

# Proceeding APMAA Taiwan

*by dewi ratih*

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**PROFITABILITY DIFFERENCE TEST BETWEEN LOAN AND EQUITY AS  
FUNDING SOURCES FOR SMALL AND MEDIUM ENTERPRISES (SMEs)**

**Author:**

**Dewi Ratih, SE., MSM**

**Phone : +62 82 143 466 866**

**e-Mail : [dewiratih@widyakarya.ac.id](mailto:dewiratih@widyakarya.ac.id)**

**Address : Widya Karya University,  
Jl. Bondowoso No. 2 Malang, East Java, Indonesia**

## PROFITABILITY DIFFERENCE TEST BETWEEN LOAN AND EQUITY AS FUNDING SOURCES FOR SMALL AND MEDIUM ENTERPRISES (SMEs)

This research aims to find out whether there is a difference in the level of profitability as a proxy of business development which is seen from profitability ratios such as NPM (Net Profit Margin), ROA (Return on Asset), and ROE (Return on Equity) between the entrepreneurs of small medium enterprises who receive loan and those who do not propose loan or use their equity to develop their business.

The population in this research involved all entrepreneurs producing excellent products in small medium enterprises (SMEs) in Malang, East Java, Indonesia. Research samples were taken randomly, where 100 entrepreneurs stemmed from 50 entrepreneurs who received loan and the other 50 without loan or used their own money (equity) to set or develop their business. Data was obtained from questionnaire and particular document issued by Central Bureau of Statistics (BPS) or cooperative and Small Medium Enterprises (SMEs) in Malang, Indonesia. Data was calculated based on product moment correlation, while hypothesis on respondents who decided to use loan to develop their business and those who did not in relation to profitability was tested by means of chi square.

According to the analysis with chi square, it is concluded that there was a difference in the profitability level of small medium enterprises (SMEs) between entrepreneurs who decided to receive loan (95%) and those who used their own money in developing their business, which accounted for 75%.

This research was conducted to encourage the growth of Small Medium Enterprises (SMEs), which is believed to play an important role in the economy of Indonesia.

**Keywords:** *Small Medium Enterprises (SMEs), loan, equity, profitability*

### INTRODUCTION

Small Medium Enterprises (SMEs) is one of the economic sectors which plays an essential role in the growth of economy in Indonesia, especially in the

employment. In 2013, based on the data given by Deputy III of Funding, the Ministry of Cooperative and Small Medium Enterprises, there were about 57.18 million SMEs. This figure shows significant increases, compared to that in 2012 which accounted only for 5 millions. The 2008 report issued by the Ministry of Cooperative and Small Medium Enterprises implied that the contribution of SMEs to foreign exchange in commodity export experienced an increase by 28.49% or Rp. 40.75 trillions, accounting for the total percentage of national commodity export (20.17% or Rp. 183.76 trillions) ([www.depkop.go.id](http://www.depkop.go.id)). Statistically, it is shown that small enterprises in Indonesia are capable of contributing to employment in the country for as many as 90,896,270 workers (97.04%) of the total employment.

However, the majority of SMEs have not optimally developed due to particular problems. Based on the research conducted by Credit Bureau of Bank Indonesia, Surabaya in 2005 about the profile of SMEs in East java, it indicates that there were some certain aspects such as management, legality, equity, marketing, and production that still serve as barriers to the development and empowerment of SMEs. From the problems requiring special attention, equity, which is mainly linked to demanding requirement needed in receiving debt and putting collateral for proposed debt, is considered as the most frequent problem among entrepreneurs of SMEs. From the equity issue, it can be concluded that SMEs still have limited access to banks in terms of proposing loan due to complex and long institutional process, which may involve licensing process, retribution, and other requirements in the regulation that are set by the government and hamper the growth of SMEs.

Issue related to equity is quite complex and has been a concern among entrepreneurs. This is simply because of the policy which needs to be obeyed in proposing loan. Recalling that SMEs have been developing massively, it is essential that the phases of development of SMEs receive attention from the government. Small loan with less demanding requirement should be provided, as it is certainly needed by SMEs. This step can be initiated by giving the loan together with interest subsidy. By facilitating the loan in such a way, it is expected that the performance of SMEs improves.

In reality, SMEs have limited access to proposing loan from banks due to complex policy involving things related to retribution, licensing process, and other requirements set in the regulation issued by government which may halt the progress of SMEs. This condition encourages the government to take action, and on July 22, 2016, the Ministry of Cooperative and SMEs decided to give funding as much as 5 to 20 billions rupiah for loan. It was stated by the government that the government was open to any policy to minimize any difficulties related to funding faced by SMEs. Instead of grant, the funding for loan program was provided by Revolving Fund Management Agency (LPDB) or banks.

The government policy is aimed to overcome the existing condition related to small amount of loan given to SMEs, which may have impact on the progress of business activities such as the increase of product volume, product development, and marketing penetration and network. The loan is limited while the desire to expand business is mounting. This condition forces some entrepreneurs to propose loan from informal institutions which tend to charge higher interest, leading to weaker competitiveness among SMEs and high cost economy in this sector. Is the policy able to overcome issue on loan provision for SMEs? Is the loan provided able to increase profitability? To come to the solution for those questions, by selecting excellent products in Malang, Indonesia as a tourist destination, it is deemed important to conduct a research to investigate the correlation between the loan provided and profitability of SMEs, and whether there is significant difference in the profitability level between the business supported by loan and that without any loan given.

Profitability is defined as capability of entity to earn profit and support the growth of enterprises in both a long term and short term (source: Wikipedia). Profitability should receive more attention, as it is understood that businesses done must be profitable in order to keep them running. Without profit, it is difficult for companies/enterprises to propose loan to expand the business. This research was conducted by examining financial report of companies, which was done by analyzing financial ratios. The profitability of a company can be measured by correlating the profit gained from business activities with the operating asset (assets of a company that could be used to

earn profit). The ratio of profitability could be performed by using a variety of components in financial report, especially balance and profit and loss report. This measure could be performed for some periods of operation. This allows us to track down the growth of a company at certain time, whether it shows increase or decrease, and to find out the cause of such changes. Therefore, the ratio of profitability is often recognized as one of measures to examine the performance of management. The ratio of profitability used in this research involved Net Profit Margin (NPM), Return on Asset (ROA), and Return on Equity (ROE).

The measure on profitability took the respondents of SMEs. The small enterprises consisted of 0 worker, meaning that it involved no other workers, or it involved 1 to 19 workers. Medium enterprises involved 20 to 49 workers. In some previous research, it is mentioned that small and medium enterprises are generally categorized into independent enterprises, meaning that the enterprise is owned by an individual and is low-quality product oriented without any well-structured management and administration. The people involved in such a business come and go by, as they are usually not bound with contract and the enterprise scale is relatively limited.

The improvement in SMEs is not only determined by sufficient equity available, but it is also influenced by the equity management. Effectiveness of the equity management is determined by skills and working performance of the entrepreneurs of SMEs. Therefore, strong entrepreneurship is a must in a business. Three motives of friendship, achievement, and power are correlated to behavior and ideas. It is clear that there is a positive correlation between an individual who is achieving and the quality of entrepreneurship (Hidayat and Triwidodo, 2002). Meanwhile, a company is deemed healthy when it meets the standard in terms of liquidity, solvability, and rentability. All those three aspects could be measured when a company applies well-organized and systematic bookkeeping accordingly. Systematic bookkeeping could serve as the fundamental of measure of profitability level of each period, so that the growth of business could be controlled and evaluated.

## RESEARCH METHODS

The population in this research involved 215 entrepreneurs of excellent products of SMEs in Malang, Indonesia. The number of samples was 100 samples, in which 50 entrepreneurs received loan to help grow their business while the other 50 receives no loan. Samples were taken randomly, for the respondents were quite homogenous.

Variables used in this research were debt as independent variable and the level of profitability as dependent variable. Credit fund is defined as loan that has to be paid back within certain period of time. The credit fund used by the entrepreneurs of SMEs is provided by banks. The amount of the fund given was in Rupiah (IDR) with the following categories: high ( $>IDR10,000,000$ ), medium (ranging from  $IDR5,000,000$  to  $IDR10,000,000$ ), and low ( $<IDR5,000,000$ ).

Primary and secondary data were employed in this research. The primary data was obtained by interviewing and distributing questionnaire in 2015. Operational and financial activities were recorded in questionnaire filled by the respondents, while the interview was aimed to figure out the aspiration, opinion, and perception of the respondents which may be missed in the questionnaire. The secondary data was obtained from library research, in which the sources related to credit funding and entrepreneurship were required. Statistical reports issued by Central Bureau of Statistics and Cooperatives and SMEs in Malang were also obtained in order to get a general overview of respondents and small business.

Data process began with descriptive technique applied to give general overview of the profiles of respondents, the behavior, and the growth of enterprises based on the percentage of the respondents receiving loan or not. Correlation tested involved product-moment, partial and compound while the coefficient was used to determine the hypothesis. Moreover, Chi-square was employed to figure out whether there is a difference in profitability between the respondents who received loan and those who did not.

## **RESULTS AND DISCUSSION**

### **Characteristics of Respondents**

The respondents taken in this research were divided into two categories: the respondents who were helped with loan, who are then categorized in TYPE A and those who received no loan, who are categorized in TYPE B. Fifty respondents were taken randomly from each type of respondents.

It was shown that the majority of the respondents were males (94%). It implies that males serve as the breadwinner of the family. Of the two groups of respondents, 85% were within the range of 25 -56 years old, meaning that they were in their productive age and are quite independent to earn money on their own. There were about 46 entrepreneurs (46%) who were at their 35 years of age. Mostly, they finished their education at high school level (48%), while twenty-six respondents went to secondary school (26%), bachelor degree or diploma (10%), and the rest just finished primary school. It can be concluded that there is always a chance to develop the human resource. There may be two reasons why those earning their bachelor degree are willing to be involved in SMEs. They were likely to believe that the entrepreneurship they were involved in may bring them to a better future, or they may think that getting a job especially in government offices is too competitive nowadays.

It was shown that 98 % of respondents were married, while there were only 2 unmarried people (2%). It is quite common because this age group is considered mature enough to get married. This fact implied that the family they started encouraged them to earn more money for their family and future. Seeing those facts, it is clear that most of them (36%) chose to continue the business their parents had initially set up.

### **Profitability**

Whether or not a company has made an achievement could be mainly seen through how much profit it makes. In addition to the fact that profit is an indicator of competency of a company, profit is also considered as an element that contributes to the image building of a company which shows the prospect of the company in the future. It takes the effectiveness of managing the equity,

including the source of funding. Profitability can be defined as the competence of the company in gaining maximum profit. Efficiency and effectiveness of the company must be well maintained in order to bring profit to the company. In this research, the analysis of the change of financial ratios was performed to investigate the tendency related to the progress or regress of the financial performance in a company. When the tendency is figured out, financial management is able to determine new policy in financial management. The progress or regress of a company can be seen from the peaks and troughs of liquidity, solvability, and profitability in a company.

Business expansion can be seen from the profitability ratios such as NPM, ROA, and ROE. From all those ratios, there were 48 respondents in type A who received loan with varied amount of loan gaining medium and high increase of profit (32 SMEs and 15 SMEs, respectively). In type B, according to its classification of equity, there were 28 SMEs which experienced a medium increase of profit, and 9 SMEs saw a high increase of profit.

It can be concluded that respondents in type A performed better in developing their business than those of type B in terms of profitability change.

### **Hypothesis Testing**

To test how significant is the difference between the loan given and the growth of the business measured with the profitability ratios, the following correlation analyses were performed:

1. Product moment analysis was employed to find out the correlation between the change of profitability level and variables in the amount of loan. Correlation coefficient  $r = 0.7067$  was obtained. According to the test result, there was significant correlation with the significance level of 5%. It implies that the correlation between the change in profitability level and the amount of loan was quite significant.
2. From the compound correlation analysis which focused on the correlation between variable in the amount of loan and variable in the change of profitability level, multiple R value (compound correlation coefficient) = 0.8671 was obtained.

3. The result of coefficient of determination analysis ( $R^2$ ) for the variable in the amount of loan towards the change of profitability level showed  $R^2 = 0.7864$ .

Chi-square was employed in the research to find out whether there was significant difference between the respondents who received loan and those who did not. The result showed that there was difference between the respondents who received loan and those who did not, with the significance level of 5%. It was shown that 95% of respondents receiving loan gained more profit in their business, while there were only 78% of respondents without loan received gained increased profit. Chi-square was also applied to figure out the increase in the profitability in medium and high level between the respondents who received the loan and those who did not with the significance level of 5%. In other words, the respondents with the loan performed better in terms of their business growth than those receiving no loan.

### **Discussion**

The correlation between the respondents who received loan and the increase in profitability in SMEs in Malang implies that the loan given is very influential on the growth of business they run. The growth of business run by those receiving loan showed significant change compared to the business run by the respondents who did not receive any loan. This should encourage banks or institutions which provide credit to give more access for debtors to credit grant regulated in the credit policy. The hindrance to this program is the lack of reliable collateral and company legality. Therefore, the interference of government needs to be involved in terms of providing security through regional fund allocation or revolving fund which is circulated by local government, recalling that funding is considered as the main problem in SMEs.

The result of chi square test shows a significant difference between the respondents receiving loan and those who did not. It emphasizes that the higher amount of loan given to the entrepreneurs of SMEs could help their business grow faster than that without any loan. In other words, debtors proved that they were more able to show better profitability ratio than the entrepreneurs who received money other than loan to run their business.

## **CONCLUSION AND SUGGESTION**

### **Conclusion**

From the above analyses, it can be concluded that there was difference between the respondents who received loan and those who did not in relation to the growth of their business. There were 95% of respondents receiving loan experienced an increase in their profit, while there were only 78% of respondents without loan received who saw the profit increase in their business.

The loan given to the entrepreneurs helped their business grow well. It was strengthened by the result of chi square test which showed that there was a significant difference in the growth of enterprises between the respondents who received loan and those who did not.

### **Suggestion**

It is suggested that the entrepreneurs in SMEs should be given easier access to proposing loan with affordable requirement and lower interest rate. Therefore, the government is required to be involved by establishing special institutions providing credit security for the entrepreneurs of SMEs and funding support as interest subsidy. Intensive training in entrepreneurship should be taken into account in addition to the financial support given, which should be the responsibility of both the government and educational institutions to give assistance in such an area in order to sharpen the sense of entrepreneurship through appropriate entrepreneurship education and training.

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