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Analysis Banking Role to Performance Improvement on Indonesia Small Medium Enterprises

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Abstract:

This study aims to analyze the role of banks to increase small and medium enterprises and economic growth in Yogyakarta province, Indonesia. The focus of this study examines how the role of banks in terms of lending to small and medium enterprises, credit to the private sector and its impact on economic growth in Yogyakarta Province. The data used in this research is secondary data obtained from the Central Bureau of Statistics.

Data processing tools using EViews 8.0 program. The results of this study indicate that bank credit to small and medium enterprises, the number of small and medium enterprises, the output value of small and medium businesses significant positive effect on economic growth. While credit to the private sector significant negative effect on economic growth.

Statistically, the model used in this study deserves to explain economic growth in Yogyakarta province.

Keywords: *Bank Loans, Bank Credit, Number of SMEs, The Output Value of Small and Medium Enterprises.*

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1. Introduction

Small and Medium Enterprises (SMEs) sector have been widely accepted and recognized as a means of achieving economic growth and poverty eradication in the world. However, internationally, SMEs carry different meanings. SMEs play a role in economic development and providing jobs in a country. Small and medium enterprises SMEs contribute greatly in improving a country's economy (Anyanwu, 2001; Afolabi, 2012; Uremadu *et al.*, 2014). Small and medium enterprises (SMEs) result in creating more direct jobs compared to big enterprises. SMEs are training grounds to those who want to develop technical and entrepreneurial skills (Kira, 2013; Uremadu *et al.*, 2014).

Quaye *et al.* (2014), Microfinance has succeeded in the provision of finance and gradually helps SMEs to acquire financial assistance. Competence, effective, and efficient, Microfinance serves the financial needs of informal sectors. Many microfinance institutions acknowledge that the market is large enough to accommodate the traditional and universal banks. SMEs are determined to dominate their market share before the open market competition is in full effect in a country (Uremadu *et al.*, 2014; Theriou, 2016; Havlicek *et al.*, 2013; Breckova and Havlicek, 2013; Anureev *et al.*, 2017).

The potential development of Small and Medium Enterprises (SMEs) in Indonesia is inseparable from the support of banks in distributing bank credits to SMEs. Every year, loans to SMEs grow, generally higher than the growth in the total of bank credit. One way to raise capital for SMEs is by borrowing from financial institutions. Credit is a financial facility that allows a person or business entity to borrow money, to buy products and pay it back within the prescribed period. The problem faced by Small and Medium Enterprises (SMEs) in Indonesia can essentially be categorized into internal issues and external issues (Hamid and Susilo, 2010; Susilo, 2010).

The problems associated with the internal factors are: (1) lack of capital, (2) human resources are limited, and (3) weak business networks and market penetration capability. Problems associated with external factors are: (1) the business environment is not yet conducive, (2) limited facilities and business infrastructure, (3) regional autonomy implication, (4) the nature of the product *life time* which is short, (5) lack of market access, and (6) the implications of free trade. Lacking capital, SMEs need the support of financial institutions, including banks. From the results of various studies, it turns out that SMEs access to bank still limited. This problem is related to the profile of debtors' micro enterprises which are less or even not bankable or not compliant with the banks' technical requirements. This leads to the feasibility aspects thus, the debtors' micro enterprises are eventually neglected (Hamid and Susilo, 2010). According to (Susilo, 2010; Hamid and Susilo, 2010) financing small and medium enterprises is very important for promoting sustainable economic growth and reducing poverty within a country. Government intervention is

necessary to promote SME financing and regulate policy to reduce loans interest rate. This will stimulate and enhance the development and sustainability of SMEs.
The economic growth of a country will be affected by various macro and micro economic factors. Steady economic growth must meet the balanced requirements which is similarity between the output growth, the capital growth and labor growth rate. The existence of SMEs in Indonesia is able to contribute greatly to the economic growth (Susilo, 2010). The potential development of Small and Medium Enterprises (SMEs) in Indonesia is inseparable from the support of banks in distributing bank credits to SMEs (Susilo, 2010). Economic growth in one country is strongly influenced by the role of microfinance in supporting the existence of SMEs. Sustainability of SMEs supported by banks affects social welfare improvement (Anyanwu, 2001; Afolabi, 2012; Joseph & Dansu, 2013; Quaye *et al.*, 2014; Katua, 2014; Uremadu *et al.*, 2014; Breckova, 2016).

2. Literature Review

Most of the businesses that we see today are Small and Medium Enterprises (SMEs). Overall, SMEs have a very significant contribution to goods and services provisions to the community. Without SMEs, large companies may be unable to meet the customers' demands. Currently, there is no agreed definition upon SMEs which can be received all over the world (Omar *et al.*, 2009; Ogujiuba, 2013; Uremadu *et al.*, 2014; Helisek, 2016; Tcvetkov *et al.*, 2015; Thalassinos *et al.*, 2015).

An analysis of SMEs definition indicates that the definition of SMEs depends on who is defining and from which they define it. The same person would define SMEs differently depending on where they are located. According Garikai (2011), SMEs are defined based on the number of workers employed, capital and turnover. SMEs are classified by the number of employees and / or the value of their assets. So, classification that is based on the size of SMEs relevant to their business sector. Classifying SMEs is more precise when we gauge their revenue than the numbers of labor employed. A company of a certain size could be small when surrounded by many competitors. While the company of the same proportions can be considered large in other sectors with fewer players and / or companies are generally smaller in it.

Kongolo, 2010; Kira, 2014 stipulates that small business owners, globally, have the same characteristics, encounter the same constraints but differ in comprehending of how small businesses help economy grow. SMEs have the ability to boost economic growth because they create new jobs, expand the tax base, and captain innovations. According to Beck *et al.* (2005); Uremadu *et al.* (2014), SMEs increase competition and entrepreneurship that have external benefits to the efficiency of the economy, innovation and overall productivity.

2.1 Definition and business constraints in Indonesia

The Ministry of Cooperatives defines that micro enterprise is a productive enterprise belonging to individuals and / or individual businesses entities, a net worth of at most 50 million, excluding land and building and has an annual sales turnover of IDR 300 million. Small businesses are productive economic activities that stand alone, carried out by an individual or business entity that is not a subsidiary or branch of a company, not owned, controlled, or a part either directly or indirectly of medium or large businesses, a net worth of more than IDR 50 million up to at most 500 million, excluding land and buildings or having an annual sales turnover of more than 300 million up to at most 2.5 billion. Medium Enterprises is a productive economic activity that stand alone, carried out by an individual or business entity that is not a subsidiary or branch of companies owned, controlled, or a part either directly or indirectly of a small business or large enterprise with total net assets or annual sales revenue, has a net worth of more than 500 million up to a maximum of IDR 10 billion, excluding land and buildings or having an annual sales turnover of more than IDR 2.5 billion to a maximum of IDR 50 billion.

MSME loans are loans to debtors of micro, small and medium enterprises that meet the definition and criteria of micro, small and medium enterprises as stipulated in the Constitution No. 20 Year 2008 on MSMEs. Under the bill, MSMEs are productive businesses that meet the criteria of business within certain net worth constraints and annual revenue. The Indonesian government fosters MSMEs through the Department of Cooperatives and SMEs in each province or regency / city. The Constitution no. 10 of 1998 states that the credit is the provision of money or bills which can be equated with it, based on agreements between banks with another party that requires the borrower to repay the debt after a certain period of time with interest.

To minimize risk when providing loans, bank should consider several issues related to the good faith and the debtors' ability to pay back the loan with interest, character, capacity, capital, collateral and economic circumstances. Character, disposition, nature, and debtors' habits (accounts receivable parties) are very influential in the provision of credit. Creditor (the creditor) can examine whether a prospective borrower enter into Denied Persons List (DPT) or not. Creditors can also examine their bio and information of the business environment. The capacity is related to the debtor's ability to repay the loan. To measure it, the creditor may examine the ability of the debtor in the areas of management, finance, marketing, and others. Judging from the amount of capital owned by the debtor or how much capital invested in the business of the debtor, the debtor's creditors can assess capital. The more capital invested the more seriously the debtor will be considered in conducting business. Collaterals are required in case the debtor cannot repay their loans. Usually the collateral value is higher than the loan. The economic state of debtors' surrounding is also taken into account to assess future economic state. Economic conditions that need to be considered include the buying power, broad market, competition, technological developments, raw materials, capital markets, and so forth.

2.2 Previous Studies

Dionco-Adetayo *et al.* (2006) analyze how the program's promotion policy affects the development of small enterprises. Particularly, this study aims to identify programs, promote small-scale industries, assess them on how they meet their objectives, and test the effects of this program on business growth. The study was conducted in the state of Lagos where industrial and commercial activities are highly concentrated. The independent variables consist of: small business development measured by the size of the amount of labor, business structure, and technology development. On the other hand, the dependent variable is company promotion policy program that is operated and measured with Likert scale. Data of descriptive and inferential analyses collected through the questionnaire revealed that the corporate promotional programs focused on the development of small industry in terms of technical aspects, education, training, technology adaptation and commercialization, and information services. The awareness level of SMEs of such programs is still low which hampers small industries in utilizing these programs.

Babagana, (2010) Hassan and Olaniran, (2011) examined the impact of the role played by microfinance (bank MFBS) in promoting the growth of SMEs in Nigeria. Research results indicate that the positive impact of microfinance Nigeria's role in fostering MW in the country. Akingunola (2011) considered that the specific financing options available to SMEs in Nigeria and contribution, a positive effect on economic growth. Financing aid agencies have contributed to the development of small and medium enterprises (SMEs) in Nigeria, with particular reference to the Industrial Development Center (IDC). Their SME financing aid agencies proved able to increase the output of SMEs.

Obasan and Arikewuyo (2012) examined the effects of pre-post bank consolidation on the accessibility of financing SMEs in Nigeria. Research results indicate that prior to banking consolidation, access for SMEs to get credit is very difficult. So the growth of SMEs in Nigeria time was hampered. With banking consolidation, the impact on the growth of SMEs and economic growth of Nigeria tends to be positive. Ahiawodze and Adade (2012) examined the effects of the company's access to credit for Small and Medium Enterprises (SMEs) in Ho Volta Region of Ghana using both surveys and econometric methods. This survey involves a sample of 78 SMEs in manufacturing sector of the Ho Municipality. Econometric model defined the company's growth as the dependent variable, and the independent variables including access to credit, total investments, age of the company, the initial capital, the level of education and the annual turnover of the company. Both surveys and econometric results show that access to credit provides a significant positive effect on the growth of SMEs in Ho-city of Ghana.

Joseph and Dansu (2013) examine the relationship between business risk and sustainability of SMEs in Nigeria. They assert that SMEs face a number of risks that require risk management efforts that are objective and transparent. Primary data are generated from fifty (50) SMEs in Lagos State. Data analyses and hypotheses testing

were done using Chi-square and descriptive statistics. The results show that the risk management strategies of SMEs do have a positive impact on the sustainability of their businesses.
Ogujiuba, *et al.*, (2013) Katua, (2014) analyze the availability of credit for small and medium enterprises in Nigeria and the importance of new authorized capital for SMEs. Abereijo and Fayomi (2005) examine innovative approaches to financing SMEs across the world, especially private equity financing, to identify best SMEs practices. It was found that there are still many challenges for banks across the world to overcome difficulties in implementing SMEs credit scheme, challenges related to cash flow, structuring investments, increased monitoring / value, and liquidity and exit strategies.

Kira, (2013) Quaye *et al.*, (2014) Katua, (2014) conduct a study towards the effect of bank loans to SMEs to economic growth of the country. Small and Medium Enterprises are potential for creating value-added. However, in reality, SMEs have not been maximally developed, as evidenced by many shortcomings that hamper SMEs to flourish. One factor that is significant is capital (investment). This hampers SMEs to increase the scale of production and expansion. There is a positive relationship between easy access for SMEs to credit and economic growth (Kira, 2013; Quaye *et al.,* 2014; Katua, 2014).

2.3 Hypotheses Formulation
SMEs success is determined by both financial support from banks and other financial institutions. Financing small and medium enterprises is very important for the promotion of sustainable economic growth and poverty reduction within a country (Hamid and Susilo, 2010). The role of banks in financing SMEs positively effects economic growth (Kira, 2013; Quaye *et al.*, 2014; Katua, 2014). Nigeria's microfinance role in the growth of SMEs in the country is positive. (Babagana, 2010; Akingunola, 2011; Hassan and Olaniran, 2011) assess that certain financing options available to SMEs in Nigeria and contribution positively effect on economic growth. Based on the theory and previous studies on the effect of SMEs bank loans to economic growth in this study can be formulated by the following hypothesis:

H1 = There is a significant positive influence on bank loans to SMEs towards economic growth.

Bank credits to the private sector directly and indirectly affect SMEs development in a country. Bank credit to the private sector will increase private investment that means more jobs will be available. With increasing private sector investment, more people will be employed and eventually will grow a country’s economic state (Hamid and Susilo, 2010). The higher the amount of bank credit to the private sector the more jobs will be created (Obasan and Arikewuyo, 2012; Joseph and Dansu, 2013). Dionco-Adetayo *et al.*, (2006) Abereijo and Fayomi (2005) analyzed how large enterprises promotion policy program affects the development of small industries. Hypothesis on the effect of bank credit to the private sector towards economic growth in this study can be formulated as follows:

H2 = There is a significant positive effect of bank credit to the private sector towards economic growth.

Small and medium enterprises (SMEs) have the ability to boost economic growth because they create new jobs, expand tax base, and captain innovations. Kongolo research results (2010) show that small business, generally, owners have the same characteristics, face the same constraints but differ in understanding how small businesses help economy grow. Contribution of small and medium enterprises (SMEs) make a country's economy grow (Mambula, 2002; Beck *et al.*, 2005; Kongolo, 2010). SMEs can improve competition and entrepreneurship that have external benefits to the efficiency of the economy, innovation and overall productivity. Based on the description on the effect of SMEs to economic growth from previous researchers, the hypothesis of the number of SMEs influence economic growth in this study is formulated as follows:

H3 = There is a significant positive influence on the number of SMEs towards economic growth.

Steady economic growth must meet balanced requirement which is similarity between the output growth, the capital growth and labor growth rate. (Beck *et al.*, 2005; Joseph and Dansu, 2013) The output value of SMEs can enhance entrepreneurial competition directly on the efficiency of the economy, innovation and overall productivity. Risk management strategies which are undertaken by the SME standard would result in their sustainability efforts in increasing their output (Joseph and Dansu, 2013). With the increase in the output value of SMEs, it will boost the country's economic growth. The hypothesis can be formulated as follows:

H4 = There is a significant positive influence on the output value of SMEs to economic growth.

The economic growth of a country is affected by various macro and micro economic factors. The existence of SMEs in Indonesia is able to contribute greatly to the economic growth (Susilo, 2010). The potential development of Micro, Small and Medium Enterprises (MSMEs) in Indonesia is inseparable from the support of banks in providing loans to SMEs (Hamid and Susilo, 2010). Nigeria economic growth is strongly influenced by the role of microfinance in supporting the existence of SMEs. Sustainability of SMEs supported by banks affects the social welfare development (Mambula, 2002; Obasan and Arikewuyo, 2012; Joseph and Dansu, 2013; Quaye *et al.*, 2014). The hypothesis regarding the feasibility of the model in this study is formulated as follows:

H5 = model used in this study is suitable to define economic growth.

3. Methodology

The research aims on testing towards hypotheses. This study uses descriptive quantitative approach. Analysis model used is regression analysis method which is a method with regard to the study of dependent and independent variables. The analysis used to answer the formulation problem is multiple regression data panel. The data used are data panel which combines data *cross section*, marked by the *subscript* i, and *time series* data, which is marked with the *subscript* t.
The model used in this study as follows:

$$Ln\ (\Delta GRDP_{i,t}) = \beta_0 + \beta_1 Ln\ (BCTrSME_{i,t}) + \beta_2 Ln\ (BCTrS) + \beta_3 Ln\ (SMET_{i,t}) + \beta_4 Ln(SMEOV_{i,t}) + \varepsilon \quad \ldots\ldots(1)$$

Annotation:
- $\Delta GRDP$ = GRDP in Regency/City i in the year of t
- $TBCrSME_{i,t}$ = Total Credit Bank for SMEs in Regency/City i in the year of t
- TBCrS = Total Credit Bank for Private Sector in Regency/City i in the year of t
- TSME = the number of SMEs in Regency/City i in the year of t
- $SMEOV_{i,t}$ = SME output value in Regency/City i in the year of t
- β = constant regression
- ε = error term.

4. Results and Discussion

All data used in this study are transformed into natural log form considering the gap from one year to another which is too large. Data panel regression models selected for use in statistical analysis is a Fixed Effect model.

Tabel 1: **Data Panel Regression Model Fixed Effect**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LnTBCrSME	0.013637	0.019532	6.982175	0.0000
LnTBCrS	-0.004016	0.019105	-2.102345	0.0367
LnTSME	0.028843	0.118717	2.429571	0.0159
LnSMEOV	0.004774	0.022436	2.127944	0.0345
C	0.048756	0.013086	15.18767	0.0000

Source: *Formulated with EViews 8.0 (2017)*

Based on the analysis of panel regression data in this study, regression equation can be formed as follows:

$$GRDP = 0{,}048756 + 0{,}013637\ TBCrSME - 0{,}004016\ TBCrS + 0{,}028843\ TSME + 0{,}004774\ SMEOV \quad \ldots\ldots(2)$$

From the equation model (2), it can be explained that the constant of 0.048756 indicates if there is no independent variable, the GRDP growth rate will be at 4.8756 percent. The coefficient regression credit to SMEs is amounted to 0.013637 which means a 1 percent increase in a number of loans to SMEs stimulate the GRDP growth rate by 1.36 percent. The coefficient regression credit to the private sectors is at -0.004016 that means a 1 percent increase in a number of loans to the private sectors cause GRDP cutback rate by 0.40 percent. Coefficient regression of the number of SMEs is amounted to 0.028843, which means that any increase in the number of SMEs by 1 unit, the GDP growth rate is also increased by 2.88 percent. The value of coefficient regression SMEs output variable is at 0.004774 which means a 1 percent value added SME, the rate of GDP growth increased by 0.477 percent.

Bank credit total for SMEs will have a significant positive influence on the rate of economic growth (GRDP) in the District /City of Special Region of Yogyakarta 2005-2015, the higher the bank loans for SMEs the more the value of GRDP of the area increased. From these results, it appears that the effect of bank credit total to SMEs towards economic growth has the most dominant influence compared to other variables. The local government is expected to encourage the banking sector to improve and facilitate access to credit for SMEs.

Private sector total credit has a significant negative effect towards the rate of economic growth in the District / City Province of Special Region of Yogyakarta 2005-2015. The result of this study is different from the existing theory that states with increasing bank credit total to the private sector, the economy will also grow. This does not apply in Yogyakarta province due to inability of private sector to cooperate with SMEs.

The number of SMEs (SMET) in a region has a significant positive effect on economic growth in the District / City of Special Region of Yogyakarta 2005-2015. The results are consistent with the existing theory that more SMEs within a region the more jobs will be created, which in turn can raise people's welfare and economic growth. It shows how the dominant role of SMEs in economic growth in Indonesia because SMEs can create employment and reduce unemployment. SMEs are run by the people. Therefore, empowerment of SMEs is crucial in order to increase economic growth in Indonesia.

The output value of SMEs has a significant positive effect on economic growth. If we look at the statistics obtained from the BPS (Central Bureau of Statistics), in 2016, SMEs in Yogyakarta provides an output value of IDR 3.689.719.674, which responsible for over 50 percent of economic growth (GRDP) of Special Region of Yogyakarta. It shows how the dominant role of SMEs in economic growth in Indonesia because SMEs can create employment and reduce unemployment. SMEs are run by the people. Therefore, empowerment of SMEs is crucial in order to increase economic growth in Indonesia.

The regression model estimation results in this study are feasible to be used to explain economic growth (rate of GRDP) which is influenced by the bank credit total to SMEs, bank credit total to the private sector, the number of SMEs, and the output value of SMEs in the District / City of Yogyakarta Province 2005-2015.

Based on the results, adjusted R-square value is equal to 0.975720. This may imply that the independent variables influence of 97.5720 towards the Economic Growth in Regency/City of Special Region of Yogyakarta, Indonesia, 2005-2015.

5. Conclusions and Recommendations

Total loans of SMEs have a significant positive effect on economic growth in the District / City of Yogyakarta 2005-2015. SMEs are a potential sector in creating jobs. But reality shows that SMEs in Yogyakarta is not maximally developed, evidenced by the many shortcomings that hamper SMEs to flourish. One factor that is very influential is capital (investment). Lacking in capital hampers SMEs to increase the scale of production and business. Yogyakarta local government needs to encourage banks to facilitate credit access for SMEs in order to increase the value of Gross Domestic Product (GDP) and public welfare.

Bank credit total to the private sector has a significant negative effect on economic growth in the District/City of Yogyakarta, 2005-2015. Through the private sector, local development can be enjoyed by the people of the area because the private sector can entice development through various sectors. Contribution of the private sector can also broaden the base of economic activity in various sectors, and specifically expand the field of business and lower the unemployment rate. If the unemployment rate is reduced, the welfare of the people in the region will increase and eventually impact the economic growth in the region.

The number of SMEs has a significant positive effect on economic growth in the District/City of Yogyakarta, 2005-2015. The number of SMEs has a positive influence on economic growth for SMEs is one of the production sectors that drives local economy. Increased productivity of SMEs in the form of increased output will encourage economic growth. The output value of SMEs has a significant positive effect on economic growth. If we look at the statistics obtained from the BPS (Central Bureau of Statistics) in 2016 Special Region of Yogyakarta, SME is able to contribute more than 50 percent of GRDP of Yogyakarta. SMEs are potential sectors in creating value-added. The role of SMEs in Indonesia in the form of contributions in GDP growth output is quite massive. It can be seen from the contribution and role of the SME sector in the food and beverage industries to absorb labor, it also has output value and high value-added. In addition, SME food and beverage industry can also optimize the domestic market.

The regression model estimation results in this study are feasible to be used to explain economic growth (rate of GRDP) which is influenced by the bank credit total to SMEs, bank credit total to the private sector, the number of SMEs, and the output value of SMEs in the District / City of Yogyakarta Province 2005-2015. Based on the results, adjusted R-square value is equal to 0.975720. This may imply that the independent variables influence of 97.5720 towards the Economic Growth in Regency / City of Yogyakarta, Indonesia, 2005-2015.

Future studies are expected to add or use other macroeconomic variables that are considered to affect economic growth in areas such as revenue, employment, investment, consumption, export-import, inflation, poverty and unemployment and also non-macroeconomic variables such as areas internal conditions including physical and environmental conditions, the regional economy, regional financial, demographic, social, cultural, regional infrastructure, governance and security as well as politics can also be used to analyze the rate of economic growth. Further research is also expected to expand or add to objects of research in other areas in Indonesia with a longer observation period.

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