

# What Factors Determine SMEs Business Success? A Case Study in Riau Province

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**Abstract.** Small and Medium Enterprises (SMEs) play an important and strategic role in economic development. In Indonesia's economy, SMEs are the largest business group in number. Although the number of the SMEs initiators keeps growing exponentially, in the reality, it is not easy to develop those SMEs. Hence, this research is aimed at figuring out a solution to make SMEs successful in the business, so that the growth and the development keep increasing. The research was done by taking 227 SMEs in Riau Province as the sample. The data collection was done through observations, interviews, and questionnaires. The data were analyzed by using path analysis. The results show that the technology innovation rate, leadership style, and family involvement have a significant influence on the business success either in a direct or indirect way of the business capability. To attain business success, an SME entrepreneur should establish some innovations, exhibit an effective leadership style, improve family involvement in a positive way, and improve business ability, both financial and production capabilities.

**Keywords:** business success; business ability; innovation; leadership style; family involvement

## 1 Introduction

Small and Medium Enterprises (SMEs) play an important and strategic role in economic development. SMEs have been acknowledged to have a significant role for the economic development of a nation [1, 2]. In Indonesia's economy, SMEs are business groups that have the largest number. In Riau Province alone, the number of SMEs reaches 277,980 business units, consisting of 186,818 micro business units, 87,449 small business units, and 3,713 medium business units. Every year, SMEs in Riau grow with the estimation of 5-10 percent.

Even though the number of SMEs keeps increasing, the facts show that the success of some SMEs in Riau Province has not been satisfying. One of the problems encountered is the lack of sales volume, and it results in low profit. It is believed that the problem is caused by the use of traditional business management, where family involvements are relatively dominating so that it is difficult for the SME owners in the decision making in developing the business. Besides, the human resources are lacking capabilities to do some innovations, both in the production and marketing process. As the result, the output products cannot meet with the consumers' needs. That is why SMEs should elevate their performance in order to attain the business success.

The attempts on achieving SMEs success have been investigated by several researchers in the past. In order to obtain business success, it takes a leader who has the most efficient leadership style that is in accordance with the business goal [3]. The use of innovation can also support the successfulness of a business [4]. Meanwhile, hiring family members in a business has a positive effect on the SMEs' sales growth in the Dominican Republic [5]. A family member is an important agent that can help promote and influence a new business creation and company growth [6]. However, family involvements have negative effects on the way the leader makes decisions [7].

This research is different from several studies that have been done, because this research is devoted to SMEs in Riau Province in an effort to achieve business success by adding business capability variable as an intervening variable. If the production capability and SMEs ability are good, it is expected that SMEs will achieve the business success. The results of the research are expected to find efforts that can be done to improve the success of SMEs in Riau Province and to raise the regional economy.

## **2 Theoretical Framework**

### *Business Success*

Business success is a state in which the business has improved from its previous results. The business success is the main goal of a business, where all the activities that are in that business are aimed to achieve a success. The success of the business can be seen from various aspects; financial performance, corporate image, and others [8, 9]. The success of a business is measured from the achievements or the growth of the managed business. This growth is proven by sales, owned assets, and profit growth.

### *Business Ability*

Therefore, business success is also related to business ability. The business ability can be grouped into four main elements: (1) technology: that is something more visible, such as equipment, machinery, database software, database, and so forth; (2) human resources; (3) organization; and (4) company culture [10]. The business ability has a direct and positive influence on the success of the business which implies that the wider the market access and the easier the consumer gets the product, the easier the small industry entrepreneurs will be able to increase the sales volume and the profitability. This means encouraging employers to increase the number of labors can increase their production [11].

### *Innovation*

Innovation has an important role to improve entrepreneurship capabilities [12]. Innovation is defined as a mental process that leads to the creation of new phenomena in the form of new material, services, or techniques [13]. The types of innovations that are suitable for SMEs include: product innovation (related to goods, services, and ideas); organizational innovation (based on marketing, purchasing and sales policies, administration, management and staff); and market innovation (related to territorial expansion and market segment penetration) [4]. The innovation created by the company becomes the key to advantageous competition that determines the success of a business [14, 15].

### *Leadership Style*

Leadership styles also play a role in improving business ability [11]. An approach to leadership behavior is based on the idea that success and failure of a business are determined by the attitude and decisions of the leader. The style and attitude of action will be seen from: how to give orders, how to give tasks, how to communicate, how to make decisions, how to provide guidance, how to enforce disciplines, and others [16]. Leadership is also the achievement of

goals through communication with others [17]. Corresponding Bass Theory, factors that can affect leadership include emotional intelligence. The five components associated with emotional intelligence consist of: self-awareness, self-regulation, motivation, empathy, and social skills [18]. Authoritarian leadership style to subordinates can degrade business performance. While the participative leadership style encourages the subordinates to contribute to the production activities of the company so that it affects the production [11]. Therefore, leadership style becomes really important in order to support business success [3, 19].

#### *Family Involvement*

The involvement of family members can be seen in how much family members contribute to the business. Most MSMEs that employ family members in their businesses have a positive effect on sales growth [5, 20]. Family is an important source that helps promote the products, influences the creation of new ventures and the growth of the company [6]. The influence of families on a business tends to be positive because the entrepreneurs can organize their business according to personal preference [21, 22, 23]. Small businesses can achieve superior performance since close kinship allows owners to manage a business better with family [22], and to verify the behavior of their agents to be more effective [24, 25, 26].

In addition, in many family companies, the owners employ family members in the business, because the resources of family members can reduce the need for companies to find employees outside the company. The involvement of family members in a business can be measured by: the number of family members involved; the positions of the family members within the company; and the involvement of the family members in financial terms [27]. Some consequences of family involvement in business, such as lack of self-control will make the entrepreneurs difficult in decision-making because the family influence is more dominant and it causes the entrepreneurs to be reluctant to take risks [7]. Decision-making mismatches with family members cause poor relationships with the family members [28].

### **3 Research Methods**

This research is survey research conducted in the areas of SMEs industry area in Riau Province; Siak, Dumai, Pekanbaru, Kampar, Kepulauan Meranti, and Pelalawan Regency. The primary data required in this study consist of questions or statements related to the research variables. The secondary data are obtained from the Department of Trade, Cooperatives and SMEs, and the Central Bureau of Statistics. The measurement of the research variables was based on the perception of the respondents on all indicators of the variables that have been constructed on the model. The data measurement in the research variables was using Likert scale 1-4, then transformed to 5-level ordinal scale consisting of very good, good, medium, bad, and very bad. Data were analyzed with path sub-structure 1 and 2 analyses by using SPSS software, version 21.

### **4 Results and Discussion**

The result of the average score of the research variables is shown in Table 1. The business success according to the respondents is in the high category with the score of 8.47. From the results of interviews with 277 entrepreneurs of SMEs located in Riau Province, 70 percent of the SMEs experience sales growth every year. The sales growth reflects the company's operational success in the past period and can serve as a predictable growth in the future.

Increased sales growth influences the increase of the company's profit growth. The higher the level of sales, the higher the profit obtained [29].

**Table 1.** The average score of the research variables

No.	Variable	Mean	Category
1	Business Success	8,47	High
2	Business Ability	6,35	High
3	Innovation Level	7,37	Medium
4	Leadership Style	10,82	Medium
5	Family Involvement	9,60	High

The business ability shows a high category of 6.35 in which SMEs in Riau Province has experienced an increase in the amount of the production. Nevertheless, the business ability in financial capacity still has weaknesses due to the capital source of most of the SMEs was derived from their own and family capitals. Regarding the innovation level of the SMEs, the result shows in the medium category with the score of 7.37. This shows that there are still many SMEs in Riau Province that have not innovated in their business, either in the product, marketing, or technological innovation. Innovation in marketing the product can be done via online which is a positive trend today. In addition, technological innovations from traditional machines to become the modern ones are more efficient in increasing the production. Therefore, it is quite natural that a business which does not innovate nowadays becomes difficult to develop.

The score for leadership style is in moderate level (10.82). The way business owners communicate to the employees has a big influence in encouraging the employees to work. Decision-making also has a major impact on business success. The courage that the SMEs owners take in making good decisions either in implementing an innovation or in terms of marketing used in the business, has a great influence on the success of the business.

The score for family members' involvement category shows high criteria (9.60). This is shown by the large involvement of family members in financial matters, the involvement of family members in business decision making, and the involvement of family members to become the labors. As explained earlier, the research data is analyzed by path analysis with the help of SPSS version 20 software. The results of the hypothesis test are presented in Table 2. As seen in Table 2, it is shown that the level of innovation, leadership style, family involvement and business ability have a significant effect on the success of the business either directly or indirectly.

The substructure equation 1 is as follows:

$$Y_1 = PY_1X_1 + PY_1X_2 + PY_1X_3 + e_1$$

$$Y_1 = 0.79 X_1 + 0.37 X_2 + 0.70 X_3 + 0.502$$

The equation shows that the level of innovation gives a significant direct effect on the business ability of 0.99. Leadership style gives direct influence to business ability equal to 0.37. Meanwhile, family involvement gives direct influence to the business ability of 0.90 with error 0.502. The contribution of the innovation level variable, leadership style, and family involvement, to business ability in a combined manner is 0.498.

The equation of substructure 2 is as follows:

$$Y_2 = PY_2X_1 + PY_2Y_1 + PY_2X_3 + e_2$$

$$Y_2 = 0.39 X_1 + 0.38 Y_1 + 0.35 X_3 + 0.625$$

The equation shows that the level of innovation gives a significant direct effect on the business success as much as 0.39. The style of leadership gives a direct impact on the business success of 0.38. While family involvement gives direct influence to the business success amounted to 0.35 with error 0.625. The contribution of technological innovation, leadership

style, family involvement, and business ability to business advantage, in the combined matter is 0.375.

**Table 2.** Hypotheses test results

No.	Hypothesis	<i>Path Coefficient</i>	<i>P-Value</i>	Description
H1	Innovation Level on Business Ability	0.79	<0.001	Significant
H2	Leadership Style on Business Ability	0.37	<0.001	Significant
H3	Family Involvement on Business Ability	0.70	<0.001	Significant
H4	Innovation Level on Business Success	0.39	<0.001	Significant
H5	Family Involvement on Business Success	0.35	<0.001	Significant
H6	Business Ability on Business Success	0.38	<0.001	Significant
H7	Innovation Level through Business Ability on Business Success	0.38	<0.001	Significant Mediation
H8	Leadership Style through Business Ability on Business Success	0.52	<0.023	Significant Mediation
H9	Family Involvement through Business Ability on Business Success	0.34	<0.001	Significant Mediation

Leadership style partially has an influence on the business ability (sig. <0.01). Leadership style has an effect on business ability [16]. How leaders communicate with employees can make the employees contribute more in business activities so that it affects the business production [11]. The process of directing employee behavior toward the achievement of business goals can make the employees contribute maximum efforts in business activities.

Partial family involvement has an effect on business ability (sig <0.01). The involvement of family members in a business can improve business capability [21, 22]. The involvement of family members contributes to finance (business capital) as well as participate directly in the production process, and help promote the creation of new business and growth of the company [6].

The level of innovation has an influence on the business success (sig <0.01). The use of innovation can support the business success. To be a superior entrepreneur requires creativity and the ability to innovate. Intense competition in entrepreneurship encourages entrepreneurs to have a high innovation. The SMEs that have implemented innovation in their business are proved capable of increasing sales growth and business profit.

Family involvement has an influence on the business success (sig <0.01). The involvement of family members in business has a positive impact on the business success, and it is characterized by the sales growth [5, 20]. The involvement of family members in a business will have a positive influence on business growth so that it will contribute to business success.

Business capability has an influence on business success (sig <0.01). The business capability of a SME is seen from the financial and production capability. If both capabilities are good, then the contribution to the success of SMEs in obtaining profit, gain capital, and sales growth is very high. The business capability has a direct and positive influence on business success. The implication is that the broader the market access, the easier the consumer will get the product. Therefore, the company's sales volume and profitability will increase.

The level of innovation does influence the success of the business through business capability (sig <0.01). The indirect contributions from the level of innovation to business success through business capability is 0.38 and total donation as much as 1.37. The application of innovation is able to increase production capability which indirectly impacts on the improvement of the quality of the products.

Leadership style has an influence on business success through business ability (sig <0.01). The indirect contributions of family involvement to business success through a business capability were 0.52 and a total donation of 1.75. Business success requires a leader who possesses a leadership style appropriate to answer all business problems. That a good leadership will be able to direct and manage both raw materials and human resources to perform effective and efficient production, so it will be easy to achieve business success [3]. Therefore, leaders must have the creativity to overcome various challenges and risks from both internal and external aspects.

Family involvement influences business success through the business ability (sig <0.01). The indirect contributions of family involvement to business success through business ability were 0.34 and total donation of 1.28. The involvement of family members in a business has a negative impact on decision making, making it difficult for business owners to make decisions due to dominant family influences, making business owners reluctant to take risks [7].

The level of innovation, leadership style, and family involvement will improve business capabilities, both from production capacity and financial capability. If the business ability increases, it will be easy to achieve business success. The SMEs that have good financial and production capability will be able to increase sales growth, investment growth, and profit growth.

## **4 Conclusion**

The results of the study found that there was an influence of innovation level, leadership style, and family involvement in business ability. Business capability will increase both from production capability and financial capability if SMEs continue to innovate. In addition, leadership style or how business leaders communicate with employees and manage the financial and production management, greatly affects the business ability. Family members' involvement of positive things is also beneficial to the business, as the family will be more serious about building a business on the premise that it is a mutual property, and the results will be shared. Level of innovation, leadership style, family involvement, and business ability affect the success of a business. The business success of sales, investment, and profit growth can be improved if efforts are made to continue to innovate, to apply effective leadership styles, and to engage family members in business.

There is an influence of innovation level, leadership style, and family involvement in business success through business capability. The success of the business is influenced by the ability of a business for production and financial capability. The ability of the business will be good if it continues to innovate, business owners apply the appropriate leadership style in managing the business and engage family members for positive things. Therefore, factors that

affect the success of the business - either directly or indirectly - should always be improved in terms of the quality of the management.

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