DEVELOPMENT STRATEGY FOR SMEs THROUGH PRODUCT DIFFERENTIATION AND GOVERNMENT REGULATIONS WITH WORKING CAPITAL AS MODERATING VARIABLE : CASE STUDY IN SEMARANG CITY INDONESIA

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ABSTRACT

This study is aimed to analyze the influence of product differentiation and government regulation to the performance of SMEs with working capital as a moderating variable. Data were collected through questionnaires to 100 SMEs owners in Semarang city with random sampling. The method used linear regression analysis. Independent variable are product differentiation and government regulation tested together and separately with the dependent variable performance of SMEs with working capital as a moderating variable, and then the variable working capital separated in 2 rank between the smallest and largest values so that there are 2 models of the performance of SMEs. The results obtained that model 1 demonstrate the product differentiation have a significant effect on the performance of SMEs, whereas for government regulation not significant. In model 2 shows the product differentiation and regulation have a significant effect on the performance of SMEs.

Keywords : Product differentiation, government regulation, working capital, the performance of SMEs

Introduction

The role of SMEs (Small and Medium Enterprises) is very important in economic development in Indonesia, particularly in creating job opportunities and source of income to lower income groups. SMEs sector has a very strategic role in social, economical, and political aspects by providing goods and services to consumers with low to middle level of demand. According to Teguh S. (2005), SMEs can overcome unemployment due to Indonesian economic crisis in 1997 although there must be some adjustment and improvement of its performance. SMEs at the same time also helps government to eradicate poverty through the development of economic system which is based on the people of the country.

The importance of SMEs role in Indonesian economy encouraging various efforts to enhance and develop SME for the sake of improving people’s welfare with varied ways. One of the ways to do is providing capital for SMEs to develop their business. Based on a research conducted by Setiawan, A.H. and Redjekiningsih, T.W. (2009), it is stated that supply of sustainable funds from government can increase the workers’ income (75%), increasing capital (35%), economic scale (50%), and profit (50, 27%). When it is seen from banking perspective, the credit supply to SMEs will benefit the banks since the proportions of bad credit is relatively small. It is mainly because obedience of customers who run small business is usually greater than they who run larger business. Credit supply to SMEs stirs broad spread of risk, for the supply of credit to small business with smaller value enables the banks to increase number of customers, therefore credit supply does not only concentrate on certain group or business sector. Credit that is given to SMEs with relatively greater number of customers will diversify credit portfolio and spread risk of credit supply.

From SMEs perspective, the supply of business credit means they have a good chance to develop their business by applying business development strategy and differentiating products to improve its competitiveness and fulfill market’s need. Darwanto (2010) says that to improve productivity SMEs must be able to make competitive products based on technology therefore its competitiveness will be increasing in the market.

The importance of working capital in SMEs that is used to run business operational activity and develop business is a solution to common problems by SMEs. Sri Winarni (2006) identifies common problems by SMEs such as (1) Lack of capital, (2) Difficulty in marketing, (3) Intense business competition, (4) Difficulty in raw material supply, (5) Lack of technical production and expertise, (6) Lack of managerial skill, (7) Lack of knowledge in financial management, and (8) Business atmosphere that is less conducive (permission, rules/regulations).
With proper working capital SMEs will be able to develop strategy and to promote the business through product differentiation. Kotler (1997) explains that basically differentiation is an act of formulating a set of distinction that is intended to be different from other competing companies’ offer. By differentiating the products, SMEs can penetrate larger market area with varied products based on the market preference and even can be more competitive with other kinds of business.

Development of SMEs as the central pillar of economy in Indonesia, it is supported by various policies, regulations and legislations, such as UU (Legislation) No. 9 1995 about Small Business, PP (Government’s Regulation) No. 44 1997 about Partnership, PP (Government’s Regulation) No. 32 1998 about Small Business Coaching and Development, Inpres (President’s Instruction) No. 10 1999 about Medium Business Development, Keppres (President’s Decision) No. 127 2001 about Aspect/Type of Substitute Business to Small Business and Aspect/Type of Open Business to Medium or Bigger Scale of Business with Partnership Requirement, Keppres (President’s Decision) No. 56 2002 about Small and Medium Business Credit Restructuring, Permenneg BUMN (Minister of State Company’s Regulation) Per-05/MBU/2007 about State Company’s Partnership with Small Business and Environment Development Programme, Permenneg BUMN (Minister of State Company’s Regulation) Per-05/MBU/2007 about State Company’s Partnership, and UU (Legislation) No. 20 2008 about Micro, Small, and Medium Scale of Business.

LITERATURE REVIEW

A research conducted by Yusriati, C. et al. (2011) has successfully revealed that a company using efficient working capital is going to have some benefit in business development and improve the company’s performance. Jaka S. (2010) explains that capital is one of prominent requirements needed by SMEs to develop business. Hafsa (2004) says that SMEs development needs to be given more attention by government and society in order to be competitively developed as other economic actors. Government policy in the future is expected to be more conducive to the growth and development of SMEs. Government needs to improve their role in developing SMEs while at the same time promoting mutual business partnership between great and small businessman, and improve human resource quality. Capital aspect also needs to be given attention and government or private sector is expected to take part more actively.

The development and growth of small and medium enterprises is one of economic power in Indonesia. One of characteristics of fine economic dynamic and performance in East and South East Asian countries known as Newly Industrializing Countries (NICs) such as South Korea, Singapore, and Taiwan shows their SMEs excellent, efficient, productive and competitive performance (Tambunan, 2003). In accordance, productivity and competitiveness improvement programme by making use of local resources and improvement of technology become appropriate solution and strength in SMEs sector (Darwanto, 2010).

Competition in business makes SMEs be able to compete against other products. One of strategies to compete against the other is by applying product innovation to fulfill various market segments known as differentiation strategy. Product innovation can be realized by creating unique and interesting products. This strategy has been proved to be effective, the product will have proper competitiveness and is able to survive on the stiff market competition. Indonesian government issues set of regulation that is easy to access in the form of Legislations and Government’s Regulations in order to develop SMEs as the main pillar of Indonesian economy. In UU (Legislation) No. 20 2008 about Micro, Small, and Medium Scale of Business there is regulation of SMEs Development, Partnership, Permission, Coordination and Control of SMEs promotion. As stated by Eka Handriyani (2013), Indonesian government provides access of business development service to give an easy access of capital, management access, market access and technology to improve SMEs performance. The government also provides another policy by reducing tax rate to be a low tax rate for SMEs as much as 0,5% up to 2% each year.

THEORETICAL FRAMEWORK

Working Capital

Capital is an important factor of production for SMEs, therefore an entrepreneur has to be well aware in the allocation, he or she has to avoid making inaccuracy in strategy that will disturb SMEs activity. In the SMEs, capital is a factor that determines successful operational activity, while inactive operational of SME in managing the business can be traced and is determined by capital, as a matter of fact capital issue in SMEs will never come to an end, since it includes many kinds of aspect.

According to Suad Husnan (1989) that company spending is defined as an activity to get funds and use it to improve or maximize business. Meanwhile Edilius and Sudarsono (2004) says that company spending in a narrower sense involves efforts to prepare funds, for enough funds will encourage an entrepreneur to try to get some assets, while SMEs spending in a broader sense is purchasing as a whole efforts of a SME in financial aspect that is started with financial source plan, how to spend the funds, how to get it, and every related effort to make the most of the funds optimally to achieve the goal as desired by SMEs.

Working capital holds an important role in improving company’s performance, according to Jumhur (2006) the more assets owned, the need of working capital is higher. While according to Niken (2008) there is significant influence of working capital supply variable contribution to society business development. Hindayana’s research (2008) shown that the circulation of working capital has positive and significant influence on company’s performance.

Promotion

M Fuad (2006) in his book said that the promotion are part of the activities of the company for encourage consumers to buy the products offered. Promotion is a kind of communication which gives a convincing explanation of the potential consumers of goods and services (Buchari Alma, 2002). In promotion used variously known by the name of the promotion mix. Philip Kotler
The promotion will affect consumers’ reaction in the process of decision making that is determined by several factors like cultural, social, personal, and psychological. When the most influential factor revealed and form of influence given, it will help the company to determine what the correct promotion strategy that will be done.

**Perception Theory**
Perception is the significance of communication, then interpretation as the significance of perception appears, perception will decide a message to be accepted while ignore other messages (Mulyana, 2000). Perception can be induced by internal factors such as philosophy, interest, belief, notice about something. While external factors that can influence perception include colour of object, object uniqueness, variation types of object and the such.

As stated by Thoha (2004) perception is in fact a cognitive process experienced by individual in understanding information, through sight, hearing, impression and smell senses. Then, perception will help individual to select, organize, hold and interpret stimulus to be a complete picture that has a meaning. Perception will affect behaviour and create manner (Gibson et al., 1996). Through promotion strategy information of products that will be offered by producer to consumers can be well provided.

**Reasoned Action Theory**
This theory is an integration of all behaviour components in a structure that is designed to explain and predict behaviour effectively. Reasoned action theory (developed by Fishbein, 2005) is a theory derives from the theory of manner, which focuses attention on belief and attitude to know more of this. Reasoned action theory is used to learn human behaviour and to develop further of interventions about behaviour. This theory is then developed into theory of planned behaviour to predict and understand motivation effect on behaviour that is done without being fully conscious or based on individual’s willingness in the selection process of something.

This theory explains when individual perceives something positively, he or she will act positively, and vice versa when something is perceived negatively then it will lead to a negative act. When individual thinks optimistically he will be motivated to fulfill other people’s expectation which is considered to be relevant or known as positive subjective norm. Theory of planned behaviour is based on an assumption that human is rational creature who uses every information he obtains systematically to help him in decision making whether to do or not.

**Product Differentiation**
Aulia et al. (2006) identifies company’s internal and external factors and formulate strategy plan of silk woven fabric business development in a silk weaving company Tiga Putra in its attempt to get business relation as many as possible and add the company’s profitability value. According to Siyamniah et al. (2011) the better internal factor management of a SME the better of its innovation capability will be, the better external factor management of a SME the better of its innovation capability will be and the improvement of innovation capability will lead improvement of SMEs performance.

Product differentiation is a modifying product activity that is intended to create more interesting product and make it differs from other products in the same type. This is a strategy to increase selling products and marketing. In a research conducted by Jefor Pratama S. (2013) it is found that product differentiation significantly influences consumer’s decision whether to buy certain product or not. According to a research conducted by Deni Iskandar (2005) it is concluded that price differentiation of a product to specific segment can increase the selling products. The main purpose of product differentiation is to achieve consumers’ satisfaction therefore consumers’ loyalty will be given to the company.

Making innovation by modifying products to deal with business competition is in fact fairly effective to win consumers’ heart. Without any innovation it can be predicted that consumers will get bored and look for other products. Innovation can be done by creating new products that have never been created before. This strategy is truly effective as the created products will have good competitiveness and are able to remain longer in the hard competition of market. Besides creating new product, a company can still develop the available products to be more varied products to fulfill the tastes of market. Innovation can also be done through improving product quality, redesign the label, or beautify the packaging.

**Performance of SMEs.**
SMEs performance is SMEs accomplishment that is measured in a certain period. Indicator of accomplishment can be measured from SMEs productivity, ability to get profit or another indicator such as ability to achieve market share target. According to De Waal (2001) “as the process that enables an organization to deliver a predictable contribution to sustained value creation”, therefore SMEs performance is a business accomplishment attained in a particular period that is measured based on comparison of various standards.

Business development strategy through product differentiation is a marketing strategy used to improve customers’ loyalty through certain segment. Every measurement method whether it is financial measurement or non-financial measurement has its advantage and disadvantage and measurement method enables researcher to select which one is the most suitable as a strategy (Eccles, 1991). It means the selection of performance measurement in general should consider factors or indications of profit received. Profitability or ability to get profit has still been a popular method used in many researches, for it has dual meaning, as a target that has to be achieved and as a mechanism of performance evaluation (Suryanita, 2006).
RESEARCH METHODOLOGY

The data used in this study are primary data. Primary data were obtained through questionnaires from respondents' answers to the question posed by the researcher. The data required are the respondents' answers regarding working capital, business development strategy and corporate performance.

Research Sample

Sample of the research is 100 respondents with random sampling.

Table 1 Operational Definition and Measurement of Variables

<table>
<thead>
<tr>
<th>No</th>
<th>Variable</th>
<th>Indicator</th>
<th>Measurement scale</th>
</tr>
</thead>
</table>
| 1. | Differentiation product (diff) | - the competitiveness of product differentiation  
- meet the tastes of the market with product differentiation  
- ability to expand market | using a scale measurement of 1-5 ranging from strongly disagree to strongly agree |
| 2. | Regulation (reg) | -regulation to SMEs loans  
-ease of product marketing and government facilities for SMEs  
-partnerships regulated with large businesses from government | using a scale measurement of 1-5 ranging from strongly disagree to strongly agree |
| 3. | Working capital (moderating) | -business development  
- innovation product  
- expand market and competitive product | using a scale measurement of 1-5 ranging from strongly disagree to strongly agree |
| 3. | Performance of SMEs | -sales increased  
-asset increased  
-profits increased  
-costs efficiency | using a scale measurement of 1-5 ranging from strongly disagree to strongly agree |

Research Method

Data collection method done with survey and questionnaire (self report). The questionnaire used to get respondent response data about the topic discussed and analysed in the research. The methods of analysis using linear regression analysis.

RESULTS

Result of variable tested can be seen on table 2 and 3 below

Table 2 Model 1

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Koefisien</th>
<th>Signifikan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Konstanta</td>
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<td>.000</td>
</tr>
<tr>
<td>Diff</td>
<td>.488</td>
<td>.001</td>
</tr>
<tr>
<td>Reg</td>
<td>.158</td>
<td>.158</td>
</tr>
</tbody>
</table>

Table 3 Model 2

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Koefisien</th>
<th>Signifikan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Konstanta</td>
<td>4.951</td>
<td>.093</td>
</tr>
<tr>
<td>Diff</td>
<td>.566</td>
<td>.000</td>
</tr>
<tr>
<td>Reg</td>
<td>.295</td>
<td>.031</td>
</tr>
</tbody>
</table>

Independent variable product differentiation and government regulation are tested together or separately with the dependent variable performance of SMEs with working capital as a moderating variable, subsequent the variable working capital in rank to be 2 between the smallest and largest values so that there are 2 models of the performance of SMEs. The results obtained demonstrate the of products differentiation model 1, have a significant effect on the performance of SMEs, whereas did not significant in regulation. On the model 2, product differentiation and regulation have a significant effect on the performance of SMEs. It shows that of products differentiation are important factors in the development of SMEs performance for be able to compete in the business world, SMEs with limited capital to be able to do competitive with innovative of products for meet the diverse needs and tastes of the market. Influence of government regulation for assist the development of SMEs with plays an important role in the ease of access to markets, access to capital and access to development partnerships with other government-owned enterprises.
DISCUSSION

Test results on the model 1 shows that the product differentiation is significant effect on the performance of SMEs whereas government regulation not significant, this could be due to government regulations on the development of SMEs through various efforts and ease of access to working capital is not uniformly understood or conveyed information to SMEs so that business loans from the government have not been fully exploited by SMEs. Another cause of government regulation like subsidized business loans to SMEs channeled through the banks, while the bank lending through a mechanism that requires a collateral asset for the loan, and this gives difficulties for the SMEs because of limited ownership of assets. In the future it is expected that government regulation for the development of SMEs in order to improve the performance of SMEs in Indonesia can be more evenly distributed and informed to the SMEs through direct subsidies unsecured working capital, but with a system of adequate supervision and mentoring.

CONCLUSION

Working capital plays an important role in the development of SMEs in Indonesia. Working capital are used by SMEs for increase productivity by innovating through differentiation of products for meet the various needs of diverse markets. The presence of innovative products that SMEs are able to grow and compete with other businesses so as to increase its competitiveness. Government regulations should be done in order to assist SMEs in the marketing access through rules, policies and ease of access to information and capital. With the innovations through of products and the attention differentiation Indonesian government through regulations that assist the development of SMEs, it is expected that SMEs are the economic power in Indonesia who are able to improve the welfare of society.

REFERENCES


