

1. Overall assessment and recommendations

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 which 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.

Indonesian data on SMEs are affected by a large informal economy: about 70% of national employment and more than 90% of total businesses enterprises are estimated to be informal. Widespread informality reduces the average size and performance of Indonesian SMEs, since informal enterprises need to operate under the radar of public authorities and are reluctant to engage in long-term investments.

Given that larger SMEs tend to have higher productivity levels, the Indonesian government should encourage the ongoing consolidation process and help domestic SMEs to further scale up, including through product and labour market regulatory reforms which can favour business formalisation and enterprise productivity growth.

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.

Export activity is driven by large companies

Export activity is mostly driven by the large corporate sector in Indonesia. This has become increasingly the case in recent years. Between 2006 and 2013, the share of medium-sized enterprises in total exports (excluding oil and gas) declined from 12.2% to 11.5%, the share of small enterprises from 4% to 2.8%, and the share of micro-enterprises from 1.7% to 1.4%. Survey data from the World Bank also indicate that Indonesian SMEs are less integrated into global markets, either through direct exports or as suppliers of exporters, than those of Cambodia, Malaysia and Vietnam, but more integrated than those of Myanmar, the Philippines and Thailand in the ASEAN region.

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 (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. Low R&D investments are also reflected in innovation outcomes: only 5% of small enterprises (5-19 employees) and 9.7% of medium-sized enterprises (20-99 employees) have introduced a new product and/or service in Indonesia in the last three years. The large informal sector of Indonesia is likely to drag down business investment activity, both in the form of tangible and intangible assets.

Entrepreneurship culture is healthy and business ownership is widespread

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 (i.e. the proportion of people perceiving good opportunities in the local market who indicate that fear of failure would prevent them from seizing such an opportunity) 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.

On the other hand, business ownership is widespread and is a contributing factor to the average small size of Indonesian SMEs. Women represent about 37% of total self-employed people; however, only 6% of them are employers with permanent paid workers, compared with 12% of the male self-employed.

Recommendations on SME and entrepreneurship characteristics and performance

- Design a wide range of productivity-enhancing policies which encompass targeted approaches aimed at upgrading workforce skills, managerial skills and business innovation in SMEs, as well as business-friendly product and labour market regulations such as further ease of business licensing procedures and less strict but better-enforced labour market regulations.
- Encourage further consolidation in the SME sector through the development of co-operatives and business consortia, and through a network approach to SME policy in which programmes are delivered to groups of companies rather than to individual companies.
- Consider the launch of a campaign to strengthen entrepreneurial attitudes in the Indonesian adult and youth population. This could include initiatives to raise awareness about social and growth-oriented entrepreneurship and to improve the quality of entrepreneurship training, entrepreneurship education and business incubation.
- Improve data collection on SMEs by adopting and using more frequently an employment-based definition to allow better international comparison between Indonesia and OECD countries with respect to the structure and performance of the SME sector.
- Renew the partnership between the Ministry of Co-operatives and SMEs and the Central Bureau of Statistics which had allowed annual SME data collection until 2015.

The business environment for SMEs and entrepreneurship

Macroeconomic conditions are healthy

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. However, the development of a strong manufacturing sector able to tap into global value chains has been hindered by Indonesia's strong dependence on imported raw materials and, more recently, by the depreciation of the Indonesian rupiah against the US dollar.

Labour market conditions could be improved

Indonesia's main employment indicators (employment rate, unemployment rate and labour market participation rate) are similar to the OECD averages, but domestic 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. Furthermore, Indonesian employers consider 20% of new hires with vocational education and training (VET) qualifications to

be of poor quality and claim they would hire more workers if they could find those with the right skills.

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. This is a positive development that will help simplify the business licensing process, although it typically takes some time to make such websites fully operational and commonly used by the intended beneficiaries.

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, which implies the risk of exempting large numbers of small companies from paying more significant taxes and of further hollowing out Indonesia's narrow tax base. The revenue threshold of this special tax regime 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 fully comparable statistics on small business loans are not available. Nonetheless, given the existence of other major measures to foster SME lending in Indonesia, such as the People's Business Credit Programme (*Kredit Usaha Rakyat*, KUR), the government should monitor whether these policies lead to a higher rate of non-performing loans. The Indonesian government has also encouraged access to loan finance for SMEs through

other policies such as the development of credit bureaus, collateral registries and financial education.

The government is also actively supporting the development of alternative sources of finance for SMEs. It has taken regulatory measures to facilitate peer-to-peer lending for small businesses, has simplified procedures for SMEs to make initial public offerings (IPOs), and has introduced financial incentives for private equity investors. Nonetheless, the number of investment ready SMEs is still limited, which reins in the impact of these policies.

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%. While a number of government documents acknowledge the importance of building a stronger national innovation system, frequent innovation policies such as competitive grants and R&D tax breaks are not common in Indonesia. Increased R&D activity would reinforce opportunities for innovative entrepreneurship and SME innovation and would contribute to productivity growth.

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. 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.

Trade openness in the services sector is also important to attract FDI. The OECD Service Trade Restrictiveness Index (STRI) shows that, in all 22 sectors considered, Indonesia exceeds the average restrictiveness of the 44 countries (37 OECD countries plus 7, including the 5 BRICS) covered by the index.

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.

Recommendations on the business environment for SMEs and entrepreneurship

- Simplify regulatory protection in the labour market with the aim to reduce the size of the informal sector and to favour the scale-up of existing businesses. Possible pilot measures could include simpler procedures and circumstances for individual dismissals, the replacement of the high severance pay with a form of government-backed unemployment insurance and quarterly payments (instead of monthly payments) of social contributions for small firms.
- Improve literacy and numeracy skills in the labour force, a precondition for on-the-job training and skills development, by increasing participation rates in secondary and tertiary education and by strengthening efficiency in public spending on education (e.g. through an improvement in teacher competencies).
- Reform the existing VET system by strengthening dialogue and collaboration between private-sector companies and schools in VET provision and by increasing the proportion of teachers who also have an industry, rather than only academic, background.
- Move forward with current plans to integrate (across levels of government) and digitalise the national business license and permit system, drawing inspiration from consolidated international good practices in this field.
- Lower the income threshold (currently set at IDR 4.8 billion) to which the special 0.5% turnover-based business tax rate currently applies to better target micro-enterprises. Consider combining this tax measure with additional support in terms of access to book-keeping assistance and to government support programmes for enterprises that join this tax regime.
- Improve tax collection by investing in the tax administration system, particularly staff, electronic services and databases; using technology to strengthen monitoring and detect non-compliance, including through the use of risk-based assessments for conducting tax audits; and building capacity at the subnational level through training.
- Monitor the implementation of SME loan set-asides in commercial banks to ensure that they do not result in a rise in non-performing loans and/or in reduced competition in the banking sector.
- Apply international good-practice principles to the work of public and private credit bureaus and consider extending collateral registries to moveable assets (beyond fixed assets) to reduce information asymmetries in credit markets and boost SME lending.
- Strengthen junior equity markets through the scale-up of existing investment readiness programmes for medium-sized firms and growth-oriented SMEs.
- Strengthen R&D tax credits to encourage more R&D spending in SMEs while paying attention to the design and implementation of this policy to ensure that it is not abused, for example carefully considering which eligible costs to include.
- Continue to support the development of broadband infrastructure, making sure that it reaches not only government offices but also private-sector premises, including SMEs.
- Simplify the current FDI negative investment list by reducing the number of investment categories and opening up more sectors to foreign direct investment.

- Open up more domestic services sectors to international trade with a view to attracting more FDI and improving Indonesia's performance in the OECD Service Trade Restrictiveness Index (STRI).
- Develop stronger FDI-SME relationships, including through tax incentives for multinational companies that invest in the upgrading of local suppliers through training, mentoring or staff secondment.

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. This law covers different policy areas relevant to SME and entrepreneurship development, including access to finance, business information, business support infrastructure and business licensing. 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. The Plan includes national targets to increase the contribution of SMEs to the economy and sets five main SME development priorities: improving human resource quality; enhancing access to finance; increasing the value added of SME products and their international presence; strengthening partnerships and networks; and improving rules and regulations affecting the life of SMEs.

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, including sector-focused ministries such as industry, agriculture, fisheries, tourism, and communication and informatics. 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. BAPPENAS, through the Medium-Term

Development Plan, sets out five-year development priorities and targets that also affect SMEs, while the Co-ordinating Ministry for Economic Affairs prepares “SME Policy Packages” for the relevant ministries and agencies. Despite these co-ordination mechanisms, 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.

Many countries have an Inter-Ministerial SME and Entrepreneurship Policy Committee to improve cross-government policy co-ordination. The Draft Law on National Entrepreneurship includes provisions for the creation of a National Entrepreneurship Task Force, which could perform this role if its mandate were to include SME development. One of the first tasks of the Task Force could be the preparation of a National SME and Entrepreneurship Strategy Document to rationalise the offer of existing support measures and clarify existing policy objectives and policy targets. This could build on the existing plan for a National Entrepreneurship Masterplan.

A policy portfolio analysis could help steer decisions about the best SME policy mix

An SME policy portfolio consists of an analysis of the distribution of government spending by main policy area (e.g. access to finance, export development, entrepreneurship training, etc.) and main target population (e.g. potential entrepreneurs, new start-ups, existing SMEs, etc.). This approach involves mapping all SME policy measures across ministries and agencies, assigning programmes to a specific policy category and main target group, and attaching budgets to each policy measure. An SME policy portfolio analysis can help identify policy gaps or duplications across ministries and agencies and determine the extent to which the policy mix corresponds to the government’s overall strategic objectives and to the perceived needs of businesses.

A full policy portfolio analysis is hindered in Indonesia by two main factors. First, a large number of ministries and agencies are in charge of SME programmes. Second, there is currently no co-ordinating mechanism to detail total spending allocation by programme activity and category. Based on a simple and preliminary assessment of budget figures from existing programmes, a portfolio analysis could, for example, reveal large government spending on the KUR Programme (i.e. *Kredit Usaha Rakyat*, or People’s Business Credit Programme), which favours access to finance for micro and small companies, and relatively little spending on programmes to enhance SME productivity, for example through increased R&D and innovation.

There is scope for streamlining the policy offer in certain programme areas

There are some policy areas, such as business incubators and business development services, where a large number of ministries and agencies are concurrently active. In such cases, there is scope for simplifying the current offer of programmes, including by integrating and merging similar policy initiatives operated by different ministries.

In addition, access to information on the range of programmes could be improved by creating a unified online business portal for entrepreneurs and SMEs. This could present information on available programmes by type, stage of development, delivering organisation, and location. Many Indonesian small business owners are, in fact, unaware of existing support programmes and, even when they are aware, find it difficult to use them.

Recommendations on the strategic framework and delivery system for SME and entrepreneurship policy

- Prepare an SME Strategy document that outlines the main SME policy objectives, targets and support measures and that defines roles and responsibilities of implementing ministries and agencies.
- Establish an Inter-Ministerial State Council on SME Policy to strengthen cross-government co-ordination on SME policy. The newly created National Entrepreneurship Task Force could play this role if its mandate were extended to encompass existing SMEs and not only new entrepreneurs and start-ups.
- Adopt an SME policy portfolio approach to better assess whether spending on SMEs adequately reflects government priorities and the perceived needs of SMEs.
- Explore opportunities for integrating and merging programmes offering similar services with the aim to rationalise the national SME policy offer.
- Create a national web portal and mobile phone application to collate and display business regulations and SME assistance programmes in an accessible way for small business owners and entrepreneurs.

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. Several institutions are involved in the implementation of the KUR Programme (Ministry of Finance, Bank Indonesia, Ministry of Co-operatives and SMEs), which also falls under the responsibility of the National Task Force for the Acceleration of Poverty Reduction.

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.

There are also smaller-scale access to credit programmes

There are also smaller-scale programmes which promote access to credit for SMEs and entrepreneurs. The Ministry of Finance has recently launched a microcredit programme for firms that are too small to qualify for the KUR Programme. The Revolving Fund Management Agency offers credit to co-operatives, SMEs and to financial intermediaries for SME lending. Although the agency has five local branch offices, loan decisions are centralised at the headquarters in Jakarta, which is likely to contribute to an over-

representation of the island of Java in the distribution of loans. The Beginner Entrepreneur Programme provides loans for new entrepreneurs. This programme has experienced significant budget fluctuations over the years, but has only reached an annual average of 2 000 beneficiaries.

Equity investment in SMEs could be further encouraged

Equity investment in SMEs is still at an early stage of development in Indonesia. The Indonesia Stock Exchange (IDX) operates a Development Board which has less strict listing requirements for small companies with net tangible assets of less than IDR 100 billion. However, there have been few offerings to date on this board (only seven between 2003 and 2015), making trading on this platform very thin. IDX is in the process of launching a third board – the Acceleration Board – which will have even less strict listing requirements than the Development Board and will be mostly aimed at young start-ups.

In 2017 there were 61 licensed venture capital firms operating in Indonesia, but the size of aggregate investments by venture capital firms in the country is still modest. Out of USD 90 billion in venture capital investments across Asia in 2016, only 1.29 billion (2%) were made in Indonesia. As of 2017, Indonesia did not have a large government programme (e.g. government-sponsored venture capital funds or funds of funds) in place to develop the domestic venture capital sector, although a strong government intervention has often proven important in other countries to kick-start the domestic venture capital industry.

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 assigns responsibility for incubator development to 17 different ministries and agencies and sets the target of reaching 732 incubators by 2029 from 75 in 2014. These growth projections are based on the assumption that the current plan to build 100 science and technology parks unfolds as envisaged. 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, which also delivers targeted training for new exporters. Indonesia Eximbank also operates the KURBE Programme (*Kredit Usaha Rakyat Berorientasi Ekspor*, i.e. Export-Oriented People's Business Credit), a spin-off of the KUR Programme mostly aimed at suppliers of large exporters and large employer companies. 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. This is a good initiative that helps small businesses to export by passing the export-related regulatory burden on to SOEs. One downside, however, is that this approach prevents small companies from gaining first-hand experience in the export process. One complementary government 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.

Workforce training in SMEs is still relatively sporadic

The main government institution in the field of workforce training is the Ministry of Manpower and Transmigration, which operates 22 SME Productivity Centres that deliver technical training to improve the productivity of SME workforces. Nonetheless, workforce training in SMEs remains sporadic: only about 5% of Indonesian firms offer formal training to their workers.

Many ministries deliver entrepreneurship and management training

More than 100 entrepreneurship and management training programmes are conducted annually by various ministries and government agencies in Indonesia, although the effectiveness and outcomes of these programmes is often not measured. Many of these training programmes are undertaken in collaboration with chambers of commerce and business associations. One example is the National Entrepreneurship Movement, which is operated by the Ministry of Co-operatives and SMEs and which supports 1 000 nascent entrepreneurs every year through a range of skills development activities, including peer learning from successful entrepreneurs.

The government is actively supporting entrepreneurship education in universities

Indonesia is well advanced in the field of entrepreneurship education in higher education thanks to several learning opportunities offered by the Ministry of Research, Technology

and Higher Education and the Ministry of Education and Culture. The Ministry of Research, Technology and Higher Education supports Entrepreneurship Campus Centres (*Pusat Kewirausahaan Kampus*), which offer advisory services, mentoring and lectures to encourage student entrepreneurship, and the Student Entrepreneurial Programme (*Programme Mahasiswa Wirausaha*), which offers funding to students who develop a business plan for the commercialisation of an innovative product. The Ministry of Education and Culture has developed the Entrepreneurship Lecture Programme, which nurtures entrepreneurial attitudes among students, and the Business Lecture Programme, a practical course that helps students to apply their learning to solve a social problem in a local community.

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 and young 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. The Indonesia Procurement Modernisation Project, *inter alia*, seeks to better integrate women-owned businesses into public procurement through the hire of more female procurement officers and the organisation of workshops to educate local procurement officers on gender-sensitive procurement and to train women entrepreneurs on bidding for government contracts.

The Ministry of Youth and Sport operates two main youth entrepreneurship programmes. The Young Beginner Entrepreneur Programme (*Wirausaha Muda Pemula*) offers grants to young entrepreneurs who have run a business for less than three years to purchase new equipment, participate in training courses or improve the production process. The Youth Entrepreneurship Centres (*Sentra Kewirausahaan Pemuda*) are established locally with support from the central government to provide training, mentoring and networking opportunities for young entrepreneurs.

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. The government also gives preferential treatment to micro and small enterprises in terms of the percentage of the contract that can be paid in advance (30% versus 20%) and hosts an online SME vendor directory at the National Procurement Agency. These initiatives facilitate the participation of SMEs in public procurement: in 2017, 97.5% of procurement contracts were granted to micro and small enterprises, accounting for 28.3% of total public procurement value.

Recommendations on national SME and entrepreneurship programmes

- 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.

Financing 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 possible misuse of the KUR Programme as well as the rate of KUR-backed non-performing loans.
- Consider decentralising the loan evaluation process in the LPDB Agency's Revolving Fund Programme, with the aim of improving capital allocation efficiency and favouring better geographical representation in the programme.
- Support the growth of the domestic venture capital industry through the establishment of a government venture capital fund and investment readiness programmes for growth-oriented SMEs.

Innovation programmes

- Reduce the number of ministries involved in the development of business incubators with the aim of simplifying the co-ordination of the National Roadmap for Incubator Development and increasing the size of existing incubators.
- 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.
- Open up university-based business incubators to applicants outside of the university hosting the incubator with the aim of making the selection process more competitive and improving the quality of tenant companies.
- Consider shifting the focus of the Indonesia Stock Exchange incubator from start-ups to existing high-growth firms, as the latter are typically closer to the stage of an initial public offering (IPO), which is one of the aims of the programme.
- Ensure that the location of science and technology parks is mostly driven by economic considerations, including the presence of a local base of innovative firms and knowledge-based workers.
- Support business accelerators, whose focus is on scaling up existing growth-oriented SMEs.
- Ensure that the targets of digitalisation support measures, such as the One Million id. Domain Programme, are not only met, but are also sustainable after government support comes to an end, and that they generate a real economic impact (e.g. in terms of increased revenues, profits and export at the firm level).

- Consider the development of a new intervention which fosters the adoption of digital technologies in SMEs beyond e-commerce, notably the use of hardware and software programmes supporting the professionalization of small business management.

Internationalisation programmes

- Increase budgetary resources for business internationalisation, including training measures to improve the export-related skills of SMEs and programmes such as export-oriented consortia or co-operatives that enable SMEs to gain direct exposure to export activity.
- Improve the involvement of SMEs in the KURBE Programme (i.e. the Export Oriented People's Business Credit Programme), for example by targeting not only Tier-I but also Tier-II suppliers of large exporters or SMEs which have the potential to become Tier-I suppliers.
- Strengthen existing programmes to improve the participation of Indonesian SMEs in global value chains, including by facilitating co-operation between multinationals and local SMEs.

Entrepreneurship and management training

- Initiate an evaluation of the main entrepreneurship and management training programmes with a view to assessing the outcomes (e.g. rate of business start-ups by trained participants) and identifying best-practice approaches and curricula.
- Expand the Youth Entrepreneurship Apprenticeship Programme to benefit a larger number of apprentices and SMEs. Ensure that businesses offering internships within this programme focus on the learning process of students and possibly on creating employment opportunities for them.

Entrepreneurship education

- Establish a National Commission on Entrepreneurship and Education, represented by relevant ministries and all levels of the education system, to review the entrepreneurship-related curriculum and learning outcomes at each educational level and to ensure a building-block approach (path) to the progression of entrepreneurial attitudes and competencies across the different levels of education.
- Allocate resources to the capacity building and professional development of teachers in the primary and secondary education systems to improve their competencies and abilities in the teaching of entrepreneurship content.

Social entrepreneurship and corporate social responsibility

- Establish government support for the development of social entrepreneurship and social enterprises in the form of dedicated capacity-building actions and access to finance.
- Develop a clear definition of social entrepreneurship and social enterprise in order to substantiate eligibility for government support programmes.

Programmes for specific target groups

- Consider increasing the size of the grant in the Young Beginner Entrepreneur Programme (and as a result the overall budget) to foster the creation of employer enterprises. Consider making job creation one of the requisites of the programme.
- Give stronger attention to supporting growth-oriented women-owned enterprises through appropriate programmes providing mentoring, training and access to domestic and international markets.
- Consider establishing goals or legal set-asides in terms of the proportion of procurement contracts to be awarded to women-owned businesses, whose definition and eligibility requirements should be set by the law.

Public procurement

- Strengthen SME access to public procurement through enhanced information on existing government contract opportunities and through targeted training to increase the ability of SMEs to bid for government contracts.

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.

The ease of doing business and the way of financing business also vary widely across the country

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.

The way local businesses finance their operations also changes by province: bank loans are the main source of loans for 65% of industry-based small enterprises (1-19 people employed) in the Special Region of West Papua, but for only 7% in the province of

Banten in West Java. Loans from co-operatives are mostly used in more remote provinces such as North Maluku and East Nusa Tenggara.

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 further 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 and entrepreneurship programmes are generally well-tailored to local conditions

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. Clear local tailoring is also evident in programmes for specific groups such as women and youth, for sectors and key products (e.g. food, furniture, garments), and for geographical areas, such as lagging and border regions.

National-local policy co-ordination mechanisms are flexible but struggle with the large number of institutions involved

National-local policy co-ordination mechanisms mostly stem from the national strategic plans (long-term, medium-term, and annual) which are prepared by BAPPENAS and

reflect priorities set out at the Presidential level. The local governments at province, regency and city, and district levels each have medium-term development plans that are used to adapt national plans to local conditions. In addition, elected local governors can introduce their own policy priorities in local development plans. Despite such flexible arrangements, national-local co-ordination in SME policy is complicated by the large number of national ministries and subnational entities involved in SME and entrepreneurship policy and by uneven policy capacity at the local level.

Policy recommendations on the local dimension of SME and entrepreneurship policy

- Build capacity among local policy makers to develop local SME and entrepreneurship policies, including through information and awareness raising, training and guidance material, and mentoring and peer learning networks between stronger and weaker local governments.
- Encourage local-level reviews of the range of SME programmes in place to ensure an appropriate policy mix, which should also include programmes aimed at upgrading SME productivity through the use of new technologies, workforce training and/or managerial skills upgrading.
- Match quantity with quality targets for SME and entrepreneurship policy outcomes at the local level. This will require changing targets from focusing solely on the total numbers of SMEs and entrepreneurs created and/or sustained to a wider focus on their quality in relation to indicators such as value added, wage levels and employment.
- 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 or cities, small enterprises to provinces, and medium-sized enterprises to the national level) since this is a source of complexity and risks widening the development divide between more and less prosperous regions.
- Further streamline business regulation procedures and limit the negative impact of administrative fragmentation caused by the increase in the number of local government units.
- Develop and enhance mechanisms to improve co-ordination between government institutions at national and local levels, and among local governments, through more regular co-ordination meetings and policy dialogue on SME and entrepreneurship policies.
- Strengthen policy monitoring and evaluation systems and better align national and local-level monitoring and evaluation approaches and activities.

Business development services (BDS)

Many SMEs are still unaware of existing BDS institutions and programmes

Despite the presence of many government institutions involved in BDS provision, 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 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.

Many national ministries are currently engaged in the provision of BDS

A number of ministries are involved in the provision of BDS in Indonesia, such as the Ministry of Trade, the Ministry of Industry, the Ministry of State-Owned Enterprises (SOEs) and the Ministry of Co-operatives and SMEs. The Ministry of Trade started the “SME Business Clinics” model in 2006 to provide free training and advisory services to SMEs, although this BDS model has now been mostly decentralised to local governments and universities. The Ministry of Industry operates a network of 40 Small and Medium Industry (SMI) Technical Services Units through approximately 500 technology extension workers who reach out to local SMEs to offer free technical assistance in areas mostly related to product development. The same ministry operates the SMI *Sentra* Programme, where *sentras* are groups of at least five industry-based SMEs which share similar raw material needs, production processes or end products, and which come together to receive technical assistance. The Ministry of SOEs has more recently launched the so-called “Creative Houses”, a corporate social responsibility policy to provide SMEs with technical guidance and assistance in product development, access to finance and marketing. In addition, there are about 1 000 independent BDS providers across Indonesia, some of whom are represented by the Association of Business Development Services Indonesia (ABDSI).

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 institutions providing similar services

The objective of the government is to have 200 PLUT-KUMKM Centres by the end of 2019, which is a relatively moderate target given the population size and geographical expanse of Indonesia. At the same time, the large number of government institutions involved in BDS suggests that 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. In order to serve the needs of SMEs and entrepreneurs in more remote districts, 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 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.

Recommendations on the national business development services (BDS) system

- Improve the take-up of BDS among SMEs by raising local awareness about the existence of such services and by ensuring that BDS are available across the whole country.
- Consolidate the offer of BDS in Indonesia through the integration, co-location and merger of some of the existing government-backed BDS programmes into the new PLUT-KUMKM Centres.
- Develop mobile business development services centres operating out of the PLUT-KUMKM centres to serve the needs of SMEs and entrepreneurs in more remote districts.
- Fully implement the national competency standard for business advisors through the development of a national training programme and the establishment of a certification body to attest the qualifications of professionals completing the training.
- Develop a diagnostic tool enabling SMEs to assess their performance and business counsellors to tailor the nature of advisory and consultancy services, based on the results of the diagnostic assessment.
- Ensure that business counsellors attached to the PLUT-KUMKM Centres are fully aware of existing government support programmes and local BDS consultants to be able to provide appropriate referral services to SME clients.
- Convene an annual conference for managers and business advisors of the PLUT-KUMKM Centres for the purpose of competency enhancement, sharing of good practices, and exchange of information and experience.
- Enhance the monitoring and evaluation system of the PLUT-KUMKM Centres by collecting and assessing data from users on their characteristics, types of services received, and level of satisfaction with the assistance received. Implement an electronic system to centralise this information for the purposes of aggregate analysis.



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