

The Mediating Effect of Government Policy on the Relationship Between Knowledge and Smes' Performance

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Abstract

The primary goal of this study is to investigate the impact of knowledge on the performance of SMEs in Padang, where government policy serves as a mediator. The following are the study's specific objectives: (1) to look into the effect of knowledge on SME performance, and (2) to look into the effect of government policies on SME performance. (3) Examine the impact of government policy on the relationship between knowledge and SMEs' performance. The population in this study consists of all leaders or owners of SMEs in the field. A total of 375 samples were collected. Purposive sampling is a type of non-probability sampling. This study employs PLS-SMART to test the existing hypotheses. According to the findings of the research, (i) knowledge has a positive impact on SME performance; (ii) government policies have a positive impact on SME performance; and (iii) government policies are proven to mediate the relationship between knowledge and SME performance.

Keywords— *Entrepreneurial, Competitive advantage, Prosperity, SMEs*

I. INTRODUCTION

Small and medium enterprises and industries have much to contribute to making labor-intensive and more often self-owned, relatively better levels of efficiency and better income distribution have strong socio-economic importance to the country and widely spread the benefits of economic growth, have domestic linkages stronger, and especially useful in the diversification of the industrial structure[1][1] In the business world, small and medium enterprise development continues to be a well-accepted phrase as this sector acts as a mechanism for job creation, country-wide development, poverty reduction, and economic development [2]. SMEs have more job opportunities compared to large companies and multinational companies. Other findings also state that small businesses are considered the most capable of increasing growth and livelihoods [3][3]. And globally, Small and Medium Enterprises can be accepted as a tool that can empower the economic growth of citizens of a country [5]

In Indonesia, Micro-enterprises play an important role in the economy, where they supply 99.8% of the country's employment and account for more than 95% of all enterprises in Indonesia (BPS, 2019). This is in line with the Preamble to the 1945 Constitution of the Republic of Indonesia (Kemenkop & SMEs, 2015) which explains that the Empowerment of Small and Medium Enterprises (SMEs) is an important effort to achieve Indonesia's prosperity. In addition, the empowerment of SMEs that is carried out has the aim of strengthening the economy, such as reducing poverty rates, creating jobs increasing economic added value, and having an impact on economic growth in Indonesia. This phenomenon is also proven (Maksum, Sri Rahayu, and Kusumawardhani, 2020) who conducted research with SMES owners in West Java and East Java that the role of small and medium enterprises (SMEs) can create jobs and economic growth in Indonesia.

Apart from being the provincial capital, Padang is an important location for the growth of SMEs and the largest contributor to the economy among West Sumatra's cities and regencies. According to the Central Statistics Agency (BPS), the wholesale and retail trade sector contributed IDR 10.21 trillion, or 16.41%, of the total economy last year, while the wholesale and retail trade sector contributed IDR 9.74 trillion, or 15.66%. [6]

The city of Padang is an important place for the growth of SMEs in West Sumatra. Based on secondary data released by the Padang City BPS, there has been an increase in the number of trading companies based on business scale, for small businesses there has been an increase from 2019 to 2021 by 1%. able to contribute to economic growth based on trade and job opportunities. (See table 1). This is in line with (Fahmi, Hadiyati and, 2020) who explain that SMEs have an important role and can be seen from various aspects such as having great potential in creating jobs and gross domestic product (GDP).

Table 1: Number of trading companies according to business scale

Trading Company	Number of trading companies according to business scale		
	2019	2020	2021
Big	2.447.00	2.447.00	2.447.00
Prevent	13.480.00	13.485.00	13.486.00
Small	33.101.00	33.132.00	33.133.00
Micro	1.844.00	1.850.00	1.907.00
Amount	50.872.00	50.914.00	50.974.00

Empirically, many factors can affect the performance of SMEs, both internal and external factors (Fahmi, Hadiyati, 2020) in Juzaimi, the internal factors that influence the performance of SMEs are knowledge, skills and abilities [8] the effect of entrepreneurial competence on small and medium enterprises in Kaduna [9], business networks and human resource competencies for small entrepreneurs in the culinary field [10], entrepreneurial orientation and skills on the performance of SMEs (Aliyu, 2017; Yadewani, 2022; Yadewani, 2023), other findings explain that skills and experience also affect the performance of SMEs mediated by innovation [12]

However, the results of previous research on how knowledge variables affect SME performance are still being debated. For example, some research results explain the relationship between knowledge and SME performance (Amelia, 2019; Fahmi et al., 2020; Chaithanapat et al., 2022). While some scholars find that, there is no relationship between knowledge and SME performance (Ardiana & Brahmayanti, 2010b; Echdar, 2014; Purwanto & Trihudiyatmanto, 2018)

Furthermore, the results of research [17] found that external factors consisting of aspects of government policy, socio-cultural and economic aspects, as well as aspects of the role of related agencies have a significant and positive effect on the performance of SMEs. Likewise, the results of subsequent findings emphasize government policy variables that influence the performance of SMEs (Munizu, 2010; Zainudin, 2017; Wibawa, 2018; Alabi et al., 2019).

Government policy is conceptualized as a policy in developing industry, especially SMEs or industry by providing actual activities such as training frequency, access to capital, and business partnerships [21] Government policies play an important role in the relationship between knowledge and business performance of SMEs. This means that the better the government's policy towards SMEs, the stronger the influence of knowledge on the business performance of SMEs. However, to date, there have been very few, if any, studies to investigate the mediating effects of government policies on the relationship between knowledge, and SME business performance together in an integrated framework..

Therefore, the general objective of this study is to analyze the effect of knowledge on the business performance of SMEs in Padang City: Government Policy as a mediating variable. The specific objectives of this study can be seen as follows: (1) To analyze the effect of knowledge on the performance of SMEs, (2) To analyze the influence of government policies on the performance of SMEs. (3) Examine the effect of government policy mediation on the relationship between knowledge and performance of SMEs.

2. LITERATURE REVIEW

Given that SMEs can create jobs, the performance of human resources is an important matter, so Resource View (RBV) theorists have observed that entrepreneur competence is the company's main resource which is also valuable. RBV shows that a company can differentiate itself from its competitors and can create a sustainable competitive advantage only if it owns valuable, rare, and inimitable resources. [22]. One of the intangible assets of companies that allows them to be more successful is the human presence. Thus, the valuable skills, knowledge, and abilities of an entrepreneur can lead to a sustainable competitive advantage over other companies. Only a competent entrepreneur can develop and lead a successful strategy towards business success. For example, the RBV theory of firms links their value creation processes to managers' ability to find or develop resources (Grant, 1991; Barney, 1991).

2.1 Small and Medium Enterprises

Referring to Law no. 20 of 2008 Chapter IV Article 16 which regulates Micro, Small, and Medium Enterprises (MSMEs) stipulates several MSME criteria, including:

1. Standards for Small Business

Have total assets of more than Rp. 50,000,000.- Rp. 500,000,000 and does not include business premises and land. Annual transactions have yields of IDR 300,000,000.- IDR 2,500,000,000.

2. Standards for Medium Enterprises

Total assets of IDR 500,000,000 - IDR 10,000,000,000 with a record of area restrictions and structures as a business position. Likewise, the annual offer is IDR 2,500,000,000 – IDR 50,000,000,000

2.2 Performance of Small and Medium Enterprises

According to R. Purwaningsih and Kusuma Damar (2015), the performance of SMEs is the extent to which SMES's ability to carry out work to achieve goals following their capabilities, programs, policies, and vision and mission, and the performance of SMEs can be influenced by internal factors such as human resources, finance, technical production or operations, marketing, and external factors such as government policies for telecommunications. Furthermore, (Irfani et al., 2016) explain that performance is required when measuring the achievement of a job that has been completed, as evidenced by the company's success in achieving high levels of income.

2.3 Knowledge of SME performance

(Ardiana & Brahmayanti, 2010b; Ardiana & Brahmayanti, 2010a) conceptualize knowledge as a person's understanding of science and technology obtained through the learning process and experiences during his life. Empirically the research results explain the relationship between knowledge and SME performance (Amelia, 2019; Fahmi et al., 2020; Sedyastuti et al., 2021). From the literature, the first hypothesis can be developed:

H1: Knowledge has a positive effect on the performance of Small and Medium Enterprises in Padang City

2.4 Government policy on the performance of SMEs

Many encouraging research results regarding government policies on the performance of small and medium enterprises (Sedyastuti et al., 2021; Wibawa, 2018). Interestingly, the human resources in small and medium enterprises cannot be equated with the human resources in large companies, so government policies are needed to improve the performance of SMEs. [20]. Research results (Alabi et al., 2019; Pramestinigrum & Iramani, 2020) are contrary to previous research which explains that government policies do not affect the performance of SMEs. So it can be concluded that there are still inconsistencies related to the influence of government policies on the performance of SMEs

The hypothesis can be arranged as follows:

H2: Government policies have a positive effect on the performance of Small and Medium Enterprises in Padang City

2.5 Government Policy Mediates the Relationship between Knowledge and SME Performance

The relationship between knowledge variables and SME performance has been extensively investigated by several previous scholars. In the abstract, previous researchers have shown that knowledge is related to the performance of SMEs, as was done by [28] that knowledge competence must be owned by every SMES so that later they can have a strategy in marketing while findings from other researchers such as [29] also discovered the concept of the relationship. In addition, there are also assumptions from other researchers, that the relationship between knowledge and SMES performance can have an indirect nature because there are difficulties in this relationship. So some other researchers have the assumption that the relationship between knowledge and SME performance must be mediated by other variables.

So that it can form the following causal hypothesis:

H3: Government policies mediate the relationship between knowledge and the performance of SMEs in the city of Padang

3. METHODOLOGY

A survey study was found most appropriate for this research and this was conducted using cross-sectional data. The reason for focusing on this method is that descriptive studies rest on specific hypotheses, and they are often concerned with the frequency of occurrence or association between two or more variables [30]. They are used when the research is intended to describe the characteristics of groups or to make a prediction of a relationship between variables [31]

The unit of analysis is the major entity that you are analyzing in your study [32]. For example, any of the following could be a unit of analysis in a study: individuals or organizations. Although individuals are the most common unit of analysis, various research problems can be answered more accurately through the analysis of organizational units. Thus, the unit of analysis in this study is individuals involved in running a Small and Medium Business, namely the owner or manager.

Population refers to the entire group of people, events, or things of interest that the researcher wishes to investigate [32]. The population in this study is all SMEs in Padang City, West Sumatra Province.

To determine the sample size, this study refers to the table of Sample Size for a Given Population Size which is recommended by [32]. The directory of the Department of Cooperatives and SMEs of West Sumatra Province (2021) explains the number of SMEs in the city of Padang accounted for 13,837 SMEs. Based on the sample size table, this study will use 375 SMEs. Furthermore, this study will select the sample from the population of SMEs in the city of Padang by using probability simple random sampling. Simple random sampling is every element in the population has a known and equal chance of being selected as a subject [32]

The rating scale for this study is the Likert rating scale which is designed to examine how strongly subjects agree or disagree with a statement on a 5-point Likert scale: (1) Strongly disagree, (2) Disagree, (3) Neutral, (4) Agree, (5) Strongly agree. In this study uses SEM_PLS to test hypothesis development. The conceptualization and measurement of variables can be summarized as follow

Table 2. Concepts and Measurement of the Variables

Variables	Concepts	Measurements	Source
Knowledge	A person's understanding of science and technology is obtained through the learning process as well as experiences during his or her life.	1.Business management knowledge 2.Product knowledge or services 3.consumer knowledge 4.Promotions 5.Marketing strategy.	[8]
Government Policy	A policy in developing industry, especially small and medium enterprises or industries by providing actual activities such as training frequency, capital access, and business partnerships	1. Training frequency 2. Capital Access 3. Business partnerships	[21]
Performance of SMEs	The extent to which the ability of SMEs to carry out work to achieve goals under their capabilities, programs, policies, as well as the vision and mission that has been stated.	1. Profitability 2. Growth of sales and revenues 3. Return on assets 4. The trend of return on assets 5. Market shares 6. Operational and cost-efficiency 7. Productivity 8. Return on sales 9. The trend of return on sales.	[33]

4. RESULTS AND DISCUSSION

4.1 Demographic Profile

Demographics include position in the business, gender, education, and length of business. The results of the analysis are presented in the form of frequency and percentage values, which describe the demographic profiles of all respondents included in the data study. Table 3 Describes the demographic profile of all respondents included in the study. Based on the position of the respondents 202 (53.87%) respondents were owners and 173 (46.13%) were managers. Based on gender, it was dominated by women, namely 192 (51.20%) and the remaining 183 (48.80%) male respondents disagreed. In terms of education, 47.47% of respondents disagree had a high school diploma, 36% bachelor's degree, and 16.53% master's degree. Meanwhile, from the length of operation, 50.93% had a period of less than 5 years, which was between 5 - 10 years as much as 37.

Table 3 Summary of Respondents' Demographic Profile

<i>Criteria</i>	<i>frequency</i>	<i>Percentages</i>
Position in Business		
a. owner	202	53,87
b. manager	173	46,13
Gender		
a. Man	183	48.80
b. Woman	192	51,20
Education		
a. senior high school	178	47,47
b. Bachelors	135	36
c. Masters	62	16.53
Length of Business		
a. < 5 years	191	50,93
b. 5 – 10 years	142	37,87
c. > 10 years	42	11,2

Source: Processed Primary Data (2020)

4.2 Convergent Validity

Convergent validity is measured by determining whether each estimated indicator validly measures the dimensions of the concept being measured. The AVE value is at least 0.5. This value describes adequate convergent validity which means that one latent variable can explain more than half of the variance of its indicators in the average[34]

In conducting convergent validity testing, it can be assessed based on outer loadings or loading factors and Average Variance Extracted (AVE).

Usually, the research used a loading factor limit of 0.70. An indicator can be declared to meet convergent validity and have a high level of validity when the outer loadings value is > 0.70, while the Average Variance Extracted (AVE) value is > 0.50 [35]. This can be seen in Figure 1 below.

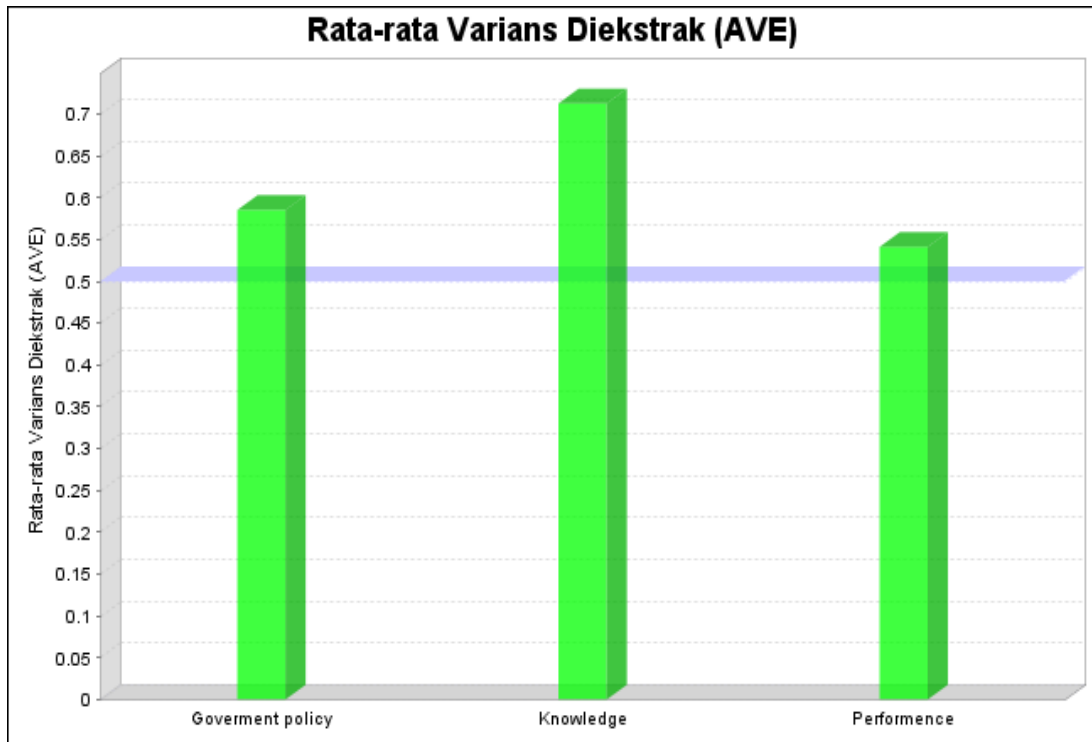


Figure 1. AVE chart

Table 4. Construct reliability and validity

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Government policy	0.608	0.796	0.789	0.585
Knowledge	0.898	0.930	0.925	0.713
Performance	0.890	0.909	0.911	0.541

Source: Processed Primary Data (2022)

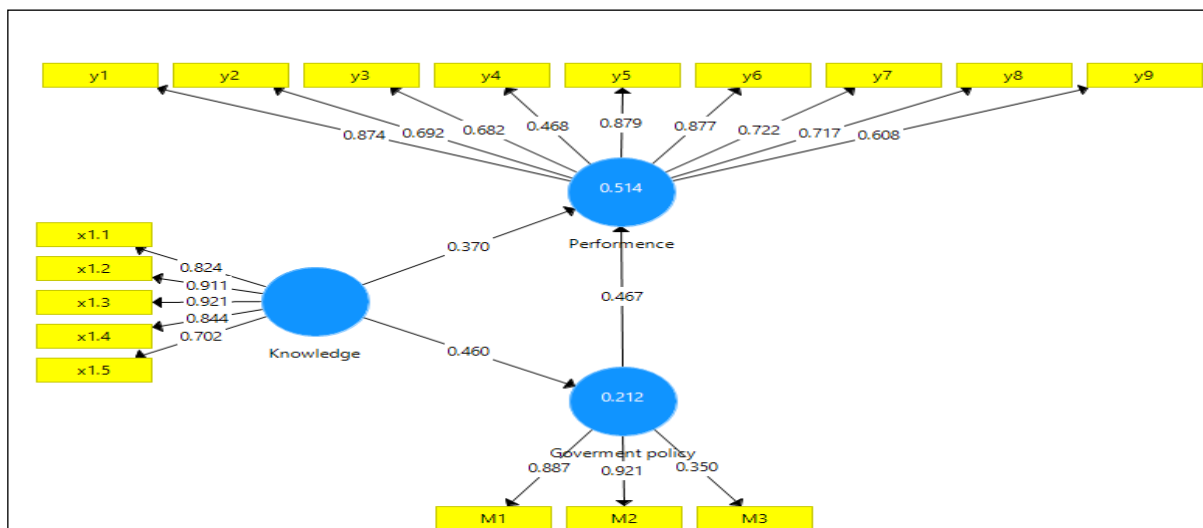


Figure 2: Outer Loading Values in the First

Discriminant Validity: cross-loading, Fornell-Larcker Criterion

The final stage of the Measurement Model analysis is Discriminant Validity which uses the Fornell-Larcker criterion[36]. In this stage, the correlation relationship of the variable compared to

that variable must be higher than the correlation relationship compared to other variables. If the AVE root value is greater than the latent correlation, the indicator meets the discriminant validity criteria. Processing results can be seen in Table 5:

Table 5 Forner-Larcker

	Government policy	Knowledge	Performance
Government policy	0.765		
Knowledge	0.460	0.844	

Source:
Data (2022)

Processed Primary

If the AVE root value is greater than the correlation between latent, then the indicators we use already meet discriminant validity, which can be seen in Table 5 above.

After validating the measurement model, the structural model is represented by determining all the relationships between the constructs. Several researchers Hair, (2014) states that the structural model offers a relationship between all variables. Furthermore, Hair et al. (2017) also suggested that the structural model can be assessed by observing the variables beta (β), R^2 , and t values respectively using a bootstrap process for a resampling size of 5,000. They also stated that effect sizes (f^2) and predictive relevance (Q^2) should be reported. Sullivan, (2012) argues that the p-value is also used to determine the presence of an effect, but cannot indicate the size of the effect. Figure 3 shows the results of the PLS (T Statistics) bootstrap drawn on the PLS 3.0 version.

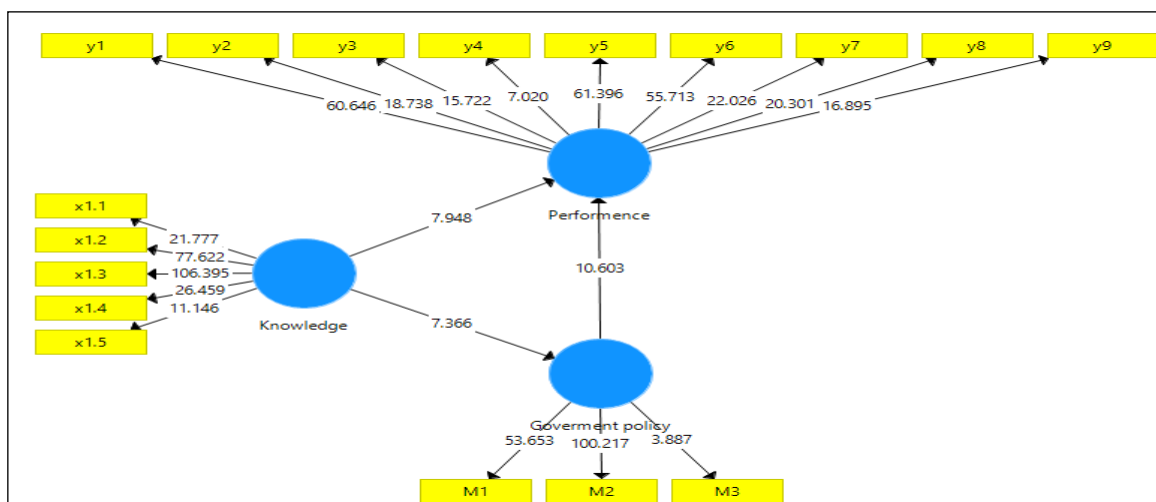


Figure 3:PLS bootstrap (t-Statistics)

Direct Hypothesis Testing

Knowledge and government Policy significantly predict performance. Thus H1 and H2 can be accepted and show the value ($\beta = 0.370$; $t = 7.948$, $p < 0.01$) and ($\beta = 0.467$; $t = 10.603$, $p < 0.01$) respectively.

Standard path coefficients indicate the strength of the relationship between exogenous and endogenous constructs. Thus, Government Policy shows a greater influence on performance than the effect of knowledge on performance. (See, table 6)

Table 6:Results of structural path analysis

Connection	Original Sample (O)	Sample Average (M)	Standard Deviation (STDEV)	T Statistics ()	P Values
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	O/STDEV D				
Government policy -> Performance	0.467	0.466	0.044	10.603	0.000
Knowledge -> Performance	0.370	0.370	0.047	7,948	0.000

Source: Processed Primary Data (2020)

Based on the results of this analysis it is known that

1. There is a positive influence of knowledge on the performance of SMEs
2. There is a positive influence of government policies on the performance of SMEs

4.4 Coefficient of Determination: value of R²

The R² value describes the variance that exists in the dependent variable which can be explained based on the independent variable. Thus, a higher R² value increases the predictive ability of the structural model. All researchers must ensure that their R² value is high so that the model achieves a minimum level of explanatory power [39]. Also, Falk, R.F., and Miller, (1992) state that the value of R² should be 0.1 so that the variance in the endogenous constructs appears adequate. Cohen, (2013) states that the value of R² is said to be substantial if it is > 0.26 and has adequate power of more than 0.02. As shown in Table 7, all R² values are very high, indicating that the model exhibits good explanatory power. Based on Cohen's theory, the R square value is included in the large category for government policies and SME performance.

Table 7: Coefficient of determination, R² value

	R Square	Adjusted R Square
Government policy	0.212	0.210
Performance	0.514	0.511

4.5. EFFECT SIZE F²

In this study, researchers also investigated the effect size (f²). The value of f² helps determine whether the exogenous latent construct shows a substantial, moderate, or weak effect on the endogenous latent construct (Gefen, Rigdon, and Straub, 2011). Furthermore, Hair et al. (2017) state that every change in the value of R² must be determined. Cohen, (2013) suggested guidelines for measuring f² values, which should be 0.35 (significant effect), 0.15 (moderate effect), and 0.02 (small effect). Table 8 describes the f² values for the models.

Table 8 Effect size results, f²

	government policy	Knowledge	performance
Government policy			0.353
Knowledge	0.269		0.222
Performance			

Evaluation of the goodness of the discriminant validity structural model seen from R square and f square.

Based on Table 8, f Square knowledge influences government policy in the moderate category because it only affects 0.269 or 26.9%. While knowledge affects performance with moderate influence with an influence value of 0.222 or 22.2%. In addition, government policies affect performance in the high category of 0.353 or 35.3%.

Indirect Hypothesis Testing

The parameter coefficient for knowledge on performance through government policies is 0.215 which means there is a positive indirect effect of knowledge on performance through government policies. Because the P value < 0.05, rejecting H₀ means that there is a significant indirect effect of knowledge on performance through government policy. This can be seen in table 9 below:

Table 9: Indirect Hypothesis Testing

	Original Sample (O)	Sample Average (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Knowledge -> Government policy -> Performance	0.215	0.211	0.030	7,093	0.000

Hypothesis Testing Results

Summarizing all the results of the hypotheses in this study which include the direct hypothesis and the indirect hypothesis, can be seen in Table 10 below:

Table 10: Summary of Results

<i>hypo</i>	<i>Results</i>
H1 Knowledge Has a Positive Effect on the Performance of SMEs.	Supported
H2 Government policies have a positive effect on the performance of SMEs	Supported
H3 Knowledge mediated by government policy on the performance of SMEs.	Supported

5. DISCUSSION

Knowledge is a person's understanding of science and technology gained through continuous education processes and experiences. In this case, an entrepreneur's understanding of what he or she has learned or experienced is expected to support his or her ability to manage the business. Hypothesis 1 investigates the impact of entrepreneurs' knowledge on the performance of small and medium-sized businesses in Padang. The findings of this study indicate that knowledge has a positive and significant impact on the performance of small and medium-sized businesses. This demonstrates that the more knowledge an entrepreneur has, the better his performance. This study's findings back up previous research by (Amelia, 2019; Fahmi and Hadiyati, 2020; Sedyastuti et al., 2021) which realized the impact of knowledge on the performance of small and medium-sized enterprises.

Hypothesis 2 investigates the impact of government policy on the performance of SMEs. This government policy in developing industries, small and medium-sized enterprises (SMEs), or industries is expected to strengthen the performance of SMEs by providing actual activities such as training frequency, access to funding, and business partnerships. According to the findings of this study, there is a positive and significant relationship between government policies and the performance of small and medium-sized businesses. The findings of this study back up previous research by [28] (Sedyastuti et al., 2021; Wibawa, 2018) that stated that government policies are consistent with the performance of small and medium-sized enterprises, or that government policies have a significant and positive impact on the performance of SMEs. That is to say, the better the government's policy, the better the performance of small and medium-sized businesses, the findings of subsequent findings emphasize the variables of government policy that affect SMES performance[28] [28]

Hypothesis 3 The mediating role of government policy on the relationship of improvement with the performance of small and medium enterprises. The ability of small and medium-sized enterprises (SMEs) to carry out their work to meet their goals through their capabilities, programs, and policies, as well as their vision and mission, is referred to as their performance. The government's role and policies, it is expected to be able to encourage the increase of knowledge among entrepreneurs for them to improve their performance. According to the study's findings, government policy can help strengthen the positive and significant impact of knowledge on the performance of small and medium-sized businesses. The findings of this study back up previous research[28] [28] that stated that knowledge competence should be possessed by every small and medium-sized enterprise operator to have a marketing strategy that increases the performance of small and medium enterprises.

6. CONCLUSION

Based on the research results, the conclusions that can be drawn are:

Knowledge has a positive effect on the performance of SMEs. This means that the knowledge possessed by SME entrepreneurs has a significant influence on their business performance in the city of Padang. In this case, this knowledge can be in the form of knowledge about managing a business, Making decisions, leading, controlling, Innovating, Situations, and Changing the business environment. That is, the more knowledge an SME entrepreneur has, the more likely it is that the SME will be successful and achieve better performance. [43]

Government policies have a positive effect on the performance of SMEs, this can explain why the government has an important role in facilitating conditions that support the growth of SMEs, such as training frequency, capital access, and business partnerships. The government has full rights to manage the country, so the government must facilitate finance and non-finance which can strengthen effectiveness in improving business performance [44].

The impact of knowledge on the performance of SMEs in Padang. This means that government policies have the potential to strengthen or weaken the link between knowledge and SME performance. Furthermore, government policies in Padang do not moderate the relationship between knowledge and SMES performance. These findings suggest that whether or not government policies are sound, they will not affect SMES performance. In this case, SMEs must be able to improve their performance and produce better and more efficient products and services, which will aid economic growth and human welfare. Especially in developing countries, the government has invested a lot of effort and resources to establish policies to increase entrepreneurship and the performance of small and medium enterprises[45]

The impact of knowledge on the performance of small and medium-sized enterprises in the field is mediated by government policy. That is, government policies could potentially strengthen or weaken the link between knowledge and performance in small and medium-sized enterprises. In addition, government policy in the field does not mediate the relationship between knowledge and the performance of small and medium-sized enterprises. These findings suggest that healthy or unhealthy government policies will not affect the performance of small and medium-sized enterprises. In this case, small and medium-sized enterprises must be able to improve their performance and produce better and more efficient products and services, which will help economic growth and human well-being.[46], highlight the significance of government support and will assist stakeholders in developing a thorough understanding of the role of key factors in shaping the global performance of SMEs. Furthermore, the government should understand that the policy that is put out in one area cannot be applied in another so that it does have an impact on the existence of small. [47]

7. LIMITATIONS

The limitation of this research is that (a) it was conducted on small and medium-sized businesses in Padang. As a result, the findings of this study cannot be generalized to small and medium-sized businesses in other areas with different characteristics. As a result, it is recommended that additional research be conducted with more representative samples so that the results can be more generalized. (b) This study only looks at the impact of knowledge on the performance of small and medium-sized businesses that are statically mediated by government policies, without considering external or internal factors that may influence this relationship.

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