

# Financing Model for Small-Medium Scale Contractors in Indonesian

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## Abstract

The important role played by the small-medium scale contractors in Indonesia has been flawed by their lack of performance and inefficiency. It demands improvement through innovation processes. Yet, the endeavor has been challenged by the limitation in sources of funding. This study therefore, was set to investigate the significance of the available source of funding to the innovation processes for Indonesian small-medium scale contractors. The result has shown that majority of the respondents were not having difficulties in accessing source of funding. Moreover, the interest rate was the most highlighted by the respondents amongst financial factors which might stimulate the innovation. However, the available source of funding still could not support the innovation processes. A solution has been proposed in order to overcome the problems. It is a system which has scanning, monitoring and training processes in one complete mechanism and known as microcredit. All the respondents agreed that the program would boost the industry performance. Yet, there was a major concern shown by the respondents for its contingency and success. The program would also bring a major change to the industry's structure.

## Keywords

Small-Medium Contractors, Innovations, Sources of Funding, Microcredit.

## 1. Introduction

Globalization has become a major challenge for the construction industry and changed its structure. Globalization means that the boundaries are becoming wider, in context of opportunities and challenges. The Indonesian construction industry naturally has become one of the effected sectors which needed to respond to it. Yet, Soeprapto and Trigunarsyah [2005] argued that the Indonesian construction industry was not ready to enter the competition. Major changes and contingency endeavors need to be done by the industry. On the other hand, the highlighted for the industry was 60% market share was taken by the big scale contractors which registered only 1% from all Indonesian contractors' population [Afriyanto, 2016]. Therefore, further studies and major concerns are needed to be addressed to the small-medium scale contractors due to their improvement for surviving within the industry.

Under the heading of small-medium scale contractors, surviving within the industry is equally with a continuous improvement or innovation. The construction industry has a unique characteristic. Almost all construction projects are temporary basis activities whilst as a corporate the construction companies are managed based on day to day basis activities. In more common words, the incomes are temporarily whilst spending are continuous. Inadequate in liquidity to support the daily activities has brought many construction companies out of the business [as Singh and Lokanathan, 1992; cited by Nesan, 2012]. On the other hands, contractors which part of construction companies, tend to bid lower prices in order to stay within the business. By doing this, contractors take more risks beyond their power and make them more vulnerable to the unexpected financial aspects during the project completions [Purnus and Bodea, 2015].

It has been known that the financial ability of small and medium-scale companies will determine their aptitudes in developing and winning the market. This is typical of a fast growing and uncertain economic environment in a developing country and it sometimes brings obstacles for such companies to achieve this objective. As Bosa 1969; Levy 1993; Keasey and Watson 1994 stated, as cited by Eyiah [2001], “Difficulties in obtaining bank loans have been recognized as major constraints on development of small businesses in developing countries”. However, it should be noted that the existence of small and medium-scale contractors in developing countries is important, especially for their contribution to the socio-economic development. Perhaps, they are the only group of contractors who would seize the prospect of undertaking relatively unattractive construction contract in rural communities [Eyiah and Cook, 2003].

Therefore, based on above overviews, there are two headings which become major concerns, there are “innovation within small and medium scale contractor” and “the sources of funding to support their business sustainability”. This anxiety has been highlighted by Bahaswan, et. al. [2020] which noted that the availability on source of funding was the main factor which could brought innovation within small-medium scale contractor successful. Hence, the research objectives were constructed to serve the purpose. Firstly, “*What are the kinds of financing sources currently used by small-medium scale contractors in Indonesia?*” and secondly, “*What is the influence level of the available financial sources to the level of innovation for small-medium scale contractors in Indonesia?*”

## **2. Literature Reviews**

### **2.1. Source of Funding on Construction Industry**

In general, the types of sources and financing available are many and varied, but can be divided into two broad categories, equity and debt. The definition of equity is finances that give the provider a proprietorial or ownership interest in the business. It is common that the amount of equity will be raised through the business development. Because of the limitation of individual sources in financing, an unlimited number of individuals or financial institutions contribute variable amounts of money in return for an appropriate shareholding in the company. On the other hand, debt also comes in many different forms. The most popular in this category is bank borrowing and trade credit. Yet, most of the businesses will be financed using a mixture of equity and debt [Calvert, et al, 1995].

A debt agreement has two common subjects to discuss. These are, the point where the debt must be refunded and interest that must be paid until the debt is repaid. On the other hand, the value of the funding which comes as equity, will be determined by the company’s performance. Nevertheless, there is, sometimes, a unique agreement which combine debt and equity as a unity. For instance, the assistance starts as a debt with an entitled amount of interest and later it may be delivered into shares of the company.

There are many ways in which the company can gain funding beside from the bank loan. The alternatives can be distinguished into two categories, which are short-term finance and long-term finance. Firms may further supplement their short-term needs by; trade credit, subcontracting, hire purchasing, leasing, stock control and venture capital. On the other hand, firms may combine these following sources of finance for their long-term finance; retained profits, clearing bank loans, merchant bank loans, shares, debentures, government grants and loans, sale and lease-back, joint venture and concession contraction. These are shortly quoted from Brett [1997], Ashworth [1996], and also Harris and McCaffer [2001].

### **2.2. Source of Funding for Small-Medium Scale Contractors**

Concerning of the contributions of small-medium scale business enterprises in the macro economy of developing countries, many assistance programs are given to them by government and financial institutions. Basically, there are two kinds of policy options in this regard: (i) those designed to reduce enterprise needs for working capital; and (ii) those to enhance their access to loans. These policy options are based on the construction industry’s characteristics and the most likely problems which can happen in developing countries. For example, contractors could not repay loans made to them if interim-certificate payments were persistently delayed, and if they could not make profits from a project because of their poor technical and managerial knowledge [Eyiah, 2001].

On the other hand, Hillebrandt and Cannon [1990] argued that the industry used to be self-financed; however, this has changed because of the following four factors: a) Lower profit margins which are in some cases slim or not

existent, b) Inflation is lower and thin, following a period of high inflation which allows laxity in financial practice, meaning that tightening up is necessary, c) More fixed price contracts, and d) More difficult credit terms.

Eyiah [2001] argues that there is a remaining gap in the relationship between banks and small firms. This highlights the importance of employing an intermediary in helping to develop and strengthen the relationship between the parties. In this regard, Eyiah proposed that this function may well be presented by microcredit programs. Eyiah emerged with a model of microcredit for small contractors in developing countries and identifies three variables of activities that can accommodate and make the model become an interrelated process. These are;

a. Screening; This function could be played by the contractor association. Providing some information about its members and documenting their works can end up with recommendations to the source of financing bodies. These processes could minimize the risk and cost of the transaction.

b. Monitoring; This process will observe and maintain the borrowers for misuse of the funding and giving help to solve the incoming problems. It also retains the interest of both parties. However, the main issue within this process happens when the interim payments to the contractor are delayed. It is obvious that small contractors will suffer because of their limitation on capital sources.

c. Training; This process is based on the identified problems. Basically, such trainings or short courses will be given to the staff members of the small firms to improve their ability and capability in dealing with such problems.

Unfortunately, this model will generally bring fundamental changes within the industry and it needs time and further research to make this model more effective. Meanwhile, a sustainable means should be implemented in order to introduce this model into the industry and educate the people. A key role for the success of this program is played by the developing countries' government who has the power to pursue changes within construction industry.

### **2.3. Source of Funding within Indonesian Construction Industry**

The background knowledge in this sub-chapter was gathered from the preliminary research which was conducted by targeting several Indonesian construction firms. In general, Indonesia as one of the developing countries seems to have a similar structure of sources of funding to the reviewed literature in this chapter. Nevertheless, an exception may occur in Indonesia's economic environment.

During the down fall of economic, construction industry was the first economic sector impacted and suffered the most. This is because the nature of the industry highly depends on the financial institutions/banks to support its financing ability. Unfortunately, many economists blame the industry as the main reason of the collapse of the financial structure. It might be reasonable because the majority of the financial institutions spent their credits on the construction industry. When the crisis happened, many of the credits within the industry were stuck and became non-refundable [Kompas, 2003].

On the other hand, the recovery of the Indonesian financial structure after the crisis seems to go slower than what people might have expected. This indeed indicates that there was another problem within the financial structure itself. Therefore, in order to provide a good economic environment, whether for the macro or micro economy, the government must first prioritize the recovery of the financial structure. This means that the credit processes would be more difficult [Djiwandono, 2004].

However, the government realizes that the recovery process within the construction industry is also important. This condition emerges parallel to the demand of small housing for the middle-class people. Therefore, in response to such conditions, the government has established agreements with chosen banks/financial institutions. There are 31 chosen banks/financial institutions that are designed to provide such assistance. Yet, the effectiveness of this policy seems still far from what it should be. It is because from those 31 chosen banks, only 5 of them have the capability to perform as required. The problems faced regarding this are; a) the financial institutions do not have a mechanism and qualified human resources which can support this policy, b) the housing mechanism itself has many internal problems, c) uncertain contribution made by the local government (municipality) to support the policy, d) slow agreement process, e) the requirement of a permit made by the local government makes the credit process slower, and f) the credibility of the contractors sometimes brings lack of trust to the banks [Media Indonesia, 2004].

## **3. Methodology**

This research uses qualitative approach and gathers the data from the respondents using questionnaires. The questions are open ended type. All gathered data was documented and analyzed individually based on the arising

questions. The data was compared and patterns were expected for each of the questions. Moreover, in order to give a better overview, the graphs and charts will be used.

The research started with a literature reviews under the heading of research's objectives. This knowledge guided and constructed the enquiries within the questioner. Moreover, as Naoum [1998] wrote that a preliminary research could bring a more solid results and conclusions. It tests the arising questions constructed from literature reviews and avoids bias to the respondents. Therefore, the constructed questioner was firstly tested by interviewing a credible individual within the industry and some chosen small-medium scale contractors.

The questioner distributed to the respondents majority by email, whilst some of them were direct interviews. Based on the preliminary research, this type of questions supposes be answered by those on the top management level of the company. The respondents need to have a knowledge in area of company's policies specially on accessing sources of funding. The targeted respondents were small-medium scale contractors located in East Java Province of Indonesia.

## 4. Results and Discussion

### 4.1. Results

The questionnaire consists of eight questions. The respondents' answers are summarized and illustrated in pie charts to make it easier to read and observe. The further discussion regarding the research findings is presented on each question results discussions.

Question 1: *What are the sources of funding that your company currently uses?*

Results;

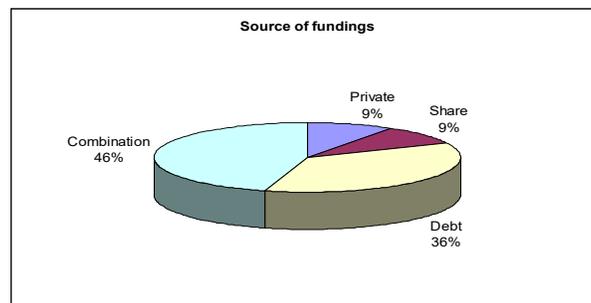


Figure 1. The source of funding used by the respondents

Figure 1 shows the data of source of funding used by the respondents. The most common used source of funding is the combination (46%) and is followed by debt (36%). The private and share funding scored only 9% each. In addition, it is important to point out that almost all the combination funding users combine debt and private sources to finance their projects. On the other hand, in terms of debt financing, bank/financial institutions are not the only providers used by the debentures. In certain cases, especially for short term periods (1-2 month or even weeks), they prefer to use individual sources which can be liquidated faster and are less complicated to access. Regarding this, a good relationship between constructors and individuals within the industry becomes more significant.

Question 2: *If your company uses assistance for funding, in what way will it be?*

Results;

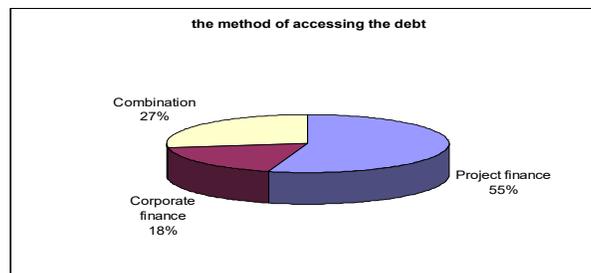


Figure 2. The method of accessing the debt

As discussed on the question number 1, almost all of the respondents have used debt as their financial source. This enquiry explores further on what methods/mechanisms debt has been accessed. As can be seen in Figure 2, that the majority of the respondents utilize their projects as debt mortgage (55%) and only 18% of the respondents use it as corporate finance. As discussed earlier, the variety of the projects undertaken sometime makes the financial mechanisms become inconsistent. This has been observed by 27% of the respondents who has utilized both project financing and corporate financing.

**Question 3:** *Has your company experienced difficulties when accessing such sources of funding?*  
Result;

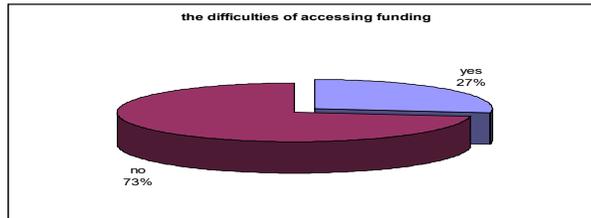


Figure 3. The difficulties of accessing source of funding

In general, the respondents do not have a significant problem accessing such funding and this was confirmed by 75% of the respondents. Almost all of the respondents argue that they have been using funding schemes regularly to start their projects. However, as illustrated in Figure 3, which clearly pictures that accessing funding is not a problem, the finding challenges the earlier industry’s perspective regarding this issue. On the other hand, the difficulties might occur when instant circumstances emerge which (normally) it will delay the projects. The limited sources mean any delays might bring a major problem to the small contractors’ financial position.

**Question 4:** *Does your current source of funding support the process of innovation?*  
Results;

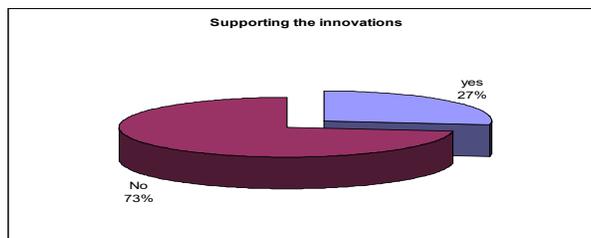


Figure 4. The supporting level of the sources of funding to the innovation

The majority of the respondents, as summarized in Figure 4, argue that their source of funding has been used only on the projects (73%). There is not much room for the companies to use the funding for innovation purposes. The innovation might only be conducted by optimizing profit earned from the projects. This condition has decreased the willingness to undertake such innovations. On the other hand, another group of respondents, which in this case are medium scale firms, argue that their exceeded resource might lead them to conduct such innovation.

**Question 5:** *In your opinion, from the finance factors below, in what respect is the sequence supporting the innovation process?*  
Results:

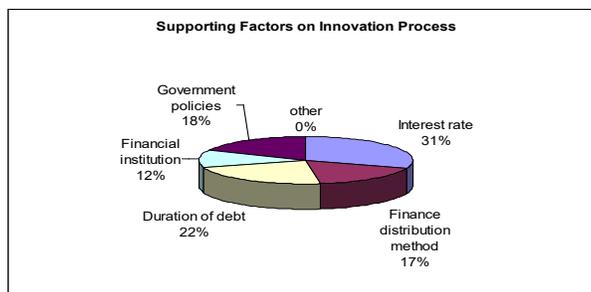


Figure 5. The sequence of the financial aspects supporting innovation process

The Figure 5 illustrates that from six answer given categories, the respondents see that the most influencing financial factor to the innovation process is the interest rate (31%). It is followed by duration of debt, government policies and financial distribution method with 22%, 18% and 17% respectively. Last, the financing institution chosen by the firms contributes only 12%.

**Question 6:** *Will a special funding program (microcredit) help the company in the innovation processes?*  
Result;

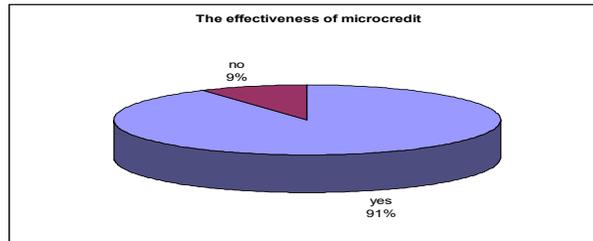


Figure 6. The significance of the microcredit to the innovation

As pictured in Figure 6, almost all respondents feel that microcredit will help them to undertake such innovations and only 9% of the respondents who against it. The majority argue that within the proposed mechanism, the chance of applying innovation will be possible and higher. However, there is a major concern shared by the respondents regarding this, which is the skeptical view from the respondents that such a major change on the structure of the industry, as has been proposed by the microcredit program, cannot easily take place within the industry.

**Question 7:** *Does the professional body that your company registered help you through difficulties accessing such sources of funding and innovation processes that your company might have?*  
Results;

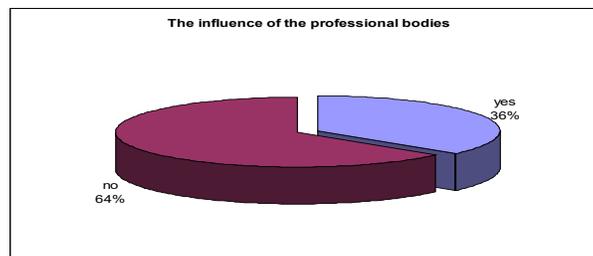


Figure 7. The contribution made by the professional bodies

It has been confirmed by 64% of the respondents that the professional bodies, which they have been registered, are no more than to serve administrative purposes only. Yet, the respondents argue that their membership may lead to indirect effects which, in some cases, can help to solve the financial problems and the accessing of information amongst the members. This is what the rest of respondents underline as the advantage of being the member of certain associations. The Figure 7 illustrates the data gathered from the respondents.

**Question 8:** *In general, what is your opinion concerning this subject, please explain?*  
Results;

The responses to this question are varied amongst the respondents. However, there are certain aspects which can be summarized regarding this issue. First of all, we can highlight the respondents' enthusiasm regarding the proposed mechanism (microcredit). This is because despite the recently problems faced by the industry, it seems that the government's efforts to create a conducive industry environment are not significant, especially on small-medium scale contractors. On the other hand, another major concern coming from the respondents is the contingency of the program. If there was such a program, the majority of the respondents doubt that it would be easily applied. Considering the changes which might be needed and the availability of adequate human resources, there are several stages that need to be taken by the government and other responsible bodies within the industry before the program comes into effect.

## 4.2. Discussion

Within this sub-chapter, the discussion constructs analysis based on literature reviews and gathered questioner's data. The discussion answers questions which been stated as research's objectives.

*“What are the kinds of financing sources currently used by small-medium scale contractors in Indonesia?”*

As has been discussed earlier, the economic crisis experienced in some time period of Indonesia economy has changed many aspects of the financial structure. Difficulties have been also experienced by the construction industry. The sources of funding used by the industry and an overview on how it has been accessed will be explored.

The economic crisis has shifted the Indonesian financial behavior. Many financial institutions tend to relocate their credits. This condition has brought difficulties to the contractors with limited resources. Moreover, the economic recovery does not mean that the industry performance has healed to the level it had before the crisis. It has been confirmed by the research that the majority of the respondents are still distressed by the difficulties accessing sources of funding.

On the other hand, the research finds that the majority of the respondents have used a combination between private and debt sources of funding as their main resource. Many factors have forced the firms to be more flexible and creative combining the available resources. The diversity of the projects undertaken, delay on the payment process and complicated credit/loan processes have forced the firms to have options for the financial resources.

Finally, concerning the methods used by the enterprises to access debt or credit the research has found that the majority of the respondents have utilized their projects as financial mortgages.

*“What is the influence level of the available financial sources on the level of innovation in small-medium scale Contractors in Indonesia?”*

This question is tightly related with the first arguments, innovation process and source of funding. To begin with, an analysis of the sources of funding currently used to support the innovation process will take place. It will then continue with the analysis of the ideal condition of sources of funding which might lead to innovation.

The conducted research denotes that the most respondents feel that their current resources do not support the innovation process within the firms. The existing resources have only been utilized for the works undertaken. Therefore, it is necessary to identify an appropriate mechanism which might support the process. The investigation has been pursued to classify and identify the sequences of the influential factors.

The research highlights that the most important financial variable when determining the pace of innovation is the interest rate. Moreover, the other factors which follow it are; the duration of the debt, the government policies, financial distribution method and financing institutions, respectively.

Meanwhile, the literature review regarding this has acknowledged that the microcredit mechanism, which theoretically might grow with the required financial conditions, could lead a proper innovation process. The research on funding confirms the most of respondents agree that this proposed financial mechanism might be appropriate for supporting the innovation. This enthusiasm comes because there has not been any assistance from the professional bodies, which in many cases are expected to be significant.

Finally, the discussion under this heading is underlined by the respondents' concern. They believe that the successful of the microcredit program depends on the consistency of the involved parties. This concern is based on the fact that the implementation of such programs might provoke a major change within the industry.

## 5. Conclusion

The research noted that in case of Indonesian construction industry, the major concern under the heading of accessing source of funding for the small-medium scale contractor was incorrect. The majority of the respondents (73%) were not having difficulties accessing source of funding for their project. Even though debt was not their main source of funding in gaining capital, only 9% of the respondents whose fully self-financed. Shared finance, fully debt

financed and combination financed were experienced 9%, 36% and 46%, respectively. However, by 73% of the respondents, the source of funding used was only served the project purposes and left no room for the companies conducting such of innovations.

Furthermore, under the heading of innovation within the Indonesian contractors, the research highlighted that amongst financial aspects, interest rate was believed could stimulated the innovation within the enterprises (31%). They agreed that the professional bodies have to contribute more in serving the purposes. Moreover, they believed that innovation process could be more appropriate under the proposed scheme (microcredits) even though it would be difficult and could change the industry's structure.

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