

THE INFLUENCE OF LOCAL GOVERNMENT SUPPORT ON SMES PERFORMANCE IN INDONESIA

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ABSTRACT

The objective of this study is to investigate of government support on the performance of SMEs. The Resource-Based View (RBV) is a theoretical framework used in strategic management to analyze how a company's internal resources and capabilities can become sources of sustainable competitive advantage. Government support for the performance of Micro, Small, and Medium Enterprises (SMEs) in Indonesia is crucial, especially in the context of post-pandemic economic recovery and strengthening competitiveness. The methodology adopted this study is explanatory research aimed at analyzing the impact of government support on the performance of micro, small, and medium enterprises (SMEs) in North Sumatra. The type of data used is primary data, collected through the distribution of questionnaires to 221 respondents. The analysis includes testing research instruments (inner model and outer model) and hypothesis testing (bootstrapping test), using Structural Equation Modeling (SEM) as the model. The findings of the study demonstrate that government support in terms of policy, financing, mentoring, and social programs significantly affects SMEs performance. Government support is crucial for the performance of SMEs in Indonesia, as it fosters business growth, which in turn enhances SME performance. Through these initiatives, local governments aim to improve SME competitiveness, strengthen the local economy, and create sustainable job opportunities. Such support is vital for SMEs to develop, compete, and make a greater contribution to the national economy. The implications of this research highlight the importance of government support in improving SME performance. While access limitations are generally within reasonable bounds given the capacity of each SME owner, effective business development and growth in the SME sector require substantial support. Running a business also necessitates aspects such as regulation, financing, mentoring, and social programs.

Keywords: Government Support, Performance, Structural Equation Modelling and SMEs.
JEL Codes : O38, L25, M21

1. Introduction

Micro, Small, and Medium Enterprises (SMEs) play a crucial role in Indonesia's economy. SMEs make a significant contribution to Gross Domestic Product (GDP) and employment, and support economic distribution across various regions, especially in less developed areas. Despite the vast potential of SMEs, this sector often faces challenges that hinder its performance, such as limited access to financing, lack of managerial skills, and marketing constraints (Melo et al, 2023; Alfarizi, 2023; Harahap & Irawan, 2022). The Indonesian government has recognized the importance of SMEs and has launched various initiatives and policies to support this sector. These programs include streamlining licensing, providing low-interest loans, skills training, and facilitating market access. Nevertheless, there are still

differences in the effectiveness and acceptance of these supports among SMEs (Suwaidi et al, 2020; Khotimah & Budi, 2020).

The issue is that there has yet to be a comprehensive study evaluating the extent to which government support truly contributes to the overall improvement in SME performance. Some SMEs may not fully utilize existing programs due to a lack of outreach or understanding. Additionally, emerging challenges such as digitalization and global market changes also impact how government support needs to be adjusted to remain relevant and effective. This research aims to explore the extent to which government support affects SME performance, focusing on aspects such as regulation, financing, mentoring, and social programs. By understanding the factors influencing the effectiveness of this support, this study hopes to provide recommendations for improving existing policies and programs, and to help SMEs utilize these supports optimally (Qalati et al, 2021; Santoso et al., 2022; Irawan, 2022).

Improving the quality of the workforce can be achieved through basic training, character development training, and advanced training. In the realm of human resource competencies, this involves knowledge, skills, attitude, and abilities in entrepreneurship. Competency development for human resources should not only focus on the business owners but also on their employees, and how this can subsequently impact SME performance. A significant form of government support includes providing social assistance, tax incentives, and credit restructuring. Research shows that these policies have a positive impact on SME development, especially during the COVID-19 pandemic, when many SMEs experienced a dramatic decline in revenue (Sugiri, 2020; Irawan, 2022; Maharani & Jaeni, 2021). Additionally, the government plays a role in offering entrepreneurship training and capital assistance, which has proven to enhance SMEs' ability to adapt to existing challenges (Teng, Wu & Yang, 2022; Utomo, 2024). Innovation and competency development are also crucial aspects of government support. Studies indicate that government support in improving accounting skills and innovation among SMEs can strengthen their competitiveness (Yudistira & Jesasta, 2022; Khotimah & Budi, 2020). Furthermore, educating SMEs about government policies and marketing strategies helps them better understand and utilize available programs, thereby improving their business performance (Suryaningrum, 2024).

Government policies focusing on digitalization are also a critical area. In the digital age, SMEs need to adapt to technology to enhance efficiency and competitiveness. Government support in this area includes training in digital technology use and access to necessary infrastructure (Kusnanto et al., 2022; Irawan, 2021; Mukhlison et al., 2022). This is highly relevant considering that many SMEs still face barriers in terms of capital access and quality of human resources (Liu & Sukmariningsih, 2021). Overall, government support for SMEs in Indonesia covers various aspects, including fiscal policies, training, and technological innovation. These efforts aim not only to recover the economy post-pandemic but also to ensure the sustainability and competitiveness of SMEs in the global market (Le et al, 2021; Sinaga et al., 2022; Suryawati, 2023). Thus, collaboration between the government, community, and SMEs is crucial to achieving these goals.

The government frequently develops policies and regulations that support SMEs, such as easing licensing requirements, providing legal protection, and offering tax incentives. For instance, the simplification of licensing and regulatory processes helps SMEs in establishing

and running their businesses (Ardiyani & Syafnita, 2021; Sari & Irawan, 2021). Various financing schemes and credit options are available for SMEs, including unsecured loans, interest subsidies, and loan programs from government-supported financial institutions. The People's Business Credit (KUR) program is a tangible example of this financial support (PramaisHELLa & Cahyono, 2018). Government agencies often provide mentoring and consulting services to assist SMEs with various business aspects, from management to strategic planning (Samira et al., 2023; Irawan, 2022). The government can also launch specific social and economic programs to support SMEs, including social assistance for businesses affected by disasters or economic crises (Sopha, Jie & Himadhani, 2021; Kurnianty & Sitorus, 2023).

2. Literature Review

2.1. Theoretical Framework

Resource-Based Theory (RBT), first introduced by Wernerfelt (1984) and further developed by Barney (1991), posits that the key to achieving sustainable competitive advantage lies in a firm's ability to acquire, develop, and utilize valuable, rare, inimitable, and non-substitutable (VRIN) resources. These resources can be tangible (e.g., capital, equipment) or intangible (e.g., knowledge, networks, brand reputation).

Firms achieve superior performance when they possess and effectively deploy unique resources that are difficult to imitate (Barney, 1991). Unlike large corporations, SMEs often lack strategic resources such as capital, technology, and managerial expertise. Therefore, external support from the government can serve as a critical complementary resource that enhances SMEs' internal capabilities. According to RBT, when government support (e.g., subsidies, training programs, infrastructure, or market access initiatives) is effectively absorbed and utilized by SMEs, it becomes a valuable and strategic asset that can boost their competitiveness and performance.

1.1 Small and Medium Enterprises (SMEs) and Their Performance

Small and Medium Enterprises (SMEs) play a vital role in promoting economic growth, employment, and innovation, especially in developing countries (Tambunan, 2019). SME performance is generally measured through financial indicators (profitability, sales growth), operational efficiency, market expansion, and innovation capacity (OECD, 2020). However, limited access to capital, markets, and technology continues to hinder their optimal performance. SMEs are the backbone of economic development in emerging markets, yet they often face structural barriers that require external support to overcome. (Beck & Demirguc-Kunt, 2006).

Several empirical studies have demonstrated the positive effects of government support on SME performance. For example: Zhang & Yang (2020) found that SMEs receiving financial and training assistance showed higher innovation and revenue growth. Aris (2021) revealed that tax breaks and easier licensing procedures increased SME survival rates during economic downturns. Hasan & Sofyani (2022) emphasized that the effectiveness of support also depends on SME capacity to absorb and implement assistance programs.

1.2 Government Support for SMEs

Government support refers to a set of policies, programs, and resources provided by the government to stimulate the growth and resilience of SMEs. These supports may include: a) Regulatory support, Simplification of business licensing and tax incentives; b) Financial support, Provision of loans, grants, and subsidies; c) Training and capacity building, Technical assistance, mentorship, and business education; d) Infrastructure and digital access, Public services and technology infrastructure to enhance competitiveness. According to Wibowo & Putra (2022), government involvement is essential to reduce market failure and help SMEs survive and grow in a competitive environment. Strategic policy intervention by governments is critical for the success and sustainability of SMEs (Storey, 2004).

2 Hypotheses Development

This conceptual framework in figure 1 explains that government support has a direct influence on improving SME performance. This support can take the form of pro-SME policies, training, financial assistance, and the provision of infrastructure and access to technology. SME performance is assessed based on aspects of business growth, efficiency, innovation, and competitiveness. In addition, this process can be influenced by moderating factors such as SMEs' ability to adopt technology (digitalization), which can strengthen or weaken this influence. It can also be influenced by mediators such as improving SMEs managerial capacity.

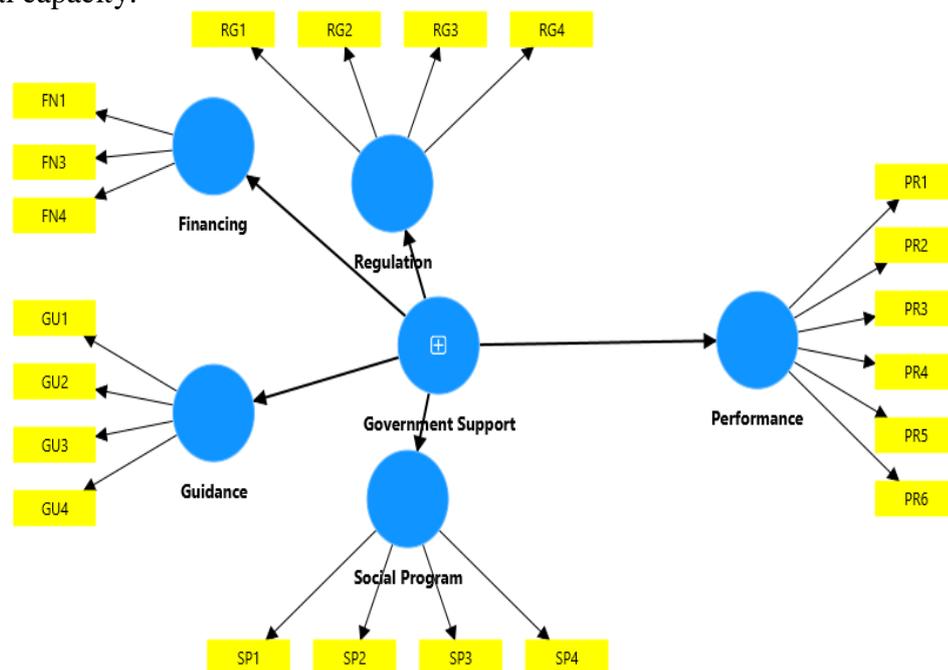


Fig.1. Conceptual framework

The Resource-Based View (RBV) is a theory in strategic management that emphasizes the importance of internal resources and capabilities as key drivers for achieving competitive advantage and organizational performance. Developed in the early 1990s by Jay Barney, RBV

has become one of the dominant approaches in business strategy studies. The Resource-Based View provides a useful framework for assessing and managing the resources and capabilities possessed by SMEs. By focusing on unique, rare, inimitable, and non-substitutable resources, SMEs can develop strategies oriented towards competitive advantage and enhance their performance in the market. The Resource-Based View (RBV) is a theoretical framework used in strategic management to analyze how a company's internal resources and capabilities can become sources of sustainable competitive advantage. This concept was first introduced by Birger Wernerfelt in 1984, emphasizing the importance of analyzing a company from the perspective of resources, rather than just products (Wernerfelt, 1984). RBV argues that companies with valuable, rare, difficult-to-imitate, and non-substitutable resources (known as VRIN) have the potential to achieve sustainable competitive advantage (Chang, 2023; Barthélémy, 2022). In the context of RBV, a company's resources include various assets, capabilities, organizational processes, company attributes, information, and knowledge held by the company (Barthélémy, 2022). The theory focuses on how companies can leverage their internal resources to create value and gain advantages in the market. For example, research indicates that effective management of information resources in financial institutions can enhance performance and profitability, aligning with the principles of RBV (Chang, 2023).

Government support for the performance of Micro, Small, and Medium Enterprises (SMEs) in Indonesia is crucial, especially in the context of post-pandemic economic recovery and strengthening competitiveness. Various policies and programs implemented by the government aim to improve SME performance, which is a vital sector in the national economy, absorbs labor, and reduces poverty (Alfarizi, 2023; Sarfiah et al., 2019). One significant form of government support includes providing social assistance, tax incentives, and credit restructuring. Research shows that these policies positively impact SME development, particularly during the COVID-19 pandemic, when many SMEs experienced a drastic decline in revenue (Sugiri, 2020; Maharani & Jaeni, 2021). Additionally, the government plays a role in offering entrepreneurship training and capital assistance, which has proven to enhance SMEs' ability to adapt to existing challenges (Utomo, 2024).

Innovation and competency development are also critical aspects of government support. Research indicates that government support in enhancing accounting competencies and innovation among SMEs can strengthen their competitiveness (Yudistira & Jesasta, 2022; Khotimah & Budi, 2020). Furthermore, disseminating information about government policies and marketing strategies helps SMEs better understand and utilize available programs, thereby improving their business performance (Suryaningrum, 2024). Government policies focusing on digitalization are also a key area. In the digital era, SMEs need to adapt to technology to improve efficiency and competitiveness. Government support in this regard includes training in digital technology usage and access to necessary infrastructure (Kusnanto et al., 2022; Mukhlison et al., 2022). This is highly relevant considering that many SMEs still face challenges in accessing capital and the quality of human resources (Liu & Sukmariningsih, 2021). Overall, government support for SMEs in Indonesia covers various aspects, including fiscal policies, training, and technological innovation. These efforts aim not only to recover the economy post-pandemic but also to ensure the sustainability and competitiveness of SMEs in the global market (Sinaga et al., 2022; Siregar & Irawan, 2021; Suryawati, 2023). Therefore,

collaboration among the government, the community, and SMEs is essential to achieving these goals.

The research hypothesis can be formulated as follows:

H: Government support has a positive and significant effect on SME performance

3. Research Methodology

This study is explanatory research aimed at analyzing the impact of government support on the performance of micro, small, and medium enterprises (SMEs) in North Sumatra. The type of data used is primary data, collected through the distribution of questionnaires to 221 respondents. The analysis includes testing research instruments (inner model and outer model) and hypothesis testing (bootstrapping test), using Structural Equation Modeling (SEM) as the model. Data was collected using a structured questionnaire distributed via online and offline channels. The questionnaire was divided into three sections: 1) Section A: Demographic and business profile; 2) Section B: Government support (measured using indicators such as financial assistance, training, policy support, infrastructure, digital access); 3) Section C: SME performance (measured by growth, profitability, innovation, and market expansion). All items were measured using a 5-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). A pilot test was conducted with 30 respondents to ensure clarity and consistency of the questionnaire.

Cronbach's alpha and Composite Reliability (CR) values above 0.7 were considered acceptable. The Average Variance Extracted (AVE) threshold was set at 0.5 to confirm convergent validity. All participants were informed about the purpose of the study, and informed consent was obtained. The responses were kept confidential, and participation was voluntary. The study adhered to research ethics standards as approved by Universitas Pembangunan Panca Budi.

3 Result

SMEs play a crucial role in the economy as they often serve as a source of employment, innovation, and local economic contribution. The government and various institutions frequently provide support and assistance to SMEs, including training, financing, and market access. This research describes the respondents' data based on specific criteria. This description provides an overview of the profiles and characteristics of the SMEs involved in the survey, offering better context about the variation and needs that may exist among SMEs operators.

Table 1. Type of business

type of business	Amount	Percentage
Micro	87	39.37%
Small	63	28.51%
Medium	71	32.13%
Total		

Source: Research Data, 2025

Table 1 illustrates the distribution of respondents based on business where the type of micro business is 87 respondents (39.37%), the type of small business is 63 respondents (28.51%) and the type of medium business is 71 respondents (32.13%). The conclusion is that the majority of SMEs are small businesses consisting of businesses with relatively small assets and annual turnover, often run by individuals or families.

Table 2. Business Sector

Business Sector	Amount	Percentage
Retail	71	32.13%
Services	55	24.89%
Food & Beverages	44	19.91%
Creative Industry		
Other		
Total		

Source: Research Data, 2025

Table 2 illustrates the distribution of respondents based on the business sector. Retail is 32.13% (71 respondents), this sector includes retail stores, boutiques, and goods buying and selling businesses. The services sector is 24.89% (55 respondents) which provides various services such as consultation, care, and other professional services. The Creative Industry is 19.91% (44 respondents) which includes businesses engaged in the arts, design, and media. Food & Beverages is 9.50% (21 respondents), this sector includes restaurants, cafes, and food processing businesses. Others are 13.57% (30 respondents) where this sector is a business that is not included in the above categories, such as agriculture and technology.

Table 3. Geographical Distribution

Geographical Distribution	Amount	Percentage
City	122	55.20%
Suburbs	52	23.53%
Rural	47	21.27%
Total	221	100%

Source: Research Data, 2025

Table 3 illustrates the distribution of respondents based on Geographical Distribution where businesses located in Urban areas are 55.20% (122 respondents) where businesses are located in large cities and economic centers. Businesses located in the Suburbs are 23.53% (52 respondents) where businesses are located in the suburbs. Businesses located in Rural Areas are 21.27% (47 respondents) where businesses are located in rural areas and outside the city.

Table 4. Duration of Business Operations

Duration	Amount	Percentage
Less than 1 Year	59	26.70%
1 - 3 Year	73	33.03%
4 - 10 Year	62	28.05%
More than 10 Year	27	12.22%

Source: Research Data, 2025

Table 4 illustrates the distribution of respondents based on the business operations of the business less than 1 year there are 26.70% (59 respondents) where the business has just started its operation. The age of the business 1-3 years there are 33.03% (73 respondents) - Businesses that have been operating for 1 to 3 years. The age of the business 4-10 years there are 28.05% (62 respondents) where businesses with longer experience in the market. The age of the business more than 10 years there are 12.22% (27 respondents) where businesses that have been operating for more than 10 years and are usually more stable.

Table 5. Application of Technology

Technology	Count	Percentage
Low	122	55.20%
Medium	52	23.53%
High	47	21.27%

Source: Research Data, 2025

Table 5 illustrates the distribution of respondents based on the application of low technology, there are 55.20% (122 respondents) where businesses use minimal or traditional technology. The application of medium technology is 23.53% (52 respondents) where businesses utilize technology in their daily operations, such as accounting software and online marketing. The application of high technology is 21.27% (47 respondents) where businesses adopt advanced technology and digital solutions in their operations.

Table 6. Income level

Income level	Count	Percentage
Less than Rp. 100 million	117	52.94%
100 - Rp. 500 million	77	35%
More than Rp. 500 million	21	9.50%

Source: Research Data, 2025

Table 6 illustrates the distribution of respondents based on annual income levels of less than Rp100 million, there are 52.940% (117 respondents) where businesses with relatively low annual income. Income levels of Rp100 million - Rp500 million are 35% (77 respondents) where businesses with medium income. Income levels of more than Rp500 million are 9.50% (21 respondents) where businesses with higher annual income. After analyzing the respondent description, the next step is to analyze the data quality by testing the inner and outer models. The following are the results of the analysis of the inner and outer models.

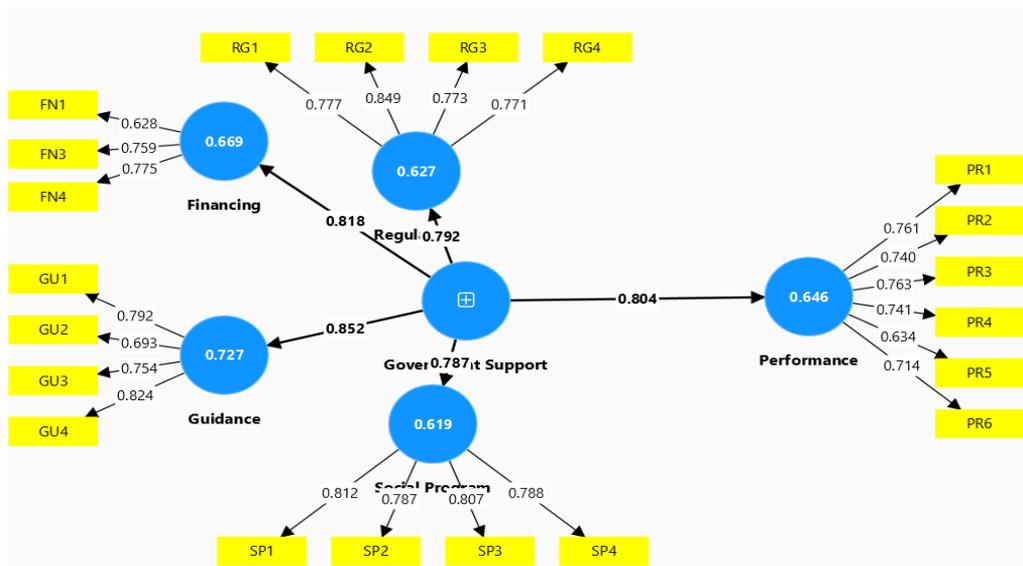


Fig 2. Outer Loading

Source: Research Data, 2025

Figure 2 shows the results of the test indicating that each item indicator has an outer loading value above 0.50, meaning all question items are considered valid. Similarly, the composite reliability values for all constructs are above 0.70. Therefore, no issues with reliability or unidimensionality were found in the constructed model. After the data meets the measurement requirements, the next step is to perform bootstrapping using SmartPLS 3.2.4. Bootstrapping is a procedure where new samples are repeatedly drawn from the original dataset of size nnn, generating NNN new samples. For each new sample, data points are drawn from the original dataset one at a time, up to nnn times (Efron & Tibshirani, 1998).

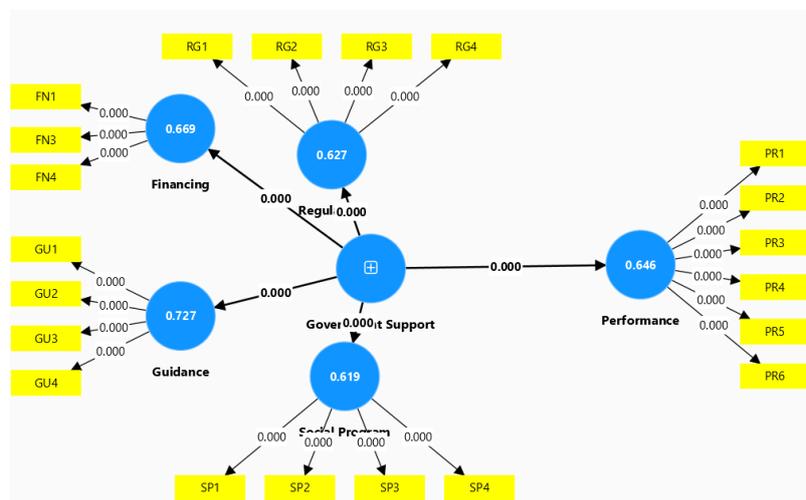


Fig 3. Bootstrapping Test

Source: Research Data, 2025

The hypothesis tested in this section is that government support has a positive impact on the performance of SMEs. The purpose of this hypothesis test is to determine whether government support influences SME performance. The bootstrapping results show a probability value of $0.000 < 0.05$, indicating that government support has a positive effect on SME performance. Therefore, Hypothesis 1 (H1) is supported.

4 Discussion

The hypothesis stating that government support positively affects the performance of SMEs has been validated, meaning that government support does indeed have a positive impact on SME performance. Specifically, the research findings conclude that government support through regulations can enhance SME performance. This support takes the form of policies aimed at developing the SME sector to boost potential and active participation in national development, particularly in economic activities, to achieve equitable development through job creation and income enhancement. The goals and guidance for small businesses include increasing the number of small enterprises and creating more resilient and independent businesses, allowing these economic actors to contribute to the national economy, enhance national competitiveness in the global market, and ensure balanced investment distribution across sectors and groups (Qalati et al, 2022; Rosyid, 2014).

Further government involvement is clearly outlined in Law No. 20 of 2008 on SMEs. This law includes general provisions, principles, and goals of empowerment, criteria, business climate development, business growth, financing and guarantees, partnerships and coordination of empowerment, administrative sanctions, and criminal provisions. Government collaboration includes the Department of Cooperatives, which oversees and regulates the progress of micro, small, and medium enterprises (SMEs), the Ministry of Industry and Trade, Bappenas, and State-Owned Enterprises (SOEs), which are financial institutions, both bank and non-bank. These efforts aim to make SMEs more independent and contribute to the equitable distribution of the national economy, particularly among small and medium-sized communities. Government support for SME development includes providing production equipment and other physical goods, requiring adequate, appropriate, and practical methods, mechanisms, and procedures that align with the needs of entrepreneurs (Nguyen et al., 2021).

The research results indicate that government support through funding programs, such as the People's Business Credit (KUR), has a positive impact on SME performance. Most respondents reported that easy access to financing and low-interest rates helped them expand their businesses and improve working capital. However, challenges related to administration and requirements, which are often considered cumbersome by SMEs, especially micro-enterprises, were noted. This suggests that while the program is effective, there is a need to simplify procedures and improve outreach regarding the benefits and access methods.

Government-sponsored mentoring and training programs also show a positive impact on improving managerial and technical skills among SMEs. Many SME operators feel more confident in managing their businesses after participating in the training. However, variations in training quality and the lack of ongoing training pose challenges. There is a need to develop training curricula that are more relevant to the specific needs of SMEs and to provide continuing education to support sustainable business development.

Overall, while government support has positively contributed to SME performance, there is room for improvement in the effectiveness and scope of this support. Addressing existing challenges and implementing the recommended measures are expected to help SMEs better utilize government support for sustainable growth and success. The growth of micro, small, and medium enterprises in Indonesia can open significant job opportunities and help strengthen the economy. In addition to providing employment, SMEs play a crucial role in economic development and community empowerment, as well as in creating new products and innovations for international markets. The role of SMEs in Indonesia's Gross Domestic Product (GDP) continues to increase annually, according to surveys and calculations by the Central Statistics Agency (BPS).

5. Conclusion

Government support for SME performance is indeed very strong. In the development of SMEs, access limitations are considered reasonable as they align with the capacity and capabilities of each SME owner. However, to achieve improvement and development in the SME sector, such support is absolutely necessary for running a business. Running a business requires various aspects such as regulation, funding, mentoring, and social programs. In other words, building an SME greatly benefits from assistance from external parties, including government support and human resource competence (HR). Competence in human resources is also crucial as a benchmark for the success and progress of micro, small, and medium enterprises, which can create new job opportunities for the surrounding community. Developing human resources with the ability to compete with other types of businesses is essential. Responsible, disciplined, skilled, and innovative human resources who can contribute valuable ideas are important for adding value to the workforce. This study emphasizes that although access limitations are often considered acceptable by SME actors, government intervention remains essential to accelerate business development—an aspect that has not been sufficiently highlighted in previous literature.

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