

# THE ROLE OF LOCAL GOVERNMENT IN DEVELOPING SMALL AND MEDIUM-SIZED ENTERPRISES

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## Abstract

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The aim of this study is to determine the local government support needed for increasing the performance of Small and Medium-sized Enterprises (SMEs). There are contradicting points of view among researchers with regard to the necessity for the government to intervene in the operation of the enterprises. This study attempts to answer questions on the effect of such interventions in a developing country. The data were collected through questionnaires that were distributed to the SMEs in certain territories in a developing country. Structural Equation Modeling was used to analyze the data. The results show that the government support process, the government support policy and social networking have a positive influence on the performance of SMEs. The government support process exhibits the strongest effect on SMEs' satisfaction as a moderating variable.

**Keywords:** Government Support Process; Government Support Policy; Small and Medium-Sized Enterprises

## 1. INTRODUCTION

SMEs have a role in enhancing public welfare significantly and providing job opportunities in Indonesia. The increase in local government revenues is supported by SMEs, and the number of SMEs has implications for labor absorption. Partomo (2004) mentions that small industries contribute to economic development, provide job opportunities and reduce urbanization.

However, SMEs that operate in Indonesia have not applied modern organizational systems and modern operational management. They run their activities, such as production, raw material procurement, marketing, administration, and book-keeping, based on traditional methods (Tambunan, 2010). Hafsah (2004) explains that this current condition of SMEs creates internal problems (limited capital; limited human resources; and weak networking), and external problems (macroeconomic conditions; limited facilities; limited infrastructure; decentralization effect; international free trade effect; and limited market access).

Tambunan (2008) argues that the low productivity of SMEs is caused by both low quality technology and human resources. The low quality of the human resources is indicated by the low number of businessmen who have graduated from universities

(only 2.2 percent). The obstacles which are faced by SMEs are capital, marketing, lack of knowledge, and low quality human resources. Knowledge is an important factor for enhancing the competitiveness of SMEs. The weakness of SMEs due to lack of knowledge influences SMEs' internal conditions, such as (1) lack of awareness and willingness to develop advanced knowledge; (2) lack of capital to develop high quality, cutting edge technology; (3) lack of ability to gain access to business networking; (4) lack of access to knowledge and technology.

Nowadays, mastery of knowledge is the key to beating the competition. Mastery of knowledge is embodied in technology, work methods, and work culture. Increased SME competitiveness will lead to productivity and state revenue contribution. The role of government in developing SMEs is very important. However, there are several obstacles to the development of SMEs through government assistance. In South Korea, a survey was conducted by The Small Medium Business Administration (SMBA) and Korean Women Entrepreneurs Association (KWEA) (2007), and the results show that SMEs have difficulties with economic activities such as financing, sales, providing labor, business information, and research and development.

This current study tests the research model which was developed by Lee, Sohn and Ju (2011). Our

research model will be used to determine government support toward SMEs, and the factors which motivate businessmen to develop their businesses, such as individual capacity, family life, social networking, and business environment. These results will help the local government to design policies which will support the development of SMEs.

The remainder of the paper is organized as follows: section 2 reviews the relevant literature and then develops the hypothesis; section 3 describes the research design; section 4 reports and discusses the results; finally, section 5 provides a conclusion.

## 2. LITERATURE REVIEW

The Ministry of Industry and Trade divides SMEs' problems into two categories: internal and external. An internal problem is one which is related to businessmen, and an external problem is one which has been given to businessmen. The following are examples of internal problems: (1) low levels of awareness and willingness of the businessman to implement knowledge and technology; (2) lack of capital to repair technologically complex machines; (3) lack of ability to take advantage of business opportunities; (4) lack of access and information related to technology and knowledge. The following are examples of external problems: (1) most research and development results have no implications for the development of SMEs; (2) the results of the process of transfer of technology to SMEs show that such a transfer has been ineffective - a lack of suitable mentoring has been noted by researchers as the reason for this; (3) publications on the results of research and development of SMEs are still limited, and are difficult to gain access to; (4) lack of financing for knowledge and technology development.

Cowling and Taylor (2001) determined the human capital factors related to businessmen, such as the ability to create jobs, level of experience, customer relationship and the ability to maintain a relationship with the supplier. Human capital is represented by experience, professionalism, financing ability and managerial style. Cooper and Gascon (1992) argued that the performance of female entrepreneurs is affected by human capital (i.e. level of experience, educational level, age, and goals). Brush (1992) found that business experience, business technique, educational level, motivation and use of mentors have an influence on the level of performance.

Schmidt and Parker (2003) examined family factors related to female entrepreneurs (i.e. family pressure, being in charge of a business and commitment to family). Shelton (2006) explained that homework and child caring are obstacles which are faced by female entrepreneurs. Carter and Shaw (2006) focused their research on the impact of pregnancy, child caring and vacation on experienced entrepreneurs. Kim and Ling (2001) showed that conflicts between family members affect work satisfaction, marriages, and day-to-day living.

Rosti and Chelli (2005) explained that factors in the business environment which have a relationship with female entrepreneurs (i.e. gender discrimination, prejudice, market conditions, job conditions) have a significant impact on the activities of female entrepreneurs. With regard to the economic environment and socio-economic conditions, Minniti

and Nardone (2007) examined economic activities conducted by female entrepreneurs. The business environment influenced female entrepreneurs' satisfaction with the economic activities that they conducted (Morris, 2006). Schmidt and Parker (2003) explained the relationship between market structures, business conditions and investment climate to gender based satisfaction with economic activities.

Woolcock (1998) found that social networking has a positive impact on increasing financing and community development. Haynes and Haynes (1999) determined that networking (via family or friends) helps entrepreneurs in increasing financing opportunities. Mok (2005) stated that business networking among university, government and industries facilitated business activities. OECD (1997) stated that public support for SMEs should be designed to provide information, technology development, and financing management. Tomiura (2007) found that promoting via business associations resulted in access advantages in export activities for SMEs. Manchester Business School (2001) stated that lack of government support leads to a lack of knowledge, lack of self-confidence, and weak networking. The government support (government support policy and government support process) could influence the economic activities of entrepreneurs. The measurement of government support would be represented by fairness, conformity, reflectability, distribution, consistency, public relation, efficiency, and scale of support (e.g. KIPA 2003; KIPA 2005).

Fernandez et al. (1996) argued that government support (i.e., capital investment, research, and development) would help small industries to achieve their goals. Pan et al. (2006) investigated the relationship between e-government systems and business-process management. Many studies showed that government support has a significant role to play for entrepreneurs (e.g., Far-Wharton and Brunetto, 2009; Forson, 2006). Based on previous studies, we define factors which have an influence on entrepreneurs, such as individual capacity, family life, social networking, business environment, government support policy and government support process. We hypothesize that these factors have a direct and indirect relationship to satisfaction and performance.

*H1: Individual capacity, family life, social networking, business environment, government support policy and government support process have a direct positive influence on entrepreneurs' satisfaction.*

*H2: Family life has a direct positive relationship to individual capacity.*

*H3: Individual capacity has a direct positive relationship to social networking.*

*H4: Social networking, government support policy and government support process have a direct positive relationship to the business environment.*

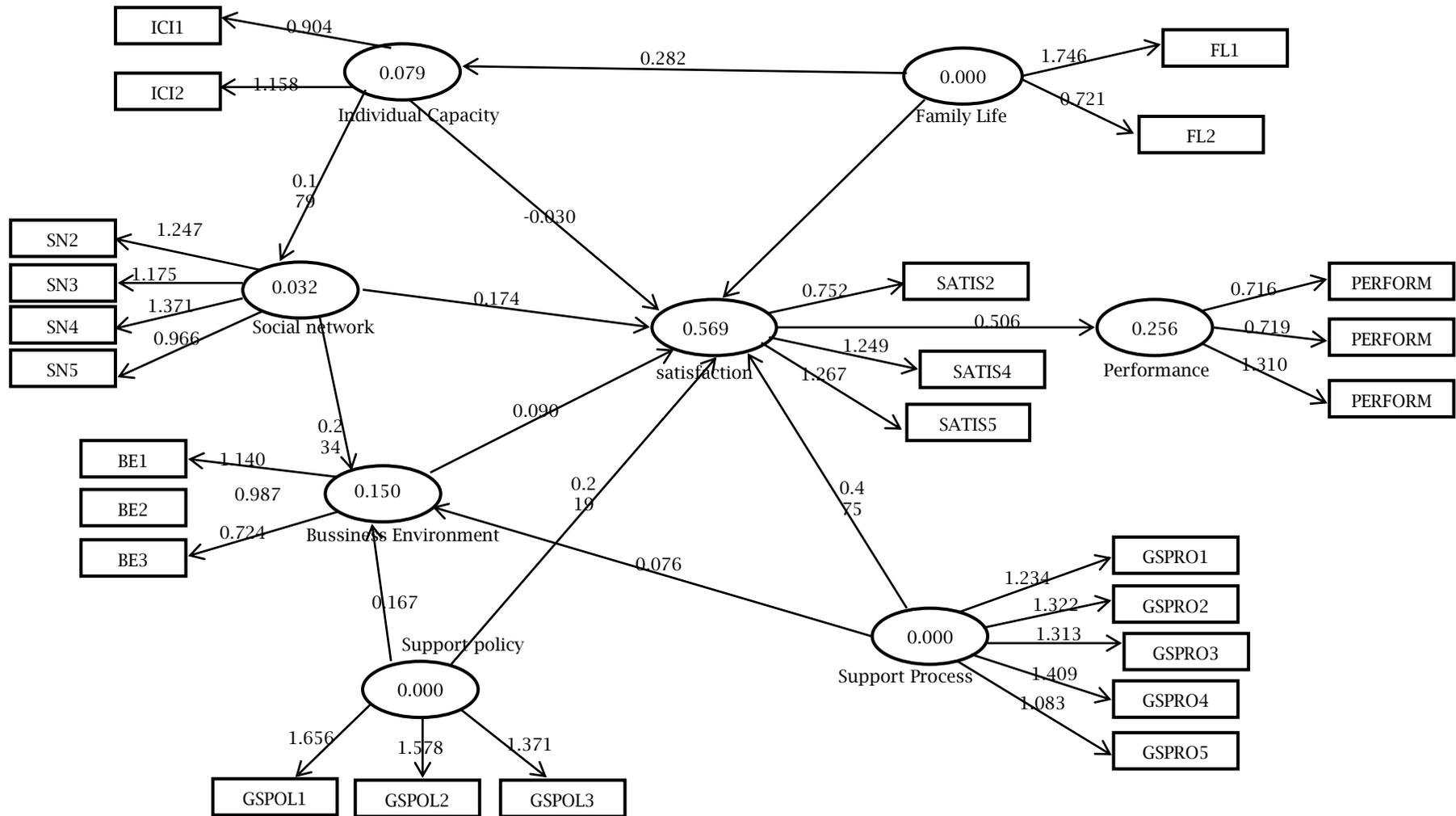
*H5: Entrepreneurs' satisfaction has a direct positive relationship to performance.*

## 3. RESEARCH METHOD

### 3.1 Data and Sample

The population for the study were SMEs located in Banyumas District.

Figure1. Research Model and PLS Output



Products from Banyumas District are of a high quality for export but the productivity level is still low. Purposive random sampling was used to take a sample. The sample was taken from the superior products of SMEs in Banyumas District: coconut sugar, essential oil and batik (traditional clothes). Data presented in this paper were collected by distributing 200 questionnaires, which represented the quantity of SMEs producing coconut sugar, essential oil and batik in Banyumas District. Only 129 questionnaires representing a response rate of 64.5% were deemed valid for further analysis.

### 3.2 Research Variables and Questionnaires

A questionnaire was developed based on research conducted by Lee et al. (2011). There are 33 question items in the questionnaires. The questionnaires were modified based on the characteristics of Banyumas District. The independent variables are individual capacity, family life, social networking, business environment, government support policy and government support process. The moderating variable is satisfaction, and performance is the dependent variable. A Likert scale was used to

measure all question items, with 1 point being assigned to the lowest answer and 7 points to the highest answer.

## 4. RESULTS

### 4.1 Measurement Model

To assess the adequacy of the measurement model, tests were performed for convergent and discriminant validity. The recommended threshold values for these two are 0.6 for composite reliability (CR) coefficients and 0.5 for average variance extracted (AVE) (Bagozzi and Yi, 1988). Table 1 shows that the values meet these threshold tests (all CR coefficients are above 0.60 and all AVE values are above 0.50). This indicates that we have reliable measures and more than 50 percent variance in the items is explained by the latent variables. The loadings are also significant at the 0.01 level and above the recommended value of 0.7 (Chin, 1998). However, IC3, IC4, SATIS1, SATIS3, BE4, SN1, FL3, FL4 and PERFORM4 have a loading below 0.70. Therefore, these indicators were excluded from further analysis.

**Table 1.** Indicator and Construct Reliabilities

<i>Variables</i>	<i>Items</i>	<i>Loading</i>	<i>AVE</i>	<i>CR</i>
Individual Capacity (IC)	IC1	0.904	1.0795	1.0388
	IC2	1.158		
Social Networking (SN)	SN2	1.247	1.4366	1.0836
	SN3	1.175		
	SN4	1.371		
	SN5	0.966		
	BE1	1.140		
Business Environment (BE)	BE2	0.978	0.9270	0.9736
	BE3	0.724		
	GSPOL1	1.656		
Government Support Policy (GSPOL)	GSPOL2	1.578	2.3705	1.2405
	GSPOL3	1.371		
	GSPRO1	1.243		
Government Support Process (GSPRO)	GSPRO2	1.322	1.6349	1.0849
	GSPRO3	1.313		
	GSPRO4	1.409		
	GSPRO5	1.083		
	SATIS2	0.752		
Satisfaction (SATIS)	SATIS4	1.249	1.2431	1.0733
	SATIS5	1.267		
	PERFORM1	0.716		
Performance (PERFORM)	PERFORM2	0.719	0.9155	0.9674
	PERFORM3	1.310		
	FL1	1.748		
Family Life (FL)	FL2	0.721	1.7876	1.3485

### 4.2 Hypothesis Testing

Partial Least Square was used to test the hypothesis. Table 2 exhibits the path coefficient and level of significance among the variables. A business environment variable has a positive path coefficient of 0.090, social network (0.170), government support policy (0.219), government support process (0.475) to satisfaction variable (Figure 1). However, family life and individual capacity have a negative path coefficient of 0.060 and 0.030, respectively. Hence, hypothesis 1 could not be supported statistically.

The coefficient between family life and individual capacity shows a positive coefficient of 0.282 and is significant at the 0.10 level (Table 2). Hypothesis 2, which states that family life has a direct positive relationship to individual capacity, was supported statistically. Individual capacity has a positive correlation (0.179) to social networking and is significant at the 0.10 level (Table 2). Hypothesis 3, which states that individual capacity has a direct positive relationship to social networking, was supported statistically. Hypothesis 4, which states that social networking, government support process, and government support policy have a positive

relationship to the business environment, was supported statistically. The path coefficient of social networking (0.173), government support process (0.475) and government support policy (0.219) is positive and is significant at 0.10. The relationship

between satisfaction and performance shows a positive coefficient (0.506) and is significant at the 0.10 level. This indicates that hypothesis 5 was supported statistically.

**Table 2.** PLS Path Estimates

	<i>Original Sample</i>	<i>Sample Mean</i>	<i>Standard Deviation</i>	<i>Standard Error</i>	<i>T Statistics</i>
BE -> SATIS	0.090357	0.09194	0.081132	0.081132	1.113695
FI -> IC	0.281539	0.253456	0.147693	0.147693	*1.906247
FL -> SATIS	-0.060324	-0.062918	0.084052	0.084052	0.717698
IC -> SATIS	-0.030381	-0.027917	0.081129	0.081129	0.374474
IC -> SN	0.178763	0.192029	0.12533	0.12533	*1.426332
SATIS -> PERFORM	0.506382	0.513005	0.08368	0.08368	*6.051405
SN -> BE	0.233634	0.240149	0.098746	0.098746	*2.366007
SN -> SATIS	0.173931	0.186997	0.092632	0.092632	*1.877661
GSPOL -> BE	0.16687	0.17069	0.123699	0.123699	*1.349002
GSPOL -> SATIS	0.219119	0.209472	0.125136	0.125136	*1.751038
GSPRO -> BE	0.077556	0.098565	0.134281	0.134281	0.57756
GSPRO -> SATIS	0.474689	0.477558	0.128254	0.128254	*3.701176

\* Significant at the 0.10 level

Based on the above results, social networking, government support process and government support policy show a positive correlation to satisfaction. The local government has issued regulations supporting the existing SMEs, however, it seems there were many problems with the implementation of this support. For instance, the local government only focused on reducing unemployment by increasing the number of SMEs. On the other hand, they paid less attention to employing advanced strategies to defeat the global competition. Satisfaction has a positive relationship to performance, so the local government should consider how to design regulations related to the development of SMEs. They also should support SMEs by implementing an advanced strategy to achieve global competitiveness. These results are consistent with previous studies (e.g., Lee et al., 2011; Far-Wharton and Brunetto, 2009; Forson, 2006).

## 5. CONCLUSIONS

The tests for convergent and discriminant validity indicates that we have reliable measures and more than 50 percent variance in the items is explained by the latent variables. The results of the hypothesis testing show that individual capacity and family life have a negative path coefficient, while social networking, business environment, government support policy and government support process have a direct positive influence on entrepreneurs' satisfaction and have a positive path coefficient; therefore, Hypothesis 1 could not be supported statistically. Hypothesis 2, which states that family life has a direct positive relationship to individual capacity, hypothesis 3, which states that individual capacity has a direct positive relationship to social networking, hypothesis 4, which states that social networking, government support process, and

government support policy have a positive relationship to the business environment, and hypothesis 5, which states that entrepreneurs' satisfaction has a direct positive relationship to performance, were supported statistically.

The result of factors which motivated businessmen to develop their business shows that family life has a positive direct influence on individual capacity and an indirect relationship to social networking. Individual capacity has a direct positive influence on social networking. Both family life and individual capacity have no direct positive influence on business environment. Here, social networking is important for the entrepreneurs because social networking helps entrepreneurs to increase financing and facilitate business activities; thus, it can help entrepreneurs to keep their businesses in operation.

The results have exhibited factors that have an influence on SMEs' performance with satisfaction as a moderating variable. The government support policy and government support process are important factors which have an impact on businessmen's satisfaction. Satisfaction has a positive relationship to performance, so the local government should consider how to design regulations related to SMEs' development. They also should support SMEs by implementing an advanced strategy to achieve global competitiveness. This result implies that a public policy to support the performance of SMEs should be designed by the local government. The local government has issued regulations supporting the existing SMEs, however, it seems there were many problems in the implementation of this. For instance, the local government only focused on reducing unemployment by increasing the number of SMEs. On the other hand, they have paid less attention to applying advanced strategies to beat the global competition. This research has the limitation of using

a small sample (only one district) and so it should increase the number in the sample in any future research.

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Appendix

Table A1. Survey Questions

Individual Capacity (IC)	
IC1	How much does your past experience (job) help current business?
IC2	How much of your knowledge learned at school is reflected on the current business?
IC3	What do you think about your management ability?
IC4	What do you think about your funding ability?
Family Life (FL)	
FL1	How much of your house work affect your business?
FL2	How much of raising children affect your business?
FL3	How much of conflict between family members affect your business?
Social Networking (SN)	
SN1	How much do you know public or personal network?
SN2	How much do you participate in business network
SN3	How much do you participate in personal network
SN4	How much would your participation in network help you?
SN5	How much would mentor help you?
Business Environment (BE)	
BE1	What do you think about market structure?
BE2	What do you think about investment environment for your business?
BE3	What do you think about availability of resources (fund, labor, information, and etc) for your business?
BE4	What do you think about business environment of your organization?
Government Support Policy (GSPOL)	
GSPOL1	What do you think about the role of government support to your business?
GSPOL2	What do you think about quality and quantity of government support?
GSPOL3	What do you think about government support to solve your business problems?
Government Support Process (GSPRO)	
GSPRO1	What well is government support department distributed?
GSPRO2	What do you think about government support procedure?
GSPRO3	What do you think about public relations of government assistance process?
GSPRO4	What do you think about the persistence of government assistance?
GSPRO5	How much government support policy reflects the characteristics of business sector?
Satisfaction (SATIS)	
SATIS1	Satisfaction of personal skill
SATIS2	Satisfaction of social network
SATIS3	Satisfaction of business environment
SATIS4	Satisfaction of government support policy
SATIS5	Satisfaction of government support process
Performance (PERFORM)	
PERFORM1	Business sales are increasing
PERFORM2	Business profit are increasing
PERFORM3	Recently business has been expanding
PERFORM4	Business outlook is good