

CHAPTER 1

INTRODUCTION

A. Background

SMEs (Small Medium Enterprises) today has evolved significantly as an impact of a trend an easyness to start a new business. Development of markets and the increasing purchasing power make SMEs more and more popular among the public and at the same time attract people to start their own SMEs.. In spite of it all Indonesian SMEs will face a new challenges in the future. Free trade market in ASEAN Economic Community (AEC) will be a new challenges for Indonesian SMEs. Along with many kind of products overwhelming the Indonesian market, local SMEs need to compete against imported products. Therefore, innovation is important for the SMEs to keep their market. The role of government to encourage those SME's to be more competitive is also a crucial thing in order to face a free trade market.

The increasing competition and the growing expectations of customers prompt companies to focus on efforts to retain the existing customers. Maintaining the existing markets through development of customer loyalty is a strategic goal of the company to maintain their business and profit (Rully, 2006:65). In terms of product quality, it reflects the ability of products to carry out their duties which include durability, reliability, progress, strength, ease of packaging, and product repair and other characteristics (Kotler and Armstrong, 1999:279).

Through the product, the company can provide satisfaction to the consumer. Therefore, it is very important to maintain product quality in order to achieve customer

satisfaction. Kotler (1996) in Wang (2006:196) defined customer satisfaction as “the level of a person felt state resulting from comparing a product’s perceived performance or outcome in violation to his/her own expectations. In this context, customer satisfaction can be considered of a comparative behaviour between inputs beforehand and post acquisition performances.

Since 1970, both academics and practitioners have recognized the importance of customer satisfaction. Over time, customer satisfaction has been defined by marketing researchers in different ways and contexts. According to Fornell in Gustafsson (2005:210) customer satisfaction is defined as a customer’s overall evaluation of the performance of an offering to date. Customer satisfaction is the emotional state that occurs as a result of customer interaction with the organization over time (Verhoef, 2003:33). Based on the definition above the author acknowledge two perspectives. Firstly, satisfaction is an affective construct that is based on feelings and emotions. Secondly, satisfaction is a dynamic construct that develops over a period of time.

SMEs are the backbone of the Indonesian economy. Number of SMEs until 2011 have reach around 52 million. SMEs in Indonesia is very important for the economy because it accounts for 60% of GDP and 97% of the workforce. However, it faces a limited access to financial institutions, which only 25% or 13 million SMEs who have access to financial institutions. Economic development in Indonesian SMEs sector is always portrayed as having an important role. It happens because not all people get the chance to get a decent education. SMEs play a strategic role in national economic development by absorbing a huge number of less educated employee, and therefore, plays its role in economic growth and employment. SMEs also play an important part in the industrial development outcomes..

SMEs become one of economic pillars in Indonesia. Mr. Hatta Rajasa as economic minister of the Republic of Indonesia stated that SMEs also make a significant contribution to the economy and employment. Therefore, increasing the excellence and contribution of

SMEs is part of our journey towards the realization of an good economic condition. SMEs accounted for 55.6 % of GDP at current price with an investment of Rp 640.4 trillion or 52.9 % of the total investment. SMEs also generate income of Rp 183.8 trillion or 20.2% of total foreign exchange of Indonesia (<http://ekbis.sindonews.com>).

SME's has several advantage compared to large companies which help the SME's to keep innovative in their product development factors. Partomo (2004:02) stated that some advantage of SME's compared to large companies as follow:

1. Innovations in technology have easily happened in product development.
2. Familiar human relationships in small firms.
3. The ability creates enough employment opportunities for labor or absorption.
4. Flexibility and ability to quickly adapt to changing market conditions compared with large-scale enterprises in general bureaucratic.
5. The presence of dynamism managerial and entrepreneurial roles.

There are some important factors contributes to the economic development in Indonesia. One of the factors that support the development of the existence of SMEs. Most of Indonesian small enterprises are covering the business area in producing and offering physical products to the customers such as garment/textiles, food beverages, handycraft and other goods which are easier to produce and do not take up a lot of costs in manufacturing. Physical products are more reacheable to produce by small enterprises, since most of the small enterprises has less capital in its business.

Contribution of Cooperatives and SMEs in East Java to economic growth in the region is very high. The growth has reached 7.22 %, it is higher than the national rate, which shows 6.5%. Seeing from the gross domestic product which reached IDR 824 trillion, cooperatives and SMEs in East Java accounted for 54.8%, or around IDR 600 trillion (<http://malang-post.com>).

One of the small enterprises that thrive today are enterprises in producing and sell Batik. Since patented by the indonesian government, Batik become more popular, and

everyone start wearing it even the youth. Astuti (2013:01) stated that today's phenomena in batik is batik transformation. This means that Batik has developed into a new transformation, the design and colouring process used in batik is way far from it was in the earlier stages of its development. The modification of Batik tends to be free as a result of the designer's creativity. Temporary motifs and colors used are quite independent and different from its original. Many Batik producers use this transformation to make the price become cheaper in the market, means sacrificing the quality itself.

Batik Jonegoroan is a kind of Indonesian Batik which currently receives a positive consideration from the market. Derived from Bojonegoro, Batik Jonegoroan began to attract customers' attention. Since it uses an original design from local potential, the producers take a very concern in the aspect of product quality. Small enterprises which produced "Batik Jonegoroan" began to grow since it was introduced 4 years ago in Bojonegoro.

According to state regulation No. 9 1995, the characteristics of small enterprises are,

1. Has a maximum net worth Rp.200.000.000, - (two hundred million dollars), not including land and buildings, or has annual sales of Rp. 1.000.000.000, - (one billion rupiah)
2. Owned by Indonesian citizen.
3. Standing alone, is not a subsidiary or branch companies owned, controlled, or affiliated directly or indirectly by Medium Business or Large Enterprises
4. Individual business form, including business entity without legal entity, or a business entity with legal status, including cooperatives.

Since the product receives a wide attention from the market, the business starts to grow and small companies that produce Batik Jonegoroan also increased and began to

market their products outside of Bojonegoro. Potential market which arises make those small enterprises compete tightly in gaining customers. Other competitors from other region such as Solo, Pekalongan, Yogyakarta and foreign country such as china and vietnam currently become new challenges for Batik Jonegoroan. The increasing number of the industry, obviously makes the competition tougher. A craftsmen must be good at seeing opportunities among tigh competition. The current batik industry in Bojonegoro may face the same problems similar to other industries in Indonesia, especially those based on small and medium enterprises. Declining in competitiveness is indicated by the higher selling price is than the selling price of similar products which are produced by other countries. Brand, standards and quality has been and will be a central feature of globalization that apply everywhere. In the face of global competition, the batik industry should pay attention on three things, namely the quality, satisfaction, and loyalty. Security supply of materials or supply chain should be a concern, in order to avoid stagnation in the production process.

The growth of the market and competition makes the enterprises put their effort in producing quality products, since product quality become one of the main factor in influencing the customers satisfaction and loyalty. Innovation must be done by these small enterprises in order to maintain their customers. By producing innovative quality products, they will be able to maintain their customer and gaining more as well. Development of batik in Bojonegoro can be said grow exponentially. In just four years, the batik fabric products began to attract consumers to buy. Development of SMEs has been showing good results. One of these SMEs has been able to record sales of over 800 million rupiah in one year

It is very crucial to produce a good product in order to obtain existing and attract new customer for small enterprises. By having a good product, these small enterprises will gain a loyal customers through their satisfaction. A good product will show the commitment of the company to their customer. Satisfaction and loyalty of the customer can't be separated

from quality of products. That important part play an important role in customer's mind. Relationship which occurred between that part determined the customer reaction and acts. That's why the researchers interested in studying the effects of the quality of the goods to the customer satisfaction and loyalty and this research is entitled as "Analyzing The Effect of Product Quality On Customer Satisfaction and Customer Loyalty In Indonesian SMEs (Case Study at Batik Bojonegoro SMEs)".

B. The Problem Formulation

Based on previous explanation, the problems in this study are formulated as follow:

1. What is the effect of Quality of Product on Customer Satisfaction in Indonesian SMEs?
2. What is the effect of Quality of Product on customer loyalty in Indonesian SMEs?
3. What is the effect of customer satisfaction on customer loyalty in Indonesian SMEs.

C. The Research Purposes

From the problem formulation above, the purposes of research are as follows:

1. To understand the effect of Quality of Product on Customer Satisfaction in Indonesian
2. To understand the effect of Quality of Product on customer loyalty in Indonesian SMEs.
3. To understand the effect of customer satisfaction on customer loyalty in Indonesian SMEs.

D. Research Contributions

1. Academic

This research are aimed to ease the next researcher to understand and analyze about the relationship between product and service quality in customer satisfaction and trust for further research especially in marketing management.

2. Company

As a guidance for the company regarding with the product quality improvements and it is expected that the success of this research can help the micro small and medium enterprises in developing their business and as a guide, especially in matters of customer satisfaction and loyalty

E. Writing Structure

The arrangement of the parts of discussion meant to make the overall scientific paper understandable and briefly outlined. The figure of the whole basic of this minor thesis content can be explained shortly into 5 chapters.

Chapter I : Introduction

This chapter explains about the case or the matter which become a background of this research, objectives and the contributions of the research. Besides that, the author also serves the problems of the study to bind the focus of the research.

Chapter II : Theoretical Framework

This chapter contains of theoretical framework that relates with the basic of problems. The theories and references will be used as analysis tool of the research problems.

Chapter III : Research Method

This chapter explains on how the research is conducted, as well as functioned as guidance of research and analysis. This chapter will discuss about the type of research, research focus, research location, and source of data, data collecting technique, research instrument, and data analysis.

Chapter IV : Result and Analysis

This chapter contain the main issues and the founding that already gathered and processed by researcher. There is detailed explanation about the research itself.

Chapter V : Conclusion and Suggestion

This chapter is the last chapter of study which contain the research result and conclusion towards the founding and its relation with the theory. It is also contain suggestion towards the next researcher based on this last research.

