

## FACTOR INFLUENCING MSMEs PERFORMANCE MEASUREMENT - A LITERATURE REVIEW

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**Abstract:** *MSME is a significant determinant of economic growth, has an enormous contribution to national GDP, and help in creating jobs, and also played a critical role in a time of economic crisis. MSMEs is demanded to be able to compete in marketing their business. The writing of this article tries to explain how to measure performance in MSMEs with the size and assessment of existing performance. This study uses a literature research approach with secondary data collected through books, research reports, scientific journals, official agency documentation such as the Indonesian Central Statistics Agency. The empowerment of MSMEs becomes very strategic because of its high potential in driving the economic activities, and at the same time, becoming the source of income for most people in improving their welfare. The creation and development of local business that create jobs and potential economic opportunities are essential for the rural economy. The region can gain competitiveness and, in turn, can increase the local income and employment. The benefits of performance appraisal can be felt by the owner with a measure of business success that can be seen from the increased level of sales, increased capital, increasing the number of workers, increased levels of income and profits, and sales or a wider market. The evaluation of MSME's performance is carried out on the internal and external parties of MSMEs. Thus, the MSME's performance will be known from inside and outside MSME in order to achieve a successful business and be able to compete in national and international markets.*

**Keywords:** *Internal factors; external factors; MSMEs performance.*

**JEL Classification:** *F01; M21.*

### 1. Introduction

Indonesia is a country with abundant natural gifts. Indonesia consists of 17,504 islands with a total land area of 1.9 million km<sup>2</sup>, which 27 percent (0.54 million km<sup>2</sup>) is freshwater. Coastlines around 81,000 kilometres and seawater area are 7.9 million km<sup>2</sup>. The area (1.3 percent of the earth's land area), has biodiversity includes 11 percent of the world's plant species, 10 percent of mammalian species, and 16 percent of bird species. It is the second largest of biological diversity after Brazil. Indonesia has 109.96 million hectares of forest area, classified as the richest in biodiversity in the world. The land suitable and available for agriculture is 100.8 million hectares, but only 68.8 million hectares utilized. Marine fish is around 6.26

million tons per year, with an allowable catch of 5.01 million tons per year (Indonesian Statistic, 2017). The potential for energy and mineral resources is also huge, makes Indonesia beautiful fantastic blessed with abundant natural wealth.

The large economy makes Indonesia become a member of the G20 countries. According to IMF 2019, Indonesia is the 7th highest-ranking country in terms of GDP. This is one of the reasons why Indonesia is no longer categorized as a developing country by the USA government. United States Trade Representative (USTR) at the World Trade Agency (WTO) since mid-February 2020, eliminating Indonesia as a developing country. However, Indonesia is still far from developed countries in terms of several parameters to measure a developed country. Human development parameters, such as poverty rate, infant mortality, adult literacy, and life expectancy, are still low in Indonesia. Inferring from the Human Development Index (HDI), education in Indonesia is still low, with the majority of the population equivalent to junior high. From the agriculture sector, the majority of farmers in Indonesia still use conventional methods, differ from developed countries, have already used high technology, and even based on Industry 4.0. The World Bank recorded Indonesia's Gross National Income (GNI) in 2018, which is 3,840 USD that far below the minimum limit of 12,235 USD. According to World Bank data, Indonesia is not in the category of high-income countries or developed countries.

On the other hand, the trade war between the US and China made a negative impact on other countries including Indonesia (Kim, 2019; Adekola, 2019; Nwoke, 2020). For instance, in the automotive industry in Indonesia, imported parts from several countries in the world, such as from Costa Rica, Romania, Thailand, and dozens of other countries. Imported parts from those countries, 20% of them are from China. The current global 2020 pandemic has delayed production in China (Ozili and Arun, 2020), resulting in those countries failed to provide to Indonesia. To survive, China will use its USD as a tool against the US. China uses it to invest in Indonesia as Foreign Direct Investment, with one objective is to generate more USD. To encounter this situation, USTR revokes Indonesia from the developing country list, which will get an exemption from the Generalized System of Preferences (GSP) incentives from the US for Indonesia (Nwoke, 2020). Revocation of Indonesia from the list of developing countries, making export products Indonesia to the US will have difficulty competing with other developing countries, such as Vietnam. This situation makes China no longer want to invest in Indonesia, and at the same time, the US prefers to invest in other countries such as Vietnam and India.

To address the various problems above, the Indonesian Government makes every effort to maintain economic growth by cooperating with other countries such as Hungary (Ministry Of Foreign Affairs Of The Republic Of Indonesia, 2020). The cooperation between Indonesia and Hungary that has been implemented is a clean water project that has been implemented in 36 locations in 12 provinces in Indonesia. Another collaboration is a scholarship program provided by the Hungarian Government for 100 Indonesian students. The Hungarian Government is also committed to simplifying the visa process for Indonesian citizens. Hungary and Indonesia also establish agreement related to sports, training of Indonesian soccer players in Hungary. Hungary also offers cooperation in building hospitals that focus

on cancer therapy and oncology, as well as developing military hospitals and joint investment for infrastructure.

The two countries need to explore cooperation to increase investment in addition to the development of water treatment has been completed. Information technology and start-up are a necessary collaboration between these two countries. The majority of Indonesian products exported to Hungary are office/printing machines, coffee, cocoa, and rubber. According to the Indonesian Trade Ministry (2020) in Sirha Budapest 2020 event, during the January-September 2019 period, the total trade between Indonesia and Hungary reached USD 120.97 million. This value consisted of Indonesian exports to Hungary of USD 57.10 million, up 8.08 percent compared to the previous year, and the value of Indonesia's imports from Hungary at USD 63.87 million. In 2018, Indonesia was Hungary's trading partner in the 47th rank, with a 0.1 percent share. To enhance collaboration in trade and investment, the Indonesian Trade Ministry expects facilities ease of access from the Hungarian Government for Indonesian exporters and Indonesian investors in Hungary. This is very important because Hungary's strategic location to connect Central and Eastern Europe, making Hungary a vital market and entry point for Indonesian products in Europe. Vice versa, Indonesia also has the advantage and potential to become the entrance for western countries in the ASEAN market. During this time, Indonesian and Hungarian Trade is constrained by transportation and logistics because of the geographical conditions between the two countries. There are no direct flights from Indonesia to Hungary. The majority of export-import activities are carried out by the sea.

Furthermore, the Indonesian government also established bilateral relations with objectives that Indonesia can produce dollars in the form of the trade so that it can benefit both parties. In the context of international trade, the comparative advantage play an essential role (Abbas, and Waheed, 2017). Besides the quality and lower-cost production, the exported products have to be unique. This type of product is suitable for small business in Indonesia. The advantage of a small business is a large workforce, local skilled crafts, and abundant natural resources. Local entrepreneurs have special abilities that have been passed down for generations in producing a local handicraft. A local product is created because of the abundant resources in the area used by the people from generation to generation so that it can produce a good quality domestic product and low production costs (Tambunan, 2009).

## **2. Importance to Measure the MSMEs Performance**

Small business is a significant determinant of economic growth (Bello, Jibir, and Ahmed, 2018). It has an enormous contribution to national GDP, and help in creating jobs (Arunagiri, Kalaippiriya, Krishna, Vithya, and Kalaivani, 2015). MSMEs also played a critical role in a time of economic crisis as these enterprises are the ones least affected and can endure even when a national crisis occurred (Trinugroho, Agusman, and Tarazi, 2014). In 2008 when the big companies, especially in the financial services sector across the globe, are struggling to survive. On the other

hand, the small businesses in Indonesia kept growing in number at 2.37% on average from 2007-2010 (Green, 2004). There is no doubt that small business performance is crucial for the Indonesian economic development, especially when Indonesian facing the ASEAN free trade agreement or ASEAN Economic Community (AEC)

Although there is still high volatility in its performance, small businesses offer a potential source of growth for the economy, especially in the suburban area (Dixit and Pandey, 2011). Most of the small businesses in the suburban area are divided into MSME. Kindangen, Tumiwa, and Sepang (2019) found that MSMEs play a significant role in local Indonesian economic performance, especially in North Sulawesi. The creation and development of local enterprises that create jobs and potential economic opportunities are essential for the rural economy. The region can gain competitiveness and, in turn, can increase the local income and employment. Flora and Johnson (1991) observed that in rural areas, micro and small enterprises are the most rapid segment to grow and as an essential source of new employment opportunities through expansion. Miller (1991) states that, in a suburban area, micro and small enterprises are growing more rapidly, and have better-surviving rate than big enterprises or companies.

### **3. MSMEs in Rural Area**

The empowerment of MSMEs in Indonesia, especially in rural areas, is one of the priorities in national economic development. The development of this UMKM can expand the economic base more broadly and can make a significant contribution to accelerating structural changes and will improve the regional economy and national economic resilience (Westhead, Ucbasaran, and Binks, 2004).

Most of the land in North Sulawesi is the rural area with the potential for natural wealth is quite abundant: the sea is rich, the soil is fertile, and nature is beautiful. Soil fertility is clearly seen in coconut, clove, and nutmeg plants, as a traditional commodity for this area. Rice and pulses also easily grow and fertile. Abundant natural wealth has not been utilized well enough. The number and extent of land that which not cultivated can be seen easily across the province. Old coconut gardens were not rejuvenated, many clove gardens were left unattended - especially since the clove prices plummeted in 1998. Agricultural potential, including livestock and fisheries potential in this area, is far from optimal utilization, even though the need for agricultural products remains high or even higher because of the increasing population (Tumiwa and Nagy, in press).

To emphasize the potential abundant agricultural sources, MSMEs in North Sulawesi need to develop their performance (Al-Bakri and Katsioloudes, 2015). There are several factors influencing MSME performance as follow: political, social, land availability, technological, infrastructural, marketing, financial, management, and entrepreneurship factor (Eze, Olatunji, Chinedu-Eze, and Bello, 2018; Glas, and Ešig, 2018 Kovács & Nábrádi, 2020). Human capital or Individual is the main factor in determining performance. A competent entrepreneur can build a business that can sustain for a long time, as well as the employee (Man, Man, Lau, and Chan, 2002).

Employees with a higher degree of education or training often represent a competitive advantage for the MSMEs. In the current globalization era, the MSMEs is demanded to be able to compete in marketing their business. The empowerment of MSMEs becomes very strategic because of its high potential in driving the economic activities, and at the same time, becoming the source of income for most people in improving their welfare (Karadag, 2016). MSMEs are obligated to make changes to improve their competitiveness (Man, et al., 2002).

#### 4. Literature review

The specific, accurate measurement of MSME's performance have not existed because generally, previous researchers focus on variables where information is easily obtained. There is no consensus regarding the performance measurement at the MSME level. The Balance scorecard is one of the several methods frequently used to measure business performance (Kaplan & Norton, 2001). Unfortunately, the BSC method is not the best fit for MSMEs, which is their conditions are considerably different from big companies. This opinion is supported by Gumbus & Lussier (2006), stated that the BSC model could not be applied as it is; there should be some adjustments in the dimensions and measurements of this model to apply for MSMEs. Business performance measurement frequently uses the dimensions defined by BSC. However, there is one dimension that is rarely measured, which is from the entrepreneurial performance aspect that is attached to the MSME. The MSME characteristic where the owner is also a manager makes it impossible to separate the business performance from the entrepreneurial performance (Wu, 2009). Previous researches use performance measures based on manager/owner perceptions to anticipate the unavailability of business performance data (Covin & Slevin, 1989). Research could use subjective measures where the sample consists of a variety of small and medium businesses that have different performance measurement objectives and criteria. Chandler and Hanks (1999) and Dess and Robinson (1994) show a close correlation between subjective and objective performance measures. MSME researches chose subjective measurements of performance for the following reasons:

- Previous researchers identified that subjective measurements are consistent with objective measurements and have a high level of reliability and validity (Dess and Robinson, 1994).
- MSMEs are often very careful, and maintaining business financial data information actively, makes subjective performance information data is much easier to obtain rather than financial statements.
- MSME financial data are often absent or incomplete reported. Even if available, most are difficult to interpret because the purpose of making financial statements is different from general (Covin and Slevin, 1989; Tumiwa and Tuegeh, 2019).

Dess, Lumpkin, and Covin (1997) state that the interaction/relationship between entrepreneurial orientation and strategy has a positive effect on business performance. Miller and Friesen (1984) suggest that companies with entrepreneurial

orientation are more innovating in product markets, dare to run risky businesses, and start proactive innovations. Lee and Tsang's (2001) research results show that entrepreneurship orientation has a positive effect on business growth and performance.

Several previous studies shown that to measure the performance of MSMEs, there are several related factors, which are internal and external factors(David & Kovács, 2020; Madai, Bittner, David, Kovács, Nagy & Nábrádi, 2020). Initial capital, the availability of credit, product mix, and demand, as well as age, level of education, and ethnicity of the entrepreneur, are related to the growth of the company (in labor changes). In contrast, Crijns and Ooghi (2000) revealed that each stage of company growth is the result of two internal and external environments. Critical external factors that influence company growth are industry and markets, competing companies, and the economic climate, while internal factors that are very important for company growth are: small entrepreneurs as managers, companies as organizations, ownership, or ownership structures.

Zhang (2001) argues that there are two main preconditions for the small businesses' growth, which are the company's ability to maintain long-term survival and the ability of managers to overcome management obstacles. Concerning environmental aspects, Wilkinson (2002) states that MSMEs will grow if the regulatory environment/policy supports, the macroeconomic environment is well managed, stable and predictable, information that can be trusted and easily accessed, and the social environment encourages and appreciates the success of the business.

Manager/owner characteristics, company characteristics, external business environment, and the impact of economic and social policies have a direct, positive, and significant influence on business strategy and business growth. Arieftiara, Utama, Wardhani, and Rahayu (2019) argue that the impact of social and economic policies have a direct negative effect on business strategy. Based on the various literature that has been presented and the existence of previous empirical studies and previous research, it can be concluded that there are factors that can affect the performance of MSMEs, including:

1) Internal factors, consisting of:

- Human resources (HR): Those are the owner of UMKM, labor, intellectual capital (IC), spiritual leadership, the leadership style of the UMKM owner (Na Nan, Pukkeeree, and Chaiprasit, 2020; Iyortsuun, Goyit, and Dakung, 2020; Diaz-Villavicencio, 2020; Raharjo, 2019).
- Natural resources: the advantages possessed as MSME business resources, local knowledge, and skill passed from family generation to generation (Basco and Calabrò, 2016; Raharjo, 2019; Lee, 2008)
- Source of funds (financial): financing, capital or loan funds (credit) (Tumiwa and Tuegeh, 2019; Mahmood and Mohd Rosli,2013; Abe, Troilo, and Batsaikhan, 2015; Anwar, Nidar, Komara, and Layyinaturobanayah, 2019)
- Products: the quality of products produced, product innovation (Najib, and Kiminami, 2011)
- Marketing: the marketing strategy (Gilmore, Carson, and Grant, 2001; Al Badi, 2019)

- Facilities owned (Battistoni et al, 2013; Kuswanto et al, 2012; Fatimah et al, 2013; Hosseininia and Ramezani, 2016; Kindangen, Tumiwa, and Sepang, 2019)
  - Location/place (Battistoni et al, 2013; Kuswanto et al, 2012; Fatimah et al, 2013; Hosseininia and Ramezani, 2016; Kindangen, Tumiwa, and Sepang, 2019)
  - Profit level (Kindangen, Tumiwa, and Sepang, 2019)
- 2) External factors, consisting of:
- Information Technology (Cimini, Boffelli, Lagorio, Kalchschmidt, and Pinto, 2020; Wang and Wang, 2020; Okundaye, Fan, and Dwyer, 2019; Najib and Kiminami, 2011))
  - Global market (Ho, 2019)
  - Government through economic policies (Cancino et al, 2015; Hadiyati, 2015; Karanja et al, 2013; Kamaunge et al, 2014; Papzan et al, 2008; Sidek and Mahamad, 2014)
  - Customers (Gilmore et al., 2001; Al Badi, 2019., Nábrádi and Kovács, 2020)
  - Competitor (Nohong, Sanusi, Nurqamar, and Harun, 2018).
  - Supplier (Pablo and London, 2020; Lee, 2008; Nábrádi & Kovács, 2020),
  - Social, economic, and cultural conditions (Paruntu and Tumiwa, 2016)
  - The influence of other institutions such as the university, non-profit oriented organization, and others (Paruntu and Tumiwa, 2016).

The MSMEs performance can be measured by several indicators of the evaluation of the success of MSME performance, which is reflected in the following (Anton et al, 2015; Barth et al, 2017; Battistoni et al, 2013; Bayaraa, Tarnoczi, and Fenyves, 2019; Beley and Bhatarkar, 2013; Clarke, et al. 2009; Fenyves-Tarnóczi, 2020; Hadiyati, 2015; Karanja et al, 2013; Lans et al, 2013; Sidek and Mahamad, 2014):

- Increased sales growth/sales turnover
- Increased capital / financial growth rates
- High rates of growth in the workforce
- Broad market growth rates
- The rate of profit growth continues to increase

## 5. Conclusion

From the literature review, it can be seen that internal and external factors can influence the performance of MSMEs. The performance of MSMEs can be measured by the success of MSMEs indicator, which is an increase in sales, an increase in business capital, an increase in income and operating profit, as well as an increase in the labor used, and a market expansion.

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