

## **CHAPTER I**

### **INTRODUCTION**

#### **A. Background of the Problem**

The Covid-19 pandemic is spreading throughout the world and Indonesia is no exception. The impact of the Covid-19 pandemic is very influential and causes crises in various sectors, including the health, education and economic sectors. In economic sector, the huge impact is felt by Micro Small and Medium Enterprises (MSME) / Small Medium Enterprises (SME) sector in Indonesia. MSMEs are the largest contributor to Gross Domestic Product (GDP) for the Indonesian economy and are the mainstay of employment and distribution of finished and semi-finished goods (Hiqomah, 2021).

It has been a history, where the whole world has been affected by the Covid-19 pandemic. The facts revealed that an estimated 25 million people around the world lost their jobs. The results of a survey conducted online by the Indonesian Institute of Sciences (LIPI), the Manpower Research and Development Agency of the Ministry of Manpower and the Demographic Institute of the Faculty of Economics and Business, University of Indonesia, from April 24 to May 2, 2020 on the population aged 15 years and over, with a total of 2,160 respondents from 34 provinces in Indonesia, revealed that a total of 15.6 percent of workers experienced layoffs and 40 percent of workers experienced a decrease in income, including 7 percent of laborers' income falling by 50 percent. In terms of entrepreneurs, the Covid-19 pandemic has caused the cessation of business activities and the low ability of entrepreneurs

to survive. The survey results recorded 39.4 percent of businesses stopped, and 57.1 percent of businesses experienced a decrease in production. Only 3.5 percent were not affected. In the next two to three months, unemployment would increase by 25 million people, consisting of 10 million self-employed workers and 15 million free workers (Aldila, 2020).

In Indonesia, the impact of Covid-19 on MSMEs is very much felt. During the pandemic, MSMEs, which have been quite helpful to the country's economy, experienced a decrease in turnover. Meanwhile, MSMEs that carry out import and export activities must stop due to lockdown policies in many countries. The decrease in the quantity of exports and imports, and the disruption of transportation movements also occurred due to internal domestic restriction policies. The decline in the number of tourists was clearly very impactful for tourist centers. The decline in almost all economic activities and even to the bond and stock markets was spontaneously disrupted (Izzah, 2022).

In the context of organizing local government in accordance with the 1945 Constitution of the Republic of Indonesia, the local governments can regulate and manage their own government affairs according to the principle of autonomy and assistance tasks. In addition, local governments are directed to be able to accelerate the realization of community welfare through improvement, service, and empowerment.

Developing MSMEs should be a patent option for governments both at the central and regional levels. Building the independence of MSMEs is an

obligation. There are several reasons and references why we are obliged to do so, as state in the Qur'an, Surah Al-Hasry verse 7:

مَا آفَاءَ اللَّهِ عَلَى رَسُولِهِ مِنْ أَهْلِ الْقُرَى فَلِلَّهِ وَلِلرَّسُولِ وَلِذِي الْقُرْبَى  
وَالْيَتَامَى وَالْمَسْكِينِ وَابْنِ السَّبِيلِ لِكَيْ لَا يَكُونَ دُولَةً لِّلْأَغْنِيَاءِ  
مِنكُمْ وَمَا آتَاكُمُ الرَّسُولُ فَخُذُوهُ وَمَا نَهَاكُمْ عَنْهُ فَانْتَهُوا وَاتَّقُوا اللَّهَ  
إِنَّ اللَّهَ شَدِيدُ الْعِقَابِ

Meaning:

Whatever booty Allah gives to his apostle (of property) from the inhabitants of the cities is for Allah, for the apostle, the relatives, the orphans, the poor and those on a journey, lest it should circulate among the rich alone among you, what the apostle gives you, accept and what he forbids you, leave it and fear Allah verily, Allah is very severe in punishment.

Micro, Small and Medium Enterprises (MSMEs) continue to contribute to gross domestic product (GDP) from year to year. The contribution of MSMEs to GDP at constant prices amounted to IDR 7,034.1 trillion in 2019, up to 22.9% from the previous year which amounted and up to IDR 5,721.1 trillion. Meanwhile, the contribution of MSMEs to GDP at current prices amounted to IDR 9,580.8 trillion. This contribution increased by 5.7% from the previous year which amounted to Rp 9,062.6 trillion. MSMEs have a large contribution to GDP, namely 61.97% of total national GDP or equivalent to IDR 8,500 trillion, and in 2020 there was a decrease compared to the previous year of 562 trillion. The main cause was due to the Covid-19 pandemic. In 2021, based on

the data from the Ministry of Cooperatives and Small and Medium Enterprises (Kemenkop UKM) in March 2021, the contribution of MSMEs to Gross Domestic Product (GDP) was 61.07 percent or IDR 8,573.89 trillion. Meanwhile, in 2022, the contribution of MSMEs to GDP, he said, reached 60.51 percent or IDR 9,580 trillion. MSMEs absorb 120.59 million workers, investment value is 60.42 percent of total investment, filling 15.65 percent of non-oil and gas exports, and 24 percent of MSME players have utilized e-commerce.

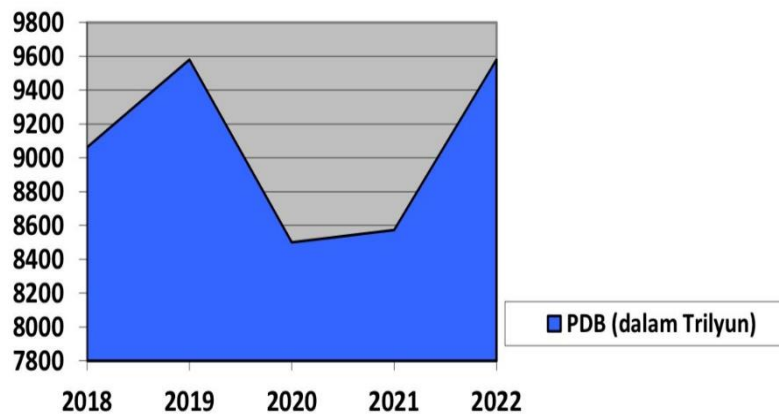


Figure 1. 1 MSME Contribution to GDP in 2018-2022

Based on the data above, it can be interpreted that from 2018-2022 the existence of MSMEs contributed to the increase of the country's GDP. Gross Domestic Product (GDP) is an indicator of a country's economic growth. Besides, MSMEs contribute to absorb 119.6 million or 96.92% of the total workforce in business units. This is in line with Candra and Hoetoro's research, stating that if GDP increases by one percent (1%), there will be a creation of employment opportunities of 0.56% in micro businesses, 0.71% in small businesses and 0.17% in medium businesses. The description above shows that

MSMEs are an important pillar in the Indonesian economy, not only contributing to increasing GDP but also creating jobs, which have been the government's duties in alleviating unemployment (Candra & Hoetoro, 2013).

Although in 2020-2021 coincided with the Covid-19 pandemic, almost all sectors experienced an economic crisis, including MSMEs, the existence of the Community Activities Restrictions Enforcement (CARE) policy caused MSME players in Indonesia to experience a decrease in income or sales turnover, and based on Kase's research in 2022 there were as many as 80% of MSME players in the business sector of food stalls, vegetable stalls, glassware stalls, supermarkets, restaurants, transportation services, photocopying services, taylor services, furniture services, photography services, beauty salon services, boarding services, computer rental services and agribusiness services that experienced a decrease in sales turnover and business profits by 85-90% during the Covid-19 pandemic (Kase et al., 2022).

The post-pandemic period has been equally tough, as all sectors have had to work hard to recover and adapt to the changes. MSMEs are the sectors that has experienced the fastest revival. This is evidenced by the five business fields in MSMEs contributing 65% to Indonesia's GDP (Adawiyah, 2014). The recovery of the MSME sector, which had previously slumped during the pandemic, is partly due to the fact that the majority of MSMEs use their own business capital without capital assistance from banks. So, when there is a banking crisis and bank interest rates rise, it does not affect the performance of the MSMEs themselves.



Figure 1. 2 Source: Ministry of Cooperatives and MSMEs 2022

Based on the data from the Ministry of Cooperatives and Small and Medium Enterprises (Kemenkop UKM, 2022), the number of MSMEs reached 64.2 million from the number of Large Enterprises of 5,637, Medium Enterprises of 65,465, Small Enterprises of 789,679 and Micro Enterprises of 64,058,201. The figure shows the condition where the majority of MSMEs are still in the Micro Business category with a percentage of 99.97% or more than 64 million business actors.

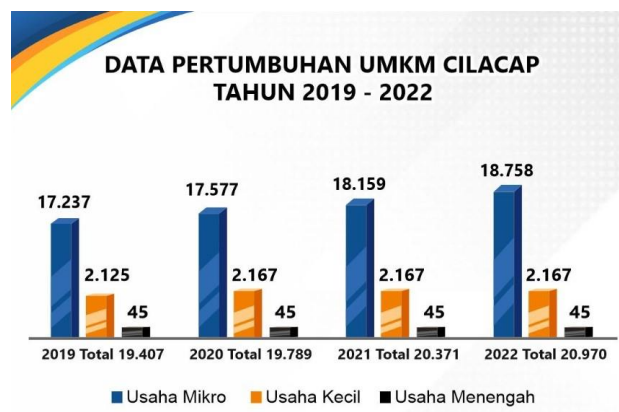


Figure 1.3 Source: data.kabcilacap.id 2022

Based on the data above, it can be seen that the development of MSMEs in Cilacap has increased dramatically during the pandemic, the number of MSME players in Cilacap in 2019 was 19,407 people. Then in 2020 there was an increase of 382 people to 19,789 people. Then, in 2021 there was an increase

in the number of MSME players by 582 to 20,371 people. Meanwhile, in 2022 there was an increase of 599 people. So that there are 20,970 MSME players in Cilacap.

Cilacap is one of the largest regencies in Central Java Province with an area of 2,385 km<sup>2</sup> and a population of 2 million in 2023 (BPS Cilacap 2023). Seeing the potential of this fairly large area makes Cilacap Regency have a good potential to be developed both in the agriculture, plantation, fisheries and tourism sectors. Based on data from the Central Bureau of Statistics, Cilacap's economic structure is dominated by five business field categories, namely the processing industry (agriculture, forestry, and fisheries), construction, wholesale and retail trade, repair of cars and motorcycles, and mining and quarrying. The data shows that the processing industry dominates the economy in Cilacap, including the micro, small and medium enterprise (MSME) industry.

Based on Law Number 20 of 2008 concerning Micro, Small and Medium Enterprises, policies carried out between the Central and Regional Governments regarding the implementation of guidance, financing, supervision of Micro, Small and Medium Enterprises have significant potential in encouraging MSMEs in Indonesia, considering that for 2020, MSMEs are the main focus in the National Economic Recovery (PEN) programme in the Covid-19 Pandemic. Since the enactment of Government Regulation of the Republic of Indonesia Number 7 of 2021, the Government must strive for a synergistic business climate through equal ease of access for all Micro, Small,

and Medium Enterprises. In order to achieve this, the Metro City Government must provide financing and guarantees, which this authority is in the Business Capital Strengthening Assistance Programme for MSMEs.

Business capital is money that is used as a principal (parent) to trade, release money and so on or capital is property (money, goods and so on) that can be used to produce something to increase wealth (Pamungkas, 2015). In Micro, Small and Medium Enterprises (MSMEs), large capital will affect business development (Anggraeni, 2013). Business capital is needed when entrepreneurs want to establish a new company or to expand an existing business. Without sufficient capital, it will affect the smooth running of the business. Capital can come from personal capital or loan capital from other parties such as financial institutions or investors. However, in general, micro, small and medium enterprises use personal capital that is not too large in amount.

MSME players still face the problem that is businesses are hampered due to slow capital turnover, especially in the period after the Covid-19 pandemic (Anggraeni, 2013). In doing business, capital has a big influence because without capital, a business will be hampered. So, if in doing business, business actors are constrained by capital, it will certainly complicate the running of a business. The importance of knowledge about capital in a business is an important consideration so that business capital can rotate properly. Based on the description above, business capital can affect business development



because the more capital a business actor has, the more opportunity he has to increase the volume of his business and to develop it.

Based on the research conducted by ABDSI (*Asosiasi Business Development Services Indonesia*) in 2020, 68 percent of micro businesses decided to stop their business. Although there are 28 percent of businesses are still running, many of them have to make savings by reducing employees. This is certainly inseparable from the condition of micro businesses where 53 percent of micro businesses have no cash supply at all in their household operations. This shows the importance of encouragement for businesses with regard to cash availability. It also describes that the existence of business capital is very important not only to develop the business, but also to maintain the business to exist in difficult times such as the Covid-19 pandemic.

Nur Fajar Istinganah and Widiyanto's research in 2020 states that there is a simultaneous and partial influence between business capital, education level, and entrepreneurial characteristics on the development of SMEs in Pedurungan District, Semarang Municipal. The suggestion of this research is that business owners must have a strategy to obtain capital, take part in training for those who have low education, must have high self-confidence, have a leadership spirit, dare to take risks, and are not easily discouraged so that these characteristics possessed by every entrepreneur must be done to develop their business (Istinganah & Widiyanto, 2020). Arniati Lasoma's research in 2021 stated that partially business capital has a significant effect on micro business development in Kabila District, Bone Bolango Regency; marketing strategy

had a significant effect on micro business development in Kabila District, Bone Bolango Regency; and simultaneously business capital and business development affected micro business development in Kabila District, Bone Bolango Regency, with a contribution of 28.6%, while the remaining 71.4% was influenced by other factors such as labor and the benefits obtained by the micro business actors themselves (Lasoma et al., 2021). Based on the previous research above, this is in accordance with the researchers' temporary assumption that the existence of business capital has an influence on the development of MSMEs.

One of the government's efforts to help MSMEs in order to develop their businesses during the current recovery is through the National Economic Recovery Policy (PEN), one of which is intended for MSMEs. The total budget allocated to help MSMEs is also quite large, namely IDR123.5 trillion, or 17.7 percent of the total national Covid-19 handling budget stimulus of IDR695.2 trillion in 2020. In this position, MSME players can take advantage of the assistance provided by the government to increase their business capital.

In addition to business capital, there are other factors that are no less important in MSME development efforts, namely innovation. According to Drucker, innovation is a specific tool for companies, where innovation can explore or utilize changes that occur as an opportunity to run a different business. This can be presented as a discipline, learning, and practiced (Kustiyah et al., 2017). Product innovation will create a variety of product designs, thereby increasing alternative choices and the benefits or value

received by customers, which in turn will improve product quality as expected by customers (Kresna & Purnama, 2021). Companies can make various innovations by creating a variety of product designs and adding value to the use of an item. Product innovation is also one of the impacts of rapid technological change. Rapid technological advances and the high level of competition require each company to continuously innovate products which will ultimately increase business development (Kresna & Purnama, 2021).

Suryono Hadi Elfahmi's research in 2019 stated that product innovation affected competitiveness, product innovation affected SMEs to upgrade and product innovation affected SMEs to upgrade through competitiveness (Elfahmi & Jatmika, 2019). Shinta Avriyanti also conducted research related to the effect of innovation on business development, the result of which was that there was an effect of product innovation on business development amid the Covid-19 Pandemic in culinary MSMEs in Tabalong Regency (Avriyanti, 2022). So, the product innovation variable has a positive and significant influence on the development of MSMEs. Based on the previous research above, the researcher considers that innovation can have an influence on the development of an MSME.

MSME players have a very important role in sustaining economic growth in Indonesia. Considering its important role, the MSME segment needs to be equipped with increasingly complex financial literacy skills (Manurung, 2009). Manurung states that financial literacy is an asset of skills and knowledge that enables an individual to make effective decisions based on existing financial

resources. Muraga and John (2015), stated that insight into financial literacy could be utilized by entrepreneurs as a guide in deciding accurate decisions in the financial field for their companies.

Research by Yuliyawati and Mardiana stated that financial literacy had a significant impact on the sustainability of MSMEs. It means that if MSME entrepreneurs are financially literate, the business and financial provisions made will certainly lead to better development over time, foster business skills to settle from the crunch, and in the end form the right decisions (Yuliyawati & Mardiana, 2023). Research conducted by Maulana et al. also identified that financial literacy had a positive and significant effect on business continuity. Knowledge and financial management skills helped improve business continuity because they could ensure that they were able to overcome dynamic economic turmoil (Maulana et al., 2022).

The performance achieved by entrepreneurs can be determined by the ability of these entrepreneurs to manage their finances (Dahmen & Rodríguez, 2014). Logically, this opinion explains that with adequate financial literacy knowledge, businesses can recognize and respond to changes in the economic, financial, and business climate so that every policy decided will contain innovative, appropriate, and targeted solutions to improve the performance and sustainability of their business. Based on the previous research above, the researcher develop a temporary statement that financial literacy can have an influence on the development of an MSME.

Supporting financial literacy in MSMEs is also one of the efforts that the government must make to develop financial inclusion that can be accelerated so as to create a truly inclusive Indonesian financial sector and contribute optimally to the national economy. The government has shown a strong commitment to the sustainability of Micro, Small and Medium Enterprises (MSMEs) after the Covid-19 pandemic.

Concrete measures have been taken to support the MSME sector to recover and grow after experiencing significant economic impacts during the pandemic. The government provides various fiscal incentives, low-interest financing, and simplified regulations to help MSMEs survive and thrive. In addition, training and mentoring programs have also been strengthened to improve the skills and competitiveness of MSMEs in the post-pandemic era.

Research conducted by Kurnianty and Sitorus stated that government support has a positive and significant effect on MSME performance (Kurnianty & Sitorus, 2023). Based on the research, the researcher makes a temporary statement that government support can have an influence on the development of an MSME.

Based on the description above, the researcher will conduct research with the title of **"THE EFFECT OF BUSINESS CAPITAL, INNOVATION, FINANCIAL LITERACY AND GOVERNMENT SUPPORT ON THE SUSTAINABILITY OF MSMES POST COVID-19 PANDEMIC"**.

In accordance with the phenomenon that occurred, namely the Covid-19 pandemic caused the cessation of business activities and the low survival ability

of entrepreneurs, causing many MSME players to have to close their businesses. Therefore, this research use contingency theory, which is a concept formulated by Drazin and Van de Ven. This theory proposes three important approaches in contingency research, namely selection, interaction, and system. Contingency theory in a broad sense states that organizational effectiveness is a function of the compatibility between the environmental systems in which an organization operates. Contingency theory is the first and most well-known tool for explaining variations in organizational structure.

This research is a replication of research by Iqnatia et al., 2021 which examines 'The Effect of Financial Literacion, Innovation, and The Role of Government on the Development of Small Medium Enterprises' The aspects studied in the study are financial literacy, innovation, and the role of government in the development of small and medium enterprises. In this study, data was taken from questionnaires distributed to small and medium enterprises in Cipayung District, East Jakarta. In this study, researchers added independent variables, namely Business Capital and MSME Sustainability as dependent variables. The technique in collecting data was taken by distributing questionnaires to MSME actors in Cilacap City, Central Java. This research is very important to do where, as is well known, MSMEs are the most important pillar in the economy in Indonesia and MSMEs are the fastest sector to experience a revival.

## **B. Problem Formulation**

Based on the background above, the researcher formulates the problems as follows:

1. How does business capital affect the sustainability of MSMEs post Covid-19 pandemic in Cilacap?
2. How does innovation affect the sustainability of MSMEs post Covid-19 pandemic in Cilacap?
3. How does financial literacy affect the sustainability of MSMEs post Covid-19 pandemic in Cilacap?
4. How does government support affect the sustainability of MSMEs post Covid-19 pandemic in Cilacap?

## **C. Research Objectives**

Based on the formulation of the problem above, the researcher aims:

1. To determine the effect of business capital on the sustainability of MSMEs post Covid-19 pandemic in Cilacap.
2. To determine the effect of innovation on the sustainability of MSMEs post Covid-19 pandemic in Cilacap.
3. To determine the effect of financial literacy on the sustainability of MSMEs post Covid-19 pandemic in Cilacap.
4. To determine the effect of government support on the sustainability strategy of MSMEs post Covid-19 pandemic in Cilacap.

#### **D. Research Benefits**

##### **1. Theoretical benefits**

The results of this study are expected to provide a deeper picture and understanding of the influence of business capital, innovation, financial literacy, and government support on the development of MSMEs, as well as a reference for similar researchers in the future.

##### **2. Practical Benefits**

The results of this study are expected to be general input and consideration for agencies or institutions in an effort to maximize or improve business development for MSMEs.