



OECD Studies on SMEs and Entrepreneurship

SME and Entrepreneurship Policy in Indonesia 2018

Policy highlights



Notes

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SME and entrepreneurship characteristics and performance

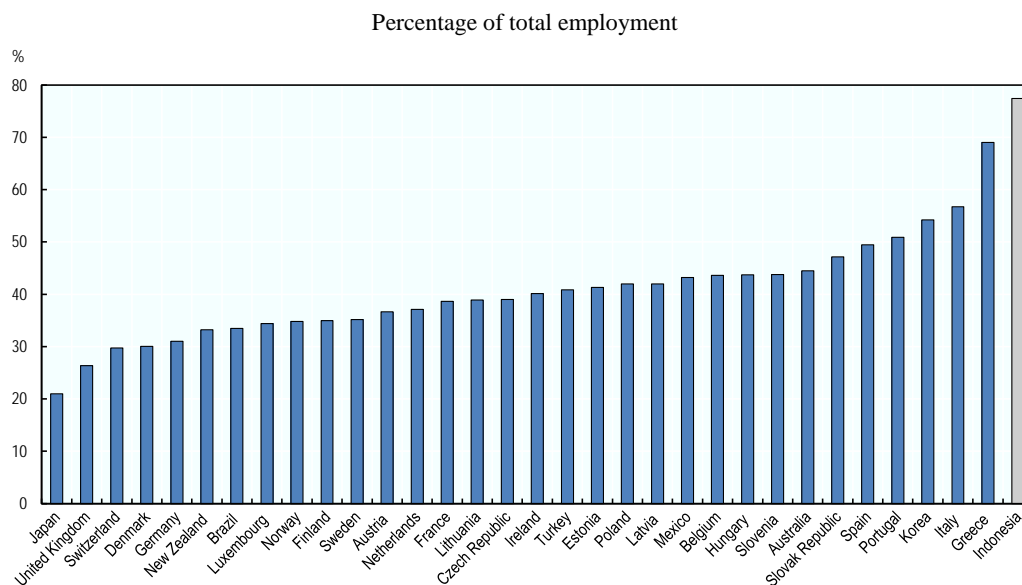
There has been a recent consolidation process in the Indonesian SME sector, but the average enterprise size is still small

Indonesia has a large number of small and medium-sized enterprises (SMEs). In 2014, according to data from the Ministry of Co-operatives and SMEs that include the agricultural sector and follow a turnover and asset-based SME definition, there were 59.3 million enterprises: 98.75% were micro-enterprises, 1.15% were small enterprises and 0.1% were medium-sized enterprises.

Data from the Ministry of Co-operatives and SMEs point to an important consolidation process in the period 2006-2014 whereby the share of micro-enterprises in private-sector employment shrunk from 91% to 87%, while small enterprises increased their employment share from 3.5% to 5.7% and medium-sized enterprises from 3% to 4%.

Despite the recent consolidation, internationally comparable data from the last Indonesian Economic Census (2016) and the OECD Structural and Demographic Business Statistics (SDBS) database, both of which follow an employment-based SME definition, show that Indonesian SMEs are still small by international comparison. Small companies employing less than 20 people accounted for 76.3% of Indonesian employment in 2016, more than any OECD country.

Figure 1: Share of total employment in small companies (1-19 people employed) across OECD countries and Indonesia, 2014 and 2016



Note: Data refer to enterprises, except for Indonesia, Korea and Mexico where data refer to establishments. Data for Korea and Japan refer to employees, rather than to total people employed. Data for Indonesia are from 2016, data for most OECD countries refer to 2014.

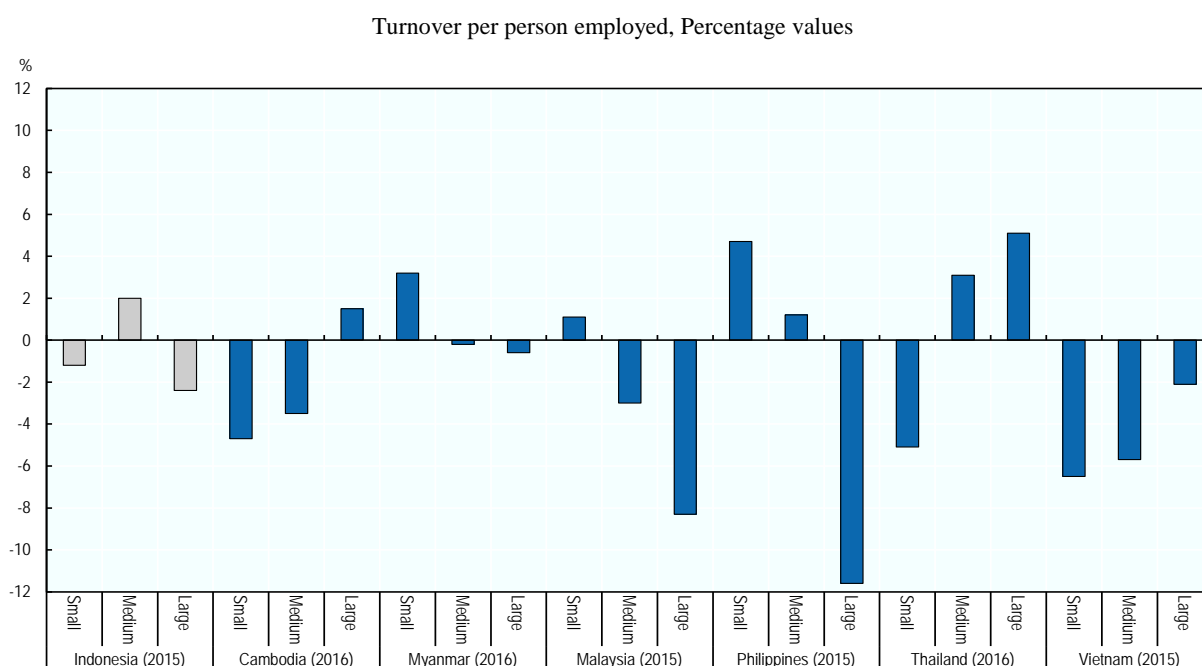
Source: OECD (2017), *Entrepreneurship at a Glance 2017*, OECD Publishing, Paris, https://doi.org/10.1787/entrepreneur_aag-2017-en and Indonesian Economic Census 2016.

Average labour productivity is low, but there are strong variations within the SME sector

According to data from the Asian Labour Productivity Organisation (APO), Indonesia's average labour productivity (GDP per worker) was slightly higher than the ASEAN average in 2016: USD 24 300 compared with USD 21 900. However, this aggregate figure hides strong variations within the Indonesian SME sector. According to data from the Ministry of Co-operatives and SMEs, GDP per worker in micro-enterprises was only 3% of GDP per worker in large enterprises, while GDP per worker in small enterprises and medium-sized enterprises was respectively 16% and 31% that of large companies. Productivity growth over the period 2006-2013 was modest across all business size classes, with average annual rates of 1.1% among micro-enterprises, 0.3% among small enterprises, and 0.6% among medium-sized enterprises (World Bank Enterprise Survey data).

Comparable data on the specific subset of industry-based small companies (1-19 people employed) show that Indonesia's labour productivity (measured as turnover per worker) in this business segment is about one-quarter of the OECD median value.

Figure 2: Average labour productivity growth in selected ASEAN countries by firm size, three years preceding the survey (2015 or 2016)

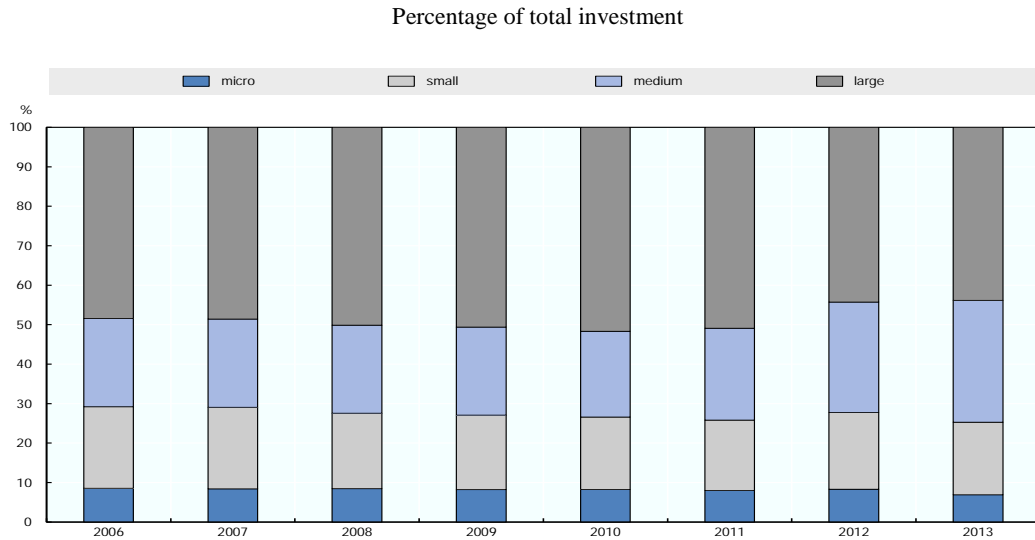


Note: Small companies are companies with 5-19 employees; medium-sized with 20-99 employees; large companies with 100+ employees. Average labour productivity growth in the WBES is measured over the three years preceding the national survey.

Source: World Bank Enterprise Survey (WBES) Database.

Indonesian SMEs actively invest in tangible assets, but less so in intangible assets

SMEs account for an important share of aggregate investment in Indonesia, 56.2% of the total in 2013 according to data from the Ministry of Co-operatives and SMEs. The share of total investment by medium-sized enterprises, in particular, leapt from 22.4% to 30.9% between 2006 and 2013. Conversely, Indonesian SMEs are less engaged in investments in intangible assets. According to World Bank survey data, only 2% of Indonesian firms invest in R&D, although the proportion goes up to 10% in the case of companies employing more than 100 employees.

Figure 3: Investment volumes by firm size in Indonesia, 2006-2013

Note: Data in constant prices. The SME definition of Law 20/2008 is used in this graph.

Source: OECD based on data from the Ministry of Co-operatives and SMEs.

Entrepreneurship culture is healthy

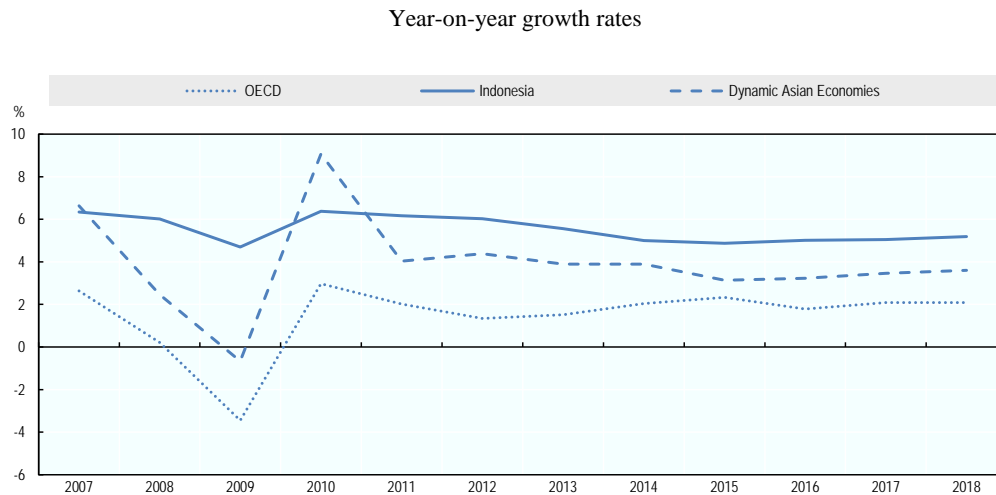
Entrepreneurial attitudes are generally healthy in Indonesia. Nearly half (47.7%) of the Indonesian adult population (aged 18-64) see good opportunities to start a business in the area where they live; perceived levels of entrepreneurship capabilities to exploit such opportunities are also high (Global Entrepreneurship Monitor -GEM- data). However, GEM data also show that risk aversion is relatively high in Indonesia, at 47%, compared with the OECD median value of only 37%. The rate of nascent or new entrepreneurship, captured by the GEM Total Entrepreneurial Activity (TEA rate), is also low by international standards.

The business environment for SMEs and entrepreneurship

Macroeconomic conditions are healthy but labour market conditions could be improved

Indonesia's macroeconomic conditions are supportive of SME and entrepreneurship development and include a young and growing population, a large domestic market, abundant natural resources, a stable political system, a prudent fiscal policy framework and steady economic growth. Indonesia's employment rate is also lower than the OECD average, but working conditions are, on average, poor. Informal employment is estimated at 70% of total employment and vulnerable employment (e.g. own account workers and unpaid family workers) at 58% of total employment, higher than in China (45%), the Philippines (37%) and Malaysia (22%). There are also signs of skills deficits in the Indonesian labour market. Twenty-seven percent of the total labour force has only completed primary education and 17% has not attended or has not graduated from primary school.

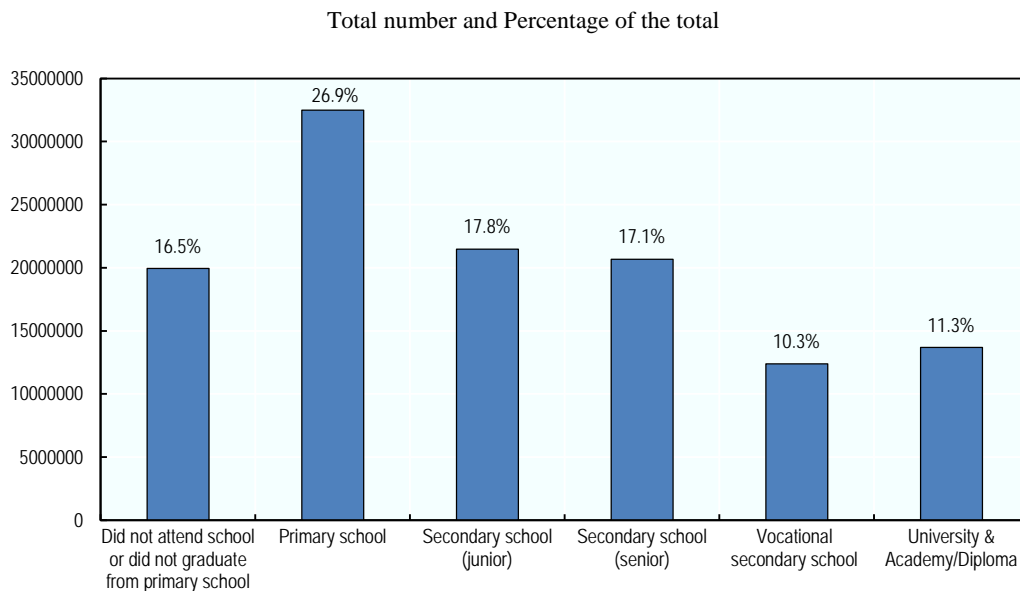
Figure 4: Annual GDP growth rates in Indonesia, OECD and dynamic Asian economies, 2007-2018



Notes: Gross domestic product in US dollars and constant exchange rates. Dynamic Asian Economies include Chinese Taipei, Hong Kong (China), Malaysia, the Philippines, Singapore, Thailand and Viet Nam.

Source: OECD Economic Outlook Database.

Figure 5: Indonesian workforce by educational attainment, 2016



Source: Central Bureau of Statistics (*Badan Pusat Statistik*), <https://www.bps.go.id>

Indonesia has made progress in the ease of doing business, but the licensing system remains complex

The OECD Product Market Regulation index shows that Indonesia is in line with key comparator countries on measures such as the level of barriers to entrepreneurship and to trade and investment. Indonesia performs better than Brazil, China and India on barriers to entrepreneurship, while it has a higher level of state control in the economy compared to other major emerging-market economies. Indonesia has also made significant progress in the World Bank's ease of doing business indicator, gaining 48 positions (from 120th to 72nd) between 2015 and 2018 thanks to a wide range of reforms in areas such as property registration and tax compliance. However, Indonesia's business license and permit system remains fairly complex and contributes to Indonesia's low position (144th) in the specific World Bank Doing Business indicator of "starting a business". The Indonesian government is currently developing an online single submission system to centralise licensing procedures from all levels of government in one single website which should facilitate the ease of starting a business.

A special tax regime has been introduced to reduce small business informality

Since 2013, Indonesia has operated a revenue-based tax regime for small businesses with annual revenues below IDR 4.8 billion, whereby small business owners are only asked to pay taxes corresponding to 0.5% of their monthly revenues. The aim of this special tax regime is to attract small informal businesses into the formal sector and to expand the national tax coverage. As of 2018, 1.5 million small enterprises had joined this regime, 1.2 million of which were individual companies.

A special micro-enterprise tax regime to reduce the size of the informal economy is common to other emerging-market economies with large informal sectors (e.g. Mexico). However, the revenue threshold for eligibility seems to be high in the case of Indonesia; this could be lowered, while additional benefits could be offered to participants in the regime such as access to book-keeping assistance and government support programmes.

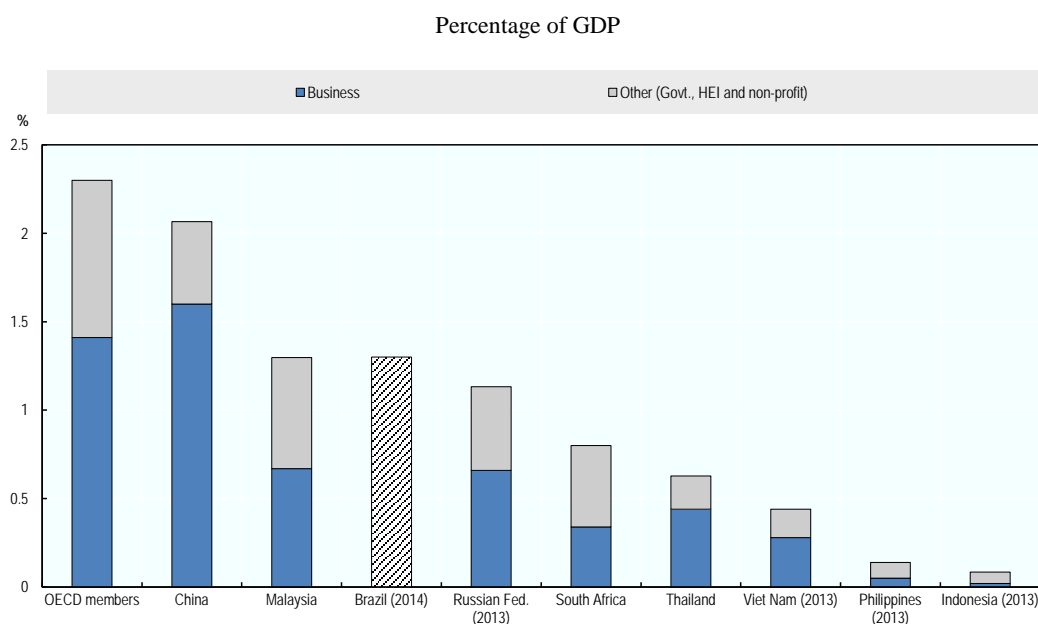
Important reforms have been introduced to strengthen SMEs' access to finance

In 2015, only 27.4% of Indonesian firms had a bank loan or a credit line and only 12.8% of business investment was financed by bank loans. The government has taken significant measures to increase access to finance for SMEs, the most important of which has been the requirement for all banks to allocate 20% of their business loans to SMEs. The 20% target seems reasonable based on the experience of OECD countries, although the government should monitor whether this policy together with others (e.g. the KUR Programme) leads to a higher rate of non-performing loans.

ICT adoption by SMEs is a government priority, but other aspects of the knowledge economy require further development

The Indonesian government has placed a strong emphasis on ICT development and ICT adoption at the firm level, notably by ramping up spending on broadband infrastructure and by implementing an E-commerce Roadmap that involves several ministries and government agencies. However, other aspects of the knowledge economy require further attention. R&D expenditure, in particular, accounts for only 0.08% of GDP in Indonesia, compared with an OECD average of 2.5%.

Figure 6: R&D expenditure across OECD and selected emerging market economies, 2016 or latest available year



Note: “Other” includes R&D expenditures by government, higher education institutions and non-profit organisations. Data for Indonesia, Viet Nam, South Africa and the Philippines refer to 2013; data for Brazil refer to 2014 and are not differentiated by source of investment. Data for Indonesia, Viet Nam, Malaysia, Thailand and the Philippines are from the World Bank World Development Indicators; data for OECD members, China, Russia, Brazil and South Africa are from the OECD Main Science and Technology Indicator (MSTI) Database.

Source: OECD Main Science and Technology Indicator (MSTI) Database and World Bank World Development Indicators.

Stronger FDI inflows could become a lever for SME development

Foreign Direct Investment (FDI) is a key lever for SME development, especially in emerging-market economies. Over the last ten years, FDI inflows as a share of GDP have not been as large in Indonesia as in some other BRICS and ASEAN economies. In this field, Indonesia shows stricter FDI regulatory restrictions than both the OECD average and the ASEAN-9 average, which is the result of a relatively long list of sectors that are either closed or only partly open to foreign investors. Indonesia’s negative investment list was simplified in 2016, but still remains relatively complex to navigate with six different investment categories. Indonesia’s main policies to attract FDI include tax breaks for foreign investments which have high value, are labour intensive or have high local content, as well as the recent creation of an “investment one-stop” online service that intends to reduce the time to process foreign investment applications. Tax breaks could also be designed to foster collaboration between foreign investors and SMEs.

The strategic framework and delivery system for SME and entrepreneurship policy

Law 20/2008 and the National Medium-Term Development Plan set a clear framework for national SME and entrepreneurship policy

SME development is a priority of the Indonesian government that is enshrined in Law 20/2008, also known as the Micro, Small and Medium Enterprise (MSME) Law. Law 20/2008 sets to strengthen the participation of SMEs in economic growth, job creation and poverty reduction, with the aim of making Indonesia an equitable economic democracy. The MSME Law also makes it clear that SME policy is not the prerogative of only one government ministry, and that it falls within the remit of both the national and subnational governments.

The national SME policy agenda is further detailed by the National Medium-Term Development Plan 2015-2019, which is the main planning document of the executive in office.

Policy emphasis on entrepreneurship has increased

The government's emphasis on entrepreneurship development has also recently increased. In 2017, the Ministry of Co-operatives and SMEs, in collaboration with other ministries and national stakeholders, prepared a Draft Law on National Entrepreneurship to foster social entrepreneurship, innovative entrepreneurship, entrepreneurship education and easier business licensing for micro and small enterprises. The Draft Law also refers to the future creation of an Inter-Ministerial National Entrepreneurship Task Force and to the preparation of a National Entrepreneurship Masterplan.

Several ministries are involved in SME and entrepreneurship policy

Given the central role of SMEs in national development strategies, many ministries are involved in SME policy. The Ministry of Co-operatives and SMEs has a mandate for SME policy co-ordination that is mentioned in Law 20/2008, but important co-ordinating roles are also played by the Ministry of National Development Planning-National Development Planning Agency (BAPPENAS) and the Co-ordinating Ministry for Economic Affairs. Nonetheless, there are not always strong synergies among SME support programmes on the ground, which has led on occasion to programme duplications and to some programmes lacking sufficient scale. For example, with respect to business incubators and business development services, there is scope for simplifying the current offer of programmes, including by integrating and merging similar programmes operated by different ministries.

The draft and implementation of a National SME and Entrepreneurship Strategy Document could help rationalise the offer of existing support measures and clarify existing policy objectives and policy targets.



National SME and entrepreneurship programmes

KUR is the largest SME programme in Indonesia

Kredit Usaha Rakyat (KUR, i.e. People's Business Credit) is the largest SME programme in Indonesia by budget. It is a microcredit programme which combines a loan guarantee with an interest rate subsidy that allows banks to lend to SMEs at a capped interest rate. Together with other policies (e.g. the 20% SME loan set-aside requested of commercial and state-owned banks), the KUR Programme has succeeded in increasing the credit flow to SMEs and is contributing to poverty alleviation and social inclusion through economic activity. However, there are also some concerns surrounding its high opportunity cost (i.e. some of the resources committed to this single large programme could be spent on other policy initiatives), the sustainability of the initiative (i.e. the cost has increased by ten times since the interest rate subsidy was added to the loan guarantee in 2015), the possible crowding out of unsubsidised lending, and potential misuse of programme-backed loans.

The government has a roadmap in place for the development of business incubators

Business incubation activity has not yet reached its full potential in Indonesia. Most incubators are small in scale (with 3-5 tenant enterprises) and do not offer a full range of services in the form of consulting, technical support, mentoring/coaching, and linkages to sources of finance for tenant enterprises. Furthermore, only 10-20% of incubated enterprises are estimated to graduate from the incubator and move on to become sustainable companies.

The government has launched the Roadmap for Incubator Development, 2014-2029, to increase the number of incubators and improve their performance. The Roadmap sets the target of reaching 732 incubators by 2029 from 75 in 2014. As part of the Roadmap, operating standards for business incubators and a certification programme for managers of incubators are being developed.

SME digitalisation is a priority of the national government

Only 18% of Indonesian SMEs are currently engaged in e-commerce through the use of a website or social media, and only 9% adopt more sophisticated e-commerce strategies. The national government is enacting an E-Commerce Roadmap to boost the use of e-commerce by SMEs. Three main programmes in the E-Commerce Roadmap, all of them operated by the Ministry of Communication and Informatics, are the SME Go Online Programme, the One Million id. Domain Programme, and the 1 000 Digital Start-up Programme. These programmes complement each other: the first two help SMEs to expand their markets by building an online presence, while the third encourages the development of digital start-ups. An important challenge facing these interventions will be not only to meet the ambitious targets they have set, but also to make sure that the outcomes they achieve are sustainable after the phase-out of government support and have a real impact on business growth.

SME internationalisation policies include both traditional and innovative approaches

Indonesia encourages business internationalisation through both traditional and innovative policies. Export financing services (i.e. credit, guarantees and insurance) are managed by Indonesia Eximbank, the national export financing agency. The Ministry of Trade, by contrast, supports business internationalisation through non-financial services, such as market information, product development, export information and export training. The Ministry of State-Owned Enterprises (SOEs) also encourages small business internationalisation through an innovative programme (i.e. Business Aggregator Programme) by which SOEs act as trading houses for small enterprises which want to export but find it difficult to deal with export regulations and documentation. One complementary strategy could consist in supporting export-oriented consortia or co-operatives through which small enterprises can learn to cope with the export process in a collective and direct manner.

Corporate social responsibility is encouraged as a tool for SME development

Support for social entrepreneurship is still limited in Indonesia, but corporate social responsibility is commonly used to encourage SME development. For example, through the Partnership Programme with Small Business (PKBL), state-owned enterprises (SOEs) are asked to reserve 4% of their net profit after tax for programmes fostering small business development and community development. This can include small business loans for equipment and working capital or grants to participate in productivity-enhancing activities (training, coaching, etc.).

There is dedicated support for women entrepreneurs

There are multiple government programmes for women entrepreneurship, including vocational training, technical assistance and microloans. However, most of these programmes are small in scale and primarily targeted at self-employed and micro-enterprises. Conversely, there is little support for larger and growth-oriented women-owned businesses, although one notable exception is access to public procurement.

SMEs are recognised in public procurement policies

Access by SMEs to government contracts is promoted through a regulation that mandates government ministries and agencies to allocate small working packages of up to IDR 2.5 billion to SMEs. In 2017, 97.5% of procurement contracts were granted to micro and small enterprises, accounting for 28.3% of total public procurement value.

The local dimension of SME and entrepreneurship policy

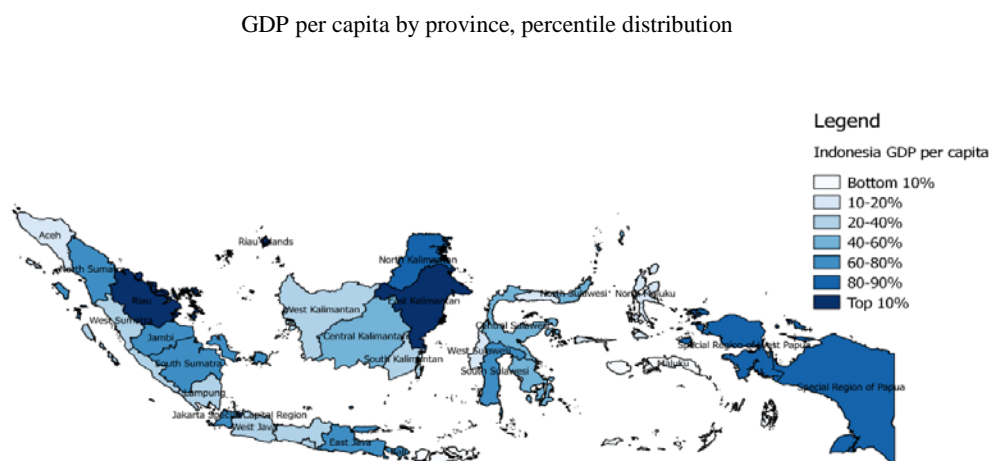
There is strong heterogeneity in socio-economic conditions across Indonesian provinces

As many as 17 500 islands comprise the archipelago of Indonesia, about 1 000 of which are inhabited by a population of 261 million. Over half of the Indonesian population live on the island of Java, which also hosts the capital city Jakarta. There is strong heterogeneity across Indonesian provinces in terms of population density, GDP per capita and industry structure. Variations in local GDP per capita are primarily the result of geography and natural resource endowments, with the richest provinces found on the island of Java and in resource-rich places such as East Kalimantan (oil and gas), Papua (copper and gold) and Riau (palm oil), and the poorest provinces mostly located in remote southern and eastern islands of the archipelago.

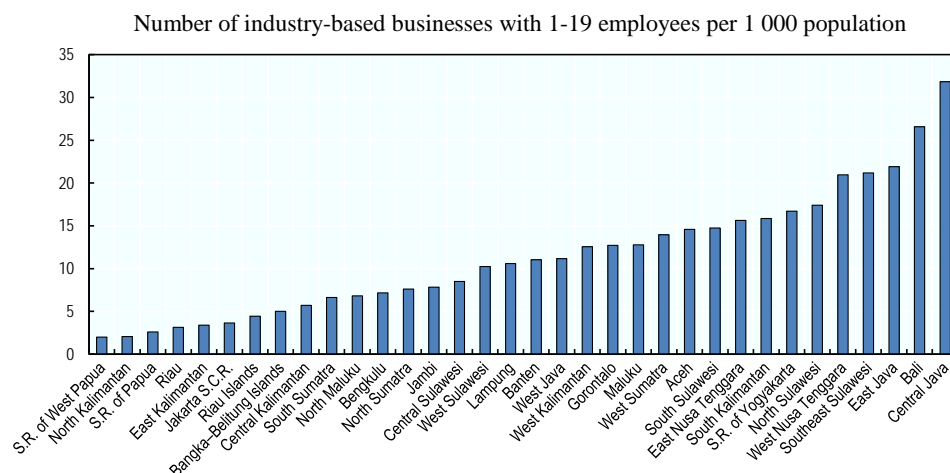
Local economic conditions (e.g. the presence of natural resources and large employers, the size of the informal sector, etc.) affect business density (i.e. the number of enterprises per thousand people) at the local level. Densely populated areas such as Central Java, Bali and East Java have comparatively high business-to-population ratios, while the lowest ratios are found in the Special Region of West Papua, Papua, North and East Kalimantan.

There are also notable local differences in the ease of doing business. The sub-national World Bank Doing Business Survey finds significant variations across Indonesian cities with respect to the burden of business regulations. Similarly, the Indonesia Governance Index reveals high heterogeneity in the quality of local government.

Figure 7: GDP per capita across Indonesian provinces, 2015



Source: OECD based on Central Bureau of Statistics.

Figure 8: Regional variations in industry small business density, 2015

Notes: S.R. stands for Special Region, S.C.R. for Special Capital Region.

Source: OECD calculations based on Central Bureau of Statistics, “Micro and Small Manufacturing Industry Survey” and Population Statistics.

An extensive devolution process has contributed to variations in the quality of the local business environment

Regional variations in the ease of doing business are, in part, the result of the extensive and rapid devolution process which the Indonesian government undertook in the early 2000s and which has led to strong differences in local business regulations and licensing regimes.

Variations in the quality of the local business environment could be widened by Law 23/2014 on the role of local governments, which assigns responsibility for supporting firms of different sizes to different tiers of government. The national government is mandated to support co-operatives and medium-sized firms, as well as training for all firm size classes; provincial governments are responsible for developing policies for small enterprises; and cities and regencies are responsible for supporting micro-enterprises. Such neat distinctions of responsibilities are not easily enforceable and are likely to cause confusion among both policy makers and entrepreneurs. Furthermore, if fully implemented, this provision could increase regional disparities to the extent that richer provinces and cities will have more resources to support their own micro and small enterprises.

Local financial resources and institutional capacity for policy design and implementation are uneven

Although local governments have a high degree of autonomy, lack of financial resources constrains the ability of many subnational governments to finance adequate policies for SMEs and entrepreneurs, especially at the city and district levels. In addition to lacking resources, local governments may lack the capacity to analyse the local situation and develop appropriate policy responses, particularly in less developed regions. This means that the range of SME and entrepreneurship policy support is somewhat narrow in some places; for example, there are very few local programmes that encourage productivity growth at the firm level.

National SME programmes are generally well-tailored to local conditions, but effective policy co-ordination is difficult

National programmes for SMEs and entrepreneurs are generally well tailored to local conditions, which is also a result of the decentralised governance system of Indonesia. Several ministries use local tailoring of national SME programmes as a means to focus policy support on local priority areas. The One Village, One Product Programme, for example, provides support for the development of a product that is unique to its local area. However, national-local co-ordination in SME policy is complicated by the large number of national ministries and subnational governments involved in SME policy and by uneven policy capacity at the local level.



Business development services (BDS)

Many SMEs are still unaware of existing BDS institutions and programmes

Most SMEs are unaware of existing BDS programmes and, even when they are aware, find it difficult to obtain information on how to participate. Data from the Indonesian Central Bureau of Statistics (BPS) show that over 95% of small industry-based businesses (1-19 people employed) have never received business advisory services, and that the main reason for this is lack of awareness. These figures suggest the importance of promoting increased opportunities for access to BDS, including by consolidating the existing offer of programmes, creating a clear and visible entry point into the national BDS system, and extending the outreach of BDS nationwide.

The Integrated Business Services Centres have been established to improve the standardisation and accessibility of BDS nationwide

BDS provision sees the concurrent presence of different national ministries offering similar services and support activities to SMEs. In 2013, with the aim of improving the standardisation, co-ordination and accessibility of BDS nationwide, the Ministry of Co-operatives and SMEs launched the Integrated Business Services Centres for Co-operatives and SMEs (PLUT-KUMKM Centres). These centres intend to provide a more standardised level of services in areas such as management advice, assistance with legal affairs, marketing and adoption of digital technology. As of mid-2017, 51 PLUT-KUMKM Centres were active in different locations across Indonesia.

The PLUT-KUMKM Centres build on a close collaboration between the Ministry of Co-operatives and SMEs, provincial governments and, in some cases, local authorities (regencies and cities). The Ministry has issued technical guidelines on the design, organisational structure and technical responsibilities of the centres to ensure homogeneity in services delivery across

the country. On the other hand, local governments are asked to provide the premises of the centres and to assume full responsibility for the management of the centres after the first three years of central government support.

There is scope for building synergies between the Integrated Business Services Centres and other government institutions providing BDS

The objective of the government is to have 200 PLUT-KUMKM Centres by the end of 2019. However, given the large number of government institutions involved in BDS, there is scope for building stronger synergies between the PLUT-KUMKM Centres and other similar government programmes, including through mergers as appropriate. The development of rural and remote areas would also profit from mobile BDS centres, which could operate out of the PLUT-KUMKM Centres in collaboration with the Ministry of Villages, Disadvantaged Regions and Transmigration. Mobile units could provide regularly scheduled visits to peripheral areas to provide initial advice and information to aspiring and existing entrepreneurs.

A national competency standard to certify BDS providers has been developed

In an attempt to ensure good quality services, the Ministry of Co-operatives and SMEs has developed, together with the Association of Business Development Services Indonesia (ABDSI), a national competency standard and curriculum for certifying BDS providers. This will be complemented by a national training programme for future business advisors and coaches, which is currently under development. An essential component for the management of the certification programme will be the establishment of a national certification body.

The development of an online diagnostic tool could help better assess the advisory and training needs of SMEs

To be able to deliver the most appropriate training for small enterprises, the Indonesian government could develop a diagnostic tool to help SMEs to assess their current strengths and weaknesses and business advisors to identify the areas in greatest need of improvement at the firm level. Adopting such a diagnostic service would allow the PLUT-KUMKM Centres to better tailor programme assistance to individual needs, including referrals to consultancy advice and technical assistance in areas not covered by the range of services of the centres. This effort should be complemented by the mapping of government support available at the national and local levels and by the publication of such information in an online portal accessible to the PLUT-KUMKM staff.

Main policy recommendations

- Improve data collection on SMEs by adopting and using more frequently an employment-based SME definition to allow better international comparison of the structure and performance of the SME sector between Indonesia and OECD countries.
- Develop and implement an SME Strategy that outlines the main SME policy objectives, targets and support measures and that defines roles and responsibilities of implementing ministries and agencies.
- Explore opportunities for integrating and merging programmes offering similar services with a view to streamlining the national SME policy offer. For example, with respect to business development services, consider merging some of the existing initiatives under the framework of the new Integrated Business Services Centres for Co-operatives and SMEs (PLUT-KUMKM Centres).
- Increase spending on programmes that aim to improve SME productivity (e.g. innovation, internationalisation, managerial and workforce skills) by augmenting the overall SME policy budget or, alternatively, by transferring some of the existing resources from other more socially-driven programmes.
- Consider increasing the focus of the KUR Programme on certain target groups of disadvantaged borrowers, such as first-time borrowers, enterprises in lagging regions, and sectors experiencing more constrained access to finance.
- Monitor the implementation of SME loan set-asides in commercial banks and other access to finance policies (e.g. KUR Programme) to ensure that they do not result in an increase of non-performing loans and/or in reduced competition in the banking sector.
- Ensure that incubators are well integrated into the local entrepreneurial ecosystem by building relationships with external business support service providers, universities, research organisations and sources of equity finance.
- Consider the launch of a new policy that fosters the adoption of digital technologies in SMEs beyond e-commerce, notably the use of software programmes supporting the professionalisation of small business management.
- Strengthen existing programmes to improve the participation of Indonesian SMEs in global value chains, including by facilitating co-operation between multinationals and local SMEs via targeted tax incentives (e.g. for companies which invest in the upgrading of local suppliers through training, mentoring or staff secondment).
- Consider amending Law 23/2014 where it assigns responsibility for the development of specific business size classes to specific levels of government (micro-enterprises to regencies/cities, small enterprises to provinces, and medium-sized enterprises to the national government); this provision is difficult to implement and risks widening the development divide between more and less prosperous regions.

This booklet summarises the key findings of OECD (2018), SME and Entrepreneurship Policy in Indonesia 2018, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris.

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