SME Development in The Poverty Reduction Program: TRADE AND LABOR ISSUES
Many parties are convinced now that SMEs deserve special attention for supporting their development, since SMEs are considered to contribute to the economy and to provide employment opportunities to many in the labour force. Various government institutions and society often voice their interests in SMEs, and some of them are already involved in various activities to improve SMEs’ performance by formulating public policies and their implementation. At the national policy level, promotion of SMEs is on the government’s agenda for poverty elimination.

It is considered that large, middle and small entrepreneurs all have specific roles in the national economic development. In government policies, therefore, policies for each of the entrepreneurs should not conflict each other, but instead they must be synchronized for their maximum contribution to the economy. In short, the promotion of SMEs is based on an objective to enable small businesses to become middle businesses, and to assist middle businesses to transform into large businesses. This is the basic characteristic of business actors, who in general try to enlarge its size, and thus maximize profit.

The APINDO, as an employers’ association, supports government’s endeavours to enhance SME performance, since there is always a mutual interest among business actors. Interdependency between
large businesses and SMEs is not only based on “charity”, which would be extended from big business actors to middle or small ones, but also on mutual interests.

In order to forge the APINDO’s support towards the SME development, which in turn is expected to contribute to the nation’s poverty reduction, the APINDO’s team has conducted with assistance from the ILO a study on practical recommendations for the APINDO to create a business environment conducive to the development of SMEs. It is expected that these recommendations would also become inputs to the government’s effort to improve the business climate, for SMEs and the business in general.

Jakarta, 16 June 2005
Board of Executives of APINDO

**Sofjan Wanandi**
Chairman
According to Central Board of Statistics, in 2003, Small and Medium Enterprises in Indonesia made a significant contribution to economic development, accounting for over half of the Gross Domestic Product (62.42%) and absorbing almost the entire workforce available (99.44%, compared with 0.56% absorbed by large enterprises). These indicators underline the central role of small and medium enterprises in national economic development and job creation, which, from the ILO perspective, is the key to poverty alleviation.

This APINDO report on “SME Development in the Poverty Reduction Programme: Trade and Labour Issues”, published by ILO Jakarta, highlights the importance of public policy improvement on trade and labour issues in shaping a conducive environment for small and medium enterprise development in the context of poverty reduction.

ILO recognizes the importance of stronger coordination among the national players, local government and the private sector, including APINDO, on policies and programmes aimed at fostering SME development initiatives. Through the publication of this study, ILO is providing concrete support for APINDO’s involvement in the improvement of SME development policies, not only because APINDO’s membership constitutes SMEs, but also because the vast majority of women and men in Indonesia derive their livelihood and income from SMEs.
I hope that this publication will contribute to the development of a more SME-friendly policy environment by drawing on international best practice, and, in so doing, help to achieve the ultimate goal of alleviating poverty in Indonesia.

Jakarta, June 2005

Alan Boulton
Director
ILO Jakarta
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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>APEC</td>
<td>Asia Pasific Economic Cooperation</td>
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<td>APINDO</td>
<td>Asosiasi Pengusaha Indonesia (The Employers’ Association of Indonesia)</td>
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<tr>
<td>AusAID</td>
<td>Australian Agency for International Development</td>
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<tr>
<td>BAPPENAS</td>
<td>Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency)</td>
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<tr>
<td>BDS</td>
<td>Business Development Services</td>
</tr>
<tr>
<td>BKKBN</td>
<td>Badan Koordinasi Keluarga Berencana Nasional (National Family Planning Coordinating Agency)</td>
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<tr>
<td>BPPT</td>
<td>Badan Pengkajian dan Pengembangan Teknologi (Agency for the Assessment and Application of Technology)</td>
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<td>BPS</td>
<td>Biro Pusat Statistik (Central Bureau of Statistics)</td>
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<tr>
<td>BUMN</td>
<td>Badan Usaha Milik Negara (State-owned Enterprise)</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<tr>
<td>CPA</td>
<td>Certified Public Accountant</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FGD</td>
<td>Focus Group Discussion</td>
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<tr>
<td>FORDA UKM</td>
<td>Forum Daerah Usaha Kecil dan Menengah (Regional Forum of Small and Medium Enterprises)</td>
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<td>FORNAS UKM</td>
<td>Forum Nasional Usaha Kecil dan Menengah (National Forum of Small and Medium Enterprises)</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GEMA PKM</td>
<td>Gerakan Pengembangan Keuangan Mikro (Micro Credit Development Movement)</td>
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<tr>
<td>GWM</td>
<td>Giro Wajib Minimum (Minimum Reserve Requirement)</td>
</tr>
<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>JNP UKM</td>
<td>Jaringan Nasional Pendukung Usaha Kecil dan Menengah (National Support Network for SMEs)</td>
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<tr>
<td>KADIN Indonesia</td>
<td>Kamar Dagang dan Industri Indonesia (Indonesian Chamber of Commerce and Industry)</td>
</tr>
<tr>
<td>KPEN</td>
<td>Komite Pemulihan Ekonomi Nasional (National Economic Recovery Committee)</td>
</tr>
<tr>
<td>KPPOD</td>
<td>Komite Pemantauan Pelaksanaan Otonomi Daerah (Regional Autonomy Watch)</td>
</tr>
<tr>
<td>KPPU</td>
<td>Komisi Pengawas Persaingan Usaha (Business Competition Oversight Committee)</td>
</tr>
<tr>
<td>LP3ES</td>
<td>Lembaga Penelitian, Pendidikan dan Penerangan Ekonomi dan Sosial (Institute for Social and Economic Research, Education and Information)</td>
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<tr>
<td>MSE</td>
<td>Micro and/or Small Enterprise</td>
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<td>NGO</td>
<td>Non-Governmental Organization</td>
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<td>PERR</td>
<td>Partnership for Enterprise Policy Reform</td>
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<tr>
<td>PINBUK</td>
<td>Pusat Inkubasi Bisnis Usaha Kecil (Business Incubator for Small Enterprises)</td>
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<tr>
<td>PRSP</td>
<td>Poverty Reduction Strategic Program</td>
</tr>
<tr>
<td>PUPUK</td>
<td>Perkumpulan Untuk Peningkatan Usaha Kecil (Association for Small Enterprise Empowerment)</td>
</tr>
<tr>
<td>RPJM</td>
<td>Rencana Pembangunan Jangka Menengah Nasional (National Medium Term Development Plan)</td>
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<tr>
<td>SENADA</td>
<td>Indonesia Enterprise and Agricultural Development Activity</td>
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<tr>
<td>SME</td>
<td>Small and/or Medium Enterprise</td>
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<tr>
<td>TAF</td>
<td>The Asia Foundation</td>
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<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Executive Summary

One of the main strategies for reducing poverty, as the provisional Indonesia PRSP (Poverty Reduction Strategy Program) document mentions, is by improving people’s access to jobs through an SME development program, since it is anticipated that this will be an effective means of absorbing job seekers. There is strong evidence that Indonesian SMEs make a significant contribution to the GDP as well as labour absorption.

As one of the major employers’ associations in Indonesia, APINDO is intent on contributing to improving the country’s business environment by developing a policy and regulatory framework that is conducive to SME development in the context of a poverty reduction strategy, and, in so doing, contribute to the implementation of the national PRSP.

Identifying an appropriate advocacy agenda for a better policy and regulatory environment calls for a policy analysis study. This study focuses on SME-related policies with respect to Trade and Labour. The rationale for selecting these two domains was, 1) APINDO members—who are mostly large-scale entrepreneurs—are willing to facilitate SMEs to widen their distribution channels through a mutually beneficial relationship between large-scale enterprises and SMEs; and 2) APINDO’s core competence is in the field of industrial relations in general, and labour issues in particular.
This is a qualitative study that relies on an analysis of relevant laws and regulations based on a set of criteria, together with the insights gained from in-depth interviews and focus group discussions with the parties concerned. The statistical data used in this study provide additional information to support the qualitative analysis.

From the general analysis—not limited to trade and labour—the study finds that government policy, as reflected in the existing legislation, is committed to SME development by addressing the specific needs of SMEs. Through a number of laws and regulations, the government protects SMEs from domination by large-scale enterprises, applies lower borrowing rates for SMEs, obliges state-owned enterprises to develop business partnerships with SMEs, and has created a special ministry for SMEs; thus, policy wise, it has created a conducive business environment for SMEs. However, weak coordination and cooperation among central government institutions and between central and local governments has resulted in minimal impacts on SME performance.

Regarding policy, the laws and regulations on trade at the national level do support SME development in general, although not to any great extent. The absence of a law on domestic trade is a major obstacle. On the other hand, the implementation of domestic trade regulations, specifically concerning retailer-supplier relationships, indicates that the bargaining position of SMEs vis-à-vis large enterprises (big retailers/hypermarkets) is very weak, and that fair competition tends to lose out to free competition.

In the context of regional autonomy, the laws and regulations related either directly or indirectly to trade provide discretion to regional governments to create their own regional regulations. This has prompted many local governments to enact legislation that has brought about a high cost economy through the implementation of tariff and non-tariff barriers to domestic trade. This high cost economy reduces business competitiveness in
general, especially that of SMEs, which are the most affected due to their sensitivity to increases in production and distribution costs.

With regard to manpower, while the laws and regulations on labour unions and arbitration between employer and employee are adequate, those concerning the minimum wage fail to take into account the specific needs of SMEs. The requirements for obtaining a deferment of the implementation of the minimum wage for companies that cannot afford to pay it are burdensome, forcing SMEs to operate in the informal economy and consequently removing any labour protection from the government for employees of SMEs.

Another problem on the manpower issue is the tendency of some autonomous regions to put into practice an affirmative action policy, giving employment priority to people indigenous to the region. Even though it does not really affect SMEs, which normally employ local people, this practice potentially hinders access to jobs and is therefore contradictory to the basic principles adopted by Indonesia as a unitary state, namely freedom of the flow of goods, people and capital throughout the territory.

To eliminate policy weaknesses and distortion of policy implementation, APINDO—which as an employers’ association, has an important role in developing Indonesia’s economy—should act on its commitment to support SME improvement in the trade and labour domains by carrying out activities on two levels. First, it should conduct policy advocacy, by submitting a proposal for overcoming the weaknesses of the current policies (such as the revision of laws and regulations that distort business activities), and developing a concrete blueprint for SME development. APINDO should initiate a conducive policy dialogue involving the main stakeholders in SME development to make the advocacy more effective. Second, APINDO needs to facilitate business links between large enterprises and SMEs. Partnerships should be developed along the lines of an interdependent, mutually beneficial
business relationship based on the industry cluster approach. In such partnerships, the large-scale enterprises would provide technical assistance to SMEs on various aspects of SME development such as production, distribution, and access to financing.
1. Background

The provisional Indonesia Poverty Reduction Strategy Program (PRSP) document states that “poverty is no longer understood purely as the lack of economic capacity but also the failure to fulfil the basic rights of the people and to treat individuals or groups of people, men and women, fairly in their efforts to live with dignity”. In the Indonesian context, admittedly, economic growth is not the only answer to poverty, yet given the fact that the open unemployment rate is still high—10.1% in 2003—and more than 40% of workers in the formal sector work less than 36 hours per week, it has to be considered a vital factor.

One of the poverty reduction strategies mentioned in the document is improving people’s access to jobs by developing the capacity of SMEs, since it is anticipated that this will be an effective means of absorbing job seekers. Indonesian SMEs are demonstrably not just a veneer on the country’s economy. Data from the Ministry of Cooperatives and SMEs derived from a collaboration with BPS (the Central Bureau of Statistics) indicate that small enterprises account for 46.06%, medium enterprises 16.36% and large-scale enterprises 36.59% of Indonesia’s GDP (based on current prices and excluding Oil & Gas). This means that SMEs contribute more than half of the total GDP. The same report also shows that of a total workforce of 79,474,991, 88.43% was absorbed by small

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1 Provisional PRSP document (October 2004 version)
enterprises, 11.01% by medium enterprises and only 0.56% by large-scale enterprises. These facts and figures underline the need for a broad empowerment of SMEs based on a comprehensive blueprint, aimed at enhancing the role of SMEs in the country’s economic growth.

The blueprint should carry with it prospects for the creation of a conducive business environment for linkages between large, medium and small enterprises on an interdependent and mutually beneficial model. Avoidance of overregulation, a common trap in many poor countries, is also a top priority. Otherwise, illegal fees and inefficiency in public institutions will hinder business growth in general and likely force more entrepreneurs into the so-called informal economy.

It is against this backdrop that APINDO, in cooperation with the ILO, has conducted this study. As one of the major employers’ associations in Indonesia, APINDO is intent on contributing to improving the country’s business environment by developing a policy and regulatory framework that is conducive to SME development in the context of a poverty reduction strategy, and, in so doing, contribute to the implementation of the national PRSP.

1.1. Objective

This is a practical rather than an academic study, aimed at supporting APINDO’s formulation of a set of recommendations for improving SME development policy through a review of the regulatory environment.

1.2. Scope

This is a policy analysis study that focuses on SME-related policies in the domains of (1) Trade and (2) Labour. The rationale for selecting these two domains was, first, APINDO members—who are mostly large-scale entrepreneurs—are willing to

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2 Ministry of Cooperatives and SMEs, and BPS (Central Bureau of Statistics)
3 Terms of reference (TOR) of the ILO Program on Poverty Reduction through SME Development
facilitate SMEs to widen their distribution channels through a mutually beneficial relationship between large-scale enterprises and SMEs. Second, APINDO’s core competence in the field of industrial relations in general, and labor issues in particular. Third, the fact that little attention has been given to building the market penetration capacity of SMEs. Time constraints also demanded that the study be limited to just these two domains.

To analyze existing policies on trade and labour, this study mainly refers to laws and regulations at the national level, which in Indonesia are arranged in the following hierarchy: Law (Undang-Undang), Government Regulation (Peraturan Pemerintah), Presidential Decree (Keputusan Presiden), and Ministerial Decree (Keputusan Menteri). Although Local Regulations (Peraturan Daerah), which are ranked lowest in the hierarchy, are not analysed directly, the findings from other studies on local regulations have been taken into account in this analysis.

Because the existing legislation barely takes micro enterprises into account, this policy study deals primarily with SMEs and large-scale enterprises. The definition of SME used here refers to the taxonomy jointly developed by BPS and the Ministry of Cooperatives and SMEs, which categorizes enterprises according to value of sales. Companies with sales above IDR 50 billion (US$522,000) are classified as large-scale enterprises, those between IDR 1 billion (US$104,000) and 50 billion are medium-scale enterprises while those with a sales value of up to IDR 1 billion are classed as small enterprises. The latter are further specified into two categories: small enterprises are those with sales of between IDR 50 million and IDR 1 billion per year, and micro enterprises have an annual sales value of up to IDR 50 million.
The various definitions of SMEs used by different government institutions notwithstanding, this policy analysis refers to the classification set forth in Law No. 9/1995:

a. Having a maximum net worth, excluding land and buildings, of IDR 200 million (US$21,000);
b. Having an annual sales turnover of up to IDR 1 billion (US$104,000);
c. Owned by an Indonesian citizen;
d. Being an independent entity, and not a subsidiary or branch of a company that is either owned, controlled or affiliated directly or indirectly with a medium or large enterprise;
e. Being a sole enterprise, a non-legal entity enterprise, or a legal entity; this includes cooperatives.

1.3. Research Questions

The research objective above is elaborated into the following questions:

• What is the quality of existing domestic trade and labour policies, and how do these policies affect SME trade activities?
• What obstacles are there to the implementation of existing trade and labour policies on SME development in Indonesia?
• Do the existing trade and labour policies encourage mutually beneficial business relations between large-scale enterprises and SMEs?
• What policy reform is needed to improve trade and labour policies?
• Which parties are seriously committed to supporting SME development in Indonesia?

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5 As stated in Law No. 9/1995, the figures in points ‘a’ and ‘b’ may be changed pursuant to a Government Regulation.
2. Methodology

2.1. Method of Analysis

- **Literature study** sourcing available studies, papers and other references related to aspects of SME development.
- **Secondary data analysis** on pertinent laws and regulations as well as statistics.
- **In depth interviews** with various parties representing SMEs, large-scale enterprises, and key decision makers in government.
- **Focus Group Discussions** involving stakeholders such as SMEs, large enterprises, and relevant government officials.

A set of criteria is needed to qualify the laws and regulations and determine whether they can be deemed ‘best practice’ for SME development.

In an analysis of policy—in this case laws and regulations—the assessment criteria depend on the specific objectives of each policy, and therefore will differ from one policy to another. Nevertheless, there are a number of general criteria applicable to both targets of this study, apart from the additional criteria specific to each field.

The **general criteria** are:
- The legislation does not conflict with other pertinent legislation at the national level.
- There are clear guidelines or direction for local governments, and other related parties, regarding compliance.
• It accommodates the specific needs of SMEs in view of the fact that SMEs and large-scale enterprises have different characteristics and therefore require different treatment.
• The technical provisions on legal drafting are fulfilled.

Additional assessment criteria for trade:
• The legislation clearly prohibits tariff and non-tariff barriers on the movement of goods within Indonesian territory
• It allows all business entities, whether multinational, national or local to do business throughout Indonesian territory without being subject to discriminatory treatment.

Additional assessment criteria for labour:
• The legislation ensures equal treatment for all Indonesians in finding employment anywhere throughout Indonesian territory, irrespective of the place of origin (province, regency, city and so on) of the job seeker.

2.3. Sources of Information

Secondary data. The laws and regulations, as well as the statistical data, were derived from the relevant ministries and other government agencies. The existing studies on SMEs were obtained from universities, donor institutions, research-based NGOs as well as government institutions.

Primary data. This study also collected primary data through in-depth interviews with selected numbers of key respondents (four sources from SMEs, two from large-scale enterprises, four government officials, and two NGO personnel) who were questioned individually. The information gathered from these interviews was then confirmed in a focus group discussion (FGD) where the same respondents were joined by a number of representatives of the APINDO management to ascertain the group perception.
3. General Overview

SMEs play a significant role in the Indonesian economy. By number, they make up by far the largest category of businesses: according to BPS, in 2003, 42,388,505 units out of a total of 42,390,749 companies Indonesia—99.99%—were SMEs. They were the national economic backbone during the economic crisis of 1997-1998 when the majority of big enterprises collapsed. However, as mentioned in the previous section, little attention seems to have been paid to their development.

Table 1 breaks down the contribution of SMEs to the country’s GDP by major economic sector. This demonstrates quite clearly the enormous contribution SMEs have made in various sectors, notably agriculture (food crops, livestock and fisheries) and trade.
From the perspective of manpower absorption, Table 2 shows clearly that SMEs in the Agriculture and Trade sectors have generated considerable employment opportunities.
<table>
<thead>
<tr>
<th>No</th>
<th>Sector</th>
<th>Year 1999</th>
<th>Year 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Small</td>
<td>Medium</td>
</tr>
<tr>
<td>1</td>
<td>Agriculture</td>
<td>31,839.125</td>
<td>684.748</td>
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<tr>
<td>2</td>
<td>Mining &amp; Quarrying</td>
<td>235.042</td>
<td>99.486</td>
</tr>
<tr>
<td>5</td>
<td>Construction</td>
<td>235.468</td>
<td>213.386</td>
</tr>
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<td>6</td>
<td>Trade, Hotel and Restaurant</td>
<td>14.982.542</td>
<td>1,346.314</td>
</tr>
<tr>
<td>7</td>
<td>Transportation and Communication</td>
<td>2.190.707</td>
<td>220.671</td>
</tr>
<tr>
<td>8</td>
<td>Finance, Property and Business</td>
<td>106.001</td>
<td>248.663</td>
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<td>9</td>
<td>Services</td>
<td>3.572.842</td>
<td>968.723</td>
</tr>
</tbody>
</table>

Source: BPS (Central Bureau of Statistics)
3.2. Current Position of SMEs on Trade and Labour

In general, there are three fundamental problems confronting SMEs: 1) limited access to markets, 2) difficulty in securing finance, and 3) weak business management, which has a number of other ramifications touching on, for example, certainty of raw materials supply and product/service quality.

On the trade side, interviews with SME respondents suggest that micro enterprises trade only within a two-kilometre radius of their premises, whereas small enterprise markets are generally confined to their district or city. Only a very small number have a market reach beyond provincial or national boundaries. This illustrates the extremely limited capacity of small enterprises to reach wider markets.

Another obstacle SMEs have to face are the ‘modern’ retailers (supermarkets). SMEs claim that such retailers are reluctant to give them shelf space in their supermarkets. For their part, the supermarkets point out that SMEs lack the capacity to guarantee quality and continuity of supply. Yet another barrier preventing SMEs from getting their products to the market are the listing fees and promotion costs imposed by hypermarkets. (This issue will be discussed further later on in the report).

Meanwhile, on the labour side, most SMEs—especially small enterprises—do not operate within the prevailing labour laws and regulations. Not only do these enterprises not comply with minimum wage requirements, but there are also many that employ child workers. The lack of compliance with minimum wage regulations is a direct result of the SMEs’ financial limitations—they simply cannot afford to pay. Breaches of the laws on underage workers, on the other hand, are rooted in socio-cultural factors: giving jobs to the children of poor families at least guarantees those families an income. Such extra-legal practices have, in many cases, caused SMEs to operate in the informal economy. (This discussion will be expanded in the next part of this report).
Several parties are involved in the development of SMEs, both government and non-government. A brief overview of each party is given here to illustrate the specific role they have played to date, and, more importantly, to help APINDO identify potential partners in its forthcoming SME development program.

The Indonesian government has put SMEs at the forefront of its policy, and has formulated and implemented several measures aimed at SME development. The existence of the Ministry of Cooperatives and SMEs is another indicator of the importance the government places on SMEs. Despite this, institutionalization without the necessary planning, organization, application and coordination to bring these expectations to reality has more or less left the SMEs to fend for themselves.

The existence of a ministry specifically to deal with small and medium enterprises notwithstanding, SME development is in fact a cross-sectoral issue. SMERU\(^6\) has mapped the agencies involved. They include BKKBN (National Family Planning Coordinating Agency), BPPT (Agency for the Assessment and Application of Technology), the Home Affairs Ministry, the Ministry of Maritime Affairs and Fisheries, the Ministry of Industry and Trade, the Ministry of Agriculture, the Ministry of Social Affairs, the Ministry of Manpower and the Coordinating Ministry of Social Welfare.

The involvement of these other ministries is vital if a truly comprehensive policy approach is to be achieved. Presenting a basic policy or a blueprint is certainly the primary responsibility of the Ministry of Cooperatives and SMEs, but it should be done with the support of the other ministries. In the case of taxation, for example, the Ministry of Finance should

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\(^6\) SMERU, a research institute, compiled various activities on SME issues conducted by government institutions, NGOs and donor agencies; see further in “Efforts to Empower Micro and Small Enterprises 1997-2003”.
come up with a pro-SME policy that includes incentives, such as tax rates lower than those presently imposed on large-scale enterprises; with regard to financing, the Central Bank could apply policies to steer the national banking sector towards greater support for SME development, and so forth.

In practice, unfortunately, support for SME development seems to have been narrowly interpreted as a need for technical upgrading: although several ministries have undertaken pilot projects they are all essentially very similar. The Coordinating Ministry for Social Welfare, for example, has cooperated with state-owned banks on SME credit schemes; the Ministry of Manpower has an SME mentoring program; while the Ministry of State-owned Enterprises has a parallel but unrelated program. The overall picture is one of scattered efforts here and there; a comprehensive approach to SME development is lacking.7

The weak coordination and cooperation among ministries should not be dissociated from the government’s over-cautious approach to delineating the tasks, structure and function of each ministry. Presidential Decree No. 9/2005 on the Status, Tasks, Function, Organization and Operational Procedures of Ministries of the Republic of Indonesia stipulates that the authority of the Ministry of Cooperatives and SMEs is confined to formulating and coordinating, but not executing, a national policy. However, this regulation—a product of the newly installed Yudhoyono cabinet—is to be revised to allow the ministry to play a part at the technical execution level. Underlying all of this is the poor coordination between various parties in the government.

Apart from the government, there are other parties involved in the development of SMEs in Indonesia. These parties fall into the following

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7 This is the entirely subjective opinion of the non-government resource persons for this study (as well as a few of the government sources), expressed through interviews; in the group discussions in which the same people participated, no objections were voiced regarding these perceptions.
Private Sector

categories: private sector, civil society and donor institutions.

A number of partnership programs have been set up by large-scale enterprises to give SMEs broader access to the market. These programs are basically driven and managed on a business, not charitable, basis, resulting in benefits for both parties.

**Partnership between Large and Small Enterprises (SME)**

Example 1: PT UKMI (Usaha Kita Makmur Indonesia) is a trading company established by a successful former executive of a leading food and beverage manufacturer in Indonesia, to channel SME products to broader (global) markets. What justifies this program is the mutual benefit relationship between the two. The SMEs benefit by gaining a bigger share of the market for their products, while the trading company enjoys profits from the sales margin of the products supplied by the SMEs.

Example 2: PT Bogasari Flourmills, a very large group of companies producing wheat flour and derivative products, has established a partnership program with micro and small enterprises (MSEs), who use the wheat flour produced by Bogasari. In the partnership Bogasari guarantees the quality and continuity of supply of the raw material along with technical assistance aimed at the increasing the MSEs’ ability to produce various high quality end products (e.g. noodles and bread). In addition to this, Bogasari also provides mentoring for management (especially in the field of trade), as well as access to financial institutions, with the eventual aim of enabling these MSEs to expand their markets independently. The partnership approach has not only brought benefits for the MSEs in the shape of better product quality and a bigger share of the market, but has also worked to the advantage of Bogasari: by increasing the number of MSE partners (who now absorb some 60% of its total production), it has leveraged demand for the raw materials it produces.
The two examples above—both of which are purely private sector initiatives—are worth studying because although both essentially represent a business partnership between large- and small-scale actors, the sales direction is different. In the first case, the small enterprise acts as supplier for the larger one, while in the second case it is the large enterprise that supplies the MSE.

In the second case, it is harder to see whether or not both parties in the partnership gain proportional benefits. A relationship that is too one-sided, with one party gaining more than the other, will surely jeopardize the partnership in the long term. There is some justification for raising this point, given the fact that Bogasari dominates the domestic wheat flour market and has thus created a situation of so-called imperfect competition (market monopoly). Under such conditions, the MSE, despite its enhanced technical capacity, is still in a very weak bargaining position with respect to securing a proportional increase in benefits. Unless the structure of the commodity market changes, a reasonable rate of return for the MSE remains highly dependent on the goodwill and fair play of the larger player.

Similar programs have been initiated and executed by other private sector companies, including PT. Astra International Tbk, PT. Bahana Artha Ventura, PT. Pos Indonesia, PT. Sucofindo and PT. Unilever. Some of the national banks that have conducted programs in support of SME development are Bank Bukopin, BCA, Bank Mandiri, Bank Danamon, BRI and Bank Niaga.

APINDO has also been involved through its Women’s Entrepreneurship program. Aimed at empowering both members and non-members, this program embraces female-run businesses (almost all of them SMEs) by providing consultations on various government policies (e.g., advising on permits and licenses, and on complex bank finance requirements) and management training (e.g. marketing, finance, industrial relations). This is a

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8 Ibid, SMERU
joint program between the central executive board of APINDO and its regional branches, with support from donor institutions/agencies. It has now been running for two years and has been implemented in several parts of the country.

A number of NGOs have initiated their own SME development programs, including Bina Swadaya, GEMA PKM, FORNAS UKM, JNP UKM, PUPUK, Kadin Indonesia, Darma Bhakti Astra Foundation, LP3ES, PINBUK and so on. Some of these operate at the national level, while others work at the local level, but in general their activities are focused on policy advocacy, capacity building, and improving access to markets and financing.

GEMA PKM (Micro Credit Development Movement), for example, concentrates on microfinance; Bina Swadaya provides technical assistance for SMEs in the agricultural sector; FORNAS UKM (National Forum of SMEs) is the umbrella organization for more than 60 local SME forums and focuses on market expansion and policy advocacy; Kadin Indonesia (Indonesian Chamber of Commerce and Industry) supports a large trading company to facilitate the penetration of SMEs products into a broader marketplace; and so forth. Likewise, several international NGOs such as Care International, CRS and Mercy Corps are implementing various types of SME development programs.

No less important is the support of donor institutions like ADB, TAF, USAID, AusAID, the World Bank and the EU, through their technical assistance programs and grants, both to the government and to some of the NGOs mentioned above.
ADB (Asian Development Bank), for example, has been promoting a capacity building program for SMEs through the establishment of service centres known as BDS (Business Development Services). It is interesting to note how the operation of the BDS has evolved: whereas originally its approach was simply charitable, it is now based on a much more businesslike arrangement that yields benefits for both parties.

The Asia Foundation (TAF), through its PEPR (Partnership for Enterprise Policy Reform) program works intensively with SMEs to establish regional SME forums in several districts. USAID, in cooperation with TAF and local NGOs, has successfully improved the business environment with regard to business licensing processes.11

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11 According to a TAF-USAID report, The Asia Foundation established about fifteen one-stop-shops (OSS) providing various business licensing and registration services. The results are impressive: 1) the time taken to register a company has been cut by 60%, and on average now takes only 15 days; 2) business licensing costs have been reduced by 30%; 3) nearly 70% of the firms reported higher profits and higher employment after registering, and 75% paid higher salaries; 4) the OSS have generated economic growth, jobs and prosperity.
Public policy analysis is crucial because the policies, and the way they are implemented, can either encourage or inhibit the economic activity of which SMEs are a part. In the context of this study, an analysis of the trade and labour aspects of SME policy has to be linked to poverty reduction efforts, since the role of SMEs in promoting job creation and leveraging public purchasing power is considerable. It is therefore necessary to eliminate any constraints on the potential of SMEs improve their economic performance.

The policy analysis in this study covers laws, government regulations, presidential decrees, ministerial decrees and local regulations, in order to ascertain whether government policy on SMEs is implemented in a comprehensive manner. Before going further into the specific issues related to SMEs in terms of trade and labour, there are some fundamental principles that need to be presented as frame of reference for SME development.

Going back to the absence of a comprehensive blueprint on the SME development, the fundamental terms of reference are the importance of coordination and cooperation between government agencies at the central level and a harmonious relationship between central and local government. No less important are relations between government (central and local) and non-governmental stakeholders—specifically, large and small scale enterprises.
Moreover, the blueprint must also demonstrate that the interdependency between large- and small-scale enterprises is mutually beneficial. This has to be well understood not only by those subject to the policy, but also by the policy makers, in order to avoid falling into the trap of executing activities that are merely charitable, and losing sight of the real objectives of SME development.

The literature study (see in JICA-GoI, 2004), supported by the opinions expressed by the respondents, confirms that SME development based on the model of interdependencies between small and large enterprises has to be approached through the establishment of industry clusters specific to each industry. The partnerships exemplified in the **Box** above have been successful over the long term because there is business linkage between the parties concerned within the same industry.

Based on the principles above, the analysis of trade and labour policies\(^\text{12}\) undertaken in this study therefore refers to the existing governance and classification of industries, with reference to the analytical criteria outlined previously in the Methodology section.

Bearing in mind that the scope of this study is limited to trade and labour policies, this can be only a partial analysis of the issue of SME development.

Unlike other business sectors such as forestry, mining, and oil and gas, which have their own laws, domestic trade in Indonesia has never been regulated in a specific law. Over the last three years the government has attempted to draft a domestic trade bill, but as of the time of writing it has yet to be completed. Hence, domestic trade is currently governed by a number of government regulations, presidential decrees and ministerial decrees on trade affairs and indirectly by laws in other sectors.

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\(^\text{12}\) Lihat lampiran daftar peraturan perundang-undangan yang dianalisis dalam studi ini.
that also have implications for trade. At the same time, in the international trade sphere, Indonesia has been relatively quick to adopt various global and regional trade policies by ratifying agreements made under the WTO, for example. At the regional scale, Indonesia has acted on the APEC consensus on reducing trade barriers between member countries.

The study of existing laws and regulations at the national level indicates a likelihood of disharmony between the policies issued by the government and their implications for the trade sector. One point of dispute concerns Law No. 7/1994 on the Ratification of WTO Trade Policies—by signing, Indonesia has aligned itself with the global trend on lifting barriers to international trade, but this has not been followed up by any domestic trade policy. The fact is that Law No. 22/1999 on Local Governance (for which the Home Affairs Ministry is the leading sector), as the legal basis for the application of regional autonomy, devolves full authority to the regions to regulate their own trade. Likewise, Law No. 34/2000 on Local Taxes and User Charges (leading sector: Ministry of Finance) allows local governments wide discretion to levy their own taxes and charges.

In normative terms, the two laws do not conflict directly with the principle of "a single economic zone for domestic trade", because they stipulate certain criteria for local governments that are supposed to ensure that regional policy making does not distort national domestic trade. To guarantee harmony amongst all the levels of laws and regulations, the two laws also allow the central government to overturn any local regulation that conflicts with national policy.

Nevertheless, the fact that both laws allow local governments to regulate their own trade and fiscal affairs has led to a distortion of domestic trade activity in general. Studies carried out by KPPOD and other research and advocacy groups have revealed local regulations that do in fact impose either tariff
or non-tariff barriers on national domestic trade.\textsuperscript{13} By law, it is the central government’s prerogative to repeal these local regulations, but weak institutional capacity at the central level combined with the resistance of the autonomous regions has hampered efforts to overcome this problem.

These trade barriers inevitably exact a price. The high cost economy they have engendered affects all businesses but it is SMEs, due to their sensitivity to any increase in production or distribution costs, that bear the brunt.

In the case of Indonesia, the ongoing political transition from authoritarianism to democracy has given way to a transition from a centralized government to a decentralized one, with all the problems that implies. Against this background, it would be better for the aforementioned laws to allow the local governments limited leeway to issue their own regulations without going beyond what is legally provisioned by the Law. This opinion is also endorsed by Kadin Indonesia (the Indonesian Chamber of Commerce and Industry) in its recommendations to the Government of Indonesia.\textsuperscript{14}

Business relations between large-scale enterprises and SMEs are also relevant to this analysis. In this regard, the government, through a policy issued by the Ministry of Trade and Industry has shown its commitment to SME development by stipulating that modern markets—in this case supermarkets—are to allocate 20% of their shelf space for SME products. Akin to this is another government policy that allows hypermarkets to operate only on the outskirts of towns, which is

\textsuperscript{13} Of 1,025 local regulations analyzed by KPPOD (Regional Autonomy Watch), around 30.15% of them have the potential to create a high cost economy; one cause is the imposition of entry/exit tariffs by local governments on goods traded from one region to another of Indonesia. Many business associations, including SMEs, have complained about this unnecessary additional cost. See further in KPPOD: “Report on Local Regulations Desk Analysis” (2002 & 2003), and “Rating the Investment Attractiveness of 214 Districts/Cities in Indonesia”, 2004. See also SMERU, “Regional Autonomy and Investment Climate”.

\textsuperscript{14} See “Revitalization of Industry and Investment” Kadin Indonesia, 2004.
soon to be reinforced by the planned issuance of a Presidential Decree to replace Ministerial Decree No. 154/MPP/Kep/5/1997 that restricts hypermarkets strictly to provincial capitals. These policies are, in principal, aimed at giving SMEs more access to market their products and to create fairer competition between large and small business actors.

Unfortunately, as mentioned earlier, SMEs face serious difficulties in getting their products into the supermarkets, which are dominated by the big suppliers. SMEs claim that this is due to resistance on the part of the retailers, while the supermarkets justify their position on the grounds that the SMEs’ inability to guarantee quality and continuity of supply will in turn adversely affect their own performance.

This kind of dispute calls for the Ministry of Trade to play an active role by monitoring and following up the findings from investigations in the field. If there are cases of arbitrary practices on the part of ‘modern’ retailers, it should not be as tough as it now seems for the government to take action to rectify the situation. On the other hand, if the SMEs do indeed have weaknesses in terms of product quality and continuity of supply, the government has to proactively seek a win-win solution. One possible approach is industry clustering that takes into account the interests of both parties. The government could direct raw materials suppliers to advise their SME customers—as exhibited in the partnership between Bogasari and MSEs above—on how improve their business practices in order to achieve the quality and continuity required by the retailers.

Using this model, each party plays its role in a way that yields mutual benefits. Where there are potential linkages between business entities, the government needs only to act as a facilitator, and in this way, saves a lot of resources it may have had to make use of otherwise.

The action plan on SME empowerment issued by the Ministry of Cooperatives and SMEs for the period 2005–2009 suggests that the government recognizes the importance of clustering within
specific industries. This plan sets out the creation of SME market networks through the establishment of trading houses and e-commerce centres; fostering interdependent partnerships in certain industries through core-plasma schemes, franchising, agency schemes and so forth; and facilitating SME access to financial resources.15

In theory, this program covers nearly everything required for SME development—as long as the ministry sticks to policymaking, facilitating and evaluating, while the enterprises, large or small, are the main actors in the program. As yet, there has been no evaluation of program implementation because it has only just started.

Administrative relations between central and regional governments are another question. In the current context of regional autonomy, wherein local governments have strong political legitimacy, the ministry should delegate the program’s execution fully to the local authorities.16 It is the local authorities who know exactly which industrial clusters and products to promote, who should become the subjects of the program and when is the right time to start it up.

It should be reiterated that the role of the central government, through the technical ministries, is limited to making policies in support of SME development, monitoring them, and evaluating them. The central government may harness its existing apparatus-reaching out to provinces, even down to districts—to help coordinate the development of clusters of industry based on specific product competitiveness in each region, and from this, to determine exactly at which scale the economic development is needed. It may be at the provincial level, or the city/district level, but in any case each cluster of industry will require a different strategy.

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15 See further in the "Action Plan on SME Empowerment 2005-2009" issued by the Ministry of Cooperatives and SMEs.

16 It is important to note that since the MPR (General Consultative Assembly) removed the GBHN (Broad Guidelines of State Policy) in the hierarchy of Indonesian development planning instruments, the highest national development planning document is the PROPENAS (Program of National Development Planning), which is endorsed as a Law. Theoretically, the PROPENAS—which is further translated as the Medium Term Development
The discussion in this section focuses again on the business relationship between SMEs and modern retailers, in this case hypermarkets. The disharmony between these two parties has already been discussed; basically, the SMEs feel unfairly burdened by the charges they need to pay to get their products displayed on the hypermarket shelves, so-called listing fee.

Hypermarkets impose the listing fee, as well as other promotional costs, on all their suppliers. For the big suppliers, this is not deemed a problem; it is a common practice in this kind of relationship. For the SME suppliers that cannot afford to pay, however, it is a different story: the listing fee policy keeps them from accessing the market.

According to the entrepreneurs grouped in the Association of Hypermarket Suppliers (the majority of whose members are SMEs), cases like this are not uncommon, yet they are rarely made public. As a result of their decision to expose the issue, it reached the KPPU (the Business Competition Oversight Committee), and provoked a widespread response from the public. Through the mass media, the hypermarkets concerned explained that the listing fee actually depends on the market positioning of a supplier’s product. The less well-known or less in demand the product, the higher the listing fee, and vice versa. Under this practice, leading manufacturers may not even have to bother with the listing fee at all because the hypermarket is actually the one in need of their products.

So there is more than just a matter of letting the invisible hand work freely behind the principle of supply and demand, with all the power of capital at its disposal. This case shows that the market mechanism is not working perfectly—large capital is squeezing out small capital. The question is, is it fair to impose listing fees on SMEs? What’s more, when these smaller payers eventually go bankrupt, the hypermarkets refuse to return the fees. Obviously, free competition does not necessarily mean fair competition.
This is the kind of unfair competition upon which the government can make the case for intervention. The forthcoming presidential decree should stress the importance of the principles of fair competition over free competition. The time is ripe for the government to rearrange the structure of the relationship between SMEs and hypermarkets by seriously considering the need for a special scheme for SMEs, not for protection, but to guarantee them a fair chance in the competition, otherwise SMEs will have very little chance of surviving against the bigger players. Improving SMEs’ access to the market by accommodating their specific needs will ultimately lead to improvements in their capacity.

This new policy has to make it clear how a small enterprise is defined, and to what extent it is entitled to participate in the scheme. For this reason, Law No. 9/1995 on Cooperatives and SMEs needs to be redefined, taking into account the various existing definitions of SMEs used by government institutions, NGOs, donors etc., leaving only one ultimate legal reference.

The key issue in Law No. 13/2000, which regulates labour affairs, concerns the minimum wage. The law states that in order to protect the interests of workers, employers are required to comply with the provisions on the minimum wage. The law further states that employers who are not in a position to fulfil this requirement can—if they meet certain conditions—apply for a deferment. The provisions governing this are outlined in Decree of the Minister of Manpower No. 231/MEN/2003, which requires any company requesting such a waiver to first secure the approval of its labour union—to ensure that there are proper industrial relations between the employer and workers—and to supply a financial audit report by a CPA (Certified Public Accountant) to verify its claim of financial inability to pay the minimum wage.
For SMEs, especially the smaller ones, the requirement to submit an audit report is a huge burden—in most cases they lack the capacity to meet the minimum standards of accounting. Nor it is possible for most enterprises of this sort to pay a CPA to audit the company. It is just such obstacles that force SMEs into non-compliance with almost all legal formalities, including registration with the Ministry of Manpower, and drives them into the informal sector.
small workforce of most SMEs these two issues have less significance. From the SME perspective, these two laws, particularly No 21/2000, are deemed sufficient.

**Regional Policy**

The implementation of regional autonomy has given rise to indications of discrimination against certain job seekers. A number of regional governments have put in place policies that prioritize local people—however they are defined—for jobs in the region.

Several regions are formally adopting such policies through regional regulations, while others have taken a more informal route by engineering local opinion to put pressure on companies operating in the region to observe this priority.

Applied through regional regulations, such policies require companies operating in the region to comply with various employment quotas formulating certain percentages for local people. In many regions the scope of these regulations is not limited to the provincial level, but extends to the district, sub-district and even village levels. Any breach of these rules is subject to fines and financial compensation to the regional administration concerned.

For Indonesia, despite the noble-sounding excuse of equal employment opportunities for the indigenous people, as well as other social justifications, this kind of affirmative local policy may in the long term endanger national unity; Indonesia professes itself to be a unitary state, within which the free flow of goods, people and capital is strenuously defended. These distorting policies have their roots in the national policy on regional autonomy, reflected in Law No. 22/1999 on Regional Governance, which transfers authority over labour affairs to the hands of each local administration.

In general, such affirmative action has little impact on SMEs which, for the most part, employ
local people. Even so, in the context of fair and equitable treatment for all citizens, who should have the right to work anywhere within the territory, the problem cannot be overlooked.

The regulation of business sectors for large, medium and small enterprises, leveraging access to financing for SMEs, managerial guidance (technical assistance), and fiscal and monetary policy, are other issues of policy that deserve to be reviewed briefly.

To protect SMEs from the domination of large-scale enterprises, Presidential Decree No. 99/1999 (later amended by Presidential Decree No. 127/2001) on Business Sectors Reserved for SMEs and Sectors Open to Large Enterprises through Partnerships with Smaller Enterprises, signifies that the government has already taken the necessary steps. Without this regulation, it is very likely that SMEs operating in the sectors concerned would be unable to withstand the competition if a large enterprise decided to enter.

Concerning SMEs’ access to financial institutions, the Central Bank’s policy No. 3/2/PBI/2001 in theory enables SMEs to enjoy micro credit facilities for business expansion. As for fostering better management of SMEs, Central Bank Regulation No. 5/18/2003 provides for banking support for SMEs through technical assistance and information on markets, locally competitive commodities and so forth.

Running parallel with the Central Bank policies is a Decree of the Minister of State-owned Enterprises (abbreviated as BUMN in Indonesian) No. 236/BMU/203, pertaining to partnerships between BUMNs and SMEs, which requires BUMNs to allocate 1% to 5% of their net profits to a soft loan scheme, with an interest rate of a maximum 12% per annum, that is earmarked for SMEs.\(^\text{17}\)

\(^\text{17}\) Indonesia’s commercial bank borrowing rate was 17-21% per annum when this ministerial decree was enacted. The interest rate now stands at around 14-17%.
Moreover, this same decree also provides for a Community Development fund, under which the BUMNs award grants to small enterprises in their vicinity.

Despite the positive message the above policies imply for the development of SMEs, some caveats need to be made. First, in terms of the interest rate for the soft loan, regular adjustments need to be made to ensure it stays in line with the current downward trend in lending rates, so that it remains competitive against the commercial rate. Otherwise, if the interest rate does not reflect that of a soft loan, what use is it to the SMEs? Secondly, with regard to the allocation of profits for SMEs, most of the BUMNs only allocate the absolute minimum, i.e. 1%, for the partnership program. From a policy point of view there is nothing wrong with this; however, both policies are due for a comprehensive evaluation.

Fiscal, especially taxation, and monetary policies also influence the performance of SMEs. In the existing taxation system, for example, there is no differentiation of the corporate income tax rate for SMEs and big corporations. A joint government-private sector team coordinated by Kadin Indonesia (the Indonesian Chamber of Commerce and Industry) is currently looking into ways of reforming the tax system; for SMEs, the key issue is the plan to introduce a lower tax rate than that applied to large enterprises. With regard to monetary policy, one recommendation voiced by the respondents that deserves further study was that the central bank should consider allowing some flexibility with respect to its minimum reserve requirement for national banks whose funds are channelled into SME financing. The expectation was that this would serve as an incentive for the national banking sector to channel more of their funds to SMEs.

18 Dr. Sri Adiningsih in "Regulation in the Revitalization of Small and Medium Enterprises in Indonesia"
From the description in sections 4.1, 4.2, and 4.3 concerning policies that have a direct influence on the development of SMEs in the trade and labour domains, as well as other pertinent policies, it is obvious that the substance and the implementation of the policy will qualitatively affect any improvement in SME capacity and performance. The policy analysis, based on the set criteria, together with the confirmations from the respondents, reaffirms the correlation between the development of SMEs and the quality of the relevant policies—in terms of both substance and implementation.

It should be admitted that relying on a qualitative analysis of the substance of the policies and the subjective confirmation made by individual respondents—the collective confirmation through the focus groups notwithstanding—is an unsatisfactory way to assess the extent to which the SMEs have been influenced by those policies. An analysis of the available quantitative data would at least support the qualitative analysis. The data below, therefore, may be of use as additional indicators to supplement the policy analysis.

<table>
<thead>
<tr>
<th>Year</th>
<th>Small</th>
<th>Medium</th>
<th>Small &amp; Medium</th>
<th>Large</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>People</td>
<td>%</td>
<td>People</td>
<td>%</td>
<td>People</td>
</tr>
<tr>
<td>2000</td>
<td>15.223.033</td>
<td>91,61</td>
<td>1.367.924</td>
<td>8,39</td>
<td>16.590.957</td>
</tr>
<tr>
<td>2001</td>
<td>14.971.538</td>
<td>91,61</td>
<td>1.345.325</td>
<td>8,39</td>
<td>16.316.863</td>
</tr>
<tr>
<td>2002</td>
<td>15.547.307</td>
<td>91,61</td>
<td>1.397.063</td>
<td>8,39</td>
<td>16.944.370</td>
</tr>
<tr>
<td>2003</td>
<td>16.145.340</td>
<td>91,61</td>
<td>1.450.801</td>
<td>8,39</td>
<td>17.596.141</td>
</tr>
</tbody>
</table>

Source: BPS (Central Bureau of Statistics)

**Table 3** above shows that SMEs absorb almost all employment (99.4%) across the trade sector (including hotel and restaurants). Of these SMEs, 91.61% are small enterprises. While percentage wise, there was no change in the structure of the SME contribution to this sector from 2001 to 2003, there was an upward trend in the absolute figures:
absorption of employment by SMEs rose by around 3.8% each year (2001: 1,345,325; 2002: 1,397,063; and 2003: 1,450,801). Thus, despite their small size, SMEs in the trade sector continue to contribute to the absorption of new entrants to the workforce.

Meanwhile, with regard to added value, SMEs have also made a considerable contribution to the trade sector Regional Gross Domestic Product (PDRB), as shown in Table 4 below: an average of at least 96% between 1999 and 2003, of which an average 75% is contributed by small enterprises. Table 3 also shows that although there was little change in the percentage contribution of SMEs over this period, the absolute value of the contribution increased by an average 3.5% per annum, comparable to that of the large-scale enterprises operating in this same sector.

### Table 4: Trade (Trade and Retail) Small, Medium and Large Enterprises PDRB Contribution (based on 1993 constant prices); USD 1=IDR 9,575 (April 2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Small Million IDR</th>
<th>Medium Million IDR</th>
<th>Small &amp; Medium Million IDR</th>
<th>Large Million IDR</th>
<th>Total Million IDR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Million IDR %</td>
<td>Million IDR %</td>
<td>Million IDR %</td>
<td>Million IDR %</td>
<td>Million IDR %</td>
</tr>
<tr>
<td>1999</td>
<td>35,732,573 75.11%</td>
<td>10,084,57121.20%</td>
<td>45,817,144 96.31%</td>
<td>1,757,357 3.69%</td>
<td>47,574,501 100.00%</td>
</tr>
<tr>
<td>2000</td>
<td>37,723,384 74.95%</td>
<td>10,750,03621.36%</td>
<td>48,473,420 96.30%</td>
<td>1,860,401 3.70%</td>
<td>50,333,821 100.00%</td>
</tr>
<tr>
<td>2001</td>
<td>38,819,578 77.57%</td>
<td>11,227,95921.59%</td>
<td>50,047,537 96.25%</td>
<td>1,950,263 3.75%</td>
<td>51,997,800 100.00%</td>
</tr>
<tr>
<td>2002</td>
<td>40,250,202 77.59%</td>
<td>11,622,76821.58%</td>
<td>51,872,970 96.29%</td>
<td>1,998,449 3.71%</td>
<td>53,871,419 100.00%</td>
</tr>
<tr>
<td>2003</td>
<td>41,503,897 77.34%</td>
<td>12,163,67421.85%</td>
<td>53,667,571 96.39%</td>
<td>2,009,288 3.61%</td>
<td>55,676,859 100.00%</td>
</tr>
</tbody>
</table>

Source: BPS (Central Bureau of Statistics)

Inadequate as they are to demonstrate how far policy has affected SME performance in the trade sector, the above data may at least serve as a preliminary indicator that SMEs have hardly been influenced at all by policy—it has caused neither an increase nor a decrease in their performance. Perhaps this is in line with the qualitative analysis of trade and labour policy related to SME development in sections 4.1 and 4.2 above, which is judged to be merely adequate—not really positive, but not distortional either.
Regarding the impact of the financial access and management development policies on SME development discussed in section 4.3, no quantitative analysis can be made here because the Central Bank and the Ministry of State-owned Enterprises only issued these policies in 2003, and aggregate data for 2004 are not yet available.

Ideally—according to national policymaking procedure—the national PRSP (Poverty Reduction Strategy Program) should have been completed ahead of the more strategic national RPJM (Medium Term Development Plan). Had this been the case, the poverty reduction program could have been accommodated in the RPJM, which not only determines the direction of national development policy but also serves as the guideline for the autonomous local governments’ development plans.

Lamentably, though, as of the time of writing the PRSP is still being discussed at Bappenas (the National Development Planning Agency), who will then have to submit it to the Coordinating Minister for Social Welfare. This year—2005—the academic narrative will have to be drafted before it can finally be enacted as a law, despite the fact that the RPJM has already been endorsed by the president. Nevertheless, since Bappenas is also the agency responsible for producing the RPJM—with input from all the other ministries—it can be assumed that it will have included elements of the provisional PRSP at the drafting stage.19

As is mentioned in the background to this study, the PRSP document refers to SME development as the mechanism for one of the key strategies for poverty reduction strategy, i.e. improving people’s access to jobs.

19 The Regional Development & Decentralization Deputy of Bappenas is the key member of the PRSP working group that consolidates and formulates inputs from line ministries. He is currently still evaluating the draft PRSP document before forwarding it to the Coordinating Minister for Social Welfare (Menko Kesra).
SME development in the poverty reduction strategy is aimed at enhancing the capacity of these enterprises to grow their business—micro enterprises will become small enterprises, small enterprises will expand to become medium enterprises and so on. A simple calculation would suggest that building SME capacity will therefore enable them to absorb more employment, which will ultimately lead to an increase in people’s purchasing power. Statistically, this will reduce poverty.

To ensure that SME development yields the expected results in terms of poverty reduction, it is strongly suggested that such programs prioritize areas most affected by poverty.

There are 190 districts in Indonesia that are categorized as “left behind” or underdeveloped, according to government mapping, and one of the criteria for this classification is closely linked to poverty. Identifying an area’s potentially competitive products and commodities can be the first step towards developing the local economy. The next step—based on the industry clustering approach—is how to create a synergy between this economic potential, local SMEs, and large-scale enterprises that will be able to convert the potential into real economic strength for the people. The synergy should take in all aspects of SME development, be it production (product diversification and quality, raw material supply chain, and so on), marketing and trade (continuity of product supply, distribution networks), support from financial institutions (national banking sector, non-bank institutions, micro credit agencies), and so forth.

Central and local government commitment to developing industrial clustering is demonstrated by at least three indicators. First, the making of policies to support industry clustering, including efforts to mitigate the constraints posed by existing regulations such as those discussed in sections 4.1,
4.2 and 4.3. *Second*, facilitating, monitoring and evaluating the implementation of these clusters. *Third*, a budget commitment to the development of the specific infrastructure and facilities needed by the SMEs.

Focusing on SME development through industry clustering in these underdeveloped areas should allow SMEs to have a significant impact on poverty reduction.
5. Conclusions And Recommendations

In general, government policy, as reflected in the existing laws and regulations, has been supportive of the specific needs of SMEs. Through a number of laws and regulations, the government protects SMEs from domination by large-scale enterprises, sets favourable interest rates for SMEs, obliges state-owned enterprises to develop business partnerships with SMEs, has created a special ministry for SME, and more; thus, at the policy level at least, it has created a conducive business environment for the development of SMEs. However, in terms of implementation, the weak coordination and cooperation among central government institutions and between central and local governments has meant that policy has not had the intended effect on SME performance.

A number of specific findings from this analysis of legislation on domestic trade and labour are given below in an attempt to answer the specific research questions.

With regard to policy, the quality of national legislation on trade is sufficient to support SME development in general, even if cannot yet be described as very conducive. On the other hand, the findings on the implementation of domestic trade regulations, specifically concerning the retailer-supplier relationship, tell us that the bargaining position of SMEs vis-à-vis large enterprises (hypermarkets) is still very weak: fair competition tends to give way to free competition.
In the regional autonomy context, the substance of the laws and regulations related directly or indirectly to trade increases the chances for policy distortion at the regional level. This has prompted local governments to enact regional regulations that work to the detriment of domestic trade through the implementation of tariff and non-tariff barriers. These barriers have an adverse impact on the competitiveness of SMEs because of their extreme sensitivity to any increases production or distribution costs.

Turning to manpower, the legislation on labour unions and arbitration between employer and employee does not pose any problems for SMEs. On the wage issue, however, the specific needs of SMEs are ignored, particularly concerning the deferment of the minimum wage for companies that cannot afford to pay it. The conditions stipulated by the government for obtaining this deferment are simply too burdensome for most SMEs, forcing them into the informal sector where, among other things, there is no protection for labour.

Another problem with regard to manpower is the tendency for autonomous regions to apply affirmative employment policies to favour the local workforce. The effect of the generally low capacity of human resources at the local government level combined with weak supervision by the central government is that people seeking to find employment outside their area of origin are likely to encounter discriminatory treatment.

To overcome the weaknesses in policy and the distortions in policy implementation, APINDO’s contribution to SME improvement should start with the following:

- In broad terms, APINDO, in cooperation with the other business associations under Kadin Indonesia, should initiate a policy dialog with government to develop or revise a number of
laws in the related sectors, which will work to the benefit of both SMEs and big business.

• On trade legislation, APINDO and Kadin Indonesia should be active participants in the drafting of the proposed Domestic Trade Law, with a target of getting the new law enacted no later than the end of 2005.

• The revision of Law No. 34/2000 regarding Local Tax and User Charges, which has thrown up barriers to domestic trade. The revision should focus on limiting the types of charges that can be applied at the regional level in order to avoid multiple interpretations on the part of the policy makers at district and provincial level. In cooperation with KPEN (National Economic Recovery Committee) and KPPOD, APINDO should advocate for the amendment of this law by the middle of 2005.

• On manpower, APINDO should be actively involved in the drafting or revision of government regulations, presidential decrees and ministerial decrees to elaborate Law No. 13/2000 regarding Manpower. One specific objective will be to revise Ministerial Decree No. 231/MEN/2003 by the end of 2005 in order to dispense with the requirement for SMEs to submit an audit report from a public accountant with their application to defer the minimum wage.

• To support the specific recommendations for policy advocacy on trade and labour, this study also recommends that APINDO initiate a policy dialog with government and other related parties to create a comprehensive blueprint for SME development.

• The SME blueprint should be based on at least six fundamental principles: 1) a clear definition of SMEs as a point of reference; 2) promoting the market economy through fair competition by accommodating the specific needs of SMEs, including fiscal and non-fiscal incentives; 3) mutually beneficial linkages between SMEs and large-scale enterprises in industry clusters; 4) positioning the Ministry of Cooperatives and SMEs as the leading sector among government institutions; 5) confining the role of government
to policy making, monitoring, and evaluating policy implementation; 6) positioning the autonomous regions as the most important actors at the implementation level.

In the Background section, reference was made to the willingness on the part of APINDO members to assist in the development of linkages between large enterprises and SMEs. Starting early 2006, APINDO should therefore follow up its policy advocacy by facilitating partnership programs, taking the following considerations into account:

- The partnership program should be packaged as a mutual benefit business relationship between large and small enterprises. The approach should be industry clustering between large-scale enterprises and SMEs in the same line of business. In the partnership, the large enterprise should provide technical assistance and mentoring for the SMEs on various aspects of SME development such as production, distribution, and financial access.
- The cluster development should be located in one of the 190 underdeveloped regions identified by the government, in order to align SME development efforts with the poverty reduction strategy. The selection of the region will be determined by the following factors: the economic potential of the region, strong commitment from local government, and the existence of a large-scale enterprise that has a firm commitment to improving SME performance in the respective industry.
- It will be ideal if the cluster development may be merged to the APINDO existing program on ‘women entrepreneurship’ in order to achieve a sound result.
- APINDO should explore the possibility of donor support for the program. One potential donor is USAID, through a new program scheduled for
launching in mid-2005. This program, entitled SENADA (‘working in harmony’), will focus, among other things, on industry cluster development.
6. Annexes

1. Law No.7/1981: The Obligation for Enterprises to Report Manpower Status
2. Law No.25/1992: Cooperatives
4. Law No.1/1995: Limited Companies
5. Law No.5/1995: Healthy Business Competition / Anti Monopoly
6. MPR (General Assembly Decree) Decree No.XVI/MPR/1998: The Political Economy in respect of a Democratic Economy
9. Law 22/1999: Regional Governance
11. Law No.23/1999: The Central Bank of Indonesia
12. Law No.21/2000: Labour Unions

6.1. Laws and Regulations Reviewed
to Large and Medium Enterprises through Partnerships with Small Enterprises

17. Presidential Decree No. 56/2002: Restructuring Small & Medium Enterprise Credit
18. Law No.13/2003: Manpower
20. Decree of the Minister of Manpower No.233/MEN/2003: Types of Continuous Occupations
21. Decree of the Minister of Manpower No.235/MEN/2003: Types of Occupations that Endanger the Health, Safety, or Morals of Children
22. Decree of the Minister of State-Owned Enterprises No.236/BMU/2003: Partnership Programs between State-Owned Enterprises and SMEs, and Community Development Programs
23. Decree of the Minister of Manpower No.244/MEN/2003: Obligations for Enterprises that Employ Women Between 11pm and 7am
24. Central Bank Regulation No.5/18/PBI/2003: Technical Assistance for SME Development
25. Law No.2/2004: The Settlement of Industrial Relations Disputes
26. Decree of the Minister of Manpower No.102/MEN/VI/2004: Overtime and Overtime Wages
27. Presidential Regulation No.7/2005: Medium-Term Development Program
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