

ISSN 2477-3115

# PROCEEDING

## International Conference on Accounting, Business & Economics

December 10<sup>th</sup>-11<sup>th</sup>, 2015

Inna Garuda Hotel  
Yogyakarta, Indonesia



UNIVERSITAS  
ISLAM  
INDONESIA



UPM  
UNIVERSITI PUTRA MALAYSIA  
BODILAH BERKUALITI



UNIVERSITI SAINS ISLAM MALAYSIA  
جامعة العلوم الإسلامية الماليزية  
ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA



IKATAN AKUNTAN INDONESIA



## Introduction

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The International Conference of Accounting, Business and Economics is event organised by the Faculty of Economics, Universitas Islam Indonesia in cooperation with the University Putra Malaysia and the University Sains Islam Malaysia. The conference is an annual event organised by these universities to promote collaboration, networking and knowledge sharing.

In addition to parallel sessions that enable all participants to engage in academic conversation, the conference organises keynote speeches delivered by experts in the field, echoing the conference theme of 'Promoting Economic Growth Through Good Governance, Transparency and Accountability'. These speeches serve as a forum for participants to get closer to understanding the current state of knowledge in relation to the themes. In short, this conference is an excellent event where academics, business practitioners and other interested parties can share their knowledge and experience.

## Welcome message from the Conference Chair

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On behalf of the International Conference of Accounting, Business and Economics, it is my pleasure and privilege to welcome to Yogyakarta all the distinguished participants of this event.

The main purpose of this conference is to exchange ideas, knowledge and experience. Thus, it is now time for us to discuss our mutual interest with participants hailing from different universities and countries.

Transparency and accountability are critical for the efficient functioning of a national economy and the promotion of economic development. These two issues have been major concerns for many development agents, as they require further exploration before they are fully implemented. This event is a good forum for all interested parties to get involved in designing ideal policies for promoting transparency and accountability; it is hoped that all participants will benefit from their involvement in this conference.

It is gratifying to note that the topic of the conference covers a wide range of very interesting items relating to the theme. This means that there are a large number of experts from different countries excited about the theme of this conference, who are keen to share their ideas. This year, the conference has attracted participants from a number of countries, including Malaysia, Thailand and Australia indicating the enthusiasm of the participants of this event.

I would also like to express my gratitude to all organising committee members, keynote speaker, editors, reviewers and participants for their contributions. This conference would not have been possible without their support. Last but not least, I would like to invite all conference delegates to take the opportunity during your stay in Yogyakarta to explore the city, which is not only popular as a city of culture and education but also well known because its people, who are very warm and welcoming to visitors.

**Anjar Priyono, Ph.D**

Conference Chair

## Message from the Dean, Faculty of Economics Universitas Islam Indonesia

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It gives me great pleasure to extend to you all a very warm welcome to the International Conference of Accounting, Business and Economics in Yogyakarta, Indonesia. It is a great honour for the Faculty of Economics, Universitas Islam Indonesia to host this conference.

On behalf of the Faculty, I would like also to say how grateful we are to all our conference partners, including the University Sains Islam Malaysia, the University Putra Malaysia and *Ikatan Akuntan Indonesia* (the Indonesian Institute of Accountants), who have accepted our invitation to collaborate on organising this conference.

This year, the theme of this conference is 'Promoting Economic Growth Through Good Governance, Transparency and Accountability'. Without doubt, this is a theme that it is timely to address, and this conference is desperately needed by all parties concerned with economic development: business, government, policy makers and academia should all work together to address this issue. I am convinced that all participants will benefit from this conference and will make a valuable contribution to the development of the fields related to the theme.

I would also like to express my sincere congratulations and gratitude to the committee members. This conference *would* not have been possible without their hard work, persistence and creativity. Finally, I hope that you all enjoy the conference, build strong professional networks and gain invaluable knowledge, as well as have a pleasant stay in Yogyakarta. Thank you.

**Dr. D. Agus Hardjito**

Dean  
Faculty of Economics  
Universitas Islam Indonesia

## Keynote Speech

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### **A Discussion on Islamic Corporate Financing Structure**

**Fauzias Mat Nor  
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#### **Abstract**

Islam recognizes external financing from sale-based, lease-based, agency-based and partnership based financing of a firm. Islam also recognized equity financing of a firm. In seeking additional funding, therefore a firm has an option either to get financing from external party or to find partner for the business or to get financing from issuance of new equity or internal fund. It should be noted however getting financing from external party must be strictly done without paying interest as it is prohibited in Islam. In order to facilitate firms in this purpose, Islamic banking institutions offer a number of debt-based instruments by applying classical Islamic contracts such as *murabahah* (mark up sale) and *ijarah* (leasing). In the former contract, Islamic banks will purchase merchandises from suppliers of behalf of the firms and then sell the merchandises with mark-up price. The firms will pay fixed installments over an agreed period to Islamic banks.

Equity based financing involves *musharakah* i.e. the sharing of risk and rewards between the shareholders, sharing of reward between shareholders and company management (*mudarabah* arrangement and *wakalah* arrangement). Ideally *mudarabah* or *musharakah* is the choice of financing where risk sharing, justice, fairness and stability would prevail.

Despite the permissibility of sale-based financing and equity financing, there is no indication showing that one is preferred over the other. Is equity financing is more preferable than **sale-based** financing? If that is the case, what is the ideal composition of equity and sale-based financing in a Shariah approved firm? Or Shariah does not put any limit for firm to choose either equity or sale-based financing as long as it can achieve the optimum value? It should be noted financing should not predominate over partnership financing. Can a corporation take advantage of lower cost of capital of sale-based financing to maximize its value? Can the principle of the Shariah is that: "No risk, no gain" be applied for sale-based financing?

It is also noted that the financing structure decision for Shariah approved firms is also influenced by the payment of *zakah* in addition to corporate taxes. This paper will discuss the model for Islamic financing structure decisions taking into account notion of serving the *ummah* will become the driving force for corporate and businesses to accumulate wealth.

## Introduction

The corporation provides certain distinct business feature and characteristics not available in other forms of business organization. Some of these are: (i) limited liability of the stockholders, (ii) divisibility and easy transferability of ownership, (iii) stock certificates can change hands without the prior approval of other stockholders, (iv) a judicial person or a separate legal entity of the corporation apart from its stockholders, enabling the corporation to sign contracts in its own name, to sue and be sued, and to continue its separate existence perpetually irrespective of the turnover of its stockholders. The *fuqaha'* have now in general approved the corporate form on the basis of the *fiqh* principles of *qiyas* (analogy) and *istihsan* and *al-maslahah al-mursalah* (public interest).

Islam rejects such theory of wealth maximization to achieve the pursuit of self-satisfaction. Contrary to this secular's view, Muslims treat wealth as a trust (*amanah*). The absolute owner of the wealth rests with Allah and mankind is only entrusted to manage the wealth in this world. In Islam, the concept of wealth creation is wider than just making a lot of money. Since wealth is a test from Allah, making a lot of money can entail destruction of worldly life. For Muslims, the main aim is to achieve the true success (*al-falah*) which is the success in the world and the hereafter. This concept differentiates the behavior of Muslim in business and corporate environment. In theory, monetary profit will be secondary objective in pursuing and developing a business empire. Rather, the notion of serving the *ummah* will become the priority and main agenda.

Obviously from our discussion, the motivation for a Muslim to engage into wealth creation is not due to the pursuit of self-satisfaction, greed, the desire to survive, the desire for individual power and the enjoyment for riches. Rather, Muslims embark into wealth creation activities because of the desire to serve others and the enjoyment of entrepreneurial spirit.

Sale-based financing is considered as risk transfer and equity as profit and/or risk sharing. Therefore, lower cost of capital is expected for sale-based financing and more cost of financing for equity (risk taker). Therefore, the wealth creation by firm is expected through this environment when there is an element of tax saving and zakah. This discussion is only limited to sales-based and equity financing only. It did not include lease based financing, agency financing as agency financing is related to service or agency fees and partnership financing which is meant for a specific project which generally has a fixed time period.

## Capital Structure: An Overview of Conventional Financing Structure

The investments of a firm are financed by investors who have various types of claims on the firm's cash flows. These investors hold several types of financial claims such as debt, equity, and hybrid securities. The two main sources of capital for a firm are debt and equity. Debt holders have the first claim to the firm's cash flows. Equity holders have claim to the residual cash flows in addition to maintaining control of the firm. Each type of financing has a cost for the firm. The cost of any financing source is the minimum rate of return accepted by the provider of that financing. The rate of return accepted by each type of claimant differs because the risk associated with each type of financing is different. The cost of all financing sources is called the weighted average cost of capital and the weights usually reflect the extent to which each source of capital is used. Since the cost of each source of financing differs from other sources, changing the weight of any one of these sources will change the cost of capital for the

firm. Firms attempt to minimize the cost of capital. Theoretically, the cost of capital is the rate at which the firm's cash flows should be discounted in order to determine the value of the firm (Copeland et al. 2005). Therefore, a lower cost of capital for the firm leads to a higher value of the firm.

### **MM Capital Structure Theory Revisited**

Modern capital structure theory was introduced through the seminal work of Modigliani and Miller (1958), who demonstrate that capital structure can be irrelevant to the value of the firm under certain conditions. Though not realistic, once the conditions for the irrelevance of capital structure are known, determining the circumstances in which capital structure is relevant will be possible. In order to make a more realistic theoretical foundation for the capital structure issues, some of the original assumptions of Modigliani and Miller (1958) can be relaxed.

Basic Assumptions of Capital Structure Theories:-

- There are no taxes
- Individual can borrow and lend at the risk free rate. There are only two kinds of funds used by a firm i.e. risk free debt and risky equity.
- Capital market are frictionless i.e. no transaction cost
- No Bankruptcy cost
- No agency cost
- Symmetry of market information i.e. no signaling opportunities
- The firm's total financing remains constant
- Business risk is constant over time
- The firm has perpetual life.

### **MM Proposition 1 (without taxes)**

MM Proposition 1 is a proposition that the value of the firm is independent of the firm's capital structure. It means that the market value of a firm is not affected by the capital structure of a company. Under conditions of perfect and frictionless markets with no transaction costs, taxation or default risk, Modigliani and Miller (1958) note that when a firm includes a certain debt level in capital structure, all it does is divide its free cash flow between fund suppliers. If the financing supplier, whether debt or equity, is interested in a certain level of leverage, but that level is not offered by the firm or the financing supplier desires to get rid of any unwanted leverage that a firm already takes, the fund supplier can make a homemade leverage that suits his/her needs. For instance, if two firms are identical in everything except their financing sources and the capital structure is assumed to affect the value of the firm, investors can always make their own leverage that maximizes their wealth by selling the overvalued firm and, using the proceeds along with some borrowing, invest in the undervalued firm. This is an arbitraging process that will continue until the value of the two firms is identical and no more arbitrage can be profitable. The arbitrage-free equilibrium implies that the market value of a levered firm and an unlevered firm are identical, or

**MM Proposition 11 (without taxes)**

MM proposition II is the proposition that a firm's cost of equity capital is a positive linear function of the firm's capital structure. MM proposition II deals with the Weighted Average Cost of Capital (WACC). It says that as the proportion of debt in the company's capital structure, the riskiness of the equity increases. Therefore the required rate of return on equity to shareholders increases in a linear fashion. Since the benefit of cheaper debt will then exactly off set by the increase of the cost of equity, the WACC will remain constant. Therefore value of a firm is not affected by the capital structure of a company.

**MM Proposition I and II (with corporate taxes)**

When there are taxes, the value of the firm is enhanced by the tax shield provided by this interest deduction. The tax shield will lower the cost of debt and thus lower the WACC as more debt is used. Since there is no offsetting cost for the benefits of debt financing, this proposition implies that the optimal leverage is almost 100 percent debt, which is not realistic. This flaw opens the door for more realistic interpretations offered later by trade-off theories.

**Trade-Off Theories and Optimal Capital Structure**

In a tradeoff between tax benefit and bankruptcy related cost, the firm is supposed to substitute debt for equity and vice versa until the value of the firm is optimised. Myers (1984) refers this as balancing the value of interest tax shield against various costs of bankruptcy or financial embarrassment. The combination of debt and equity that satisfies the balancing condition is called the target capital structure.

**The Pecking Order Theory**

The pecking order theory was discussed by Myers and Majluf (1984). They argue that if managers have much better information about the future investment opportunity compared to the potential investors (asymmetric information), they would face problems in securing external finance. This is due to the fact that the possibility of funding a bad firm exists thus leads to outsiders demanding for a premium as compensation. If the firm issues equity to finance new projects, the possibility of being under-priced would be so great that a good firm might resort to rejecting some of the projects though with positive NPV. Comparatively, internal sources of funds do not suffer such consequences. The chances to be under-priced are much lesser if debt is preferred to equity. This scenario leads to a financing hierarchical preference. A firm will prefer internal to external finance and debt over equity. A firm will firstly use available internal fund like retained earnings to finance new project. Next alternative will be reducing firm dividend policy to generate additional internal fund if the first alternative turns out to be insufficient. If these internal sources facing exhaustion, the firm may eventually resort to external funding, starting with issuing safest security like debt and when the firm has no more debt capacity, then hybrid securities like convertibles and finally equities will be the last resort. This hierarchical financing choice is known as the pecking order theory.

**Asymmetric Information**



Asymmetric information is a situation which different parties have different information. In a corporation, managers will have better information set than investors. The degree of symmetric information varies among companies and industries. The effect of variation in information will lead to asymmetric information and signaling interpretation by the investors. Information Asymmetry can lead to two main problems:

1. Adverse selection
2. Moral Hazard

### **Agency Theory**

The Agency Theory was discussed by Jensen and Meckling (1976). They argue that agency costs play an important role in financing decisions due to the conflict that may exist between shareholders and debt holders. They claim that there are cases where managers opt to pursuing their own self-interest projects or investments rather than on value maximizing financing decisions. Basically there are three components of agency costs which are: the adverse incentive effects associated with highly levered firms, monitoring cost generated by these effects and bankruptcy costs. The optimal capital structure can be achieved by trading off the agency costs, which include the monitoring expenditure by the principal, the bonding expenditure by the agent and the residual loss, against the benefits of debt.

Three types of agency cost

1. Asset substitution effect
2. Underinvestment problem (or Debt overhang problem)
3. Free cash flow

### **Capital Structure Analysis**

It is very crucial that firms estimate their current capital structure to ensure that the firm is at its optimal capital structure or maintain its predetermined capital structure policy. Optimal capital structure can increase the firm's value and thus increase in shareholders' wealth. However, poorly planned capital structure could reduce the value of a firm and shareholders' wealth.

The value of a firm is determined by the expected future free cash flow (FCF) discounted by its weighted average cost of capital (WACC). This is determined by:

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Where,

When the WACC increase, the value of the firm will decrease, and vice versa. Therefore, a firm's agent would need to reduce WACC to increase the firm's value. On the other hand, WACC is affected by the cost of debt, equity, and tax rate. Tax shield would reduce the effective cost of debt and WACC as a whole. Therefore, the increase of capital funding from debt would actually increase the value of a firm. However, this only happen to certain extent as the increase of funding from debt would increase the future cost of debt and cost of equity. This is because the higher debt would increase the risk of bankruptcy and thus creditors would demand a higher return (higher cost of debt) for bearing higher risk. As for the shareholders, the possible future FCF available for shareholders would be reduced because a larger portion of firm's earnings before tax would be used to service the debt. As a result, investors would demand higher required rate of return for bearing higher risk and reduce cash flow.

### Islamic Financing Structure

Islamic recognizes sale-based financing and equity financing. In seeking additional funding, a firm has an option either to borrow from external party or to find partner for the business. It should be noted however borrowing from external party must be strictly done without paying interest as it is prohibited in Islam. In order to facilitate firms in this purpose, Islamic banking institutions offer a number of sale-based instruments by applying classical Islamic contracts such as *murabahah* (mark up sale) and *ijarah* (leasing). In the former contract, Islamic banks will purchase merchandises from suppliers of behalf of the firms and then sell the merchandises with mark-up price. The firms will pay fixed installments over an agreed period to Islamic banks.

On the other hand, equity financing is conducted based on profit and loss sharing (PLS) principle. The main contract in PLS principle are *musharakah* and *mudarabah*. The PLS principle is formulated based on the Shariah rejection on the notion that 'money could yield money' without bearing any risk. For money to generate money, it must be linked with a certain degree of risk. The linking of the lawfulness of gain to risk-taking is based on two classical legal maxims. The legal maxims postulate that (1) *al-kharaj bi-dhaman* - gain comes with the liability for loss and (2) *al-ghunmu bi al-ghurmi* - gain is the result of risk taking. These legal maxims are derived from *hadith*. The first legal maxim is actually a saying of the Prophet reported in the five major Sunni *hadith* collections (Sahih al-Muslim (d.261/875), Sunan Ibn Majah (d.273/887), Sunan Abu Dawud (d.275/889), Sunan al- Tirmidhi (d. 279/893) and Sunan al-Nasa'i (d.303/916) (Ibn Hajar al-Asqalani, 1979, p.183). The second legal maxim is derived from the understanding of *hadith* on pledge (*al-rahn*) narrated by al-Daraqutni (d.385/995) and al-Hakim (d.405/1015) (as cited in Shaharuddin, 2010).

Despite the permissibility of sale-based financing and equity financing, there is no indication showing that one is preferred over the other. Is equity financing is more preferable than sale - based financing? If that is the case, what is the ideal composition of equity and sale-based financing in a Shariah approved firm? Or Shariah does not put any limit for firm to choose either equity or sale-based financing as long as it can achieve the optimum value? It should be noted that financing should not predominate over partnership financing. Can a corporation take advantage of lower cost of capital of sale-based financing to maximize its value? Can the principle of the Shariah is that: "No risk, no gain" be applied for sale-based financing?

Habib (2007) views that a firm which operates under the Shariah principle has restriction on its ability to borrow. This is because a debt in Islamic framework has to be backed by asset. He suggests that a Shariah approved firm cannot have a debt exceeding its tangible asset, thus it

implies that a firm with lower tangible assets will relatively have lower debt ratio. On the other hand, the emphasis on PLS principles is generally advocated by early works in Islamic finance (see for example Siddiqi 1987 & al-Ashker 1987). However, Habib views are still debatable under the condition of potential value created. The PLS principles is viewed to be the ideal basis in achieving the Islamic finance objectives i.e. economic welfare and socio-economic justice. In theory, the PLS school of thought propose that a Shariah approved firms should choose equity over debt in their capital structure.

Besides the theoretical discussion, research in Islamic corporate finance in general and capital structure in particular take in the form of empirical research. Pratomo & Ismail (2006) examined the capital structure of Islamic banking institution in Malaysia and proved that a high leverage reduces the agency costs and increase firm values. The findings imply that preference of equity over debt financing is not necessarily able to optimize the firm values. Nagano (2010) further confirmed that debt is chosen over equity by firms in Malaysia and the Middle East. The behaviors of Islamic firms that they investigated are correlated with pecking order and trade off theories. Firms prefer to issue *sukuk* (which is regarded as debt-based instrument) in raising funds because issuance of *sukuk* brings an additional benefit which normal traditional external finance does not provide.

The capital structure decision for Shariah approved firms is also influenced by the payment of zakat in addition to corporate tax. Corporate taxes in general terms are a financial obligation imposed by the state on corporation, from which the state spends on the public interest, such as transportation, health, education and securities i.e. it should be spent in the real interests of the ummah. Whereas Zakah is a form of obligatory alms-giving and religious tax in Islam. It is based on income and the value of all of one's possessions. It is customarily 2.5% of a Muslim's total income, savings and wealth above a minimum amount known as nisab. For the corporate zakah, it is based on profit and loss account or net working capital (current assets minus current liabilities)

### **Islamic Capital Structure Analysis**

The value of a firm is determined by the expected future free cash flow (FCF) discounted by its weighted average cost of capital (WACC). Time valuation is possible only in business and trade of goods but not in exchange of monetary value, loans or debt. This is determined by:

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Where,

WACC is affected by the cost of sale-based financing, equity, and tax rate. Tax shield and zakah shield (profit and loss method) would reduce the effective cost of sale-based financing and

WACC as a whole. Therefore, the increase of capital funding from sale-based financing would actually increase the value of a firm. However, this only happen to certain extent as the increase of funding from sale-based financing would increase the future cost of sale-based financing and cost of equity. This is because the higher sale-based financing would increase the risk of bankruptcy and thus financier would demand a higher return (higher cost of sale-based financing) for bearing higher risk in credit risk. As for the shareholders, the possible future FCF available for shareholders would be reduced because a larger portion of firm's earnings before tax would be used to service the sale-based financing. As a result, investors would demand higher required rate of return for bearing higher risk and reduce cash flow.

### **Effect of Profit And Loss Sharing Claims for All Financings**

If all financings were based on Profit and Loss sharing claims, the important component will be on the net cash flow from the operation. The risk of bankruptcy and agency cost will be shared by the investors and the investee.

### **Effect of Profit And Loss Sharing Claims on Equity and Sale-Based Financing**

Under this condition of equity and sale-based financing, the firms would be financed by more sale-based financing than equity to minimize WACC. In a tradeoff between tax benefit and bankruptcy related cost, the firm is supposed to substitute sale-based financing for equity and vice versa until the value of the firms is optimized.

### **Effect of Financing on Stakeholders or Ummah versus Shareholders Maximization Theory**

Islamic Finance is within the scope of Islamic economy whose main goal is to promote maslahah or public interest and prevent harm (mafsadah). It is built upon principles underlined by Shariah. It takes into consideration issues of social justice, equity and fairness and the practicality of commercial transaction which are shariah compliant. While zakah is given to the recipients of zakah, according to Quran, corporate tax should be spent in the real interests of the ummah, and then the question of tax shield and zakat shield in the choice of equity and sale-based financing should not be part of the arguments to increase firm's value. The focus should be maximizing the net cash flow from operation as long as it is deemed legal and lawful by the Shariah and is free from any prohibition. Therefore, the total value of a firm should be the potential net cash flow plus the tax and zakah discounted at the weighted average of cost of capital.

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### **Suggestion for Future research**

Future researchers should provide empirical works that reflect financing under Shariah financial design for Shariah Compliance Company either locally or cross countries comparison.

### **Conclusions**

Despite the permissibility of sale-based financing and equity financing, there is no indication showing that one is preferred over the other. Is equity financing is more preferable than sale-based financing? If that is the case, what is the ideal composition of equity and sale-based financing in a Shariah approved firm? Or Shariah does not put any limit for firm to choose either equity or sale-based financing as long as it can achieve the optimum value? It should be noted financing should not predominate over partnership financing. Can a corporation take advantage of lower cost of capital of sale based financing to maximize its value? Can the principle of the Shariah is that: "No risk, no gain" be applied for sale based financing?

It is also noted that the capital structure decision for Shariah approved firms is also influenced by the payment of zakat in addition to corporate taxes. While zakah is given to the recipients of zakah, according to Quran, corporate taxes should be spent in the real interests of the ummah, and then the question of tax shield and zakah shield in the choice of equity and sale-based should not be part of the arguments to increase firm's value. The focus should be maximizing the net cash flow from operation before tax and zakah as long as it is deemed legal and lawful by the Shariah and is free from any prohibition

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**Keynote Speech**

**By**

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at

International Conference on Accounting, Business and Economics

10 – 11 December 2015, Faculty of Economics Islamic University of Indonesia,  
Yogyakarta

**PROMOTING ECONOMIC GROWTH  
THROUGH GOOD GOVERNANCE,  
TRANSPARENCY AND ACCOUNTABILITY:**

**(Re) Understanding the Behavior of Corruption for  
Improving the Effectiveness of Anti-Corruption Measures  
in Building a Stronger Economy and a More Civilized  
Society**

**1. Introduction**

Distinguished Participants, Ladies and Gentlemen,

It is a great honor for me to deliver a keynote speech at this very special event. First I would like to congratulate the committee of this event for the excellent arrangements for this conference. I trust all participants are enjoying their activities in this event. I would also like to thank the Faculty of Economics Islamic University of Indonesia for supporting the organization of this conference.

For this keynote speech, let me first start with a brief outline about the current state of corruption in the world and in Indonesia. This is an important issue as on 9 December 2015 once again we celebrate the International Anti-Corruption Day for raising our awareness on the danger of corruption to our society as well as our roles in fighting it. I then would like to focus the discussion on the behavioral side of corruption to highlight the root of the problem with special reference to Indonesia. Thirdly I would like to dwell further into the issues of behavioral changes required to effectively address the corruption problem in our nation. As you appreciate, the topics proposed by the organizer in this conference are wide ranging which will be further elaborated during the presentations and discussions following this keynote speech.

## 2. Defining Corruption

Ladies and Gentlemen,

Generally defined as the abuse of public power for private benefits, corruption has been a major problem in the world causing low economic growth, distorted investment and low quality of public services. Corruption has now escalated into a worldwide crisis. Many countries have been struggling with corruption for decades and Indonesia is not an exception. In the early 1990s corruption began to receive serious attention worldwide despite still being a little-talked about issue. However, historical records suggest that corruption may well be as old as human civilization itself. For example, around two thousand years ago corruption was already discussed in a book, *Arthashastra*, written by the prime minister of an Indian kingdom, Kautilya. Despite being a worldwide problem, there have been numerous different definitions of corruption used for the purpose of identification and prosecution. The Organization for Economic Co-operation and Development (OECD), for example, defined corruption as the abuse of public or private office for personal gain. In Indonesia, the Law No. 31 Year 1999 as amended by the Law No 20 Year 2001 on the Eradication of Corruption lists seven categories of offences that constitute corruption: acts that cause losses to the nation; bribery; occupational embezzlement; extortion; deception; fraudulent procurement of goods and services; and gratification.

## 3. Current State of Corruption

Ladies and Gentlemen,

Despite worldwide initiatives to stamp out corruption evidence suggests that the problem persists and thus more still need to be done in the future. A number of trends in corruption have been highlighted by various studies worldwide. First, in most if not all countries plagued with corruption, bribery appears to be its most common form especially within the interactions between people and public officials. This correlates with the fact that public institutions entrusted to protect people often suffer the worst levels of bribery whereas governments are often deemed too soft to be doing enough to prosecute the offenders.

Worldwide experience has shown that corruption affects not only the perpetrators but also their environments and even their countries. More than a few high profile politicians, world leaders, businessmen, and even governments have fallen because of accusations of corruption. Conflicts arising from corruption-related issues have even claimed the lives of many innocent people. Regardless of the difficulty in quantification, no one denies that the political, economic and social development costs of corruption are becoming increasingly evident.

In Indonesia, according to the Indonesia Corruption Watch (ICW), the estimated losses from corruption in the first half of 2015 alone is nearly Rp 700 billion (around US\$ 50 million). According to the KPK's investigation data, from the total 423 major cases investigated by the commission in 2004 – 2015 (up until May 2015), bribery appears to be the most prevalent type of corruption in Indonesia. Around 46% of the major corruption cases in the past decade were in this category. Goods and services procurement cases (31%) which has brought down a number of high ranking public officials is the second most common corruption type in the country. This is of no surprise as kickbacks, in particular within public contract such as to supply goods or construct a public infrastructure, is a common problem in developing countries including Indonesia.

Regardless of the classification, in practice, the major offences of corruption as depicted by the KPK's investigation data (fraudulent goods and service procurement, unlawful licensing, bribery, unauthorized collection, budget misallocation, money laundering, and obstruction of investigation) are often interconnected to one another. When private sector vendors approach government officials to unlawfully seal a procurement contract, for example, they may offer a huge amount of bribes to the officials who then conceal the money or other assets from the authorities' attention by various means of money laundering. Similarly, the deliberate misallocation of state budget, unauthorized collection, and unlawful licensing will often be connected to money laundering at some point for hiding the flow of the illegal funds.

According to the KPK's statistics, 25% of corruption offenders under the commission's investigation in the period of 2004 – 2015 worked in the private sector and another 25% were higher echelon (I, II, and III) public officials. The fact that bribery constituted 46% of the major corruption cases in the past decade is believed to be related to the rent-seeking activities by, for example, businesses to obtain privileges from corrupt public officials in return for bribes to increase their efficiency and profits.

The pervasiveness of corruption in the Indonesian bureaucracy has even gained international recognition. For example, the Global Competitiveness Report 2014 – 2015 by the World Economic Forum mentioned Indonesia as one of the countries in the world with pervasive corruption problem. Another report by the U.S. Commercial Service, "Doing Business in Indonesia: 2014 Country Commercial Guide for U.S. Companies", also revealed that, from U.S. investors' perspective, the pervasiveness of corruption in Indonesia was seen as a major obstacle in investing in the country.

#### **4. Re-Understanding Corruption**

Ladies and Gentlemen,

Many anti-corruption scholars believe that the rampaging corruption in Indonesia is caused by factors such as large amounts of public resources especially those from natural resources, conflict of interests within political networks, low civil service salary, weak regulatory framework, just to name a few. On the other hand, it is also important to understand that one of the major causes corruption remains entrenched in Indonesia is the fact that we often view it as a single dimension problem. For example, many only see corruption problem from legal perspective and thus resources are allocated mostly for investigation and prosecution. In reality, however, corruption is a complex multidimensional issue that requires extensive approaches to resolve. One of the often forgotten sides of corruption is the behavioral side which is essentially related to the human interactions behind corrupt acts including the mental process of how an individual decides on whether or not to engage in such acts.

Simply put, from the behavioral perspective, corruption offenders committed corruption because it is perceived as the most logical course of action to deal with their perceived situations or problems. In the presence of pressure, opportunity and rationalization (i.e. the Fraud Triangle) an offender commits a corrupt act because he or she believes that it is the best option which will result in the highest perceived net benefits (perceived benefits deducted by perceived costs). For example, in the case of bribery in Indonesia, the common benefits that may have been expected by public officials who accept bribes include but are not limited to living an extravagant live, desire to attain high status, power, and prestige; and loyalty to superiors and organizations. On the other hand, they may also recognize the risk of detection



and prosecution, guilt and fear, disappointment, humiliation, and possible restitution as the costs or negative consequences that may come with the action.

At the core of the corruption problem in Indonesia are the various behavioral issues associated with the patrimonial leadership style and the rent-seeking behavior which render anti-corruption measures ineffective. For example, studies revealed that for many Indonesian public officials upholding loyalties to peers and superiors was a priority above everything else. Such an attitude has made many public officials reluctant to report to higher authorities wrongdoings within their institutions which in turn undermines the effectiveness of the existing whistleblowing systems.

When a public official perceives the net benefits of accepting a bribe is higher than not doing so he or she will likely choose the former option. This mental process is contained in a structure known as the “schemata”. As originally postulated by Frederic Bartlett, schemata is an active organization of past reaction, or of past experiences which also serves as a “processing unit” for handling and interpreting information from the existing environment. Three levels of schemata which influence one another are individual schemata, organizational schemata and societal schemata.

A common means an individual’s schemata are shaped is through interactions within organizations where they belong. So far as theories and practices are concerned, the ability of corruption to regenerate in an organization is largely contributed by the continuous process of normalization with three mutually supporting pillars of *institutionalization* (making corruption part of organizational schemata), *rationalization* (using multiple justifications for corrupt acts) and *socialization* (making corruption part of organization members’ individual schemata). Within this normalization process organization members’ morality gradually decreases over time.

As the so-called “Tone at the Top”, leaders play a crucial role in shaping an organization’s schemata (i.e. culture). In other words, whether or not an organization will become corrupt is largely depending on their leaders. Many anti-corruption scholars identify leadership as a determining factor for pressure, opportunity and rationalization to emerge within an organization. They believe that the role of bad leadership in corruption is an evolution of processes of transformation from caution, honesty, respect and valuing others to the thrill and excitement of selfishness, narcissistic and omnipotent gratuity. A survey by the Corruption Eradication Commission (KPK) on the integrity of Indonesian election revealed that the majority of Indonesians who understand the meaning of the term “integrity” are those with high education whereas those with low education are generally unfamiliar with such a term. This indicates that uneducated voters may have used incorrect criteria to select their leaders and thus accidentally gave their votes to potentially corrupt leaders

Just as any other human being, every leader uses their individual schemata to make multiple decisions in their line of duties. Their individual schemata also serve as a reference for their subordinates’. In many cases of corrupt leaders, they will usually attempt (by coercion if necessary) to capture their subordinates’ allegiance and shape their schemata to mimic their own. Therefore, selecting leaders with strong moral compass is very detrimental in building an accountable organization.

In Indonesia, due to public participation in the process, general and regional elections serve strategic roles in securing good leadership. However, numerous corruption cases in Indonesia involving high-ranking public officials in the executive, legislative and judicative institutions suggests that the existing leader selection process remains ineffective in producing leaders with high integrity.

## 5. Future Directions

Ladies and Gentlemen,

As we all know, one of the current projects of the ASEAN countries is the establishment of the ASEAN Economic Community (AEC) with an aim to integrate Southeast Asia's diverse economies, a region with 600 million people and a combined gross domestic product of US\$2.4 trillion. This also means every country in the region needs to prepare themselves for a tougher competition in the market. Increasing efficiency will be among the strategies in improving the competitiveness of a country's economy. This highlights the importance of minimizing losses from corruption which may erode market competitiveness. For this, the multiple dimensions of corruption need to be simultaneously addressed to ensure that the problem will not regenerate over time. Decision makers must allocate sufficient resources not only to address issues in a single area (e.g. law) but also to cope with other issues in a number of other different areas which also means giving more attention to behavioral issues behind the problem.

So far as behavioral science development is concerned, we are still far from truly understanding the schemata transformation that sustains the growth of corruption. The three decades of schemata engineering during the New Order era in Indonesia had resulted in a corrupt culture seemingly resilient to changes. Long-term strategies need to be devised to gradually change Indonesian people's schemata to be more intolerant to corruption. Part of these strategies is education for the youth of the nation who will become the future country leaders which requires active participation from educational institutions.

As places where young generations' minds are equipped with various skills and knowledge to prepare them for future competition, educational institutions play an important role in eradicating corruption by instilling ethics and moral into young minds. Therefore, it is of utmost importance for educational institutions to be a corruption – free environment for students to learn about honesty and integrity. Many experts believe that children who are exposed to corruption and other misconducts in their early childhood and within their schools may not develop an appropriate sense of dignity, integrity and respect for human rights and are eventually accustomed to corruption and the disregard of human rights, and consider these practices a natural part of social interaction.

As an important determinant in shaping organizational schemata leaders with impeccable character and integrity can be the agents of change in particular within organizations or communities where corruption is already accepted as a norm. Against all odds, such figures will initiate bold movements to tear down the three pillars (institutionalization, rationalization and socialization) of corruption normalization. There have been a number of figures in the history of Indonesia who had been seen as the embodiments of justice, integrity and honor who stood against any form of corruption in the country. Names such as Dr. Muhammad Hatta (the first Vice-President of Indonesia) are Police General Hoegoeng Iman Santoso (Former Chief of Police of Indonesia) are synonymous with courage and integrity. In an honor of Dr. Muhammad Hatta, the Bung Hatta Anti-Corruption Award (BHACA) has been given to a number of figures deemed to have demonstrated unwavering commitment in promoting integrity and accountability in their organizations and communities. For the year 2015 the award was given to the former mayor of Surabaya, West Java, and the current regent of Batang, Central Java. Both leaders are excellent examples of how even one individual can make a big impact in the struggle against corruption in our community. An important attribute of a corruption intolerant leader is his or

her so-called moral development stage. Referring to Kohlberg's Moral Development Theory, the lowest stage of moral development is when one's action is primarily guided by fear of punishment whereas the highest is represented by the dominant role of one's conscience in guiding his or her actions.

A leader with corruption resistant schemata is a product of a lifelong process of moral development through social and family interactions. On the other hand, a corruption tolerant leader is also a product of similar process but with a different result. If we could truly understand what constitute the process to produce a morally sound leader then we may be able to replicate it to make more of them to lead the country. When a country is dominated by leaders who see corruption as an illogical course of action then corruption will have no place to grow and to flourish. For anti-corruption scholars this highlights the need for "reverse engineering" honest and accountable leaders through extensive studies on multiple factors that shape their individual schemata to reject the idea of corruption. Once we can produce many corruption intolerant leadership figures to lead our country then we can win our fight against corruption and our economy will be stronger than ever.

I sincerely hope that this conference will provide us with useful insights to contribute to the development of our economy by promoting transparency and accountability particularly in the ASEAN region.

Thank you very much for your kind attention and I hope the conference will be a great success.

Thank You

## Editorial

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## **Small medium enterprises (smes) growth model (marketing entrepreneurial approach)**

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### **Abstract**

Research on entrepreneurship has focused on a personal approach where business success is determined by the characteristics and competencies of the owners / managers of small businesses. Managerial approach also has significance as a factor determining the success of SMEs. Managerial approach emphasizes entrepreneurial behavior in running a business, including in this approach is the strategy, innovation, and marketing. Determinant of the success of small businesses is not only determined by the owner / manager, but is also determined by how the owner/manager to run the business, environmental influences including competition, economic conditions, and resources. Theoretical studies required the development of an integrative model among individuals, organizations, and the environment that contribute to business growth. Several studies have been conducted on internal factors include individuals and organizations, how the relationship between the individual factors in developing further analyzes effective organization of environmental factors, how environmental factors in this case acts as an inhibiting factor or a growth driver. Finally, it is also important application of the marketing concept of entrepreneurship as an integrative model, in terms of resource constraints and problems that exist in small businesses.

Keyword: *integratif model of entrepreneurial, personal approach, managerial approach, entrepreneurial marketing appro*

### **INTRODUCTION**

SMEs proved able to survive the uncertain economic conditions, even able to absorb the labor force is large enough, but the problem is the success rate is still low (Sarwoko, 2013). Research on the factors that influence the success of SMEs so far can be classified into 3 groups: individual factors, organizational factors, and environmental factors (Baum et al., 2001; Papadaki dan Chami, 2002; Zhou and Wit, 2009). Two main factors have often been the focus of entrepreneurial research are individual factors and organizational factors. Individual factors include the characteristics of the owner/manager, owner/manager competences in the entrepreneurial process (Booheme, 2008; Nimalathasam, 2008; Li, 2009; Sarwoko, 2013) demographic factors, entrepreneurial competence (Lee dan Tsang, 2001; Kiggundu, 2002; Man et al., 2002; Blackman, 2003; Zoya dan Herath, 2007; Kotey dan Meredith, 2007; Man & Wafa, 2008; Ahmad et al, 2010, Sarwoko, 2014). Individual factors that affect the SMEs performance can be divided into 4 groups: 1) personal characteristics; 2) psychological characteristics; 3) human capital; 4) behavioral (Li, 2009).

Research on organizational factors include characteristics of the company, the organization's resources, the company's competency, organizational culture, structure, strategy (Covin & Slevin, 1991; Sarwoko, 2014; Street & Cameron, 2007). Included in the organizational factor is the emphasis on the behavior of the owner/manager in the operations to succeed. Owner/manager will determine the strategy by considering environmental factors, meaning that

the behavior will affect managerial decisions that result in business performance (Covin and Slevin, 1991; Hasim, 2000; Gibcus dan Kemp, 2003; Li et al., 2005, Sarwoko, 2013).

SME is a unique business, has characteristics that are not the same as large companies, including in applying marketing. The concept of marketing has been growing (traditional marketing) originally developed for large companies, can not be directly applied to small businesses without adjustments, then comes entrepreneurial approach marketing as kotingensi approach is more appropriate, in terms of resource constraints and problems that exist in SMEs (Stokes, 2000). Entrepreneurial marketing has attracted researchers not only from a marketing and entrepreneurship, but also of economics, psychology and sociology. Initially entrepreneurial marketing is the marketing activities undertaken in the new venture (Ionita, 2012). Entrepreneurial Marketing is an organizational function and the processes for creating, communicating and delivering value to customers and for managing customer relationships in ways that benefit the organization and stakeholders, and is characterized by innovation, risk-taking, pro-active, and may be done with limited resources power (Kraus, Harms et al., 2010). This article discusses the importance of entrepreneurial marketing approach that is integrated with a personal approach (individual factors), the organization, as well as the environment as a determinant of successful models of small and medium enterprises.

## **Literatur Review**

### ***Personal Approach***

Research on personal factors that affect the performance of the business can be divided into 4 groups (Li, 2009), namely:

1. Entrepreneur characteristics, traits and motives which distinguishes an entrepreneur instead.
2. Psychological characteristics: the need for achievement, internal locus of control, risk-taking, creativity, and innovation.
3. Human capital: education, work experience, experience, skill and technical knowledge.
4. Behavioral: entrepreneurial competence to identify and define the characteristics of a successful manager.

Special behavioral group developed the concept of entrepreneurial competency shows the relationship between the owner attribute behavior that will affect the success or performance of the business. Attributes are characteristics of entrepreneurship that include demographic characteristics, attitudes, knowledge, skills, abilities, skills and behavioral tendencies are needed to achieve business success (Kiggundu, 2002; Ahmad; 2010, Sarwoko, 2013).

Research with managerial approach found that the effective use of resources and efficient ultimately determine the performance/success of the business. In this way the performance of the organization depends on how strategies and implement practices to handle effectively and efficiently organization. Li et al. (2005) states that the performance of business related to entrepreneurial strategies. Entrepreneurial strategy is positively related to business performance because it can help companies to take advantage of the start of the activity in advance and take advantage of existing opportunities (Zahra & Covin, 1995).

### ***Organizational Approach***

The company's growth is the increase certain attributes such as sales, production, and profitability of a company between two points within a certain time (Hakkert & Kemp, 2006). The company's growth is determined by the effectiveness and capabilities of the company's resources such as labor, capital and knowledge acquired, organized and transformed into products and services through the activities of the organization, practices and structures (Nickell, Nicolitsas & Dryden, 1997).

Organizational approach in entrepreneurial emphasis on 1) the attributes of the company; 2) strategy; 3) resource companies; 4) the organizational structure; and 5) the ability to dynamically (Zhou and Wit, 2009). So the research on organizational factors emphasis on entrepreneurial behavior in conducting their business in order to succeed, including in this approach is the strategy and innovation.

The general finding in the literature is that most small companies, developing start small and grow, but it is easy to fall due to competition. One major reason is that most of them start businesses that are imitative in mature industries that serve local markets (Baldwin and Gellatly, 2003). Samundsson and Dahlstrand (2005) studied 262 young technology-based Swedish company and found that companies that want to take advantage of new market opportunities based knowledge tends to achieve substantial growth than companies who want to exploit market opportunities based on existing knowledge. Environmental factors in this competition is a factor causing small businesses to grow.

### **Entrepreneurial Marketing Approach**

The concept of entrepreneurial marketing is focused on innovation and development of ideas in line with an intuitive understanding of market needs. In the traditional marketing assumes that a thorough assessment of the needs of customers ahead of the development of a product or service development (Stokes, 2000). Entrepreneurial marketing is a concept that developed between the marketing and entrepreneurship. Entrepreneurial marketing construct not only the relationship between marketing and the entrepreneurial process which has existed as a conceptualization of conventional, but fully cover all aspects of marketing and entrepreneurship (Morrish, Miles et al., 2010), thus becoming strategic orientation even exceed the marketing function (Schindehutte dan Morris, 2010).

The fundamental difference between traditional marketing with an entrepreneurial marketing according to Stokes (2000) are presented in the following table:

**Table 1.** Differences in Entrepreneurial Marketing Traditional Marketing

Marketing Principles	Traditional	Entrepreneurial
Orientations	Customer orientation	Inovation
Strategy	Top down approach	Bottom up approach
Methods	4/7 P's Marketing mix	Word of mouth, direct selling, referrals methods
Market intelligence	Formalized and intelligence system	Informal networking and information gathering

Source: Stokes, D (2000), "Putting Entrepreneurship into Marketing: The Process of Entrepreneurial Marketing", *Journal of Research in Marketing & Entrepreneurship*, 2(1), p. 13.

## **DISCUSSION**

### **1. Personal Approach (Owner/Manager and SMEs Performance)**

An entrepreneur has different characteristics and practices vary, it is important to understand the relationship between the characteristics of the owner / manager with the performance. Previous research shows small-business performance is determined by personal values of the owner / manager (Zoysa and Herath, 2007; Lee and Tsang, 2001; Street, 2007; Blackman, 2003; Nimalathasan 2008). Performance/business success is determined by: individual characteristics, organizational characteristic (Street, 2007; Nimalathasan, 2008, Sarwoko, 2013).

In general, the characteristics of the owner/manager leads to competence, consisting of motive someone, nature, aspects of the role of a person's self-image or social, skills, and knowledge are used (Boytazis, 1982). So the role attribute the behavior of entrepreneurs will be

determined by their competence, competence will play a mediating relationship attributes with the behavior of entrepreneurs. the experience of entrepreneurs, training, education, family background and demographic variables are being considered as factors affecting the entrepreneurial competence (Herron and Robinson, 1993). This suggests a relationship between the characteristics of entrepreneurs with competence (Sarwoko, 2013).

The success or failure of the business will be affected by the skills and abilities (competencies) of owners/managers. The role of the entrepreneur reflects the competencies required by employers to ensure business survival and success of the business. The role of the owner/manager is focused on the development of entrepreneurial competence (Akhmad 2010; Kiggundu, 2002). So the stronger the knowledge, skills and abilities of the manager / owner will cause the higher the ability to face changes in the external environment, so as to define a strategy to address these environmental changes (Sarwoko, 2013).

Entrepreneurial competence significantly influence the success of a businessman Ahmad et al. (2010), on small businesses in Malaysia found that entrepreneurial competence as a predictor of business success of SMEs in Malaysia. Ability and personality characteristics of those who manage the company is universally regarded as one of the most powerful factors have a positive or negative impact on the performance (Zoysa and Herath, 2007).

## **2. Organizational Approach**

Li et al. (2005) suggested a relationship between entrepreneurial strategies and performance with environmental factors and the company's competency as a moderate variable. Special entrepreneurial strategy has a positive relationship with performance when the environment is highly uncertain and when the company has a strong marketing competence. Entrepreneurial strategy is positively related to business performance because it can help companies to take advantage of the start of the activity in advance and take advantage of existing opportunities (Covin & Slevin, 1991; Zahra & Covin, 1995).

Business performance depends on how the preparation of the strategy in the management of the organization and to apply business practices effectively and efficiently. These practices are determined by the characteristics of entrepreneurship (Nimalathasan, 2008). According Kotey and Meredith (1997) empirically owner/manager of personal values, business strategy relationship to enterprise performance. Differences in personal characteristics will determine the difference in the strategy, and will affect the performance (Boohene, 2008). Rue and Ibrahim (1998) found a positive relationship between strategy and performance of the company, as well as presenting various types of strategies and their impact on performance.

A key factor in the creation and implementation of the strategy in small business is the influence of the value of the owners / managers (Olson and Currie, 1992). Owners/managers values determine business objectives and influence their management style, problem- solving and decision-making as well as business structure and strategies used (Verheul et al., 2002). SMEs are usually formulated strategy on non-formal (McCarthy, 2003), because small companies typically do not write the formulation of strategies, they develop strategies and inferred from the pattern of behavior of the owner-manager and the allocation of resources (Schindehutte and Morris, 2001). So the business strategy will be determined by how the ability of owner / managers in the face of environmental situation changing, meaning that the success of the strategy on the achievement of personal performance is determined by the value that has the entrepreneurial competence.

## **3. Entrepreneurial Marketing Approach**



The application of entrepreneurial marketing depends on two things: 1) the ability of owner / managers to predict changes in the business environment, 2) long-term corporate objectives, namely growth (Westerlund and Leminen, 2012). Entrepreneurial Marketing concept developed is actually a long time, but started the receipt of marketing concepts in entrepreneurship, started in 1982, and the results of the first empirical studies of entrepreneurial marketing started in 1985, this period is the first milestone in the development of entrepreneurial marketing. Ten years later, namely in 1996 began the second milestone in which the research results see the similarities between marketing and entrepreneurship. In the end, after 20 years, conducted a symposium to encourage quality scientific thinking and research on Entrepreneurial marketing in 2006, and developing ideas and thoughts about marketing entrepreneurial (Ionita, 2012).

Entrepreneurial marketing will bring new elements and strengthen the existing elements, such as a focus on change, innovative attitude and alertness to opportunities. Entrepreneurial marketing will integrate entrepreneurs or entrepreneurs in the marketing process (Hultman, 1999).

There is a difference between entrepreneurial marketing with traditional marketing. If traditional marketing simply related to marketing activities undertaken, entrepreneurial marketing is a concept that is not necessarily related to company size, age or resources. An owner/manager of a small business can not directly apply the concept of conventional marketing, due to the small business has unique characteristics that differentiate with other business organizations, so as to be oriented innovation, approach from the bottom up, the target is based on a customer, the method of interaction marketing, mout of mouth, direct selling, as well as the network is done on an informal basis for the purpose of small business can succeed.

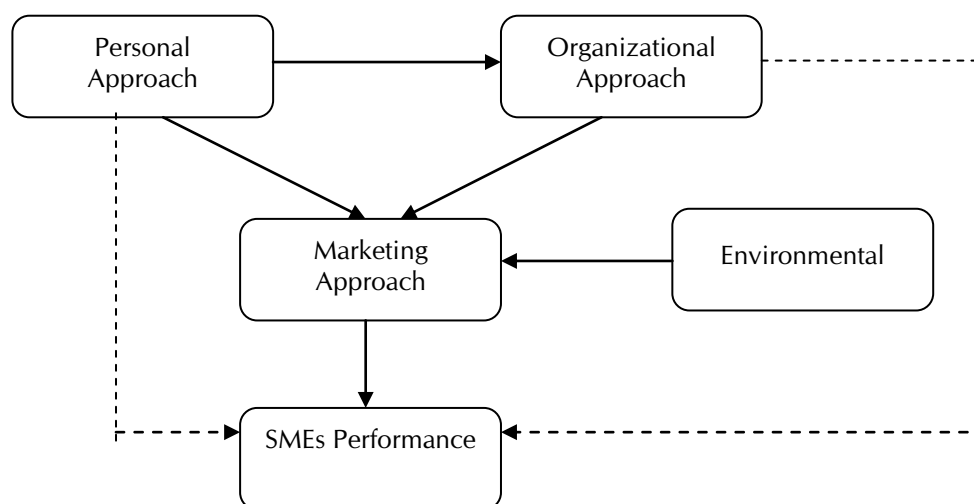
#### **4. Future Research**

Discussion about the success and growth of small businesses would have known about the factors that influence. Although it proved to be a small business to survive in the face of the economic crisis, but many have not managed to grow and develop into a business that has long-term prospects. This is due to start from the characteristics of the owner/manager, the behavior of the owners/managers in running their business more oriented to short-term gain, low competitiveness, and ability to apply the concept of marketing is low. Various studies entrepreneurship successfully test and prove the determinants of the success of small businesses, but with a research perspective different, because based on discussions on the approach to the individual, the organization's approach, and the approach of entrepreneurial marketing is necessary to do research to develop an integrative model of the performance of SMEs, as in figure 1.

Entrepreneurial research starts from the attention on aspects of entrepreneurs (owner/manager), how the characteristics of an entrepreneur, competency owner/manager in the entrepreneurial process, demographic background, psychological characteristics, human capital (Booheme, 2008; Nimalathasam, 2008; Li, 2009; Sarwoko, 2013), kompetensi wirausaha (Lee dan Tsang, 2001; Kiggundu, 2002; Man et al., 2002; Blackman, 2003; O'Regan et al. 2005; Zoya dan Herath, 2007; Kotey dan Meredith, 2007; Man & Wafa, 2008; Ahmad et al, 2010).

Individual characteristics are not sufficiently considered as a determinant of success, because basically the individual characteristics will determine the competence of an entrepreneur. Owner/manager is the person running the business, the management of a business is determined how the behavior of the owner/manager in the operations to succeed, establish appropriate strategies to read the market opportunities and meet market demand, using the organization's resources effectively and efficiently, as well as building a culture. So the organization as well as the factors determining the success of a small business, which includes characteristics of the enterprise, the organization's resources, the company's competency,

organizational culture, structure, strategy (Covin & Slevin, 1991; Sarwoko, 2014; Street & Cameron, 2007). Owner/manager will determine the strategy by considering environmental factors, meaning that the behavior will affect managerial decisions that result in business performance (Covin and Slevin, 1991; Hasim, 2000; Gibcus dan Kemp, 2003; Li et al., 2005, Sarwoko, 2013).



**Figure 1.** SMEs Growth Model (Entrepreneurial Marketing Approach)

Strong individual characteristics which will be able to run the organization effectively and efficiently, two aspects of this individual and organizational factors that will determine the success of small businesses. One more aspect that is equally important is how small businesses are able to apply entrepreneurial marketing as the final part of a business activity. Business environment increasingly strong competition, on the other hand a small business has unique characteristics, so as to be able to implement a marketing strategy that fits entrepreneurial according to the characteristics of the organization and characteristics of the owner/managers.

Entrepreneurial marketing as a marketing approach in entrepreneurship need to be tested empirically, because small businesses have different characteristics from conventional business in general, due to be oriented innovation, using an approach from the bottom up, the target is based on a customer, the method of interaction marketing, mout of mouth , direct selling, as well as the network is done on an informal basis for the purpose of small business to be successful, so expect the above research model can be tested by the researchers in the field of entrepreneurship.

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