

DEVELOPMENT AND SOME CONSTRAINTS OF SME IN INDONESIA

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I. Recent Development

In Indonesia, small and medium enterprises (SMEs) have historically been the main player in domestic economic activities, as they provide a large number of employment and hence generating primary or secondary source of income for many rural poor households. They generally account for more than 90 per cent of all firms across sectors (Table 1) and they generate the biggest employment, providing livelihood for over 90 per cent of the country's workforce, mostly women and the young. The majority of SMEs, especially microenterprises (MIEs), which are dominated by self-employment enterprises without wage- paid workers, are scattered widely throughout the rural areas, and, therefore, are likely to play an important role in developing the skills of villagers, particularly women, as entrepreneurs (Tambunan, 2006a, 2009).

Table 1: Total Enterprises by Size Category in All Economic Sectors, Indonesia (000 units)

Size Category	2000	2001	2003	2004	2005	2006	2007	2008
MIEs & SEs	39,705.2	39,883.1	43,372.9	44,684.4	47,006.9	48,822.9	49,720.3	51,217.9
MEs	78.8	80.97	87.4	93.04	95.9	106.7	120.3	39.7
Les	5.7	5.9	6.5	6.7	6.8	7.2	4.5	4.4
Total	39,789.7	39,969.97	43,466.8	44,784.14	47,109.6	48,936.8	49,845.02	51,262.0

Note: MIEs = microenterprises; SEs = small enterprises; MEs = medium enterprises; LEs = large enterprises

Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

The structure of enterprises by size category indicates that the majority of enterprises in all sectors are from the SME category, mainly MIEs. Whereas, the distribution of total SMEs by sector shows that the majority of these enterprises in Indonesian are involved in agriculture (Tables 2 and 3). The second largest sector is trade, hotel and restaurants, while the third is manufacturing. In the latter sector, the enterprises are engaged mainly in simple, traditional activities such as manufacturing of wood products, including furniture, textiles, garments, footwear, and food and beverages. Only a small number of SMEs are involved in the production of machineries, production tools and automotive components. In the automotive industry, they operate through subcontracting systems with several multinational car companies in Indonesia such as Toyota and Honda.

As shown in Tables 4 and 5, agriculture is the key sector for SMEs, and within the group, agriculture is more important for MIEs and SEs than MEs. In the manufacturing industry, based on output contribution, SMEs are traditionally not so strong as compared to LEs. In this sector, SMEs are engaged mainly in simple, traditional activities such as manufacturing of wood products, including furniture, textiles, garments, footwear, and food and beverages, and handicrafts. Only a small number of these enterprises, mostly SEs and MEs, are involved in the production of medium to high technology based goods such as industrial machineries, production tools and

automotive components. In these industries, they operate mainly as subcontractors producing certain components and spare parts for LEs (including foreign direct investment/FDI-based companies). This structure of SMEs by sector is, however, not an Indonesian unique; it is a key feature of this category of enterprises in developing countries, especially in countries where level of industrialization is relatively low.

Table 2: Structure of Enterprises by Size Category and Sector, Indonesia, 2008 (units)

	MIEs	SEs	MEs	LEs	Total
Agriculture	26,398,113 (52.07)	1,079 (0.21)	1,677 (4.23)	242 (5.54)	26,401,111 (51.50)
Mining	258,974 (0.5)	2,107 (0.41)	260 (0.66)	80 (1.83)	261,421 (0.51)
Manufacture	3,176,471 (6.27)	53,458 (10.28)	8,182 (20.63)	1,309 (29.94)	3,239,420 (6.32)
Elect, gas & water supply	10,756 (0.02)	551 (0.11)	315 (0.79)	125 (2.86)	11,747 (0.02)
Construction	159,883 (0.32)	12,622 (2.43)	1,854 (4.68)	245 (5.60)	174,604 (0.34)
Trade, hotel & restaurant	14,387,690 (28.38)	382,084 (73.45)	20,176 (50.88)	1,256 (28.73)	14,791,206 (28.85)
Transport & communication..	3,186,181 (6.29)	17,420 (3.35)	1,424 (3.59)	319 (7.30)	3,205,344 (6.25)
Finance, rent & service	970,163 (1.91)	23,375 (4.49)	3,973 (10.02)	599 (13.70)	998,110 (1.95)
.Services	2,149,428 (4.24)	27,525 (5.29)	1,796 (4.53)	197 (4.51)	2,178,946 (4.25)
Total (percentage)	50,697,659 (100.00)	520,221 (100.00)	39,657 (100.00)	4,372 (100.00)	51,261,909

Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

Table 3: Structure of Enterprises by Size Category and Sector, Indonesia, 2008 (workers)

	MIEs	SEs	MEs	LEs	Total
Agriculture	41,749,303	66,780	643,981	229,571	42,689,635
Mining	591,120	28,762	21,581	78,847	720,310
Manufacture	7,853,435	1,145,066	1,464,915	1,898,674	12,362,090
Elect, gas & water supply	51,583	19,917	31,036	54,233	156,769
Construction	576,783	137,555	51,757	31,016	797,111
Trade, hotel & restaurant	22,168,835	1,672,351	472,876	179,895	24,493,957
Transport & communication..	3,496,493	145,336	111,854	98,191	3,851,874
Finance, rent & service	2,063,747	313,921	279,877	156,064	2,813,609
.Services	5,096,412	462,683	178,311	49,723	5,787,129
Total	83,647,711	3,992,371	3,256,188	2,776,214	93,672,484

Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

Table 4: GDP of SME and LEs by Sector in Indonesia, 2006-2008 (Rp trillion)

Sector	Size of enterprises	Current prices			Constant prices (2000)			GDP share (%) at constant prices (2000)		
		2006	2007	2008	2006	2007	2008	2006	2007	2008
Agriculture	SME	414.66	524.06	679.45	251.28	260.38	272.76	13.60	13.26	13.65
	LE	18.56	23.17	33.84	11.13	11.21	11.58	0.60	0.57	0.58
Mining	SME	40.48	51.79	69.16	18.91	20.39	21.69	1.02	1.04	1.09
	LE	326.03	389.04	474.21	149.12	150.98	150.61	8.07	7.69	7.54
Manufacture	SME	219.68	255.47	435.33	129.20	133.73	172.18	6.99	6.81	8.62
	LE	699.86	813.34	945.41	384.90	404.35	385.58	20.84	20.59	19.30
Elect, gas & water supply	SME	2.46	2.82	3.09	1.14	1.18	1.23	0.06	0.06	0.06
	LE	27.90	31.91	37.76	11.11	12.34	13.76	0.60	0.63	0.69
Construction	SME	165.74	201.77	156.07	74.54	81.45	49.49	4.04	4.15	2.48
	LE	85.39	103.44	263.25	37.69	40.45	81.33	2.04	2.06	4.07
Trade, hotel & restaurant	SME	483.57	569.99	666.81	300.53	326.07	348.52	16.27	16.60	17.44
	LE	17.98	20.83	25.31	11.99	12.88	14.80	0.65	0.66	0.74
Transport & communication.	SME	126.74	135.90	152.16	61.31	64.66	68.45	3.32	3.29	3.43
	LE	105.07	129.35	160.29	63.67	78.28	97.63	3.45	3.99	4.89
Finance, rent & service	SME	171.79	194.08	230.88	108.84	117.10	126.52	5.89	5.96	6.33
	LE	97.33	111.13	137.24	61.23	66.56	72.27	3.32	3.39	3.62

Other services	SME	161.10	185.42	216.40	89.86	96.68	104.42	4.86	4.92	5.23
	LE	175.16	213.87	9.83	80.85	85.29	4.91	4.38	4.34	0.25
GDP	SME	1 786.22	2 121.31	2604.69	1 035.61	1 101.64	1165.26	56.06	56.09	58.33
	LE	1 553.26	1 836.09	1564.14	811.68	862.34	832.47	43.94	43.91	41.67
GDP National (exl. oil & gas)		3 339.48	3 957.40	4168.83	1 847.29	1 963.97	1997.73	100.00	100.00	100.00

Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

Table 5: Structure of GDP by Size of Enterprise and Economic Sector, Indonesia, 2008 (%; based on constant 2000 prices)

	MIE&SE	ME	LE	Total
Agriculture	87.37	8.57	4.06	100.00
Mining & quarrying	10.52	2.07	87.41	100.00
Manufacture	18.86	12.01	69.13	100.00
Elect., gas & water supply	1.36	6.87	91.77	100.00
Construction	16.37	21.47	62.16	100.00
Trade, hotel & restaurant	83.41	12.52	4.07	100.00
Transport & communication	25.40	15.81	58.79	100.00
Finance, rent & service	21.19	42.45	36.36	100.00
Services	83.50	12.00	4.50	100.00

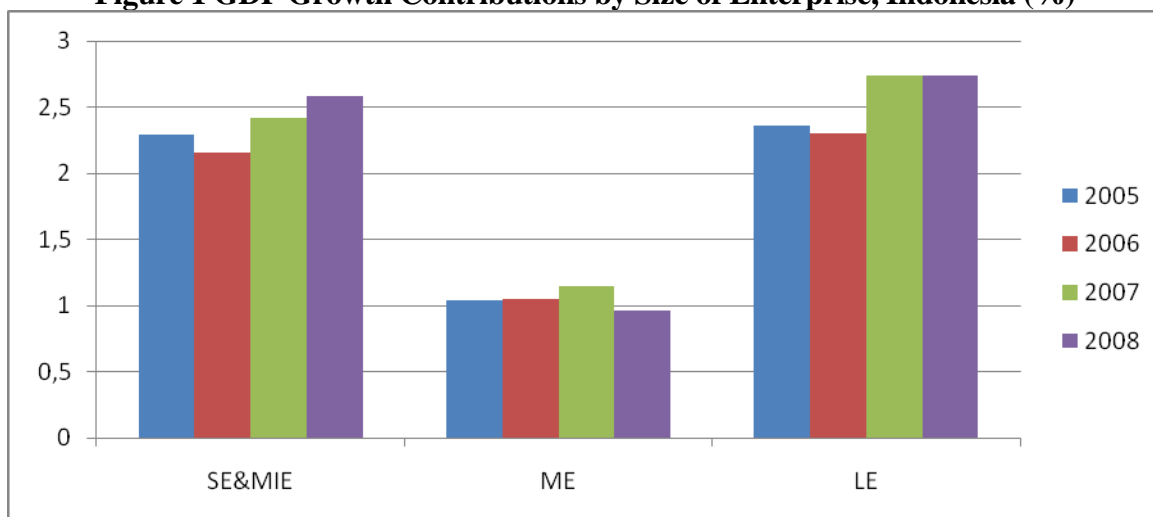
Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

With respect to the output growth, interestingly, the annual growth rates of SMEs are always higher than those of LEs. However, this is not because the level of (labour or total factor) productivity in SMEs is higher than that in LEs. It is mainly because the number of units of the SME category is much larger than that of LEs. Within the SMEs, the output growth of SEs and MIEs together is lower than that of MEs. But, the gap tends to become smaller by year during the period reviewed.

SMEs' contribution to the annual GDP growth is also higher than that of LEs (Figure 1). In 2005, the GDP growth rate was 5.69 per cent, from which 3.33 per cent originated from SMEs, compared to 2.36 per cent from LEs. In 2007, the SMEs' share in GDP growth was 3.57 per cent, and slightly declined to 3.54 percent in 2008. More interestingly, within the SME group, the total contributions of MIEs and SEs to GDP growth have always been higher than that of MEs. In 2007, from the GDP growth rate at 6.32 per cent, the total contribution from MIEs and SEs was about 2.42 per cent, compared to 1.15 per cent from MEs, and in 2008 the shares were 2.58 per cent and 0.96 per cent, respectively.

As a comparison, Table 6 provides data on SMEs in some other Asian countries. Although generally official data on SMEs in these countries are very limited, some studies (e.g. Goh, 2007, ADB, 2009b, Tambunan, 2009b, and UN-ESCAP, 2009), which the table is based on, managed to make estimates of actual contributions of the enterprises in the particular countries' economy. As can be seen, in all countries where estimates are available, SMEs reveal as the majority in number of units, employment creation and value added generation. With respect to value added contribution, SMEs in Cambodia have the highest share, followed by those in Indonesia and China. In regard to employment creation, Cambodia and Indonesia are both in top position as their SMEs contribute almost 100 per cent of total employment creation.

Figure 1 GDP Growth Contributions by Size of Enterprise, Indonesia (%)



Source: Ministry of Cooperative and SMEs (www.depkop.go.id) and BPS (www.bps.go.id)

Table 6: SMEs' Contributions to Total Enterprises, Employment and Value Added in selected developing countries in Asia, 2000-2008.

	China	India	Indonesia	Malaysia	Philippines	Thailand	Vietnam	Pakistan	Cambodia
Number of unit	99.7	95.0	99.9	94.4	99.6	98.0	96.8	Na	Na
Employment	74.0	80.0	99.0	40.4	69.1	55.8	96.8	90.0	99.0
Value added	60.0	40.0	63.1	26.0	32.0	47.0	39.0	40.0	76.7

Note: na=data not available

Sources: Goh (2007), ADB (2009), UN-ESCAP (2009), Tambunan (2009).

II. Main Constraints

Based on official (BPS) data, Table 7 provides information about the main constraints faced by MIEs and SEs in the manufacturing industry in Indonesia. It reveals that not all of the surveyed producers consider the lack of capital as their serious business constraints. For those who faced capital constraint were mainly MIEs located in rural/backward areas and they never received any credit from banks or from various existing government sponsored MSME credit schemes. They depend fully on their own savings, money from relatives and credit from informal lenders for financing their daily business operations.

Table 7: Number of SEs and MIEs in the Manufacturing Industry by Main Problem

	SEs	MIEs	Total SEs & MIEs
Have no serious problem	46,485	627,650	674,135
Have serious problems	192,097	1,862,468	2,054,565
- lack or high prices of raw material	20,362	400,915	421,277
- marketing difficulties	77,175	552,231	629,406
-lack of capital	71,001	643,628	714,629
-transportation/distribution difficulties	5,027	49,918	54,945
-high price or short supply of energy	4,605	50,815	55,420
-high labor cost	2,335	14,315	16,650
-others	11,592	150,646	162,238
Total SEs & MIEs	238,582	2,490,118	2,728,700

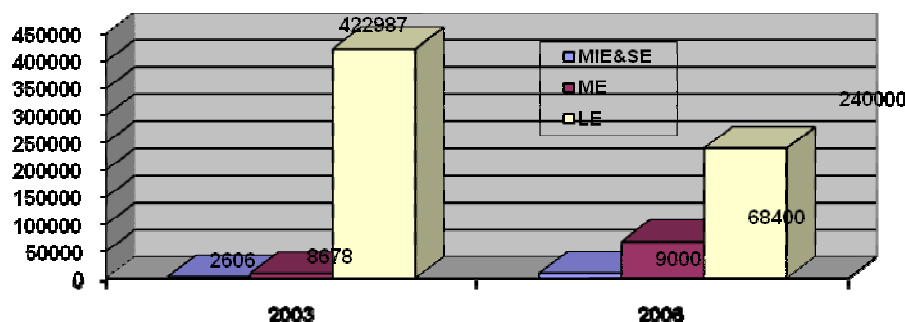
Source: Tambunan (2008)

Others' include cumbersome and onerous business regulations and restrictions. Basically, these problems which hamper business activities in Indonesia reflect the poor governance in the country. One of the most egregious restrictive regulations which hampered bona fide business in Indonesia, including SMEs, was the policy-generated barriers to domestic competition and trade. These policy-generated barriers included the barriers to inter-regional and inter-island trade and proliferation of several state and private monopolies which proliferated during the New Order era (1966-1998). The policy-generated barriers to domestic competition and trade included barriers to entry in certain economic activities, officially sanctioned cartels and monopolies, price controls, dominance of state-owned companies (SOCs) in certain sectors and preferential treatment for selected favored LEs. However, shortly after the 1997/98 crisis, with the help of the International Monetary Fund (IMF), Indonesia started its large economic reforms in almost all sectors and dealing with almost all aspects of daily business, including reducing the dominance of SOC's in the economy.

In fact, in the context of international trade and global competitiveness, two key problems currently faced by Indonesian SMEs especially in comparison with more developed SMEs in other APEC member countries like Japan, South Korea and Chinese Taipei are shortages in skilled workers as well as entrepreneurs and technology. These shortages are obviously reflected in low productivity of Indonesian SMEs. Thus, the larger GDP contribution of SMEs as compared to that of LEs as shown before does not mean that productivity in the first group of enterprises is higher than that in the second one, but it is mainly because the number of unit of SME is huge. As shown in Figure 2, the value added-labour ratio in SMEs is much lower than that in LEs. Within the SME group, the ratio varies, however, with lower in MIEs and SEs than in MEs.

Source: BPS

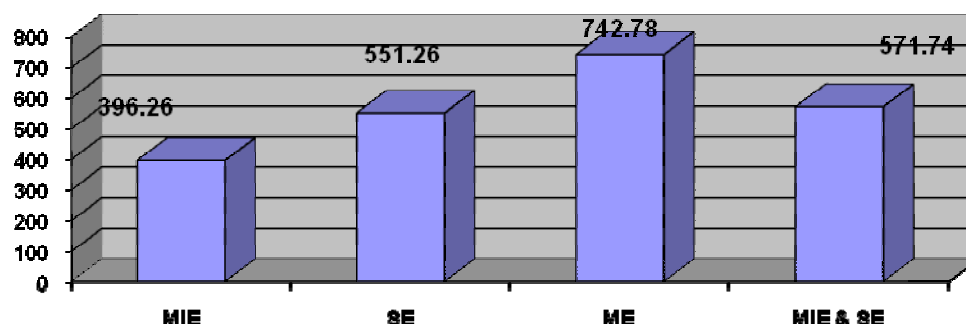
Figure 2: Labor Productivity of MIEs, SEs, and MEs in Indonesia (Rp/worker)



Source: BPS

Since the average income per worker often goes along with the level of productivity, there is a negative correlation between the size and the average income per worker (Figure 3). However, incomes or wages are not only different by size of enterprises, but also by sector (Table 8) or manufacturing subsector (Table 9) for the same enterprise group. The difference is due to differences in such as output and labor market conditions, skills required in production process facing different sectors or subsectors.

Figure 3: Average Income per Worker in MIEs, SEs and MEs, 2006 (000 rupiah)



Source: BPS

Table 8: Wages in SEs and MIEs in Some Sectors, 2004

Sector	Wage (000 Rp)
- Mining & Construction	5843.872
- Manufacturing	316.5308
- Transportation	6009.211
- Services	4821.893

Source: BPS

Table 9: Wages in SEs and MIEs in Manufacturing Industry, 2003

Industry	Wage (000 Rp)
- Food, beverages & tobacco	3104.262
- Textile, garments & leather	4987.538
- Products of wood, bamboo, & rattan	5287.153
- Pulp & paper, printing & publishing	5474.672
- Chemical product, rubber & plastics	4971.232
- Non-metal products	3485.213
- Basic metal products	3814.985
- Machinery, tools and other metal products	5643.118
- Others	3590.231

Source: BPS

The lacks of skilled workers and entrepreneurs and technology facing Indonesian SMEs are also reflected in their low intensity of export. Although data on exports of SMEs' are not easily available or are difficult to verify at least for Asian developing countries, some sources provide information that might be useful.. For instance, according, Harvie (2004), SMEs in East Asia generate about 30 percent of direct exports (or US 930 billion in 2000), much less than their contribution to employment (about 60 to 70 percent) or output (about 50 percent). The figures range from about 5 percent or less in Indonesia to about 40 percent of total exports in the Republic of Korea. Whereas, according to Tambunan (2009) using various official data and other sources for 1990s up to 2006, SMEs in China play the leading role with their highest export contribution between 40 and 60 percent of the country's total merchandize exports, followed by Chinese Taipei with 56 percent (Table 10).

Another important feature of Indonesian export-oriented SMEs is that not all of them do export directly. Due to lack of technology, capital and human resource, most of the Indonesian export-oriented SMEs are involved indiretly through either subcontracting with exporting LEs or via traders or trading companies.

Table 10: Share of SME exports in Total Exports in Selected Asian Developing Countries, average for the period 1990s and 2006

Country	Share (%)
China	60
India	38-40
Chinese Taipei	56
Vietnam	20
Singapore	16
Malaysia	15
Indonesia	18
Thailand	46
Philippines	22
Pakistan	25

Source: Tambunan 2009.

III. Policy recommendations

Based on the above evidence especially with respect to the main constraints facing Indonesian SMEs, the question now in the context of APEC is that, what the Indonesian SMEs can benefit from this regional cooperation. The answer is that, at least potentially, there are many benefits that Indonesian SMEs can have, but with two preconditions. First, Indonesian SMEs must be involved directly as well as indirectly with all activities generated by APEC. APEC has two main activities, namely regional trade and foreign direct investment flows among member countries. The generation of these two activities is the main objective of the establishment of this regional cooperation.

With respect to regional trade, especially export, the Indonesian SMEs must also have part of the action. Government of individual member countries must give the highest priority to their national firms, including SMEs, instead of multinational companies (MNCs) located in their countries (especially MNCs from countries of origin outside APEC region) to be engaged in exports activities or in regional production/supply chains. Of course, the priority must be given not in the form of protection or discrimination measures, but in the form of technical assistance, trainings in export and other issues relevant to regional trade, special export financing scheme, market information, easy or sustainable raw materials procurement.

The second option is to promote with various facilities subcontracting arrangements between local SMEs and domestic located export-oriented MNCs. The facilities may include tax incentives for MNCs to encourage them to use components, spareparts or semi-final goods made by local SMEs. But for this purpose, the government, either individually or in the form of co-operation among governments of member countries, must seriously support the capacity building in local SMEs in order to make them ready as efficient and highly global competitive local suppliers or subcontractors.

With respect to investment among member countries, local SMEs should be promoted to be engaged with any investment projects through e.g. subcontracting activities, joint venture, strategic alliance and other forms of business linkages/cooperations. But, again, local SMEs must be improved in many areas especially technology (innovation), human resource, management and business organisation, and this is mainly the task of individual governments.

The second condition, Indonesian local SMEs must be ready either as highly competitive exporting firms or local subcontractors. Many have been discussed before about the strategic role of Indonesian government in this respect. The cluster approach which has been adopted by the Indonesian government in supporting SMEs is the right option. However, it must be improved, especially with respect to the following two issues. First, the approach must be fully harmonised with or support by other development policies, e.g. rural development, infrastructure development, investment policies, trade policies, and so on. What often happen in Indonesia is that many SME clusters in rural areas are assisted by government but at the same time the areas lack of infrastructure and unsustainability in the supply of raw materials caused by e.g. a trade policy which permits export of such unprocessed materials.

Second, the effectiveness of a cluster approach (measured by the level of collective or economic agglomeration benefits and level of competitiveness of individual firms inside the supported clusters) is highly determined by the fully involvement of all parties, i.e. local R&D institute, university, training institute, bank or other financial institute, related local government bodies, business associations, and chamber of commerce. In Indonesia, many SMEs clusters have been supported by the government, but most of the clusters do not have cooperations with such parties.

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