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Enhancing MSMEs Financial Resilience: Integrating Working Capital Management and Sustainability Reporting

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Abstract

This study examines the influence of sustainability reporting (SR) comprehension and working capital management (WCM) on the financial performance of small and medium-sized manufacturing enterprises (MSMEs). Furthermore, the study emphasizes WCM's impact on financial performance, which is linked to understanding SR among MSMEs actors. The study incorporates control variables in the model (e.g., age, size, ownership type, organizational culture, market orientation, entrepreneurial orientation). The sample is selected using quota sampling of MSMEs in the manufacturing sector in Palembang, Indonesia, from October to November 2023. Primary data collection is distributed online through questionnaires. The results show that understanding SR and WCM positively affect the financial performance of MSMEs. The findings deliver several contributions. Firstly, the implementation of SR of MSMEs – in the long term – would benefit the government in supporting sustainable development goals (SDGs). Secondly, it bridges the literature gap regarding the implementation of SR and WCM to examine the performance of MSMEs.

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Introduction

The initiation of the Sustainable Development Goals (SDGs) was prompted by concerns regarding the well-being and security of future generations, addressing issues such as economic disparity, poverty, environmental challenges, and climate variations (Rosati & Faria, 2019). In 2015, global leaders and the United Nations (UN) formally endorsed the SDGs as an extensive worldwide developmental framework, comprising 17 objectives and 169 targets, scheduled for attainment within fifteen years from their enactment in 2016 to 2030. The agenda calls upon all nations to collaboratively work towards these objectives and targets, guided by the principle of "leave no one behind", emphasizing a balance between economic growth, social inclusion, and environmental preservation (SDG Indonesia, 2017).

The active participation of all stakeholders is indispensable for the effective implementation of SDGs (Chakraborty et al., 2017; Singh & Roy, 2019). Within the corporate sector, adherence to SDG prerequisites has emerged as a paramount priority (Tsalis et al., 2020). In Indonesia, the focus on SDGs experienced a substantial surge in the third year following ratification, leading to the widespread adoption of Sustainability Reporting (SR) as the primary channel for conveying sustainable corporate strategies and methodologies (Singh & Roy, 2019; Buallay et al., 2020). Nevertheless, the implementation of SR poses more significant challenges for Micro, Small, and Medium Enterprises (MSMEs) due to limitations in capital, equipment, knowledge, and expertise (Reynolds & Yuthas, 2008; Borga et al., 2008; Singh & Roy, 2019).

Despite MSMEs having a relatively modest environmental impact compared to more giant corporations, their involvement is crucial, given their representation of over 90 percent of global industrial units (Singh et al., 2015). In Indonesia, MSMEs constitute 99 percent of all commercial entities, making substantial contributions to the GDP (60.5 percent) and the national workforce (96.9 percent) (Ministry of Cooperatives and SMEs, 2019; Coordinating Ministry for Economic Affairs of Indonesia, 2021). While serving as pivotal drivers of economic growth, MSMEs can simultaneously generate detrimental environmental and societal consequences through unsustainable business practices (Schaper, 2002; Singh & Roy, 2019).

Prior research demonstrates a robust interconnection between financial performance and SR (Chvatalová et al., 2011; Buallay et al., 2020; Burhan & Rahmanti, 2020). Social (non-financial) investments are also considered to outperform traditional (financial) investments (Lean et al., 2015; Buallay et al., 2020). However, investigations into the relationship between WCM and financial performance in MSMEs remain limited (Padachi, 2006; García-Teruel & Martínez-Solano, 2007; Tauringana & Afrifa, 2013; Othuon et al., 2021). Similarly, a dearth of research exists in scrutinizing the correlation between financial performance and SR in MSMEs in Indonesia (Chvatalová et al., 2011; Buallay et al., 2020; Burhan & Rahmanti, 2020).

Furthermore, Masso and Vahter (2012) found that, in terms of resources, larger companies have greater access to resources. Based on this analogy, it can be asserted that medium and large enterprises are better positioned to manage their working capital more effectively and efficiently than small companies. Working capital management (WCM) is closely related to the success or failure of a company (Knauer & Wöhrmann, 2013). The research findings of Dunn & Cheatham (1993) revealed that poor WCM was a fundamental reason behind the failure of MSMEs. Limited access to long-term capital makes MSMEs rely on internal funds and short-term loans.

In this context, the study aims to fill the gap in the literature by examining the association between WCM, the understanding of SR and the financial performance of MSMEs in Palembang, South Sumatra, Indonesia. Considering the limited capital and resources available to MSMEs, coupled with the economic and societal context in Indonesia, this research is anticipated to contribute to the effective implementation of SR and WCM in the MSME sector, reinforce economic formalization, and ultimately, contribute to the realization of the SDGs.

Literature Review

Legitimacy Theory and The Resource-Based View (RBV) are valuable lenses through which to understand the dynamics of MSMEs in developing economies like Indonesia. Compared to giant corporations, MSMEs face distinct challenges, particularly regarding financial performance, sustainability reporting, and working capital management. These challenges are further complicated by resource constraints and the need to align with societal expectations.

MSMEs often operate under resource constraints that limit their ability to invest in high-value resources or advanced financial systems (Ali, 2003). According to the RBV theory, an enterprise's competitiveness and financial performance are primarily determined by the effective management and utilization of its internal resources (Barney, 1991). For MSMEs, optimizing existing resources is crucial, as they frequently rely on financial metrics like gross profit and net profit margins to gauge their performance (Ali, 2003). Despite limited financial resources, MSMEs can leverage unique internal assets such as local networks, community relationships, and specialized knowledge to drive their financial outcomes (Wernerfelt, 1984). This RBV perspective highlights that while MSMEs may lack the financial capital of larger firms, their strategic use of internal resources can still yield competitive advantages and improved financial performance (Barney, 1991). Legitimacy theory complements this view by emphasizing the importance of aligning organizational practices with societal expectations (Suchman, 1995). For MSMEs, demonstrating responsiveness to community and environmental concerns can enhance legitimacy and foster stronger relationships with stakeholders, ultimately contributing to better financial performance (Brown & Deegan, 1998).

The challenge of formulating effective sustainability reporting metrics for MSMEs is rooted in their limited financial resources and the perception of SR as a non-financial investment (Lean et al., 2015). RBV theory underscores that strategic resources, whether financial, human, or relational, are fundamental for long-term competitiveness (Barney, 1991). In the context of MSMEs in Indonesia, limited access to these resources directly impacts their ability to implement comprehensive SR initiatives (Singh et al., 2015). However, RBV also suggests that MSMEs can leverage their unique strengths, such as deep local knowledge and community engagement, to develop SR practices that align with their resource constraints (Wernerfelt, 1984). This approach enables MSMEs to address critical environmental and social responsibilities within their means (Borga et al., 2008). From a legitimacy perspective, aligning SR practices with societal expectations is crucial for maintaining organizational legitimacy and fostering trust with stakeholders (Suchman, 1995). Developing SR guidelines tailored to the specific conditions of MSMEs can help bridge the gap between financial constraints and societal expectations, enhancing both the effectiveness of SR initiatives and the overall legitimacy of MSMEs (Steinhöfel, 2019).

Working Capital Management (WCM) is a critical area where MSMEs face significant challenges due to their limited financial resources (Berryman, 1983). According to RBV theory, resource availability is crucial to WCM efficiency (Barney, 1991). Larger enterprises typically benefit from excellent resource access, enabling more effective working capital management (Masso & Vahter, 2012). In contrast, MSMEs must optimize their limited resources to manage working capital effectively (Yousaf et al., 2021). RBV emphasizes that competitive advantage can be achieved by strategically deploying existing resources (Barney, 1991). For MSMEs, this involves leveraging localized knowledge, operational flexibility, and strong supplier relationships to enhance cash flow management (Prasad et al., 2018). Legitimacy theory further supports this approach by suggesting that MSMEs can improve their legitimacy and financial performance by demonstrating effective WCM practices that align with business objectives and societal expectations (Suchman, 1995). Efficient working capital management helps MSMEs maintain operational stability and reinforces their commitment to responsible business practices by enhancing their legitimacy in the eyes of stakeholders (Akbar et al., 2021).

In summary, integrating Legitimacy and RBV Theories provides a comprehensive framework for understanding financial performance, sustainability reporting, and working capital management of expectations. By leveraging unique strengths, MSMEs can navigate the challenges they face and achieve both operational and reputational success.

Hypothesis Development

Previous studies have explored the relationship between WCM and the performance of MSMEs, considering various environmental and industry aspects (Ebben & Johnson, 2011; Panda et al., 2020; Ahangar, 2021). Several studies, such as Padachi (2006), García-Teruel & Martínez-Solano (2007), Afrifa et al. (2014), and Ahangar (2021), found a significant impact between WCM and the financial performance of MSMEs. Although Aregbeyen (2013) did not find a significant impact, this finding applies only to samples of large companies. The Cash Conversion Cycle (CCC), used as a WCM proxy, represents the overall components of working capital, namely inventory, sales, and debt, by measuring the time between purchasing raw materials and receiving payment for the sale of finished goods. Therefore, CCC is considered representative of the overall WCM conditions in small businesses. Some previous studies using CCC as a WCM metric for MSMEs include Panda et al. (2020), Ahangar (2021), and Ebben and Johnson (2011).

Even though existing literature provides diverse insights, especially within the context of developed countries and Asia, which may vary from that of Indonesia, managers and business owners persist in demonstrating reluctance when making decisions about WCM. Consequently, this study aims to scrutinize the relevance of WCM concerning the financial performance of MSMEs, specifically within the manufacturing sector in Palembang, Indonesia. In this context, the study posits the following hypothesis:
H1: *WCM has a positive impact on the financial performance of MSMEs*

Studies by Chvatalová et al. (2011), Buallay et al. (2020), and Burhan and Rahmanti (2020) found a close relationship between Social Responsibility (SR) and the financial performance of companies. An increasing body of literature indicates that socially responsible investments (non-financial) can outperform conventional investments (financial) (Chvatalová et al., 2011; Lean et al., 2015; Buallay et al., 2020). Buallay et al. (2020) even tested the role of SR in the banking industry in the MENA region, finding that investors in those countries pay a premium for companies with higher SR levels, demonstrating their commitment to stakeholders. On the other hand, research by Burhan and Rahmanti (2020) indicates that the relationship between financial performance and SR on the Indonesia Stock Exchange is not always decisive. However, it emphasizes that the disclosure of social performance has a closer relationship with financial performance.

With the rapid growth of the MSME sector in Palembang, with more than 37,000 MSMEs and an increase of 3.66 per cent every year (Rahadi, 2017), and the development of technology and information driving changes in the business sector, MSMEs play a vital role in mitigating the impact on the environment and society. Although previous research indicates the importance of SR for MSMEs (Borga et al., 2008; Singh et al., 2015; Singh & Roy, 2019), the absence of SR guidelines for MSMEs in Indonesia implements SR far from reality, besides reasons of cost and impracticality. With this argument, this study examines the relationship between financial performance and the understanding of SR by MSME actors to determine the extent to which SR implementation is possible if standard guidelines are available. Thus, the study proposes the following hypothesis:

H2: *Enhanced understanding of SR leads to higher financial performance of MSMEs and otherwise*

Research Methods

Data Collection

This study adopts a quantitative approach by distributing online and in-person questionnaires to MSMEs actors in Palembang, Indonesia during September to October 2023. The data collected serves as the primary source and is specifically focused on the manufacturing sector, a key area of interest due to its relatively higher environmental impact compared to other industries. The questionnaire includes demographic questions (e.g., name, gender, age) and structured questions designed to measure key variables. The variables examined include financial performance, measured using net profit and sales data; working capital management (WCM), which incorporates data on inventory, accounts receivable, and debt payments; and sustainability reporting (SR) awareness, assessed using questions based on indicators from the MSMEs Sustainability, Disclosure Index (MSDI). Control variables in the study include company age, size, ownership type, organizational culture, market orientation, and entrepreneurial orientation.

While the combination of online and in-person questionnaires offers flexibility in data collection, it also introduces certain limitations. These potential limitations, such as varying response rates and inconsistencies in data quality due to respondents' varying levels of understanding or engagement, should be considered when interpreting the results of this study. Additionally, relying on self-reported data could lead to biases, particularly in the context of financial performance and SR understanding.

Population and Sample

There are approximately 37,351 MSMEs in Palembang (Cooperative and SME Agency of South Sumatra Province, 2019). However, there is no valid data regarding the actual population size of MSMEs in the manufacturing sector in Palembang. Hence, we employed non-probability sampling in sample selection (Sugiyono, 2014). Additionally, the characteristics of manufacturing MSMEs in Palembang tend to be homogeneous, with relatively uniform average assets and turnovers. With this justification, the sample is determined using the quota sampling method.

Quota sampling allows for selecting a sample from an undefined population with specified criteria until the desired sample size is reached (Sugiyono, 2001; Margono, 2004). The criteria for inclusion in this study are (1) active MSMEs operating since 2021, (2) MSMEs with assets not exceeding 10 billion Rupiah, and (3) MSMEs with complete data available for at least the past two years. The selected sample was further classified into specific groups, with quotas assigned to each group (Margono, 2004). The final sample size consists of 200 MSMEs, with classification details provided in Table 1.

Tabel 1. The Clasification of Quota Sampling

Demography	Criteria
The Type of business ownership	150 MSMEs are owned by individuals or personals and 50 MSMEs are owned by legal forms such as: limited partnership, firm, or limited company
Business establishment	20 MSMEs are already established more than 10 years
Location	Approximately minimum 10 MSMEs per subdistrict in Palembang

The use of quota sampling in this study presents several limitations. One significant drawback is that this method may restrict the representativeness of the sample in reflecting the broader population of manufacturing MSMEs in Palembang. The choice of this method was influenced by the unavailability of official data on the population size, as relevant government agencies have yet to publish comprehensive survey results. While quota sampling addresses the data limitations, it also hampers the generalizability of the study's findings. It is crucial for future research to urgently explore alternative sampling methods, such as stratified or random sampling, if more accurate population data becomes available. These methods could significantly enhance the representativeness and robustness of the result, leading to more generalizable conclusions.

Measurements

In this study, we explore the financial resilience of MSMEs. Evaluating the financial strength of small enterprises like MSMEs is a more complicated task due to the lack of readily available public data. Consequently, data acquisition necessitates an empirical approach, allowing for directly extracting information from research sources. Moreover, challenges arise from the limited expertise and resources of MSME actors, often resulting in an imprecise portrayal of their business performance. Consequently, the financial performance of MSMEs utilizes straightforward metrics to facilitate research sources and provide responses that still genuinely reflect the closest semblance of financial reality. Top of

Drawing upon prior research, this study utilizes Net Profit Margin (NPM) as the metric for assessing the financial performance of MSME, particularly within emerging countries, a context considered pertinent to the framework of this research (Davis et al., 2010; Harpriya et al., 2020; Kossaï & Piget, 2014).

Arena & Azzone (2012) elaborate on the prerequisite measures before implementing SR metrics for MSMEs by employing Key Sustainability Indicators. These indicators are included since the Global Reporting Initiative (GRI) guidelines are considered inappropriate for MSMEs (Borga et al., 2008; Arena & Azzone, 2012). Subsequently, in 2015, Singh et al. (2015) introduced the MSDI as the SR benchmark for MSMEs, refined by Singh & Roy (2019) in 2019. Given the suitability of research contexts between Singh et al. (2015) and Singh & Roy (2019) with the scope of this study (i.e., MSMEs in emerging countries), the researcher employs the MSDI guideline to assess the depth of MSME actors' understanding of SR, adapting each indicator for the specific circumstances of MSMEs in Indonesia.

Moreover, regarding WCM, this study utilizes the Cash Conversion Cycle (CCC) assessment. The crucial data for this evaluation encompass prevailing inventory data, the temporal requirements for cash accrual, and outstanding obligations. This exploration refers to various WCM studies in MSMEs positing that CCC encapsulates the culmination of manipulated working capital conditions (Panda et al., 2020; Ahangar, 2021; Othuon et al., 2021).

Furthermore, within our research framework, we introduce control variables. These variables play a crucial role as determinants of financial performance in fiscal terms, specifically the size and age of the company. Some previous investigations adopted company size as a regulatory variable to examine the connection between the impact of WCM and SR on performance. In large corporations, company size is typically quantified using total assets, but in our study, we substitute the count of active employees as a proxy for the size, aligning with the methodology employed in the research conducted by (Othuon, et al., 2021). Additionally, previous research that incorporates age in the context of its influence on financial performance includes studies by (Braimah et al., 2021; Ahangar, 2021; Othuon et al., 2021; Howorth & Westhead, 2003; Afrifa et al., 2014). Subsequently, in terms of non-fiscal aspects, this study includes ownership type, organizational culture, market orientation, and entrepreneurship orientation as factors influencing financial performance in MSMEs. These control variables are essential for a comprehensive research framework.

Tabel 2. Operational Variables

Variables	Definitions	Measurements	References
Financial performances	the achievement of success for MSMEs in financial terms	Net Profit Margin = net profit/sales	Davis, et al., 2010; Harpriya, et al., 2020; Kossaï & Piget, 2014
Working capital management	the management and components of current assets and current liabilities of MSME	Cash Conversion Cycle = Days Inventory Outstanding + Days Sales Outstanding – Days Payable Outstanding	Panda, et al, 2020; Ahangar, 2021; Othuon, et al., 2021
The understanding of sustainability reporting	The understanding of activities of MSME in economic, environmental, and social aspects	Questionnaire instrument adapted from points within the MSMEs Sustainability, Disclosure Index (economic, environment, social disclosure – consist of 47 indicators), where: Yes=1 dan No=0	Singh, et al., 2015; Singh & Roy, 2019
Size	Size of MSMEs	MSMEs Number of active MSMEs employees	Howorth & Westhead, 2003; Braimah, et al. 2021
Age	The duration of MSME has been operating	Observation year subtracted from the establishment year of MSMEs	Howorth & Westhead, 2003; Braimah, et al. 2021; Ahangar, 2021
Business ownership type	The ownership structure of MSMEs in Indonesia	Personal =1; Limited partnership=2; partnership=3;	Tudose & Avasilcai, 2020
Organizational Culture	Shared values among all MSME members are deliberately communicated and can be put into practice in the conduct and attitudes of individual workers within the organizational context	Questions regarding risk inclination, inquiries concerning achieving outcomes, queries related to employee interests, and questions regarding task focus	Tudose & Avasilcai, 2020

Market Orientation	An approach to business where MSMEs concentrate on satisfying customer needs and preferences through their product offerings	Questions of culture and behavior perspective	Vyas & Jain, 2020
Entrepreneurship Orientation	A business approach in which MSMEs engage in the production of both existing and innovative goods or services	Questions related to innovative independence, willingness to take risks, proactivity, and assertiveness.	Vyas & Jain, 2020

Data Analysis

Given that the data originates from primary sources distributed through a questionnaire, it is imperative to conduct reliability and validity tests to ensure its accuracy. Additionally, the research data falls under the category of cross-sectional data, representing information gathered at a single point in time (Sugiyono, 2014). Consequently, this study requires three classical assumption tests: a normality test, a heteroscedasticity test, and a multicollinearity test (Gujarati, 2012).

To address the problem statement, the researcher employs data analysis techniques for hypothesis testing. The ordinary least square (OLS) regression method is chosen to ascertain the significant impact of independent variables on the dependent variable, addressing hypotheses 1 and 2. The OLS method is deemed favourable for producing optimal estimates when all classical assumptions are satisfied (Sugiyono, 2014). The proposed regression model is expressed as follows:

$YFP = \alpha + \beta 1WCM + \beta 2SR + \beta 3CONTROL + \varepsilon$..(1)

YFP is financial performance; WCM stands for working capital management; and CONTROL comprises Size of MSMEs; Type of business ownership; Organizational culture; Market orientation; and Entrepreneurship orientation.

Result and Discussion

Descriptive Statistics

In this study, a non-probability sampling method was employed, using specific criteria for sample selection. A total of 200 respondents were initially collected, adhering to the predetermined quota for the research. However, only 172 questionnaires could be included in the analysis due to incomplete essential data. Among the 172 respondents, 19 samples did not meet the established criteria, which led to a final sample of 153. Descriptive statistics are presented in Table 3.

Table 3. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
The size of MSMEs	153	2.693	2.601	1	25
The Age of MSMEs	153	3.425	2.52	1	15
WCM	153	37.033	9.451	12	60
Financial Performance	153	16.163	3.786	4	20
The understanding of SR	153	31.033	6.014	10	45
Organizational Culture	153	19.353	5.273	8	34

Market Orientation	153	17.876	2.34	12	23
Entrepreneurship Orientation	153	16.222	4.227	10	40
Type of ownership	153	**Percentage** Personal: 63.40 Limited Partnership: 29.41 Partnership: 7.19		**Amount** Personal: 97 Limited Partnership: 45 Partnership: 11	

Source: Processed data (2023)

Table 3 provides insights into the characteristics of MSMEs, revealing an average employee count of 2 and an average establishment duration of approximately 3.4 years. The data suggests that the sampled MSMEs range in size, with a maximum of 15 employees and operational durations spanning up to 15 years. WCM shows an average of 36.033 and a standard deviation of 9.451, indicating that the sample data is clustered around its mean. This suggests that the average WCM value is representative of the sampled MSMEs and falls within the range of effective WCM practices. The financial performance, with an average of 16.163, suggests that most samples exhibit positive financial outcomes.

Moreover, Table 1 highlights a positive understanding of SR among the sampled MSMEs, evident in an average value of 31.033, surpassing the midpoint of its total value (total value = 47). This outcome surpasses the author's expectations, challenging the assumption that a significant portion of MSMEs may not fully grasp the concept of SR.

To achieve a comprehensive understanding of the research findings, a demographic overview of the respondents is essential. This demographic profile, as presented in Table 4, provides a thorough and insightful understanding of key attributes and characteristics such as revenue, position, gender, age, and educational background among the sampled respondents, ensuring that the audience feels well-informed and knowledgeable.

Table 4. Respondent Demographics

Demography	Classification	Percentage	Total
Revenue	50 – 300 million	90,85%	139
	300 – 500 million	7,84%	12
	> 500 million	1,31%	2
Position	Owner	74,51%	114
	Manager	3,92%	6
	Employee	21,57%	33
Gender	Male	56,21%	86
	Female	43,79%	67
Age	18 – 30	50,98%	78
	30 – 45	39,87%	61
	> 45	9,15%	14
Educational Background	≤High School	76,47%	117
	≥Bachelor Degree	23,53%	36

Source: Processed data (2023)

The demographic profile of the respondents primarily originates from the manufacturing sector of MSMEs in Palembang, presenting turnovers ranging between 50 to 300 million Rupiah. The majority of respondents are owners of these MSMEs. These findings align with the results obtained from the descriptive statistics in Table 1, emphasizing the prevalence of individually-owned MSMEs within the sample. The gender distribution among respondents approaches equilibrium, indicating a lack of disproportionality between male and female participants. Furthermore, the respondents predominantly fall within the age of 18 to 30 years, characterized as a productive age, encompassing late adolescence or early adulthood. Within this demographic segment, the prevailing educational attainment for most respondents is at the level of junior high school or senior high school.

Hypothesis Testing

Prior to hypothesis testing, we assessed validity and reliability. The results show that the data is valid and reliable. Furthermore, we assessed normality, heteroscedasticity, and multicollinearity. The data show no classic assumption issue.

Table 5. Multicollinearity Test Results

Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1) npm	1.000								
(2) size	0.095	1.000							
(3) age	-0.039	0.136	1.000						
(4) wcm	0.419	0.170	-0.097	1.000					
(5) sr	0.448	0.028	0.267	0.117	1.000				
(6) typ	0.055	0.293	0.099	0.065	0.075	1.000			
(7) cul	0.239	0.019	-0.084	0.663	0.092	0.011	1.000		
(8) market	0.659	0.002	0.013	0.291	0.329	-0.026	0.128	1.000	
(9) entre	0.010	0.152	0.777	-0.039	0.159	0.099	-0.045	-0.034	1.000

Source: Processed data (2023)

Table 6. Hypothesis Testing Results

VARIABLES	**(1)** **model1**
wcm	0.1***
	(0.0)
sr	0.2***
	(0.0)
size	0.1
	(0.1)
age	-0.4**
	(0.1)
type	0.1
	(0.1)
culture	-0.0
	(0.0)
market	0.8***
	(0.1)
entre	0.2**
	(0.1)
Constant	-8.9***
	(2.3)
Observations	153
R-squared	0.6

Source: Processed data (2023)

The results of the hypothesis testing are presented in Table 6. Table 6 reveals that WCM positively impacts the financial performance of MSMEs. It implies that improved WCM leads to an enhancement in financial performance, in contrast to detrimental WCM, which results in a decline in financial performance. These findings support the validation of Hypothesis 1. Furthermore, understanding SR positively influences the performance of MSMEs. This result suggests that an increase in SR understanding correlates linearly with the financial performance of MSMEs and otherwise. Therefore, Hypothesis 2 is accepted.

WCM and Financial Performance of MSMEs

The findings indicate that WCM has a positive impact on financial performance. This implies that with effective WCM, financial performance tends to improve. Meanwhile, poor WCM leads to a decline in financial performance. The findings of this study support the argument put forth by Nguyen (2020), asserting that companies can enhance their performance by managing their WCM more efficiently. This study aligns with the conclusions of Filbeck and Zhao (2017) and Wang (2002), who emphasize the significance of WCM for well-performing companies. One possible explanation for this relationship, as proposed by Sawarni et al. (2020), is that companies with a shorter CCC utilize more liquidity that can be invested in growth opportunities, thereby leading to higher corporate performance. Within the scope of this study, MSMEs generally exhibit proficient WCM practices. WCM, in this context, refers to a straightforward calculation of the duration for which cash can be sustained from operational business processes.

Furthermore, the study reveals that simple practices such as routine examination of debts, managing receivables, addressing unrecoverable receivables, proficient cash flow management, and regulating inventory turnover contribute positively to financial performance. This affirms that a basic understanding and implementation of WCM among MSMEs could yield tangible benefits, assisting them in maintaining or enhancing their financial stability. Specifically, WCM seeks to settle the corporate dilemma of how much short-term assets, such as inventory, receivables, and cash, or short-term commitments, such as account payables, a firm must hold at any particular period to maximize returns (Braimah et al., 2021). Regardless of the policy choice, there are associated costs and benefits; hence, managers who are astute in choosing the optimal working capital level tend to create value for the firm (Gorondutse et al., 2017; Ukaegbu, 2014). For instance, a liberal policy of holding a high volume of receivables improves sales, enhances customer relations, attracts financially constrained customers, and consequently increases profitability (Abuhommous, 2017; Ukaegbu, 2014). Holding extensive inventories may enable the firm to avoid stock out, ensure uninterrupted production and take advantage of quantity discounts (Baños-Caballero et al., 2012; Koumanakos, 2008; Yuh et al., 2011) (Baños-Caballero et al., 2012; Ching et al., 2011; Koumanakos, 2008).

Efficient cash management enables MSMEs to maximize the utilization of their funds. By maintaining an adequate cash level for day-to-day operations without excess, MSMEs could avoid opportunistic costs and enhance liquidity. MSMEs must ensure control over their receivables, identifying customers who can make timely payments and assessing those at risk of delayed payments. By minimizing outstanding receivables, MSMEs can accelerate cash inflows and alleviate the risk of payment defaults.

Moreover, efficient inventory management minimizes storage costs and the risk of obsolescence. Furthermore, maintaining an extensive inventory can reduce supply costs and shield the company from price fluctuations, particularly in economies with high inflation rates and unfavourable macroeconomic factors, among other benefits (Le et al., 2018). A more enormous inventory also mitigates the risk of stockouts. In the event of a stockout, the company may incur high costs due to potential disruptions in the production process or losses in business operations resulting from shortages of goods (Blinder & Maccini, 1991). MSMEs must maintain inventory at levels necessary to meet demand without excess, preventing funds from being tied up in unsold or expired goods. Effective management helps MSMEs reduce interest costs and enhance supplier relationships in the context of liabilities. Timely debt payments and negotiating favourable payment terms can help maintain a healthy working capital.

In the context of RBV theory, this research underscores the importance of internal assets, specifically the WCM capability possessed by MSMEs. RBV highlights that internal assets and resources of an entity, such as the knowledge and skills in WCM, can be valuable and rare, offering a competitive advantage. Thus, this study aligns with the RBV perspective that competitive advantage can be achieved by effectively managing internal assets, particularly the WCM capability. MSMEs that can optimize these assets adeptly are poised to enhance their market position and achieve better financial performance. The RBV focuses on the firm's ability to maintain a combination of resources that competitors cannot own or build similarly (Yakob et al., 2021).

The Understanding of SR and Financial Performance of MSMEs

The understanding of SR has been proven to influence the financial performance of MSMEs positively. Financial performance improves with a strong understanding of SR; conversely, a lower understanding of SR diminishes financial performance. Financial performance is fundamental to an organization's understanding of its sustainability (Umar et al., 2021). SR opens doors to larger markets as contemporary businesses and consumers engage with entities committed to sustainable business practices. MSMEs demonstrating this commitment through SR can attract new customers and expand their market reach. Financial performance measures how well a firm uses its resources to make a profit, and it is important to stakeholders. These stakeholders include trade creditors, bondholders, investors, employees and management (Umar et al., 2021).

Furthermore, through SR, MSMEs can identify and manage their environmental and social impacts, such as efforts to reduce energy and resource consumption, minimize waste, or contribute to the local community. These actions reduce operational costs, enhance efficiency, and improve profit margins. By embracing sustainability, micro-, small---, and medium-sized enterprises (MSMEs) can gain a competitive advantage, attracting customers and investors who share these values (Martínez-Peláez et al., 2023).

Additionally, SR assists MSMEs in risk reduction. By identifying potential issues that could harm reputation or pose regulatory challenges, MSMEs take preventive measures, saving costs and resources in the long run. Cost savings contribute to higher profits and better financial performance for MSMEs. Sustainability reporting reduces information asymmetry and risk perceived by investors, increases market efficiency, and reduces a firm's cost of capital (Dhaliwal et al., 2011; Warren & Thomsen, 2012).

Moreover, the data indicates that within the MSME sector, over 30 per cent of MSME owners comprehend the definition and impact of SR. Some MSMEs have delved into sustainability concepts, realizing the importance of reporting business activities' social, environmental, and economic impacts and the long-term benefits for their businesses.

On the other hand, many MSMEs have yet to grasp or fully appreciate SR's existence. Some may need more resources, such as limited time and workforce, making it challenging to engage in these practices. Their focus may be on daily tasks essential for running their businesses. The main challenge lies in mindset; MSMEs often perceive the benefits of SR as less visible in the short term, with impacts more felt in the long term, while owners of MSMEs tend to concentrate on short-term business growth objectives. Hence, a profound understanding of the long-term benefits offered by SR is necessary. Education and external support are vital to enhancing MSME understanding of SR. Training programs, consultants, or other support resources can help MSMEs better comprehend these concepts and integrate them into their business practices, overcoming resource-related barriers and unlocking opportunities for sustainable growth.

Regulations and policies also influence MSMEs' understanding and actions related to SR. Legal requirements or incentives in some regions encourage MSMEs to report their sustainability impacts, while in others, it may be more voluntary. In the context of MSMEs, SR serves as a tool to gain legitimacy and support from stakeholders. MSMEs communicate their commitment to sustainable business practices through SR, including efforts to reduce their negative impact on the environment and society. When MSMEs successfully obtain legitimacy from stakeholders through SR, it positively impacts financial performance. MSMEs with a positive reputation in sustainability can more easily attract new customers who prefer to do business with entities caring about social and environmental issues, leading to increased sales and revenue.

Discussions

This research was conducted in a specific context: MSMEs in the manufacturing sector in Palembang, Indonesia. While this provides valuable insights into how WCM and SR understanding can influence financial performance within this particular sector, the ability to generalize these findings to broader contexts should be considered with caution. The practices observed in this study may be influenced by regional factors, such as the economic environment, market conditions, or even cultural considerations unique to Palembang.

In more developed or diverse economies, MSMEs in other sectors face different challenges, particularly regarding access to resources, regulatory requirements, or consumer expectations, which affect how WCM and SR are managed. Therefore, the results here should be understood within the local context. Extending these findings to MSMEs outside of Palembang or in different sectors would require further research that accounts for these broader variables. Cross-country comparisons or studies within different economic zones could provide more insights into how these findings apply in different settings.

For example, in more developed economies or sectors with higher technological advancement, MSMEs face different challenges or have access to more sophisticated financial and operational tools. As a result, the effective practices in this context require adaptation or may not be directly applicable. Therefore, while this study adds to the local literature and provides a valuable reference for similar settings, the findings may need more generalizability beyond the specific context of this research. Further comparative studies across different regions, sectors, or economic conditions are necessary to validate whether these conclusions hold in more diverse or complex environments.

Conclusion

The results of this study demonstrate that understanding SR and WCM influences the performance of MSMEs. Moreover, a deeper understanding of SR has positively impacted financial performance, indicating that enhanced SR comprehension leads to better outcomes. Furthermore, WCM also positively influences financial performance, playing a crucial role in MSMEs where proper and efficient WCM aligns with financial performance.

Given the inherent constraints in MSMEs related to knowledge, facilities, and capital, the effective utilization of internal resources is expected to positively affect financial performance. The results of this study, which are anticipated to contribute specifically to the MSMEs sector, particularly in the scope of effective WCM, offer a promising outlook for the future. Additionally, this study contributes to the formulation of SR for MSMEs, which in the long term aids in the development and implementation of SR strategies to support SDGs, in particular for MSMEs owners in Indonesia.

SR is not merely a social responsibility but also directly impacts the financial performance of MSMEs. Through a commitment to sustainability, MSMEs seize opportunities for sustainable business growth and reap long-term benefits for their finances. However, it is crucial to note that SR practices must be conducted with honesty and transparency. Engaging in dishonest practices or greenwashing (making false claims about sustainability) cannot only damage reputations and result in financial losses but also impair investor trust, highlighting the potential risks of such practices.

The limitations of this study include the online data collection through a questionnaire, which may impact respondent participation rates and the quality of responses. Additionally, quota sampling methods may restrict the sample representation of the manufacturing MSME population in Palembang. Furthermore, this study only incorporates control variables in the model, potentially overlooking other factors influencing MSME financial performance, such as external and internal elements.

Suggestions for future research involve considering diverse data collection methods, such as interviews or observations, to ensure better participation and higher response quality. Furthermore, expanding the sample scope and considering additional factors that may influence MSME financial performance, including external and internal factors, could provide a more comprehensive understanding of the relationship between sustainability reporting awareness, working capital, and financial performance.

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