CHAPTER I
Introduction

1.1 Problem Identification

Manufacturing industry has an essential role in Indonesia's economic development. Its contribution to the total value-added can prove it. According to the World Bank (2019), the manufacturing industry contributed 220.502 billion USD of value-added to Indonesia's GDP, higher than all ASEAN countries (Table 1.1). Furthermore, the manufacturing sector contributed 19.70 percent of total value-added in Indonesia and made it the biggest contributor to GDP (*BPS,* 2020).

Table 1.1

The Value-Added of Manufacturing Industry in ASEAN Countries, 2019

Country	Manufacturing, value-added at the current price (Billion USD)
Indonesia	220.50
Malaysia	78.18
Singapore	72.83
Vietnam	43.17
Lao DPR	1.43
Cambodia	4.41
Philippines	69.77
Thailand	139.49
Myanmar	17.01
Brunei Darussalam	1.83

Source: World Bank (2019)

According to the facts aforementioned, the manufacturing industry has great potential to be developed on all business scales, including micro and small scales. Micro and small-scale business from all economic sectors (not only the manufacturing industry) is dominating all businesses in Indonesia. In 2019, out of 65,471,134 enterprises, 98.67% are micro-enterprises, 1.22% are small-enterprises,

0.10% are medium-enterprises, and only 0.01% are large-enterprises. Moreover, the micro and small-scale businesses employed 93.85% of total labor and contributed 46.88% of Indonesia's GDP. Therefore, the contribution of micro and small-scale businesses' total unit is great in promoting entrepreneurship, generating employment, and creating value-added. Additionally, employment creation can provide income generation opportunities for low-income groups leading to improved quality of life and increased purchasing power, thereby contributing to the local economy. So, as a part of micro and small-scale businesses, the micro and small manufacturing industries (MSI) also play a role in employment creation and income generation, as mentioned above.

According to the data from Micro and Small Industry Profile (*Profil Industri Mikro dan Kecil*) published by the Central Bureau of Statistics, the contribution of MSI to GDP is relatively low. These industries generated 274.7 trillion Rupiah of value-added in 2017, 217.8 trillion Rupiah in 2018, 220.6 trillion Rupiah in 2019, and 229 trillion Rupiah in 2020. Meanwhile, the total GDP in 2017 was 2739.7 trillion Rupiah, 2947.5 trillion Rupiah in 2018, 3119.6 trillion Rupiah in 2019, and 3068 trillion Rupiah in 2020. Compared to the GDP, the manufacturing industry's contribution can be seen in the following table.

Table 1.2

The Contribution of Manufacturing Industry to Indonesia's GDP at the Current Prices (%)

Year	All Manufacturing Industry	Micro and Small Manufacturing Industry
2017	20.16	2.02
2018	19.87	1.47
2019	19.70	1.39
2020	19.88	1.48

Source: Processed by Author (2022)

The performance of the manufacturing industry is mainly declined at current prices, as seen by its contribution to the GDP (Table 1.2). At the constant price, the manufacturing industry, as the most significant contributor to GDP,

experienced the largest contraction. It is contracted by 2.93 percent in 2020 compared to 2019 cumulatively (*BPS*, 2022). This case happened because of the COVID-19 outbreak. COVID-19 is an infectious disease caused by the newly discovered coronavirus. The rapid spread of this virus caused countries to implement lockdowns policy and large-scale social restrictions to decrease the number of infectious people. These restrictions caused contrary effects on the economy; from the individual, household, firm (micro to large), and country. At first, all businesses could not operate as usual as they do. Then, they were forced to adapt to the new condition. As the pandemic worsened, some businesses were forced to close temporarily or even permanently, terminated some of their labors due to the extreme depreciation of their income, and changed their businesses to be survived the pandemic situation. Thus, it became a global pandemic and caused economic shock. The economic growth experienced a declining growth. These situations also affect micro and small manufacturing industries as a part of economic sectors in Indonesia.

Starting from the fact that the manufacturing industry as a whole is the biggest contributor to GDP but its micro and small scale industries' contribution is still low, it matters to study what factors influence the performance of micro and small manufacturing industries in Indonesia so that they can support the economy by creating more job opportunities and giving significant contribution to GDP.

1.2 Problem Statement

The development of the manufacturing industry supports the Indonesian economic growth as it is the most significant contributor to the GDP. This development also generates micro and small-scale businesses that have essential roles in improving the economy by promoting entrepreneurship, developing employment, and creating value-added.

The performance of the manufacturing industry declined as its contribution to the GDP declined for several years. This problem is also in line with micro and small manufacturing industry contribution to the GDP, which is relatively low and has fallen for several years. Furthermore, the global pandemic

caused an economic shock and affected the micro and small manufacturing industry as one of the economic sectors.

Hence, it is essential to pay attention to the micro and small manufacturing industries' development so that they can contribute to accelerating economic growth in Indonesia. Starting from the fact mentioned above, it matters to study what factors influence the performance of micro and small manufacturing industries in Indonesia. Accordingly, this study will be focused on:

1. What factors influence Indonesia's micro and small manufacturing industries' performance?

2. How is the effect of COVID-19 on the micro and small manufacturing industries' performance in Indonesia?

1.3 General Research Objectives

This study aims to analyze what factors influence the performance of micro and small manufacturing industries in 34 provinces of Indonesia from 2017 to 2020 by using static panel data.

1.4 Research Advantages

Several advantages are expected to be taken from this study, including:

1. This research can expand insights and knowledge about the factors affecting micro and small manufacturing industry performance in Indonesia.

2. The research results can be used as study material and additional references for further research.

3. This research is expected to be used as input and consideration for the government to formulate appropriate policies.

1.5 Systematic of Writings

The systematic of writings consists of several chapters, namely:

CHAPTER I: Introduction

This section consists of the problem identification, problem statement, general research objectives, research advantages, and systematic writings.

CHAPTER II: Literature Review

This chapter reviews the theory and prior research as a foundation of information and knowledge in conducting this research. The research framework and hypothesis are also stated in this chapter.

CHAPTER III: Theoretical Framework and Research Methodology

This chapter consists of operational research objectives, research method, data collection technique, analysis technique, linear panel model explanation, and model specification.

CHAPTER IV: Empirical Results and Analysis

This chapter elaborates on the empirical result of the analysis.

CHAPTER V: Conclusion and Suggestions

This chapter concludes the analysis of this research and its result, along with further research suggestions.