



SMEs have a very important role in the country's economy. In 2019, Bank Indonesia estimates that the contribution of SMEs to GDP will reach 64 percent, 14 percent for exports, and 95 percent for employment. In Malaysia, the contribution of SMEs to GDP reached 38.3% in 2018 from around 6.2 percent in 2017. This segment plays an important role in Malaysia's growth as it accounts for 98.5% of total registered businesses. This proves that SMEs have a strategic role as a means of alleviating poverty and equalizing the welfare of the middle-class community. Even so, if SMEs become a priority sector that needs to be continuously encouraged to increase national economic growth.

However, the reality of SMEs is currently still full of obstacles, especially those related to limited market access, competitiveness, inadequate use of technology, management, and limited access to finance. Besides, digitalization of business and online marketing, as well as increasing exports can be a way for SMEs to survive in an environment of global competition.

Therefore, the book "Cross Border SMEs: Malaysia and Indonesia", Second Edition, launched as an extension of a compilation of works designed to foster the status, growth, progress, and development of SMEs, particularly in Malaysia and Indonesia.

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Edited By:

Moha Asri Abdullah / Rizal Yaya
Dzuljastri Abdul Razak / Bedjo Santoso

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Preface

SMEs have a very important role in the country's economy. In 2019, Bank Indonesia estimates that the contribution of SMEs to GDP will reach 64 percent, 14 percent for exports, and 95 percent for employment. In Malaysia, the contribution of SMEs to GDP reached 38.3% in 2018 from around 6.2 percent in 2017. This segment plays an important role in Malaysia's growth as it accounts for 98.5% of total registered businesses. This proves that SMEs have a strategic role as a means of alleviating poverty and equalizing the welfare of the middle-class community. Even so, if SMEs become a priority sector that needs to be continuously encouraged to increase national economic growth. However, the reality of SMEs is currently still full of obstacles, especially those related to limited market access, competitiveness, inadequate use of technology, management, and limited access to finance. Besides, digitalization of business and online marketing, as well as increasing exports can be a way for SMEs to survive in an environment of global competition. This is a challenge for SMEs in facing various economic crises. Previously, SMEs were the businesses most able to survive when an economic crisis occurred. This is due to several factors; (a) in general, SMEs produce consumer goods and services that are close to the needs of the community, (b) SME entrepreneurs generally utilize local resources such as human resources, capital, raw materials, and equipment, (c) in general, SMEs are not supported by loan funds from banks, but from their funds, and (d) SMEs are very flexible, meaning that it is very easy to adapt to a changing society.

So far, the growth of SMEs has been supported by the market as the population continues to increase. However, in its development, SMEs face major challenges in the form of the threat of the presence of imported products in the domestic market. This challenge comes as a consequence of international free trade agreements in several regions approved by the government, including the ASEAN Economic Community Agreement. National SME actors are forced to compete with giant-scale global economic players who have market opportunities and obtain many facilities from their home countries. This requires the full support of the

government for national SMEs in the form of a healthy business climate, the availability of market opportunities, and various policies that can support the business world to run a business in good conditions. Not only the role of the government, SME actors also need to continue to improve competitiveness and product quality to be able to compete with global company products or services.

Apart from the challenges of global marketing, the challenges for SMEs also arise from their weak capabilities in financial matters. Access to finance is a significant obstacle in inhibiting the growth of SMEs. These financial constraints will also have a negative impact on productivity, survival, and profitability. Although external and government intervention into SME financial access is common among developing countries, programs designed to meet the financing needs of SMEs are not automatically interpreted as better performance.

This challenge must be faced through innovation and the use of digital technology in every business process to make it more effective and efficient. The innovation and utilization of digital technology enable SMEs to produce higher productivity; products and services are higher quality, and the price offered is more competitive. The use of digital technology in business processes not only creates cost efficiency but also time and energy efficiency. The use of technology such as digital marketing applications to easily market products through social media, websites, or digital advertisements; and the use of tools for the production planning process, production process, packaging, and technology-based branding is the right step to increase the competitiveness of SMEs in the global market.

Even so, technological developments will not be a solution if it is not accompanied by an increase in the quality of Human Resources (HR) in SME sectors itself. This requires business actors to improve their abilities and expertise in accordance with dynamic developments to create reliable human resources to meet market demands. SME players need to understand how to use digital marketing tools, design, produce, package, and manage business finances with the help of technology. Thus, SMEs in Indonesia and Malaysia have been striving for industrial improvement in cost reduction by providing relatively lower prices which have brought about transformation to industrial structures and new market developments

along with large and multinational companies (MNCs). SMEs (directly and indirectly) assist and facilitate growth, reproduction, and replication into an adequate mass across industries and sectors. Since the 80s, SMEs have started to become more innovative and flexible in terms of cost reduction, technology adoption, and product diversification. Furthermore, we must ensure that SMEs, which are facing one of the toughest times in the history of this industry, are strongly supported by relevant stakeholders, such as; government, financial institutions, organizations, and associations.

Recognizing the need to further take advantage of the development of small and medium enterprises (SMEs) in these two fraternal countries, Malaysia and Indonesia, a small group of scholars/researchers from IIUM, UMY, UNIDA Gontor, and UNISSULA have collaboratively initiated a small-scale project known as Research Matching Grant Schemes (RMGS), International Islamic University Malaysia (IIUM), Project ID: RMGS 17-001-0027. After the Workshop on Malaysian - Indonesian SMEs in 2019 which was held to present all the RMGS findings, the next effort was to compile selected related papers in book form so that the updated knowledge and findings could be shared with the wider community. Therefore, the book “Cross Border SMEs: Malaysia and Indonesia”, Second Edition, launched as an extension of a compilation of works designed to foster the status, growth, progress, and development of SMEs, particularly in Malaysia and Indonesia. Such efforts have not been made elsewhere.

We would like to appreciate the Research Management Center (RMC) of International Islamic University Malaysia (IIUM), the research center of Universitas Muhammadiyah Yogyakarta (UMY), Universitas Darussalam (UNIDA) Gontor, and Universitas Islam Sultan Agung (UNISSULA) that have given us the opportunity for a research grant under RMGS. The grants from our respective institutions allow us to produce and integrate this research paper into an edited book. Hence, a special thanks and flagship appreciation to those who contributed their papers and provided endless support so that this edited book can be successfully launched.

Edited By: Moha Asri Abdullah, Rizal Yaya, Dzuljastri Abdul Razak, and Bedjo Santoso

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CHAPTER 01

ANALYSIS OF ISLAMIC FINANCIAL INCLUSION FOR MSMEs IN YOGYAKARTA

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Abstract

Micro, small and medium enterprises (MSMEs) play a significant role in the economic development in Yogyakarta. Based on the 2016 census data, the total number of businesses comprising 246,217 business units was 235,313 MSMEs or 98.40% of the total businesses in Yogyakarta. Yogyakarta's economic growth in 2017 was 5.26% (yoy), where the share of MSMEs was quite significant, around 95%. However, the major problem faced by the MSMEs is financial inclusion, which is still low. In view of this, there is a lack of information that demands a need to empirically investigate to what extent MSMEs have gained access to Islamic financial credit facilities and to examine causes that lead to such a situation.

The purpose of this research is to assess the selected attributes of the MSMEs and to analyze the causes of the low access to Islamic finance. Data was obtained using survey techniques and in-depth observation to provide answers to the problems faced to explain the phenomenon. The results indicate that MSMEs' access to Islamic finance is relatively low and only 30% of them use funds sourced from sharia financial institutions at the beginning of their business. This condition is an irony, given that there is a rapid development of Islamic financial institutions, especially

BMTs, in Yogyakarta, and most business actors are micro and small scale, which should be served by sharia microfinance institutions. Overall, this research provides some important insights for Yogyakarta to highlight possible steps for the policy makers as a reference to formulate policies related to increasing financial access for MSMEs.

Micro, small and medium-sized enterprises (SMEs) play a significant role in the economic development of Yogyakarta. Based on the 2016 census data, the total number of enterprises comprising 246,217 business units was 235,313 or 98,40 per cent of the total number of enterprises in Yogyakarta. Yogyakarta's economic growth was 5.26% (yoy) in 2017, where the share of small and medium-sized enterprises (SMEs) was quite significant, around 95%. However, the major problem faced by MIPYMEs is that it is still low in terms of financial inclusion. In view of this, there is a lack of information which calls for a need to empirically investigate the extent to which MSMEs have gained access to Islamic financial credit facilities and to examine the causes that lead to such a condition.

The purpose of this research was to assess the selected attributes of small and medium-sized businesses and to analyze the causes of low access to Islamic finance. Data was obtained utilizing quantitative methods and in-depth evaluation to provide answers to the problems posed in order to explain the phenomena. Results indicate that MSMEs have relatively low exposure to Islamic finance and that only 30 per cent of them have access to funds from Sharia financial institutions at the outset of their sector. This is an irony due to the rapid growth of Islamic financial institutions, especially BMTs, in Yogyakarta, and most of the market players are micro-and small-scale, which should be supported by sharia microfinance institutions. Ultimately, this work offers some important insights for Yogyakarta to illustrate potential measures for policy makers to implement policies to improve financial exposure for small and medium-sized enterprises (SMEs).

Keywords : MSMEs, financial inclusion, microfinance, sharia finance

1.1 Introduction

Micro, Small and Medium Enterprises (MSMEs) in Indonesia have a significant role in the national economy. Their contributions are numerous such as a significant share in the Gross Domestic Product (GDP), consisting of more than 99 percent of the total number of business establishments which is about 57.9 million establishments in the year 2017, employment opportunities totaling 51.7 and poverty alleviation. Of this number, only 30% can access financing from banking financial institutions. Many have noted that MSMEs have been the backbone of the Indonesian economy. The existence of MSMEs also has a direct impact on people's lives in the lower sector, at least covering three things which include: firstly, MSMEs which are a means of poverty alleviation because of its tendency to develop on the basis of cooperative advantage, so that it has the potential in labor absorption; secondly, it has an important role in the economic equality of the community; and lastly, MSMEs provide income for the state in the form of foreign exchange.

Based on the 2016 census data, the total number of businesses in Yogyakarta is around 246,217 business units. Out of this, MSMEs comprise of 235,313 establishments representing about 98.40% of the total businesses in Yogyakarta. This shows that micro establishments represent a very important proportion consisting of 55 percent (Disperindagkop, 2016). Previous studies have shown that MSMEs growth is closely related to the economic growth of respective country/region (Ma'ruf, 2015). With economic growth in Yogyakarta recorded at 5.05 percent in 2016 which increased to 5.26 percent in 2017, there is ample opportunity for the MSMEs to grow and expand. This also indicates that the prospects for MSMEs in Yogyakarta are promising and their existence would be able to sustain economic growth, and their flexibility in the production structure possibly would fend off possible economic downturn in the region of Yogyakarta.

Beside the various performances and achievements of MSMEs in the formation of added value in Yogyakarta's economy, as well as the continued development of this sector when the national economy faded since 2014, MSMEs were also faced with various issues that require comprehensive handling. These various problems include weak business

networks, lack of human resources capability, lack of capital access, low technology utilization, weak institutions, and unstable regulation and macroeconomy (Disperindagkop DIY,2016). As the backbone of the regional economy, MSMEs are the main stakeholders as users of funds from the financial sector. Therefore, the understanding of MSMEs towards inclusion and financial literacy becomes very important. The understanding and the ability of financial management is very important to be applied to business finance. The cause of low financial access for MSMEs in Yogyakarta was due to the relatively low level of financial literacy of these MSMEs. Financial literacy is a person's ability to manage their finances (Chen and Volpe, 1998) both in terms of their knowledge and ability to manage their finances. Bhushan and Medury (2013) explained that financial literacy is very important for several reasons. People with a good level of financial literacy will face difficult financial conditions, because they have accumulated investments, bought insurance and diversified investments.

Financial inclusion is the right of everyone to have access and full service from financial institutions in a timely, convenient, informative and affordable manner, with full respect for their dignity (Rakhmindyarto,2014). Financial inclusion is also a situation where the majority of individuals can utilize available financial services and minimize the existence of groups of individuals who are not yet aware of the benefits of financial access that is available without high costs (Salim,2014). Financial inclusion system not only provides credit to the poor and small micro-enterprises, but also has a more holistic goal, namely, reducing poverty, distributing income to achieve higher quality economic growth without sacrificing and even sustaining financial system stability (Ismawati,2015). Empirical evidence shows that countries with large population have not had broad access to the formal financial institutions sector and also show higher poverty ratios and higher inequality (Chakrobarty, 2011). Thus, financial inclusion is not currently an option, but it is a necessity, and banking is the main driver for the implementation of financial inclusion (Nengsih,2015). Financial inclusion is important and urgent because there are still a large number of Indonesians who do not have access to the formal financial sector. In

addition, the formal financial sector is a public good and therefore every citizen has the right to access a variety of quality, timely, convenient, clear and affordable financial products and services (OJK, 2015).

Expanding access to MSMEs financially is not only from formal financial institutions but also from microfinance institutions. Evidence indicate that it would lead to the alleviation of poverty in Indonesia (Wijono,2005). Microfinance institutions are able to provide various types of financing to MSMEs, so that it can be a potential alternative financing. Susilo (2010) confirmed that, in addition to optimizing the role of banks, it is also necessary to encourage the role of non-bank financial institutions such as venture capital and the Credit Guarantee Agency. In this case, Bank Indonesia, for instance, should consider the demand side and supply side policies to improve banking access.

Looking at the issue in hand, this research attempted to explore financial access of MSMEs in Yogyakarta. In realizing this, the research sought to address on the three major fronts including: to what extent MSMEs access in Yogyakarta is able to secure access to Islamic finance, constraints that affect MSMEs' access to financing from sharia financial institutions, and the challenges of MSMEs in facing global economic development. Previous research findings will also be used to strengthen literature review and research report in later stage of the research. Finally, an in-depth interview with MSMEs and Focus Group Discussion were utilized to provide answers for the problems faced in order to explain the phenomenon.

1.2 Related literature : Financial Inclusion and MSMEs

Financial inclusion has been defined differently and there has not been a consensus on this. The following quotations reflect the definitions given by selected institutions.

“state in which all working age adults have effective access to credit, savings, payments, and insurance from formal service providers. Effective access involves convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than

existing informal options” (Global Partnership for Financial Inclusion (GPFI)).

“process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated, mainstream institutional players”(RBI/Reserve Bank of India).

“financial inclusion involves providing access to an adequate range of safe, convenient and affordable financial services to disadvantaged and other vulnerable groups, including low income, rural and undocumented persons, who have been underserved or excluded from the formal financial sector” (Financial Action Task Force (FAFT))

The terms financial inclusion for MSMEs has already become a major issue for quite some time. The situation was even more emphasized after the 2008 crisis, considering the impact of the crisis was on the bottom group of the pyramid (low and irregular income, living in remote areas, disabled people, workers who do not have legal identity documents, and marginalized communities who largely operate and run MSMEs in respective nations). They generally come from outside developing countries (BI, 2014). In 2009, in the G20 Pittsburgh Summit, the members agreed on the need to increase financial access for this group which was confirmed at the Toronto Summit in 2010, with the issuance of nine (9) Principles for Innovative Financial Inclusion as a guideline for developing inclusive finance. These principles are leadership, diversity, innovation, protection, empowerment, cooperation, knowledge, proportionality, and framework.

It is widely noted that there are a number of reasons why financial accessibility has become a problem. They are found from two main sides of the market, i.e. the supply side (service providers) and the demand (community). This occurs due to various barriers including price barrier (expensive); information barrier (not knowing); design of barrier products (suitable products); and channel barrier (means appropriate).

Therefore, financial inclusion (FI) issues can be implied due to the absence of price or non-price barriers that are found in the use of financial services (Chakrabarty and Rupayan, 2013; World Bank, 2012). Hence, when it is related to FI, it does not cover the access to financial services, but it entails timeliness.

Demirgüç, -Kunt et al. (2015) gave global statistics about financial inclusion with 2014 data from the Global Findex database. First, 62 percent of adults globally own an account at a formal financial institution, either at a bank or with a mobile money provider. Account ownership has been substantially increasing in the developing world, reaching 54 percent of the population in 2014, notably thanks to innovations like mobile banking. However, the share of the population with a formal account is still far lower than in high-income economies (94 percent). Second, 56 percent of adults world-wide declared having saved money aside in the past 12 months in 2014. One quarter of adults reported having saved money at a formal financial institution, representing half of the savers. However, the percentage of formal saving varies greatly between high-income economies (70 percent among savers) and developing economies (40 percent among savers). Finally, 42 percent of adults worldwide declared having borrowed money in the past 12 months. Formal credit at a financial institution has only been used by 9 percent of adults in developing countries, while it has been used by 18 percent in high-income economies.

The condition of financial access in Indonesia is considered to be less encouraging. This is reflected in the low level of financial inclusion in Indonesia. The latest survey conducted by the World Bank in 2014 showed that Indonesia's financial inclusion was only 36 percent. That is, out of 100 Indonesian adults, only 36 people have accounts with formal financial institutions. The low level of financial inclusion can trigger negative impacts on the economy, one of which is a shadow economy that is not recorded so that it is prone to create turmoil for financial system stability (BI, 2017). In terms of financial system stability, low financial inclusion causes exclusivity. This means that only a small percentage understands and has access to financial products and services. Financial stability was also disrupted due to the vulnerability of shadow

economy activities given the lack of access of the financial industry to the economic activities of the community. Financial exclusivity will also hamper the culture of saving and nurturing assets so that the public does not have the funds to guard in financing future needs. Meanwhile, Hariharan and Marktanner (2012) stated that lack of financial inclusion is a multifaceted socioeconomic phenomenon that results from various factors such as geography, culture, history, religion, socioeconomic inequality, structure of the economy and economic policy. Financial inclusion indicates that majority of the population has access to a portfolio of quality financial products and services which include loans, deposit services, insurance, pensions and payment systems, as well as financial education and consumer protection mechanisms. Greater financial inclusion can promote economic development through the establishment of mechanisms that allow more access to products and services of financial institutions.

With regard to financial inclusion for MSMEs, the consistent application of financial inclusion to the MSMEs sector can encourage the strengthening of the financial system in the long run. The role of financial inclusion is very important for banks and society, because it can reduce the intermediary costs that are still high and improve the welfare of the population. Good financial inclusion can also provide economic activities for people who have not been directly touched by the banking system, so that the impact can overcome the problem of poverty and inequality (Ronald, 2016). Financial inclusion is one of the programs for financial literacy, especially in order to improve the community's ability to use financial services to obtain direct impact from financial institutions (Terzi, 2015). The results of Terzi's research (2015) show that the increase of financial inclusion by SMEs can contribute positively to the success of SMEs and ultimately can improve the financial stability of a state. Unfortunately, although there has been growing recognition of the importance of SMEs for job creation and economic development, SMEs themselves reported the lack of access to finance to be one of the greatest barriers to their growth. Half of SMEs in emerging markets are credit constrained (Terzi, 2015).

A country's level of financial development exerts a different effect on small firms compared to large ones. Removing the growth constraints on MSMEs will accelerate disproportionately the growth of industries. This can largely contribute to technological progress by MSMEs (IRIS Center, 2006). According to Alalade et al. (2013), this finance could be generated both internally and externally. The role of finance has also been viewed as a critical element for the development of MSMEs by Cook (2001). It has been widely recognized that lack of sufficient finance and access to credit are the major constraints to the development of MSMEs in many parts of the world. A study by Thorsten (2007) found that the relationship between financial constraints and MSMEs in developing countries is significantly essential based on the concept of the access possibilities frontier to explain how difficulties in managing risks and transaction costs involved in SMEs lending noted the importance of finance on the promotion of MSMEs.

In relation to Islamic finance, the significance of profit-sharing finance can have positive economic effects. Thus, there is no discrepancy to direct investment leading to strong economic development (El-Gari 2004). Promotion of entrepreneurship and risk-sharing are two key features of Islamic finance. In this regard, MSMEs require both encouragement of entrepreneurship and risk-sharing from where appropriate for Islamic finance and SME financing. Islamic SME finance concepts can be seen to provide a comprehensive asset-based economic and equitable model that fulfills expectations such as social justice and human-centered sustainable development. Financing modes that best suit SMEs include mudharabah (principle/agent) and musharakah (equity partnership). Both forms serve useful purposes especially in terms of providing investors with high liquidity at low risk. Islamic banks were recently encouraged to provide more profit-sharing finance and are developing arrangements to reduce risks and the costs of funding. Askari (2011) noted that it can realize towards setting up specialized institutions, as well as introducing new consistent products with the aim of reducing risks. This is realized through pooling the funds and establishing Wakalah agencies to perform monitoring and to minimize moral hazards.

1.3 Methodology

The method of research focused on two main sources: secondary and primary data. Secondary sources of data and information derive from existing body of knowledge from the existing literature. In addition, secondary data were obtained through respective banks and official published data, reports and records to update on the issues. Meanwhile, a set of questionnaires was designed which was used to collect primary data from respondents of MSMEs. The questionnaire was designed in order to serve the objectives of the research. It covered the background of the entrepreneurs, risk analysis, MSMEs profile, their capital uses and prospects of Islamic finance, requirement analysis and finally, the issues, performance and prospects.

The survey method that has often been used contributes accuracy and relatively cost-efficient data for the research. Thus, the sampling frame used in this research contained the MSMEs that were obtained from the local authority of Yogyakarta. Having considered the conventional approach of field survey, a total of 300 MSMEs in Yogyakarta were interviewed. They comprised of MSMEs' owners and managers in five districts in Yogyakarta, namely, Bantul, Sleman, Kulonprogo, Gunungkidul and Yogyakarta City. The determination of the sample size of 300 respondents was made in line with the approach adopted by Gudono who stated that the minimum respondent is 100 (Gudono, 2014). The sampling technique that was used in this study was the proportionate stratified random sampling. This was done by dividing the population into several strata each of which was homogeneous. For certain parts of the questionnaire, a 5- point Likert scale was used as a means to measure preferences of the items. Moreover, a 5-point Likert scale requires respondents to provide a relative assessment of various statements in the questionnaire on a continuum ranging from 'strongly disagree' to 'strongly agree' that are very commonly used for collecting primary data in empirical research.

1.4 Description of Respondents

This research was conducted in the Special Region of Yogyakarta. Samples in this research include MSMEs' (Micro, Small and

Medium Enterprises) owners throughout the five districts in the Special Region of Yogyakarta. In total, there were 300 respondents in this study. Data collection in this research included ownership status, gender, age, education, asset, number of workers, and turnover values within a year. Generally speaking, most of the owners of MSMEs business had no entrepreneurship experience before running their own business. It might be possible that most of the MSMEs in Yogyakarta are family businesses with the continuation of its operational given to the children or other family members across generations. Most of the learning process of business management are given directly to the subsequent generation or through self-learning in which the family members contribute to the business intensively as employees or volunteers.

In order to develop a business, adequate skills and knowledge are required for business firms which are not only for MSMEs but also for entrepreneurs in large scale businesses. There are several benefits acquired by the business world, such as: (1) increasing work performance, (2) preparing the employers to have skills in certain areas as required by the company, (3) having adequate skills and knowledge to ensure that the employers have security and are appreciated, and gain satisfaction. The findings of this research indicate that there are MSMEs have gone through.

The existence of sharia financing in Indonesia is relatively new compared to conventional financial institutions. This has been revealed in this research when a significantly small proportion of MSMEs secured Islamic-based financial facilities. This finding signals a number of implications one of which is that a few members in the community of MSMEs have not still realized the existence of Islamic financial facilities in Yogyakarta. Table 1.1 clearly shows this.

Table 1.1 indicates that only a few MSMEs in Yogyakarta have realized the existence of sharia finance. The Table shows that only 13 percent and 8.9 percent, respectively, are aware and very aware of the Islamic financial facilities. On the other hand, a significant proportion of MSMEs in Yogyakarta, i.e. 43.2 percent, are not aware of any Islamic financial facilities and another 0.7 percent are not aware at all. As a consequence, only 8.6 percent of MSMEs secured Islamic financial

facilities as compared to 89.7 percent who used conventional finance to run and operate their MSMEs in Yogyakarta. These findings clearly illustrate the lack of knowledge and information on the existence of Islamic financial facilities as one of the possible reasons.

Table 1.1 :
Awareness Level of MSMEs toward Sharia Financing

Awareness of the differences between Islamic Financing and Conventional Financing method		
Variables	Frequency	Percent (%)
Not aware at all (0)	2	0,7
Not Aware (1)	126	43,2
Not Sure (2)	54	18,5
Little Aware (3)	46	15,8
Aware (4)	38	13,0
Very Aware (5)	26	8,9
Missing	9	
Source of Capital		
Islamic	21	8,6
Conventional	218	89,7
Self Funding	2	0,8
Missing	60	

Source: Survey Data (processed)

Even though there are many business firms not utilizing the funding from sharia financial institutions, either from the banks or micro financial institutions, there is no possibility for them to utilize the fund from sharia financial institution in the future, and only a few of them are willing to utilize the fund, which accounted for 9 respondents or 3.2 percent. Meanwhile, for economic agents who had already utilized the fund from sharia financial institutions, there is no possibility to still continue utilizing the fund from sharia financial institutions in the future. There are only 22 respondents who are committed to continue utilizing the fund from sharia financial institutions which account for 22%. The detailed findings are shown in Table 1.2.

Table 1.2 :
Possibility of MSMEs Utilizing Sharia Finance

Responses	If you are currently not using Islamic Finance, do you intend to utilize it in the near future?		If you are currently using Islamic Finance, do you intend to continue using it in the future?	
	Frequency	Percent (%)	Frequency	Percent (%)
Definitely No	11	4,0	3	1,5
No	77	27,7	41	20,0
Not Sure	140	50,4	33	16,1
Yes	41	14,7	83	40,5
Definitely Yes	9	3,2	45	22,0
Total	278		205	
Missing	23		96	

Source: Survey Data (processed)

1.5 Results and Discussion

1.5.1 Financial Access of MSMEs

The existence of micro, small and medium enterprises (MSMEs) reflects the reality of social and economic life for typical Indonesian society, including the Special Region of Yogyakarta. Besides, MSMEs have been proven to survive in crisis situations, absorb large pool of workers spread out in almost all sectors of the economy, and improve income distribution. In relation to their characteristics, business firms are the main stakeholders who utilize the funds from financial institutions (i.e. bank, microfinance, and co-operative, both in conventional and sharia basis) as financing sources. However, there are still possibilities for business firms to utilize or not utilize the funds from those financial institutions as they can obtain funds from other sources, such as personal funds, loans from families, loan sharks, and rotating finance. The distribution of funds utilization to develop the business from various financing sources can be seen in Table 1.3.

Table 1.3 :
Capital Sources of MSMEs by Period

Source of Financial Capital	INITIAL		CURRENT		FUTURE	
	Freq	Percent (%)	Freq	Percent (%)	Freq	Percent (%)
Bank	30	10	52	17,3	56	18,6
Cooperation	4	1,3	2	0,7	5	1,7
Crowd Funding	45	15	10	3,3	8	2,7
Loan Relative	10	3,3	6	2	7	2,3
Micro Finance	0	0	4	1,3	3	1
NGO	132	43,9	136	45,2	139	46,2
Personal Savings	80	26,6	63	20,9	58	19,3
Registered Money Lender	2	0,7	0	0	2	0,7
Rotating Finance (arisan)	4	1,3	0	0	2	0,7
Unregistered Money Lender	2	0,7	0	0	0	0
Others	44	14,6	44	14,6	0	0

Source: Survey Data (processed)

Based on Table 1.3, it is apparent that initially most of the business firms run their business with funding from Non-Government Organization, which is also known as BKM or *Badan Keswadayaan Masyarakat*. There are 132 respondents or 44% of them who utilized funds from BKM at the initial stage of business activities, while there are some business firms who started their business by relying upon personal funding from their savings, which account for 80 respondents or 27% of them. There are also business firms who utilized the funds via crowd funding by the time they started their businesses. In contrast, there are

only 30 respondents or 10% who utilized funds from banks to start their business activities. It gives us evidence that most definitely access to formal financial institution, such as bank and microfinance, did not provide enough space for business firms of MSMEs in Yogyakarta.

In relation to the difficulty for financial institution to provide more space for business firms of MSMEs in Yogyakarta, the data can be traced in Table 4. Based on Table 1.4 it is obvious that funds from Non-Government Organizations or NGOs are the most accessible funds. It does make sense as the business firms do not need complicated requirements, such as business plan, or collateral. These are revolving funds that originally were part of the central government's economic empowerment programme. As the funds revolve, the management of the funds is granted to the NGOs.

Table 1.4 :
Accessibility of MSMEs toward Financing Sources

Source of Capital	Accessibility									
	Not Accessible		Can be accessed		Neutral		Accessible		Satisfied with the accessibility	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Bank Loan	4	1	6	2	21	7	63	21	41	14
Coop Society	11	4	5	2	34	11	38	13	6	2
Crowd Fund	16	5	5	2	28	9,3	58	19	26	8,6
Loan Relative	6	2	11	4	35	12	33	11	17	5,6
Microfinance	11	4	8	3	35	12	36	12	5	1,7
Non- Gov	11	4	9	3	35	12	73	24	79	26
Personal Saving	12	4	3	1	16	5,3	43	14	51	17

Registered Money Lenders	20	7	3	1	31	10	37	12	2	0,7
Rotating	19	6	9	3	23	7,6	34	11	2	0,7
Unregistered Money Lender	12	4	2	1	14	4,7	19	6,3	2	0,7

Source: Survey Data (processed)

1.5.2 Access of MSMEs to Sharia Finance

One of the financing sources for business firms of MSMEs in Yogyakarta is capital or financing from sharia financial institution with various financing products and forms. However, the existence of products from sharia financial institutions does not seem to be familiar to the business firms of MSMEs in Yogyakarta. The majority of them, which account for 88 respondents, do not recognize financing products from sharia financial institutions, while only 6 respondents have noticed the products. Among the 300 respondents, there are 94 respondents or 31% who did not answer the questions about access to the banking sector or sharia financial institutions. This finding implies that the majority of MSMEs' owners in Yogyakarta are still unfamiliar with the existence of sharia financial institutions, particularly with financing products from sharia financial institutions. This condition can be seen in Table 1.5 and Table 1.6.

Table 1.5 :
Familiarities of MSMEs toward Sharia Financing Products

Familiar Islamic Finance Products	Frequency	Percent (%)
Yes	6	2
No	88	29,2
Total	94	31,2
Missing	207	

Source: Survey Data (processed)

Table 1.6 :
Utilization of Sharia Financing Products

Type of Islamic Finance Products	Utilization					
	INITIAL		CURRENT		FUTURE	
	Freq	%	Freq	%	Freq	%
Diminishing Musharaka			1	0,3		
Ijara			1	0,3		
Kafala	5	1,7	4	1,3	5	1,7
Mudaraba	4	1,3	6	2	4	1,3
Murabaha			3	1	2	0,7
Musharaka			1	0,3	1	0,3
Qard Hassan			1	0,3	1	0,3
Sukuk						

Source: Survey Data (processed)

From Table 1.6, it is evident that the majority of the respondents did not answer the questions related to the utilization of financing products from sharia financial institutions, both sharia bank and sharia microfinance, such as BMT. There are only 9 respondents who utilized the funds from sharia financing at the beginning of their business. This number increased to 17 business firms by the time of the survey, but decreased to 13 respondents in later. This number decreased in Mudharaba and Murabaha. Thus, it is essential for regular socialization for the business firms of MSMEs so that utilization of the funds from sharia financing can grow. As the majority of the business firms in Yogyakarta are micro and small enterprises with small needs of the funds, it is very plausible for them to be served by sharia financial institutions, including both sharia banks and sharia microfinance, such as BMT.

The limited utilization of the funds from sharia financial institutions can be recognized as the degree of accessibility of MSMEs to sharia finance. The lack of familiarity of business firms of MSMEs in Yogyakarta with financing products from sharia financial institutions

shows the lack of access to sharia financial institutions. Table 1.7 provides information which shows that the access to sharia finance is relatively easy. However, only a few respondents answered this question as most of the respondents are not familiar with sharia financial products.

Table 1.7 :
Accessibility of MSMEs to Sharia Finance

Type of Islamic Finance Products	Accessibility									
	Not Accessible		Can be accessed		Neutral		Accessible		Satisfied with the accesibility	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Diminishing Musharaka	3	1	8	2,7	5	1,7	3	1		
Ijara	3	1	8	2,7	5	1,7	3	1		
Kafala	1	0,3	8	2,7	7	2,3	6	2	1	0,3
Mudaraba	1	0,3	8	2,7	3	1	8	2,7	2	0,7
Murabaha	1	0,3	9	3	2	0,7	7	2,3		
Musharaka	3	1	8	2,7	6	2	1	0,3	1	0,3
Qard Hassan	4	1,3	6	2	3	1	6	2		
Sukuk	3	1	2	0,7			1	0,3		

Source: Survey Data (processed)

1.5.3 Challenges of MSMEs

Although the owner of micro, small, and medium enterprises in Yogyakarta is the backbone and the main contributor of value added in the economy, the business firms have to deal with uneasy challenges, particularly when they are confronted with globalization and the digital era. On the other hand, the world has changed as we enter a new situation which is full of volatility, uncertainty, complexity, and ambiguity (VUCA). This condition is due to rapid technological growth in the world, which may impact MSMEs. The potential challenges for business firms of MSMEs in Yogyakarta can be seen in Table 8.

The respondents think that, in the following three years, the hardest challenge for entrepreneurs of MSMEs in Yogyakarta is

operational cost. It is difficult to anticipate this cost as some raw materials are imported, which, therefore, depends on the exchange rates. Besides, costs of energy, such as fossil fuel or electricity, have been adjusted by the market, and thus business firms must be ready to face higher prices due to government policy. Another challenge for MSMEs entrepreneurs in Yogyakarta is on how to keep employees who have performed well when confronting final products from overseas in the context of free trade policy with ASEAN countries or MEA. It is plausible that these employees will move to other workplaces with higher salaries. Considerable inflows of goods from Malaysia, Thailand, and Vietnam also have impact on more variations of consumer choices with lower prices. This condition impacts them by having strict competition towards products from MSMEs' entrepreneurs in Yogyakarta, particularly in terms of price and quality, which in turn reduces the sales of business firms. Moreover, the trend of online shopping can be a threat MStoMEs' products in Yogyakarta as the technology grows more rapidly. The business firms with internet system do not need large spaces, production areas, and many employees. They only need a computer or a mobile phone to market their products and sometimes their products are imported from overseas.

Table 1.8 :

Potential Challenges for MSMEs in the Special Region of Yogyakarta

Challenges	Level of Challenges									
	1		2		3		4		5	
	Freq	%	Freq	%	Freq	%	Freq	%	Freq	%
Competitive advantage	38	13	20	7	70	23	118	39	51	17
Economic fluctuations	54	18	32	11	86	29	90	30	32	11
Environmental concern	49	16	38	13	108	36	67	22	29	9,6
Finance difficulties	70	23	45	15	64	21	72	24	41	14

Foreign product competition (MEA)	65	22	48	16	63	21	63	21	53	18
ICT Development	47	16	45	15	91	30	72	24	37	12
Knowledge and skills in finance and accounting	46	15	41	14	114	38	67	22	24	8
Knowledge and skills in marketing	46	15	36	12	110	37	79	26	22	7,3
Knowledge and skills in technology	55	18	40	13	105	35	64	21	27	9
Knowledge and skills in research& development	22	7	29	10	118	39	91	30	31	10
Margins (Profit)/	27	9	26	9	99	33	106	35	34	11
Operational cost	42	14	25	8	75	25	83	28	64	21
On-line sales	20	7	24	8	90	30	109	36	49	16
Product cost	51	17	39	13	89	30	81	27	31	10
Recruiting staff	58	19	39	13	94	31	70	23	30	10
Retaining staff	24	8	21	7	98	33	94	31	53	18
Uncertainty of market direction	5	2	5	2	32	11	25	8,3	28	8,3
Other (specify)	23	8	13	4	65	22	64	21	35	12

Source: Survey Data (processed)

1.6 Conclusion

The large number of MSMEs in Yogyakarta makes researchers interested in analyzing financial inclusion and financial literacy challenges for entrepreneurs. Micro and Small Medium Enterprises is one sector that drives the economy in Yogyakarta. Based on a field survey that was conducted for one month on 300 respondents, MSMEs in Yogyakarta were divided into 8 sectors, namely, Consumer (40.8%), Trading / Services (39.8%), Industrial (11.5%), Construction (2.1%), Plantation (2.1%), Properties (1.6%), Transportation (1.6%) and Technology (0.5%). Based on the discussion and analysis, it can be concluded that:

1. The main source of capital or funds obtained when establishing a business for most MSMEs in Yogyakarta is funds originating from non-government organisations, in this case, the BKM or the Community Self-Reliance Agency. This institution was created by the government to roll out funds in order to help people who need funds to start a business. This fund is relatively cheap and easily obtained because there is no collateral needed. Meanwhile, the second source of funds which is the mainstay for starting their businesses is personal funds or personal savings. These funds might not be many, but they do not contain any risks.
2. Only 10% of businesses in Yogyakarta, especially MSMEs, are aware of the existence of sharia finance, while the remaining 90% still rely on funding from conventional financial institutions. In the future, enthusiasm might still not be shown to use funds sourced from sharia financial institutions as it is proven that only 3.2% will likely use funds from sharia financial institutions, while those who have currently used the funds sourced from sharia micro finance institutions, might still be keen to use them to in the future.
3. Access to MSME business actors in Yogyakarta towards financial institutions is also still relatively low because the funding products of these sharia financial institutions do not seem to be very familiar to business actors as 70% of the respondents do not know them yet. Only 3% of the respondents at the beginning of their businesses used funds sourced from sharia financial institutions. This condition is an irony

because of the rapid development of Islamic financial institutions, especially BMTs in Yogyakarta, while most business actors are micro and small scale, which should be served by shariah microfinance institutions or BMTs.

4. In relation to the new situation which is full of volatility, uncertainty, complexity, and ambiguity (VUCA), operational costs is the hardest challenge for entrepreneurs of MSMEs in Yogyakarta. This is because some raw materials are imported and the costs will be dependent on the exchange rates. Keeping well performing employees is also a challenge while facing final products from overseas in the context of free trade policy with ASEAN countries or MEA.

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CHAPTER 02

A STUDY OF FINANCIAL LITERACY AND MICRO SMALL MEDIUM ENTERPRISES IN EAST JAVA PROVINCE INDONESIA

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Abstract

The research determines the Islamic financial literacy of the selected Micro, Small and Medium Enterprises (MSMEs) in Indonesia. The purpose of this paper is to assess the level of literacy and the impact on sustainability of MSMEs in the East Java Province. The paper used a questionnaire to explore and gain the primary data in an attempt to measure the level of Islamic financial literacy among MSMEs in the district. A total of 250 respondents participated in the study which was based on random sampling method. A survey methodology was utilized to accomplish the objectives of this study. In an attempt to collect the data, this research designed a structured questionnaire as an instrument that can evaluate the level of financial literacy. The collected data was tabulated using Microsoft Excel. Descriptive and inferential analysis were used to examine the extent of awareness regarding financial literacy among MSMEs.

Keywords: Literacy, Enterprise, Sustainability, Indonesia

2.1 Introduction

MSMEs plays a significant role in the development of the Indonesian economy. This can clearly be seen from the portion of contribution to Gross Domestic Product (GDP) of the country, which was around 60% in both periods, 2011 and 2012 (Bank Indonesia & LPPI, 2015). In addition, this type of enterprise has a potential impact in creating a large proportion of jobs due to its efforts create job vacancies of around 97% of the total workers at the national level, particularly in the retail sectors such as foods, beverages and tobaccos. Hafni (n.d.) has shown that MSMEs have a significant impact in reducing the unemployment rate in Indonesia. This indicates that the MSMEs have crucial advantages in dealing with the unemployment issues of the nation. Therefore, the existence of MSMEs is essential in order to achieving the national economic targets.

Despite its advantages, MSMEs are facing several financial literacy challenges which play a crucial role in their sustainability. Based on the data published by Klapper, Lusardi, & van Oudheusden (n.d.) the literacy around the world in 2014, clearly witnessed that Indonesia's literacy index is 32, which is lower than Malaysia, Myanmar and Singapore's which achieved 36, 52, 59 respectively in terms of the level of ASEAN countries. This means that MSMEs still have limited access to the financial services, which could assist the sustainability of the business compared to the other neighboring countries mentioned before. Hence, financial literacy becomes the major concern of both governments and financial institutions in achieving economic sustainability from the perspective of financial education and access.

One of the most cogent ways to explain the lack of financial awareness among MSMEs is the complexity in accessing formal finance. This means that the micro-enterprises are still facing some difficulties in applying several products provided by financial institutions. This has been proven by Osei-Assibey (2010a) who found that micro-enterprises prefer easier and faster funds, particularly free funds, rather than be concerned about the cost of borrowing. In other words, not only will micro entrepreneurs depend on the grants funded by the governments but it would also mean avoiding formal finance due to its cost and difficulties. If all MSMEs had more capital through financial instruments, they could develop their business in the future. Thus, the complexity in

applying financial instruments should be measured in an attempt to increase financial literacy.

Turning to the importance of financial literacy, it has obviously been found that some recent studies conducted (Brown, Saunders, & Beresford, 2006; Kojo Oseifuah, 2010) articulated that financial literacy has a significant influence on business performance and entrepreneurship skills. Additionally, Osei-Assibey (2010) concluded that the MSMEs' ability to access formal financial products could accelerate their productivity significantly compared to receiving a package of free money or grant from governments or other social organizations. This means that the illiterate MSMEs will face some stumbling blocks in developing their enterprises. Hence, by understanding financial instruments, the sustainability and the success of micro-enterprises in the future will be better and more positive.

Another advantage of financial literacy is that it is a significant factor in designing a financial decision. This has been observed by Abdullah & Anderson (2015) who found that the financial literacy as it relates to the view of financial products have a meaningful influence on financial decisions. This means that entrepreneurs will not use any financial products, if they did not really understand the value of such instruments. In addition, (Maarten van Rooij, Annamaria Lusardi, & Rob Alessie (n.d.) held that the lack of understanding about economics and finance or low financial literacy has impact on financial decision to invest in stocks. Therefore, a huge number of MSMEs are still illiterate in finance by which they are influenced to decide using formal finance.

Based on the discussion above, this paper will illustrate and explain the level of financial literacy and impact on the sustainability of MSMEs in the East Java Province of Indonesia. This study is motivated by the need to determine the micro entrepreneurs' cognitive ability to understand and use financial information in the context of the business environment in which they operate.

2.2 Literature Review

There have been a plethora of studies regarding the importance of financial literacy. The most cogent explanations related to financial literacy was conducted by Brown et al. (2006) who provided evidence

that the degree of financial literacy has implications for the success or failure of a business community. In addition, Kojo Oseifuah (2010) stated that financial literacy could contribute meaningfully to the level of entrepreneur skills. One of the required skills is the ability in undertaking financial decision-making, which is explained by Abdullah & Anderson (2015) according to whom, financial literacy has a significant impact on financial decision-making, including the decision in selecting Islamic financial products and instruments. Furthermore, the perception about the value of financial products is the most crucial factor in making financial decisions. This has been proven from the research conducted by Maarten van Rooij et al. (n.d.) who explained that the low participation in stock investment is a consequence of the lack of understanding of economics and finance.

Another research discussed the impact of financial literacy on productivity. This has been proven by Osei-Assibey (2010b) who found that the awareness about utilizing formal finance has a significant impact on productivity compared to free money or grants. In other words, too much grant or free money can be counterproductive. In addition, it is found that productivity in the level of MSMEs is influenced by formal finance, technical and managerial advice. Osei-Assibey (2010a) also articulated that micro entrepreneurs prefer an easier and faster access to finance rather than the cost of borrowing.

Regarding factors that cause the level of financial literacy discussed by Mohamed Rosli Mohamed Sain, Mohammad Mafizar Rahman, & Rasheda Khanam (2016), they found that financial literacy causes financial exclusion, which is a process whereby people encounter difficulties accessing and using financial services and products in the mainstream financial system that are in accordance to their needs and requirements. Societal, supply and demand factors remains the common causes of financial exclusion. Another explanation related to this issue can be observed from Lantara & Kartini (2016) who showed that education, gender, economics and business major for university students and the level of income have a positive impact on financial literacy rate. In addition, financial literacy of university students in Indonesia is lower compared to the US and Australia.

Turning to variables related to financial literacy, one of the most crucial elements is budgeting. Uddin & Chowdhury (2009) explained that financial literacy could be determined by budgeting mechanism, in particular, capital budgeting, conducted by MSMEs. A second essential one should be financial records. This issue has been discussed by Sucuahi (2013) who explained that measuring financial literacy can be based on financial records, savings, financing and budgeting in which MSMEs considered such measurements as the downsides of financial behaviour of micro businesses. Additionally, Gupta & Kaur (n.d.) confirmed that the variables mentioned were the downsides of financial behaviour of micro-enterprises and these were record keeping practices, poor cash management, improper saving habits, and less awareness regarding different financial products and instruments which express the level of financial literacy.

2.3 Research Method

The objective of this study was to assess the level of Islamic financial literacy among MSMEs in East Java Province. To meet the objective of this study, descriptive research was carried out. The data was collected from both primary as well as secondary sources. The former was collected through a structured questionnaire. The items included in the questionnaire were based on previous surveys conducted by various researchers. Probing questions were also the part of the instrument used.

The population of this research covered the MSMEs in the province which amounted to 250 micro entrepreneurs, who were selected randomly and which formed the sample for the study. Questionnaires were distributed to all the respondents among which were three respondents who provided incomplete information. So the missing data was corrected by imputing the missing data through statistical a tool package. By doing this the final respondent number that was considered for the result remained at 250.

The collected data was tabulated using Microsoft Excel spreadsheet with appropriate coding. Further, the data was also analysed by using Microsoft Excel. Financial skills of micro entrepreneurs were

assessed using different parameters including record keeping, budgeting, use of accounting information, risk and monitoring and financial report awareness.

2.4 Discussion

Demographic Data

Presented in Table 2.1 is the descriptive statistics of the profile of the respondents taken from MSMEs in the East Java Province. It is clear seen that there are more female entrepreneurs (50.8 percent) compared to to males (49.2 percent). It could be concluded that a higher number of females are involved in enterprises rather than males, who are doing regular jobs with their current occupation as household managers, involved in taking care of children while taking time for entrepreneurial work and focus. Enterprise engagements of the female entrepreneurs would be limited, and the focus shall be directed towards cash flow management.

Table 2.1 :
Sex group of respondents

Sex	<i>Frequency</i>	%
Male	123	49.2
Female	127	50.8
Total	250	100

Source: Field data, 2018

Table 2.2 presents the group of entrepreneurs based on ages. It is clearly seen that about two-fifths (37.6 per cent) of the respondents are between 40 and 49 years of age, about one-thirds (33.6 per cent) are in the 30-39 age bracket, nearly one-fifths (18 per cent) are in the 20-29 years age group and around one in ten (10 per cent) are 50 years and above.

Table 2.2 :
Age group of respondents

Age	<i>Frequency</i>	%
20-29	45	18.0
30-39	84	33.6
40-49	94	37.6
50 and above	27	10.8
Total	250	100

Source: Field data, 2018

Table 2.3 presents the educational level of the respondents. It is observed that a majority (62.8 per cent) of the micro entrepreneurs have secondary level education, and about two-fifths (19.2 per cent) graduated from higher education institutions, and possess diplomas, undergraduate and postgraduate degrees.

Table 2.3 :
Educational background of respondents

Educational background	<i>Frequency</i>	%
Non Formal	3	1.2
Primary School	42	16.8
Secondary School	157	62.8
Diploma	9	3.6
Undergraduate	35	14.0
Postgraduate	4	1.6
Total	250	100

Source: Field data, 2018

It can be observed from Table 2.4 that of the 133 respondents 53.2 percent are enterprise owners, 49 persons (19.6 per cent) are managers, 66 respondents (26.4 per cent) are both owners and managers, and 2 entrepreneurs (0.8 per cent) are others.

Table 2.4 :
Occupational Status of respondents

Occupational Status	<i>Frequency</i>	%
Owner	133	53.2
Manager	49	19.6
Both (Owner & Manager)	66	26.4
Others	2	0.8
Total	250	100

Source: Field data, 2018

Financial Record Literacy

As shown in Table 2.5, financial record literacy is explained through four questions. Firstly, it can be observed from the data that 28.4 per cent of the respondents always record separately their business and personal financial cash flow, 26 per cent of them do not record, while the other categories such as seldom, often and sometimes perform this activity at 14, 15.2 and 16 per cent, respectively.

Secondly, regarding the use of accounting software in operating MSMEs, it is clearly witnessed that the majority, 56.8 per cent of the respondents, never use the accounting application. Thirdly, about one-thirds (35.2 per cent) of the respondents never make monthly income statement, while around one-fifths (20.4 per cent) of them always do. Finally, approximately two-fifths (41.2 per cent) of the respondents never report their financial statement annually, while the other categories are less than one-fifth.

Table 2.5 :
Financial Record Literacy

Financial Record	Frequency			%
	Male	Female	Total	
Business and personal financial cash flow recorded separately				
Never	36	30	66	26.4
Seldom	13	22	35	14.0
Sometimes	18	22	40	16.0
Often	18	20	38	15.2
Always	38	33	71	28.4
Use of accounting software				
Never	70	72	142	56.8
Seldom	9	12	21	8.4
Sometimes	19	19	38	15.2
Often	12	9	21	8.4
Always	13	15	28	11.2
Monthly income statement				
Never	49	39	88	35.2
Seldom	18	15	33	13.2
Sometimes	19	24	43	17.2
Often	16	19	35	14.0
Always	21	30	51	20.4
Annual balance sheet statement				
Never	57	46	103	41.2
Seldom	14	18	32	12.8
Sometimes	18	28	46	18.4
Often	15	15	30	12.0
Always	19	20	39	15.6

Source: Field data, 2018

Budgeting

Regarding budgeting behaviour, it can be observed that a majority of the respondents (40 per cent) plan annual budgeting in operating their enterprises. In addition, around one-third (27.2 per cent) of respondents, seldom generate monthly budgeting, while about a quarter of them never set the monthly budget. Turning to budget preparation, the majority of the respondents are distributed in categories “never, seldom, sometimes” at 30, 33.6, 30.8 per cent, respectively.

Table 2.6 :
Budgeting

Budgeting	<i>Frequency</i>			%
	<i>Male</i>	<i>Female</i>	<i>Total</i>	
<i>Annual Budgeting</i>				
Never	48	52	100	40.0
Seldom	21	27	48	19.2
Sometimes	27	32	59	23.6
Often	13	6	19	7.6
Always	14	10	24	9.6
<i>Monthly Budgeting</i>				
Never	35	30	65	26.0
Seldom	26	42	68	27.2
Sometimes	28	21	49	19.6
Often	16	16	32	12.8
Always	18	18	36	14.4
<i>Having trained accountant in budget preparation</i>				
Never	37	38	75	30.0
Seldom	42	42	84	33.6

Sometimes	36	41	77	30.8
Often	6	2	8	3.2
Always	2	4	6	2.4

Source: Field data, 2018

Use of Accounting Information

Based on the presented data in Table 2.7, it is easily found that a majority of the respondents are in ‘never’ and ‘sometimes’ categories in using financial reports for their business decision making, at 36.4 per cent and 35.2 per cent, respectively. For accounting information utilised for calculating MSMEs environmental cost, about one-third (33.2 per cent) of the respondents never used accounting information for the mentioned purpose, while around a quarter of them always used. Moreover, approximately one-third of the respondents never used the information for tax and zakat calculations.

Table 2.7 :
Use of accounting information

Use of accounting information	<i>Frequency</i>			%
	<i>Male</i>	<i>Female</i>	<i>Total</i>	
<i>Use of financial report for business decision</i>				
Never	42	49	91	36.4
Seldom	20	22	42	16.8
Sometimes	48	40	88	35.2
Often	5	6	11	4.4
Always	8	10	18	7.2
<i>Use of accounting information for environmental cost calculation</i>				
Never	41	42	83	33.2
Seldom	22	27	49	19.6
Sometimes	15	20	35	14.0

Often	7	6	13	5.2
Always	38	32	70	28.0
<i>Use of accounting information for tax and zakat calculation</i>				
Never	49	42	91	36.4
Seldom	23	30	53	21.2
Sometimes	33	41	74	29.6
Often	6	4	10	04.0
Always	12	10	22	08.8

Source: Field data, 2018

Risk and Monitoring

Regarding risk management and monitoring, Table 2.8 illustrates the awareness of MSMEs in maintaining financial management and recording delayed payments. It is obvious that a majority of them are distributed in 'never, seldom, sometimes and always' categories (26.8, 20.0, 26.0, and 21.2 per cent). Hence it can be seen that those who never consider the importance of financial management for business belong to the highest percentages. In contrast, the awareness in recording debtor transaction has a high percentage (38.4 per cent) compared to other categories. This means that many micro-entrepreneurs are aware of the importance of recording the credit transactions.

Table 2.8 :
Risk and Monitoring

Risk and Monitoring	Frequency			%
	Male	Female	Total	
Consideration in the importance of financial management for business				
Never	32	35	67	26.8
Seldom	28	22	50	20.0
Sometimes	30	35	65	26.0

Often	9	6	15	06.0
Always	24	29	53	21.2
<i>Recording debtor transaction</i>				
Never	10	9	19	7.6
Seldom	12	18	30	12.0
Sometimes	29	35	64	25.6
Often	26	15	41	16.4
Always	46	50	96	38.4

Source: Field data, 2018

Financial Literacy

Table 2.9 :
Financial Literacy

Financial Literacy	Frequency			%
	Male	Female	Total	
Confidence in understanding financial statement				
Not at all	33	24	57	22.8
A little	32	13	45	18.0
Not sure	32	49	81	32.4
General understanding	6	7	13	5.2
Very well	20	34	54	21.6
Benefit of accounting information for operating business				
Not at all	10	15	25	10.0
A little	30	27	57	22.8
Not sure	34	38	72	28.8
Useful	34	34	68	27.2
Very useful	15	13	28	11.2

<i>Person in charge for providing financial statement</i>				
Internal staff	97	108	205	82.0
External staff (hired)	16	1	17	6.8
No answer	10	18	28	11.2

Source: Field data, 2018

One of the preferred ways to explore the level of financial literacy achieved can be seen from the following table. Table 2.9 indicates that a majority (32.4) of the respondents are not sure about understanding financial statements. Another variable could be the benefit of accounting information in the management of MSMEs, which amounts to 28.8 per cent of the respondents who are not sure that accounting information benefits the performance of their business.

In addition, regarding the person who provides and generate financial statements, it can be observed that a majority of the respondents (82 per cent) make financial statements with the assistance of internal staffs and employers.

2.5 Findings and Conclusion

Based on the analysis above, the data shows that females are the majority of MSMEs accounting for 50.8 per cent of the total respondents. Around two-fifths (37.6 per cent) are in 40-49 years age group. In addition, about three-fifths (62.8 per cent) have completed the secondary schools level. Also over half (53.2 per cent) are the owners of the MSMEs.

With regard to keeping financial records, it is seen that the majority of the respondents have never kept records of the annual balance (41.2 per cent), monthly income statement (35.2 per cent) and never used accounting software for their business. Even though they have a lower financial record in performance as mentioned, a majority of them could keep personal and business records. Another consideration in this issue is budgeting in which the majority of the respondents never

undertook to perform annual budgeting (40 per cent), 27.2 per cent of them who seldom plan the budget and around one-thirds (33.6 per cent) hired a trained accountant to do their budgeting.

As far as the use of accounting information is concerned, 36.4 per cent of the respondents never used it at all. They also never used the accounting information for calculating environmental studies, tax and zakat. Furthermore, the risk and the monitoring are the most important to be considered. More than a quarter of the respondents (26.8 per cent) never thought of the importance of financial management.

Additionally, related to the data, it is observed that the literacy level of the respondents are still limited. Both variables, the understanding and the benefit provided by financial management, is rated at 32.4 per cent and 53.2 respectively.

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CHAPTER 03

THE ROLE OF MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES) TOWARD SUSTAINABLE DEVELOPMENT GOALS (SDGS) THROUGH ISLAMIC FINANCIAL INSTITUTIONS (IFIS)

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Abstract

Research regarding the relationship between MSMEs, IFIs and SDGs is an interesting topic, and many studies have been conducted on this. However, there are few studies conducted that involved a comprehensive approach. It is therefore the aim of this study which can be viewed from two aspects. The first aspect focuses on the demand perspective: to assess the perceptions and knowledge of MSMEs on their own capacity to access Islamic finance institutions and to identify the reasons why they use or do not use IFIs as a source of financing. The second aspect focuses on supply related matters : to what extent is the role of IFIs to support MSMEs toward SDGs, and what are the possible strategies to deal with the problems related to such issues. This research is basically a descriptive research which uses the mix method. The demand aspect of this study used a quantitative method which involved 384 respondents and semi-structured interviews to select important respondents. The findings reveal that IFIs support MSMEs towards SDGs achievement, in

terms of poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth, and income distribution. Currently, from the demand perspective, the intention to use and access MSMEs to IFIs is still very low, but in the future it could be better, if a strategy is implemented such as financial literacy that improves MSMEs' understanding of the advantages and features of Islamic financial products. Besides that, the role of government concerns support for the regulations and policies. From the supply perspective, the support for IFIs to strengthen the role of MSMEs toward SDGs is also very weak, as the number of IFIs financing, which is available to support MSMEs, is low with an average of just 5% of total financing. However, Islamic microfinance has a good chance of supporting the MSMEs by increasing their capacity, and the role of government is therefore crucial. This study suggests that future research should explore important factors that have an impact on why both sides are very low.

Keywords: MSMEs, IFIs, Development, SDGs, Strategy, Accessibility, Financing.

3.1 Introduction

Many parties expect that the MSMEs can play a significant role in the economic field, especially the economics of Indonesia. Many parties expect that MSMEs can play a significant role in the economic field, particularly in the Indonesian economy. The government also hopes that MSMEs can contribute to sustainable development in Indonesia or play a role in the SDGs (Sustainable Development Goals).

In particular, the Head of BAPPENAS expects MSMEs and entrepreneurs to play a major role in the economy, in particular SDGs, with a view to achieving the objectives of decent work, economic growth and stability, infrastructure, industry and innovation (Bappenas, 2018). The Government has committed itself to establishing SDGs as a platform for economic development that focuses on empowering small and medium-sized enterprises to achieve SDGs because they have a crucial role to play in improving the community's economy, in particular by promoting poverty alleviation and creating a sustainable business environment to achieve SDGs (Pomare, 2018).

Much research has been conducted related to the role of SMEs in economic development, including Hailey's (1991) study which concluded that MSMEs have a role in poverty alleviation and income redistribution including job creation, increased income and output. Besides that, Ng & Kee (2017) stated that MSMEs have the potential for industrial growth. Asmy, Thaker, Mohammed, Duasa, & Abdullah (2016) in their paper stated that MSMEs share in employment. Abdullah & Hoetoro (2011) concluded that MSMEs are the main actors in the domestic economy, encompassing social entrepreneurship and empowering instruments. Caska & Indrawati (2018) found from another perspective that MSMEs have driven economic community activities in an area. Moha Asri Abdullah (2018) stated that MSMEs have driven the halal industrial sector. From the aspect of increasing GDP through MSMEs, research has also been carried out by Tambunan (2011). Furthermore, Pomare (2018) stated that MSMEs applied the goal of ensuring sustainable national consumption and production. In addition, from a broader perspective, Razak, Abdullah, & Ersoy (2018) also asserted that MSMEs have played a significant role in providing economic and social opportunities, new job opportunities, lower unemployment rates, increasing competition, productivity and providing substantial benefits to the economy.

From the description above, it has been shown that the development of the economic growth of a country has been proven by MYMEs. However, no research has been conducted to summarize the above factors in the framework of the SDGs.

In relation to the Indonesian SDGs, it is hoped that the Islamic Financial Institutions (IFIs) can contribute to realizing sustainable economic growth, one of the structures needed to develop MSMEs. Many studies have revealed that IFIs have contributed to MSMEs, including Asmy, Thaker, Mohammed, Duasa, & Abdullah (2016a) which concluded that IFIs through cash waqf are effective sources of financing SMEs. Widiyanto (2016) concluded that MSMEs receiving funding from Islamic Finance had improved their business as indicated by increased sales turnover, number of workers and customers (Farida, 2013; Herianingrum, 2016; Nurrohmah, 2015). Moreover, Okello, Ntayi,

Munene, & Malinga (2017) stated that an increase in access to Islamic Finance facilitates MSMEs to expand and enhance their profitability, productivity and competitive advantage in developing economies. In relation to MSMEs with IFIs, cooperation between institutions is needed in social capital structure (M A Abdullah & Hoetoro, 2011). Furthermore M A Abdullah & Hoetoro (2011) also stated that MSMEs were contributed by the World Business Council for Sustainable Development (WBCSD). However, the above statement is still general, and therefore, it is necessary to elaborate how IFIs support SMEs in realizing SDGs.

Based on the explanation above, this study aims to find out how the role of IFIs to support MYMEs in the implementation of SDGs, from the perspective of MYMEs ' perceptions of access to IFIs, factors that affect MYMEs ' access to IFIs, the role of IFIs in delivering MYMEs to SDGs, and the role of government and business to support these goals.

3.2 Research Objectives And Method

The aims of this study can be categorized by two aspects: the demand side, to assess the perceptions and knowledge of MSMEs on their own capacity to access Islamic Finance Institutions; secondly, the supply side, to identify factors why they use or do not use IFIs as source of financing. The supply side asks the question: What is the extent of the role of IFIs in supporting MSMEs toward SDGs, and what are the possible strategies to deal with the problem related to such issues.

This research is basically a descriptive research which uses the mix method. The first aspect of this study used a quantitative method by involving 384 respondents to complete questionnaires. The sampling method used was purposive area sampling. The supply aspect of this research used semi-structured interviews of selected respondents who were experts in Islamic Finance and who were eligible to evaluate IFIs financing.

3.3 Literature Review

3.3.1 Islamic Approach to Empower Micro, Small and Medium Enterprises (MSMEs)

Micro, Small and Medium Enterprises (MSMEs) have an important role in contributing to economic growth, employment creation, industrialization, wealth creation, output expansion, local resources utilization and adaptation to technology (Hailey, 1991; Razak & Abduh, 2012) which can be reflected in the increase in Gross Domestic Product (GDP) and an increase in the amount of employment (Asmy et al., 2016b; Harif, 2010; Salleh & Abdullah, 2015; World Bank, 2011).

In developed and developing countries, there are many programs to empower MSMEs that have worked well and made significant progress. In general, the objectives of each MSMEs development policy can be categorized into the following categories: For creation of an industry itself; supporting industry; industrial sector reform; and employment (M A Abdullah & Hoetoro, 2011). In addition, Abdullah & Hoetoro (2011) further revealed that the purposes of the strategy to empower MSMEs were to: (a) assist and provide incentives to MSMEs, (b) adjust industrial structures and provide suitable spaces for MSMEs for their survival and opportunities to grow (Zarrouk, Ghak, & Haija, 2017), (c) respond to community needs because businesses can no longer focus solely on profits (Ali & Oseni, 2016), and (d) attention to individual and social balance (Mohtsham, 2007).

Muslim entrepreneurs must have a vision that they no longer produce products at the minimum quality level, but they must strive to do their best in producing high-quality products at reasonable prices (M A Abdullah & Hoetoro, 2011). Mohtsham (2007) has explained the main elements that shape the vision of Islam, and they are, among others: clarity of direction; ambition, motivation and enjoyment; memory; relevance to customers; truth; community needs; and vision sharing. Islamic finance requires a good and facilitative legal framework so that it can operate effectively, with adequate recognition, support, and legal protection to support MSMEs (Hassan, Kayed, & Oseni, 2013).

Figure 3.1 below illustrates how Islam influences MSMEs' vision which directs business objectives to fulfill the needs of MSMEs especially, and the community or society, in general.

The role of Islamic values as contributing to the development of MSMEs is implemented in accordance with the Islamic vision of Muslim entrepreneurs i.e. producing products with high quality and at reasonable prices, and serving the needs of the people. In addition, MSMEs need a favorable institutional framework in order to develop steadily, especially since only a few MSMEs have the financial or human resources needed to handle their operational burdens.

One initiative in an effort to create a profitable institutional framework for MSMEs has been contributed by the World Business Council for Sustainable Development (WBCSD). This institution has established an institutional framework to empower MSMEs' development that can be implemented by the government and the business sector (M A Abdullah & Hoetoro, 2011; Ali & Oseni, 2016; Hassan et al., 2013).

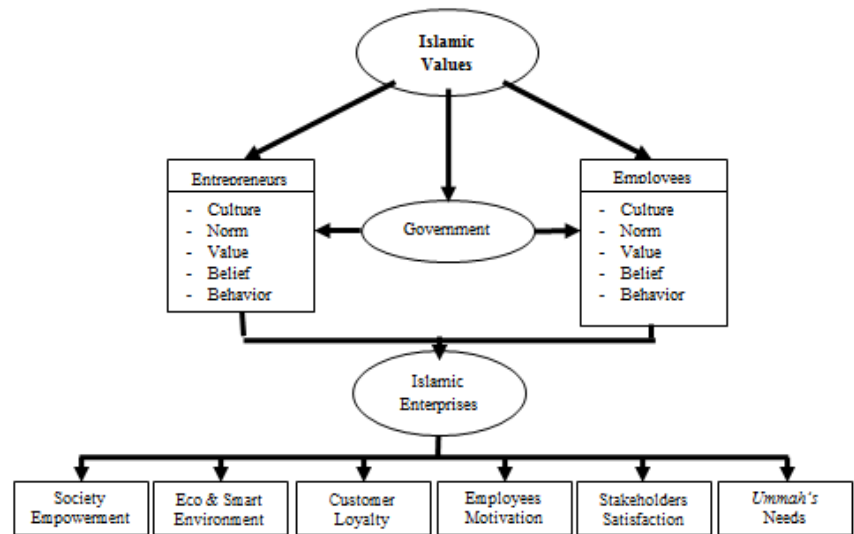


Figure 3.1. The Role of Islamic Values in MSMEs Development
Source : Adopted from Abdullah & Hoetoro (2011)

These initiatives are beneficial for institutions that support Islam in an effort to empower MSMEs through the Islamic approach. Thus, Islamic financial institutions and business development services are expected to be able to contribute and work together, side by side, to implement the initiative, while other supporting institutions are trying to strengthen MSMEs and also to direct the activities of MSMEs to realize people's welfare in general.

3.3.2 The Role of MSMEs to Sustainable Development Goals (SDGs)

SDGs and MSMEs, seen from the aspect of mission, indirectly have close economic and social relations (George, Howard-Grenville, Joshi, & Tihanyi, 2016; United Nation, 2017a, 2017b). SDGs, which are driven by the United Nations, are believed to be very important to address global economic and social challenges faced by today's international and national employers (United Nation, 2017a, 2017b).

In the implementation of the SDGs that were previously MDGs (Millenium Development Goals), data availability has been improved, but better data is still needed. To overcome this, High Level Panel of Eminent Person (HLPEP) suggested a data revolution. The core of the data revolution includes two things, namely, the integration of statistics in the public and private sectors and the building of trust between the public and the government through transparency and accountability. In Indonesia, the implementation of the MDGs has provided positive change. Although there are still a number of MDGs' targets that still need hard work to be realized, , yet many targets have shown significant progress.

According to the Central Bureau of Statistics (BPS, 2015), Indonesia has a new challenge to realize the SDGs. The SDGs have 17 goals, 169 targets and 240 indicators. One of the objectives of the SDGs is to promote Inclusive and Sustainable Economic Growth, Employment and Decent Work for all where MSMEs take part in achieving these goals. MSMEs have a crucial role in fostering the economy of the community, especially in supporting poverty alleviation and creating a sustainable business environment in realizing the SDGs.

Previous research has shown that MSMEs have played a role in SDGs in social contexts (George et al., 2016; Lumpkin, Moss, Gras, Kato, & Amezcua, 2013). Lumpkin et al. (2013) have shown that correlation exists between four antecedents (mission/social motivation, identification of opportunities, access to resources/funding, and various stakeholders) and three outcomes (i.e. social value creation, sustainable solutions, and satisfying many stakeholders) as well as five MSMEs' orientation dimensions (innovation, proactive, risk taking, competitive aggressiveness, and autonomy) (Lumpkin & Dess, 2015). Governments, regulatory parties, and other non-governmental organizations have a role in utilizing the SDGs and the performance of MSMEs. They must increase the sensitivity of MSMEs toward SDGs and the contribution of stakeholders (Pomare, 2018).

Pickernell, Jones, Thompson, & Packham (2016) offered insights for the determinants of the success of MSMEs. Pickernell et al. (2016) showed that the determinants of the success of MSMEs include (1) the industrial sector; (2) MSMEs age; (3) characteristics of owners and managers; and (4) MSMEs' resources (human resources, technology, and intellectual property).

MSMEs tend to sort out social and commercial logic as the core of its function (Pomare, 2018). Acs, Boardman, & McNeely (2013) stated that the success of MSMEs comes from social motivation, highly innovative efforts that are able to create significant economic values (Acs, Audretsch, Lehmann, & Licht, 2016). Other research has indicated that a determinant factor of MSMEs' success is to focus on a strategy (Hockerts, 2015), the practice of governance, leadership style (Maak & Stoetter, 2012) and the internal processes (Acs et al., 2016). In addition, sustainable orientation also plays an important role in improving the performance of MSMEs (Leonidou, Christodoulides, & Thwaites, 2016).

In implementing the policies of MSMEs, the Indonesian government has set out eight main focuses i.e., funding, innovation, internalization, workforce training, training management, entrepreneurship, programs for specific target groups, and procurement

of public goods and services (Bank Indonesia, 2017). Thus, it is expected that MSMEs in Indonesia can continue to be supported to strengthen community-based welfare. As a result, MSMEs, in relation to the SDGs, can become a pillar in creating various products and services needed by the community in order to improve the quality of their living standards (Bank Indonesia, 2017; Caska & Indrawati, 2018; Ng & Kee, 2017; Pomare, 2018; Tambunan, 2011; Zarrouk et al., 2017).

3.3.3 The Role of Islamic Financial Institutions (IFIs) to MSMEs

The World Bank (2013) declared that knowledge and financing have helped MSMEs gain access to financial services in order to be able to manage risks and grow so that they can create jobs and increase income.

MSMEs have many development challenges, ranging from product marketing to capital problems (Irmawati, 2013). High credit interest rates and the need for material guarantees are one of the factors that cause MSMEs to experience difficulties in obtaining business capital. The existence of profit-sharing financing products offered by IFIs can help the growth of the MSMEs' sector to work optimally (Okello et al., 2017; Tambunan, 2011; Yusuf, Shirazi, & Abdullah, 2016; Zarrouk et al., 2017). In addition, there is a need for a financial inclusion for MSMEs, so that, the capital problems can be resolved early, because, currently, more than 40% of MSMEs are still financially excluded.

IFIs, especially Islamic banking, is one of the financial institutions whose role is highly demanded by MSMEs because there are more funds available in Islamic banks compared to microfinance institutions such as *Baitul Mal Wat Tamwil* (BMT) and Islamic financial services cooperatives (KJKS). This happens because, operationally, these two institutions have very close relationships (Rini, 2017; Zamroni, 2013).

Islamic financial institutions have developed several financial products in accordance with Islamic values and principles. Many of these instruments are based on equal participation, deferred payments and

interest-free loans (M A Abdullah & Hoetoro, 2011). IFIs provide the same contribution to the financial system and the economy by combining ethical and moral values in its financing mode, motivating Muslims to mobilize funds and providing external resources for venture capital. Through a profit and loss sharing mechanism, its impact on economic development has the potential to become more important. Islamic financial institutions offer capital loans for the production process and with instruments aimed at contributing to the company's capital (Zarrouk et al., 2017).

Through these instruments, Islamic financial institutions pursue specific goals, namely, to support a holistic approach in supporting business and entrepreneurship; productive activities; and risk management. In addition, Islamic financial institutions also pursue Islamic religious principles that mandate social responsibility and assistance for those in need (M A Abdullah & Hoetoro, 2011; Zarrouk et al., 2017). An Islamic finance operating mechanism is shown in Figure 2.

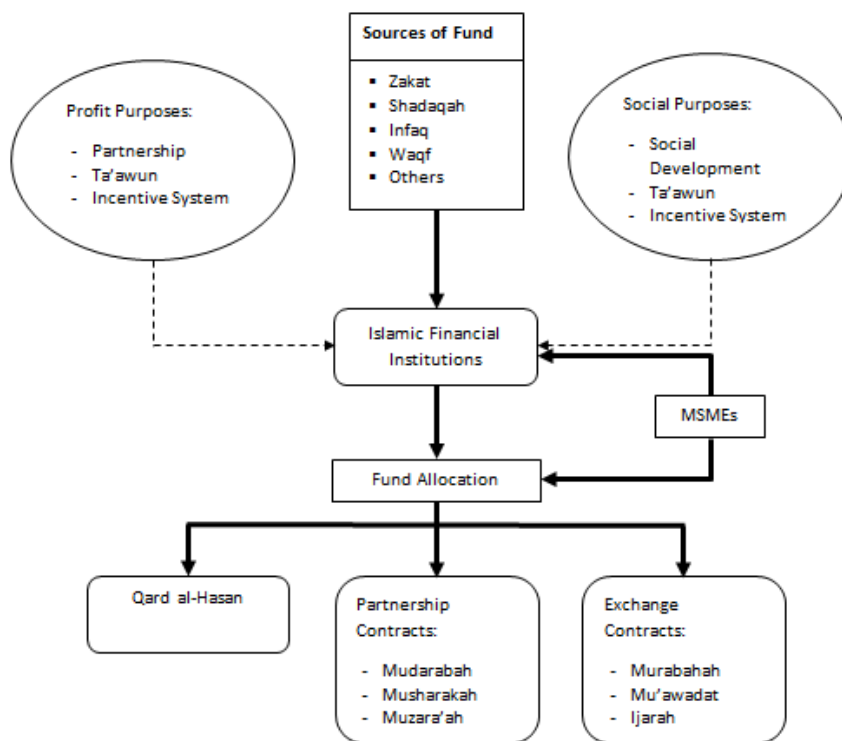


Figure 3.2. Islamic Financing in MSMEs Setting

Source: Abdullah & Hoetoro (2011)

The Islamic finance serves as a financial intermediary for MSMEs to build local structures that help MSMEs to grow progressively (Mahmood, Fatima, Khan, & Qamar, 2015).

Nevertheless, the problems that arise in this effort may not be fully related to policy, access to capital, and entrepreneurial skills. There are also social details that must be considered such as problems related to the level of distrust and lack of cooperation between MSMEs which have the potential to reduce the benefits of financial support for empowering MSMEs itself (M A Abdullah & Hoetoro, 2011; Ali & Oseni, 2016; Alom, Abdullah, Moten, & Azam, 2016).

Several empirical studies conducted on IFIs have assessed the performance and stability of IFIs compared to conventional ones (Arbi, Basov, & Bhatti, 2014; Basov & Bhatti, 2014; Hanif, Tariq, Tahir, & Momeneen, 2012; Hasan & Dridi, 2010; Mansor, Bhatti, & Ariff, 2015). There are several studies that analyze the correlation between IFIs and economic growth. Furqani & Mulyany (2009), for example, have examined the dynamic interaction between Islamic banking and MSMEs. Abduh & Chowdhury (2012) also analyzed the long-term and dynamic relationship between the development of Islamic banking and the growth of MSMEs.

Other research also confirmed that there is a positive and significant correlation between the ease of access to IFIs and the growth of MSMEs in the long and short term. According to Widiyanto (2016), based on the results of his research, it was also concluded that MSMEs receiving funding from IFIs, experienced business improvements as indicated by increased sales turnover, number of workers and number of customers (Farida, 2013; Herianingrum, 2016; Martiana, 2014; Nurrohmah, 2015).

3.3.4 SMEs Intention to Use or to Access IFIs services

Islamic financial institutions have enormous potential in the economy (M A Abdullah & Hoetoro, 2011), especially in the Islamic banking system, which is very suitable for developing MSMEs that have a strategic role in driving national economic development. One example is to increase the accessibility of financing, which is to provide easier requirements and to conduct training and business assistance. Islamic banking is expected to continue to grow in empowering MSMEs (M A Abdullah & Hoetoro, 2011; Bank Indonesia, 2017). Therefore, the contribution of Islamic banking in the development of MSMEs is expected to run more optimally (Okello et al., 2017; Pomare, 2018; Tambunan, 2011; Yusuf et al., 2016; Zarrouk et al., 2017).

The study on the role of the IFIs towards MSMEs in theory and in most research supports the research of Abduh & Chowdhury (2012). This study concluded that in the long and dynamic term there is a significant

correlation between the development of Islamic banking and the growth of MSMEs. This research also emphasized that if MSMEs have easy access to IFIs, the growth of MSMEs in the long and short term will increase.

In supporting MSMEs, the government has a policy which continues to expand access to bank loan products, so that business people no longer need to borrow from relatives, families or loan sharks. However, most government support is still limited to conventional schemes, while Islamic-based financing scheme is still very limited (Kartiko, 2019). On the other hand, it will be seen how the MSMEs intend to use and access the IFIs according to the research conducted.

Based on research conducted by Rasheed, Siddiqui, & Rahman (2018), it is stated that a large number of MSMEs in North Africa, the Middle East and South Asia prefer Islamic financial products rather than conventional ones. However, unlike in Pakistan, lack of financial knowledge or awareness of Islamic financial products makes it difficult for MSMEs to identify and determine the financing options available for their business financial needs. Thus, this study focused more on determining the importance of awareness factors in influencing the intention of MSMEs' owners in adopting Islamic finance in meeting their business financial needs. Furthermore, the results of this study are expected to be the basis for more structured research, on the issue of financing from the adoption of Islamic financial products for MSMEs.

Meanwhile, the research conducted by Lajuni, Wong, Yacob, Ting, & Jausin (2017) found that the perception of MSME owners of certain products will lead to their intention in choosing products especially related to financing products of IFIs. This research extends the scope of the existing literature by providing insights on the subject matter in developing countries to direct MSMEs to banking services, so as to be able to provide better services to their customers. Based on the results of the study, it can be stated that the presence of attitudes, government support, and social influence on MSMEs have a clear and predictive capacity to direct their intention to use Islamic banking products.

In addition, research conducted in Malaysia (Jaffar & Musa, 2014), confirms that MSMEs' knowledge of IFIs greatly influences the intent to use and access IFIs' services. Another factor is the level of religious (Islam) understanding, namely, whether or not using IFIs is an obligation. The reputation and trust of the IFIs has also greatly determined the decision of MSMEs, meaning that the more trustworthy the IFIs, the higher will be the intent to use IFIs by MSMEs. Besides, MSMEs in using IFIs, also pay attention to business calculations which are important factors, as there is consideration of cost-benefits, meaning that, if it is profitable on a business basis, IFIs will be used, but if it is not, then MSMEs prefer not to use IFIs. Therefore the policy maker must pay attention to these matters so that MSMEs' access to IFIs becomes easier.

Based on the studies mentioned, it can be concluded that MSMEs actually have the desire to access and use IFIs if:

1. MSMEs have a fairly good knowledge of IFIs
2. MSMEs have the awareness to use Islamic financial products
3. There are attitudes, government support, and social influences on MSMEs to use IFIs
4. MSMEs have a good level of understanding of the Islamic religion, so they prefer IFIs to conventional financial institutions
5. Reputation and trust of IFIs are good enough to influence MSMEs to use and access them.
6. Consideration of the calculation of business profits by MSMEs that are considered more profitable using IFIs than conventional financial institutions.

3.4 Findings And Discussion

The size of Micro, Small and Medium Enterprises (MSME) markets in Indonesia raises the question of how Islamic financial institutions take opportunities to be involved in the markets as capital providers which are fairer and in accordance with Islamic provisions as a religion adopted by the majority of the people in Indonesia.

The analysis divides this study into two key aspects, namely, the demand side, that observes the role of current Islamic financial institutions, by looking at various aspects, such as the utilization of MSMEs and the understanding of MSMEs actors on Islamic-based financing products. Then conducting an observation in terms of public responses to the services provided by those Islamic financial institutions, which is seen from the ease of access. The second part of the analysis looks at the supply side which includes the capabilities of the IFIs to support SMEs toward SDGs. The question is, to what extent the IFIs support MSMEs toward SDGS?

Demand Sides Analysis : The Roles and The Opportunities of IFIs as a Source of Capital for MSMEs

Capital is an important part believed to be able to improve business continuity. This was conveyed by 123 respondents, out of a total of 252 respondents, who answered about the issue of related assistance needed for business continuity (code C open question. Finance Number 20). MSMEs' actors also emphasize the types of capital requirements they need.

Based on the results of interviews with 374 respondents, an overview was obtained by this study concerning the forms of funding sources, which were most widely used by MSMEs' actors, from the initial business establishment to future plans to re-anticipate funding needs.

Based on the table, it can be seen that MSMEs actors tend to use their own funds (personal savings) to run their businesses. The second source of funds is from bank loans which have been well known to almost all Indonesians, both from the upper class and lower class society. Particularly with the existence of government programs through banking institutions, such as People's Business Credit (KUR) for small and medium-sized communities, in particular businesses, making bank financial products in the form of loans is becoming the most sought-after source of external financing.

Table 3.1 :
Decision on the Utilization of Indonesian MSME Funding Sources

Types of Capital Sources		Initial	Current	Future Plan
		Number	Unit of (n)	MSMEs
Internal Sources	Personal Saving	202	191	130
	Family Loan (Relative Loan)	77	29	18
External Sources	Bank Loans	137	96	89
	Cooperatives	26	29	33
	Microfinance Institutions	12	9	23
	Crowd-Fund	2	3	23
	Rotating Saving Loan Scheme	4	5	18
	Non-governmental organization	8	4	21
	Registered Moneylenders	4	5	14
	Moneylenders Not Registered	9	2	14
	Others	1	1	1
Total		482	374	384

Source: Primary Data Processed (2019)

Even so, MSMEs actors have different ideas as time passes by, they have a tendency to no longer use their own funds or utilize conventional banking facilities. This can be seen from the decline in the use of their own funds and bank loans by MSMEs actors in meeting current capital needs, MSMEs actors even tend not to plan maintaining the source of these funds in the future. On the other hand, the interest in utilizing microfinance institutions and cooperatives has increased

slightly. Although the number of Islamic and cooperative financial service users is still low, MSMEs actors see the funding source as a better alternative, and therefore, they have plans to utilize Islamic financial products as a source of their capital.

Utilizing Islamic Financial Products by MSMEs Actors

The low utilization of financial resources through IFIs is one which is based on the lack of MSMEs actors' understanding about the existence of Islamic-based financing in Indonesia. This can be based on the new existence of IFIs in Indonesia, which was first initiated by the establishment of *Bank Muamalat* Indonesia in 1993. The following table presents the MSMEs actors' understanding about the differences between conventional and Islamic finance.

Table 3.2 :
MSMEs Actors' Understanding and Behavior on Islamic-based Funding

Awareness of differences in Islamic and conventional financing	155 (not so aware)	76 (not aware)	87 (not sure)	30 (sure)	26 (very sure)
Plan to use Islamic funding	4 (surely no)	57 (no)	156 (not sure)	90 (yes)	20 (very sure)

Source: Primary Data Processed (2019)

Based on the results of processing the respondents' data, it is known that only 26 MSMEs actors really understand the difference between Islamic-based and conventional financing while the majority of MSMEs do not really understand the difference between the two patterns of financial products. This is further strengthened by only 24 respondents who have experience utilizing Islamic financial products, while 281 others stated in their answers that they do not even have any experience with Islamic financial institutions (Questionnaire number 18, Part C. Finance). This may also be the reason why many MSMEs have not yet

regarded Islamic financial products as a source of their capital (statement 2. in Table 2, about Plans to use Islamic funding).

Strategy of the Role of Optimization of Islamic Financial Institution

The use of capital is not only seen from where the fund sources will be, but from how to get the funds. This is also a concern for MSMEs to get capital which is not only light in accordance with their expectations, but also easily accessible.

Table 3.3 :

Accessibility of Capital Resources based on Types of Funding Sources

Types of Capital Sources	Accessibility				
	1 (Difficult to Access)	2 (Fair)	3 (Neutral)	4 (Accessible)	5 (Satisfying)
Personal Savings	15	10	43	113	109
Bank Loans	27	16	78	103	63
Family Loan (Relative Loan)	20	33	74	61	42
Cooperative	37	33	88	52	22
Microfinance Institutions	55	34	66	30	17
Non- governmental organization	79	40	41	16	7
Rotating Saving Loan Scheme	94	17	46	10	6
Registered Moneylenders	107	17	33	5	9
Moneylenders Not Registered	107	16	34	6	9
Crowd-Fund	99	44	39	12	3
Others	1	0	0	0	2

Source: Primary Data Processed (2019)

MSMEs actors have experience in searching funding sources, and the majority feel that it is easier to fulfill the capital needs using their own savings. This can be understood from the fact that the majority of MSMEs belongs to the Micro Business groups, with assets of less than IDR. 50,000,000, or a total turnover per year of less than IDR. 300,000,000.

Table 3.4 :
Profile of MSMEs based on Business Groups

Business Groups	Based on Total Assets	Based on Total Turnover per Year
Micro business	168 MSMEs	261 MSMEs
Small business	143 MSMEs	109 MSMEs
Medium Business	63 MSMEs	43 MSMEs
TOTAL	374 MSMEs	374 MSMEs

Source: Processed Primary Data (2019)

Notes:

- Micro Business Category: Total Assets <IDR. 50,000,000,- or Total Turnover <IDR. 300,000,000,-
- Small Business Category: Total Assets between IDR 50,000,000,- to IDR 500,000,000,- or Total Turnover between IDR 300,000,000,- to IDR 2,500,000,000,-
- Medium Business Category: Total Assets> IDR 10,000,000,000,- or Total Turnover> IDR 50,000,000,000,-

Table 3.5 :
Profile of MSMEs based on the form of business

Form of Business	Number of businesses
Cooperative	5 MSMEs
Limited Liability Company (Private)	20 MSMEs
Partnership	20 MSMEs

CV	329 MSMEs
TOTAL	374 MSMEs

Source: Processed Primary Data (2019)

Based on Table 3.4 which concerns business grouping based on size, it can be concluded that the majority of MSMEs in Indonesia are still in the micro category, that is, with total assets of no more than IDR 50,000,000,- and a total turnover of less than IDR. 300,000,000.- With small business assets, and if this is not supported by other assets owned by business actors, MSMEs will find it difficult to obtain financing from banks because of weak guarantees. Furthermore, more business status are as CV or *Commanditaire Vennootschap*, which make business records, especially the recording of financial statements, does not have to be neat and structured according to standard in general (Indonesian tax law states companies with a turnover of less than IDR 4,800,000,000,- are not required to do bookkeeping). Instead, by upholding neat and complete bookkeeping, it will be able to improve the bank's assessment of these MSMEs, and the opportunity for MSMEs to obtain financing from the banking sector will be easier.

Therefore, it is not surprising that the existence of Islamic banking is still very small in the MSMEs environment, which is, not only due to its status as a newcomer to the funding source group, but also due to various weaknesses possessed by MSMEs, in being able to access Islamic financial institutions, which still have many requirements (homework) to be fulfilled. Moreover, the MSMEs capital needs are dominated by expectations of low-cost capital, while this is slightly contrary to the responsibility of the banking sector which is not only tasked as a stimulant in the business sector, but also tasked with sharing attractive benefits for their customers as the main source of funds managed by banks (third party funds).

Intention to Use and Access IFIs Products and Services

It has been explained in the previous sub-chapters that the understanding of MSMEs actors on Islamic financial products and IFIs are still very

low. The intention to use and access IFIs services is respectively 3.125% in the beginning, 8.85% currently, and 9.89% in the future. This reflects a very weak condition, in terms of the potential of MSMEs to use and access IFIs.

However, in the future it is predicted that the response will be much better, if they have treated by Islamic financial literacy programs, related the features of IFIs products and services. As for the types of Islamic financial products, the opportunities for using Islamic financial products can be described as follows.

Table 3.6 :

Interest in the Use of Islamic Financial Products based on the Agreement

Types of Product	Initial	Current	Future Plan
<i>Musyarakah Mutanaqisah</i>	3	1	4
<i>Ijarah</i>	1	4	6
<i>Kafala</i>	-	3	3
<i>Mudharabah</i>	5	6	11
<i>Murabahah</i>	-	8	3
<i>Musyarakah</i>	2	4	6
<i>Qard Hassan</i>	1	5	2
<i>Sukuk</i>	-	3	3
Others	-	-	-
TOTAL	12	34	38

Source: Processed Primary Data (2019)

Meanwhile, if it is evaluated based on the realization process of using Islamic-based funds, it can be shown in the accessibility table as follows.

Table 3.7 :
Perception of Accessibility for Utilization of Islamic Financial Products
by MSMEs Actors

Types of Product	Accessibility				
	1 (Difficult to Access)	2 (Fair)	3 (Neutral)	4 (Accessible)	5 (Satisfying)
<i>Musyarakah</i>	2	2	9	4	0
<i>Mutanaqisah</i>					
<i>Ijarah</i>	1	1	10	5	1
<i>Kafala</i>	1	1	9	5	0
<i>Mudharabah</i>	1	2	9	12	2
<i>Murabahah</i>	1	1	6	5	4
<i>Musyarakah</i>	1	2	6	5	1
<i>Qard Hassan</i>	2	1	7	4	2
<i>Sukuk</i>	3	2	6	3	1
Others	0	0	0	0	0

Source: Processed Primary Data (2019)

Based on the table, 38 respondents used IFIs (just 9.89% from total), mostly they used the murabaha skeme or buying and selling contracts. This is further strengthened by the perception of MSMEs that felt that Islamic financial products with *murabahah* contracts were the easiest to reach, followed by Islamic financial products based on cooperation i.e. *mudharabah*.

The most favourite financing products also refer to the business patterns owned by MSMEs actors, where the majority are businesses in the trade or service sectors, followed by business in the consumerism and industry sectors.

Table 3.8 :
MSME Group based on Business Sector

TYPES OF SECTOR	
1 Consumer	97
2 Constructions	2
3 Hotel and Tourism	3

4 Industrial	64
5 Mining	0
6 Plantation	10
7 Properties	7
8 Technology	3
9 Trading/Services	177
10 Transportation	11
11 (Type)	0
TOTAL	374 (MSMEs)

Source: Calculated Primary Data (2019)

By understanding the business sectors that are most in demand for MSMEs, as well as the preferences of MSME actors, by using Islamic financial products based on their contracts in the future, Islamic banks are encouraged to formulate appropriate strategies for offering product schemes that are relevant to the needs and interests of MSME actors.

As for the majority of the weaknesses of MSMEs, which relate to collateral which may not necessarily fulfill banking requirements, as well as the completeness of providing needed administrative information such as recording and bookkeeping reports which are acknowledged by MSMEs actors as their shortcomings in managing the business, this weakness can be addressed in two ways, and they are by providing appropriate scheme Islamic financial products, and related training.

The Strategies of IFIs to Strengthen Their Role in MSMEs in Indonesia

Basically, the need for increased financial skills in MSMEs is not fully related to Islamic finance, but if IFIs can capture the opportunities of this form of da'wah, it is not impossible to further introduce Islamic-based financing schemes to MSMEs actors (one of the problems is that Islamic financial inclusion is still low among MSMEs). Moreover, the good and positive opportunities of Indonesian MSMEs actors towards Islamic-based financing products can also be considered.

Aside from the importance of training to improve the understanding of MSMEs actors regarding capital fulfillment strategies, as voiced by 123 of the 252 respondents who answered open questions, the importance of financial management education is also stated by the majority of 374 respondents. The financial training needs are not only needed for current business conditions, but also for the future (sustainable training).

Table 3.9 :
Training Needed by MSMEs for Current Conditions

CURRENT NEEDS						
	<i>1 Definitely NO</i>	<i>2 No</i>	<i>3 Not Sure</i>	<i>4 Yes</i>	<i>5 Definitely YES</i>	<i>TOTAL</i>
<i>Finance</i>	3	35	48	195	93	374
<i>HR</i>	3	42	60	184	85	374
<i>IT</i>	4	37	56	192	85	374
<i>Marketing</i>	3	51	87	151	82	374
<i>Product Dev</i>	9	35	57	178	95	374
<i>Operational Management</i>	5	40	69	172	88	374
<i>Quality Dev</i>	4	32	53	186	99	374
<i>R&D</i>	5	35	71	169	94	374
<i>Sustainability</i>	6	37	89	160	82	374
<i>Others</i>						0

Source: Processed Primary Data (2019)

Table 3.10 :
Training Needed by MSMEs for the Future

Future Needs						
	<i>1 Definitely NO</i>	<i>2 No</i>	<i>3 Not Sure</i>	<i>4 Yes</i>	<i>5 Definitely YES</i>	<i>TOTAL</i>
<i>Finance</i>	4	28	46	143	153	374
<i>HR</i>	2	34	54	151	133	374
<i>IT</i>	4	31	47	148	144	374
<i>Marketing</i>	4	47	64	124	135	374

<i>Product Dev</i>	5	36	51	140	142	374
<i>Operational Management</i>	1	42	56	147	128	374
<i>Quality Dev</i>	6	31	46	146	145	374
<i>R&D</i>	4	39	56	131	144	374
<i>Sustainability</i>	8	45	70	119	132	374
<i>Others</i>						0

Source: Processed Primary Data (2019)

The product scheme in accordance with the needs of MSMEs refers to various weaknesses possessed by MSMEs (the gap between MSMEs that need capital, and Islamic banks as the owners of capital), is strengthened by the opportunity for IFIs to enter the MSMEs market share when MSMEs actors feel the saturation of conventional financing sources and expect a more equitable funding source, such Islamic financial products.

The results of the analysis of the opportunities for Islamic financial products to enter the MSMEs market share in Indonesia can be summarized in the form of a SWOT analysis table (Strength, Weakness, Opportunity, and Threat).

Table 3.11 :

SWOT Analysis of Islamic Financial Institutions in MSME Market Share in Indonesia

STRENGTHS <ul style="list-style-type: none"> • Flexible Islamic financial product scheme (based on contract) • Schemes of Islamic financial products that are in accordance with Islamic principles (fairer) 	WEAKNESSES <ul style="list-style-type: none"> • Market inability (MSMEs) to fulfill the qualifications of prospective debtors (collateral and completeness of business reports) • Tremendous lack of understanding of MSME actors towards the existence of Islamic financial institutions
OPPORTUNITIES <ul style="list-style-type: none"> • Market saturation towards conventional loans • Positive response of market regarding Islamic financial products 	THREATS <ul style="list-style-type: none"> • Other cheaper financial products • Other more accessible financial products

Source: Personal Document (2019)

The Arrangement of Islamic Financing Product Schemes

Some literature has conveyed the weaknesses of credit through banks by MSMEs actors. This weakness is related to the lack of a form of guarantee for credit application.

Solutions

- Contracts such as asset-based finance capital (OECD, 2015) to fulfill the requirements for collateral which can use the new asset
- Collaboration with Islamic Micro-finance institutions which have faster accessibility and simpler fulfillment requirements
- Collaboration with social institutions such as ZISWAF institutions to provide low-cost financing. This collaboration is intended for Micro Enterprises with a choice of 2 schemes; 1) qardul hasan financing which only needs to return the principal, and there is an obligation to pay ZISWAF, 2) financing at a very low cost because it is not profit-oriented.

Supply Side : The Role of IFIs in MSMEs in the SDGs Terms

The role of IFIs in MSMEs in realizing SDGs is described as follows:

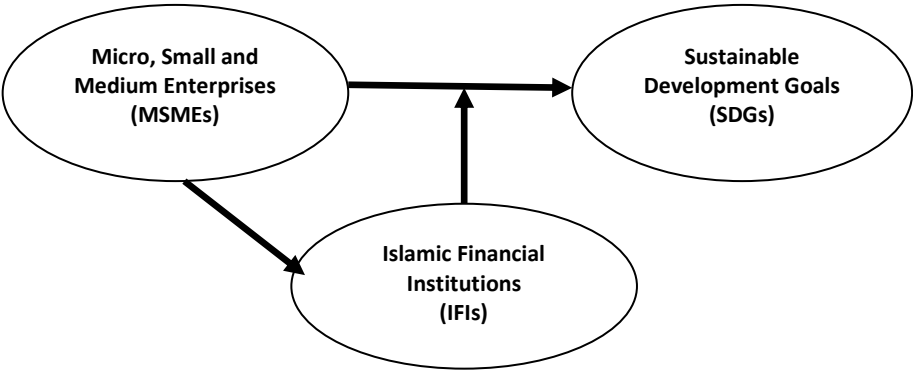


Figure 3.3. The Role of IFIs on MSMEs in the SDGs terms

From the figure above, it can be explained that IFIs can help MSMEs towards SDGs from the aspect of supply with indicators of SDGs achievement, and these indicators are: poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth, and income distribution. Therefore, several Islamic financial analysts have carried out interviews to assess this.

In relation to the potential, commitment and implementation of IFIs to develop MSMEs in achieving SDGs, based on the results of the interviews, several conclusions were drawn as follows:

1. Whatever it takes, IFIs (Islamic Banks, Islamic capital markets, Islamic mutual funds, etc.) are business institutions that place financial benefits as the main consideration in the decision to finance, or not to finance MSMEs.
2. There's a possibility that there is a greater chance of financing MSMEs. Therefore, in Indonesia, IFIs are still reluctant to channel their funding to MSMEs with that in mind.
3. IFIs are more impartial to large companies than MSMEs. The fact is that if IFIs have funds of USD 1 million, for example, IFIs prefer to channel funds to several large companies rather than channel their funds to 1000 MSMEs. This is because the large entrepreneurs are more able to make profits and are more secure in paying back loans than MSMEs.
4. According to the facts, assistance to 1000 MSMEs can enhance the economy of the people better, and at the same time, help to equalize income. But, in fact, the IFIs prefer the issue of economic growth through helping several large entrepreneurs. This goal can be achieved if there is government intervention in the form of support with regulations and laws. Yet, until now, this has not been available quite well and even seems that the government is willing to help MSMEs because there are certain political purposes, for example, when there is a general election coming up.
5. If MSMEs obtain assistance and empowerment based on Islamic values, the MSMEs can realize the objectives of the SDGs, such as

poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth, and more equitable income.

6. However, the Islamic Microfinance (*Baitul Mal wat Tamwil* / BMT) several decades ago had a large capacity or potential in helping MSMEs in both financing and empowerment. However, currently, with the elimination of subsidy from government to Islamic microfinance interest, such support has vanished/reduced. Even now many BMTs are collapsing because they are unable to compete with conventional credit institutions formally or informally.
7. Many BMTs have failed due to tax debt problems. Therefore, it can be said that the support of IFIs in realizing MSMEs towards the SDGs is still far from expectations.
8. Basically, there is a hope that Islamic microfinance has a cheap source of capital from *zakat* and *waqf* originating from the community. This is based on prepositions if Islamic microfinance gets cheap funding sources, the ability to empower MSMEs towards SDGs is more powerful.
9. The government has not provided strong support to increase the collection of *zakat* and *waqf* through BMT. If the government conducts socialization and ease of service, the people, especially those with middle income, will choose this method rather than go to the Umrah or Hajj many times.
10. In fact, there is an opportunity to increase BMT in helping MSMEs in the digital era 4.0, and this is through Equity crowd funding model. In this model, BMT is given the right to raise funds from the public to finance MSMEs with a profit-sharing system.
11. Besides, with the Block chain system, the fundraising model to finance MSMEs becomes much larger because, in the digital era, based on block chain, investor relations with customers can be direct and very efficient and do not require a third party.
12. However, the government's support and concern in this case is felt to be lacking.

Based on some of the points mentioned above, it can be concluded that IFIs' support for MSMEs in Indonesia has not been carried out systematically and has tended to decline lately. Thus, it can be

said that the role of MSMEs is still low in terms of realizing the SDGs in terms of poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth, and income distribution. It can therefore be said that the role of MSMEs in achieving the SDGs is still low in terms of poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth and income distribution.

However, there are significant opportunities if Islamic values are implemented in the community, especially in terms of helping and cooperation. This is where the role of the government becomes important in accordance with the principle of the first principle of the Pancasila, namely the notion of a state based on One Supreme God with the obligation to carry out Islamic for Muslims.

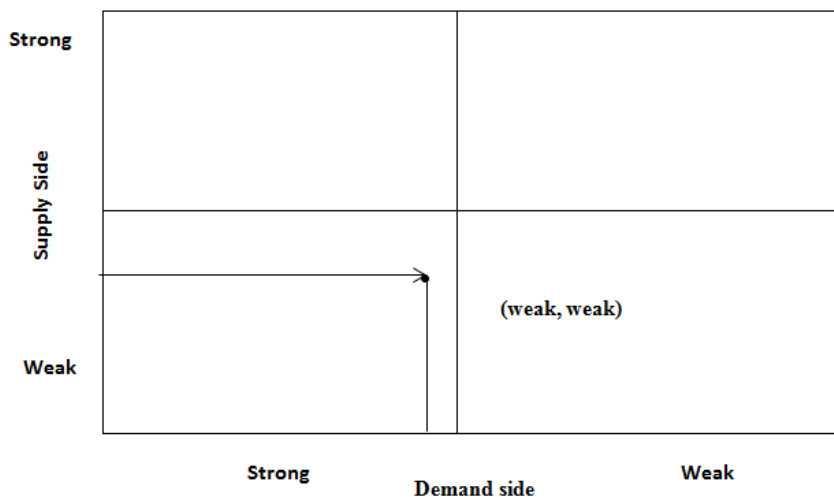


Figure 3.4. MSMEs, IFIs and SDGs Mapping

In the figure above, it appears that the relationship between IFS support for MYMEs and SDGs is a combination of weak and weak. Both the demand side and the supply side are weak. The appropriate strategy for addressing this condition is that it is imperative for the government to intervene. Because of the problems of business development, Islamic Financial Systems and SDGs are government areas and authorities. Government as the main stakeholder. However, future research is needed

to answer to what extent the government should play a role to address the problems.

3.5 Conclusion

Based on the results of the study, the majority of MSMEs seem to have small business assets which makes it difficult for MSMEs in obtaining financing from banks due to the weak collateral they have. In addition, the recording of financial statements by MSMEs that are not in accordance with the standards in general, makes it more difficult for MSMEs to obtain financing from the banking sector. Therefore, it is not surprising that the participation of Islamic banking is still very low in the MSMEs environment, which is not only because of its status as a newcomer to the funding source group, but also due to various shortcomings that MSMEs have which makes it difficult for them to qualify for financing.

Basically, once an Islamic financial institution can capture this opportunity for *da'wah* by financing the capital needs of these MSMEs, it is not impossible to introduce Islamic-based financing schemes to MSME actors. Moreover, it can be proven by seeing the good and positive outcomes related to Indonesian MSMEs actors familiar with Islamic-based financing products. Aside from the importance of training to improve the understanding of MSMEs actors regarding the capital fulfillment strategies, financial management education is also important. The need for financial training is not only needed for current business conditions, but also for the future (ongoing training). The product scheme, in accordance with the needs of MSMEs, which refers to various weaknesses possessed by MSMEs (the gap between MSMEs, those who need capital, and the IFIs as the owners of capital), is strengthened by the great opportunity for IFIs to enter the MSMEs market share when SMEs feel the saturation of conventional financing sources and expect more equitable funding sources such as Islamic financial products.

Some studies have referred to weaknesses in the credit process in the conventional financial institutions experienced by MSME actors. One of the weaknesses is related to the lack of a form of guarantee for

applying for credit. Thus, the strategies that can be carried out by IFIs, that can be easily used and accessed by MSMEs include implementing contracts such as asset-based finance capital (OECD, 2015), cooperating with Islamic microfinance institutions, working with social institutions such as ZISWAF to provide financing at a lower cost.

Meanwhile, based on the results of the SWOT analysis of IFIs on the MSMEs market share, it can be seen that even though IFIs have several weaknesses, there are few MSMEs who understand IFIs and access is still relatively difficult compared to Conventional Financial Institutions. However, IFIs also have several opportunities and strengths including having flexible and appropriate financial product schemes in Islamic law. This means that in its operation, IFIs are fairer and not burdensome to MSMEs, if they choose funding products via IFIs compared to conventional ones. In addition, IFIs tend to have a positive response to some people who already understand IFIs and their products. Thus, IFIs market has a large potential and sufficient opportunities to continue to grow in the community. This would involve making it easier to access all services offered by IFIs, especially for MSMEs actors.

Furthermore, IFIs can help MSMEs towards SDGs from the aspect of supply with indicators of SDGs achievement such as: poverty alleviation, industrial innovation, infrastructure, financial stability, economic growth, and equal distribution of income if Islamic values are implemented in the community, especially in terms of helping and cooperation. This is where the role of the government becomes important to make regulations and policies that are appropriate to realize these goals.

3.6 Future Research

Further research is needed to create a model for MSMEs to increase access to IFIs and how IFIs support MSMEs businesses. Future research must be comprehensive, involving indicators and important factors with broader respondents. All stakeholders (government, business people, Islamic financial institutions, academics and scholars) must be

involved so that comprehensive results can be obtained to improve the IFIs strategy in supporting MSMEs towards the SDGs.

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CHAPTER 04

ESTABLISHING A COMMUNITY OF PRACTICE (COP) TO REDUCE SMES BARRIERS IN ACCESSING ISLAMIC FINANCIAL INSTITUTIONS

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Abstract

The purpose of this research is to identify the obstacles of SMEs in accessing financing from sharia-based financial institutions and the level of financial literacy or financial skills possessed by SMEs. Data were collected from 374 SMEs in Java as a whole, by using questionnaire and its analysis using descriptive analysis. The findings of this study indicate that there are several internal and external barriers that affect SMEs in accessing Islamic financial institutions. Some of the obstacles include the low level of knowledge about finance and accounting, as well as the low level of knowledge about Islamic Financial Institutions. To overcome these internal and external barriers, this research offers solutions through mentoring, training and increasing the knowledge capacity by forming a community of practice (CoP). CoP is an informal institution consisting of experts and stakeholders involved in Islamic financial access to SMEs.

Keywords: Small and Medium Enterprises, community of practice (CoP), Islamic Financial Institution (IFI).

4.1 Introduction

SME is one of the business sectors that are easily run by the community in Indonesia. For example: culinary, fashion, education, automotive, agribusiness, tour & travel, creative crafts, etc. The strategic advantage of Indonesian SMEs is the availability of employees, abundant natural resources, and the relatively small capital needed. There are many SMEs which do not have the ability to work formally. The SME business sector is more informal, that is, its business activities have not been well organized, because the business establishment process does not involve facilities from the existing formal institutions, without licensing, business processes are not patterned?, such as uncertainty of worktime and workplaces, as well as business fields. There are still many MSMEs that utilize traditional technology, because of limited capital; this leads to relatively small production levels. The capacity of employee is still limited, most of the local employees, or employees in their family-owned company, the source of capital comes from personal funds or informal finance.

Besides that, one of the weaknesses of SMEs in Indonesia is the limited knowledge and ability to develop their business from being a local SME to a global SME scale. Research by Nicholls-nixon (2005) mentions that the limited knowledge and abilities to access global markets , and access financial management, application of modern technology, managerial capabilities, and lack of coaching of the workforce hinders the growth of MSMEs and entry into the international market. The competency of MSME actors and employees is still limited and the lack of knowledge and competency in entrepreneurship causes the level of productivity and skills of workers to be difficult to develop and upgrade. They have not been able to manage their business, for example in terms of administration/bookkeeping, not becoming legal entities, due to lack of knowledge about legality and licensing, and lack of product innovation capabilities to be able to compete in the international market. To overcome the constraints of the limitations and abilities of MSMEs in global competition, capital is needed. There are

still many difficulties in accessing capital for MSME actors. The study by Tambunan (2008) explains some of the problems faced by SMEs in Indonesia, especially the factor of capital and managerial skills. The dominant factor that inhibits the growth of SMEs in global markets is financial access and marketing (Elasrag†, 2016).

Barriers to access capital from formal financial institutions have caused many SMEs to choose informal microfinancing institutions, even those with a higher interest burden. In addition, requirements for formal financing institutions are needed to meet the requirements for bookkeeping and administration. Meanwhile, findings of research shows that SMEs are weak in bookkeeping. Their administration still uses manual bookkeeping. They have not been able to calculate sales turnover and profit due to limited bookkeeping knowledge. This knowledge deficiency prevents them from being aware of their business status and position in order to identify strategies that can give them a better competitive advantage in the future.

To deal with these challenges, a strategy that involves government participation is needed, in the form of extensive networking to bridge the needs of SMEs with stakeholders. (Premaratne, 2008) examines three types of networks namely social networks, business-focused networks, and inter-firm strategic networks. Entrepreneurship skills networks are developed starting from pre-start-up, start-up and on-going networks. In the early stages of pre-start-up, more social networks are needed with influential actors (friends, co-workers), the start-up stage requires more professional networking with influential actors (friends, co-workers, support agents, and business professionals), then the on-going stage requires more inter-firm networking with influential actors (other similar businesses, other similar businesses that support each other, and agency).

The MSME players need to reconstruct the network forms needed to run their businesses to be more effective and efficient in facing global competition. Relations among networks will form a collective community. The network community that is formed collectively among SMEs consists of several groups, such as culture, country, resources, etc.

SME actors use social network relationships to achieve business success, such as accessing finance through sharia-based financial institutions. Some research shows that the role of Islamic financial Institutions is able to support the success of SMEs in meeting financial needs and management requirements. Research of (Shaban, Duygun & Fry, 2016) found that capital loans provided by Islamic finance to SMEs, provide a win-win situation that is favorable for SMEs and Islamic finance. Studies conducted by (Balushi et al., 2018) show that IFI plays a role in determining financial decision-making in terms of access to capital. (Haron & Ibrahim, 2016) IFI is able to influence SMEs to choose alternative access to capital available in IFI, so that they are able to improve financial performance. A study conducted by Aysan, Disli, Ng, & Ozturk (2015) on MSMEs in Turkey, demonstrates the role of IFI through Islamic banking which helps facilitate access to credit for MSME actors.

Thus, the purpose of this study is to identify the level of financial literacy of SMEs, accessibility levels in accessing capital and accessing financing institutions, especially Islamic financial institutions. Furthermore, this study proposes a Community of Practice (CoP) framework to help strengthen Islamic financial literacy of SMEs and the capacity of MSMEs to access sharia compliant capital and financing institutions.

The rest of the paper is organized as follows. Section 2 discusses literature review regarding Islamic Financial Literacy, Islamic Financial Institution, Community of practice (CoP), and Section 3 provides the research methodology. Section 4 presents the findings and discussion, and the conclusion and recommendations are provided in section 5.

4.2 Literature Review

4.2.1 SMEs and Financial Literacy

One of the efforts to increase the capacity of SMEs is to increase the capacity of working capital. Availability of capital for SMEs helps them to be able to invest and improve performance, so that it will

encourage economic growth and open new employment opportunities. (Kersten, Harms, Liket, & Maas, 2017) found that financial programs run by MSMEs have a positive effect on access to capital and investment. The success of SMEs in accessing finance through R & D programs in Mexico, has resulted in increased sales, value-added, and increased exports (Lopez-Acevedo & Tinajero, 2010).

There are many ways to strengthen working capital and one of them is access to capital. Some access to capital for SMEs, such as low interest loans, securities exchanges, joint ventures and other forms of capital access (Rupeika-Apoga, 2014), however, SMEs have their weaknesses: lack of ability to access capital, barriers in marketing and administration, lack of skills about accounting systems, weaknesses in HR turnover management, bureaucracy and government policies such as licensing etc. (Shaban, Duygun, & Fry, 2016), and Financial Literacy (Elasrag†, 2016).

Financial Literacy is a comprehensive understanding of financial products for consumers and investors and their ability and trust to make informed decisions, and to take effective actions to improve financial well-being (Bayrakdaroglu & Şan, 2014). Financial literacy is also called financial intelligence, which is the skill needed to manage existing financial resources, so as to achieve organizational goals. Like other basic competencies needed by MSMEs for the sustainability of its business, financial literacy is also important. The level of financial intelligence of each individual is different, and these differences affect decision-making. Financial literacy, for example which incorporates the concept of financial knowledge, the concept of financial communication skills, skills to manage personal finance, the capacity to adjust decision-making, and the ability to plan financial? effectively in the future. Meanwhile, Islamic financial literacy is a level of someone having a range of knowledge, attention / care, and skills to understand basic financial information and services that influence their behavior to make decisions to choose an Islamic financial institution (Balushi, Locke, & Boulanouar, 2018). Islamic financial activities are often managed by an Islamic Financial Institution.

An Islamic Financial Institution is defined as a financial institution, whose operations are guided by Islamic principles, avoiding usury, gharar, maisir and the contracts which are not in conflict with Islamic principles (Tatiana, Igor, & Liliya, 2015). IFI products must conform to the main aspects of Islamic sharia and operational legal aspects and guidelines of the Sharia Supervisory Board, as a financial institution (justice, partnership, transparency, and universal).

Thus Islamic finance literacy is a combination of knowledge, actions and behaviors needed related to financial decision-making (Grohmann, Klühs, & Menkhoff, 2018). Conceptually, Islamic financial intelligence can be interpreted as a person's capacity to utilize financial knowledge, skills, and behavior in the framework of managing financial resources based on Islamic principles (Salman & Nawaz, 2018). The difference between IFI and other financial institutions is that IFI focuses on financial investment by taking profits without usury following the principle of profit and loss sharing methods based on Shariah compliance. The financing activities and investment savings of IFI in their transactions do not use the interest system (Chapra, 2011). The removal of the interest-based system has become an effective solution to overcome the injustice between the owners of capital and business actors who need financing because, basically, taking advantage of interest, the fund collector is harmed. If high-interest rates burden business actors as capital borrowers, it inhibits investment and causes productivity to decline. Islam teaches social solidarity and uses available financial resources in mutually beneficial cooperation, and increasing Islamic financial institutions literacy expected from each of the SMEs actors will help increase the availability of funds to be distributed through increasing funding needs from consumers so that they find funding that is in accordance with sharia principles.

4.2.2 Community of Practices (CoP)

A community of Practice is a group of people with a common interest, a common goal of improving, and a group who shares experiences. Community practice does not mean making what?, but

rather to foster and maintain sustainability (informal, prioritizing comfort and focus on values). The existence of this community is due to the relationship and social responses from the routine of their work activities. Community of practice consists of practitioners with competencies based on their respective fields of work experience.

CoP plays a role in providing benefits to individuals and organizations. The discussion of fellow members will allow the development of effective knowledge for individual's CoP. The role of the CoP for organizations is to support the creation of innovation, even a review of some literature shows that CoP can facilitate the process of developing knowledge in organizations. More broadly, the CoP also supports the level of organizational innovation by encouraging the creation, development, and use of knowledge. Furthermore, by combining a common sense of identity and discussion of the overlapping understanding of CoP, it increases the potential for sharing knowledge among fellow members.

The CoP has a role in supporting the process of knowledge creation. In CoP, the effective knowledge processes take place ; they involve sharing, creation, and utilization of Knowledge, overlapping values and shared identity. Knowledge in CoP contains values of assumptions that support knowledge and the process in effective knowledge processes? Overlapping value in CoP occurs in the sharing, creation, and utilization phases of effective knowledge processes. Shared identity in CoP creates conducive conditions for sharing knowledge through effective knowledge processes (sharing, creation, and utilization).

Several studies have provided examples of the success of CoP. Research on several SMEs in Sweden by (Patricio, Axelsson, Blomé, & Rosado, 2018) is able to improve the ability of SMEs to interrelate in networking to collaborate among fellow SMEs so as to increase economic gain through global markets. Study conducted by (Li, Li, Goerzen, & Shi, 2018) prove CoP is able to encourage SMEs to expand their overseas markets through financial and intellectual resource growth. Furthermore, Hirsch, Nitzl, & Schoen (2018) also shows that the CoP

that exists among SMEs and between SMEs and financial institutions providing capital has an impact on increasing trust among them, which can reduce the cost of access to credit through increased negotiations because, CoP helps raise the confidence levels of financial institutions to enhance a bank's monitoring process to deal with the more intensive SMEs. Research on local knowledge creation, (Backman, 2018) describes Community of Practice to stimulate collaboration of SMEs through industrial energy networks, focusing on knowledge creation (practical experience, trust among members and informal learning) to achieve energy efficiency improvements.

4.3 Methodology

4.3.1. Data Measurement

Type of research used in this study is descriptive. This method aims to create a picture or a description of a situation objectively. In this study, the authors aim to describe the factors that challenge SMEs in Indonesia in accessing Islamic Financial Institutions.

The main research instrument used in gathering primary data for the study has been a survey questionnaire. Most SMEs operating in Central Java, Indonesia are family-owned businesses. The researchers supported by research assistants made use mostly of personal contacts to approach owner managers, who are the main participants in this study. It can be said that convenience sampling was used for this study, where those who were willing to give information were invited to complete the provided questionnaire.

Samples from 374 SMEs owners were selected at randomly and 510 questionnaires were distributed directly to respondents, who were selected by officers who had been trained first. 425 answers were received or got a response rate of around 83.33%. Evaluation of the validity of the data, it was found 374 valid and reliable data that were used as the basis of analysis (around 73.33 percent). This might be considered a good response rate because of the topic sensitivity, the nature of the problem under study, and the barriers management might

have regarding this survey. The main construction of the marketing challenge for this study was measured by a Likert type scale with 5 points ranging from very low (score 1) to very high (score 5).

Section A dealt with the general background of the business concern and consisted mostly of multiple choice questions, where owner managers, as respondents were called upon to choose the alternative which best describes the characteristics of the business concern, such as gender, education level, organizational tenure, number of staff. Information mostly pertained to the extent to which SME actors desire SMEs to access capital using Islamic Financial Institutions.

Section B identifies what obstacles SMEs face in accessing capital from Islamic Financial Institutions.

Section C attempted to gauge the perception that owner managers had with respect to needed skill and knowledge to access Islamic Financial Institutions. The parameters of investigation are in line with the literature as previously discussed. Except for two open-ended questions, the section gauged the knowledge on challenges to financial access through a five-point Likert scale system rating.

4.3.2 Data analysis techniques

Given the nature of the survey data, this study uses exclusively descriptive statistics regarding the perceptions of financial access to Islamic Financial Institutions, about the extent of their desire to access capital from LKS. *First*, the analysis section of the financial analysis is based on the use of access to capital in the past, at present and the plan to continue to use capital from an Islamic institution in the future, by Indonesian SMEs, using descriptive statistics.

4.3.3 Nature of business, workforce and legal entity

Out of the 374 respondents, 20 per cent are from the manufacturing sector, while the service sector represents 80 per cent of the sample. This overrepresentation of the service sector is in line with the national statistics and SMEs tend to concentrate on the traditional

markets.

In all, 87.1 percent of the sample SMEs are by family-owned businesses, while 8.6 and 4.3 percent is established as partnerships and companies, respectively. As expected, a family-owned business tends to employ fewer employees, it is likely to be a proxy for size entity, (not clear) and it may be concluded that the entity tends to remain small. All of the samples engage below 25 employees. The religion table illustrates that most SMEs, namely as many as 96.52 are Muslim. This shows the potential for capital access from Islamic Financial Institutions which needs to be improved. Seen from the viewpoint of business legality, 88 percent of SMEs are individual companies. Summary of this result is presented in Table 4.1.

Table 4.1 :
Demographic of Respondents

Gender	Male	Female					Total
	212	162					374
%	56.7	43.3					100
Education	Non-formal	Primary	Secondary	Diploma	First Degree	Post Degree	0
	2	28	201	35	98	10	374
%	0.5	7.5	53.7	9.4	26.2	2.7	100
Organizational Tenure	0-5	6-10 years	11-20 years	> 20 years			0
	183	125	12	78			374
%	48.9	33.4	3.2	20.9			150
Status	Owner	Owner & Manager	Manager	Other			0
	155	171	32	16			374
%	41.4	45.7	8.6	4.3			100

Source: Primary data processed, 2018

Table 4.2 :
Type Sector

TYPE OF SECTOR	Number	Percentage	Manufacture	Service	Total
Consumer	97	25.94			
Constructions	2	0.535			
Hotel and Tourism	3	0.802		102	
Industrial	64	17.11			
Mining	0	0			
Plantation	10	2.674	74		
Properties	7	1.872			
Technology	3	0.802			
Trading/Services	177	47.33			
Transportation	11	2.941			
	0	0		198	
TOTAL	374	100	74	300	374
Manufacture (%)			19.79		
Service (%)				80.21	

Source: Primary data processed, 2018

Table 4.3 :
Religion

Religion	Total	%
Buddha	0	0
Hindu	0	0
Christian	13	3.4759
Islam	361	96.524
Other	0	0
Total	374	100

Source: Primary data processed, 2018

Table 4.4 :
Legal Form

Legal Form	Total	%
Private Limited	5	1.34
Partnership	20	5.35
Sole Proprietorship	329	88.00
Other (specify)	40	10.60
Total	354	100

Source: Primary data processed, 2018

4.4 Findings and Discussions

4.4.1. Knowledge about Islamic Financial Institutions

Table 4.5 shows the differences in knowledge level as related to Islamic and conventional financing. It can be concluded that almost half of them have no knowledge of Islamic Financial Institutions. This is also confirmed by the data in table 4.6, which shows that the schemes for the sources of funding for their businesses are mostly from conventional institutions. However, in table 4.7, respondents who thought that they wanted to use funding sourced from IFI is rated at almost 88 percent.

Table 4.5 :

The level of knowledge about the differences in Islamic and conventional financing

Knowledge of IFI		%
1: don't know	155	41.444
2: don't really know	76	20.321
3: neutral	87	23.262
4: know	30	8.0214
5: really know	26	6.9519
Total	374	100

Source: Primary data processed, 2018

Table 4.6 :
Scheme of business funding sources

Scheme of business funding sources		
Sharia	47	12.57
Conventional	327	87.43
Total	374	100

Source: Primary data processed, 2018

Table 4.7 :
Plan for Use of IFI

Plan for Use of IFI	Total	%
Surely yes	4	1.07
Yes	327	87.43
Not sure	0	0
No	0	0
Surely no	0	0
No response	43	11.49
Total	374	100

Source: Primary data processed, 2018

Table 4.8 :
Accessibility to Islamic financial products (Initial, Current and Future)

Time / Product Type	Initial	Current	Future
Musharaka Mutanaqisah	3	1	1
Ijara	1	4	5
Kafala		3	2
Mudaraba	5	6	7
Murabaha		8	8
Musharaka	1	4	4
Qadr Hassan	1	5	5
Sukuk		3	3
Others	11	34	35
Total	374	374	374

Source: Primary data processed, 2018

From tables 4.7 and 4.8, it can be concluded that the majority of MSME actors have not chosen to access capital from Islamic Financial Institutions both before, now and in the future.

Table 4.9 :
Habits with IFI products

Familiar with IFI products		%
Yes	24	6.4
No	281	75.1
Not sure	69	18.4
	374	

Source: Primary data processed, 2018

Table 4.10 :
The level of accessibility to Islamic financial products

Type of product	1	2	3	4	5	Total	F	%
Musharaka Mutanaqisah	2	2	9	4	0	17	8.24	2.202
Ijara	1	1	10	5	1	18	7.78	2.08
Kafala	1	1	9	5	0	16	8.75	2.34
Mudaraba	1	2	9	12	2	26	5.38	1.44
Murabaha	1	1	6	5	4	17	8.24	2.202
Musharaka	1	2	6	5	1	15	9.33	2.496
Qadr Hassan	2	1	7	4	2	16	8.75	2.34
Sukuk	3	2	6	3	1	15	9.33	2.496
Others								17.59

Note :

- 1- Not accessible;
- 2- Less accessible
- 3- Neutral
- 4- Accessible
- 5- Satisfied with the Accessibility

Source: Primary data processed, 2018

On the question of the habits and accessibility of SMEs to IFI, the data shows that their level of understanding of Islamic financing products is still very low. Moreover, the results of field data collection found that the majority of respondents did not answer because of their low understanding of financing sourced from IFI. On the other hand, at the level of accessibility of SMEs to IFI, respondents who answered in the range of 4 or 5 (accessible and satisfied with the accessibility are relatively low. Mudharabah products are IFI products that are perceived to be the most accessible by SMEs.

4.4.2. Source of financing

Questions about where they sourced their capital at the beginning, present, and future are presented in table 4.11. It can be seen that most SMEs use personal savings and loans from banks at the beginning of starting a business. At the current time (the time that they filled out the questionnaire, the biggest source is still from personal savings and bank loans).

Table 4.11
Source of capital based on time

Source of capital	Initial	%	Current	%	Future	%
Bank Loan	134	35.83	96	25.67	89	23.8
Coop Society	25	6.684	29	7.754	33	8.824
Crowd-Fund	2	0.535	3	0.802	23	6.15
Loan Relative	73	19.52	29	7.754	18	4.813
Micro finance	12	3.209	9	2.406	23	6.15
Non-Gov	8	2.139	4	1.07	21	5.615
Personal Saving	102	27.27	191	51.07	120	32.09
Registered	4	1.07	5	1.337	14	3.743
Rotating	4	1.07	5	1.337	18	4.813
Unregistered	9	2.406	2	0.535	14	3.743
Others	1	0	1	0.267	1	0.267
Total respondents	374		374		374	

Source: Primary data processed, 2018

The table below explains the sources of capital that are accessed by SME actors. SME actors use capital access more from bank loans and personal saving.

Table 4.12 :
Accessibility to financial resources

Funding Capital Source	1	2	3	4	5	F	%
Bank Loan	7	27	56	83	73	49.2	13.16
Coop Society	17	44	67	42	22	38.4	10.27
Crowd-Fund	66	55	28	12	10	34.2	9.144
Loan Relative	0	44	40	61	42	37.4	10
Micro finance	34	45	56	30	37	40.4	10.8
Non-Gov	49	53	31	16	27	35.2	9.412
Personal Saving	5	21	23	93	109	50.2	13.42
Registered	67	28	23	20	19	31.4	8.396
Rotating	54	28	26	10	16	26.8	7.166
Unregistered	75	29	24	7	19	30.8	8.235
Others						0	0
Total	374	374	374	374	374	374	100

Note :

- 1- Not accessible
- 2- Less accessible
- 3- Neutral
- 4- Accessible
- 5- Satisfied with the Accessibility

Source: Primary data processed, 2018

Table 4.13 :
Accessibility to financial resources rank

Sources of funding	%	Rank
Personal Saving	13.422	1
Bank Loan	13.155	2
Micro finance	10.802	3
Coop Society	10.267	4

Sources of funding	%	Rank
Loan Relative	10	5
Non-Gov	9.4118	6
Crowd-Fund	9.1444	7
Unregistered	8.2353	8
Registered	8.3957	9
Unregistered	7.1658	10

Source: Primary data processed, 2018

From all the respondents' answers, the most widely used funding source by SMEs is from personal savings, amounting to 13.42 percent. This shows that according to the SME actors, personal saving becomes the most satisfying and easily accessible funding source.

4.4.3 Financial Literacy

Data on knowledge proficiency of SMEs about budgeting, use of accounting information, risk and control are in table 4.14, while table 4.15 provides data about accounting literacy.

Table 4.14 :
Budgeting, Use of Accounting Information, and Risk and Control

Budgeting	Yearly Budget	15.39
	Monthly Budget	17.82
	Cash Flow	0
	Trained Accountant	5.13
Use of Accounting Information	Financial Statement	16.47
	Accounting Inf	5.94
	Tax Computation	12.42
Risk and Control	Financial Management	36.45
	Record of Debtor	19.71

Source: Primary data processed, 2018

Table 4.15 :
Accounting Literacy

Record Keeping	Business Expense	30.78
	Accounting	6.48
	Stetement	15.66
	Balance Sheet	11.61
Budgeting	Yearly Budget	15.39
	Montly Budget	17.82
	Cash Flow	0
	Trained Accountant	5.13
Use of Accounting Information	Financial Statement	16.47
	Accounting Inf	5.94
	Tax Computation	12.42
Risk and Control	Financial Management	36.45
	Record of Debtor	19.71

Source: Primary data processed, 2018

Table 4.15 explains the literacy level of SMEs in finance and accounting, seen from the aspect of keeping records, budgeting, use of accounting information, and risk and control. In the aspect of keeping records of SMEs, they always keep records at the business expense, amounting to 30.78 percent. A monthly budget is also always implemented from the aspect of recording budgeting, amounting to 17.82 percent. Whereas in the aspect of the use of accounting information and risk and control, SMEs always record tax computation and financial management, which are 12.42 percent and 36.45 percent respectively.

Table 4.16
Financial Literacy

Financial Literacy	1	2	3	4	5	Total
Understand financial statement	30	82	86	150	26	374
%	8.1	22.14	23.22	40.5	7.02	
Useful Accounting	20	45	82	141	86	374
%	5.4	12.15	22.14	38.07	23.22	

- 1- not at all
- 2- a little
- 3- not sure
- 4- general understanding
- 5- very well

Meanwhile, table 4.16 illustrates the extent to which SME actors understand financial statements. The use of accounting is an excellent knowledge possessed by SMEs by 23.22 percent, while understanding of financial statements is also well understood by SMEs.

4.4.4 Proposed Solution

From the results of the data analysis that has been done, SMEs have a low intention to connect with microfinance institutions, because of two things, namely, poor accounting and financial knowledge. The first comes from the condition of the SME itself, such as not having complete financial reporting, lack of knowledge about sharia, lack of access to sharia financial institutions, incomplete administrative management and limited ability to absorb technology, lack of market penetration capability which results in unsatisfactory sales and the mentality of SME entrepreneurs who still lack capacity to innovate.

The second obstacle comes from the sharia financial institution, such as the lack of human resources, undeveloped information technology such as conventional (what?), lack of service to the community, the public image that Islamic banking is more expensive than conventional banking and limited product variation compared to conventional banking.

Therefore, an informal network-based group is needed that will bridge the problem of barriers between SMEs and Islamic financial institutions. A community of practice that has the task of providing knowledge to SMEs and IFI will facilitate the relationship between SMEs and Islamic financial institutions. This Community of Practice consists of all elements that affect the activities of SMEs both directly and indirectly. This community will disseminate regulations that have been obstacles for SMEs to become opportunities for SMEs to enter in contact with Islamic financial institutions. This community consists of the government, Sharia Supervisory Board, Central Bank, Financial Services Authority,

Religious Scholars, Consumer, Management, Shareholders and Society. Figure 4.1 illustrates the design of the CoP framework.

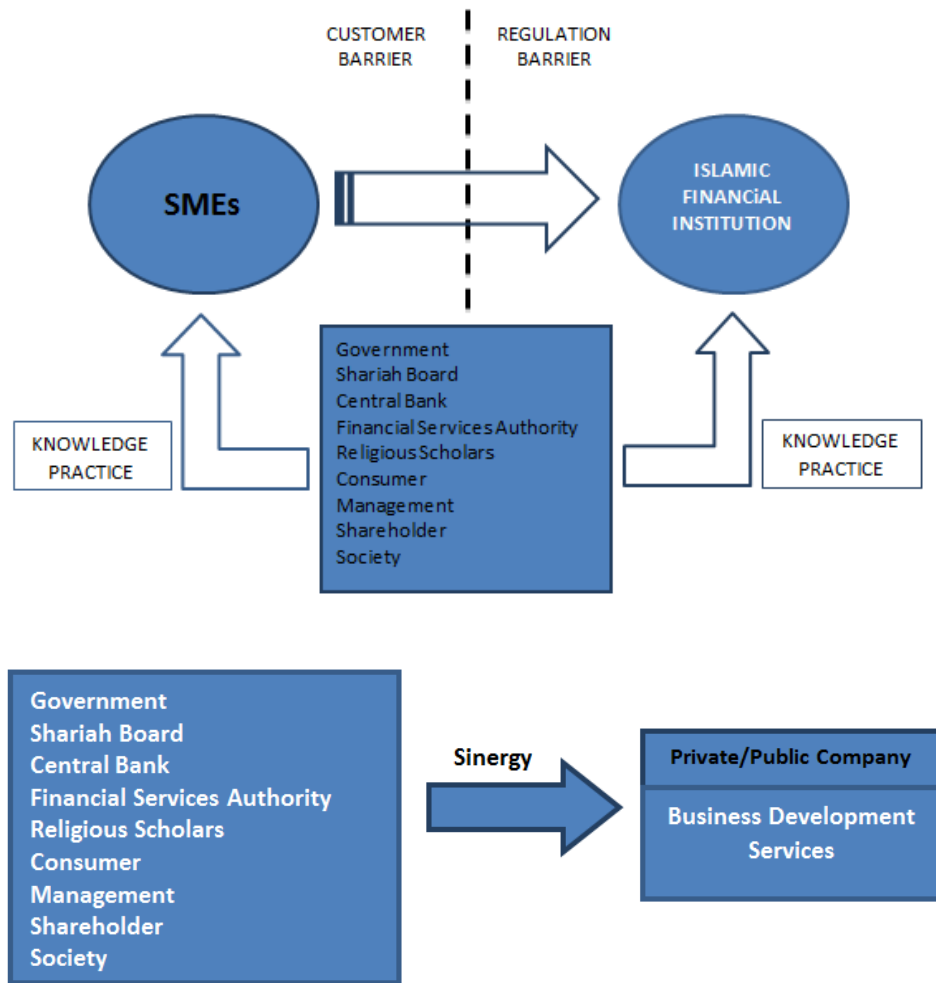


Figure 4.1. Framework of Community of Practice (CoP)

Our proposed CoP includes several practices or experts which are: government, shariah board, central bank, financial services authority, religious scholars, customer, management and shareholder.

In addition, the tasks of each expert or practice are as follows:

Table 4.17 :
The tasks of each expert or practice

No.	Roles
Government	<ul style="list-style-type: none">- compile will politics such as making laws or regulations in the placement of funds to sharia financial institutions
Dewan Pengawas Syariah	<ul style="list-style-type: none">- issue a fatwa to the public about the definition of Islamic financial institutions- involved in the socialization program of Islamic financial institutions to the community
Bank Central	<ul style="list-style-type: none">- assisting macro-finance to support the development of sharia financial institutions
Financial Services Authority	<ul style="list-style-type: none">- make regulations to facilitate the opening of sharia financial institutions
Religious Scholars	<ul style="list-style-type: none">- conduct knowledge sharing with the community together with sharia financial institution about products of Islamic financial institution- conduct research studies on the effectiveness of marketing sharia financial institution- assisting the sharia supervisory board to formulate Islamic financial institutions products that can reach all levels of society- spread the understanding of Islamic financial institution in the community
Customer	<ul style="list-style-type: none">- share knowledge with Islamic financial institutions about the condition of society- share knowledge with the public about Islamic financial institutions- change the perception that sees Islamic financial institutions as being the same as conventional financial institutions.

No.	Roles
Management (administrator/initiator)	<ul style="list-style-type: none">- make regulations and operational techniques that make it easier for experts to share tasks with the CoP- manage the running of the community and measure the contribution of the members and measure the success of the CoP
Shareholder	<ul style="list-style-type: none">- working with the commissioners to ask the directors to facilitate regulation so that people are more easily connected with sharia financial institutions
Society	<ul style="list-style-type: none">- search for relevant information about the operations of Islamic financial institutions- disseminating information that is in accordance with the purpose of establishing a sharia financial institution- reduce incorrect information about sharia financial institutions

It is expected that these CoP members will work together to bring together the needs of SMEs and IFIs, so that the capacity of SMEs to access funding sources from IFIs will increase and IFIs develop clear policies to improve their services to SMEs.

4.5 Conclusion and Future Research

The SMEs in Central Java have a poor level of knowledge about the existence of IFIs and their roles and benefits. They also have little desire to use IFI as a reference to access finance and funding. This is because most SMEs have low financial literacy. In addition, most SMEs use personal savings to strengthen their finances. In the long term, this situation will make it difficult for SMEs to develop progressively, especially for entry into the international market. Therefore, a synergy from various parties is needed, which should be focused on the

development of SMEs and also IFIs. This research proposes a community framework to help SMEs and IFIs which we have termed as ‘Community of Practice (CoP)’. For future research, it is necessary to conduct research on the basis of a greater role of CoP in helping people to recognize sharia financial institutions, an institution that already exists in Indonesia in the form of Business Development Services (BDS) which is a private institution that works to assist SMEs in preparing documents required by the regulation of Islamic financial institutions.

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CHAPTER 05

GLOBAL MARKETING CHALLENGES FOR SMALL MEDIUM ENTERPRISES (SMEs) IN INDONESIA

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Abstract

This paper aims to explain descriptively about the problems and challenges of global marketing for SMEs in Indonesia. In this context, the discussion focuses on the characteristics of SMEs and how they affect the characteristics of global marketing. There were 374 SMEs that were selected to be analysed, described and concluded in terms of several challenges that are related to global market knowledge and other factors supporting the success of SMEs in the global market. This study found that the average value of the index of global marketing challenges is in the medium category. This shows that most of the SMEs still face serious obstacles in global market competition. Through an in-depth examination of various global marketing studies on the management of SMEs and Entrepreneurship, this paper offers a unique analysis of the characteristics of SMEs, obstacles, challenges and also strategies that must be faced in global markets.

Keywords: *Global Marketing, Small Medium Enterprises, Global Challenges*

5.1 Introduction

In 2017, the Indonesian economy grew around 5.2 percent and the opportunity to increase this growth in the following years were very large due to the large potential in the population (around 261.89 million people), National GDP (around IDR 12,406 trillion), GDP of the Creative Economy (around IDR 852 trillion), the E-Commerce market (around IDR 337 trillion), Mining GDP (around IDR 897 trillion), Agricultural GDP (around IDR 1,688 trillion), 132 million internet users and demography bonuses in 2020. Achieving ambitious economic growth of 5.2% to 5.5% in 2019 will require a special campaign to reduce the constraints that happened in the use of resources and improvement for better future growth. This growth requires Indonesia to push the SMEs sectors with various activities that are able to increase productivity and income distribution for workers, owners and public income (Muharram, 2018).

Based on BPS (Central Bureau of Statistics) (2016), the total business units in Indonesia was 59.693.791, the contribution of SMEs to GDP reached 62.57%, the employment absorption was 96.50% and the Non-Oil and Gas Exports were 16.45% (Statistics, 2018). In 2016, large businesses only reached 5,969 units or 0.01% of the total businesses in Indonesia. Medium-sized businesses reached around 59,772 units or around 0.10% of the total business units in Indonesia. Small businesses have around 684,196 units or 1.15% of the total business units in Indonesia, while micro businesses reached around 58,943,768 units or 98.74% of the total business units in Indonesia. Therefore, small and micro enterprises have become the foundation of the Indonesian economy and medium-sized businesses as the pillar of the economy (Muharram, 2018).

In addition, SMEs also played a role as the backbone of the national economy because it became the dominant business actor. SMEs generate around 60% of GDP, a growth rate of 6.4% per year contributing to export volumes to reach around 14% of the total national exports and providing basic needs services that are needed by the community in order to become an instrument of income equality and

reduce inequality in public welfare. It is a forum for the creation of new entrepreneurs in creating new jobs to minimize dependency on imported components while utilizing raw materials and local resources that are easily found and available around them so as to save foreign exchange, encourage economic growth and realize national stability.

The Indonesian government has implemented so many strategies in supporting SMEs through the Ministry of Cooperatives and MSMEs. First, through the instruments of developing SMEs, Indonesia has (1) Law Number 25 of 1992 concerning Cooperatives, (2) Law Number 9 of 1992 concerning Capital Markets, (3) Law Number 10 of 1998 concerning Banking, (4) Law Number 20 of 2008 concerning SMEs, (5) Law Number 21 of 2011 concerning OJK (Financial Services Authority), (6) Law Number 1 of 2016 concerning Guarantee. Secondly, from a practical point of view, there are several regulations that were made for the development of MSMEs such as: (1) Government Regulation (Government Regulation No. 09 of 1995 concerning KSP (Saving and Loan Cooperative), Government Regulation No. 33 of 1998 concerning Equity Participation in Cooperatives; Government Regulation No. 17 of 2013 concerning Implementation of the SMEs Law); (2) Presidential Regulation (Presidential Regulation Number 59 of 2017 concerning Implementation of Achievement of Sustainable Development Goals); (3) Ministerial Regulation (Regulation of the Coordinating Minister for Economy Number 9 of 2016 concerning Guidelines for Implementation of People's Business Credit); (4) Minister of Cooperatives and SMEs Regulations (Minister of Cooperatives and Cooperatives Regulation No. 10 of 2015 concerning Cooperative Institutions, Minister of Cooperatives and Cooperatives Regulation No. 11 of 2015 concerning Implementation Guidelines for Fertilizing Equity Capital in Cooperatives, Minister of Cooperatives and Cooperatives Regulation No. 15 Year 2015 concerning Conventional Savings and Loans and Minister of Cooperatives and Cooperatives Regulation no. 16 of 2015 concerning Sharia Savings and Loans Business). Third, in terms of funding, in 2019, the Government, through the Ministry of Cooperatives and MSMEs, has submitted a budget for the development of SMEs around IDR 3.3 trillion for management support programs and the implementation of technical tasks,

cooperative institutional strengthening programs, programs for the improvement of facilities and infrastructure of the Ministry of Cooperatives and SMEs, micro enterprise-based sustainable livelihood enhancement programs and programs to increase the competitiveness of SMEs and Cooperatives. Fourth, the enactment of income tax incentives for SMEs is one of the fiscal facilities provided by the government to the SMEs to encourage the potential/activity of the SMEs sector with a reduction in final tax rates from 1% to 5%. The decline in new tariffs is expected to stimulate the emergence of new SMEs to develop and provide financial space (business opportunities) by reducing the cost of SMEs to be used in business expansion (Muharram, 2018).

As a tradition, SMEs base their competitiveness on a number of factors, such as their tendency to concentrate in certain areas and the high level of specialization and flexibility generated from their informal organizations, where employers usually become the only one who can represent decision makers. In recent years, due to the emergence of drivers of market change (for example, market internationalization, increased global competition and ICT diffusion), their traditional success factors are specialization and flexibility; however, they have lost their strategic relevance to other key factors such as the global marketing orientation (Kiriinya & Kiriimi, 2015). Many researchers focus on producing SMEs situational marketing solutions for their marketing challenges in Indonesia. This article aims to explain the position of SMEs in Indonesia with a focus on utilizing the intangible attributes of their resources and their capabilities in creating products and services for customers, providing psychological benefits and consumption experience to customers and achieving competitive advantage in the global market. Therefore, global marketing orientation is important to enable local companies to achieve better performance and sustainable competitive advantage in the long term. Specific references to the marketing characteristics of small and medium-sized enterprises and business challenges are explored in the literature to help identify the nature of entrepreneurial marketing by SMEs in Indonesia.

5.2 Marketing Resources Challenges for SMEs

SMEs global marketing means the process of internationalizing business activities across national borders by small and medium enterprises in creating value in organizations. Internationalization becomes a significant aspect in maximizing business opportunities in the global market. In recent decades, many SMEs have begun internationalization to achieve business successes. Many SMEs have managed to organize activities outside the domestic market and have an important role in contributing to future growth (Knowles *et. al.*, 2006). In addition, the domestic business environment is increasingly influenced by international economic factors and the ability of SMEs to isolate themselves from foreign competition has diminished (Andersson *et. al.*, 2004). They assumed that the internationalization of business (especially exports) can enhance the company's managerial skills and abilities, contribute to the economic development of countries, be able to develop national industries, increase productivity and create jobs, facilitate the use of resources better and give them a degree of flexibility of greater risk of doing business risks (Pinho & Martins, 2010). The trend of the increasing internationalization of global markets emphasizes the importance of understanding how companies behave and how they do the international market. This is mainly because internationalization encourages exporting companies to increase exports, encourages non-exporters to start exporting, creates jobs and provides imports with foreign currencies and become a vehicle for growth and increasing profits for SMEs (Al-Hyari *et. al.*, 2012). These expectations are only possible if each SME has the resources and capability of marketing to compete in the global market.

Marketing has been studied by various researchers as a fundamental part of competitive advantage and improving business performance. Several theories are available in strategic management with insights into marketing strategies which are widely used to develop an integrated conceptual framework to link marketing with business performance (Morgan, 2012). For example, Resource-Based View (RBV) has been the subject of the increasingly critical theoretical attention in strategic management. Critics of this theory have highlighted the

weakness in the inability of the RBV theory to explain how resources are developed and used to achieve competitive advantage (Peteraf, 1993; Barney, 2001) and their failure to consider the impact of a dynamic market environment (Colbert, 2004). In dealing with these weaknesses, strategic management theorists have made a number of developments that are collectively labelled as the theory of Dynamic Capability (Teece *et al.*, 1997; Wang & Ahmed, 2007; Cui & Jiao, 2011). The Dynamic Capability approach seeks to explain the ability of larger companies to adapt to the demands of the environment by changing their resource base (Nieves & Haller, 2014). In such conditions, the company has a few opportunities to obtain the appropriate value from existing resources and capabilities, which means that competitive advantage may be temporary (D'Aveni *et al.*, 2010; McGrath, 2013). Due to the dynamic market, and not because of simple heterogeneity in company resources, the capability of a company's resources must be obtained and used in a manner that is appropriate to the market environment so that it will explain the differences in business performance among companies over time (Teece *et al.*, 1997; Cui, 2011; Lin & Wu, 2013). In this perspective, resources are considered as stocks of tangible and intangible assets that are available to companies, while capability is the process where the companies acquire new resources and transformations that are available for realized market value offerings (Hitt *et al.*, 2001).

Although SMEs tend to be more reluctant to adopt a global marketing approach due to the lack of resources and skills specifically for owners/managers as they are only decision makers, they must make choices to be globally oriented or not. Their choice to adopt or not to adopt the marketing approach lies in their way of thinking about global marketing and the consequences of adopting such marketing approaches in organizations (Kiriinya & Kirimi, 2015). Many researchers have emphasized the importance of inherent characteristics on SMEs entrepreneurs in their choice to adopt a global marketing approach (Bhasin & Venkataramany, 2010; Gliga & Evers, 2010). The characteristics of typical SMEs such as the organizational flexibility, specialization, lack of resources, lack of marketing knowledge and skills make SMEs entrepreneurs who adopt marketing approaches tend to be

more simple, informal, instinctive and thus this is different from the theoretical paradigms that were developed in the managerial literature (Kiriinya & Kirimi, 2015). Therefore, even though marketing becomes an important business function, its role in the organization and its relevance is related to the business environment in which the company operates as a complex relationship (Simpson *et. al.*, 2006). In global markets, export barriers often provoke failure in foreign operations, bring financial losses and affect the negative attitude of owners/managers of SMEs to international activities among exporters today and in the future (Leonidou, 1995). Export barriers make the business performance of SMEs more difficult overseas as compared to domestic market activities. In this case, eliminating or minimizing these obstacles will contribute to higher export trends and performance. These obstacles can be in the form of low knowledge of the global market and weak facilities and infrastructure to support success in the global market.

Market knowledge resources. Knowledge is power (Liu & Tsai, 2013). Therefore, SMEs need to manage it properly and correctly. The ability to manage knowledge is related to the ability for acquisition, creation, documentation and diffusion of knowledge (Liu & Tsai, 2013). Knowledge in the company is implicit and related to how the knowledge is needed to do the task. Such implicit knowledge can only be obtained through direct experience. Knowledge resources used through organizational capabilities are often based on organizational memory (Baker & Sinkula, 1999). Some examples of knowledge related to marketing are like the knowledge to look for opportunities and threats in foreign markets, knowledge of competition in foreign markets, knowledge of product adaptability to foreign markets and knowledge of promotion and assistance programs by the government.

Resources to support the performance of SMEs in the global market. This consists of ICT knowledge resources, cultural and linguistic knowledge, information and finance. Information has long been seen as a major marketing asset (Jaworski & Kohli, 1993; Wei & Wang, 2011), especially information about customers, channel members and competitors (Narver & Slater, 1990; Cillo *et. al.*, 2010). This information

is part of the resources that are important for marketing activities such as pricing, advertising, product development and marketing planning (Day, 1994; Morgan, 2012). Financial resources involve cash availability for investment in activities related to global marketing. From this perspective, marketers obviously care more about the size and accessibility of the relevant marketing budget (Piercy 1987). It is apparent that access to financial resources needed is important in determining a company's ability to successfully engage in marketing activities. Two important financial sources for the development of SMEs in the global market are the financial resources for conducting research in the international market and the lack of adequate working capital to finance export activities.

5.3 Methodology

Secondary and primary data sources were used to collect information and analyse the challenges of global marketing of SMEs in Central Java (Indonesia). The main sources of the secondary data were journals, articles, press reports, books, documents and research studies. The research population consists of all SMEs owners in Indonesia. SMEs consist of micro businesses with the annual turnover of up to IDR 300 million per year and assets up to IDR 50 million; micro businesses with the annual turnover around IDR 300 million to IDR 2, 5 billion and assets around IDR 50 million to IDR 500 million; and micro businesses with annual turnover of around IDR 2, 5 billion to IDR 50 billion and assets around IDR 500 million to 10 billion.

Samples from 374 SMEs owners were selected randomly and 510 questionnaires were distributed directly to the respondents who were selected by officers who were trained. 425 answers were received or a response rate of around 83.33% were received. The evaluation of the validity of the data found that 374 were valid and reliable data that were used as the basis of analysis (around 73.33 percent). This was considered a good response rate that was given due to the sensitivity of the topic, the nature of the problem that has not been studied and the barriers that might have occurred in the management relating to the survey. The main

construction of the marketing challenge questionnaire for this study was measured with a 5-point Likert-type scale ranging from very low (score 1) to very high (score 5).

Descriptive analysis was used to explain the two issues related to market resources, namely: market knowledge and resources supporting market success. Market knowledge involves knowledge to look for opportunities and threats in global markets, competition in foreign markets, information about marketing channels and networks, quality standards of importers, market systems, government promotion and assistance programs, adaptability in foreign markets and cultural and language barriers. Then, supporting the resources by transporting ICT resources, cultural, linguistic knowledge, financial information and sources of funds.

The selected respondents consisted of 56.68% of men and 43.32% of women aged between 20 years and 60 years. They are owners (41.44%), owners and managers (45.71%), managers (8.53%) and others (trusted employees) around 4.28%. Most of them are married and have worked for more than 3 years. Most of them (53.74%) have secondary school education, 9.36% Diploma and 28.87% Bachelors degrees.

5.4 Findings and Discussion

Market understanding, identifying customer needs, desires and requests are the starting point of every successful marketing strategy (Kotler et al., 2008). However, marketing in SMEs becomes a matter of debate among academics and practitioners (Gilmore *et. al.*, 2001). The development of marketing theory in SMEs is rather limited and often depends on the application of classical marketing models used in large businesses to small businesses (Simpson *et. al.*, 2006). In general, marketing activities of SMEs in the global market are driven by owners/managers and their personalities and are defined in terms of tactics to attract new businesses by focusing on competitors, customers and the business environment. There are many barriers faced by SMEs in global markets, both internal and external. (Paula *et. al.*, 2017) or barriers related to products and services, industry, host country markets and

domestic barriers (Pinho & Martins, 2010). Some of the obstacles to global marketing are explained in this study.

The results of data analysis on the challenges of SMEs in the global market show the average index value with the medium category. This shows that SMEs in Indonesia still have quite complicated problems in the international market. In part, most SMEs consider that they still have problems in finding opportunities and understanding threats in foreign markets; the ability to compete in foreign markets; limited information about marketing and network channels; limited financial resources for conducting research in the international market; limited working capital to finance export activities; lack of management commitment to develop reporting activities; less experience in product adaptability in foreign markets; limited knowledge of the market system; cultural and language barriers; less information about export procedures; limited knowledge about promotion and assistance programs by the government; limited knowledge about information and communication technology and limited information and communication technology facilities and infrastructure for businesses. These obstacles and constraints do not have to dampen SMEs to develop their businesses. Opportunities to increase the business capacities of SMEs still have considerable prospects, especially for the economic sectors of SMEs which contribute large portions of GDP (BI, 2015).

5.5 Limited Market Knowledge

Knowledge to look for opportunities and threats in foreign markets. Table 1 shows that the challenges of SMEs in Indonesia in looking for opportunities and threats in foreign markets falls in the medium position. This shows that most SMEs in Indonesia still have problems in finding opportunities and understanding threats in foreign markets. This result is in line with the research conducted by Pinho and Martins (2010) which showed some weaknesses in export markets such as the limitations in knowledge of potential markets, quality export personnel, quality of products/services, technical suitability, tariffs and administrative barriers in target markets and information from

sector/market (Pinho & Martins, 2010). Barriers to the export of SMEs also involve internal and external barriers. Internal barriers consist of difficulties in choosing reliable distributors, lack of negotiating power, little understanding of target markets and challenges, poor organization of the export department, inability to access information, short international experience, inability to achieve competitive advantage in advanced markets and lack of capital and insufficient resources. External barriers, on the other hand, are barriers such as lack of appropriate trade institutions, lack of incentives and protection from the government, political instability, legal and political problems, lack of demand and problems of adaptation from market entry (Paula *et. al.*, 2017). These weaknesses disrupt and hamper the export activities of most of the SMEs in Indonesia. These export barriers also disrupt the ability of companies to start, develop, or enforce business operations in foreign markets (Morgan *et. al.*, 2012). These obstacles often make the business performance more difficult abroad as compared to domestic market activities.

Table 5.1 :

Index value of respondents' answers to the level of SME business challenges faced in the global market participation

No	Challenge	Score	Respondent's Scale of Answers					Total	Index Value
			1	2	3	4	5		
1	Limited knowledge of seeking opportunities & threats of foreign markets	F	58	46	130	82	58	374	Medium
		%(FxS)	15.51	24.6	104.28	87.7	77.5	61.93	
2	Knowledge of competition in foreign markets	F	71	39	119	83	62	374	Medium
		%(FxS)	18.98	20.86	95.455	88.77	82.9	61.39	
3	Less knowledge of adjusting products to foreign markets	F	54	48	137	80	55	374	Medium
		%(FxS)	14.44	25.67	109.89	85.56	73.5	61.82	
4	Knowledge of promotional programs & government assistance	F	41	47	156	79	51	374	Medium
		%(FxS)	10.96	25.13	125.13	84.49	68.2	62.78	
5	Knowledge of information and communication	F	27	50	166	87	44	374	Medium
		%(FxS)	7.219	26.74	133.16	93.05	58.8	63.8	

No	Challenge	Score	Respondent's Scale of Answers					Total	Index Value
			1	2	3	4	5		
	technology								
6	Information technology & business communication facilities and infrastructure	F	28	44	155	93	54	374	Medium
		%(FxS)	7.487	23.53	124.33	99.47	72.2	65.4	
7	Cultural and language barriers	F	55	40	141	84	54	374	Medium
		%(FxS)	14.71	21.39	113.1	89.84	72.2	62.25	
8	Information about export procedures	F	57	41	133	91	52	374	Medium
		%(FxS)	15.24	21.93	106.68	97.33	69.5	62.14	
9	Limited information about marketing and network channels	F	42	63	136	79	54	374	Medium
		%(FxS)	11.23	33.69	109.09	84.49	72.2	62.14	
10	Lack of financial resources to conduct research on the international market	F	55	60	123	78	58	374	Medium
		%(FxS)	14.71	32.09	98.663	83.42	77.5	61.28	
11	Lack of adequate working capital to finance export activities	F	58	52	121	80	63	374	Medium
		%(FxS)	15.51	27.81	97.059	85.56	84.2	62.03	

Source: Primary data processed, 2018

Knowledge of competition in foreign markets. Knowledge of competition in foreign markets is at a medium level. This shows that most SMEs in Indonesia still lack complete knowledge of competition in foreign markets. This has become a constraint in achieving a competitive advantage in the global market. This is similar to the findings of Pinho and Martins (2010) which show that SMEs have constraints in the limited knowledge of potential markets and market information. In Indonesia, usually, SMEs do not have a product marketing strategy and still have problems in arranging business plans because the competition in seizing the market is getting tougher (BI, 2015). Today, the trend of globalization in the international economic arena has been continuing and has increased competition even in industries that were previously considered free from the onslaught of foreign competition (Ma, 2004). In this era, many multinational companies and local players are forced to continue to struggle to create, renew and maintain their competitive advantage in the global market (Porter, 1985; Kaleka, 2002; Stonehouse & Snowdon,

2007). This must also be addressed by Indonesian SMEs as a learning process that is beneficial for the improvement of performance. Hunt and Morgan (1995) explained competition as a process of provoking imbalances, a continuous process consisting of continuous struggle among companies to obtain a comparative advantage in resources in order to produce a competitive advantage in the market, and also obtain superior financial performance. Due to SMEs that often lack the resources and ability of individuals to overcome scale-based challenges and innovation in global markets, we consider that the collection efficiency resulting from the coordination of appropriate joint actions among SMEs allow these companies to overcome these difficulties and strengthen their ability to compete globally. Manufacturing productivity derived from relational coordination of sequential activities is likely to bring cost-based competitive advantage for SMEs in the global market (MESQUITA and LAZZARINI, 2008).

Knowledge of product adaptability to foreign markets. The findings indicate that the constraint of product adjustment to foreign markets is in the medium category. This shows that SMEs in Indonesia still have limitations in product adaptability in export destinations. This finding is similar to the research described by Pinho and Martins (2010) and Paula *et. al.* (2017) that the majority of SMEs that carry out exports still have product/service quality constraints, technical suitability in export destination countries, response times to consumer needs in the export destination markets and adaptation problems to enter the market.

Adaptability is the key to success in the export market. Companies that are able to adapt products to the export market generally produce competitive advantages and better financial performance. Companies that only have sufficient adaptability in the export market will experience difficulties in creating competitive advantage and superior financial performance in their export markets. The limited adaptability of products in the export market in the medium category shows that there are still many SMEs that still have constraints on the adaptation in the export market. In fact, to succeed in the international market, SMEs must have adaptive capabilities in the export destination countries. An adaptive

capability is the ability of an organization to identify and utilize emerging market opportunities (Wang & Ahmed, 2007; Biedenbac & Müller, 2012). A key element of adaptive ability is the ability to respond to external product market opportunities, investment in marketing activities and the speed of response to change market conditions (Chavosha *et. al.*, 2011; Biedenbac & Müller, 2012). Response to changes in market conditions means the response to customers and competitors' strategies in the export market. Customer response means providing the right needs for customers at the right time (Chavosha *et. al.*, 2011). Understanding changes in customer needs and carrying out rapid fulfilment in an effective approach will provide companies with a sustainable competitive advantage. Fast response to customer demands can put the company as the first mover on the market and as a result it can improve the performance of companies in the market (Pehrsson, 2014). To achieve a superior customer response, companies must have the ability to do superior work above their competitors in identifying the right customer needs and fulfilling their satisfaction so that they can ultimately produce competitive advantage and increase export performance (Chavosha *et. al.*, 2011).

Knowledge of promotion and assistance programs by the government. The scale of knowledge of promotion and government assistance in the medium category shows that there are still many SMEs that have not received promotional assistance from the government. From the perspective of resource-based theory, competitive benefits can be obtained from seeking and receiving external business assistance (Mole *et. al.*, 2016). External sources in the form of suggestions can increase strategic knowledge that lead to competitive benefits and increase business potential. External assistance can overcome information and knowledge gaps, especially in the smallest and youngest businesses, because of their lack of resources and skills, though, this assumption is sometimes debated (Johnson *et al.*, 2007). However, according to Mole *et. al.* (2016), many SMEs were not willing to accept external assistance. Various explanations have been put forward as to why SME owner-managers do not seek external assistance. First of all, they can use advisory services suboptimal because they do not have enough

information to make informed choices. Other than that, there are concerns about the costs of getting expert advice, doubts about whether it provides the best value for money and concerns about the time needed to fully implement and benefit from these suggestions. In addition, owners are unsure of their ability to deal with smart and sophisticated consultants with equal requirements. Finally, there is distrust as advisors do not fully understand their business needs.

5.6 Limited Supporting Factors in Market Performance

Knowledge of information and communication technology. The medium category in terms of knowledge about ICT shows that there are still many SMEs in Indonesia that have not utilized ICT in the business development process in the global market. This is mainly because there are still obstacles in accessing technology, and e limited business facilities and infrastructure related to technological tools. They are still relying on the use of simple technology. Thus, they are weak in the use of information technology and the internet. This is the same as that experienced by Malaysia, namely the lack of utilization of information and communication technology in the marketing field. Most SMEs consider barriers to implementing IT in their business operations as expensive initiatives, risks, complicated procedures which require technical expatriates and customer service (Chong *et. al.*, 2012; Dahnil *et. al.*, 2014). It was also faced by SMEs in Australia in adopting e-commerce, where they still lack e-commerce softwares that are cost-effective, lacks general resources, complications in implementing changes, lack of technical skills and training, computer concerns, lack of ongoing cost support, lack of motivation from organizations and giving less priority to e-commerce initiatives (Hornby *et. al.*, 2002). This is what causes the competitiveness of SMEs products at the international level. Therefore, the impetus for innovation, especially innovation in the form of technology accompanied by an increase in workforce expertise, is absolutely necessary for the development of SMEs (BI, 2015).

In the knowledge society, companies need to develop competitive advantages based on adequate and intensive use of Information and

Communication Technology (ICT), which is an important element of market success today. From an economic and management standpoint, ICT has been considered as (1) social construction; (2) information providers; (3) infrastructure - hardware and software and (4) business processes and systems. From a marketing point of view, ICT has also been seen as (1) various separate applications (Internet, database, PowerPoint); (2) marketing channels; (3) communication / promotion media; (4) marketing techniques and (5) tools for relationship marketing (Barba-Sánchez *et. al.*, 2007). This fact is very relevant for Small and Medium Enterprises (SMEs), whose survival depends on some other factors such as the use of ICTs to develop new organizational models that compete in new markets or improve the relationships of internal and external communications that they provide to develop SMEs. ICTs have the potential to produce changes that make them more competitive, innovative and produce growth (Barba-Sánchez *et. al.*, 2007). For example, the use and adoption of social media marketing as a new communication tool provides a unique opportunity for SMEs to enter the global market (Dahnil *et. al.*, 2014).

To get market information, SMEs need to have market learning capabilities, namely the ability of companies to actively and deliberately learn about customers, competitors, channel members and the broader business environment in a way that not only allow a deep understanding of current market conditions but also allow future market changes to be predicted (Cayla & Arnould, 2013). In increasingly complex and dynamic markets, companies need to be more active in investigating and experimenting to be able to anticipate broader market changes rather than passively monitoring the market and responding accordingly when changes occur (Day, 1994). Two important sources of information for the development of SMEs in the global market are information about marketing and network channels and information about export procedures.

Knowledge of culture and language. The medium category in limited knowledge about culture and language shows that SMEs in Indonesia still have quite serious obstacles to overcome in the adaptation

of culture and language in foreign markets. As several studies have shown, the limitations of SMEs in the knowledge of culture and language (Knowles *et. al.*, 2006; Pinho & Martins, 2010), seems that SMEs in Indonesia has the same problem. Communication is one of the biggest obstacles when doing international business. Therefore, the adaptation approach can accommodate cultural, legal, language, communication and geographical differences in the market (Hornby *et. al.*, 2001). Strong international orientation seems to be the determinant of success in international trade. Decision makers of successful companies are more likely to have high foreign language skills but often do not use their foreign language skills in business. The use of English globally as a business language forms an attractive basis for decision makers to break away from having to learn foreign languages altogether. On the other hand, it is important to learn the language of trading partners to succeed in international businesses. All companies get the benefits from international skills development (foreign language and/or intercultural awareness). This is the skill development in successful companies that facilitate the transfer of business acumen from the domestic market to the international market. The development of skills and knowledge for international trade takes place through the process of exports, imports, inward investment and international research arrangements (Knowles *et. al.*, 2006).

Information resources. The resource limitation index is in the medium category which shows that SMEs in Indonesia still do not have complete access to information about the global market. The inability to access information, especially market information, is a common obstacle faced by SMEs at the international level (Pinho & Martins, 2010; Paula *et. al.*, 2017). Information obtained through different network relationships from companies is positively related to the introduction of various types of innovations (products / processes / markets / organizations) in SMEs (Varis & Littunen, 2010). Networks occur as a natural and inherent entrepreneurial activity. Networking is an inherently natural aspect of marketing decision making for SME owners to conduct business processes. SME owners/managers do marketing through their natural and inherent network activities, through all their normal

communication activities, such as interacting and participating in social, business and trade activities. The frequency and focus can vary, depending on the nature of the market where the company operates. For example, the international networks may be more focused than domestic networks because of the need for future planning, while contact with the domestic markets may be more frequent than with the international markets because of convenience (Varis & Littunen, 2010).

Financial resources. The limited index of financial resources in the medium category shows that SMEs in Indonesia still have limited financial resources to support global marketing. This is related to the internal constraints regarding government support for the SMEs globalization. Pinho and Martins (2010) and Paula *et. al.* (2017) stated that the limited capital support for marketing activities in the global market has reduced the role of SMEs in the export market.

Financial resources involve cash availability for investment in activities related to corporate marketing. From this perspective, marketers obviously care more about the size and accessibility of the relevant marketing budget (Piercy, 1987). However, many activities related to marketing can attract direct or indirect financial resources from outside the specified marketing budget. It is evident that access to financial resources needed is important in determining a company's ability to successfully engage in marketing activities such as advertising, distribution processes and market research. Two important financial sources for the development of SMEs in the global market are financial resources for conducting research in the international market and adequate working capital to finance export activities. About 60-70% of MSMEs have not obtained access to bank financing yet. Thus, that funding facilities with low-interest rates are also very necessary to support MSMEs business activities, and the ease of credit in the ceiling, interest rate, time period and the process of submission are highly expected by MSME business actors.

5.7 Conclusion

Globalization has presented SMEs with many threats and challenges (Al-Hyari *et. al.*, 2012). Obstacles and challenges involve market knowledge and supporting success in the global market. The research findings show that the majority of SMEs in Indonesia still have limited knowledge about markets, especially those related to the search for overseas market opportunities, competition in foreign markets, product adaptability to foreign markets, information about marketing channels and networks and aspects of culture and language. The limitations of supporting factors, in addition, include the support of financial resources, technology and information capabilities, support for promotional programs and government assistance, and physical facilities supporting global marketing. Knowledge of the obstacles to global marketing is the basis of public policy creations that can support companies and overcome existing obstacles. Public policy measures and export assistance agencies must be made and directed at efforts to reduce the barriers to global marketing to encourage increased export activities of domestic SMEs. The government must strive to maintain and improve national information networks such as trade show institutions, the use of e-commerce as a tool to overcome market distance and trade missions for the purpose of increasing export sales.

At the level of SMEs management, there are several managerial implications that can be drawn from this study. Export activities may be very attractive from a manager's perspective; exceeding national borders and exporting to foreign markets can provide many positive benefits for SMEs such as growth, expansion and survival. More specifically, through exports, SMEs can generate more funds for re-investments and growth, extend the lifecycle of their products, build stronger competitive positions, diversify their businesses and minimize risks by operating in various markets and using foreign markets to absorb their excess capacity. This can be achieved through closer cooperation with foreign customers and the creation of strategic alliances with other exporters. Then, to ease the negative relationship between lack of managerial experience and export performance, more overseas visits, export

workshops, seminars and overseas training programs should be conducted on product development and marketing in order to help SME managers to overcome mental barriers and develop positive attitudes towards international marketing activities.

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CHAPTER 06

MSME'S PERCEPTION OF OBSTACLES TO TRADE IN THE GLOBAL MARKET: CASE STUDY IN EAST JAVA, INDONESIA

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Abstract

Most of the business actors in East Java are micro, small, medium and large businesses (MSMEs), which comprise 99.85% of all businesses. In 2013, East Java MSMEs were able to absorb employment of 6.8 million people. The MSME sector has a unique business pattern, which is done more in the informal sector. One of them is that the MSME sector is facing challenges in an environment which supports the use of funding sources of its own ability, and does not use funds from financial institutions. This paper aims to analyze the constraints and business challenges and obstacles faced by East Java MSMEs in participating in the global market. How to prioritize strategies in developing MSME competencies of East Java, in an effort to improve economic competitiveness to enter the global market. However, there are fourteen aspects which have become challenges or obstacles. The lack of knowledge to explore opportunities and threats in foreign markets is a low category of barriers for Micro, Small and Medium Enterprises in East Java. Knowledge of competition in foreign markets is a high category barrier for the respondents to enter the international market. In

the meantime, the twelve aspects which consist of information limits relating to marketing and network channels, lack of financial resources to conduct research on the international market, lack of working capital time and sufficient funds to finance export activities, lack of management emphasis / commitment to develop export activities, limited knowledge in meeting importer's quality standards, lack of knowledge to adapt products to foreign markets, lack of the market system, cultural and language barriers, limited information about export procedures, lack of knowledge of promotion and assistance programs by the government, knowledge of Information and Communication Technology, Information and Communication Technology Facilities and Infrastructure for business are also quite challenging issues for Micro, Small, Medium, Enterprises in East Java to enter the Global Market.

Keywords: Micro Small Medium Enterprises, Challenges and Obstacles, Global Market

6.1 Introduction

The target of economic development can only be achieved with the synergy of cross-sectoral economic development programs and programs, especially the need for synergy of development programs among government agencies, as well as the synergy of the government with the business world and society. The development targets above can be achieved if collaborating with Cooperatives, which are already known to the public. So that MSMEs (micro, small and medium enterprises) can be used as an engine of innovation and national economic growth, so as to be able to provide employment. The role of micro, small and medium enterprises (MSMEs) in the Indonesian economy, should have been implemented concretely and seriously within the past 10-20 years. A reflection as to whether 2015, would be the start of the ASEAN Economic Community which can deliver MSMEs hope in the future, at least can be seen from several aspects such as the following: 1. Its position as a major player in economic activities in various sectors. 2. The largest employment provider. 3. An important player in the development of local economic activities and community empowerment.

4. New market creators and sources of innovation. 5. Its contribution in maintaining the balance of payments through export activities. Managerial assistance for MSMEs needs to be considered by cooperation with universities, as the key channel of education, research and community service. Moreover, it cannot be denied that MSMEs still have limited competencies and other skills, including understanding of accounting procedures.

Many sectors that can be developed and receive attention such as the Malaysian MSMEs in the future which are more oriented towards the development of biotechnology, as well as the Thai MSMEs that include various MSMEs in producing automotive products. What about Indonesian MSMEs? The activity sector related to plantations, fisheries and processing industries is an activity that is very closely related to the creation of initial strengths for the people's economic endeavors to gain space in large-scale businesses with high added value. The government should expand the access of SMEs to productive resources, in order to be able to take advantage of local potentials, especially natural resources. To enable increased capacity of SMEs in utilizing local opportunities and the global market, this needs to be supported by the development of companion institutions that are expected to be able to provide reinforcement support to enhance the ability of SMEs to gain access to technology and markets (non-financial) as well as access to capital. In this regard, the growth of training institutions and those that provide services for SMEs in a reasonable manner need to be developed extensively.

Ardiana (2010) explained that of the 140 respondents of the 2008 MSME entrepreneurs in Surabaya, had a variety of educational levels, namely Elementary Schools totaling 21 people, and the Junior High School with as many as 17 people and Public High Schools with 72 people. From the data presented in the study, it was concluded that as many as 73% of MSME entrepreneurs with an undergraduate education background, with a relatively young age distribution, namely <25 years, 22 people, entrepreneurs aged 25 to 30 years, and age 30.01 to 35 years amounted to 32 people, and the age of 35.01 to 40 years amounted to 23

people, in the management aspects of the duration of the business mentioned ranged from 10-20 years amounting to 36%. So, it can be concluded that in managing MSMEs there are managerial limitations. To what degree does the competency consist of Knowledge, Skills and Abilities possessed by MSME members? Of course, there is no denying that proficiency in knowledge involves many aspects such as individual encouragement, impact and results, analytical power, strategic thinking, creative thinking, decisive decision making, commercial assessment, management team and leadership, ability to adapt and overcome change and pressure, ability to plan and control projects.

Economic growth in East Java (East Java) during the first quarter of 2018 reached 5.5 percent, which is a reduction compared to the fourth quarter of 2017, which rose to 5.7 percent. However, this growth is higher than the national economic growth rate of 5.1 percent. From the demand side, the slowdown in the performance of domestic net exports and investment was the main cause of East Java's economic slowdown in the first quarter of 2018. This earlier sluggish trend is due to lower demand for Eastern Indonesia (Kalimantan, Sulawesi, Bali, Nusa Tenggara, Papua) consumer goods, East Java's main trading partner. The Micro, Small and Medium Enterprises (MSME) sector contributes greatly to the economy of East Java (East Java). It was recorded in the first semester of 2018, that East Java's economic growth reached 5.57% with a GDP at Current Prices (ADHB) reaching Rp 544.44 trillion. This achievement was due to the support of MSMEs in East Java. MSMEs also contribute greatly to the realization of investment. The realization of investment in East Java in 2017 from the MSME sector amounted to Rp152.39 trillion. In the first semester of 2018 it was Rp.95.95 trillion, up 22.87% from the same period in 2017 (BPS, 2018).

6.2 Literature Review

Micro, Small, and Medium Enterprises (MSMEs)

Definition of Small Business: According to Law No. 9 of 1995 concerning Small Businesses: "Small-scale businesses are small-scale economic activities of the people and fulfill the criteria for net worth or

annual sales proceeds and ownership as stipulated in this Law. Criteria for Small Businesses are: a. has a net worth of at most Rp. 200,000,000 (two hundred million rupiahs), excluding land and buildings of business premises; b. has the highest sales of Rp. 1,000,000,000 (one billion rupiah); c. owned by Indonesian citizens; d. stand alone, not a subsidiary or branch of a company that is owned, controlled or affiliated directly or indirectly with a Medium or Large Business; e. in the form of businesses of individuals, business entities that are not legal entities, or business entities incorporated as legal entities, including cooperatives. "

According to Law No. 20 of 2008, concerning Small, Micro and Medium Enterprises: (a) Micro business is a productive business owned by individuals and / or individual business entities that meet the criteria of being a Micro Enterprise as stipulated in this Law. The criteria for Micro Enterprises are to have maximum assets of Rp. 50,000,000 and a maximum turnover of Rp. 300,000,000. (b) Small Business is a standalone productive economic enterprise, carried out by individuals or business entities that are not subsidiaries or not branches of companies owned, controlled, or have become a part of either directly or indirectly of medium-sized businesses or large businesses that meet the criteria for Small Businesses as referred to in this Law. The criteria for Small Business are the ones that have assets of Rp. 50,000,000 to Rp. 500,000,000 and a turnover between Rp. 300,000,000 to Rp. 2,500,000,000. (c) Medium Enterprises are productive economic activities that are independent, carried out by individuals or business entities that are not subsidiaries or branches of companies that are owned, controlled, or become part of either directly or indirectly with Small Businesses or large businesses with a number of net assets or annual sales proceeds as stipulated in this Act. Criteria for Medium Enterprises is to have assets of Rp. 500,000,000 up to Rp. 10,000,000,000, and the turnover is between Rp. 2,500,000,000 and Rp. 50,000,000,000.

Micro business is a productive business owned by a family or an individual with Indonesian citizenship which has has a maximum sale of Rp. 100,000,000.00 (one hundred million Rupiah) per year as referred to in the Minister of Finance's Decree No.40 / KMK.06 / 2003. The criteria

for Micro Business are as follows: (a) has a net worth of at most Rp. 50,000,000 (fifty million rupiahs) excluding land and buildings of business premises; or (b) has annual sales of a maximum of Rp. 300,000,000 (three hundred million rupiah).

The definition of Small Business and its Criteria according to Law No. 20 of 2008, is that Small-scale Enterprises are productive economic businesses that are independent, carried out by individuals or business entities that are not subsidiaries or not branches of companies that are owned, controlled, or have become a good part, directly or indirectly, of Medium Businesses or Large Businesses that meets the criteria for Small Businesses as referred to in this Law. According to Law No. 9 of 1995, Small Business is a small-scale people's economic activity and meets the criteria for net wealth or annual sales proceeds and ownership as stipulated in this Law; Criteria for Small Business are as follows:

- a. has a net worth of more than Rp 50,000,000 (fifty million rupiahs) up to a maximum of Rp 500,000,000.00 (five hundred million rupiahs) excluding land and building of business premises; or
- b. has annual sales of more than Rp. 300,000,000.00 (three hundred million rupiahs) up to a maximum of Rp. 2,500,000,000.00 (two billion five hundred million rupiahs).

The principle of classification according to the type of economic activity follows the concept of ISIC (International Standard Classification of All Economic Activities) Revised in 1968. The classification of this sector aims to facilitate the comparison of the level of economic activity between various types of activities. For the purpose of compiling the classification of Micro, Small and Medium Enterprises here 9 main categories (main) of the economic sector are used (Statistics of Small and Medium Enterprises in 2007-2008) which two (Trade, Restaurants, and Transportation) of 9 main categories are objects of research include: Agriculture, Mining, Processing Industry, Electricity, Building or Construction Buildings, Trade-Hotels-Restaurants, Transportation – Communication Transportation, Finance, Leasing and Company Services.

Global Market

According to (Strange, 1996) The global market is the place where the company operates and competes. Global market is marketing that accepts the existence of complex world markets (geocentric) through the integration of cosmetics, foreign and international marketing activities that can lead to synergies while maintaining the organization's strategic goals and competitive advantage as a force over global marketing efforts (Budiarto and Tjiptono, 1997: 341). Moorthy (2012) in his study of 7443 MSMEs in Malaysia, stated that the effective variables of entrepreneurship, human resource management, marketing information and information technology applications significantly influence the performance of MSMEs. It should be noted that the managers of MSMEs aged 26–35 years were found to be 17.7%, while those aged 36–45 were 40.7%, and 40.2% were over 46 years old. Diploma level education was rated at 44.5%, and Strata 1 at 50.7%. MSMEs in Indonesia need to be supported by various approaches in the development of MSMEs, especially in East Java.

Tedjasuksmana (2014) stated that the support needed was mainly assistance to increase the ability to obtain market access, technology and capital developed through banks or non-banks. Disbursement of funds from any source needs to be studied more deeply, what percentage of funds is received, because it can be possible that the disbursement of funds is very small, besides that it is necessary to do research whether the funding institution requests collateral assets, while MSMEs are generally limited to ownership of fixed assets. There is a concern that the realization of the vision and mission of financial institutions should not only be oriented towards "channeling" funds for profit motives alone, in other words, whether the form of funding disbursement available to small businesses that need funds is given purely on a "cooperative" basis. The views of large companies that have entered the world of international trade, should be governed by government policies, namely at least cooperating with MSMEs as partners. MSMEs are an important part of the company, as did the IPB incubator. Through the collaboration process it will have an influence on many aspects. The participation of

MSME incubators in national and international exhibitions is expected to produce positive results. Seeing this description, the Ministry of Cooperatives and SMEs in cooperation with the Ministry of Education should include the world of higher education, especially in transferring expertise to MSME members, in incubator containers, so that they can help improve efforts for better performance, both in management assistance and other skills. In the end even though poverty can be reduced through growth with equity, but vulnerable poorer groups still need social intervention.

Funding and Marketing Management Aspects of SME's

Speaking of funding institutions as institutions providing capital for a business, cannot be seen as separate from the perspective of bank observing financial information of a business that can provide a description of the sources and uses of funds presented in the form of cash flow. Ardianti & Retno (2013) as many as 141 micro and small entrepreneurs in East Java studied have considerable social capital, which refers to financial support by parents, networks of parents, family members, friends, colleagues, group organizations, moral parents, family members, and friends. Suggestions for entrepreneurs are that they should change their attitude in giving a positive response in every event, so that they can strengthen the relationship that exists and this will ultimately increase support in the financial sector, as well as moral support. In addition, an entrepreneur is expected to be able to be more flexible in the sense that he is able to adapt to the traits possessed by others so that an entrepreneur can establish relationships that exist both for colleagues, family members, parents, friends, and groups of organizations which can lead to entrepreneurs having a large amount of social capital. Respondents, who have high entrepreneurial leadership, where respondents are able to create changes both in character and environment, according to Thornberry, 2006), has the potential for larger social capital, because it has social support, both through bonding (parents, family members, friends) or bridging (associates, groups or affiliated organizations (Stone, 2013).

Most of the micro, small and medium enterprises (MSMEs) in East Java still face a number of obstacles to improve export performance, one of which is the brand and product packaging problem. Out of 6.2 million MSMEs in East Java, only 3,476 MSMEs have been able to penetrate the export market. This number tends to have a slower growth due to a number of obstacles faced. Whereas there were around 70,000 MSMEs (East Java Cooperative and UMKM Office, 2016). We recognize that packaging and brand issues are important in exports. For example, food when it is wrapped in plastic without a brand and with details of content might sell locally, but it would not sell overseas because consumers need assurance and quality. To boost the performance of East Java MSMEs, the East Java Cooperative and MSME Office in 2016 budgeted a direct expenditure of around Rp.116 billion to be used as shopping for the needs of training, exhibitions and promotions for East Java's leading MSMEs. As for 2016 the East Java Cooperative and UMKM Service has 40 exhibitions outside the province, and there are 4 countries for overseas exhibitions including Japan, Singapore, Thailand and Germany. In addition to packaging and brand issues, the obstacles that have been experienced by MSMEs are capital and marketing problems. However, he said, this year the East Java Provincial Government has prepared a financing scheme for MSMEs by preparing IDR 400 billion through the Loan Agreement scheme with Bank Jatim. The scheme prepared by this government will help MSMEs in terms of financing or capital with low interest at a maximum of 9%. Well, we (who) ? at the Department of Micro MSME's and Cooperation act as a connector and guarantor, so that banks are keen to channel their credit to potential MSMEs. From East Java there will be a range of consumer goods such as fashion, craft, food and beverage products, herbs, accessories, leather products, agriculture, furniture and banking services.

6.3 Research Methods

The object of this research was about the perceptions of micro MSMEs in East Java. This research scope related to area in East Java (Ponorogo, Madiun, Mantingan-Ngawi, Kediri, Surabaya, Malang). University of Darussalam Gontor plays a role as one of the academic

institutions in East Java, with its Faculty of Economics and Management taking part and supporting the analysis of MSMEs in East Java's development to compete in the Global Market. This research was conducted with the aim of finding out what obstacles were faced by MSMEs in East Java and which area of development was the main priority to be solved based on the MSME's perspective. The approach used in this research was quantitative and involved data collection techniques such as survey methods using questionnaires given to respondents in the study. The population in this study were all entrepreneurs of MSMEs in East Java, while the sample used, which was 250 respondents, was mostly MSMEs in East Java which covered some MSMEs in Ponorogo, Madiun, Mantingan-Ngawi, Kediri, Surabaya, Malang area. This research used nonprobability sampling with purposive sampling technique which involved restaurants, transportation, and retail outlets. Data analysis was carried out by means of descriptive statistical tests, which was analyzed using SPSS 20.

6.4 Finding and Discussion

The development of MSMEs in Indonesia shows enormous potential. With an increase of 2.88% in 2008, its existence contributed greatly to the National Gross Domestic Product (GDP) of 55.56% on 2008, with a value of Rp. 2,609.36 trillion. MSMEs absorb around 97.04% of the total employment force at the national level, which is 90,896,270 people. The total number of MSMEs is 99% of the total existing business units or 51,257,537 units. With a very large percentage it shows how big the potential of MSMEs is. If the government and related parties can be more concerned about MSMEs development, the potential for MSMEs to grow will be very large and will be making MSMEs the main driving force of the Indonesian economy.

6.5 Profiles of Respondents

Gender

The gender of the respondents consisted of both men and women. After the questionnaire was distributed to 250 respondents, identification of

respondents, who were sampled based on sex, was conducted, and the respondents were dominated by men 123 people or 49.2% and women accounted for 127 people or 50.8%. The profile of respondents, according to sex can be seen in appendix 1.

Level of education

As far as the education level of the respondents is concerned, as many as 157 or 62.8% of the respondents had high school education followed by S1 educated respondents who accounted for 35 people or 14%, 42 respondents had elementary school education or 16.8%, 9 respondents had diplomas or 3.6% and as many as 4 people or 1.6% of them had S2 education as seen in appendix 2.

Business Ownership Status

The ownership status of the respondent's business consisted of 3 main categories, namely, the owner, manager and owner manager category. After the questionnaire was distributed to 250 respondents, identification of respondents was conducted. Respondents who had ownership status were as many as 133 people or 53.2%, respondents who had ownership status as managers accounted for 49 people or 19.6% and respondents who had ownership status as owners as managers were as many as 66 people or 26.4%. Respondents who had other ownership status only involved 2 people or 0.8%.

Entrepreneurial Skills

The entrepreneurial expertise possessed by respondents before opening a business consisted of two categories, namely having entrepreneurial expertise and not having entrepreneurial skills. After the questionnaire was distributed to 250 respondents, identification of respondents who had entrepreneurial skills involved 132 people or 52.8% and respondents who did not have entrepreneurial skills accounted for as many as 118 people or 47.2%.

Religion

From the results of processing questionnaires obtained profiles of respondents who were sampled in this study. After the questionnaire was distributed to 250 respondents, it was clear that respondents who were Moslems were 250 people or 100%.

Types of Training that have been attended

The processing of questionnaires enabled the researcher to ascertain the profiles of respondents who were sampled in this study into three categories, namely, respondents who had attended vocational-based training, training based on the job training, and training in universities. After the questionnaire was distributed to 250 respondents, identification of respondents was conducted. Respondents who attended vocational training included 21 people at 8.4 %, 111 or 44.4 % of those who attended on - the-job training, and 10 or 4 % of those who attended college training, and 106 or 42.4 % of those who attended other training (from government agencies and so on).

Challenge and Obstacle Aspects

There were fourteen aspects that were identified as challenges and obstacles for Micro Small Medium and Enterprises to enter into the Global Market. These are a lack of knowledge to look for opportunities and threats in foreign markets; Knowledge of competition in foreign markets; Information limitations about marketing and network channels; Lack of financial resources to conduct research on the international market, lack of working capital time and sufficient funds to finance export activities; lack of management emphasis / commitment to develop export activities; limited knowledge in meeting importer's quality standards; lack of knowledge to adapt products to foreign markets; lack of knowledge of the market system, cultural and language barriers; lack of information about export procedures, lack of knowledge on promotion and assistance programs by the government; lack of knowledge on Information and Communication Technology; lack of Information and Communication Technology facilities and infrastructure for business.

Meanwhile, MSMEs or Micro, Small and Medium Enterprises are in great demand by many people in Indonesia. No wonder the MSMEs are the largest business group in Indonesia and contribute to Indonesia's economic growth by 60%. In addition, the MSME business is stronger in facing the global crisis. To be able to face the global market is indeed a tough challenge, because MSME products will have to compete with the products of other countries. The strategy of proper matching is needed to develop MSMEs, in order to compete with the global market based on 14 aspects as follows.

Lack of knowledge of opportunities and threats on international market.

MSMEs in East Java have a lack knowledge of opportunities and threats relating to participation in the international market. Based on the results of the research, 40% of the MSMEs business sector reported that this issue has become a serious challenge, then 24% of the business is in providing consumer goods, 26.8% in other fields, and the rest in the fields of transportation, industry, construction and also agriculture.

The Ministry of Trade's Director of Market Development and Export Information the obstacle that was often encountered by entrepreneurs who want to enter the export market, especially for micro, small and medium enterprises (MSMEs), was the lack of understanding and information about the export destination countries (Satria, 2019).

Lack of low barriers knowledge to explore the opportunities and threats in foreign markets is the low say it more precisely categories of obstacles for the respondent to enter the international market. As many as 98 people or 39.2 percent of the respondents said that MSME's in East Java was seen to be able to enter the international market.

Knowledge of competition in foreign markets

Knowledge of competition in foreign markets is a high category barrier for the respondents to enter the international market. As many as 36% of the respondents or 90 people stated that this was seen as a high barrier to MSMEs in East Java to be able to enter the international market.

(Tamjuddin, 2013) said that competition in international trade is very determined on the primacy of owned or resulting product excellence, core competencies as a flagship product that proclaimed, that yet is a step concrete one village one product, the necessary political will, for more 70,000 villages should be prepared find/determine the product benefits to serve as the flagship business. Rewrite.

Limitations of information on marketing channels and networks

Limitations of information on marketing channels and networks are a barrier to the admission of respondents to the international market in this segment. As many as 49.2% of the respondents or 123 people stated that this was seen as quite a challenging obstacle for MSMEs in East Java to be able to enter the international market. Micro Small Medium Enterprises has limitations in a variety of ways, including the following limitations to access market information, market coverage limitations, limitations of the network's work, and the limitations of a strategic effort to access location (Shaferi & Widiastuti, 2019). This paper aims at putting together a description of the marketing system of Micro Small Medium Enterprises, in order to secure competitive advantage in the era of globalization and autonomy of the region.

The lack of financial resources to research in international markets

The lack of financial resources to research in international markets is an obstacle that was quite challenging for respondents to enter the international market. As many as 48.4% of respondents or 121 people have declared that this was seen as quite challenging an obstacle for MSMEs in East Java to be able to enter the international market. According to Salsabiila (2018), competitiveness among Micro Small Medium Enterprises in Indonesia is still weak in facing competition in a global market. A problem common in the Micro Small Medium Enterprises sector is still the lack of capital, the lack of human resource experts, a poor infrastructure, inefficient bureaucracy, and lack of market information for owners of Micro Small Medium Enterprises to develop their markets

Lack of time and sufficient working capital to finance export activities

The lack of time and sufficient working capital to finance export activities is a challenging category (please standardize this expression) for the respondents to enter the international market. As much as 46.8% of the respondents or 117 people stated that this was seen as quite a challenging obstacle for MSMEs in East Java to enter the international market. Asbiantari, Hutagaol, & Asmara, (2016) said the increase in the contribution of the processing industry indicates that the processing industry showed an increase, where such activities, with increased working capital needs will increase. Lack of working capital for micro small medium enterprises as domestic economy potential in international trade (exports minus imports) showed a relatively small contribution, even in almost in every quarter during the period 2012-2014 indicated a negative contribution. Although in the period 2012-2014 the exports had accounted for 23.70% of GDP, the value of imports was greater i.e. 25.37%. This tendency suggests the presence of positive and negative aspects. The positive side indicates that the GDP of Indonesia rests on the strength of the domestic economy, however the downside if the trend declines in the contribution of the trade surplus continued to decline to negative or could even result in a deficit balance trade, rewrite it is not clear then this needs to be controlled so as not to flood the imported products will harm domestic products.

A lack of management emphasis/commitment to developing export activities

A lack of management emphasis/commitment to developing export activities constitute another category of barriers which is quite challenging for respondents to enter the international market. As much as 47.2% of the respondents, or 118 people, stated that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. The study by Yolamalinda, Utami, & Amaluis (2016) found that the orientation of the market is a large enough influence on the MSME's, new products,

product quality, customer service, sales-force commitment, relationships, ROA, profits, sales volume, market share and growth. To shift the orientation of companies from domestic to international measurement what do you mean? is also required from the domestic market based on consumers, competitors, as well as external markets.

The limitations of knowledge in the fulfillment of the quality standard importers what do you mean?

The limitations of knowledge in the fulfillment of the quality standard of the importer is a challenging enough category of barriers for the respondents to enter the international market. As much as 47.6% of the respondents, or 119 people, stated that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. According to Wibowo (2016), standardization that is considered high for small and medium companies in Indonesia have been the discouraging export opportunities. The global economic situation also affected the flaggling export figures in Indonesia, but noted that there are sources of potential export commodities to add export that has not been disbursed because of being hampered by export regulations complicated and the product certification process face to face on the bureaucracy.

Lack of knowledge to customize products for foreign markets

Lack of knowledge to customize products for foreign markets is an obstacle and is in a category that is quite challenging for respondents to enter the international market. As much as 45.6% of respondents, or 114 people stated, that this was seen as quite challenging an obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. Yolamalinda, Utami, & Amaluis (2016) suggested that Cadogan could be used to measure the performance of an export company. Variables used by Cadogan, among others, are: Export Intelligence generation, export intelligence dissemination, export intelligence responsiveness, coordinating mechanism. Cadogan conducted his research using a sample manufacturing company in the

United Kingdom and Netherlands with test items that were used to measure the orientation of the export market. This testing method used cross-cultural validation. The results showed that the size of the export market orientation was quite a valid criterion to test the export performance of a company.

Knowledge of the market system

Knowledge of the market system is the obstacle that is quite challenging for respondents to enter the international market. As much as 50.8% of the respondents, or 127 people, stated that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. The identification of barriers in the face that also Developing Business in the MSME's Tarakan. The obstacles and problems encountered in developing the business of MSME's in the town of Tarakan in general can be caused by internal and external factors. Where are the internal limitations of availability of funds include namely the workforce or human resources management that is still very simple and yet effective so that less efficient, the lack of limitations in terms of capital, lack of means of and infrastructure as well as poor knowledge of the marketing system and the lack of infrastructure is lacking support (Ariani & Utomo, 2017).

Cultural and language barriers

Cultural and language barriers are also obstacles that are quite challenging for the respondents to enter the international market. As many as 48.4% of the respondents, or 121 people, declared that this was seen as quite a challenging obstacles for micro, small and medium enterprises in East Java to be able to enter the international market. Amelia, Prasetyo, & Maharani (2017) stated that, in addition to the constraints with the knowledge community (manufacturers) are related to marketing through technology, link not clear there are also other constraints, that is related to the language in this interaction related to trade vague? To that end, the Government offers an efficient marketing system via the web to help manufacturers in marketing their products.

Information on export procedures

Information about the export procedures is also an obstacle that is quite challenging for respondents to enter the international market. As much as 47.6% of the respondents, or 119 people, stated that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. Information about the export procedure is an obstacle for MSME's to enter the global market. Based on the results of the research by Salsabiila (2018), the strategies implemented by SMEs in an effort to sell *tempe* (soy bean products) and *tempe* chips products abroad varied. The first fact that was obtained by researchers from the first MSME's was from Mr. Syaiful Bakrie who focused more on how to enter the Southeast Asian market through learning food standards, export terms and procedures. He also focused on standards for packaging goods and food quality standards. This is similar to the statement by Mrs. Niskha Sandriana from the Malang City Industry Service about fulfilling certain conditions and that later the product can be accepted abroad and can compete with other products on the international market.

Knowledge of program promotion and assistance by the Government

Knowledge of program promotion and assistance by the Government is quite a challenging obstacle for respondents to enter the international market. As much as 50.4% of the respondents, or 126 people, stated that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. Lack of knowledge about program promotions and assistance given by the local government to trade in global markets was also faced by MSME's in Madiun, and, therefore, the local government should collaborate with other relevant institutions for international market promotion. Firmansyah, Pratiwi, & Riyanto, (2014) reported that the local government has facilitated *brem* (cassava's fermentation product) entrepreneurs in Kaliabu Village by helping *Brem* entrepreneurs with market information assistance, providing promotional assistance,

helping Brem entrepreneurs by collaborating with supermarket owners and souvenir shops for typical Madiun Regency food, so that Brem can enter into it and include the products of brem in local, regional and national exhibitions. Diskoperindagpar, Madiun Regency has participated in exhibitions in Madiun City, Nganjuk, Jakarta, Jombang, Sumenep and Malang City.

Knowledge of information and communication technology

Knowledge of information and communication technology is an obstacle that is categorized as quite challenging for respondents to enter the international market. As much as 41.6% of the respondents, or 104 people, stated that this was seen as quite challenging an obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. Research by Nadya Chandra Rosianti (2017) indicates the lack of knowledge on information and communication technology as seen from an MSME's perspective on East Java. Based on the three aspects studied in the information technology readiness area, the highest aspect with IT concerns IT Application. This is because the majority of points in the area do not require a special budget and are available free, such as e-mail, social media, internet use, or software applications used. These are then followed by aspects of IT Infrastructure and IT HR. The IT Infrastructure aspect is motivated by the condition of MSMEs that have limited funding allocations. In addition, the majority of MSMEs do their businesses offline, and so they do not need the high-tech IT infrastructure. The IT HR aspect is the lowest average aspect because the MSME business process does not require the latest IT infrastructure, and, therefore, MSME's do not allocate employees specifically to handle IT.

Facilities and infrastructure, information and communication technology for business

Facilities and infrastructure, information and communication technology to business is categorized as a sufficiently challenging obstacle for the respondents to enter the international market. As much as 40 % of the

respondents, or 100 people, claimed that this was seen as quite a challenging obstacle for micro, small and medium enterprises in East Java to be able to enter the international market. Many MSMEs in Indonesia still use old or traditional technology in the form of old machines or manual production tools. The backwardness of this technology makes the total factor of productivity and efficiency low. The lack of use and availability of IT facilities is a business limitation since IT and e-commerce facilitate greater efficiency, mass adjustment, where IT and e-commerce allow interactive communication between buyers and designers, so customers can quickly and correctly configure the desired product. In addition, electronic orders increase the speed of the production facility in minutes (Widajanti, 2011).

6.6 Conclusion

There are fourteen aspects that have become challenges and obstacles for Micro Small Medium and Enterprises in East Java to enter into Global Market. Lack of knowledge to explore the opportunities and threats in foreign markets is categorized as low obstacles for Micro, Small, and Medium Enterprises in East Java. Knowledge of competition in foreign markets are barriers of a high category for the respondents to enter the international market. Meanwhile, the twelve aspects which are also quite challenging for Micro, Small, Medium, Enterprises in East Java to enter the Global Market consist of Information limitations about marketing and network channels, lack of financial resources to conduct research on the international market, lack of working capital time and sufficient funds to finance export activities, lack of management emphasis / commitment to develop export activities, limited knowledge in meeting importer's quality standards, lack of knowledge to adapt products to foreign markets, lack of knowledge of the market system, cultural and language barriers, lack of information about export procedures, lack of knowledge about promotion and assistance programs of the government, lack of knowledge of Information and Communication Technology, lack of Information and Communication Technology Facilities and Infrastructure for business.

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Ependix :

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Pemilik	133	53.2	53.2	53.2
	Manajer	49	19.6	19.6	72.8
	Pemilik sekaligus manajer	66	26.4	26.4	99.2
	Lainya	2	.8	.8	100.0
	Total	250	100.0	100.0	
2					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	123	49.2	49.2	49.2
	Female	127	50.8	50.8	100.0
	Total	250	100.0	100.0	
5					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Non Formal Education	3	1.2	1.2	1.2
	Primary School	42	16.8	16.8	18.0
	Secondary School	157	62.8	62.8	80.8
	Diploma	9	3.6	3.6	84.4
	First Degree	35	14.0	14.0	98.4
	Postgraduate	4	1.6	1.6	100.0
	Total	250	100.0	100.0	
6					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Islam	250	100.0	100.0	100.0
7					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	132	52.8	52.8	52.8
	No	118	47.2	47.2	100.0
	Total	250	100.0	100.0	
D4-1_ PartD4 Trading					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	42	16.8	16.8	16.8
	2	35	14.0	14.0	30.8

	3	44	17.6	17.6	48.4
	4	100	40.0	40.0	88.4
	Highest	29	11.6	11.6	100.0
	Total	250	100.0	100.0	
D4-2					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	37	14.8	14.8	14.8
	2	48	19.2	19.2	34.0
	3	55	22.0	22.0	56.0
	4	90	36.0	36.0	92.0
	Highest	20	8.0	8.0	100.0
	Total	250	100.0	100.0	
D4-3					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	41	16.4	16.4	16.4
	2	25	10.0	10.0	26.4
	3	123	49.2	49.2	75.6
	4	43	17.2	17.2	92.8
	Highest	18	7.2	7.2	100.0
	Total	250	100.0	100.0	
D4-4					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	53	21.2	21.2	21.2
	2	33	13.2	13.2	34.4
	3	121	48.4	48.4	82.8
	4	23	9.2	9.2	92.0
	Highest	20	8.0	8.0	100.0
	Total	250	100.0	100.0	
D4-5					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	54	21.6	21.6	21.6
	2	32	12.8	12.8	34.4
	3	120	48.0	48.0	82.4
	4	20	8.0	8.0	90.4
	Highest	24	9.6	9.6	100.0
	Total	250	100.0	100.0	
D4-6					
		Frequency	Percent	Valid Percent	Cumulative Percent

Valid	Lowest	63	25.2	25.2	25.2
	2	25	10.0	10.0	35.2
	3	121	48.4	48.4	83.6
	4	13	5.2	5.2	88.8
	Highest	28	11.2	11.2	100.0
	Total	250	100.0	100.0	
D4-7					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	65	26.0	26.0	26.0
	2	17	6.8	6.8	32.8
	3	119	47.6	47.6	80.4
	4	21	8.4	8.4	88.8
	Highest	28	11.2	11.2	100.0
	Total	250	100.0	100.0	
D4-8					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	49	19.6	19.6	19.6
	2	33	13.2	13.2	32.8
	3	114	45.6	45.6	78.4
	4	29	11.6	11.6	90.0
	Highest	25	10.0	10.0	100.0
	Total	250	100.0	100.0	
D4-9					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	50	20.0	20.0	20.0
	2	18	7.2	7.2	27.2
	3	127	50.8	50.8	78.0
	4	24	9.6	9.6	87.6
	Highest	31	12.4	12.4	100.0
	Total	250	100.0	100.0	
D4-10					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	67	26.8	26.8	26.8
	2	20	8.0	8.0	34.8
	3	121	48.4	48.4	83.2
	4	21	8.4	8.4	91.6
	Highest	21	8.4	8.4	100.0
	Total	250	100.0	100.0	
D4-11					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	66	26.4	26.4	26.4
	2	16	6.4	6.4	32.8
	3	119	47.6	47.6	80.4
	4	26	10.4	10.4	90.8
	Highest	23	9.2	9.2	100.0
	Total	250	100.0	100.0	

	Total	250	100.0	100.0	
D4-12					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	54	21.6	21.6	21.6
	2	20	8.0	8.0	29.6
	3	126	50.4	50.4	80.0
	4	19	7.6	7.6	87.6
	Highest	31	12.4	12.4	100.0
	Total	250	100.0	100.0	
D4-13					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	56	22.4	22.4	22.4
	2	29	11.6	11.6	34.0
	3	104	41.6	41.6	75.6
	4	32	12.8	12.8	88.4
	Highest	29	11.6	11.6	100.0
	Total	250	100.0	100.0	
D4-14					
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Lowest	57	22.8	22.8	22.8
	2	36	14.4	14.4	37.2
	3	100	40.0	40.0	77.2
	4	24	9.6	9.6	86.8
	Highest	33	13.2	13.2	100.0
	Total	250	100.0	100.0	

CHAPTER 07

ACCOUNTING PRACTICES AND FINANCIAL LITERACY OF SMES IN MALAYSIA

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Abstract

Small and medium-sized enterprises (SMEs) contributes significantly to the economic and social development of Malaysia. The SME sector provides new job opportunities, stimulates competition and thus boosts productivity which are then translated into lower unemployment rate and many other substantial benefits to the economy. Hence, to ensure the sustainability of SMEs, an understanding towards their financial literacy, especially on the accounting practices and financial literacy, is worth studying. This study will provide an indicator on the level of financial literacy of SMEs and on how SMEs have used accounting information to sustain their businesses. The findings of the study will also provide useful information and potential policy remedies to policy makers, researchers and SMEs owners especially in the context of SMEs in the Muslim countries. The survey was conducted using a structured questionnaire that involved 16 questions in terms of a) record keeping, b) budgeting, c) use of accounting information, and d) financial literacy. Data collected from 344 respondents from the Klang Valley were analyzed using descriptive statistics.

Keywords: Accounting practices, Financial Literacy, Small Medium Enterprise, Malaysia

7.1 Introduction

Small and medium-sized enterprises (SMEs) contribute significantly to the economic and social development of many countries, be it developed or developing. In particular, the sector provides new job opportunities, stimulates competition and thus boosts productivity. This is then translated into lower unemployment rate, increased economic growth as well as enhanced competitiveness and wealth of a country. In Malaysia, SMEs comprise 98.5% of total business establishments and contributed 37.1% to the country's GDP in 2017 (SME Corp, 2018). Thus, this is a very pertinent sector of the economy and it is integral to the country's economic transformation process. Accordingly, the sustainability of SMEs is of paramount importance. However, according to Boachie et al. (2005), 60% of SMEs fail within the first five years of their operations. This is indeed alarming. Prior studies have also shown that SMEs have great difficulty in accessing credit facilities from banks primarily due to a lack of proper financial records (William, 2008; Tagoe et al. 2001). Essentially what this implies is that this may hinder the expansion of SMEs. Subsequently, this will pose a challenge to its sustainability.

Most SMEs are owner operated and it is primarily due to this that they perceive they have less need for a proper accounting system as they are involved in the day to day operations of their business. However, banks generally rely on the financial statements of a business to determine if it is going to extend any loans. Without proper books of record, it would be difficult for a firm to produce its financial statements. Given that accounting is pertinent to ensure the survival of SMEs, our study aimed to examine the accounting practices of SMEs in Malaysia. Specifically, the study focused on four main objectives. The first is to investigate the extent to which SMEs in Malaysia keep proper books of account and whether financial statements are prepared. The second focused on the importance of preparing budgets while the third

investigated the extent to which accounting information was used in making decisions in the day to day running of the business. Finally, the study looked at the extent to which the managers of SMEs understood accounting. The findings of the study will provide useful information and potential solutions to policy makers to further enhance the growth of SMEs in Malaysia. More specifically, the results will help determine if SMEs in Malaysia are able to meet the expectations of finance providers and, if not, what can policy makers do to address this. Additionally, this research will enhance the body of knowledge on this important area of accounting in SMEs. The remainder of the paper is structured as follows. The following section focuses on the review of literature, whilst section 3 discusses the research methodology. Section 4 provides the results of the study and section 5 concludes the study.

7.2 Review of Literature

The contribution of SMEs to the economic development of most developing countries cannot be denied. As alluded to earlier, SMEs provide employment, help poverty reduction and also contribute to the government coffers through the payment of income tax. Effective 1st January, 2014, SME Corporation of Malaysia defines SMEs as follows: For the manufacturing sector, a *micro* enterprise has a sales turnover of less than RM300,000 or has less than 5 employees. A *small* enterprise has a sales turnover between RM300,000 and RM15 million or a firm with between 6 and 75 employees. A *medium* enterprise has a sales turnover from RM15 million to not exceeding RM50 million or has more than 75 and not exceeding 200 employees. For the services sector, a *micro* enterprise has a sales turnover of less than RM300,000 or have less than 5 employees. A *small* enterprise has a sales turnover between RM300,000 and RM 3 million or a firm with between 5 and 30 employees. A *medium* enterprise has a sales turnover from RM 3 million to RM 20 million or has more than 30 but not exceeding 75 employees.

Most SMEs are generally registered as sole proprietorship as this is the simplest form of business organization in terms of its registration procedures. It may well be due to this phenomenon that SMEs generally

comprise a large proportion of business enterprises. A vibrant SME sector enhances the economic development of a country, particularly in developing countries. Accordingly, ensuring the sustainability of this sector is important. One of the factors that may contribute to sustainability is the need for SME owners to possess financial literacy. Past studies have found that most owners of SMEs lack accounting knowledge and because of this, ensuring sustainability of SMEs pose a big challenge. In particular, without a proper accounting system in place, measuring its true performance may not be possible.

The importance of financial literacy in ensuring the financial stability of any business has been highlighted by many past studies. More importantly, accounting information can provide insights into the growth or expansion of current business operations (Cristina, 2016). Knowledge on record keeping, reading financial statements and budgeting are essential for owners of SMEs as such knowledge will ensure its sustainability. Keeping financial records organized is important for any successful business. It provides a source of pertinent information vital for informed decision-making as well as minimizing risks (Gray, Sebstad, Cohen and Stack, 2009). The keeping of proper financial records is important for several reasons. The first is for tax returns. The second is for credit facilities and finally, proper financial records enable SME owners to make more informed decisions.

Maseko and Manyani (2011), in their study on SMEs in Zimbabwe, found that SMEs did not keep complete accounting records due to a lack of accounting knowledge and it is for this reason that its financial performance were not able to be measured. The study by Okoli (2011) revealed that the failure of SMEs in South Eastern Nigeria was the use of a single entry accounting system. Similarly, Al Smirat (2013) found that SMEs in Jordan also adopt the single entry accounting system primarily because of its simplicity and the fact that most owners of SMEs do not have adequate knowledge of accounting. Additionally, the micro enterprises have no formal financial planning and control, financial analysis as well as lack investment appraisal. However, they did maintain purchase and sales books as its primary source of data of its

operations (Fatoki, 2012). Having sound accounting practices will help SMEs in the planning and control of their operations. A case in point is the preparation of annual budgets. Whilst most SMEs are interested in only the cash flows, it is important for SMEs to prepare budgets.

The importance of budgeting is that it enables SMEs to control their income and direct capital and operating expenses of the business. Budgets also allow owners to identify possible problems in managing their resources, thus ensuring that a business will have enough money for the things they need and the things that are important to their business. However, Torres (2008) found that small business owners are not concerned about budgeting. Their main concern is more on the cash flow. It is primarily because of the lack of financial literacy amongst owners/managers of SMEs that they fail to understand that budgeting will actually allow them to plan their cash flows more efficiently and effectively.

Financial statements are important to any business as it is the primary means of communicating financial information to internal and external users of accounts. Accordingly, owners of SMEs need to be able to read such statements. An understanding one's financial position will enable the firm to spot problem areas.

7.3 Research Method

Data was collected using a questionnaire survey. Questions focused on record keeping, budgeting, use of accounting information as well as on the ability to read financial statements. Table 1 presents the list of questions that respondents had to rate using a scale of 1 (Never) to 5 (Always).

Under the heading "record keeping" questions focused on the types of records they keep, if an accounting software was used and if financial statements were prepared. The second category of questions focused on budgets, while the third category focused on the extent to which accounting information is used in decision making. The last focused on the extent of financial literacy among the managers of SMEs.

	Particulars	Never to Always[1]				
	Record keeping	1	2	3	4	5
1	Do you separate records of business expenses and personal expenses?					
2	Do you use accounting software to manage your accounting records?					
3	Do you prepare Statement of Profit and Loss?					
4	Do you prepare Balance Sheet (Statement of Financial Position)?					
5.	Do you keep records of your debtors (credit sales)?					
	Budgeting					
6	Do you prepare yearly budgets (<i>financial allocations</i>)?					
7	Do you prepare monthly budgets?					
8	Do you have a trained accountant to prepare budgets for your company?					
	Use of accounting information					
9	Do you use financial statement for business decision making?					
10	Do you use accounting information to calculate environmental cost (e.g. wastage cost)?					
11	Do you use accounting information for tax/ <i>zakat</i> computation?					

12	Do you think financial management is important for your business?					
	Financial Literacy					
13	How well do you understand financial statements from scale 1 – 5?					
	1 – Not at all, 2 – a little, 3 – not sure, 4 – general understanding,					
	5 – very well					
14	How useful is the accounting information for your business from scale 1 – 5?					
	1 – Not at all, 2 – a little, 3 – not sure, 4 – useful 5 – very useful					
15	Who prepares the financial statement for your organization?	Own staff		Outside firm		

¹ **1** – Never **2** – Seldom **3** – Sometimes **4** – Often **5** – Always

The questionnaire was administered by six enumerators employed to conduct the survey. There were two discussion sessions held with the enumerators before they collected the data. The whole survey was monitored periodically to maintain the accuracy of data collected. In total, 344 small and medium-sized enterprises from the Klang Valley area were surveyed.

7.4 Results and discussion

Data collected were then analyzed using the SPSS software.

Reliability and validity of data

A reliability test was undertaken on the 16 scaled items examining accounting practices. A Cronbach alpha of 0.912 was obtained, thus indicating a high level of internal consistency.

Profile of Respondents

Table 7.2 provides the profile of the respondents. Sixty-seven percent (67 %) of the respondents were male while 75 percent of the respondents were married. About 66 percent of the respondents were between the ages of 30 and 49 years. Only about 14 percent of the respondents were above 50 years. About 42 percent (or 144) of the respondents had completed secondary school and other 47 percent had either diploma or a first degree. In terms of religion, 78.5 percent of the respondents were Muslims and 14 percent Buddhists.

Table 7.2:
Background of the Respondents

	Frequency	Percent (%)
1. Gender:		
Male	229	66.6
Female	115	33.4
Total=	344	100.0
2. Marital Status		
Single	78	22.5
Married	258	75.0
Others	5	1.5
Total=	341	100.0
3. Age		
20-29 Years	71	22.6
30-39 Years	115	33.4
40-49 Years	111	32.3
50 Years and above	47	13.7
Total=	344	100
4. Education:	Frequency	Percent (%)
Non-formal education	3	.9
Primary school	8	2.3
Secondary School	144	41.9
Diploma	72	20.9
First	93	27.0

	Frequency	Percent (%)
Degree/Equivalent		
Postgraduate degree	21	6.1
Total=	343	99.7
5. Religion:	Frequency	Percent (%)
Buddhism	48	14.0
Christianity	3	.9
Hinduism	16	4.7
Islam	270	78.5
Others	7	2.0
Total	344	100.0

Source: Primary data processed, 2018

Record Keeping

Table 7.3 shows the record keeping practices of SMEs. Results indicate that 70% of respondents keep records of business expenses and personal expenses separately. It is indeed commendable to observe that 60% of SMEs use accounting software to manage their record keeping. Thus it is not a surprise to see that more than 62% prepare statements of profit and loss and statements of financial position.

Table 7.3 :
Record Keeping

Parti-culars	Response (Never to Always)											Mean	Std. Dev.
	Never		Seldom		Some times		Often		Always				
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent			
Do you separate records of business expenses and personal expenses?	2	.6	36	10.5	66	19.2	120	34.9	120	34.9	3.930	1.0	
Do you use accoun-ting software to manage your accoun-ting records?	8	2.3	27	7.8	103	29.9	129	37.5	77	22.4	3.698	0.97	
Do you prepare state-ment of profit and loss?	3	0.9	19	5.5	90	26.2	128	37.2	103	29.9	3.901	0.92	
Do you prepare Balance Sheet (State-ment of Finan-cial Position)?	2	0.6	43	12.5	83	24.1	130	37.8	86	25.0	3.741	0.98	

Source: Primary data processed, 2018

Budgeting

Table 7.4 shows that almost half (47%) of the SMEs claimed that they prepare yearly budget to allocate resources. A higher percentage of SME

(63%) prepare budgets on a monthly basis. Forty percent (40%) indicated that they have a trained accountant to prepare the budget for their company. Fifty-five percent (55%) of SMEs also prepare statements of cash flow on a monthly basis.

Table 7.4 :
Budgeting

Parti- culars	Response (Never to Always)											Me an	Std. Dev.
	Never		Seldom		Some- times		Often		Always				
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent			
Do you prepare yearly budget (<i>financial allocations</i>)?	7	2.0	57	16.6	117	34.0	96	27.9	67	19.5	3.46 ₂	1.04	
Do you prepare monthly budget?	3	0.9	35	10.2	88	25.6	120	34.9	98	28.5	3.79 ₉	0.99	
Do you prepare cash flow statement monthly?	3	.09	43	12.5	107	31.1	120	34.9	71	20.6	3.61 ₉	0.97	
Do you have a trained accountant to prepare budget for your company?	14	4.1	51	14.8	143	41.6	78	22.7	58	16.9	3.33 ₄	1.05	

Source: Primary data processed, 2018

Use of Accounting Information

Table 7.5 shows the usefulness of accounting information to SMEs. Almost half (48%) “often” and “always” use financial information for decision making and calculating environmental costs. A slightly higher percentage (54%) shows that they are used accounting information for tax/zakat computation.

Table 7.5 :
Use of Accounting Information

Parti- culars	Response (Never to Always)											Me- an	Std. Dev.
	Never		Seldom		Some- times		Often		Always				
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent			
Do you use financial statement for business decision making?	7	2.0	18	12.2	115	37.5	138	34.0	66	14.2	3.692	0.90	
Do you use accoun-ting informa- tion to calculate environ-mental cost (e.g. wastage cost)?	7	2.0	42	12.2	129	37.5	117	34.0	49	14.2	3.462	0.95	

Do you use accounting information for tax/ <i>zakat</i> computation?	8	2. 3	26	7.6	12 4	36. 0	11 9	34. 6	67	19. 5	3.61 3	0.9 6
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Source: Primary data processed, 2018

Risk and Control

Although questions on risk and control are embedded in some of the other categories, for discussion here, we have singled out the question on record keeping of debtors and the importance of financial management as part of risk and control of SMEs. Table 7.6 presents the element of risk and control in SMEs. About 70% of the SMEs view financial management as important for business. Accordingly, this is being translated into 71% SMEs keeping records of their debtors. For SMEs, being in control of cash collection is important. Thus, one can conclude that there is some element of control being practised in SMEs through its use of accounting information.

Table 7.6 :
Risk & Control

Particulars	Response (Never to Always)											Me- an	Std. Dev .
	Never		Seldom		Some- times		Often		Always				
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent			
Do you think financial management is important for your business?	0	0	2	0.6	102	29.7	127	36.9	113	32.8	4.020	0.80	
Do you keep records of your debtors (credit sales)?			14	4.1	85	24.7	142	41.3	102	29.7	3.968	0.84	

Source: Primary data processed, 2018

Literacy on financial statements

Table 7.7 shows the literacy of SMEs in reading financial statements. About 67% claimed that they “often” and “always” prepared statements of profit and loss and 58% SMEs employed outside firms to prepare financial statements. Sixty one percent (61%) also indicated that they could understand the financial statements. However, a slightly lower percentage (58.9%) felt that accounting information was useful for their business, thus indicating that financial literacy amongst the SMEs surveyed appears to be high.

Table 7.7 :
Literacy on financial statements

Particulars	Response (Never to Always)											
	Never		Seldom		Some-times		Often		Always		Me-an	Std. Dev.
	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent		
How well do you understand financial statements?	0	0	24	7.0	111	32.3	165	48.0	44	12.8	3.666	0.78
How useful is the accounting information for your business?	0	0	20	5.8	118	34.3	140	40.0	65	18.9	3.729	0.83
Do you prepare statement of profit and loss?	3	0.9	19	5.5	90	26.2	128	37.2	103	29.9	3.901	0.92
Who prepares financial statement for your organization ?	Own Staff						Outside firm				Mea n	Std. Dev.
	Frequency		Percent		Freque ncy		Percent					
	143		41.6		201		58.4				1.58	0.49

Source: Primary data processed, 2018

Chi Square Test

Table 8 reveals that the p-value is less than the significance level ($\alpha=0.005$) which suggests that there is a correlation between financial literacy and all independent variables.

Table 7.8 :
Chi Square Test

Dependent Variable	Independent Variable	Chi-Square value	p- Value
Financial Literacy	Education	462.786	.000
	Training Received	1107.022	.000
	Future Training Requirement	3048.770	.000

Source: Primary data processed, 2018

Table 7.9 :
Path Coefficient

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Education Level -> Financial Literacy	0.141	0.136	0.061	2.292	0.022
Education Level -> Future Training requirement	0.280	0.282	0.051	5.536	0.000
Education Level -> Training Received	-0.486	-0.491	0.053	9.144	0.000
Future Training requirement -> Financial Literacy	0.234	0.231	0.051	4.581	0.000
Training Received -> Financial Literacy	-0.427	-0.441	0.059	7.186	0.000

Source: Primary data processed, 2018

Table 7.10 :
Correlation Matrix

	Education Level	Financial Literacy	Future Training requirement	Training Received
Education Level	1.000			
Financial Literacy	0.414	1.000		
Future Training requirement	0.280	0.380	1.000	
Training Received	-0.486	-0.554	-0.249	1.000

Source: Primary data processed, 2018

7.5 Conclusion

From the results just discussed it may be concluded that SMEs in Malaysia appear to have good book keeping practices as they keep records of business expenses separately from personal expenses. Additionally, quite a significant number of SMEs prepare financial statements with the assistance of accounting software. However, the fact that 58% percent of SMEs outsource the preparation of financial statements to external parties may indicate the less than adequate level of financial literacy. Annual and monthly budgets are widely prepared by SMEs in Malaysia, thus indicating the level of financial literacy of SMEs. Further, SMEs are also indicate that accounting information is useful for computation of environmental costs, zakat as well as for decision making purposes. It is indeed encouraging to know that SMEs in Malaysia find accounting information useful and relevant for their sustainability.

In general, the results indicate that half of the SMEs are financially literate and they consider financial management as important to them. Nonetheless, there are SMEs that still require coaching and mentoring on financial literacy. SME Corp, a central agency which coordinates the implementation of SMEs development programmes across all related Ministries and agencies, may want to consider focusing on financial literacy of SMEs.

The results should be interpreted in light of certain limitations. Only SMEs in the Klang Valley were surveyed. Accordingly, the findings cannot be generalized to all SMEs in Malaysia. Further research with larger coverage may provide deeper understanding on the

accounting practices and the level of financial literacy among SMEs in Malaysia.

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CHAPTER 08

THE ROLE OF ACCOUNTING TOWARDS SUSTAINABILITY OF SMALL AND MEDIUM ENTERPRISES IN EAST JAVA

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Abstract

This study aims to explore further information on the background role of accounting for the sustainability of MSMEs in East Java. The results of the identification can be utilized in various ways: as a consideration in determining policies, especially in terms of accounting guidance for entrepreneurs and as a contribution of ideas in solving problems faced by companies related to financial information in order to support the survival of MSMEs. This research used the quantitative approach and the technique used for data collection was a survey method which is by using a questionnaire. The data analysis technique that this study utilized was the descriptive statistical test. The samples in this study were mostly MSMEs in East Java with 250 respondents. This study shows that the accounting role of MSMEs in East Java can be seen based on an aspect of MSMEs which is by always separating records of business expenses and personal expenses with the percentage of 28.4%. Not all MSMEs in East Java have an accounting software to regulate their accounting records, as

is evident by the results of this research with a percentage of 56.8%. Accounting records in SMEs in East Java, Indonesia are still mostly done in traditional ways, without using any software. The majority of MSMEs in East Java in Indonesia have prepared monthly income statements, as indicated by the average value of 2.71, which is in the range of values between 'rarely' and 'sometimes'. MSMEs have not prepared an Annual Balance Sheet Report (Assets, Debt and Capital) which is as indicated by an assessment percentage of 54% of MSMEs that rarely and never prepare an Annual Balance Sheet Report. MSMEs have not prepared an annual budget (financial allocation) which is as indicated by a percentage of 59.2% of MSMEs that rarely and never prepare for the annual budget. MSMEs have not prepared a monthly budget simultaneously, which is as indicated by a percentage assessment of 53.2% of MSMEs who rarely and never prepare for the monthly budget. The majority of MSMEs do not yet have trained accountants to prepare the company budgets. This is indicated by an assessment percentage of 63.6% which are rarely and never have trained accountants to prepare the company's budget. MSMEs have not used any financial statements in business decision-making as it was indicated by a percentage of 53.2% of MSMEs that rarely and never use financial statements in business decision making, and the percentage of valuation is 33.2% of MSMEs who have never used accounting information to calculate environmental costs (such as waste costs). MSMEs have not used accounting information for tax / zakat calculation as indicated by a percentage of 53.2% of MSMEs who rarely and never use accounting information for tax / zakat calculation. The majority of MSMEs in East Java in Indonesia already think that financial management is important for business, as indicated by an assessment percentage of 53.2% which is sometimes, often and always think that financial management is important for business. MSMEs in East Java in Indonesia have understood the importance of financial management for businesses in order to achieve company goals by using strategies launched at the beginning of the period. Financial management is also considered important in assessing the performance of MSMEs during a certain period of time.

Keywords: Role of Accounting, MSMEs, East Java, Micro, Small and Medium Enterprises

8.1 Introduction

Micro, Small and Medium Enterprises (MSMEs) are one of the drivers of the nation's economy that are proven to be resistant to various economic crisis shocks. In the face of the ASEA Economic Community (MEA), which began at the end of 2015, MSMEs must be able to support an increase in national competitiveness, economic growth, poverty reduction and improvement in the living standards of the Indonesian population.¹

The development of MSMEs is currently getting more serious attention from various circles. Problems that are often faced by MSME actors include product marketing, technology, financial management, quality of human resources and capital. Financial management problems occur because, when carrying out business activities, MSME managers often find it difficult to keep a record of what is happening in their business operations. Many MSMEs focus more on operational activities, and therefore, recording and reporting are often overlooked. However, without good records and reports, the evaluation of the performance of MSMEs is not easy to do.

The capital constraints for developing businesses is that basically, MSMEs have a great opportunity to get credit as a capital injection. Until now, there are many financing programs for MSMEs which are run by the government, banks, state-owned enterprises and the private sector. In its application, capital distribution is often hampered because the capital channelers do not have adequate access to information regarding the condition of MSMEs. This is also supported by the low quality of MSME financial reports in Indonesia. The low quality of MSMEs reports causes the quality of financial statements to have no positive effect on the amount of credit received.

In an effort to develop MSMEs, the government, institutions and other parties can carry out various programs through education, training, financial assistance, entrepreneurship assistance and other development

programs. In supporting this, the profile and characteristics of MSMEs in East Java are needed in order to determine the model of MSME development seen in various aspects. Departing from the above explanation, the research problem will revolve around the role of accounting for the sustainability of MSMEs in East Java.

The formulation of the research problem is as follows: "What is the role of accounting for the sustainability of MSMEs in East Java?" In general, the objective of this research is to explore further information about the background, the role of accounting for the sustainability of MSMEs in East Java, in the hope that the identification of the results can be utilized in various ways, namely, by formulating a policy, identifying problems faced by MSMEs, and mapping a strategy that is expected to build a competitive advantage for MSMEs as a sector that has an important role for the Indonesian economy.

8.2 Literature Review

8.2.1 Accounting Information

Accounting information is a quantitative information that relates to facts and data that can be quantified APA?Abdul Halim and Bambang Supomo (1990: 5). Accounting information is an important information that helps to regulate a company from various kinds of problems that is related to the economic activities (Dr. Belal Yousef AL Smirat, 2013: 169) He also added that the information in a question is an information generated in the form of financial statements. Accounting information is information that has a large contribution in a company's decision-making activities (Kingsley Obinna Nwaigburu , 2014: 168). According to Munawir (2002: 7), the types and details of information needed for an organization will be different from other organizations depending on the type, size of the organization, and the diversity of its business fields. Large organizations are the same, namely, information which are qualitative and quantitative in nature.

From the understanding mentioned above, the author concludes that accounting information is a transformation process by parties such as

managers, investors, suppliers, customers, labor, and government that help in forming information about the company's financial data and evaluating a business agreement inside it. Thus, the use of accounting information is a process of using information that provides benefits in the form of quantitative and qualitative data that is needed by a company organization.

8.2.2 Use of Accounting Information

Soemarso (2004: 2) states that in a large company, the information needed is very large and varied. In an era where accountability is a focal point in society, the usefulness of accounting will be increasingly felt. In many individuals they must account for their income. For example, he must pay taxes and therefore he needs information on incomes and deductible costs. With this information, the company can make reports on taxes. Soemarso (2004: 3) also stated that in the accountability system, there is a flow of information from those who are accountable to those who accept responsibility.

Accounting can help in producing the information needed. Based on the description above, it can be concluded that accounting will produce information that is useful for both the parties that organize it and the outside parties. These uses are mainly related to the decision-making process and accountability.

8.3 Research Methodology

The design that became the objective of this study was the role of accounting for the sustainability of Micro, Small and Medium Enterprises (MSMEs) in the East Java province. This research is targeted in the East Java region because it is a province with a total of 9.59 million MSMEs in 2018. This research was conducted with the aim to find out the role of accounting for the sustainability of the East Java Micro, Small and Medium Enterprises (MSMEs) which is expected to be a contribution to the development of MSMEs in improving accounting knowledge and using accounting information to produce better performance.

The data collection technique that was used in this study is the survey method using a questionnaire given to the respondents. The population in this study were all MSME business actors in East Java, while the samples used were a part of MSMEs in East Java with 250 respondents / East Java SMEs.

This study used Nonprobability Sampling Purposive with Sampling techniques. The sample used was MSME actors who were engaged in culinary, transportation and trade. This determination was based on the number of MSMEs in East Java that were engaged in this field compared to other fields.

8.4 Results And Discussion

8.4.1 East Java UMKM General Condition

East Java is one of the provinces in Indonesia, with an area of 47,922 km². The National economic census data stated that the number of MSMEs in East Java was 9.59 million, with 4.61 million MSMEs that were engaged in the non-agricultural sector and 4.98 million MSMEs that were engaged in the agricultural sector. East Java contributed 14.85% for the National Gross Domestic Product.

The results of this study will present the role of accounting for the sustainability of MSMEs in East Java province with 250 informants, namely MSMEs in the culinary, trade and transportation fields.

1. The number of respondents is based on the separation of business records and personal expenses

Table 8.1 :

D3-1, The separation of business records and personal expenses

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	66	26.4	26.4	26.4
	Seldom	35	14.0	14.0	40.4
	Sometimes	40	16.0	16.0	56.4

	Often	38	15.2	15.2	71.6
	Always	71	28.4	28.4	100.0
	Total	250	100.0	100.0	

2. The number of respondents is based on ownership of accounting software to regulate accounting records

Table 8.2 :

D3-2, ownership of accounting software to regulate accounting records

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	142	56.8	56.8	56.8
	Seldom	21	8.4	8.4	65.2
	Sometimes	38	15.2	15.2	80.4
	Often	21	8.4	8.4	88.8
	Always	28	11.2	11.2	100.0
	Total	250	100.0	100.0	

3. The number of respondents is based on preparing the monthly income statement

Table 8.3 :

D3-3, preparing the monthly income statement

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	88	35.2	35.2	35.2
	Seldom	33	13.2	13.2	48.4
	Sometimes	43	17.2	17.2	65.6
	Often	35	14.0	14.0	79.6
	Always	51	20.4	20.4	100.0
	Total	250	100.0	100.0	

4. Number of respondents based on preparation of annual balance sheet reports (assets, debt, capital)

Table 8.4 :

D3-4, Preparation of annual balance sheet reports (assets, debt, capital)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	103	41.2	41.7	41.7
	Seldom	29	11.6	11.7	53.4
	Sometimes	46	18.4	18.6	72.1
	Often	30	12.0	12.1	84.2
	Always	39	15.6	15.8	100.0
	Total	247	98.8	100.0	

5. The number of respondents is based on preparation of the annual budget report

Table 8.5 :

D3-5, preparation of the annual budget report

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	100	40.0	40.0	40.0
	Seldom	48	19.2	19.2	59.2
	Sometimes	59	23.6	23.6	82.8
	Often	19	7.6	7.6	90.4
	Always	24	9.6	9.6	100.0
	Total	250	100.0	100.0	

6. The number of respondents is based on preparation of the month budget

Table 8.6 :
D3-6, preparation of the month budget

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	65	26.0	26.0	26.0
	2	68	27.2	27.2	53.2
	3	49	19.6	19.6	72.8
	4	32	12.8	12.8	85.6
	5	36	14.4	14.4	100.0
	Total	250	100.0	100.0	

7. The number of respondents based on ownership of accountants trained to prepare the company budget

Table 8.7 :
D3-7, Ownership of accountants trained to prepare the company budget

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	75	30.0	30.0	30.0
	2	84	33.6	33.6	63.6
	3	77	30.8	30.8	94.4
	4	8	3.2	3.2	97.6
	5	6	2.4	2.4	100.0
	Total	250	100.0	100.0	

8. Number of respondents based on the use of financial statements in decision making

Table 8.8 :

D3-8, The use of financial statements in decision making

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neveer	91	36.4	36.4	36.4
	Seldom	42	16.8	16.8	53.2
	Sometimes	88	35.2	35.2	88.4
	often	11	4.4	4.4	92.8
	Always	18	7.2	7.2	100.0
	Total	250	100.0	100.0	

9. Number of respondents is based on the use of accounting information to pay environmental costs (waste)

Table 8.9 :

D3-9, The use of accounting information to pay environmental costs (waste)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	83	33.2	33.2	33.2
	2	49	19.6	19.6	52.8
	3	35	14.0	14.0	66.8
	4	13	5.2	5.2	72.0
	5	70	28.0	28.0	100.0
	Total	250	100.0	100.0	

10. The number of respondents is based on the use of accounting information for calculating zakat tax

Table 8.10 :

The use of accounting information for calculating zakat tax

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	91	36.4	36.4	36.4
	2	53	21.2	21.2	57.6
	3	74	29.6	29.6	87.2
	4	10	4.0	4.0	91.2
	5	20	8.0	8.0	99.2
	9	2	.8	.8	100.0
	Total	250	100.0	100.0	

11. The number of respondents is based on the importance of financial management for business

Table 8.11 :

D3-11, The importance of financial management for business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Never	67	26.8	26.8	26.8
	Seldom	50	20.0	20.0	46.8
	Sometimes	65	26.0	26.0	72.8
	Often	15	6.0	6.0	78.8
	Always	53	21.2	21.2	100.0
	Total	250	100.0	100.0	

12. The number of respondents is based on recording sales on credit

Table 8.12 :
D3-12, Recording sales on credit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	19	7.6	7.7	7.7
	2	30	12.0	12.1	19.8
	3	64	25.6	25.9	45.7
	4	38	15.2	15.4	61.1
	5	96	38.4	38.9	100.0
	Total	247	98.8	100.0	

13. Number of respondents based on understanding of financial statements

Table 8.13 :
D3-13, Understanding of financial statements

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not at All	57	22.8	23.1	23.1
	a little	45	18.0	18.2	41.3
	Not Sure	78	31.2	31.6	72.9
	General understanding	13	5.2	5.3	78.1
	Very well	54	21.6	21.9	100.0
	Total	247	98.8	100.0	
Missing	System	3	1.2		
Total		250	100.0		

14. Number of respondents based on the benefits of accounting information

Table 8.14 :
D3-14, The benefits of accounting information

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	25	10.0	10.1	10.1
	2	57	22.8	23.1	33.2
	3	69	27.6	27.9	61.1
	4	68	27.2	27.5	88.7
	5	28	11.2	11.3	100.0
	Total	247	98.8	100.0	

8.5 Discussion

The processing of data in this study is shown in the table above:

1. From the table above, at point D3-1, we can see that MSMEs always separate records of business expenses and personal expenses, as evidenced by the results of the percentage of research at 28.4%. MSMEs in East Java Indonesia have been aware of the importance of separating out expenses for personal expenses for business. This is to anticipate uncontrolled expenditure from MSME owners.
2. From the table above, we can see at point D3-2 that not all MSMEs have accounting software to regulate their accounting records, which is shown by the results of the percentage of research of 56.8%. Accounting records in MSMEs in East Java Indonesia are still mostly done in traditional ways, without using certain software. Recordings are done by taking notes in a special cash book and by making a summary of record at the end of the week or at the end of the month.
3. Point D3-3 in the table above shows that the majority of MSMEs in East Java in Indonesia have prepared monthly income statements, as indicated by the average value of 2.71 which is in the range of values of 'rarely and sometimes'. Thus, it can be concluded that MSMEs have prepared an income statement even though not all MSMEs are registered in the population. MSMEs in East Java Indonesia have understood the importance of business income statements in order to

assess the performance of MSMEs during a certain period. It should be noted that the remainder of the MSMEs have not yet prepared monthly income statements for various reasons, one of which is because they do not know how to prepare a good and correct income statement.

4. Points D3-4 in the table above also show that MSMEs have not prepared Annual Balance Sheet reports (Assets, Debt and Capital) which are indicated by an assessment percentage of 54% of MSMEs that rarely and never prepare Annual Balance Sheet reports. This is due to the lack of knowledge of MSMEs in the preparation of good and correct Annual Balance Sheet reports. In addition, MSMEs also see that it is still not too important to prepare an annual balance sheet reports compared to income statements.
5. Based on point D3-5 in the table above, we can see that MSMEs have not prepared an annual budget (financial allocation) which is indicated by a percentage of 59.2% of MSMEs that rarely and never prepare for the annual budgets. This is because there is still a lack of knowledge of MSMEs on how to prepare their annual business budgets.
6. In addition, we can see from the table above, specifically in point D3-6 that MSMEs have not prepared monthly budgets simultaneously which is indicated by a percentage of 53.2% of MSMEs that rarely and never prepare for the monthly budget. As for preparing the annual budget, this is because there is still a lack of knowledge of MSMEs on how to prepare their business monthly budgets. Some also feel the lack of importance in compiling the monthly budgets.
7. Point D3-7 in the table above shows that the majority of MSMEs do not have trained accountants yet in order to prepare company budgets, as indicated by an assessment percentage of 63.6%, who rarely and never have trained accountants to prepare company budgets. MSMEs in East Java Indonesia do not have trained accountants yet to prepare company budgets because the human resources used in MSMEs are not as many as in medium and large companies. Besides, MSMEs in East Java Indonesia do not yet feel the need to use trained accountants in preparing the company's budget.

8. In addition, we can see from the table above, namely in point D3-8, that MSMEs have not used financial statements in business decision making, as indicated by a percentage of 53.2% of MSMEs, who rarely and never use financial statements in taking business decisions. This is because MSMEs still use the ideas, thoughts and instincts of MSME owners in determining business decisions. UMKM financial statements are commonly used by MSME owners for reporting to third parties, such as to the tax office, to debtors and to creditors.
9. From point D3-9 in the table above, we can see that MSMEs have not used accounting information to calculate environmental costs (such as waste costs) which are indicated by a percentage of 33.2% of MSMEs, who have never used accounting information to calculate costs environment (such as waste costs). This is because MSMEs still do not calculate environmental costs in their operations and, as mentioned above, the MSMEs' financial statements are commonly used by MSME owners for reporting to third parties, such as to the tax office, to debtors, and to creditors.
10. Then, in point D3-10 from the table above shows that MSMEs have not used accounting information for tax / zakat calculation as indicated by a percentage of 53.2% of MSMEs that rarely and never use accounting information for tax / zakat calculation. This is because the calculation of tax / zakat is still held by MSME owners without using accounting information alone, but uses the ideas, thoughts and instincts of their owners. Accounting information is used to make tentative decisions on MSMEs and tax / zakat calculations are calculated by third parties.
11. In addition, point D3-11 in the table above shows that the majority of MSMEs in East Java in Indonesia already think that financial management is important for business, as indicated by a percentage of 53.2% which is sometimes, often and always thought that financial management is important for business. MSMEs in East Java Indonesia have understood the importance of financial management in order for businesses to achieve company goals by using strategies launched at the beginning of the period. Financial management is also considered

important in assessing the performance of MSMEs during a certain period.

12. Point D3-12 in the table above shows that SMEs have recorded debtors (credit sales) simultaneously, as evidenced by the results of an assessment percentage of 79.2% which means that MSMEs in East Java Indonesia sometimes, often and always record debtors in their sales credit. MSME managers feel the need to record debtors in their credit sales to ensure collectible receivables are all and anticipate the risk of bad credit. This is also needed to increase the liquidity of MSMEs.
13. The D3-13 rating point in the table above also shows that the majority of MSMEs in East Java in Indonesia already understand financial statements as indicated by an assessment percentage of 58% which means that MSMEs sometimes, often and always understand financial statements. MSMEs in East Java Indonesia have understood the role of financial statements, their benefits, how to arrange them and also other aspects even though in a simple and traditional way. Understanding the financial statements shows the future prospects for the use of accounting reports in MSME operations.
- 14 In addition, point D3-14 in the table above shows that the majority of MSMEs in East Java in Indonesia have thought of the benefits of accounting information for businesses if assessed on a scale of 1 to 5, as indicated by the percentage percentage of 66.2% which means that MSMEs sometimes, often and always think about the benefits of accounting information for business. MSMEs in East Java Indonesia have understood the importance of accounting information for businesses to achieve company goals through planned strategies.

8.6 Conclusion

From the results of the research that has been conducted, it can be concluded that:

1. MSMEs in East Java Indonesia are already aware of the importance of separating out personal expenses and business expenses. This is to anticipate uncontrolled expenditure from MSME owners.
2. Accounting records in MSMEs in East Java in Indonesia are still mostly done in traditional ways, without using certain software.
3. MSMEs in East Java Indonesia have understood the importance of business income statements in order to assess the performance of MSMEs during a certain period.
4. There is a lack of knowledge of MSMEs in preparing good and correct Annual Balance Sheet reports. In addition, MSMEs also still view that it is not too important to prepare an annual balance sheet reports compared to income statements.
5. MSMEs have not prepared annual budgets (financial allocation). This is because there are MSMEs that still lack the knowledge on how to prepare their annual business budget.
6. MSMEs still lack knowledge on how to prepare their business monthly budgets. Some also feel the lack of importance in compiling monthly budgets.
7. MSMEs in East Java Indonesia do not have trained accountants yet in order to prepare company budgets because the human resources used in MSMEs are not as many as in medium and large companies. Besides, MSMEs in East Java Indonesia do not feel the need to use trained accountants yet in order to prepare the company budgets.
8. MSMEs still use the ideas, thoughts and instincts of MSME owners in determining business decisions. UMKM financial statements are commonly used by MSME owners for reporting to third parties, such as the tax office, debtors, and creditors.
9. MSMEs still do not calculate environmental costs in their operations. UMKM financial statements are commonly used by MSME owners for reporting to third parties, such as the tax office, debtors and creditors.
10. The calculation of tax / zakat is still done by MSME owners without using accounting information alone, but using ideas, thoughts and instincts of their owners. Accounting information is used to make

tentative decisions on MSMEs, and tax / zakat calculations are calculated by third parties.

11. MSMEs in East Java Indonesia already understand the importance of financial management for businesses in order to achieve company goals by using strategies launched at the beginning of the period. Financial management is also important in assessing the performance of MSMEs for a certain period.
12. Note the debtor in the sale of credit to ensure collectible receivables are all and anticipate the risk of bad credit. It is useful to increase the liquidity of MSMEs.
13. Understanding the financial statement shows the future prospects for the use of accounting reports in MSME operations.
14. MSMEs in East Java Indonesia already understand the importance of accounting information for businesses.

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