

CHAPTER I

INTRODUCTION

1.1 Background of the study

Indonesia, a big nation in Southeast Asia with more than 200 million people only ranked 2nd within this area in term of nominal GDP per capita. Most of Indonesia revenue is coming from different sectors such as; agriculture, forestry, marine, mining, processing industry, electricity, gas, water supply, waste and recycle, construction, small and big trade, vehicle repair, transportation and warehousing, accommodation, eating and drinking supply, information and communication, finance and insurance services, real estate, company's services, government administration, defense and social security, education services, health services and others services. From this diversity of income, Indonesia is not that inferior towards other countries which results in Indonesia being capable of becoming big player in world economics towards the future.

Indonesia's nominal GDP which is almost 900 million dollars in 2016 and per capita \$3500 (Rolando Y, 2017). Economy in Indonesia can be seen as an emerging lower middle-income nation with *Rp* 15.833,9 trillion in GDP or around 1.126 billion dollars in 2019 and per capita *Rp* 59.1 million or 4.174.9 USD. (Badan Pusat Statistik, 2020). There is an increase number of 200 million dollars of increased GDP and 600 dollars per capita therefore Indonesia GDP has experienced

sustained rates of growth over the last three years. This a good sign, meaning Indonesia citizens are producing more goods and services as nation incomes increase. Government is working to increase economic growth with building infrastructure across Indonesian archipelago.

As Indonesia driving towards becoming next big economic player in the world stage, being a member of such a big forum such as G-20 and APEC, monetary crisis is not evitable even for Indonesia. Indonesia faced two big crisis, first happened during Asian financial crisis in 1997/1998 and 2008/2009 world financial crisis in which government is still fighting to recover from it until today.

In 1998/1999 monetary crisis Indonesia economy suffered a big blow. As *Rupiah (Rp)* value dropped, most of big companies collapsed because they were too dependent towards foreign capital. In order to stabilize monetary crisis during 1998/1999, Small and Medium Enterprises (SMEs) or in Indonesian called *Usaha Kecil dan Menengah (UKM)* play a big role in recovery period, this kind of SMEs didn't rely on foreign capital in business activities, SMEs used domestic raw materials and produce good domestically therefore most of them survived and were able to carry on. Meanwhile, when there were fluctuation in exchange rate, big companies got the biggest impact. In 1997 there was 4.3 million people and increase to 5.1 million people. (LPPI, BANK INDONESIA, 2015).

Under the Constitution number 20 year 2008 stated:

1. A micro enterprise is based in a traditional industry and is managed privately, and has net assets of no more than 50 million rupiah (not including land or buildings) and annual sales of no more than 300 million rupiah.

2. Small enterprises are managed privately or by a corporate entity, but are independent from and are not the subsidiary or branch office of a medium or large enterprise. They have net assets of at least 50 million rupiah, and no more than 500 million rupiah (not including land or buildings), and they have annual sales of between 300 million and 2.5 billion rupiah.
3. Medium enterprises have net assets of between 500 million and 10 billion rupiah (not including land or buildings), and have annual sales of between 2.5 billion and 50 billion rupiah.

According to *Badan Pusat Statistik* (BPS), SMEs are classified by the number of employees. Small enterprises have five to 19 employees, while the medium enterprises have 20 – 99 employees.

According to (Nabila, 2019) there are common characteristics in each small and medium enterprises. Here are the characteristics:

1. Small Enterprises: product or commodity is fixed, and not easily change. The place of doing business is fixed and not moving. Having financial administration even though it is still simple. There is a separation between personal finance and business finance. Have balance sheet. Business owners, leaders or employees have experience in entrepreneurship. Most of enterprises have access to bank or other finance entities that are not bank in case they are in need of capital. Does not have a good management.
2. Medium Enterprises: better management and organization therefore creating a clear work divisions such as marketing, finance, and production. Having a finance management by applying accounting system orderly, therefore easing the auditing done by banks. Applying rules and labor organization. Have access to all banks and or other finance entities not bank in case of the need of capital. Generally having human resources that are educated and trained.

From the criteria above there are more than 60 million enterprises in Indonesia in which almost 100% of those enterprises are small and medium enterprises (SMEs) while the rest are big enterprises. Most of these SMEs are divided into main categories, those are agriculture and non-agriculture. In addition non-agriculture consists more than 25 million SMEs in which are divided into 15 business

field. All SMEs absorb more than 95% of Indonesian workforce which accounted around 115 million people while big enterprise only absorb less than five percent or around 4 million people. Three of the biggest of SMEs which accounted of 80% non-agriculture undergoing as merchant (wholesaler and retailer), food and beverages industries, and processing industry (Haryanti & Hidayah, 2018).

Accordin to (BPS Sumatera Utara, 2020), Medan's medium and big enterprises contributed in more than 90 billion rupiah in production value and with only 338 enterprises. While no data recorded in micro and small enterprises. The contribution of SMEs towards Medan city predicted only at 40% while big enterprise contributed 60% this shows how big enterprises so capable and the limitation of SMEs. (Harahap, 2018)

Therefore the power of SMEs in Indonesia cannot be underestimate as it being the backbone of Indonesia. According to (Tjahjadi, Purwandari, & Massie, 2019, p. 1)

SMEs have a considerable contribution to the economic national development. It was about 60 percent to GDP of Indonesia and absorbed up to 116 million labors in late 2017. The rapid development of SMEs has been shown by their contribution to the national income, the provision of employment, as well as the number of business units and entrepreneurs.

Association of Southeast Asian Nations (ASEAN) SMEs' contributed up to four percent of world GDP in 2017. Fulfilling ASEAN potential becoming big player in world economics in coming years, big part of ASEAN economy were generate of 90% to 99% of SMEs between these ASEAN country member and contribute to members' GDP from 30% to around 50% and able to generate 50% to 97% of total labor employment (Pratama, 2019). Despite that number Indonesian SMEs is relatively small by international standard.

Despite being able to help in both monetary crisis. SMEs are not quite developed yet in Indonesia. Such uneven proportion is created because of several issues in SMEs' factors itself. One of the main factor informal establishment according to (OECD, 2018)

Indonesian data on SMEs are affected by a large informal economy: about 70% of national employment and more than 90% of total businesses enterprises are estimated to be informal. Widespread informality reduces the average size and performance of Indonesian SMEs, since informal enterprises need to operate under the radar of public authorities and are reluctant to engage in long-term investments. Given that larger SMEs tend to have higher productivity levels, the Indonesian government should encourage the ongoing consolidation process and help domestic SMEs to further scale up, including through product and labor market regulatory reforms which can favor business formalization and enterprise productivity growth

Lacking promotion towards customers is another factor, as business which capital is limited, owners must not risk such valuable resource being used for promotion even some of the capital probably calculated to be used for promotion. Therefore bigger competitors' goods are being more recognized than SMEs products. Indonesia SMEs lack in investment towards R&D, only a small of percentage does this. The outcome of this no innovation or new product and services. Similar factor SMEs hard to compete is because limited technology or traditional technique that used in developing or creating SMEs products. Most of SMEs products are produced in limited numbers which match the capability of manufacturing, and probably time consuming. Small business and medium enterprises (SMEs) in Indonesia accounted for more than 50% of total GDP in 2011. This number are increasing throughout the years. Even though being able to rescue Indonesia's monetary crisis twice, not all SMEs are developed yet. The problem in

Indonesia SMEs according to (Anton, Muzakan, Muhammad, Syamsudin, & Sidiq, 2015) :

First, SME in Indonesia mainly owned by local people and it absorbs millions of workforce in the country. Second, SME is very common in rural areas, and their business based on agriculture, thus they are become important for rural economic development. Third, SME is labor intensive, with many less-educated and youngsters involved in the business. Fourth, SME in Indonesia obtain their financial operations from personal savings. Fifth, this businesses produce simple consumer goods. They serve domestic market and targeted on low income consumers.

Last factors that might change the SMEs development towards better future is human resource limitation. Whether SMEs' owners or leaders hire the right workforce that suit the business design or not. Owners or leaders lacking of entrepreneurship skill, business education and other human resources factors that might hinder business growth.

SMEs in Medan, does have several issues in productivity according to (Pemerintah Kota Medan, 2013) such as:

1. Low quality of human resources and entrepreneurship, this can be seen with the limited of education, and no finance statement.
2. Low usage of technology, most of the tools are manully operated or traditional therefore the product is lack of quality.
3. Marketing, less than one percent of SMEs that able to market their product overseas, and more than 95% for locally marketed.
4. Capital, in this issues almost half of SMEs needed finance support.

According to (Harahap, 2018) "the capital, numbers of employees, and formal education affects the income of SMEs in Medan Johor regency in Medan".

Owners in SMEs participate in business activities from establishing the firm until day-to-day operation. SMEs owners acts as a leaders in their firm, most of the workload being done by themselves even though workers only help in several

aspects such as packaging, operating machine and distribution. Owners create product design, business framework, driving firm's value, hiring policy and deciding what best for the firm. Being owners/leaders in firm, needed leadership skill at least.

Being a leader in SMEs might have the same function as a managers in bigger firm. Leader needs to motivate, guide, supervised employees not only that leaders need to have a bright vision for the firm. Leaders able to foresee upcoming change that might affect firm directly or indirectly. Leaders need to be stable or calm despite crisis within firm.

According to (Mbah, 2016) the success or failure of the business depends on the leadership styles employed by the leaders. Therefore leadership styles might affect company's performance. As leadership considered to be the key of how leaders communicate towards employees, as its' effect on how employees perception of leaders way of doing things and company's values and goals.

Human resource limitation can be seen as one of the main reason of why SMEs problems. The human resource limitation can be divided in into limited education and lack of entrepreneurship, and leadership is a part of entrepreneurship. Leadership will be used as an alternative to solve the problem of SMEs performance.

Based on description above, the writer is interested in SMEs leadership and the performance therefore writer proposes with title **“The Relationship between**

Leadership and Performance in Small and Medium Enterprises (*UKM*) in Medan”

1.2 Problem Limitation

The writer realizes due the limitation of time, knowledge and experiences in doing research. Therefore writer will focus on two type on leadership in this research, only transactional and transformational leadership will be uses as indicator. Only Small and Medium Enterprises will be the main focus of this research. This research will be conducted in Medan and fulfill the criteria mention above.

1.3 Problem Formulation

Based on the background of the study above, the writer found this problems:

1. Does leadership have relationship with Medan’s SMEs’ performance?
2. Does leadership help the performance of Medan’s SMEs’s performance?

1.4 Objective of the Research

After examining background of study, problem limitation and problem formulation. The objective of this research is to find out:

1. To prove whether leadership has relationship SMEs' performance in Medan
2. To analyze if leadership increases SMEs' performance in Medan.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

By completing this research, the benefit that the writer expects is to help people understand the importance of leadership in doing business. In order to make those enterprises drive towards better future and sustain longer in doing business.

1.5.2 Practical Benefit

This research will help SMEs' leader or owner to understand better or choose which leadership that might contribute to the SMEs' performance particularly Medan in order to become more successful.

1.6 Systems of Writing

The systems of writing in this research will be;

Chapter I: Introduction

This chapter will be focused of introducing background of the study of leadership on SMEs performance, problem

limitation faced by the writer in this research, problem formulation included. Last it will state benefit of this study.

Chapter II: Literature Review and Hypothesis Development

In this chapter, consists of theoretical review of topic related to leadership, leadership styles, transformational and transactional leadership, and performance.

Chapter III: Research Methodology

This chapter consists of information regarding research design, how the population and sample will be conducted. Explaining how data collection method followed by operational variable definition and variable measurement and what method to use during data analysis.

Chapter IV: Data Analysis and Discussion

This chapter consists discussion of research object and data analysis. Comprehensive discussion about results and hypothesis testing included.

Chapter V: Conclusion

This chapter discusses about conclusion of this research, implication of this research, and recommendation for future research