

# A Review of MSME's Competitiveness in Indonesia

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**Abstract.** The Industrial Revolution 4.0 raises not only opportunities but also challenges, especially for Micro, Small and Medium-Sized Enterprises (MSMEs). To be able to compete in the existing business competition, MSMEs are required to be able to adapt to the digital-based economic transformation. The success of MSMEs in surviving and winning the competition is certainly very much determined by their competitiveness. This article discusses the literature review on the Indonesian MSMEs competitiveness. The discussion includes the development of MSMEs in Indonesia, the empowerment of MSMEs in particular related to the issue of business transformation, strategies to improve MSME competitiveness, empirical studies related to MSMEs in Indonesia and ends with a discussion of the results of a study on MSME competitiveness in Indonesia. Based on the review of the existing literature, this article is expected to contribute in identifying various problems, strategies and policies in the management of MSMEs so that competitiveness can be improved.

**Keywords:** MSMEs, Strategies, Policies, Competitiveness

## 1 Introduction

The industrial revolution 4.0 which is synonymous with the application of digital technology in every aspect of the company's operational activity has an impact on the importance of digital-based business transformation for companies, including micro, small and medium enterprises (MSMEs). It is undeniable that the adoption of digital technology will have a positive impact on companies to improve their performance and competitiveness. For example, the adoption of technology in the marketing sector will have a positive impact in expanding the reach of market share so that it is expected to increase revenue which of course will also have positive impact on improving company's performance and competitiveness. Problems will arise if the company does not have the ability to take advantage of the rapid development of existing technology, the company will be unable to compete in business competition and threaten their survival. Therefore, an understanding of competitiveness in business competition, especially for MSMEs is necessary so that MSMEs can adapt to the changes that occur.

Business competition is defined as the ability of a business to produce goods or services in international quality standards that might compete in the international market so as to have an impact on improving the welfare and economy of a country. MSMEs have an important role in the economy, especially in developing countries such as Indonesia. In 2020, the Central Statistics Bureau reported that the contribution of MSMEs to Indonesia's GDP reached 61% with the absorption rate of domestic workers reaching 99% [1]. This could be an indicator that MSMEs are the pillar of the Indonesian economy. However, there are still many problems,

both internal and external, to the challenges of rapid technological developments which have resulted in MSMEs in Indonesia still having a fairly low competitiveness even when compared to other countries in ASEAN. These internal problems include institutional and human resources, production and marketing, and intellectual capital, while external problems are related to funding, bureaucracy, and infrastructure issues.

The conceptual literature has so far discussed the concept of competitiveness at different levels, include nationally, regionally, industrially, and corporately. At the national level, the concept of competitiveness refers to the concept of productivity with the aim of achieving a better level of the economy of a country [2]. The World Economic Forum (WEF) defines competitiveness at the national level as competitiveness at the macro level as measured by the competitiveness of a country. At the regional, industry and enterprise levels, the objective of increasing competitiveness focuses on achieving better performance and achieving competitive advantage. Competitive advantage is the implementation of a strategy that is currently not implemented by other companies and provides an advantage for the company in terms of reducing production costs, exploiting market opportunities, and neutralizing competitive threats [3]. Competitiveness in this paper refers to competitiveness at the company level which shows the company's capacity to be able to compete in the domestic market in order to increase market share, increase exports by expanding marketing to international markets and increase profits by growing sustainably. Conceptually, a company's competitiveness can be measured through several indicators such as the availability of infrastructure, education level, financial market efficiency, market size, and level of innovation [4].

Competitiveness is a determining factor for the success of MSMEs in maintaining survival and winning business competition. As a pillar and support for the economy, the competitiveness of MSMEs needs important attention so that the survival and growth of MSMEs can be achieved. This paper is a literature review that focuses on discussing the competitiveness of MSMEs in Indonesia. The flow of writing this paper is as follows: the discussion begins with a conceptual review of business transformation and the importance of digital transformation in MSME business activities in responding to the challenges of the industrial revolution 4.0, then the discussion focuses on how to empower MSMEs in the Industrial 4.0 era and the strategies and policies implemented by the government to improve the competitiveness of Indonesian MSMEs. The discussion ends with a review of the results of an empirical study on the competitiveness of MSMEs in Indonesia and conclusions.

### **Digital-based Transformation in MSMEs Business Activities**

The industrial revolution 4.0 has an impact on the birth of new trends in the economy that must get important attention from MSMEs. Some of these trends include flexible work, the need for personalization related to consumer experiences, data-based decision making, cyber security issues, the use of artificial intelligence and cloud systems. For example, regarding the problem of data-based decision-making, MSMEs can no longer make decisions only based on feelings and assumptions, but also must be data-based. Like large-scale companies, big data provides benefits for companies that are able to invest in information technology infrastructure and data analysis. Big data also provides benefits in improving consumer experience because proper analysis of consumer needs and desires will provide knowledge for MSMEs to understand consumer behavior. Thus, MSMEs can make better decisions, especially with regard to product offerings to meet consumer needs and desires.

To be able to adapt to changing trends that occur in the era of the Industrial Revolution 4.0, MSMEs need to carry out digital-based business transformations in order to survive and

increase competitiveness. In the Industrial Revolution 4.0 era, all companies without exception have the opportunity to radically transform business models by utilizing digital technologies such as social networks, mobile, big data, internet of things, and other innovations such as blockchain. Digital-based business transformation involves changes in core business operations and focuses on product and process modifications, to transformations in organizational structures to support complex transformation processes. In other words, the concept of digital transformation can be defined as the process of integrating digital technology and business processes in the digital economy era which is the main characteristic in the Industrial Revolution 4.0 era. In its implementation, companies need to define important jobs and capacities to support the development of effective digital technologies [5].

Ayodya [6] stated that to carry out a digital-based business transformation called MSME 4.0, MSMEs need to make changes in managing resources, operating and production activities, product marketing methods, to business financial management. Resources are an important aspect for MSMEs since they are part of business needs. Several factors that must be considered in resource management include man, material, money, machine, method, and market. Each resource factor is closely related and supports each other in the effort to achieve the business goals that have been set. For example, in the field of natural resource management is the implementation of digital HR transformation that provides benefits for employees in securing access to human resource services and related data and automation. Through this service, employees get convenience in doing self-service.

In relation to the operational and production aspects of the company, to support the digital-based business transformation process, MSMEs must have a good operational system and production system. The production system refers to the method or production process used to convert inputs into outputs in the form of goods or services. Another strategy needs to be done is the development of standard operating procedures (SOPs). SOP is a set of instructions that are used as directive instructions. The instructions is a sequence of processes in doing a job from beginning to end. Through the use of SOPs, it is expected that the production system can regulate production standards from the start to prepare raw materials related to the number and size, stages of production work and the time required for each stage of work, until the finished product is produced. An example of digitization in the production sector is applying digital technology and product creation processes. To support this program, the Government of Indonesia focuses on building production houses and providing modern production tools for the development of MSME production.

In relation to the marketing aspect, to carry out digital-based business transformation, a good marketing plan is needed which includes determining sales targets, sales methods and marketing strategies. Sales targets are important in achieving company goals and need to be set based on the results of the calculations. For example, to determine sales targets, the total operating costs are divided by the average gross profit per unit. Sales methods for the MSMEs business scale can be done with various options, for example opening a place to sell, entrusting sales to stores or other people, trading around, taking orders, to doing online sales [6]. Determination of marketing strategies is also important to ensure survival and increase product competitiveness. The MSME marketing strategy should focus on the marketing mix known as the 4Ps (Product, Price, Place, and Promotion). For example, MSMEs might take advantage of the marketplace as a channel to sell and promote their products as well as the importance of customer relationship management to retain customers

Regarding the financial aspect, it is necessary to pay attention to the division of the financial division into several sections which include the receipt and payment section, the recording section, and the supervision section. By doing a simple division, MSMEs are

expected to be able to solve classic problems that have been characteristic of MSMEs, such as the absence of separation between personal assets and business assets, not having a recording and control system since the business owner has full responsibility of financial problems, especially in conditions where the level of sales and demand is minimal, the business owners will usually sacrifice their personal assets to meet operational needs and ensure business continuity [1]. The digitization process in the financial aspect might be done by implementing the digitization of budget management through the implementation of software that supports features that accelerate the process of financial bookkeeping, financial reporting, invoicing, purchase orders, and other accounting processes.

### **MSMEs Empowerment in Industry 4.0 Era**

As a pillar of the Indonesian economy, the empowerment of MSMEs is needed to increase the productivity, performance and competitiveness of MSMEs, especially in the Industrial Revolution 4.0 era. Since the Industrial Revolution 4.0 era effect to disruptive technologies such as artificial intelligence, internet of things (IoT), genetic engineering, autonomous vehicles which will certainly have an impact on social, political and economic systems [7]. Specifically, the Industrial Revolution 4.0 also has a significant impact on the operational activities of MSMEs. For example, the development of digital markets and online services will enable the empowerment of MSMEs when they are able to adapt to changes and developments that occur.

To support the government program to empower MSMEs in Indonesia, Lembaga Pengelola Dana Bergulir Koperasi Usaha Mikro Kecil dan Menengah atau LPDB KUMKM) from the Ministry of Cooperatives and SMEs is developed to support MSMEs to follow the development of existing technology and utilize digital technology in terms of marketing the products produced. LPDB KUMKM also encourages Indonesian MSMEs to be able to upgrade to MSMEs on a larger scale through the Kredit Usaha Rakyat (KUR) program with a fairly low interest rate of 6 percent. With low loan interest rates, it is expected that MSMEs might focus more on efforts to develop their business and improve their business competitiveness. This effort can be carried out by involving the banking industry in collaboration with MSMEs that have superior products and are oriented to the global market. Banks also have an important role in providing guarantees and lending to MSMEs of 20% of the total loans disbursed. The program certainly receives support from the Government, regulators and financial service actors, which is strengthened through the regulations stipulated in PBI no 17/12/PBI/2015. The regulation concern on the provision of credit or financing by commercial banks and technical assistance in the context of empowering MSMEs [8].

MSMEs empowerment in the Industrial Revolution 4.0 era is to encourage the motivation and desire of MSMEs to digitize and utilize social media as a channel of promotion. It is undeniable that MSMEs digital knowledge and literacy in Indonesia is still quite low. Due to this reason, activities such as training, internships, exhibitions are needed to empower MSMEs to increase MSMEs competitiveness. Several empirical studies were conducted for the purpose of knowing how the MSME empowerment strategy was carried out to increase MSME competitiveness. Nugroho and Andarini [9] suggest that one solution to poverty alleviation is through MSMEs empowerment. Facing the era of the Industrial Revolution 4.0, empowering MSMEs through empowering local wisdom is needed to implement to explore the potential and utilize the potential of the community such as community cultural traditions. For example, the culture and habits of the Javanese people who produce batik are a form of empowering MSMEs based on local wisdom.

The study conducted by Sularsih and Narsi [10] aims to investigate the strategies applied by MSMEs in facing the Industrial Revolution Era 4.0 by using qualitative methods with descriptive analysis techniques and involving MSME actors in the food and beverage sector registered with the Pasuruan Regency. The results of the study show that MSMEs in the food and beverage sector might focus on the Strength Opportunities strategy by maximizing strengths and taking advantage of opportunities to increase competitiveness in the Industrial Revolution 4.0 era. Efforts to increase the ability to adopt technology, determine strategic locations, and the availability of relatively cheap raw materials are needed so that MSMEs could survive and increase competitiveness.

Efforts to empower MSMEs certainly require support from various parties including the government, universities and stakeholders. The government's support and role in efforts to empower MSMEs can be carried out through several policies including improving the flow of goods and services, improving the quality of human resources, developing an innovation ecosystem, and incentives for investment in technology. The role of universities or higher education can be done through the application of the Tri Dharma of Higher Education which refers to aspects of teaching, research, and community service. In the field of teaching, universities must have a strong commitment to produce graduates who are ready to use in industry and society with adequate knowledge and skills. In the field of research, universities might contribute in research that provides solutions to problems faced by industry and society. In the field of community service, universities might focus on efforts to improve the welfare of the community through the application of science and art, providing expert assistance, and providing services to the community, especially MSMEs. Meanwhile, stakeholders have an important role in building institutions for the development of MSMEs towards a productive economy through expanding market share, increasing income, opening employment opportunities, and utilizing digital technology in every aspect of MSME operations.

### **Strategies to Improve MSMEs Competitiveness**

To increase competitiveness in preparing themselves to face the era of the industrial revolution 4.0, there are two essential things that MSMEs must pay attention to, namely high level of digital literacy and high product quality. High digital literacy is absolutely necessary to ensure the survival and increase the competitiveness of MSMEs in the industrial revolution 4.0 era with the high level of digital technology implementation in every aspect of organizational activities. To be able to compete, at least MSMEs must have internet capital in running a business and to take advantage of the adoption of digital technology, MSMEs must have sufficient digital literacy. Many MSMEs have quite high digital literacy and have switched to using digital technology such as e-commerce in selling and marketing their products.

The second key factor that should receive important attention is the high quality of the product. By utilizing digital technology, selling and marketing products through e-commerce platforms, MSMEs might expand their market share reach and compete with various products from other regions with competitive quality and prices. Facing this condition, of course MSMEs must have a competitive strategy that is right on target in order to survive and win the existing competition and product quality will determine the success of MSMEs in business competition.

Several strategies that might be done to increase the competitiveness of MSMEs are to focus on core competencies, the importance of mastering skills, focus on customer centric strategies, reduce production costs, and expand market share to the international level. The strategy to focus on core competencies is to produce products according to their core

competencies and outsource products outside of their core competencies. Mastery of skills is also needed to support a strategy to focus on core competencies, it can be explained that by focusing on core competencies, it is expected that MSMEs can improve human resource competencies related to several things such as skills, critical thinking skills, ability to analyze problems, and utilize technological developments effectively. right. For this reason, MSMEs should be able to build a conducive working atmosphere, increase investment in human resource development through continuous training and development programs so that human resources can upgrade their skills. One way that can be done is by collaborating with universities as knowledge-producing institutions through a knowledge transfer mechanism [11].

Another strategy that can be applied is to focus on the consumer as king. Consumers have the right to choose various products offered in the market. With the use of digital technology, consumers have more and more choices of products with attractive and varied price offers. To be able to win potential customers, MSMEs need to focus on customer centric strategies to be able to offer goods or services that attract the attention of potential consumers. Some of the strategies that can be done are through offering faster delivery services, convenience in getting after-sales service, ease in making payments and other transactions, to ease in obtaining information about products. To achieve this objective, MSMEs need to emphasize customer loyalty by providing customer support, branding strategies, and utilizing social media.

The strategy to reduce production costs might be done if MSMEs already have high productivity. Several things that need to be considered in supporting this strategy are improving product design and production processes continuously. MSMEs also focus on optimal communication and coordination among the parties involved in every aspect of MSMEs operations. The strategy to expand market share at the international level focuses on efforts to produce export-oriented products. Some specific strategies that might be conducted are developing strategic alliances and partnerships with other parties in other countries to gain a specific understanding of the needs and wants of the target market, demographic trends, tastes , to a new target market share spending pattern.

### **A Brief Review on MSMEs Competitiveness Study**

Anatan et al. [12] conducted a study to examine the effect of knowledge and innovation on the competitiveness of MSMEs in Indonesia. The research model being tested adopts the research conducted by Lee et al. [13] which examines the relationship between several variables, namely knowledge management practices, technological innovation and competitive advantage. The study was conducted on manufacturing companies in Malaysia and the results show that knowledge has a significant influence on technological innovation and competitive advantage. The study conducted by Lee at al. [13] also prove that technology innovation mediates the relationship between management practices and competitive advantage.

Research conducted by Anatan et al. [12] involved 43 respondents with a response rate of 53.75%. The results of the study show that there is a significant effect of knowledge on the competitiveness of MSMEs, while technological innovation and managerial skills do not have a significant influence on the competitiveness of MSMEs. This is due to the low mastery of technology and knowledge and skills possessed by MSME actors involved in the research. In this study, information was obtained that limited capital, low mastery of technology are the main challenges for SMEs in facing the Industrial Revolution 4.0 era. Meanwhile, the strategy to increase the competitiveness of MSMEs might focus on increasing the knowledge and skills of human resources through several programs such as training and development.

The study also presented the results of a literature review showing that the competitiveness of MSMEs in Indonesia is still quite low even when compared to other ASEAN member countries. Another challenge that must be resolved in order to increase the competitiveness of MSMEs in Indonesia is the low level of human resource productivity and the low level of quality control of MSME production. This has resulted in greater challenges that must be faced by Indonesian MSMEs when they want to expand their market specifically through the development of export-oriented products.

## 2 Conclusion

The industrial revolution 4.0 has an impact on the importance of digitizing MSMEs in order to survive and win the existing competition by improving the performance and competitiveness of MSMEs. To be able to achieve this goal, digital-based business transformation needs to be conducted and requires the support of two key factors, namely the level of digital literacy and high quality of products or services. Some strategies that can be done are to focus on core competencies, mastering skills, customer centric strategies, reduce production costs, and expand market share to the international level.

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