THE ROLE OF GOVERNMENT SUPPORT FOR INNOVATION AND PERFORMANCE OF SMEs

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ABSTRACT

This study inspect and analyzes the impact of government support on SME performance both directly and indirectly through innovation. The sample in this study was 165 SMEs in East Java which focused on several regencies / cities which were the eastern development corridor area and had a distinctive superior food and beverage business. The collected data is then analyzed using path analysis. Of the four hypotheses proposed in this study, all were accepted. The results of testing the hypothesis of direct influence indicate that government support influences the performance of SMEs, government support influences SMEs innovation, and innovation influences the performance of SMEs. The results of hypothesis testing indirect effects indicate that government support influences the performance of SMEs through innovation.

Keywords: Government Support, Innovation, Performance, SMEs.

INTRODUCTION

Small and Medium Enterprises (SMEs) in the country of Indonesia are the main ammunition for local economic development. The Indonesian government has taken several steps to improve the performance of SMEs, one of which is by making SMEs empowerment one of the national priorities in the Making Indonesia 4.0 initiative. In 2017, SMEs in Indonesia contributed 99.99% of the total business units, 97.02% of the total workforce, 60% of the total Gross Domestic Product (GDP), 14.17% of the total non-oil and gas exports, and 58,18% of the total investment. These figures show the essentiality of SMEs in shaping the Indonesian economy.

However, SMEs in less developed countries have the opportunity to hold up and even grow in the long term (Tambunan, 2008). The growth of SMEs remains a problem because of barriers to financial access that prevent greater participation in the economy and prevent SMEs from expanding their business operations. SMEs need more research and development subsidies to innovate than large businesses (Czarnitzki and Delanote (2015). Subsidies offered by the government can be in the form of tax credits or direct grants (Kobayashi, 2014; Cin *et al.*, 2017).

One of the things that needs to be done by SMEs in facing global competition, is using information technology (IT). As a developing country, SMEs districts in Indonesia still do not fully use and utilize IT in business processes. Government support will tend to move SMEs to adopt IT (Nugroho, 2015). That is, there is very little availability of skilled labor in Indonesia, urging the government to focus on producing skilled workforce that meets the requirements of SMEs.

Interventions designed to support SMEs are very popular among policy makers, given the role of SMEs in the economy in Indonesia. According to Amar (2012), support must be in accordance with the needs of SMEs. Unfortunately, the current government program to strengthen local SMEs is still far from their needs, especially to help their innovation adoption.

Given the importance of SMEs to the local economy, it is important to study and evaluate the performance of SMEs. This study is intended to investigate the performance of Indonesian SMEs and fill the research gap by highlighting the factors of government support to improve the performance of SMEs both straight and indirectly over innovation. Several empirical studies have assert the role of government support for the performance of SMEs (Adebiyi *et al.*, 2017; Briozzo dan Cardone-Riportella, 2016; Motta, 2018; Cin *et al.*, 2017; Karhunen dan Huovari, 2016; Romero-Jordan *et al.*, 2014; Garone *et al.*, 2015) and the role of government support for SMEs innovation (Paik *et al.*, 2017; Cowling, 2016; Yu-Bing *et al.*, 2011; Czarnitzki dan Delanote, 2015; Uvarova, 2019 However, several studies have examine the effect of government support on SMEs performance through the mediating effects of innovation variables (Yang, 2017; Hervas-Oliver *et al.*, 2016; Udimal *et al.*, 2019) directing the author to concentrate this research as a central focus. Thus, the research question for this study was formulated: Does government support affect SMEs performance and innovation? Does innovation affect the performance of SMEs? Is innovation considered an important mediating effect on the relationship between government support and SMEs performance?

LITERATURE REVIEW

1.1 Small and Medium Enterprises (SMEs)

Some institutions and even Laws (UU) in Indonesia afford definitions of SMEs. The Central Statistics Agency (BPS) is afforded an explanation of SMEs based on the abundance of labor, namely for small businesses having a workforce of 5 to 19 people, while medium businesses have a workforce of 20 to 99 people.

The definition of SMEs delivered by Law No. 20 of 2008 is also different from the definition above. According to Law No. 20 of 2008, the so-called Small Business is a productive economic enterprise that is independent, carried out by individuals or business entities that are not subsidiaries or not branches of ompanies that are owned, controlled, or become part directly or indirectly with Small or Large Enterprises that statisfy the criteria for Medium Business. While Medium Enterprises are productive economic businesses that are independent, carried out by personal or business entities that are not subsidiaries or branches of of association that are become part, owned, or controlled of either directly or indirectly with Small or Large Businesses that statisfy the criteria of Business Middle.

Table 1. Criteria for SMEs Based on Assets and Turnover

Business Size	Criteria	
	Asset	Turnover
Small Business	> Rp 50 Million – Rp 500 Million	> Rp 300 Million – Rp 2,5 Billion
Medium Business	> Rp 500 Million – Rp 10 Billion	> Rp 2,5 Billion – Rp 50 Billion

Sources: Law No. 20 of 2008

2.2 Government Support for SMEs

The author reviews preceding studies on government support for SMEs in various countries.. Ismail and Kuivalainen (2015) argue that institutional theory is very important to investigate the strategies of SMEs in Malaysia because the rules of the game, such as triggering certain policies and the economic prosperity of the nation. SMEs that have a agreeable domestic institutional climate have a positive effect on international performance.

Access to finance is one of the most dangerous challenges for SME entrepreneurs (Rupeika-Apoga, 2014). The results of the study indicate the priority of alternative external financing resources for small developing countries such as the baltic and the need to support the design and evaluation of policy measures and to monitor the indication of financial reform on access to smes financing.

The growth of SMEs in Europe is very high dependent on financial access (Moreira, 2016). Accede to Prelipcean and Boscoianu (2014), the government must behave more earnestly to resolve the difficulties faced by SMEs in accessing finance through capital injections in guaranteed loan programs, direct loan programs, micro credit loans and other guarantees. These programs must also be devise through other interesting innovative pattern such as private partnerships, special special investment funds with flexible structures.

Klonowski (2010) evaluates government assistance programs for SMEs in Poland and assesses the effectiveness of these programs in stimulating the development of the SMEs sector. The study shows that the Polish government support program is unstructured, fragmented and not targeted. In addition, these programs do not meet the actual needs of the SMEs sector and are used poorly and there is a liquidity gap in financing the SMEs sector.

The UK coalition government wants to increase access of SMEs to public procurement (Loader, 2016). Besides SMEs in Europe and America, public acquisitions are progressively perceived as a strategic behaviour of public administration because of the large amount of resources consumed, as well as the important policy objectives that are to be promoted, including the objectives related to SMEs (Kidalov and Snider, 2011).

The government and SMEs in India are expected to form partnerships to increase the level of skills in the SMEs sector (Thiruchanuru, 2016). This can be done through increasing funding for training SMEs workers by the government. In addition, the government established an SMEs consultation and training center to help SMEs with their challenges.

2.3 SMEs Innovation

Confer to Fontana (2011:40), innovation is a econimic and social accomplishment because of the addition of new things or new combinations of old ways or new combinations of old ways to convert inputs into output in such a way that large changes are made in the comparison between the value of benefits and prices confer to the perceptions of buyers and / or the user. Wignaraja (2003) states that in assessing the factors that shape innovation are divided into four elements: opportunities, incentives, resources and managerial capabilities. Opportunities depend on a combination of technological and market ideas to identify new organizational products, processes or methods. Incentives depend on the expectation of sufficient profits to offset risk in relation to invested capital. Resources include not only formal R & D elements but also all the complementary assets needed to transfer ideas into practice. Capability relates to the knowledge and skills of company organizations involved in managing the innovation process.

With the arrival of globalization and a knowledge-based economy, SMEs must continue to innovate to stay competitive. An important issue similar to this consideration is the role of IT competence in enabling innovation processes such as developing new products, and in determining the performance of product innovations from SME. Raymond *et al.* (2018) argue that there are three configurations of IT capabilities for SME in Canada, namely IT Defenders, IT Analyzers and IT Prospectors, the latter two of which are correlate with greater product innovation performance.

Open innovation is the key to the success of many companies based on the use of all possible resources intelligently, including collaboratioswitzn with parties outside the company. SMEs in Switzerland emboulden collaborative development by building bridges between startups and SMEs, making identification of achievable new technology users (SMEs) more reachable to startups, and making startups more detectable by SMEs (Mercandetti *et al.*, 2017).

External knowledge, internal innovation and the R & D department are the main determinants of SME open innovation performance in Malaysia (Hameed *et al.*, 2018). Spanish SME that carry out the process of innovation strategies rely densely on amass external sources of knowledge to complement their weak internal innovation capabilities, and their innovation patterns show clear differences from traditional R & D-based product innovation strategies (Hervas-Oliver *et al.*, 2014).

There are three factors that SMEs in Australia take to survive and innovate in a changing business environment (Evans and Bosua, 2017), namely (i) emphasis on developing knowledge; (ii) openness to sustainable learning; and (iii) involvement in social networks with various stakeholders. In addition, information technology plays an enabling and supportive role in strengthening the ability of SMEs to be more innovative.

Recently, the trend towards continuous advancement has led to varied Oriented Innovation / SOI categories (Ciang Wu, 2017). However, developing SOI is a difficult task for SMEs because they

have limited resources and expertise, especially for family-based SMEs. Family SMEs are the unity of ownership and leadership (Werner *et al.*, 2018). The next generation of family company leaders seems to be more risk-averse than the founding generation. As a result, the output of innovation continues to decline from generation to generation. Strength, experience and culture that will accelerate innovation for family SMEs in Thailand (Pitchayadol *et al.*, 2018).

2.4 SMEs Performance

SMEs Performance Confer to Bititci (2015:33-34), performance is the Efficiency is the amount of resources that an operation uses to provide results / output. Effectiveness is the extent to which the results of an action meet our expectations / requirements / specifications.

Performance assessment is the process of assemble, analyzing and reporting information about the performance of an action (Bititci, 2015:35-36). Throughout the 1980s and 1990s various models of performance measurement and frameworks emerged. This was largely developed to respond to increased complexity within and outside the organization, together with management needs for better organizational control. financial and non-financial are indicators for general performance measurement. Company performance measurement can also be done in the company's internal and external environment.

Government intervention through business support can improve the performance of SMEs and construct jobs in low and middle income countries (Cravo and Piza, 2018). However, slight is known about which interventions are most successful for SMEs.

Lee and Jo (2018) argue that government support does not only expand R & D investments and registration of intellectual property rights for SMEs in Korea, but also increase investment in tangible assets and human resources and marketing. Meanwhile, the results of the Tingvall and Videnord (2018) study on SMEs in Sweden show that there is no guarantee that grants will have an impact on the company's growth, both positive and negative. The positive growth effect is most likely to be found for public-sponsored R & D grants that target SMEs located in areas that are rich in skilled labor, while the reverse is found for SMEs located in areas with limited supply of skilled labor.

Many studies show that government policies such as R & D subsidies and public credit guarantees will stimulate company growth and activities that are consistent with the objectives of this SMEs policy. The results of the Tsuruta study (2018) show that SMEs policies can be important to reduce market failure. However, the SMEs policy implemented in Japan hampered the company's growth. Therefore, the government must be careful in implementing a series of excessive policies to support SMEs.

2. Hypothesis Development

2.1 Government Support and SMEs Performance

The study of the role of government support for SMEs performance has been carried out previously. This is due to the assertive role played by SMEs in most developed and developing countries. Adebiyi *et al.* (2017) conducted a study of 250 SMEs in the State of Lagos, the results of the study showed that there was a significant relationship between the practice of financial management and the performance of SMEs. The government must put in point flexible arrangements for SMEs to facilitate them to access funds. The government must find ways to encourage financial institutions to lend to SMEs by providing guarantees, interest rate subsidies and other incentives. The study of Briozzo and Cardone-Riportella (2016) analyzes the impact of two Spanish public programs

that provide financial support to SMEa, namely subsidized loans by the Official Credit Institution and bank loans guaranteed by the mutual guarantor community. These programs can influence the growth of assets, sales, and sales ratios of SMEs assets. Motta (2018) also settle that SMEs that applied for bank loans but were rejected had lower equalize of labor productivity than SMEs that gain financing.

Cin *et al.* (2017) find significant evidence that there is a positive effect of public R & D subsidies on R & D spending and the added value of productivity of Korean manufacturing SMEs. In line with that, R & D subsidies also produce positive employment effects and increase the survival of companies for SMEs in Finland (Karhunen and Huovari, 2016). Study results of Romero-Jordan *et al.* (2014) showed different results that tax credits and public grants on R & D investments from Spanish manufacturing SMEs had a very low impact. This evidence directs the government to discuss alternative public policy designs. The Garone *et al.* (2015) evaluated the jolt of Brazil Arranjos Produtivos Locais (APL) policy, a gather development policy, on the performance of SMEs in Brazil. The results of the study indicate that APL policy produces a positive direct impact on three interesting results, namely on employment growth, total export value, and the possibility of exporting

Depend on the statement and evidence above, the researcher expects:

H_1: Government support influences SMEs performance

3.2 Government Support and SMEs Innovation

There are a number of studies on government support and SMEs innovation. Paik *et al.* (2017) conducted a study of 250 IT sector SMEs in Korea. The result shows that government support has a positive effect on the ability of technology standardization for SMEs innovation. The government can build infrastructure and encourage the approval and utilization of companies. The results of the Cowling study (2016) show that the acceptance of tax credits by SMEs in the UK leads to increased product, service, or process innovation. Furthermore, there are few additional product and service innovations, and there is evidence of radical radical process improvements, especially if combined with strong capabilities and planning at the company level.

An important important key factor affected the development of information network platforms is government services and technical support and the level of consciousness of high-tech SMEs in Shanxi towards information network platforms (Yu-Bing *et al.*, 2011). Whereas the R & D policy on SMEs innovation in the European Union's high-tech sector shows that independent high-tech companies do not have a lower output effect than other companies and thus indicate that the current policy focus on certain types of companies is not effective (Czarnitzki and Delanote, 2015). Uvarova (2019) identifies key threat and space for the introduction of innovation in SMEs in six European countries (Bulgaria, Czech Republic, Hungary, Italy, Latvia and Slovenia). Recommended policy recommendations to promote innovation in rural SMEs by focusing on cooperation and networking, information and training, innovation support programs, marketing and sales promotion and labor availability.

Based on the statement and evidence above, the researcher expects:

H_2: Government support influences SMEs innovation

3.3 Innovation and SMEs Performance

Innovation is a key variable for improving SMEs performance. Vladimirov (2016) conducted a study of 500 SMEs in the manufacturing sector in Bulgaria. The results of the study reveal that product innovation has a direct and positive impact on performance, while progress innovation has a positive and significant effect, but only indirect determine on performance. In increasingly erratic and competitive markets, tourism sector SMEs are often pressured to innovate in various types of

innovations (Verreynne *et al.*, 2019). The diversity of innovations creates synergies where capabilities developed for one type can increase the yield of other types of innovations. The study found that innovation diversity reduced the negative effects of uncertainty on SMEs performance.

While most studies inspect the effect of marketing, innovation, and learning ability on performance separately, research by Sok *et al.* (2013) developed an integrated model to investigate the combined effect of this ability on performance. The study findings show that marketing, innovation, and learning abilities are positively similiar to the performance of SMEs. In other, these competence interact with each other to create great synergies in achieving SMEs performance. Business Model Innovation (BMI) is a key driver for corporate endurance and superior performance notably in developing industries. Anwar (2018) study of 303 SMEs in the manufacturing sector in Pakistan showed that BMI had a significant positive impact on competitive advantage and SMEs performance. Innovations accompanied by the use of corporate IT have a significant effect on the performance of SMEs in Cameroon (Tsambou and Fomba Kamga, 2017) contribute to the productivity of the company. The use of IT can quicken the innovation mechanism and enhance the performance of SMEs in terms of cost devaluation and process rationalization.

Based on the statements and evidence above that researchers foresee:

H_3: Innovation influences the performance of SMEs

3.4 Innovation Mediates Government Support and SMEs Performance

Previous research has found that one of the factors that influence SMEs performance through innovation is government support. The results of the Yang (2017) study conducted on SMEs in Latin America and the Caribbean showed that the benefits of innovative SMEs declined more than non-innovation companies when aspects of regulation or governance were poor. Creating a enabling environment involves many pillars, but what cannot be overlooked is the role of governance and government institutions.

Hervas-Oliver *et al.* (2016) conducted a study of 2,837 SMEs in Spain. The results of the study show that the integration of technology and organizations creates high-level complex innovation capabilities and positive complementarity that improves performance. For policy makers, the results of this study make it clear that policies must promote not only greater technological innovation but also the adoption of non-technological innovation companies (i.e. introduction of management innovation) and that there must be investment in social and managerial capabilities. In other words, policy makers must realize the potential for improved performance when innovation is handled in a more comprehensive view, including the integration of technological and non-technological innovations.

Udimal *et al.* (2019) focus on authority of financing innovation from the key government in the pattern of tax credits, subsidies, bank loans, venture capital (VC), and from foreign partners in SMEs in Ghana. Government subsidies and tax credits have a significant positive reaction on sales revenue for new product innovations. Compared to other SMEs financing sources, they were found to have a significant influence on sales revenue. The increase in units in government subsidies and tax credits directed at innovation results are approximately 42% and 21% in sales of new products, respectively.

Based on the statement and evidence above, the researcher expects:

H_4: Innovation will mediate the influence between government support for performance SMEs

Based on theoretical and empirical studies, Figure 1 shows the framework and research hypothesis.

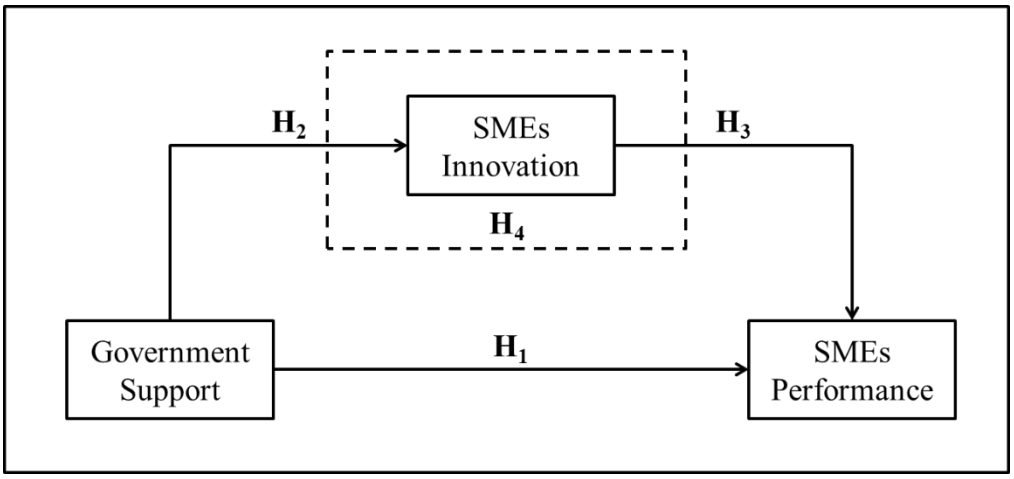

Figure 1. Hypothesis Model

RESEARCH METHOD

The population of this study is all SMEs in East Java which focus on several districts / cities that are the eastern development corridor area and have a superior typical food and beverage business (280 SMEs). The districts / cities chosen were Probolinggo City, Probolinggo Regency, Lumajang Regency, Jember Regency, Bondowoso Regency, Situbondo Regency, and Banyuwangi Regency. Sampling in this study used the proportionate sampling method based on the proportions of each Regency / City. The method used to determine the number of samples is using the Slovin formula with an error rate of 5% obtained by the number of samples of 165 SMEs.

This study used a questionnaire using a 5-point Likert scale and adapted from the appropriate literature. The measurement of government support variables was adapted from a questionnaire developed by Kim *et al.* (2016), measurements of innovation variables were adapted from a questionnaire developed by Ciang Wu (2017), and measurements of company performance variables were adapted from a questionnaire developed by Ar *et al.* (2011) and McDermott *et al.* (2012).

The main data collection method for the purposes of testing the hypothesis in this study using a questionnaire. The unit of analysis is an organization which in this case is represented by leaders / entrepreneurs / owners / managers of SMEs. The questionnaire was submitted to the respondent directly by visiting the respondent. The submission of the questionnaire was conducted from April to May 2019.

3. Results and Discussion

From the general description of the respondents, several conclusions can be drawn. First, most of the respondents were women (81.8%). Second, the majority of respondents are 41-50 years old (54.5%). Third, almost all respondents were married (96.4%). Fourth, the most recent education of most respondents was dominated by high school / vocational school graduates (39.4%) and junior high school (32.1%). Fifth, the highest length of time of conducting respondents' business is 6-10 years (44.8%).

The results of the direct effect testing are presented in Table 2. Of the three direct path models, all of them have a significant effect.

Table 2. Hypothesis Testing Results Direct Effect

No.		Hypothesis	Coefficient Path		
			Estimation	C.R	ρ
1.	H_1	Government Support → SMEs Performance	0,18052	3,99552*	***
2.	H_2	Government Support → SMEs Innovation	0,15493	3,46305*	***
3.	H_3	Innovation → SMEs Performance	0,21494	2,79122*	0,00525

C.R* : significant at the level of α = 5%

The results of testing for indirect effects are presented in Table 3. One indirect test model tested proved to have a significant effect.

Table 3. Hypothesis Testing Results Indirect Influence

No.		Hypothesis	Coefficient Path		
			Estimation	C.R	ρ
1.	H_4	Government Support → Innovation → SMEs Performance	0,053	2,173*	0,0298

C.R* : significant at level α = 5%

Government support has a positive and significant effect on the performance of SMEs so that H_1 is accepted. That is, if innovation optimized it will increase the performance of SMEs. This finding provides evidence that government support consisting of direct and indirect support indicators will have a significant effect on the performance of SMEs. This finding supports the theory and findings of previous studies (Adebiyi *et al.*, 2017; Briozzo dan Cardone-Riportella, 2016; Motta, 2018; Cin *et al.*, 2017; Karhunen dan Huovari, 2016; Romero-Jordan *et al.*, 2014; Garone *et al.*, 2015).

Government support has a positive and significant effect on SMEs innovation so H_2 is accepted. That is, if government support increases it will also increase SMEs innovation. This finding provides evidence that SMEs that have received support from the government in making innovations will be able to improve their innovations in both product, process and organizational innovation. This finding supports the theory and findings of previous studies (Paik *et al.*, 2017; Cowling, 2016; Yu-Bing *et al.*, 2011; Czarnitzki dan Delanote, 2015; Uvarova, 2019).

Innovation has a positive and significant impact on the performance of SMEs so that H_3 is accepted. That is, if innovation increases it will enhance the performance of SMEs. This finding provides evidence that innovation consisting of indicators of product, process, and organizational innovation will have a significant effect on the performance of SMEs. This finding supports the theory and findings of previous studies (Vladimirov, 2016; Verreynne *et al.*, 2019; Sok *et al.*, 2013; Anwar, 2018; Tsambou dan Fomba Kamga, 2017).

Government support has a conclusive and significant response on the performance of SMEs through innovation so that it supports decisions from H4. When compared with the direct effect of government support on SMEs performance, it can be concluded that government support has a direct and indirect influence on the performance of SMEs through innovation. So that it can be said that innovation is a partial mediating variable between government support and SMEs performance. This finding supports the theory and findings of previous studies (Yang, 2017; Hervas-Oliver *et al.*, 2016; Udimal *et al.*, 2019).

CONCLUSIONS

This study aims to examine and analyze the effect of government support on the performance of SMEs both directly and indirectly through innovation. Of the four hypotheses proposed in this study, all were accepted. The results of testing the hypothesis of direct influence indicate that government support influences the performance of SMEs, government support influences SMEs innovation, and innovation influences the performance of SMEs. The results of hypothesis testing indirect effects indicate that government support influences the performance of SMEs through innovation.

The results of this study contribute to the District / City Government related that the government needs to provide support to SMEs so that they can improve innovation and performance of SMEs. Such support can be directly in the form of financial support and indirect support in the form of support in carrying out innovations, support ranging from purchasing raw materials to marketing products.

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