



## Strengthening Competitiveness For SMES: A Conceptual Framework

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### ABSTRACT

*The development of SMEs has very important role in creating employment and reducing poverty. However, the intensity of business competition is very high too, so the SMEs need to have the strength of competitiveness in order to sustain in the business world. Therefore, the purpose of this paper is to identify the main factors influencing the success of the SME competitiveness. Exploration is used as the basis approach for the analysis, in which the flexibility and productivity of the business become the main aspects. The results showed that the ability of SMEs in building a network effectively and efficiently is a determinant of the level of flexibility and productivity of SMEs. The network characteristics are marked by three conditions, namely (i) the efficiency of business by minimizing transaction costs, (ii) the increase of working capital accessibility, and (iii) the innovative business climate. The analysis provides important insights for the government that the efficient and effective expansion of the business network should be focused on the SME development policy.*

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## 1. Introduction

The Existence of Small and Medium Enterprise (SME) has important role in the economy development and growth of a country, especially in the scope of regional economy (Nikraftar, 2016). Some indicators of this important role of SME are seen from its contributions in: (i) creating job opportunity; (ii) making capital; (iii) contributing to export; (iv) decreasing poverty; (v) reducing imbalance among regions because of its flexibility in determining the location of the business that can not be reached by the large-scale industries. Thus, SME becomes so crucial because of its role as driver of regional economic development through new perspective in seeing the important role of entrepreneurship of local competence (*local genius*) (Kiyabo& Isaga, 2019).

However, SMEs are often hampered by the difficulty of developing a long-term scale business. It is related to the low competitiveness of SMEs in term of business performance (Kadocs, 2006). Moreover, in making policy government tends to consider the development of SME competitiveness is only about production capacity. Even though the development of production is very important, the government can hardly fulfill the improvement of the institutional aspects such as marketing and the adaptation of market environment. Whereas, this is the determinant factor of underdevelopment of SME capacity that impacts the sustainability of the business in the midst of intense market competition (Irfayanti& Azis, 2012). As stated in the study of Idar et.al (2012), Jiang& Ling (2009), Irfayanti& Azis (2012), that marketing aspect and network governance is the key factor for: (i) a basis of decision-making strategy for SMEs in understanding the characteristics of the market and competitors; (ii) responding customer needs; (iii) implementing management quality and organization governance; as well as (iv) maintaining sustainability





of the business for long term. This argument strengthens the weaknesses of neoclassical view that assumes the company as the exclusive unit of analysis without considering aspects of entrepreneurship collectively.

Based on the previous arguments, the purpose of this paper is to explore more in seeing the success factor of SME Competitiveness according to institutional aspect for maintaining and developing long-term business. This is expected to contribute to the literature by conducting an empirical investigation that is rarely done, in which the institutional aspect is seen by the effectiveness and efficiency of the network and its implications for the high level of flexibility and productivity. Once the identification is known, it can be a reference for policy-making to develop SMEs through effective and efficient strategy of business networks.

## 2. Literature Review

### a. Characteristic of SMEs

So far there is no clear definition of the SME accepted globally. It is supported by the opinion of Kimura & Lim (2009), that SME is indeed very heterogeneous group, so it brings out many various perspectives in different countries. One of the reasons is because its style features such as skill characteristic, with diverse operational organization based on the social background.

In Indonesia, there are various opinions in defining SME. Most of researchers in Indonesia define SME as business unit that is mostly informal and characterized by labor intensive, and also it generally requires small capital to build (Hamdani & Maulani, 2019). While Panggabean (2007), describes that SME (i) is firm that does not separate the position of both owner and managerial structure, (ii) uses its own labor, (iii) is unbankable and uses its own capital, (iv) has a low level of entrepreneurship, and mostly does not have legal status. Some of these limitations have implications for existing condition of SMEs in Indonesia which is characterized by: (i) SME has limited managerial and production innovation; (ii) SME has lack of quality management; (iii) SME is innovation and technology illiterate; (iv) SME is insulated from market access; (v) SME is hard to reach government's supports or programs, and (vi) SME still rely on the chain factors that are passed from generation to generation with the very simple product management. This argument is reinforced by several findings, such as Utomo & Dodgson (2001); Doloruex (2004); Braun, William & Lowe (2005), that SME issues that are difficult to overcome (such as lack of information technology because of slow and uneven infrastructure) made the SME development tends to stagnate due to difficulties in facing the global economic environment. Based on this range of issues, the definition of SMEs in Indonesia often refer to some of the main indicators, namely the value of assets, sales volume, and number of employees.

But in recent empirical studies, the government is still paying less attention to some of the constraints faced by SMEs, such as (i) policies that are not supportive for the condition of SME Development, and (ii) inadequate infrastructure. Other external issues frequently faced by SMEs in Indonesia are the accessibility of information and intense competition due to the opening of the free market like ACFTA (Hamdani & Maulani, 2019). This finding is reinforced by Darwanto et.al (2019) that the limited access to information for SMEs in Indonesia is caused by the obstacle in adopting information technology due to slow and uneven infrastructure, while the free trade develops so fast. This condition is also the reason why the target markets of SMEs in Indonesia are relatively small and why they are easily defeated by imported products. Thus, the definition of SME based on its function and role broadly refers to populist business that then makes SME as a strategic sector.

### b. Institutional Aspect as the Accelerator of Competitiveness of SMEs

Much literature explains that competitiveness of SMEs in the international and national market is characterized by strong production techniques. Thus, many in the field use this perspective of improving the quality of the products as a legitimate basic in the development of SMEs. Under this context, concentration on the improvement of the quality of the products is seen as a determining factor in maintaining and improving business performance as to improve competitiveness (Anton et.al, 2015).

However, those who believe on institutional perspective criticize the above argument; this party states that the analysis developed is still very limited in solving all the problems faced by those in the business (Sabatini, Modena & Tortia, 2011). Institutional perspective argues that production perspective simply focuses on production and individual behavior which is rationally based on competitive environment (Utami & Lantu, 2014). This is dominated by the standard microanalysis, in which





hypotheses are built on their own business exclusively without considering collective entrepreneurship aspects. In the meantime, factors such as organizational development, human resources, product development, chain supply management through collaboration and participation build in cooperation with clients, suppliers, distributors, competition, and organizations affect competitiveness more significantly than the previously argued factors (Lewis, Pun & Lalla, 2006). The latter is more closely related with quick adaptation with the changes in business climate in order to maintain sustainable business development.

Thus, institutional perspective sees the old analysis level as premature since SMES is basically people's collective business (Lang & Roessi, 2012). Therefore, problems emerge are the ones related with analyses of situation commonly faced by SMEs, such as procedure and institutional arrangements, and mechanism in cooperation strategies (Singh & Grag, 2008).

This institutional view then explains the fact that the role of the existing SMEs is related to its strong relevance with some institutional implementation, especially related with: (i) the role of participation and institutional arrangements in pulling up transactional cost; (ii) social capital element which is created based on basic price and authority as differentiating factor from big business; and (iii) some other variables such as trust, network, and norms as clearer separating factors in explaining people's business such as SMEs. Some other studies, such as Gafsi & Brossier (2002); Noe & Halberg (2002) show that SMEs practices which are participative and based on networking help changing business operationalization to be better. Operationally, this happens since SMEs can improve group ability to participate in negotiation, control, and cooperation, as well as in learning to be independent and to act objectively.

### 3. Research Methodology

This study is intended to reveal the conceptual framework of competitiveness of SMEs. In many studies, such cases like this can only be better understood when analyzed through perspective of literature review. In this context, desk study research was often employed for case study methodology because it allowed identifying and understanding the different dimensions that are characterized by the phenomenon, meaning, as well as the holistic nature. This identification revealed by literature investigations to explore the reasons why and how conceptual framework of strengthening of competitiveness for SMEs. This approach tends to be considered as content analysis approach as it employs apriory-based analytical models. Content analysis was a research technique for the objective description, and systematic mapping and interpretation of certain document (Ceci & Lubatti, 2011). Where this analysis for the interpretation of the content of text data through a process of analysis, developing standard categories, systematic classification of coding and identifying themes or patterns, coding materials by checking the reliability of the data of literature, analyzing and interpreting information, and validation.

### 4. Discussions

#### a. The Motive Behind SMEs Networking

Some researchers state different reasons in explaining networking process in SMEs. There are, at least, two approaches in seeing this phenomenon. *First*, this happens due to government policy, and *second* it simply is the intention of SMEs to create networking. Government intervention usually happens due to the demand from high volume of trading in the other areas which finally requires the creation of network as a form of supervision to see the economy structure in SMEs (Ceci & Lubatti, 2012; Wignaraja, 2012). The internal factor comes from SMEs caused by variety in the location of supply, variety in the delivery, and the need to cooperate for many reasons (Constantin, 2002).

In the recent development, motivation seen as effective for SMEs to create network is the internal one. Even though SEMs is faced with many problems and limitation, some argue that this limitation is actually the main factor pushing SMEs to use their resources more efficiently (Rengkung, Pangemanan & Sondak, 2017). In the case of networking in SEMs, there is an orientation to share knowledge as to create business efficiency individually (Tobing, Fathorazzi & Wulandari, 2018). This becomes a competitive advantage from individual contribution to the larger interests (Cecily, Castleman & Parker, 2012). Thus, the knowledge learned from the existence of SMEs can contribute to the creation of added value through innovation and creativity process (Constantin, 2002).





The above argumentation emphasizes the fact that networking for SMEs is mostly caused by the limitation of the business, such as (i) the limitation to capital and funding access, (ii) un-bankable in nature, and (iii) not legally based which finally forces SMEs to cooperate. The need to cooperate emerges from some condition as the implication of many problems, such as (i) managerial limitation and product innovation, (ii) low quality control management, (iii) market isolation, (iv) does not find access to government assistance, and (v) still rely on simple and inherited ways of managing business from one generation to the other. This argumentation is supported by other studies, such as Utomo & Dodgson (2001), stating that problems persistently faced by SMEs which are difficult to solve (such as the lack of information technology due to lack of infrastructure) have hindered cooperation and networking, regarding to the fast development of trend and technology. In addition, Braun, Williams, & Lowe (2005) state that local network is a response to the unsafe position related to the fast development and advancement of technology. People involved in SMEs need to collaborate and create network to reduce uncertainty in the fast developing global economy as well as to complement the limited resources they have (Wisentige & Guoping, 2016).

In addition, the motivation for the development of networks is also due to personal relationship and informal work relationship. One of the characteristics of networks is the co-existence of many kinds of relationship, both personal and professional (Cecci & Lubatti, 2012). The personal and informal relationship is determined by trust among those in SMEs. The argumentation gives a new point of view—that effective and efficient networks are the ones formed by the internal motivation and willingness of those in SMEs, which are full of certain local characteristics, although the locality may be full of weaknesses and limitation. Thus, these limitations must not be seen as a hindering factor when there is awareness of those in SMEs. These limitations must be seen as potential, the factor to create and develop network of SMEs in certain areas.

## **b. Productivity and Flexibility as Two Key Competitiveness Aspects of SMEs**

Productivity refers to the number of goods and service provided per work hour (Mankiw, 2006). Moreover, Sitompul (2012) asserts that productivity is a comparative ratio of what has been achieved and what has been sacrificed in order to achieve a goal. In this case, she shares a common thought with Lussiar & Sanja (2001) in that productivity generally relates outputs with inputs, creating a certain comparative value between achievements and resources used, or between the number of production and the degree of resource use. Further, Ngah, Wahab & Salleh (2015) describes productivity as a comparison of the whole value of goods and service obtained or produced and the whole value of goods and service spent in order to achieve the goal. Therefore, all the definitions of productivity above are related to the ability of a company (in this case, SMEs) to increase the ratio between input and output calculated on the basis of the production process value in which the measurement indicators are income and expenditures. When an SMEs has a high level of productivity, its ability to survive within difficult situations will be higher, seen from its relatively stable condition during crisis. All this indicates that productivity is one of key aspects in empowering the competitiveness of SMEs.

Meanwhile, flexibility of an SMEs has been defined from many different perspectives. One example is Alisjahbana (2006) who states that flexibility tends to relate with freedom to accept or hire manpowers no matter their life background. This concept comes to existence as the worldwide labor market nowadays is directed to its more flexible form along with the rise of world economic liberalization (Nugroho & Tjandraningsih, 2007). This flexible labor market, followed by a flexible production system, is believed to pull out the economic growth, allow for a greater diversity of working opportunities, and increase the people's income level in the midst of tigher competition in the global economy era. Moreover, Marijan (2005) explains that there are three factors which affect the flexibility level of an SMEs as follows: (i) location or place, meaning that SMEs as small-scaled economic units can do their activities in whichever place appropriate for their business; (ii) demand, meaning that SMEs is much more flexible to set pricing as they have no obligations to set budget for taxes and wages, thus making it more flexible to satisfy the needs of the society well; (iii) human resource, meaning that SMEs is wide open for labor with lower qualifications in that formal sector cannot absorb. This flexibility of SMEs makes it more advantageous in dealing with market competition as it is more dynamic seen from different aspects.

## **c. How is the Networking Process Creates the SMEs Productivity and Flexibility?**

SMEs behavior formed after the networking process is an inevitably interesting phenomenon to observe, particularly that concerning with how the networking process affects the company's operation.





According to a field analysis, this process is carried out to interpret how networking can manage and facilitate every activity of its member (SME). This finding suggests that one key aspect to empower the SMEs operation is by networking quality strategy. The quality of a networking has an implication on the function of a facilitator or mediator in sharing a common orientation or goal between the members of a networking group. This indicates that not all networking is beneficial to its members, particularly when it does not state a common orientation or goal.

On the basis of some theoretical review, the kind of networking refers to an alliance or network congestion in which all parties involved in the group agree to a common orientation. This process encourages its members to share their meaningful resources on new things and on creating a new value (Prasanna et.al, 2019). As Patrick (2017) says, in the networking group takes place a range of activities which greatly contribute to the end value or the service given to customers, suggesting a relationship between firms value chain and supplier value chain as well as distribution (*channel*).

Furthermore, the results of the field analysis indicate that the orientation of such a networking is leading to a networking organization in a long term. Siddik (2018) find that this networking organization should be made as an advantageous factor to the extent to which it forms a competitiveness advantage by creating new values that competitors seldom or never think of. Beside, its great implication lies on its power to affect its members' entrepreneurship orientation. Singh & Grag (2008) give an example of this implication on the members' export orientation which will encourage the organization's members to attend workshops and get involved in exhibitions.

These conditions have an implication towards the competitiveness of SMEs which is indicated by the high level of productivity and flexibility. This is suggested by the findings of the analysis which conclude that productivity highly affects the level of profitability, while flexibility is one of the SMEs characteristics in the networking for its easy access on raw materials, capital, and market. In an operational sense, the SMEs productivity and flexibility can be achieved as there is a linkage in the group through an information system for the sake of the optimalization and coordination of various activities. This will imply on the sustainable competition advantage as there is a chain which links various value chain of the members or partners such as technology, capability (production, marketing, and management), and products. The findings are also considered consistent with what Nikraftar (2016) has found in that the optimum economic activities cannot be separated from the objective aspect within the networking group as it forms a socially strong fundamental.

It is these three benefits of accessibility that encourage an SMEs to work together in a networking organization. This relationship pattern contributes to an important construction on how SMEs adjusts itself during the grouping phase of networking (Ceci & Lubatti, 2012). This adjustment behavior indicates the effect on the SMEs behavior after the relationship within the networking is established. This will lead to changes in the principles of management praxis, in the overall turnover, in the market demand, in the performance in terms of a better one than competitors, and in the development of the orientation itself (Setyaningsih, 2012). Therefore, it can be said that a high quality networking has an important role in increasing competitiveness, particularly that of the SME.

#### **d. Implications on SMEs Competitiveness**

Paper has shown that the role of business networks has a implications on the profitability of Small and Medium-sized Enterprises (SMEs). The finding reinforces Wignaraja (2012), stating that the benefit of the network can be identified through its functions towards the sustainability of its members' business. One of the measurements is the level of obtained profitability. This profitability indicates business productivity.

In addition, SMEs incorporated in networks also retain a high level of business flexibility. In accordance with the findings of Jiang and Ling (2009), the effect is due to the flexibility of the network to provide the accessibility of business integration, namely input, process and output. The benefit of such accessibility sustainability can be seen in the level of profitability obtained by the SMSE's members (Resmi, 2011). Thus, the correlation between productivity and flexibility for network is highly significant.

Therefore, it can be stated that the more the business increases, the more the SMEs become flexible in responding to market demand. Here, it can be seen that the business networks are beneficial to the survival of the city's business competitiveness. There are several key factors to this, which are:

##### 1) *Creating an efficient business by minimalizing transaction costs*

In general, the kinds of transaction costs appeared in the business praxis of SME, according to Yustika (2008), are as follows: (i) costs for searching out information, (ii) costs for designing,





implementin, and monitoring contracts, (iii) costs during the waiting time from one period of production to another, (iv) management costs, and (v) distribution costs. In fact, prior to the business network, members find it difficult to search out information, particularly in terms of raw materials (input) and marketing with an appropriate pricing. When that kind of information is not obtained, most SMEs will be the victims of asymmetric information which obviously harm the business development in a long term. Contrary to the fact, once the business network has been formed, there will be a cohesion of information in the cooperation contract with providers of input or users of output. Having signed the contracts, SMEs possess a guarantee to survive in a long term. This is proven by lower transaction costs of each member. These costs often appear when SMEs conduct a business management repairment, input or output distributions, and as transportation costs.

Network as a place for mutual cooperation, therefore, can lead to an efficiency in transaction which is able to deal with both mirco- and macro-scaled market imperfections. In a micro scale, the rise of large-scaled companies is innovative to correct such market imperfections while taking an advantage of the organization mechanism. In a macro scale, the imperfections are executed by the government (Supratikno, 2007), so the management of organization structure in the network will affect the choice of organization available for the decision making of each member (Pattit, Raj& Wilemon, 2012). This act of decision making has a significant role towards the success of SMEs' economic performance both in the organizational level or in a wider context.

## 2) *Improving the capital accessibility*

It has been found that SMEs' capital accessibility prior to joining into a business network is weak as it is reviewed from the start-up capital point of view and the capital accessibility for a long term investment. In mobilizing the start-up capital, the function of the network includes three aspects, that is, financial assistant, technical assistant, and guarantee program. Moreover, to improve the capital accessibility, there has to be an optimalization of the role of others in subsidizing members who need help. Such is an attempt to cover up members who are not able to absorb accesses on bank credit. In other words, this is the form of a social insurance among members of the group.

## 3) *The creation of an innovative business climate*

Prior to joining the networks, Most of the SMEs were limited to traditional ways in managing and producing their products. After participating in the networks, however, theSMEs gained ease in terms of marketing, technology, information access, entrepreneurship readiness, capital, etc. This has stimulated the development of related marketing, better product management (production), including designing products that are more appealing to consumers. Thus, the networks contributes to build a more innovative environment. This is indisputably due to the networks' ability to carry out the dissemination of innovation, create value-added products and and create more jobs (Cecily, Castleman, & Parker, 2012; Muresan & Gogu, 2012). This may have implications on the performance of SMEs due to its effect on the cost of production and exchange (as reviewed by North, 1990; within Fuentes, 1998), due to stimulation of productive institutional environment (Mura & Buleca, 2012). This productive institutional environment may also stimulate ideas, beliefs and actions applied by SMEs, in both formal and informal sectors. Therefore, the researchers believe that creating the right institutional in network management is as important as the acquisition of appropriate incentives for the advancement of SMEs (Marchese& Porter, 2011). This finding is important as the fundamental concept of network formation in the policy-making level; whereas previously SMEs merely focused on the concept of competition without any cooperation between organizationswhich was based on their ability in creating, processing, and implementing efficiency-based knowledge (Indrawati, 2012).

The role of the local company networking in disseminating knowledge and creating innovative business climate reinforce the discovery of some researchers, such as Kiyabo & Isaga (2019), as disclosed by Doloreux & Parto, (2005), which relates the transfer of knowledge as specific resources (local capabilities, skills, institutions, and various social values and culture). These specific resources are beneficial to drivecompany'sinnovation and competitiveness to createcompetitive advantages which eventually affects the social and institutional conditions,emerging new concepts in planning the development of the SMEs' competitiveness, such as learning areas, innovative milieu, industrial district, as well as local productive system.

## 5. **Conslusions, Contributions, and Limitations**





Based on the analysis and findings of the literature review, some of the functions of the business network are to cover the internal and external problems. This internal problems happen due to poor business management. Some of the main internal problems of SMEs before joining the business network can be classified into five aspects, namely: (i) financial management issue, (ii) difficulty in accessing labor, (iii) difficulty in managing raw materials, (iv) difficulty in managing quality & quantity control, and (v) cultural issues of the entrepreneurs relating to entrepreneurial spirit. While for external problems, there are several factors that affect the problem, including: (i) institutional aspects, (ii) the socio-politics, (iii) infrastructure, and (iv) marketing.

In the analysis of growth and development, the business network has benefits in some product innovation and marketing expansion, strategies in business are aimed to improve product quality in order to compete in the broader market, and expansion functionates in strengthening and improving product quality and innovation. Literature explained, a good quality product is the product that can meet the needs and exceed the expectations of consumers, and it can fulfill the dimensions of quality in terms of performance, features, reliability, conformation, durability, service ability, aesthetics, and perceived quality. The dimensions of quality for service can be measured from: direct evidence (tangibles), empathy, reliability, responsiveness, and assurance. When the aspects in micro outward looking aspect model can be catered, then the implications for the flexibility and productivity of SMEs can be run well and can be perpetuated in the long run.

From the previous conclusions, the important role of the network is its function in improving the accessibility of the network members in the supply of raw materials, capital and market expansion. Because this function is very important, the network needs to be managed by professionals who have the entrepreneurial spirit, so as the network can develop its link to get suppliers of raw materials, the owner of capital, as well as business participants widely. It is expected that the business network is not the forum for the opportunists who is just seeking rent, especially, the government's aid hunters that are covertly using development programs as their modus. Moreover, because there are some differences of fundamental problems faced by SMEs either micro, small, and medium business, the development of the business network should be tailored to the specific needs of SMEs, such as the expansion of market for micro and small SMEs. Through this action, it is expected that the interest of SMEs to participate in the business network increases. Coaching and the network empowerment should not be conducted based on the principle of equality but the principle of the needs of its members. So that the activities of the network are diverse. The findings contribute greatly to the development policy made by the government that expansion of an effective and efficient business network has to be the main focus.

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