

Research of the Impact of Financial Dimensions and Entrepreneurial Capacity on Business Performance in Small and Medium Enterprises in Central Java

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Abstract Background: The number of Indonesian SME units in 2018 was 99.9% of the total business units (62.9 million units), absorbing 97% of the total employment and contributing 60% to GDP. However, two fifth of Indonesia SMEs has internal and external capital and financial acquisition constraints. **Purpose:** Based on the entrepreneurship and finance theories, this study aims to analyze the influence of the entrepreneurship capability on improving the business performance of a Central Java fashion industry of *batik* SMEs with the mediating effect of financial dimension. **Methodology:** Types of data used in this study are primary data and secondary data. The study population was the owner of the SME batik business in Pekalongan, Central Java. The sampling technique was non-probability sampling with a purposive sampling approach of saturated sampling. **Principal results:** The results showed that the entrepreneurship capability and the internal financial dimension had a positive effect on the business performance of the *batik* SMEs, while the external financial dimension had a negative effect on the business performance. Moreover, the internal financial dimension was able to mediate the entrepreneurship capability on the business performance of the *batik* SMEs. **Major conclusions:** The improvement in the performance of *batik* SMEs is influenced by the entrepreneurship capability and it will increase if it is mediated by the internal financial dimension. **Contributions to the field:** There are research contributions of this study, by exploring the indicators

from the funding dimension variable and indicators from the entrepreneurship capability variable from a psychological side. **Important aspects of the study:** What makes this research different from previous researches is that the independent variables used and the research object are different and broader.

Keywords Entrepreneurship Capabilities, Financial Dimension, Business Performance, SMEs, *Batik*

1. Introduction

Small and Medium Enterprises (SMEs) are an important part of the economy of a country or a region, including in Indonesia, because they have high adaptability to the country's economic conditions [1]. After the economic crisis in 1997-1998, the number of Small and Medium Enterprises (SMEs) in Indonesia increased and was able to absorb 85 million to 107 million workers, 5.97% contributing to GDP by 57.6% and SMEs could contribute value export amounting to 15.7%, equivalent to IDR 192.5 trillion [2]. The success of small and medium enterprises (SMEs) will have a direct impact on the country's economic growth [3].

The development of SMEs in Indonesia has constraints in the form of internal and external factors, which cause

SMEs to not develop properly and optimally. Internal factors are the level of education, skills, level of entrepreneurial knowledge, network marketing, and capital constraints. And external factors include: infrastructure, facilities and infrastructure and government policies that do not provide positive stimulus [4]. SMEs experienced business difficulties reaching 79.29%, and it was caused by capital (financial) factors (33.33%) as the highest factor, followed by raw material factors and marketing factors [5]. These constraints are interesting to study because the results are still inconsistent with the performance of SMEs. Several factors that improve the performance of SMEs will be examined in this study.

Batik SME is one of the largest SME in Indonesia. Batik is one of Indonesia's cultural heritages that have high value. Batik is already an identity for the Indonesian people, the uniqueness and diversity of the batik motifs characterize the uniqueness and diversity of the Indonesian nation. Batik is increasingly echoing its echoes in Indonesia, after UNESCO designated batik as Indonesia's cultural heritage on October 9, 2009. This has an impact on the world of Indonesian batik which is starting to grow and progress. Batik Pekalongan is one of the most popular batik motifs in Indonesia. The advantage of Pekalongan batik is that it has bold and bright colors. The biggest center for Pekalongan batik is the Kauman Batik Center, Pekalongan. Batik entrepreneurs in Pekalongan are classified into three elements of entrepreneurs, which are entrepreneurs who have large capital, batik craftsmen and independent entrepreneurs.

Based on literature study data from the Pekalongan government, the banking sector, and previous empirical research related to the performance of Batik SMEs, there were several obstacles faced by batik SMEs in Pekalongan. The basic problems are: 1) Human resources lacking knowledge and skills in business development (entrepreneurship side); 2) Problems with business capital or dimensions of business funding (financial side) [6, 7, 8, 9, 10, 11, 12], lack of product marketing access [13].

Two main obstacles to the development of SME will be researched and it is hoped that it will open up access to overcome the problems faced by Pekalongan batik SMEs, so that in the future Pekalongan Batik SME will increase and develop. Here, the purpose of this study is to analyze the effect of internal financial dimension and the external financial dimension on the business performance; the influence of entrepreneurship capability on the business performance, and the mediating effects of internal and external financial dimensions in mediating the influence of the entrepreneurship capability on business performance of Pekalongan batik SMEs. Based on literature review and previous research, this study will examine the influence of the dimensions of funding and entrepreneurship capabilities on the performance of SMEs. What makes this research different from previous researches is that the independent variables used are

different and broader, the research object is different, and there are additional research components, namely indicators from the funding dimension variable and indicators from the entrepreneurship capability variable from a psychological side. The performance of SMEs in this study uses indicators of 1) financial; 2) market; 3) entrepreneurial performance.

2. Literature Review

2.1. Theory of Finance and Theory of Entrepreneurship

Theory of finance explains that individuals will allocate various combinations of limited resources at all times [14]. The emphasis is that the resource is obtained from two things, namely: 1) Provided either internally or externally; 2) how is the allocation of these resources. Meanwhile, theory of entrepreneurship states that entrepreneurship produces novelty in resources, including some resources of raw materials, methods, products, markets and organizations [15]. Theory of Entrepreneurship developed into several theories: 1) economic entrepreneurship theory; 2) psychological theory of entrepreneurship [16, 17], resources based entrepreneurship theory [18].

Resource based theory explains that employees are the main driving force for the company. The company's performance depends on the employees' performance ability. Previous research has stated that human data sources influence business continuity and competitive advantage [19, 20]. Pecking Order Theory explains alternative sources of business funding, by considering the cost of capital arising from different types of funding. The funding sequence is to use retained earnings first, then take debt, and the final alternative is to issue new shares [21]. The choice of funding sources is inseparable from the imbalance situation of information held by people within the company with external parties. SMEs tend to bear greater costs of asymmetric information than companies that have gone public. The absence of sources of information for external parties such as audited financial reports (even if the quality of the information is not guaranteed its validity), will increase the imbalance situation of information [22]. Pecking Order Theory will be used as a reference theory to determine the variable dimensions of funding for Small and Medium Enterprises (SMEs) in this study.

2.2. Performance of Small and Medium Enterprises (SMEs)

Theory of the firm states that maximizing the value of the firm is the company's main goal [23]. Firm value is very important because it reflects the company's performance which can affect investors' perceptions of the company. Companies that have high values will have a

good image and foster trust for the parties associated with the company. SME business performance has indicators including 1) finance, 2) market and 3) entrepreneurial performances.

2.3. Financial Dimensions

One of the biggest obstacles in developing SMEs is the financial dimension, especially funding decisions. One of the classic problems is the capital constraint that underlies investment decisions and day-to-day business operations. Efforts to maximize business value in order to have strong competitiveness require three financial planning policies, namely: a funding policy, an investment policy and a dividend policy [24]. Funding policies or funding decisions can come from own capital and from debt (outside finance). Debt, one of the sources of finance for SMEs, has two sides for the survival of SMEs. On one positive side, debt is used to run a business and expand its business. Debt has a negative side if there is debt mismanagement. Several previous studies have documented that the problem of limited funds will have a negative impact on business performance [25]. Meanwhile, capital adequacy will strengthen innovation and business processes of a business [26]. Previous empirical research have explained the relationship between financing strategies and investment decisions [6, 7, 8, 9, 10]. In terms of the strategy of the funding system in Indonesia, it shows that there is no uniform funding pattern for batik SMEs even though they are in the same industry and business cycle, and the funding patterns of each SME also experience changes throughout their life cycle. Funding is an absolute resource and capital is an antecedent to starting a business [27, 28].

Theory of financial entrepreneurship as a rationale for the financial dimensions and performance of SMEs, this theory discusses the role of funders for Small and Medium Enterprises. This theory examines the financial and entrepreneurial side. Several previous studies examined indicators from the funding aspect, including: (1) the capital owned which reflects the amount of capital used to start a business and is obtained from the owner's wealth; (2) borrowed capital which refers to loan capital is capital that comes from loans from financial institutions, both from banks and non-banks; and (3) the rate of profit and capital accumulation which is the use of business profits to increase capital to develop a business [29].

Several previous studies linked the financial aspects to the performance of Small and Medium Enterprises (SMEs), the capacity of the financial aspects of SMEs. The results of the study explain that financial aspects have a significant negative effect on financial performance. The higher the capacity of the financial aspects, the lower the financial performance of SMEs [30]. This result contradicts the results of research which explains that managing SMEs requires an organized management of

financial aspects so that it will improve business performance [31]. This explains that if the financial aspects are good, the performance of SMEs will increase. A funding policy is a financial management policy for obtaining funds. Investment policy is a policy of selecting the desired investment from a group of opportunities, selecting one or more investment alternatives that are considered the most profitable. SME financial planning focuses on funding policies. The funding policy will provide direction to SMEs to determine the amount of funds they have, sources of funds and the ability to finance the company's strategy to increase business value. SME owners will use the financial portion to carry out their business strategies.

2.4. Entrepreneurship Capability

The business phenomenon states that the other biggest obstacle in developing SMEs is the entrepreneurship capability. The performance of SMEs increases if the entrepreneurship capability shows good value, as well as previous research that explains the dimensions of entrepreneurial behavior [12, 32]. Preliminary research on the entrepreneurship capabilities of SMEs explains innovation. The results explain that the role of entrepreneurship in marketing innovation has the highest elasticity in batik production and sales, and is then followed by the role of entrepreneurs in new product innovation and business alliances [33]. The estuary of this research is a solution to improve the performance of SMEs [34, 35, 36]. An entrepreneurial orientation is a process strategy that supports organizations on the basis of entrepreneurial decisions and actions [37]. The concept of entrepreneurial orientation is then divided into: innovation (innovativeness), willingness to take risks, proactive (pro-activeness), competitive aggressiveness and autonomy [38]. On the other hand, entrepreneurship has three important dimensions, including: innovation, risk-taking and proactivity. Innovation refers to the development of a unique product, service or process. Taking risks is personal which refers to an active willingness to pursue opportunities. Several previous studies have linked entrepreneurial aspects with the performance of SMEs. Entrepreneurial orientation has a positive effect on the growth of SME performance [39]. There is a positive relationship between entrepreneurship, innovation and the quality of the performance of SMEs [40]. Indicators of three dimensions of entrepreneurship include: risk taking, proactivity and autonomy. Based on the above, the following assumptions have been introduced:

- H1. There is a significant influence between the financial dimension in the form of internal funding (own capital) on the business performance of SMEs.*
H2. There is a significant influence between the financial dimensions in the form of external funding

(debt) on the business performance of SMEs

H3. There is a significant influence between the entrepreneurship capabilities on the business performance of SMEs.

H4. Internal funding is able to mediate the relationship between entrepreneurship capability on the business performance.

H5. External funding is able to mediate the relationship between entrepreneurship capability on the business performance.

Based on the introduced hypotheses, the Framework was formed, shown in Figure 1. It is an overview of the framework in this article.

3. Research Method

The types of data in this study are primary and secondary data. The study population was the owner of the SME batik business in the Kauman batik village of Pekalongan, Central Java. The sampling technique used in this study was non-probability sampling with a purposive sampling approach used [41]. This research model tends to be recursive, consisting of latent variables and observed variables. Exogenous latent variables of entrepreneurship capabilities are proxied by: 1) strategy orientation; 2) HR orientation; 3) management structure; 4) growth orientation; 5) entrepreneurial culture; 6) entrepreneurial orientation; 7) the philosophy of appreciation [42]. Funding dimension variables are: 1) Own capital funding and 2) Debt financing. While the exogenous variable performance of Small and Medium Enterprises (SMEs) is proxied by: 1) Financial; 2) Market; 3) Entrepreneurial Performance. The questionnaire was made with closed and open questions, statements in a closed questionnaire

were measured using interval data measurements [43]. Measurement of interval data was carried out using a bipolar adjective technique (agree-disagree scale) using a 1-10 point scale to obtain interval data with a score or value of 1 (strongly disagree) and 10 (strongly agree). The analysis technique is cluster analysis, a tool used with PLS SEM [44].

4. Results

As a brief overview, the craftsmen in Kauman Pekalongan batik village produce several hand-written batik, printed batik and batik combinations. Some pranggok or batik craftsmen produce three kinds of batik according to their respective capacities. Kauman batik village is located in Kauman sub-district, East Pekalongan city and is allegedly the oldest batik village in Pekalongan. In the area of Kauman Pekalongan batik village, there are several workshops which are individual workshops or workshops which are group workshops. The main income earner of this village is mostly batik craftsmen. The total number of batik entrepreneurs in Kauman batik village who are active is 24 entrepreneurs. In Kauman Batik Village, Pekalongan, there is an association of batik craftsmen and entrepreneurs, but it has not been going well. Entrepreneurs run their businesses from 1 year to 60 years, and most of them are hereditary businesses with simple business management systems. The turnover earned per month ranges from 2,000,000 to someone who gets 150,000,000 per month. Most of the entrepreneurs have a good education equivalent to S1. From the description of the profile of batik businesses and entrepreneurs in Kauman Batik Village, Pekalongan, it is still open for business training and funding.

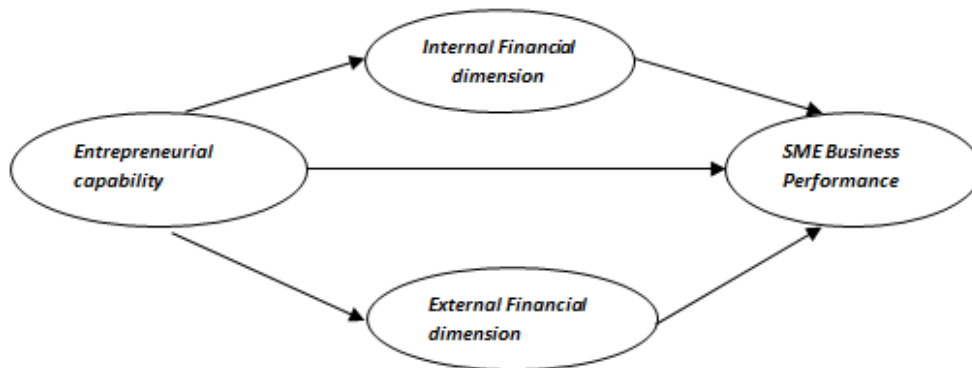


Figure 1. Research Framework

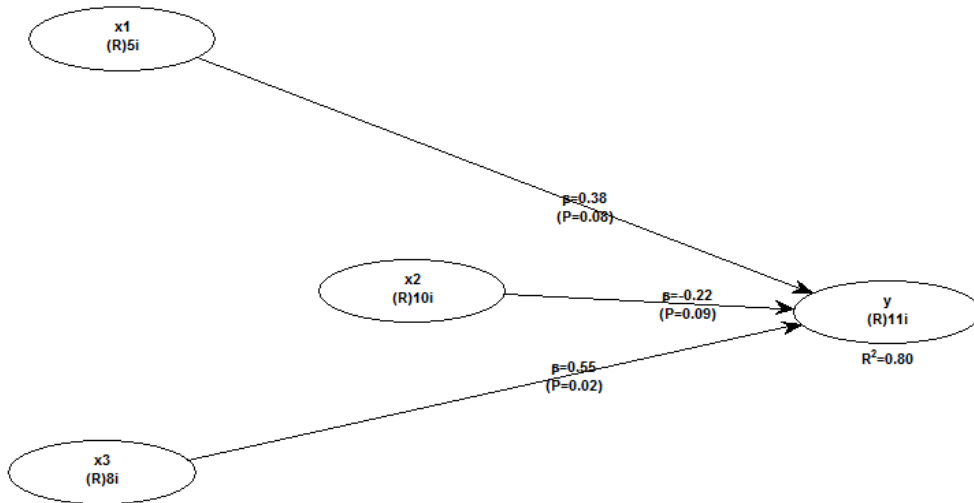


Figure 2. Step-wise approach results in structural testing

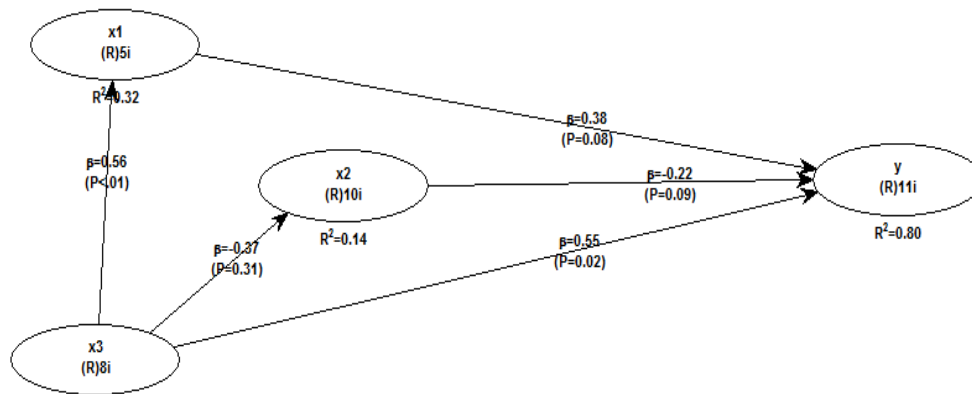


Figure 3. Full Model

Next test is the stage for entering the structural model. The aim is to test whether internal funding (X1), external funding (X2), and entrepreneurship (X3) affect the performance of SMEs. Following Baron & Kenny [45] this study uses a step-wise approach in structural testing. First, testing whether internal funding, external funding and entrepreneurship have a direct effect on performance (to test H1, H2, and H3).

The output in Figure 2 shows that variables X¹ and X³ have a positive effect on Y while variable X² has a negative effect on Y. Therefore, H1 which states that internal funding (X¹) has a positive effect on performance (Y) can be supported. Likewise, H3 which states that entrepreneurship (X³) has a positive effect on performance (Y) can be supported. Meanwhile, H2 which states that external funding has a positive effect on performance cannot be supported because it has the opposite effect.

The output shown in Table 1 shows that internal funding has a positive effect on performance with a significance level of 10% (coefficient = 0.38; p = 0.08), external funding has a negative effect on performance with a significance level of 10% (coefficient = -0.22; p = 0.09), entrepreneurship has a positive effect on performance with a significance level of 5% (coefficient =

0.55; p = 0.02), entrepreneurship has a positive effect on internal funding with a significance level of 1% (coefficient = 0.56; p < 0.01), entrepreneurship has no effect on external funding. To analyze the fit model, it is done by clicking on the view general results so that a display is obtained as shown in Table 1.

Table 1. Model Fit and Quality Indices

Indices	Value
Average path coefficient (APC)	0.416, P<0.001
Average R-squared (ARS)	0.419, P=0.003
Average adjusted R-squared (AARS)	0.375, P=0.012
Average block VIF (AVIF)	1.412, acceptable if <=5, ideally <=3.3
Average full collinearity VIF (AFVIF)	1.991, acceptable if <=5, ideally <=3.3
Tenenhaus GoF (GoF)	0.481, small >0.1, medium >=0.25, large >=0.36
Sympson's paradox ratio (SPR)	1.000, acceptable if >=0.7, ideally =1
R-squared contribution ratio (RSCR)	1.000, acceptable if >=0.9, ideally =1
Statistical suppression ratio (SSR)	1.000, acceptable if >=0.7
Nonliner bivariate causality direction ratio (NLBCDR)	1.000, acceptable if >=0.7

The output on Table 2 shows that the criteria for the four indicators of the fit model have met the requirements.

Table 2. Path coefficients and p-values

Path analysis	X1	X2	X3
X1	-	-	0.564 (0.001)
X2	-	-	-371 (0.307)
Y	0.379 (0.082)	-0.221 (0.091)	0.548 (0.024)

The output on Table 2 shows that the standardized path coefficient (beta/standardized path coefficient) from entrepreneurship to internal funding is 0.564 and is significant with a p value smaller than 0.001. This shows that entrepreneurship has a positive effect on performance or in other words, the increase in entrepreneurship, the higher the internal funding. Furthermore, entrepreneurship towards external funding has no effect because the p value is above 10%. Meanwhile, internal funding and entrepreneurship have a positive effect on performance with a significance level of 10% and 5% respectively. Meanwhile, external funding has a negative effect on performance with a significance level of 10%.

Moreover, for testing the mediation it can be done by testing the influence between entrepreneurial capability influence on business performance. Testing internal/external funding as mediating variables for the effect of entrepreneurial influence on performance can be done by following two steps Baron & Kenny [45]. First, it is done by estimating the direct effect of entrepreneurship on performance. The estimation result of direct effect is 0.55 and it is significant at 5% level, and second, to estimate indirect effects simultaneously with the PLS SEM model triangle, namely entrepreneurship → performance, entrepreneurship → internal/external funding, and internal/external funding → performance (Table 3).

Table 3. Direct and Indirect effects

Relationship	Model direct effect	Model indirect effect
Entrepreneurial capability (X1) → internal funding (X2) → business performance (Y)	X1 → Y: B=0.55** (sig at 5%)	X1 → X2 → Y X1 → Y: B= 0.548 ** (sig at 5%) X1 → X2: B= 0.56*(sig at 1%) X2 → Y: B=0.38*** (sig at 10%)
Entrepreneurial capability (X1) → external funding (X3) → business performance (Y)	X1 → Y: B=0.55** (sig at 5%)	X1 → X3 → Y X1 → Y: B= 0.548 ** (sig at 5%) X1 → X3: B= 0.56*(sig at 1%) X3 → Y: B=0.38*** (sig at 10%)

It is concluded that internal funding (Table 3) can mediate the influence of entrepreneurship on performance with partial mediation effect. It is indicated by the relations of X1 → Y with Beta coefficient of 0.38 and significant at p-value of *** (>0.05). Moreover, in the relationship between Entrepreneurial capability (X1) → external funding (X3) → business performance (Y), it can be concluded that external funding cannot mediate the effect of entrepreneurship on performance because step 2 is not fulfilled, namely on path which is not significant (p-value >0.05). These results support the results of Syahsudarmi [30] research which states that funding will not necessarily improve business performance. The results also show that although entrepreneurship has a good entrepreneurship dimension, it does not have the ability to access external funding, so this is not able to improve business performance [46]. Based on the primary analysis, the researchers concluded that the batik SME entrepreneurs in Pekalongan did not yet have the ability and consistency in compiling good and correct financial reports if they were to apply for external funding [47, 48].

5. Conclusions

By examining the effects of entrepreneurship capability on the business performance of SMEs with the mediating effect of financial dimension, the results showed that the entrepreneurship capability and the internal financial dimension had a positive effect on the performance of the batik SMEs, the external financial dimension had a negative effect on the business performance. However, the internal financial dimension was partially able to mediate the entrepreneurship capability on the business performance of the batik SME.

This research shows that the improvement in the performance of SMEs is influenced by the entrepreneurship capability and it will increase if it is mediated by the internal financial dimension. This supports the theory of entrepreneurship, which explains that the novelty of the resource, including resources: raw materials, methods, products, markets and organizations will be able to improve business performance and supports the theory of finance which states that individuals will allocate various combinations of limited resources at all times by utilizing internal resources to improve business performance.

Future studies are suggested to extend the research period. The research only took research samples in limited area. Future research is being developed to other batik villages that still exist in the city of Pekalongan. So that the mapping of Financial dimension and entrepreneurship capability in batik SME can be expanded to all batik craftsmen in Pekalongan, even Indonesia.

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