REFORMING POLICIES FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN INDONESIA

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Preface

Small and medium-sized enterprises (SMEs) are an integral part of Indonesia's economy, accounting for more than 99 percent of all firms and approximately 97 percent of total national employment. Increases in output and productivity could raise the wages paid by SMEs and lift millions out of poverty. However, these enterprises face a number of constraints that inhibit their growth. Furthermore, there is a surprising lack of understanding about the direct and indirect impacts of SME support programmes that attempt to alleviate those constraints.

To foster awareness and consensus within the Indonesian government for more comprehensive and coherent development strategies and policies for SMEs at the national level, the RAND Corporation and AKATIGA, a social policy research institute based in Indonesia, assessed the gap between existing SME support programmes and SME needs. This report analyses both primary and secondary data and offers policy recommendations for the government and other stakeholders. This report will primarily be useful for the National Team for the Acceleration of Poverty Reduction (TNP2K), the Poverty Reduction Support Facility (PRSF) and other stakeholders associated with the broader SME policy reform project.

Abstract

Small and medium-sized enterprises (SMEs) are critical for emerging economies like Indonesia but simultaneously challenging for policymakers looking to support their growth. Including micro firms, SMEs are responsible for more than 97 percent of total employment in Indonesia and represent 99 percent of all firms. The Indonesian government has tried to assist SMEs through programmes, such as subsidised credit, one-stop shops to lower business registration costs and government-sponsored trade fairs. However, there is little evidence on how effective these programmes are or on ways to improve government policies aimed at helping SMEs. We conducted structured interviews with 192 firms across five provinces in Indonesia to investigate the constraints that firms face and how existing programmes do – or do not – help reduce these constraints. We conclude the report with policy recommendations targeted at the Indonesian government and other stakeholders, focusing on the importance of credit and on the need to remove information barriers.

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Acronyms and Abbreviations

BPS   Statistics Indonesia (*Badan Pusat Statistik*)

DEPKOP   Ministry of SMEs and Cooperatives, Indonesia (*Kementerian Koperasi dan Usaha Kecil dan Menengah*)

ICT   information and communication technologies

IMK   Statistics Indonesia survey of micro and small enterprises (*Survei Industri Mikro Dan Kecil*)

KEI   knowledge economy index

KUK   Small Enterprise Credit programme (*Kredit Usaha Kecil*)

KUR   People's Business Credit programme (*Kredit Usaha Rakyat*)

MSME   micro, small and medium-sized enterprise

OSS   one-stop shop (programme to simplify firm registration)

PPP   purchasing power parity

R+A   RAND Corporation and AKATIGA research institute

Rp   Indonesian rupiah

SME   small and medium-sized enterprise

SVLK   Timber legality verification system (*Sistem Verifikasi Legalitas Kayu*)

TNP2K   National Team for the Acceleration of Poverty Reduction (*Tim Nasional Percepatan Penanggulangan Kemiskinan*)

UMKM   micro, small and medium-sized enterprises (*usaha menengah kecil mikro*)

USD   United States dollars

WBES   World Bank Enterprise Survey

Summary

Small and medium-sized enterprises (SMEs) are critical for emerging economies like Indonesia but simultaneously challenging for policymakers looking to support their growth. Including micro firms (companies with fewer than five employees), SMEs are responsible for more than 97 percent of total employment in Indonesia and represent 99 percent of all firms (Mourougane 2012). Small firms tend to be labour intensive and relatively unproductive, typically using outdated or less sophisticated technologies to produce goods. As a consequence, SMEs produce only 57 percent of Indonesia's total value-added output (Mourougane 2012). A central challenge for the Indonesian government is how to encourage SMEs to grow so that they and the industries they operate in can benefit from the dynamics of economies of scale, contribute to national economic growth and provide more employment opportunities for Indonesians. This report addresses the basic but difficult question of what limits growth for Indonesian SMEs and what role the government should play in fostering their growth.

Using nationally-representative surveys collected by the Government of Indonesia and the World Bank, we confirm five key points about Indonesia's micro firms and SMEs:

1. Most firms in Indonesia are micro firms and SMEs represent a considerable portion of Indonesia's economy and employment.
2. SMEs in Indonesia tend to pay low wages.
3. SMEs tend to be less productive than large firms.
4. The owners and operators of SMEs tend to lack formal education and those owners with higher education levels are more likely to operate larger SMEs and to formally register their firms.
5. Many SMEs serve local markets and have not taken steps to expand their businesses.

Although we can gain many insights on SMEs from high-quality national surveys, existing data sources in Indonesia do not allow researchers and policymakers to understand in detail the reasons behind the challenges that SMEs face. Many aspects of the decisions that SMEs make, their business environment and their production functions are difficult to measure quantitatively. To provide an in-depth understanding of the constraints they face and to evaluate the effectiveness of existing policies that attempt to alleviate those constraints, we designed and fielded a new mixed-methods survey, the 2014 RAND and AKATIGA SME Survey (R+A SME survey). We administered this survey to a purposive sample of 192 Indonesian SMEs in August 2014. Our goal in designing and fielding the survey was to develop a deeper understanding of SMEs in Indonesia and how they interact with the existing policy environment. While the sample of firms was selected to cover multiple sectors and geographic regions, this survey was not designed to be nationally representative. Instead of surveying the smallest and most vulnerable firms, our focus was on the challenges faced by slightly larger SMEs that were more growth-oriented. We interviewed firms from seven different industries across four provinces.

To guide our data collection and subsequent analysis, we developed a basic analytical framework for understanding the various decisions that SMEs make. This framework borrows from the economic theory of the firm and involves a precise formulation of the objectives that SMEs are trying to achieve and the constraints they face when making decisions that affect their business operations.[1] The framework is built around owners of a small firm who are trying to operate the business, maximise profits and determine how to expand. The owners combine basic inputs to production – labour, production technologies and physical capital – with their financial capacity and management ability to produce output. To be successful, they must identify intermediate or final consumers who demand their products and conduct their production and sales activities within the broader business environment, driven by rules, regulations, and institutional norms determined by the Indonesian government and the market environment.

Despite the variety of constraints that firms could face in doing business, two problems emerged as most important: (1) credit constraints and (2) access to information. Credit constraints were the most frequently cited challenge for doing business, preventing firms from expanding and investing in new technologies that would lead to growth. Many of the firms we interviewed felt that the terms of credit offered to them by banks were too expensive, with exorbitant interest rates and difficult collateral requirements, and this was why they decided not to pursue formal sources of financial capital.

Inadequate access to various forms of information was also a pervasive problem for SMEs. This prevented them from learning about programmes sponsored by government or non-governmental organisations, including trade fairs that could help them access markets and worker-training programmes that could improve their productivity. We found that the government also lacks information and an accurate national registry of SMEs would enable policymakers to improve the design of SME support programmes and target these programmes more effectively. Moreover, while it may not be feasible to eliminate the overlap between government offices responsible for supporting SMEs, policies could be introduced to encourage communication and coordination across offices at both local and national levels and reduce the barriers for firms trying to navigate government policies and programmes.

Access to information also affected the issue of formality. While concerns about the informal sector are common in many developing countries, we know less about why firms remain informal. To explore the informal sector in Indonesia, we reviewed economic theories of why informal firms exist and compared those theories with what we learnt from our analysis of quantitative and qualitative data on Indonesian SMEs. Some results were surprising. Firms lamented the high cost of registration although some licensing procedures are free in Indonesia and many firms said that they remained informal because they found the process too complicated or because the costs of complying with formal business regulations would be prohibitive. In view of this, we recommend that the government focuses on promoting the benefits of registration, rather than just trying to reduce the costs. This may require better access to information through mechanisms that explain the benefits of registration and how to navigate the process. The literature on formality suggests that making the benefits clearer, along with increasing enforcement, may lead to higher rates of formality, which is consistent with stronger growth and greater productivity for firms. General strategies to encourage poverty reduction and economic growth may lead to firms exiting the informal sector, entering the formal sector and reallocating workers to the formal sector.

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[1]   Spulber (2009) provides a modern treatment of the theory of the firm.

These challenges create significant opportunities to support SME growth by leveraging modern information and communication technologies. A natural role for government would be to promote infrastructure that supports information sharing. The government could do this through web-based portals where firms could access information about the benefits of registration, lending options, how to register and what programmes there are for managerial training – whether run by the private or public sector. Given the prevalence of mobile phone and even smart phone technology in Indonesia, web systems could be supported by SMS-based information dissemination tools that could help level the playing field between firms. This would also buttress against any favouritism on the part of some government officials who allocate SME support.

1 Introduction

Small and medium-sized enterprises (SMEs) are critical for emerging economies like Indonesia but simultaneously challenging for policymakers looking to support their growth. Including micro firms (companies with fewer than five employees), SMEs are responsible for more than 97 percent of total employment in Indonesia and represent 99 percent of all firms (Mourougane 2012). Small firms also tend to be labour intensive and relatively unproductive, typically using outdated or less advanced technologies to produce goods. Indonesia's SMEs produce only 57 percent of total value-added output (Mourougane 2012). A central challenge for the Indonesian government is how to encourage SMEs to grow so that they and the industries they operate in can benefit from the dynamics of economies of scale, contribute to Indonesian economic growth and provide more employment opportunities for Indonesians. This report addresses the basic but difficult question of what limits growth for Indonesian SMEs and what the role of government should be in fostering their growth.

SMEs face many challenges to growth. Small firms may have difficulty accessing sources of credit or, if they have access, they may not have the collateral required to borrow or may be charged prohibitively high interest rates. These firms must confront a range of labour-market challenges, including finding skilled workers, complying with minimum wage laws and avoiding employee turnover. Access to steady sources of raw materials can be problematic, particularly for certain industries. For example, there may be supply bottlenecks, some internationally-produced raw materials may fluctuate in price and SMEs can face unfavourable competition for raw materials with large firms. In addition, small firms struggle to market their products and compete with larger firms on quality and price. They also have problems obtaining licences to formally operate and many who should formalise their business and can afford to pay taxes, still do not do so.

Recognising the importance of encouraging SMEs to grow and expand, the Indonesian government has allocated considerable resources to addressing the challenges that these enterprises face. Major national SME support programmes include one-stop shops for business licences, which reduce the red tape involved in obtaining licences, and People's Business Credit (KUR), a scheme to subsidise lending to smaller firms. These programmes and others attempt to alleviate the constraints that SMEs face as they struggle to grow. However, there is a sense that existing SME support programmes do not reach potential recipients and, even when they do, they may not be effective in changing outcomes. This could be because the programmes are not well designed or properly implemented, or it could be because government programmes are targeting constraints best solved by other actors.

In 2014, the RAND Corporation, in collaboration with AKATIGA Pusat Analisis Sosial, a social policy research institution in Bandung, Indonesia, conducted research to assess the constraints facing Indonesian SMEs as well as the current support policies, and make recommendations to the government and other stakeholders about reforms. RAND and AKATIGA carried out the analytical part of this study which included analysing existing, nationally-representative survey data on SMEs and collecting primary data from almost 200 Indonesian firms across a number of provinces and industries. We aimed to answer the following research and policy questions:

- What SME support policies seem to be working? What policies do not?
- What do SMEs need from government and what are they actually getting?
- What can we learn about SMEs from the diversity of their experiences?
- How do the incentives and constraints faced by policymakers affect the delivery of SME policies?
- What are the appropriate roles for local and national governments in supporting SMEs, and how should policies be reformed?

This report summarises the RAND team's research approach, data collection, results and recommendations to the government of Indonesia on its policies geared toward SMEs. We describe the results of a new mixed-methods data collection survey conducted to help identify and describe the constraints that Indonesian SMEs face and provide insights into the effectiveness of existing policy measures used to alleviate those constraints. In the remainder of this chapter, we briefly review the existing literature on constraints to SME growth and provide the definition of a small firm that we will use throughout the report.

Brief summary of the literature on policies to promote SMEs

The literature on constraints to growth for SMEs and on policy and programme solutions is vast so we do not attempt to summarise that literature in its entirety here. However, to develop the methodology and analytical framework to guide this research study, we drew on the wealth of studies that have been done on SMEs in Indonesia and other regions. We assessed what the government of Indonesia, other researchers, organisations and the media have said or written in recent decades about the composition of SMEs in the country and the challenges they face. We also reviewed the laws and policies designed to support SMEs in Indonesia, taking care to understand the historical context in which those policies were established. We reviewed experiences and lessons learnt from efforts to support SME growth in other countries. Evidence from recent policy evaluations that used randomised experiments on firms in developing countries influenced and shaped our understanding of which policies are likely to succeed and which are not (Duflo, Glennerster and Kremer 2007).

We also sought to summarise the Indonesian laws, policies and programmes that are designed to promote SMEs. These strategies are varied and difficult to track due to a lack of easily accessible information but we have included a detailed list in appendix D.

Evidence of constraints

There is well-documented evidence that firms in developing countries are often credit-constrained (Tambunan 2009; Banerjee and Duflo 2004) and that the average returns to capital for small firms in credit-constrained environments tend to be high (de Mel, McKenzie and Woodruff 2008; Anagol and Udry 2006; Kremer et al. 2013). Nevertheless, the question of the significance of credit constraints is not completely settled. For instance, Hsieh and Olken (2014) argue that larger firms tend to have higher returns to capital than smaller firms in developing countries, suggesting that greater lending to small firms would not enhance growth as much as greater lending to large firms. Administering high-quality credit programmes is difficult and their levels of success are mixed. This is true in Indonesia where McPherson and Rous (2010) found that firms in East Java were not responsive to programmes designed to increase access to credit. Overall, although credit constraints are thought to be a major impediment to growth, it is not easy to develop and administer effective policies to address these constraints.

Existing evidence on the effects of worker training programmes in developing countries varies and their effectiveness depends on how well they are designed and targeted. For example, Miyamoto and Todo (2003) found that firms were often willing to train workers themselves but, for this to be cost-effective, they needed to offer lower wages which minimum wage laws usually preclude. Evidence of the impact of basic education programmes is stronger. Duflo (2001) found that school construction programmes in Indonesia raised wages by 1.5–2.7 percent. Despite their obvious importance, general education programmes do not directly target SMEs.

Small firms often rely on outdated or inefficient technologies and production processes. Directly promoting technology is difficult and evidence from the literature suggests that even well-targeted policies can be surprisingly ineffective. Atkin *et al*. (2014) provided better technology for football manufacturers in Pakistan but found low rates of technology adoption. This was at least partly due to the wage structure of firms participating in the experiment because many firms used incentive systems that led to reductions in average wages under the new technology (therefore workers did not adopt the technology). Berry, Rodriguez and Sandee (2001) found that subcontracting can be an effective mechanism to support technology adoption but work by Tambunan (2006, 2007) in Indonesia found that the "foster parent" programme, which actively created links between large and small firms, had limited effectiveness due to its heavy-handed implementation.

The evidence on the effects of managerial training is mixed (McKenzie and Woodruff 2014). For example, personalised management consulting may be effective but it is also expensive. Bloom et al. (2013) conducted an experiment where they provided individualised, high-quality consulting services to large textile firms in India. Although this training resulted in large improvements in productivity, it was expensive and was unlikely to be a cost-effective solution for better management in SMEs. Business training courses appear to be more effective for new businesses. For example, de Mel, McKenzie and Woodruff (2013) found that training increased rates of entry for new firms but for established firms, training had no resulting effect on desirable outcomes, such as productivity. Research on the Indonesian context found that government-sponsored technical assistance programmes often result in a pattern of one-shot services with little follow-up or long-term benefits (Berry, Rodriguez and Sandee 2001).

There is abundant evidence that access to markets is important for firm growth. Regarding infrastructure, a long-standing body of work documents the benefits of road and transport networks (Jacoby 2000; Casaburi, Glennerster and Suri 2012; Faber 2013; Rothenberg 2013). One challenge is that this literature is not specific to SMEs and there is less evidence about specific market access programmes, such as trade fairs or night markets, that are not standard government service provision programmes (such as roads).

The literature on SME programmes

Evidence on specific programmes and policies designed to improve the general business environment in Indonesia is limited. The United Nations produced a guidebook for SMEs in Asia and the Pacific (Abe et al. 2012) but it applies blanket recommendations to several countries, despite each country's unique circumstances. Firm registration and formality has received significant attention in the literature but SME formality is typically characterised by a binary approach of formal versus informal, with little middle ground (for example, see Arnold 2012). High registration costs are often thought to drive firms to remain informal but reducing the costs of registration may not be enough to encourage them to formalise. Arnold (2012) reviews policy recommendations for broad tax reforms and recommends reforming policies and their administration. For example, he argues that the government should "allocate more tax audits on the basis of risk assessments and eliminate automatic audit requirements."

While brief, our summary of the literature suggests that there are some promising areas for programmes to support SMEs but previous experiences of government efforts have been at best mixed. The constraints that SMEs face in different industries and locations vary and programmes need to respond to these specific challenges and consider how the firms interact with the business environment. Our research in this report focuses on documenting Indonesian SMEs' experiences and trying to isolate the specific constraints those firms face.

Definition: What is an SME?

We define an SME as any organised production unit that specialises in producing something or providing a service and adds value.[2] Production involves transforming basic goods or raw materials into semi-finished or finished products and, in the process, adding value for consumers. Information is one possible raw material which is why businesses in the service sector are also considered to be firms. Moreover, middlemen who collect products from one location and sell it to another are also adding value which is why they are considered firms as well. Firms are often but not always located in a single building or production facility and one or more individuals are responsible for managing the business. Firms are established, according to Coase (1937) and Williamson (1979, 1985), in order to reduce transaction costs which can arise from the time and effort required to search for raw materials, acquire capital, use production technologies and find trading partners who serve as markets for their products.

When considering small firms, the many different ways of defining what it means to be an SME are a source of confusion and policymakers and researchers have not reached consensus on the most appropriate definition. For example, Indonesia's Ministry of SMEs and Cooperatives (DEPKOP) and Bank Indonesia use net asset or total sales thresholds to determine whether a firm is an SME.[3] This definition is useful for the purposes of corporate taxation but it is difficult to obtain accurate measures of these statistics for many small firms because many do not keep detailed business records. It is far easier to observe employment sizes. Indonesia's statistical agency, Statistics Indonesia (BPS) and the World Bank Enterprise Survey (WBES 2009) define SMEs based on the total number of employees: small firms have 5–19 employees, while medium-sized firms have 20–99 employees. Micro firms have 1–4 employees.

For this report, we define SMEs based on employment size, primarily because this is easier to measure. Our definitions for different sizes of firms, which conform to the definitions used by Statistics Indonesia, are shown in table 1. In doing field research, we found it difficult to access figures for sales or net assets and many firms did not know or refused to answer questions about their total sales or profitability. Nevertheless, we recognise that this definition has its limitations, for example, a large manufacturing plant may employ only ten people or a small information technology company may have only 20 employees, even when both are large in terms of profits. There are also many SMEs that employ seasonal labour and, even though an SME is run by a core set of employees, its employment size could fluctuate substantially, which could influence annual outputs and revenue.

Table 1   Definitions of firm sizes used in this report

Type of firm	Number of employees
Micro	1–4
Small	5–19
Medium	20–99
Large	100+

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2   Note that this broad definition is used by Statistics Indonesia (BPS) to determine whether an organisation qualifies as a firm and to design its surveys. We adopt this consistent definition here.

3   The Ministry of SMEs and Cooperatives defines micro firms as those with net assets worth less than Indonesian rupiah (Rp)50 million or total annual sales of less than Rp300 million. Small firms have net assets worth Rp50 million to Rp500 million and total annual sales of Rp300 million to Rp2.5 billion. Medium-sized firms have net assets worth Rp500 million to Rp10 billion and total annual sales of Rp2.5 million to Rp50 billion.

Organisation of the report

The rest of this report is organised as follows.

Chapter 2 gives a concise background to SMEs in Indonesia to set the context for our work, reviewing evidence from nationally-representative survey data.

Chapter 3 presents an analytical framework for understanding how SMEs operate and make decisions. In addition, we describe the data collection process for our qualitative interviews with firms, conducted to gain a better understanding of the constraints that SMEs face. We designed a mixed-methods survey and administered it to 192 firms in 21 districts in Indonesia in August 2014. We describe the design of the survey, sample selection, organisation of data collection and other implementation details in this chapter.

Chapter 4 analyses the main constraints and reviews a concise list of the most important challenges facing small firms in Indonesia. We summarise firms' experiences using quantitative and qualitative analyses, supported by detailed accounts from a selection of firms.

In Chapter 5, we discuss issues surrounding formalising the informal sector in Indonesia, and make policy recommendations to encourage greater formality.

Finally, in Chapter 6, we turn to policy recommendations directed at the government of Indonesia and other stakeholders interested in supporting SME growth.

2 Micro, Small and Medium-sized Enterprises in Indonesia

In this chapter, we describe the characteristics of micro, small and medium-sized enterprises (MSMEs) in Indonesia. This preliminary analysis uses representative samples to help provide the context for our subsequent targeted data collection and analysis. We used two data sources: the Statistics Indonesia 2013 survey of micro and small enterprises (*Survei Industri Mikro Dan Kecil* – IMK 2013) and the World Bank 2009 Indonesia Enterprise Survey (WBES 2009). The IMK 2013 survey was a 1 percent sample survey of micro and small firms, representative at the province level. The survey asked more than 40,000 firms about their production, output, value-added, capital, labour and production technologies, among other topics.

Although the IMK 2013 survey contained rich quantitative information about micro and small firms and their factors of production, it did not collect data on medium-sized firms or ask many detailed questions about the business environment or challenges to doing business. It also did not include good measures of informality and business registration. For these reasons, we supplement data from the IMK 2013 survey with data from the WBES 2009.

The WBES 2009 was a random sample of small, medium and large firms in Indonesia, stratified by industry, size and region. In addition to questions about employment, output, total sales and compensation, the survey asked firms about the challenges they faced associated with the business environment, registration, taxes, informal payments and access to finance. Although it was more detailed than the IMK 2013 survey, less than 1,000 firms were interviewed, resulting in a much smaller sample from which to draw inferences.[4] In the absence of a comprehensive survey of SMEs in Indonesia, we combined these two data sources to provide a more comprehensive description of the SME environment. Although our study focused on small and medium-sized firms and not on microenterprises, most firms in Indonesia are micro firms, so they are important to discuss.

Our description of SMEs is organised around five key stylised points:

1. Most firms in Indonesia are micro firms and SMEs represent a considerable portion of Indonesia's economy and employment.
2. SMEs in Indonesia tend to pay low wages.
3. SMEs tend to be less productive than large firms.
4. The owners and operators of SMEs tend to lack formal education, and those owners with higher education levels are more likely to operate larger SMEs and to formally register their firms.
5. Many SMEs serve local markets and have not taken steps to expand their businesses.

Most firms in Indonesia are small

SMEs account for a significant portion of Indonesia's economic activity. Including micro firms, SMEs represent more than 99 percent of total firms in Indonesia and are responsible for approximately 97 percent of total national employment (Mourougane 2012). In figure 1, we report the distribution of firm sizes in Indonesia in 2006, where the size of a firm is measured by the total number of workers it employs. The left panel in figure 1 features a histogram showing the percentage of total firms that employ different numbers of workers. Although separate bars are drawn at ten-worker intervals, only the first two bars are distinguishable. This histogram depicts a highly skewed distribution and the percentage of firms with fewer than ten workers is difficult to distinguish visually from 100 percent.

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4   We restricted our WBES 2009 analysis further by dropping firms in Aceh due to data quality issues. This left a total of 884 small, medium and large firms in five regions in our data subset.

Figure 1   Firm size distribution, measured by number of workers
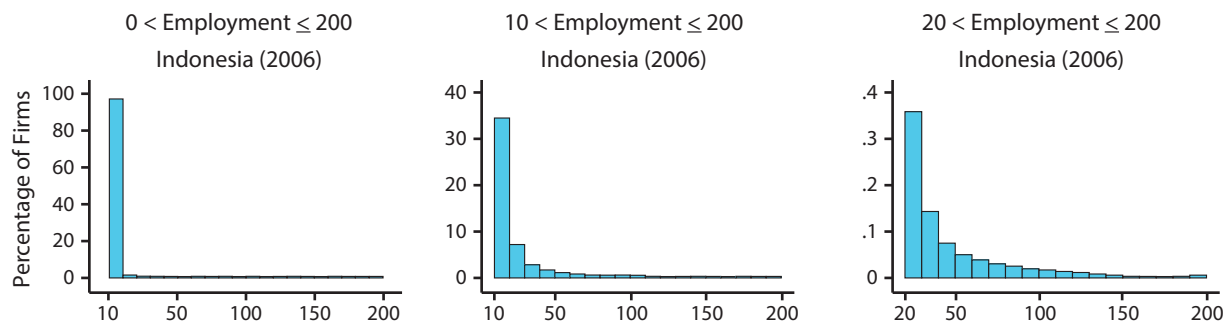
SOURCE: Adapted from Hsieh and Olken (2014) who use firm-level data from the 2006 Economic Census

In the centre panel of figure 1, the histogram is redrawn after dropping micro firms from the dataset. This panel restricts the range to between ten and 200 employees and rescales the y-axis, effectively plotting the size distribution for many SMEs, as well as larger firms. A similar skewed firm-size distribution appears in this graph. Notice that the first bar, depicting the share of firms with between ten and 20 employees, is less than 2 percent of the total. In the right panel, we plot the histogram only for firms with 20 or more employees (medium and large firms). Contrary to widely held notions about firms in developing countries (for example, see Tybout 2000), these three graphs depict no evidence of a "missing middle" in Indonesia's firm-size distribution. If anything, medium and large firms are both missing from the distribution.[5]

Using data from the IMK 2013 survey, we focus more closely on micro and small firms, examining the distribution of firm sizes for firms with no more than 20 employees. Figure 2 shows that even when we focus on just the micro and small firms, the distribution of employment sizes remains highly skewed. More than two-thirds of micro and small firms had no more than two employees. If we focus only on small firms, with more than four but less than 20 employees, more than 45 percent of those firms employed only five or six employees and almost 75 percent had fewer than ten employees.

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5   Columns 1 and 2 of table 2 show that many micro and small firms in Indonesia pay low wages to their workers. The median micro or small firm paid a monthly salary of Rp800,000 in 2013 which is only USD215.92 in PPP-adjusted current dollars. The bottom 25 percent of micro or small firms paid wages of less than Rp420,000 per month, which is only USD113.36 in PPP-adjusted current dollars and the bottom 5 percent paid wages that would amount to living on slightly more than USD1 per day.

Figure 2 Number of workers, micro and small firms
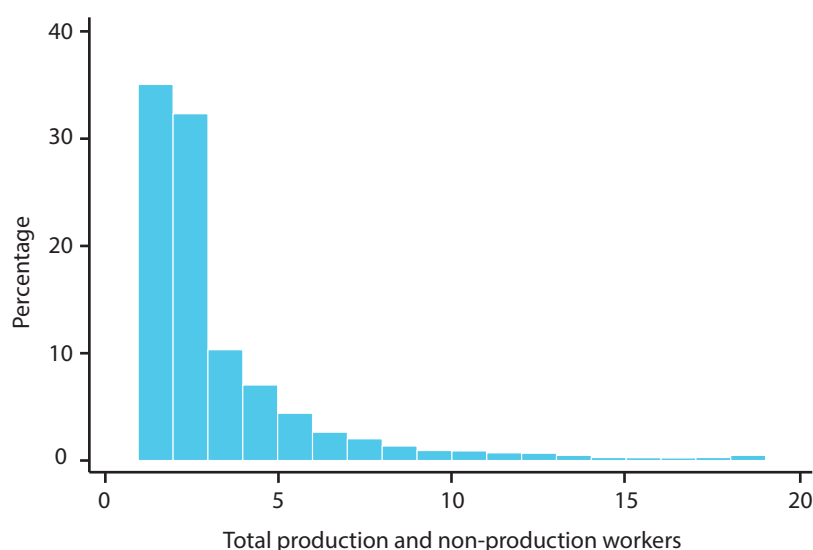
SOURCE: Authors' calculations using IMK 2013 data
NOTE: Separate bars are drawn for each integer of the number of workers, using the total of production and non-production workers in each firm.

Figures 1 and 2 show that the firm-size distribution in Indonesia is highly skewed and small firms tend to be very small. A considerable amount of theoretical and empirical work in economics has been devoted to supporting the proposition that economies of scale can play a crucial role in promoting economic growth. As economies develop, firm-size distributions become less skewed and more workers tend to work in larger firms, where they are employed more productively. Larger firms tend to produce goods at a lower per-unit cost and they are often better able to invest in and use capital equipment, allowing production to be less expensive, more sophisticated and of higher quality. For these reasons, a central challenge in private-sector development in Indonesia is to promote the creation and growth of large firms.

Many SMEs pay low wages

SMEs are responsible for employing a large share of Indonesia's workers therefore, it is important to examine the wages they pay. Wage income is typically highly correlated with an individual's actual income and reflects standards of living for workers. In perfectly competitive environments with a large number of firms, wages will also equal the value of the additional product that a particular worker produces. In this way, examining wage distributions also allows us to examine the relative productivities of different SMEs.

Figure 3 presents a histogram of monthly wages paid by micro and small firms to their workers, using data from the IMK 2013 survey.[6] The histogram is drawn with wages reported using nominal Indonesian rupiah (Rp). As with firm-size distribution, the distribution of wages is skewed but it tends to vary more. We report the percentiles of the distribution of wages for micro, small and medium-sized firms in table 2 and convert Indonesian rupiah wage figures into US dollars (USD) using purchasing power parity (PPP) adjusted exchange rates.[7]

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6 Wages per worker are calculated as the firm's total wage bill divided by the number of workers employed. Note that wage data were only available for roughly 65 percent of firms and the data we worked with were trimmed at the top 1 percent. For many firms, particularly small firms, wages are hard to measure. There may be a number of reasons for this: small firms do not always keep good records; they may employ family workers and not pay them wages; and firms may be reluctant to share this information with survey enumerators.

7 Using market exchange rates can sometimes result in misleading international comparisons because market exchange rates fluctuate rapidly, while the purchasing power of local currency is often stable. PPP adjustments are used to estimate what exchange rate between two currencies would equalise the purchasing power of the two countries' currencies.

Figure 3 Monthly wages per worker, micro and small firms
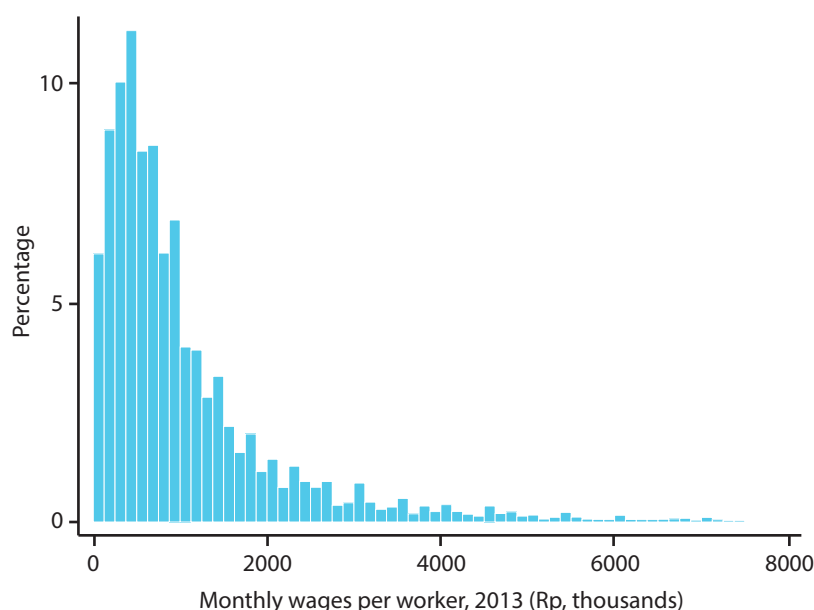
SOURCE: Authors' calculations using IMK 2013 data.

Columns 1 and 2 of table 2 show that many micro and small firms in Indonesia pay low wages to their workers. The median micro or small firm paid a monthly salary of Rp800,000 in 2013 which is only USD215.92 in PPP-adjusted current dollars. The bottom 25 percent of micro or small firms paid wages of less than Rp420,000 per month, which is only USD113.36 in PPP-adjusted current dollars and the bottom 5 percent paid wages that would amount to living on slightly more than USD1 per day.

Table 2 Distribution of monthly wages per worker, micro, small and medium-sized firms

Percentile	Micro and small firms		Medium-sized firms	
	Rp	USD (PPP-adjusted exchange rates)	Rp	USD (PPP-adjusted exchange rates)
1%	45,499.96	12.28	21,935.27	5.92
5%	125,000.00	33.74	102,492.60	27.66
10%	200,000.00	53.98	340,082.40	91.78
25%	419,999.72	113.36	718,599.50	193.94
50%	800,000.02	215.92	1,269,379.00	342.59
75%	1,499,999.11	404.85	1,934,691.00	522.15
90%	2,640,000.44	712.54	3,290,291.00	888.02
95%	3,791,665.35	1,023.38	5,264,466.00	1,420.83
99%	7,488,002.83	2,021.03	10,700,000.00	2,887.82

SOURCE: Authors' calculations using IMK 2013 data and WBES 2009 data
NOTE: The Indonesian rupiah figures from the WBES 2009 were converted to 2013 dollars using nominal and PPP exchange rates, taken from the World Bank's International Comparison Project.

However, some micro and small firms pay decent wages, with the top fifth percentile paying employees more than Rp3.7 million per month (approximately USD1,023 in PPP-adjusted current dollars).

Medium-sized firms tend to pay higher wages than micro and small firms, presumably reflecting their larger productivity, although some also pay lower wages than micro or small firms. The median medium-sized firms paid a monthly salary of Rp1.2 million which was USD342.59 in PPP-adjusted current dollars. This represents almost 60 percent more than the wages paid by the median micro or small firm.

SMEs have relatively low labour productivity

Although SMEs employ a large portion of Indonesia's workforce, they tend to be less productive than larger firms (Berry, Rodriguez and Sandee 2001). Small firms tend to be more labour intensive and they often use outdated technologies and run less efficiently than larger firms. Despite being responsible for over 97 percent of total employment in Indonesia, SMEs produce only 57 percent of the nation's total value added.

Figure 4 plots a histogram of the distribution of value added across micro and small firms, using data from the IMK 2013 survey. The x-axis in the histogram is plotted in logarithmic scale and, in logs, the data appear to follow a normal distribution or bell curve. Most of the firms in the data (97.9 percent) had a total annual value in 2013 of between Rp1 million (USD269.89 in PPP-adjusted current dollars) and Rp10 billion (USD2.6 million in PPP-adjusted current dollars).

Figure 4   Value added, micro and small firms
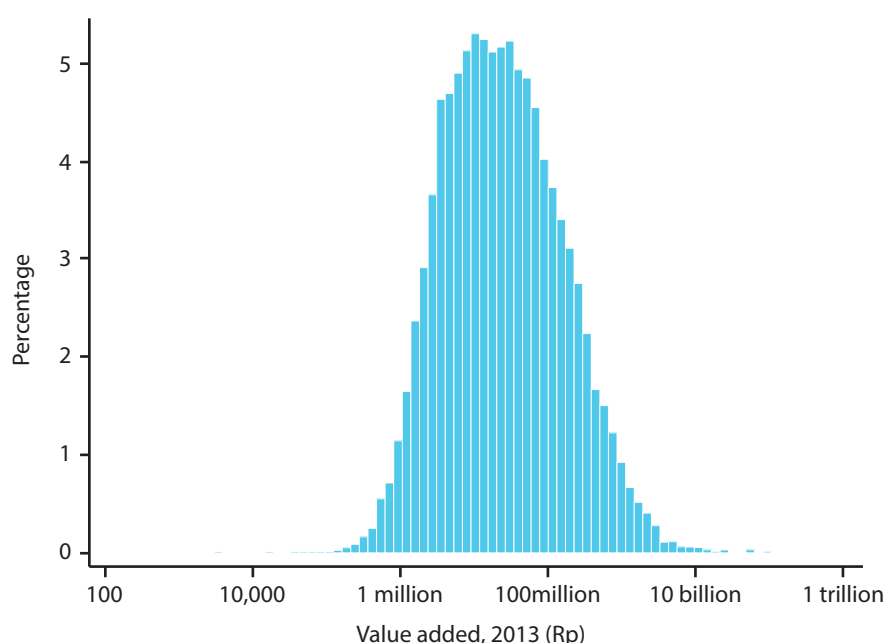
SOURCE: Authors' calculations using IMK 2013 data.
NOTE: Value added on the x-axis is plotted in a log scale.

To measure the relative productivity of SMEs compared with larger firms, we first constructed a measure of the value added per worker for each firm in the IMK 2013 and total sales per worker in the WBES 2009 data sets. These figures represent estimates of average labour productivity. We then divided each firm's labour productivity by the average labour productivity of large firms in Indonesia, defined as firms with 100 or more employees. This created a relative productivity ratio which we express in percentage terms.[8]

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8   Average labour productivity of large firms in 2013 was approximately Rp266 billion, according to Statistics Indonesia (2013).

Table 3 gives percentiles of the distribution of relative productivity. These figures show that micro and small firms in Indonesia are extremely unproductive when compared with large firms. The median micro firm has a value added per worker measure that is less than 4 percent of the average value added per worker of large firms and the median small firm has a value added per worker that is only 13.8 percent of the average value added per worker of large firms. Even the 95th percentile of small firms and the 99th percentile of micro firms are less productive than Indonesia's largest firms. Only the top 1 percentile of small firms employs a workforce that is more productive than the average large firm.

Although most medium-sized firms are considerably less productive than large firms, some are as or more productive than large firms. The top 5 percent of medium-sized firms are more than 50 percent more productive than the average large firm. However, productivity and firm size are not perfectly correlated. The bottom 25th percentile of medium-sized firms has only 7 percent of the value added per worker as the average large firm and looks similar to the bottom 25th percentile of small firms.

Table 3   Relative labour productivity of micro, small and medium-sized firms compared with large firms (percentage)

Percentile	Micro firms	Small firms	Medium-sized firms
1%	0.16	0.26	0.13
5%	0.38	1.75	1.58
10%	0.59	3.09	2.74
25%	1.31	6.57	6.98
50%	3.51	13.84	13.66
75%	9.47	29.02	34.16
90%	21.00	56.09	101.51
95%	32.80	89.19	153.27
99%	87.79	215.29	761.29

SOURCE: Authors' calculations using IMK 2013 data, WBES 2009 data and Statistics Indonesia 2013 data.
NOTE: Columns show the percentage of value added per worker (for micro and small firms) or total sales per worker (medium firms) compared with the average value added (total sales) per worker for large firms.

Managers of SMEs have limited formal education

Managing and operating an SME is difficult and involves making hundreds of complex decisions, some of them almost constantly. One reason why SMEs may suffer from relatively low labour productivity is that they may not be well managed (Bloom et al. 2010). While owners may abound in initiative and drive, they may not be making optimal decisions about how to invest, manage finances, hire workers, access capital or market their products.

Although it is difficult to measure managerial ability, the IMK 2013 and WBES 2009 surveys allow us to understand differences in managers' gender, age and educational attainment. Nearly 60 percent of micro and small firms were operated by men and 40 percent were operated by women. However, as we show in figure 5, women were more likely to operate the smallest micro firms. More than 46 percent of micro firms were operated by women, while only 16.1 percent of small firms were operated by women and even fewer medium-sized firms were operated by women.[9] Men were more likely to be operating larger SMEs.

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9   Gender differences in ownership between micro and small or medium-sized firms were statistically significant, using a t-test, at conventional significance levels.

Some of the variation by gender is explained by variation in industries. For instance, women managed 82 percent of micro and small textile producers and 51 percent of micro and small garment firms. However, less than 4 percent of micro and small firms producing furniture were managed by women.

Figure 5   Gender of micro, small and medium-sized firm managers and operators
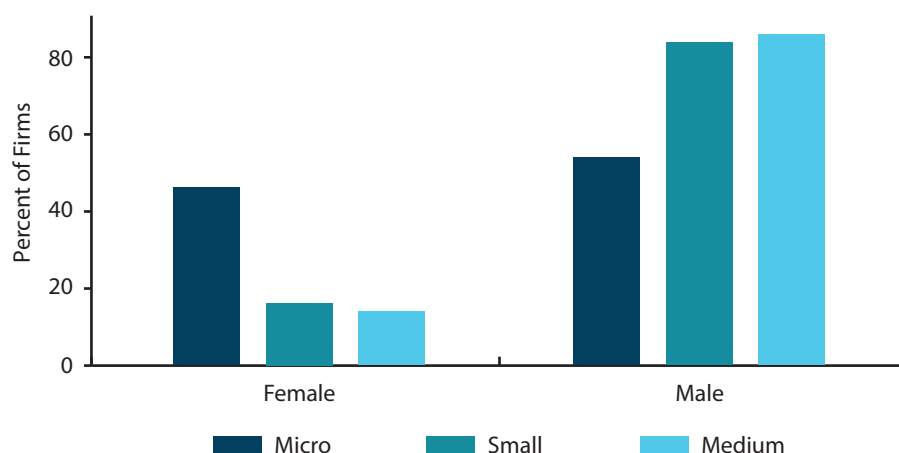
SOURCE: Authors' calculations using IMK 2013 data.

There were no significant differences between the ages of managers of micro firms, small firms and medium-sized firms. However, micro and small firms tended to be operated by managers with relatively low levels of formal education, while medium-sized firms tended to be operated by people with higher levels of education (figure 6). More than 84 percent of micro firm managers and 63.5 percent of small firm managers did not complete secondary school. Only 25.4 percent of medium-sized firm managers did not complete secondary school.

Few micro firm managers had attained higher levels of education. Less than 5 percent had acquired a bachelor degree or higher. For small firm managers, these figures were better but less than 8 percent had at least a bachelor's or associate's degree. However, almost one-quarter of medium-sized firm managers had a bachelor's degree or higher.

One possible explanation for these trends in educational attainment is that individuals started firms because they were forced to leave school to make ends meet (Margolis 2014). If this is the case, such individuals should not be considered entrepreneurs per se; they started firms because they were severely constrained. Continuing education was either not possible because they could not afford to continue or not desirable because available opportunities to use acquired skills were limited. Although our survey data are limited in their ability to shed light on this hypothesis, evidence on the distribution of education by age provides some insight.

Figure 7 plots data on the relationship between educational attainment and age, using IMK 2013 data. Each bar reports the percentage of managers of micro and small firms with different levels of educational attainment; within an age bracket, the bars sum up to 100 percent. This graph shows that the highest rates of uncompleted primary school are concentrated in the older age groups, particularly the 51–60 and 61+ age brackets. Furthermore, older entrepreneurs were less likely to have completed high school than younger entrepreneurs. This suggests that when older entrepreneurs were making educational decisions, they may have been severely constrained and started their businesses out of necessity rather than by choice. It could also reflect that when older individuals made educational decisions, they had limited opportunities for schooling. For example, Duflo (2001) describes a massive school construction programme in Indonesia in the 1970s; individuals making their decisions before this programme was implemented may not have had as much access to education as they would have today.

Figure 6   Educational attainment of micro, small and medium-sized firm managers and operators
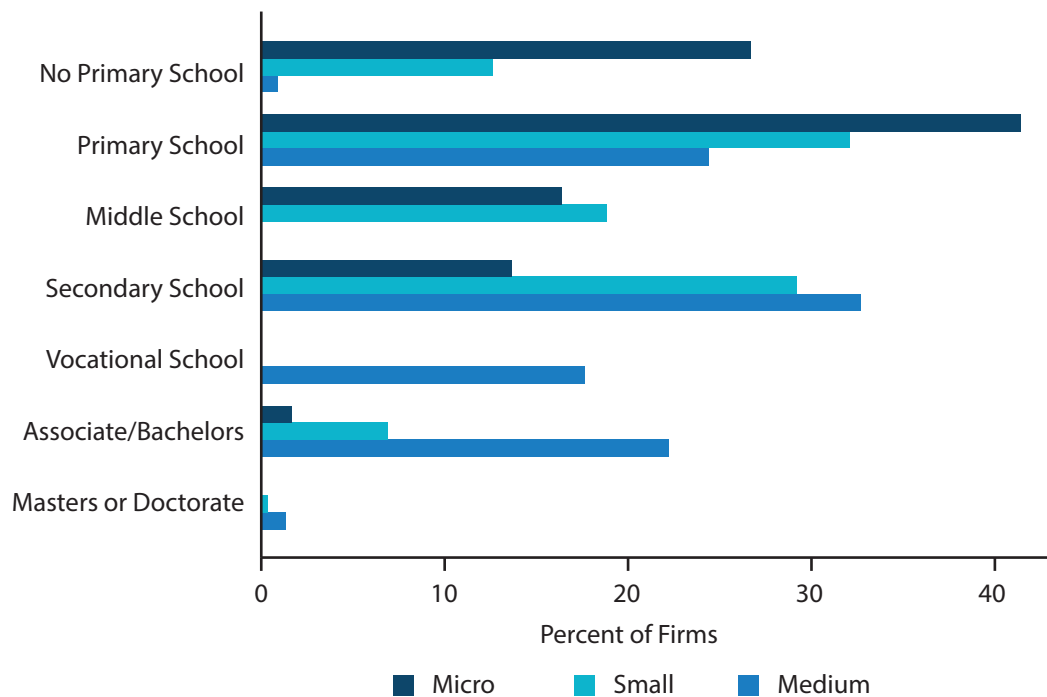
SOURCE: Authors' calculations using IMK 2013 and WBES 2009 data
NOTE: The education codes between these surveys were slightly different; the IMK 2013 survey does not ask about vocational school.

However, younger age cohorts have higher education levels and more than 30 percent of those aged 21–30 had finished high school. This could suggest that in recent years, people are more likely to have started firms by choice rather than out of necessity. However, it could also reflect the changes in government education policy, such as the introduction of mandatory primary education and increased school construction which could be changing educational attainment over time.

Figure 7   Educational attainment of micro and small firm managers and operators, by age group
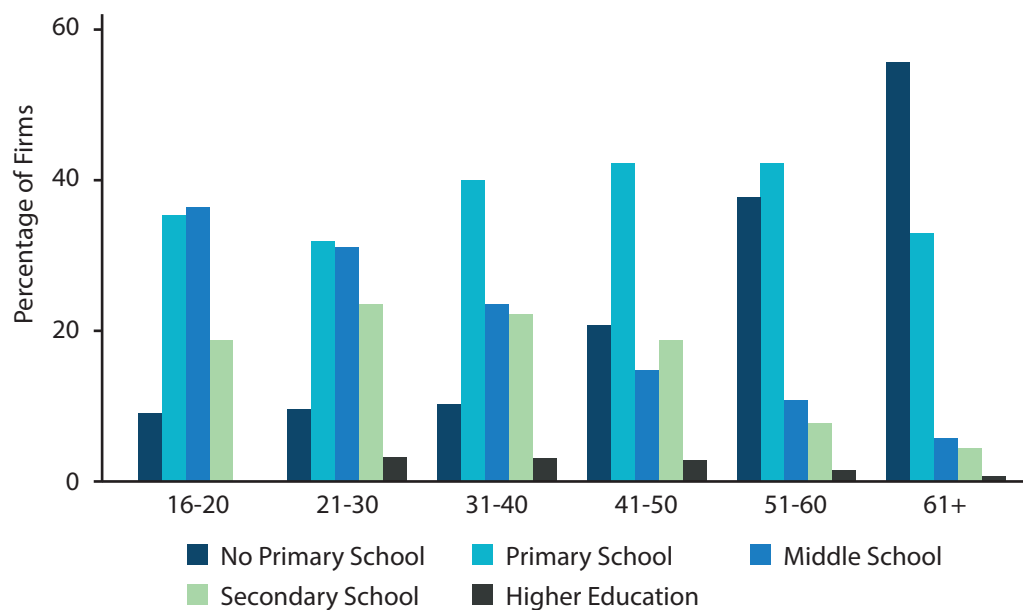
SOURCE: Authors' calculations using IMK 2013 data.
NOTE: All micro and small firms are used in the analysis. We include the 16-20 age group to capture older youth who have started a business.

Figure 8 uses WBES 2009 data to plot the highest level of education obtained by firm managers against the registration status of the firm; this figure is plotted only for SMEs. In this survey, respondents were asked in what year, if ever, the firm formally registered. If the respondent gave a year, we defined the firm as registered. This figure shows that managers of registered firms had higher educational levels than managers of unregistered firms. Nearly 30 percent of registered firms were managed by people with a university degree and 2.7 percent of registered firms were managed by people with a postgraduate degree. However, only 3.7 percent of unregistered firms were managed by people who had a university degree and no unregistered firms had managers who had attained a postgraduate degree. At the same time, 36.4 percent of unregistered firms were managed by people who had completed only primary school while for registered firm owners this was only 10.4 percent. These differences in educational attainment suggest that entrepreneurs with higher education levels are more likely to register their firms.

Figure 8   Educational attainment of small and medium-sized firm managers and operators, by registration status
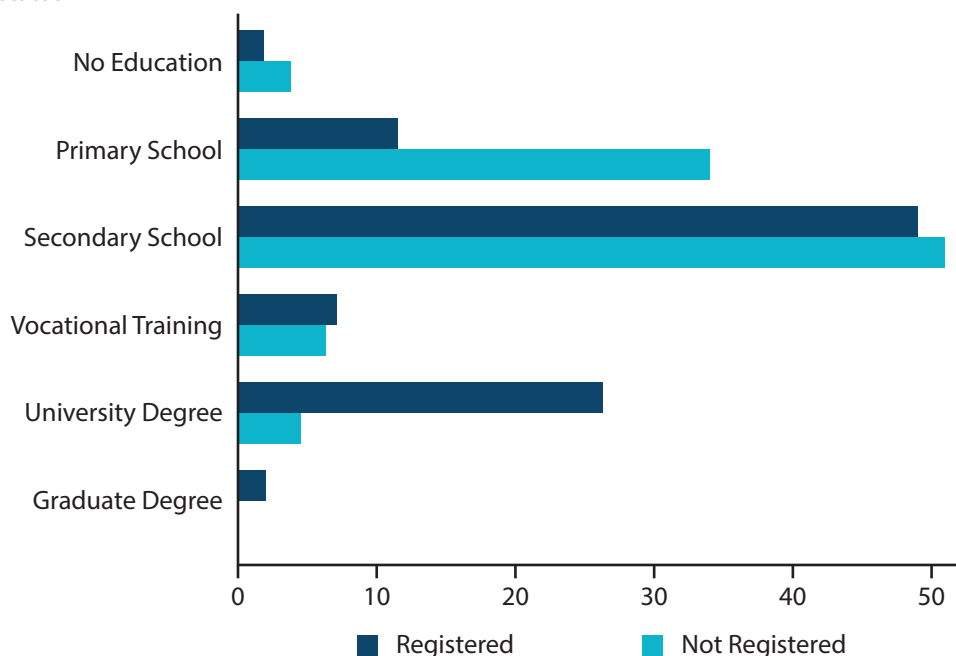
SOURCE: Authors' calculations using WBES 2009 data

Another way to assess the ability of managers is to examine their years of experience. Table 4 reports the distribution of the year that SMEs began operation. This table shows that a substantial percentage of SMEs are new to doing business. Approximately 8.5 percent of micro and small firms began operations in the past three years and 36 percent of micro and small firms began operations in 2004 or later, so they have less than 10 years of experience. In any given year, the distribution of experience reflects firm entry, survival and exit so it is difficult to interpret this on its own. That said, the significant portion of SMEs that began operation in the past three years suggests that many SMEs may enter and exit within a short time frame. Such patterns of entry and exit are normal, even in developed countries. For instance, using establishment-level panel data from the United States, Kerr and Nanda (2009) report that between 1977 and 1998, 42 percent of firms created survived for three years or less. Nearly 95 percent of these short-lived, churning entrants are small firms with fewer than 20 employees.[10]

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10   Existing data sources do not allow researchers to track the performance of Indonesian SMEs over time, so it is hard to describe patterns of entry and exit and to understand the survival probabilities of SMEs.

Table 4   Distribution of year started for micro, small and medium-sized firms

Year started	Micro and small firms		Medium-sized firms	
	Number	Percent	Number	Percent
1970 or earlier	108,925	3.2	991	4.9
1971–1980	251,932	7.4	921	4.55
1981–1990	512,116	15.1	5,050	24.96
1991–2000	962,233	28.3	9,378	46.35
2001–2010	1,274,740	37.5	3,895	19.25
2011–2013	289,379	8.5		
Total	3,399,325	100.0	20,325	100.0

SOURCE: Authors' calculations using IMK 2013 and WBES 2009 data

Many SMEs serve local markets and do not expand their businesses

Most SMEs have a narrowly-focused demand market. According to the IMK survey, nearly 75 percent of micro and small firms sold their entire output of goods locally, in the same district where the goods were produced. Less than 6 percent of micro and small firms sold output to markets outside of the same province and less than 0.5 percent of micro and small firms exported any goods.[11] However, as expected, larger firms were more likely to be outward-oriented than smaller, micro firms. While 82 percent of micro firms sold their entire output in their same province, only 50 percent of small firms sold their entire output in their same province. Small firms were also more likely to export goods than micro firms but less than 3 percent of small firms exported any of their output, compared with less than 0.5 percent of micro firms.

Some of the variation in the tendency to serve a local or export market can be explained by differences across industries. According to the IMK 2013 survey, more than 80 percent of food-processing micro and small firms sold their entire output in the same local district. In contrast, only 56 percent of micro and small garment manufacturers sold their entire output in the same district. Furniture-making micro and small firms were also considerably more likely to export some of their products than food-processing firms although the absolute rates of participation in export markets were both small (0.6 percent of furniture-making firms and 0.2 percent of food-processing firms).

Although it is difficult to measure the extent to which managers of SMEs want to grow or expand their businesses, the WBES 2009 asked small, medium-sized and large firms several questions that reflected whether they had made significant attempts to grow their businesses. These questions asked owners whether their firms had applied for electrical connections or construction permits over the previous two years and whether over the previous fiscal year, their establishments had made any investments by purchasing fixed assets or applying for a loan. Note that these questions address the actual behaviour of firms. A crucial question is whether many SMEs would like to grow but cannot due to issues relating to credit constraints, business regulations or a difficult operating environment. In chapter 3, we describe a new qualitative survey that investigates this question more directly.

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11   Note that because Indonesia is a vast archipelago, selling goods outside one's province may involve using ports to ship goods over waterways. This is significantly more challenging than using land transport to move goods to an adjacent state or county, as in many countries that are contiguous land areas.

Table 5 summarises the results of the WBES 2009. In the 12 months before the survey, only 28 percent of SMEs had made investments by purchasing fixed assets and only 17 percent had applied for a loan. In the previous two years, only 5 percent of SMEs had applied for a construction permit and only 13 percent had applied for an electrical connection. This suggests that many SMEs have not taken steps to expand their businesses.

Table 5   SMEs taking steps to expand (percentage)

	Applied for a construction permit in past two years?		Applied for an electrical connection in the past two years?	
	No	**Yes**	**No**	**Yes**
All SMEs	95	5	87	13
Medium-sized firms	83	17	59	41
Small firms	96	4	90	10
Formal firms	93	7	89	11
Informal firms	98	2	90	10

SOURCE: Authors' calculations using WBES 2009 data

In general, whether firms took steps to grow their businesses seemed to be positively correlated with firm size. Medium-sized firms were more likely than small firms to purchase fixed assets, apply for construction permits, apply for loans and apply for electrical connections. Only 16 percent of small firms in the survey reported applying for a loan in the previous year and only 24 percent had purchased any fixed assets. However, more than one-quarter of medium-sized firms had applied for a loan in the previous year and nearly two-thirds had purchased fixed assets.

Implications for our research

This chapter provided an overview of micro, small and medium-sized firms in Indonesia, drawing on two representative data sets collected between 2009 and 2013. The IMK and WBES data show that while SMEs are abundant in Indonesia, they are typically less productive, pay lower wages and take fewer steps to expand their businesses than larger firms. They also lack managerial capacity, based on the basic characteristics of their owners. This is the background against which we present our research in the remaining chapters.

As described in chapter 3, we designed a new qualitative survey to better understand the constraints that SMEs face. Although we do not survey a representative sample of firms, as with the IMK and WBES data, we focus on high-performing, growth-oriented SMEs and describe their interactions with the existing policy environment. Our survey was able to delve more deeply into the constraints that SMEs face and the patterns we observe may be driving the results obtained from large-scale surveys.

3 Qualitative Interviews with Small and Medium-sized Firms

Existing data sources on SMEs in Indonesia do not give researchers and policymakers a detailed understanding of the challenges that these enterprises face. This is because many aspects of SME decision-making, their business environment and their production functions are difficult to measure quantitatively. To provide an in-depth understanding of the constraints that SMEs face and to evaluate the effectiveness of existing policies that attempt to alleviate those constraints, we designed and fielded a new mixed-methods survey, the 2014 RAND and AKATIGA SME Survey (R+A SME Survey), which we administered to 192 Indonesian SMEs in August 2014. Our goal with this survey was to develop a more comprehensive understanding of SMEs in Indonesia and how these firms interact with the existing policy environment. Instead of surveying the smallest and most vulnerable firms, our focus was on the challenges faced by slightly larger small and medium-sized firms that tend to be more growth-oriented. We also opted for a data collection strategy that involved administering a longer, more detailed questionnaire to a small number of firms, choosing depth over breadth, unlike many existing surveys, which tend to administer a shorter survey to a larger number of firms.

In this chapter, we outline the theory-driven data collection process we developed and undertook for this project. We first describe a basic analytical framework for understanding the different decisions that SMEs make. This framework borrows from the economic theory of the firm and involves a precise formulation of the objectives that SMEs are trying to achieve and the constraints they face when making decisions that affect their business operations.[12] This analytical framework was used to structure and guide our data collection.

After describing the analytical framework and our research focus, we discuss our approach to data collection by geographic and industry selection. The survey we developed was a comprehensive, mixed-methods survey which predominantly focused on qualitative, open-ended interview questions, although some response items were quantitative in nature. We interviewed a small sample of firms that was not randomly selected from the population; instead, we focused on core sectors and regions of interest to policymakers. We conclude the chapter by discussing questionnaire development, firm sample selection and the site selection processes. More precise implementation details, such as the composition of data collection teams, timeline of the survey and fieldwork logistics can be found in appendix C.

Analytical framework

We begin by outlining a simple model of SME production and growth, depicted visually in figure 9. The blue box in this figure represents the SME owner and operator. This owner draws on a quantity of financial capital and decides how to spend that capital on different factors of production, such as hiring labour, purchasing (or leasing) capital equipment, obtaining raw materials and determining what sort of production technology to use to produce the desired goods or services. The owner then determines how to combine those productive factors and the production technology to produce output. When output is produced, it is sold to the demand source. This demand source is often final consumers who consume the finished products. However, if the firm is producing intermediate inputs or components of a larger product, the demand source may be other firms or middlemen.

The sale of goods produced by the firm generates revenue to cover the firm's costs, including wages paid to workers and the costs of acquiring capital, renting land or retail space and complying with business regulations (taxes, registration permits and so on). If the firm is small and producing in a competitive environment, many prices that govern firm profits, such as the prices of final goods that are delivered to consumers, wage rates or the cost of raw materials, may be determined nationally or internationally and are essentially outside the firm's control. Over time, the net profits generated from a stream of sales revenue may be reinvested in the firm to

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12   Spulber (2009) provides a modern treatment of the theory of the firm.

facilitate growth. A successful business may decide to use its profits to hire more workers or expand into a new location. It may also be able to use its profits to negotiate terms with a lender, so that it can borrow at more favourable rates to finance an expansion.

Figure 9   A simple model of SME production and growth
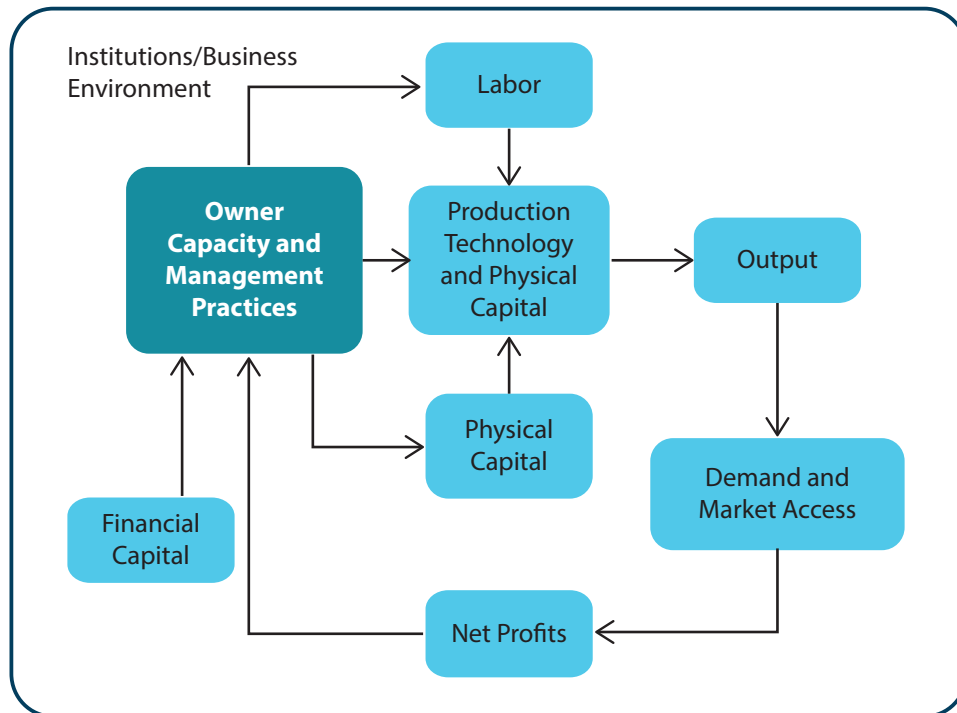
The entire production process operates within the business environment, represented by the large box that surrounds everything in the model. The business environment is an amalgamation of government institutions and market-driven conditions that affect the firm's decision-making process. For example, a stringent regulatory environment could increase the cost of complying with tax regulations. Government policies that favour large firms or promote monopolies could create an environment that is averse to firm entry and competition. If contracts laws are inadequately enforced, it could make it difficult to secure a source of raw materials or make it easier for buyers to renege on a sale.

Importantly, this model of firm behaviour could potentially have multiple equilibria. Virtuous circles of growth occur when firms produce output and sell it for a substantial profit and that profit can be reinvested in the firm, allowing it to hire more workers, rent more capital or invest in new technologies. This leads to greater output and higher revenues. On the other hand, if firms cannot access sources of finance or more productive technologies, they may not be able to produce much to sell on the market and this reduces profits and limits further reinvestment in the firm. With policies designed to alleviate the constraints that SMEs face, the government endeavours to push those firms out of the vicious cycle, poverty-trap equilibrium and into the virtuous cycle, development and growth equilibrium.

SME policies can affect any of the nodes in the conceptual model in figure 9. Policies can have direct impacts, such as capacity-building programmes to improve a firm's labour quality, or indirect impacts, such as a programme that promotes an Indonesian sector abroad, increasing demand for every firm that is part of that sector. In the next sections of this chapter, we describe how we used this analytical framework to design a survey that focused on SMEs that are struggling to overcome their challenges to growth.

Research focus: larger, growth-oriented SMEs

As discussed in chapter 2, many of Indonesia's firms are extremely small, add little value when they produce goods and pay low wages to workers. La Porta and Shleifer (2014) argue that developing economies often exhibit characteristics of a dual economy, characterised by the simultaneous presence of a sector with high value added and a sector with low productivity and low value added. Many of the smallest firms in developing countries, most of which may be in the informal sector, are not likely to be major sources of economic growth, simply because they do not have the capacity to make the transition from the traditional sector to the more productive, modern sector. Entrepreneurs with little formal education manage these small, inefficient firms and they produce lower-quality goods for poorer consumers. Because of their market orientation, these firms have few incentives to grow and do not compete with the larger, more productive firms, which produce different products for more affluent consumers.

Instead of focusing on these extremely small, vulnerable and often poorly-managed firms, we sought to learn more about slightly larger firms with both the potential and the desire to be growth-oriented. These firms are the most likely beneficiaries of SME support programmes because they show the most promise in terms of growth and we sought to understand the constraints and challenges they face in doing business.

Our research strategy was to conduct in-depth interviews with a small number of firms to better understand the choices they make and the environment in which they operate. Although the firms that we interviewed were not randomly sampled or selected using a probability sample, we covered many key industries and conducted interviews in four different provinces, so our survey attempted to be broadly representative.

In the following sections of this chapter, we set out our approach to interviewing these firms. We first describe the survey questionnaire, then we discuss our industry and geographic selection and finally we explain how firms were recruited to participate in the survey.

Survey questionnaire development

Our research team designed a new survey questionnaire to elicit detailed information about how SMEs operate, the constraints they face, and the successes and failures of existing government programmes and policies in helping these firms to grow. The survey focused on open-ended questions and was designed as a guide for structured one-on-one interviews with owners of SMEs. Although the body of the survey was dedicated to fielding open-ended questions, we also included many quantitative response items which were more direct and specific.

Table 6 shows the various sections in the questionnaire. The questions in these sections were chosen to shed light on the constraints that firms may face, based on the analytical framework described earlier. After enumerators had filled out the basic interview information (section O), they began the survey by asking SME owners or managers basic questions about individual-level demographic characteristics, the type of products produced by the firm they manage, the hours they work and their typical season of operation (section A). Next, they asked about starting and operating the business, including how the business started and why the particular industry was chosen. Finally, owners and managers were asked to choose the top three most important challenges that were affecting the success of their business at that time. This question was used to structure the rest of the conversation between the enumerator and the firm owner or manager. Areas that were most important were assigned higher priority and if the interview ran out of time, lower-priority questions were left out. The remainder of the survey covered elements of the analytical framework in depth, including licensing (section B), raw materials (section C), access to markets (section G), credit constraints (section I) and taxation and informal payments (section M), among others.

Table 6   Questionnaire sections

Section	Description
O	Interview information
A	Basic information (location, firm and respondent information, starting and operating the business)
B	Licensing
C	Raw materials
D	Production
E	Sales and distribution
F	Profits and growth
G	Access to markets
H	Managerial training
I	Credit constraints
J	Labour and human capital
K	Production technology
L	Cooperatives and industry associations
M	Taxation and informal payments
N	Other government policies

The full questionnaire can be found in appendix A.

Our in-depth interviews with SME owners or managers typically lasted between 60 and 90 minutes. The full questionnaire is reproduced in appendix A. After administering the questionnaire, enumerators were asked to fill in a debriefing form to summarise the firm's responses to the major questions in the survey. The debriefing form is reproduced in appendix B.

Industry selection

To determine the firms to be interviewed, we first selected the industries that are currently major sources of employment for SMEs and focus sectors for Indonesia. These industries are potential targets for policy changes to facilitate broad economic growth and poverty reduction. We also included industries that are more aspirational, innovative and dynamic that may be currently growing in importance. These industries are also dispersed over several provinces, allowing us to highlight the diversity of experiences and challenges that different firms in Indonesia face in different regions of the country. Table 7 shows the final set of industries we selected based on internal discussions, analysis of existing data, anecdotal evidence and discussions with researchers at the World Bank and TNP2K.

Table 7   Primary industries for qualitative interviews

Current sources of employment	New industries with growth potential
Food and food processing (chips, tofu and tempeh)	Modern garments: Muslim fashion
Coffee	High-value-added information and communications technologies (ICT)
Traditional garments: Batik	
Teak furniture	
Services: Restaurants (*Warungs*), auto repair	

We selected industries that are current employment sources based in part on data from the IMK 2013 survey. Table 8 reports the most important SME industries, based on the number of firms (and number of employees). The food sector was the single largest industry category for micro and small firms, accounting for 35.1 percent of micro firms and 30 percent of small firms. For this reason, we chose food and food processing (chips, tofu and tempeh) and coffee as primary industries. The garment sector is another important industrial sector for SMEs, accounting for 18.6 percent of small firms and 8.3 percent of micro firms. We chose batik textiles, a traditional garment industry, and modern Muslim fashion, a potential source of future growth, as two representative industries in this sector. Another important industry is furniture, accounting for 5.8 percent of small firms, which guided our choice of teak furniture as a primary industry.

Table 8   Micro and small enterprises, by industry

KBLI Code	Description	Percentage of total firms		Percentage of total workers	
		Micro	Small	Micro	Small
10	Food	35.1	30.0	38.0	29.0
11	Beverages	1.6	0.4	1.4	0.3
12	Tobacco products	1.7	2.8	1.5	2.6
13	Textiles	9.2	5.2	6.9	5.8
14	Garments	8.3	18.6	7.0	20.6
15	Leather, footwear and related products	0.6	4.2	0.7	4.8
16	Industrial wood and wood products	25.3	10.0	22.8	9.3
18	Printing and reproduction of recorded media	0.8	1.6	1.0	1.7
23	Other non-metallic mineral products	6.8	13.0	8.9	12.1
25	Fabricated metal products	2.1	3.3	2.6	3.0
31	Furniture	3.5	5.8	4.0	5.6
32	Other manufacturing	2.6	2.6	2.5	2.6
99	Other industries	2.5	2.5	2.6	2.8
		100	100	100	100

SOURCE: Authors' calculations using IMK 2013 data
NOTE: The industrial wood and wood products industry (KBLI code 16) excludes furniture. Other industries (code 99) aggregate all firms that operate in several other industries, each of which had no percentage value of total firms or employment greater than one. Medium-sized firm information from the WBES 2009 data could not be included because of differences in industry codes.

Geographic selection

After selecting industries, we selected subdistricts (*kecamatan*) where firms in specific industries tended to be concentrated. The study team wanted a broad geographic scope and chose four provinces in which to conduct interviews: West Java (and Jakarta), Central Java, North Sumatra and South Sulawesi. Within each province, we selected the sites based on existing data whenever possible. We also relied on anecdotal evidence on important areas to study, although ease of access played a role, drawing on lessons learnt from previous field research in Indonesia.[13]

Enumerators conducted interviews with SME owners and managers in four research teams, operating independently and simultaneously, in August 2014. Table 9 describes the composition of interviews across industries and locations. A total of 48 interviews were conducted in each of the four provinces. Our sample includes 30 SMEs involved in food processing, 48 firms in the coffee industry, 30 firms in the services sector (restaurants and motorcycle repair), 48 firms in the garment industry (24 in batik and 24 in modern Muslim fashion) and 12 firms in the high-value-added information and communication technology industry (ICT). In most instances, all interviews in the same industry were conducted in a single province but, for the 60 food processing and services firms, industries were spread across multiple provinces.

Table 9:   Field research teams, industries and sample sizes

Industry	Team 1	Team 2	Team 3	Team 4	Total interviews (by Industry)
	West Java	Central Java	North Sumatra	South Sulawesi	
	Jabodetabek, Bandung	Solo, Pekalongan, Jepara	Medan, Aceh	Makassar, Toraja	
Food processing	6		12	12	30
Services (restaurants)	3		6	6	15
Services (motorcycle repair shops)	3		6	6	15
Batik textiles		24			24
Modern Muslim fashion	24				24
Teak furniture		24			24
Coffee			24	24	48
High-value-added ICT	12				12
Total interviews (by team)	48	48	48	48	192

SOURCE: Authors' calculations
NOTE: Jabodetabek covers the urban area surrounding Jakarta, including Jakarta Bogor, Bekasi, Depok, Tangerang and South Tengerang.

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13   Ideally, we would have selected our sample by first stratifying by industry, then randomly selecting locations with firms in those industries and randomly selecting firms from those industry-location cells. However, because there is no detailed, comprehensive register of SMEs in Indonesia that could be used for sampling, this was not practical.

Description of fieldwork and selection of firms

Field research teams attempted to select firms for interviews quasi-randomly, within selected subdistricts, to make the sample as representative as possible. However, as we did not design a probability sample, we were not expecting to achieve a representative sample of firms.

In each subdistrict visited, the field team first met with key informants (local and regional government officials) who dealt with SME affairs to obtain a list of these enterprises in the area. Data on SMEs made available by these key informants were often outdated or included partial or no contact information and the criteria captured about SMEs in these lists varied according to the government offices concerned. For example, a list might contain the name of the business and a phone number but no address. For some teams, official lists were difficult or impossible to obtain, for example if local government officials were not available or the office did not keep records. When lists were available, teams tried to contact every third SME on the list for an interview. If the SME declined or was not available, the team would go to the next SME on the list and start the pattern over.

For teams that could not obtain official lists and for those teams with lists needing a larger sample to contact, teams used a "windshield sampling" method, which involved identifying firms visually and selecting a sample. Windshield sampling can be used when there is a large concentration of firms in an area. The research team used this method to select firms to interview essentially randomly. For example, on a street with a cluster of motorcycle repair shops, every third SME was asked to participate in an interview. If the firm was not interested, the field teams would move to the next SME and repeat the pattern of inviting every third SME accordingly. In areas where firms were more sparse, using a snowball method, the teams would often ask a firm or a key informant to identify potential interview subjects in the selected sector.

Using four teams collecting data over a three-week period and interviewing up to three firms per day, we expected to sample approximately 192 firms in total. This goal was met, and the sample included SME owners and managers from Indonesia, as well as a few foreign-owned SMEs.

Because of our sampling approach, our final firm sample was not randomly selected and is unlikely to be representative. Although it is difficult to assess the extent to which our sample is biased based on our sampling approach, we also believe non-response by firms contributed to a non-representative sample. Our impressions were that some of the most successful firms with the strongest potential for growth may have refused to participate in the survey. Our survey was relatively long (60 to 90 minutes) and several busy firms refused to participate when they realised the amount of time it would take out of their working day. In some cases, the SME owner or manager asked the research team to come back at a later time or date to finish the survey, resulting in some surveys being incomplete because the respondents were still too busy to complete the surveys at a later time. Moreover, although the teams were able to meet our desired sample sizes, many had considerable difficulty finding SMEs to interview. Because the interviews were conducted in the weeks after Idul Fitri (Eid) some firm owners or managers were travelling on business or for personal reasons.

In addition to interviewing firms, all teams conducted short interviews with key informants for each industry. These informants included government officials at local and regional levels, as well as experienced informants who work in the private industry and have a deep understanding of the business environment. While these interviews were not the main focus of this work, their discussions added to the richness of this analysis.

Sample characteristics

In table 10, we report basic descriptive statistics of the firms in our survey and compare them with those taken from nationally-representative data sets. The firms we interviewed had, on average, approximately 21 employees; this is substantially larger than the average size of the workforce for micro and small firms (column 1) but smaller than the average size of the workforce in medium-sized firms (column 2).

Approximately 10 percent of the firms we interviewed were seasonal, similar to micro and small firms. Women managed 30 percent of the firms we interviewed. Perhaps the most striking difference between our survey and other nationally-representative surveys is that approximately 87 percent of the managers had completed secondary school. This is substantially larger than the average secondary school completion rates for micro, small and medium-sized firms. Approximately 18 percent of the firms we interviewed exported some of their output, also significantly higher than the average rates of export for firms of this size.

Table 10   Summary statistics: RAND and AKATIGA Survey sample vs nationally-representative data

| | Combined IMK and WBES data | | R+A SME sample | |
	Micro and small firms mean (SD)	Medium firms mean (SD)	Mean (SD)	N
Number of workers	2.8 (2.5)	36.4 (18.0)	20.9 (30.6)	192
Value added (millions of Rp)	173.1 (820.5)	12,580 (147,112.3)	N/A	
Monthly wages per worker (thousands of Rp)	831.2 (877.9)	1,746.3 (1,865.2)	N/A	
Seasonal	0.1 (0.3)	0.2 (0.4)	0.1 (0.3)	192
Male owner/manager	0.6 (0.5)	0.8 (0.6)	0.7 (0.5)	192
Manager completed secondary school	0.2 (0.4)	0.7 (0.4)	0.9 (0.3)	192
Entire output sold locally	0.8 (0.4)	0.8 (0.4)	N/A	
Any exports	0.0 (0.0)	0.0 (0.2)	0.2 (0.4)	192

SOURCE: Authors' calculations using IMK 2013 data, WBES 2009 data and R+A SME data.
NOTE: Three firms with labour forces of more than 100 were interviewed; these were seasonal firms in the furniture industry. Excluding these firms, the average labour force size was 17.9 workers (standard deviation – SD – 17.01).

In the following sections, we provide background on the industries we surveyed, and we discuss the reasons for focusing on these industries in our study. We also identify specific policy initiatives pertaining to these industries that we were hoping to learn more about during the data collection.

Food processing

As discussed earlier, the food industry is an important source of employment in Indonesia and many SMEs currently operate in this industry. Apart from its size, food processing is also useful to study because it plays a crucial role in rural development in Indonesia. Improving productivity in food-processing SMEs could generate employment opportunities in rural areas, raise producer prices for agricultural products and lead to increases in food availability. It would lead to considerable economic growth and reduce poverty.

Within the broad industrial category of food processing, two sub-industries stand out in terms of importance. These include the chips and crackers industry, and the tofu and tempeh industries. Together, these two industries account for nearly 48 percent of small firms involved in food processing. Coffee is another important industry with regard to economic activity in Indonesia, both in terms of production and in terms of the links between processors and retailers in the supply chain. We describe these three food-processing industries below.

Chips (kripik)

Indonesian chips (*kripik*) are snack foods and are produced in many parts of the country. Many different kinds of nuts, fruit and root vegetables can be made into *chips*, for example, *kripik singkong* (cassava chips), *kripik apel* (apple chips), *kripik nangka* (jackfruit chips) and *kripik ubi* (sweet potato chips). Figure 10 shows a photo of an SME from Bandung, West Java, that produces *kripik pisang* (banana chips); this firm, owned and operated by a woman, has six employees and has been in operation since 1993.

Different types of chips are produced in different regions, often as a consequence of the local availability of specific food products. The chip industry includes small, household-level industries, as well as slightly larger, medium-sized firms. At the household level, chips are produced using simple technologies, such as sunlight to dry raw materials. Promoting the use of even simple but more efficient technologies could have a meaningful impact on output in this industry. Logistical improvements to help chip-producing SMEs access the raw materials they need would also be beneficial. Indonesia's chip industry has benefited from an increased demand for ready-to-eat food, especially in cities, and from improvements in transport links between rural and urban areas.

Figure 10   Banana chips (kripik pisang) SME, Bandung, West Java

SOURCE: SME survey respondent, banana chip processing

Tofu and Tempeh

Tofu and tempeh, both derived from soybeans, are two of the most commonly consumed food products in Indonesia. According to the 2009 National Socioeconomic Survey (Susenas) data, more than 63 percent of Indonesian households consumed tofu and nearly 70 percent consumed tempeh. Productivity improvements in the tofu and tempeh industries could not only lead to better wages for the workers in those industries but could also lead to lower food prices and welfare improvements for many Indonesian consumers. Figure 11 depicts an SME from Makassar, South Sulawesi, that produces tofu. This SME, owned and operated by a man, has five employees and has been operational since 1997.

Tofu and tempeh SMEs are vulnerable because they rely on imported soybeans for production. As a result, the profitability of these firms is subject to considerable world price fluctuations. Indonesia's domestic demand for soybeans exceeds 2.2 million tons per year but local farmers are able to meet only 60 percent of domestic needs.[14] Due to this high dependence on imports, the industry feels the effects of fluctuations in international soybean prices. However, up to the present, demand for tofu and tempeh has been strong, especially because prices are relatively low compared with protein substitutes, such as meat products. Nationally, tofu and tempeh producers are organised with the support of an industry association, *Koperasi Pengusaha Tempeh Indonesia* (KOPTI). The purpose of this cooperative is to provide raw materials and help this industry to develop.[15]

Figure 11 Tofu processing SME, Makassar, South Sulawesi

SOURCE: SME survey respondent coffee producer and roaster

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14   For example, see Ministry of Industrial Development (2014).

15   Note that the role of KOPTI may be changing, as sales agents are increasingly responsible for supplying raw materials.

Some coffee plantations, including those in Aceh, have developed into small industries, where coffee is milled, roasted and sold at local markets (in subdistricts or districts) and coffee shops. However, domestic consumption of coffee in Indonesia is relatively low at 0.9kg per capita per year. This is below the average of 1.1kg per capita per year in Asia and far from the top consuming countries. However, the growth of coffee shops in urban areas (including local SMEs and international chains such as Starbucks) may lead to an increased demand for coffee and domestic consumption is increasing.

Coffee

Indonesia is the world's fourth-largest producer of coffee and the world's single-largest producer of robusta coffee varieties. Coffee production in Indonesia began with its colonial history and, for many decades, coffee has been a significant source of economic growth. Indonesia has many favourable agronomic and climatic conditions for coffee plantations. In recent years, export markets have taken a keen interest in small-scale coffee producers and particularly in coffee varieties produced in Sumatra (Mandailing, Batak) and Sulawesi (Kalosi, Toraja). Although coffee accounts for only a small percentage of SMEs (less than 0.5 percent of food-industry SMEs), it may become a future source of economic growth and employment, particularly in rural areas. The SME photographed in figure 12, owned and operated by a man, is a coffee growing and roasting firm that has been operational since 1994 and has between 10 and 60 employees, depending on the season. The firm is located in the mountains north of Tana Toraja, South Sulawesi.

Figure 12 Unroasted beans from a coffee-producing SME, South Sulawesi

Some coffee plantations, including those in Aceh, have developed into small industries, where coffee is milled, roasted and sold at local markets (in subdistricts or districts) and coffee shops. However, domestic consumption of coffee in Indonesia is relatively low at 0.9kg per capita per year. This is below the average of 1.1kg per capita per year in Asia and far from the top consuming countries. However, the growth of coffee shops in urban areas (including local SMEs and international chains such as Starbucks) may lead to an increased demand for coffee and domestic consumption is increasing.

Indonesia's coffee-processing industry is still underdeveloped. Locally processed coffee amounts to less than 4 percent of exports, while raw beans make up the rest of exports. If Indonesia wants to expand its coffee industry, it faces a number of challenges. Processing is inhibited by the seasonality of coffee plantation bean yields, the lack of available roasting and grinding technologies, inadequate storage facilities and local distribution problems. Increased demand has affected the environment and concerns about sustainability have been growing (see the Common Code for the Coffee Community Association).

We focused on the coffee industry because it is likely to be a continued source of comparative advantage for Indonesia. However, the firms in this industry face many difficulties in marketing their products, finding ways to connect to export markets, navigating international trade and coping with poor transport infrastructure. Issues of compensation, market power from distributors and international competition may also need to be highlighted and discussed.

In conducting interviews, we surveyed different types of firms in the production and distribution process, including smallholder plantations, coffee processors and distributors (bean filterers, roasters, grinders and distributors) and coffee retailers (coffee shops, restaurants).

Descriptive statistics

In table 11, we present summary statistics on the food and food-processing industry, comparing the data we collected (R+A SME Survey data) with data from the IMK 2013 survey and WBES 2009. The first column of this table reports the mean and standard deviation of several different variables for all micro and small firms in the food processing industry, and the second column reports those same summary statistics for medium-sized firms. The third column presents the summary statistics for our sample.

Table 11   Summary statistics for food-processing micro, small and medium-sized firms

	Combined IMK and WBES data		R+A SME sample	
	Micro + small Mean (SD)	Medium firms Mean (SD)	Mean (SD)	N
Number of workers	2.8 (2.5)	36.4 (18.0)	14.9 (15.4)	78
Value added (millions of Rp)	173.1 (820.5)	12,580 (147,112.3)		
Monthly wages per worker (thousands of Rp)	831.2 (877.9)	1,746.3 (1,865.2)		
Seasonal?	0.1 (0.3)	0.2 (0.4)	0.2 (0.4)	78
Male owner/manager?	0.6 (0.5)	0.8 (0.6)	0.8 (0.4)	78
Manager completed secondary school?	0.2 (0.4)	0.7 (0.4)	0.8 (0.4)	74
Entire output sold locally?	0.8 (0.4)	0.8 (0.4)		
Any exports?	0.0 (0.0)	0.0 (0.2)	0.1 (0.3)	78

SOURCE: Authors' calculations using IMK 2013, WBES 2009 and R+A SME Survey (2014) data.
NOTE: Summary statistics are calculated only for firms in the food and food-processing industries.
For the R+A SME Survey data, the industries represented include coffee and food processing (chips and tofu).

The 78 food-processing firms that we surveyed had an average of almost 15 employees, which is much larger than the average employment size for micro and small food-processing firms but smaller than the average medium-sized food-processing firm. Rates of seasonality and male ownership or management were similar. However, the owners of food-processing firms that we interviewed tended to be more likely to have completed secondary school than most MSMEs in Indonesia. Of the firms in our sample, 80 percent were operated by a manager who had completed secondary school, compared with 70 percent of owners of medium-sized food-processing firms and 20 percent of owners of micro or small firms in the nationally-representative data sets. Our sample of firms was also significantly more likely to export than the average food-processing MSME.

Garments

The garment sector is another industry that accounts for a large portion of SME activity. Nearly 10 percent of all SMEs operate in the garment sector and they account for 12.3 percent of total SME employment. The garment sector tends to be labour intensive and generally pays low wages to its workers. Productivity growth in this sector could be valuable as a means of reducing poverty. A major constraint is that these SMEs tend to use outdated production technologies and, due to increasing international competition, the industry is often referred to as a "sunset industry".

Products in the garments sector tend to be differentiated between mass-produced garments that are woven and printed cheaply, using extensive capital equipment, and hand-crafted garments made with traditional, often labour-intensive technologies. Large and medium-sized garment firms that tend to produce garments using capital-intensive production methods, sometimes export their products to the United States and Europe but most small and household enterprises tend to serve the domestic market. Import competition, as a consequence of the Association of Chinese Asian Nations (ASEAN) China Free Trade Act and the rise of illegal imports, has had serious adverse effects on the industry. Rising wages have also made this sector less competitive (Tambunan 2007).

Traditional garments: batik

To capture the traditional garment sector, we focused on batik, which is a technique of creating intricate designs on textiles by applying wax-resistant dyes. Originally, batik garments were produced mostly by small craftsmen or artisans but hand-dyed batik has faced increasing competition from mass-produced garments. Batik is mostly produced in Java and particularly in Central Java. Batik shirts on sale at the shop of an SME from Pekalongan, Central Java, are shown in figure 13. This firm, run by a woman, employs 11 workers and has been operating since 1974.

Different regions have different styles. Along the north coast of Java (in cities such as Rembang and Blora in Central Java or Cirebon in West Java), batik is influenced by the Chinese style and tends to use brighter colors. This contrasts with the more muted colour palette exhibited by batik printed in Solo or Yogyakarta in Central Java. A variety of differentiated products are produced and sold in the batik garment industry, ranging from low-quality, mass-produced batik to high-quality, artisanal garments.

Imported competition from China has become more intense in recent years. At the same time, batik has experienced growing popularity and new designers are experimenting with different production methods and inventing new designs.[16] The demand for batik in Indonesia is high and is expected to remain so for the foreseeable future. Some government offices and private-sector companies require their employees to wear batik on certain days.

Modern garments: Muslim fashion

In addition to traditional garment firms, we also interviewed firms from a more dynamic, forward-looking garment sector, Muslim fashion. Recently, many SMEs have become involved in designing and producing hijabs, veils that cover the head and chest and are typically worn by Muslim women. With rising levels of income, the demand for more stylish, innovative hijabs has been growing. Muslim fashion designers in Indonesia also focus on dresses and other clothes for Muslim women. An example of a Muslim fashion design firm from Bogor, West Java, is shown in figure 14. This firm, which began operations in 2010, is owned and operated by a woman and employs six workers.

Figure 13   Batik shop, Pekalongan, Central Java

SOURCE: SME survey respondent batik shop

"Hijabers" have also established an industry association called the Hijabers Community (*Republika Online 2012*). In Bandung and Jakarta, there has been an upsurge of new hijab designs, incorporating more flair and modern design principles. This has given rise to a modern hijab industry, attracting international consumers and providing a source of local employment. Bandung, West Java, is a central location for the new hijab fashion industry. Recently, Bandung's airport has opened up direct flights to Kuala Lumpur and many Malaysian customers fly directly to Bandung to purchase hijabs and other articles of clothing.

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16   The United Nations Educational, Scientific and Cultural Organisation (UNESCO) has been involved with the Indonesian government in ensuring authentic batik traditions and appropriate labelling of authentic batik. See UNESCO (2012).

Figure 14 Muslim fashion design SME, Bogor, West Java

SOURCE: SME survey respondent, Muslim fashion designer

Challenges faced by Indonesia's Muslim fashion industry include: dependency on imported materials, such as cotton or silk; outdated production technologies; absence of qualified staff; and the need for more market research and better designs (Ministry of Industrial Development 2012). The previous Tourism and Creative Economy Minister, Mari Elka Pangestu, set a target for Indonesia to become a global Muslim fashion hub by 2020, due to the country's flourishing Muslim garment and clothing industry (*Jakarta Post* 2014).

Although modern Muslim fashion may not currently be a large employment generator, this is an example of a creative and innovative sector in which SMEs can be active participants and it is a potential growth industry as the demand for modern Muslim fashion increases.

Descriptive statistics

Table 12 compares summary statistics for the garment industry firms we interviewed against the average summary statistics of all garment-producing MSMEs.

Table 12   Summary statistics for garment-producing micro, small and medium-sized firms

	Combined IMK and WBES data		R+A SME sample	
	Micro + small firms Mean (SD)	Medium-sized firms Mean (SD)	Mean (SD)	N
Number of workers	3.7 (4.0)	32.5 (12.9)	20.5 (19.9)	48
Value added (millions of Rp)	249.0 (760.5)	69,376 (348,946)		
Monthly wages per worker (thousands of Rp)	1,051.0 (959.9)	1,153.26 (555.4)		
Seasonal?	0.0 (0.2)	0.3 (0.5)	0.0 (0.1)	48
Male owner/manager?	0.5 (0.5)	0.8 (0.4)	0.3 (0.5)	48
Manager completed secondary school?	0.3 (0.5)	0.9 (0.3)	1.0 (0.2)	47
Entire output sold locally?	0.6 (0.5)	0.8 (0.4)		
Any exports?	0.0 (0.0)	0.0 (0.2)	0.1 (0.3)	48

SOURCE: Authors' calculations using IMK 2013 data, WBES 2009 data and R+A SME Survey (2014) data.
NOTE: For the R+A SME Survey data, the garment industry is represented by the combination of batik and modern Muslim fashion owners or managers.

The 48 garment SMEs that we interviewed employed an average of about 20 workers. This is significantly bigger than the average workforce for micro and small garment firms but smaller than the average workforce of medium-sized garment firms. Roughly 70 percent of the firms we interviewed were owned or operated by women, compared with 50 percent of micro and small garment firms, and 20 percent of medium-sized garment firms in the nationally-representative data sets. Nearly every firm we interviewed was run by someone with at least a secondary school certificate, compared with 30 percent of micro and small firms and 90 percent of medium-sized firms. More than 10 percent of the firms we interviewed exported products, compared with less than 7 percent of medium-sized firms and roughly 1 percent of micro and small firms. Garment MSMEs tend to employ more workers, on average, than MSMEs in other industries.

Furniture

The furniture industry accounts for 22.9 percent of all micro and small firms and 17.8 percent of total micro and small firm employment, according to IMK 2013 data.[17] However, the furniture industry tends to be a controversial industry in Indonesia. Although production is reasonably competitive, with many SMEs involved, there is a bottleneck in the distribution of wood to furniture producers. A state-owned enterprise, Perum Perhutani, has the monopoly on the rights to sell newly-harvested wood to furniture producers throughout Java and Madura. This firm was created in 1972 under Suharto's New Order Regime. Although *Perum Perhutani* was established in the context of environmental protection and aimed to manage forests for sustainable wood cultivation, in practice, there are indications that it engages in rent-seeking to inflate prices, undermining

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17   Furniture firms are not well surveyed in the WBES 2009 data set, so these statistics have not been provided for medium-sized firms.

furniture producers (Rosaydi and Nuryartono 2003).[18] Moreover, after the fall of Suharto in 1998, the effectiveness of *Perum Perhutani* in combating illegal logging began to decline, increasing ecological degradation and tempering wood prices.[19]

The most famous centre for teak furniture production is Jepara, located on the north coast of Central Java. Teak furniture from Jepara is especially well known for its intricate carving. Another centre for teak furniture is in nearby Solo (Widyaningrum 2003). An example of teak furniture from an SME showroom in Solo is depicted in Figure 15. This firm, owned and operated by a man, started operation in 1999 and employs seven workers.

Figure 15 Teak furniture from a SME showroom in Central Java

SOURCE: SME survey respondent, teak furniture

The teak furniture industry in Jepara grew after the 1998 Asian financial crisis. The demand for Jepara furniture increased at the end of the 1990s which led to the rise of exporting firms and foreign investment. As a result of foreign investment restrictions, sometimes foreigners directly employ locals to be de jure owners of the firm, even though the foreigners themselves make all of the investment and operating decisions.

18   While *Perum Perhutani*'s control over the industry makes policymaking difficult, many industries in Indonesia are similarly controlled by monopolies. This absence of competition creates deadweight losses for consumers and hurts small businesses (rattan, sugarcane, tobacco). Describing how SMEs react to these challenges is important and could serve as a useful case study for long-term policymaking.

19   For an overview of forest management practices in Indonesia, see Nomura (2008). Burgess et al. (2012) describe how decentralisation created the potential for increased illegal logging and led to lower forest cover throughout the archipelago.

Local industry associations in Jepara's teak furniture industry include the Jepara Wood Craftsmen Association, (*Asosiasi Pengrajin Kayu Jepara*) and the Jepara Wood Craftsmen Association for Small-scale Firms (*Asosiasi Pengrajin Kayu Jepara Skala Kecil*). These industry associations enable their members to negotiate better selling prices for their products and to increase their orders by marketing their products locally, nationally and internationally. National industry associations include Asmindo (*Asosiasi Pengusaha Mebel Indonesia*) and the Wood and Rattan Furniture Association of Indonesia (*Asosiasi Mebel Kayu dan Rotan Indonesia*).

Descriptive statistics

Table 13 shows that the furniture SMEs we interviewed tended to be significantly larger than most micro and small SMEs. They were more likely to be owned and operated by women and their owners and operators were more likely to have completed secondary school. They were also much more likely to export than the average micro or small furniture-producing SME.[20]

Table 13   Summary statistics for furniture micro small, and medium-sized firms

	IMK data	R+A SME sample	
	Mean (SD)	Mean (SD)	N
Number of workers	3.4 (3.1)	46.5 (70.0)	24
Value added (millions of Rp)	212.0 (339.2)		
Monthly wages per worker (thousands of Rp)	1,497.7 (1,225.2)		
Seasonal?	0.0 (0.2)	0.0 (0.0)	24
Male owner/manager?	1.0 (0.2)	0.8 (0.4)	24
Manager completed secondary school?	0.3 (0.5)	1.0 (0.0)	24
Entire output sold locally?	0.7 (0.5)		
Any exports?	0.0 (0.0)	0.7 (0.5)	24

SOURCE: Authors' calculations using IMK 2013 data and R+A SME Survey (2014) data

Services (restaurants and motor repair shops)

Although not included in the 2013 IMK survey, the services sector probably accounts for a large source of employment in Indonesia. Within services, there are many different types of firms and the composition of firms is heterogeneous. We chose to focus on small restaurants and auto or motorcycle mechanics. Small restaurants (known as *warungs*) and auto mechanics are located throughout many cities and small towns in Indonesia.[21]

Many service-sector SMEs tend to not be formally registered, which is discussed using our data later in the report. Previous research is inconclusive on the extent to which service-sector firms would switch to the formal sector if it were possible.

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20   The WBES 2009 sampled only a single medium-sized furniture producer, so we do not present summary statistics for medium-sized firms in table 13.

21   A specific type of restaurant called *warung Tegal* has a large market in Jakarta, with about 27,000 SMEs in the city and its surrounding areas. A large community of entrepreneurs from Tegal work in these restaurants and sometimes even the ingredients for food have been sourced from Tegal (for example, duck's eggs).

Descriptive statistics

Table 14 compares summary statistics for the services firms we interviewed with summary statistics for all firms from the IMK 2013 survey. The services firms we interviewed had more workers, were more likely to be owned and operated by men and were more likely to be owned and operated by someone who had completed secondary school than the average micro or small firm. There were no major differences in seasonality.

Table 14   Summary statistics for services firms

	IMK data	R+A SME sample	
	Mean (SD)	Mean (SD)	N
Number of workers	2.9 (2.8)	15.3 (15.5)	30
Value added (millions of IDR)	148.3 (728.8)		
Monthly wages per worker (thousands of IDR)	1,031.2 (1023.4)		
Seasonal?	0.0 (0.3)	0.0 (0.0)	30
Male owner/manager?	0.6 (0.5)	0.8 (0.4)	30
Manager completed secondary school?	0.2 (0.4)	0.8 (0.4)	30
Entire output sold locally?	0.7 (0.4)		
Any exports?	0.0 (0.1)	0.0 (0.0)	30

SOURCE: Authors' calculations using IMK 2013 data and R+A SME Survey (2014) data
NOTE: This table includes only IMK data because the World Bank survey coverage for the furniture industry is limited. For the R+A SME Survey data, the industries represented in this table include restaurant and motor repair services.

High-value-added ICT

The final sector we focused on was high-value-added ICT which helps to track Indonesia's progress towards increasing its share of knowledge-based firms. To measure and monitor the extent to which economies are knowledge-based, the World Bank developed a knowledge economy index (KEI) which is based on four pillars: (1) the quality of the economic and institutional regime; (2) the education and skill of the population; (3) the information infrastructure; and (4) the innovation system. Figure 16 plots this index for all countries in Asia and the Pacific. In 2012, Indonesia was below the average for Asian economies and only Myanmar and Cambodia had lower KEI scores in Southeast Asia. Indonesia also scored poorly on each of the sub-indexes, relative to other Southeast Asian nations.

As Indonesia takes steps to change to a more knowledge-based economy, ICT firms with high value added may become important sources of employment for high-skilled workers. Several of these firms currently exist in Indonesia, particularly in Jakarta. We interviewed firms specialising in software development, mobile applications, video games and digital animation.

Descriptive statistics

As in table 14, table 15 compares summary statistics for the high-value-added ICT firms with summary statistics for all firms from the IMK 2013 survey. The ICT firms we interviewed had more workers, were more likely to be owned and operated by men and were more likely to be owned and operated by someone who had completed secondary school than the average micro or small firm. Unsurprisingly, no ICTs are seasonal but they are highly export-oriented – 50 percent exported products, compared with only 1 percent of all micro and small firms.

Figure 16   Knowledge economy index, Asia

	Value
Taipei, China	8.77
Hong Kong, China	8.52
Japan	8.28
Singapore	8.26
Rep. of Korea	7.97
Malaysia	6.1
Thailand	5.21
Georgia	5.19
Armenia	5.08
Kazakhstan	5.04
Azerbaijan	4.56
Mongolia	4.42
People's Republic of China	4.37
Philippines	3.94
Fiji	3.94
Kyrgyz Republic	3.82
Sri Lanka	3.63
Viet Nam	3.4
Uzbekistan	3.14
Tajikistan	3.13
Indonesia	3.11
India	3.06
Pakistan	2.45
Lao PDF	1.75
Cambodia	1.71
Nepal	1.58
Bangladesh	1.49
Myanmar	0.96

OECD Average (8.25)

Asia and the Pacific Average (4.39)

SOURCE: Data: World Bank Knowledge Economy Index with figure generation by Asian Development Bank, Asian Development Bank (2014)

Table 15   Summary statistics for high-value-added ICT firms

	IMK data	R+A SME sample	
	Mean (SD)	Mean (SD)	N
Number of workers	2.9 (2.8)	23.8 (14.6)	12
Value added (millions of Rp)	148.3 (728.8)		
Monthly wages per worker (thousands of Rp)	1031.2 (1023.4)		
Seasonal?	0.0 (0.3)	0.0 (0.0)	12
Male owner / manager?	0.6 (0.5)	1.0 (0.0)	12
Manager completed secondary school?	0.2 (0.4)	1.0 (0.0)	12
Entire output sold locally?	0.7 (0.4)		
Any exports?	0.0 (0.1)	0.5 (0.5)	12

SOURCE: Authors' calculations using IMK 2013 and R+A SME Survey (2014) data
NOTE: This table includes only IMK 2013 data because the WBES 2009 coverage for the ICT industry is limited.

4 Major Constraints Faced by Micro, Small and Medium-sized Enterprises

This chapter describes the many different constraints that Indonesian SMEs face as they do business and attempt to grow. Existing surveys of SMEs, such as the WBES 2009 and IMK 2013, asked firms to identify their most important constraints in doing business and we describe the results from those data here. However, these surveys provide relatively little insight into the reasons behind these constraints so we use information obtained from our qualitative interviews with SMEs to address the root causes.

We first describe the self-reported constraint data from the IMK 2013 and WBES 2009 surveys. We also provide information about the differences in constraints that firms face within and across industries and within and across regions. We next describe the four most important challenges for SMEs doing business in Indonesia: (1) access to finance and credit; (2) access to raw materials; (3) issues with labour and human capital; and (4) access to markets and demand. We conclude with a discussion of other challenges that SMEs face and look towards addressing these challenges through policy changes.

Self-reported constraints faced by MSMEs

Self-reported constraint data have been used in empirical research on firms in developing countries but they have their limitations. Across multiple self-reported surveys about constraints the questions are asked slightly differently and this can affect the interpretation of results. More importantly, many firms may not have sufficient understanding of the market or of their firm's growth potential to recognise what the real problems are in conducting their business operations. Despite these issues, table 16 presents data on self-reported constraints to doing business for micro, small and medium-sized firms. In panel A, we report results from the IMK 2013 data, which cover micro and small firms, while in panel B, we report results from the WBES 2009 data, covering small and medium-sized firms. These two surveys asked firms to name the most important constraint or problem associated with conducting their business operations but these two surveys gave firms different answer options, so the data cannot be compared directly. Responses to a similar question, asked again slightly differently in our survey of SMEs, appear in table 17.

Table 16   Most important constraint to doing business, universe of firms (by percentage)

Panel A: IMK 2013 survey	Micro + small (%)	Micro (%)	Small (%)
Capital	28.0	28.0	27.8
Raw materials	18.4	18.3	19.1
Marketing	15.7	15.4	17.0
Other problems	7.8	7.5	9.5
Worker skills	2.4	2.0	4.7
Fuel/energy	1.4	1.4	1.4
Transportation	1.2	1.2	0.7
Ability to pay wages	0.6	0.5	0.7
No problems	24.6	25.6	19.1

Table 16   Most important constraint to doing business, universe of firms (by percentage) (Continued)

Panel B: WBES 2009 survey	All Medium (%)	All SMEs	
		Formal (%)	Informal (%)
Access to finance	29.0	34.0	23.6
Political instability	19.4	10.0	29.5
Practices of competitors in the informal sector	11.3	17.6	4.6
Electricity	6.8	8.8	4.7
Crime, theft and disorder	3.6	6.6	0.3
Transport	3.3	1.9	4.7
Labour regulations	2.5	4.9	0.0
Corruption	2.4	3.8	0.9
Business licensing and permits	2.1	2.0	2.1
Customs and trade regulations	1.7	3.1	0.1
Inadequately educated workforce	0.7	1.4	0.0
Access to land	0.6	1.2	0.0
Courts	0.6	0.6	0.5
Taxes	0.5	1.0	0.0
Does not know	14.8	1.9	28.4
Does not apply	0.9	1.1	0.6

SOURCE: Authors' calculations using IMK 2013 and WBES 2009 data
Note: The "other problems" category is a catch-all in the IMK 2013 data set.

Table 17   Most important constraint to doing business, R+A SME survey

	All firms (%)
Credit constraints	19.9
Raw materials	18.8
Labour and human capital	17.2
Access to markets	16.7
Sales and distribution	9.7
Licensing	7.5
Managerial training	3.2
Production	3.2
Production technology	2.2
Profits and growth	1.6

SOURCE: Authors' calculations using R+A SME Survey (2014) data

In both tables 16 and 17, credit constraints and access to finance were the most frequently chosen primary constraints to doing business. Approximately 28 percent of micro and small firms identified credit as the major problem, while 36 percent of medium-sized firms interviewed listed this as the number one problem. In our data, nearly 20 percent of firms selected credit constraints as the most important barrier. Other major problems identified in table 17 included access to raw materials, access to markets, and labour and human capital problems. Although the exact rank of importance between our survey and the universe of firms was different, there is broad agreement about the major constraints to doing business.

Differences in constraints by industry

Firms that are operating in different industries and different market environments do not hold the same view of constraints to doing business. This could be due to different operating environments or differences in labour or capital intensity. Figure 17 presents evidence of these differences, focusing on three industries well covered in the IMK 2013 survey: food and food processing, garments and furniture.

Credit constraints were important for firms in all three sectors but only 25.8 percent of food and food-processing firms identified credit constraints as the most important, compared with roughly one-third of firms operating in the other two sectors. Access to raw materials was relatively less important for the garments industry, with only 5.9 percent of firms ranking this constraint as the most important. Almost 30 percent of firms in the garment industry reported no problems in doing business, compared with 25 percent of firms in the food-processing industry and only 15.5 percent of firms in the furniture sector.

The differences in the importance of constraints faced by different industries makes it difficult to design and promote a national, one-size-fits-all SME support policy to improve SME growth in all industries simultaneously. We describe the general challenges associated with doing business in the rest of this chapter, such as: access to information about credit programmes and how to get finance; how to learn about product marketing opportunities; and how to register a business. But we also highlight the diverse approaches that firms in our target industries use to attempt to overcome these challenges.

Figure 17 Differences in constraints by industry, micro and small firms
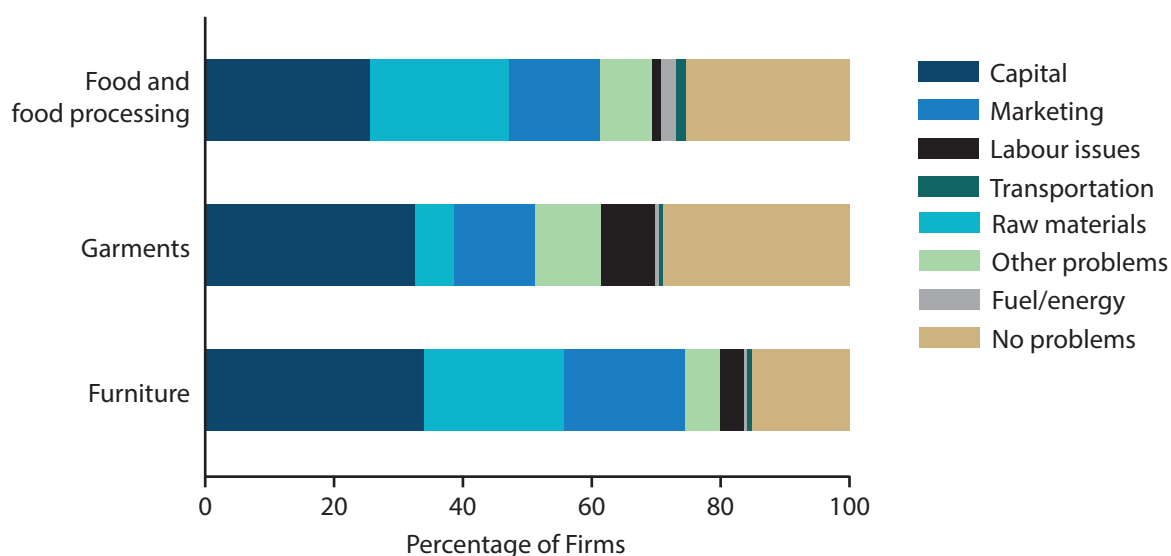
SOURCE: Authors' calculations using IMK 2013 data

Differences in constraints by province

Firms operating in different provinces may also view constraints differently. Regions have different industrial structures, market environments, labour markets, laws and regulations, and implementation of national policies, which can drive heterogeneity in firm experiences. Figure 18 presents data on the constraints faced by all firms across our four study provinces and Jakarta.

Figure 18 Differences in constraints by province, micro and small firms
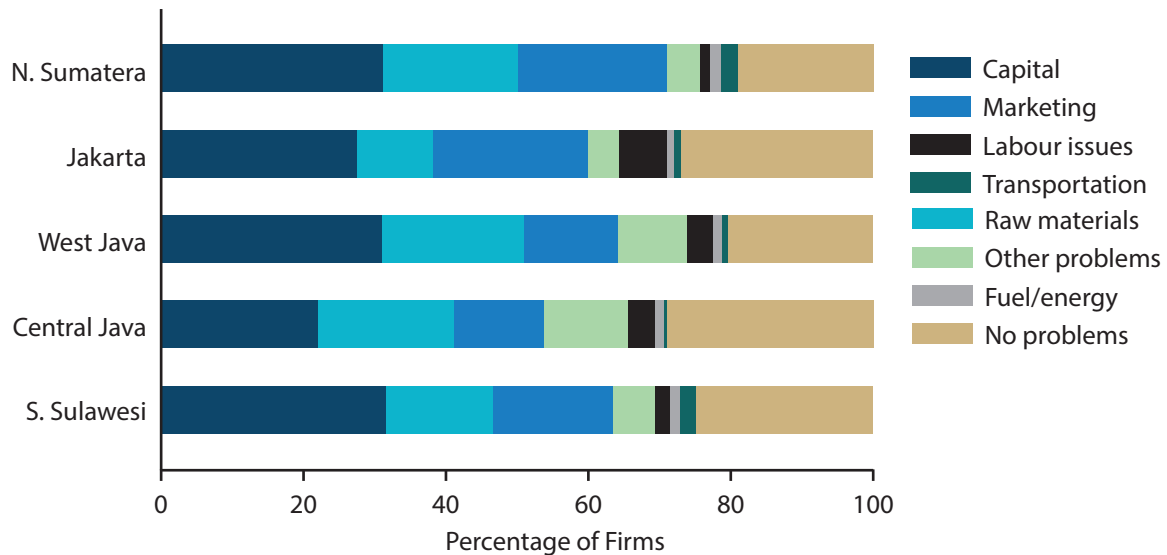
SOURCE: Authors' calculations using IMK 2013 data

For micro and small firms, the most important constraints include access to capital, marketing and raw materials. However, the percentage of firms in Jakarta that have trouble with raw materials is substantially smaller than that percentage for other provinces, presumably reflecting Jakarta's status as a major international capital and import destination. In Central Java, firms were much less likely to report capital constraints as the major problem with doing business than firms in North Sumatra and South Sulawesi. Central Java also had a larger number of micro and small firms that reported no problems with doing business.

Access to finance and credit constraints

Inadequate access to financial capital is an important constraint to doing business for MSMEs in Indonesia. From the IMK 2013 survey, 28 percent of micro firms and 27.8 percent of small firms reported capital as the single greatest constraint to doing business. From the WBES 2009, 29 percent of medium-sized enterprises reported that access to finance was the greatest barrier to growth. From our survey of firms, with results reported in table 17, nearly 20 percent of firms reported that credit constraints were the largest barrier to growth.

Credit constraints can occur for a variety of reasons. A common problem is that lenders are unwilling to provide credit to small firms because investment in new businesses is inherently risky, small firms often fail and many firms often have no collateral to secure the loan. To offer credit to new businesses without collateral, banks have to charge high interest rates that would make many firms unprofitable.[22] Many SMEs we spoke to complained about high interest rates that are symptomatic of failures in the credit market; for instance, one coffee producer

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22   Another problem is that small firms may face unfavourable repayment terms, such as short time windows.

in Central Aceh said that she was offered a loan from a formal financial institution at an interest rate of 12–15 percent. If she accepted this loan, her net profits would not be enough to cover the debt servicing, so she uses informal financial sources as much as possible.[23]

Many managers and owners of SMEs also exhibited a strong tendency to avoid risks and this affected their decisions about how much and from whom to borrow. Borrowing funds from the formal financial sector was seen as inherently more risky than borrowing from family members, who may be lenient or not penalise them if loan repayments are not received on time. Many firms felt that if they could be sure of a stream of profits, they would be willing to take out a loan but doubts about their ability to successfully use borrowed funds to stimulate higher profits prevented them from doing so.

Credit constraints prevent SMEs from investing in new technologies, increasing output, hiring more workers, moving to a more desirable location to reach customers and responding appropriately to demand signals. When faced with credit constraints, many firms obtain capital by self-financing or relying on informal sources, such as loans from individuals and family.[24]

In box 1, we describe the experiences of two batik-producing SMEs in their interactions with formal financial institutions to try to alleviate credit problems. One firm tried as much as possible to rely on informal financial sources but ended up being forced to use an expensive formal loan to pay its workers. Another firm obtained more favourable lending terms by being formally registered and making connections with business associates and government officials. Interestingly, informal firms tended to report credit constraints as the largest barrier to growth more frequently than firms in the formal sector.

While many SMEs face credit constraints, certain industries may give SMEs an opportunity to access and obtain credit more easily. SMEs in the information technology sector that develop mobile applications, for example, often work with private and foreign investors who may be other sources of credit. For example, Doni, the founder of an ICT company with 16 workers in West Java, described how he was made an offer by an investor from Singapore when the firm's founders were collecting funds for start-up capital. The investor contacted Doni when he learnt the firm had won an award in an Indonesian ICT competition in 2010. Doni's company also became a finalist in the Asia Pacific Information and Communications Technology Alliance competition in 2009. The funds that Doni's firm received from the investor were enough to help him expand his business. However, the procedures and information on the proper permits for using foreign funds were unclear. The notary that dealt with the permit also did not understand the regulations for foreign investment funds for companies in Indonesia. Even with these obstacles, the foreign investment allowed him to run a successful business without taking out formal loans.

Access to raw materials

In our survey of SMEs, the second most frequently reported problem with doing business was inadequate access to raw materials. A total of 18.8 percent of firms chose this option as the most important constraint. This was also the second most frequently reported constraint in the IMK 2013 survey of micro and small firms, where 18.3 percent of micro firms and 19.1 percent of small firms identified raw materials as the most important constraint to doing business.[25]

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23   Interest rates for SMEs at formal banks can reach more than 20 percent (IFC 2010) and for other informal financial institutions lending credit, interest rates can be higher than formal lending institutions, especially if the informal credit lenders are not requesting collateral (USAID 2013).

24   Few firms that we interviewed attempted to get investment from sources outside of Indonesia. Those that did were in the high-value-added ICT industry.

25   Note that this large share of firms reporting raw material problems is not entirely explained by them being agriculture-based industries. In our survey, 22.4 percent of firms outside of food processing and coffee chose raw materials as the most important issue.

SMEs in a range of industries face challenges concerning raw materials. Of the firms interviewed, we identified several different types of raw material problems that firms endure: (1) high or variable prices; (2) inadequate access to high-quality materials; and (3) high transport, fuel and electricity costs.

Box 1.   Stories of batik-producing firms with credit constraints

In the batik industry, we highlight two different experiences with accessing credit and finance.

Melati is the owner of a batik firm in Pekalongan, Central Java, that employs 12 workers. She inherited this firm from her parents in 1994 and targets the domestic market for sales of finished batik garments. From the beginning, she felt that the main problem with the business was a lack of financial capital. She needed money primarily to purchase raw materials, pay wages and finance business operations before making sales. Because of her opinion of the credit market, she always tried "as much as possible to use my own money". Melati did not use the existing credit market because of the high interest rates and terms of payment offered to her. When she needed additional money, she borrowed from family and close friends because loan requirements were simple compared with bank loan requirements. She once borrowed from eight family members at once to finance her business and she felt safe doing this because the terms of payment were more flexible than those of a bank loan. For instance, if sales fell temporarily, she could ask for an extension on the loan payment from her family without penalty.

In 2014, she planned to expand her market by opening a store in one of the batik centres in Pekalongan. However, the plan was dropped due to the high rent for the booth (Rp25,000,000 or current USD1,982) which had to be paid in cash in advance for the year. She did not have that much money so she cancelled her plan. She was afraid to spend that much cash and she would have felt more secure paying for the booth through regular installments, given her fluctuating sales.

Also in 2014, at the time of *Lebaran (Eid)*, she had to provide customary allowances (*Tunjangan Hari Raya*) or *Eid* bonuses to her workers and she did not have enough money to do so because sales were down. At that time, she needed a minimum of Rp6,000,000 (current USD476) just for bonuses for her workers, not including operational costs and wages. Even though SME owners are not formally required to give *Lebaran* bonuses, she had been doing this regularly every year.

To finance these bonuses, Melati ended up borrowing money from a bank. She borrowed Rp15,000,000 current USD1,189) and must pay back Rp19,200,000 (current USD1,522) within a year, due to interest. She knows that a 28 percent interest rate is high but she really needed to pay her workers to keep her business running. She decided to borrow from the bank which had contacted her several times to offer a loan. She said that bank employees have lending targets to meet which is why they were so persistent. Moreover, her family had a lot of *Lebaran* expenses and hence were unable to lend her the money.

Mawar, the owner of a batik-producing SME with 31 workers, also in Pekalongan, Central Java, had a different experience with credit. Previously, she had sold handicraft products for export but Mawar started her batik business in 2010 to sell batik within the local market. To start her business, she needed a loan. At the time, with her experience and business network, the credit requirements were easy to meet and she obtained a government bank loan of Rp400,000,000 (current USD31,720) with an interest rate of 12 percent per year. She also got credit from other sources (state-owned enterprises) for smaller sums and at lower interest rates (6 percent per year) and could make repayments quickly.

Mawar understands the process of formal registration and has good connections for information about possible sources of credit. She felt that formally registering her firm helped her access government-sponsored credit programmes. She also felt that having information on various credit sources provided her with choices for the best credit to use to run the business.

High or variable prices

Most of the SMEs we interviewed mentioned that the high, rising or unstable prices of raw materials affected their ability to produce output, generate revenue and earn profits. For example, one respondent in the batik industry noted that several materials used in the production process, including wax and dye, are growing more expensive over time, although there were no shortages in the market. In the coffee industry, fertiliser has increased in price over time, adversely affecting coffee production and interrupting the supply chain for coffee processors.

Unfavourable exchange rate fluctuations can also increase the price of imported raw materials. Batik-producing SMEs mentioned that they often purchased dyes using United States dollars but the products they produced were sold in Indonesian rupiah. If firms purchase raw materials in a stronger currency than they are selling the

products in, they risk having higher costs than revenue. Another example is the tofu and tempeh industry, where soybeans, the main ingredient used, are often imported. In Indonesia, soybeans are not grown in abundance but tofu and tempeh are a large part of the diet for many Indonesians and are a cheaper consumption option than meat products, such as beef or poultry. Demand for tofu and tempeh may be higher in rural and impoverished areas which are sometimes hard to reach for firms importing soybeans.

Inadequate access to high-quality inputs

Many firms we interviewed noted that high-quality raw materials are difficult to find or, if they can be found, they may be too expensive to purchase. For instance, in the Muslim fashion industry, designers often look for high-quality fabrics for production (for example, fabrics with high thread counts and that dye easily). Several firms in this industry noted that high-quality materials are scarce and they need to search for these materials outside the local market.

Some Muslim fashion firms mentioned that they import a significant share of their materials from other countries, such as China, to obtain higher-quality fabrics. Importing raw materials can be challenging for SMEs because of difficulties with customs and immigration. To import raw materials, firms must pay for a legal import permit, which can be expensive. Sometimes, firms have to pay off corrupt inspection officers who can hold textiles in customs and will only release them upon receipt of an unofficial fee. One SME manager we spoke to had obtained an import permit but his goods had been held; he did not want to pay a bribe so he had to ask a third-party agent to help him.

In the services industry, many restaurants we interviewed want to serve high-quality products, including meat, which is a basic item on menus. Restaurants want to ensure that the meat they are serving is fresh, meets halal certification and is up to their quality standards. However, local meat supplies can be limited. A restaurant owner in Makassar serves a traditional beef rib dish, known as sop konro, with almost every item on the menu. To prepare this dish, the restaurant imports meat from overseas because the same quality cannot be found locally. With this business model, the owner pays a high cost for the meat due to import tariffs. Restrictions on the amount of meat that can be imported mean that this business sometimes faces shortages of essential ingredients.

A small number of firms we interviewed reported that they had little difficulty obtaining raw materials. Some firms had developed innovative ways to overcome obstacles with raw materials while maintaining diversity within their business. A food-processing SME in West Java is able to make banana chips with supplies from the local market but sweet potatoes are hard to find and chips are in demand. Their collaborative solution is to import sweet potato chips processed by other firms and to market them as their own. Rather than evidence that accessing raw materials is not a constraint, this exemplifies the types of creative solutions that SMEs turn to in the face of such constraints.

Transport issues and high fuel and electricity prices

Some SMEs have trouble obtaining raw materials due to infrastructure and logistics issues or because of elevated fuel and electricity prices. Poor road conditions or traffic congestion, especially in mountainous regions, can delay delivery of inputs needed by SMEs. One restaurant owner in Tana Toraja orders specific ingredients from Makassar that are not available in the local market. Delays can disrupt what is advertised on the menu and affect what can be served, and this can undermine customer opinions and business profits. Many firms mentioned that to create their main product, electricity and gas are essential, and fluctuating prices can affect their production output.

Two stories that highlight the challenges that SMEs face in obtaining access to raw materials are summarised in box 2.

Box 2.   Stories of firms with raw material constraints

Raw material problems faced by most SMEs in this study include price fluctuations, lack of quality, unstable supplies, costly imports, uneven distribution and monopoly effects.

Teak furniture

SMEs in the teak furniture industry have to deal with the state-owned monopoly, Perum Perhutani, which operates under the Ministry of Forestry and holds the right to control and manage a state-owned teak tree plantation, which is the sole supplier for high-quality raw teak materials.

Ani, the owner of a teak furniture producer with 62 workers in Jepara, Central Java, started her business in 1999. She said that high-quality wood can only be bought from *Perum Perhutani* and the wood is expensive and rare, and prices fluctuate a lot. The price of wood can increase by 10–20 percent within two or three months. Ani's firm does not have direct access to the teak because big traders buy the teak from *Perum Perhutani* in large quantities. Ani explains further that smaller SMEs do not want to take the risk of buying large quantities of wood, because they cannot afford to. Instead, they buy wood based on customer orders, keeping minimal inventories.

Ani has bought wood from a smaller supplier but high-quality wood is becoming scarce and she has to find lower qualities of wood to meet production demands. Wood scarcity has lowered the quality of her furniture products. If she insists on using only the teak provided by *Perum Perhutani*, she has to raise the price of her products and she is not sure that her customers will want to buy her furniture at a higher price.

Food-processing tofu and tempeh

Tofu and tempeh producers interviewed in Banda Aceh have to cope with the increasing price of imported soybeans that cuts into their profits. To deal with the increasing price, Tengku, a producer of tofu and tempeh with seven workers, who started his business in 2004, has to mix imported soybeans with locally sourced ones to make tofu and tempeh. He prefers imported soybeans because the quality is better. He noted that the supply of local soybeans is irregular and often difficult to procure.

Acep and his eight employees in West Java also produce tofu and tempeh, and Acep expressed concerns about local soybean supplies. He felt that the government should design a policy that benefits local soybean farmers and keeps the soybean price stable. He said that as fuel prices rise, soybean prices also go up. Price protection for local soybeans might benefit both farmers and producers.

Labour and human capital

SMEs can experience a range of problems associated with their workforce. In our survey, 17.2 percent of firms identified labour and human capital as the most important constraints to doing business. In the WBES 2009 and IMK 2013 data sets, labour market problems were less significant factors but these surveys only allowed firms to select specific aspects of labour issues: (1) shortages of worker skills; (2) inability to pay workers; and (3) labour market regulations.

Human capital is a critical component of any business and firms that do not have access to the workers they need may not be able to operate effectively or to grow. This was the problem that most of the firms identified with in our study of growth-oriented SMEs. However, according to the IMK 2013 data, only 2 percent of micro firms and 4.7 percent of small firms felt that worker skills and shortages of human capital were the most important constraints to doing business. The small number of firms that selected skills shortages as a major constraint could reflect the low skills required to produce goods in small firms, many of which are not growth-oriented.

Human capital issues were particularly salient in the Muslim fashion and batik industries. These included difficulty in finding skilled tailors or batik makers and designers (pembatik). For example, most batik makers and designers are within the 30–40 years age bracket and it is hard to find younger workers that are as productive because young people do not consider it a fashionable profession. A similar problem is encountered by teak furniture SMEs where it is difficult to find a skilled carver or carpenter. While there are vocational schools with specific skills training programmes, most graduates are still not meeting the needs of the SMEs in these industries. For one furniture maker we interviewed, the issue was that a local school focused training on production with power tools, while the furniture maker was focused on hand-carving methods. Even with this schooling, many workers still need to be trained on the job to be able to do the work effectively.

Inability to pay wages was the most important constraint for doing business for only 0.5 percent of micro firms and 0.7 percent of small firms in the IMK 2013 survey. As discussed in chapter 2, small firms pay low wages and often have low levels of labour productivity, so it may not be surprising that few micro and small firms find it difficult to afford the labour they hire.

 From the WBES 2009 data, labour market regulations were the major problem for about 4 percent of medium-sized firms. MSMEs may experience difficulties complying with labour market regulations, particularly with minimum wages and severance laws, although previous studies suggest that regulations are not a primary concern for these firms. In the informal sector, often a large share of the workforce is willing to supply labour at rates below official minimum wages. Many informal SMEs may not be aware of labour market regulations or they may not feel that they are subject to these regulations even if they are aware of them. As informal SMEs grow and begin to consider formalising, they are faced with the costs of complying with minimum wage laws or other labour market regulations and this could limit their desire for growth. Strict rules for severance limit the ability of firms to hire and fire workers and introduce labour market rigidities that could create difficulties for SMEs that are trying to grow and develop.

Firms in our survey responded that the minimum wage was not a major constraint to operating their businesses. Less than half of the firms interviewed in the R+A survey said they were aware of exemptions from minimum wage compliance. Most SMEs do not pay the minimum wage, often because wages are paid on a piece-rate basis, for example, in the batik industry. In addition to wages, some SME workers get a meal and lodging allowance, either in kind or in cash. Owners typically also provide their workers with their Eid allowance.

Informal labour relations are a common feature of SMEs. Informality brings advantages and disadvantages from the point of view of the SME owners in this study. While non-compliance to formal labour regulations can reduce costs, the disadvantage is the relatively strong bargaining position of the workers and the managers' lack of ability to hold employees accountable for non-compliance. Informal labour relations have in some cases created loose and flexible work relationships that often put the owners in a weak position vis-à-vis their workers.

Narrow labour markets are also a problem for SMEs. Firms operating in the teak furniture and batik sectors in particular cited scarcity of workers as a major challenge. This was due to the shifting preferences of the new entrants into the labour force who prefer to work in large enterprises or in the service sector in urban areas.

Access to markets and demand

Product demand and market access is central for any firm. Without demand for what the firm produces and a way to access buyers, a firm will not survive. In our data, 17.2 percent of SMEs reported that access to markets was the most challenging problem they faced in doing business. In the IMK 2013 survey, 18.3 percent of micro firms and 17 percent of small firms reported that marketing issues were the most important problem.

There are several reasons why market access may be challenging for small firms. Because of their size, small firms may have difficulty identifying demand markets, especially non-local markets. For example, foreign markets can be lucrative for small firms but there may be many barriers to accessing those markets, such as information challenges, incumbents and government policies that favour large firms. In North Sumatra, an SME we interviewed noted that a government ban on exports of green, unprocessed beans would be detrimental to coffee growing and production. Another firm in the same province acknowledged that certifications and procedures required for exporting are cumbersome and expensive.

One way that SMEs might be able to overcome market access challenges is through electronic marketplaces. Decentralised electronic markets enable small firms to advertise their products broadly and more efficiently find the consumers who want them. However, many SMEs we surveyed had limited experience with electronic markets. Figure 19 illustrates that, of the SMEs interviewed, the four industries with the highest rates of experience selling products electronically are high-value-added ICT, Muslim fashion, furniture and batik textiles.

Reasons for the lower penetration of electronic markets in Indonesia include the high cost of purchasing and maintaining websites, shortage of skilled programmers or social media experts and limited Internet access for consumers. One SME in Central Java noted that consumers are reluctant to purchase furniture items online because they want to view the product in person to ensure its quality. A coffee shop in Makassar believes that Internet promotion is not useful in increasing customers and instead relies on conventional, local advertising. However, several firms do choose to use inexpensive electronic platforms, including Instagram and Facebook, to promote and sell their products.

Figure 19 Firm experience selling products electronically
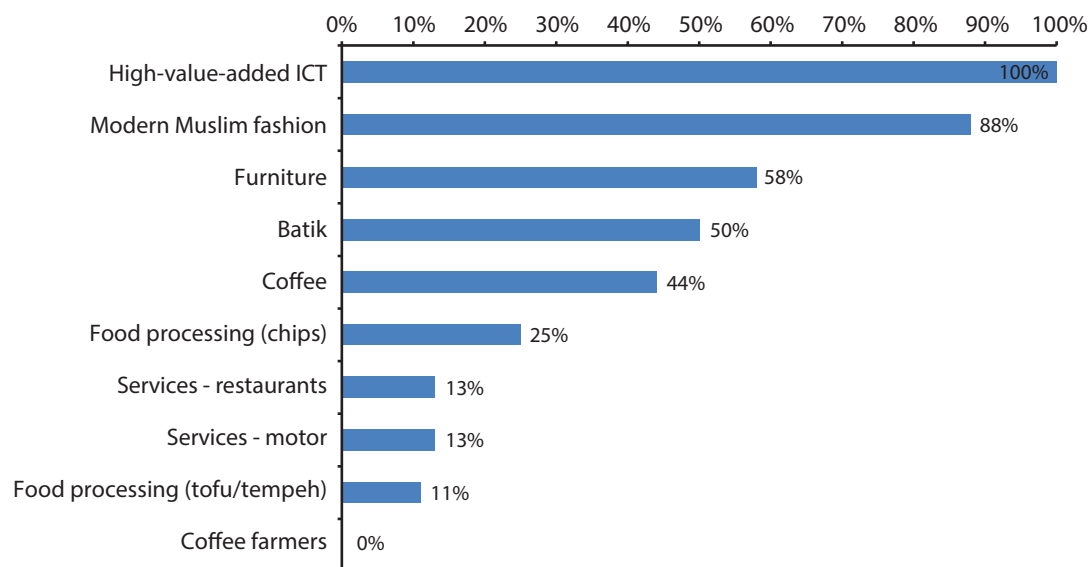
SOURCE: Authors' calculations using R+A SME Survey (2014) data

Another challenge related to market access is transport and logistics. Although, according to the IMK 2013 survey, only 1.2 percent of micro firms and 0.7 percent of small firms reported transport as the most central issue, for small firms in rural areas, transport and logistical issues may be constraining. In Tana Toraja, coffee growers hire drivers who act as middlemen, transporting beans and selling them in the local market for a fee. The cost of doing business this way leads to higher final prices of goods on the market and firms encounter cheaper prices from competitors that did not have to spend money on logistics. These uncompetitive prices negatively affect profits.

For some SMEs, the location of their business is crucial to reaching customers. Commercial rents in strategic areas are often too high for SMEs. This was a particular concern for restaurants and Muslim fashion vendors seeking desirable locations. Although some firms could afford expensive rents, they were unwilling to risk paying high rents as they could not be sure their profits would cover this expense in the long term. Consequently they may end up choosing less-than-optimal locations for their businesses.

SMEs can also encounter challenges when trying to become fully integrated into a supply chain and connect with upstream buyers or downstream suppliers through subcontracting arrangements. Such connections are extremely valuable to small firms, as they typically result in a large, steady stream of business, but they can be difficult to secure.

To market their products, SMEs may have to work with intermediaries and this can create challenges. In our sample, more than 40 percent of SMEs used intermediaries for this purpose. Although intermediaries collect products and transport them to demand sources, providing a valuable service to producers, they may charge high prices for their services and deprive producers of revenue. There are many different relationships between SMEs and intermediaries, depending on the industry, and differences in contracts, regularity of interaction and market power determine how these relationships contribute to growth.

As an example, one tofu distributor in Makassar sells its tofu to about 20 different middlemen who distribute it to various markets. SMEs also use middlemen in inventive ways. One restaurant owner reaches clientele by using a tour guide to attract foreigners to the restaurant and create a steady stream of business. Lastly, furniture sellers use middlemen to sell their products at exhibitions.

Detailed stories of SMEs that experienced difficulties with access to markets are summarised in box 3.

Box 3   Stories of firms with market access constraints

Ghalib has been a green bean coffee producer since 2011 and he currently employs five workers. In 2013, he was invited by the Ministry of Forestry and Plantations to a national coffee exhibition in Bali. He saw this as an opportunity to expand his export opportunities because the promotional materials for the exhibition explained that local and international coffee importers and producers would participate. He decided to attend the exhibition, which included travel expenses, but the exhibition turned out to be disappointing. Only a small number of local buyers attended but there was strong attendance by local government and Ministry of Agriculture officials, as well as coffee producers from numerous provinces. There was not a single coffee importer. Fortunately, Ghalib was able to secure an order for 100kg from a local buyer.

Ghalib also tried to expand his market by himself. He went directly to potential customers to offer his product, including a famous cafe in the region. He knew that the cafe already had a constant supply from the largest coffee company in North Toraja but he challenged the owners to try his coffee and offered lower prices. He closed the deal with the cafe and now supplies 10kg of coffee powder per month.

Tara, a teak furniture producer in Central Java with 20 employees, started her business in 2002. In her interview, she mentioned that SMEs that have no timber legality verification system (*Sistem Verifikasi Legalitas Kayu* or SVLK) can export their products through other enterprises that have this certification, instead of following procedures themselves. They can "borrow" the SVLK from other SMEs who act as intermediaries and pay a fee to the SVLK owner to export their product. She sees this practice as negative because she complies with the export procedures and has competitors who don't comply.

Another firm we interviewed sees the benefit of working with a larger firm. Ali is a small furniture producer with seven workers who started his business in 1985. He uses a larger teak producer as both buyer of his product and as broker. When Ali wants to export his product, he can borrow the bigger enterprise's name and only has to pay 5 percent of the total transaction to the enterprise.

Other important constraints

In this section, we describe some of the other challenges that Indonesian SMEs experience, based on our analytical framework. These include owner capacity and management practices (including access to information) as well as production technology and physical capital. Although these problems were not as widely cited by respondents as the four constraints described earlier in this chapter, many firms we interviewed reported that they are important for doing business.

Owner capacity and management practices

At the core of an SME is the management – one or more individuals who typically started the firm and are responsible for making day-to-day and long-term investment decisions. Particularly in small firms, poor management practices can severely limit SME growth. While owners may abound in initiative and drive, they may not always make optimal decisions about investing, managing finances, hiring workers, accessing capital or marketing their products. Moreover, in a small firm, one person usually makes all of these decisions, limiting the benefits of management specialisation and decentralised decision-making. In short, maximising profit is a difficult task, especially if the owner is relatively inexperienced or has limited formal education. Information barriers can also prevent owners from making well-informed decisions because they cannot effectively observe market conditions or monitor employees or because they do not understand regulations and the benefits of formalisation.

While only 3.2 percent of firms in our survey self-reported that managerial training issues were the most important problems in doing business, around 10 percent of the SMEs interviewed discussed the managerial issues that they face and noted that they would like to see more government programmes designed to improve business skills. It is not surprising that only a few SME owners and operators cited managerial practices as the most important constraint since respondents may not find it easy to admit personal shortcomings.

Figure 20   Percentage of firms that maintain financial records
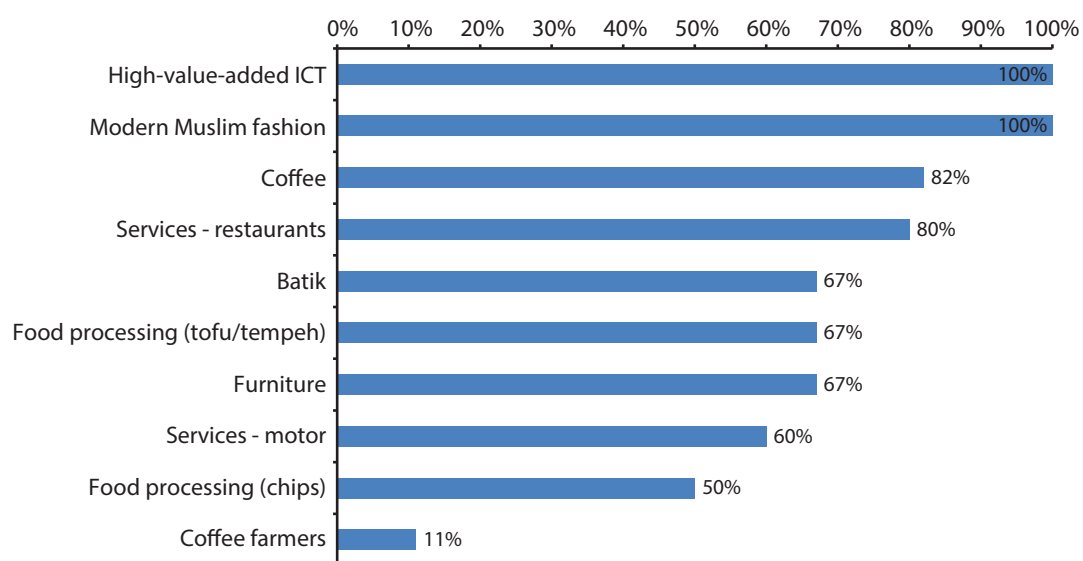
SOURCE: Authors' calculations using R+A SME Survey (2014) data

Another aspect of managerial decision-making that firms cited is record-keeping. Financial records are important, not only for keeping track of business decisions but also for securing loans from formal financial sources. In our survey of 192 SMEs, 73 percent of the managers we interviewed indicated that the firm kept financial records. However, more than half of the managers did not keep separate accounts for household and business affairs, and some SME owners only kept partial records, such as receipts from raw materials. Some firms keep hand-written records instead of electronic records, although they recognise that electronic records would make it easier to keep track of important outcome measures, such as daily profits. Figure 20 shows that the percentage of firms keeping records varies across industries. All of the Muslim fashion and ICT firms keep financial records but only two-thirds of batik, furniture and food-processing SMEs keep financial records.

Firms provided a number of explanations for incomplete or low-quality financial records. One SME owner in Central Java found professional accounting challenging and although he had participated in financial management training, he found it difficult to apply the lessons learnt from the workshop. One restaurant owner in South Sulawesi has been operating for 14 years but has never kept financial records. The owner views not having financial records as beneficial because he can account for all of the business financial transactions by himself and thus does not have to include other managers in the process. However, he recognises that this makes it difficult to expand because opening a new branch would be difficult for another manager who would need financial records to estimate costs of expansion.

Several managers we interviewed suggested ways to design training programmes that would better meet their needs. Managers reported needing training on how to manage cash flows, calculate net profits, participate in Internet marketing and branding, and operate packaging machines. Industry-specific assistance was also important, for instance, operators of motor service repair shops wanted to learn about new production technologies useful for their business and how to train workers on production processes.

Production technology and physical capital

Firms rely on some sort of technology to produce goods. The ability to access, understand and use relevant technologies can be critical for firm growth. The challenge that many small firms face is that they often rely on outdated production technologies that are typically inefficient, reducing firm productivity while increasing costs. Technology-related problems can stem from inadequate information about better technologies, limited supply of technologies or the absence of technical expertise. If labour is relatively inexpensive, there may be little incentive to adopt new technologies.

Despite its importance in the economic activities and business operations of the firm, only 2.2 percent of firms in our survey reported problems with production technologies. There are several possible reasons for this but one is that in some industries traditional technologies are highly valued and integral to how products are marketed. For instance, in the batik industry, many consumers want to purchase handmade textiles even though they are more expensive and mass-produced textiles are seen as a lower-quality product. The same may hold in the teak furniture industry where artists hand carve each piece of furniture individually. In such firms, adopting new production technologies may not be possible because it would change the product they are selling.

For those SMEs that reported production technologies as a constraint a large number had a strong desire to grow. These SMEs saw the acquisition of tools and technology as a means of improving productivity, cutting costs in their production process, increasing their clientele base and improving overall efficiency. Production technology, however, also intersects with credit constraints and access to capital. Many SMEs felt that they were unable to invest in the technology they had either heard about or researched, because they had insufficient funds

to do so. The technology was "too expensive".[26] When describing steps taken to reach their goals, some SMEs reported looking into loans that could help them acquire better technology; others discussed how they were saving up money, while a few simply seemed to be resolved that they would not have access to this technology due to costs.

Growth orientation of firms

Although not a constraint, we conclude this section with a brief discussion of the ways in which firms in our sample were oriented towards growth. In our survey of SMEs, we found that 59 percent of firms reported actively taking steps to expand in the past six months. Figure 21 plots expansion attempts by industry. Nearly every firm interviewed in the high-value-added ICT industry noted that they have taken steps to expand within the past six months. The owner of an ICT firm in West Java that specialises in mobile phone applications and software mentioned that the firm was aggressively developing product applications. To accomplish this, the firm planned to focus on developing proprietary products while reducing the number of client-ordered products. Another ICT firm in Jakarta is focused on hiring 200 employees within its first ten years of production. The industry that reported taking steps to expand the least (27 percent) in the past six months was the motor services sector. The types of expansion these firms mentioned focused on expanding services to car and motorbike owners, selling spare parts and planning to increase revenue.

Figure 21 Percentage of firms expanding, by industry
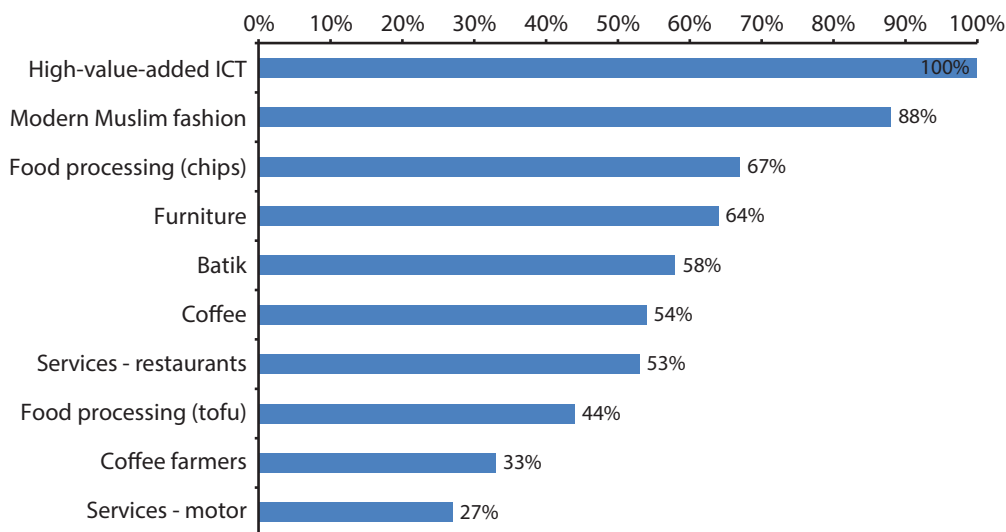
SOURCE: Authors' calculations using R+A SME Survey (2014) data.

Box 4 describes one example of what may constrain firms that are actively tying to expand. It tells the story of a firm from the ICT sector that mentioned having no impediments to growth. However, the manager was aware of similar firms that faced barriers to doing business and when he learnt about these barriers, that included a lack of clear information on and transparency in government tax compliance rules and regulations in the ICT sector for SMEs, he actively avoided getting any bigger even though he had wanted the firm to grow.

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26   New technologies were described as too expensive by one-third of the SMEs that reported production technologies as one of their constraints.

Box 4   Stories of firms overcoming growth constraints

Amir is an ICT entrepreneur in West Java who established his mobile application business in 2011. He has 14 employees and feels that his business currently does not face any significant obstacles. Amir has managed to overcome all of the firm's problems related to financial capital, technology and marketing up to this point. Currently, the company has increased turnover and profits from each project they have taken. Amir wants to focus on securing fewer projects with larger values and longer contracts, rather than dealing with a lot of smaller contracts that have lower funding levels, which are tiring and difficult to manage. To attract clients, Amir and his company are working on developing a new product, instead of simply filling client orders. In addition, the company is looking for new markets; he wants to help other SMEs that want to increase their consumer base and sales through electronic media promotion.

Amir is hesitant to develop his firm into a larger company. This concern stems from the experience of his friend whose firm was visited by a tax agent undertaking a "routine check" after the firm reported an increase in sales. The agent ran the audit and claimed to find that the company had a tax liability twice as big as their annual sales. The tax agent asked for a bribe, saying he would not disclose this SME's tax liability if the company paid a fee instead. The company chose to pay the bribe because the owner did not know much about tax regulations and feared that his reputation would be jeopardised. To remain an SME, Amir decided to keep the number of the employees and company revenue relatively constant until the policies and regulations are clearer and until there are relevant and useful mechanisms in place on taxation and other rules for SMEs in the ICT sector.

Summary

In this chapter, we described the many different challenges that firms face in doing business. Credit constraints, the most frequently cited challenge, prevent firms from expanding and making investments in new technologies that would lead to growth. In our assessment, the firms interviewed seemed to feel that the credit offered by banks was too expensive, with exorbitant interest rates and infeasible collateral requirements, and this was why firms decided not to pursue formal financial sources of capital.

The challenges faced in accessing raw materials include unstable and elevated prices and inadequate access to high-quality materials. This challenge may be difficult for governments to adequately address. Subsidising the prices of some raw materials may benefit some firms but harm others and this could create distortions in the economy that would have adverse or unintended consequences.

Many firms also noted problems related to labour and human capital. The most common complaint for many industries was inadequate access to skilled workers. Increased efforts in relation to vocational and specialised skills training (such as advanced degree programmes in computer science), and more generalised improvements in Indonesia's education system could improve the labour market.

The next most common challenge was access to markets. Many firms had difficulty connecting with consumers or other firms that use their products as inputs. This is another area where government investments, if targeted appropriately, could improve outcomes for small firms.

In the next two chapters, we make recommendations for improving policies geared toward SMEs, based on our understanding of the challenges they face.

5 Policies to Reduce Informality in Indonesia

Policymakers in Indonesia are concerned about the size of the informal sector for several reasons. First, informal firms do not pay taxes and this restricts the government's ability to provide support for public goods and services (Levy 2008). Second, the coexistence of formal and informal firms means that some firms competing in the same industry face different marginal production costs (labour costs and taxes). This leads to an inefficient allocation of resources in the economy (Hsieh and Klenow 2009; Levy 2008). Third, informal firms may be competing unfairly with law-abiding formal-sector firms, using their cost advantages to obtain market share. This could restrict economic growth (Farrell 2004). Since informal firms may not be able to legally obtain access to financial credit or export their products, informality may directly constrain economic growth.

In this chapter, we describe the challenges surrounding business licences and formalising the informal sector. We focus on formality separately from the constraints in chapter 4 because formality is thought to be both a cause and effect of other factors that limit the growth of firms. In addition, formalisation is an issue of particular relevance for small firms; medium-sized and larger firms tend to have higher rates of formalisation and in many cases are more able to navigate the registration process and bear the associated costs. We first review the development economics literature on formalisation and theories of formality. Then we describe the challenges associated with formalisation in Indonesia. Finally, we present policy recommendations.

Theories of the informal sector

There are three different views of informality discussed in the literature on firms in developing countries. Two classic views are the exclusion model and the rational exit model (Parry et al. 2007). A third possibility is that the informal sector and the formal sector are different segments of a dual economy which are largely unrelated (Lewis 1954; Harris and Todaro 1970; Rauch 1991). Although these models may oversimplify real conditions, they provide a useful way of thinking about the informality problem and of framing the debate. More importantly, the appropriate policy response to informality depends crucially on the extent to which each of these different models explains why firms decide to remain in the informal sector.

In the exclusion model, government regulations exclude or hold back, a large potential pool of entrepreneurs (De Soto 1989, 2000). In this view, informal firms are an untapped reservoir of entrepreneurial energy, which can be released by reducing entry regulations and changing legal environments (property rights, informal taxes). The exclusion view of formality also tends to be consistent with "missing middle" stories (Tybout 2000; Hsieh and Olken 2014). If expensive regulations hold back firms, there may be a large pool of informal-sector firms that cluster at the threshold of formality.

If cumbersome, expensive registration procedures are holding back firms and keeping them informal, the appropriate policy response to the informal sector is to drastically lower registration costs. This is a widely held view among policymakers who feel that if the costs of registration were lower, more firms would formalise. Many existing government programmes, such as Indonesia's one-stop shops (OSSs) for business licences, focus on reducing the costs of business registration.

The second approach to thinking about informality, the rational exit model, is associated with Levy (2008) and Maloney (2004), among others. This view posits that firms rationally exit the formal sector when the benefits of formality are outweighed by the costs of being formal. When firms decide to remain informal, they weigh the benefits of formality, such as reduced chances of informal payments, increased access to banks, courts, government contracts or skilled labour, against the costs of formality, including tax payments, registration costs and the costs of complying with different business regulations, such as official labour market policies. Firms make the formality decision like any other investment decision, evaluating expected benefits and costs.

According to the rational exit model, informal-sector firms may enjoy tax advantages, cheaper wage rates and other cost advantages from not complying with tax rules and other regulations. Because of this, firms in the informal sector may be competing with formal firms in a way that undermines growth. The appropriate policy response to encourage more formality is not to focus just on registration costs but to also increase the benefits of formality or make the existing benefits more evident to firms and to better enforce registration requirements.

The third view, the dual economy model, suggests that informal firms and formal firms are fundamentally different (La Porta and Shleifer 2014). Informality is a by-product of poverty. Informal firms are typically small, inefficient and run by entrepreneurs with little formal education. The productivity of informal firms is generally too low to allow them to survive in the formal sector. Because of this, informal firms are largely segregated from the formal economy. They produce different products, with different labour, capital and entrepreneurial inputs, and they serve different customers.

The only real cure for informality in the dual economy model is economic growth. Demand-side factors play a large role in propping up the informal sector; goods produced by informal-sector firms are purchased by informal-sector employees. Economic growth, poverty reduction and rising incomes will bolster demand for formal-sector products, resulting in the exit of informal firms. This does not necessarily require policies that explicitly tax or punish informal firms for being informal. Instead, broad-based economic growth should both reduce the size of the informal sector and, at the same time, encourage the formation and expansion of formal firms. Over time, workers in the informal sector will switch and move into the formal sector, reducing the adverse employment effects from the exit of firms and declining employment in the informal sector.

Business licensing as a constraint

One of the major findings of our study is that the exclusion model often does not adequately explain why firms are informal. Despite the attention given to reducing registration costs in policy circles, relatively few firms felt that business licensing and permit issues were the most important problems they faced in doing business. According to the WBES 2009, only about 4 percent of firms felt that licensing issues were the most important constraint to doing business. In our survey, only 7.5 percent of firms cited licensing issues as a major cost of doing business. Less than 20 percent of the firms we interviewed ranked licensing as the first, second or third most important problem, so while these issues may still represent a significant challenge for doing business, they were not often the most pressing concern for firms.

Instead, informality in Indonesia seems to be better explained by a combination of the rational exit and the dual economy models. Many firms we interviewed complained that the process of registration or certification, which can be expensive and time-consuming, was often not worth the benefits of being registered. Furthermore, these benefits were ambiguous, uncertain and difficult to quantify. Many firms also implicitly felt that because they were not interested in growing or were catering for a lower-tier market, it did not make sense to try to formalise. Evidence presented in chapter 2 suggests that many SMEs in Indonesia are small, unproductive and serve local markets. They do not take steps to expand and it is unlikely that these firms would register even if the costs were low. The owners of these firms may not have ever bothered to investigate how to become formal and were probably unaware of the process. We describe the issues associated with two types of business licences, business registration permits and product certifications in more detail in the following paragraphs.

Business registration permits

Even if many firms do not formalise for strategic reasons, it is still preferable to reduce business registration costs as much as possible. Some firms we interviewed complained about the complicated process required to obtain permits to officially register their businesses. Firms were frustrated that the procedures themselves were complicated, expensive and often took many months to complete. At the time of writing this report, in order to officially register a business in Indonesia, firms were required to complete at least ten different procedures, depending on the industry and the location of the business.[27] As an example, table 18 lists the procedures required to start a business in Jakarta, which involve interaction with several different ministries. Although many of these procedures are officially free of charge, the initial cost of obtaining clearance for the company's name is quite high. According to the Doing Business 2015 report, the entire process takes about 53 days to complete and costs 21.1 percent of per-capita income (World Bank 2014).

Table 18   Summary of procedures for starting a business, Jakarta

Step No.	Description	Time to complete	Cost
1	Obtain clearance for the company's name at the Ministry of Law and Human Rights	6 days	Name clearance fee is Rp200,000. Legal services fees (PNBP) are Rp1,580,000. Maximum notary fee is 1.5% of the object of the deed.
2	Apply to the Ministry of Law and Human Rights for approval of the deed of establishment	Less than one day (online)	No charge
3	Obtain a Building Management Domicile Certificate	1 day	No charge
4	Apply for the Certificate of Company Domicile	2 days	No charge
5	Apply to the Ministry of Industry and Trade for the permanent business trading licence (*Surat Izin Usaha Perdagangan* – SIUP)	15 days	No charge
6	Obtain company registration certificate (*Tanda Daftar Perusahaan* –TDP) from the local government office	14 days	No charge
7	Register with the Ministry of Manpower	14 days	No charge
8	Apply for the Workers Social Security Programme (BPJS *Ketenagakerjaan*)	7 days (simultaneous with #7)	No charge
9	Apply for health care insurance with BPJS (*Badan Penyelenggara Jaminan Sosial*) *Kesehatan*	7 days (simultaneous with #7)	No charge
10	Obtain a taxpayer registration number (NPWP) and a value added tax collector number (NPPKP)	1 day (simultaneous with #7)	No charge

SOURCE: World Bank (2014)
Note: BPJS Kesehatan = Social Security Agency for Health

Note that in many cities in Indonesia, one difficult part of business registration is applying for a certificate of company domicile. Although this certificate tends to be free, it is issued by the local government and can create difficulties for firms. Many cities have spatial plans that dictate the types of economic activity that are allowed to take place in different locations. If SMEs wish to engage in production activities that are forbidden in certain city zones, they will be denied access to this permit. Spatial plans attempt to mitigate noise pollution or environmental externalities caused by industrial activity reaching near commercial or residential locations,

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27   Note that President Joko Widodo is currently attempting sweeping reforms of the business registration system in Indonesia. Reforms include centralising registration by creating a national one-stop shop (OSS) at Indonesia's Investment Coordinating Board and, for SMEs, reducing the paperwork involved down to a single-page form. It remains to be seen how effective these procedures will be in reducing registration costs.

so there could be good reasons for denying firms these permits. However, sometimes these spatial plans are inflexible. According to focus group discussions in Bandung, for instance, the most recent spatial plan of the city was created for a 30-year period and revising the plan is not easy, requiring an act of the local legislature.

Need for transparent information

Interestingly, the exact procedure for registering a business varies significantly depending on where your firm is located. One key difficulty that many firms faced was the absence of clear information about registration requirements. For many firms we interviewed, there was often a great deal of confusion about which permits were necessary for doing business and which level of government should be responsible for issuing and managing the permit registration process. One firm owner that we interviewed mentioned that although he secured a few of the necessary permits for doing business, local officials harassed him for not having all of the necessary permits. It is possible for firms to be officially registered with the government but not have all of the necessary permits for doing business. Many firms did not have the information they needed about what permits were required and government officials could exploit this uncertainty in extracting informal payments from them.

Some firms we spoke to felt that local governments should be in charge of these permits, while others felt that the process should be centralised. One firm mentioned that there used to be an effective online system for registering SMEs, which was easy for the SME owner to handle. However, because of the increased role of the provincial government, this was no longer possible, and online registration needed to be followed up with visits to government offices to complete the registration process.

Despite the widespread acknowledgement of the difficulty in successfully registering businesses, there was generally little consensus on the benefits of registration. Some firms felt that registration would enable firms to obtain access to credit from formal financial sources in a more cost-effective manner. Others felt that official registration would enable them to avoid paying informal taxes and getting "harassed" by local officials. Still others mentioned that business registration would be helpful for competing for government contracts. Few mentioned that business registration would enable the firm to attract valuable, skilled workers. Instead, the predominant theme among firms that decided not to register was that registration would make things more complicated and paying taxes, health care and higher wages was not desirable, given their business orientation. Instead of viewing the lack of registration as something that held them back, many firms chose to be informal, either for strategic reasons or because they were operating in entirely different markets from formal-sector firms.

Product certification

Product certification is different from formal registration. Product certifications are used to ensure that the products produced by firms meet certain quality standards. In many instances, firms felt that unequal access to product certification held them back and excluded them from participating in certain markets. This was the only instance where regulations held back firms, as in the exclusion model of informality.

As an example, furniture producers are often required to certify the legality of the wood they use for production if they want to export their products. In the United States and Europe, furniture imports are required to be produced using legally-obtained wood. Furniture produced in Indonesia is certified using the Ministry of Environment and Forestry's verification system, known as SVLK. The verification system was created by a ministerial decree in 2009 and was subsequently revised in 2011 and 2012. As of 2015, all furniture producers are required to obtain verification system certification.

Many firms in the teak furniture industry said that the verification system was difficult and expensive. One firm from Jepara, Central Java, mentioned that because the cost of verification system certification was so high (approximately Rp30 million, nearly USD2,500 at current exchange rates), the firm required help from an industry association to pay for certification. The firm also hired a worker whose sole purpose was to make sure that the firm was in compliance with verification system regulations. Many furniture producers felt that the legality verification system was so expensive that it kept them out of participating in export markets.

Furniture-producing SMEs typically obtain their wood from *Perum Perhutani*, the state-owned corporation with a monopoly on timber extraction in much of Indonesia's forests. Many firms felt that it made more sense for *Perum Perhutani* and other wood suppliers to deal with the certification permits, instead of the producers themselves. Firms that use wood as a raw material believed it would be better to redirect the certification process upstream.

As another example of product certification, many foods in Indonesia, particularly meat products, need to be halal-certified. Food that is halal-certified is permissible for Muslims to eat or drink under Islamic law. In Indonesia, the system of halal certification is run by *Majelis Ulama Indonesia*, the country's top Muslim clerical body and a quasi-governmental agency.[28] Many SMEs were interested in obtaining certification from the agency because it would enable them to sell their products to supermarkets and expand their access to markets. However, halal certification is expensive and, after a firm is initially certified, it is required to be retested for compliance every two years. As a result, many firms did not want to obtain these certifications, which limits their potential market.

Evidence on policies to promote registration

For most of the existing policies geared toward the informal sector in Indonesia, the primary objective is to reduce the costs of business registration. One-stop shops for business licences are designed to reduce registration costs by centralising the process of paying fees and filling out forms, so that firm owners or managers do not have to deal with each ministry separately. The argument presented in this chapter is that many firms choose to remain informal because the benefits of registration do not outweigh the costs. Attempts to continue to reduce registration costs will only affect firms that are on the margin between registering and not registering. Based on the evidence in chapter 2 and in this chapter, not many firms are in this category.

Although we do not have any direct evidence on the effectiveness of Indonesia's one-stop shops programme, some SMEs we spoke to had had experience of them in their areas and had found the process time-consuming and expensive, contrary to their intention. Some respondents said they even preferred to hire a middleman to acquire the licences they needed rather than use the one-stop shops available to them. Although the design of the programme seems sensible, a report by the Asia Foundation (2007) found many implementation issues. The best centres showed marked improvements in the delivery of registration services to SMEs but some service centres neither reduced licensing processing time nor registration requirements. Box 5 recounts an anecdote on how and why a one-stop shop was not used by an SME in Bandung.

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28   The agency was created by Suharto as an interface between the secular Indonesian government and the Islamic community.

Box 5 Story of an SME with the one-stop shop programme 63

Anton has a restaurant in Bandung, established in 2011, and currently has 66 employees. For his first restaurant business licence, he was assisted by an officer of Satpol PP, a local government agency that maintains peace and public order and enforces the local regulations. The officer offered to process the business licences that Anton did not have yet and said he could help Anton acquire a business permit more quickly than with the required procedure (*nembak*). In order to get his business up and running as soon as possible, Anton took the officer up on the offer because he had heard that processing the licence by himself could take up to six months. The permit was issued in less than one week and it cost Rp8,000,000 (USD630). He planned to obtain his second business's building permit at the one-stop shop this year. It is difficult to obtain a business licence with a business building permit because he needs to get permit letters from the Office of Landscape and City Planning and the Office of Culture and Tourism first. According to the Office of Culture and Tourism, Anton needed a permit because his restaurant is located in a residential zone instead of a business zone. He found this confusing because the street where his restaurant is located is full of various businesses. This confusion led him to stop trying to process the permit himself. He instead considered an offer from the government official to deal with these permits.

Evidence from other countries on the effectiveness of programmes to reduce the costs of formalising is not encouraging. In a field experiment in Sri Lanka, de Mel, McKenzie, and Woodruff (2013) randomly altered both the information costs and the monetary benefits of formalising for firms. Their main finding was that providing information about how to register and paying for registering were not sufficient to induce registration. To persuade firms to register, the government needed to also provide firms with substantial monetary compensation for registering. In another field experiment in Bangladesh, De Giorgi and Rahman (2013) provided an information campaign to a randomly-selected sample of firms in an effort to reduce the costs of registration. They found that treated firms became more aware of the business registration procedures but the programme itself had no impact on actual registration.

The most promising evidence on policies to promote registration comes from policies that increase enforcement. In a field experiment in Brazil, de Andrade et al. (2013) evaluated several different treatments, including: (1) an information campaign about registration procedures; (2) payment of registration costs; (3) an enforcement visit from a municipal inspector; and (4) enforcing neighbouring firms (to examine spillovers). They found that direct enforcement (inspection) increased the likelihood of registration by more than 20 percentage points. Informal firms only register when forced to do so.

Recommended policy actions

To encourage informal-sector SMEs to enter the formal sector, we recommend the following policies:

- Instead of focusing on reducing the costs of obtaining business licences, the government should focus more on making the benefits of formal registration stronger and more evident. These benefits include: the ability to obtain cheaper credit from formal financial sources; the eligibility to compete for government contracts; and the likelihood of attracting skilled workers. An appropriately-targeted information campaign that advertises the benefits of formalising may encourage informal firms to formalise.
- At the same time, simplifying and streamlining the process of registration would be beneficial to firms and eliminate waste, even if it did not increase registration and formality rates. It would also remove the uncertainty associated with whether a firm has all the licences it needs. A push to both simplify the registration process and harmonise it, so that procedures are the same across Indonesia's different cities and districts, would help firms and remove a potential source of corruption and informal taxation. One respondent suggested a comprehensive online registration system, which would cut down on registration costs by eliminating any need to pay a middleman to complete the process. It could also significantly reduce time spent on the registration process.

- Information about required registration and certification procedures is not easy for firms to obtain. This creates an environment of uncertainty and corrupt officials can exploit this uncertainty by unfairly penalising firms that are making efforts to participate in the formal sector. A national programme that provides this information to firms – either through bulletin boards, radio and media outlets or web-based platforms – could reduce registration costs, increase formality and remove the uncertainty in the system.

- As businesses become officially registered, an effort to create a national registry of firms, accessible to both national and local policymakers, would be useful. An online registration system could contribute to easy aggregation of this national registry. This information system would contain basic information about the firm, such as the industry, location of production facilities, number of workers and contact information. Policymakers could use this in designing and implementing SME support programmes, and it could be used for other purposes, such as measuring economic activity.

- Government could do more to promote public awareness about the importance of registering businesses, differentiating tax types (business or personal), paying taxes and contributing to the common good. This should help the public better understand what types of taxes are being collected, how businesses should file tax forms and how these funds are being used to finance transport and communications infrastructure, schools, ports and other public goods that benefit firms and lower production costs. The government should frequently provide clear and transparent tax regulations and requirements information to all SMEs through information campaigns.

- Broad-based strategies to promote economic growth and poverty reduction, such as investments in infrastructure, health and education, will eventually lead to an exit of informal-sector firms, entry of formal firms and a reallocation of workers to the formal sector. It is important to recognise that curing the informality caused by the dual economy is a long-term process and there are no quick fixes to change the situation.

6 Recommendations for Improving Policies to Support Small and Medium-sized Enterprises

In this chapter, we evaluate the government programmes designed to reduce the constraints that SMEs face in doing business, as outlined in chapter 4. In so doing, we recommend improvements to the existing range of SME support policies that we discussed with owners and managers in our interviews. We also identify ways in which the government can support SME growth by reducing government-imposed barriers to operation. Our recommendations focus on SME programmes and policies as our goal was not to address the general, systemic problems that the Indonesian government may face – although these may impede SME growth – but to offer guidance on areas for possible reform based on constraints, as viewed by firms. We try to recommend specific changes that the regional, local or national governments can make but we avoid overly granular recommendations or one-policy-fits-all approaches, given how diverse the stakeholders are in each province. We view these recommendations as forming the basis for further government discussions and engagement to craft specific policy solutions, which is a critical next step in this line of work.

How policymakers design and implement SME support programmes

Official support for SMEs in Indonesia has been a priority of all post-independence governments, from Sukarno to Susilo Bambang Yudhoyono. Support for SMEs has featured prominently in key government documents, such as five-year plans (*Repelita*), Broad Outlines of Government Policy and other official statements (Hill 2001). Indonesia's newest president, Joko Widodo also made promoting SMEs and reducing the cost of obtaining business licences a priority in his campaign platform.

However, many policymakers view support for SMEs as a form of social welfare. Programmes to enhance the performance of SMEs are often justified with arguments for equity or fairness and considerations for social justice. During the Suharto era, SMEs were often not considered a vital part of the economy but seen as a social group in need of assistance (Wie 2006). From informal discussions with policymakers, this view persists and it is thought that because SMEs are inherently disadvantaged by unfair competition in the marketplace, they require special support. Programmes to promote SMEs are sometimes justified on the basis of encouraging rural or regional development and gender equality or redressing perceived ethnic imbalances in business ownership (Hill 2001).

In chapter 2, we argued that SMEs play a vital role in Indonesia's economy. If we include micro firms, nearly all firms in Indonesia are SMEs and these firms account for approximately 97 percent of total employment. Given the prominence of SMEs in Indonesia and their role in paying wages and employing workers, it is important to stop viewing support for SMEs as a form of social assistance. Instead, policies to promote SMEs should be focused on promoting economic growth and improving productivity, not on reducing inequality, reducing regional disparities or promoting inclusive growth. These policies should be evaluated and justified on the basis of economic efficiency instead of equity.

In box 6, we describe the experiences of several policymakers and their attempts to collect data on SMEs, design and implement programmes to support them and work with other offices responsible for supporting these businesses. Policymakers encountered a range of challenges when they tried to implement programmes, including inadequate accurate information on SMEs in their jurisdictions and coordination issues between different agencies implementing programmes.

Box 6   Stories of policymakers' experiences with SME support programmes

Aceh, North Sumatra Department of Cooperatives and MSMEs
An officer we interviewed in the provincial Department of Cooperatives and MSMEs in Aceh believes that capital and access to markets are major barriers for SMEs in Aceh. He reported that the local Office for SMEs and Cooperatives, Industry, Trade and Labour in Aceh has a number of programmes designed to help SMEs, including training courses, organising events and procuring equipment. However, their main constraint over the years has been maintaining updated data on active SMEs. The officer was aware that the original data they had did not accurately reflect the existing firms. The earthquake and tsunami in 2004 had destroyed all the data on SMEs and other business enterprises in Aceh. This led the office to collect new data in 2014 so they could provide assistance and design suitable programmes for these enterprises. After the ten-year gap in data collection, the district found that most of the SMEs formerly listed no longer existed although they still showed up as registered beneficiaries of government programmes. Another challenge is inaccurate data due to the frequent rotation of district officials who are charged with collecting basic information on SMEs.

North Sumatra Office of Industry and Trade
One officer in North Sumatra's Office of Industry and Trade identified food processing and coffee as leading sectors in the area. While the government has run training programmes on access to credit, procuring equipment and technology development, this officer said that the main obstacle for SME programmes was the weak coordination among government offices. SME-related offices (the Office of Cooperatives and SMEs and the Office of Integrated Licensing) each designed and implemented their own separate programmes. The officer recommended that all SME development programmes should be planned, implemented and evaluated in a coordinated manner across offices. A related problem is that local governments treat SMEs differently. For example, some local governments concentrate on administrative issues for small businesses but do nothing to expand their markets while other local governments have broader agendas for SMEs.

Central Java Department of MSMEs, Cooperatives and Markets
An officer in the Central Java Department of MSMEs, Cooperatives and Markets had transferred from another government office six months prior to our interview. Rotational positions among local government offices are common and, in this officer's experience, this leads to a lack of knowledge about SMEs among government officials. Due to the rotation policy, the officer is not able to do anything innovative so is just continuing the SME programmes already in place. This officer finds it difficult to collect detailed data on SMEs because (1) there is limited data to be collected and a lack of cooperation with Statistics Indonesia, and (2) SME owners are afraid that government will burden them with taxation. He also pointed out that there are a lot of overlaps among the departments in charge of SMEs. For example, the local Office of SMEs, Cooperatives and Markets and the local Office of Industry and Trade are working in the same area, and carrying out similar programmes, such as fairs and training for SMEs, but the division of authority between the two offices is not clear.

Bandung, West Java Local Office of Cooperatives and SMEs
A city government official in the local Office of Cooperatives and SMEs in Bandung, West Java, thought that the constraints SMEs face included capital, marketing, production technology and financial administration. The official also noted that SME owners often mix up company and household funds. This leads to problems with obtaining bank loans. Some entrepreneurs cannot calculate the annual revenue of their businesses, so the information for bank lenders is unsatisfactory. In his work, he found that SME programmes and events are not well planned. For example, he has been asked to find participants for SME training at short notice. He asked the subdistrict officials to identify entrepreneurs who had the time to participate but the local government did not have SMEs listed in their database.

Recommended policy actions

We recommend the following policy actions to improve the existing range of SME support policies and to help policymakers make more informed decisions:

- Policies to assist SMEs should focus on promoting economic growth, improving productivity and creating an enabling business environment. Issues of inclusive growth, inequality or social assistance are secondary.
- A more detailed and frequently updated national registry of SMEs made available at all levels of government would enable policymakers to design and target SME support programmes more effectively.
- Policymakers need accurate and timely information about the actual size and importance of the SME sector in the Indonesian economy, which will help shape the debate about how the government views and treats SMEs.

- Many SMEs, especially the smallest, are probably not growth-oriented but policymakers and their policies need to target those SMEs that are growth oriented.
- While eliminating overlaps between government offices responsible for supporting SMEs may not be feasible, policies and financial resources that support better communication and coordination across offices, at the local and national levels, may reduce barriers for firms trying to navigate government policies and programmes.

Improving access to information about SME support programmes

Many SMEs we spoke to were not aware of programmes to promote the growth or facilitate the expansion of their businesses. In our data, 45 percent of the firms we interviewed had heard of the one-stop shop programme, 45 percent were aware of managerial training programmes, 54 percent were aware of credit programmes, 38 percent were aware of worker training programmes and 67 percent were aware of programmes designed to improve access to markets. As we interviewed a sample of firms that were growth-oriented, these awareness statistics may represent the upper band of overall awareness. Smaller, less growth-oriented firms may be less aware of these programmes. However, low awareness could also reflect the situation that these programmes were simply not available in their areas.

Even when SME managers had heard about SME support programmes, many complained that it was difficult to obtain information about eligibility and how to participate. Information about how to participate in government-run programmes is typically made available only to well-connected firms, which either have good relationships with local officials or are members of influential business associations. The exclusivity of access to SME support programmes means that firms have unequal opportunities to grow and favouritism undermines competition and adversely affects growth.

Box 7 presents two stories, one about a firm that had trouble accessing SME support programmes and another about a firm that used political connections to access a government programme. In general, wider advertising of SME support programmes and easier access to information about them would enable more firms to participate and benefit from these programmes. It would also help to level the playing field for all firms.

Box 7   Stories of firms and their access to SME support programmes

Surya has eight employees working in his motor service and repair shop. He had previously been fired by a spare parts company and eventually decided to open his own motorcycle service shop in 2002. Surya does not know of any assistance provided by the government to SME owners like him and does not believe there are government policies that assist his business. However, if there are such programmes, he feels they are not promoted well enough. There are many small business owners like him who do not know what programmes and assistance the government provides. While he has heard of the People's Business Credit programme (KUR), he does not know who runs the programme or how he can access it. He thinks that the government should publicise these programmes among the smallest SMEs because without direct publicity and with limited public awareness, only a select group will know about the programmes and be able to benefit from them.

Yando runs a batik business established in 1980 and currently has 10 employees. In 2007, he was delegated by the local government to be one of the key organisers of the batik centre in the region because he had been an active member in the Society of Batik Entrepreneurs. He received a lot of information and assistance for his business from local government and that support extended to batik entrepreneurs around him. The support that Yando received included awareness about bank credit, computer assistance, information about local and national exhibitions, a stand at the national exhibition, batik training, managerial training and subsidies for a batik sales location in one of the malls in Jakarta, among others. He received information from the local government through text messages, official letters and phone calls. This access to information was possible because he had a lot of contacts within local government. He wants to expand his business but does not have a concrete plan. His turnover (sales) has increased due to rising demand, especially after he grew closer to local government.

Recommended policy actions

We recommend the following policy actions to help inform SME owners and managers about policies and programmes targeted to assist them:

- SME support programmes need to be better marketed to the body of potential beneficiaries (formal SMEs who have registered their businesses). Better methods of disseminating information about programmes are needed and this information needs to be made available to firms in a timely fashion.
- Any government-sponsored SME programme should be required to be advertised publicly and participation should not be exclusive but rather open to all firms.
- To better advertise these programmes, the government could sponsor the development of an online platform (for example,web portal or smart phone application), a text messaging service or an email mailing list that disseminates information about locally available SME support programmes.
- SME support programmes at different levels of administration (local, regional or national) could be advertised on television, on the radio and in newspapers. This could also include non-governmental programmes for SMEs.
- While it would be difficult to solve the political connections issue, further efforts to monitor corruption and improve the administration of government services, particularly at the local levels, would be beneficial.

Improving the quality of SME support programmes

Many SME owners and managers that we spoke to complained that the SME support programmes they had participated in were not always helpful. As an example, the manager of one coffee-processing SME from Central Aceh participated in an entrepreneurial training programme, sponsored by the government and non-governmental organisations. The manager found that he had more knowledge about how to effectively run and operate a business than the entrepreneur who was running the workshop. From his point of view, this meant the programme was not useful. For managerial training programmes to be effective, they need to be tailored to the needs of specific industries. This can be hard to achieve because the business climate, demand and production can change rapidly and effective business training programmes need to be constantly revised to reflect the current market situation.

As another example, the government in Solo sometimes sponsors worker-training programmes for finishing furniture. However, these training workshops are often outdated so while there are new techniques for finishing furniture that have been developed, they are not featured in the curriculum. Overall, the government spends a substantial amount on training programmes but it has not done a serious assessment of SME needs and without better management of these programmes, these efforts can be wasteful.

Recommended policy actions

We recommend the following policy actions to help improve the quality of SME support programmes:

- Local, regional and national governments should reconsider their direct involvement in designing and implementing workshops and training programmes to help SMEs. Compared with government officials, industry associations may possess more contextualised knowledge, better understanding of current market trends and a more informed outlook on growth. These associations should be better placed to design and run training and business development workshops.

- Instead of running workshops directly, the government could provide funds to industry associations to run these workshops themselves. If funds are scarce, industry associations could bid competitively for them. These industry associations will be better able to target programmes, advertise them and make them relevant to SMEs.
- If the government continues to design and run training programmes itself, government officials with high levels of experience in administering needs assessments should conduct standardised assessments with SMEs at the local, regional and national levels. These should be done with transparent and detailed information and lessons learnt being shared at all levels of government.
- Regardless of who runs SME support programmes, there is a role for government, more likely at the national level, to put in place mechanisms that ensure that information about programmes is made available to all interested firms through a transparent mechanism.

Credit programmes and access to finance

Insufficient access to finance was the most widely cited problem for firms doing business in Indonesia. SMEs find it difficult to secure bank loans because interest rates are too high or because they cannot demonstrate that they have the required collateral to cover the loan in case of default. To lend money to firms without collateral, banks have to charge high interest rates, making it more difficult for firms to pay back the loans. As a result, many SMEs do not use the formal banking system and instead rely on informal sources of capital to finance their business operations and investment, such as personal savings or loans from family or friends.

Historically, the Indonesian government has used a series of programmes to divert financial capital to SMEs. In 1990, the Suharto government introduced the Small Enterprise Credit programme (*Kredit Usaha Kecil* or KUK). Under this programme, all commercial banks were required to allocate 20 percent of their loan portfolio to small enterprises and cooperatives at market interest rates. The programme proved difficult to implement because banks had trouble meeting the 20 percent requirement and, instead of lending to SMEs for investment purposes, the programme often resulted in loans for consumption purposes. Furthermore, the SMEs that benefited tended to be larger and more successful than other SMEs. The limited success of this programme led to it being discontinued after the Asian financial crisis.

In late 2007, another major credit programme, the People's Business Credit programme (*Kredit Usaha Rakyat* or KUR) was launched by the Yudhoyono administration. This programme was a mechanism to increase lending to SMEs by providing government-sponsored credit guarantees to enterprises with limited collateral. Instead of interfering directly with how banks determined what portion of their lending portfolio to allocate to SMEs, the government simply offered guarantees for loans given to SMEs in case of default. Loans in default would be partially paid back by the government, at 70 percent of their face value. Interest rates for these loans were also kept lower than market rates, for example People's Business Credit "Mikro" loans have an interest rate cap of 22 percent, while the "Retail" loans have an interest rate cap of 14 percent. Eligible banks, which are only partly state-owned, are free to determine the borrowers of these loans. To date, the programme has reached millions of borrowers, lending close to USD10 billion since its inception (Toth 2014).

According to Bank Indonesia data, 21.6 percent of total loans in 2011 went to micro firms and SMEs. Most of that lending went to firms involved in trade, hotels, restaurants, construction and agriculture, with 40 percent going to firms in Java and Bali. Interestingly, most of the credit (70 percent) was for working capital rather than investment. Of the lending to MSMEs, 21 percent went to micro firms, 31 percent to small firms and 47 percent to medium-sized firms.

In our survey, several SME owners and managers discussed their experiences of attempting to or successfully acquiring additional funds for their businesses. One respondent had extensive administrative experience working with an international firm and another gathered the collateral needed for the loan by tapping into her mother's finances. Despite being able to access credit programmes and loans, most SMEs had heard of these programmes but had opted not to apply for them for a broad range of reasons.

There were a number of factors that SMEs perceived as barriers to applying for credit programmes like the People's Business Credit. Some respondents believed they needed an official licence to access these programmes, which reduced the number of firms without registration or licences that applied for credit or loan programmes. Many SMEs doubted they could acquire the necessary collateral for the loan they were hoping to get and firms expressed the collective perception that the potential loss of collateral was simply too high a risk for them to go ahead with the application. In addition, firms mentioned that the limits on the amount of funds they could apply for did not meet their needs. Currently, People's Business Credit loans are limited to a maximum of Rp25 million (approximately USD1,972). For many businesses interested in acquiring new production technologies or renting a storefront at a local market, this loan is inadequate. Moreover, in order to be eligible for repayment in case of default, loan officers are required to collect a lot of information about the firm, including detailed revenue and expense statements, which many SMEs do not typically collect. The lengthy application process meant that applying for government credit programmes was not worthwhile for several firms. They felt they would not be able to get enough back financially in return for their efforts. A few other SMEs did not apply because they did not feel they had the right connections and they thought government credit programmes favoured certain firms over others.

Box 8   Recounts one firm's interactions with industry associations in trying to meet its capital needs.

One of the problems experienced by SMEs is that credit lenders and credit programmes avoid lending to SMEs because of the default risk. This was experienced by some SME owners in the furniture and coffee sectors in our survey.

For example, **Ihsan** has a lot of experience in the coffee business. He started work in a coffee-processing firm in 1998 and decided to start his own export-oriented coffee business in 2001. Ihsan said that the coffee business in North Sumatra was not strong and a lot of coffee export firms had had to close their businesses because it was difficult to access raw materials (coffee beans). In 2010, he too went bankrupt. One reason he cited for this was that he did not have adequate financial capital. That, combined with numerous customer purchase orders and limited availability of raw materials, meant that he could not meet demand.

As a result, he decided to borrow money from a bank to increase the supply of coffee beans. However, the bank did not trust him with a loan and Ihsan found it hard to rebuild his business. Fortunately, he received useful information from the fair trade coffee association that he joined. As a member of the association, he was eligible for financial assistance and he received USD10,000 from the Islamic Development Bank at an interest rate of 5.5 percent per year. With this assistance, he was able to rebuild his business. He has now expanded to the point where he hires hundreds of temporary workers at the height of the harvest period.

Recommended policy actions

We recommend the following policy actions to help support SMEs in accessing credit:

- The government should thoroughly review the purpose, design, effectiveness and implementation of existing lending programmes for SMEs.
  - Very small micro firms should be offered loans primarily by microfinance lenders with experience in offering non-traditional lending contracts, such as group lending, "teaser" loans (where small loan amounts are offered initially, then larger amounts offered later, on repayment) or dynamic incentives where successful repayment leads to future lower interest rates. Such loans are particularly helpful in overcoming the information problems that lead to under-provision of credit for small firms.
  - Lending to micro firms with non-traditional contracts involves large transaction costs and some of these costs require banks to charge higher interest rates. Additionally, existing evidence on the rates of return to capital for smaller firms suggests that high interest rates may be accepted by SMEs (Karlan and Morduch 2010). Because of this, interest rate caps, such as those mandated by the People's Business Credit, may create credit shortages, preventing some firms from accessing loans they would be willing to accept.
  - A programme like the People's Business Credit may be useful for subsidising loans for growth-oriented SMEs but the loan amounts need to be raised to accommodate the demands of these firms. Given the Rp25 million cap on loan amounts, it is not surprising that only small percentages of these loans are being used for investment.
  - Lending programmes, for both micro firms and growth-oriented SMEs, may be more effective if they are coupled with financial education and business management programmes to help entrepreneurs learn about keeping better records, managing their inventory and committing to repaying loans.
  - The government would benefit from a rigorous, quantitative evaluation of the People's Business Credit programme to guide reforms to this and other credit programmes.
- In addition to reforming SME-specific lending programmes, the government should carefully review its approach to overseeing the broader banking sector to address and reform regulations that lead to inefficient market structure and behaviour that can create barriers to entry into bank lending.
- SMEs need to be able to present alternative sources of collateral to apply for loans. Existing sources of collateral, such as property ownership, could be strengthened by clarifying property rights and reducing regional variations due to different property rights systems. Alternative mechanisms to secure loans could include certificates of completion of managerial training courses (for example, courses in business development, training on building advanced business plans) or collateralised streams of revenue. Lowered interest rates paid over a longer period of time should also be considered.
- The government should require that transparent information be provided to all SMEs (even those that may not be considering credit programmes currently) on the terms and conditions of loan agreements, including interest rates offered through formal banks. The ability to compare interest rates between formal and informal lending institutions could help SMEs make better-informed borrowing decisions.
- Information technology could help match borrowers and lenders, especially lenders that are not formal banks. The government could support infrastructure to develop web-based lending markets, allowing firms to access private sources of credit outside their city or province.
- Information systems could also help banks collect and analyse repayment histories. This could help banks identify which firms are successfully repaying loans and which ones are not successful which would lead to better lending outcomes.

Market access

One of the most frequently cited barriers to doing business for SMEs was access to markets, including problems connecting to sources of demand. Many firms said they would like to grow larger and produce more but they needed a better idea of the customers to whom they would be selling.

One policy response developed by government officials in Indonesia to improve access to markets is to sponsor trade fairs. In certain industries, government-sponsored trade fairs allow firms to showcase their products through stalls set up in a central location where national or international buyers can view these stalls and purchase their merchandise.

Many of the SMEs that we interviewed felt that these trade fairs were inefficient and ineffective. The cost of attending the government-sponsored trade fairs was often high compared to fairs sponsored by industry associations or other organisations and the quality of contracts developed from government-sponsored trade fairs tended to be low. The trade fairs were often badly planned and sometimes no customers attended.

> **Box 9** Presents a case study of an SME participating in a privately and publicly run trade fair.
>
> Mulyana has been a restaurant businessman since 2011 and his staff has grown to 66 employees. To expand his market, he attended two major culinary festivals/trade fairs in Bandung run by the private sector. These provided him with a big turnout of potential new clients. Mulyana said that in the first two years, the trade fairs were well run. In particular, they were well managed, held in a reasonable location and a large number of entrepreneurs and visitors attended. He felt that an event like this really helps SMEs to expand their market and increase profit through the high turnout.
>
> However, in the third year, the event was sponsored by the local government and there were changes in the way it was run. This time, there was a wider range of participants, from large culinary businesses to street vendors whereas before the participants had all been businesses of a similar size to Mulyana's. Mulyana did not benefit from this trade fair because he could not compete with the street vendors who sold similar kinds of food but very cheaply. Also, more vendors than consumers or potential clients attended the event. Consequently, he decided not to attend any more trade fairs unless the management of the event is changed.

Recommended policy actions

We recommend the following policy actions to enhance SMEs' access to markets:

- Governments should not directly design and sponsor trade fairs. Instead, they should direct funds to industry associations or other private organisations that are better qualified to organise and fund these events. Funding to sponsor trade fairs should be made available to organisations by application. If these events include foreign investors, translators should be made available to overcome any language issues.
- Instead of funding product-specific trade fairs, the government should focus on infrastructure and do more to upgrade and sponsor urban markets for SME products. As an example, Solo's free night market was successful in attracting customers and tourists, helping SMEs connect with consumers. This type of government investment could effectively improve market access for SMEs.
- For SMEs entering the export market, such as coffee processors in North Sumatra, the government should provide clear information on obtaining export certifications and publish relevant policies and procedures to facilitate their interactions in this market.
- Some respondents discussed how electronic platforms, such as Instagram, can be an inexpensive and effective way for SMEs to sell products to a larger market. Government at all levels could work with industry associations and other private-sector actors to train SMEs on the most up-to-date electronic marketing schemes.

Uncertain costs of complying with regulations

Political connections can be advantageous to SMEs. If they have connections with local officials, SMEs not only learn more about government programmes but also pay fewer informal taxes and payments. Complying with government regulations is easier for firms that are politically connected. The firms we interviewed reported that they did not know or did not fully understand registration requirements. Although some registrations are free, others are costly and firms often do not know what costs to expect. Moreover, some firms reported that they faced significant informal costs, often required by government agencies or officials. These include quasi-formal "fees" for local government officials, as well as losses when regulatory officials or policies required firms to give away their product for free (for example, meals in restaurants). As firms were often not formally registered, they did not feel that they could avoid informal regulatory costs. Box 10 gives two accounts of SMEs that struggled with the uncertainty of regulatory costs.

Recommended policy actions

We recommend the following policy actions to help SMEs understand and comply with regulations:

Box 10   Stories of firms and uncertain costs of complying with regulations

Tegar is the owner of an ICT company that has focused on mobile applications for cell phones since 2011 and employs 14 workers. He feels that the government should implement the rules more clearly and simply. He fears that if his SME grows, his company will become a target for extortion by tax officials, something experienced by his fellow ICT businessmen. He believes that ICT-related policies, such as tax exemptions for online transactions, should be made clear and be well marketed. He mentioned that the government should learn from Singapore, which provides a three-year tax holiday for new ICT companies. Tegar argued for less government involvement and control, especially in the ICT sector, which would make his small ICT business easier to grow.

Lia is a furniture business owner who started the business in 2002 and now has 20 employees. She expressed similar concerns and felt that being formal and following the rules did not give a business a lot of advantages. There are still many businesses that do not have a licence but can still achieve a lot, such as selling their goods abroad. Punishment and rewards for compliance need to be applied clearly so that SMEs that follow the rules do actually benefit. She added that there should be export licensing services at the one-stop shop. In her experience of obtaining an export permit, she had to travel to Jakarta from Jepara and go back and forth just to correct paperwork that was identified as incorrect. She thought that the one-stop shop mechanism would be helpful, whether online or not.

- The government should publish registration policies and fee schedules more transparently. This should include both national and local requirements and would give firms clearer expectations and additional leverage with officials who deviate from the official requirements.
- Electronic systems would be beneficial in efficiently and effectively clarifying information about registration procedures and business regulations. However, not all SMEs have reliable Internet access, so developing an SMS-based system would also be helpful.
- In general, government should aim to reduce the regulatory burden on firms. Some regulation is useful and helps, for example, to ensure a level playing field or maintain health standards, but excessive regulation only causes confusion and raises costs.

Raw materials, labour and human capital

Many SME owners and managers interviewed for our survey noted that there are numerous constraints to accessing raw materials, including high or variable prices, lack of access to quality materials and high transport, fuel and electricity costs. In addition, many SMEs reported problems in developing a skilled workforce and in paying workers and complying with labour market regulations.

Recommended policy actions

We recommend the following policy actions to help SMEs overcome constraints related to raw materials, labour and human capital:

- To address issues that come with informal labour relations, the government should provide clear and detailed information to all SMEs on minimum wage regulations, the benefits of compliance and the costs of non-compliance to the SME owner, SME employees and to the overall economy.
- The government should provide information to all SMEs (including those that have informal labour practices) on the benefits of adhering to formal labour regulations, as well as the protections and benefits (financial, social) this offers SME owners when employees do not comply with their work agreements.
- To help SMEs find skilled workers to meet their needs, the government could hire an ICT SME to create an electronic platform where workers in different provinces can advertise their skills. With this platform, the government could promote this service to SME owners in various industries through information campaigns.

7 Conclusion

In this report, we have investigated the challenges faced by small and medium-sized enterprises as they try to do business in Indonesia. SMEs are critical for Indonesia's economy, constituting more than 97 percent of total employment in Indonesia and representing 99 percent of all firms (Mourougane 2012). In order to accelerate economic growth and poverty reduction, policymakers in Indonesia need to design and implement policies to encourage SMEs to improve productivity, to formalise and to grow.

Our study of SMEs in Indonesia combined two different research methodologies: (1) quantitative analysis of nationally-representative data sets and (2) primary qualitative data collection. The data we collected were analysed using a basic analytical framework for understanding the different decisions that SMEs make, developed around the economic theory of the firm.

Although SMEs could face many potential problems in doing business, we found that two key problems emerged: (1) credit constraints and (2) access to information. Credit constraints were the most widely cited challenge that firms faced. Inadequate access to finance prevented firms from expanding and making investments in new technologies that would lead to growth. Many firms felt that the credit offered to them by banks was too expensive, with exorbitant interest rates and stringent collateral requirements. This was why firms relied more heavily on informal financial sources, such as family or social networks. Existing credit programmes, such as People's Business Credit, are a step in the right direction but they could be improved and need to be re-evaluated. In particular, the People's Business Credit programme has a Rp25 million cap on the loans it subsidises and this is too small an amount of money for businesses wanting to invest in new technologies or to expand.

Inadequate access to information of many different forms was also a pervasive problem for SMEs. Information problems prevented firms from learning about support programmes sponsored by government and non-governmental organisations, including trade fairs that might help them access markets and worker-training programmes that might help them become more productive. Not only do SMEs lack information about government programmes but the various levels of government, the banks and non-governmental organisations lack information about SMEs. A better national registry of SMEs would enable policymakers to more effectively design and target SME support programmes. However, creating this registry and keeping it up to date will be challenging, given that SMEs can start up and close down quickly and many SMEs may be wary of being on government lists (especially if they do not want to pay taxes).

A lack of access to information also affected the decisions of firms to remain in the informal sector. Although firms sometimes complained about the high cost of registration – despite some licensing procedures being free in Indonesia – many firms said that they remained informal either because they found the process too complicated or because the costs of complying with formal business regulations would be prohibitive. Although reducing registration costs is an important and worthy goal, this may not reduce the size of the informal sector. To promote formality, the government should focus on promoting the benefits of registration rather than just trying to reduce costs. This may require improving access to information, through mechanisms that help firms understand why registration can be beneficial and how they can navigate the registration process. The literature on formality suggests that making benefits clearer, along with increased enforcement, may lead to higher rates of formality, which is consistent with stronger growth and productivity for firms. General strategies to encourage poverty reduction and economic growth may lead to an exit of firms from the informal sector, an entry of more firms into the formal sector and a reallocation of workers into formal firms.

Although we have identified many key problems facing SMEs in Indonesia and provided some policy recommendations to address them, many important research questions remain. Access to finance is one area in particular where more careful work needs to be undertaken to assess how useful government's programmes to subsidise credit for small firms are or whether they create unwanted and unintended consequences. A more thorough analysis of government-sponsored trade fairs would also be useful to assess whether the benefits of providing these programmes are outweighed by their costs. Finally, more-detailed, careful research on how regional autonomy has affected the implementation of national SME support programmes would also be useful.

Appendices

Appendix A:
Interview questionnaire

Reformasi Kebijakan Indonesia Mengenai Usaha Kecil dan Menengah (UKM)
Principal Investigator: Dr. Alexander Rothenberg

Pendahuluan

Terima kasih banyak telah meluangkan waktu untuk berbicara dengan saya hari ini. Nama saya [nama depan, nama belakang]. Saya bekerja di AKATIGA, sebuah organisasi riset Indonesia yang mengumpulkan informasi untuk studi tentang kebijakan dan program yang mempengaruhi UKM dalam negeri. Penelitian ini dilakukan oleh RAND Corporation, sebuah organisasi riset di Amerika Serikat, dengan dana dari Department of Foreign Affairs and Trade (DFAT) melalui Tim Nasional Percepatan Penanggulangan Kemiskinan (TNP2K). Kami ingin persetujuan Anda untuk berpartisipasi dalam studi penelitian. Sekarang saya akan membacakan beberapa informasi tentang penelitian dan meminta persetujuan Anda. Anda juga dapat mengajukan pertanyaan kapan saja setelah berartisipasi dalam penelitian ini. Hasil penelitian ini akan membantu pembuat kebijakan untuk lebih memahami bagaimana mendukung pertumbuhan UKM dan keberlangsungannya.

(**Introduction** *Thank you very much for taking the time to talk to me today. My name is [first, last name]. I work at the AKATIGA, a research organization based in Indonesia that is collecting information for a study on policies and programs affecting SMEs in the country. The study is being done by the RAND Corporation, a research organization based in the United States, with funding from the Poverty Support Reduction Facility (PSRF). We would like your consent to participate in a research study. I will now read you some information about the study and ask for your consent. You may also ask questions at any time after joining the study. The results will help policymakers better understand how to promote SME growth and sustainment.)*

Prosedur

Jika Anda setuju untuk berpartisipasi dalam penelitian ini, Anda akan diwawancarai oleh anggota tim. Ini adalah keputusan Anda untuk terlibat atau tidak dalam penelitian ini. Anda dapat menghentikan wawancara kapan saja dan menolak untuk menjawab pertanyaan. Partisipasi Anda dalam penelitian ini sifatnya adalah sukarela. Anda memiliki hak untuk menarik diri dari penelitian ini setiap saat. Jika Anda memiliki pertanyaan, komentar, atau kekhawatiran tentang partisipasi dalam studi ini, Anda bisa berbicara dengan para peneliti yang mewawancarai Anda. Anda dapat menghubungi pemimpin studi yang tercantum di bawah.

Kami berharap survei ini mengambil sekitar satu jam dari waktu Anda. Nama Anda tidak akan digunakan dalam setiap laporan atau publikasi penelitian tanpa persetujuan Anda. Tidak akan ada manfaat langsung kepada Anda untuk menyelesaikan wawancara. Manfaat jangka panjang dari data yang dikumpulkan, dapat digunakan untuk merekomendasikan perubahan kebijakan pemerintah terkait sektor swasta. Penelitian kami memungkinkan pemahaman yang lebih baik mengenai dukungan terhadap sektor swasta di Negara berpenghasilan rendah dan menengah.

Informasi yang kami kumpulkan dari Anda akan dijaga kerahasiaannya. Satu-satunya orang yang akan memiliki akses informasi yang Anda berikan adalah orang-orang yang bekerja untuk penelitian. Penelitian ini diharapkan akan selesai pada bulan Desember 2014. Kami akan menghancurkan informasi identitas pribadi setelah penelitian selesai.

*(**Procedures** If you agree to participate in this study, you will be interviewed by a member of our research team. It is your decision whether or not to be in this study. You can stop the interview at any time and refuse to answer any question. Your participation in this research project is completely voluntary. You have the right to withdraw from the research study at any time. If you have any questions, comments, or concerns about participation in this study, you should talk to the researchers who interviewed you. You may contact the study leader with any questions you may have about this research study. We expect the survey to take approximately one hour of your time. Your name will not be used in any reports or publications of research without your agreement. There will be no direct benefit to you for completing the interview. Any benefit is in the long-term in that data collected from this survey may be used to recommend changes in government policy related to the private sector. Our study may allow a better understanding of how better to support private sector providers in low- and middle-income countries. The information we collect from you will be kept strictly confidential. The only persons who will have access to the information you provide will be people who work for the study. The study is anticipated to be completed in December 2014. We will destroy any personally identifying information after the study is completed.)*

Orang yang Dapat Dihubungi

Jika Anda ingin berbicara dengan seseorang tentang penelitian ini karena Anda pikir Anda tidak diperlakukan secara adil, atau berpikir bahwa Anda telah dirugikan dengan penelitian ini, atau Anda memiliki pertanyaan lain tentang penelitian, Anda dapat menghubungi peneliti utama, Dr Alexander Rothenberg pada nomor + 1-703-413-1100 ext. 5661. Jika Anda memiliki pertanyaan atau masalah tentang hak-hak Anda sebagai subjek penelitian, silakan hubungi Komite Perlindungan Subyek Manusia di RAND, 1700 Main Street, Santa Monica, CA 90407, + 310-393-0411 ext. 6369.

Apakah Anda memiliki pertanyaan tentang peneltian ini atau tentang apa yang saya baru katakan?

Apakah Anda bersedia untuk berpartisipasi dalam wawancara ini? YA / TIDAK (bulatkan pilihan) *(**Persons to Contact** If you want to talk to anyone about this research study because you think you have not been treated fairly, think you have been hurt by joining the study, or you have any other questions about the study, you should call the principal investigator, Dr. Alexander Rothenberg at extension +1-703-413-1100 ext. 5661. If you have any questions or concerns about your rights as a research subject, please contact the Human Subjects Protection Committee at RAND, 1700 Main Street, Santa Monica, CA 90407, +310-393-0411 ext. 6369. Do you have any questions about this project or about what I've just told you? Are you willing to participate in this interview? YES/NO (circle one))*

Persetujuan tambahan untuk bukti foto:

Kami juga ingin mengambil beberapa foto dari usaha Anda, untuk membantu kami menggambarkan jenis perusahaan yang kita bicarakan selama penelitian.Ini adalah pilihan Anda apakah kami dapat mengambil foto, dan sifatnya sukarela. Foto-foto dapat digunakan dalam publikasi yang kami hasilkan dari penelitian ini. Foto-foto memungkinkan kita untuk membantu orang memvisualisasikan jenis usaha yang sedang kami teliti. Jika Anda bersedia untuk kami ambil fotonya, kami ingin memasukkan nama perusahaan Anda dan nama Anda bersama dengan foto tersebut, tetapi Anda bisa menolak untuk menyertakan nama Anda. *(**Supplemental consent for photographic evidence**: We would also like to take a few photographs of your business, to help us describe the types of firms we talked to during our researcher. It is your choice whether we take photos, and it is completely voluntary. The photos may be used in publications that we produce from this research. The photos allow us to help people visualize the types of firms we are writing about. If you are willing to let us take photos, we would like to include the name of your firm and your name along with the photo, but you may tell us not to include your name.)*

Are you willing to let us take photos? YES/NO

Are you willing to let us use your firm's name and/or your name with the photo?

BAGIAN O: INFORMASI WAWANCARA (*Interview information*)

O1. Nomor Wawancara (*Interview number*)	
O2. Tanggal (*Date*)	_____/_____/_____
O3. Jam mulai dan jam berakhir wawancara (*Time interview began and time it ended*)	_____ Mulai (*Beginning*) _____ Selesai (*End*)
O4. Kode tim (*Team code*)	
O5. Nama enumerator (*Names of enumerators*)	
O6. Kondisi wawancara (*Interview atmosphere*) Jelaskan bagaimana jalannya wawancara. Apakah responden terlihat partisipatif? Tertarik? Enggan untuk bicara? (*Describe how the interview went. Was the subject engaged? Interested? Reluctant to talk?*)	

BAGIAN A: INFORMASI DASAR (*Basic information*)

TEMPAT (Location)

A1. Provinsi (*Province*)		(KODE BPS)
A2. Kabupaten/Kota (*District/municipality*)		
A3. Kecamatan (*Subdistrict*)		
A4. Desa/Kelurahan (*Village*)		

INFORMASI PERUSAHAAN DAN RESPONDEN (Firm and Respondent Information)

A5. Posisi responden dalam perusahaan (*Respondent's position*)		
A6. Gender responden (*Respondent's gender*)	1. Pria (*male*)	3. Wanita (*female*)
A7. Siapa yang membuat keputusan operasionaluntuk perusahaan ini? Apakah Anda atau orang lain? (*Who makes the operational decisions for this firm? You? Or someone else?*)	1. Anda (*you*)	3. Orang lain (*someone else*) 3x_____ Jelaskan (*describe*)
Probing: • Siapa yang membuat keputusan tentang tenaga kerja? (*Who makes the decisions about workers?*)	1. Anda (*you*)	3. Orang lain (*someone else*) 3x_____ Jelaskan (*describe*)
• Siapa yang memutuskan untuk memproduksi barang tertentu dan mengikuti pasar? (*Who makes the decision to make a certain product?*)	1. Anda (*you*)	3. Orang lain (*someone else*) 3x_____ Jelaskan (*describe*)

A8. Siapa yang membuat keputusan investasi untuk perusahaan ini? Apakah Anda atau orang lain? (Who makes the investment decisions for this firm? You? Someone else?)	1. Anda (*you*) 3. Orang lain (*someone else*) 3x_____ Jelaskan (*describe*)
Jika jawaban A7 dan A8 adalah orang lain, mohon wawancara dihentikan dan cari orang lain di UKM tersebut untuk diwawancara atau pindah ke UKM lain. [*If "someone else" was the answer to A7and A8, please stop this interview and find someone else at the firm to speak to or move on to another firm.*]	
A9. Usia (*Respondent's age*)	
A10. Pendidikan Terakhir (*Respondent's highest education level*)	
A11. Nama Perusahaan (*Name of firm*)	
A12. Alamat Perusahaan (*Contact address for the firm*)	
A13. Nomor Telepon (*Telephone number*)	
A14. Jika kami memiliki pertanyaan sesudah wawancara, apakah kami dapat menelpon Anda? (*If we have any questions after the interview, can we call you?*)	1. Ya (*yes*) 3. Tidak (*no*)
A15. Alamat e-mail/website (*Email address /Homepage*)	
A16. Produk utama yang dihasilkan (*Main type of products produced / service provided*) Probing untuk mengerti lebih jauh mengenai perusahaan dan produk yang dihasilkan. (*Probe as needed to understand the nature of this firm and its output*)	
A17. Sifat usaha (periode musiman atau bukan musiman) (*Seasonal or non-seasonal operation*)	1. Musiman (*seasonal*) 3. Bukan musiman (*non- seasonal*)
A18. Berapa hari kerja dalam satu minggu? (*How many working days in a typical week?*)	
A19. Berapa minggu/bulan kerja dalam setahun? (*How many weeks / months of operation in a typical year?*)	_____ Minggu dalam setahun (*weeks per year*) _____ Bulan (*months per year*)

MEMULAI DAN MENJALANKAN USAHA (Starting and Operating the Business)

A20. Siapa pemilik usaha ini? (*Who owns this firm?*)	1. Anda (*you*) 3. Orang lain (*someone else*) 3x_____ Jelaskan (*describe*)
A21. Apakah Anda menyimpan catatan keuangan mengenai usaha Anda? (*Do you keep financial records about your business?*)	1. Ya (*yes*) 3. Tidak (*no*) 1x_____ Jelaskan (*describe*)
A22. Apakah Anda memiliki rekening terpisah untuk rekening rumah tangga dan usaha ini? (*Do you have separate accounts for household affairs and this business?*)	1. Ya (*yes*) 3. Tidak (*no*)
A23. Tahun perusahaan didirikan (*Year business established*)	1. _____ 9. Tidak tahu (*don't know*)
A24. Apakah Anda membantu memulai perusahaan ini? (*Did you help to start this business?*)	1. Ya (*yes*) 3. Tidak (*no*) ⟹ **Bagian B** (*Section B*)

A25. Bagaimana proses yang Anda lalui untuk memulai bisnis Anda? (*Tell us about the process that you went through to start your business*)
 	
Cakupan topik (*Topics to cover*):
  a) Sebelum memulai bisnis ini, apakah Anda bekerja/magang di tempat lain terlebih dahulu? (*When you started your business, had you worked/been an apprentice in another firm at first?*) Jelaskan (*describe*):
  b) Bagaimana Anda membuka usaha ini?Berasal dari warisan atau inisiatif sendiri?(*How did you open this business? Inheritance or by yourself, or other?*)
  c) Mengapa Anda memilih bidang usaha ini?(*Why did you choose this industry?*)
  d) Apa tantangan utama yang dihadapi saat memulai bisnis Anda? Bagaimana Anda mengatasi tantangan tersebut?(*What were the major challenges you faced in starting your business? How did you overcome those challenges?*)
	1. Ya (*yes*) 3. Tidak (*no*)

A26. Dari daftar dibawah ini, mohon urutkan tantangan paling penting yang mempengaruhi suksesnya bisnis Anda (*From the list below, please rank the top three most important challenges that affect the success of your business today*):

Tantangan (*Challenge*)	Bagian/Hal (*Sect/Page*)	Ranking (*Rank*)	Tantangan (*Challenge*)	Bagian/Hal (*Sect/Page*)	Ranking (*Rank*)
Perizinan (*Licensing*)	B, 7		Akses terhadap Pasar (*Access to markets*)	G, 18	
Bahan Baku (*Raw materials*)	C, 10		Pelatihan Manajerial (*Managerial training*)	H, 21	
Produksi (*Production*)	D, 11		Kendala Mendapatkan Pinjaman/ Kredit (*Credit constraints*)	I, 22	
Penjualan & Distribusi (*Sales & distribution*)	E, 13		Tenaga Kerja dan Modal Manusia (*Labour and human capital*)	J, 25	
Keuntungan & Pertumbuhan Perusahaan (*Profit & growth*)	F, 16		Teknologi Produksi (*Production technology*)	K, 29	

[Enumerator: Gunakan pertanyaan ini untuk menentukan prioritas kelompok pertanyaan dalam kuesioner sesuai dengan jawaban responden.] [*Enumerator: Use this question to structure the rest of the interview, turning to the sections indicated by the respondent. As the discussion changes course, move on to other sections. After completing these sections, turn to the beginning and try to fill out the remaining unanswered questions.*]

[H] BAGIAN B. PERIZINAN (Licensing)

[H]	B1. Apakah usaha Anda punya Surat Izin Usaha resmi? (*Does your business have an official business permit?*)	1. Ya (*yes*) 3. Tidak (*no*) ⇒ **Ke B3(Go to B3)**

[H]   B2. [Jika YA](*If Yes*)Ceritakan kepada kami mengapa Anda memutuskan untuk mendaftarkan usaha Anda? (*Tell us more about why you decided to obtain (or not obtain) the Surat Izin Usaha [licence] for your business.*)
a) Bagaimana Anda mengurus perizinan untuk usaha Anda? (How did you get your licences?)
b) Darimana Anda mendapatkan informasi mengenai perizinan usaha? (*Where did you find information about where and how to obtain licences?*)
c) Berapa biaya yang Anda keluarkan? Berapa lama waktu yang dibutuhkan? (*How much did it cost? How long did it take toregister?*)
d) Apa saja keuntungan yang diperoleh dari Surat Izin tersebut? (*What is the benefit of the licence?*)

[CATATAN PEWAWANCARA: Langsung ke Pertanyaan B4][**INTERVIEWER NOTE: Go to B4**]	
[H] B3. [Jika TIDAK] Ceritakan kepada kami(*If no, please tell us*): a) Mengapa Anda memutuskan untuk tidak mendaftarkan usaha Anda? (*Why did you decide not to register your business?*) b) Apakah ada usaha dari pihak-pihak lain (seperti konsultan atau biro jasa) untuk membantu proses pendaftaran? (*Is there any attempt made by other parties, such as consultants or service bureaux, to encourage registration? Describe.*) c) Apakah menurut Anda tidak memiliki Surat Izin akan membatasi kemampuan Anda berkembang? (*Does not having a licence limit your ability to grow?*)	
[H] B4. Apa jenis izin-izin lain yang Anda miliki? (*What type of other licence or licences do you actually have for this business?*) Probing dengan pertanyaan, khususnya untuk izin tidak resmi. (*Probing question, especially on informal licences.*)	
[H] B5. Apakah Anda mengetahui program-program pemerintah untuk layanan izin satu atap? (*Are you aware of the government's programmes for one-stop-shops for business licences?*) Tanyakan hanya jika ada layanan satu atap di daerah tersebut (*Only ask when there is a one-stop-shop in the area*)	1. Ya (*yes*)　　　　3. Tidak (*no*) ⟹ **Bagian C (*Section C*)**
[H] B6. Apakah Anda menggunakan layanan satu atap ini untuk memperoleh izin usaha? (*Did you use this one-stop-shop to obtain a business licence?*) Tanyakan hanya jika ada layanan satu atap di daerah tersebut (*Only ask when there is a one-stop-shop in the area*)	1. Ya (*yes*)　　　　3. Tidak (*no*) ⟹ **Bagian C (*Section C*)**
[H] B7. Ceritakan kepada kami pengalaman Anda tentang layanan satu atap.(*Tell us about your experience with one-stop-shops. Only ask when there is a one-stop-shop in the area*)	

[L] BAGIAN C. BAHAN BAKU (*Raw Materials*)

[H] C1. Apakah sulit mencari bahan baku untuk produk utama Anda? Mengapa? (*Do you ever find it difficult to find the raw materials for you product? Why or why not?*)	
[H] C2. Apakah Anda memiliki kontrak kerjasama formal (tertulis) dengan penyedia bahan baku? (*Do you have a formal contract with your suppliers?*)	1. Ya (*yes*)　　　　3. Tidak (*no*) ⟹ **Ke C3(*Go to C3*)**
Probing: a) Adakah mekanisme pinjaman yang dijalankan? Bagaimana mekanisme tersebut? (*Is a loan made available at times? How does the loan mechanism work?*)	
[H] C3. Apakah Anda memiliki kontrak kerjasama informal (tidak tertulis) dengan penyedia bahan baku? (*Do you have an informal contract with your suppliers?*)	1. Ya (*yes*)　　　　3. Tidak (*no*)
Probing: a) Adakah mekanisme pinjaman yang dijalankan? Bagaimana mekanisme tersebut? (*Is a loan made available at times? How does the loan mechanism work?*)	

[L] BAGIAN D. PRODUKSI (*Production*)

[H] D1. Apakah Anda memproduksi sendiri produk utama Anda atau kombinasi kerjasama dengan pihak lain? (*Do you produce the products yourself or combine or cooperate with other actors?*)	1. Kombinasi (*combine*) 3. Sendiri (*oneself*) ⟹ **Ke D6 (*Go to D6)*** Bagaimana komposisinya? (*What is the work composed of?*)
[H] D2. Apakah Anda memiliki kontrak kerjasama produksi formal (tertulis) dengan pihak/ perusahaan lain? (*Do you have a formal production contract with other actors/firms?*) Probing: a) Dengan siapa *(With whom?)* b) Bagaimana sistem pengaturannya?*(How does the arrangement work?)*	1. Ya (*yes*) 3. Tidak (*no*) ⟹ **Ke D4 (*Go to D4)***
[H] D3. Apakah Anda memiliki kontrak kerjasama produksi informal (tidak tertulis) dengan pihak/ perusahaan lain? (*Do you have an informal contract with other actors/firms?*) Probing: a) Dengan siapa (*With whom?*) b) Bagaimana sistem pengaturannya?*(How does the arrangement work?)*	1. Ya (*yes*) 3. Tidak (*no*) ⟹ **Ke D4 (*Go to D4)***
[L] D4. Ceritakan masalah yang Anda hadapi terkait dengan proses produksi. Bagaimana Anda menghadapi masalah tersebut? Bantuan apa yang Anda butuhkan? (*Describe your problems with production. How do you respond to these problems? What do you need assistance with?*)	
[H] D5. Berapa biaya produksi per produk yang dihasilkan? Bagaimana struktur biaya produksi tersebut?*(What are your production costs per product? How are they structured?)* Cakupan topik *(Topics to cover)*: a) Total biaya produksi rata-rata per unit produk (*Average total production cost per product*) b) Bahan baku (*Raw materials*) c) Tenaga Kerja (*Workers/Employees*) d) Biaya lain-lain (*Overheads*)	

[L] BAGIAN E. PENJUALAN DAN DISTRIBUSI (*Sales and Distribution*)

[H] E1. Kemana saja Anda menjual produk utama Anda? (*Where do you sell your products?*)	
[H] E2. Apakah Anda lebih banyak menjual barang langsung ke konsumen, ke perusahaan lain, atau keduanya? (*Do you primarily sell goods to consumers or do you sell products to other firms, or both?*) Note: Bila produknya merupakan produk jadi, maka termasuk menjual ke konsumen. Bila produknya merupakan produk setengah jadi, maka termasuk menjual ke perusahaan lain. (*If the goods are final goods – no added value – then it is selling it to the consumer. If the goods are intermediary goods then it is selling it to other firms.*)	1. Konsumen (*consumers*) 2. Perusahaan lain (*other firms*) 3. Keduanya (*both*)
[H] E3. Apakah usaha Anda menjual produk secara lokal (domestik), ekspor, atau keudanya?(*Is the business selling its products in domestic/ local markets or through export trade, or both?*)	1. Lokal (*local*) 2. Ekspor (*export*) 3. Keduanya (*both*)
[H] E4. Apakah Anda menjual produk tersebut lewat perantara? (*Do you sell goods via a middleman?*)	1. Ya (*yes*) 3. Tidak (*no*) ⇒ **Ke E6 (Go to E6)**
[L] E5. Mengapa Anda memilih jalur tersebut? (*Why have you chosen this sales method?*)	
[H] E6. Berapa rata-rata pendapatan/omset perminggu/ per bulan dalam setahun terakhir? (*What is your average revenue per week/month in the last year?*) Note: Jika responden tidak dapat menjawab pertanyaan ini, untuk sektor kopi dan rumah makan dapat melakukan pendekatan seperti pada E6A dan E6B. (*If the respondent cannot answer this question, for the coffee and restaurant industry, use the approach in E7A and E7B*)	_____pendapatan per minggu dalam Rupiah (*revenue per week*) OR _____pendapatan per bulan dalam Rupiah (*revenue per month*)
[H] E6A. Untuk industri kopi: pendapatan per tahun, jumlah pohon, luas lahan, keuntungan per panen (kg)? (For coffee – ask for number of trees, land size, profit per harvest / per year) **[CATATAN PEWAWANCARA: KONVERSI KE PENDAPATAN PER-MINGGU/BULAN DAN ISI KE E7]** [*INTERVIEWER NOTE: CONVERT TO WEEKLY AND MONTHLY REVENUE AND FILL E7*]	_____ pendapatan per tahun (*revenue per year*) _____ pendapatan per panen (*revenue per harvest*) _____ jumlah pohon (*number of trees*) _____ luas lahan dalam Ha (*land in hectares*)
[H] E6B. Untuk rumah makan: berapa orang datang per hari? Berapa rata – rata orang membayar? (*For restaurant – ask for number of people coming in each day, average customer spending*) **[CATATAN PEWAWANCARA: KONVERSI KE PENDAPATAN PER-MINGGU/BULAN DAN ISI KE E7]** [*INTERVIEWER NOTE: CONVERT TO WEEKLY AND MONTHLY REVENUE AND FILL E7*]	_____ jumlah konsumen per hari (*number of people per day*) _____ rata-rata jumlah pengeluaran per konsumen per hari (*average amount spent per customer/ per day*)

[H]	E7. Berapa kuantitas produk yang dijual perminggu/ per bulan dalam setahun terakhir? *(What is your average number of products sold per week/month in the last year?)*	_____kuantitas produk dijual per minggu *(quantity of products sold per week)* OR _____ kuantitas produk dijual per bulan *(quantity of products sold per month)*
[L]	E13. Ceritakan masalah lain terkait penjualan dan distribusi yang belum kami sebutkan. Bagaimana Anda menangani masalah ini? Bantuan apa yang Anda perlukan? *(Describe any other problems with sales and distribution that we have not mentioned. How do you respond to these problems? What do you need assistance with?)*	
[H]	E6A. Untuk industri kopi: pendapatan per tahun, jumlah pohon, luas lahan, keuntungan per panen (kg)? (For coffee – ask for number of trees, land size, profit per harvest / per year) **[CATATAN PEWAWANCARA: KONVERSI KE PENDAPATAN PER-MINGGU/BULAN DAN ISI KE E7] [*INTERVIEWER NOTE: CONVERT TO WEEKLY AND MONTHLY REVENUE AND FILL E7*]**	_____ pendapatan per tahun *(revenue per year)* _____ pendapatan per panen *(revenue per harvest)* _____ jumlah pohon *(number of trees)* _____ luas lahan dalam Ha *(land in hectares)*
[H]	E6B. Untuk rumah makan: berapa orang datang per hari? Berapa rata – rata orang membayar? *(For restaurant – ask for number of people coming in each day, average customer spending)* **[CATATAN PEWAWANCARA: KONVERSI KE PENDAPATAN PER-MINGGU/BULAN DAN ISI KE E7] [*INTERVIEWER NOTE: CONVERT TO WEEKLY AND MONTHLY REVENUE AND FILL E7*]**	_____ jumlah konsumen per hari *(number of people per day)* _____ rata-rata jumlah pengeluaran per konsumen per hari *(average amount spent per customer/ per day)*
[H]	E7. Berapa kuantitas produk yang dijual perminggu/ per bulan dalam setahun terakhir? *(What is your average number of products sold per week/month in the last year?)*	_____kuantitas produk dijual per minggu *(quantity of products sold per week)* OR _____ kuantitas produk dijual per bulan *(quantity of products sold per month)*
[L]	E13. Ceritakan masalah lain terkait penjualan dan distribusi yang belum kami sebutkan. Bagaimana Anda menangani masalah ini? Bantuan apa yang Anda perlukan? *(Describe any other problems with sales and distribution that we have not mentioned. How do you respond to these problems? What do you need assistance with?)*	

[H] BAGIAN F. KEUNTUNGAN DAN PERTUMBUHAN *(Profits and Growth)*

[L] F1. Apakah terjadi peningkatan omset dalam 1 tahun terakhir? *(Has your revenue increased within the last year?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke F4 *(Go to F4)***
[L] F2. Mengapa terjadi peningkatan omset?Apakah karena pasarnya lebih luas?Pembeli lebih bervariasi? *(If yes, why do you think it has increased? For example, wider markets or wider range of buyers?)*	
[L] F3. Jika meningkat, apakah peningkatan omset menyebabkan peningkatan keuntungan? Mengapa?*(Does this increase in revenue affect your profits? Explain why.)*	
[H] F4. Apakah kondisi usaha Anda sudah sesuai dengan target yang ingin Anda capai? *(Does the current state of the business meet your desired goals for the business?)*	1. Ya *(yes)* 3. Tidak *(no)*
[H] F5. Apakah Anda pernah mengambil langkah tertentu dalam 6 bulan terakhir untuk mengembangkan usaha Anda? *(Have you taken any steps in the past 6 months to expand your business?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke F7 *(Go to F7)***
[H] F6. Jenis langkah konkrit apa yang Anda ambil? *(What are the steps have you taken?)* Cakupan topik (Topics to cover): Jawaban bisa lebih dari satu *(They can choose more than one answer)*	a. Pasar pelanggan baru *(New consumer markets)* b. Investasi baru *(new investment)* c. Produk baru *(new products)* d. Rekrutmen pekerja baru *(hire more workers)* e. Investasi dalam metode produksi baru *(invest in new production methods)*
Probing: Mengapa Anda memutuskan untuk melakukan ini? *(Why have you decided to do this?)*	
[H] F7. Jika belum ada langkah yang diambil untuk berkembang, mengapa?*(If you haven't taken any steps to grow, why not?)*	

BAGIAN G. AKSES TERHADAP PASAR *(Access to Markets)*

G1. Apakah Anda menghadapi kesulitan dalam menjual produk utama Anda?Apakah Anda membutuhkan bantuan dalam hal ini? Mengapa demikian? *(Do you have any difficulty finding markets for your products? Is this an area where you need help? If so, what would be most helpful? Why?)*	
G2. Apakah Anda memiliki pengalaman menjual produk dengan internet, computer, handphone? *(Do you have any experience with selling through internet, computer, cellphone?)* Note: Yang dimaksud dengan pertanyaan ini adalah proses penjualan yang dilakukan tidak secara bertemu tatap muka dan menggunakan teknologi.*(The selling processes implied in this question are indirect sales and sales using technology)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke G4 *(Go to G4)***
G3. Ceritakan kepada kami pengalaman pemasaran Anda. *(Tell us about your marketing experience.)* a) Apakah Anda menggunakan media ini untuk berjualan atau hanya promosi produk utama Anda? *(Do/did you use it for trading or just promoting your product?)* b) Jika ya, di media apa? Mengapa? Bagaimana dampaknya terhadap usaha? *(If you have tried online media, why did you try it? Do they have an impact on your business?)* c) Jika belum menggunakan media ini, mengapa? *(If you have not used it, why not?)* d) Apakah Anda mengetahui program pemerintah mengenai perdagangan dengan platform elektronik?*(Do you know of any government programs about electronic platform?)*	

G4. Apakah Anda mengetahui adanya program yang mencoba untuk membantu perusahaan Anda menemukan pasar yang lebih baik dan lebih menentu untuk produk utama Anda? *(Are you aware of any programmes that attempt to help your firm find a better, more certain market for your products?)* Contoh program (*Programme example*): • Pekan Raya (*trade fair*) • Ruang Pamer(*exhibition*) • Pasar Malam(*night market*)	1. Ya (*yes*)　　　　3. Tidak (*no*) ⟹ **Bagian H (Section H)**
G5. a) Bagaimana Anda mendengar mengenai program ini? *(How did you hear about this programme?)* b) Apakah nama program tersebut? *(What was the name of the programme?)* c) Siapa yang menjalankan program tersebut? Pemerintah? LSM? *(Who was running the programme? The government? NGOs?)*	
G6. Apakah Anda pernah mengikuti program seperti itu? *(Have you participated in any programmes like this?)*	1. Ya (*yes*) 3. Tidak (*no*) Probing alasan mengapa (*Probe the reasons in short answer/s*) Jika Tidak (*if No*) ⟹ **Ke Bagian H (Section H)**
G7. Apa dampak dari program ini bagi usaha Anda? Hal baru apa yang Anda lakukan setelah mengikuti program ini? *(What were the impacts? What new things do you do after being involved in this programme?)*	

[H] BAGIAN H. PELATIHAN MANAJERIAL (*Managerial Training*)

[H] H1. Apakah Anda pernah mendengar mengenai program pelatihan manajerial untuk sector usaha Anda? *(Have you ever heard of any managerial training programmes for your industry?)*	1. Ya (*yes*)　　　　3. Tidak (*no*) ⟹ **Ke H4 (Go to H4)**
[H]　H2. a) Bagaimana Anda mendengar mengenai program ini? *(How did you hear about this programme?)* b) Apakah nama program tersebut? *(What was the name of the programme?)* c) Siapa yang menjalankan program tersebut? Pemerintah? LSM? *(Who was running the programme? The government? NGOs?)*	
[H] H3. Apakah Anda pernah mengikuti program seperti itu? *(Have you participated in any programmes like this?)*	1. Ya (*yes*) 3. Tidak (*no*) Probing alasan mengapa (*probe the reasons in short answer/s*) Jika Tidak (*if No*) ⟹ **Ke H5 (Go to H5)**
[H] H4. Apa dampak dari program ini bagi usaha Anda? Hal baru apa yang Anda lakukan setelah mengikuti program ini? *(What were the impacts? What new things do you do after being involved in this programme?)*	
[H] H5. Dari mana Anda mengetahui atau mendapat training manajerial?*(Where and how did you get your training on managing a business?)*	

[L] BAGIAN I. KENDALA KREDIT (*Credit constraints*)

[H] I1. Dari mana Anda mendapatkan modal awal Anda? *(Where did you get your initial startup capital?)*	

[H] I2. Bagaimana Anda mendanai operasional sehari-hari Anda?*(How do you finance your daily operations?)*

[L] I3. Jika Anda ingin membeli peralatan baru, memperluas bangunan, atau membuka lokasi baru, bagaimana kira – kira Anda mendanainya? *(If you wanted to buy new equipment, expand your building or open a new location, how would you finance that?)*

Jelaskan kondisi pendanaan ini. *(Please describe the nature of this extra capital.)*
Cakupan topik *(Topics to cover)*:
a. Biaya sendiri. Mengapa? *(His/her own money. Why have you chosen this method?)*
b. Kredit dari bank atau koperasi formal. Mengapa? *(Formal credit from bank or cooperatives. Why have you chosen this method?)*
c. Pinjaman non formal, yaitu…. Mengapa? *(Non-formal credit such as…Why have you chosen this method?)*

[H] I4. Apakah Anda pernah mencoba untuk memperoleh sumber investasi dari luar Indonesia? *(Have you tried to get investment from sources outside Indonesia?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke I6 (Go to I6)**

[H] I5. Ceritakan mengenai pengalaman Anda dengan sumber investasi luar negeri ini.(**Please describe your experiences with this outside investment source. Topics to cover**:)
a) Siapa yang membantu Anda mencari pendanaan dan mengapa? *(Who did you seek funding from and why?)*
b) Dimana mereka berada? *(Where were they located?)*
c) Seberapa sukses atau gagalkah Anda?*(How successful or unsuccessful were you?)*
d) Apakah prosesnya mudah? Sulit? Jelaskan.*(Was the process easy? Difficult? Please describe)*

[L] I6. Apakah Anda mengalami kesulitan dalam mendapatkan akses terhadap kredit?Apakah Anda membutuhkan bantuan dalam hal ini? Jika ya, bantuan apa yang akan sangat membantu? Mengapa demikian? *(Do you have any difficulty finding access to credit? Is this an area where you need help? If so, what would be most helpful? Why?)*

[H] I7. Apakah Anda mengetahui program yang membantu Anda mengakses kredit? *(Do you know of any programmes that help you access credit?)* From bank, cooperation or private organization, and so on.	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke Bagian J (Section J)**

[H] I8.
a) Bagaimana Anda mendengar mengenai program ini? *(How did you hear about this programme?)*
b) Apakah nama program tersebut? *(What was the name of the programme?)*
c) Siapa yang menjalankan program tersebut? Pemerintah? LSM? *(Who was running the programme? The government? NGOs?)*

[H] I9. Apakah Anda pernah mengikuti program seperti itu? *(Have you participated in any programmes like this?)*	1. Ya *(yes)* 3. Tidak *(no)* Probing alasan mengapa *(Probe the reasons in short answer/s)* Jika Tidak (if No) ⇒ **Ke Bagian J (Section J)**

[H] I10. Apa dampak dari program ini bagi usaha Anda? Hal baru apa yang Anda lakukan setelah mengikuti program ini? *(What are the impacts? What new things do you do after being involved in this programme?)*

[H] BAGIAN J. TENAGA KERJA DAN MODAL MANUSIA *(Labour and human capital)*

[H]	J1. Berapa total jumlah pekerja saat ini? *(How many workers do you have at this firm in total?)*	_____laki-laki*(men)*
		_____perempuan *(women)*

[H] J2. Ada berapa 'tipe pekerja'? (Misal: tidak dibayar, tetap, kontrak, borongan) Bagaimana sistem pembayaran? Berapa rata-rata gaji pekerja Anda? *(What types of employees do you have? [permanent, contract, output based] How are they paid? What is the average wage for a production worker?)*

Tipe (Type)	Jumlah (#)	Sistem pembayaran *(Payment system)*	Rata-rata gaji (Rp. Per unit waktu) *(Average wage (Rp per time unit)*
Tidak dibayar *(unpaid)*			-
Tetap *(permanent)*			(Rp. Per _____)
Kontrak *(contract)*			(Rp. Per _____)
Borongan *(piecemeal)*			(Rp. Per _____)
Lainnya: _____ *(others)*			(Rp. Per _____)
Lainnya: _____ *(others)*			(Rp. Per _____)

J3.	Apakah ada pekerjaan yang membutuhkan keahlian khusus? Bagaimana Anda mendapatkan tenaga kerja yang mampu mengerjakannya?*(Do you need workers with special skills? If yes, how do you recruit them?)*
J4.	Apa saja kesulitan terbesar Anda untuk merekrut pekerja? *(What are your biggest difficulties in recruiting workers?)*
J5.	Seberapa sering terjadi pergantian pekerja dalam pekerjaan ini?Berapa banyak pekerja yang telah Anda pekerjakan tahun lalu?Seberapa banyak yang berhenti kerja?Mengapa? *(How high is your employee turnover? How many employees have you had in the past year? How many employees resigned/quit? What were their reasons?)*
J6.	Apa saja yang Anda lakukan agar pekerja Anda betah atau tidak pindah bekerja? *(What efforts do you make to retain your workers?)*
J7.	Apakah Anda membutuhkan program peningkatan kapasitas bagi pekerja Anda? Seperti apa? *(Is worker training something you could use help with? What kind of training would be useful to you?)*

[H] J8. Apakah Anda pernah mendengar program pelatihan pekerja bagi industri Anda? *(Have you ever heard of any worker training programmes for your industry?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke J 12 *(Go to J 12)***
[L] J9. a) Bagaimana Anda mendengar mengenai program ini? *(How did you hear about this programme?)* b) Apakah nama program tersebut? *(What was the name of the programme?)* c) Siapa yang menjalankan program tersebut? Pemerintah? LSM? *(Who was running the programme? The government? NGOs?)*	
[H] J10. Apakah Anda pernah mengikuti program seperti itu? *(Have you participated in any programmes like this?)*	1. Ya *(yes)* 3. Tidak *(no)* Probing alasan mengapa *(Probe the reasons in short answer/s)* Jika Tidak *(if No)* ⇒ **Ke J12 *(Go to J 12)***
[H] J11.Apa dampak dari program ini bagi usaha Anda? Hal baru apa yang Anda lakukan setelah mengikuti program ini? *(What are the impacts? What new things do you do after being involved in this programme?)*	
[L] J12. Apakah Anda mengetahui peraturan-peraturan terkait dengan pekerja Anda? Misalnya: upah minimum di daerah Anda, aturan pesangon, aturan pemutusan hubungan kerja. *(Are you aware of regulations regarding workers? E.g. minimum wages in your area, severance regulations, employee dismissal laws.)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Bagian K *(Section K)***
Probing: Peraturan lain selain yang telah disebutkan. *(Laws beside the ones mentioned above)*	
[L] J13. Apakah peraturan tersebut dilaksanakan dalam usaha Anda?*(Are they being applied in your business?)*	
[L] J14. Apakah Anda tahu bahwa Anda bisa mendapatkan pengecualian sementara perihal menaati aturan upah minimum? *(Do you know that it is possible to obtain a temporary exemption from the government for complying with minimum wage laws?)*	1. Ya *(yes)* 3. Tidak *(no)*
[L] J15. Apakah Anda pernah/telah menerima pengecualian ini? *(Have you obtained this exemption?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Bagian K *(Section K)***
[L] J16. Bagaimana Anda memperoleh pengecualian ini.*(Tell us about your experience with this minimum wage law exemption.)* a) Apakah pengecualian tersebut sulit diperoleh? *(Was it difficult to obtain?)*	

BAGIAN K. TEKNOLOGI PRODUKSI (*Production Technology*)

[H] K1. Kami ingin mendiskusikan mengenai pengalaman Anda menggunakan teknologi baru (*We'd like to discuss your experiences with new technologies*.)	

Cakupan topik *(Topics covered)*:
   a) Apakah Anda mengetahui adanya mesin,alat atau teknologi baru di bidang industri Anda? Apa teknologi tersebut? *(Are you aware of any new machines, tools, techniques, recipes in your field? What are they?)*
   b) Darimana Anda biasanya mempelajari teknologi baru? *(How do you learn about new technologies?)*

K2. Apakah dalam 1 tahun ke depan Anda memiliki rencana untuk berinvestasi dalam teknologi produksi baru? *(Have you ever thought of investing in new production technologies?)* Note: Sebutkan contoh bagi masing-masing industri *(Mention examples tailored for each industry)*	1. Ya *(yes)* 3. Tidak *(no)*

K3. Ceritakan teknologi produksi baru yang pernah Anda minati. (**Please describe the new production technologies you have thought about**)

Cakupan topik *(Topics covered)*:
   a) Jika ya, untuk apa? *(If yes, what for?)*
   b) Jika tidak, mengapa demikian? *(If no, why not?)*
   c) Dengan cara apa teknologi ini akan mempengaruhi pertumbuhan produktivitas atau keuntungan? *(How would this lead to productivity growth or profits?)*

[H] K4. Adakah teknologi yang ingin Anda gunakan, selain yang telah digunakan saat ini, untuk meningkatkan efisiensi? Siapa yang memberi saran untuk mendapatkan teknologi tersebut?*(Are there technologies other than equipment that you use or would like to use to improve efficiency? Who gives you advice about getting these technologies?)*

BAGIAN L. KOPERASI DAN ASOSIASI INDUSTRI (*Cooperatives and Industry Associations*)

L1. Apakah Anda mengetahui adanya koperasi untuk jenis perusahaan Anda? *(Are you aware of any industry cooperative for your business?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke L5 *(Go to L5)***
L2. Apakah perusahaan ini memiliki keanggotaan di koperasi asosiasi? *(Does this firm have membership in cooperative?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **Ke L5 *(Go to L5)***
L3. Nama koperasi (*Name of cooperative*)	
L4. Ceritakan pengalaman Anda dengan koperasi tersebut. (*Please describe your experiences with this cooperative.*)	

Cakupan topik *(Topics covered)*:
   a) Apa keuntungan yang diberikan oleh koperasi tersebut? *(What benefits does this cooperative provide?)*
   b) Apa yang Anda harap dilakukan oleh koperasi yang tidak/belum dilakukan saat ini? *(What do you wish the cooperative did that it does not currently do?)*

L5. Apakah Anda mengetahui adanya asosiasi untuk perusahaan Anda? *(Are you aware of any industry association, for your business?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **BAGIAN M *(Section M)***
L6. Apakah perusahaan ini memiliki keanggotaan di asosiasi industri? *(Does this firm have membership in an industry association?)*	1. Ya *(yes)* 3. Tidak *(no)* ⇒ **BAGIAN M *(Section M)***

L7.	Nama asosiasi industri *(Name of industry association)*	

L8.	Ceritakan pengalaman Anda dengan asosiasi tersebut. *(Please describe your experiences with this association.)*

Cakupan topik *(Topics covered):*
  a) Apa keuntungan yang diberikan oleh asosiasi tersebut? *(What benefits does this association provide?)*
  b) Apa yang Anda harap dilakukan oleh asosiasi yang tidak/belum dilakukan saat ini? *(What do you wish the association did that it does not currently do?)*

BAGIAN M. PAJAK YANG DIKENAKAN PADA PERUSAHAAN (*Taxation and informal payments*)

M1.	Apakah usaha Anda membayar pajak dan/atau retribusi dalam setahun terakhir? *(Did your firm pay formal taxes in the past year?)*	1. Ya *(yes)* 3. Tidak *(no)* ⟹ **Ke M3** *(Go to M3)*
M2.	Jenis pajak dan retribusi apa saja yang Anda bayar? Dimungkinkan lebih dari satu jenis pajak. *(Which formal taxes do you pay? Can be more than one type.)*	_____ Nama pajak *(name of tax)* _____Frekuensi pembayaran (bulanan/tahunan) *(payment frequencies)* _____ Jumlah yang dibayar *(amount paid)*
Note: • Pajak resmi adalah *(Formal taxes are):* PPh, PBB, PPN, Pajak Kendaraan • PBB dan Pajak Kendaraan hanya dicatat jika bangunan dan kendaraan digunakan untuk keperluan usaha (PBB –Land tax– and Pajak Kendaraan– *Vehicle tax – are noted only if the building and vehicle are used for business purposes)*	_____Nama pajak *(name of tax)* _____Frekuensi pembayaran (bulanan/tahunan) *(payment frequencies)* _____ Jumlah yang dibayar *(amount paid)* _____ Nama pajak *(name of tax)* _____Frekuensi pembayaran (bulanan/tahunan) *(payment frequencies)* _____ Jumlah yang dibayar *(amount paid)*

M3.	Selain pajak, adakah pembayaran (iuran) yang Anda lakukan? *(Aside from taxes, what other regular payments do you make?)* a) Sebutkan iuran apa saja dan lakukan probing untuk setiap iuran *(List the payments and probe each)* b) Untuk apa saja pembayaran tersebut? *(What was the payment for?)* c) Kepada siapa pembayaran tersebut ditujukan? *(To whom was this paid?)* d) Frekuensi pembayaran? *(How often do you make these payments?)* e) Berapa besar biaya yang Anda keluarkan untuk pembayaran tersebut bagi usaha Anda? *(How much do these payments cost your business?)*

M4. Apa saja pembayaran tak tentu (bisa jadi merupakan pungutan resmi) yang Anda lakukan? Jelaskan. *(What other irregular payments do you make? Describe.)* a) Sebutkan pembayaran apa saja dan lakukan probing untuk setiap pembayaran *(List the payments and probe each)* b) Untuk apa saja pembayaran tersebut? *(What was the payment for?)* c) Kepada siapa pembayaran tersebut ditujukan? *(To whom was this paid?)* d) Kapan Anda melakukan pembayaran tersebut? *(When do you make these payments?)* e) Berapa besar biaya yang Anda keluarkan untuk pembayaran tersebut bagi usaha Anda? *(How much do these payments cost your business?)*

BAGIAN N. KEBIJAKAN PEMERINTAH LAINNYA (*Other government policies*)

N1.	Apa saja bantuan dari pemerintah nasional dan lokal untuk UKM yang Anda ketahui selain yang sudah disebutkan sebelumnya? *(What other support from national and local governments for SMEs are you aware of aside from those mentioned above?)*
N2.	Apakah ada kebijakan pemerintah (nasional, lokal) yang membantu perkembangan usaha Anda? Jelaskan nama dan dampaknya? (Is there any government *(local or national)* policy that helps you to grow your business?)
N3.	Apakah ada kebijakan pemerintah (nasional, lokal) yang menghambat perkembangan usaha Anda? Jelaskan nama dan dampaknya? *(Is there any government – local or national – policy that prevents you from growing your business?)*
N4.	Menurut Anda, apa yang sebaiknya dilakukan oleh pemerintah nasional untuk membantu usaha kecil seperti usaha Anda? *(In your opinion, what can the national government do to help SMEs such as your business?)*
N5.	Apa yang menghambat pemerintah (nasional, lokal) dalam mengembangkan usaha kecil? *(What do you think obstructs the local or national government in developing SME?)*
N6.	Siapa yang paling mungkin menurut Anda membantu usaha seperti Anda? (nasional, lokal, dinas tertentu, non pemerintah, dll) *(Who do you think will be most likely to help SMEs such as your business?)*
N7.	Adakah hal lainnya yang ingin Anda bahas terkait dengan pengalaman Anda dengan kebijakan pemerintah, pejabat atau program bantuan terkait UKM? *(Is there anything else you would like to discuss in reference to your experiences with government programmes, policies or officials in relations to SME support?)*

Izin Tertulis untuk Mengambil Gambar (*Signed Permission to use Photograph*)

Saya mengizinkan AKATIGA dan RAND Corporation, perwakilan dan karyawan mereka, untuk mengambil gambar saya dan perusahaan ini dalam kaitan dengan studi untuk Proyek Reformasi Kebijakan UKM.Saya memberikan hak kepada RAND dan AKATIGA untuk menggunakan dan mempublikasikan gambar-gambar tersebut dalam bentuk cetak maupun elektronik. Saya setuju bahwa RAND dan AKATIGA boleh menggunakan gambar saya, tanpa nama, dan untuk tujuan taat hukum lainnya, termasuk misalnya untuk tujuan publikasi, ilustrasi, dan isi website.

I grant to AKATIGA and the RAND Corporation, its representatives and employees, the right to take photographs of me and this firm in connection with the study for the SME Policy Reform Project. I authorise RAND and AKATIGA the rights to use and publish these photographs in print and/or electronically. I agree that RAND and AKATIGA may use such photographs of me, without my name, and for any lawful purpose, including for example such purposes as publicity, illustration, and webcontent.

Tanda Tangan (*Signature*) _____

Tanggal (*Date*)   _____

Apakah Anda bersedia untuk dihubungi lagi (oleh Ogilvy), untuk menjawab beberapa pertanyaan atau (sekali lagi) diambil gambarnya untuk studi kasus mendalam?Kami mungkin tertarik untuk mengangkat cerita Anda sebagai ilustrasi bagaimana pemerintah dapat lebih mendukung pertumbuhan UKM.
1. Ya   3. Tidak (lingkari)

Would you be willing to be contacted again (by Ogilvy), answer additional questions, or have your picture taken (again) for a more in-depth case-study? We may be interested in highlighting your story as an illustration of how the government should better support SME growth/development.

Reforming Indonesia's Policies Towards Small and Medium Sized Enterprises (SMEs)
Principal Investigator: Dr. Alexander Rothenberg

Introduction

Thank you very much for taking the time to talk to me today. My name is [first, last name]. I work at the AKATIGA, a research organization based in Indonesia that is collecting information for a study on policies and programs affecting SMEs in the country. The study is being done by the RAND Corporation, a research organization based in the United States, with funding from the Poverty Support Reduction Facility (PSRF). We would like your consent to participate in a research study. I will now read you some information about the study and ask for your consent. You may also ask questions at any time after joining the study. The results will help policymakers better understand how to promote SME growth and sustainment.

Procedures

If you agree to participate in this study, you will be interviewed by a member of our research team. It is your decision whether or not to be in this study. You can stop the interview at any time and refuse to answer any question. Your participation in this research project is completely voluntary. You have the right to withdraw from the research study at any time. If you have any questions, comments, or concerns about participation in this study, you should talk to the researchers who interviewed you. You may contact the study leader with any questions you may have about this research study.

We expect the survey to take approximately one hour of your time. Your name will not be used in any reports or publications of research without your agreement. There will be no direct benefit to you for completing the interview. Any benefit is in the long-term in that data collected from this survey may be used to recommend changes in government policy related to the private sector. Our study may allow a better understanding of how better to support private sector providers in low- and middle-income countries.

The information we collect from you will be kept strictly confidential. The only persons who will have access to the information you provide will be people who work for the study. The study is anticipated to be completed in December 2014. We will destroy any personally identifying information after the study is completed.

Persons to Contact

If you want to talk to anyone about this research study because you think you have not been treated fairly, think you have been hurt by joining the study, or you have any other questions about the study, you should call the principal investigator, Dr. Alexander Rothenberg at extension +1-703-413-1100 ext. 5661. If you have any questions or concerns about your rights as a research subject, please contact the Human Subjects Protection Committee at RAND, 1700 Main Street, Santa Monica, CA 90407, +310-393-0411 ext. 6369.

Do you have any questions about this project or about what I've just told you?

Are you willing to participate in this interview? YES/NO (circle one)

Supplemental consent for photographic evidence:

We would also like to take a few photographs of your business, to help us describe the types of firms we talked to during our researcher. It is your choice whether we take photos, and it is completely voluntary. The photos may be used in publications that we produce from this research. The photos allow us to help people visualize the types of firms we are writing about. If you are willing to let us take photos, we would like to include the name of your firm and your name along with the photo, but you may tell us not to include your name.

Are you willing to let us take photos? YES/NO

Are you willing to let us use your firm's name and/or your name with the photo?

Appendix B
Interview debriefing form

BAGIAN O: INFORMASI WAWANCARA (*Interview information*)

NOTE: INFORMATION FROM THIS SECTION SHOULD BE COPIED FROM THE INTERVIEW QUESTIONNAIRE.

01. (*Firm number*)	*This will just be a unique number for each firm. First interview is #1, second is #2, etc.*
01A. Kabupaten 01B. Kecamatan 01C. Kelurahan (*if known*)	01A. _____ 01B. _____ 01C. _____
O2. (*Date*)	___August___/_____/__2014__
O3. (*Time began and time finished*)	_____ Mulai (*began*) _____ Selesai (*ended*)
O4. (*Team code*)	
O5. *Interviewers*	
O6. (*Name of person who filled out this form*)	

BAGIAN A: ANALISIS WAWANCARA (*Analysis of interview*)

A0. Briefly describe the SME (industry, size of firm, whether the SME has appropriate business licences)

A1. Was the SME interested in growing or expanding its business? If it was not interested in growing, what was more important—what are its goals?

A2. How was the SME constrained? If possible, identify constraints from these categories:

- Credit constraints
- Difficulty with access to markets (demand, other firms or end consumers)
- Difficulty with access to raw materials markets (supply)
- Labour market problems
- Outdated production technologies
- Difficulty with managerial practices
- Institutional environment: licensing, informal payments, contract enforcement

Summary (*required*):
A3. How does the SME interact with the government? Does it make use of any existing government programmes? Is it aware of the role of the government at all? What recent challenges has it had with the government recently? Does the government do anything beneficial?

A4. Based on A1-A3, how should government policies be modified or reformed to encourage or alleviate the constraints faced by the SME? (Differentiate between your conclusions and any recommendations the firm made.)

A5. Summarise any relevant/interesting experiences the firm reported related to operations, investment, expansion, the business environment (things that would enrich a write-up or provide insight into how Indonesia firms operate)?

Appendix C
Interview fieldwork logistics

1. Field research teams and interviews

Interviews were conducted by four research teams, operating independently and simultaneously, throughout the month of August 2014. Table 1.1 describes the industries and locations that were surveyed by each of the four teams and provides the actual number of interviews conducted for each of those industries.

Table C.1   Field research teams, industries and Intended sample sizes

Industry	Team 1	Team 2	Team 3	Team 4	Total interviews (by industry)
	West Java	Central Java	North Sumatera	South Sulawesi	
	*JABODETABEK, Bandung	Solo, Pekalongan, Jepara	Medan, Aceh	Makassar, Toraja	
Food processing	6		12	12	30
Services (restaurants)	3		6	6	15
Services (motorcycle repair shops)	3		6	6	15
Batik textiles		24			24
Modern Muslim fashion	24				24
Teak furniture		24			24
Coffee			24	24	48
High-value-added ICT	12				12
Total Interviews (by Team)	**48**	**48**	**48**	**48**	**192**

Source: Authors' calculations
JABODETABEK covers the urban area surrounding Jakarta including Jakarta Bogor, Bekasi, Depok, Tangerang and South Tengerang.

Each fieldwork team was intended to be comprised of at least one staff member from either RAND or the World Bank (WB) and at least two staff members from AKATIGA for the full three weeks of data collection. Due to time constraints of some World Bank staff, each team had a World Bank staff member for part of the time and a senior researcher from AKATIGA and a contact from the National Team for the Acceleration of Poverty Reduction (TNP2K) were able to be with these teams part time as well. Team composition and size varied somewhat by location and depended on team member availability and language capabilities. The combined teams bring expertise in data collection methods and experience, Bahasa Indonesia language capability, and local/industry knowledge. Each team focused on either two or three research sites based on industry locations. We describe the site-industry-researcher team combinations below:

Team #1: West Java: (JABODETABEK, Bandung)

- Primary industries: Muslim fashion, High-value-added ICT
- Secondary industries: Food processing (Industri Makanan), Services (restaurants/motorcycle repair shops)
- RAND/WB team member: Connor Spreng, Rini P. Radikun, Kaitlin Shilling
- AKATIGA team members: Viesda Pithaloka, Putri Djelantik, Dany Hadiana

Table C.2   West Java data collection timeline

No	Activities	August 2014																					
		10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
1	Research Permit in west Java		▮	▮																			
2	Key Informan interviews in bandung (one of the businessmen and heads og goverment agencies)		▮	▮	▮																		
3	Surveys of 24 respondents in Bandung, key informan interviews, secondary data collection)	▮	▮	▮	▮	▮	▮	▮	▮	▮													
4	Moving to Jakarta										▮												
5	Research permit in jakarta											▮	▮										
6	Surveys of 24 respondents in jakarta, key informan interviews, secondary data collection)										▮	▮	▮	▮	▮	▮	▮	▮	▮	▮	▮		
7	Finalization of the questionnaires and data collection.																					▮	
8	Back to Bandung																						▮

Team #2: Central Java: (Solo, Pekalongan, Jepara)

- Primary industries: Batik garments, Teak furniture
- The Solo / Pekalongan comparison may be useful, given Indonesia's political situation and anecdotal evidence about the different successes of policies in the two cities.
- RAND/WB team member: Kailtin Shilling, Isono Sadoko
- AKATIGA team members: Charina Chazali, M. Ekazaki, Asti Januart

Table C.3   Central Java data collection timeline

No	Activities	August 2014																				
		11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
1	Travel to Semarang	▉																				
2	Arrange the working permit in Semarang	▉																				
3	Travel to jepara and arrange the working permit in Jepara, interviews key informants (local government or SME owner)		▉																			
4	Data collection: Survey 18 respondents, key informants, secondary data			▉	▉	▉	▉															
5	Travel to Pekalongan							▉														
6	Arrange the working permit in Pekalongan, interview key informants (local government or SME owner)								▉													
7	Data collection: Survey 18 respondents, key informants, secondary data									▉	▉	▉	▉	▉								
8	Travel to Solo														▉							
9	Arrange the working permit in Solo, interviews key informants (local government or SME owner)															▉						
10	Data collection: Survey 18 respondents, key informnts, secondary data																▉	▉	▉	▉	▉	
11	Travel fom Solo-Bandung																					▉

Team #3: North Sumatra: (Medan, Aceh)

- Primary industry: Coffee
- Secondary industries: Food processing, Services
- RAND/WB team member: Arya Gaduh / Rini P. Radikun
- AKATIGA team members: Ikhsan Muharma, Budiani

Table C.4   North Sumatra data collection timeline

No	Activities	August 2014 10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
1	Research Permit in Aceh	▓																					
2	Key information interviews in Aceh		▓	▓																			
3	Key information interviews the food processing, service and coffee sectors		▓	▓																			
4	Travel to Takengon, Aceh				▓																		
5	Interviews in coffee, food processing and services sectors Aceh					▓	▓	▓	▓	▓	▓												
6	Travel to Medan											▓											
7	Research Permit in Medan												▓										
8	Interviews in coffee, food processing and services sectors Medan													▓	▓	▓	▓	▓	▓	▓	▓	▓	
9	Travel back to Bandung																						▓

Team #4: South Sulawesi: (Makassar, Toraja)

- Primary industry: Coffee
- Secondary industries: Food processing, Services (restaurants/motorcycle repair shops)
- RAND/WB team member: Sarah Weilant
- AKATIGA team members: Herlina Wati, Syarifudin

Table C.5   South Sulawesi data collection timeline

| No	Activities	August 2014																					
		10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
1	Travel to Makassar	▮																					
2	Manage permission of the local government in province and maping respondents base on cluster, centre and key informant in the city of Makassar.		▮	▮																			
3	Travel to Toraja Utara			▮	▮																		
4	Manage permission of local government in kabupaten of North Toraja, interviews SMEs local government and mapping respondent base on cluster, centre and key informant				▮	▮																	
5	Interview respondents of coffee processing, food processing, motorcycle service repair and restaurant					▮	▮	▮	▮	▮	▮	▮	▮										
6	Travel to Makassar												▮	▮									
7	Manage permission of local government in city of Makassar, interview SMEs local government and interview respondents of coffee processing, food processing, motorcycle service repair and restaurant													▮	▮	▮	▮	▮	▮	▮	▮	▮	
8	Travel to Bandung																						▮

2. Fieldwork timeline and implementation details

Table C.6   Overall fieldwork timeline

Phase	Dates
Field work training (Bandung)	6-8 August 2014
Site data collection	11-29 August 2014
Wrap-up workshop	1-2 September 2014

Training workshop

RAND and AKATIGA researchers worked together to develop the full schedule for the training workshop, held in Bandung on 6–8 August 2014. The core elements of the workshop included discussion sessions and interview practice sessions. The discussion sessions included "classroom-based" sessions where the entire group discussed the overarching goals of the project, walked through the questionnaire and reviewed sample selection ensuring that all research teams had a comprehensive understanding of the data collection process. Local sector-specific experts also attended the workshop to provide background on the sectors, such as batik. The workshop also included a "field-test" component where the teams conducted practice interviews with SME owners from Bandung using the questionnaire. This was followed by a group debrief where first impressions of the questionnaire and clarifying questions were discussed. The goal was to make sure everyone became familiar with the interview questions and were using as similar methods or approaches as possible to ensure that the fieldwork provided consistent and interpretable data.

Conducting interviews at each site

At each site, the team met briefly with the head offices (Kepala Dinas) and, if possible, local experts on the industries targeted at that site, to help orient the team. They then conducted interviews with firms, in both the urban and semi-rural locations. One to three people participated in each interview, depending on the team size and composition. In most cases the AKATIGA staff took the lead on communicating directly with the interviewee in Bahasa Indonesia, while the RAND/WB/TNP2K staff helped to guide the discussion and suggest follow-up questions. Translators were not present during the interviews but AKATIGA staff were able to translate important points to the RAND/WB staff during the interview without disrupting the conversation flow. In addition, a second AKATIGA staff person and the RAND/WB person took notes throughout the interview. When there were enough people to conduct multiple interviews simultaneously, teams divided into smaller groups to increase the number of interviews per day.

The interview was conducted with someone at the firm who had the authority to make decisions about operations or investment. Teams sought out the owner of the firm when possible but a manager was also an acceptable respondent. The team interviewed the owner or manager for approximately 60-90 minutes, using a questionnaire (see appendix A) that included quantitative, categorical and qualitative questions. The interview used mixed methods, allowing interview teams to adjust the emphasis on issues that were important to that firm, while still ensuring consistency across teams and interviews.

At the end of each day of interviews, the team was asked to meet to debrief about the interviews. Given the time constraints of each team, the teams debriefed about every three days. These discussions provided an opportunity to review insights from the interviews, the themes that emerged, useful anecdotes or stories, and so on. For each interview, the teams completed a debrief form (see appendix B) that was built around the high-level goals or questions for the project. This form helped to: (a) speed up the process of distilling lessons or results; (b) limit recall issues post-field work; and (c) limit the translation we needed to do after the field work.

Debrief forms were submitted electronically from the field to the RAND staff in the United States in Bahasa and in English when time allowed for translation. These staff reviewed the data in the debrief forms being collected to identify any discrepancies in interview approaches across teams and to conduct preliminary analysis on the data collected. The results and thoughts based on this process were fed back to the interview teams during the fieldwork.

Data collection wrap-up workshop

A workshop was conducted at the end of the fieldwork period from 1-2 September 2014. The combined team met over two days to discuss the experiences across the teams and to pull together the results from the work. Table 2.2 shows the list of people who attended the workshop.

Table C.7   SME data collection wrap-up workshop attendees

Sarah Weilant	RAND Corporation
Kaitlin Shilling	World Bank
Pak Latif and Rini P. Radukin	TNP2K
Arie Agustien	PRSF
All data collection researchers and Indrasari Tjandraningsih	AKATIGA

The workshop was conducted with group participation as the main way of communicating findings. This allowed field teams to discuss their research and data collection experiences in the field. The workshop agenda included:

Table C.8   SME data collection wrap-up workshop agenda

Individual team reporting on fieldwork experiences: challenges and successes in accessing respondents and informants
Team presentations on the sector profile: • The actors and their relationships; • Government role and programmes • Challenges faced by SMEs in accessing government programmes • Local government perspectives on SMEs and their role in supporting SMEs
SME spectrum of formality, what it means and how the survey sample fit this spectrum
Policy-specific discussion: • Programme uptake & effectiveness, major government policies, challenges and needs (governmental and non-governmental)
SMEs interesting stories from each sector
Preliminary policy recommendations

Appendix D
Literature review:
laws, policies and definitions

1. Laws and policies

Below we summarise the laws, policies and programmes that are targeted either generally at the SME sector or that promote SMEs in a way that lies outside our conceptual model. For example, the first entry in table 1 is a 2005 presidential regulation that outlined a medium-term development plan for SMEs, focusing on a diverse array of goals, from promoting agribusiness to supporting SME development in rural regions. We also include information about regional governance laws that define the roles and responsibilities of different levels of government in terms of their SME promotion activities. With the decentralisation of the Indonesian government in 1999, "500 provincial, district and municipal governments now deliver public services and investment and local governments account for 38 percent of public spending and 50 percent public investment" (Oberman et al. 2012).

In general, Indonesia's decentralisation may present both opportunities and challenges in the design and delivery of effective SME policies. As local governments may be more knowledgeable about the specific needs and constraints that SMEs face within their borders, they may be better at designing more effective policies. Moreover, national policymakers may look to the different policy programmes tried at local levels when they try to determine what policies work and what may be worth expanding. On the other hand, national programmes may be implemented in different ways by local governments, creating uneven results. Local governments may also be more prone to corruption and may suffer from a lack of capacity for implementing programmes that were designed at national levels. Since we are collecting data on the same industries in different provinces in Indonesia, our study will hopefully be able to shed some light on the differences in the performance of local governments in delivering and designing policies, and what the appropriate roles of local and national governments are for different types of support programmes.

Table D.1   General SME policies in Indonesia

No	National/ Regional/Local	Policy Name/Law Name	Description
1.1	National	Presidential regulation No: 7/2005 Article 20	Medium-term Development Plan 2004-2009 contains policies for development of SMEs: Increase the productivity and export value of cooperatives and SMEs' products; Expand the businesses of cooperatives and SMEs to agribusinesses; Raise the number of new enterprises based on science and technology; Increase the capacity of micro enterprises, particularly for under privileged groups in rural and underdeveloped regions Sembiring 2008).
1.2	Local	Law 22/1999 Local Government Autonomy	The highest authority within local government is the legislative council, elected directly by citizens, and it has extensive budgeting authority, including for local economic development (LED) programmes. With the passage of this law, local governments suddenly became the chief providers of various services previously handled by the central government, including economic development (USAID 2009:9).

Table D.1   General SME policies in Indonesia (Continued)

No	National/ Regional/Local	Policy Name/Law Name	Description
1.3	Regional	Regional Governance Law 32/2004	"Revises Law 22/1999 on local governance, scaling back the power given to the local council and restoring some authority to the provincial governor. In terms of SME support, however, this law gives both the provincial and local governments the authority – and an obligatory role – in facilitating the development of cooperatives and SMEs" (USAID 2009).
1.4	Regional	Government Regulation 38/2007 on the Division of Roles between National, Provincial and Local Governments	"Elaborates on the provisions of Law 32/2004 on regional governance. In terms of MSME support, it stipulates that for the MSME sector, the role of national, provincial and district/city governments are similar and include SME empowerment (improving the business climate, expanding financing and access to credit for SMEs), as well as provision of monitoring and evaluation to track SME empowerment activities. The regulation also notes that both provinces and districts have "discretionary functions". There is no guidance on whether provincial or district/city governments take precedence when assuming such functions."
1.5	National/Regional	Law 20/2008 on Micro, Small and Medium Enterprises	"Describes the scope of central and local government responsibilities in "empowering" MSMEs. The law details activities related to improving the business climate (e.g. expanding access to financing, simplifying business licensing regulations); facilitating business development capacity (e.g. improving production techniques, improving human capital capabilities in entrepreneurship and management); providing financing and loan guarantees (e.g. financing provided directly by the government or state enterprises; promoting development of a venture capital industry, promoting creation of non-bank financial institutions); and facilitating partnerships between large enterprises and MSMEs (e.g. through subcontracts, mentorship programmes, trading arrangements).The law notes that these functions are the responsibility of both central and local governments but again is silent as to how provincial and local governments should interact in providing these services."
1.6	Regional	Government Regulation 50/2007 on Guidelines for Regional Cooperation	"Constitutes a legal basis for provincial and local governments to cooperate or partner with other jurisdictions as well as with other public institutions and private sector entities on public service management."

2. SME definitions

The public and private sectors have used several methods of defining which firms qualify as "small and medium-sized" and the subgrouping of firms within the SME classification. Although we do not intend to harmonise the various definitions here, it is helpful to clarify how these definitions vary, since SME classifications affect policy and programme targeting and effectiveness. Table 2 describes SME definitions that are applicable in Indonesia, showing the variation across entities that support or analyse small firms. The different SME definitions mean that so-called "SME" policies may apply to different sets of firms, and not all "small" firms will have access to all policies. For instance, according to Indonesian government law, the definition of MMEs is based on the firm's total assets or total sales; firms with net assets less than Rp50 million (land and building assets excluded) or firms with less than Rp300 million in total annual sales are classified as MSMEs. However, Indonesia's statistical agency, Statistics Indonesia (*Badan Pusat Statistik* – BPS), and many other international organisations, such as the World Bank, make use of definitions that are based on the size of the firm's labour force. We will explore the issue of inconsistent definitions further during later stages of our analysis.

Table D.2   SME Definitions

Organisation/ sector	Criteria for definition	Description of the law/ definition	Law/regulation name & number (if applicable)
Indonesian Government Law	Net assets	Micro, small, medium-sized enterprise definition: Enterprises with net assets less than Rp50 million (land and building excluded) or; Enterprises which have less than Rp300 million total annual sales. Small enterprise: Enterprises with net assets from Rp50 million – Rp500 million (land and building excluded) or;. Enterprises with total annual sales from Rp300 million – Rp 2.5 billion (Sembiring 2008)	Law No. 20/2008
World Bank	Size of labour force	Small firms: 5-–19 employees Medium firms: 20–99 employees (OECD 2012:80)	
DEPKOP (Indonesia's Ministry of Cooperatives)	Net assets, total annual sales	Small Firms: Net assets from Rp50-500 million, total annual sales from Rp300 million to Rp2.5 billion Medium Firms: Net assets from Rp500 mil-10 billion, total annual sales from Rp 2.5 billion to Rp50 billion (OECD 2012:80)	
Statistics Indonesia (BPS)	Number of workers	Small, medium-sized enterprises having, respectively, 5–19 and 20–99 workers (USAID 2009)	
DEPKOP (Indonesia's Ministry of Cooperatives)	Net assets, annual turnover	Tax registration: Small firms assets valued between Rp50 – 500 million and annual turnover between Rp300 million – Rp2.5 billion. Medium firms: assets valued between Rp500 million – Rp10 billion & annual turnover between Rp2.5 billion – Rp50 billion (OECD 2012:80)	
Indonesian Government Law	Net assets & annual turnover, number of workers	Small enterprises: maximum net asset value of Rp200 million, excluding land and buildings for business, or having a maximum annual turnover of Rp1 billion. Small enterprises can receive bank credit at the minimum of Rp50 million up to Rp500 million (Nazara and Gitaharie 2008) 5-19 and 20-99 workers respectively Tambunan 2006)	Law No. 9/1995
Indonesian Government Rule	Net assets	Medium enterprises: net assets of more than Rp200 million up to a maximum of Rp10 billion excluding land and buildings for conducting business. Its business setup can be in the form of an individual enterprise, a business unit with or without legal status. This business unit can receive bank credit from a minimum of Rp 500 million up to Rp5 billion (Narara and Gitaharie 2008)	Presidential Instruction No. 10/1999
Coordinating Minister for Social Welfare and the Bank of Indonesia	Net assets, annual turnover	Small enterprises: net assets at a maximum of Rp200 million other than land and building for operating business or a maximum annual turnover of Rp1 billion with a maximum credit ceiling of Rp50 million. Medium enterprise: Credit given to entrepreneurs other than micro and small enterprises, for which criteria will be set later, with a credit above Rp500 million up to Rp5 billion	

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Small and medium-sized enterprises (SMEs) are critical for emerging economies like Indonesia but simultaneously challenging for policymakers looking to support their growth. Including micro firms, SMEs are responsible for more than 97 percent of total employment in Indonesia and represent 99 percent of all firms. The Indonesian government has tried to assist SMEs through programmes, such as subsidised credit, one-stop shops to lower business registration costs and government-sponsored trade fairs. However, there is little evidence on how effective these programmes are or on ways to improve government policies aimed at helping SMEs. We conducted structured interviews with 192 firms across five provinces in Indonesia to investigate the constraints that firms face and how existing programmes do – or do not – help reduce these constraints. We conclude the report with policy recommendations targeted at the Indonesian government and other stakeholders, focusing on the importance of credit and on the need to remove information barriers.

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