

CHAPTER 1

INTRODUCTION

The purpose of this research paper is to explore and explain a broader scope of SMEs who are currently facing issues and challenges that are becoming more popular in the era of globalization. This research, to be exact, addresses the difficulties in terms of funding and innovation that affect the competitiveness of a SMEs. Nowadays, SMEs are very important in the economy, and it has become the source of a significant portion of job creation in any modern economy. Furthermore, this research aims to discover the factors, especially the issue in funding and innovation that influence the competitiveness in Indonesian small or medium-sized enterprise (SME), particularly in the local coffee shop industry. This research study is very important and it should be conducted by SMEs in order to have a sustainable competitive advantage and a strong position in the market. By the regulations and constitutions of building business in Indonesia, ease of doing business for people in Indonesia has been progressing. By having leniency on the regulations, the economy starts to grow by the number of SMEs that were produced month after month. This has caused some SMEs to largely think differently due to the high level of competitiveness in the market. In order for SME to be successful or achieve certain goals, competitiveness advantage should be highly considered as one of the top priority, since it may affect the growth of the company (Nadarajah, & Kadir, 2014). The problem of SMEs may lead to competition and failing in sustaining a small and medium-sized enterprise.

In this chapter, the author will provide an introduction of the research paper which include the background of the topic, the research objectives and problem, its scope, aims and benefits of this research paper.

1.1 Background

SME (Small Medium-Enterprise) refers to small to medium sized businesses in a certain economy system. It is called small to medium due to its size of headcount, which typically has below 20 employees in the business. A small and medium sized enterprise is also defined as a business that manages below a certain level of assets, sales and operating scale (Ward, 2019). In an economically developing world, SMEs play a crucial role by helping to preserve sustainable economic development, by providing job creation or incentives for the unemployed as well as increasing trade (Al-Haddad et al, 2019). Also, small-medium sized enterprises (SMEs) rarely import goods from other countries, as it requires a huge resource cost to develop the business (Al-Haddad et al, 2019). By this, SMEs focus more on local resources to be transformed into products that have the same quality yet lower price. Production wise, SME products only require a simple process in order to create the item from scratch into something, hence the cheap price (OECD Ministerial Conference, 2018). SMEs impose a powerful influence on all countries' markets, especially in the rapidly developing and highly competitive marketplace. Building a small business requires an extreme amount of effort and due diligence. Mostly, small businesses are created by the younger millennials who are trying to adapt and to start making a business that they can earn money from. However, SMEs are prone to succeed and fail at the same time (Islam, Khan, Obaidullah, & Alam, 2011).

1.1.1 SME in Indonesia

In this research paper, the author will be focusing on the country of Indonesia. Indonesia is currently a developing country and is the world's fourth largest population with more than 261 million people, has been largely influenced by rapid economic growth, triggering a shift in food and drinks consumption and an evolving retail sector (EIBN Report, 2017). SME has been a hot topic of discussion since the economic crisis in 1997 and it is still growing up until now. Before 1997, SME was not a particular sector that the government would look at, due to the number of SME that exists in Indonesia (Adiningsih, 2004). According to Rahmadi, Wiratama and Vincent (2018), currently SME dominates and contributes to the business sector of the country by approximate growth of 100% than the previous generation. According to the Kementrian Koperasi dan UKM (2018), in 2017-2018, the number of businesses in Indonesia was 64.199.606 units. From the amount, SMEs in Indonesia contributed 64.194.057 units or 99.9%. The number of growth SMEs in Indonesia continues to grow. In 2017, the number of SMEs in Indonesia is 62.922.617 units, and in 2018, it developed to 64.194.057 which is growing to 1.271.440 business units with different industry sectors. This amount is very large when compared to the amount large companies in 2017 where it only has 5.460 business units and it becomes 5.550 units in 2018 or only increased by only 90 units or 0.01%, for the clearer data can be seen in the Table 1.

Table 1: Number of SMEs and Large companies in Indonesia contribution in 2017 and 2018

No	Indicator	Quantity	2017	2018	Growth in 2017 - 2018
1	SMEs	Unit	62.922.617	64.194.057	1.271.440
	Large Companies	Unit	5.460	5.550	90
	SMEs + Large Companies	Unit	62.928.077	64.199.606	1.271.529

Source: Kementrian Koperasi dan UKM, 2018)

Furthermore, building a small business requires an extreme amount of effort and due diligence. Mostly, small businesses are created by the younger millennials who are trying to adapt and to start making a business that they can earn money from. However, SMEs are prone to succeed and fail at the same time. According to the International Labor Organization (2019), Indonesian SMEs employs about 97 per cent of the Indonesia's total workforce, generating approximately 57 per cent of GDP.

SMEs are vital to the economy in the matter of sustainable growth and employment. By 2020, Indonesia's economic growth will be increasing from 5.1% in 2019 to 5.2% (Indonesia economic outlook, 2019). The past decades have seen a renewed importance in starting a business in Indonesia because between 4 million to 6 million companies have been launched in the Indonesia market (Trade financial group, 2018).

Indonesia, particularly across the Java island, has a lot of various business industry sectors. One of the sectors that has the best development prospect is SMEs in the food and beverage sectors. According to United Nations Data (2017), Indonesia is

a large and promising market for food and beverage products. Currently, the food and beverage sectors occupies the second largest place and is still growing. It can be seen from the rise of food and beverage SMEs that can be found in Jakarta itself. Based on the 2006 – 2016 economic census conducted by the Central Statistics Agency, it was found out that the food and beverage business had become one of the businesses sectors with the largest number of business units in Jakarta. Jakarta economic census (2016) noted that there are 345,640 food and beverage businesses in Jakarta, this amount has grown by more than 20% over the past years, where there are 287,203 food and beverage businesses in Jakarta in 2006. This growth rate has increased a lot and overcome the car and motorcycle repair business which turned out to be stagnant and decreased 0.32% for the period 2006 – 2016, even though the car and motorcycle has the largest amount of contribution in business. This can be seen in the table 2 below. This food and beverage business growth rate has the largest number and most significant when compared to the growth of other business sectors in Jakarta. This even exceeds the average growth of all business units in Jakarta for 10 years which is only 10.04%. By this, we can see that the food and beverage sectors has become a very promising business and has the greatest potential for more development.

Table 2: Number of the economic censuses in 3 largest business sectors in Jakarta 2006 -2016

Year	Business Category		Total of all Business Category
	Car and Motorcycle Repair	Food and Beverage	
2006	455,255	287,203	742,458
2016	453,812	345,640	799,452
Percentage	-0.32%	+20.35	+20.03

Source: Badan Pusat Statistik, 2006 – 2016

From the data above (see **Table II**), there are a lot of business units in Jakarta that are focusing on the food and beverage sectors. However, there are some issues that SMEs in Indonesia are facing in terms of competitive advantage in the country. Prior research shows that two major failings for most of the SMEs in Indonesia are lack of funding and lack of technology innovation which affect the competitiveness in the country. In order to have a sustainable competitive advantage, financial and innovation is very important in the enterprise. This research paper has three variables which are funding, innovation, and competitive advantage. The purpose of using these three variables will be explained deeply in chapter 2.

1.1.2 Coffee shop SME in Jakarta

This research study will focus on the food and beverage sector which mainly emphasis on the small and medium-sized coffee shop in Jakarta. According to Widiati (2015), coffee shop business in Indonesia is developing in recent years. This may be seen from the giant increase inside the number of the coffee shops and domestic coffee consumption from the past 3 years (Widiati, 2015). In 2019, Indonesia had approximately 2,950 coffee shops, tripled the amount of shops in comparison to 2016. Due to the explosive amount of coffee shops open in the region, Indonesia is identified to be one of the world's biggest coffee market, due to the exponential demand of coffee in the country. To support this argument, yearly growth rate for coffee markets in Indonesia is estimated to increase approximately 11.4% every year from 2017 until 2021. Due to the increasing growth of coffee retailers, it is deemed as the world's fastest growing coffee market in the world (Normala, 2018).

Exponential growth in the coffee sector leaves a footprint of the ever increasing opportunity for business to invest in opening coffee retail shops. Looking at the exponential growth in demand side, young people and coffee addicts in Jakarta, demand that coffee shops express their own creativity and innovation to be able to serve them with all kinds of unique flavours and experiences (Normala, 2018). Jakarta is well known for its culinary tourism and unique coffee shops, making food and beverage industry as one of the leading economy sectors in Jakarta. However, due to the vast market opportunity and demand, sustaining a coffee business in Jakarta will face complexity, aggressive competitors, unprecedented change, and abnormal uncertainty (Wijaya, 2019). Due to this, coffee shop owners need to plan a high level strategy to be able to get ready and compete in one of the most aggressive competition industry in Jakarta (Cleland, 2019). To be able to sustain the business, coffee shops need their own unique competitive advantage to be offered to the demand market (Anggadwita, Profityo, Permatasari, Alamanda, & Hasfie, 2019).

1.1.3 Importance of Food and Beverages in Indonesia

From the data table above (see **Table II**), it can be seen that the growth of food and beverage in Indonesia has risen approximately 20% in ten years. From this, food and beverage is the current emerging dynamic market in Indonesia. According to the Indonesian Food and Beverage Producers Association (GAPMMI , 2019), the food and beverage industry's contribution to GDP increased from 5.32% in 2014 to 6.25% in 2018. By this, it can be seen that food and beverage industry has been increasing over the past four years. Moreover, food and beverages are the basic needs essential for human life. According to Maslow's hierarchy basic needs, every human being has to fulfill five levels of needs. The first and most primary level of the entire needs are

food and beverage, which the two things that associated with the basic human needs (Aruma, & Hanachor, 2017). Therefore, the author of this research agrees with this and focus on the food and beverage industry for this research paper.

1.1.4 Funding

Funding and finance is one of the backbones in creating a sustainable model of SMEs. It is one of the key to growth and success in bringing the whole business to run well and efficiently, into the goals that it wants to be achieved (Kyaw, 2008). Traditionally, the way of getting funds to start or create a business is through the banking and financial sector or through personal savings or loans. Banking and financial sector has been playing a huge role in helping and developing owners to bring their business idea to life, also sustaining and extending their businesses into more market size and market sectors. Other sectors that may help funding of SMEs can be from internal or external funding (Abdulsaleh, & Worthington, 2013). SME business loans are designed to help the SMEs start and thrive. Various researches reveal that there are many available alternative formal sources of financing schemes for SMEs in many countries. The facility of having bank loans and investment from other sectors may accommodate the SME to thrive and have the opportunity to grow as a business. This facility was created for a reason that SME needs to have the same and fair opportunity to be able to compete with the market (Business Matters, 2018). Moreover, banks and financial services providers are important to SMEs to facilitate financial transactions.

Funding is necessary when it comes to building the company. According to Duff (2017), the funds that were used by SME are mostly used for incorporation,

business license, insurance, facilities, equipment, marketing collateral and the hiring of staff. Companies in the food and beverage industry may need more funds from the internal and external funding due to the aggressive nature of competitiveness in this particular industry. This competitiveness level forces SME to call for help from the strategic partners, in order to maintain the costing and revenue of the business as a whole (Nay, 2014). The other crucial thing for funding is that it may boost the company's valuation and growth, thus, more opportunity in creating better quality of products and services (OECD, 2018). Therefore, it is important to have and maintain funding in a food and beverage enterprise, especially in the local coffee shop industry to compete with other competitors and achieve the sustainable competitive advantage in the industry sector.

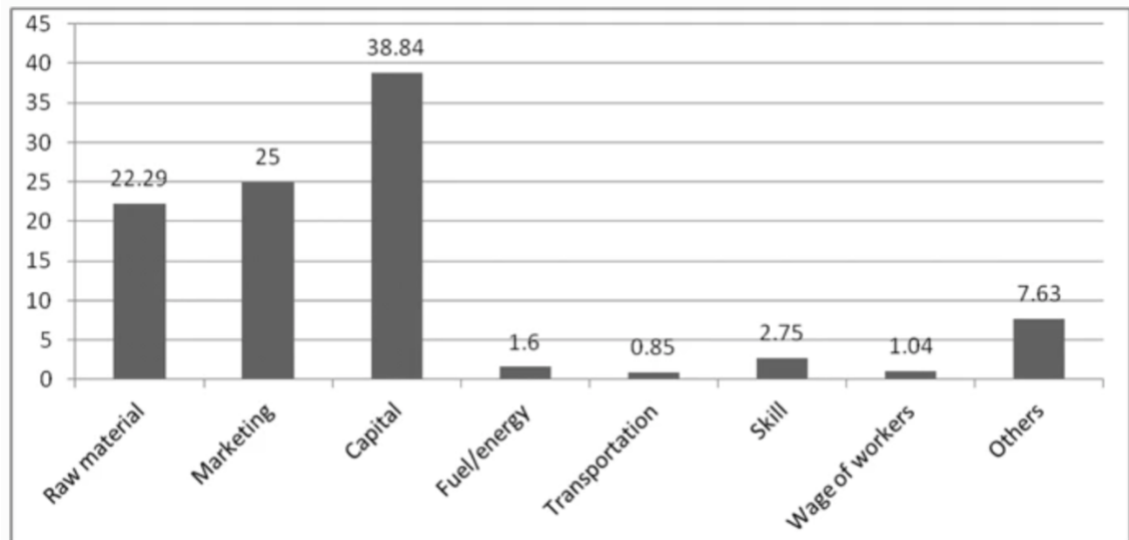
In the business, there are two types of funding which are internal and external funding. Internal funding include the personal capital whereas external funding are from the venture capital, angel investors and business loan. During the period of 1991 – 2014, there had been 11,686 companies funded by venture capital companies in Indonesia (Rosa, Saraswati & Sukoharsono, 2019). OJK (Indonesian Financial Services Authority) released the number of growth in 2015 that SME has grown into 61 companies dealing and transacting businesses day by day. This is a significant growth as Indonesia is considered as the number one country in Southeast Asia that has more than 5 unicorns that are established in the country. From this observation, it can be seen that a lot of SMEs in Indonesia are being funded by the venture capital.

In the first year of operation, lack of funds is the most common problem faced by an SME and one of the main reasons for shutdown (Pertkovic, & Jager, 2016). A

lack of financial access for SMEs is reflected in the Indonesian Banking Statistics (SPI) data routinely published by Bank Indonesia and the Financial Services Authority. The SPI data for October 2008 shows that of the total loans provided by the banking industry (worth 5,168.2 trillion rupiah), a mere 951 trillion rupiah was allocated to the SME sector. This means that 19% of the banking industry's total credit was allocated to the SME sector. Since Bank Indonesia has provided a significant amount into SME, this translates to funding SME is one of the most important aspects in this research, since lack of working capital may produce some severe impact towards the business growth. Moreover, lack of funding makes it difficult in growing the small-business in the future as well as influence the competitiveness of a company in the food and beverage sectors (Pfitzer, & Krishnawasmy, 2007). A reduced amount of funding may impact the acquisition and purchasing of the resources in order to build quality products to maintain competitiveness (Johnson, 2020). If a company continues to experience problems with growth, it may find itself losing revenue and growth to competitors.

The graph below (see **Figure 1**) shows that lack of funding is one of the biggest constraint in the food and beverage industry sector. According to Tambunan (2019), food and beverage industry SME in Indonesia faced difficulty in acquiring funds in order to start and develop the business cycle. Lack of capital contributes to 38.84%, highest amongst other factors in the industry. Lack of capital may be caused by several factors including no prospect in the business idea/model, lack of investor relations and no government support.

Figure 1: Main factors that affect the competitiveness in the food and beverage industry SME in Indonesia, 2015 (%)



Source: Tambunan, T. (2019). Recent evidence of the development of micro, small and medium enterprises in Indonesia. *Journal of Global Entrepreneurship Research*, 9(1), 18.

Funding in a SMEs is important in two things which are firstly, funding is needed to improve products, services, and technologies and secondly funding is essential to maximize the business value. Therefore, according to Ahemdova (2015) funding is one of the most important factors that influence the SME competitiveness in a developing country like Indonesia. By this, the author agrees with the studies that have been found in the previous research regarding the impact of funding for small and medium sized enterprises.

1.1.5 Innovation

In order for businesses to keep on improving and impact this world, products/services need to be different. One of the crucial ways to make this difference is by innovating. Innovation does not only impact the business sector but it keeps the economy wheel spinning and progressing. (Lundvall, 1998). Innovation is very critical particularly in regards to product innovation. Schumpeter (1934) argues that

innovation can be described as the process of introducing new goods and services to the marketplace, which then may become a catalyst of change and growth for the organization (Schumpeter, 1934). Thus, innovative ideas can be the boosting factor for the quality and increase the competitiveness that may bring a paradigm shift to the economy. In order to keep competitive in modern times would allow the enterprises to seek innovation (Teece, 2007). Innovation is therefore an important factor which offers opportunities for new innovations and markets (Kuhn & Marsick, 2010). Through innovation, trade and growth may be significantly impacted. It has also the potential to create a whole new competitiveness standard due to the unique features that are being presented. (Birkinshaw, 2011; Clawson 2009; Grant, 2010; Hamel, 2002; Kim & Mauborgne, 2005). As the competitors expand, innovation should be considered by a firm in order to enhance the competitiveness of the business. The importance of innovation is that business needs to continuously grow by building and creating things that do not even exist yet. The products/services that are created needs to have a unique value proposition in order for it to be a successful innovation.

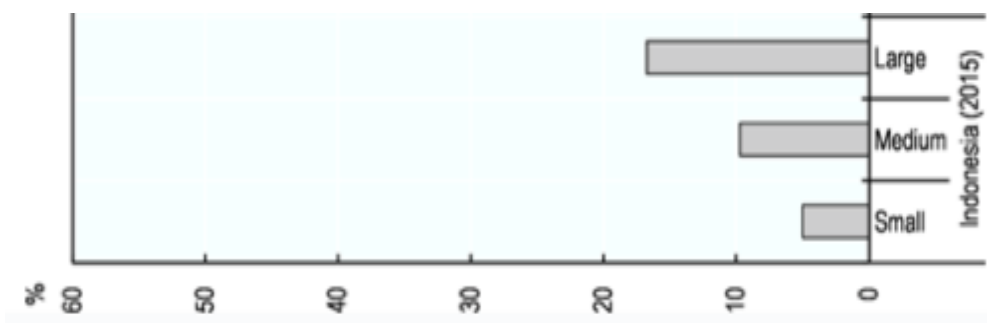
Customer expectations push creativity in the world's food and beverage industries. Synder (2020) identified that innovation is highly involved in the food and beverage sector in which around 90% respondents claim that the business develop innovation. According to the data above, it is argued that customers necessitate innovation in the food and beverage industry in order for the business to grow. Innovations that involve the uniqueness of the product, new sourcing and quality enhancement. The research by Synder (2020) stated that companies that are committed to always innovate their products/service will generally improved in the global market.

By this, the author of this research agrees that innovation has impact the business in terms of the competitiveness in the industry.

Due to the nature of the high competitiveness level in the food and beverage industry, SMEs are heavily dependent on the ability to innovate things to attract growth. Implementing innovation should be thoroughly considered and planned in detail and in line with the general framework of the company's strategy (Mokrzycka, 2010). Therefore, the importance of having a good innovation in the food and beverage sector is that it helps SMEs in achieving their success metrics and leverage their competitiveness level in the market (Rodgers, 2007).

Figure 2 below shows the percentage of firms that innovate new products/services in Indonesia, 2015 – 2016 (OECD, 2018). This can be seen that Indonesia has a lack of innovation in the small and medium sized enterprise compared to the large firms. By having a lack of innovation in SME, this will affect the competitiveness level, thus, even further impacting the company's performance as well as the economic growth (Mahmutaj, 2014). According to various researchers, innovations through technologies are among the most influential factors that affect the SMEs to gain sustainable competitive advantage in the globalized era. However, the SMEs ability to adopt innovation in business technology is limited mainly due to the lack of financial capital (Hoffman, Parejo, Bessant & Perren, 1998).

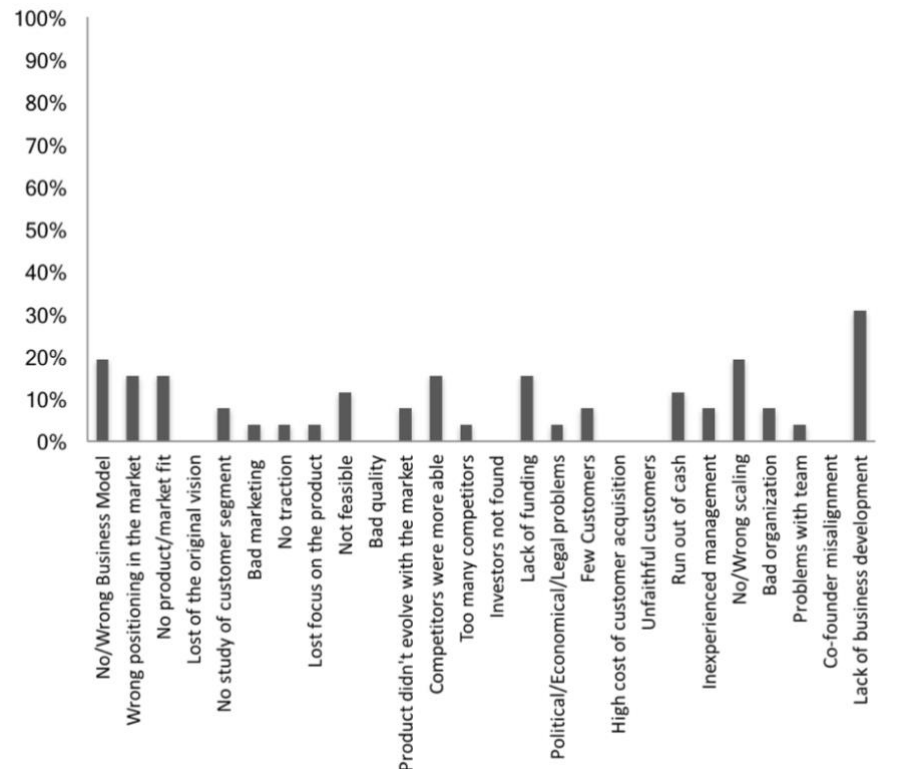
Figure 2: Percentage of small, medium and large firms that innovate new products or services by firm size in Indonesia, 2015 – 2016



Source: OECD based on the World Bank Enterprise Survey Database (2018)

Furthermore, innovation is a major issue for SMEs' survival in dynamic competitive environments (Adams et al 2006). From the graph below (see **Figure 3**), it shows that lack of innovation/business development is the highest among other factors that affect the success rate of an SME (Cantamessa et al, 2018). Lack of innovation accounted for approximately 30% on the reason of failure for SME in the food and beverage industry in 2018. The reason for the lack of innovation/business development was caused by not constantly meeting and researching on what the market needs. The author of this research argued that identifying the market needs and innovate the product/services will enhance the success rate of the business accordingly. Therefore, lack of innovation is one of the most important aspect in determining the competitiveness level in SME.

Figure 3: Reason of SME failure in the food and beverage industry in 2018



Source: Cantamessa, M., Gatteschi, V., Perboli, G., & Rosano, M. (2018). Startups' roads to failure. *Sustainability*, 10(7), 2346.

Without innovation, SME are prone to a low competitiveness level amongst the market, which will affect the growth of the business (Adhikari, 2011). In summary, innovation provides an important foundation as to determining the competitiveness level in the global business sector. Researchers have gathered and suggested that by innovating new products using new technology, will enhance the competitiveness between businesses (Williams & Hare, 2012). Therefore innovation is one the most important factors in influencing a sustainable business model and maintaining competitive advantage. By this, the author agrees that innovation is one of the most important factors that influence competitiveness.

1.1.6 Competitiveness of SME

Competitiveness plays an important role in determining the success of the business, as it acts like an indicator to measure the business growth and exposure towards the global market (Papadimitriou, Poufinas, & Galanos, 2018). Due to the economy crisis that Indonesia has faced as a country in 1997 and 2008, competitiveness in the world economy is disturbed. However, it has been proven that Indonesia were able to maintain their growth and competitiveness level in the world, despite the challenges faced (Adiningsih, 2004). Due to the strong economy that Indonesia has possessed, it has been highlighted as one of the countries that are able to create and build an environment for SME to thrive. The most convenient way of thinking into leveraging competitiveness level is to provide products or services that attract the niche market (Tracey, Vonderembse, & Lim, 1999). Companies face competitiveness issues due to two important factors which are lack of funding (Wang, 2016) and lack of innovation in the market (Porter, 1990). Those are the two important factors to encourage growth of SMEs in order to foster the overall economy. According to Najib (2011), in the food and beverage sector, innovation and funding are considered as one of the most important factors to enhance competitiveness. Overall, the competitiveness level of a business depends on many factors, however in this research study, the main focus are on the two important factors, which are funding and innovation that influence the competitiveness in Indonesia SME.

1.2 Research Problem

SMEs in developing countries such as Indonesia are facing some issues in funding and innovation which affect their competitiveness in the organization (Tambunan, 2011). There are several factors that affect competitiveness such as

ineffective business behavior (Franco, & Haase, 2009), lack of education system (Darwish, 2014), international trade (Bonga, 2014), lack of funding (Fatoki, 2014) and lack of innovation (Tambunan, 2011) in a SME. However, this research study will only focus on the two most important factor that influence the competitiveness which are lack of funding and lack of innovation. Data will be presented in order to support the reasoning on choosing these two factors. Although there were already some strategies that have been implemented by previous research, there were still constraints that SME has to deal with, regarding innovation and funding that will significantly affect the competitiveness of SME.

1.3 Research Objectives and Research Questions

1.3.1 Research Objective

The research objective in this paper is to conclude how does lack of funding and innovation affect the competitiveness in Indonesian small and medium sized enterprises (SMEs), especially in the food and beverage sectors. The result will discover the importance of funding and innovation in the SMEs focusing in the F&B sectors and emphasizing in the local coffee shop industry. This research also intended to find out the relationship in terms of funding and innovation that affect the competitiveness in Indonesian F&B sectors, specifically in the local coffee shop industry.

1.3.2 Research Questions

1. Does funding has a positive correlation towards the competitiveness in the local coffee shop industry in Jakarta SME?
2. Does product innovation has a positive correlation towards the competitiveness in the local coffee shop industry in Jakarta SME?

3. Do both funding and innovation has a strong relationship towards the competitiveness in the local coffee shop industry in Jakarta SME?

1.4 Scope

The research paper will focus more on the two factors which are lack of funding and innovation that influence the competitiveness and strategies that the enterprise should implement in the future in order to maintain a sustainable competitive advantage in a business. This research is limited to only interviewing 100 SME focusing on the local coffee shops in Jakarta. The reason that the researcher choose the particular city is that, Jakarta is the most populated city in the respective country. According to the World Population Review (2020), Jakarta is the capital of Indonesia, the largest and most populated city in Indonesia which estimated at 10.7 million people, hence more data can be obtained. The person that is being interviewed by the researcher is based on the 'higher position' in the enterprise such as directors, leaders, managers and employers of the enterprise. This is because they have deeper information about the company's management and success (Zaleznik, 2004).

1.5 Aims and Benefits

This research paper is aimed to determine the importance of funding and innovation that affect the competitiveness of Indonesian SMEs in the food and beverage sectors and to fill the gap in literatures. The author aimed that this research paper can become an article paper that can be published in the university library. There are various benefits that are expected to be obtained maximally in this research. For the business entities, the researcher believes that this research can assist SMEs, especially in the local coffee shop industry in achieving competitiveness. It is expected

that the data provided will create new guidelines for the SMEs to make alternative considerations. For the benefit of the researchers, the researcher wishes that this research can find the importance of the factors that affect the enterprise's competitiveness and is anticipated to provide knowledge about the field of competitive advantage. This research study is also beneficial for the readers to have a right concept on the importance of funding and innovation that they are going to face when they are going to start a new SMEs in today's generation and also in order to remain competitive in their industry.

1.6 Structures

This research paper will consist of 5 chapters that are going to discuss from a wider perspective to in depth view. In each chapter, there are different topics that are going to be covered. In chapter 1, the author will discuss the overview of the background of the topic and also explain the aim and benefits of this research. Chapter 2 provided several theories and concept frameworks that are related to the topic and have been used by previous research. Next, chapter 3 will cover the research design and methodology in which will be implemented and the data collection method and analysis will also be stated in this chapter. Chapter 4 discussed the data that has been collected using the data collection methodology and questions and answers were also stated in this chapter. All the findings will be expanded in detail in order to achieve the main objective of this research. Lastly, chapter 5, the conclusion and recommendations which it provides the conclusion of the results and limitations and recommendations were provided in this chapter for the future analyst.