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Urgency of Tax Incentives in Indonesia for Research, Development, and Internationalization of MSMEs

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Abstract

The purpose of this research is to reveal and find out some of the factors needed by micro, small and medium enterprises (MSMEs) to develop their business through development research in order to increase economic growth and business networks at the international level. This study uses library research methods, through a qualitative approach with deductive and inductive process analysis. The data source is secondary data, namely relevant previous scientific work. Data processing is done by: analyzing correlations and building concepts to predict, explain, and control the studied phenomena, and draw conclusions based on the theoretical framework. The results of this study indicate that the development of MSME entrepreneurship is the main driver of economic growth in several countries, including Indonesia. For the development of MSMEs, the government can provide a conducive environment for the business world and MSMEs through financial support such as providing tax incentives. So that MSME development research is the main focus in innovation and technological change to increase higher economic growth. Improving the performance of MSMEs through innovation, job creation, export growth, and the emergence of new highly competitive entrepreneurs is an opportunity to gain greater access to new markets at the international level.

Keywords: internationalization, micro small and medium enterprises, tax incentives, MSMEs

Introduction

Internationalization has become a new trend among business actors at various levels, with varying degrees of sophistication and scale over the past few years. This new trend has led to an increase in cross-border business transactions (Adeleye and Esposito, 2018; Ibeh et al., 2012). The overall growth and development of economies have given rise to many new entrants in domestic and regional markets, exploiting opportunities with creativity, innovation, and expansion to ensure sustainable survival (Adeleye and Boso, 2016).

Undeniably, for several decades, foreign multinational companies have dominated the business landscape in some developing countries. However, the internationalization of companies in developing countries has begun to change this narrative, positioning many domestic companies as unavoidable competitors. The drive, scope, and speed at which some companies are internationalizing have become a highly intriguing phenomenon in recent times (Adeleye and Boso, 2016).

Internationalization has enabled the expansion of companies in various industries and sectors across different countries, including manufacturing and services, such as the telecommunications, financial, agricultural, oil and gas industries, and others. Research on the internationalization of companies is still limited due to economic orientation constraints and the difficulty companies face in achieving internationalization status completely (Ibeh et al., 2012). Currently, the advancement of technology and reduced trade barriers have led to the belief among the business world and researchers that the relevance of internationalization models remains a challenge, especially in the context of small and medium-sized enterprises (Adeleye and Esposito, 2018). Investigations into contemporary internationalization theories to adapt to the dynamic present-day environment are ongoing and increasing.

Research and development (R&D) is increasingly seen as a growth catalyst, leading to improved competitiveness and, ultimately, increased well-being (David, Hall, & Toole, 2000). The evolution of growth theories emphasizes the importance of technological change and innovation. Technological differences are considered a source of productivity differences among countries, sectors, and industries (Acemoglu, 2012). Most countries aim to boost R&D activities to achieve higher and sustainable growth rates. R&D activities in the business sector are highly correlated with R&D intensity and a country's growth performance (OECD, 2001).

The internationalization efforts of micro, small, and medium-sized enterprises (MSMEs) are a suitable program and initiative because the majority of businesses in Indonesia consist of MSMEs, totaling 8.71 million business units (Santika, 2023). Therefore, research on the internationalization of MSMEs is essential. The objective of this research is to explore how MSMEs can employ global strategies by utilizing tax incentive policies optimally.

It is known that more than 90 percent of the Indonesian workforce is employed in the MSME sector. Directly or indirectly, through the utilization of tax incentive policies, MSMEs can have a positive impact on the livelihoods of people in the lower-income segments of society. MSMEs play three crucial roles in society: (a) as a means to alleviate people from poverty; (b) as a means to equalize the economic status of small-scale citizens; and (c) as a source of revenue for the country. With these three roles, MSME participants should not be underestimated, as they are one of the drivers of the national economy.

As a national economic driver, it is imperative to empower MSMEs to enhance the quality of economic growth and provide a solution for the existing economic disparities. One way to support micro, small, and medium-sized business owners is by financially supporting their business activities through tax incentive policy strategies.

Literature Review

a. Entrepreneurship of Micro, Small, and Medium-Sized Enterprises (MSMEs)

There is a common thread between Entrepreneurship and Micro, Small, and Medium-sized Enterprises (MSMEs). Entrepreneurship involves the process of creating or identifying innovative opportunities for new products or improving existing products/services, considering associated risks and proposed rewards (Agwu and Emeti, 2014). Drucker's publication (1985) titled "Entrepreneurship and Innovation" highlights the commonality between these concepts. According to Drucker, entrepreneurs create new things while adding greater value involving numerous innovations. In contrast, MSMEs are businesses that may not necessarily introduce new products or services. Drucker also states that, to be entrepreneurial, products/services must be standardized and developed in a unique way, capable of creating new markets, customers, and demand. Thus, an entrepreneur often can start as an MSME, but not all MSME owners will become entrepreneurs.

The sustainability of micro, small, and medium-sized enterprises can be classified as sustainable when they can overcome day-to-day challenges, both in the external and internal environments in which they operate. Previous research on MSMEs has contributed significantly to job growth in many countries worldwide. In some countries, MSMEs have made a significant contribution to the increase in the Gross Domestic Product (GDP), whereas the contribution to GDP by large companies is usually relatively stable (Ebitu et al., 2015).

Peter Drucker and Howard Stevenson put forth an opportunity-based theory of entrepreneurship. This theory supports various entrepreneurial research with a conceptual framework (Shane, 2003). It is stated that entrepreneurs do not necessarily cause change but rather exploit opportunities created as a result of changes in consumer preferences, technology, and other factors. Drucker (1985) further defines entrepreneurs and entrepreneurship as individuals who seek change, respond to change, and strive to capitalize on the opportunities resulting from that change. The key point of Drucker's opportunity construct is that entrepreneurs pay more attention to the opportunities they see rather than the challenges they face. Stevenson (1990) further extends Drucker's opportunity-based theory by incorporating rationality into the theory. Stevenson concludes that entrepreneurs strive to exploit every available opportunity without being overly concerned about their current resources. Research by Fowosire et al. (2017) also highlights the importance of opportunity-based entrepreneurship theory, which explains how entrepreneurs seek to identify opportunities and ensure that these opportunities are explored and transformed into profitable business ventures.

b. The Government Policy, Financial Accessibility, and Infrastructure Development

Busari and Oduwole (2014) argue that the nature of government policies and bureaucratic procedures can have both positive and negative impacts on MSMEs and entrepreneurial activities. Therefore, the government can formulate and implement policies that support the creation of innovative technological solutions and products for business practitioners. Research conducted on the available infrastructure and government policy nature that enables support for MSMEs by Akerejola et al. (2019) provides insight into the lack of proper guidelines and enabling policies for MSMEs to have the opportunity to survive and thrive in a challenging business environment.

While Aluko (2015) discusses the role of MSMEs in the growth and development of many countries, Lawal (2014) reveals the low contribution of MSMEs to the Gross Domestic Product (GDP) and job provision. Previous research conducted by Afolabi (2013), Sokoto and Abdullahi (2013), and Victor et al. (2019) on MSMEs and entrepreneurship has focused on the influence of loans or credit provided by banks to MSMEs without comparing how MSMEs contribute to the GDP. Research conducted by Iyortsuun (2017) performs an empirical analysis of the influence of business incubation processes and the performance of MSMEs with the disclosure of their access to financial institutions.

Some countries struggle to enhance and sustain economic growth without substantial infrastructure development in the country (Ebitu et al., 2016) because infrastructure development can stimulate entrepreneurial activities and development (Fowosire et al., 2017).

Hence, creating a conducive and business-friendly environment for start-ups, entrepreneurship, innovation, and adequate infrastructure should be addressed promptly (Akerejola et al., 2019).

c. Research on Development and Internationalization

As a result of several factors, such as market failures in research and development (R&D) (Arrow, 1962), leading to private investment falling below socially desired levels, financial constraints of small or newly established businesses, and the high cost of some technology development, R&D investment by businesses should ideally seek government support. For this purpose, the government offers generous R&D incentives through direct funding mechanisms like R&D procurement, grants, and subsidies, and as an indirect funding mechanism, R&D tax incentives. In the past decade, tax incentives have been widely used to promote R&D investment in the business sector. In 2020, 33 out of 37 OECD countries implemented R&D tax incentives as a policy tool, showing an increase from 20 countries in 2000 (OECD, 2020).

Researchers view internationalization from various different perspectives, leading to different definitions. Goncalves and Smith (2019) define internationalization as the means by which businesses seek to operate across borders. Johanson and Vahlne (1977) define it as the means by which firms increase their desire and direct and indirect influence to engage in transactions beyond their boundaries. Luiz et al. (2017) also define it as structures, strategies, and resources deliberately adapted to meet a company's drive for internationalization. While some researchers argue that businesses drive internationalization, and some argue that governments are invaluable driving forces (Code, 2007; Fedorov, 2011), legislative bodies, and entrepreneurship education.

In simple terms, companies that export goods or services have the potential to drive internationalization. Globalization and economic changes, along with technological advancements, also play roles in driving internationalization (Mitgwe, 2006). According to the internationalization process model by Johnson and Vahlne (1977), it involves building a series of stages encompassing market knowledge, commitment decisions, current activities, and commitments to markets and business networks.

Research Method

This research employs the library research technique, which does not involve quantitative analysis with statistics but rather utilizes a qualitative approach (Baidan & Erwati, 2016). It involves research techniques that use deductive and inductive analysis processes related to the relationships and changes between observed phenomena, guided by scientific reasoning.

The primary goal of this research is to develop a concept of sensitivity to address specific issues, related to a grounded theory approach, and to gain a deeper understanding of the observed phenomena. From an explanatory perspective, this research falls under associative research, aiming to identify the relationships between two or more variables or objects of study to construct a theory that serves prediction and explanation purposes, as well as control over a phenomenon or occurrence (Kisworo & Iwan, 2017).

The research is based on secondary data, which consists of relevant earlier academic works in the form of books or scholarly journals that discuss tax incentives and the development of MSMEs. Data processing involves (i) analyzing the correlation or relationships between various relevant data sources within the context of the discussion, (ii) analyzing and constructing a concept to predict, explain, and control the phenomena under study, and (iii) drawing conclusions based on the theoretical framework of the research conducted.

Result & Discussion

a) Internationalization and Globalization

Marketing experts define internationalization as the sequential and orderly process of a company's involvement in international business and the changes that occur in the organizational structure as a result of this process (Andersen, in Kaukab, 2016). Calof & Beamish (1995) define internationalization as the process in which a company adapts its operations (strategy, structure, resources) to the international environment. Beamish, et al. (1997) continue the definition of internationalization as a process in which a company increases its awareness of future international activities and engages in transactions with companies in other countries. Another definition of internationalization is provided by Zweig (2002) as the flow of goods, services, and people across national borders, increasing the transnational market share compared to domestic companies and accompanied by a decrease in regulatory barriers between countries in this flow process. Meanwhile, The Group of Lisbon (1995) combines internationalization in the economic and social context, defining it as the flow of raw materials, semi-finished goods, finished products, services, money, ideas, and people between two or more countries.

The concept of globalization is much younger than the concept of internationalization. The concept of globalization only gained popularity in the early 1990s. At the macroeconomic level, globalization is necessary as a concept that enhances global relationships in the economic sphere due to increased transactions of goods, services, international financial flows, and technology transfer as its consequences. In the business education context, globalization is defined as the production and distribution of products and services that have uniform types and qualities worldwide (Rugman & Verbeke, 2001).

Globalization is seen as a process that has several models and can occur in several ways. Ruigrok and Van Tulder (1995) distinguish seven basic dimensions of global economic globalization, which serve as a framework for company activities, especially in the internationalization process, including: financial globalization and ownership, market and strategy globalization, technology and knowledge globalization, consumption, lifestyle, and cultural globalization, regulatory and governance capability globalization, political unification globalization, and perception and agreement globalization.

b) Internationalization Strategies for SMEs

Over the past few decades, small and medium-sized enterprises (SMEs) have played a significant role in the national economy, characterized by their dominance in terms of employment and job creation. SMEs also have dynamic and flexible characteristics, making them adaptable to unstable economic conditions and various risks. In the face of liberalization with intense competition, SMEs are confronted with many new challenges and must be capable of reacting to adapt to these conditions. The processes of internationalization and globalization represent both threats and opportunities for SMEs. Opportunities include exporting, entering new markets, and foreign collaborations, while the threats include escalating competition.

According to the SME Observatory Survey Summary by the European Commission (2007), the primary motivation for SME internationalization is the desire to enhance competitiveness, specifically by gaining access to new and larger markets. In theoretical terms, the most fundamental assumption behind SME internationalization is driven by growth factors, attempting to enter foreign markets.

There are four factors that accelerate SME internationalization (OECD, 2007). The first is the entrepreneurship factor, where growth-oriented entrepreneurs are highly enthusiastic about expanding their businesses in international markets. This factor is the most crucial among the others. The second factor is drivers, where companies are unable to increase growth in the domestic market. This factor is sometimes referred to as a negative factor, forcing companies to leave highly competitive markets. The third factor is pull factors, which involve how companies understand opportunities in foreign markets or when demand for their products only arises in foreign markets. This factor is often referred to as a positive factor. The fourth factor is opportunity, where companies have the chance to enter international markets.

Stehr (2010) argues that an increasing number of companies are developing globalization strategies in entrepreneurship. According to Stehr, there is a difference between entrepreneurial internationalization and entrepreneurial globalization. Entrepreneurial internationalization (business internationalization) is considered achieved when a product is supplied by another country. On the other hand, entrepreneurial globalization is the expansion of international economic activities without regard to national borders. Internationalization is closely related to a company's activities abroad, with the most prominent activity being exports, illustrating how companies expand their business by seeking a broader international market.

With the rapid growth of global networks and communication between countries, SMEs have the opportunity to enter international market competition. SME products that previously only circulated in local and domestic markets must improve their quality to meet export standards. Exporting has a positive impact on a country's economic development, and exporting companies typically have higher productivity than non-exporting companies (Achtenhagen, 2011). The challenge for SMEs is how to create a competitive advantage due to intense competition, both domestically and globally.

Several barriers often occur for SMEs in Indonesia, and various strategies can be applied to reduce the likelihood of failure in the SME internationalization process (Kaukab, 2016): (a) The prospects of SMEs in the era of free trade are highly dependent on the efforts made by the government to develop SME businesses through the creation of a conducive business environment through policy development; (b) The development of SMEs directed towards supply driver strategies focuses on market-oriented, demand-driven programs, which are based on efficiency and the real needs of SMEs, with a focus on sustainable SME productivity growth; (c) Reforming business structures that are more relevant to provide room for SMEs to catch up and use appropriate strategies; (d) Trade liberalization provides opportunities for expanding SME product markets; (e) The formation of strategic alliances between SMEs and foreign companies is the most important and effective mechanism for transferring business information, technology, managerial and organizational capabilities, and access to export markets with government support; (f) Strategies to boost SME performance and role in the free market and address disparities; (g) Developing foreign export support institutions by revitalizing the role of export support institutions.

In a study conducted by Fernandez and Nieto (2006), Buckley and Casson (1976), and Dunning (1981), they stated that the concept and theory of internationalization strategies can be divided into two: internalization theory and eclectic theory. The internalization theory emerged due to the growth of large companies in the 1970s, which posed a threat to SMEs. Over time, this theory sought to internalize the benefits that could be obtained from internationalization, localization, and ownership. On the other hand, the eclectic theory in internationalization strategies places more emphasis on the resources and knowledge SMEs possess in determining the markets and networks they will choose to market their products.

One indicator of a company's growth is its expansion into foreign or international markets (Dunning & Lundan, 2008). The international market represents a highly open market opportunity for companies. This is due to the very large market size and the untapped potential for many players. This is evident from the following data, as reported by Lassare (2010).

Multinational companies start their activities from their home country and then expand into foreign markets (host countries). The factors that drive this process include globalization (Lassare, 2010), the breakdown of boundaries between countries, the emergence of newly industrialized countries (NICs), as well as developments in technology and innovation in various fields.

In theory, there are two schools of thought on the internationalization of companies as per Analia & Emilia in Kaukab (2016): the traditional school and the new venture school. The traditional school emphasizes the internationalization process, while the new venture school focuses on the speed of entering international markets. Furthermore, in Kaukab (2016), Loustarinen and Hellman, in their study, concluded that there is a holistic approach to the internationalization process, which includes four stages and different pathways: (a) the first stage is the domestic stage, where the company has no international activities; (b) the second stage is the inward stage, which involves limited international activities such as technology transfer or importing raw materials or components; (c) the third stage, the outward stage, is when the company starts engaging in export activities, establishes sales branches or factories abroad, subcontracts or manufactures on a contract basis, and licenses its products; and (d) the fourth stage is the cooperation stage, where the company enters into cooperation agreements for various activities such as production, purchasing, or research and development.

c. Entrepreneurship Development, Infrastructure, and Productive Environment

The research findings have demonstrated the importance of entrepreneurship development for job creation. Entrepreneurship development has become a primary driver of growth in most advanced countries (Estay et al., 2013), but in some developing nations, the full potential of these investments has not yet been harnessed. This is why there are still setbacks in job creation, poverty alleviation, and improving living standards (Bruton et al., 2010), as found in the studies by Carsamer (2012) and Nambisan and Baron (2013). These findings align with the theory of entrepreneurial opportunity, which states that the government does not create jobs but provides an environment that helps the business world create employment.

Creating a conducive environment for entrepreneurship to thrive is the responsibility of the government, particularly in the field of infrastructure development. Research results show that infrastructure development positively contributes to entrepreneurship development (Kaukab, 2016). Therefore, when there is a lack of basic facilities to facilitate business operations and enhance productivity for SMEs, it hampers entrepreneurship development as well.

Moreover, various tax policies, business registration barriers, and ease of doing business are still significant obstacles for SMEs (Atiase et al., 2017). Meanwhile, stakeholders aim for self-reliant communities with the potential to generate more jobs and reduce poverty rates if fully and optimally leveraged (Sergi et al., 2019).

d. Government policies for research, development, and the internationalization of SMEs

Research by Sergi et al. (2019) indicates that entrepreneurship in developed countries benefits from the extensive support provided by governments, including financial assistance. Developing countries need to learn how to provide financial aid to entrepreneurs to support business growth, job opportunities, poverty reduction, and improved living standards (Atiase et al., 2017).

However, companies that qualify for special tax incentives may not necessarily use them for various reasons (Hosono, 2022). First, they may not invest due to a lack of profitable opportunities. Second, they may not be aware of the tax incentives even if they do invest. Third, their investments may not meet the mentioned criteria, even if they are aware of the tax incentives. Fourth, they may be in a loss position even if their investments meet these criteria.

Because R&D activities in the business sector are highly correlated with a country's R&D intensity and growth performance (OECD, 2001), R&D expenditure by this sector is considered more critical. Increasing R&D spending in the business sector is one of the primary focuses of countries for innovation, technological change, and consequently, higher growth rates. The business sector tends to invest in R&D at levels lower than socially desired, and government support is aimed at encouraging firms and bridging the gap between private and social benefits of R&D investment (Akçomak, 2016; Arrow, 1962; Carvalho, 2011; Czarnitzki et al., 2011; Martin and Scott, 2000). In this approach, government intervention is considered from a broader perspective beyond market failures, including enhancing the innovation system through institutional frameworks and knowledge diffusion (Akçomak, 2016; Bleda & Río, 2013). Like any other investment decision, R&D investment requires profit opportunities for private companies. The government seeks to address the issue of underinvestment in R&D by the business sector by implementing a mix of policies that typically include both funding mechanisms as complementary actions (Guceri, 2016).

With the help of these supportive mechanisms, the government aims to reduce the relative costs and uncertainties of R&D investments. While the government has several supportive tools for R&D, such as public-private research partnerships, direct subsidies, and fiscal incentives, the choice of which to use depends on national conditions, such as the corporate and industry structure, innovation performance, observed market failures in R&D, and the structure of the corporate tax system (Appelt et al., 2020; Carvalho, 2011). While direct funding mechanisms like grants, subsidies, and public procurement allow the government to choose R&D projects that have higher social benefits, thereby increasing government control over R&D implementation (OECD, 2003). On the other hand, choosing the most useful R&D projects might involve high administrative costs and can be challenging in practice due to asymmetric information between project owners and the government. Furthermore, governments tend to reward lobbyists and bureaucrats rather than making optimal decisions (Hall & Reenen, 2000). Despite all these drawbacks, direct funding provides a high level of certainty for companies and SMEs. This enables business units to know the amount funded by the government or cost reduction before starting a project (Ravšelj & Aristovnik, 2020). Moreover, this can be more beneficial, especially for financial constraints for small or newly established companies, by providing initial funding for their R&D projects. On the other hand, the application process for direct support can impose costs on companies, and the potential costs may not be low, especially for SMEs (Busom et al., 2011).

Following international expansion, substantial debate about the role and importance of tax incentives in innovation policies has developed, with empirical studies in various countries dedicated to assessing and measuring their impact. There is substantial evidence of the additional effects of these policy tools on business research and development (R&D) investment (Hall, 2020), but there is little consensus on their effectiveness (Blandinieres, Steinbrenner, & Weiß, 2020; Hall, 2020). Recently, this research agenda has expanded to investigate innovation outputs and company performance (Dechezlepr^etre, Eini€o,Martin, Nguyen, & van Reenen, 2016; Nilsen, Raknerud, & Iancu, 2020).

Despite such challenges, a considerable body of literature has been dedicated to assessing the additional outputs of innovation tax policies (Nilsen et al., 2020). Studies of this kind have found evidence of positive effects of tax incentives on various measures, such as the market share of new products (Czarnitzki, Hanel, & Rosa, 2011), patenting (Tian et al., 2020; Ivus et al., 2021), and the development of new products (Aralica & Botric, 2013). Company performance can also be positively influenced by fiscal policies that encourage innovation, leading to job growth (Nilsen et al., 2020), export growth (Freel, Liu, & Rammer, 2019), and more entrepreneurship (Fazio, Guzman, & Stern, 2019). On the other hand, such incentives appear not to affect productivity (Nilsen et al., 2020; Cappelen, Raknerud, & Rybalka, 2007), suggesting that this may be a limitation or challenge that needs to be addressed in the design of these policy tools.

Conclusion

The development of entrepreneurship and micro, small, and medium-sized enterprises (MSMEs) has become a major driver of economic growth in most developed countries. To foster entrepreneurship among MSMEs, the government can create an environment conducive to assisting the business world and MSMEs in their development. Creating a conducive environment for entrepreneurship to thrive is the responsibility of the government, especially in the area of infrastructure development. Entrepreneurship and MSMEs in developed countries leverage the many facilities provided by the government to support business growth, including financial support.

Increasing expenditures on research and development (R&D) in the business and MSME sectors is a primary focus for achieving innovation and technological change, which can support higher economic growth rates. Businesses tend to have lower investments in R&D, necessitating government support. Positive effects of tax incentives have been observed through various schemes, such as increased sales shares for new products, patenting outcomes, and the development of new products. The performance of business units and MSMEs can also be positively influenced by fiscal policies that encourage innovation, leading to job creation, export growth, and the emergence of new businesses and MSMEs.

Therefore, business actors and MSMEs can enter international markets. Internationalization of MSMEs enhances competitiveness and provides access to larger new markets, ultimately contributing to economic development in the country.

Declaration of conflicting interest

We are the authors of the article titled 'The Urgency of Tax Incentives in Indonesia for Research, Development, and Internationalization of MSMEs,' and we declare that there is no conflict of interest in the writing of this article.

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