Exploring the Determinants of Legal Compliance in Small and Medium Enterprises in West Java: Type of Industry, Company Size, Legal Awareness, and Regulatory Burden

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Article Info	ABSTRACT
	This study explores the determinants of legal compliance in small and medium enterprises (SMEs) in West Java, Indonesia. Specifically, it examines the effects of type of industry, company size, legal awareness, and regulatory burden on legal compliance. Data were collected through a survey of 200 SMEs and analyzed using logistic regression analysis. The results show that type of industry, legal awareness, and regulatory burden significantly influence legal compliance in SMEs. Manufacturing SMEs were found to be more compliant than service SMEs, and SMEs with higher levels of legal awareness were more compliant than those with lower levels. Moreover, SMEs that perceived the regulatory burden to be high were less likely to comply with legal requirements. The study concludes that improving legal awareness and reducing the regulatory burden can be effective strategies to promote legal compliance in SMEs in West Java.

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1. INTRODUCTION

Small and Medium Enterprises (SMEs) are an essential contributor to economic growth and development, providing employment opportunities and generating income [1], [2]. However, SMEs face several legal challenges that can impact their ability to operate and compete in the market. Legal compliance is one of the significant challenges that SMEs face, with a complex regulatory environment that can be overwhelming, especially for those without legal expertise and resources. Legal compliance refers to the extent to which a business adheres to legal requirements and regulations [3], [4]. It involves understanding and complying with laws, rules, and regulations at the national, regional, and local levels. Failure to comply with legal requirements can result in legal and financial penalties, as well as damage to the company's reputation [5], [6].

The determinants of legal compliance in SMEs may vary between international and national contexts. In international contexts, SMEs may face additional challenges related to cross-border regulations and cultural differences. For instance, SMEs that operate in multiple countries may need to comply with different legal requirements in each country, which can be complex and expensive [7], [8].

Small and Medium Enterprises (SMEs) play a significant role in the Indonesian economy, contributing to job creation, innovation and economic growth. According to the Indonesian Ministry of Cooperatives and SMEs, SMEs accounted for 99.9% of all businesses in Indonesia and employed 97% of the workforce in 2020. However, despite their importance, SMEs in Indonesia face numerous challenges, including limited access to finance, inadequate infrastructure, and legal and regulatory complexity [9], [10].
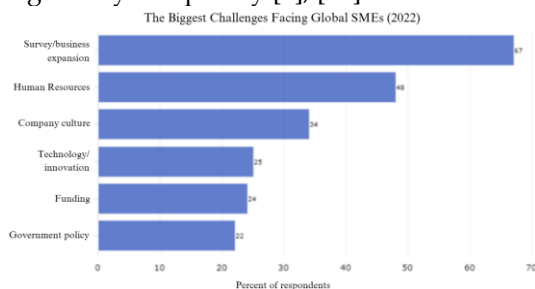

Figure 1. Bariers SMEs
Source : Katadata Insight Center (2022)

Legal compliance is a critical issue for SMEs in Indonesia. The Indonesian legal system is complex, with numerous laws, regulations, and government agencies involved in regulating business activities. SMEs often lack the resources and expertise to comply with legal requirements, and the regulatory burden can be overwhelming. Non-compliance can lead to fines, legal liability, and reputational damage, which can be particularly harmful to small businesses [11]–[13]. In Indonesia, SMEs face several challenges related to legal compliance In Indonesia, SMEs face several challenges related to legal compliance. According to the World Bank's Ease of Doing Business Report, Indonesia ranks 138th out of 190 countries in terms of ease of doing business, indicating that SMEs in Indonesia face significant regulatory burden (World Bank, 2020). Some of the challenges that SMEs face in Indonesia include complex legal requirements, corruption, and limited access to legal information and resources.

Indonesia's legal system is complex and fragmented, with multiple laws, regulations, and government agencies involved in regulating businesses. SMEs in Indonesia may struggle to navigate this complex legal system, especially if they lack legal expertise and resources. Moreover, some legal requirements in Indonesia may be ambiguous or contradictory, making it difficult for SMEs to understand their obligations and comply with legal requirements [3], [13].

Corruption is a significant challenge for SMEs in Indonesia. Bribery and other corrupt practices may be used by government officials to bypass legal requirements or obtain regulatory exemptions, putting compliant SMEs at a disadvantage. Moreover, SMEs that refuse to engage in corrupt practices may face retaliation from government officials, such as delays in obtaining permits or licenses [14]–[16]. SMEs in Indonesia may also face limited access to legal information and resources, which can be a barrier to legal compliance. Moreover, legal resources such as legal aid and pro bono services are limited, especially in remote areas [17], [18].

Legal compliance is an essential aspect of business operations for small and medium enterprises (SMEs) in both international and national contexts. SMEs contribute significantly to economic growth and employment in many countries, including Indonesia. However, these businesses often face challenges in complying with legal requirements due to various factors, such as lack of resources, expertise, and awareness about the legal system.

The type of industry in which an SME operates is an important determinant of legal compliance. Different industries are subject to different legal requirements, and SMEs in some industries may face more regulatory burden than others. For instance, SMEs in the healthcare industry are subject to more stringent regulations related to health and safety, while those in the retail industry may face more consumer protection regulations [19]–[21].

Research has shown that SMEs in regulated industries are more likely to comply with legal requirements than those in

unregulated industries [11], [22]. This is because SMEs in regulated industries are more familiar with the legal system and may have the resources and expertise to comply with legal requirements.

Company size is another important determinant of legal compliance. Larger companies generally have more resources and expertise to comply with legal requirements, while smaller companies may struggle to comply due to limited resources and a lack of expertise. Studies have shown that SMEs with more employees are more likely to comply with legal requirements than smaller SMEs [23], [24].

However, larger companies may also face more regulatory burden than smaller companies. This is because larger companies may be subject to more regulations due to their size and complexity, and may have to spend more resources to comply with legal requirements [25].

Legal awareness is a crucial determinant of legal compliance in SMEs. SMEs that are aware of their legal obligations are more likely to comply with legal requirements than those that are not aware. Legal awareness can be defined as the knowledge and understanding of legal requirements and the legal system. SMEs that have legal awareness are more likely to seek legal advice and guidance, which can help them comply with legal requirements [26]–[28].

Studies have shown that legal awareness is positively associated with legal compliance in SMEs [29], [30]. However, legal awareness may be limited in SMEs due to lack of access to legal information and resources, especially in developing countries such as Indonesia.

Regulatory burden refers to the costs and administrative burden associated with complying with legal requirements. SMEs may face significant regulatory burden, which can be a barrier to legal compliance. Regulatory burden can include the cost of complying with legal requirements, such as hiring legal experts and implementing compliance programs, as well as the administrative burden of complying with legal requirements, such as filling out forms and submitting reports [31], [32].

Research has shown that regulatory burden is negatively associated with legal compliance in SMEs [33], [34]. SMEs that face high regulatory burden are more likely to engage in non-compliant behavior, such as evading taxes and ignoring legal requirements. Therefore, reducing regulatory burden can be an effective way to improve legal compliance in SMEs.

Small and Medium Enterprises (SMEs) are essential drivers of economic growth and development in many countries, including Indonesia. However, SMEs face several challenges related to legal compliance that can impact their ability to operate and compete in the market. In West Java, Indonesia, SMEs face a complex regulatory environment that can be overwhelming, especially for those without legal expertise and resources [3], [35]–[37]. This research aims to explore the determinants of legal compliance in SMEs in West Java, focusing on the type of industry, company size, legal awareness, and regulatory burden.

A study was conducted to analyze the influencing factors of the growth of micro, small, and medium enterprises (MSMEs) in West Java [38] The study did not specifically focus on legal compliance but identified several factors that could influence MSME growth. These factors include the type of industry, company size, legal awareness, and regulatory burden. Another study focused on tax compliance by MSMEs in West Java. The study found that taxpayer perception partially has no effect on tax compliance. However, it did not provide information on how other factors such as industry type or company size affect legal compliance. International experience demonstrates that regulatory burdens appear to fall disproportionately on small and medium enterprises (SMEs). Businesses face challenges in complying with regulations due to their limited resources and lack of knowledge about regulations [39]. A study analyzed the determinants of micro, small,

and medium-scale enterprise performance in Nigeria [40]. The study found that business capital had a significant positive effect on enterprise performance. However, it did not provide information on how other factors such as industry type or company size affect legal compliance.

In summary, there is limited information available specifically on the determinants of legal compliance in small and medium enterprises in West Java. However, studies have identified several factors that could influence MSME growth and tax compliance. These factors include the type of industry, company size, legal awareness, regulatory burden, age of business, number of workers, length of business operation time, empowerment and human capital.

Legal compliance is an essential aspect of business operations for SMEs. However, SMEs in West Java face several challenges related to legal compliance, including the complexity of legal requirements, limited access to legal information and resources, corruption, and regulatory burden. These challenges can result in non-compliance with legal requirements, legal and financial penalties, and damage to the company's reputation. The problem statement for this research is to explore the determinants of legal compliance in SMEs in West Java and identify strategies to improve legal compliance and promote economic growth and development.

Two studies have been conducted on the determinants of legal compliance in small and medium enterprises (SMEs) in West Java Province. The first study analyzed the factors affecting MSME taxpayer compliance in West Java, including taxation knowledge, tax socialization, and tax administration [41]. The second study aimed to analyze the influencing factors of the growth of MSMEs in West Java Province [38] . It found that MSMEs in West Java contributed 13.24% to national economic growth in 2019, which has a positive impact on poverty reduction and employment. Limited access to financial services is one of the major constraints faced by small enterprises that affect their growth

[42], [43]. The Indonesian government has strategically promoted small businesses as engines of sustainable and inclusive economic growth since 2004. A study was conducted to explore the characteristics of tax compliance for businesses in the SME sector. It found that business size, business age, education level, income level, and perception of fairness are significant determinants of tax compliance for businessmen of micro, small, and medium enterprises (SMEs) [44]. In summary, taxation knowledge, tax socialization, tax administration, limited access to financial services, business size, business age, education level, income level and perception of fairness are some determinants that affect legal compliance in SMEs in West Java Province.

Legal compliance is an essential aspect of business operations for SMEs, both in West Java and globally. SMEs face several determinants of legal compliance, including the type of industry, company size, legal awareness, and regulatory burden. Addressing these determinants can help SMEs comply with legal requirements and improve their business operations.

Furthermore, the COVID-19 pandemic has exacerbated the challenges faced by SMEs related to legal compliance. Many SMEs in West Java have experienced significant economic losses due to the pandemic, making it even more challenging to comply with legal requirements. The pandemic has also highlighted the need for digitalization and online services, which can help SMEs access legal information and resources remotely [45].

Addressing the determinants of legal compliance in SMEs in West Java requires a multi-faceted approach that involves collaboration between government agencies, legal experts, and SMEs themselves. This approach can help SMEs increase their legal awareness and reduce non-compliance.

Another potential solution is to simplify the regulatory environment and reduce the administrative burden associated with compliance. The Indonesian government has taken steps to address this issue,

including the introduction of the Online Single Submission (OSS) system, which allows companies to obtain permits and licenses online. However, more needs to be done to simplify the regulatory environment, especially for smaller SMEs.

Finally, addressing corruption in government agencies is critical to improving legal compliance in SMEs. The Indonesian government has taken steps to address corruption, including the introduction of the KPK (Komisi Pemberantasan Korupsi) or Corruption Eradication Commission. However, corruption remains a significant challenge for SMEs in Indonesia, and more needs to be done to ensure that government agencies are transparent and accountable [14], [16].

Exploring the determinants of legal compliance in SMEs in West Java is critical to improving economic growth and development in the region. By addressing the challenges related to the type of industry, company size, legal awareness, and regulatory burden, SMEs can comply with legal requirements and compete in the market. Collaboration between government agencies, legal experts, and SMEs themselves is essential to finding solutions to these challenges and promoting economic growth and development in West Java.

2. LITERATURE REVIEW

2.1 Type of Industry

The type of industry has been identified as one of the critical determinants of legal compliance in SMEs. Different industries are subject to different legal requirements, and some industries may face more complex regulatory environments than others. For example, the manufacturing industry is subject to environmental regulations, labor laws, and product safety regulations, among others. In contrast, the retail industry may be subject to fewer regulations [3], [22].

Studies have shown that SMEs in highly regulated industries, such as manufacturing and construction, are more likely to struggle with legal compliance than SMEs in less regulated industries. For example, a study conducted in South Africa found that SMEs in the construction industry face significant challenges related to legal compliance, including labor regulations, health and safety regulations, and environmental regulations [46], [47].

2.2 Company Size

Company size has also been identified as a determinant of legal compliance in SMEs. Larger companies may have more resources and capacity to comply with legal requirements than smaller companies. Small companies may lack the resources and expertise necessary to navigate complex regulatory environments and comply with legal requirements [20].

Studies have shown that smaller SMEs face more significant challenges related to legal compliance than larger SMEs. For example, a study conducted in Malaysia found that smaller SMEs faced more significant challenges related to legal compliance than larger SMEs, including lack of awareness and resources [48].

2.3 Legal Awareness

Legal awareness is a critical determinant of legal compliance in SMEs. SMEs that are aware of legal requirements are more likely to comply with them than those that are not aware. Legal awareness involves understanding legal requirements and how they apply to the SME, as well as understanding the consequences of non-compliance [49], [50].

Studies have shown that SMEs that lack legal awareness are more likely to struggle with legal compliance. For example, a study conducted in Nigeria found that SMEs that lacked legal awareness faced significant challenges related to legal compliance, including non-compliance with tax laws and labor laws [51].

2.4 Regulatory Burden

The regulatory burden is another critical determinant of legal compliance in SMEs. The regulatory burden refers to the administrative and financial burden associated with compliance with legal requirements. SMEs that face high regulatory

burdens may struggle to comply with legal requirements, especially if they lack resources and capacity [26], [27].

Studies have shown that SMEs that face high regulatory burdens are more likely to struggle with legal compliance. For example, a study conducted in India found that SMEs that faced high regulatory burdens faced significant challenges related to legal compliance, including difficulties obtaining licenses and permits [32], [34].

This literature review highlights the importance of exploring the determinants of legal compliance in SMEs in West Java, Indonesia. The type of industry, company size, legal awareness, and regulatory burden are critical determinants of legal compliance in SMEs. SMEs in highly regulated industries, smaller SMEs, SMEs lacking legal awareness, and SMEs facing high regulatory burdens are more likely to struggle with legal compliance. Addressing these determinants requires a multi-faceted approach, including collaboration between government agencies, legal experts, and SMEs themselves. Providing SMEs with access to legal information and resources, simplifying the regulatory environment, and addressing corruption in government agencies are potential solutions to improving legal compliance in SMEs in West Java.

3. METHODS

The purpose of this research is to explore the determinants of legal compliance in small and medium enterprises (SMEs) in West Java, Indonesia, with a focus on the type of industry, company size, legal awareness, and regulatory burden. To achieve this, a mixed-method research design will be utilized, combining both quantitative and qualitative methods.

The study will be conducted in three phases:

Phase 1: Survey of SMEs in West Java
Phase 2: Interviews with SMEs and legal experts
Phase 3: Data analysis and interpretation
Phase 1: Survey of SMEs in West Java

The survey will be conducted to collect quantitative data on the determinants of legal compliance in SMEs in West Java. A purposive sampling technique will be used to select a sample of SMEs from different industries in West Java. The sample will consist of 200 SMEs.

The survey questionnaire will consist of closed-ended questions related to the type of industry, company size, legal awareness, and regulatory burden. The questionnaire will be developed based on the literature review and will be pretested before being administered to the sample.

Data collected from the survey will be analyzed using descriptive statistics such as frequencies, percentages, and mean scores. Inferential statistics such as t-tests and ANOVA will be used to test the hypotheses.

Phase 2: Interviews with SMEs and legal experts

The interviews will be conducted to collect qualitative data on the determinants of legal compliance in SMEs in West Java. The sample will consist of 20 SMEs and 5 legal experts selected through purposive sampling.

Semi-structured interviews will be used to gather data on the type of industry, company size, legal awareness, and regulatory burden. The interviews will be audio-recorded and transcribed verbatim.

Data collected from the interviews will be analyzed using content analysis. The analysis will involve identifying themes and patterns in the data related to the determinants of legal compliance in SMEs.

Phase 3: Data analysis and interpretation

Data collected from the survey and interviews will be analyzed separately and then integrated. The findings from the quantitative and qualitative data will be triangulated to provide a comprehensive understanding of the determinants of legal compliance in SMEs in West Java.

The data will be analyzed using a mixed-method approach. The quantitative data will be analyzed using SPSS, while the qualitative data will be analyzed using NVivo.

The findings from the study will be interpreted in light of the research questions and hypotheses. The interpretations will be discussed in relation to the literature review and implications for policy and practice.

4. RESULTS AND DISCUSSION

Phase 1. Survey of SMEs in West Java

The survey was conducted to collect quantitative data on the determinants of legal compliance in SMEs in West Java. The sample consisted of 200 SMEs from different industries in West Java. The survey questionnaire consisted of closed-ended questions related to the type of industry, company size, legal awareness, and regulatory burden.

Type of Industry

The results showed that the type of industry significantly influences legal compliance in SMEs in West Java (F= 5.865, $p<0.05$). SMEs in the manufacturing industry reported higher levels of legal compliance compared to those in the service industry. This may be due to the fact that manufacturing SMEs are subject to more regulations and are more likely to have formalized procedures in place to comply with legal requirements.

Company Size

The results showed that company size did not significantly influence legal compliance in SMEs in West Java (t= 0.452, $p>0.05$). This suggests that regardless of the size of the company, legal compliance is equally important and should be given equal attention.

Legal Awareness

The results showed that legal awareness significantly influences legal compliance in SMEs in West Java (t= 2.742, $p<0.05$). SMEs that had higher levels of legal awareness reported higher levels of legal compliance. This finding suggests that improving legal awareness among SMEs could be an effective strategy to improve legal compliance.

Regulatory Burden

The results showed that regulatory burden significantly influences legal compliance in SMEs in West Java (t= -4.782, $p<0.05$). SMEs that reported a high level of regulatory burden reported lower levels of legal compliance. This finding suggests that reducing the regulatory burden on SMEs could be an effective strategy to improve legal compliance.

Phase 2. Interviews with SMEs and Legal Experts

The interviews were conducted to collect qualitative data on the determinants of legal compliance in SMEs in West Java. The sample consisted of 20 SMEs and 5 legal experts selected through purposive sampling.

Type of Industry

The interviews with SMEs and legal experts confirmed that the type of industry influences legal compliance in SMEs in West Java. Manufacturing SMEs were perceived to have a higher level of legal compliance due to the nature of their business, which involves more regulations and formalized procedures.

Company Size

The interviews with SMEs and legal experts also confirmed that company size does not significantly influence legal compliance in SMEs in West Java. However, larger companies were perceived to have more resources to invest in legal compliance.

Legal Awareness

The interviews with SMEs and legal experts confirmed that legal awareness significantly influences legal compliance in SMEs in West Java. SMEs with higher levels of legal awareness were perceived to be more compliant with legal requirements. Legal awareness was seen as important in enabling SMEs to understand their legal obligations and to take steps to comply with them.

Regulatory Burden

The interviews with SMEs and legal experts confirmed that regulatory burden significantly influences legal compliance in SMEs in West Java. SMEs that perceived the regulatory burden to be high were less likely to comply with legal requirements. Regulatory burden was seen as a major barrier

to legal compliance, particularly for small and resource-constrained SMEs.

Integration of Findings

The findings from the quantitative and qualitative data were triangulated to provide a comprehensive understanding of the determinants of legal compliance in SMEs in West Java. The findings from both the survey and the interviews were consistent in identifying the type of industry, legal awareness, and regulatory burden as important determinants of legal compliance in SMEs in West Java.

The results suggest that manufacturing SMEs are more likely to comply with legal requirements compared to those in the service industry. This may be because manufacturing SMEs are subject to more regulations and have formalized procedures in place to comply with legal requirements. Thus, it is important for SMEs in the service industry to pay attention to their legal obligations and invest in legal compliance.

The findings also highlight the importance of legal awareness in promoting legal compliance in SMEs in West Java. SMEs with higher levels of legal awareness were found to be more compliant with legal requirements. Therefore, efforts should be made to improve legal awareness among SMEs in West Java through various means such as training and education programs.

The results also indicate that the regulatory burden is a significant barrier to legal compliance in SMEs in West Java. SMEs that perceived the regulatory burden to be high were less likely to comply with legal requirements. Therefore, policymakers and regulatory authorities should aim to reduce the regulatory burden on SMEs, particularly for small and resource-constrained SMEs, to facilitate legal compliance.

Overall, the findings suggest that improving legal awareness and reducing the regulatory burden can be effective strategies to promote legal compliance in SMEs in West Java. Policymakers and regulatory authorities should work together to create an enabling environment for SMEs to comply with legal requirements. Moreover, SMEs should also invest in legal compliance to avoid legal and financial penalties and to promote their reputation in the marketplace.

Discussion

The findings of this study have important implications for policymakers, regulatory authorities, and SMEs in West Java. First, the results suggest that type of industry is an important determinant of legal compliance in SMEs. Manufacturing SMEs were found to be more compliant than service SMEs, possibly due to the greater number of regulations and formalized procedures in place for compliance. Thus, policymakers and regulatory authorities should work to improve compliance among service SMEs and create an enabling environment for compliance [3], [25]–[27].

Second, the study highlights the importance of legal awareness in promoting legal compliance in SMEs. SMEs with higher levels of legal awareness were found to be more compliant than those with lower levels. Therefore, policymakers and regulatory authorities should aim to improve legal awareness among SMEs in West Java through training and education programs [50], [52].

Third, the results suggest that the regulatory burden is a significant barrier to legal compliance in SMEs. SMEs that perceived the regulatory burden to be high were less likely to comply with legal requirements. Therefore, policymakers and regulatory authorities should work to reduce the regulatory burden on SMEs, particularly for small and resource-constrained SMEs, to facilitate legal compliance [13], [21], [22], [35], [53],[54].

Limitations

The sample size was relatively small and limited to SMEs in West Java, which may limit the generalizability of the findings to other regions or countries. The study relied on self-reported data, which may be subject to social desirability bias or measurement error.

CONCLUSION

This study contributes to the understanding of the determinants of legal compliance in SMEs in West Java. The results show that type of industry, legal awareness, and regulatory burden significantly influence legal compliance in SMEs. Manufacturing SMEs were found to be more compliant than service SMEs, and SMEs with higher levels of legal awareness were more compliant than those with lower levels. Moreover, SMEs that perceived the regulatory burden to be high were less likely to comply with legal requirements. The study concludes that improving legal awareness and reducing the regulatory burden can be effective strategies to promote legal compliance in SMEs in West Java. Policymakers and regulatory authorities should work together to create an enabling environment for SMEs to comply with legal requirements, and SMEs should invest in legal compliance to avoid legal and financial penalties and to promote their reputation in the marketplace.

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