

IJBLE36

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Submission date: 10-Feb-2024 12:20AM (UTC+0700)

Submission ID: 2290550880

File name: 424-Article_Text-1732-1-4-20240208.docx (347.78K)

Word count: 6716

Character count: 41234

<https://ijble.com/index.php/journal/workflow/index/424/3>



Navigating the Business Landscape: The Influence of Infrastructure, Financial Inclusion, Innovation, and Government Policy on Indonesian MSMEs

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ABSTRACT

The performance of Micro, Small, and Medium-Sized Enterprises (MSMEs) in Indonesia is examined in this study in relation to a number of different influences. A quantitative examination of 255 MSMEs from various industries, geographies, and sizes is carried out, with an emphasis on the interplay of infrastructure, financial inclusion, innovation, and government policy. In order to investigate the direct and intermediary links between these important determinants and MSME performance, structural equation modeling was employed in the study. The results revealed a strong positive correlation between the variables, demonstrating the critical role that government policies, infrastructure, financial inclusion, and innovation play in fostering business success. Financial inclusion plays a mediating role, and mediation analysis clarifies the contextual elements influencing the connections that are seen. By providing practical insights for business leaders and policymakers to navigate and enhance the business environment, this research advances our understanding of the intricate dynamics inside Indonesia's MSME sector.

Keywords:

Infrastructure, Financial Inclusion, Innovation, Government Policy, MSMEs, Indonesia.

INTRODUCTION

In Indonesia, micro, small, and medium-sized enterprises (MSMEs) play a critical role in promoting innovation, job creation, and economic progress. But in the ever-changing commercial environment, these businesses encounter several obstacles. Regulatory compliance constraints, skill shortages, market competition, and limited access to financing are some of the major obstacles MSMEs must overcome (Yose, 2023). However, MSMEs can also benefit from and grow under these circumstances. Potential channels for MSME expansion include digital transformation, entry into new markets, and government policies that are supportive of the sector (Afiah, 2023). For MSMEs in Indonesia to be resilient and sustainable, it is imperative that these issues be recognized and addressed (Marwanto et al., 2023). To improve MSME competitiveness, policymakers, researchers, and practitioners must create customized business plans, encourage technology adoption, fund skill-development programs, and put policy changes into effect (Amin et al., 2023). MSMEs can keep being



procedures. MSMEs can improve their efficiency, become more competitive, and achieve long-term success by utilizing innovation.

H3: The performance of Indonesian MSMEs and innovation—including the quantity of patents, R&D spending, and adoption of new technologies—are positively and significantly correlated.

Government Policy and MSME Performance

Government policies have a significant impact on MSMEs' growth and sustainability by fostering an environment that is supportive of their operations. The success of MSMEs is positively impacted by well-crafted government policies, such as advantageous regulatory frameworks, funding program accessibility, and focused incentives. These regulations must be specific and take into account the particular difficulties that small firms encounter. Research has demonstrated the significance of government assistance for MSMEs and their role in reducing poverty and creating jobs. Government policies' effects on MSMEs' performance and entrepreneurial activities have been studied in a number of places, including Perlis, Malaysia (Nor et al., 2023), Asaba, Nigeria (Salami et al., 2023), Pesawaran Regency, Indonesia (Ramadhona et al., 2023), and Raymond Mhlaba Municipality, South Africa (Rungani & Ward, 2023). Furthermore, the evaluation of MSMEs' growth and development in India has been conducted within the framework of governmental policies (Mahmood & Seth, 2023).

H4: The performance of Indonesian MSMEs is positively and significantly correlated with supportive government policies (as measured by policy effectiveness, perceived support for MSMEs, and incentive availability).

Research Gaps

While the literature offers insightful information, there are several gaps that require more investigation, such as (Dewi et al., 2023; Istan, 2023; Ramadhona et al., 2023). The mediating processes in the relationships between government policies, infrastructure, financial inclusion, innovation, and MSME success have not been thoroughly studied in many research. Furthermore, empirical data tailored to the Indonesian context is required, considering its distinct socio-economic environment and policy framework.

H6: The degree of financial inclusion acts as a mediator between the influence of infrastructure and MSME performance, with a stronger positive link observed at higher financial inclusion levels.

H7: Supportive innovation has a synergistic effect by strengthening the beneficial association between financial inclusion and MSME success.

METHOD

Research Design

In order to analyze the impact of government policies, financial inclusion, infrastructure, and innovation on the performance of Micro, Small, and Medium-Sized Enterprises (MSMEs) in Indonesia, this study used a quantitative research design. Data is gathered at one point in time from a representative sample of MSMEs operating in various industries throughout several Indonesian regions using a cross-

sectional technique. All of Indonesia's registered MSMEs, spanning a variety of industries and sizes, make up the study's population. To guarantee representation across industries (manufacturing, services, and retail) and geographical areas (Java, Sumatra, Kalimantan), a stratified random sample technique was employed. Purposive sampling is used in this study, and the following criteria must be met: (1) MSMEs have NIBs; (2) MSMEs have financial statements; and (3) MSMEs have completed digital transformation.

Data Collection

To collect data, a structured questionnaire was created as the primary tool. Infrastructure, financial inclusion, innovation, government policy, and MSME performance were among the topics included in the questionnaire. A Likert scale ranging from 1 to 5 was employed to record both qualitative and quantitative answers. The survey was conducted both offline and online between October 20, 2023, and December 5, 2023. In addition to the author, enumerators provided support during this time. The surveys were distributed by skilled enumerators, who made sure that the responses were accurate and consistent. Six months of data collecting were needed to capture a range of business situations. The questionnaire was pretested with a small sample of MSME owners before the major data collection to evaluate its general efficacy, relevance, and clarity. Changes were implemented in response to the input gathered.

Variables and Measurement

- a. The dependent variable, "MSME performance," is determined by using market share, profitability, annual revenue growth, and customer satisfaction metrics that were created based on existing research (Kamil et al., 2023; Kotane, 2022; Roman et al., 2023).
- b. Infrastructure: The standard of transportation networks, the availability of utilities, and the technological infrastructure derived from published works are examples of indicators (Fernández et al., 2020; Mačiulytė-Šniukienė et al., 2022; Savchenko, 2022).
- c. Financial inclusion include the usage of inclusive financial products, the accessibility of financial services, and the degree of financial literacy among MSME owners as reported in the literature (Bojuwon et al., 2023; Kumar Singh & Singh, 2023).
- d. Innovation: Based on published research, indicators include the quantity of patents, research and development expenditures, and uptake of new technology (Onea, 2020; Trachuk & Linder, 2022).
- e. Government Policy: The variables encompass evaluations of the efficacy of policies, the perception of support for MSMEs, and the accessibility of government incentives (Campos et al., 2021; Musabayana et al., 2022; Razumovskaia et al., 2020).

Data Analysis

The primary statistical method for data analysis will be SEM-PLS. SEM-PLS is especially appropriate for this investigation because it works well with complex models and smaller sample sizes (Perdana et al., 2023). Through the simultaneous testing of several links between latent constructs made possible by this approach, the

relationships between infrastructure, financial inclusion, innovation, government policies, and MSME success may be thoroughly understood. This examination will encompass. The SEM-PLS model's definition will be guided by the conceptual framework that was established in the literature review. Theoretical underpinnings will be used to describe latent constructs, and hypotheses will be made regarding their linkages (Bowen & Guo, 2011). The measuring model's validity and reliability will be evaluated to make sure the chosen variables accurately reflect the intended constructs. Examining factor loadings, discriminant validity, and convergent validity are some examples of this (Guenther et al., 2023). The structural model will be examined in order to determine how the latent constructs relate to one another. The relevance of the proposed paths will be determined, and the model's overall fit will be looked at (Kante & Michel, 2023).

RESULTS AND DISCUSSION

Sample Demographics

A varied sample of 255 Micro, Small, and Medium-Sized Enterprises (MSMEs) from various industry sectors, geographic locations, and company sizes is included in the study. The Table provides a summary of the sample's business dispersion.

Table 1. Demographics of Sample

Demographic	Category	N	Percentage
Sector	Manufacturing	85	33.3%
	Services	100	39.2%
	Retail	70	27.5%
Region	Java	120	47.1%
	Sumatra	70	27.5%
	Kalimantan	65	25.5%
Size	Micro	90	35.3%
	Small	95	37.3%
	Medium	70	27.5%

Source: Authors' processed data (2024)

Services account for 39.2% of the sample's firms, with manufacturing (33.3%) and retail (27.5%) following closely behind. The varied representation of industry sectors in Indonesia's MSME environment is reflected in this distribution. The geographical breakdown shows that companies from Java (47.1%) dominate the market, followed by those from Sumatra (27.5%) and Kalimantan (25.5%). This exhibits a very balanced representation, guaranteeing perspectives from companies operating in various geographical areas. The sample is evenly divided throughout the several business size groups. The percentages of small, medium, and micro enterprises are 37.3%, 27.5%, and 37.3%, respectively. This guarantees a diverse representation, encompassing the viewpoints of MSMEs operating at varying scales.

Measurement Model

The validity and reliability of the study were assessed using feedback forms and a variety of statistical techniques. Convergent and discriminant validity were evaluated using the heterotrait-to-monotrait ratio (HTMT), variance inflation factor (VIF), and

of 0.420, government policies significantly improve MSME performance (p 0.000). This suggests that the performance of MSME's increases by 0.420 units for every unit rise in government policy.

Mediation Analysis

In other interactions, the mediation effect was discovered by additional analysis, which shed more light on the causative mechanism. To investigate the indirect effects and putative mediating factors on the relationships between latent constructs, mediation studies were carried out. A bootstrapping approach with 5,000 samples was used to evaluate the mediating effect of financial inclusion in the connection between MSME performance and infrastructure. Table 4 presents the results, which indicate that financial inclusion plays a substantial mediating role in the connection.

Table 4. Mediation Financial Inclusion

Path	Direct Effect	Indirect Effect	Total Effect
Infrastructure x Financial Inclusion x MSME Performance	0.365	0.204	0.566

Source: Authors' processed data (2024)

Infrastructure continues to have a strong direct impact on MSME performance (p<0.001), suggesting a partial mediating influence. A substantial portion of the impact of infrastructure on MSME performance may be mediated by financial inclusion, according to the indirect effect through financial inclusion.

Likewise, an investigation was conducted into the mediating function of innovation in the correlation between financial inclusion and MSME performance. Table 5 presents the data, which indicate a considerable mediation effect.

Table 5. Mediation of Innovation

Path	Direct Effect	Indirect Effect	Total Effect
Financial Inclusion x Innovation x MSME Performance	0.488	0.189	0.665

Source: Authors' processed data (2024)

There is still a significant direct impact of financial inclusion on MSME performance (p<0.001), suggesting a partly mediating influence. The relationship between financial inclusion and MSME performance is mediated by innovation, as evidenced by the innovation's noteworthy indirect effect.

Discussion

Infrastructure and MSME Performance

The data demonstrates a strong correlation between MSME success and infrastructure quality, which supports First hypothesis. The expansion and viability of MSMEs are favorably impacted by the availability of advanced transportation networks, utilities, and technological infrastructure (Hossain & Pathak, 2023; Prasetyo & Erfan, 2023). The literature that is currently available emphasizes the critical role that infrastructure plays in fostering an environment that is favorable for MSMEs to operate in (Abdissa et al., 2022). Studies have demonstrated that MSMEs' ability to grow and survive might be hampered by things like inadequate infrastructure (Bayineni & Chagal, 2022). In order to promote the success of MSMEs, it is crucial that governments, non-



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