

A COMPARATIVE STUDY OF SMALL AND
MEDIUM ENTERPRISES'S (SMEs) BUSINESS
SUCCESS FACTORS BETWEEN MALAYSIA AND
INDONESIA: ENVIRONMENT EMPHASIS

BY

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A thesis submitted in fulfilment of the requirement for the
degree of Master of Economics

Kulliyyah of Economics and Management Sciences
International Islamic University Malaysia

DECEMBER 2020

ABSTRACT

Small and Medium Enterprises (SMEs) in Malaysia and Indonesia contribute significantly towards the nations' economies in terms of gross domestic product (GDP), employment creation, poverty alleviation and economic growth. However, to ensure the long-run survival and accelerated growth of SMEs, the most important factors for their business success should be identified and studied. This present study aims to examine the relationship between business success factors and SMEs performance in Malaysia and Indonesia. This study also targets to explore the similarities and differences in terms of business success factors between Malaysia and Indonesia and to what extent environmental preservation measures impacted their SMEs performance. For this purpose, this research employs regression analysis and relates the findings with economic theories and puts more emphasis on environmental indicators. It was found that for Malaysia, financial management, credit accessibility and prospective human resource challenge have a significant and positive correlation with SMEs' business success. Specifically, in the Indonesian context, it was portrayed that environment measure and environment initiatives' benefit correlate positively and significantly with SMEs' performance. For prospective ICT challenge, it was shown to have a significant and positive correlation with SMEs' performance for both countries. Finally, this study offers several policy recommendations for policymakers and suggestions for future research.

خلاصة البحث

تُسهّم الشركات الصغيرة والمتوسطة في ماليزيا وإندونيسيا في دعم مؤشرات الاقتصاد الوطني من مثل الناتج المحلي الإجمالي، وخلق فرص العمل، والتخفيف من حدة الفقر، والنمو الاقتصادي، ولضمان الاستمرار والنمو السريع لهذه الشركات يجب تحديد أهم العوامل المتعلقة بنجاحها ودراستها؛ لذا يهدف هذا البحث إلى استكشاف عوامل نجاح الشركات الصغيرة والمتوسطة في ماليزيا وإندونيسيا، وتمييز التشابه والاختلاف في عوامل النجاح بين الدولتين، ومدى تأثير تدابير الحفاظ على البيئة على أداء هذه الشركات، وقد توّسلّ البحث تحليل الانحدار لربط النتائج بالنظريات الاقتصادية، مع التركيز على المؤشرات البيئية، وبيّنت نتائج البحث في السياق الماليزي أن الإدارة المالية، وإمكانية الوصول إلى الائتمان، والتحدي المحتمل للموارد البشرية؛ ترتبط كلها بعلاقة كبيرة معنوية مع نجاح الأعمال التجارية للشركات الصغيرة والمتوسطة، أما في السياق الإندونيسي فتبيّن أن تدابير حماية البيئة والمبادرات البيئية ترتبط بعلاقة إيجابية معنوية مع أداء الشركات الصغيرة والمتوسطة، كما اتّضح أن تقانة المعلومات والاتصالات ترتبط بعلاقة إيجابية كبيرة مع أداء الشركات الصغيرة والمتوسطة في البلدين، وعليه؛ يُقدّم هذا البحث عددًا من التوصيات لصانعي السياسات ومقترحات للأبحاث المستقبلية.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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ACKNOWLEDGEMENT

In the name of Allah, the Most Gracious, the Most Merciful. “... *And if you should count the favors of Allah, you could not enumerate them*” (Al-Quran: 14:34). All praise is due to Almighty Allah for graciously giving me numerous bounties to complete my master’s thesis. I would humbly express my heartfelt gratitude to everyone who have contributed towards the completion of this thesis.

Firstly, I would like to express my deep and sincere appreciation to my research supervisor, Prof. Dr. Moha Asri Abdullah, for providing invaluable guidance throughout this research. His dynamism, wisdom, sincerity and motivation have deeply inspired me. It was a great privilege and honor to work and learn under his guidance. I am extremely grateful for what he has offered me. I would also like to thank him for his assistance, empathy, and patience. Besides my supervisor, I would like to thank my examiner, Assistant Professor Dr Mohamed Asmy Bin Mohd Thas Thaker for his encouragement, insightful comments and critical questions.

I am extremely grateful to my parents, Musa Malik and Rohana Talib for their love, prayers, caring and sacrifices for educating and preparing me for my future. I am very much thankful to my siblings; Hafiz, Afeefah, Amirah and Adlina for their love, understanding, prayers and continuing support to complete this research work. I also want to express my thanks to my sister in law and brother in laws for their support and valuable prayers.

I would also like to thank my respectful lecturers that I treasure so much for educating and nurturing me well. Thank you for your valuable knowledge and life lessons. Indeed, you provided me with the tools that I needed to choose the right direction and successfully completed my academic requirement. I wish to express my appreciation and thanks to all administrative staff at Department of Economics, Kuliyyah of Economics and Management Sciences (KENMS) Postgraduate Office, Centre for Postgraduate Studies (CPS), Darul Hikmah Library staff, security personnel, Mahallah Ameenah’s office staff and all facilities providers within IIUM, thank you for your kindness towards me.

I would like to acknowledge my friends and course mates at Kuliyyah of Economics and Management Sciences KENMS, International Islamic University Malaysia (IIUM) as well as my comrades from Harmoni IIUM Club and IKRAM for their wonderful collaboration and assistances. You supported me greatly and were always willing to help me. I would like to specifically mention my best friends; Afiqah, Diyana, Hidayah, Hanis, Silmi, Khadijah, Hasya, Sofia, Alyaa and Zulaikha for your genuine support and motivation given throughout my Master journey. Not to forget, I want to thank my naqibah, fellow usrah mates and all sisters who joined my sisters’ circle for your prayers and constant encouragement.

Furthermore, my sincere appreciation also goes to the research teams from International Islamic University Malaysia (IIUM), Universitas Darussalam Gontor

(UNIDA), and Sultan Agung Islamic University (UNISSULA), Indonesia that provided me with the data and information used in this research. I hope this dissertation can benefit various parties in promoting and achieving sustainable development for SMEs industry in Malaysia and Indonesia. Last but not least, my gratitude goes to all the people who have supported me to complete the thesis directly or indirectly.

TABLE OF CONTENTS

Abstract	ii
Arabic Abstract	iii
Approval Page.....	iv
Declaration	v
Copyright Page.....	vi
Acknowledgment	vii
Table of Contents	ix
List of Tables	xi
List of Abbreviations	xii
CHAPTER ONE:INTRODUCTION	1
1.1 Background of the Study	1
1.2 Problem Statement.....	4
1.3 Research Questions.....	6
1.4 Research Objectives.....	6
1.5 Significance of Research	7
1.6 Limitations and Scope of Study.....	8
1.7 Organisation of Thesis	8
CHAPTER TWO:LITERATURE REVIEW.....	9
2.1 Introduction.....	9
2.2 Definition of Smes	9
2.3 Smes’ Business Success Factors.....	11
2.4 Determinants of Business Success.....	14
2.4.1 Financial Management	14
2.4.2 Credit Accessibility	17
2.4.3 Environmental Measures.....	20
2.4.4 Prospective Challenges Factors	25
2.4.4.1 Prospective Human Resource Challenges	25
2.4.4.2 Prospective ICT Challenges	28
2.5 Research Gap	30
2.6 Research Framework	31
2.7 Conceptual Framework.....	33
2.7.1 Financial Inclusion Theory	33
2.7.2 Equimarginal Principle.....	34
2.7.3 Human Capital Theory	35
CHAPTER THREE:RESEARCH METHODOLOGY	37
3.1 Introduction.....	37
3.2 Research Design	37
3.2.1 Descriptive	37
3.3 Research Methodology	38
3.4 Population of Study	38
3.5 Data Collection Method.....	39

3.5.1 Data Sources and Selected Questionnaires	39
3.6 Sampling Methods	40
3.7 Data Analysis Methods.....	40
3.7.1 Descriptive Analysis	41
3.7.2 Factor Analysis	41
3.7.3 Reliability Test.....	42
3.7.4 Multiple Regression Analysis	43
3.7.5 Economic Analysis.....	44
CHAPTER FOUR:RESULT AND ANALYSIS	45
4.1 Introduction.....	45
4.2 Profile of Owners/Managers.....	45
4.3 Profile of the Businesses.....	48
4.4 Data Screening.....	51
4.4.1 Missing Data	52
4.5 Exploratory Factor Analysis	53
4.6 Modification of the Model.....	60
4.7 Regression Analysis.....	61
4.7.1 Financial Management and SMEs Business Success.....	62
4.7.2 Credit Accessibility and SMEs Business Success	63
4.7.3 Environment Measure and SMEs Business	65
4.7.4 Environmental Awareness and SMEs Business Success	66
4.7.5 Environment Initiatives' Benefit and SMEs Business Success ...	68
4.7.6 Prospective ICT Challenges and SMEs Business Success	69
4.7.7 Prospective Human Resource Challenges and SMEs Business Success.....	70
CHAPTER FIVE:CONCLUSION AND POLICY RECOMMENDATIONS.....	73
5.1 Introduction.....	73
5.2 Concluding Thoughts	73
5.3 Managerial Implications	75
5.4 Policy Recommendations for Malaysia	76
5.4.1 Financial & Management Support: Management Improvement.....	76
5.4.2 Financial Support: Loan, Funding and Credit Guarantee support	77
5.4.3 Management Support: Human Resources Support	77
5.5 Policy Recommendations for Indonesia	78
5.5.1 Environmental Measure: Campaign on Affordable Environment Measures and Profitability	78
5.5.2 Management support: Support for business transaction & expansion	78
5.6 Policy Recommendations for Both Countries	78
5.6.1 Knowledge Support: Training on Information and Communications Technology (ICT) Development	79
5.7 Future Research	79
REFERENCES.....	80

LIST OF TABLES

Table 2.1 Definition of SMEs in Malaysia	10
Table 2.2 Definition of SMEs in Indonesia	11
Table 2. 3 Business Success Indicators	14
Table 2.4 Financial Management Indicators	17
Table 2.5 Credit Accessibility Indicators	20
Table 2.6 Environmental Measures Indicators	25
Table 2.7 HR Prospective Challenge Indicators	28
Table 2.8 ICT Prospective Challenges Indicators	30
Table 4.1 Malaysian and Indonesian Respondents' Profile (Gender, marital status and age)	46
Table 4.2 Malaysian and Indonesian Respondents' Profile (Highest educational attainment, religion and business expertise prior to opening own business)	47
Table 4.3 Malaysian and Indonesian SMEs' Profile	51
Table 4.4 KMO and Bartlett's Test	54
Table 4.5 Rotated Component Matrix (Malaysia)	55
Table 4.6 Rotated Component Matrix (Indonesia)	58
Table 4.7 Regression Table for Malaysia	61
Table 4.8 Regression Table for Indonesia	61
Table 5.1 Comparison of variables on the success of SMEs between Malaysia and Indonesia	74

LIST OF ABBREVIATIONS

BEIS	Business, Energy and Industrial Strategy
BNM	Bank Negara Malaysia
CFA	Confirmatory Factor Analysis
EFA	Exploratory factor analysis
EMS	Environmental Management System
FIs	Financial institutions
GDP	Gross domestic product
HR	Human resource
HRM	Human resource management
ICT	Information, communication and technology
IUM	International Islamic University Malaysia
IOTs	Internet of Things
KMO	Kaiser-Meyer-Oklin
LCs	Large companies
MEMA	Monetary environment management accounting
MIEs	Microenterprises
MITI	Ministry of International Trade and Industry
MSMEs	Micro, small, and medium enterprises
MPC	Malaysian Productivity Centre
NGOs	Non-government organisations
OECD	Organisation for Economic Co-operation and Development
PCA	Principal component analysis
PUNB	Permodalan Usahawan Nasional Berhad
ROSCA	Rotating Savings and Credit Association
SDGs	Sustainable Development Goals
SMEs	Small and medium enterprises
SPSS	Statistical Package for the Social Sciences
UK	United Kingdom
UMY	Universitas Muhammadiyah Yogyakarta
UNIDA	Universitas Darussalam Gontor
UNISSULA	Universitas Islam Sultan Agung

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Across the globe, the entire business establishment has been dominated by small and medium enterprises (SMEs), especially in developing countries. SMEs contribute significantly towards nations' economies in terms of gross domestic product (GDP), employment creation and economic growth. From African to Asian continent, SME is one of the key instruments in inclusive development which does not leave any segments of societies behind. SMEs assist in poverty alleviation and inequality reduction within the countries. United Nation had highlighted SMEs as a key priority area for attaining the Sustainable Development Goals (SDGs) due to SMEs significant impact to broader social economics objectives, including the creation of jobs (Liu, 2017).

Due to outstanding benefits and future great opportunities created by SMEs, Malaysia, and Indonesia place great emphasis on SMEs in their policies as SMEs continue to become the backbone of their economies. In Malaysia, SMEs continue to demonstrate their pivotal role in boosting economic growth as they contributed RM435.1 billion, which is equivalent to 37.1% to the nation's GDP in 2017.

Malaysian SMEs remains unwavering as they are responsible for 17.3% of overall exports in 2017 and 66.0% of overall employment in the same year (SME Annual Report 2017/2018). Recognising its vital contribution to the national economies, various ministries and agencies exert a concerted effort to support the development of SMEs and assist in accelerating their growth.

Similar to Malaysia, the Indonesian government is also committed in the development of SMEs as it is indispensable in boosting domestic demand and spearhead national socio-economic agenda (Asian Development Bank, 2018). Statistics provided by Ministry of SMEs and Cooperatives in 2017 shows that MSMEs encompass approximately 99% of the entire business establishments in Indonesia whilst contributing 58.08% to nation's GDP as well as 15.73% export of the country. It is also visible across diverse industries including agriculture, manufacturing, services and others. Majority of Indonesian SMEs come from the agricultural - based sector which signifies their 'local' significance for rural economic development.

There are several issues related to SMEs that the author thinks to need more attention. In terms of financial management, Mohd Alwi and Sulaiman (2019) claimed that majority of their Malaysian SME respondents are operated by their owners hence viewed that it is of lesser necessity to possess a proper accounting system. In addition, they aver that the absence of proper record books, the firms faced difficulties with preparing its financial statements. Meanwhile, in Indonesia, Yusti and Faradisi (2019) uncover that approximately more than 50% of their respondents rarely and never prepare their annual budget, monthly budget and utilise financial statements to make a decision, respectively. Both findings denote the low quality of financial management in Malaysian and Indonesian SMEs.

In terms of credit accessibility, Mohd Thas Thaker et al. (2019) cited Abdullah et al. (2010), emphasized that merely small proportion of SMEs in Malaysia can secure financing from financial institutions. Despite the government directives since existing various financial institution did not seem to make it a reality. In 2012, a survey of 200 Java's SMEs uncovered that the second most significant obstacles for them are access to finance (Iriayanti, Maya and Anton Mulyono Azis, 2012). International Labour

Office (2019) claimed that numerous SMEs in Indonesia are not yet bankable either due to lack of financial and managerial capability or non-transparent financial management.

Besides, Yacob et al. (2018) uncovered that Electrical and Electronics Manufacturing SMEs in Malaysia paid less attention to involvement in green technology that will improve their sustainable green practices. Another study in Malaysia discovered that merely 14% of SMEs in Klang Valley always utilise financial information for calculating environmental costs and making a decision (Mohd Alwi and Sulaiman, 2019). In Indonesia, Fatimah, Biswas, Mazhar and Islam (2013) claimed that majority of the SMEs in their research generates more pollution and not environmentally efficient because of lacking in waste management and advanced technology.

In terms of human resource challenge, Baron (2003) avers that the human capital management that is not effective entail the downfall of numerous SMEs. Among the factors that caused the productivity issues within Malaysian SMEs which had been discovered by Malaysian government includes overly emphasizing on over hiring unskilled workers vis-à-vis business's competitiveness and long-run sustainability (Kaliannan, Abraham and Ponnusamy, 2015). Meanwhile, Dros et al. (2002) revealed that Indonesia was placed lowest in utilising training as a medium for rewarding their staffs as well as most lacking in current training investment to enhance technical skills.

In the case of information, communication and technology (ICT), Lim (2006) mentioned that most Malaysian SMEs aware that ICT is significant towards their companies' performance and productivity. However, ICT systems' implementation and maintenance are constrained because of the inability to manage, lack of experts in ICT's project management and owing to high staff turnover. In Central Java of Indonesia, the largest obstacle to respondents in Internet usage is the absence of connection or the still

high internet connection's cost for them. Not only that, almost the majority of them do not own business websites (Untari and Sanjaya, 2013).

Due to these worsening issues faced by SMEs in both countries, this study opts to discover the key business success factors for them. In the case of Malaysian and Indonesian SMEs, several business success factors have been identified which include financial management, accessibility to credit, environmental measures, prospective human resource (HR) challenges, and prospective information, communication and technology (ICT) challenges. Environmental measures are one of the factors that are hardly found in works of literature on SMEs business success factors in both countries. In this study, regression analysis is undertaken, and the results are discussed using several economic theories. Financial inclusion theory will be used to analyse accessibility to credit factor; human capital theory will be utilised to discuss in-depth on the factors pertaining to financial management, prospective human resource challenges, and prospective technological improvement challenges; and equimarginal principle theory will be used to dissect the environmental measures factor. Ultimately, this study delineates the comprehensive comparative analysis of SMEs business success factors between Malaysia and Indonesia.

1.2 PROBLEM STATEMENT

Despite the remarkable impacts that SMEs had made in both countries, they also face problems that limit their potential and further contribution towards the nation. Despite the merits brought by MSMEs, few limitations hinder the acceleration of their business growth and success. Firstly, the rate of jobs lost is higher in small firms. Apart from having bigger potentials to provide more employment, it is also synonym with job destruction (Davis et al., 1993) as cited in Fanta (2015). Small businesses are more

fragile and unstable compared to large firms, and the former will be forced to lay off some of their workers during the recession. Secondly, in a country where there is a low level of ease in doing business, it might deter rural people from venturing into business. The financial constraints due to difficulties of getting loans for the unbankable people occurs because of lack of government support. In this case, although they have products to sell, a financial constraint might lead them to not getting access to the market.

Furthermore, Chong (2012) claimed that the rate of failure is getting higher. Nevertheless, various support and assistance from the authorities in the case of Malaysia. The reality in Malaysia depicts that SMEs' failure rate is alarmingly high at approximately 60% which urge for absolute attention from the authority, practitioners, related agencies as well as academia (Nordin, Hamid & Woon, 2011; Chong, 2012; Husin & Ibrahim, 2013 as cited in Rahman et al., 2019).

According to Tambunan (2011), micro, small and medium enterprises (MSMEs) are frequently hindered the growth and the efficiency of businesses due to many factors, inclusive of institutional limitation. On top of that, Indonesian SMEs faced several problems such as lack of skills, inadequate capital and problems in business development (Kementerian KUKM & BPS, 2004). Indarti and Langenberg (2004) aver that SMEs in Indonesia are being put in a vulnerable position due to rising business competition from large and modern competitors

Both worrying circumstances in the two countries urge for the study of business success factors to unleash the real potential of SMEs. Although numerous works of literature and studies had been conducted pertaining to this topic, not many are doing comparative study accompanied by economics combined with an emphasis on environmental indicators. The author believes that this study can assist in exploring the

business success factors in-depth and its mechanisms to facilitate the SMEs owners and relevant stakeholders in better decision making.

1.3 RESEARCH QUESTIONS

1. What is the relationship between business success factors and SMEs performance in Malaysia and Indonesia?
2. What are the similarities and differences in terms of business success factors between Malaysia and Indonesia?
3. To what extent environmental preservation measures impacted SMEs performance in Malaysia and Indonesia?
4. What are the recommended policies for SMEs in Malaysia and Indonesia?

1.4 RESEARCH OBJECTIVES

The primary aim of this research is to assess the business success factors of SMEs in Malaysia and Indonesia. Then make a comparative analysis of the results of the study to determine the most significant SMEs' business success factors for both countries.

Hence, the sub-aims of the research are delineated as follows:

1. To determine the relationship between various business success factors and SMEs performance in Malaysia and Indonesia.
2. To explain the similarities and differences between business success factors in Malaysia and Indonesia.
3. To assess the impact of environmental measures on SMEs business performance in Malaysia and Indonesia.
4. To propose policy recommendation based on the findings for both countries.

1.5 SIGNIFICANCE OF RESEARCH

SMEs play a crucial role in realising a better future for Malaysia and Indonesia. SME Masterplan (2012-2020) for instance, focusing on speeding up Malaysia's SMEs growth towards attaining the status of the high-income nation by 2020 (SME Annual Report 2017). The government of Indonesia highlights the SMEs role as the key driver for social inclusion and economic growth (Organisation for Economic Co-operation and Development (OECD) Report 2018). This paper aspires to bring significant benefits to relevant parties or stakeholders involved in SMEs sustainable growth mission.

Firstly, SMEs entrepreneurs attain better understanding of factors that significantly affect business success, particularly in Malaysia and Indonesia, which are critical for their businesses' continuity and growth in the long term. Secondly, academicians and researchers can benefit from comparative analysis as it identifies and explains the similarities and differences between SME business success factors across societies. Comparisons can entail exciting insights, discovering knowledge gap hence presenting a new perspective for accelerating SMEs growth in both countries, in the future.

Thirdly, as environmental measures and sustainable development is widely getting attention, this paper will contribute to depicting the impact of SMEs' environmental preservation measures on their financial performance, from both countries' perspectives. Although environmental initiatives can bring the greater cost to SMEs, this paper will shed light on the long term as well as the short term on hidden positive impacts on the firm performance. Finally, it may facilitate the policymakers in understanding the SMEs issues and improve their decision making. This paper will end with several policy suggestions that aspire to provide solutions for the prevailing failures or stagnation issues of SMEs in both countries.

1.6 LIMITATIONS AND SCOPE OF STUDY

The study includes only registered SMEs in Malaysia and Indonesia, according to the definition stated above. By utilising specific selection methodology, questionnaires were circulated to SMEs managers and owners in the Klang Valley area. For Indonesia, questionnaires were distributed to the same target profession in East Java and Central Java province. This method implies that the findings are restricted to the SMEs in the stated geographical location only, hence limiting the primary aim of this study, which is to evaluate the impacts of relevant determinants on SMEs success across both countries. In terms of time frame, it just focuses on the 2018-2019 phase.

1.7 ORGANISATION OF THESIS

This thesis is organised into five chapters. The first chapter covers the background of research, research objectives and its questions, problem statements and significance of this particular study. The second chapter reviews previous works of literature, commencing with the review of previous empirical findings from pieces of literature relevant to factors that determine SMEs business performance, in both countries as well as other countries. This chapter also outlines the explanation of financial inclusion theory, human capital theory and equimarginal principle; these theories are discussed in relation to business success factors. The third chapter will include the research methodology, research design, data collection method and data analysis method used in this study. The fourth chapter involves data analysis, results in interpretations from economic perspectives, and significant findings' discussion. The fifth chapter concludes this research and presents several policy recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter commences with the definition of SME concept, followed by business success indicators for SMEs. It will then delve deeper into determinants of SMEs' business success with evidence from real-world cases in Malaysia and Indonesia. Finally, this chapter will delineate the theoretical framework for this study which includes several economic theories from development economics and environmental economics.

2.2 DEFINITION OF SMES

Researchers primarily defined SME in regard to the socio-economic development of each country. Hence, there is no consensus on a single definition of SME. An SME in the United States is a business with 500 or fewer workers (Cavusgil, Knight & Riesenberger, 2008) whilst an SME in Taiwan is a business that hires 650 employees or less (Lin & Chaney, 2007). Chittithaworn, Islam, Keawchana and Muhd Yusuf (2011) claimed that Thailand had categorised the type of SMEs according to the value of the assets of each enterprise and number of full-time workers.

In the case of Malaysia, SME Corporation Malaysia (SME Corp Malaysia) revised its SME definition in January 2014, which was established on quantitative criteria such as sales turnover, number of employees, total capital or total assets. The definition differs according to the types of the sector as SME Corp Malaysia differentiates between manufacturing sectors and non-manufacturing sectors. For

example, a small business in the non-manufacturing industry refers to a company with five to less than 30 employees and sales turnover ranging from RM300, 000 to less than RM3 million. On the other hand, a small business in the manufacturing sector is a company with five to less than 75 employees and sales turnover ranging from RM300, 000 to less than RM15 million (SME Corp Malaysia, 2018). This definition is further shown in Table 2.1.

Table 2.1 Definition of SMEs in Malaysia

Category	Micro	Small	Medium
Manufacturing	Sales turnover of less than RM300,000 OR Employees of less than 5	Sales turnover from RM300000 to less than RM15 million OR Employees from 5 to less than 75	Sales turnover from RM15 million to not exceeding RM50 million OR Employees from 75 to 200
Services and other sectors	Sales turnover of less than RM300000 OR Employees of less than 5	Sales turnover from RM300,000 to less than RM3 million OR Employees from 5 to less than 30	Sales turnover from RM3 million to not exceeding RM20 million OR Employees from 30 to 75

Source: SME Corp Malaysia (2018)

In the context of Indonesia, the 2008 Indonesian Government Law No. 20 defines a small business as an enterprise entity which possesses net worth between IDR 50 million and less than IDR 500 million excluding buildings and land, with yearly sales turnover from between IDR 300 million and less than IDR 2.5 billion. On the other hand, the criteria of the medium enterprise include net worth between IDR 500 million and less than IDR 10 billion excluding buildings and land, with yearly sales turnover between IDR 2.5 billion and less than IDR 50 billion (Suryani, Iramani, & Lindiawati, 2017). Sembiring (2008) cited the same Indonesian Government Act, which includes

the definition for micro-enterprise which is a company that possesses net worth less than IDR 50 million and total yearly sales less than IDR 300 million. This definition differs from Malaysia's definition as it does not consider the number of employees as one of the indicators. This definition is further shown in Table 2.2.

Table 2.2 Definition of SMEs in Indonesia

Category	Micro	Small	Medium
Net Worth/ Assets (excluding buildings and land)	Less than IDR 50 million	More than IDR 50 million to less than IDR 500 million	IDR 500 million to < IDR 10 billion
Total Annual Sales	Less than IDR 300 million	IDR 300 million to < IDR 2.5 billion	IDR 2.5 billion to < IDR 50 billion

Source: Indonesia Government Law No. 20 (2008)

2.3 SMEs' BUSINESS SUCCESS FACTORS

Various researches have been conducted to assess the business success factors of SMEs across the years and regions. This section will delineate the business success indicators extracted from previous empirical researches (refer to Table 2.3).

A study conducted by Vilkinas, Cartan and Saebel (2011) described 20 criteria for business success which include customers' satisfaction, profit and increasing demand for products indicated by the number of customers. They ranked the mean importance of the criteria based on the perspectives of business owners in Australia. Even though the businesses are not all considered as SMEs, the criteria are still applicable and relevant for this type of business due to its similar nature. Dut (2015) added that the overall improvement of business and production cost could also act as a measure of success of SMEs, particularly in the Vietnamese context.

Ahmad and Seet (2009) examined business success via the perception of SME business owners in Malaysia and Australia. Through their semi-structured interview and content analysis, they identified several criteria indicating success which were divided into four categories: financial, customer satisfaction, lifestyle and social responsibility. Both countries witnessed similarities in their SME owners' perception of financial indicators of success: sales growth and profitability. The authors cited Marlow and Strange (1994), who claimed that financial capability is crucial to maintain the viability of the business. Based on the interviews, the authors also uncovered other definitions of success for Malaysian SME owners which are business growth, increase in market share and low debt level. However, the small sample size in the study is not adequate to provide strong evidence of the Malaysian SME owners' perception.

In 2011, Chittithaworn et al. studied the factors influencing SMEs business success in Thailand. They defined firm performance, specifically the firm's capability to produce reasonable results and actions, as the indicator of a firm's success in the market. Chittithaworn et al. (2011) posited that there are two vital success dimensions: (a) short term vs long term and (b) financial vs other success. There are different forms of success definitions which include return on investment, survival, profit, number of workers employed, happiness, sales growth and reputation. A regression analysis made via Statistical Package for the Social Sciences (SPSS) software uncovered five significant factors: finance and resources, customer and market, SME characteristics, way of doing business and external environment. Another three factors, which are management knowledge, strategy, and product and services, were found to be insignificant in Thailand. However, the finding was purely based on SMEs owners' perception and was not objectively quantified.