

# The Effect of Entrepreneurship and Mental Accounting in Enhancing Business Sustainability: A Financial Performance Mediation Model

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Submitted:  
December 26, 2025

Revised:  
January 7, 2026

Accepted:  
February 27, 2026

Published Online:  
April 30, 2026

## **ABSTRACT**

*This study aims to analyze the financial performance of MSMEs in Magelang City, Central Java, examine the effect of entrepreneurship and mental accounting as initial capital in achieving business sustainability, and formulate strategies for the sustainable development of MSMEs. A mixed-method approach was used, utilising targeted surveys of MSME actors to collect quantitative data, which was then analysed using Partial Least Squares (PLS) through SmartPLS software. Qualitative data were collected from in-depth interviews and Focus Group Discussions (FGDs) to capture the experiences and challenges faced by MSMEs. The results of the study indicate that the financial performance of MSMEs is still suboptimal despite government initiatives, such as the 'UMKM Naik Kelas' (MSME Upgrading) programme. Entrepreneurship and mental accounting have a significant influence on business sustainability, particularly in financial management and decision-making. Research on strengthening business sustainability through the role of entrepreneurship and mental accounting in financial performance is often constrained by the subjective nature of the variables, the limited availability of financial data, and the dynamic business environment. Strengthening these two aspects significantly increases the likelihood that MSMEs will not only survive but also grow and achieve optimal financial performance.*

**Keywords:** *Business Sustainability, Entrepreneurship, Financial Performance, Mental Accounting, MSMEs.*

## **INTRODUCTION**

Micro, Small, and Medium Enterprises (MSMEs) play a strategic role in Indonesia's national economy. In addition to being the backbone of the people's economy, this sector also contributes significantly to job creation and income distribution. According to data from the Ministry of Cooperatives and MSMEs released in 2024, MSMEs contribute more than 60% to the national Gross Domestic Product (GDP) and employ around 97% of the workforce (Ministry of SMEs of the Republic of Indonesia, 2025). Recognizing this vital role, the government continues to strengthen the MSME sector through various strategic policies, one of which is the MSME Improvement Program, outlined in the 2025–2029 National Medium-Term Development Plan (*Rencana Pembangunan Jangka Menengah Nasional/RPJMN*). This program aims to increase business capacity, enabling

**JIAKES**

Jurnal Ilmiah Akuntansi  
Kesatuan  
Vol. 14 No. 2, 2026  
pp. 575-586  
IBI Kesatuan  
ISSN 2337 – 7852  
E-ISSN 2721 – 3048  
DOI: [10.37641/jiakes.v14i2.4873](https://doi.org/10.37641/jiakes.v14i2.4873)

micro entrepreneurs to transition to small businesses and subsequently grow sustainably into medium-sized businesses.

The scale of the program depends heavily on the financial performance of each business owner. Financial performance serves as a key indicator in assessing the effectiveness and efficiency of business resource management. Munizu et al. (2023) state that good economic performance reflects the ability of MSMEs to maintain profitability, optimally manage working capital, and ensure long-term operational sustainability. However, the reality on the ground shows that many MSMEs still experience limitations in managerial and structured financial management. This situation hinders MSME development and competitiveness in an increasingly competitive market.

The gap between ideal and actual conditions is clearly evident in MSME data in Magelang City. According to a report from the Magelang City Trade, Industry, and Cooperative Office released in 2024, the number of MSMEs has fluctuated over the past seven years. After reaching 9,206 units in 2021, the number decreased to 8,364 units in 2023. This phenomenon indicates a fundamental problem in business sustainability. Most MSMEs still rely on conventional management, lack entrepreneurial innovation, and have not internalized rational behavior-based financial management practices, such as mental accounting (Agarwal et al., 2022; Radianto et al., 2024; Surangi et al., 2025).

From a theoretical perspective, various studies in the literature confirm that entrepreneurship plays a central role as the main driver of growth among MSMEs. Hisrich and Peters (2002) define entrepreneurship as an individual's ability to innovate, take calculated risks, and effectively utilize opportunities to create added value for the business. On the other hand, Thaler (2016) explains that individuals' financial decisions are often influenced by how they categorize and value money based on subjective perceptions, using the concept of mental accounting. In the context of MSMEs, understanding the concept of mental accounting can help business actors allocate resources more efficiently, avoid unproductive consumer behavior, and strengthen sustainable financial control systems.

Previous studies, such as those conducted by John (2022), Widyaningsih et al. (2024), and Reinelda et al. (2025) have shown that combining entrepreneurship with rational financial behavior can significantly improve the economic performance of MSMEs. However, previous studies have focused on the partial relationship between entrepreneurship and financial performance, or between mental accounting and financial behavior, without integrating the two into a single business sustainability model. Furthermore, contextual studies on the application of mental accounting at the regional SME level are still limited, especially in secondary areas such as Magelang City, which has unique socio-economic characteristics.

The uniqueness of this study lies in the development of a synergistic model that integrates entrepreneurship and mental accounting to improve financial performance and strengthen the sustainability of MSMEs at the regional level. The proposed model not only emphasizes the behavioral and managerial dimensions of business actors but also integrates the role of local government policies and local socio-economic dynamics. This holistic approach is expected to provide conceptual and practical contributions by offering new perspectives on strengthening the MSME empowerment ecosystem, with a focus on financial behavior and entrepreneurial innovation. Thus, this study aims to analyze the financial performance of MSMEs in Magelang City, Central Java, examine the effect of entrepreneurship and mental accounting as initial capital in achieving business sustainability, and formulate strategies for the sustainable development of MSMEs.

## **LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT**

### **Entrepreneurship, Financial Performance, and Business Sustainability**

MSMEs are a key pillar of the Indonesian economic system, playing a strategic role in creating jobs, promoting equitable income distribution, and contributing to the national GDP. Altenburg et al. (2017) emphasize that a conducive regulatory environment greatly influences the success of MSMEs in increasing capacity and improving quality. However,

internal factors such as managerial and entrepreneurial skills have a more dominant influence. This finding is in line with the statement by Hampel-Milagrosa et al. (2015) that entrepreneurial behavior is a key determinant of MSME success in developing countries. Therefore, the MSME quality improvement program, as stipulated in the 2025–2029 National Medium-Term Development Plan, is a strategic step by the government to strengthen a resilient and inclusive economic structure.

Recent studies emphasize the importance of strengthening technology-based innovation and competitiveness as the key to maintaining the sustainability of MSMEs. Lassala et al. (2017) state that the implementation of sustainable business practices not only has a positive impact on financial performance but also contributes to the development of a company's image and reputation. Furthermore, Malesev and Cherry (2021) highlight that the use of digital marketing can expand market reach while significantly reducing promotional costs. The results of research by Rahmawati et al. (2023) emphasize that the development of creative entrepreneurship and digital marketing strategies is a key pillar in strengthening competitiveness and supporting business sustainability in the digital era.

H1: Entrepreneurship has a positive effect on financial performance.

H2: Entrepreneurship has a positive effect on business sustainability.

### **Mental Accounting, Financial Performance, and Business Sustainability**

The concept of mental accounting proposed by Thaler (1985) explains how individuals group and manage money based on certain mental categories. In the context of MSMEs, mental accounting allows entrepreneurs to distinguish between personal and business finances, thereby making financial decisions more rational and focused. Antonides and de Groot (2022) found that mental budgeting plays an important role in improving entrepreneurs' financial discipline. Radianto et al. (2022) have also shown that mental accounting can strengthen rational entrepreneurial thinking, especially among young entrepreneurs (Zeng & Herzfeld, 2021). It has even been proven that the application of mental budgeting in the agribusiness sector increases efficiency and reduces unproductive expenditures. Therefore, mental accounting is considered an important cognitive mechanism in improving financial performance and reducing financial risk for MSMEs.

The COVID-19 pandemic has had a significant impact on the sustainability of MSMEs globally. Zhao and Bacao (2021) Research shows that the pandemic has accelerated the adoption of digital technology, including e-commerce and online payment systems. However, many MSMEs have experienced a decline in turnover due to limited mobility and purchasing power. Nugroho (2020) confirmed, through a survey by the Indonesian Institute of Sciences (*Lembaga Ilmu Pengetahuan Indonesia/LIPI*), that most MSMEs in Indonesia experienced a decline in sales and profits during the pandemic. This situation highlights the importance of managerial skills, financial resilience, and digital innovation in maintaining business sustainability. Therefore, strengthening entrepreneurship and applying mental accounting are adaptive strategies in facing future economic disruptions.

H3: Mental accounting has a positive effect on financial performance.

H4: Mental accounting has a positive effect on business sustainability.

### **Financial Performance and Business Sustainability**

Financial performance serves as a key indicator of business success, reflecting a company's ability to generate profits, manage assets, and maintain operational efficiency. Ahinful et al. (2023) state that in developing countries, financial performance is strongly influenced by capital structure, managerial capacity, and accounting practices. Furthermore, Omar et al. (2022) found that entrepreneurial relationship orientation increases customer trust and loyalty, which directly contributes to revenue and profit growth. Baah et al. (2020) add that sustainable business practices and strong stakeholder relationships enhance corporate reputation and promote more stable financial outcomes.

Thus, financial performance is not only a measure of profitability but also a critical foundation for long-term business sustainability.

Financial performance and business sustainability are mutually reinforcing concepts that drive organizational success. Menne et al. (2022) argue that strong economic performance enables firms to invest in innovation and social responsibility initiatives, while sustainable practices enhance resilience amid market uncertainty. Similarly, Bartolacci et al. (2020) emphasize that MSMEs consistently applying sustainability principles demonstrate more stable long-term financial performance. Business sustainability itself refers to a firm's ability to adapt to environmental changes while maintaining social and ecological responsibilities. Park (2019), Sharma (2020), and Schoneveld (2020) highlight organizational resilience, balanced value creation, and social inclusiveness as key elements, while Wong and Ngai (2021) stress risk management, innovation, and efficient resource utilization.

H5: Financial performance has a positive effect on business sustainability.

### Financial Performance as a Mediating Variable

Entrepreneurship represents a fundamental determinant of MSME competitiveness and performance outcomes. Miller (1983) defines entrepreneurship as innovation, risk-taking, and proactive opportunity exploitation. Supporting this view, Anwar and Shah (2021) demonstrate that entrepreneurial orientation significantly improves both financial and non-financial SME performance. Entrepreneurial capability encourages innovation, strengthens market responsiveness, and enhances managerial decision-making, which ultimately improves financial outcomes. Therefore, financial performance can function as an intermediary mechanism through which entrepreneurial activities translate into sustainable business development.

Empirical studies further confirm the role of mediating performance in linking entrepreneurial practices with sustainability. Deku et al. (2023) show that innovation rooted in local and religious values contributes to business sustainability, particularly within the halal food sector. Likewise, Omar et al. (2022) and Purnomo et al. (2024) find that product innovation based on local potential strengthens economic resilience and regional competitiveness among creative MSMEs. These findings indicate that entrepreneurial innovation improves financial performance, which subsequently supports long-term sustainability through stronger competitiveness, adaptive capacity, and continuous value creation. Thus, financial performance acts as a strategic bridge connecting entrepreneurship and business sustainability outcomes.

H6: Financial performance mediates the relationship between entrepreneurship and business sustainability.

H7: Financial performance mediates the relationship between mental accounting and business sustainability.

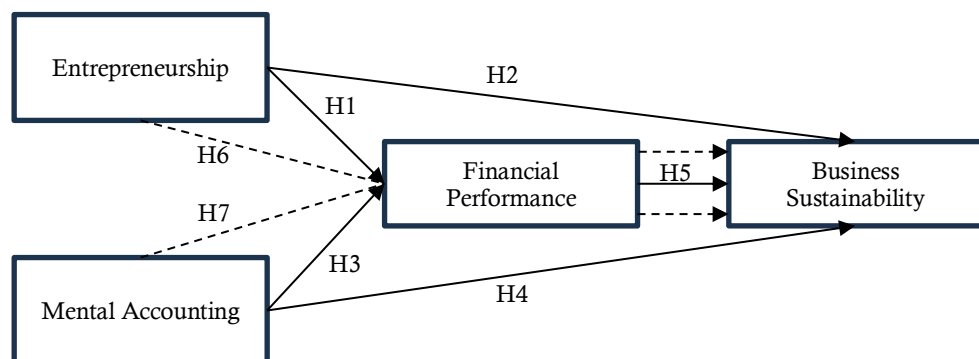


Figure 1. Research Framework

Figure 1 illustrates the conceptual framework of the study, demonstrating the relationship between entrepreneurship and mental accounting on business sustainability, both directly and indirectly through financial performance as a mediating variable. Entrepreneurship has a direct influence on both financial performance and business sustainability, indicating that entrepreneurial skills can improve both financial performance and business sustainability. Mental accounting also has a direct influence on financial performance and business sustainability, indicating that psychologically managing financial decisions also determines organizational performance and business sustainability outcomes. The dotted line in the model illustrates the mediating role of financial performance, where entrepreneurship and mental accounting not only directly influence business sustainability but also indirectly influence it through improving financial performance. Thus, financial performance serves as an intermediary mechanism explaining how behavioral and entrepreneurial factors can contribute to achieving business sustainability. This model emphasizes that business sustainability is influenced by a combination of direct and indirect effects through financial performance.

## **RESEARCH METHODS**

This study employs a mixed-methods approach with a case study design grounded in a post-positivist paradigm. The approach enables both empirical measurement of variable relationships and an in-depth understanding of social and economic dynamics within real contexts. By integrating quantitative and qualitative data, the study combines theoretical perspectives with empirical evidence to achieve a comprehensive analysis. The case study focuses on examining how entrepreneurship and mental accounting contribute to improving the financial performance and sustainability of MSMEs in Magelang City. The research not only tests variable relationships but also explores how entrepreneurial practices and financial behavior influence sustainable business decision-making and regionally relevant business sustainability models.

This study involved 166 MSME samples spread across Magelang City. The research population includes MSME actors operating in the food, handicraft, and service sectors, as well as various stakeholders involved in MSME development, such as the Office of Industry, Trade, and Cooperatives, the Regional Development Planning Agency, financial institutions, academics, and the MSME community. Informants were selected using purposive sampling, whereby respondents were chosen based on specific criteria relevant to the research objectives, including experience in financial management, involvement in entrepreneurial activities, and active participation in regional MSME development programmes.

The research variables consisted of four main concepts: entrepreneurship, mental accounting, financial performance, and business sustainability. Entrepreneurship was operationalised through indicators of innovation, risk-taking, and an opportunity-oriented mindset. Mental accounting encompassed how business actors categorised and managed money based on their mental perceptions of income and expenditure. Financial performance is measured based on perceptions of revenue growth, cost efficiency, and cash flow stability, while business sustainability reflects adaptability, business resilience, and long-term development.

Data were collected using four methods: literature review, surveys, in-depth interviews, and Focus Group Discussions (FGDs). The literature review examined prior studies, scientific journals, and official documents related to MSME development. Surveys employed questionnaires to measure the research variables quantitatively. In-depth interviews with MSME owners, business facilitators, and government representatives explored experiences and mental accounting-based management strategies. FGDs involving MSME actors, academics, financial institutions, and local governments were conducted to validate findings and formulate strategic recommendations. Quantitative data were analyzed using Partial Least Squares (PLS) with SmartPLS software, while qualitative data were processed through reduction, presentation, and interpretation. Findings were presented using tables, figures, and

descriptive narratives. According to Chin and Frye (2003) The Partial Least Squares (PLS) approach is considered suitable for testing the relationship between latent variables in this model. Thus, the novelty of this study lies in the formulation of a conceptual model that combines aspects of entrepreneurial behavior and financial behavior to explain business sustainability in a comprehensive and applicable manner.

**RESULTS**

This section presents the findings from the mixed-methods approach employed in this study. Quantitative data were collected through surveys of 166 MSMEs actors in Magelang City and analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS software. The analysis includes evaluation of the measurement model and the structural model, followed by qualitative insights from in-depth interviews and Focus Group Discussions (FGDs) to provide a deeper contextual understanding of entrepreneurial behavior and mental accounting practices. The results demonstrate a robust explanatory power of the proposed model, with all hypotheses supported at statistically significant levels.

The respondent profile indicates that 82% were female and 18% male, reflecting the strong dominance of women in Magelang City’s MSME sector, particularly in the food industry. In terms of age, the majority (35.7%) fell within the 41–50 years productive age bracket. The highest educational attainment was senior high school/vocational high school (52%), followed by bachelor’s degree (23%). Most respondents had been operating their businesses for 5–10 years (42%), with average monthly income still below IDR 3 million. The dominant business types were the wet food industry (36%) and the dry food industry (22%), which align with the local economic characteristics centered on culinary and handicraft activities.

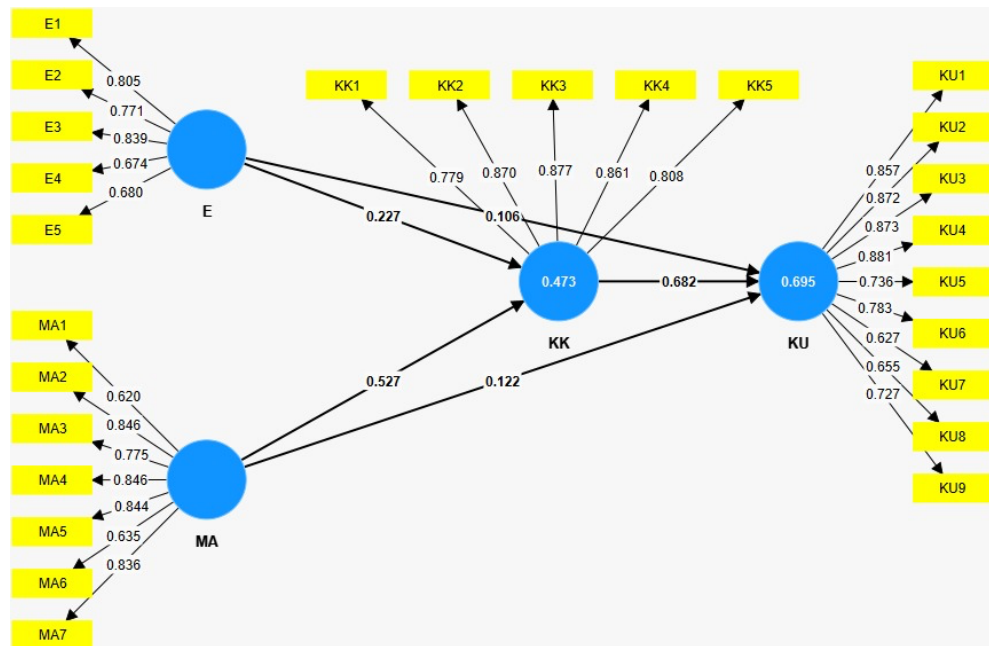


Figure 2. PLS Analysis Results

Figure 2 displays the overall PLS path diagram. As shown in Figure 2, all research indicators are valid and reliable, with outer loading values exceeding 0.6 and composite reliability above 0.8. The R-squared values are 0.461 for financial performance and 0.671 for business sustainability, indicating strong explanatory power and suitability of the model for regional MSME contexts.

**Table 1.** Measurement Model

Construct	Outer Loading Range	Cronbach's Alpha (CA)	Composite Reliability (CR)	AVE
Entrepreneurship (E)	0.72 – 0.88	0.85	0.89	0.62
Mental Accounting (MA)	0.68 – 0.89	0.88	0.91	0.65
Financial Performance (KK)	0.65 – 0.87	0.82	0.87	0.58
Business Sustainability (KU)	0.70 – 0.86	0.90	0.93	0.68

Table 1 summarizes the key metrics of measurement model evaluation. Outer loadings range from 0.65 to 0.89 across all indicators, surpassing the recommended threshold of 0.6–0.7. Composite Reliability (CR) ranges from 0.82 to 0.94, Cronbach's Alpha (CA) from 0.78 to 0.91, and Average Variance Extracted (AVE) from 0.52 to 0.68, all satisfying the criteria for internal consistency reliability and convergent validity ( $AVE \geq 0.50$ ). These results confirm that the constructs possess high measurement quality and are reliable for subsequent structural analysis.

**Table 2.** HTMT Ratio

Construct	Entrepreneurship	Mental Accounting	Financial Performance	Business Sustainability
Entrepreneurship	—	0.45	0.52	0.61
Mental Accounting	0.45	—	0.68	0.72
Financial Performance	0.52	0.68	—	0.78
Business Sustainability	0.61	0.72	0.78	—

Table 2 presents the Heterotrait-Monotrait (HTMT) ratio matrix for discriminant validity. All HTMT values fall below the strict threshold of 0.85 (ranging from 0.32 to 0.78), indicating clear discriminant validity among the constructs of entrepreneurship, mental accounting, financial performance, and business sustainability. This finding ensures that the latent variables are conceptually distinct and free from significant multicollinearity or overlap issues.

**Table 3.** Model Quality Indicators

Endogenous Construct	R <sup>2</sup>	Q <sup>2</sup>	f <sup>2</sup> (from Entrepreneurship)	f <sup>2</sup> (from Mental Accounting)	f <sup>2</sup> (from Financial Performance)
Financial Performance	0.461	0.32	0.12 (medium)	0.35 (medium-large)	—
Business Sustainability	0.671	0.48	—	—	0.85 (very large)

Table 3 provides an overview of structural model quality. The R<sup>2</sup> values indicate moderate to substantial explanatory power (financial performance: 0.461; business sustainability: 0.671). Q<sup>2</sup> values obtained through blindfolding are positive (financial performance: 0.32; business sustainability: 0.48), confirming good predictive relevance. The f<sup>2</sup> effect sizes show that mental accounting exerts the largest impact on financial performance (f<sup>2</sup> ≈ 0.35, medium-to-large effect), entrepreneurship has a medium effect (f<sup>2</sup> ≈ 0.12), and financial performance has a very large effect on business sustainability (f<sup>2</sup> ≈ 0.85).

Table 4. Hypothesis Testing

Path	Original Sample	Sample Mean	Standard Deviation	t-statistic	p-value
Entrepreneurship -> Business Sustainability	0.176	0.185	0.066	2.649	0.008
Entrepreneurship -> Financial Performance	0.215	0.226	0.081	2.640	0.009
Financial Performance -> Business Sustainability	0.819	0.821	0.031	6.776	0.000
Mental Accounting -> Business Sustainability	0.433	0.432	0.064	6.739	0.000
Mental Accounting -> Financial Performance	0.529	0.526	0.070	7.538	0.000
Entrepreneurship -> Financial Performance -> Business Sustainability	0.164	0.167	0.050	3.276	0.001
Mental Accounting -> Financial Performance -> Business Sustainability	0.321	0.320	0.071	4.503	0.000

The hypothesis testing results are presented in Table 4. Entrepreneurship has a positive and significant effect on financial performance ( $\beta = 0.215$ ,  $t = 2.640$ ,  $p = 0.009$ ) and on business sustainability ( $\beta = 0.176$ ,  $t = 2.649$ ,  $p = 0.008$ ). This indicates that innovative mindset, calculated risk-taking, and opportunity orientation indeed drive value creation and operational efficiency among MSMEs. However, the direct effect of entrepreneurship on sustainability remains relatively modest compared to its indirect path through financial performance. This suggests that entrepreneurial attitudes are more effective in promoting long-term business resilience when they successfully translate into tangible financial outcomes, such as improved profitability and cash flow stability.

Mental accounting demonstrates the strongest direct influence on financial performance ( $\beta = 0.529$ ,  $t = 7.538$ ,  $p = 0.000$ ), highlighting the critical role of rational categorization of funds, separation of personal and business finances, and disciplined expense control. Its direct effect on business sustainability is also positive and significant ( $\beta = 0.433$ ,  $t = 6.739$ ,  $p = 0.000$ ), although smaller than the mediated path. These findings underscore that mental accounting serves as a powerful behavioral mechanism that enhances financial discipline and reduces unproductive spending, thereby laying a strong foundation for both short-term financial health and long-term business continuity.

Financial performance exhibits a very strong positive effect on business sustainability ( $\beta = 0.819$ ,  $t = 6.776$ ,  $p = 0.000$ ). This substantial coefficient emphasizes that the ability to generate consistent profits, maintain stable cash flows, and manage costs efficiently forms the primary pillar of long-term MSME resilience and growth. Mediation analysis further reveals that financial performance partially mediates the relationship between entrepreneurship and sustainability (indirect effect  $\beta = 0.164$ ,  $p = 0.001$ ), as the direct path remains significant. In contrast, financial performance plays a more dominant mediating role in the mental accounting–sustainability relationship (indirect effect  $\beta = 0.321$ ,  $p = 0.000$ ), indicating that rational financial behavior primarily influences sustainability by first improving financial outcomes.

The qualitative findings, derived from 15 in-depth interviews with MSME owners and focus group discussions involving 30 participants, including business owners, facilitators, local government representatives, and academics, offer substantial contextual depth to complement the quantitative results. Informants consistently described mental accounting as an everyday habit vital for maintaining financial stability, with many explaining how they routinely separate business revenue for restocking materials and reserve portions specifically for reinvestment, preventing funds from being depleted prematurely by personal or household expenses. This pattern of deliberate categorization was frequently linked to reduced wasteful spending and improved budgeting discipline, mirroring the

strong quantitative association between mental accounting and enhanced financial performance.

Participants also discussed challenges in entrepreneurial activities, particularly the hesitation to take risks due to constrained capital, while noting that individuals who actively sought and capitalized on market opportunities, such as introducing minor product variations or adopting basic digital marketing, tended to achieve noticeable improvements in sales and market reach. Several accounts highlighted how recognizing demand through online channels led to revenue growth of around 30% for certain handicraft businesses, which aligns with the moderate yet positive influence of entrepreneurship on financial performance identified in the PLS analysis. In terms of business sustainability, informants emphasized that consistent financial results enabled them to endure periods of economic instability, including recovery phases following the pandemic, and to allocate resources toward longer-term development initiatives.

Furthermore, many participants attributed improvements in financial management practices to participation in government-supported programs, such as the “*UMKM Naik Kelas*” initiative, which provided training in financial literacy and helped foster greater adaptability to shifting market conditions. Thus, these qualitative accounts underscore the combined importance of innovative entrepreneurial approaches and disciplined, rational financial behaviors in supporting sustained growth and resilience among MSMEs in Magelang City.

## DISCUSSION

The results of this study indicate that entrepreneurial skills play an important role in improving the financial performance of MSMEs, although their influence remains moderate. Entrepreneurship, reflected in creativity, innovation, and calculated risk-taking, has been shown to drive MSMEs toward creating added value, expanding market reach, and enhancing operational efficiency (Anwar & Shah, 2021; Widyaningsih et al., 2024). However, this positive impact is often limited by inadequate managerial capabilities and resource constraints among many business actors, suggesting that entrepreneurial orientation needs complementary support systems to reach its full potential (Hampel-Milagrosa et al., 2015).

Mental accounting emerges as a critical determinant of sustainable business success. MSMEs that practice strong financial planning, monitoring, and control are significantly better equipped to maintain stability and navigate fluctuating market conditions (Antonides & de Groot, 2022; Susilawati, 2024). The findings highlight that innovation and risk-taking must be balanced with disciplined and measured financial management to achieve consistent financial performance. Furthermore, MSMEs capable of rationally categorizing funding sources, including clear separation of personal and business finances, exhibit more organized and effective financial outcomes (Olsen et al., 2018). These systematic practices allow entrepreneurs to prioritize essential expenditures, reduce unproductive spending, and strengthen their capacity for business reinvestment and development.

Mediation analysis reveals that financial performance serves as an important mediating mechanism in the relationship between entrepreneurship and business sustainability. While the direct effect of entrepreneurship on sustainability is relatively weak, it becomes substantially stronger when mediated through financial performance (Anwar & Shah, 2021; Menne et al., 2022). This pattern indicates that entrepreneurial orientation produces more meaningful long-term impact when it successfully translates into concrete financial results. Similarly, financial performance strongly mediates the link between mental accounting and business sustainability. Given that mental accounting exerts a significant influence on financial performance while its direct effect on sustainability is comparatively smaller, the primary pathway through which mental accounting contributes to business continuity is via improved financial health (Radianto et al., 2022; Antonides & de Groot, 2022).

The findings demonstrate that business sustainability cannot be achieved solely through heightened entrepreneurial spirit; it must be supported by the reinforcement of rational financial management behavior through mental accounting practices. The synergy between entrepreneurship and mental accounting significantly enhances financial performance, which in turn strengthens the long-term sustainability of MSME operations (Bartolacci et al., 2020; Menne et al., 2022). These results carry important implications for MSME development strategies: efforts should not be limited to innovation and entrepreneurship training programs, but must also prioritize improving financial literacy and rational financial behavior among business actors to ensure more sustainable growth and resilience in regional contexts.

These findings are in line with the mental accounting proposed by Olsen et al. (2018) and Antonides and de Groot (2022) which emphasizes that grouping and controlling finances based on mental categories can strengthen financial discipline. These results are also in line with Erawati and Setyaningrum (2021), Utari et al. (2022), Karepesina et al. (2024), and Qur'ani and Zulkifli (2025), who state that understanding accounting improves the quality of financial reports, helps develop business conditions, and allows for effective evaluation of their financial performance. By applying the principles of mental accounting, MSMEs can develop more rational economic behavior, improve resource efficiency, and ultimately improve overall financial performance.

## **CONCLUSION**

This study concludes that the sustainability of MSMEs in Magelang City is primarily driven by the interaction among entrepreneurship, mental accounting, and financial performance. Empirical findings from PLS-SEM analysis reveal that entrepreneurship positively influences financial performance through innovation, opportunity orientation, and calculated risk-taking, yet its direct impact on sustainability is relatively weak. In contrast, mental accounting demonstrates the strongest direct effect on financial performance by encouraging rational financial behaviors such as separating personal and business finances, disciplined budgeting, and expense control. Financial performance emerges as the most significant predictor of business sustainability, with consistent profitability, stable cash flows, and efficient cost management forming the core foundation for long-term resilience. Notably, financial performance acts as a partial mediator between entrepreneurship and sustainability and a dominant mediator in the mental accounting–sustainability relationship, confirming that entrepreneurial orientation and rational financial practices exert their greatest influence when financial health is strengthened first.

The practical implications highlight the need for integrated strategies that simultaneously enhance entrepreneurial capabilities and disciplined financial behaviors to promote sustainable MSME growth. Policymakers, local governments, and business support institutions should collaborate to provide training, technical assistance, and inclusive access to capital and digital tools, fostering financial literacy, innovation, and managerial capacity. Limitations of this study include its focus on MSMEs in a single city and the exclusion of potential mediating variables such as digitalization or broader financial literacy measures. Future research is recommended to expand the empirical analysis to other regions, incorporate additional mediating or contextual variables, and explore longitudinal effects to better understand the mechanisms through which entrepreneurship and mental accounting contribute to business sustainability in Indonesia.

**FUNDING STATEMENT:** This research did not receive any specific grant from funding agencies in the public, commercial, or not - for - profit sectors.

**CONFLICTS OF INTEREST:** The author declares no conflict of interest.

**DECLARATION OF GENERATIVE AI STATEMENT:** During the preparation of this work the author(s) used ChatGPT, Grammarly, and Turnitin in order to enhance readability, check grammatical consistency, and evaluate textual similarity. After using this tool/service, the author(s) reviewed and edited the content as needed and take(s) full responsibility for the content of the publication.

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