

CHAPTER I

INTRODUCTION

A. Background

In Indonesia, Small and Medium Enterprises (SMEs) serve as the primary catalyst for the national economy. The number of SMEs has experienced rapid growth in recent years the number of SMEs reached 64.2 million with a contribution to the Gross Domestic Product of 61.07 percent or Rp8,573.89 trillion in 2021. SMEs can absorb 97 percent of the total workforce and can collect up to 60.42 percent of the total investment in Indonesia (Ministry of Cooperatives and SMEs Indonesia, 2021). This increase in the number of SMEs is observed across various regions in Indonesia, with the highest concentration on Java Island. The current direction of Indonesia's government policy is focused on upgrading SMEs (scaling up), considering that a significant portion of them still falls under the micro category (Ministry of Economic Affairs, 2022) as per the Ministry of Finance (2020).

According to Brustam (2016), small and medium-sized enterprises (SMEs) have significant business potential. Bustam (2016) goes on to show that the degree of employment absorption rises in tandem with the development of MSMEs. Suparwo et al. (2018), however, suggest that the main obstacle SMEs confront is obtaining the capital needed for company expansion. The availability of cash for investment needs is one of the primary difficulties facing SMEs, according to the research findings.

Indonesia's robust economy thrives on its Small and Medium Enterprises (SMEs), creating 108 million jobs (Ministry of Cooperatives and SMEs Indonesia, 2021). However, despite their vital role in economic growth, many enterprises need help accessing formal financial services.

Indonesia's robust economy thrives on its Small and Medium Enterprises (SMEs), creating 108 million jobs (Ministry of Cooperatives and SMEs Indonesia, 2021). Despite their crucial contribution to economic growth, many of these enterprises struggle to access formal financial services. This financial exclusion poses a significant challenge to their development and sustainability. Moreover, as Wisdrome's recent survey and extensive engagement with SMEs and industry stakeholders reveal, a significant hurdle in implementing sustainable practices is the "lack of knowledge and skills," identified by 69% of survey respondents.

The issues overshadows concerns about high initial costs, unclear legislation, and insufficient economic incentives, which received far less emphasis. These insights align with Wisdrome's ongoing dialogues with SMEs, academia, and public administration, indicating that SMEs with a solid grounding in sustainability can more effectively adopt regenerative and circular practices. Such practices not only reduce costs and enhance competitiveness but also open new market opportunities, boosting SMEs' visibility and reputation. However, acquiring the necessary sustainability expertise remains a formidable challenge for many SMEs. They often lack

access to adequate training, resources, and the transformative mindset essential for integrating sustainable practices. As we continue to explore these critical areas, upcoming articles will delve deeper into the core competencies and knowledge that are pivotal for SMEs to thrive sustainably, much like their counterparts in Indonesia strive for formal financial inclusion to bolster their economic role.

This issue becomes particularly relevant when considering the influence of risk perception, risk tolerance, overconfidence, and financial literacy on investment decisions in the SMEs sector. With most of these businesses relying on personal capital for development, understanding how risk factors come into play is crucial for fostering a robust and sustainable entrepreneurial ecosystem in Indonesia.

With regard to the issue of investment in Islam, the Quran as a guide for Muslims that applies throughout the ages has given recommendations. The advice is contained in Surah Al-Baqarah verse 282 and HR Muslim which reads::

يَأَيُّهَا الَّذِينَ ءَامَنُوا إِذَا تَدَايَنْتُمْ بِدَيْنٍ إِلَىٰ أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ ۚ وَلْيَكْتُب بَيْنَكُمْ كَاتِبٌ بِالْعَدْلِ ۚ
وَلَا يَأْب كَاتِبٌ أَنْ يَكْتُبَ كَمَا عَلَّمَهُ اللَّهُ ۚ فَلْيَكْتُبْ وَلْيُمْلِلِ الَّذِي عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا يَبْخَسْ مِنْهُ
شَيْئًا ۚ فَإِنْ كَانَ الَّذِي عَلَيْهِ الْحَقُّ سَفِيهًا أَوْ ضَعِيفًا أَوْ لَا يَسْتَطِيعُ أَنْ يُمِلَّ هُوَ فَلْيُمْلِلْ وَلِيُّهُ بِالْعَدْلِ ۚ
وَاسْتَشْهِدُوا شَهِيدَيْنِ مِنْ رِجَالِكُمْ ۚ فَإِنْ لَمْ يَكُونَا رَجُلَيْنِ فَرَجُلٌ وَامْرَأَتَانِ مِمَّن تَرْضَوْنَ مِنَ الشُّهَدَاءِ أَنْ
تَضِلَّ إِحْدَاهُمَا فَتُذَكَّرَ إِحْدَاهُمَا الْأُخْرَىٰ ۚ وَلَا يَأْبَ الشُّهَدَاءُ إِذَا مَا دُعُوا ۚ وَلَا تَسْمُرُوا أَنْ تَكْتُبُوهُ صَغِيرًا
أَوْ كَبِيرًا إِلَىٰ أَجَلٍ ۚ ذَلِكُمْ أَفْسَطُ عِنْدَ اللَّهِ وَأَقْوَمٌ لِلشَّهَادَةِ وَأَدْنَىٰ أَلَّا تَرْتَابُوا ۗ إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً

ثُدِيرُونَهَا بَيْنَكُمْ فَلَيْسَ عَلَيْكُمْ جُنَاحٌ أَلَّا تَكْتُبُوهَا ۗ وَأَشْهِدُوا إِذَا تَبَايَعْتُمْ ۚ وَلَا يُضَارَّ كَاتِبٌ وَلَا شَهِيدٌ ۚ وَإِنْ تَفْعَلُوا فَإِنَّهُ فُسُوقٌ بِكُمْ ۗ وَاتَّقُوا اللَّهَ ۖ وَيُعَلِّمُكُمُ اللَّهُ ۗ وَاللَّهُ بِكُلِّ شَيْءٍ عَلِيمٌ

O adherents! Put any agreement you have for a fixed-term loan in writing. Permit the scribe to uphold the parties' sense of justice. The scribe has been taught to write by Allah, thus they should not reject to write. They will not cheat the debt; instead, they will write what the debtor requests, keeping Allah in mind. Let the debtor's legal guardian make decisions on their behalf if they are incapable, feeble, or incompetent. Two of your men should be called to witness. When called upon, the witnesses cannot decline. Whether the amount is modest or large, you cannot be against writing 'contracts' for a set length of time. This is more convenient to produce evidence and dispel suspicions, and it is more just 'for you' in Allah's eyes. But, if you execute a transaction amongst yourselves right away, you can consummate a deal without recording it and just call witnesses. Please protect the witnesses and the scribe from danger. If so, you have seriously gone over your limits. Remember Allah, for He is the One who imparts knowledge to you. Furthermore, Allah is fully aware of everything. (Q.S. Al-Baqarah: 282)

As the verse mentioned, investment decisions within SMEs should not be taken lightly as it involves the allocation of limited resources to various opportunities and projects. Investment holds significant importance for Small and Medium Enterprises (SMEs) as it serves as a

catalyst for growth and sustainability. Through investment, SMEs can expand their operations, innovate, and enhance productivity, thus staying competitive in dynamic markets. However, SMEs encounter various obstacles when considering investment decisions. Limited financial resources, coupled with a high perception of risk, often hinder their willingness to invest. Moreover, a lack of expertise in evaluating investment options and difficulty accessing financing further complicates matters. Additionally, SMEs' short-term focus and regulatory burdens contribute to the challenges they face in making strategic investment decisions. Overcoming these obstacles requires a comprehensive approach, including financial planning, risk management, access to resources, and support programs tailored to SMEs' needs. By addressing these challenges, SMEs can unlock their growth potential and contribute to economic development.

The investment decisions are influenced by several factors, including risk perception, risk tolerance, overconfidence, and financial literacy strategies employed by SME owners and managers (Seraj, et al., 2022). According to Slovic (1987), risk perception is a basic cognitive process that influences how people see and assess the risks connected to different investment options.

Perceptions of risk can vary widely depending on individual experiences, cultural factors, and industry-specific considerations (Sitkin

and Pablo, 1992). Furthermore, risk tolerance is also considered capable of influencing one's investment decisions where the more courageous someone takes risks, the bolder they are in investing. Wulandari and Iramani, (2014) stated that the risk tolerance variable is an important component that affects a person's investment level. It was also found that when risk tolerance is high, the level of investment of SMEs gets lower (Farooq and Sajid, 2015). Another behavioural bias aspect that might affect how decisions are made is overconfidence Logitama, et.al., 2021). Overconfident investors sometimes underestimate risk, which can result in an asset allocation that is not as optimal as it could be (Dittrich, et.al, 2005).

Financial literacy is the final behavioural bias component that might affect how investments are made. This factor doesn't only impact relevant information for investment considerations but also impacts the investment decisions of every investor. Yet, financial literacy is important to avoid financial issues.. Based on Jain et al., (2022), The ability to comprehend, evaluate, and manage funds in order to make wise financial decisions and prevent issues is known as financial literacy. However, there are still inconsistencies in the previous studies regarding the Investment decision of SMEs. Research by Chandra et al. (2023) has demonstrated that risk. perception and financial literacy have a simultaneous impact on investing decisions in Surabaya. Meanwhile, as evidenced by the research conducted by aidah et al., (2020), it was found that variables such as

financial literacy, demographic factors, and risk tolerance collectively influence investment decisions in SMEs in Kudus. Similarly, in research conducted by (Yulianis and Sulistyowati, (2019), it was revealed that the influence of financial literacy, overconfidence, and risk tolerance has no significant affect.

Differences in research results (research gap) that have been described above are related to the causes that a person considers in investing, where these variables include risk perception, risk attitude, risk tolerance, and financial literacy. The varied research results are possible due to differences in respondents' culture, environmental conditions, and respondents' backgrounds. The author wants to reexamine the factors that influence the investment desire of SMEs players. Given the research gaps outlined earlier, the author is intrigued to title this research: "The Influence of Risk Perception, Risk Tolerance, Overconfidence, and Financial Literacy on SMEs Investment Decisions in Yogyakarta and Surabaya".

This research took place in Yogyakarta and Surabaya as one of the huge amount city of SMes in Indonesia. In the specific context of Yogyakarta and Surabaya are regions known for their rich cultural heritage and diverse economic activities, risk perception, attitude, and management influence. Thus, SMEs decisions becomes particularly pertinent. The region's unique socio-cultural characteristics may introduce distinctive factors affecting how SMEs in Yogyakarta approach and make

investment decisions. According to data released by the Central Bureau of Statistics in 2022, the distribution of Small and Medium Enterprises (SMEs) across various cities in Indonesia reflects a diverse landscape of economic activity. Surabaya, a bustling city in East Java, hosts a considerable number of SMEs, totalling 64,352. Meanwhile, Yogyakarta, renowned for its cultural heritage and vibrant atmosphere, boasts the highest number of SMEs among the listed cities, with a staggering 329,132 establishments. The capital city, Jakarta, a hub of commerce and trade, follows closely with 1,151,080 SMEs, showcasing its pivotal role in Indonesia's economic ecosystem. Bandung, known for its creative industries and educational institutions, is home to 41,220 SMEs, contributing to its dynamic economic fabric. Semarang, a strategic port city, accommodates 141,830 SMEs, illustrating its significance as a center of business and commerce in Central Java. These statistics underscore the vital role SMEs play in driving economic growth and fostering entrepreneurship across Indonesia's diverse urban landscape.

Moreover, this study also examines other variables such as risk perception, overconfidence, and investment decision as a continuation of a study conducted by Halim and Pamungkasb(2023). The earlier study looks at how investors might think through carefully before deciding what to buy and how psychological variables may influence their choice. The research indicates that overconfidence, and risk perception have a favourable impact on investment decisions.

Chandra et.al (2023) found that there is a significant effect of financial literacy and risk perception on investment decisions. Further, this research doesn't just measure the financial literacy of respondents but also aims to assess whether, apart from financial literacy and risk tolerance, the perception of risk plays a significant role in their investment decisions. Therefore, this study aims to analyze the effect of the influence of risk perception, risk tolerance, overconfidence, and financial literacy on smes investment decisions in Yogyakarta and Surabaya.

B. Research Questions

Based on the background above, it can be formulated as follows:

1. Does risk perception have a positive effect on the investment decision in SMEs?
2. Does risk tolerance have a positive effect on the investment decision in SMEs?
3. Does overconfidence have a positive effect on the investment decision in SMEs?
4. Does financial literacy have a positive effect on the investment decision in SMEs?

C. Research Objectives:

Based on the research formulation above, the research objectives are as follows:

1. To test and find empirical evidence on the positive effect of risk perception on the investment decisions in SMEs
2. To test and find empirical evidence on the positive effect of risk tolerance on the investment decisions in SMEs
3. To test and find empirical evidence on the positive effect of overconfidence on the investment decisions in SMEs
4. To test and find empirical evidence on the positive effect of financial literacy on the investment decisions in SMEs

D. Research Benefit

Based on the research purposes above, the research benefits are as follows:

1. Theoretical Objective

Develop a comprehensive theoretical framework that integrates risk perception, risk tolerance, overconfidence, and financial literacy in the context of SME investment decisions, specifically tailored to the Yogyakarta and Surabaya region.

2. Practical Objectives

Empirically analyse and quantify the influence of risk perception, risk tolerance, overconfidence, and financial literacy on investment decisions made by SMEs in Yogyakarta and Surabaya. To Identify and evaluate the most common risk tolerance strategies employed by SMEs in Yogyakarta and Surabaya and investigate

how the cities have s unique socio-cultural factors impact SMEs' approach to risk and investment decisions.

a. Benefit for scholar

Engaging in research has afforded valuable experience and a deeper understanding of the research process. Through extensive literature reviews, data collection, and analysis, the author has honed the research skills and gained insights into various methodologies. Furthermore, Author is confident that the outcomes of this research endeavour will not only contribute to the existing body of knowledge but also serve as a valuable resource for future researchers. By disseminating our findings and insights, the author hope to provide a solid foundation upon which others can build, fostering continuous progress in our field. In essence, this research represents a meaningful step forward, with the potential to shape the direction of future investigations in a positive and constructive manner.

b. Benefits for Policymaker

Contribute to the academic understanding of how risk-related factors interact and influence SME investment decisions, providing a nuanced perspective on the

Yogyakarta and Surabaya context. This research aims to provide a deeper understanding of the factors influencing SME investment decisions in Yogyakarta and Surabaya, offering theoretical insights and practical implications for SME stakeholders and policymakers alike.

c. Benefits for SMEs

For SMEs players, it is a solution to increase knowledge about the risks in investing for their respective SMEs. Additionally, this research can be a benchmark for SMEs to acknowledge investment on SMEs sustainability. Investment decisions are critical for the growth and sustainability of small and medium-sized enterprises (SMEs). The author's research offers SMEs valuable insights into the risks associated with investment, empowering them to make informed decisions. By understanding these risks, SMEs can mitigate potential pitfalls and optimize their investment strategies. Moreover, this research serves as a benchmark for SMEs, providing a framework for assessing the impact of investments on sustainability. This knowledge equips SMEs with the tools to not only thrive in the present market but also to build a resilient and enduring business model for the future