



THE EFFECT OF LEGAL COMPLIANCE ON THE FINANCIAL PERFORMANCE OF MSMEs IN INDONESIA

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Abstract

This study examines the influence of legal compliance on the financial performance of Micro, Small, and Medium Enterprises (MSMEs) in Indonesia, with a particular focus on financial stability, profitability, and competitiveness. Employing a descriptive-analytical design with a conceptual approach, this research synthesizes legal and financial theories through an extensive review of secondary data, including academic literature, regulatory frameworks, and governance studies. Legal compliance is operationalized across four key dimensions: business licensing, taxation, employment, and consumer protection. The findings indicate that legal compliance plays a strategic role in enhancing financial stability by reducing regulatory risks, minimizing unexpected costs, and improving cash flow management. Furthermore, compliance contributes to profitability through cost efficiency and improved access to financing with more competitive capital costs. In terms of competitiveness, legally compliant MSMEs demonstrate stronger reputational capital, greater market access, and higher adaptability within digital and global markets. The study also highlights that compliance should not be perceived merely as a regulatory obligation but as a financial strategy that strengthens governance quality and long-term business sustainability. However, the effectiveness of compliance is contingent upon regulatory simplification and MSME capacity, including legal literacy and administrative readiness. This study contributes to the integration of business law and financial performance perspectives in the MSME context and offers policy relevant insights for strengthening MSME resilience.

Keywords: *legal compliance, MSMEs, financial performance*

1. INTRODUCTION

Business law is a fundamental instrument that shapes the structure, behavior, and sustainability of economic activity, including in the context of micro, small, and medium enterprises (MSMEs). In the global economy, MSMEs play a strategic role as key drivers of economic growth and job creators. However, this role is not always accompanied by adequate levels of legal compliance. Globally, approximately 70% of MSMEs in developing countries still operate in the informal sector without full legal compliance, and more than 50% lack access to the formal legal system (World Bank, 2022; OECD, 2023). This situation indicates that business legality remains a structural challenge that impacts business legitimacy and sustainability.

A similar phenomenon also occurs in Indonesia. Although MSMEs contribute significantly to the national economy, approximately 59% of MSMEs remain in the informal sector, and only about 40% have a Business Identification Number (BPS, 2023; Ministry of Cooperatives and SMEs, 2024). This high level of informality reflects low legal compliance, which in turn has implications for limited access to economic resources, including financing and legal protection. Thus, there is a gap between the economic role of MSMEs and their level of legal compliance, potentially hampering financial performance and business competitiveness.

Conceptually, law in MSME activities functions not only as a normative framework governing business legality, contracts, taxation, and consumer protection, but also as a determinant of financial

performance. Legal compliance enables MSMEs to reduce the risk of sanctions, litigation costs, and cash flow disruptions, thereby contributing to business stability and profitability (Rinaldo et al., 2023; Usman et al., 2022; Lestari et al., 2024; Novandi et al., 2018; Nurfitriana, 2023; Saptono et al., 2024; Wulandari et al., 2022). This perspective positions legal compliance as a strategic instrument in creating economic efficiency and enhancing business sustainability.

However, the implementation of legal compliance by MSMEs faces various structural obstacles, particularly limited resources and low legal and financial literacy. Globally, only around 33% of small businesses have adequate financial literacy (World Bank, 2021), while in Indonesia, the financial literacy rate among MSMEs is around 49.68%, and legal literacy is estimated to be even lower (OJK, 2022; Ministry of Law and Human Rights, 2023). These limitations impact MSMEs' ability to understand and implement legal obligations, increasing their exposure to financial and operational risks.

The impact of low legal compliance is also evident in access to financing. Globally, the MSME financing gap reaches USD 5.7 trillion annually, with approximately 40% of formal MSMEs in developing countries lacking adequate financing (IFC, 2023). In Indonesia, the MSME financing gap reaches approximately IDR 1,600 trillion, and only about 20% of MSMEs have access to formal bank credit (OJK, 2023). Legal non-compliance, particularly regarding business legality, is a major factor hindering access to formal financing, thus limiting MSME expansion capacity and financial performance.

Within the governance framework, the concept of Good Corporate Governance (GCG) is a relevant approach to explaining the relationship between legal compliance and financial performance. GCG principles such as transparency, accountability, responsibility, independence, and fairness have been proven to improve financial performance and access to financing, including at the MSME scale (Rinaldo et al., 2023; Usman et al., 2022; Lestari et al., 2024; Novandi et al., 2018; Widiyati & Payamta, 2023; Saptono et al., 2024). However, the implementation of GCG in MSMEs requires adaptation that takes into account resource limitations, so governance indicators need to be simplified to remain effective without burdening business actors (Rinaldo et al., 2023; Novandi et al., 2018; Nurfitriana, 2023).

Additionally, other factors such as financial literacy, social responsibility practices, and tax compliance also contribute to the financial performance of MSMEs. Studies show that MSME tax compliance in developing countries remains in the range of 50–60% (IMF, 2022), while in Indonesia it reaches around 65% (Directorate General of Taxes, 2023). However, this compliance is still partial and is heavily influenced by incentives and policy dissemination (Natalina et al., 2024; Damayanti & Prihanto, 2024; Harahap et al., 2023; Saptono et al., 2024; Wulandari et al., 2022). This indicates that legal compliance has not been fully internalized as part of MSME business strategies.

The increasingly complex dynamics of the business environment, particularly due to global disruptions such as the COVID-19 pandemic, further emphasize the importance of legal compliance and governance in maintaining MSME resilience. Globally, approximately 25 - 30% of MSMEs experienced a significant decline in revenue during the pandemic (World Bank, 2021), while in Indonesia, approximately 84% of MSMEs were negatively impacted (BPS, 2021). MSMEs with good legal standing and governance have been shown to be better able to access government assistance and

maintain financial performance during the crisis (Widiyati & Payamta, 2023; Natalina et al., 2024; Purnawan et al., 2019; Wulandari et al., 2022; Masdiantini et al., 2023).

Furthermore, massive digital transformation has also increased demands on business legality. Globally, approximately 70% of MSMEs have shifted to digital platforms (UNCTAD, 2022), while in Indonesia, approximately 64% of MSMEs have digitized, but not all have formal legal status (Ministry of Cooperatives and SMEs, 2024). This mismatch between digitalization and legal compliance creates new risks that can impact the financial stability and performance of MSMEs.

Overall, the literature and empirical data indicate that legal compliance, governance, financial literacy, and access to financing are interrelated factors in determining the financial performance of MSMEs. However, a gap remains between the importance of legal compliance and its implementation in practice. Therefore, a study that comprehensively integrates legal and financial perspectives is needed to understand how legal compliance can function as a strategic determinant in improving the stability, profitability, and competitiveness of MSMEs in Indonesia.

This study aims to analyze the relationship between legal compliance and the financial performance of MSMEs in Indonesia. Specifically, this study examines the effect of legal compliance on MSME financial stability, as reflected in the ability to maintain liquidity and operational sustainability. Furthermore, this study also aims to identify the impact of legal compliance on profitability, particularly in the context of managing legal costs and risks.

Furthermore, this study analyzes the role of legal compliance in enhancing the competitiveness of MSMEs, both within the domestic market context and in accessing broader markets. Thus, this study seeks to provide a comprehensive understanding of the role of legal compliance as a strategic factor in improving MSME financial performance.

This research provides a theoretical contribution by integrating business law and financial perspectives in the context of MSMEs, which have tended to be studied separately. This integration results in a conceptual framework that positions legal compliance as a strategic variable in determining MSME financial performance.

Practically, this research provides implications for MSMEs in formulating legal compliance strategies that are not only oriented towards fulfilling administrative obligations but also serve as an instrument for increasing efficiency, reducing risk, and strengthening competitive position. Furthermore, this research also provides input for policymakers in designing regulations that are more adaptive, simpler, and tailored to the characteristics of MSMEs, thereby effectively increasing levels of legal compliance.

2. METHODS

2.1 Types of Research

This study employs a descriptive analytical approach. The descriptive approach is used to systematically describe the relationship between legal compliance and MSME financial performance based on a relevant theoretical framework. Meanwhile, the analytical approach is used to in-depth examine the conceptual linkages between legal and financial variables and identify causal and implicational patterns of relationships.

The analytical, descriptive nature of this research does not aim to statistically test hypotheses, but rather to construct scientific arguments based on a comprehensive literature synthesis. Therefore,

this research focuses on conceptual exploration and theoretical interpretation of the phenomenon of legal compliance in the context of MSME financial performance.

2.2 Approach

This research uses a conceptual approach, focusing on developing a framework based on relevant concepts, theories, and doctrines in the field of business and financial law. This approach is used to construct the relationship between legal compliance as an independent variable and the financial performance of MSMEs as a dependent variable.

In its implementation, a conceptual approach is carried out through the identification and analysis of key concepts, such as legal compliance, financial performance, and governance principles. These concepts are then integrated into an analytical framework that explains the mechanisms by which legal compliance affects the financial stability, profitability, and competitiveness of MSMEs.

The analysis in this study is also based on legal and financial theories. From a legal perspective, a normative approach is used, emphasizing regulatory compliance obligations and the legal implications of non-compliance. From a financial perspective, the concept of financial performance is used, encompassing cost efficiency, risk management, and resource optimization. The integration of these two perspectives allows for a more comprehensive, multidisciplinary analysis.

2.3 Data Sources

This study utilizes secondary and tertiary data as the primary sources in the analysis process. Secondary data include scientific journal articles discussing legal compliance, financial performance, and MSMEs, both in national and international contexts, which are used to build the conceptual and empirical foundations of the study. Furthermore, textbooks and academic literature in the field of corporate law and business law are utilized to explain the principles of legal compliance and their implications for business activities. Literature related to Good Corporate Governance (GCG) is also used as an analytical framework in understanding relevant governance practices, including their adaptation in the context of MSMEs.

Meanwhile, tertiary data includes laws and regulations related to MSMEs, particularly those governing business legality, taxation, and licensing, as well as official policy documents and guidelines issued by the government or relevant institutions that regulate MSME operations. The use of this combination of secondary and tertiary data aims to ensure that the analysis is not only theoretically sound but also highly relevant to the applicable regulatory framework.

2.4 Data Collection Techniques

The data collection technique in this study was conducted through library research, which involves a systematic process of searching, selecting, and collecting various literature sources relevant to the research topic. The initial stage was carried out by identifying literature sources based on keywords related to legal compliance, financial performance, and MSMEs. Next, a literature selection process was carried out by considering the credibility of the sources, their relevance to the research focus, and their contribution to the development of the conceptual framework. The selected literature was then classified into thematic categories, covering legal aspects, financial aspects, and the integration of the two. The next stage was the extraction of primary information that included

concepts, empirical findings, and theoretical arguments that supported the research analysis. Through this approach, the study was able to consolidate various academic perspectives in a systematic and structured manner.

2.5 Analysis Techniques

The analytical technique used in this study is descriptive qualitative analysis, which is conducted by interpreting and synthesizing various concepts and findings from the collected literature to explain the relationship between legal compliance and the financial performance of MSMEs. The analysis process begins with the data reduction stage, which simplifies and sorts information relevant to the research focus. Next, the data is presented in the form of a structured conceptual narrative to facilitate understanding of the relationships between variables. The final stage is drawing conclusions through in-depth interpretation of the relationships between the analyzed concepts.

Furthermore, this study employs a theoretical synthesis technique by integrating various legal theories and financial performance indicators into a coherent analytical framework. This synthesis allows for the identification of the relationship mechanisms between legal compliance and financial performance variables, such as financial stability, profitability, and competitiveness. This analytical approach yields an argumentative construction that confirms that legal compliance not only has a normative dimension but also serves as a strategic instrument in improving the financial performance of MSMEs.

3. RESULTS AND DISCUSSION

3.1 The Relationship between MSME Legal Compliance and Financial Stability

3.1.1 Concept of MSME Legal Compliance

Legal compliance of MSMEs represents the level of conformity of business behavior to applicable norms and regulations, which include aspects of licensing, taxation, employment, and consumer protection. From a conceptual perspective, this compliance is not only limited to the formal-administrative dimension but also reflects internal mechanisms for risk management and strengthening business governance. The literature confirms that legal compliance serves as a signal of credibility and an instrument to avoid unproductive legal costs, thus contributing to operational efficiency and business sustainability (Halim et al., 2023; Khumaidi et al., 2022; Firman & Rohendi, 2023; Judijanto, 2024; Hidayah & Airawaty, 2023; Wisnumurti, 2022).

The four main dimensions of legal compliance—business licensing, tax obligations, employment compliance, and consumer protection—form an integrated system that directly impacts the operational and financial stability of MSMEs. This integration demonstrates that legal compliance is not partial but systemic, where failure in one aspect can trigger risks in other aspects (Andriani, 2022; Ekawarti et al., 2021; Zohani et al., 2023; Pramesti et al., 2022; Devianti et al., 2023; Kumaini et al., 2024).

In the Indonesian context, the implementation of the Online Single Submission (OSS) system and the issuance of Business Identification Numbers (NIB) are key instruments in promoting business formality. The OSS/NIB serves not only as administrative legality but also as a mechanism to strengthen MSMEs' access to legal protection, government programs, and financing sources. Therefore, business legality through the OSS/NIB plays a crucial role in enhancing the credibility and

financial stability of MSMEs (Ekawarti et al., 2021; Khumaidi et al., 2022; Zohani et al., 2023; Firman & Rohendi, 2023; Diana et al., 2022; Hermawansyah et al., 2023; Billah et al., 2023).

3.1.2 Relevant Regulations for MSMEs

The regulatory framework for MSMEs in Indonesia is supported by the OSS (Online Business Registration) and NIB (National Identity Number) systems, which serve as the primary foundation for business legality. The OSS system is designed to simplify the licensing process and integrate various administrative services into a single system, while the NIB serves as an official identity attached to business activities, including access to financing and social protection programs. Theoretically, the implementation of the OSS/NIB improves administrative formality and efficiency, ultimately supporting business stability (Ekawarti et al., 2021; Khumaidi et al., 2022; Zohani et al., 2023; Firman & Rohendi, 2023; Diana et al., 2022; Hidayah & Airawaty, 2023; Wisnumurti, 2022).

On the other hand, tax regulations for MSMEs are designed with a simplified approach through relatively low rates and simpler administrative procedures. This policy aims to encourage voluntary compliance and broaden the tax base. However, implementation in the field still faces obstacles, particularly related to administrative understanding and tax literacy. This suggests that the relationship between tax compliance and financial stability is determined not only by policy design but also by the capacity of business actors to implement it (Andriani, 2022; Judijanto, 2024; Wisnumurti, 2022; Jannah et al., 2022).

Furthermore, regulations related to operational standards and product quality are crucial for consumer protection and increasing the competitiveness of MSMEs. Compliance with these standards impacts a business's cost structure and cash flow, thus directly impacting financial stability. Overly complex regulations have the potential to increase compliance costs, while adaptive regulations can improve business efficiency and sustainability (Gultom, 2020; Ekawarti et al., 2021; Asnaini et al., 2022; Hidayah & Airawaty, 2023).

3.1.3 Financial Stability of MSMEs

The financial stability of MSMEs is a condition in which a business is able to maintain operational continuity through effective management of financial resources. This stability is determined by several key indicators, namely liquidity, operational cash flow, and a relatively simple capital structure. A key characteristic of MSMEs is their high dependence on daily cash flow, so even minor operational disruptions, including those resulting from legal non-compliance, can significantly impact business continuity.

In this context, legal compliance serves as a mechanism to maintain cash flow continuity and reduce the potential for operational disruptions. Furthermore, business legality through OSS/NIB and tax compliance increase MSMEs' opportunities to access external financing, subsidies, and training programs that can strengthen financial capacity and business resilience (Andriani, 2022; Ekawarti et al., 2021; Asnaini et al., 2022; Bimarasmana et al., 2023; Diana et al., 2022; Wisnumurti, 2022; Khumaidi et al., 2022; Zohani et al., 2023; Firman & Rohendi, 2023; Judijanto, 2024; Hidayah & Airawaty, 2023).

3.1.4 Impact of Compliance on Financial Stability

Legal compliance directly impacts the financial stability of MSMEs through several key mechanisms. First, compliance reduces unproductive costs arising from administrative sanctions, tax penalties, or potential business closures. This cost reduction contributes to cash flow stability and operational efficiency (Andriani, 2022; Ekawarti et al., 2021; Pramesti et al., 2022; Devianti et al., 2023; Diana et al., 2022; Hermawansyah et al., 2023; Billah et al., 2023; Jannah et al., 2022).

Second, legal compliance improves access to government programs, including financing, subsidies, and training. This access strengthens the financial capacity of MSMEs and increases resilience to economic shocks. Third, from an external perspective, legal compliance enhances business credibility in the eyes of stakeholders, such as suppliers, customers, and financial institutions. This credibility serves as a positive signal, facilitating access to financing and expanding business opportunities, ultimately improving long-term financial stability (Gultom, 2020; Andriani, 2022; Asnaini et al., 2022; Firman & Rohendi, 2023; Hidayah & Airawaty, 2023; Wisnumurti, 2022).

However, the effectiveness of legal compliance in improving financial stability is not automatic. The implementation of OSS/NIB as a formality instrument still depends heavily on the capacity of MSMEs to access and utilize the system. Limited digital infrastructure, low technological literacy, and administrative barriers are key inhibiting factors. Therefore, policy interventions in the form of outreach, mentoring, and training are crucial to ensuring effective legal compliance implementation (Ekawarti et al., 2021; Halim et al., 2023; Zohani et al., 2023; Pramesti et al., 2022; Judijanto, 2024; Ihsan et al., 2023; Wisnumurti, 2022; Waziana et al., 2023).

The literature shows variations in the intensity of the impact of legal compliance on the financial stability of MSMEs. Some studies emphasize that OSS/NIB significantly improves stability through access to government programs and increased credibility. However, other studies indicate that the direct impact on cash flow is not always significant without capacity support, such as financial literacy and administrative assistance. This indicates that legal compliance should be viewed as part of a broader ecosystem, rather than as a stand-alone variable (Andriani, 2022; Khumaidi et al., 2022; Firman & Rohendi, 2023; Judijanto, 2024; Hermawansyah et al., 2023; Wisnumurti, 2022; Jannah et al., 2022).

Furthermore, the complexity of cross-sectoral regulations is also a significant issue. While the OSS (Online Financial System) seeks to simplify the licensing process, the interconnectedness of various regulatory domains, such as taxation, consumer protection, and quality standards, demands a holistic and adaptive approach. The literature emphasizes that the successful implementation of legal compliance in MSMEs relies heavily on the principles of proportionality and alignment with organizational capacity (Gultom, 2020; Ekawarti et al., 2021; Khumaidi et al., 2022; Asnaini et al., 2022; Hidayah & Airawaty, 2023; Waziana et al., 2023).

These findings suggest that MSME legal compliance needs to be understood as a multidimensional framework encompassing licensing, taxation, employment, and consumer protection, with integration between external regulations and internal governance as a key element. The implementation of OSS/NIB serves as a driver of formality and access to economic resources, but its effectiveness is highly dependent on MSME literacy and operational capacity (Gultom, 2020; Ekawarti et al., 2021; Khumaidi et al., 2022; Asnaini et al., 2022; Firman & Rohendi, 2023; Judijanto, 2024; Hidayah & Airawaty, 2023; Wisnumurti, 2022; Billah et al., 2023).

The relationship between legal compliance and financial stability is confirmed through three main channels: reducing unproductive costs, increasing access to financing and government programs, and strengthening business credibility. However, increased compliance does not automatically lead to financial stability without capacity support, such as tax literacy, cash flow management, and administrative assistance (Andriani, 2022; Ekawarti et al., 2021; Pramesti et al., 2022; Devianti et al., 2023; Hermawansyah et al., 2023; Halim et al., 2023; Zohani et al., 2023; Judijanto, 2024; Ichsan et al., 2023; Waziana et al., 2023).

Policy-wise, an integrated approach is needed, encompassing regulatory simplification, increased legal and financial literacy, and strengthened MSME mentoring programs. Synergy between the government, financial institutions, and educational institutions is a key factor in enhancing the effectiveness of legal compliance, which determines MSME financial stability.

3.2 Impact of Legal Compliance on MSME Profitability and Competitiveness

3.2.1 Legal Compliance and Cost Efficiency

Legal compliance directly contributes to the operational cost efficiency of MSMEs by reducing unexpected costs arising from regulatory violations, such as fines, administrative sanctions, and dispute resolution costs. From a financial perspective, this reduction in non-productive costs serves as a protective mechanism for profitability, particularly for MSMEs with limited margins and high sensitivity to cash flow disruptions (Usanti et al., 2019; Kashyap & Lunagariya, 2023).

Furthermore, compliance encourages the development of more systematic and documented operational processes. This structuring improves resource management efficiency, minimizes operational errors, and reduces inefficiencies often caused by informal practices. In the long term, this leads to increased business margins through cost optimization and increased productivity (Usanti et al., 2019; Enaifoghe, 2023).

From a financing perspective, legal compliance through the possession of legal documents increases trust in financial institutions, which results in lower costs of capital and credit risk. Thus, compliance not only reduces internal costs but also reduces external costs related to financing, thereby strengthening overall cost efficiency (Risha & Samudro, 2021; Usanti et al., 2019; Kashyap & Lunagariya, 2023).

3.2.2 Legal Compliance and Reputation of MSMEs

Legal compliance has significant implications for building an MSME's reputation as an intangible asset. From a governance perspective, compliance reflects a business's integrity and credibility, which creates a positive perception among stakeholders. A good reputation serves as a signal of business quality and reliability, indirectly improving financial performance (Usanti et al., 2019; Enaifoghe, 2023; Mulyati & Murwadji, 2024).

Compliance with consumer protection regulations strengthens customer confidence in product quality and safety. Furthermore, legal certainty improves relationships with suppliers and micro-investors through higher perceptions of business viability. In this context, reputation serves as a mechanism for strengthening customer loyalty and revenue stability (Usanti et al., 2019; Enaifoghe, 2023; Mulyati & Murwadji, 2024).

The reputation built through legal compliance also serves as a competitive advantage that is difficult to replicate. This is due to the accumulative and trust-based nature of reputation, making it a sustainable differentiating factor in market competition (Usanti et al., 2019; Enaifoghe, 2023; Mulyati & Murwadji, 2024).

3.2.3 Legal Compliance and Access to Financing

Legal compliance is a key determinant of MSME access to formal financing. Business legality is a basic prerequisite for financial institutions, both banks and fintech companies, in assessing creditworthiness. Compliance increases transparency and accountability, thereby strengthening lender trust (Usanti et al., 2019; Muhammad et al., 2023; Suleiman, 2021).

Furthermore, legal compliance reduces credit risk by improving governance quality and reducing operational risk. This enables MSMEs to obtain financing at a more competitive cost of capital. Conversely, MSMEs without clear legal standing tend to face limited access to formal financing and rely on more expensive and risky informal financing sources (Usanti et al., 2019; Kashyap & Lunagariya, 2023; Suleiman, 2021).

3.2.4 Legal Compliance and Competitiveness of MSMEs

Legal compliance increases the competitiveness of MSMEs by expanding market access and meeting quality standards. In the digital economy, legality verification is a primary requirement for participation in marketplace platforms and export activities. Therefore, compliance serves as an enabler for MSME integration into global and digital markets (Usanti et al., 2019; Enaifoghe, 2023; Iswanto et al., 2021).

Furthermore, meeting legality and certification standards helps MSMEs meet international market requirements, thereby reducing barriers to expansion. Compliance with these standards also improves product quality perceptions, which in turn improves competitiveness and market position (Usanti et al., 2019; Enaifoghe, 2023; Kashyap & Lunagariya, 2023).

3.2.5 Legal Compliance and Risk Management

Legal compliance is an integral component of MSME risk management. Compliance reduces legal and financial risks arising from regulatory uncertainty. Furthermore, compliance fosters adaptability to policy changes, enabling MSMEs to respond more proactively to regulatory dynamics (Usanti et al., 2019; Enaifoghe, 2023; Crisyanti et al., 2023).

By reducing the potential for sanctions and operational disruptions, compliance also reduces the likelihood of financial shocks that could disrupt business stability. This makes compliance a crucial risk mitigation tool in maintaining the financial sustainability of MSMEs (Usanti et al., 2019; Enaifoghe, 2023; Iswanto et al., 2021).

3.2.6 Legal Compliance and Human Resource Productivity

Compliance with labor regulations has direct implications for human resource productivity. Fulfillment of workers' rights, including wages, job security, and welfare, increases employee motivation and loyalty. A stable and regulatory-compliant work environment also reduces the potential

for industrial conflict, thus supporting improved operational and financial performance (Usanti et al., 2019; Enaifoghe, 2023; Kashyap & Lunagariya, 2023).

While much of the literature demonstrates a positive relationship between legal compliance and improved cost efficiency, reputation, access to financing, and competitiveness of MSMEs, there are important nuances related to administrative burdens. Several studies highlight the phenomenon where excessive regulatory complexity and licensing procedures can hinder MSME participation in the formal economy. This situation has the potential to reduce compliance incentives if not balanced with regulatory simplification and effective outreach (Dina & Dewaranu, 2022; Enaifoghe, 2023).

In the context of Sharia-based financing, compliance with specific regulations, such as the DSN-MUI Fatwa and OJK regulations, is a key factor in building product legitimacy and increasing MSME access to Sharia financing. This demonstrates that legal compliance is not homogeneous but rather contextual, depending on the characteristics of the financial system used (Fithria, 2022; Usanti et al., 2019).

Overall, legal compliance can be positioned as a strategic determinant influencing the profitability and competitiveness of MSMEs through six main channels: cost efficiency, reputation, access to financing, market competitiveness, risk management, and human resource productivity. However, the effectiveness of this relationship depends heavily on proportional regulatory design and the MSMEs' capacity to implement compliance effectively.

4. CONCLUSION

The analysis shows that legal compliance plays a crucial role in shaping the financial performance of MSMEs, particularly in terms of financial stability, profitability, and competitiveness. Compliance with regulations covering business licensing, taxation, employment, and consumer protection has been shown to function not only as a normative obligation but also as a strategic mechanism in strengthening the financial and operational foundations of MSMEs.

In the context of financial stability, legal compliance contributes by reducing legal risk, minimizing unexpected costs, and improving the quality of governance and financial discipline. This enables MSMEs to maintain liquidity, cash flow stability, and resilience to external disruptions. From a profitability perspective, compliance drives operational cost efficiency, reduces the burden of sanctions or administrative inefficiencies, and improves access to financing at a more competitive cost of capital.

Furthermore, legal compliance strengthens the competitiveness of MSMEs by enhancing their reputation and credibility in the eyes of stakeholders, including consumers, suppliers, and financial institutions. Business legality is also a key prerequisite for expanding market access, both on digital platforms and in export markets, thereby increasing opportunities for business growth and expansion.

MSMEs with a high level of legal compliance tend to be more resilient to risks, have broader access to formal financing sources, and are able to build a reputation as a credible and sustainable business entity. Therefore, legal compliance can no longer be viewed merely as an administrative burden, but rather as a financial strategy oriented towards improving business performance and sustainability.

The implication is that strengthening legal compliance in MSMEs needs to be positioned as an integral part of business development strategies, supported by regulatory simplification, increased

legal and financial literacy, and policies that are adaptive to the characteristics and limitations of MSMEs.

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