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Institutional Support and SME Financial Performance in an Emerging Economy: A Sequential Mediation Model of Entrepreneurial Competency and Behavioral Finance

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ABSTRACT

This study investigates the role of institutional support in enhancing SME financial performance in an emerging economy by uncovering the underlying micro-foundational mechanisms. While prior research suggests that access to external resources such as bank finance and government support improves firm performance, empirical evidence remains inconsistent. This study addresses this gap by proposing a sequential mediation model that explains how institutional support is transformed into financial performance through entrepreneurial competency and financial decision-making behavior.

Using a cross-sectional survey of 245 SMEs in Indonesia and applying Partial Least Squares Structural Equation Modeling (PLS-SEM), the findings reveal that institutional support does not exert a strong direct effect on financial performance. Instead, its impact operates indirectly through a multi-stage mechanism: institutional support enhances entrepreneurial competency, which improves financial decision-making behavior, ultimately leading to superior financial performance.

This study contributes to the literature by integrating institutional theory, capability-based view, and behavioral finance into a unified framework. It advances the micro-foundational perspective by demonstrating that resource availability must be activated through internal competencies and behavioral mechanisms to generate economic value. The findings also provide policy implications, emphasizing that SME support programs should prioritize capability development and behavioral financial literacy rather than relying solely on financial disbursement.

Keywords: Institutional support, SME performance, Entrepreneurial competency, Behavioral finance, Emerging economy

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INTRODUCTION

Small and Medium Enterprises (SMEs) constitute the backbone of economic development in emerging economies, contributing significantly to employment generation, income distribution, and regional growth. Despite their strategic importance, SMEs often operate within institutional environments characterized by structural inefficiencies, including limited access to finance, regulatory uncertainty, and weak managerial infrastructure. These institutional voids constrain the ability of SMEs to leverage growth opportunities effectively.

To mitigate such constraints, governments and financial institutions provide various forms of institutional support, including bank financing, subsidies, training programs, and financial inclusion initiatives. From a theoretical standpoint, the Resource-Based View (RBV) and institution-based view suggest that access to external resources should enhance firm performance. However, empirical findings remain inconclusive. While some studies report positive effects, others find insignificant or inconsistent relationships.

This inconsistency points to a fundamental limitation in existing research: the tendency to assume a direct linkage between resource availability and performance outcomes. Such an approach overlooks the internal processes through which external resources are transformed into economic value. As highlighted in the literature, resource availability does not necessarily translate into resource productivity.

This study addresses this gap by adopting a micro-foundational perspective, arguing that institutional support functions as a latent enabling structure that requires activation through internal mechanisms. Specifically, this study proposes that entrepreneurial competency and financial decision-making behavior serve as critical transmission channels that convert institutional support into financial performance.

By integrating institutional theory, capability-based view, and behavioral finance, this study develops and tests a sequential mediation model:

Institutional Support → Entrepreneurial Competency → Financial Decision-Making Behavior → SME Financial Performance

This study contributes to the literature in three ways. First, it extends institutional theory by incorporating a micro-level explanation of how institutional support influences firm outcomes. Second, it introduces a dual sequential mediation mechanism that captures the transformation from resources to competencies and from competencies to behavior. Third, it expands the application of behavioral finance into the SME context in emerging economies.

LITERATURE REVIEW

Institutional Theory and Institutional Support In the Context of SMEs

Institutional theory asserts that organizational behavior and performance are shaped by formal structures, regulations, norms, and institutional pressures (North, 2012; Scott, 2014). In the context of emerging economies, institutional voids—such as weak financial systems, regulatory uncertainty, and underdeveloped market infrastructure—will affect firms' ability to access and utilize resources (Khanna & Palepu, 2010; Webb et al., 2020; Liedong et al., 2020).

The institution-based view (Peng et al., 2008) states that corporate strategy and performance are the result of the interaction between internal resources and the institutional environment. Bruton et al. (2010) emphasize that in entrepreneurship, institutions are not only constraints but also enabling mechanisms.

In the context of SMEs, institutional support typically takes two main forms:

1. Bank financing (access to credit and external financing)
2. Government support (subsidies, training, policy incentives)

The literature on SME finance indicates that limited access to finance is a major barrier to SME growth (Beck & Demirgüç-Kunt, 2006; Beck et al., 2008; Berger & Udell, 2006). Ayyagari et al. (2011) emphasize the vital role of SMEs in global job creation, making financial support a strategic issue.

From a public policy perspective, Arasti et al. (2014) explain that government interventions are designed to address market failures. However, Colombo et al. (2013) found that government subsidies do not always result in sustainable performance improvements, indicating the presence of internal mechanisms mediating this relationship.

In the context of emerging markets, which are characterized by high uncertainty and institutional complexity (Wright et al., 2005; Kiss et al., 2012; Webb et al., 2014), the effectiveness of institutional support depends heavily on the firm's internal capacity to respond to such an environment.

Based on the institutional theory framework and the SME finance framework, the following hypotheses can be formulated:

H1: *Bank finance has a positive effect on SME financial performance.*
H2: *Government support has a positive effect on SME financial performance.*

Institutional Support and Development of Entrepreneurial Competency

Entrepreneurial competency is defined as a combination of knowledge, skills, and abilities that enable entrepreneurs to identify opportunities and manage resources effectively (Man et al., 2002; Mitchelmore & Rowley, 2010). Entrepreneurial competency is a key determinant of SME success. From the capability-based and resource-based view perspectives (Barney, 1991), capabilities are the primary determinants of the creation of competitive advantage.

Teece (2007), through the concept of dynamic capabilities, emphasizes that companies need to develop sensing, seizing, and transforming capabilities to capitalize on external opportunities in a dynamic environment. In the context of the institutional environment, external support can serve as a stimulus for learning-by-doing, thereby strengthening entrepreneurial competence (Peng et al., 2008).

Adel et al. (2020) and Zulu-Chisanga et al. (2021) demonstrate that institutional support and public policy play a role in enhancing managerial capabilities and entrepreneurial orientation. Zahra et al. (2006) add that capability development under conditions of uncertainty is crucial for firms in emerging markets. Therefore, institutional support is expected to strengthen competencies through learning and the accumulation of experience. Based on institutional theory and entrepreneurial competency, the following hypotheses can be formulated:

H3: *Bank financing has a positive effect on entrepreneurial competency.*
H4: *Government support has a positive effect on entrepreneurial competency.*

Entrepreneurial Competency and Financial Decision-Making Behavior

The behavioral finance literature emphasizes that financial decision-making is influenced by bounded rationality, heuristics, loss aversion, and mental accounting (Kahneman & Tversky, 1979; Thaler, 1985). Thaler (1985) introduced mental accounting as a mechanism of bias in resource allocation. Barberis & Thaler (2003) and Baker & Wurgler (2007) demonstrate that sentiment and cognitive biases influence investment and financing decisions.

In the corporate context, Shefrin (2007) developed behavioral corporate finance, which explains how managerial biases affect economic outcomes. Weerasekara & Bhanugopan (2023) found that an entrepreneur's decision-making style influences the financial performance of SMEs. Entrepreneurial competency is expected to improve decision-making quality by: reducing cognitive biases, enhancing risk assessment, and optimizing capital allocation Based on entrepreneurial competency and financial decision-making behavior, the following hypothesis can be formulated:

H5: *Entrepreneurial competency has a positive effect on financial decision-making behavior*

Financial Decision-Making Behavior and Financial Performance

Decision quality is a key determinant of economic outcomes. Behavioral corporate finance (Shefrin, 2000) explains that rational investment and financing decisions enhance profitability and growth. Barberis & Thaler (2003) demonstrate that bounded rationality can lead to mispricing and suboptimal resource allocation. In the context of SMEs, Weerasekara & Bhanugopan (2023) demonstrate that effective decision-making styles are correlated with improved performance.

SME performance is often associated with entrepreneurial orientation and strategic capabilities (Wiklund & Shepherd, 2005). A meta-analysis by Rauch et al. (2009) reveals a consistent relationship between entrepreneurial orientation and performance. In performance measurement, Venkatraman & Ramanujam (1986) distinguish between financial performance and business performance. Measurements of SME financial performance often employ subjective approaches that are valid in the context of private firms (Dess & Robinson, 1984). Based on behavioral corporate finance and financial performance, the following hypothesis can be formulated:

H6: *Financial decision-making behavior has a positive effect on SME financial performance.*

Mediation Mechanism: Internalization of Institutional Support

Institutional theory (North, 2012; Scott, 2014) posits that institutions influence behavior through the internalization of norms and structures. In the complex context of emerging economies (Webb et al., 2014; Wright et al., 2005; Kiss et al., 2012), the impact of institutional support is likely indirect. However, the effects are not always immediate. Jayeola et al. (2022) demonstrate that the impact of government support is mediated by internal mechanisms.

Zulu-Chisanga et al. (2021) and Nguyen & Luu (2020) found that public policies often exert their impact through the enhancement of capabilities. Capabilities (Barney, 1991; Teece, 2007; Zahra et al., 2006) and behavioral mechanisms (Kahneman & Tversky, 1979; Shefrin, 2007) are expected to serve as channels for the transmission of economic value. Based on entrepreneurial competency and financial performance, the following hypotheses can be formulated:

H7: *Entrepreneurial competency mediates the relationship between bank finance and SME financial performance.*
H8: *Entrepreneurial competency mediates the relationship between government support and SME financial performance*

Competency–Behavior–Performance Chain

By integrating a competency-based perspective with behavioral finance, the following relationship is proposed: *Entrepreneurial Competency → Financial Decision Behavior → Financial Performance*.
Man et al. (2002) and Shefrin (2007) indicate that managerial competence influences the quality of decisions, which in turn determines economic outcomes. Based on financial decision-making behavior, the following hypothesis can be formulated:

H9: *Financial decision-making behavior mediates the relationship between entrepreneurial competency and financial performance.*

Sequential Mediation: Institutional Activation Mechanism

Drawing on the institution-based view (Peng et al., 2008) and the micro-foundational perspective, institutional support is expected to operate through a sequential process:

Institutional Support → Entrepreneurial Competency → Financial Decision Behavior → Financial Performance

This model extends previous findings on sequential mediation (Jayeola et al., 2022) by incorporating behavioral finance mechanisms. Based on the mechanism of financial decision-making behavior, the following hypotheses can be formulated:

H10: *Entrepreneurial competency and financial decision-making behavior sequentially mediate the relationship between bank finance and financial performance.*
H11: *Entrepreneurial competency and financial decision-making behavior sequentially mediate the relationship between government support and financial performance.*

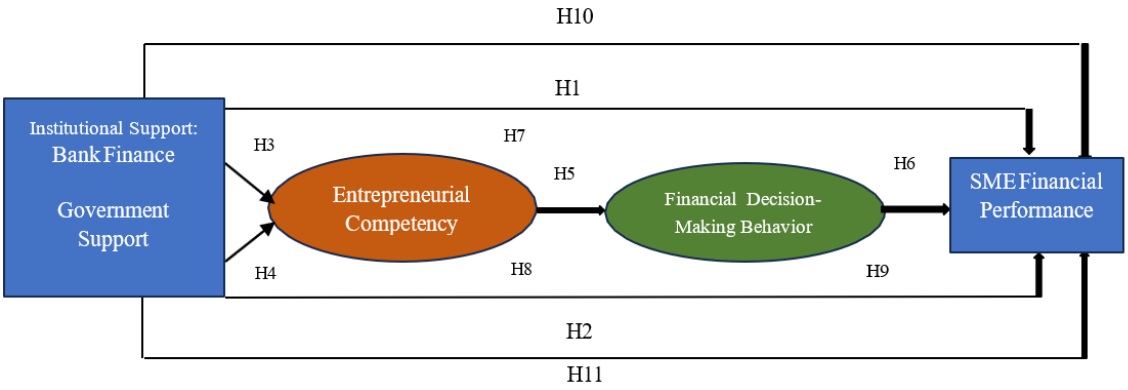


Figure 1. Sequential Mediation Model of Institution Support, Entrepreneurial Competancy and Finacial Decision Behavior on SME Fiancial Performance. Source: Compiled by the Author (2026)

METHOD

Research Design

This study employs a quantitative cross-sectional survey design. The unit of analysis is SME owners or top managers, who are the primary decision-makers in financial and strategic matters.

Sample and Data Collection

The sample consists of 245 SMEs in Indonesia, selected using purposive sampling based on the following criteria:

1. SMEs operating for at least three years
2. Experience with bank financing or government support

Data were collected using structured questionnaires with a five-point Likert scale (1 = strongly disagree to 5 = strongly agree).

Measurement

All constructs are modeled as reflective latent variables:

1. Bank Finance (BF): adapted from Beck & Demirgüç-Kunt (2006); Berger & Udell (2006); Ayyagari et al. (2011); Yazdanfar (2012); Cámara & Tuesta (2014). Comprising eighteen items focused on Short- and Long-Term Debt Levels; Trade Credit; Access to Loans; Reliance on Financing; Account and Savings Holdings.
2. Government Support (GS): adapted from Colombo et al. (2013); Bruton et al. (2010); Sefiani (2013); Zhu et al. (2012); Choe & Pattnaik (2007); Kent Baker et al. (2018). Comprising twenty-one items focused on access to training & management; effectiveness of support; bureaucratic barriers; fair competition; support for innovation; facilities & subsidies.
3. Entrepreneurial Competency (EC): adapted from Man et al. (2002); Mitchelmore & Rowley (2010); Teece (2007); Kyndt & Baert (2015). Comprising ten items focused on decisiveness; future planning; independence; spotting opportunities; market understanding.
4. Financial Decision-Making Behavior (FDB): adapted from Kahneman & Tversky (1979); Thaler (1985); Shefrin (2007); Kent Baker et al. (2018); Raveendra et al. (2018). Comprising twenty-two items focused on behavioral biases (overconfidence, self-attribution, anchoring, loss aversion, heuristics, mental accounting, cognitive dissonance, regret aversion, herding, emotional factors, framing).
5. SME Financial Performance (FP): adapted from Dess & Robinson (1984); Wiklund & Shepherd (2005); Rauch et al. (2009); Delmar et al. (2003); Santos & Brito (2012). Comprising twenty-three

items focused on sales growth; employee growth; consistency & stability; profitability; customer satisfaction.

Control Variables, to control for external influences on financial performance, this study includes:

1. Firm age (years in operation)
2. Firm size (number of employees)
3. Sector (manufacturing and services)

Data Analysis

Data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with the aid of SmartPL-3 software. The PLS-SEM technique was chosen for its suitability for exploratory models, prediction-oriented analysis, and its ability to handle complex models with moderating variables. The study involved two main stages (Hair et al., 2026):

1. Measurement model assessment: evaluating construct validity and reliability through composite reliability (CR), average variance extracted (AVE), and outer loadings.
2. Structural model assessment: examining the significance of hypothesized relationships using bootstrapped t-statistics and p-values. Path coefficients were interpreted alongside model fit indices, including the Standardized Root Mean Square Residual (SRMR), Normed Fit Index (NFI), and the d-ULS (discrepancy).
3. A mediation analysis was conducted to test the role of mediating variables in explaining the relationship between the independent and dependent variables. This test aimed to determine whether the indirect effects observed were significant, as well as to identify the type of mediation involved—whether full or partial mediation

RESULTS

Respondent Profile

The sample is dominated by female entrepreneurs (54.3%), individuals aged 26–40 (67.8%), and SMEs operating in the goods sector (65.7%). This profile reflects a dynamic and productive segment of SME actors. (seeTabel 1.)

Table 1. Respondent Profile

Category		Frequency	Percentage
Sector	Goods	161	65.7
	Service	84	34.3
Age	26-40	166	67.8
	Other	79	32.2
Gender	Female	133	54.3
	Male	112	45.7
Total		245	100

Source: *Data processed, 2026*

Measurement Model

The results confirm that all constructs meet reliability and validity criteria. Convergent validity is established with AVE values above 0.50. Furthermore, Cronbach's Alpha values exceed 0.6 for all constructs, indicating sufficient internal consistency (Hair et al., 2026). Composite Reliability and rho_A values are also within the acceptable threshold (> 0.7) (see Tabel 2.).

Table 2. First-order construct validation

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Bank Finance	0.745	0.745	0.839	0.566
Entrepreneurial Competency	0.696	0701	0.831	0.621
Financial Decision-Making	0.932	0.940	0.939	0.544
Government Support	0.795	0.794	0.858	0.548
SME Financial Performance	0.753	0.756	0.843	0.574

Source: *Data processed, 2026*

While discriminant validity is confirmed using Fornell-Larcker and HTMT criterion (see Tabel 3). The square root of the AVE of each construct is greater than its highest correlation with any other construct, confirming satisfactory discriminant validity.

Table 3. Fornell-Larcker criterion

	Bank Finance	Entrepreneurial Competency	Financial Decision-	Bank Finance	Entrepreneurial Competency
Bank Finance	**0.752**				
Entrepreneurial Competency	0.647	**0.788**			
Financial Decision-Making	0.279	0.219	**0.738**		
Government Support	0.657	0.566	0.099	**0.740**	
SME Financial Performance	0.712	0.683	0.220	0.656	**0.758**

Source: *Data processed, 2026*

This research also evaluated the coefficient of determination (R^2) and predictive relevance (Q^2) to determine the model's explanatory power. Endogenous constructs showed R^2 values exceeding 0.25, with Q^2 values > 0, for entrepreneurial competency and sme financial performance indicating the model's predictive relevance (Hair et al., 2026). The R-squared value for SME Financial Performance is 0.573, meaning that 57.3% of the variability in SME financial performance is influenced by government support, bank financing, entrepreneurial competency, and financial decision-making behavior, while the remaining 42.7% is explained by other factors outside the model. The Entrepreneurial Competency variable has an R^2 value of 0.454 (45.4%). On the other hand, the Financial Decision-Making Behavior variable has a very low R^2 value of 0.048 (4.8%), indicating that the respondents' financial behavior is largely influenced by other external factors not measured in this study (see Tebel 4).

Table 4. R-squared values

	R Square	R Square Adjusted
Entrepreneurial Competency	0.454	0.449
Financial Decision-Making	0.048	0.044
SME Financial Performance	0.573	0.567

Source: *Data processed, 2026*

Structural Model and Hypotheses Testing

Direct effect tests were conducted to test hypotheses H1 through H6. A hypothesis was considered supported if the P-value was <0.05 and the t-statistic was > 1.96.

Based on Table 5, nearly all direct effect hypotheses were supported (H1, H2, H3, H4, and H5), with significance levels meeting the criteria (P-values <0.05). This demonstrates that bank financing and government support can directly improve financial performance and entrepreneurial competence empirically. However, hypothesis H6 was not supported (P-values = 0.203> 0.05), indicating that financial decision-making behavior does not have a significant direct effect on SME financial performance.

Table 5. Results of the Hypothesis Test on Direct Effects

	Original Sample (β)	T Statistics (|O/STDEV)	P Values	Decisison
H1. *Bank Finance → SME Financial Performance*	0.475	6.976	0.000	Supported
H2. *Government Support → SME Financial Performance*	0.339	6.230	0.000	Supported
H3. *Bank Finance → Entrepreneurial Competency*	0.485	6.052	0.000	Supported
H4. *Government Support → Entrepreneurial Competency*	0.404	0.408	0.000	Supported
H5. *Entrepreneurial Competency → Financial Decision-Making Behavior*	0.219	3.958	0.000	Supported
H6. *Financial Decision-Making Behavior → SME Financial Performance*	0.054	1.274145	0.000	Not Supported

Source: *Data processed, 2026*

The testing of the hypothesis regarding indirect effects aims to examine the role of the mediating variables—Entrepreneurial Competency and Financial Decision-Making Behavior—in the model, both through single mediation and sequential mediation.

Based on Table 6, the mediation tests yielded mixed results. Hypotheses H7 and H8 were found to be statistically supported. This demonstrates that Entrepreneurial Competency positively and significantly mediates the relationship between bank financing and government support on the financial performance of SMEs. In other words, bank and government facilities will have a far greater impact on financial performance if SME actors possess adequate competency to manage them.

Conversely, all mediation hypotheses originating from financial decision-making behavior (Financial Decision-Making Behavior) to SME financial performance—namely H9, H10, and H11—were rejected (P-Values > 0.05). The failure of this mediation chain is consistent with the results of the previous direct effect test (rejection of H6). This means that although bank financing and government support successfully fostered competencies that subsequently improved financial decision-making behavior (as seen in the significant initial pathway), this behavior was empirically not strong enough to translate into a tangible improvement in financial performance (such as profit or sales) in practice.

Table 6. Results of the Hypothesis Test on Indirect Effects

	Original Sample (β)	T Statistics (|O/STDEV)	P Values	Decisison
H7. *Bank Finance → Entrepreneurial Competency → SME Financial Performance*	0.475	6.976	0.000	Supported
H8. *Government Support → Entrepreneurial Competency* → SME Financial Performance	0.339	6.230	0.000	Supported
H9. *Entrepreneurial Competency → Financial Decision-Making Behavior→ SME Financial Performance*	0.485	6.052	0.000	Not Supported
H10. *Bank Finance → Entrepreneurial Competency→ Financial Decision-Making Behavior →SME Financial Performance*	0.404	0.408	0.000	Not Supported
H11 *Government Support → Entrepreneurial Competency → Financial Decision-Making Behavior → SME Financial Performance*	0.219	3.958	0.000	Not Supported

Source: *Data processed, 2026*

In addition to testing the primary relationships among constructs, this study also includes three control variables—firm age, firm size, and industry sector—to ensure that the effects of the independent

variables on the financial performance of MSMEs are not influenced by the firms' basic characteristics. The selection of these control variables is based on the theoretical consideration that companies that have been operating longer tend to have better experience and stability, larger companies typically have higher resource capacity, while the business sector can create differences in market opportunities and challenges. Thus, the inclusion of control variables aims to enhance the internal validity of the model and minimize potential bias resulting from external factors that are not the primary focus of the study. The analysis results indicate that among the three control variables, only firm age has a marginally significant effect on SME financial performance (β = 0.074; t = 1.779; p = 0.076), suggesting that firms with a longer operating history tend to have a slight advantage in achieving better financial performance. Conversely, firm size (β = 0.032; t = 0.834; p = 0.404) and industry sector (β = 0.017; t = 0.432; p = 0.666) did not show a significant effect.

These findings confirm that variations in financial performance within the model are better explained by the main constructs—such as bank financing, government support, entrepreneurial competency, and financial decision-making behavior—than by firm-level structural characteristics. In other words, the control variables serve as moderators within the model, while the main results continue to reflect the substantive relationships among the proposed theoretical variables.

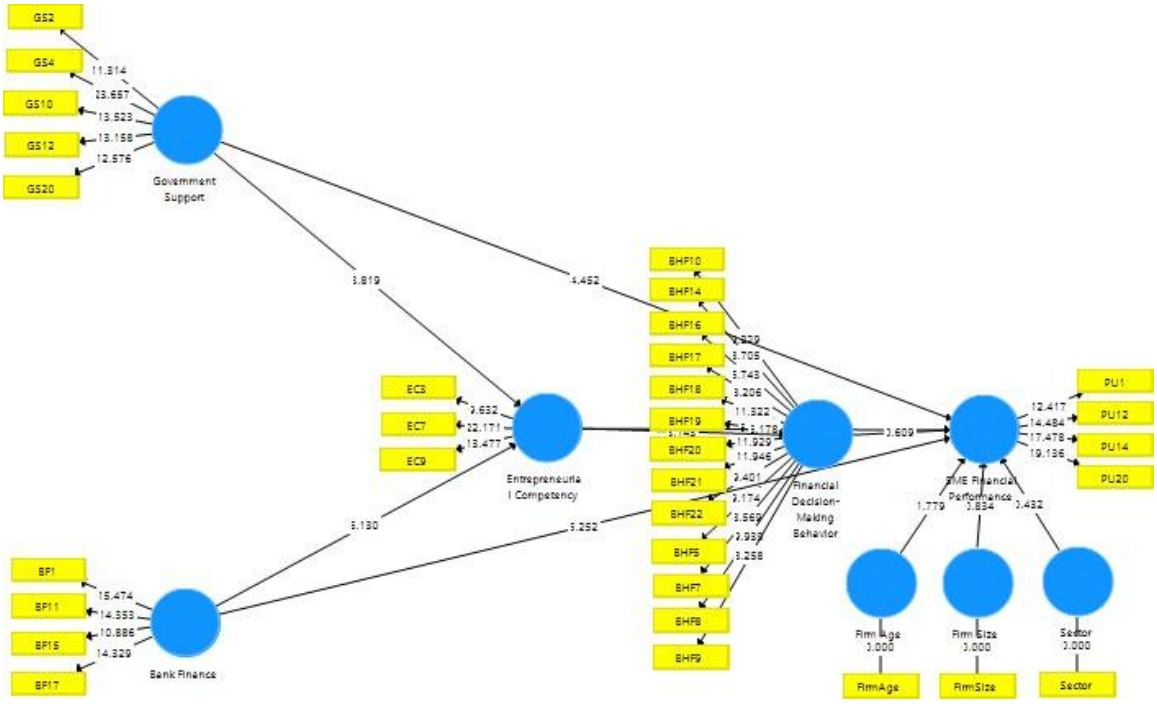


Figure 2. Bootstrapping Result. Source: Data Processed, 2026

Discussion

The main findings of this study indicate that institutional support—whether through bank financing or government support—directly and indirectly, via entrepreneurial competence, can significantly improve the financial performance of SMEs. However, this study also found that financial decision-making behavior has no significant effect on financial performance, thereby breaking the previously hypothesized sequential mediation chain. These findings make an important contribution to management literature by clarifying that strengthening internal strategic capabilities is more urgent for SMEs than merely mitigating psychological biases in financial decisions. These results address the need for a deeper understanding of the mechanisms by which institutional support is transformed into tangible performance outcomes in developing economies.

Research findings showing the positive impact of institutional support on performance are consistent with the institutional perspective, which holds that external resources are crucial in an economic environment still grappling with institutional imperfections. These findings reinforce previous

studies by Beck and Demirguc-Kunt (2006) as well as Berger and Udell (2006), which position access to banking as the primary driver of liquidity and investment capacity for small firms. Similarly, the significant role of government support confirms the arguments of Bruton et al. (2010) and Arasti et al. (2014) that public policy interventions are effective in reducing operational barriers resulting from limited access to information and markets. The success of entrepreneurial competence as a mediating variable also supports Teece's (2007) dynamic capabilities theory, which emphasizes that external resources must be integrated with internal managerial expertise to generate sustainable financial value.

Conversely, the non-significant results regarding the influence of financial decision-making behavior on performance offer a different perspective from some traditional behavioral finance literature. An alternative explanation for this anomaly is that, at the SME level, macroeconomic fluctuations and changes in consumer purchasing power are far more dominant in determining profits than the cognitive biases of individual managers. Furthermore, overly rigid loss-aversion behavior may actually limit entrepreneurs' willingness to take the investment risks necessary for business expansion. These findings differ from the results of Weerasekara and Bhanugopan (2023), who previously suggested a strong link between decision-making style and performance, indicating that the local SME context in this study possesses unique characteristics in responding to financial risks amid market uncertainty

CONCLUSION

This study aims to examine the mediating roles of entrepreneurial competence and financial decision-making behavior in the relationship between institutional support and the financial performance of SMEs. Overall, the main research question has been answered with the conclusion that the availability of bank financing and government support can directly and significantly improve the financial performance of SMEs. Furthermore, this study demonstrates that entrepreneurial competence acts as a highly essential mediator. Financial support and public facilities have been shown to yield far more optimal results when SME actors possess the strategic capacity to manage them. However, this study also concludes that the mediation chain is broken at the aspect of financial decision-making behavior. Efforts by SME actors to avoid cognitive biases or act too rationally have been shown to have no tangible impact on increasing their profits or sales growth.

This study has limitations because data collection was conducted only once at a specific point in time (cross-sectional), and thus was unable to capture the dynamics of changes in SME financial performance over time.

Recommendations

In practical terms, the findings of this study provide crucial strategic guidance for the government and banking authorities. The framework developed through this research indicates that SME empowerment programs should not stop at the stage of disbursing capital loans or providing physical subsidies. Policymakers must integrate such financial support with intensive mentoring programs specifically designed to hone entrepreneurial competencies, such as training in business strategy development and market opportunity identification. Empirical evidence shows that strengthening these internal strategic capabilities is far more practical and effective for optimizing SME financial performance than merely attempting to correct the psychological biases of business managers.

Future research should explore other mediating variables, such as digital innovation capabilities, or adopt a longitudinal approach to gain a more comprehensive understanding of the impact of institutional support over time. This is crucial to ensure that external support is effectively translated into robust performance.

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