



**INDONESIAN RESPONSES TOWARD ASEAN'S SME  
DEVELOPMENT FRAMEWORK POLICY**

**BY**

**MISS AINUN HABIBAH**

**A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF  
THE REQUIREMENTS FOR THE DEGREE OF  
MASTER OF ARTS (ASEAN STUDIES)**

**PRIDI BANOMYONG INTERNATIONAL COLLEGE  
THAMMASAT UNIVERSITY**

**ACADEMIC YEAR 2015**

**COPYRIGHT OF THAMMASAT UNIVERSITY**

**INDONESIAN RESPONSES TOWARD ASEAN'S SME  
DEVELOPMENT FRAMEWORK POLICY**

**BY**

**MISS AINUN HABIBAH**



**A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF  
THE REQUIREMENTS FOR THE DEGREE OF  
MASTER OF ARTS (ASEAN STUDIES)  
PRIDI BANOMYONG INTERNATIONAL COLLEGE  
THAMMASAT UNIVERSITY  
ACADEMIC YEAR 2015  
COPYRIGHT OF THAMMASAT UNIVERSITY**



THAMMASAT UNIVERSITY  
PRIDI BANOMYONG INTERNATIONAL COLLEGE

THESIS

BY

MISS AINUN HABIBAH

ENTITLED

INDONESIAN RESPONSES TOWARD ASEAN'S SME DEVELOPMENT  
FRAMEWORK POLICY

was approved as partial fulfillment of the requirements for  
the degree of Master of Art (ASEAN Studies)

on July 22, 2016


Chairman



---

(Professor Jaran Maluleem, Ph.D.)


Advisor



---

(Assistant Professor Sunida Aroonpipat , Ph.D.)


Member



---

(Associate Professor Withaya Sucharithanarugse , Ph.D.)


Member



---

(Anas Amatayakul , Ph.D.)

Dean



---

(Associate Professor Niyom Rathamarit, Ph.D.)

Thesis Title	INDONESIAN RESPONSES TOWARD ASEAN'S SME DEVELOPMENT FRAMEWORK POLICY
Author	Miss Ainun Habibah
Degree	Master of Arts (ASEAN Studies)
Major Field/ Faculty/ University	ASEAN Studies Pridi Banomyong International College Thammasat University
Thesis Advisor	Assistant Professor Sunida Aroonpipat, Ph.D
Thesis Co-Advisor	Associate Professor Withaya Sucharitanarugse, Ph.D
Academic Year	2015

## **ABSTRACT**

The issue of Small and Medium Enterprises (SME) has been put as one of the priority issues in ASEAN Economic Community Blueprint (AEC Blueprint). Under the goal of enhancing equitable economic development, ASEAN arranged the regional framework namely ASEAN Policy Blueprint for SME Development (APBSD) and ASEAN Strategic Plan for SME Development. These frameworks are the guidance for every country in region for developing SME in order to accelerate the pace of SME development in a region as well as enhance the competitiveness and dynamism of ASEAN SMEs.

This study assessed how Indonesian national policy in respond to regional framework since the literature stated that a consistent SME policy both at national and regional level is significant to be addressed. There were five key areas to see and measures whether Indonesian policy is supportive toward APBSD and ASEAN SAPSD. Those five key areas are: 1) Human resources development policy; 2) Financing access policy; 3) Technology capability policy; 4) Promotion activity policy; and 5) Enhancing marketing capability.

This research was conducted in qualitative ways by interviewed some persons from related ministries as well as reviewed literatures regarding SME's policy

in Indonesia. This research found that ASEAN's SME frameworks can only be applied in ASEAN countries at certain level due to the different complexity among countries. In the case of Indonesia, the government considered ASEAN's SME initiatives and agreements as focal input to develop SME in Indonesia even though did not refer directly to those two frameworks. In addition, the significant efforts of were made by the government in complies the components from the Action Plan especially in term of providing better access to finance yet less emphasis in the developing skill of human resources and improving innovation capability.

**Keywords:** Small and Medium Enterprises, ASEAN Policy Blueprint for SME Development, Strategic Action Plan for SME Development

## ACKNOWLEDGEMENTS

First of all, I would like to express my deep sincere appreciation to my supervisor, Assistant Professor Sunida Aroonpipat, Ph.D. for her supervision, useful consultation and informative advice as well as her patience and kindly attention throughout my study and while conducting this research. I wish to express my gratitude to my co-supervisor and committee members, Assoc. Prof. Withaya Sucharitanarugse, Prof. Jaran Maluleem and Dr. Anas Amatayakul who have provided informative and constructive comments and suggestion to improve this study.

I would like to express my special thanks to the interviewees who provided me data and relevant information for this study: Ministry of Cooperatives and SME, Coordinated Ministry of Economy, Ministry of Foreign Affairs and other interviewees from SMEs in Yogyakarta Province.

I wish also to express my gratitude to my colleagues in PBIC, Khun Tangmo, all the lectures and staffs of PBIC, Thammasat University who always give me support, useful insight, fun discussion and always encourage me to finish my study on time.

Finally, I would like to express my deep gratitude and appreciation to my family: my father, my mother and my siblings who always give me never ending support. My gratitude also goes to all friends and colleagues both in Thailand and Indonesia who never getting tired to support me. Without their great care, I could never have accomplished this thesis.

Miss Ainun Habibah

## TABLE OF CONTENTS

	Page
ABSTRACT	(1)
ACKNOWLEDGEMENTS	(3)
LIST OF TABLES	(8)
LIST OF FIGURES	(9)
LIST OF ABBREVIATIONS	(10)
CHAPTER 1 INTRODUCTION	
1.1 Problem and its significant	1
1.2 Research question	7
1.3 Objectives	8
1.4 Research method	8
CHAPTER 2 REVIEW OF LITERATURE	
2.1 Overview of SME Development in ASEAN	10
2.1.1 Human Resources Development	12
2.1.2 Access to Finance	14
2.1.3 Access to Technology	16
2.1.4 Facilitating Promotion for SMEs	17
2.1.5 Enhancing Marketing Capability for SMEs	19
2.2 Literature Gap	21
2.3 Research Conceptual Framework	22

## CHAPTER 3 INDONESIA POLICY TOWARD ASEAN SME FRAMEWORK POLICIES

3.1 Profile of Indonesian SME	24
3.1.1 Definition of SME in Indonesia	24
3.1.2 Institutional Framework and Policy Platform for SME Development in Indonesia and its Linkages to ASEAN's SME Regional Framework Policy	25
3.2 Human resources policy of Indonesian SME	30
3.2.1 Regulation in Human Resources Issue	31
3.2.2 Policies, Programs and its Implementation to Improve Capacity of SMEs	32
3.2.2.1 Encourages Entrepreneurship Development Program	33
3.2.2.2 Enhances SME-sector skills in management and organization	35
3.2.2.3 Fosters SME capabilities for inter-firm networking and linkages	39
3.2.3 National Policies and Programs toward ASEAN's SME Framework Policy	40
3.3 Access to finance of Indonesian SME	43
3.3.1 Regulations on Accessing to Finance for SMEs	44
3.3.2 Policies, Programs and its Implementation on Accessing to Finance	46
3.3.2.1 Capacity building for improved SME access to finance	46
3.3.2.2 Financial institutional capacity building for improved SME financing	47
3.3.2.3 Widening and deepening SME access to credit	49
3.3.3 The aspect of access to finance toward AEC 2015	52
3.4 Access to technology policy for Indonesian SME	54
3.4.1 Regulations of Technology Development for SME	54
3.4.2 Programs and Policies regarding Access to Technology for SME	55



3.4.2.1	Policy and Program of SME technology upgrading	55
3.4.2.2	Policy regarding technology incubators	59
3.4.3	Access to Technology for SME toward AEC	60
3.5	Promotion activity for Indonesian SME	63
3.5.1	Regulation, Program and Implementation Regarding Promotional Activity	64
3.5.1.1	Promoting SME to international market	64
3.5.1.2	Wider dissemination of information on SMEs trade fairs and festivals in each AMSs and facilitating them to participate in these events	67
3.5.2	Promotion Activity towards AEC	70
3.6	Enhancing marketing capabilities for Indonesian SME	72
3.6.1	Programs for Enhancing Marketing Capabilities for SMEs	72
3.6.1.1	Encourage Using e-commerce	74
3.6.1.2	Encourage sub-contracting activity	76
3.6.2	SME's Marketing Capability towards AEC	79
3.7	Indonesian responses toward ASEAN's SME framework policy	80

## CHAPTER 4 THE APPLICATION OF ASEAN SME FRAMEWORK UNDER INDONESIA CONTEXT

4.1	Challenges in applying ASEAN SME Framework	85
4.2	Critical factor in developing SME in Indonesia	88
4.2.1	Inward looking characteristic	89
4.2.2	Less Favorable Environment to Develop SME	90
4.3	Prospect of Indonesian SME in the era of AEC	94
4.3.1	Indonesia as a world's Muslim fashion center	95
4.3.2	The emergence of stylist Muslim fashion	96
4.3.3	Batik as potential fashion industry	98

## CHAPTER 5 CONCLUSION AND RECOMMENDATION

5.1	Conclusion	99
-----	------------	----

5.2 Recommendation	101
BIBLIOGRAPHY	104
BIOGRAPHY	108



## LIST OF TABLES

Tables	Page
1.1 ASEAN Policy Blueprint for SME Development (ABPSD) 2004-2014	1
1.2 Strategic Action Plan for SME Development	2
1.3 List of interviewees	
3.1 Numbers of SMEs by year	41
3.2 Contribution of SMEs in GDP	42
3.3 Contribution of export sharing (SMEs and large enterprises)	73
3.4 Exporting SME clusters in Indonesia by provinces (2005)	77

## LIST OF FIGURES

Figures	Page
1.1 Relative economic importance of SMEs in ASEAN in 2013	1
2.1 Research conceptual frameworks	2
3.1 Institutional arrangement in developing SME in Indonesia	27
3.2 Indonesia towards ASEAN's SME Framework Policy	82



## LIST OF ABBREVIATIONS

Symbols/ Abbreviations	Terms
AEC	ASEAN Economic Community
AMS	ASEAN Member States
APBSD	ASEAN Policy Blueprint for SME Development
APEC	Asia Pacific Economic Cooperation
ASDD	ASEAN SME Development Decade
BDS-P	Business Development Service Provider
CLMV	Cambodia, Laos, Myanmar, Vietnam
COBLAS	Consulting-based Learning for ASEAN SME
ERIA	Economic Research Institute for ASEAN and East Asia
FTA	Free Trade Agreement
FP	Foster Parent (Program)
GDP	Gross Domestic Product
IBSC	Integrated Business Service Center
ICT	Information, Communication and Technology
IDR	<i>Indonesia Dalam Rupiah</i> (Indonesian Rupiah Currency)
JAIF	Japan-ASEAN Integration Fund
KUR	<i>Kredit Usaha Rakyat</i> (People's Business Credit Program)
MNC	Multinational Corporation
MNE	Multinational Enterprises
MoCSME	Ministry of Cooperatives and SME
MSME	Micro, Small and Medium Enterprise



OECD	Organization for Economic Cooperation and Development
NGO	Non-Government Organization
NLTDP	National Long-Term Development Plan
NMTDP	National Medium-Term Development Plan
NPCE	National Program for Community Empowerment
OVOP	One Village One Product
RENSTRA	<i>Rencana Strategis</i> (Strategic Plan)
SEOM	Senior Economic Official Meeting
SME	Small and Medium sized Enterprises
SMEWG	Small and Medium Enterprises Working Group
SMK	<i>Sekolah Menengah Kejuruan</i> (Vocational High School)

# CHAPTER 1

## INTRODUCTION

### 1.1 Problem and its Significance

Small and Medium Enterprises (SMEs) play an important role in the economic sector in ASEAN. Lim and Kimura (2009) mentioned that the SME sector forms the backbone of Southeast Asia's economy. In terms of the numbers, it accounts for a majority of all private-sector firms (Asasen, 2003 cited by Lim and Kimura, 2009); it makes a substantial contribution to employment, which accounts for 40-90 per cent in each country in Southeast Asia; it also contributes to export sharing (more than one-quarter), and plays different dynamic roles that drive economic growth and industrial development (Wengel & Rodrigues, 2006)

Gibson and Vaart (2008) in their research also conclude that SMEs have a central role in poverty reduction as "connectors" of local economic activity. This strength of SMEs is also seen as a tool to narrow the economic gap among areas. Moreover, ASEAN and the East Asia Summit both stated in 2011 that the role of SMEs are as vehicles for accelerating intraregional trade, rebalancing economies toward domestic and regional demand, and promoting inclusive growth in Asia (Sato, 2013)

However, SMEs in Southeast Asia are still facing many problems. Lim and Kimura (2009) identified four main constraints faced by SMEs in Southeast Asia: 1) lack of a sustainable entrepreneurial drive; 2) lack of skill and expertise in organization and management; 3) the inward-looking mentality, especially typical among family enterprises which make it difficult for them to access information, markets and inputs; and 4) SMEs in Southeast Asia mostly find difficulty in gaining access to financing.

A strong, dynamic and efficient SME sector will ensure the sustainable economic development and contribute to greater economic growth of the ASEAN region. At the same time SMEs are confronted with a wide-range of challenges and issues, therefore concerted actions and development programs will truly be needed (APBSD documents, 2004). Therefore, some of the regulations at the regional level is arranged to provide guidance for each country to make sure that the agenda of SME

development can be delivered successfully, especially when faced with the formation of the ASEAN Economic Community (AEC). An appropriate SME policy framework is fundamentally important for the growth of SMEs, as is the need to ensure that the adverse consequences of external or exogenous disturbances emanating from regional trade partners have a minimal disruptive impact on domestic and regional economies (ERIA, 2014). Moreover, the SMEs nowadays also face the changing of the business environment: shorter product cycles, greater time pressure in the launch of new products, increased cost pressures, continuous training of employees as well as difficulties in finding sufficient numbers of skilled workers (EU, 2014). All of those problems cannot be sufficiently addressed by each national government in each country. Furthermore, in the context of regional economic development, it has been proven in recent years that a region's development has been determined not so much by attracting large industrial enterprises to the region, but rather by developing the region's internal potential (EU, 2014). Therefore, maintaining and developing enterprises through comprehensive policy at the regional level is needed.

To address the SME's issue in the region, the AEC Blueprint put the SME issue as one of their agenda priorities. Under the point of how to "enhance a region of equitable economic development", the SME development issue has started to be discussed. The objectives of SME development mentioned in the AEC Blueprint are to: (a) accelerate the pace of SME development, optimizing the diversity of the economic levels of ASEAN Member Countries; (b) enhance the competitiveness and dynamism of ASEAN SMEs by facilitating their access to information, markets, human resource development and skills, and finance as well as technology; (c) strengthen the resilience of ASEAN SMEs to better withstand adverse macroeconomic and financial difficulties, as well as the challenges of a more liberalized trading environment; and (d) increase the contribution of SMEs to the overall economic growth and development of ASEAN as a region. Meanwhile, in order to meet those objectives, ASEAN issued detailed guidance as a framework for SME development in the region namely the ASEAN Policy Blueprint for SME Development 2004-2014 (APBSD). They also then turned out a strategic plan namely the ASEAN Strategic Action Plan for SME Development 2010-2015



The APBSD framework issued by the ASEAN Economic Ministers (AEM) on 2004 aims to facilitate the emergence of a SME sector which is characteristically entrepreneurial, growth oriented, outward-looking, modern and innovative. In this APBSD, there are five focus policies to improve SMEs in the region: (i) Human Resources Development and Capacity Building; (ii) Enhancing Marketing Capabilities; (iii) Access to Financing; (iv) Access to Technology; and (v) Creating Conducive Policy Environment.

Table 1.1

*ASEAN Policy Blueprint for SME Development (ABPSD) 2004-2014*

<b>Program Area</b>	<b>Activities</b>
Human resources development and capacity building	<ul style="list-style-type: none"> <li>• Entrepreneurship development program</li> <li>• Enhancing SME-sector skills in management and organization on a self-reliant basis</li> <li>• Fostering SME capabilities for inter-firm networking and linkages</li> <li>• Tracking and benchmarking SME capabilities, dynamism and competitiveness</li> </ul>
Enhancing marketing capabilities	<ul style="list-style-type: none"> <li>• Setting up regional and sub-regional networks of interlinked, on line clearing points or trading houses for SME business</li> <li>• Enhancing SME capabilities in and reliance on ICTs and e-commerce</li> <li>• Tracking and benchmarking SME readiness as subcontractors and compliance to non-negotiable subcontracting preconditions or compliance requirements on the demand-side</li> </ul>
Access to financing	<ul style="list-style-type: none"> <li>• Capacity building for improved SME access to financing</li> <li>• Financial institutional capacity building for improved SME financing</li> <li>• Widening and deepening SME access to credit</li> </ul>
Access to technology	<ul style="list-style-type: none"> <li>• SME technology upgrading and transfers of innovative technologies</li> </ul>

Creating conducive policy environment	<ul style="list-style-type: none"> <li>• Simplification, streamlining, and rationalization of the procedures for SME registration and the process of SME support services</li> <li>• Fine-tune policy and regulatory framework for SME development</li> <li>• Promotion of public-private synergizes and partnership for SME development and integration</li> </ul>
---------------------------------------	---

*Note.* From “ASEAN Policy Blueprint for SME Development 2004-2014”, by SMEWG, 2003, *ASEAN Secretariat*, p.7-26

APBSD is the ASEAN’s SME first framework that has been mentioned in the AEC blueprint with the timeline of implementation is from 2004 to 2014. To make more concrete actions for SME development in region to face the implementation of the AEC, ASEAN created further guidance under the ASEAN Strategic Action Plan for SME Development (ASEAN SAPSD). In this action plan, the policy is more focused to address five issues: (i) Access to finance; (ii) Facilitation; (iii) Technology development; (iv) Promotion; and (v) Human resource development

Table 1.2

*Strategic Action Plan for SME Development 2010-2015*

<b>Program Area</b>	<b>Activities</b>
Access to financing	<ul style="list-style-type: none"> <li>• SME Financial Facility in each Member Country</li> <li>• Feasibility study of SME credit systems for enhancing SME access to bank lending and loan guarantee in ASEAN</li> <li>• Regional SME Development Fund</li> </ul>
Facilitation	<ul style="list-style-type: none"> <li>• Multi-media self-reliant system toolkit package</li> <li>• Technology transfers and licensing within SME sector through dissemination of concrete good practices</li> <li>• Hyperlink national SME Portals</li> <li>• SME service center with regional and sub-regional linkages in AMSs</li> </ul>

	<ul style="list-style-type: none"> <li>• Dissemination of information on regional &amp; international opportunities in trade &amp; investment to SMEs</li> </ul>
Technology development	<ul style="list-style-type: none"> <li>• Sharing of information on technology availability for SMEs in AMSs</li> <li>• Developing key performance indicators (KPIs) on SME Innovation</li> <li>• Development of technology incubators to nurture &amp; support techno entrepreneurs from infancy to take-off &amp; commercialization stages</li> </ul>
Promotion	<ul style="list-style-type: none"> <li>• Identification of top 1000 ASEAN SMEs</li> <li>• ASEAN SME Innovation Awards</li> <li>• Promoting ASEAN SMEs to the international market</li> <li>• Dissemination of information on SMEs trade fairs &amp; festivals &amp; facilitate SMEs' participation in these events</li> </ul>
Human resources development	<ul style="list-style-type: none"> <li>• Common curriculum for entrepreneurship in ASEAN</li> <li>• Regional program for promotion of internship scheme for staff exchanges &amp; visits for skills trainings</li> </ul>

*Note.* From “ASEAN Strategic Action Plan for SME Development 2010-2015”, by SMEWG, 2009, *ASEAN Secretariat*, p.5-10

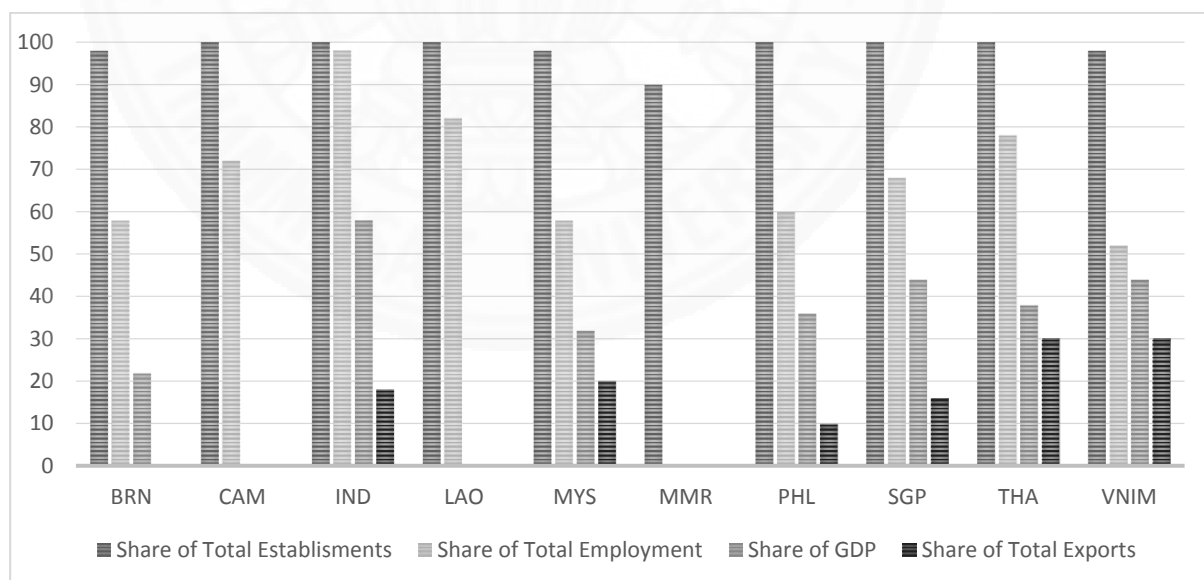
To create and promote a conducive business environment for SME development with both government at the regional and national level as well as private sector assumes synergistic and complementary roles which is truly needed due to greater competition, rapid technological advances, more demanding market requirements and constant changes in consumer demands which requires SMEs to be innovative to face the challenges of the global market (APBSD, 2004).

Each country in ASEAN should interlink their domestic policy with these regional frameworks in order to meet its objectives, as has been mentioned in ABPSD and ASEAN Strategic Action Plan. Thus, the comprehensive policies both at the regional level (ASEAN level) through some initiatives and agreements as well as national policies and programs (in each country) are, beyond doubt needed (ERIA, 2014). Moreover, based on a Policy Recommendation Report by the US-ASEAN Business Alliance for Competitive SME (2014), one of their recommendations stated

that the harmonization between the regional and national level is indeed needed to enable the competitiveness of ASEAN SMEs in order to: support international market expansion, integration into global supply chains, finding new customers as well as to synchronize the regulation of standards and procedures among countries in ASEAN.

However, the capability of each country in ASEAN in response to the SME issue is somehow different. During this time, both ABPSD and the Strategic Action Plan is assessed based on their focus on regional initiatives and there is less emphasis on consistent national SME policies. Furthermore, the application of the focused programs under the ASEAN SME's framework policy is currently up to each ASEAN member state, depending on their domestic needs and level of economic development (Basu Das, 2013). This research aims to analyze how the national governments respond to linkages in their national policy within the regional framework of SMEs, particularly in one of the countries in ASEAN, namely Indonesia.

Indonesia was chosen because among the other countries in ASEAN, the number of SMEs in Indonesia is the largest (both quantity and percentage). Moreover, its contribution in employment and GDP (Gross Domestic Product) is significant.



*Figure 1.1.* Relative economic importance of SMEs in ASEAN in 2013

*Note.* From “ASEAN SME Policy Index 2014” by Economic Research Institute for ASEAN and East Asia (ERIA), 2014, *ERIA Project Report no 8, June 2014*

In terms of the establishment, the number of SMEs in all countries in ASEAN is enormous. The establishment of SMEs in ASEAN accounts for more than 96% of all enterprises and 50%-85% of domestic employment. However the contribution of SMEs to total GDP is various, between 30%-53%. Furthermore, the contribution to exports ranges from less than 10% to 31%.

As mentioned in figure 1.1, the percentage of establishment, employment and share of GDP in Indonesia is the highest among other countries although the contribution in export sharing remains low compared to other ASEAN-6 countries such as Malaysia, Thailand and Vietnam. The number of SMEs in Indonesia in 2013 account for more than 99.7% (57,895,721) of all enterprises and 96% employment. In addition, its contribution to GDP accounts for around 56% with the total export 16%, lower than other ASEAN counterparts such as Vietnam, Malaysia and Thailand

Since it has such a significant contribution to the national economy of Indonesia, the comprehensive national policy regarding SME development is required. Moreover, the literature stated that to face further challenges, it is somehow important that the SME's national policy be synchronized with SME's policy framework at the regional (ASEAN) level. A consistent SME policy framework in ASEAN at both the national and regional level is a significant issue that needs to be addressed because SMEs are critical for the robust growth of the ASEAN Member States (AMSs) and the whole region itself (ERIA, 2014). This research aims to see the linkages between regional (ASEAN) and national (Indonesia) level; as well as to analyze to what extent the national policy of the Indonesian government's responds to the SME's policy framework based on APBSD and its Action Plan so that it can be seen whether the policy created by national level is supportive and complies with policy at regional level or not.

## **1.2 Research Question**

The questions in this research are:

1. How does the national policy of Indonesia respond to the SME's policy framework in ASEAN?
2. What factor is the most significant for developing SME's in Indonesia?

### 1.3 Objectives

The expected objectives that will be gained are:

1. To analyze the extent to which and the reason why policies and programs of the Indonesian government respond to and support the SME's policy framework in ASEAN
2. To identify the most critical factor for Indonesia's SME development under the Indonesian context and economic development strategy.

### 1.4 Research Method

Data collection in this research was done in qualitative ways. The primary data have been collected through interviews at the government level as well as from the SME's actor. In addition, the author also used official statistical data, journals, online newspapers as well as related research to complement this research. The main issue is related to five areas of policy as well as its implementation regarding SME development in Indonesia: human resources development policy, financial access policy, technological capability policy, promotion activity and marketing capabilities policy. The table below shows the name of the interviewees:

Table 1.3

*List of interviewees*

<b>Interviewees</b>	<b>Affiliation</b>	<b>Date of Interview</b>
Hitono Prio (Mr)	Head Division of Enhancement of Competitiveness of SMEs and Cooperatives, Coordinated Ministry for the Economy, Republic of Indonesia	24 November 2015
Palupi Mustajab (Mrs)	Directorate of ASEAN Economic Cooperation, Ministry of Foreign Affair	17 December 2015

Victoria Simanungkalit (Mrs)	Ministry of Cooperatives and SMEs	19 January 2016
Inatha Rezitha (Ms)	Revolving Fund Management Agency, Ministry of Cooperatives and SMEs	22 January 2016
Timbul Raharjo (Mr)	SME in the sector of handicraft and pottery in Bantul District, Province of Yogyakarta and Chairman of Indonesian Association of Furniture and Handicraft, Province of Yogyakarta ( <i>Asosiasi Permebelan dan Kerajinan Indonesia/ ASMINDO</i> )	27 July 2015
Stanisius Tandelilin (Mr)	Co-Founder and vice CEO of start-up company “Sale Stock Indonesia”, the leading mobile e-commerce for affordable woman’s clothes.	19 February 2016
Erlin (Mrs)	SME in the sector of Batik textiles	Interview has been conducted in 2014
Ika (Mrs)	Head of Microfinance Division of Bank of Mandiri, Yogyakarta Branch	Interview has been conducted in 2014

*Note.* Created by author.

## **CHAPTER 2**

### **REVIEW OF LITERATURE**

This chapter reviews SME development policy at the regional level, reviews of related-existing studies that have been conducted by other scholars and the literature gap that indicates further required research. The review starts with an overview of ASEAN SME frameworks policy (APBSD and ASEAN's Strategic Action Plan) and is grouped around five chosen issues: 1) human resources development; 2) access to finance; 3) access to technology; 4) promotion activity; and 5) enhancing marketing capability. The conceptual framework for this research is stated at the end of this chapter.

#### **2.1 Overview of SME Development Policy in ASEAN**

The concept paper on the framework of SME development in ASEAN has been discussed by the ASEAN Small and Medium Enterprise Agencies Working Group (SMEWG). The cooperation on SME development began in 1995, when fostering SME development became one of the priority areas in respect of policy focus and resources. Furthermore, SMEWG, which comprises representatives from ASEAN SME agencies, formulated policies, programs, and initiatives to spur SME development in the region.

At the 8<sup>th</sup> Meeting of the ASEAN SMEWG held in Yangon in May 2001, a concept paper on the ASEAN SME Development Decade (ASDD) 2002-2012 was proposed. Then it was further discussed at the 9<sup>th</sup> meeting of ASEAN SMEWG in Jakarta in 2001, with a further meeting held in Manila in 2002. The study was finalized at the 13<sup>th</sup> meeting of SMEWG in Singapore in September-October 2003 and renamed the framework from ASDD to ASEAN Policy Blueprint for SME Development (APBSD) 2004-2014. This APBSD was then submitted to and endorsed by the Senior Economic Officials Meeting (SEOM) on 12-14 February 2004 in Siem Reap, Cambodia and approved by the ASEAN Economic Ministers at the 36<sup>th</sup> meeting in September 2004 in Jakarta, Indonesia.



This APBSD is comprised of strategic work programs, policy measures, indicative outputs as well as an implementation timeframe. This framework focuses on five issues in SME development which are considered as the priority areas to be developed: (a) human resources development and capacity building; (b) enhancing SME marketing capabilities; (c) access to financing; (d) access to technology; and (e) creating a conducive policy environment.

Another framework regarding SME Development has been arranged in order to drive the implementation of SME development policies and programs. This framework has been endorsed at the 14<sup>th</sup> ASEAN Summit in Thailand where the AEC Council was tasked to develop an ASEAN Action Plan. This plan, the ASEAN Strategic Action Plan for SME Development 2010-2015 aims to provide specific activities to be conducted in the short and medium term, wider dissemination of information on regional activities to ASEAN SMEs as well as implementation of national and regional SME policies and programs. In this plan, there are five strategic programs which are to be given the priority for development: (a) access to financing; (b) facilitation; (c) technology development; (d) promotion; and (e) human resources development.

Thus far, there are two frameworks regarding SME development issued by ASEAN namely APBSD and its further guidance namely the ASEAN Strategic Action Plan. These two frameworks supposedly mandate AMS's to comply and follow it in order to meet its objectives as has been mentioned in the AEC blueprint.

Since the aim of the research is to analyze to what extent the national policy of the Indonesian government responds to the regional framework namely the APBSD and the ASEAN SAPSD. The points that will be analyzed according to those two frameworks comprise five policy issues: (1) human resources development; (2) access to financing; (3) access to technology; (4) facilitating promotion activity; and (5) enhancing marketing capabilities. The main argument why five issues are chosen is due to these five areas being the greatest impediments for SME development in ASEAN, therefore those five issues are mentioned in the framework of the APBSD and the ASEAN Strategic Action Plan. The following sub-chapter explains in detail those five issues.

### **2.1.1 Human Resources Development**

Human resources are one of the prominent issues in SME development. Although important factors such as technology, finance and production process are truly needed, the more important sources of additional and newly created value of SME's are their employees with their intellectual capital/ assets, skills, creativity and information (Ceranic & Popovic, 2009). The human element became the single element which the competition could not copy (Ceranic & Popovic, 2010). In addition, according to the research conducted by Wignaraja (2012), human capital proved a key which could make a significant contribution to a firm's performance. Higher levels of human capital are generally linked with development of more effective business strategies and more rapid technological learning that can provide a competitive edge at the enterprise-level.

Several studies identify that low human resources capabilities are the major constraint in SME development in developing countries (Batra & Tan 2003; Lee 2001; Mc Elwee & Warren 2000 cited by Hussain, Si & Wang, 2011). Due to this reason, this issue occurs as a prominent problem to be addressed in ASEAN SME development policy

In most developing countries, the capacity building issue accounts for significant obstacles in developing SME's. This issue is due to several factors. Some scholars mention that the lack of human resources capability is always related to the internal capacity of the SME itself: it is due to the lack of entrepreneurial spirit among SMEs (Shane & Venkantaraman, 2000; Thanh, Narjoko & Ouhm, 2010; and Wignaraja, 2012). OECD and APEC (2008) also find that the most significant impediments for SME development in developing countries were related to internal capabilities rather than those related to the business environment.

However, other scholars argue that the lack of human resources' capability is not always related to internal capacity of the SME itself but also to external factors. Some scholars such as Lim and Kimura (2009) argued that the lack of capacity of SMEs can be attributed to a weak innovation culture in a particular country and the over-reliance on technologies brought in by MNCs. This can be a determinant factor which can extinguish the entrepreneurial culture and attitude.

Both factors, either internal (lack of entrepreneurship among SMEs) and external (weak innovation culture), cause the dearth of human resources capacity among SMEs in developing countries, whereas the human resources factor determines the success of running the business. In other words, if there is no attempt to improve the capacity of human resources among SMEs, the SMEs in the developing country will face serious obstacles in development.

To address the problem, some studies offer a lot of schemes to improve the human resources' issues. It is imperative that government's offer support to these policies. Learning from Singapore, after the 1985 recession, the government of Singapore started to focus more attention on the SME' human resources issue. Under the SME Master Plan launched in 1989, the government applied some programs related to entrepreneurial activities to improve the number of local businessman as well as improve the productivity through training and other related programs. In addition, the expenditure for education has consistently been the second highest in the government's annual fiscal budgets (OECD, 2013). It shows that Singapore has made a concerted effort to strengthen their human resources more than any other factor to develop their economic prospects.

On the other side, Khayaban (2012) said that the most important factor to deal with the human resources' issue is to strengthen non-formal skills and entrepreneurship development in order to better prepare workers for employment and to improve the population's general capacity for self-employment. A case study in South Asian countries (SAARC, 2012) identified the important components in developing human resources consisted of six areas namely: (i) developing and strengthening training institutions; (ii) establishing a framework for regular sector-wise technical workshops; (iii) promoting apprenticeship programs; (iv) facilitating partnership among individuals, businesses and governments; (v) facilitating incubator programs; and (vi) facilitating franchising and joint ventures programs.

One similar point from those various studies is the need to create appropriate policies in terms of producing new entrepreneurs as well as improving the capacity of existing entrepreneurs. This point has also been mentioned in the frameworks of ASEAN SME development. In the frameworks, several related activities should have been conducted by the national governments, such as: (i) encouraging

entrepreneurship development programs (for instance conducting common curriculum concerning entrepreneurship); (ii) enhancing SME-sector skills in management and organization; (iii) and fostering SME capabilities for inter-firm networking and linkages.

The various studies above show that improving human resources capability is a prominent issue in developing SMEs. The sufficient capacity of human resources can drive them to be more creative and innovative to develop business. ASEAN's SME framework policy also made this point an important issue with several key initiatives to improve the capacity of human resources in AMSs, which are comprised of the following : (i) encourages entrepreneurship development program; (ii) enhances SME-sector skills in management and organization; and (iii) fosters SME capabilities for inter-firm networking and linkages. This study identifies the attempts of Indonesia in complying to those key initiatives.

### **2.1.2 Access to Financing**

The second factor that will be used in this research concerns access to finance. This factor is also a serious matter since the financial issue is a key element of national SME sector development (ADB, 2013). Sufficient funding is necessary to help SMEs do the following activities: set up and expand their operations, develop and or create new products as well as invest in new staff or production facilities.

The financial access has a significant impact on SMEs' innovation capability and participation in the export market (ERIA, 2012). The bigger SMEs with access to larger loans with longer terms and at a lower interest rate are more capable of innovation and exporting activity. It indicates that the access to external finance is important not only to start up or expand the business but also to engage in export activities. Sufficient capital as well as friendly financial institution are required to allow the SME to maintain their businesses.

However, SMEs in developing countries often run into problems regarding financial issues because they find it much harder to obtain financing from banks, capital markets or other suppliers of credit because they face the challenges regarding guarantees, venture capital leasing and so on. Several studies recognized that the lack of access to finance is one of the greatest impediments to SME development, particularly in developing countries, including ASEAN countries (Ayyagari,

Demirgüç-Kunt & Maksimovic 2006; Beck et al. 2006; Cook & Nixson 2000; Minton 2006; Tambunan 2008; Zia 2007; Lim & Kimura 2009; Vo, Narjoko & Oum 2009; Hussain, Si & Wang 2011)

The difficulties SMEs face in accessing finance are due to some factors. First, it is due to the financial system as well as the lack of government assistance in their particular country. This argument was supported by scholars. Lim and Kimura (2009) said that this problem can be attributed to imperfections in the financial markets and a lack of critical primary and secondary markets such as those for SME equity and bond financing. Moreover, the existing structure of the financial sector in most countries was developed to only serve medium to large enterprises rather than SMEs (Duan, Han & Yang, 2009; Khayaban). Therefore, the SMEs which are characterized by low-or insufficient capital and collateral face difficulties in gaining financial assistance from formal institutions.

However, other scholars argued that internal capacity of SMEs themselves also have significant contribution that make it difficult for them access to finance. According to the research conducted in Malaysia, the internal capacity of SMEs such as the lack of collateral, management's knowledge of business, as well as a lack of good track records are the most significant barriers for SMEs in accessing capital from financial institutions (Hasnah, et.al, 2012; Haron, Said, Jayaraman & Ismail, 2013)

In the case of Indonesia, lack of financial access is one of the obstacles for SMEs, especially for export-oriented SMEs. According to Tambunan (2008), this financial problem is due to: (i) limited capital owned by SMEs, especially investment capital; and (ii) lack of support from financing and guarantee institutions for SMEs. It means that both causes (internal and external factors) are considered as serious impediments for Indonesian SMEs in gaining access to finance.

Considering the fact that financial access is an important key to develop SMEs in ASEAN countries, this issue then has been put on ASEAN's SME framework policy as an issue that needs to be addressed. In order to provide better access to finance for SMEs, the ASEAN SME frameworks initiated some of the following activities: (i) capacity building for improved SME access to financing; (ii) financial institutional capacity building for improved SME financing; and (iii) widening

and deepening SME access to credit. This research will identify to what extent Indonesian national policy is providing better access to finance for SMEs through those components.

### **2.1.3 Access to Technology**

The third variable regards access to technology. Several studies conducted find that the greatest impediment in improving SMEs in developing countries technological capability (Lee 2001; Romijn 2001; Yusuf et al. 2003, Hussain, Si & Wang 2011). Technological capability and research development are other important factors to be considered in order to develop the SMEs in the region besides other factors such as human resources capacity and access to finance. It should not be neglected that technology is the key for developing core competency in industry. Technological innovation is regarded as a tool for strengthening the competitiveness of a nation (Sikka 1999 cited by Hussain, Si & Wang 2011). That is why technology development in SMEs is considered crucial for innovation and growth of firms.

The literature shows that investment in technological capability for SMEs is important to maintain and develop the firms. In the case of Singapore, technological upgrading for SMEs is supported by the government which consistently allocates the highest amount of funding for Research and Development (R&D) expenditures. The allocation for R&D in Singapore is the highest among other countries in ASEAN, and accounted for 2.04 per cent of its GDP in 2013<sup>1</sup>. This significant funding has affected to the development of Singaporean's firms. According to the survey conducted in 2006, well-adopted technology in Singapore mainly resulted in increasing productivity (53%), increasing cost efficiency (37%), and helping enterprises to meet customer expectations (23%) (SMRJ, 2008).

However, in other countries, improving access to technology still faces many challenges. Wignaraja (2012) stated that building technological capabilities for SMEs in developing countries is not just a simple function of years of production experience, rather, it requires conscious investment in creating skills and information to operate imported technology efficiently. In the case of technological capability in

---

<sup>1</sup> According to the report of ADB (2014), government spending for R&D expenditure in Singapore is the highest among other countries in ASEAN. Malaysia only spent 0.50 per cent, Thailand 0.22 per cent, Vietnam 0.19 per cent and Indonesia is not more than 0.1 per cent of its GDP.

ASEAN countries, Yuri Sato (2012) in her study assesses the pattern of technological improvement in each country in Southeast Asia using some indicators. The results show that Singapore, Thailand and Malaysia are the leaders in technological capabilities among other ASEAN countries. Apart from that, the results suggest a relatively low level of institutional development and of industrialists' awareness of technological upgrading in ASEAN countries.

To upgrade the technological capability among ASEAN countries, ASEAN meetings in Hua Hin which occurred in 2009 committed to improving SMEs through the establishment of business and technology incubators. In general, a technology incubator is a property-based venture which provides tangible and intangible services of new technology to help SMEs increase their chances of surviving in the early stages of development (OECD, 1997). A common characteristic in technology incubators is the physical and intangible support that they provide to new firms, especially to help them to commercialize knowledge-intensive products and services (Caleb, Olaopa & Siyanbola, 2012). Over two decades, technology incubators have been applied in many developed countries and ASEAN was about to adapted this model to develop SMEs in the region. This mechanism will be adapted to AMSs in reference to the success of the Business and Technology Incubator Model in Japan. In the future, all AMSs are expected to endorse and adopt this model in their own country. That is one of the attempts made by ASEAN to improve the technological capability for SME in AMSs.

As demonstrated from the above section, improving technological capability is required to develop SMEs in countries. With regards to the framework of the APBSD and the ASEAN Action Plan have made this issue a priority in developing SMEs in the region with several key activities that every AMS should address: (i) the policy of SME technology upgrades in the country; and (ii) policy regarding technology incubators to nurture and support techno-entrepreneurs. This research analyzes the attempts of government in improving technological capability for SMEs through those two activities.

#### **2.1.4 Facilitating Promotion of SMEs**

Promotion activity for SMEs is another important factor to facilitate them to become involved in global economic activity. In general, promotion refers to

the entire set of activities, which communicate the product, brand or service to the user. The basic idea of promotion is to make people aware, attract and induce them to buy the product<sup>2</sup>. In other words, the promotion activity is needed to introduce the product to the customer; make it well-known among other similar products; and attract the customer to consume their product.

In the case of promotion programs in ASEAN's Action Plan, the promotion activity is focused on making potential SMEs in ASEAN involved in global market activity. It is due to the fact that SMEs are still relatively under-represented in the global economy. According to the research conducted by the OECD in 2004, SMEs only contribute between one-quarter and one-third of manufactured exports and account for a very small share, usually less than 10% of FDI (Schreyer, 1996; Hall, 2002; Sakai, 2002; cited by OECD, 2004). The low numbers of SMEs which are active on the global market can be explained by various reasons. According to the OECD (2004) it is because the SMEs are relatively unprepared and less well-resourced compared to larger firms and which makes SME's conditions more complex and risky at the international level.

Some of these risks and complexities can be solved by government through regulation and creating a conducive business environment, including the support from governments to promote SMEs in order to enhance their ability to engage in global market activity. The activity to promote SMEs has been mandated in the action plan through some programs such as facilitating them to participate in promotional activities (festivals, international exhibitions, etc.). The promotional activity by governments will help SMEs to be more well-known, so they can get better access to international networks.

At the regional level, ASEAN often held international exhibitions for SMEs to make the prospective SMEs more well-known. One of the latest events was held in May 2015 in Malaysia with the theme "ASEAN SME Showcase and Conference 2015". In this event there were more than 300 exhibitors who showcased their products, services and innovative technology, and more than 10.000 trade visitors from ASEAN enterprises and large MNCs from ASEAN and FTA partners (ASEAN Secretariat,

---

<sup>2</sup> Definition cited from [www.economictimes.com](http://www.economictimes.com)



2015). Besides encouraging the international exhibition, ASEAN also supported each national country in the region so that they could conduct similar events in their own countries in order to promote the SMEs, especially with a view towards the AEC 2015.

Since one of the objectives of the AEC is to encourage SMEs to be more engaged in global markets, the issue of promotional activity has been mandated in the ASEAN SME frameworks. It orders each country to do some following activities namely: (i) promoting SMEs on the international market; and (ii) wider dissemination of information on SMEs at trade fairs and festivals in each AMSs and facilitating them to participate in these events. Through the national and regional initiatives and programs, the SMEs in each country will be well-promoted. This research assesses the policies and programs promotional activity in Indonesia through those two activities.

### **2.1.5 Enhancing Marketing Capabilities for SME**

In the framework of SME development arranged by SMEWG, one of the priorities of the agenda which is to be addressed is enhancing marketing capabilities for SMEs in each country in Southeast Asia. This notion has strong reasons, since marketing is one of the key needs in successfully running a business. In general, marketing is defined as a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and values with others' (Kotler et al, 2005). The definition of marketing has now been enlarged and is not only related to informing the customers of particular products. Marketing in the context of SME development is related to how those SMEs maintain as well as increase their network to expand the market.

In the classic study of SME's marketing, it has now been recognized that small firm marketing has unique characteristics that differentiates it from large organizations (Fillis 2002, Gilmore et al 2001, Reijonen 2009). The characteristics of SMEs that include the association with informal, loose, unstructured and spontaneous have some weaknesses that relate to issues of planning, pricing, training and forecasting (McCartan Quin & Carson 2003; Reijonen 2009) as well as difficulties regarding marketing activity which inevitably restricts their scope and activity because of their limited resources (O'Dwyer, Gilmore & Carson, 2009).

According to that argument, the regional framework regarding SME development in ASEAN puts the point of enhancing marketing capabilities as one of

the priority agenda. Enhancing marketing capabilities in the framework means that the countries should set up the regulations to improve the capability of SMEs in marketing affairs through some means. One instance of this is to use e-commerce and be able to join in subcontracting activities. In short, this point emphasizes how government policy empowers the internal capacity of SMEs to be able to expand their market (in both the domestic or international market).

First, ASEAN SME frameworks encourage governments to improve SME capabilities in and reliance on ICTs and e-commerce. If an SME wants to attract new customers, it means that they have to expand their market. ICT and e-commerce offer the way to do so because by using this technology benefits will accrue to a wide range of business process. According to the OECD (2004), the benefits of using ICT and e-commerce can be at different levels: at the firm level, ICT and its applications can make communication within the firm faster and it makes the firm's resources more efficient; at the inter-firm level, the internet and e-commerce have great potential for reducing transaction costs and increasing the speed and reliability of transactions; and at B2C (business to customer) context, it can be effective tools for better communication as well as improving quality of services and to attract new customers.

Second, the ASEAN SME frameworks encourage governments to facilitate SMEs to be able to join in subcontractor activities. Van der Lande and Hansen (OECD, 2008) noted that the linkages between SMEs and MNEs in subcontracting and business partnerships could promote the SMEs' products and services. Tai Chew (OECD, 2008) remarked that experience had shown that SMEs that took part in subcontracting activity were successful in generating a large share of their total revenues from overseas markets.

Those two points are some of the ways to fulfill marketing support systems for SMEs in order to expand the market overseas. The ASEAN SME frameworks encourage the government to improve marketing capabilities of SMEs through those ways, thus this research reveals the attempts of government in doing the key activities in the ASEAN SME framework that consist of: (i) the policy to encourage using e-commerce; and (ii) the policy to encourage sub-contracting activities between local SMEs and domestic located-export MNCs'

## 2.2 Literature Gap

Since the deadline of the implementation of SME development's policy at the regional level ended by 2015, some institutions and scholars assessed the achievement of the program and policy in each country according to those two frameworks. In 2012, ASEAN collaborated with ERIA and launched the Mid Term Review Report assessing the achievement of SME Development in each country based on the AEC Blueprint and APBSD. The result shows the effectiveness of SME programs in the ASEAN was largely moderate or low, except for a few cases especially in Malaysia and the Philippines (ERIA, 2012). In addition, ERIA collaborated with the OECD and ASEAN SMEWG launched the SME Policy Index 2014 and evaluated performance of AMSs in complying with the ASEAN SME Frameworks. This research analyzed the gaps between policy and its implementation in each country in ASEAN by using some indicators. In general, the results from the SME Policy Index suggests uneven levels of performance in the implementation of SME development policy at the national level between the two traditional groups of the ASEAN countries: (a) the less developed members (CLMV countries) and (b) the more advanced members (ASEAN-6). Based on the Policy Index, the countries of Singapore, Malaysia, Indonesia, Thailand and the Philippines are in the top order of the index score followed by other countries.

Other research came from individual researchers, who evaluated the implementation of SME's regional framework policy in each country. The study conducted by Aldaba (2013) evaluated the performance in one ASEAN country namely the Philippines in response to APBSD and the ASEAN Strategic Action Plan. The research found low average effectiveness scores for the implementation of APBSD and the ASEAN Strategic Action Plan. The scores ranged from without-to no-or little concrete impacts on the implementation of various programs on access to financing, facilitation, technology development, promotion, human resource development and other regional SME initiatives (Aldaba, 2013). This research showed that the key initiatives in the ASEAN SME frameworks were mostly implemented in this country but with moderate impacts or with no or little concrete impacts. Another study regarding implementation of ASEAN's SME policy framework was conducted by Basu

Das (2013). This study evaluated the performance of Cambodia in complying with the regional framework of SME's policy in ASEAN. This research found that in the case of Cambodia, the implementation of key initiatives in the blueprint is still limited due to a lack of funding and awareness (Basu Das, 2013). In addition, among many points that have been mentioned both in the APBSD and the ASEAN SAPSD, access to finance is consistently viewed as one of the biggest constraint faced by SMEs in Cambodia. From those two studies, in the case of the Philippines and Cambodia, it found that some of the key initiatives and activities in the ASEAN SME frameworks have been implemented although with various impacts.

However, in the case of Indonesia, this kind of assessment does not yet exist. The existing research only focuses on particular points and does not refer to the APBSD or ASEAN's Action Plan. As an example, research conducted by Kuncoro (2000) focused only on partnership and empowerment of SMEs; Tambunan (2008) on networking, innovation and market expansion; and Tambunan (2011) regarding the prospect for internationalization of Indonesian SMEs.

Considering SMEs in Indonesia play significant roles in economic development and have the highest percentage of the economic share among ASEAN countries in terms of their establishment, employment and GDP income (as shows in Figure 1.3), research concerning SME is still needed. Furthermore, there are few studies which see the linkages between the regional and national level; whether the regional initiatives are compatible when it comes to the national level; and to what extent the national policy is following the regional policy. Therefore, this study is significant as it will seek to reveal those issues.

### **2.3 Research Conceptual Framework**

This research aims to analyze to what extent the national policy of the Indonesian government has responded to the SME's policy framework based on the APBSD and the ASEAN Strategic Action Plan; to see the linkages between regional initiatives and national policy, whether the national policy follows and accomplishes the regional goals or not. To do so, this research uses five variables to analyze whether the national policy of the Indonesian government is supportive towards regional

frameworks in ASEAN and what have been done so far to comply to those frameworks. These five variables are the prior points discussed with regards to the APBSD and ASEAN's Action Plan as priority issue that must be addressed by AMSs

The variables chosen to analyze the achievement of the Indonesian government comprise five points: (1) human resources development; (2) access to financing; (3) access to technology; (4) facilitating promotional activity; and (5) enhancing marketing capabilities.

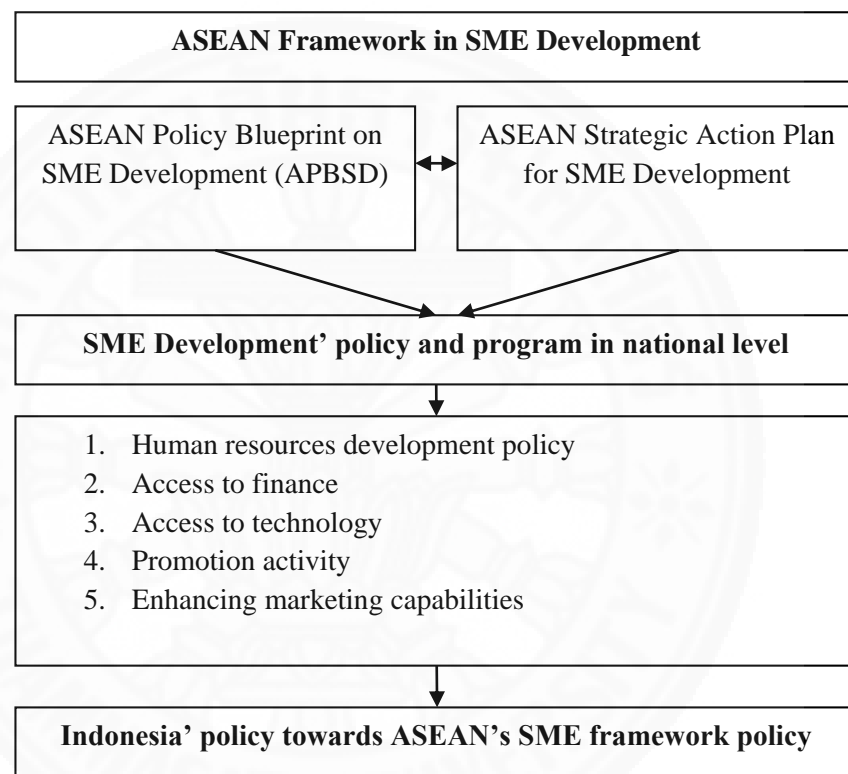


Figure 2.1. Research conceptual framework created by the author.

This research followed the conceptual framework presented in figure 2.1. Figure 2.1 describes how ASEAN has arranged the framework for SME development in AMSs which are comprised of the APBSD and followed by ASEAN's Action Plan. Each ASEAN member country should be interlinked by their policies and programs based on that regional frameworks in order to meet the objectives of the AEC. This research tries to see those linkages: whether the policies and initiatives of ASEAN at the regional level have been implemented by national governments and how to assess to what extent Indonesia has complied with ASEAN's SME regional framework.

## **CHAPTER 3**

### **INDONESIAN POLICY TOWARDS ASEAN's SME FRAMEWORK POLICY**

This chapter explains the policy of SME development in Indonesia, particularly in five aspects namely: a) human resources development; b) access to finance; c) access to technology; d) promotion activity; and e) enhancing marketing capability. This chapter answers research questions and the primary objective of this research is to explain to what extent the policies and programs of Indonesian SME development is in response to ASEAN's SME framework policy (APBSD and ASEAN Action Plan) which includes the aforesaid five characteristics. The data collected in this chapter came from interviewing some candidates from both SMEs and the government including various ministries, comprising the Coordinated Ministry for the Economy, Ministry of Cooperatives and SMEs and the Ministry of Foreign Affairs. Other sources were obtained from published documents and by reviewing previous related research. This chapter begins with a brief explanation about the profile of SMEs in Indonesia.

#### **3.1 Profile of Indonesian SME**

##### **3.1.1 Definition of SME in Indonesia**

Small and Medium Enterprises (SME) in many literatures has been stated as the economic backbone, especially for developing countries. It is because SMEs are significant in increasing national income, contributing to exports, as well as reducing poverty especially in rural areas. In Indonesia itself, the development of small and medium enterprises is a major part of economic development (Omura, 2008). However, the definition of SMEs itself is quite broad and variegated. Quantitative measurements such as the employment number, possession of assets and or the revenue/sales are utilized to classify SMEs

SMEs in Indonesia are defined as independent productive enterprises, which are run by individuals or companies that are not subsidiaries and are owned, run or become, both directly or indirectly, part of a large enterprise. Act no. 20 of 2008

regarding Micro, Small and Medium Enterprises (MSMEs) classifies the SMEs based on the possession of assets (excluding land and buildings) and annual revenue. Act no 20 of 2008 is the most prominent law regarding SMEs in Indonesia. It is the amendment act from a previous law titled Act no 9 of 1995 regarding Small Enterprises. Under this act, the criteria for SMEs in Indonesia can be classified as follows<sup>3</sup>:

- Small-scale enterprises classify as a business unit if the amount of net assets comprises between IDR 50,000,000 to IDR 500,000,000 and there is an annual revenue/ sales of IDR 300,000,000 to IDR 2,500,000,000
- Medium-scale enterprises classify as a business unit if the amount of its net assets comprises between IDR 500,000,000 to IDR 10,000,000,000 and there is an annual revenue/ sales of IDR 2,500,000,000 – IDR 50,000,000,000

In Indonesia the majority of SMEs still consists of micro enterprises which account for 57,189,393 or around 98.77% of total SMEs in 2013. Meanwhile the number of small and medium enterprises accounted for 654,222 or 1.13% and 52,106 or 0.09% at the same year respectively.

### **3.1.2 Institutional Framework and Policy Platform for SME Development in Indonesia and its Linkages to ASEAN's SME Regional Framework Policy**

The basic guide to developing SMEs in Indonesia references the document called The National Medium Term Development Plan (NMTDP) which is arranged every five years. This five year plan was then elaborated in greater detail in the Strategic Plan or *Rencana Strategis* (RENSTRA) for every institution.

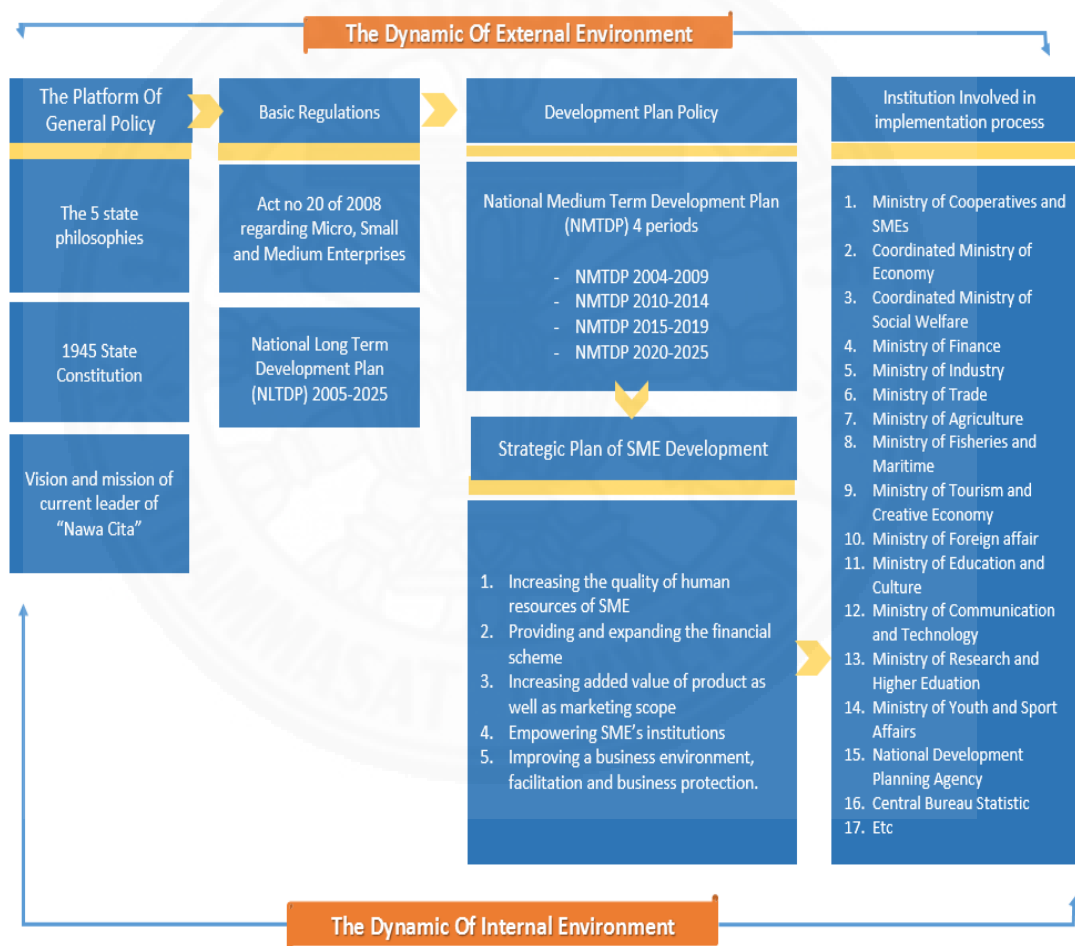
Every ministry and institution are required to implement the policies and programs in the NMTDP and RENSTRA. In regards to SME development, the Ministry of Cooperatives and SMEs (MoCSME) is the leading institution that is responsible for developing SMEs in Indonesia.

Between 2015-2019, the development of SMEs in Indonesia will focus on five aspects to increase the competitiveness of SMEs: (i) improving *the capacity of human resources* of SMEs; (ii) increasing *financial access* and expanding

---

<sup>3</sup> The enterprises which have their net asset possession and annual revenues as less than the provisions mentioned below can be classified as micro enterprises. In Indonesia the number of micro enterprises forms the highest proportion of enterprises totally

the fund scheme; (iii) increasing the *value added* of SME's product as well as the marketing scope; (iv) *empowering the business institutions*; and (v) providing *better facilitation* for establishment of new enterprises. Those five priorities are elaborated through the action and program conducted not only by Ministry of Cooperatives and SMEs but also other related ministries and institutions<sup>4</sup>. There are at least 30 ministries and institutions involved in the issue of SME development in Indonesia each with their own various special actions and programs. Thus, the programs and policies often overlap within the ministries and create inefficiencies. The figure below shows the institutional arrangement on SME development in Indonesia in general.



<sup>4</sup> The ministries involved in SME issues in Indonesia, include the Coordinating Ministry for the Economy, the Coordinating Ministry for the Social Welfare, the Ministry of Finance, the Ministry of Industry, the Ministry of Trade, Ministry of Foreign Affairs, the Ministry of Youth and State Affairs, the National Development Planning Agency, the Ministry of Agriculture, the Central Bureau of Statistics, etc. However, the leading institution in SME development is the Ministry of Cooperatives and SMEs.



*Figure 3.1.* Institutional arrangement in developing SME in Indonesia created by the author.

The figure above illustrated the platform for SME development in Indonesia as well as the institutions that are in charge of this issue. The development of SMEs in Indonesia has been described in the NMTDP which is elaborated from the National Long Term Development Plan (NLTDP) and must be adjusted with the vision and mission of the president. The current president, Joko Widodo, has a mission euphemistically called “Nawa Cita” or the nine priorities agenda for Indonesian development. Under this vision, the NMTDP should be designed to achieve the goal of Nawa Cita.

The target and focus program in NMTDP should then be more detail-oriented through the document called the Strategic Plan or RENSTRA in for every ministry. This document is then used as concrete guidance for every ministry in order to implement the activities and programs regarding SME development. For instance, the Ministry of Agriculture, has an agenda that focuses on improving the SME and its capacity particularly in the agriculture sectors; Ministry of Education and Ministry of Youth and Sport are responsible in holding the entrepreneurship competition for students and youth; the Ministry of Finance is in charge of distributing financial assistance for SMEs, etc.

Moreover, one of the important factors that influenced the process of formulating policies on SME issues pertains to the factor of the external environment, which means that the dynamics of the global context also affected the national’ policy decisions. The implementation of the AEC by 2015 has been considered the factor that has been the most influential in ordering the national agenda. In the document of the NMTDP, it is stated that the momentum of the AEC must be addressed comprehensively both at the local and national level because it can be seen as both an opportunity and a challenge for Indonesia. Therefore, in the case of Indonesian SMEs, increasing their competitiveness is necessary.

Since the implementation of the AEC is one of the considerations of the national’ policy formulation, the government has then issued some related regulations, for instance the Presidential Decree number 37 of 2014 regarding the

Establishment of National Committee for Preparation toward AEC; Presidential Instruction number 6 of 2014 regarding Increasing National Competitiveness and Preparedness toward the AEC 2015; and Presidential Instruction number 11 of 2011 regarding commitment to implementing the AEC Blueprint. In the regulation of Presidential Instruction no 6 of 2014, it is mandated that the government is to increase national competitiveness and preparedness to face the AEC, including increasing the competitiveness of SMEs. Thus, that regulation as well as other documents (NTMDP and RENSTRA) are arranged to prepare Indonesian SMEs to face the AEC:

Following the regulation (Presidential Instruction no 6 of 2004) about the competitiveness, which is one of them is SMEs, the ministry (Coordinated Ministry for the Economy) currently is in the process to arrange action plan and road map to increase competitiveness of SME in the era of AEC. It is still ongoing process now, and we hope we can distribute it to the related ministries soon (Interview with Hitono Prio, 24 November 2015)

In addition, the Ministry of Cooperatives and SMEs, also responded to the AEC through issue specific policies to support and improve SMEs. The minister of MoCSME, Mr. Puspayoga said that the following actions are the efforts to increase the competitiveness of SMEs so that they will be able to compete with other countries: (1) Increasing the number of cluster industries through the program of One Village One Product (OVOP) in order to improve the local featured product; (2) Improving the quality of human resources through the activity of entrepreneurial education, training, and workshop programs; (3) Increasing the quality and value added of the SME's products, especially facilitating the SMEs to meet the product standard (SNI), get the Halal certification (for particular products) as well as intellectual property rights (IPR)<sup>5</sup>; (4) Providing better scheme for SMEs to access credit through formal financial institutions, especially through the Revolving Fund Management Agency/ LPDB

---

<sup>5</sup> For the registration of copyright/ patents of product and standardization, the Ministry of Cooperatives and SMEs collaborates with the Ministry of Justice and Human Rights to do the certification for SME's products.

(*Lembaga Pengeola Dana Bergulir*); (5) Tightening the supervision in the border areas to prevent the illegal products from entering Indonesian markets.

Basically, all the above efforts have been made to increase the competitiveness of local SMEs, not simply to face the AEC. The notion of “people-centered economy” has been mentioned in the State Philosophy and the 1945 Constitution<sup>6</sup>. All those provisions mandate that the government use the resources of the country in order to serve the welfare of the people. This is supposed to drive the national policy towards a more people-oriented agenda. In regards to that, the SME policy is also be arranged to facilitate SMEs in order to increase their welfare.

All the programs we conducted (from related ministries) to improve the capacity of SME, to increase the competitiveness of their products, it is for increase the quality of our SME. That is our main target since long time ago, not simply to face AEC (Interview with Hitono Prio, 24 November 2015)

Despite the government’s own roadmap and guidance to develop SMEs, it also strongly supports the idea of the ASEAN Economic Community and perceives it as a way to gain momentum to increase the national competitiveness. However, according to the document of NMTDP as well as the statement from interviewees, the Indonesian government neither put the ABPSD nor the ASEAN Strategic action plan as the direct guidance to drive SME’s national policy due to some reasons below.

*First*, as ASEAN’s SME frameworks are guidance for developing SMEs for AMSs’, however the various conditions of the economy in each country makes those guidelines unable to accommodate the needs and interests of all ASEAN member states. As Basu Das (2013) mentioned, the application of the focused programs under ASEAN’s SME framework policy is currently up to the discretion of each ASEAN member state, depending on their domestic needs and their level of economic development. It shows that there is neither force nor punishment in order to bind all the

---

<sup>6</sup> in the clause 5 paragraph (1), clause 20, clause 27 paragraph (2) and clause 33

countries in ASEAN to comply with the ASEAN's SME framework. The government in each country can only comply or implement some activities according to the needs of SMEs in their own country as long as they work in tandem with what has been mentioned in ASEAN's SME framework.

*Second*, there are some activities that are not accordance with the needs of Indonesian SMEs. The point of internationalization of SMEs (through promotion activity), for example, is an aspect that is not yet in accordance with the conditions of most SMEs in Indonesia nowadays. On the other side, there are also key aspects that have been completed by the government without referring directly to those frameworks. This is due to the fact that some of the provisions and actions in the ASEAN's SME frameworks are quite broad and have fewer details for concrete implementation.

The following sub-chapter describes detailed information regarding policies and programs as well as their implementation to develop SMEs in Indonesia. Even the government stated that the national policy does not directly refer to ASEAN SME frameworks, the programs and policies show some of the ASEAN SME's initiatives are compatible and accordance with national agenda. Nevertheless, it also shows that there are initiatives that have not yet been applied by the government.

Since this research focuses on five variables in the ASEAN's SME framework, the following sub-chapters explain the actions of the government related to five variables which comprise the following, including human resources development, access to finance, access to technology, promotional activities and marketing capabilities.

### **3.2 Human Resources Policy of Indonesian SME**

This sub-chapter explains in detail the policies, programs and their implementation regarding human resources of SMEs in Indonesia. The finding shows that as regards Human Resources Development, that the majority of activities in ASEAN's SME frameworks have conducted by the government. The issue of human resources is one of the most prominent concerns in developing SMEs in the country as this issue is identified as one of the greatest obstacles in developing SMEs in Indonesia

The problem of the lack capacity of SMEs has been reiterated in the legal document of RENSTRA or strategic plan of the Ministry of Cooperatives and SMEs of Indonesia. In these documents, it has been mentioned that most of the SMEs have low educational skills, a lack of technical expertise, a lack of competence and entrepreneurial skills as well as low capacity for managerial skills (Document of Strategic Plan of MoCSME 2009-2014; and Document of Strategic Plan of MoCSME 2015-2019). This is supported by the research of Tambunan (2008) which mentioned that one of the greatest obstacles faced by SMEs in Indonesia is the lack of skilled workers as well as the minimal knowledge about market potential and global business strategies.

This research found that there are plenty of actions and programs needed to improve the capacity of SMEs conducted by government. These efforts are mostly compatible with the key activities in APBSD and ASEAN Strategic Action Plan. In the ASEAN frameworks, the key activities related to human resources issues comprise the following: (i) encourage entrepreneurship development programs; (ii) enhance SME-sector skills in management and organization; and (iii) foster SME capabilities for inter-firm networking and linkages. In fact, most of those activities have been done through several actions and programs. As a result, the number of SME's established in the country has increased, yet the quality still needs to be improved. A more detailed explanation follows below.

### **3.2.1 Regulation in Human Resources Issue**

The basic regulation for SME development in Indonesia is Act number 20 of 2008 regarding Micro, Small and Medium Enterprises. In Chapter III of Principles and Objectives of SME's Empowerment, the purpose of the development of SMEs in Indonesia is to improve the competitiveness of SMEs as well as encourage the SMEs to become reliable and independent enterprises<sup>7</sup>.

---

<sup>7</sup> According to Article 19, Act no. 20 of 2008, there are some activities that must be done by the government to address the issue of human resources of SMEs: (i) socialize and encourage the entrepreneurial activities; (ii) upgrade the capacity of SMEs through improving technical and managerial skills; (iii) establish and improve the education and training institutions to boost the activities such as training, socialization, education, motivation and other business activities along with creating new entrepreneurs.

Besides the Act no. 20 of 2008, the programs and actions in the NMTDP 2015-2019 are also designed to increase the capacity of SMEs through the following activities: i) increasing the quality of human resources of SMEs; and point (iv) empowering SME's institutions to assist the SMEs to increase their competitiveness. These efforts are to improve SME's productivity, feasibility and value-added of SMEs so it will be possible for them to scale up and become more competitive. These issues were then elaborated in the Strategic Plan (RENSTRA) of Ministry of Cooperatives and SMEs to be implemented as concrete actions and programs<sup>8</sup>. Besides all those documents, there are several specific regulations that have been launched to support the government (both local and national government) to empower SMEs<sup>9</sup>. It shows that the issue of the lack capacity of SMEs is one of the greatest impediments in developing SMEs in Indonesia.

### **3.2.2 Policies, Programs and their Implementation to Improve Capacity of SMEs**

This section describes the attempts of the government in increasing the capacity of SMEs through specific programs and actions. From the findings, we can see that several programs conducted by the government have completed the ASEAN's SME initiatives even if they did not refer directly to APBSD or ASEAN's Action Plan.

---

<sup>8</sup> In this RENSTRA, there are three dimensions of development, namely the Dimension of Human Development; the Dimension of Development of Leading Sector; and the Dimension of Equalization and Cantonal. In the dimension of human development, several actions must be conducted by related ministries. Some of these activities in this dimension were designed to improve the human resources of SMEs such as: (a) Increasing the capacity of SME's human resources through the training and assistance which involve related institutions, local government, the business sector, the universities and civil society; (b) Providing better access and facilities regarding licensing issues for prospective SMEs; and (3) Improving the database of SMEs

<sup>9</sup> Besides the basic regulation of Act no. 20 of 2008 and the five years plan of the NMTDP, there are several specific regulations concerning human resources issues for SMEs, for instance: Presidential Regulation no. 27 of 2013 regarding the Development of Business Incubator; Presidential instruction no. 10 of 1999 regarding The Empowerment of Medium Enterprises; Presidential Instruction number 6 2007 regarding Acceleration of Development of Real Sector and Empowerment of SMEs; Presidential Instruction no. 6 of 2009 regarding Development of Creative Economy; Regulation of Minister of Cooperatives and SMEs no. 02 of 2008 regarding The guidelines for Developing Business Development Services Provider (BDS-P) for the development of cooperatives and SMEs; The Regulation of Minister of Cooperatives and SMEs no. 9 of 2013 regarding The Guidelines for implementation of enhancing Integrated Business Service Center (IBSC); and The Regulation of Minister of Cooperatives and SMEs no. 18 of 2015 regarding The guidelines for education and training for human resources of Indonesian SMEs; etc.

### **3.2.2.1 Encourages Entrepreneurship Development Program**

The first activity regarding the Human Resources Policy in the ASEAN's SME framework is to encourage the entrepreneurship program in every country in ASEAN. This is important in order to boost the number of entrepreneurs as well as give the training and entrepreneurial education to increase the capacity of SMEs to be more competitive and outward-looking. To achieve those goals, ASEAN launched a project to implement "Common Curriculum for Entrepreneurship in ASEAN" that was funded by the Japan-ASEAN Integration Fund (JAIF). The goal of the project was to establish a common curriculum for entrepreneurship in the ASEAN region with the use of an entrepreneurial educational program that was adopted from Japan. The training method developed for entrepreneurial education is based on the COBLAS (Consulting-based Learning for ASEAN SME) method. However, relatively few universities in Myanmar, the Philippines and Vietnam have implemented this project. In Indonesia, this kind of project has not yet been implemented. Even so, the government also supports an entrepreneurship development program through several activities and programs.

Some of the supporting regulations, for instance the Presidential Instruction no. 6 of 2007, mandates that the government increase the capacity of SMEs, promote entrepreneurship among youth, as well as improve the role of universities in developing the BDSP; Presidential Instruction no. 6 of 2009 encourages entrepreneurial education in special schools; and the Regulation of Minister of Cooperatives and SME no. 18 of 2015 that establishes the program including, training and education curricula as well as a competency standard for SME development.

According to David Mc Cleland, to become a prosperous country, the minimum number of entrepreneurs should be at least 2% out of the total population. In Indonesia, of the established number of SMEs is the highest among Southeast Asian countries (see figure 1.1). However, this is not yet adequate compared to the more than 250 million people in this country. According to the Association of Indonesia Business Incubator Institution (AIBI) and MoCSME of the Republic of Indonesia, the number of entrepreneurs in Indonesia is still low, which only accounted for around 1.56% of the population in 2013 and rose to 1.65% in the second quarter of

2014. As a comparison, America has 12%, China 10%, Singapore 7.2% and Malaysia 5%.

To boost the number of entrepreneurs, the government is providing entrepreneurship education and programs in school. Through the Directorate General of Secondary Education and Directorate General of Higher Education, Ministry of Education of Culture, the government is obsessed in promoting entrepreneurial education at the secondary level of school as a compulsory subject in their curricula in order to boost the number of creative and talented entrepreneurs. However, this attempt has been done only at the vocational high school/ SMK (*Sekolah Menengah Kejuruan*)<sup>10</sup>. Some of the majors in the SMK provide entrepreneurial education (theoretically and practically) in their curricula. However, although the number of SMKs is increasing year by year, there are still many limitations to conducting entrepreneurial education and training. According to Subijanto (2012), some of the impediments in conducting entrepreneurial education in vocational high schools are: (i) the insufficient numbers of practical facilities in schools; (ii) the collaboration between SMKs and business/ private firms are still poor; and (iii) the lack of competency of the trainee.

Apart from the issue of entrepreneurial education in SMKs, in public secondary school, the similar curricula has not yet been implemented. However, the effort to put entrepreneurship in the curriculum is about to begin. In the five years' plan of the NMTD and Strategic Plan (RENSTRA) of Ministry of Education and Culture 2015-2019, the government will start to put entrepreneurial education in the curricula of general high school by 2016<sup>11</sup>. Those two documents state that one of the objectives of education in Indonesia is to improve the entrepreneurial skills among the youth and motivate them to create their own businesses in the near future to solve the problems of poverty and unemployment.

---

<sup>10</sup> In the secondary school, beside the general high school, now government started to highly promote the vocational high school or SMK. This SMK offer an alternative path to provide students with particular skills (mostly technical skills). This programs last three to four years and are targeted at 16 to 18 years-old.

<sup>11</sup> By 2016, the government plans to put the entrepreneurial education in the public high school/ SMA. The target for this trial is around 1,100 schools.



However, at the university level, there are still a limited number of universities offering degrees in entrepreneurship programs. Only some programs put entrepreneurship courses as either a compulsory or elective course. At the university level there are several entrepreneurship programs conducted by the government as a concrete action to create new entrepreneurs, for instance, Student Entrepreneurial Program or PMW (*Program Mahasiswa Wirausaha*) and Entrepreneurship Student Creativity Program or PKMK (*Program Kreativitas Mahasiswa Kewirausahaan*). These programs are student competitions designed to create new, creative and prospective business plans, both in public and private universities. After the selection process, the committee will choose the selected business plan and give the initial capital for the students to establish the enterprises. This program is initiated by the Directorate General of Higher Education, Ministry of Education and Culture to motivate the students to create their own business as well as to change the mindset of the students from being a job seeker (upon graduation) to become a job creator. Those programs are fully funded by the government with monitoring and evaluation systems.

### **3.2.2.2 Enhances SME-sector skills in management and organization.**

The second activity in ASEAN's SME framework is to enhance SMEs in management and organization. During this time, the inability to manage business was one of the most formidable obstacles in developing SMEs. In order to improve their capacity, the government both at the local and national level conducted routine training and transferred knowledge through workshops, management trainings, etc. In the NMTDP 2015-2019, the government set the target to upgrade one million SMEs; give training and education for 125,000 micro enterprises in rural areas and 33,000 small and medium enterprises in urban areas. Several activities have been and are being conducted to increase the number of SMEs as well as improve their capacity. The following section describes some activities and programs that have been successful in enhancing SME's skill in management and organization.

#### **(1) Capacity building programs for SMEs**

On 2007 the government through the Coordinated Ministry for the Social Welfare and the Ministry of Finance and Ministry of Home Affairs launched the program of National Program for Community Empowerment or NPCE as

a social policy to alleviate poverty both in rural and urban areas. According to many scholars, the program of the NPCE has been effective in reducing poverty and alienation because it is directly involved in community's decision making as well as designing and approving their development agenda. According to the report by World Bank (2012), the qualitative impact evaluation shows that NPCE programs have enabled members of the community to create their own business as well as improve the ability of the local SMEs through some programs such as facilitating business training and education, business consultation, improving innovation and creativity, etc. This program is effective to boost the quality of micro, small and medium enterprises, particularly in the business sectors of agriculture, fisheries, creative industry and any others with micro and small enterprises.

Another program for increasing the capacity of human resources was also conducted by the Ministry of Education and Culture through several programs, such as Life Skill Training; Entrepreneurship Education for People; and Vocational Village Programs. On 2014, the government spent IDR 19.15 billion for these three programs.

Moreover, there are still many programs conducted by several ministries to increase the number of entrepreneurs as well as to increase the capacity of existing SMEs. For instance, the Ministry of Youth and Sport gave the socialization and business plan competition for youth to establish their businesses; the Ministry of Maritime and Fisheries Affairs emphasizes the need to increase the capacity of fisherman and SMEs in the sector of fisheries; the Ministry of Industry has routine agenda to give socialization, training and knowledge transfers to the small industries, etc.

## **(2) Establishment of Integrated Business Service Center**

On 2013 the government through the Ministry of Cooperatives and SMEs established the Integrated Business Service Center (IBSC) for SMEs. Under Act no. 20 of 2008 then issued of The Regulation of Minister of Cooperatives and SMEs no. 9 of 2013 as a guideline to enhance IBSC in every province and city in Indonesia. Under those regulations, it was mandated that the government establish the IBSC at the provincial level and district and city level. The government aims to establish IBSC in strategic locations, especially in the provinces and districts

which have greater potential for SMEs. At the present time 42 IBSCs have been established at the provincial level and district level throughout Indonesia<sup>12</sup>.

The aim of the IBSC is to facilitate the ability of SMEs to develop and improve their capacity and competitiveness. This institution is in charge of activities which include the goal of becoming (i) a center of problem solving for SMEs which provide the assistants and trainers for needed SMEs; (ii) a center of referral which becomes a mediator and information source that could give specific solutions for SMEs; and (iii) a center for best practice including a show room for prospective SMEs.

The various services regarding improvement of SMEs are provided by this institution. Concerning the issue of human resources, IBSC provides business consultation, business mentoring and assistance as well as business training for SMEs. The business consultants in IBSC come from the Department of Industry and SMEs in particular districts/ provinces, expertise from universities, successful businessmen, NGOs and other private consultants. The work program to improve human resources depends on each IBSC in each district/ province. The national IBSC will monitor and evaluate the performance of local IBSC every year.

### **(3) Establish and Enhance the Capacity of SME's Assistance Institutes**

Another attempt to increase the capacity of SMEs is through the establishment of the Business Development Service Provider (BDSP) or the assistance institutions for SMEs. The role of the BDSP is important since they are closer to SMEs so they could identify the needs and problems of SMEs in the local region.

The rule for establishing and developing BDSP is contained in the Regulation of Minister of Cooperatives and SMEs no. 02 of 2008 that mandates the ministries to develop and empower the existing BDSP in order to make them able to give comprehensive assistance for SMEs.

The establishment of BDSP accelerated particularly after the launch of Act no. 32 of 2004 regarding Local Government, when Indonesia transformed from a centralized to a decentralization state. The authority of local government was

---

<sup>12</sup> In addition, in the target of NMTDP 2015-2019, the government plans to establish 215 IBSC in provinces/ districts throughout Indonesia.

strengthened and a devolution from centralized decision-making occurred. They had more power to develop and improve their own region, this impacted the development of SMEs in each region. Since then, there were many local assistance institutions created by the local government in order to develop SMEs in their areas. These local institutions were initiated by the departments which were in charge of SME's affairs in each particular province/district and aimed to facilitate the SMEs to upgrade their capacity through many programs. They usually conducted routine training programs, and the focus trainings were adjusted by the needs of SMEs in that particular area.

Besides the service institutions provided by the government, the private sector (NGOs, corporations, individuals, and others) as well as universities also provided the SME's consultation and development services as their contribution to increase the capacity of Indonesian SMEs. These kinds of institutions (both those created by the government and independent ones) can be a catalyst to bridge the government's programs and the interests of SME's. According to the law, the BDSP has at least three functions for assisting local SMEs, they are: a) consultation service for improving the business for SMEs; b) business assistance; and c) facilitating the ability of SMEs to access productive resources, such as capital, markets, technology, management resources and information.

Apart from the importance of BDSP for SMEs in local regions, their capacity also should be improved to be able to fulfill the needs of SMEs. Some of the capacity building programs are conducted to improve this assistance institution. An instance of this is the development of a competency standard, certification, the improving of capacity and skills of the experts/ consultants for SMEs, financial support, as well as monitoring and evaluation in each BDSP's program. National governments through the Deputy of Development and Business Restructuring, MoCSME and local government are those who are responsible to conducting this program.

### **3.2.2.3 Fosters SME capabilities for inter-firm networking and linkages**

The third activity in ASEAN's SME framework is to foster SME capabilities for inter-firm networking and linkages. This is due to the fact that in order to develop linkages and networks that can address the classical problem of SMEs

which is related to their size, production processes, and marketing as well as improve their competitive position. However, most SMEs still have not yet realized this importance.

According to the Integrated Business Survey on SMEs by the Central Bureau of Statistics, in 2004, from more than 16 million firms covered by survey, about 91.7% of them have no partnership with others (Tambunan, 2008). Meanwhile, in the survey conducted by ASEAN Studies Center (2014) about SMEs in Yogyakarta province, it was shown that only 24% of them have linkages/ networks with others. These surveys show the low awareness of the need of SMEs to the necessity of building cooperation with others, this is also related to the characteristics inherent in of SMEs themselves: some operate in the informal sectors; run by the owner and some recruit family member as employees; focus on domestic market; and only some have access to government programs and have connections to large enterprises (Tambunan, 2012).

Since 1992, the government through the national program called Foster Parent (FP) requested that all state-owned enterprises and large private companies assist SMEs through a partnership with capital, training, technical assistance, and other means. This program aimed to create linkages between the SME and large enterprises. However, this program mostly only applied to the sectors of manufacturing and automotive.

As the government realized the importance of making networks among SMEs and other sectors, the government then promoted the various programs of sub-contracting activities in order to increase the competitiveness of SMEs, not only in manufacturing or heavy industry but also in other sectors based on the featured product of each region, including creative industry.

### **3.2.3 National Policies and Programs toward ASEAN's SME Framework Policy**

The human resources of SMEs are one of the priority issues to be addressed by the Indonesian government. Many attempts have been made to improve the capacity of SMEs as well as to boost their number through some regulations and concrete programs. Thus, these efforts seem in line with the key activities in the

ASEAN's SME frameworks. In the ABPSD and ASEAN's Strategic Action Plan, ASEAN mandates every country to do the following activities: (i) Entrepreneurship development program; (ii) Enhancing SME-sector skills in management and organization on a self-reliant basis; and (iii) Fostering SME capabilities for inter-firm networking and linkages.

The research found that the programs and activities in the national agenda are mostly compatible with ASEAN's SME framework. As a result of these efforts, the quantity of SMEs increases yearly.

Table 3.1 shows the increasing number of SMEs in Indonesia by year<sup>13</sup>. However, it is still dominated by micro enterprises rather than small or medium enterprises. Nevertheless, we can see the attempt of the government to boost the number of SMEs is quite significant. This effort is reasonable since the role of SMEs in Indonesia is significant as the biggest employment creator (Tambunan, 2008) and their high contribution to GDP as shows in table 3.2.

Table 3.1

*Numbers of SMEs by year*

No	Enterprises	2009	2010	2011	2012	2013
1	Micro enterprises	52.176.771	53.504.416	54.559.969	55.856.176	57.189.393
2	Small enterprises	546.643	568.397	602.195	629.418	654.222
3	Medium enterprises	41.336	42.008	44.280	48.997	52.106
	<b>Total</b>	<b>52.764.750</b>	<b>54.114.881</b>	<b>55.206.444</b>	<b>56.534.592</b>	<b>57.895.721</b>

*Note.* Adapted from the Data of Micro, Small, Medium and Big Enterprises 2009-2014, by the Ministry of Cooperatives and SMEs Republic of Indonesia

<sup>13</sup> During 2015-2019, in the five years' plan of NMTDP, the government set the target to increase the number of SMEs. In 2016, the ministry plans an increase of 7,400 units of new entrepreneurs and 12,400 units per year from 2017 up to 2019. Cumulatively, the government is set to increase the number of new entrepreneurs to one million within five years.

Table 3.2

*Contribution of SMEs in GDP*

	2009	2010	2011	2012	2013
<b>Amount (IDR Billion)</b>	2,969,346.2	3,411,574.7	4,321,830.0	4,869,568.1	5,440,007.9
<b>Percentage (%)</b>	56.18	56.22	58.05	59.08	60.34

*Note.* Adapted from the Data of Micro, Small, Medium and Big Enterprises 2009-2014, by the Ministry of Cooperatives and SMEs Republic of Indonesia

However, although there are several programs to improve the capacity of SMEs, the quality of SMEs themselves are still low. In general, according to the Human Development Report (2014), compared with other countries in ASEAN, the Human Development Index (HDI) of Indonesia in 2013 ranked 108th, below that of Singapore (9), Brunei Darussalam (30), Malaysia (62) and Thailand (89). It shows that, overall the capacity of Indonesian human resources is lower than other ASEAN-6 countries. In addition, the 2010 World Bank Skill Survey assessed the capacity of Indonesian businessman based on their education. According to that survey, the skills of senior education graduates did not meet the expectations of Indonesian employers. Only 7% were rated 'very good', with most considered just 'fair'. In addition, 40% indicated they lack thinking and behavioral skills as well as vocational skills that are transferable between jobs like computer literacy and language proficiency (Mourougane, 2012). It shows that despite the efforts done by the government, there are still many things to do to improve the capacity of SMEs.

There are still many problems in our SMEs, especially the lack of competitiveness and innovation. It is strongly related to the human resources of SME itself. That's why the government focuses on this issue, increase their competitiveness... (Interview with Hitono Prio, 24 November 2015)

The biggest obstacle to develop SME comes from internal SME itself. Most of SME in Bantul (district of Bantul) is categorized as a craftsmanship, not a businessman. They have skill to produce good handy crafts, but only few of them can produce something unique and different and able to market it. Only few of them classified as both craftsmanship and businessman... the real entrepreneurs... who can see the potential market, what consumers want as well as bravely taking risks. That what makes them developed” (Interview with Timbul Raharjo, 27 July 2015)

The government tries to improve training, entrepreneurial programs, knowledge transfer and so on, every year... but, it must be followed by the spirit of SME to increase its competitiveness by themselves... (interview with Victoria Simanungkalit, 19 January 2016)

To summarize this section, human resources is still one of the most prominent problems in developing SMEs in Indonesia. However, the government has made many attempts by conducting lots of programs as well as issuing supportive regulations. From the previous explanation, we can see that the existing laws and the future plans of SME development in Indonesia mostly supports and is in line with ASEAN’s framework policy in terms of human resources development.

*First*, the goal to encourage entrepreneurial programs have been delivered by entrepreneurial promotion programs both for youth in school (senior high school and universities) and especially for SMEs. However, Indonesia has not yet implemented the common curriculum for entrepreneurship in ASEAN. This shows that ASEAN has designed the comprehensive project to be implemented in ASEAN countries, however it is up to each country to implement these programs.

*Secondly*, the goal to enhance SME-sector skills in management and organization has also been implemented through several routine programs. However, during this time, the routine programs were related to technical training programs instead of managerial programs. In addition, these trainings and workshops did not enhance SME skills simultaneously with the socialization of the AEC, with its



challenges and opportunities. Due to their lack of knowledge about the AEC, many of the SMEs did not focus attention to this issue.

*Thirdly*, is the activity to foster SMEs for inter-firm networking and linkages with bigger enterprises or MNCs. This issue has been addressed from 1990 through the Foster Parents (FP) program even though at that time it was only applied to certain sectors industry such as automotive and heavy industries. Now, the program to create linkages between SMEs and large enterprises are implemented through sub-contracting activity that not only applied to certain sectors but also other sectors based on the featured product of each region.

### **3.3 Access to Finance for Indonesian SMEs**

This sub-chapter explains in detail policies, programs and their implementation regarding access to finance for Indonesian SMEs. The finding shows that as regards the issue of access to finance, most of the activities that have been mentioned in ASEAN's SME frameworks have been done by the government. This is due to the fact that financial problems for SMEs has been identified as the greatest obstacle in developing SMEs, not only in Indonesia but also in almost all developing countries, therefore the government takes this as a serious issue to be addressed.

The Indonesian government started to take this issue as a serious problem that should be addressed, particularly after the financial crisis in 1998. At that time, many big enterprises and MNCs were down due to their strong dependency on credits from banks or other financial institutions as well as the increasing dependency on imported capital and intermediate goods, components and raw materials (Tambunan, 2010). On the other hand, SMEs that were less reliant on formal credit or imported raw materials could survive and were less affected by the crisis. Before the financial crisis, the bank loans were mostly distributed to large enterprises and for consumption purposes, yet only small amounts were distributed for SMEs. However, once the economic conditions were stable after the financial crisis, there were more programs and policies to facilitate the ability of SMEs to access credit. This continues up until the present day.

In the framework of the ABPSD and ASEAN's Strategic Action Plan, the activities related to financial issues comprised: (i) capacity building for improved SME access to financing; (ii) financial institutional capacity building for improved SME financing; and (iii) widening and deepening of SME access to credit. The research found that most of the activities in the frameworks were compatible with national agendas, thus they have been completed by the government through several programs and assistance policies for SMEs enabling them to access credit. In addition, among the other key aspects in the frameworks, I argued that the government directed the most effort to this aspect rather than other aspects.

The following section describes in greater detail the regulations, programs and activities conducted by the government that were compatible with what has been mentioned both in the APBSD and ASEAN's Strategic Action Plan with regards to finance.

### **3.3.1 Regulations on Access to Finance for SMEs**

Much research has shown that SMEs in developing countries often grapple with the problem of finance because they find it much more difficult to obtain financing from banks, capital markets or other suppliers of credit. This problem occurs due to the challenges regarding guarantees, venture capital leasing and so on. Several studies recognized that the lack of access to finance is one of the greatest impediments in SME development, particularly in developing countries including ASEAN countries (Ayyagari, Demirgüç-Kunt & Maksimovic 2006; Beck et al. 2006; Cook & Nixon 2000; Minton 2006; Tambunan 2008; Zia 2007; Lim & Kimura 2009; Vo, Narjoko & Oum 2009; Hussain, Si & Wang 2011).

In Indonesia, the lack of finance was also recognized as one of the greatest impediments faced by SMEs. This is affirmed by the 2005 Bank of Indonesia survey on MSMEs, which suggested that access to finance becomes increasingly problematic as the scale of the business decreases. Mourougane (2012) identifies the cause of the lack of finance in Indonesia due to some factors: 1) lack of collateral of SMEs as the binding constraint to credit access; 2) lack of needed skills of managers of SME's which results in the inability to meet bank standards; 3) the lack of SME's

knowledge on how to gain creditworthiness; and 4) the characteristics of Indonesia's banking system may also inhibit lending to small firms.

According to Omura (2008), in Indonesia at least 60 percent of small and medium enterprises at present are unable to obtain loans. These enterprises are largely self-funded. He argued there are several reasons behind that lack of finance for SMEs in Indonesia. *First*, the lack of management skills of SMEs and their inability to apply fine accounting practices that makes them ineligible for examination to obtain bank loans; *second*, SME's lack of collateral and trustworthy acquaintances; and *third*, SMEs preference to borrow the capital from family or friends rather than from banks because it seems easier for them. In addition, Muliaman Hadad,<sup>14</sup> in his statement stated that only 22% of Indonesians are connected to formal financial institutions (KPMG Indonesia, 2015). The causes of this indicate that they are due to both external and internal factors. The implications are that capacity building is needed to improve both SMEs as well as financial systems themselves.

As regards that serious problem, the government then took several concrete actions to facilitate the ability of SMEs to access funds for their business. Therefore, there are a lot of regulations regarding financial schemes for SMEs that have been issued to solve this problem.

Besides the prominent law of Act no. 20 of 2008 about Micro, Small and Medium Enterprises (article 7, 8 and 9) that mandates local and national governments provide facilities for SMEs in accessing credit, other concrete regulations were also issued to support these objectives: *establish and enhance the capacity of financial institutions* (Act no 1 of 2013 regarding Microfinance Institution; The Regulation of Minister of Cooperatives and SME no. 8 of 2006 and no. 30 of 2007 regarding Enhancing Financial Institutions for SMEs through Saving and Loans Cooperative Institution and Venture Capital Institution; etc); *implement supporting financial assistance programs* (The Regulation of Coordinated Ministry for the Economy no. 9 of 2015 regarding The Implementation of People's Business Credit Program; The Regulation of Minister of Cooperatives and SMEs no. 1 of 2014 regarding The Guidelines of Implementation of Social Assistance for Developing

---

<sup>14</sup>Muliaman Hadad is the Chairman of the *Otoritas Jasa Keuangan* (OJK), the Indonesian Financial Services Authority

SMEs; Regulation of Bank of Indonesia no 3 of 2001 regarding Micro Credit Project; etc.

All these efforts were made to fulfill the mission of 2009-2014 and 2015-2019 of the NMTDP that mandates the government provide adequate financial schemes for SMEs as well as expand their scope, not only concentrated in Java but also outside Java. All these regulations were then implemented through concrete actions which involved several actors, both government and non-government such as Coordinated Ministry of Economy, Coordinated Ministry of People Welfare, Ministry of Cooperatives and SME, Ministry of Finance, Bank of Indonesia, Guarantor Institutions, Bank, etc.

### **3.3.2 Policies, Programs and their Implementation on Accessing to Finance**

This section describes the attempts of the government to facilitate SMEs in ability to access finance through specific programs and actions. From the finding, several programs conducted by the government have completed the ASEAN's SME initiatives even though it did not refer directly to the APBSD or ASEAN's Action Plan. The key initiatives in the sphere of access to finance in the ABPSD and ASEAN's Action Plan comprises of the following: i) capacity building for improved SME access to financing; (ii) financial institutional capacity building for improved SME financing; and (iii) widening and deepening of SME access to credit.

#### **3.3.2.1 Capacity building for improved SME**

*Capacity building for improved SME access to finance* is the first activity in the area of access to finance for SMEs in ASEAN's SME frameworks. This aspect is related to the strategy for strengthening the ability of SMEs access loans from financial institutions. During this time, SMEs often face difficulties in their ability to access finance, some of these causes are due to internal problems such as the lack of collateral, low revenue, and lack of good track records. Moreover, for most of the micro enterprises in the rural areas, the preference is to borrow money from loan sharks instead of formal financial institutions.

The government has taken actions to solve these problems through routine socialization and the transfer of knowledge conducted by the local BDSP and several assistance programs. Moreover, efforts have been made through the

development of the Indonesian Financial Inclusion Framework in order to facilitate and empower SMEs in their ability to access financial institutions. In addition, in order to tackle the issue of the lack of collateral, from 2014 the commercial banks have been allowed to accept assets other than land or buildings<sup>15</sup> as deductions in determining loan loss reserves when allocating credit to SMEs (Mourougane, 2012). Moreover, Presidential Decree no. 98 which was issued in 2014 regarding Licensing for MSMEs, stated that every licensed-firm will be provided facilities such as mentoring guarantees, assurance business premises, and access to banks with only the signature of the head of sub-district/ head of village needed.

### **3.3.2.2 Financial institutional capacity building for improved SME financing**

The second activity is financial institutional capacity building for improved SME financing. The efforts in this area have been done through several actions that includes, for instance, the establishment of the Revolving Fund Management Agency under MoCSME as a special agency to distribute financial assistance for SMEs. This agency issued some regulations which mandate that the local government increase the number of microfinance institutions in local region as well as to improve the capacity of the cooperatives as non-bank financial institutions which provide loans for SMEs. This is the attempt of the government through the Authority Finance Service (OJK) to improve capacity of local governments through routine training and workshops.

#### **(1) Establishment of LPDB (Revolving Fund Management Agency)**

The government established financial institutions owned by the government namely LPDB in order to increase the number of SMEs who were able to access loans. LPDB or the Revolving Fund Management Agency (*Lembaga Pengelola Dana Bergulir*) is a special institution to distribute funds for cooperatives and MSME which was established in 2007. This institution is under the Ministry of Cooperatives and SMEs.

---

<sup>15</sup> The banks now are soften their collateral. The SMEs which have no material things (land, building, etc) could access to the loans with other things for their collateral such as certificate of marriage, certificate of births and any other. This is only to bind the commitment of SMEs to return the loans.

In the 2015-2019 RENSTRA of MoCSME, the government set the target to facilitate 600,000 cooperatives and SMEs to get revolving funds from the LPDB. Up until 9 April 2015, total loans disbursed were IDR 5.70 trillion (US\$ 432 million). The large disbursement was distributed to some provinces in Java: Central Java (IDR 1.375 trillion for 703 borrowers); East Java and West Java with the value at IDR 809.96 billion and IDR 744.65 billion for 377 and 855 borrowers, respectively. These funds were distributed to more than 4,000 business partners, 2,306 local cooperatives, 193 venture capital firms and banks and 690,000 units of micro, small and medium enterprises.

On 2016, the government provided IDR 1.55 trillion (US\$ 117 million) to be distributed to the cooperatives and prospective SMEs. This amount will be used to fund the cooperatives to the level of IDR 920 billion (US\$ 69 million) as well as prospective SMEs to the level of IDR 630 billion (US\$ 47 million)

## **(2) Microfinance Institution**

Another way to increase the number of SMEs with access to loans in formal institutions is through the establishment and propagation of microfinance institutions. There are two types of microfinance institutions in Indonesia: banks and non-banks (cooperatives or other microfinance institutions). Nowadays, almost all of the banks in Indonesia provide microfinance facilities for SMEs (both private and government-owned banks; both conventional or *syari'a* system). These institutions provide microfinance facilities and operate throughout the country.

In addition, after the launch of Act no. 1 of 2013 regarding Microfinance Institution, the government encourages the local government as well as regional-owned enterprise to establish and increase the number of microfinance institutions throughout the country. Moreover, this regulation mandates that the government through the Authority Financial Services as the institution which is in charge of regulating and supervising the banking in Indonesia conduct training and routine workshops to increase the capacity of local governments as the operator of microfinance institutions. However, the database of microfinance institutions in

Indonesia is poor<sup>16</sup>. That is why a comprehensive inventory is needed to determine the strategic pace for improving the quality of microfinance institutions in Indonesia.

### **3.3.2.3 Widening and deepening SME access to credit**

The third activity in ASEAN's SME framework that pertains to the access to finance involves the widening and deepening of SME access to credit. This is due to the fact that during this time, the scope of financial assistance was concentrated only in Java and only focused on particular sectors of SMEs. This issue then has been addressed through several activities as follows.

#### **(1) People's Business Credit Program/ KUR (Kredit Usaha Rakyat)**

On 2007, the former president Susilo Bambang Yudhoyono launched the program of People's Business Credit Program/ KUR (*Kredit Usaha Rakyat*) to provide credit guarantees for non-bankable firms in order to boost the bank loans of SMEs. According to the official website of the KUR program, KUR is defined as a credit/ working capital and/or investment financing schemes specifically dedicated to micro, small and medium enterprises and cooperatives in the productive enterprises sector, where enterprises are unable to meet certain requirements set by banks (not yet bankable). There are three objectives of the KUR program: (i) To accelerate development of the real sector and the empowerment of micro, small, and medium-sized enterprises (MSMEs) and cooperatives; (ii) Improve access to finance and develop access of MSMEs and cooperatives to financial institutions; (iii) Control poverty alleviation and expansion of employment opportunities.

There are three main actors that involve in the implementation of this program. The first actor is the government, which is comprised of the Bank of Indonesia (BI) and their technical departments<sup>17</sup> and is the main actor to assist and support SMEs through the implementation of credit provisions. The second actor is the guarantor institution that guarantees the credit distributed by the banks. It is comprised

---

<sup>16</sup> There are various versions concerning the number of microfinance institutions. According to the official data from the House of Representatives, the number of MIF is around 637.838, meanwhile the data from various ministries mentions that the number of MIF reaches over 90.000, however the Central Bank of Indonesia (BI) stated that there are only 14.000 MIFs in Indonesia.

<sup>17</sup> Ministry of Finance, Ministry of Agriculture, Ministry of Forestry, Ministry of Maritime Affairs and Fisheries, Ministry of Industry and Ministry of Cooperatives and SMEs.

of two companies: PT Asuransi Kredit Indonesia (PT Askrand) and Perusahaan Umum Jaminan Kredit Indonesia (Perum Jamkrindo). And the third actor is the bank who act as recipients of the guarantees that function as credit distributors to SMEs. So far, there are six commercial banks (four state-owned banks and two sharia banks) and 26 regional banks that have participated in this program.

According to the data from the report of the People's Bank of Indonesia or BRI (2009), KUR is estimated to have had a positive impact on wages and production. In total, from the beginning of the program (2007) up until 2014, total disbursement of KUR reached IDR 168.3 trillion (US\$1.209 billion). In 2015, the total amount of loans to be disbursed has been set at IDR 30 trillion (US\$ 2.25 billion)<sup>18</sup>, however as of December 31 total loans disbursed only reached IDR 21.4 trillion (US\$ 1.54 billion) to 960,424 customers, which was lower than the target<sup>19</sup>.

This program has been ongoing until the present time and has been judged to be relatively successful. However, although the program aims to facilitate the ability of SMEs to access finance throughout Indonesia, it is rather difficult to distribute the aids in the area that lack of financial institution. The availability of financial institutions (banks or microfinance institutions) in every province/ district will be decisive in the distribution of KUR to SMEs. According to the research conducted by Damayanti and Adam (2015), up until September 2014, from the total disbursement of IDR 168.3 trillion, only 52.9% was distributed to Java. However, the government was committed to broaden the scope of the KUR program and establish many financial institutions, especially in the eastern part of Indonesia. Besides broadening the scope, the government also needs to expand the KUR in each particular sector, it is because during this time, the credit distributed to the productive sector (particularly in agriculture) has been on the rise but remains smaller than that going to the trading sector (38.5% of total disbursements).

Apart from these weaknesses of the KUR distribution, KUR is still one of the outstanding programs to facilitate the access to funds of non-bankable enterprises. Therefore, in 2016, the government set a target of IDR 100 trillion to 120

---

<sup>18</sup><http://www.thejakartapost.com/news/2015/06/27/govt-involves-more-banks-its-people-s-credit-scheme.html>

<sup>19</sup><http://www.thejakartapost.com/news/2016/01/04/more-banks-finance-firms-allowed-channel-govt-backed-loans.html>



trillion of KUR loans to be disbursed, this amount was more than twice that of 2015 target<sup>20</sup>. Most of the SMEs who accessed KUR are those who had just started their business.

The requirements for taking credit from KUR is quite easy. First, you have to pass the checking from Central Bank of Indonesia to make sure that you have clean record (not categorized as a nonperforming loan) by sending the citizenship ID or Family Certificate, then you should have evidences that you've established the business, it can be a documentations (photo) and business planning. After that, you only need to pass the survey checking by our bank. It is quite easy to get the aids from KUR, but the problem is, this is not well-informed... so most of our SMEs still perceive that its difficult to access credit from bank... (Interview with Ika in 2014)

The funding for SME basically is not a problem right now. We allocate the budget effectively through KUR program. The thing is... the dissemination of the information is still less.. and that is what we need to be increased.. so that they (SMEs) could access the aids (Interview with Hitono Prio, 24 November 2015)

The requirements for accessing KUR assistance is much easier than other financial assistance programs. It does not require collateral from the debtor because the main target of KUR are those who are bankable enterprises (or had just started their business). However, these facilities are not well-informed, therefore there is a lack of information on the lack of ease in accessing these institutions.

## **(2) Subsidies in the Agricultural Sector**

SMEs in Indonesia are still dominated by the agricultural sector. According to the data, in 2011, the productive sector such as agriculture, livestock, forestry and fisheries together accounted for 48.85% out of the total SME sector in Indonesia, followed by the sector of trade, hotels and restaurants;

---

<sup>20</sup><http://www.thejakartapost.com/news/2016/01/04/more-banks-finance-firms-allowed-channel-govt-backed-loans.html>

transportation and communication; and manufacturing with 28.83%, 6.88% and 6.41% respectively.

The realization that the largest number of SMEs are in the agricultural sector prompted the government, several years ago, to give special credit and financial aid for SMEs in the agricultural sector. This aims to cover the needs of finance for SMEs in this sector. During this time, the loans were primarily distributed to a particular sector of SMEs, primarily trade or another industry. It is because those sectors were perceived to be the businesses that had the smallest risk of default rather than as compared to the agricultural sector. Some of those programs are, for instance: 1) *Kredit Ketahanan Pangan dan Energi* or KKPE program, which is the credit assistance for SMEs in the sector of food security (this encompasses agricultural products: rice, corn, soybeans, sweet potatoes, sugar cane, cassava, peanuts, sorghum; horticulture products; fisheries/ cultivation of marine products; livestock; etc.) which is given through farmers group (*Kelompok Tani*) as well as cooperatives; 2) *Kredit Pengembangan Energi Nabati dan Revitalisasi Pertanian* or KPEN-RP program, is the credit assistance in the sector of palm oil, coconut and cocoa cultivation; 3) *Kredit Usaha Pembibitan Sapi* or KUPS program, is the credit assistance for cattle raisers in the sector of livestock which is given through government banks. This effort aims to broaden the scope of SME's assistance, since during this time the financial assistance for the sector of agriculture is still low compared to financial assistance for other sectors.

### **3.3.3 The aspect of access to finance toward AEC 2015**

According to those explanations, we can see that the attempts of the Indonesian government in terms of providing better access to finance was adequate. The ability of SMEs to access finance can be seen in some aspects, such as the amount of financial aid which is increasing yearly; the establishment of financial institutions which is providing better and easier access for SMEs to obtain loans; several regulations to ensure that SMEs face no impediments in accessing funds; increasing the number of microfinance institutions throughout Indonesia; and many supporting programs to facilitate the ability SMEs to access loans.

The APBSD and the ASEAN Strategic Action Plan comprise three main activities (i) capacity building for improved SME access to finance; (ii) financial

institutional capacity building for improved SME financing; and (iii) widening and deepening SME access to credit, which have been implemented by the government through plenty of policies and programs. The main focus in this aspect is to provide and expand the financial scheme throughout the country. Despite these efforts, the government still needs to improve some aspects of the financial assistance issue.

*First*, disseminate the information regarding financial assistance. Recently, there have been many microfinance institutions established throughout the country, including in the rural areas. In addition, the amount of financial aid is also increasing, the credit scheme is getting easier and these facilities are intended to be utilized by non-bankable SMEs. However, the lack of information about these facilities make the SMEs (especially in rural areas) hesitant to access loans from financial institutions. Therefore, socialization concerning this issue must be conducted routinely in order to provide greater knowledge for SMEs.

*Second*, the financial aid is primarily allocated to the trading sector instead of the agriculture sector (including dairy, fisheries and forestry). This is due to the fact that most of the financial institutions still perceive a higher risk of default from those micro and small enterprises in the agriculture sectors as opposed to those in the trading sector. The government must make a more concerted effort to establish new schemes for accommodating the SMEs in the sector of agriculture. This is important since the percentage of micro, small and medium enterprises in Indonesia remains the highest number SMEs as opposed to other sectors.

*Third*, there remains the perception among SMEs that obtaining loans via formal institutions has a greater risk, this inhibits them from obtaining loans via these institutions. They assume that accessing funds from formal financial institutions will be very complicated and entail greater risks, in lieu of this they choose to borrow the credit from individuals or family, or loan sharks, because they think it will be easier to access these loans directly as opposed to formal financial institutions (Mourougane, 2012). To change their mindset, comprehensive actions to improve their knowledge of opportunities that exist from formal institutions. Again, the socialization and transfer of knowledge must be done by the government to solve this trust issue.

Despite the challenges faced by the government in facilitating the abilities of SMEs to access finance, Indonesia has improved in providing financial

assistance for SMEs. The report of the SME Policy Index (2014) shows the improvement of Indonesia in terms of providing better financial access for SMEs. The score of Indonesia as regards facilitating access to finance in the SME Policy Index is also above the ASEAN average. The report said that the legal and regulatory frameworks on credit in Indonesia is advanced. However, apart from that, these efforts are simply to increase the productiveness of SMEs, not only to face AEC.

### **3.4 Access to Technology for SME**

This section describes how governments deal with the problem of access to technology for SMEs. The issue of technology for SMEs is important as one of the key aspects mentioned in the APBSD and ASEAN's Action Plan. This is because technology is the key for developing core competency in industry, as well as to enhance innovativeness to improve the business.

Technological innovation is regarded as a tool for strengthening the competitiveness of a nation (Sikka 1999 cited by Hussain, Si & Wang 2011). That is why technology development for SMEs is considered crucial for the innovation and growth of firms. Several studies were conducted and find that the greatest impediments in improving SMEs in developing countries includes technological capability (Lee 2001; Romijn 2001; Yusuf et al. 2003, Hussain, Si & Wang 2011).

The activity in the APBSD and ASEAN's Strategic Action Plan also focuses on technological capabilities for SMEs since one of the objectives of this framework is to increase the innovativeness of SMEs through the use of technology. These key initiatives are comprised of: i) the policy of SMEs with regards to upgrading technology in the country; and (ii) policies regarding technology incubators to nurture and support techno-entrepreneurs. The research shows that there are plenty of programs and actions to improve technology development for SMEs in Indonesia, yet this effort still needs to be improved. More detailed information follows in the section below.

#### **3.4.1 Regulations of Technology Development for SME**

The importance of technological upgrading for SMEs has been mentioned in 2015-2019 Strategic Plan of MoCSME as well as the Ministry of Research

and Technology. Meanwhile, one of the five main agendas mentioned in NMTDP to develop SMEs in Indonesia is the need for increasing the value added of the SME's product and the scope of marketing network. To increase the value added, the government also focuses on the technological capability of SMEs, as technology is a key aspect to enhance innovation.

The prominent law of Act no. 20 of 2008 regarding MSME in articles 16, 17 and 20 mandates that the government cooperate with SMEs and the private sector to increase the transfer of technology for SMEs and improve the capacity of SMEs in research and development. Besides, there are several regulations to show the commitment of the government in developing technology for SMEs, for instance the Presidential Regulation no. 27 of 2013 about Development of Business Incubator; Presidential regulation no. 69 of 2014 about 2014-2019 Indonesia Broadband Expanding Plan; and Government Regulation no. 35 of 2007 about Allocating Partial Revenue of Business Entities for Increasing the Capacity of Innovation and Technology.

Those several regulations then implemented by actual actions which involved several ministries and institutions such as the Ministry of Research and Technology, the Ministry of Communication and Informatics, the Indonesian Institutes and Sciences (LIPI), the Agency for the Assessment and Application of Technology (BPPT), etc. The government also encourages partnership with the private sector and NGOs and institutional donor institutions to improve access to technology for SMEs.

### **3.4.2 Programs and Policies regarding Access to Technology for SME**

This section describes the attempts of the government to facilitate the ability of SMEs to access technology through some programs and policies. According to the finding, among other aspects in ASEAN's SME Frameworks, the aspect of access to technology for developing SMEs is the weakest.

#### **3.4.2.1 Policy and Program of SME technology upgrading**

The first point in the pertains to the access to technology in the APBSD and ASEAN's Strategic Action Plan is to focus on increasing the number of policies and programs regarding technology upgrading for SMEs. Sato (2012) mentions that technological capabilities is one of the prerequisites of innovation for SMEs. The

programs below are some of the efforts of the government to develop technology and adapt it to SMEs.

**(1) Encourage SME's digital**

A report by Deloitte Access Economics and Google entitled “SMEs Powering Indonesia’s Success: The Connected Archipelago’s Growth Engine” which was released on 2015 argued that if Indonesian SMEs were to be empowered via digitalization, the country’s economic growth would see a 2% increment. The digitalization of SMEs will give greater benefit for SMEs, including: (i) up to 80% higher growth in revenue; (ii) being one-and-a-half times more likely to increase employment; and (iii) being 17 times more likely to be innovative. As regards to these issues, the government supports them through providing a better infrastructure by issuing Presidential Regulation no. 69 of 2014 regarding 2014-2019 Indonesia Broadband Expanding Plan that encourages the plan to expand broadband throughout Indonesia in order to encourage SMEs based on information technology and communication.

To raise the goals, the Ministry of Communication, Information and Telecommunication issued several steps. There are five steps to support the digital localization of SMEs:

a) *Increasing broadband access.* Existing internet access in Indonesia remains relatively expensive and slow. According to Oakla Net Index, in July 2014, the position of Indonesia is the third worst among other countries in ASEAN in terms of average download speeds with the average speed only 4.54 Mbps, which is only slightly higher than the Philippines (3.4 Mbps) and Laos (3.76 Mbps). Increasing broadband access and the quality of service will encourage digital technology adoption by SMEs and improve performance of existing technologies. This issue has been followed up by the government through the launch of Presidential Regulation no. 96 of 2014 regarding the 2014-2019 Indonesia Broadband Expanding Plan.

b) *Helping all SMEs to do digital business.* Many government agencies provide SME support programs, including those targeted at increasing SME digital engagement. In addition, the government also established OSS or “One Stop Shops” to facilitate the SMEs in administrative issues. However, they often have overlapping (regulation) as well as limitations in scale.

c) *Expanding e-payments.* Improving trust in e-commerce payment platforms, increasing bankability of Indonesian consumers and businesses as well as expanding alternative payment systems will increase the volume of digital transactions.

d) *Expanding access to finance.* Digital SMEs need a mix of domestic and international sources of finance which are currently barriers that reduce their potential for growth.

e) *Expanding e-government services.* Government services delivered through online platforms are more cost effective and efficient. More online government services would build consumer confidence in online activities and services over time. Several programs and policies were launched to support the e-government services. Some of them are: the implementation of 4G/LTE in some regions, Independent Design House policy, and the latest one is the arrangement of roadmaps for e-commerce policy.

The importance of promoting internet-based SMEs is due to the fact that these facilities proved to be an effective tool in reducing production and marketing costs as well as giving other benefits. Akhtar, Azeem and Mir (2014) in their research concluded that internet technologies play an important role in business expansion by providing access to valuable information, expanding the networks, minimizing communication costs, improving the opportunities to go global for SMEs, etc. Therefore, it is critical to build supporting infrastructure to provide internet connections throughout Indonesia.

## **(2) Assistance programs for knowledge and technology transfers**

The most important thing to increase business is the ability to create unique, new, and innovative products to enlarge the market. This innovation in turn relies on the capacity of the human resources of SMEs. To encourage the innovativeness of the SMEs, the government through several institutions and ministries held various assistance programs. For example, the government institution through the Indonesian Institute of Sciences (LIPI) along with five department institutes established a program to develop SME capabilities in the field of technology transfer and innovation in 28 provinces. In addition, research institutions and a SME Innovation

Center were established by the government and universities as well as the private sector and NGOs<sup>21</sup> to give similar assistance. These institutions play the roles including: business development (consultant productivity improvement); technology development (prototyping, licensing of technology); incubation technology (new enterprises development); HRD; access facility (providing facilities offices, measurement, standards, testing and quality/MSTQ); Access expertise (technical assistance, expert); Access information (database information on technical aspects, marketing, funding, IPR); Legitimizing (accreditation and certification); Intermediaries (technology brokering, financial aspects, market); Networking (synergy between business and technology, research cooperation). These kind of collaboration between research institutes, industry and SMEs are being promoted to encourage the collaboration between industry (SME), research institutes (government) and academia (university).

However, those kinds of collaboration are still weak. Several studies show that the interaction between important components of innovation (research institutes, industry and government) is still weak. For instance, some research institutes are inward oriented, on the other side several industries depend heavily on their foreign principal. In addition, the commitment of the government to increase technological capabilities are still low. This was proved by some indicators such as the amount of research funding, the number of researcher as well as research facilities. According to the research conducted by the Ministry of Research and Technology and BPPT on 2011, the technology resulted from research institutes or universities which have not yet been applied by SMEs. This gap is due to some factors, including the capacity of SMEs to adopt the technology; the technology which is not accordance with real needs; integration among research institutes; etc.

#### **3.4.2.2 Policy regarding technology incubators**

In developing countries, business incubators are the most important approach to accelerate technology, industry and business expertise

---

<sup>21</sup> There are several institutions formed by government in order to develop technology and innovativeness to improve the capacity of SME. They are LIPI (Institute of Sciences), BPPT (Agency for the Assessment and Application of Technology), Research Agency under several ministries (Ministries of Industry, Ministry of Trade, Ministry of Health, etc). In addition, plenty of universities (both public and private) now establish the research institute in order to develop applied technology as well as advocate the SME to adopt it (there are at least 24 universities which are provide research institute registered in LIPI).



development as well as to create new entrepreneurs and prospective businesses (Muafi, et.al, 2012). According to Allen and McCluskey (1990, cited by Hutabarat & Pandin, 2014) a business incubator can be defined as “a facility that provides affordable space, shared office services, and business development assistance in an environment conducive to new venture creation, survival, and early stage growth”. The existence of business incubators is important for establishing difficult enterprises since it provides conducive environments especially for the start-up companies. According to The National Business Incubation Association (1997, cited by Muafi, et.al, 2012) the incubator programs accelerated the successful development of entrepreneurial companies through assets of shared resources and services, guided by incubator management and offered both in the incubator and through its network of contacts. It provides a controlled environment in order to help the conception, gestation, hatching, and early development of new enterprises. It is offering affordable rents, convenient service, business assistance and financing in a flexible and supportive environment which appears to be logical and efficient (Hutabarat & Pandin, 2014).

In the case of Indonesia itself, Muafi, et.al (2012) said that the incubator in Indonesia has been developed since 1992, initiated by the government, Cooperative Department and universities. Then the effort continued in 1997 when there was a program called The Development of Entrepreneurship Culture in Universities and further activity was the New Entrepreneur Incubator. These efforts continued and was the one of the strategic issues for creating new entrepreneurs up to the present time. Through the Presidential Regulation no. 27 of 2013 regarding Development of Business Incubator, the government mandates every sector (including universities and the private sector) establish and increase the number of business incubators for SMEs to support technology transfers and improve their innovativeness.

The importance of business incubators has also been mentioned in the Strategic Plan of Ministry of Cooperatives and SME as well as the Ministry of Research and Technology as one of the priority agendas set to be developed in order to increase the number of techno-entrepreneurs (“*techno-preneur*”) (entrepreneurs involved with high technology). For the 2015-2019, the ministry has set targets to establish and improve 100 business incubators in Indonesia. Moreover, from 2016 to 2019, the ministry plans to create 80 new business incubators throughout Indonesia to

facilitate *techno-preneurs* to develop their businesses<sup>22</sup>. Up until 2012, there were around 50 business incubators in Indonesia<sup>23</sup>. Of this number, is the majority were developed by government and private universities. While other incubators were built by other actors such as: Job Training House Service, Technology Business Center BPPT, BPPT Incubator House, and corporations as their CSR (Muafi, et.al, 2012). However, despite all the efforts, the business incubators in Indonesia still contend with many difficulties. According to Bank Indonesia, there are some weaknesses in developing business incubators for nurturing SMEs, such as: (a) the limitation of operational facilities; (b) the lack of seed capital support; and (c) lack of commitment and support as well as inconsistent policy programs by the government and other actors. In addition, an insufficient number of experts as well as limited capacity are other issues. The research conducted by Hasbullah et.al (2015) assessed the effectiveness of business incubators in the food processing industry and found that a majority of business incubators have sufficient performances (75%); only a small portion performs well (17%) or excellent (8%). This is because most of the business incubators had multiple limitations in process, quality and facilities in the incubation program, low efficiency as well as the issue of financial independence. This indicates that improvements are needed to increase the numbers as well as the quality of technology incubators to nurture new entrepreneurs and increase their capacity.

### **3.4.3 Access to Technology for SME toward AEC**

Technological development for SMEs is one of the main problems in developing SMEs Indonesia (APEC, 2006 and OECD, 2010), therefore the agenda to improve it has been reiterated in several documents such as the 2015-2019 Strategic Plan of MoCSME and Ministry of Research and Technology. Despite the efforts that have been made, the government realizes that the issue of technological development for SMEs still needs improvement.

Although we don't refers directly to ASEAN's initiative, but we do support the points in the AEC Blueprint. That's why the government issued the

---

<sup>22</sup> In addition, it also targets to train 16,000 *techno-preneurs* from 2016 to 2019.

<sup>23</sup> In the RPJMN 2015-2019, the government set the target to establish and empower 100 business incubator throughout Indonesia

regulation which is accordance with the provisions in the ASEAN's initiative... the policies are mostly the same. We tries to implement that points... and among the other aspects, the technological development is the least... (Interview with Hitono Prio, 24 November 2016)

One of the challenges in developing innovation systems and technology adaptations for small and medium scale enterprises in Indonesia is due to the transition from agricultural led economic growth to industrialization, due to this there is a dependence on foreign on foreign technology transferences. Thus R&D activities are not highly prioritized (Gu, Ho and Loban, cited by Padmadinata, 2007). In fact, the R&D expenditure in Indonesia is among the lowest in Southeast Asia. According to the World Bank, Indonesia's gross expenditure on R&D is less than 0.1% of GDP in 2013.

In the era of the AEC there is a growing necessity for SMEs to be more innovative, outward-looking and dynamic. The need to adapt advanced technology for SMEs is necessary. ASEAN sets the guideline for every member country in order that they implement several of the following things: (i) technology upgrading policy for SMEs; and (ii) enhance technology incubators to nurture and support techno-entrepreneurs.

The first activity regarding technology upgrading for SMEs, pertains to the government initiative to establish infrastructure in order to succeed the program of digitalization of SMEs. In addition, the establishment of SME innovation centers (both government-owned and privately-owned) are also part of the countries technology upgrading policy. The second activity pertains to the issue of technology incubators, an effort started in 1992 and continuing up to the present. In 2013, the Association of Indonesian Business Incubator (AIBI) joined the ASEAN Incubator Network. This membership displayed in the government's efforts to stay in step with the declarations of ASEAN's SME framework policy.

However, despite all of these efforts, Indonesia remains limited in the effort to upgrade technology and lags behind other countries. According to the SME Policy Index (2014), the innovation strategy is only sporadically referenced in some policy documents without a consistent approach. There is neither synergy nor a system

synchronization of all the strategy elements in the country. There are several challenges that hamper the technological upgrades for SMEs in Indonesia. *First*, the commitment of the government to increase technological capabilities is still low. This is proven by the limited number of research and innovation centers for SMEs, the dearth of facilities, funds, as well as the low number of researchers. This low level of commitment can also be seen in the yearly amount of R&D funding.

*Second*, the interaction between important components of innovation, which comprise research institutes, industry and government, remains weak. For instance, some research institutes are inward orientated, but on the other hand several industries heavily depend on their foreign principal. Furthermore, there is a shortage of science and technology resources on some spheres such as the number of researchers, research funding and research facilities (Padmadinata, 2007)

*Third*, the technology results from research institutes or universities have not yet been applied by SMEs due to several factors, such as the lack of capacity of SMEs to adopt the technology; the technology that is not accordance with the real needs of SMEs; lack of integration among research institutes; etc. During this time, the attention of the government in upgrading technological capacity seems low. The effort to develop SMEs is focused on financial aspects rather than technology development, innovation capability and skills development.

In response to ASEAN's SME frameworks, Indonesia has committed to build the business and technology incubators as has been mandated in the guidelines. In the 2009 ASEAN leaders meeting in Hua Hin, Thailand, ASEAN member states agreed to improve the capacity of SMEs through the establishment of business and technology incubators. This assessment should be carried out for the progress and model of best business and technology incubators for ASEAN. Indonesia was the first ASEAN member to initiate a discussion of this issue. Following that decision, the two-day workshop on "ASEAN Project Cooperation on Strengthening SME Business and Technology Business Incubators" was held in Indonesia in 2013 and it was decided that several actions were to be taken to enhance the technology incubators for all ASEAN member states. This resulted in the creation of the ASEAN Incubator Network. In 2013, the Association of Indonesian Business Incubator (AIBI), as a representative of

Indonesia became a member of the ASEAN Incubator Network and was willing to adopt it.

### 3.5 Promotion Activity for Indonesian SMEs

Another key aspect in ASEAN's SME framework relates to the internationalization of SMEs. This aspect emphasizes the need of each national government to promote their SMEs so their products will be recognized internationally and can expand to markets overseas.

It is important to address the issue of promotion due to a still relatively under-representation of SMEs in the global economy. According to the OECD (2004), SMEs only contribute between one quarter and one third of manufactured exports and account for a very small share, usually less than 10% of FDI (Schreyer, 1996; Hall, 2002; Sakai, 2002; cited by OECD, 2004).

The government has made attempts to promote SMEs overseas as stipulated in provisions in the ASEAN's SME frameworks: (i) *promoting SME to international market*; through establishment of the Indonesia Trade Promotion Center in several cities around the world and conducting routine international-scale exhibitions for SMEs and (ii) *wider dissemination of information on SMEs trade fairs and festivals in each AMSs and facilitating them to participate in these events* through facilitating them to participate in international-scale exhibitions around the world and establish the promotion centers and trading houses as centers of information for SMEs.

In fact, there are only low numbers of SMEs that could access those facilities. Most of these are medium enterprises that have already been well-established. The activity of the internationalization of SMEs, in fact, is not in accordance with the needs of most SME in Indonesia. Most of the SMEs in Indonesia are dominated by micro and small sized enterprises rather than medium enterprises. They often face difficulties due to internal limitations (the capacity of SMEs, financial access, consistency, etc.) and primarily focus on fulfilling domestic demands rather than exporting their product. Meanwhile, the promotion activity is more focused on introducing the SMEs' products to international markets, and this activity is only compatible with medium enterprises (and a few number of small enterprises).

This following sub-chapter describes in detail the regulations, programs and extent of government promotional activity for SMEs in Indonesia.

### **3.5.1 Regulation, Programs and Implementation regarding Promotional Activity**

In the case of Indonesia, the issue of promotion has been given priority in the important strategic guide of 2009-2014 and 2015-2019 Strategic Plans (RENSTRA). These documents mention the need for the government to facilitate and support the promotion of SMEs through Marketing Services Agency for SMEs and Cooperatives (under Ministry of Cooperatives and SMEs) as a trading house, innovation center and SME's product gallery as well as to facilitate products of SMEs through exhibitions, both national and international.

Act no. 20 of 2008 regarding MSMEs, mandates both national and local governments promote SMEs as well as encourage those who have export orientation. As per article 18 of this Act, the government must promote SMEs in some ways: do the research regarding promotion; expand the market information; increase the managerial ability as well as provide professional consultants for promotion. The implementation of this regulation has been undertaken by several ministries and institutions such as the Ministry of Culture and Tourism, the Ministry of Communication and Informatics, the Ministry of Cooperatives and SMEs, and the Ministry of Trade etc.

The following part describes several actions conducted by the government to promote SMEs, especially in preparation for the AEC 2015.

#### **3.5.1.1 Promoting SMEs on the International Market**

One of the main objectives in ASEAN's SME frameworks is to promote the internationalization SME. After the implementation of the AEC, SME is expected to be more outward-looking due to the fact that governments in all member countries in ASEAN have removed the trade barrier for almost all of the products, therefore SMEs are expected expand the presence of their products overseas.

In the case of Indonesia itself, the effort to promote prospective SMEs globally has been carried out by the governments themselves, even before the implementation of the AEC. However, during this time the targets here were only the

prospective enterprises, usually medium sized enterprises. Some of the efforts to promote SMEs overseas are:

**(1) Indonesian Trade Promotion Center (ITPC)**

The courage to promote Indonesian local products has also been carried out through the trade attaché and House of Indonesia in certain countries. In addition, the Ministry of Trade through Directorate General for National Export Development (DGNED) established the Indonesian Trade Promotion Center (ITPC) in several cities in some countries. There are over 19 offices around the world. This institution is a non-profit Indonesian Government Organization that aims at advancing Indonesia's international trade by providing information, professional advice and services. ITPC assists Indonesian exporters in their efforts to enhance and expand their businesses in overseas market; facilitates the participation of Indonesian companies in trade exhibitions, trade missions and business visits. The government has established ITPC in several big cities around the world such as Los Angles (USA), Chicago (USA), Busan (ROK), Chennai (India), Vancouver (Canada), Sydney (Australia), Hamburg (Germany), Budapest (Hungary), Osaka (Japan), etc.

There are many activities conducted by the ITPC to boost the Indonesian non-oil-and-gas export development. An instance of this is the goal to facilitate and participate in overseas trade promotions and trade exhibitions, the organization of business meetings and trade relations; observation of local government policy, competitors and potential business opportunities in the particular country; disseminating information to the Indonesian business communities; arranging the meeting between Indonesian exporters and foreign importers; and public relations to promote Indonesian products to the buyers through medias (conventional and social media). Although these attempts seem to have been applied to large enterprises which have larger export markets, the ITPC will also facilitate the efforts of medium sized enterprises to expand in overseas markets.

**(2) Conduct exhibitions for SMEs**

The government has developed routines to hold large exhibitions for SMEs in large cities in Indonesia, for instance the *Pekan Produk Kebudayaan Indonesia* (PPKI) or Indonesian Cultural Products Week and Indonesia Fashion Week (IFW) which is conducted routinely in Jakarta. This event was then

adopted by some local governments and transformed to be “Yogyakarta Fashion Week”, “Surabaya Fashion Week”, “Bandung Fashion Week” etc. These kinds of events are frequently held by the government who collaborated with several related actors such as the Indonesia Chamber of Commerce (KADIN), private sectors and MNCs, NGOs, the association of SMEs and the intellectual community (academia, artists, etc.).

Not only are national-scale exhibitions conducted, the government has also often held international-scale exhibition, in collaboration with the private sector. An instance of this, the International SME Exhibition 2013 in Bali last held in 2013; the SMESCO Festival in 2014 in Jakarta; the Trade Expo Indonesia (TEI) in which has routinely been held in Jakarta since the 1980s and so on. Besides the government, the private sector is also contributing significant time and energy to ensure the success of these exhibitions, especially those conducted on an international scale.

There are so many exhibitions held in Jakarta. But in my observation, mostly it is success when it was held by private sector, or when the government collaborates with private. For example, the Trade Expo Indonesia (TEI), it was so big exhibition with a lot of prospective international buyer, but when it held by only the government, its not that success... (Interview with Timbul Raharjo, 27 July 2015)

Sometimes our government not too competent in holding the international scale exhibition, but I do really appreciate their assistance. They often facilitate us by buying the booth/ stand (in the exhibition) then we can use it together. It is important because the price to buy a booth in international scale exhibition is so expensive, therefore the aids from government is so helpful... I, myself... have been facilitated by the government three times before decided to buy (the booth) by myself (Interview with Timbul Raharjo, 27 July 2015)

This demonstrates the significant role that the private sector plays in conducting international-scale exhibitions. This is not only due to their



professional competency in holding these types of events, but also their wide networks that succeed in drawing in international customers.

Apart from that, besides facilitating international scale exhibitions inside the country, the Ministry of Cooperatives and SMEs usually collaborates with the Ministry of Tourism, the Ministry of Trade or the Ministry of Industry which often facilitate the prospective SMEs ability to participate in International scale exhibitions in other countries. Although fewer SMEs can be assisted by the government in international exhibitions, these efforts serve as incentives for other SMEs so that they can increase the competitiveness and expand their market<sup>24</sup>.

### **3.5.1.2 Wider dissemination of information on SMEs trade fairs and festivals in each AMSs and facilitating them to participate in these events**

One of the objectives of SME development in ASEAN's SME framework policy is to promote SMEs to be more outward-looking. To do so, the promotion activity such as trade fairs, international exhibitions and festivals are frequently conducted. However, during this time, those who can participate in these kinds of events are still limited and only concentrated to a particular industry. These following sections describe the efforts of the government to widen the information about trade fairs and festivals as well as to facilitate SMEs to participate in these kinds of events.

#### **(1) SMESCO Indonesian Company as a National Trading House for SMEs**

One of the ways to prepare SMEs to deepen their participation in the international market is through providing sufficient information for them. Trading house is one of the facilities that offers such information as well as providing facilities such as management training, marketing advocacy, promotion partnership and SME's product display. As regards this, along with the preparation toward AEC, the government of Indonesia through MoCSME collaborates with the Ministry of Finance which launched a trading house for SMEs called "SMESCO Indonesia Company".

---

<sup>24</sup> The selected SMEs will be facilitated by government to participate in International exhibitions, for instance at the Halal Showcase in Malaysia (since 2004), China International SME Festival (since 2003), China International Furniture Fair 2012, International SME' Expo in France (FoireInternationale de Marseille) in 2009, Autumn Fair in England 2015, and various international expos held by ASEAN member states (the detailed event can be seen on [www.aseansme.org/search\\_calendar](http://www.aseansme.org/search_calendar) )

SMESCO has been managed by a public service agency under the Ministry of Cooperatives and SMEs namely LLP-KUKM (*Lembaga Layanan Pemasaran Koperasi dan UMKM*) or Marketing Services Agency for SMEs and Cooperatives. The legal standing of the establishment of SMESCO is based on The Regulation of Ministry of Cooperatives and SMEs number 19 of 2016 and The Regulation of Ministry of Finance no. 159 of 2007.

SMESCO was founded in March 2007 with one overall goal which is to promote the outstanding quality of Indonesian products to the world as well as providing top-notch professional services to local and foreign clients. The vision of SMESCO is to be a professional institution with international scale in marketing the products of Indonesian SMEs in order to make SMESCO Indonesia an icon of SME's creative industry and its empowerment. To do so, some activities have been conducted, for instance: (i) provide facilities for exhibitions; (ii) promote and market Indonesian products to international buyers through Trading House activities; (iii) hold training and enhancement for SMESCO; (iv) provide permanent retail showcase for unique, top quality Indonesian made products at UKM GALLERY; and (v) build the "SMESCO Indonesia building management" as an exhibition hall and offer leases for commercial office space and other support facilities (such as Banks, ATMs, Money Changers, Travel Agents, Minimarkets, Restaurants, etc.). The activities of SMESCO are executed in the building of the SME Tower which is located in the strategic business district of Gatot Subroto, Jakarta.

In the five years' plan of 2015-2019 RPJMN, the government plans to improve the role of the SMESCO trading house in order to support the promotion of local products. There are four points that have to be improved (2015-2019 RPJMN of Ministry of Cooperatives and SMEs):

a) Improve the role of trading houses for SMEs through enhancement of market information systems at both the national and international level (marketing intelligence), update databases and profiles of SMEs, improve quality of products through standardization processes, improve the export facilities for SMEs, marketing advocacy, improves the capacity of SMEs, and promotion partnerships;

b) Facilitates promotion SME's products through some activities: national and international exhibitions, improves e-commerce services, promotion of the SMEs products through various media, etc.

c) Management supports through monitoring and evaluation of the projects as well as improving the capacity of organizations and their human resources.

d) Improve the quality of facilities and infrastructures such as improving the function of the SME Tower and the SMESCO Hills and complete the promotion equipment in the trading house.

The SME Tower as a business center located in a strategic place in Jakarta has provided a venue for SMEs to display their products. There are at least 754 SMEs from 32 provinces which have been displayed at this location. In addition, in early 2015, SMESCO established the "WOW" Gallery of SMEs as a gallery for outstanding SMEs, and thus far there are 500 outstanding SME' products throughout Indonesia which have been displayed in this gallery. This gallery also provides advanced additional facilities to improve the competitiveness of SMEs namely the experiment lab, curated concept store, co-working space, investor meeting place and creative hub<sup>25</sup>.

Before the establishment of SMESCO, there were also several trading houses located in Jakarta such as PT Sarinah, PT PPI, SME Tower, etc. All of these strongly promote outstanding SMEs throughout Indonesia. With the presence of SMESCO, there are more trading houses which could encourage more SMEs to be promoted and facilitated to enlarge the market.

## **(2) Encourage local government to establish promotion centers**

Despite the effort to establish national trading houses as promotion and information centers for SME's products, the government has also

---

<sup>25</sup> Experiment lab is the examination place and workshop for the SMEs where the SMEs could examine or display their product competitiveness to the visitors. Curated concept store is the outlet which sells the products of SMEs that has been curated/ examined by the curator committee. Co-working space is a common room which is used for businessman or freelancers to do their work. Investor meeting place is the meeting place for investors who will be partnered with members of Galeri Indonesia WOW. The creative hub is the meeting place for creative people such as the SMEs, artists or the actors who will develop the events or promotion activities to bring the customers in.

encouraged the local government to build and enhance the promotion center in their local region. Act no. 32 of 2004 regarding Local Government gives more power to local governments to set up their own agenda to develop their local regions. As a result of this the promotion centers in the provinces are built with local budgets and most of them usually collaborate with the private sector. Nevertheless, the establishment of promotion centers in the provinces/ cities/ districts face some constraints such as limited budget and a lack of willingness on behalf of the local leadership (governor/ major/ regent). In Indonesia, most of the successful trading houses were built and managed by the private sector. Therefore, encouraging the involvement of the private sector to establish trading houses and promotion centers in the provinces/ cities/ districts is important in order to assist the SMEs to promote their products.

### **(3) Online Promotion**

Besides providing direct promotion and market information through local and national trading houses, the government runs the official websites to promote SME's products as well as a tools to meet the SMEs and potential buyers, such as [www.smescotrade.com](http://www.smescotrade.com) and [www.indonesia-product.com](http://www.indonesia-product.com). Moreover, the private sector/ individual persons also managed similar websites to disseminate information regarding SME's expos and events such as [www.jadwalevent.web.id](http://www.jadwalevent.web.id) (available in the Indonesian version only); social media of twitter (@InfoJadwalEvent) and facebook (Festival Indonesia) can be accessed freely.

### **3.5.2 Promotion Activity towards AEC**

The activity to promote SMEs overseas is one of the objectives in the AEC since this region has reduced barriers to facilitate national firms to easily enlarge the market. The promotional activity is one of the key initiatives contained in ASEAN's SME framework. It mandates ASEAN countries do several activities: (i) promoting SME to the international market; and (ii) wider dissemination of information on SMEs trade fairs and festivals in each AMS and facilitating their participation in these events.

In the case of Indonesia, there are plenty of programs conducted by the government (in collaboration with some private sectors) to do those activities. The first activity regarding promoting SMEs on the international market has been done through various programs and actions. The establishment of a trade attaché and International Trade Promotion center could be considered one of the direct efforts to

promote local products overseas. Another attempt is through facilitating prospective SMEs to participate in international exhibitions in other countries. Meanwhile, the second key initiative in ASEAN's SME framework is the wider dissemination of information on trade fairs and festivals. These attempts have been carried out through the establishment of national and local trading houses that function as information sources as well as training and display places for SMEs.

These all efforts have been in place to encourage SMEs to expand the market overseas. The activities have been conducted for a long duration of time, and not simply in preparation for accession to the AEC.

Concerning promotional activity... long before AEC, the government always have routine programs regarding promotion, like facilitate them to join in international exhibition... we facilitate about 750 SMEs to be exhibited, not only in one country... beside that, the Ministry of Communication and Information also has a special sites (website) to promote our SMEs' product. That's an effort to market our potential product to international customers. And for expand the market domestically, we (the government) encourage local governments to make their own exhibition place in their cities... (Interview with Hitono Prio, 24 November 2016)

The attempt of the government to promote SMEs in international markets, both ASEAN and other countries, is fairly well-developed (SME Policy Index, 2014). There have been various promotional programs as well as various export facilities to encourage SMEs to sell their products abroad. In addition, the budget for promoting SME's products is increasing. For instance, the Ministry of Trade increased the amount of promotional budget from IDR 220 billion in 2015 to IDR 850 billion this year, particularly in order to welcome the AEC.

Indonesia is also active both as host and participant in exhibitions that have been conducted by AMS. For instance, ASEAN Ceramics 2015 in Thailand, International Halal Showcase in Malaysia, ASEAN SME Expo 2015 in Indonesia, and so on. This shows the government supports the effort of AMS to enhance ASEAN's

SMEs to be more competitive and outward looking. Even so, during this time, those who actively participate in international promotional activities mostly come from medium-scale enterprises that are already well-established instead of majority SMEs that are still dominated with micro and small enterprises who primarily regard domestic markets as their major market place.

### **3.6 Enhancing Marketing Capabilities of SMEs**

In the ASEAN's SME development framework policy, one of the priority agendas that will be addressed is enhancing marketing capabilities for SMEs in each country in Southeast Asia. Enhancing marketing capabilities in the framework means that the countries should establish regulations to improve the capabilities of SMEs in marketing. ASEAN's SME frameworks emphasize that the governments in each country empower the internal capacity of SMEs to be able to expand the market both domestically and internationally through some of the following activities: (i) encourage using e-commerce; and (ii) join in the subcontracting activities through facilitating subcontracting arrangements between local SMEs and domestic located-export MNCs'.

This section explains the efforts of the government in enhancing marketing capabilities for SMEs through the use of e-commerce and subcontracting activities. The research indicates that the government is hampered in their efforts due to the classic problem relating to SMEs which is their internal capacity.

The following sub-chapter describes the attempts of the government to empower SMEs in various ways: increase the competitiveness by using e-commerce and involving SMEs in sub-contracting activity.

#### **3.6.1 Programs for Enhancing Marketing Capabilities for SMEs**

The goal of marketing activities for SMEs is to make SMEs more competitive so that they can expand their markets both domestically and internationally. This is important since not insignificant number of SMEs is not always positively correlated with their contribution in the national income and export sharing. The following table shows the contribution of SMEs in export sharing compared to large enterprises.

Table 3.3

*Contribution of export sharing (SMEs and large enterprises)*

<b>Enterprises</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Micro, small and medium Enterprises (number in IDR billion/ percentage)	175,894.9 (15.81%)	187,441.824 (16.44%)	166,626.5 (14.06%)	182,112.7 (15.68%)
Large Enterprises (number in IDR billion/ percentage)	936,825.0 (84.19%)	953,009.312 (83.56%)	1,018,764.5 (85.94%)	979,214.8 (84.32%)

*Note.* Adapted from the Data of Micro, Small, Medium and Big Enterprises 2009-2014, by the Ministry of Cooperatives and SMEs Republic of Indonesia

The table above shows that less than 20% of SMEs could market their products overseas. Most of them focus on domestic market as their major marketplace. The majority of SMEs in Indonesia are unable to meet the product quality standards of international markets because of their limited capacities (Seung Jin and Jang Won, 1992). Hadiyati (2014) said that the most dominant issues in SME's marketing in Indonesia are: market and product competition, institution and market information access that supports marketing.

Considering the importance of marketing for SME development, the government has attempted to address this issue through the regulation and implementation of these measures through several programs. In the 2015-2019 of the NMTDP it was stated that expanding the scope of marketing is one of the key strategies for developing SMEs. Some of the activities in this document such as increasing the productivity of SMEs and linking the SMEs to larger enterprises which are export-oriented (sub-contracting).

In ASEAN's SME framework, in enhancing marketing capability for SME can be done through at least two activities: (i) encourage SME in e-commerce; and (ii) join to sub-contract activity.

### 3.6.1.1 Encourage Using e-commerce

In the small context, the use of technology for technical matters is also important, for instance, the use of the internet for promoting products or expanding markets. One Indonesian scholar, C.P.F Luhulima in Jakarta Post (2014) said *“Additionally, the SMEs should be encouraged to computerize their firms and utilize Internet services to speed up their businesses, both domestically and on an ASEAN basis in order to close the competitiveness gap between Indonesian SMEs and their ASEAN counterparts. Once better connected, Indonesia can ‘go higher’ together with the other ASEAN member state”*. The importance of the use of the internet can also be seen from the statement made by Hadiyati (2015) who said that the online marketing arena has experienced significant growth over the past few years, while the traditional marketing has deteriorated mainly due to high costs. This means the use of the internet decreases marketing costs of SMEs. Significantly, it also increases economic growth in general, as has been mentioned in the above portion of this paper. Deloitte Access Economics states that boosting digital engagement among Indonesia’s SMEs could increase the country’s annual economic growth by 2%.

Unfortunately, the use of e-commerce by SMEs is still low. The Asia Foundation (2002) shows that only 18% of the 227 SMEs in large cities used e-commerce. Bayu Krisnamurthi, the Vice Minister of Trade once stated that the government still has many things to do to improve the capacity of SMEs so they more adequately be able to use e-commerce, because until now the number of SMEs who utilized e-commerce in Indonesia is still very low. This is contradicted by the fact that this country has the highest number of internet users who account for 88.1 million users with more than 79 million social media users. The Wall Street Journal reports that Indonesia is one of the biggest social media users in the world, with 69 million Facebook users and around 50 million Twitter users. The large youth population as well as the growth in middle class income are some of the reasons for the popularity of social media in the country.

According to the Ministry of Communication and Information, e-commerce’ transactions in 2013 reached IDR 130 trillion and are predicted to increase yearly. Vela Asia (2013) estimated that Indonesia’s e-commerce potential is ranked



number one in Southeast Asia<sup>26</sup> due to the impressive increase in Indonesia's e-commerce:

In the past, if we want to establish business, we should have land, building, employee as well as big capital. Once we want to expand the business, we also need big number of capital to do so (more land, more building, more employees). But nowadays, the trend has changed. Our society now is a social media' generation. The ecommerce' business is effective, efficient and prospective enough... (Interview with Stanisius Tandelilin, 19 February 2016)

This shows that despite of the limited numbers of SMEs that utilize e-commerce, the prospect of e-commerce business is quite promising. This should be a new trend for establishing businesses, by setting up new enterprises that do not require high costs for initial outlays (start-up capital, land, buildings, etc.), but have sufficient skill in operating the technology of ICT.

Several actions must be conducted to encourage the use of e-commerce for SMEs in Indonesia. As has been mentioned in chapter 3.4.2.1 regarding technology capability, there is the need to build infrastructure and supporting facilities to support this program. The other important thing besides the infrastructure issue is the improvement of human resources capacity. In the research conducted by the ASEAN Studies Center (2014), in Yogyakarta Province, the use of internet and other ICT tools is low. The SMEs in that area are more likely to choose to use conventional methods rather than using internet or online services in running their business. It shows that, even in a large city, only few of the enterprises are using the internet and online services. The comprehensive plan along with the willingness of the government is indeed needed to socialize the use of internet for running businesses for SMEs.

### **3.6.1.2 Encourage sub-contracting activity**

Besides the attempt to encourage e-commerce among SMEs, another effort to enhance SME's marketing capabilities are through sub-contracting

---

<sup>26</sup> <http://www.bsd-kadin.org/news/news-detail/id/83>

activities. This notion has been mentioned in ASEAN's SME framework as an approach to increase the capacity of SMEs in the production process as well as marketing issues.

In developed countries, such as Japan and Korea, the strategy of subcontracting has played a central role in the successful integration especially in the sector of manufacturing. It has been a major vehicle for the achievement of rising and eventually high levels of productivity in those firms (Berry, Rodriguez and Sandee, 2001). Since the 1980s, the Indonesian government has started to encourage subcontracting activity, but this has been limited to automotive components. This policy called the "foster parents" policy, referred to a partnership program which involved large private companies which had been requested to assist SMEs through a partnership with capital, training, technical assistance, marketing, procurement of raw material and many other issues. Sub-contract activity is no longer applied in the field of heavy industry, but also through various industries and sectors.

The government has started to encourage the potential sector in each area through the program called cluster industry which has been developed as a new concept of sub-contracting policy. In general, clustering SMEs refers to various industrial colonies composed of enterprises in identical and closely connected industries in specific areas (Xiangfeng, 2008). Porter (2000) stated that cluster industry is a geographically proximate group of interconnected enterprises and associated institutions in a particular field, linked by commonality and complementary. SME clustering is the centralization of SMEs in their location, considered an important feature of SME development, therefore through cluster industry, individual enterprises can address their current problems related to their size, production process, marketing, procurement of inputs and market information as well as improve their competitive positions. Research by Sandee (1995) found that small firms that are parts of the cluster are in a better position to adopt innovations than their dispersed counterparts.

As regards this issue, the government has started to improve the capacity of SMEs through the establishment of cluster industries in several potential areas. Based on the most recent data from the Ministry of Cooperatives and SMEs, in 2005 alone, there were a total of 450 SME clusters assisted by the Ministry, some these clusters are even export oriented (Tambunan, 2015). The table below shows the exporting SME clusters in Indonesia by 2005

Table 3.4

*Exporting SME clusters in Indonesia by provinces (2005)*

Provinces	Total number of clusters	Exporting clusters*		
		No.of clusters	Total firms	Total workers
Nangroe Aceh Darussalam	9	2	68	205
North Sumatera	16	5	211	724
West Sumatera	6	n.a	n.a	n.a
Riau	11	3	166	367
Jambi	14	4	182	580
South Sumatera	17	n.a	n.a	n.a
Bengkulu	6	1	36	109
Lampung	16	4	206	530
Jakarta	6	2	210	295
West Java	35	11	593	2,292
Central Java	58	20	1,558	7,803
Yogyakarta	18	8	600	1,676
East Java	71	10	499	1,976
Banten	9	1	55	388
Bali	17	7	515	1,484
West Nusa Tenggara	15	6	509	4,635
East Nusa Tenggara	6	3	99	412
West Kalimantan	10	1	30	91
Central Kalimantan	11	n.a	n.a	n.a
South Kalimantan	17	1	50	150
East Kalimantan	17	3	73	250
North Sulawesi	3	n.a	n.a	n.a
Central Sulawesi	11	n.a	n.a	n.a
South Sulawesi	26	n.a	n.a	n.a
Southeast Sulawesi	6	2	80	205
Gorontalo	5	n.a	n.a	n.a

West Sulawesi	4	1	69	90
Maluku	4	n.a	n.a	n.a
North Maluku	1	n.a	n.a	n.a
West Papua	1	n.a	n.a	n.a
Papua	3	1	30	90

Note: n.a= not available

*Note.* Processed data from [www.depkop.go.id](http://www.depkop.go.id) (Ministry of Cooperatives and SMEs) in “Trade Facilitation and Enabling Trade: a Study on SMEs in Indonesia by Tulus Tambunan, 2015, Center for Industry, SME and Business Competition Studies

Through SME clusters, the knowledge and technology would effectively be transferred to small industries from larger industries and related institutions. This directly affects the capacity of the small and medium-enterprises in that area. Sufficient resources, adequate market information and good capacity of SMEs would enable them to produce goods that are able to meet demands of international consumers.

However, the table above clearly shows that the largest proportion of SME clusters, including the export-oriented SME cluster are located in Java. The government must place more attention on developing SME clusters outside this island so that they can create competitive products and meet international standards.

In addition, since 2008, Indonesia has started to implement another SME clusters namely the OVOP or “One Village, One Product”. This program is one of the outstanding programs recently implemented. It has been in effect from 2008 under the auspices of the Ministry of Industry then continued by the Ministry of Cooperatives and SMEs in 2010. It was then supported by the issuing of the regulation of Presidential Instruction no. 6 of 2007 that mandates that the government conduct a program which could promote local products through supporting programs, such as One Village One Product (OVOP). From 2011 to 2014, the Ministry of Cooperatives and SMEs has expanded the scope of the OVOP program to 33 provinces throughout Indonesia at 100 central points. In addition, the Central Bank of Indonesia (BI) has also supported this program through technical support for 35 clusters particularly in the sectors of agriculture, livestock, forestry and fisheries. The selected locations are based

on the result mapping and identification of potential and prospective products, suitability of natural resources potencies as well as human resources. As of 2014, there were at least 50 OVOP's products which have export quality. These products are marketed through direct market, e-commerce, as well as through partnerships with supermarkets or international partners. In the next five years, the government plans to establish and develop 500 OVOPs throughout Indonesia.

### **3.6.2 SME's Marketing Capability towards AEC**

In the ASEAN's SME framework, enhancing marketing capabilities means that the countries should establish regulations to improve the capability of SMEs in marketing affairs in order to expand the market domestically and internationally. Some of the activities in that framework comprise (i) encourage the use of e-commerce; and (ii) encourage SMEs to join in sub-contracting activities.

The activity to promote e-commerce has begun recently through the effort of the government in expanding and broadening the scope of the internet throughout Indonesia. This is due to the fact that by using e-commerce, firms would be more efficient and innovative. In addition, the numerous internet users in Indonesia will gain greater benefits for SMEs that utilize the internet and e-commerce in their business. However, uneven infrastructure sufficiency among regions in Indonesia as well as the lack of human resources capacities needed to operate such technology would be significant obstacles to promote e-commerce among SMEs.

The second activity in the ASEAN's SME framework pertains to the effort to create linkages between SMEs too large enterprises/ MNCs. This has been done through several programs. Since the 1970s, the government started doing this through subcontracting policy namely the "foster parent policy". Until now, this kind of subcontracting activity is still on-going and expanding its scope to not only facilitate heavy and manufacturing industry linkages to large enterprises but also other sector industries as well.

In addition, in response to ASEAN's SME framework, Indonesia has followed and implemented the selected initiatives in ASEAN's SME framework to improving rural living conditions through the one village one product movement. Indonesia is one of the ASEAN countries which adopted and accepted direct assistance from Japan to develop OVOP. In 2014, Indonesia was the host for the workshop on

“Improvement of Rural Living Conditions through One Village One Product”. This workshop was organized by the Ministry of Cooperatives and SMEs of the Republic of Indonesia and the participants comprised of representatives from ASEAN member states who were in charge of OVOP movement in each country, representatives from the Japan International Cooperation Agency (JICA) and the International OVOP Exchange Committee from Oita Prefecture. Through the program of OVOP, the government has tried to empower the community especially in rural areas to develop their local featured products based on their characteristics and resources in each area.

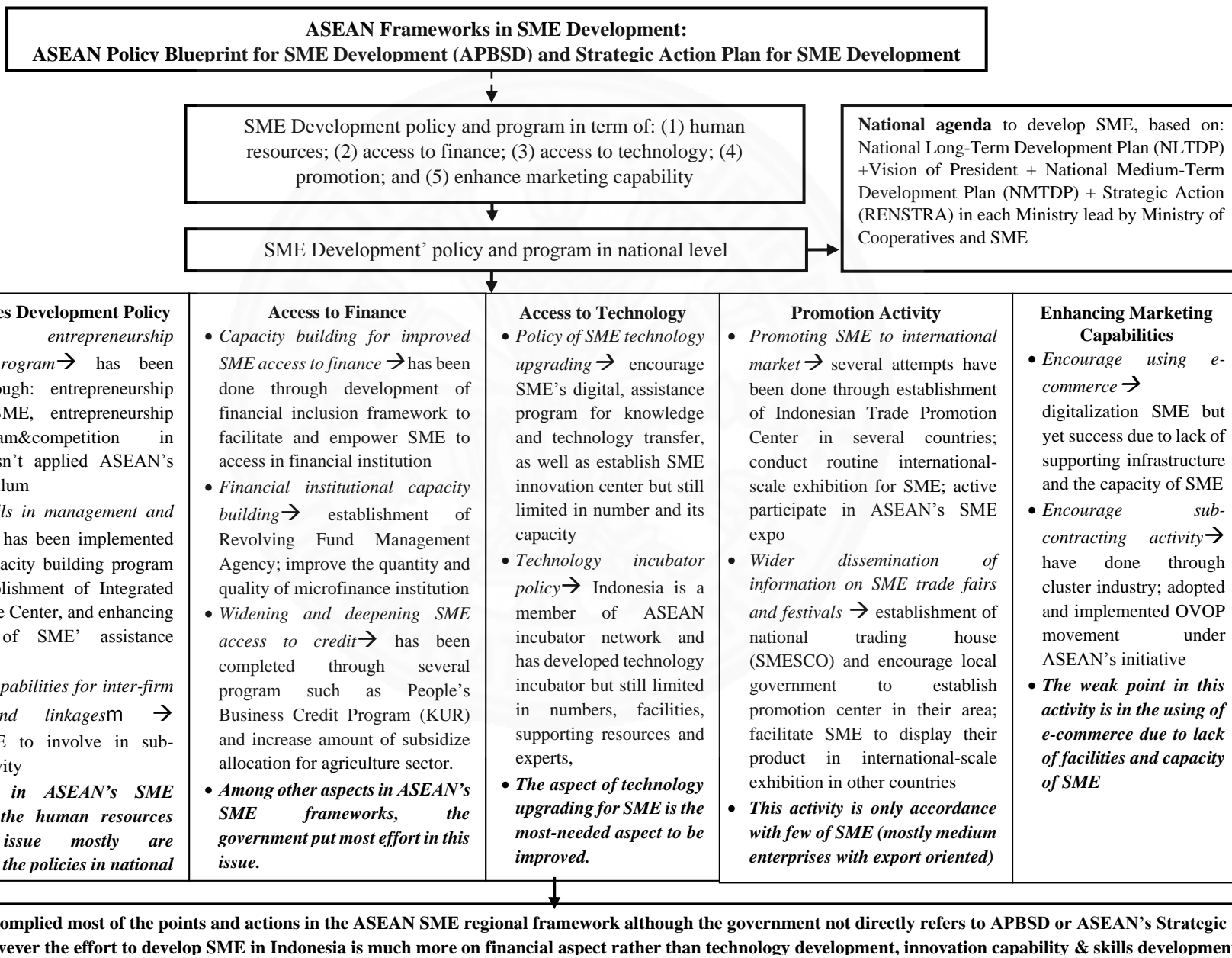
### **3.7 Indonesian Responses toward ASEAN SME Framework Policy**

This last sub-chapter summarizes the findings of the research and tries to answer the first research question: “How does the national policy of Indonesia respond to the SME’s policy framework in ASEAN?” in order to see to what extent Indonesia has complied and followed the SME’s framework policy at the regional level through five aspects that have been mentioned in the framework of the APBSD and Strategic Action Plan for SME Development.

Basically, ASEAN’s SME frameworks are arranged in order to accelerate the implementation of the AEC blueprint and achieve the goal of creating equitable economic development in the region. In its objectives, it stated that ASEAN’s SME frameworks aim to give a guidance for countries so that ASEAN SMEs shall be world-class enterprises, capable of integration into the regional and global supply chains, able to take advantage of the benefits of the AEC and operate in a policy environment that is conducive to SME development, export and innovation. However, the fact that different economic conditions among ASEAN countries makes it difficult to achieve those goals simultaneously. ASEAN’s SME frameworks emphasizes that SMEs be more outward-looking and able to engage in the global market, meanwhile many of ASEAN’s SME characteristics mostly focus on domestic markets rather than exports. In Indonesia for example, the large population as well as the rise of middle-class incomes make SMEs and other industries focus on fulfilling domestic demands rather than export their products overseas.

On the other hand, some of the key points in ASEAN's SME frameworks show general and broad initiatives. As a result, although the government states that developing SMEs in Indonesia does not refer to ASEAN's SME initiatives, still, some of the key points are compatible and in accordance with the needs and actions of the government's policies and plans. The figure below shows the summary of actions and activities of the Indonesian government in five variables that have been mentioned in ASEANs SME development framework policy







*Figure 3.2* Indonesia towards ASEAN's SME Framework Policy created by the author.

The figure 3.2 summarizes the activities and programs that have been done by the government in developing SMEs in Indonesia, particularly in five key aspects. According to the research, there is a multitude of national programs and policies that are accordance and compatible with key initiatives at the regional level although the government has stated that the national agenda is not directly referring to the ABPSD or ASEAN's Action Plan. For instance, as pertains to enhancing marketing capabilities and access to technology for SMEs, Indonesia has followed and applied the guidelines that have been offered by ASEAN.

Indonesia has applied the key initiatives to improving rural living conditions through the OVOP movement and was one of the ASEAN countries that accepted direct assistance from Japan to develop the OVOP. Another key initiative that has also been applied by the Indonesian government is in term of access to technology. Indonesia has committed to building business and technology incubators by joining as a member of the ASEAN Incubator Network. By doing this, Indonesia has applied and adopted the guidelines to develop business and technology incubators that were offered by JAIF and ASEAN although, until recently, there are still a lot of improvements needed in developing technology and business incubators.

As regards human resources development, all the points in ASEAN's SME framework have been implemented. However, Indonesia has not applied a common curriculum that has been arranged by ASEAN. This shows that every country has its full sovereignty on whether or not to implement ASEAN's initiatives when it comes to national interests. As Basu Das (2013) mentioned in his research, whether or not to apply the focused programs under ASEAN SME's framework is up to each ASEAN member state, depending on their domestic needs and level of economic development.

To summarize this chapter, I can say that SMEs in the region are inescapably faced with different challenges to survive in the AEC. To address these issues, there needs to be not only a macro policy which helps a country's economic situation but also a specific and micro policy which directly addresses the problems of SMEs in each country, therefore ASEAN's SME frameworks which are broad and general in their provisions cannot be the main guidance for each individual country. The

problem of SMEs in Singapore would definitely be different than the problems of SMEs other countries which have greater obstacles in innovation and market competitiveness. Different degrees of government support in each country in terms of the financing system, HR development, knowledge management and research and development issues require that SMEs in each country face different challenges. As regards this, a common policy among ASEAN countries was not necessarily needed, however the most important thing is how to integrate each policy in each country to achieve the goal of the AEC.



## **CHAPTER 4**

### **THE APPLICATION OF ASEAN SME FRAMEWORKS UNDER INDONESIAN CONTEXT**

The previous chapter describes policies and programs conducted by the government in developing SMEs in Indonesia, particularly in five aspects that have been mentioned in the APBSD and the Strategic Action Plan for SME Development as well as the linkages between regional policy (ASEAN) and national policy (Indonesia) in terms of developing SMEs. The research found that the government is not directly referring to ASEAN SME frameworks in developing SMEs in Indonesia. However, what has been done by the government is mostly compatible with the key initiatives in ASEAN's SME framework policy. Thus, this chapter tries to identify what factors are behind this finding.

Moreover, this chapter also tries to answer the second research question and objectives which is the explanation of the most significant factor/ crucial aspect in developing SMEs in an Indonesian context.

The data gathered for this chapter came from interviewees both at the government level and SME level, as well as other related academic sources.

#### **4.1 Challenges in Applying ASEAN SME Frameworks**

As to the need to enhance equitable economic development under the third pillar in the AEC blueprint, ASEAN leaders have arranged ASEAN's SME framework as a guidance to facilitate SME in the region to achieve particular goals: enhance competitiveness and dynamism of ASEAN SMEs; strengthen its resilience; and increase its contribution to the overall economic growth and development (AEC Blueprint, 2008). Having regional frameworks means that AMSs should be better able to link/ apply those frameworks in their domestic policy in order to meet the objectives. According to the Policy Recommendation Report by the US-ASEAN Business Alliance for Competitive SME (2014), harmonizing policy between the regional and national level is needed to enable the competitiveness of ASEAN SMEs in order to face these

issues: market expansion, integration into global supply chains, finding new customers and synchronizing the regulation of standards and procedures among countries in ASEAN. This is important since these challenges are difficult to address by national policy only. Hence, a consistent SME policy both at the national and regional level is needed because SMEs are critical for the robust growth of the AMS and the whole region itself (ERIA, 2014).

Even so, the research found that basically Indonesia is not directly referring to ASEAN's SME framework in developing SMEs in the country. These frameworks are only used as the input for SME policy, not as a main reference. Several reasons could be the cause of this.

*First*, ASEAN's SME frameworks policy consists of some key initiatives and actions created by SMEWG which aim to create resilience and innovative SMEs in the region. However, the current application of the key initiatives and actions are still up to each country to implement. Therefore, there is neither punishment nor sanction for those who do not apply these initiatives. This loose mechanism allows the country to have full sovereignty to decide whether or not to follow the regional framework.

I argue that ASEAN has started to make strong progress by arranging SME's regional policy. This guidance is a good focal point for input for developing SMEs in ASEAN countries; it illustrates the problems of SME's the region as well as how to address it through some actions and programs; the assessment is also necessary to evaluate the performance in each country; and on the other side, it has no strict binding that could force a single country to apply all those actions when it comes to each national country due to various problems and interests of each country.

However, at the end of the day, domestic regulations are the ones that determine how successful SMEs will be in gaining benefits from the AEC. Dr Sok Siphana in a speech at the seminar of Regional Economic Cooperation Forum in 2014, stated that the benefit of the AEC would not be delivered if there are no comprehensive domestic regulations. To gain the advantage from the AEC, the investment climate and the trade facilitation process will have to be streamlined and the political situations need to be stable. This all depends on the domestic policy in each country.

In addition, Professor Mari Elka Pangestu<sup>27</sup> in an interview with Asian Management Insight (2015) stated that the process of regional integration through the AEC 2015 has probably benefited Indonesia as many MNCs chose Indonesia as their regional hub or regional production center. Moreover, Indonesian producers and exporters already view ASEAN as a potential market, however this kind of benefit has probably not yet accrued to SMEs. Although the regional regulations have been arranged, the key success in enabling SMEs to benefit from the AEC is still dependent on domestic regulations. In the case of Indonesia, she mentioned the fact that the Indonesian government still needs to focus on improving capacity building for SMEs.

*Secondly*, the complexity of SMEs in every country is different. It depends on the economic situation as well as supporting national policy in that particular country. Some countries might have sound policies to address SME's issues in their country, some might not. In addition, the focus and objectives of each government in developing SMEs is different from one another. For instance, in the case of Indonesia, the key focus in developing SME's is to improve the capacity of SMEs, and to increase the product's competitiveness as well as broadening the scope of financial support throughout Indonesia while the issue about 'internationalization SME' or SME that based on technology is still beyond the capacity of most SMEs in Indonesia (Hitono Prio, 2015).

On the other side, the main attention of ASEAN's SME framework is to make SMEs able to take advantage of the benefits of the AEC, and to be more outward-looking and able to engage in the global market. Thus, the key activities are related to 'internationalization' issues and export activity, which, as the key initiatives in ASEAN's SME framework still seem relevant if applied in the context of Indonesia. It is because the majority of SMEs in Indonesia comprise of micro and small sized enterprises and mostly only focus on domestic markets rather than international markets. This is also supported by the large population in the country which accounts for 40%, or 255.5 million people, of the total population in ASEAN. Furthermore, this country is also set to become a prominent consumer force since the middle-class income

---

<sup>27</sup> Mari Elka Pangestu served as Indonesia's Minister of Trade from 2004 to 2011, and as Minister of Tourism and Creative Economy from 2011 until October 2014. She is currently Professor of International Economics at the Faculty of Economics, University of Indonesia and is on the Board of Directors of the Centre for Strategic and International Studies, Indonesia's leading thinking tank

is rising significantly<sup>28</sup>. With these conditions, the enterprises definitely point toward the domestic market as a major marketplace since the massive demands are inside the country.

Thus, this framework could not be the main guidance for SMEs in the region due to the complexity of SME's conditions in AMSs. Therefore, it is difficult to cover all needs and interests of SMEs in the region into one simple, common framework. Even the definition of SME in the region itself also remains diverse<sup>29</sup>. In addition, there are still many SMEs that do not register themselves, so the officials cannot record their existence. All of these can be major constraints to capturing a comprehensive picture of ASEAN SMEs, thus it will also hamper ASEAN's ability to identify the problems and needs of SMEs in each country. It is a significant challenge for ASEAN to set a common framework that can be applied in all countries with all these different problems and interests.

#### **4.2 Critical Factor in Developing SME in Indonesia**

The previous explanation describes some of the reasons why not all of the key initiatives in ASEAN's SME frameworks could be applied when it comes to the national level. The various characteristics and problems of SMEs in each country in ASEAN makes these initiatives and actions only applicable at certain levels, depending on each national agenda and interest.

Each country has its own problems and challenges in applying the key initiatives in ASEAN's SME framework to achieve the objectives of the AEC. This sub-chapter shows critical challenges faced by Indonesian SMEs.

---

<sup>28</sup> According to the World Bank, the middle class income in Indonesia is continuously rising become the world's fourth largest middle class with 17.3 million households as of 2014 (behind the USA at 25.3 million, India at 74 million, and China at 112 million). It will be predicted to continue rising to become 20 million households by 2030, creating more potential consumers base to drive demand and spending in the country ([www.euromonitor.com](http://www.euromonitor.com))

<sup>29</sup> According to official definition of SMEs among ASEAN countries, we can found that the classification of SMEs are various. There are some countries that use number of workers as main criteria, some use amount of assets, some other else use revenue/ possession of capital.

#### 4.2.1 Inward looking characteristics

The majority of SMEs, especially micro and small sized enterprises are mostly characterized as self-employment enterprises without paid workers, some are un-registered, and widely dispersed, including in rural areas. Most of them rely on domestic markets as their major market place. In the research conducted by Tambunan (2008), it was revealed that the contribution of SMEs is more capable in fulfilling the needs of the domestic market, especially in the sectors of agriculture, finance, rent and services and transportation and communication rather than expanding the market overseas. Despite the lack of capacity of SMEs to meet the market standards, there are some factors that hamper direct export activity, such as (i) SMEs do not have strong direct access to export markets, or no access to information on export markets; (ii) SMEs are not able to adjust to rapid changes in export markets; (iii) high risk in payment and shipment as well as high cost for direct export activity (Tambunan, 2008).

Due to the above constraints, it is reasonable that most of the SMEs are only able to fulfill domestic demands instead of exporting their products overseas. The table below shows the export performance of Indonesian SMEs which fluctuated from 15 to 17 per cent by year.

Table 4.1

##### *SME's export in number*

	2010		2011		2012		2013	
	IDR (billion)	(%)	IDR (billion)	(%)	IDR (billion)	(%)	IDR (billion)	(%)
Micro enterprises	16.687,5	1.50	17.249,3	1.51	15.235,2	1.29	15.989,5	1.38
Small enterprises	38.001,0	3.42	39.311,7	3.45	32.508,8	2.74	32.051,8	2.76
Medium enterprises	121.206,4	10.89	130.880,8	11.48	118.882,4	10.03	134.071,4	11.54
<b>Total</b>	<b>175.894,9</b>	<b>15.81</b>	<b>187.441,8</b>	<b>16.44</b>	<b>166.626,5</b>	<b>14.06</b>	<b>182.112,7</b>	<b>15.68</b>

*Note.* Adapted from “Official Database of SMEs in Indonesia 2010, 2011, 2012 and 2013” by Ministry of Cooperatives and SME ([www.depkop.go.id](http://www.depkop.go.id))

As has been captured in figure 4.1 the contribution of SMEs towards export sharing remains low, it only accounts for 13-16% per year. It shows that despite the number of SMEs which are numerous, the export activity is still dominated by large enterprises. In addition, the contribution of SMEs to GDP (table 3.3) accounted for 50-60% which also raises the question. With 99% of the SME establishment, is the contribution of SMEs significant enough when compared to large enterprises that only account for 0.01% of all enterprises and contribute 40% of GDP? The higher GDP contribution of SMEs compared to larger enterprises is not due to higher productivity, but because they are more numerous. This shows that SMEs in Indonesia are suffering with the problem of a lack of productivity and concomitant inability to meet export standards. This supposition is supported by the research conducted by Tambunan (2012) which stated that in the context of international trade and global competitiveness, two key problems currently faced by Indonesian SMEs are shortages in skilled workers as well as entrepreneurs (internal factor) and technology and business environmental factors (external factor). These two factors are the main constraints in developing SME in Indonesia.

The internal factor regarding lack of capacity and entrepreneurship has been explained in the previous chapter (look at Chapter 3.2). Despite the problems related to lack of adequate skills to develop businesses, the mentality of the workforce, the lack of innovation and creativity as well as the lack of consistency, are compounded by the policy from the government which is sometimes not in accordance with the needs of SMEs. The issue of the education system, the lack of follow-up for capacity building programs, the lack of monitoring and further assistance, and the low capacity of trainers in BDSP are some of the factors that contribute to this problem.

#### **4.2.2 Less Favorable Environment to Develop SMEs**

The second critical factor in developing SMEs in Indonesia is the external factor, which is comprised of technology and the business environment. The issue of technology upgrading for SME development has been explained in the previous chapter (look at Chapter 3.4). It reveals that there are several factors that cause difficulties in applying advanced technology for SMEs, such as the lack of the government's commitment to improve technological capability for SMEs; weak



interaction among research institutes/ universities, industry and government; and the inability to apply the technological results from research institutes due to the lack capacity of SMEs ability to adopt the technology and or the technology that might not be in accordance with the real needs of SMEs.

Besides the lack of technology usage, another external factor is related to the business environment. According to Sandee and Wengel (2008), the policy environment in Indonesia is reportedly less favorable for SME development compared to several neighbors. Therefore, this barrier must be overcome in order to create a conducive atmosphere in which to promote SMEs. This 'environment' is comprised of several issues including the availability of infrastructure as well as supra-structure to support the development of SMEs in the country.

The *first one* is the issue of infrastructure in Indonesia. Uneven conditions of infrastructure in every region in Indonesia causes different levels of SME development. The supporting facilities such as the availability of roads, electricity, telephone service, and internet service are some required components in developing SMEs. The infrastructure gap in Indonesia remains high between Java (the western part of Indonesia) and non-Java (especially the eastern part of Indonesia), and it will be a significant challenge for the government.

In terms of electricity availability, according to Morris and Tsjin (2015), only 81 per cent of households have modern access to electricity. Another important infrastructure component is main roads, and these are also insufficient to meet the needs of the populace. According to the OECD (2013), the infrastructure in the western part of Indonesia, the municipalities and main islands are of higher quality than in the eastern part of Indonesia, the regencies, and smaller islands. Moreover, in the other report, it was stated that nearly 80% of the networks are in bad condition, whereas connectivity is a key to narrow the gap among the regions. This creates a high cost economy. The average transport time per 100 kilometers in Indonesia is 2.6 hours, it is worse compared to the 1.4 hours of average transport time in Thailand, and 1.2 hours of average transport time in China (Morris & Tsjin, 2015). In addition, the shipping of goods in and out as well as within the islands in the eastern part of Indonesia are costlier than in other regions of Indonesia. This high cost economy, due to bad connectivity, will make it difficult for developing SMEs since the SME needs to distribute the raw

materials until its final products reach the customer. Furthermore, it will be costlier if the product is exported. In regards to that issue, narrowing the infrastructure gap between the western and the eastern part of Indonesia is indeed needed to reduce economy cost

*Secondly, is the issue of supra-structure or intangible supporting facilities to encourage SMEs in Indonesia. An instance of this would be the willingness of local governments to support SMEs. Since the decentralization era that has been implemented in Indonesia as of the end of 1999, the role of local governments has begun to be more powerful. The development of the local regions now heavily depends on the leadership of the local governments, as it does in the developing of SMEs. Besides the programs and policies that have been ordered through the national regulation, the initiatives of local governments through programs and policies to improve the numbers and capacity of SMEs is needed. The supporting policies and hospitable business environment will help SMEs to become well-developed. According to a Business Survey in 2000-2001, it was found that since the start of decentralization, potential investors place more emphasis on local regulations than on economic potential when making their investment decisions (Brodjonegoro, 2004). It shows that discretion and innovation of local governments to create fine and conducive business environments play important roles to attract and develop new enterprises.*

The policy in every region is different, thus the role of the local government is very important here. If the local government concerns about SMEs, we believe that they (the SMEs) will also better, and vice versa. In the other hand, sometimes the regulations are overlapping between national and local (regulation), and even contradictory... that hampers our SMEs (Interview with Victoria Simanungkalit, 19 January 2016)

For instance, on the issue of licensing services. Some of the areas have now established one-stop services (OSS) called *Pusat Pelayanan Terpadu Satu Pintu* (PTSP) or *Kantor Pelayanan Prizinan Terpadu* (KPPT) in several regions. This aims to simplify the processes for business registration, therefore the entrepreneurs no longer need to visit different local agencies with complicated procedures to obtain permits.

With the existence of OSS, it is expected that red tape, costs, delays, uncertainty, and corruption can be eliminated. On the other hand, there are also regions/ cities that are less supportive toward local SMEs and have even issued the local regulation (*Peraturan Daerah/ Perda*) which complicates SMEs with procedures of registration, taxation, additional fees, and other issues.

The World Economic Forum (2014) evaluates the facilitation and easiness to enable trade through the index named the Enabling Trade Index (ETI). This framework captures the various dimensions of enabling trade and breaks them into four overall issue areas to see the overall condition of each country in establishing business. The indicators comprise: (i) market access; this measures the extent and complexity of a country's tariff regime, as well as tariff barriers faced and preferences enjoyed by a country's exporters in foreign markets; (ii) border administration; this assesses the quality, transparency and efficiency of border administration of a country; (iii) infrastructure; this assesses the availability and quality of transport infrastructure of a country, associated services, and communication infrastructure, necessary to facilitate the movement of goods within the country and across the border; (iv) operating environment; this measures the quality of key institutional factors impacting the business of importers and exporters active in a country. The result of the report shows that Indonesia is in the 4<sup>th</sup> rank among ASEAN countries (below Singapore, Malaysia and Thailand) and 58<sup>th</sup> among 138 countries in the world.

According to the ETI report, Indonesia's tariff regime offers relatively favorable conditions of access to its domestic market. However, it is still left behind in terms of infrastructure availability, which includes both transport infrastructure and transport services

Table 4.2

*The ETI ranking of ASEAN countries*

Member states	Rank	
	ASEAN	World (138 countries)
Singapore	1	1
Malaysia	2	25

Thailand	3	57
Indonesia	4	58
The Philippines	5	64
Vietnam	6	72
Cambodia	7	93
Lao PDR	8	98
Myanmar	9	121

*Note.* From “Trade Facilitation and Enabling Trade: A Study on SMEs in Indonesia”, by Tulus Tambunan, 2015, *Center for Industry, SME and Business Competition Studies*, p.11

In conclusion, sub-chapter 4.2 shows some crucial aspects that should be improved by the government to develop SMEs, particularly in the case of Indonesia. From the study, I argue that the internal factors (lack of capacity and inward-looking mentality) and external factors (less favorable business environment and infrastructure and technology gap) are the obstacles that could hamper developing SMEs in Indonesia.

In the context of our SME, the aspect of technology and entrepreneurship are two things that need to be improved. We still left behind other countries in term of those two things. This is the result of my discussion with Mandiri Institute... (Interview with Hitono Prio, 24 November 2015)

Thus, the main priority of the Indonesian government besides focusing on increasing the capacity of SMEs is also to synchronize the local and national regulations first in order to ensure the harmonization of coordination between local and national governments.

### **4.3 Prospect of Indonesian SME in the era of AEC**

By reducing the tariff and non-tariff barriers, as well as setting regulations and providing other facilities, SMEs in the region are expected to gain benefits from the AEC; to be more outward looking and competitive; become involved in the global market; and able to look at regional opportunities. However, due to the similarity of the

products among AMSs, it diminishes the ability of SMEs to engage in exports to other ASEAN markets due to them occupying the same market niche. Hence, the country must have something that could make the product distinctive from other countries. For example, Malaysia created the “Halal industry” as their identity and Thailand is the home for well-known agriculture products, processed foods and fruit products. With those characteristics, they are able to be frontrunners among ASEAN countries.

Meanwhile, Indonesian SMEs do not look towards ASEAN as the main market for their products. According to the data, the export trade from Indonesia to AMSs in 2014 was less than the import-trade from AMSs to Indonesia. The extra trade from Indonesia accounted for 22.6% and import trade from AMSs accounted for 25.6%, and was mostly still dominated by the products of steel, automotive parts, palm oil, copper, tin and food and beverages from large/ big enterprises (Simanungkalit, 2016). Unfortunately, there is no data available that can show the performance of Indonesian SME’s exports to ASEAN countries.

However, it does not mean that Indonesia’s SME’s products could not compete with other ASEAN countries. Recently, the Ministry of Trade, Ministry of Industry and Ministry of Cooperatives and SMEs recognized a product that could be a prominent product among ASEAN countries. That product is the product of fashion, lifestyle and consumer-related products.

Talking about era of AEC... I am pretty sure that some of our products are good enough to win the competition. For example the textiles and handicraft... (Interview with Victoria Simanungkalit, 19 January 2016)

The section below describes the prospective product that is distinct it from other ASEAN countries’ products.

#### **4.3.1 Indonesia as a world’s Muslim fashion center**

Indonesia is home to the largest Islamic population in the world. According to the Pew Research Center in the report of The Future of the Global Muslim Population (2011), Islam has 1.57 billion adherents, and around 62 per cent of the world’s Muslims live in South and Southeast Asia. Indonesia itself is home to 12.7 per

cent of the world's Muslims. This is definitely a potential market to develop Muslim fashion, especially for women's fashion.

In Indonesia, the female Muslim fashion products emerged recently. The government as well as business entities are quite optimistic with the prospect of Indonesian Muslim fashion and believe that this country will not only be the center of female Muslim fashion in ASEAN, but also in the world.

Indonesia now is trying to be a trendsetter for Muslim fashion in the world. In ASEAN, we are pretty sure that we can be a winner, even in the world... (Interview with Victoria Simanungkalit, 19 January 2016)

In addition, the Director of Product Export Development, Ministry of Trade, Sulistyawati in a press conference at Indonesia Fashion Week (IFW) 2015 stated that Indonesia has a big opportunity to be a center for Muslim fashion in ASEAN since Indonesia is the largest Muslim population in the world.

The market of Muslim fashion now is not only in the Middle East and Africa, but also America and Europe. With the biggest Muslim population in the world, Indonesia has a big potency to develop its Indonesian Muslim fashion. Furthermore, the emergence of Muslim fashion community also support the establishment of center of fashion Muslim product, especially in ASEAN region (Sulistyawati, 2015 cited by Yudi Suharso, 24 February 2015)<sup>30</sup>

The government stated that Indonesia will be the World's Muslim Fashion Center by 2020. Many believe that Indonesia will become the center of Muslim fashion in Southeast Asia and even in the world.

#### **4.3.2 The emergence of stylist Muslim fashion**

Nowadays, wearing a hijab/ veil for women in Indonesia is seen not only as a symbol to show the identity of Muslims, but also as a trend, especially for the

---

<sup>30</sup> <http://mysharing.co/indonesia-bisa-jadi-pusat-fashion-muslim-asean/>

female youth. For the entrepreneurs, it can be seen as an opportunity to create a fashionable and trendy female Muslim dress. A number of Indonesian brands of female Muslim dress can support this phenomenon. Some are becoming large enterprises such as the brands of Rabbani, Al-Fira, Al-Misa, etc. In addition, the online Muslim shops are also on the rise, such as HijUP, Yoya Hijab, Rahma O-Shop, etc.

The entrepreneurs in this field also mentioned that they are confident enough to compete with other countries upon entering into effect the AEC. During previous times, the trendsetter of Muslim fashion was the middle-east, yet Indonesia has now replaced this region to become the leader in this industry and has exported the product to the middle-east and other regions. Furthermore, it has expanded the market to Southeast Asia, especially in Malaysia, Brunei Darussalam and Thailand.

We are not worry welcoming AEC, because we (Hijabstory) is the place for creative and innovative people who produce good products. Our product is good as any other countries. And for now, we accommodate a lot of SMEs from Bandung (district in West Java), and plans to increase the number of stores (Suyud Satria, the owner of Hijabstory in [www.inilahkoran.com](http://www.inilahkoran.com), 7 October 2015).

Due to a wealth of cultural and ethnic elements in Indonesia that can be value-added in producing a trendy and stylish Muslim fashion, this industry is predicted to become a potential business. So that the entrepreneurs are confident they will be winners in the ASEAN market. Thus, since the prospect of female Muslim fashion is good, the government tries to facilitate this business through some actions, for instance conducting international scale Islamic fashion exhibitions. In September 2015, the first annual International Indonesian Islamic Fashion Fair was organized in Jakarta. A collective of Indonesian fashion designers, industry associations, government agencies, media and other fashion-related entities was gathered to enliven the exhibition. In addition, the ministries (Ministry of Cooperatives and SMEs, Ministry of Industry, Ministry of Trade and Ministry of Tourism and Creative economy) often facilitate this industry to participate in international-scale exhibitions in other countries. This attempt aims to introduce the brand of Indonesian Muslim Fashion.

### **4.3.3 Batik as potential fashion industry**

Besides female Muslim fashion, another kind of fashion industry from Indonesia is also believed to be a winner in ASEAN countries. That is the product of “Batik”. Batik is well-known as one of the national identities of Indonesia. It has been stated to be “an intangible world heritage from Indonesia” by UNESCO and is believed to be one of the leading and prospective products in the era of the AEC.

In Indonesia itself, there are several districts/ provinces that are well-known as producers of high quality Batik. Those several districts/ provinces have their own particular motif, features and characteristics that are distinct from each other, therefore, the Batik is named after the area of production, for example Batik Surakarta, Batik Pekalongan, Batik Cirebon, Batik Yogyakarta, etc. With various motifs and features, people started to produce innovative and fashionable Batik. In the past, Batik was only used for certain occasions, such as uniforms for the government officers, formal and official dresses for weddings and other ceremonies. But now, Batik can be used as a fashionable daily outfit for all generations. The industry of Batik then continued to rise and started to expand onto the international market.

During this time, the biggest export destinations for Batik by country are the United States, Hong Kong and Japan. More recently the exports targets have expanded to other countries such as the European Union countries as well as Southeast Asian countries.

As the result of the expansion of this prospective sector, the export growth for fashion products during 2009-2013 also increased around 10.59% per year. According to the data from the Ministry of Trade (2014), in 2013 the export value for fashion products of Indonesia reached USD 11.78 billion. Meanwhile during January-November 2014, the fashion’s export value reached USD 12.51 billion or increased up until 16.59% from previous periods with the countries of destination comprising USA (35.60%), Japan (6.79%), Germany (6.04%) and the Arab countries (4.18%). These exports value is predicted to increase every year, including the products of Muslim fashion. Unfortunately, there is no exact data regarding the export value of fashion product to ASEAN countries. However, it shows that Indonesia has an opportunity to win the competition among ASEAN countries, especially in the sector of fashion (specifically Muslim fashion) and textiles (Batik).



## **CHAPTER 5**

### **CONCLUSION AND RECOMMENDATION**

This research was conducted to answer the question – How does the national policy of Indonesia response to the SME’s policy framework in ASEAN?; and what factor is the most significant for developing SME in Indonesia? The study aimed to analyze to what extent Indonesia’s government in comply and execute the ASEAN’s SME framework as well as identify the most critical factor for Indonesia’s SME development under Indonesian context.

#### **5.1 Conclusion**

ASEAN Economic Community put the issue of SME as one of the priorities in the blueprint. Under the point of enhancing equitable economic development, it aims to accelerate the pace of SME development in a region; enhance the competitiveness and dynamism of ASEAN SMEs; strengthen its resilience; and as a result, increase its contribution to the overall economic growth and development of ASEAN as a region. However, to fully participate in the process of ASEAN economic integration, SMEs need to overcome barriers and develop their capacities, enabling them to become more intrinsically engaged and competitive in global markets. To help achieve that ambitious goals, ASEAN leaders arranged the frameworks namely ASEAN Policy Blueprint for SME Development (APBSD) and Strategic Action Plan for SME Development.

With using five components that have been mentioned both in APBSD and Strategic Action Plan namely: (i) human resources development; (ii) access to finance; (iii) access to technology; (iv) promotion activity; and (v) enhancing marketing capability, this research tried to identify to what extent Indonesia through its national policies followed and accomplished the ASEAN’s SME framework. This is significant to see whether the ASEAN’s SME frameworks as a regional initiatives are compatible to be implemented when it comes to the national agenda since the growth and development of SME is determined by the consistency of both of ASEAN initiatives and agreements in regional level as well as national policies and programs.

This research found that the government of Indonesia is referring to NMTDP and other related documents as a main direction for developing SME in the country, neither directly refers to APBSD nor Strategic Action Plan. However, the government considers the ASEAN's SME initiatives and agreements as focal input to develop SME in national level. During this time, both ABPSD and Strategic Action Plan focus primarily on regional initiatives and have less emphasis on consistent national SME policies (ERIA and OECD, 2014). Nevertheless, there are several key initiatives and activities in ASEAN SME frameworks that compatible with national interest. ASEAN SME frameworks can only be applied in AMSs at certain level, depends on each AMSs agenda. This due to some reasons.

*Firstly*, various economic condition, SME's characteristics, and national interests make the challenges of SME in each country different one and others. Consequently, it is difficult to arrange a single frameworks that can be applied in all countries, therefore not all the key initiatives and activities in those frameworks compatible in national's interest/ needs. *Secondly*, due to those complexity, some of the key initiatives and activities are broad and not detail. Therefore, although the country is not referring to those frameworks, some national policies are accordance with the key initiatives in the regional frameworks. *Thirdly*, ASEAN realizes that the issues and interests among AMSs are different, therefore they set a less-binding framework, where the application of the initiatives and activities are up to each country. This because SME development framework is intended to serve the government only as a "road map" for the development of SME in each country (Basu Das, 2013). I argued that the most important thing is not to uniform the policies and programs in all countries by set common frameworks, but how to integrate the policies in each country in order to gain benefits of AEC for SMEs.

In case of Indonesia, the research found that most of the points and actions in the ASEAN's SME framework are accomplished by Indonesian government even its not directly refers to regional initiatives. This due to the some activities and initiatives that compatible with the national interests. However, the other aspects which emphasize the 'internationalization' thing seems yet accordance with the needs of most SMEs in Indonesia because SME in Indonesia is still suffering with the classical problems such

as inward looking mentality (the capacity of SMEs)<sup>31</sup> as well as less conducive of business environment (external factor).

## 5.2 Recommendation

This research was conducted to study the response of government towards ASEAN's SME framework policy in the field of SME development; the linkage between regional frameworks (ASEAN SME framework) and national policies; whether the government followed and accomplished the frameworks; and analyzed what is the most significant factor in developing SME. The following points of interests need to be considered regarding this study

*Firstly*, this study argued that ASEAN has started good point by providing regional framework that not bind all countries to apply it. By doing this, each country has full authority to implement the key activities that only accordance with their needs. However, since ASEAN now is arranging the new SME initiatives post 2015, it would be better if it provides more clear and rational implementation time frame. A more structured and targeted MSME programs will be instituted to enhance MSME competitiveness, resilience and to enable greater benefits from ASEAN integration through the new blueprint namely AEC Blueprint 2025. In addition, the ASEAN SME Working Group (SMEWG) through its 36<sup>th</sup> meeting on May 2015 formulated 10-year strategic action plan for SME development (2016-2025) as a follow up from previous frameworks. However, another important thing is the mechanism to evaluate and monitor the framework so that would be revealed the performance of each country in applying those frameworks. The framework should be periodically reviewed and revised to reflect changing condition and priorities for each country in AMSs because during this time, there is no or less evaluation of ASEAN's SME initiatives when it comes to the national country.

---

<sup>31</sup> In 2013, only 15.68% of SMEs who active and able to export their product, this small group of SME mostly using trade networks as intermediaries link to market their product internationally instead of direct exports. This small groups of SMEs usually have accessed formal credit, using more sophisticated technology and have a lot of networks and partnerships. Thus, the government program to promote expanding the market for SME, more or less, only accordance with this small groups.

*Secondly*, the government in each country also needs to increase sense of belongings of people toward AEC by raise their awareness to participate in global market. In regards with this, the socialization and knowledge transfer for SME is a must. In addition, giving good understanding of the advantages and potential of sub-contracting is also necessary to increase the number of SME to involve in this activity.

Regarding the focal issue in developing SME in Indonesia, there are some points that need to be improved. First of all, the main problem in SME development in Indonesia is in its competitiveness. The competitiveness is the prior issue that has to be addressed. There are many ways to improve it, for instance through the cluster industry approach. Clusters of SME are of importance for small firm's development because productivity in clusters appears to be higher than in dispersed firms (Klapwijk, 1997; Weijland, 1999; Supratikno, 2008). Research conducted by Sandee (1995, cited by Supratikno, 2008) also stated that small firms that are parts of clusters are in a better position to adopt innovations than their dispersed counterparts. Also, the focus of government assistance for SME must be evolved, from individual companies to one center on cluster development. It aims to strengthen linkages between suppliers, complementary players and supporting firms within various industry sectors by fostering greater collaboration and cooperation (Shanmugaratnam, 2004). As a result, it would encourage the productivity among the firms, both SME and large enterprises and creates win-win solution, therefore encourage the form of cluster industry is needed.

*Secondly*, the government should put more attention in the productive sector such as agriculture, fisheries, forestry, and livestock. These all sectors are the most dominant in SME (in term of establishment and employment). These sectors account for 48.85 % in 2011 out of all SME's sector and mostly located in rural area. Undoubtedly, this sector contributes to alleviate poverty in rural are, yet its productivity remains low. In addition, the Directory of Outstanding SME (2014) which has been launched by ASEAN shows that the sector of agriculture in Indonesia is left behind other countries such as Malaysia, the Philippines and Thailand, whereas the potency of agriculture in Indonesia is big. Thus, it is significant to give particular actions for this sector, not only in term of technical matters (increase amount of financial assistance/subsidy, bring in more advance technology for efficiency, improve research and development, etc) but also improve the capacity of SME through empowerment

programs. In addition, for the prospective products such as textile and fashion industry which could be predicted to be a winner in ASEAN market, supporting programs and policies must be encouraged.

Thirdly, the government also needs to make better mechanism to disseminate and widening the information to SME related to their needs. Providing more information center for SMEs are needed. In particular, the government should also encourage the socialization of AEC, its challenges and opportunities in general. This is important since only few of SMEs know and understand what AEC is and ready to integrate in it. And finally, harmonize between national and local government is beyond needed. The national government should produce supporting regulation, create comprehensive evaluation for the programs and policies implementation, eliminates the complicated procedure and at the end, the local government must create supporting local government regulation (*Perda*) as well as make innovative policies to maintain the favorable environment.

## BIBLIOGRAHY

- Akhtar, Nadeem et al. (2014). *Strategic Role of Internet in SMEs Growth Strategies*. International Journal of Business Management and Economic Research (IJBMER), Vol 5(2),2014,20-27
- Aldaba, Rafaelita M. (2013). *ASEAN Economic Community 2015 SME Development: Narrowing Development Gap Measure*. Philippine Institute for Development Studies: Discussion Paper Series no 2013-05
- ASEAN Policy Blueprint for SME Development 2004-2014*. (2003). Jakarta: ASEAN Secretariat
- Basri, M. Chatib and Pierre van der Eng. (2004). *Business in Indonesia: New Challenges, Old Problems*. Singapore: Institute of Southeast Asian Studies (ISEAS)
- Basu Das, Sanchita. (2013). *ASEAN Economic Community Scorecard: Performance and Perception*. Institute of Southeast Asian Studies, Project Muse Web, 7 July 2015 from [www.muse.jhu.edu](http://www.muse.jhu.edu)
- Caleb M, Adewlowo, Olaopa R.O, Siyanbola W.O. (2012). *Technology Business Incubation as Strategy for SME Development: How Far, How Well in Niegeria?.* Scientific & Academic Publishing 2012; 2(6):172-181
- Ceraninc, Slobodan and Blazenka Popovic. (2010). *Human Resources Management in Small and Medium Enterprises*. Budapest: APSTRACT Agroindform Publishing House
- Document of National Medium Development Plan of Related Ministries of 2009-2014 and 2015-2019*
- Document of Strategic Plan of Ministry of Cooperatives and SME 2009-2014 and 2015-2019*
- ERIA (2009). *Integrating Small and Medium Enterprises (SMEs) into the More Integrated East Asia*. ERIA Research Project Report 2009, No. 8
- ERIA. (2012). *ASEAN SME Policy Index 2014: Towards Competitive and Innovative SMEs*. ERIA Research Project Report 2012, no 8

- European Union. (2014). *Guidebook series: How to support SME policy from structural funds. Regional Implementation of the SBA*. European Union, Belgium
- Gibson, Tom and H. J. van der Vaart. (2008). *Defining SMEs: A Less Imperfect Way of Defining Small and Medium Enterprises in Developing Countries*. Brookings Global Economy and Development.
- Hanouz, Margareta Drzeniek, Thierry Geiger, Sean Doherty. (2014). *The Global Enabling Trade Report*. Geneva: World Economic Forum 2014
- Hasbullah, Rokhani, et.al. (2015). Peran Inkubator Bisnis Peruruan Tinggi dalam Peningkatan Kinerja Usaha UKM Pangan [Role of University Business Incubators on the Improvement of Food SMEs Business Performance]. Indonesia: Jurnal Ilmu Pertanian Indonesia (JIPI), Indonesia, April 2015 vol.20(1): 59 65 ISSN 0853-4217
- JICA. (2002). *Approaches for Systematic Planning of Development Project, Chapter 3: Promotion of Small and Medium Enterprises*. Japan: Institute for International Cooperation. Japan International Cooperation Agency
- Kuncoro, Mudrajat. (2000). *Usaha Kecil di Indonesia: Profil, Masalah dan Strategi Pemberdayaan* [SMEs in Indonesia: Profile, Problems and Empowerment Strategies] on stadium general conducted in Yogyakarta, 18 November 2000
- Lim, Hank and Fukunari Kimura. (2009). *The Internationalization of SMEs in Regional and Global Value Chains*. Inter-American Development Bank and ADBI Institute in Fifth LAEBA Annual Meeting Singapore – July 15th, 2009
- Mourougane, Annabelle. (2012). *Promoting SME Development in Indonesia*. OECD Economics Department Working Papers no 995
- Muafi, et.al. (2012). *Creating Entrepreneurs through Business Incubator*. IRACST- International Journal of Research in Management & Technology (IJRMT), ISSN: 2249-9563 Vol. 2, No. 4, August 2012
- National Development Medium Plan 2010-2015 and 2015-2019 various ministries and institutions*
- O'Dwyer, Michele, Audrey Gilmore and David Carso. (2009). *Innovative marketing in SMEs: a theoretical framework*. European Business Review Vol. 21 No. 6, 2009 pp. 504-515, Emerald Group Publishing Limited

- OECD. (2004). *Conference of Ministers Responsible for Small and Medium-Sized Enterprises (SMEs) Promoting Entrepreneurship and Innovative SMEs in a Global Economy: Towards a More Responsible and Inclusive Globalization*. Istanbul, Turkey 3-5 June 2004 on 2<sup>nd</sup> OECD Conference
- OECD. (2013). *Structural Policy Challenges For Southeast Asian Countries: Structural Policy Country Notes of Indonesia*. OECD
- OECD. (2014). *Economic Outlook for Southeast Asia, China and India 2014*. OECD and ASEAN Secretariat, this report also can be accessed on [www.oecd-ilibrary.org](http://www.oecd-ilibrary.org)
- Okamoto, Yumiko and Fredrik Sjöholm. (2001). *Technology Development in Indonesia*. European Institute of Japanese Studies Working Paper no 124, May 2001
- Omura, Keiji. (2008). *Small and Medium Enterprises Development in Indonesia in SME Development in 6 Countries*. Japan: Organization for Small and Medium Enterprises and Regional Innovation (SMRJ)
- Padmadinata, Utama H. (2007). *The Importance of SME Innovation Center in Indonesian SME*. APEC SME Innovation Briefing no 3, June 2007
- Sato, Yuri. (2013). *Development of Small and Medium Enterprises in the ASEAN Economies* in Y. Soeya (ed.), *Beyond 2015: ASEAN-Japan Strategic Partnership for Democracy, Peace, and Prosperity in Southeast Asia*. Tokyo: Japan Center for International Exchange.
- Simmons, Beth A and Lisa R. Martin. (2002). *International Organizations and Institutions: Handbook of International Relations*. Thousand Oaks, CA: Sage Publications, 2002. pp. 192-211
- Strategic Action Plan for SME Development 2010-2015*. (2009). Jakarta: ASEAN Secretariat
- Tambunan, Tulus. (2008). *SME Development in Indonesia with Reference to Networking, Innovativeness, Market Expansion and Government Policy*, in Lim, H. (ed.), *SME in Asia and Globalization*. ERIA Research Project Report 2007-5, pp.99-131
- Tambunan, Tulus. (2010). *The Indonesian Experience with Two Big Economic Crises*. Scientific Research Journal, Modern Economy 2010, 1, 156-157



- Tambunan, Tulus. (2012). *Peluang, Tantangan dan Ancaman Bagi UMKM Indonesia dalam Era CAFTA dan MEA 2015* [Opportunities, Challenges and Threats of Indonesian SMEs in the era of CAFTA and AEC 2015]. National Seminar and Conference Proceeding of Business Management, 26 May 2012
- Tambunan, Tulus. (2015). *Trade Facilitation and Enabling Trade: a Study on SMEs in Indonesia*. Center for Industry, SME and Business Competition Studies  
*Various laws and regulations regarding SME development policy in Indonesia*



## BIOGRAPHY

Name	Miss Ainun Habibah
Date of Birth	20 August 1991
Nationality	Indonesia
Educational background	Academic Year-2014: <i>Sarjana Ilmu Politik/SIP</i> (Bachelor in Political Science) Major in Public Administration

