

The Role of Micro, Small, and Medium Enterprises (MSMEs/UMKM) in Promoting Regional Economic Development: A Case Study in Indonesia

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Abstract: This study examines the role of Micro, Small, and Medium Enterprises (MSMEs) in regional economic development in Indonesia. MSMEs have become the backbone of the national economy with significant contributions to Gross Domestic Product (GDP) and employment creation. Through a qualitative approach with literature studies and interviews with MSME actors in five provinces, this research identifies that MSMEs play roles as local economic drivers, employment absorbers, regional potential developers, and innovation catalysts. Challenges faced include limited access to capital, human resource capacity, market access, and digital infrastructure. The research recommends strengthening the MSME ecosystem through integrated policies, technical assistance, digitalization, and strengthening production-distribution networks to enhance the competitiveness of MSMEs in promoting sustainable regional economic growth.

Keywords: MSMEs, regional economic development, inclusive growth, local innovation, MSME development policy

INTRODUCTION

Micro, Small, and Medium Enterprises (MSMEs) hold a strategic role in the structure of Indonesia's economy. Data from the Ministry of Cooperatives and MSMEs shows that MSMEs contribute about 60% of Indonesia's Gross Domestic Product (GDP) and are able to absorb more than 97% of the national workforce (Ministry of Cooperatives and MSMEs, 2023). The presence of MSMEs is spread across all regions of Indonesia, including remote areas, thus having great potential to drive regional economic growth and reduce development disparities between regions. The Indonesian government has established various policies to support the development of MSMEs, especially since the 1998 economic crisis which demonstrated the resilience of this sector. As stated by Tambunan (2018), MSMEs have proven to be more resistant to economic shocks compared to large enterprises due to their flexibility and adaptability to market changes.

However, the role of MSMEs in regional economic development still faces various challenges, such as limited access to capital, the need to improve human resource capacity, and uneven supporting infrastructure. This study aims to analyze the role of MSMEs in driving regional economic development in Indonesia, identify factors influencing the success of MSMEs as local economic drivers, and formulate strategies to strengthen MSMEs to increase their contribution to the regional economy. The focus of the study is directed at five provinces representing different regional characteristics in Indonesia, namely DKI Jakarta, East Java, North Sumatra, South Sulawesi, and Bali.

LITERATURE REVIEW

The concept of MSMEs in Indonesia is regulated under Law Number 20 of 2008 concerning Micro, Small, and Medium Enterprises. Based on this regulation, MSMEs are categorized according to assets and turnover, with micro enterprises having a maximum asset of IDR 50 million and a maximum turnover of IDR 300 million per year; small enterprises having assets ranging from IDR 50 million to IDR 500 million and turnover ranging from IDR 300 million to IDR 2.5 billion per year; and medium enterprises having assets from IDR 500 million to IDR 10 billion and turnover from IDR 2.5 billion to IDR 50 billion per year. The theory of regional economic development according to Todaro and Smith (2020) emphasizes the importance of inclusive growth that involves all layers of society. Effective economic development must touch all elements of society and provide benefits for vulnerable groups, including micro and small enterprises which serve as the livelihood backbone for communities, as explained by Todaro and Smith (2020). MSMEs are viewed as an effective instrument in realizing inclusive growth because they can reach various layers of society and regions.

Tambunan (2019) identifies that MSMEs contribute significantly to local economic development through job creation, utilization of local resources, and development of products based on local wisdom. According to research conducted by Hermuningsih and Wardani (2018), MSMEs play a vital role in driving regional economic growth through the multiplier effect generated from production and consumption activities. A study by Bank Indonesia (2022) reveals that innovative MSMEs connected to global value chains contribute more significantly to regional economies. Integration of MSMEs into global value chains not only increases product added value but also promotes technology transfer and knowledge beneficial for developing local capacity, as explained in the Bank Indonesia report (2022). Prasetyo (2021) states that MSME development needs to be supported by integrated public policies and a conducive business ecosystem. His research in several regions in Indonesia shows that synergy between government, private sector, and academia plays a role in creating an environment that supports MSME growth.

RESEARCH METHODS

This study uses a qualitative approach with a case study method to analyze the role of MSMEs in regional economic development in Indonesia. Data collection was carried out through a combination of literature review, interviews, and field observations. The literature review includes studies of scientific publications, policy documents, and statistical reports related to MSME development and regional economy during the period 2018-2024. Interviews were conducted with 75 respondents consisting of MSME actors, regional government officials, business associations, and academics in five selected provinces: DKI Jakarta, East Java, North Sumatra, South Sulawesi, and Bali. The selection of provinces was based on considerations of economic characteristic diversity, MSME density, and regional economic development achievements. As stated by Creswell and Poth (2018), choosing diverse research locations allows for the identification of rich patterns and variations in the studied phenomena.

Primary data collection was conducted from November 2023 to March 2024 through face-to-face interviews and field observations of MSME activities in the study areas. Observations focused on production patterns, marketing, labor absorption, and MSME interactions with the local economy. Data analysis used thematic analysis techniques involving coding and categorization processes to identify main themes. Data validity was enhanced through source triangulation by comparing the results of interviews, observations, and

literature review. As recommended by Sugiyono (2022), data source triangulation is one technique to ensure the validity of qualitative research data.

RESULTS AND DISCUSSION

The research results indicate that MSMEs play a strategic role in regional economic development in Indonesia through four main dimensions: as drivers of the local economy, labor absorbers, developers of regional potential, and promoters of economic innovation.

MSMEs as Drivers of the Local Economy

Data analysis shows that MSMEs contribute significantly to the creation of added economic value in the regions. In East Java, MSMEs contributed 57.8% to the province's GRDP, with a growth rate of 5.4% in 2023. The MSME sector in this province is dominated by food and beverage processing industries, crafts, and fashion. As expressed by the Head of the Cooperative and MSME Office of East Java, MSMEs have become the economic engine in almost all regencies/cities in East Java, with diverse characteristics according to each region's potential. In Bali, tourism-based and creative economy MSMEs are the backbone of the local economy, contributing up to 65% of the province's GRDP. As stated by Rai (2022), MSMEs in Bali have successfully created a resilient local economic ecosystem due to their ability to adapt to the dynamics of the tourism market and utilize local wisdom as a value-added aspect of their products.

MSMEs as Labor Absorbers

Research findings show that MSMEs are the main sector in labor absorption in the regions. In North Sumatra, MSMEs absorb 92.3% of the workforce, dominated by agriculture, trade, and service sectors. According to Siregar (2023), MSMEs in North Sumatra play a role in reducing unemployment and urbanization as they can create jobs even in remote villages. In South Sulawesi, MSME growth of 7.2% in 2023 correlates with a decrease in the unemployment rate by 1.8% during the same period. This finding aligns with the study by Kadir and Hasbi (2022), which states that every 1% growth of MSMEs in South Sulawesi contributes to a 0.25% reduction in unemployment.

MSMEs as Developers of Regional Potential

The study identifies that MSMEs play a role in optimizing the utilization of local resources and developing products based on regional advantages. In East Java, the batik MSME clusters in Pamekasan and ikat weaving in Lamongan utilize local wisdom to create high-value products. According to Widodo and Fitriana (2021), the development of MSMEs based on local potential not only generates economic value but also strengthens regional identity and cultural heritage preservation. In South Sulawesi, MSMEs in the processing of marine and agricultural products show significant development by leveraging the advantages of regional natural resources. Local government policies encouraging certification and standardization of MSME products contribute to improving the quality and competitiveness of local products.

MSMEs as Drivers of Economic Innovation

Research findings indicate that MSMEs act as catalysts for economic innovation in the regions. In DKI Jakarta, tech-based MSMEs grew by 15.7% in 2023, focusing on the development of applications, digital content, and information technology services. As revealed by Respondent 12, a fintech MSME actor: "The startup and tech MSME ecosystem in Jakarta drives innovation and the development of solutions for various urban problems." In Bali, MSME innovation is demonstrated through the development of ecotourism products and creative economy sectors that integrate traditional values with modern market needs. According to Putra et al. (2023), the ability of MSMEs in Bali to innovate is a key factor in the

region's economic resilience in facing external challenges such as the pandemic and global economic uncertainty.

Challenges and Strategies for MSME Development

Although showing a positive role, MSMEs in the research areas still face various challenges. Access to capital is the main obstacle, with 68% of respondents stating difficulty in accessing formal credit due to complex requirements and high collateral. As expressed by Respondent 34, an MSME actor in North Sumatra: "Access to financing remains our main barrier to developing the business, especially for technology investment and expanding production capacity." Human resource capacity is also a challenge, with 56% of respondents reporting difficulties in adopting digital technology and modern business management. This aligns with Wahyudi's (2022) findings which show that limited digital capacity is a major factor hindering the transformation of Indonesian MSMEs in the digital economy era.

Market access and integration into value chains are the next challenges, with 61% of respondents indicating difficulties in marketing products to broader markets. According to Lubis (2021), limited market information and distribution networks hinder MSMEs from accessing potential markets beyond their production areas. Based on the analysis of these challenges, the study formulates MSME development strategies to enhance their contribution to regional economic development, including:

1. Strengthening the MSME financing ecosystem through diversification of financial instruments and simplification of credit access.
2. Enhancing human resource capacity through structured training and technical assistance.
3. Facilitating market access through the development of digital marketing platforms and strengthening distribution networks.
4. Strengthening supporting infrastructure for MSMEs, especially digital and logistics infrastructure.
5. Strengthening the value chain by linking MSMEs to large industries and global markets.

CONCLUSION

This study confirms that MSMEs play a vital role in regional economic development in Indonesia through their contributions as local economic drivers, labor absorbers, developers of regional potential, and promoters of innovation. The flexible nature of MSMEs and their closeness to communities enable them to be effective instruments in realizing inclusive and sustainable economic growth at the regional level. The challenges faced by MSMEs require an integrated policy approach focused on strengthening the supporting ecosystem. Synergy between local governments, the private sector, academia, and communities is key to optimizing the role of MSMEs in regional economic development.

This study recommends strengthening MSME development policies oriented toward increasing productivity, competitiveness, and innovation. The digitalization strategy for MSMEs needs to be accelerated to help business actors adapt to changes in the global economic landscape. Local governments need to develop policy approaches tailored to the specific characteristics and needs of MSMEs in their regions. Future research is expected to further examine the impact of digital transformation on MSME performance and their contribution to the regional economy, as well as analyze innovative models in MSME financing and capacity development.

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