

# SMALL AND MEDIUM ENTERPRISES TOWARDS ECONOMIC GROWTH IN NORTH SULAWESI, INDONESIA

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**ABSTRACT** – Attention to the development of small and medium enterprises is increasing. The high contribution of SMEs to the economy has placed the sector as one of the backbones of economic growth. This study aims to analyze the contribution of SMEs to regional economic growth. This research uses time series data in all regencies and cities in North Sulawesi. The findings of this study explain that the performance of good SMEs will open more jobs and increase investment.

**Index Terms** – Labor, investment, production capacity, production value, and economic growth

## I. INTRODUCTION

Small and medium enterprises (SMEs) have received support from the central and regional governments, the support is aimed at spurring economic growth, thus opening up employment, increasing gross domestic product (GDP), and export growth (Tambunan, 2011). Naidu & Chand (2012) explains that globally there is increasing awareness of various countries on the important role of SMEs in the country's economic development. SMEs have become the main engine behind economic growth, as it contributes to GDP.

SMEs' contribution is stronger to the economy if cluster and development (Narayana, 2007). The sustainability of SMEs growth can be achieved through the management of internal and external factors, so the role of managers is crucial to establishing the competitive advantage of SMEs (O'Gorman, 2001). Shibia & Barako (2017) mentioned several factors affecting the success of SMEs namely perception of justice, access to credit, and training and education. Other factors that influence the success of SMEs are innovation, entrepreneurship, and risk-taking (Ndubisi & Iftikhar, 2012).

Turner et al. (2016) expressed the importance of the government's role in economic development through the promotion of SMEs. Interaction between government and private sector can realize SMEs promotion effectiveness. Development of SMEs as a tool to achieve sustainable economic growth, although SMEs are vulnerable to obstacles, such as the lack of capital (Naidu & Chand, 2012).

SMEs in Indonesia reach 57.9 million spread across provinces with various sectors (trade, agriculture, and processing). Improving the performance of SMEs has had an impact on the opening of large jobs every year. The contribution of the SMEs sector has increased from 57.84% to 60.34%, so SMEs have a strategic role for the national economy. Although SMEs in Indonesia have many advantages, SMEs have an obstacle to the global supply chain, which is only 0.8%. Another challenge is that the distribution of SMEs industry in Indonesia is still concentrated in Java Island. This study aims to analyze the contribution of SMEs to regional economic growth.

## II. LITERATURE REVIEW

Academics and practitioners have been aware of SMEs' important contribution to the economy (Taiwo, Ayodeji, & Yusuf, 2012). Makanyeza & Dzuke (2015) conducted a survey of 200 SMEs, the study found that the success of SMEs is determined by the ability of managers to innovate although the impact of innovation on the benefits of SMEs is different according to industry characteristics. The contribution of SMEs as the economic supporting power due to its capacity in increasing the economic output and improving human welfare (Akingunola, 2011). Afolabi Studies (2013) that SMEs output and commercial bank loans to SMEs are significant factors to promote economic growth.

SMEs supported by innovation is an important driver of economic growth, innovation can be improved quality, and lower prices. In an increasingly competitive global marketplace, innovation is essential to securing a viable competitive position (Carmona, Momparler, & Gieure, 2012). The informal sector is still a mainstay for the economic economy of developing countries. Most employment opportunities are largely dependent on the SMEs sector (Akugri, Bagah, & Wulifan, 2015). Bouazza (2015) finds that if the performance of SMEs is low then it has a direct impact on low employment.

Rahayu (2013) and Terungwa (2011) examined the magnitude of the effect of investment on the performance of SMEs. The performance of all types of industries both SMEs and large industries require funds for capitalization, working capital and rehabilitation, as well as the creation of new investments (Terungwa, 2011). Inadequate sources of internal financing and inadequate external accessibility can be an obstacle to making new investments for SMEs. The capital structure is also related to SMEs investment decisions (Trinh et al., 2017).

The driving force of development in Schumpeter's theory is the entrepreneurs, innovators, and creative individuals who characterize having initiative, foresight and risk-taking. Schumpeter describes the characteristics of economic development as follows: (1) the introduction of new goods; (2) introduction of new production methods; (3) opening up new markets; (4) supply of new raw materials; and (5) new organizations in an industry. Adam Smith attributes the increase in public wealth by increasing output from production (land, labor and capital), in labor productivity growth and capital increase. Solow focuses on the process of capital formation and also assumes that production is related to capital, labor, and technology. Solow's model explains that long-term economic growth is explained by the workforce by making technological changes and with increasing capital, developing the concept of total factor productivity.

SMEs play an important role in increasing production, employment and export growth (Subramanyam & Reddy, 2013). The development of SMEs and changes over time in sales as well as outputs, output compositions, market and location orientations are considered to be related to many factors, including rates of economic development, changes in real incomes per capita, population growth, and technological progress (Tambunan, 2006). Schumpeter in economic development theory explains the role of SMEs businessmen as the main actors in the transformation stage of capitalism.

### III. DATA AND METHOD

Sources of data in this study are secondary data (time series) obtained from the Department of Cooperatives SMEs Industry and Trade of North Sulawesi Province in 2010 until 2016. The variables of this study consisted of independent variables ie labor (Lab), investment (Inv), production capacity (Prod), value of production (Value), and dependent variable is economic growth (Growth). Labor variables are measured by employment, investment is measured using the amount of working capital (own capital and banking capital) based on rupiah (Rp), production capacity is measured using the amount of output produced (unit), the production value is measured using the total production cost of all products every year based on the rupiah (Rp), and economic growth is measured using the level of economic progress achieved through increased production as measured by the percentage of 15 districts / cities of North Sulawesi Province within the period of 2010 to 2016. Analytical techniques used multiple linear regression analysis. The system of simultaneous equations formed the estimation equations as follows:

$$Y_1 = \alpha_0 + \alpha_1 X_1 + \alpha_2 X_2 + \alpha_3 X_3 + \alpha_4 X_4 + \mu_1$$

### IV. RESULTS AND DISCUSSION

The potential development of SMEs in North Sulawesi continues to be developed to promote economic growth. Economic development in North Sulawesi has increased compared to the previous period. By the end of 2016, the economy grew 6.17% while in 2015, by 6.12. Similarly, the unemployment rate in North Sulawesi is only 6.20%, this result indicates that the contribution of SMEs has created new jobs. SMEs contribution is also evident from the growth of new entrepreneurial investment of 35.37%. In the year 2017 there is an increase of investment in small and medium industries that is Rp 24.99 billion. The growth is dominated by food industry as much as 488 business units, chemical industry and building materials as many as 255 units, 175 electronics and electronic industries, and clothing industry as many as 111 business units, and handicraft industry as many as 54 business units.

Economic growth in North Sulawesi in the second quarter of 2017 amounted to 5.80%, the figure is higher than the national economic growth of 5.01%. Sources of improvement of North Sulawesi's economic growth from improving the performance of agriculture, processing and construction industries. The processing industry in North Sulawesi is dominated by the food and beverage industry by 85% of the total output of the processing sector. Based on the results of regression analysis, it can be presented in the following table.

Table 1. Regression output for the data

Variable	Coefficient	Standard Error	t-ratio	p-value
Constant	1.445	0.562	2.573	0.012
Lab.	0.342	0.091	3.746	0.001
Inv.	0.195	0.071	2.732	0.007
Prod.	0.056	0.106	0.524	0.601
Value	0.064	0.089	0.714	0.477
Fstatistic	= 7.573	R-square	= 0.232	
p-value	= 0.001	Adj. R-Squared	= 0.202	

Tests of significance are collectively used to determine the effect of labor variable (Lab), investment (Inv), production capacity (Prod), and value of production (Value) to economic growth (Growth). Testing criteria states if the value of p-value is smaller than 0.05, then there is a significant influence between all independent variables on Growth. Tests of significance together

resulted in Fstatistic value of 7.573 with p-value of 0.001, indicating that there is a simultaneous influence between independent variables on economic growth.

Partial significance test, Lab variable to Growth yields t-ratio value of 3,746 with p-value equal to 0.001, the value of p-value is smaller than 0.05 indicates that there is positive influence and significant partially variable Lab against Growth. The coefficient variable value of Lab. of 0.342 indicates that as much as 34.2% contribution of Lab variable against Growth. Partial significance test, Inv. to Growth yields t-ratio value equal to 2,732 with p-value equal to 0.007, p-value value less than 0.05 indicates that there is positive influence and significant partially variable Inv. against Growth. Value of variable coefficient of Inv of 0.195 shows that by 19.5% contribution of Inv. against Growth.

Testing of partial significance, variable of Prod to Growth yields a t-ratio value of 0.524 with p-value of 0.601, the value of p-value greater than 0.05 indicates that the variable of Prod no significant effect on Growth. Value coefficient variable Prod. of 0.056 indicates that only as much as 5.6% contribution of variable Prod against Growth. Partial significance test, Value to Growth variables yielded t-ratio value of 0.714 with p-value of 0.477, the value of p-value is greater than 0.05 indicates that the variable Value has no significant effect on Growth. Value coefficient variable Value of 0.064 indicates that only equal to 6.4% contribution variable Value to Growth.

## V. CONCLUSION

The large potential of SMEs in North Sulawesi is a strategic capital for the region to further enhance economic growth through enhancing SMEs' performance across all sectors or industries. The economy in North Sulawesi supported by various sectors is one of SMEs that has been proven to open employment and increase the productivity of human resources. The results of this study found that the variables of production capacity and variable of production value did not significantly influence the economic growth in North Sulawesi. The practical contribution of research emphasizes to the local government to maximize the potential of regional SMEs.

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