MSMEs can be encouraged to adopt capital structures that are in line with their financial goals and operational requirements by providing incentives or other forms of support.

Limitations and Future Research

A few of the study's shortcomings are its small sample size and dependence on self-reported data. These restrictions can be addressed in future studies, along with other variables that affect MSMEs' financial viability.

5. CONCLUSION

In light of the tax sector reforms affecting MSMEs, this study concludes by offering a thorough analysis of the intricate relationship between financial literacy, financial competence, capital structure, and financial sustainability. The results validate how important it is for financial literacy and aptitude to influence these companies' capital structure choices, which in turn impact their long-term viability. The interconnectedness of these variables is highlighted by the positive and substantial associations that were found, underscoring the necessity of a comprehensive strategy for financial management in MSMEs. These insights can be used by policymakers to create focused programs that support an atmosphere that encourages sustainable growth.

Given their ability to enhance strategic decision-making, MSME owners and managers are urged to give financial education and capacity-building initiatives top priority. The study's educational ramifications reach beyond organizations and training providers, promoting curriculum designed to meet MSMEs' need for financial capacity and literacy. Essentially, this study lays the groundwork for future investigations into the complex relationships influencing MSMEs' financial health. Stakeholders may collaborate to create a robust and prosperous MSME sector by tackling the issues raised by tax sector reform and advancing financial capabilities and knowledge.

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