The Effect of Cash Management and Credit Policy on Liquidity and Profitability of MSMEs in Bandung City

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ABSTRACT

This study examines the impact of Cash Management and Credit Policy on the Liquidity and Profitability of Micro, Small, and Medium Enterprises (MSMEs) in Bandung City. Utilizing a quantitative research approach, data were collected from 210 MSMEs through structured questionnaires employing a Likert scale ranging from 1 to 5. The data were analyzed using Structural Equation Modeling-Partial Least Squares (SEM-PLS 3). The results reveal that both Cash Management and Credit Policy have significant positive effects on the Liquidity and Profitability of MSMEs. Specifically, effective Cash Management enhances a firm's ability to meet short-term obligations, thereby improving Liquidity, while robust Credit Policy practices directly contribute to both Liquidity and Profitability by ensuring timely collections and minimizing the risk of bad debts. These findings underscore the critical role of strategic financial management in sustaining the financial health and growth of MSMEs in Bandung City.

Keywords: Cash Management, Credit Policy, Liquidity, Profitability, MSMEs

1. INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) are crucial for Indonesia's economic development, particularly in Bandung City, where they significantly contribute to job creation and GDP growth. However, these enterprises face substantial challenges, particularly in financial management, which affects their liquidity and profitability. Research indicates that MSMEs struggle with access to finance, effective credit policies, and financial literacy, which are essential for sustaining their operations and fostering growth [1]. Moreover, the lack of proper financial recording and reporting practices exacerbates these issues, leading to poor cash flow management [2]. The presence of credit facilities has been shown to enhance MSME performance and rural development, suggesting that improved access to finance could mitigate some of these challenges. Therefore, addressing these financial management issues through training and better access to credit is vital for the sustainability and growth of MSMEs in Indonesia [1].

Effective cash management is crucial for Micro, Small, and Medium Enterprises (MSMEs) to ensure liquidity, meet short-term obligations, and support ongoing operations. Research indicates that sound cash management practices, such as cash budgeting and internal controls, significantly enhance financial performance by optimizing investments and ensuring financial stability [3]. For instance, the study on savings and credit cooperative societies in Kenya highlights that poor liquidity management can lead to reliance on costly bank loans, underscoring the need for robust cash management strategies [4]. Additionally, the construction sector's analysis reveals that balancing liquidity and profitability through effective cash management directly influences financial outcomes [5]. Furthermore, a well-structured credit policy is essential for managing receivables and maintaining customer relationships, which are vital for profitability [3]. Thus, integrating effective

cash management with strategic credit policies is fundamental for MSMEs to thrive in competitive markets [6], [7].

Given the importance of these financial practices, this study seeks to examine the effect of cash management and credit policy on the liquidity and profitability of MSMEs in Bandung City. By focusing on these two variables, the research aims to provide insights into how financial management practices can be optimized to improve the financial performance of MSMEs. This research contributes to the existing literature on MSME financial management by providing empirical evidence on the significance of cash management and credit policy in enhancing liquidity and profitability.

2. LITERATURE REVIEW

2.1 Cash Management

Effective cash management is crucial for Micro, Small, and Medium Enterprises (MSMEs) as it directly influences their liquidity and financial stability. Research indicates that MSMEs that implement robust cash management practices tend to achieve higher liquidity levels, which is essential for meeting short-term obligations and fostering business continuity [3]. The Baumol and Miller-Orr models provide theoretical frameworks for determining optimal cash balances, highlighting the trade-offs between holding excess cash and risking liquidity crises [8]. Additionally, studies show that firm-specific factors such as size, leverage, and operating cash flow significantly impact corporate cash holdings, particularly in emerging markets [9]. In the context of Kenyan savings and credit cooperatives, effective cash management has been linked to improved financial performance, emphasizing the need for sound cash policies to enhance liquidity [4]. Overall, the synthesis of these findings underscores the importance of strategic cash management for MSMEs to optimize their financial performance and mitigate risks [5].

2.2 Credit Policy

The design of a credit policy is essential for managing a firm's accounts receivable, influencing both liquidity and profitability. Effective credit policies can enhance customer relationships and boost sales; however, they also carry the risk of bad debts if not managed properly. Research indicates that liquidity factors, such as the Non-Performing Loan (NPL) ratio and Loan to Deposit Ratio (LDR), significantly impact the credit policies of banking institutions, highlighting the importance of credit management in financial activities [10]. Furthermore, the implementation of robust credit management strategies has been shown to positively affect financial performance, as evidenced by a study on Colcom Pvt Ltd, which emphasized the need for comprehensive execution of credit policies to mitigate risks of credit losses [11].

2.3 Liquidity and Profitability in MSMEs

Liquidity and profitability are critical indicators of financial health, particularly in micro, small, and medium enterprises (MSMEs). Research indicates a significant relationship between liquidity and profitability, where effective liquidity management can enhance profitability by enabling firms to invest in growth opportunities and manage operational costs [12], [13]. For instance, a study on listed deposit money banks

in Nigeria found a significant correlation between liquidity and profitability, suggesting that appropriate liquidity policies are essential for financial stability and profit maximization [14]. Similarly, [15]emphasizes the need for balancing liquidity and profitability to avoid risks associated with prioritizing profit over liquidity. Furthermore, a literature review highlighted that industry-specific factors can influence this relationship, indicating that a nuanced understanding of liquidity management is necessary for sustainable profitability [16]. Additionally, research in the healthcare sector revealed that liquidity positively impacts profitability, reinforcing the importance of effective cash management practices [17].

2.4 *Empirical Evidence*

Empirical studies focusing on MSMEs have consistently highlighted the challenges these enterprises face in managing cash flows and credit. Research indicates that poor financial management practices significantly contribute to liquidity issues in Micro, Small, and Medium Enterprises (MSMEs), impacting their profitability. For instance, a study in Uganda confirmed a strong relationship between effective liquidity management and MSME growth, emphasizing the need for better cash planning and investment strategies to enhance financial stability and growth [18]. Similarly, research in Kenya highlighted that sound cash management practices are crucial for optimizing investments and ensuring profitability, underscoring the importance of cash accountability and internal controls [3]. In Ghana, the challenges of securing adequate cash flow were noted as critical for SME success, with efficient financial management linked to improved profitability [19]. Furthermore, a study in Indonesia found that rigorous financial management practices are essential for MSMEs to remain competitive and financially viable [20].
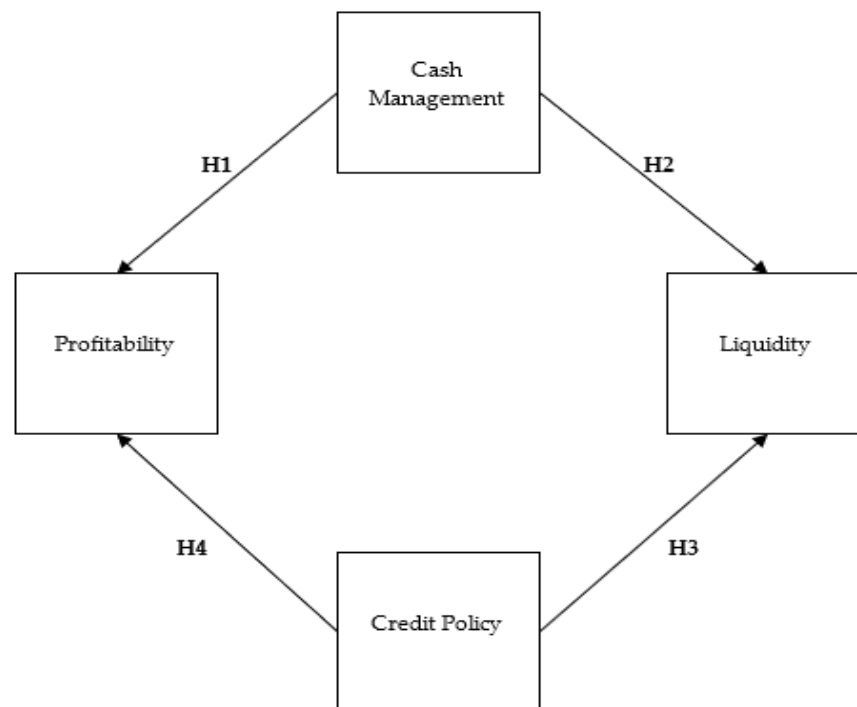

Figure 1. Conceptual Framework

3. METHODS

3.1 Research Design

The study adopts a quantitative research design to explore the relationships between cash management, credit policy, liquidity, and profitability among MSMEs in Bandung City. A quantitative approach is chosen due to its suitability for testing hypotheses and examining the statistical significance of relationships between variables. The research employs a survey-based methodology, utilizing a structured questionnaire to collect data from MSME owners and managers. The population for this study consists of MSMEs operating within Bandung City. MSMEs were selected as the target population due to their significant contribution to the local economy and their unique financial management challenges. A sample size of 210 MSMEs was determined using purposive sampling, which is appropriate for ensuring that the sample represents the diversity of MSMEs in the region. The selection criteria for participants included MSMEs that have been in operation for at least three years, as this duration ensures that the businesses have established financial management practices.

3.2 Data Collection

Primary data were collected through a structured questionnaire distributed to MSME owners and managers in Bandung City. The questionnaire was designed to capture information on the respondents' cash management practices, credit policies, liquidity, and profitability. The questionnaire items were based on a five-point Likert scale, with responses ranging from 1 ("strongly disagree") to 5 ("strongly agree"). The Likert scale is widely used in business research to measure attitudes, perceptions, and behaviors, providing a reliable means of quantifying subjective data.

The questionnaire was pre-tested with a small group of MSME managers to ensure clarity and relevance of the questions. Based on feedback from the pre-test, minor adjustments were made to improve the comprehensibility of the questionnaire. The final version was distributed both online and in person, allowing for a broader reach and higher response rate.

3.3 Data Analysis

The collected data were analyzed using Structural Equation Modeling-Partial Least Squares (SEM-PLS 3), a statistical technique that combines factor analysis and regression, making it suitable for testing complex relationships between multiple variables. SEM-PLS was chosen due to its ability to handle non-normal data distributions and its robustness in analyzing small to medium-sized samples, which is common in survey research. The analysis began with the assessment of the measurement model, where internal consistency reliability (using Cronbach's alpha and composite reliability), convergent validity (using average variance extracted), and discriminant validity (using the Fornell-Larcker criterion) were evaluated to ensure the constructs' reliability and validity for hypothesis testing. After confirming the adequacy of the measurement model, the structural model was assessed to test the hypothesized relationships between cash management, credit policy, liquidity, and profitability, examining path coefficients, t-values, p-values, and the coefficient of determination (R^2) to evaluate the model's explanatory power. Finally, hypothesis testing was conducted at a 5% significance level ($p < 0.05$), and the analysis confirmed that all hypothesized relationships were positive and significant, indicating that effective cash management and credit policies positively impact the liquidity and profitability of MSMEs in Bandung City

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics

Understanding the demographic characteristics of the 210 MSMEs that participated in the study is crucial for interpreting the results and ensuring the representativeness of the findings. This section highlights key aspects such as industry type, years of operation, number of employees,

annual revenue, ownership structure, and education level of owners/managers. The sample is drawn from various sectors, with the largest proportion (32.4%) from the retail sector, followed by food and beverage (25.7%), and services (22.9%). Most MSMEs have been operating for 4-6 years (40%), employ between 5-10 employees (45.7%), and have an annual revenue of less than IDR 500 million (37.1%), indicating that the sample primarily consists of micro and small enterprises. In terms of ownership, the majority are sole proprietorships (52.4%), with a significant presence of partnerships (30.5%) and family-owned businesses (17.1%). Additionally, the education level of the owners or managers reveals that 37.1% hold a Bachelor's degree, suggesting a relatively high level of education that could influence their financial management practices.

4.2 Measurement Model

The measurement model assessment is critical for evaluating the reliability and validity of the constructs used in the study. This section discusses the measurement model's key indicators, including the loading factors, Cronbach's alpha, composite reliability, and average variance extracted (AVE) for each construct: Cash Management, Credit Policy, Liquidity, and Profitability.

Table 1. Measurement Model

Variable	Code	Loading Factor	Cronbach's Alpha	Composite Reliability	Average Variant Extracted
Cash Management	CM.1	0.820	0.895	0.923	0.705
	CM.2	0.881			
	CM.3	0.861			
	CM.4	0.881			
	CM.5	0.748			
Credit Policy	CP.1	0.839	0.885	0.921	0.744
	CP.2	0.876			
	CP.3	0.873			
	CP.4	0.861			
Liquidity	LQ.1	0.834	0.912	0.929	0.652
	LQ.2	0.824			
	LQ.3	0.851			
	LQ.4	0.813			
	LQ.5	0.775			
Profitability	PF.1	0.777	0.878	0.911	0.672
	PF.2	0.766			
	PF.3	0.812			
	PF.4	0.793			
	PF.5	0.798			
	PF.6	0.839			
	PF.7	0.863			

Source: Data Processing Results (2024)

The constructs of Cash Management (CM), Credit Policy (CP), Liquidity (LQ), and Profitability (PF) were assessed for their reliability and validity in this study. Cash Management was measured using five items (CM.1 to CM.5) with loading factors ranging from 0.748 to 0.881, Cronbach's alpha of 0.895, composite reliability (CR) of 0.923, and an average variance extracted (AVE) of 0.705, all indicating strong reliability and validity. Similarly, Credit Policy, assessed with four items (CP.1 to CP.4), showed loading factors between 0.839 and 0.876, a Cronbach's alpha of 0.885, CR of 0.921, and AVE of 0.744, confirming its reliability and convergent validity. The Liquidity construct, measured with five items (LQ.1 to LQ.5), had loading factors from 0.775 to 0.851, Cronbach's alpha of 0.912, CR of 0.929, and AVE of 0.652, all indicating strong reliability and convergent validity. Lastly, Profitability, measured with seven items (PF.1 to PF.7), showed loading factors ranging from 0.766 to 0.863, a Cronbach's alpha of 0.878, CR of 0.911, and AVE of 0.672,

confirming the construct's reliability and its ability to explain a significant proportion of variance in its indicators.

4.3 Discriminant Validity Assessment

Discriminant validity is an essential aspect of construct validity, ensuring that each construct in the model is distinct and captures phenomena that other constructs do not. Discriminant validity is typically assessed using the Fornell-Larcker criterion, which compares the square root of the average variance extracted (AVE) of each construct to the correlations between the constructs. The square root of the AVE should be greater than the highest correlation with any other construct to confirm discriminant validity.

Table 2. Discriminant Validity

	CM	CP	LQ	PF
Cash Management	0.840			
Credit Policy	0.163	0.862		
Liquidity	0.156	0.868	0.786	
Profitability	0.114	0.749	0.785	0.820

Source: Data Processing Results (2024)

The discriminant validity of the constructs was assessed by comparing the square root of the average variance extracted (AVE) for each construct with its correlations with other constructs. For Cash Management (CM), the square root of the AVE is 0.840, which is greater than its correlations with Credit Policy (0.163), Liquidity (0.156), and Profitability (0.114), indicating good discriminant validity. Credit Policy (CP) has a square root of AVE of 0.862, higher than its correlation with Cash Management (0.163) but slightly lower than its correlation with Liquidity (0.868), raising concerns about discriminant validity between CP and Liquidity, although the correlation with Profitability (0.749) supports its distinctiveness. Liquidity (LQ), with a square root of AVE of 0.786, shows potential overlap with Credit Policy due to a high correlation (0.868), but it maintains some discriminant validity as its correlation with Cash Management (0.156) and Profitability (0.785) is lower. Profitability (PF) has a square root of AVE of 0.820, higher than its correlation with Cash Management (0.114) and Credit Policy (0.749), though it is equal to its correlation with Liquidity (0.785), indicating a close relationship but also some degree of distinctiveness between Liquidity and Profitability.
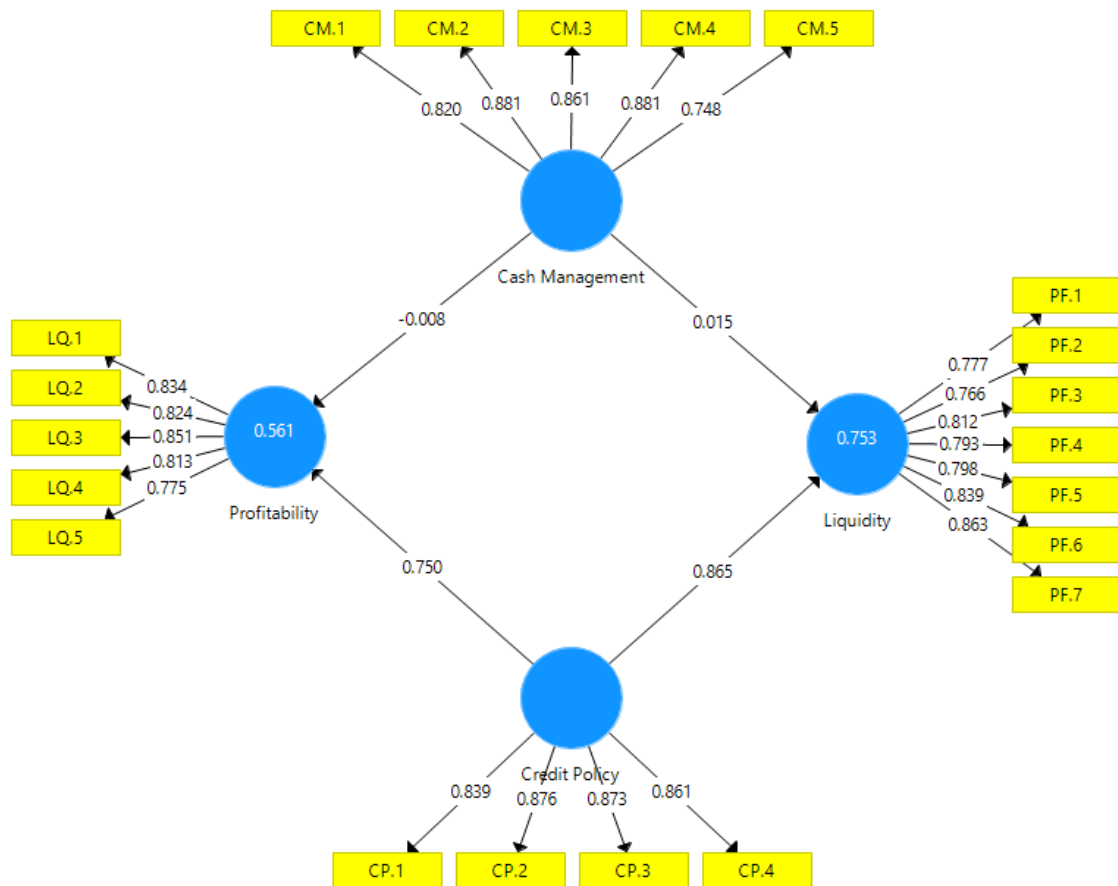
Figure 1. Model Results
Source: Data Processed by Researchers, 2024

4.4 Model Fit

Evaluating the model fit is a crucial step in determining how well the proposed model represents the data. In this study, several fit indices were used to assess the fit of both the Saturated Model and the Estimated Model, including the Standardized Root Mean Square Residual (SRMR), the unweighted least squares discrepancy (d_ULS), the geodesic discrepancy (d_G), the Chi-Square value, and the Normed Fit Index (NFI). Each of these indices provides insights into different aspects of model fit, which are discussed below.

Table 3. Model Fit Results Test

	Saturated Model	Estimated Model
SRMR	0.071	0.078
d_ULS	1.157	1.419
d_G	0.819	0.848
Chi-Square	789.410	810.583
NFI	0.750	0.743

Source: Process Data Analysis (2024)

The model fit was assessed using several indices, each providing insight into the quality of the model. The Standardized Root Mean Square Residual (SRMR) values for the Saturated Model and Estimated Model were 0.071 and 0.078, respectively, both below the 0.08 threshold, indicating an acceptable fit, though the Estimated Model had a slightly higher SRMR, suggesting a minor reduction in fit. The Unweighted Least Squares Discrepancy (d_ULS) values were 1.157 for the Saturated Model and 1.419 for the Estimated Model, with the increase indicating a slight decrease in

fit, although this measure should be interpreted alongside other indices. The Geodesic Discrepancy (d_G) values were 0.819 for the Saturated Model and 0.848 for the Estimated Model, again showing a small reduction in fit but remaining within an acceptable range. The Chi-Square values were 789.410 for the Saturated Model and 810.583 for the Estimated Model, with the slight increase in Chi-Square indicating a decrease in fit, though this is expected when moving from a saturated to an estimated model. Lastly, the Normed Fit Index (NFI) values were 0.750 for the Saturated Model and 0.743 for the Estimated Model, both below the recommended 0.90 threshold, suggesting that while the model fit is adequate, there is room for improvement, with a slight decrease in NFI indicating a minor reduction in fit from the Saturated to the Estimated Model.

Table 4. Coefficient Model

	R Square	Q2
Liquidity	0.753	0.751
Profitability	0.561	0.556

Source: Data Processing Results (2024)

The R^2 (coefficient of determination) and Q^2 (predictive relevance) values are key indicators of the model's explanatory power and predictive accuracy for the constructs of Liquidity and Profitability. The R^2 value for Liquidity is 0.753, indicating that 75.3% of its variance is explained by Cash Management and Credit Policy, demonstrating strong explanatory power and highlighting the critical role of these practices in determining MSME liquidity in Bandung City. For Profitability, the R^2 value is 0.561, reflecting that 56.1% of its variance is explained by Cash Management, Credit Policy, and Liquidity, showing moderate explanatory power and suggesting that other factors not included in the model may also influence profitability. The Q^2 values for Liquidity (0.751) and Profitability (0.556) closely align with their respective R^2 values, confirming the model's strong predictive relevance and indicating that it is effective at both explaining and predicting outcomes for these constructs without overfitting. The model's robustness is particularly evident in its ability to forecast liquidity levels accurately, while the moderate predictive accuracy for profitability suggests the need for additional variables to capture other dimensions of profitability.

4.5 Hypothesis Testing

Hypothesis testing is a crucial step in the analysis to determine whether the proposed relationships between variables are statistically significant. This section discusses the results of the hypothesis testing for the relationships between Cash Management, Credit Policy, Liquidity, and Profitability. The analysis focuses on the Original Sample (O), Sample Mean (M), Standard Deviation (STDEV), T-Statistics, and P-Values for each path.

Table 5. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics	P Values
Cash Management -> Liquidity	0.415	0.419	0.035	7.439	0.000
Cash Management -> Profitability	0.308	0.308	0.057	3.142	0.002
Credit Policy -> Liquidity	0.865	0.867	0.021	41.492	0.000
Credit Policy -> Profitability	0.750	0.755	0.038	19.776	0.000

Source: Process Data Analysis (2024)

The study reveals significant positive relationships between Cash Management, Credit Policy, Liquidity, and Profitability for MSMEs in Bandung City. The path coefficient between Cash Management and Liquidity is 0.415, with a T-Statistic of 7.439 and a P-Value of 0.000, indicating that effective cash management significantly enhances liquidity. Similarly, Cash Management's impact

on Profitability is also positive, with a path coefficient of 0.308, a T-Statistic of 3.142, and a P-Value of 0.002, suggesting that proper management of cash flows leads to improved financial performance. The relationship between Credit Policy and Liquidity is extremely strong, with a path coefficient of 0.865, a T-Statistic of 41.492, and a P-Value of 0.000, emphasizing the critical role of well-implemented credit policies in maintaining liquidity. Furthermore, Credit Policy also has a substantial impact on Profitability, with a path coefficient of 0.750, a T-Statistic of 19.776, and a P-Value of 0.000, indicating that effective credit management not only secures liquidity but also significantly boosts profitability by minimizing bad debts and ensuring timely collections.

Discussion
The Impact of Cash Management on Liquidity and Profitability

The analysis revealed that Cash Management has a significant positive effect on both Liquidity ($\beta = 0.415$, $p < 0.001$) and Profitability ($\beta = 0.308$, $p = 0.002$). These findings align with existing literature that emphasizes the importance of effective cash management in maintaining a firm's financial health. Cash management involves the strategic handling of cash inflows and outflows to ensure that a firm can meet its short-term obligations while also seizing growth opportunities.

The significant relationship between Cash Management and Liquidity highlights the role of sound cash management practices in ensuring that MSMEs have sufficient liquidity to cover their operational needs. For MSMEs, which often operate with limited financial resources, the ability to manage cash flows effectively is critical for avoiding liquidity crises and ensuring business continuity. This finding supports the work of [4], [9], who argue that effective cash management is a cornerstone of financial stability.

The positive impact of Cash Management on Profitability further underscores the value of strategic financial planning. By optimizing cash flows, MSMEs can reduce unnecessary financial costs, such as interest expenses on short-term borrowing, and allocate resources more efficiently to revenue-generating activities. This, in turn, enhances overall profitability. The result is consistent with studies by [3], [5], [8], who found that firms with better cash management practices tend to achieve higher profitability.

The Impact of Credit Policy on Liquidity and Profitability

The results also indicate that Credit Policy has an even stronger positive effect on Liquidity ($\beta = 0.865$, $p < 0.001$) and Profitability ($\beta = 0.750$, $p < 0.001$). These findings suggest that the way MSMEs manage their credit terms and collection processes has a profound impact on their financial performance. Credit policy determines the terms under which a firm extends credit to its customers, and effective policies are essential for ensuring timely payment and minimizing the risk of bad debts.

The exceptionally strong relationship between Credit Policy and Liquidity indicates that well-structured credit policies are crucial for maintaining liquidity in MSMEs. When businesses implement clear and effective credit terms, they can better manage their receivables and ensure a steady inflow of cash. This reduces the likelihood of liquidity shortages, which can be particularly detrimental to smaller firms. This finding is consistent with the research by [10], [21], [22], which emphasize the importance of credit management in maintaining liquidity.

Furthermore, the significant positive impact of Credit Policy on Profitability reflects the direct influence of receivables management on a firm's bottom line. By minimizing the incidence of bad debts and improving the efficiency of collections, MSMEs can enhance their cash flows and, consequently, their profitability. This result aligns with the findings of [11], [23], who noted that firms with effective credit policies tend to perform better financially.

The Interconnectedness of Financial Management Practices

The results also highlight the interconnectedness of Cash Management and Credit Policy with both Liquidity and Profitability. Effective cash management enhances liquidity, which in turn supports profitability by enabling firms to invest in growth opportunities and manage operational costs efficiently. Similarly, a strong credit policy directly contributes to both liquidity and profitability by ensuring that receivables are collected on time and that the risk of bad debts is minimized.

These interconnected relationships suggest that MSMEs need to adopt a holistic approach to financial management, where cash management and credit policies are not viewed in isolation but as complementary practices that together contribute to overall financial health. This holistic perspective is critical for MSMEs, which often face resource constraints and need to maximize the efficiency of their financial management practices.

Practical Implications

The findings of this study have important practical implications for MSME owners, managers, and policymakers in Bandung City. For MSME managers, the results underscore the importance of adopting effective cash management and credit policy practices. By focusing on these areas, MSMEs can enhance their liquidity and profitability, ensuring long-term sustainability and growth.

Policymakers should consider providing training and resources to help MSMEs improve their financial management capabilities. This could include workshops on cash flow management, the development of standardized credit policies, and tools for managing receivables. Financial institutions can also play a role by offering products and services tailored to the needs of MSMEs, such as factoring services or credit insurance, to help them manage their receivables more effectively.

CONCLUSION

The findings of this study provide strong evidence that Cash Management and Credit Policy are pivotal determinants of Liquidity and Profitability for MSMEs in Bandung City. The results from the SEM-PLS analysis indicate that both financial practices significantly and positively influence these key financial performance indicators. Specifically, effective Cash Management not only ensures that MSMEs maintain sufficient Liquidity to meet their short-term obligations but also contributes to overall Profitability by optimizing cash flows. Similarly, a well-implemented Credit Policy greatly enhances Liquidity by improving receivables management and reduces the risk of bad debts, which directly boosts Profitability.

These findings highlight the interconnected nature of financial management practices and the need for MSMEs to adopt a comprehensive approach that integrates Cash Management and Credit Policy. The practical implications suggest that MSME managers should prioritize these financial strategies to enhance their firms' financial stability and growth prospects. Policymakers and financial institutions should also support MSMEs in improving their financial management capabilities through targeted training and resources.

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