Impact of Profitability on the Growth of Small and Medium Enterprises in the Culinary Sub-sector of the Creative Industry in Bandung City, Indonesia

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ABSTRACT

This study aims to determine and test the impact of profitability on the growth of small and medium businesses in the culinary sub-sector of the creative industry in the city of Bandung. Profitability is measured using return on equity (ROE) and net profit margin (NPM), while business growth is measured using asset growth. This study is an explanatory research with quantitative research methods. The population included small and medium business actors in the culinary sub-sector of the creative industry in Bandung City recorded from 2016–2018. The sampling technique used was purposive sampling based on the determined criteria obtained by 47 business actors as research samples. Results showed that ROE and NPM have significant impacts on asset growth both simultaneously and partially

Keywords: *return on equity, net profit margin, asset growth, creative industry, culinary sub sector*

I.   INTRODUCTION

The performance of small and medium enterprises (SMEs) has been considered as one of the most important driving forces behind the economies of developed and developing countries owing to the SMEs' multiple contributions. In most developing countries, the performance of SMEs is a key issue today (Herath and Mahmood, 2013)

SMEs in Indonesia play a great role in contributing to the economy. Based on 2009 statistics, 56.72% of the total GDP in the manufacturing sector was earned by SMEs, which represent 99.96% of the total number of manufacturing industries (3.27 million companies) and absorb employment for 87.47% of the total industry workers (Fatimah et al., 2013). SMEs in Indonesia contribute significantly to national export performance. In 2010 and 2011, SMEs' contributions to national export performance were approximately IDR 175,894.90 billion (15.81%) and IDR 187,441.82 billion (16.44%), respectively. The flagship export products for SMEs include handicraft (30%), fashion and accessories (29%), furniture (27%), food and beverage (10%) and health and beauty products (4%). These figures prevail despite the wide-ranging affirmative policy initiatives in developing SMEs launched by the Indonesian government (Manzilati, 2015)

SMEs play an essential role in a country's economy because of their implications for the sustainability of a country. SMEs should be maintained and conducted continuously so that they bring about profit for the country (Dai, 2013).

The purpose of the current research is to investigate the impact of working capital management on companies' profitability. The research examines two variables of working capital management: working capital turnover and cash conversion cycle. Profitability is measured using return of equity (ROE). A quantitative method of research approach is adopted

to test the hypothesis. The objects of this research are 17 food and beverages companies listed in the Indonesia Stock Exchange during 2010–2014. The method used to pick samples is judgement sampling. A total number of 12 companies are chosen as samples. The result shows a statistically significant impact between working capital management measured using working capital turnover and cash conversion cycle on the profitability of companies measured using ROE (Kostini and Marliasari, 2017)

Creative economy is defined as all economic activities that make creativity (intellectual property), culture and cultural and environmental heritage as the foundation of the future (Howkins, 2001). In Indonesia, especially in Bandung, creative economy shows significant growth. The establishment of Bandung City as a Creative City, as confirmed by United Nations Educational Scientific and Cultural Organization (UNESCO), became a supporting factor for the development of the creative economy. The large number of creative industries that exist is also the main factor that strengthens the creative economy in Bandung City. There are 15 creative industry sub-sectors in Bandung that contribute to the GRDP (Table 1).

Table 1 Contribution of Creative Economy Sub-sector to Bandung City GRDP, 2014

No	Sub-sector	Contribution to **GRDP (in %)**
1.	Architecture	0.015
2.	Research and development	0.005
3.	Design	0.119
4.	Fashion	7.361
5.	Film, video and photography	0.035
6.	Publishing and printing	0.045
7.	Advertising	0.461
8.	Interactive games	0.005
9.	Information technology and software	0.035
10.	Television and radio	0.303
11.	Craft	2.505
12.	Music	0.015
13.	Art and antiques market	0.104
14.	Performing art	0.010
15.	Culinary	**2.783**

Source: Agency of Culture and Tourism of Bandung City, 2014

The data in Table 1 show the three major sub-sectors of the creative industry in Bandung, namely fashion, culinary and craft. The culinary industry sub-sector ranks the second largest, with a contribution to Bandung's GRDP of 2.783%. In addition, with the proportion of businesses amounting to 20.17% of the total number of businesses in Bandung City, the culinary industry sub-sector can provide 4.63% of business opportunities. Most business actors engaged in the culinary industry sub-sector are SMEs.

The growth of SMEs, especially those in the Bandung culinary industry sub-sector, is continuous. At the end of 2012, the rate of micro-enterprises and SMEs reached 7,218 units with a volume of IDR 3 trillion and assets of IDR 2.5 trillion, while the workforce absorbed as many as 60,546 people.

Many factors can support the growth of SMEs, including profitability. Profitability can be expressed in various sizes, including ROE and net profit margin (NPM). ROE shows the ability of the business to generate net profits from the use of its capital, while NPM states the comparison between the amount of net income and sales. The greater the value of NPM, the better the operational activities of the company will be. Similarly, the greater the ROE value, the better the ability of the company to generate business profits.

II. LITERATURE REVIEW

Profitability is the ability of a company to generate profits over a certain period by using productive assets or capital, both capital as a whole and own capital (Van Horn and Wachowiez, 2012). Subramanyan and Wild (2013) state several indicators that can be used to measure profitability, namely ROE and NPM. ROE is a ratio that states the company's ability to obtain net income from the use of capital. The formula for ROE is

$$ROE = \frac{Earning\ After\ Tax}{Equity} x100\%$$

If the ROE value is greater than 1 or ROE>1, then it can be interpreted that the company's ability to generate net income is getting better. Thus, the company can manage its capital optimally. NPM states the magnitude of the comparison between net income and sales. NPM can be defined as the company's ability to generate net income from each sales unit. The formula for NPM is

$$NPM = \frac{Earning\ After\ Tax}{Sales} x100\%$$

The greater the value of NPM, the greater will be the company's ability to generate net income from each sale. Brigham and Houston (2011) state that 'high returns allow these companies to do most of their funding through funds generated internally'. This means that company profitability is one of the indicators included in the information about company performance. A high rate of return indicates that the company has good performance.

Companies that have high returns will certainly achieve the expected growth rate. Every company strives to achieve high growth annually because its growth provides an overview of the developments that occur (Fauzi and Suhadak, 2015). According to Brigham and Houston (2011), companies that have fast growth must rely more on external capital. Small businesses face different conditions because more of the capital used is from the company's internal capital. Small businesses generally invest more in their assets. Thus, to assess the growth of small companies, it will be more appropriate to use an asset growth indicator.

Asset growth is the difference between the total assets owned by the company in the current period and the previous period against the total assets of the previous period. The size of the asset growth rate refers to Weston and Copeland (2008), who use the following formula:

$$Asset\ Growth = \frac{Total\ Asset_t - Total\ Asset_{t-1}}{Total\ Asset_{t-1}} x100\%$$

A fast-growing company may face growth-related difficulties that have an impact on decreasing profitability and possible financial difficulties. Overall, it is difficult to imagine sustainable growth without profitability (Fitzsimmons et al. 2005).

III. RESEARCH METHODS

In accordance with the purpose of testing the hypothesis, the research design used in this study is causal design. The population is the small business culinary sub-sector of the creative industry in Bandung City. Determination of the sample was based on the purposive sampling method through which a sample size of 47 small businesses was obtained.

To analyse the research data, multiple linear regression was conducted. To analyse the regression model, the data must be good and fit. Good and fitness assessment is done by using a data quality test consisting of descriptive statistics and classic assumptions

$$Y = a + b_1.X_1 + b_2.X_2 + \varepsilon$$

where

Y	= asset growth
X_1	= ROE and
X_2	= NPM
a	= intercept
b1 and b2	=constants

Hypothesis Testing

To test the significance of profitability (Xi) on company growth (Y) (i.e., H1), statistical test F and t statistical test will be carried out to determine the simultaneous and partial effects, respectively.

F-stat test

Simultaneous testing of hypotheses is conducted as follows:

If the significance value is smaller than the error tolerance level of 5% ($\alpha = 0.05$), then H0 is rejected and H1 is accepted.

If the significance value is greater than the error tolerance level of 5% ($\alpha = 0.05$), then H0 is accepted and H1 is rejected.

T test

Partial testing of the hypothesis is performed as follows:

If the significance value is smaller than the error tolerance level of 5% ($\alpha = 0.05$), then H0 is rejected and H1 is accepted.

The multiple determination coefficient, that is, the ratio between the number of squares of regression and the sum of total squares, is used to determine the contribution of profitability to company growth (ups and downs).

IV. RESEARCH RESULTS AND DISCUSSION

The results of research data processing indicate the influence of NPM and ROE on company growth, which is represented by the growth of assets in SMEs in the culinary sub-sector of the creative industry in Kota Bandung. The test results can be statistically seen in the following table:

Table 2 Test Results for Multiple Linear Regression

Model	Coefficients [a]			t	Sig.
	Un-standardised Coefficients		Standardised Coefficients		
	B	Std. Error	Beta		
1 (Constant)	.054	.002		17.686	.000
NPM (X_1)	.905	.028	.793	31.619	.000
ROE (X_2)	.061	.004	.312	12.473	.001

a. *Dependent Variable: Asset Growth (Y)*

On the basis of Table 2 above, the regression equation is obtained as follows;

$$Y = 0.054 + 0.905X1 + 0.061X2$$

The asset growth constant value is equal to 0.054, which means that if the value of the independent variable (X) is 0, then the dependent variable (Y) is 0.054. The regression coefficients of each independent variable are positive, proving its contribution to the growth of the company. Specifically, the growth of assets in SMEs in the culinary sub-sector of the creative industry of Bandung City can be influenced by NPM and ROE.

Simultaneous tests (F test) were conducted to identify the effects of ROE and NPM on company growth. In this case, the measure is the growth of assets. Testing is carried out at a 95% confidence level with the following criteria: if F count > F table, then H0 is rejected and H1 is accepted; if F count < F table, then H0 is accepted and H1 is rejected.

The results of the F Test reveal that the F value is 11.25 and the F table value is 9.28. Thus, if F-count > F table with a significance value of 0.000 is smaller than the alpha value of 0.05, then H0 is rejected and H1 is accepted, which means the independent variable consisting of NPM (X1) and ROE (X2) can explain the diversity of the dependent variable, namely the

growth of assets (Y). The variables NPM and ROE simultaneously have a positive effect on asset growth. It can also be said that profitability has a simultaneous effect on the growth of SMEs in the culinary sub-sector of the creative industry in Bandung City.

The results of the t test show the t-count value for the NPM variable of 31.619 is greater than the t-table value equal to 2.446, and the significance value of 0.000 is smaller than alpha (0.05). Thus, H0 is rejected and H1 is accepted. In other words, the NPM has a positive and partial effect on asset growth.

The results of processing the t test also show the t count value for the ROE variable of 12,473 is greater compared with the t-table at 2,446. If the significance value of 0.001 is smaller than alpha (0.05), then H0 is rejected and H1 is accepted or, partially, the ROE variable has a positive and significant effect on asset growth. In other words, ROE has a positive and significant effect on the growth of small and medium business assets in the culinary sub-sector of the creative industry in Bandung City.

On the basis of the description above, profitability, as represented by NPM and ROE, has an influence on the growth of SMEs in the culinary sub-sector of the creative industry in Bandung City.

The magnitude of the influence, based on the calculation of the coefficient of determination, is 78%. In other words, other factors can affect the growth of business, which is equal to 22%. Similar to the findings of Lopez-Garcia and Puente (2012) and Rivard (2014) regarding novelty and access to credit, debt is an important element to explain the growth of the company, but both factors are not significant determinants in the growth process of SMEs.

CONCLUSION

Results indicate that NPM and ROE simultaneously and partially have a significant effect on business growth. NPM and ROE are variables that represent profitability, and asset growth is a variable that represents company growth. Therefore, profitability has a significant effect on the growth of SMEs in the culinary sub-sector of the creative industry in Bandung City.

This study recommends further research to find reference models for growth measures and specific models for small businesses as a form of developing new knowledge about small businesses and finding new theoretical perspectives.

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