

# The Relationship Between Institutions and Business Opportunities Toward Economic Growth

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**The Relationship Between Institutions and Business Opportunities Toward Economic Growth**

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**Abstract**

This study aimed at explaining the relationship, and effects of human capital, entrepreneurial business opportunities, institutional economics, and regional economic growth. It was carried out to develop fundamental microeconomic model in rural development to assist human capital roles and institutions as well as entrepreneurial business for the economic growth. Further, the researchers used simultaneous system method in form of a recursive correlational path analysis model. This modeling system provides simplicity and easy understanding. The main source of the data were the empirical micro fundamental data of the business doers in rural areas measured by Gini index ratio. The findings showed that human capital and institutions were the main pillars in improving the quality of regional economic growth. Interestingly, there was a strong relationship between business opportunities and economic growth. However, the business opportunities had significantly negative effect toward the regional economic growth. These indicate the existence of a disturbance outside the model, namely the presence of bank credit which apparently made the business doers suffered losses. In this way, there is a need to examine further the reasons why the bank credits given to MSMEs negatively effect the economic growth.

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## INTRODUCTION

Rural development-based Micro Small Medium Enterprises (MSMEs) entrepreneurship is the main agent in encouraging new businesses in rural area. According to Prasetyo (2019c) factors of entrepreneurship productivity are the main and the first booster of regional economic growth and employment opportunities in rural area, while MSMEs entrepreneurship doers in rural area are the main doers of changes who continuously attempt to create a new environment and businesses for villagers and development improvement. Kulkarni (2018) confirms that the contribution of rural entrepreneurship development program positively effects on development of rural area. According to Kulkarni (2018), the entrepreneurship helps to create an inclusive, sustainable, and balanced growth.

The important role of institutional economics in economic development has been widely accepted since Douglass North was awarded a Nobel Prize in 1993. For instance: Vernon L. Smith (2003) recommends institutional context as a new focus of study, especially in understanding the rational behaviors. Acs. (2008, 2018) investigated the relation between economic growth, production factor input, human capital, entrepreneurship, economic growth, and institutions.

His findings show complex interdependencies between individual factors, such as perception, business opportunity, initial motivation and environmental or national institutional condition. For more, his study have also found supports for entrepreneurial ecosystem roles on economic growth. Meanwhile Acemoglu (2014) considers the role of institutions on economics performance. Institutions have a decisive impact on prevalence and entrepreneurship characteristics (Bosma, 2018). Further, Bosma's (2018) study proves that entrepreneurship productively contributes to economic growth. The emerging problem in current era is the not optimal roles of economic institutions in Indonesia as part of social institution in meeting the stable needs of

community, especially in rural areas. In fact, there are a lot of entrepreneurships and economists who are able to make economy becomes more efficient, effective, productive, and adaptive. However, many corruption cases in Indonesia cause economy becomes inefficient, ineffective, unproductive, and not adaptive. The roles and functions of economic and banking institutions are still weak and not optimal (Susilo, 2010; Haryanto, 2011). Susilo's study shows the role of banking in MSMEs financing and small industries in Yogyakarta (DIY) and Surakarta has not been optimal. Haryanto (2011) confirms that generally MSMEs are almost untouched by formal financial institutions. In other words, a serious problem happens since financial institutions and banks are supposed to have an important role in entrepreneurial growth (das-Solen). However, the fact is the opposite (das-Sein). The interesting research problem to explain in this study was the relationship between institutional roles in rural areas and new entrepreneurial business opportunities toward regional economic growth.

In the new institutional economics theory based on knowledge and innovation, the concept of human capital, entrepreneurship, and institutions become the main factors of economic growth that are increasingly important for development not only for urban areas, but also rural areas (Ganeva, 2010; Josipovic, 2018; Prasetyo, 2008, 2019a, 2019b, 2019c). The interesting novelty of this study was how the role of human capital and the relationship between new economic institutions and business opportunities of entrepreneurship in rural areas supported regional economic growth and rural economic development. Ganeva (2010) suggests that the stock of human capital is considered as the main production factors in company, modern economic growth, and whole economic parts.

Economic growth is an important indicator in economic development of a country. Policy economists have considered human capital, institutions, and entrepreneurial culture as an important key and main pillar in driving sustainable economic growth (Dias, 2012 ;

Ehrlich, 2017; Acs, 2018; Mithanti, 2018; Prasetyo, 2019a). The main problem is which economic policy that drives more sustainable economic growth. Theoretically, the answer is to achieve sustainable economic growth are mostly determined by physical and non-physical investments including new institutions and economic freedom (Tanin, 2017; Seran, 2018; Miller, 2019). For more, human development and democracy improvement is the main key in economic freedom (Miller, 2019). Therefore, the focus of policy must be able to improve capacity and quality of human resource, institutions, and entrepreneurial culture.

Based on preliminary explanation, the specific objective of this study was to describe the relationship and effects of human capital, entrepreneurial business opportunities, institutions, and regional economic growth that were qualified and sustainable as well as the policy implication that must be done. In a concept of new institutional economics theory, the main policy implication in driving economic growth is related to institutional structure (Dias, 2012).

According to Dias (2012), the acceleration of human capital growth rate produces further improvement in structural institutions. Again, Armeanu (2017) argues that sustainable economic growth of a country cannot grow well unless the minimum level of literacy and knowledge of its citizen has been met. Hence, the policy of improving outcomes related of higher education becomes fundamental for policy makers to increase productivity and labor market as well as increase the democracy. Then for further research, Armeanu suggests to be more focus on achieving more sustainable development goal (SDGs).

## RESEARCH METHODS

This study employed quantitative approach, and regression-correlational method with simultaneous system in the form of recursive correlational path analysis model. The simultaneous system of recursive form was chosen since it performed precise results in both

rank and order test. Basically, there are 3 kinds of analysis path model, namely (1) correlated path model; (2) mediated path model; and (3) independent path model. However, this study chose correlated path model since it was in line with the objective and provided other benefits. Based on this path analysis, the direct effect of separated each exogenous variable towards endogenous variable as well as its indirect and total effects can be known. Another advantage of this analysis of path model is the ability to use regression coefficient in standard form. Therefore, the coefficient value of its prediction function would be more precise and efficient. In addition, the role of path analysis in econometrics can be one of solutions to reduce multicollinearity cases.

This study focused on socio-humanity field cluster of the SBK (standard costing) of *riset dasar lapangan* (basic domestic field study) in 11 regencies in two provinces in Central Java and DIY (Yogyakarta). The developing areas which have plenty new MSMEs were selected as the research site, such as Bantul, Sleman, Kulonprogo, Surakarta, Jepara, Kudus, Semarang Regency, Banjarnegara, Kendal, Magelang, and Pekalongan. The research population were 256 households of MSMEs doers who tended to use local wisdom and culture, such as batik, culinary, and others crafting businesses including trade, agrobusiness, and other home industries. Additionally, these businesses were those which are still running productively, have active employers, and have dynamic characteristics.

Then by using probability technique of cluster random sampling and based on its criteria, there were 125 households samples of MSMEs doers who in recent three years have been consistently and continuously growing to develop the businesses and have completed data in accordance with the variables needed. Since the characteristics of the population data were homogeneous, those samples were considered as the representatives. Whereas, the dimensions of variables used were measured by using Gini Index (GI) ratio whose general formula has been

well known by the readers, as a result there is no need to rewrite it in detail.

$$IGx = 1 - \sum_{i=1}^n f_i (Y_i - Y_{i-1})$$

IGx is (the index value of the variable Xn used);  $f_i$  is the total percentage (%) of income or variable income of the i-th class of entrepreneurship household group;  $Y_i$  is the cumulative percentage (%) of income or expenses in the i-th class of entrepreneurship household. Furthermore based on the index value, the final value of each variable was between zero and one according to the standard values on the referred index ratio.

The structural equation model of simultaneous system path analysis form was designed in the following. The equation models 1-3 were the basic models of mathematic equation of simultaneous system:

$$Y_1 = \alpha_0 + \alpha_1 X_1 + \alpha_2 X_2 + \alpha_3 Y_2 + \mu_1 \dots \dots (1)$$

$$Y_2 = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Y_1 + \mu_2 \dots \dots (2)$$

$$Z = \tau_0 + \tau_1 X_1 + \tau_2 X_2 + \tau_3 Y_1 + \tau_4 Y_2 + \mu_3 \dots \dots (3)$$

The equation of model 4-6 structures was in form of structural equation of path analysis that have been derivate from 1-3 equations.

$$Y_1 = \rho Y_1.X_1 + \rho Y_1.X_2 + \rho Y_1.Y_2 + \epsilon_1 \dots \dots (4)$$

$$Y_2 = \rho Y_2.X_1 + \rho Y_2.X_2 + \rho Y_2.Y_1 + \epsilon_2 \dots \dots (5)$$

$$Z = \rho Z.X_1 + \rho Z.X_2 + \rho Z.Y_1 + \rho Z.Y_2 + \epsilon_3 \dots \dots (6)$$

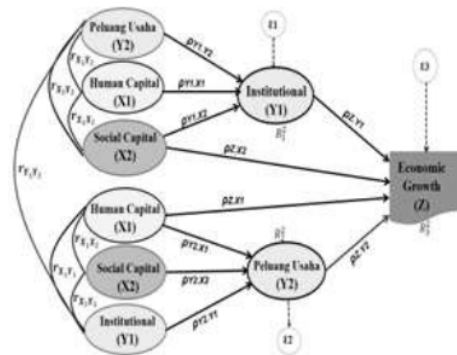


Figure 1. diagram model of path analysis of double correlational form

Furthermore, based on 4-6 equation models, a diagram of path analysis was drawn in figure 1. Hence, the model form of figure 1 was

the specification form of approach models used to analyze the problems and objectives of this study.

## RESULTS AND DISCUSSION

Before proceeding to the details of the findings, there is a need to know that the variable of entrepreneurial business opportunities in rural areas was defined as “entrepreneurship” at the level of village done by the communities. This could be in form of various business, such as sundries shop, household industry, agricultural business covering agribusiness, and agricultural product technology, and other businesses in form of MSMEs or even a supermicro business functioning as the main reinforcing factor for rural development.

Furthermore, the institutional economics variable was in form of economic institution that was the part of social institution both internal and external, formal and informal, and functions as the facilitator and dynamicator of the rural areas community to optimize resources, and maximize output and outcome in order to meet the needs of local community life. Then, the rural institutions were in form of *lumbung desa* (village barn institution), village empowerment agency (LKMD), cooperatives, and other socio-cultural, and political institutions which are generally informal and able to improve village development. In this study, the institutional economics ruled the economic activities for the betterment, and meeting the expectation or at least it can reach the balance (*das-Solen and das-Sein*).

This study found not optimum institutional roles and functions, and indicated that the smaller, and more isolated the business was, the weaker its institutional roles would be. These findings support the previous studies conducted by Susile (2010), and Haryanto, (2011). However, these did not fully support Acemoglu’s study (2014) which states that the roles of institutions have good performance in economy. Hence, this study found that this theory was dynamic, namely there were times when the low quality of the institution actually worsened the economic performance of the

region. Besides, the findings generally showed negatively significant contribution by new business opportunities toward the regional economic growth. It meant that the findings did not fully support Bosma's study (2018) which says that productive entrepreneurship has positively contributed to the economic growth. However, this difference results appeared because this study has not differentiated new productive and unproductive business opportunities.

Furthermore, the findings of this study were presented quantitatively based on the background and objectives of the study. Methodologically, the main objective of this study was to explore the causal relationship between new institutional economics and productive MSMEs business opportunities in rural areas to foster the level of growth and regional economic development. Further, by using quantitative data, the objective of this study specifically explained the relationship between central roles and functions of human capital, institutional economics, and business opportunities in fostering the regional economic growth to be high, quality, and sustainable.

Table-1 indicates that there was a close and significant relationship between institutions

and business opportunities in rural areas, namely 83.5%. Meanwhile, the relationship between institutions and economic growth was smaller, namely 74.6%. Similarly, the correlation between business opportunities and economic growth was 65.5%. These showed that the factor that had a better and greater relationship with economic growth was human capital of 75.9%. It proved that the emergence of new business opportunities in rural areas referred to the allocation of human capital, or human resources of the village which are more resilient, creative, innovative, and dynamic as well as not depending on the situation and real community economic situation. The unemployment condition in rural areas are supposed to trigger creative individuals to be more motivated to create new business opportunities in their regions.

By referring to the above description, the current study findings support the original theory of Schumpeter called as "refugee" effect or "push effect vs "Schumpeter" effect (Bonnet, 2015: Langroodi, 2017). According to "refugee" effect, unemployment can actually lead to a new company (new business) by having the unemployed people creating new jobs for themselves.

**Table 1.** The Results of Karl Pearson Product Moment Partial Correlation Research

		Economic_growth	Human_capital	Social_capital	Business_opportunities	Institutional
Pearson Correlation	Economic_growth	1.000	.759	.607	.655	.746
	Human_capital	.759	1.000	.510	.671	.733
	Social_capital	.607	.510	1.000	.800	.723
	Business_opportunities	.655	.671	.800	1.000	.835
	Institutional	.746	.733	.723	.835	1.000
Sig. (1-tailed)	Economic_growth	.	.000	.000	.000	.000
	Human_capital	.000	.	.000	.000	.000
	Social_capital	.000	.000	.	.000	.000
	Business_opportunities	.000	.000	.000	.	.000
	Institutional	.000	.000	.000	.000	.

Further, the existence of this short-term or long-term entrepreneurship would reduce the unemployment and result “Schumpeter” effects. J.A. Schumpeter’s theory says that a new entrepreneurship can be created by push effect or refugee effect because of some individuals or a number of unemployed people having potentials to create a new opportunity for themselves. That is, with a group of people who have good human capital capacity a new business opportunity could be established as least to support their own lives. This empirical fact was proved by a quite significant correlation value of 67.1% by human capital and new business opportunities by rural area MSMEs. Then, Schumpeter effect’s theory

may happen as the new businesses progressing. In this way, unemployed people can be reduced. However, since this achievement has not been optimum, there was a need for institutional economics roles and functions as a ruler to optimize the resources for the betterment.

The roles and function of new institutional economics factor could strengthen and enhance new business opportunities in rural areas. By having such a good management, resources and production factors can be optimized and further maximize the outputs and outcomes. In other words, the new institutional economics were able to facilitate the development of the new businesses.

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**Table 2.** The results of research on the value of standardized coefficients regression path analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t-stc	Sig.	
	B	Std. Error	Beta			
1	(Constant)	.198	.020		9.749	.000
	Human_capital (X1)	.262	.048	.323	5.407	.000
	Social_capital (X2)	.157	.066	.177	2.392	.018
	Business_opportunities (Y2)	.368	.066	.476	5.552	.000
2	(Constant)	-.124	.031		-3.957	.000
	Human_capital (X1)	.152	.065	.145	2.351	.020
	Social_capital (X2)	.481	.070	.418	6.885	.000
	Institutional (Y1)	.552	.099	.426	5.552	.000
3	(Constant)	-.060	.041		-1.473	.143
	Human_capital	.500	.082	.485	6.136	.000
	Social_capital	.243	.101	.214	2.390	.018
	Institutional	.435	.137	.342	3.173	.002
	Business_opportunities	-.125	.112	-.127	-1.119	.265

Model-1: Endogen variable: Institutional

Model-2: Endogen variable: Business\_opportunities

Model-3: Endogen: Economic growth

These findings implied that there happened a strong and significant causality by the opportunities and the quality of the new institutional economics the particular rural areas. This strong relationship also meant the complex

dependency among the factors (unemployment condition, human capital, social capital, business opportunities, institutions, and the surrounding environment condition). Thus, the findings of this study support ACs’s study (2018) which

found complex interdependencies between individual level factors, such as perceptions, business opportunities, initial motivation on one side, and between environmental conditions or national institutions on the other sides. Based on the data in table-2, model-3 shows that the standardized coefficient factor of human capital gained 48.5%, while institutional factor was 34.2%. Both of them were the first and second largest factors with positive and significant contribution to the level and quality of the regional economic growth. These results are consistent with the results of the above table-1. That is, human capital and institutions were the key factors of the regional economic growth. Equally, the results support the findings of previous studies by (Ganeva, 2010; Chowdhur, 2018; Radzevica, 2018). Ganeva (2010) confirmed that the human capital factor is considered as the main production factor in industrial company as a whole. The New Growth Theory (RM. Solow) is also supported by the findings of the study, namely good quality economy is results determined by new technological changes, accumulation of human capital, and the existing intensives to make decision on economic capital. Theoretically, the findings have been consistent in contributing stronger empirical support for the postulates of the old economic theory by Adam Smith and Joseph A. Schumpeter which states that human capital and institutions enable entrepreneurship in Schumpeter, which in turn, human capital factors, institutional economics and entrepreneurship can facilitate economic growth (Elliott, 2017). Keywords in the original theory of modern economic growth Robert M. Solow (1956) mainly explain the factors in increasing human capital capacity and internal institutional factors. Meanwhile, keywords in the original theory of The Theory of Economic Development from Joseph A. Schumpeter (Elliott, 2017), mainly explain external institutional factors and entrepreneurial resource capacity.

Model-1 in table-2 shows that business opportunities and human capital had positive and significant contribution, namely 47.6%, and

32.3% to the new institutional economics in the community. Meanwhile, model-2 describes that institutional roles (42.6%), and social capital (41.8%) apparently gave greater contribution to the new businesses, while the roles of human capital slightly decreased of 14.5%. In depth, the table-2 shows that the newly established institutions could slightly decreased the contribution of human capital roles to the individuals who had abilities to share with the community rather than to make a new business for themselves. In other words, as a ruler the new institutions apparently encouraged the capacity of human capital to disseminate knowledge and abilities to community to support people opening new businesses. Therefore, it was confirmed that a social capital factor that could encourage new businesses to open was the strength of human capital.

Another thing to examine in table-2 is model-3. It is because the table-3 revealed a special case in which the roles of new businesses apparently had negative and insignificant contribution to the economic growth. This phenomenon contradicted the previous study by Bosma (2018) that new entrepreneurial business opportunities can positively contribute to the economic growth. However, it was normal because the findings of this study did not distinguish the productive and unproductive new business opportunities. This study also revealed that some of business doers suffered loss because the bank capital credit made them became unproductive. Meanwhile, those who had no bank capital remained productive and developing. It can be concluded that, the business doers who have been existing and had no bank capital loan were still able to be productive and positively contribute to improve economic growth. Oppositely, the new business doers whose main capital was from bank declined in productivity, and experienced bankruptcy. Therefore, these new business doers contributed negative effect to the economic growth. Thus, it can be stated that the good business opportunities are supposed to be productive, and able to positively contribute regional economic growth.



It is in accordance with Bosma's study (2018). Further, there found a strong evidence that the negative business opportunities was caused by the business doers who had bank credit. It can be said that the credit from banking institution tends to negatively affect the economic growth seen from the MSMEs productivity level being facilitated.

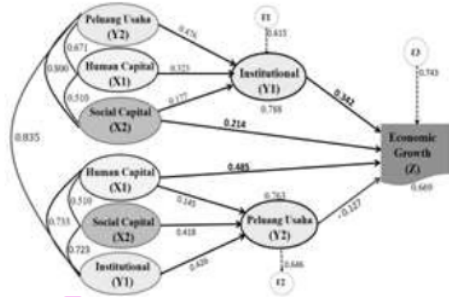
The above negative argumentation was based on the fact the business doers were continuously burdened by the amount of interest, and installments as an obligation, while the bank did not care about the difficulties experienced by the doers. Based on the information from the doers, the bank did not care about and did not want to tolerate the business them. The bank even gave increasing number of fine for every delay, pressures and threats which caused the business doers stressful and unproductive. However, the researchers got limited data to give further explanation because there is a need for broader and deeper macroeconomics study to prove that credit from the bank gives negative effect on the economic growth. Therefore, the future studies are suggested to use broader and more complete data both microeconomics and macroeconomics at the national level.

The findings can only explain that bank credit maximally could only open up short-term new business opportunities, but could not give opportunities for them to develop well, including the increase in both short-term and long-term economic growth. It is because the business actually has experienced loss before wars. Unfortunately, the researchers could not explain this phenomenon further. Therefore, the future researchers are recommended to examine the role of bank credit provided to MSME entrepreneurial businesses both using microeconomic data and macroeconomic data to further prove the truth of the indication.

The researchers were also interested in discussing the relationship between human capital and social capital factors in model-1 and model-2 in table-2 above. In model-1, the role of human capital factor was stronger than social

capital in term of supporting entrepreneurial business opportunities to support the establishment of new institutional economics in rural areas. On the other hand, model-2 shows more dominant role of social capital in accompanying business opportunities to support the increasing entrepreneurial business opportunities in the community. In this model, the effect of both human capital and social capital remained positive and significant in encouraging new institutional economics and new business opportunities in rural areas. Next, the model-3 remained consistent in providing positive and significant contribution to the economic growth both directly and indirectly. These findings are in line with studies conducted by (Yu, 2015; Chitsaz, 2019; Prasetyo, 2019a, 2019b and 2019c).

Chitsaz's study (2019) shows that there is a positive and significant effect of the dimensions of human capital and social capital in entrepreneurial activities. Meanwhile, Yu (2015) explains that the implementation of policies through the formation of human capital and social capital can enhance stronger economic growth. Also, Prasetyo, (2019b) emphasizes that the role of human capital and social capital is able to encourage economic growth and competitiveness. In figure 2, the correlational value between institutional economics and new business opportunities was 83.5% or can be said as a strong starting point to encourage the establishment of good growth, good quality, and sustainable rural areas economy. This correlation was also able to assist other factors (human capital & social capital) in fostering the economic growth. Nevertheless, the human capital has got more assists from new institutional economics factor for the economic growth. Meanwhile, the social capital factor has got stronger support from new business opportunities factor in fostering the economic growth. In relation to this, diagram-2 clearly describes the correlation between new institutional economics and new entrepreneurial business opportunities in fostering good growth, good quality, and sustainable rural areas economy.



**Figure 2.** The Results of path analysis diagrams in the form of a double track correlational model

The diagram also indicates that direct and indirect effects which supported the economic growth were dominated by human capital as the key factor, while other factors were supplementary, and supporting It was confirmed

that the human capital aspect (SDM) was the key factor to encourage and promote good economic growth, (high, quality and sustainable). Therefore, the policy implications that must be carried out by local and central governments to promote good economic growth are supposed to be done through overall capacity and quality improvement of Indonesian Human Resources, both in rural and urban areas.

It was said so because good economic growth must remain high, quality, sustainable, and be able to reduce the following problems: unemployment, poverty and inequality in rural areas which tends to increase even more (Prasetyo, 2011). Actually, it is still okay if economic growth is driven by investment and consumption. However, the good, and correct investment is the domestic investment and domestic products consumption themselves.

**Table 3.** the results of the path analysis of direct, indirect and total effects.

Variable	Direct Effects	Indirect Effects					Total Effects
		Human Capital	Social Capital	Instituti onal	Business Opportun ities	Sub Total	
Human Capital (X <sub>1</sub> )	0.235		0.025	0.109	0.044	0.182	0.417
Social Capital (X <sub>2</sub> )	0.046	0.025		0.029	0.081	0.106	0.152
Institutional (Y <sub>1</sub> )	0.117	0.109	0.029		0.007	0.145	0.262
Business Opportunities (Y <sub>2</sub> )	0.016	0.044	0.081	0.007		0.132	0.148
<b>Total</b>	<b>0.414</b>					<b>0.565</b>	<b>0.979</b>

Source: Primary data processed.

Based on table-3, the total effect was dominated by human capital with the percentage of 41.7%. This factor also gained higher effect in the direct than the indirect, namely 23.5%, and 18.2% respectively. Interestingly, the human capital factor was able to contribute the greatest value or domination both the direct, the indirect, and total effects. These conditions proved that the human capital was the key factor in driving the economic growth. This also implied that in

order to have good economic growth, the policy should be focused on the improvement of the capacity and quality of human resources (human capital). Thus, all parties all over Indonesia must have the same and strong commitment to continuously increase the capacity, and quality of themselves, family, community, and nation with the aim of increasing the growth, quality, and sustainable economy with no burden on foreign investment, and the increasing debt.

## CONCLUSION

There have been a number of theoretical and empirical studies discussing and proving the human capital factor as the key factor in driving the economic growth, and development. Other than this, the current study also serves the roles and functions of institutions, and entrepreneurial business opportunities in fostering the regional economic growth that have not yet been optimum, so the future studies are needed for the comprehensive investigation. The contribution of human capital factor has been stable as the main key in fostering the sustainable economic growth. However, the roles and functions of new institutional economics need to be investigated and improved in term of quality in order to drive the sustainable economic growth. The researchers recommend this follow-up because the findings of this study indicate the strong correlation between the quality of new institutional economics with increased production, productivity, competitiveness and economic growth. Thus, the researchers conclude that to encourage good economic growth, there is a need for the basic capital needs, namely the factors of human capital capacity, and quality. In addition, this effort should be supported by the other four pillars, namely social capital, institutional quality, productive entrepreneurship levels and strong and resilient business competitiveness.

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